UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT
Appeal No. 16-6024

IN RE MICHAEL P. HARRIS, BKY 15-44062
Debtor, Chapter 7

THOMAS E. PEREZ, Secretary of Labor
Plaintiff/Appellee,

v.

MICHAEL P. HARRIS,
Defendant/Appellant.

On Appeal from the Decision
of the United States Bankruptcy Court for the
District of Minnesota, Adv. No. 16-04019

BRIEF FOR THE U.S. SECRETARY OF LABOR

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STATEMENT OF THE ISSUES PRESENTED

As restated by the U.S. Secretary of Labor Thomas E. Perez ("Secretary"), the issues on appeal are:

1. Whether the bankruptcy court properly applied the doctrine of collateral estoppel to the conclusions of law and findings of fact made by the U.S. District Court for the District of Minnesota in Perez v. Harris, No. 12-CV-3136 (D. Minn. Nov. 9, 2015), which rendered judgment under the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001, et seq., against debtor-appellant for breaching his fiduciary duties to his employees and their healthcare plan by diverting the employees' healthcare-premium payments to pay company expenses.

2. Whether the bankruptcy court correctly concluded appellant's debt to his employees and their plan incurred under the district court's judgment is nondischargeable under the Bankruptcy Code, 11 U.S.C. § 523(a)(4), because it involved a defalcation by the debtor while acting in a fiduciary capacity.

STATEMENT OF THE CASE

A. Factual Background

In 2001, debtor-appellant Michael Harris became the Chief Executive Officer, President, and Board Chairman of Faribault Woolen Mills Company ("Faribault"). Doc. 11, Ex. 2 (Statement of Undisputed Facts) ¶ 2. Faribault

sponsored the Faribault Woolen Mills, Inc. Fully Insured Hospital Life Welfare Plan ("Plan") to provide health insurance for its employees. Id. ¶¶ 9–10. The Plan contracted with HealthPartners Health Insurance Company ("HealthPartners") to provide healthcare benefits for Plan participants. Id. ¶ 11. Participants paid 100% of all premiums owed by the Plan to HealthPartners via payroll deductions. Id. ¶ 14. Faribault withheld premium payments from the employee-participants' paychecks and then remitted the amount owed to HealthPartners from its general operations account on the first of each month. Id. ¶¶ 12–13, 15–17. Faribault also paid its general corporate expenditures from the same general operations account. Id. ¶ 17.

Harris had ultimate authority during at least the first quarter of 2009 to determine which of Faribault's expenses would be paid. Doc. 11 Ex. 3 (District Court Decision) ¶¶ 23–25. Harris's approval was thus necessary to remit employee contributions to HealthPartners. Indeed, Harris signed the checks Faribault sent to HealthPartners to pay the Plan's insurance premiums. See Doc. 11, Ex. 2 ¶¶ 24–25, 29.

In 2008, Faribault began having difficulty remitting timely premium payments to HealthPartners. Id. ¶¶ 22–24, 39. Faribault failed to timely remit premium payments on ten occasions in 2008; each time, HealthPartners sent Faribault a letter indicating its monthly payment was late. Id. ¶ 22. Gary Glienke,

Faribault's Vice President of Human Resources, received each late-payment notice and would inform Harris about it. Id. ¶¶ 3, 23. Harris would usually respond by asking Glienke to obtain an extension on payment. Id. In 2008, Faribault sent two checks—both signed by Harris—to HealthPartners, which HealthPartners returned for insufficient funds; however, Faribault was able to later remit the payment on both occasions, thereby preventing a loss of the Plan's insurance coverage. Id. ¶ 24.

On January 27, 2009, Faribault issued a check signed by Harris to HealthPartners for $22,593.02 to pay the premiums owed for January 2009. Id. ¶ 25. HealthPartners returned the check for insufficient funds. Id. In a February 28, 2009 letter, HealthPartners informed Glienke of this fact and its intention to cancel the Plan's insurance if Faribault did not pay in full. Id. ¶ 26. HealthPartners also sent letters to Plan participants dated February 28, 2009, informing them that Faribault had failed to remit their January 2009 premium payments. Id. ¶ 27. As a Plan participant, Harris received that letter. Id. ¶ 28.

On February 27, 2009, Faribault issued a check signed by Harris to HealthPartners for $19,466.91 to pay the premiums owed by the Plan for February 2009. Id. ¶ 29. HealthPartners returned the February 27 check to Faribault. Id. ¶ 30. In an accompanying letter dated March 3, 2009, HealthPartners informed

Carmen Dorr, Faribault's Chief Financial Officer, that it would accept only wire payments due to the insufficient-fund checks it had received. Id. ¶¶ 4, 30.

On March 26, 2009, Harris personally asked HealthPartners for an extension to pay the January and February 2009 premiums. Id. ¶ 32. HealthPartners denied the request and demanded full payment of the January and February premiums by March 31. Id. When Faribault did not remit the overdue payments, HealthPartners canceled the Plan's insurance policy on April 1, 2009. Id. ¶¶ 33–34. Faribault thus never remitted $55,040.61 withheld from its employees' paychecks for insurance premiums from January 9, 2009, to March 20, 2009. Id. ¶ 61.

