No. 17-1261

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

U.S. Department of Labor,
Plaintiff-Appellee,

v.

Michael P. Harris,
Defendant-Appellant.

On Appeal from the U.S. Bankruptcy Appellate Panel
for the Eighth Circuit

APPELLEE'S BRIEF

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APPELLEE'S SUMMARY OF THE CASE

On November 9, 2015, the U.S. District Court for the District of Minnesota issued a decision in favor of the U.S. Department of Labor and against debtor-appellant Michael Harris. The district court concluded that Harris violated his fiduciary duty of loyalty under the Employee Retirement Income Security Act of 1974 ("ERISA") when he decided to use the money withheld from his employees' paychecks, meant to pay the premiums for their health insurance, to instead pay himself and corporate expenses. The district court found Harris liable for $67,839.60 in his employees' withheld but unpaid premium payments, plus prejudgment interest. Harris did not appeal the judgment.

Instead, two weeks later, Harris filed a Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the District of Minnesota, listing the November 9, 2015 judgment as a dischargeable debt. The U.S. Secretary of Labor ("Secretary") filed an adversary proceeding, arguing that the November 9, 2015 judgment was nondischargeable under 11 U.S.C. § 523(a)(4) because it arose from "defalcation while acting in a fiduciary capacity." The bankruptcy court agreed with the Secretary and granted his motion for summary judgment. On appeal, the U.S. Bankruptcy Appellate Panel for the Eighth Circuit agreed with the Secretary and affirmed the bankruptcy court's decision. This appeal now follows. The Secretary respectfully requests 15 minutes for oral argument.

APPELLEE'S STATEMENT OF ISSUES PRESENTED

1. Whether the bankruptcy court and the bankruptcy appellate panel correctly determined that appellant acted in a fiduciary capacity under 11 U.S.C. § 523(a)(4), when Harris had a fiduciary responsibility for ERISA plan assets withheld from his employees' paychecks that preexisted his diversion of those assets to pay himself and other corporate expenses?

Apposite Cases:
Tudor Oaks Ltd. P'ship v. Cochrane (In re Cochrane), 124 F.3d 978, 984 (8th Cir. 1997);
Chao v. Gott (In re Gott), 387 B.R. 17 (Bankr. S.D. Iowa 2008);
Trs. of Colo. Ironworkers Pension Fund v. Gunter (In re Gunter), 304 B.R. 458 (Bankr. D. Colo. 2003);
Eavenson v. Ramey, 243 B.R. 160 (N.D. Ga. 1999).

2. Whether the bankruptcy court and the bankruptcy appellate panel correctly determined that appellant committed defalcation when he decided to use plan assets withheld from his employees' paychecks to pay himself and other corporate expenses instead of remitting those assets to his employees' health insurance provider, as required by ERISA and his employees' health plan?

Apposite Cases:
Bullock v. BankChampaign, N.A., 133 S. Ct. 1754 (2013);
Raso v. Fahey (In re Fahey), 494 B.R. 16 (Bankr. D. Mass. 2013);
United States v. Van Elsen, 652 F.3d 955 (8th Cir. 2011).

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"). J.A. at 602 (Statement of Uncontested 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. The Plan was solely funded by contributions from the employee-participants. Id. at 603, ¶ 14. Participants paid 100% of all premiums owed by the Plan to HealthPartners; the employer, Faribault, did not contribute any money to the Plan. Id. Faribault withheld the 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. J.A. at 620–22 (District Court Decision), ¶¶ 23–25. Harris's approval was thus necessary to remit employee contributions to HealthPartners. Id. at 635–37, ¶¶ 13–16. Indeed, Harris

signed the checks Faribault sent to HealthPartners to pay the Plan's insurance premiums on behalf of the employees. See id. at 606–07, ¶¶ 24–25, 29.

In 2008, Faribault began having difficulty remitting timely premium payments to HealthPartners. J.A. at 606–09, ¶¶ 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. at 606, ¶ 22. Gary Glienke, Faribault's Vice President of Human Resources, received each late-payment notice and would inform Harris about it. Id. at 602, 606, ¶¶ 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; Faribault was able to later remit full payment on both occasions, thereby preventing a loss of the Plan's insurance coverage. Id. at 606–07, ¶ 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. J.A. at 607, ¶ 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,

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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. J.A. at 607, ¶ 29. HealthPartners returned the February 27 check to Faribault. Id. at 607–08, ¶ 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-funds checks it had received. Id. at 602, 607–08, ¶¶ 4, 30.

On March 26, 2009, Harris personally called HealthPartners and asked for an extension to pay the January and February 2009 premiums. J.A. at 608, ¶ 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. at 612, ¶ 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 debts.

J.A. at 610, ¶¶ 54–55. In February 2009, Faribault paid $324,686.83 from its general operations account for other corporate expenditures. Id.

In March 2009, Faribault paid $246,240.52 from its general operations account to pay other corporate creditors. J.A. at 610, ¶¶ 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. at 611, ¶ 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 Harris 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. at 612, ¶ 61.

