QUALIFIED RETIREMENT PLAN BENEFITS AND THE DEBTOR PARTICIPANT

in the Ninth Circuit in Light of the U.S. Supreme Court's Ruling in *Patterson v. Shumate*

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I. INTRODUCTION

The number of personal bankruptcies filed in the United States in the last few years has significantly increased.[2] This has brought a greater awareness of the plight of participants' benefits in retirement plans and of a perceived clash between the Bankruptcy Reform Act of 1978, as amended ("Bankruptcy Code" or the "Code"),[3] on the one hand, and the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and the Internal Revenue Code of 1986, as amended (the "IRC"), on the other. A recent decision by the United States Supreme Court[4] has substantially changed this landscape. In *Patterson v. Shumate*,[5] the High Court protects all benefits in plans subject to Title I of ERISA by finding them to be excluded from the bankruptcy estate. *Patterson* holds that ERISA qualifies as "applicable nonbankruptcy law" and, in so doing, bases its holding on the "plain meaning" of the relevant provisions in the Code and in ERISA. In fact, Justice Scalia, in a scathing concurring opinion, takes to task the Courts of Appeals (such as the Ninth Circuit) which have held pension benefits of debtors not to be protected under ERISA.[6]

Historically, however, the perceived ambiguity as to the meaning of "applicable nonbankruptcy law," and the perceived "clash" between the Bankruptcy Code and ERISA/IRC, have caused varying and irreconcilable treatment of the benefits in retirement plans when a participant in such a plan becomes a debtor. Ile differences in treatment have depended upon the state and, ultimately, the federal circuit in which the debtor resided. This result was always at odds with the goal of ERISA which, as expressed in the preemption provision,[7] is that the protection of participants' benefits be as strong and as uniform as possible. The scope of this article is to discuss the scope of the holding in *Patterson v. Shumate*,[8] to describe the state of the law in the Ninth Circuit Court of Appeals prior to Patterson, and the residual effect that prior law may have in light of Patterson.

This article focuses on the treatment of benefits in plans which are "qualified" under the IRC. A "qualified" plan is a retirement plan - generally, a defined benefit pension plan, profit sharing plan (including a cash or deferred arrangement or "401(k) plan"), money purchase pension plan, or stock bonus plan - which meets the requirements of IRC § 401(a) and, in turn, receives certain tax-favored treatment. The tax-favored treatment includes a deduction for the employer who makes contributions to the plan,[9] deferral of taxation on the earnings on plan investments, and deferral of taxation to participants on amounts held in the plan on their behalf.[10] Taxation to a participant is generally deferred until the time distribution is actually made to the participant.[11]

Most, but not all, qualified plans are also subject to Title I of ERISA. The main exceptions to ERISA coverage are for a qualified plan which covers only an individual and his spouse (who also own the business which sponsors the plan) and a qualified plan which covers only self-employed individuals.[12] (This distinction may be material to the application of the Bankruptcy Code to individual participants' benefits in qualified plans.) However, the lower courts have generally ignored this subissue (of whether a plan is covered by the IRC and Title I of ERISA or only by the IRC) in discussing the broader issue of whether the benefits are includible in the participant/debtor's bankruptcy estate. Unfortunately, this issue also is not discussed in *Patterson*.

Both ERISA and the IRC contain a section which requires every retirement plan covered by their respective requirements to include a provision which prohibits assignment or alienation of a participant's benefit under the plan.[13] The provision in the IRC, moreover, conditions a plan's income tax qualification on the inclusion of such a provision.[14] Furthermore, in addition to meeting the qualification requirements as it is written, a plan must actually be administered in accordance with this provision (and all other "qualification requirements") in order to retain its tax-favored status. If a plan does not comply with this "anti-alienation" requirement in the IRC, it could be disqualified by the Internal Revenue Service (the "IRS"). Therefore, paying over a participant's benefit to a bankruptcy trustee may disqualify a plan. In fact, the IRS has stated that a plan is subject to disqualification if it pays over a participant's benefits to a bankruptcy trustee (pursuant to a court order or otherwise) because such payment violates the anti-alienation requirement of IRC § 401(a)(13).[15]

In addition to the "anti-alienation" provision, ERISA also includes a preemption provision.[16] This preemption provision provides generally that Title I of ERISA, which includes the anti-alienation provision, "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan. . . . [17] The IRC does not contain a parallel provision.

Section 541 (a) of the Bankruptcy Code provides generally that the bankruptcy estate of a debtor includes all legal and equitable interests of the debtor in property "wherever located and by whomever held." In the retirement plan context, where the participant is the debtor, this broad language is expansive enough to capture an individual's retirement benefits unless they are otherwise excluded or exempted from the bankruptcy estate.

To the bankruptcy law specialist, the system of exclusions and exemptions is well known. The general ground rules are set forth here for the nonspecialist who may read this article. Section 541(c)(2) *excludes* from the bankruptcy estate, so that it never becomes part of the estate in the first place, any property which is subject to "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under *applicable nonbankruptcy law*. . . ." [Emphasis added.]

Section 522(b) sets out two alternate provisions which will *exempt* property from the bankruptcy estate. For this purpose, the property is initially included as part of the bankruptcy estate and then, if it comes within the exemption applicable to the debtor, and the debtor elects to exempt the property, it is exempted from the estate. The first alternative exemption is set out in section 522(b)(1). This section exempts property listed in section 522(d) unless the debtor's domicile state has "opted out" of this provision by enactment of a statute to that effect, so that the debtor does not have this option.[18] Most states have opted out of this Statutory Federal Law Exemption, including five of the eight states in the Ninth Circuit.[19]

The second alternative exemption is set out in section 522(b)(2)(A).[20] This section states that it exempts from the estate any property which is exempt under federal law (other than the Statutory Federal Law Exemption as provided in section 522(b)(1)) or under any state or local law.[21]

Thus, reading them straightforwardly, these three sections of the Bankruptcy Code together provide that a debtor's benefit in his qualified plan(s) could be (1) excluded from the estate if ERISA and the IRC are "applicable nonbankruptcy law" under section 541(c)(2); or (2) exempted from the estate "to the extent reasonably necessary" for his/her support and that of any dependent under (i) section 522(b)(1) (if the debtor is in a state which has not opted out of this provision, such as Arizona, Hawaii, or Washington) or (ii) section 522(b)(2)(A) (if the debtor either elects this alternative or lives in a state which has opted out of the section 522(b)(1) alternative) if the state has a statute which is intended to protect the plan or if the ERISA/IRC anti-alienation provision were found to be a section 522(b)(2)(A) "other Federal law."

However, the application by the lower courts over the years has proven to be more difficult than the analysis. The cases discussed in this article, and nearly all other cases treating this issue, arose when a trustee in bankruptcy objected to a debtor's claim of exclusion or exemption for his pension benefits from his bankruptcy estate. Because the U.S. Supreme Court granted *certiorari* to resolve a conflict among the circuits,[22] and because the Court discusses this conflict extensively in arriving at its decision, we will discuss the state of the law in the Ninth Circuit before analyzing the U.S. Supreme Court decision in Patterson.

II. NINTH CIRCUIT CASES PRIOR TO PATTERSON V. SHUMATE

A. IN RE DANIEL

The seminal case in the Ninth Circuit on this subject was *In re Daniel*.[23] The debtor in *Daniel* was a physician, resident in California. He was the sole shareholder and director of his medical corporation, which sponsored a qualified profit-sharing plan. There were four participants in the plan. Although not made explicit in the case, it appears that most of the assets in the plan were allocated for Dr. Daniel's benefit, and the other participants were probably all rank-and-file employees of the corporation.

