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ERISA QUALIFIED PENSION PLAN BENEFITS AS PROPERTY OF THE BANKRUPTCY ESTATE: THE UNANSWERED QUESTIONS AFTER *PATTERSON v. SHUMATE*

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I. INTRODUCTION

Prior to the 1992 Supreme Court decision in *Patterson v. Shumate*,¹ a vexing issue in bankruptcy law was whether ERISA qualified pension plan benefits should be considered an asset of the debtor that should be included in the bankruptcy estate, and thereby be made available to the trustee to satisfy creditor claims. This problem emanated from interpretations of two important subsections of the Bankruptcy Code. First, section 541(a)(1) provides that the bankruptcy estate shall consist of "all legal or equitable interests of the debtor in property as of the commencement of the case."² There can be no question that this broad language was meant to include pension plan benefits as property of the

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1. 112 S. Ct. 2242 (1992).

2. 11 U.S.C. § 541(a)(1) (1988). See H.R. REP. NO. 595, 95th Cong., 1st Sess. 367 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6323; S. REP. NO. 989, 95th Cong., 2d Sess. 82 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5868.

bankruptcy estate absent some other disqualifying provision within the Code. The second part of this pre-*Patterson* analysis required a review of section 541(c)(2) which states that a trust will be excluded from the estate if there is an anti-alienation clause restricting the participant's ability to freely transfer an interest.³ In addition, this "anti-alienation" provision is required by the Bankruptcy Code to be enforceable under "applicable nonbankruptcy law."⁴

For nearly a decade a veritable judicial free-for-all developed among the various federal appellate courts as to the correct interpretation of the phrase "applicable nonbankruptcy law."⁵ Bankruptcy debtors had much at stake in this dispute since all ERISA qualified pension plans by definition include an anti-alienation clause, thereby raising the prospect that plan benefits should be excluded from the estate.⁶ Interestingly, there is a similar anti-alienation provision in the Internal Revenue Code (IRC),⁷ which raised even more questions concerning Congressional intent as to whether pension plan benefits were property of the bankruptcy estate.

Three case lines eventually developed delineating different approaches to this definitional problem. Prior to 1991, the majority view held that "applicable nonbankruptcy law" should be defined narrowly to mean only state spendthrift trust law.⁸ Although this approach seemed at odds with the actual language of the Bankruptcy Code, proponents were able to find support in the legislative history.

A second approach achieved parity with the majority view in 1991. Decisions by the Third,⁹ Sixth,¹⁰ and Tenth¹¹ Circuits posited that the majority view prior to 1991 was derived from an improper reliance on legislative history.¹² Proponents of this

3. 11 U.S.C. § 541(c)(2) (1988). The Internal Revenue Code, 26 U.S.C. § 401(a)(13) (1988), and ERISA, 29 U.S.C. § 1056(d)(1) (1988), contain similar anti-alienation clauses.

4. 11 U.S.C. § 541(c)(2).

5. See *infra* notes 26-39 and accompanying text.

6. 29 U.S.C. § 1056(d)(1) (1988).

7. 26 U.S.C. § 401(a)(13)(A) (1988).

8. See *infra* notes 29-40 and accompanying text.

9. *Velis v. Kardanis*, 949 F.2d 78 (3d Cir. 1991).

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

11. *In re Harline*, 950 F.2d 669 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 2991 (1992).

12. *In re Lucas*, at 603.

approach held that had Congress intended to limit the meaning of "applicable nonbankruptcy law" to state spendthrift trust laws it would have provided explicit language in section 541(c)(2) restricting the reach of the Code.¹³ Proponents of the second view concluded "applicable nonbankruptcy law" certainly contemplated both state and federal law and that this provision should be accorded its "plain meaning."¹⁴ The obvious conclusion from this analysis was that the federal ERISA statute must be viewed as "applicable nonbankruptcy law," and therefore, an anti-alienation provision in any plan meant that plan benefits had to be excluded from the bankruptcy estate.¹⁵

Another line of cases achieved the same result as the second approach, but did so by relying on the preemption clause contained in section 541(a) of ERISA.¹⁶ This section provides that ERISA shall "supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."¹⁷ Such preemption provisions are contained in other federal statutes,¹⁸ and according to proponents of this approach rendered any discussion about the inclusion of pension plan benefits in the bankruptcy estate moot.¹⁹ Under this approach state spendthrift trust law was nullified by the preemption provision.

Finally, a third approach arose from decisions exclusively within the Eighth Circuit. These decisions held that ERISA qualified pension plan benefits must be included in the bankruptcy estate, and that the proper question was whether the benefits could then be claimed by the debtor as exempt property under either state or federal law.²⁰

13. *Shumate v. Patterson*, 943 F.2d 362, 364-65 (4th Cir. 1991), *aff'd*, 112 S. Ct. 932 (1992).

14. *Id.* at 364-65.

15. *Id.* at 365.

16. 29 U.S.C. § 514(a) (1988).

17. *Id.*

18. The Airline Deregulation Act of 1978 provides in § 1305(a)(1) that the states are preempted from enforcing any law "relating to rates, routes, or services of any air carrier." 49 U.S.C. app. § 1305(a)(1) (1988). By comparison, the Telephone Consumer Protection Act of 1991 (TCPA) contains a provision which expressly provides that state law which imposes intrastate requirements more restrictive than federal law will not be preempted by the TCPA. 47 U.S.C. § 227(e) (Supp. III 1991).

19. *See, e.g., In re Sellers*, 107 B.R. 152 (Bankr. E.D. Tenn. 1989); *In re Bryant*, 106 B.R. 727 (Bankr. M.D. Fla. 1989).

20. *In re Graham*, 726 F.2d 1268 (8th Cir. 1984). *See also In re Ridenour*, 45 B.R. 72, 77 (Bankr. E.D. Tenn. 1984), *overruled by In re Leamon*, 121 B.R. 974

The decision in *Patterson* put to rest the ambiguity regarding the treatment of qualified pension plan benefits in bankruptcy proceedings. The Court relied heavily on the fact that the Bankruptcy Code is fraught with specific references to "state law," and posited that it is, therefore, inconceivable that the phrase "applicable nonbankruptcy law" should be construed to refer only to state spendthrift trust law.²¹ In the Court's view, a narrower construction of this language could only be supported by an express reference to state law.²²

The result reached in *Patterson* is not as important as the manner in which the Court dealt with the competing views. Given that the opinion appeared to deal summarily with the opposing views, why did it take the Supreme Court so long to take on this issue? Also, how could the federal appellate courts have reached so many different opinions regarding the meaning of the phrase "applicable nonbankruptcy law" as used in the Bankruptcy Code? In the past, the Supreme Court has been less than forthright in consistently following a "plain meaning" analysis of the Bankruptcy Code's language. In his concurring opinion in *Patterson*, Justice Scalia pointed out that in *Dewsnup v. Timm*²³ the Court had refused to follow a consistent methodology in defining statutory language such as that being debated in *Patterson*.²⁴ In *Dewsnup*, the Court refused to consider how a phrase was used in another section of the Code in favor of focusing on its meaning in one isolated subsection.²⁵

The *Patterson* decision left many questions unanswered. Since *Patterson* dealt with ERISA qualified pension plans, serious questions still exist as to the proper treatment in bankruptcy of nonqualified plans, such as Individual Retirement Accounts (IRA) and Keogh accounts. Participants in these plans clearly are not afforded the broad protection of *Patterson*, and they are left to seek remedies in other sections of the Bankruptcy Code. Additionally, there remain serious questions about how the *Patterson* case will square with potential issues raised under the fraudulent transfer and voidable preference provisions of the Code. Finally,

(E.D. Tenn. 1990) (quoting H.R. REP NO. 595, 95th Cong., 1st Sess. 176 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6136).

21. *Patterson v. Shumate*, 112 S. Ct. 2242, 2246-47 (1992).

22. *Id.* at 2246.

23. 112 S. Ct. 773 (1992).

24. *Patterson*, 112 S. Ct. at 2250-51.

25. *Dewsnup*, 112 S. Ct. at 776-78.

there is the issue of nondischargeability of debts. Should ERISA qualified plan benefits survive bankruptcy, will nondischarged creditors be able to access the assets of a qualified plan following the termination of the bankruptcy proceeding? These open questions raise significant issues of equity for participants in nonqualified versus qualified pension plans which would appear not to be in keeping with the underlying policy rationale of *Patterson*.