During that same time period, Faribault used the funds in its general operations account to pay other corporate expenses. In January 2009, Faribault paid $303,632.01 from its general operations account for other corporate expenditures. Id. ¶¶ 54–55. In February 2009, Faribault paid $324,686.83 from its general operations account for other corporate expenditures. Id. ¶¶ 54–55.

In March 2009, Faribault paid $246,240.52 from its general operations account for other corporate expenditures. Id. ¶¶ 54–55. From March 26 to March 31, 2009, alone, Faribault used over $70,000 from its general operations account to either make transfers to other Faribault accounts or to pay other creditors and expenses. Id. ¶ 56. Harris and his wife received $27,031.48 in payments from Faribault's general operations account during this end-of-March period. Id. Those

payments included a $21,531.48 payment on Harris's home equity line of credit, which he directed Dorr to make on March 31, 2009. Id. ¶ 56.c.

Faribault never repaid its employees for the amounts it withheld from their paychecks during this period. Id. ¶ 61.

B. ERISA Litigation against Harris

On December 19, 2012, the Secretary filed a complaint against Harris, alleging he violated ERISA by failing to remit the $55,040.61 in withheld healthcare premiums to HealthPartners. Complaint, Perez v. Harris, No. 12-cv-3136 (D. Minn. Dec. 19, 2012). Specifically, the Secretary alleged that, by failing to remit the withheld premiums, Harris breached his fiduciary duty of loyalty to Faribault's employees and their Plan in violation of ERISA section 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A). Id.

The U.S. District Court for the District of Minnesota conducted a three-day bench trial. Doc. 11, Ex. 1. On November 9, 2015, the district court issued a judgment in the Secretary's favor, concluding Harris violated his fiduciary duty of loyalty under ERISA by diverting $55,040.61 in employee contributions to pay for corporate expenses and his own home-equity loan. Doc. 11, Ex. 3.

The district court first determined Harris acted as an ERISA fiduciary in relation to his employees' withheld but unremitted payments for their health insurance premiums. Id. at 25. The court noted that the amounts withheld from

Faribault employees' paychecks for premium payments became plan assets "as of the date on which the employees' wages were paid (i.e., the date on which the employees' contributions were withheld)." Id. at 24. The court then found that Harris exercised authority or control respecting the management or disposition of those plan assets, id. at 23–25, a basis for ERISA fiduciary status, see 29 U.S.C. § 1002(21)(A)(i). For example, Dorr testified that she did not have the authority to pay any bills or expenses without Harris's approval, including the remittance of employee contributions to HealthPartners. Doc. 11, Ex. 3 at 23. Harris signed the checks to HealthPartners. Id. Moreover, when Glienke brought HealthPartners's past-due notices to Harris's attention, Harris asked Glienke to try to get an extension or, as in March 2009, called HealthPartners himself to request an extension. Id.

Harris's testimony to the contrary did not compel a different result, as his claim that Dorr (and not Harris) actually determined when and how to pay HealthPartners and other corporate expenses "lack[ed] credibility given the great weight of evidence to the contrary." Id. at 24–25. The court thus determined Harris was a Plan fiduciary "from at least January 1, 2009 to March 31, 2009," as he exercised authority and control over plan assets during that time. Id. at 25.

Second, the district court found "that Harris breached his [fiduciary] duty of loyalty to the Health Plan by failing to remit plan assets to the Health Plan and

instead using those assets to pay corporate creditors and personal expenses." Id. at 27. Specifically,

> [h]e breached that duty when, in late March 2009—after he claims he first learned that the January and February premiums had not been remitted to HealthPartners—he directed or allowed funds from [the general operations account] to be used to pay Faribault Mills's expenses and debts instead of the HealthPartners premiums.

Id.

The district court also concluded Harris's fiduciary breach caused the $55,040.61 in losses suffered by the Plan. Id. at 28.

> Harris's decision not to remit the employee withholdings to HealthPartners caused the $55,040.61 loss to the Health Plan. . . . [T]he evidence shows that an amount of money significantly higher than the amount of premiums that was due to HealthPartners was removed from the account from which premiums were paid and was neither paid to HealthPartners nor returned to the employees, but instead was used to pay other corporate expenses or debts.

Id.

The district court thus issued a judgment on November 9, 2015, in the Secretary's favor, finding Harris liable to the Plan for $55,040.61 in restitution and, with prejudgment interest, a total of $67,839.60 (hereinafter, "ERISA Judgment Debt"). Id. at 29–31. Harris did not appeal this judgment.

C. Bankruptcy Litigation

On November 23, 2015, Harris filed a Chapter 7 bankruptcy petition with the U.S. Bankruptcy Court for the District of Minnesota. Petition, In re Harris, No.

