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David L. Gladwell v. Douglas James Reinhart : Reply Brief

Utah Supreme Court

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IN THE UTAH SUPREME COURT

In re DOUGLAS JAMES REINHART, Debtor.	**REPLY BRIEF OF APPELLEE**
DAVID L. GLADWELL, Trustee, Appellant, v. DOUGLAS JAMES REINHART, Appellee.	Case No. 20091087-SC United States Court of Appeals Tenth Circuit Case No. 09-4028 (U.S. District Court No. 2:08-cv-562)

ON CERTIFICATION FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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TABLE OF CONTENTS

ARGUMENT 1

I. THE STATUTORY TEXT, LEGISLATIVE HISTORY, AND *IN RE KAPLAN* DO NOT SUPPORT THE TRUSTEE'S STRICT VIEW OF THE EXEMPTION STATUTE 1

II. THE LOWER COURTS' DECISIONS PROVIDE A CLEAR AND MEANINGFUL TO STANDARD TO THE EXEMPTION STATUTE 5

CONCLUSION 9

CERTIFICATE OF SERVICE 10

TABLE OF AUTHORITIES

Cases

In re Goldschein, 244 B.R. 595, 601-02 (Bankr. D. Md. 2000) 5
In re Kaplan, 162 B.R. 684, 697 (Bankr. E.D. Pa. 1993) 1, 3, 4
In re Kunz, 2004 UT 71, ¶ 8, 99 P.3d 793 .... 1, 4, 9
In re Plunk, 481 F.3d 302 (5th Cir. 2007) 5
Kitches & Zorn, L.L.C. v. Kim, 2005 UT App. 164, ¶ 8, 112 P.3d 1210 2
Myron v. United States, 550 F.2d 1145 (9th Cir. 1977) 5

Statutes

Utah Code Ann. § 78-23-5(1)(a)(x) (2000) 1, 2, 9

Other Authorities

Rev. Proc. 2006-27, Part IV, §§ 8 & 9; Part V 7

ARGUMENT

I. THE STATUTORY TEXT, LEGISLATIVE HISTORY, AND *IN RE KAPLAN* DO NOT SUPPORT THE TRUSTEE'S STRICT VIEW OF THE EXEMPTION STATUTE

In his opening brief, the Trustee has attempted to rewrite the exemption statute at issue, Utah Code Ann. § 78-23-5(1)(a)(x) (2000), by arguing that, in order to be "described in" Section 401(a) of the tax code, a plan "must necessarily be" operationally "qualified under" the tax code. Aplt. Brief at 12. The Trustee's strict interpretation of the exemption statute is not supported by the statutory text, legislative history, or the case of In re Kaplan, 162 B.R. 684, 697 (Bankr. E.D. Pa. 1993). Also, his strict interpretation runs afoul of this Court's historical policy of construing exemption statutes "liberally . . . in favor of the debtor to protect him and his family from hardship." In re Kunz, 2004 UT 71, ¶ 8, 99 P.3d 793.

First, the Trustee's view is not supported by the statutory text. The exemption statute states a retirement plan must be "described in"—and not "qualified under"—Section 401(a) of the IRC in order to be exempt. Utah Code Ann. § 78-23-5(1)(a)(x) (2000). In fact, the exemption statute does not even use the word "qualified." See id.

The crux of the Trustee's argument on this issue is that the headings of Sections 401 and 401(a) of the IRC contain a variation of the word "qualified" in its title. See Aplt. Brief at 12-13. However, the exemption statute does not, by its terms, even refer to the heading of Section 401 nor does it purport to incorporate by reference said heading. See Utah Code Ann. § 78-23-5(1)(a)(x) (2000). In addition, the Trustee's argument ignores the obvious: if the Utah Legislature had intended to state that a retirement plan can only be exempt if it is actually, and operationally, "qualified under" Section 401(a) of the IRC, it could have done so. See Kitches & Zorn, L.L.C. v. Kim, 2005 UT App. 164, ¶ 8, 112 P.3d 1210 (stating that if legislature had intended to use different word, it could have done so). Thus, the text does not support the Trustee's strict interpretation of the exemption statute.

Second, the legislative history does not support the Trustee's strict interpretation of the exemption statute. In his opening brief, the Trustee quotes two statements made by legislators, but acknowledges that such statements do not explain why the Utah Legislature chose to use the words "described in" instead of "qualified under." Aplt. Brief at 13. Hence, such statements do not support the Trustee's strict reading of the exemption statute. In fact, said statements weigh against the Trustee's position because they show the legislators were familiar with the term "qualified," as it relates to retirement plans, yet the Utah Legislature chose not to use that word in the exemption statute.

