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Corporate Pension Plans as Property of the Bankruptcy Estate

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Notes

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The status of a debtor's interest in bankruptcy in an employer-created Employee Retirement Income Security Act (ERISA)[1] plan is uncertain. The debtor views this interest not as a present asset but as a substitute source of income for retirement. To the debtor's creditors, however, the debtor's interest in an ERISA plan represents a significant asset that should be liquidated to satisfy their claims. The United States Courts of Appeals for the Eighth[2] and the Eleventh[3] Circuits recently have sided with the creditors, holding that a debtor's interest in an employer-created ERISA plan must be included in the debtor's bankruptcy estate.

The statutes applicable to the debtor's interest are ambiguous. Although the Bankruptcy Code (Code) requires that all legal or equitable property interests of the debtor be transferred to the bankruptcy estate,[4] section 541(c)(2) of the Code excludes from the estate interests in trusts that are subject to restrictions on alienation or assignment enforceable under "applicable nonbankruptcy law."[5] ERISA requires that qualified plans contain just such restrictions on alienation and assignment.[6] Despite these restrictions, however, most courts have held that the "applicable nonbankruptcy law" exclusion of section 541(c)(2) applies only to state law spendthrift trusts and not to ERISA plans generally.[7] A few courts, however, have in-

1. 29 U.S.C. §§ 1001-1461 (1982).

2. *In re* Graham, 24 Bankr. 305 (Bankr. N.D. Iowa 1982), *aff'd*, 726 F.2d 1268 (8th Cir. 1984).

3. *In re* Lichstrahl, 750 F.2d 1488 (11th Cir. 1985).

4. 11 U.S.C. § 542(a) (1982) requires an entity, other than a custodian, who is in possession of the debtor's property to "deliver to the trustee, and account for, such property or the value of such property."

5. 11 U.S.C. § 541(c)(2) (1982). "A restriction on the transfer of the beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable . . . under this title." *Id.*

6. *See* 29 U.S.C. § 1056(d) (1982).

7. *See, e.g.*, *Lichstrahl*, 750 F.2d at 1490; *Graham*, 726 F.2d at 1273; *In re* Goff, 706 F.2d 574, 580 (5th Cir. 1983).

terpreted this phrase more broadly to exclude from the bankruptcy estate ERISA plans that fail to satisfy state spendthrift trust requirements.[8]

If a court determines that the debtor's interest in the ERISA plan is excluded from the bankruptcy estate, the debtor's interest automatically is protected from the claims of creditors.[9] If, however, the court rules that the debtor's interest is included in the estate, it must then determine whether the debtor's interest may be exempted under Code section 522.[10] Debtors who elect the federal exemptions may exempt an in-

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8. *See, e.g., In re* Phillips, 34 Bankr. 543, 545 (Bankr. S.D. Ohio 1983) (concluding that "the language of [s]ection 541(c)(2) is clear on its face and does not limit itself to spendthrift trusts"); *In re* Holt, 32 Bankr. 767, 772 (Bankr. E.D. Tenn. 1983) (restrictions on transfer required by ERISA are enforceable under federal nonbankruptcy law; debtor's interest in an employer-created ERISA plan therefore was properly excluded from the bankruptcy estate under § 541(c)(2)); *In re* Pruitt, 30 Bankr. 330, 331 (Bankr. D. Colo. 1983) (anti-assignment provisions required by ERISA are sufficient to exclude debtor's interest from bankruptcy estate under § 541(c)(2), notwithstanding debtor-employee's present right to withdraw funds); *see also In re* Rogers, 24 Bankr. 181, 183 (Bankr. D. Ariz. 1982) (courts need not look to state law of spendthrift trusts to determine whether debtor's interest in medical clinic's profit-sharing plan is excludible from the bankruptcy estate).

9. *See In re* Phillips, 34 Bankr. 543, 546 (Bankr. S.D. Ohio 1983).

10. 11 U.S.C. § 522(b) (1982), *as amended by* Act of July 10, 1984, sec. 306, Pub. L. No. 98-353, 98 Stat. 353 (1984)(effective for cases filed after Oct. 7, 1984). Section 522(b) provides:

> Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. . . .
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> (1) property that is specified under subsection (d) of this section, unless the state law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,
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> (2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or state or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and
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> (B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

Section 522 departs significantly from prior bankruptcy law. Under the old Bankruptcy Act, a debtor's exemptions varied drastically because the availability of these exemptions was dependent entirely on state law. *See* Joslin, *Debtors' Exemption Law: Time for Modernization,* 34 IND. L.J. 355 (1959). In an effort to reduce this disparity, the Code provides a "laundry list" of federal exemptions, *see* 11 U.S.C. § 522(d), and allows the debtor to choose either federal or state exemptions, unless the debtor's state has "opted out" of either exterest in a pension plan "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."[11]

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emption system. 11 U.S.C. § 522(b); *see In re* McManus, 681 F.2d 353, 354-56 (5th Cir. 1982).

Most states have taken advantage of the § 522(b) provisions allowing them to "opt out" of the federal system and require their residents to rely on state exemption systems. For a listing of those states that have elected this course for their residents, see 3 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 522.02 (15th ed. 1984). California's opt-out statute, CAL. CODE CIV. PROC. § 703.130 (Deering 1982), recently was held unconstitutional in *In re* Garrido, 43 Bankr. 289 (Bankr. S.D. Cal. 1984). The court found that the California statute, which permitted debtors in certain situtations to elect the federal exemptions of § 522(d) as a matter of state law, was unconstitutional under the supremacy clause. *Id.* at 543.

11. 11 U.S.C. § 522(d) sets up a system of minimum exemptions for those electing the federal system:

> (1) The debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.
> (2) The debtor's interest, not to exceed $1,200 in value, in one motor vehicle.
> (3) The debtor's interest, not to exceed $200 in value in any particular item, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor.
> (4) The debtor's aggregate interest, not to exceed $500 in value, in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.
> (5) The debtor's aggregate interest, not to exceed in value $400 plus any unused amount of the exemption provided under paragraph (1) of this subsection, in any property.
> (6) The debtor's aggregate interest, not to exceed $750 in value, in any implements, professional books, or tools of the trade of the debtor or the trade of a dependent of the debtor.
> (7) Any unmatured life insurance contract owned by the debtor, other than a credit life insurance contract.
> (8) The debtor's aggregate interest, not to exceed in value $4,000 less any amount of property of the estate transferred in the manner specified in section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmatured life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent.
> (9) Professionally prescribed health aids for the debtor or a dependent of the debtor.
> (10) The debtor's right to receive—
> (A) a social security benefit, unemployment compensation, or a local public assistance benefit;
> (B) a veteran's benefit;
> (C) a disability, illness, or unemployment benefit;
> (D) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

Debtors opting for state law exemption systems, on the other hand, may exempt ERISA plan interests only if state law so allows, or if the court determines that a debtor's interest falls within the "other federal law" exemption of Code section 522(b)(2)(A).[12] Again, the courts have divided, with the majority concluding that ERISA is not "other federal law" as contemplated by section 522 and that the debtor's interest in such a plan therefore is not exempted.[13]

This Note examines the treatment of an employee-debtor's

(E) *a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, unless—*

(i) *such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;*

(ii) *such payment is on account of age or length of service; and*

(iii) *such plan or contract does not qualify under section 401(a), 403(a), 403(b), 408, or 409 of the Internal Revenue Code of 1954 (26 U.S.C. § 401(a), 403(a), 403(b), 408, or 409).*

(11) The debtor's right to receive, or property that is traceable to—

(A) an award under a crime victim's reparation law;

(B) a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(C) a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(D) a payment, not to exceed $7,500, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent; or

(E) a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

11 U.S.C. § 522(d)(emphasis added).

12. Section 522(b)(2)(A) allows debtors electing the state exemption system to exempt "any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law." Subsection (d) is the "laundry list" of federal exemptions, set out *supra* note 11.

