**Nos. 13-55308, 13-55301**

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE NINTH CIRCUIT**

RICHARD ALAN SCHOENFELD, an individual,
Defendant-Appellant,
v.
THOMAS PEREZ, Secretary, United States
Department of Labor,
Plaintiff-Appellee.

On Appeal from the United States District Court for the
Central District of California
Case Nos. 12-cv-00618 SJO, 12-cv-02220 SJO
The Honorable Judge S. James Otero

# BRIEF FOR THE SECRETARY OF LABOR

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# TABLE OF CONTENTS

**TABLE OF CONTENTS—(continued)**

Page

**TABLE OF CONTENTS—(continued)**

Page

## TABLE OF AUTHORITIES

**Federal Cases:** Page

**Federal Cases--(continued):** Page

**Federal Cases--(continued):** Page



**Federal Statutes:**

**Federal Statutes--(continued):** Page

**Federal Statutes--(continued):** Page



**Miscellaneous:**

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**BRIEF FOR THE SECRETARY OF LABOR**

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STATEMENT OF THE ISSUES

In this appeal, Richard Schoenfeld seeks to reverse the district court's determination that his multiple breaches of his fiduciary duties under the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1001 et seq., constituted "defalcation while acting in a fiduciary capacity" under 11 U.S.C. § 523(a)(4), and therefore cannot be discharged in bankruptcy. After the district court entered summary judgment in this case, the Supreme Court held that defalcation under section 523(a)(4) of the Bankruptcy Code requires a grossly reckless or intentional mental state, Bullock v. BankChampaign, N.A., 133 S. Ct. 1754, 1757 (2013), a standard different from that applied by the Ninth Circuit when the district court decided this case. The questions presented are:

1. Whether Schoenfeld possessed the requisite mental state for "defalcation," within the meaning of 11 U.S.C. § 523(a)(4), when he misappropriated funds from a pension plan and transferred these funds to his company's accounts with reckless disregard of the clear risk that his conduct violated his duties as an ERISA fiduciary.
2. Whether Schoenfeld waived any argument that his Chapter 13 bankruptcy precluded the Secretary's claims inasmuch as he failed to raise the issue prior to the district court's final judgment and the district court acted within its discretion by denying post-judgment supplemental briefing on the issue.

## STATEMENT OF JURISDICTION

The district court had jurisdiction over the underlying actions under 28 U.S.C. § 1331 and 28 U.S.C. § 157(d). This Court has jurisdiction to review the district court's final judgment and orders on the parties' cross-motions for summary judgment pursuant to 28 U.S.C. § 1291. This Court also has jurisdiction under 28 U.S.C. § 1291 to review the district court's denial of Schoenfeld's post-judgment Request to Submit Supplementary Opposition, in which he asked the court to order briefing on the never-before asserted preclusive effect of his Chapter 13 bankruptcy plan.

The court lacks jurisdiction to order the injunction that Schoenfeld now seeks against the Secretary based upon his Chapter 13 bankruptcy plan. This Court primarily has *appellate* jurisdiction. 28 U.S.C. § 1291; 28 U.S.C. § 1292; 28 U.S.C. § 1651. If Schoenfeld wanted to obtain injunctive relief based on the bankruptcy plan, he should have sought such relief in a timely manner in a court of original jurisdiction. He did not seek such relief prior to judgment by the district court, as we explain, infra, at 38 through 46, and accordingly cannot do so now.

To the extent the district court construed Schoenfeld's post-judgment request as a motion for relief from a final judgment under Federal Rule of Civil Procedure 60(b), this Court lacks jurisdiction to review the district court's determination on that motion because Schoenfeld did not amend his prior notice of appeal or file a new notice appealing the post-judgment order. Fed. R. App. P. 4(a)(4)(B)(ii).

## STATEMENT OF THE CASE

### I. Schoenfeld's Chapter 13 Bankruptcy

On February 3, 2011, Schoenfeld filed a voluntary petition for bankruptcy under Chapter 13 of the Bankruptcy Code, 11 U.S.C. § 1300, et seq. ER 259.[1] On August 1, 2011, the Secretary of Labor ("Secretary"), who had been investigating Schoenfeld for some time, filed a proof of claim for ERISA violations in the amount of $69,511.36 plus interest. ER 217-20. Schoenfeld submitted his Chapter

[1] "ER" and "SER" refer to the Excerpts of Record and Supplemental Excerpts of Record, respectively, followed by the page number.

13 plan on October 11, 2011, and a bankruptcy judge confirmed the plan on November 10, 2011. ER 212-16, 210-11. The plan provided that:

> Class 1 claimants will be paid according to this plan after confirmation unless the . . . class 1 claimant files a proof of claim in a different amount than that provided in the plan. If . . . a class 1 creditor files a proof of claim, that creditor will be paid according to that creditor's proof of claim, unless the court orders otherwise.

ER 213. The plan classified the Department of Labor as a class 1 claimant, and listed $0 as the total payment amount to the Department. ER 215. The Secretary did not object to the Chapter 13 plan.

On January 17, 2012, the Secretary filed an adversary complaint with the bankruptcy court, seeking a declaratory judgment that Schoenfeld's ERISA liability was not dischargeable because these debts arose from "defalcation while acting in a fiduciary capacity," under 11 U.S.C. § 523(a)(4). ER 226.

## II. The Secretary's ERISA Action Against Schoenfeld

On January 24, 2012, the Secretary filed a complaint against Schoenfeld in the United States District Court of the Central District of California. ER 174-80. As the Secretary alleged, Schoenfeld breached numerous fiduciary obligations under ERISA when he transferred assets from the Tomco Auto Products Inc. Employee Stock Ownership Plan, an employee pension benefit plan, ("Pension Plan" or "Plan") to Tomco Auto Products Inc.'s ("Tomco") operating account for business expenses.[2] Id. The district court consolidated the Secretary's ERISA and nondischargeability actions on July 23, 2012. ER 235.

III. The District Court's Orders on the Parties' Dispositive Motions

A. Schoenfeld's Partial Motion for Summary Judgment

Schoenfeld filed a motion for partial summary judgment on September 17, 2012, asserting that he did not commit defalcation under 11 U.S.C. § 523(a)(4). ER 66; ER 239. Among other things, Schoenfeld argued that defalcation requires "some degree of culpability," which he purported to lack; that the Plan authorized him to transfer the funds;[3] and that the transfers "benefitted" Plan participants. ER 68. The district court rejected Schoenfeld's culpability argument, because at the time, "the law of the Ninth Circuit" did not "require culpability before conduct is considered to be defalcation." ER 69. The court also found that Schoenfeld "was not authorized to make the transfers of Plan funds." ER 71. Finally, the district court found no evidence to support Schoenfeld's claim that the transfers were primarily for the benefit of Plan participants. ER 70-71. Accordingly, the court denied Schoenfeld's motion for partial summary judgment on nondischargeability. ER 72.

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[2] The Secretary's action also named Tomco Auto Products, Inc. as a defendant in the ERISA action. ER 174-80. The district court entered a default judgment against Tomco on January 31, 2013. ER 1. Tomco is not a party to this appeal.

[3] Schoenfeld did not revive this argument in his opening brief in this Court, and it is therefore waived. Smith v. Marsh, 194 F.3d 1045, 1052 (9th Cir. 1999).

B. The Secretary's Motion for Summary Judgment

On October 26, 2012, the Secretary filed a motion seeking summary judgment that Schoenfeld breached his fiduciary duties and engaged in transactions that are prohibited under ERISA by transferring assets from the Plan to Tomco, and that, as a consequence, his debt to the Plan is nondischargeable because his actions constituted defalcation under 11 U.S.C. § 523(a)(4).

