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2009 Volume I No. 41

Discharge Under the Code for ERISA "Fiduciaries"

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The Bankruptcy Code ("Code") provides debtors with relief from many of their outstanding debts. However, even under the broad protection of the Code, some debts cannot be erased. Pursuant to section 523(a)(4) of the Code, an individual debtor may not discharge any debt for fraud or defalcation (unauthorized appropriation of money) while acting in a fiduciary capacity. 11 U.S.C. § 523(a)(4). The federal courts are currently split on the issue of whether a debtor who qualifies as a "fiduciary" under the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1132 *et seq,* ("ERISA") will also qualify as a fiduciary under the Code.

At stake in two recent cases was the status of a corporate officer's liability where employee benefit fund contributions withheld by the corporate employer were not remitted to the respective union pension and welfare funds prior to the corporation's bankruptcy. In *Trustee of Iron Workers v. Mayo (In re Mayo*), 2007 Bankr. Lexis 3197 (D. Vt. Sept. 17, 2007), the Vermont Bankruptcy Court sided with those courts finding that being an ERISA fiduciary makes a debtor a fiduciary under the Code. As a result, the owner of a steel erection company, when declaring personal bankruptcy, was barred from discharging the $181,000 debt his company owed under a collective bargaining agreement to the employee benefit funds. Meanwhile, the Sixth Circuit held the opposite in *Bd. of Trustees of the Ohio Carpenters' Pension Fund v. Bucci (In re Bucci*), 493 F.3d 635 (6th Cir. 2007), *cert. denied,* 128 S. Ct. 2903 (2008), permitting a company president to discharge liability for the debt his company owed to a multiemployer

Cite as: *Discharge Under the Code for ERISA "Fiduciaries"*, 1 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 41, at 1 (2009), http://www.stjohns.edu/academics/graduate/law/journals/abi/sjbrl_main/volume/v1/Sullivan.stj (follow "View Full PDF").

pension fund, ruling that the president's status as an ERISA fiduciary was not sufficient to trigger the Code's bankruptcy discharge exception. The split in authority comes down to the differences between the ERISA and Code definitions of "fiduciary." While ERISA uses a functional test to determine whether a relationship is fiduciary, the Code employs a formal test that asks whether a fiduciary relationship was explicitly agreed upon between the creditor and party in bankruptcy. Those jurisdictions that have precedent building upon a narrow construction of the Code's term "fiduciary capacity" are unable to reconcile ERISA's functional definition of fiduciary with their prior decisions. However, other jurisdictions are not so constrained by prior opinions and have easily found that an ERISA fiduciary satisfies the requirements of the Code's exception to discharge provision. The following discussion traces the reasoning in *Bucci* and *Mayo*, further discusses the reasons for the split in authority, and provides advice for practitioners going forward.

In re Bucci – ERISA Fiduciary is Not a Fiduciary Under the Code

In February 2003, Charles Bucci, the president and sole shareholder of Floors by Bucci, Inc. signed a collective bargaining agreement ("CBA") with the Northeast Ohio Carpenters union. As part of that agreement, Bucci was required to make monthly contributions to certain pension, hospitalization, and annuity funds ("Funds"), and make other withholdings from employees' wages. In January 2005, Bucci filed for Chapter 7 bankruptcy and scheduled for discharge a $99,000 debt to the Funds for unpaid employer contributions. Shortly thereafter, the Funds sued Bucci for these unpaid contributions, arguing that these debts were not dischargeable under § 523(a)(4). The bankruptcy court found that Bucci's unpaid employer contributions were dischargeable because Bucci did not act as a fiduciary of the contributions. The court held "that a

defalcation is limited to situations where the parties to a creditor relationship intend for the debtor to act as a trustee of the monies owed." *In re Bucci,* 493 F.3d at 638; *see Bd. of Trustees of the Ohio Carpenters' Pension Fund v. Bucci*, 351 B.R. 876 (N.D. Ohio 2006). The bankruptcy court concluded that Bucci merely had a contractual obligation to pay the benefit contributions, and that because there was no evidence that Bucci acted as a trustee, Bucci did not maintain a fiduciary relationship with the Funds. Hence, Bucci could discharge the unpaid funds' contributions in bankruptcy. The case was appealed to the Sixth Circuit, which upheld the bankruptcy court's decision based on a precedent of narrow construction of the term "fiduciary capacity" within the Code.

