[Missouri Law Review](https://scholarship.law.missouri.edu/mlr)

Volume 56
Issue 3 *Summer 1991*

Article 1

Summer 1991

# Including Retirement Benefits in a Debtor's Bankruptcy Estate: A Proposal for Harmonizing ERISA and the Bankruptcy Code

Michelle A. Cecil
*University of Missouri*, cecilm@missouri.edu

MISSOURI
LAW REVIEW

VOLUME 56 SUMMER 1991 NUMBER 3

# Including Retirement Benefits in a Debtor's Bankruptcy Estate: A Proposal for Harmonizing ERISA and the Bankruptcy Code

*Michelle M. Arnopol**

## I. INTRODUCTION

In 1974, Congress enacted the Employee Retirement Income Security Act ("ERISA")[1] in response to the tremendous growth of privately-funded pension and profit-sharing plans throughout the country.[2] ERISA's stated purpose was to encourage employees to save for their retirement and to ensure that employees' anticipated pension benefits be available to them upon retirement.[3]

---

* Associate Professor of Law, University of Missouri-Columbia. B.A., University of Illinois, 1979; J.D., University of Illinois, 1982. Research for this article was partially funded by grants from the Edgar Mayfield Faculty Research Fellowship and the Robert W. Maupin Faculty Research Fellowship. The author wishes to thank Shelly Sharp and Timothy Hausman for their invaluable research assistance.

1. Pub. L. No. 93-406, 88 Stat. 832 (1974) (codified as amended at 29 U.S.C. §§ 1001-1461 (1988 & Supp. I 1989)). ERISA's original section numbers were changed when it was codified in Title 29 of the United States Code, which contains the federal labor provisions. Additionally, portions of ERISA were codified in the Internal Revenue Code, Title 26 of the United States Code. References to ERISA in this article will be to the 1988 edition of Title 29 and, where applicable, to the Internal Revenue Code of 1986, as amended [hereinafter referred to as the "Code"].

2. 29 U.S.C. § 1001(a) (1988 & Supp. I 1989).

3. Congress declared its policy behind ERISA in the body of the statute itself:

> The Congress finds that the growth in size, scope, and numbers of employee benefit plans in recent years has been rapid and substantial; that the operational scope and economic impact of such plans is increasingly interstate; that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; . . . that despite the enormous growth in such plans many employees with long

One of the ways in which Congress protected employees' pension benefits was to provide in ERISA that such benefits could not be assigned or alienated. Courts have generally held that ERISA's anti-alienation provisions prevent an employee's creditors from reaching the employee's plan benefits to satisfy their claims.[4]

An issue that has received significant attention recently by courts and commentators alike is whether the Bankruptcy Code[5] overrides ERISA's anti-

---

> years of employment are losing anticipated retirement benefits owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that owing to the termination of plans before requisite funds have been accumulated, employees and their beneficiaries have been deprived of anticipated benefits; and that it is therefore desirable in the interests of employees and their beneficiaries, for the protection of the revenue of the United States, and to provide for the free flow of commerce, that minimum standards be provided assuring the equitable character of such plans and their financial soundness.

*Id.*

4. Retirement Fund Trust of the Plumbing v. Franchise Tax Bd., 909 F.2d 1266, 1284 (9th Cir. 1990) ("We conclude that the Board's tax levy procedure is prohibited under ERISA's anti-alienation provision"); Anderson v. Raine (*In re* Moore), 907 F.2d 1476, 1480 (4th Cir. 1990) ("ERISA's non-alienability provisions prevent both voluntary and involuntary encroachments on vested benefits"); Crawford v. LaBoucherie Bernhard Ltd., 815 F.2d 117, 121 (D.C. Cir. 1987) ("most courts have construed section 206(d)(1) [29 U.S.C. § 1056(d)(1)] to prohibit the garnishment of pension benefits by creditors, and . . . the legislative history of the statute supports that interpretation"); United Metal Prods. Corp. v. National Bank of Detroit, 811 F.2d 297, 300 (6th Cir. 1987) (pension and profit-sharing plan benefits are not generally subject to garnishments); Tenneco Inc. v. First Va. Bank of Tidewater, 698 F.2d 688, 689-90 (4th Cir. 1983) ("By virtue of the [ERISA] statute and the regulation, an employee's accrued benefits under such a qualified plan may not be reached by judicial process in aid of a third-party creditor"); General Motors Corp. v. Buha, 623 F.2d 455, 460-63 (6th Cir. 1980) (the court concluded "that pension plan benefits are not subject to garnishment"); St. Paul Fire & Marine Ins. Co. v. Cox, 583 F. Supp. 1221, 1224-25 (N.D. Ala. 1984), *aff'd,* 752 F.2d 550 (11th Cir. 1985) ("to allow garnishment of a pension trust fund would violate the clear intent of the pension plan terms and disregard federal law which is supported by sound public policy"); Commercial Mortgage Ins. Inc. v. Citizens Nat'l Bank of Dallas, 526 F. Supp. 510, 517-18 (N.D. Tex. 1981) ("the assignment-alienation prohibition extends to involuntary assignments such as garnishments"); *In re* Komet, 104 Bankr. 799, 807 (Bankr. W.D. Tex. 1989) ("ERISA § 206(d)(1) [§ 1056(d)(1)] successfully insulated qualified plans from state law garnishment").

5. 11 U.S.C. §§ 101-1330 (1988 & Supp. I 1989), referred to in this Article as the "Bankruptcy Code." The Bankruptcy Code was enacted as Title I of the

alienation provisions, thereby allowing creditors to reach a debtor's interest in ERISA plan benefits once the debtor has filed for relief under the Bankruptcy Code. The treatment accorded a debtor's retirement benefits turns on whether they become part of the bankruptcy estate available for distribution to creditors.

When a debtor files for relief under the Bankruptcy Code, a bankruptcy estate is created by operation of law.[6] Section 541 of the Bankruptcy Code determines which property of the debtor is to be included in the bankruptcy estate[7] and is intended to be broadly inclusive.[8] It states in part:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all of the following property, wherever located and by whomever held:
>
> (1) Except as provided in subsection (b) and (c)(2) of this section, *all legal or equitable interests* of the debtor in property as of the commencement of the case . . . .[9]

Sections 541(b) and 541(c)(2) of the Bankruptcy Code provide that certain items are excluded from the bankruptcy estate. The provisions are intended to be very narrow in scope.[10] The issue of whether retirement plans that are qualified under ERISA should be excluded from a debtor's bankruptcy estate hinges on the proper interpretation of section 541(c)(2) of the

---

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549. The Bankruptcy Code was amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"), Pub. L. No. 98-353, 98 Stat. 333, 392, and again by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088, 3114. For the most recent series of amendments to the Bankruptcy Code, *see* Comment, *Recent Amendments to the Bankruptcy Code—A Politically Motivated Less Fresh Start?*, 56 MO. L. REV. 705 (1991).

6. 11 U.S.C. § 541 (1988). *See also* H.R. REP. NO. 595, 95th Cong., 2d Sess. 367, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6323. The bankruptcy estate serves as a cornerstone in the bankruptcy process. In a Chapter 7 liquidation, for example, property remaining in the bankruptcy estate after the debtor exercises his right to exempt certain property out of the estate for his fresh start is distributed to creditors in partial or full satisfaction of their claims. For a more complete discussion of the debtor's exemption privilege, *see infra* notes 187-293 and accompanying text. In a Chapter 13 rehabilitation, the size of the debtor's bankruptcy estate determines how much he is required to pay his unsecured creditors under his Chapter 13 plan. *See* 11 U.S.C. § 1325(a)(4) (1988).

7. 11 U.S.C. § 541(a)(1)-(7) (1988).

8. S. REP. NO. 989, 95th Cong., 2d Sess. 82, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5868.

9. 11 U.S.C. § 541(a)(1) (1988) (emphasis added).

10. 11 U.S.C. § 541(b), (c)(2) (1988).

Bankruptcy Code. That section excludes from a debtor's bankruptcy estate his beneficial interest in a trust that contains a restriction on transfers enforceable under "applicable nonbankruptcy law."[11] The term "applicable nonbankruptcy law" is not defined in the Bankruptcy Code and has been interpreted in various ways by courts addressing the issue. A majority of courts have held that ERISA's anti-alienation provisions are not "applicable nonbankruptcy law" within the meaning of section 541(c)(2) of the Bankruptcy Code, and, therefore, have included a debtor's interest in his ERISA-qualified retirement plan in his bankruptcy estate.[12] Two circuit courts of appeals, however, have recently concluded that ERISA constitutes "applicable nonbankruptcy law" and have thus excluded the debtor's interest in these plans from the estate.[13] The Supreme Court has refused to grant certiorari on the issue.[14]

Under either the majority or minority approach, it is impossible to harmonize ERISA and the Bankruptcy Code. If the majority view prevails, one of the principal purposes of the Bankruptcy Code, the protection of creditors' rights, is furthered. Retirement plans may, however, lose the favorable tax treatment accorded plans that meet the requirements of ERISA, including its anti-alienation provisions.[15] Moreover, debtors may be required to forfeit substantial retirement assets, thereby defeating the explicit objective of ERISA to protect individuals' pension benefits and potentially imposing significant financial burdens on the government when the debtor retires.

On the other hand, excluding retirement plans from the bankruptcy estate creates different conflicts. First, it promotes ERISA at the expense of creditors. Additionally, prior to filing for bankruptcy, a debtor may be

---

11. 11 U.S.C. § 541(c)(2) (1988). The statute provides in pertinent part that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." *Id.*

12. At least five circuit courts of appeals currently take this position. *See* John Hancock Mutual Life Ins. Co. v. Watson (*In re* Kincaid), 917 F.2d 1162 (9th Cir. 1990); *In re* LeFeber, 906 F.2d 330 (7th Cir. 1990); Brooks v. Interfirst Bank, Fort Worth (*In re* Brooks), 844 F.2d 258 (5th Cir. 1988); Daniel v. Security Pacific Nat'l Bank (*In re* Daniel), 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986); *In re* Lichstrahl, 750 F.2d 1488 (11th Cir. 1985); Samore v. Graham (*In re* Graham), 726 F.2d 1268 (8th Cir. 1984); Goff v. Taylor (*In re* Goff), 706 F.2d 574 (5th Cir. 1983).

13. The Fourth and Sixth Circuits reached this conclusion in Anderson v. Raine (*In re* Moore), 907 F.2d 1476 (4th Cir. 1990) and Forbes v. Lucas (*In re* Lucas), 924 F.2d 597 (6th Cir.), *cert. denied*, 111 S. Ct. 2275 (1991), respectively. For district and bankruptcy court cases reaching the same result, *see* cases cited *infra* notes 81 and 174.

14. *In re* Lucas, 924 F.2d 597 (6th Cir.), *cert. denied*, 111 S. Ct. 2275 (1991).

15. *See infra* notes 315-22 and accompanying text.

tempted to place assets beyond the reach of creditors by investing them in a retirement plan. Permitting debtors to convert nonexempt assets into exempt assets before bankruptcy further frustrates the policy of protecting the rights of creditors.[16]

Even if a debtor's interest in her retirement plan is included in her bankruptcy estate, however, plan benefits may still be placed beyond the reach of creditors if the debtor is permitted to exempt all, or a portion, of such benefits out of the estate for her fresh start.[17] Whether a debtor can retain retirement benefits through this exemption process depends upon the exemption provisions that are applicable to the debtor. Three possible exemptions are available: the Bankruptcy Code's federal exemption scheme;[18] the exemption statute in the debtor's state of domicile;[19] or the anti-alienation provisions of ERISA.[20] A significant body of case law has developed around each of these possible exemption schemes.[21]

In order to advance the policies of both ERISA and the Bankruptcy Code, a comprehensive solution to the pension issue is necessary. This Article first examines the conflicting policies of ERISA and the Bankruptcy Code. It then explores how the various courts have attempted to reconcile these policies when faced with the issue of whether a debtor's interest in retirement plan assets should be available for distribution to creditors in bankruptcy. In analyzing the relevant case law, the Article examines cases addressing the exclusion issue (whether pension plans should be excluded from the bankruptcy estate entirely). It also evaluates cases addressing the exemption issue (whether plan assets, once included in the bankruptcy estate, can be exempted out of the estate by the debtor as part of his fresh start). Finally, the Article proposes extensive amendments to the relevant provisions of both ERISA and the Bankruptcy Code in an effort to strike a balance between the competing objectives of the two statutes and resolve the conflict that has emerged among the circuits.

---

16. For a discussion of the conversion issue, *see infra* notes 312-14 and accompanying text.

17. The fresh start concept is discussed *infra* notes 55-56 and accompanying text.

18. 11 U.S.C. § 522(b)(1) (1988).

19. 11 U.S.C. § 522(b)(2) (1988).

20. 29 U.S.C. § 1056(d)(1) (1988 & Supp. I 1989).

21. For a complete discussion of each alternative exemption scenario, *see infra* notes 187-293 and accompanying text.

## II. RETIREMENT PLAN ASSETS AS PROPERTY OF THE BANKRUPTCY ESTATE: STATUTORY FRAMEWORK AND COMPETING POLICY CONSIDERATIONS

### A. *The Policy Objectives of ERISA*

In enacting ERISA, Congress established a comprehensive scheme for regulating private pension plans.[22] According to the House committee report, the statute was designed to:

> achieve a strengthening of the role played by private retirement plans within the fabric of our economic and social structures. Its most important purpose will be to assure American workers that they may look forward, with anticipation, to a retirement with financial security and dignity, and without fear that this period of life will be lacking in the necessities to sustain them as human beings within our society.[23]

Congress employed two complementary approaches in ERISA to strengthen the role of private pension plans in the economy. First, labor provisions were included in ERISA that were intended to safeguard pension investments and improve employees' understanding of plans. These provisions, which are codified in Title 29 of the United States Code,[24] (i) require that employees' plan benefits be vested within a specified period of time;[25] (ii) establish funding requirements to assure that a plan retain sufficient funds to pay benefits due to its employees;[26] (iii) institute a mandatory insurance program to guarantee that employees receive their vested benefits should a pension plan be terminated;[27] and (iv) compel employers to communicate certain informa-

---

22. H.R. REP. NO. 533, 93d Cong., 1st Sess. 9 (1973), *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4647.

23. H.R. REP. NO. 533, 93d Cong., 1st Sess. 8, *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4646.

24. Pub. L. No. 93-406, 88 Stat. 832 (1974) (codified as amended at 29 U.S.C. §§ 1001-1461 (1988 & Supp. I 1989)).

25. In the legislative history of ERISA, Congress defines vesting as "[t]he nonforfeitable right of interest which an employee participant acquires in the pension fund. The benefit credits may vest in the employee immediately, although in most cases participants do not become eligible for vesting of benefits until a stipulated age or period of service, or a combination of both, is attained." H.R. REP. NO. 533, 93d Cong., 1st Sess. 5 (1973), *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4643-44.

26. H.R. REP. NO. 533, 93d Cong., 1st Sess. 7 (1973), *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4645.

27. S. REP. NO. 127, 93d Cong., 1st Sess. 2 (1973), *reprinted in* 1974 U.S. CODE

tion regarding the operation of the plan to their employees in a format that can be easily understood.[28]

Second, tax provisions were included in ERISA and codified in Title 26 of the United States Code that were designed to encourage the formation and growth of private pension plans by affording favorable tax treatment to "qualified" plans[29] in the Internal Revenue Code.[30] This favorable tax treatment can be summarized as follows:

> Employers, within certain limits, are permitted to deduct contributions made to these plans for covered employees whether or not their interests are vested; earnings on the plan's assets are exempt from tax; and covered employees defer payment of tax on employer contributions made on their behalf until they actually receive the benefits, generally after retirement when their incomes and hence applicable tax rates tend to be lower.[31]

ERISA is an extraordinarily complex statute, and its dual labor and tax provisions often use different terminology to refer to essentially similar types of plans. Although a complete discussion of the characteristics of the various ERISA-qualified plans is beyond the scope of this Article,[32] a brief examination of the structure of ERISA is necessary to understand the types of plan benefits that trustees and creditors are attempting to incorporate into the bankruptcy estate.

---

CONG. & ADMIN. NEWS 4838, 4838-39.

28. H.R. REP. NO. 533, 93d Cong., 1st Sess. 11 (1973), *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4649.

29. H.R. REP. NO. 807, 93d Cong., 2d Sess. 2, *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4671. A plan is "qualified" if it meets certain nondiscrimination and vesting rules established in the Internal Revenue Code. *Id.* A discussion of the Code's plan qualification rules is beyond the scope of this Article.

30. Provisions governing ERISA plans are scattered throughout the Internal Revenue Code. However, the major provisions of ERISA, including plan qualification requirements, are contained in I.R.C. §§ 401-457 (1988 & Supp. I 1989).

31. H.R. REP. NO. 807, 93d Cong., 2d Sess. 3, *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4672.

32. For an excellent discussion of the numerous plans and interests governed by ERISA, as well as the rights of the participants under such plans, *see* Seiden, *Chapter 7 Cases: Do ERISA and the Bankruptcy Code Conflict as to Whether a Debtor's Interest in or Rights Under a Qualified Plan Can be Used to Pay Claims?* (pt. 1), 61 AM. BANKR. L.J. 219, 220-30 (1987).

### *B. The Statutory Structure of ERISA*

ERISA governs the operation of "employee benefit plans."[33] An employee benefit plan includes both welfare plans and pension plans.[34] Welfare plans are plans that are established or maintained by an employer to provide benefits to its employees for matters such as health care, sickness, disability, vacation, death, or unemployment.[35] Pension plans, on the other hand, are those plans that are established or maintained by an employer to provide retirement benefits to its employees.[36] For purposes of ERISA, the

---

33. 29 U.S.C. § 1001(b) (1988 & Supp. I 1989).

34. 29 U.S.C. § 1002(3) (1988 & Supp. I 1989).

35. 29 U.S.C. § 1002(1) (1988 & Supp. I 1989). It provides:

> The terms "employee welfare benefit plan" and "welfare plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 186(c) of this title (other than pensions on retirement or death, and insurance to provide such pensions).

*Id.*

36. 29 U.S.C. § 1002(2) (1988 & Supp. I 1989). It provides in relevant part:

> [T]he terms "employee pension benefit plan" and "pension plan" mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund or program-
>
> (i) provides retirement income to employees, or
>
> (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond,
>
> regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.

*Id.*

term "pension plan" generally includes both profit-sharing plans[37] and pension plans.[38]

Only pension plans, and not welfare plans, are required to comply with ERISA's anti-alienation provisions.[39] The purpose of these provisions is to protect an employee's accrued retirement benefits from the reach of creditors as well as from the employee's own financial irresponsibility.[40] ERISA's anti-alienation provisions are found in the federal labor statutes and state that "[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated."[41] Similarly, the Internal Revenue Code provides that a retirement plan and accompanying trust will not receive favorable tax treatment unless the plan contains an anti-alienation provision.[42] Although the terms "assigned" and "alienated" are not defined by statute, treasury regulations under the Internal Revenue Code have expanded upon the terms by stating that plan benefits cannot be "anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution or other legal or equitable process."[43]

---

37. Profit-sharing plans are one type of defined contribution plan. For a discussion of the different types of defined contribution plans, *see* Seiden, *supra* note 32, at 221-22. *See also* 29 U.S.C. § 1002(34) (1988 & Supp. I 1989).

38. 29 U.S.C. § 1002(2)-(3) (1988 & Supp. I 1989). *See also* Seiden, *supra* note 32, at 238. Pension plans are referred to as defined benefit plans. 29 U.S.C. § 1002(35) (1988 & Supp. I 1989).

39. 29 U.S.C. § 1056(d)(1) (1988 & Supp. I 1989).

40. Anderson v. Raine (*In re* Moore), 907 F.2d 1476, 1480 (4th Cir. 1990); Crawford v. LaBoucherie Bernhard Ltd., 815 F.2d 117, 121 (D.C. Cir. 1987); Commercial Mortgage Ins. Inc. v. Citizens Nat'l Bank of Dallas, 526 F. Supp. 510, 517-18 (N.D. Tex. 1981). *See also* Brankey & Darr, *Debtor Interests in Pension Plans as Property of the Debtor's Estate*, 28 AM. BUS. L.J. 275, 279 (1990).

41. 29 U.S.C. § 1056(d)(1) (1988 & Supp. I 1989).

42. The Code states in pertinent part: "A trust shall not constitute a qualified trust under this section unless the plan of which such trust is part provides that benefits provided under the plan may not be assigned or alienated." I.R.C. § 401(a)(13)(A) (1988 & Supp. I 1989).

43. Treas. Reg. § 1.401(a)-13(b)(1) (as amended in 1988). The regulations further provide that the terms "assignment" and "alienation" include

> (i) Any arrangement providing for the payment to the employer of plan benefits which otherwise would be due the participant under the plan, and
>
> (ii) Any direct or indirect arrangement (whether revocable or irrevocable) whereby a party acquires from a participant or beneficiary a right or interest enforceable against the plan in, or to, all or any part of a plan benefit payment which is, or may become, payable to the participant or beneficiary.

Treas. Reg. § 1.401(a)-13(c) (as amended in 1988).

There are three statutory exceptions to ERISA's anti-alienation provisions. First, a plan participant who is receiving benefits under a pension plan can voluntarily assign up to ten percent of any benefit payment to another party without violating the plan's anti-alienation clause, so long as the assignment is revocable.[44] Second, if certain requirements are met, a plan participant can use her vested benefits as collateral for a loan from the plan.[45] Finally, in response to a judicially created exception for family support obligations,[46] Congress enacted a third exception to ERISA's anti-alienation provisions in 1984. Effective on January 1, 1985, a plan participant's benefits can be assigned for the benefit of a spouse, child, or other dependent pursuant to a qualified domestic relations order ("QDRO").[47] Additionally, several courts created a judicial exception to ERISA's anti-alienation provisions for liabilities arising from an employee's criminal misconduct toward his employer;[48] the Supreme Court, however, has recently

---

44. 29 U.S.C. § 1056(d)(2) (1988 & Supp. I 1989); I.R.C. § 401(a)(13)(A) (1988 & Supp. I 1989). A garnishment or attachment is not considered a voluntary assignment. Treas. Reg. § 1.401(a)-13(d)(1) (as amended in 1988).

45. 29 U.S.C. § 1056(d)(2) (1988 & Supp. I 1989); I.R.C. § 401(a)(13)(A) (1988 & Supp. I 1989); Treas. Reg. § 1.401(a)-13(d)(2) (as amended in 1988).

46. For a discussion of this exception, *see* Crawford v. LaBoucherie Bernhard Ltd., 815 F.2d 117, 121 (D.C. Cir. 1987).

47. 29 U.S.C. § 1056(d)(3) (1988 & Supp. I 1989); I.R.C. § 401(a)(13)(B) (1988 & Supp. I 1989); Treas. Reg. § 1.401(a)-13T (1985). A domestic relations order is defined as:

> any judgment, decree, or order (including approval of a property settlement agreement) which—
>
> (I) relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of the participant, and
>
> (II) is made pursuant to a State domestic relations law (including a community property law).

29 U.S.C. § 1056(B)(ii) (1988 & Supp. I 1989).

48. *Crawford*, 815 F.2d at 121; St. Paul Fire & Marine Ins. Co. v. Cox, 583 F. Supp. 1221, 1228 (N.D. Ala. 1984), *aff'd*, 752 F.2d 550 (11th Cir. 1985). *But see* Ellis Nat'l Bank of Jacksonville v. Irving Trust Co., 786 F.2d 466 (2d Cir. 1986), where the court refused to adopt the "criminal misconduct" exception to ERISA's anti-alienation provisions. Moreover, another court refused to find an exception to ERISA's anti-alienation provisions for fraud. United Metal Prods. Corp. v. National Bank of Detroit, 811 F.2d 297, 300 (6th Cir. 1987).

There are also several limited exceptions to ERISA's anti-alienation provisions authorized by treasury regulations, including income tax withholding on plan benefits as well as an exception allowing recovery from the participant of benefit overpayments. Treas. Reg. § 1.401(a)-13(c)(2) (as amended in 1988). For a more complete discussion of exceptions contained in treasury regulations, *see also* Seiden, *supra* note held such an exception to be inappropriate, stating that any exception to ERISA's anti-alienation provisions should be left to Congress.[49]

Because welfare plans are not subject to ERISA's anti-alienation provisions, there is no disagreement that benefits received by a debtor under such plans should be included in the debtor's bankruptcy estate.[50] Only the fate of pension plans is in dispute. Whether a debtor's interest in a pension plan should become part of his bankruptcy estate depends upon the proper interpretation of section 541 of the Bankruptcy Code.

### C. The Policy Objectives of the Bankruptcy Code

The federal bankruptcy system was established in 1898,[51] and was substantially modified in 1938 following the Great Depression.[52] Congress finally overhauled the bankruptcy laws completely in 1978 in an effort to

---

32, at 241-42.