13. *See, e.g., Lichstrahl*, 750 F.2d at 1490-91 (debtor's interest in ERISA plan not exempt under § 522(b)(2)(A)); *Graham*, 726 F.2d at 1274 (same); *Goff*, 706 F.2d at 582-86 (same). *But see In re* Hinshaw, 23 Bankr. 233, 235 (Bankr. D. Kan. 1982) (debtor's interest in ERISA plan exempt under § 522(b)(2)(A)). *See infra* notes 93-110 and accompanying text.

interest in an employer-created ERISA plan under the Bankruptcy Code. Part I sets out the operative provisions of ERISA. Part II analyzes the "applicable nonbankruptcy law" exclusion of section 541(c)(2). Part III then discusses the exemption provisions of the Code and their effect on ERISA plans. Finally, Part IV considers possible exceptions to the proposed general rule necessary to prevent the use of ERISA plans to defraud creditors. This Note concludes that in the absence of actual fraud, a debtor's interest in a qualified ERISA plan should be excluded from the bankruptcy estate under section 541(c)(2).

I. ERISA

Congress enacted ERISA in 1974 to provide additional security to employees participating in private pension plans.[14] ERISA establishes a uniform law[15] giving employees certain protections with respect to the vesting and funding of employer-created employee retirement plans.[16] Under ERISA, contributions to qualified plans are placed in a trust, and employees cannot reach fund contributions until retirement.[17] Both employers and employees receive beneficial tax treatment for qualified ERISA plan contributions. A trust created pursuant to ERISA is exempt from taxation if under the terms of the trust instrument the funds cannot be used or diverted for any purpose other than for the exclusive benefit of employees or their beneficiaries.[18] Thus, under a qualified plan, employee contributions are exempt from taxation when made,[19] and income is recognized only when proceeds are distributed in accordance with the provisions of the plan.[20] Moreover, because

14. *See* S. REP. NO. 127, 93rd Cong., 1st Sess. 1, *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 4838.

15. 29 U.S.C. § 1144(a) (1982) preempts state law applicable to pension plans qualified under ERISA. ERISA provisions "supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" within the coverage of ERISA. *Id.*; *see* Wadsworth v. Whaland, 562 F.2d 70, 77 (1st Cir. 1977), *cert. denied*, 435 U.S. 980 (1978).

16. *See* 29 U.S.C. §§ 1051-1061 (1982) (establishing minimum vesting and participation standards); 29 U.S.C. § 1082 (1982) (establishing minimum funding standards for qualified plans).

17. *See* 29 U.S.C. § 1056(a) (1982).

18. 26 U.S.C. § 401(a)(2) (1982). To be qualified, a trust must provide that benefits may not be assigned or alienated. *See* 26 U.S.C. § 401(a)(13). Despite this general prohibition, a participant currently receiving benefits may make voluntary assignments of up to 10% of any benefit payment. *Id.*

19. 26 U.S.C. § 3401(a)(12)(A) (1982).

20. 26 U.S.C. § 402(a)(1) (1982).

ERISA plan contributions are tax deductible by the employer,[21] the employer may provide essentially the same retirement benefits to employees under an ERISA-qualified plan at a substantially lower cost than it could under a nonqualified plan. If the plan fails to qualify, however, employers may not deduct plan contributions, and employees must recognize income at the time of their employer's contribution.[22]

To qualify for tax deferral, an ERISA plan must meet several requirements. Perhaps the most significant limitation is that benefits under the plan cannot be assignable or alienable.[23] Specifically, the Treasury Regulations provide that "a trust will not be qualified [for tax exempt status] unless the plan of which the trust is a part provides that benefits provided under the plan may not be anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution or other legal or equitable process."[24] The regulations define assignment or alienation to include a transfer of the debtor's interest to the bankruptcy trustee.[25] Thus, a transfer of a debtor's interest in an ERISA plan to the bankruptcy estate would disqualify the plan.

II. EXCLUSION UNDER SECTION 541(c)(2)

A debtor's ERISA plan interest avoids a disqualifying transfer only if the debtor's interest in the plan is excluded from the bankruptcy estate.[26] The 1978 Bankruptcy Code[27] changed the concept of the property of the bankruptcy estate. Under the old Bankruptcy Act,[28] only nonexempt property passed to the bankruptcy estate.[29] The Code, however, provides

21. *See* 26 U.S.C. § 404(a) (1982).

22. If § 402 did not explicitly make pension plan contributions taxable in the year of distribution, they would be taxable in the year in which the funds were contributed under 26 U.S.C. § 61 (1982) as part of the employee's total compensation.

23. *See* 26 U.S.C. § 401(a)(13).

24. Treas. Reg. § 1.401(a)-13(b)(1) (1984).

25. An assignment or alienation includes "[a]ny direct or indirect arrangement . . . whereby a party acquires from a participant or beneficiary a right or interest enforceable against the plan in, or to, all or any part of a plan benefit payment which is, or may become, payable to the participant or beneficiary." Treas. Reg. § 1.401(a)-13(c)(1)(ii) (1984).

26. *See supra* notes 23-25 and accompanying text.

27. 11 U.S.C. § 101 *et seq.* (1982), *as amended by* Act of July 10, 1984, Pub. L. No. 98-353, 98 Stat. 353 (1984)(effective for cases filed after Oct. 7, 1984).

28. Law of July 1, 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 *et seq.* (repealed 1978)).

29. Section 110(a)(5) under the old Act provided that:

that *all interests* of the debtor, except for those falling within certain narrow *exclusions*, pass into the bankruptcy estate.[30] After the property has passed to the trustee in bankruptcy, however, the property still may be *exempted* under either the state or federal exemption systems.[31] By expanding the concept of the bankruptcy estate to include exemptable property, Congress hoped to increase the amount of assets available to creditors and to promote efficient administration in bankruptcy.[32]

Faced with the question whether a debtor's interest in a pension plan constituted nonexempt property includible in the bankruptcy estate under the old Act, courts considered the nature of the debtor's interest in the plan,[33] the source of the plan's funds,[34] and the effect of state law on the plan.[35] Under the Code, however, pension plans are included in the bankruptcy estate unless excluded by section 541(c)(2), which prevents the passing of a beneficial interest in such a trust when

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> The trustee of the estate of a bankrupt . . . shall . . . be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition . . . to . . . property, including rights in action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon or sold under judicial process against him, or otherwise seized, impounded, or sequestered . . . .

