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Whose Pension Is It Anyway? ERISA and the Bankruptcy Code

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WHOSE PENSION IS IT ANYWAY? —ERISA AND THE BANKRUPTCY CODE

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I. BACKGROUND

The question of whether an individual's ERISA-qualified pension plan is subject to the claims of creditors following that person's bankruptcy filing appears, at long last, to be coming to a head.[1] This issue, which in recent years has split the U.S. Courts of Appeals virtually down the middle, may be resolved in the near future by the U.S. Supreme Court, which recently granted certiorari in the case of *Shumate v. Patterson.*[2] Congress may act even sooner—legislation has been introduced recently in both the Senate and the House, in an effort to end the confusion arising from conflicting case law.[3]

Whether the debtor or her or his creditors are entitled to the debtor's ERISA-qualified pension plan is of more than academic interest. In recent years the number of personal bankruptcy filings has increased sharply.[4] The assets in the debtor's pension plan are often of significant

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1. For the purposes of this article, the terms "ERISA-qualified pension plan" and "ERISA plan" each means a "pension plan" as defined in 19 U.S.C. §1002(2)(A) which is also qualified under §§401, 406 and 409 of the Internal Revenue Code.

2. 943 F.2d 362 (4th Cir. 1991), *cert. granted*, 112 S.Ct. 932, 60 U.S.L.W. 3498 (1992).

3. S. 1985 (Bankruptcy Code Reform Act, Introduced 11/19/91, Sen. Heflin); H.R. 3804 (Personal Bankruptcy Pension Protection Act of 1991, Introduced 11/19/91, Rep. Gibbons).

4. In the fiscal year ending June 30, 1991, 880,399 petitions were filed under Chapters 7 and 13, up from 725,484 for the fiscal year ending June 30, 1990. This rate of filings represents one Chapter 7 or 13 filing for every 106 households in the United States for the year ending on June 30, 1991. On June 30, 1991, more than one million cases (1,123,433)

value, and the debtor and creditors involved in the bankruptcy proceeding are likely to vigorously contest ownership of those assets. The conflicting societal interests of giving the debtor a "fresh start" and preventing the impoverishment of retirees, and of treating creditors equitably, loom large and are difficult to reconcile. Other issues of fairness are also present; for example, should the determination of who is entitled to the debtor's retirement fund be made primarily on the basis of whether the debtor resides within the jurisdiction of one federal Court of Appeals as opposed to another?

The legal rubric within which this controversy has developed is complicated. The case law, both at the Court of Appeals level and in the lower courts, has turned on the interpretation of a number of provisions in the Bankruptcy Code, various ERISA provisions and the peculiarities of state law. This article summarizes the grounds on which ERISA-qualified pension plans have been subjected to or exempted from the claims of creditors, discusses the likelihood of the U.S. Supreme Court's being able to resolve all of these issues by its grant of certiorari in the *Shumate* case, and critiques the pending federal legislation.

II. PROPERTY OF THE ESTATE—IS ERISA "APPLICABLE NONBANKRUPTCY LAW" UNDER SECTION 541(c)(2) OF THE BANKRUPTCY CODE?

The threshold question on which the Courts of Appeals have differed is whether an ERISA-qualified pension plan is property of the estate under Section 541 of the Bankruptcy Code. The Bankruptcy Code of 1978 included in Section 541 an expanded definition of the property of the estate. Under Section 541, the commencement of a case under the Code creates an estate comprised of "all legal and equitable interests of the debtor and property as of the commencement of the case."[5] Numerous commentators have observed that the legislative history of the Bankruptcy Code indicates that Section 541 was intended to "bring anything of value that the debtors have into the estate."[6] But the clear intent of Section 541 to include as property of the estate all possible kinds of property is subject to the notable exception contained in Section 541(c)(2), which provides that:

> A restriction on a transfer of the beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

And the question of whether ERISA is "applicable nonbankruptcy law" under Section 541(c)(2) is the first issue on which the Courts of

were pending under Chapters 7 and 13, up from 961,919 on June 30, 1990.

5. 11 U.S.C. §541(a)(1).

6. H.R. Rep. No. 595,95 Cong., 1st Sess. 176 (1977).

Appeals have differed.

At the date of the writing of this article, there is an even split in the Courts of Appeals which have ruled on whether ERISA is "applicable nonbankruptcy law" under Section 541(c)(2). Four circuits—the 5th, 8th, 9th and 11th—have determined that ERISA is not "applicable nonbankruptcy law" under Section 541(c)(2). Another four circuits—the 3rd, 4th, 6th and 10th—have held that ERISA is "applicable nonbankruptcy law" under that provision. The remaining four circuits have not yet ruled on the issue. The basis for this split is discussed below.

A. GOFF AND ITS PROGENY—ERISA PLANS ARE PROPERTY OF THE ESTATE BECAUSE ERISA IS NOT "APPLICABLE NONBANKRUPTCY LAW" UNDER SECTION 541(c)(2)

The earliest and leading case to hold that ERISA plans are property of the estate because "applicable nonbankruptcy law" under Section 541(c)(2) of the Bankruptcy Code does not include ERISA is *In re Goff*.[7] The debtors in the *Goff* case were Elbert Wayne Goff and Gloria Jane Schadoer Goff, husband and wife, who had filed a voluntary joint petition in bankruptcy under Chapter 7 of the Bankruptcy Code. According to the court, the Goffs "elected to avail themselves of the state rather than the federal[8] bankruptcy exemptions presumably because of the high equity value of their homestead which could be retained under Texas law but not the federal law."[9] The matter on appeal was whether the Goffs' ERISA-qualified pension plans, valued at $90,000, were property of the estate under Section 541 of the Bankruptcy Code. The Goffs contended that Section 541(c)(2) exempted all ERISA-qualified pension plans, all of which plans contain restrictions on assignment and alienation which are "enforceable under applicable nonbankruptcy law" as the term is used in Section 541(c)(2).[10]

The *Goff* court disagreed, holding that the pension plan was property of the estate. This determination was based on the court's "examination of the Bankruptcy Code's provisions and of discernible congressional intent" which revealed to the court "that applicable nonbankruptcy law was intended as a narrow reference to state spendthrift trust law and not as a broad reference to all other law, both federal and state including ERISA."[11]

