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ERISA Benefits Under the Bankruptcy Code and A New York Debtor's Rights

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ERISA BENEFITS UNDER THE BANKRUPTCY CODE AND A NEW YORK DEBTOR'S RIGHTS

INTRODUCTION

The Employee Retirement Income Security Act of 1974 ("ERISA")[1] is a federal regulatory scheme enacted to ensure the protection and preservation of private pension plans.[2] To encourage employers to participate in these plans, Congress coordinated various provisions of the Internal Revenue Code ("I.R.C.") with ERISA to provide favorable tax treatment.[3] As a result, recent years have seen tremendous growth in the number and size of ERISA-qualified benefit plans.[4]

Under ERISA, participants may not assign or alienate pension benefits.[5] The statute's complex framework protects pen-

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[1] Pub. L. No. 93-406, tit. I, § 2, 88 Stat. 832 (codified at 29 U.S.C. § 1001-1461 (1985)).

[2] Congress enacted ERISA "in the interests of employees and their beneficiaries, and to provide for the general welfare and the free flow of commerce, that disclosure be made and safeguards be provided with respect to the establishment, operation, and administration of [employee benefit] plans." 29 U.S.C. § 1001(a).

[3] The I.R.C. affords ERISA plans as well as other qualified retirement plans favorable tax treatment. I.R.C. section 401(a) permits employers to deduct contributions to a trust made exclusively for the benefit of employees. A trust that qualifies under I.R.C. section 401 is exempt from taxation under I.R.C. section 501(a). In addition, qualified plans must contain provisions restricting the assignment and alienation of plan benefits. 26 U.S.C. § 401(a)(13) (1986). This section is almost identical to ERISA's section 206(d). *See infra* note 5.

[4] Assets held in private pension funds grew from $153 billion dollars in 1970 to $1,986 trillion dollars in 1989. UNITED STATES DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES, table 597 (111th ed. 1991).

[5] ERISA provides:

> 1) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.
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> 2) For the purpose of paragraph (1) of this subsection, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment, or of any irrevocable assignment or alienation of benefits executed before September 2, 1974. The preceding sentence shall not apply to any assignment or alienation made for the purposes of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 of Title 26 (relating to tax on pro-

sion assets by limiting the ways both employers and employees can use the assets. In addition, qualified plan benefits cannot be subject to a garnishment proceeding by a judgment creditor in satisfaction of a debt. State laws that otherwise permit garnishment are preempted by ERISA, either by operation of the anti-alienation or the anti-assignment provision,[6] or by ERISA's own mandate that it must supersede all state laws relating to qualified plans.[7] The combined purpose of these statutory restraints is to ensure that benefits due employees or their families would not be extinguished by garnishment proceedings before retirement and would not be subject to different treatment from state to state.[8]

The increased number of ERISA plans parallels the explosion of personal bankruptcies in the United States.[9] Because many bankruptcy proceedings involve pension funds,[10] a ques-

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hibited transactions) by reason of section 4975(d)(1) of Title 26.

ERISA § 206(d), 29 U.S.C. § 1056(d) (1985 & Supp. 1990). However, a voluntary revocable assignment of up to 10% of benefit payments is permitted. ERISA § 206(d)(2), 29 U.S.C. § 1056(d)(2).

[6] Several courts have held that ERISA's assignment and alienation provisions create a general federal exemption for qualified plans from the claims of creditors. *In re* Graham, 726 F.2d 1268, 1270-71 (8th Cir. 1984), *citing* Commercial Mortgage Ins., Inc. v. Citizens Nat'l Bank of Dallas, 526 F. Supp. 510, 516-518 (N.D. Tex. 1981). Further, the Supreme Court's decision in Guidry v. Sheet Metal Workers Pension Fund, 493 U.S. 365 (1990), made clear that placing pension benefits in a constructive trust after a finding that the recipient was embezzling pension funds is prohibited by the anti-alienation and anti-assignment provisions found in ERISA section 206(d)(1).

[7] ERISA preempts state law as follows:

> Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter *shall supersede any and 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.

29 U.S.C. § 1144(a) (West Supp. 1991) (emphasis added).

[8] One of the purposes of ERISA is to expand private retirement plans and "increase the number of participants receiving private retirement benefits." H.R. REP. No. 533, 93rd Cong., 2d Sess., at 2, *reprinted in* 1974 U.S.C.C.A.N. 4639, 4640. *See also, In re* Wimmer, 121 B.R. 539, 541 (C.D. Ill. 1990) ("To insure national uniformity in employee benefit laws, Section 1144(a) of ERISA provides that ERISA shall supersede any and all state laws insofar as they may relate to any employee benefit plan.").

[9] The number of bankruptcy petitions filed in the United States increased from 360,329 in 1981 to 642,993 in 1989, a 78% increase. Of petitions filed in 1989, 457,240 (71%) sought relief under Chapter 7 of the Bankruptcy Code. UNITED STATES DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES, table 884 (111th Edition 1991).

[10] For the purposes of deciding whether ERISA pension funds are included in the bankruptcy estate, this Note will refer only to the Chapter 7 bankruptcy proceedings of individual debtors.

tion frequently raised is whether these funds are subject to creditors' claims—as the Bankruptcy Reform Act of 1978,[11] with its broad definition of a debtor's estate, seems to imply—or whether these funds should be exempted under ERISA. On the one hand, under the Bankruptcy Code, a debtor's estate[12] includes all legal and equitable interests of a debtor.[13] Typically included in the estate are cash, other accounts readily accessible by the debtor,[14] real property held solely or jointly by the debtor or a partnership interest.[15] In addition, payments to the debtor, although received after bankruptcy, may be included in the estate to the extent that they represent pre-bankruptcy earnings or property.[16] Thus, assets in pension plans arguably fall within the definition of property of the estate.[17]

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[11] Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified in 11 U.S.C. §§ 101-1330 (1990). (hereinafter Bankruptcy Code or Code.))

[12] Filing a bankruptcy petition creates an estate that is comprised of all legal "and equitable interests of the debtor in property at the commencement of the case." 11 U.S.C. § 541(a)(1) (1990).

[13] *Id.*

[14] Such accounts could include Individual Retirement Accounts (I.R.A.) or Keogh plans. An I.R.A. is an account established by an employee not covered by a governmental or employer-sponsored retirement plan to make annual tax-deductible contributions for his or her future benefit. I.R.C. § 408 (1988). To obtain tax benefits, a trust or custodial account must be established. The trustee must be either a bank, another person, or an organization that meets Internal Revenue Service qualifications. Similarly, a Keogh plan allows a self-employed individual to establish a qualified pension or profit sharing plan in order to obtain favorable tax incentives. I.R.C. § 401(a)(13). Both of these plans allow the settlor (the creator of the trust or account) to reach the corpus (body) of the trust upon the imposition of a penalty, usually tax disqualification. Because the debtor is permitted immediate access to funds upon the payment of a penalty, such accounts have been held to be akin to a savings plan. *In re* Kramer, 128 B.R. 707 (Bankr. E.D.N.Y. 1991), *infra* note 160, following *In re* Iacono, 120 B.R. 691 (Bankr. E.D.N.Y. 1990), *infra* note 117.

[15] Intangibles are also included in the estate. Section 541(a) sweeps broadly, and can include the debtor's rights in a commercial or residential lease, a copyright or trademark, or a contract to supply goods or services. *See, e.g.*, Matter of Fugazy, 124 B.R. 426, 430 (Bankr. S.D.N.Y. 1991) (FCC license held by debtor is property of the estate); *In re* Johann, 125 B.R. 679, 682 (Bankr. M.D. Fla. 1991) (proprietary rights and technology related to computer software are included as property of the estate); *In re* Family Health Services, Inc., 105 B.R. 937, 943 (Bankr. C.D. Cal. 1989) (debtor's good will and contracts with subscribers are property of the estate); *In re* Altchek, 124 B.R. 944, 956 (Bankr. S.D.N.Y. 1991) (income from debtor's partnership interest is property of the estate).

[16] 11 U.S.C. § 541(a)(6). For example, post-petition payments from a pension or profit sharing plan, earned or accumulated by the debtor prior to bankruptcy, are included in the estate. They may later be exempted through section 522(d) of the Code. *See infra* note 18 and accompanying text.

[17] 11 U.S.C. section 541(c)(2) creates a narrow exception by excluding certain prop-

On the other hand, once the estate has been determined, certain property initially included may later be exempted through federal or state statutory schemes.[18] The Code allows a debtor to retain those assets necessary for his or her own use after the conclusion of the bankruptcy proceeding. By this method, a debtor is afforded the opportunity for a "fresh start"[19] upon a discharge from pre-petition debts—an essential goal of the Bankruptcy Code.[20] Furthermore, in light of ERISA's

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erty from the estate. By enacting this subsection, Congress sought to preserve restrictions on the transfer of the debtor's interest in a spendthrift trust to the extent that the restriction is also recognized by state law. *See infra* note 34 and accompanying text. Property thus excluded cannot be reached by creditors. Whether ERISA's restrictions on transfers are also included within the scope of section 541(c)(2) will be addressed in Part I of this Note.

[18] Under section 522 of the Code, the debtor may exempt certain property that would otherwise be subject to the claims of creditors. Section 522(b) allows the debtor to choose between a series of exemptions prescribed by the Code in subsection (d), and those state law exemptions offered to a debtor by the State in which he or she is domiciled. For example, a debtor utilizing the federal exemptions would be permitted to exempt his or her interest in a homestead, a motor vehicle, household goods, furnishings, clothing, and other items held primarily for personal use. Specified payments to the debtor for injury, wrongful death, life insurance, or workers' compensation may also be exempted to the extent reasonably necessary for the debtor's support. 11 U.S.C. § 522(d)(1-11). A debtor choosing to utilize his or her state exemptions would be permitted to exempt only property in accordance with that state's particular exemption schedule. Assuming that most debtors would choose the more generous list of exemptions, the amount of property left after discharge could vary from state to state, even when prebankruptcy assets were equal. Further, if the debtor chooses the state exemptions, section 522(b)(2)(A) allows the debtor to exempt property that is exempt "under Federal law" other than that listed in subsection (d).

The Code also allows a state to dictate that debtors in that state use the state exemption scheme. 11 U.S.C. § 522(b)(1). States that do not allow debtors to choose the Code's exemptions are said to have "opted out" of the federal exemption scheme, a path New York has followed. N.Y. DEBT. & CRED. LAW § 284 (McKinney 1990). The opt-out provision found in the Code has been challenged based on arguments that it usurps Congress's power to establish uniform laws on bankruptcies and that it impermissibly delegates such powers to the states. The provision has been upheld. Matter of Sullivan, 680 F.2d 1131 (7th Cir. 1982).

[19] Segal v. Rochelle, 382 U.S. 375, 380 (1966). Before *Segal*, the Court held that "[i]t is the twofold purpose of the Bankruptcy Act to convert the estate of the bankrupt into cash and distribute it among creditors and then to give the bankrupt a fresh start with such exemptions and rights as the statute left untouched." Burlingham v. Crouse, 228 U.S. 459, 473 (1913).

[20] Congress's intent regarding bankruptcy exemptions is expressed as follows:

> 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 not be left destitute and a public charge . . . [the bill] adopts the position that there is a Federal interest in seeing that a debtor that goes through bankruptcy

limits on the alteration of pension funds, a strong argument can be made that such funds are exempt from the estate for bankruptcy proceedings. This apparent conflict between the Bankruptcy Code and ERISA has divided the courts of appeals, leading to inconsistent judicial treatment of pension benefits.[21] Although the Supreme Court recently considered the strength of ERISA's anti-alienation provisions in a narrower context,[22] the status of an ERISA-qualified pension plan in bankruptcy has

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comes out with adequate possessions to begin his fresh start.

H.R. REP. No. 595, 95th Cong., 1st Sess. 126, *reprinted in* 1978 U.S.C.C.A.N. 5787, 6087.

[21] *See In re* Coffman, 125 B.R. 238, 239 (Bankr. W.D. Mo. 1991) (agreeing with the majority view expressed by the Eighth Circuit in *In re* Graham, 726 F.2d 1268 (8th Cir. 1984), the court noted the "minefield of conflicting decisions" within the Western District of Missouri alone). *Compare In re* Williams, 118 B.R. 812, 815 (Bankr. N.D. Fla. 1990) (Florida statute § 222.21 that provides an exemption for retirement plans qualified under I.R.C. § 401 & § 403, does not "relate to" ERISA for preemption purposes), *with In re* Smith, 123 B.R. 423, 427 (Bankr. M.D. Fla. 1990) (debtors' ERISA plan could not be exempted pursuant to *Fla. Stat.* § 221.21; state statute sufficiently related to ERISA and could not survive preemption).

[22] Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365 (1990). Guidry was a former union official of the Sheet Metal Workers International Association. He also served as a trustee of the union's pension fund. As a result of his employment he was eligible to receive benefits from three ERISA-qualified pension funds. In 1981 an investigation by the Department of Labor revealed that Guidry had embezzled more than $377,000 from the union. He was subsequently convicted of embezzlement, and two of the plans refused to pay his accrued benefits, asserting that he had forfeited his right to receive benefits as a result of his criminal conduct. Alternatively, the Union argued that if Guidry's right to benefits still existed, those benefits should have been paid directly to the Union, rather than to Guidry. The Union sought the imposition of a constructive trust, imposed by equity (as opposed to an ordinary trust intentionally established by the settlor for his or another's benefit). *Id.* at 368.

The Supreme Court rejected the Union's argument. In reversing both the Court of Appeals and the District Court, the Court upheld ERISA's prohibition on the assignment or alienation of pension benefits, thereby mandating the payment of benefits. Despite the compelling circumstances, the Court also declined to impose a constructive trust on the pension funds in favor of the Union since this would circumvent the protective, anti-garnishment procedures of ERISA. *Id.* at 376. Instead, the Court cited the goals of ERISA to protect pension funds and the interests of beneficiaries from any type of garnishment: "[C]ertain broad social policies sometimes take precedence over the desire to do equity between particular parties." *Id. Guidry*, however, did not involve a bankruptcy proceeding, and therefore ERISA's protective anti-alienation provisions were not considered in relation to the Bankruptcy Code. *See also* Ellis Nat'l Bank of Jacksonville v. Irving Trust Co., 786 F.2d 466 (2d Cir. 1986) (ERISA's anti-alienation provisions did not allow employer to reclaim, through imposition of constructive trust, monies embezzled by employee); Vink v. SHV North America Holding Corp., 549 F. Supp. 268 (S.D.N.Y. 1982) (former employer could not refuse to pay ERISA benefits to plan beneficiary, despite the fact that beneficiary, a former employee, was convicted of defrauding company).

not yet been determined. The majority of courts have held that ERISA plans are included in a debtor's estate and thus subject to the claims of creditors.[23] A minority of courts have interpreted the Bankruptcy Code to exclude such plans entirely, based on ERISA's mandatory transfer restrictions.[24] While New York courts have adhered to the majority view, the New York State Assembly recently enacted legislation offering generous treatment of benefit plans to achieve the minority's exclusionary result.[25] This Note reviews both the majority and minority lines of cases and argues that despite many sound arguments of the minority view, the majority interpretation achieves a more equitable result.