1. Schoenfeld's Liability for ERISA Fiduciary Breaches

On January 31, 2013, the district court issued an order holding that Schoenfeld breached multiple fiduciary duties under ERISA when he transferred funds from the Pension Plan to pay Tomco's business expenses. ER 5. First, the court reasoned that, by using Plan "funds to benefit parties other than Plan participants or beneficiaries," Schoenfeld "violated the clear statutory language" of ERISA section 404 (a)(1)(A)(i), 29 U.S.C. § 1104(a)(1)(A)(i), which requires a fiduciary to "discharge his 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." ER 9 (emphasis added).

In addition, because the third-party to whom Schoenfeld transferred the funds was Tomco, the Pension Plan participants' employer or former employer, the court found that Schoenfeld violated the following three provisions of ERISA: (1) ERISA section 403(c)(1) which provides that the "assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purpose of providing benefits to participants in the plan and their beneficiaries," 29 U.S.C. § 1103(c)(1) (emphasis added); (2) ERISA section 406(a)(1)(D), which prohibits "transfer[s] . . . of any assets" of a pension plan to any employer whose employees are covered by the plan, 29 U.S.C. § 1106(a)(1)(D); and (3) ERISA section 406(a)(1)(B) which prohibits the "lending" of plan funds to such employers, 29 U.S.C. § 1104(a)(1)(B). ER 11-12.

The court also found that "no . . . language in the Plan could possibly be read to authorize the transfer of Plan funds to Tomco." ER 11. Accordingly, the court concluded that Schoenfeld violated ERISA section 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D), which requires fiduciaries to discharge their duties "in accordance with the documents and instruments governing the plan" unless doing so would violate ERISA. ER 10.

The district court further held that Schoenfeld breached his duty under ERISA section 406(b)(2), 29 U.S.C. § 1106(b)(2), to refrain from acting on both sides of a transaction involving plan assets. ER 14. Because Schoenfeld acted on behalf of Tomco when he transferred funds from the Pension Plan to the company, the court reasoned that he did not "exert maximum economic power for the Plan or its participants." Id. For example, he failed to execute any agreement for repayment of the funds, obtain any collateral to secure repayment, or set an interest rate. Id. at 14. In addition, because Schoenfeld used the funds that he took from the Plan to pay executive compensation—including his own compensation—the court determined that Schoenfeld "clearly engaged in self-dealing in violation of ERISA section 406(b)(1)," 29 U.S.C. § 1106(b)(1), which prohibits a fiduciary from using plan assets for his own interest or account. ER 13.

Finally, the court held that Schoenfeld breached his fiduciary duty to act prudently under ERISA section 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B), by commingling Plan assets with Tomco property and failing to consider alternative sources of funding to pay Tomco's expenses. ER 9-10.

2. Nondischargeability under Bankruptcy Code section 523(a)(4)

Based on these violations, the district court found Schoenfeld liable to the Pension Plan for the $47,000 in Plan assets that have not been returned, as well as $22,511.36 in lost-opportunity costs and post-judgment interest. ER 19. Schoenfeld could not discharge this debt in bankruptcy, the court further held, because his breaches constituted defalcation while acting in a fiduciary capacity under 11 U.S.C. § 523(a)(4). ER 15. Relying on the three-part test for defalcation that the Ninth Circuit applied at that time, the district court found that: (1) the Pension Plan constituted an express trust; (2) Schoenfeld was a Pension Plan fiduciary; and (3) he engaged in conduct that "constitutes a 'misappropriation of trust funds' . . . when he "utilized Plan assets to pay Tomco's business expenses in violation of ERISA . . . and failed to repay the debt." Id.

At the time the district court issued its opinion and order, the Ninth Circuit did not require a showing of gross recklessness or intentional misconduct to find that a debtor's breach constitutes defalcation. The court, therefore, rejected Schoenfeld's argument that he did not commit defalcation because he lacked a culpable state of mind. The court held that Schoenfeld's debt to the Plan was nondischargeable, but did not make a specific finding as to his mental state. Id.

3. Injunctive Relief

The district court also ordered equitable relief. In light of Schoenfeld's "serious misconduct" in misusing Plan funds, the court enjoined him from serving as an ERISA fiduciary in the future. ER 20. The court also granted the Secretary's request for an independent fiduciary to manage the Pension Plan assets moving forward. Id. The district court instructed the Secretary to file a motion proposing an individual to appoint as the independent fiduciary. ER 2.

IV. The District Court's Post-Judgment Order

After Schoenfeld filed a notice of appeal on February 11, 2013, the Secretary moved to appoint Maribel Larios as the independent fiduciary for the Plan. ER 250; SER 7. Schoenfeld opposed the motion on March 9, 2013, and the

Secretary replied to his opposition on March 15, 2013. ER 250. Then on March 18, 2013, Schoenfeld filed a "Request to Submit Supplementary Opposition" to the Secretary's motion to appoint Ms. Larios, in which he argued, for the first time, that his Chapter 13 bankruptcy plan was res judicata on the Secretary's underlying action for monetary damages. SER 2. Schoenfeld did not discuss how or whether this issue related to Ms. Larios. SER 9-11.

The district court rejected Schoenfeld's attempt to assert a preclusion defense in this manner. SER 2-3. Schoenfeld, the court found, had "ample opportunity" to assert res judicata during the prior year and two months' litigation, but failed to do so. SER 2. Indeed, the court noted that Schoenfeld had "seemingly conceded" that the Secretary's adversary proceeding was not precluded. Id. Thus, the court in its discretion declined to allow post-judgment supplemental briefing on the issue. Id.

To the extent that the request constituted a motion for relief from the judgment under Federal Rule of Civil Procedure 60(b), the district court also declined to grant it. Id. at 3. Schoenfeld had not shown a change in law, the emergence of new material facts, or that the court failed to consider all of the material facts presented to it. Id. Schoenfeld "therefore waived any argument concerning the res judicata effect of his confirmed Chapter 13 bankruptcy plan by waiting to unveil it until this very late date." SER 3.

Following entry of this order, Schoenfeld did not amend his prior notice of appeal or file a new notice appealing the post-judgment order. ER 250-51.

## STATEMENT OF THE FACTS

### I. The Tomco Auto Products Employee Pension Plan

In 1995, Tomco established the Pension Plan for employees who completed one year of service. ER 167; SER 36, 62. From its inception until May 2005 or later, Richard Schoenfeld was a named fiduciary, trustee, and member of the committee charged with administering the Pension Plan. ER 167; SER 14, 56, 119, 139. Schoenfeld is a certified public accountant ("CPA"). ER 166. He holds a degree in business administration with concentrations in accounting and finance. SER 119. Prior to joining Tomco, Schoenfeld was a partner at an auditing firm. SER 118. Tomco hired Schoenfeld as its Treasurer and Controller in 1986, and promoted him to Executive Vice President and Chief Operating Officer in 1993 and to President on October 1, 2004. ER 166-67; SER 118.

The Pension Plan documents permitted Schoenfeld to authorize disbursement of assets to participants and beneficiaries. SER 75. The Plan also permitted him to direct investment of assets, but only as "authorized by the provisions of the trust." Id. The trust instrument forbid Schoenfeld from using "any part of the principal or income" for "purposes other than the exclusive benefit of the Participants or their beneficiaries." SER 258.

In his role as committee member, Schoenfeld prepared filings for the Pension Plan, including, in July of 2003, the annual report (Form 5500) that ERISA requires to be filed with the Department of Labor. SER 120; SER 276; SER 372. The Form 5500 asked a series of questions about Plan transactions, including whether the Plan had engaged in the previous year "in any non-exempt transaction with any party-in-interest," and whether the plan during that time period had any "loss, whether or not reimbursed . . . , that was caused by fraud or dishonesty." SER 375. Schoenfeld answered "no" to both questions. Id.

