Louisiana Law Review

Volume 54 | Number 3
January 1994

Bankruptcy

Louis M. Phillips

Diane Sciacca

Bankruptcy

*Judge Louis M. Phillips**
*Diane Sciacca***

I. PROPERTY OF THE BANKRUPTCY ESTATE AND EXEMPTION: ERISA PENSION AND WELFARE PLANS

Recently the United States Supreme Court answered a question that had perplexed federal courts (bankruptcy, district, appellate), debtors, and creditors nationwide: whether a debtor's interest in his or her Employee Retirement Income Security Act of 1974 (ERISA) qualified retirement plan becomes property of the debtor's bankruptcy estate.[1] This section of the paper will discuss the genesis of the question, the jurisprudential wrestling therewith, and the resolution. In addition, the Supreme Court resolution will be slightly knocked, and this writer will (finally) offer observations as to the effect of the resolution upon the continued viability of certain Louisiana exemption statutes.

A. The Statutory Problem

Section 541(a) of the Bankruptcy Code establishes that the bankruptcy estate is created by the commencement of a bankruptcy case and sets out what property comprises the estate.[2] Bolstering section 541(a) is section 541(c)(1), which is

---

* United States Bankruptcy Judge, Middle District of Louisiana; Adjunct Professor of Law, Louisiana State University Law Center, Baton Rouge, Louisiana.

Vast appreciation is extended to Marlene C. Stubbs, my secretary (nay, "Judicial Assistant"), for her unflagging efforts in transcription (and translation of my formless, unreadable script).

Note: all references to "this writer" are limited to Louis M. Phillips (by agreement with Ms. Sciacca, she should be spared any fallout).

** B.A., University of Illinois, 1989; J.D., Loyola University of Chicago School of Law, 1993; Member, Illinois Bar. Ms. Sciacca is currently the law clerk for Judge Phillips.

1. Patterson v. Shumate, 112 S. Ct. 2242 (1992).
2. Section 541(a) provides:

> The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
>
> (2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—
>
> (A) under the sole, equal, or joint management and control of the debtor; or
>
> (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.
>
> (3) Any interest in property that the trustee recovers under section 329(b), 363(n),

preemptive of applicable nonbankruptcy law and agreements that purport to restrict transfer of property.[3] Section 541(c)(1) also provides that notwithstanding such agreements or nonbankruptcy law, property subject thereto becomes property of the bankruptcy estate.[4] This section is limited, however, by section 541(c)(2), which provides that:

> A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.[5]

This exception to the preemptive section 541(c)(1) has the effect of excluding a beneficial interest in a spendthrift trust from property of the estate, to the extent the interest is subject to enforceable restrictions on transfer (anti-alienation provisions) under the controlling state law.[6]

543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

11 U.S.C. § 541 (1988).

3. Section 541(c)(1) provides as follows:

Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

11 U.S.C. § 541 (1988).

4. *See* Butner v. United States, 440 U.S. 48, 99 S. Ct. 914 (1978); Board of Trade of the City of Chicago v. Johnson, 264 U.S. 1, 44 S. Ct. 232 (1924); State of California v. Farmers Market, Inc. (*In re* Farmers Markets), 792 F.2d 1400 (9th Cir. 1986).

5. 11 U.S.C. § 541 (1988).

6. *See, e.g.*, Daniel v. Security Pacific Nat'l Bank (*In re* Daniel), 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016; 106 S. Ct. 1099 (1986); Lichstrahl v. Bankers Trust (*In re*

The question bound to arise, of course, is whether section 541(c)(2) should be limited in application to spendthrift trusts settled under state law or be viewed expansively as applicable to "trusts" established by federal law that, while the beneficial interests might well be subject to transfer restrictions, would not qualify as state law spendthrift trusts.[7]

B. Jurisprudential Wrangling

The United States Fifth Circuit Court of Appeals in *Goff*,[8] as a matter of first impression, faced the question of whether a debtor's interest in a self-employed Keogh Plan, qualified under ERISA[9] and subject to 26 U.S.C. § 401(a)(13)[10] and 29 U.S.C. § 1056(d)(1),[11] was included in the debtor's bankruptcy estate. The Goffs, individual debtors, sought to exclude their interest in self-employed Keogh Plans from their Chapter 7 bankruptcy estate under section 541(c)(2), asserting that the anti-alienation provisions of 29 U.S.C. § 1056(d) constituted a restriction on transfer of their beneficial interest in an ERISA "trust," which was enforceable under applicable bankruptcy law.[12] Refusing to approve a settlement of the question between the Goffs and their trustee, the bankruptcy court held that the

---

Lichstrahl), 750 F.2d 1488 (11th Cir. 1985); Samore v. Graham (*In re* Graham), 726 F.2d 1268 (8th Cir. 1984); Goff v. Taylor (*In re* Goff), 706 F.2d 574 (5th Cir. 1983).

7. The term "trust" is not defined in the Bankruptcy Code.

8. 706 F.2d 574.

9. 29 U.S.C. §§ 1001-1461 (1988).

10. 26 U.S.C. § 401(a)(13) (1988) reads:

(13) Assignment and alienation.—

(A) In general.—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. For purposes of the preceding sentence, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment made by any participant who is receiving benefits under the plan unless the assignment or alienation is made for purposes of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 (relating to tax on prohibited transactions) by reason of section 4975(d)(1). This paragraph shall take effect on January 1, 1976 and shall not apply to assignments which were irrevocable on September 2, 1974.

(B) Special rules for domestic relations orders.— Subparagraph (A) shall apply to the creation, assignment, or recognition of a right to any benefit payable with respect to a participant pursuant to a domestic relations order, except that subparagraph (A) shall not apply if the order is determined to be a qualified domestic relations order.

11. 29 U.S.C. § 1056(d)(1) (1988) reads:

(d) Assignment or alienation of plan benefits

(1) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.

12. *Goff*, 706 F.2d at 576-77.

entirety of the debtors' interest in the Keogh Plan was property of their bankruptcy estate and was therefore to be liquidated to pay claims of creditors.[13]

On direct appeal from the bankruptcy court, the Fifth Circuit affirmed, concluding that Congress, in enacting section 541(c)(2), did not intend the provision to extend to ERISA-qualified plans, but intended "a limited exemption for 'spendthrift trusts,' as defined by reference to state law." The court further held that because the Goffs' pension plan did not qualify under applicable (Texas) law as a spendthrift trust, the corpus of the plan was to be included in the bankruptcy estate.[14]

To reach its conclusion, the court employed the following analysis:

> First, we examine the explicitly narrow legislative intent behind the facially broad reference in section 541(c)(2) to "applicable bankruptcy law." Second, we consider the overall congressional scheme embodied in the Bankruptcy Code, particularly the exemption system election provision, Section 522, which directly addresses the degree to which pensions may therein be exempted and also explicitly references "Federal law" and ERISA. Third, we assess the relationship and effect upon ERISA of the intent of the Bankruptcy Code . . . .[15]

Resorting to the scant legislative history underlying section 541(c)(2), the court noted that the only explicative references are those made to the debtor's beneficial interest in a "spendthrift trust."[16] The court concluded, upon these limited references, that "Congress intended by its reference to 'applicable nonbankruptcy law' to exempt from the estate only those 'spendthrift trusts' traditionally beyond the reach of creditors under state law. This provision carries over from the old Act the previously recognized exemption for spendthrift trusts."[17]

---

13. *Id.* at 577.
14. *Id.* at 589.
15. *Id.* at 581.
16. *Id.* at 581-82 (quoting H.R. Rep. No. 595, 95th Cong., 2d Sess. 369 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6325).

The *Goff* court relied upon the House report analysis of the intent of section 541(c)(2), which states:

> Subsection (c) [of Section 541] invalidates restrictions on the transfer of property of the debtor, in order that all of the interests of the debtor in property will become property of the estate. . . . *Paragraph (2) of subsection (c), however, preserves restrictions on transfer of a spendthrift trust to the extent that the restriction is enforceable under applicable nonbankruptcy law.*

(emphasis in opinion). The court further noted:

> The bill also continues over the exclusion from property of the estate of the debtor's interest in a *spendthrift trust to the extent the trust is protected from creditors under applicable State law. The bankruptcy of the beneficiary should not be permitted to defeat the legitimate expectations of the settlor of the trust.*

Id. (quoting H.R. Rep. No. 595, 95th Cong., 2d Sess. 176 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6136) (emphasis in opinion) (footnote omitted).

17. *Id.* at 582 (citing *In re* Witlin, 640 F.2d 661 (5th Cir. 1981) (recognition, under the

The more complicated leg of the court's analysis is leg two, consideration of the exemption sections and references therein to federal law and ERISA.[18] Unlike section 70 of the Bankruptcy Act of 1898 (the predecessor to section 541), which excluded property "held to be exempt" from the estate,[19] the mechanics of the Bankruptcy Code cause all property covered by section 541(a) to come into the estate, subject to being exempted out of the estate by the debtor's claims of exemption.[20] The substantive bankruptcy exemption scheme is found in section 522. Two subsections of section 522, 522(b) and (d)(10), are applicable to this discussion. Under section 522(b),[21] individual debtors are entitled to elect

---

applicable prior Act, that spendthrift trusts were exempt pursuant to state trust law)).

18. *See supra* note 15 and accompanying text.

19. Bankruptcy Act of 1898, Section 70(a), 11 U.S.C. § 110.

20. *See, e.g.*, Owen v. Owen, 500 U.S. 305, 111 S. Ct. 1833 (1991) (holding that an estate in bankruptcy consists of all the interests in property, legal and equitable, possessed by the debtor at the time of filing, as well as those interests recovered or recoverable through transfer and lien avoidance provision); Larson v. Camerone (*In re* Larson), 147 B.R. 39 (Bankr. D.N.D. 1992); Lonstein v. Rockman (*In re* Lonstein), 950 F.2d 77 (1st Cir. 1991) (recognizing that § 541(a)(1) includes "all legal or equitable interests of the debtor in property as of the commencement of the case" as property of the estate); Brandt v. Woodlawn Auto Workers (*In re* Bradt), 757 F.2d 512 (2d Cir. 1985); *In re* Wilson, 694 F.2d 236 (11th Cir. 1982); *In re* Linderman, 20 B.R. 826 (Bankr. W.D. Wash. 1982); Bush Gardens Inc. v. United States, 10 B.R. 506 (Bankr. N.J. 1979); *In re* Ford, 3 B.R. 559 (Bankr. D. Md. 1980); H.R. Rep. No. 595, 95th Cong., 1st Sess. 367-68 (1977), *reprinted in* 1978 U.S.S.C.A.N. 5963, 6323-24 (stating that § 541(a)(1) includes all kinds of property, including tangible or intangible property, causes of action, and all other forms of property currently specified in § 70a of the Bankruptcy Act); S. Rep. No. 989, 95th Cong., 2d Sess. 82-3 (1978) (same), *reprinted in* 1978 U.S.C.C.A.N. at 5787, 5868; H.R. Rep. No. 595, 95th Cong., 2d session 367 (1977), *reprinted in* 1978 U.S.S.C.A.N. 5963, 6323-24; 4 Collier on Bankruptcy ¶ 541.06, at 541-28 to 29, ¶ 541.08, at 541-41 (Lawrence P. King et al. eds., 15th ed. 1992). *See also* United States v. Whiting Pools, Inc., 462 U.S. 198, 205 n.9, 103 S. Ct. 2309, 2313 n.9 (1983) (determining that the scope of § 541(a)(1) is broad and pervasive); Garner v. Strauss (*In re* Garner), 952 F.2d 232 (8th Cir. 1991); Humphrey v. Buckley (*In re* Swanson), 873 F.2d 1121 (8th Cir. 1989).

21. 11 U.S.C. § 522(b) (1988) provides:

> (b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Bankruptcy Rules, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (2) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is—
>
> (1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,
>
> (2) (A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of

between the federal exemptions found in section 522(d) and applicable state law exemptions, unless the state law exemption scheme does not authorize such an election. If the applicable state law exemption statute requires that a debtor claim exemptions under state law, the state can be said to have "opted out" of the federal exemption scheme established by section 522(d). Debtors within these "opt out" states may claim both the state exemptions and exemptions covering "any property that is exempt under Federal law, other than subsection (d) of this section."[22] The legislative history of section 522(b) contains an illustrative list of other federal laws, the benefits of which may be exempted under section 522(b)(2)(A):

> —Foreign Service Retirement and Disability payments, 22 U.S.C. § 1104 [Foreign Relations and Intercourse];
> —Social security payments, 42 U.S.C. § 407 [The Public Health and Welfare];
> —Injury or death compensation payments from war risk hazards, 42 U.S.C. § 1717;
> —Wages of fishermen, seamen, and apprentices, 46 U.S.C. § 601 [Shipping];
> —Civil service retirement benefits, 5 U.S.C. §§ 729, 2265 [Government Organization and Employees];
> —Longshoremen's and Harbor Workers' Compensation Act death and disability benefits, 33 U.S.C. § 916 [Navigation and Navigable Waters];
> —Railroad Retirement Act annuities and pensions, 45 U.S.C. § 231m [former section 228(L) of Title 45, Railroads];
> —Veterans benefits, 45 U.S.C. § 352(E);
> —Special pensions paid to winners of the Congressional Medal of Honor, 38 U.S.C. § 3101 [Veterans' Benefits]; and
> —Federal homestead lands on debts contracted before issuance of the patent, 43 U.S.C. § 175 [Public Lands].[23]

The other relevant provision, 11 U.S.C. § 522(d)(10)(E),[24] allows an

---

such 180-day period than in any other place; and
(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

22. 11 U.S.C. § 522(b)(2)(A) (1988).

23. S. Rep. No. 989, 95th Cong., 2d Sess. 75 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5861; H.R. Rep. No. 595, 95th Cong., 2d Sess. 360 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6316.

24. 11 U.S.C. § 522(d)(10)(E) (1988) reads:
(10) The debtor's right to receive—
. . .
(E) a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor,

individual debtor, who chooses the federal exemption scheme, to exempt the right to receive payments under ERISA plans "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor," as long as, *inter alia*, the plan is qualified for favorable tax treatment under the Internal Revenue Code.

The Goffs had claimed their exemptions under Texas state law (which at that time had no provision for exemption of retirement plans), but did not claim that the retirement plans at issue were exempt under section 522(b)(2)(A).[25] Given the failure of the Goffs to claim an exemption, the only vehicle available as of the proceeding in bankruptcy court, and in the opinion of the Fifth Circuit, was exclusion from the estate under section 541(c)(2).[26] Though the applicability of the exemption section was not "directly involved in this appeal,"[27] the *Goff* court plunged into the exemption thicket, seeking further evidence concerning whether Congress intended the reference to "applicable nonbankruptcy law" within section 541(c)(2) to extend to the federal law comprising ERISA.

Immediately apparent to the court was the fact that ERISA is not found within the illustrative listing of federal laws found in the legislative history underlying section 522(b)(2)(A).[28] While wary of drawing the negative inference of exclusion through silence,[29] the court posited a two-fold distinction between the listed federal laws and ERISA:

> 1. The statutes referred to in the legislative history contain express prohibition on alienation, voluntary or involuntary, while the ERISA anti-assignment and alienation provisions are "contingent" in nature ("ERISA merely provides that *as a condition of obtaining qualified status*—with its attendant tax and other benefits—a pension plan must preclude alienation or assignment of its benefits").[30]
> 2. The property interests covered are also different in nature (". . .the *private pension and welfare benefits sweepingly regulated* by ERISA differ considerably from the *public funded and/or created pension and*

---

unless—

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

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

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

25. Goff v. Taylor (*In re* Goff), 706 F.2d 574, 582 (5th Cir. 1983).

26. *Id.* at 587. Under the present state of the law, a debtor may amend a claim of exemptions at any time before the case is closed when undue prejudice will result. Zielinsky v. Hill (*In re* Hill), 972 F.2d 116 (5th Cir. 1992); *In re* Herzog, 118 B.R. 529 (Bankr. N.D. Ohio 1990); *In re* Luna, 100 B.R. 605 (Bankr. S.D. Fla. 1989).

27. *Goff*, 706 F.2d at 582.

28. *Id.* at 585.

29. *Id.*

30. *Id.* (emphasis in original).

welfare systems, or the *few exceptional, traditionally guarded industries* covered by the illustrative listings.").[31]

Additionally, the court noted that specific reference is made to ERISA-qualified plans within section 522(d)(10)(E).[32] The court concluded that when drafting the Bankruptcy Code, Congress was aware of ERISA and referred specifically to it when intending to include ERISA benefits into an exemption scheme (section 522(d)(10)(E)), and in its reference to other "Federal law" within section 522(b)(2)(A), Congress intended that the "narrow characteristics of the cited statutes . . . was [sic] intended as the operative thread by which the federal statutes—overlooked or yet to be enacted—might be included."[33] Therefore, though not necessary to its ultimate holding, the court concluded that "Congress did not intend to include ERISA-qualified plans within the other 'Federal law' exception of the Section 522 election provision."[34]

Melding the two-legged analysis (and section 541(c)(2) with section 522), the court read section 541(c)(2) in light of its interpretation of the legislative history of section 522. Congress mentioned federal pension law and ERISA particularly when it intended to, but did not do so in section 541(c)(2). Moreover, Congress took ERISA into consideration when it drafted section 522, "and did not grant a broad exemption," thereby evidencing its intent to insulate pensions created by federal law "only to the extent recognized by Section 522."[35] Further, while the preemption provisions of ERISA[36] require that ERISA preempt state law, ERISA is not to be preemptive of other federal law (except for those limited exceptions referred to in the statute itself).[37] The intent underlying the promulgation of the Bankruptcy Code (with respect to sections 541 and 522) was to expand the bankruptcy estate and to limit exemption of ERISA benefits from the estate.[38]

---

31. *Id.* at 586 (footnotes omitted) (emphasis in original).
32. *Id.* at 587.
33. *Id.* at 586
34. *Id.*
35. *Id.*
36. One of the preemptive provisions of ERISA relevant to this discussion is 29 U.S.C. § 1144(a) (1988), which reads:

> *(a) Supersedure; effective date*
>
> Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

37. *Goff*, 706 F.2d at 586. *See* 29 U.S.C. § 1144(d) (1988), which reads:

> *(d) Alteration, amendment, modification, invalidation, impairment, or supersedure of any law of United States prohibited*
>
> Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 1031 and 1137(b) of this title) or any rule or regulation issued under any such law.

38. *Goff*, 706 F.2d at 586.

