U. S. BANKRUPTCY COURT
WESTERN DISTRICT OF NC

AUG 15 1995

J. BARON GROSHON
BY: [signature]
Deputy Clerk

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
Charlotte Division

In Re:	Case No. 92-31782
	Chapter 13
KENNETH LEE CLINE and LINDA CLINE,	JUDGMENT ENTERED ON AUG 15 1995
Debtors.	**JUDGMENT**

THIS MATTER was before the court on the Trustee's Motion to Modify Plan and upon the Debtor's Motion to Amend Debtor's Exemptions. A hearing was held on July 11, 1995. In consideration thereof, and for the reasons stated in this Court's Memorandum Opinion entered concurrently herewith, JUDGMENT shall be granted as follows:

1. In favor of Warren Tadlock the Trustee and against the male Debtor, **KENNETH LEE CLINE**, for the sum of $4,425.64.

2. This judgment may be satisfied by modification of the Debtors' Chapter 13 plan to pay the present value of this sum over the plan term.

3. In the event the Debtors fail to complete their Chapter 13 Plan, as modified, however, the Trustee shall be entitled to the judgment amount as against Cline, plus interest at the legal rate, which debt shall not be dischargeable by conversion or refiling.

This the 15th day of August, 1995.

J. Craig Whitley
U. S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
Charlotte Division

IN RE: **KENNETH LEE CLINE and LINDA CLINE,** Debtors.	Case No. 92-31782 Chapter 13 **MEMORANDUM OPINION**

THIS MATTER came before the Court on the Motion of Trustee to Modify Plan and upon the Debtor's Motion to Amend Debtor's Exemptions. A hearing was held on July 11, 1995. In consideration of the stipulated facts and the arguments of counsel, the Court finds and concludes as follows:

FINDINGS OF FACT

The Debtors filed a Chapter 13 case with this Court on September 29, 1992. On November 13, 1994 the Debtors' Chapter 13 plan was confirmed, which plan called for monthly payments over a period of sixty (60) months (the "Chapter 13 plan").

At the date he filed bankruptcy, the male Debtor David Cline ("Cline") was employed by The Kuhlman Electric Corp. ("Kuhlman"). Cline was a participant in Kuhlman's 401(k) Plan, an ERISA-qualified retirement plan (the "retirement plan"). Accordingly, in his Bankruptcy Schedules, Cline listed an interest in the retirement plan with a net value (after a loan owed to the plan) of $3,800.00. He claimed a North Carolina "wild card" exemption under G.S.1C-1601(a)(2) of $200.00 in this asset.

While still in Chapter 13, Cline was terminated by Kuhlman. The record does not reflect why. That termination resulted in

Cline receiving in 1994 a lump sum distribution of his interests in the retirement plan.

On April 24, 1995, the Trustee who had by now learned of this distribution, moved the Court to require the Debtor to appear and show cause for his failure to disclose the retirement plan distribution and to account for these monies. At a hearing on that motion on May 9, 1995, it was established that the Debtor's interest in the retirement plan had been liquidated as follows:

Gross balance in Retirement plan (as of 6/30/94)	$13,859.32
L: Loan owed to Retirement plan (withheld)	(3,161.82)
L: Federal tax withheld from distribution	(2,771.86)
Net distribution to debtor	$ 7,925.64

It was determined at the May 9 hearing that as of the bankruptcy filing date, the Debtor's interest in the Retirement plan was substantially less than $13,859.32. As of September 30, 1992, the Debtor's retirement plan account had a gross balance of $6,611.53, less a loan balance of $3,549.50, for a net total of $3,062.03. The additional funds in Cline's retirement account at the date the distribution was made are attributable to his service with Kuhlman while he was in Chapter 13.

Cline did not roll over the net distribution he received into another ERISA vehicle, but rather spent the proceeds.

On May 16, 1995, the Debtors moved the Court to allow the amendment of their exemptions to claim these monies to the extent that the distribution was not otherwise exempt under ERISA. Thereafter on June 15, the Trustee moved to modify the Debtors' Chapter 13 plan to require that the present value of the amounts distributed (over the $3,500.00 exemption amount) should be paid into the Chapter 13 Plan. Both Motions were heard together.

The Trustee's position is that while Cline's retirement plan interest was not property of the bankruptcy estate under 11 U.S.C. 541 at the date of Bankruptcy, these monies when distributed became property of the bankruptcy estate pursuant to Code Section 1306(a). His view is that receipt of these funds constituted a material, unforseen change in the Debtors' financial condition, requiring postpetition modification of their Chapter 13 plan, as by the Fourth Circuit's holding in In re: Arnold, 869 F.2d 240 (4th Cir. 1989).

