ROUSEY AND THE NEW RETIREMENT FUNDS EXEMPTION

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For debtors concerned with protecting their retirement funds, this past April brought two welcome developments. On April 4, in *Rousey v. Jacoway*,[1] the Supreme Court found an exemption for traditional individual retirement accounts ("IRAs") in the problematic language of section 522(d)(10)(E) of the Bankruptcy Code ("the Code").[2] On April 20, that result was ratified and extended with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").[3] Section 224 of BAPCPA, captioned "Protection of Retirement Savings in Bankruptcy," provides a straightforward exemption for a wide range of tax-exempt retirement funds, including both traditional and Roth IRAs.[4]

Part I below sets the context with an overview of how debtors' retirement funds, particularly IRAs, have been treated in bankruptcy until now. Part II then turns to *Rousey*, focusing on the Court's strict textualist reasoning and proposing an alternative approach. Part III takes up the new exemption. By way of conclusion and forecast, Part IV considers the reduced role remaining for the old exemption and the continuing relevance of *Rousey*.

I. SPENDTHRIFT TRUSTS AND DEBTORS' RETIREMENT FUNDS IN BANKRUPTCY BEFORE *ROUSEY*

In a bankruptcy case, the source for any distribution to creditors is nonexempt property of the estate. It has long been established that some retirement funds are entirely excluded from the estate. For other funds that are assets of the estate, including IRAs, exemptions have often been claimed—but with mixed success.

A. Excluding "ERISA-Qualified" Pension Plans from the Bankruptcy Estate

In 1992, the Supreme Court held in *Patterson v. Shumate* that "a debtor's interest in an ERISA-qualified pension plan may be excluded from the property of the estate pursuant to section 541(c)(2)"[5] of the Code. That statement involves three federal statutes whose interrelationships continue to shape the treatment of

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[1] 125 S. Ct. 1561 (2005).

[2] 11 U.S.C. § 522(d)(10)(E) (2000) (stating debtor may exempt right to receive certain payments).

[3] Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified in scattered sections of 11 U.S.C.).

[4] *Id*. § 224, 119, Stat. at 62 (to be codified in various subsections of 11 U.S.C. § 522).

[5] 504 U.S. 753, 765 (1992).

retirement funds in bankruptcy—the Code itself, the Employee Retirement Income Security Act of 1974 ("ERISA"),[6] and the Internal Revenue Code ("IRC").[7]

The estate in bankruptcy consists generally of "all legal or equitable interests of the debtor in property as of the commencement of the case."[8] The debtor's property generally goes into the estate even if it is otherwise non-transferable.[9] However, section 541(c)(2) of the Code provides an exception: "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."[10] As Congress clearly intended, a debtor's interest as the beneficiary of a spendthrift trust is thereby excluded from the estate.[11]

In the classic scenario for a spendthrift trust, a wealthy settlor transfers property to a trustee for the support of an improvident or incompetent relative.[12] The trust provides that "a beneficial interest shall not be transferable by the beneficiary or subject to claims of the beneficiary's creditors."[13] The beneficiary has no control over the trust property until the trustee distributes it.[14] Once distributed, however, the property is subject to the creditors.[15]

The creditors' inability to reach spendthrift trust assets is a consequence of the beneficiary's lack of access. If the beneficiary acquires "ownership equivalence" (or the power to force immediate distribution) of that property, it becomes accessible to creditors as well.[16]

Those rules pose a conflict between the settlor's interest in controlling his property and the creditors' rights to satisfy claims from funds exclusively devoted to their debtor. Because of that conflict, spendthrift trusts have long been controversial.[17] Today creditors generally cannot reach them in most states; but they are subject to limited categories of favored claims, including those for unpaid

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[6] ERISA is codified as amended at 29 U.S.C. §§ 1001-1461. Because ERISA's section numbers are different from the numbers assigned ERISA provisions in the codification of title 29, citations include both numbers.

[7] The IRC is codified as title 26 of the United States Code. Citations to the IRC below are in the conventional form "I.R.C. § __."

[8] 11 U.S.C. § 541(a)(1) (2000).

[9] *Id*. § 541(c)(1) (2000).

[10] *Id*. § 541(c)(2) (making enforceable in bankruptcy restriction on transfer of beneficial interest of debtor in trust enforceable under applicable non-bankruptcy law).

[11] *See* H.R. REP. NO. 95-595, at 369 (1977), *as reprinted in* 1978 U.S.S.C.A.N. 5963 (noting effect of section 541(c)(2) on spendthrift trusts).

[12] *See* GEORGE T. BOGERT, TRUSTS § 40 (6th ed. 1987) (summarizing law of spendthrift trusts).

[13] RESTATEMENT (THIRD) OF TRUSTS § 58 (2001) (restating terms of spendthrift trust).

[14] *See id*. comment b (restating requirements for valid spendthrift trust).

[15] *See id*. comment d(2) (restating rights of beneficiary's creditors in spendthrift trust assets).

[16] *See id*. comment b(1) (restating circumstances and consequences of ownership equivalence in spendthrift trust).

[17] *See id*. § 58 Reporter's Notes comment a (summarizing controversy over validity of spendthrift trusts); Bogert, *supra* note 12, § 40 (summarizing law of spendthrift trusts).

alimony and child support.[18] In ratifying that broad protection in the Code, Congress rejected a recommendation from the 1973 Commission on the Bankruptcy Laws. The Commission had favored making spendthrift trusts "reachable by the trustee in bankruptcy to the extent of any income in excess of that reasonably necessary for the support of the debtor and his dependents."[19]

There are key similarities between common law spendthrift trusts and pension plans "subject to ERISA" that is, subject to all of title I of ERISA.[20] Those plans are generally required to hold their assets in a trust.[21] Under section 206(d)(1) of ERISA, moreover, "[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated."[22] (Again, there are exceptions, including one for "qualified domestic relations orders.[23]) In a traditional defined benefit plan, participants, like the beneficiary of a spendthrift trust, generally have no pre-distribution access to the funds set aside for pensions.[24]

On the other hand, some plans subject to ERISA differ considerably from common law spendthrift trusts. For example, such plans may include funds contributed by participants.[25] Yet it is black-letter law that a settlor cannot validly protect assets in a spendthrift trust for his own benefit.[26] Moreover, some defined-contribution plans depart from the spendthrift model in permitting participants who

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[18] *See* Bogert, *supra* note 12, § 40 (summarizing spendthrift trusts' protection from and exposure to creditors of beneficiary); RESTATEMENT (THIRD) OF TRUSTS, *supra* note 13, § 59 (restating exceptions to spendthrift trust protection for particular types of creditors).

[19] *See* Executive Dir., Comm'n on the Bankr. Laws of the U.S., Report of the Comm'n on the Bankr. Laws of the U.S., H.R. Doc. No. 93-137, pt. 2, at 147–148 (1973) (proposing to limit protection of spendthrift trusts to extent of any excess over those needed to support debtor and dependents).

[20] ERISA title I, commonly called "the labor title," has broad applicability to both pension plans and welfare plans established by employers engaged in commerce and unions representing their employees. ERISA § 4, 29 U.S.C. § 1003 (2000) (defining scope of ERISA title I). However, Part 2 of title I, which contains the anti-alienation language applied in *Patterson,* excludes all welfare plans and some pension plans as well. ERISA § 201, 29 U.S.C. § 1051 (2000) (outlining scope of Part 2 of ERISA title I); ERISA § 206(d), 29 U.S.C. § 1056 (requiring anti-alienation language in pension plans).

[21] *See* ERISA § 403, 29 U.S.C. §1103 (2000) (necessitating trust ownership of plan assets generally but providing limited exceptions).

[22] *See* ERISA § 206(d), 29 U.S.C. § 1056(d) (involving anti-assignment language in pension plans).

[23] *See* ERISA § 206(d)(2), 29 U.S.C. § 1056(d)(3) (excepting qualified domestic relations orders from anti-assignment rule).

[24] *See* JAY CONISON, EMPLOYEE BENEFIT PLANS IN A NUTSHELL 163–164 (West 2003) (summarizing tax treatment of early distributions from defined benefit plan).

[25] A Keogh plan that covers the self-employed sponsor (who contributes on his own behalf) and some other employee (besides the sponsor's spouse) can be both tax-qualified and subject to ERISA. *See, e.g.*, Yates v. Hendon, 541 U.S. 1, 7–8 (2004) (illustrating plan as tax-qualified and subject to ERISA); *see also* Anthony M. Sabino, *A Final Battle at the Last Line of Defense—The Struggle to Keep ERISA-Qualified Pension Plans Outside the Reach of Creditors in Bankruptcy Cases*, 12 AM. BANKR. INST. L. REV. 501, 504–519 (2004) (discussing *Yates* and its relation to other cases).