11 U.S.C. § 110(a)(5)(repealed 1978).

30. Section 541(a) of the new Code provides that "[e]xcept as provided in subsections (b) and (c)(2) of this section, *all legal or equitable interests* of the debtor in property as of the commencement of the case" are included in the bankruptcy estate. 11 U.S.C. § 541(a)(emphasis added). Section 541(c)(2) excludes beneficial interests that are protected by transfer restrictions under applicable nonbankruptcy law. Section 541(b)(1) excludes "any power that the debtor may exercise solely for the benefit of an entity other than the debtor." 11 U.S.C. § 541(b)(1).

31. *See supra* notes 11-12 and *infra* notes 91-95.

32. *See* S. REP. NO. 989, 95th Cong., 2d Sess. 5, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5791.

33. Under the old Act, courts held that a bankrupt's interest in a pension plan could not be included in the bankruptcy estate unless it was fully vested. *See In re* Goodwin, 57 F.2d 31, 32 (6th Cir. 1932); *In re* Howe, 381 F. Supp. 1025, 1026 (N.D. Fla. 1974); *see also In re* Nunnally, 506 F.2d 1024, 1025 (5th Cir. 1975), *reh'g denied*, 509 F.2d 576 (5th Cir. 1975)(vested interests in retirement pensions are property rights).

34. *See Goodwin*, 57 F.2d at 32 (bankrupt's pension funded from public monies constituted a "mere gratuity" that would not pass to the trustee in bankruptcy). *But cf. In re* Short, 507 F.2d 425, 427 (8th Cir. 1974) (funds attributable to debtor's contributions to retirement plan were required to be included in the bankruptcy estate).

35. Because state law affects the transferability and leviability of property, state law was decisive in determining whether the property was transferred to the trustee in bankruptcy by § 110(a)(5) of the old Bankruptcy Act. *See* Annot., 34 A.L.R. FED. 316, 319-20 (1977); *supra* note 29.

the trust is subject to transfer restrictions "enforceable under applicable nonbankruptcy law."[36]

Courts have divided with respect to the proper meaning of the crucial phrase "applicable nonbankruptcy law" in section 541(c)(2). Although ERISA specifically preempts state law,[37] it also provides that "[n]othing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States."[38] Thus, the Code will control to the extent that it conflicts with ERISA. In *In re Graham*,[39] the Eighth Circuit found that these provisions precluded creditors from reaching the debtor's interest in a qualified ERISA plan under state law governing enforcement of judgments. The court concluded, however, that the interest was includible in the federal bankruptcy estate.[40] Although it acknowledged that ERISA preempted state law affecting pension plans, the *Graham* court held that only ERISA plans meeting the requirements of state law governing spendthrift trusts were excludible from the bankruptcy estate.[41] The effect of this holding is indirectly to permit state law to govern ERISA pension plans.

Other courts have declined to rely on state spendthrift trust law in determining the excludibility of a debtor's interest in an ERISA plan. In *In re Threewitt*,[42] the United States District Court for the District of Kansas held that the anti-alienation provisions of an ERISA plan enforceable against general creditors are likewise enforceable against the bankruptcy trustee, and thus the "plain and simple language" of section 541(c)(2) requires exclusion of the debtor's interest in the plan from the bankruptcy estate.[43] The court concluded that limiting the section 541(c)(2) exclusion to spendthrift trusts recog-

36. 11 U.S.C. § 541(c)(2); *see supra* note 5.

37. 29 U.S.C. § 1144(a); *see supra* note 15.

38. 29 U.S.C. § 1144(d).

39. 726 F.2d 1268 (8th Cir. 1984).

40. *Id.* at 1273.

41. *Id.* at 1271; *see infra* notes 71-72 and accompanying text. *But cf. In re* Holt, 32 Bankr. 767 (Bankr. E.D. Tenn. 1983) (preemption provisions of ERISA make it unnecessary to evaluate the plan under state law when considering inclusion in the estate; debtor's interest in employer-created ERISA plan excluded from the bankruptcy estate under § 541(c)(2)).

42. 24 Bankr. 927 (D. Kan. 1982).

43. *Id.* at 929. Courts have held that debtor interests in qualified ERISA plans are beyond the reach of general creditors in nonbankruptcy proceedings. *See, e.g.*, General Motors Corp. v. Buha, 623 F.2d 455, 463 (6th Cir. 1980) (benefits under a pension plan covered by ERISA were not subject to garnishment by a beneficiary's creditors); Commercial Mortgage Ins., Inc. v. Citizens Nat'l Bank, 526 F. Supp. 510, 516 (N.D. Tex. 1981) (ERISA's anti-alienation and anti-

nized by state law was an "unnecessarily narrow construction" of that section.[44] The *Threewitt* court reasoned that if Congress had intended section 541(c)(2) to exclude only spendthrift trusts, the statute would have specified the phrase "spendthrift trust" rather than "applicable nonbankruptcy law."[45]

In *In re Phillips*,[46] the Bankruptcy Court for the Southern District of Ohio found that both the language and the policy of ERISA require the exclusion of the debtor's interest in an ERISA plan under section 541(c)(2).[47] The court held that section 541(c)(2) on its face is not limited to spendthrift trusts. Courts, therefore, need not resort to extrapolation from the Code's legislative history to determine the excludibility of ERISA plans.[48]

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assignment provisions create a general federal exemption of pension benefits from claims of commercial creditors).

44. *Threewitt*, 24 Bankr. at 929.

45. *Id.* Evaluating the legislative history relied on by the *Graham* court, the *Threewitt* court observed:

> Since Congress did not choose to use the term "spendthrift trust" in the language of the section itself, there is no reason to suppose that when the term appears in the legislative history it should be taken as a term of art; it is more reasonable to suppose that the term should be given its ordinary, more general meaning as "inclusive of all trusts which bar creditors from reaching a beneficiary's interest . . . ."

Id.

The *Threewitt* court noted that Congress was perfectly capable of writing a narrow exclusion when it so intended. *Id.* at 930; *cf.* Southeastern Community College v. Davis, 442 U.S. 397, 411 (1979) ("Congress understood accommodation of the needs of handicapped individuals may require affirmative action and knew how to provide for it in those instances where it wished to do so."); Ruefenacht v. O'Halloran, 737 F.2d 320, 328 (3rd Cir. 1984) ("When Congress wished to exempt a class of instruments from some or all of the Acts' [The Securities Act of 1933 and the Securities Exchange Act of 1934] provisions, it had little trouble in doing so expressly."), *cert. granted sub nom.* Gould v. Ruefenacht, 105 S. Ct. 428 (1984).