In 1981, 10 years after the plan was established, Dr. Daniel borrowed $75,000 from the plan under its participant loan provision. This represented over half the plan's assets. The purpose of the loan was to purchase a home. The original promissory note required repayment of the entire loan on May 20, 1982, but when the loan became due, Dr. Daniel extended the loan and amended the note to require annual repayment of interest only, with the first installment due May 20, 1983, and the principal due May 20, 1987.

Shortly thereafter, he designated himself as the sole trustee of the plan. Then, on September 20, 1982, the corporation contributed $39,000 to the plan - the largest contribution made to the plan in its 13-year history. In addition, all previous contributions to the plan had been made only at or near March 3 1, the fiscal year end. The court found that this contribution was not based on profits, because none could be calculated for the year in mid-year. This contribution comprised all the corporation's available cash. Approximately two weeks after making this contribution to the plan, Dr. Daniel filed for bankruptcy.[24]

Dr. Daniel argued on appeal[25] that his benefits under the plan were, alternatively, (i) excluded from the estate under section 541(c)(2) because the anti-alienation provisions in ERISA and the IRC were restrictions on alienation enforceable under "applicable nonbankruptcy law" or (ii) exempt from the estate under California Code of Civil Procedure ("CCP") § 690.18(d)[26] pursuant to section 522(b)(2)(A).[27]

The Court found that Dr. Daniel's plan benefits were neither excluded from the estate under section 541(c)(2) nor exempt under section 522(b)(2)(A). In finding that the benefits were not excluded from the estate, the court relied upon a leading case from the Fifth Circuit, *In re Goff*.[28] Although the reference in section 541(c)(2) to "applicable nonbankruptcy law" appears unambiguous on its face, the *Goff* court looked to the legislative history of that section[29] to find that Congress intended that language to refer only to traditional state spendthrift trust law.[30]

The Ninth Circuit in Daniel adopted this reasoning and held that:

> Congress never intended for the ERISA and IRC anti-alienation provisions to create exemptions or exclusions for pension plans under either the federal nonbankruptcy exemptions of 11 U.S.C. 522(b)(2)(A) or the non-bankruptcy exclusions of 11 U.S.C. 541(c)(2).[31]

Thus, in the Ninth Circuit under Daniel, despite the apparently clear language of the Bankruptcy Code, ERISA and the IRC anti-alienation provisions have *not* been counted as "applicable nonbankruptcy law" under section 541(c)(2) nor "other federal law" under section 522(b)(2)(A).

The court in *Daniel* further found that Dr. Daniel's plan benefits were not exempt under section 522(b)(2)(A) under the applicable California statute.[32] Specifically, the court found that the profit- sharing plan was not "used for retirement purposes" as the court found was required by the California statute. It came to this conclusion by finding Dr. Daniel's use of the plan to be abusive: his borrowing such a large amount of the assets with no repayments made as of the date he filed for bankruptcy, the extension of the loan at its original due date, and the "stuffing" of the plan with a large contribution of all the corporation's ready cash immediately before filing for bankruptcy.[33] Accordingly, Dr. Daniel's retirement benefits were included in full in his bankruptcy estate.

B. IN RE BLOOM

In 1988, the Ninth Circuit again considered some of these same issues in another California case. *In re Bloom*,[34] like *Daniel*, involved a physician. In *Bloom*, the debtor was a 50 percent owner of a medical corporation. Another physician owned the other 50 percent. The corporation sponsored two qualified retirement plans, a pension plan and a profit-sharing plan. The two physicians were the sole trustees for the plans. The decision does not indicate whether there were other participants in the plans.

Dr. Bloom, the debtor, began borrowing money from her plan accounts almost immediately after the plans were established. Between 1978 and 1982, when she filed for bankruptcy, she had borrowed more than 63 percent of her total account balances. The court stated that Dr. Bloom did not pledge any security for the loans.[35]

Dr. Bloom, unlike Dr. Daniel, did make some attempt to repay her loans. She made annual payments equal to the accrued interest on the principal. The court also found that Dr. Bloom was charged a "reasonable rate" of interest on the loans,[36] and that she followed the procedures set out in the trust agreement for participant loans. Finally, in distinguishing the facts from those in Daniel, the court noted that Dr. Bloom did not make a large, unscheduled contribution to the plans immediately before filing for bankruptcy.[37]

In finding in favor of Dr. Bloom and against the trustee in bankruptcy, the court considered the case only as a section 522(b)(2)(A) exemption case. As it had in *Daniel*, the court held that the only relevant inquiry under that section was under the California statute;[38] the anti-alienation provisions of ERISA and the IRC were not considered as possible bases of exemption under this section.[39] Importantly, the court extended the restriction in the California statute explicitly applicable to profit-sharing plans to all retirement plans: that is, after *Bloom*, to qualify for this state statutory exemption under section 522(b)(2)(A), any retirement plan must be "designed and used for retirement purposes. " [40]

C. IN RE KINCAID

The next major pronouncement of the court came two years later in *In re Kincaid*.[41] The benefits under consideration in *Kincaid* were held under a plan quite different from those in the previous two cases in one important respect. The plan was a cash or deferred arrangement, popularly known as a "401(k) plan" (which is a special type of profit-sharing plan in which an employer contributes money on a pretax basis), but it was sponsored by the John Hancock Mutual Life Insurance Company.[42] Therefore, the plan sponsor was not a small professional corporation, but a very large, national employer. Ms. Kincaid was a rank-and-file employee of John Hancock who was still employed at the time she filed for bankruptcy.[43] The plan provided that participants could take out loans from the plan, similar to the plan in *Daniel* and *Bloom*. The granting of any loan under the plan, however, was within the discretion of the plan administrator.[44] It appears that Ms. Kincaid had not taken out any loans from the plan at the time she filed for bankruptcy.[45]

The plan also provided that participants who qualified could take "hardship withdrawals" from the plan, which also were granted within the discretion of the plan administrator.[46] At the time she filed for bankruptcy, Ms. Kincaid had not taken any hardship withdrawals from the plan, At the request of the bankruptcy trustee, Ms. Kincaid applied for a hardship withdrawal. However, the plan administrator denied her application for withdrawal.[47]

In *Kincaid*, the court's holding was also on a different basis than it was in the previous two cases. Here, the Ninth Circuit held that Ms. Kincaid's benefits in the 401 (k) plan were *excluded* from her bankruptcy estate under section 541 (c)(2) as a traditional state law spendthrift trust under Oregon law.[48] The court, relying on *Daniel*, reiterated that the retirement plan benefits could not be excluded from the estate on the basis of the anti-alienation provisions in ERISA and the IRC being "applicable nonbankruptcy law" under section 541(c)(2).[49]

In finding Ms. Kincaid's benefits to be excluded under state spendthrift trust law, the court focused on the amount of "dominion and control" which Ms. Kincaid exercised over the plan which held her benefits.[50] The court found that the mere fact that the plan provided for participant loans and hardship distributions or that the participant/debtor would become eligible for a distribution by terminating employment with John Hancock was not "sufficient by itself to destroy the spendthrift character of the trust."[51] Ms. Kincaid's interest in the retirement trust assets was not "self- settled" because she did not personally have "dominion and control" over her benefits in the plan of this large employer, a fact which was demonstrated even more forcefully by the denial of her application for a hardship distribution.

For the first time, the Ninth Circuit addressed the issue of whether a state law exclusion might be preempted by ERISA.[52] Unfortunately, the court's discussion of this issue is conclusory and cursory, [53] and of little value as legal analysis. However, it was noteworthy for future cases that the issue had been raised in the Ninth Circuit. Moreover, based on the concurring opinion in *Kincaid*, discussed below, the preemption issue was ripe for further development in the Ninth Circuit after *Kincaid*.