Schoenfeld also worked with the Plan's counsel to amend the Plan from time to time. SER 276-77. Schoenfeld authorized such an amendment in 2003. SER 139-40. Following this amendment, Tomco published a Summary Plan Description ("SPD") for Plan participants, which listed Schoenfeld as a trustee and committee member who could answer participants' questions about the Plan. SER 225-26, 228, 240. The SPD explained that:

> ERISA imposes duties on the people who are responsible for the operation of the employee benefit plan. The people who operate your Plan, called 'fiduciaries' of the Plan have a duty to do so prudently and in the interest of you and other Plan Participants and beneficiaries.

SER 242.

II. Sale of Tomco

After several years of declining revenues, Tomco began negotiating in 2004 with TAP Holdings, LLC ("TAP") for the sale of Tomco's assets to TAP. SER 36.

From the outset, the parties intended that Schoenfeld would become the President of TAP, and would continue to receive his same pay and benefits after the transaction closed. SER 147, 438. At that time, Schoenfeld was receiving base compensation of more than $172,900 annually, a higher salary than any other Tomco employee. SER 148, 186.

A letter from TAP to Tomco provided an exhaustive list of liabilities that TAP would assume in the transaction, including accrued expenses "incurred in the ordinary course of business." SER 436, 444. A separate paragraph defining such expenses stipulated that Tomco would "not incur any indebtedness for borrowed money" before the sale closed. SER 441. Language stating that TAP would assume ordinary business expenses also appeared in the asset purchase and sale agreement between Tomco and TAP. ER 55, 169.

## III. Transfer of Pension Plan Funds to Tomco

In the months leading up to the sale, Schoenfeld decided to transfer money from the Pension Plan to Tomco to meet operating expenses. SER 282; ER 36. He explained that "it was important to retain employees and maintain operations because the buyer wanted . . . an operating, if cash strapped, entity." ER 63-64. Schoenfeld did not investigate whether Tomco's owners or officers could have supplied funds to meet Tomco's business expenses. SER 184-85. Nor did he apply for a new bank loan. Id. Schoenfeld did not know how many current Tomco employees were Pension Plan participants, and by the time of the transfers, at least some Pension Plan participants had left the company and were no longer Tomco employees. SER 175, 181-82.

On October 1, 2004, Schoenfeld liquidated a $103,498.21 certificate of deposit held by the Pension Plan, and wrote a $100,000 check from the Pension Plan to Tomco's general account. ER 27; ER 168; SER 36. Tomco used the Pension Plan assets to pay business expenses, including executive payroll checks and employee payroll checks. ER 27; ER 83. On October 22, 2004, Schoenfeld used Tomco funds to replace the missing $100,000 without interest. SER 37.

On November 1, 2004, Schoenfeld withdrew another $42,000 from the pension fund and again transferred the money to Tomco's account. ER 168; SER 37. The next day, Schoenfeld withdrew an additional $30,000 from the pension fund and deposited it in Tomco's general account. ER 169; SER 133-34. According to Schoenfeld, he transferred the funds, "to enable [] Tomco to satisfy its immediate cash obligations until the transaction closed." ER 145; <u>see</u> <u>also</u> ER 27; SER 162-63. Tomco used the money to pay taxes to the government, even though it had already withheld them from employees' wages, and to pay vendors, employee payroll checks, and executive payroll checks. ER 83.

The sale of Tomco's assets closed on Friday, November 4, 2004.[4] ER 169. Four days later, Schoenfeld withdrew an additional $25,000 from the pension fund, and deposited it in the operating account. ER 169; SER 37. Again, Schoenfeld used this money from the Pension Plan to pay vendors, employee payroll, and executive payroll. ER 84. On February 25, 2005, Schoenfeld used TAP funds to replace $50,000 of the misappropriated Pension Plan assets. Id.; SER 128.

As Schoenfeld later explained to TAP, none of the transfers he made from the Pension Plan to Tomco were "based on any interest bearing notes or loans." ER 145; see also ER 35. There are no notes evidencing a debt to the Pension Plan or setting a repayment schedule. There is no evidence that Tomco put up a security or offered any consideration for the funds. ER 35.

During the year that followed, disputes arose between TAP and the former owners of Tomco over the sales contract. SER 37. On October 2, 2005, Schoenfeld warned TAP that "[a]ny participant in the plan could sue old Tomco or the trustees and committee members" to recover the funds Schoenfeld took from the Pension Plan. ER 145. On October 10, 2005, TAP, Schoenfeld and the former owners of Tomco entered into an agreement obligating TAP to repay the missing

[4] It is unclear what would have happened if the Tomco and TAP failed to close the asset sale. Apparently, the officers of Tomco did not have "formal discussions" about this contingency. SER 299. In his deposition, Schoenfeld explained that he could "only speculate" about how such a development would have affected Tomco and its employees. SER 152 ("[T]here are any number of scenarios that could have occurred. I have no idea what it might have meant.")

Pension Plan funds. ER 119-20. TAP's representative testified that TAP had no obligation to the Pension Plan prior to this agreement. SER 413. In fact, neither TAP nor Schoenfeld have ever repaid the remaining $47,000 that was misappropriated, or any interest on this amount. ER 6.

Following the agreement, Schoenfeld sent emails urging TAP to repay the remaining funds. In a January 8, 2007 email, he wrote that the Department of Labor was "turning up the heat" and warned that the "money remain[ed] unpaid," and the "existence" of the transfers "in the first place," could "result in an assessment of penalties." ER 132.

## SUMMARY OF THE ARGUMENT

1. Although Schoenfeld was a trustee, administrator, and fiduciary of the Pension Plan, he deliberately misappropriated plan assets that he was obligated to hold in trust exclusively for the payment of retirement benefits and diverted those assets to his company's coffers. Schoenfeld is a seasoned accounting and financial professional, who had administered the Pension Plan for nearly a decade. The Pension Plan's governing documents, the trust instrument, and the Summary Plan Description all put Schoenfeld on notice of the very fiduciary obligations that he violated. Accordingly, Schoenfeld does not and could not argue that his actions were authorized by the Pension Plan documents. Nor does he deny that, as the President and highest paid employee of Tomco, he stood to benefit from the

transfer of plan assets to cover corporate expenses (including his own salary). Yet, he repeatedly took money from the Plan for Tomco's benefit, without even the fig leaf of treating the misappropriation as a "loan" by executing a promissory note from Tomco to the Plan, establishing an interest rate for the advanced sums, or obtaining collateral to secure recovery of the plan's assets, much of which has never been recovered.

In this manner, Schoenfeld acted with utter disregard of the clear risk – and reality – that his conduct violated ERISA and thus acted with "gross recklessness in respect to, the improper nature of the relevant fiduciary behavior." Bullock v. BankChampaign, N.A., 133 S. Ct. 1754, 1757 (2013). Because his actions constituted a gross deviation from the standard of conduct a professional trustee would observe in his circumstances, the record establishes that Schoenfeld acted with the culpable state of mind requisite for "defalcation while acting in a fiduciary capacity," under 11 U.S.C. § 523(a)(4). Id.

It is immaterial that Schoenfeld purportedly expected to replace the missing funds. The only risk relevant to Schoenfeld's mental state is the risk that his actions would constitute the multiple fiduciary breaches for which the district court held him liable, and which he has not challenged on appeal. This was more than a risk, it was a certainty, and his supposed intent to repay does not negate the intentional wrong of his unauthorized diversion of plan assets for his own benefit and that of the companies for which he acted.

Schoenfeld wholly disregarded the most fundamental obligation of an ERISA fiduciary, the obligation to act with undivided loyalty to the plan and its participants. Indeed, given the fundamental nature of the duty of loyalty, this Court should adopt a presumption, as the First Circuit has, that a fiduciary who acts disloyally acts with the kind of extreme recklessness necessary to establish a "defalcation" under the Bankruptcy Code. In re Baylis, 313 F.3d 9, 20 (1st Cir. 2002).

