The Erisa Exclusion: Shielding Assets from Creditors in the Bankruptcy Estate

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I. INTRODUCTION

Once an individual files for voluntary bankruptcy under chapter 7 of the Bankruptcy Code, all assets of the debtor enter the bankruptcy estate where they may be liquidated by a trustee for the benefit of creditors. The debtor is, however, entitled to retain certain exempt property

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2. 11 U.S.C. § 704(1).
under either federal or state law. In addition, the Code excludes certain property from the debtor's estate by negative inference through its definition of \textit{property of the estate}. Over the past decade, courts have struggled with the question of whether pension plans governed by the Employee Retirement Income Security Act of 1974 (ERISA) are exempt property. Much of the confusion has centered around whether Congress, by using the phrase \textit{applicable nonbankruptcy law}, intended for ERISA pension plans to be exempt from the bankruptcy estate. In other words, the question is whether Congress intended the phrase to include only state spendthrift trusts or to include all laws outside of the Bankruptcy Code? The Supreme Court recently decided the issue in \textit{Patterson v. Shumate} and held that the term \textit{applicable nonbankruptcy law} included ERISA pension plans.

The Supreme Court's decision ignores several serious problems which arise when ERISA plans are deemed excludable. The ruling ignores the significance of control over the plan by the debtor. Debtors who strategically plan a bankruptcy filing may potentially abuse this control. This decision is also contrary to congressional intent to broaden the inclusion of assets in the bankruptcy estate. The ability to shield assets is exactly what Congress attempted to eradicate in amending the Bankruptcy Code in 1978. Therefore, the \textit{Patterson} ruling must be remedied. Two possible solutions exist that may correct these problems. One solution is the institution of a test by the Supreme Court to determine the extent of the debtor's control over the ERISA plan. Another alternative would be for Congress to amend the Bankruptcy Code to replace the phrase \textit{applicable nonbankruptcy law} with a phrase such as \textit{state spendthrift trust law}.

3. Id. § 522(b)(1)(d).
4. Id. § 522(b)(1)-(2).
5. Id. § 541.
8. 11 U.S.C. § 541(c)(2).
10. Id. at 2247.
11. \textit{See infra} notes 104-07 and accompanying text.
12. Abuse occurs the debtor contributes funds to the pension plan prior to filing a petition in bankruptcy or withdraws funds from the plan after discharge.
II. HISTORY OF EXEMPTIONS UNDER BANKRUPTCY LAW

In enacting the Bankruptcy Reform Act of 1978, Congress defined property of the bankruptcy estate as all property in which a debtor has a legal or equitable interest as of the commencement of the case. Congress adopted this broad approach in order to include as much of the debtor's property in the estate as possible and to simplify the definition that was used in the prior Act. The Bankruptcy Act of 1898 had attempted to distinguish between interests rooted in the pre-bankruptcy past and those needed for a post-bankruptcy fresh start for the debtor. Congress did not want the debtor hampered by debts accumulated prior to the filing of the petition in bankruptcy after the debtor was discharged in accordance with the Bankruptcy Act. This approach was "a complicated melange of references to State law, and [did] little to further, bankruptcy policy of distribution of the debtor's property to his creditor in satisfaction of his debts." Apparently, the legislators believed that too many of the assets were being excluded from the bankruptcy estate.

The Code does, however, leave the debtor with the option to exempt certain assets from the estate. Although the Code limited many of the exclusions available to the debtor, some exemptions have survived. In fact, "[b]oth the federal bankruptcy law and state laws provide exemptions for debtors." For instance, section 522(b)(1) of the Code permits the debtor to exempt property under section 522(d) or the debtor's state law unless the state in which the debtor has filed the petition has opted out of the federal exemptions. Included in section 522(d) is an exemption for "the debtor's right to receive a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of

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14. Id.
15. Id. § 541(a)(1).
16. Goff v. Taylor (In re Goff), 706 F.2d 574, 578 (5th Cir. 1983).
19. Id.
22. Id. § 522(d).
24. 11 U.S.C. § 522(b)(1). A state that "opts out" has determined that debtors filing in that state will have only one option for exemptions: the state exemptions and federal nonbankruptcy exemptions.
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." 25 A number of states, including Virginia, Shumate's home state, have opted out of the federal exemptions leaving the debtor only one option: to exempt the property pursuant to state law and federal nonbankruptcy law. 26