[26] *See* RESTATEMENT (THIRD) OF TRUSTS § 58(2) (2001) (restating invalidity of restraint on alienation of beneficial trust interest retained by settlor).

demonstrate "hardship" to obtain access to their contributions before retirement[27] and in allowing loans from the plan to participants.[28]

Before 1992, some courts of appeals had relied on those differences in holding that section 541(c)(2) does not exclude ERISA-subject plans from the bankruptcy estate.[29] Rejecting that approach, *Patterson* relied primarily upon the "plain language of the Bankruptcy Code and ERISA."[30] However, the Court also observed that its decision gave "full and appropriate effect to ERISA's goal of protecting pension benefits."[31] That goal is served by generally denying both participants and their creditors early access to funds set aside for retirement, much as the settlor's intentions are given effect by generally holding spendthrift trust assets beyond the reach of the beneficiaries and their creditors.

Patterson has led to some confusion with its use of the term "ERISA-qualified pension plan."[32] The debtor there was a participant in a retirement plan that was both subject to ERISA and qualified for advantageous tax treatment under IRC section 401.[33] As the Court observed, tax qualification itself independently requires that plan assets be held in a trust with a provision that "benefits provided under the plan may not be assigned or alienated."[34]

Indeed many of the pension provisions in ERISA have a counterpart in the tax qualification rules. At the same time, each body of law has separate requirements of its own.[35] Although the pension plan in *Patterson* was subject to both regimes, there are some retirement funds that are tax-qualified but not subject to ERISA[36]

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[27] *See, e.g.*, I.R.C. § 401(k)(2)(B)(IV) (2000) (permitting distribution before age 59 ½ in cases of hardship to employee); Treas. Reg. § 1.401(k)-(1)(d)(3) (2005) (regulating hardship distributions from 401(k) plans).

[28] While such loans are generally prohibited, ERISA § 406. 29 U.S.C. § 1106, they are permitted in the circumstances set forth in ERISA § 408(b)(1), 29 U.S.C. § 1108(b)(1).

[29] *See, e.g.*, Reed v. Drummond (*In re* Reed), 951 F.2d 1046, 1049–50 (9th Cir. 1991) (including retirement trust in estate because of pervasive control of assets by debtor, who was employer's sole shareholder); Goff v. Taylor (*In re* Goff), 706 F.2d 574, 588 (5th Cir. 1983) (including assets of Keogh plan in estate on grounds trust was settled by debtor for his own benefit).

[30] Patterson v. Shumate, 504 U.S. 753, 757, 759 (1992) (reading statute's plain language as "encompass[ing] any relevant nonbankruptcy law, including . . . ERISA.").

[31] *Id.* at 764–65 (quoting Court's decision to protect "stream of income for pensioners . . . even if that decision prevents others from securing relief for the wrongs done them . . . ." in Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 376 (1990)).

[32] *Id.* at 765 (excluding "ERISA-qualified pension plan" from bankruptcy estate property).

[33] *See id.* at 755 (describing *Patterson* pension plan in those terms).

[34] *Id.* at 759 (quoting I.R.C. § 401(a)(13) (2000)).

[35] *See, e.g.*, JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 234-39 (3d ed. 2000) (listing tax qualification requirements with ERISA counterparts and tax requirements with no ERISA counterpart).

[36] For example, IRC § 401(d) contemplates and imposes a requirement for qualification of Keogh plans, which provide benefits for owners-employees of a business and sometimes for other employees as well. However, ERISA title I does not apply to such plans when the only participants are owners. *See* 29 C.F.R. § 2510.3-3(b) (excluding from ERISA title I plans in which only partners or sole proprietor are participants). Plans established by governmental and church employers are broadly excluded from all of ERISA by ERISA § 4(b)(1) & (2), 29 U.S.C. § 1003(b)(1) & (2). Yet both types of plans may contain trusts qualified under IRC § 401. *See* Donna Litman, *Bankruptcy Status of "ERISA Qualified Pension Plans"—An Epilogue to*

and others subject to ERISA that may not be tax-qualified.[37] "Qualification" is a concept employed only in the IRC, not in ERISA.[38]

However, the term "ERISA-qualified" has led some courts to exclude from the bankruptcy estate only retirement plans that are both subject to ERISA and tax-qualified.[39] Others require simply that the plan be subject to ERISA.[40] Even if a plan is not subject to ERISA, it is excluded if it satisfies the requirements for a spendthrift trust.[41] The controversy has drawn scholarly attention,[42] but its practical importance is lessened by the new retirement exemption.

Under any interpretation of *Patterson*, however, a debtor's IRA is an asset of the bankruptcy estate. IRAs are expressly excluded from ERISA.[43] Moreover, they are not tax qualified, even though they do receive favorable tax treatment under their governing statute, IRC section 408.[44] As a result, IRAs are not subject to any federal statutory anti-alienation requirement. (In a few instances, however, IRAs have been excluded from bankruptcy estates on the basis of state laws restricting alienation.)[45]

But including IRAs in the estate does not automatically require that they be surrendered for the benefit of creditors. Some estate assets are preserved for the debtor as exempt.

B. Exempting Retirement Funds under Section 522(d)(10)(E)

Patterson v. Shumate, 9 AM. BANKR. INST. L. REV. 637, 656-691 (2001) (discussing application of *Patterson* to plans not subject to ERISA but with qualified trusts).

[37] *See* Litman, *supra* note 36, at 691–98 (discussing application of *Patterson* to plans subject to ERISA with trusts which may not be qualified).

[38] *See, e.g.*, Litman, *supra* note 36 at 643–56 (recognizing anomaly of combining "ERISA" with "qualified" and tracing term's development).

[39] *See, e.g.*, *In re* Hall, 151 B.R. 412, 427 (Bankr. W.D. Mich. 1993) (requiring plan be tax-qualified for exclusion from estate under section 541(c)(2)).

[40] *See, e.g.*, *In re* Sewell, 180 F.3d 707, 711 (5th Cir. 1999) (excluding from bankruptcy estate plan subject to ERISA but not tax-qualified); *In re* Baker, 114 F.3d 636, 639 (7th Cir. 1997) (Easterbrook, J.) (excluding ERISA-qualified plan from bankruptcy estate).

[41] *See, e.g.*, *In re* Moses, 167 F.3d 470 (9th Cir. 1999) (excluding non-ERISA plan from estate as spendthrift trust).

[42] *See, e.g.*, Litman, *supra* note 36 *passim* (analyzing application of *Patterson* to plans which are either subject to ERISA but not tax-qualified or tax-qualified but not subject to ERISA); Anthony J. Sabino and John P. Clarke, *The Last Line of Defense: The New Test for Protecting Retirement Plans from Creditors in Bankruptcy Cases*, 48 ALA. L. REV. 613 *passim* (1997) (advocating exclusion of plans subject to ERISA regardless of tax qualification).

[43] ERISA § 201(6) (2000), 29 U.S.C. § 1051 (2000) (excluding IRAs from Part 2 of ERISA title I)

[44] IRC § 408 (2000) (prescribing requirements and tax treatment for IRAs). Unlike tax-qualified plans, IRAs are not subject to spendthrift provisions. With some exceptions, IRC section 72(t) provides simply for a tax penalty of 10% of the amount of any funds withdrawn before age 59 ½. Hence the IRC permits (but discourages) withdrawals by the account holder at any time. IRC section 72(t)(1) uses the phrase "qualified retirement plan" (as defined in section 4974(c)) with reference to IRAs, but the general term "tax qualified" refers to plans meeting the requirements of IRC section 401 and related provisions). *See, e.g.*, CONISON, *supra* note 24 at 19–20 (detailing "qualified plan"); Langbein & Wolk, *supra* note 35 at 235 (explaining "qualified plan").

[45] *See, e.g.*, 735 ILL. COMP. STAT. § 5/12-1006(b)(3) & (c) (2003) (defining "retirement plan" to include IRAs and presuming retirement plans to be spendthrift trusts).

Since the enactment of the Code, section 522(d)(10)(E) has provided an exemption for

> the debtor's right to receive . . . a payment under a stock bonus, pension, profitsharing, annuity or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor, *unless*—
> (i) such plan or contract was established by or under the auspices of an insider that employed the debtor at the time the debtor's rights under such plan or contract arose;
> (ii) such payment is on account of age or length of service; *and*
> (iii) such plan or contract does not qualify under section 401(a), 403(a), 403(b), or *408 of the Internal Revenue Code of 1986*.[46]

Some of the states have adopted materially identical exemptions to be applied when their domiciliaries file bankruptcy.[47]

Unlike complete exclusion from the estate under section 541(c)(2), that exemption protects assets only "to the extent necessary for the support of the debtor and any dependent of the debtor." In *Patterson*, one of the arguments considered by the Court played upon that contrast. In resisting the application of section 541(c)(2) to retirement funds, the trustee in bankruptcy had argued that "[i]f a debtor's interest in a pension plan could be *excluded* in full from the bankruptcy estate . . . then there would have been no reason for Congress to create a limited *exemption* for such interests . . . ."[48] The Court rejected that argument with the observation that the exemption would still have a role to play in protecting debtors' rights in retirement funds outside the scope of ERISA, specifically including IRAs.[49]

In the aftermath of *Patterson*, four circuits gave effect to that observation in holding IRAs exempt under either section 522(d)(10)(E) itself or essentially identical state law exemptions.[50] Those decisions heavily relied on the reference in the exemption to IRC section 408. As the Ninth Circuit explained in *In re*

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[46] 11 U.S.C. § 522(d)(10)(E) (2000) (emphasis added). As noted in footnote 44, *supra*, references to "qualification" in connection with IRAs do not entail tax-qualification in the proper sense.

