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Spendthrift Trusts and Employee Pensions: The Problem of Creditors’ Rights†

JEFFREY G. SHERMAN*

BACKGROUND

Pension Trusts

Most pension plans† that employers maintain to provide their employees with retirement benefits are funded‡ by means of trusts.§ Typically, the plan will call for the employer (and sometimes the participating employees as well) to make periodic contributions to the trust; the trustee will thereupon invest the contributions and, as each participantretires or otherwise becomes eligible for a benefit, make distributions to him from the trust in accordance with the plan’s provisions. Since the interest of a trust beneficiary is generally regarded as a property right and liable for the beneficiary’s debts along with his legal interests,¶ unless exempted by direction of the settlor or by statute, there is a danger that funds in a pension

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any plan, fund, or program . . . established or maintained by an employer or
by an employee organization, or by both, to the extent that by its express terms
or as a result of surrounding circumstances such plan, fund, or program—
(A) provides retirement income to employees, or
(B) results in a deferral of income by employees for periods extending to the
termination of covered employment or beyond . . . .
Id. § 3(2), 29 U.S.C. § 1002(2) (1976). This definition is employed throughout this article.
§ That the word “fund” (along with “parent”) should have become a verb is one of the barbarisms of our age. This use of the word has, however, become so deeply ingrained among pension practitioners that no attempt will be made herein to avoid it. In the context of pension law the “funding medium” of a plan is the entity that serves to receive contributions and make benefit payments.
¶ Other funding media that may be used include retirement bonds, group annuity contracts and custodial accounts. See generally A. Collins, Federal Income Taxation of Employee Benefits §§ 5.02[9], 5.03[8] (1978), which describes the kinds of arrangements that may be used to fund plans that qualify for favorable tax treatment pursuant to I.R.C. § 401(a). As of 1970, 79% of collectively-bargained-for multi-employer pension plans and 69% of all other pension plans were funded by means of trusts rather than insurance or annuity contracts. Employee Benefits FactBook 465 (1972).
¶ G. Bogert, Trusts and Trustees § 193 (2d ed. 1965).
trust\(^5\) intended to be made available to a participant at retirement may long since have been appropriated by his creditors.

Section 206(d)\(^6\) of ERISA is Congress' response to this problem. In order to ensure that the benefits that have accrued to a participant are available to him at retirement,\(^7\) every pension plan (with certain unimportant exceptions\(^8\)) is now required to prohibit the assignment or alienation of plan benefits.\(^9\) In addition, ERISA amended the Internal Revenue Code\(^10\) to impose a similar requirement on all pension plans intended to be "qualified"\(^11\) pursuant to

\(^5\) A pension trust is the trust by means of which a pension plan is funded.


\(^8\) This provision of ERISA applies to all pension plans established or maintained by any employer or by any employee organization or organizations representing employees, where such employer or organization engages in commerce (that is, trade between any State and any place outside thereof) or in an activity affecting commerce, with the exception of the following kinds of plans:

1. Governmental plans (as defined in ERISA § 3(32), 29 U.S.C. § 1002(32) (1976));
2. Certain church plans (as defined in ERISA § 3(33), 29 U.S.C. § 1002(33) (1976));
3. Plans maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws;
4. Plans maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens;
5. Excess benefit plans (as defined in ERISA § 3(36), 29 U.S.C. § 1002(36) (1976));
6. Employee welfare benefit plans (as defined in ERISA § 3(1), 29 U.S.C. § 1002(1) (1976));
7. Plans which are unfunded and are maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees;
8. Plans established and maintained by a society, order, or association described in I.R.C. § 501(c)(8) or (9), if no part of the contributions to or under such plans are made by employers of participants in such plans;
9. Trusts described in I.R.C. § 501(c)(18);
10. Plans which are established and maintained by a labor organization described in I.R.C. § 501(c)(6) and which do not at any time after September 2, 1974, provide for employer contributions;
11. Agreements providing payments to a retired partner or a deceased partner's successor in interest, as described in I.R.C. § 736; and
12. Individual retirement accounts or annuities described in I.R.C. § 408, or individual retirement bonds described in I.R.C. § 409.


\(^9\) Prior to the enactment of ERISA, there was no requirement that pension plans contain spendthrift provisions. See Rev. Rul. 56-432, 1956-2 C.B. 284.

\(^10\) The amendment was effected by ERISA § 1021(c), which added § 401(a)(13) to the Internal Revenue Code.

\(^11\) The tax advantages obtained when a pension plan is qualified include the following:
I.R.C. § 401(a), whether or not such plans are covered by ERISA § 206(d).  

Section 206(d) of ERISA provides:  

(1) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.  

(2) For the purposes of paragraph (1) of this subsection, there shall not be taken into account any voluntary and revocable assignment of not to exceed 10 percent of any benefit payment, or of any irrevocable assignment or alienation of benefits, executed before the date of enactment of this Act. The preceding sentence shall not apply to any assignment or alienation made for the purpose of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by Section 4975 of the Internal Revenue Code of 1954 (relating to tax on prohibited transactions) by reason of Section 4975(d)(1) of such Code.  

The language of I.R.C. § 401(a)(13) is essentially identical.  

(1) Contributions to the plan by the employer are currently deductible by the employer whether or not any participating employee obtains a nonforfeitable right to that contribution at the time it is made. I.R.C. § 404.  

(2) The employer contributions are not included in the gross income of any participating employee until actually distributed or made available to him, even though he may have obtained a nonforfeitable right to those contributions prior to distribution or availability. I.R.C. § 402.  

(3) On the death of a participating employee his interest in the plan payable to a named beneficiary will be exempt from estate tax to the extent such interest is attributable to employer contributions, unless the distribution receives the favorable income tax treatment accorded lump sum distributions. I.R.C. § 2039(c).  

(4) The trust by means of which the plan is funded is exempt from income tax. I.R.C. § 501(a).  

It is expected that most pension plans will be subject to both ERISA § 206(d), 29 U.S.C. § 1056(d) and I.R.C. § 401(a)(13). Each of the provisions, however, carries with it different penalties for violation. See note 13 infra.  

The Internal Revenue Code speaks of the trust, rather than the plan, as being “qualified,” although some of the requirements for the trust's qualification are imposed upon the plan rather than the trust. For example, in order for the trust to be qualified, the trust must meet the requirement of I.R.C. § 401(a)(2), and the plan of which such trust is a part must meet the requirement of I.R.C. § 401(a)(3). Nonetheless, it is customary to speak of the plan, rather than the trust, as being qualified, see, e.g., Treas. Reg. § 1.401-1(a) (1963); Rev. Rul. 73-534, 1973-2 C.B. 132, and this usage is adopted herein.  

Title I of ERISA, on the other hand, by its terms imposes requirements upon only plans, not upon trusts.  

The legislative history of ERISA reveals that Congress' original plan for correcting the many abuses in the private pension system that had been brought to its attention during the early 1970's was to amend Subchapter D of the Internal Revenue Code to augment the body of requirements that a plan had to meet in order to obtain the tax advantage of qualification.
This article will explore the ramifications of ERISA § 206(d) and I.R.C. § 401(a)(13), which purport to make every pension trust a spendthrift trust. In order to understand how these provisions will operate, however, it is first necessary to review the means whereby, in the absence of spendthrift restrictions, a creditor may satisfy a debt out of the interest his debtor may have in a trust.

**Creditor's Rights to Debtor's Trust Interest**

In general, the creditor of a trust beneficiary may proceed in equity to seek satisfaction of the beneficiary's debt. Indeed, equitable remedies are frequently the only relief available to such a creditor. Typically, however, the creditor may not proceed in equity until he has reduced his claim to judgment and unless he can establish that, because the debtor hasn't enough property of his own...
to satisfy the judgment, the creditor's legal remedies are inadequate. The equity court may order that the beneficiary's interest be sold to pay the debt or, if the court considers it practicable and more in the interests of the parties, may simply require that the periodic trust distributions be applied, as they come due, to payment of the debt.

The judicial sale of a beneficiary's interest does not bring about the termination of the trust as to that beneficiary or the transfer of corpus to the purchaser. Rather, the purchaser at a judicial sale steps into the shoes of the beneficiary, and his rights in the trust are subject to the same restrictions and contingencies as the beneficiary's rights. He has no right to a distribution of trust property prior to the time distribution would have been made to the beneficiary, and if the occurrence of a particular contingency would have defeated the beneficiary's interest, such occurrence will similarly defeat the purchaser's interest. Thus, if, by the terms of a pension plan, a participant was not entitled to a distribution of his interest in the plan until he terminated his employment, an attaching creditor or a purchaser on judicial sale would be obliged to wait until the debtor terminated his employment before receiving anything from the trust; and if the plan provided that a participant whose employ-

21 County Nat'l Bank & Trust Co. v. Sheppard, 136 Cal. App. 2d 205, 288 P.2d 880 (1955);
G. BOSSERT, supra note 4, at § 188.
22 Vellacott v. Murphy, 16 F.2d 700 (5th Cir.), cert. denied, 273 U.S. 767 (1927); Perabo v. Gallagher, 241 Mass. 207, 135 N.E. 113 (1922); In re Hall's Estate, 248 Pa. 218, 93 A. 944 (1915); see Moser & Son v. Tucker & Co., 87 Tex. 94, 26 S.W. 1044 (1894). Where a life insurance beneficiary irrevocably elects to receive insurance proceeds in monthly installments over 20 years and where the proceeds were garnished by the beneficiary's creditor, the creditor is entitled to the installments as they come due but not to lump sum satisfaction of the claim. John Hancock Mutual Life Ins. Co. v. Frost Nat'l Bank of San Antonio, 393 F. Supp. 204 (E.D. Tenn. 1974), aff'd without opinion, 516 F.2d 901 (6th Cir. 1975); Roth v. Kaptowski, 401 Ill. 424, 82 N.E.2d 664 (1948). See note 24 infra.
ment terminated prior to the completion of, say, ten years of service forfeited his entire interest in the trust, the debtor-participant's termination of employment prior to completing that period of service would defeat the interest of such creditor or purchaser.\textsuperscript{24}

\textbf{FEDERAL PREEMPTION}

\textit{The Scope of Preemption}

Section 514(a) of ERISA\textsuperscript{25} provides in part that the provisions of Title I of the statute "supersede any and all State laws insofar as they may . . . relate to any employee benefit plan," with certain narrow exceptions not here pertinent.\textsuperscript{26} Clearly, the word "laws" in this provision comprehends judicial decisional law as well as statutory law,\textsuperscript{27} but what is meant by the word "relate"? Does ERISA purport to preempt only state laws that by their express terms are made applicable to employee benefit plans; or does the preemption provision extend to all state laws that in fact have any effect on plans? Let us consider a specific case. ERISA § 206(d), as we have seen, requires all covered pension plans to contain a "spendthrift"

\textsuperscript{24} If the interest of a beneficiary is a contingent interest, the ability of his creditors to reach it may depend on the remoteness of the contingency. Clarke v. Fay, 205 Mass. 228, 91 N.E. 328 (1910); see Moser & Son v. Tucker & Co., 87 Tex. 94, 26 S.W. 1044 (1894). Where a contingency is particularly remote, "the price received at a forced sale would be so disproportionate to the value of the interest if it should vest that some courts at least have regarded it as unfair to the beneficiary to permit his creditors to force a sale of it. The benefit to the creditor would be small, since the price received would usually be merely nominal, and the possible loss to the beneficiary would be great." 2 A. Scott, \textit{supra} note 20, at § 162. There is disagreement among courts, however, as to when that degree of remoteness is reached. \textit{Compare} Smith v. Gilbert, 71 Conn. 149, 41 A. 284 (1888) (son's interest contingent on surviving mother held not to be reachable by creditors) with Reilly v. Mackenzie, 151 Md. 216, 134 A. 502 (1926) (son's interest contingent on surviving mother held reachable by creditors). Some courts, when faced with the problem of levying upon a contingent interest, have employed the sensible expedient of declining to order a sale but granting the creditor a lien against the interest and postponing the sale until such time as the interest vests. Mid-America Corp. v. Geimarr, 380 P.2d 85 (Okla. 1963); \textit{see} Meyer v. Reif, 217 Wis. 11, 258 N.W. 391 (1935).

Strictly speaking, the interest of the participating employee described in the accompanying text would be classified as an equitable fee simple subject to defeasance. While there is a legal difference between a contingent interest and a vested interest subject to defeasance, the better view, in determining a creditor's rights in the interest, is to focus on the likelihood that the debtor will come into possession, without regard to the technical classification of the interest. Smith v. Gilbert, 71 Conn. 149, 41 A. 284 (1888); Loeb v. Loeb, 261 Ind. 193, 301 N.E.2d 349 (1973). \textit{See generally} Carey & Freeman, \textit{Alienation of Future Interests in Illinois}, 31 I.L.L. L. Rev. 1, 13-14 (1936); Halbach, \textit{Creditors' Rights in Future Interests}, 43 Minn. L. Rev. 217, 233-37 (1958).

\textsuperscript{25} 29 U.S.C. § 1144(a) (1976).

\textsuperscript{26} The statutory exceptions involve state insurance, banking, and "generally applicable" criminal laws. ERISA § 514(b), 29 U.S.C. § 1144(b) (1976).