Section 541(c)(2) of the Code allows the debtor to exclude from the estate property held in a trust that has "a restriction on the transfer of a beneficial interest of the debtor." 27 In addition, the trust must be "enforceable under applicable nonbankruptcy law." 28 Thus, two interpretations may result from this statute, the effect of each being to exclude the property from the estate. 29 One interpretation includes the property in the estate initially and later exempts it from the estate. 30 The other interpretation completely excludes the property from the estate. 31 Section 541(c)(2) of the Bankruptcy Code, however, does not specify the type of trust required, nor does it define the term "applicable nonbankruptcy law." 32 Therefore, the question arises whether pension plans established under ERISA are excludable due to their restrictions on assignment and alienation, since these are restrictions on the transfer of a beneficial interest.

III. ERISA PENSION PLANS

ERISA is a very complicated set of rules that primarily "regulates private employer pension systems." 33 Although a thorough discussion of ERISA is beyond the scope of this note, some of ERISA's provisions must be established to determine its applicability under section 541(c)(2). All ERISA plans must provide that "the plan may not be assigned or alienated." 34 The plan must also comply with specific sections of the

25. Id. § 522(d)(10)(E).
26. Seiden, supra note 18, at 235. Virginia opted out of the exemption. VA. CODE ANN. § 34-3.1 (Michie Supp. 1983); Seiden, supra note 18, at 302 n.157. This is important because the cause of action was brought in a Virginia court. Therefore, under 11 U.S.C. § 522(b)(2)(A), Shumate could use only the exemptions allowed under Virginia state law and federal nonbankruptcy law.
27. 11 U.S.C. § 541(c)(2). ("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.").
28. Id.
29. Seiden, supra note 18, at 236.
30. Id.
31. Id.
32. Id. at 237.
33. In re Daniel, 771 F.2d 1352, 1361 (9th Cir. 1985) (citing In re Graham, 726 F.2d 1268, 1274 (8th Cir. 1984)).
34. 29 U.S.C. § 1056(d)(1).
Internal Revenue Code. In fact, 26 U.S.C. § 401(a)(13) mandates that in order to receive preferential tax treatment under ERISA, "[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." In addition to the alienation provision, ERISA contains various laws limiting such items as contributions, terminations and the like. These provisions enable some ERISA plans to qualify not only as ERISA plans, but also as tax exempt plans.

IV. Case Law Prior to Patterson

Prior to Patterson, many of the circuit courts had reached conflicting decisions regarding whether an ERISA pension plan was excludable. The circuit courts divided into two factions. One group disallowed the exclusion based on legislative intent and the extent of control exercised by the debtor over the plan. The other group found that the plain language of the statute provided for the exclusion.

The leading case disqualifying ERISA plans from exclusion was In re Lucas, 924 F.2d 597, 600 (6th Cir. 1991). The Lucas court recognized that there was a split in the courts that had decided the exclusion issue based on the phrase applicable nonbankruptcy law. The court stated: "[S]everal circuits have interpreted the phrase narrowly, relying on the section's legislative history to hold that § 541(c)(2) was intended to refer only to state 'spendthrift trust' law." Id. (citing In re Daniel, 771 F.2d 1352, 1360 (9th Cir. 1985); In re Lichstrahl, 750 F.2d 1488, 1490 (11th Cir. 1985); In re Graham, 726 F.2d 1268 (8th Cir. 1984); In re Goff, 706 F.2d 574 (5th Cir. 1983)). The Lucas view only allowed exclusion from the bankruptcy estate if the trust qualified as a state spendthrift trust. Id.

The court also noted the minority position (at the time) of several circuit courts that held that ERISA qualified plans were exempt. Id. The court commented that "[t]hese courts reason that the legislative history does not evidence an attempt by Congress to restrict the scope of § 541(c)(2) to state spendthrift trust law, but simply reflects a ratification of a long-standing prior law honoring state spendthrift trust law." Id. (citing In re Moore, 907 F.2d 1476 (4th Cir. 1990); In re Majul, 119 B.R. 118 (Bankr. W.D. Tex. 1990); In re Komet, 104 B.R. 799 (Bankr. W.D. Tex. 1989); In re Raslin, 61 B.R. 502 (Bankr. D. Kan. 1986); In re Mosley, 42 B.R. 181 (Bankr. D. N.J. 1984); Warren v. G.M. Scott & Sons, 34 B.R. 543 (Bankr. S.D. Ohio 1983); In re Three Watt, 24 B.R. 927 (Bankr. D. Kan. 1982)).