"These policy-based provisions of the Code would be frustrated were ERISA's anti-alienation and assignment provisions applied with a sweeping brush."[39]

Completing its analysis, the court concluded that the Keogh Plan at issue did not qualify as a spendthrift trust under applicable Texas law, and, therefore, the retirement plan became property of the Goffs' bankruptcy estate, to be used to pay the claims of creditors.[40]

Subsequent to *Goff*, the Fifth Circuit extended its reasoning to municipal pension plans,[41] a vested interest in an ERISA-qualified trust settled by covering a group of physicians,[42] annuities established under a group master plan,[43] and again to self-settled trusts established by professionals.[44]

The *Dyke* case represents an interesting reflection on *Goff*. Recall the complicated second leg of the *Goff* analysis, which attempted to show that where Congress intended to refer to ERISA, it did (section 522(d)(10)(E)), and where it intended to exclude ERISA (the legislative references to other federal laws), it was silent. Utilizing clarifying hindsight, the court in *Dyke* reformed its analysis of the interplay between section 541(c)(2) and section 522(d)(10)(E) and purported to make clear what was on its mind when *Goff* was conceived. The *Dyke* court opined:

> As we recognized in *In re Goff*, the federal exemption scheme in the Bankruptcy Code authorizes the exemption of funds in ERISA retirement plans. 706 F.2d at 585. If Congress had intended in section 541(c)(2) to *exclude* ERISA plans from the bankruptcy estate, then Congress would not have authorized the federal *exemption* of such plans. *Id.* at 582. Thus, the Court in *In re Goff* attempted to avoid an interpretation of ERISA which would have rendered superfluous the federal exemption of retirement plans: the Court concluded that ERISA section 541(c)(2) does not exclude retirement plans from the bankruptcy estate unless they qualify under state law as a "spendthrift trust." *Id.* at 587.[45]

The *Goff* holding was embraced by several circuit courts, which not only followed the holding of *Goff*, but effectively reiterated its reasoning as their own.[46]

---

39. *Id.* at 587.

40. *Id.* at 589.

41. Reagan v. Austin Municipal Fed. Credit Union (*In re* Reagan), 741 F.2d 95 (5th Cir. 1984).

42. Brooks v. Interfirst Bank (*In re* Brooks), 844 F.2d 258 (5th Cir. 1988).

43. Johnson v. Fenslage (*In re* Johnson), 724 F.2d 1138 (5th Cir. 1984).

44. Heitkamp v. Dyke (*In re* Dyke), 943 F.2d 1435 (5th Cir. 1991) (physicians and an attorney).

45. *In re* Dyke, 943 F.2d at 1442-43 (footnotes omitted) (emphasis in original). Though omitted above, part of footnote 20 is worthy of repeating: "If this Court were to conclude that *all* retirement plans are excluded from the bankruptcy estate under section 541(c)(2), then we would render Bankruptcy Code section 522(d)(10)(E), which authorizes the exemption of retirement plans, mere surplusage . . . ." *Id.* at 1443 n. 20. It seems almost as though the court in *Dyke* believed that if this statutory observation were repeated enough, it would somehow show up in *Goff.*

46. *See* Daniel v. Security Pacific Nat'l Bank (*In re* Daniel), 771 F.2d 1352 (9th Cir. 1985),

However, acclaim was not universal. There developed a divergent line of circuit court authority repudiating *Goff* and its focus on legislative history. In adherence to a pledge of allegiance to interpretation of statutes according to their "plain meaning," this authority maintained that the phrase "applicable nonbankruptcy law" within section 541(c)(2) "means exactly what it says: all laws, state and federal, under which a transfer restriction is enforceable."[47]

Specifically, the courts adopting the "excluded from the estate" interpretation succinctly address the two primary arguments of *Goff* (perhaps as enhanced by *Dyke*), that Congress would have specifically mentioned federal law within section 541(c)(2) if the section was intended to refer to ERISA-qualified plans and that excluding retirement plans from the estate under section 541(c)(2) would render section 522(d)(10)(E) meaningless (though the courts do mention the irrelevance of such an analysis, given the plain wording of the statute).

First, the courts adverse to *Goff* note that the phrase "applicable nonbankruptcy law" used in other sections of the Code (sections 108, 365(n), 1125) clearly refers to both state and federal law.[48] Second, the reference to "a payment under a stock bonus, pension, profit sharing . . . or similar plan"[49] is to be distinguished from the corpus of the plan itself. "Even if pension plan assets in the hands of a [plan] trustee are beyond reach of creditors because not part of the debtor's estate under section 541(c)(2), distributions made from the plan to the debtor would not enjoy such protection, in the absence of exemption under section 522(d)(10)(E)."[50] Moreover, the anti-*Goff* cases assert, exclusion of ERISA-qualified benefits from the bankruptcy estate harmonizes ERISA with the Bankruptcy Code.[51]

C. The Resolution

The Supreme Court in *Patterson v. Shumate*[52] affirmed the Fourth Circuit[53] and held that a debtor's interest in an ERISA-qualified retirement plan is excluded from the bankruptcy estate under 11 U.S.C. § 541(c)(2). Referring to the "plain language of the Bankruptcy Code and ERISA" as "our determinant," noting that "[n]othing in section 541 suggests that the phrase 'applicable nonbankruptcy law' refers . . . exclusively to state law" and that "the text contains no limitation on

---

cert. denied, 475 U.S. 1016, 106 S. Ct. 1199 (1986); Lichstrahl v. Bankers Trust (*In re* Lichstrahl), 750 F.2d 1488 (11th Cir. 1985); Samore v. Graham (*In re* Graham), 726 F.2d 1268 (8th Cir. 1984).

47. Anderson v. Raine (*In re* Moore), 907 F.2d 1476, 1477 (4th Cir. 1990); *see also* Gladwell v. Harline (*In re* Harline), 950 F.2d 669 (10th Cir. 1991); Velis v. Kardanis, 949 F.2d 78 (3d Cir. 1991); Shumate v. Patterson, 943 F.2d 362 (4th Cir. 1991), *aff'd*, Patterson v. Shumate, 112 S. Ct. 2242 (1992); Forbes v. Lucas (*In re* Lucas), 924 F.2d 597 (6th Cir. 1991), *cert. denied* 111 S. Ct. 2275 (1991).

48. *In re* Harline, 950 F.2d at 674; *Velis*, 949 F.2d at 81-82.

49. 11 U.S.C. § 522(d)(10)(E) (1988).

50. *Velis*, 949 F.2d at 81-82.

51. *In re* Harline, 950 F.2d at 675-76; *Shumate*, 943 F.2d at 365.

52. 112 S. Ct. 2242 (1992).

53. *Shumate*, 943 F.2d 362.

'applicable nonbankruptcy law' relating to the source of the text,"[54] the Court eschewed resort to legislative history (chiding the appellate courts who so resorted as having "misconceived the appropriate analytical task").[55]

Turning the *Goff* analysis on its head, the Supreme Court (offering its perspective on how to read the Code as a textual whole) noted that "[t]he Code reveals, significantly, that Congress, when it desired to do so, knew how to restrict the scope of applicable law to 'state law' and did so with some frequency."[56]

The Court also pointed out that the phrase "applicable nonbankruptcy law" found in other Code sections encompasses both state and federal law, citing *Morris-Knudsen Construction Co. v. Director, OWCP*,[57] as "recognizing the principal 'that a word is presumed to have the same meaning in all subsections of the same statute.'"[58]

Responding to the argument that excluding ERISA-qualified plans under section 541(c)(2) renders section 522(d)(10)(E) superfluous,[59] the Court concluded that "§ 522(d)(10)(E) exempts from the bankruptcy estate a much broader category of interests than § 541(c)(2) excludes,"[60] and therefore that section 522(d)(10)(e) is not rendered meaningless.

Finally, the Court harmonized its decision with what it views as the relevant "policy considerations." Citing *Butner v. United States*[61] and *Guidry v. Sheet*

54. *Patterson*, 112 S. Ct. at 2246.

55. *Id.* at 2248 n.4.

56. *Id.* at 2246. Examples offered by the *Patterson* Court include: "11 U.S.C. § 109(c)(2) (entity may be a debtor under chapter 9 if authorized 'by State law'); 11 U.S.C. § 522(b)(1) (election of exemptions controlled by 'the State law that is applicable to the debtor'); 11 U.S.C. § 523(a)(5) (a debt for alimony, maintenance, or support determined 'in accordance with State or territorial law' is not dischargeable); 11 U.S.C. § 903(1) ('a State law prescribing a method of composition of indebtedness' of municipalities is not binding on nonconsenting creditors)." *Id.* at 2246.

57. 461 U.S. 624, 103 S. Ct. 2045 (1983).

58. *Patterson*, 112 S. Ct. at 2247 n.2 (citing Morris-Knudsen Constr. Co. v. Director, OWCP, 461 U.S. 624, 633, 1035 S. Ct. 2045, 2050 (1983)). This reference apparently fuels the concurrence of Justice Scalia, who does some chiding of his own: "This application of a normal and obvious principle of statutory construction would not merit comment, except that we explicitly rejected it, in favor of a one-subsection-at-a-time approach, when interpreting another provision of this very statute earlier this Term." *Id.* at 2251 (Scalia, J., concurring) (citing Dewsnup v. Timm, 112 S. Ct. 773, 777-78 n.3 (1992) (stating that "we express no opinion as to whether the words [at issue] have different meaning in other provisions of the Bankruptcy Code.").

59. *See* discussion *supra* notes 47-48 and accompanying text and *infra* note 66 and accompanying text.

60. *Patterson*, 112 S. Ct. at 2249. The Court refers, for example, to plans "established by governmental entities and churches" as not being necessarily covered by the anti-alienation provision of ERISA in order to be "qualified" plans, citing 29 U.S.C. § 1003(b)(1) and (2); 26 CFR 1-401(a)-13(a) (1991); and Individual Retirement Accounts (26 U.S.C. § 408) as exemptible under § 522(d)(10)(E), but not excluded from the estate under § 541(c)(2). *Id.*

61. 440 U.S. 48, 55, 99 S. Ct. 914, 918 (1978) (stating that "uniform treatment of property interests prevents a party from receiving a 'windfall merely by reason of the happenstance of bankruptcy . . .'") (citing Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603, 609, 81 S. Ct. 347, 350 (1961)).

Metal Workers Pension Fund,[62] the *Patterson* Court refused to endorse a policy which would preclude involuntary alienation of ERISA-qualified pension plans outside of bankruptcy but would require, in essence, involuntary alienation of such plans inside bankruptcy (if plans are not excluded from the estate).[63] Rather, "our decision today ensures that the treatment of pension benefits will not vary based upon the beneficiary's bankruptcy status."[64]

From the foregoing, it is fairly simple to encapsulate the Court's holding: an individual debtor's interest in a retirement plan, the qualification of which under ERISA is subject to the anti-alienation provisions of ERISA and which is in fact qualified on the basis of required anti-alienation language contained within the plan document, is excluded from the debtor's bankruptcy estate under 11 U.S.C. § 541(c)(2).[65] If a debtor's interest is excluded from the estate, the issue of whether the debtor's interest is exempt under 11 U.S.C. § 522 is irrelevant (or moot).[66]

Before moving to a discussion of certain implications of and questions raised by *Patterson* (*e.g.*, the issue of the validity of certain portions of the Louisiana exemption laws[67]), an alternative approach to the interpretation of the interplay between section 541(c) and section 522 is offered, one which was not dealt with by the Court in *Patterson* (or by the courts in *Goff* and its progeny), and which provides support for the *Goff* holding.[68]

D. Knocking at the Resolution

Recall that section 522(b)(2)(A) allows the individual debtor in an "opt out state" to claim an exemption on "any property that is exempt under federal law, other than subsection (d) of this section," along with any exemption provided under applicable state or local law.[69] Recall also that the *Goff* court, analyzing the legislative history behind section 522(b)(2)(A) (the illustrative listing of federal laws providing exemptions under this subsection), concluded that, in light of the specific references to retirement plans subject to ERISA within section

62. 493 U.S. 365, 110 S. Ct. 680 (1990) (finding that "labor union may not impose constructive trust or pension benefits of union officials who breach fiduciary duties and embezzled funds").

63. *Patterson*, 112 S. Ct. at 2249-50.

64. *Id.* at 2249.

65. In a recently decided case, McGraw v. Society Bank & Trust (*In re* Bell & Beckwith), 5 F.3d 150 (6th Cir. 1993), the Sixth Circuit held that contributions which are in excess of those provided for under a partnership ERISA-qualified profit sharing plan (because, for example, the partnership earned no net income—profits) are "void *ab initio*"; are not valid contributions to the plan, and, therefore, because such contributions never became part of the plan, are not subject to the anti-alienation provisions of 29 U.S.C. § 1056(d). *Id.* at 153.

66. *Patterson*, 112 S. Ct. at 2250.

67. Particularly, La. R.S. 13:3881(D)(1), (2) (1990) and La. R.S. 20:33(1) (1983). For full text, see *infra* notes 97-99 and accompanying text.

68. In anticipation of the question, "Why is this writer wasting space on an argument contrary to the final word—a Supreme Court opinion?," this writer can only respond, "This is a law school faculty symposium, isn't it?"

69. 11 U.S.C. § 522(b)(2)(A) (1988).

522(d)(10)(E) and the failure to mention ERISA within the legislative history of section 522(b)(2)(A), ERISA was not a federal law providing an exemption under that subsection.[70] Additionally, the court extended its analysis (perhaps by a jump) to conclude that because "Congress made reference to federal law and pension benefits when such a characterization was intended," and was "well aware of ERISA . . . and did not grant a broad exemption" in section 522, "[t]he only reasonable inference is that Congress intended that pensions provided for by federal law be insulated from bankruptcy only to the extent recognized in section 522."[71]

Did the court miss a step? Perhaps. Especially in light of the requirement of initial focus upon the wording of the statute espoused by the Supreme Court in *Patterson*,[72] the Fifth Circuit in *Goff* conceivably resorted to legislative history too quickly in its analysis of section 541(c) and somewhat confusedly in its analysis of section 522.

Though the court noted that section 522(b)(2)(A) only refers to "federal law other than subsection (d)"[73] and that the legislative history provides only illustrative guidance,[74] the court simultaneously referred to what Congress "*clearly* did not do directly in section 522, although section 522 *explicitly addresses* the extent to which other 'Federal law' and retirement benefit exemptions would be recognized."[75] The problem with the court's approach is that legislative history is resorted to as the basis for the court's conclusion as to what section 522 clearly and explicitly addresses and does. As the *Patterson* Court teaches, this clearly will not do. What about an approach that recognizes that the *Goff* court might have had something but did not know what? Let us see.

Clearly, statutes within a scheme (or Code) are to be interpreted, if possible, so that the reading of one statute does not create conflict with other provisions or render other provisions redundant, meaningless, or superfluous.[76] The Supreme

70. Goff v. Taylor (*In re* Goff), 706 F.2d 574, 585-86 (5th Cir. 1983).

71. *Id.* at 586.

72. Patterson v. Shumate, 112 S. Ct. 2242, 2246, 2248 n.4 (1992).

73. *Goff*, 706 F.2d at 582.

74. *Id.* at 583.

75. *Id.* at 582 (emphasis supplied).

76. Connecticut Nat'l Bank v. Germain, 112 S. Ct. 1146, 1149 (1992) (holding that a statute should be construed in a manner which brings all of its provisions into harmony); Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 376, 110 S. Ct. 680, 687 (1990) (same); Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 370, 106 S. Ct. 1890, 1899 (1986); Morton v. Mancari, 417 U.S. 535, 551, 94 S. Ct. 2474, 2483 (1974); Federal Power Comm'n v. Panhandle Eastern Pipe Line, Co., 337 U.S. 498, 514, 69 S. Ct. 1251, 1260 (1949) (holding that all sections of the Natural Gas Act must be reconciled if possible so as to produce a symmetrical whole); United Steelworkers v. North Star Steel Co., Inc., 5 F.3d 39, 43 (3d Cir. 1993) (deciding that a statute's provisions should be read to be consistent with one another); Coar v. Kazimir, 990 F.2d 1413, 1419-20 (3d Cir. 1993) (same), *cert. denied*, 114 S. Ct. 179 (1993); FDIC v. Hirsch (*In re* Colonial Realty Co.), 980 F.2d 125, 132 (2d Cir. 1992) (opining that in addressing arguably inconsistent requirements of two statutes, the courts must give effect to both where possible); United States v. Gordon, 961 F.2d 426, 431 (3d Cir. 1992) (determining that "[c]ourts should attempt to reconcile two seemingly conflicting statutory provisions whenever possible"); Atwell v. Merit Sys. Protection Bd., 670 F.2d 272, 286

Court has often resorted to legislative history when, notwithstanding the apparent plain meaning of a statute, attributing such meaning would contravene a consistent reading of the statute as a whole[77] or be directly contrary to clearly expressed legislative intent.[78] Now, to the statute at hand.

The Court in *Patterson* was clearly satisfied that its reading of section 541(c) did not render section 522(d)(10)(E) surplusage, though the effect of the opinion was to limit the applicability of section 522(d)(10)(E) drastically.[79] What about the "other federal law" provision of section 522(b)(2)(A)? The Court did not address this question and neither did the court in *Goff*. Secondly, should the Court in *Patterson* have been so self-assured in its harmonizing of section 541(c)(2) and section 522(d)(10)(E)?

Adhering to the espoused penchant for "words only" if the meaning is plain, the first question is whether the meaning of the federal exemption component of

---

(D.C. App. 1981) (stating that "it is a court's mission to reconcile arguably contradictory statutory passages where the intent of Congress is clear but implementation is somewhat faulty, and such passages should be construed whenever possible to achieve consistency"); United States v. Tighe, 551 F.2d 18, 20 (3d Cir. 1977) (same), *cert. denied*, 434 U.S. 823, 98 S. Ct. 68 (1977); *In re* Nadler, 122 B.R. 162 (Bankr. D. Mass. 1990) (same).

77. *See* Crandon v. United States, 494 U.S. 152, 157, 110 S. Ct. 997, 1001 (1990) (stating that in determining a statute's meaning, the court must look to the statutes language as well as the design and object of the statute as a whole); K-Mart Corp. v. Cartier, Inc., 486 U.S. 281, 291, 108 S. Ct. 1811, 1818 (1988) (same); Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 51, 107 S. Ct. 1549, 1555 (1987); Kokoszka v. Belford, 417 U.S. 642, 650, 94 S. Ct. 2431 2436 (1974) (holding that "[w]hen 'interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute and the objects and policy of the law . . .'") (citing Brown v. Duchesne, 19 How. 183 (1857)); Richards v. United States, 369 U.S. 1, 11, 82 S. Ct. 585, 591-92 (1962) (same); Philbrook v. Glodgett, 421 U.S. 707, 713, 95 S. Ct. 1893, 1898 (1975); Chemehuevi Tribe of Indians v. FPC, 420 U.S. 395, 402-03, 95 S. Ct. 1066, 1071-72 (1975); United States v. Heirs of Boisdore, 49 U.S. (8 How.) 113, 122 (1849); *accord*, United States Nat'l Bank of Oregon v. Independent Ins. Agents of America, Inc., 113 S. Ct. 2173, 2182 (1993); King v. St. Vincent's Hospital, 112 S. Ct. 570, 574 (1991); Dole v. United Steelworkers, 494 U.S. 26, 35, 110 S. Ct. 929, 934 (1990); Tidewater Oil Co. v. United States, 409 U.S. 151, 157, 93 S. Ct. 408, 413 (1972).