Judge Fletcher, in an opinion concurring with the holding of the majority,[54] argued that the court should retreat from its holding in *Daniel* as being erroneously decided. In her opinion, Judge Fletcher reviewed both U.S. Supreme Court and other federal circuit court cases decided subsequent to *Daniel*, as well as the purpose and statutory scheme of ERISA. Judge Fletcher persuasively argued that ERISA/IRC and the Bankruptcy Code do not necessarily clash, but that it was the faulty reasoning in *Daniel* which set up the conflict.

D. IN RE CHENG

In re Cheng[55] took another step along the path being developed by the Ninth Circuit. With *Cheng*, the facts again are familiar from the likes of *Daniel* and *Bloom*. The case arose in California, and the debtor, Dr. Cheng, was the sole shareholder, director, and CEO of his medical corporation, which sponsored two qualified retirement plans. (The types of plans are not specified, but knowing the types of plans is not material to understand the Ninth Circuit Court of Appeals' holding.)

In the bankruptcy court, Dr. Cheng had argued that his plan benefits were exempted under the California exemption statute[56] pursuant to section 522(b)(2)(A). In following the *Bloom* holding, the bankruptcy court found (and the district court affirmed) that Dr. Cheng's plan had been designed and used for retirement purposes. However, the California statute exempts in full benefits in retirement plans sponsored by "corporations," but exempts benefits in plans sponsored by the self- employed (that is, sole proprietors or partnerships) only "to the extent necessary to provide for the support of the ... debtor and for the support of the spouse and dependents of the ... debtor ... when the ... debtor retires."[57] The bankruptcy judge held, and the district court affirmed, that Dr. Cheng's benefits were subject to this restriction notwithstanding the fact that his plan was sponsored by a corporation, because it was only a one-person corporation and therefore tantamount for this purpose to retirement plans sponsored by self-employed persons.[58] The lower courts went on to hold that none of the plan benefits was needed for Dr. Cheng's and his dependents' support in retirement and, therefore, that all of the benefits were to be included in his bankruptcy estate.[59]

The only issue to be decided by the circuit court was whether Dr. Cheng's plan, sponsored by a corporation, was nonetheless subject to the "only to the extent necessary" restriction applicable to the plans of the self-employed under the California statute.[60] The court acknowledged that this issue had not been raised in *Bloom*.[61]

The bankruptcy trustee argued that the restriction should be applicable since Dr. Cheng, although incorporated, had as a one-person corporation the same amount of dominion and control over his plan that a sole proprietor or partner would have over its retirement plan.[62] The Ninth Circuit Court did not agree. It held that "a corporation is a corporation is a corporation."[63] The court appeared to apply a different standard of statutory construction here than it did in *Daniel*. The court in *Cheng* noted that the legislative history of California Code of Civil Procedure § 704.115 indicates that the policy behind the restrictive language in subsection (e) was to limit the exemption for plans controlled by one person. But it refused to look beyond the words of a statute unambiguous on its face:

> [T]he statute [CCP § 704-1151 says what it says, and it was improper for the bankruptcy court to read beyond it. If the California legislature intended to treat closely held corporations differently than large corporations, it could have done so explicitly.[64]

The court indicated that it was uncomfortable in having to find that "one-person medical corporations are treated the same as General Motors"[65] because it created the possibility for abuse, but it refused to rewrite the legislation. The court noted further that it refused to "open the floodgates of litigation" which would follow, if it held for the bankruptcy trustee in this case, because of the need to then determine when a corporation becomes a "real" corporation - with two shareholders? three? four? Thus, the court which in *Daniel* had consulted legislative history to interpret an arguably unambiguous statute enacted by Congress (i.e., section 541(c)(2)) refused in *Cheng* to do the same thing to a statute enacted by the California legislature.

The court's opinion in *Cheng* that "a corporate plan is a corporate plan" regardless of the size of the corporation is based on the very narrow issue of whether California Code of Civil Procedure § 704.115(e) applies to a one-person corporation. However, the underlying theme of the court's opinion is that, regardless of the fact that the sole shareholder in a one-person corporation may in fact have as much control over a qualified plan as does a partner or a sole proprietor, the existence of the corporation is enough to treat the corporate plan differently from the way a plan sponsored by a partnership or a sole proprietor is treated. This premise would appear to be broad enough to extend the logic of the court's holding to not permit treating the plan sponsored by a one-person corporation differently from a plan sponsored by a large corporation for any purpose in the bankruptcy context. That is, even though the sole shareholder in a one-person corporation has unlimited ability to amend his or her plan (within the bounds of ERISA and the IRC) to permit in- service distributions[66] and participant loans, the court may have directed its path to rule next that this is not enough to cause the plan to be treated other than as a corporate plan not subject to the "dominion and control" to which a plan sponsored by a partnership or sole proprietorship is subject. This, however, remains to be seen: The court has hinted at such an expansion of its reasoning in a case decided subsequent to *Cheng*.

E. PITRAT V. GARLIKOV AND IN RE REED

In fact, the Ninth Circuit spoke on these issues at least twice subsequent to *Cheng* and before *Patterson* was decided. Both *Pitrat v. Garlikov*[67] and *In re Reed*[68] arose in Arizona. Both cases involved the Arizona statute intended to exempt a debtor's qualified retirement plan benefits from his or her bankruptcy estate.[69]

In contrast to its earlier cases as cited above, the Ninth Circuit in these two latter cases for the first time discussed preemption at length. In both *Pitrat* and *Reed*, the court found that the Arizona statute was preempted by ERISA and, therefore, could not form the basis in either case for the debtors to exempt qualified plan benefits from their respective bankruptcy estates.[70] The court also discussed in each case the other major issues treated in the earlier cases. While the court's treatment of most of the issues arising throughout these cases is consistent, it is not consistent - nor necessarily correct based on ERISA - in regard to the preemption issue.[71]

Pitrat actually involved two separate debtors whose cases were consolidated solely to determine the treatment of their respective pension plans: Ronald and Reda Garlikov on the one hand and James Flindall on the other.

Five plans were involved: two for the Garlikovs and three for Flindall. The facts for both debtors are similar, although it is impossible to tell in at least one important aspect whether they are identical, based on what the court relates as the factual basis for its conclusion. Of the five plans, the court tells us the number of participants in only one; one of the Garlikov's plans had six participants[72] (this is a material fact as to the application of ERISA preemption, as noted above).[73]

The court relied on *Daniel* [74] which it specifically refused to reverse, in holding that the anti-alienation provisions of ERISA and the IRC are not "applicable nonbankruptcy law" under section 541(c)(2)[75] and do not qualify as federal law exemptions under section 522(b)(2)(A).[76]

Furthermore, the court found that the Arizona statute did not protect the debtors' plans under section 522(b)(2)(A) as a state law exemption because it was necessarily preempted by ERISA.[77] One problem with the holding is that the facts as related in the case do not reveal whether the ERISA preemption provision[78] is applicable to four of the five plans. For the one plan with six participants, ERISA preemption would apply, since the plan would be subject to Title I[79]; but if, for example, the other four plans had only the business owners as participants, preemption would be inapplicable to those plans,[80] and they should be protected from the bankruptcy estates under the Arizona exemption statute. However, as noted, the court ignored this issue, and found that ERISA preempted the Arizona statute for all five plans.