B. The U.S. District Court Determined Harris Violated ERISA and Is Liable to the Plan for the Losses He Caused It to Suffer

On December 19, 2012, the Secretary filed a complaint against Harris in the U.S. District Court for the District of Minnesota ("district court"), alleging he violated ERISA by failing to remit the $55,040.61 in withheld employee earnings to pay the Plan's healthcare premiums to HealthPartners. Complaint, Perez v. Harris, No. 12-cv-3136 (D. Minn. Dec. 19, 2012) (Doc. 1). Among other claims, the Secretary alleged that, by failing to remit the withheld premiums, Harris

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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.

On November 9, 2015, after a three-day bench trial, see J.A. at 30–601, the district court issued a judgment in the Secretary's favor, concluding that 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, id. at 613, 643.

The district court first determined Harris acted as an ERISA fiduciary in relation to his employees' withheld but unremitted contributions to the Plan to pay their health insurance premiums. J.A. at 637. 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 636. The court then found that Harris exercised authority or control respecting the management or disposition of those plan assets, id. at 635–37, 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. J.A. at 635. Harris also signed the checks to HealthPartners. Id. Moreover, when Glienke brought HealthPartners's past-due notices to Harris's attention, Harris asked Glienke to try

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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." J.A. at 636–37. 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 637.

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 639. 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 640.

> 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

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> 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"). J.A. at 641–43. Harris did not appeal that judgment.

C. The Bankruptcy Court Determined Harris's ERISA Judgment Debt Is Nondischargeable under 11 U.S.C. § 523(a)(4)

On November 23, 2015, Harris filed a Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the District of Minnesota ("bankruptcy court"). 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 a determination that his $67,839.60 judgment debt was nondischargeable pursuant to 11 U.S.C. §§ 523(a)(4) and 727. J.A. at 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

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capacity," based on those factual and legal determinations. See 11 U.S.C. § 523(a)(4); J.A. at 648. For summary judgment purposes, the parties stipulated to sixty-two uncontested facts identified in the district court's opinion as its "Findings of Fact." J.A. at 658.

The bankruptcy court granted the Secretary's motion for summary judgment. J.A. at 718. First, the court agreed that collateral estoppel applied to this case and accepted the district court's legal conclusions and factual findings. Id. at 709. The bankruptcy court then turned to the question of whether Harris's actions constituted defalcation within a fiduciary relationship under section 523(a)(4) of the Bankruptcy Code.

The bankruptcy court held that Harris acted as a section 523(a)(4) fiduciary with respect to the health insurance premiums withheld from employee paychecks. J.A. at 714. The court recognized that, under ERISA, employee contributions become plan assets when they are withheld from employee paychecks. Id. Because Harris exercised control over employee contributions to the Plan held in Faribault's general account, Harris exercised control over plan assets and thereby became a fiduciary with obligations under ERISA to protect the Plan's assets in that account and to prevent their misuse. Id. at 710–14.

The bankruptcy court also found that Harris's control over withheld employee contributions began well before his decision to divert those employee

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contributions to pay corporate expenses in late March 2009. J.A. at 714. Thus, Harris had a statutory fiduciary obligation to protect the Plan assets before he decided to violate his fiduciary duties and divert those assets to pay for his own and corporate expenses, the act from which his ERISA Judgment Debt arose. Id. at 712–14.

Finally, applying the Supreme Court's decision in Bullock v. BankChampaign NA, 133 S. Ct. 1754 (2013), the bankruptcy court determined Harris had committed defalcation under section 523(a)(4). J.A. at 718. 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 714. 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 the employees' own paychecks. Id. at 714–18. Therefore, "Harris exhibited a reckless and conscious disregard . . . [in] violat[ing] a duty of undivided loyalty to the plan[.]" Id. at 718.

The bankruptcy court thus concluded Harris's ERISA Judgment Debt was nondischargeable under section 523(a)(4). J.A. at 718.

D. The Bankruptcy Appellate Panel Affirmed the Bankruptcy Court's Decision

Harris appealed the bankruptcy court's decision to the U.S. Bankruptcy Appellate Panel for the Eighth Circuit ("BAP Court"). J.A. at 719. After briefing and oral argument, the BAP Court agreed with and affirmed the bankruptcy court's decision on January 6, 2017. Id. at 723–24.

The BAP Court first determined that money withheld from employee paychecks constituted a trust res, as "Faribault was holding funds that actually belonged to someone else . . . and it had a duty to use the employees' money to make the premium payments." J.A. at 732–33. In so doing, the BAP Court, like the bankruptcy court, noted a distinction between cases involving unpaid employer contributions to ERISA plans, which do not typically constitute a trust res, and cases involving withheld but unremitted employee contributions to ERISA plans, which do constitute a trust res because they are plan assets as a matter of law. Id. at 731–33. Consistent with this distinction, the court held that "this case fits squarely with those cases holding that a trust is created when the employer withholds wages for payments to a plan providing benefits to employees." Id. at 733 & n.23 (citing supporting caselaw).