49. Guidry v. Sheet Metal Workers Nat'l Pension Fund, 110 S. Ct. 680, 687 (1990). The Court in *Guidry* held:

> Nor do we think it appropriate to approve any generalized equitable exception—either for employee malfeasance or criminal misconduct—to ERISA's prohibition on the assignment or alienation of pension benefits. Section 206(d) [the anti-alienation provision] reflects a considered Congressional policy choice, a decision to safeguard a stream of income for pensioners (and their dependents, who may be, and perhaps usually are, blameless), even if that decision prevents others from securing relief for the wrongs done them. If exceptions to this policy are to be made, it is for Congress to undertake that task.

*Id.* (footnote omitted).

50. There was disagreement over this issue until 1988, when it was resolved by the Supreme Court in Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825 (1988). For a complete discussion of the *Mackey* case and its application to welfare benefit plans, *see* Note, *ERISA, Employees, and Creditors' Rights: A Search for a Consistent Theme*, 67 WASH. U.L.Q. 461, 473-75 (1989). *See also infra* notes 264-93 and accompanying text. However, disability, sickness, and unemployment benefits may be exempted out of the debtor's bankruptcy estate, and therefore beyond the reach of creditors, pursuant to § 522(d)(10) of the Bankruptcy Code if the debtor elects the federal exemption scheme. For a complete discussion of property exemptions in bankruptcy, *see infra* notes 187-293 and accompanying text.

51. Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978). This act is entitled the Bankruptcy Act of 1898, and will be hereinafter referred to as the Bankruptcy Act.

52. Act of June 22, 1938, ch. 575, 52 Stat. 840 (the "Chandler Act"). A history of the evolution of modern day bankruptcy law can be found in E. WARREN & J. WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 187-93 (2d ed. 1991).

modernize the court system and provide greater relief for consumer debtors.[53] One of the overriding goals of Congress in establishing the federal bankruptcy system has been to provide uniformity in the treatment of both debtors and creditors across the country.[54]

The current Bankruptcy Code is intended to promote two competing policies. First, it gives debtors a fresh start after bankruptcy, unencumbered by most pre-bankruptcy debts,[55] in order to "give an honest debtor a new opportunity in life without the pressure and discouragement of substantial indebtedness."[56] Second, the Bankruptcy Code attempts to provide an equitable distribution of the debtor's property to his creditors and maximize the return to creditors without hindering the debtor's need for a fresh start.[57]

The Bankruptcy Code significantly amended the old Bankruptcy Act in defining the scope of the bankruptcy estate. Under the old Bankruptcy Act, the estate consisted of all the debtor's property that could be transferred by the debtor or levied upon and sold,[58] except that needed for his fresh start. The

---

53. Pub. L. No. 95-598, 92 Stat. 2549, (codified as amended at 11 U.S.C. §§ 101-1330 (1988). *See* H.R. REP. NO. 595, 95th Cong., 2d Sess. 3-4, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 5965-66.

54. H.R. REP. NO. 595, 95th Cong., 2d Sess. 1, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 5963; S. REP. NO. 989, 95th Cong., 2d Sess. 1, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5787.

55. The concept of the fresh start is reiterated in the legislative history of the Bankruptcy Code: "At the heart of the fresh start provisions of the bankruptcy law is section 727 covering discharge. The discharge provisions require the court to grant the debtor a discharge of all his debts except for very specific and serious infractions on his part." S. REP. NO. 989, 95th Cong., 2d Sess. 7, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5793. *See also* Samore v. Graham (*In re* Graham), 726 F.2d 1268, 1271 (8th Cir. 1984).

The primary means by which the debtor is afforded a fresh start is through the exemption process, whereby the debtor can retain certain property needed for survival, such as a homestead and a modest amount of clothing and furniture. *See* 11 U.S.C. § 522 (1988). *See also infra* notes 187-293 and accompanying text.

56. B. WEINTRAUB & A. RESNICK, BANKRUPTCY LAW MANUAL 1-3 (1986).

57. H.R. REP. NO. 595, 95th Cong., 2d Sess. 177-78, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6138.

58. Section 70(a)(5) of the old Bankruptcy Act gave the bankruptcy trustee title to all property of the debtor "which, prior to the filing of the petition he [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." 11 U.S.C. § 110(a)(5) (1970) (repealed 1978).

This was the provision in the old Act that excluded spendthrift trusts from the debtor's bankruptcy estate. "Under this transferability-leviability standard, a bankrupt's beneficial interest in a trust was not part of the estate if the interest could not be transferred or levied upon under state law. Thus to the extent a state recognized the

Bankruptcy Code expanded the definition of property of the estate to include all of the debtor's property interests, including property needed for his fresh start.[59] After the estate is established, the debtor can then exempt certain property out of the estate and retain it for his fresh start, such as a homestead and limited amounts of clothing and furniture.[60] The legislative history of the Bankruptcy Code reveals that the purpose underlying the expansion of the scope of the estate was to give the bankruptcy judge greater control over the exemption and distribution process, thereby promoting the dual policies of the Bankruptcy Code.[61]

### D. *The Statutory Framework of the Bankruptcy Code*

The filing of a bankruptcy petition, either by the debtor in a voluntary case[62] or by the creditors in an involuntary case,[63] creates a bankruptcy estate.[64] Section 541(a) of the Bankruptcy Code provides that the estate consists of all legal or equitable property interests owned by the debtor at the time that the bankruptcy petition is filed.[65] It is intended to be broad in

---

validity of a spendthrift trust provision, the trustee in bankruptcy had no rights to the trust funds." *Graham*, 726 F.2d at 1271 (citations omitted).

59. The legislative history to the Bankruptcy Code states that section 541(a) "includes as property of the estate all property of the debtor, even that needed for a fresh start. After the property comes into the estate, then the debtor is permitted to exempt it under proposed 11 U.S.C. 522 . . . ." H.R. REP. No. 595, 95th Cong., 2d Sess. 368, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6324; S. REP. No. 989, 95th Cong., 2d Sess. 82, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5868.

60. The exemption process was not a departure from prior law, but Congress amended the old Bankruptcy Act by providing two different exemption schemes, state and federal, from which the debtor could choose. *See* H.R. REP. No. 595, 95th Cong., 2d Sess. 360, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6316. For a more complete discussion of the exemption process, *see infra* notes 187-293 and accompanying text.

61. For example, the Senate Report states that "Chapter 5 reflects the policy of the revision of the Bankruptcy Act to include all of the property of the debtor in the bankruptcy case . . . . As a result of these changes the amounts that will be returned to all creditors can be greater." S. REP. No. 989, 95th Cong., 2d Sess. 5, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5791. *See also* 4 COLLIER ON BANKRUPTCY § 541.02(1) (L. KING 15th ed. 1991); Samore v. Graham (*In re* Graham), 726 F.2d 1268, 1271 (8th Cir. 1984).

62. 11 U.S.C. § 301 (1988).

63. 11 U.S.C. § 303 (1988).

64. 11 U.S.C. § 541(a) (1988). *See also supra* text accompanying notes 6-10.

65. 11 U.S.C. § 541(a)(1) (1988).

scope, including both tangible and intangible property, causes of action, and any possessory interest of the debtor, such as a leasehold interest.[66] Generally, the Bankruptcy Code ignores provisions in agreements or instruments that restrict or condition transfer of a debtor's property interest, and includes such interests in the estate.[67] There is, however, a limited exception to this rule in section 541(c)(2) of the Bankruptcy Code, which states that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under *applicable nonbankruptcy law* is enforceable in a case under this title [the Bankruptcy Code]."[68]

The issue with which courts and commentators have been grappling in recent years is what constitutes "applicable nonbankruptcy law" for purposes of section 541(c)(2).[69] If ERISA's anti-alienation provisions are considered "applicable nonbankruptcy law" for purposes of the Bankruptcy Code, then such restrictions are enforceable and a debtor's interest in an ERISA-qualified pension plan will be excluded from the debtor's bankruptcy estate. Although it is difficult at first blush to understand why ERISA would not constitute "applicable nonbankruptcy law," an argument can be made that the legislative history of section 541 restricts the exclusion under section 541(c)(2) to state spendthrift trust law. For example, the House Report states that:

> The bill also continues over [from the old Bankruptcy Act] the exclusion from property of the estate of the debtor's interest in a spendthrift trust to the extent the trust is protected from creditors under applicable *State law.* The bankruptcy of the beneficiary should not be permitted to defeat the legitimate expectations of the settlor of the trust.[70]

---

66. H.R. REP. NO. 595, 95th Cong., 2d Sess. 367, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6323; S. REP. NO. 989, 95th Cong., 2d Sess. 82, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5868.

67. 11 U.S.C. § 541(c)(1) (1988). It provides in pertinent part:

> Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—
>
> (A) that restricts or conditions transfer of such interest by the debtor . . . .

*Id.*

Although any transfer restrictions are ignored for purposes of determining property of the estate, such provisions may restrict the trustee's rights to affect the property. *See, e.g., infra* notes 323-31 and accompanying text for an illustration of this concept with respect to retirement plans.

68. 11 U.S.C. § 541(c)(2) (1988) (emphasis added).

69. *See infra* notes 81-186 and accompanying text.

70. H.R. REP. NO. 595, 95th Cong., 2d Sess. 176, *reprinted in* 1978 U.S. CODE

In another reference to section 541(c)(2), the House Report provides that this subsection "preserves restrictions on transfer of a spendthrift trust to the extent that the restriction is enforceable under *applicable nonbankruptcy law*."[71]

The legislative history thereby creates an ambiguity as to the scope of section 541(c)(2). Was it intended only to preserve a pre-existing exclusion of the traditional state law spendthrift trust or, rather, was the section intended to be broader in scope than the legislative history might suggest? Before examining how courts have differed in their construction of the statute and its legislative history, it is critical to understand the evolution and nature of spendthrift trusts because much of the relevant case law has turned on the status of the specific ERISA plan at issue as a spendthrift trust under state law.

### *E. The Traditional Spendthrift Trust*

The Second Restatement of Trusts defines a spendthrift trust as a trust which, by its terms or by statute, validly restrains both voluntary and involuntary transfers of the beneficiary's interest therein.[72] A self-settled trust

---

CONG. & ADMIN. NEWS 5963, 6136 (footnote omitted) (emphasis added).

71. H.R. REP. NO. 595, 95th Cong., 2d Sess. 368, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6324 (emphasis added). The Senate version of section 541(c)(2) was quite different from the House version. The Senate version enforced transfer restrictions only to the extent necessary for the debtor and his dependents' support. It provided: "Paragraph (2) of subsection (c), however, preserves restrictions on a transfer of a spendthrift trust that the restriction is enforceable nonbankruptcy law to the extent of the income reasonably necessary for the support of a debtor and his dependents." S. REP. NO. 989, 95th Cong., 2d Sess. 83, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5869.

The Senate's version of section 541(c)(2) was ultimately rejected in the final draft of the legislation. 124 CONG. REC. H11,089 (daily ed. Sept. 28, 1978), *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 6436, 6455 (statement of the Hon. Don Edwards, Chairman of the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary). *See also* 124 CONG. REC. S17,406 (daily ed. Oct. 6, 1978), *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 6505, 6524 (statement of the Hon. Dennis DeConcini, Chairman of the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary).

72. RESTATEMENT (SECOND) OF TRUSTS § 152(2) (1959). In determining whether a restraint on transfer is valid, the Restatement provides:

> Except as stated in §§ 156 and 157, if by the terms of a trust the beneficiary is entitled to the income from the trust property for life or for a term of years and it is provided that his interest shall not be transferable by him and shall not be subject to the claims of his creditors, the restraint on the voluntary and involuntary transfer of his right to the income accruing during his life is valid.

(one in which the settlor is the beneficiary of the trust), however, cannot be a valid spendthrift trust under the Restatement.[73] Although it is irrelevant whether the beneficiary of a spendthrift trust is really a "spendthrift," oftentimes a settlor creates such a trust to protect the beneficiary against "his own folly or inefficiency or misfortune."[74]

A number of courts have also attempted to define a spendthrift trust. For example, in Kansas, courts have defined it as "a trust created to provide a fund for the maintenance of a beneficiary and at the same time to secure the fund against his improvidence or incapacity. Provisions against alienation of the trust fund by the voluntary acts of the beneficiary or by his creditors are its usual incidents."[75] Similarly, other cases have held that in order for a beneficiary to establish that a trust qualifies as a spendthrift trust, he must show that he cannot alienate his interest in the trust, and in addition, that he does not enjoy absolute and effective control over distributions from, or termination of, the trust.[76] While there appears to be no single recognized definition of a spendthrift trust, courts have agreed that, as a general rule, a self-settled trust cannot qualify as a spendthrift trust because of the degree of control that the beneficiary/settlor can exercise over the trust.[77]

---

*Id.* § 152(1). For an exhaustive discussion of the law of spendthrift trusts, including their origin and validity, *see* E. GRISWOLD, SPENDTHRIFT TRUSTS (1947).

73. "Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest." RESTATEMENT (SECOND) OF TRUSTS § 156 (1959).

74. 2 A. SCOTT, THE LAW OF TRUSTS 1131 (3d ed. 1967). *See also In re* Abbott, 123 Bankr. 784, 786 (S.D. Ohio 1991).

75. *In re* James, 126 Bankr. 360, 362 (Bankr. D. Kan. 1991) (quoting *In re* Estate of Sowers, 1 Kan. App. 2d 675, 574 P.2d 224, 228 (1977)). *See also* Levey v. First Va. Bank, 845 F.2d 80, 82-83 (4th Cir. 1988), in which the court stated

> Under Virginia law, a spendthrift trust has three defining characteristics: First, the trust must provide for the support and maintenance of its beneficiary; second, the settlor must intend to protect the trust from the beneficiary's creditors; and third, the settlor must intend to prevent the beneficiary's voluntary or involuntary alienation of trust property.

*Id.*

76. *In re* Kazi, 125 Bankr. 981, 985 n.5 (Bankr. S.D. Ill. 1991) (quoting *In re* Wimmer, 121 Bankr. 539, 543 (Bankr. C.D. Ill. 1990), *aff'd*, No. 91-1021 (C.D. Ill. July 19, 1991) (WESTLAW, FBKR-CS database).

77. *See, e.g., In re* Groves, 120 Bankr. 956, 961 n.3 (N.D. Ill. 1990); *In re* Smith, 103 Bankr. 882, 884 n.1 (N.D. Ohio 1990); *In re* Gifford, 93 Bankr. 636, 638 (N.D. Ind. 1988); *In re* Phelps, Nos. 85-09910-3, 86-0024-3 (W.D. Mo. July 28, 1986) (WESTLAW, FBKR-CS database); Tabor v. Employee Benefits Comm. (*In re* Cress), 121 Bankr. 1006, 1013 (Bankr. S.D. Ind. 1990), *aff'd sub nom.* Employee Benefits Comm. v. Tabor (*In re* Cress), 127 Bankr. 194 (S.D. Ind. 1991). *But see* IND. CODE § 30-4-3-2(c) (1989).

Some states do not recognize spendthrift trusts at all.[78] Among those that do, the incidents of the trust are sometimes established by the common law and are sometimes defined by statute.[79] The various states' treatment of spendthrifts trusts has proved quite relevant to courts trying to determine whether ERISA-qualified pension plans should be included in a debtor's bankruptcy estate. A majority of courts addressing the issue have held that a debtor's interest in an ERISA plan is included in the estate *unless* the plan at issue qualifies as a traditional spendthrift trust under applicable state law.[80] The discussion which follows thus illustrates the complete lack of uniformity in the cases addressing this issue due to the wide disparity in treatment of spendthrift trusts among the states.

## III. INCLUDING RETIREMENT PLAN ASSETS IN THE BANKRUPTCY ESTATE: THE CONFLICT AMONG THE CIRCUITS

Until last year, only a handful of bankruptcy and district courts had held that ERISA pension benefits were excluded from the debtor's bankruptcy estate under section 541(c)(2) of the Bankruptcy Code.[81] A clear majority of

---

78. *See* W. MCGOVERN, S. KURTZ & J. REIN, WILLS, TRUSTS, & ESTATES 342 n.29 (1988). *See also* 76 AM. JUR. 2D *Trusts* § 396 n.54 (1975).

79. For example, Indiana courts will only recognize the validity of a spendthrift trust if it meets specific statutory requirements:

> (a) The settlor may provide in the terms of the trust that the interest of a beneficiary may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee.
> (b) Except as otherwise provided in subsection (c), if the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest will not prevent his creditors from satisfying claims from the interest in the trust estate.
> (c) Subsection (a) applies to a trust that meets both of the following requirements, regardless of whether or not the settlor is also a beneficiary of the trust:
>> (1) The trust is a qualified trust under 26 U.S.C. 401(a).
>> (2) The limitation on each beneficiary's control over the beneficiary's interest in the trust complies with 29 U.S.C. 1056(d).

IND. CODE § 30-4-3-2 (1989).

80. For a complete discussion of the majority view, *see infra* notes 86-138 and accompanying text.

81. *See In re* Threewitt, 24 Bankr. 927, 929 (D. Kan. 1982) (debtor's vested, undistributed interest in ERISA pension plan was excluded from estate; court refused to give § 541(c)(2) an "unnecessarily narrow construction" so as to exclude ERISA from its ambit); *In re* Ralstin, 61 Bankr. 502, 504 (Bankr. D. Kan 1986) (debtor's beneficial interest in an ERISA-qualified plan was excluded from his bankruptcy estate

the courts addressing the issue have expressed the view that the phrase "applicable nonbankruptcy law" in section 541(c)(2) encompasses only traditional state spendthrift trust law, and not ERISA's anti-alienation provisions.[82] Therefore, under the majority view, ERISA pension benefits should not be excluded from the debtor's bankruptcy estate by virtue of the anti-alienation provisions of ERISA contained in the *federal* law. Many of these courts, however, have nevertheless then excluded such benefits if the ERISA plan at issue qualified as a traditional spendthrift trust under *state* law.[83]

---

under § 541(c)(2)); *In re* Wiggins, 60 Bankr. 89, 95 (Bankr. N.D. Ohio 1986) (debtor's interest in an ERISA plan was excluded from his estate); *In re* Mosley, 42 Bankr. 181, 191 (Bankr. D.N.J. 1984) (ERISA was "applicable nonbankruptcy law" under Bankruptcy Code; therefore, debtor's employee benefit plans were excluded from the estate in their entirety); *but see In re* Velis, 109 Bankr. 64, 68 (Bankr. D.N.J. 1989) *aff'd*, 123 Bankr. 497 (D.N.J. 1991) (only ERISA plans qualifying as spendthrift trusts are excluded from the estate under § 541(c)(2)—*Mosley* reconsidered); *In re* Phillips, 34 Bankr. 543, 545 (Bankr. S.D. Ohio 1983) (both the terms of the trust and the ERISA statute imposed restraints on alienation enforceable in bankruptcy and which excluded pension plan assets from the debtor's estate; holding supported by public policy); *but see In re* Gribben, 84 Bankr. 494, 495 (S.D. Ohio 1988) (ERISA plans can only be excluded from bankruptcy estate if they qualify as state spendthrift trusts); *In re* Holt, 32 Bankr. 767, 772 (Bankr. E.D. Tenn. 1983) (debtor's interest in qualified ERISA profit-sharing plan was excluded from the debtor's estate as ERISA was "applicable nonbankruptcy law" under § 541(c)(2)); *but see In re* Ridenour, 45 Bankr. 72, 78 (Bankr. E.D. Tenn. 1984) (following the decision in *Graham*, the court concluded that Congress intended to exclude only those ERISA-qualified plans which were valid spendthrift trusts under state law); *contra In re* Leamon, 121 Bankr. 974, 981 (Bankr. E.D. Tenn. 1990) (effectively overruled *Ridenour* and reinstated *Holt*, *see infra* note 174); *In re* Pruitt, 30 Bankr. 330, 331 (Bankr. D. Colo. 1983) (debtor's interest in ERISA-qualified thrift plan was not property of the estate); *but see In re* Matteson, 58 Bankr. 909, 911 (Bankr. D. Colo. 1986) (reconsidered *Pruitt* and concluded that Congress intended § 541(c)(2) to apply only to spendthrift trusts recognized under state law); *In re* Rogers, 24 Bankr. 181, 183 (Bankr. D. Ariz. 1982) (benefits of the debtors under an ERISA plan were not property of the estate under § 541(c)(2)); *but see In re* Daniel, 771 F.2d 1352, 1360 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1985) (ERISA plan benefits became property of the bankruptcy estate unless the plans qualified as spendthrift trusts under state law). *See also In re* Bizon, 28 Bankr. 886, 889 (Bankr. D. Md. 1983), *aff'd sub nom.* SSA Baltimore Fed. Credit Union v. Bizon, 42 Bankr. 338, 350 (D. Md. 1984) (debtor's interest in a retirement fund containing an anti-alienation provision similar to ERISA was not property of the bankruptcy estate).

82. *See infra* notes 86-138 and accompanying text.

83. *See infra* notes 114-38 and accompanying text.

The Fourth Circuit's 1990 decision in *Anderson v. Raine (In re Moore)*[84] is a pivotal case because it represents the first instance of a court of appeals adopting the minority view, thereby excluding ERISA pension benefits from a debtor's bankruptcy estate without resorting to state spendthrift trust law. *Moore* has thus triggered a reevaluation of this issue by courts and commentators alike.[85]

### A. *In re Graham: The Majority View*

One of the leading cases addressing whether pension benefits should be included in a debtor's bankruptcy estate is *Samore v. Graham (In re Graham)*,[86] in which the Eighth Circuit found that the term "applicable nonbankruptcy law" referred exclusively to state spendthrift trust law.[87] Accordingly, the court held that ERISA's restrictions on assignment or alienation were not considered "applicable nonbankruptcy law."

In *Graham*, the issue faced by the court was whether the debtor's interest in a profit-sharing retirement plan had to be turned over to the debtor's bankruptcy estate.[88] Graham was a physician whose professional services provided the earnings for Charles W. Graham, M.D. Ltd., a professional corporation. Graham was the sole stockholder, director, and officer of the corporation and had established the plan for his employees.[89] The plan met all of the requirements of ERISA, and was thus considered a qualified plan.[90] The participants in the profit-sharing plan were Graham and one other employee. Both received plan contributions from the professional corporation as determined by its board of directors, and both were also allowed to make voluntary employee contributions. At the time Graham filed for bankruptcy protection, his fully vested, accrued benefits under the plan were $150,000, from employer contributions.[91] The bankruptcy trustee filed a complaint to force the turnover of the debtor's accrued benefits to the bankruptcy estate.[92]

---

84. 907 F.2d 1476 (4th Cir. 1990).

85. *See infra* notes 161-86 and accompanying text. *See also* Koger & Goucher, *Exception, Exemption and Preemption: The Words that Launched a Thousand Opinions*, 1991 COM. L. BULL. 10 (Jan./Feb. 1991).

86. 726 F.2d 1268 (8th Cir. 1984).

87. *Id.* at 1271.

88. *Id.*

89. *Id.* at 1269.

90. *Id.* The plan also met the requirements of I.R.C. § 401(a). *Id.*

91. *Id.*

92. *Id.* at 1270.

The bankruptcy court held that Graham's interest in the plan should be included in the estate and ordered that the benefits be turned over.[93]

Graham's appeal focused on the language in section 541(c)(2) of the Bankruptcy Code, which excludes from the debtor's bankruptcy estate a property interest subject to a restriction on alienation that is enforceable under "applicable nonbankruptcy law."[94] Graham argued that section 541(c)(2) excluded his plan benefits; the anti-alienation clause contained in his profit-sharing plan[95] and required under the provisions of ERISA[96] was a restriction on transfer or alienation enforceable against general creditors, and thus should be enforceable against the bankruptcy trustee.[97]

The Eighth Circuit first recognized the scope of section 541(a) as a broad, inclusionary provision.[98] The court then focused on the exceptions and concluded that Congress intended section 541(c)(2) to be construed narrowly to preserve the status of the spendthrift trust as it existed under the old Bankruptcy Act.[99] The court examined the legislative history of the Bankruptcy Code to find the intent of the drafters when enacting section 541(c)(2). It found that the House and Senate Reports indicated a clear intent on the part of Congress to preserve the status enjoyed by traditional spendthrift trusts under the old Bankruptcy Act.[100] In its opinion, the court quoted extensively from the House Report which accompanied the Bankruptcy Reform Act of 1978; it emphasized that the bill retained the old Bankruptcy Act's "exclusion from property of the estate of the debtor's interest in a spendthrift trust to the extent the trust is protected from creditors under applicable State law."[101] The court also examined the Senate Report and

---

93. *Id. See In re* Graham, 24 Bankr. 305 (Bankr. N.D. Iowa 1982).

94. *Graham,* 726 F.2d at 1270.

95. The anti-alienation provision stated: "The participant . . . shall not assign or alienate any benefit provided under the Plan, and the Trustee shall not recognize any such assignment or alienation." *Id.* The trustee also had the power to make a loan to a participant from the plan if the loan was secured by the participant's nonforfeitable accrued benefit. *Id.*

96. 29 U.S.C. § 1056(d)(1) (1976).

97. *Graham,* 726 F.2d at 1271. Graham cited two cases in support of his position that his ERISA benefits should not be available to satisfy creditors' claims: General Motors Corp. v. Buha, 623 F.2d 455 (6th Cir. 1980) and Commercial Mortgage Ins. Inc. v. Citizens Nat'l Bank, 526 F. Supp. 510 (N.D. Tex. 1981).