78. *See* Immigration and Naturalization Serv. v. Cardoza-Fonseca, 480 U.S. 4421, 433 n.12, 107 S. Ct. 1207, 1214 n.12 (1987) (noting that the Court looks to the legislative history to determine whether there is "clearly expressed legislative intention" contrary to the language of the statute); United States v. James, 478 U.S. 597, 606, 106 S. Ct. 3116, 3121 (1986) (same); Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108, 100 S. Ct. 2051, 2056 (1980); Cass v. United States, 417 U.S. 72, 77, 94 S. Ct. 2167, 2170-71 (1974); National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers, 414 U.S. 453, 458, 94 S. Ct. 690, 693 (1974) (stating that general principles of statutory construction must yield to clear contrary evidence of legislative intent); Neuberger v. Commissioner, 311 U.S. 83, 88, 61 S. Ct. 97, 101 (1940) (same); Rector of Holy Trinity Church v. United States, 143 U.S. 457, 460, 12 S. Ct. 511, 512 (1892). *See also* Watt v. Alaska, 451 U.S. 259, 266, 101 S. Ct. 1673, 1677 (1981) (concluding that the plain meaning rule does not prohibit resort to legislative history to determine legislative intent).

79. Patterson v. Shumate, 112 S. Ct. 2242, 2249 (1992). As the Court illustrated, § 522(d)(10)(E) only refers and applies to retirement plans which are *not* subject to the alienation provisions of § 1056(d) of ERISA. As noted, the Supreme Court could name but three (church plans, governmental employee plans, and individual retirement accounts—IRA's). *See also supra* note 60.

section 522(b)(2)(A) can be gleaned from the words of the statute.[80] Even if limited by the *Patterson* Court's requirement that a finding of ambiguity necessarily precedes resort to legislative history, isn't the need for such guidance immediately apparent? The statute refers to no general or specific federal law of exemption and limits the extent of section 522(b)(2)(A) only by reference to section 522(d). This limitation does not, on its face, resolve interpretative issues. For example, section 522(d)(10)(A) provides an exemption covering "the debtor's right to receive a social security benefit," and subsection (d)(10)(B) exempts "the debtor's right to receive a veteran's benefit." Does reference to social security and veteran's benefits within section 522(d) exclude these benefits from exempt status under section 522(b)(2)(A) for debtors filing in "opt out states"? The interpretative problem arises from the language of the social security and veteran's benefits statutes relating to the exempt status of benefits. Under 38 U.S.C. § 5301(a), veteran's benefits are not assignable and payments are generally exempt from seizure "either before or after receipt by the beneficiary."[81] In addition, social security benefits are not assignable, and benefits "paid or payable" are exempt from seizure.[82]

While this writer should not use his own acuity level as a yardstick for distinguishing between "plainly meant" and ambiguously worded statutes (there would be precious little that is plain), legislative history of section 522(b)(2)(A) seems clearly appropriate in search of the answers, for example, to the questions: (i) whether reference to social security and veteran's benefits within section 522(d)

---

80. 11 U.S.C. § 522(b)(2)(A) (1988). Recall: "any property that is exempt under Federal law, other than subsection (d) of this section . . . ."

81. 38 U.S.C. § 5301(a) (Supp. IV 1992) reads as follows:

Non-assignability and exempt status of benefits

(a) Payments of benefits due or to become due under any law administered by the Secretary shall not be assignable except to the extent specifically authorized by law, and such payments mad to, or on account of, a beneficiary shall be exempt from taxation, shall be exempt from the claim of creditors, and shall not be liable to attachment, levy, or seizure by or under any legal or equitable process whatever, either before or after receipt by the beneficiary. The preceding sentence shall not apply to claims of the United States arising under such laws nor shall the exemption therein contained as to taxation extend to any property purchased in part or wholly out of such payments. The provisions of this section shall not be construed to prohibit the assignment of insurance otherwise authorized under chapter 19 of this title, or of servicemen's indemnity. For purposes of this subsection, in any case where a payee of an educational assistance allowance has designated the address of an attorney-in-fact as the payee's address for the purpose of receiving a benefit check and has also executed a power of attorney giving the attorney-in-fact authority to negotiate such benefit check, such action shall be deemed to be an assignment and is prohibited.

82. 42 U.S.C. § 407(a) (1988) reads as follows:

(a) The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.

excludes them from the coverage of section 522(b)(2)(A); (ii) whether the apparent limitation within section 522(d) to "the debtor's right to receive" benefits excludes past payments clearly contemplated by 38 U.S.C. § 5301(a) and 42 U.S.C. § 407(a); (iii) whether, if past payments are excluded from exemption under section 522(d), this exclusion would bring at least past paid benefits under the effect of section 522(b)(2)(A); and (iv) whether the limitation in section 522(b)(2)(A) should be narrowly construed so that only property which derives its federally operated exemption status *solely* from section 522(d) is excepted from exemption under section 522(b)(2)(A).[83]

Reference to legislative history, as mentioned, reveals an illustrative list of federal laws, the benefits pursuant to which are to be exempt (if section 522(b)(2) is chosen or required by applicable state law).[84] Clearly, according to the congressional reports, both social security and veteran's benefits, as well as, for example, railroad and civil service employee retirement benefits are exempt. If resort to legislative history is not objectionable, Congress' clear intention in enacting section 522(b)(2)(A) was to include these benefits in the individual debtor's bankruptcy estate, subject to the debtor's right to make a proper claim of exemption. Analysis of a random sampling of the illustrative federal laws (social security and veteran's, civil service, and railroad employee retirement benefits) arguably places the *Patterson* Court on shaky ground. All of the benefits referred to are subject to anti-alienation provisions restricting voluntary and involuntary alienation.[85]

Of the four examples mentioned, each style of benefit clearly is not only exempt from execution process, seizure, *etc.* (involuntary transfers), but also (at

83. While these may be interesting (and hard) questions, answers to them are outside the scope of this article. I try to establish their geneses in the language of the statute so that the legislative history door can be opened. With respect to two of the questions (iii and iv), see Walker v. Treadwell (*In re* Treadwell), 699 F.2d 1050 (11th Cir. 1983) (holding that debtor who chooses § 522(d) exemption scheme may only claim an exemption covering the right to receive future payments, while debtors who choose exemptions under § 522(b)(2)(A) may claim the exemption afforded under 42 U.S.C. § 407(a) (1988) and exempt past payments as well as future benefits).

84. *See supra* note 23 and accompanying text.

85. *See supra* notes 81-82 for text of the pertinent parts of the anti-assignment statutes relative to veteran's and social security benefits. The railroad retirement anti-assignment statute is 45 U.S.C. § 231m (1988), which reads, in pertinent part:

> (a) Except as provided in subsection (b) of this section and the Internal Revenue Code of 1954 [26 U.S.C. § 1 et seq.], notwithstanding any other law of the United States, or of any State, territory, or the District of Columbia, no annuity or supplemental annuity shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated.

(footnote omitted). The anti-assignment statute relative to civil service retirement benefits is 5 U.S.C. § 8346 (1988), which reads, in pertinent part:

> (a) The money mentioned by this subchapter is not assignable, either in law or equity, except under the provisions of subsections (h) and (j) of section 8345 of this title, or subject to execution, levy, attachment, garnishment, or other legal process, except as otherwise may be provided by Federal laws.

least with respect to the debtor's present interest in future benefits) is subject to restriction on voluntary assignment or transfer. Therefore, an individual debtor's interest in retirement benefits established by these federal laws is subject to restrictions on transfer, which are identical in nature to the restriction on transfer imposed upon ERISA plans subject to the provisions of section 1056(d).

In response, it could be argued that the distinction between an interest in an ERISA plan and an interest in retirement benefits under any of the four examples is that the debtor's interest in the ERISA plan is a beneficial interest in a trust, which makes section 541(c)(2) directly applicable, while a right to receive the other federal retirement benefits is not.[86] However, this argument does not hold. For example, 42 U.S.C. § 401(a) and (b) establish two trusts, the "Federal Old Age and Survivors Insurance Trust Fund" and the "Federal Disability Insurance Trust Fund." Payments of benefits due under the social security laws are payable from these "trusts."[87] The statutes establishing railroad employee retirement benefits provide for the continuation of "The Railroad Retirement Account" to be maintained by appropriations and tax collections for the purpose of funding benefits due.[88]

---

86. The *Patterson* Court equates the debtor's interest in an ERISA qualified plan with having a beneficial interest in a trust (and, in fact, uses "plan" and "trust" interchangeably). Patterson v. Shumate, 112 S. Ct. 2242, 2247-48 (1992).

87. 42 U.S.C. § 401(h) (1988), which reads as follows:

(h) Benefit payments

Benefit payments required to be made under section 423 of this title, and benefit payments required to be made under subsection (b), (c), or (d) of section 402 of this title to individuals entitled to benefits on the basis of the wages and self-employment income of an individual entitled to disability insurance benefits, shall be made only from the Federal Disability Insurance Trust Fund. All other benefit payments required to be made under this subchapter (other than section 426 of this title) shall be made only from the Federal Old-Age and Survivors Insurance Trust Fund.

88. 45 U.S.C. § 231n(a) (1988), which reads as follows:

(a) Maintenance of account; authorization of appropriations

The Railroad Retirement Account established by section 15(a) of the Railroad Retirement Act of 1937 [45 U.S.C. § 228o(a)] shall continue to be maintained in the Treasury of the United States. There is hereby appropriated to such Account for each fiscal year, beginning with the fiscal year ending June 30, 1975, to provide for the payment of benefits to be made from such Account in accordance with the provisions of section 231f(c)(1) of this title, and to provide for expenses necessary for the Board in the administration of all provisions of this subchapter, an amount equal to amounts covered into the Treasury (minus refunds) during each fiscal year under the Railroad Retirement Tax Act [26 U.S.C. § 3201 et seq.], except those portions of the amounts covered into the Treasury under sections 3211(b), 3221(c), and 3221(d) of such Tax Act [26 U.S.C. §§ 3211(b), 3221(c), 3221(d)] as are necessary to provide sufficient funds to meet the obligation to pay supplemental annuities at the level provided under section 231b(e) of this title and, with respect to those entitled to supplemental annuities under section 205(a) of title II of this Act, at the level provided under section 205(a).

Similarly, Congress has created a separate "Civil Service and Disability Fund" for the purpose of paying benefits due retirees.[89] (There is no separately created fund established for the purpose of payment of veterans' benefits.)

While among the aforementioned examples, the social security statutes make the sole reference to benefits being paid from a "trust," the establishment of a fund administered by the agency purely for the benefit of retiree/beneficiaries represents, from a statutory standpoint, no perceptible practical difference. Therefore, according to the legislative history, at least three of the examples of federal law *exemptions* bear the operative hallmarks of the ERISA "trust," including the restrictions on alienation.[90]

---

89. 5 U.S.C. § 8348(a) (1988 & Supp. IV 1992), which reads, in pertinent part:

> *(a)* There is a Civil Service Retirement and Disability Fund. The Fund—
>
> *(1)* is appropriated for the payment of—
>
> *(A)* benefits as provided by this subchapter or by the provisions of chapter 84 of this title which relate to benefits payable out of the Fund; and
>
> *(B)* administrative expenses incurred by the Office of Personnel Management in placing in effect each annuity adjustment granted under section 8340 or 8462 of this title, in administering survivor annuities and elections providing therefor under sections 8339 and 8341 of this title, or subchapters II and IV of chapter 84 of this title, in administering alternative forms of annuities under sections 8343a and 8420a (and related provisions of law), and in withholding taxes pursuant to section 3405 of title 26; and
>
> *(2)* is made available, subject to such annual limitation as the Congress may prescribe, for any expenses incurred by the Office in connection with the administration of this chapter, chapter 84 of this title, and other retirement and annuity statutes.

90. In fact, notwithstanding the reliance of the *Patterson* Court upon prior case law interpreting ERISA as containing an *actual* restriction on assignment or transfer (voluntary or involuntary), *see Patterson*, 112 S. Ct. at 2250, the statutory examples do in fact contain more concrete anti-alienation language than does ERISA (29 U.S.C. § 1056(d)). Recall that in *Goff*, the court noted the distinction between the ERISA requirement that "each pension plan shall provide that benefits under the plan may not be assigned or alienated" (29 U.S.C. § 1056(d)(1)) and the absolute prohibitions contained within the illustrated statutes, and concluded that the ERISA requirement "merely provides that *as a condition of obtaining* qualified status—with its attendant tax and other benefits—a pension plan must preclude alienation or assignment of benefits." Goff v. Taylor (*In re* Goff), 706 F.2d 574, 585 (5th Cir. 1983) (emphasis added).

The Supreme Court has taken an interesting approach to its conclusion that the ERISA provision operates as a statutory bar to involuntary alienation. In Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825, 108 S. Ct. 2182 (1988), the Court faced the question of whether a particular state statute prohibiting garnishment of welfare benefit plans was preempted by ERISA (and, if so, whether the general garnishment statute of the state, which would allow garnishment of welfare benefits, would also be preempted). Within the opinion, the Court, distinguishing welfare benefits from pension benefits, remarked that "when Congress was adopting ERISA, it had before it a provision to ban the alienation or garnishment of ERISA plan benefits, and chose to impose that limitation only with respect to ERISA pension benefits plans, and *not* ERISA welfare benefit plans." *Mackey*, 486 U.S. at 837, 108 S. Ct. at 2189 (emphasis in original).

Subsequently, in Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 110 S. Ct. 680 (1990), the Court on its way to holding that the anti-alienation provisions of § 1056(d) prohibit imposition of a constructive trust upon the interest of a participant guilty of embezzlement from the plan fund (in favor of those parties injured), noted the prior discussion in *Mackey* and reiterated that

Though the *Goff* court does ultimately conclude that "[t]he only reasonable inference to draw is that Congress intended that pensions provided for by federal law can be insulated from bankruptcy only to the extent recognized in Section 522,"[91] the analysis is backdoor. As shown above, the court distinguished the ERISA anti-alienation provisions from those within the legislative illustration underlying section 522(b)(2)(A), determined that interests in ERISA plans were not exempt under section 522(b)(2)(A), and used this determination as the basis for its conclusions that (i) because Congress made reference to "federal law" in section 522 and not in section 541(c)(2), section 541(c)(2) is limited to applicable state law; and (to come full circle) (ii) because section 541(c)(2) is limited to state law, Congress clearly intended to deal with federal retirement and pension benefits under section 522 only. The *Goff* court has something of a cart/horse problem that resort to legislative history in the manner and for the purpose proposed above perhaps could have resolved.

Attempting to read sections 541(c)(2) and 522(b)(2)(A) *in pari materia* (without regard to whether ERISA-qualified pension plans can be exempt under section 522(b)(2)(A)) arguably yields the conclusion that reading "applicable nonbankruptcy law" expansively either renders section 522(b)(2)(A) meaningless or results in a construction of that statute that contravenes the clear legislative intent to deal with federally created trusts (or retirement plan accounts) through the exemption statute (or both).[92]

---

§ 1056(d) "proscribes the assignment or alienation of pension plan benefits, but that no comparable provision applies to ERISA welfare benefit plans." *Id.* at 371, 110 S. Ct. at 685.

Despite the plain wording of the statute, that the "plan shall provide that benefits . . . may not be assigned or alienated" (which plainly means only that the *plan shall provide*), the Court, without a statutory shoehorn, has bootstrapped ERISA into an absolute prohibition on assignment or alienation. Without additional or supporting statutory language, it is difficult to construe the requirement that the *plan shall provide* to mean "because the plan must provide that benefits . . . may not be assigned or alienated, this restriction shall be enforceable as against all transferees, and shall act to exempt from execution, process, seizure, encumbrance a participant's interest in a plan qualified under this subsection."

Therefore, in light of *Mackey* and *Guidry*, the ERISA restrictions on transfer are to be interpreted as indistinguishable from those absolute statutory provisions in the statutory examples. However, from the words themselves, it takes a big jump to get to *Mackey* and *Guidry* (and but a small tiptoe to get to *Goff*).

91. *Goff*, 706 F.2d at 586.

92. As mentioned above, the Goffs sought to exclude their plans from their estate, having claimed exemptions under state law. The court in *Goff* makes clear that with respect to § 522(b)(a), the Goffs "did not attempt to claim exemption of their ERISA-qualified Keogh plans under this other 'Federal law' exemption." *Id.* at 582 (footnote omitted). Clearly, the *Goff* court's view is that the plan would not have been so exempt. While this writer's proposed analysis does not necessarily undermine the court's conclusion that ERISA-qualified plans are not exempt under § 522(b)(2)(A), at least the portion of the opinion seeking to distinguish between the absolute prohibition on alienation contained in the statutes illustratively listed and the more limited provision in ERISA probably does not hold water in light of *Mackey* and *Guidry*, both decided subsequently to *Goff*. For cases dealing with this issue, see Reed v. Drummond (*In re* Reed), 951 F.2d 1046 (9th Cir. 1991) (holding that Congress did not intend to allow ERISA exemption), *superseded on other grounds*, 985

The *Patterson* Court's conclusion that its interpretation of section 541(c)(2) does not render section 522(d)(10)(E) superfluous is also shaky because it fails to consider the effect upon section 522(d)(10)(A) and (B). While perhaps section 522(d)(10)(E) does encompass a broader range of retirement plans than those covered by the anti-alienation provisions of 29 U.S.C. § 1056(d), certainly the right to receive social security and veteran's retirement benefits falls neatly within the sphere of the anti-alienation provisions covering those specific types of benefits. If the foregoing analysis is good for anything other than using paper, an argument that the Court's holding does not render subsections (A) and (B) of section 522(d)(10) superfluous is hard to maintain.[93]

So, what of all of this? This writer, for what it is worth, has attempted to show that the Supreme Court could have taken a different approach, one that would have done less damage to the prospect of reading the statutes comprising the Bankruptcy Code as an integrated whole. However, one must ultimately ask, "So what?" (because the Court's holding is the Court's holding, and from a political perspective, there will be no groundswell to prod legislation that embraces this writer's analysis).[94] Once this question is asked, it is time to move on.