The most interesting developments in *Pitrat*, however, arose in the court's discussion of spendthrift trust law. First, the court here appeared to expand its reasoning in Cheng, as discussed above, although it did not cite *Cheng*.

The court initially presented the facts of the case as follows: There were five separate plan sponsors. The debtors were either sole shareholders or 50 percent shareholders of all five plan sponsors. The debtors were sole trustees of their respective plans; each had substantial benefits in the plans; and each had at least one outstanding participant loan from one or more of his respective plans.[81] The court then noted that the parties neglected to include the plan documents themselves as part of the court record, so that the terms of the plans are not part of that record.[82]

After a lengthy discussion about the effect of *Kincaid*[83] on the definition of "selfsettled" trust,[84] the Ninth Circuit Court vacated the lower court's ruling that the plans were not spendthrift trusts and remanded the case for further development of the record.[85] The court found this necessary in order to be able to determine the debtors' "dominion and control" over their respective plans. Thus, a prerequisite of the holding was that being sole trustee, sole shareholder and a participant with substantial benefits and one or more outstanding loans is *not* sufficient to cause a qualified retirement trust to be self-settled. The court did point out, of course, that the provisions of such a plan must be more restrictive than those in plans such as that in *Kincaid*,[86] where the sponsor of the plan was a large employer, and the debtor had no dominion and control whatsoever over the plan.[87] In other words, for example, where the debtor is sole trustee of the plan and sole shareholder of the sponsor, the plan almost certainly could not provide for in-service distributions.[88]

The second interesting point made by the court in *Pitrat* is in a footnote. As discussed earlier in this article,[89] the Ninth Circuit has consistently held that qualified plan benefits cannot be excluded from the bankruptcy estate on the basis of the anti-alienation provisions in ERISA and the IRC because these are not "applicable nonbankruptcy law" under section 541 (c)(2), and that they cannot be exempted under the federal law exemption under section 522(b)(2)(A). Moreover, it has consistently gone on to hold that state spendthrift trust law may be a basis for exclusion of the benefits under section 541(c)(2), as noted throughout this article. In *Pitrat*, however, the court stated in a footnote:

> None of the parties claim [sic] that ERISA preempts Arizona spendthrift trust law. We express no opinion on this question.[90]

As noted above, this issue has been raised only once in the Ninth Circuit, and the court dealt with it peremptorily there in *dicta*.[91] The fact that the court went to the effort to raise this issue on its own volition may indicate that the court was seeking an appropriate case to more fully consider whether state spendthrift trust law is preempted by ERISA. The short discussion in *Kincaid* gave some slight indication that the court believed it not to be preempted. It would have been helpful to bankruptcy and ERISA counsel alike, and their clients, to have this issue openly discussed. To ERISA attorneys it appeared since the court's pronouncement in *Daniel* (that "applicable nonbankruptcy law" means only state spendthrift trust law) that ERISA would seem necessarily to preempt that state common law just as it does the state statutes discussed in the cases above. (However, such a ruling would have left debtors in the Ninth Circuit in a worse position than the one in which they found themselves prior to *Patterson v. Shumate.* It seemed unlikely the court would have put itself in a position of being required to rule that pension benefits were not protected in any situation. Thus, looking back, it seems unlikely that the court would have ruled state spendthrift trust law to be preempted (perhaps it could have found such non-preemption on the basis that state spendthrift trust law does not "relate" to ERISA).)

In re Reed[92] is the second of the two cases decided by the Ninth Circuit after *Cheng*.[93] The Reed court held on all counts along the same lines the Ninth Circuit has held in all the cases previously discussed in this article except *Cheng*. It upheld *Daniel*[94] in holding that ERISA and the IRC anti- alienation provisions are not "applicable nonbankruptcy law" under section 541(c)(2) and do not qualify as a federal law exemption under section522(b)(2)(A).[95]

The court also held that Dr. Reed's plan did not qualify as a spendthrift trust, and so was not excluded from the bankruptcy estate on that basis under section 541(c)(2).[96] The court based its opinion here on the following facts: Dr. Reed was the sole participant in the plan and the plan's sole trustee[97]; he was also the sole shareholder of the sponsoring employer and had an outstanding loan from the plan at the time he filed bankruptcy.[98]

What is surprising in *Reed* is that the court, based on the facts iterated above, held that Dr. Reed's plan was also not protected under A.R.S. § 33-1126(B) [99] on the ground that ERISA preempted that statute. This holding is inconsistent with the result in *Cheng*. The actual holding in *Cheng* was on the very narrow point of whether a one-person corporation was to be treated under the California statute as a corporate plan or a selfemployed plan. But the court was explicit in its holding that a corporate plan is a corporate plan for all purposes. The court violated that conclusion at least in spirit when it stated:

> Reed, as the sole shareholder of his professional corporation, *is actually self-employed* and in fact exercises unrestricted control over the funds.[100]

Of course, the issue of preemption was never raised in *Cheng*.

And it should never have been raised in *Reed*. Dr. Reed's plan was not subject to Title I of ERISA and, therefore, not covered by the preemption provision in Title I.[101] Accordingly, Dr. Reed's plan benefit should have been excluded from the bankruptcy estate based on the Arizona statute.

F. SUMMATION OF NINTH CIRCUIT HOLDINGS

In conclusion, the Ninth Circuit's path from 1985 to 1992 was somewhat tortured. The concurring opinion in *Kincaid*, taken together with the analysis in *Cheng*, seemed to indicate that the Ninth Circuit could have been amenable, in the appropriate case, to back away from its holding in *Daniel*. Thus, it appeared possible that the Ninth Circuit could have been ready to hold that the ERISA and IRC anti-alienation provisions were "applicable nonbankruptcy law" pursuant to section 541(c)(2) - or at least "other federal law" under section 522(b)(2)(A). Either way, qualified plan benefits of bankrupt participants would have been protected as contemplated by ERISA, uniformly at least in the Ninth Circuit, and available to provide for the time when those participants currently in bankruptcy would retire. Moreover, under such rulings, administrators of qualified plans would not have continued to be put in the untenable position of having to choose between (i) having the plan disqualified if it paid over a participant's benefit to the trustee in bankruptcy and (ii) being found in contempt of court for refusing to comply with a bankruptcy court's order to pay over the benefit to the bankruptcy trustee in contravention of the anti-alienation provisions in ERISA and the IRC.

However, the Ninth Circuit did not take that route. The decisions in *Pitrat* and *Reed* exhibit the court's refusal to back away from its holding in *Daniel*, and its continued confusion over the preemption issue.

Thus, the Ninth Circuit held firm in its position that the anti-alienation provisions in ERISA and the IRC did not qualify as applicable nonbankruptcy law, and was joined in that conclusion by at least three other circuits.[102] On the other hand, four different circuit courts had interpreted the phrase "applicable nonbankruptcy law" in section 541(c)(2) to include the ERISA and IRC anti-alienation provisions, so that debtors' qualified plan benefits were always excluded from their bankruptcy estates.[103]

III. PATTERSON V. SHUMATE

In view of this deep split among the Circuits, the U.S. Supreme Court granted *certiorari* to a case from the Fourth Circuit Court of Appeals. *Shumate v. Patterson*[104] held that the anti-alienation provisions in ERISA and the IRC constitute "applicable nonbankruptcy law" under section 541(c)(2) so that debtor Shumate's qualified plan benefits were excluded from his bankruptcy estate.[105]

The U.S. Supreme Court affirmed the Fourth Circuit.[106] In a unanimous decision, the Supreme Court held that the retirement benefits of Mr. Shumate in the pension plan sponsored by his employer were excluded from his bankruptcy estate under section 541(c)(2) because ERISA is "applicable nonbankruptcy law" under that section, and ERISA section 206(d) (the "anti-alienation" provision) is a "restriction on the transfer" of the participant's benefit in the pension plan and that restriction is "enforceable" under ERISA.[107]

The High Court based its decision on the "plain reading" and "clarity" of the provisions of section 541 (c)(2). The Supreme Court justices clearly were mystified by the reasoning of those courts of appeal which had restricted "applicable nonbankruptcy law" to mean only state spendthrift trust law.[108] And, in a concurring opinion, Justice Scalia had scathing words for the legal abilities of those lower courts.[109]

In the wake of *Patterson*, it is tempting to say that participants' benefits in *all* qualified employee pension plans are protected from the participants' bankruptcy estates when participants file for bankruptcy protection. Unfortunately, the holding in *Patterson* may not be this broad.

