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PROTECTING PENSION ASSETS IN PERSONAL BANKRUPTCY

JEANNE CULLINAN RAY*

INTRODUCTION

An innate tension exists between the goals of the Employee Retirement Income Security Act of 1974 ("ERISA")\(^1\) and the Bankruptcy Reform Act of 1978 ("Bankruptcy Code").\(^2\) One of the most significant goals of ERISA is to preserve and protect pension benefits for the retirement security of American workers.\(^3\) By contrast, one of the primary goals of the Bankruptcy Code is to create a fair and equitable system for recompense to creditors, while discharg-

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\(^3\) See 29 U.S.C. § 1001(a) (1994). The Act states that "the continued well-being and security of millions of employees and their dependents are directly affected by these [ERISA-governed] plans," and that it is therefore desirable that "safeguards be provided with respect to the establishment, operation, and administration of such plans." *Id.*

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ing debtors from their debts.\textsuperscript{4} Obviously, the inclusion of a
debtor's pension benefits in the debtor's bankruptcy estate is of
great interest to creditors. Conversely, the ability to preserve re-
tirement assets is of primary concern to the debtor.

At the outset, it is helpful to examine \textit{Guidry v. Sheet Metal
Workers National Pension Fund},\textsuperscript{5} a nonbankruptcy case, to set the
stage for consideration of the conflicting goals of ERISA and the
Bankruptcy Code. In \textit{Guidry}, the United States Supreme Court
decided that Curtis Guidry, the chief executive officer of a labor
union local who had embezzled more than $377,000 from the
union, was entitled to receive his union pension benefits with no
offset for his embezzlement.\textsuperscript{6} The Court decided that the union's
effort to impose a constructive trust on Guidry's pension fund ben-
efits until the union was “made whole for its losses”\textsuperscript{7} was inappro-
priate, based on ERISA's section 206(d) prohibition of assignment
or alienation of benefits.\textsuperscript{8} Section 206(d), the Court reasoned, re-
flects a congressional policy decision to safeguard a stream of in-
come for pensioners and their dependents—who may be blame-
less—even if this prevents others from securing relief.\textsuperscript{9}

Clearly, ERISA's section 206(d) anti-alienation and assign-
ment provision is a pivotal factor in determining whether a plan
participant's pension benefits can be protected from the reach of
creditors in personal bankruptcy proceedings. When bankruptcy
trustees seek to reach these pension interests on behalf of credi-
tors, the key issue under the Bankruptcy Code is whether a given
set of restrictions on transfer and debtor access is sufficient to ex-
clude the restricted assets from the bankruptcy estate under sec-
tion 541(c)(2) of the Code.\textsuperscript{10}

\textsuperscript{4} See generally S. Rep. No. 989, 95th Cong., 2d Sess. 989 (1978) (discussing goals
of the Bankruptcy Code).

\textsuperscript{5} 493 U.S. 365 (1990).

\textsuperscript{6} Id. at 371-74.

\textsuperscript{7} Id. at 368 n.5.

\textsuperscript{8} Id. at 376; see 29 U.S.C. § 1056(d)(1) (1985 & Supp. 1990) (“Each pension plan
shall provide that benefits provided under the plan may not be assigned or
alienated.”).

\textsuperscript{9} \textit{Guidry}, 493 U.S. at 376. \textit{Guidry} left open the question of whether a different
result would be reached if a fiduciary breached a duty to the plan itself. Id. at 372-73;
\textit{see also} Pension Benefit Guar. Corp. v. Solmensen, 743 F. Supp. 125, 129 (E.D.N.Y.
1990) (recognizing exception to anti-alienation provision where fiduciary breached
duty to pension plan itself).

The general rule under the Bankruptcy Code is that a bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the [bankruptcy] case."\(^{11}\) This general rule is applicable "notwithstanding any provision . . . that restricts or conditions transfer of such interest by the debtor."\(^{12}\) Section 541(c)(2), however, 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 [also] enforceable in a case under [the Bankruptcy Code]."\(^{13}\) In other words, a property interest that falls within section 541(c)(2)'s blanket exception is excluded from the debtor's bankruptcy estate.

At the same time, the Bankruptcy Code, in section 522(d)(10)(E),\(^{14}\) provides for a limited exemption of particular pension benefits to the extent reasonably necessary for the support of the debtor and dependents. This article will examine the applicability of these exemptions to debtors' pension plan assets.

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\(^{12}\) Id. § 541(c)(1)(A).

\(^{13}\) Id. § 541(c)(2) (emphasis added).