98. *Graham,* 726 F.2d at 1270. For the text of section 541(a), *see supra* text accompanying note 9.

99. *Graham,* 726 F.2d at 1271. For a discussion of the provisions of the old Bankruptcy Act affecting the spendthrift trust, *see supra* note 58.

100. *Graham,* 726 F.2d at 1271-72.

101. *Graham,* 726 F.2d at 1272 (quoting H.R. REP. NO. 595, 95th Cong., 2nd Sess. 175-76, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6136).

found the same intent on the part of the drafters to preserve the status of spendthrift trusts valid under state law.[102]

After its review of the legislative history, the court concluded that the term "applicable nonbankruptcy law" was intended to include only state spendthrift trust restrictions,[103] and not the anti-alienation provisions contained in ERISA. Accordingly, Graham's interest in his qualified profit-sharing plan was included in his bankruptcy estate.

The court found further support for its decision in the fact that pensions are specifically addressed under the exemption provisions of the Bankruptcy Code.[104] Section 522(d), which sets forth the federal exemption scheme,[105] provides that a debtor can exempt out of his bankruptcy estate his right to receive:

> (E) a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless -
>
> (i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;
> (ii) such payment is on account of age or length of service; and
> (iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), 408, or 409 of the Internal Revenue Code of 1954 (26 U.S.C. 401(a), 403(a), 403(b), 408, or 409).[106]

The *Graham* court recognized that, with the limited exception for plans established by insiders, the foregoing exemption would apply to plans not qualified under ERISA. It also stated, however, that ERISA-qualified plans would fall within the ambit of the exemption provision as well.[107] In order

---

102. *Graham*, 726 F.2d at 1272. *See* S. REP. NO. 989, 95th Cong., 2d Sess. 83, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5869.

103. The court in *Graham* defined a spendthrift trust as one "in which the right of the beneficiary to future payments of income or capital cannot be voluntarily transferred by the beneficiary or reached by his or her creditors." *Graham*, 726 F.2d at 1271.

104. 11 U.S.C § 522(d) (1988 & Supp. I 1989). For a discussion of the effect of the exemption provisions on the bankruptcy estate, *see infra* notes 187-293 and accompanying text.

105. For a complete discussion of the exemption process, *see infra* notes 187-293 and accompanying text.

106. 11 U.S.C. § 522(d)(10)(E) (1988 & Supp. I 1989). *See Graham*, 726 F.2d at 1272.

107. *Graham*, 726 F.2d at 1272.

for the plan proceeds to be exempted out of the bankruptcy estate, the court reasoned, they must first be included in the estate.[108]

The court in *Graham* found no conflict between ERISA and the Bankruptcy Code because of a provision in ERISA stating that it was not to affect the operation of other federal statutes. "Nothing in this subchapter [including the anti-alienation provisions] shall be construed to modify, invalidate, impair, or supersede any law of the United States . . . or any rule or regulation issued under any law."[109] Thus, according to the court, ERISA's anti-alienation provisions would not prohibit Graham's retirement benefits from being included in his bankruptcy estate by operation of section 541 of the Bankruptcy Code. Based upon these considerations, the Eighth Circuit concluded that ERISA-qualified retirement plans must be included in a debtor's bankruptcy estate.[110]

A number of courts, including five courts of appeals, have followed the Eighth Circuit's decision in *Graham*.[111] They have held that ERISA's anti-alienation provisions do not constitute "applicable nonbankruptcy law" under section 541(c)(2) of the Bankruptcy Code.[112] Most of these courts, however,

---

108. *Id.* The court concluded: "A debtor's interest in pension funds first comes into the bankruptcy estate. To the extent they are needed for a fresh start they may then be exempted out." *Id.* For a recent decision reaching the same conclusion, *see In re* Nadler, 122 Bankr. 162, 166 (Bankr. D. Mass. 1990).

109. *Graham*, 726 F.2d at 1273 (quoting 29 U.S.C. § 1144(d) (1988 & Supp. I 1989)).

110. The remaining issue, which is discussed *infra* at notes 187-293 and accompanying text, is to what extent a debtor's pension benefits, once included in the bankruptcy estate, can be exempted out of the estate by the debtor and retained for his fresh start.

111. The Fourth, Fifth, Seventh, Ninth, and Eleventh Circuits have rendered decisions following the reasoning of the Eighth Circuit in *Graham*. *See* John Hancock Mutual Life Ins. Co. v. Watson (*In re* Kincaid), 917 F.2d 1162 (9th Cir. 1990); *In re* LeFeber, 906 F.2d 330 (7th Cir. 1990); Brooks v. Interfirst Bank, Fort Worth (*In re* Brooks), 844 F.2d 258 (5th Cir. 1988); Daniel v. Security Pacific Nat'l Bank (*In re* Daniel), 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986); *In re* McLean, 762 F.2d 1204 (4th Cir. 1985); *but see* Anderson v. Raine (*In re* Moore), 907 F.2d 1476 (4th Cir. 1990); *In re* Lichstrahl, 750 F.2d 1488 (11th Cir. 1985); Goff v. Taylor (*In re* Goff), 706 F.2d 574 (5th Cir. 1983). *See also In re* Swanson, 873 F.2d 1121, 1123 (8th Cir. 1989), in which the Eighth Circuit reaffirmed its decision in *Graham*, holding that the language of § 541(c)(2) should be given a narrow reading to encompass only the traditional spendthrift trust. For a seemingly exhaustive list of cases following the majority view, *see* Koger & Goucher, *supra* note 85, at 12-14.

112. One district court in the Eighth Circuit, however, has refused to follow *Graham* and has instead treated ERISA as "applicable nonbankruptcy law," thereby excluding the debtors' retirement benefits from their bankruptcy estates. *See In re* Carver, No. 91-3041-CV-S-4 (W.D. Mo. June 26, 1991) (WESTLAW, Allfeds

have then gone on to analyze whether the ERISA plan at issue in the case would qualify as a spendthrift trust under state law, and have excluded the debtor's pension benefits from his bankruptcy estate if the plan fit within the spendthrift trust definition. Only a few courts have taken the position that ERISA plan benefits must be included in the estate regardless of whether the plan would qualify as a traditional spendthrift trust.[113]

### B. *The Majority's Analysis of State Spendthrift Trust Law*

Courts that have considered whether a debtor's interest in an ERISA-qualified plan constitutes a spendthrift trust under applicable state law have consistently examined the degree of the debtor's "dominion and control" over the assets in the plan.[114] If the debtor lacks a sufficient degree of control over plan assets, then the plan is generally held to constitute a valid spendthrift trust and the debtor's interest in the plan is excluded from the bankruptcy estate under section 541(c)(2).[115] Conversely, if the debtor is found to exercise a great deal of control over plan assets, then the plan ordinarily does not qualify as a traditional spendthrift trust, and, therefore, the debtor's interest in the plan becomes part of the estate.[116] Some courts have

---

database). In reaching its decision, the court relied on the Supreme Court's decision in *Guidry v. Sheet Metal Workers Nat'l Pension Fund*, 110 S. Ct. 680 (1990). It reasoned that, because *Guidry* held that Congress must initiate any exception to ERISA's anti-alienation provisions, "any judicial opinion creating an exception for the trustee to reach the debtor's benefits in an ERISA plan is contrary to the holding in *Guidry*." *Carver*, slip. op. at 4. For a discussion of courts of appeals cases adopting this minority view, *see infra* notes 139-73 and accompanying text.

113. These have generally been cases in the Eighth Circuit that have interpreted *Graham* as holding that a debtor should be permitted to retain his pension benefits only if they could be exempted out of the bankruptcy estate under § 522(b) of the Bankruptcy Code. *See, e.g., In re* Loe, 83 Bankr. 641, 645 (Bankr. D. Minn. 1988); *In re* Bowen, 80 Bankr. 1012, 1016 (Bankr. D.S.D. 1987); *In re* Bartlett, 67 Bankr. 455, 456 (Bankr. W.D. Mo. 1986); *In re* McKenna, 58 Bankr. 221, 223 (Bankr. N.D. Iowa 1985). *See also In re* White, 47 Bankr. 410, 413 (W.D. Wash. 1985); *In re* Crenshaw, 44 Bankr. 30, 33 (Bankr. N.D. Ala. 1984). For a discussion of the exemption process in bankruptcy, *see infra* notes 187-293 and accompanying text.

*Graham* has also been interpreted as holding that an ERISA plan can be excluded from the debtor's estate entirely if it qualifies as a spendthrift trust under state law. *See, e.g., In re* O'Brien, 94 Bankr. 583, 585-86 (W.D. Mo. 1988); *In re* Gallagher, 101 Bankr. 594, 602 (Bankr. W.D. Mo. 1989).

114. *See, e.g., Kincaid*, 917 F.2d at 1167; *In re* Kaplan, 97 Bankr. 572, 577 (Bankr. 9th Cir. 1989).

115. *See infra* notes 118-28 and accompanying text.

116. *See infra* notes 131-38 and accompanying text.

adopted a middle ground position and have held that a portion of the debtor's interest in plan assets, generally those contributed by the employer, are excluded from the estate as a valid spendthrift trust. The remainder of the debtor's interest, generally those assets contributed by the debtor, are included in the bankruptcy estate because that portion of the plan does not constitute a spendthrift trust.[117]

In *John Hancock Mutual Life Insurance Co. v. Watson (In re Kincaid)*,[118] the Ninth Circuit held that an ERISA-qualified Deferred Salary Plan was a valid spendthrift trust under Oregon and Massachusetts law,[119] thereby excluding the debtor's interest in the plan from her bankruptcy estate.[120] The court first determined that the plan was not self-settled since it was created by the debtor's employer, not the debtor herself, and that the debtor had no access to or control over the contributed funds.[121] It noted that some courts had held a plan to be self-settled if the employee could choose voluntarily to participate in the plan,[122] but rejected that notion.

The Ninth Circuit then looked to "the amount of 'dominion and control' exercised by the debtor over the trust property" in order to determine whether the plan at issue created a valid spendthrift trust.[123] It concluded that Kincaid did not exercise enough control over the plan to remove it from the ambit of a traditional spendthrift trust, despite the fact that the debtor could receive her interest in the plan upon termination of her employment,[124]

117. *See infra* notes 129-30 and accompanying text.

118. 917 F.2d 1162 (9th Cir. 1990).

119. Although the plan provided that it was to be governed by Massachusetts law, a question was raised by the court below as to whether Massachusetts had a sufficient nexus to the parties or the transaction so that the choice of law provision in the plan could be honored. The court in *Kincaid*, however, did not address the choice of law issue since both Massachusetts and Oregon law reached the same conclusion on the spendthrift trust issue. *Id.* at 1167 n.2.

120. *Id.* at 1168.

121. Had the plan been self-settled, the court recognized that under both Oregon and Massachusetts law, a valid spendthrift trust could not have existed. *Id.* at 1167.

122. *Id.* (citing *In re* Cates, 73 Bankr. 874, 876 n.3 (Bankr. D. Or. 1987); *In re* Sanders, 89 Bankr. 266, 270 (Bankr. S.D. Ga. 1988)). *Accord In re* Davis, 125 Bankr. 242, 245 (Bankr. W.D. Mo. 1991).

123. *Kincaid*, 917 F.2d at 1167 (quoting *In re* Kaplan, 97 Bankr. 572, 577 (Bankr. 9th Cir. 1989)). *See also In re* Jones, 43 Bankr. 1002, 1006 (Bankr. N.D. Ind. 1984) (the court held that in order to establish a valid spendthrift trust, the debtor had to prove, among other facts, that "the debtor-beneficiary has no present dominion or control over the plan corpus").

124. The court stated: "While it is true that termination of one's job is often in one's own hands, it would be a rather drastic step to take for the purpose of obtaining funds in the Plan." *Kincaid*, 917 F.2d at 1168. *Accord In re* Zabelski, 81 Bankr. 89,

borrow from the plan,[125] and obtain funds from the plan for hardship.[126] The court thus held that the debtor's interest in the plan was not property of her bankruptcy estate, stating: "[w]e are confirmed in this position by the knowledge that it attenuates the clash between ERISA and bankruptcy law, and thus helps prevent our legal system from becoming a mere farrago of unrelated provisions."[127]

Numerous other courts have concluded that the ERISA-qualified retirement plans at issue were valid spendthrift trusts, thus excluding plan benefits from a debtor's bankruptcy estate.[128] Some courts, however, have accorded spendthrift treatment only to that portion of the retirement plan consisting of employer contributions.[129] Reasoning that the portion of the

---

90 (Bankr. N.D. Fla. 1988). *But see In re* Silldorff, 96 Bankr. 859, 864 (C.D. Ill. 1989); *In re* Hartman, 115 Bankr. 171, 175 (Bankr. W.D. Ark. 1990), in which courts have held that a debtor's ability to access funds in a pension plan by terminating employment gave the debtors sufficient control over plan assets to deny spendthrift trust status to the plans at issue. For other district court cases reaching the same result, *see In re* Green, 123 Bankr. 327, 329 (W.D. Mo. 1990); Employee Benefits Comm. v. Tabor (*In re* Cress), 121 Bankr. 1006 (Bankr. S.D. Ind. 1990), *aff'd*, 127 Bankr. 194, 200 (S.D. Ind. 1991).

125. According to the court, if a loan has to be repaid with interest, and if the administrator of the plan is not required to make the loan to the participant, then most courts have held that the loan provision in the plan does not destroy the status of the plan as a spendthrift trust. *Kincaid,* 917 F.2d at 1168 (citing *In re* Hysick, 90 Bankr. 770, 776-77 (Bankr. E.D. Pa. 1988) and *In re* West, 81 Bankr. 22, 25 (Bankr. 9th Cir. 1987)). In *Kincaid,* the debtor was required to repay any loan from the plan with interest, and the administrator could decide whether or not to make the loan in his sole discretion. Finally, the plan specifically provided that "[t]his provision shall not be used as a means of distributing benefits before they otherwise become payable." All of these factors aided the court in its determination that the ability of Kincaid to obtain a loan from the plan did not destroy its spendthrift character. *Kincaid,* 917 F.2d at 1168. *But see In re* Bloom, 839 F.2d 1376, 1379 (9th Cir. 1988), where a debtor's interest in her retirement plan was found exempt despite the fact that the debtor borrowed over half of the funds in her retirement plan without security.

126. The Ninth Circuit concluded that the hardship provision did not destroy the status of the plan as a spendthrift trust because it was discretionary and very limited in nature. The court pointed to the fact that the debtor's hardship petition was denied in this case as an example of the restrictive nature of the hardship provision in the plan. *Kincaid,* 917 F.2d at 1168.

127. *Id.*

128. *See, e.g., In re* LeFeber, 906 F.2d 330, 331 (7th Cir. 1990); *In re* Taylor, 84 Bankr. 159, 161 (Bankr. E.D. Mo. 1988). For an extensive compilation of cases holding that an ERISA-qualified pension plan constituted a valid spendthrift trust under applicable state law, *see* Koger & Goucher, *supra* note 85, at 18-19.

129. *See, e.g., In re* Tisdale, 112 Bankr. 61, 65 (Bankr. D. Conn. 1990); *In re*

plan consisting of employee contributions is a self-settled plan, these courts have bifurcated employer and employee contributions; they hold the employer portion a valid spendthrift trust, if all other requirements for spendthrift treatment are met, while holding the employee portion to be self-settled, and therefore not a valid spendthrift trust.[130] Accordingly, these courts have excluded the employer's contributions from the debtor's bankruptcy estate but have included the debtor/employee's contributions in his estate for the benefit of creditors.

The majority of courts considering this issue, however, have held that the relevant ERISA plan did not rise to the level of a spendthrift trust under applicable state law. Generally, they have based their decisions upon the degree of the debtor's control over plan assets. For example, their decisions in *In re Lichstrahl*,[131] the Eleventh Circuit denied spendthrift status to two pension plans established by a professional association in which the debtor was the sole director, officer, and stockholder. Although the plans contained anti-alienation provisions required by ERISA, they gave the professional association the power to amend or terminate them.[132]

The court looked to Florida law, the governing state law, and determined that it defined a spendthrift trust as one which is:

> created with a view of providing a fund for the maintenance of another, and at the same time securing it against his own improvidence or incapacity for self-protection. The provisions against alienation of the trust fund by the voluntary act of the beneficiary, or invitum by his creditors, are the usual incidents of such trusts.[133]

The court determined that because the debtor could amend or terminate the plans as agent of the professional association, he enjoyed dominion and control over the plan assets, and, therefore, the plans were not valid spendthrift trusts. Not allowing substance to prevail over form, the court found it

---

Elsea, 47 Bankr. 142, 146-47 (Bankr. E.D. Tenn. 1985). Some courts have even held that if a plan participant has the option of making contributions to the plan, the entire plan is self-settled and, therefore, cannot be a spendthrift trust. *In re* Davis, 125 Bankr. 242, 246 (Bankr. W.D. Mo. 1991); *In re* Smith, 124 Bankr. 787, 790 (Bankr. W.D. Mo. 1991).

130. *Tisdale*, 112 Bankr. at 65; *In re* Cates, 73 Bankr. 874, 877 (Bankr. D. Or. 1987); *In re* Berndt, 34 Bankr. 515, 517 (Bankr. N.D. Ind. 1983). *See also Davis*, 125 Bankr. at 246.

131. 750 F.2d 1488 (11th Cir. 1985).

132. *Id.* at 1489.

133. *Id.* at 1490 (quoting Croom v. Ocala Plumbing & Elec. Co., 62 Fla. 460, 465, 57 So. 243, 244 (1911)).

irrelevant that the debtor was not the settlor of the plans, since he had complete control over the professional association that was the settlor.

While many courts have denied spendthrift treatment to self-settled pension plans,[134] other courts have refused to find the existence of a spendthrift trust even in instances in which the debtor exercised far less control over plan assets. In *Brooks v. Interfirst Bank, Fort Worth (In re Brooks)*,[135] for example, the Fifth Circuit held that a debtor's ERISA-qualified profit-sharing plan was not a valid spendthrift trust where the debtor was one of thirty-two doctors who participated in the plan through an association, and from time to time sat on a board of directors that made decisions regarding the pension plan. Although it did not articulate the reasons for its decision, the court implied that the plan was self-settled, despite the fact that the debtor was not a member of the association when it established the plan.[136] Similarly, in *In re Rodriguez*,[137] the court held that the debtor's right to receive his vested benefits upon termination of his employment negated the existence of a spendthrift trust. Thus, even those courts which espouse the majority view that "applicable nonbankruptcy law" includes only traditional state spendthrift trust law have still reached vastly different conclusions regarding whether pension plan benefits become part of the debtor's bankruptcy estate.[138]

---

134. *See, e.g.*, Goff v. Taylor (*In re* Goff), 706 F.2d 574, 588 (5th Cir. 1983) (debtors' self-settled Keogh plans could not be insulated from creditors as spendthrift trusts because the debtors exercised considerable control over plan assets); *In re* Hartman, 115 Bankr. 171, 174 (Bankr. W.D. Ark. 1990) (a settlor cannot set up a self-settled trust so that he can receive income as a beneficiary while also attempting to protect trust assets from creditors); *In re* Dickson, 114 Bankr. 740, 742 (Bankr. N.D. Okla. 1990) ("the spendthrift provisions of a self-settled trust of which the settlor is also the beneficiary are not enforceable"); *In re* Tisdale, 112 Bankr. 61, 65 (Bankr. D. Conn. 1990) (a spendthrift clause in a self-settled trust is void as a matter of public policy).

135. 844 F.2d 258 (5th Cir. 1988).

136. It is possible that the court relied in part on the fact that the plan allowed the participant to reach plan assets upon termination of employment after three years, or that a participant could request a loan from the plan for "hardship," in reaching its decision. *Id.* at 260. It is even more likely that the decision was based in part on the fact that the debtor's vested balance in his plan account reached $645,123.09 while his bankruptcy proceeding was still pending. *Id.*

137. 82 Bankr. 74, 76 (Bankr. W.D. Ark. 1987). *See also supra* note 124.

138. Some states have attempted to create uniformity in the treatment of retirement benefits in bankruptcy by enacting statutes that provide that ERISA-qualified retirement plans constitute spendthrift trusts under state law. ILL. ANN. STAT. ch. 110, para. 12-1006 (Smith-Hurd Supp. 1991); KAN. STAT. ANN. § 60-2308 (Supp. 1990). At least one Illinois bankruptcy court has held Illinois' provision to be

### C. *In re Moore: The Minority View*

Although the Eighth Circuit's view in *Graham* has been adopted by a majority of other circuits, it was recently rejected by the Fourth Circuit in *Anderson v. Raine (In re Moore)*.[139] The court in *Moore* found that the phrase "applicable nonbankruptcy law" referred not only to state law (primarily state spendthrift trust law) but also to federal law. Including federal law within the ambit of "applicable nonbankruptcy law" thus excluded plans qualifying under ERISA from the bankruptcy estate.[140]

*Moore* involved a group of debtors who participated in a comprehensive retirement program through their employer. The debtors' retirement plans contained an anti-assignment provision which prohibited the alienation of the employees' interests in the plans, thus qualifying the plans under the terms of ERISA. Under the plans, employees could receive their vested benefits only upon retirement, disability, or termination of their employment. The trustee brought suit against the administrator of the plans, claiming that the plans did not qualify as spendthrift trusts under South Carolina law, and, therefore, the proceeds of the plans were required to be turned over to the debtors' bankruptcy estates.[141]

The bankruptcy court held that because the plans qualified under ERISA, they were excluded from the debtors' bankruptcy estates under section 541(c)(2) of the Bankruptcy Code.[142] The bankruptcy court found that whether the plans also qualified as state spendthrift trusts was irrelevant. The district court affirmed.[143]

In its decision, the Fourth Circuit focused on the interpretation of "applicable nonbankruptcy law" under section 541(c)(2) and rejected the trustee's argument that the language referred only to retirement plans with restrictions on transfer or alienation enforceable under state spendthrift trust law. The court found the language to be broad, determined that the provision included both federal and state laws recognizing transfer restrictions as enforceable,[144] and found no contradictory limiting language in the statute.

---

unconstitutional. *See In re* Wimmer, 121 Bankr. 539, 543 (Bankr. C.D. Ill. 1990), *aff'd*, No. 91-1021 (C.D. Ill. July 19, 1991) (WESTLAW, FBKR-CS database). Thus, whether these statutes will, in fact, create uniformity is doubtful.

139. 907 F.2d 1476 (4th Cir. 1990). For a discussion of the *Moore* decision, *see* Note, *A Debtor's Interest in ERISA Funds as Property of the Estate: A Question of Statutory Interpretation*, 56 MO. L. REV. 787 (1991).

140. *Moore*, 907 F.2d at 1476-78.

141. *Id.* at 1476-77.

142. *Id.* at 1476.

143. *Id.* Neither the bankruptcy nor the district court opinion is published.

144. *Id.* at 1477. The court stated:

In attempting to define the phrase "applicable nonbankruptcy law," the Fourth Circuit looked not only to its plain meaning, but also examined the definition that was attributed to the same phrase when used elsewhere in the Bankruptcy Code.[145] For example, the court cited section 1125(d) of the Bankruptcy Code,[146] which sets forth certain requirements for disclosure statements, and found that the language "not governed by any otherwise applicable nonbankruptcy law" in that provision included the federal securities laws.[147] Additionally, the court noted that the phrase "applicable nonbankruptcy law" in section 108(a) of the Bankruptcy Code (dealing with extensions of time for a trustee to bring a cause of action which the debtor could have brought) has been held to encompass the tolling provisions of the Racketeer Influenced and Corrupt Organization Act, among other statutes.[148] Because identical words are to be given the same meaning when found within the same statute,[149] the court in *Moore* reasoned that the phrase "applicable nonbankruptcy law" must include federal as well as state law wherever that phrase is found in the Bankruptcy Code, including the exclusionary provisions of section 541(c)(2).

The court further reasoned that, when the drafters of the Bankruptcy Code intended a statutory reference to include only state law, the term "state law" rather than "applicable nonbankruptcy law" was used.[150] The court also pointed out that the drafters would have used the phrase "state spendthrift trust law" or "traditional spendthrift trusts" if their intent had been to exclude

---

> "Applicable nonbankruptcy law" means precisely what it says: all laws, state and federal, under which a transfer restriction is enforceable. Nothing in the phrase "applicable nonbankruptcy law" or in the remainder of § 541(c)(2) suggests that the phrase refers exclusively to state law, much less to state spendthrift trust law.

*Id.*

145. *Id.*

146. 11 U.S.C. § 1125(d) (1988).

147. *Moore*, 907 F.2d at 1477-78 (citing *In re* Stanley Hotel, Inc., 13 Bankr. 926, 931 (Bankr. D. Colo. 1981)).

148. *Moore*, 907 F.2d at 1478 (citing *In re* Ahead By a Length, Inc., 100 Bankr. 157, 162-63 (Bankr. S.D.N.Y. 1989)).

149. *Moore*, 907 F.2d at 1478 (quoting Morrison-Knudsen Constr. Co. v. Director, Office of Workers' Compensation Programs, 461 U.S. 624, 633 (1983)).