In upholding the bankruptcy court's decision, the Sixth Circuit explained that a debt is nondischargeable as a defalcation when three elements are met: (1) a preexisting fiduciary relationship exists between the parties; (2) there is a breach of that fiduciary relationship by one of the parties; and (3) one of the parties to the relationship suffers a resulting loss. The Sixth Circuit did not find that a fiduciary duty existed in *Bucci,* so only the first element was discussed in detail. In determining whether a fiduciary relationship was present, the court explained that the Sixth Circuit narrowly construes the term "fiduciary capacity" found in § 523(a)(4) and has limited the defalcation provision to express or technical trusts, while refusing to extend its application to constructive or implied trusts. *See Bucci,* 493 F.3d at 639; *see also In re Interstate Agency*, 760 F.2d 121, 125 (6th Cir. 1985). Typically, to create a trust, a creditor must demonstrate the existence of an intent to create a trust, a trustee, a trust *res* (property for which a trustee is responsible), and a definite beneficiary. However, there is a special analysis used to determine if a statute, such as ERISA, creates a trust. For an express or technical trust to be established under a statute, (1) the statute must define the trust *res*; (2) the statute must impose

duties on the trustee; and (3) those duties must exist prior to any wrongdoing. *Bucci,* 493 F.3d at 639. In its analysis, the Sixth Circuit rightly breaks the second prong into two parts, asking not only if duties were imposed on Bucci, but also whether Bucci was indeed a trustee.

The Funds unsuccessfully argued that ERISA created an express trust between the Fund and Bucci for the purposes of § 523(a)(4). First, the Funds contended that the employer contributions, explicitly defined under ERISA as plan assets, were the trust *res*. Second, according to the Funds, ERISA imposed duties on Bucci. Specifically, Bucci was required to hold the plan assets for the benefit of his employees. Furthermore, the Funds argued that Bucci was a trustee under ERISA because he exercised control over the fund contributions by choosing not to pay them to the funds. For the third prong, the Funds relied on the fact that ERISA required Bucci to hold the plan assets for the benefit of his employees, implicitly arguing that Bucci's ERISA obligations arose prior to wrongdoing.

Thus, the Funds argued being an ERISA fiduciary should qualify as "fiduciary capacity" under the Code. Citing to the Sixth Circuit itself, the Funds claimed that established case law defines a "fiduciary" under ERISA to include a person "who exercises discretionary control or authority over a plan's management, administration, or assets." *See Moore v. LaFayette Life Ins. Co.,* 458 F.3d 416, 438 (6th Cir. 2006). Bucci's exercise of control, claimed the Funds, was enough to create a fiduciary duty under ERISA. For the final step, the Funds cited to the Ninth Circuit and federal bankruptcy courts in New York, New Hampshire, and Georgia that have held that being a fiduciary under ERISA law satisfies the fiduciary capacity element of § 523(a)(4). *See Bucci,* 493 F.3d at 640–41; *see also Blyler v. Hemmeter (In re Hemmeter*), 242 F.3d 1186, 1190 (9th Cir. 2001); *Chao v. Duncan (In re Duncan*), 331 B.R. 70, 82 (E.D.N.Y.2005); *Weaver*

v. Weston (In re Weston), 307 B.R. 340, 343 (D.N.H.2004); *Morgan v. Musgrove (In re Musgrove),* 187 B.R. 808, 814 (N.D.Ga.1995).

The Sixth Circuit agreed with the Fund that a trust might indeed be created by statute, but disagreed that Bucci being a fiduciary under ERISA created the express or implied trust that the Code's definition of "fiduciary capacity" requires. The court found that ERISA's definition of who may be considered a fiduciary as one "who exercises discretionary control" was too broad and could not be reconciled with the court's tradition of narrow construction of the Code's term "fiduciary capacity." The Sixth Circuit had repeatedly construed "fiduciary capacity" of § 523 more narrowly than the common law definition of fiduciary relationship. Yet, the definition of a fiduciary under ERISA "is broader than the common law definition, and does not turn on formal designations such as who is the trustee." *Bucci,* 493 F.3d at 641–642. *See Smith v. Provident Bank*, 170 F.3d 609, 613 (6th Cir. 1999); *R.E. America, Inc. v. Garver (In re Garver),* 116 F.3d 176, 178 (6th Cir. 1997) Thus, the court preferred to "examine the substance of the alleged fiduciary relationship to determine if the requirements for a defalcation are satisfied." *Id.* at 642. To aid in its determination of whether Bucci was indeed a fiduciary, the Sixth Circuit gleaned a final piece of doctrine from its prior case law. In two prior cases finding that requisite trust relationships could be based upon a statute, the trust at issue existed separate and prior to the act creating the debt and independent of any contractual obligation to make payment. *See Id.* at 642; *see also Capitol Indemnity Corp. v. Interstate Agency, Inc. (In re Interstate Agency),* 760 F.2d 121 (6th Cir.1985); *Carlisle Cashway, Inc. v. Johnson (In re Johnson),* 691 F.2d 249 (6th Cir.1982). Turning to the facts, the Sixth Circuit found that the trust, alleged by the Funds, established between Bucci and the Fund under ERISA did not satisfy the narrow definition of "fiduciary capacity" found in the defalcation provision of § 523(a)(4) under the Code.