\textsuperscript{27} ERISA § 514(c)(1), 29 U.S.C. § 1144(c)(1) (1976).
provision so that an employee's accrued benefit under the plan cannot be attached by his creditors. In a number of states, however, spendthrift provisions are, for reasons of public policy, given no effect by courts, so that the creditors of a trust beneficiary can

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28 Strictly speaking, ERISA § 206(d) and I.R.C. § 401(a)(13) require that plans by their terms prohibit only "assignments" and "alienations." No mention is made of levies or attachments by creditors. Thus, it could be claimed that a plan that prohibits voluntary alienations by participants but permits involuntary alienations on behalf of participants' creditors complies with ERISA. Indeed, one court so construed the statute, thus permitting a judgment creditor of a participant to garnish the participant's pension benefits. National Bank of N. America v. IBEW Local 3, 93 Misc. 2d 590, 400 N.Y.S.2d 482 (Sup. Ct. 1977), aff'd, 69 App. Div. 2d 679, 419 N.Y.S. 2d 127 (1979). The trial court's holding was based on a misreading of the legislative history and on the fact that other federal statutes prohibiting the assignment of benefits, 38 U.S.C. § 3101 (1976) (veterans' benefits); 42 U.S.C. § 407 (1976) (Social Security benefits), also refer to levy or garnishment by creditors, whereas ERISA does not. The legislative history on which the court focused was the following passage from the Joint House and Senate Conference Committee Report:

Under the conference substitute, a plan must provide that benefits under the plan may not be assigned or alienated. However, the plan may provide that after a benefit is in pay status there may be a voluntary revocable assignment . . . by an employee. . . . For purposes of this rule, a garnishment or levy is not to be considered a voluntary assignment.

H.R. Rep. No. 1280, 93d Cong., 2d Sess., 280 (1974) (emphasis supplied). Contrary to what the court found, the clear implication of the passage is that a garnishment or levy is prohibited by the general rule to which the "voluntary revocable assignment" provision is an exception. Indeed, other courts seem simply to have assumed without discussion that ERISA § 206(d) was designed to preclude creditors from reaching pension plans assets. See Cody v. Riecker, 454 F. Supp. 22 (E.D.N.Y. 1978), aff'd, 506 F.2d 314 (2d Cir. 1979); Stone v. Stone, 450 F. Supp. 919 (N.D. Cal. 1978), appeal docketed, No. 78-2313 (9th Cir. June 21, 1978). Furthermore, as a matter of general common law, provisions in a private trust instrument that purport to preclude voluntary alienation by a beneficiary are held to preclude involuntary alienation as well. Roberts v. Stevens, 84 Me. 325, 24 A. 873 (1892); Partridge v. Caven- der, 96 Mo. 452, 9 S.W. 785 (1888); Winthrop Co. v. Clinton, 196 Pa. 472, 46 A. 435 (1900). Contra, Koelliker v. Denkinger, 148 Kan. 503, 83 P.2d 703, modified on other grounds, 149 Kan. 299, 66 P.2d 740 (1938) (a statute, since completely altered, which by its terms made certain trust interests nonalienable by beneficiaries was held nonetheless to permit creditors to reach the interests).

Curiously, ERISA does not by its terms prohibit alienations; it merely requires that plans prohibit them. Suppose an employer establishes a pension plan but does not include in the plan instrument the required spendthrift language. Is a participant's creditor therefore able to attach his interest under the plan, or does ERISA by its own force preclude attachments, notwithstanding the absence of any spendthrift language in the plan? One is tempted to suppose that ERISA does indeed by its own force preclude attachments. Otherwise, the only recourse available to a participant whose creditor attached his interest would be an action for damages against the plan sponsor for having omitted the required language, and it is unlikely that ERISA would accord the participant such a cause of action. In view of the legislative history of this provision, see note 7 supra, it is more reasonable to suppose that Congress, rather than leaving such a participant without recourse, intended § 206(d) to preclude attachments by its own force. (There are no cases in point, and search has revealed no comparable statutes. Those other statutes designed to prohibit the alienation of benefits or beneficial interests invariably do so by their own terms rather than by requiring some other instrument to contain prohibitory language. See, e.g., 42 U.S.C. § 407 (1976); TENN. CODE ANN. § 26-601 to -604 (1955); WASH. REV. CODE § 6.32.250 (1978)).
attach, and the beneficiary can assign, his interest under the trust, notwithstanding the presence of a spendthrift provision in the trust instrument. Clearly, this state rule regarding spendthrift trusts was not designed to deal with employee benefit plans, yet it does in fact affect them. Is it preempted by ERISA?

If the question is answered in the negative—that is, if ERISA's preemption provision is construed to be limited to state laws that are expressly applicable to employee benefit plans, the trustee of a qualified pension trust subject to, say, New Hampshire law could find himself in a most awkward position. Suppose a creditor of an employee participating in the pension plan obtains a judgment in state court against the employee, and the employee's interest in the trust is levied upon by an execution issued upon the judgment. When the trustee receives the court order directing him to pay trust assets over to the creditor, what is he to do? To refuse to comply with the order could result in a default judgment against the trustee personally in favor of the creditor; but to pay over the funds as ordered would violate ERISA § 206(d), and for such violation the trustee might be held personally liable to make good the employee's loss. Moreover, a payment of plan assets to the judgment creditor

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29 E.g., Brahmey v. Rollins, 87 N.H. 290, 179 A. 186 (1935); Chinnis v. Cobb, 210 N.C. 104, 185 S.E. 638 (1936) (spendthrift restrictions are enforced only if the trust complies with the limitations set forth in N.C. Gen. Stat. § 41-9 (1976), among which is the requirement that the trust be for the support and maintenance of a relative of the grantor); Industrial Nat'l Bank v. Budlong, 106 R.I. 780, 264 A.2d 18 (1970).


31 This particular conflict between a state and a federal rule might, of course, be resolved simply by reference to the Supremacy Clause of the Constitution. U.S. Const. art VI, cl. 2. See Philpott v. Essex County Welfare Board, 409 U.S. 413 (1973) (holding that the federal statute exempting Social Security benefit payments from creditors' claims took precedence, because of the Supremacy Clause, over a New Jersey statutory scheme giving a county welfare board a claim against the recipient's assets). However, because, for purposes of the analysis to be set forth in this article, it is important to develop the concept of federal preemption under ERISA § 514(a), 29 U.S.C. § 1144(a) (1976), the discussion of the resolution of this conflict will focus on the ERISA preemption provision rather than on the Supremacy Clause.


33 It is clear that the employee would have a cause of action pursuant to ERISA § 502(a)(1)(B), 29 U.S.C. § 1132(a)(1)(B) (1976), but it is less clear whether the cause of action would lie against the trustee personally or only against the plan. Actions authorized by ERISA § 409(a), 29 U.S.C. § 1109(a) (1976), however, may always be brought against the trustee personally, and it appears that the employee would have a cause of action under this section as well. Section 409(a) declares that a plan fiduciary can be held personally liable for any losses resulting from a breach by the fiduciary of any of the duties imposed upon him by Title I of ERISA. Among those duties is that of carrying out his responsibilities with respect
would violate I.R.C. § 401(a)(13), and the plan would consequently be disqualified.\textsuperscript{34}

Fortunately for the trustee, the legislative history suggests most strongly that Congress intended to preempt all state laws that in fact affect covered plans, whether or not those laws were expressly made applicable to such plans. The bills from which ERISA evolved generally limited the scope of preemption to state regulation of certain enumerated areas expressly covered by those bills.\textsuperscript{35} But such

to the plan "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter." ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (1976). Since the plan document would presumably contain the anti-assignment language of ERISA § 206(d), the trustee, by paying funds to the attaching creditor, would indeed be carrying out his responsibilities in a manner inconsistent with the plan document and hence would violate § 404(a)(1)(D), giving rise to personal liability pursuant to § 409(a).

It is true that the language of § 409(a) suggests that the provision is limited to conduct which affects the integrity of the plan as a whole, rather than conduct which affects an individual participant's interest under the plan. Nonetheless, the language is susceptible of the construction given it herein, and the Labor Department evidently so construes it. See ERISA Enforcement Guide—Dept. of Labor [CCH] § 305.0 et seq. (1978). Search has revealed no cases addressing this issue.

\textsuperscript{34} To "disqualify" a plan means to hold that the plan no longer meets the requirements of I.R.C. § 401 and accordingly is no longer entitled to the favorable tax treatment accorded qualified plans. See note 11 supra. Thus, one consequence of disqualification would be that each participating employee would thereupon be required to include in his gross income any employer contributions previously made to the plan on his behalf to the extent that his interest in those contributions was, at the time of disqualification, nonforfeitable. See I.R.C. § 402(b); M. CANAN, QUALIFIED RETIREMENT PLANS § 20.6 (1977). Typically, any finding of disqualification (or "nonqualification" if a newly-adopted plan is at issue) would be made initially by the Internal Revenue Service, either at the time of an audit of the employer's income tax return (when the employer claims a deduction for a plan contribution pursuant to I.R.C. § 404) or in response to a request for a determination letter (that is, an official finding by the Service that a particular plan meets the requirements of I.R.C. § 401, see, e.g., Rev. Proc. 72-6, 1972-1 C.B. 710, amplified by Rev. Proc. 75-47, 1975-2 C.B. 581). Court review is available if the Service finally determines a tax deficiency, I.R.C. § 6213, or declines to issue a favorable determination letter, I.R.C. § 7476.

\textsuperscript{35} For example, § 514 of H.R. 2, 93d Cong., 2d Sess., enacted by the House on February 28, 1974, provided:

Sec. 514. (a) It is hereby declared to be the express intent of Congress that, except for actions authorized by section 503(e)(1)(B) of this Act and except as provided in subsection (b) of this section the provisions of part 1 of this subtitle shall supersede any and all laws of the States and of political subdivisions thereof insofar as they may now or hereafter relate to the reporting and disclosure responsibilities, and fiduciary responsibilities, and persons acting on behalf of any employee benefit plan to which part 1 applies.

(c) It is hereby declared to be the express intent of Congress that the provisions of parts 2, 3, and 4 of this subtitle shall supersede any and all laws of the States and of political subdivisions thereof insofar as they may now or hereafter relate to the nonforfeitability of participant's benefits in employee benefit plans described in section 201(a) or 301(a), the funding requirements for such plans,
partial preemption ultimately raised the specter of endless litigation to determine whether a particular state law improperly impinged upon federal regulation by falling within the preempted subject area, and accordingly the joint conference committee substituted in the final version of the bill a broad, indeed sweeping, preemption provision. In his statement to the House of Representatives Congressman Dent, Chairman of the Subcommittee on Labor of the House Committee on Education and Labor, stated:

The conferees . . . applied this [preemption] principle in its broadest sense to foreclose any non-Federal regulation of employee benefit plans. Thus, the provisions of [ERISA § 514] would reach any rule, regulation, practice or decision of any State, subdivision thereof or any agency or instrumentality thereof . . . which would affect any employee benefit plan as described in [ERISA § 4(a)] and not exempt under [ERISA § 4(b)].

This legislative history has led at least one court to conclude:

The courts are to be spared the task of deciding whether a particular state law governing some aspect of an employee benefit plan may be enforced concurrently with federal law. Rather, the preemption question is to be resolved relatively easily by determining whether the plan in question is a covered federal plan. . . . [If it is,] no state statute, regulation, or common law rule, operating of its own force, may govern any aspect of [the] case.

the adequacy of financing of such plans, portability requirements for such plans, or the insurance of pension benefits under such plans.

Speaking on behalf of the conference committee's version of the bill, Senator Javits (ranking minority member of the Senate Labor and Public Welfare Committee) said, Both House and Senate bills provided for preemption of State law but—with one major exception appearing in the House bill—defined the perimeters of preemption in relation to the areas regulated by the bill. Such a formulation raised the possibility of endless litigation over the validity of State action that might impinge on Federal regulation, as well as opening the door to multiple and potentially conflicting State laws hastily contrived to deal with some particular aspect of private welfare or pension benefit plans not clearly connected to the Federal regulatory scheme.


As a consequence of this construction it has been held, for example, that ERISA preempts the ordinary equity power of state courts to make judicial settlement of trustees' accounts where the trusts involved are the funding media of employee benefit plans, and preempts the states' taxing power where the tax is made specially applicable to employee benefit plans.