Specifically, the *Goff* decision noted that the Bankruptcy Code was intended to create "a more uniform and comprehensive scope to property to the estate which is subject to the reach of debtors' creditors than had

7. 706 F.2d 574 (5th Cir. 1983).
8. 11 U.S.C. §522(d).
9. 706 F.2d at 577.
10. 706 F.2d 576-577.
11. 706 F.2d at 577.

previously existed under the old Bankruptcy Act. . . . Under Section 541 of the Code, all property in which the debtor has a legal or equitable interest at the time of bankruptcy comes into the estate.[12] This is so," continued the court, "notwithstanding any provision [except as recognized in subsection (2)] that restricts or conditions transfer of such interests by the debtor."[13]

But what of Section 541(c)(2)? The Goffs' had claimed that the restrictions against assignment or alienation, which were contained in their ERISA-qualified pension plan pursuant to ERISA, 26 U.S.C. Section 401(a)(13) and 29 U.S.C. Section 1056(d)(1), were enforceable under "applicable nonbankruptcy law" as provided in Section 541(c)(2).[14] Thus, the plans were not property of the estate. The *Goff* court disagreed: "Congress did not evidence an intent, by reference to applicable nonbankruptcy law to include an ERISA plan exemption. Rather, we find that Congress intended to exclude only trust funds in the nature of spendthrift trusts from the property of the estate."[15]

In reaching this conclusion, the court reasoned that the "legislative history of Section 541(c)(2) indicated that Congress had something very specific in mind with its facially broad reference to applicable nonbankruptcy law as the benchmark for assessing the enforceability of trust restraints on alienation in bankruptcy."[16] The court cited the House Report accompanying H.R. 8200, which asserted 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." The court also referred to the Senate Report accompanying S. 2266, which explained that Section 541(c)(2) "preserves restrictions on a transfer of a spendthrift trust . . . enforceable [under] nonbankruptcy law."[17] The court referred to several similar additional items of legislative history, and concluded that it was "clear that Congress intended by its reference to applicable nonbankruptcy law to exempt from the estate only those spendthrift trusts traditionally beyond the reach of creditors under state law."[18]

There are two major difficulties with the *Goff* court's reasoning in this first step of its analysis. First, as enunciated by the U.S. Supreme Court, the generally accepted rule for the judicial review of a statutory provision is that if the statutory provision being construed is unambiguous, then a review of legislative history is neither necessary nor proper.[19] The

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12. 11 U.S.C. §541(a)(1).

13. 706 F.2d at 578.

14. 706 F.2d at 580.

15. *Id.*

16. 706 2d at 581.

17. 706 F.2d at 582, citing S.Rep. No. 95-989, 95th Cong., 2d Sess. 83, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5787, 5869.

18. 706 F.2d at 582.

19. *Davis v. Michigan Department of Treasury*, 489 U.S. 803, 109 S.Ct. 1500, 1504 n.3, 103 L.Ed.2d 891 (1989); *Burlington Northern R.R. v. Oklahoma Tax Commission*,

term "applicable nonbankruptcy law" as used in Section 541(c)(2) would appear to be clear on its face, as constituting a reference to both federal and state nonbankruptcy law, and is not limited to a narrower scope either expressly or by implication.

But even absent such a rule of statutory construction, the legislative history cited by the *Goff* court nowhere indicated that Congress had intended Section 541(c)(2) to include *only* spendthrift trusts, and thus exclude ERISA-qualified pension plans. ERISA was enacted in 1974, and by 1978 millions of potential debtors had ERISA-qualified pension plans. Since the enactment of ERISA occurred between the enactment of the Bankruptcy Act and the 1978 Bankruptcy Code which replaced it, logic dictates that had Congress intended to exclude ERISA plans from the exceptions set forth in Section 541(c)(2), then either the express language of Section 541(c)(2) or the legislative history would have addressed the issue. It is also clear that the statements contained in the legislative history which indicated the intent of Congress to carry forward the spendthrift trust exemption are equally lacking in any indication that state spendthrift trust law was the *only* "applicable nonbankruptcy law" intended to be covered by Section 541(c)(2).

The second basis on which the *Goff* court concluded that the term "applicable nonbankruptcy law" does not refer to ERISA was an analysis of other provisions of the Bankruptcy Code which expressly refer to "federal law." Section 522(b)(2)(A) provides that, if a debtor elects the "state" system of exemptions, then that debtor may also exempt property pursuant to "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."[20] The *Goff* court reasoned that consideration of this provision was "helpful in understanding this case because we find that Congress did not intend to do ambiguously in Section 541 that which it clearly did not do directly in Section 522, although Section 522 explicitly addresses the extent to which other 'Federal law' and retirement benefit exemptions would be recognized."[21]

Again, the *Goff* court referred to the legislative history of the Bankruptcy Code. Both the House and the Senate Reports, in explaining the other 'Federal law' provision of Section 522(b)(2)(A), provided a list of illustrative property which might be exempted under federal laws other than the Bankruptcy Code. Ten federal statutes were specifically listed; ERISA was not included in that list. The *Goff* court reasoned that the "failure of Congress to include ERISA in its listing of illustrative federal statutes is highly probative of congressional intent that ERISA was not within the group of 'federal law' based exemptions. . . . Congress knew of the previously-enacted ERISA when drafting Section 522(b)(2)(A), yet neither the House nor the Senate deemed fit to include it within their

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481 U.S. 454, 461, 107 S.Ct. 1855, 1860, 95 L.Ed.2d 404 (1987).

20. 11 U.S.C. §522(b)(2)(A).

21. 706 F.2d at 582.

respective illustrative lists."[22]

It is difficult to follow the reasoning of the *Goff* court's analysis of Section 522(b)(2)(A), if that Section of the Bankruptcy Code is read in the context of the possible interpretations of Section 541(c)(2). As discussed above, "applicable nonbankruptcy law" as used in Section 541(c)(2) may be interpreted as either including ERISA or excluding ERISA. If such term in Section 541(c)(2) was intended by Congress to include ERISA, then ERISA-qualified pension plans would not be included as property of the estate, and any need to permit a debtor to exempt such plans under Section 522(b)(2)(A) would be unnecessary. The fact that the Senate and House Reports failed to list ERISA among the ten statutes which were illustrative of "Federal law" pursuant to which a debtor's property could be exempted under Section 522(b)(2)(A) indicates, if anything, strong evidence that such property was already excluded under Section 541(c)(2).