The court also noted the minority position at the time of several circuit courts that held that ERISA qualified plans were exempt. Id. The court commented that "these courts reason that the legislative history does not evidence an attempt by Congress to restrict the scope of § 541(c)(2) to state spendthrift trust law, but simply reflects a ratification of a long-standing prior law honoring state spendthrift trust law." Id. (citing In re Daniel, 771 F.2d 1352 (9th Cir. 1985), cert. denied, 475 U.S. 1016 (1986); In re Lichstrahl, 750 F.2d 1488 (11th Cir. 1985); In re Goff, 706 F.2d 574 (5th Cir. 1983).

40. See In re Daniel 771 F.2d 1352 (9th Cir. 1985), cert. denied, 475 U.S. 1016 (1986); In re Lichstrahl, 750 F.2d 1488 (11th Cir. 1985); In re Goff, 706 F.2d 574 (5th Cir. 1983).

41. See Velis v. Kardanis, 949 F.2d 78 (3d Cir. 1991); In re Lucas, 924 F.2d 597 (6th Cir.), cert. denied, 111 S. Ct. 2275 (1991); In re Moore, 907 F.2d 1476 (4th Cir. 1990).
Soon after Goff, the Eleventh Circuit in *In re Lichstrahl* and the Ninth Circuit in *In re Daniel* followed the Goff reasoning. All three of these cases involved ERISA qualified plans established by the owner of a business who had initiated a Chapter 7 bankruptcy proceeding. In disallowing the exclusion, these circuit courts expressed similar reasons, citing legislative intent, control over the plan, and public policy.

Legislative intent was a central factor throughout these opinions. The Fifth Circuit examined the Senate and House reports that accompanied the Bankruptcy Reform Act of 1978 and concluded that the phrase *applicable nonbankruptcy law* was meant to exclude only spendthrift trusts under state law. The court stated "that Congress had something very specific in mind with its facially broad reference to 'applicable nonbankruptcy law' as the benchmark for assessing the enforceability of trust restraints on alienation in bankruptcy." Likewise, the Eleventh and Ninth Circuit Courts viewed legislative intent as an important factor.

Another factor the circuit courts studied was the amount of control the debtor exercised over the plan. Although each of the courts were examining the ERISA plans established by the debtor as a matter of state spendthrift trust law, it illustrates the importance of debtor control over the plan. All of the courts expressed that the policy behind spendthrift trusts could be subverted by allowing an exclusion. In fact, the Goff court stated that a case where a debtor exercised control of the plan was "significantly different from the usual case of employer-created funds in which the beneficiary employee has little or no control during the term of his employment, and may only withdraw funds upon termination of employment."

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42. 706 F.2d 574 (5th Cir. 1983).
43. 750 F.2d 1488 (11th Cir. 1985).
44. 771 F.2d 1352 (9th Cir. 1985).
45. *Daniel*, 771 F.2d at 1353-54; *Lichstrahl*, 750 F.2d at 1489; *Goff*, 706 F.2d at 577.
46. *Goff*, 706 F.2d at 581-82. The court first reviewed the House Report which stated: 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.* (citing H.R. REP. No. 595, 95th Cong., 2d Sess. 176 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6136).
47. *Id.* at 581.
48. *See Daniel*, 771 F.2d at 1359-60; *Lichstrahl*, 750 F.2d at 1490.
49. *See Goff*, 706 F.2d at 588. (noting that if exclusions were allowed, debtors could shelter funds prior to declaring bankruptcy and withdraw them upon discharge); *see also Lichstrahl*, 750 F.2d at 1490 (holding the trust invalid since absolute dominion existed over it). *Cf. Daniel*, 771 F.2d at 1357.
50. *Goff*, 706 F.2d at 589.
Finally the circuit courts considered public policy. Among the cited reasons for disallowing the exclusion was that the plan was not being used for retirement purposes. The courts also reasoned that ERISA was not created to be an exemption from creditors' processes. These issues are crucial to the determination of the exclusion because they may allow the debtor to otherwise create a mirage, using the pension plan to effectively shield assets from creditors until after the bankruptcy is filed.

