ORS §23.170(1)
Exemptions
Pensions

U.S. Lumber Sales, Inc. v. Lucas BAP No. OR 89-1503-AsVR
In Re Lucas Bk. No 388-00171

5/31/90 BAP (Reversing J. Hess) Unpublished

The debtors were the sole shareholders of a corporation which established two pension plans qualified under Internal Revenue Code § 401(a). At the time the plans were established, one of the debtors, Virgil Lucas, was the trustee for both plans.

While trustee, Mr. Lucas exercised unfettered control over the assets of the pension plans and used them extensively for his personal benefit. Six months prior to filing his chapter 7 petition, Mr. Lucas resigned as trustee of both plans, and an independent trustee was appointed.

A pension will not be exempt under ORS 23.170 if the debtor exercises such control over the asset as to make it more like a conventional savings account and less like a true retirement fund. The bankruptcy court found that the resignation of Mr. Lucas 6 months prior to the petition effectively divested him of control. Therefore, it held that on the date of the petition the funds were exempt. The court considered the situation analogous to the prepetition conversion of a nonexempt asset into an exempt one prepetition. The BAP reversed for the reason that "[i]f the plan were not exempt prior to Lucas' resignation, the resignation cannot make it exempt, at least as to amounts in the plan at that time."

P90-21(11)

NOT FOR PUBLICATION

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MAY 31 1990 C.A.

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OF THE NINTH CIR.

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re VIRGIL M. LUCAS and SHIRLEY A. LUCAS Debtor(s).	BAP No. OR 89-1503-AsVR BK. No. 388-00171-H7
U. S. LUMBER SALES, INC., Appellant(s), v. VIGRIL M. LUCAS and SHIRLEY A. LUCAS, Appellee(s).	**MEMORANDUM**

Argued and Submitted on
January 19, 1990 at Portland, Oregon

Filed - MAY 31 1990

Appeal from the United States Bankruptcy Court
for the District of Oregon

Honorable Henry L. Hess, Jr., Bankruptcy Judge, Presiding

Before: ASHLAND, VOLINN, and RUSSELL, Bankruptcy Judges.

U.S. Lumber Sales, Inc. appeals the bankruptcy court's order overruling its objection to the debtors' exemption of pension funds. We reverse and remand.

FACTS

The debtors Virgil and Shirley Lucas filed a voluntary Chapter 7 petition in January 1988. The debtors' schedules listed as exempt under Or. Rev. Stat. § 23.170 their interest in two pension plans. Mr. Lucas was a participant in the two pension plans sponsored by Lucas Plywood & Lumber Co., an Oregon corporation.

Both pension plans were qualified plans under Internal Revenue Code § 401(a) and required employment with the sponsor as a condition of eligibility. The plans also required a minimum length of service before benefits would vest and restricted the withdrawal of a beneficiary's interest.

At the time the plans were established, the debtors were the sole shareholders of Lucas Plywood & Lumber Co., and Mr. Lucas was the trustee for both pension plans. While acting as trustee, Mr. Lucas engaged in a number of transactions for his personal financial benefit, including: 1) using trust funds to invest in property he owned; 2) making loans of trust funds to businesses in which he or his relatives had an interest; 3) purchasing real estate in which he had an interest; 4) borrowing money from the plan to buy real estate in his own name; 5) using the funds to purchase the assets of the company when it filed bankruptcy and allowing those assets to be used without compensation by a company in which he had an interest; and 6) using pension funds to pay one

month's payroll and to purchase supplies of Lucas Plywood.

Six months prior to the filing of the bankruptcy petition Mr. Lucas resigned as trustee of both plans. Another individual was named as successor trustee. U.S. Lumber Sales, Inc. filed an objection to the exemption of the debtors' interest in the pension plans. U.S. Lumber's primary argument is that by virtue of his conduct while acting as trustee of the pension plans, Mr. Lucas exercised control over the funds in such a manner so as to lose his exemption in the pensions.

The bankruptcy court found that both pension plans were funded entirely by Mr. Lucas' employer, and that he made no voluntary contributions to the plans. The bankruptcy court held that, while Mr. Lucas did use trust funds for his personal benefit to such an extent that the money held by the trust would not be exempt under § 23.170 if he had remained as trustee, after his resignation as trustee six months before bankruptcy Mr. Lucas had no control over the pension plans and the debtors' interest once again became exempt.

ISSUE

Whether the bankruptcy court erred in overruling U.S. Lumber's objection to the debtors' exemption in the pension plans.

DISCUSSION

A two-step analysis is required to determine whether the bankruptcy court properly overruled U.S. Lumber's objection to the debtors' claimed exemption in the pension plans. First, we must determine whether Mr. Lucas' interest in the plans is subject to a

spendthrift provision that is enforceable under Oregon law. If it is, then under § 541(c)(2) his interest in the plans is not property of the bankruptcy estate. If there is no valid spendthrift trust then we must ascertain whether Mr. Lucas' interest is exempt under Or. Rev. Stat. § 23.170. In re West, 64 B.R. 738, 743 (Bankr. D. Or. 1986), aff'd, 81 B.R. 22 (9th Cir. BAP 1987).