150. *Moore*, 907 F.2d at 1478. The court in *Moore* pointed to examples, such as 11 U.S.C. § 109(c)(2) ("state law"), 11 U.S.C. § 522(b)(1)-(2) (1988) ("state law that is applicable"), and 11 U.S.C. § 523(a)(5) (1988) ("made in accordance with state and territorial law"), all of which show explicit references to "state law," where it was the intended source. *See also* 11 U.S.C. §§ 362(b)(12), 903(1), 1145(a) (1988).

from a debtor's bankruptcy estate only those plans qualifying as spendthrift trusts.[151]

The Fourth Circuit recognized that other courts had narrowly read the phrase "applicable nonbankruptcy law" to include only state spendthrift trust law, but it specifically refused to follow those decisions. The court emphasized that the majority of courts holding that state spendthrift trust law was the proper interpretation of the statute did so by looking to the legislative history of section 541(c)(2).[152] The court in *Moore* refused to resort to legislative history when the language of the statute was clear.[153] Moreover, the court determined that, even if it turned to the legislative history to assist in its decision, the legislative history was inconclusive. According to the court in *Moore*, the repeated references to state spendthrift trust law in the House and Senate Reports only suggested that Congress intended spendthrift trust law to fall within the purview of "applicable nonbankruptcy law," and did not mean that the phrase was limited exclusively to spendthrift trust law.[154]

Finally, the Fourth Circuit considered whether ERISA contained enforceable transfer restrictions which would bring the statute within the ambit of "applicable nonbankruptcy law." After examining the policies of ERISA, the court concluded that its overriding purpose was to protect an employee's retirement benefits.[155] The court stated that "ERISA ensures that 'if a worker has been promised a defined pension benefit upon retirement—and if he has fulfilled whatever conditions are required to obtain a vested benefit—he will actually receive it.'"[156] The court reviewed ERISA's anti-alienation provisions and noted that relevant case law has interpreted those provisions as preventing both voluntary and involuntary transfers of vested benefits. Because ERISA prohibits a debtor's creditors from reaching his vested pension benefits, the court in *Moore* held that ERISA constitutes "applicable nonbankruptcy law" with enforceable transfer restrictions. Accordingly, the debtors' pension benefits were excluded from their

151. *Moore*, 907 F.2d at 1478.

152. *Id.*

153. *Id.* (quoting Davis v. Michigan Dept. of Treasury, 109 S. Ct. 1500, 1504 n.3 (1989) ("Legislative history is irrelevant to the interpretation of an unambiguous statute"); Burlington Northern R.R. v. Oklahoma Tax Comm'n, 481 U.S. 454, 461 (1987) (quoting Rubin v. United States, 449 U.S. 424, 430 (1981) ("unless exceptional circumstances dictate otherwise, '[w]hen we find the terms of a statute unambiguous, judicial inquiry is complete'"))).

154. *Moore*, 907 F.2d at 1479.

155. *Id.*

156. *Id.* (quoting Nachman Corp. v. Pension Benefit Guar. Corp., 446 U.S. 359, 375 (1980)).

bankruptcy estates.[157] In its discussion, the court noted that the beneficiaries of the retirement plans had no control over plan assets and could not borrow against the plans. It is unclear whether these factors affected the outcome of the decision.

The Fourth Circuit further justified its decision on two policy grounds. First, the court's holding ensured "that the security of employee retirement benefits will not depend on the particularities of state spendthrift trust law."[158] A contrary holding, the court reasoned, would elevate state law above ERISA's anti-alienation provisions, in direct contradiction to ERISA's preemption of state law.[159] Second, the court emphasized that its holding would prevent ERISA-qualified pension plans from risking the loss of their tax-exempt status when plan benefits were included in the debtor's bankruptcy estate in violation of the plan's anti-alienation provisions.[160] The *Moore* decision did not address the exemption issue raised in *Graham*.

The Sixth Circuit agreed with the Fourth Circuit's holding in *Moore* in *Forbes v. Lucas (In re Lucas)*.[161] *Lucas* involved a debtor's interest in an employee benefit plan which allegedly met the requirements of both ERISA and the Internal Revenue Code. The bankruptcy court held that the plan was not excluded from the debtor's bankruptcy estate and found that the trustee could recover the pension assets for the benefit of the estate.[162] The district court affirmed.[163]

The Sixth Circuit examined the circuit court decisions reaching differing conclusions as to whether pension plan assets should be included in a bankruptcy estate. While acknowledging that the majority of circuits had included such assets in the estate, the court found the minority view followed by the Fourth Circuit in *Moore* to be the better reasoned analysis. In reaching its decision, the court relied on the axiom of statutory construction that it is improper to resort to legislative history when a statute is unambiguous.[164] The court found the language of section 541(c)(2) to be clear and unambiguous and, therefore, any analysis of the provision's legislative history was

157. *Moore*, 907 F.2d at 1480.

158. *Id.*

159. *Id. See* 29 U.S.C. § 1144(a) (1988 & Supp. I 1989). *See also infra* notes 258-93 and accompanying text.

160. *Moore*, 907 F.2d at 1480-81.

161. 924 F.2d 597 (6th Cir.), *cert. denied,* 111 S. Ct. 2275 (1991).

162. Forbes v. Lucas (*In re* Lucas), 100 Bankr. 969 (Bankr. M.D. Tenn. 1989).

163. Forbes v. Lucas (*In re* Lucas), 110 Bankr. 335 (M.D. Tenn. 1989).

164. Forbes v. Lucas (*In re* Lucas), 924 F.2d 597, 600 (6th Cir.), *cert. denied,* 111 S.Ct. 2275 (1991).

improper. The Sixth Circuit, like the Fourth Circuit before it, found that the legislative history was inconclusive, even if it were deemed relevant.[165]

The court in *Lucas* examined the language in ERISA and the Bankruptcy Code in order to give full effect to both federal statutes.[166] It found that the purpose behind ERISA was to insure that "employees and their beneficiaries would not be deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds have been accumulated in the plans."[167] One of ERISA's methods of protecting an employee's retirement benefits was to prohibit assignment of those benefits through its anti-alienation provisions.[168] The court in *Lucas* reasoned that, once a plan complied with ERISA, both voluntary and involuntary encroachments on the employee's benefits were forbidden. Accordingly, the debtor's interest in his pension plan was found to be outside the reach of both general creditors and the bankruptcy trustee.[169]

The Sixth Circuit cited several advantages to a rule of law finding pensions qualifying under ERISA to be outside the bankruptcy estate. First, such a result harmonized the Bankruptcy Code with ERISA and the Internal Revenue Code. Second, it prevented a plan from losing its qualified tax-exempt status when a single debtor's interest in an ERISA plan was turned over to the bankruptcy trustee. Finally, the result guaranteed uniform treatment of pension benefits. The Sixth Circuit reversed and remanded the case to determine if the plan in dispute constituted a pension plan under ERISA.[170]

The concurring opinion by Judge Fletcher of the Ninth Circuit in *John Hancock Mutual Life Insurance Co. v. Watson (In re Kincaid)*[171] also supports the holdings of the Fourth and Sixth Circuits. Judge Fletcher disagreed with the analysis of the majority, which found that a retirement plan qualified under ERISA was included in the bankruptcy estate unless it also qualified as a state spendthrift trust. Judge Fletcher argued that ERISA itself

165. *Id.* at 602.

166. *Id.* (citing *Moore*, 907 F.2d at 1479 (citing Morton v. Mancari, 417 U.S. 535, 551 (1974))).

167. *Lucas*, 924 F.2d at 602 (quoting Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 214 (1984)).

168. *Lucas*, 924 F.2d at 602. *See also* 29 U.S.C. § 1056(d)(1) (1988 & Supp. I 1989).

169. *Lucas*, 924 F.2d at 603.

170. *Id.*

171. 917 F.2d 1162 (9th Cir. 1990). The opinion of the majority held that while pensions that qualify under ERISA are not automatically excluded from the bankruptcy estate, the particular plan at issue in *Kincaid* was excluded from the debtor's estate because it met the definition of a spendthrift trust under state law. *Id.* at 1186.

should protect a pension plan from inclusion in the bankruptcy estate. He, too, raised the concern that, by failing to exclude ERISA-qualified plans from a debtor's bankruptcy estate, the plans could be disqualified under ERISA and lose their tax-exempt status.[172] Judge Fletcher concluded that it was "unthinkable that Congress intended to eviscerate in this manner so much of the protection granted benefit plans under ERISA."[173]

### D. *Issues Left Unanswered by Moore and Lucas*

While no other courts of appeals have yet adopted the reasoning in *Moore* and *Lucas*, a number of bankruptcy courts and at least one district court have reached decisions consistent with these holdings.[174] In one such case, *In re Wyles*,[175] a bankruptcy court in the Fourth Circuit responded to an issue left unanswered in the *Moore* decision.

#### 1. *In re Wyles*: Application of *Moore* to a Self-Settled Trust

*Wyles* involved a doctor who formed a corporation that adopted ERISA-qualified pension plans. Wyles alone controlled the corporation and acted as trustee of the plans. He borrowed money from one of the plans on at least

---

172. *Id.* at 1169-70.

173. *Id.* at 1170.

174. *See In re* Carver, No. 91-3041-CV-S-4 (W.D. Mo. June 26, 1991) (WESTLAW, Allfeds database) (debtors' interests in defined contribution plans were excluded from their bankruptcy estates based upon the Supreme Court's holding in Guidry v. Sheet Metal Workers Nat'l Pension Fund, 110 S. Ct. 680 (1990)); *In re* Suarez, 127 Bankr. 73 (Bankr. S.D. Fla. 1991) (debtor's IRA's and Keogh plans were excluded from the bankruptcy estate because ERISA constituted "applicable nonbankruptcy law"); *In re* Wyles, 123 Bankr. 733 (Bankr. E.D. Va. 1991) (self-settled trust was excepted from bankruptcy estate; debtor was enjoined from receiving a distribution from pension plan until age 59 1/2); *In re* Idalski, 123 Bankr. 222 (Bankr. E.D. Mich. 1991) (benefits payable from an ERISA-qualified plan were excluded from the debtor's estate under § 541(c)(2)); *In re* Leamon, 121 Bankr. 974 (Bankr. E.D. Tenn. 1990) (phrase "applicable nonbankruptcy law" is broad enough to include Internal Revenue Code's anti-alienation provisions; *In re* Ridenour, 45 Bankr. 72 (Bankr. E.D. Tenn. 1984) is overruled); *In re* Cheaver, 121 Bankr. 665 (Bankr. D.D.C. 1990) (debtor's interest in ERISA-qualified retirement plan was excluded from debtor's estate under § 541(c)(2) of the Bankruptcy Code; the fact that the debtor could reach plan benefits by terminating her employment was deemed irrelevant); *In re* Majul, 119 Bankr. 118 (Bankr. W.D. Tex. 1990) (pension benefits were excluded from the debtors' bankruptcy estates under the reasoning in *Moore*; result prevents plans from losing their tax-exempt status).

175. 123 Bankr. 733 (Bankr. E.D. Va. 1991).

one occasion and amended the plans several times. At the time that Wyles and his wife filed a joint Chapter 7 bankruptcy petition, Wyles was the beneficiary of approximately 72% of the plans' assets.[176]

The *Wyles* case presented the issue of whether a self-settled trust[177] was controlled by the rationale of the *Moore* decision. Because the court in *Moore* noted that the beneficiaries did not have any control over plan assets and had no power to borrow against the assets of or to amend the plans, it appears that these factors may have been significant in the court disposing of the case in the manner in which it did. Thus, the *Wyles* court suggested that the Fourth Circuit may have reached a different conclusion in *Moore* had a self-settled trust been present instead.[178]

The court in *Wyles* concluded that the debtor's pension benefits should not be included in his bankruptcy estate despite the fact that the debtor controlled the ERISA plans at issue and could access the funds in the plans at any time. The court provided three separate justifications for its decision. First, although Wyles had a large degree of control over plan assets, the court found no showing that Wyles established or maintained the plans in an effort to defraud his creditors. Rather, the plans were merely vehicles to provide retirement benefits to Wyles and his employees.[179] Moreover, a holding that closely-held corporations cannot effectively place retirement assets beyond the reach of creditors in bankruptcy would have a significant adverse impact on such corporations. Not only would myriad plans be cancelled, but creditors would use the procedure of involuntary bankruptcy in order to reach the pension benefits of owners of closely-held corporations as well as professional corporations.[180] Finally, many plans could face the loss of their tax-exempt status. According to the court, all of these consequences run contrary to the policy goals articulated in *Moore* of "insuring uniformity of law, not allowing pension assets to be reached through an involuntary proceeding, and not allowing an entire plan to be disqualified through the attachment of the interest of a single beneficiary."[181]

---

176. *Id.* at 734.

177. Although the trust and plans involved in *Wyles* were not technically in the nature of a self-settled trust, *see supra* note 73, cases that have involved similar trusts, in which the settlor of the trust was a corporation whose sole shareholder and the person who controlled the corporation was also the beneficiary of the trust, have consistently held that such trusts should be treated as self-settled trusts. *See, e.g., In re* O'Brien, 94 Bankr. 583, 587 (W.D. Mo. 1988); *In re* Ott, 69 Bankr. 1, 2 (D. Or. 1986).

178. *Wyles,* 123 Bankr. at 735.

179. *Id.*

180. *Id.* at 736.

181. *Id.* at 735-36.

The court in *Wyles* handled the issue of the debtor's ability to reach plan assets after bankruptcy in a most creative manner. It enjoined the trustee of the plans from making any distributions to the debtor or his assignees without prior court approval until the debtor reached age fifty-nine and one-half. Moreover, the court enjoined the corporation's directors from amending the plans without court approval. Finally, it provided that if any violation of these injunctions occurred, the bankruptcy case would be reopened and the debtor's pension assets would be made available for distribution to his creditors.[182] Although the *Wyles* court's holding would guard against a debtor's misuse of plan assets, it would also place a significant administrative burden on bankruptcy judges, who would be forced to retain jurisdiction over all bankruptcy proceedings involving self-settled retirement plans.

### 2. The Conflict Between Section 541(c)(2) and the Exemption Provisions

One troubling issue raised by the Eighth Circuit in *Graham* was why Congress would provide for the exemption of pension benefits from the bankruptcy estate if they were already excluded from the estate under section 541(c)(2) of the Bankruptcy Code.[183] Neither *Moore* nor *Lucas* addressed this issue. In *In re Majul,*[184] however, a Texas bankruptcy court recently concluded that two debtors' interests in ERISA-qualified pension and profit-sharing plans were excluded from the debtors' bankruptcy estates under the reasoning in *Moore*. The court squarely confronted the exclusion/exemption issue raised by other courts. *Majul* rejected the other courts' contention that there was an inconsistency between excluding certain pension benefits from the bankruptcy estate under section 541(c)(2) and exempting certain pension benefits out of the estate under section 522(b)(10)(E) of the Bankruptcy Code. It stated:

> Section 522(d)(10)(E) exempts the right to receive payments necessary for support from a wide range of sources, *tax-qualified or not,* including, for example, Christmas stock bonuses paid upon 25 years of service, or profit-sharing plans restricted to senior employees, or an annuity purchased to provide income to a worker disabled in an industrial accident. The Court does not consider it remarkable that Congress did not bother to further

182. *Id.* at 736. The court stated that it would rule favorably on a request to amend the plans to keep them in compliance with ERISA and the Internal Revenue Code. *Id.*

183. *See supra* notes 104-08 and accompanying text.

184. 119 Bankr. 118 (Bankr. W.D. Tex. 1990).

> complicate an already complex code by taking pains to insure that there was no overlap between Section 522(d)(10)(E) and Section 541(c)(2).[185]

The bankruptcy court in *Majul* concluded that any possible overlap in the exemption and exclusion provisions of the Bankruptcy Code should not be construed as evidence of any Congressional intent that retirement benefits should be included in a debtor's bankruptcy estate.[186]

## IV. EXEMPTING RETIREMENT PLAN ASSETS OUT OF THE BANKRUPTCY ESTATE: THE BANKRUPTCY CODE'S DUAL EXEMPTION SCHEME AND ERISA'S PREEMPTION OF STATE LAW

As illustrated in the discussion above, there are two ways in which a debtor can retain her vested pension benefits in bankruptcy. The first way is to *exclude* them from the bankruptcy estate. Under the majority view, this is generally accomplished by demonstrating that the ERISA plan constitutes a spendthrift trust under applicable state law. Under the minority view, the debtor must prove only that the plan contains enforceable restrictions on transfer or alienation, even if it does not rise to the level of a spendthrift trust. If the debtor is successful under either view, then she is entitled to retain all of her pension benefits, and they are placed beyond the reach of creditors in bankruptcy.

If a debtor cannot succeed in excluding retirement benefits from her bankruptcy estate, a second way in which she can attempt to retain at least a portion of the benefits is to *exempt* them out of the estate.[187] When it enacted the Bankruptcy Code, Congress departed significantly from the old Bankruptcy Act by providing a debtor a choice between two exemption schemes: the exemption system established by the debtor's state of residence or the federal exemption scheme.[188]

---

185. *Id.* at 123 (quoting *In re* Threewitt, 24 Bankr. 927, 930 (D. Kan. 1982)).

186. *Majul,* 119 Bankr. at 123. For another bankruptcy court decision reaching a similar conclusion, *see In re* Cheaver, 121 Bankr. 665, 665-66 (Bankr. D.D.C. 1990) ("Not all ERISA-qualified plans (e.g., a church plan) need include an anti-assignment clause and this destroys the trustee's argument that 11 U.S.C. § 522(d)(10)(E) evidences an intention that ERISA plan interests are always estate property unless qualifying as state law spendthrift trusts.").

187. The term "exemption" has been defined as "a right given by law to allow a debtor to retain a portion of their personal property free from seizure and sale by their creditors under judicial process." *In re* Komet, 104 Bankr. 799, 806 (Bankr. W.D. Tex. 1989) (citing Clark v. Nirenbaum, 8 F.2d 451, 452 (5th Cir. 1925), *cert. denied,* 270 U.S. 649 (1926)).

188. H.R. REP. NO. 595, 95th Cong., 2d Sess. 360, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6316. *See also* 11 U.S.C. § 522(b) (1988).

### A. The Bankruptcy Code's Dual Exemption Scheme

Although all property not specifically excluded by statute is included initially in the debtor's bankruptcy estate,[189] the debtor is afforded an opportunity to remove certain property from the estate before creditors' claims are satisfied.[190] The property that the debtor can exempt is generally that property considered necessary for the debtor's survival after bankruptcy. This "exempt" property facilitates one of the major policies of the Bankruptcy Code by providing an honest debtor a fresh start after bankruptcy.[191]

The amount and type of property that a debtor can exempt from his bankruptcy estate is determined by the exemption provisions applicable to that debtor. There are two possible exemption regimes. First, the Bankruptcy Code provides a set of federal exemption categories.[192] Alternatively, the debtor's state of residence may have established its own set of exemptions and immunities that may or may not be similar to those exemptions established under the federal scheme.[193] The Bankruptcy Code allows a debtor to

---

189. 11 U.S.C. § 541 (1988).

190. 11 U.S.C. § 522(b) (1988).

191. *See supra* notes 55-56 and accompanying text. For an outstanding discussion of the concept of the fresh start in bankruptcy, *see* Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393 (1985).

192. 11 U.S.C. § 522(d) (1988). The federal exemption scheme provides dollar limits for certain exemption categories, such as $7,500 for the debtor's homestead, $1,200 in value for one motor vehicle, $4,000 in clothing and furniture, $500 in jewelry, and $750 for tools of the debtor's trade. *Id.* Additionally, certain exemption categories contain reasonability limits, such as pension and profit-sharing plan payments, wrongful death payments, and life insurance contract payments which are reasonably necessary for the debtor's and his dependents' support, while other categories contain no dollar limits at all, such as health aids and social security, disability, and support benefits. *Id.* One exemption category, referred to as the "wildcard," allows a debtor to exempt up to $400 (plus up to $3,750 of any unused amount of the homestead exemption) in any property, including property that does not fall within any specific exemption category. *Id.*

193. In fact, one of the primary reasons Congress adopted a federal exemption scheme was because many states had not amended their exemption statutes in years, making them out of date and "unnecessarily parsimonious," *In re* Komet, 104 Bankr. 799, 812 (Bankr. W.D. Tex. 1989), thereby depriving debtors of their fresh start. The House Report to section 522 of the Bankruptcy Code states:

> [S]ome State exemption laws have not been revised in this century. Most are outmoded, designed for more rural times, and hopelessly inadequate to serve the needs of and provide a fresh start for modern urban debtors. The historical purpose of these exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will

forego the federal bankruptcy exemptions and instead choose to exempt property specified under his state's exemption scheme, together with property that is exempt under federal law other than the Bankruptcy Code's exemption provisions (often referred to as "federal nonbankruptcy exemptions").[194] The Bankruptcy Code has provided states the opportunity to "opt out" of the federal exemption scheme;[195] thus, debtors who live in states that have

---

> not be left destitute and a public charge. The purpose has not changed, but neither have the level of exemptions in many states. Thus, the purpose has largely been defeated.... [The Bankruptcy Code] adopts the position that there is a Federal interest in seeing that the debtor that goes through bankruptcy comes out with adequate possessions to begin his fresh start.

H.R. REP. NO. 595, 95th Cong, 2d Sess. 126, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6087.

194. 11 U.S.C. § 522(b)(2)(A)-(B) (1988) provides that a debtor who chooses to forego the federal exemption scheme can instead exempt:

> (2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and
>
> (B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

*Id.*

For a discussion of the types of property that would be exempt under "other" federal law, *see infra* notes 226-57 and accompanying text.

195. 11 U.S.C. § 522(b)(1) (1988). There are currently thirty-six states that have opted out of the federal exemption scheme. Those states' opt-out provisions can be found in the following statutes: ALA. CODE § 6-10-11 (Supp. 1990); ALASKA STAT. § 09.38.055 (1983); ARIZ. REV. STAT. ANN. § 33-1133(B) (1990); CAL. CIV. PROC. CODE § 703.130 (West 1987); COLO. REV. STAT. § 13-54-107 (1987); DEL. CODE ANN. tit. 10, § 4914(a) (Supp. 1990); FLA. STAT. ANN. § 222.20 (West 1989); GA. CODE ANN. § 44-13-100(b) (Michie 1990); IDAHO CODE § 11-609 (1990); ILL. ANN. STAT. ch. 110, para. 12-1201 (Smith-Hurd 1984); IND. CODE ANN. § 34-2-28-0.5 (Burns 1986); IOWA CODE ANN. § 627.10 (West Supp. 1991); KAN. STAT. ANN. § 60-2312 (Supp. 1990) (statute does, however, permit exemptions under 11 U.S.C. § 522(d)(10) in addition to the state exemptions); KY. REV. STAT. ANN. § 427.170 (Michie/Bobbs-Merrill Supp. 1990); LA. REV. STAT. ANN. § 13:3881 (West 1991); ME. REV. STAT. ANN. tit. 14, § 4426 (Supp. 1990); MD. CTS. & JUD. PROC. CODE ANN. § 11-504 (1989); MISS. CODE ANN. § 85-3-2 (1991); MO. ANN. STAT. § 513.427 (Vernon Supp. 1991); MONT. CODE ANN. § 31-2-106 (1989); NEB. REV. STAT. § 25-15,105 (1989); NEV. REV. STAT. ANN. § 21.090(3) (Michie 1987); N.H. REV. STAT. ANN. § 511:2-a (1983); N.Y. DEBT. & CRED. LAW § 282 (McKinney 1990); N.C.

opted out must use the exemption and immunity provisions established by that state, together with other federal nonbankruptcy exemption provisions. Debtors in other states can choose either the federal scheme or the state scheme, but not both.[196]

Exemption schemes vary dramatically from state to state. Not all states impose dollar limits on categories of exempt items; rather, the limitations may be based on characteristics other than monetary value. A prime example of this is the homestead. While some states provide that the debtor can retain a certain dollar amount of equity in the debtor's home,[197] other states limit the homestead not by dollar value, but instead by acreage.[198] Consequently, whether a debtor chooses the Bankruptcy Code's federal exemption scheme

---

GEN. STAT. § 1C-1601(f) (1987); N.D. CENT. CODE §28-22-17 (Supp. 1989); OHIO REV. CODE ANN. § 2329.662 (Anderson 1991); OKLA. STAT. ANN. tit. 31, § 1(B) (West 1991); OR. REV. STAT. § 23.305 (1989); S.C. CODE ANN. § 15-41-35 (Law Co-op 1991); S.D. CODIFIED LAWS ANN. § 43-31-30 (1983); TENN. CODE ANN. § 26-2-112 (1980); UTAH CODE ANN. § 78-23-15 (1987); VA. CODE ANN. § 34-3.1 (1990); W. VA. CODE § 38-10-4 (1985); WYO. STAT. § 1-20-109 (1990).

196. Section 522(b) provides that "[n]otwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) [the federal exemption scheme] or, *in the alternative*, paragraph (2) [the state exemption scheme] of this subsection." 11 U.S.C. § 522(b) (1988) (emphasis added). That section also provides that where a husband and wife file a joint bankruptcy petition under § 302 of the Bankruptcy Code or whose individual petitions are jointly administered under Rule 1015(b) of the Bankruptcy Rules, they must both elect either the federal or the state exemption scheme. In such circumstances, one spouse cannot choose the federal scheme while the other elects the state scheme. *See* 11 U.S.C. § 522(b) (1988).