\(^{14}\) Id. § 522(d)(10)(E). Section 522(d)(10)(E) exempts from a debtor's bankruptcy estate "[t]he debtor's right to receive a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor." Id. Section 522(b)(1) of the Bankruptcy Code, however, grants to each state the authority to use its own exemption statutes for its citizens rather than § 522(d). Id. § 522(b)(1); see Rhodes v. Stewart, 705 F.2d 162-63 (6th Cir.) (examining congressional prerogative allowing states to opt out of federal scheme), cert. denied, 464 U.S. 983 (1983). Thus, debtors in states that have opted out are not protected by the § 522(d)(10)(E) exemption.

I. The Impact of the Supreme Court Ruling in Patterson v. Shumate

A. Pre-Patterson v. Shumate Circuit Court Cases

The United States Supreme Court's June 15, 1992 decision in Patterson v. Shumate provided considerable protection to debtors who participate in corporate pension plans that are tax-qualified under section 401(a) of the Internal Revenue Code ("IRC") and also subject to ERISA. Specifically, the Court held that a debtor's interest in such a plan does not become property of the bankruptcy estate, and thus is protected from creditors' claims in a personal bankruptcy proceeding.

Prior to Shumate, the Fifth, Eighth, Ninth, and Eleventh Circuits had determined that the phrase "applicable nonbankruptcy law" in section 541(c)(2) referred only to state spendthrift trust laws. The anti-alienation provisions of ERISA standing alone, therefore, did not provide a basis for exempting the debtor's pension benefits from the bankruptcy estate. The Second and Seventh Circuits reached the same conclusion on other types of retirement programs which, although not subject to the anti-alienation and assignment provisions of IRC section 401(a)(13) and ERISA section 206(d)(1), contained contractual anti-assignment provisions. Courts adopting these approaches turned to an analysis of whether the debtors' retirement programs were analogous to

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17 112 S. Ct. at 2248.
19 See, e.g., Reed v. Drummond, 951 F.2d 1046, 1049 (9th Cir. 1991), vacated, 113 S. Ct. 314 (1992); Heitkamp v. Dyke (In re Dyke), 943 F.2d 1435, 1443 (5th Cir. 1991); John Hancock Mut. Life Ins. Co. v. Watson (In re Kincaid), 917 F.2d 1162, 1165-66 (9th Cir. 1990); Lichstrahl v. Bankers Trust (In re Lichstrahl), 750 F.2d 1488, 1490 (11th Cir. 1985), superseded by statute, as stated in In re Gherman, 101 B.R. 369, 371 (Bankr. S.D. Fla. 1989); Samore v. Graham (In re Graham), 726 F.2d 1268, 1271 (8th Cir. 1984).
20 See, e.g., In re Dyke, 943 F.2d at 1441 (citing In re Goff, 706 F.2d 574 (5th Cir. 1983)).
21 I.R.C. § 401(a)(13) (1988). This section states, in part: "A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated." Id.
22 See supra note 9 and accompanying text.
23 See Morter v. Farm Credit Servs., 937 F.2d 354, 358 (7th Cir. 1991), cert. denied, 112 S. Ct. 2991 (1992); Regan v. Ross, 691 F.2d 81, 82 (2d Cir. 1982).
spendthrift trusts and thus excludable from their bankruptcy estates. The Fifth, Eighth, Ninth, and Eleventh Circuits concluded that the ERISA-governed retirement plans were not valid spendthrift trusts for one of two reasons. First, if the participant created the plan, it was a self-settled trust which could not be a spendthrift trust (often the courts were reviewing so-called “Keogh” or “HR-10” plans established by self-employed individuals for themselves and their employees). Second, the debtor may have exercised too much control over the extent and timing of distributions under the plan, i.e., the debtor could obtain lump-sum distributions or plan loans.

On the other hand, some courts treated tax-qualified pension plans as equivalent to spendthrift trusts for purposes of exclusion from a bankruptcy estate. The Third, Fourth, Sixth, and Tenth Circuits held that the phrase “applicable nonbankruptcy law” in section 541(c)(2) included ERISA-governed plans, based on either ERISA’s section 206(d)(1) anti-alienation and assignment provision or IRC’s section 401(a)(13) anti-alienation and assignment provision or both coordinate anti-alienation and assignment provisions (which must be included in each tax-qualified plan, except for certain governmental and church plans). The Ninth Circuit found that a 401(k) plan that provided for loans and withdrawals

24 See Goff v. Taylor (In re Goff), 706 F.2d 574 (5th Cir. 1983). Keogh or HR-10 plans are retirement plans for self-employed individuals established pursuant to the Keogh-Smathers Act, Pub. L. No. 87-792, 76 Stat. 809 (1962) (codified in scattered sections of the IRC). See In re Dyke, 943 F.2d at 1443 (holding that self-settled trusts cannot be spendthrift trusts under Texas law).