Furthermore, the legislative comments cited by the Trustee actually support the Debtor's position in this case. For example, Senator Finlinson stated that the purported intent of the exemption statute was to "make our bankruptcy treatment [of retirement plans] *consistent* with the federal [taxation] law." Aplt. Brief at 14 (quoting Senator Finlinson) (emphasis added).

Here, the Trustee's position treats the exemption statute *inconsistently* with federal taxation laws: while federal taxation laws would allow the Debtor to correct all of the defects in the Plan and retain the Plan's tax benefits (through the IRS program "Employee Plans Compliance Resolution System" ("EPCRS")), the Trustee's position completely ignores the availability of EPCRS to a debtor. Thus, it is the Debtor's position (not the Trustee's) which is consistent with the legislators' statements.[1] As a result, the legislative history does not support the Trustee's strict interpretation of the exemption statute.

Third, and finally, the case of In re Kaplan, 162 B.R. 684, 697 (Bankr. E.D. Pa. 1993), does not support the Trustee's strict interpretation of the exemption statute. In his opening brief, the Trustee tries to diminish and twist the actual holding of In re Kaplan by relying on dicta concerning what may happen "if" the

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[1] Under the heading of "Legislative History" the Trustee also gives his own speculative opinion as to why the Utah Legislature did not use the words "qualified under" but instead the words "described in." See Aplt. Brief at 15-16. As rebutted by the Debtor before the Tenth Circuit Court of Appeals, see 10th Circuit Aplee. Brief at 18 n.6, such opining is not "legislative history," was never argued before the Bankruptcy Court, and is not supported by any legal authority. See id. Thus, the Trustee's argument should be rejected by this Court.

IRS should in the future rule that the plan was not tax-qualified. Aplt. Brief at 17-18.

Notably, in Kaplan the IRS had not ruled that the plan was disqualified. See In re Kaplan, 162 B.R. at 696-97. The same is true in this case—at no time has the IRS ruled or found that the Plan is disqualified. (Aplt. App. at 47, ll. 11-13). Thus, Kaplan squarely supports the Debtor's position because both Kaplan and this case deal with an exemption statute that does not use the more specific phrase "qualified under," the retirement plan has not been disqualified by the IRS, and all defects are correctable. As a result, In re Kaplan does not support the Trustee's strict interpretation of the exemption statute.

In summary, then, the Trustee's position in this case is not supported by the statutory text, legislative history, or the case of In re Kaplan. Instead, the statutory text, legislative history, and In re Kaplan support the Debtor's position in this case—that a retirement plan is exempt where it has not been disqualified by the IRS and all defects are correctable through IRS procedures. The Debtor's position, which was adopted by both the Bankruptcy Court and the District Court, is also consistent with this Court's historical policy of construing exemption statutes "liberally . . . in favor of the debtor to protect him and his family from hardship." In re Kunz, 2004 UT 71, ¶ 8, 99 P.3d 793. Therefore, the Trustee's strict view of the exemption statute should be rejected by this Court.

II. THE LOWER COURTS' DECISIONS PROVIDE A CLEAR AND MEANINGFUL TO STANDARD TO THE EXEMPTION STATUTE

In Part II of his opening brief, the Trustee argues that the Bankruptcy Court did not provide a meaningful standard for the phrase "described in," and then proceeds to characterize the Debtor has having committed a series of bad acts as the administrator of the Plan. See Aplt. Brief at 19-24. As shown below, the facts in this case provide a meaningful standard for the phrase "described in": a retirement plan is "described in" Section 401(a) of the IRC where it has not been disqualified by the IRS and all alleged defects are correctable through IRS procedures.

In an attempt to bolster his argument, and to cast the Debtor in a bad light, the Trustee first places the Debtor in the same category as parties who omitted from 5 to over 100 employees from a retirement plan, and a debtor who included a non-employee spouse in the retirement plan, made loans to himself from the plan in excess of $400,000, and generally used the plan as a "personal piggy bank." See Aplt. Brief at 20-23 n.22 & 26 (citing Myron v. United States, 550 F.2d 1145 (9th Cir. 1977); In re Goldschein, 244 B.R. 595, 601-02 (Bankr. D. Md. 2000); In re Plunk, 481 F.3d 302 (5th Cir. 2007)). Notably, the foregoing cases are also distinguishable because the applicable state exemption statutes required the plans to be "qualified under" the IRC in order to be exempt.