This sweeping type of federal preemption, though it has the virtue of precluding what would otherwise be a good deal of litigation directed at determining whether a particular state law is preempted by ERISA, may spawn an even greater quantity of litigation of another kind. Where state law is preempted and no specific federal provision governs, a "court is forced to make law or leave a void where neither state nor federal law applies. In such a situation it is a reasonable inference that Congress intended some law, and therefore federal law, to apply." In other words, courts will now be called upon to fashion a federal common law of pension plans and pension trusts, and the legislative history indicates that this is precisely what Congress intended, even though the necessity of


Senator Javits, speaking on behalf of the conference version of ERISA, stated: "It is... intended that a body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans." 120 Cong. Rec. 29942 (1974). The Joint Explanatory Statement of the Conference Committee that accompanied ERISA specified that civil actions under ERISA, whether filed in the state or federal courts, "are to be regarded as arising under the laws of the United States in similar fashion to those brought under section 301 of the Labor-Management Relations Act of 1947." [1974] U.S. CODE CONG. & AD. NEWS 5107. (Under § 301 of the LMRA, 29 U.S.C. § 185 (1976), to which the Committee Statement refers, the courts have been obliged to fashion a federal common law of collective bargaining. See Textile Workers Union v. Lincoln Mills, 353 U.S. 448 (1957)).
creating federal rules of decision may result in more litigation than the broad-brush preemption rule averted. 46

Procedural Matters

Although a state law that purports to deny effect to spendthrift provisions in a pension trust would, as we have seen, be preempted by ERISA, a pension trustee faced with a state court writ of execution must nonetheless respond, either by appearing as defendant in the state court enforcement proceeding and seeking to have the writ dissolved, 46 or by seeking some sort of injunctive or declaratory relief in federal court against the state proceeding. 47 Obviously, the trustee can seek to vindicate the federal “exemption” by asserting it as a defense in the state court action, 48 but if he elects to defend in the state forum, he is bound by the decision of the state tribunals, according to the normal rules of res judicata, and cannot collaterally attack an adverse judgment in federal court. 49

Instead of defending in state court, may the trustee bring a suit in federal court to enjoin the state proceeding? Unless the trustee

46 Of course, although the source of this new law must be federal and uniform, state law where compatible with national policy, may be resorted to and adopted as a federal rule of decision. Moragne v. States Marine Lines, Inc., 398 U.S. 375, 406-08 (1970); Zdanok v. Glidden Co., 327 F.2d 944 (2d Cir.), cert. denied, 377 U.S. 934 (1964).
48 See, e.g., Cody v. Riecker, 594 F.2d 314 (2d Cir. 1979); American Tel. and Tel. Co. v. Merry, 592 F.2d 118 (2d Cir. 1979); Operating Engineers Local 428 Pension Trust Fund v. Zamborsky, 470 F. Supp. 1174 (D. Ariz. 1979). The trustee could, of course, do nothing, but then he would be faced with a state default judgment and with the same problem of whether to respond to it in state or in federal court. See note 32 supra. Could the trustee, as stakeholder, simply interplead the employee and the creditor and let the two of them litigate the issue? This approach has not yet been tried, perhaps because ERISA § 404, 29 U.S.C. § 1104 (1976), which imposes certain broad responsibilities upon plan fiduciaries, can be read as requiring the trustee to defend the employee’s interests. The section provides in part that “a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries . . . .” Id.
Lavasek v. White, 339 F.2d 861 (10th Cir. 1965). Since the application of a federal statutory exemption is at issue, the trustee could obtain United States Supreme Court review of an adverse decision if it is the final judgment of the highest state court in which a decision could be had. 28 U.S.C. § 1257 (1976). See generally C. WRIGHT, A. MILLER & E. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4017 (1977). For an interesting discussion of whether the trustee may, at least where the creditor is the spouse or former spouse of the employee, remove the case to federal court, see Stone v. Stone, 450 F. Supp. 919 (N.D. Cal. 1978), appeal docketed, No. 78-2313 (9th Cir. June 21, 1978). See generally C. WRIGHT, THE LAW OF FEDERAL COURTS § 38 (1976).
can show that the continuation of the state proceeding would cause irreparable harm and that the legal remedy of appearing as defendant in state court is inadequate, he will not be entitled to an injunction. Ordinarily, exposure to litigation is not such irreparable harm as will justify an injunction. The trustee would not be entitled to injunctive relief merely by demonstrating that, without it, he would have to defend against the writ of execution in state court.50

The so-called “multiplicity of actions” rationale is a better argument to support the trustee’s petition for an injunction. Frequently, a court will grant an injunction where, because it would require a multiplicity of actions at law to arrive at a result that can be accomplished by a single injunction, the remedy at law is deemed inadequate.51 The trustee should argue that one of the purposes of ERISA is to enable plan participants to predict what their future benefits will be, by assuring them that their accrued benefits will be safe from attack by creditors; the trust property should therefore be devoted to the payment of retirement benefits and not be consumed in defending the trust, however successfully, against a succession of writs of execution.

These goals can be achieved more readily by a federal injunction and declaratory judgment than by a successful defense by the trustee in a particular state proceeding involving a particular writ. Indeed, if the trustee defends in a state proceeding on both a state and a federal ground, and the state court finds for the trustee on the basis of the state defense, the state court result leaves the participants and the trustee as uncertain as before of their rights and obligations. For example, suppose the trustee appeared as party defendant in state court and opposed enforcement of the writ on two grounds: (1) that the state statute of limitations on enforcement of such writs had run, and (2) that ERISA barred the enforcement of the writ. If the state court declined to enforce the writ on the ground that the statute of limitations had run and did not address the ERISA issue, the trustee and participants would still be unsure whether accrued benefits under the plan would be safe from attack by more vigilant creditors.

Even if the trustees can establish that there is no adequate remedy at law, will the federal anti-injunction statute52 preclude relief? This statute excepts from its general prohibition injunctions

51 A leading case is Colliton v. Oxborough, 86 Minn. 361, 90 N.W. 793 (1902).
52 “A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments.” 28 U.S.C. § 2283 (1976).
"expressly authorized by Act of Congress." In order for this exception to apply, it is not necessary that a federal law contain an express reference to the anti-injunction statute or expressly authorize an injunction against a state court proceeding.\(^5\) "The test, rather, is whether an Act of Congress, clearly creating a federal right or remedy enforceable in a federal court of equity, could be given its intended scope only by the stay of a state court proceeding."\(^6\) As to the first part of this test, it is clear that ERISA § 206(d) creates a federal right and that ERISA § 502 gives the federal courts exclusive jurisdiction to entertain suits by plan fiduciaries to enjoin all acts or practices that violate that right.\(^7\) As to the second part of the test (the requirement that the federal right cannot be given its intended scope unless the state proceeding is enjoined), so long as the state execution proceeding is in progress, the status of the participant's accrued pension benefit is uncertain, and section 206(d) was designed to insulate benefits from just that uncertainty. Consequently, the anti-injunction statute should not be a bar to the trustee's suit, and the courts have agreed.\(^8\)

**Federal Common Law of Spendthrift Trusts**

Even that majority of jurisdictions that gives effect to spendthrift provisions nevertheless permits creditors to levy upon spendthrift trust assets in certain exceptional circumstances. Three of these exceptions merit our attention: (1) self-settled trusts; (2) claims for alimony and child support; and (3) tax claims. Since the courts will be called upon to fashion a federal common law of

\(^6\) Id. at 238.
\(^7\) ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3) (1976), authorizes suits by plan fiduciaries "to enjoin any act or practice which violates any provision of this subchapter or . . . to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this title . . . ." ERISA § 502(e)(1), 29 U.S.C. § 1132(e)(1) (1976), gives federal courts exclusive jurisdiction to entertain such suits.
\(^8\) Cartledge v. Miller, 457 F. Supp. 1146 (S.D.N.Y. 1978); Senco, Inc. v. Clark, 473 F. Supp. 802 (M.D. Fla. 1979); see Marshall v. Chase Manhattan Bank (Nat'l Ass'n), 558 F.2d 680, 683 (2d Cir. 1977). There is an important line of recent Supreme Court cases, chief among which is Younger v. Harris, 401 U.S. 37 (1971), holding that principles of comity unique to "Our Federalism" prevent federal courts from enjoining state proceedings in certain circumstances, even where the anti-injunction statute would permit the injunction. The cases so far, however, have confined this limitation to state criminal proceedings and quasi-criminal proceedings to which a state is a party. See Trainor v. Hernandez, 431 U.S. 434 (1977) (suit by state to recover fraudulently-obtained welfare payments); Huffman v. Pursue, Ltd., 420 U.S. 592, 603-05 (1975) (nuisance action brought by state).
spendthrift trusts in connection with employee pension plans, the extent to which these exceptions will be incorporated into this federal law is a matter of some importance.

Self-Settled Trusts

It is uniformly held at common law that where the settlor of a spendthrift trust is also a beneficiary of the trust, the spendthrift provision will not insulate his interest from the claims of his creditors, since "[i]t is against public policy to permit a man to tie up his own property in such a way that he can still enjoy it but can prevent his creditors from reaching it." (Any other beneficiaries of such a trust, however, would be protected by the spendthrift clause.) Frequently, pension plans permit or even require employees to make contributions to the plan, which are invested by the trustee along with the contributions made by the employer. Should the courts, in fashioning a federal common law of spendthrift trusts, adopt the self-settled trust exception, so that, notwithstanding the language required by ERISA § 206(d) and I.R.C. § 401(a)(13), a creditor of an employee could attach that portion of the employee's interest in the trust attributable to the employee's own contributions?

In support of a "no exceptions" construction of section 206(d), it could be argued that section 206(d) is designed to protect plans qua

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57 See notes 42-45 & accompanying text supra.
58 Nelson v. California Trust Co., 33 Cal. 2d 501, 202 P.2d 1021 (1949); Warner v. Rice, 66 Md. 496, 8 A. 84 (1887); Deposit Guaranty Nat'l Bank v. Walter E. Heller & Co., 204 So. 2d 556 (Miss. 1967); Chormley v. Smith, 139 Pa. 584, 21 A. 135 (1891). But cf. Booth v. Chadwick, 154 S.W.2d 268 (Tex. Ct. App. 1941) (holding that where the settlor, while in prison, creates a spendthrift trust for his own benefit, the spendthrift provision will be valid, at least while he remains in prison).


59 2 A. Scott, supra note 20, at § 156.
60 Suppose A owns Blackacre, worth $100,000. A transfers Blackacre to B in exchange for B's establishment of a $100,000 spendthrift trust for A's benefit. Since A furnished the consideration for the trust, he will be regarded as the settlor of the trust for purposes of the self-settled trust rule. Id. The argument could therefore be made in the case of a pension trust that since the employee furnishes the consideration (labor) for the establishment of the trust by the employer, the employee should be regarded as the settlor of the trust, and the spendthrift restriction should therefore have no effect on the employee's interest. This construction, however, would render ERISA § 206(d) meaningless and ought therefore to be rejected if it is ever suggested in litigation. See Fordyce v. Fordyce, 80 Misc. 2d 909, 365 N.Y.S. 2d 323 (Sup. Ct. 1974) (a pre-ERISA case that rejected an analogous argument with reference to a state statute similar to § 206(d)).
plans: that is, that ERISA's spendthrift provision is designed not to protect employees from creditors but rather to protect plans from the burden of having to respond to garnishments or make payments of benefits to assignees. It has been held, for example, that the provision of the Railroad Retirement Act\(^6\) exempting the retirement fund from attachment "was intended solely to relieve the Federal authorities as administrators of the fund from the annoyance of attachment of pensions or annuities in their hands."\(^6\) In view of the legislative history of ERISA,\(^6\) however, and in view of ERISA provisions which in some circumstances permit voluntary and revocable assignments,\(^6\) the view that section 206(d) is designed to protect plans rather than employees is unsound and was properly rejected in *Stone v. Stone.*\(^6\) We must therefore turn elsewhere for a solution to this problem.

A somewhat tautological Pennsylvania statute\(^6\) provided\(^6\) that if a pension plan prohibited the voluntary or involuntary alienation of benefits, those benefits should indeed be exempt from the claims of creditors; in other words, the statute purported to authorize, though it did not require, the imposition of spendthrift restrictions upon pension plan assets. *Avenue Motor Co. v. Emro*\(^6\) involved a contributory pension plan. As a condition of employment, each employee was required, by means of a deduction from his wages, to make a contribution to the plan, and the employer contributed a matching amount. Although the plan contained the spendthrift provision contemplated by the state statute, the creditor of a participating employee sought to levy upon that portion of the employee's accrued benefit attributable to the employee's own contributions. The creditor cited the Restatement of Trusts in support of the levy: "Where

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\(^{63}\) See note 7 supra.

\(^{64}\) See notes 176-83 & accompanying text infra.

\(^{65}\) 450 F. Supp. 919, 930 (N.D. Cal. 1978). Cf. Johnston v. Johnston (*In re Marriage of Johnston*), 85 Cal. App. 3d 900, 149 Cal. Rptr. 798 (1978), where the court refused to allow the plan trustee to deduct $5.00 per garnished pension payment to reimburse the trust for the allegedly greater administrative cost of making two payments per month (part of the benefit went to the employee and part to the creditor, his spouse) instead of one.


\(^{67}\) Although the statute, in recodified form, is still on the books, it has presumably been preempted by ERISA. See notes 35-40 & accompanying text supra.

\(^{68}\) 124 PITT. LEGAL J. 103 (C.P. Allegheny County 1976).
a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest." The court dissolved the writ of execution, thereby upholding the spendthrift protection, stating:

[P]ension funds are created for the mutual benefit of employe [sic] and employer. The employer is particularly interested in maintaining the morale of each employe and the esprit de corps of all employes and also is interested in minimizing the fiscally enervating cost of employe turnover. Thus, it may well be concluded that even if the trust was created in part by the action of the employee Defendant in authorizing the withholding of wages or salary as savings, the trust was created, at least in part, by the employer and was therefore not created exclusively by the employee for his own benefit within the meaning of [RESTATEMENT (SECOND) OF TRUSTS § 156].