F.2d 1026 (9th Cir. 1993); Pitrat v. Garlikov, 947 F.2d 419 (9th Cir. 1991) (same), *superseded on other grounds*, 992 F.2d 224 (9th Cir. 1993); Daniel v. Security Pac. Nat'l Bank (*In re* Daniel), 771 F.2d 1352 (9th Cir. 1985); Lichstrahl v. Bankers Trust (*In re* Lichstrahl), 750 F.2d 1488 (11th Cir. 1985); Samore v. Graham (*In re* Graham), 726 F.2d 1268 (8th Cir. 1984); *In re* Fullmer, 127 B.R. 55 (D. Utah 1991), *rev'd on other grounds*, 977 F.2d 595 (10th Cir. 1992); *In re* Knowles 123 B.R. 428 (Bankr. M.D. Fla. 1991); *In re* Rosenquist, 122 B.R. 775 (Bankr. M.D. Fla. 1990); Nelson v. Carver (*In re* Carver), 128 B.R. 239 (Bankr. W.D. Mo. 1990); *In re* Morrow, 122 B.R. 151 (Bankr. M.D. Fla. 1990); *In re* McIntosh, 116 B.R. 277 (Bankr. N.D. Okla. 1990); *In re* Gardner, 118 B.R. 860 (Bankr. M.D. Fla. 1990); *In re* Brown, 95 B.R. 216 (Bankr. N.D. Okla. 1989); *In re* Alagna, 107 B.R. 301 (Bankr. D. Colo. 1989); *In re* Toner, 105 B.R. 978 (Bankr. D. Colo. 1989); *In re* Gribben, 84 B.R. 494 (Bankr. S.D. Ohio 1988); Wear v. O'Brien (*In re* O'Brien), 94 B.R. 583 (Bankr. W.D. Mo. 1988).

But see In re Shaker, 137 B.R. 930 (Bankr. W.D. Wisc. 1992) (concluding that the ERISA anti-alienation provision is a federal nonbankruptcy exemption under § 522(b)(2)(A)); *In re* Hennessey, 135 B.R. 711 (Bankr. D. Mass. 1992) (same); *In re* Sawyers, 135 B.R. 371 (Bankr. W.D. Mo. 1992); *In re* Damast, 136 B.R. 11 (Bankr. D.N.H. 1991); *In re* Enfield, 133 B.R. 515 (Bankr. W.D. Mo. 1991); *In re* White, 131 B.R. 526 (Bankr. D. Mass. 1991); *In re* Suarez, 127 B.R. 73 (Bankr. S.D. Fla. 1991); *In re* Majul, 119 B.R. 118 (Bankr. W.D. Tex. 1990); Richardson v. Daily (*In re* Starkey), 116 B.R. 259 (Bankr. D. Colo. 1990); *In re* Messing, 114 B.R. 541 (Bankr. E.D. Tenn. 1990), *rev'd*, No. 90-00601 (E.D. Tenn. Dec. 13, 1990), *rev'd sub nom.* Mostoller v. Messing (*In re* Messing), 944 F.2d 905 (6th Cir. 1991), *cert. denied*, 112 S. Ct. 1585 (1992) and 112 S. Ct. 2991 (1992); *In re* Felts, 114 B.R. 131 (Bankr. W.D. Tex. 1990); *In re* Burns, 108 B.R. 308 (Bankr. W.D. Okla. 1989); *In re* Komet, 104 B.R. 799 (Bankr. W.D. Tex. 1989); *see also* Checkett v. Vickers (*In re* Vickers), 954 F.2d 1426 (8th Cir. 1992), *cert. denied*, 113 S. Ct. 4 (1992) (holding that preemption of a state statute which furthers the purposes of ERISA would invalidate § 522, which allows states to opt out and create their own exemptions); Heitkamp v. Dyke (*In re* Dyke), 943 F.2d 1435 (5th Cir. 1991) (same).

93. *See* Walker v. Treadwell (*In re* Treadwell), 699 F.2d 1050 (11th Cir. 1983), referred to *supra* at note 83. The court in that case had no difficulty handling the relationship between § 522(b)(2)(A) and § 522(d)(10)(A) from an exemption perspective.

94. In fact, quite the contrary. Pending legislation will, if passed, amend § 541(c) by adding

E. Effect of Patterson *on Louisiana Exemption Law*

Patterson does not address questions of exemption law, but one of the ripple effects arguably has been to render certain portions of the Louisiana exemption law unconstitutional.

As of the *Goff* opinion, Texas exemption law did not grant an exemption covering ERISA-qualified plans.[95] As a result of the *Goff* holding, the Texas legislature amended the state exemption statute to provide a state law exemption for pension plans qualified for favorable tax treatment under the Internal Revenue Code.[96] Louisiana law, as of 1952, has contained an exemption statute pertaining to pensions.[97] Louisiana Revised Statutes 20:33(1) was amended in 1983 to provide as follows:

> *Pension, annuity, and gratuity payment by employers*
> The following shall be exempt from all liability for any debt except alimony and child support:
> (1) All pensions, all proceeds of and payments under annuity policies or plans, all individual retirement accounts, all Keogh plans, all simplified employee pension plans, and all other plans qualified under Sections 401 or 408 of the Internal Revenue Code. However, an individual retirement account, Keogh plan, simplified employee pension plan, or other qualified plan is only exempt to the extent that contributions thereto were exempt from federal income taxation at the time of contribution, plus interest or dividends that have accrued thereon. No contribution shall be exempt if made less that [sic] one calendar year from the date of filing for bankruptcy, whether voluntary or involuntary, or less than one calendar year from the date writs of seizure are filed against such account or plan.[98]

---

a new subsection (§ 541(c)(3)), which in its present form reads:

> (3) (A) Subject to subparagraph (B), assets and benefits accumulated for the benefits of a debtor pursuant to a pension, profitsharing, stock bonus, or other plan qualified under section 401(a), 403(a), 403(b), or 408(k), or a governmental plan under 414(d), or 457 of the Internal Revenue Code of 1986 and any rights of debtor to such assets or benefits shall be excluded for the property of the estate.
> (B) Subparagraph (A) does not apply to plan assets or benefits attributable to contributions of the debtor to the extent that such contributions were in excess of the applicable limits on such contributions under section 401(k), 401(m), or 415 of the Internal Revenue Code of 1986.

S. Rep. No. 540, 103d Cong., 1st Sess., § 207 (1993).

95. *Goff*, 706 F.2d at 579.

96. Heitkamp v. Dyke (*In re* Dyke), 943 F.2d 1435, 1439 (5th Cir. 1991).

97. The legislature first enacted the provision as La. R.S. 20:33 (1952) (1952 La. Acts No. 117, § 1), which read in pertinent part as follows:

> *Pension, annuity, and gratuity payment by employers*
> [T]he following shall be exempt from all liability for any debt except alimony and child support:
> (1) All pensions and all proceeds of and payments under annuity policies or plans.

98. 1983 La. Acts No. 362, § 1.

Subsequently, the Louisiana legislature amended Louisiana Revised Statutes 13:3881 by adding subsection (D), which reads:

> D. (1) The following shall be exempt from all liability for any debt except alimony and child support: all pensions, all proceeds of and payments under annuity policies or plans, all individual retirement accounts, all Keogh plans, all simplified employee pension plans, and all other plans qualified under Sections 401 and 408 of the Internal Revenue Code. However, an individual retirement account, Keogh plan, simplified employee pension plan, or other qualified plan is only exempt to the extent that contributions thereto were exempt from federal income taxation at the time of contribution, plus interest or dividends that have accrued thereon.
>
> (2) No contribution shall be exempt if made less than one calendar from the date of filing for bankruptcy, whether voluntary or involuntary, or less than one calendar year from the date writs of seizure are filed against such account or plan.[99]

Even if not so intended, the effect of the amendments to these exemption statutes was to take Louisiana debtors out from under the purview of the *Goff* holding by providing a state law exemption covering retirement plans qualified under and regulated by ERISA.[100]

The Louisiana exemption statute has decreed, pursuant to section 522(b)(2)(A) of the Bankruptcy Code, that Louisiana citizens filing bankruptcy are limited to claiming state law exemptions and those exemptions established by other federal law, except under subsection (d) of section 522.[101] Therefore, under Louisiana state law, debtors are ostensibly protected from the discussion in *Goff* that excludes ERISA from the list of other federal laws (those found in section 522(d)) providing exemptions. So far, all appears well.

In bankruptcy law, however, appearances can be deceiving. Numerous state legislatures apparently took the same approach to offering state law exemption protection to ERISA-qualified retirement plans as did Louisiana and Texas.[102] Rather than solve the *Goff* problem, these state statutes created a concern doubtless unforeseen, a problem that was foreshadowed by *Shaw v. Delta Airlines, Inc.*[103]

---

99. 1990 La. Acts No. 495, § 1.

100. Louisiana Legislative history has not been researched to determine whether this effect was an intended or incidental consequence of the amendments to the exemption statutes.

101. La. R.S. 13:3881(B)(1) (1982), which reads:

> B. (1) In cases instituted under the provisions of Title 11 of the United States Code, entitled "Bankruptcy," there shall be exempt from the property of the estate of an individual debtor only that property and income which is exempt under the laws of the state of Louisiana and under federal laws other than Subsection (d) of Section 522 of said Title 11 of the United States Code.

102. *See infra* note 112 and cases cited therein.

103. 463 U.S. 85, 103 S. Ct. 2890 (1983).

and came to fruition as a result of the Supreme Court case *Mackey v. Lanier Collection Agency Service, Inc.*[104]

In *Mackey*, the Court was faced with the question of whether a Georgia statute was unconstitutional because it was preempted by ERISA.[105] The statute excluded funds and payments from employee welfare plans subject to the provisions of ERISA from garnishment process, except to collect child support or alimony.

ERISA contains a preemption section, which states:

> *(a) Supersedure; effective date*
>
> Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.[106]

Interpreting section 1144(a) and citing *Shaw v. Delta Airlines, Inc.*,[107] the court reiterated that "a law 'relates to' an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such plan,"[108] and that "we have virtually taken it for granted that state laws which are 'specifically designed to effect employee benefit plans' are preempted under § 541(a) [29 USC § 1144(a)]."[109] It is of no moment, says the Court, that the state law "was enacted by the Georgia legislature to help effectuate ERISA's underlying purposes" for ERISA "'displaces all state laws that fall within its sphere, even including state laws that are consistent with ERISA's substantive requirements.'"[110]

Because the Georgia statute "singles out ERISA employee welfare benefit plans for different treatment under state garnishment procedures," and because the "statute's express reference to ERISA plans suffices to bring it within the federal law's preemptive reach," the Court struck down the statute as preempted by ERISA and of no force and effect.[111]

After *Goff*, an immense body of case law developed that followed the holding that ERISA-qualified plans became property of the bankruptcy estate and were not

---

104. 486 U.S. 825, 108 S. Ct. 2182 (1988).

105. *Id.* at 827, 108 S. Ct. at 2185.

106. 29 U.S.C. § 1144(a) (1988).

107. *Shaw*, 463 U.S. at 96-97, 103 S. Ct. at 2900.

108. *Mackey*, 486 U.S. at 829, 108 S. Ct. at 2185 (emphasis in original).

109. *Id.* (citation omitted).

110. *Id.* (citation omitted).

111. *Id.* at 830, 108 S. Ct. at 2185. The Court went on to uphold the general garnishment statute which, by general effect, would allow garnishment of welfare benefit plans as not being sufficiently related to ERISA and not contravening the anti-alienation provisions of § 1056(d). *Id.* at 841, 108 S. Ct. at 2191. (Recall that welfare benefit plans are not subject to the anti-alienation provision of § 1056(d). *See supra* note 90).

exempt under federal law exemptions under section 522(b)(2)(A). In addition, these cases went even further. Using *Shaw* and *Mackey* as authority, this body of jurisprudence held (in cases where debtors were required by state law to claim state law exemptions or choose state law exemptions instead of those afforded under section 522(d)) that state laws that purported to exempt plans subject to the provisions of ERISA were preempted by ERISA.[112]

The effect of these case holdings was that debtors in such situations found that their retirement plans were property of their bankruptcy estates, but because of the combination of the *Goff* holding (no exemption under "other federal laws") and preemption of the state law exemption statutes, they were entitled to no exemption covering ERISA-qualified plans. Therefore, though the retirement plans (as long as subject to 29 U.S.C. § 1056(d)) could not be seized *outside* of bankruptcy, once inside the "protection" of the Bankruptcy Code, these same plans were defenseless against bankruptcy trustees seeking to liquidate the plans for the benefit of creditors.[113]

---

112. *See, e.g.*, Pitrat v. Garlikov, 947 F.2d 419, 429 (9th Cir. 1991) (finding the Arizona exemption statute preempted by ERISA); Gaines v. Nelson (*In re* Gaines), 121 B.R. 1015, 1022-23 (W.D. Mo. 1990) (holding that ERISA preempts state-created exemptions established pursuant to § 522(b)(2)(A)); *In re* Vanmeter, 137 B.R. 908, 916 (Bankr. N.D. Ind. 1992) (same); *In re* Hennessey, 135 B.R. 711, 714 (Bankr. D. Mass. 1992); *In re* McIntosh, 116 B.R. 277, 280 (Bankr. N.D. Okl. 1990); *In re* Starkey, 116 B.R. 259, 263 (Bankr. D. Colo. 1990); *In re* Martin, 115 B.R. 311, 322-23 (Bankr. D. Utah 1990), *aff'd sub nom. In re* Fullmer, 127 B.R. 55, 59 (D. Utah 1991) *rev'd on other grounds*; *sub nom.* Fullmer v. Rupp (*In re* Fullmer), 977 F.2d 595 (10th Cir. 1992); *In re* Messing, 114 B.R. 541, 544-45 (Bankr. E.D. Tenn. 1990), *rev'd on other grounds*, No. 90-00601 (E.D. Tenn. Dec. 13, 1990), *rev'd on other grounds, sub. nom.* Mostoller v. Messing (*In re* Messing), 944 F.2d 905 (6th Cir. 1991) *cert denied*, 112 S. Ct. 1585 (1992) and 112 S. Ct. 2991 (1992); *In re* Conroy, 110 B.R. 492, 496-97 (Bankr. D. Mont. 1990); *In re* Alagna, 107 B.R. 301 (Bankr. D. Colo. 1989); *In re* Sellers, 107 B.R. 152 (Bankr. E.D. Tenn. 1989); *In re* Sheppard, 106 B.R. 724 (Bankr. M.D. Fla. 1989); *In re* Weeks, 106 B.R. 257 (Bankr. E.D. Okla.. 1989); Fogler v. Flindall (*In re* Flindall), 105 B.R. 32, 37-40 (Bankr. D. Ariz. 1989); *In re* Komet, 104 B.R. 799, 801-04 (Bankr. W.D. Tex. 1989); *In re* Brown, 95 B.R. 216 (Bankr. N.D. Okl. 1989); Penick v. Hirsch (*In re* Hirsch), 98 B.R. 1 (Bankr. D. Ariz. 1988), *aff'd sub nom. In re* Siegel, 105 B.R. 556 (D. Ariz. 1989).

But see In re Vickers, 954 F.2d 1426, 1428 (8th Cir. 1992) (finding that ERISA does not preempt state exemptions statute because the statute was consistent with ERISA's substantive provisions and preemption would impermissibly modify or impair exemption scheme contemplated by § 522(b)(2)(A) of the Bankruptcy Code); *In re* Volpe, 943 F.2d 1451, 1452-53 (5th Cir. 1991) (same); Heitkamp v. Dyke (*In re* Dyke), 943 F.2d 1435, 1450 (5th Cir. 1991); *In re* Shaker, 137 B.R. 930, 942 (Bankr. W.D. Wisc. 1992); *In re* Suarez, 127 B.R. 73 (Bankr. S.D. Fla. 1991); *In re* Hentzen, 126 B.R. 600 (Bankr. D. Kan. 1991); *In re* James, 126 B.R. 360 (Bankr. D. Kan. 1991); *In re* Williams, 118 B.R. 812 (Bankr. N.D. Fla. 1990); *In re* Nuttleman, 117 B.R. 975, 982 (Bankr. D. Neb. 1990), *aff'd in part, rev'd in part sub nom.* Nuttleman v. Myers, 128 B.R. 254 (D. Neb. 1991); *In re* Seilkop, 107 B.R. 776 (Bankr. S.D. Fla. 1989); *In re* Martinez, 107 B.R. 378 (Bankr. S.D. Fla. 1989); *In re* Bryan, 106 B.R. 749 (Bankr. S.D. Fla. 1989); *see also* Pitrat v. Garlikov, 947 F.2d 419, 432 (9th Cir. 1991) (Sneed, J., dissenting).

113. To many, it must be supposed, this result seemed quite a perverse consequence of "protective" state legislation. Those persons rendered ,anxious by such cases were not limited to debtors. Bankruptcy trustees who had administered hundreds or even thousands of cases without attempting to liquidate retirement plans, because of state law exemption statutes, were (or should have

For debtors in the Fifth Circuit, help was on the way. The court, in *In re Dyke*,[114] faced and reaffirmed its holding in *Goff*, but went on to explore the preemption issue in connection with the Texas exemption statute.[115] Focusing upon the savings clause found in 29 U.S.C. § 1144(d),[116] the court concluded that because ERISA cannot be construed "to modify or impair the policies of other federal laws," and that because the Bankruptcy Code has vested in these states the authority to promulgate "a state exemption scheme that would advance the principal goal of the Bankruptcy Code. . ., ERISA section 514(d) [29 USC § 1144(d)] saves the Texas state exemption scheme from preemption."[117] In other words, by providing that states can fashion exemption statutes applicable to citizens in bankruptcy cases within the states, the Bankruptcy Code federalizes such state exemption schemes.

Finding that the Texas exemption statute, which provided as a limitation only that the contributions and the plan be qualified for favorable treatment under the Internal Revenue Code,[118] did not conflict with the objectives of the Bankruptcy Code, the court held that the statute was therefore enforceable against a bankruptcy trustee.[119]

What of Louisiana debtors? This writer has located no decisions on the preemption question prior to *Dyke*.[120]

Even after *Dyke*, however, a question remained for Louisiana debtors. Unlike the Texas exemption statute, the Louisiana exemption statutes purport to allow seizure of a portion of a debtor's interest in an ERISA plan. Generally, this portion consists of all contributions not exempt from federal income taxation and *all* contributions made within one year before bankruptcy or nonbankruptcy seizure.[121] Conceivably, under the authority of *Dyke*, this limitation could have been enforced. The trustee's argument would focus on the thrust of *Dyke*, that the state exemption statute not be inconsistent with the objectives of the Bankruptcy Code.[122] Because section 522(d)(10)(E) provides an exemption of retirement plans "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor," unless the plan was established by an insider of the debtor, is based upon length of service, or is not qualified for favorable tax

---

been) quite anxious themselves.

114. 943 F.2d 1435 (5th Cir. 1991).

115. *Id.* at 1447-50.

116. For text of 29 U.S.C. § 1444(d) (1988), *see supra* note 37.

117. *In re Dyke*, 943 F.2d at 1450.

118. *Id.* at 1439-40.