15-bk-44062 (Bankr. D. Minn. Nov. 23, 2015) (Doc. 1). Harris's petition listed the U.S. Department of Labor as an unsecured nonpriority creditor for the $67,839.60 he owed under the district court's November 9, 2015 judgment. Id. On February 29, 2016, the Secretary filed an adversary proceeding against Harris seeking nondischargeability of his $67,839.60 debt pursuant to 11 U.S.C. §§ 523(a)(4) and 727. Doc. 1.

The Secretary moved for summary judgment on June 30, 2016, arguing that (1) the collateral-estoppel doctrine gave preclusive effect in the bankruptcy case to the district court's factual and legal determinations; and (2) Harris's debt was nondischargeable because it arose from "defalcation while acting in a fiduciary capacity," 11 U.S.C. § 523(a)(4). Doc. 12. For summary judgment purposes, the parties stipulated to sixty-two uncontested facts identified in the district court's opinion as its "Findings of Fact." Id. at 6; Doc. 11 at 4.

The bankruptcy court held a hearing on July 19, 2016. Doc. 20 (Tr.). After oral argument, the court granted the Secretary's motion. Tr. 83.9–.11. First, the court agreed that collateral estoppel applied to this case and accepted the district court's legal conclusions and factual findings. Id. at 46.3–47.5. With those factual and legal determinations at its disposal, the bankruptcy court turned to the question of whether Harris's actions constituted defalcation within a fiduciary relationship under section 523(a)(4) of the Bankruptcy Code.

First, the court determined that Harris had acted as a fiduciary under section 523(a)(4). Id. at 66.24–67.3. The bankruptcy court noted that in Hunter v. Philpott, 373 F.3d 873 (8th Cir. 2004), the U.S. Court of Appeals for the Eighth Circuit stated that ERISA fiduciaries are not *per se* section 523(a)(4) fiduciaries. Id. at 52.21–53.8. Nonetheless, the court held that Harris acted as a section 523(a)(4) fiduciary with respect to the health insurance premiums withheld from employee paychecks and used to pay corporate expenses. Id. at 66.24–67.3. The court recognized that, under ERISA, employee contributions are plan assets when they are withheld from employee paychecks. Id. at 66.6–.19. Because Harris exercised control over employee contributions to the Plan held in Faribault's general account, Harris undertook fiduciary obligations under ERISA to protect the Plan's assets in that account and to prevent their misuse. Id. at 51.19–67.3.

The court found that Harris's control over withheld employee contributions began well before his decision to divert those employee contributions to pay corporate expenses in late March 2009. Id. at 66.24–67.3. Thus, Harris had a statutory fiduciary obligation to protect Plan assets that arose before he diverted those assets to pay for corporate expenses, the act from which his ERISA Judgment Debt arose. Id. at 60.12–67.3. The court concluded that because he had control over Plan assets once the employee contributions were withheld from the

employee's payroll deductions, Harris was a fiduciary under section 523(a)(4). Id. at 65.17–67.3.

Finally, applying the Supreme Court's decision in Bullock v. BankChampaign NA, 133 S. Ct. 1754 (2013), the court determined Harris had committed defalcation under section 523(a)(4). Tr. 82.11–.25. Specifically, the court held that "several undisputed facts suggest that the Debtor was willfully blind to a substantial and unjustifiable risk that his conduct will turn out to violate a fiduciary duty, thereby qualify[ing] his conduct as defalcation under section 523(a)(4)." Id. at 69.13–.20. Those facts included: (1) Harris's authority and control over Faribault's bank accounts; (2) his signing of checks, including those that HealthPartners returned for insufficient funds; and (3) his decision to pay himself, Faribault, and other creditors instead of remitting to HealthPartners his employees' healthcare premiums withheld from their paychecks. Id. at 69.21–82.25. Therefore, "Harris exhibited a reckless and conscious disregard . . . [in] violat[ing] a duty of undivided loyalty to the plan[.]" Id. at 83.19–.24.

The bankruptcy court thus concluded Harris's ERISA Judgment Debt was nondischargeable under section 523(a)(4). Id. at 82.11–.25. Harris now appeals the bankruptcy court's decision to this Court.

SUMMARY OF THE ARGUMENT

1. The bankruptcy court properly applied the collateral-estoppel doctrine. The court relied on the doctrine of collateral estoppel solely to adopt the district court's factual and legal determinations in the Secretary's ERISA action against Harris. On appeal, Harris does not challenge the bankruptcy court's use of collateral estoppel for those purposes. Instead, he incorrectly argues the bankruptcy court relied on the district court's determination that he was an ERISA fiduciary who breached his fiduciary duties to automatically conclude he was also a fiduciary who had committed defalcation under 11 U.S.C. § 523(a)(4). To the contrary, the bankruptcy court specifically acknowledged that ERISA fiduciaries are not automatically section 523(a)(4) fiduciaries in the Eighth Circuit. Accordingly, the bankruptcy court considered the relevant bankruptcy case law interpreting the scope and nature of section 523(a)(4) fiduciaries and defalcation, and then applied that provision and its related case law to the undisputed facts. Based on its independent examination of the bankruptcy case law and its application, the bankruptcy court correctly decided that Harris: (1) was not only an ERISA fiduciary but also a fiduciary for bankruptcy purposes under 11 U.S.C. § 523(a)(4); and (2) had committed defalcation as defined by 11 U.S.C. § 523(a)(4) and the pertinent case law.