Two aspects of Avenue Motor ought to be noted. First, although the plan asserted as one of its defenses that ERISA § 206(d) precluded the execution, the court never once adverted to ERISA in its opinion, and indeed the writ of execution seems to have been issued prior to the effective date of the ERISA provision. However, because the plan contained the same language that section 206(d) now requires, this case does at least suggest the direction that the federal common law of pension trusts ought to take. Second, while the court's analysis, quoted above, is persuasive as regards mandatory employee contributions, it begins to break down when voluntary employee contributions are considered. Indeed in Fordyce v. Fordyce, another pre-ERISA case, a New York court interpreting New York statutory law drew a distinction between voluntary and mandatory employee contributions. It denied execution against the portion of the accrued benefit attributable to mandatory employee contributions, using reasoning similar to that employed by the

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70 Restatement (Second) of Trusts § 156(1) (1959).
72 Mandatory employee contributions are contributions required as a condition of employment, as a condition of participation in the plan, or as a condition of obtaining benefits under the plan attributable to employer contributions.
73 80 Misc. 2d 909, 365 N.Y.S.2d 323 (Sup. Ct. 1974).
74 N.Y. Est., Powers & Trusts Law § 7-3.1 (McKinney 1967) provides that "'[a] disposition in trust for the use of the creator is void as against existing or subsequent creditors of the creator.' N.Y. Civ. Prac. Law § 5205(c) (McKinney 1978) provides that "'[a]ny property while held in trust for a judgment debtor, where the trust has been created by, or the fund so held in trust has proceeded from, a person other than the judgment debtor, is exempt from application to the satisfaction of a money judgment.'"
Avenue Motor court, and permitted execution against the portion attributable to the voluntary contributions. The court reasoned that this latter portion was in essence a self-settled trust, because the employee had on his own put the property aside for his own use later, and because such contributions were essentially unrelated to his labor, the employer having served as a mere conduit for this investment.\(^7\)

In view of Congress' announced policy of protecting employees' expectations regarding retirement benefits,\(^7\) it seems clear that courts, in fashioning a federal common law of pension trusts, should follow Avenue Motor, and hold that mandatory employee contributions are not in the nature of self-settled trust contributions and that, accordingly, the ERISA spendthrift provision prevents attachment or alienation of accrued benefits attributable to mandatory employee contributions. But what of accrued benefits attributable to voluntary employee contributions? On the one hand, the implied congressional policy of encouraging employee thrift suggests that courts ought to reject the self-settled trust exception for voluntary contributions as well. On the other hand, insulating voluntary contributions from creditors' claims would encourage some employees to make plan contributions in excess of their legitimate retirement needs solely for the purpose of defeating creditors.

The Internal Revenue Service has ruled that a pension plan will fail to qualify under I.R.C. § 401 if the terms of the plan permit an employee to make voluntary contributions in excess of ten percent of his compensation,\(^7\) and search has revealed no case in which this rule has even been challenged. The Service's position is based on its view that

the tax advantages provided under a qualified . . . plan were not intended by Congress to be extended to unlimited contributions by employees made primarily to escape [current taxation of the income those contributions earn while in the pension trust]. However, where the purpose of a voluntary contribution feature in a plan is to encourage savings by participants, such feature is acceptable provided the contributions are kept within reasonable bounds. In this respect . . . employee contributions are deemed to be reasonable if they do not exceed ten percent of compensation.\(^8\)

This analysis suggests that courts ought to distinguish between vol-

\(^7\) 80 Misc. 2d 909, 913, 365 N.Y.S.2d 323, 328 (Sup. Ct. 1974).
untary employee contributions reasonably necessary for retirement saving and those contributions in excess of that amount and consequently deemed to have been made for a nonprotected purpose; the "reasonable" contributions would be protected by the spendthrift provision, and the "excess" would not. The suggested rule would apply to qualified and nonqualified plans alike.

Ought courts to adopt the Service's ten percent rule as the line of demarcation, or should they, rather, determine what is "reasonable" on a case-by-case basis? Ordinarily, of course, the establishment of specific numerical limits is more the province of a legislature or an administrative agency than a court, since a court is presumed to lack the technical expertise needed to formulate such rules. Recent judicial developments, however, suggest a greater willingness on the part of courts to make such formulations.9

The Supreme Court has observed that "[t]reasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law."8 Since the Service's position with respect to voluntary employee contributions was first announced no later than 1959,1 a strong case can be made that this ten percent figure represents the upper limit on what Congress regards as voluntary employee contributions made for the purposes it had in mind when it created the qualified plan concept. Of course, not all Title I pension plans are qualified, and the Service did not fashion the ten percent rule with spendthrift restrictions in mind; but the situations are sufficiently analogous to suggest that courts should adopt the rule that the portion of an accrued benefit attributable to voluntary employee contributions up to ten percent of compensation is exempt from attachment and that the portion attributable to voluntary employee contributions in excess of ten percent is vulnerable to attachment.2
The alternative, at least in the absence of further congressional action, would be a less predictable rule: that voluntary employee contributions in excess of what is "reasonably related" to retirement saving are not protected by the spendthrift provision.\textsuperscript{53}

So far in this discussion of self-settled trusts, we have assumed that the employer and the employee are separate entities; but suppose they are the same. Suppose a self-employed physician establishes a pension plan pursuant to which he is required to contribute to a trust an amount equal to fifteen percent of his earnings. Will the entire contribution be regarded as the equivalent of voluntary employee contributions with the result that (assuming the "ten percent" rule is adopted) one-third of that contribution (the amount in excess of ten percent) will be unprotected by the ERISA spendthrift restriction? If so, then self-employed individuals who make contributions to pension plans would receive less protection from creditors than would common law employees on whose behalf contributions are made, a result at pronounced variance with the trend in Congress, at least as regards qualified plans, to eliminate any differences in tax treatment between self-employed persons (includ-
ing partners in partnerships) and common law employees.\(^4\)

Search has revealed five cases raising the issue of the self-settled trust exception in the context of pension plans for the self-employed.\(^5\) The cases arose in New York, where statutory law automatically exempts from execution in satisfaction of money judgments the corpus of any trust and ninety percent of the income of any trust created for the benefit of the judgment debtor, unless “the trust has been created by, or the fund so held in trust has proceeded from, . . . the judgment debtor. . . .”\(^6\) The cases are puzzling in that, although ERISA § 206(d) was clearly applicable to each transaction, not one of the opinions refers to it; instead, each opinion focuses only on the New York statute. In every case but Alexandre\(^7\) the creditor was permitted to reach the assets in the Keogh plan,\(^8\) but the reasoning in these cases was inadequate. In Lerner and Pafumi the courts found for the creditor because they concluded

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\(^4\) Prior to 1962 pension plans in which sole proprietors or members of partnerships participated could not qualify under I.R.C. § 401 because such persons were not “employees” within the meaning of I.R.C. § 401(a). I.T. 3350, 1940-1 C.B. 64; I.T. 3268, 1939-1 C.B. 196. The Self-Employed Individuals Tax Retirement Act of 1962, Pub. L. No. 87-792, 76 Stat. 809 (1962), extended the benefits of qualified plans to the self-employed, but because Congress thought that plans covering the self-employed would tend to be small plans, offering greater opportunities for abuse than large corporate plans, H.R. Rep. No. 378, 87th Cong., 1st Sess. (1961); S. Rep. No. 1615, 86th Cong., 2d Sess. (1960), special restrictions were placed upon plans for the self-employed. Among these was a limitation on the deductions that could be claimed pursuant to I.R.C. § 404 for contributions on behalf of the self-employed. The limitation was the lesser of $2,500 or 10% of the self-employed individual’s earned income from the trade or business for which the plan was established. See generally Chadwick & Foster, Federal Regulation of Retirement Plans: The Quest for Parity, 28 VAND. L. REV. 641, 658-65 (1975).

In 1974, with the enactment of ERISA, these limits were increased to $7,500 and 15%, respectively, ERISA § 2001; I.R.C. § 404(e), and for the first time significant limits were imposed upon contributions to and benefits payable under qualified plans covering only common law employees. ERISA § 2004, I.R.C. § 415.

Qualified plans covering self-employed individuals are frequently called “Keogh plans” (after the New York congressman who was a co-sponsor of the original bill dealing with qualified plans for the self-employed) or “H.R. 10 plans” (after the number of the bill that became the 1962 Act).


\(^6\) N.Y. CIV. PRACT. LAW § 5205(c)-(d) (McKinney’s 1978). If a court finds any part of that 90 percent of trust income to be unnecessary for the reasonable requirements of the judgment debtor and his dependents, such part is not exempt under this statute.

\(^7\) 61 App. Div. 2d 537, 403 N.Y.S.2d 21 (1978). The opinion in Alexandre was inconclusive, since the court found the record insufficient and directed that the trial court hold a plenary hearing on the issue of what the contracting parties to the plan—the trustee and the partnership—intended their agreement to mean.

\(^8\) For the definition of “Keogh plan,” see note 84 supra.
that in both cases the debtor had a present right to withdraw his
interest from the trust fund,89 a conclusion that, at least in the case
of Lerner, was erroneous90 and was impliedly criticized in Alexandre.

89 If a trust, from its very inception, provides that the principal is to be paid to a beneficiary
whenever he may demand it, any spendthrift language in the trust instrument is ignored, and
the beneficiary’s interest is vulnerable to his creditors. Croom v. Ocala Plumbing and Electric
Co., 62 Fla. 460, 57 So. 243 (1911); Ullman v. Cameron, 186 N.Y. 339, 78 N.E. 1074 (1906).
The courts reason that in such a case the spendthrift restriction is illusory—that the settlor
did not really intend to insulate the funds from the beneficiary’s improvidence but instead
attempted to give the beneficiary property more or less outright without exposing it to any
claims of the beneficiary’s creditors. Public policy should thwart such attempts.

90 The courts in these cases seem to have assumed that because the debtor-participant was
self-employed, he automatically retained the right to reclaim whenever he wished the contribu-
tions made to the trust on his behalf by the partnership. This assumption is unfounded.
First of all, if the plan is qualified and the participant in question has more than a 10%
interest in the capital or profits of the partnership, the trust instrument must expressly
prohibit him from withdrawing any portion of his trust account (except that attributable to
nondeductible contributions made as an “employee”) prior to age 59 ½, except in the event
of disability or death. I.R.C. § 401(d)(4)(B). Second, the common law of trusts would ordin-
arily prevent such withdrawals, even if I.R.C. § 401(d)(4)(B) was not a bar, unless the instru-
ment expressly permits them. See 4 A. Scott, supra note 20, at § 329A.

Suppose the partner in question controls the settlor-partnership: i.e., he has more than a
50% partnership interest. Would he, by virtue of such control, automatically retain the right
to reclaim contributions made to the plan on his behalf by the partnership? The settlor of a
trust cannot, of course, terminate the trust unless all the beneficiaries of the trust consent,
in the absence of an express power to do so reserved by the settlor in the trust instrument.
Sutliff v. Aydelott, 373 Ill. 633, 27 N.E.2d 529 (1940); Engel v. Guaranty Trust Co., 280 N.Y.
43, 19 N.E.2d 673 (1939). It is equally clear that a trust beneficiary cannot, without the
consent of the settlor, terminate or modify the trust unless it is clear that such termination
or modification would not frustrate any material purpose of the settlor in establishing the
trust. Clafin v. Clafin, 149 Mass. 19, 20 N.E. 454 (1889); RESTATEMENT (SECOND) OF
TRUSTS §§ 337(2), 338(1) (1959). There is some case law to suggest, however, that where the settlor
and one of the beneficiaries consent, the trust can be terminated as to that beneficiary,
provided that such “partition” of the trust does not adversely affect the interests of the other
beneficiaries. Ames v. Hall, 313 Mass. 33, 46 N.E.2d 403 (1943); Fidelity Union Trust Co. v.
Birch, 121 N.J. Eq. 132, 186 A. 816 (1936); see Duncan v. Kahn, 151 Cal. App. 2d 402, 311
P.2d 587 (1957). It is difficult to see how a participant in a Keogh plan could realistically
claim that his interest in the trust would be adversely affected by the withdrawal of the
controlling partner’s interest. A Keogh plan is typically drafted to provide that moneys
originally contributed for the benefit of one participant cannot be forfeited and used to
provide benefits for another participant. Since most Keogh plans are invested in bank trust
departments with funds commingled with those of other plans, no participant could realistically
claim that the removal from the fund of one participant’s share makes the portfolio less
diversified. If, therefore, the controlling partner (by virtue of such control, not by virtue of
being a partner) has the power to withdraw his interest from the pension trust whenever he
wishes, it would follow that he is not protected by the spendthrift provision. See note 89 supra.
Since that result is obviously at variance with Congress’ intentions, is there any escape from
it?