As discussed above,[110] the holding on its face - that the anti-alienation provision is applicable nonbankruptcy law - appears to apply only in construing ERISA § 206(d)(1), and not to apply in construing IRC § 401(a)(13). The Court states as follows:

> *Held:* The plain language of the Bankruptcy Code and ERISA establishes that an anti-alienation provision in a qualified pension plan constitutes a restriction on transfer enforceable under "applicable nonbankruptcy law" for purposes of § 541(c)(2).[111]

Because this holding explicitly mentions only ERISA and not the IRC *per se*, the narrow reading of the meaning of *Patterson* is that it applies only to plans which are subject to Title I of ERISA.[112] This reading would mean that the benefits of participants in all employee benefit pension plans would be protected under *Patterson* when they filed for bankruptcy unless they were either (i) sole proprietors or partners in a plan which covered only such self-employed persons or (ii) owners of an incorporated business which sponsored a plan which covered only those owners.

Thus, if this narrow reading is given to *Patterson*, it is the qualified plans of many small businesses which would not be protected. Where would these plan participants be left, then, under this interpretation of the High Court's only decision to date on this issue?

These small-employer plans would then either be subject to possible exemption under "other federal law" (in states which have not opted out of the Statutory Federal Law Exemption) or under state law (when either the participant/debtor is domiciled in a state which has opted out or chooses the state law exemptions).[113]

In California (and other opt-out states in the Ninth Circuit) then, the participant/debtor would be left with whatever protection he or she may find under state law or "other Federal law." In California, for plans not covered under Title I of ERISA, state law[114] appears, under *Cheng*,[115] most favorable for plans sponsored by corporations. It is significant, however, that in *Reed*,[116] the Ninth Circuit held that ERISA preempted Arizona state law. This holding is incorrect, if the reported facts are correct that the debtor in Reed was the sole participant in the plan since, in that event, the plan was not subject to Title I; as a result, as discussed above,[117] the plan is not subject to the preemption provision contained in Title I. Thus, the authors would argue that the result in *Cheng* is the correct one, where a non-Title I plan may rely on state law.

Whether ERISA or the IRC constitutes "other Federal law" under section 522(b)(2)(A) is left open by the court in *Patterson* since the point was moot for Mr. Shumate.[118] However, given the High Court's unanimous, broad support for protection of pension plan benefits,[119] it seems likely that this Court would hold that ERISA and the IRC on their face constitute "other Federal law" as that term is used in section 522(b)(2)(A).

It is also important to note that, in Ninth Circuit states which have not opted out of the Statutory Federal Law Exemption, *Patterson* leaves open at least two issues under section 522(b)(1): (i) whether the benefit of a participant/debtor may be exempted at all under the provision in section 522(d)(10)(E); and (ii) if so, whether the exemption is limited to distributions which a participant/debtor has an immediate right to receive, as opposed to the entire benefit held in the plan for the participant.[120] Note that, in any event, this exemption applies only to the extent that the benefit is "reasonably necessary for the support of the debtor" and his dependents.[121] This issue could become important in a state in which there is no protection under state law or where state law protection is more limited than the federal provision (for example, under the California statute, plans must be found to be designed for retirement purposes).[122]

Patterson does support a broader reading than the one set out above.[123] Although the holding itself does not specifically mention the IRC or IRC § 401(a)(13), [124] the holding does state that "**an** anti-alienation provision in a ***qualified*** pension plan constitutes a restriction on transfer enforceable under 'applicable nonbankruptcy law' for purposes of § 541(c)(2)."[125] Pension plans are "qualified" under the IRC, not under ERISA, and IRC § 401(a)(13) contains the identical anti-alienation provision found in ERISA § 206(d)(1). Accordingly, this statement in the holding is best interpreted, even on its face alone, to mean that the benefits of debtors in *all* employee benefit pension plans which are qualified under the IRC, whether or not they are also subject to Title I of ERISA, are excluded from a participant's bankruptcy estate.

Moreover, throughout the decision, the Court uses the term "ERISA-qualified";[126] although the Court does not define this term, and it is not a term used in either ERISA or the IRC, it is reasonable to interpret the Court's meaning to include plans which are covered under ERISA and the IRC, as well as those which are qualified under the IRC but are not subject to Title I of ERISA. This interpretation gives the term a meaning consistent with ERISA and the IRC, whereas giving the term the meaning that a plan is “qualified” under ERISA does not.

In addition, the Court cites IRC § 401(a)(13), noting that it contains "similar restrictions" to those in ERISA § 206(d)(1). [127] Furthermore, after discussing the "plain language " [129] and "natural reading" [129] of ERISA § 206(d)(1) and Bankruptcy Code § 541(c)(2), the court goes on to say,

> The text of § 541(c)(2) does not support petitioner's contention that "applicable nonbankruptcy law" is limited to state law. Plainly read, the provision encompasses **any relevant nonbankruptcy law, including federal *law such as* ERISA**.[130]

While this is *dicta*, and does not constitute precedent, when coupled with the Court's clear, strong support of the policy of protecting retirement benefits and having a uniform treatment of them, it is reasonable to interpret Patterson to mean that the Court did not intend to limit the protection of pension benefits to only ERISA-covered plans.

For example, the Court notes that its decision in *Patterson* "ensures that the treatment of pension benefits will not vary based on the beneficiary's bankruptcy status"[131] and that it gives "full and appropriate effect to ERISA's goal of protecting pension benefits.[132] The Court states, in addition, that its holding "furthers another important policy underlying ERISA: uniform national treatment of pension benefits."[133]

The IRC anti-alienation provision in section 401 (a)(1 3) is substantially similar to that contained in ERISA § 206(d)(1). Moreover the Court in *Patterson* made strong statements concerning statutory construction and uniform treatment of pension benefits. In light of these facts, and the *dicta* noted above, it is so unlikely as to be tantamount to impossibility that the Supreme Court would find, were a case to be presented to it, that the benefits of a participant in a qualified plan (which therefore would contain the anti-alienation provision in IRC § 401(a)(13)) were not excluded under section 541(c)(2) because the plan under which the benefits were held was not subject to ERISA Title I. Such a negative result would turn the Court's appeal for an "agreed-upon methodology for creating and interpreting text"[134] into parody because, under the Court's construction, it appears impossible to interpret the phrase "applicable nonbankruptcy law" in section 541(c)(2) to exclude IRC § 401(a)(13) since that phrase has been interpreted in *Patterson* to include the parallel provision in ERISA § 206(d)(1). It therefore remains to be seen whether the symbol of our profession will continue to be the scales, or will become the see-saw, as Justice Scalia characterized it.

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[2] Kurtzman, *Bankruptcy Courts Are Mired in the ERISA Quicksand*, 18 BNA PENSION REP. 804 n.2 (May 6, 1991).