25 See In re Reed, 951 F.2d 1046, 1050 (9th Cir. 1991), vacated, 113 S. Ct. 314 (1992); In re Lichstrahl, 750 F.2d 1488, 1489-90 (11th Cir. 1985) (superseded by statute, as stated in In re Gherman, 101 B.R. 369 (Bankr. S.D. Fla. 1989)); In re Graham, 726 F.2d 1268, 1269 (5th Cir. 1984). But see Morter, 937 F.2d at 355 (pension plan was spendthrift under state law); In re Dyke, 943 F.2d at 1450, (state law allowed debtor to exempt pension plan from bankruptcy estate); In re Kincaid, 917 F.2d 1162, 1168 (9th Cir. 1990) (holding that 401(k) plan which provided for loans and hardship withdrawals was spendthrift under state law).

was analogous to a spendthrift trust under state law.\(^{27}\) Additionally, the Fifth and Eighth Circuits determined that state laws allowing debtors to exempt tax-qualified plans from their bankruptcy estates were not preempted by ERISA.\(^{28}\)

The conflicting results in the various courts of appeals made the matter ripe for Supreme Court review. Fortunately, a case involving a tax-qualified, ERISA-governed pension plan was the first granted review by the Court.

B. Analysis of Patterson v. Shumate

The debtor in *Patterson v. Shumate*,\(^{29}\) Joseph B. Shumate, Jr., was employed for more than thirty years by the Coleman Furniture Corporation ("Coleman").\(^{30}\) Eventually, he became Coleman's controlling shareholder, president, and chairman of the board.\(^{31}\) Shumate participated in the Coleman pension plan, which satisfied all of the requirements for ERISA applicability and tax-qualified status under the IRC, including the anti-alienation and assignment provisions of both statutes.\(^{32}\) Eventually, both Coleman and Shumate encountered financial difficulties.\(^{33}\) In 1982, Coleman commenced a Chapter 11 bankruptcy proceeding, which was converted to a Chapter 7 liquidation proceeding.\(^{34}\) Subsequently, Shumate commenced his own Chapter 7 proceeding to liquidate his personal assets and obtain a discharge of his personal debts.\(^{35}\) The Coleman bankruptcy trustee liquidated the Coleman pension plan and made full distributions to all participants except Shumate, who had managed the plan.\(^{36}\) Thereafter, Shumate and his bankruptcy trustee, Patterson, sought to recover

\(^{27}\) *In re Kincaid*, 917 F.2d at 1168. *But see* Reed v. Drummond, 951 F.2d 1046, 1050 (borrowing by sole participant from tax-qualified plan indicated sufficient lack of restriction on funds to disqualify plan as spendthrift trust) *vacated*, 113 S. Ct. 324 (1992) (9th Cir. 1991).


\(^{30}\) *Id.* at 2245.

\(^{31}\) *Id.*

\(^{32}\) *Id.*

\(^{33}\) *Id.*

\(^{34}\) 112 S. Ct. at 2245.

\(^{35}\) *Id.*

\(^{36}\) *Id.*
Shumate's interest in the Coleman pension plan. The two actions were consolidated in the U.S. District Court for the Western District of Virginia.

The district court was faced with deciding whether Shumate's interest in the pension plan was property of the bankruptcy estate or whether it should be distributed to him in full. The court held that ERISA was not "applicable nonbankruptcy law" under section 541(c)(2); therefore, the plan's ERISA-mandated anti-alienation provision was not enforceable in bankruptcy and the interest was part of the bankruptcy estate.

The United States Court of Appeals for the Fourth Circuit reversed the district court's decision, holding that ERISA did constitute "applicable nonbankruptcy law" and that the anti-alienation provision in the pension plan effectively excluded Shumate's interest in the plan from the bankruptcy estate. Patterson appealed to the Supreme Court, which granted certiorari. The Supreme Court unanimously affirmed the Fourth Circuit's decision, agreeing that ERISA constitutes a type of "applicable nonbankruptcy law" contemplated by section 541(c)(2), and that interests in ERISA-governed plans are therefore excluded from bankruptcy estates.

The Court based its ruling on the plain language of 541(c)(2). It rejected the argument that the reference to "applicable nonbankruptcy law" encompassed only state law, and construed the statutory language as embracing federal law as well. The Court noted that this broader construction of the phrase comports with other references in the Bankruptcy Code to sources of law, and that when Congress intended to refer only to state law, it

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38 Shumate, 112 S. Ct. at 2245.
39 Creasy, 83 B.R. at 406. The court held that "applicable nonbankruptcy law" under Bankruptcy Code § 541(c)(2) referred to state law. Id. Therefore, in order to qualify under the exclusion, the pension plan had to qualify as a valid spendthrift trust under state law. Id. The court found that Shumate retained too much control over the pension plan, including the ability to terminate the plan and receive lump sum payments. Id. at 408-09.
41 943 F.2d at 364.
44 Id. at 2246-47.
45 Id.
did so explicitly. Thus, the Court found that Congress must have intended the phrase “applicable nonbankruptcy law” to include any applicable nonbankruptcy law, including federal law such as ERISA.