In contrast, the Third, Fourth, and Sixth Circuit Courts allowed the exclusion. Each of these courts ruled that the plain language of the statute was unambiguous. As such, the courts found no reason to resort to legislative history. However, the Fourth Circuit distinguished its decision from the Goff line of decisions by stating that those cases "involved self-settled trusts in which the settlor is the beneficiary with the power to amend or to terminate the trust without penalty." Similarly, the Third Circuit distinguished its decision from the Goff line of decisions by holding that "substantial or unusual contributions to a self-settled pension trust made within the preference period, or with intent to defraud creditors, should receive no protection under either Section 541(c)(2) or Section 522(d)(10)(E)."

An additional reason for allowing the exclusion was public policy. The courts recognized that employee retirement benefits should be protected. The Lucas court stated that it was important "to ensure that employees and their beneficiaries would not be deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds have been accumulated in the plans. . ." Moreover, the Fourth Circuit was particularly concerned that creditors may force a debtor into

51. Daniel, 771 F.2d at 1358.
52. Goff, 706 F.2d at 583 (citing In re Graham, 24 B.R. 305, 311-12 (Bankr. N.D. Iowa 1982)).
55. See Velis, 949 F.2d at 81; Lucas, 924 F.2d at 600; Moore, 907 F.2d at 1477.
56. See Velis, 949 F.2d at 81; Lucas, 924 F.2d at 600; Moore, 907 F.2d at 1477.
57. Moore, 907 F.2d at 1478.
58. Velis, 949 F.2d at 82.
59. Moore, 907 F.2d at 1479 ("The overriding purpose of ERISA is to guarantee the security of employees' retirement income."); see also Velis, 949 F.2d at 82. The establishment of ERISA, Individual Retirement Accounts, and Keogh plans is intended to protect retirement income. Id.
60. In re Lucas, 924 F.2d 597, 602 (6th Cir. 1991).
involuntary bankruptcy. Other factors presented by the courts included giving full effect to bankruptcy, ERISA, and Internal Revenue statutes, the treatment of retirement benefits, and the importance of not disqualifying the plan from ERISA.

V. PATTERSON V. SHUMATE

The procedural aspects of Patterson prior to the Supreme Court decision are lengthy and complex. The action was originally filed as a Chapter 11 reorganization by Coleman Furniture Company (CFC), but it was later converted to a Chapter 7 liquidation. The trustee, therefore, sought to determine the rights to the funds of the CFC employee pension plan and recover the excess funds as assets of CFC's bankruptcy estate. Joseph B. Shumate, the owner and an employee of CFC, was to obtain a substantial portion of the plan if it was liquidated. Shumate, an intervenor in the case, claimed the excess of the trust should not be property of the estate. The Fourth Circuit, however, found that the assets were included in the debtor's estate.

Mr. Shumate, who was also undergoing personal liquidation, filed a motion to compel the chapter 7 trustee to pay him his pension interest. Shumate's chapter 7 trustee intervened in the case and claimed Shumate's interest in the ERISA pension plan. The plan complied with the ERISA and Internal Revenue Code requirements of prohibiting alienation of benefits or the transfer of plan assets for the benefit of creditors. The plan provided that CFC could terminate the plan at any time with a recipient receiving either a single lump sum payment or a life annuity.

Mr. Shumate was the majority shareholder of CFC stock and

61. Moore, 907 F.2d at 1480. The Fourth Circuit reasoned that the position opposing the exclusion would permit creditors to circumvent the restrictions against gaining access to an ERISA qualified plan. Id. (citing Seiden, supra note 18, at 242).
62. Lucas, 924 F.2d at 603.
64. Id. at 657. Roy Creasy was the chapter 7 trustee in the case; thus, the name of the case differs from the subsequent actions. Id.
65. Id. at 658.
66. Id. at 659.
67. Id. at 662.
69. Id.
70. Id.
71. Id.
72. Id.; see also Shumate v. Patterson, 943 F.2d 362 (4th Cir. 1991). Shumate owned 96 percent of the voting stock and had the power to appoint and control the board of directors. Id. at 363.
could terminate the ERISA plan at any time prior to bankruptcy and receive his personal pension interest and also any excess funds not needed to satisfy the rights of other participants. On the motion to compel, the bankruptcy court, following Fourth Circuit precedent, ruled that the phrase applicable nonbankruptcy law referred to state law. The court then decided the case based on Virginia spendthrift trust law. Upon finding that the CFC pension plan complied with the state spendthrift law, the court turned its attention to public policy reasons for disallowing the exemption. The court looked specifically at the amount of control the debtor exercised over the fund’s assets. The court stated that the control test applies to ascertain the “power a beneficiary can exercise over a spendthrift trust.” The court viewed Shumate’s control over the trust as “inconsistent with the notion of [a] spendthrift trust” and ruled in favor of the chapter 7 trustee based on the control issue, denying Shumate’s claim that he lacked control of the fund. Thereafter, Shumate appealed the decision to the Fourth Circuit Court of Appeals.