119. *Id.* at 1450.

120. Beginning in about 1990, trustees in the Middle District of Louisiana filed a blanket of objections to claims of exemptions which covered the entire range of cases involving retirement plans. Many objections were settled before hearing. By the time a matter worth fighting over came up for hearing, *In re Dyke* was on appeal. This writer, risking the perception of cowardice, waited it out.

121. *See supra* note 99 and accompanying text.

122. *In re* Dyke, 943 F.2d 1435, 1450 (5th Cir. 1991).

treatment under sections of the Internal Revenue Code,[123] the trustee would attempt to convince the court that deducting only one year's worth of contributions and those not qualified for favorable tax treatment would not conflict with the "reasonably necessary" limitation imposed by the Bankruptcy Code itself. Also, the limitation of the exemption "to the extent that contributions thereto were exempt from federal income taxation at the time of contribution" found in both applicable Louisiana exemption statutes would appear consistent with the limitation contained within section 522(d)(10)(E) and, therefore, enforceable under *Dyke*.[124]

What about these statutory limitations after *Patterson*? If a debtor's retirement plan is subject to the anti-alienation provisions of 29 U.S.C. § 1056(d), *Patterson* teaches that the plan is not property of the bankruptcy estate. Therefore, the issue of exempt status is moot. If the plan is not property of the estate and, therefore, not subject to the exemption provisions of section 522(b)(2)(A), can it be said that the exemption statute, as it relates to ERISA qualified plans, is promulgated by authority vested by the Bankruptcy Code? It is doubtful that any Bankruptcy Code objective can be articulated to support the notion that the exemption provisions of the Bankruptcy Code apply to federalize state law exemption statutes covering property that is not property of the bankruptcy estate. (In fact, as shown throughout this article, property that is not property of the bankruptcy estate is not subject to a claim of exemption within the bankruptcy case.)

If the state law exemption statutes covering ERISA-qualified plans cannot be seen to have a federal genesis, then it seems to follow that 29 U.S.C. § 1144(d)[125] is not applicable, and the exemption statute is to be scrutinized from the perspective of the preemption provision of ERISA, 29 U.S.C. § 1144(a).[126]

Analysis of the Louisiana legislation under the guidance of *Mackey* generates the conclusion that at least a great portion of Louisiana Revised Statutes 13:3881(d) and 20:33(1) are preempted by ERISA. Both statutes specifically refer to retirement plans regulated by ERISA. Indeed, though it could be argued that a state statute granting an exemption fully corresponds with the substantive requirements of ERISA, particularly section 1056(d), such coalescence of objectives does not spare a statute from preemption.[127] Further, the Louisiana statutes are not even consistent on all fours with the substantive provisions of ERISA. The anti-alienation section, 29 U.S.C. § 1056(d), has been conclusively determined to constitute an absolute bar to seizure.[128] Therefore, the Louisiana statutory limitation of the extent of the exemption, which specifically allows seizure (by a bankruptcy trustee or creditor outside of bankruptcy) of one year's worth of

123. 11 U.S.C. § 522(d)(10)(E) (1988).
124. *See* La. R.S. 20:33(1) (1983) and La. R.S. 13:3881(D) (1990).
125. *See supra* note 37 for full text.
126. *See supra* note 36 for full text.
127. Mackey v. Lanier Collection Agency Serv., Inc., 486 U.S. 825, 829, 108 S. Ct. 2182, 2185 (1988).
128. *See supra* note 90.

contributions and any contributions which are not exempt from taxation, clearly contravenes the ERISA bar against alienation of interests in qualified plans.[129]

It appears, therefore, that at least to the extent Louisiana Revised Statutes 13:3881(D) and 20:33(1) apply to a debtor's interest in an ERISA-qualified plan subject to the anti-alienation requirements imposed by 29 U.S.C. § 1056(d), the statutes are preempted by ERISA and, therefore, are unconstitutional. Thus, caution is warranted before relying upon the provisions of Louisiana Revised Statutes 20:33(1) and 13:3881(D) as authority for the proposition that a portion of a judgment debtor's retirement plan is subject to seizure (for example, by writ of *fieri facias*).[130]

II. AVOIDING POWERS: EXPANDED PREFERENCE PERIOD AGAINST NON-INSIDERS

Generally, the bankruptcy trustee (or debtor-in-possession)[131] has the power to avoid pre-petition preferential transfers.[132] The trustee's avoiding power is designed to accomplish an equitable distribution of estate property to creditors and to prevent the debtor from choosing which creditors to repay.[133]

Section 547(b) of the Bankruptcy Code sets forth the elements of an avoidable preference:[134]

---

129. There is no requirement within ERISA that contributions to a plan be exempt from federal taxation to be subject to the prohibition on alienation under § 1056(d).

130. *See* La. Code Civ. P. arts. 2291-2299. See particularly Article 2298, which provides injunctive relief and a claim for damages, if "(1) . . . the sheriff is proceeding with the execution contrary to law."

131. Section 1107(a) of the Bankruptcy Code places a debtor-in-possession in the shoes of a trustee. The debtor-in-possession has all of the rights, powers, and duties of a trustee, except the right to compensation and the duty to investigate the debtor. 11 U.S.C. § 1107 (1988).

132. 11 U.S.C. § 547 (1988).

133. H.R. Rep. No. 595, 95th Cong., 1st Sess. 177-78 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6138. *See* Danning v. Bozek (*In re* Bullion Reserve of N. Am.), 836 F.2d 1214, 1217 (9th Cir. 1988) ("The dual purpose of § 547 . . . is to discourage creditors from racing to the courthouse to dismember the debtor during its slide into bankruptcy and to further the prime bankruptcy policy of equal distribution among similarly situated creditors."), *cert. denied*, 486 U.S. 1056, 108 S. Ct. 2824 (1988); Coral Petroleum, Inc. v. Banque Paribas-London, 797 F.2d 1351, 1355 (5th Cir. 1986); Grover v. Gulino (*In re* Gulino), 779 F.2d 546, 548-49 (9th Cir. 1985); Ray v. Security Mut. Fin. Corp. (*In re* Arnett), 731 F.2d 358, 363 (6th Cir. 1984); Valley Bank v. Vance (*In re* Vance), 721 F.2d 259, 260 (9th Cir. 1983); Yellowhouse Mach. Co. v. Mack (*In re* Hughes), 704 F.2d 820, 822 (5th Cir. 1983); Barash v. Public Fin. Corp., 658 F.2d 504, 508 (7th Cir. 1981). *See also* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 748 (1985) ("Statements in the legislative history also mention preserving the bankruptcy policy of 'equality' of distribution. But, with creditors classified for distribution purposes on the basis of liens and priorities, no bankruptcy policy of 'equality' exists. A policy of preserving classes and of preserving equality within classes does exist, however, and the preference concept is designed to preserve this policy.") (footnotes omitted).

134. Each of the elements listed in § 547(b) must exist before the trustee can avoid a transfer as preferential. *In re* Bullion Reserve of N. Am., 836 F.2d at 1217 ("The burden of proving the

(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;

(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;

(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.[135]

Therefore, the preference (or reachback) period applicable to transfers to or for the benefit of non-insider creditors is ninety days, while the period extends to a year before bankruptcy for insiders.[136] Though the Code as originally enacted

---

existence of these elements is on the bankruptcy trustee.") (citing *In re* Gulino, 779 F.2d at 549, *cert. denied*, 486 U.S. 1056, 108 S. Ct. 2824 (1988)); Waldschmidt v. Ranier (*In re* Fulghum Constr. Corp.), 706 F.2d 171, 172 (6th Cir.), *cert. denied sub nom.* Ranier & Assocs. v. Waldschmidt, 464 U.S. 935, 104 S. Ct. 342 (1983); *Barash*, 658 F.2d at 507. *See* 11 U.S.C. § 547(g) (1988) ("For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section . . . .").

135. 11 U.S.C. § 547(b) (1988).

136. Section 101(31) defines an insider as:

(A) if the debtor is an individual—

(i) relative of the debtor or of a general partner of the debtor;

(ii) partnership in which the debtor is a general partner;

(iii) general partner of the debtor; or

(iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation—

(i) director of the debtor;

(ii) officer of the debtor;

(iii) person in control of the debtor;

(iv) partnership in which the debtor is a general partner;

(v) general partner of the debtor; or

(vi) relative of a general partner, director, officer, or person in control of the debtor;

(C) if the debtor is a partnership—

(i) general partner in the debtor;

(ii) relative of a general partner in, general partner of, or person in control of the debtor;

required, in connection with avoidance actions against insiders concerning transfers made outside the ninety-day period, that the trustee prove that the debtor was insolvent *and* that the insider knew or should have known of the debtor's insolvency,[137] the statute now requires only that insolvency be established at the time of the transfer (regardless of the applicable reachback period).[138]

Such neat encapsulization, however, does not comport with the realities of the financial marketplace. Typically, loan transactions are structured so that the creditor-debtor financial arrangement involves both a principal obligation (and obligor) and an obligation to guarantee performance (payment) of the principal obligation that runs from a third party (or parties) to the creditor. The guarantor is commonly a person or entity who fits the definition of "insider."[139] Under general principles of subrogation, the guarantor who is called upon to pay the principal obligation acquires the right to pursue the principal obligor to the extent payment is made on account of the guaranty agreement.[140] It is also easy to see (if it is assumed that the guaranty is of the entirety of the principal obligation) that

---

(iii) partnership in which the debtor is a general partner;
(iv) general partner of the debtor; or
(v) person in control of the debtor;

(D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;
(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and
(F) managing agent of the debtor;

11 U.S.C. § 101(31) (Supp. IV 1992).

137. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as 11 U.S.C.).

138. Section 547, as enacted by the Bankruptcy Reform Act of 1978, superseded § 60a and b of the former Bankruptcy Act of 1898, 11 U.S.C. § 96. For a transfer to be avoidable under § 547, it must have been made while the debtor was insolvent. 11 U.S.C. § 547(b)(3) (1988). Section 547(f) specifically provides that for purposes of § 547, "the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition." 11 U.S.C. § 547(f) (1988); *see* Sandoz v. Fred Wilson Drilling Co. (*In re* Emerald Oil Co.), 695 F.2d 833, 838 n.5 (5th Cir. 1983) ("The 1978 creation of the presumption of insolvency was a change in the prior law designed to simplify the trustee's former burden of reconstructing the debtor's books and records, even though it was unusual that a debtor was not insolvent for the 90 days before the bankruptcy petition was filed.").

For a discussion of the provisions of former § 60a and the changes made under § 547, see Barkley Clark, *Preferences Under the Old and New Bankruptcy Acts*, 12 UCC L.J. 154 (1979-80); Michael Kaye, *Preferences Under the New Bankruptcy Code*, 54 Am. Bankr. L.J. 197 (1980); Charles J. Young, *Preferences Under the Bankruptcy Reform Act of 1978*, 54 Am. Bankr. L.J. 221 (1980); Vernon O. Teofan & L.E. Creel, III, *The Trustee's Avoiding Powers Under the Bankruptcy Act and the New Code: A Comparative Analysis*, 85 Com. L.J. 542 (1980); Elizabeth A. Orelup, Note, *Avoidance of Preferential Transfers Under the Bankruptcy Reform Act of 1978*, 65 Iowa L. Rev. 209 (1979).

139. Though perhaps there exists specific authority for these propositions, the primary source utilized here is the author's personal experience as both lawyer and judge. Attempting to ground these observations in concrete source authority would seemingly differ little from dredging up authority for the law of gravity (objects that are dropped, fall to the earth).

140. *See generally* La. Civ. Code arts. 1825-1830.

each payment by the principal obligor reduces the exposure of the guarantor under the guaranty agreement.

Under the Bankruptcy Code, the guarantor, who holds at least a contingent claim against the principal obligor (even without having made payments), is a "creditor" or a holder of a "claim" against the principal obligor.[141] Therefore, payment by the principal obligor to the creditor is to be seen as payment (of an antecedent debt) to or for the benefit of the guarantor "creditor," to the extent the payment reduces the guarantor's exposure to the non-insider creditor who received the payment.

Another section of the Bankruptcy Code must be folded in. Section 550 establishes the trustee's rights and parties' liability in connection with avoidable transfers and provides, with section 550(a)(1), that if a transfer is avoidable under section 547, the trustee may recover (either the property transferred or its value) from "the initial transferee of such transfer or the entity for whose benefit such transfer was made."[142]

---

141. Section 101(10) defines "creditor" as:

> (A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;
>
> (B) entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(g), 502(h) or 502(i) of this title; or
>
> (C) entity that has a community claim;

11 U.S.C. § 101(10) (Supp. IV 1992).

The legislative history of § 101(10) also supports the proposition that a guarantor is a "creditor":

> A guarantor of or surety for a claim against the debtor will also be a creditor, because he will hold a contingent claim against the debtor that will become fixed when he pays the creditor whose claim he has guaranteed or insured.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 309-10 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6266-67; *see also* S. Rep. No. 989, 95th Cong., 2d Sess. 22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5808.

Section 101(5) defines "claim" as:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured;

11 U.S.C. § 101(5) (Supp. IV 1992).

142. 11 U.S.C. § 550(a)(1) (1988). Section 550 reads, in pertinent part:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.
>
> (b) The trustee may not recover under section (a)(2) of this section from—

Therefore, notwithstanding the nifty truism that a ninety-day reachback period applies to non-insiders, but a one-year period applies to insiders, the question arises: If a transfer is avoidable as a preference because of the benefit in favor of the insider guarantor, might not the non-insider who actually received the payment be subject to a one-year reachback period under section 550(a)(1)?

What follows is a discussion of the jurisprudence which has developed in response to this question, lawyers' responses to the problem, a pending legislative response to the courts' emergent interpretation, and finally a projection of the consequences facing lawyers (and clients) in the event of passage of legislation designed to overrule what has become, in the last three to five years, the majority view among the courts.

A. *Expanding Preference Period Against Non-insider Creditors*

The early jurisprudence analyzing the question of whether the non-insider transferee is subject to the one-year reachback period constructed an analysis which insulated the non-insider transferee from exposure. This analysis was grounded in principles of equity and has come to be known as the "two-transfer theory." Under this theory, the first transfer is represented by the direct payment from the debtor to the non-insider creditor. The second transfer (a theoretical transfer), from the debtor to the guarantor, is comprised of the benefit received by the insider/guarantor by virtue of the satisfaction or reduction of the guarantor's contingent liability. Use of this second transfer isolates the *second* transfer as providing the benefit to the insider, thereby limiting the scope of the benefit conveyed by the payment to the non-insider; only the non-insider benefits from the first transfer. Accordingly, under section 547(b)(4)(B), only the second transfer to the insider/guarantor falls within the extended preference period and therefore is avoidable because only the second transfer was to or for the benefit of the insider creditor. The first transfer, to and for the benefit of the non-insider creditor only, is not avoidable, however, because the ninety-day preference period applies.[143]

> (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
>
> (2) any immediate or mediate good faith transferee of such transferee.

11 U.S.C. § 550(a)-(b) (1988).

143. *See* Block v. Texas Commerce Bank Nat'l Ass'n (*In re* Midwestern Cos.) 102 B.R. 169 (W.D. Mo. 1989) (distinguishing between insiders and non-insiders by specifying different preference periods); Official Creditors' Comm. of Arundel Hous. Components, Inc. v. Georgia-Pacific Corp. (*In re* Arundel Hous. Components, Inc.), 126 B.R. 216 (Bankr. D. Md. 1991) (same); Ray v. City Bank & Trust Co. (*In re* C-L Cartage Co.), 70 B.R. 928 (Bankr. E.D. Tenn. 1987), *aff'd*, 113 B.R. 416 (E.D. Tenn. 1988), *aff'd in part, rev'd in part*, 899 F.2d 1490 (6th Cir. 1990); *In re* Aerco Metals, Inc., 60 B.R. 77 (Bankr. N.D. Tex. 1985); Goldberger v. Davis Jay Corregated Box Corp. (*In re* Mercon Indus., Inc.), 37 B.R. 549 (Bankr. E.D. Pa. 1984); Schmitt v. Equibank (*In re* R.A. Beck Builder, Inc.), 34 B.R. 888 (Bankr. W.D. Pa. 1983); Bakst v. Schilling (*In re* Cove Patio Corp.), 19 B.R. 843 (Bankr. S.D. Fla. 1982); Backhus v. Central Trust Co., N.A. (*In re* Duccilli Formal Wear,

During the "old days" one bankruptcy court opinion, *Mixon v. Mid-Continent Systems, Inc. (In re Big Three Transportation, Inc.)*,[144] however, stood against the majority view by imposing the one-year period against a non-insider creditor.[145] The opinion does not delve into the dual-transfer analysis, but assumes there is only one transfer (by means of one payment). The transfer is made to the bank and for the benefit of the insider, as a result of reduction in insider exposure to the bank.[146] The court then looked to section 550, which states in part that recovery can be had against the initial transferee of such transfer *or* the entity for whose benefit such transfer was made (*i.e.*, the bank or the insider), and concluded that the statute gives the trustee an alternative source of recovery, whether or not the transfer to the non-insider, if looked at alone, is preferential.[147]

Subsequently, there were several reported decisions aligning with *In re Big Three*, including the district court opinion in *Levit v. Ingersoll Rand Financial Corp. (In re V.N. Deprizio Construction Co.)*.[148] Appeal to the Seventh Circuit yielded the first circuit court opinion to embrace the *In re Big Three* holding.[149]

Although the Seventh Circuit Court of Appeals in *Deprizio* expanded upon the rationale in *In re Big Three*, the court essentially relied on what it considered the clear language of the Code.[150] The analysis of the court is as follows:

> (1) Section 547 allows the recovery of avoidable transfers made to *or* for the benefit of a creditor;[151]
> (2) A payment effects a single transfer, though the single transfer can have more than one beneficiary;[152]
> (3) If the transfer is avoidable under section 547, the trustee looks to section 550 of the Code to determine from whom the transfer can be recovered;[153]

Inc.), 8 B.C.D. 1180 (Bankr. S.D. Ohio 1982); Seeley v. Church Bldgs. and Interiors, Inc. (*In re* Church Bldgs. and Interiors, Inc.), 14 B.R. 128 (Bankr. W.D. Okla. 1981); 4 Collier on Bankruptcy, *supra* note 20, ¶ 550.02, at 550-12 to 14. *See also* T.B. Westex Foods, Inc. v. Alaska Continental Bank (*In re* T.B. Westex Foods, Inc.), 96 B.R. 77 (Bankr. W.D. Tex. 1989) (denying expanded preference period to allow trustee's recovery from non-insider creditor), *aff'd*, Bankr. No. 88-70059, Adv. No. 88-7023, 1990 WL 359063 (W.D. Tex. May 22, 1990), *rev'd*, 950 F.2d 1187 (5th Cir. 1992); Levit v. Melrose Park Nat'l Bank (*In re* V.N. Deprizio Constr. Co.), 58 B.R. 478 (Bankr. N.D. Ill. 1986) (same), *rev'd sub nom.* Levit v. Ingersoll Rand Fin. Corp. (*In re* V.N. Deprizio Constr. Co.), 86 B.R. 545 (N.D. Ill. 1988), *aff'd in part, rev'd in part*, 874 F.2d 1186 (7th Cir. 1989).