197. For example, Missouri allows a debtor to exempt up to $8,000 of equity in the debtor's home, MO. REV. STAT. § 513.475 (1986), while Wisconsin is more generous, allowing a debtor to exempt up to $40,000 in equity. WIS. STAT. § 815.20 (1990).

198. Minnesota, for example, chooses to limit its homestead exemption based on acreage and allows every urban debtor the same quantity of land regardless of the quality or value of the home that is built on that acreage. Rural debtors are permitted to exempt more acreage. MINN. STAT. ANN. §§ 510.01-510.09 (West 1990). *See also In re* Haggerty, 448 N.W.2d 363 (Minn. 1989), in which the Supreme Court of Minnesota upheld the constitutionality of Minnesota's homestead exemption.

Texas has a similar scheme, limiting the homestead exemption by acreage. The Texas statute also differentiates between the urban homestead, which is limited to one acre, and the rural homestead, which is limited to 100 acres for a single debtor. TEX. PROP. CODE ANN. § 41.002 (Vernon Supp. 1991). Thus, whether a debtor in Texas owns a one bedroom shack or a Southfork-style ranch, so long as both properties meet the definition of a homestead under Texas law, both would be exempt under the same provision regardless of value.

or his state's scheme will depend primarily upon two factors: (i) whether the debtor's state of residence is an "opt-out" state, and, if not, (ii) which system allows the debtor to retain more property for his fresh start. One court summarized the choice between the federal and state exemption schemes best when it stated:

> Section 522(b) permits a bankrupt a choice between a "federal" or "state" exemption system. The debtor may elect to exempt either as the "federal" exemption the property set out in subsection (d) of Section 522 of the Code, *or* as the "state" exemptions the property specified as exempted under the law of his domicile, plus property exempted by "Federal law, other than subsection (d)." The election choice of federal versus state exemptions is the debtor's to make. The choice, obviously, will hinge upon the debtor's individual assessment of which exemption system would permit him to retain a larger share of his assets. This decision, in turn, will often depend upon the type of property held by the debtor, as state exemptions may vary in kind as well as degree from the federal bankruptcy exemptions.[199]

A debtor whose pension benefits are included in his bankruptcy estate may thus be able to exempt them out of the estate under one of three possible exemption provisions: the Bankruptcy Code's federal exemption scheme; a federal nonbankruptcy exemption; or the domiciliary state's exemption provisions. The discussion which follows will examine the substantial body of case law that has developed under each of these options.

### *B. Exempting Retirement Benefits Under the Bankruptcy Code's Federal Exemption Scheme*

A debtor in bankruptcy who chooses the Bankruptcy Code's federal exemption scheme rather than the exemption scheme established in the debtor's state of residence[200] can exempt retirement benefits out of the estate under section 522(d)(10)(E) of the Bankruptcy Code only to the extent that they are reasonably necessary for the support of the debtor and any of the debtor's dependents.[201] There is not a significant body of case law analyz-

---

199. Goff v. Taylor (*In re* Goff), 706 F.2d 574, 579 (5th Cir. 1983) (footnotes omitted).

200. Of course, this option is only available if the state has not opted out of the federal exemption scheme. *See supra* notes 194-96 and accompanying text.

201. 11 U.S.C. § 522(d)(10)(E) (1988). For the exact language of this section, *see supra* text accompanying note 106.

A debtor cannot exempt any retirement benefits out of his bankruptcy estate, however, if all three of the following conditions are met: (1) the plan was established ing the "reasonably necessary for support" standard under section 522(d)(10)(E), presumably because the vast majority of states have opted out of the federal scheme.[202] Moreover, the Bankruptcy Code does not define what is reasonably necessary for the support of the debtor and his dependents;[203] the legislative history of section 522(d)(10)(E), however, states that the provision was added to exempt out of the estate "certain benefits that are akin to future earnings of the debtor."[204] The legislative history also states that the federal exemption scheme was derived in part from the Uniform Exemptions Act, which was promulgated in 1976.[205] The Uniform Exemptions Act provides some insight into the "reasonably necessary for support" standard. It states:

> [t]he phrase "property to the extent reasonably necessary for the support of him and his dependents" means property required to meet the present and anticipated needs of the individual and his dependents, as determined by the

---

by an *insider* who employed the debtor when the debtor's rights under the plan arose; (2) payments due to the debtor under the plan are on account of age or length of service; and (3) the plan is not qualified under sections 401(a), 403(a), 403(b), 408, or 409 of the Internal Revenue Code. 11 U.S.C. § 522(d)(10)(E)(i)-(iii) (1988 & Supp. I 1989) (emphasis added). *See In re* Miller, 33 Bankr. 549, 552 (Bankr. D. Minn. 1983).

Section 101(31)(A) of the Bankruptcy Code defines an insider to include a "corporation of which the debtor is a director, officer, or person in control." Thus, an individual debtor employed by a corporation will be able to exempt any retirement benefits reasonably necessary for his support unless he is a director or officer of the corporation or is in control of the corporation and the retirement plan is not qualified under the Internal Revenue Code.

The Internal Revenue Code sections enumerated in requirement three, above, refer to the various types of qualified plans under the Code. Section 401(a) of the Code generally refers to corporate or Keogh plans. Section 403(a) is the Code section dealing with qualified annuity plans; section 403(b) governs annuities purchased by exempt organizations or public schools; section 408 covers individual retirement accounts; and section 409 governs a special form of retirement bond. *See* Seiden, *Chapter 7 Cases: Do ERISA and the Bankruptcy Code Conflict as to Whether a Debtor's Interest In or Rights Under a Qualified Plan Can Be Used to Pay Claims?* (pt. 2), 61 AM. BANKR. L.J. 301, 304 (1987).

202. *See supra* notes 194-95 and accompanying text.

203. The Bankruptcy Code does, however, define a "dependent" for purposes of § 522 to include a spouse, whether or not that spouse is actually dependent upon the debtor for support. 11 U.S.C. § 522(a)(1) (1988).

204. H.R. REP. NO. 595, 95th Cong., 2d Sess. 362, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS. 5963, 6318.

205. H.R. REP. NO. 595, 95th Cong., 2d Sess. 361, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS. 5963, 6317.

court after consideration of the individual's responsibilities and all the present and anticipated property and income of the individual, including that which is exempt.[206]

Because the Bankruptcy Code and its legislative history offer little assistance in defining the "reasonably necessary for support" standard, courts have been forced to interpret the standard on a case-by-case basis. Courts have enumerated eleven factors to be considered in determining whether a debtor's interest in a retirement plan is reasonably necessary for his or his dependents' support:

(1) Debtor's present and anticipated living expenses;
(2) Debtor's present and anticipated income from all sources;
(3) Age of debtor and dependents;
(4) Health of the debtor and dependents;
(5) Debtor's ability to work and earn a living;
(6) Debtor's job skills, training and education;
(7) Debtor's other assets, including exempt assets;
(8) Liquidity of other assets;
(9) Debtor's ability to save for retirement;
(10) Special needs of the debtor and dependents;
(11) Debtor's financial obligations, e.g. alimony or support payments.[207]

The factors enumerated above are not exhaustive, and, according to the bankruptcy courts, no one factor is determinative.

In an Iowa case, a debtor attempted to exempt his retirement rights under a Keogh plan, valued at $36,000, out of his bankruptcy estate. He claimed that they were reasonably necessary for the support of his family, under an Iowa exemption statute substantially similar to section 522(d)(10)(E).[208] The debtor was fifty-eight, had three children, one who was a senior in high school, and had a forty-eight-year-old wife who was partially disabled from an automobile accident. The combined income of the family was approximately $10,000, and the debtor's wife required specialist care for a heart condition at a cost of approximately $1,200 per year. The court found the debtor's entire interest in his Keogh plan to be reasonably necessary for his support and the support of his family. This finding was based upon his income, the lack of prospects for substantial future earnings, and the fact that

206. UNIF. EXEMPTIONS ACT § 6(b), 13 U.L.A. 207, 224-25 (1986). *See also* Seiden, *supra* note 201, at 305.

207. *In re* Hentzen, 126 Bankr. 600, 602 (Bankr. D. Kan. 1991) (quoting *In re* Flygstad, 56 Bankr. 884, 889-90 (Bankr. N.D. Iowa 1986)). *See also In re* Davis, 125 Bankr. 242, 246-47 (Bankr. W.D. Mo. 1991).

208. *In re* Lawrence, 57 Bankr. 727 (Bankr. N.D. Iowa 1986).

the debtor did not contribute any assets to the plan just prior to bankruptcy in an effort to conceal assets from his creditors. In reaching its decision, the court stated that "[i]f this bankruptcy proceeding involved a relatively young professional, the withholding of sizable funds from creditors on mere speculation as to financial needs at a distant retirement age would raise a natural disinclination to view the exemption favorably."[209]

A Wisconsin bankruptcy court recently found a debtor's Individual Retirement Account ("IRA"), which was valued at approximately $17,000, reasonably necessary for his support, based on several factors.[210] First, at the time of the exemption trial, the debtor was fifty-four years old; thus, his ability to build a new pension prior to retirement was severely limited by his age. Moreover, after trial the debtor died, leaving his wife little ability to save for her retirement. Finally, the court noted that the party objecting to a claimed exemption bears the burden of proving the exemption to be improper, a burden which the objecting creditor did not meet.[211] In reaching its determination, the bankruptcy court found irrelevant the fact that the debtor exercised control over the funds in his IRA. According to the court, control was only relevant in determining whether the IRA was included as property of the bankruptcy estate, not whether the debtor had a right to exempt the IRA to the extent reasonably necessary for his support. The court held that "just as a claimed exemption for a homestead or a motor vehicle shall not be denied because the debtor controls his house or his car, a claimed exemption for an IRA shall not be denied because the debtor controls his IRA."[212]

Although most cases, like those discussed above, appear to turn on the debtor's age, some courts have recently begun to focus primarily on the debtor's ability to rebuild a pension before retirement. For example, a Kansas bankruptcy court recently allowed husband and wife debtors to exempt the wife's entire interest in her pension plan, which was valued at approximately $14,000, finding that the plan assets were reasonably necessary for their support.[213] Even though the debtor was only thirty-eight years old and his wife was only forty at the time the bankruptcy petition was filed, the court nevertheless determined that the pension assets were reasonably necessary for their support because their combined monthly income was not enough to meet their actual monthly expenses; thus, they had little ability to rebuild their pension in the future.[214] The court also took into consideration the fact that

209. *Id.* at 730.

210. Cilek v. Cilek (*In re* Cilek), 115 Bankr. 974, 990 (Bankr. W.D. Wis. 1990).

211. *Id.* at 989 (citing Bankruptcy Rule 4003(c)).

212. *Cilek*, 115 Bankr. at 987. *Contra In re* Flygstad, 56 Bankr. 884, 890-91 (Bankr. N.D. Iowa 1986).

213. *In re* Hentzen, 126 Bankr. 600, 603 (Bankr. D. Kan. 1991).

214. *Id.* at 603. *Accord In re* Smith, 124 Bankr. 787, 791 (Bankr. W.D. Mo.

the husband had carpal tunnel syndrome and needed surgery but could not afford it, as well as the fact that their fourteen-year-old daughter had significant orthodontic bills.[215]

Similarly, a Missouri bankruptcy court found a debtor's $43,000 interest in his employer's profit-sharing plan exempt from the reach of creditors.[216] In that case, the debtor was a forty-seven-year-old warehouse material handler with a congenital blood disease for which there was no known cure. He was married; his wife was unemployed, and the couple raised the wife's two minor children from a prior marriage. The debtor had minimal assets, including a pick-up truck and some household furnishings and clothing. He also had no substantial prospects for additional income in the future. Based on these facts, the court held that the debtor's entire interest in his retirement plan was reasonably necessary for his support and the support of his family. According to the court, taking away the debtor's retirement assets would "deny him the 'fresh start' envisioned by Congress."[217]

---

1991) (debtors were found to have little monthly income with which to rebuild a pension, based on their fixed expenses and the debtor's inability to earn excess income in the future).

215. *Hentzen*, 126 Bankr. at 603.

216. *In re* Thompson, 103 Bankr. 205, 206-07 (Bankr. W.D. Mo. 1989).

217. *Id.* at 206. In reaching its decision, the court stated:

> Were debtor to have other assets, or longer to amass same, or have substantial future income potential, or better health, or some other factor not present, such factors might well dictate a different finding and conclusion; it is for this reason that the Court has been careful to point out that such cases are factually driven.

*Id.* at 206-07.

Injecting a bit of humor into its decision, the court hastened to point out that such a case-by-case analysis "does create steady employment for lawyers and judges who might otherwise find their services superfluous." *Id.* at 206.

For other cases holding that a debtor's retirement assets were reasonably necessary for support, *see In re* Flygstad, 56 Bankr. 884, 891 (Bankr. N.D. Iowa 1986) (court determined that debtor's pension assets were reasonably necessary for support; however, the record was insufficient to prove that assets in profit-sharing plan, valued at $40,000, were necessary for support); *In re* Johnson, 36 Bankr. 54, 56 (Bankr. D.N.M. 1984) (47-year-old unemployed debtor with alimony expenses of $250 per month was allowed to exempt retirement assets of $12,278 as reasonably necessary to meet his basic needs); *In re* Miller, 33 Bankr. 549, 553 (Bankr. D. Minn. 1983) (decision was same as *Flygstad*); *In re* Donaghy, 11 Bankr. 677, 680 (Bankr. S.D.N.Y. 1981) (62-year-old debtor with emphysema, caring for a spouse with cancer, was permitted to exempt $22,000 in pension assets as reasonably necessary for the couple's support).

Of course, a number of cases have found a debtor's interest in his retirement plan not to be reasonably necessary for his support. In *In re Kochell*,[218] the debtor was a forty-four-year-old medical doctor who worked at a women's clinic in Wisconsin. He had amassed approximately $127,000 in retirement benefits prior to filing for bankruptcy. Additionally, Dr. Kochell had $850,000 in life insurance coverage, which would also pay benefits upon his total disability. His average monthly income was $36,000 and his average monthly expenses were $34,000. The debtor attempted to claim that his pension benefits were exempt under section 522(d)(10)(E) of the Bankruptcy Code as reasonably necessary for his support. The Seventh Circuit denied the debtor's claimed exemption. The denial was based upon the debtor's age as well as his future earning capacity and ability to reestablish a retirement fund. In attempting to define the reasonably necessary standard, the court stated that "the appropriate amount to be set aside for the debtor ought to be sufficient to sustain basic needs, not related to his former status in society or the lifestyle to which he is accustomed."[219]

In a Missouri case with facts less egregious than those in *Kochell*, the debtor had interests in three retirement plans maintained by her employer.[220] The first plan, a pension plan, would pay the debtor approximately $587 per month upon retirement. The trustee apparently conceded that creditors could not reach the debtor's interest in this pension plan. The second plan was an employee stock ownership plan ("ESOP"), in which the debtor's vested interest was approximately $40,000. Finally, the debtor's interest in her profit-sharing plan was approximately $25,000 at the time the bankruptcy petition was filed.[221] The court held that the debtor's interests in the profit-sharing and ESOP plans were not reasonably necessary for her support for several reasons. First, the debtor would be able to save for her retirement in the future. She had disposable income of $791 per month, was fifty-three years old, in good health, and had a steady job. Thus, the court concluded that she could apply a portion of her disposable income to saving for retirement for approximately twelve years. Second, because the trustee conceded that the debtor's pension plan assets were beyond the reach of her creditors, she was assured of $587 per month upon retirement. Additionally, the debtor's husband had a retirement plan, which could also be used for her support upon retirement.[222]

The Third Circuit has adopted a unique interpretation of section 522(d)(10)(E) of the Bankruptcy Code. Contrary to the decisions discussed

---

218. 732 F.2d 564 (7th Cir. 1984).
219. *Id.* at 566 (quoting *In re* Taff, 10 Bankr. 101, 107 (Bankr. D. Conn. 1981)).
220. *In re* Davis, 125 Bankr. 242 (Bankr. W.D. Mo. 1991).
221. *Id.* at 243-44.
222. *Id.* at 247.

above, the Third Circuit has consistently held that section 522(d)(10)(E) applies only in situations in which the debtor is currently receiving payments from the pension or profit-sharing plan at issue.[223] In the leading case espousing this view, *In re Clark*, the Third Circuit noted that the purpose behind the Bankruptcy Code's exemption provisions was to provide honest debtors with a fresh start after bankruptcy. The court reasoned that "[t]he exemption of present Keogh payments, to the extent they are necessary for the support of the debtor, is consistent with this goal. The exemption of *future* payments, however, demonstrates a concern for the debtor's long-term security which is absent from the statute."[224] Moreover, even in those cases in which a debtor's benefits are currently in pay status, courts in the Third Circuit still must determine whether those benefits are reasonably necessary for the support of the debtor and his dependents.[225]

The foregoing cases illustrate that deciding whether retirement benefits are reasonably necessary for support is an inherently factual determination. Because no formal guidelines have been established for analyzing this issue, debtors who reside in states that have not opted out of the federal exemption system must make a difficult decision: should they elect the federal scheme and gamble on whether their retirement benefits are reasonably necessary for support, or should they elect the exemptions available under their state exemption scheme as well as any other federal nonbankruptcy exemptions available to them? As illustrated below, case law in this area makes a debtor's decision particularly difficult.

### *C. Exempting Retirement Benefits Using the Federal Nonbankruptcy Exemptions*

If a debtor in bankruptcy elects his state's exemption scheme rather than the federal exemption scheme,[226] the debtor can exempt assets out of his bankruptcy estate using both the exemptions provided by his state as well as

223. Clark v. O'Neil (*In re* Clark), 711 F.2d 21, 23 (3d Cir. 1983). *See also In re* Tisdale, 112 Bankr. 61, 66 (Bankr. D. Conn. 1990); *In re* Velis, 109 Bankr. 64, 71 (Bankr. D.N.J. 1989) *aff'd,* 123 Bankr. 497 (D.N.J. 1991); *In re* Heisey, 88 Bankr. 47, 51 (Bankr. D.N.J. 1988).

224. *Clark*, 711 F.2d at 23.

225. *Tisdale*, 112 Bankr. at 66.

226. The debtor would elect the state's scheme if either (i) the exemptions provided in his state of residence are more generous than the federal exemptions, or (ii) his state has elected out of the federal exemption scheme, and, therefore, he is only entitled to use the state exemptions. For a list of the states that have opted out of the federal exemption scheme, *see supra* note 195 and accompanying text.

federal nonbankruptcy exemptions.[227] One issue with which courts have grappled in the pension area is whether ERISA's anti-alienation provisions constitute a federal nonbankruptcy exemption available to debtors in bankruptcy. If they do, then the debtor who elects his state's exemption scheme can exempt his retirement benefits in full under ERISA, without having to resort to the state's exemption provision governing retirement benefits.

A majority of courts addressing this issue have held that ERISA does not create a federal nonbankruptcy exemption under section 522(b)(2)(A) of the Bankruptcy Code.[228] These courts have relied primarily upon the legislative history of section 522 in reaching their decisions. Both the House and Senate Reports contain a nonexclusive list of federal statutes that provide nonbankruptcy exemptions within the meaning of section 522(b)(2)(A).[229] ERISA is not contained in that list.[230] The cases espousing the majority view

227. 11 U.S.C. § 522(b)(2)(A) (1988). For the precise language of this statute, *see supra* note 194.

228. *See, e.g.*, Daniel v. Security Pacific Nat'l Bank (*In re* Daniel), 771 F.2d 1352, 1359-61 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986); *In re* Lichstrahl, 750 F.2d 1488, 1491 (11th Cir. 1985); Samore v. Graham (*In re* Graham), 726 F.2d 1268, 1274 (8th Cir. 1984); Goff v. Taylor (*In re* Goff), 706 F.2d 574, 583-86 (5th Cir. 1983); *In re* Fullmer, 127 Bankr. 55, 58 (D. Utah 1991); *In re* Gaines, 121 Bankr. 1015, 1019 (W.D. Mo. 1990). For an extensive list of decisions holding that ERISA does not create a federal nonbankruptcy exemption, *see* Koger & Goucher, *supra* note 85, at 16-17.

229. H.R. REP. NO. 595, 95th Cong. 2d Sess. 360, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6316; S. REP. NO. 989, 95th Cong., 2d Sess. 75, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5861.

230. The list includes:

Foreign Service Retirement and Disability payments, 22 U.S.C. 1104;
Social security payments, 42 U.S.C. 407;
Injury or death compensation payments from war risk hazards, 42 U.S.C. 1717;
Wages of fishermen, seamen and apprentices, 46 U.S.C. 601;
Civil service retirement benefits, 5 U.S.C. 729, 2265;
Longshoremen's and Harbor Workers' Compensation Act death and disability benefits, 33 U.S.C. 916;
Railroad Retirement Act annuities and pensions, 45 U.S.C. 228(L);
Veterans benefits, 45 U.S.C. 352(E);
Special pensions paid to winners of the Congressional Medal of Honor, 38 U.S.C. 3101; and
Federal homestead lands on debts contracted before issuance of the patent, 43 U.S.C. 175.

H.R. REP. NO. 595, 95th Cong. 2d Sess. 360, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6316; S. REP. NO. 989, 95th Cong., 2d Sess. 75, *reprinted in* acknowledge that the statutes enumerated in the legislative history are not intended to be exhaustive. They reason, however, that because ERISA, a significant piece of legislation enacted just four years earlier, was in existence at the time of the Bankruptcy Code's enactment, coupled with the fact that ERISA is referenced elsewhere in the Bankruptcy Code,[231] the exclusion of ERISA from the list of statutes constituting federal nonbankruptcy law was intentional.[232] Additionally, those courts holding that ERISA does not constitute federal nonbankruptcy law have pointed to an important distinction between those statutes listed in the legislative history of section 522 and ERISA: ERISA governs private pension plans while the enumerated statutes relate to public property interests, such as civil service retirement benefits and veterans benefits.[233] Based upon this distinction, a majority of courts have concluded that it is reasonable to infer that Congress intentionally excluded ERISA from the list of federal nonbankruptcy statutes. Therefore, the majority view holds that ERISA-qualified retirement plans cannot be exempted out of a debtor's bankruptcy estate under section 522(b)(2)(A) of the Bankruptcy Code.[234]

---

1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5861.

231. Section 522(d)(10)(E)(iii) refers to I.R.C. §§ 401(a), 403(a), 403(b), 408, and 409 (1988 & Supp. I 1989), which are the provisions that generally confer tax advantages on various types of ERISA-qualified plans.

232. *Lichstrahl*, 750 F.2d at 1491 ("[t]he failure to mention ERISA in the legislative history accompanying § 522(b)(2)(A) is, therefore, both purposeful and reasoned"); *Graham*, 726 F.2d at 1274 (the Eighth Circuit found "the failure of Congress to include ERISA plan benefits probative of Congressional intent that ERISA was not a 'Federal Law' upon which a § 522(b)(2)(A) exemption could be based"); *Goff*, 706 F.2d at 585 (Congress' failure to mention ERISA when dealing with § 522(b) was intentional). *See also Daniels*, 771 F.2d at 1360-61; *Gaines*, 121 Bankr. at 1019; *In re* Gribben, 84 Bankr. 494, 497 (S.D. Ohio 1988); Hendrick, *Federal Nonbankruptcy Law Includes ERISA*, 1990 TEX. B.J. 854, 857 n.6.

233. *In re* Lichstrahl, 750 F.2d 1488, 1491 (11th Cir. 1985). The court in *Lichstrahl* stated:

> Despite the similarity between the anti-alienation provisions of ERISA and some of the listed statutes, the "pensions, wages, benefits and payments included in the . . . list are all peculiarly federal in nature, created by federal law or related to industries traditionally protected by the federal government. In sharp contrast, ERISA regulates private employer pension systems."

*Id.* (quoting *Graham*, 726 F.2d at 1274). *See also* Goff v. Taylor (*In re* Goff), 706 F.2d 574, 586 (5th Cir. 1983); *Gribben*, 84 Bankr. at 497.

234. *See supra* note 233 for a list of cases comprising the majority view. Several commentators concur in the majority view. *See, e.g.*, Sterbach, Weiss, & Salerno, *Pre-Bankruptcy Planning for Professionals and ERISA Qualified Pension Plans: Are State Created Statutory Exemptions D.O.A. in Bankruptcy Proceedings?*, 94 COM. L.J. 229,

Despite the overwhelming authority to the contrary, a small number of courts have held that ERISA's anti-alienation provisions do create a federal nonbankruptcy exemption available to debtors who elect their state's exemption scheme.[235] The most recent case to adopt this view, *In re Suarez*, rejected the majority's argument that the legislative history of section 522 of the Bankruptcy Code indicates a clear Congressional intent to exclude ERISA from the ambit of federal nonbankruptcy law.[236] The *Suarez* court, relying on the recent Supreme Court case of *United States v. Ron Pair Enterprises, Inc.*,[237] determined that there was no need to resort to section 522's legislative history because the statute itself was clear and unambiguous on its face.[238]

Similarly, in *In re Burns*,[239] an Oklahoma bankruptcy court, in a well-reasoned opinion, concluded that ERISA provided a federal nonbankruptcy exemption for qualified pension plans within the meaning of section 522(b)(2)(A) of the Bankruptcy Code.[240] The *Burns* court agreed with the debtor's assertion that the absence of ERISA from the legislative history "does not compel the conclusion that ERISA may not be includable within that provision."[241] The court offered several reasons for its conclusions. First, two of the statutes cited in the legislative history as creating federal nonbankruptcy exemptions have since been repealed.[242] Two other statutes listed in

---

242 (1989).