The Fourth Circuit held that applicable nonbankruptcy law included ERISA plans. The Fourth Circuit reasoned that the plain language of section 541(c)(2) of the Bankruptcy Code did not limit the exclusion to state spendthrift law, but that the exclusion also applied to ERISA plans. Patterson attempted to dispute the Anderson v. Raine (In re Moore) decision to allow the exclusion as an exclusion based on state

73. Creasy, 83 B.R. at 405.
75. Creasy, 83 B.R. at 406.
76. Id.
77. Id.
78. Id.
79. Id. at 408.
80. Id.
81. Id. First, Patterson argued he did not control the plan because the provisions of a loan agreement with North Carolina National Bank Financial Services prohibited him from terminating the plan. Id. The loan agreement disallowed the payment of a dividend of greater than $50,000. Id. at 408 n.4. The court disagreed with Patterson, stressing that he still exercised control over the plan. Id. at 409. Second, Patterson argued that his control had been taken away from him by his individual and CFC’s corporate bankruptcy filings. Id. The court denied this argument by stating that the control at issue was the amount of control Patterson exerted over the plan prior to the filing of the bankruptcy petition. Id.
82. See Shumate v. Patterson, 943 F.2d 362 (4th Cir. 1991).
83. Id. at 364.
84. Id.
85. 907 F.2d 1476 (4th Cir. 1990).
spendthrift trust law or public policy and not ERISA. The Court disagreed with Patterson’s proposition, stating that Patterson had “misplaced his reliance on state spendthrift trust law.” Reasoning that control of the trust was irrelevant, the Court held that the only important facet of section 541(c)(2) was that section’s treatment of an ERISA plan. In reversing the trial court decision, the Fourth Circuit reasoned that in passing ERISA the legislature intended to protect worker’s benefits. Patterson then appealed the Fourth Circuit’s reversal to the Supreme Court.

VI. THE SUPREME COURT DECISION IN PATTERSON V. SHUMATE

The Supreme Court strictly interpreted section 541(c)(2), thus excluding Shumate’s ERISA qualified plan from his bankruptcy estate. It held that nothing in the statute suggested that the phrase applicable nonbankruptcy law applied only to state law. Additionally, the Court stated that “[t]he Code reveals, significantly, that Congress, when it desired to do so, knew how to restrict the scope of applicable [nonbankruptcy] law to ‘state law’ and did so with some frequency.” Thus, the Court concluded that the plain meaning of the statute constituted the manner in which Congress intended it to be used.

Having determined the plan was eligible for exclusion, the Court turned its attention to whether CFC’s ERISA plan complied with ERISA standards. The Court ruled that the ERISA plan met all the ERISA requirements, as well as those in the Internal Revenue Code.

Next, considering Patterson’s arguments concerning the legislative history of the statute, the Court determined there was no reason to refer to legislative history. Although the Court determined that the plain

86. Shumate, 943 F.2d at 364.
87. Id.
88. Id. at 365.
89. Id.
91. Id. at 2246.
92. Id.
93. Id.
94. Id. at 2246-47.
95. Id. at 2247.
96. Id. The Court discussed Article 16.1 of the Coleman Furniture Plan, which contained the anti-alienation provision. This fulfilled the requirement for a restriction on the transfer of a beneficial interest. Id.
97. Id. at 2248. “[T]he clarity of the statutory language at issue in this case obviates the need for any such inquiry.” Id. (citing Ron Pair Enters., Inc., 489 U.S. at 241; Davis v. Michigan Dep’t of Treasury, 489 U.S. 803, 809 n.3 (1989)). The Supreme Court stated that those circuit court decisions that had applied the term to only state spendthrift law were incorrect. Id. at 809 n.4.
meaning of the statute negated the need to inquire into legislative history, it discussed the effects of such an inquiry. Nonetheless, the Court decided that the legislative history was insufficient to override the clear language of the statute.