[3] Unless otherwise stated, all statutory references are to the U.S. Bankruptcy Code.

[4] Patterson v. Shumate, ___ U.S. ___, 112 S. Ct. 2242 (1992) (reh'g. denied).

[5] *Id*.

[6] Justice Scalia states:

> When the phrase "applicable nonbankruptcy law" is considered in isolation, the phenomenon that three Courts of Appeals could have thought it a synonym for "state law" is mystifying. When the phrase is considered together with the rest of the Bankruptcy Code (in which Congress chose to refer to state law as, logically enough, "state law"), the phenomenon calls into question whether our legal culture has so far departed from attention to text, or is so lacking in agreed-upon methodology for creating and interpreting text, that it any longer makes sense to talk of "a government of laws, not of men." The authors have found four Circuit Courts of Appeals (including the Ninth Circuit) which have held "applicable nonbankruptcy law" to mean only state spendthrift trust law. [See *infra* note 106 and accompanying text.]
>
> Speaking of agreed-upon methodology: It is good that die court's analysis today proceeds on the assumption that use of the phrases "state law" and "applicable nonbankruptcy law" in other provisions of the Bankruptcy Code is highly relevant to whether "applicable nonbankruptcy law" means "state law" in § 541(c)(2), since consistency of usage within the same statute is to be presumed.... 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. See Dewsnup v. Timm, _ U.S. _, 112 S. Ct. 773, 777-78, 116 L. Ed. 2d 903 (1992); id., at _--, 112 S. Ct. at 775-76 (SCALIA, J. dissenting). "We express no opinion," our decision said, "as to whether the words (at issue) have different meaning in other provisions of the Bankruptcy Code." Id. at [7], n.3, 112 S. Ct. at 778, n.3. **I trust that in our search for a neutral and rational interpretive methodology we have now come to rest, so that the symbol of our profession may reside in the scales, not the see-saw.**

112 S. Ct. at 2250 (emphasis added). In fact, Patterson would appear to be only the latest pronouncement by the High Court in the war over the parameters of statutory construction. In the seven months immediately preceding the decision in Patterson, the U.S. Supreme Court decided at least three other cases, all construing provisions of the Bankruptcy Code, and all turning specifically on the turn of a phrase. We highlight those decisions here, although none involved any issue under ERISA, to indicate the broader pattern of the Court's apparent battle over the proper method of statutory interpretation, using the Bankruptcy Code increasingly as a popular forum in which to wage that war. See Union Bank v. Wolas, 502 U.S. _, 112 S. Ct. 527 (1991); Dewsnup v. Timm, _ U.S. _, 112 S. Ct. 773 (1992); United States v. Nordic Village, _ U.S. 112 S. Ct. 10 11 (1992).

In those three cases, Justice Scalia wrote a concurring opinion in one, a dissenting opinion in the second, and the majority opinion in the third. Justice Scalia, in particular, seems engaged in a quest to return statutory construction to the plain meaning rule" (although in the third case, the dissenting opinion takes Justice Scalia to task for avoiding the "plain meaning" of the statute in question).

[7] ERISA § 514(a).

[8] Patterson v. Shumate, ___ U.S. ___, 112 S. Ct. 2242 (1992) (reh'g. denied).

[9] IRC § 404.

[10] IRC § 501(a).

[11] IRC § 402(a).

[12] Department of Labor Regulations § 2510.3-3 provides in relevant pail as follows:
Employee benefit plan. - (a) *General*. This section clarifies the definition in section 3(3) [of ERISA] of the term "employee benefit plan" for purposes of Title I of the Act [ERISA] and this chapter... [O]nly employee benefit plans within the meaning of section 3(3) are subject to Tide I.
(b) *Plans without employees*. For purposes of Title I of the Act and this chapter, the term "employee benefit plan" shall not include any plan, fund or program, other than an apprenticeship or other training program, under which no employees are participants covered under the plan. .
(c) *Employees*. For purposes of this section:
(1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse, and
(2) A partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.
See also IRC § 401(c).

[13] ERISA § 206(d)(1) and IRC § 401(a)(13). ERISA § 206(d)(1) provides as follows:
(d) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.

[14] IRC § 401(a)(13) provides in relevant part as follows: (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.
See also Treas. Reg. § 1.401(a)-13

[15] Private Letter Rulings 8951067, 9011037. See also Private Letter Ruling 910905 1, where the plan administrator and the bankruptcy trustee came to an agreement, approved by the court, wherein a distribution payable to a participant could be mailed directly to the office of the bankruptcy trustee, to be endorsed over to the bankruptcy trustee by the participant.

[16] EIUSA § 514(a).

[17] ERISA § 514(a) provides as follows:
(a) . . . The provisions of this title [title 11 and title IV [which is inapplicable for purposes of this article] shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b). This section shall take effect on January 1, 1975.
In contrast, ERISA § 514(d) provides, with respect to federal laws, as follows:
(d) Nothing in this title shall he construed to after, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections I I I and 507(b)) or any rule or regulation issued under any such law.
This latter section is often cited by bankruptcy courts in determining that the Bankruptcy Code has priority in any event over any provision in ERISA. *See, e.g., In re Goff*, 706 F.2d 584, 587, 588 n.38 (5th Cir. 1983).

[18] 11 U.S.C. § 522(b)(1) provides as follows:
(b) Notwithstanding section 541 of this tide, 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. . 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 (subsection (2)(A) - see *infra* note 20).

11 U.S.C. § 522(d) provides in relevant part as follows:
(d) The following property may be exempted under subsection (b)(1) of this section:

(10) the debtor's right to receive - . . .

(C) a disability, illness, or unemployment benefit; . . . .

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

(i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;
(ii) such payment is on account of age or length of service; and
(iii) such plan or contract does not qualify under section 401(a), 403(b), 408, or 409 of the Internal Revenue Code of 1954 (26 U.S.C. § 401(a), 403(a), 403(b), 408, or 409) [*sic*].

[19] 3 Collier on Bankruptcy § 522.02 n.4a. The California statute which "opts out" of the Statutory Federal Law Exemption provides in relevant part as follows:
CAL. CODE CIV. PROC. § 704.115 (West 1987):

(a) As used in this section, "private retirement plan" means:

(1) Private retirement plans, including, but not limited to, union retirement plans.
(2) Profit-sharing [*sic*] plans designed and used for retirement purposes.
(3) Self-employed retirement plans and individual retirement annuities of accounts provided for in the Internal Revenue Code of 1954 as amended, to the extent the amounts held in the plans, annuities, or accounts do not exceed the maximum amounts exempt from federal income taxation under that code.

(b) All amounts held, controlled, or in process of distribution by a private retirement plan, for the payment of benefits as an annuity, pension, retirement allowance, disability payment, or death benefit from a private retirement plan are exempt.
. . . .

(d) After payment, the amounts described in subdivision (b) and all contributions and interest thereon returned to any member of a private retirement plan are exempt. (e) Notwithstanding subdivisions (b) and (d), except as provided in subdivision (f), the amounts described in paragraph (3) of subdivision (a) are exempt only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires. In determining the amount to be exempt under this subdivision, the court shall allow the judgment debtor such additional amount as is necessary to pay federal and state income taxes payable as a result of the applying of an amount described in paragraph (3) of subdivision (a) to the satisfaction of the money judgment.

[20] 11 U.S.C. § S22(b)(2)(A) provides as follows:

(2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or state or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place[.]

[21] *Id*.

[22] Patterson v. Shumate, ___ U.S. ___, 112 S. Ct. 2242, 2246 (1992) (reh'g. denied).

[23] 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986).