To better understand the impact of *Patterson*, as well as future debates regarding conflict between state and federal law in the Bankruptcy Code, this article will review the underlying case law that set the stage for this judicial showdown. Part II specifically analyzes the competing case lines which excluded pension plan benefits from the bankruptcy estate. Part III briefly summarizes those cases which concluded that plan benefits must be included in the estate but may be subject to exemption under state or federal law. Part IV reviews the *Patterson* opinion in detail, as well as the issues and analysis presented by the Court, and Part V addresses the open questions that remain after *Patterson*. Finally, some concluding remarks are offered to summarize the importance of *Patterson* in terms of its impact on uniform treatment of debtors regardless of jurisdiction, as well as the possibility of future conflicts over Bankruptcy Code language given the Supreme Court's reliance on the so-called "plain meaning" approach.

II. INCLUDING ERISA PLAN BENEFITS IN THE BANKRUPTCY ESTATE PRE-*PATTERSON*

Section 541(c)(2) of the Bankruptcy Code provides that a debtor's interest in a pension plan will not become the property of the bankruptcy estate if two conditions are met.²⁶ First, the plan must include an anti-alienation clause prohibiting transfer of plan assets.²⁷ This is a mere formality when qualified plans under ERISA are being considered since ERISA requires that an anti-alienation clause be included in any qualified pension plan. Second, the transfer restriction must be enforceable under "applicable nonbankruptcy law."²⁸ This presents the more difficult question regarding the treatment of pension plan benefits. The construction of the phrase "applicable nonbankruptcy law" is determina-

26. 11 U.S.C. § 541(c)(2) (1988).

27. *Id.*

28. *Id.*

tive of whether plan benefits are included in the bankruptcy estate.

The majority view prior to 1991 held that the phrase referred strictly to state spendthrift trust law, not to any other federal or state law. Presumably, this meant that there could be no collateral references to ERISA or the Internal Revenue Code. This view was followed by the Second,²⁹ Fifth,³⁰ Ninth,³¹ and Eleventh³² Circuit Courts of Appeals and presented a curiously limited interpretation of the phrase "applicable nonbankruptcy law." No such limitation was specifically mentioned in the Bankruptcy Code, yet federal appellate courts seemed convinced that such a restrictive view was necessary. By following state spendthrift trust law, these courts believed that the pension plan should place serious restrictions on the participants' ability to control the fund assets. These "employer settled" plans were distinguished from "self settled" plans which were ruled not to qualify as state spendthrift trusts since the debtor typically had too much control over the trust fund.

The decision by the Fifth Circuit in *In re Goff*³³ highlighted the primary points of the majority view. In *Goff*, the Court reviewed the legislative history of section 541(c)(2) and examined the language which referred to spendthrift trusts.³⁴ This language provided that a "debtor's interest in a spendthrift trust to the extent the trust is protected from creditors under applicable state law" would be excluded from the bankruptcy estate.³⁵ According to the Fifth Circuit, the only logical interpretation was

29. See, e.g., *Regan v. Ross*, 691 F.2d 81 (2d Cir. 1982).

30. See, e.g., *In re Goff*, 706 F.2d 574 (5th Cir. 1983).

31. See, e.g., *In re Daniel*, 771 F.2d 1352 (9th Cir. 1985), cert. denied, 475 U.S. 1016 (1986).

32. See, e.g., *In re Lichstrahl*, 750 F.2d 1488 (11th Cir. 1985), superseded by statute as stated in *In re Gherman*, 101 B.R. 369 (Bankr. S.D. Fla. 1989).

33. 706 F.2d 574 (5th Cir. 1983).

34. *Id.* at 578. The court defined a spendthrift trust:

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

Id. at 580.

35. *Id.* at 581 (quoting H.R. REP. NO. 595, 95th Cong., 2d Sess. 369 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6325).

that this passage referred only to state spendthrift law and to no other nonbankruptcy law.³⁶

In *Goff*, the court also analyzed whether Congress intended pension plan benefits to be included as property of the bankruptcy estate under section 541(a) or to be considered exempt property pursuant to section 522.³⁷ This approach was justified since section 522, the federal exemption provision, made specific reference to pension plans, whereas section 541(c)(2) made no mention of such plans.³⁸ According to the Fifth Circuit, this narrowly defined the term "applicable nonbankruptcy law" to include only appropriate state spendthrift trust law.³⁹ Finally, the Fifth Circuit considered the question of federal preemption under ERISA. The Fifth Circuit concluded that ERISA's broad preemption provision did not extend to the Bankruptcy Code, or to any other federal statute for that matter.⁴⁰ For all practical purposes, the *Goff* decision was limited in that it did not extend to all pension plans, but rather only to those that were controlled by appropriate state spendthrift trust law.

Before 1991 only the Fourth Circuit followed the approach that would ultimately be adopted by the Supreme Court in *Patterson*. The so-called "plain meaning" view supported an interpretation of section 541(c)(2) that was not as constraining as that followed by the then majority of appellate courts.⁴¹ *In re Moore* held that the phrase "applicable nonbankruptcy law" should be construed broadly so as to include both state and federal law.⁴² Any restriction limiting an analysis to only state spendthrift trust law was overly narrow, and all that mattered was that the court consider whether the plan benefits were subject to any claims by creditors arising from any nonbankruptcy law.⁴³ The *Moore*

36. *Id.* at 582. See also *In re Brooks*, 844 F.2d 258 (5th Cir. 1988).

37. *Goff*, 706 F.2d at 581.

38. *Id.* at 585-86.

39. *Id.* at 586.

40. *Id.* at 587-89.

41. *In re Moore*, 907 F.2d 1476 (4th Cir. 1990).

42. *Id.* at 1477. See also *In re Threewit*, 24 B.R. 927 (Bankr. D. Kan. 1982); *In re Holt*, 32 B.R. 767 (Bankr. D.N.J. 1984); *In re Phillips*, 34 B.R. 543 (Bankr. D.S. Ohio 1983); *In re Rodgers*, 24 B.R. 181 (Bankr. D. Ariz. 1982); *In re Pruitt*, 30 B.R. 330 (Bankr. D. Colo. 1983); *In re Ralston*, 62 B.R. 502 (Bankr. D. Kan. 1986). The *Ralston* court noted that "the term 'spendthrift trust' does not appear in any relevant section of the Bankruptcy Code, in fact, it is not mentioned except in reports of the House and Senate." *Id.* at 503.

43. *In re Moore*, 907 F.2d 1476 (4th Cir. 1990).

court's analysis did not consider the legislative history even though the *Goff* court had relied on it heavily.⁴⁴ More importantly, according to the Fourth Circuit, section 541(c)(2) was not vague or ambiguous in terms of references to state law.⁴⁵ Congress had been very specific in the Bankruptcy Code when it intended to refer only to state law.⁴⁶ Such references were clear and incontrovertible. Since section 541(c)(2) did not contain any such reference, an interpretation limiting the scope of the provision to state law was inconsistent with a complete reading of the Code.⁴⁷ The "plain meaning" view increased in popularity in 1991. Beginning in January, four cases were decided by the Third,⁴⁸ Sixth,⁴⁹ and Tenth⁵⁰ Circuit Courts of Appeals that evened the split between the appellate courts and set the stage for a review by the Supreme Court. The first case to follow the *Moore* opinion was *In re Lucas*,⁵¹ which was decided by the Sixth Circuit on January 14, 1991. Again, the facts were not materially different from all other cases presenting the same issue at the federal appellate level. The Sixth Circuit, however, was somewhat more insightful by making two very important observations. First, if the anti-transfer clause of a qualified ERISA pension plan can be enforced against a creditor, then such clause could similarly be enforced against a bankruptcy trustee.⁵² From this point, it was logical to conclude that the ERISA required anti-alienation clause had to be "applicable nonbankruptcy law" as that term was used in the appropriate Code section.⁵³ Considering the inter-relationship of three significant federal statutes, the Bankruptcy code, ERISA and the Internal Revenue Code, the then majority approach could not possibly reflect the intent of the statutory language.⁵⁴

The Sixth Circuit also addressed an issue not considered previously by other courts. Specifically, whether the Internal Revenue Service could and would disqualify any pension plan where

44. *Id.* at 1478-79.