The *Goff* court also noted that the federal statutes listed in the Senate and House Reports "which establish or guarantee certain benefits *directly preclude* all such benefits from alienation or assignment," while ERISA, though it favors qualified plans, envisions that a "disqualified" plan may be formed which is still subject to ERISA's regulatory scheme but which does not restrict alienation or assignment.[23] Again, this is hardly probative of congressional intent. The state spendthrift trust cited in *Goff* more perfectly resembles an ERISA trust in this regard than it does any of the benefits created by the ten federal statutes referred to in the legislative history of Section 522(b)(2)(A). Clearly, it is as likely to be true that trusts which purport to be spendthrift trusts may fail to qualify as such because they do not restrict alienation or assignment as it is that ERISA plans will have the same shortcoming. Neither ERISA nor state spendthrift trust law "directly precludes" the principal or interest of the trust from being subject to alienation or assignment. And both an ERISA trust and a spendthrift trust will remain subject to other law applicable to such trust even if a flaw in the trust leaves its assets alienable and assignable.

Finally, the *Goff* court, in determining whether "applicable nonbankruptcy law" in Section 541(c)(2) was intended to include ERISA plans, noted the express reference in Section 522(d)(10)(E)(iii) to such plans. Section 522(d)(10)(E)(iii) provides that if the debtor elects the Federal list of exemptions, then among the available exemptions are the "debtor's 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 . . . (iii) such plan or contract does not qualify under §401(a), 403(a), 403(b), 408 or 409 of the Internal Revenue Code of 1954 (26

22. 706 F.2d at 585.
23. 706 F.2d at 585 (emphasis in original).

U.S.C. 401(a), 403(a), 403(b), 408, or 409)." The court reasoned that, since Congress expressly referred to ERISA in Section 522(d)(10)(E)(iii), Congress's failure to refer to ERISA in Section 541(c)(2) must indicate that ERISA was not included in the term "applicable nonbankruptcy law" as used in that section.

Again, there are significant flaws in this reasoning. As noted above, Section 541(c)(2) does not enumerate *any* laws, whether federal or state, or whether for illustrative purposes or otherwise. The statutory provision is equally silent with regard to both ERISA, which the court held was not covered by Section 541(c)(2), and state spendthrift law, which the court held was. Nonetheless, the *Goff* court raised a potentially perplexing issue in its analysis of Section 522(d)(10)(E)(iii). Stated simply, if ERISA-qualified pension plans are excluded from property of the estate under Section 541(c)(2), then it can be argued that it is superfluous to permit a debtor to exempt ERISA plan assets as permitted under Section 522(d)(10)(E)(iii).

But this problem, which was not thoroughly explored by the *Goff* court, is reconciled by a precise reading of the statutory language. Section 541(c)(2) provides 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." Under such a provision, as long as none of the income or principal of the trust is distributed to the debtor, such income or principal will be excluded from property of the estate. However, Section 541(c)(2) does not protect from the claims of creditors any income or principal of the trust which is distributed to the debtor prior to the conclusion of the case. Section 522(d)(10)(E)(iii), to the contrary, expressly exempts the "debtor's right *to receive* . . . a payment" under an ERISA-qualified pension plan. Taking the plain meaning of the word "receive" in the context of an ERISA-qualified pension plan, Section 541(c)(2) and Section 522(d)(10)(E)(iii) are not difficult to reconcile at all; indeed they are elegantly complimentary.

The third and final basis on which the *Goff* court concluded that the ERISA-qualified pension plans were property of the estate followed the court's comparison of ERISA and the Bankruptcy Code. The court noted that, while "ERISA preempts state law, 29 U.S.C. §1144(a), it clearly was not intended to affect the operation of other federal law." However, the court continued, 29 U.S.C. Section 1144(d) provides that nothing in ERISA "shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States [except pre-existing federal pension law] or any rule or regulation issued under such law."[24] The court continued that the general policy of the Bankruptcy Code to "broaden the 'property of the estate' available to creditors in bankruptcy" would be "frustrated if ERISA's anti-alienation and assignment

24. 706 F.2d at 587.

provisions were applied with a sweeping brush."[25]

This third basis for the *Goff* court's conclusion is as unconvincing as the other bases. The issue of whether ERISA provisions should prevail over Bankruptcy Code provisions to the contrary or vice versa was not before the court. The court neglected to cite any section of ERISA which might "alter, amend, modify, invalidate, impair or supersede" any section of the Bankruptcy Code, nor did the court point to any provision of the Bankruptcy Code which would strike down a contrary ERISA provision. The sole question before the court was whether the Bankruptcy Code itself was intended to include ERISA-qualified pension plans as property of the estate, or whether the Bankruptcy Code itself was intended to mean the contrary. This clash of statutory titans which the *Goff* court claimed to have mediated in fact never occurred.

The balance of the *Goff* opinion is anti-climactic. Having concluded that Section 541(c)(2) referred only to state spendthrift trust law, the court then examined Texas law. Under Texas law, self-settled trusts did not constitute spendthrift trusts. The court further noted that the Goffs' exercised considerable control over their pension plans. Since the Goffs' pension plans did not qualify as spendthrift trusts under state law, they were included in the debtors' estates.[26]

Over the next several years, the 8th, 9th and 11th Circuit Courts of Appeals followed *Goff*, adopting essentially the same analysis of Section 541(c)(2). In the case of *In re Graham*[27] the debtor argued that "applicable nonbankruptcy law" under Section 541(c)(2) included ERISA.[28] The *Graham* court drew upon the same items of legislative history which indicated a congressional intent to preserve the spendthrift trust exemption, and concluded that Section 541(c)(2) was not intended to include any trust other than a "traditional spendthrift trust, as recognized by state law."[29] The court did further elaborate on the apparent conflict between Section 541(c)(2) and Section 522(b)(10)(E), noting that "pension benefits are specifically treated under the Code's *exemption provisions*, clearly indicating that they were intended and assumed to be part of the estate." The *Graham* court did not address the significance of the term "receive" as used in Section 522(b)(10)(E).[30]

