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U.S. Supreme Court Rules That Individual Retirement Accounts May Be Exempted

In ***Rousey v. Jacoway***, 125 S. Ct. 1561 (2005), the United States Supreme Court resolved a split among the circuits by holding that funds in an Individual Retirement Account may be exempted in bankruptcy.

When the married debtors received a lump sum distribution from their pension plans upon termination of their employment, they deposited those amounts into individual IRA accounts, which under Section 408(a) of the Internal Revenue Code, are trusts "created or organized in the United States for the exclusive benefit of an individual or his beneficiaries." Such rollovers of pension payments are non-taxable under Section 408(d)(3) of the Internal Revenue Code.

Several years later the debtors jointly filed chapter 7 and claimed that portions of their IRAs were exempt under Section 522(d)(10)(E) of the Bankruptcy Code, which allows a debtor to exclude from the bankruptcy estate the right to receive "a payment under a stock bonus, pension, profit sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor . . . ."

The bankruptcy trustee objected to the claimed exemption and prevailed in the bankruptcy court and the Eighth Circuit. The Court of Appeals reasoned that even if IRAs were "similar plans or contracts" to stock bonus, pension, profit sharing, or annuity plans, they create no right to receive payment "on account of age" because the debtors could avail themselves of their IRA funds at any time for any purpose with the exception of a 10% penalty for withdrawals made prior to age 59½.

The Supreme Court unanimously reversed. Justice Thomas delivered the opinion and noted that in ***Patterson v. Shumate***, 504 U.S. 753 (1992) the Court stated: "Although a debtor's interest in an IRA could not be excluded under Section 541(c)(2) . . . that interest nevertheless could be exempt under Section 522(d)(10)(E)." Justice Thomas elevated that statement in *Patterson* to a holding.

The Supreme Court disagreed with the trustee's assertions that a debtor's right to receive an IRA distribution was not "because of" any of the listed factors, since the Internal Revenue Code allowed the debtors to withdraw funds from their IRA for any reason as long as they paid a 10% penalty. The Supreme Court noted that the 10% penalty imposed on withdrawals prior to age 59½ was a "substantial deterrent," suggesting that Congress intended to preclude early access to IRAs. The very small percentage of account holders taking early withdrawals confirms this conclusion. Therefore, the Supreme Court concluded that the right to withdraw the balance of an IRA is a right to payment "on account of age."

The debtors argued that IRAs are "similar" to stock bonus, pension, profit sharing or employee annuity plans within the meaning of Section 522(d)(10)(E) because they have the same primary purpose of enabling people to save for their retirement. The trustee argued that the listed plans are different because they provide "deferred compensation" while IRAs allow undeferred access to deposited funds.

The Supreme Court concluded that IRAs are similar to the listed plans because they all provide income that substitutes for wages earned as salary or hourly compensation. Payments exempted under other subparagraphs of Section 522(d)(10), including social security, unemployment, and disability benefits, share the same feature.

The Internal Revenue Code's treatment of IRA income also indicates that it substitutes for wages. Justice Thomas pointed to the minimum distribution requirements imposed once the account holder turns 70½ (enforced by a 50% penalty for non-compliance), deferral of taxation of IRA funds until the year in which they are distributed, and the penalty for withdrawals before age 59½.

Finally, the Supreme Court noted that under Bankruptcy Code Sections 522(d)(10)(E)(i) – (iii), the estate includes payments from a plan that was established by "an insider" that employed the debtor but that does not qualify under Section 408 of the Internal Revenue Code. As a general matter it makes little sense to exclude from the exemption plans that fail to qualify under Section 408, unless all plans that do qualify under Section 408, including IRAs are generally within the exemption.

NOTE: Under the recent Bankruptcy Code amendments IRAs are exempt in an amount not to exceed $1,000,000 after the October 2005 effective date.

Reopening of Case Left to Discretion of the Bankruptcy Court

In *Apex Oil Co., Inc., v. Sparks (In re Apex Oil Co., Inc.)*, No. 04-2489 (8th Cir., April 29, 2005), the Eighth Circuit recognized the bankruptcy court's broad discretion under Bankruptcy Code Section 350(b) to grant or deny a motion to reopen a case. Section 350(b) permits the court to reopen a closed case in order "to administer assets, to accord relief to the debtor, or for other cause." 11 U.S.C. § 350(b).

Apex's plan of reorganization was confirmed in 1990 as part of its chapter 11 case filed in 1987. The plan provided a broad discharge and injunction in favor of Apex in accordance with Bankruptcy Code Sections 524(a) and 1141(d)(1). The bankruptcy court subsequently declared Apex's plan final and closed the case in 1996. In 2003, a class action complaint was filed against Apex, the purchaser of Apex's petroleum refinery in the bankruptcy case and other defendants. The complaint was brought by a group of homeowners seeking damages and injunctive relief arising from the operation of the refinery. Apex removed the case to federal district court and filed an answer with affirmative defenses asserting that the homeowners' claims arose prior to the plan confirmation order and thus were discharged by the plan. Apex also filed a motion with the bankruptcy court seeking to reopen the case and asking the bankruptcy court to enforce the discharge and injunction orders, hold the homeowners in contempt and dismiss their claims against Apex. The bankruptcy court denied the motion to reopen the case and the district court affirmed.