45. *Id.*

46. *In re Moore*, 907 F.2d 1476, 1478 (4th Cir. 1990).

47. *Id.*

48. *See Velis v. Kardanis*, 949 F.2d 78 (3d Cir. 1991).

49. *See In re Lucas*, 950 F.2d 597 (6th Cir. 1991), *cert. denied*, 111 S. Ct. 2275 (1991).

50. *See In re Harline*, 950 F.2d 669 (10th Cir. 1992).

51. 924 F.2d 597 (6th Cir. 1991), *cert. denied*, 111 S. Ct. 2275 (1991).

52. *Id.* at 603.

53. *Id.* at 601.

54. *Id.* at 603.

the trustee transferred fund assets pursuant to a court decision interpreting section 541(c)(2).⁵⁵ During the 1980's, the IRS issued a series of private letter rulings in which it consistently took the position that a court ordered transfer of assets to the bankruptcy trustee by a trustee of a qualified pension plan, would trigger the disqualification of the plan.⁵⁶ Although some observers doubted that the IRS would take such serious action, there was no question that the consequences would be catastrophic for plan participants. Any plan assets distributed to a bankruptcy trustee would have been taxable to the individual participants as ordinary income. Further, the employer would lose a deduction for plan contributions. Most of the primary tax incentives that led to the creation of the plan would be lost. Regardless of whether the IRS was simply declaring its statutory prerogative or setting the stage for either judicial or legislative action on this matter, the Sixth Circuit reasoned that the "plain meaning" approach was a more consistent approach to solving this problem.⁵⁷

Following the lead of the Fourth and Sixth Circuits, in late 1991, the Third⁵⁸ and Tenth⁵⁹ Circuits rendered decisions adopting the "plain meaning" approach. Little noticed at this time was the fact that the Fourth Circuit had affirmed its decision in *Moore* by applying the precedent in *Shumate v. Patterson*.⁶⁰ Although there is no way to be certain, it seems reasonable to speculate that this issue was getting considerable attention and the even split of eight circuits, following the state spendthrift trust and plain meaning views, mandated a resolution.

It also should be noted that the Eighth Circuit Court of Appeals had weighed in with yet a third view regarding the inclusion of pension plans in the bankruptcy estate. In the case of *In re Graham*,⁶¹ the Eighth Circuit held that plan benefits were includable in the estate, but became subject to potential exemp-

55. *Id.*

56. Priv. Ltr. Rul. 91-09-051 (Dec. 5, 1990); Priv. Ltr. Rul. 90-11-037 (Dec. 20, 1989); Priv. Ltr. Rul. 89-51-067 (Sept. 28, 1989); Priv. Ltr. Rul. 89-10-035 (Dec. 9, 1988); Priv. Ltr. Rul. 88-29-125 (Mar. 30, 1984); Priv. Ltr. Rul. 81-31-020 (May 5, 1981).

57. *In re Lucas* 924 F.2d 597, 603 (6th Cir.), *cert. denied*, 111 S. Ct. 2275 (1991).

58. *Velis v. Kardanis*, 949 F.2d 78 (3d Cir. 1991).

59. *In re Harline*, 950 F.2d 669 (10th Cir. 1991).

60. 943 F.2d 362 (4th Cir. 1991), *aff'd*, 112 S. Ct. 2242 (1992).

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

tion under section 522.⁶² This decision was premised on the rationale that the language of the exemption provision was specific in delineating special treatment for pension plan benefits.⁶³ This exemption approach had received consideration in a number of bankruptcy cases⁶⁴ and those opinions revealed yet another interesting twist in resolving the question as to how qualified plan benefits should be handled ultimately.

III. ERISA PLANS AS EXEMPT PROPERTY PRE-*PATTERSON*

Under pre-*Patterson* law, a debtor whose pension plan benefits were included in the bankruptcy estate could still argue that these assets were exempt property under Bankruptcy Code section 522.⁶⁵ This section provides a list of property that is considered exempt under federal bankruptcy law and must be returned to the debtor. A debtor is permitted to choose between this list of exempt property and an exemption list provided by state law and "other federal nonbankruptcy law," the only restriction being that the state in which the petition is filed must have chosen not to "opt out" of the federal exemption list. Section 522(b)(2)(A) provides that debtors in these so-called "opt out" states may rely on state exemption law, as well as any exemptions provided by "other federal nonbankruptcy law."⁶⁶ In states that had not opted out of the federal scheme, pre-*Patterson* debtors could claim a partial exemption for pension benefits under section 522(d)(10)(E). This particular provision limited the exemption, however, to that amount "reasonably necessary for the support of the debtor and any dependent of the debtor."⁶⁷ Under the decisions interpreting this provision, debtors were not very successful in protecting the full value of the plan.⁶⁸ Consequently, debtors in non-opt-out states often sought to protect their full plan benefits pursuant to

62. *Id.* at 1273.

63. *Id.* at 1272.

64. *In re Hinshaw*, 23 B.R. 233 (Bankr. D. Kan. 1982).

65. 11 U.S.C. § 522(d) (1988).

66. Thirty-five states have enacted statutes opting out of the federal exemption list including: Alabama, Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Missouri, Montana, Nebraska, Nevada, New Hampshire, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming.

67. 11 U.S.C. § 522(d)(10)(E) (1988).

68. *In re Clark*, 711 F.2d 21 (3d Cir. 1983); *In re Taff*, 10 B.R. 101, 107 (Bankr. D. Conn. 1981).

section 522(b)(2)(A).⁶⁹ They were, in essence, similarly situated with those debtors in opt-out states who were precluded from relying upon the federal exemption list.

This situation led to yet another controversy relative to the interpretation of Code language. Since section 522(b)(2)(A) allowed debtors to protect plan benefits by looking either to a state exemption list or exemptions provided under "other federal nonbankruptcy law," they sought refuge in the ERISA statute in order to protect maximum plan benefits. The argument was made that ERISA constituted "other federal nonbankruptcy law" as contemplated in section 522, and therefore, the entire plan should be exempt. Not surprisingly, most of the federal circuits following the state spendthrift rule took the position that ERISA was the type of federal law that could be applied by these debtors.⁷⁰ These circuits held that the legislative history's non-exclusive list of benefits and payments that could be exempted under other federal nonbankruptcy law did not specifically mention ERISA, and as a result, did not contemplate ERISA as falling within the purview of section 522.⁷¹ This majority view was adopted despite a limited number of bankruptcy court rulings to the contrary.⁷²

IV. MANDATED EXCLUSION: *PATTERSON V. SHUMATE*

On June 15, 1992, the Supreme Court rendered its decision in *Patterson v. Shumate*,⁷³ and in doing so ended the debate as to whether ERISA qualified pension plan benefits should be included in the bankruptcy estate. For all the conflicting precedents in the lower courts, the *Patterson* decision was strikingly straight forward. The Court did not engage in a lengthy review of the disparate viewpoints followed by the various courts of appeals, but rather, chose to deal with these issues briefly in concluding that the uniformity of treatment of pension plans was a key objective.⁷⁴

69. 11 U.S.C. § 522(b)(2)(A) (1988).

70. *In re Goff*, 706 F.2d 574, 583-86 (5th Cir. 1983); *In re Graham*, 726 F.2d 1268, 1274 (8th Cir. 1984); *In re Daniel*, 771 F.2d 1352, 1360-61 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986); *In re Lichstrahl*, 750 F.2d 1488, 1491 (11th Cir. 1985).

71. *In re Goff*, 706 F.2d at 586.

72. *In re Hinshaw*, 23 B.R. 233 (Bankr. D. Kan. 1982).

73. 112 S. Ct. 2242 (1992).