Patterson contended that the exclusion of the ERISA plan would frustrate the purpose of section 541(a)(1) of the Bankruptcy Code. The Court disagreed, commenting that allowing an exemption for the plan will guarantee a uniform treatment of pension benefits. Also, the Court was persuaded that creditors might force a debtor into involuntary bankruptcy. Further, for public policy reasons, the Court insisted it was very important to protect pension benefits. However, in so doing, the Court ignored any relationship between the exclusion of the plan from the estate and the control over the plan by the debtor. Because it ignored the amount of control that Shumate had over the plan, the Court failed to consider one of the more crucial factors which all the circuit courts had found relevant.

VII. ANALYSIS

Two factors are important in determining whether an ERISA pension plan should be excluded from the debtor's bankruptcy estate: the extent of the debtor's control over the ERISA pension plan; and the legislature's intended use of the language found in section 541(c)(2) of the Bankruptcy Code.

A. Extent of Debtor Control

1. Significance of Control

In Patterson, the Court made no reference to the control exerted by

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98. Id. The Court examined Senate and House reports and concluded that the meaning of applicable nonbankruptcy law did not include state spendthrift trusts. Id.
99. Id.
100. Id. at 2249. Patterson argued that construction of § 541(c)(2) to exclude ERISA plans from the bankruptcy estate would render § 522(d)(10)(E) superfluous. Id. Patterson based this argument upon the premise that an exemption in a pension plan would not require another exemption elsewhere in the Code. Id. The Court rejected this argument because, in its opinion, § 522(d)(10)(E) "exempts a broader category of interests" than § 541(c)(2). Id. In addition, Patterson contended that an ERISA exemption defeats the purpose of broad inclusion of assets as promulgated by the 1978 Bankruptcy Reform Act. Id. The Court rejected this argument. Id.
101. Id. at 2249-50 (citing Butner v. United States, 440 U.S. 48, 55 (1979)).
102. Id. at 2250. A creditor could strategically manipulate bankruptcy laws to gain access to otherwise inaccessible funds.
103. Id. The Court commented that "construing 'applicable nonbankruptcy law' to include federal law ensures that the security of a debtor's pension benefits will be governed by ERISA, and not left to the vagaries of state spendthrift trust law." Id.
the debtor over the ERISA plan. This was unusual because almost all of the court circuit courts addressed this issue, including those that allowed the exclusion.\textsuperscript{104} The extent of a debtor's control over an ERISA pension plan is significant because it distinguishes between plans being held for a beneficiary and those that are being used by a beneficiary as a glorified savings account.

The difference between plans controlled by a beneficiary and those that are merely held for a beneficiary cannot be over-emphasized. When an individual creates the ERISA plan, the opportunity exists for that person to effectively be both the settlor and the beneficiary of the ERISA plan. As a result, many of the restrictions that apply to the plan may not apply to the beneficiary.\textsuperscript{105} This is true because the employee with no control does not have the ability to terminate the plan like a debtor in control of an ERISA plan may. For a debtor in control, the plan effectively becomes a savings account with a penalty for early withdrawal. On the other hand, a plan created for an employee requires that an employee must terminate employment to gain access to the funds.\textsuperscript{106} Obviously, without a restriction greater than a ten percent penalty on such plans, the debtor who is also the settlor of the plan can circumvent the system by only satisfying ERISA on its face.

Clearly, the \textit{Patterson} ruling affects any debtor who has an interest in an ERISA qualified plan. However, when the plan is created by the person who has an interest in it, many differences emerge. The primary difference is that a debtor who controls the plan has little or no restrictions on their own actions with regard to the pension plan as opposed to a debtor who has no control, but only an interest in the plan. Therefore, a test should be applied to determine the extent of control over the plan.\textsuperscript{107}

2. Public Policy Concerns

The public policy concerns expressed in \textit{Patterson} fail to acknowledge the control issue, although the Court did express concern about the public policy behind creation of retirement plans. The Court recognized