Part I of this Note discusses recent judicial treatment of ERISA-qualified pension plans by both the majority and the minority interpretations. This Note argues that the majority properly adheres to congressional intent by viewing the conflict between the two federal statutes strictly within the bankruptcy context. Accordingly, this Note finds the Bankruptcy Code to take priority over ERISA. The minority, on the other hand, promotes the goals of ERISA by sacrificing the meaning and intent behind the Code. Part II of this Note examines the treatment of a New York debtor's pension plan under recent amendments to the state's exemptions law. In seeking to protect the pensions of self-employed individuals, the New York legislature has ignored both the rights of creditors and the clear potential for abuse created by the statute. More importantly, there is a likelihood of federal preemption from two sources that has been purposefully overlooked. The New York law may be found to conflict with both ERISA and the Bankruptcy Code, and may be superseded by both statutory schemes.

Finally, this Note concludes that the majority view is the

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[23] *In re* Swanson, 873 F.2d 1121 (8th Cir. 1989); *In re* Daniel, 771 F.2d 1352 (9th Cir. 1985); *In re* Lichstrahl, 750 F.2d 1488 (11th Cir. 1985); *In re* Graham, 726 F.2d at 1273; *In re* Goff, 706 F.2d 574 (5th Cir. 1983); *In re* Ross, 691 F.2d 81 (2d Cir. 1982).

[24] Velis v. Kardanis, 949 F.2d 78 (3d Cir. 1991); Shumate v. Patterson, 943 F.2d 362 (4th Cir. 1991); *In re* Lucas, 924 F.2d 597 (6th Cir. 1991); *In re* Moore, 907 F.2d 1476 (4th Cir. 1990); *In re* Komet, 104 B.R. 799 (Bankr. W.D. Tex. 1989); *In re* Ralstin, 61 B.R. 502 (Bankr. D. Kan. 1986); *In re* Mosley, 42 B.R. 181 (Bankr. D.N.J. 1984); *In re* Threewitt, 24 B.R. 927 (Bankr. D. Kan. 1982).

[25] N.Y. CIV. PRAC. L. & R. § 5205(c) (McKinney 1990) and N.Y. DEBT. & CRED. LAW § 282(2)(e) (McKinney 1990) were both amended effective July, 1989. These amendments are discussed in Part II of this Note.

better approach and that the New York legislature has adopted an overly generous view of such plans. The likely result of the New York statute will be either an abuse of the bankruptcy process by debtors who seek to shelter excess income from the claims of creditors, or the statute's invalidation by operation of ERISA or by courts in an effort to curb such abuse.

I. Property of the Estate

Section 541 of the Bankruptcy Code provides that the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[26] The bankruptcy estate also includes property, "notwithstanding any provision that restricts or conditions transfer of such interest by the debtor."[27] The legislative history of this section indicates that Congress intended the statutory definition of property of the estate to be overly broad so as to promote the efficient distribution of assets to creditors in satisfaction of pre-petition debts.[28] Such a definition seems to indicate that once the debtor has an interest in any type of property, it will be automatically included in the estate upon bankruptcy.

There is, however, an exception to section 541(c)(1)(A)'s broad inclusion of property in the estate. 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."[29] Therefore, if "applicable nonbankruptcy law" imposes a restriction on the transfer of the debtor's interest in a trust, this interest may be excluded from the bankruptcy estate. While most courts have interpreted restrictive trust provisions without difficulty,[30] many have expressed divergent views regarding the ref-

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[26] 11 U.S.C. § 541(a)(1) (1982).

[27] 11 U.S.C. § 541(c)(1)(A) (1982).

[28] "The scope of this paragraph is broad . . . it includes as property of the estate all property of the debtor, even that needed for a fresh start." H.R. Rep. No. 595, 95th Cong., 2d Sess. 367-68 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6323-24. By drawing a line between the debtor's assets at the moment of bankruptcy and those acquired post-petition, the Code promotes the goal of satisfying creditors' claims while still allowing the debtor to retain newly acquired property that is necessary to the "bankrupt's ability to make an unencumbered fresh start." Segal v. Rochelle, 382 U.S. 375, 380 (1966). *See supra* note 19 and accompanying text.

[29] 11 U.S.C. § 541(c)(2) (1982).

[30] Many trusts commonly contain restrictions that prohibit the transfer of the bene-

erence to "applicable nonbankruptcy law."[31] Should ERISA, with its prohibitions against alienation and assignment, be included as "applicable nonbankruptcy law" within the meaning of section 541(c)(2), thus making ERISA funds part of the debtor's estate and subject to creditors' claims?

A. *The Majority View*

The majority of courts have included ERISA-qualified pension plans in the bankruptcy estate.[32] These courts have held that the reference to "applicable nonbankruptcy law" is unclear and have looked to the legislative history of section 541(c)(2) to ascertain congressional intent.[33] These courts have concluded that Congress intended the statute only to apply to "traditional" spendthrift trusts.[34] A spendthrift trust is a trust established and funded by one person for the benefit of another, with restrictions on the beneficiary's control. Such restrictions often consist of a valid restraint, imposed by the terms of the trust or

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ficiary's interest, except upon certain conditions. For example, a retirement plan, whether self-settled or not, may mandate the payment of a tax or interest penalty upon early withdrawal. In addition, the alienation of any part of a trust—through voluntary assignment or involuntary garnishment—may be prohibited except upon a showing of hardship or termination of employment. *See infra* note 53 and accompanying text. The above restrictions usually give the debtor some control.

[31] *See supra* note 21 and accompanying text.

[32] The Second, Fifth, Seventh, Eighth, Ninth and Eleventh Circuits have interpreted ERISA plans as property of a debtor's estate. *See In re* Ross, 691 F.2d 81 (2d Cir. 1982); Matter of Brooks, 844 F.2d 258 (5th Cir. 1988); *In re* Goff, 706 F.2d 574 (5th Cir. 1983); Matter of LeFeber, 906 F.2d 330 (7th Cir. 1990); *In re* Newman, 903 F.2d 1150 (7th Cir. 1990); *In re* Graham, 726 F.2d 1268 (8th Cir. 1984); *In re* Kincaid, 917 F.2d 1162 (9th Cir. 1990); *In re* Daniel, 771 F.2d 1352 (9th Cir. 1985); *In re* Lichstrahl, 750 F.2d 1488 (11th Cir. 1985). The First and Tenth Circuits have not yet rendered a decision on this question.

[33] Many courts have found § 541(c)(2) unclear as a result of the statutory conflict between ERISA's anti-alienation provision (11 U.S.C. § 1056(d)), the Bankruptcy Code's broad inclusion of property in the estate for the benefit of creditors (11 U.S.C. § 541(a)(1)), and ERISA's preemptive provision, that mandates that ERISA must yield to all other federal laws (29 U.S.C. § 1144(d)). This is discussed in section B of part II of this Note.

[34] The House Report to the 1978 Code states in part:

> Subsection (c) invalidates restrictions on the transfer of property of the debtor, in order that all of the interests of the debtor in property will become property of the estate . . . . Paragraph (2) of subsection (c), however, preserves restrictions on a transfer of a *spendthrift trust* to the extent that the restriction is enforceable under applicable nonbankruptcy law.

H.R. REP. No. 595, 95th Cong., 2d Sess. 369 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6325 (emphasis added).

by statute, prohibiting alienation of the beneficiary's interest.[35] Concededly, ERISA's non-alienation and non-assignment provisions are valid against creditors under state law.[36] Most ERISA plans, however, provide for the voluntary participation and contribution of the debtor. Consequently, courts consider ERISA plans to be self-settled and therefore do not include ERISA within the class of "spendthrift" trusts.[37]

Many courts have looked to other Code provisions to determine the congressional intent behind section 541(c)(2). Of particular interest is the specific reference to pension plans found in section 522—the exemptions section of the Code. Section 522(d)(10)(E) provides:

> EXEMPTIONS. (d) The following property may be exempted under subsection (b)(1) of this section:

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[35] A spendthrift trust is defined as: "A trust in which by the terms of the trust or by statute a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed." RESTATEMENT (SECOND) OF TRUSTS § 152(2), at 311 (1959). In contrast, a trust established and funded by the beneficiary is considered a self-settled trust. An I.R.A. or Keogh plan is an example of a self-settled trust. *See supra* note 14 and accompanying text. Traditionally self-settled trusts have been considered nonspendthrift because they are ineffective as against creditors: "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(1), at 326. *See also supra* note 30 and accompanying text.

[36] These anti-alienation provisions were tested in Guidry v. Sheet Metal Workers National Pension Fund, 493 U.S. 365 (1990). In *Guidry* the Supreme Court upheld ERISA's anti-alienation prohibitions in a nonbankruptcy context. The court refused to impose a constructive trust on a beneficiary's pension benefits in favor of a judgment creditor. *See supra* note 22 and accompanying text.

[37] An example of a self-settled trust would include both an IRA and a Keogh plan. *See supra* note 14 and accompanying text. These trusts are typically not included within the rather narrow class of spendthrift trusts. The leading case in this area is *In re* Goff, 706 F.2d 574 (5th Cir. 1983). *Goff* involved the exclusion or exemption of a Keogh trust valued at more than $90,000, established and funded by the debtors. Three days before filing bankruptcy the debtors deposited $2,878 into their Keogh account in an attempt to prevent the creditors' access to the funds. The Fifth Circuit refused to exclude any part of the account from the estate. First, it held that section 541(c)(2) of the Bankruptcy Code should be construed as a narrow reference to state spendthrift trust law that does not include ERISA and all other laws. Second, it found that the Goffs were able to exercise total control over the funds, which were also self-settled. For these reasons, the Keogh trust could not qualify under state spendthrift trust law for exclusion under section 541(c)(2). *Id.* at 580. Although *Goff* involved an IRA, it also set forth clear rules for Keogh and ERISA plans. For an example of a trust with sufficient restrictions to qualify as spendthrift, see *In re* Kreiss, 72 B.R. 933 (Bankr. E.D.N.Y. 1987) (trust established by debtor's father, providing for payments to be made within sole discretion of trustee, restricted debtor's rights to alienate or assign funds, and was excluded from estate under section 541(c)(2)).

> (10) The debtor's right to receive-
> (E) A payment under a stock bonus, *pension*, profit-sharing, annuity, *or similar plan or contract* . . . to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.[38]

Many courts see this Code provision to indicate Congress's intent to deal with ERISA-qualified plans *only* through the exemption process.[39] These courts reason that if all ERISA plans were excluded through section 541(c)(2), then the statutory provision specifically exempting a debtor's pension plan would be rendered meaningless.[40]

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[38] 11 U.S.C. § 522(d)(10)(E) (1982) (emphasis added).

[39] A debtor's exemptions are set forth under section 522 of the Code. Section 522 provides two basic options by which the debtor can exempt property that is included in the estate. He or she can choose (1) the federal exemptions set forth under subsection (d); or (2) the exemptions allowed under state law, and in addition may exempt other property which is exempt under "other federal law." 11 U.S.C. § 522(b)(2)(A).

The federal exemptions enumerated in subsection (d) permit a limited exemption for pension benefits to the extent reasonably necessary for the support of the debtor and the debtor's dependents. 11 U.S.C. § 522(d)(10)(E). Nevertheless, many debtors seek a full exemption for their ERISA plan under section 522(b)(2)(A), contending that ERISA's anti-garnishment provisions qualify as "other federal law" under which pension plans are exempt from garnishment or attachment. *See supra* note 5 and accompanying text. Should ERISA be included under section 522(b)(2)(A) as "other federal law," a debtor could retain 100% of his or her vested interest from creditors without raising the issue of whether ERISA constitutes applicable nonbankruptcy law under section 541(c)(2).

Most courts, though, do not interpret ERISA as "other federal law" so as to allow a total exemption in bankruptcy because ERISA is not included in the "laundry list" of federal exemptions contained in the House and Senate Reports to the Bankruptcy Reform Act of 1978. *See Goff*, 706 F.2d at 582-585, *citing* S. REP. No. 989, 95th Cong. 2d Sess. at 75 (1978), *reprinted in* 1978 U.S.C.C.A.N 5861; H.R. REP. No. 595, 95th Cong. 2d Sess. 360 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6316. These courts reason that if the legislative history of section 522(b)(2)(A) of the Code explicitly *omits* ERISA, then the more ambiguous language of section 541(c)(2) would hardly include it by implication. *Goff*, 706 F.2d at 582-86. *See In re* Daniel, 771 F.2d at 1361 ("The failure to mention ERISA in the legislative history accompanying section 522(b)(2)(A) is, therefore, both purposeful and reasoned.").

Despite the prevalence of such decisions, a growing minority of courts allow this exemption because they see the list in the House and Senate Reports to the Bankruptcy Reform Act as a laundry list of illustrative, not exhaustive, exceptions. These courts define ERISA as "other federal law" within the meaning of section 522(b)(2)(A), and therefore allow ERISA's total exemption at the debtor's option. *See In re* Starkey, 116 B.R. 259, 264-65 (Bankr. D. Colo. 1990); *In re* Komet, 104 B.R. 799, 805-8 (Bankr. W.D. Tex. 1989). An in-depth analysis of the exemption process for ERISA plans is beyond the scope of this Note. For an excellent discussion of whether ERISA deserves its own "federal law" exemption under the Code, see Note, *Exemption of ERISA Benefits Under Section 522(b)(2)(A) of the Bankruptcy Code*, 83 MICH. L. REV. 214 (1984).

[40] *See, e.g., In re* Swanson, 873 F.2d 1121, 1124 (8th Cir. 1989) ("if section 541(c)(2)

In addition to relying on the legislative history and other Code provisions to limit section 541(c)(2) to spendthrift trusts, courts supporting the inclusion of ERISA in bankruptcy estates often compare the spirit and overall purpose of an ERISA plan to that of a traditional spendthrift trust.[41] ERISA section 206(d)

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were construed to exclude retirement funds from the bankruptcy estate then [section 522(d)(10)(E)(iii)] that provides a limited federal exemption for these funds would be rendered meaningless"); *In re* Graham, 726 F.2d at 1272 ("the question of pension rights is dealt with as a matter of *exemption*" (emphasis added)); *In re* Goff, 706 F.2d at 585 (the specific reference to pension plans found in section 522(d)(10)(E)(iii) of the Bankruptcy Code demonstrates that Congress did not "overlook" ERISA in the drafting of other Code provisions); Regan v. Ross, 691 F.2d 81, 86 (2d Cir. 1982) ("an exemption for pension benefits . . . would be surplusage if the benefits were not meant to be property of the estate"); Employee Benefits Comm. v. Tabor, 127 B.R. 194, 198 (Bankr. S.D. Ind. 1991) (Congress did not intend to exclude ERISA from the estate given the fact that § 522(d)(10)(E) expressly provides for a partial exemption of ERISA pension plans); *In re* Kazi, 125 B.R. 981, 984 (Bankr. S.D. Ill. 1991) ("The Bankruptcy Code specifically provides that pension benefits may be *exempted*, 11 U.S.C. § 522(d)(10)(E), 'clearly indicating that they were intended and assumed to be part of the estate' " in *In re* Graham, 726 F.2d at 1272); *In re* McIntosh, 116 B.R. 277, 278 (Bankr. N.D. Okl. 1990) (interpreting section 541(c)(2) to exclude all ERISA-qualified plans would render 11 U.S.C. § 522(d)(10)(E) meaningless; if Congress had intended to exclude all ERISA plans from the bankruptcy estate there would have been no need for such plans to be expressly included in the federal exemption scheme).