74. *Id.* at 2250. The Court stated:

Finally, our holding furthers another important policy underlying ERISA: uniform national treatment of pension benefits. . . Construing "applicable nonbankruptcy law" to include federal law insures that the

Patterson involved a pension plan operated by the Coleman Furniture Company. Coleman's plan had approximately four hundred participants and was qualified under ERISA. One of the participants, and the respondent in *Patterson*, was John B. Shumate, a thirty year employee of the firm who eventually rose to the position of president and chairman of the corporate board.⁷⁵

By the early 1980's, Coleman was experiencing serious financial difficulties which led to the filing of a Chapter Eleven reorganization petition.⁷⁶ The firm was unable to satisfactorily meet the requirements of reorganization, and ultimately its case was converted to a Chapter Seven liquidation with Roy V. Creasy serving as trustee.⁷⁷ During this same time period, Shumate's personal financial condition worsened, and he was forced to file for protection under the reorganization provisions of the Bankruptcy Code. His case also was converted to a Chapter Seven liquidation with John R. Patterson being appointed as trustee.⁷⁸ Creasy was the first to take action regarding Coleman's pension plan. Creasy terminated the plan according to court order, provided for liquidation of assets, and made complete distributions to all plan participants with the exception of Shumate.⁷⁹ At that point Patterson took an

security of a debtor's pension benefits will be governed by ERISA, not left to the vagaries of state spendthrift law.

Id.

75. *Id.* at 2245. Shumate controlled 96% of all issued and outstanding stock at Coleman Furniture Company. He owned 54% outright and controlled another 42% through a revocable trust, which he had set up as settlor and was also acting as trustee. Eventually, he revoked the trust in order to own 96% of Coleman's stock outright. Brief for the Petitioner at 5 (hereinafter referred to as "Petitioner's Brief"). Patterson, acting as Shumate's bankruptcy trustee, also emphasized that as Coleman's majority stockholder, Shumate was in a position to replace the entire Board of Directors and that the Board could terminate the company's Plan at will and without cause. *Id.* at 5-6. This argument was relied upon at the district court level, which held that "Shumate could have terminated the plan at any time before the bankruptcy and received not only his pension interest, but any excess funds not needed to satisfy the rights of other participants." *Id.* at 6.

76. *Id.* The Chapter Eleven petition was filed on November 3, 1982. Brief of Respondent at 2 (hereinafter referred to as "Respondent's Brief").

77. *Id.* There is some disagreement as to whether the Chapter Seven conversion occurred in February 1983, see Petitioner's Brief at 6, or in November 1983, see Respondent's Brief at 2.

78. *Id.* Shumate filed a Chapter 11 petition on June 1, 1984, which later was converted to Chapter 7 on August 24, 1984.

79. *Id.* See *Creasy v. Coleman Furniture Corp.*, 763 F.2d 656 (4th Cir. 1985). Since all participants in the Coleman Plan except Shumate had a distribution,

adversarial position by filing an action to protect and recover Shumate's interest in the plan.⁸⁰ This action was filed in the Bankruptcy Court for the Western District of Virginia and was coupled with a request made to the United States District Court for the Western District of Virginia as part of a related proceeding over which the latter court had jurisdiction.⁸¹ In the district court proceeding, Patterson requested an order compelling Creasy to pay the plan benefits over to him. Subsequently, both actions were consolidated in district court.⁸²

Shumate contended that his Plan interest had to be excluded from his bankruptcy estate. However, the district court ruled that the reference in Bankruptcy Code section 541(c)(2) to "nonbankruptcy law" included only state law and not federal law.⁸³ Shumate's interest was reviewed in accordance with Virginia case law to determine if it could be termed a spendthrift trust, thereby qualifying for protection. The court concluded that it did not, and similarly disposed of Shumate's alternative argument that his Plan interest was to be treated as exempt property pursuant to section 522(b)(2)(A).⁸⁴ Creasy was finally directed to pay Shumate's plan interest over to Patterson on behalf of the individual bankruptcy estate. An appeal from this decision was taken to the Fourth Circuit.⁸⁵

the surplus or "plan reversion" was paid over to the Company's bankruptcy estate. Petitioner's Brief at 8.

80. *Patterson v. Shumate*, 112 S. Ct. 2242, 2245 (1992). The Adversary Proceeding for turnover was filed in Bankruptcy Court on April 24, 1987, pursuant 11 U.S.C. § 542. This "Turnover Action" was instituted to secure Shumate's plan benefits for his personal bankruptcy estate. See Petitioner's Brief at 8, and Respondent's Brief at 3.

81. *Id.* It was agreed by Shumate, Patterson, and Creasy, that Shumate's interest in the Plan was valued at \$250,000. This agreement subsequently was approved by court order dated December 3, 1987. Respondent's Brief at 3.

82. *Id.* The district court agreed to hear all matters relating to the disposition of Shumate's company plan benefits. Petitioner's Brief at 8.

83. *Id.* The memorandum opinion was issued on February 29, 1988.

84. *Id.* See generally Petitioner's Brief at 10-13. Since Virginia had opted out of the Bankruptcy Code's federal exemption scheme, the district court held that ERISA was not intended to be a federal exemption pursuant to § 522(b)(2).

85. *Id.* Patterson filed a motion for disbursement and final order before the district court which was granted on September 2, 1988. The order directed the payment of Shumate's Plan interest to Patterson to be used for the benefit of Shumate's creditors. See Respondent's Brief at 4. The district court's decision in the bankruptcy estate was premised on the argument that Shumate's control over the pension plan was so pervasive so as not to qualify it as a spendthrift trust under Virginia state law. 83 B.R. 404. Additionally, the benefits were not

Subsequent to the district court's decision, but prior to the appeal being heard by a Fourth Circuit panel, the circuit issued its decision in the *Moore* case. As discussed above, *Moore* held that any qualified plan which includes a non-alienation provision, by definition, constitutes "applicable nonbankruptcy law." This "plain meaning" interpretation was premised on the notion that such plans necessarily include restrictions on the transfer of participants' interests, and therefore, inclusion of plan interests in the bankruptcy estate is prohibited. Accordingly, the Fourth Circuit relying upon *Moore* held that Shumate's plan interest came under the purview of section 541(c)(2) and should be properly excluded from the bankruptcy estate.⁸⁶ The Supreme Court granted certiorari to address this important bankruptcy issue and to end the controversy that existed amongst the circuit courts of appeals.

The Supreme Court carefully framed the issues in the case around the proper definition to be accorded the phrase "applicable nonbankruptcy law" for purposes of determining the exclusion question under section 541(c)(2).⁸⁷ From the beginning of its opinion, the Court stressed the importance of looking to the plain language of the statute.⁸⁸ Read in a straightforward fashion, section 541 does not suggest that there is any limitation on "applicable nonbankruptcy law," and certainly no restriction that it be limited to only state law.⁸⁹ The Court noted that the Bankruptcy Code

exempt under § 522 (b)(2)(A) since the Plan benefits were not "exempt under federal law." *Id.* at 410. See *supra* note 75 for discussion of Shumate's controlling stock interest in the company.

86. *Patterson v. Shumate*, 112 S. Ct. 2242, 2245 (1992). The Fourth Circuit stated:

We see no reason to restrict § 541(c)(2)'s exclusion provision to spendthrift trusts. Instead, following the rule that, whenever possible, statutes should be read in harmony and not in conflict, . . . we interpret these in such a way as to give full effect to both ERISA and the Bankruptcy Code by holding that interests in ERISA-qualified pension plans are excluded from a bankrupt's estate.

Shumate v. Patterson, 943 F.2d 362, 365 (4th Cir. 1991) (citations omitted). See also *In re Moore*, 907 F.2d 1476, 1479-80 (4th Cir. 1990).

87. 112 S. Ct. at 2246. The Court expressly stated that it had granted certiorari "to resolve the conflict among the Courts of Appeals" relative to the exclusion question. *Id.*

88. *Id.* Petitioner *Patterson* took issue with the "plain meaning" argument stating that such an approach contradicts the language of the Bankruptcy Code.