235. *In re* Suarez, 127 Bankr. 73, 79 (Bankr. S.D. Fla. 1991); *In re* Majul, 119 Bankr. 118, 124 (Bankr. W.D. Tex. 1990); *In re* Burns, 108 Bankr. 308, 313-15 (Bankr. W.D. Okla. 1989); *In re* Komet, 104 Bankr. 799, 805-16 (Bankr. W.D. Tex. 1989); *In re* Hinshaw, 23 Bankr. 233, 236 (Bankr. D. Kan. 1982).

236. *Suarez*, 127 Bankr. at 79.

237. 489 U.S. 235 (1989).

238. *Suarez*, 127 Bankr. at 79. The court stated:

> The task of resolving the dispute . . . begins where all such inquiries must begin: with the language of the statute itself. In this case it is also where the inquiry should end, for where, as here, the statute's language is plain, "the sole function of the courts is to enforce it according to its terms." The language before us expresses Congress' intent . . . with sufficient precision so that reference to legislative history and to pre-Code practice is hardly necessary.

*Id.* (quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1988)) (citations omitted).

239. 108 Bankr. 308 (Bankr. W.D. Okla. 1989).

240. *Id.* at 314-15.

241. *Id.*

242. The two statutes that were repealed were the civil service retirement benefit statute, which was repealed in 1966, and the foreign service retirement and disability statute, which was repealed in 1974. *Id.* at 315 n.7.

the legislative history contained citations that were improper.[243] Moreover, the *Burns* court pointed out that the legislative history was not intended to provide an all-inclusive list of statutes containing federal nonbankruptcy exemptions. Both the House and Senate Reports state that "*some* of the items that may be exempted . . . *include* . . .,"[244] clearly indicating that the statutory list in the legislative history was not exhaustive. Finally, the court in *Burns* noted that the policy behind the enactment of ERISA was to protect participants' interests in privately-funded pension plans. It stated that a holding that ERISA's protections were ineffectual "simply because the Congress failed to specify ERISA in a nonexclusive list of legislative examples in the legislative history, would fly in the face of ERISA's principal purpose."[245] Thus, the bankruptcy court in *Burns* concluded that ERISA-qualified plans could be exempted out of a debtor's bankruptcy estate under section 522(b)(2)(A) of the Bankruptcy Code as federal nonbankruptcy law.[246]

Clearly the most thorough and insightful decision espousing the minority view is *In re Komet*,[247] a case in which a Texas bankruptcy court directly challenged the Fifth Circuit's decision in *Goff v. Taylor (In re Goff)*.[248] In

243. "The citation given for '[s]pecial pensions to winners of the Congressional Medal of Honor' is to a statute dealing with veterans' benefits in general, *including* winners of the Congressional Medal of Honor. The citation given for 'veterans benefits' is to a statute dealing with railroad unemployment insurance." *Id.*

244. *Id.* at 315 (quoting H.R. REP. NO. 595, 95th Cong., 1st Sess. 360-61, *reprinted in* NORTON BANKRUPTCY LAW PRACTICE 354 (1988-89 ed.); S. REP. NO. 95-989, 95th Cong., 2nd Sess. 75-76, *reprinted in* NORTON BANKRUPTCY LAW AND PRACTICE 355 (1988-89 ed.) (emphasis added)).

245. *Burns*, 108 Bankr. at 315.

246. *Id.* The court in *Burns* hinted that Congress may want to impose a dollar limitation on the ERISA nonbankruptcy exemption. It stated:

> Section § 522(b)(2)(A) [sic] contains no monetary or other limitations. It is not for this court, by judicial fiat, to establish any such limitations, whether based upon this court's personal perception of fairness or equity or otherwise. Should the Congress determine that some limitation upon the available exemption is appropriate, or that ERISA plans should not be includable under § 522(b)(2)(A), it is within its province, not that of this or any other court, to enact appropriate legislation in furtherance of such determination.

*Id.* at 316.

247. 104 Bankr. 799 (Bankr. W.D. Tex. 1989).

248. 706 F.2d 574, 585 (5th Cir. 1983). The court in *Komet* described *Goff's* decision, which stated that ERISA's anti-alienation provisions did not create a federal nonbankruptcy exemption, as "strong dicta." *Komet*, 104 Bankr. at 805.

rejecting the contention that ERISA's anti-alienation provisions create a federal nonbankruptcy exemption, the Fifth Circuit in *Goff* stated:

> ERISA's anti-assignment and alienation provisions are different in kind from those contained in the statutes listed in the Code's legislative history . . . ERISA merely provides that as a condition of obtaining qualified status - with it attendant tax and other benefits - a pension plan must preclude alienation or assignment of its benefits. It does not prohibit pension funds from permitting alienation or assignments; rather, while it encourages and favors qualified plans, it envisions that "disqualified" plans may be formed which are still subject to ERISA's regulatory scheme but do not restrict alienation or assignment.[249]

The court in *Komet* disagreed with *Goff* in four respects. First, *Komet* asserted that ERISA's anti-alienation provisions are required to be included in any retirement plan, not just qualified plans eligible for tax-exempt status.[250] Second, contrary to the Fifth Circuit's contention in *Goff* that the legislative history of the Bankruptcy Code evidenced a Congressional policy disfavoring the retention of pension benefits, *Komet* persuasively argued that the intent of Congress in enacting the exemption statutes was to permit debtors to exempt their retirement benefits, either under the Bankruptcy Code's federal exemption scheme or, alternatively, under ERISA as a federal nonbankruptcy exemption.[251] The court reasoned that debtors who elect their state's exemption scheme should not be penalized for that election by being forced to forego the exemption of their pension benefits.[252]

---

249. *Goff*, 706 F.2d at 583, 585.

250. *Komet*, 104 Bankr. at 809 (citing 29 U.S.C. § 1056(d) (1988 & Supp. I 1989)). The *Komet* court stated:

> More is at stake than mere loss of tax benefits, for ERISA is first of all a *labor* statute which seeks to regulate nearly all private employee pension benefit plans, whether they want to be regulated or not . . . . *Goff* is incorrect, therefore, when it states that the anti-alienation language required by ERISA § 206(d)(1) serves only a tax purpose. Certainly the tax provisions are the "carrot" which induces voluntary compliance with ERISA's labor regulations. The threat of loss of tax benefits is an effective *means* to enforce the equitable requirements imposed by Part I of ERISA. But it is just that—the means, not the end.

*Komet*, 104 Bankr. at 809 (emphasis in original).

251. *Id.* at 812-13.

252. The *Komet* court stated:

> The overall structure of Section 522(b) manifests a congressional policy which generally *favors* debtors retaining their retirement benefits. The legislative history is effusive in according sufficient property to debtors for their fresh start, with nary a hint of an intent to penalize debtors for

Third, *Komet* rejected *Goff's* contention that the absence of ERISA from the list of federal exemption statutes in section 522's legislative history evidenced a congressional intent to exclude ERISA from federal nonbankruptcy law. The court in *Komet* stated: "*Goff* breaks a cardinal rule of statutory construction when it relies so heavily on the listing in the legislative history to support its conclusion that Congress did not intend to include ERISA plans under the 'other federal law' rubric."[253] Thus, *Komet* concluded that "[a]s *Goff's* interpretation derives from its heavy reliance on the illustrative list in the legislative history, its logic must be rejected in the face of the statute, which is clear and unambiguous on its face."[254]

Finally, *Komet* disagreed with the suggestion in *Goff* that ERISA's anti-alienation provisions were effectively overruled by the Bankruptcy Code.[255] The *Komet* court found no conflict between ERISA's anti-alienation provisions and the Bankruptcy Code.[256] Accordingly, the bankruptcy court in *Komet* permitted the debtor to exempt all of his retirement benefits using ERISA's federal nonbankruptcy exemption.[257]

While the vast majority of courts have held that ERISA's anti-alienation provisions do not create a federal nonbankruptcy exemption, it remains to be seen whether cases like *Burns* and *Komet* will have an impact on future decisions. Despite the thoughtful and persuasive analysis contained in these cases, the minority view has yet to be adopted by any court of appeals.

---

choosing one exemption scheme over the other.

*Id.* at 813.

253. *Id.* at 814.

254. *Id.*

255. The court in *Goff* held that ERISA "clearly was not intended to affect the operation of other federal law. . . . Thus, ERISA's specific provision precluding interference with the operation of federal law renders the Bankruptcy Code effective over any ERISA provisions to the contrary . . . ." *Goff*, 706 F.2d at 587, 589.

256. *Komet*, 104 Bankr. at 816.

257. *Id.* Indeed, a number of commentators have recently rejected the reasoning in *Goff* and its progeny and have concurred in the bankruptcy court's holding in *Komet*, concluding that ERISA should be included as federal nonbankruptcy law under § 522(b)(2)(A) of the Bankruptcy Code. *See, e.g.*, Hendrick, *supra* note 232, at 856 ("[t]he reasoning under *Goff* suffers from numerous weaknesses—most significantly, the *Goff* court's reliance on incredible legislative history and misconstrued congressional silence."); Note, *No More Bananas In the Oklahoma Split: Exempting ERISA-Qualified Pension Plans Under Section 522(b)(2)(A) of the Bankruptcy Code*, 25 TULSA L.J. 799, 811 (1990) ("[a]lthough the majority viewpoint is from Circuit Courts of Appeals, the reasoning used to reach the conclusion that a federal exemption does not exist in ERISA is not well-supported and should not be followed by the Tenth Circuit").

Consequently, debtors attempting to exempt their retirement benefits in opt-out states must rely primarily on their states' exemption schemes.

### *D. Exempting Retirement Benefits Under a State's Exemption Scheme: Effect of ERISA's Preemption of State Law*

A debtor who forgoes the Bankruptcy Code's federal exemption scheme is entitled to claim both (i) the federal nonbankruptcy exemptions outlined above and (ii) the exemptions provided by her state of domicile.[258] The debtor's domiciliary state is defined as "the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place."[259] Presumably this provision was incorporated into the Bankruptcy Code to prevent a debtor from changing her state of residence just before filing bankruptcy in order to take advantage of that state's more generous exemption provisions.

Just as homestead exemption provisions vary widely from state to state, the various states' exemption provisions pertaining to pension benefits similarly vary dramatically. Some states, like Texas and New York, have recently adopted legislation which allows a debtor to exempt the benefits from all qualified pension and profit-sharing plans.[260] Others, like California and

---

258. If a debtor elects the state exemption scheme, she can also exempt any interest held as joint tenant or tenant by the entirety if that interest "is exempt from process under applicable nonbankruptcy law." 11 U.S.C. § 522(b)(2)(B) (1988). An entire body of law has developed to analyze this provision; however, the issue is beyond the scope of this Article. *See* Note, *"Fresh Start" or "Head Start": Missouri Courts Rethink the Role of Tenancies by the Entirety in Bankruptcy*, 56 MO. L. REV. 817 (1991) for a discussion of recent case law analyzing § 522(b)(2)(B) of the Bankruptcy Code.

259. 11 U.S.C. § 522(b)(2)(A) (1988).

260. *See* TEX. PROP. CODE ANN. § 42.0021 (Vernon Supp. 1988); N.Y. CIV. PRAC. L. & R. LAW § 5202(c)(2) (McKinney Supp. 1991). *See also* ARK. STAT. ANN. §16-66-220 (Supp. 1989). It is interesting to note that Texas amended its exemption provisions, effective September 1, 1987, following the Fifth Circuit's decision in Goff v. Taylor, (*In re* Goff), 706 F.2d 574 (5th Cir. 1983), which had held that a debtor's pension benefits were part of the bankruptcy estate. The Texas exemption statute also encompasses governmental and church plans, which are beyond the scope of federal protection under ERISA. *See* Gote, *The Texas Exemption of Retirement Benefits: Interaction with the Bankruptcy Code and Possible Preemption by Mackey v. Lanier Collections Agency & Service,* 26 HOUS. L. REV. 497 (1989). *See also* Hall, *Retirement Benefits: Texas Property Code Amendment,* 1987 TEX. B.J. 993. Similarly, prior to 1989, New York had no provision allowing an exemption for retirement benefits. New York's current exemption provision was added in 1989.

Missouri, follow the federal exemption provision and allow a debtor to exempt only those benefits reasonably necessary for the support of the debtor and his dependents.[261] Finally, some states have adopted other novel and creative exemption provisions. Minnesota, for example, has taken a quite liberal approach, allowing a debtor to exempt all retirement benefits from qualified plans and, in addition, up to the present value of $42,000 in benefits from non-qualified plans to the extent reasonably necessary for the debtor's and her dependents' support.[262] The differences in state exemption provisions thus can be quite dramatic and can influence a number of decisions facing a bankrupt debtor.[263]

Even though some states may offer a bankrupt debtor the opportunity to exempt all, or at least a significant portion, of the debtor's retirement benefits out of his bankruptcy estate, the debtor may nevertheless be prohibited from taking advantage of such exemption provisions because of ERISA's preemption of state law. Congress enacted ERISA in an attempt to provide a uniform set of provisions regulating and protecting pension and welfare plans.[264] In

---

Illinois' exemption statute varies slightly in that it allows an exemption of retirement assets from plans "intended in good faith" to be qualified plans. ILL. ANN. STAT. ch. 110, para. 12-1006 (Smith-Hurd Supp. 1991). Like many other states, Illinois amended its exemption provision to provide for a more liberal exemption of retirement benefits in 1989, effective for all proceedings filed after August 30, 1989, presumably in response to the massive amount of litigation over the issue. *See* P.A. 86-1329 § 1 (1989).

261. CAL. CIV. PROC. CODE § 703.140 (West 1987); MO. REV. STAT. § 513.430(10)(e) (1986).

262. MINN. STAT. ANN. § 550.37, Subdiv. 24 (West 1988 & Supp. 1991). When this provision was originally added to the Minnesota exemption statute, the cap on amounts from non-qualified plans was $30,000; however, that amount was increased for inflation in 1990.

263. For example, a debtor who cannot protect her home from the reach of creditors because a state's homestead exemption is quite limited may chose not to file for bankruptcy relief at all, or may choose to file under Chapter 13 of the Code rather than Chapter 7. Moreover, it is not unheard of for debtors to change their state of residence prior to filing a bankruptcy petition in order to take advantage of more generous exemption provisions in another state. In a tongue-in-cheek introduction to his article, for example, one commentator recently suggested that in order to protect ERISA plan benefits from the reach of creditors in bankruptcy, an Arkansas debtor should move to Kansas before filing bankruptcy. *See* Westbrook, *Retirement Plan Assets in an Arkansas Bankruptcy*, 43 ARK. L. REV. 253, 253 (1990). *See also* Jackson, *supra* note 191, at 1437 n.141. Of course, as discussed above, the debtor must reside in the new state long enough so that it qualifies as his state of domicile for bankruptcy purposes. *See supra* note 259 and accompanying text.

264. 29 U.S.C. § 1001(a) (1988 & Supp. I 1989). *See also supra* notes 1-4 and accompanying text.

order to accomplish this objective, ERISA contains a provision which preempts state and local laws, thereby preventing them from infringing upon ERISA's protections.[265] ERISA preempts "any and all State laws insofar as they may now or hereafter *relate to* any employee benefit plan" covered by ERISA.[266] According to the Supreme Court in *Mackey v. Lanier Collection Agency & Service, Inc.*,[267] a state law "relates to" an ERISA plan "if it has a connection with *or reference to* such a plan."[268] Following *Mackey*, bankruptcy and district courts have been divided over the issue of whether ERISA preempts states' exemption provisions dealing with retirement plans in a bankruptcy context.[269]

In *Mackey*, the Supreme Court was faced with the issue of whether a Georgia statute that prohibited the garnishment of a participant's interest in an ERISA welfare benefit plan (as opposed to a pension benefit plan) was preempted by ERISA. While ERISA requires that all pension benefit plans contain anti-alienation provisions, welfare benefit plans need not contain such provisions to be qualified under ERISA.[270] Based upon this distinction, the Georgia Supreme Court had concluded that the Georgia statute "prohibits that which the federal statute permits,"[271] and, therefore, was preempted by ERISA. The Supreme Court affirmed, stating that the Georgia law "related to" ERISA within the meaning of ERISA's preemption provision.[272] The Court found irrelevant the possibility that Georgia enacted the statute to help effectuate ERISA's underlying goals. According to the Court, ERISA's preemption provision displaces "all state laws that fall within its sphere, even

265. As Representative John H. Dent stated in the legislative history to ERISA, "the crowning achievement of [ERISA is] the reservation to Federal authority [of] the sole power to regulate the field of employee benefit plans. With the preemption of the field, we round out the protection afforded participants by eliminating the threat of conflicting and inconsistent State and local regulation." 120 CONG. REC. H29,197 (1974).

266. 29 U.S.C. § 1144(a) (1988 & Supp. I 1989) (emphasis added).

267. 486 U.S. 825 (1988).

268. *Id.* at 829 (quoting Shaw v. Delta Airlines, Inc., 463 U.S. 85, 96-97 (1983)) (emphasis in original).

269. To date, it appears that no court of appeals has addressed the preemption issue in a bankruptcy context following the Supreme Court's decision in *Mackey*. *Mackey* did not involve a bankruptcy scenario.

270. *See supra* notes 33-39 and accompanying text.

271. *Mackey*, 486 U.S. at 828 (quoting Lanier Collection Agency & Serv., Inc. v. Mackey, 256 Ga. 499, 501, 350 S.E.2d 439, 441-42 (1986)).

272. *Mackey*, 486 U.S. at 829.

including state laws that are consistent with ERISA's substantive requirements."[273]

Based upon the Supreme Court's holding in *Mackey*, a majority of courts that have addressed the issue of whether a debtor can exempt retirement benefits in bankruptcy under his domiciliary state's exemption provisions have held such provisions to be preempted by ERISA; they have thus disallowed the debtor's exemption request.[274] These courts have consistently held that even state law which is consistent with ERISA and furthers its intended purposes is preempted.[275] Under the majority view, it is irrelevant whether the state exemption statute at issue actually *refers to* ERISA; any statute that indirectly involves ERISA plans is preempted.[276] Finally, courts espousing the majority view have consistently rejected the argument that because state exemption schemes are expressly permitted in bankruptcy by virtue of Bankruptcy Code section 522(b), that such exemption schemes become the functional equivalent of federal legislation, which cannot be preempted by ERISA.[277]

---

273. *Id.* (quoting Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724, 739 (1985)).

274. *In re* Fullmer, 127 Bankr. 55, 59 (D. Utah 1991); *In re* Gaines, 121 Bankr. 1015, 1021-23 (W.D. Mo. 1990); *In re* Wimmer, 121 Bankr. 539, 543 (Bankr. C.D. Ill. 1990), *aff'd*, No. 91-1021 (C.D. Ill. July 19, 1991) (WESTLAW, FBKR-CS database); *In re* Martin, 115 Bankr. 311, 322 (Bankr. D. Utah 1990); *In re* Conroy, 110 Bankr. 492, 496 (Bankr. D. Mont. 1990); *In re* Burns, 108 Bankr. 308, 311 (Bankr. W.D. Okla. 1989); *In re* Flindall, 105 Bankr. 32, 37-38 (Bankr. D. Ariz. 1989); *In re* Komet, 104 Bankr. 799, 801-02 (Bankr. W.D. Tex. 1989); *In re* McLeod, 102 Bankr. 60, 63 (Bankr. S.D. Miss. 1989); *In re* Dyke, 99 Bankr. 343, 351-52 (Bankr. S.D. Tex. 1989). For other cases holding that state law exemption provisions are preempted by ERISA, *see* Koger & Goucher, *supra* note 85, at 17-18.

275. *See, e.g., Fullmer*, 127 Bankr. at 59, wherein the court stated that "[t]he language of § 1144(a) [ERISA's preemption provision] is broad, and does not restrict ERISA's preemptive effect to only those state laws with which it conflicts. Even state law that furthers ERISA's purposes is preempted because § 1144(a) 'displaces all state laws that fall within its sphere, even including state laws that are consistent with ERISA's substantive requirements.'" *Id.* (quoting *Mackey*, 486 U.S. at 829). *See also Komet*, 104 Bankr. at 802.

276. *See, e.g., Gaines*, 121 Bankr. at 1022-23; *Komet*, 104 Bankr. at 801 n.3. In *Gaines*, for example, the court pointed out that "even indirect state action bearing on private pensions may encroach upon the area of exclusive federal concern." *Gaines*, 121 Bankr. at 1022 (quoting Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 525 (1981)).

277. *See Gaines*, 121 Bankr. at 1023; *Martin*, 115 Bankr. at 322; *In re* Felts, 114 Bankr. 131, 133 (Bankr. W.D. Tex. 1990); *In re* Weeks, 106 Bankr. 257, 263 (Bankr. E.D. Okla. 1989). *See also In re* Siegel, 105 Bankr. 556, 561-62 (D. Ariz. 1989). This argument has often been referred to as the "federalization" of state law by courts addressing the preemption issue.

Despite the overwhelming body of authority to the contrary, a small number of courts have interpreted *Mackey* narrowly to hold that only state exemption statutes that conflict with ERISA's stated purposes are preempted by ERISA.[278] In *In re Vickers*,[279] a Missouri bankruptcy court was faced with the issue of whether the Missouri statute exempting ERISA plans to the extent reasonably necessary for support, which parallels the Bankruptcy Code's federal exemption provision, was preempted by ERISA.[280] The bankruptcy court found that the Missouri exemption provision was not preempted by ERISA because it was consistent with both ERISA and the Bankruptcy Code. The court reasoned:

> Congress specifically provided that ERISA would not be construed to conflict with any law of the United States .... ERISA reads as follows: ... "Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States ...." Thus, Congress did not intend ERISA to conflict with any other Federal law. The Bankruptcy Code is such a law .... [T]he Code would allow the debtor to exempt his pension benefits to the extent reasonably necessary for support. The Code also allows states to opt-out and create their own bankruptcy exemptions. Surely Congress did not intend to prohibit states from enacting exemption laws similar or identical to those contained in the Bankruptcy Code itself. In any event, Congress determined that the Code is paramount to ERISA. The same is true for state laws enacted pursuant to specific authority of the Bankruptcy Code .... Since the Code specifically allowed the states to create exemptions, and since ERISA does not prohibit or even speak to such exemptions, the only way to harmonize [ERISA and the Bankruptcy Code] is to allow the exemption.[281]

*Vickers* was decided before the District Court for the Western District of Missouri's decision in *In re Gaines*, which rejected the "federalization" of state exemption law argument and held that Missouri's exemption provision

278. It appears that bankruptcy courts in three jurisdictions have adopted the minority view. *See In re* Volpe, 100 Bankr. 840 (Bankr. W.D. Tex. 1989); *but see Felts*, 114 Bankr. at 13 and *Komet*, 104 Bankr. at 799; *In re* Vickers, 116 Bankr. 149 (Bankr. W.D. Mo.), *aff'd*, 126 Bankr. 348 (W.D. Mo. 1990); *but see In re* Gaines, 121 Bankr. 1015 (W.D. Mo. 1990); *In re* Suarez, 127 Bankr. 73 (Bankr. S.D. Fla. 1991); *In re* Wines, 113 Bankr. 787 (Bankr. S.D. Fla. 1990); *In re* Martinez, 107 Bankr. 378 (Bankr. S.D. Fla. 1989); *In re* Bryan, 106 Bankr. 749 (Bankr. S.D. Fla. 1989).

279. 116 Bankr. 149 (Bankr. W.D. Mo.), *aff'd*, 126 Bankr. 348 (W.D. Mo. 1990).

280. *Id.* at 150.

281. *Id.* at 154.

was preempted by ERISA.[282] The *Vickers* decision, however, was also later upheld on appeal by the Western District.[283]

The Bankruptcy Court in the Southern District of Florida recently reaffirmed the minority view in *In re Suarez*.[284] In *Suarez*, the court refused to apply the preemption doctrine because the Florida exemption statute at issue was consistent with the policies of ERISA. The court stated that "unlike the State law involved in *Mackey* which sought to impose a different result than ERISA, [the Florida exemption statute] is consistent with ERISA's purpose of protecting pension money from attachment of creditors."[285] Accordingly, the court found no need for preemption because the Florida exemption statute complemented ERISA's stated purpose, resulting in no conflict between state and federal law.

