Bankruptcy Law - The Exemption of ERISA-Qualified Plans from the Bankruptcy Estate

James A. Boyd Jr.

Follow this and additional works at: https://digitalcommons.law.villanova.edu/vlr

Part of the Bankruptcy Law Commons

Recommended Citation
Available at: https://digitalcommons.law.villanova.edu/vlr/vol37/iss4/9

This Issues in the Third Circuit is brought to you for free and open access by the Journals at Villanova University Charles Widger School of Law Digital Repository. It has been accepted for inclusion in Villanova Law Review by an authorized editor of Villanova University Charles Widger School of Law Digital Repository.
BANKRUPTCY LAW—THE EXEMPTION OF ERISA-QUALIFIED PLANS FROM THE BANKRUPTCY ESTATE


I. INTRODUCTION

The Bankruptcy Code (Code) was enacted to reconcile two juxta-posed interests: preserving the creditor’s rights and providing the debtor with a fresh start. The Code, however, has not provided, as was envisioned in its promulgation, a bright line to distinguish these two interests. This lack of clarity is especially evident in the Code’s treatment of retirement savings plans regulated by the Employee Retirement Income Security Act (ERISA).

1. Samore v. Graham (*In re* Graham), 726 F.2d 1268, 1271 (8th Cir. 1984). The *Graham* court noted that the Code was enacted to “convert[] the estate into cash for distribution among creditors.” *Id.* In addition, the Code permits the debtor “to exempt property [from the estate] needed for a fresh start.” *Id.*

2. Goff v. Taylor (*In re* Goff), 706 F.2d 574, 578 (5th Cir. 1983). The Code was enacted to replace the morass of the then existing Bankruptcy Act (Act). *Id.* Under the Act, there was a blurred line between the property included in the bankruptcy estate, which would be accessible to the creditor, and the property excluded from the bankruptcy estate, which would be available for the debtor’s unencumbered fresh start. *Id.* The categorization of property interests was provided by the Act’s “complicated melange of references to State law . . . [which did] little to further the bankruptcy policy of distribution of the debtor’s property to his creditor in satisfaction of his debts.” H.R. Rep. No. 595, 95th Cong., 2d Sess. 175 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6136. The Code was enacted to simplify this identification process by including in the bankruptcy estate all property in which the debtor had a “legal or equitable interest.” *Goff*, 706 F.2d at 578; *see also* 11 U.S.C. § 541(a)(1) (1988). For the text of § 541(a), see *infra* note 17.


Of the nine circuits which have addressed the issue of retirement savings plans regulated by ERISA, four have held that such plans are part of the bankruptcy estate, unless they are enforceable under state law as spendthrift trusts. *See* Daniel v. Security Pac. Nat’l Bank (*In re* Daniel), 771 F.2d 1352, 1360 (9th Cir. 1985) (holding that “ERISA and IRC anti-alienation provisions in debtors pension and profit sharing plan does not create a Federal non-bankruptcy exclusion”), *cert. denied*, 474 U.S. 1016 (1986); Lichstrahl v. Bankers Trust (*In re* Lich-
Under § 541(c)(2) of the Code, a debtor’s interest in a trust is excluded from the bankruptcy estate if the trust has “[a] restriction on [its] . . . transfer . . . that is enforceable under applicable nonbankruptcy law.”4 Unfortunately, Congress has not provided any definitive guidance regarding the scope of the phrase “applicable nonbankruptcy law.”5 Consequently, courts have been compelled to determine whether § 541(c)(2) protects trusts with restrictions imposed under federal statute,6 or whether the exclusion provided under § 541(c)(2) is limited to

strahl), 750 F.2d 1488, 1490 (11th Cir. 1985) (holding that “ERISA-qualifying pension plans . . . are excluded pursuant to § 541(c)(2) only if they are enforceable under state law as spendthrift trusts”); Graham, 726 F.2d at 1271 (holding that “Congress only intended by § 541(c)(2) to preserve the status traditional spendthrift trusts, as recognized by state law, enjoyed under the old Bankruptcy Act”); Goff, 706 F.2d at 577 (stating that exemption § 541(c)(2) “was intended as a narrow reference to state ‘spendthrift trust’ law and not as a broad reference to all other law, both federal and state, including ERISA”).

Four other circuits have held that retirement savings plans regulated by either federal or state law are exempt from the bankruptcy estate. See Gladwell v. Harline (In re Harline), 950 F.2d 669, 674 (10th Cir. 1991) (holding that “a tax-qualified ERISA pension or profit sharing plan is exempt from the bankruptcy estate under § 541(c)(2)”); Velis v. Kardanis, 949 F.2d 78, 83 (3d Cir. 1991) (holding that “the restrictions which must be recognized in bankruptcy under § 541(c)(2) are not limited to state spendthrift-trust law, but include restrictions enforceable under either state or federal law”); Forbes v. Lucas (In re Lucas), 924 F.2d 597, 598 (6th Cir.) (stating that “debtor’s interests in an ERISA-qualified pension plan are not property of the debtor’s bankruptcy estate”), cert. denied, 111 S. Ct. 2275 (1991); Anderson v. Raine (In re Moore), 907 F.2d 1476, 1478 (4th Cir. 1990)(indicating that exemption allowed under § 541(c)(2) “suggests no limitation to state spendthrift trust law”).

The United States Court of Appeals for the Seventh Circuit has held that an ERISA-qualified pension plan “is a spendthrift trust under Indiana law and therefore not included in the bankruptcy estate.” In re LeFebre, 906 F.2d 330, 331 (7th Cir. 1990).

4. 11 U.S.C. § 541(c)(2) (1988) (emphasis added). Section 541 provides in pertinent part:

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate. . . .

(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.

Id. § 541(c)(1)-(2) (emphasis added).

5. For an analysis of the legislative history of § 541(c)(2) and the meaning of the phrase “applicable nonbankruptcy law,” see infra notes 33-35 and accompanying text.

6. The federal statutes to which this Casebrief will refer are § 401(a)(13) of the Internal Revenue Code (IRC) and § 1056(d)(1) of ERISA. Under § 401(a)(13)(A), “[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.” 26 U.S.C. § 401(a)(13)(A) (1988). Under § 1056(d)(1), “[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated.” 29 U.S.C. § 1056(d)(1), (1988). To be an ERISA-qualified plan, the pension plan must, among other things, prohibit the assignment or alienation of benefits. See id. Upon meeting the ERISA criteria, the plan gains tax-exempt status under
spendthrift trusts created under state law.\footnote{7}

In \textit{Velis v. Kardanis},\footnote{8} the United States Court of Appeals for the Third Circuit considered whether an individual’s ERISA-qualified pension plan, Keogh plan\footnote{9} and Individual Retirement Account (IRA)\footnote{10} were

\section*{§ 401(a)(13) of the IRC. 26 U.S.C. § 401(a)(13). For a discussion of Congress’ intent in the promulgation of ERISA, see supra note 3.}

7. A spendthrift trust is a creation of state law and is essentially “a trust created to provide a fund for the maintenance of a beneficiary, with only a certain portion of the total amount to be distributed at any one time.” \textit{Goff}, 706 F.2d at 580. Under state spendthrift law, the settlor places restrictions upon the trust “which operate in most states to place the fund beyond the reach of the beneficiary’s creditors, as well as to secure the fund against the beneficiary’s own improvidence.” \textit{Id.} In addition, almost every state requires that the trust be established for the benefit of an individual other than the person creating the trust. Newell, \textit{supra} note 3, at 202.

A spendthrift trust created for the benefit of the person creating the trust is considered a “self-settled” trust. \textit{Id.} Under state spendthrift trust law, a self-settled trust is not entitled to the restrictions upon alienation and assignment granted to other spendthrift trusts. \textit{Id.} at 203. The exclusion of these restrictions from a self-settled trust was imposed to prevent debtors from shielding their assets from their creditors. \textit{Id.}

State law is not uniform with respect to the criteria necessary to establish a spendthrift trust. \textit{Goff}, 706 F.2d at 580. In all states, however, the determinative factor in finding that a spendthrift trust is self-settled is whether the trust is funded by the beneficiary. Newell, \textit{supra} note 3, at 203.