The Court next determined that the anti-alienation provision in the Coleman pension plan was enforceable under section 541(c)(2) of the Bankruptcy Code. According to the Court, the anti-alienation provisions called for by ERISA and the IRC clearly impose “restriction[s] on the transfer of a debtor’s ‘beneficial interest’ in the trust.” Coleman’s plan complied with these requirements and therefore contained a “restriction on the transfer” of the debtor’s “beneficial interest” in the plan. This restriction was “enforceable under applicable nonbankruptcy law” because a plan trustee was required by ERISA to discharge its duties “in accordance with the documents and instruments governing the plan.” Therefore, the Court held that the debtor’s interest in the Coleman pension plan was excluded from the bankruptcy estate by the plain language of section 541(c)(2).

Furthermore, the Court rejected the bankruptcy trustee’s argument that application of the section 541(c)(2) exclusion to pension plans would render superfluous the explicit exemption for pension benefits in section 522(d)(10)(E) of the Bankruptcy Code. Section 522(d)(10)(E) provides for an exemption of payments under a pension or similar plan to the extent “reasonably necessary for the support of the debtor and any dependent of the debtor.” The Court concluded that this exemption covers a significantly broader array of interests than simply tax-qualified pension plans subject to ERISA and excluded under section 541(c)(2). Thus, interests in non-tax-qualified plans such as section 403(b) annuity plans and IRAs, as well as interests in non-ERISA-governed plans such as governmental plans and certain church plans, which would generally be included in the bank-

46 Id.; see, e.g., 11 U.S.C. § 522(b)(1) (1988) (electing exemptions controlled by “the state law that is applicable to the debtor”).
47 Shumate, 112 S. Ct. at 2246-47.
48 Id. at 2247-50.
49 Id. at 2247.
50 Id.
51 Id. (quoting 29 U.S.C. § 1104(a)(1)(D) (1988)).
52 112 S. Ct. at 2248.
53 Id. at 2248-49.
55 Shumate, 112 S. Ct. at 2249.
ruptcy estate because they do not contain enforceable anti-alienation provisions, might nevertheless be exempt to some extent under section 522(d)(10)(E) based on a "needs" analysis.\textsuperscript{56} The Court found, therefore, that its interpretation of the section 541(c)(2) exclusion did not render the section 522(d)(10)(E) "needs" exemption superfluous.\textsuperscript{57}

Finally, the Court noted that even if bankruptcy law is principally concerned with making a broad range of the debtor’s assets available to creditors,\textsuperscript{58} the exclusion of qualified pension plan interests from the estate furthers two other important policy goals: (1) it assures the same treatment for pension interests irrespective of whether the debtor is in bankruptcy;\textsuperscript{59} and (2) it ensures uniform national treatment of pension plan interests, instead of subjecting them to the vagaries of state spendthrift trust laws.\textsuperscript{60}

The Supreme Court's rationale in \textit{Shumate} should also be extended to non-ERISA, tax-qualified pension plans and ERISA-governed, non-tax-qualified pension plans.\textsuperscript{61} If a pension plan is not subject to ERISA because, for example, it is a governmental pension plan, but is a tax-qualified pension plan under IRC section 401(a) or section 403(a), then the debtor's interest could be excluded based on the IRC section 401(a)(13) anti-alienation and assignment provision. (Note, however, that this provision is not technically required to be included in a tax-qualified governmental pension plan.) Similarly, if a pension plan is subject to ERISA, but is not tax-qualified under the IRC because, for example, it is a section 403(b) annuity plan, then the debtor should be able to rely on ERISA's section 206(d) anti-alienation and assignment provision.

\textsuperscript{56} Id.

\textsuperscript{57} Id. at 2248-49.

\textsuperscript{58} See 11 U.S.C. § 541(a)(1) (1988) (bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case"). The Court, however, notes that "petitioner mistakes an admittedly broad definition of includable property for a 'policy' underlying the Code as a whole." \textit{Shumate}, 112 S. Ct. at 2249.


\textsuperscript{60} \textit{Shumate}, 112 S. Ct at 2249-50; \textit{see Fort Halifax Packing Co. v. Coyne}, 482 U.S. 1 (1987) (construing “applicable nonbankruptcy law” to include ERISA, so that pension rights would not be determined by state spendthrift trust law).