Ordinarily, whether an asset is property of the estate is determined by examining the nature of the asset on the date that the debtor filed bankruptcy. West, 64 B.R. at 12. However, as the bankruptcy court correctly noted, the debtors in this case have not denied that their interest in the pensions are property of the estate. As a result, the bankruptcy court expressly declined to address the issue. As in the bankruptcy court, neither party to this appeal contends that the debtors' interest in the plans is not property of the estate. Therefore, our analysis proceeds under the assumption that pursuant to Oregon law a valid spendthrift trust did not exist, and we move to the question of whether the debtors' interest in the plans was nevertheless exempt.

The applicable state law provides:

> The following shall be exempt . . . :
>
> (1) All pensions granted to any person in recognition or by reason of a period of employment by or service for . . . any person, partnership, association or corporation.

Or. Rev. Stat. § 23.170(1). Based on the plain language of the statute and a review of applicable Oregon case law a two-part test

has been developed to determine the applicability of § 23.170(1) to a particular debtor's interest in a pension. As stated in Hebert v. Fliegel :

> Two tests have been established by courts to determine whether a specific plan falls within the ORS 23.170 exemption. First, the person granting the trust must be different from the person granted the trust. Secondly, the debtor may not exercise such control over the assets of the pension as to make it more like a conventional savings account and less like a true retirement fund.

813 F.2d 999, 1001 (9th Cir. 1987) (citing West, 64 B.R. at 744); accord In re Ott, 53 B.R. 388, 389-90 (Bankr. D. Or. 1985), aff'd in part rev'd in part, 69 B.R. 1 (D. Or. 1986).

The first test stems from the general rule that if a person creates a trust for his own benefit and inserts a "spendthrift" clause restraining alienation or assignment, the trust is void as far as his creditors are concerned. In re Cates, 73 B.R. 874, 875 (Bankr. D. Or. 1987); see also In re Masters, 73 B.R. 796, 797 (Bankr. D. Or. 1987); In re Mace, 4 B.C.D. 94, 95 (Bankr. D. Or. 1978). In this case there is no dispute that the pensions were established and sponsored by Lucas Plywood, Mr. Lucas' employer. Both pension plans were funded by the employer corporation, and provided the option for employee contributions. Mr. Lucas as an employee never made any voluntary contributions to the plans. While it is true that the debtors were the sole shareholders of Lucas Plywood when the pensions were established, and that Mr. Lucas acted as the trustee of the plans, the bankruptcy court found that there was no basis for disregarding the distinction between

the debtors and the corporation which established and funded the plans.

On appeal U.S. Lumber points to no facts which suggest that the corporate entity should be disregarded as the sponsor of the plans and the debtors substituted in its place. One plan has fourteen participants and the other nineteen. Each participant received uniform treatment under the terms of the plan with respect to funding.

As the debtors point out, the focus of U.S. Lumber's complaint is the administration of the plans and not the formation or funding of the plans. Cases considering whether a pension violated the first test, e.g. that the person granting the pension and receiving benefits are one and the same, have unanimously focused on who or what entity created and funded the plan and whether the employee/debtor made any voluntary contributions to the plan. See In re Masters, 73 B.R. at 797 (Deferred income account not exempt); In re Cates, 73 B.R. at 875-76 (Voluntary salary deferrals not exempt); In re West, 64 B.R. at 744 (Contributions made entirely by employer exempt); In re Mendenhall, 4 B.R. 127, 131 (Bankr. D. Or. 1980)(Self-funded Keough plans not exempt); In re Mace, 4 B.C.D. at 95 (Self-funded IRA not exempt). Thus, under Oregon law Mr. Lucas was not the same person that established the pensions.

U.S. Lumber argues that the pension was not granted in recognition of a period of employment or service as required by § 23.170(1), because when Mr. Lucas resigned as trustee the funds were non-exempt and he was no longer an employee of the company

thus the fund "created" by his resignation was not exempt. Mr. Lucas' resignation as trustee did not "create" any fund or plan. The plan was established by Lucas Plywood and funded entirely by the company. In addition, the plans expressly provided that participants were limited to employees of the company. Furthermore, the plans required a certain period of employment before the interest of the participant vested.

The real focus of our inquiry, like that of the bankruptcy court, must be the second test enunciated in Hebert, namely did Mr. Lucas exercise such control over the assets of the pensions that they were more like personal savings accounts than like true retirement funds. To this end, U.S. Lumber argues that Mr. Lucas used the trust funds for his personal benefit to such an extent that his interest in the pensions would not be exempt under § 23.170(1). The leading case examining the degree of control exercised by the debtor and its impact on an exemption claimed under § 23.170(1) is In re Ott, 53 B.R. 388 (Bankr. D. Or. 1985), aff'd in part rev'd in part, 69 B.R. 1 (D. Or. 1986).