89. *Id.* The *Moore* court framed this question very succinctly: "'Applicable nonbankruptcy law' means precisely what it says: all laws, state and federal,

makes numerous references to "state law" in various sections, and had the drafters intended such a limitation in section 541(c)(2), they would have so stated.⁹⁰ In fact, the absence of such language gave the clear impression that Congress intended that debtors be allowed to look to both state and federal law in determining what constituted "applicable nonbankruptcy law."⁹¹ Consequently, the Court concluded its analysis of the trustee petitioner's first argument by stating that ERISA was but one example of federal law to which the questioned phrase was referring, and given the clarity of the Code section being evaluated, there was no choice but to "enforce the statute according to its terms."⁹²

At this point it was clear that the Court had determined that under its plain meaning section 541 could not be restricted or limited to state law. Without referring to the split in the circuit courts of appeals, the Court made it clear that the majority view, limiting "applicable nonbankruptcy law" to state spendthrift trust law, would no longer be followed. Having disposed of petitioner's first argument, the Court next focused on whether the plan in question contained an anti-alienation provision comporting with ERISA section 541(c)(2).⁹³ This section states that a "pension plan shall provide that benefits provided under the plan may not be assigned or alienated."⁹⁴ The applicable Internal Revenue Code section similarly states that a "trust shall not constitute a qualified trust under this section unless the plan of which such

under which a transfer restriction is enforceable. Nothing in the phrase 'applicable nonbankruptcy law' . . . suggests that the phrase refers exclusively to state law." *In re Moore*, 907 F.2d 1476, 1477-79 (4th Cir. 1990) (cited in *Shumate v. Patterson*, 943 F.2d 362, 364 (4th Cir. 1991)). See also Petitioner's Brief at 25-26. The Petitioner also urged the Supreme Court to read the Bankruptcy Code statute as "a whole and not in isolated parts." *Id.* at 26 (citing *United States v. Morton*, 467 U.S. 826 (1984)).

90. *Patterson v. Shumate*, 112 S. Ct. at 2246. The legislative history of § 541(c)(2) is not dispositive of this question as the term "state law" is not mentioned. See H.R. REP. NO. 595, 95th Cong., 2d. Sess. 1 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5869.

91. *Patterson v. Shumate*, 112 S. Ct. 2242, 2246-47 (1992). The Court cited several court decisions where "applicable nonbankruptcy law" has been construed to include both state and federal law. This observation was in accord "with prevailing interpretations of that phrase as it appears elsewhere in the Code." *Id.* at 2247 n.2.

92. *Id.* at 2247 (citing *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241, (1989)).

93. *Patterson*, 112 S. Ct. at 2247 (citing 29 U.S.C. § 206(d)(1)).

94. *Id.*

trust is a part provides that benefits provided under the plan may not be assigned or alienated."⁹⁵ Shumate's qualified plan included the provision that a participant's benefit, right or interest shall not be "subject to alienation, sale, transfer, assignment, pledge, encumbrance or charge, seizure, attachment or other legal, equitable or other process."⁹⁶ The Court took notice of the ERISA section which requires that plan trustees discharge their duties in conformance with the documents governing the plan, and concluded that the transfer restriction in question was more than adequate to constitute an enforceable transfer restriction pursuant to Bankruptcy Code section 541(c)(2).⁹⁷

The Court then dealt with three additional arguments presented by the petitioner challenging the conclusion that qualified pension plan benefits should be excluded from the bankruptcy estate. First, petitioner contended that the legislative history of section 541(c)(2) was replete with quotes reflecting an unmistakable intent on the part of Congress to limit the exclusion of plan benefits to those qualifying as state spendthrift trusts.⁹⁸ However, these references were reviewed by the majority and termed "meager" relative to supporting petitioner's claim.⁹⁹ Petitioner next argued that any decision to exclude plan benefits from the estate in a wholesale fashion would render the exemption provision contained in section 522(d)(10) meaningless.¹⁰⁰ This provision states that a debtor electing to use the federal exemption list in section 522 may exempt from the estate any right to receive "a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract."¹⁰¹ As mentioned previously, this exemption option is limited to those amounts necessary to provide reasonably necessary support to the debtor and the debtor's dependents.¹⁰²

The Court refused to accept this argument on the theory that the exemption provision was written much more broadly than the anti-alienation exclusion in section 541(c)(2).¹⁰³ The exemption

95. *Id.* (citing 26 U.S.C. § 401(a)(13)).

96. *Patterson v. Shumate*, 112 S. Ct. 2242, 2247 (1992) (citing Article 16.1 of Coleman's plan).

97. *Id.* at 2247-48.

98. *Id.* at 2248.

99. *Id.*

100. *Id.* at 2248-49.

101. *Patterson v. Shumate*, 112 S. Ct. 2242, 2249 (1992).

102. *Id.*

103. *Id.*

provision permits the debtor to exempt rights in both qualified and nonqualified plan benefits, whereas the anti-transfer exclusion is limited to those ERISA qualified plans containing the required restrictive clauses.¹⁰⁴ Finally, the Court dismissed the argument that its interpretation of the Bankruptcy Code would frustrate a broader policy of insuring that the bankruptcy estate casts a wide net in capturing the debtor's assets.¹⁰⁵ Justice Blackmun rejected petitioner's interpretation given the plain meaning of the sections in dispute.¹⁰⁶ To the contrary, the Court's opinion was consistent with previous cases in which it had "declined to recognize any exceptions to ERISA's anti-alienation provision *outside* the bankruptcy context."¹⁰⁷ Further, the Court's adoption of the plain meaning view would provide appropriate support to ERISA's broad goal of protecting pension plan benefits, as well as the overriding policy of insuring an "uniform national treatment of pension benefits."¹⁰⁸

V. UNANSWERED QUESTIONS AFTER *PATTERSON*

A. *Nonqualified Pension Plans*

The *Patterson* decision gives every appearance of finally putting to rest the question of how qualified pension plan benefits are to be handled in bankruptcy proceedings. There is general acknowledgement that the decision will govern a large percentage of corporate retirement plans. However, the pension plan at issue in *Patterson* included over four hundred employees and was not specifically designed to serve as a "top heavy" plan benefitting only one or just a few highly compensated individuals. The *Patterson* plan was in all respects a traditional "qualified" plan as contemplated by ERISA, and the analysis provided by the Supreme Court centered around the language in the ERISA statute which affords special protections to those pension plans meeting the requisite statutory requirements.¹⁰⁹

Unfortunately, many workers are heavily involved in pension plans that fall outside the umbrella of ERISA. These plans include Keogh plans or Individual Retirement Accounts (IRA),

104. *Id.*

105. *Patterson v. Shumate*, 112 S. Ct. 2242, 2249 (1992).

106. *Id.*

107. *Id.* at 2050.

108. *Id.*

109. *Id.* at 2245.

which are quite popular with self-employed individuals and are "self settled" in that the grantor of the trust is also the beneficiary. In either case, the pensioner faces the prospect that these non-qualified pension plan benefits will not be covered by *Patterson* because these trusts do not include an anti-alienation provision as required by ERISA. As a result, a serious unanswered question following *Patterson* concerns the treatment of nonqualified pension plan benefits as property of the bankruptcy estate.¹¹⁰

If *Patterson* does not exclude nonqualified plan benefits from the bankruptcy estate, then the debtor must seek protection of these assets under exemption rules. As discussed above, section 522 of the Bankruptcy Code provides a list of exempt property that is reserved for debtors who do not reside in "opt out" states. Under section 522(d)(10)(E)¹¹¹ the debtor generally can exempt payments from a pension plan, ERISA qualified or not, "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."¹¹² This obviously provides only partial protection since the support requirement is subject to interpretation, and in any event, would not provide *Patterson*-like one hundred percent protection unless substantial support needs were demonstrated by the debtor.

Absent support needs, though, the federal exemption would be meaningless. It should also be pointed out that the protection afforded by *Patterson* is irrespective of the debtor's need for support payments. Practically speaking, the federal exemption requires that the debtor tap the pension plan for living expenses, rather than preserve it for the intended purpose of providing support at retirement. As a policy matter, this result is at severe

110. In *Patterson*, the Supreme Court noted that a variety of nonqualified pension plans do not include an anti-alienation clause as required by ERISA and, therefore, would not be afforded coverage under the decision:

[P]ension plans established by governmental entities and churches need not comply with Subchapter I of ERISA, including the anti-alienation requirement of § 206(d)(1). . . . So too, pension plans that qualify for preferential tax treatment under 26 U.S.C. § 408 (individual retirement accounts) are specifically excepted from ERISA's anti-alienation requirement. . . . Although a debtor's interest in these plans could not be excluded under § 541(c)(2) because the plans lack transfer restrictions enforceable under "applicable nonbankruptcy law," that interest nevertheless could be exempted under § 522(d)(10)(E).