Second, the BAP Court determined Harris had a fiduciary relationship to the trust res that preexisted his defalcatory act. J.A. at 736. The court noted that Harris had fiduciary duties to the Plan and its assets "throughout the period in

which the funds withheld from wages were not remitted to HealthPartners," as his authority over management or disposition of those plan assets "existed throughout" that time. Id. at 735. The court explained, "[Harris] was the person who had ultimate responsibility to determine which bills would be paid out of the company's scarce resources, and he exercised that authority to his own benefit." Id. at 736. Harris thus had a preexisting fiduciary duty to the funds withheld from his employees' paychecks, which constituted a statutorily defined trust res. Id. As a result, he "act[ed] in a fiduciary capacity" as that phrase is used in section 523(a)(4). See id.

Third, the BAP Court determined Harris acted with sufficient scienter to come under the meaning of defalcation, which requires that the debtor act either intentionally or with gross recklessness. J.A. at 741 & n.36. The court explained that "[b]etween March 26 and 31, [Harris] knew that more than $55,000 of the funds in Faribault's operating accounts were withheld from employee wages and did not belong to the company—yet, [Harris] chose to use those funds to pay personal and corporate expenses." Id. at 739. The court further explained that, "[b]ased on [those] undisputed facts, and based on [Harris's] failure to offer a justifiable reason for his decision not to use the remaining funds for the benefit of the employees for whom they were held in trust, the Bankruptcy Court properly concluded" that Harris acted with conscious disregard to a substantial and

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unjustifiable risk that his conduct would violate a fiduciary duty. Id. at 741. The BAP Court therefore affirmed the bankruptcy court's holdings that Harris committed defalcation while acting in a fiduciary capacity and that his ERISA Judgment Debt was consequently nondischargeable under section 523(a)(4). Id. at 742.

Harris now appeals to this Court. J.A. at 743.

SUMMARY OF THE ARGUMENT

Harris's ERISA Judgment Debt is nondischargeable in his Chapter 7 bankruptcy because that debt arose from his "defalcation" of ERISA plan assets while acting as a "fiduciary" to the ERISA plan within the meaning of 11 U.S.C. § 523(a)(4).

1. The bankruptcy court and the BAP Court correctly determined that Harris was "acting in a fiduciary capacity" as that phrase is used in section 523(a)(4). First, "acting in a fiduciary capacity" requires the debtor to have a fiduciary relationship to an express or technical trust. A statute can establish the "fiduciary relationship to a trust" requirement when the statute creates a definable trust res and imposes trustee-like responsibilities for the res on the debtor. Here, the withholdings from employee paychecks became plan assets under ERISA on the date the paychecks were issued, and those plan assets constituted a trust res because ERISA subjects all plan assets to a trust requirement. Furthermore,

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because ERISA imposed trustee-like fiduciary duties on Harris based on his control over how that trust res was used, he had a statutorily-created fiduciary relationship and accompanying fiduciary duties to that trust res and its beneficiaries.

Harris does not contest these conclusions on appeal. Instead, Harris makes three narrow arguments in favor of reversal. First, he argues that he was not a "fiduciary" until the "wrongful" act of misusing employee contributions occurred in late March 2009, so that his fiduciary status did not predate the defalcation as is required under section 523(a)(4). Harris's argument directly contradicts the district court's factual findings, binding here based on collateral estoppel, that Harris had fiduciary and trustee-like duties to the premiums withheld from employee paychecks at least as early as January 2009 and through the time he committed the defalcatory acts in late March 2009.

Second, Harris argues he is not "personally" liable as a fiduciary under section 523(a)(4) because he acted as a corporate officer when he exercised authority over plan assets. This argument fails, as ERISA imposes fiduciary duties on any *individual* to the extent he exercises authority or control over plan assets. Further, courts have similarly construed section 523(a)(4) in other contexts to apply to corporate officers who are personally entrusted with fiduciary obligations over a trust res by a statute.

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Harris's third argument—that this Court should reverse the bankruptcy court's and BAP Court's decisions based on Hunter v. Phillpott, 373 F.3d 873 (8th Cir. 2004)—is equally unavailing. Hunter involved unremitted *employer* contributions to an ERISA plan, which are not plan assets subject to ERISA's trust requirements, unlike the unremitted *employee* contributions here, which are plan assets subject to ERISA's trust requirements as a matter of law. His three arguments do not undermine the lower courts' sound conclusion that Harris was a fiduciary to a trust under ERISA and section 523(a)(4).

2. The bankruptcy court and the BAP Court also correctly determined that Harris's breach of his fiduciary duties in late March 2009 constituted defalcation. As the Supreme Court explained in Bullock v. BankChampaign, N.A., defalcation under section 523(a)(4) applies only to intentional or grossly reckless acts. 133 S. Ct 1754 (2013). Gross recklessness is a conscious disregard of a substantial and unjustifiable risk of violating fiduciary duties. Harris acted intentionally, or at least with gross recklessness, when he decided in late March 2009 to use plan assets—i.e., the monies withheld from the employees' paychecks—to pay other corporate expenses and debts Faribault owed him, rather than remit those plan assets to HealthPartners as he had done in the past and as required by his fiduciary obligations. His actions in late March 2009 therefore

constituted defalcation while acting in a fiduciary capacity, and his ERISA Judgment Debt is nondischargeable under section 523(a)(4).