Some courts, however, oppose this view. Instead these courts reason that the possibility of an overlap between two Code sections is perfectly permissible, and does not flout congressional mandates regarding property of the estate. *In re* Majul, 119 B.R. 118, 123 (Bankr. W.D. Tex. 1990); *In re* Pruitt, 30 B.R. 330, 331-332 (Bankr. D. Colo. 1983); *In re* Threewitt, 24 B.R. at 930. These courts find that any overlap between various Code provisions concerning ERISA would result in either: (1) the full exclusion of ERISA plans under section 541(c)(2) by virtue of their restrictions on transfer; (2) a partial exemption under section 522(d)(10)(E) as a pension plan; or (3) a full exemption under section 522(b)(2)(A) as a separate nonbankruptcy federal exemption. *In re* Suarez, 127 B.R. 73, 81 (Bankr. S.D. Fla. 1991).

[41] Unlike a classic spendthrift trust that prohibits alienation or control of benefits, ERISA allows the debtor access to benefits. Under 29 U.S.C. § 1056(d)(2), the debtor may voluntarily assign up to 10% of his or her ERISA benefit payments, and may borrow from the plan, so long as the loan is secured by the participant's vested interest. Such access is, however, conditioned on the loss of favorable tax status. I.R.C. § 501(a). Were ERISA plans true spendthrift trusts, such access would not be allowed. The majority thus views ERISA section 206(d)(1)'s prohibition against alienation as a provision that merely "restricts or conditions transfer of" the debtor's interest based upon the debtor's desire for favorable tax treatment. Such a clause will not preclude the inclusion of the trust in the bankruptcy estate under section 541(c)(2). 11 U.S.C. § 541(c)(1)(A). *See In re* Kazi, 125 B.R. at 985 (only true spendthrift trusts are to be excluded from the estate under section 541(c)(2); state law that excludes ERISA plans from property of the estate frustrates the intent underlying section 541(c)(2) of the Bankruptcy Code); *In re* Knowles, 123 B.R. 428 (Bankr. M.D. Fla. 1991) (dominion and control exercised by debtor over retirement plan, as opposed to spendthrift trust, is ultimate question in deciding whether retirement plans should be excluded from estate); *In re* Smith, 115 B.R.

merely requires non-alienation and non-assignment of funds to qualify for favorable tax treatment.[42] The beneficiary retains the power to reach the entire balance of funds.[43] In contrast, a spendthrift trust forbids alienation of the trust's assets under any circumstances and distributes only a specified percent of the trust to the beneficiary, who has no control over the remainder.[44] Therefore, courts favoring a literal interpretation of section 541(c)(2) often conclude that a retirement plan will be excluded as a traditional spendthrift trust only when there is a *total* absence of control by the debtor over the plan's assets.[45]

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144 (Bankr. C.D. Ill. 1990) (the power of a beneficiary to compel total distribution of the corpus is antithetical to the nature of a spendthrift trust); *In re* McLean, 41 B.R. 893 (Bankr. D.S.C. 1984), *rev'd*, McLean v. Central States, Southeast and Southwest Areas Pension Fund (*In re* McLean), 762 F.2d 1204, 1208 (4th Cir. 1985) ("while a classic spendthrift trust does not allow a beneficiary to transfer any portion of his interest in the trust, ERISA specifically allows a beneficiary of a qualified pension plan to voluntarily assign up to ten percent of any benefit payment").

[42] 29 U.S.C. § 1056(d)(1) (West Supp. 1991). *See supra* note 5 and accompanying text.

[43] Concededly, an ERISA-qualified plan must contain a provision prohibiting alienation or assignment of benefits to qualify for favorable tax treatment. However, the plan may also contain different conditions under which the beneficiary is permitted to reach his or her vested interest. Most retirement plans either include a borrowing provision requiring payback of any loans from the plan, or require a showing of hardship, or threatened loss of tax benefits, for the beneficiary to reach the funds prematurely. All of these conditions, although restrictive, still allow the debtor access to the funds. *See Goff*, 706 F.2d at 585; *supra* note 30 and accompanying text.

[44] The *Goff* court defined a spendthrift trust as:

> a trust created to provide a fund for the maintenance of a beneficiary, with only a certain portion of the total amount to be distributed at any one time. The settlor places "spendthrift" restrictions on the trust, which operate in most states to place the fund beyond the reach of the beneficiary's creditors, as well as to secure the fund against the beneficiary's own improvidence.

706 F.2d at 580.

[45] The ability of a debtor to reach his or her entire interest in a retirement plan has been cited most often as the dispositive factor in classifying the plan—whether as an ERISA plan or not. A line of cases has developed espousing this stricter view: *In re* Jordan, 914 F.2d 197 (9th Cir. 1990) (trust containing restrictions against assignment and alienation, created to compensate debtor for personal injury claim, was considered self-settled by debtor's consent to trust's creation, and therefore could not be considered spendthrift trust under state law); *In re* Swanson, 873 F.2d at 1124 (statutory restrictions on a Teachers' Retirement Fund did not qualify fund as a traditional spendthrift trust under Minnesota law despite restrictive language akin to that found in most spendthrift trusts); *In re* Graham, 726 F.2d at 1272; *In re* Silldorff, 96 B.R. at 859 (debtor's ability to quit job and receive lump sum distribution from pension plan constituted sufficient control to disqualify plan as spendthrift trust under Illinois law); *In re* Ridenour, 45 B.R. 72, 78 (Bankr. E.D. Tenn. 1984) (legislative history of § 541(c)(2) mandates a narrow reading of the statute to exclude only those ERISA-qualified pension plans that

Some recent appellate decisions, however, suggest that this view may be too narrow. While accepting the majority view that Congress had spendthrift trusts in mind when promulgating section 541(c)(2), these courts have examined a particular plan or trust to determine whether it qualifies as a "non-traditional" spendthrift trust under nonbankruptcy law.[46] Courts favoring this more lenient interpretation have excluded ERISA plans from bankruptcy estates, so long as access to debtors is severely limited.[47]

The Ninth Circuit recently espoused this more flexible interpretation of an ERISA plan in *In re Kincaid*.[48] In *Kincaid* the debtor had an interest in a 401(k) deferred salary plan in which she voluntarily chose to participate.[49] Contributions to the plan were made by both the debtor and her employer.[50] At the time of bankruptcy, the debtor claimed an exemption in her ERISA plan and the bankruptcy court sustained an objection by the trustee. The plan administrator, however, subsequently denied a request to turn over the funds to the trustee.[51] The bank-

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constitute valid spendthrift trusts under state law).

[46] *In re* Goff, 706 F.2d at 587. *Goff* interpreted section 541(c)(2) as referring to traditional state spendthrift trusts only. However, the Keogh plan at issue in that case could still have qualified for exclusion from the estate if it fell within the spendthrift trust definition provided by state law. *See also In re* McIntosh, 116 B.R. at 273; *In re* Starkey, 116 B.R. at 262.

[47] The ability of an individual debtor to gain access to a trust has been cited most often as the key factor in classifying the plan, whether ERISA-qualified or not. Morter v. Farm Credit Servs., 937 F.2d 354, 357-358 (7th Cir. 1991); *In re* Knowles, 123 B.R. 428 (Bankr. M.D. Fla. 1991).

[48] 917 F.2d 1162 (9th Cir. 1990).

[49] The I.R.C. provides favorable tax treatment for funds deposited in trusts that are subject to certain specified restrictions on alienation or withdrawal. 26 U.S.C. §§ 401(a)(13), (k).

[50] Contributions to the plan were made in three ways: a 2% reduction in employee compensation, supplemental amounts contributed by the employee and a specified matching amount donated by the employer that could equal up to 50% of the reduction in employee compensation. *Kincaid*, 917 F.2d at 1164.

[51] The plan administrator argued that the Plan was not property of the estate, relying on the Supreme Court's broad interpretation of ERISA's preemptive provisions. *Id.* at 1166, *citing* Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987). In *Pilot Life* the Supreme Court held that ERISA's preemptive provision, 29 U.S.C. § 1144(a), should be construed broadly to preempt "any and all state laws" relating to ERISA plans. 481 U.S. at 41. Under this construction, ERISA superseded all state laws that would otherwise subject a qualified plan to inclusion in the bankruptcy estate. In *Kincaid* the plan administrator refused the turnover request, arguing that state spendthrift law also related to ERISA and was therefore preempted. He contended that an ERISA-governed plan could not be subject to the requirements of state spendthrift law to determine whether

ruptcy court ruled in favor of the trustee and the bankruptcy appellate panel affirmed.[52] The panel held that the plan's anti-alienation provisions alone did not qualify the plan as a spendthrift trust because the debtor was allowed access to the funds under certain conditions.[53] Moreover, because the plan was partially funded by the debtor's voluntary contributions, the court held it to be self-settled in nature. Therefore, the court held that the plan could not qualify for spendthrift status under applicable nonbankruptcy law.[54]

The Ninth Circuit disagreed.[55] Recognizing the conflict between ERISA and the Bankruptcy Code,[56] the court opted to

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the debtor's interest entered the estate because that very law was preempted and invalidated by virtue of ERISA. *Kincaid*, 917 F.2d at 1166.

[52] *In re* Kincaid, 96 B.R. 1014, 1016 (B.A.P. 9th Cir. 1989).

[53] Kincaid was allowed to reach the corpus of the trust upon retirement, attainment of age 59½, disability, death or termination of service. Withdrawals could be made only upon a showing of hardship that the Plan defined as "immediate and heavy financial need . . . of a Participant or his dependents." *Id.* at 1015-16.

[54] Self-settled trusts are not considered spendthrift trusts. *See supra* note 35 and accompanying text.

[55] *Kincaid*, 917 F.2d at 1163.

[56] The court noted an incongruous result in the following: before bankruptcy, ERISA's anti-alienation provisions protect a debtor's interest in a retirement plan. Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365 (1990). However, the restrictions accompanying other types of self-settled trusts, such as IRAs and Keogh plans, do not offer such absolute protection against garnishment or transfer. *See supra* note 14 and accompanying text. In contrast, only state spendthrift law will protect debtors both before and in bankruptcy. *Kincaid*, 917 F.2d at 1166; 11 U.S.C. § 541(c)(2). Under such circumstances, protection of ERISA plans would depend upon whether the plan could qualify under the spendthrift trust law of individual states. For example, two debtors live on opposite sides of a state line and work for the same employer. Both participate in the same ERISA-qualified plan. Both file Chapter 7 bankruptcy petitions in their respective districts. One state recognizes and enforces the restrictions on spendthrift trusts as against creditors. The other state neither recognizes nor protects spendthrift trusts. The debtor domiciled in the first state will be entitled to preserve her interest in bankruptcy; the debtor domiciled in the second state will be afforded no protection for her interest under state law, ERISA or the Bankruptcy Code. Such unequal treatment of identical property would be in contravention to the goals of the Bankruptcy Code, and would oppose the constitutional grant of power to Congress to establish *uniform* laws on bankruptcy. U.S. CONST. art. I § 8, cl. 4. Moreover, this result also weakens the effect of ERISA's state preemptive provisions that were enacted to ensure *national* uniformity with respect to pension rights and obligations. *See* Fort Halifax Packing Co. v. Coyne, 482 U.S. 1 (1987); 29 U.S.C. § 1001(a), note 2 *supra*.

An alternative view to the above quandary is found in the Code itself. When the bankruptcy estate is created, the Bankruptcy Code explicitly looks to state law to determine the debtor's interest in property. 11 U.S.C. § 541(a)(1). Accordingly, if state spendthrift law in one jurisdiction differs in its definition of a spendthrift trust from another jurisdiction, the Code must respect each definition in bankruptcy.

examine the nature of the plan and its restrictions, rather than draw a line at the debtor's voluntary participation and contributions. The issue, according to the Ninth Circuit, was whether the plan could meet the *standard* of a spendthrift trust. The threshold inquiry, therefore, was whether the trust was self-settled.[57]

The court held that the ERISA plan was *not* self-settled, despite both the debtor's voluntary participation and prior case law to the contrary.[58] Noting the plan's restrictions, the court observed that "the employee does not have the right to the funds contributed to the Plan at any time prior to their contribution . . . . Moreover, the amount contributed never belongs to the employee . . . . Therefore, the trust was not self-settled."[59] The debtor's access was also severely limited once the funds were contributed. The plan allowed distribution of a participant's interest only upon death, attainment of age 59½, disability, retirement or termination of employment.[60]

The Ninth Circuit acknowledged that some courts, mindful of debtors' interests in sheltering assets from creditors, find that *any* voluntary action by a debtor to gain access to a trust, including leaving one's employment, destroys the spendthrift character of the trust.[61] But the court declined to follow this interpretation. It found the ramifications of having to leave one's job

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[57] *Kincaid*, 917 F.2d at 1167.

[58] The Ninth Circuit had previously considered this issue in *In re* Daniel, 771 F.2d 1352, 1360 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986). In *Daniel* the court held that "the phrase 'applicable nonbankruptcy law' in 11 U.S.C. § 541(c)(2) was intended to be a narrow reference to *state* 'spendthrift' trust law and not a broad reference to *all* other laws, including ERISA and IRC, which prohibit alienation." *Daniel*, 771 F.2d at 1360 (emphasis in original).

[59] *Kincaid*, 917 F.2d at 1167.

[60] *Id.* The court also considered the fact that Kincaid's only access to the funds was under the loan or hardship provisions, and even this access was solely within the discretion of the plan administrator. Therefore, she was able to exercise very little, if any, dominion or control over the trust, including the extent of her own contributions. *Id.* at 1168. *See also In re* Bartlett, 116 B.R. 1015, 1020 (Bankr. S.D. Iowa 1990) (plan's restrictions that rendered debtor unable to demand any distribution of her interest qualified the plan as a spendthrift trust under state law.).

[61] When an employee participates in an employer-sponsored retirement plan, the funds can be reached upon the termination of the employer-employee relationship (for example, upon the debtor's retirement or resignation). The contributions previously made to the fund by the employee may now be fully withdrawn. Because there is some way the debtor can gain full and unrestricted access to his vested interest—even if the debtor does not intend to do so—bankruptcy courts have considered such plans self-settled and subject to the beneficiary's control. *Kincaid*, 917 F.2d at 1168 (citing *In re* Silldorff, 96 B.R. 859, 863 (Bankr. C.D. Ill. 1989)).

to gain access to retirement funds sufficient to deter abuse by debtors seeking to shield assets through the bankruptcy process.[62] Thus, since the plan sufficiently restricted the debtor's control to make it akin to a spendthrift trust, the court excluded the plan's funds from the bankruptcy estate.[63]

In many ways, the *Kincaid* analysis clearly produces an equitable result. The debtor's interest is placed beyond the reach of her creditors by the same restrictions that placed it beyond the reach of the debtor. Dishonest debtors are prevented from excluding the bulk of their assets from the reach of creditors by placing restrictions on their transfer while the debtors themselves continue to exercise total dominion and control.[64] At the

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[62] The court mused that even debtors *intending* to shelter assets through their retirement plans would not quit their jobs to do so since this would be a "rather drastic step" to take. *Id.* at 1168.