The determination of which trusts are excluded by § 541(c)(2) is contingent upon the court’s interpretation of the phrase “applicable nonbankruptcy law.” \textit{Velis}, 949 F.2d at 81. For the context of the phrase “applicable nonbankruptcy law” in § 541(c)(2), see \textit{supra} note 4. For a discussion of the three distinct interpretations of “applicable nonbankruptcy law,” see \textit{infra} notes 36-55 and accompanying text.


9. Keogh plans are ERISA-qualified retirement savings plans which are available for a self-employed sole proprietor or a partner. Grotberg, Comment, \textit{supra} note 3, at 169. One of the ERISA-imposed requirements on a Keogh plan is the inclusion of anti-alienation and assignment provisions. \textit{Velis}, 949 F.2d at 79-80. Like other ERISA-qualified savings plans, contributions to Keogh plans are tax-free until the participant receives distributions from the plan. Grotberg, Comment, \textit{supra} note 3, at 170. An individual is permitted to make withdrawals from the plan beginning at age 59\%\textsubscript{2}. \textit{Id.} However, a Keogh plan participant is not required to make withdrawals until he or she attains the age of 70\%\textsubscript{2}. \textit{Id.} If funds are withdrawn before the specified age requirements, they are subject to a 10\% tax penalty. \textit{Id.}

Under state spendthrift trust law, Keogh plans are considered self-settled trusts. Newell, \textit{supra} note 3, at 203. Because the Keogh plan is established by the self-employed for his or her own benefit, the plan fails to qualify as a spendthrift trust. \textit{Id.} For a discussion of self-settled trusts, see \textit{supra} note 7.

10. An IRA is another form of an ERISA-qualified retirement savings plan. Grotberg, Comment, \textit{supra} note 3, at 171. Made available to virtually any working individual, an IRA is considered a supplemental form of retirement savings. \textit{Id.} IRAs are similar to Keogh plans in that they are subject to the same age limitations and premature withdrawal penalties as Keogh plans. \textit{Id.} at 172. An important distinction between IRAs and Keogh plans, however, is that ERISA does not require that IRAs have anti-alienation or assignment provisions. \textit{Velis},
exempt from his bankruptcy estate under § 541(c)(2). The Velis court held that retirement savings plans, with restrictions upon alienation and assignment enforceable under federal statute, are entitled to the same status as state spendthrift trusts and, therefore, are exempt from the debtor’s bankruptcy estate. Thus, by including ERISA under the umbrella of “applicable nonbankruptcy law,” the Third Circuit has provided federally regulated retirement savings plans the protection Congress envisioned in its promulgation of ERISA and the Code.

To properly understand the Third Circuit’s holding in Velis and its accompanying impact upon a bankrupt individual’s ERISA-qualified savings plan, one must first be familiar with the Code’s valuation of the bankruptcy estate. Accordingly, the next section of this Casebrief examines the bankruptcy estate and the exemptions which the Code allows in creating the estate. This Casebrief next discusses how other circuit courts have applied § 541(c)(2) in the context of ERISA-qualified savings plans. Finally, this Casebrief discusses and analyzes the Velis court’s holding and the case’s impact upon ERISA-qualified savings plans.

II. Valuation of the Bankruptcy Estate

The Code provides under § 541(a) that at the commencement of a bankruptcy case, the debtor’s bankruptcy estate is established. The Third Circuit held that it was “reasonable to conclude that Congress intended to provide protection against the claims of creditors for a person’s interest in pension plans,” which would include retirement savings plans governed by federal statute. Specifically, the Third Circuit held that it was one of first impression for the Velis court. Id. at 82. Specifically, the Third Circuit held that it was “reasonable to conclude that Congress intended to provide protection against the claims of creditors for a person’s interest in pension plans,” which would include retirement savings plans governed by federal statute. Id. at 82. For a discussion of Keogh plans, see supra note 9. For a discussion of the Velis court’s application of § 541(c)(2) to IRAs, see infra notes 75-99 and accompanying text. Id. at 79. The question of the status of retirement savings plans regulated by federal statute was one of first impression for the Velis court. Id. at 82.

11. Velis, 949 F.2d at 79. For a discussion of the Three Circuit’s holding in Velis and its impact upon ERISA-qualified savings plans, see infra notes 75-99 and accompanying text.

12. Id. at 82. Specifically, the Third Circuit held that it was “reasonable to conclude that Congress intended to provide protection against the claims of creditors for a person’s interest in pension plans,” which would include retirement savings plans governed by federal statute. Id. at 82. Specifically, the Third Circuit held that it was “reasonable to conclude that Congress intended to provide protection against the claims of creditors for a person’s interest in pension plans,” which would include retirement savings plans governed by federal statute. Id. at 82. For a discussion of ERISA and its policies, see supra note 3. For a discussion of the Third Circuit’s holding in Velis and its impact upon ERISA-qualified savings plans, see infra notes 75-99 and accompanying text.

13. Id. at 82. Specifically, the Third Circuit held that it was “reasonable to conclude that Congress intended to provide protection against the claims of creditors for a person’s interest in pension plans,” which would include retirement savings plans governed by federal statute. Id. at 82. Specifically, the Third Circuit held that it was “reasonable to conclude that Congress intended to provide protection against the claims of creditors for a person’s interest in pension plans,” which would include retirement savings plans governed by federal statute. Id. at 82. For a discussion of the Code’s valuation of the bankruptcy estate, see infra notes 17-35 and accompanying text.

14. For a discussion of the three distinct views on the application of the § 541(c)(2) to ERISA-qualified savings plans, see infra notes 36-56 and accompanying text.

15. For a discussion of the Velis court’s holding, see infra notes 57-99 and accompanying text. For a discussion of the impact of Velis on ERISA-qualified savings plans, see infra notes 100-10 and accompanying text.

16. For a discussion of the Velis court’s holding, see infra notes 57-99 and accompanying text. For a discussion of the impact of Velis on ERISA-qualified savings plans, see infra notes 100-10 and accompanying text.

17. 11 U.S.C. § 541(a)(1988). Section 541 establishes the bankruptcy estate, which includes virtually all of the debtor’s assets. Grotberg, Comment, supra note 3, at 177. This section provides in part:

§ 541. Property of the estate
(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
tially, the estate is composed of "all legal or equitable interests of the debtor in property as of the commencement of the case." The Code, however, does allow certain property interests of the debtor to be excluded from the bankruptcy estate and thus remain under the possession and control of the debtor during and after the bankruptcy case.

Under the precursor to the Code, the Bankruptcy Act (Act), the bankruptcy estate was comprised of the debtor's property which fell within the definition of "transferability or leviability." In contrast, under the Code, the bankruptcy estate includes all property interests of the debtor and then permits the debtor to "exempt property needed for a fresh start." This change in the formation of the bankruptcy estate was enacted to remedy the deficiencies of the Act. Accordingly, § 541 was "intended to be broad in scope."

To provide for the debtor's fresh start, § 522 provides for certain property to be exempt from the debtor's bankruptcy estate. Under

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 541(a)(1). For the text of the exclusion allowed under subsection (c)(2) of § 541, see supra note 4.


19. See 11 U.S.C. §§ 522, 541(c)(2) (1988) (exemption and exclusion provisions of the Code, respectively). For a discussion of § 522 and its exemption of assets from the bankruptcy estate, see infra notes 24-29 and accompanying text. For a discussion of § 541(c)(2) and its exclusion of assets from the bankruptcy estate, see infra notes 30-35 and accompanying text.

20. Samore v. Graham (In re Graham), 726 F.2d 1268, 1271 (8th Cir. 1984). Property which "could not be transferred or levied upon under state law" did not even enter the bankruptcy estate under the Act. Id.