The 11th Circuit in *In re Lichstrahl*[31] cited both *Goff* and *Graham*, as well as a number of lower court decisions, in holding that " 'applicable nonbankruptcy law' refers only to state spendthrift trust law."[32] In *In re Daniels*[33] the 9th Circuit stated that the "*Goff* case makes it clear that

25. *Id.*
26. 706 F.2d at 589.
27. 726 F.2d 1268 (8th Cir. 1984).
28. 726 F.2d at 1270.
29. 726 F.2d at 1271-1272.
30. *Accord*, *In re Swanson*, 873 F.2d 1121 (8th Cir. 1989).
31. 750 F.2d 1488 (11th Cir. 1985).
32. 750 F.2d at 1490.
33. 771 F.2d 1352 (9th Cir. 1985).

Congress *never intended* for the ERISA IRC anti-alienation provisions to create exemptions or exclusions for pension plans under . . . the nonbankruptcy exclusions of 11 U.S.C. §541(c)(2)."[34]

In sum, the first 4 Circuit Courts of Appeals to examine the applicability of Section 541(c)(2) to ERISA-qualified pension plans held that Section 541(c)(2) did not exclude such plans from the property of the debtor's estate.

B. MOORE AND ITS PROGENY—ERISA IS "APPLICABLE NONBANKRUPTCY LAW" UNDER SECTION 541(C)(2)—ERISA-QUALIFIED PENSION PLANS ARE NOT PROPERTY OF THE ESTATE

It was not until *In re Moore*[35] that a Court of Appeals gave Section 541(c)(2) its plain meaning: " 'Applicable non-bankruptcy law' means precisely what it says: all laws, state and federal, under which a transfer restriction is enforceable. Nothing in the phrase 'applicable non-bankruptcy 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."[36]

In support of its conclusion, the *Moore* court noted that in numerous places in the Bankruptcy Code, the term "applicable nonbankruptcy law" is used to refer to federal as well as state law.[37] It would be "incongruous," wrote the court, "to give the same phrase in Section 541(c)(2) a narrower construction than the identical phrase in other parts of the Bankruptcy Code, particularly since the disparate sections of the Bankruptcy Code were enacted together in a single comprehensive statute."[38] The court also cited a number of provisions of the Bankruptcy Code which specifically referred to state but not federal law, noting that Section 541(c)(2) was not one of them.[39]

But the most convincing basis on which the *Moore* court declined to follow *Goff* and the decisions which had followed *Goff* was that "legislative history is irrelevant to the interpretation of an unambiguous statute,"[40] and that the legislative history of the Bankruptcy Code is "in any

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34. 771 F.2d at 1359.

35. 907 F.2d 1476 (4th Cir. 1990).

36. 907 F.2d at 1477.

37. In particular, the court referred to 11 U.S.C. §1125(d), in which the reference to "applicable nonbankruptcy law" had been interpreted to include federal securities law, citing *In re Stanley Hotel, Inc.*, 13 B.R. 926, 931 (Bkrtcy. D Colo. 1981), and also referred to 11 U.S.C. §108(a), in which the term "applicable nonbankruptcy law" had been held to refer to the Racketeer Influence and Corrupt Organization Act, citing *In re Ahead By a Length, Inc.* 100 B.R. 157, 162-63 (Bkrtcy. S.D.N.Y. 1989).

38. 907 F.2d at 1478.

39. *Id.*

40. Citing *Davis v. Michigan Department of Treasury*, 489 U.S. 803, 109 F.2d 1500, 1504 n. 3, 103 L.Ed.2d 891 (1989), and other cases.

event inconclusive."[41] The *Moore* court took issue with the fundamental precept of *Goff*'s characterization of the legislative history of the Bankruptcy Code:

> At most, these passages suggest that Congress intended state spendthrift trust law to be included within the meaning of 'applicable nonbankruptcy law'. . . . Congress' emphasis in the legislative reports on 'preserving', 'continuing' and 'restrictions on' a transfer of a state spendthrift trust meant only that it wanted to insure that state spendthrift trust law be included within the restrictions of transfer enforceable under 'applicable nonbankruptcy law;' nothing in the legislative history indicates, however, that Congress meant 'applicable nonbankruptcy law' to refer exclusively to state spendthrift trust law. The clarity of this statutory term is simply not clouded by the legislative history.[42]

The *Moore* court then turned to the question of whether the conditions of the Internal Revenue Code which must be satisfied for a pension plan to qualify under ERISA constitute a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law," and thus "is enforceable in a case under the Bankruptcy Code." The court cited 26 U.S.C. Section 401(a)(13) which requires that the plan "may not be assigned or alienated," and Treasury Regulation Section 1.403(a)-13(b)(1), which requires that the plan must provide "that benefits provided under the plan may not be anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution or other legal or equitable process." Since ERISA's non-alienability provisions prevent both voluntary and involuntary encroachments, neither plan participants nor general creditors may reach the benefits under an ERISA-qualified pension plan. Thus, ERISA is "applicable nonbankruptcy law" under the plain and simple language of Section 541(c)(2).

The *Moore* opinion was soon followed by the 6th Circuit in the case of *In re Lucas*[43] "It is an axiom of statutory construction" wrote the court, "that resort to legislative history is improper when a statute is unambiguous."[44] The *Lucas* court also agreed with *Moore* that the legislative history of the Bankruptcy Code was in any event inconclusive on the subject of whether Section 541(c)(2) was intended to be limited to state spendthrift trust law only. The *Lucas* court further agreed that ERISA was "applicable nonbankruptcy law," and thus that ERISA-qualified pension plans were excluded from the property of the debtor's estate under Section 541(c)(2).