46. 34 Bankr. 543 (Bankr. S.D. Ohio 1983).

47. Specifically, the *Phillips* court found that Congress had enacted ERISA to provide "uniformity of the law, including minimum standards" to promote the national interest involved in protecting the security of millions of employees and their dependents and that this uniformity would be destroyed if the excludibility of a debtor's interest in the plan depended on state law. *Id.* at 545. The *Graham* court recognized that under its construction uniformity would be sacrificed. *See Graham*, 726 F.2d at 1271. The *Graham* court observed that "[t]here is a conflict of authority among the states on the question of the validity of such [spendthrift] trusts and on the extent to which a beneficiary's right to future income and principal can be protected." *Id.* This conflict among the states, when combined with the *Graham* court's conclusion that the operation of the section 541(c)(2) exclusion depends on state spendthrift trust law, destroys both the uniformity and minimum standards that Congress intended ERISA to provide. *See infra* notes 73-78 and accompanying text.

48. *Phillips*, 34 Bankr. at 545 (citing *In re* Pruitt, 30 Bankr. 303, 331

Since ERISA plan anti-alienation clauses are enforceable against general creditors,[49] the court concluded that they are enforceable under nonbankruptcy law.[50] Thus, the court held, section 541(c)(2) excludes a debtor's interest in a qualified ERISA plan from the bankruptcy estate.[51]

The *Threewitt* and *Phillips* courts properly relied on the plain language of section 541(c)(2) in excluding the debtors' interests in qualified ERISA plans from the bankruptcy estate. General principles of statutory interpretation require that courts adhere to the plain meaning of statutory language without resort to legislative history or other secondary sources if the meaning of the statute is clear.[52] Section 541(c)(2) provides that trusts containing restrictions on alienation or assignment that are enforceable under "applicable nonbankruptcy law" may be excluded. This language of itself provides no basis for assuming that "applicable nonbankruptcy law" does not include ERISA. To interpret "applicable nonbankruptcy law" to mean only "applicable *state* nonbankruptcy law," as the courts in *Graham* and *Lichstrahl* implicitly do, is to ignore the plain meaning of section 541(c)(2). If "applicable nonbankruptcy law" is interpreted to include ERISA, no unintended conflict arises between the Code and ERISA.[53] Thus, properly interpreted, section 541(c)(2) represents an attempt to harmonize the provisions of the Code and ERISA.

Even if a court should find that section 541(c)(2) is not clear and unambiguous on its face and that resort to secondary sources therefore is appropriate to aid its interpretation, the legislative history of section 541(c)(2) does not support the inclusion of qualified employer-created ERISA plans in the bankruptcy estate. In *Graham*, the court concluded that the section 541(c)(2) exclusion was designed to "preserve the status traditional spendthrift trusts had under the old Act."[54] Although

(Bankr. D. Colo. 1983)); *see also In re* Holt, 32 Bankr. 767, 771 (Bankr. E.D. Tenn. 1983); *In Re* Rogers, 24 Bankr. 181, 183 (Bankr. D. Ariz. 1983).

49. *See supra* note 43.

50. *Phillips*, 34 Bankr. at 544.

51. *Id.*

52. The Supreme Court has stated that "[w]hen confronted with a statute which is plain on its face, we ordinarily do not look to legislative history as a guide to its meaning." Tennessee Valley Authority v. Hill, 437 U.S. 153, 184 n.29 (1978). *See generally* 2A C. SANDS, STATUTES AND STATUTORY CONSTRUCTION ¶ 46.01 (3d rev. ed. 1973).

53. *See supra* note 38 and accompanying text.

54. *Graham*, 726 F.2d at 1272. The court relied on S. REP. NO. 989, 95th Cong., 2d Sess. 83, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5869

section 541(c)(2) clearly excludes such trusts, the legislative history does not limit the exclusion to *only* state law spendthrift trusts.[55] The legislative history provides no indication that the reference to state law spendthrift trusts was intended to be exhaustive. It therefore does not support the *Graham* court's conclusion that only those ERISA trusts that can be characterized as state law spendthrift trusts fall within the exclusion of section 541(c)(2).

The *Graham* court also reasoned that the existence of a federal exemption specifically applicable to pension benefits, Bankruptcy Code section 522(d)(10)(E),[56] evidenced a congressional intent to include ERISA plans in the bankruptcy estate.[57] The court found that this federal pension exemption and similar state exemptions comprise a "coherent scheme regarding a debtor's pension rights under the Code consistent with the Code's general policy"[58] that would be upset by excluding ERISA plans under section 541(c)(2). The court concluded that because Congress included a specific exemption dealing with pension benefits, such pension benefits are a matter of exemption, not exclusion.

A fair reading of section 522(d)(10)(E) does not support the *Graham* court's conclusion. That exemption is broad enough to cover plans that are not ERISA-qualified as well as those that are qualified.[59] Furthermore, there is no reason to believe that

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and H.R. REP. NO. 595, 95th Cong., 2d Sess. 369, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6325. The House report states:

> Subsection (c) [of Section 541] 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 the 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. at 369, 1978 U.S. CODE CONG. & AD. NEWS 6325.

55. *See* Kladder, *Employee Benefit Assets Under the Bankruptcy Reform Act and ERISA,* 10 J. PENSION PLANNING AND COMPLIANCE 85, 91 (1984).

In *Lichstrahl,* 750 F.2d at 1488, the court stated that "[b]oth [the] House and [the] Senate reports *expressly limit* section 541(c)(2) to spendthrift trusts." *Id.* at 1490 n.3 (emphasis added). A close reading of the legislative history cited by the court, however, does not reveal any such express limitation. *See* H.R. REP. NO. 395, 95th Cong., 2d Sess. 176, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5963, 6136; S. REP. NO. 989, 95th Cong., 2d Sess. 83, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5869.

56. 11 U.S.C. § 522(d)(10)(E). The text of section 522(d) is set out *supra* note 11.

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

58. *Id.*

59. *See supra* note 11. The *Graham* court conceded that "the § 522(d)

Congress did not intend qualified ERISA plans to be treated differently than other pension plans. Indeed, the more favorable tax treatment given to qualified ERISA plans under section 501 of the Internal Revenue Code[60] suggests that Congress did in fact intend to treat ERISA plans differently than other pension plans. Thus, although the inclusion of a statutory provision exempting pension plans generally may suggest that Congress intended to include a debtor's pension plan interest in the estate, section 522(d)(10)(E) does not necessarily require that a debtor's interest in a qualified ERISA plan be included in the bankruptcy estate.