In holding that Bucci could discharge the unpaid fund contribution, the court focused on two points. The court first assumed *arguendo* that Bucci became a fiduciary under ERISA when he exercised control over the plan assets in making the decision not to remit the contribution payments. Second, Bucci's decision to not remit payment created the debt Bucci sought to discharge under the Code. Thus, reasoned the court, because the alleged fiduciary relationship did not preexist the debt, there was no preexisting trust relationship to satisfy § 523(a)(4). In explaining the fatal flaw in the Fund's reasoning the court stated,

> [I]f an employer failing to pay contributions becomes an ERISA fiduciary only after the contributions are due, then the trust relationship springs from the act from which the debt arose. Such a trust relationship does not create an express or technical trust for the purposes of § 523(a)(4).

Bucci, 493 F.3d at 643. Since the court found that Bucci was not a fiduciary, the court stylized Bucci's obligation to the Fund as merely contractual. Merely contractual obligations to pay do not satisfy the exception to discharge of debts in bankruptcy found in § 523 because there is no formal trust agreement. For these reasons, the Sixth Circuit held that Bucci could discharge the debt of unpaid employer fund contributions in bankruptcy.

***In re Mayo* – ERISA Fiduciary is a Fiduciary Under the Code**

In April of 2002, Theodore Mayo, Sr. on behalf of his company, Superior, signed a collective bargaining agreement with Local 474 of the International Association of Bridge, Structural, Ornamental, and Reinforcing Iron Workers union. The agreement required Mayo to pay, in addition to wages to covered employees, benefits to health and pension funds ("Fund"). Soon after, Mayo created Super Lift Crane Rentals, an alter ego company to Superior in an effort to avoid obligations under the CBA. Shortly thereafter, the Funds sued Mayo, Superior, and

Super Lift for violations of the CBA, including unpaid fund contributions. In February 2004, Super Lift filed for bankruptcy.

The Vermont Bankruptcy Court, although reaching the opposite conclusion as *Bucci*, followed the Sixth Circuit's framework to determine whether Mayo's relationship with the Fund fell within the discharge exception of § 532(a)(4). According to the Vermont court, first the debt must have resulted from an express or technical trust; second, the debtor must have acted in a fiduciary capacity with respect to the trust; and third, the transaction in question must have been a defalcation within the meaning of bankruptcy law. *Mayo,* 2007 Bankr. Lexis 3197, at *20–21 (citations omitted). The *Bucci* court considered the first and second prongs together under the question of whether there was a preexisting fiduciary duty. In *Mayo*, the court analyzed these two findings out separately. What follows is the *Mayo* court's discussion of the first and second prongs of the test.

First, the Vermont court found that ERISA created an express trust between the Fund and Mayo. Citing *Bucci,* the Vermont court posited that a statute may create a trust for purposes of § 523(a)(4). For a statutory trust to exist, it must be established that (1) the property was entrusted to a trustee; (2) the statute creates or identifies a fiduciary duty; and (3) the trust was in place when the defalcation giving rise to the debt occurred. *Mayo,* 2007 Bankr. Lexis 3197, at *20–21. This framework is identical to that of the *Bucci* court.

The Vermont court quickly moved through the first prong of the test. The court found the CBA that Mayo signed established Mayo's obligation to contribute payments (property) to the union health and pension funds. These funds clearly fell under ERISA covered "employee welfare benefit plans." Thus, the CBA was found to be an ERISA covered plan and the court

found there was an express or technical trust to satisfy the first prong on the dischargeability test. The court moved on the second prong of the test.