[47] *See, e.g.*, CAL. CIV. PRO. CODE § 703.140(10)(E) (providing applicable exemptions when Californians file bankruptcy); N.Y. DEBT. & CRED. LAW § 282(2) (providing similar exemptions for New Yorkers).

[48] Patterson v. Shumate, 504 U.S. 751, 762 (1992).

[49] *Id*. at 762–63.

[50] *See* Dettmann v. Brucher (*In re* Brucher), 243 F.3d 242 (6th Cir. 2001) (holding IRA exempt under section 522(d)(10)(E)); Farrar v. McKown (*In re* McKown), 203 F.3d 1188, 1190 (9th Cir. 2000) (holding IRA exempt under California law materially identical to section 522(d)(10)(E)); Dubroff v. First Natl. Bank of Glens Falls (*In re* Dubroff), 119 F.3d 75, 78 (2d Cir. 1997) (holding IRA exempt under New York law materially identical to section 522(d)(10)(E)); Carmichael v. Osherow (*In re* Carmichael), 100 F.3d 375, 376 (5th Cir. 1996) (holding IRA exempt under section 522(d)(10)(E)).

McKown, "There could be no reason for legislators to exclude non-qualifying IRAs from the exemption, as the exception does, unless they intended that qualifying IRAs could be exempt. Indeed, there could be no reason even to mention section 408, the IRA section, unless 'similar plan or contract' included them."[51]

In exempting the corpus of IRAs, those courts of appeals departed from an older line of decisions in the Third Circuit, beginning in 1983 with *In re Clark*.[52] There the Court of Appeals focused on the opening phrase of the exemption, "the debtor's right to receive . . . a payment." The 43-year old debtor was denied any exemption for his Keogh retirement account on the ground that he had no present right to those funds unless he paid a 10% tax penalty imposed on withdrawals made before the age of 59 ½.[53]

Patterson expressly reserved decision "on the separate question whether § 522(d)(10)(E) applies only to distributions from a pension plan that a debtor has an immediate and present right to receive, or to the entire undistributed corpus of a pension trust."[54] Even before the Eight Circuit's decision in *Rousey v. Jacoway*, therefore, the circuits were divided on how to interpret the exemption.

II. *ROUSEY V. JACOWAY*

A. Preliminaries

In 1998, Richard G. Rousey left his job at Northrup Grumman Corporation, where he had accumulated funds in a company-sponsored retirement plan.[55] The plan required participants to take lump-sum distributions when they left the company. Mr. Rousey complied by rolling his balance over to an IRA at the First National Bank of Berryville, Arkansas.[56] Not much later, his wife, Betty Jo Rousey, left her job at Northrop Grumman and likewise rolled her company retirement account over to a separate IRA at the same bank.

In 2001, the Rouseys filed a joint chapter 7 bankruptcy in the Western District of Arkansas. By that time, he was 57 years old and she was 53.[57] They scheduled among their assets the two IRAs, his with a balance just under $43,000 and hers just

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51 *McKown*, 203 F.3d at 1190.

52 Clark v. O'Neill (*In re* Clark), 711 F.2d 21 (3d Cir. 1983) (holding section 522(d)(10)(E) applicable only to rights present payment without penalty).

53 *Id*. at 22–23 (denying exemption because present withdrawal would be penalized). The 10% penalty is imposed by I.R.C. § 72(t).

54 Patterson v. Shumate, 504 U.S. 751, 763 n.5 (1992).

55 Except where otherwise indicated, this statement of the facts is drawn from *Rousey v. Jacoway*, 125 S. Ct. 1561, 1564–65 (2005).

56 Although the bank is not identified in the Court's opinion, its name appears in *Rousey v. Jacoway* (*In re Rousey*), 283 B.R. 265, 268 (B.A.P. 8th Cir. 2002).

57 The Rouseys' ages are drawn from Brief for the Petitioners at 35, *Rousey v. Jacoway*, 125 S. Ct. 1561 (2005) (No. 03-1407).

over $12,000.[58] The Rouseys claimed an exemption for each IRA under section 522(d)(10)(E) of the Code.

The trustee in bankruptcy, Jill R. Jacoway, objected to the Rouseys' exemption claim and moved that they be ordered to turn the IRAs over to her for distribution among their creditors.

The bankruptcy court ruled in favor of the trustee.[59] The pivotal fact was that each debtor was entitled to withdraw money from his or her IRA at any time, subject to a 10% tax penalty the Internal Revenue Code ("IRC") imposes on IRA withdrawals made before the accountholder reaches age 59½.[60] (That penalty is waived in the event of disability or other special circumstances.[61]) The court concluded from the debtors' ready access to the IRAs that payments received from them were not "on account of illness, disability, death, age, or length of service" and that an IRA itself was not "a stock bonus, pension, profit sharing, annuity or similar plan or contract."[62] There was no contest over whether the Rouseys' IRAs were "reasonably necessary" for their support.

The bankruptcy court's decision was affirmed, first by the Bankruptcy Appellate Panel for the Eighth Circuit[63] and then by the Court of Appeals.[64] In affirming, the Court of Appeals agreed that funds in the IRAs were accessible without regard to the exemption's trigger events of "illness, disability, death, age, or length of service." As to whether an IRA is a "similar plan or contract," however, the Eighth Circuit took no firm position. That reticence was based largely on the reference in the exemption to IRC section 408.[65]

The Eighth Circuit's denial of the exemption in *Rousey* could not be reconciled with either *Clark* or the decisions of the four circuits that had more broadly exempted IRAs. With a three-way division among the courts of appeals, the stage was set for an authoritative resolution.

B. The Supreme Court's Decision in Rousey

The Rouseys ultimately succeeded in exempting their IRAs under section 522(d)(10)(E).

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[58] The balances in the Rouseys' IRAs are drawn from *Rousey v. Jacoway* (*In re Rousey*), 347 F.3d 689, 691 (8th Cir. 2003).

[59] *In re* Rousey, 275 B.R. 307, 309 (Bankr. W.D. Ark. 2002).

[60] *Id*. at 313–17. The 10% penalty is imposed by I.R.C. § 72(t)(1) (2000) ("If any taxpayer receives any amount from a qualified retirement plan . . . the taxpayer's tax . . . shall be increased by an amount equal to 10 percent of the portion of such amount which is includable in gross income.").

[61] I.R.C. § 72(t)(2) (2000) (listing exceptions to 10% penalty).

[62] *In re* Rousey, 275 B.R. 307, 311, 317 (Bankr. W.D. Ark. 2002).

[63] Rousey v. Jacoway (*In re* Rousey), 283 B.R. 265, 273 (B.A.P. 8th Cir. 2002).

[64] Rousey v. Jacoway (*In re* Rousey), 347 F.3d 689, 693 (8th Cir. 2003).

[65] *See id.* at 692–93 (relying on reference to section 408 in inferring that Congress probably meant to include some IRA's as "similar plans or contracts").