[24] Dr. Daniel filed for bankruptcy under Chapter 7 of the Bankruptcy Code of 1978.

[25] The U.S. District Court for the Northern District of California affirmed the Bankruptcy Court, which had held that the corporate plan in which Dr. Daniel's benefit was held in trust was not exempt from Dr. Daniel's bankruptcy estate under California law, and that it was neither exempt nor excluded under ERISA and the IRC. *Daniel* at 1352. The lower court decisions are unreported.

[26] CAL. CODE CIV. PROC. § 690. 1 8(d) (West 1982) was the predecessor to CAL. CODE CIV. PROC. § 704.115, *supra* note 19. It provided in relevant part as follows:

(d) .... money held, controlled, or in process of distribution by any private retirement plan, including, but not limited to, union retirement plan [sic], or any profit-sharing [sic] plan designed and used for retirement purposes, or the payment of benefits as an annuity, pension, retirement allowance, disability payment or death benefit from such retirement or profit-sharing plans, and all contributions and interest thereon returned to any member of any such retirement or profit-sharing plan, whether die same hall be in actual possession of such pensioner or beneficiary, or deposited by him, are exempt from execution, attachment, or garnishment.... the exemption given by this subdivision shall apply to any moneys held in self-employed retirement plans and individual retirement annuities or accounts provided for in the Internal Revenue Code of 1954 as amended by the federal "Employee Retirement Income Security Act of 1974" (P.L. 93-406, 29 U.S.C. 1001 et seq.) and by the "Tax Reform Act of 1976" (P.L. 94-455), provided that such moneys do not exceed the maximum amounts exempt from federal income taxation under these acts.

[27] Since California is an "opt out" state, Dr. Daniel did not have the option to use the federal exemptions under Bankruptcy Code § 522(b)(1). CAL. CODE CIV. PROC. § 703.130 (West 1987) provides as follows:

Federal bankruptcy exemptions; not authorized
Pursuant to the authority of paragraph (1) of subsection (b) of Section 522 of Title 11 of the United States Code, the exemptions set forth in subsection (d) of Section 522 of Title I I of the United States Code (Bankruptcy) am not authorized in this state.

[28] 706 F.2d 574 (5th Cir. 1983).

[29] H.R. REP. No. 95-595, 95th Cong., 2d Sess. 369 (1977), *reprinted* in 1978 U.S.C.C.A.N. 5963, 6325; S. REP. No. 95-989, 95th Cong., 2d Sess. 83, *reprinted* in 1978 U.S.C.C.A.N. 5787, 5 869.

[30] 706 F.2d 574, 580 el seq. (5th Cir. 1983). Still not satisfied with just going beyond the face of Bankruptcy Code § 541(c)(2), the *Goff* court went further and looked at the legislative history of Bankruptcy Code § 522(b)(2)(A) to further explain the meaning of Bankruptcy Code § 541(c)(2).
The legislative history of Code § 522(b)(2)(A) includes an illustrative list of property which might be exempted from the estate under this section under federal laws other than the Bankruptcy Code. Although the list explicitly is referred to in the legislative history as illustrative and not exhaustive, the *Goff* court (and many subsequent courts like it) found it to be determinative that ERISA is explicitly excluded from the list since ERISA had been enacted prior to the Bankruptcy Reform Act of 1978 and was not explicitly included on the list. S. REP. No. 95-989, 95th Cong., 2d Sess. 75, ~~reprinted~~ in 1978 U.S.C.C.A.N. 5787, 5861; H.R. REP. No. 95--595, 95th Cong. 2d Sess. 360 (1977), *reprinted* in 1978 U.S.C.C.A.N. 5963,6316.

[31] 771 F.2d at 1359 (emphasis in original).

[32] CAL. CODE CIV. PROC. § 690.18(d) (West 1982), *supra* note 26.

[33] The issue of preemption under ERISA § 514(a) was not discussed by the *Daniel* Court.

[34] 839 F.2d 1376 (9th Cir. 1998).

[35] Both ERISA and the IRC require that any participant loan from a qualified plan be "adequately secured" in order to avoid being a "prohibited transaction". ERISA § 408(b)(1), IRC § 4975(d)(1). The Court here may have meant that the only security pledged was Dr. Bloom's account balances, and that there was no other "outside" security pledged; it is not clear in the case as reported. The Court in *Daniel*, 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986), specifically noted that Dr. Daniel had pledged his account balance in the plan as collateral for his participant loan.

[36] A "reasonable rate of interest" on participant loans is also required pursuant to ERISA § 408(b)(1) and IRC § 4975(d)(1).

[37] 839 F.2d at 1379.

[38] CAL. CODE CIV. PROC. § 704.115 (West 1987). 7th Court noted that CAL. CODE CIV. PROC. § 690.18(d) (West 1982) was the predecessor to CAL. CODE CIV. PROC. § 704.115, and stated, "For our purposes, the new statute is identical in meaning to the old." 839 F.2d at 1378 n.2. As in *Daniel*, 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986), the Court in *In re Bloom*, 839 F.2d 1376 (9th Cir. 1988), does not discuss the preemption issue raised under ERISA § 514(a).

[39] The court in *In re Bloom*, 839 F.2d 1376 (9th Cir. 1988), does not discuss at all the possible exclusion of Dr. Bloom's benefits pursuant to § 541 (c)(2).

[40] 839 F.2d at 1378.

[41] 917 F.2d 1162 (9th Cir. 1990).

[42] *Id*. at 1163.

[43] *Id*. at 1164.

[44] *Id*. at 1167-68.

[45] *Id*. at 1164.

[46] *Id*. at 1168.

[47] *Id*. at 1164.

[48] *Id*. at 1168. The court noted that the plan would also have qualified as a spendthrift trust under the law of the state of Massachusetts, the law which the plan provided would govern. *Id*. at 1167 n.2.

[49] *Id*. at 1166.

[50] *Id*. at 1167.

[51] *Id*. at 1168.

[52] Between the decisions in *In re Bloom*, 839 F.2d 1376 (9th Cir. 1988), and *In re Kincaid*, 917 F.2d 1162 (9th Cir. 1990), the United States Supreme Court had ruled on an issue of preemption involving a welfare plan governed by ERISA. *Mackey v. Lanier Collections Agency & Service*, 486 U.S. 825 (1988). The Supreme Court held in *Mackey* that ERISA preemption under § 514(a) is very broad, and that it preempted a Georgia statute which, in attempting to protect ERISA plans from garnishment, specifically mentioned that statute by name. Several cases decided subsequent to *Mackey* have cited it in determining that state law, including statutes attempting specifically to protect ERISA retirement plans from bankruptcy, as well as state common law on spendthrift trusts, is preempted by ERISA § 514(a). Note that any qualified plan which is not also covered by ERISA (*see supra* notes 11-12 and 16-17 and accompanying text) would not preempt these state laws, so that such a plan might be protected under state law.

[53] 917 F.2d at 1166.

[54] *Id*. at 1169.

[55] 943 F.2d 1114 (9th Cir. 1991).

[56] CAL. CODE CIV. PROC. § 704.115 (West 1987) (*see supra* note 19).

[57] CAL. CODE CIV. PROC. § 704.1 15(c) (West 1987).

[58] 943 F.2d at 1115-16.

[59] *Id*. at 1115.

[60] The Court once again did not discuss preemption (*see supra* notes 16-17, 33, 52-53 and accompanying text), presumably because the issue was not raised. If the court *had* considered whether the preemption provision in Title I of ERISA were applicable, it should have found it *not* to be applicable in *Cleng* because Dr. Cheng was the only participant in his plans. These plans are not subject to Tide I of ERISA and, therefore, are not subject

to the ERISA preemption provision (*see supra* note 17). Accordingly, Dr. Cheng correctly could rely on California state law to protect his qualified retirement plan monies.