Both the Fifth Circuit in *Matter of Goff*[61] and the Eleventh Circuit in *In re Lichstrahl*[62] held that all qualified ERISA pension plans are included in the bankruptcy estate unless the plan conforms to the technical requirements of the state spendthrift trust law.[63] Spendthrift trusts, however, generally must contain valid restraints on the transfer of the beneficiary's interest.[64] By definition, qualified ERISA plans satisfy this requirement.[65] In *Lichstrahl*, however, the court pierced the debtor's corporate veil to hold that the settlor-debtor's reservation of a power to amend or terminate the trust through his corporation gave him "absolute dominion" over the trust property. The trust, therefore, could not be a spendthrift trust under Florida law.[66]

In *Goff*, the trust at issue was a self-settled Keogh plan.[67] The court concluded that such a plan could not be a spendthrift trust because Texas law did not permit the settlor to be a bene-

(10)(E) exemption would apply to non-ERISA plans," but it concluded that qualified ERISA plans were within its scope as well. *Graham*, 726 F.2d at 1272.

60. 26 U.S.C. § 501 (1982); *see supra* notes 18-22 and accompanying text.

61. 706 F.2d 574 (5th Cir. 1983).

62. 750 F.2d 1488 (11th Cir. 1985).

63. *Lichstrahl*, 750 F.2d at 1490; *Goff*, 706 F.2d at 587; *see also Graham*, 24 Bankr. at 310.

64. RESTATEMENT (SECOND) OF TRUSTS § 152 (1959) defines a spendthrift trust 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."

65. *See supra* notes 23-25 and accompanying text.

66. *Lichstrahl*, 750 F.2d at 1490. Significantly, the court did not decide whether the trust qualified for special tax treatment under 26 U.S.C. § 401. *Id.* at 1490 n.4. *See infra* notes 116-22 and accompanying text.

67. A Keogh plan is a pension plan for self-employed wage-earners. *See* 26 U.S.C. § 401(c).

ficiary of a spendthrift trust.[68] This restriction is imposed to "prevent any person from placing his property in what amounts to a revocable trust for his own benefit which would be exempt from the claims of his creditors."[69]

A close reading of *Goff* and *Lichstrahl* suggests that even if state spendthrift trust law is to be determinative, a debtor's interest in a qualified employer-created ERISA plan usually should be excluded under 541(c)(2). In both *Goff* and *Lichstrahl*, the interests were included because the plans were not spendthrift trusts under state law. In general, however, qualified employer-created ERISA plans will comply with state law spendthrift trust requirements; the employer is the settlor, the employees are the beneficiaries, and the assignment and alienation restrictions satisfy the required restraints on transfer.[70] In *Graham*, in which the court determined that section 541(c)(2) excludes only those plans that qualify as spendthrift trusts under state law, the court did not cite any provisions of the plan that violated Iowa spendthrift trust law.[71] Instead, it simply relied on *Goff*, which involved a self-settled Keogh plan rather than an employer-created ERISA plan.[72]

Even though most ERISA plans would qualify as state spendthrift trusts, reliance on state spendthrift trust law to determine the excludibility of a debtor's interest creates several problems. Although spendthrift trusts are not reachable by general creditors, in some states spendthrift trust assets may be

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68. *Goff*, 706 F.2d at 586-88. The prohibition against settlors being beneficiaries of their spendthrift trusts is well established. *See* RESTATEMENT (SECOND) TRUSTS § 156 (1959); *see also* IND. CODE ANN. 30-4-3-2(b) (Burns Supp. 1984)("If the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest will not prevent his creditors from satisfying claims from his interest in the trust estate."); KY. REV. STAT. ANN. § 381.180(7) (Bobbs-Merrill Supp. 1984) ("If a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary alienation of his interest, his interest nevertheless shall be subject to alienation by operation of law or legal process.").

69. *Goff*, 706 F.2d at 588 (quoting *In re* Witlin, 640 F.2d 661, 662 (5th Cir. 1981)).

70. *See supra* note 64 and accompanying text.

71. The bankruptcy court in *Graham* concluded that the ERISA plan violated Iowa state spendthrift trust law because Graham was both the settlor and beneficiary. *Graham*, 24 Bankr. at 310. The court recognized that "in form, the settlor is the corporation" (Charles W. Graham, M.D., Ltd.), but concluded that because "Graham's earnings from his medical practice furnished the corpus of the trust . . . [Graham was] therefore both the settlor and beneficiary of the Fund." *Id.* The appellate court, however, did not note any specific violations of Iowa law.

72. *See infra* notes 111-15 and accompanying text.

reached by certain classes of creditors.[73] Common exceptions include creditors' claims for alimony,[74] for payment for necessary services,[75] and for federal and state taxes.[76] The provisions vary from state to state. Moreover, some states completely proscribe spendthrift trusts.[77] Under the *Goff* and *Lichstrahl* analysis, these variations result in different treatment of debtors' ERISA plan interests in different states. For example, if a debtor lived in a state in which spendthrift trusts are not permitted, the debtor's interest in the pension plan would become part of the bankruptcy estate. On the other hand, another debtor residing in a state that permits spendthrift trusts may be able to exclude the interest in the plan from the estate. ERISA, however, was intended to provide uniformity for pension plans by preempting state laws affecting them.[78] Reliance on state trust law to determine the scope of the 541(c)(2) exclusion would result in different treatment of ERISA plans in different states and thus destroy this intended uniformity.

Transfer of the debtor's interest in a qualified plan to the trustee in bankruptcy also would disqualify the plan under ERISA. A transfer gives the trustee a "right or interest enforcea-

73. *See* RESTATEMENT (SECOND) TRUSTS § 157 (1959); *see, e.g.,* KY. REV. STAT. ANN. § 381.180(6) (Bobbs-Merrill Supp. 1984) ("Although a trust is a spendthrift trust, the interest of the beneficiary shall be subject to the satisfaction of an enforceable claim against the beneficiary: (a) by the spouse or child of the beneficiary for support, or by the spouse for maintenance; (b) for necessary services rendered to the beneficiary or necessary supplies furnished to him; and (c) by the United States or the Commonwealth of Kentucky for taxes due from him on account of his interest in the trust or the income therefrom.").

74. *See, e.g.,* MO. REV. STAT. ANN. § 456.080 (Vernons Supp. 1984); OKLA. STAT. ANN. tit. 60, § 175.25 (West 1971); PA. STAT. ANN. tit. 48, § 136 (Purdon 1965).

75. *See, e.g.,* LA. REV. STAT. ANN. 9:2005 (WEST 1965); OKLA. STAT. ANN. tit. 60, § 175.25 (West 1971); WASH. REV. CODE ANN. § 11.96.150 (Supp. 1984).

76. *See* 4 G. BOGERT, HANDBOOK ON THE LAW OF TRUSTS AND TRUSTEES § 224 (rev. 2d ed. 1979)("The use of spendthrift provisions in a trust cannot relieve the beneficiary from obligations to the United States or a state so as to insulate his interest against a claim based on income or death taxes or similar liabilities.").