In Ott, the court denied an exemption under § 23.170(1) for a pension plan established by the professional corporation David H. Ott, D.C., P.C. where Dr. Ott was the sole stockholder of the corporation and the trustee of the plan. The court focused on the amount of control exercised by the debtor over the plan. The court noted that the debtor could withdraw the pension funds at any time without restriction, that the debtor was the sole shareholder and employee of the corporation, and that he and his wife were the sole

beneficiaries of the plan. The employer had sole discretion as to the amount of contribution each year, and the participants were vested upon entry into the plan. In short, the court determined that the employer professional corporation had:

> [S]ole discretion to determine to what extent contributions will be made to the plan each year, the nature of the property to be contributed and may terminate the plan, thus permitting the withdrawal of plan assets, at any time by the debtors.

Ott, 53 B.R. at 390. After applying a totality of the circumstances analysis, the Ott court concluded that there was no truly separate, distinct employer/employee relationship; therefore, the debtors were not entitled to an exemption under § 23.170. Id.

U.S. Lumber urges us to follow In re Daniel, 771 F.2d 1352 (9th Cir. 1985), cert. denied, 475 U.S. 1016 (1986), in which the debtor's corporation formed a pension plan which was managed and controlled by the debtor. The debtor, acting as trustee of the plan made a $75,000 unsecured loan to himself and transferred $39,000 from the corporation into the plan on the eve of bankruptcy. Id. at 1357. We note that Daniel was based on former Cal. Civ. Proc. Code § 690.18(d) which is materially different than the Oregon statute. But even so, the court in Daniel applied a totality of the circumstance analysis to determine if the pension funds were used for a proper retirement purpose. In the recent case of In re Bloom, 839 F.2d 1376 (9th Cir. 1988), the court analyzed the successor to § 690.18(d). In Bloom, the debtor Dr. Bloom was one of two fifty percent shareholders in a professional corporation that created a pension plan. Bloom was a trustee of

the plan and had an interest in the plan of approximately $475,000. However, the plan had made unsecured loans to Bloom of $300,000. Id. at 1377. In allowing the exemption, the court stated "All factors are relevant, but no one is dispositive. Rather, all of them must be considered in light of the fundamental inquiry - whether the plan was designed and used for a retirement purpose." Id. at 1379-80.

The bankruptcy court in this case applied its own totality of the circumstances analysis and reached a contrary result. The bankruptcy court noted significant factors that distinguish this case from Ott. As of the petition date, the debtors had absolutely no control over the plans, because Mr. Lucas had resigned as trustee six months earlier. There are numerous plan beneficiaries. The debtors could not compel distributions at any time. The debtors did not control contributions to the plans. The participants in the plan were vested only after a certain length of employment.

U.S. Lumber places great weight on the bankruptcy court's finding that Mr. Lucas used the pension funds for his personal benefit to such an extent that he would have lost his exemption had he not resigned. However, the bankruptcy court did not hold that as matter of law, Mr. Lucas' resignation as trustee somehow created an exemption where none existed previously. The court was merely analyzing the resignation as one of the facts in the totality of the circumstances concerning the debtors' control over the pension funds. The fact that Mr. Lucas did resign as trustee of the plans

six months before he filed bankruptcy is an important factor to any consideration of how much control he exercised over the plans. If the plan were not exempt prior to Lucas' resignation, the resignation cannot make it exempt, at least to amounts in the plan at that time.

As stated above, the central inquiry is the degree of control that the debtor exercised over the assets of the pension plans. The debtor admitted that while acting as trustee he used pension funds to invest in property that he owned, that he loaned pension funds to businesses in which he or his relatives had an interest, that he used pension funds to purchase real estate in which he had an interest, that he used pension funds to buy real estate in his own name, that he used pension funds to purchase the assets of Lucas Plywood when it filed bankruptcy and allowed those assets to be used without compensation by a company in which he had an interest, and that he used pension funds to pay operating expenses of Lucas Plywood. Viewed in totality, it is apparent that the debtor, by virtue of his position as trustee, exercised unfettered control of the pension plan assets and used them for his personal benefit. As a result, the Mr. Lucas' interest in the pension plans fails the second test set forth in Herbert. Under the totality of the circumstances it is clear that the bankruptcy court erred in holding that the debtor could exempt his interest in the pension plans under § 23.170(1).

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CONCLUSION

The bankruptcy court's judgment overruling U.S. Lumber's objection to the debtors' scheduled exemption in the pension plans is reversed. The bankruptcy court should determine the amount contributed to the plans after Lucas' resignation and set that amount aside as exempt.