21. Id.

22. Goff v. Taylor (In re Goff), 706 F.2d 574, 578 (5th Cir. 1983). Specifically, Congress concluded that the convoluted analysis required under the Act to determine the bankruptcy estate represented a deficiency in the statute. Id. The new Code simplified the determination of the estate by including all property interests of the debtor. Id. This eliminated the "analytical conundrum" that the courts used under the Act. Id.


24. See 11 U.S.C. § 522(b) (1988). Section 522(b) provides in part: Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. . . . Such property is —

(1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

(2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located . . . .
§ 522(b), the debtor must select one of two mutually exclusive exemption plans: the federal exemption plan provided under § 522(b)(1) or the federal, state and local exemption plan allowed under § 522(b)(2). The federal exemption plan available under § 522(b)(1) limits the debtor’s exemptions to the federal exemptions explicitly delineated in § 522(d).

A debtor can elect to opt out of the federal exemption plan provided by § 522(b)(1) and instead elect to proceed under the exemption plan provided by § 522(b)(2). Section 522(b)(2)(A) provides that “any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law” is exempt from the bankruptcy estate. This allows the debtor to evaluate which valuation of the bankruptcy

Id. § 522(b)(1)-(2)(A).

25. Id. § 522(b)(1)-(2). For the text of § 522(b)(1) and (2), see supra note 24. The federal exemptions allowed under § 522(b)(1) are delineated in § 522(d)(1)-(11). Id. § 522(d). For example, § 522(d)(1) allows the debtor to exclude up to $7,500 of the debtor’s residence from the bankruptcy estate. Id. § 522(d)(1). In addition, included in § 522(d)(10) is the provision for the exemption of certain pension plan payouts. Id. § 522(d)(10)(E). The debtor is entitled to payments from a qualified plan “to the extent reasonably necessary for the support of the debtor.” Id. The section does not specifically protect the principal or corpus of the plan; rather, it only protects the debtor’s right to retain such reasonable distributions from the plan. Id.

To qualify as a pension plan under § 522(d)(10)(E), the Code requires that the plan meet the criteria of “§ [§ ] 401(a), 403(a), 403(b), 408, or 409” of the IRC. Id. § 522(d)(10)(E)(iii). It should be noted that ERISA-qualified plans also meet the criteria of § 401(a) of the IRC. See 26 U.S.C. § 401(a)(13) (1988).

26. 11 U.S.C. § 522(b)(1). A debtor electing to proceed under the federal exemption plan cannot take advantage of any other federal exemptions beyond those exemptions listed in § 522(d). Id. In addition, the federal exemption plan forces the debtor to forego any state or local exemptions. Id. For the text of § 522(b)(1), see supra note 24.

27. 11 U.S.C. § 522(b). An important element of this section’s exemption plans is the mutually exclusive nature of the two options. See id. § 522(b). Federal exemptions that are available under § 522(b)(1) are not available under § 522(b)(2) and vice-versa. Id. For the text of § 522(b)(1) and § 522(b)(2), see supra note 24.

28. 11 U.S.C. § 522(b)(2)(A) (emphasis added). Section 522(b)(2)(A) allows the debtor to take advantage of any state or local law which provides exemptions from the bankruptcy estate. Id. In addition, any property which is exempt under federal law, other than the property listed in § 522(d), is also exempt from the debtor’s bankruptcy estate. Id. For an example of the federal exemptions granted by § 522(d), see supra note 25. Unfortunately, the text of § 522(b)(2)(A) does not specify the applicable federal law to which it refers. For the text of § 522(b)(2)(A), see supra note 24. The legislative history accompanying § 522(b)(2)(A), however, does provide an illustrative list of the applicable federal law envisioned by Congress in enacting § 522(b)(2)(A). See Samore v. Graham (In re Graham), 726 F.2d 1268, 1273-74 (8th Cir. 1984). The list includes Social Security payments and other federally funded benefits; it does not include ERISA-qualified pension plans. Id. at 1274. While this list is not intended to be exclusive, the Graham court, relying upon this legislative history, found that ERISA was “not a ‘Federal law’ upon which a § 522(b)(2)(A) exemption could be based.” Id.
estate "would permit him to retain a larger share of his assets": the federal exemptions allowed under § 522(d) or the federal, state and local exemptions allowed under § 522(b)(2).

As mentioned above, § 522 removes property that has already been included in the bankruptcy estate; section 541(c)(2) operates to exclude certain trusts from the bankruptcy estate altogether. Under § 541(c)(2), a debtor can exclude from the bankruptcy estate his interest in a trust which has restrictions upon its transfer that are "enforceable under applicable nonbankruptcy law." Unfortunately, Congress did not define the scope of the phrase "applicable nonbankruptcy law" in the text of the Code.

The legislative history accompanying § 541(c)(2) provides some guidance concerning what is included under the umbrella of "applicable nonbankruptcy law." The House Report stated that "[p]aragraph (2) of subsection (c) . . . preserves restrictions on transfer of a spendthrift trust to the extent that the restriction is enforceable under applicable nonbankruptcy law." Thus, while the legislative history does not explicitly exclude federal law from the scope of "applicable nonbankruptcy law," it specifically includes trusts enforceable under state spendthrift trust laws within the scope of § 541(c)(2). Because neither the statute nor the legislative history definitively establish the intended scope of the phrase "applicable nonbankruptcy law," the federal circuit courts have been required to define the scope of the exclusion allowed under

---

29. Goff v. Taylor (In re Goff), 706 F.2d 574, 579 (5th Cir. 1983). For example, most states allow a larger exemption for the debtor's residence than is allowed under § 522(d)(1). Id. at 577. If the total value of all the federal exemptions allowed under § 522(d) is less than the total value of exemptions allowed under § 522(b)(2), then the debtor will probably take advantage of the federal, state and local exemptions allowed under § 522(b)(2). Id.


31. 11 U.S.C. § 541(c)(2) (emphasis added). Determining the meaning of the phrase "applicable nonbankruptcy law" gave rise to the controversy in Velis v. Kardanis, the focus of this Casebrief. For various interpretations of this phrase, see infra notes 36-74 and accompanying text.

32. See 11 U.S.C. § 541(c)(2). For the text of § 541(c)(2), see supra note 4.


34. Anderson v. Raine (In re Moore), 907 F.2d 1476, 1479 (4th Cir. 1990). The Moore court noted that the legislative history only identified state spendthrift trusts as one of the items included under "applicable nonbankruptcy law." Id. For a further discussion of the Moore court's interpretation of the legislative history and its impact upon the scope of § 541(c)(2), see infra notes 48-52 and accompanying text.

Other circuit courts have held that the legislative history indicates Congress' intent to limit "applicable nonbankruptcy law" to state spendthrift trust law. See, e.g., Goff v. Taylor (In re Goff), 706 F.2d 574, 581 (5th Cir. 1983). For a further discussion of these courts' interpretations of the legislative history and its impact upon the scope of § 541(c)(2), see infra notes 39-47 and accompanying text.
III. THE SCOPE OF "APPLICABLE NONBANKRUPTCY LAW"

To date, nine circuit courts have considered the scope of the phrase "applicable nonbankruptcy law" as referenced in § 541(c)(2). As a result, three distinct views on the phrase's application have developed. Four of the circuits have narrowly interpreted the phrase, limiting its application to pension plans enforceable as state spendthrift trusts. On the other hand, four other circuits, including the Third Circuit, have broadly interpreted "applicable nonbankruptcy law" as exempting trusts with restrictions upon alienation and assignment which are enforceable under either state or federal law. Finally, the Seventh Circuit has avoided the interpretational analysis of "applicable nonbankruptcy law" by holding that all ERISA-qualified pension plans are spendthrift trusts under Indiana law and, therefore, are excluded from the bankruptcy estate.