Cline for his part argues these funds, being ERISA-qualified, are not property of the bankruptcy estate under the line of decisions deriving from the Supreme Court's decision in Patterson v. Shumate, __U.S.___, 112 S.Ct. 2242, 119 L.Ed.2d 519 (1992) and Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 110 S.Ct. 680, 107 L.Ed.2d 782 (1990). If found to be estate property, however, Cline asserts that his wildcard exemption would cover the entire net distribution. [Cline contends that only the net balance of the account as of the date of bankruptcy, $3,062.03, would be brought into the estate by Section 1306 and that any funds accruing thereafter are his.]

DISCUSSION

The issue to be resolved is whether a Chapter 13 Debtor's interest in an ERISA-qualified retirement plan, which is admittedly not property of the estate under 11 U.S.C. 541 at the date of bankruptcy, becomes estate property under 11 U.S.C. § 1306 when, during the pendency of the Chapter 13 plan, the Debtor is terminated from his employment, receives a lump sum distribution of the retirement plan proceeds and does not roll these monies over into another qualified Plan. This Court concludes that they do.

This case presents yet another instance of the tension between bankruptcy law and ERISA. Under the former, when an individual files bankruptcy, an estate is created consisting basically of all of the Debtor's nonexempt property interests. 11 U.S.C. 541. Property of the bankruptcy estate is defined broadly and, generally includes all "legal or equitable interests of the debtor in property as of the commencement of the case." 11 USC 541(a). The purpose of the statute is clear. All of the debtor's assets which are not capable of being exempted should be made available to satisfy the claims of creditors.

ERISA, the Employee Retirement Income Security Act, on the other hand, is designed to ensure a stream of income for retirees. Guidry, 110 S.Ct. at 687. To that end, ERISA law specifies that benefits provided under qualified plans may not be assigned or alienated. 29 USC 1056(d)(1). Where an individual who possesses an interest in an ERISA-qualified Plan files for bankruptcy, these two purposes collide.

This conflict has been partially reconciled by the Supreme Court's interpretation of Code Section 541(c)(2). That Section of the Bankruptcy Code excludes from the bankruptcy estate, property which is subject to a restriction on transfer enforceable under "applicable nonbankruptcy law." 11 U.S.C. § 541(c)(2). The Supreme Court has concluded that the antialienation provisions contained in ERISA plans fall within the 541(c)(2) exception, and thus, interests in ERISA-qualified plans do not come into the bankruptcy estate--at least, if the plan participant files bankruptcy while his money is still in the Plan. <u>Patterson v. Shumate</u>, 112 S.Ct. at 2250; <u>Guidry v. Sheet Metal Workers Nat'l Pension Fund</u>, 110 S.Ct. at 687. Within the Western District of North Carolina, this ERISA exclusion has been extended to situations where the employee has been terminated prior to bankruptcy, but has not yet received his retirement plan distribution. <u>Winkler v. Gorham</u>, 164 B.R. 728 (D.W.D.N.C.1994), aff'd, No. 94-1475, (4th Cir.Jan. 1995).

Most recently the Fourth Circuit has held, in a nonbankruptcy case, that where the employee has retired and is entitled to receive monthly distributions under an ERISA-qualified plan, these payments are not subject to garnishment either. In <u>U.S. v. Smith</u>, 47 F.3d 681 (4th Cir. 1995), the Defendant Smith had pled guilty to wire fraud and as a part of restitution had been ordered by the Court to turn over to his creditors monthly pension benefits being paid to him under an ERISA-qualified retirement plan. The Fourth Circuit ruled that this order violated the anti-alienation provision of ERISA.

The <u>Smith</u> Court, relying upon the Supreme Court's decision in <u>Guidry</u>, concluded that a distinction must be drawn between cases where ERISA funds are being paid to a party <u>as a part of his</u>

retirement and others where the Retirement plan participant elects to have his funds distributed before retirement. In the first instance, it held, ERISA would protect the plan distribution from creditor attachment. However, where the plan participant has chosen to receive a distribution before retirement, the Court concluded he has made an affirmative act to waive the ERISA anti-alienation protections. The plan monies when received by the participant are then subject to execution. Smith, 47 F.3d at 682.