2. The bankruptcy court correctly concluded that Harris's ERISA Judgment Debt was nondischargeable under section 523(a)(4). The bankruptcy court correctly determined that Harris was a section 523(a)(4) fiduciary because he had a statutory fiduciary duty to remit employee contributions—the Plan's money—to HealthPartners, a duty that existed prior to his misappropriation of those funds. The bankruptcy court also correctly determined that Harris's breach of fiduciary duties constituted defalcation when he decided to pay corporate expenses and payments to himself, instead of remitting the employee contributions to HealthPartners, as he had done in the past.

ARGUMENT

In a Chapter 7 bankruptcy action, a court may not discharge "an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity." 11 U.S.C. § 523(a)(4). In the bankruptcy court below, the Secretary established the two elements necessary to show Harris's debt was nondischargeable under section 523(a)(4): (1) a fiduciary relationship existed between the Plan and Harris; and (2) Harris committed defalcation in the course of that fiduciary relationship. Jafarpour v. Shahrokhi (In re Shahrokhi), 266 B.R. 702, 707 (B.A.P. 8th Cir. 2001). Thus the bankruptcy court granted the Secretary's summary judgment motion and correctly declared Harris's ERISA Judgment Debt

nondischargeable. This Court now reviews the bankruptcy court's grant of summary judgment de novo. Id. at 706.

I. The Bankruptcy Court Properly Applied Collateral Estoppel

On appeal, Harris argues the bankruptcy court misapplied the collateral-estoppel doctrine to the issues of whether Harris was a section 523(a)(4) fiduciary, and whether he had committed "defalcation" under section 523(a)(4). Specifically, he contends that the bankruptcy court improperly determined Harris was a section 523(a)(4) fiduciary who committed defalcation by applying collateral estoppel to the district court's determination that Harris was an ERISA fiduciary who had breached his fiduciary duties, as "[t]he issue of fiduciary defalcation under § 523(a)(4) is not the same issue as breach of fiduciary duty under ERISA." Appellant's Br. 10–11.

The collateral-estoppel doctrine provides that "when an issue of ultimate fact has been determined by a valid and final judgment, that issue cannot again be litigated between the same parties in another lawsuit." United States v. Brekke, 97 F.3d 1043, 1049 (8th Cir. 1996). Five elements must be met for collateral estoppel to apply, but appellant's argument focuses on only one of them: whether "the issue sought to be precluded is the same as the issue involved in the prior action." Turner v. U.S. Dep't of Justice, 815 F.3d 1108, 1111 (8th Cir. 2016).

Appellant's argument constructs a strawman by misconstruing the bankruptcy court's analysis. Contrary to appellant's argument, the bankruptcy court clearly recognized that in the Eighth Circuit, an ERISA fiduciary is *not* automatically a fiduciary for purposes of the Bankruptcy Code. Tr. 52.21–.24. The bankruptcy court also recognized that a breach of ERISA fiduciary duties is not automatically defalcation under section 523(a)(4). Instead, the court specifically applied the defalcation standard articulated in Bullock.

Neither the Secretary nor the bankruptcy court used collateral estoppel to automatically establish fiduciary status or defalcation under section 523(a)(4) by virtue of Harris's ERISA fiduciary status and his breach of his ERISA fiduciary duties, as appellant now contends. See Doc. 12 at 3–6; Tr. 46.3–83.24. Indeed, appellant himself understands this—in his other two points on appeal, he challenges the court's application of the relevant bankruptcy case law to the facts in this case on the issues of Harris's fiduciary status and defalcation under section 523(a)(4).

The court examined all relevant case law, e.g., Hunter v. Philpott, 373 F.3d 873 (8th Cir. 2004), and Bullock, 133 S. Ct. at 1759–60. See Tr. 51.19–60.11. The court then applied the statute and case law to this case, ultimately determining Harris met the requirements of a section 523(a)(4) fiduciary. Id. at 60.12–67.3. The bankruptcy court also determined Harris's conduct constituted defalcation after

listing numerous instances of Harris's reckless and willful conduct. Id. at 67.4–82.25.

It is true that the bankruptcy court applied the collateral-estoppel doctrine to conclude that a number of factual and legal determinations made by the district court were binding, such as whether Harris was a fiduciary under ERISA and whether he breached his duties under ERISA. The parties also stipulated to the district court's findings of fact. These determinations are relevant but not dispositive to the bankruptcy court's ultimate holdings applying section 523(a)(4).