Justice Thomas' opinion for a unanimous Court addressed two issues. It considered first the requirement that the payment be "on account of illness, disability, death, age, or length of service." Citing two dictionaries and one of its own previous bankruptcy decisions, the Court began its analysis by defining "on account of" to mean "because of."[66] Although those with IRAs are entitled to make withdrawals before age 59½ if they are willing pay a 10% tax penalty, the opinion observed that penalized early withdrawals are in fact quite rare.[67] Inferring therefore that the penalty is an effective deterrent and noting that it expires at age 59½, the Court found the requisite causal connection between the Rouseys' age and their right to withdraw funds from their IRAs.[68]

The second focal point was whether an IRA is "a stock bonus, pension, profitsharing, annuity, or similar plan or account," as section 522(d)(10)(E) requires. The Court again began with a dictionary definition: "To be 'similar,' an IRA must be like, though not identical to, the specific plans or contracts listed in § 522(d)(10)(E)."[69] After canvassing the defining attributes of each item on the list, the Court concluded that "[t]he common feature of all of these plans is that they provide income that substitutes for wages earned as salary or hourly compensation."[70] Those plans were contrasted with "mere savings accounts." IRAs were then placed on the "wage substitute" side of that divide because of the 10% penalty and other tax provisions that discourage withdrawals before retirement.[71]

The Court concluded its analysis by noting the reference in the exemption to section 408 of the Internal Revenue Code: "As a general matter, it makes little sense to exclude from the exemption plans that fail to qualify under § 408, unless all plans that do qualify under § 408, including IRAs, are generally within the exemption. . . . More specifically, clause (iii) suggests that plans qualifying under [§ 408], including IRAs are similar plans or contracts."[72]

C. *Textualism and Some Problems with* Rousey

The equities strongly favored the Rouseys. Their IRAs had been funded entirely from their Northrup Grumman 401(k) accounts. Because 401(k)'s are generally both tax qualified and subject to ERISA,[73] those accounts themselves

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[66] Rousey v. Jacoway, 125 S. Ct. 1561, 1566 (2005) ("Thus, 'on account of' in § 522(d)(10)(E) requires that the right to receive payment be 'because of' illness, disability, death, age, or length of service.").

[67] *Id*. at 1567, 1567 n.1 (noting low rates of early withdrawals from IRA's is consistent with view penalty has large impact on withdrawal behavior).

[68] *See id*. at 1567–68 (relying on removal of 10% penalty when accountholder turns 59 ½ to infer "the Rouseys' right to balance of their IRAs is a right to payment 'on account of' age.").

[69] *Id*. at 1568.

[70] *Id*. at 1569.

[71] *See id*. (describing tax disincentives to early withdrawals from IRA's).

[72] *Id*. at 1570.

[73] Cash or deferred arrangements, commonly called 401(k)s, take that common name from the IRC provision that prescribes requirements for their tax qualification. *See* I.R.C. § 401(k)(2) (2000). 401(k)s are

would presumably have been excluded from the bankruptcy estate under *Patterson*.[74] Rolling them over into IRAs was made tax-free precisely to encourage plan participants to keep such funds in reserve for retirement instead of immediately spending them.[75] By the time of the Court's decision, moreover, Mr. Rousey had already passed the retirement-eligibility age of 59½ and his wife was not far behind him.

However, the Court's decision was based not on those equities but rather on the statutory text of section 522(d)(10)—the bare text, interpreted with definitions of key terms but without regard to legislative history or bankruptcy policy.

There is an ongoing academic debate over the advantages and drawbacks of textualism as an approach to statutory interpretation in general.[76] Several scholarly surveys of the Court's approach to the Code in particular have identified textualism or "plain meaning" as its primary (but not exclusive) analytical technique.[77] *Rousey* conforms to that pattern.

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generally "pension plans" in the sense of ERISA § 3, 29 U.S.C. § 1102. As such, they are subject to ERISA title I Part 2 per ERISA § 201, 29 U.S.C. § 1051.

[74] *See, e.g.*, Mfrs. Bank & Trust Co. v. Holst, 197 B.R. 856, 858 (Bankr. N.D. Iowa 1996) (applying *Patterson* to exclude tax-qualified 401(k) plan subject to ERISA, notwithstanding debtor's right to demand immediate distribution on basis of age).

[75] *See, e.g.*, Carmichael v. Osherow (*In re* Carmichael), 100 F.3d 375, 378 (5th Cir. 1996) ("By analogizing the treatment of IRAs to Congress' treatment of other retirement plans in section 522(d)(10)(E), we find it more than plausible to infer that Congress intended IRAs to be treated similarly for purposes of exemption. Indeed, to hold otherwise would be to create a trap for the unwary in those frequent instances in which funds from other exempt plans are "rolled over" into IRAs when those other plans terminate or when employment ceases. After all, Congress has, in the overall retirement scheme of the IRC, selected the IRA to serve as a sort of universal conductor through which transfers must pass if they are to avoid the rocks and shoals of inadvertent taxable events.").

[76] *See, e.g.*, WILLIAM N. ESKRIDGE, JR., PHILIP P. FRICKEY & ELIZABETH GARRETT, LEGISLATION AND STATUTORY INTERPRETATION 223–39 (Foundation Press 2000) (summarizing debate over textualist theories).

[77] *See, e.g.*, Lee Dembart & Bruce A. Markell, *Alive at 25? A Short Review of the Supreme Court's Bankruptcy Jurisprudence, 1979-2004*, 78 AM. BANKR. L.J. 373, 386, 390–91 (2004) (finding "plain meaning" or textualism dominant technique in Court's interpretation of Code but recognizing exceptions); Walter A. Effross, *Grammarians at the Gate: The Rehnquist Court's Evolving "Plain Meaning" Approach to Bankruptcy Jurisprudence*, 23 SETON HALL L. REV. 1636, 1638–39 (1993) (noting Supreme Court has "increasingly embraced a 'plain meaning' approach to the statutory text" but follows drafters' intent where provision is "open to interpretation"); Karen M. Gebbia-Pinetti, *Interpreting the Bankruptcy Code: An Empirical Study of the Supreme Court's Bankruptcy Decisions*, 3 CHAP. L. REV. 173, 279 (2000) (commenting although Supreme Court embraces plain meaning rule in many bankruptcy opinions, Court sometimes consults other sources or is wary of finding language plain if it conflicts with prior practice); Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 106–07 (1996) ("Most bankruptcy commentators (and courts for that matter) describe the Supreme Court's bankruptcy decisions as overwhelmingly textualist or 'plain meaning.' . . . [However,] the Court sometimes will abandon textualism in a particular case."); Robert K. Rasmussen, *A Study of the Costs and Benefits of Textualism: The Supreme Court's Bankruptcy Cases*, 71 WASH. U. L.Q. 535, 540 (1993) (observing most prominent contemporary theories employed by Supreme Court in interpreting statutes today are textualism and dynamic interpretation); Alan Schwartz, *The New Textualism and the Rule of Law Subtext in the Supreme Court's Bankruptcy Jurisprudence*, 45 N.Y.L. SCH. L. REV. 149, 151 (2000-2001) ("In the bankruptcy field, the Court is new textualist in that . . . it almost never reasons from a policy to a result except when a case implicates two statutory schemes . . . and the question is which scheme should control. The words in either statute seldom can settle the issue in such cases."); Charles

At the outset, the case might not have seemed to present promising terrain for the textualist. After scrutinizing section 522(d)(10)(E), six circuits had arrived at three different conclusions on whether it exempts IRAs—yes, no, and yes but only if the debtor has a present right to payment without penalty. None of those conclusions is irrational: the text will bear each appellate interpretation with varying points and degrees of stress. How then can that text alone yield a convincing construction?

The Court's approach was to ignore the Third Circuit's decision in *Clark* and the underlying statutory language. The remaining split among the circuits was then resolved largely with the aid of dictionaries. The Court's decision to exempt the Rouseys' IRAs under section 522(d)(10)(E) is defensible on grounds suggested below, but its reasoning is problematic.

1. Ignoring *Clark* and "the Debtor's Right to Receive a Payment"

In *Clark*,[78] the Third Circuit announced an idiosyncratic interpretation of section 522(d)(10)(E) based on its opening phrase, "the debtor's right to receive . . . a payment." Reading that to encompass only present rights to payment without penalty, the court held that the exemption was not available to a debtor who had not yet reached age 59½.

Clark took a narrow view of the purpose of exemptions, quoting legislative history to the effect that they seek to assure that "the debtor will not be left destitute and a public charge."[79] From that perspective, the court observed, "[t]he exemption of present . . . payments, to the extent that they are necessary for the support of the debtor, is consistent with this goal. The exemption of *future* payments, however, demonstrates a concern for the debtor's long-term security which is absent from the statute."[80] In exempting present payments while exposing the underlying fund to creditors, *Clark* reversed the treatment of corpus and distribution in spendthrift trust law.[81]

Jordan Tabb & Robert M. Lawless, *Of Commas, Gerunds, and Conjunctions: The Bankruptcy Jurisprudence of the Rehnquist Court*, 42 SYRACUSE L. REV. 823, 879 (1991) (commenting Rehnquist Court's bankruptcy decisions have used "only the Code's 'plain meaning' and eschew[ed] other considerations traditionally applied in statutory interpretation").

[78] Clark v. O'Neill (*In re* Clark), 711 F.2d 21, 22 (3d Cir. 1983) (quoting 11 U.S.C. § 522(d)(10)(E) (Supp. V. 1981)).

[79] *Id*. at 23 (quoting H.R. REP. NO. 95-595, at 126 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6087).

[80] *Id*.