As to the second prong, the court found that Mayo served in an ERISA fiduciary capacity, which satisfied the requirements of being a fiduciary under the Code. The court split the discussion of the second prong into two parts: (1) did Mayo act as a fiduciary under ERISA; and (2) if so, is an ERISA fiduciary also a fiduciary under § 523(a)(4). For the first part of the second prong, the court distinguished a fiduciary under federal law from the "broad, general definition of fiduciary, involving confidence, trust and good faith" which the court explained is not applicable under the Code. *Mayo,* 2007 Bankr. Lexis 3197, at *23. The court explained that a fiduciary under ERISA exercises "discretionary authority or discretionary control" in respect to management of a covered employee benefit plan or "exercises any authority or control respecting management or disposition of its assets," or "has any discretionary authority or discretionary responsibility in the administration of the plan." *Mayo,* 2007 Bankr. Lexis 3197, at *23–24. *See also* 11 U.S.C. § 1002(21)(A). According to the Supreme Court, this definition is viewed "not in terms of formal trusteeship, but in functional terms of control and authority under the plan." *See Mertens v. Hewitt Assocs.,* 508 U.S. 248, 262 (1993). Turning to the facts, the court examined Mayo's affidavit to determine his responsibilities and obligations under the CBA. As head of Superior, Mayo was responsible for deciding what bills to pay, and Mayo admitted that he was in control of Superior's pension plan. The court found these two admissions established Mayo's discretionary authority and responsibility in the administration of the plan, which was sufficient to support a finding that he acted in a fiduciary capacity under ERISA with respect to the Fund. Having found Mayo was a fiduciary under ERISA, the court next considered whether this alone would satisfy the requirements of the Code.

In deciding whether an ERISA fiduciary satisfies the "fiduciary capacity" provision of the Code, the *Mayo* court considered court decisions on both sides of the split in authority, including *Bucci.* The *Mayo* court chose to follow the courts that in essence held, "where the debt arises from an ERISA fiduciary acting in his or her fiduciary capacity under the statute, then Section 523(a)(4)'s requirement that the debtor acted in a fiduciary capacity will be met." *Mayo,* 2007 Bankr. Lexis 3197, at *26. *See Chao v. Duncan (In re Duncan),* 331 B.R. 70, 82 (E.D.N.Y. 2005). In regards to Mayo's duties responsibilities, the court pointed out that Mayo was, in addition to serving as president of Superior, secretary and director of that company and was in control of the employee pension plans and had discretionary authority in the administration of these plans at Superior. Applying this rationale to the facts in *Mayo,* the court found that Mayo,

> served in an ERISA fiduciary capacity with regard to the Funds and . . . considering [Mayo's] control and authority over the plan in functional terms, the Court therefore finds that he also acted in a fiduciary capacity for purposes of § 532(a)(4).

Mayo, 2007 Bankr. Lexis 3197, at *28. Thus, the court in *Mayo* dispensed with the narrow construction of "fiduciary capacity" in favor of a more lenient functional test to permit an ERISA fiduciary to satisfy the dischargeability provision of the § 523(a)(4). The Vermont Court went on to find that Mayo's actions were indeed a defalcation and thus the unpaid Funds' contributions were not a dischargeable debt under the Code.

Reasons for the Split in Authority and Practice Tips

At its root, the split in authority in the above cases comes down to court leanings regarding formal or functional tests for determining fiduciary status under the Code. The *Mayo* court, although following the same analysis found in *Bucci,* was at ease expanding ERISA's definition of fiduciary to satisfy the Code's requirements. Meanwhile, the Sixth Circuit has an

undeniable tradition of narrow construction of Code terms found in § 523. Going forward, prudent practitioners crafting collective bargaining agreements within Sixth Circuit jurisdiction will be wise to explicitly establish an agreement of trust between employers and their employee pension and health funds. Specifically, an ideal contract would declare unpaid employer contributions as assets of the Funds. This explicit language in the agreement would from the outset establish a fiduciary relationship between the Funds and a contributing employer.

Conclusion

Although the Supreme Court has denied certiorari for *Bucci*, the issues above continue to divide the courts across America, as the *Bucci* and *Mayo* decisions illustrate. It will be interesting to see if the current economic climate influences the courts to take a more lenient or more strict view of what constitutes a fiduciary relationship in order to safeguard pension and health fund monies from employer misuse.

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