A. The Narrow Interpretation View

The narrow interpretation of the phrase "applicable nonbankruptcy law" was first espoused by the Fifth Circuit in In re Goff. The Goff court reached its conclusion by applying a three-step analysis. First, the court examined the "explicitly narrow legislative intent behind the facially broad reference in Section 541(c)(2) to 'applicable nonbankruptcy law'" and concluded that Congress intended the exclusion under § 541(c)(2) to be narrowly interpreted. Second, the court considered the broad

35. For a list of circuit court holdings and their interpretations of "applicable nonbankruptcy law," see supra note 3.
36. For a discussion of the circuit courts which have narrowly interpreted § 541(c)(2), see infra notes 39-47 and accompanying text.
37. For a discussion of the circuit courts which have broadly interpreted § 541(c)(2), see infra notes 48-52 and accompanying text.
38. In re LeFeber, 906 F.2d 330, 331 (7th Cir. 1990). Indiana state law specifically mentions § 1056(d) of ERISA, which restricts the alienation and assignment of ERISA-qualified savings plans in defining spendthrift trusts. Id.; see 29 U.S.C. § 1056(d)(1) (1988). Accordingly, the LeFeber court held that an ERISA-qualified savings plan was a spendthrift trust and excluded by § 541(c)(2) from the bankruptcy estate. LeFeber, 906 F.2d at 331. For a discussion of the Seventh Circuit's view, see infra notes 53-55 and accompanying text.
39. 706 F.2d 574, 576 (5th Cir. 1983) (noting that it was first circuit court to determine the scope of phrase "applicable nonbankruptcy law"). The debtors in Goff were a husband and wife who had voluntarily filed a Chapter 7 petition for bankruptcy. Id. at 577. The trust at issue in the Goff case was an ERISA-qualified Keogh plan in which both debtors had made contributions. Id. At the time the Goffs filed for bankruptcy, their Keogh plan was valued at over $90,000, of which nearly $3,000 had been contributed three days prior to filing for bankruptcy. Id. No withdrawals were ever made by the Goffs. Id. For a discussion of Keogh plans, see supra note 9.
40. Goff, 706 F.2d at 581. The Goff court determined that a review of the legislative history of § 541(c)(2) revealed that Congress intended to narrowly
congressional policies envisioned in the promulgation of the Code and determined that the legislative history's failure to mention ERISA in its list of federal law under § 522(b)(2)(A) indicated Congress' intention to exclude ERISA-qualified pension plans from § 522(b)(2)(A). Finally, the court evaluated the Code's goal concerning ERISA and concluded that the Code's goal to broaden the bankruptcy estate would be eviscerated by broadly interpreting the phrase "applicable nonbankruptcy law." Other circuits that have adopted this narrow interpretation of apply the exclusion provided by the phrase "applicable nonbankruptcy law." Id.; see also Lichstrahl v. Bankers Trust (In re Lichstrahl), 750 F.2d 1488, 1490 n.3 (11th Cir. 1985) ("Both House and Senate reports expressly limit section 541(c)(2) to spendthrift trusts."); Samore v. Graham (In re Graham), 726 F.2d 1268, 1272 (8th Cir. 1984) ("There is no indication whatever that Congress intended § 541(c)(2) to be a broad exclusion which would apply to . . . ERISA plan[s].").

The House and Senate reports' explanation of § 541(c)(2) was the dispositive factor in the Goff court's determination. Goff, 706 F.2d at 581. For a discussion of the legislative history accompanying § 541(c)(2), see supra notes 33-35 and accompanying text. According to the Goff court, the legislative history of both congressional houses indicates that § 541(c)(2) was enacted to continue the exclusion of the "debtor's interest in a spendthrift trust to the extent the trust is protected from creditors under applicable State law." Goff, 706 F.2d at 581 (quoting H.R. Rep. No. 595, 95th Cong., 2d Sess. 176 (1977), reprinted in 1978 U.S.C.C.A.N. 6136). The court noted that the legislative history indicated that § 541(c)(2) was included in the Code to continue the old Bankruptcy Act's exclusion of spendthrift trusts: "Section 541(c)(2) 'preserves restrictions on a transfer of a spendthrift trust . . . enforceable [under] nonbankruptcy law.' " Id. at 582 (quoting S. Rep. No. 989, 95th Cong., 2d Sess. 83 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5869).

Under the Act, state spendthrift trusts were explicitly excluded from the bankruptcy estate. Goff, 706 F.2d at 581 n.19. Also, a creditor was not allowed access to a trust unless the debtor's interest in the trust was "alienable or amenable" under local law. Id. By definition, spendthrift trusts are not "alienable or amenable" under local law. Id. For a discussion of spendthrift trust law, see supra note 7.

The Goff court held that despite § 541(c)(2)'s "facially broad reference to 'applicable nonbankruptcy law[,]" Congress intended its application to be limited to state spendthrift trusts. Goff, 706 F.2d at 581. The Goff court rejected the debtor's claim that § 541(c)(2) should be interpreted broadly to incorporate ERISA-qualified savings plans. Id.

41. Goff, 706 F.2d at 585. The court noted that the trusts listed under the legislative history accompanying § 522(b)(2)(A) were either "public[ly] funded and/or created pension and welfare systems" or a "few exceptional, traditionally guarded industries." Id. at 586. Examples include pensions paid to the winners of the Congressional Medal of Honor and wages paid to seamen. Id. at 586 nn.31-32. Based on these observations, the Goff court concluded Congress did not intend the Code to provide any preferential treatment to ERISA-qualified pension plans. Id. at 586. The court acknowledged that the application of § 522(b)(2)(A) was not involved in the case at bar; however, the court noted that consideration of the applicable federal law under § 522(b)(2)(A) would be "helpful" in determining the scope of § 541(c)(2). Id. at 582. For a discussion of § 522(b)(2)(A) and its accompanying exemptions, see supra notes 24-29 and accompanying text.

42. Goff, 706 F.2d at 581. The Goff court noted that it was the Code's intent "to broaden the 'property of the estate' available to creditors" and to "limit any
§ 541(c)(2) have followed the reasoning of the *Goff* court.45

Consequently, under the narrow interpretation view, “applicable nonbankruptcy law” only includes pension plans which are enforceable under state spendthrift trust law.44 Accordingly, ERISA-qualified savings plans that also meet the criteria of the debtor’s state spendthrift trust laws will be excluded from the bankruptcy estate.45 However, certain ERISA-qualified plans, such as Keogh plans,46 will not qualify as spendthrift trusts and, therefore, will not be excluded from the bankruptcy estate by those courts embracing the narrow interpretation view.47

B. The Broad Interpretation View

Four circuits, including the Third Circuit, have broadly interpreted “applicable nonbankruptcy law” to include trusts with restrictions upon alienation and assignment which are enforceable under either federal or exemptions of pension funds.” *Id.* at 587. The court based its interpretation of the congressional intent in promulgating of § 541(c)(2) upon the legislative history accompanying the Code. *Id.* at 578.

The legislative history accompanying § 541 notes that “[t]he scope of this paragraph is broad.” S. Rep. No. 989, 95th Cong., 2d Sess. 82 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5868. In addition, the legislative history indicates that “[s]ubsection (c) [of § 541] invalidates restrictions on the transfer of property of the debtor, in order that all of the interests of the debtor in property will become property of the estate.” *Id.* at 83. According to the *Goff* court, a broad interpretation of “applicable nonbankruptcy law” would frustrate this intent of the Code. *Goff*, 706 F.2d at 587. The court noted that it was axiomatic that while ERISA was intended to preempt state law, ERISA was not intended to “supersede any law of the United States [except pre-existing federal pension law].” *Id.* (quoting 29 U.S.C. § 1144(d) (1982)). Therefore, the *Goff* court held that the Code superseded any conflict between itself and ERISA. *Id.* For a discussion of the valuation of the bankruptcy estate, see *supra* notes 17-35 and accompanying text.