[81] *See supra* notes 13–15 and accompanying text (summarizing creditors' rights in debtor's spendthrift trust interest). In *Velis v. Kardanis*, 949 F.2d 78, 81–82 (3d Cir. 1991), the court was directly concerned with the section 541(c)(2) exclusion of the debtor's retirement plan but provided the following explication of the *Clark* exemption:

> Section 522 deals with distributions [already] made from a pension plan and distributions which the debtor has a present right to receive (citing *Clark*). Even if pension plan assets in the hands of a trustee are beyond the reach of creditors because not part of the debtor's estate under § 541(c)(2), distributions from the plan made to the

Clark was never particularly influential outside the Third Circuit:[82] none of the other courts of appeals followed it.[83] It is nevertheless remarkable that *Rousey* simply ignored the Third Circuit cases, particularly after *Patterson* had expressly identified and reserved decision on the interpretive issue they raise. As a purely verbal matter, *Clark's* reading of "the debtor's right to receive . . . a payment" is not altogether implausible. The phrase does seem to mark a distinction between distributions from a fund and the underlying fund itself.

That distinction is underscored when the text of section 522(d)(10)(E) is contrasted with its counterpart in the bill proposed in 1973 in the Report of the Commission on the Bankruptcy Laws of the United States. That bill, which served as a starting point in the drafting of the Code,[84] would have exempted "before or after retirement, such rights as the debtor may have under a . . . plan which is established for the primary purpose of providing benefits upon retirement by reason of age, health or length of service."[85] Arguably, then, the language ultimately enacted embodies Congress' deliberate retrenchment from the Commission bill—a retrenchment captured in the distinction between distribution and corpus.

There are certainly reasonable responses to that argument: a "right to payment" could consist of a present right to future payments, which would be lost if the underlying corpus were forfeited; *Clark* misconstrued the legislative history; there is no sense in providing an exemption for debtors who have reached age 59½ but not those a few months younger, etc. The Rouseys' brief advanced those points and others to the same effect.[86] On the other hand, respondent Jacoway expressly declined to defend *Clark*.[87]

So why didn't the Court address and expressly reject *Clark*? No one can say for sure, but one surmise seems particularly likely. To displace convincingly one among several plausible constructions of a text, it may be necessary to adduce extra-textual resources. Perhaps the Court's commitment to textualism explains its reluctance to engage with *Clark*.

> debtor would not enjoy such protection, in the absence of exemption under § 522(d)(10)(E).

Id.

[82] Within the Third Circuit, *Clark* was established law; bankruptcy courts there followed it. *See*, *e.g*., Reitmeyer v. Gralka (*In re* Gralka), 204 B.R. 184, 189 (Bankr. W.D. Pa. 1997) (denying exemption for IRA for lack of present right to payment).

[83] In considering before *Patterson* whether a profit-sharing plan subject to ERISA was excluded from the estate under section 541(c)(2), Gladwell v. Harline (*In re* Harline), 950 F.2d, 669, 675 (10th Cir. 1991) did quote in dictum the language from *Velis* quoted *supra* note 81.

[84] *See, e.g.*, Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 945–46 (1979) (describing role of Commission's bill in legislative development of the Code).

[85] H.R. Doc. No. 93-137, *supra* note 19, Part II at 125 (1973).

[86] Brief for the Petitioners, *supra* note 57, at 29–38.

[87] Brief for Respondent at 21 n.8, Rousey v. Jacoway, 125 S. Ct. 1561 (2005) (No. 03-1407). However, *Clark* has found an academic defender in Professor C. Scott Pryor. *See* Pryor, *"May It Please the Court": Answers to Questions Not Raised in* Rousey v. Jacoway, Part 1, AM. BANKR. INST. J., Feb. 2005, at 40; & Part 2, AM. BANKR. INST. J., Mar. 2005, at 18.

In any event, it is clear from the decision to exempt the corpus of the Rouseys' IRAs that *Clark* has been dispatched *sub silentio*. The Court's opinion has left other matters less clear.

2. Interpreting "on Account of"

After examining *Rousey's* construction of the pivotal statutory language, this discussion goes on to suggest an alternative approach.

a. Rousey's *Textualist Approach*

The Court began its legal analysis with the requirement in section 522(d)(10)(E) that the right to payment be "on account of illness, disability, death, age or length of service." After defining "on account of" to mean "because of,"[88] the opinion turned to the relationship between the Rouseys' age and their right to receive payments from their IRAs.

The ensuing exposition presented the arguably relevant circumstances:[89] the Rouseys were entitled to draw on the funds at any time and for any purpose; they would generally be subject to a 10% tax penalty if they did so before reaching age 59½; the Internal Revenue Code lifts that penalty for distributions occasioned by some of the other exemption trigger events (death or disability), as well as payments for certain non-triggered favored purposes (medical expenses, first-time home purchase, etc.); penalized early withdrawals have run at a very low rate.

Those circumstances supported verbally plausible arguments by each side. Ms. Jacoway contended that the Rouseys' right to make immediate withdrawals demonstrated that payments were not dependent on age or other trigger events; the debtors responded that the 10% penalty on untriggered distributions deprived them of ready access to their full balance. Ms. Jacoway inferred from the exceptions to the penalty for favored expenditures that the debtors could reach the funds regardless of the triggers; the Rouseys countered that section 522(d)(10)(E) requires only that there be a right to payment based on one or more of the specified events, not that the account be inaccessible in their absence.[90]

In agreeing with the Rouseys, the Court clearly opted for one of the competing plausible interpretations of the statute. What is missing is a persuasive justification of that choice. Once one concedes that the relevant text is ambiguous (which the Court never does in *Rousey*), such support must come from some extra-textual source. Examples of that type of reasoning are provided by two of the cases *Rousey* cites for the meaning of "on account of," *Bank of America National Trust and*

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[88] *Rousey*, 125 S. Ct. at 1566.
[89] *See id*. at 1566–68.
[90] *See id*.

Savings Ass'n v. 203 North LaSalle Street Partnership[91] and *O'Gilvie v. United States*.[92]

In *LaSalle Street*, the Court was concerned with the Code's absolute priority rule, which sets standards for confirming a chapter 11 plan that has been rejected by a class of creditors. Unless the plan provides the dissenting class with full payment, the rule requires that "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan *on account of* such junior claim or interest any property."[93] Does that language allow the pre-bankruptcy owners of a reorganizing business to continue as owners without making such full payment so long as they contribute new capital to the business? The answer depends on whether their continued ownership would be "on account of" their contribution of new value, as opposed to their previous interest.

The owners in *LaSalle Street* had argued that "on account of" means "in exchange for" or "in satisfaction of."[94] The Court recognized textual difficulties with that argument but also found it problematic as a matter of reorganization policy.[95] After rejecting the owners' position, *LaSalle Street* adopted "the more common understanding of 'on account of' to mean 'because of.'"[96] The Court then went on to address the requisite degree of causation, criticizing in light of relevant policy the Government's contention that any degree at all would defeat the plan.[97]

O'Gilvie[98] was a tax case involving the proceeds of a judgment for actual and punitive damages in a wrongful death action. The O'Gilvies contended that the Internal Revenue Code excluded all those monies from gross income as "damages . . . *on account of* personal injury or sickness."[99] The Government insisted to the contrary, that the reason for the punitive damages was the defendant's bad conduct, not the decedent's personal injuries.

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[91] 526 U.S. 434 (1999) (cited in *Rousey*, 125 S. Ct. at 1566).

[92] 519 U.S. 79 (1996) (cited in *Rousey*, 125 S. Ct. at 1568 n. 4).

[93] 11 U.S.C. § 1129(b)(2)(B)(ii) (2000) (articulating requirements for confirmation of plan despite objection of impaired class of unsecured creditors).

[94] *See LaSalle Street*, 526 U.S. at 449 (summarizing the owners' construction of "on account of").

[95] If the owner's view prevailed, any contribution whatever would suffice for them to continue as owners: regardless of its amount, it would defeat the contention that they were awarded ownership in exchange for their previous interest. In rejecting that view, the Court noted "the unlikelihood that Congress meant to impose a condition as manipulable as [the absolute priority rule] would be if 'on account of' meant to prohibit merely an exchange unaccompanied by a substantial infusion of new funds but permit one whenever [any amount of] substantial funds changed hands." *Id*. at 449–450.

[96] *Id*. at 450.

[97] The Court criticized the Government's view as "starchy," expressing doubt that Congress would have wished to impede reorganizations with such a strict rule. *Id*. at 451. Although *LaSalle Street* ultimately reserved decision on the requisite degree of causation, the Court appeared to favor an alternative approach: "A less absolute statutory prohibition would follow from reading the 'on account of' language as intended to reconcile the two recognized policies underlying Chapter 11, of preserving going concerns and maximizing property available to satisfy creditors." *Id.* at 453.

[98] 519 U.S. at 81.

[99] *Id*. at 82 (quoting from I.R.C. section 104(a)(2) as it read in 1988).