77. *See, e.g.,* N.C. GEN. STAT. § 36A-115 (Supp. 1981). This statute provides that "all estates or interests of trust beneficiaries are alienable either voluntarily or involuntarily to the same extent as are legal estates or interests of a similar nature." *Id.* The only exceptions to this general rule are discretionary, support, and protective trusts. Under this statute, no ERISA-qualified plan could be excluded from the bankruptcy estate as a spendthrift trust. *Id.*; *cf.* Industrial Nat'l Bank v. Budlong, 106 R.I. 780, 786-88, 264 A.2d 18, 21-22 (1970) (under the minority position of Rhode Island law, all spendthrift provisions are invalid).

78. *See supra* note 15.

ble against the plan," which constitutes an assignment or alienation under the Internal Revenue Code.[79] Since benefits under a plan may not be alienated or assigned if the plan is to remain qualified, the transfer to the trustee in bankruptcy would disqualify the plan.[80] Those courts that have limited the section 541(c)(2) exclusion to ERISA plans satisfying the requirements of state spendthrift trust law have overlooked this important potential consequence.[81] Furthermore, a narrow construction of section 541(c)(2) endangers not only the debtor's retirement funds but also those of the debtor's co-employees, since disqualification of the plan for one member disqualifies that plan for all other participants as well.

Moreover, the requirement that the plan not be "subject to" any process suggests that a plan in which the benefits could be reached by the trustee in bankruptcy would be disqualified at inception.[82] Therefore, in those states that do not recognize spendthrift trusts or impose technical requirements not satisifed by a particular plan, ERISA-qualified plans would be unavailable.[83] Once a plan is found to be not qualified, all of

79. Treas. Reg. § 1.401(a)-13(c)(1)(ii) (1984); *see supra* note 25.

80. 26 U.S.C. § 401(a)(13) (1982); *see also* supra notes 23-25 and accompanying text. This conclusion is supported by an Internal Revenue Service private letter ruling concluding that honoring a pension deduction order of a bankruptcy court would disqualify the plan:

> Neither the regulations under Code section 401(a)(13), nor the legislative history of this section provide any exception to the anti-alienation requirements for an attachment arising from a bankruptcy proceeding. In this case, the above-described order of the United States Bankruptcy court, if honored, would benefit the general creditors of the plan participant in question and thus, would result in a prohibited attachment.
>
> Therefore, we conclude that the honoring by Company M of the pension deduction order of the United States Bankruptcy Court will violate section 401(a)(13) of the Code and will result in the disqualification of Plan X.

IRS Letter Rulings Reports (CCH) 8,131,020 (May 5, 1981). It should be noted that private letter rulings may not be cited as precedent. 26 U.S.C. § 6110(j)(3) (1982).

81. *See Lichstrahl*, 750 F.2d at 1490; *Goff*, 706 F.2d at 587.

82. BLACK'S LAW DICTIONARY 1278 (rev. 5th ed. 1979) defines "subject to" as "*[l]iable*, subordinate, subservient, inferior, obedient to; governed or affected by; provided that; provided; answerable for." (emphasis added). If the possibility exists that a bankruptcy trustee could reach an employee-debtor's interest in an ERISA plan, the plan would be "subject to" legal or equitable process at the inception of the plan, even if no petition in bankruptcy had been filed at that time.

83. In states such as North Carolina, which proscribe the validity of anti-alienation and anti-assignment provisions in trust instruments, the provisions required by 29 U.S.C. § 1056(d) and 26 U.S.C. § 401(a) would not be enforcea-

the funds lose their tax-exempt status and all plan participants incur immediate tax liability.[84] In *Graham* only two participants were involved, and in *Lichstrahl* only one participant was affected, but in larger plans many unsuspecting participants would be forced to recognize income immediately because of the disqualification.[85] This result conflicts with ERISA's policy of encouraging deferral of compensation for use in retirement years and would render ERISA plans less attractive to both employees and employers.[86] Reliance on state spendthrift trust law to interpret section 541(c)(2) thus is inappropriate.

Cases limiting the section 541(c)(2) exclusion to state law spendthrift trusts usually have involved self-settled plans, whereas cases in which courts read section 541(c)(2) more broadly to exclude the debtor's interest from the bankruptcy estate often have involved employer-created ERISA plans.[87] Those courts that deny exclusion of ERISA plans from the bankruptcy estate under section 541(c)(2) may be moved by an often unarticulated concern that a contrary interpretation would encourage fraudulent exclusions.[88] Such a concern is not groundless, yet possibilities of fraud would be better handled on a case-by-case basis rather than by a general interpretation in-

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ble under state trust law. *See supra* note 77. If the § 541(c)(2) exclusion is held to depend on state trust law, all ERISA plans would be included in the bankruptcy estate in states such as North Carolina. Similarly, if a plan covered any employees who were residents of North Carolina the plan would be disqualified from inception because it would always be subject to claims by bankruptcy trustees.

84. *See supra* notes 21-22 and accompanying text.

85. *See id.*

86. Employers that have employees in many states would encounter substantial difficulty in qualifying pension plans under ERISA. The employer's problems would be compounded by having to requalify the plans every time a plan participant petitions for relief in bankruptcy.

87. Cases involving employer-created plans include: *In re* Phillips, 34 Bankr. 543 (Bankr. S.D. Ohio 1983); *In re* Holt, 32 Bankr. 767 (Bankr. E.D. Tenn. 1983); *In re* Pruitt, 30 Bankr. 303 (Bankr. D. Colo. 1983); and *In re* Threewitt, 24 Bankr. 927 (D. Kan. 1982). *In re* Johnson, 724 F.2d 1138 (5th Cir. 1984), involved a self-settled annuity, and *In re* Goff, 706 F.2d 574 (5th Cir. 1982), involved a self-settled Keogh plan. *Lichstrahl,* 750 F.2d at 1488, and *Graham,* 726 F.2d at 1268, both involved employer-created trusts that the courts treated as self-settled. *See infra* notes 113-15 and accompanying text.

88. *See Johnson,* 724 F.2d at 1141 (commenting that it is "unjust to allow any person to voluntarily place property in a revocable trust for his own benefit and claim it as exempt from the claims of his creditors"). *But see Goff,* 706 F.2d at 588 ("Debtors could shelter funds in Keogh plans immediately before declaring bankruptcy . . . and immediately after discharge of all debts withdraw such funds for their own benefit.").

cluding many ERISA plans in the bankruptcy estate.[89] Although it may be appropriate to deny exclusion for self-settled trusts generally,[90] to deny the section 541(c)(2) exclusion to employee interests in all employer-created ERISA plans would be contrary to both the language of the Code and the policy of ERISA. Failure to afford protection to debtors' interests in qualified, employer-created ERISA plans in bankruptcy defeats the legitimate expectation of the employee-debtor that ERISA funds will be available as an income substitute for retirement. In the long run, such a policy inevitably would discourage participation in ERISA plans. To avoid this result, and the consequent destruction of employee retirement protection, courts should hold that in the absence of fraud in the particular case, a debtor's interest in an employer-created ERISA plan is excluded from the bankruptcy estate under section 541(c)(2).