144. 41 B.R. 16 (Bankr. W.D. Ark. 1983).
145. *Id.* at 19-20.
146. *Id.* at 19.
147. *Id.* at 20-21.
148. 86 B.R. 545 (N.D. Ill. 1988), *rev'g* 58 B.R. 478 (Bankr. N.D. Ill. 1986).
149. Levit v. Ingersoll Rand Fin. Corp. (*In re* V.N. Deprizio Constr. Co.), 874 F.2d 1186 (7th Cir. 1989).
150. *Id.* at 1196-97.
151. *Id.* at 1189.
152. *Id.* at 1195-96.
153. *Id.* at 1190, 1194.

(4) While section 547 distinguishes insiders from non-insiders (providing one-year and 90-day preference periods, respectively), section 550 does not;[154]
(5) Because section 550 says that an avoidable transfer can be recovered from either the initial transferee (in this case, the bank) or an entity other than the initial transferee, if that entity derived a benefit, and is a creditor, the trustee can recover from the bank;[155]
(6) The one-year preference period is applicable to the bank because section 550 does not require that the preference actually be avoidable as against the initial transferee, but only that it be avoidable as to one of the entities from whom recovery is possible. Since the one-year preference period applies to transfers that benefit the insider creditor, the bank, as initial transferee (the one which received the money) is exposed to any preference action that could have been brought against the insider creditor.[156]

As noted in *Deprizio*, the bankruptcy court (which had followed the two-transfer theory in denying recovery against the bank) relied a good deal on "equity" in finding that the non-insider creditor was not subject to the one-year period.[157] In response, the Seventh Circuit stated:

> [I]n what sense is it "inequitable" to recapture payments to creditors that may have been favored only because payment reduced insiders' exposure (recall that the insiders select which debts to pay first), then distribute these monies according to statutory priorities and contractual entitlements? In what sense is it "inequitable" to require outside lenders to pursue the insider-guarantors for any shortfall, when they bargained for exactly that recourse?[158]

Deprizio has been embraced by the majority of courts opining subsequently.[159] Because of its pervasive effect, and because of the consequences of the

154. *Id.* at 1194.

155. *Id.*

156. *Id.*

157. *Id.* at 1198 (citing Levit v. Ingersoll Rand Fin. Corp. (*In re* V.N. Deprizio Constr. Co.), 86 B.R. 545, 552-53 (N.D. Ill. 1988)).

158. *Id.*

159. *See, e.g.*, Manufacturers Hanover Leasing Corp. v. Lowrey (*In re* Robinson Bros. Drilling, Inc.), 892 F.2d 850 (10th Cir. 1989) (adopting the district court opinion at 97 B.R. 77 (W.D. Okl. 1988), which followed the reasoning of *Deprizio*, 86 B.R. 545 (N.D. Ill. 1988), *aff'd in part, rev'd in part*, 874 F.2d 1186 (7th Cir. 1989), and *In re* Big Three Transp., Inc., 41 B.R. 16 (Bankr. N.D. Ill. 1986)); Harrison v. Brent Towing Co. (*In re* H & S Transp. Co.), 110 B.R. 827 (M.D. Tenn. 1990) (following the reasoning of *Deprizio* in rejecting the "two transfer" theory), *aff'd*, 939 F.2d 355 (6th Cir. 1991); Cambridge Meridian Group, Inc. v. Conn. Nat'l Bank (*In re* Erin Food Servs., Inc.), 117 B.R. 21, 29 (Bankr. D. Mass. 1990) (adopting the *Deprizio* opinion in holding that the one-year insider preference period applies to payments made to a creditor which benefit the inside guarantor);

court's analysis (some that the court itself refused to anticipate), a bit more reflection on the opinion is warranted.

Remember that section 547 requires that the transfer be to or for the benefit of *a creditor*. *Deprizio* also involved a preference action against the IRS seeking to recover payments made during the year before bankruptcy on account of withholding tax liability.[160] The officers of the debtor corporation were potentially liable for an assessment of the tax liability (the dreaded 100% penalty) as responsible parties.[161] Therefore, the trustee argued that payments to the IRS reduced the insiders' exposure and thus these payments were recoverable from the IRS under the theory asserted against the bank.[162] The court found that the requirement of section 547(b)(1), that the transfers be "to or for the benefit of a creditor," was not met in connection with the officers since there was no right of subrogation or contribution over and against the corporation if the individuals had to pay the tax penalty.[163] The court held, therefore, that there was no preference.[164]

In arguing their positions, the secured creditors in *Deprizio* created numerous hypothetical nightmares, hoping to sway the court with "policy." The court's treatment of one of these hypothetical situations in dicta may very well not hold the water that the court believed it carried and may reveal that the court failed to comprehend the logical extension of its holding. One of the hypothetical horrors urged upon the court by the creditor defendants was:

> Lender #1 extends credit and takes security. It is so oversecured that Lender #2 is willing to make a second loan and take a junior security interest. This second loan (but not the first) is backed up by an insider's guarantee. Every payment to Lender #1 increases the amount of security

---

Billings v. Zions First Nat'l Bank, N.A. (*In re* Granada, Inc.), 110 B.R. 548, 549-52 (Bankr. D. Utah 1990) (following the holdings of *Deprizio* and *Robinson Bros.*); *In re* Installation Servs., Inc., 101 B.R. 282, 284 (Bankr. N.D. Ala. 1989) (adopting the rational of *Deprizio*); Coastal Petroleum Corp. v. Union Bank & Trust Co. (*In re* Coastal Petroleum Corp.), 91 B.R. 35, 37-38 (Bankr. N.D. Ohio 1988) (same). *But see* Rubin Bros. Footwear, Inc. v. Chemical Bank (*In re* Rubin Bros. Footwear, Inc.), 119 B.R. 416 (S.D.N.Y. 1990) (declining to apply the *Deprizio* ruling); Block v. Texas Commerce Bank Nat'l Ass'n (*In re* Midwestern Cos.), 102 B.R. 169 (W.D. Mo. 1989) (rejecting the expanded preference period theory adopted by the court in *Deprizio* and requiring that the transfer be preferential with respect to the initial transferee before § 550 allows recovery therefrom).

160. *Deprizio*, 874 F.2d at 1191-92.

161. *Id. See* Emshwiller v. United States, 565 F.2d 1042, 1047 (8th Cir. 1977); Monday v. United States, 421 F.2d 1210, 1218 (7th Cir.), *cert. denied*, 400 U.S. 821, 91 S. Ct. 38 (1970), *remand*, 342 F. Supp. 1271 (E.D. Wis. 1972), *aff'd*, 478 F.2d 1404 (7th Cir.), *cert. denied*, 414 U.S. 910, 94 S. Ct. 233 (1973); *In re* FJS Tools & Mfg. Co., 88 B.R. 866, 870 (Bankr. N.D. Ill. 1988); Arrigoni v. Commissioner, 73 T.C. 792, 800-801 (1980); Policy Statement P-5-60, 1 Internal Revenue Manual (CCH) 1305-14.

162. *Deprizio*, 874 F.2d at 1191.

163. *Id.* at 1191-92.

164. *Id.* at 1192.

available for Lender #2, which produces a benefit to Guarantor by reducing his exposure.[165]

The court opined that the transfers to Lender #1, though bestowing a benefit upon the guarantor, are not preferential on two grounds. First, the court stated that if payments were made according to the debt instruments, the defense assertable under section 547(c)(2), that the payments were made in the ordinary course of business, etc., would preclude recovery.[166]

The court went on to say that even if the ordinary course of business defense is not assumable:

> By assumption Lender #1 is over-secured, *so its position has not been improved relative to a Chapter 7 liquidation*, § 547(b)(5). The benefit in

---

165. *Id.* at 1200.

166. *Id.* Section 547(c)(2) reads as follows:

> (c) The trustee may not avoid under this section a transfer—
>
> . . . .
>
> (2) to the extent that such transfer was—
>
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms; . . . .

11 U.S.C. § 547(c)(2) (1988). As of the issuance of the court's decision in *Deprizio*, this assertion was problematic given a number of decisions which excluded payments on account of long term debt from the § 547(c)(2) defense. *See* CHG Int'l, Inc. v. Barclays Bank (*In re* CHG Int'l, Inc.), 897 F.2d 1479, 1485-86 (9th Cir. 1990) (concluding that the "ordinary course of business" exception in § 547(c)(2) does not include payments on long-term loans); WJM, Inc. v. Mass. Dep't of Public Welfare, 840 F.2d 996, 1011 (1st Cir. 1988) (same); Marathon Oil Co. v. Flatau (*In re* Craig Oil Co.), 785 F.2d 1563, 1567 (11th Cir. 1986) (stating that "the scope of [§ 547(c)(2)'s] protection is necessarily limited to trade credit which is 'kept current' or other transactions which are paid in full within the initial billing cycle"); Covey v. Pottery Workers Credit Union (*In re* Rogers), 127 B.R. 844, 846 (C.D. Ill. 1989); Lingley v. Stuart Shaines, Inc. (*In re* Acme-Dunham, Inc.), 50 B.R. 734, 741 (D. Me. 1985); Gray v. A.I. Credit Corp. (*In re* Paris Indus., Corp.), 130 B.R. 1, 5 (Bankr. D. Maine 1991); Ragsdale v. Citizens and S. Nat'l Bank (*In re* Control Elec., Inc.), 91 B.R. 1010, 1017 (Bankr. N.D. Ga. 1988); McCullough v. Garland (*In re* Jackson), 90 B.R. 793, 796-97 (Bankr. D.S.C. 1988); McClanahan v. Lakeside Nat'l Bank (*In re* RDC Corp.), 88 B.R. 97, 100 (Bankr. W.D. La. 1988) (holding that payments on 90-day working capital loans, whose maturity had been extended several months, were not transactions within the ordinary course of business exception); Aguillard v. Bank of Lafayette (*In re* Bourgeois), 58 B.R. 657, 660 (Bankr. W.D. La. 1986) (opining that "[t]o hold such payments on long term loans to be in the ordinary course of business within the meaning of section 547(c)(2) would be to flout the clear intent of that subsection, and the entire policy of the preference section as a whole.").

Reversing the Ninth Circuit court's decision in *In re* CHG Int'l, Inc., 897 F.2d 1479 (9th Cir. 1990), which followed *Bourgeois, et al.*, the Supreme Court, in Union Bank v. Wolas, 112 S. Ct. 527 (1991), held that because the plain meaning of § 547(c)(2) yields the conclusion that there is no limitation on the applicability of the ordinary course of business defense grounded in the nature of the indebtedness, the defense is clearly applicable to preferential transfer actions attacking payments on long-term debt. *Wolas*, 112 S. Ct. at 533.

> such a case is negligible at best, so the case for recapture is weak. Because neither the bankruptcy court nor the district court considered this question in detail, we do not resolve it, but the Trustee has an uphill battle.[167]

The court's espousal on this second score is at best problematic. The rationale underlying its decision to expand the preference period to allow recovery from non-insiders focuses on the benefit derived by the *guarantor/insider*, not the initial transferee.[168] Remember, the payments to the bank that were deemed recoverable were not preferences *vis-a-vis* the bank, but were recoverable from the bank, as the initial transferee, because they were preferences to the guarantor.[169] The question of whether the requirements of section 547(b)(5) have been met (that the transferee receive more than it would have if the transfer had not been made and the estate was liquidated under Chapter 7) is asked in connection with the benefit derived by the guarantor, *not* the payment to the bank.[170]

Analysis by mathematical example reveals the problem and, according to the actual analysis of *Deprizio*, shows that the court's holding clearly stands for the proposition that an oversecured lender *without* a guarantor can be liable for return of payments received (despite the court's protestation to the contrary):

Assume: Property worth $100,000 (non-income producing)
1st mortgage = $70,000 (no guarantor)
2nd mortgage = $50,000 ($50,000 guarantee by insider)
Other creditors = $50,000
Other assets = $30,000
Payment on 1st mortgage (from unencumbered assets) = $10,000
(reducing other assets to $20,000)

Before payment, guarantor exposure is $20,000 (the difference between the value of the collateral and the second mortgage claim amount).

Assume bankruptcy within one year after payment.

Liquidation result:
1st mortgage = $60,000—paid by property
2nd mortgage = $50,000—$40,000 paid by property
$10,000 paid by guarantor

167. *Deprizio*, 874 F.2d at 1200 (citing Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 895 (7th Cir. 1988)) (emphasis added).

168. *Id.* at 1200-01.

169. *Id.*

170. Recall that in order for a preference to be avoidable, all elements of § 547(b) must be met. 11 U.S.C. § 547(f) (1988). Therefore, if the payments to the bank are analyzed under § 547(b) separate from any benefit derived by the guarantor, the payments between 90 days and one year before bankruptcy are not preferential—the bank is not an insider. Clearly, then, the question is not whether the fully secured bank received a benefit greater than it would have received in Chapter 7, but whether the *guarantor* did.

Claims against estate = $60,000 ($50,000—other creditors + $10,000 guarantor claim)

Payment to creditors of bankruptcy estate = $\frac{\$20,000}{\$60,000}$ = 33.33%

Question: What did guarantor really get?
Answer: Guarantor received 66.66% of claim, $10,000 (or 50%) as a result of the payment to the first mortgage holder (through reduction of exposure) and $3,333 (or 16.66% of the original $20,000 exposure) as a result of liquidation of other assets.
Question: Did guarantor receive more than it would have if payment were not made and estate liquidated under Chapter 7?
Answer: Yes.

Analysis:
If payment is not made and estate is liquidated in Chapter 7:

Debt	*Property*
$70,000 mortgage	$100,000
$50,000 mortgage	$ 30,000 (other assets)
$50,000 other creditors	

After liquidation of the mortgaged property and payment of the $20,000 shortfall by guarantor, the liquidation is concluded:

Debt	*Property*
$50,000 other creditors	$30,000 (other assets, including the payment not made)
$20,000 guarantor claim	
$70,000 total	

Creditors, including guarantor, receive three-sevenths of the claims, or 42.857% of their claims. Guarantor is 23.8% of $20,000 (or $4,760) worse off than it was with payment. Therefore, because the payment resulted in $4,760 benefit to the guarantor, the benefit under the court's *actual analysis* is recoverable from the fully secured first mortgage holder who did *not* have a guarantor. The fully secured status of the first mortgage holder is irrelevant if the payment made was from a source other than the actual collateral for its mortgage claim. As the example above shows, it is the benefit conferred by the bootstrapping of the second mortgage holder into a more secure position (at the expense of the estate) that causes the problem for the first mortgage holder with no guarantor.

There is a difference, however, if the first mortgage creditor receives payment from actual collateral. If the first mortgage claim is reduced correspondingly with a reduction of collateral value, the second mortgage holder and its guarantor are either not benefitted or do not derive a benefit additional to that which *they* would receive in a Chapter 7 liquidation.[171]

B. Other Decisions of Note on the Issue

Shortly after the Seventh Circuit's decision in *Deprizio*, the Sixth Circuit reached a similar result. In *Ray v. City Bank & Trust Co. (In re C-L Cartage Co.)*,[172] the court held that recovery can be made from an outsider transferee for transfers made during the extended preference period when the beneficiary of the transfers is an insider creditor or insider guarantor.[173]

C-L Cartage involved a bank which loaned funds to insiders who subsequently loaned money to the debtor corporation. A third insider then guaranteed both loans. During the year preceding bankruptcy, several payments were made by the corporate obligor to the insiders, who then paid the bank. Several payments were made directly to the bank, thus reducing the insider's exposure.[174] In reaching its holding, the Sixth Circuit Court of Appeals concluded that insiders are "creditors" within the meaning of section 547(b)(1), as opposed to equity contributors, because they have a real or contingent claim against the debtor corporation.[175] Because the payments to the bank discharged the debtor's liability to the insider creditors, the payments to the bank were preferential and, under the court's analysis, recoverable from the bank.[176]

The *C-L Cartage* court reasoned that payments to creditors are preferential to insiders and the bank is the mediate transferee.[177] The payments, therefore, can be recovered. The bank argued that its loans to the company were fully secured and, therefore, it did not receive more than it would have in a liquidation as required under section 547(b)(5).[178] The court found that it is the *insider* who

171. *See In re* Prescott, 805 F.2d 719, 731 (7th Cir. 1986) (deciding that a second lienholder realized appreciation in the value of its inventory collateral when an undersecured first lienholder on the same inventory collateral offset the positive balance in debtors' bank account against the loan during the preference period, and, therefore, the second lienholder received an avoidable indirect preferential transfer to the extent of the appreciation in value of its collateral); Kapela v. Newman, 649 F.2d 887, 894 (1st Cir. 1981) (holding that "a guarantor does not receive a preference when a debtor uses a corporate asset to reduce the size of a creditor's loan provided the asset is one in which the creditor held a perfected security interest and is not available to general creditors."); Zimmerman v. Pennsylvania (*In re* Rimmer Corp.), 80 B.R. 337, 340 (Bankr. E.D. Pa. 1987) (concluding that "a payment made to a secured claimant, the priority of whose security extends to at least the amount of the payment made, is not preferential."); Mazer v. Aetna Fin. Co. (*In re* Zuni), 6 B.R. 449, 452 (Bankr. D.N.M. 1980) (finding that "payment of a secured claim is not a preference if such payment is accompanied by the release of an equivalent value to the estate.").

172. 899 F.2d 1490 (6th Cir. 1990).

173. *Id.* at 1494-95.

174. *Id.* at 1491-92.

175. *Id.* at 1493.

176. *Id.*

177. *Id.* at 1495.