The Court agreed with the Government. The decision rested in part on a dictionary definition of "on account of" and recent case precedent. But the Court also adduced the statutory history and the underlying tax principle that a return of capital is not income. On that basis, compensatory damages were seen as replacing the human capital lost in a tort—and therefore excluded from income.[100] That rationale does not extend to punitive damages. In effect, *O'Gilvie* effectively defines "on account of" as "in compensation for."

On the surface, *O'Gilvie*'s definition seems to run counter to *LaSalle Street's* rejection of "in exchange for." Yet both decisions are persuasive. What reconciles them is that each construes the statutory "on account of" in light of what it understands to be the underlying policy. Lacking any comparable articulated foundation in legislative history or bankruptcy policy, *Rousey* is less persuasive.

b. Toward a Contextual Alternative Approach

So why *does* section 522(d)(10)(E) require that the debtor's right to payment be "on account of illness, disability, death, age or length of service"? The most directly pertinent legislative history comes from a House Report on a draft version of the Code. Explaining language virtually identical to section 522(d)(10), the report comments as follows: "Paragraph (10) exempts certain benefits that are akin to *future* earnings of the debtor."[101]

A look at section 522(d)(10) confirms that it deals for the most part with present rights to future payments, including social security, public assistance, veterans' benefits, unemployment compensation and alimony.[102] Those rights are assets of the

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[100] *Id*. at 83–86.

[101] H.R. REP. NO. 95-595, at 362, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6318.

[102] 11 U.S.C. § 522(d)(10) (2000) exempts the right to receive:

> (A) a social security benefit, unemployment compensation, or a local public assistance benefit;
> (B) a veterans' benefit;
> (C) a disability, illness, or unemployment benefit;
> (D) alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;
> (E) a payment under a stock bonus, pension, profit sharing, 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(a), 403(b) or 408 of the Internal Revenue Code of 1986.

Id.

bankruptcy estate—or there would be no point to exempting them. However, they are inaccessible to the debtor until the benefits are disbursed.

In limiting its protection to payments "on account of" specific trigger events, section 522(d)(10)(E) embodies both the future orientation mentioned in the House Report and the protection from creditors of assets inaccessible to a debtor. Funds available only in special circumstances are more likely than general savings accounts to remain available for retirement needs. Placing such funds beyond the reach of creditors reflects and complements the debtor's lack of access, as with the spendthrift trusts that have served as a model for federal pension law.

Any rationale for section 522(d)(10)(E) must, however, take account of the fact that access to retirement accounts is not absolutely conditioned on the trigger events. For instance, the Rouseys could have made withdrawals from their IRAs at any time if they had been prepared to pay the 10% tax penalty. Citing data on the very low rate of penalized early withdrawals, the Court found that the penalty operates as an effective deterrent.[103]

That finding reasonably supports the conclusion that the Rouseys' right to payment was "on account of" age. Trigger events are designated to preserve retirement savings for "future" use by discouraging un-triggered withdrawals, not necessarily eliminating them completely. Indeed even some tax-qualified ERISA pension plans structured as spendthrift trusts permit early withdrawals on grounds of hardship as well as loans to participants.[104] Yet *Patterson* held all "ERISA-qualified" plans excluded from the bankruptcy estate.

However, there are some tax provisions waiving the penalty on untriggered withdrawals if they are used for certain favored purposes, such as health insurance premiums.[105] Do those waivers break the required link between the trigger events and access to IRA funds? At two points, *Rousey* dismisses those waivers as involving only special circumstances and limited amounts of money.[106] That argument is reasonable on grounds just mentioned: the statutory purpose of discouraging untriggered withdrawals does not require that they be eliminated.

More problematic is another response by the Court to penalty-free untriggered withdrawals: "Moreover, § 522(d)(10)(E) requires that the right to payment be on account of age—not that it be solely on account of this factor."[107]

That statement is correct in the sense that payment need not be on account of age if it is on account of death or one of the other trigger events. The Court's

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[103] *See* Rousey v. Jacoway, 125 S. Ct. 1561, 1567 (2005) ("The low rates of early withdrawals are consistent with the notion that this penalty substantially deters early withdrawals from such accounts.").

[104] *See, e.g.*, *supra* notes 27–28and accompanying text (documenting allowance for hardship withdrawals and loans from 401(k) plans).

[105] *See, e.g.*, I.R.C. § 72(t)(2)(D)–(F) (permitting unpenalized and untriggered distributions for health insurance premiums, certain higher education expense, and first-time home purchase).

[106] *See Rousey*, 125 S. Ct. at 1567 n.3; 1570; 1570 n.9 (construing "on account of" requirement and construing "similar plan or contract" requirement).

[107] *Id*. at 1567 n.3.

apparent purport, however, is that the exemption is available for plans providing for payment upon a trigger event—even if the plan allows for payment in other circumstances. On that basis, section 522(d)(10)(E) would exempt a debtor's interest in a freely accessible profit-sharing plan, just as long as it also provided for a distribution upon the participant's death (one of the trigger events).

What point is there to specifying trigger events in section 522(b)(10)(E) if the exemption is available for an account that can be drawn upon in their absence? If a right to payment is exempt without any trigger, how can it be plausible to maintain that the exemption requires a causal link between them? *Rousey's* apparent acceptance of such an attenuated relationship as "causal" is at odds with *LaSalle Street's* rejection of minimal standards of causation. (It would be perfectly reasonable to deny any inconsistency in view of the different roles of "on account of" in those two cases. But that denial depends upon an attention to context that is foreign to *Rousey*.)

Whatever its persuasiveness, *Rousey's* interpretation of "on account of" is authoritative. The trigger events should therefore not be much of an issue for debtors claiming section 522(b)(10)(E) exemptions in the limited contexts where they still matter after BAPCPA.

3. Blurring the Boundaries of "Similar Plan or Contract"

Section 522(d)(10)(E) exempts only rights to payment "under a stock bonus, pension, profit sharing, annuity, or similar plan or contract." To meet that standard, the Rouseys' IRAs would have to be "similar plan[s] or contract[s]."

The Court was clearly correct in defining "similar" as "like, though not identical to."[108] But applying that definition requires some sense of what will count as a relevant resemblance or difference. Cats and dogs are alike in having (usually) four legs each, but dogs bark while cats meow. For the purpose of casting the soundtrack for a cat food commercial, they are different; in deciding how many leg warmers to buy, they are similar.

To assess similarity under section 522(d)(10)(E), therefore, one must identify the purpose of the exemption. In keeping with its strict textualism, *Rousey* made no effort to find that in the legislative history. The Court instead articulated a criterion of similarity by summarizing the opposing contentions of the parties and then announcing: "We agree with the Rouseys that IRAs are similar to the plans specified in the statute. Those plans, like the Rouseys' IRAs, provide a substitute for wages (by wages, for present purposes, we mean compensation earned as hourly or salary income), and are not mere savings accounts."[109]

Rousey went on to define the terms "profitsharing," "stock bonus," "pension" and "annuity," concluding that their "common feature . . . is that they provide

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[108] *Id*. at 1568.
[109] *Id*.

income that substitutes for wages earned as salary or hourly compensation."[110] The Court then found that same feature in the rights to payment exempted in the other subparagraphs of section 522(d)(10), including social security, public assistance, veterans' benefits, unemployment compensation and alimony.[111]

All that remained was to determine whether the payments the Rouseys are to receive from their IRAs are also wage substitutes. The Court pointed out tax provisions that either discourage early withdrawals from IRAs (*e.g.*, the 10% penalty) or insure that accountholders themselves use the funds (*e.g.*, the mandate to begin distributions no later than age 70½).[112] On that basis, *Rousey* concluded, "IRA income substitutes for wages lost upon retirement and distinguishes IRAs from typical savings accounts."[113]

It is anomalous to look for a criterion of similarity in the parties' arguments instead of the legislative history or relevant policy. The Court's dichotomy between wage substitutes and savings accounts is ultimately not convincing. Retirees routinely use savings for expenditures they would previously have funded with their wages. In those circumstances, savings function as a wage substitute.

What is missing from *Rousey's* standard of similarity is the dimension of futurity mentioned in the House Report: "Paragraph (10) exempts certain benefits that are akin to *future* earnings of the debtor."[114] Lacking that guidance, the Court's opinion defined the statutory terms "profitsharing" and "stock bonus" to include both "deferred compensation [and] 'cash plans' in which a predetermined percentage of the profits is distributed to employees at set intervals."[115] There are indeed cash versions of both profitsharing and stock bonus plans. As Professors Langbein and Wolk observe in their leading casebook, however, "[a] cash plan is not a retirement plan."[116] If cash plans are exemptible under section 522(d)(10)(E), it becomes even less plausible to base similarity for purposes of the exemption on being different from a savings account.