Additionally, Schoenfeld's assertion that his breaches "benefitted" Pension Plan participants by promoting corporate viability and helping them keep their jobs is legally irrelevant and factually unsupported. An ERISA fiduciary cannot negate culpability for an unauthorized transfer of plan assets by arguing that he somehow prevented plan participants' future unemployment. United States v. Mett, 178 F.3d 1058, 1067 (9th Cir. 1999). Plan assets must be managed "for the exclusive purpose of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." 29 U.S.C. § 1104(a)(1). Paying Tomco's corporate expenses, including Schoenfeld's salary, was neither a plan benefit nor a plan expense. Absent a genuine dispute of material fact as to Schoenfeld's knowledge or willful blindness to the fact that he breached his fiduciary duties by looting the Plan on behalf of the corporation, this Court should affirm the judgment below that these breaches constituted defalcation while acting in a fiduciary capacity and Schoenfeld therefore cannot discharge his liability for the diverted Plan assets in bankruptcy.

2. Misunderstanding this Court's appellate jurisdiction, Schoenfeld now argues that his Chapter 13 plan is res judicata and, for the first time, seeks an order enjoining the Secretary from collecting on his nondischargeable ERISA liability. The preclusive effect of Schoenfeld's Chapter 13 Plan is not properly before this Court, however, because Schoenfeld failed to raise the argument in his summary judgment papers, and this Court lacks original jurisdiction to issue the injunctive relief he now seeks. Instead, this Court's review of Schoenfeld's preclusion argument is narrowly limited. Following a full round of post-judgment briefing on the Secretary's motion to appoint Maribel Larios as the independent fiduciary, Schoenfeld requested permission to file a surreply that would for the first time raise preclusion and other issues unrelated to Ms. Larios. This Court has jurisdiction only to review the district court's order denying that request. Given that Schoenfeld had more than a year of litigation to assert a res judicata defense, but failed to do so, the district court's decision was not an abuse of its discretion and should be affirmed. In any event, there is no merit to this argument.

# ARGUMENT

## I. SCHOENFELD POSSESSED THE MENTAL STATE REQUIRED FOR DEFALCATION BECAUSE HE KNOWINGLY TRANSFERRED PLAN ASSETS IN DISREGARD OF THE SUBSTANTIAL RISK THAT DOING SO WOULD BREACH HIS FIDUCIARY DUTIES

An individual debtor cannot discharge in bankruptcy liabilities that arise, among other things, from "defalcation while acting in a fiduciary capacity." 11 U.S.C. § 523(a)(4) ("A discharge . . . does not discharge an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."). Under Ninth Circuit precedent predating the Supreme Court's opinion in Bullock, defalcation occurs when (1) a trust obligation exists, and (2) gives rise to a fiduciary capacity, and (3) the conduct at issue constitutes defalcation. In re Niles, 106 F.3d 1456, 1459 (9th Cir. 1997). A breach of an ERISA fiduciary duty satisfies the conduct component for defalcation if it involves a failure to account for or a misappropriation of trust assets. In re Hemmeter, 242 F.3d 1186, 1190-1911 (9th Cir. 2001). In the district court, Schoenfeld did not dispute that he had fiduciary obligations to the Pension Plan, and on appeal, he has not challenged, nor could he successfully challenge, the district court's holding that his conduct constituted a "misappropriation of trust funds" under Hemmeter. ER 15.

After the district court decided this case, however, the Supreme Court held that defalcation under section 523(a)(4) includes not only a conduct component but also a scienter component. Bullock v. BankChampaign, N.A., 133 S. Ct. 1754, 1757 (2013). Because the summary judgment record leads to the unavoidable conclusion that Schoenfeld consciously disregarded a substantial and unjustifiable risk, indeed a certainty, that transferring funds from the Pension Plan to Tomco would violate his fiduciary duties, this Court should affirm the district court's judgment that Schoenfeld's ERISA liability is nondischargeable pursuant to 11 U.S.C. § 523(a)(4).

A. Standard of Review

This Court reviews the district court's summary judgment orders de novo, viewing the evidence in the light most favorable to the non-moving party. F.T.C. v. Stefanchik, 559 F.3d 924, 927 (9th Cir. 2009). To avoid summary judgment, the non-moving party "must show a genuine issue of material fact by presenting affirmative evidence from which a jury could find in his favor." Id. at 929. A fact is "material" only if "the fact may affect the outcome of the case." Far Out Prods., Inc. v. Oskar, 247 F.3d 986, 992 (9th Cir. 2001). "An issue is 'genuine' only if there is sufficient evidence for a reasonable fact finder to find for the non-moving party." Id. "A non-movant's bald assertions or a mere scintilla of evidence in his favor are both insufficient to withstand summary judgment." Id.

Moreover, "[i]t is an established principle that an appellate court may affirm a lower court's grant of summary judgment on any basis supported by the record even if the lower court applied the incorrect legal standard." USA Petroleum Co. v. Atl. Richfield Co., 13 F.3d 1276, 1279 (9th Cir. 1994); see also Video Software Dealers Ass'n v. Schwarzenegger, 556 F.3d 950, 956 (9th Cir. 2009), aff'd sub nom., Brown v. Entm't Merchants Ass'n, 131 S. Ct. 2729 (2011); see generally 10A Fed. Prac. & Proc. Civ. § 2716 (3d ed.). Accordingly, although the district court granted summary judgment based on now-abrogated Ninth Circuit precedent, and therefore did not make specific findings regarding Schoenfeld's mental state, remand is unnecessary if this Court can reasonably infer from the record facts that suffice to affirm the judgment. This Court can and should do so.

B. *Bullock's* Gross Recklessness Standard

Prior to the Supreme Court's decision in Bullock, the courts of appeals disagreed about the mental state that must accompany "defalcation" under section 523(a)(4). This Circuit and the Fourth did not impose a scienter requirement, embracing negligent and "even innocent" acts within the term. Bullock, 133 S. Ct. at 1758. The First and Second Circuits, in contrast, required "something close to a showing of extreme recklessness." Id. (quoting In re Baylis, 313 F.3d 9, 20 (1st Cir. 2002). Other courts of appeal fell in-between. 133 S. Ct. at 1758. The Supreme Court resolved the issue by adopting the approach of the First Circuit in

Baylis and Second in In re Hyman, 502 F.3d 61, 69 (2d Cir. 2007). 133 S. Ct. at 1761. The Court held that "defalcation" requires a culpable state of mind "akin to that which accompanies application of the other terms in the same statutory phrase" – i.e., for fraud while acting in a fiduciary capacity, embezzlement, or larceny. Id. at 1757.

A specific intent to defraud while committing defalcation is not necessary for culpability, however. 133 S. Ct. at 1760. Rather, the Supreme Court described a sufficiently blameworthy mental state for defalcation as "one involving knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior." Id. at 1757. This scienter requirement, the Court noted, would "most likely help . . . nonprofessional trustees, perhaps administering small family trusts potentially immersed in intrafamily arguments that are difficult to evaluate in terms of comparative fault." Id. at 1761. Bullock involved just such a situation.

Bullock's test for gross recklessness turns on the risk that a fiduciary's actions are improper. A fiduciary possesses a grossly reckless state of mind, if he "'consciously disregards'" a "'substantial and unjustifiable risk' that his conduct will turn out to violate a fiduciary duty." 133 S. Ct. at 1759. (emphasis added) (citing ALI, Model Penal Code § 2.02(2)(c), p. 226 (1985)). Whether a risk of breach is substantial and unjustifiable is an objective inquiry. 133 S. Ct. at 1760. A court must consider the "nature and purpose of the actor's conduct and the circumstances known" to the fiduciary, and ask if disregarding such a risk "'involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation.'" Id. (emphasis in original).