[61] 943 F.2d at 1116.

[62] *Id*. at 1116.

[63] *Id*.

[64] *Id*. at 1117.

[65] *Id*.

[66] "In-service distributions" are distributions for which a participant is eligible prior to the time he or she reaches retirement age or terminates employment with the plan sponsor.

[67] 947 F.2d 419 (9th Cir. 1991).

[68] 951 F.2d 1046 (9th Cir. 1991).

[69] Arizona Rev. Stat. Ann. § 33-1126(B) (1991) provides in relevant part:

> Any money or other assets payable to a participant or beneficiary from, or any interest of any participant or beneficiary in, a retirement plan which is qualified under §§ 401 (a), 403(a), 403 (b), 408, or 409 of the United States internal revenue code [*sic*] of 1986, as amended, shall be exempt from any and all claims of creditors of the beneficiary or participant.

[70] 947 F.2d at 427-29; 951 F.2d at 1048.

[71] Although we have not read the appellate briefs in either *Pitrat* or in *Reed*, the plan in Reed clearly had only one participant on the facts presented. (In *Pitrat*, as discussed in the text accompanying nn.72-73 *infra*, it is unclear how many participants were in most of the plans involved, so that it is impossible to know whether preemption was applicable.) In any event, we assume that the attorneys for the debtor in *Reed* did not point out the fact that Dr. Reed's plan was not subject to Title I of ERISA and, therefore, that the Arizona statute was not subject to preemption. Thus, after *Reed*, there existed a conflict within the Ninth Circuit. (*See* text accompanying n.98 *infra*.) While *Reed* was more favorable to trustees in bankruptcy than *Cheng*, it left Dr. Reed in a position much less favorable than that of Dr. Cheng, and for no apparent mason based on the statutory and case law.

[72] 947 F.2d at 422.

[73] *See supra* notes 11-12, 16-17 and accompanying text.

[74] *See supra* note 23.

[75] 947 F.2d at 423.

[76] *Id*. at 426.

[77] *Id*. at 429.

[78] *See supra* notes I I - 12, 16-17 and accompanying text.

[79] *See supra* notes 11 - 12, 16-17 and accompanying text.

[80] Preemption would be inapplicable because these latter plans would not be subject to Title I of ERISA, in which the preemption provision is set forth. *See supra* notes 11-12, 16-17 and accompanying text.

[81] 947 F.2d at 423.

[82] *Id*.

[83] *See supra* note 41.

[84] 947 F.2d at 424-25.

[85] *Id*. at 425.

[86] *See supra* note 41.

[87] 947 F.2d at 425.

[88] *See supra* note 66.

[89] *See supra* notes 23-30, 48-51 and accompanying text.

[90] 47 F.2d at 423 n.4.

[91] *See supra* notes 52-53 and accompanying text.

[92] *In re Reed*, 951 F.2d 1046 (9th Cir. 1991).

[93] *In re Cheng*, 943 F.2d 1114 (9th Cir. 1991).

[94] *In re Daniel*, 771 F.2d 1352 (9th Cir. 1995), cert. denied, 475 U.S. 1016 (1986).

[95] 951 F.2d at 1048-50.

[96] *Id*. at 1050.

[97] *Id*. at 1047.

[98] *Id*. at 1050.

[99] *See supra* note 69.

[100] 951 F.2d at 1050 (emphasis added).

[101] *See supra* notes I 1- 12, 16-17 and accompanying text.

[102] The Fifth, Eighth and Eleventh Circuits concur. *See, e.g*., *In re Goff*, 706 F.2d 574 (5th Cir. 1983); *In re Dyke*, 943 F.2d 1435 (5th Cir. 199 1); *In re Graham*, 726 F.2d 1268 (8th Cit. 1984); *In re Lichstahl*, 750 F.2d 1488 (11th Cir. 1985).

[103] The Third, Fourth, Sixth and Tenth Circuits have so held. *See*, *e.g*., Velis v. Kardanis, 949 F.2d 78 (3d Cir.), *reh'g. denied*, ___ F.2d ___ (199 1); *In re Moore*, 907 F.2d 1476 (4th Cir. 1990); Shumate v. Patterson, 943 F.2d 362 (4th Cit. 1991), *cert. granted*, Patterson v. Shumate, ___ U.S. ___, 112 S. Ct. 932 (1992); *In re Lucas*, 924 F.2d 597 (6th Cir.), *cert*. denied - U.S. ___, III S. Ct. 2275 (1991); *In re Harline*, 950 F.2d 669 (10th Cir. 1991).

[104] 943 F.2d 362 (4th Cit. 1991), *cert. granted*, Patterson v. Shumate, ___ U.S. ___, 112 S. Ct. 932 (1992).

[105] *Id*. at 362, 364.

[106] *Patterson*, 112 S. Ct. at 2244, 2250.

[107] *Id*. at 2244. In light of this holding, the Court found it unnecessary to consider Mr. Shumate's alternative argument that his pension benefits were exempted from inclusion in his bankruptcy estate under the provisions of Bankruptcy Code § 522(b)(2)(A). *Id*. at 2250.

[108] *Id*. at n.4.

[109] *Id*. at 2250.

[110] *See supra* note 11 and accompanying text.

[111] *Patterson*, 112 S. Ct. at 2244.

[112] *See supra* notes 11-12, 16-17 and accompanying text. *See also* Reed v. Drummond, 951 F.2d 1046 (9th Cir. 1991), *vacated and remanded*, ___ U.S. ___, 113 S. Ct. 314 (1992). In this case (which as of January 11, 1993, had not been reported as decided by the Court of Appeals on remand), the debtor was the sole shareholder of his medical corporation and the sole participant in his qualified pension plan. The Ninth Circuit affirmed the bankruptcy court and the U.S. District Court in finding that the debtor's retirement benefit in the plan was not protected under either Arizona law or under section 522(b)(2)(A) or section 541(c)(2) of the Bankruptcy Code. Ile Supreme Court vacated and remanded the decision for "further consideration in light of Patterson v. Shumate, 504 U.S. ___, 112 S. Ct. 2242 (1992)." The decision on remand should provide some insight on the position parties and the courts will take with regard to qualified plans which am not also subject to ERISA, as discussed in this article.

[113] *See supra* notes 18-21 and accompanying text.

[114] *See supra* note 19.

[115] *See supra* note 55.

[116] *See supra* note 68.

[117] *See supra* notes 99-101 and accompanying text.

[118] *Patterson*, 112 S. Ct. at 2250.

[119] *See infra* notes 131-33 and accompanying text.

[120] *See Patterson*, 112 S. Ct. at 2250 n.4, and accompanying text.

[121] *See supra* note 18.

[122] *See supra* notes 19 and 40 and accompanying text.

[123] *See supra* notes 107-109 and accompanying text.

[124] *See supra* note 107 and accompanying text.

[125] *Patterson*, 112 S. Ct. at 2244 (emphasis added).

[126] *See, e.g., Patterson*, 112 S. Ct. at 2244, 2245, 2246 and 2247.

[127] *Patterson*, 112 S. Ct. at 2247.

[128] *Id*. at 2246.

[129] *Id*.

[130] *Id*. at 2247 (emphasis added).

[131] *Id*. at 2249.

[132] *Id*. at 2250.

[133] *Id*.

[134] *Id*. *See also Patterson*, 112 S. Ct. at 2250 n.4.

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