ARGUMENT

In a Chapter 7 bankruptcy, 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) (emphasis added). 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 reviews de novo the bankruptcy court's grant of summary judgment and the BAP Court's affirmance of that decision, viewing the facts in the light most favorable to the nonmoving party. See Blocker v. Patch (In re Patch), 526 F.3d 1176, 1179 (8th Cir. 2008).

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The relevant facts here are undisputed, and the district court's factual determinations and legal conclusions apply to this case by virtue of collateral estoppel.[1]

I. At the Time of His Defalcation of ERISA Plan Assets, Harris Was Acting in a Fiduciary Capacity to the Plan and Its Assets (the Trust Res) that Predated His Defalcation

This Court has held that a fiduciary relationship under section 523(a)(4) can arise only if the debtor (1) was a fiduciary to an "express or technical trust" (2) "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). This section will address each element in turn.

A. ERISA Created an Express or Technical Trust to which Harris Had Fiduciary Duties

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

[1] Harris does not challenge the lower courts' application of collateral estoppel in this appeal. See Ahlberg v. Chrysler Corp., 481 F.3d 630, 634 (8th Cir. 2007) (points not argued in opening brief are deemed waived). This Court has applied collateral estoppel in determining defalcation by a fiduciary under section 523(a)(4). E.g., In re Speight, 16 F.3d 287, 287 (8th Cir. 1994); Cochrane, 124 F.3d at 983 ("issues concerning Cochrane's breach of his fiduciary duties were fully, fairly, and actually litigated and were essential to the final judgment entered in the underlying state court action. We therefore hold that the bankruptcy court did not err in concluding that Cochrane is bound by the jury's findings.").

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(In re Long), 774 F.2d 875, 878 (8th Cir. 1985). To create such a fiduciary relationship, a "statutory trust must (1) include a definable res and (2) impose 'trust-like' duties." In re Nail, 680 F.3d at 1040 (citation omitted).

ERISA provides the statutory basis for Harris's fiduciary status. 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"); Mertens v. Hewitt Assocs., 508 U.S. 248, 262 (1993) (ERISA also "expand[ed] the universe of persons subject to fiduciary duties" beyond those considered fiduciaries "[u]nder traditional trust law."). ERISA governs and protects employee benefit plans, including the Plan here, by requiring that plan assets be held in trust and by 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 Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc., 472 U.S. 559, 570 & n.10 (1985) ("[R]ather than explicitly enumerating all of the powers and duties of trustees and other fiduciaries, Congress invoked the common law of trusts to define the general scope of their authority and responsibility." (citing ERISA's legislative history)); 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). As

most relevant here, ERISA requires fiduciaries to "discharge [their] duties with respect to a plan *solely* in the interest of the participants and beneficiaries and for *the exclusive purpose* of providing benefits to participants and their beneficiaries." 29 U.S.C. § 1104(a)(1)(A) (emphasis added); see NLRB v. Amax Coal Co., 453 U.S. 322, 329 (1981) ("[An ERISA] trustee bears an unwavering duty of complete loyalty to the beneficiary of the trust, to the exclusion of the interests of all other parties."). ERISA imposes these duties to prevent and redress 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 reasonably 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 that the withheld employee contributions became Plan assets "on the date on which the employees' wages were paid," and it is undisputed on appeal that collateral estoppel applies in this case to the district court's factual findings and legal conclusions. J.A. at 635. The statute and regulations state that the failure to forward employee contributions to a plan as

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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 thus requires fiduciaries like Harris, who control the distribution of their employees' hard-earned wages, to manage and remit the employees' health plan contributions (plan assets) for the exclusive benefit of the Plan and its employee-participants—not for other uses. See, e.g., LoPresti v. Terwilliger, 126 F.3d 34, 39 (2d Cir. 1997) (ERISA fiduciary violated duty of loyalty by using withheld employee contributions to pay corporate creditors). ERISA clearly imposes fiduciary obligations on individuals, like Harris, who control withheld employee contributions. FirsTier Bank, N.A. v. Zeller, 16 F.3d 907, 911 (8th Cir. 1994).

Accordingly, bankruptcy courts in numerous jurisdictions have determined ERISA fiduciaries with control over withheld employee contributions 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). Harris cites no contrary authority. This is consistent with the Bankruptcy Code's treatment of non-ERISA fiduciaries as trustees when they similarly fail to remit funds under their care. 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).