The other jurisdiction espousing the minority view is the Western District of Texas, where there is a split among the bankruptcy judges on the preemption issue.[286] The leading minority case on the preemption issue is *In re Volpe*.[287] The court in *Volpe* offered four arguments in support of its conclusion that ERISA did not preempt Texas' exemption provision governing ERISA retirement plans. First, *Volpe* contended that only state statutes that conflicted with ERISA were preempted.[288] Second, the *Volpe* court bolstered its decision by arguing that the Supreme Court in *Mackey* intended only for ERISA to preempt state laws that *have* reference to ERISA, not statutes that *make* reference to ERISA.[289] Because the Texas statute merely referred to ERISA, its connection with ERISA was too tenuous to evoke preemp-

282. *Gaines*, 121 Bankr. at 1021-23.

283. *In re* Vickers, 116 Bankr. 149 (Bankr. W.D. Mo.), *aff'd*, 126 Bankr. 348 (W.D. Mo. 1990). It will be interesting to observe the reaction of the bankruptcy court in the Western District of Missouri to the *Gaines* and *Vickers* dichotomy. Both *Vickers* and *Gaines* are currently on appeal to the Eighth Circuit. Following the Eighth Circuit's decision, there may be only two remaining jurisdictions that uphold the minority view on the preemption issue.

284. 127 Bankr. 73, 78 (Bankr. S.D. Fla. 1991).

285. *Id.*

286. *See supra* note 278. *See also* Note, *ERISA Preemption of State Exemption Laws: The Effects in Bankruptcy*, 7 BANKR. DEV. J. 615 (1990) [hereinafter Note, *ERISA Preemption*]; Gote, *supra* note 260, at 527.

287. 100 Bankr. 840 (Bankr. W.D. Tex. 1989).

288. *Id.* at 847-48. The court stated that "[n]o state law is preempted unless it conflicts with valid federal law." *Id.* The court also relied on the statement by Representative Dent in the legislative history to the Bankruptcy Code that only state statutes conflicting with ERISA were affected by its preemption provisions. *See supra* note 265 and accompanying text.

289. *Volpe*, 100 Bankr. at 848.

tion.[290] Third, *Volpe* argued that the Texas exemption statute did not relate to ERISA because it did not regulate ERISA plans or their participants.[291] Finally, *Volpe* supported its decision by holding that ERISA did not preempt the Texas statute because the statute was one of general application, which only peripherally related to ERISA.[292]

Although several bankruptcy courts have made valiant attempts to uphold their states' exemption provisions in bankruptcy, the great weight of authority has nevertheless invalidated such exemption statutes under ERISA's preemption provisions. Thus, in states that have opted out of the Bankruptcy Code's federal exemption scheme, there appears to be no protection for debtor's ERISA benefits in bankruptcy.[293]

## V. A PROPOSED SOLUTION AIMED AT HARMONIZING ERISA AND THE BANKRUPTCY CODE

It is difficult to believe that it has been thirteen years since the enactment of the Bankruptcy Code in 1978, and yet such fundamental issues as whether pension benefits are included in a debtor's bankruptcy estate still remain unanswered. The circuit courts of appeals are clearly divided on the issue, and the Supreme Court has thus far chosen not to resolve the resulting dispute. Regardless of the outcome of this issue, however, a conflict exists between ERISA and the Bankruptcy Code that must be resolved. In order to harmonize these two federal statutes, a number of difficult issues must be addressed. First, does ERISA constitute "applicable nonbankruptcy law" so that section 541(c)(2) of the Bankruptcy Code excludes a debtor's pension benefits from his bankruptcy estate? If so, is this the proper result? Does it best promote the policies of both ERISA and the Bankruptcy Code? As discussed below, a thorough analysis of the Bankruptcy Code and relevant case law leads inexorably to the conclusion that *In re Moore* and its progeny have correctly interpreted the language of section 541(c)(2) to conclude that ERISA benefits are excluded from a debtor's bankruptcy estate. Unfortunate-

---

290. Several commentators have strongly criticized *Volpe* for this distinction. *See* Sterbach, Weiss, & Salerno, *supra* note 234, at 248-49; Note, *ERISA Preemption*, *supra* note 286, at 634.

291. *Volpe*, 100 Bankr. at 854.

292. *Id.* For an excellent discussion of the *Volpe* decision, as well as the contrary authority decided by the Western District of Texas bankruptcy courts, *see* Note, *ERISA Preemption*, *supra* note 286, at 632-39.

293. *See* Dunn & Knasinski, *Bankruptcy Debtors: ERISA's Impact on Pension and Retirement Benefits*, 63 WIS. LAW. 20, 22 (1990); Checkett, *Missouri Bankruptcy Exemption of Pension Benefits*, 46 J. MO. B. 267, 269 (1990). *See also* Sterbach, Weiss, & Salerno, *supra* note 234, at 250-51.

ly, as is the case here, proper statutory construction does not always lead to equitable policy results.

### A. *In re Moore Correctly Interprets Bankruptcy Code Section 541(c)(2)*

The Fourth Circuit in *Moore* concluded that the phrase "applicable nonbankruptcy law" in section 541(c)(2) referred to both state and federal law, thus bringing ERISA within the meaning of the phrase. Consequently, *Moore's* interpretation of the Bankruptcy Code resulted in the exclusion of ERISA-qualified retirement plans from a debtor's bankruptcy estate. This minority view is better reasoned than the view espoused in *Graham* and its progeny. It is also in accordance with fundamental principles of statutory construction.

For example, as *Moore* pointed out, clearly Congress knew how to distinguish between state law, federal law, and "applicable nonbankruptcy law." The phrase "applicable nonbankruptcy law" has consistently been held to include both state and federal law.[294] The Bankruptcy Code is replete with references to each of these three terms; in fact, section 522(b) contains separate references to federal law, state law, and "applicable nonbankruptcy law."[295] As the court in *Moore* stated, it is a basic axiom of statutory

---

294. *See supra* notes 145-49 and accompanying text.

295. Section 522(b) establishes the dual federal and state exemptions schemes. It provides in pertinent part that the following property is exempt from the reach of creditors:

> (1) Property that is specified under subsection (d) of this section, unless the *State law* that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or in the alternative,
> (2)(a) any property that is exempt under *Federal law*, other than subsection (d) of this section, or *State or local law* that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and
> (b) any interest in property which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under *applicable nonbankruptcy law.*

11 U.S.C. § 522(b) (1988) (emphasis added).

There are numerous other references to "state law" in the Bankruptcy Code, including 11 U.S.C. § 109(c)(2) (1988); 11 U.S.C. § 362(b)(12) (1988); 11 U.S.C. § 903(1) (1988); Bankruptcy Rule 3001(g). Moreover, the Bankruptcy Code contains numerous references to "applicable nonbankruptcy law" as well, including: 11 U.S.C. § 101(56) (1988); 11 U.S.C. § 108(a)-(c) (1988); 11 U.S.C. § 363(f)(1) (1988); 11 U.S.C. §§ 365(c)(3), (h)(1), (n)(1)(A)-(B) (1988); 11 U.S.C. § 510(a) (1988); 11

construction that identical phrases contained in the same statute must be given the same meaning.[296] Accordingly, the reference to "applicable nonbankruptcy law" in section 541(c)(2) of the Bankruptcy Code must include both state and federal law. ERISA is such a federal law, and its anti-alienation provisions prevent creditors from reaching a debtor's qualified plan benefits. Moreover, ERISA is not a bankruptcy law. Consequently, it satisfies the literal requirements of section 541(c)(2) of the Bankruptcy Code.[297]

There are two potential problems with the Fourth Circuit's interpretation of section 541(c)(2). First, the legislative history suggests a much narrower interpretation of that section than the *Moore* court has accepted. Although legislative history can be an important tool in ascertaining congressional intent, it is well-settled that resorting to legislative history is both unnecessary and unwarranted where the language of the statute itself is clear and unambiguous on its face.[298] The only instance in which a review of legislative history is appropriate is in those "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters."[299] This is not such a case. There is nothing inherently ambiguous about the term "applicable nonbankruptcy law," especially in light of the fact that there are numerous references to the term throughout the Bankruptcy Code, and, in addition, the phrase "applicable nonbankruptcy law" is clearly distinguished from the phrase "state law" therein.

Moreover, as *Moore* suggested, even if one were to resort to legislative history, it is inconclusive at best.[300] The legislative history of section 541(c)(2) merely suggests that state spendthrift trust law was an *example* of the type of restrictions enforceable under "applicable nonbankruptcy law" that would be enforceable in bankruptcy. There is absolutely no suggestion in the legislative history that section 541(c)(2) was intended to encompass *only* state spendthrift trust law. As two commentators recently suggested, the absence

U.S.C. § 524(c) (1988); 11 U.S.C. § 927 (1988); 11 U.S.C. § 943(b)(6) (1988); 11 U.S.C. § 1123(a) (1988); 11 U.S.C. § 1125(d) (1988); 11 U.S.C. § 1126(b)(1) (1988); 11 U.S.C. § 1142(a) (1988).

296. *See supra* note 149 and accompanying text. *See also* Barnson v. United States, 816 F.2d 549, 554 (10th Cir. 1987).

297. Two commentators have recently urged the adoption of this analysis, which they refer to as the "plain meaning" approach. *See* Brankey & Darr, *supra* note 40, at 299.

298. United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242 (1989); Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982); Caminetti v. United States, 242 U.S. 470, 485 (1917).

299. *Ron Pair Enters.*, 489 U.S. at 242 (quoting *Griffin*, 458 U.S. at 571).

300. *See supra* notes 152-54 and accompanying text.

of any reference to ERISA in the legislative history probably means merely that Congress did not consider the specific situation involved herein when it adopted the Bankruptcy Code.[301] Additionally, resort to the legislative history of section 541(c)(2) is unfounded because it is internally inconsistent. Compare, for example, two references to section 541(c)(2) in the House Report. The first reference states that the section excludes a "debtor's interest in a spendthrift trust to the extent the trust is protected from creditors under applicable *State law*."[302] Elsewhere in the legislative history, the House Report states that section 541(c)(2) "preserves restrictions on transfer of a spendthrift trust to the extent that the restriction is enforceable under *applicable nonbankruptcy law*."[303] While both excerpts refer to spendthrift trusts, one relies on state law while the other refers to "applicable nonbankruptcy law." These inconsistencies hardly form the basis upon which to conclude that Congress clearly intended the phrase "applicable nonbankruptcy law" to encompass only state spendthrift trust law, even though the use of the phrase elsewhere in the Bankruptcy Code includes both state and federal law.

The second potential problem with the *Moore* approach is the possible conflict between section 541(c)(2) and section 522(d)(10)(E), the Bankruptcy Code's exemption provision governing pension benefits. Recall that, under that provision, pension benefits can be exempted out of the bankruptcy estate to the extent reasonably necessary for the support of a debtor and his dependents, unless the plan at issue (i) was created by an insider of the debtor, (ii) was on account of age or length of service, and (iii) was not a qualified plan.[304] Based upon this statutory provision, some courts have reasoned that Congress must have intended to include qualified pension benefits in a debtor's bankruptcy estate; otherwise, a provision exempting such benefits out of the estate would have been unnecessary.[305]

Although these provisions might have been more artfully drafted, there is no inherent inconsistency between sections 541(c)(2) and 522(d)(10)(E). Individual retirement accounts ("IRA's") and certain church plans are not required to contain anti-alienation provisions in order to be qualified under ERISA. Hence, there are some types of qualified plans that do not contain transfer restrictions and are, therefore, included in a debtor's estate even under a *Moore* analysis.[306] Consider, then, the following interpretation of these

301. *See* Brankey & Darr, *supra* note 40, at 300.

302. H.R. REP. NO. 595, 95th Cong., 2d Sess. 176, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6136 (emphasis added).

303. H.R. REP. NO. 595, 95th Cong., 2d Sess. 368, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6324 (emphasis added).

304. 11 U.S.C. § 522(d)(10)(E)(i)-(iii) (1988).

305. *See supra* notes 104-08 and accompanying text.

306. *See* Seiden, *supra* note 201, at 318.

sections: interests in ERISA-qualified retirement plans, except IRA's and certain church plans, are excluded from the bankruptcy estate under section 541(c)(2); interests in non-qualified plans, IRA's, and such church plans are included in the estate but can be exempted out to the extent reasonably necessary for support *unless* the plan at issue was established by an insider of the debtor, such as his wholly-owned corporation or a corporation in which the debtor is a director or officer.[307] Such an interpretation of these statutory provisions renders them entirely consistent and, additionally, leaves a host of both qualified and unqualified retirement plans available for exemption by the debtor.[308]

### *B. Should Retirement Benefits be Excluded from the Bankruptcy Estate?*

Concluding that *Moore* and its progeny have correctly interpreted section 541(c)(2) of the Bankruptcy Code is merely the first step in analyzing the pension issue. It is next necessary to determine whether such a result best promotes the policies of ERISA and the Bankruptcy Code, or, alternatively, whether a different result could better harmonize the two federal statutes. While excluding retirement benefits, regardless of size, from a debtor's bankruptcy estate certainly promotes the purpose of ERISA, it does so at the expense of bankruptcy creditors. Allowing a debtor to retain over $945,000 in retirement benefits in bankruptcy, as the court permitted in *In re Wyles*,[309] hardly provides an equitable distribution to creditors, one of the fundamental policy objectives of the Bankruptcy Code.[310] Particularly troublesome is the case of the self-settled pension plan and trust, where the debtor has established the retirement plan and retains complete dominion and control over the plan. If plan assets are excluded from a debtor's estate in such a case, creditors are denied access to plan benefits, even though the debtor can gain access to them at will, subject only to possible adverse tax consequences.[311] In the case of a self-settled plan, it is difficult to elevate ERISA's policy of protecting an

---

307. *See, e.g.*, 11 U.S.C. § 101(31)(A)(iv) (1988).

308. One may argue that the provision in § 522(d)(10)(E) disallowing certain non-qualified plans from exemption implies that qualified plans are available for exemption. However, an equally plausible interpretation is that the provision implies that qualified plans are already excluded from the bankruptcy estate under § 541(c)(2); therefore, it would only be necessary to exempt non-qualified plan interests from the bankruptcy estate.

309. 123 Bankr. 733 (Bankr. E.D. Va. 1991).

310. *See supra* note 57 and accompanying text.

311. *See, e.g.*, *Wyles*, 123 Bankr. at 733. *See also supra* notes 73-77 and accompanying text.

employee's anticipated pension benefits from his employer's improvidence or misconduct over the Bankruptcy Code's policy of maximizing creditors' payments, because the employee and employer are generally one and the same.

The final problem with the minority approach espoused in *Moore* is that it encourages debtors contemplating bankruptcy to sell property which would otherwise be nonexempt and invest the proceeds in qualified retirement plans, thus placing the assets beyond the reach of creditors. The legislative history of the Bankruptcy Code seems to suggest that the drafters condoned this process, which is often referred to as pre-filing conversion. It states: "[a]s under current law, the debtor will be permitted to convert non-exempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law."[312] Despite this legislative history, a number of courts have held such pre-filing conversion to be a fraud on creditors, and have denied the debtor a discharge from his debts upon the conclusion of the bankruptcy proceeding.[313] If a debtor is permitted to liquidate nonexempt assets and invest them in a qualified retirement plan before bankruptcy, the policy of protecting creditor's rights is further frustrated. Surely this was not the type of retirement saving that Congress wished to foster in enacting ERISA.[314]

All of the criticisms that can be waged against excluding retirement benefits from a debtor's bankruptcy estate appear to center around the concept of fairness to creditors. It somehow seems fundamentally unfair to allow a debtor to retain thousands of dollars in retirement benefits while being discharged from debts that the debtor legitimately owes to creditors.

Would the policies of ERISA and the Bankruptcy Code be better served if all ERISA plan benefits were included in the bankruptcy estate? Unfortunately, such a solution is also fraught with difficulties. The most serious problem with this approach is that including plan benefits in a bankruptcy estate would violate ERISA's anti-alienation provisions, thereby potentially

312. S. REP. NO. 989, 95th Cong., 2d Sess. 76, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5862.

313. *See, e.g., In re* Tveten, 848 F.2d 871 (8th Cir. 1988). *See also* Koger & Reynolds, *Is Prefiling Engineering Prudent Planning or Section 727 Fraud? (Or, When Does a Pig Become a Hog?)*, 93 COM. L.J. 465 (1988).

314. Consider, for example, the case of a Florida psychologist who injured a small child in an automobile accident. A lawsuit seeking $6.5 million in damages was filed against the psychologist as a result of the accident. Subsequent to the filing of the lawsuit, the doctor converted nonexempt assets into exempt pensions and other annuities and then filed for bankruptcy relief. The court upheld the transfers, determining that they were not a fraud on creditors. *See In re* Kimmel, No. 90-24577 (Bankr. S.D. Fla. June 13, 1991) (LEXIS, Genfed library, Bankr. file).

disqualifying the plan and forcing it to lose its tax-deferred status. Because the favorable tax consequences associated with an ERISA-qualified plan are contingent upon the plan containing anti-alienation provisions, a court order requiring turnover of plan assets to a bankruptcy trustee at least arguably violates ERISA's prohibition against alienation of plan benefits. The Internal Revenue Service has taken the position that such a forced turnover of plan benefits would disqualify the entire pension plan.[315] Devastating tax consequences could result if the Internal Revenue Service is successful in causing such plans to lose their tax-advantaged status. For example, the employer who established the plan would no longer be able to deduct contributions made to the plan. Moreover, interest earned on the plan's assets would be taxable currently. Finally, employees would be unable to defer taxes owed on employer contributions made on the employees' behalf, even if the employees do not currently receive the benefits.

The position taken by the Service has put plan trustees in a very precarious position. If the trustees comply with the court order requiring turnover of plan assets, and the plan is thereby disqualified, they may be breaching their fiduciary obligations with respect to beneficiaries of the plan.[316] Hallmark Cards, Inc., for example, has recently appealed a bankruptcy court decision requiring an employee's interest in three retirement plans established by the company to be turned over to the bankruptcy trustee for distribution to the employee's creditors. Hallmark is appealing the ruling both to protect the employee's future retirement savings and to protect itself from being exposed to millions of dollars in retroactive tax liabilities.[317] A number of other large corporations are also contesting bankruptcy court orders requiring turnover of plan assets, and this litigation is seriously depleting plan assets.[318]

---

315. Priv. Ltr. Rul. 8951067 (Sept. 28, 1989); Priv. Ltr. Rul. 8910035 (Mar. 10, 1989); Priv. Ltr. Rul. 8131020 (May 5, 1981). Although these private letter rulings have no precedential value with respect to any party other than the taxpayer requesting the ruling, they nevertheless evidence the Service's position with respect to the disqualification issue. The Internal Revenue Service has also espoused this position in at least one bankruptcy court case. *See In re* Witte, 92 Bankr. 218, 223 (Bankr. W.D. Mich. 1988).

316. *See* 29 U.S.C. §§ 1101-14 (1988 & Supp. I 1989). For an excellent discussion of the potential adverse ramifications facing a plan administrator if forced to turn over plan assets to a bankruptcy trustee, *see* Seiden, *supra* note 201, at 334-45.

317. The Kansas City Star, May 28, 1991, at D3, col 2. The article states that according to court documents, Hallmark's retirement fund contained $317 million in 1989 and its profit-sharing plan contained $1.08 billion in assets at the end of that year. *Id.*

318. Wal-Mart is one such corporation contesting a turnover order. *Id.*

Although some courts that have included a debtor's retirement benefits in his bankruptcy estate have grappled with the plan disqualification issue, none have reached a satisfactory resolution to the problem. Some courts have simply rejected the plan disqualification argument without providing any reasoning for their decisions.[319] Other courts, for example, have ruled that, because the Bankruptcy Code was enacted after ERISA, it created an implicit exception to ERISA's anti-alienation provisions.[320] As two commentators have persuasively argued, however, the contention that the Bankruptcy Code created an implied exception to ERISA is weakened by the fact that Congress created an express exception to ERISA's anti-alienation provisions in 1984 when it enacted the qualified domestic relations order provisions, and yet failed to create such an exception for bankruptcy orders at that time.[321] The argument is further undermined by the Supreme Court's recent decision in *Guidry v. Sheet Metal Workers National Pension Fund*, wherein the Court refused to recognize an implied exception to ERISA's anti-alienation provisions for an employee's criminal misconduct.[322]

A second problem with including a debtor's retirement benefits in his bankruptcy estate is that it conflicts with ERISA's stated purpose of insuring that employees' benefits be available for retirement. The resulting problem is twofold. First, the objectives of the Bankruptcy Code are promoted at the expense of those of ERISA; second, the government may incur significant financial burdens if forced to support debtors who have no pension benefits accumulated upon retirement.

Finally, the inclusion of pension benefits in a debtor's bankruptcy estate may prove to be an administrative nightmare. A bankruptcy trustee steps into the shoes of the debtor and takes property subject to the same restrictions that were imposed on the debtor before bankruptcy. Therefore, the trustee may be unable to compel an immediate distribution of assets from the debtor's ERISA

319. *See, e.g., In re* Gribben, 84 Bankr. 494, 498 (S.D. Ohio 1988); *In re* Threet, 118 Bankr. 805, 809 (Bankr. N.D. Okla. 1990); *In re* Gallagher, 101 Bankr. 594, 604 (Bankr. W.D. Mo. 1989).

320. *In re* DiPiazza, 29 Bankr. 916, 923 (Bankr. N.D. Ill. 1983). The bankruptcy court in *DiPiazza* stated that an order requiring turnover of plan assets would not disqualify a plan from receiving favorable tax benefits, despite the fact that a private letter ruling was issued by the Internal Revenue Service which ruled otherwise. *Id. See also* Regan v. Ross, 691 F.2d 81, 87 (2d Cir. 1982), wherein the court stated: "We believe, however, that to the extent that Congress evidenced clear intent to include pension benefits in the property of a Chapter 13 estate—a matter which we believe is demonstrated above—it necessarily amended §401(a)(13) and applicable Treasury regulations accordingly." *Id.*

321. *See* Brankey & Darr, *supra* note 40, at 297-98.

322. 110 S. Ct. 680 (1990).

plan if the debtor had no present right to do so.[323] Many debtors have successfully claimed that, because they have no access to their pension funds in the absence of an event triggering distribution, such as death, retirement, or termination of employment, the bankruptcy trustee cannot compel immediate turnover of pension fund assets.[324] Under this line of cases, the bankruptcy trustee has three options. First, he can choose to keep the bankruptcy proceeding open until the debtor retires, dies, or terminates employment.[325] Second, the bankruptcy trustee can sell the contingent right to receive distributions in the future and use the funds for distribution to creditors.[326] Finally, the trustee can abandon the property because it has a present value that is inconsequential to the estate.[327]

The first alternative, keeping the bankruptcy estate open until a contingency permitting distribution occurs, is administratively unfeasible. Nearly all debtors filing for bankruptcy relief have interests in pension plans that they are not currently able to reach. Requiring bankruptcy courts to keep all of these proceedings open is simply unworkable, particularly in light of their already overburdened dockets. The second alternative, permitting the trustee to sell the contingent future income stream, may also prove administratively difficult because few investors would be willing to commit the time necessary to make difficult calculations of the present value of a future income stream for relatively small pension distributions. The final alternative,

323. *See In re* Schauer, 835 F.2d 1222, 1225 (8th Cir. 1987); *In re* Silldorff, 96 Bankr. 859, 866 (C.D. Ill. 1989). The bankruptcy trustee may, however, be entitled to petition for a hardship withdrawal from the plan if the debtor possessed that right. *See id.* at 867.

324. *In re* Groves, 120 Bankr. 956, 965-66 (Bankr. N.D. Ill. 1990); *In re* Bartlett, 116 Bankr. 1015, 1024 (Bankr. S.D. Iowa 1990); *In re* Smith, 115 Bankr. 144, 147 (Bankr. C.D. Ill. 1990); *In re* Balay, 113 Bankr. 429, 445 (Bankr. N.D. Ill. 1990); *In re* Loe, 83 Bankr. 641, 646 (Bankr. D. Minn. 1988); *In re* DeWeese, 47 Bankr. 251, 256 (Bankr. W.D.N.C. 1985). *See also Silldorff*, 96 Bankr. at 868.

325. *Groves*, 120 Bankr. at 966. The court in *Groves* correctly points out, however, that any post-petition contributions made by the debtor are not property of the estate and must be returned to the debtor. *Id.* at 966 n.12. *See also* 11 U.S.C. § 541(a) (1988). In one case, the debtor terminated his employment during the pendency of the bankruptcy proceeding and the trustee was allowed to recover the pre-petition portion of the debtor's pension benefits for the bankruptcy estate. *In re* Ryerson, 739 F.2d 1423 (9th Cir. 1984).

326. *Groves*, 120 Bankr. at 966.

327. *Id. See also* 11 U.S.C. § 554 (1988); *Bartlett*, 116 Bankr. at 1024 n.13, wherein the court suggested that it would probably grant an order seeking abandonment of plan assets over creditors' objections.

abandonment of the pension plan interest, certainly results in only a pyrrhic victory for the bankruptcy trustee.[328]

Although most cases have held that the bankruptcy trustee succeeds only to those rights that the debtor had at the time of the bankruptcy filing, a recent line of cases has emerged that permits a trustee to compel immediate turnover of plan assets to the bankruptcy estate.[329] In most of these cases, the debtor has the ability to obtain the pension funds at any time simply by terminating employment. The courts espousing this view thus reason that the trustee has also gained the present right to require distribution of the funds,[330] even though the trustee does not have the right to compel the debtor to terminate his employment relationship.[331]

This recent line of cases compelling immediate turnover of plan assets seems to violate the spirit of ERISA. A plan participant cannot generally receive distributions, except in limited circumstances such as hardship, until an event such as retirement or termination of employment occurs. Therefore, the fact that the trustee is permitted to receive a distribution from the plan prior to such a triggering event would appear to violate ERISA. Nevertheless, it is becoming more commonplace for courts to require immediate turnover of plan assets so as to avoid administrative difficulties in the future.