III. EXEMPTION UNDER SECTION 522

If a court determines that the debtor's interest in an ERISA plan is not excluded from the bankruptcy estate, it must determine whether the debtor's interest in the plan is exempted from the claims of the debtor's creditors. Under section 522 of the Code, the debtor may choose either the federal or state exemptions.[91] Debtors choosing the federal exemptions may exempt an interest in a pension plan "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."[92] Debtors choosing the state exemptions may under section 522(b)(2)(A) put beyond the reach of creditors any property exemptable under state law[93] and also "any property that is exempt under Federal law other than [section 522(d)]."[94] The section 522(b)(2)(A) "other federal law" exemption reflects a congressional intent to ensure the availability of certain exemptions in the event that the debtor's state has

89. *See infra* notes 113-15 and accompanying text.

90. *See id.*

91. As noted above, the debtor's choice is in fact determined by the state of the debtor's domicile. *See supra* note 10.

92. 11 U.S.C. § 522(d)(E)(10). The text of § 522(d) is set out *supra* note 11.

93. *See generally* 2 W. COLLIER, COLLIER'S BANKRUPTCY MANUAL ¶ 522.07 (3d ed. 1982) (discussing types of exempt property).

94. 11 U.S.C. § 522(b)(2)(A) (debtor may exempt "any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing").

opted out of the federal exemption scheme.[95]

In both *Graham* and *Lichstrahl*, the debtor chose the state exemptions.[96] After determining that the plans were includible in the debtors' bankruptcy estates, both courts held that the debtors' pension plans were not exempted under section 522(b)(2)(A).[97] Both debtors argued that their ERISA plan interests were exempt under federal law, asserting that the anti-assignment and anti-alienation provisions required by ERISA[98] and the Internal Revenue Code[99] barred garnishment of qualified plans by the general creditors of the beneficiary.[100] The *Graham* court, noting that the list of federal statutes set out in the legislative history illustrating the "other federal law" exemptions did not include ERISA,[101] concluded that the protection from garnishment did not constitute a federal exemption of the type referred to in the Code.[102]

The list of "other federal law" exemptions contained in the legislative history to section 522 was intended to be merely illustrative and not exclusive.[103] Although the *Graham* court perhaps placed too much emphasis on Congress's failure to include ERISA in its illustrative catalog,[104] the court's decision

95. *See In re* Hinshaw, 23 Bankr. 233, 234 (Bankr. D. Kan. 1982) (although a state may have opted out, Congress intended that all debtors have available § 522(b)(2) exemptions); *cf.* H.R. REP. NO. 595, 95th Cong., 2d Sess. 126, *reprinted in* U.S. CODE CONG. & AD. NEWS 5963, 6087 ("[T]he bill continues to recognize the States' interest in regulating credit within the States, but enunciates a bankruptcy policy favoring a fresh start.").

96. *Lichstrahl*, 750 F.2d at 1490; *Graham*, 726 F.2d at 1273.

97. *Lichstrahl*, 750 F.2d at 1492; *Graham*, 726 F.2d at 1274.

98. *See* 29 U.S.C. § 1056(d)(1) ("Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.").

99. *See* 26 U.S.C. § 401(a)(13); *see also supra* note 23 and accompanying text.

100. *See* General Motors Corp. v. Buha, 623 F.2d 455, 462-63 (6th Cir. 1980); Commercial Mortgage Ins., Inc. v. Citizens Nat'l Bank, 526 F. Supp. 510, 516 (N.D. Tex. 1981); *see also supra* note 43 and accompanying text.

101. *See supra* note 13 and accompanying text.

102. *Graham*, 726 F.2d at 1274.

103. The statutes listed are designated as "*some* of the items that may be exempted under Federal laws." S. REP. NO. 989, 95th Cong., 2d Sess. 75, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5861; H.R. REP. NO. 595, 95th Cong., 2d Sess. 360, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6316 (emphasis added).

104. *See Graham*, 726 F.2d at 1274. Relying on *Goff*, the *Graham* court concluded that ERISA was not within this exemption because it would have been included in this list had Congress intended to exempt benefits under ERISA. *Id.* The *Goff* court stated, "Congress did not 'overlook' ERISA. Given the extensive and general reach of ERISA-qualified plans, it is highly improbable that Congress intended their inclusion without mention in the Section

not to exempt the debtor's interest in an ERISA plan under section 522(b)(2)(A) is sound. The listed statutes govern pensions, wages, or benefits provided by the federal government or by employers in industries that traditionally have been closely regulated by the federal government.[105] The private pension system established under ERISA, however, is materially different from those listed. The federal government has a special interest in protecting the pensions it establishes for its employees that is not present in private pension plans.[106]

Even if a court determines that private pension fund interests may properly be exempted,[107] it still must address the problem of tax disqualification. If the exemption is allowed, the debtor will retain at least a part of the plan funds for retirement, but the entire ERISA plan would be disqualified because of the transfer of the funds to the bankruptcy trustee.[108] Immediately upon transfer, the plan becomes disqualified and the debtor *and all other plan participants* automatically must recognize the funds as gross income.[109] The exemption provisions cannot cure this result.[110]

IV. EXCEPTIONS

The language of the Bankruptcy Code, as well the policy underlying the Code and ERISA, strongly supports the exclusion of a debtor's interest in employer-created ERISA plans from the bankruptcy estate under section 541(c)(2). As some courts have recognized,[111] however, exclusion maybe inappro-

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522(b)(2)(A) exemption in the midst of a listing of significantly less comprehensive and less well known statutes." *Goff*, 706 F.2d at 585.

105. The *Graham* court observed that the listed statutes are limited in their application and govern payments that are "all peculiarly federal in nature." *Graham*, 726 F.2d at 1274.

106. The *Goff* court observed that the " 'property' covered by ERISA differs in nature from that covered under the [statutes listed in the legislative history]." *Goff*, 706 F.2d at 585-86. ERISA "sweepingly regulated" private pensions and welfare benefits, and the listed statutes dealt with pensions and welfare benefits that were publicly funded or created. *Id.* at 586; *see also supra* note 34 (public pensions were exempt under the Act because they were a "mere gratuity").

107. *See In re* Hinshaw, 23 Bankr. 233, 235 (Bankr. D. Kan. 1982).

108. *See supra* notes 18-22.

109. *See supra* notes 79-81 and accompanying text.

110. If courts continue to interpret the § 541(c)(2) exclusion to apply only to state law spendthrift trusts, 11 U.S.C. § 401(a)(2) should be amended so that this type of transfer would not be a violation of the anti-alienation restrictions. *See supra* note 80.