On appeal, Harris does not contest the lower courts' conclusions that ERISA imposes trust and fiduciary requirements on employee contributions, and, thereby, satisfies the "trust" and "fiduciary" elements necessary for defalcation of employee contributions to be non-dischargeable under Bankruptcy Code section 523(a)(4). His brief narrowly challenges the lower courts' conclusions only on three points, arguing that: (1) he was not a "fiduciary" under ERISA or under section 523(a)(4) until the "wrongful" act of misusing employee contributions, so his fiduciary status did not predate the defalcation; (2) he was not individually liable as a fiduciary for the defalcation under section 523(a)(4); and (3) this case should be analogized to this Court's decision in Hunter v. Philpott, 373 F.3d 873

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(8th Cir. 2004). For the reasons stated in the following three sections, his narrow arguments are without merit.

B. Harris's Fiduciary Status Predated his Defalcation

For section 523(a)(4) to apply, the fiduciary relationship "must exist before the incident creating the contested debt and apart from it. It is not enough that the trust relationship spring from the act from which the debt arose." Devaney v. Dloogoff (In re Dloogoff), 600 F.2d 166, 168 (8th Cir. 1979) (citing Davis v. Aetna Acceptance Co., 293 U.S. 328, 333 (1934)). This requirement excludes from section 523(a)(4)'s ambit those trusts created by virtue of a court-ordered remedy, commonly known as "constructive trusts." In re Talcott, 29 B.R. 874, 878 (Bankr. D. Kan. 1983) (fiduciary relationship under § 523(a)(4) must "aris[e] out of a pre-existing express or technical trust, not implied or constructive trusts"); see also In re N.S. Garrott & Sons, 772 F.2d 462, 467 (8th Cir. 1985) ("A constructive trust is an equitable remedy imposed under circumstances where it would be unfair for the owner of the property to enjoy the beneficial interest and would result in his unjust enrichment."). Yet this limitation to section 523(a)(4)'s application is itself narrow—section 523(a)(4) is satisfied whenever a trust-like relationship exists prior to and separate from the defalcatory act, even if that relationship arises near-in-time to that act. See Devaney, 600 F.2d at 168 (excluding from section

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523(a)(4)'s application only defalcation that *itself* creates the fiduciary relationship simultaneously).

Harris now erroneously cites this narrow limitation and argues that he was not a section 523(a)(4) fiduciary to the Plan until he exercised "authority in March of 2009 by permitting payment of other expenses rather than meeting Faribault's obligation to pay the health insurance premiums" and, therefore, his fiduciary status under section 523(a)(4) arose only "out of the wrongdoing in question." Appellant's Br. 11–16. This argument ignores the district court's findings, which are directly to the contrary and binding on him by the doctrine of collateral estoppel. The district court found that Harris exercised control over plan assets from at least January 1, 2009, before he diverted any employee contributions. J.A. at 636–37. 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. Id. at 635–37. 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 found by the bankruptcy court and uncontested here, Harris is

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bound by the district court's factual findings and legal conclusions, which he did not appeal.[2]

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, which were plan assets as a matter of law. Harris concedes this fact in his appellate brief, noting that the district court found he "had authority regarding . . . [plan] assets" in January 2009, Appellant's Br. 12. He also admits that he, "as CEO of Faribault, had authority over health plan payments[.]" Appellant's Br. 8. Accordingly, based on undisputed facts, Harris was a "fiduciary" to those Plan assets under both ERISA and section 523(a)(4) starting from at least January 2009, well before any act of defalcation.

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[2] In his brief, Harris relies heavily on testimony offered at trial that was rejected as either not credible or in conflict with other evidence. See, e.g., Appellant's Br. 4–5 (citing J.A. at 604, ¶ 21(a)–(e), which the district court had described as "somewhat conflicting" and had listed contrary testimony, see also id. at 603–06, ¶¶ 19–21). Moreover, the district court clearly resolved the relevant factual disputes in reaching its holding. For example, Harris claims in his appellate brief that "[a]lthough he had ultimate authority to approve expenditures, the Finance Department (CFO Dorr) determined when and how to pay corporate expenditures, including Health Partner bills." Appellant's Br. 5. The district court specifically found that this claim "lacks credibility given the great weight of evidence to the contrary[.]" J.A. at 636 (citing contrary evidence). As noted earlier, Harris does not challenge the lower courts' application of collateral estoppel to the district court's findings.

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C. Harris was "Personally" Acting as a Fiduciary under Section 523(a)(4)

Harris also contends that "[t]he fact that a corporate officer has authority regarding the trust asset does not establish that he is personally acting as a [section 523(a)(4)] fiduciary," id. at 14 (citing Long, 774 F.2d at 878–79). Harris ignores this Court's statement in Long that "there are cases charging individuals, by virtue of their corporate officer status, with the corporation's fiduciary obligations. To the extent these cases hold that *a statute or other state law rule may create fiduciary status in an officer which is cognizable in bankruptcy proceedings*, we agree." Long, 774 F.2d at 878 (citations omitted) (emphasis added). Based on Long, courts have readily found fiduciary status for individuals when the statute imposes fiduciary obligations on individuals. E.g., Meyer v. Rigdon, 36 F.3d 1375, 1382 (7th Cir. 1994) (citing Long, 774 F.2d at 878); In re Roussel, 504 B.R. 510, 520 (E.D. Ark. 2013) (same); In re Collins, 137 B.R. 754, 756 (Bankr. E.D. Ark. 1992) (same).