\textsuperscript{61} \textit{See infra} notes 66-81 and accompanying text (discussing recent Seventh Circuit case concerning non-tax-qualified government pensions).
C. Legislative Initiatives

The Supreme Court's decision in *Shumate* left unresolved the issue of whether non-tax-qualified pension plans, e.g., 403(b) annuities and IRA's, which are also not subject to ERISA (such as governmental pension plans and certain church pension plans) can also be excluded from the participant-debtor's bankruptcy estate. This unresolved issue was addressed by Senate Bill 1985, a comprehensive bankruptcy bill introduced by Senators Howell T. Heflin (D-AL) and Charles E. Grassley (R-IA) on November 19, 1991. The bill would have excluded from bankruptcy estates some non-tax-qualified pension plan accumulations, such as section 403(b) annuity plans, section 408(k) Simplified Employee Pensions ("SEPs"), section 414(d) governmental pension plans, and section 457 deferred compensation plans. During the closing days of the 102d Congress, however, the pension protection provisions were stripped from the bill, primarily because the Judiciary Committee had not consulted with the Senate Labor and Human Resources Committee. The Senate passed the stripped-down bill by a vote of ninety-seven to zero.

On March 10, 1993, Senator Heflin introduced Senate Bill 540 entitled the "Bankruptcy Amendments Act of 1993," which included many of the provisions that were cut from the original bill. This comprehensive bankruptcy bill proposed a new section, 541(c)(3)(A), to exclude from a debtor's bankruptcy estate the assets and benefits accumulated pursuant to a pension, profit-sharing, stock bonus or other plan qualified under IRC section 401(a), 403(a), 403(b) or 408(k), or a governmental plan under IRC section 414(d) or 457. This exclusion would not apply to the extent that contributions were made in excess of IRC section 401(k), 401(m), or 415 limits on plan contributions.

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64 Id.
65 139 Cong. Rec. S2619 (1993). In its June 17, 1993 comment letter, however, the Employee Benefits Committee supported interposing a one-year "look back rule" for such excess contributions.
II. Non-ERISA, Non-Tax-Qualified Pension Plans

A. Analysis of the Seventh Circuit’s Decision in Morter v. Farm Credit Services

*Shumate* did not address the bankruptcy treatment of non-tax-qualified public pension plans that do not contain strict anti-alienation provisions. The Seventh Circuit, however, did rule on such a plan in *Morter v. Farm Credit Services*. The Supreme Court denied the creditor’s petition for certiorari, thereby leaving intact the Seventh Circuit’s holding that the *noncashable* teacher’s retirement annuity contract accumulations at issue were excluded from the participant-debtor’s bankruptcy estate under section 541(c)(2) of the Bankruptcy Code, and that these accumulations were not to be afforded dissimilar treatment in bankruptcy proceedings.

In this case the debtor, Raymond Lione Morter, had been a professor at Purdue University for more than thirty years. Under the school’s mandatory retirement policy, Professor Morter was forced to retire in 1990 at age seventy. As a condition of his employment, Morter had participated in Purdue University’s governmental retirement plan, which was funded with Teachers Insurance and Annuity Association of America/College Retirement and Equity Fund (“TIAA-CREF”) *noncashable* retirement annuity contracts. All TIAA and CREF retirement annuity contracts contain strict anti-alienation provisions. Under Purdue’s plan, the employer paid all pre-retirement contributions on Professor Morter’s behalf.

When he filed a voluntary bankruptcy petition pursuant to Chapter 7 of the Bankruptcy Code, Professor Morter listed his

67 *Id.* at 359.
68 *Id.* at 355.
69 *Id.*
70 *Id.* The TIAA-CREF plan provided funding for the retirement programs of more than 500,000 employees in over 3000 universities and colleges. *Id.; see* Peters v. Wayne State Univ., 476 F. Supp. 1343 (E.D. Mich. 1979), *rev’d*, 691 F.2d 235 (6th Cir. 1982).
71 *Morter*, 937 F.2d at 355. The TIAA contract specifically provides that “[a]ny assignment or pledge of this contract or of any benefit hereunder will be void and of no effect.” *Id.; see* Connick v. Teacher’s Ins. & Annuity, 784 F.2d 1018 (9th Cir.) (annuitant may not reach assets of TIAA-CREF plan until retirement and then only as set forth in plan), *cert. denied*, 479 U.S. 822 (1986).
72 *Morter*, 937 F.2d at 355.
interest in the retirement plan as exempt.\textsuperscript{74} The Farm Credit Services of Madison, Wisconsin and the United States bankruptcy trustee objected to this claimed exclusion.\textsuperscript{75}