Patterson, 112 S. Ct. at 2250.

111. 11 U.S.C. § 522(d)(10)(E) (1988).

112. *Id.*

cross-purposes with the *Patterson* decision, wherein the Court noted that one goal of ERISA was to insure that "if a worker has been promised a defined pension benefit upon retirement - and if he has fulfilled whatever conditions are required to obtain a vested benefit - he actually will receive it."¹¹³

If the debtor resides in an "opt out" state, the handling of non-qualified pension plan benefits depends on the wording of state exemption law. States that base their exemption protection of pension plans on spendthrift trust law would pose a serious problem to the IRA or Keogh participant. These latter plans are typically "self settled" and do not include the restrictions on the beneficiary's ability to utilize or assign the proceeds that are required in a spendthrift trust arrangement. This would leave IRAs and Keogh accounts outside the protection of state exemption law, and thereby force their inclusion in the bankruptcy estate.

Another consideration regardless of whether the state exemption law focuses on spendthrift trusts, is the possibility that any state law exempting retirement plans from the bankruptcy estate would be subject to preemption by ERISA.¹¹⁴ Even though the ERISA preemption provision has been held not to apply to IRAs by most bankruptcy courts,¹¹⁵ the debtor with nonqualified pension plan assets bears the burden of ascertaining the consequences in the state where the petition will be filed. This result is also at cross-purposes with *Patterson*, since one of the reasons the Supreme Court agreed to hear the case was due to the wide disparity in the various Circuits that clearly had placed a premium on pre-bankruptcy forum shopping by debtors with significant sums in ERISA qualified plans. If such forum shopping by qualified plan participants was a problem prior to *Patterson*, then it continues to be a problem with similarly situated nonqualified plan participants.

113. *Patterson v. Shumate*, 112 S. Ct. 2242, 2250 (1992) (citing *Nachman Corp. v. Pension Benefit Guar. Corp.*, 446 U.S. 359, 375 (1980)).

114. 29 U.S.C. § 1144(a) (1988). Section 514(a) of ERISA states that the statute shall "supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." *Id.*

115. *In re Laxson*, 102 B.R. 85 (Bankr. N.D. Tex. 1989); *In re Ridgway*, 108 B.R. 294 (Bankr. N.D. Okla. 1989); *In re Martin*, 102 B.R. 653 (Bankr. W.D. Tenn. 1989); *In re Ewell*, 104 B.R. 458 (Bankr. M.D. Fla. 1989).

B. *Fraudulent Transfers*

Section 548(a)¹¹⁶ of the Bankruptcy Code provides that a trustee has the power to avoid a fraudulent transfer by the debtor of his interest in property, if such transfer was made within one year prior to filing the petition.¹¹⁷ Under section 541(a)(1), the trustee must prove either that the debtor exhibited actual intent to defraud, or that there were significant indications or "badges of fraud" present to infer actual intent, and therefore, to establish constructive fraud.¹¹⁸ In the latter case, courts generally have considered a variety of factors to establish constructive fraud, such as: 1) the failure of debtor to receive adequate consideration, 2) the alleged fraudulent transfer occurring after the debtor's financial difficulties have begun, and 3) the debtor continuing using or enjoying the benefits of the transferred property.¹¹⁹ If actual intent can be proven, either directly or by inference, the transfer is voidable without a showing that the debtor was insolvent at the time of the transfer.¹²⁰ Finally, a transfer is also deemed to be fraudulent pursuant to section 548(a)(2)(A) if the debtor received less than a reasonably equivalent value and was insolvent on the date the transfer was made or became insolvent as a result of the conveyance.¹²¹

116. Section 548(a) of the Bankruptcy Code provides:

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily —

(1) made such transfer or incurred such obligation with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent . . . ;

(ii) . . . [had] unreasonably small capital; or

(iii) . . . would be beyond the debtor's ability to pay . . .

11 U.S.C. § 548(a) (1988).

117. *Id.*

118. 11 U.S.C. § 541(a)(1) (1991).

119. *See In re Kaiser*, 722 F.2d 1574 (2d Cir. 1983).

120. 11 U.S.C. § 548(a)(2)(B)(iii) (1988).

121. Although there are a number of tests used to determine whether the debtor received "less than reasonably equivalent value" for the alleged fraudulent transfer, a detailed discussion is not necessary when considering pre-bankruptcy payments by a debtor to pension plan. This is due to the fact that the debtor receives nothing from the trust fund in return, and therefore, would

Given the context of the *Patterson* decision, what exposure does a debtor anticipating bankruptcy have under Code section 548 when he purposefully makes significant contributions to a qualified pension plan in order to avoid having the cash assets be made part of the bankruptcy estate? The intended purpose would be clearly to defeat creditor claims to the assets. Such transfers could be attacked easily, and even if actual intent could not be established, a good case for constructive fraudulent intent could be made based on the factors noted above. This issue was not addressed specifically by the Court, although nothing in the *Patterson* decision should be construed as overcoming this fraudulent transfer provision. The problem with this potential argument is that it is policy based, and if one thing is made clear by Justice Blackmun's opinion, it is that the overriding consideration in *Patterson* was to give "full and appropriate effect to ERISA's goal of protecting pension benefits."¹²² Blackmun went on to say that "our holding furthers another important policy underlying ERISA: uniform national treatment of pension benefits."¹²³

In effect, in a battle of policy arguments, debtors can make the case that the policy embodied in section 548 must give way to that broader policy enunciated in *Patterson* regarding consistent treatment of pension plans. Trustees and creditors clearly will argue that a transfer deemed fraudulent under section 548 must be construed as an exception to the *Patterson* case. However, in the meantime, given the uncertainty that this policy exception will be recognized, debtors would be well advised to engage in some creative pre-bankruptcy planning by making cash transfers to qualified plans and thereby force the courts to address the issue.

C. Voidable Preferences

A similar issue is presented by the Code's voidable preference provision. Under section 547(b),¹²⁴ a transfer made within ninety

always be construed to have received less than reasonably equivalent value for the cash transfers.

122. *Patterson v. Shumate*, 112 S. Ct. 2242, 2250 (1992).

123. *Id.* The Court stated further that its decision would ensure "that the treatment of pension benefits will not vary based on the beneficiary's bankruptcy status." *Id.* at 2249.

124. Section 547(b) of the Bankruptcy Code provides:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property —
 (1) to or for the benefit of a creditor;

days of filing the bankruptcy petition is voidable by the trustee if it is made while the debtor is insolvent, it is made to or for the benefit of a creditor in consideration for an antecedent debt, and it results in the creditor receiving more than he would have been entitled to had the transfer not occurred and had the estate been completely liquidated in accordance with Chapter Seven.¹²⁵ Most importantly, the ninety day period can be extended to one year if the creditor is an insider.¹²⁶

Once again assume a hypothetical debtor contemplating bankruptcy has fallen behind in making payments to his or its qualified pension plan pursuant to the plan agreement. The trust becomes a creditor of the debtor and now has a claim that can be considered to be a preexisting or antecedent debt. Having been advised of the legal consequences of the *Patterson* decision, the debtor makes a significant contribution to the qualified pension plan within ninety days preceding bankruptcy. Will the policy underlying the voidable preference provision prevail given the policy objectives of the *Patterson* case? The bankruptcy trustee would argue that had the payments not been made, the pension plan would not have received as much, and would have been rele-

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made —

(A) on or within 90 days before the date of the filing of the petition;
or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if —

(A) the case were a case under chapter 7 of this title [11 U.S.C. §§ 701-706];

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title [11 U.S.C. §§ 101-1330].

11 U.S.C. § 547(b) (1988). An antecedent debt has been construed to be a preexisting debt of a "liability on a claim." In the context of considering transfers to a pension plan, the pre-bankruptcy payments to the fund would have to be due and owing prior to the date the petition was filed. A mere voluntary payment to a pension plan arguably would not come under the purview of this provision. *Id.* at § 101(11). *Kallen v. Litas*, 47 B.R. 977 (Bankr. N.D. Ill. 1985).

125. 11 U.S.C. § 547(b)(5) (1988).