Here, there is no doubt that ERISA imposes fiduciary obligations on individuals, like Harris, who satisfy ERISA's definition of a fiduciary, not just on corporate entities. E.g, Olson v. E.F. Hutton & Co., 957 F.2d 622, 625 (8th Cir. 1992) ("'[W]hether or not an individual or entity is an ERISA fiduciary must be determined by focusing on the function performed, rather than the title held.'") (quoting Blatt v. Marshall & Lassman, 812 F.2d 810, 812-13 (2d Cir. 1987)); see

also 29 U.S.C. § 1002(9), (21) (imposing fiduciary obligations on any "individual" who satisfies the "fiduciary" definition). Indeed, Harris does not dispute he is "personally liable" as an ERISA fiduciary. Appellant's Br. 12, 15, 16 (discussing Harris's "personal liability"). As the district court found and is undisputed on appeal, Harris had personally exercised authority and control over employee contributions kept in Faribault's general operations account since at least January 2009, and he was a fiduciary in his individual capacity.[3] J.A. at 636–37; see also FirsTier Bank, N.A., 16 F.3d at 911 (ERISA's fiduciary provision "imposes those duties *whenever* one deals with plan assets. This distinction is not accidental—it reflects the high standard of care trust law imposes upon those who handle money or other assets on behalf of another."). Accordingly, Harris was personally a fiduciary under ERISA and section 523(a)(4) since, at least, January 2009.

This result is consistent with numerous other cases in analogous circumstances where similar arguments were rejected. E.g., Woodworking Enters., Inc. v. Baird (In re Baird), 114 B.R. 198, 204–05 (B.A.P. 9th Cir. 1990) (president and sole shareholder of corporation was personally liable for breaches of Arizona

[3] In support of this determination, the district court credited certain testimony over Harris's testimony to the contrary: "[f]or example, Dorr testified that she did not have the authority, without Harris's approval, to remit employee contributions to HealthPartners. Indeed, the checks to HealthPartners were signed by Harris." J.A. at 635, ¶ 13. The district court also credited the fact that "Dorr, Michael, and Harris all testified that Harris had ultimate authority during at least the first quarter of 2009 to determine which of Faribault Mill's expenses would be paid." Id. at 636, ¶ 14.b.

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builder's trust fund statute because he was "the only person responsible for disbursing funds held by [his corporation]" and therefore "directly and actively participated in the defalcation" of those funds); Baker v. Wentland (In re Wentland), 410 B.R. 585, 599 (Bankr. N.D. Ohio 2009) (defendant, who was president of corporation and controlled corporation's finances, was personally liable for failure to apply funds withheld from employee's wages to payments of health insurance premiums); Nuchief Sales, Inc. v. Harper (In re Harper), 150 B.R. 416, 419 (Bankr. E.D. Tenn. 1993) (corporate stockholder, officer, director, bookkeeper, and day-to-day operational supervisor was personally liable for corporation's breaches of fiduciary duties under the Perishable Agricultural Commodities Act; "focus of fiduciary liability is upon the actor responsible for the act rather than the corporate form"; "it is the employee or officer responsible for implementing the fiduciary responsibilities who is liable for any acts of defalcation").

In short, Harris was a fiduciary in his individual capacity under both ERISA and section 523(a)(4) before he decided to divert the employee contributions (plan assets) for personal and corporate uses in late March 2009.

D. Hunter v. Philpott Is Inapposite

Harris also relies on the factual situation in Hunter, which ultimately concluded the debtor, an ERISA fiduciary, was not a fiduciary under section

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523(a)(4). Appellant's Br. 14–16 (quoting Hunter v. Philpott, 373 F.3d 873, 877 (8th Cir. 2004)). His reliance on Hunter is misplaced. As the bankruptcy court recognized, this Court 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). 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, and 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 Rahm v. Halpin (In re Halpin), 566 F.3d 286, 289–90 (2d Cir. 2009) (agreeing with Secretary of Labor's "interpretation that employer contributions become assets only after being paid") (citing 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), http://bit.ly/2cGlqja). Harris concedes this factual difference is "significant." Appellant's Br. 14.