While illustrative of the broad protections that ERISA benefits enjoy, none of these decisions reaches the question of what happens when a Chapter 13 debtor/employee is terminated, receives a lump sum distribution, and rather than rolling the funds over into another Plan, spends them instead.

Chapter 13 cases differ from other bankruptcy cases in that under Chapter 13, estate property includes not only the property types specified in section 541, but also all property that the debtor acquires while he is in Chapter 13, including his postpetition earnings. 11 USC 1306. Section 1306 provides in relevant part:

> Property of the estate includes, in addition to property specified in section 541 of this title---
>
> (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11 or 12 of this title, whichever occurs first; and
>
> (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first. 11 U.S.C. 1306(a).

As none of the aforementioned cases dealt with a Chapter 13 filing, one must look to an earlier Fourth Circuit decision, Tenneco, Inc. v. First Virginia Bank, 698 F.2d 688 (4th Cir. 1983), and a recent decision by this Court, In re Spurling, Case No. 93-30261 (Bankr.W.D.N.C. May 1993) (Hodges, J.) for guidance.

In Tenneco, an ERISA plan participant was terminated by his employer before he reached retirement age, causing all of his accrued benefits to became payable to him. Thereafter, Sweeney, the former employee, drew some $37,000.00 out of this account a few weeks before a creditor, First Virginia Bank of Tidewater (the "Bank") obtained a judgment against him. After successfully garnishing a portion of the monies which Sweeney had withdrawn and placed in the hands of a broker, the Bank then sought to garnish some $5,000.00 which was still in Sweeny's retirement plan account.

The Fourth Circuit, citing ERISA, held that the monies which were still in the hands of the retirement plan trustee were not subject to garnishment, for reasons similar to those espoused in Patterson v. Shumate and its progeny. Tenneco, 698 F.2d 688, 690.

More importantly for the present case, the Fourth Circuit brushed aside Sweeney's argument that the money already withdrawn from the ERISA plan, being traceable to his ERISA plan, was forever immune from creditors claims. Tenneco, 698 F.2d at 691. The Tenneco Court found Sweeney's contention that the ERISA exemption continues ad infinitum to be without merit--a result consistent with the Circuit Court's conclusion about voluntary withdrawals made in Smith.

This Court has had occasion to deal with the pension plan distribution issue in In re Spurling. In Spurling, a Chapter 13 case decided upon facts all but identical to those in this case, Judge Hodges ruled that where a debtor receives a lump sum distribution from an ERISA-qualified Plan while he is in Chapter 13, ERISA's anti-alienation protections are lost. By operation of Section 1306(a), that property becomes then property of the bankruptcy estate. At that point, Spurling holds that the Debtor is entitled to amend his exemptions to claim as much of the funds as exempt as the exemption statute permits. However, over and beyond this amount, the monies must be paid into the Chapter 13 plan. Spurling, p.6.

This Court believes that neither the Supreme Court's rulings in Patterson and Guidry, nor the Fourth Circuit's in Smith, affect the viability of Tenneco and Spurling. The latter appear to be controlling in the present case.

Here, Cline having received a lump sum distribution of $7,925.64 from his employer's plan proceeds and having failed to roll these over to another qualified account, these monies became property of this bankruptcy estate.

The amounts coming into Cline's bankruptcy estate are not limited to $3,062.03, the net sum which had accrued in Cline's account prior to bankruptcy. Section 1306(a) operates to draw in postpetition earnings and postpetition acquired property, so the pension plan contributions which accrued while Cline was in Chapter 13 also become property of this estate. Cline is, however, entitled to an exemption of $3,500, so in this case a net sum of $4,425.64 becomes estate property.

Cline's termination and the subsequent receipt of these funds constitute unforeseeable changes in his and his wife's financial circumstances. Under Arnold, this Court would ordinarily require the debtor to turn over these monies to the Chapter 13 Plan. This is not possible as the funds in question have previously been spent. Therefore, it is appropriate to enter judgment in favor of the Trustee and against the male Debtor for the sum of $4,425.64. This judgment may be satisfied by modification of the Debtors' plan to pay the present value of this sum over the plan term. In the event the Debtors fail to complete their Plan, as modified, however, the Trustee shall be entitled to recover the judgment amount against Cline, plus interest at the legal rate, which debt shall not be dischargeable by conversion or refiling.

IT IS SO ORDERED.

This the 15th day of August, 1995.

J. Craig Whitley

United States Bankruptcy Judge