126. 11 U.S.C. § 101(30) (1988).

gated to a payment under a fourth priority as detailed in Bankruptcy Code section 507(a)(4).¹²⁷

The debtor would certainly argue in this situation that the payments fall within the "transfer in the ordinary course of business" exception to the voidable preference rule.¹²⁸ The critical issue would be whether the debt had been incurred in the ordinary course of business as that term is contemplated in the Code. Although the Code generally envisions this exception being applied to a more traditional creditor with whom the debtor has conducted business, courts have considered factors such as whether the debt accrued in prior course of dealing and was in accordance with ordinary business terms.¹²⁹ Certainly, these arguments can be made by the qualified plan trustee who would ascend to the status of creditor once the required funding payments were not made. More importantly, the trustee could argue that the court should never even reach the exceptions to section 547(b), since the pension protection policy of *Patterson* is clear, unambiguous, and controlling.

A more interesting voidable preference issue is presented if the above referenced debtor is a corporation, which after falling behind in payments to the qualified plan, relies on an insider who personally guarantees a promissory note payable to the plan. In this case the argument is stronger that the insider is also a creditor of the debtor since any pre-bankruptcy payments made to the plan would reduce the insider's personal liability on the guarantee. This exact scenario was presented in *Levit v. Ingersoll Rand Fin. Corp.*,¹³⁰ and Judge Easterbrook of the Seventh Circuit held that payments to pension plans made more than ninety days prior to filing the petition could be recovered by the bankruptcy trustee if the plan trust negotiated for and received a personal guarantee from an insider.¹³¹ In that case, the funds paid to the plan "should be treated just like any other outside creditor"¹³² pursuant to the voidable preference rules. This case has been followed by other

127. 11 U.S.C. § 507(a)(4) (1988). See generally *In re Columbia Packing Co.*, 47 B.R. 126 (Bankr. D. Mass. 1985).

128. 11 U.S.C. § 547(c)(2) (1988); *In re Fulghum Constr. Corp.*, 872 F.2d 739 (6th Cir. 1989).

129. *In re White*, 58 B.R. 266 (Bankr. E.D. Tenn. 1986).

130. 874 F.2d 1186 (7th Cir. 1989).

131. *Id.* at 1200-01.

132. *Id.* at 1200.

circuits¹³³ but openly criticized by bankruptcy courts¹³⁴ and Congress.¹³⁵ In fact, the National Bankruptcy Review Commission Act¹³⁶ contains language in section 204 which would specifically overrule the result reached in *Levit*.¹³⁷ However, the practical matter is that the Bankruptcy Reform Amendments of 1992 have not been enacted, leaving this Seventh Circuit decision intact. The issue presented here is how will the *Levit* case affect the ability of a bankruptcy trustee to recover these guaranteed payments under the voidable preference provision in light of the seeming broad protection afforded qualified plans by the *Patterson* decision?

133. *In re Erin Food Serv., Inc.*, 980 F.2d 792 (1st Cir. 1992); *In re C-L Cartage Co.*, 899 F.2d 1490 (6th Cir. 1990); *In re H & S Transp. Co.*, 939 F.2d 355 (6th Cir. 1991); *Plumbers Pension Fund v. Niedrich*, 891 F.2d 1297 (7th Cir. 1989), *cert. denied*, 495 U.S. 930 (1990); *In re Suffola, Inc.*, 2 F.3d 977 (9th Cir. 1993); *In re Robinson Bros. Drilling*, 97 B.R. 77 (Bankr. W.D. Okla. 1988), *aff'd*, 892 F.2d 850 (10th Cir. 1989); *Southmark Corp. v. Southmark Personal Storage, Inc.*, 993 F.2d 117 (5th Cir. 1993).

134. *In re Erin Food Services, Inc.*, 980 F.2d 792 (1st Cir. 1992); *In re C-L Cartage Co.*, 899 F.2d 1490 (6th Cir. 1990); *In re H & S Transp. Co.*, 939 F.2d 355 (6th Cir. 1991); *Plumbers' Pension Fund v. Niedrich*, 891 F.2d 1297 (7th Cir. 1989); *In re Suffola*, 2 F.3d 977 (9th Cir. 1993); *In re Robinson Bros. Drilling*, 97 B.R. 77 (Bankr. W.D. Okla. 1988), *aff'd*, 892 F.2d 850 (10th Cir. 1989); *Southmark Corp. v. Southmark Personal Storage, Inc.*, 993 F.2d 117 (5th Cir. 1993).

135. *In re Rubin Bros. Footwear, Inc.*, 119 B.R. 416 (Bankr. S.D.N.Y. 1990); *In re J.T.L. Supermarket Corp.*, 145 B.R. 4 (Bankr. N.D.N.Y. 1992); *In re Arundel Hous. Components*, 126 B.R. 216 (Bankr. D. Md. 1991); *In re Performance Communications, Inc.*, 126 B.R. 473 (Bankr. W.D. Penn. 1991).

136. National Bankruptcy Review Commission Act, S. 1985, 102d Cong., 2d Sess. (1992), reported in 138 Cong. Rec. § 8241 (June 16, 1992). Senator Heflin commented on section 204 of the Act:

This section seeks to overturn the Deprizio line of opinions begun in *Levit V. Ingersoll - in re V.N. Deprizio Construction Co.* - 874 F.2d 1186, 7th Cir 1989. This case turned upon issues involving guarantees and who may be considered an insider for purposes of the Bankruptcy Code. The specific language of this section has received a great deal of attention in order to narrowly but clearly overrule this series of opinions. We believe that we have accomplished this task. The specific language contained in the substitute bill which is before the Senate is different from that which was reported by the committee. We believe that we have improved upon the language which is reflected in this bill, and that it accomplishes its task of returning the understanding of the status of the law to that which predated the Deprizio opinion.

Id.

137. *Id.* at § 8242.

According to *Levit*, an insider who personally guaranteed payment to a pension trust fund would be treated as any other creditor for purposes of the voidable preference rule, noting that the ninety day period would be extended to a full year. This decision clearly conflicts with *Patterson* and makes no distinction between cases where the insider-creditor may have acted in good faith in signing the personal guarantees. The practical effect of *Levit* is that the pension trust fund would be in a preferred position if the insider did not sign the personal guarantee, thereby implementing the ninety day voidable preference period under section 547(b). In any event, given the facts as presented in *Levit*, a bankruptcy trustee could rely on this precedent to recover the pre-filing payments made to the pension fund despite the holding in *Patterson*.

C. Nondischargeable Debts and Rollovers

Assuming that a debtor has not made transfers that may be subject to attack under the fraudulent or voidable transfer provisions of the Code, simply relying on *Patterson* to protect a qualified pension plan through the bankruptcy proceeding may not deter some creditors from ultimately gaining access to the trust fund. The *Patterson* case speaks only to the protection of qualified pension plan funds during the bankruptcy process. However, when a bankruptcy proceeding is terminated, many debtors are still burdened with a variety of debts that are nondischargeable pursuant to Code § 523.¹³⁸ This provision applies to all debtors granted a discharge under Chapters Seven, Eleven, or Twelve, as well as hardship discharges under Chapter Thirteen.¹³⁹ In any event, the effect of the discharge is to allow creditors with debts that were not discharged to pursue the debtor for collection. The only requirement is that the creditor wait until the debtor is actually discharged so as not to violate the automatic stay imposed upon the filing of the petition, which prohibits all legal actions outside the context of the bankruptcy proceeding.¹⁴⁰

A debtor who has successfully negotiated the bankruptcy process and thereby protected her qualified pension plan must be aware that plan proceeds are not immune from potential post-bankruptcy collection efforts by nondischarged creditors, or by creditors with debts accruing post-petition. This problem is of

138. 11 U.S.C. § 523 (1988).

139. 11 U.S.C. § 523(a) (1988).