Employing an "abuse of discretion" standard of review, the Eighth Circuit affirmed. The Court first noted the bankruptcy court's discretion under the statute and stated that courts may, but are not required to, reopen closed cases on the grounds set forth in the statute. Within that discretion, bankruptcy courts should examine the particular circumstances and equities of each case.

The Eighth Circuit next held that the factors relied upon by the bankruptcy court in denying the motion were permissible. Those factors were: (1) the availability of relief in another forum; (2) the presence of other defendants in the class action not subject to the bankruptcy court's jurisdiction; (3) the lengthy passage of time (over 6 years) since Apex's bankruptcy case was closed and the filing of the class action; and (4) the lack of impact on Apex's bankruptcy estate by the class action. In particular, the Eighth Circuit found significant the availability of relief in an alternative forum, the settled nature of Apex's bankruptcy estate (noting that reopening usually occurs to address ministerial issues), and the lengthy period of time between the closing of the bankruptcy case and the motion to reopen. The Eighth Circuit agreed that the longer the time period is, then the more compelling the reason to reopen should be.

NOTE: The Eighth Circuit did not foreclose the possibility that, given the same or similar facts, a bankruptcy court could use its discretion to grant the motion to reopen.

Bankruptcy Court Denies Insurers' Demand For Jury Trial

In *In re A.P.I. Inc., No. 05-30073* (Bankr. D. Minn., April 29, 2005), Debtor was in the business of installing insulation at large industrial and commercial sites. Until 1973, it used insulation containing asbestos. Over the last 20 years, it has been named as a defendant in thousands of product liability lawsuits. Approximately 700 were pending when Debtor filed for bankruptcy relief. Because of the large number of claims many of the insurers asserted that the aggregated claims had reached the limits of coverage under the applicable insurance policies. When Debtor's bankruptcy petition was filed, a declaratory judgment action over the coverage issue was pending in the Minnesota state court.

Debtor sought to obtain confirmation of a pre-packaged plan. Via the plan, Debtor would establish a trust under Section 524(g)(2)(b) of the Bankruptcy Code that would assume liability for asbestos related claims against Debtor and would pay those claims from assets received post-confirmation. Debtor's insurers filed a motion to have all insurance coverage issues raised by the proposed plan transferred to the United States District Court for jury trial, or alternatively, transfer the entire bankruptcy proceeding. The motion was styled under Local Rule 5011-3(a) (Transfer of Proceedings). The motion was denied by the bankruptcy court.

In denying the motion, the bankruptcy court noted that the Bankruptcy Code contains no provisions governing the right to jury trial in cases commenced under it. The court therefore conducted its analysis within the strictures of the 7th Amendment of the United States Constitution, and applicable case law. Quoting *Granfinaciera, s a. v. Nordberg*, 492 U.S. 33(1989), the bankruptcy court set forth the applicable two prong test for determining the right to a jury trial under the 7th Amendment: "First we compare the statutory action to the 18th Century actions brought in the Court of England prior to the merger of the Courts of Law and Equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature." *Id*. at 42.

The bankruptcy court first applied this analysis to the request for transferring only certain issues to the district court.

Obviously troubled by the vagueness of the request, the court noted that no authority was offered by the insurers to support their request. Furthermore, the bankruptcy court determined that issues arising out of these statutory rearrangements of rights under the Bankruptcy Code did not constitute a suit at common law. The bankruptcy court thus denied the request to transfer a "bundle" of insurance issues to the district court.

The bankruptcy court then applied the analysis to the request for transferring the entire proceeding to the District Court. At oral argument, counsel for the insurers clarified the request by noting that they wanted to transfer the confirmation proceeding alone, not the whole case. Comparing confirmation of the plan to reformation of a contract, the bankruptcy court found the confirmation process to be equitable in nature and denied the insurers' alternative request.

COURT NEWS

CM/ECF Update

The Bankruptcy Court has started the attorney registration process for CM/ECF in Minnesota. The Clerk recently sent an email to all attorneys in the ERS database with a web address and instructions to register for CM/ECF. The registration form enables attorneys to update their information with the Court, indicate whether they want CM/ECF training, and register staff for training. **Attorneys are requested to complete the registration form as soon as possible.**

Attorneys will be required to successfully submit two test filings to the Court before they are certified in CM/ECF. Training is not required, but is available for attorneys or staff who file on behalf of the attorney. The Court has two online training programs available on the home page, www.mnb.uscourts.gov at the CM/ECF button. One, ECF 101 provides an overview of CM/ECF; the other is a series of computer based training modules which provide interactive instruction on bankruptcy case opening, converting documents to PDF, filing a motion, filing an answer to complaint, filing an objection to a motion, filing proofs of claim, queries, setting up automatic e-mail notification, uploading a creditor matrix, and Windows file management. Two other training options will be provided, including demonstration and Q&A sessions, as well as hands-on training. Attorneys will receive email notification when these classes have been posted on the Court's web site, and they will be able to register for classes online. The demonstration and Q& A sessions will begin in late June.

For questions regarding CM/ECF please contact Margaret Dostal-Fell at 612-664-5273.