First Trust Co. v. United States, 321 F. Supp. 1025 (D. Minn. 1970), involved a pension
plan in which there participated a person who owned 97% of the stock of the company
maintaining the plan. The Internal Revenue Service argued that because the stockholder had
the power, by virtue of such control, to compel the plan administrators to make a discretion-
ary distribution to him (even though such discretionary distributions had never been made
Neither case, however, makes any reference to the self-settled trust rule. It is unclear whether the decisions in *Sheehan* and *Plymouth Rock* permitted attachment because of the self-settled trust rule or because the creditor had what the courts supposed was a present right to withdraw his interest from the trust fund. The situation is further complicated by the fact that *Sheehan* and probably *Lerner* involved claims for alimony or support, which might be another unstated reason for the decisions in those cases, since alimony and support claims are generally regarded as favored claims unaffected by spendthrift restrictions.81

The self-settled trust rule, if applied relentlessly in this context, leads to unfortunate results. Congress, in order to allow a sole proprietor to establish a qualified plan and deduct contributions to it, provided in the Internal Revenue Code that the proprietor is to be regarded as both employer and his own employee. As an employer, he may make a plan contribution for his own benefit as an employee up to the lesser of $7,500 or fifteen percent of the income he earns from the proprietorship, and he may claim a tax deduction for that contribution.82 Any contribution he makes in excess of that amount is deemed to have been made by him as an employee and is consequently not deductible. (The same rules apply in the case of a partnership; the partnership may contribute and deduct on behalf of each partner up to the lesser of $7,500 or fifteen percent of his income earned from the partnership business. Any additional contribution is regarded as having been made by the partner himself as an employee of the partnership and is not deductible.)

Suppose, for example, a sole proprietor earns $100,000 from the proprietorship and contributes $10,000 on his own behalf to a Keogh

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81 See notes 98-100 & accompanying text infra.
82 I.R.C. §§ 401(d)(5)(A), 404(e)(1).

in the past to anyone), he should be treated for tax purposes as if he had actually received that distribution. The court found for the taxpayer, pointing out that even though the stockholder may have had the power in theory, in fact he would not have exercised it, since to do so would have destroyed the plan. (The court was stretching a bit here. What they probably meant was that if the stockholder had demanded the distribution and got it, it would have created ill-feeling among the rank-and-file employees, who did not have this privilege and whose good-will the plan was adopted to foster; and that if the rank-and-file *had* been given this privilege, so many assets would have left the plan that it would have been a shell of its former self.) In addition, the court noted that if the stockholder had withdrawn his interest by exercising his control power over the plan administrators, the plan would have lost its qualification. See I.R.C. § 401(a)(4).

The reasoning of the *First Trust* case is applicable to the problem at hand. If a controlling partner in fact withdrew his interest from the Keogh plan, it would cause the very problems noted in *First Trust*. If, therefore, the controlling partner should not be "penalized" for having a mere theoretical power to withdraw his interest from the trust, he should not forfeit the benefits of the spendthrift clause on account of the existence of that power.
plan. He may deduct $7,500 from his gross income, since for tax purposes that amount is regarded as having been paid by his "employer." The remaining $2,500 is treated as a voluntary contribution made by him as an employee and is not deductible. But for purposes of the self-settled trust rule, is the proprietor deemed to have made a "voluntary" employee contribution of $10,000, $2,500, or nothing? Earlier it was suggested that voluntary employee contributions not in excess of ten percent of compensation should be treated as not coming within the self-settled trust rule—that is, they should be protected by the spendthrift provision. That suggestion was offered, however, with regard to common law employees, who presumably have no direct control over the amount of contributions made by the employer. A sole proprietor, on the other hand, has such control: all contributions made by a sole proprietor, even if those contributions fall within the deductible limits, are in a sense "voluntary." However, to regard the entire contribution as voluntary for purposes of the self-settled trust rule would mean either that a sole proprietor could not enjoy the benefit of the spendthrift restriction to any extent at all, or that he could enjoy that benefit only to the extent of ten percent of his earnings from the proprietorship, a figure which is less than the deductible limits now applicable to the proprietor. Either way, the sole proprietor would be at a disadvantage when compared with a corporate employee, as far as spendthrift protection is concerned, and Congress has been trying to eliminate any kind of difference in treatment between the two groups of taxpayers.

One tempting solution is to accord a sole proprietor spendthrift protection at least to the extent of the deductible limits of I.R.C. § 404(e); but what about a nonqualified plan established by a sole proprietor? The deductible limits of I.R.C. § 404(e) are inapplicable to such a plan; indeed, no portion of the contribution made by the proprietor to his own account under the plan would be deductible. Does that mean that under such a plan the proprietor would not

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11 If the sole proprietor is the only participant in such plan, he may not make any voluntary contributions; he may contribute only $7,500. I.R.C. § 401(d)(5)(B).
12 See notes 77-83 & accompanying text supra.
13 See note 84 supra.
14 A Pennsylvania statute takes this approach, exempting from attachment or execution any retirement or annuity fund or any self-employed person (to the extent of payments thereto made while solvent, but not exceeding the amount actually excluded or deducted as retirement funding for Federal income tax purposes) and the appreciation thereon, the income therefrom and the benefits or annuity payable thereunder.
42 Pa. Cons. Stat. § 8124(b)(8) (Pamph. 1979). The statute, though still on the books, has presumably been preempted by ERISA.
have the benefit of the spendthrift protection? ERISA § 206(d) clearly applies to a nonqualified funded plan established by a sole proprietor, even if the proprietor is the only participant, which certainly implies that Congress wants such a plan to be protected by the spendthrift provision. Yet if the plan was so protected, a sole proprietor would be able to insulate from his creditors whatever portion of his earnings he desired simply by placing it in a trust fund that he denominated a pension plan. Clearly, Congress has not thought the issue through. The question of the effect of the spendthrift provision upon self-employed persons requires more thoughtful and detailed legislative attention.

Alimony and Support

It has long been held as a matter of general common law that the spouse or children of the beneficiary of a spendthrift trust may enforce against the beneficiary's interest in the trust their claims against him for support. The traditional justification for this rule is that a provision in a trust prohibiting attachment by creditors was not intended by the settlor to apply to support claims of a wife or child, because they are not "creditors" in the usual sense and the obligation to support them is not a debt. A more straightforward explanation is simply that it is against public policy to allow a trust beneficiary to enjoy trust property and yet relodge to the state the burden of supporting his pauperized dependents. It is submitted that this rule ought to be adopted as part of the federal common law of pension plans: the ERISA spendthrift provision should be held not to bar the claims of a participant's spouse or children for support or alimony.

ERISA and the Internal Revenue Code both make special concessions in other areas to the spouses of participating employees: for example, the requirements relating to joint and survivor annuities

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97 When a plan is nonqualified, there are no limitations on the amount that may be contributed thereto and no prohibition against discrimination as to coverage in favor of the proprietor.

98 Keller v. Keller, 284 Ill. App. 198, 1 N.E.2d 773 (1936); Safe Deposit & Trust Co. v. Robertson, 192 Md. 653, 65 A.2d 292 (1949); Dillon v. Dillon, 244 Wis. 122, 11 N.W.2d 628 (1943).

99 2A. Scott, supra note 20, at § 157.1.

100 Id.

101 ERISA § 205, 29 USC § 1055 (1976), and I.R.C. § 401(a)(11) require plans that make benefit payments in the form of annuities to contain elaborate provisions relating to the form those annuities are to take, where the annuitant is married. The purpose of these provisions is to prevent the participant from inadvertently failing to make provision under the plan for...
and those relating to improper post-retirement accumulations.\footnote{102} Spendthrift provisions in other federal statutes have been construed to permit executions enforcing support obligations. The District of Columbia Life Insurance Act, for instance, provided that no money or other benefit to be paid on account of disability would be liable to execution or garnishment,\footnote{103} but in spite of that restriction it was held in \textit{Schlaefer v. Schlaefer}\footnote{104} that execution enforcing a support obligation could be levied against such insurance benefits:

\begin{quote}
[T]he usual purpose of exemptions is to relieve the person exempted from the pressure of claims hostile to his dependents' essential needs as well as his own personal ones, not to relieve him of familial obligations and destroy what may be the family's last and only security, short of public relief.\footnote{105}
\end{quote}

A similar provision in the Social Security Act, purporting to exempt his spouse in the event that the participant dies before receiving his full benefit. \textit{See} note 131 & accompanying text \textit{infra}.

\footnote{102} The Internal Revenue Service has consistently ruled that a qualified plan may not be used as a device to provide benefits to the employee's survivors instead of to the employee himself. Accordingly, when a participant retires, he may not select a form of benefit payment calculated to provide his beneficiary with greater benefits than he himself will get. When the participant elects a form of benefit that includes a survivor's benefit, the present value (at retirement) of the participant's benefit must be greater than 50\% of the total present value of the participant's benefit and the survivor's benefit. For example, suppose when a participant retires, he elects to receive his benefit in the form of an annuity of $100 per month for his life, and upon his death $100 per month to his granddaughter X for her life if she survives him. Let us say that the present value of the participant's annuity is $10,000, and that (because of X's youth and consequent long life expectancy) the present value of the participant's benefit and the survivor's benefit is $40,000. Because $10,000 is not greater than 50\% of $40,000, this form of benefit payment is not permitted. However, if the designated survivor annuitant is the spouse of the participant, this restriction is ignored. Rev. Rul. 74-359, 1974-2 C.B. 129; Rev. Rul. 74-325, 1974-2 C.B. 127; Rev. Rul. 72-241, 1972-1 C.B. 108; Rev. Rul. 72-240, 1972-1 C.B. 108; Rev. Rul. 56-656, 1956-2 C.B. 280.

\footnote{103} Act of June 19, 1934, Pub. L. No. 73-436, ch. V, § 16(a), 48 Stat. 1175 provided:

\begin{quote}
No money or other benefit paid . . . by any company on account of the disability from injury or sickness of any insured person shall be liable to execution, attachment, garnishment, or other process, or to be seized, taken, appropriated or applied by any legal or equitable process or operation of law, to pay any debt or liability of such insured person whether such debt or liability was incurred before or after the commencement of such disability, but the provisions of this section shall not affect the assignability of any such disability benefit otherwise assignable, nor shall this section apply to any money income disability benefit in an action to recover for necessaries contracted for after the commencement of the disability covered by the disability clause or contract allowing such money income benefit.
\end{quote}

This provision is now codified, in substantially altered form, in D.C. Code Encl. § 35-716 (West 1968).

\footnote{104} 112 F.2d 177 (D.C. Cir. 1940).

\footnote{105} \textit{Id.} at 185.
from garnishment benefits under the Act, has likewise been held not to bar garnishments for alimony or support claims. As one court put it:

[T]he intent of the exemption in §407 of the Social Security Act is to enable the insured to support himself, his family, and those legally dependent upon him, and to protect the family unit from the claims of general creditors, not to allow him to protect himself from money obligations owed to his dependents.

The majority of cases construing the spendthrift provision of ERISA have likewise held, and properly so, that the claims for support of a participating employee's spouse or children are enforceable against the participant's interest in a pension plan; indeed, search has revealed only one case that holds to the contrary. Taking no comfort in this line of cases, however, Senators Harrison and Javitz included in their proposed ERISA Improvements Act of 1979 a provision (section 128) that would amend ERISA §§ 206(d) and 514(b) and I.R.C. § 401(a)(13) to expressly permit enforcement against covered pension plans of state court judgments or orders affecting marital property rights, alimony or child support payments.

Suppose the person whose pension benefits are garnished to pay his spouse's claims was never an employee. For example, E is covered by a pension plan which provides that upon E's death prior to retirement it will pay E's surviving husband, H, the sum of $200 per month for his life. E does indeed die prior to retirement, and the

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106 Social Security Act § 207, 42 U.S.C. § 407 (1976) provides:

The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.


109 General Motors Corp. v. Townsend, 468 F. Supp. 466 (E.D. Mich. 1976). The court simply held that ERISA § 206(d) prevented the garnishment, and it did not even mention the common law exception for alimony and support.

benefits to her husband commence. Some years later H marries W. Later still, W divorces H and obtains an alimony judgment against him. May this judgment be satisfied out of H’s interest in the pension plan? It is at least arguable, in view of the language in ERISA § 2, that a distinction ought to be made between claimants who are “beneficiaries” of the participant and those who are not; with the result that W, not being a natural object of E’s bounty, would have no claim against H’s pension, while any children of H (by his marriage with E) would have such a claim. But it has not been suggested that the claims of spouses and dependent children be accorded special treatment because of the status of those persons as “beneficiaries” within the meaning of ERISA § 2. Indeed, ERISA defines “beneficiary” to mean anyone whom the participant or plan so designates; the term is in no way limited to dependents. Rather, support claims of spouses and children are given special treatment because of the public policy reasons previously set forth herein. Accordingly, and in view of the language in both ERISA § 206(d) and I.R.C. § 401(a)(13) which refers only to “benefits provided under the plan” and makes no distinction between benefits payable to the participant (E) and benefits payable to the participant’s beneficiary (H), the better view is that H’s dependents ought to be able to garnish H’s pension regardless of their relation to E.

How is state community property law affected by ERISA §§ 206(d) and 514? Specifically, when a couple obtains a divorce and their community property is divided, how should the court treat a spouse’s interest in a pension plan attributable to his employment during marriage? Some courts ordinarily divide community property on an item-by-item basis, giving each spouse a fractional interest in each asset. Clearly, such division of a spouse’s accrued pension benefit would constitute an alienation within the meaning of the section 206(d) prohibition. On the other hand, some courts

111 ERISA § 2(b), 29 U.S.C. § 1001(b)(1976) provides in part: “It is hereby declared to be the policy of this chapter to protect . . . the interests of participants in employee benefit plans and their beneficiaries . . . .”