111. *See In re* Goff, 706 F.2d 574, 589 (5th Cir. 1982) (employer-created and

priate for self-settled plans.[112] Although employer-created ERISA plans must contain restraints on assignment and alienation corresponding to the restrictions on transfer generally required for spendthrift trusts,[113] most self-settled plans do not contain such restrictions. The required restrictions in employer-created plans serve to alleviate the risk that a debtor may attempt to use a pension fund as a means of defrauding creditors. In the absence of such restrictions, a debtor may attempt to use a self-settled plan to avoid the lawful claims of creditors. For example, the debtor could create a pension trust, transfer nonexempt property to the trust, and then, after discharge in bankruptcy, remove the assets from the trust.[114] Courts must beware of such schemes and determine on the facts of each case whether the debtor's conduct was designed to defraud creditors. If, for example, the debtor retains control of the trust funds, as in *Goff*,[115] or if the debtor transfers funds to the trust on the eve of bankruptcy, the court should not hesitate to include the debtor's interest in the plan in the bankruptcy estate. Because disqualification of the self-settled plan would not bring about adverse tax consequences to others, the court should include the plan interest in the bankruptcy estate and deal with the debtor's interest as a matter of exemption under section 522.

A similar problem arises if the employer is a corporation of which the pension plan beneficiary is the controlling shareholder. Again, because the debtor has indirect control over the funds, the debtor may attempt to assert control for the purpose of defrauding creditors. In *In re Klayer*,[116] for example, the debtor failed to observe corporate formalities and did not segregate the trust assets from his own.[117] Rather than properly

-controlled plans would be analogous to spendthrift trusts and would merit treatment different from the self-created and self-controlled Keogh plan).

112. Both Keogh plans and IRAs are self-settled pension plans. The settlor can determine the ways in which these funds are invested and, if willing to pay taxes and penalties, can terminate the plan or withdraw the funds. Keogh plans are subject to anti-alienation provisions, but other types of self-settled retirement plans are not. *See* Kladder, *supra* note 55, at 86-88; *see also* Weintraub & Resnick, *From the Bankruptcy Courts*, 16 U.C.C. L.J. 264 (1984) (discussing Keogh plans and IRAs as property of the bankruptcy estate).

113. *See supra* note 54 and accompanying text.

114. *See Goff*, 706 F.2d at 588.

115. *Id.* at 589.

116. 20 Bankr. 270 (Bankr. W.D. Ky. 1981). In *Klayer*, the pension plan was terminated in 1970, four years before ERISA was enacted. The court therefore was not required to address the question of whether an employer-created ERISA plan was includible in the bankruptcy estate under § 541(c)(2).

117. *Id.* at 274 ("[T]he debtor has made such personal use of the trust assets

holding trust assets, Klayer used them to purchase a home for his own use.[118] Similarly, in *In re Watson*,[119] the debtor contributed virtually all the funds in the plan and retained the power to withdraw those funds and terminate the trust at will. In both of these cases, the courts properly included the trust assets in the bankruptcy estate, holding in effect that each trust had become a self-settled trust.

In re Graham presents the more difficult situation in which the beneficiary is the sole shareholder of a corporation whose corporate identity has not been disregarded. Although Dr. Graham, the debtor, did not settle the trust, his corporation, Charles W. Graham M.D., Ltd., did. As director of the corporation, however, Graham determined the amount contributed to the plan. Dr. Graham did not exercise any control over the trust assets except in his capacities as director of the corporation, trustee of the plan, and member of the plan's advisory committee. Consequently, because his only powers over the plan were fiduciary in nature, the plan was analogous to a spendthrift trust.

Dr. Graham was involved in the administration of the trust, but because he was not acting in his individual capacity, the court's discussion of the self-settled nature of the trust is not dispositive.[120] The Eighth Circuit held that the section 541(c)(2) exclusion was limited to spendthrift trusts recognized by state law.[121] If the court had not ignored the corporate form, however, the plan may have qualified as a spendthrift trust. If the court was ignoring the corporate entity on the grounds that the corporation was the alter ego of Dr. Graham, it should have done so explicitly. Courts have long recognized the separate corporate existence of single shareholder corporations, and there is no reason to refuse to do so in bankruptcy if

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and has engaged in self-dealing to such a degree as to cause a merger of the legal and equitable interests in the trust.").

118. *Id.* at 271.

119. 13 Bankr. 391 (Bankr. M.D. Fla. 1981). In this case, although the plan was ERISA-qualified, all of the plan contributions were made by the debtor, and he could withdraw them at any time.

120. Although Iowa follows the general rule that one cannot be both the settlor and the beneficiary of a spendthrift trust, *see* Harrison v. City Nat'l Bank, 210 F. Supp. 362, 370 (S.D. Iowa 1962); DeRousse v. Williams, 181 Iowa 379, 382, 164 N.W. 896, 897 (1917), in *Graham* two distinct legal entities occupied these positions: the corporation was the settlor and Dr. Graham was the beneficiary.

121. The only problem cited by the court was the plan's self-settled nature. Unless the corporate entity was ignored, however, the plan was not self-settled.

the corporate form is not abused. If, on the other hand, the court believed that the corporate form was being abused, there is a well-developed body of law allowing the court to "pierce the corporate veil."[122] Thus, the *Graham* court could have reached the same result without construing section 541(c)(2) narrowly to exclude only state law spendthrift trusts. Upon finding either an abuse of the corporate entity or an attempted fraud on creditors, courts should include the debtor's interest in the bankruptcy estate. Sole shareholders, however, should not be penalized merely for choosing the corporate form.

CONCLUSION

A debtor's interest in a qualified employer-created ERISA plan usually should be excluded from the bankruptcy estate under section 541(c)(2) of the Bankruptcy Code. This exclusion would effectuate ERISA's policy of preserving pension funds for use in retirement and also would avoid the inequities created by limiting the exclusion to plans that satisfy variant state spendthrift trust law. The concern that debtors may use pension plans as a means of defrauding creditors, which seems to be the basis for decisions including ERISA funds in the bankruptcy estate, is better dealt with on a case-by-case basis rather than by a blanket rule mandating inclusion. By excluding employer-created ERISA plans from the bankruptcy estate and exempting debtor's interests in self-created plans, absent a finding of fraud, courts can protect the rights of creditors while preserving ERISA's goal of encouraging employees to save for their retirement years.

Nancy Roetman Menzel

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122. *See* F. O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE § 1.10 (2d ed. 1971).

In *Lichstrahl*, the court apparently recognized that it was ignoring the corporate entity:

> While appellant as beneficiary cannot assign or alienate his interest in the trusts, he as sole officer and director of the settlor P.A. can amend or terminate the trusts. That appellant can only amend or terminate the pension plans in his capacity as agent for the P.A. is not important here. He alone enjoys the authority to act, whether as an agent of the settlor or in his own right as trustee and beneficiary. He therefore enjoys "absolute dominion" over the property of the trusts. The reasons for creating and enforcing spendthrift trusts would not be served if we were unwilling to look beyond legal forms in this case.

Lichstrahl, 750 F.2d at 1490.