178. *Id.* at 1493.

must have defenses, not the bank.[179] The court remanded, however, to see if the bank had defenses under section 550(b)(1).[180]

The Fifth Circuit has spoken directly (and, at the same time, indirectly) on the issue of extended preference periods in *T.B. Westex Foods, Inc. v. FDIC (In re T.B. Westex Foods, Inc.)*.[181] *Westex* involved a Chapter 11 debtor-in-possession ("Westex") which sought recovery of an allegedly preferential transfer to Alaska Continental Bank ("Alaska").[182] The president of Westex ("Bond") was indebted to Alaska, and Westex was indebted to the president.[183] Alaska obtained a judgment against Bond and served a writ of garnishment upon Westex (January, 1987).[184] Westex failed to answer the garnishment writ and Alaska confirmed a default judgment against Westex for the entire judgment against Bond.[185] Alaska then garnished Westex's bank accounts and received $37,743.60 toward the judgment against Westex (November, 1987).[186] Some four months later (more than ninety days after receipt of the funds from the bank accounts), Westex filed bankruptcy.[187] During the bankruptcy case, Alaska was declared insolvent, and the FDIC was appointed receiver.[188]

The bankruptcy court[189] found for Alaska, holding that the transfer occurred in January 1987, when the original garnishment writ was served upon Westex, and was therefore outside the maximum one-year preference period.[190] Moreover, the court held that the transfer did not benefit Bond, the insider, because Westex possessed an indemnity claim against Bond for any amount paid.[191] Alternatively, the court reasoned that even if all other provisions of section 547(b) were met, it would be inequitable to allow a one-year reachback period against a third party creditor solely on the basis of the existence of a guarantor or insider.[192] On appeal, the District Court affirmed the bankruptcy court's judgment solely on the basis that to allow Westex to recover from Alaska would be inequitable.[193]

---

179. *Id.* at 1495.

180. *Id.* Section 550(b)(1) provides that no recovery is available if the "transferee . . . takes for value, including satisfaction or securing of a present or antecedent debt, *in good faith, and without knowledge of the voidability of transfer avoided.*" 11 U.S.C. § 550(b)(1) (1988) (emphasis added).

181. 950 F.2d 1187 (5th Cir. 1992).

182. *Id.* at 1188.

183. *Id.*

184. *Id.*

185. *Id.* See La. Code Civ. P. art. 2413 for a similar result for failure to answer garnishment interrogatories.

186. *Westex*, 950 F.2d at 1188.

187. *Id.*

188. *Id.*

189. T.B. Westex Foods, Inc. v. Alaska Continental Bank (*In re* T.B. Westex Foods, Inc.), 96 B.R. 77 (Bankr. W.D. Tex. 1989).

190. *Id.* at 80-81.

191. *Id.* at 80.

192. *Id.* at 81.

193. T.B. Westex Foods, Inc. v. Alaska Continental Bank (*In re* T.B. Westex Foods, Inc), Bankr. No. 88-70099, Adv. No. 88-7023, 1990 WL 359063 (W.D. Tex. May 22, 1990).

The Fifth Circuit Court of Appeals reversed the lower court's judgment.[194] The court reasoned that the transfer took place upon the service of the writ of garnishment served upon the bank, in which the funds were held within Westex's bank accounts, within one year of the bankruptcy case.[195] The court further determined that the transfer did benefit Bond; the payment by Westex to Alaska reduced Westex's debt to Bond, and it also reduced the claim of Alaska against Bond.[196] Thus, Bond benefitted by the difference between the payment to Alaska and the amount he would receive from Westex, on account of his unsecured claim, upon liquidation pursuant to section 547(b)(5).[197]

Next, the *Westex* court determined that all elements of the preference were met *vis-a-vis* Bond, but the remaining question was whether Westex could proceed against Alaska.[198] The court analyzed the two theories underlying the cases which prohibit any extension of the reachback period against non-insider creditors—the "two transfer" theory and the "equity" argument.[199]

First, the court stated that two transfers arguably take place when there is an insider/guarantor situation because two separate debts exist.[200] The court determined that this case was different, however, because Westex's payment represented only one obligation—Westex's debt to Bond.[201] "Instead of paying Bond, Westex has simply paid a garnishor standing in Bond's shoes."[202]

There is a problem with this urge to distinguish. Remember, Alaska had procured a separate judgment against Westex for the full amount of the Bond judgment. Therefore, the amount owed by Westex to Bond is irrelevant. The seizure was *not* effected by a writ of garnishment seeking to enforce the Alaska judgment against Bond, but against Westex, and therefore the liability of Westex could not be limited by (or to) amounts due from Westex to Bond.

The court purported to resolve this problem by assuming that Westex owed Bond at least the amount of the debt owed by Bond to Alaska (and also by Westex to Alaska).[203] The utilization of this assumption allowed the court to proceed within its analysis, convinced that it is without logical pitfall. The court went on to read section 550(a) as being unambiguous and requiring that recovery can be had from either Bond or the initial transferee, Alaska.[204]

Regarding the second theory, the *supposed* inequity of making the prudent creditor who obtained a guarantor worse off than the imprudent creditor, the court

194. T.B. Westex Foods, Inc. v. FDIC (*In re* T.B. Westex Foods, Inc.), 950 F.2d 1187 (5th Cir. 1992).
195. *Id.* at 1191.
196. *Id.* at 1192.
197. *Id.* at 1192-93.
198. *Id.* at 1193.
199. *Id.* at 1193-94.
200. *Id.* at 1194.
201. *Id.*
202. *Id.*
203. *Id.*
204. *Id.* at 1194-95.

reiterated its distinguishment of the Westex/Alaska situation (payment by Westex was only payment of its debt to Bond to the third party, Alaska) and other situations. The concluding paragraph of the court's equitable argument is exasperating to certain lower courts looking for guidance: "Alaska has not demonstrated any sufficiently compelling equity to warrant deviation from the statutory scheme, even assuming, *arguendo* only, that in other contexts (*e.g.*, the insider-guarantor) such might be appropriate."[205]

According to the Supreme Court, "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."[206] And what of the supposed distinction that generates the reservation by the court of embracing the prospect of equitable considerations overriding (or warranting deviation from) an *unambiguous* statutory scheme?

Couldn't (shouldn't) Bond have argued (he is the one suffering as a result of the avoidance of any payments by Westex to Alaska) that because Westex failed to respond to the garnishment interrogatories, the payments from Westex were on account of Alaska's judgment claim against Westex and were independent of any claim of Bond against Westex? This argument yields analytical fruit in two ways. First, it forces the court to analyze its supposed distinction. If Bond is correct, the court erroneously concluded that payment to Alaska reduced *both* the obligation of Bond to Alaska *and* the obligation of Westex to Bond.[207] If the separate nature of the Westex judgment is held in proper focus, it is clear to this writer that the court should have faced the legal consequence of payment by Westex to Alaska upon the debt of Westex to Bond as a question rather than an assumption.

Second, recall that the court assumes (without facts of record) that the debt of Westex to Bond was at least equal to the debt of Bond to Alaska. What if it wasn't? Before the judgment, Westex could only owe Alaska what it owed Bond, and if the interrogatories had been answered, and liability to Alaska thereby limited, the court's analysis (payment to Alaska is equivalent to payment to Bond) would have been more clearly correct. To the extent liability was assumed by Westex over and above the amount owed by Westex to Bond, the incurring of the indebtedness under the judgment could have been attacked under section 548(a)(2) as a fraudulent transfer.[208] Actions under section 548 have a one-year reachback period,

---

205. *Id.* at 1195.

206. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S. Ct. 963, 969 (1988).

207. *Westex*, 950 F.2d at 1194. If Westex has incurred this separate obligation upon its failure to answer garnishment interrogatories, Bond will argue on behalf of his claim against Westex that it is not reduced; the fact that Alaska has no right to be paid twice does not yield the legal or logical conclusion that Westex can avoid paying twice.

208. Section 548(a)(2) reads:

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

regardless of insider involvement. Failure to resort to facts of record to resolve this issue could be a problem. Recall that the payment must be to or for the benefit of a creditor to be avoidable under section 547. Any payment by Westex over and above what was owed to Bond cannot be seen as having been paid to or for the benefit of Bond as a creditor (only to or for the benefit of the creditor, Alaska). Because the lower courts in *Westex* had not addressed the extent to which the insider benefitted from the transfer, the Court of Appeals remanded for further proceedings.[209]

The Fifth Circuit recently revisited the insider/non-insider preference period dichotomy in *Southmark Corp. v. Southmark Personal Storage, Inc. (In re Southmark Corp.)*.[210] In *Southmark*, a subsidiary of Southmark Corporation, Southmark Personal Storage, Inc. ("SPS"), borrowed two million dollars from First Nationwide Bank ("FNB").[211] SPS pledged several promissory notes as collateral to secure the FNB loan.[212] In addition, Southmark guaranteed all of SPS's debt to FNB.[213] The guaranty agreement did not require FNB first to seek recovery from SPS before collecting from Southmark.[214] Approximately seven months before Southmark filed for bankruptcy, it transferred $222,000 to FNB in payment for collateral notes on which SPS was in default.[215] Southmark, as debtor-in-possession, subsequently sought to recover the payment as a preferential transfer from both SPS and FNB.[216]

Southmark's complaint was dismiss by the bankruptcy court for failure to allege to state the necessary elements of a preference pursuant to section 547(b)(1) and (2).[217] The bankruptcy court found that "Southmark's payment did not benefit SPS 'for or on account of an antecedent debt,' . . . because Southmark was not indebted to SPS on the guaranty underlying the transfer to FNB."[218] On appeal, the district court affirmed the dismissal.[219]

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

11 U.S.C. § 548(a)(2) (1988).

209. *Westex*, 950 F.2d at 1195.

210. 993 F.2d 117 (5th Cir. 1993).

211. *Id.* at 118.

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.*

216. *Id.*

217. *Id.*

218. *Id.* at 119 (citing Southmark Corp. v. Southmark Personal Storage, Inc. (*In re* Southmark Corp.), 138 B.R. 831, 835 (Bankr. N.D. Tex. 1992)).

219. *Id.* at 121.

In its analysis, the Fifth Circuit strictly construed the language of section 547(b) and determined that the antecedent debt for which the transfer is made (Southmark's guaranty obligation) must be the same debt which gives rise to the insider creditor's (SPS's) claim.[220] The court stated, "[t]he transfer must do more than incidentally benefit inside creditor SPS;[221] the transfer must benefit SPS in relation to the antecedent debt that triggered the transfer."[222] Apparently SPS was a creditor of Southmark on claims unrelated to the guaranty agreement.[223]

The *Southmark* court illustrated the differences between the facts in *Southmark* and those in *Westex*. The court noted that in *Westex*, "Alaska had a claim against Westex solely because of Alaska's right to enforce Bond's claim under garnishment law."[224] Therefore, the only "antecedent debt" was Westex's debt to Bond.[225] Unlike *Westex*, however, the claims of SPS against Southmark were independent from the guaranty agreement which generated payment to FNB.

The *Southmark* court referred to the Seventh Circuit's analysis in *Deprizio* that for the one-year preference period to apply under section 547(b), "the insider must be a creditor *in connection with the debt underlying the transfer*,"[226] as additional support for its position. The expanded preferential period applied in *Deprizio* because the insider was also the guarantor of the debtor/obligor's debt to the non-insider creditor upon which payments were made, and consequently the debtor's payments on such debt directly reduced the insider's liability on the guaranty (dollar for dollar) and therefore the claim of the insider against the debtor.[227]

---

220. *Id.* at 119. The court particularly focused on the language of § 547(b)(5), which provides that a trustee may avoid a transfer "to or for the benefit of a creditor" ((b)(1)), "for or on account of an antecedent debt" ((b)(2))—

> (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;
> (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. § 547(b)(5) (1988) (emphasis added).

221. Although SPS was a creditor of Southmark, SPS's claim was not related to Southmark's guaranty obligation to FNB. *Southmark*, 993 F.2d at 119.

222. *Id.*

223. *Id.*

224. *Id.* (discussing *In re* T.B. Westex Foods, Inc., 950 F.2d 1187 (5th Cir. 1992). *See* disagreement with this perception *supra* at pp. 71-73.

225. *Southmark*, 993 F.2d at 119 (discussing *In re* T.B. Westex Foods, Inc., 950 F.2d 1187 (5th Cir. 1992).

226. *Id.* at 120 (citing Levit v. Ingersoll Rand Fin. Corp. (*In re* V.N. Deprizio Constr. Co., 874 F.2d 1186 (7th Cir. 1989)) (emphasis added) (footnote omitted). *See also* Hendon v. Associates Commercial Corp. (*In re* Fastrans, Inc.), 142 B.R. 241, 245 (Bankr. E.D. Tenn. 1992) (following *Deprizio* and concluding that "it is not enough that an insider be a creditor of the debtor in a general sense; the insider must have a 'claim' against the debtor attributable to the specific debt he or she guaranteed in order to render transfers made by the debtor on account of that debt to the non-insider transferee avoidable under § 547(b).").

227. *See* discussion *supra* at pp. 56-58. The *Southmark* court distinguished the facts before it from those in *Deprizio* by pointing out that "[the] payments to the lenders [in *Deprizio*] were 'for

In contrast, as SPS could not derive creditor status upon default by Southmark, the fact that SPS was a creditor with regard to unrelated obligations was seen by the court to be irrelevant. Though the court mentioned that payment by Southmark benefitted SPS (by reducing its principal obligor exposure),[228] SPS derived no benefit on account of a claim against Southmark arising from the guaranty agreement. While benefit to the insider by means of reduction of the insider's exposure is part of the equation, that benefit must simultaneously bestow a benefit *vis-a-vis* the debtor's obligation to the insider. While reduction of a guarantor's exposure on a guaranty by means of payment by the principal obligor has the simultaneous effect of reducing the guarantor's claim against the principal obligor, payment by the guarantor generates a claim against, as opposed to a benefit upon, the principal obligor.

The court also analyzed the similarities between the SPS-Southmark relationship and the insiders who derived benefit in *Deprizio* from payments made by the debtor of tax obligations.[229] While payment of the tax obligations reduced the insider's exposure to responsible party liability to the IRS, the payments did not benefit the insider as creditor because the insider possessed no entitlement, through subrogation or otherwise, to a corresponding claim against the debtor arising from payments on account of responsible party liability.[230] Because payments to the bank did not benefit the insider on account of creditor status arising from the same (guaranty) transaction establishing the obligation pursuant to which the payments were made, the transfers were not avoidable as to either SPS or FNB as preferential transfers. The rule espoused is that "the transfer must benefit SPS in relation to the antecedent debt that triggered the transfer."[231]

From this writer's simple-minded figuring of the relationships, it appears clear that payment by Southmark, the guarantor, in fact gave rise to a claim by Southmark against SPS—the exact opposite of the relationship as was dealt with in *Deprizio* (guarantor was non-debtor). In this case, the holder of the contingent claim is the *debtor*. Therefore, with respect to the antecedent debt triggering the transfer, it is clear that the insider derived no benefit. The overall debt was not in fact reduced, only shifted. The balance over and above the payment remains owed to the bank, and the amount of the payment, by the guarantor's right of subrogation, is owed by the insider to the guarantor.

Perhaps, however, there is another way of looking at the question of benefit derived by the insider; one not mentioned by the court. The court makes reference to the "incidental benefit" obtained by SPS from the transfer, but does not delineate the nature of the incidental benefit.[232] Resort to the bankruptcy court opinion

---

the benefit' of the insider (§ 547(b)(1)), because those payments reduced the insider's exposure on the guaranty." *Southmark*, 993 F.2d at 120 (citing *Deprizio*, 874 F.2d at 1190).

228. *Id.* at 121.
229. *Id.* at 120.
230. *Id.*
231. *Id.* at 119.
232. *Id.*

yields the observation that Southmark alleged in its complaint "that the transfer was made 'for the benefit of SPS' because the transfer 'reduced the amount owed by SPS to FNB.'"[233] In concluding its analysis, the bankruptcy court states:

> As a result of the transfer to FNB, SPS did not receive a greater percentage of its claim against Southmark had the transfer not been made. SPS had no claim against Southmark that was reduced by the transfer. The transfer had no effect on the SPS claim based on the intercompany transfer. While SPS received a benefit from the transfer, it did not receive a benefit or payment based on or on account of its claim against Southmark.[234]

The Fifth Circuit does not provide much discussion regarding the connexity between the payment by Southmark and the unrelated claim of SPS, relying upon statutory language and the support of *Deprizio* for the rule espoused.[235] Therefore, the court arguably deemed irrelevant the concern with the extent to which SPS derived a benefit on account of its unrelated claim from the payment (preferring to announce the rule that the insider must be a creditor in connection with the obligation triggering the transfer—that's it, nothing further need be asked).

What of the bankruptcy court's observation, though? Recall that the payment by Southmark generated a claim by Southmark against SPS. Prior to the payment, SPS is (apparently) an unsecured creditor destined to share, *pro rata*, in the assets of the debtor, Southmark. What about after the payment? Functionally, the asset pool of Southmark numerically remains the same—the payment is converted into a claim for a like amount of dollars against SPS. Prior to the Southmark payment, SPS could assert an unsecured, *pro rata*, claim to the dollars which came to make up the payment. After the payment, however, SPS conceivably could assert a *secured claim* to the extent of the claim of Southmark against it under section 506(a) of the Bankruptcy Code.[236]

---

233. Southmark Corp. v. Southmark Personal Storage, Inc. (*In re* Southmark Corp.), 138 B.R. 831, 833 (Bankr. N.D. Tex. 1992).

234. *Id.* at 835.

235. *Southmark*, 993 F.2d at 120.

236. Section 506(a) reads:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a) (1988).

More proud than embarrassed (that I didn't think of it), this writer owes (and gladly pays) specific citation to one of his students, Hansel M. Harlan, not for planting the seed of this argument, but for

The concept is not difficult. The creditor, SPS, upon Southmark obtaining a claim against it through subrogation, can argue that under applicable non-bankruptcy law, it possesses a right to setoff (or compensation) that secures its claim against Southmark to the extent of the debt that it owes Southmark.[237] Because SPS has obtained a secured claim (on account of its unrelated claim against Southmark) as a result of the payments by Southmark to the bank, the argument of Southmark is that SPS in fact received a direct benefit on account of its claim (within a year prior to bankruptcy), and, therefore, the payment is at least preferential as to SPS. Once this step is established, why wouldn't the bank, as initial transferee, owe the preference?

Clearly, the bankruptcy court opinion was incorrect in its vehement pronouncements about the absence of a benefit bestowed upon SPS as a result of the payments.[238] Was the Fifth Circuit also incorrect in not addressing this argument? Probably not incorrect, though analysis perhaps would have more completely stitched its quilt.

The problem with the posed argument is section 553 of the Bankruptcy Code and its purpose, as interpreted by the jurisprudence.[239] Section 553 is the specific

---

advancing it, pretty well full-blown, within a classroom discussion during the fall semester, 1993.

237. For a discussion of the necessity of possessing a right to setoff under applicable non-bankruptcy law, see 4 Collier on Bankruptcy, *supra* note 20, ¶ 553.06, at 553-38 to 42. In Louisiana, the term "setoff" approximates the Law of Compensation. *See* La. Civ. Code arts. 1893-1902.

238. *See supra* at p. 78.