In determining whether the noncashable pension accumulations should be excluded from Morter's bankruptcy estate, the Seventh Circuit stated that the “proper inquiry under section 541(c)(2), then, is not whether the accumulated funds are in a ‘traditional’ spendthrift trust, but whether the retirement plan bars the beneficiary and his creditors from reaching the funds. If it does, the plan is tantamount to a spendthrift trust under state law\textsuperscript{76} and is thus excludable from the bankruptcy estate. The court emphasized Morter's lack of access to the funds and his employer's expectations as the plan's sole funder in imposing this restriction on access.\textsuperscript{77} In fact, under the plan Morter would not have any access to the accumulations until retirement, and then only as set forth in the plan.\textsuperscript{78} Because of its approach to section 541(c)(2), and its determination that the \textit{contractual} anti-alienation provisions were enforceable under “applicable nonbankruptcy law,” the court excluded the TIAA and CREF accumulations from Morter's bankruptcy estate.\textsuperscript{79}

This holding, that qualified pension plan accumulations will be \textit{excluded} from the participant-debtor's bankruptcy estate under section 541(c)(2), is certainly preferable for debtors, as opposed to a finding that the accumulations are \textit{includable} in the bankruptcy estate, subject only to the “needs test” exemption of section 522(d)(10)(E). A blanket exclusion under section 541(c)(2) enables the pension plan to: (1) avoid having to participate in the bankruptcy proceedings in order to explain the kinds of benefits available, and being subject to investigations as to the amounts reasonably necessary for the future support of the debtor and the debtor's dependents under the section 522(d)(10)(E) exemption; and (2) avoid potentially inconsistent results among bankruptcy cases involving plan participants, depending upon the participants' levels of need to support themselves and their dependents.

\textsuperscript{74} 937 F.2d at 356.
\textsuperscript{75} Id.
\textsuperscript{76} Id. at 358.
\textsuperscript{77} Id. at 358-59. The court determined that this retirement plan was not self-settled because plan participation was a condition of employment and the debtor's employer was the sole contributor. \textit{Id.} at 358.
\textsuperscript{78} \textit{Id.} at 358; \textit{see supra} note 71.
\textsuperscript{79} 937 F.2d at 358-59.
The Morter decision required a finding that the pension accumulations were exempt under nonbankruptcy law. The state law exemptions, unlike the anti-alienation provisions of a tax-qualified plan or an ERISA-governed plan, are far from uniform and may be subjected to constitutional and public policy challenges. In addition, trends toward legislative constraint of these exemptions are emerging, e.g., the imposition of monetary caps similar to the section 522(d)(10)(E) cap or other “needs tests”). Such trends need to be monitored if the Bankruptcy Code is not amended to exclude pension funds.

Because a governmental plan is not subject to the ERISA section 206(d) anti-alienation and assignment provision, and because a section 403(b) annuity plan is not subject to the IRC section 401(a)(13) anti-alienation and assignment provision, neither fits squarely within the holding of the Supreme Court in Patterson v. Shumate.

It is arguable, however, that a section 403(b) annuity is also subject to a “restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law” within the meaning of section 541(c)(2) of the Bankruptcy Code. IRC section 401(g) provides that for purposes of sections 401, 402, 403, and 404 of the Code, the term “annuity” does not include any contract or certificate issued after December 31, 1962, which is transferable, if owned by any person other than the trustee of a section 401(a) tax-qualified trust.

Treasury Regulation 1.401-9(b)(1)(i) provides that an annuity contract will receive section 403(b) tax treatment only if it satisfies the requirements of section 401(g) and regulation 1.401-9. Satisfaction of regulation 1.401-9 requires that annuity contracts expressly contain the provisions that make the contract non-transferable within the meaning of regulation 1.401-9(b)(1)(i). In the case of a group annuity contract, the restrictions on transferability must apply to the participant’s interest under the contract.

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80 Id. at 358 (pension plan accumulations exempt if “plan is tantamount to a spendthrift trust under state law”).
83 I.R.C. § 401(g) (1988).
85 Id.
e.g., the certificate issued to the employee, rather than to the employer's interest under the group annuity contract as a whole. An annuity contract is transferable if the owner can transfer any portion of his interest in it to any person other than the contract's issuer. Thus, an annuity contract is transferable:

[I]f the owner can sell, assign, discount, or pledge as collateral for a loan or as security for the performance of an obligation or for any other purpose his interest in the . . . contract to any person other than the issuer thereof. On the other hand, for purposes of section 401(g), . . . [an] annuity contract is not considered to be transferable merely because such . . . contract, or the plan of which it is a part, contains a provision permitting the employee to designate a beneficiary to receive the proceeds of the . . . contract in the event of his death, or contains a provision permitting the employee to elect to receive a joint and survivor annuity, or contains other similar provisions.