Hard on the heels of *Moore* and *Lucas*, the 3rd Circuit, in *Velis v.*

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41. 907 F.2d at 1479.
42. 907 F.2d at 1479.
43. 924 F.2d 597 (6th Cir. 1991).
44. Citing *Burlington Northern R.R. v. Oklahoma Tax Commission*, 481 U.S. 454, 461, 107 S.Ct. 1855, 1860, 95 L.Ed. 2d 404 (1987); *Bradley v. Austin*, 841 F.2d 1288, 1293 (6th Cir. 1988).

Kardanis,[45] and the 10th Circuit, in *In re Harline*,[46] followed the reasoning of *Moore* that the plain meaning of Section 541(c)(2) excluded from the estate the debtor's interest in an ERISA-qualified pension plan, and that even if resort to legislative history were made, such resort would be inconclusive. The *Velis* court went on to address the supposed inconsistency between Section 541(c)(2) and Section 522(d)(10)(E), which was raised by the *Goff* and *Graham* courts. "Section 522," wrote the *Velis* court, "deals with distributions made from a pension plan and distributions which the debtor has a present and immediate right to receive."[47]

The *Velis* court then applied these conclusions to the facts before it. Since the debtor was sixty-three years old when his bankruptcy petition was filed, he could withdraw funds from his IRA without penalty. Thus, there were no enforceable restrictions with respect to the IRA account, and the IRA was part of the debtor's estate under Section 541(c)(2).

With respect to the debtor's pension plan and Keogh plan, the court concluded that "to the extent the assets in these plans have already been distributed to or for the benefit of the debtor, the debtor no longer has available the protection which might otherwise have been accorded under the ERISA statute. Section 541(c)(2) requires recognition of restrictions upon transfer which are enforceable by law; it does not operate to require non-recognition of transfers which have already occurred, nor does it apply to assets in the possession of the debtor without restrictions."[48] Thus, the funds withdrawn by the debtor from his pension plan and Keogh plan were no longer pension assets, but had become part of the debtor's estate. By contrast, undistributed assets in the pension plan and Keogh plan were excluded under Section 541(c)(2).[49]

The *Harline* court, following the same analysis, could "not perceive any ambiguity in the phrase 'applicable nonbankruptcy law' that would permit" it to differentiate state from federal law. The phrase on its face is "clear and broad" and "interpretation of 'applicable bankruptcy law' to include both federal and state laws is consistent with Congress' use of that same term in other sections of the Bankruptcy Code."[50] The *Harline* court also found persuasive the *Velis* court's conclusion that Section 522(d)(10)(E) deals with distributions made from a pension plan, and thus does not render inconsistent the clear intent of Section 541(c)(2) to exclude non-distributed ERISA-qualified pension assets from the property of the estate.[51]

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45. 949 F.2d 78 (3rd Cir. 1991).
46. 950 F.2d 669 (10th Cir. 1991).
47. Citing *Clark v. O'Neill* (*In re Clark*) 711 F.2d 21 (3d. Cir. 1983).
48. 949 F.2d at 82.
49. 949 F.2d at 83.
50. No. 90-4157 at 674.
51. 950 F.2d at 675.

C. A Blip in the Line of History—ERISA-Qualified Pension Plans are State Spendthrift Trusts and Excluded from Property of the Estate Under Section 541(c)(2)

This discussion of the evolution of the judicial interpretation of Section 541(c)(2) would be complete at this juncture, were it not for decisions in the 7th Circuit Court of Appeals and in the District Courts of the 2nd Circuit holding that ERISA-qualified pension plans constitute state spendthrift trusts, at least in part. In *In re Tisdale*[52] the court rejected the debtor's contention that Section 541(c)(2) excluded all ERISA-qualified pension plan assets from property of the estate. The court then analyzed Connecticut law, and concluded that the portion of the debtor's plan which was employer-funded contained restraints on alienation and empowered the trustees to withhold distribution. Thus the plan constituted a spendthrift trust under Connecticut law.

The same result was reached in *In re Kleist*,[53] on the basis of an unusual New York law. In *Kleist*, the court upheld a New York statute which provided that ERISA-qualified pension plans "shall be conclusively presumed to be spendthrift trusts under [such statute] and the common law of the state of New York for all purposes including. . . all cases arising under or related to a case arising under" the Bankruptcy Code.[54] Though the court decried the "potential for abuse" created by the New York legislature's use of a "conclusive presumption," it further noted that Section 541(c)(2) required "that deference be accorded to the respective state created boundaries defining spendthrift trusts."[55] Thus, the debtor's interest in a plan which was "conclusively presumed" to be a state spendthrift trust under the New York statute was not part of the estate pursuant to Section 541(c)(2).

And in *In re LeFeber*,[56] the 7th Circuit Court of Appeals upheld an Indiana spendthrift trust statute, which had been amended in 1987 to provide that self-settled pension trusts, including ERISA-qualified pension plans, were spendthrift trusts under Indiana law. The court held that the Indiana statute was "applicable nonbankruptcy law" under Section 541(c)(2), that the debtor's pension plan was a spendthrift trust under the Indiana statute, and thus that the pension plan assets were excluded from property of the estate under Section 541(c)(2).

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52. 112 B.R. 61 (Bkrtcy. D.Conn. 1990).

53. 114 B.R. 366.

54. 114 B.R. at 368-369, citing N.Y.C.P.L.R. §5205(c).

55. 114 B.R. at 369-70.

56. 906 F.2d 330 (7th Cir. 1990).

III. ROUND TWO—IS ERISA "FEDERAL LAW" UNDER SECTION 522(b)(2)(A)?

The second round in the battle over ERISA plans focused on the exemption provisions of Section 522 of the Bankruptcy Code. Under Section 522, a debtor may elect either the "Federal" exemptions listed in Section 522(d) or what is commonly referred to as the "state" list of exemptions which are more particularly described in Section 522(b)(2). The "state" list permits the debtor to exempt from property of the estate "any property that is exempt under Federal law, other than Subsection (e) of this section, or state or local law that is applicable on the date of filing the petition at the place "of the debtor's domicile."[57] There is one qualification to the debtor's right set forth in Section 522 to choose between exemption schemes: a state may enact legislation prohibiting a debtor who is domiciled in that state from electing the Federal scheme set forth in Section 522(d), thereby forcing the debtor to use that state's exemptions.[58] At the time of the writing of this article, approximately thirty-five states have enacted statutes limiting their domiciliaries to the state exemption list.[59] Further adding to this exodus away from the Federal exemption scheme contained in Section 522(d) is the fact that most state exemption lists are more favorable to the debtor than the Federal list contained in Section 522(d).