Next, the Trustee lists up to eight alleged problems with the Plan, in an attempt to distort the nature and severity of the alleged Plan defects.[2] Contrary to the Trustee's characterizations of the Plan defects, the Bankruptcy Court found only four defects in the Plan: (i) one person was omitted from the Plan, the Debtor's spouse; (ii) a loan of 3% of the Plan's assets, where funds were not withdrawn from the custodial account and the loan was not made to the Debtor or his family; (iii) an excess contribution of $1,455.75 in the year 2000; and (iv) the failure to allocate contributions to the money purchase plan portion of the Plan. (Aplt. App. at 46, ll. 7-22).

As explained in the Debtor's opening brief to this Court, see Debtor's Opening Brief at 15, the foregoing operational defects are minor and do not rise to the level of the parties in the cases cited by the Trustee. And, more importantly, all of the alleged operational failures in the Plan are correctable through the IRS

[2] Paragraph 2 and footnote 23 on page 21, and footnote 9 on page 7, of the Trustee's opening brief contain arguments not previously raised on appeal by the Trustee, and which are not supported by the Bankruptcy Court's findings. Therefore, such arguments should be ignored by this Court.

program EPCRS. (Aplt. App. at 47, ll. 2-4; 228-229).[3] EPCRS was designed to allow employers to correct retirement plan defects, thereby avoiding the loss of tax benefits that otherwise would result from plan disqualification. (Aplt. App. at 204, ll. 14-19; 223, ll. 8-17; 227).

Therefore, despite the Trustee's attempts to vilify the Debtor, this case is not a case in which egregious acts were committed by a debtor to take advantage of his retirement plan. Instead, this case is representative of common operational failures that can occur in the administration of a retirement plan. Because the IRS allows such operational failures to be corrected, it is proper to interpret the Utah exemption statute as allowing exemptions for retirement plans that have correctable defects and have not been disqualified by the IRS. Such a standard is

[3] While discussing the subject of EPCRS, the Trustee attempts to distinguish between "VCP" and "SCP" procedures. See Aplt. Brief at 23. Before the 10th Circuit Court of Appeals, the Trustee argued that "insignificant" operational failures may be corrected through Self Correction Procedures ("SCP") while "significant" operational failures must be corrected through Voluntary Correction Procedures ("VCP"). However, the Trustee's expert never distinguished the alleged Plan operational failures as "significant" or "insignificant." In addition, the Revenue Procedure cited by the Trustee states that both "significant" and "insignificant" failures may fall under SCP, while the distinguishing characteristic of VCP is that under VCP the corrections are made with the approval of the IRS. See Rev. Proc. 2006-27, Part IV, §§ 8 & 9; Part V. Again, the key fact to this analysis is that the Trustee's own expert testified, and the Bankruptcy Court found, that all of the alleged operational failures in the Plan were correctable. (Aplt. App. 47, ll. 2-4; 228-229).

meaningful and clear, and upholds the legislative purpose and policies of Utah exemption statutes.

The same cannot be said for the Trustee's interpretation of the statute, where even the slightest failure by an employer to correctly operate a retirement plan would result in debtors losing their exemptions—even if such failure were correctable under federal taxation laws. The Trustee's own expert, Mr. Lloyd, acknowledged that the purpose of EPCRS was to avoid the harsh results that would otherwise occur where, for example, a single employee is not included in a retirement plan:

> As you can imagine, the consequences in a plan that covers hundreds of thousands of participants and has hundreds of millions, if not billions of dollars in it, the consequence that arises, if it turns out that plan forgets, for example, to include a particular employee in its facility down in some far away place, and yet, the failure to include that one employee in the plan is a document – is an operational failure.

(Aplt. App. at 226).

Thus, for the Utah exemption statute to be truly consistent with federal taxation laws, the phrase "described in" should be interpreted as allowing debtors to exempt retirement plans where the alleged plan defects are correctable through IRS procedures and the plan has not been disqualified by the IRS. Such a construction is supported by the statutory text, legislative history, and this Court's historical policy of construing exemption statutes "liberally . . . in favor of the debtor to protect him and his family from hardship." In re Kunz, 2004 UT 71, ¶ 8, 99 P.3d 793.

CONCLUSION

As set forth above, this Court should reject the Trustee's strict interpretation of Utah Code Ann. § 78-23-5(1)(a)(x) (2000). Instead, this Court should liberally construe the exemption statute, and keep it consistent with federal taxation laws, by holding that a Keogh plan can be "described in" section 401(a) of the IRC—and is therefore exempt under Utah law—despite failing to fulfill that section's requirements for qualification, where the qualification failures are correctable through IRS procedures.

DATED this 8th day of June, 2010.

/s/

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing **REPLY BRIEF OF APPELLEE** was served this 8th day of June, 2010, via searchable PDF on CD and via regular U.S. mail, postage prepaid upon the following:

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