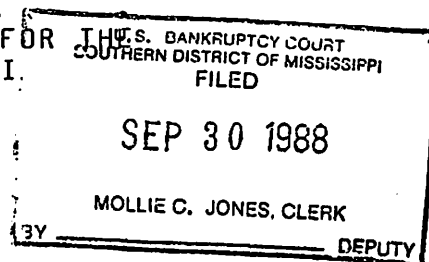


IN THE UNITED STATES BANKRUPTCY COURT FOR
SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION



IN RE:

LEWIS CARROLL CASE

CASE NO. 8700655JC

LEWIS CARROLL CASE

PLAINTIFF

vs.

ADVERSARY NO. 870078JC

FIRST FEDERAL SAVINGS AND
LOAN ASSOCIATION

DEFENDANT

Barney E. Eaton, III
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Attorney for Debtor

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Federal Savings &
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Robert G. Nichols, Jr.
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Trustee

Edward Ellington, Bankruptcy Judge

**OPINION AND ORDER ON "APPLICATION FOR TURNOVER
OF RETIREMENT FUNDS AS EXEMPT PROPERTY OF DEBTOR"
FILED BY LEWIS CARROLL CASE**

An Order for Relief under 11 U.S.C. Chapter 7
was entered on a petition filed by Lewis Carroll Case
on March 19, 1987.

On June 2, 1987, this adversary proceeding was commenced by the Debtor filing an "Application for Turnover of Retirement Funds as Exempt Property of the Debtor." Debtor claims that his vested interest in the pension plan trust fund established by First Federal Savings and Loan Association of McComb, Mississippi (First Federal) is exempt under Miss. Code Ann. §71-1-43 (1972).

As Chapter 7 Trustee, Robert G. Nichols, Jr. filed "Trustee's Response to Application of Debtor to Turnover of Retirement Fund."

First Federal filed its "Response to Application for Turnover of Retirement Funds as Exempt Property of Debtor."

A trial was held on the Debtor's Application. The Court instructed all parties to submit a brief in support of their respective positions. After reviewing the evidence presented at the trial and considering the briefs of counsel, this Court finds that the proceeds from the Debtor's interest in the pension plan trust fund is property of his bankruptcy estate; the Debtor's interest in the proceeds from the pension plan trust fund are not exempt property under Miss. Code Ann. §71-1-43 (1972); and that First Federal was not entitled to a set-off of the funds under §553 of the Bankruptcy Code.

STATEMENT OF THE CASE

The Debtor, Lewis Carroll Case, was an employee of First Federal from December, 1976 until March 1, 1987. Debtor served as President of First Federal for the last eight years of his employment with First Federal.

First Federal established an Employee Trust Fund to provide pension benefits for its employees. The pension plan trust fund established by First Federal is a "Defined Contributory Plan" where the employee's benefits are determined by reference to the contributions made by the employer to the plan, to the earnings or losses attributable to the plan's investment of such contributions and to plan expenses. Seiden, Chapter 7 Cases: Do ERISA and the Bankruptcy Code Conflict as to Whether a Debtor's Interest in or Rights Under a Qualified Plan Can Be Used to Pay Claims?, 61 Am.Bankr. L.J. 219, 221 (1987).

From 1976 to 1985 the Debtor participated in First Federal's original pension plan trust fund. Debtor continued his participation in First Federal's pension plan trust fund in July of 1985 when First Federal adopted its current pension plan trust with Travelers Insurance Company.

In late 1986 and early 1987, Debtor was experiencing financial difficulties. First Bank of

McComb, Mississippi filed suit against the Debtor to collect on a note Debtor had with First Bank. This led to Debtor's resignation as President of First Federal. Debtor's resignation was effective as of March 1, 1987; however, Debtor's actual last day of work at First Federal was February 11, 1987.

On February 11 and 12, 1987, James Louis Alford, the chief executive officer of First Federal, met with the Debtor. Mr. Alford agreed to pay Debtor his salary through March 1, 1987, his salary for accrued vacation time, automobile allowance for March, 1987, and his interest in the pension plan trust fund.

Also on February 12, 1987, Ms. Emily Kohn, the secretary/treasurer of First Federal, was instructed by Mr. Alford to obtain the Debtor's vested interest in the pension plan trust fund from the administrator of the pension plan trust fund, Leggett and Company.

The Debtor filed a petition for relief under Chapter 7 on March 19, 1987.

On or about March 20, 1987, First Federal received one check in the amount of \$36,965.08 payable to First Federal as Trustee.