\begin{itemize}
\item \textsuperscript{104} See \textit{In re Daniel}, 771 F.2d 1352, 1357 (9th Cir. 1985); \textit{In re Lichstrahl}, 750 F.2d 1488, 1490 (11th Cir. 1985); \textit{Goff} v. Taylor (\textit{In re Goff}), 706 F.2d 574, 588 (5th Cir. 1983). Cf. \textit{Velis} v. \textit{Kardanis (In re Velis)}, 949 F.2d 78, 82 (3d Cir. 1991); \textit{In re Moore}, 907 F.2d 1476, 1478 (4th Cir. 1990).
\item \textsuperscript{105} \textit{Goff}, 706 F.2d at 589. The court took special notice of the control the debtor had over the plan and ruled that a ten percent tax penalty for early withdrawal was significantly different from a case where an employee has little or no control over the plan. \textit{Id}.
\item \textsuperscript{106} \textit{Id}.
\item \textsuperscript{107} See \textit{infra} notes 116-24 and accompanying text.
\end{itemize}
the need to treat pension benefits in a uniform fashion in order to provide sound precedent for subsequent cases.108 Also, the Court cited prior cases to help establish the goal of ERISA.109 The problem with this analysis is that it ignores control and the failure of the debtor to use the plan for retirement purposes.

Often the debtor who controls the ERISA plan does not use the plan solely for retirement purposes. In fact, opinions from the circuit courts that disallowed the exclusion provide examples where debtors used the funds for other purposes.110 These examples illustrate the potential abuse of the system by crafty debtors. Thus, as the system currently operates, the debtor can effectively shield assets from creditors.

Shielding assets from creditors is a major concern when an individual files a petition in bankruptcy. The Eleventh Circuit voiced this concern in Lichstrahl when it stated that "there is . . . a strong public policy that will prevent any person from placing his property in what amounts to a revocable trust for his own benefit which would be exempt from the claims of his creditors."111 Thus, public policy demands that a test be implemented to determine control over the plan and whether or not it is being used for retirement purposes.

B. Legislative Intent

In Patterson, the Court rejected legislative intent and stated that a "broad definition of includable property for a policy underlying the Code" was a mistaken argument on Patterson's behalf.112 The Court added that "the clarity of the statutory language at issue in this case obviates the need for such inquiry."113 The problem, however, does not lie in the Court's statutory analysis. The problem is grounded in the language itself.

The House Report specifically referred to "spendthrift trust law."114

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109. Id. (citing Butner v. United States, 440 U.S. 48 (1978)).
110. See Velis v. Kardanis (In re Velis), 949 F.2d 78, 82 (3d Cir. 1991). The debtor used the money excluded by ERISA to purchase an apartment complex. Id. See also In re Daniel, 771 F.2d 1352 (9th Cir. 1985). The debtor had made a large unsecured loan to himself and a $39,000 contribution to the plan only two weeks prior to the filing of the bankruptcy petition. Id. at 1354, 1357. The contribution had the effect of reducing the value of the corporation's stock, thus shielding an asset from creditors. Id. See also Goff v. Taylor (In re Goff), 706 F.2d 574, 577 (5th Cir. 1983). The debtor made a contribution of $2,878 only three days prior to the filing of bankruptcy. Id.
111. In re Lichstrahl, 730 F.2d 1488 (11th Cir. 1985).
112. Patterson, 112 S. Ct. at 2249 (denying Patterson's contention that an exclusion would frustrate the purpose of § 541(a)(1)).
113. Id. at 2248.
This language, however, was not carried forward to section 541(c)(2) of the Bankruptcy Code. Therefore, it is difficult to determine if Congress truly intended for this statute to apply solely to state law or to all nonbankruptcy law. Thus, it is imperative that Congress reveal its true intent by either amending the statute or defining the phrase applicable nonbankruptcy law as it is used in section 541(c)(2).

VIII. Possible Solutions

A. Alternative Tests to Determine Extent of Debtor Control

A test to determine the extent of debtor control could provide a better determination of the excludability of an ERISA plan. Using a test may allow some portion of the plan to remain in the bankruptcy estate, while excluding other portions. This appears to be an appropriate vehicle for distinguishing between those plans that are controlled by individuals who are settlors of the plan and those created for employees who have no control over the plan funds.

A test could resemble the one used in In re Berndt. In that case, involving a debtor who was both the settlor and beneficiary of a trust, the court allowed an exclusion under section 541(c)(2) of the Bankruptcy Code for the employer-funded portion of the retirement plan, but disallowed the exclusion for the portion which represented the debtor's contributions. The court considered the debtor's contributions to be part of a savings plan rather than part of a retirement plan. The distinction was important because the employee contributions were withdrawable without penalty at any time as long as written notice was provided by the debtor. Under this test, a debtor's pension plan would be excluded as long as the debtor had no control over the plan until retirement. If the debtor could control his withdrawals prior to retirement, then they would be viewed as a savings plan, and would be non-excludable. This test would preserve funds intended for retirement purposes, while allowing creditors to receive a fair portion of the debtor's estate. Using this analysis, the Supreme Court could have ascertained Shumate's proper exclusion from the estate.