Treasury Regulation 1.401-9(c), Example (1), sets forth an example of the P Employees' Annuity Plan which is funded by individual annuity contracts issued by the Y Insurance Company. According to Example (1):

Each annuity contract issued by such [insurance] company after December 31, 1962, provides on its face, that it is "NOT TRANSFERABLE." The terms of each such contract further provide that, "This contract may not be sold, assigned, discounted, or pledged as collateral for a loan or as security for the performance of an obligation or for any other purpose, to any person other than this company." The annuity contracts of the P Employees' Annuity Plan satisfy the requirements of section 401(g) and this section.

Because the section 401(g) nontransferability requirements attaching to post-1962 section 403(b) annuity contracts do significantly restrict the employee-participant's ability to transfer a beneficial interest in the contract, section 401(g) should arguably serve to exclude a section 403(b) annuity contract from the participant-debtor's bankruptcy estate under Bankruptcy Code section 541(c)(2).

86 Id. § 1.401-9(b)(1)(ii).
88 Treas. Reg. § 1.401-9(c) (Ex.1) (1963).
89 It should be noted, however, that the participant-debtor's ability to transfer funds from one § 403(b) annuity contract to another § 403(b) annuity contract (or to a § 403(b)(7) custodial account) might be construed by the courts to undermine the pro-
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It will be interesting to see if future courts consider section 401(g) in analyzing whether a participant-debtor's interest in a section 403(b) annuity contract should qualify for exclusion from the debtor's bankruptcy estate under Bankruptcy Code section 541(c)(2). It is more probable, however, that in the case of non-ERISA, non-tax-qualified section 403(b) annuity contracts, the courts will look to applicable state laws.

B. Impact of Cashability

It is not clear whether cashability will ultimately negatively affect non-tax-qualified public pension plan accumulations in bankruptcy proceedings. Currently, in order to be excluded from the bankruptcy estate, non-tax-qualified public pension plan accumulations must be analogous to "spendthrift trusts" and exempted by applicable nonbankruptcy law.\footnote{See Rev. Rul. 90-24, 1990-1 C.B. 51.} Spendthrift trusts limit the access of beneficiaries to accumulations. Thus, plans with cashability provisions may be unable to successfully assert that they are analogous to spendthrift trusts so that they can rely on the section 541(c)(2) bankruptcy estate exclusion.

The courts clearly take a negative view of participant-debtor access to pension accumulations.\footnote{See, e.g., Morter v. Farm Credit Servs., 937 F.2d 354, 358 (7th Cir. 1991), cert. denied, 112 S. Ct. 2991 (1992); In re VanMeter, 137 B.R. 908, 910-11 (Bankr. N.D. Ind. 1992).} Courts often include the debtor's interest in pension funds to which the debtor has access in the bankruptcy estate, often forcing pension plans to participate in the bankruptcy proceedings to explain the plan benefits, participant access, and other details. These proceedings are costly, time-consuming, and unpleasant processes in which plan participants run the risk of losing pension accumulations. The plans themselves run the risk of inconsistent results, adverse tax consequences, and disgruntled participants.

Two Indiana cases illustrate the courts' lack of tolerance for participant access to pension accumulations. In \textit{In re VanMeter},\footnote{\textit{See infra} notes 92-106 and accompanying text (discussing courts' disfavor of participant access to pension accumulations).} the United States Bankruptcy Court for the Northern District of Indiana found the most significant test under \textit{Morter} to be "the
extent of access to the plan and who has that access.\(^9\) The Van-Meter court looked favorably upon decisions that found a termination of employment requirement for cashability insufficient to support exclusion of the pension accumulations from the bankruptcy estate.\(^9\) In sum, the court implied that it would not exclude accumulations cashable only upon termination of employment, because such access defeats the analogy to those spendthrift trusts for which section 541(c)(2) was designed.\(^9\)

Another Indiana decision further illustrates the courts' negative attitude toward cashable accumulations. In *In re Garvin*,\(^9\) the bankruptcy court held that an expansive Indiana exemption\(^9\) for pension accumulations was unconstitutional for, inter alia, being too broad and not requiring limited access.\(^9\) The *Garvin* court cited an Oklahoma court's review of that state's exemption, in which the court asserted that a blanket exemption "heedlessly demolishes" the traditional public policy disfavoring trusts that allow participant access to accumulations.\(^9\)

A further issue in exemption law is the question of what happens to plan proceeds once they move from the pension plan into the possession of the participant-debtors themselves. A recent nonbankruptcy case is informative. In *Auto Owners Insurance v.*

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\(^9\) Id. at 910 (quoting Morter, 937 F.2d at 358). The VanMeter court held that the proper inquiry under § 541(c)(2) was not whether the funds were in a "traditional" spendthrift trust, but whether the plan bars the beneficiary and his creditors from reaching his funds. *Id.*