At the time of his resignation, Debtor was behind in his payments to First Federal on several loans in the approximate amount of \$17,840.97. First Federal asserts that the Debtor verbally agreed at the

February 12, 1987 meeting to pay the \$17,840.97 arrearage out of his pension funds. Because of this verbal agreement, First Federal caused two checks to be written on March 30, 1987 -- one payable to Carroll Case for \$19,124.11 and one payable to Carroll Case and First Federal Savings and Loan for \$17,840.97. The second check for \$17,840.97 represented the amount which would bring the Debtor current with First Federal.

The Debtor would not endorse the two checks or sign an assignment agreement. Consequently, First Federal reissued two checks which did not bear Mr. Case's name. First Federal applied \$17,840.97 to the Debtor's account, reducing the amount Debtor owes First Federal to \$218,216.77. The Chapter 7 Trustee is holding the remaining \$19,124.11.

Debtor argues that his entire interest in the pension plan trust fund is exempt under Mississippi law. At the time the debtor filed his petition, Debtor had the option of electing either federal exemptions under the Bankruptcy Code, 11 U.S.C. §522(b)(1) or state exemptions under 11 U.S.C. §522(b)(2)(A). The Debtor elected to claim state exemptions. Therefore, the Debtor is limited to the exemptions available under Mississippi law. In Schedule B-4 filed by the Debtor, he claimed certain personal property exempt pursuant to

Miss. Code Ann. §85-3-1 (1972) and the proceeds from the pension plan trust fund exempt pursuant to Miss. Code Ann. §71-1-43 (1972).

The Debtor further argues that First Federal was not entitled to a set-off of any portion of his pension plan trust funds.

The Trustee argues that the Debtor's proceeds from the pension plan trust fund are property of the estate and are not exempt because the plan does not meet all of the requirements of Miss. Code Ann. §71-1-43. Specifically, the Trustee argues that the pension plan trust fund has not been qualified as tax exempt under the Internal Revenue Code, and therefore, it is not exempt under §71-1-43.

The Trustee also argues that First Federal was not entitled to a set-off because the only reason the funds came into the hands of First Federal was in its capacity as Trustee of the pension plan trust fund. Therefore, the Trustee argues that First Federal has not met the requirements of Bankruptcy Code §553 and was not entitled to a set-off.

First Federal argues that neither federal nor state exemptions will qualify the Debtor's interest in the pension plan trust funds as exempt. First Federal states that due to the fact that the pension plan trust fund was never determined by the Internal Revenue

Service to be a tax exempt plan under the Internal Revenue Code, the Debtor cannot meet all of the elements necessary to establish that his proceeds of the pension plan trust fund are exempt. First Federal states that it is "entitled to set off the indebtedness of Mr. Case to the bank, as no exemption set forth in §553 protects Mr. Case from this set-off."

DISCUSSION

The first issue raised by the parties in this matter is the question of whether First Federal's employee pension plan trust fund was qualified as tax exempt under the Internal Revenue Code. This Court does not find it necessary to rule on this particular issue. The plan adopted by First Federal, "The Travelers Prototype Defined Contribution Plan 02", specifically details the status of the participant upon his or her termination. It also details the procedure to be followed in order for a terminated participant to obtain his or her interest in the pension plan trust fund from the Trustee of the plan. (See Trial Exhibit #1, pp. 49-54).

Section 11.01 of The Plan states:

11.01 Termination of Participation.

If a Participant's Employment Status shall terminate for any reason except death, retirement or disability retirement as defined in Section 9.07, such Participant

shall become a terminated Participant as of the day he ceases to be an Employee. A terminated Participant shall have no further rights to, or interest in, nor receive any benefit under this Plan except as provided in this Article. ...

Debtor left his employment with First Federal on February 11, 1987. The official last day of his employment was March 1, 1987. Therefore, at the very latest, Mr. Case became a "terminated employee" and lost all further rights or interests, except those which had vested, in the pension plan trust fund on March 1, 1987.

Section 11.05 of the Plan pertains to distribution of a terminated employee's vested interest in the plan:

11.05 Cash-Outs and Plan Repayment Provisions.

(a) Time of Distribution. The portion of a terminated Participant's Vested Interest derived from Employer contributions may, in the sole discretion of the Plan Administrator, be distributed currently or be deferred until the Participant's Normal Retirement Date or be paid at any intervening time, ...

(b) Form of Distribution. The Plan Administrator may, in his sole discretion elect to distribute such Vested Interest in cash or in kind
....

On or about February 12, 1987, the Debtor requested Mr. Alford to distribute Debtor's entire vested interest in the pension plan trust fund to him.

Mr. Alford agreed to give Debtor his entire vested interest in the plan at that time.