140. 11 U.S.C. § 363(a) (1988).

particular importance to debtors who, pursuant to the terms of their pension plan, are eligible to make withdrawals from the fund, have a right to assign any or all of the fund's assets, or have reached an age where withdrawals from the trust fund are mandatory. When this is the case, the anti-alienation clause does not afford the debtor the same protection as discussed earlier,¹⁴¹ and the nondischarged creditor can assert a right to any share of the plan's assets which the debtor could presently claim. To underscore the importance of this unsettled issue, the *Patterson* decision anticipated such questions by including a footnote which explicitly stated that this matter was being reserved. The Court stated, "We express no opinion on the separate question whether section 522(d)(10)(E) applies only to distributions from a pension plan that a debtor has an immediate and present right to receive, or to the entire undistributed corpus of a pension trust."¹⁴²

The essence of this post-bankruptcy argument is that if the debtor has a right to the plan's funds, regardless of whether she chooses to exercise that right, the nondischarged creditor is legally entitled to effect a collection action against that share of the plan's assets.¹⁴³ Alternatively, the creditor may also initiate an action in equity to force the debtor to make the withdrawal or assignment. This may be preferable from the perspective of the plan's trustee since it would be the actual plan participant making the request, rather than the trustee responding to a court order mandating direct payment to the nondischarged creditor. In this latter case, the trustee would quite correctly be concerned about violating the ERISA anti-alienation restriction and thereby jeopardizing the trust fund's qualified status.¹⁴⁴

Pension plan participants must also be cognizant of the unprotected status of IRAs and Keogh accounts, especially in the

141. The anti-alienation clause contained in Bankruptcy Code § 541(c)(2) excludes pension plans that have such a transfer made by a trustee in violation of this clause would risk disqualification of the plan. See *supra* note 56 for IRS private letter rulings supporting this statement. Consequently, if a plan participant's right to make a withdrawal from the fund had matured, or existed pursuant to any valid claim under law, the trustee would not be risking the qualified status of the fund by making the transfer. This would mean that the anti-alienation clause could not successfully be used as a shield by the participant and the fund trustee to thwart a creditor's efforts to force a transfer to the participant.

142. *Patterson v. Shumate*, 112 S. Ct. 2242, 2249 n.5 (1992).

143. *In re Reid*, 139 B.R. 19 (Bankr. S.D. Cal. 1992).

144. See *supra* note 56 and accompanying text.

context of making a rollover contribution. Rollovers are often considered by plan participants in a variety of circumstances. A participant having accepted employment with another company, may want to terminate her retirement account with her previous employer. Also, as was the case in *Patterson*, the employer may terminate operations, either in or outside of bankruptcy, and liquidate its pension plan by making distributions to all participants.¹⁴⁵ Finally, the participant may seek to consolidate a number of pension plans for convenience in fund management, or to simplify annual withdrawals upon reaching retirement age. In each of these scenarios, a rollover into a nonqualified plan would strip the debtor of coverage under *Patterson*.

In light of the fact that *Patterson* protection will not be available, it would be preferable for debtors to leave funds in a qualified plan. The debtor should also consider transferring nonqualified plan assets into a corporate qualified plan whenever that option is available. However, it is important to remember that post-*Patterson* nonqualified plans will be governed by exemption law. Therefore, if the debtor's state of residence provides for a one-hundred percent exemption of IRAs, which would include rollovers from qualified plans, the debtor could consider this option, keeping in mind potential violations of the fraudulent or voidable transfer rules discussed above.

Rollovers in violation of fraudulent or voidable transfer rules could be reversed despite favorable state exemption law. However, the fraudulent transfer rules are generally applicable to transactions where the debtor seeks to convert non-exempt property into exempt property. In a rollover from a qualified plan to a nonqualified plan, the assets are also exempt property as part of the qualified plan and would arguably remain exempt property once deposited in the IRA. A debtor could argue that the character of the property never changed during the rollover process, and therefore, the fraudulent transfer rules do not apply.¹⁴⁶

Rollovers present a policy problem similar to that discussed with respect to fraudulent and voidable transfers. The treatment of rollovers into a nonqualified plan depends upon the peculiarities of state exemption law. Debtors who live in states with less than favorable exemption law may be able to achieve the same advantage by establishing an IRA in a state that has the desired

145. See *supra* notes 77-79 and accompanying text.

146. See generally *In re Swift*, 124 B.R. 475 (Bankr. W.D. Tex. 1991).

exemption law, and preferably, where this question has already been tested in the courts. Given these circumstances, in a bankruptcy proceeding the debtor could argue that in accordance with conflict of laws principles, the bankruptcy court is obligated to follow the exemption law of the state in which the IRA is situated, rather than the law of the state in which the petition was filed.

Once again, it is obvious that the *Patterson* ruling has left open potential forum shopping and creative pre-bankruptcy planning options that are just as significant as those that existed prior to the Court's handling of this matter. However, planning opportunities that exist now with respect to rollovers are fraught with potential pitfalls and dire consequences to the pre-bankruptcy debtor if undertaken casually. Since state law varies widely on the exemption and rollover issues, it is vital that debtors rely on expert advice prior to effecting any such transactions, regardless of whether bankruptcy is contemplated.

V. CONCLUSION

Prior to the *Patterson* decision there can be no question that the various case lines concerning the includability of qualified pension plan benefits in the bankruptcy estate were contradictory and irreconcilable. The *Patterson* case clarified this question in a summary fashion, forestalling any serious conflicts with the IRS that might have led to catastrophic consequences had any plans been disqualified as the private letter rulings indicated.¹⁴⁷ Given this potential result the question remains why it took so long for the Supreme Court to address this matter. From 1982 to 1985 the primary cases delineating the state spendthrift trust view had been decided by the four circuits following this approach,¹⁴⁸ while after the Fourth Circuit's *Moore* decision six years passed before the issues were addressed by enough of the other circuits such that the "plain meaning" view achieved parity.

Perhaps the Supreme Court was hesitant to overrule a view that achieved a seeming overwhelming majority status in such a short period of time, and maybe it took the decisions of 1991 to convince the Court that the time had come to settle the matter. This is, of course, mere speculation, but the fact that the *Patterson* opinion is virtually devoid of any substantive discussion of the relative merits of the competing views, indicates that there was vir-

147. See *supra* note 56 for a listing of these Private Letter Rulings.

148. See *supra* notes 26-40 and accompanying text.

tually no disagreement as to what the outcome of the case would be. Only Justice Scalia, in his concurring opinion in *Patterson*, raised the question as to how so many appellate courts could have reached any other conclusion regarding the interpretation of the phrase "applicable nonbankruptcy law" than that reached by the *Goff* court in 1983.¹⁴⁹

In the end, though, it can be said that *Patterson* offers significant assistance relative to the handling of qualified pension plan benefits in bankruptcy, despite the serious questions that remain unanswered.¹⁵⁰ The decision is an important step toward achieving the equitable and consistent treatment of debtors with qualifying plan assets that is a trademark policy of the Bankruptcy Code. The importance of *Patterson* will become more evident when the decision is harmonized with the other provisions contained in the Code. Congress is already dealing with some of the issues presented in this article, most notably the questions raised about the treatment of nonqualified pension plans and their potential interplay with the *Patterson* decision, as well as the insider-creditor issue presented in *Levit*. Under current legislation aimed at reforming the Bankruptcy Code and which codifies the *Patterson* result, the scope of protection afforded pension plans is expanded to include many nonqualified plans.¹⁵¹ However, this is little consolation to debtors currently contemplating bankruptcy. They must work with the *Patterson* decision and its attendant unanswered questions.

149. *Patterson*, 112 S. Ct. at 2250-51 (Scalia, J., concurring).

150. Shortly after the *Patterson* decision was handed down, the Supreme Court considered the question of whether a governmental pension plan should be included in the bankruptcy estate. See *In re Leadbetter*, 946 F.2d 895 (6th Cir. 1991) (unpublished). The Sixth Circuit held that a state employee's interest in a governmental pension plan covered by 26 U.S.C. § 457 (1988) had to be included in the bankruptcy estate. The Supreme Court vacated and remanded the case for consideration in light of *Patterson*. See *Ohio Pub. Employees Deferred Compensation Program v. Sicherman*, 112 S. Ct. 2987 (1992). The Court had noted in the *Patterson* opinion that this type of pension plan was not covered relative to the manner in which the issues had been presented in that case. *Patterson*, 112 S. Ct. at 2249.

151. S. 1985, 102d Cong., 1st Sess. § 202(c) (1991). See also H.R. 3804, 102d Cong. 1st Sess. § 2(a) (1991).