112 ERISA § 3(8), 29 U.S.C. § 1002(8) (1976) provides that for purposes of Title I of ERISA, “[t]he term ‘beneficiary’ means a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder.”


115 In Phillipson v. Board of Administration, 3 Cal. 3d 32, 473 P.2d 765 (1970), it was held that community property claims were not barred by a state statutory provision analogous to ERISA § 206(d), on the theory that a nonemployee spouse’s interest in community assets is an ownership interest, rather than an interest as creditor or assignee. “[R]ecognition of an ownership claim cannot be described as the levy of execution, garnishment, attachment or
divide community property on an aggregate basis, awarding to each spouse whole community assets having a total value of one-half the community (e.g., the house to the wife and the pension to the husband). Such aggregating of the pension ought nonetheless to be regarded as an alienation, albeit by indirect means, since it does deprive a participant of the enjoyment or benefit of part of that pension.

Having determined that the enforcement upon divorce of community property rights in a pension constitutes an alienation within the meaning of ERISA § 206(d), we must now inquire whether such alienation is in fact barred by ERISA. The leading case is Stone v. Stone. In a long and thoughtful opinion, the court held that sec-

assignment of property." Id. at 44, 473 P.2d at 772. This bit of sophistry was properly rejected in Stone v. Stone, 450 F. Supp. 919, 925-26 (N.D. Cal. 1978), appeal docketed, No. 78-2313 (9th Cir. June 21, 1978).


Hisquierdo v. Hisquierdo, 439 U.S. 572 (1979) held that the anti-assignment provision in the Railroad Retirement Act, 45 U.S.C. § 231m (1976), barred the state court from considering the husband's expected retirement benefits as part of the aggregate to be divided. Accord, Hetrick v. Reading Co., 39 F. Supp. 22 (D.N.J. 1941). The provision reads as follows:

Notwithstanding any other law of the United States, or of any State, territory, or the District of Columbia, no annuity or supplemental annuity shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated . . . .

To be sure, the Supreme Court laid stress on the presence in the statute of the word "anticipated": a word that does not appear in ERISA § 206(d) or I.R.C. § 401(a)(13), and a word the Court regarded as uniquely applicable to this aggregate approach to dividing community property. But it is submitted that the Court's emphasis on this word was misplaced, since it has long been held that no particular form of words is needed to create a spendthrift trust. Kelley v. Lincoln Nat'l Bank, 235 F.2d 23 (D.C. Cir. 1956); Pacific Guano Co. v. Weller (In re De Lano's Estate), 62 Cal. App. 2d 808, 145 P.2d 672 (1944); Kirkland v. Mercantile-Safe Deposit and Trust Co., 218 Md. 17, 145 A.2d 230 (1958); Ewalt v. Davenhill, 257 Pa. 385, 101 A. 756 (1917). And a spendthrift clause that expressly bars only voluntary alienations will be held nonetheless to bar involuntary alienations as well. Roberts v. Stevens, 84 Me. 325, 24 A. 873 (1892); Partridge v. Cavender, 96 Mo. 452, 9 S.W. 785 (1888); Winthrop Co. v. Clinton, 196 Pa. 472, 46 A. 435 (1900). Contra, Koelliker v. Denkinger, 148 Kan. 503, 83 P.2d 703, modified on other grounds, 149 Kan. 259, 86 P.2d 740 (1938). Indeed, the Treasury Regulation interpreting ERISA's anti-assignment provision includes anticipation among the enumerated prohibited transfers. Treas. Reg. § 1.401(a)-13(b)(1) (1978).

If the employee spouse's interest in the pension plan is not fully vested at the time the community property must be divided (that is, if his interest under the plan is subject to forfeiture in the event his employment terminates prior to the completion of a specified period of service), the aggregate approach to property division may yield unfair results unless both spouses are made to bear equally the risk of such future forfeiture. For an excellent discussion of this issue, see Note, Dividing the Community Property Interest in Nonvested Pension Rights, in Survey, The Supreme Court of California 1975-1976, 65 Cal. L. Rev. 231, 275 (1977).

tion 206(d) did not bar a nonemployee spouse from asserting her community property rights in her husband's pension, on the ground that ERISA was designed to protect the family unit—the type of argument we have already discussed. In addition, the court held that the preemption provision of section 514 did not preempt state community property laws. This portion of the opinion is less persuasive, since the court was able to advance only these two rather weak arguments in support of this second conclusion. First, if the provision of ERISA that deals specifically with alienations (section 206(d)) permits the enforcement of community property claims, the more general provision (section 514) should not be construed as forbidding it; and second, the Supreme Court has held that "the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."

Carpenters Pension Trust for Southern California v. Kronschnabel reached the same result as Stone but went considerably further by holding that state laws that affect merely the distribution of vested pension benefits were not preempted by section 514 of ERISA. The court arrived at this surprising and erroneous conclusion by focusing on the following definition of "State" in section 514: "The term 'State' includes a State [or] any political subdivision thereof, . . . which purports to regulate . . . the terms and conditions of employee benefit plans covered by this [title]." The court concluded that "[t]he phrase 'terms and conditions' pertains to the plan's administration and operations, and does not relate to whether the participant's benefits are to be distributed as community or separate property." Such a narrow construction of the phrase seems entirely without foundation.

There is one case that denies a claim of a community property interest in a pension plan. Francis v. United Technologies Corp.,
decided by the same court (but not the same judge) that decided Stone, simply disagreed with Stone and held that "ERISA has preempted the operation of so much of California's community property laws as purport to give a non-employee spouse an interest in the plan benefits."\textsuperscript{125}

Stone is currently on appeal to the Ninth Circuit,\textsuperscript{127} and in that appeal the Department of Labor has filed an amicus brief\textsuperscript{128} arguing that ERISA preempts California's community property law, but that there is an implied exception to ERISA's anti-assignment rule that would permit the recognition of community property rights in accrued pension benefits upon divorce. This seemingly self-contradictory resolution is actually most sensible. We have already seen that federal preemption of state laws relating to employee plans is intended to be sweeping,\textsuperscript{129} and there can be no doubt that community property law does indeed "relate" to employee plans within the meaning of ERISA \S 514. Community property law grants to each spouse certain rights to manage and dispose of community assets,\textsuperscript{130} and these rights, when accorded the nonemployee spouse, may be inconsistent with rights that ERISA guarantees to the employee alone. For example, ERISA \S 205\textsuperscript{131} provides that if a pension plan offers retirement benefits in the form of an annuity, the employee must be given the opportunity to elect to receive his benefit in the form of a joint and survivor annuity with his spouse. Thus, if the normal form of retirement benefit to which an employee would be entitled is $100 per month for his life, he must be given the right to elect to receive that benefit in the form of an annuity of, say, eighty dollars per month for his life, and after his death forty dollars per month to his wife for her life. Obviously, the wife's views

\textsuperscript{121} See text at notes 35-38, supra. It is worth noting that the same judge who decided Stone, Judge Renfrew, had earlier handed down two decisions that may represent the most sweeping view of ERISA's preemption provision ever judicially adopted: Standard Oil Co. v. Agsalud, 442 F. Supp. 695 (N.D. Cal. 1977), appeal docketed, No. 78-1095 (9th Cir. Jan. 16, 1978); Hewlett-Packard Co. v. Barnes, 425 F. Supp. 1294 (N.D. Cal. 1977), aff'd, 571 F.2d 502 (9th Cir. 1978), cert.-denied, 439 U.S. 831 (1979).


\textsuperscript{131} 29 U.S.C. \S 1055 (1976).
on how the employee ought to exercise his right of election might be at variance with those of her husband, so that to permit her to exercise the management rights in the pension that community property law would ordinarily accord her would interfere with the husband’s section 205 rights. Similarly, to permit the wife, should she predecease her husband, to exercise the normal community property power to dispose by will of half the community interest in the accrued pension benefit free of the husband’s control would sharply conflict with other rights given the husband by ERISA.

There are, however, two objections that might be raised to the conclusion that section 514 preempts community property law. First, in construing federal statutory preemption provisions, courts generally observe that “the basic police powers of the States, particularly the regulation of domestic relations, are not superseded by federal legislation, unless that was the clear and manifest purpose of Congress.” One might therefore argue that since Congress expressly preempted community property law in connection with certain ERISA provisions, its failure to do so in section 514 suggests that courts ought to be most chary of reading into section 514 an intent to preempt community property law.

The second and more persuasive argument relates to employee contributions. Suppose an employee contributes part of his salary to a pension plan. If he is married at the time such salary is earned, the salary constitutes community property; yet once contributed to the plan, that money and any benefits attributable thereto be-

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132 The Supreme Court of California has held that the nonemployee spouse has no power to manage the pension plan interest, even though that interest constitutes community property. In re Marriage of Brown, 15 Cal. 3d 838, 849-50, 544 P.2d 561, 568 (1976). Search has revealed no comparable holdings in the other community property jurisdictions.

133 See generally 1 W. Page, Wills § 16.9 (Bowe-Parker rev. ed. 1960).


136 Section 2002(a)(1) of ERISA added § 219(c)(2) to the Internal Revenue Code, which provides that for purposes of computing the maximum amount that an individual may deduct for contributions to an individual retirement account, community property law is to be disregarded. It should be noted, however, that ERISA § 2002(a)(1) is to be found in Title II of the statute, while the preemption provision of § 514 states only that the provisions of Title I preempt state law. Consequently, one ought not to infer from the presence of a specific reference in Title II to community property and the absence of such a reference in Title I a congressional intent to except community property from the general preemption provision of § 514.

come subject to the employee's right of election under section 205, which right, as we have seen, is conferred by ERISA upon the employee alone. If it is held that ERISA preempts the nonemployee spouse's right to participate in the section 205 decision, then in effect the employee has the power to appropriate community property from his wife and place it in an arrangement beyond her powers of management. But the United States Supreme Court seems to have disposed of this very objection in Wissner v. Wissner. There, a husband used his army wages, earned while married and therefore held to be community property, to pay the premiums on a life insurance policy on his own life issued pursuant to the National Service Life Insurance Act of 1940 (NSLIA), and he designated his mother as beneficiary under the policy. Upon the insured's death his wife claimed one-half the policy proceeds, in accordance with normal principles of California community property law. The Supreme Court denied her claim, holding that her community property rights in the proceeds were preempted by a provision of the NSLIA to the effect that

[t]he insured shall have the right to designate the beneficiary or beneficiaries of insurance . . . and shall . . . at all times have the right to change the beneficiary or beneficiaries.

The Wissner case has not gone without criticism, and there was a vigorous, though brief, dissent by Justice Minton in which Justices Frankfurter and Jackson joined. But to hold that ERISA does not preempt community property law would frustrate Congress' goal of a uniform federal law of pensions, because the community property rights otherwise accorded the nonemployee spouse are extensive and may vary considerably from state to state. Furthermore, the Wissner principle was recently reaffirmed by the Supreme Court in Hisquierdo v. Hisquierdo, though the latter presented a somewhat easier case in view of the statutory language before the Court.

Hisquierdo involved a divorced California wife claiming an interest, under community property law, in her former husband's expectancy in a pension to be paid pursuant to the Railroad Retirement

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138 See generally W. de Funiak & M. Vaughn, Principles of Community Property §§ 119-23 (2d ed. 1971).
143 E.g., W. de Funiak & M. Vaughn, supra note 138, at § 123.
Act of 1974 (RRA). The Act provides a statutory benefit for an employee's spouse but states that such benefit or any right thereto terminates when the spouse and the employee are divorced. The Act also contains a spendthrift provision, to which an exception was later made permitting the retirement benefits to be reached to satisfy a legal obligation for child support or alimony. Two years after this exception was enacted, however, Congress reexamined the statute and defined "alimony" to exclude any payment or transfer of property or its value by an individual to his spouse or former spouse in compliance with any community property settlement, equitable distribution of property, or other division of property between spouses or former spouses.

In view of the statute's language and history, the conclusion of Hisquierdo that the wife could not claim a community property interest in her former husband's railroad pension expectancy seems almost inescapable. But does it necessarily follow that the result must be the same for an ordinary private pension covered by ERISA?

The Court explicitly declined to express an opinion on this issue, but made the following observation in a footnote:

In this case, Congress has granted a separate spouse's benefit, and has terminated that benefit upon absolute divorce. Different considerations might well apply where Congress has remained silent on the subject of benefits for spouses, particularly when the pension program is a private one which federal law merely regulates. See Employee Retirement Income Security Act of 1974. . . . Our holding intimates no view concerning the application of community property principles to benefits payable under programs that possess these distinctive characteristics.

There is certainly at least a faint implication here that the Court would reach a different result under ERISA from that reached under the RRA. But it must be remembered that what we are proposing is a two-part conclusion to the question of a nonemployee spouse's community property rights in an employee's pension: first, that

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ERISA preempts state community property law; and second, that notwithstanding such preemption, the nonemployee spouse may assert community property rights against the pension plan upon divorce to obtain her community property share of the pension. The Court has distinguished ERISA pensions from RRA pensions on the ground that the RRA provides a specific statutory benefit for employees' spouses while ERISA does not. This distinction does not relate to the broader question of whether ERISA preempts community property law generally; but it does afford a basis of distinguishing ERISA and RRA insofar as they affect the right of a nonemployee spouse to assert claims against retirement benefits upon divorce. ERISA could not have been intended to deny a divorcing community property spouse rights which it has preserved for divorcing common law property spouses. Because, as the Hisquierdo footnote observes, ERISA does not provide a statutory spouse's benefit that would suggest that the spouse should have no other interest in the plan upon divorce, logic requires the conclusion that, notwithstanding ERISA's preemption of community property law generally, the nonemployee spouse may still look to the employee spouse's pension to satisfy community property claims upon divorce.