### C. Schoenfeld was Grossly Reckless to the Substantial and Unjustifiable Risk that Transferring Pension Plan Funds to Tomco Would Violate His Fiduciary Duties

Evaluating whether Schoenfeld was grossly reckless with respect to the improper nature of his fiduciary behavior must begin with "reference to the duty involved." In re Baylis, 313 F.3d at 20. Under ERISA, Schoenfeld was bound by a fiduciary duty to act prudently and "solely in the interest of the participants and beneficiaries." Bins v. Exxon Co. U.S.A., 189 F.3d 929, 934 (9th Cir. 1999) on reh'g, 220 F.3d 1042 (9th Cir. 2000); 29 §1104(a)(1). He was also bound by duty to use Plan assets exclusively for "providing benefits to participants and their beneficiaries" and defraying the Plan's reasonable administrative expenses. 29 § 1104(a)(1)(A)(i). Moreover, he was strictly prohibited from using Pension Plan assets for Tomco's benefit or transferring or lending Plan assets to Tomco. ER 11-12; 29 U.S.C. § 1103(c)(1); 29 U.S.C. § 1106(a)(1)(B), (D). He was additionally obligated not to self-deal or act on both sides of a transaction involving Pension Plan assets. ER 13-14; see 29 U.S.C. § 1106(b)(1), (2). Finally, he was also required to refrain from making transfers not authorized by the plan documents. ER 10; see 29 U.S.C. § 1104(a)(1)(D).

When Schoenfeld knowingly transferred plan assets to Tomco's operating accounts, there was more than a substantial and unjustifiable risk that his behavior would turn out to breach each of these duties. There was a certainty that these actions would violate ERISA. Schoenfeld, who was an experienced accountant and Plan administrator and trustee certainly should have been aware that his actions were prohibited by ERISA. Therefore, unlike the non-professional trustee administering a family trust in Bullock, who repaid with interest all the money he borrowed from the trust to repay his deceased father's business loans, 133 S. Ct. at 1757, Schoenfeld acted with the mental state required for defalcation under Bullock.

1. Schoenfeld's Breach of his Duty of Undivided Loyalty Raises a Presumption of Gross Recklessness

Perhaps the "most fundamental duty of a trustee is that he must display throughout the administration of the trust complete loyalty to the interests of the beneficiary and must exclude all selfish interest and all consideration of the interests of third persons," Bogert, The Law Of Trusts And Trustees § 543, a duty expressly set forth in ERISA's fiduciary duty provision. 29 U.S.C. § 1104(a)(1). Because violating the duty of undivided loyalty is quintessentially improper fiduciary behavior, the First Circuit presumes extreme recklessness, and thus defalcation, when a fiduciary breaches this obligation. In re Baylis, 313 F.3d at 20-22 (holding that a fiduciary breached his duty of undivided loyalty and therefore exhibited the "extreme recklessness" necessary for defalcation when he used trust funds without permission to settle a trust-related suit against him personally); see also In re Fahey, 494 B.R. 16, 22 (Bankr. D. Mass. 2013) (a post-Bullock case, the in which the court correctly applied the Baylis presumption to hold that an ERISA fiduciary who violated his duty of loyalty under 29 U.S.C. § 1104, possessed the requisite fault for defalcation).

Given that the Supreme Court favorably cited the First Circuit's decision in Baylis and adopted its test of defalcation, this Court should follow the First Circuit's lead in presuming defalcation where, as here, a fiduciary acts disloyally. See Bullock, 133 S. Ct. at 1761 (noting the "administrative" and "practical" feasibility of the Baylis approach). As the First Circuit recognizes, when a fiduciary enters into a transaction conscious that his or another's interest is adverse to the beneficiary's interests, he almost always disregards a considerable risk that his conduct "will turn out to violate" a fiduciary duty. Id. at 1759. Accordingly, courts may reasonably infer that a fiduciary who breaches his duty of loyalty acts with gross recklessness, unless there is evidence that the fiduciary was somehow unaware of the conflict or his actions were authorized.

In this case, there is no question that Schoenfeld violated his duty of undivided loyalty to the Pension Plan participants. The court below found Schoenfeld liable for "using Plan funds to benefit parties other than Plan participants or beneficiaries," ER 30, and Schoenfeld has not challenged this holding on appeal. The district court also held Schoenfeld liable for self-dealing. ER 34. Schoenfeld dealt with Pension Plan assets in his own interest, the court found, because the transfers "allowed him to continue as a highly paid officer and director of first Tomco and then TAP." Id. Schoenfeld has not challenged any of this on appeal, and his bald assertion that he did not benefit any more than any other Tomco employee, Appellant's Br. at 16, is irrelevant as well as untrue given that he was a highly compensated individual who stood to become president of the newly-formed company once the sale to TAP went through.

In any event, Schoenfeld has conceded, as he must, that he served Tomco's interests when he transferred funds from the Pension Plan to the employer's operating account. Id. at 16. Because there is no evidence that he acted innocently in this matter, this Court should presume that by prioritizing the interests of others above those of the Pension Plan participants, Schoenfeld acted with a culpable state of mind. In re Baylis, 313 F.3d at 21. Given the fundamental nature of the duty of loyalty, and ERISA's clear command that plan assets be used for the "exclusive purpose" of providing plan benefits and defraying reasonable expenses, 29 U.S.C. § 1104(a)(1)(A), Schoenfeld acted with gross recklessness, if not conscious disregard of the legal standards, when he deliberately withdrew plan assets for the benefit of himself and his company, and knowingly used those assets to pay corporate expenses.

2. Schoenfeld Acted in Gross Deviation from the Standard of Conduct a Law-Abiding Professional Trustee Would Observe

Even without the First Circuit's presumption, the inescapable conclusion from the record below is that Schoenfeld was grossly reckless as to the improper nature of his fiduciary behavior. When he transferred Pension Plan funds to Tomco, Schoenfeld faced more than a "substantial and unjustifiable risk" this would "turn out to violate" his fiduciary duties to use pension plan assets solely in the interest of the participants and beneficiaries and for "the exclusive purpose" of providing plan benefits and defraying plan expenses; to hold plan assets in trust; not to transfer or lend Pension Plan assets to Tomco; not to self-deal or act on both sides of a Pension Plan transaction; and to conform his actions to the Plan documents. Bullock, 133 S. Ct. at 1759-60.

Indeed, given his professional circumstances, Schoenfeld should have been certain that he was violating these duties. Schoenfeld is a CPA, with university training in business administration, accounting, and finance. ER 166; SER 119. For decades, he was Tomco's Treasurer and Controller or Chief Operating Officer.

ER 166-67; SER 118. Prior to joining Tomco, Schoenfeld was a partner at an auditing firm. SER 118. In addition, he served for many years as the trustee of the Pension Plan, and the trust instrument expressly prohibited him from using Plan assets for "purposes other than the exclusive benefit of the Participants or their beneficiaries." SER 258. Indeed, the plan document, trust instrument, and SPD all put him on notice of the specific provisions that his conduct violated. SER 107 (referencing ERISA section 514, which makes effective ERISA's fiduciary responsibility provisions); SER 111 (referencing "the fiduciary responsibility provisions under ERISA"); SER 242-43 (describing a fiduciary's duty to administer the Pension Plan in the interest of participants and beneficiaries, and not to "misuse the Plan's money").

Nonetheless, it is undisputed that, on four different occasions, Schoenfeld knowingly and intentionally withdrew money from the Pension Plan fund. ER 168-169. It is also undisputed that Schoenfeld knowingly and intentionally deposited these funds into Tomco's account. Id. Finally, it is undisputed that Schoenfeld made these transfers for the purpose of paying Tomco's business expenses. Id. at 27,145; SER 162-63. These actions can only be seen as a gross deviation from the standard of care that a law-abiding trustee in Schoenfeld's situation and circumstances would observe.

As the district court found, "no . . . language in the Plan could possibly be read to authorize the transfer of Plan funds to Tomco." ER 11.[5] To the contrary, these documents carefully restrict Schoenfeld's authority to withdraw funds to two specific situations: disbursing of assets to participants and beneficiaries, and directing investment of assets, but only as "authorized by the provisions of the trust." SER 75. Neither of these provisions permits Schoenfeld to transfer funds – even temporarily – for the use of a third party. SER 258.