In Hunter, the debtor owned a construction business that had signed a collective bargaining agreement ("CBA") with a union. 373 F.3d at 874. Under

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the CBA, the business agreed to make employer contributions to certain union benefit plans from the company's own accounts. Id. at 874–75. The business failed to make those CBA-required payments to the plans. 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, this Court "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

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Labor, Advisory Op. No. 93–14A (May 5, 1993). See generally Halpin, 566 F.3d at 289 (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 a contract in which the parties agree, for example, that title to the unpaid contribution passes to the plan when the contribution is due and payable. See, e.g., ITPE Pension Fund v. Hall, 334 F.3d 1011, 1013–14 & n.2 (11th Cir. 2003). In Hunter, this Court 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. This Court, 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.; 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

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complained of: that is, his failure to hold money to satisfy the business's owed contributions." 373 F.3d at 875–76. 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 individually 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 were indisputably plan assets under the statute and applicable regulation (as the district, bankruptcy, and BAP 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"); Secretary U.S. Dep't of Labor v. Kwasny, __ F.3d ___, No. 16-1872, slip op. at 5 (3d Cir. Apr. 5, 2017) ("Plan funds protected under [ERISA] include money withheld from employees' paychecks for purposes of the benefit plan but not yet delivered to the benefit

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plan."); In re Halpin, 566 F.3d at 289 (employee contributions are plan assets pursuant to Department of Labor regulations) (citing 29 C.F.R. § 2510.3-102).

Further, under the statute, Harris individually had fiduciary duties because he controlled these Plan assets. His obligation to remit funds to pay the HealthPartners premium was not a mere "contractual obligation." As the individual with authority and control over these withholdings, he was a fiduciary and had a corresponding *statutory* duty to protect all plan assets, including withheld employee contributions, and to ensure they were used in the employees' exclusive interests. See 29 U.S.C. § 1002(21)(A) (defining "fiduciary" under ERISA); 29 U.S.C. § 1104(a)(1) (listing ERISA fiduciary duties); 29 U.S.C. § 1104(a)(1)(A)(i) (ERISA fiduciary must discharge duties to plan for exclusive purpose of providing benefits to participants and beneficiaries). 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 preexisted his diversion of those contributions; as the district court held, Harris had this statutory 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 likewise distinguished the contractual obligations surrounding employer

contributions from the pre-existing trust and fiduciary requirements imposed by statute on persons (like Harris) controlling employee contributions. 406 F.3d 1192, 1205 & n.6 (10th Cir. 2005); see also 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); 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, 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, e.g., In re Gott, 387 B.R. at 23.

Based on the undisputed facts, the district court's findings of fact and conclusions of law, and the weight of authority on this issue, Harris had fiduciary responsibilities to Plan assets held in Faribault's general operations account starting at least on January 1, 2009. And because that fiduciary relationship preexisted Harris's defalcatory act, his fiduciary relationship clearly meets the requirements for application of section 523(a)(4).

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II. Harris Committed Defalcation When He Intentionally or Recklessly Used Funds Withheld from Employee Paychecks for Health Insurance Premiums to Pay Himself and Other Corporate Expenses

"Defalcation is defined as the misappropriation of trust funds or money held in any fiduciary capacity; [the] failure to properly account for such funds." 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 lower courts' conclusion that Harris had the requisite scienter.

The district court held that 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 J.A. at 639–40 (emphasis added). The district court found Harris knew of his

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obligation to remit the withheld contributions for January and February of 2009 to HealthPartners by March 26, 2009, at the latest, 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 640. For example, when faced with a choice, Harris intentionally and wrongfully ordered Dorr to pay Harris's personal home equity line of credit. J.A. at 636, ¶ 14.c; id. at 629, ¶ 58.c. 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 very least, a misappropriation of trust funds undertaken with conscious disregard to the substantial and unjustifiable risk that doing so would result in a breach of Harris's fiduciary duty of loyalty, when simply paying HealthPartners instead of corporate or personal 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"); see also In re Roussel, 504 B.R. 510, 523 (E.D. Ark. 2013) ("Defalcation may be

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presumed from breach of the duty of loyalty, the duty not to act in the fiduciary's own interest when that interest comes or may come into conflict with the beneficiaries' interest" (quoting In re Baylis, 313 F.3d 9, 20 (1st Cir. 2002))). 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 corporate or personal expenses in complete disregard for the employees' rights to their own wages. See Kansas v. Nebraska, 135 S. Ct. 1042, 1056 (2015) ("In some areas of the law and for certain purposes, the distinction between purposefully invading and recklessly disregarding another's rights makes no difference." (citing Bullock, 133 S. Ct. at 1759)). The bankruptcy court correctly reached this conclusion by cataloguing Harris's intentional and reckless actions when dealing with employee contributions. J.A. at 714–18.

In a post-Bullock case, the U.S. 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

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> 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, including payments to himself. Harris thus committed defalcation when he paid other corporate and personal expenses instead of remitting the withheld employee contributions to HealthPartners.

The case cited by Harris, IBEW Local 231 v. Pottebaum (In re Pottebaum), does not counsel a different result. No. 11-9050, 2013 WL 5592368 (Bankr. N.D. Iowa Oct. 9, 2016). In Pottebaum, the debtor filed a Chapter 7 bankruptcy petition after his electrical contractor company, of which he was the sole shareholder, went out of business. Id. at *1. As the company was struggling, the debtor communicated and worked with his employees' representative, the International Brotherhood of Electrical Workers, Local Union 231 (Union), "to try to fund all his obligations," including the remittance to the Union and two Union funds of wages withheld from employee paychecks. Id. at *1–2, *6. The bankruptcy court found credible the debtor's testimony that "[h]e took money he needed for other things and used it to pay the Funds until the money ran out," and that "he had no

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intent to wrong or harm the workers or Union Funds." Id. at *2. A Union representative also testified as to how he and the debtor worked together to save his Union members' jobs. Id. Based on this, the court concluded the debtor did not commit defalcation, as he did not act with a scienter sufficient to meet the standard announced by the U.S. Supreme Court in Bullock. Id. at *5–6.