The Javits bill\footnote{ERISA Improvements Act of 1979, S. 209, 96th Cong., 1st Sess. (1979).} would codify this two-part conclusion in a neat and sensible manner. Under the bill, a state court, in adjudicating marital property rights upon divorce in a community property jurisdiction, may use the employee spouse's pension as a source of funds with which to satisfy the other spouse's marital property claims to the same extent the court could do so in the absence of ERISA, \textit{provided} (and this proviso is included in the bill presumably to protect the preemption interests discussed above\footnote{See notes 130-34 & accompanying text supra.}) that the plan is not required "to alter the effective date, timing, form, duration, or amount of any benefit payments under the plan or to honor any election which is not provided for under the plan or which is made by a person other than a participant or beneficiary."\footnote{S. 209, 96th Cong., 1st Sess. § 128 (1979).} In view of our earlier discussion, however, it is evident that a court even now could arrive at this two-part conclusion purely as a matter of statutory construction, regardless of the fate of the Javits bill.

\textit{Tax Claims}

Under the common law, government claims against the beneficiary of a trust for unpaid taxes may be enforced against his interest
in the trust notwithstanding a trust provision purporting to prohibit assignments or alienations;\textsuperscript{154} that is true whether or not the tax liability arises out of the trust. Some courts have reached this result on public policy grounds:

The reasons which have actuated some courts . . . to uphold spendthrift trusts against the claims of creditors do not necessarily apply to tax claims of the government either federal or State. . . . The public policy involved is quite different. In the one case the donor of the property has the right to protect the beneficiary against his own voluntary improvident [sic] or financial misfortune; but in the other the public interest is directly affected with respect to collection of taxes for the support of the government. The imposition of the tax burden is not voluntary by the beneficiary. In a sense the property itself incurs the tax; or rather the property is held \textit{cum onere}.\textsuperscript{155}

Where federal taxes are concerned, others have reached the same result on the basis of the Supremacy Clause.\textsuperscript{156} They argue that any exemption which might otherwise arise from the presence of spendthrift language in a trust instrument is a creature of state law and must therefore yield to sections 6321 and 7403 of the Internal Revenue Code, the former giving the United States a lien upon the property of the taxpayer for unpaid taxes and the latter providing for the enforcement of such lien.\textsuperscript{157}

May either a state or the federal government enforce a claim for unpaid taxes against a participant’s interest in a pension plan? In view of ERISA § 514(d), which provides that “[n]othing in this title shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States . . . ,” sections 6321 and 7403 of the Internal Revenue Code should continue to operate as before and allow the federal government to enforce its tax claims against the pension plan. The Treasury Regulation confirms this

\textsuperscript{154} 2 A. Scott, \textit{supra} note 20, at § 157.4; G. Bogert, \textit{supra} note 4, at § 224 n.49. Curiously, when the government’s claim is not one for unpaid taxes, it will frequently be unable to reach an interest under a spendthrift trust. \textit{See, e.g.}, McElhany v. United States, 101 Ct. Cl. 286 (1944) (collection of fine); State v. Caldwell, 181 Tenn. 74, 178 S.W.2d 624 (1944) (contract claim).

\textsuperscript{155} Mercantile Trust Co. v. Hofferbert, 58 F. Supp. 701, 705 (D. Md. 1944) (citation omitted).

\textsuperscript{156} Leuschner v. First Western Bank and Trust Co., 261 F.2d 705 (9th Cir. 1958); United States v. Dallas Nat’l Bank, 152 F.2d 582 (5th Cir. 1945); Jackson v. D’Aubin, 316 So. 2d 478 (La. App. 1975), aff’d, 338 So. 2d 575 (1976); cf. Fried v. New York Life Ins. Co., 241 F.2d 504 (2d Cir.), \textit{cert. denied}, 354 U.S. 922 (1957) (proceeds of disability insurance that are, pursuant to state law, exempt from claims of creditors are not exempt from federal tax liens).

\textsuperscript{157} United States v. Dallas Nat’l Bank, 152 F.2d 582, 585 (5th Cir. 1945).
view. As to state taxes, however, the result is less clear, and the regulation is silent on the point. It is submitted, however, that a state should not be permitted to levy execution upon the pension plan interest.

Consider the case of Philpott v. Essex County Welfare Board. Pursuant to New Jersey law, the debtor, as a condition of receiving state disability assistance, signed an agreement to reimburse the Board for these disability payments should he later acquire any assets of his own. Some years later the debtor began receiving Social Security disability payments, which he deposited in a bank in the name of Doris Philpott as trustee. The Social Security Act contains a spendthrift provision applicable to all benefits. The case arose on an order to show cause why a judgment should not be entered in favor of the Board, directing the bank to turn over to the Board these monies on deposit. The Supreme Court of New Jersey held that the federal exemption statute did not bar the Board's claim.

On writ of certiorari a unanimous United States Supreme Court, in a brief opinion by Justice Douglas, reversed the New Jersey court simply on the authority of the Supremacy Clause.

Because ERISA, like the Social Security Act, contains a spendthrift provision, the Philpott case suggests that a state may not attach the assets in an ERISA-covered pension plan to enforce a judgment for unpaid taxes. Indeed, the case for barring such state action is even stronger under ERISA than under the Social Security Act, since the former contains an express provision preempting state law whereas the latter statute does not. Furthermore, Congress had been alerted to the problem of the preemption provision's effect upon state tax law. While considering the House and Senate versions of the bill that eventually became ERISA, the conference committee received a suggested modification in the preemption provision that was submitted jointly by the Secretaries of Labor and Treasury.

158 Treas. Reg. § 1.401(a)-13(b)(2) (1978) provides: "A plan provision satisfying the requirements of [the ERISA spendthrift provision] shall not preclude the following: (i) The enforcement of a Federal tax levy made pursuant to section 6331. (ii) The collection by the United States on a judgment resulting from an unpaid tax assessment." For the explanation of why only Treasury regulations, rather than Labor Department regulations, have been promulgated to construe the ERISA spendthrift provision, see note 13 supra.

159 There is a negative pregnant in the regulation from which one might infer that the state may not, in the opinion of the Service, enforce its claims for taxes against a pension plan.


161 See note 106 supra. As a matter of general common law claims by a state for reimbursement of welfare payments are generally enforceable against any interest the welfare recipient might have in a spendthrift trust. See 2 A. Scott, supra note 20, at § 157.2.


Treasury. The proposal read in part: “Notwithstanding the provisions of this section, a State shall have the authority to prescribe rules and regulations governing the tax qualification and taxation of contributions, distributions or income, of an employee pension plan.” Yet when Congress finally enacted ERISA, though cognizant of the problem of state tax law, it chose to exempt from the statute’s broad preemption of state law only insurance, securities, banking, and generally-applicable criminal law.

May the state subject pension payments to income tax once those payments have been received? Spendthrift provisions are held not to preclude execution once the trust income is in the hands of the beneficiary, so presumably ERISA § 206(d) is not violated by such taxation. But what about ERISA § 514? Would such income taxation be preempted on the ground that it “relates” to a covered employee benefit plan? The only case in point at this writing is *National Carriers’ Conference Committee v. Heffernan*. The case involved a dental reimbursement plan, which constitutes an “employee welfare benefit plan” within the meaning of ERISA and which, like a pension plan, is subject to the preemption provision of ERISA § 514. Connecticut had enacted a tax that required any entity maintaining an employee welfare plan to pay a tax of 2.75% of “the amounts paid as benefits to or on behalf of residents of” Connecticut. The court held that the tax was preempted by ERISA § 514 but made the following crucial observation:

The statute is not merely a general taxing provision that catches employee benefit plans within its wide sweep. On the contrary, the tax is specifically directed at such plans exclusively, and is


146 2 A. Scott, supra note 20, at § 152.5. The statutory spendthrift provision before the court in Philpott v. Essex County Welfare Board, 409 U.S. 413 (1973) (see note 160 supra) was unusually sweeping in that it purported (and was held by the court) to bar the attachment of moneys already paid out, at least until those moneys were placed in some sort of “permanent investment” and were no longer “readily withdrawable” by the recipient.

147 The Treasury Regulation provides that the spendthrift language required by ERISA does not preclude the withholding of any federal, state or local tax from benefit payments. Treas. Reg. § 1.401(a)-13(c)(2)(ii) (1978). However reasonable this exception may seem as a matter of policy, it would appear to be invalid as regards state and local tax withholding. Such withholding constitutes an alienation which is barred by ERISA § 206(d), 29 U.S.C. § 1066(d) (1976).


distinct from the tax applied to insurance company premiums. . . . Clearly it "relates to" ERISA-covered plans.\footnote{454 F.Supp. 914, 915 (D. Conn. 1978) (citation omitted).}

In support of its conclusion that the tax was preempted by ERISA, the court went on to point out that the tax had a regulatory side-effect: that since Connecticut imposed a 2.75% tax on inter vivos welfare plan benefits while imposing a tax of only 2% on the premiums received by domestic insurance companies,\footnote{CONN. GEN. STAT. § 12-202 (1972).} the tax structure might operate as an incentive for employers to use insurance rather than trusts to fund welfare plans.\footnote{454 F. Supp. at 918.} Because state taxes can be a means of regulation, the court ruled that "preempting state taxation of ERISA-covered plans is necessary to effectuate Congressional objective."\footnote{Many states, following the lead of the federal government, exempt pension trusts from the state income tax if, but only if, the trusts comply with certain requirements similar to the qualification requirements of I.R.C. § 401(a). Such regulation of pension plans by means of state tax law is presumably invalid as a consequence of ERISA § 514. Perhaps the state tax scheme could be "saved" if, like that of Minnesota, it merely requires that plans and trusts meet whatever requirements are imposed by federal law, see MINN. STAT. ANN. § 290.26(1) (1979). But even where the state regulatory scheme is identical with the federal, the fact that the state tax scheme is regulatory in its intent could justifiably lead a court to conclude that the tax scheme "relates to" pension plans and is therefore preempted. Further congressional action on this issue is sorely needed.} But it should follow from this decision that a generally-applicable state tax that does not treat ERISA-covered plans specially does not "relate to" those plans within the meaning of ERISA § 514 and, consequently, is not preempted.\footnote{454 F. Supp. at 918.}

**Statutory Exceptions**

ERISA provides at least two exceptions to the general rule that the benefits under a covered pension plan may not be assigned or alienated: (1) voluntary and revocable assignments; and (2) use of accrued benefits as security for loans.

**Voluntary and Revocable Assignments**

Section 206(d) of ERISA provides that, notwithstanding the general required spendthrift provision, a plan may permit "voluntary and revocable" assignments by a participant of not more than ten percent of any benefit payment, provided that the assignment is not "made for purposes of defraying plan administration costs," and a

\footnote{Welfare plan benefits are exempt from the 2.75% tax to the extent they are "insured by an insurance company." CONN. GEN. STAT. § 12-212b(1) (Supp. 1979).}
comparable exception is found in I.R.C. § 401(a)(13). Thus, if a participant in pay status is receiving a pension of $500 per month, the plan may permit him to assign no more than $50 per month of his benefit, provided the assignment is voluntary and revocable and is not used to defray plan administration costs. This exception was probably engendered by Congress’ concern that certain check-off arrangements would otherwise be imperiled. Suppose an employee who reaches retirement wishes to continue his coverage under his employer’s medical insurance program. The employer will hardly object but will presumably insist that the retiree pay the premiums himself since he is no longer an employee. The insurer granted the employer a favorable group rate at least in part because the insurer did not have to look to each individual employee for premium payments, but rather needed to look only to the solvent employer. Typically, therefore, an employer might agree to pay the premiums for the retiree, in order to satisfy the insurer’s demand for a single obligor, provided that the employer was reimbursed out of the employee’s pension. In other words, if the employee’s pension is $500 per month and the cost of his insurance coverage is $50 per month, the employer would pay the $50 to the insurer, but the employee would agree that $50 of his pension was to be paid to his employer.

Suppose, however, the amount which is thus paid to the employer is more than ten percent of the benefit payment. Does that mean that such a check-off arrangement will be barred by ERISA? Not necessarily. When an obligee truly assigns his claim, the assignment gives the assignee the right to bring an action against the obligor directly. It is this right that distinguishes a true assignment from a mere authorization or power of attorney. Again, suppose that a

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176 I.R.C. § 401(a)(13) indicates that the exception for voluntary and revocable assignments applies only in the case of a “participant who is receiving benefits under the plan.” The exception as it appears in ERISA § 206(d) is not so limited. No explanation for this difference is offered except that of careless legislative drafting. As a practical matter, however, it is unlikely that a participant not in pay status would be in a position to avail himself of this exception; a potential assignee would have little interest in a revocable assignment of a benefit not yet payable.

