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When Plans Go Unpaid: A Look at the Defalcation Exception as Applied to Pension-Plan Sponsors and Underfunded Plans

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INTRODUCTION

The year was 1963. The Studebaker Corporation, in business for decades producing automobiles, closed its South Bend, Indiana plant.[1] At the time, around 10,000 current and retired employees were receiving or expecting benefits from the company's pension plan. After the close, 3,600 employees already at retirement age received their promised full benefits. But the rest of the employees weren't so lucky. Four thousand workers between the ages of forty and fifty-nine who had worked for ten years or more for the company received only 15% of the value of their pensions; the remaining 2,900 workers got nothing. Realizing the devastating effect of the Studebaker shutdown, Congress sprang into action. In the 1970s, Congress enacted the

[1] James A. Wooten, *"The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683 (2001).

Employee Retirement Income Security Act (ERISA) in hopes of establishing sustainable retirement packages for American workers. The Act was, and still is, designed to create a regulatory scheme to ensure employers properly fund employee retirement plans. ERISA also created the Pension Benefits Guaranty Corporation (PBGC) to insure employer-sponsored plans. Decades later, Congress enacted the Pension Protection Act (PPA) to address some shortfalls of ERISA.

Despite this regulation, employers are still underfunding pension plans. Facing a grossly underfunded pension plan and economic distress, many employers file bankruptcy. Generally, bankruptcy provides a "fresh start." Furthering that policy, most debt is discharged after bankruptcy. However, there are some exceptions, specifically the defalcation exception that prevents a debtor from discharging a debt if the debtor has acted in such a way that discharge is no longer warranted. Reflecting on the growing problem of underfunded pensions and the impact of discharge on the innocent employee, some courts have applied the defalcation exception to pension-plan sponsors. The result: the debt owed by the pension-plan sponsor to the pension plan survives bankruptcy, meaning the debt is still owed to the pensioners. More courts, however, have held that the defalcation exception does not apply, instead discharging all of the debt—including the liability for the underfunded pension plan.

The fact that there is an incentive to underfund pension plans and then file for bankruptcy is concerning. Given the number of underfunded pension plans even after the enactment of ERISA and the PPA, something must be done to remedy this problem and create a greater incentive for employers to fully fund their pension plans. Part I describes the main types of pension plans and the problems arising out of those plans. Part II looks at ERISA and the PPA and how they address underfunded pension plans. This Part also evaluates the requirements for creating a fiduciary relationship, a requirement for ERISA liability and application of the defalcation exception. Part III summarizes current bankruptcy law, specifically evaluating the defalcation exception to discharge and the requirements for establishing a fiduciary relationship under the Bankruptcy Code. Part IV argues that the courts should create a presumption of a fiduciary relationship for a plan sponsor under the Bankruptcy Code for funds not yet deposited into the pension fund. Given the recent U.S. Supreme Court decision in *Bullock v. BankChampaign*, which heightened the standard needed to satisfy the defalcation exception, plan sponsors should be sufficiently protected by the Bankruptcy Code, even with this presumption. Meanwhile, the presumption would increase accountability for plan sponsors, give pensioners more recourse against the plan sponsor, and hopefully reduce the problem of underfunding.

I. PENSIONS AND THE PBGC—THE PROBLEM

The use and contents of pension plans have changed over the years. Still, many companies utilize some form of a pension plan to create an incentive for their employees to remain loyal to the company. The following Part will detail the main pension forms used today and will illustrate the problems associated with these pensions. Section A discusses current pension plans used by employers today. Section B discusses the problem of underfunded pension plans, including specific examples from businesses in bankruptcy.