44. *Goff*, 706 F.2d at 587. In narrowly interpreting § 541(c)(2), the *Goff* court held that all ERISA-qualified plans are not automatically included in the bankruptcy estate. *Id.* Rather, the determinative factor was whether the ERISA-qualified plan would also qualify as a state spendthrift trust. *Id.* If an ERISA-qualified plan did qualify as a spendthrift trust under state law, then the plan would be excluded by § 541(c)(2). *Id.*

45. *Id.*

46. For a discussion of Keogh plans and why they do not qualify as spendthrift trusts, see *supra* note 9.

47. *Goff*, 706 F.2d at 588. The court noted that under spendthrift trust law, Keogh plans were self-settled trusts and therefore were not excluded from the bankruptcy estate. *Id.*
The United States Court of Appeals for the Fourth Circuit first established this broad interpretation of § 541(c)(2) in In re Moore. The Moore court based its decision upon several factors: the plain language of § 541(c)(2), Congress' specific reference to state law in other sections of the Code, and the lack of conclusive evidence in the legislative history of the Code. Thus, circuit courts aligned with this broad interpretation view have permitted the debtor to exclude all ERISA-qualified plans from the bankruptcy estate under the auspices of § 541(c)(2).

C. The Seventh Circuit's View

As previously discussed, courts espousing the narrow interpretation view reasoned that an ERISA-qualified plan must be enforceable under

48. See Gladwell v. Harline (In re Harline), 950 F.2d 669, 674 (10th Cir. 1991) (holding that "a tax-qualified ERISA pension or profit sharing plan is exempt from the bankruptcy estate under [section] 541(c)(2)"); Velis v. Kardanis, 949 F.2d 78, 83 (3d Cir. 1991) (same); Forbes v. Lucas (In re Lucas), 924 F.2d 597, 603 (6th Cir.) (same), cert. denied, 111 S. Ct. 2275 (1991); Anderson v. Raine (In re Moore), 907 F.2d 1476, 1480 (4th Cir. 1990) (same). For a discussion of the Velis court's interpretation of "applicable nonbankruptcy law," see infra notes 75-99 and accompanying text.

49. 907 F.2d 1476 (4th Cir. 1990). The debtors in Moore were employees of Spring Industries, Inc., which was located in South Carolina. Id. at 1476. The employees were participants in the company's comprehensive retirement program which consisted of a profit sharing plan and a retirement savings plan. Id. at 1477. Both of these plans were ERISA-qualified plans and therefore contained the ERISA-required provisions prohibiting alienation or assignment. Id.

50. Moore, 907 F.2d at 1477. The Fourth Circuit held that "'[applicable nonbankruptcy law] means precisely what it says: all laws, state and federal, under which a transfer restriction is enforceable." Id. The court also noted that the phrase "applicable nonbankruptcy law" is used elsewhere in the Code to refer to both state and federal law. Id. According to the Moore court, it is incongruous to give the same phrase in § 541(c)(2) a narrower construction than the identical phrase in other parts of the Bankruptcy Code." Id. at 1478.

51. Id. The Moore court noted that in other provisions of the Code, "when Congress intended to refer to state law, it did so explicitly." Id. For example, under § 109(c)(2), only debtors qualified under "State law" can file for Chapter 9. Id.; see also 11 U.S.C. § 109(c)(2) (1988) ("An entity may be a debtor under chapter 9 of this title if and only if such entity . . . is generally authorized to be a debtor under such chapter by State law."). In addition, Congress used the phrase "applicable nonbankruptcy law" to refer to both state and federal law in other areas of the Code. Moore, 907 F.2d at 1478. For example, under § 1125(d), the contents of post-petition disclosure statements are "'not governed by any otherwise applicable nonbankruptcy law' which includes, inter alia, federal securities law." Id. at 1477-78. Accordingly, the Moore court concluded that if Congress had intended to limit § 541(c)(2) to state law, the Code would have explicitly stated that limitation. Id.

52. Moore, 907 F.2d at 1479. The Moore court first noted that it was inappropriate to refer to the legislative history of § 541(c)(2) because the language of this section is clear. Id. at 1478. Nevertheless, the court examined the legislative history and determined that Congress did not intend "applicable nonbankruptcy law" to refer exclusively to state spendthrift trust law. Id. at 1479.
applicable state spendthrift trust law before it can be excluded under § 541(c)(2).\textsuperscript{53} In In re LeFeber,\textsuperscript{54} the United States Court of Appeals for the Seventh Circuit avoided this analytical step by holding that all ERISA-qualified plans are state spendthrift trusts and thus qualify as exclusions under either the narrow or broad interpretation of "applicable nonbankruptcy law."\textsuperscript{55}

IV. CASE ANALYSIS: VELIS V. KARDANIS

Against this backdrop of disagreement among the circuit courts, the Third Circuit considered the issue of whether § 541(c)(2) excluded an ERISA-qualified pension plan, Keogh plan and IRA from a bankrupt's estate in Velis v. Kardanis.\textsuperscript{56}

A. Facts and Procedural History

The debtor in Velis was a physician employed by a professional corporation (PC) of which he was the sole stockholder.\textsuperscript{57} The PC had established a pension plan for all of its employees.\textsuperscript{58} In addition, the PC created a Keogh plan and an IRA for the benefit of the debtor and a separate IRA for the benefit of the debtor's wife.\textsuperscript{59} All three plans met the qualification requirements of § 401(a)(13) of the Internal Revenue Code (IRC) and § 1056(d)(1) of ERISA, both of which require the inclusion of provisions in the plan documents prohibiting the assignment or alienation of benefits from the plans.\textsuperscript{60}

53. For a discussion of the narrow interpretation view, see supra notes 39-47 and accompanying text.

54. 906 F.2d 330 (7th Cir. 1990). The debtor in LeFeber was an Indiana resident who received a $1,000 per month pension from the Teamsters Central States Southeast and Southwest Areas Pension Fund. Id. at 330. The fund was an ERISA-qualified plan and contained provisions forbidding the assignment of benefits. Id. Under Indiana state spendthrift trust law, all ERISA-qualified plans are spendthrift trusts. Id.

55. Id. at 331.

56. 949 F.2d 78 (3d Cir. 1991).

57. Id. at 79. The debtor owned 100% of the PC's stock and was the only physician employed by the PC. Id.

58. Id. "In January 1980, the PC established a pension plan for the benefit of the debtor, his wife and two other employees." Id. At the time he filed for bankruptcy protection, the debtor's interest in the pension plan was valued at $184,000. In re Velis, 123 B.R. 497, 501 (Bankr. D.N.J.), aff'd in part and rev'd in part, Velis v. Kardanis, 949 F.2d 78 (3d Cir. 1991).

59. Velis, 949 F.2d at 79. Upon the date the debtor filed for bankruptcy, his interest in his Keogh Plan was valued at $162,478, and his interest in the IRA was valued at $9,100. Velis, 123 B.R. at 501.

In August of 1986, the debtor and his wife entered into a contract to purchase office space in which the PC was located. In October of 1986, prior to the closing of the sale, the creditor in Velis obtained a $2.1 million medical malpractice judgment against the debtor. On December 18, 1986, pursuant to the creditor's efforts to collect the judgment, the debtor filed for Chapter 11 bankruptcy protection. However, less than two weeks after filing for bankruptcy, the debtor withdrew money from the retirement savings plans to meet the payment required under the newly negotiated contract to purchase the office space.

The creditor in Velis claimed that § 541(c)(2) did not exclude retirement savings plans regulated by federal statute. Accordingly, the creditor maintained that she was entitled to have both the withdrawn and untouched portions of the savings plans included in Velis' bankruptcy estate. The debtor, on the other hand, claimed that his property interests in the various retirement savings plans were excluded from the bankruptcy estate pursuant to § 541(c)(2) and, therefore, not subject to the estate in Velis.

61. Velis, 949 F.2d at 80. The PC was located within two cooperative apartments. Id. The purchase price for the apartments was $775,000. Id. Velis made a down payment of $77,500. Id. The funds for the down payment were obtained through the sale of the Velis' house in Seabright, New Jersey. Velis, 123 B.R. at 501. Velis also received a commitment from a bank to finance $620,000 of the balance owed on the apartments. Id. The entire balance of the purchase price, $697,500, was due upon the closing of the purchase contract, which was scheduled for the end of December. In re Velis, 109 B.R. 64, 66 (Bankr. D.N.J. 1989).

62. Velis, 109 B.R. at 66. The creditor in Velis was a patient of Velis' who had sued him for medical malpractice. Id. The initial judgment against Velis was $3.7 million; however, the judgment was later reduced to $2.1 million. Id. Unfortunately for the debtor, his malpractice insurance policy had a limit of $1 million. Id.