Furthermore, the fund transfers lacked any indicia to reassure a law-abiding person, much less a financial professional and trustee, that they were innocent "loans." Schoenfeld did not execute a note evidencing a debt to the Pension Plan and setting forth a schedule for repayment. Nor did he set an interest rate or secure the debt in any way. ER 35, 145. Instead, Schoenfeld simply withdrew the Pension Plan funds and converted them to Tomco's use. He did so with full knowledge that Tomco would spend the money to cover already-written checks and his own salary, and, accordingly, with the expectation that the Pension Plan

[5] Before the district court, Schoenfeld argued that language in the Pension Plan documents permitting trustees to borrow money on behalf of the Pension Plan somehow authorized him to transfer money from the Plan to Tomco, an argument that the district court quite rightly rejected. Schoenfeld did not revive that argument in this Court and it is now waived. Smith v. Marsh, 194 F.3d 1045, 1052 (9th Cir. 1999).

would be deprived of the funds for some indefinite period of time. Such behavior is "so egregious" that it comes "close to the level that would be required to prove . . . embezzlement." In re Baylis, 313 F.3d at 20; see also Bullock, 133 S. Ct. at 1760 (explaining that embezzlement requires conversion and an "intent to deprive"). By disregarding the risk that these actions were improper, Schoenfeld grossly deviated from the standard of care a law-abiding professional trustee and accountant – or any reasonable person – would observe.

Indeed, there was an especially substantial risk that Schoenfeld's actions were improper because ERISA section 406 clearly and categorically forbids these very activities. First, section 406(a)(1)(D) expressly prohibits ERISA fiduciaries from "transfer[ring] . . . any assets of the plan" to or for the use by or benefit of a related party (referred to in ERISA as a "party-in-interest"), including an employer. 29 U.S.C. § 1106(a)(1)(D); 29 U.S.C. § 1002(a)(14). Similarly, section 406(a)(1) prohibits ERISA fiduciaries from "lending" plan assets to an employer party-in-interest. 29 U.S.C. § 1106(a)(1)(D). These prohibited transfer provisions "supplement" an ERISA "fiduciary's general duty of loyalty to the plan's beneficiaries, § 404(a), by categorically barring certain transactions," because of the high likelihood that they will harm the plan and its participants and beneficiaries. Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc., 530 U.S. 238, 241-42 (2000).

Bankruptcy courts applying Bullock and the First Circuit's extreme recklessness test have not hesitated to find a culpable mental state when a fiduciary consciously disregards a clearly prescribed statutory duty to safeguard trust funds. In re D'Urso, 05-22274, 2013 WL 3286222, at *10 (Bankr. D.N.J. June 27, 2013) (holding that, in light of the fact that the fiduciary was a "sophisticated businessman," his failure to observe the requirements of the New Jersey Rent Security Deposit Act can "only be viewed as intentional, or at best, in reckless disregard of his obligations" in satisfaction of Bullock's culpable mind requirement); In re Bartlett, 397 B.R. 610, 622-23 (Bankr. D. Mass. 2008) (debtor-fiduciary who used receivables held in trust under the Perishable Agricultural Commodities Act, 7. U.S.C. § 499(a) et seq. ("PACA") to pay business and personal expenses, acted with the extreme reckless mental state required for defalcation under In re Baylis). Although the debtor-fiduciary in In re Bartlett insisted that she was unaware of her obligations, the court held that it could infer knowledge or reckless disregard of her obligations because she handled and signed certain documents alerting her to the statutory responsibilities. In re Bartlett, 397 B.R. at 622.

Given Schoenfeld's position and experience, his disregard of ERISA's prohibited transactions rules involved "a gross deviation from the standard of conduct that a law-abiding person would observe" in his situation. Bullock, 133 S.

Ct. at 1760 (emphasis in original). When he transferred the funds from the pension plan to Tomco, Schoenfeld had served as an ERISA trustee and Pension Plan committee member for nearly a decade. ER 167. He signed or was the contact person for various documents alerting him to his statutory obligations under ERISA. SER 139-140; SER 225-26, 228, 240, 242-43. He had even certified to the federal government that the Pension Plan had not engaged in any prohibited transactions with parties-in-interest during the previous fiscal year, and so was presumably aware of what this entailed. SER 375. Schoenfeld, moreover, is a CPA and the former partner of an auditing firm. ER 166; SER 118. Furthermore, e-mails he sent shortly after the transfers show that he was aware, at least by that time, that the transfers were questionable. ER 132. Given all of this, if Schoenfeld did not know that he was about to violate ERISA's prohibited transaction rules when he transferred funds from the plan to Tomco, at a minimum, a fact-finder would be compelled to conclude that he turned a willfully blind eye to this risk.

### 3. <u>Schoenfeld Has Not Presented Any Evidence Sufficient to Defeat Summary Judgment on Defalcation</u>

Schoenfeld nevertheless contends that he lacked the requisite state of mind for defalcation, because some Pension Plan participants purportedly "benefitted" as employees from the use of plan assets to protect their corporate employer's finances, and because he allegedly believed money would later become available from Tomco's receivables or the new owner from which he planned to replace the misappropriated funds. Appellant's Br. at 22. Neither of these unproven assertions is legally sufficient to defeat summary judgment in the Secretary's favor.

a. Schoenfeld's "Benefit" Theory Fails as a Matter of Law

An ERISA fiduciary does not lack culpability for an unauthorized transfer of plan assets simply because the transfer has the effect or intention of conferring some other short-term benefit on participants who are employees. United States v. Mett, 178 F.3d 1058, 1067 (9th Cir. 1999). In Mett, ERISA fiduciaries facing criminal liability for withdrawing pension plan funds to cover an employer's operating expenses maintained that they lacked wrongful intent because they "had the best interests of the employees at heart" and intended to rescue them from "impending unemployment." Id. at 1067. The Ninth Circuit flatly rejected this argument. Id. at 1068. Because the "fundamental tenet of ERISA policy is that pensions earned in fact be available at retirement," id., this Court reasoned that funds in an ERISA trust "are committed to securing a particular long-term benefit." Id. Thus, any intent to provide "short-term benefits of their own devising" did not negate the fiduciaries' culpable mental state in sacrificing the employees' pensions. Id.

Like the defendant-fiduciaries in Mett, Schoenfeld cannot negate a culpable mental state by arguing that his breaches prevented plan participants' future unemployment or that these same participants "benefitted" from his use of the misappropriated pension funds to pay wages and related taxes (as well as his own wages among other corporate expenses). The company, not the Plan, was obligated to pay its employees' wages. The unauthorized transactions also "benefitted" Schoenfeld himself, who has acknowledged that nearly $47,000 in Plan assets went to fund executive payroll. ER 83-84. And none of these funds went to Pension Plan participants who were no longer Tomco employees. SER 175. As noted above, ERISA section 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A), expressly provides that plan assets must be used for the "exclusive purpose" of providing plan benefits or defraying the expense of plan administration. The fact that Schoenfeld intended to use the plan's money to pay the company's bills is not a defense. Instead, it's further evidence of his utter disregard of the fundamental fiduciary standards that governed his conduct.

b. Schoenfeld's Purported Intent to Repay the Plan Does Not Negate the Intentional Wrong of his Unauthorized Transfer of Plan Assets

Schoenfeld also contends that because he expected to be able to use TAP funds to repay the missing money, he did not consciously disregard a "risk" that the Pension Plan "would not be repaid," and therefore he lacked the mental state required for defalcation. Appellant's Br. at 22. But this is a different "risk" than the "risk" with which the Supreme Court was concerned in Bullock.