[63] *Id.* The Seventh Circuit is of the same opinion as the Ninth Circuit. In *In re* LeFeber, 906 F.2d 330, 331 (7th Cir. 1990), decided three months before *Kincaid,* the Seventh Circuit excluded a debtor's pension plan under section 541(c)(2) as a spendthrift trust. The debtor received a $1,000 monthly payment from an ERISA-qualified pension plan that contained restrictions in compliance with 29 U.S.C. § 1056(d). These limitations barred him from assigning the right to receive benefits. However, an exception permitted him to make a revocable assignment of 10% of his benefits. The plan's absolute restriction on 90% of the pension benefits clearly fell within section 541(c)(2). The more difficult question was whether the debtor's ability to assign the remaining 10% of his benefits destroyed the spendthrift aspect of the trust. The Seventh Circuit held that "a revocable assignment is no better than no assignment at all," and therefore the debtor really had no right to assign or otherwise alienate his own pension benefits. *Id.* Indiana spendthrift law, therefore, applied to the benefits, and the debtor's monthly payments were excluded from the estate. *Id. See also In re* Bartlett, 116 B.R. 1015 (Bankr. S.D. Iowa 1990) (debtor's retirement plan excluded as a spendthrift trust under section 541(c)(2) because restrictions could impose up to 25 year wait for debtor's interest to be turned over to trustee).

[64] This type of abuse has become more prevalent in recent years as the level of debtor sophistication grows. Wealthy professionals with substantial incomes form professional corporations and establish retirement plans for themselves that contain restrictive provisions. They subsequently file bankruptcy petitions to discharge debts incurred through business ventures, while at the same time sheltering the bulk of their assets in pension plans, IRAs and Keogh accounts. These debtors then claim that the funds are not property of the bankruptcy estate because the Code enforces the restrictions on transfer that the debtor imposed upon his own interest. Bankruptcy courts will seldom allow this, however. One of the leading cases in this area is *In re* Goff, 706 F.2d 574 (5th Cir. 1983), *supra* note 37. Other examples of attempts at excluding a self-settled fund posing as a retirement plan are *In re* Velis, 109 B.R. 64 (D.N.J. 1991), *aff'd in part, rev'd in part sub nom,* Velis v. Kardanis, 949 F.2d 78 (3d Cir. 1991), and *In re* White, 61 B.R. 388 (Bankr. W.D. Wash. 1986). For an analysis of this topic, see Charles R. Sterbach, et al., *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 (1989).

same time, this interpretation does not penalize honest debtors who stumble into bankruptcy, by allowing their retirement funds to become fair game for creditors.[65]

B. *The Minority View*

A minority of courts have excluded ERISA-qualified pension plans from a debtor's bankruptcy estate. These courts hold that section 541(c)(2)'s reference to "applicable nonbankruptcy law" includes ERISA, thereby excluding any and all ERISA pensions by virtue of the restrictions on their transfer.[66] Rather

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[65] A debtor may still opt to exempt his or her retirement interest under section 522(d)(10)(E) of the Code—an alternative that the *Kincaid* court failed to consider. 11 U.S.C. § 522 (d)(10)(E). This provision allows the debtor whose pension is included in the estate to retain an amount reasonably necessary for his or her support and for the support of dependents while, at the same time, permitting creditors to get at any excess funds in the debtor's pension fund, and thus a few more cents on the dollar. The "reasonably necessary" exemption is built into the Code through section 522 (d)(10)(E). *See supra* note 39 and accompanying text. Had the *Kincaid* plan been included in the bankruptcy estate, the debtors would still have had the option of utilizing this limited exemption. For an excellent example of the way courts interpret the "reasonably necessary" standard, compare *In re* Donaghy, 11 B.R. 677 (Bankr. S.D.N.Y. 1981) (taking into account the special needs of elderly and infirm debtors) with *In re* Taff, 10 B.R. 101 (Bankr. D. Conn. 1981) ("reasonably necessary" standard requires court to take into account debtor's basic needs, not related to his or her former status in society or the lifestyle to which the debtor was accustomed prior to bankruptcy.) *But see In re* McGoy, 86 B.R. 174, 176 (Bankr. E.D. Mo. 1988) (debtor's claimed exemption for stock bonus payments, received prior to bankruptcy, was not allowed; debtor's "right to receive" payment was extinguished at time of payment prior to bankruptcy; distinguishing and limiting *Donaghy* to its facts).

A debtor who resides in an opt-out state, however, will not have the option of choosing the section 522(d) exemptions. Instead, these debtors must rely on the exemptions provided by their own states for debtors in bankruptcy. The granting to states of the right to "opt-out" of the federal exemption scheme has been subject to constitutional attacks, but has been upheld. *In re* Sullivan, 680 F.2d 1131 (7th Cir.), *cert. denied*, 459 U.S. 992 (1982). For a closer look at the plight faced by debtors in opt-out states that do not recognize the section 522 exemptions, see Sterbach, *supra* note 64, at 250-51.

The *Kincaid* court further suggested that ERISA-qualified plans still deserve greater protection in bankruptcy; the mere opportunity to meet the requirements of state spendthrift law is simply not enough. Judge Fletcher's thoughtful concurrence found it "unthinkable that Congress intended to eviscerate in this manner so much of the protection granted benefit plans under ERISA." *Kincaid*, 917 F.2d at 1170. Instead, she viewed the ERISA-mandated restrictions as sufficient by themselves to exclude the debtor's interest from the estate. *Id.* at 1167. The concurrence would reject the Ninth Circuit's prior opinion in *Daniel*, that limited applicable nonbankruptcy law to state spendthrift trust law only, and would adopt the view espoused in *In re* Moore, 907 F.2d 1476 (4th Cir. 1990), *infra* note 72.

[66] The following cases have held that the anti-alienation and anti-garnishment provisions of ERISA, 29 U.S.C. § 1056(d), are enforceable in bankruptcy: Forbes v. Holiday

than resort to legislative history, courts adopting this position rely on section 541(c)(2)'s plain language, holding that it unambiguously includes "all laws, state and federal, under which a transfer restriction is enforceable."[67]

The Fourth Circuit recently expressed this view in *In re Moore*.[68] The debtors in *Moore* participated in an ERISA-qualified pension and profit-sharing plan maintained by their employer. The trustee for the bankruptcy estate brought suit against the plan administrator to compel him to turn over the debtors' interests in the plan as assets of the estate. The trustee argued that since the plan was not a spendthrift trust under governing state law, the debtors' interests were part of the bankruptcy estate.[69] Both the bankruptcy court and the district court held that ERISA's restrictions on transfer were enforceable in bankruptcy and therefore were not subject to inclusion in the

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Corp. Sav. & Ret. Plan, 111 S.Ct. 2275 (1991); Velis v. Kardanis, 949 F.2d 78 (3d Cir. 1991); Shumate v. Patterson, 943 F.2d 362 (4th Cir. 1991); *In re* Lucas, 924 F.2d 597 (6th Cir.), *cert. denied sub nom.*, Forbes v. Holiday Corp. Sav. & Ret. Plan, 111 S.Ct 2275 (1991); *In re* Moore, 907 F.2d 1476 (4th Cir. 1990); *In re* Wyles, 123 B.R. 733 (Bankr. E.D. Va. 1991); *In re* Idalski, 123 B.R. 222 (Bankr. E.D. Mich. 1991); *In re* Cheaver, 121 B.R. 665 (Bankr. D.D.C. 1990); *In re* Majul, 119 B.R. 118 (Bankr. W.D. Tex. 1990); *In re* Pruitt, 30 B.R. 330 (Bankr. D. Colo. 1983); *In re* Threewitt, 24 B.R. 927 (Bankr. D. Kan. 1982).

[67] The Sixth Circuit recently held that section 541(c)(2) is clear and unambiguous, and includes "all laws, state and federal." *In re* Lucas, 924 F.2d at 601 (citing *Moore*, 907 F.2d at 1477). This includes the entire federal statutory scheme of ERISA. This notion was expressed much earlier in *In re* Pruitt: "When a statute is clear on its face there is no need to resort to legislative history." 30 B.R. at 331.

[68] *In re* Moore, 907 F.2d at 1476. The Sixth Circuit's decision in *In re* Lucas is more recent. *Lucas* involved a debtor's $2,000 vested interest in an employer-sponsored retirement account qualified under I.R.C. sections 401(a) and (k). The debtor claimed the funds exempt based on their ERISA qualifications. The bankruptcy and district courts held that the section 541(c)(2) exclusion applied to spendthrift trusts only, and because it was conceded that the debtor's plan was not such a trust, it was included in the estate. The Sixth Circuit reversed, relying on *Moore*, and rejected the majority view that relied on legislative history to reach a narrow view of section 541(c)(2). *In re* Lucas, 924 F.2d at 601. *See also* Shumate v. Patterson, 943 F.2d 362, 365 (4th Cir. 1991).

Although both *Lucas* and *Shumate* are more recent opinions, this Note will analyze *Moore*, since the *Lucas* and *Shumate* courts rely heavily on *Moore* for their holdings. In addition, the Third Circuit has now adopted the minority view. In Velis v. Kardanis, 949 F.2d 78, 83 (3d Cir. 1991), the court held that qualified pension and Keogh plans and IRAs may be excluded from the bankruptcy estate. This holding reversed bankruptcy and district court decisions that specifically included such plans in the debtor's estate. *See supra* note 64 and accompanying text.

[69] Because the Plan was governed by the laws of South Carolina, it had to meet the requirements of South Carolina spendthrift trust law. *In re* Moore, 907 F.2d at 1477.

estate.[70]

The Fourth Circuit affirmed, holding that the language of section 541(c)(2) is plain and unambiguous: it excludes *all* beneficial interests of the debtor subject to a restriction that is enforceable outside of bankruptcy.[71] Such plain and unambiguous statutory language made resort to legislative history "inappropriate."[72] Moreover, even if the legislative history were consulted, it would be inconclusive. The court found that although the United States House and Senate Reports referred to spendthrift trust restrictions as preserved under the Bankruptcy Code, they merely suggested that Congress intended to *include* state spendthrift restrictions within the statute.[73] There was no further evidence that Congress intended such a reference in the legislative history to mean that "applicable nonbankruptcy law" was *exclusively* limited to state spendthrift law.[74]

After interpreting the statute broadly to include ERISA, the court next considered the ERISA-mandated restrictions on transfer to determine whether they were enforceable outside of

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[70] *Id.*

[71] *Id.*

[72] The *Moore* court held that "the language of section 541(c)(2) is clear," and therefore the legislative history was "irrelevant" and any reference to it was considered "inappropriate." *Id.* at 1478. Further, even if the legislative history were relevant, the court noted that Congress enacted only the language found in section 541(c)(2) itself, exclusive of any accompanying legislative reports. No authority was vested in the court by virtue of the above language to limit a clear statute "by recourse to the views of a legislative subgroup." *Id.* at 1479.

[73] 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." H.R. REP. No. 595, 95th Cong., 2d Sess. 369 (1977), *reprinted in* 1978 U.S.C.C.A.N 5963, 6325. The Senate Report uses identical language. *See* S. REP. No. 989, 95th Cong., 2d Sess. 83 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5869.

[74] *In re* Moore, 907 F.2d at 1478, 1479. The court viewed the majority's construction of section 541(c)(2) as narrow and inconsistent, since the phrase "applicable nonbankruptcy law" was given a broader interpretation in numerous other sections of the Bankruptcy Code. Because the Code was enacted as a single comprehensive statutory scheme, it would be "incongruous to give the same phrase in section 541(c)(2) a narrower construction than the identical phrase in other parts of the Bankruptcy Code." Moreover, "[i]f Congress had intended section 541(c)(2) to only apply to state spendthrift trusts, the term 'spendthrift trust' would have appeared in the statute, rather than the phrase 'applicable nonbankruptcy law'." *Id.* (citing *In re* Ralstin, 61 B.R. 502, 503 (Bankr. D. Kan. 1986)).

In addition, *Moore* was not the first instance in which the Fourth Circuit had considered this issue. *See* McLean v. Central States, Southeast & Southwest Areas Pension Fund, 762 F.2d 1204, 1207 n.1 (4th Cir. 1985)(declining to apply a restrictive interpretation of section 541(c)(2) as well).

bankruptcy. The anti-alienation and anti-assignment provisions[75] of the plan clearly prevented general creditors and debtors from reaching the body of the trust. ERISA therefore constituted the "applicable nonbankruptcy law" under which restrictions on the transfer of pension interests may be enforced.[76]

To support its above analysis, the court then turned to the policy rationale of ERISA, noting that one of Congress's main purposes in enacting the statute was to ensure the uniform treatment of pension benefits throughout the country.[77] If such benefits were not uniformly protected in bankruptcy, a state that did not protect or even recognize spendthrift trusts could nullify ERISA's anti-alienation provisions—a result that clearly goes against ERISA's preemptive thrust.[78] Moreover, the alienation of ERISA benefits, even for the purpose of turnover to a bankruptcy trustee, threatened the loss of the favorable tax status accorded trusts satisfying I.R.C. mandates.[79] Such a result could have serious and far-reaching consequences. Should an

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[75] 29 U.S.C. §§ 1056(d)(1), (2). *See supra* note 5 and accompanying text.

[76] *In re* Moore, 907 F.2d at 1480. Courts that have adopted the minority view acknowledge the majority view that section 522(d)(10)(E)'s specific exemption for pension plans mandates ERISA's inclusion in the bankruptcy estate. The minority argues, however, that the mere existence of an overlap between those trusts included in section 541(c)(2) and those included in section 522(d)(10)(E) was not indicative of any intent to include ERISA in the estate. Rather, such an overlap was perfectly permissible. In drafting a statutory scheme with many separate provisions like the Bankruptcy Code, Congress could not be expected to account for every overlap. McLean v. Central States, Southeast and Southwest Areas Pension Fund (*In re* McLean), 762 F.2d 1204, 1208 (4th Cir. 1985), *rev'g In re* McLean, 41 B.R. 893 (D.S.C. 1984) (construing section 541(c)(2) to exclude pension interests from estate property does not undercut exemption provision of section 522(d)(10)(E)); *In re* Idalski, 123 B.R. 222, 231 (Bankr. E.D. Mich. 1991) (nothing remarkable about section 522(d)'s exemption of pension plans would include plans already excluded from the estate under section 541(c)(2)); *In re* Majul, 119 B.R. 118, 123 (Bankr. W.D. Tex. 1990) (the alleged inconsistency found in the overlap between section 541(c)(2) and section 522(d)(10)(E) was "not a valid basis to conclude that Congress intended to include self-settled ERISA pension benefits in the bankruptcy estate").

[77] "ERISA was designed to ensure that substantive pension benefits not be subject to the vagaries of state law." *In re* Moore, 907 F.2d at 1480 (citing PPG Indus. Pension Plan A v. Crews, 902 F.2d 1148 (4th Cir. 1990)).