Once Debtor terminated his employment and requested his vested interest in the pension plan trust fund and the request was granted, the Debtor no longer had any interest in the corpus of the pension plan trust fund because his vested interest was no longer a part of the pension plan trust fund. Rather, the Debtor had an interest in and a right to receive his vested interest from the pension plan trust fund. Consequently, on or after March 1, 1987, the Debtor's share of the pension plan trust fund was no longer a part of the pension plan trust fund. From and after March 1, 1987, the Debtor's share of the pension plan trust fund was in the process of being distributed to him, and it is therefore irrelevant as to whether or not the pension plan trust fund was qualified under the Internal Revenue Code as tax exempt.

The next issue is whether the Debtor's proceeds from the pension plan trust fund are property of the Debtor's estate. On pages 2 and 8 of his Brief, the Debtor properly concedes that the proceeds from the pension plan trust fund are "property of his estate." Bankruptcy Code Section 541(a)(1) defines what is property of a debtor's bankruptcy estate.

§541. Property of the estate.

(a) The commencement of a case under section 301, 302, or 303 of

this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

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

"Under Section 541 of the Code, all property in which a debtor has a 'legal or equitable interest' at the time of bankruptcy comes into the estate. 11 U.S.C. §541(a)(1)." Goff v. Taylor (In re Goff), 706 F.2d 574, 578 (5th Cir. 1983). Applying this to the case at bar, since the Debtor was entitled to the money at the time he filed his petition, this right to the money is an asset of his Chapter 7 estate.

Even assuming, arguendo, that the pension plan trust fund was qualified as exempt under the Internal Revenue Code, the Debtor's interest in the pension plan trust fund would still be property of his bankruptcy estate under the Fifth Circuit case of Goff v. Taylor (In re Goff), 706 F.2d 574 (5th Cir. 1983).

In In re Goff, the Fifth Circuit stated that an ERISA qualified pension plan trust fund was property of the estate and was not excluded from the estate under §541(c)(2).

Section 541(c)(2) states:

A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

In In re Goff, the court held that Congress did not intend to exclude under §541(c)(2) a qualified ERISA pension plan trust fund from the bankruptcy estate. Rather, the court held "that Congress intended to exclude only trust funds in the nature of 'spendthrift trusts' from the property of the estate." In re Goff, 706 F.2d at 580. Since First Federal's pension plan trust fund was not a spendthrift trust, the Debtor's interest in the pension plan trust fund -- even if a "qualified plan" -- would be property of his estate and would not be excluded from his estate by §541(c)(2).

The Fifth Circuit's ruling in In re Goff that §541(c)(2) excludes from the Debtor's estate only trust funds which are spendthrift trusts has been accepted and followed by several other Courts of Appeal. See: Daniel v. Security Pacific National Bank (In re Daniel), 771 F.2d 1352 (9th Cir. 1985); McLean v. Central States, Southeast and Southwest Areas Pension Fund (In re McLean), 762 F.2d 1204 (4th Cir. 1985); Lichstrahl v. Bankers Trust (In re Lichstrahl), 750 F.2d 1488 (11th Cir. 1985); Samore v. Graham (In re Graham), 726 F.2d 1268 (8th Cir. 1984); Reagan v. Austin Municipal Federal Credit Union (In re Reagan), 741 F.2d 95 (5th Cir. 1984).

In addition, the funds would also be property of the Debtor's estate even if the Plan was a qualified

ERISA plan due to the fact that the Debtor terminated his employment with First Federal prior to the time he filed bankruptcy. Therefore, the Debtor had the right to receive the pension funds before he filed bankruptcy.

[I]f a debtor has terminated employment or retired on or before the day the bankruptcy case commenced and has the right to receive his or her benefits in a lump sum as of the commencement of the case, then ERISA would not be thwarted by including that right as property of the debtor's estate.

Seiden, Chapter 7 Cases: Do ERISA and the Bankruptcy Code Conflict as to Whether a Debtor's Interest in or Rights Under a Qualified Plan Can Be Used to Pay Claims?, 61 Am.Bankr.L.J. 219, 339 (1987). [See also: 4 Collier on Bankruptcy ¶541.09(2) (15th ed. 1988)]. Consequently, Debtor's interest in the pension plan trust fund is property of his bankruptcy estate either under the ruling of In re Goff or due to the fact that the Debtor had the right to the money when he filed his petition.

11 U.S.C. §522(d) enumerates the various exemptions which are available to debtors who elect the federal exemptions rather than state exemptions. 11 U.S.C. §522(d)(10)(e) specifically exempts certain benefits under a pension plan, but the debtor acknowledges on page 3 of his Brief that this provision is not applicable because he chose to use state exemptions.