Without a clear criterion of similarity, lawyers cannot confidently apply the exemption to new categories of retirement assets. In the immediate aftermath of the Court's decision, for example, a newsletter expressed uncertainty about exempting Roth IRAs under section 522(d)(10)(E).[117] Section 408A of the Internal Revenue Code, which governs Roth IRAs, calls them "retirement" plans;[118] but they differ considerably from traditional IRAs.

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[110] *Id*. at 1568–69.
[111] *See id*. at 1569.
[112] *See id*.
[113] *Id*.
[114] H.R. REP. NO. 95-595, at 362, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6318 (listing examples of such benefits).
[115] Rousey v. Jacoway, 125 S. Ct. 1561, 1568 (citing Langbein & Wolk, *supra* note 35, at 48).
[116] Langbein & Wolk, *supra* note 35, at 48.
[117] *Supreme Court Confirms Bankruptcy Exemption For IRAs*, Pension & Benefits Week Newsletter (RIA), April 11, 2005 (reviewing Court's decision and resolution of conflict among circuits).
[118] I.R.C. § 408A(b) (2000) (defining term "Roth IRA" as type of individual retirement plan).

For example, contributions to a Roth IRA can generally be withdrawn without penalty five years after the account is established, regardless of the accountholder's age.[119] Moreover, there is no requirement that distributions begin by age 70½.[120] In these respects, Roth IRAs lack the characteristics that the Court relied upon in exempting the Rouseys' traditional IRAs.

If one had to rely only on section 522(b)(10)(E) as construed in *Rousey*, it would be unclear whether Roth IRAs are sufficiently "similar" to be exempted. With the enactment of BAPCPA, however, that question has been obviated.

III. THE NEW RETIREMENT FUNDS EXEMPTION[121]

BAPCPA adds to the Bankruptcy Code an exemption for "[r]etirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986."[122] That language straightforwardly exempts from creditors both Roth IRAs (tax-exempt under IRC section 408A) and traditional IRAs like the Rouseys' (tax-exempt under IRC section 408). Among the other retirement assets exempted with them are tax-qualified pension, profit sharing and stock bonus plans[123]; employee annuities[124]; and deferred compensation plans of state and local governments and tax-exempt organizations.[125]

For many of the funds just mentioned, there will be no occasion to claim any bankruptcy exemption: "ERISA-qualified" plans are entirely excluded from the bankruptcy estate under *Patterson*.[126] However, the new exemption does matter for many types of retirement accounts outside the scope of ERISA, including (among others) traditional IRAs and Roth IRAs.[127]

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[119] *See* Treas. Reg. §1:408A–6 (prescribing in questions and answers ## 1, 4, and 5, the tax and penalty treatment of distributions from Roth IRA's).

[120] *See* I.R.C. § 408A(c)(5) (2000) (waiving general mandatory distribution rules for Roth IRAs).

[121] For an insightful explication of the new retirement funds exemption, see Margaret Howard, *Exemptions Under the 2005 Bankruptcy Amendments: A Tale of Opportunity Lost*, 79 AM. BANKR. L.J. 397, 412-418 (2005).

[122] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 224(a), 119 Stat. 23, 62–63 (2005) (to be codified at 11 U.S.C. § 522(b)(3)(C), (d)(12)). Other provisions of BAPCPA § 224 are directly pertinent to the new retirement exemption. *See id*. § 224(a) (to be codified at 11 U.S.C. § 522(b)(4)) (limiting bankruptcy courts' involvement with issues of tax-qualification and protecting retirement funds rolled over or directly transferred from one tax-exempt fund to another); *id*. § 224(e)(1) (to be codified at 11 U.S.C. § 522(n)) (capping new exemption for IRAs and Roth IRAs at $1 million).

[123] These plans may be tax-exempt under I.R.C. section 401. *See generally* I.R.C. § 401 (2000) (establishing requirements for tax-qualification).

[124] These plans may be tax-exempt under I.R.C. section 403. *See generally* I.R.C. § 403 (2000) (setting requirements for favored tax treatment).

[125] These plans may be tax-exempt under I.R.C. section 457. *See generally* I.R.C. § 457 (2000) (prescribing requirements for favored tax treatment).

[126] *See supra* notes 5–45 and accompanying text.

[127] ERISA applies only to employee benefit plans established by an employer engaged in commerce and/or an employee organization representing employees engaged in commerce. *See* ERISA § 4(q); 29 U.S.C. §

BAPCPA imposes a $1,000,000 limit on the new exemption for both types of IRAs,[128] but that cap is unlikely to matter very often. It does not apply to monies rolled over from employer-sponsored pensions or annuities, like the Rouseys' IRAs.[129] It caps only exemptions for IRAs entirely funded with contributions by the debtor (or rollovers from one such IRA to another).[130] But those contributions are currently limited to $4,000 annually.[131] With that maximum and an investment return of 9% a year, it would take over 36 years to accumulate $1,000,000.[132] Even then, the cap "may be increased if the interests of justice so require."[133] That language is nebulous, but the legislative history suggests that it contemplates a debtor facing extreme hardship.[134]

Because the new exemption is unlimited for tax-exempt retirement funds other than IRAs, the controversy over the term "ERISA-qualified" now matters less. Once it has been established that funds are tax-exempt, they are protected for the

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1003(a). There are some types of employer-sponsored traditional IRAs (e.g., simple retirement accounts per IRC § 408(p)), but they are excluded from ERISA title I Part 2. *See* ERISA §201(6); 29 U.S.C. § 1051(6).

[128] BAPCPA provides as follows:

> For assets in Individual Retirement Accounts described in Section 408 or 408A of the Internal Revenue Code of 1986, other than a simplified employee pension under section 408(k) of such Code or a simple retirement account under section 408(p) of such Code, the aggregate value of such assets exempted under this section, without regard to amounts attributable to rollover contributions under section 402(c), 402(e)(6), 403(a)(4), 403(a)(5), and 403(b)(8) of the Internal Revenue Code of 1986, and earnings thereon, shall not exceed $1,000,000 in a case filed by a debtor who is an individual, except that such amount may be increased if the interests of justice so require.

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 224(e), 119 Stat. 65 (2005) (to be codified at 11 U.S.C. § 522(n)). The cap is to be periodically adjusted for inflation. *Id*. at § 224(e)(2), 119 Stat. 65 (to be codified at 11 U.S.C. § 104(b)) (adjusting dollar amounts in Bankruptcy Code based on changes in Consumer Price Index).

[129] Because the Rouseys funded their IRAs entirely with monies from a 401(k), those accounts are excluded from the exemption cap as "amounts attributable to rollover contributions under section 402(c), 402(e)(6), 403(a)(4), 403(a)(5), and 403(b)(8) . . . ." Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 224(e) (to be codified at 11 U.S.C. § 522(n)).

[130] The statement in text is based on reading the "other than" phrase in the cap as leaving the exemption uncapped for SEP IRAs and SIMPLE IRAs. *But see* Howard, *supra* note 121, at 417–18 (reading language instead as subjecting those accounts to cap but excluding them from possibility of escaping it in "interests of justice").

[131] *See* I.R.C. § 219(b)(1)(A), (b)(5)(A) (setting maximum qualified retirement contributions). Those age 50 or older are entitled to contribute an additional $500. *See id*. § 219(b)(5)(B).

[132] From an online calculator, $4,000 a year invested at 9% would be worth some $944,000 after 36 years. *See* Savings Calculator, http://cgi.money.cnn.com/tools/savingscalc/savingscalc.html (last visited Oct. 30, 2005). Until 2002, the limit on annual contributions had been $2000. *See* STEPHEN J. KRASS, THE PENSION ANSWER BOOK 29-5–29-6 (Aspen Publishers 2002).

[133] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 224(e) (to be codified at 11 U.S.C. § 522(n)), *supra* note 128 and accompanying text (capping the retirement funds exemption).

[134] During Senate debate on a forerunner of BAPCPA with a materially identical retirement funds exemption, the author of the bill, Senator Grassley, commented as follows: "There could be a catastrophic illness that could eat up a lot of the money, even $1 million, presumably. We have taken that into consideration; that is, we have an interest of justice exception that would be applicable in this case." 147 CONG. REC. S2142-02 (daily ed. Mar. 12, 2001) (statement of Sen. Grassley (R-Iowa)).

debtor. If they are not excluded from the estate under section 541(c)(2), they will be protected by the new exemption.

In one key respect, the new exemption introduces some much-needed uniformity. It applies in all bankruptcies, whether the debtor is claiming exemptions under section 522(d) of the Code or under state law.[135] In contrast, section 522(d)(10)(E) is available only with the Code exemptions. Some thirty-five of the states have "opted out" of those, thereby restricting their domiciliaries to exemptions under state law.[136] The states have differed considerably and confusingly in exempting retirement assets.[137] The bankruptcy courts will now be spared that source of confusion, but the state law exemptions will continue to matter when creditors seek to execute judgments.