In fact, appellant relied heavily on the district court's factual findings and legal conclusions in his briefs below. See Doc. 11at 3–4, 8–10. He has not challenged the application of collateral estoppel in this case to the stipulated factual findings and the legal determinations concerning ERISA made by the district court. Appellant's Br. 8 (referencing "the undisputed facts of this case"). As a result, appellant has waived any challenge to the bankruptcy court's actual application of collateral estoppel or its use of the stipulated facts from the district court in this case. See Jenkins v. Winter, 540 F.3d 742, 751 (8th Cir. 2008) (issues not raised in opening brief are waived).

II. The Bankruptcy Court Correctly Concluded Appellant's Debt Is Nondischargeable under 11 U.S.C. § 523(a)(4).

Section 523(a)(4) provides that the Bankruptcy Code does not discharge any debt "for fraud or defalcation while acting in a fiduciary capacity[.]" 11 U.S.C.

§ 523(a)(4). Appellant challenges the bankruptcy court's rulings on the two components necessary for nondischargeability under section 523(a)(4): (a) whether Harris acted as a fiduciary under that provision, and (b) whether Harris committed defalcation. These challenges are meritless.

A. A Fiduciary Relationship Existed Between the Plan and Harris

The Eighth Circuit has held that a fiduciary relationship under section 523(a)(4) can arise only if the debtor was a fiduciary to an "express or technical trust" "imposed before and without reference to the wrongdoing that caused the debt." Tudor Oaks Ltd. P'ship v. Cochrane (In re Cochrane), 124 F.3d 978, 984 (8th Cir. 1997) (citation omitted). Generally, a fiduciary relationship and an "express or technical" trust under section 523(a)(4) can be created by statute or common law. See In re Thompson, 458 B.R. 504, 508 (B.A.P. 8th Cir. 2011); see also Arvest Mortg. Co. v. Nail (In re Nail), 680 F.3d 1036, 1040 (8th Cir. 2012); Barclays Am./Bus. Credit, Inc. v. Long (In re Long), 774 F.2d 875, 878 (8th Cir. 1985). To create such a fiduciary relationship, the "statutory trust must (1) include a definable res and (2) impose 'trust-like' duties." In re Nail, 680 F.3d at 1040 (citation omitted).

The Eighth Circuit has recognized that a statute may label a relationship as a "fiduciary" relationship that is "intrinsically more contractual than fiduciary." In re Nail, 680 F.3d at 1040. For example, parties may contractually agree to hold a

party liable as a "fiduciary" under a statute even if the statute itself does not impose upon him fiduciary duties over a trust. The Eighth Circuit has held section 523(a)(4) does not generally cover trusts "which the law implies from [a] contract." Id. at 1039. "It is the substance of a transaction, rather than the labels assigned by the parties, which determines whether there is a fiduciary relationship for bankruptcy purposes." In re Long, 774 F.2d at 878–79.

ERISA abounds with the language and terminology of trust law. Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110 (1989); see also CIGNA Corp. v. Amara, 563 U.S. 421, 439 (2011) (ERISA "typically treats" plan fiduciary "as a trustee"). ERISA governs and protects employee benefit plans, including the Plan here, by requiring that plan assets be held in trust and imposing fiduciary obligations on those who manage them. See 29 U.S.C. § 1103 ("all assets of an employee benefit plan shall be held in trust"); see also Prudential Ins. Co. of Am. v. Doe, 76 F.3d 206, 209 (8th Cir. 1996). ERISA also defines who acts as fiduciaries with regard to plan assets, as well as their attendant fiduciary obligations. See 29 U.S.C. §§ 1002(21)(A), 1104(a). ERISA imposes these duties to prevent fiduciary mismanagement, like Harris's diversion of Plan assets. Doe, 76 F.3d at 209.

It is undisputed that, under the governing ERISA regulation, when or shortly after Faribault withheld premiums from employee paychecks, those monies

became the Plan's assets to be held for the benefit of the Plan's participants. Withheld employee contributions become plan assets on the earliest date on which they can be segregated from the employer's general assets. See 29 C.F.R. § 2510.3-102(a), (c) (2010); Graphic Commc'ns Int'l. Union Upper Midwest Local 1M Health & Welfare Plan v. Bjorkedal, 516 F.3d 719, 733 (8th Cir. 2008). The district court found in this case that the withheld employee contributions became Plan assets "on the date on which the employees' wages were paid." Doc. 11, Ex. 3 at 23. The statute and regulations state that the failure to forward employee contributions to a plan as soon as they can be reasonably segregated from the employer's general assets constitutes a breach of fiduciary duty and violates ERISA's trust requirement. 29 U.S.C. § 1103; 29 C.F.R. § 2510.3-102 (2010); see generally 44 Fed. Reg. 50,363, 50,365 (Aug. 28, 1979); 53 Fed. Reg. 17,628, 17,629 (May 17, 1988); 61 Fed. Reg. 41,220, 41,227–28 (Aug. 7, 1996). ERISA requires fiduciaries like Harris, who control the distribution of their employees' hard-earned wages, to manage employees' money for the employees' exclusive benefit and not for other uses. See, e.g., LoPresti v. Terwilliger, 126 F.3d 34, 39 (2d Cir. 1997) (ERISA fiduciary violated loyalty duty by using withheld employee contributions to pay other corporate creditors).