[78] Further support for enforcing ERISA's anti-alienation provisions is provided by the recent Supreme court decision in Guidry v. Sheet Metal Workers Pension Fund, 493 U.S. 365 (1990). In addition, Ellis National Bank of Jacksonville v. Irving Trust Co., 786 F.2d 466 (2d Cir. 1986), supports the Supreme Court's later view in *Guidry* that the anti-alienation provision of 29 U.S.C. § 1056(d) is not to be disturbed, regardless of the surrounding circumstances. *See supra* note 22 and accompanying text.

[79] *See supra* note 3 and accompanying text.

ERISA plan lose its tax-free status by virtue of one participant's bankruptcy, innocent pension beneficiaries as well as the debtor could be penalized, again in contravention of the policies underlying ERISA.[80]

C. *A Critique of the Minority View*

Despite the fact that *Moore* concerns a bankruptcy proceeding, the statutory analysis espoused by the *Moore* court centers around ERISA's nonbankruptcy policy considerations. Much of the authority cited by the court concerns the garnishment of ERISA-qualified benefits by a commercial or third-party creditor, rather than a bankruptcy creditor.[81] These cases do not refer

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[80] The I.R.C. requires that all plans or trusts contain anti-alienation and anti-garnishment provisions to qualify for certain tax exempt status. I.R.C. § 401(a)(13). Plans that contain these provisions will be exempt from taxation. The alienation of ERISA benefits, even for the purpose of transferring funds to a bankruptcy trustee, could jeopardize the tax status of the entire plan. The loss of exempt status could result in the imposition of tax liability upon *all* participants, including innocent pension beneficiaries. Furthermore, plan administrators could be placed in the awkward position of having to choose between tax disqualification of an entire plan, and the imposition of sanctions for defying a bankruptcy court order for turnover. N.Y.S. Bar Association, Report No. 140, Approval of Bill introduced by Senator Dale M. Volker to amend C.P.L.R. § 5205(c)(d), April 13, 1989.

Moreover, the elimination of tax incentives may result in a decrease in ERISA participation throughout the country. *In re* Lucas, 924 F.2d 597, 603 (6th Cir. 1991); *In re* Moore, 907 F.2d at 1480-81; McLean v. Central States, Southeast & Southwest Areas Pension Fund, 762 F.2d 1204, 1206 (4th Cir. 1985); *In re* Majul, 119 B.R. 118, 124 (Bankr. W.D. Tex. 1990); *In re* Komet, 104 B.R. 799, 805 n.10 (Bankr. W.D. Tex. 1989). Congress specifically sought to prevent such a result by enacting both the anti-alienation and anti-garnishment provisions found in 29 U.S.C. §§ 1056 (d)(1), (2), ERISA § 206(d), and the preemptive provisions found in 29 U.S.C. § 1144(a) ERISA § 514(a). H.R. REP. No. 533, 93rd Cong., 2d Sess., *reprinted in* 1974 U.S.C.C.A.N. 4640, 4671, 4676.

Several courts have rejected this argument as a basis for the exclusion of ERISA benefits. Regan v. Ross, 691 F.2d 81, 87 (2d Cir. 1982) (Bankruptcy Code's inclusion of all debtor's property in the estate necessarily amended I.R.C. section 401(a)(13), resulting in no loss of tax status by virtue of turnover to a bankruptcy trustee); Employee Benefits Comm. v. Tabor, 127 B.R. 194, 201 (S.D. Ind. 1991) (potential loss of tax-exempt status is insufficient to shift the balance in the debtor-beneficiary's favor); *In re* Balay, 113 B.R. 429, 443 (Bankr. N.D. Ill. 1990) (court not persuaded by debtor's arguments that tax qualified status will be jeopardized by including ERISA in estate); *In re* DePiazza, 29 B.R. 916, 923 (Bankr. N.D. Ill. 1983) (refusing to recognize an IRS Private Letter ruling that an order to turnover benefits to a trustee would result in plan's disqualification under I.R.C. section 401(a)(13), instead holding that favorable tax treatment would still be derived even when ERISA benefits included in estate).

[81] Fort Halifax Packing Co. v. Coyne, 482 U.S. 1 (1987). In *Moore* the court cites Smith v. Mirman, 749 F.2d 181 (4th Cir. 1984); General Motors Corp. v. Buha, 623 F.2d 455 (6th Cir. 1980); and Tenneco, Inc. v. First Virginia Bank of Tidewater, 698 F.2d 688

to the treatment of ERISA under the Code.[82] Thus the *Moore* holding ignores the effect of federal bankruptcy law on other provisions of ERISA, notably section 514(d).

Section 514(d) is the preemptive provision of ERISA which provides that ERISA may not supersede any other federal laws.[83] As a result, where conflict exists between ERISA and federal bankruptcy law, the Bankruptcy Code must prevail.[84] If the Code's policy of enlarging and preserving a debtor's estate for the benefit of creditors clashes with ERISA's policy of protecting pension benefits,[85] ERISA itself mandates that it must yield to

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(4th Cir. 1983). Each of these cases enforced ERISA's restrictions on assignment and alienation of benefits in a nonbankruptcy setting. Accordingly, these courts addressed the effect of ERISA's preemptive provision on a creditor's state law rights only. 29 U.S.C. § 1144(a). The effect of ERISA on the operation of *federal* law, such as parties asserting a right to payment in the context of a bankruptcy proceeding, was not considered.

[82] The Supreme Court's enforcement of the anti-alienation provisions found in ERISA in favor of a dishonest pension beneficiary also took place within a nonbankruptcy setting. Guidry v. Sheet Metal Workers Pension Fund, 493 U.S. 365 (1990).

[83] *"Nothing in [ERISA] shall be construed to* alter, amend, modify, invalidate, impair, or *supersede any law of the United States* . . . or any rule or regulation issued under any such law." ERISA § 514(d), 29 U.S.C. § 1144(d) (1991)(emphasis added).

[84] "The policy of enlarging the bankruptcy estate to the maximum extent allowable under the Code is of paramount importance . . . ." *In re* Swanson, 873 F.2d 1121, 1124 (8th Cir. 1989). The Fifth Circuit also made this clear: "If a distinction is created by operation of bankruptcy law, which might conflict with ERISA, bankruptcy law prevails." *In re* Goff, 706 F.2d 574, 589 (5th Cir. 1983).

Unfortunately, there is a dearth of legislative history to indicate congressional intent regarding the conflict between ERISA and the Bankruptcy Code. The House and Senate Reports accompanying the 1974 enactment of ERISA refer only to ERISA's non-preemption of other federal laws. 29 U.S.C. § 1144(d). These reports could not make explicit reference to the Bankruptcy Code as the Code itself did not exist until 1978, four years later.

The Bankruptcy Code likewise contains no legislative history that speaks to the treatment of ERISA. Although the federal pension scheme was well known, Congress made no reference to it in drafting the Code, nor does the legislative history contain reference to ERISA, despite the specific mention of spendthrift trusts in the legislative history to section 541(c)(2). *See supra* notes 34, 40-41 and accompanying text. However, there may well have been no need for Congress to indicate ERISA's relationship to federal bankruptcy law at that time. The conflict between the two federal statutory schemes had not yet arisen, and could *not* have arisen, until *after* the Code's enactment. Indeed, the Code created the conflict—albeit unintentionally.

This Note takes the position that the failure of Congress to mention ERISA in the legislative history to the Code, while explicitly referring to "pensions" in the exemptions section, is dispositive. Congress intended to include ERISA in the estate, and to mandate that ERISA yield to the Bankruptcy Code. *See infra* note 86 and accompanying text.

[85] "This is not primarily a debtor's bill, however. The bill codifies creditors' rights more clearly than the case law, which is in many ways just developing. It defines the

the Bankruptcy Code.[86]

Finally, the minority view makes no provision for dishonest debtors who, despite substantial income, seek to shelter assets from their creditors through ERISA-qualified retirement plans. The minority would allow total exclusion of pension plans, merely because they are ERISA-qualified, by debtors who exercise so much control over these plans that the restrictions placed upon them to qualify under ERISA are meaningless. A recent and unfortunate repercussion of the *Moore* legacy is seen in *In re Wyles*.[87]

In *Wyles* the bankruptcy court faced the situation of a debtor who exercised unlimited control over a pension and profit sharing plan established by a corporation under his sole control. The debtor's vested interest totalled over $945,000. Under *Moore* the court was forced to enjoin the trustee from making any distribution from the plan, including to the creditors and the debtor himself, until the debtor would have had that right according to terms of the plan itself. This ruling resulted in the sheltering of nearly one million dollars from general creditors to the extent that ERISA's restrictions—imposed and amended by the debtor himself—prevented the creditor from reaching the funds.[88]

The Fourth Circuit's subsequent decision in *Shumate v. Patterson* is equally disturbing.[89] In *Shumate* the debtor was the president and chairman of the board of his employer, and

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protections to which a secured creditor is entitled, and the means through which the court may grant that protection." H.R. REP. No. 595, 95th Cong., 2d Sess. 5 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5966. *See also supra* note 28 and accompanying text.

[86] A bankruptcy case is governed exclusively by federal law. 28 U.S.C. § 1334(a). Therefore, all bankruptcy proceedings should trigger 29 U.S.C. § 1144(d) of ERISA, which mandates that ERISA may not invalidate or supersede other federal laws. Thus, any ERISA provisions that could be construed as opposing federal bankruptcy law must yield to it. *See In re* Swanson, 873 F.2d at 1124 ("We interpret § 541(c)(2) narrowly because a broad meaning would run afoul of the policies sought to be furthered through the Bankruptcy Code."); and *In re* Goff, 706 F.2d at 589 (if the operation of bankruptcy law conflicts with ERISA, bankruptcy law prevails). Of course, the mere existence of bankruptcy law does not affect the administration of ERISA as an entire federal statutory scheme. So long as ERISA's provisions do not supersede the Bankruptcy Code, the two federal laws can coexist.

[87] 123 B.R. 733 (Bankr. E.D. Va. 1991).

[88] These restrictions on distribution would last until the debtor reached the age of 59½ years. *Id.* at 736.

[89] 943 F.2d 362 (4th Cir. 1991).

controlled 96% of the voting stock. His vested interest in an ERISA-qualified retirement plan consisted solely of employer contributions valued at $250,000. He claimed that the plan was exempt and thus protected solely by virtue of ERISA. The district court held that "Shumate's control over the pension plan was so complete as not to qualify the pension plan for spendthrift status" under state law.[90] Hence, the plan was included in the estate. On appeal, the Fourth Circuit reversed. Citing *Moore*, the Fourth Circuit held that "the status of the plan as ERISA-qualified" excluded the debtor's interest from the bankruptcy estate.[91]

The blanket exclusion of all ERISA plans without further regard to individual circumstances may work an injustice to creditors and encourage abusive filings. The results in *Moore*, *Wyles* and *Shumate*, obtained by respecting ERISA's anti-alienation provisions in bankruptcy, also contravene the Bankruptcy Code's policy of *enlarging* the estate and treating creditors fairly[92]—results that Congress neither anticipated nor desired when enacting ERISA.[93] Thus, the minority view seeks to preserve congressional intent with regard to the protection of ERISA plans while concurrently disregarding congressional intent concerning the Bankruptcy Code.

[90] *Id.* at 363.

[91] *Id.* at 365.

[92] The Bankruptcy Code defines the property of the estate as "*all* legal and equitable interests of the debtor" at the moment of bankruptcy. 11 U.S.C. § 541 (emphasis added). Congress intended this Code provision to be construed broadly. *See supra* note 28 and accompanying text. Hence, a broad reading of section 541(c)(2) to include ERISA would oppose the goals of the Bankruptcy Code to enlarge the estate to the maximum extent allowed. *In re* Swanson, 873 F.2d 1121, 1124 (8th Cir. 1989).

In addition, Congress recognized that one of the main purposes of the Bankruptcy Act was to "assemble and liquidate [the debtor's] assets for distribution to creditors." H.R. REP. No. 595, 95th Cong., 2d Sess. at 10 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5971.

[93] The minority would allow ERISA's provisions to restrict the Bankruptcy Code's ability to enlarge the estate through the inclusion of pension and retirement benefits in order to repay creditors. Under this view, ERISA section 514(d) is again violated because ERISA is being administered in opposition to the Code. Finally, the minority fails to address the fact that Congress enacted the 1978 Bankruptcy Code four years *after* the 1974 enactment of ERISA. If a specific exclusion or federal exemption were intended for ERISA benefits, Congress could have easily so provided without the necessity of legislative inquiry.

II. The Spendthrift Presumption in New York

The inclusion of retirement and pension benefits in the bankruptcy estate has sparked controversy, even among those states that adhere to the majority view. First, this view strips debtors of their pensions merely because they sought the refuge of bankruptcy court.[94] More importantly, the majority view may penalize honest debtors by discouraging them from seeking the "fresh start" promised by the Code.[95] Nevertheless, with some notable exceptions, state bankruptcy courts have obediently followed higher courts' holdings that ERISA funds must be included in the bankruptcy estate.[96]

A few states, however, have reacted more aggressively. Rather than adhere to the strict majority view, they have instead opted to exclude retirement plans from the bankruptcy es-

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[94] It is important to remember that under the majority view, once an individual files a petition in bankruptcy court, his or her pension will be subject to the claims of creditors. But if the same debtor declined to file bankruptcy, and instead allowed creditors to pursue him or her via state law remedies, the pension benefits would be protected from a garnishment proceeding by ERISA's anti-assignment provision. 29 U.S.C. § 1056(d)(1). Guidry v. Sheet Metal Workers Pension Fund, 493 U.S. 365 (1990).

[95] Penalizing honest debtors who seek the safe harbor of the federal bankruptcy laws as a refuge from creditors and collection agencies contravenes the Bankruptcy Code's policy of providing a safe haven for debtors seeking a fresh start. *See supra* note 28 and accompanying text. However, such concern is speculative. There is no evidence that debtors have been discouraged from filing bankruptcy petitions since *In re* Goff first enunciated the majority view in 1983. 706 F.2d 574 (5th Cir. 1983). To the contrary, personal bankruptcy filings totalled 457,240, or 71%, of all bankruptcy petitions filed in 1989. This Note takes the position that those debtors who are discouraged from seeking the protection of federal bankruptcy court solely because their pensions will be deemed property of the estate may well have their good faith questioned.

[96] One such court that disagreed with the binding majority view was *In re* Brown, 130 B.R. 304 (Bankr. E.D. Mo. 1991):

> [T]his Court is compelled to follow established precedent and hold that the phrase "applicable nonbankruptcy law" contained in Section 541(c)(2) applies only to state spendthrift trust law and does not include ERISA . . . . This Court encourages the Eighth Circuit to reexamine its position on this issue based on the *Lucas* and *Moore* decisions.

Id. at 307-08 n.6.