He then goes on to argue that pursuant to state exemptions that his interest in the pension plan trust fund is exempt under Miss. Code Ann. §71-1-43 (1972), which states:

§71-1-43. Income or principal of employee trust plan not to be encumbered.

The income or principal payable to a beneficiary or beneficiaries under any trust created by an employer as part of a pension plan, disability or death benefit plan, profit-sharing plan, or under any trust created under a retirement plan for which provision has been made under the laws of the United States of America exempting such trust from federal income tax shall not be pledged, assigned, transferred, sold, or in any manner whatsoever accelerated, anticipated, or encumbered by the beneficiary or beneficiaries. Nor shall any income or principal be in any manner subject or liable in the hands of the trustee for the debts, contracts, or engagements of the beneficiary or beneficiaries, or be subject to any assignment or other involuntary alienation or disposition whatsoever. Nor shall any income or principal be subject to the levy of any execution, writ of attachment, or garnishment thereon.

In simple terms, the first sentence of the code section prevents the beneficiary of a retirement plan from borrowing against his retirement benefits and pledging them as security. The third sentence prohibits judgment creditors from executing on a beneficiary's interest in a retirement plan trust fund. Neither of these factual situations are present here

and those parts of the section are irrelevant. The remaining sentence in the section provides:

"Nor shall any income or principal be in any manner subject or liable in the hands of the trustee for the debts, contracts, or engagements of the beneficiary or beneficiaries, or be subject to any assignment or other involuntary alienation or disposition whatsoever."

(Emphasis Added).

The Court interprets this sentence to mean that if a debtor were covered by a retirement plan, then his interest in the trust fund could not be reached or taken by his creditors. However, the critical words in the sentence are "...in the hands of the trustee..." This language means that any interest which a debtor might have in a pension plan trust fund must be strictly under the control of the trustee, pursuant to the terms of the particular plan involved. In the case at bar, from and after March 1, 1987, the proceeds of the Debtor's interest in the pension plan trust fund were no longer "in the hands of the trustee" within the meaning of the code section. The Debtor had terminated his employment and had requested the proceeds of his vested interest in the pension plan trust fund. The funds were no longer under the control of the trustee. They were in the process of being

disbursed to the Debtor. Unfortunately for the Debtor, at the time he filed on March 19, 1987, he no longer was a participant in the pension plan trust fund and his vested interest in the pension plan trust fund was no longer protected.

Having determined that the funds are property of the estate and are not exempt, the question of First Federal's set-off under §553 must be addressed. The Trustee argues that First Federal improperly set-off \$17,840.97 of the Debtor's interest in the pension plan trust fund against his indebtedness with First Federal.

This court is in agreement with the Trustee. Section 553(a) specifically authorizes set-off and it provides in part:

Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case...

In order for First Federal to set-off the \$17,840.97 against the \$218,216.77 Debtor owed First Federal, there must be "mutual debts" between the same parties. The Debtor, First Federal Savings and Loan

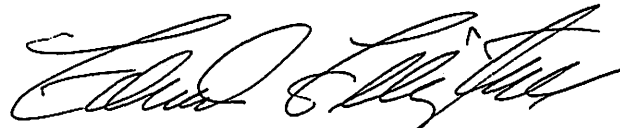
Association and the pension plan trust fund were three separate legal entities. The only reason the funds came into the hands of First Federal Savings and Loan Association was in its capacity as Trustee of the pension plan trust fund. The Debtor was not indebted to the Trustee of the pension plan trust fund. Instead, the Trustee was indebted to the Debtor because the Trustee owed the Debtor his proceeds from the pension plan trust fund. There were no mutual debts between the Debtor and First Federal in its capacity as Trustee of the pension plan trust fund. Rather, the Debtor was indebted to First Federal Savings and Loan Association only. Since there were no mutual debts between the Debtor and the pension plan trust fund, First Federal did not meet the requirements of §553(a) to properly set-off the \$17,840.97 of the Debtor's interest in the pension plan trust fund.

IT IS, THEREFORE, ORDERED AND ADJUDGED that the \$36,965.08 which represents the Debtor's interest in First Federal's pension plan is property of the bankruptcy estate and is not exempt from Debtor's bankruptcy estate.

IT IS FURTHER ORDERED AND ADJUDGED that First Federal was not entitled to the set-off of \$17,840.97, and First Federal is to hereby turn over to the bankruptcy trustee, Robert G. Nichols, Jr., \$17,840.97 plus

interest at a rate equal to that which the Trustee received on the \$19,124.11 which he has been holding.

SO ORDERED this the 30th day of September, 1988.


UNITED STATES BANKRUPTCY JUDGE