Accordingly, bankruptcy courts in numerous jurisdictions have determined ERISA fiduciaries with control over withheld employee contributions to ERISA

plans are fiduciaries of "trusts" under section 523(a)(4), even if those contributions are held in a corporate account. This is because those withheld employee contributions are plan assets (a "definable res") subject to a statutory trust requirement and protected by ERISA's fiduciary obligations ("trust-like duties"). See Chao v. Gott (In re Gott), 387 B.R. 17, 22 (Bankr. S.D. Iowa 2008); Trs. of Colo. Ironworkers Pension Fund v. Gunter (In re Gunter), 304 B.R. 458, 461 (Bankr. D. Colo. 2003); Eavenson v. Ramey, 243 B.R. 160, 164, 166 (N.D. Ga. 1999); Morgan v. Musgrove (In re Musgrove), 187 B.R. 808, 814 (Bankr. N.D. Ga. 1995). This is consistent with the Bankruptcy Code's treatment of non-ERISA fiduciaries as trustees when they similarly fail to remit funds. See, e.g., Quaif v. Johnson, 4 F.3d 950, 954 (11th Cir. 1993) ("technical trust" exists under section 523(a)(4) when fiduciary has duty to remit funds to insurer but does not segregate those funds from other corporate assets prior to remittance).

Appellant erroneously states that Harris "did not become an ERISA fiduciary until he exercised discretion with respect to making the payments to Health Partners" by diverting employee contributions to pay corporate expenses in late March 2009. Appellant's Br. 13.[1] The district court, however, directly held to

[1] Harris misstates ERISA's definition of "fiduciary" under 29 U.S.C. § 1002(21)(A)(i). ERISA fiduciary status requires only an exercise of "authority or control" over plan assets, not "discretionary authority or control." See FirsTier Bank, N.A. v. Zeller, 16 F.3d 907, 911 (8th Cir. 1994).

the contrary. It found that Harris exercised control over plan assets from at least January 1, 2009, before he diverted any employee contributions. During the first quarter of 2009 at least, Harris had signatory authority over the general operating account in which Plan assets were held and had control over disbursements from that account, including the power to determine whether corporate expenses or healthcare premiums would be paid. Doc. 11, Ex. 3 at 23–25. The district court found that between January 1 and March 31, 2009, Harris decided if and when to remit withheld premium payments for January and February 2009, and he approved and signed the checks to HealthPartners for those months' premiums. Id.

As a result, from at least January 2009, Harris exercised control over Faribault's general operations account, including the withheld employee contributions in that account. With control over employee contributions, Harris was a fiduciary to those Plan assets. Consequently, Harris was a fiduciary under section 523(a)(4) before he decided to divert the contributions for corporate uses in late March 2009.

Appellant's reliance on Hunter is misplaced. As the bankruptcy court recognized, the Eighth Circuit stated in Hunter v. Philpott that an ERISA fiduciary is not "*ipso facto* a fiduciary for the purposes of § 523(a)(4)." 373 F.3d 873, 875 (8th Cir. 2004). In Hunter, the Eighth Circuit ultimately concluded the debtor, an ERISA fiduciary, was not a fiduciary under section 523(a)(4). Id. at 873.

However, Hunter involved different circumstances than here, as this case concerns the *employees'* own contributions to their plan, which were plan assets once withheld from their paychecks, upon which ERISA imposes trust and fiduciary requirements to protect against any misuse. In contrast, Hunter concerned the *employer's* contractual obligation to contribute the employer's funds to its employees' benefit plan. ERISA does not impose similar requirements on unpaid employer contributions in the employer's possession, which are usually not considered plan assets. See Brief for the Secretary of Labor as Amicus Curiae Supporting Debtor-Defendant-Appellee at 8–18, Rahm v. Halpin (In re Halpin), 566 F.3d 286 (2d Cir. 2009) (Nos. 07-3234-BK, 07-3206-BK) [hereinafter Halpin Br.], http://bit.ly/2cGlqja (discussing differing regulatory treatment of employee and employer contributions to ERISA plans).

In Hunter, the debtor owned a construction business that had signed a collective bargaining agreement ("CBA") with certain union benefit plans. 373 F.3d at 874. Under the CBA, the business agreed to make employer contributions to the benefit plans from the company's own accounts. Id. at 874–75. The business failed to make payments to the plans required under the CBA. Id. at 875. After the plans sued the business and the debtor for those unpaid contributions, the debtor, an officer of the business, filed for bankruptcy. Id. The plans filed an adversary proceeding against the debtor seeking section 523(a)(4)

nondischargeability of the unpaid employer contributions. Id. In deciding whether the employer contributions were nondischargeable, the Eighth Circuit "look[ed] specifically at the property that [wa]s alleged to have been defalcated to determine whether [the debtor] was legally obligated to hold that specific property for the benefit of the [plans]." Id.