Some lower courts, however, have felt so strongly about this issue that they have refused to include ERISA plans in the bankruptcy estate despite binding circuit court decisions to the contrary. *See In re* Suarez, 127 B.R. 73, 81 (Bankr. S.D. Fla. 1991) (holding ERISA to be applicable nonbankruptcy law and excluded under section 541(c)(2), or exempt under section 522(b)(2)(A) as other federal law); *In re* Majul, 119 B.R. 118 (Bankr. W.D. Tex. 1990) and *In re* Komet, 104 B.R. 799 (Bankr. W.D. Tex. 1989) (holding that ERISA-qualified pension plans are exempt from the bankruptcy estate despite the contrary view of the Fifth Circuit in *In re* Goff, 706 F.2d 574 (5th Cir. 1983)).

tate by enacting legislation specifically designed to protect ERISA-qualified and other types of employee benefit plans.[97] These states have chosen to protect a debtor's interest in a benefit plan—whether spendthrift or not—by labeling certain types of trusts or retirement plans "spendthrift." Bankruptcy courts adhering to the majority view are thereby forced to exclude benefit plans from the estate when interpreting section 541(c)(2)'s reference to "applicable nonbankruptcy law."[98] New York is one state that has enacted such statutory protection for retirement plans by amending its state exemption statute.[99]

The New York Civil Practice Law and Rules ("NYCPLR") was amended by the New York State legislature effective July 7, 1989.[100] The amendments reflect a desire to protect all retirement plans of debtors from the claims of creditors.[101] Although this section of New York law had previously set forth the requirements for state exemptions outside of bankruptcy, the 1989 amendments make specific reference to ERISA and other trusts and retirement plans, and their treatment *in bankruptcy*. In particular, the following provision was added to section 5205:

> (c) TRUST EXEMPTION. 3. All trust, custodial accounts, annuities, insurance contracts, monies, assets, or interests described in paragraph two of this subdivision *shall be conclusively presumed to be spendthrift trusts under this section* and the common law of the state of New

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[97] Prior to such enactments, more knowledgeable debtors would plan their pensions around existing law. *See supra* note 64 and accompanying text.

[98] *See supra* notes 33-34 and accompanying text.

[99] Article 52 of New York Civil Practice Laws and Rules ("NYCPLR") sets forth the nonbankruptcy exemptions allowed a debtor domiciled in New York. This Article was amended in July, 1989. This Note will examine the specific treatment of ERISA-qualified and other pension plans as set forth in section 5205(c) of Article 52, and the effect rendered by this statute in bankruptcy.

[100] 1989 N.Y. Laws Ch. 280, Assembly Bill A.6356-B, Senate Bill S.3909.

[101] Before the amendments, New York adhered to the majority view as expressed by the Second Circuit in Regan v. Ross, 691 F.2d 81 (2d Cir. 1982). *Regan* held that pension funds are included in the bankruptcy estate unless they are deemed a spendthrift trust. This appears to be the only Second Circuit decision on this issue. *See also In re* Kreiss, 72 B.R. 933, 942 (Bankr. E.D.N.Y. 1987); Matter of Hecht, 54 B.R. 379, 382 (Bankr. S.D.N.Y. 1985), *aff'd sub. nom.*, Togut v. Hecht, 69 B.R. 290, 291 (S.D.N.Y. 1987). Seven years after *Regan*, the New York legislature enacted identical amendments to the Civil Practice Law and Rules, and Estates, Powers and Trusts Law. These amendments mandated that spendthrift status be accorded certain qualified retirement plans for the purposes of rendering them exempt from the claims of creditors both in and outside of bankruptcy. N.Y. CIV. PRAC. L. & R. § 5205(c)(3) (McKinney 1990); N.Y. EST. POWERS & TRUSTS LAW §§ 7-3.1(b)(1), (2) (McKinney Supp. 1991).

> York for all purposes, *including*, but not limited to, *all cases arising under or related to a case arising under sections 101 to 1330 of title 11 of the United States Bankruptcy Code*, as amended.[102]

As a result, the same treatment formerly accorded beneficiaries of traditional spendthrift trusts is now granted to New York debtors, both in and out of bankruptcy, for their retirement plans. Qualified plans now enjoy statutory protection regardless of whether they are self-settled or indeed true spendthrift trusts.[103] To date, this conclusive presumption has been applied by two New York bankruptcy courts—in *In re Kleist*[104] and in *In re Iacono*[105]—with different results.

A. *The New York Cases*

In *Kleist* the debtor participated in a "Savings and Security Fund," a retirement plan sponsored by his employer.[106] The plan qualified for preferential tax treatment under the I.R.C.,[107] but withdrawals were allowed for any reason.[108] Kleist claimed

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[102] N.Y. Civ. Prac. L. & R. § 5205(c)(3) (McKinney 1990) (emphasis added). In addition, paragraph 2, to which this subsection refers, reads as follows:

> 2. For purposes of this subdivision, *all trusts*, custodial accounts, annuities, insurance contracts, monies, assets or interests established as part of, and all payments from, either a Keogh (HR-10), *retirement or other plan established by a corporation, which is qualified under section 401 of the United States Internal Revenue Code of 1986, as amended*, or created as a result of rollovers from such plans pursuant to sections 402(a)(5), 403(a)(4) or 408(d)(3) of the Internal Revenue Code of 1986, as amended, *shall be considered a trust which has been created by or which has proceeded from a person other than the judgment debtor*, even though such judgment debtor is (i) a self-employed individual, (ii) a partner of the entity sponsoring the Keogh (HR-10) plan, or (iii) a shareholder of the corporation sponsoring the retirement or other plan.

N.Y. Civ. Prac. L. & R. § 5205(c)(2) (McKinney 1990) (emphasis added).

[103] The interest of a beneficiary in a true spendthrift trust cannot be reached by his or her creditors. N.Y. Est. Powers & Trusts Law § 7-1.5(a)(1) (McKinney Supp. 1991). Traditionally, state spendthrift law has held that a self-settled trust, which benefits its creator, is ineffective or void as against existing or subsequent creditors of the creator. N.Y. Est. Powers & Trusts Law § 7-3.1(a) (McKinney Supp. 1991). Hence, because a self-settled trust cannot operate to exclude creditors, it may not be deemed a spendthrift trust.

[104] 114 B.R. 366 (Bankr. N.D.N.Y. 1990).

[105] 120 B.R. 691 (Bankr. E.D.N.Y. 1990).

[106] *Kleist*, 114 B.R. at 366.

[107] The Kleist plan qualified under section 401(a) of the I.R.C. It was not, however, ERISA-qualified. Therefore, ERISA's anti-alienation and preemptive provisions did not govern the administration of the plan.

[108] *Kleist*, 114 B.R. at 367. At the time of filing, the debtor's vested interest totalled

his entire vested interest was exempt under applicable law;[109] the trustee objected, arguing that the debtor's ability to reach all of the funds at any time made the plan akin to a savings plan and therefore not exempt as a pension for future support. The bankruptcy court agreed, holding that the state exemption was inapplicable to the *Kleist* plan.[110] The court nevertheless excluded the plan and in doing so addressed the exclusionary effect of amended section 5205(c).[111]

According to the *Kleist* court, the legislature dictated a mandatory interpretation by employing the phrase "conclusively presumed" in the statute. A court interpreting such statutory language[112] is left with little choice but to consider any trust falling within the statute's parameters as spendthrift.[113] The statute's broad language demonstrated the legislature's intent *not* to limit exclusion to spendthrift trusts and true retirement plans, but instead to protect other types of plans as well. The *Kleist* court reluctantly sheltered the plan under the broad statutory language and excluded it from the bankruptcy estate. It reasoned that to do otherwise in light of the amendment would usurp a legislative function. Nonetheless, the court expressed displeasure with the "bootstrapping" technique used by the New

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$11,971. He could therefore withdraw this entire amount the day before bankruptcy or, if exempt from the estate, the day after bankruptcy. However, the right of withdrawal was limited to once per year.

[109] New York has "opted out" of the federal exemption scheme set forth in the Code. N.Y. DEBT. & CRED. LAW § 284 (McKinney 1990). Therefore, instead of section 522(d) of the Code being "applicable law," the New York debtor must look to section 282 of New York Debtor and Creditor Law to exempt property from the estate. Section 282(2)(e) exempts pension plans as follows:

> 2. Bankruptcy exemption for right to receive benefits. The debtor's right to receive or the debtor's interest in . . . (e) all payments under a stock bonus, pension, profit sharing or similar plan or contract on account of illness, disability, death, age, or length of service unless (i) such plan or contract, except those qualified under section 401 of the United States Internal Revenue Code of 1986, as amended, was established by the debtor or under the auspices of an insider that employed the debtor.

N.Y. DEBT. & CRED. LAW § 282(2)(e) (McKinney 1990).

[110] *Kleist*, 114 B.R. at 368.

[111] Section 5205(c) was amended exactly two months before the Kleists filed their Chapter 7 bankruptcy petition. *Id.* at 369 n.2.

[112] *Kleist* noted that such a statutory presumption renders the existence of a fact irrebuttable. *Id.* at 369 (citing BLACK'S LAW DICTIONARY 1067 (5th ed. 1979)).

[113] Despite an "abundance of countervailing evidence," the statute forced the presumption that a trust was "spendthrift." *Id.* at 369.

York legislature to protect pension plans,[114] noting the potential for abuse by such a presumption.[115]

Although *Kleist* upheld the statute, subsequent courts addressing this issue have expressed general disapproval of such broad, artificially protective measures. Seven months after *Kleist*, another New York bankruptcy court made headlines[116] when it refused to interpret the same statute as including a debtor's individual retirement plan in *In re Iacono*.[117]

Iacono addressed the issue of whether an IRA is excluded or exempt in a chapter 7 bankruptcy proceeding.[118] The debtors, husband and wife, filed a joint petition under chapter 7 of the Code. They claimed that their IRA was exempt under prior New York case law.[119] But in a departure from precedent, the *Iacono* court refused to find that the IRA was automatically exempt,

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[114] The court observed:

> Congress has declared, through Code § 541(c)(2), that deference will be accorded to the respective state created boundaries defining spendthrift trusts. New York has exercised its prerogative by "bootstrapping," that is, statutorily placing certain property under the control of the debtor within the protection ordinarily provided only to trusts possessing traditional spendthrift qualities.

Id. at 370.

[115] The *Kleist* court opined:

> The potential for abuse created by the New York legislature's use of a "conclusive presumption" in this context, also a product of the 1989 amendments, is further troubling. It allows debtors to retain the freedom to withdraw their funds, while simultaneously insulating those assets from creditors. The effect of this dichotomous treatment appears, unfortunately, to subvert the policy underlying the state spendthrift trust law, as well as the United States Bankruptcy Code's intent.

Id. at 369-70 (citations omitted). Despite the court's doubts, the *Kleist* court included the Savings and Security Fund within the "other plan" language of the statute, apparently feeling helpless to do otherwise.

[116] Cerisse Anderson, *IRAs Ruled Subject to Creditors' Claims*, N.Y. L.J., Nov. 15, 1990, at 1.

[117] 120 B.R. 691 (Bankr. E.D.N.Y. 1990).

[118] An IRA is an individual retirement account. *See supra* note 14. These types of accounts were originally established to encourage individual employees with no other pension or retirement plans to establish savings for their future needs, while easing their present tax burden to enable them to do so. *Id.* at 693 (citing Pub. L. 93-406, 1974 U.S.C.C.A.N. 4639, 4791).

[119] The debtors relied on *In re* Fill 84 B.R. 332 (Bankr. S.D.N.Y. 1988). In *Fill* an IRA was assumed to be property of the estate. *Iacono* rejected such an assumption, instead opting to reexamine the statutes involved, especially in view of the recent amendments to both New York's Debtor and Creditor Law, and the NYCPLR. *Id.* at 694-95. At the time of bankruptcy, the amount of the Iaconos' IRA totalled $4,400.00. *Id.* at 692. This exemption was claimed pursuant to section 282(2)(e) of the New York Debtor and Creditor Law. *See supra* note 109 and accompanying text.

instead holding that the issue of whether an IRA was property of the estate was never fully decided in New York.[120] The court opted to reexamine an IRA's treatment under the relevant New York statutes to determine whether it was directly or indirectly protected.[121]

Under the New York Debtor and Creditor Law, personal property that is exempt under section 5205(c) of the NYCPLR will remain exempt in bankruptcy.[122] To be included under the broad protective umbrella of section 5205(c), an account must be "established as part of a retirement or other plan established by a corporation."[123] An IRA, clearly private and individual in nature, cannot qualify under this language because it is not established by a corporation. Moreover, an IRA cannot be excluded as a spendthrift trust because it is, in essence, a self-settled savings plan created by and for the debtor's benefit.[124] In addition, the

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[120] The debtors relied upon the *Fill* opinion that emphasized the standards applied by the bankruptcy court to decide the proper amount of retirement benefits reasonably necessary for the debtor's support. *See supra* note 119 and accompanying text. *Iacono* observed that the amended statute deleted the "reasonably necessary" language, thereby rendering a *Fill*-type analysis inapplicable. In addition, *Iacono* noted that the *Fill* court's automatic inclusion of IRA funds within the parameters of New York's exemption law was without any analysis or support. For that reason, an analysis supporting or denying the exclusion of such funds was now appropriate as it applied to the Iaconos. *Id.* at 694-95.

[121] New York Debtor and Creditor Law *directly* exempts a debtor's right to receive "all payments under a stock bonus, pension, profit sharing, or similar plan or contract on account of illness, disability, death, age or length of service." N.Y. DEBT. & CRED. LAW § 282(2)(e) (McKinney 1990). Therefore, for the Iaconos' IRA to be exempt, it would have had to qualify as a similar plan or contract. The court held that it did not. An *indirect* exemption would have applied to the IRA if it had been first exempt under section 5205(c) of the NYCPLR, because section 282 preserves as exempt all personal and real property that is already exempt from the claims of creditors under section 5205(c). *See infra* note 122 and accompanying text.

[122] New York Debtor and Creditor law provides:

> § 282. Permissible exemptions in bankruptcy.
>
> Under section five hundred twenty-two of title eleven of the United States Code, entitled "Bankruptcy," an individual debtor domiciled in this state may exempt from the property of the estate, to the extent permitted by subsection (b) thereof, only (i) personal and real property exempt from application to the satisfaction of money judgments under sections fifty-two hundred five and fifty-two hundred six of the civil practice law and rules.

N.Y. DEBT. & CRED. LAW § 282 (1984).

[123] N.Y. CIV. PRAC. L. & R. § 5205(c)(2) (McKinney Supp. 1990).

[124] *Iacono* compared an IRA to a traditional pension plan, observing that "the most compelling distinction is the [d]ebtors' ability to exercise complete control over the funds." Such total control by debtors is "clearly inapposite to the underlying policy of preserving the pension funds until retirement." *Iacono*, 120 B.R. at 694. This kind of

language in section 5205(c) contained no specific reference to IRAs, even though they were well known and widely popular at the time the statute was amended. The *Iacono* court concluded that the New York legislature had *not* intended to protect IRA-type retirement plans from creditors either in or out of bankruptcy.[125]

The *Kleist* and *Iacono* courts produced different results in applying the same statute to comparable retirement plans.[126] In each of their zealous analyses, however, both New York bankruptcy courts failed to address an obvious problem presented by the New York amendment: in passing a statute that by its own language applies to "all cases arising under or related to a case arising under . . . title 11 of the United States Bankruptcy Code," the New York legislature apparently overstepped federal constitutional boundaries.[127] This clear attempt by New York's legislature to establish rules that affect bankruptcies is in violation of the constitutional mandate that Congress alone "shall have the power to . . . establish uniform Laws on the subject of Bankruptcies throughout the United States."[128] Nonetheless, neither court declared the statute unconstitutional on its face, instead expressing concern about the effect of the statute in *dicta*.[129] However, in less than one year, another state's bank-

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control distinguished an IRA from the type of retirement plan that was traditionally exempt from the claims and excluded from the bankruptcy estate. *See supra* note 92 and accompanying text. Subsequent bankruptcy cases involving individual retirement plans have concurred with *Iacono*. *See, e.g., In re* Swenson, 130 B.R. 99 (Bankr. D. Utah 1991) (debtor's IRA did not fall within Utah's exemption for "annuity or other similar plan"); *In re* Kramer, 128 B.R. 707 (Bankr. E.D.N.Y. 1991). *See also* Sterbach, et. al., *supra* note 64, at 254-56.