The new exemption may also appear to effect a simplification by obviating inquiry into whether the debtor's "right to payment" is "under a stock bonus, pension, profit sharing, annuity or similar plan or contract" and "on account of illness, disability, death, age, or length of service." But *Rousey* has already taken much of the challenge out of that inquiry.

In contrast, the new exemption depends on something that can be genuinely complex—whether retirement assets are tax-qualified or otherwise tax-exempt.[138] BAPCPA recognizes and addresses those complexities with procedural provisions limiting the bankruptcy courts' obligation to resolve them.[139]

But *why* does the new exemption rely on tax law? The IRC is apparently being used here simply to provide an indirect limit on how much may be exempted.

A pivotal point in the legislative process culminating in BAPCPA was the issuance in 1997 of the Report of the National Bankruptcy Review Commission ("NBRC"). There the NBRC recommended to Congress that it exempt "all funds

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[135] The retirement funds exemption is codified in two sections. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 224(a)(2), 119 Stat. 64 (2005) (to be codified at 11 U.S.C. § 522(d)(12)) (including retirement fund exemption among Code exemptions); *Id*. at § 224(a)(1), 119 Stat. 63 (to be codified at 11 U.S.C. § 522(b)(3)(C) (making retirement fund exemption applicable to debtors claiming exemptions under state law).

[136] 4 COLLIER ON BANKRUPTCY ¶ 522.02[1] n.3 (Alan R. Resnick & Henry J. Sommer eds., 15th ed. rev. 2005).

[137] *See, e.g*., C. Scott Pryor, *Rock, Scissors, Papers: ERISA, the Bankruptcy Code and State Exemption Laws for Individual Retirement Accounts*, 77 AM. BANKR. L.J. 65 *passim* (2003) (addressing confusion over relationship between ERISA and state laws exempting IRAs).

[138] *See, eg*., CONISON, *supra* note 24, at 234 (commenting on complexity of requirements for tax qualification); Langbein & Wolk, *supra* note 35, at 40 (same).

[139] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 224(a), 119 Stat. 23, 62–63 (2005) (to be codified at 11 U.S.C. § 522(b)(4)(A)–(B)). Those provisions create a presumption for purposes of the new exemption that a plan that has received a favorable determination of its tax status from the IRS remains tax-exempt. For plans which have not received such a determination, the exemption is allowed if the debtor demonstrates that (1) there has been no adverse determination of tax-exempt status by the IRC or a court and (2) either the fund is substantial compliance with IRC requirements or, if not, the debtor is not responsible for that failure. The kinds of complications that ensue when bankruptcy courts make independent assessments of a retirement fund's tax status are explored in Litman, *supra* note 36, at 691–97.

held directly or indirectly in a trust that is exempt from federal income tax pursuant to sections 408 or 501(a) of the Internal Revenue Code."[140] In its accompanying commentary, the NBRC argued that IRC's annual contribution limits would provide an objective standard to avoid shielding too much from creditors.[141] Whatever its other disagreements with the NBRC, Congress accepted its suggestion to look to the IRC for a cap.

In two major respects, however, the Congressional process of developing and enacting the new retirement funds exemption shares with *Rousey* a lack of attention to basic policy.

First, there is no evidence that Congress considered the rationale for the IRC's limits on contributions and how that does or does not relate to the purpose of the new exemption. On a very general level, the tax provisions embody a balance between the national policy favoring retirement savings and the government's need for revenues. How, if at all, does an amount fixed for that purpose bear upon the very different balance struck in bankruptcy between maximizing the distribution to creditors and leaving the debtor with a decent minimum? That question entails a wide range of issues beyond the scope of this discussion. The point here is that Congress appears not to have seriously considered them.[142]

Second, the provision of BAPCPA that has drawn the most attention is means-testing for eligibility for chapter 7 liquidations.[143] The test takes the form of presuming abuse by debtors seeking that relief if (1) their current income exceeds the median income in their state and (2) the monthly surplus of their income over their expenses exceeds $166.66. (In some cases, a lower surplus will trigger the presumption).[144] Absent a rebuttal by the debtor, the chapter 7 case must be dismissed or converted to a chapter 13 repayment case. The apparent rationale for means-testing is that many debtors whose income permits substantial payments to creditors have until now filed for liquidation.[145]

If it is a central objective of BAPCA to require debtors to pay what they can afford, how can it make sense to exempt retirement funds without regard to whether

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[140] NAT'L BANKRUPTCY REV. COMM'N, FINAL REPORT: BANKRUPTCY: THE NEXT TWENTY YEARS, Recommendation 1.2.5, at 139 (1997).

[141] *Id*. at 141. IRC § 415 imposes limits on benefits and contributions under qualified plans. IRC § 415 (2000). Contributions to traditional IRAs and Roth IRAs are limited by IRC §§ 408 and 408A, respectively. IRC §§ 408, 408A (2000).

[142] For a thoughtful discussion of these issues, see generally Patricia E. Dilley, *Hidden in Plain View: The Pension Shield Against Creditors*, 74 IND. L.J. 355 *passim* (1999).

[143] *See, e.g*., Eugene R. Wedoff, *Means-Testing in the New § 707(b)*, 79 AM. BANKR. L.J. 231, 231 (2005) (characterizing means test as "perhaps the best known and most discussed feature of" BAPCPA).

[144] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 102(a), 119 Stat. 23, 27–29 (2005) (to be codified at 11 U.S.C. § 707(b)(2)(A) and elsewhere in the Code).

[145] For an influential statement of that view, see generally Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 B.Y.U.L. REV. 177, 178 (1999). *Contra* Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AM. BANKR. L.J. 483, 493 (1997) (questioning view that many debtors in bankruptcy are able to make substantial payments to creditors).

they are necessary for the debtor? The legislative history reflects only the most tangential consideration of that question.[146]

IV. WHAT'S LEFT OF *ROUSEY* AND SECTION 522(d)(10)(E)?

The new retirement exemption obviates recourse to section 522(d)(10)(E) for protecting tax-exempt retirement funds. However, the old exemption remains in the Code and will continue to matter in two kinds of settings.

First, there are plans providing payments based not on retirement but rather on one or another of the other statutory trigger events: illness, disability, death or length of service. For example, healthcare plans are beyond the scope of ERISA title I Part 2[147]—and therefore not excluded from the bankruptcy estate under *Patterson*. Benefits under those plans clearly are not protected by the new exemption, but section 522(d)(10)(E) may still exempt them.

Second, there are retirement plans that are neither tax-qualified nor subject to ERISA. The most common example is an excess benefit plan, which provides highly compensated employees with a level of benefits exceeding the maximum allowed for tax qualification.[148] Section 522(d)(10)(E) may exempt them with two caveats: (1) such plans are particularly likely to run afoul of the requirement that the payments be "reasonably necessary for the support of the debtor and any dependent of the debtor" and (2) if the debtor is an "insider" of the employer (a partner, officer, director or controlling person—in other words, one kind of likely candidate for excess benefits), the exception at the end of the exemption will apply if the payments are "on account of age or length of service."

In the greatly reduced settings where section 522(d)(10)(E) does still matter, *Rousey* should on balance ease the debtor's burden. The decision clearly forecloses once troublesome arguments distinguishing a present right to payment from the underlying fund. Moreover, the Court's construction of "on account of" relaxes another requirement for the old exemption. After *Rousey*, the primary interpretative problems under section 522(d)(10)(E) will arise from the Court's failure to set clearer bounds to "similar plan or contract."

Rousey's primary continuing significance may lie most in what it suggests for the future development of bankruptcy law. Beyond any of the specific analytical

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[146] The only floor debate on the amount of the retirement funds exemption had to do with the $1 million cap with respect to IRAs and Roth IRAs. Senator Kennedy was opposed to having any cap at all; Senators Grassley and Sessions favored the cap. *See* 147 CONG. REC. S2172-02 (2001); 147 CONG. REC. S2142-02 (2001).

[147] ERISA § 201(1), 29 U.S.C. § 1051(1) excludes any "employee welfare benefit plan" from title I Part 2; that term includes health plans under ERISA § 3(1), 29 U.S.C. § 1002(1). ERISA §§ 201(1) & 3(1) (2000). 29 U.S.C. §§ 1051(1), 1002(1) (2000).

[148] By definition, excess benefit plans are not tax-qualified because they provide benefits in excess of the limits of IRC § 415. ERISA § 3(36) (2000); 29 U.S.C. § 1002(36) (2000). Excess benefit plans are expressly excluded from ERISA title I Part 2. ERISA § 201(7) (2000), 29 U.S.C. § 1051(7) (2000).

problems discussed above, the Court's relentless textualism follows a pattern repeatedly observed in its approach to the Code.[149] If that persists, there is little reason to expect the Court often to articulate broadly applicable bankruptcy principles.

[149] *See supra* note 77 and accompanying text.