\(^9\) Id. at 910-11. The court stated that it would be "inequitable and unfair" to creditors to permit exclusion of a debtor's plan interest "and the day after she receives her discharge enable her to terminate her employment and receive the whole amount . . ." *Id.* at 911; see Employee Benefits Comm. v. Tabor, 127 B.R. 194 (S.D. Ind. 1991); *In re Cress*, 121 B.R. 1006, 1012 (Bankr. S.D. Ind. 1990); *In re Cook*, 43 B.R. 996 (N.D. Ind. 1984). The *VanMeter* court commented that even if quitting one's job to gain access to the accumulations is considered extreme and unlikely, "in a true spendthrift trust there is no possible voluntary action a beneficiary can take which would initiate an early termination of the trust or invasion of the corpus." 137 B.R. at 911.

\(^9\) 137 B.R. at 911.


\(^9\) The Indiana state law exemption essentially provides that an interest a judgment debtor has in a pension fund, a retirement fund, an annuity plan, or any similar fund, either private or public, is not subject to levy or sale on execution or any other final process. *See* Ind. Code § 34-2-28-1(a)(6) (Supp. 1990).


\(^9\) *Id.* at 602-03 (quoting *In re Garrison*, 108 B.R. 760 (Bankr. N.D. Okla. 1989)). TIAA-CREF had a similar experience with its *cashable* supplemental retirement annuity contracts under North Carolina law. *See* Richardson v. TIAA-CREF, 123 B.R. 540 (E.D.N.C. 1991) (holding that cashable retirement annuities could not be exempted from bankruptcy estate as matter of public policy).
Berkshire, the Illinois Court of Appeals ruled that if the participant-debtor continues to hold and use funds distributed by the plan for support, the exemption statutes will continue to mandate their exemption. Conversely, if the debtor takes a lump-sum distribution and reinvests it, the purpose of the exemption statutes—to support the debtor and dependents and prevent them from becoming public wards—is not being satisfied and the funds will not be exempted. Funds not being used for support will lose their exempt status. Thus, exempt funds in the bank accounts of the debtor retain their status as long as they retain the "quality of moneys." Since recent legislative initiatives fail to deal with this issue, cases such as Berkshire may provide a basis for similar litigation under the Bankruptcy Code.

C. Treatment of Other Plans

Keogh or HR-10 plans are tax-qualified plans established by self-employed individuals for themselves or their employees. As tax-qualified plans, Keogh plans are required to include the Code section 401(a)(13) anti-alienation and assignment provision. To the extent that Keogh plans cover common-law employees, they will normally be subject to ERISA and its section 206(d) anti-alienation and assignment provision. Hence, Keogh plan accumulations are probably protected under the reasoning of Patterson v. Shumate.

IRC section 408(a) individual retirement accounts, and section 408(b) individual retirement annuities (collectively "IRAs"), are essentially self-settled. IRAs are non-tax-qualified, do not restrict alienation, and permit total distribution on demand subject only to tax penalties. As a result, they are deemed includ-
able in a participant's bankruptcy estate by case law. In fact, IRAs would not even qualify for exclusion under the proposed Bankruptcy Code section 541(c)(3)(A) in the 1993 version of Senate Bill 540. Under the theory articulated in Shumate, however, they might nevertheless be exempted under section 522(d)(10)(E) subject to proof of the needs of the debtor and his dependents. Several courts have held that the debtor's interest in an IRA becomes the property of the bankruptcy estate, unless it is a so-called "rollover IRA." SEPs under section 408(k) of the Code have been afforded similar treatment. Proposed Bankruptcy Code section 541(c)(3)(A), however, would exclude SEPs from a participant's bankruptcy estate.

CONCLUSION

The 1990 Supreme Court decision in Guidry set the stage for the use of ERISA section 206(d) to preserve and protect pension benefits by disallowing the imposition of a constructive trust on the debtor's pension benefits. Today, all pension plan participants benefit greatly from the 1992 Supreme Court decision in Patterson v. Shumate, where the Court clearly balanced two significant competing goals in favor of the non-alienation of retirement accumulations. Additionally, plan administrators of tax-qualified or ERISA-governed plans can relax, no longer threatened with having to choose between disobeying turnover orders from the bankruptcy courts and possible tax disqualifications by the I.R.S. Finally, Shumate has given Congress a strong incentive to further amend the Bankruptcy Code to expressly extend the pension benefit exclusion to non-ERISA plans, such as governmental plans and certain church plans, and to certain non-tax-qualified plans, such as section 403(b) annuities and rollover IRAs.

111 See Patterson v. Shumate, 112 S. Ct. 2242, 2249 (1992) ("§ 522(d)(10)(E) exempts from a bankruptcy estate a much broader category of interests than § 541(c)(2).").