First, Pottebaum relies on a false premise, namely that the debtor-fiduciary had any legal basis to use his employees' monies, the plan's assets, for corporate or personal use. See, e.g., Amax, 453 U.S. at 329–30 ("A fiduciary cannot contend 'that, although he had conflicting interests, he served his masters equally well or that his primary loyalty was not weakened by the pull of his secondary one.'" (quoting Woods v. City National Bank & Trust Co., 312 U.S. 262, 269 (1941))); LoPresti, 126 F.3d at 40 (holding that insurance premiums deducted from employees' paychecks and commingled with corporate assets were plan assets in accordance with Department of Labor regulations, see 29 C.F.R. § 2510.3-102(a), and therefore that president of employer corporation acted as a fiduciary when he failed to separate those assets for payment to the funds and instead used them to pay company creditors); see also J.A. at 638 (citing similar cases).

In fact, this Court rejected a similar argument in the criminal context. In United States v. Van Elsen, a criminal defendant argued that he lacked the "mens rea" for the "stealing" or "conversion," also described as a "defalcation," of funds

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from his employees' Individualized Retirement Accounts (IRAs), because he "genuinely intended to repay" the employees after misusing their retirement savings. 652 F.3d 955, 958 (8th Cir. 2011).[4] This Court concluded that the defendant's purported intent to repay the employees does not obviate the defendant's intentional wrong in misusing the employees' own money to pay for corporate and personal expenses in the first place. See id. at 960. Similarly, here, Harris's arguments that he attempted but never in fact repaid the employees is "irrelevant" to his scienter, i.e., that he intentionally, or at least with gross recklessness, violated his duty of loyalty under ERISA.

Moreover, the facts of this case are quite different from Pottebaum. Harris did not consult with his employees about which bills he should pay and when he should pay them. Instead, he alone prioritized which bills Faribault would pay in

[4] For example, the criminal intent for conversion

> may include misuse or abuse of property. It may reach use in an unauthorized manner or to an unauthorized extent of property placed in one's custody for limited use. Money rightfully taken into one's custody may be converted without any intent to keep or embezzle it . . . .

Van Elsen, 652 F.3d at 958 (quoting Morissette v. United States, 342 U.S. 246, 262 (1952)). This Court held that there is no requirement for a specific intent to *permanently* deprive the employees of their retirement money. Id. Similarly, here, a reckless disregard for fiduciary duties requires only that Harris have a specific intent at the time to misuse the employee contributions by using the employees' money in an unauthorized manner, such as paying down his own loans.

late March 2009. And unlike the debtor in Pottebaum, Harris decided to *pay himself with Plan assets* for debts owed to him by Faribault. For example, Harris does not dispute that, "after speaking with Dorr and determining that Faribault Mills would be unable to pay the full premium due to HealthPartners, he directed Dorr to . . . use the funds available in the checking account from which premiums were paid to make a March 31, 2009 payment on his home equity line of credit." J.A. at 629, 636; see also Appellant's Br. 5.[5] The district court also found that Harris "had ultimate authority during at least the first quarter of 2009 to determine which of Faribault Mills's expenses should be paid." J.A. at 636. He could have preserved the withholdings; instead, Harris knowingly misused the Plan's assets for his own and his corporation's purposes. Id. at 639–40. Indeed, the district court found, and it is undisputed on appeal, that Harris made a "decision not to remit the employee withholdings." Id. at 640 (emphasis added). Finally, the district court made credibility determinations, applicable here pursuant to collateral estoppel, *against* Mr. Harris's testimony to reach its conclusions that (1) Harris was the sole decision-maker of how and when bills were paid, and (2) Harris had control and exercised control over health plan assets. Id. at 636–37.

[5] This undisputed fact, among other undisputed facts, contradicts Appellant's baseless assertion that after March 27, 2009, Harris "no longer had financial control of Faribault Mills' affairs." Appellant's Br. 7. As Harris recognized, he only resigned as the CEO in May. Id.

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The bankruptcy court and the BAP Court correctly concluded Harris acted with conscious disregard to a substantial and unjustifiable risk that his conduct would violate a fiduciary duty. Based on the foregoing, Harris committed defalcation in late March 2009 when he chose to use plan assets to pay himself and other corporate expenses instead of remitting those assets to HealthPartners.

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CONCLUSION

The Secretary respectfully requests that this Court affirm the bankruptcy court's judgment and the BAP Court's affirmance of that judgment, as Harris's ERISA Judgment Debt is nondischargeable pursuant to 11 U.S.C. § 523(a)(4).

Respectfully Submitted,

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1. This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B) because: this brief contains 9,941 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii)

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