A. Pensions in Use Today

There are two main kinds of pension plans: the defined-benefit plan and the defined-contribution plan. A defined-benefit plan provides employees with a specified monthly benefit at retirement.[2] Benefits are often paid out based on a "plan formula that considers such factors as salary and service—for example, 1 percent of average salary for the last 5 years of employment

[2] *Retirement Plans, Benefits & Savings*, U.S. DEP'T LABOR, http://www.dol.gov/dol/topic/retirement/typesofplans.htm (last visited Mar. 3, 2014).

for every year of service with the employer."[3] Benefits may also be paid out in a set amount per month.[4] These plans are employer funded, rather than employee funded, making them the most costly and "administratively complex" kind of plan.[5] While there used to be some 114,000 defined-benefit plans in the mid-1980s, there are only about 38,000 of these plans in existence today, many of which are held by Americans nearing retirement age.[6]

Unlike defined-benefit plans, defined-contribution plans can be funded by the employer, the employee, or both.[7] The contributing parties contribute an amount, usually set by the terms of the plan, per year into an account.[8] The money is then invested for the employee through the employer's investment accounts.[9] The employee is entitled to the contents of the account upon retirement, including any gains or losses from the investment.[10] Unlike a defined-benefit plan, there is no set amount to be received by the employee at retirement.[11] These plans are generally more familiar to consumers, as employers have begun using them more frequently. Examples of these kinds of plans include the 401(k), 403(b), and Employee Stock Ownership Plan.

In addition to single employer plans, multiemployer plans have been developed to help spread the risk of maintaining a pension plan.[12] These plans are funded by multiple companies so

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[3] *Id.*
[4] *Id.*
[5] *Choosing a Retirement Plan: Defined Benefit Plan*, IRS (Aug. 5, 2013), http://www.irs.gov/Retirement-Plans/Choosing-a-Retirement-Plan:-Defined-Benefit-Plan.
[6] *Id.*
[7] *Retirement Plans, Benefits & Savings*, *supra* note 2.
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] Lorraine Woellert, *Twinkies Bankruptcy Exposes Peril to Some U.S. Pensions: Economy*, BLOOMBERG (Feb. 26, 2014, 10:02 AM), http://www.bloomberg.com/news/2014-02-26/twinkies-bankruptcy-raises-specter-of-u-s-pension-fund-failures.html. These plans are "considered low risk because they don't rely on a single company for financing." *Id.*

that no one company bears the burden of financing the plan and so the plan can hopefully remain after bankruptcy. But that isn't how it always works out.[13]

B. The Growing Problem: Underfunded Pensions

In the wake of a struggling economy, financially distressed companies have had to take drastic action, which has revealed just how deep the recession is. For example, last July, Delphi Corporation, which is one of the largest suppliers of auto parts, terminated its pension plans.[14] And Delphi wasn't alone. It is estimated that in January 2009, the auto industry had unfunded pension liabilities of about $42 billion.[15] The result: plan participants were left to endure a potential loss of several million dollars through reduced benefits.[16] When plan liabilities are so high, pensioners' benefits are often reduced, leaving them with considerably less money than they had anticipated.[17] The Pension Benefit Guaranty Corporation is tasked with remedying this kind of problem.

1. *The Pension Benefit Guarantee Commission*

The Pension Benefit Guaranty Corporation (PBGC) was developed in 1974 as part of ERISA, essentially as a private-sector insurance company for pension plans.[18] Like a traditional insurance company, the PBGC collects premiums from employers sponsoring insured pension

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[13] *See Id.*
[14] U.S. GOV'T ACCOUNTABILITY OFFICE, TROUBLED ASSET RELIEF PROGRAM, AUTOMAKER PENSION FUNDING AND MULTIPLE FEDERAL ROLES POSE CHALLENGES FOR THE FUTURE (2010), *available at* http://www.gao.gov/assets/310/302830.pdf.
[15] *Id.*
[16] *Id.*
[17] *See, e.g.*, Mary Williams Walsh, *Thought Secure, Pooled Pensions Teeter and Fall*, N.Y. TIMES (Apr. 12, 2014, 11:20 AM), http://dealbook.nytimes.com/2014/04/12/thought-secure-pooled-pensions-teeter-and-fall/?_php=true&_type=blogs&_r=0.
[18] Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829; (codified at 29 U.S.C. § 1302(a) (2006)). Specifically, the PBGC was developed to carry out the following tasks:

> (1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,
> (2) to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which this subchapter applies, and
> (3) to maintain premiums established by the corporation under section 1306 of this title at the lowest level consistent with carrying out its obligations under this subchapter.