In light of these statutory developments in the states, it is not surprising that considerable attention has been given to Section 522(b)(2) which describes the exemptions available to a debtor if she or he elects to proceed under the state exemption scheme. The "state" list set forth in Section 522(b)(2)(A) permits the debtor to exempt "any property that is *exempt under Federal law*, other than subsection (d) of this section [which contains the "Federal" exemption scheme], or State or local law".[60]

In re Graham[61] was the first case to confront the issue of whether an ERISA plan is property which is "exempt under Federal law" under Section 522(b)(2)(A), and thus may be exempted by a debtor electing the "state" scheme of exemptions.[62] The debtor in *Graham* argued that his pension plan's "prohibition on assignment and alienation required by ERISA, 29 U.S.C. §1056(d), and by the Internal Revenue Code in order to qualify the plan for tax purposes, 26 U.S.C. §401(a)," made "his interest in the plan 'property that is exempt under Federal law' " as that

57. 11 U.S.C. §522(b)(2)(A).

58. 11 U.S.C. §522(c)(1).

59. Alvin J. Golden and Cynthia Degitz, "What Have We Stepped Into? Qualified Plans in Bankruptcy," *ACTEC Notes*, Vol. 17, No. 3, Winter 1991, p. 209-213.

60. 11 U.S.C. §522(b)(2)(A) (emphasis supplied).

61. 726 F.2d 1268 (8th Cir. 1984).

62. As discussed in paragraph II.A of this article, the court in *Graham* also followed the *Goff* court's conclusion that ERISA-qualified pension plans were property of the estate under §541(c)(2).

term was used in Section 522(b)(2)(A) of the Bankruptcy Code.[63] The court referred to the House and Senate reports, which provided an illustrative list of property which might be exempted under Federal law pursuant to Section 522(b)(2)(A). ERISA was not included in that list. The court concluded that, though the "list was not meant to be exclusive, we find the failure of Congress to include ERISA plan benefits probative of Congressional intent that ERISA was not a 'Federal law' upon which a Section 522(b)(2)(A) exemption could be based."[64] The court also pointed to the "conceptual distinction between the property exempted by the listed laws and the property covered by ERISA. The pensions, wages, benefits and payments included in the illustrative list are all peculiarly federal in nature," continued the court, "created by federal law or related to industries traditionally protected by the federal government. In sharp contrast, ERISA regulates private employer pension systems."[65]

The *Graham* decision was followed by *In re Lichstrahl*[66] and *In re Daniel*[67] both of which followed *Graham*'s reasoning with respect to Section 522(b)(2)(A). Both cases focused on the list of Federal statutes referred to in the legislative history of Section 522(b)(2)(A), and concluded that Congress had not intended that ERISA was "other Federal law" under Section 522(b)(2)(A).

In the more recent case of *In re Dyke*,[68] the 5th Circuit Court of Appeals acknowledged that the *Goff* court's conclusion that the "Federal law" reference in Section 522(b)(2)(A) did not include ERISA "was mere dicta: the Court need not have reached the question of the applicability of the 'other federal law' exception. It nonetheless did so, and its reasoning remains persuasive."[69]

It is difficult to argue with the conclusion reached by the 5th, 9th and 11th Circuits regarding the meaning of "Federal law" in Section 522(b)(2)(A), although the analysis used by those courts may be questioned. In *Graham*, *Lichstrahl*, *Daniel* and *Dyke*, the courts went beyond the plain meaning of the term "exempt under Federal law" as used in Section 522(b)(2)(A) and concluded, on the basis of legislative history, that the term did not include ERISA. This analysis was unnecessary.

63. 726 F.2d at 1273.

64. 726 F.2d at 1274.

65. 726 F.2d at 1269. In reaching its conclusion, the court cited the *Goff* case: "We thus conclude, as did the 5th Circuit [citing *Goff*], that Congress did not intend to include ERISA plans with the other 'Federal law' exemption of §522." The court implied that the *Goff* opinion had held that the debtors in *Goff* could not exempt their ERISA plans under §522(b)(2)(A). In fact, the *Goff* opinion does not indicate that the debtors ever sought to claim an exemption for their ERISA plans under §522(b)(2)(A). The *Goff* court's discussion of §522(b)(2)(A) was undertaken solely for the purpose of determining whether the legislative history of §541(c)(2) indicated that ERISA was "applicable nonbankruptcy law."

66. 750 F.2d 1488 (11th Cir. 1985).

67. 771 F.2d 1352 (9th Cir. 1985).

68. 943 F.2d 1435 (5th Cir. 1991).

69. 943 F.2d at 1445.

Section 522(b)(2)(A) permits the debtor to exempt property that "is exempt under Federal law." ERISA does not provide that ERISA-qualified pension assets are exempt under the Bankruptcy Code. Thus, Section 522(b)(2)(A), by its plain meaning, does not include ERISA.[70]

In sum, no U.S. Court of Appeals has held that "Federal law" as used in Section 522(b)(2)(A) includes ERISA.

IV. EXEMPTIONS UNDER SECTION 522(b)(2)(A)—MAY STATE EXEMPTION SCHEMES PERMIT THE EXEMPTION OF ERISA PLANS, OR ARE THE STATES PREEMPTED FROM DOING SO BY ERISA?

As discussed above, Section 522(b)(2)(A) permits the debtor to elect the "state" exemption scheme, and thereby exempt "any property that is exempt under Federal law . . . . or State or local law." Perhaps in response to the rulings of the U.S. Courts of Appeals which exposed ERISA-qualified pension plans to the claims of creditors, a number of states enacted state exemption schemes in accordance with Section 522(b)(2)(A), which permitted the exemption by debtors of ERISA plans.

The final chapter in the tortured history of the relationship between the Bankruptcy Code of 1978 and ERISA involves the question of whether the states may include in their exemptions lists ERISA-qualified pension plans, or are preempted from doing so by the provisions of ERISA itself.