The risk relevant to Schoenfeld's mental state for defalcation is the risk that his actions will "turn out to violate a fiduciary duty." Bullock, 133 S. Ct. at 1759. Regardless of whether he or TAP repaid the Pension Plan, Schoenfeld's actions violated his fiduciary duties to act prudently, to use Plan assets solely in the interest of the participants and beneficiaries, to hold plan assets in trust, to refrain from transferring or lending Pension Plan assets to Tomco, to refrain from self-dealing or acting on both sides of a Pension Plan transaction, and to follow Plan documents. Schoenfeld's alleged desire to replace the misappropriated pension funds – if and when additional money from Tomco or TAP became available – fails to negate the strong inference, if not inevitable conclusion, that he was reckless in the extreme in disregarding the improper nature of his actions as a fiduciary.

Even when considering the higher degree of fault necessary to show embezzlement under section 523(a) of the Bankruptcy Code, courts have not required the rightful owners to show that the embezzler intended to permanently deprive them of their property. Fraudulent intent is present so long as the embezzler intends to divest the rightful owner of property even temporarily. In re Gunstream, 10-03686-TLM, 2011 WL 6301183 (Bankr. D. Idaho Dec. 16, 2011); Matter of Shuler, 21 B.R. 643, 644 (Bankr. D. Idaho 1982); cf. United States v. Anderson, 850 F.2d 563, 565 (9th Cir. 1988) (stating the rule for criminal law);

United States v. Faulkner, 638 F.2d 129, 130 (9th Cir. 1981) (same). This same principle applies with equal if not greater force here. Schoenfeld committed defalcation when he knowingly withdrew pension funds, and knowingly transferred them to Tomco, with full awareness that Tomco would spend them to pay the operating expenses of the company. Even if Schoenfeld planned to eventually replace the missing money with later-acquired funds, this does not diminish the intentional wrong of the unauthorized transfers.

To the extent that Schoenfeld's repayment argument is an attempt to show that he did not act in bad faith, this is also immaterial under the Supreme Court's test for defalcation. See Bullock, 133 S. Ct. at 1759 (explaining that a showing of intentional wrong is required only when the "the conduct at issue does not involve bad faith"). The proper inquiry is whether Schoenfeld knew or consciously disregarded an excessive risk that his actions breached his fiduciary duties, not whether he intended the bad consequences of his actions suffered by the Pension Plan participants. Cf. In re Baylis, 313 F.3d at 20 ("A debtor fiduciary may not escape the exclusion from discharge of his debt arising out of defalcation by saying he had no specific intent. As in other areas of the law, circumstances will provide the level of wrongdoing needed to constitute a defalcation.").

Nor is there merit to Schoenfeld's assertion that he "knew that TAP was contractually obligated to reimburse the Plan" based on the Asset and Sale

Agreement between Tomco and TAP. Appellant's Br. at 22; ER 169. In fact, the Letter of Intent for the sale excludes indebtedness for borrowed money as a type of ordinary business expense that TAP intended to assume, SER 441, and one of TAP's directors testified that the company assumed this obligation for the first time as part of the settlement agreement that was reached several years after Schoenfeld withdrew the Pension Plan assets and transferred them for Tomco's use. Id. at 393. Moreover, far from negating any ill intent, the fact that he urged TAP to pay the balance due by noting that that the Department of Labor was "turning up the heat" and that the transfer of the funds could "result in an assessment of penalties," ER 132, demonstrates his clear understanding that he breached his duties under ERISA.[6]

[6] Schoenfeld notes in passing that the Pension Plan participants voted to approve the asset sale from Tomco to TAP. Appellant's Br. at 22. To the extent that Schoenfeld means to imply that this vote authorized him to divert plan funds to Tomco, this suggestion must fail. Those who misappropriate "from ERISA pension funds cannot argue that their otherwise illegal transactions were 'authorized' by the plan participants because the participants themselves lack the legal power to 'authorize' such a diversion of pension monies." United States v. Mett, 178 F.3d 1058, 1068 (9th Cir. 1999). And in any event, the record contains no evidence whatsoever that the Tomco pension plan participants knew about the transfers.

## II. THE PRECLUSIVE EFFECT OF SCHOENFELD'S CHAPTER 13 PLAN IS NOT BEFORE THIS COURT; REVIEW IS LIMITED TO THE DISTRICT COURT'S DISCRETIONARY DECISION TO DENY SUPPLEMENTAL BRIEFING

### A. This Court Lacks Jurisdiction to Determine Whether the Bankruptcy Plan is Res Judicata, or to Enjoin the Secretary from Enforcing the Debt

Profoundly misunderstanding the scope of appellate jurisdiction, Schoenfeld argues that his Chapter 13 Plan estops the district court from holding him liable for money damages, and asks this Court to enjoin the Secretary from collecting any claim for money arising from his actions as trustee of the Pension Plan. Appellant's Br. at 4, 27. But Schoenfeld never sought an injunction against the Secretary in the district court, in the bankruptcy court, or any court of original jurisdiction. There is no order denying injunctive relief against the Secretary for Schoenfeld to appeal. The jurisdiction of a Circuit Court, however, is primarily appellate; it is limited to reviewing "final decisions" of the district courts, reviewing certain interlocutory district court orders, and, in extraordinary circumstances, issuing writs in aid of its own jurisdiction. United States v. Garner, 632 F.2d 758, 761 (9th Cir. 1980); 28 U.S.C. § 1291 (final decisions); 28 U.S.C. § 1292 (interlocutory orders); 28 U.S.C. § 1651 (writs). This Court, accordingly, cannot grant the relief Schoenfeld seeks in the first instance.

Indeed, the preclusive effect of Schoenfeld's bankruptcy plan is not before this Court on appeal. Schoenfeld did not argue that his Chapter 13 Plan was res judicata in either his motion seeking summary judgment or in opposition to the Secretary's summary judgment motion. Rather, after the district court had already entered judgment, he raised this argument for the first time in briefing on the Secretary's Motion to appoint Maribel Larios as an independent fiduciary, when he requested permission to submit a supplemental response to the Secretary's Reply to his opposition brief. SER 2, 10. Schoenfeld's failure to raise preclusion at any earlier point, including in his summary judgment papers, waives his right to do so on appeal. Dimitrov v. Seattle Times Co., 230 F.3d 1366 (9th Cir. 2000); Brannan v. United Student Aid Funds, Inc., 94 F.3d 1260, 1266 (9th Cir. 1996). This Court, therefore, need not determine whether the bankruptcy plan is res judicata. The Court's review of this order is instead limited to reviewing the district court's discretionary decision to deny Schoenfeld's request for supplemental briefing.

B. The District Court Did Not Abuse Its Discretion in Denying Schoenfeld's Request to Submit a Supplementary Opposition

The district court acted appropriately within its discretion to deny Schoenfeld's request to submit a supplemental response to the Secretary's Reply. Under local rules for the Central District of California, a party may not file a response to a reply, "[a]bsent prior written order" of the district court. D. Cal. R. 7-10. The decision whether to grant or deny Schoenfeld's request to file a second brief in opposition was well "within the sound discretion of the court."

S. E. C. v. Seaboard Corp., 677 F.2d 1301, 1314 (9th Cir. 1982) ("acceptance or rejection of argumentative briefs, memoranda, and other supplementary material is within the sound discretion of the court"). Schoenfeld, moreover, did not ask for a chance to respond to arguments raised in the Secretary's Reply brief, as a party typically would in a surreply. Rather, Schoenfeld sought to raise an affirmative defense to the Secretary's claims for money judgment – after the district court had already entered judgment and for the first time after more than a year of litigation. Schoenfeld, the district court found, had "ample opportunity" to raise a preclusion defense earlier, but failed to do so, and had "seemingly conceded" the issue. SER 2. Thus, the district court did not abuse its discretion when it denied Schoenfeld's request.