63. Id. at 66. By this time, the creditor had already levied against the Velis’ joint bank account, which had a balance of $183,000. Id.

64. Velis, 949 F.2d at 80. Upon learning of the malpractice judgment against the debtor, the bank cancelled its commitment on the debtor's mortgage. Id. The debtor renegotiated the purchase contract for the PC property, and the bank granted the debtor an extension of the closing date conditioned upon the payment of $225,500 prior to December 31, 1986. Id. Since the debtor was unable to obtain financing from an institutional lender, on December 30, 1986, the debtor borrowed $225,500 from his pension plan to meet the required deposit. In re Velis, 123 B.R. at 501. The debtor made this withdrawal without the authorization of the bankruptcy court. Id.

In addition, on October 15, 1987, the debtor again borrowed money from his retirement savings plans but with the authorization of the bankruptcy court. Velis, 109 B.R. at 66. The debtor borrowed a total of $700,433, of which $355,578 was removed from the various plans. Velis, 949 F.2d at 80. All of these funds were used to complete the purchase of the PC's property. Id.

65. Velis, 123 B.R. at 503. The creditor argued that “applicable nonbankruptcy law” is narrowly limited to state spendthrift trust law and does not include ERISA. Id. The creditor, therefore, asserted that the ERISA-qualified plans would be included in the bankruptcy estate. Id.

66. Id.
to the claims of the creditor. In finding for the creditor, the bankruptcy court held that the phrase "applicable nonbankruptcy law" was limited to state spendthrift trust law and, therefore, that the savings plans were included in the bankruptcy estate.

In reaching its decision, the bankruptcy court noted that "the Court of Appeals for the Third Circuit [had] not yet addressed the meaning of 'applicable nonbankruptcy law' as that phrase is used in § 541(c)(2)." Consequently, the bankruptcy court itself was required to analyze § 541(c)(2) and determine the scope of the phrase "applicable nonbankruptcy law." In its analysis, the court explicitly rejected the broad interpretation of the Fourth Circuit in Moore and held that the exclusion available under § 541(c)(2) was limited to state spendthrift trust law.

The bankruptcy court reached its decision before the Sixth or the Tenth Circuit had addressed the issue of the interpretation of § 541(c)(2). Both of these circuit courts rejected the narrow interpretation of "applicable nonbankruptcy law" and held that state and federal law were included within the scope of § 541(c)(2). See Gladwell v. Harline (In re Harline), 950 F.2d 669, 674 (10th Cir. 1991) ("We do not perceive an ambiguity in the phrase 'applicable nonbankruptcy law' that would permit us to differentiate state from federal law. The phrase on its face is clear and broad."); Forbes v. Lucas (In re Lucas), 924 F.2d 597, 598 (6th Cir. 1991) ("We reject a narrow interpretation of the phrase 'applicable nonbankruptcy law' in § 541(c)(2) . . . , finding that the plain unambiguous language of the statute encompasses federal law other than that arising under Title 11 as well as state statutory and case law."), cert. denied, 111 S. Ct. 2275 (1991).

For a discussion of the Moore court's holding and its subsequent adoption of the broad interpretation approach, see supra notes 48-52 and accompanying text.

71. For a discussion of the Moore court's holding and its subsequent adoption of the broad interpretation approach, see supra notes 48-52 and accompanying text.
law. The court concluded that the ERISA-qualified retirement savings plans at issue, which did not qualify as spendthrift trusts, were subject to inclusion in the bankrupt’s estate. The debtor appealed this decision to the United States Court of Appeals for the Third Circuit.

B. *The Third Circuit’s Analysis of “Applicable Nonbankruptcy Law” in Velis v. Kardonis*

On appeal, the Third Circuit overturned the bankruptcy court’s decision and held that the phrase “applicable nonbankruptcy law” included federal law. The Third Circuit relied upon several factors to

72. *Velis*, 123 B.R. at 508. The court considered the *Moore* reasoning to be “particularly troubling because of its deceptive appeal.” *Id.* at 506 (emphasis added). Primarily, the bankruptcy court disagreed with the *Moore* court’s holding that “applicable nonbankruptcy law” was “plain language.” *Id.* (quoting Anderson v. Raine (*In re Moore*), 907 F.2d 1476, 1477 (4th Cir. 1990)). On the contrary, the bankruptcy court held that “the phrase ‘applicable nonbankruptcy law’ is not a term of art capable of uniform meaning, but, rather, is a ubiquitous catchall phrase.” *Id.* at 507. In addition, the *Moore* court considered it dispositive that the phrase “applicable nonbankruptcy law” was used throughout the Code to refer to both state and federal law. *Moore*, 907 F.2d at 1478. The bankruptcy court characterized this conclusion by the *Moore* court as “irrelevant” and concluded that “intra-statutory comparison for the purpose of interpretation of the phrase ‘applicable nonbankruptcy law’ [was] meaningless.” *Velis*, 123 B.R. at 507.

73. *Velis*, 123 B.R. at 514. The bankruptcy court concluded that the Keogh plan and the IRA were, by their definition, self-settled trusts and therefore did not qualify as spendthrift trusts under New Jersey law. *Id.* at 509. On the other hand, the pension plan was an employer-created trust for the benefit of an employee and technically a spendthrift trust under New Jersey law. *Id.* The bankruptcy court concluded that because the PC was the “alter ego” of Velis, the pension should also be considered a self-settled trust. *Id.* For a discussion of self-settled trusts and why they do not qualify as spendthrift trusts, see supra note 7.

74. For a discussion of the Third Circuit’s opinion in *Velis*, see infra notes 75-99 and accompanying text.

75. *Velis* v. *Kardonis*, 949 F.2d 78, 82 (3d Cir. 1991). In reaching its decision, the *Velis* court noted that four of the five circuits that had considered the issue of § 541(c)(2) had “narrowly construed the term ‘applicable nonbankruptcy law’ as used in § 541(c)(2) to encompass only state spendthrift trust law.” *Id.* at 80. For a discussion of the circuit court cases that have narrowly interpreted § 541(c)(2), see supra notes 39-47 and accompanying text. The *Velis* court also noted that the bankruptcy courts within the Third Circuit were split on the scope of the phrase “applicable nonbankruptcy law,” with a majority of the courts favoring the narrow interpretation view. *Velis*, 949 F.2d at 80; see, e.g., *In re Atallah*, 95 B.R. 910, 915 (Bankr. E.D. Pa. 1989) (holding that “[t]he term ‘applicable non-bankruptcy law’ in § 541(c)(2) refers to state spendthrift trust law”); accord *In re Hysick*, 90 B.R. 770, 773 (Bankr. E.D. Pa. 1988); *In re Heisey*, 88 B.R. 47, 51 (Bankr. D.N.J. 1988); *White v. Babo* (*In re Babo*), 81 B.R. 589, 391 (Bankr. W.D. Pa. 1988); *B.K. Medical Sys., Inc. Pension Plan v. Roberts* (*In re Roberts*), 81 B.R. 354, 374 (Bankr. W.D. Pa. 1987). *But see Bentz v. Sawdy* (*In re Sawdy*), 49 B.R. 383, 386 (Bankr. W.D. Pa. 1985) (holding that money in state-mandated and controlled public school employees’ retirement fund was excluded by § 541(c)(2) from becoming part of bankruptcy estate); *Liscinski v. Mosley* (*In re Mosley*), 42 B.R. 181, 191 (Bankr. D.N.J. 1984) (noting that “[r]eferr-
reach its decision.

First, the court found the language of § 541(c)(2) of the Code to be unambiguous. Specifically, the court concluded that the "term 'enforceable under applicable nonbankruptcy law' is not in the least ambiguous, and cannot reasonably be interpreted as 'enforceable under applicable state spendthrift-trust law.' " The court concluded that, on its face, the phrase "applicable nonbankruptcy law" is not limited to state spendthrift trust law.