[125] "This court believes that to construe the language of either section [§ 282(2)(e) or § 5205(c)] to include an IRA would clearly be judicial legislation." *Iacona*, 120 B.R. at 695.

[126] *Kleist* and *Iacono* did not analyze identical retirement plans in arriving at their respective conclusions. *Kleist* concerned an employer-sponsored retirement plan, whereas *Iacono* concerned an entirely self-created individual retirement account. For the purposes of this Note, however, both plans qualified for preferential tax treatment under I.R.C. § 401, contained no restrictions on assignment or alienation, allowed the debtors unrestricted access to funds and were viewed as being akin to a savings plan rather than funds intended for future maintenance. *In re* Kleist, 114 B.R. 366, 367-68 (Bankr. N.D.N.Y. 1990); *Iacono*, 120 B.R. at 693-94.

[127] N.Y. CIV. PRAC. L. & R. § 5205(c)(3).

[128] U.S. CONST., art. 1, § 8, cl. 4.

[129] *See supra* note 114 and accompanying text. This constitutional issue will be addressed in *In re* Wimmer, *infra* note 130.

ruptcy court picked up where New York left off. By mid-1991 an Illinois statute regarding trusts and retirement plans, similar to New York's section 5205(c), was at issue in *In re Wimmer.*[130] This Illinois decision may be the definitive pronouncement on state legislation in the bankruptcy area.

B. *The Illinois Approach*

Wimmer concerned the exclusion of an ERISA-qualified employee benefit plan from a chapter 7 bankruptcy estate. The debtor, Cynthia Sue Wimmer, had terminated her employment before bankruptcy and was therefore entitled to a lump sum distribution of her interest.[131] She claimed that the plan was protected as a spendthrift trust by virtue of an Illinois exemption statute[132] which provided that a retirement plan qualifying for favorable tax treatment would be "conclusively presumed to be a spendthrift trust" under state law.[133] Since the plan contained the requisite anti-alienation language to qualify for preferential tax treatment under the I.R.C., the debtor asserted that the plan should be treated as a spendthrift trust under state law and therefore excluded from the bankruptcy estate under section 541(c)(2)'s exception for spendthrift trusts.[134]

The Illinois bankruptcy court did not agree. Following the logic of *Iacono*, the court refused to apply the plain meaning of the statute, as amended, automatically. Instead, it looked at the overall effect of the statutory presumption and the legislative motivation behind the recent enactments.[135] The mandatory

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[130] 129 B.R. 563 (C.D. Ill. 1991), *aff'g*, 121 B.R. 539 (Bankr. C.D. Ill. 1990).

[131] At the time of bankruptcy, the debtor's interest in the plan totalled $8,526.92. Because no demand for distribution had been made prior to bankruptcy, this entire amount remained in the employee "thrift and savings plan." *Wimmer*, 129 B.R. at 565.

[132] ILL. REV. STAT. ch. 110 para. 12-1006(c) (1989).

[133] The Illinois statute provides:

> A retirement plan that is (i) intended in good faith to qualify as a retirement plan under the applicable provisions of the Internal Revenue Code of 1986, as now or hereafter amended, or (ii) a public employee pension plan created under the Illinois Pension Code, as now or hereafter amended, is conclusively presumed to be a spendthrift trust under the law of Illinois.

Wimmer, 121 B.R. at 542 (citing Illinois Code of Civil Procedure, ILL. REV. STAT. ch. 110 para. 12-1006(c) (1989)).

The above paragraph is nearly identical to the spendthrift presumption found in N.Y. CIV. PRAC. L. & R. § 5205(c)(3).

[134] *Wimmer*, 129 B.R. at 565-66; 121 B.R. at 542.

[135] The provisions of the Illinois statute at issue in *Wimmer* were amended August

spendthrift presumption that provided a blanket exclusion for pension plans sought to protect *all* pension plans of debtors in bankruptcy, whether or not the plans were true spendthrift trusts.[136] Conversely, a goal of the Bankruptcy Code is to expand the estate by gathering together assets of the debtor for distribution to creditors.[137] Given the conflict between the state statute and federal bankruptcy law, the *Wimmer* court found that enforcement of the Illinois spendthrift presumption would be out of the question; moreover, it would be unconstitutional.[138]

The Constitution vests Congress with the power to establish bankruptcy laws.[139] Because Congress has established exclusive federal jurisdiction over all bankruptcy proceedings,[140] the field has been preempted from state regulation.[141] The Illinois statute, with its broad reference to bankruptcy cases, regulates a material aspect of the bankruptcy proceeding: the determination of what property constitutes the bankruptcy estate.[142] State statutes that impose "conclusive presumptions" for cases arising under the Bankruptcy Code could therefore be seen as an impermissible attempt to usurp congressional power and authority.[143]

In addition to the State's attempt to regulate bankruptcies, the Illinois law was contrary to the Code itself. The enactment of a conclusive spendthrift presumption for the specific purpose of avoiding the inclusion of pension plans in the estate[144] undermined a primary goal of the Code to *enlarge* the amount of assets available to creditors.[145] Thus, not only do such statutes force courts to gloss over the true origins of a trust,[146] they con-

30, 1989.

[136] *Wimmer*, 129 B.R. at 567; 121 B.R. at 543.

[137] *See supra* notes 12-13 and accompanying text.

[138] *Wimmer*, 121 B.R. at 543.

[139] The Constitution provides: "Congress shall have the Power: To establish a uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States." U.S. CONST., art. I, § 8, cl. 4.

[140] The United States Code grants federal jurisdiction over all bankruptcy cases: "Except as provided in subsection (b) of this section, the district court shall have original and exclusive jurisdiction of all cases under Title 11." 28 U.S.C. § 1334(a) (1988).

[141] *In re* Goerg, 844 F.2d 1562, 1565 (11th Cir. 1988).

[142] *See supra* note 132 and accompanying text.

[143] *Wimmer*, 121 B.R. at 543.

[144] *Id.*

[145] 11 U.S.C. §§ 541(a)(1), (c)(1) (1984). *See supra* note 28 and accompanying text.

[146] "A legislature may not employ conclusive presumptions to legislate a fact which is at odds with actualities." *Wimmer*, 121 B.R. at 543, *citing* Heiner v. Donnan, 285 U.S.

travene a provision of federal bankruptcy law as well.[147] The *Wimmer* court viewed this as a clear violation of the Supremacy Clause, rendering the statute unconstitutional and invalid.[148] *Wimmer* thus ventured further than *Kleist* dared, and in so doing, obtained the more desirable result.[149] In Illinois, at least, the Bankruptcy Code now reigns supreme.[150]

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312 (1982).

[147] According to the court, the statute undermined the Bankruptcy Code in two basic ways. First, the statute tried to limit the property of the estate in contravention of section 541(a)(1) of the Code. Second, it excluded nonspendthrift retirement plans from the estate despite the intent of Congress to limit section 541(c)(2) to traditional spendthrift trusts only. For this reason, under the majority view, ILL. REV. STAT. ch. 110 para. 12-1006(c) was "a bold attempt to undermine section 541(c)(2) of the Bankruptcy Code which cannot succeed." *Id.*

On appeal, the district court affirmed the conclusion of the bankruptcy court but did not rule on the supremacy issue. Instead, the district court declined to reach the issue of whether the Illinois statute conflicted with, and was preempted by, section 541(a) of the Bankruptcy Code under the Supremacy Clause, stating: "This Court simply concludes that § 541(c)(2) of the Bankruptcy Code does not create and was not intended to create an exclusion for spendthrift trusts which are defined as broadly as the Illinois statute chose to define them." *Wimmer*, 129 B.R. 563, 568 (C.D. Ill. 1991).

[148] The Supremacy Clause to the Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judge in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST., art. VI, cl. 2.

[149] The district court observed:

> Apparently, the *Kleist* court believed that Congress, by enacting § 541(c)(2), intended to give states the prerogative to define a spendthrift trust in any manner the states felt was appropriate. Such a conclusion is contrary to the legislative intent of Congress as expressed in the legislative history of this section and contrary to the plain language of the statute.

Wimmer, 129 B.R. 563, 568 (C.D. Ill. 1991).

The bankruptcy court also noted *Kleist's* concern over the New York statute and the potential for abuse that could result: "It is essentially for those reasons that this Court reaches an opposite conclusion." *Wimmer*, 121 B.R. 539, 544 (Bankr. C.D. Ill. 1990).

Wimmer's holding, however, may have been unnecessarily broad. Federal bankruptcy law does not force all state laws that may affect bankruptcy proceedings to yield under the Supremacy Clause. Congress recognized this when enacting the Code in 1978: "The Bankruptcy Act incorporates State and general Federal law in many important areas." H.R. REP. No. 595, 95th Cong., 2d Sess. at 5 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5971. For example, the Code looks to state law regarding a debtor's rights in real property, contracts and tort. In addition, the Code allows state law to determine a debtor's exemptions. 11 U.S.C. § 522(b)(2)(A) (1988).

[150] This reign is not absolute. During approximately the same period that both *Wimmer* decisions were issued, two other Illinois bankruptcy courts reached opposite

Although *Kleist*, *Iacono* and *Wimmer* all yield different and interesting results, none involved ERISA-qualified retirement plans. As a result, none of those courts considered a different and very serious challenge to the 1989 New York amendment: ERISA's dominance over state pension law. Because ERISA supersedes related state laws, the vast majority of courts have held similar statutes invalid.[151] Frequent invalidation of state laws that refer to plans qualified under ERISA is justified by the doctrine of preemption.

C. *Preemption Of The New York Statute As It Relates To ERISA Plans*

ERISA's section 514(a) preempts all relevant state laws.[152] It provides that "[t]he provisions of this subchapter . . . shall *supersede any and all State laws* insofar as they may now or hereafter *relate to any employee benefit plan* described in Section 1003(b) of this title."[153] In 1988 the Supreme Court interpreted this language to mean that all state laws that "relate to" a qualified ERISA plan were preempted and thus invalid.[154] Since then a line of cases has invalidated most state statutes

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conclusions regarding the constitutionality of the Illinois statute. *In re* Block, 121 B.R. 810 (Bankr. C.D. Ill. 1990) and *In re* Balay, 113 B.R. 429 (Bankr. N.D. Ill. 1990), decided before *Wimmer*, enforced the spendthrift presumption imposed by ILL. REV. STAT. ch. 110 para. 12-1006(c). In *Balay* the debtor had filed bankruptcy before the amended statute became effective but the bankruptcy court rendered its decision after that date. The court expressly agreed with the majority view of including ERISA plans in the bankruptcy estate and held that the debtor's plan was included in the estate because it could not be governed by a law not yet in effect at the date of the bankruptcy filing. In *dicta*, however, the court discussed the intended effect of the Illinois statute at length, concluding that the statute was enforceable and was not preempted by ERISA. The court deferred to the legislative desire to carve out a narrow exception to Illinois spendthrift law, and further held that ERISA did not preempt paragraph (c) because that paragraph could be read independently of the statute's other provisions. 113 B.R. at 442-43. In *Block* the debtor was the sole owner, shareholder and officer of a corporation, and was a beneficiary of an employee-sponsored pension plan that qualified under ERISA. The debtor was the sole trustee of both the pension plan valued at $93,941 and a profit-sharing plan valued at $78,857, in which he was fully vested. The court allowed both interests to be fully excluded from the estate, agreeing with *Balay* that paragraph 12-1006(c) represented a legitimate exclusion created by the Illinois legislature, and was therefore enforceable against the Bankruptcy Trustee. 121 B.R. at 813.

[151] *See supra* note 7 and accompanying text; *see also infra* notes 152-54 and accompanying text.

[152] 29 U.S.C. § 1144(a) (1975).

[153] ERISA § 514(a), 29 U.S.C. § 1144(a) (1985 and Supp. 1990) (emphasis added).

[154] Mackey v. Lanier Collections Agency & Service, Inc., 486 U.S. 825 (1988).

specifically enacted to protect ERISA plans.[155] Under the doctrine of preemption, ERISA, created to protect and preserve pension and retirement funds, invalidates state laws enacted for the same reason—to protect ERISA.[156] When state laws shielding ERISA plans are preempted, creditors may then gain access to ERISA funds via the bankruptcy proceeding. Although the

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[155] Ingersoll-Rand Co. v. McClendon, 111 S.Ct. 478 (1990) (state law which purports to protect employee benefit plans under ERISA by granting cause of action to employees for wrongful discharge was preempted by ERISA); FMC Corp. v. Holliday, 111 S.Ct. 403 (1990) (state law which precludes reimbursement from benefit payments under a qualified plan for medical expenses paid by employer was preempted by ERISA); *Mackey*, 486 U.S. at 825 (ERISA preempts Georgia statute which singled out ERISA welfare plan benefits for protective treatment); Mullenix v. Aetna Life and Casualty Insurance Co., 912 F.2d 1406 (11th Cir. 1990) (Alabama statute which provided that ERISA plan participants have the right to medical services notwithstanding any plan provision to the contrary related to ERISA under 29 U.S.C. § 1144(a) was preempted); PPG Industries Pension Plan A (CIO) v. Crews, 902 F.2d 1148 (4th Cir. 1990) (West Virginia statute which required employer to maintain account for workers' compensation separate from pension benefit account, so that latter would be protected, was preempted by ERISA); *In re* Wimmer, 129 B.R. 563, 569 (C.D. Ill. 1991) (ILL. REV. STAT. ch. 110 para. 12-1006(c) (1989) clearly "relates to" an employee benefit plan under 29 U.S.C. § 1144(a) and is preempted under the Supreme Court's view in *Mackey*); *In re* Komet, 104 B.R. 799 (Bankr. W.D. Tex. 1989) (Texas statute exempting ERISA plans from state law attachment, execution or seizure impermissibly interferes with ERISA and is preempted); United Health Serv. v. Upstate Admin. Serv., 573 N.Y.S.2d 851 (Sup. Ct. Broome County 1991) (public health law which contains "reference" to benefit governed by ERISA is preempted; preemption is warranted if an indirect effect results).