177 Robinson v. City of Pine Bluff, 224 Ark. 791, 276 S.W.2d 419 (1955); Guaranty Deposit Bank v. Reedy, 272 S.W.2d 341 (Ky. 1954); A. CORBIN, CONTRACTS § 905 (1951).

In the overwhelming majority of states there are “real party in interest” statutes which permit or require an assignee to sue in his own name rather than that of the assignor. E.g., CAL. CIV. PROC. CODE § 367 (West 1973); ILL. ANN. STAT. ch. 110, § 22 (1968). For a detailed listing of such statutes and court rules, see RESTATEMENT (SECOND) OF CONTRACTS, ch. 7, statutory note p. 321. See generally A. CORBIN, CONTRACTS § 856 (1952); Williston, Is the Right of an Assignee of a Chose in Action Legal or Equitable?, 30 HARV. L. REV. 97 (1916).

178 For example, in Piedmont S. Life Ins. Co. v. Gunter, 108 Ga. App. 236, 132 S.E.2d 527 (1963), plaintiff was covered by group medical insurance provided by her employer, and she
participant is receiving a pension of $500 per month payable on the fifth day of each month, but he wishes to continue to be covered by an employer’s medical program, the cost of which is $60 per month. An arrangement is entered into whereby the trustee of the pension plan will pay $60 of that payment to the employer and only $440 to the participant. The participant reserves the power to revoke the arrangement with the pension plan at any time, provided he gives the trustee one week’s notice of the revocation. The participant revokes the authorization on June 2, to be effective immediately. Since the trustee has not been given a week’s notice with respect to the June 5 payment, he ought to pay that $60 to the employer, but suppose he does not. Under the arrangement, may the employer bring an action against the trustee directly, or is the employer limited to an action against the participant? If the employer could sue the plan directly, then the arrangement, however revocable it might be, is an assignment and is barred by ERISA since the amount exceeds ten percent of the benefit payment. But if the employer’s remedy is limited to a suit against the employee, the arrangement is not an assignment and therefore ERISA is not violated. Indeed, even if the arrangement were irrevocable, so long as the employer’s remedy for nonpayment is against the participant and not against the plan, there is no assignment, and consequently there is no violation of ERISA.

This distinction between an assignment and a mere authorization

sued to collect benefits due her. The doctor and hospital who had performed the services intervened as parties plaintiff on the basis of a document signed by the insured employee whereby she purported to assign to the doctor and hospital her right to reimbursement from the insurance company for medical expenses incurred. The court held that the employee did not intend an actual assignment of the indebtedness, but rather merely a power of attorney authorizing the insurance company to pay benefits directly to the doctor and hospital. Accordingly, the court ruled that it was error to allow the intervention, and it reversed the verdict that had been rendered in favor of the intervenors.

179 [A gratuitous assignment of his interest by the beneficiary of a spendthrift trust] is ineffective to transfer his interest. The assignment would operate, however, as a revocable authorization to the trustee to pay to the assignee the income as it accrues, and to the extent that such accrued income is paid to the assignee before revocation by the beneficiary, the trustee is protected in making the payment and the assignee can keep the amounts so paid to him. Even if the assignee pays value for the assignment, the assignment is ineffective as a transfer of the beneficial interest, and the beneficiary can at any time revoke it. It seems clear, however, that if the beneficiary revokes the assignment, the assignee is entitled to recover the amount which he paid for the assignment on the ground that there is a failure of consideration. He thereby becomes a creditor of the beneficiary for the amount so paid.

2 A. Scott, supra note 20, at § 152.3 (footnote omitted). Accord, E. Griswold, supra note 58, at § 906. See also In re Goldman’s Estate, 142 Misc. 790, 255 N.Y.S. 533 (Sur. Ct. 1932); Note, Reaching a Beneficiary’s Interest in a Trust Fund, 3 Syracuse L. Rev. 326 (1952).
appears to have been adopted by the regulation issued under I.R.C. § 401(a)(13), which provides in part as follows:

For purposes of this section, the terms "assignment" and "alienation" include—
(i) Any arrangement providing for the payment to the employer of plan benefits which otherwise would be due the participant under the plan, and
(ii) Any direct or indirect arrangement (whether revocable or irrevocable) whereby a party acquires from a participant or beneficiary a right or interest enforceable against the plan in, or to, all or any part of a plan benefit payment which is, or may become, payable to the participant or beneficiary.  

Subdivision (ii) of the above provision makes the sort of distinction just discussed, but the presence in the regulation of subdivision (i) suggests that if the employer is the party in whose favor the authorization is made, the authorization constitutes an assignment regardless of whether the employer would have the right to proceed directly against the plan. If that is the intendment of subdivision (i), the provision is at variance with the law.  

The word "voluntary" in this statutory exception is plainly intended to exclude garnishments or levies, as the Regulation states, but this obvious fact was evidently lost on the New York Supreme Court in IBEW Local 3 where it held, although neither party had raised the issue at trial, that the judgment creditor of a plan participant could, pursuant to this exception, attach up to ten percent of the participant's pension.  

Pledges as Security for Loans

Section 206(d) of ERISA also provides:

[A] loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 of the Internal Revenue Code of 1954 (relating to tax on prohibited transactions) by reason of section 4975(d)(1) of such Code.

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181 Conceivably, the Service included subdivision (i) to prevent employers from pressuring employees into making "authorizations" of benefit payments in the employers' favor. If that was the purpose of the subdivision, such a preventive is unnecessary in view of ERISA §§ 510 & 511, 29 U.S.C. §§ 1140 & 1141 (1976), which provide sanctions in the case of interference on the part of any person with the rights guaranteed to participants by ERISA.
182 Treas. Reg. § 1.401(a)-13(d)(1) (1978); see note 28 supra.
An identical provision appears in I.R.C. § 401(a)(13). The exception is inaptly worded. Obviously, it is not the loan that would otherwise constitute the alienation but rather the granting of a security interest. The reference to I.R.C. § 4975 is also inaptly phrased. Only qualified plans may, by reason of I.R.C. § 4975(d)(1), be exempted from the section 4975 tax; a nonqualified plan (and ERISA § 206(d) applies to nonqualified as well as qualified plans) is not subject to the tax at all and therefore is not exempted from it “by reason of” section 4975(d)(1). Similarly, only loans to “disqualified persons” can be subject to the section 4975 tax, so if the participant who borrows is not a disqualified person, the loan would not be exempt “by reason of” section 4975(d)(1). The last sentence of ERISA § 206(d) and the corresponding provision in I.R.C. § 401(a)(13) should therefore be “translated”:

Notwithstanding any other provision of this paragraph a participant may grant a security interest in his accrued vested benefit as security for a loan, provided that:

(1) if the plan is qualified and the participant is a disqualified person, the loan is exempt from the section 4975 excise tax by reason of section 4975(d)(1); and

(2) if the plan is not qualified or if the participant is not a disqualified person, the loan would have been exempt from the section 4975 excise tax by reason of section 4975(d)(1) had the plan been qualified and the participant a disqualified person.

When the Internal Revenue Service issued proposed regulations under this section on December 28, 1976, it took the position that this exception applied only when the lender was the plan itself. There was an immediate negative reaction. On April 15, 1977, the Service held a public hearing on the proposal at which numerous persons testified that frequently an employee was unable to obtain credit unless he could offer his accrued pension benefits as collateral, and that as a consequence of the enactment of the ERISA anti-assignment provision and the Service’s proposed restrictive interpretation of the exception thereto, employees were often making outright withdrawals from their pension plan interests (even when substantial penalties were imposed under the plan on account of

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184 I.R.C. § 4975 imposes a penalty excise tax on persons who engage in certain prohibited types of self-dealing with respect to the assets or sponsors of a qualified plan.
185 The term “disqualified person” is defined in I.R.C. § 4975(e)(2).
187 Actually, the negative reaction began somewhat earlier, since, on December 3, 1975, the Service had issued Technical Information Release 1422, which announced that “Regulations to be prescribed under section 401(a)(13) will provide that the . . . exception is applicable only to loans from the plan and not to loans from third parties.”
such withdrawals) to make purchases that they would otherwise have made with borrowed funds.\textsuperscript{188}

It is evident that the objections raised at the hearing strike at the whole theory behind ERISA § 206(d) and not just at the Service’s construction of a statutory exception. There is a bit of paternalism inherent in section 206(d). It reflects Congress’ apparent view that an employee is not equipped to make the choice between enjoying funds now (say, for educational expenses for his children) and setting aside the funds to enjoy later (for retirement), and that Congress must therefore make the choice for the employee by prohibiting him from anticipating his pension plan interest to obtain current enjoyment of the funds. The employee could, of course, if his plan permits it, withdraw the moneys prior to retirement and use them for education expenses; but once funds are withdrawn from the plan, they may not ordinarily be recontributed,\textsuperscript{189} so the employee would therefore have less money reaping the benefit of tax-free accretions. Thus, section 206(d), far from benefiting employees, may actually do them a disservice by denying them the power to choose between benefits now and benefits later and (by limiting their ability to borrow from the plan) obliging many employees to remove funds from the plan prior to retirement—thereby interfering with the very retirement saving that Congress sought to encourage.\textsuperscript{190}

But whether or not ERISA § 206(d) and I.R.C. § 401(a)(13) represent sound policy, so long as they remain the law, the Service’s interpretation of the loan exception is correct and is to be found in the final regulation.\textsuperscript{191} The Service’s view that the exception is available only when the lender is the plan itself finds support both in the legislative history and in the statutory language itself. The conference committee report states with regard to the ERISA spendthrift provision that “[v]ested benefits may be used as collateral for reasonable loans \textit{from a plan}, where the fiduciary requirements of

\textsuperscript{188} The hearing is summarized in [1977 New Developments Binder] Pension Plan Guide (CCH) ¶ 25,160.

\textsuperscript{189} There are some exceptions. For example, if a plan provides that an employee who withdraws his mandatory employee contributions from the plan forfeits the portion of his accrued benefit attributable to employer contributions, the plan must also provide for the repayment of such employee contributions and for the recrating of the forfeited benefits upon timely repayment. ERISA § 203(a)(3)(D), 29 U.S.C. § 1053(a)(3)(D) (1976); I.R.C. § 411(a)(3)(D). \textit{See also}, ERISA § 204(d), 29 U.S.C. § 1054(d) (1976); I.R.C. § 411(a)(7)(B) & (C).


the law are not violated."\footnote{102} The reference in the statute to I.R.C. § 4975(d)(1) is also clear evidence that Congress intended that only the plan would be the lender. Consider, a loan is not exempt from the section 4975 excise tax by reason of section 4975(d)(1) unless such loan "is available to all participants or beneficiaries on a reasonably equivalent basis . . . [and] is not made available to highly compensated employees, officers, or shareholders in an amount greater than the amount made available to other employees."\footnote{103} Obviously, the plan trustee cannot hope to supervise and control the lending policies of another institution. If the loan exception applied to loans from third parties, the trustee could find himself in a difficult position. Suppose an employee of XYZ Company borrows money from ABC Bank and gives the bank a security interest in his vested accrued pension benefit. Subsequently, the employee defaults on the loan, and the bank attempts to foreclose upon the pledged accrued benefit. Should the trustee abide the foreclosure or should he oppose it? If the trustee does not oppose the foreclosure and it is revealed that ABC Bank, shortly thereafter, made a loan to the president of XYZ on terms more favorable than those offered rank-and-file employees, the loan exception was not (it turns out) available, and the plan could be required to make good the employee's loss if the employee brings an action against the plan pursuant to ERISA § 502(a)(1).\footnote{104} This difficulty is avoided if the exception is limited to loans from the plan. Moreover, the Service's construction of the loan exception is consistent with Congress' paternalistic frame of mind, since it is more likely that a plan trustee would try to prevent an employee from overborrowing than would a third-party lender.

**CONCLUSION**

ERISA requires that every pension plan contain a provision prohibiting the assignment or alienation of plan benefits, and a new federal common law of pension plans must be fashioned to interpret this provision. The state common law of spendthrift trusts permits creditors to levy upon spendthrift trust assets in certain exceptional circumstances. The three most significant exceptions relate to: (1) self-settled trusts, (2) claims for alimony and support, and (3) tax

\footnote{103} I.R.C. § 4975(d)(1)(A) & (B).
claims. It remains to be seen to what extent these traditional exceptions will be incorporated into the new federal common law of pension plans.

There has been no litigation definitively addressing in an ERISA context the issue of the self-settled trust exception. The statute leaves so many questions in this area unanswered, particularly where self-employed individuals are concerned, that further legislative action is needed to clarify the law. As to the exception for alimony and support claims, there has been a good deal of definitive litigation, and the overwhelming majority of cases so far have held that alimony and support claims may be satisfied out of the obligor's interest in a pension plan. As of this writing, no case has directly addressed the question of whether tax claims against a participating employee may be enforced against his interest in a pension plan. It is submitted that federal, but not state, tax claims may be enforced against the taxpayer's pension plan interest. The barring of state tax claims is probably not a result that Congress intended, but in view of ERISA's broad preemption provision and the manner in which similar provisions in other federal statutes have been construed, further congressional action would be necessary to enable states to enforce their tax claims against pension plan interests.