Unlike employee contributions, ERISA generally does not make unpaid employer contributions plan assets until their remittance into the ERISA plan; thus such contributions are not subject to ERISA's fiduciary and trust requirements. See, e.g., Bjorkedal, 516 F.3d at 732–33 ("[c]orporate assets do not become plan assets merely because an employer has a corporate obligation to make payments to the plan"). Generally, "employer contributions become an asset of the plan only when the contribution has been made." Emp. Benefits Sec. Admin., U.S. Dep't of Labor, Field Assistance Bulletin 2008–1, at 1–2 (Feb. 1, 2008); see also U.S. Dep't of Labor, Advisory Op. No. 2005–08A (May 11, 2005); U.S. Dep't of Labor, Advisory Op. No. 93–14A (May 5, 1993). See generally Rahm v. Halpin (In re Halpin), 566 F.3d 286, 289 (2d Cir. 2009) (adopting the Secretary's position that the statute itself does not impose ERISA duties with respect to unpaid employer contributions).

Although ERISA itself does not subject unpaid employer contributions to its fiduciary or trust requirements, parties may supersede the general rule through

contract. See, e.g., ITPE Pension Fund v. Hall, 334 F.3d 1011, 1013–14 (11th Cir. 2003). In Hunter, the Eighth Circuit confronted a situation where the parties attempted to do so, and the plans argued the debtor had assumed ERISA fiduciary status under the contract. 373 F.3d at 875–76. The Eighth Circuit, however, determined the CBA did not expressly make any owed employer contributions plan assets before they were paid. See id. Thus the general rule applied, and the unpaid employer contributions were not subject to any statutory trust or fiduciary requirements; the debtor therefore did not assume any fiduciary duties with respect to the unpaid employer contributions. Id. Moreover, the CBA could not impose any fiduciary obligations on the individual debtor because he was not a party to the CBA. Id. at 876–77; cf. Raso v. Fahey (In re Fahey), 482 B.R. 678, 691 (B.A.P. 1st Cir. 2012) (contract imposed section 523(a)(4) fiduciary status over unpaid employer contributions).

As a result, the debtor's obligations in Hunter were "more contractual than fiduciary," and his "debt to the [plans] did not preexist the allegedly wrongful act complained of: that is, his failure to hold money to satisfy the business's owed contributions." Id. In other words, the debtor was not a section 523(a)(4) fiduciary because the only obligation (and breach) was his business's contractual obligation to pay the plan; the debtor had no preexisting fiduciary duty, statutory or

contractual, to set aside or protect certain funds to fulfill that contractual obligation.

In contrast, the withheld employee contributions in this case indisputably were Plan assets under the statute and applicable regulation (as the district and bankruptcy courts recognized), and thus were subject to the statutory trust and fiduciary requirements. See, e.g., Regulation Relating to Definition of "Plan Assets"—Participant Contributions, 61 Fed. Reg. 41,220-01, 41,222 (Aug. 7, 1996) (codified at 29 C.F.R. pt. 2510) ("employees who agree to deductions from their wages for contributions to a [welfare] plan are entitled to have the assurance that when the employer decides to purchase an insurance policy or medical services for the plan, it is acting as a fiduciary of the plan and is governed by the fiduciary standards of ERISA in so doing"); Halpin Br. 14–15 ("employee contributions are plan assets under the express terms of the Department's regulation, and the employer, therefore, breaches its fiduciary obligations by wrongfully diverting the plan's assets").

Further, Harris had fiduciary duties because he controlled these Plan assets. His obligation to remit funds to pay the HealthPartners premium was more than a mere "contractual obligation" because, being the individual with control over these withholdings, he was a fiduciary and had a corresponding statutory duty to protect all withheld employee contributions, because they were Plan assets, to ensure they

were used in the employees' exclusive interests. See 29 U.S.C. § 1002(21)(A) (defining "fiduciary" under ERISA). This duty existed when he made decisions with respect to the disposition of the contributions; he abided by that duty when he paid HealthPartners, but then breached it in late March 2009 when he diverted employee contributions for other purposes. This duty to protect the withheld employee contributions pre-existed his diversion of those contributions—as the district court held, Harris had this duty starting *at least* as early as January 2009.

In Navarre v. Luna (In re Luna), the U.S. Court of Appeals for the Tenth Circuit distinguished the contractual obligations surrounding employer contributions from the pre-existing trust and fiduciary requirements imposed on persons (like Harris) controlling employee contributions. 406 F.3d 1192, 1205 & n.6 (10th Cir. 2005); Bd. Trs. Ohio Carpenters' Pension Fund v. Bucci (In re Bucci), 493 F.3d 635 (6th Cir. 2007) (interpreting Hunter as rejecting § 523(a)(4) fiduciary status for employer contributions, not employee contributions); see also Cent. Laborers' Pension, Welfare & Annuity Funds v. Addison-Awalt Constr., Inc., CIV. No. 06-930-GPM, 2007 WL 4269260, at *1 (S.D. Ill. Nov. 19, 2007) (same). Following this reasoning, two bankruptcy courts in this Circuit have distinguished Hunter, concluding that a debtor whose defalcation involved *employee* and not *employer* contributions to ERISA plans was a section 523(a)(4) fiduciary. See In

re Gott, 387 B.R. at 23; IBEW Local 231 v. Pottebaum (In re Pottebaum), ADV. No. 11-9050, 2013 WL 5592368 (Bankr. N.D. Iowa Oct. 9, 2013).