239. Section 553 reads as follows:

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—

(1) the claim of such creditor against the debtor is disallowed other than under section 502(b)(3) of this title;

(2) such claim was transferred, by an entity other than the debtor, to such creditor—

(A) after the commencement of the case; or

(B)(i) after 90 days before the date of the filing of the petition; and

(ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor was incurred by such creditor—

(A) after 90 days before the date of the filing of the petition;

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

(b)(1) Except with respect to a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(14),, [sic] 365(h)(2), or 365(i)(2) of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of—

(A) 90 days before the date of the filing of the petition; and

(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

provision of the Code which provides the right on behalf of the trustee (or debtor-in-possession) to avoid setoffs.[240]

In fact, section 553 evidences congressional intent to exclude setoffs (or the right to setoff) from avoidance unless the requirements of section 553 are met.[241] Because section 553 has only a ninety-day reachback period, setoffs (or the right to obtain setoffs) that occur (or accrue) earlier than ninety days before the bankruptcy petition are not affected by section 553. Therefore, while a superficially plausible argument, the accrual of a right of setoff (accrued claim by means of the right to setoff) before ninety days prior to the bankruptcy case does not involve a preferential transfer to the insider creditor. Technically, then, the Fifth Circuit is correct (and the *Southmark* bankruptcy court would have been correct, as well, if the tenor of the observations would have been to the effect that while SPS benefitted from the payments, the benefit was not avoidable).

Most recently, the Ninth Circuit, in a case of first impression in that circuit, relied upon the *Deprizio* and *Southmark* opinions to reach its judgment that a trustee may recover from an outside creditor a transfer made within one year of bankruptcy, where the transfer benefits an inside guarantor.[242] In *In re Sufolla, Inc.*, the debtor entered into a loan agreement with the bank which was guaranteed by some of the debtor's shareholders.[243] Sometime in the year preceding the filing of the bankruptcy petition, but outside the ninety-day period, the debtor made a payment on the loan to the bank.[244] The official unsecured creditors committee initiated an adversary proceeding and sought to recover the payment as a

---

(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

(c) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

11 U.S.C. § 553 (1988 & Supp. IV 1992) (footnotes omitted).

240. Braniff Airways, Inc. v. Exxon Co., USA, 814 F.2d 1030, 1034 (5th Cir. 1987).

241. *Id.* at 1034-35. *See also In re* Morgan, 77 B.R. 81, 84 (Bankr. S.D. Miss. 1987) (holding that "[a] valid setoff may not be recovered as a preferential transfer for that would defeat the intended purpose of the setoff provisions of the Bankruptcy Code."); Brooks Farms v. USDA (*In re* Brooks Farms), 70 B.R. 368, 372-73 (Bankr. E.D. Wis. 1987) (finding that setoff rights are controlled under § 553 and not preference law); Tradex, Inc. v. United States (*In re* IML Freight, Inc.), 65 B.R. 788, 791-92 (Bankr. D. Utah 1986) (same); Quinn v. Montrose State Bank (*In re* Intermountain Porta Storage, Inc.), 59 B.R. 793, 795 (Bankr. D. Colo. 1986), *appeal dismissed, aff'd*, 74 B.R. 1011 (D. Colo. 1987); Eckles v. Petco, Inc., Interstate (*In re* Balducci Oil Co.), 33 B.R. 847, 852 (Bankr. D. Colo. 1983); 4 Collier on Bankruptcy, *supra* note 20, ¶ 553.02, at 553-9 to 14.

242. Official Unsecured Creditors Comm. of Suffolla, Inc. v. U.S. Nat'l Bank of Oregon (*In re* Sufolla, Inc.), 2 F.3d 977, 979-80 (9th Cir. 1993) (citing *In re* T.B. Westex Foods, Inc., 950 F.2d 1187 (5th Cir. 1992) (benefit to garnishee's insider); Southmark Corp. v. Southmark Personal Storage, Inc. (*In re* Southmark Corp.), 993 F.2d 117 (5th Cir. 1993); Ray v. City Bank and Trust Co. (*In re* C-L Cartage Co.), 899 F.2d 1490 (6th Cir. 1990); Manufacturers Hanover Leasing Corp. v. Lowrey (*In re* Robinson Bros. Drilling, Inc.), 892 F.2d 850 (10th Cir. 1989); Levit v. Ingersoll Rand Fin. Corp. (*In re* V.N. Deprizio Constr. Co.), 874 F.2d 1186 (7th Cir. 1989)).

243. *Suffolla*, 2 F.3d at 978.

244. *Id.*

preferential transfer.[245] The bankruptcy court held that the transfer was a preference recoverable from the bank, and the district court affirmed.[246]

The Ninth Circuit concluded that the guarantors of the debtor's loan agreement were insider creditors within the meaning of section 547(b).[247] The *Sufolla* court declined to depart from a literal reading of section 547[248] and rejected any equitable arguments made in support of protecting the non-insider creditor.[249] Moreover, the court rejected the "two transfer" theory advanced by the bank.[250] The Ninth Circuit embraced the *Deprizio* opinion in determining that a single transfer takes place when the debtor makes a payment to the outside creditor which happens to benefit two parties.[251]

Accordingly, the *Sufolla* court concluded that the payment by the debtor to the bank reduced the insiders' liability[252] and benefitted the insiders as creditors because the insiders' contingent claims against the debtor were connected directly to the debt owed to the bank.[253] Thus, because section 550 unambiguously permits recovery from an initial transferee,[254] the payment was recoverable from the bank in accordance with the extended preference period of section 547(b)(4)(B).[255]

Clearly, the tide has gone out on the two-transfer theory within the majority of circuits from which reported decisions have emanated (with the Fifth Circuit having tantalized with a dance around the issue, but as of yet exuding uncertainty). Given the exposure inherent in the *Deprizio* analysis, whether or not recognized and

---

245. *Id.* at 978-79.

246. *Id.* at 979.

247. *Id.*

248. *Id.* at 981.

249. *Id.* at 980-81 (citing *C-L Cartåge*, 899 F.2d at 1494 (holding that bankruptcy courts cannot disregard unambiguous statutory language in the name of equity) (citing Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S. Ct. 963, 969 (1988)); *Deprizio*, 874 F.2d at 1197 (questioning the premise that recovery against an outside lender is inequitable); Zolg v. Kelly (*In re* Kelly), 841 F.2d 908, 913 n.4 (9th Cir. 1988) ("Bankruptcy judges have no more power than any others to ignore the plain language of a statute in order to reach a result more in keeping with their notions of equity."); *Robinson Bros.*, 97 B.R. at 82 ("The equitable powers of the bankruptcy court under Section 105 to avoid strict construction of the Code is limited.")).

250. *Id.* at 981-82.

251. *Id.* (citing *Deprizio*, 874 F.2d at 1195-96 (rejecting the two transfers theory); *C-L Cartage*, 899 F.2d at 1494-95).

252. Although the bank was fully secured at the time of the debtor's payment, it was only partially secured on the date the bankruptcy petition was filed. *Sufolla*, 2 F.3d at 985. Accordingly, the insider guarantors did receive a benefit within the meaning of § 547(b)(1). *Id.* The *Sufolla* court noted, however, that a different result may have been reached if the bank remained a fully secured creditor at the time the bankruptcy petition was filed. *Id.* (citing Miller v. Rausch-Alan, Inc. (*In re* Gamest, Inc.), 129 B.R. 179, 182 (Bankr. D. Minn. 1991) (holding that the debtor's prepetition payments to a fully secured creditor did not benefit the insider guarantors because the insiders would have been subrogated to a fully secured claim)).

253. *Sufolla*, 2 F.3d at 983 n.7.

254. *Id.* at 983.

255. *Id.* at 986.

admitted by the court itself, what options are available to lenders' lawyers to avoid the *Deprizio* tarpit?

The most obvious response (off the top of my head) is a waiver of subrogation rights by the insider guarantor. The insider guarantor who possesses no corresponding claim against the principal obligor arising from the act of guaranty would not be a creditor of the principal obligor, and, therefore, payments to the non-insider creditor by the debtor would not be to or for the benefit of a creditor.[256] Note the ironical consequence of this possible means of escape.

Recall that the *Deprizio* court stridently disagreed with the notion that expanding the preference period against the non-insider is inequitable on the basis that insiders are in the position to determine who gets paid first (an insider who is a guarantor of the non-insider claim will want the guaranty exposure limited).[257] By requiring a waiver of subrogation rights, isn't the non-insider creditor providing a greater incentive for the insider to insure that the creditor whose debt is guaranteed gets paid first? Waiver of subrogation rights in no way lessens the guarantor's exposure on the guaranty, but only purports to extinguish the guarantor's contingent claim against the debtor, thereby obviating any hope of any recovery by the guarantor on account of payments made. So the equitable quandary: the creditor who obtains a waiver of subrogation rights creates a greater incentive for inequitable conduct on the part of the insider (and debtor). Simultaneously, the waiver is designed to insulate the non-insider from an expanded preference period by depriving the insider-guarantor of creditor status.[258]

Another approach observed by this writer is the suspension by contract of subrogation rights, so that the right of the guarantor to assert a claim against the debtor does not arise (or is suspended) until the passage of at least 366 days after each payment made under the guaranty agreement.

A third circumvention might be a reduced guaranty (e.g., principal obligation ($3,000,000), guaranteed portion is ($1,000,000)) subject to an imputation of payments agreement among the debtor, creditor, and guarantor that payments made by the debtor to the creditor are first imputed to the non-guaranteed portion of the debt.[259]

---

256. *See Deprizio*, 874 F.2d 1186 (7th Cir. 1989); Southmark Corp. v. Southmark Personal Storage, Inc. (*In re* Southmark Corp.), 993 F.2d 117 (5th Cir. 1993).

257. *Deprizio*, 874 F.2d at 1198. *See supra* at pp. 57-58.

258. It is beyond the scope of this paper to discuss the concerns, related to this writer by numerous attorneys, that a required waiver of subrogation rights is against public policy and thereby non-enforceable. *See* La. Civ. Code arts. 2029-2034 (relating to nullity of contracts). For cases dealing with the question, and which approved waivers of subrogation under applicable state law and thereby excepted the non-insider creditor from the effect of the extended preference period, see Hostmann v. First Interstate Bank of Oregon, N.A. (*In re* XTI XONIX Technologies, Inc.), 156 B.R. 821 (Bankr. D. Or. 1993) (Oregon law); Hendon v. Associates Commercial Corp. (*In re* Fastrans, Inc.), 142 B.R. 241 (Bankr. E.D. Tenn. 1992) (Tennessee law).

259. *See* La. Civ. Code arts. 1864-1868. This mechanism, functionally, would place only the last part of the loan in danger of the extended preference reachback period.

Whatever avenues are available to bank lawyers, it appears that they have proven, in the final analysis, to be too tedious. Pending legislation, if passed, will overrule *Deprizio* and its disciples. The legislation in its present form reads:

> SEC. 214. LIMITATION ON LIABILITY OF NONINSIDER TRANSFEREE FOR AVOIDED TRANSFER.
>
> Section 550 of title 11, United States Code, is amended—
>
> (1) by redesignating subsections (b), (c), (d), and (e) as subsections (c), (d), (e), and (f), respectively; and
>
> (2) by inserting after subsection (a) the following new subsection:
>
> "(b) The trustee may recover under subsection (a) a transfer avoided under section 547(b) from a first transferee or an immediate or mediate transferee of a first transferee only to the extent that-
>
> "(1) all the elements of section 547(b) are satisfied as to the first transferee; and
>
> "(2) the exceptions in section 547(c) do not protect the first transferee."[260]

This pending legislation, however, even if promulgated, will not for some time render *Deprizio* obsolete. The proposed legislation contains an effective date provision which provides, in pertinent part, that "the amendment made by this Act shall not apply with respect to cases commenced under Title 11, United States Code, before the date of enactment of this Act."[261]

Because a trustee has until the earlier of two years after the appointment of the trustee or the time the case is closed or dismissed within which to bring a preference action, it is likely that the *Deprizio* argument/analysis will remain applicable to all cases filed up through the day before the amendment to section 550 (if enacted) is enacted.[262]

260. S. Rep. No. 540, 103d Cong., 1st Sess., § 214 (1993).

261. S. Rep. No. 540, 103d Cong., 1st Sess., § 602 (1993).

262. 11 U.S.C. § 546(a)(1) and (2) (1988). Section 546, on its face, proposes to limit only the period in which a *trustee* can bring an avoidance action. In fact, some courts have limited the applicability of § 546 to actions by trustees so as to effectively free debtors-in-possession from any time constraint. *See* Korvettes, Inc. v. Sanyo Elec., Inc. (*In re* Korvettes, Inc.), 67 B.R. 730 (S.D.N.Y. 1986) (concluding that the two-year statute of limitations applicable to trustee avoidance actions does not apply to preference actions brought by debtors-in-possession); Saccurato v. Shawmut Bank, N.A. (*In re* Mars Stores, Inc.), 150 B.R. 869, 877 (Bankr. D. Mass. 1993); Cardullo v. Dwyer Mechanical Corp. (*In re* Cardullo), 142 B.R. 138 (Bankr. E.D. Va. 1992); Freedom Ford, Inc. v. Sun Bank & Trust Co. (*In re* Freedom Ford, Inc.), 140 B.R. 585 (Bankr. M.D. Fla. 1992); Pate v. Hunt (*In re* Hunt), 136 B.R. 437 (Bankr. N.D. Tex. 1991); *In re* Allegheny Int'l, Inc., 136 B.R. 396 (Bankr. W.D. Pa. 1991), *aff'd*, 145 B.R. 823 (W.D. Pa. 1992); Pullman Constr. Indus., Inc. v. National Steel Serv. Center (*In re* Pullman Constr. Indus., Inc.), 132 B.R. 359 (Bankr. N.D. Ill. 1991); United States Lines (S.A.), Inc. v. United States (*In re* McLean Indus., Inc.), 132 B.R. 247 (Bankr. S.D.N.Y. 1991), *aff'd*, 162 B.R. 410 (S.D.N.Y. 1993); Mancuso v. Continental Bank Nat'l Ass'n Chicago (*In re* Topcor, Inc.), 132 B.R. 119 (Bankr. N.D. Tex. 1991); Katon v. International Bank of Miami, N.A. (*In re* Tamiami Range & Gun Shop, Inc.), 130 B.R. 617 (Bankr. S.D. Fla. 1991); Caplan v. United States Brass & Copper Co. (*In re* Century Brass Prods., Inc.), 127 B.R. 720

III. CONCLUSION

The authors of this article are thankful for the opportunity to participate in this symposium. Upon reflection, it appears that we have offered much talk on few developments. In so doing, we have attempted first to offer an analysis of a recent bankruptcy issue with non-bankruptcy implications. Second, we have ventured to chart an important development in the law of preferences, which, though it may be rendered obsolete if pending legislation is passed, shall remain relevant for at least the foreseeable future.

(Bankr. D. Conn. 1991); Perlstein v. Saltzstein (*In re* AOV Indus., Inc.), 62 B.R. 968 (Bankr. D.D.C. 1986); Alithochrome Corp. v. East Coast Finishing Sales Corp. (*In re* Alithochrome Corp.), 53 B.R. 906 (Bankr. S.D.N.Y. 1985); Boatman v. E.J. Davis Corp. (*In re* Choice Vend, Inc.), 49 B.R. 719 (Bankr. D. Conn. 1985).

The alternative line of authority interprets § 546 as applicable to both trustees and debtors-in-possession, effectively limiting the period within which any party may bring an avoidance action. *See* Zilkha Energy Co. v. Leighton, 920 F.2d 1520, 1524 (10th Cir. 1990) (holding that the two-year statute of limitations in § 546(a) applied to the filing of a preference action by a debtor-in-possession where a trustee had not been appointed), *aff'd after remand*, 999 F.2d 548 (10th Cir. 1993); Sparmal Enters., Inc. v. Moffit Realty Corp. (*In re* Sparmal Enters., Inc.), 126 B.R. 559, 562-63 (S.D. Ind. 1991) (same); Knapp v. Applewhite (*In re* Knapp), 146 B.R. 294, 296 (Bankr. M.D. Fla. 1992); Construction Mgt. Servs., Inc. v. Manufacturers Hanover Trust Co. (*In re* Coastal Group, Inc.), 125 B.R. 730, 732 (Bankr. D. Del. 1991); Lill v. Bricker (*In re* Lill), 116 B.R. 543, 546 (Bankr. N.D. Ohio 1990).

The middle path between these two roads deals with the situation of conversion of a case to a case under another chapter (*e.g.*, Chapter 11 to Chapter 7), and the effect of conversion upon the applicable limitation period. *See* Smith v. Moody (*In re* Moody), 77 B.R. 566, 573-74 (S.D. Tex. 1987) (holding that § 546(a)'s statute of limitations begins anew following conversion of a proceeding from one chapter to another and appointment of a new trustee), *aff'd on other grounds*, 862 F.2d 1194 (5th Cir. 1989), *cert. denied*, 112 S. Ct. 1562 (1992); Daff v. Regal Recovery, Inc. (*In re* Continental Capital & Credit, Inc.), 158 B.R. 828, 830 (Bankr. C.D. Cal. 1993) (same); Amazing Enters. v. Jobin (*In re* M & L Business Machs., Inc.), 153 B.R. 308, 310-11 (D. Colo.), *aff'd*, 160 B.R. 850 (D. Colo. 1993); Roberts v. Seneca Petroleum Co. (*In re* Wikel Mfg. Co.), 153 B.R. 183, 185 (Bankr. N.D. Ohio 1993); Martino v. Assco Assocs., Inc. (*In re* SSS Enters., Inc.), 145 B.R. 915, 917 (Bankr. N.D. Ill. 1992); Pongetti v. Lee (*In re* Bingham Sys., Inc.), 139 B.R. 809, 812-13 (Bankr. N.D. Miss. 1991); Nichols v. Wood (*In re* Wood), 113 B.R. 253, 255 (Bankr. S.D. Miss. 1990) (conversion of chapter 13 proceeding to chapter 7 proceeding); Zeisler v. Conn. Bank & Trust Co. (*In re* Grambling), 85 B.R. 675, 676-77 (Bankr. D. Conn. 1988); Stuart v. Pingree (*In re* Afco Dev. Corp.), 65 B.R. 781, 787 (Bankr. D. Utah 1986); *see also* Mahoney, Trocki & Assocs., Inc. v. Kunzman (*In re* Mahoney, Trocki & Assocs., Inc.), 111 B.R. 914 (Bankr. S.D. Cal. 1990); Jet Florida, Inc. v. American Airlines, Inc. (*In re* Jet Florida Sys., Inc.), 73 B.R. 552 (Bankr. S.D. Fla. 1987); Edleman v. Gleason (*In re* Silver Mill Frozen Foods, Inc.), 23 B.R. 179 (Bankr. W.D. Mich. 1982). *But see* Ford v. Union Bank (*In re* San Joaquin Roast Beef), 7 F.3d 1413, 1415-16 (9th Cir. 1993) (interpreting § 546(a) to mean that the two-year statute of limitations begins running from the date the first trustee is appointed and that all subsequent trustees are subject to the same two-year period).