The second determinative factor the Velis court noted was that the phrase "applicable nonbankruptcy law" is used elsewhere in the Code to refer to both state and federal law. For example, § 108(a), (b) and (c) of the Code contains "the phrase [applicable law] to toll the statute of limitations for both federal and state law claims." In addition, § 365(n)(1)(B) and § 1125(d) of the Code use the phrase "applicable nonbankruptcy law" to refer to federal copyright laws and federal securities laws, respectively. Therefore, according to the Velis court, the use of the phrase "applicable nonbankruptcy law" in other sections of theCode illustrates the breadth of its meaning. The Velis court relied on the Third Circuit's interpretation of § 541(c)(2) in Moore, which held that the phrase "applicable nonbankruptcy law" encompasses both state and federal law. The Velis court found the reasoning of the Third Circuit to be persuasive.

A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—[either] because the same terminology is used elsewhere in a context that makes its meaning clear, or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law. (quoting United Sav. Ass'n of Texas v. Timbers of Inwood Forest Ass'n, Ltd., 484 U.S. 365, 371 (1988)). The bankruptcy court rejected this reasoning. In re Velis, 123 B.R. at 507. For a discussion of the bankruptcy court's conclusion, see supra note 73.

The phrase "applicable law" is used in subsections (a) and (b) of § 108 to define the statute of limitations for a trustee of a debtor to preserve the debtor's legal claims and is used in subsection (c) to preserve the creditor's legal claims. 11 U.S.C. § 108(a)-(c) (1988). The legislative history specifically mentions the federal tax code as falling within the scope of "applicable law." Velis, 949 F.2d at 81.
Code to specifically include both state and federal law is evidence that
Congress intended the phrase to encompass all applicable laws, whether
state or federal.\footnote{82} The third basis for the Velis court’s conclusion was Congress’ explicit reference to state or federal law in other sections of the Code when such a limitation was intended.\footnote{83} As an example, the court noted that other code sections, such as § 522(b)(1) and (2), explicitly specify federal or state law when such a distinction is intended.\footnote{84} Therefore, the Velis court suggested that if Congress had intended “applicable nonbankruptcy law” to mean “applicable state spendthrift trust law” in § 541(c)(2), it would have specifically included such language of limitation in the text of § 541(c)(2).\footnote{85}

The fourth factor noted by the Velis court was that the legislative history of the Code fails to limit the application of § 541(c)(2) to state spendthrift trusts.\footnote{86} The court determined that the legislative history’s mention of spendthrift trust law does not indicate congressional intent to exclude all other law.\footnote{87}

Finally, the court concluded that based upon the enactment of the federal statutes for ERISA, Keogh plans and IRAs, Congress had a “deep and continuing interest in the preservation of pension plans, and in encouraging retirement savings.”\footnote{88} In order to preserve these congressional interests, the Velis court determined that Congress must have intended “applicable nonbankruptcy law” to be broadly interpreted in § 541(c)(2) to encompass those federal statutes.\footnote{89}

Once the Velis court determined that the phrase “applicable nonbankruptcy law” included federal law, the court considered each of the debtor’s retirement savings plans to determine which of these plans were subject to restrictions under federal law which could be characterized as “applicable nonbankruptcy law.” To the extent that any portion of one of the debtor’s plans was subject to such federal restrictions, § 541(c)(2) would apply, excluding that portion of the plan from the

\footnotesize
\begin{itemize}
  \item \footnote{82} Id. at 82.
  \item \footnote{83} Id. at 81. The Velis court determined that “Congress made clear its ability to specify either state or federal law when such limitation was intended.” \textit{Id.}
  \item \footnote{84} Id. For a discussion of 11 U.S.C. § 522(b), see \textit{supra} notes 24-29 and accompanying text.
  \item \footnote{85} Velis, 949 F.2d at 81.
  \item \footnote{86} Id. The court based its interpretation of the legislative history of the Code on the reasoning of the Moore court. \textit{Id.} at 82. The Velis court agreed “that [while] Congress intended to preserve the protections afforded by state spendthrift trust laws, the legislative history plainly does not establish that that was the only purpose intended to be accomplished by § 541(c)(2).” \textit{Id.} (citing Anderson v. Raine (\textit{In re Moore}), 907 F.2d 1476 (4th Cir. 1990)). For a discussion of Moore, see \textit{supra} notes 48-52 and accompanying text.
  \item \footnote{87} Velis, 949 F.2d at 81.
  \item \footnote{88} Id. at 82. This is reflected by Congress’ promulgation of the federal statutes which provide for “ERISA, Keogh plans and IRAs.” \textit{Id.}
  \item \footnote{89} Id.
\end{itemize}
debtor's bankruptcy estate. The court first scrutinized the debtor's IRA account to determine if federal law regulated the account to the extent required to exclude this asset from the debtor's bankruptcy estate. The court noted that ERISA does not require the inclusion of anti-alienation or assignment provisions in an IRA governing instrument. Accordingly, the debtor's IRA account had "no enforceable restrictions, under any 'nonbankruptcy law' or otherwise." The court determined that the language of § 541(c)(2) did not operate to exclude the IRA from Velis' bankruptcy estate; therefore, the account was available to creditors.

The court then turned to the debtor's pension plans and Keogh plan. While these plans were both ERISA-qualified plans containing the requisite anti-alienation and assignment provisions, the Velis court bifurcated the plans into two distinct segments: the portion of the plan's assets that had already been distributed to the debtor and the portion of the plan's assets which had not been distributed to the debtor. As to the assets already distributed to the debtor, the court posited that once the debtor removed these funds from the plans, they were no longer subject to the anti-alienation and assignment restrictions. Instead, the funds were in the "unrestricted possession" of the debtor and, therefore, were neither part of the plans' assets nor subject to any significant federal nonbankruptcy law. Accordingly, the court concluded that the distrib-

90. Id.

91. Id. For a general discussion of IRAs, see supra note 10.

92. Velis, 949 F.2d at 82. The court also noted that at the time the debtor filed the bankruptcy petition, he was 63 years of age and could therefore withdraw funds from his IRA without any penalty. Id. The court did not indicate, however, whether an IRA account, with an enforceable penalty for withdrawal still in effect, would be a trust with restrictions upon transfer as required by § 541(c)(2).

93. Id. The court noted that the payout from the IRA was still "susceptible to possible exemption under § 522(d)(10)(E)," at least to the extent reasonably necessary to support the debtor and his dependents. Id. For a discussion of the exemption allowed under § 522(d)(10)(E), see supra note 25 and accompanying text.

94. Velis, 949 F.2d at 82. The pension plan and the Keogh plan were both ERISA-qualified and contained the requisite language prohibiting the assignment or alienation of benefits. Id. at 79.

95. See 11 U.S.C. § 541(c)(2) (1988). The Velis court concluded that the language of § 541(c)(2) requires the recognition of restrictions upon the transfer of trust funds which are enforceable under either state or federal law. Velis, 949 F.2d at 82. For the text of § 541(c)(2), see supra note 4. However, the court noted that § 541(c)(2) "does not operate to require non-recognition of transfers which have already occurred, nor does it apply to assets in the possession of the debtor without restrictions." Velis, 949 F.2d at 82.

96. Velis, 949 F.2d at 82. In reaching this conclusion, the court noted that the funds were used to purchase property for the debtor's own purposes. Id. If the funds had been used to purchase an asset for the pension plan, the asset would still possess the restrictions upon alienation or assignment imposed by ERISA. Id.
uted portions of the plans were part of the bankruptcy estate and not excludable under § 541(c)(2). As to the undistributed assets in the plans, the court concluded that such assets still possess the ERISA restrictions on their transfer. These assets, therefore, are subject in their entirety to “applicable nonbankruptcy law” as contemplated under § 541(c)(2) and are thus excluded from the bankruptcy estate.