---

328. According to the bankruptcy court in *Balay*, 113 Bankr. at 443, a pyrrhic victory is defined as "a victory gained at ruinous loss, such as that of Pyrrhus the Greek over the Romans in B.C. 279." *Id.* The reason that the trustee's victory is a hollow one is because he has likely incurred legal and other administrative expenses in bringing the debtor's pension benefits into the bankruptcy estate, only to have them abandoned later as of inconsequential value.

329. *See, e.g., In re* Green, 115 Bankr. 1001, 1010 (Bankr. W.D. Mo. 1990), in which the bankruptcy court justified its holding by stating the following:

> If a trustee has to wait for funds to which he is entitled, and as to which the debtor has no claim, there is no benefit to the debtor, but there is a harm to the creditors who in turn are forced to wait for their share of such proceeds. Requiring that the funds be turned over immediately enables the bankruptcy case to be processed as expeditiously as possible.

*See also In re* Lyons, 114 Bankr. 572, 578 (Bankr. C.D. Ill. 1990), wherein the court found that because the administrative impracticalities of keeping the case open and monitoring it until the debtor reached retirement age were excessive, it could compel immediate turnover of pension plan assets under its broad powers granted by § 105 of the Bankruptcy Code.

330. *See In re* Tomer, 117 Bankr. 391, 397 (Bankr. S.D. Ill. 1990); *In re* Schmitt, 113 Bankr. 1007, 1013-14 (Bankr. W.D. Mo. 1990).

331. *In re* Carlin, No. 90-60723-S (Bankr. W.D. Mo. March 6, 1991) (WESTLAW, Allfeds database).

### *C. Harmonizing ERISA and the Bankruptcy Code: A Proposed Solution*

The foregoing discussion demonstrates that it is not enough simply to conclude that retirement benefits either be included in or excluded from a debtor's bankruptcy estate. Although both options possess certain advantages, each creates numerous problems as well. Excluding pension benefits from a bankruptcy estate promotes the objectives of ERISA at the expense of creditors and encourages debtors to place nonexempt assets beyond the reach of creditors by investing them in a retirement plan before bankruptcy. Conversely, including benefits in the estate creates administrative burdens, results in potential plan disqualification, and elevates the rights of creditors under the Bankruptcy Code over the debtor's protections afforded under ERISA. Because neither approach is entirely satisfactory, a solution that attempts to harmonize the competing policies of ERISA and the Bankruptcy Code is warranted.

It seems fundamentally unfair to deny creditors any access to a debtor's retirement benefits, regardless of their size. Thus, the resolution of this problem must begin by including a debtor's retirement benefits in his estate, and then permitting exemption as necessary for the debtor's fresh start.

The proposed solution will consist of six elements: (1) repeal section 541(c)(2) of the Bankruptcy Code so that all pension benefits come into the bankruptcy estate;[332] (2) permit exemption of pension benefits to the extent reasonably necessary for the support of the debtor and his dependents, but provide specific guidelines for courts to determine what amounts are reasonably necessary for support; (3) eliminate state pension exemption schemes in bankruptcy so that a uniform exemption statute governing retirement benefits is available to all debtors in bankruptcy; (4) allow debtors to convert nonexempt assets into exempt assets, such as retirement benefits, within the prescribed limitations of the federal exemption scheme; (5) amend ERISA to provide an exception to its anti-alienation provisions for bankruptcy orders similar to the exception currently in effect for qualified domestic relations orders; and (6) further amend ERISA so that a bankruptcy trustee can force immediate turnover of plan assets for the benefit of creditors rather than wait until an event triggering distribution occurs. Each of these elements will be discussed in detail below.

332. For a discussion of the treatment accorded spendthrift trusts under this scenario, *see infra* p. 560.

### 1. The Repeal of Bankruptcy Code Section 541(c)(2)

In order to ensure that all pension benefits are initially included in the bankruptcy estate, section 541(c)(2) of the Bankruptcy Code must be repealed. In that way, even pension plans that constitute spendthrift trusts under applicable state law will fall within the ambit of the bankruptcy estate. Of course, one issue that arises with the repeal of section 541(c)(2) is the status of the traditional spendthrift trust. A debtor's interest in a traditional spendthrift trust established by another to protect against the debtor's folly or improvidence would initially be included in the estate under this scenario. Such a result, however, is not as novel as it may appear at first blush. The Senate version of section 541(c)(2) proposed that transfer restrictions under, for example, a traditional spendthrift trust, would be enforced only to the extent necessary for the support of the debtor and his dependents.[333] Accordingly, were section 541(c)(2) to be repealed, a provision should be added to the federal exemption scheme permitting a debtor to exempt spendthrift trust assets out of the bankruptcy estate to the extent reasonably necessary for support. Such a provision could be added to the end of section 522(d)(11) of the Bankruptcy Code and would state:

> (11) the debtor's right to receive, or property that is traceable to
>
> . . . .
>
> (F) a payment under a trust containing a restriction on the transfer of a beneficial interest of the debtor that is enforceable under state spendthrift trust law, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

A repeal of section 541(c)(2), coupled with this amendment to the federal exemption provisions, would give the bankruptcy judge greater control over the assets of the debtor. It would ensure the most equitable distribution to creditors while protecting traditional spendthrift trust restrictions to the extent reasonably necessary for the support of the debtor and his dependents.

### 2. Guidelines for the Exemption of Pension Benefits

While including pension benefits in the bankruptcy estate furthers the Bankruptcy Code policy of maximizing distribution to creditors, it thwarts ERISA's policy of protecting employees' pension benefits. Balancing these two competing policies requires that debtors be permitted to retain at least some of their accumulated retirement benefits. Section 522(d)(10)(E) allows

---

333. S. REP. NO. 989, 95th Cong., 2d Sess. 83, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5869. *See also supra* note 71.

debtors to exempt such retirement benefits out of the estate "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."[334] Although this exemption provision establishes a good starting point, it does not offer a complete solution because there are no guidelines to assist bankruptcy courts in determining what is reasonably necessary for support. Most courts addressing the issue have either permitted none of a debtor's benefits to be exempted out of the estate, reasoning that the debtor had the ability to rebuild a pension before retirement, or, alternatively, have permitted the exemption of all retirement benefits as reasonably necessary for support. Uniformity is needed in this area so that debtors can make informed decisions concerning whether (i) to file for bankruptcy relief under Chapter 7 or Chapter 13 of the Bankruptcy Code, or (ii) to file for bankruptcy relief at all. Knowing with certainty the amount of pension benefits that they will be able to retain in bankruptcy will assist debtors with both of these decisions. Additionally, uniform treatment of all retirement benefits in bankruptcy, regardless of the type of plan involved, will be advantageous because courts will not be forced to afford different treatment to various types of benefits depending on the particularities of the retirement plan at issue.

The guidelines would allow every debtor to retain a percentage of his retirement benefits that have accumulated at the time the bankruptcy petition is filed. The applicable percentage is determined according to a sliding scale based upon the debtor's age at the time of filing. The scale assumes that a younger debtor has a greater ability to rebuild a pension before retirement than an older debtor. The percentage calculation will differ depending upon whether the debtor's retirement benefits are in a defined benefit plan, such as a pension plan, or a defined contribution plan, such as a profit-sharing plan. Additionally, the guidelines will impose a ceiling on the maximum amount of retirement benefits that a debtor will be permitted to retain.

In a defined benefit plan, a participant does not have a separate "account," but rather is guaranteed a specified monthly payment during his lifetime, usually beginning upon retirement at age sixty-five. Conversely, in a defined contribution plan the participant has a separate account containing her retirement benefits; they are generally distributed in a lump sum to the participant upon retirement. Under the proposed guidelines, a debtor holding an interest in a defined benefit plan would be permitted to retain a percentage of projected monthly payments based upon current pension benefits; the debtor with a defined contribution plan interest would be permitted to retain a percentage of the account balance at the time the bankruptcy petition is filed. The following percentages would be applicable in either case:

334. *See supra* notes 304-08 and accompanying text for a discussion of the limited exception to this exemption privilege.

| Age | Retained Percentage |
|---|---|
| 25 | 10% |
| 30 | 20% |
| 35 | 30% |
| 40 | 40% |
| 45 | 50% |
| 50 | 60% |
| 55 | 70% |
| 60 | 80% |
| 65 | 90% |
| 70 | 100% |

Thus, for example, a forty-year-old lawyer filing for bankruptcy relief who would be entitled to a monthly payment of $500 based upon current investments in his pension plan would be allowed to retain 40% of those projected benefits, or $200 per month. Similarly, a fifty-five-year-old electrician having a $30,000 interest in his company's profit-sharing plan would be entitled to retain 70% of that interest, or $21,000. The remaining assets would stay in the bankruptcy estate for ultimate distribution to creditors. The retained percentages for debtors whose ages fall between these categories would be increased by 2% each year, so that a twenty-seven-year-old debtor would retain 14% of her retirement benefits, and a sixty-eight-year-old debtor would be entitled to 96% of otherwise allowable benefits.

There would be two exceptions to these guidelines. First, if a debtor can establish that he is permanently disabled and thus will be unable to rebuild a pension before retirement, a bankruptcy judge would have the discretion to allow the debtor to retain a greater percentage of accumulated retirement benefits than the guidelines would otherwise permit. Second, because it would be fundamentally unfair to permit a bankrupt debtor to retain a massive retirement benefit while depriving creditors of payments on their claims, the guidelines should contain a ceiling on allowable benefits. For defined benefit plans, the ceiling would provide that a debtor could not exempt more than $19,450 in annual pension benefits. This figure represents the highest annual income level that is taxed at the lowest tax rate for single individuals. The guidelines should allow that figure to be adjusted as tax brackets are adjusted for inflation. In the case of a defined contribution plan, the ceiling calculation is more difficult because the debtor receives a lump sum amount upon distribution. The maximum allowable defined contribution plan benefit that should be exempted would be an amount which, when invested at the then current annual treasury bill rate, would yield an annual return of $19,450. For example, a sixty-year-old debtor who has a $400,000 interest in his employer's profit-sharing plan would normally be able to retain 80% of that figure, or $320,000. If the current annual treasury bill rate is 10%, a $320,000 investment would yield a $32,000 annual return, disregarding any compounding factor. Because that $32,000 amount exceeds the maximum ceiling of

$19,450 annually, the debtor would only be able to exempt $194,500, rather than $320,000, from his profit-sharing plan under this ceiling rule.

The advantages of these guidelines are threefold. First, they offer certainty to debtors contemplating bankruptcy, thereby allowing them to make informed decisions regarding the appropriate course of action to take. For example, the guidelines eliminate the possibility that courts will adopt the position currently espoused by the Third Circuit that only those benefits currently in pay status are reasonably necessary for support. Second, the guidelines relieve judges of difficult facts and circumstances hearings, thus reducing their burdensome dockets, if only slightly. Finally, they harmonize the policies of ERISA and the Bankruptcy Code by allowing debtors to retain at least a portion of their retirement assets while also providing creditors some of the benefit of these often substantial assets.

The criticism that can be waged against these guidelines is that they provide only rough justice, ignoring the particularities of individual debtors and failing to take into account their special monetary needs. While this criticism is well-founded, bankruptcy judges currently tend to adopt an all-or-nothing approach, either permitting the debtor to retain all pension benefits or allowing him to retain none, despite the purported flexibility currently afforded them under the statute. Although the proposed guidelines may not accurately reflect the amount that a thirty-year-old debtor will need for support upon retirement in thirty-five years, the benefits of this bright-line approach nevertheless are a significant improvement over the realities of the present system.

### 3. Eliminating State Pension Exemption Schemes in Bankruptcy

In many instances a debtor's pension rights will be among the most important assets involved in the bankruptcy process. The proposal outlined in this Article suggests that pension benefits should be included in the bankruptcy estate initially, but can then be exempted out of the estate to the extent that they are reasonably necessary for the support of the debtor and her dependents. To be effective, however, this proposal requires that federal legislation be enacted preempting state pension exemption statutes in the bankruptcy context.

The Bankruptcy Commission established to review the old Bankruptcy Act and to recommend reform measures harshly criticized the old Act's reliance on state exemption statutes because they "(1) increased administrative expenses and promoted delays, (2) treated creditors inequitably, (3) often provided debtors with either overly generous or insufficient exemptions, and (4) delegated a national policy concern to localized and unresponsive legislative bodies."[335] As a result, when Congress enacted the Bankruptcy Code in 1978, it created the federal exemption scheme found in section 522(d) of the Bankruptcy Code as an alternative to these state exemption provisions to assure that debtors would retain at least a minimal amount necessary for their fresh start after bankruptcy.[336]

There are three possible scenarios when comparing a state's pension exemption scheme with the federal scheme. Each scenario suggests that the existence of the state scheme governing pension benefits is unwarranted in light of the policies that the Bankruptcy Code is attempting to promote and should thus be eliminated in the bankruptcy context.[337] First, a state may enact a pension exemption scheme substantially similar to section 522(d)'s federal scheme. In such a situation, the state scheme is duplicative and, therefore, unnecessary.

Second, a state may enact an exemption scheme relating to pension benefits that is far less generous than the federal scheme.[338] Under such a scenario, if the state has not opted out of the federal scheme, a debtor in bankruptcy will choose the more generous federal exemptions and the state exemption system will prove unnecessary. If, on the other hand, the state has opted out, a debtor will be forced to use the state's scheme and will be denied

335. Fox, *Section 522(b)(1): An Examination of the Opt-Out Proviso*, 1983 ARIZ. ST. L.J. 395, 398 (footnotes omitted).

336. One commentator described the various states' exemption schemes before the enactment of the Bankruptcy Code as follows:

> Exemptions in some states were criticized as being obsolete and "parsimonious in the extreme" . . . . [O]ther states' exemptions were perceived as being overly generous to debtors and unfair to creditors. The result was a bankruptcy exemption policy which treated debtors and creditors unequally based solely upon the domicile of the debtor.

Duncan, *Through the Trap Door Darkly: Nebraska Exemption Policy and The Bankruptcy Reform Act of 1978*, 20 NEB. L. REV. 219, 222 (1981) (citing Countryman, *Consumers in Bankruptcy Cases*, 18 WASHBURN L.J. 1, 2 (1978)). *See also* Mordy, Dunn & Johnson, *Constitutionality of "Opt Out" Statutes Providing for Exemptions to Bankrupts*, 48 MO. L. REV. 627, 628 (1983), wherein the authors stated that "[p]rior to enactment of the 1978 Code, the task of formulating a substantive exemption policy was abdicated to the states. As a result, an incongruous patchwork of exemptions was created, varying greatly from state to state." (footnotes omitted).

337. It is the author's personal view that all state exemption provisions be eliminated in bankruptcy for the reasons discussed herein. For purposes of addressing the issues outlined in this Article, however, it is only proposed that state *pension* exemption provisions be preempted by the Bankruptcy Code.

338. Or, worse yet, the state might not amend an antiquated scheme in which a horse and buggy could be exempted without limitation, and yet the exemption of retirement benefits is not addressed at all.

the fresh start envisioned by Congress in enacting the federal scheme, with its minimal level of exemptions necessary for such a fresh start.[339]

Under the third scenario, a state may enact a pension exemption scheme far more generous than the federal scheme. In such a situation, the opt-out provision does not even come into play, because debtors in opt-out states and non-opt-out states alike will surely choose their state's exemption scheme over the less generous federal scheme. A generous state exemption scheme governing pension benefits certainly provides debtors with their necessary fresh start,[340] but at what cost? The Bankruptcy Code's goal of maximizing the return to creditors is being circumvented, causing distrust of the bankruptcy system, and loss of the uniformity that it was intended to foster.[341] Moreover, when individuals begin to see that debtors in neighboring states emerge from bankruptcy with their $500,000 pensions preserved, those debtors with substantial retirement assets to protect who find themselves on the brink of financial ruin may be tempted to "forum shop" by moving to a state with more generous pension exemption provisions.[342]

Surely this was not what Congress envisioned when it enacted the Bankruptcy Code's dual exemption scheme. By permitting the use of state-created pension exemptions in the federal bankruptcy context, Congress has defeated its own stated policies. On the one hand, debtors in opt-out states with restrictive pension exemption provisions will be denied their fresh start, which is purportedly at the heart of the Bankruptcy Code. On the other hand, creditors in states with exemption provisions governing retirement benefits that are more generous than the federal scheme will receive minimal returns on their claims, thereby thwarting the policy of equitable distribution to the creditors of bankrupt debtors. Both situations circumvent the Bankruptcy Code's purpose of creating uniformity and certainty in the bankruptcy context.

Accordingly, the use of state pension exemption schemes should be preempted in bankruptcy proceedings by the federal pension exemption

---

339. This is precisely the reason why Congress drafted a uniform set of exemptions. *See* H.R. REP. NO. 595, 95th Cong., 2d Sess. 126, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6087.

340. In fact, some courts and commentators have suggested that the debtor is being afforded a "head start." *See, e.g., In re* Tveten, 848 F.2d 871, 876 (8th Cir. 1988); Koger & Reynolds, *supra* note 313, at 468.

341. For a discussion of the uniformity issue, *see* Fox, *supra* note 335, at 401-03, 412-13.

342. For example, one article discusses a case in which the debtor was permitted to retain a $320,000 house, a Jaguar, a Cadillac, and a Jeep through generous exemption provisions and a series of business transactions. *See* Mordy, Dunn & Johnson, *supra* note 336, at 627. *See also* Jackson, *supra* note 191, at 1437, in which the author suggests that debtors would be discouraged from changing residence prior to bankruptcy were there to be a uniform exemption scheme.

scheme. This could be accomplished simply by adding preemption language to section 522(b) of the Bankruptcy Code.

Eliminating state pension exemption schemes would not only better promote the policies of the Bankruptcy Code and provide uniformity regarding pension benefits in the federal bankruptcy context, but it would also simplify the exemption process because bankruptcy attorneys and judges would not be required to analyze individual states' pension exemption schemes in determining those retirement assets that are available for exemption. Such a proposal would also discourage debtors from changing their states of residence in order to take advantage of a more generous exemption scheme available in another state.

Finally, eliminating state pension exemption schemes in bankruptcy would solve the problems created by ERISA's preemption of state law. A majority of courts have held that ERISA preempts state pension exemption provisions. Therefore debtors in states that have opted out of the federal exemption scheme find that they are unable to exempt their pension benefits at all. By forcing debtors to resort only to the federal exemption provisions, they are assured of being able to retain at least a portion of their retirement benefits in bankruptcy. Of course, state pension exemption provisions will continue to be widely utilized in non-bankruptcy situations.

### 4. Permitting Conversion within the Federal Exemption Scheme

If a debtor is allowed to exempt a portion of his pension benefits out of his bankruptcy estate, he may be tempted to place nonexempt assets beyond the reach of creditors by selling them and investing the proceeds in a retirement plan. As discussed previously, this conversion process was apparently condoned by the drafters of the Bankruptcy Code; a number of courts, however, have denied the debtor a discharge from his debts if such pre-petition conversion is coupled with extrinsic evidence of an intent to defraud creditors.[343] Many of the cases that have found such pre-filing conversion fraudulent as to creditors have involved state exemption schemes wherein debtors converted large amounts of nonexempt assets into exempt assets on the eve of bankruptcy.[344] If overly generous state pension exemption schemes are unavailable in bankruptcy, much of the risk of conversion is thereby eliminated. Because only one uniform federal pension exemption scheme will be available to all debtors filing for bankruptcy relief under this proposal, debtors should thus be permitted to take full advantage of the

343. *See, e.g., In re* Armstrong, 127 Bankr. 852, 853 (D. Neb. 1989).

344. For example, the case of *In re* Tveten, 848 F.2d 871 (8th Cir. 1988), involved a pre-petition conversion of over $700,000 of nonexempt property into exempt property just prior to bankruptcy.

available federal exemptions, even if it involves converting nonexempt assets on the eve of bankruptcy.

The advantages of permitting pre-filing conversion without limitation are obvious. First, the administrative burden on bankruptcy judges will be reduced because they will not be required to hold time-consuming hearings to determine if pre-filing conversion has risen to the level of fraud. Moreover, debtors will not be penalized simply because their assets are invested in nonexempt property rather than exempt property, such as a pension plan. As a result, the goal of uniformity will be preserved, and most debtors will be afforded the same fresh start after bankruptcy. It is a well-settled axiom of tax law that taxpayers should be entitled to reduce their taxes as much as possible by taking full advantage of all deductions available to them under the law. Similarly, pre-petition conversion allows debtors to retain the maximum amount of property available for their fresh start by taking full advantage of the exemptions afforded them under federal bankruptcy law.

### 5. Amending ERISA's Anti-Alienation Provisions

Because the Internal Revenue Service has consistently asserted that including retirement benefits in a debtor's bankruptcy estate violates ERISA's anti-alienation provisions and results in plan disqualification, an amendment to ERISA is necessary to prevent plans from losing their tax-deferred status. In 1984, Congress amended ERISA to provide an exception to its anti-alienation provisions for transfers made pursuant to a qualified domestic relations order. A similar exception should be created for qualified bankruptcy orders. The provision could read as follows:

> (d) Assignment or alienation of plan benefits
>
> (1) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.
>
> . . . .
>
> (4) (A) Paragraph (1) shall not apply to any assignment, alienation or recognition of a right to any benefit payable with respect to a participant pursuant to a qualified bankruptcy order.
>
> (B) A qualified bankruptcy order is any judgment, decree, or order (including approval of a settlement agreement) which -
>
> (I) is granted by a court of competent jurisdiction, and
>
> (II) provides that all or a portion of a participant's benefits be turned over to the bankruptcy trustee in a case commenced under Title 11 of this Code.

The exception should appear both in ERISA's labor provisions, found in section 1056(d) of Title 29 of the United States Code, as well as in ERISA's tax provisions, found in section 401(a)(13) of the Internal Revenue Code.

This qualified bankruptcy order exception will ensure that retirement plans are not disqualified and do not lose their tax-advantaged status simply because one participant's benefits are included in his bankruptcy estate for ultimate distribution to his creditors. Such an amendment will enable plan administrators to satisfy both their fiduciary obligations to other plan participants and their legal obligations pursuant to a court order requiring that assets be assigned to the bankruptcy estate for the benefit of creditors.

### 6. Amending ERISA to Permit Immediate Turnover of Assets

One thorny problem that emerges when retirement benefits are included in the bankruptcy estate is exactly what creditors are entitled to receive. If the estate remains open until an event triggering distribution occurs, such as the debtor's death, retirement, or termination of employment, then not only are administrative difficulties created, but, in addition, the present value of such future pension benefits to the creditors is relatively low. Moreover, it is unlikely that any market will develop for the purchase of a right to receive the future income stream from a debtor's retirement benefits.

An immediate turnover of retirement plan assets for distribution to creditors thus appears the most prudent resolution of the issue. Unfortunately, ERISA contains no provision allowing such immediate turnover when the plan participant has no present right to the funds. Accordingly, ERISA should be amended to allow retirement plans to make lump-sum distributions to bankruptcy estates for the benefit of creditors. In this way, the administrative burden of keeping the estate open until an event triggering distribution occurs will be eliminated and creditors can be paid immediately. An advantage of this proposal is that creditors will be entitled to take an immediate tax deduction for any unpaid portion of their debt, rather than being required to defer the tax write-off until a distribution occurs in the distant future.[345]

In the case of defined contribution plans, the plan should have no difficulty in making a lump-sum payment to the bankruptcy estate because the funds are currently available in the participant's account. In defined benefit plans, however, a plan's funding may not have taken into account the possibility of such a lump-sum distribution. Consequently, pension plans may have to adjust their funding levels to account for such a contingency.[346] The bankruptcy trustee should deduct any tax liability resulting from the

345. I.R.C. § 166 (1988 & Supp. I 1989).

346. A complete discussion of ERISA's funding requirements is beyond the scope of this Article.

distribution of benefits—including any penalties associated with the premature withdrawal of such benefits—from the distribution as an administrative expense before the assets are divided among creditors.[347]

## VI. CONCLUSION

Bankruptcy judges, attorneys, trustees, and plan administrators are expending enormous amounts of time and resources in an attempt to determine the status of a debtor's retirement benefits in bankruptcy. It is time for Congress to act. It is not enough, however, for Congress to conclude that retirement benefits should be included in the bankruptcy estate. It must also address the collateral consequences that such an action will have on ERISA, as well as the exemption issues raised thereby. The solution outlined in this article addresses all of these concerns, and does so in a way that harmonizes the competing policies of ERISA and the Bankruptcy Code. Congress is urged to adopt such a comprehensive solution immediately, before valuable resources are depleted further.

347. These taxes and penalties should be considered a first priority administrative expense pursuant to 11 U.S.C. §§ 507(a)(1), 503(b) (1988).