A. PITRAT—ERISA PREEMPTS THE STATES FROM ENACTING EXEMPTION SCHEMES WHICH PERMIT THE EXEMPTION OF ERISA PLAN ASSETS

In *Pitrat v. Garlikov*[71] the debtors claimed a right to exempt their interests in their pension plans pursuant to the state law exemption contained in Section 522(b)(2)(A) and an Arizona statute that provided that all ERISA-qualified pension plans "shall be exempt from any and all claims of creditors of the beneficiary or participant." The trustee claimed that the Arizona statute was preempted by ERISA, 29 U.S.C. Section 1144(a), which provides that ERISA "shall supersede any and

70. Further, as discussed in Section II.A of this article, it is logical to conclude that, if ERISA plans are not included as property of the estate pursuant to §541(c)(2), then the reference to "Federal law" in §522(b)(2)(A) could not have been intended to include ERISA plan assets as property which could be exempted by the debtor under §522(b)(2)(A). Following this reasoning, the coherence of a plain meaning analysis is not disturbed, since "Federal law" as used in the exemption provisions of §522(b)(2)(A) could never include ERISA.

71. 947 F.2d 419 (9th Cir. 1991).

all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title."[72]

The court ruled against the debtor's claim to an exemption under the Arizona statute. First, the *Pitrat* court rejected the debtor's contention that the Arizona statute did not "relate to" ERISA, on the ground that the Supreme Court had repeatedly held that state laws which make reference to ERISA plans are laws that "relate to" those plans within the meaning of 29 U.S.C. Section 1144(a).[73] Second, the court held that it was "less than certain" that "conflict with Federal law is required for preemption." Third, the court declined to "address the Bankrupt's argument directly because the Arizona statute does conflict with ERISA."[74]

The 9th Circuit described the conflict between ERISA and the Arizona statute as follows: "Under *Daniel*, ERISA's anti-alienation provisions do not protect a debtor in bankruptcy. . . . However, arguably under the state law exemption of 11 U.S.C. Section 522(b)(2)(A), A.R.S. Section 33-1126(B) [the Arizona exemption statute] does protect a debtor in bankruptcy. Thus, by operation of the Bankruptcy Code, the Arizona statute would accomplish a disposition of ERISA plan funds different from that accomplished by ERISA." Thus, the court concluded, ERISA and the Arizona statute conflict.[75]

It is difficult to follow the reasoning of the *Pitrat* court with respect to its conclusion that the Arizona statute conflicts with ERISA. ERISA does not address the issue of the disposition of an ERISA-qualified pension plan in the context of a bankruptcy proceeding. Thus, there was no true conflict between the Arizona statute and ERISA. The disposition of an ERISA-qualified pension plan in a case under the Bankruptcy Code is determined under the Bankruptcy Code, which expressly permits a debtor to exempt any property which the debtor's state permits her or him to exempt. The conflict enunciated in the *Pitrat* opinion between ERISA and the Arizona statute is illusive, a reality which was not lost in a dissenting opinion which was also filed.

B. The Preemption Argument Fails—In re Dyke and In re Vickers

In *In re Dyke*[76] the debtors argued that a Texas statute permitting the exemption under Section 522(b)(2)(A) of ERISA-qualified pension plans was not preempted by ERISA. Though the court conceded that the Texas exemption statute "related to" ERISA, and that the ERISA preemption provisions were expansive, the court cited the U.S. Supreme

72. 947 F.2d at 426.
73. Citing *Mackey v. Lanier Collection Agency & Service*, 486 U.S. 825, 829 (1988).
74. 947 F.2d at 427.
75. *Id.*
76. 943 F.2d 1435 (5th Cir. 1991).

Court's holding in *Shaw v. Delta Air Lines, Inc.*,[77] that the ERISA saving clause[78] requires that "under certain circumstances ERISA, also does not preempt *state* laws which enforce Federal goals."[79] The court reasoned that "to interpret ERISA to preempt provisions of the state exemption schemes, the states would be unable to set enforceable exemption levels on retirement benefits. This would relegate many debtors to a federal exemption scheme which might be inappropriate to the locale. As a consequence, the enforcement scheme contemplated in the Bankruptcy Code would be modified and impaired." Thus, "ERISA section 514(d) saves the Texas state exemption scheme from preemption."[80] In conclusion, the court noted that it might have reached a different conclusion if the provisions of the Texas exemption statutes had been inconsistent with the provisions of the Bankruptcy Code.[81]

The same result was reached in *Checkett v. Vickers*,[82] decided in early 1992. The bankruptcy trustee in the *Vickers* case asserted that a Missouri statute which permitted a debtor to exempt ERISA plan assets to the extent reasonably necessary for support was preempted by ERISA.[83] The Missouri statute, the court reasoned, "was enacted pursuant to the authority given it by the bankruptcy code. It would be incongruous to hold pension benefits exempted under the federal bankruptcy law, but to strike down identical provisions enacted by the state under the express authorization of the bankruptcy code." Thus, concluded the court, ERISA did not preempt the Missouri exemption statute.[84]

In sum, with *Pitrat*, *Dyke* and *Vickers*, the closing months of 1991 and early 1992 saw the development of a second split in the Circuits regarding a major issue in the relationship between the Bankruptcy Code and ERISA.

V. IN RE SHUMATE—WILL THE U.S. SUPREME COURT'S GRANT OF CERTIORARI RESOLVE THE CURRENT CHAOS?

On January 21, 1992, the U.S. Supreme Court granted *certiorari* in *Shumate v. Patterson*.[85] In *Shumate*, the U.S. District Court for the Western District of Virginia, which is within the jurisdiction of the 4th Circuit Court of Appeals, held that Joseph Shumate's interest in an ERISA-qualified pension plan was property of the estate under Section

77. 463 U.S. 85, 103 S.Ct. 2890, 77 L.Ed.2d 490 (1983).
78. 29 U.S.C. §1144(b).
79. 943 F.2d at 1449 (emphasis in original).
80. 943 F.2d at 1450.
81. *Id.*
82. No. 91-1067 (8th Cir. 1992).
83. 29 U.S.C. §1144(a).
84. No. 91-0167 at 2.
85. 943 F.2d 362 (4th Cir. 1991), *cert. granted*, 112 S.Ct. 932, 60 U.S.L.W. 3492 (1992).