V. THE IMPACT OF Velis

The Velis court's holding reflects the modern trend of courts to interpret “applicable nonbankruptcy law” in a broad manner and to allow § 541(c)(2) exclusions under either federal or state “applicable nonbankruptcy law.” While such a broad interpretation of “applicable nonbankruptcy law” provides “uniform treatment of benefits throughout the country,” it also raises additional questions. Specifically, three questions are left unanswered: one, the standard of restriction that is necessary to qualify as “applicable nonbankruptcy law”; two, the use of pension plan funds to purchase assets for the funds; and three, the use of the retirement savings plan as a conduit to defraud creditors.

By providing “uniform treatment of benefits,” the Third Circuit has guaranteed security for an individual in his retirement savings.  

97. Id. The court concluded that the assets which have been distributed to the debtor are no longer subject to the restrictions imposed under ERISA and, therefore, are no longer entitled to the protections available under ERISA. Id. Such distributed assets do not fall under the category of property subject to “applicable nonbankruptcy law.” Id.

98. Id.

99. Id. at 83. The court concluded that “any undistributed assets in the pension plan and Keogh plan... may be excluded under § 541(c)(2) unless there is some other basis for challenge.” Id. The court had previously noted that the trusts would always be open to a challenge of fraud on the part of the debtor. Id. at 82. Accordingly, if a creditor can prove that there were substantial payments made to the retirement savings plans in an effort to defraud the creditor, the court would hold such conveyances void. Id. The court acknowledged that fraud was not an issue in Velis. Id.

100. Of the nine circuits that have examined the phrase “applicable nonbankruptcy law,” the four most recent cases have held that its application is not limited to state spendthrift trusts. See, e.g., Gladwell v. Harline (In re Harline), 950 F.2d 669, 674-75 (10th Cir. 1991) (“[W]e do not find a clearly expressed legislative intention to limit the meaning of § 541(c)(2) exclusively to state-recognized spendthrift trusts.”); Velis, 949 F.2d at 83; Forbes v. Lucas (In re Lucas), 924 F.2d 597, 603 (6th Cir.), cert. denied, 111 S.Ct. 2275 (1991); Anderson v. Raine (In re Moore), 908 F.2d 1476, 1480 (4th Cir. 1990). The approach adopted by these courts represents a broad interpretation of the concept of “applicable nonbankruptcy law.” Id.

101. Lucas, 924 F.2d at 603.

102. Id. The Lucas court noted that a broad interpretation of § 541(c)(2) provided uniform treatment of retirement benefits around the country, which was the statutory policy envisioned in the promulgation of ERISA. Id.

103. While uniform treatment of benefits is the goal of the Code, it also
Under the narrow interpretation theory, two participants of the same plan could receive different treatment, depending upon their state of domicile. More importantly, a broad interpretation of the scope of § 541(c)(2) allows the self-employed or the owner-employee to have the same security in their retirement savings as a non-owner employee.

In light of these concerns, some recent decisions by circuit courts adhering to the narrow interpretation of § 541(c)(2) indicate that these circuits might reverse their previous positions and adopt the broad interpretation view. For example, the Ninth Circuit in In re Kincaid noted that there is "a certain incongruity in the notion that only ERISA's anti-alienation provisions offer protection until bankruptcy, and only state spendthrift provisions do so in bankruptcy."

As mentioned earlier the broad interpretation, while effectuating the intent of the Code and ERISA, has left some open questions in the
effectuates the intent of ERISA. Watson & Hoeflisch, supra note 3, at 10. ERISA was promulgated to protect covered employees and to ensure the availability of benefits promised under their retirement savings plans. Id. A broad interpretation of the phrase "applicable nonbankruptcy law" ensures that all employee benefit plans are protected.

104. For example, state spendthrift trust law in State A may disallow certain ERISA-qualified plans as spendthrift trusts because they are self-settled, while State B’s spendthrift trust law, such as Indiana’s, might define these same ERISA-qualified plans as spendthrift trusts. Upon filing for bankruptcy, a resident of State A would have to include his ERISA-qualified plans within his bankruptcy estate, whereas a resident of State B would be able to exclude his ERISA-qualified plans from his bankruptcy estate, even though both individuals are participants in the same type of plan. For a discussion of Indiana’s spendthrift trust law, see supra notes 53-55 and accompanying text.

105. Specifically, the broad interpretation theory protects an individual’s Keogh plan, which is a pension plan for the self-employed. Even though Keogh plans are ERISA-qualified, by definition, they are self-settled trusts and are not entitled to the protections provided to spendthrift trusts. By broadly interpreting § 541(c)(2), such plans would be deemed subject to “applicable nonbankruptcy law” and would therefore be excluded from a self-employed debtor’s bankruptcy estate. Thus, under the Velis court’s broad interpretation, the self-employed are granted the security they deserve in their retirement savings plans. For a discussion of state spendthrift trust law, see supra note 7. For a discussion of Keogh plans and their identification as self-settled trusts, see supra note 9.

106. 917 F.2d 1162 (9th Cir. 1990). The debtor in Kincaid was attempting to exclude his 401(k) Deferred Salary Plan from his bankruptcy estate. Id. at 1164. The plan was ERISA-qualified, containing the anti-alienation and assignment provisions as required by § 1056(d)(1) of ERISA. Id.

107. Id. at 1166. The Kincaid court was nevertheless unwilling to overturn its previous holding in In re Daniel. Id. In Daniel, the Ninth Circuit adopted the Goff court’s narrow interpretation of § 541(c)(2). Daniel v. Security Pac. Nat’l Bank (In re Daniel), 771 F.2d 1352, 1359 (9th Cir. 1985), cert. denied, 474 U.S. 1016 (1986). For a discussion the court’s holding in Goff, see supra notes 39-58 and accompanying text. In In re Dyke, the court “recognize[d] that the federal courts have not uniformly embraced [its] decision in In re Goff.” In re Dyke, 943 F.2d 1435, 1441 (5th Cir. 1991). The Dyke court concluded that even if “we were convinced that In re Goff states an incorrect interpretation of section 541(c)(2), we still would have no authority to overrule an earlier decision of our Court.” Id. at 1442.
context of retirement savings plans. For example, the broad interpretation will likely lead to closer scrutiny of a debtor's ERISA-qualified plans, raising the question of what level of restriction is necessary to qualify as "applicable nonbankruptcy law" for the purposes of section 541(c)(2).\(^{108}\) In addition, in the context of pension plan funds, the Third Circuit itself posed the question of what happens when pension plan funds are used to purchase assets for the pension plan and not specifically for the debtor's own use.\(^{109}\) Finally, while the Third Circuit acknowledged that pension plans might be used fraudulently to shield a bankrupt's assets, the court did not provide a definitive standard on what is a "fraudulent conveyance."\(^{110}\) These questions raise the specter of potential abuse and require further attention from the courts.

VI. Conclusion

The United States Court of Appeals for the Third Circuit, by broadly interpreting the scope of § 541(c)(2) to include restrictions upon alienation and assignment enforceable under federal law, has joined at least three other circuit courts in providing an individual debtor with the protection of retirement savings plans envisioned under both ERISA and the Code. Such retirement savings plans are protected, ensuring the availability of their promised benefits, regardless of whether the debtor is an employee, self-employed or an owner-employee. At the same time, a creditor is still given an opportunity to have access via the bankruptcy estate to the ordinary payments from a debtor's retirement plan under the provision of § 522(d)(10)(E). This balancing of two juxtaposed interests serves the overall policy of the Code.

James A. Boyd, Jr.

---

108. See Dean S. Waldt, 3d Cir. Widens Split on Pension Plan Protection, 129 N.J.L.J. 1106, 1106 (1991). Waldt points out that "boilerplate anti-alienation provisions" might not meet the standards of § 541(c)(2) thereby leaving a pension plan open to the challenge of whether it is ERISA qualified. Id.


110. In Velis, the court noted that these retirement savings plans were still "vulnerable to challenge as fraudulent conveyances or voidable preferences." Id. Accordingly, "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 . . . § 541(c)(2)." Id. While this provides a framework for defining fraudulent conveyances, the court did not define what a "substantial" or "unusual" contribution would be. Id. The court did acknowledge, however, that in the Velis case, there was no evidence of an intent to defraud on the part of the debtor. Id.