B. Harris Committed Defalcation under Section 523(a)(4)

"Defalcation is defined as the misappropriation of trust funds or money held in any fiduciary capacity; [the] failure to properly account for such funds." In re Cochrane, 124 F.3d at 984. In Bullock, the Supreme Court clarified the "scienter" applicable to the term "defalcation" in section 523(a)(4). 133 S. Ct. 1754 (2013). The Court explained,

> where the conduct at issue does not involve bad faith, moral turpitude, or other immoral conduct, the term requires an intentional wrong. We include as intentional not only conduct that the fiduciary knows is improper but *also reckless conduct of the kind that the criminal law often treats as the equivalent*. . . . Where actual knowledge of wrongdoing is lacking, we consider conduct as equivalent if the fiduciary "consciously disregards" (or is willfully blind to) "a substantial and unjustifiable risk" that his conduct will turn out to violate a fiduciary duty. That risk "must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves *a gross deviation* from the standard of conduct that a law-abiding person would observe in the actor's situation."

Id. at 1759–60 (emphasis added) (citations omitted). On appeal, Harris challenges the bankruptcy court's conclusion that Harris had the requisite scienter.

The district court held Harris breached his fiduciary duty of loyalty when he "*deci[ded]* not to remit the employee withholdings to HealthPartners," and "instead us[ed] those assets to pay corporate creditors and personal expenses." See Doc. 11

Ex. 3 at 27–28 (emphasis added). The court found Harris knew of his obligation to remit the withheld contributions to HealthPartners at least by March 26, 2009, when he called HealthPartners seeking an extension to pay the withheld premiums. Despite this knowledge, he nonetheless chose to pay other corporate creditors and personal expenses instead of HealthPartners from March 26 to March 31, 2009. Id. at 28. When faced with a choice, Harris intentionally and wrongfully ordered Dorr to pay Harris's personal home equity line of credit. Harris took the employees' withheld money (which belonged to the Plan) and used it to pay his personal home equity obligation, among other things, rather than the Plan's overdue health insurance premiums, causing losses to the Plan and exposing participants to personal liability for any health expenses they incurred.

Such acts constitute an intentional misappropriation of trust funds, or at the least, a misappropriation of trust funds undertaken with conscious disregard to the substantial and justifiable risk that doing so would result in a breach of fiduciary duty of loyalty, when simply paying HealthPartners instead of other corporate expenses would have fulfilled that duty. See Stoughton Lumber Co. v. Sveum, 787 F.3d 1174, 1177 (7th Cir. 2015) (defining "gross recklessness" under Bullock as "knowing that there is a risk of serious harm and that it can be averted at reasonable cost, yet failing to act on that knowledge"). In other words, Harris committed defalcation as that term is used in section 523(a)(4) when he knowingly

failed to remit employee contributions to HealthPartners and instead knowingly used those funds to pay for other corporate expenses. The bankruptcy court correctly reached this conclusion by cataloguing Harris' intentional and reckless actions when dealing with employee contributions.

In a post-Bullock case, the Bankruptcy Court for the District of Massachusetts came to the same conclusion under parallel circumstances. In Raso v. Fahey (In re Fahey), the court concluded a debtor had committed defalcation when he violated his duty of loyalty to an ERISA plan. 494 B.R. 16 (Bankr. D. Mass. 2013). The court explained,

> The Debtor does not dispute that he was aware of his obligations to the Funds, but nonetheless failed to remit the assets. Instead, the undisputed facts indicate that the Debtor prioritized the payment of corporate expenses that were beneficial to him . . . over his obligations to the Funds. In so doing, he violated the duty of loyalty to the beneficiaries of the Funds[, and also] . . . committed a defalcation within the meaning of 11 U.S.C. § 523(a)(4).

Id. at 21–23 (footnote omitted).

Like the debtor in Fahey, Harris knew he had an obligation to remit the withheld employee contributions to HealthPartners, but he instead chose to prioritize payments of corporate expenses and creditors, and payments to himself. Harris thus committed defalcation when he paid other corporate and personal expenses instead of remitting the withheld employee contributions to HealthPartners.

CONCLUSION

Based on the foregoing, the Secretary respectfully requests that this Court affirm the bankruptcy court's judgment.

Respectfully Submitted,

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Dated: September 30, 2016

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/s/ Eirik Cheverud

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Dated: September 30, 2016

CERTIFICATE OF SERVICE

I hereby certify that on the 30th day of September, 2016, I electronically filed the Brief for Amicus Curiae, Thomas E. Perez, U.S. Secretary of Labor, with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to all registered counsel of record.

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