541(a) of the Bankruptcy Code "on the basis that Shumate's control over the pension plan was so complete as not to qualify the pension plan, under applicable Virginia law, for spendthrift trust status."[86] The District Court's decision predated the 4th Circuit's issuance of the *Moore* opinion discussed in Section II.B of this article.

Shumate appealed, and the 4th Circuit reversed, citing *Moore*. The court briefly summarized the analysis and holding in *Moore*, emphasizing that the District Court's "focus on state spendthrift trust law. . . is misplaced."[87] Because the 4th Circuit in *Shumate* held that the pension plan was excluded from the bankruptcy estate under Section 541(c)(2), it further stated that it did not reach the question of whether the debtor's interest in the plan would qualify for an exemption under Section 522(b).[88]

It is clear from the *Shumate* decision that only by affirming the 4th Circuit's decision can the U.S. Supreme Court resolve all of the issues. If the Supreme Court agrees with the 4th Circuit that Section 541(c)(2) does not include ERISA-qualified pension plans as property of the estate, then the issues raised by Section 522(d)(10)(E) and Section 522(b)(2)(A) do not need to be addressed. If, on the other hand, the U.S. Supreme Court reverses the 4th Circuit's decision in *Shumate*, then the issues of whether a debtor who elects the "Federal" scheme may exempt her or his ERISA plan under Section 522(d)(10)(E)(iii), and of whether states may include ERISA plans in their exemption schemes under Section 522(b)(2)(A) without being preempted by ERISA, will not be resolved. For this reason, the authors urge Congress to end the existing confusion. The statutes currently before Congress are analyzed in Section VI of this article.

VI. PENDING LEGISLATION

The Bankruptcy Code Reform Act[89] was introduced in the Senate on November 19, 1991 by Senator Heflin. Section 202(c) of the proposed Act provides that:

> Subsection 541(c) of title 11, United States Code, is amended by adding at the end the following new paragraph:
>
> (3)(A) Subject to subparagraph (B), assets and benefits accumulated for the benefits of a debtor pursuant to a pension, profitsharing, stock bonus, or annuity plan qualified under section 401(a), 403(a), or 403(b) of the Internal Revenue Code of 1986 and any rights of debtor to such assets or benefits shall be excluded from the property of the estate.
>
> (B) Subparagraph (A) does not apply to plan assets or benefits at-

86. 83 B.R. 404.
87. 934 F.2d at 364.
88. 934 F.2d at 365.
89. S. 1985.

tributable to contributions of the debtor during the 12 calendar months preceding the date of the filing to the extent such contributions were in excess of the applicable limits on such contributions under section 401(k), 401(m), or 415 of the Internal Revenue Code of 1986.

The Personal Bankruptcy Pension Protection Act of 1991[90] introduced in the House on November 19, 1991 by Representative Gibbons, provides as follows:

> (a) IN GENERAL—Section 541 of title 11, United States Code, is amended by adding at the end thereof the following new subsection:
>
> (e)(1) Except as provided in paragraph (2), property of the estate does not include any interest of the debtor in a plan or contract qualified under section 401(a), 403(a), or 403(b) of the Internal Revenue Code of 1986 if the plan or contract provides that benefits provided thereunder may not be assigned or alienated other than as permitted under section 401(a)(13) of such Code.
>
> (2) Paragraph (a) shall not apply—
>
> (A) to any plan or contract if the provision referred to in paragraph (1) was adopted during the 1-year period ending on the date the petition was filed, or
>
> (B) to so much of the assets of any plan or contract which are attributable to contributions made during such 1-year period, if such provision was adopted, or such contributions were made, with the intent referred to in section 548(a)(1).

Both S. 1985 and H.R. 3804 would end much of the confusion which currently reigns where ERISA and the Bankruptcy Code meet. Pursuant to both the Senate and House versions of the statute, most ERISA-qualified plan assets would be excluded from property of the estate under Section 541. The statutory exclusion of ERISA plan assets from property of the estate would end the split in the Circuits over the interpretation of Section 541(c)(2) and leave resolution of the ERISA preemption for the most part unnecessary.

Both the Senate and House versions would include in property of the estate certain transfers made within one-year prior to the date of the filing of the debtor's petition. Under the Senate version[91] contributions made within such one-year period in excess of the maximum amount deductible pursuant to the applicable provisions of the Internal Revenue Code would be included as property of the estate. Under the House version, H.R. 3804, contributions made with the intent to hinder, delay or defraud creditors under Section 548(a)(1) of the Bankruptcy Code within such one-year period would be included as property of the estate.

The authors urge enactment of either S. 1985 or H.R. 3804, to the extent that such proposed law would generally exclude ERISA-plan as-

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90. H.R. 3804.
91. S. 1985.

sets from property of the estate under Section 541. As between the limitations regarding the one-year period preceding filing contained in S. 1985 and those of H.R. 3804, the authors strongly recommend the former, which establishes a more predictable and precise formula for the limitation than the "intent to defraud" standard of Section 548(a)(1) of the Bankruptcy Code.

Of course, neither proposal would prevent states from attempting to negate the effect of the one-year "preference" period by permitting a debtor to exempt all contributions made with the one-year period under a state exemption scheme enacted pursuant to Section 522(b)(2)(A). In this limited area, the preemption controversy may continue. Therefore, the authors further suggest that the enacted legislation prohibit the states from encroaching on the one-year "preference" period pursuant to Section 522(b)(2)(A).

VII. CONCLUSION

A pension plan is often a person's most significant asset, and can determine whether she or he will have the means to lead a decent life after she or he is no longer able to work. There are few if any assets for which certainty following a bankruptcy filing is more required. The present state of the law provides none of that certainty. The grant of *certiorari* by the U.S. Supreme Court in *Shumate v. Patterson* is not likely to resolve all of the issues which currently are unsettled. The present uncertainty can best be resolved by Congress' enacting S. 1985 and H.R. 3804, and the authors urge Congress to do so.