An alternative test was used in In re Wilson. The Wilson court...
used a two-pronged test to determine whether a trust should be declared a valid spendthrift trust and, therefore, excluded from the bankruptcy estate.\textsuperscript{121} Although this test clearly applies to spendthrift trusts, it could easily be implemented to determine whether an ERISA plan should be excluded from the debtor's estate. The first prong involved the evaluation of the objective intent of the settlor who created the trust.\textsuperscript{122} The court explained that three elements were necessary to confirm the validity of the creation of the trust: "a competent settlor and trustee, an ascertainable trust res, and certain beneficiaries."\textsuperscript{123} Where the settlor and the beneficiary are the same person, the trust would be invalid and, therefore, not excluded from the bankruptcy estate. Should the plan satisfy the first prong, then the court focuses on the second prong of the test, which evaluates the subjective intent of the settlor.\textsuperscript{124} To satisfy the second prong, the court would look to the settlor's subjective intent in creating the trust to determine if the settlor truly intended that the plan's interests not be transferred. Had the Supreme Court applied this test in \textit{Patterson}, where the settlor and the primary beneficiary of the plan were the same person, the Court might have disallowed some or all of the exclusions.

B. \textit{Statutory Language}

Congress should close the loophole it created in section 541(c)(2) of the Bankruptcy Code. Examination of the House Report indicates that Congress may have intended section 541(c)(2) to apply only to state spendthrift trusts.\textsuperscript{125} However, the language from the reports was not used in this statute. To clarify this situation, Congress could amend the statute to make it applicable only to state spendthrift trusts. Elimination of the \textit{applicable nonbankruptcy law} phrase and substitution of the phrase \textit{state spendthrift trust law} could accomplish this goal. By taking this action, Congress could thus reveal its true intent regarding the bankruptcy status of ERISA pension plans.

Congress could also amend the statute to implement automatically a test such as one of those discussed above. A distinction between the types of funds within the plan could then be used to validate or limit the

\begin{footnotesize}
\begin{enumerate}
\item[121.] \textit{Id.} at 442.
\item[122.] \textit{Id.}
\item[123.] \textit{Id.}
\item[124.] \textit{Id.}
\end{enumerate}
\end{footnotesize}
exclusion. Although this test appears burdensome, Congress has provided various limits in other areas of the law, such as the Internal Revenue Code. Such limits, if applied to this situation, could provide guidance to trustees and judges and possibly limit potential abuse by debtors.

The limits could also arguably deter a creditor from forcing a debtor into involuntary bankruptcy, a possible result of major concern to the Supreme Court. Legitimate contributions set aside for retirement purposes are inaccessible to creditors. In sum, congressional action would solve all of the problems discussed above and may, in fact, be necessary to close the loophole found in section 541(c)(2).

IX. CONCLUSION

ERISA was designed primarily to protect an employee's retirement benefits throughout the years the employee spent working. The Supreme Court recognizes that safeguarding retirement plan funds is essential to financial security. However, the Supreme Court should implement a test to determine the eligibility for exclusion of a retirement plan from the bankruptcy estate, or Congress should amend the statute to set limits on the exclusion. Otherwise, the system will be abused by individuals who use a retirement plan as a facade for shielding assets from creditors.

Although implementation of a test may require more in-depth examination of an ERISA pension plan, it would provide a more equitable system for creditors. ERISA and the Internal Revenue Code requirements were established to prevent employer indiscretion with regard to retirement plans. Both were also written to encourage employers to provide such plans for their employees. The abuse of an ERISA pension plan by an employee who is involved in a bankruptcy proceeding was not a consideration. Thus, it is imperative that the Supreme Court or Congress place limits on exclusions from a bankruptcy estate for ERISA pension plans.

Future employers, especially those who are self-employed, may look at the Patterson decision and develop their plan strictly to circumvent the ERISA requirements. Variances must be used to determine the qualifications of a retirement plan despite the Supreme Court's desire to treat all benefits uniformly. This is often a difficult task. Sometimes, in order to provide a fair and equitable answer, it is necessary to distinguish between
proper and improper items. The difficulty involved in instituting a test will be more than offset by the equity provided to creditors.

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