### C. Because Schoenfeld Failed to Amend or File a New Notice of Appeal, Federal Rule of Appellate Procedure 4(a)(4)(B) Precludes Review of His Post-Judgment Request as a Motion for Reconsideration

To the extent that the district court denied a constructive request for relief from the judgment under Federal Rule of Civil Procedure 60(b), this Court lacks jurisdiction to review the decision because Schoenfeld did not amend his prior notice of appeal or file a new notice appealing the post-judgment order. Fed. R. App. P. 4(a)(4)(B)(ii); see also Whitaker v. Garcetti, 486 F.3d 572, 585 (9th Cir. 2007) (denying review of post-judgment motion for attorney's fees because plaintiffs failed to amend the notice of appeal or file a new one); "Perfecting Your

Appeal," United States Court of Appeals for the Ninth Circuit (December 2009) ("An amended notice must be filed if review of the post-judgment motion's disposition is desired.") (citing Fed. R. App. P. 4(a)(4)).

In any event, the district court's denial of reconsideration was well within its discretion. This Court will reverse a district court's denial of a motion to vacate a judgment under Rule 60(b) "only upon a clear showing of abuse of discretion." Molloy v. Wilson, 878 F.2d 313, 315 (9th Cir. 1989) (citation omitted). A "motion for reconsideration should not be granted, absent highly unusual circumstances, unless the district court is presented with newly discovered evidence, committed clear error, or if there is an intervening change in the controlling law." Marlyn Nutraceuticals, Inc. v. Mucos Pharma GmbH & Co., 571 F.3d 873, 880 (9th Cir. 2009). It "may not be used to raise arguments or present evidence for the first time when they could reasonably have been raised earlier in the litigation." Id. Here, there was no change in controlling law, and the district court determined that it had previously considered "all materials presented to it." SER 3. Moreover, Schoenfeld could have argued the res judicata effect of his Chapter 13 plan at various points throughout the litigation: in his motion for summary judgment, in opposition to the Secretary's motion for summary judgment, or in a pre-discovery motion to dismiss because the action was precluded. SER 2. Instead Schoenfeld waited to "unveil" his argument until a "very late date." SER 3. Accordingly, the district court did not abuse its discretion in denying Schoenfeld's last-ditch effort to raise this issue.

D. Nondischargeable Debt is not Discharged under Section1328(a), Even if a Creditor Fails to Object to Confirmation of a Chapter 13 Plan

Schoenfeld's late-raised preclusion defense is meritless, even if this Court could review it on the merits. Regardless of whether a creditor objects to the confirmation of a Chapter 13 plan, a debt that a court has determined to be nondischargeable under section 523(a) cannot be discharged.

Bankruptcy Code section 1328, rather than section 1327, Appellant's Br. at 24, sets forth the terms for discharge in a Chapter 13 bankruptcy. The "full" discharge section provides that:

> after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge of all debts provided for by the plan . . . except any debt . . . of the kind specified in . . . paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of section 523(a).

11 U.S.C. § 1328(a)(2). Likewise, the "partial" discharge provision at 11 U.S.C. § 1328(b), "discharges the debtor from all unsecured debts provided for by the plan . . . except any debt . . . of a kind specified in section 523(a) of this title." 11 U.S.C. § 1328(c)(2). Accordingly, upon successful completion of his payments or if the bankruptcy court approves a partial discharge, most of the debts in Schoenfeld's confirmed plan will be discharged, but not his debts arising out of his

defalcation as an ERISA fiduciary.  Following the discharge order, nothing will prevent the Secretary from enforcing the nondischargeable judgment in this case.

The cases Schoenfeld cites do not dictate a different outcome.  The Ninth Circuit decided Matter of Gregory, 705 F.2d 1118 (9th Cir. 1983), before Congress amended section 1328(a) to except embezzlement and defalcation-related debts from Chapter 13 discharge.  See 11 U.S.C. § 1328 (1983), amended by PL 109–8, 119 Stat 23 (2005).  Gregory does not, therefore, stand for the proposition urged by Schoenfeld that an "otherwise nondischargeable claim" is discharged if creditors fail to object.  Appellant's Br. at 25.

Schoenfeld's other cases deal with student loan debts under 11 U.S.C. § 523(a)(8).  See Appellant's Br. at 25-26 (citing In re Pardee, 193 F.3d 1083, 1086 (9th Cir. 1999) and Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1198 (9th Cir. 2008) aff'd, 559 U.S. 260, 130 S. Ct. 1367 (2010)).  Unlike debts arising from defalcation under section 523(a)(4), which are not dischargeable in any circumstances, student loan debts are dischargeable if "excepting such debt from discharge . . . would impose an undue hardship on the debtor and the debtor's dependents."  11 U.S.C. § 523(a)(8).  The question presented in those cases was whether a creditor may collaterally attack a bankruptcy court's decision to discharge student loan debt when the court fails to conduct a proceeding to determine or make a specific finding on undue hardship as required by the

Bankruptcy Rules. In re Pardee, 193 F.3d at 1086; Espinosa, 553 F.3d at 1198; see also Espinosa, 559 U.S. at 264 (deciding "whether an order that confirms the discharge of a student loan debt in the absence of an undue hardship finding or an adversary proceeding, or both, is a void judgment for Rule 60(b)(4) purposes").

Neither case held that a student loan debt found not to impose an undue hardship – that is, a student loan debt deemed nondischargeable under section 523(a)(8) – is later discharged by a Chapter 13 discharge order simply because the creditor previously failed to object to the plan. The statutory text of section 1328 makes the answer to that question plain: liabilities for defalcation and other debts listed at section 1328(a)(2) and (c), are "except[ed]" from Chapter 13 discharge.

## CONCLUSION

For the foregoing reasons, this Court should affirm the district court's judgment that Schoenfeld's ERISA liabilities are nondischargeable under 11 U.S.C. § 523(a)(4), and also affirm its order denying Schoenfeld's request for additional briefing post-judgment.

Respectfully submitted,

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STATUTORY ADDENDUM

ADDENDUM

**11 U.S.C. § 523(a)(4)**

§ 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . .

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny

**11 U.S.C. § 523(a)(8)**

§ 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . .

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for--

(A) (i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual

**11 U.S.C. § 1328**

§ 1328. Discharge

(a) . . . [A]s soon as practicable after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt--

- (1) provided for under section 1322(b)(5);
- (2) of the kind specified in section 507(a)(8)(C) or in paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of section 523(a);
- (3) for restitution, or a criminal fine, included in a sentence on the debtor's conviction of a crime; or
- (4) for restitution, or damages, awarded in a civil action against the debtor as a result of willful or malicious injury by the debtor that caused personal injury to an individual or the death of an individual.

(b) . . . [A]t any time after the confirmation of the plan and after notice and a hearing, the court may grant a discharge to a debtor that has not completed payments under the plan only if [certain conditions are met]

(c) A discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts provided for by the plan or disallowed under section 502 of this title, except any debt--

- (1) provided for under section 1322(b)(5) of this title; or
- (2) of a kind specified in section 523(a) of this title.

**11 U.S.C. § 1328(a) (1994), *amended by* PL 109–8, 119 Stat 23 (2005)**

§ 1328. Discharge

(a) As soon as practicable after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt--

- (1) provided for under section 1322(b)(5) of this title;
- (2) of the kind specified in paragraph (5), (8), or (9) of section 523(a) of this title; or
- (3) for restitution, or a criminal fine, included in a sentence on the debtor's conviction of a crime.

## CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(5), (6), and (7), I hereby certify that the brief for the Appellee, Thomas Perez, Secretary of Labor, complies with the typeface, style, and volume requirements because it was prepared using Microsoft Office Word 2003 utilizing Times New Roman 14 point font and contains 10,658 words, excluding parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B). The brief has been scanned and is virus free.

Date: October 25, 2013

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# STATEMENT OF RELATED CASES

There are no related cases pending in this Court.

<u>CERTIFICATE OF SERVICE</u>

I certify that on this 25th day of October, 2013, a copy of the Answering Brief for the Secretary of Labor was filed electronically through the Court's CM/ECF system. I further certify that upon receipt of a directive, I will serve original and 7 copies of the Brief in paper format to the Clerk of this Court by express mail.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

Dated: October 25, 2013

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