But see In re Nuttleman, 117 B.R. 975, 982 (Bankr. D. Neb. 1990) (ERISA does not preempt state statute exempting plans qualified under I.R.C. § 401(a) because preemption would modify and impair 11 U.S.C. § 522(b)(2)(A) of the Code that delegates to states the right to create their own bankruptcy exemptions; preemption would therefore violate 29 U.S.C. § 1144(d) of ERISA); *In re* Vickers, 116 B.R. 149 (Bankr. W.D. Mo. 1990) (since the Code specifically allows the states to create their own exemptions and ERISA does not specifically prohibit such exemptions, state statute exempting pension plans qualified under I.R.C. § 401(a) is not preempted by ERISA); *In re* Balay, 113 B.R. 429, 443 (Bankr. N.D. Ill. 1990) (state statute mandating that plans qualified under applicable provisions of the I.R.C. were conclusively presumed spendthrift trusts and were capable of being executed and enforced independently of other provisions which referred to ERISA more directly, and hence was not preempted).

[156] This is a basic facet of preemption. Under the United States Constitution's Supremacy Clause, federal laws cut off both conflicting and enabling state statutes. *See supra* note 148 and accompanying text. In *Mackey* the Supreme Court's broad construction of ERISA's preemptive powers, even state law that *furthers* ERISA's purposes, is preempted because 29 U.S.C. § 1144(a) "displaces all state laws that fall within its sphere, even including state laws that are consistent with ERISA's substantive requirements." *Mackey*, 486 U.S. at 829 (1988). Therefore, despite the seemingly ironic result reached by the court that was achieved by integrating ERISA with state exemption law, the Court refused to restrict ERISA's preemptive provision to only those state laws with which it conflicts.

1989 amendments to the NYCPLR were enacted to prevent this very result, ERISA itself preempts the New York legislature's authority to do so.[157]

[157] The amendments to section 5205 were enacted to assist self-employed individuals, partnerships and professional corporations in preserving private retirement plans that would otherwise have been subject to the claims of creditors in the event of a bankruptcy proceeding. Memorandum of Senator Dale M. Volker and Assemblyman Sheldon Silver, Bill A.6356-A, in Bill Jacket to 1989 N.Y. Laws 280. Although section 5205 had been amended in 1987 for the purpose of protecting retirement plans from the claims of judgment creditors, an explicit reference to cases arising under Chapter 11 of the Bankruptcy Code had not been included. Assembly Bill A.3262-B, 1987 N.Y. Laws 108. The 1987 Bill, also introduced by Senator Volker and Assemblyman Silver, sought to protect private retirement plans of the self-employed and the solo legal and medical practitioner by specifically exempting trusts, custodial accounts, annuity and insurance contracts established as part of a pension, profit sharing, or Keogh (HR-10) plan, from the claims of a judgment creditor. In addition, qualified plans were exempt from federal taxation. N.Y. CIV. PRAC. L. & R. §§ 5205(c)(1), (2), (3); N.Y. EST. POWERS & TRUSTS LAW §§ 7-3.1(a), (b)(1), (2) (McKinney 1987). Notably, the 1987 amendments to the NYCPLR were enacted one year before Mackey v. Lanier Collections Agency & Service, Inc., 486 U.S. 825 (1988), was decided. *Mackey* made clear that state exemption statutes which contained specific references to plans qualified under pertinent provisions of the I.R.C. related to ERISA, and were therefore preempted. In the wake of *Mackey*, therefore, it is likely that the 1987 amendments would not have survived when applied to an ERISA plan. *See supra* note 156 and accompanying text.

After 1987, an increase in bankruptcy filings and ever-mounting new case law saw these same retirement plans, although exempt outside of bankruptcy, held subject to the claims of creditors within bankruptcy. Accordingly, as support for the spendthrift provision, the 1989 Memorandum in Support noted that specific protection of retirement plans in bankruptcy was necessary both to protect the pensioner's interest and to guard against the threat of tax disqualification. A 1988 private letter ruling issued by the Internal Revenue Service, PLR 8829009, was cited in support. *See supra* note 85 and accompanying text. *See also* Letter of Michael Colodner to Honorable Evan A. Davis, June 9, 1989, page 1 (regarding Assembly Bill 6356). The Memorandum also cited the "increasingly callous manner with which bankruptcy courts are including qualified plan interests as assets available to bankruptcy creditors" as further justification for the spendthrift provision. New York State Bar Association, Report No. 140, April 13, 1989, at 2.

Interestingly, major supporters of an absolute exemption for private retirement plans were the New York State Bar Assocation, the Association of the Bar of the City of New York, the New York State Society of Certified Public Accountants and the Medical Society of the State of New York. Given the fact that attorneys, accountants and physicians constitute the majority of self-employed individuals capable of establishing generous, self-funded retirement plans, the enthusiastic support of these organizations for a bill that adversely affects the rights of all future bankruptcy creditors is self-serving. Accordingly, the danger of abuse inherent in such "bootstrapping" was aptly ignored or minimized. Letter of James F. Regan, Chairman of Permanent Commission on Public Employee Pension and Retirement Systems, July 7, 1989; Letter of Ira H. Lustgarten, Committee on Trusts, Estate and Surrogates' Court, June 28, 1989, Bill Jacket to 1989 Laws of New York, Ch. 280.

The Supreme Court's view of ERISA's preemptive powers, clarified in the 1988 *Mackey* decision, (although not yet known at the time of the 1987 amendments) was

Nor can there be any argument that there is insufficient conflict between NYCPLR section 5205(c) and ERISA to trigger preemption. Section 5205(c) refers to "trusts . . . . retirement or other plan(s) established by a corporation, which is qualified under section 401 of the United States Internal Revenue Code of 1986."[158] This clearly touches ERISA since ERISA is qualified under section 401 of the I.R.C. through its anti-alienation and anti-garnishment provisions.[159] In addition, similar cases supporting the preemption of state laws as they relate to ERISA strongly suggest that New York, for reasons of policy and statutory interpretation, will follow suit when an ERISA plan is involved.[160] The trend clearly has been to subject pension plans to the claims of creditors.[161]

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well-known to the legislature by the summer of 1989. Yet *Mackey* and its potential effect on these amendments was totally ignored. Memorandum in Support, Assembly Bill A.6356-A, S.3909; Letter of Richard L. Smith to Honorable Gerald Crotty, July 5, 1989, at 3 printed in Bill Jacket to 1989 Laws of New York, ch. 280. The amendments were approved by a unanimous vote in both the Senate and the Assembly.

[158] N.Y. CIV. PRAC. L. & R. § 5205(c).

[159] The I.R.C. provides that pension plans and trusts, in order to be tax qualified, must contain a provision prohibiting the assignment or alienation of benefits. 26 U.S.C. § 401(a)(13). The restrictions found in 29 U.S.C. § 1056(d), ERISA § 206(d) satisfy this requirement.

[160] *In re* Wimmer, 121 B.R. 539, 544 n.2 (Bankr. C.D. Ill. 1990), *aff'd*, 129 B.R. 563 (C.D. Ill. 1991). In addition to invalidating the Illinois statute's spendthrift presumption under the Supremacy Clause, the bankruptcy court strongly suggested that such language would be invalidated when applied to an ERISA plan. The court noted that the language of ILL. REV. STAT. § 12-1006(c) related to ERISA in such a way that it would probably not survive the preemptive powers found in 29 U.S.C. § 1144(a) when tested by a qualified plan. Moreover, "express references to ERISA are not required to trigger the superseding language of 29 U.S.C. Section 1144(a)." Sterbach et. al., *supra* note 64, at 247. A state law may "relate to" an employee benefit plan if it has only a mere connection or reference to the plan, and may be preempted by ERISA even if the effect is unintended and indirect. Ingersoll-Rand Co. v. McClendon, 111 S.Ct. 478, 483 (1990) (citing Shaw v. Delta Airlines, Inc., 463 U.S. 85 (1983), and Pilot Life Insurance Co. v. Dedeaux, 481 U.S. 41 (1987)).

The prediction of the bankruptcy court proved accurate. On appeal, the district court observed that the language of the Illinois Civil Practice Act § 12-1006(a) referred to any plan "intended in good faith to qualify as a retirement plan under applicable provisions of the Internal Revenue Code of 1986." *Wimmer*, 129 B.R. at 569 (C.D. Ill. 1991). Citing the Supreme Court's ruling in *Mackey*, the district court held that this was a clear attempt to affect employee benefit plans: "the Illinois statute in this case clearly 'relates to' an employee benefit plan." Therefore, it was preempted by ERISA. *Id.*

[161] *In re* Kramer, 128 B.R. 707, 709 (Bankr. E.D.N.Y. 1991) (agreeing with *Iacono* that an I.R.A. was not excluded under section 541(c)(2), nor was it a spendthrift trust under N.Y. EST. POWERS & TRUSTS LAW § 7-3.1; potential to exercise complete control over fund is "inconsistent with the concept of a spendthrift trust").

Accordingly, the New York legislature would be well advised to repeal the recent changes to the NYCPLR. Rather than impose blanket treatment of all qualified plans, a more individualized approach is needed to serve the purposes of equity. A case-by-case inquiry into the individual circumstances surrounding a plan would more adequately protect trusts and pensions not subject to the debtor's control while still allowing creditors in the bankruptcy proceeding to share in the distribution of other types of self-settled funds.[162]

This Note takes the position that New York should follow the path of the Ninth Circuit. By determining the property of the estate in accordance with the debtor's control, the New York legislature would promote ERISA's goal of protecting pensioners and their beneficiaries to a reasonable extent, while still respecting the policies of equitable treatment and distribution that underlie the Bankruptcy Code. Moreover, such treatment of qualified benefit plans also respects congressional intent regarding the preservation in bankruptcy of the debtor's interest in a

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[162] The Ninth Circuit took this approach in *In re* Neuton, 922 F.2d 1379 (9th Cir. 1990). The Neutons filed a Chapter 7 petition in bankruptcy, claiming as exempt their interest in a trust by virtue of the trust's restriction on alienation and garnishment. This restriction read as follows: "The interests of beneficiaries in principal or income shall not be subject to claims of their creditors or others nor to legal process, and may not be voluntarily or involuntarily alienated or encumbered." *Id.* at 1381 n.1. The debtors argued that since this provision prevented the debtor or creditors from reaching the corpus, the trust qualified as spendthrift and should be excluded from the bankruptcy estate under section 541(c)(2). The parties did not dispute that the above provision was enforceable under California law. However, the California Probate Code limited the force of this provision by allowing the beneficiary of a spendthrift trust to order the trustee to pay up to 25% of the beneficiary's expected payment to satisfy a judgment creditor. *Id.* at 1383, *citing* CAL. PROB. CODE § 15306.5 (West 1986). Because the state allowed the debtors access to one-quarter of their interest, the entire trust could not be deemed spendthrift within the meaning of section 541(c)(2). As a result, the 25% subject to the debtor's control was held to be property of the estate, although still subject to an exemption to the extent reasonably necessary for the support of the debtor or his or her dependents. *Id.* at 1384, *citing* CAL. PROB. CODE § 15306.5(c).

The Ninth Circuit also recognized that the remaining 75% of the trust could *not* be reached by the debtor under any circumstances. The court agreed with both the Bankruptcy Court and the Bankruptcy Appellate Panel that California law extends automatic, absolute protection to 75% of a debtor's interest in a trust which prohibits alienation. *Id.* at 1383-84 n.5. Accordingly, three-quarters of the trust deserved traditional spendthrift status and the restriction prohibiting alienation was enforceable in bankruptcy. *Id.* at 1383. Thus, to the extent that the debtor was prohibited from controlling his or her own interest, it was excluded from the estate. To the extent that the debtor could order payment from the trust, his or her interest was made subject to the claims of all creditors in bankruptcy. *Id.* (citing *In re* Peterson, 88 B.R. 5 (Bankr. D. Me. 1988)).

spendthrift trust, to the extent that it is truly spendthrift. Such an inquiry would be within the discretion of the bankruptcy court.[163] In any event, a debtor's pension cannot be protected by state legislation that should always be held invalid under preemption.

CONCLUSION

The conflict among ERISA, state pension law and the Bankruptcy Code is clear. Most courts include ERISA retirement plans in the bankruptcy estate to the extent of the debtor's control, while the minority finds that ERISA's restrictions on transfer require excluding such plans as property of the estate. Although sound arguments support the minority's protection of ERISA, the blanket exclusion of all plans without further individual inquiry poses a dual threat: the inequitable treatment of creditors and the increased threat of manipulative filings by debtors with generous self-funded pensions.[164] Moreover, by pro-

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[163] The bankruptcy court was allowed such discretion before the amendments to the New York Debtor and Creditor Law. Before the July 1989 amendments, section 282(2)(e) permitted a bankruptcy exemption for the debtor's interest in "payments under a stock bonus, pension, profit sharing, or similar plan or contract . . . unless . . . established by the debtor or under the auspices of an insider that employed the debtor . . . to the extent reasonably necessary for the support of the debtor and the debtor's dependents." N.Y. DEBT. & CRED. LAW § 282(2)(e). The determination of what amount was reasonably necessary for the debtor's support was within the discretion of the bankruptcy court and was determined on a case-by-case basis. *See In re* Donaghy, 11 B.R. 677 (Bankr. S.D.N.Y. 1981).

The 1989 amendments made two notable changes to this exemption statute. First, the specific phrase referring to payments "reasonably necessary for the debtor's support" was deleted and an exception to the exclusion of self-settled plans, established by the debtor, was added. Second, plans that were "qualified under Section 401 of the United States Internal Revenue Code of 1986, as amended" were now exempt even though "established by the debtor under the auspices of an insider that employed the debtor." The result of the amendment was to deprive the bankruptcy court of any discretion to determine what amount of pension benefits were reasonably necessary for the debtor's support, by allowing a full and unqualified exemption to any trust which came under the purview of section 282(2). Letter of Richard L. Smith to Honorable Mario M. Cuomo, Governor, State of New York, July 5, 1989, at 3, printed in Bill Jacket to 1989 Laws of New York, Ch. 280. Further, the reference to plans qualified under I.R.C. § 401 had the obvious and much intended effect of bringing ERISA within the statute's absolute protection, regardless of whether the plan was self-settled. *Id.*

This Note takes the position that the statute's original language, which mirrored section 522(d)(10)(E) of the Bankruptcy Code, should be reinstated.

[164] Before both the *Wimmer* decision and the enactment of the statutory spendthrift presumption, an Illinois bankruptcy court succinctly stated that "if a bankruptcy trustee can never reach funds held in an ERISA-qualified pension plan, then there is too

viding a federal exemption for ERISA-qualified plans in section 522(d)(10)(E) of the Code, Congress envisioned the needs-based exemption of such plans from the bankruptcy estate, rather than their exclusion. The majority view provides fairer treatment overall and preserves congressional intent behind both ERISA and the Bankruptcy Code by not permitting the debtor to keep his or her entire interest in a pension.

In New York, the state legislature's statutory protection of private retirement plans has not been tested by ERISA's preemptive powers. The trend of current case law, however, indicates that future decisions will likely include all traditional retirement plans in the estate. Because of its fatal reference to pension plans qualified under the I.R.C., section 5205(c)(3) of the NYCPLR will be preempted when applied to an ERISA-qualified plan, or invalidated under the Supremacy Clause as a usurpation of the Bankruptcy Code. Ultimately, the split among the federal courts of appeals can only be resolved by the United States Supreme Court.

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much room for manipulation by a participant anticipating bankruptcy." *In re* Silldorff, 96 B.R. 859, 863 (C.D. Ill. 1989).