29 U.S.C. § 1302(a) (2012).

plans.[19] The PBGC is run by the federal government and is headed by a director appointed by the President and confirmed by the Senate.[20] While the PBGC was established by Congress and is operated like a traditional government agency, it receives no funding from Congress.[21] Still, Congress has full authority to set the premiums to be paid by employers.[22] The PBGC insures pension plans up to a maximum guaranty, which changes yearly and is affected by the employee's age when the pension is terminated or the employer goes into bankruptcy.[23] In 2013, the maximum for workers retiring at the age of sixty-five was $57,577.24 per year.[24] For 2014, the maximum benefit for a sixty-five-year-old employee is $59,318.16.[25] According to its website, the PBGC insures forty million Americans' retirement benefits and "is responsible for the current and future pensions of about 1.5 million people."[26] The PBGC has reportedly paid out around $722 million since 2005 to support failed plans.[27]

The PBGC guarantees benefits for the following persons: (1) retirees—both those retiring early and at normal retirement age; (2) disabled employees; and (3) survivors of deceased

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[19] *Who We Are*, PENSION BENEFIT GUARANTY CORP., https://www.pbgc.gov/about/who-we-are.html (last visited Mar. 3, 2014). The PBGC is also funded by investments and funds received when it takes over a failing pension plan. *Id.*

[20] 29 U.S.C. § 1302(a); *see also Who We Are*, *supra* note 19. For more on the composition of the board, see § 1302(d).

[21] PATRICK PURCELL, SUMMARY OF THE PENSION PROTECTION ACT OF 2006, at CRS-9 (2006), *available at* http://401kpsp.com/indexes/pension%20act%20summary.pdf.

[22] PURCELL, *supra* note 21. Congress has authorized two kinds of premiums: "a per-capita premium that is charged to all sing-employer defined benefit plans and a variable premium charged to underfunded plans equal to $9 per $1,000 of underfunding (.9%)." *Id.*

[23] *Who We Are*, *supra* note 19; *Maximum Monthly Guarantee Tables*, PENSION BENEFIT GUARANTY CORP., http://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee.html (last visited April 1, 2014) (providing the basics of the guarantee and tables detailing maximum payouts by year since 1974).

[24] *Who We Are*, *supra* note 19. For more on the benefits guaranteed, see 29 U.S.C. § 1321-23 (2006).

[25] Press Release, Pension Benefit Guaranty Corporation, PBGC Maximum Insurance Benefit Increases for 2014 (Nov. 6, 2013), *available at* http://www.pbgc.gov/news/press/releases/pr13-13.html.

[26] *Who We Are*, *supra* note 19. "In 2012, the PBGC paid for monthly retirement benefits, up to the guaranteed maximum, for nearly 887,000 retirees in 4,500 single-employer and multiemployer pension plans that cannot pay promised benefits." *Id.*

[27] Woellert, *supra* note 12; *see also* PENSION BENEFITS GUARANTY CORPORATION, PENSION INSURANCE TABLES (2011), *available at* http://www.pbgc.gov/documents/pension-insurance-data-tables-2011.pdf.

employees.[28] The PBGC does not cover health and welfare benefits, life insurance, vacation pay, severance pay, or "benefits payable because of disability that occurs after the guarantees take effect."[29] In single employer plans, the PBGC generally covers all included benefits for about 85% of pensioners.[30] According to its website, the PBGC takes over pensions:

- If a sponsoring company seeking to reorganize in bankruptcy proves that it cannot remain in business and continue funding the pension plan
- If a plan runs out of money to pay benefits
- If a sponsoring company files for liquidation (as opposed to reorganization).[31]

Many companies have had to seek assistance from the PBGC for these very reasons.

2. *Case Studies*

In 2010, the Government Accountability Office released a report detailing its concerns about the GM and Chrysler pension plans following the companies' 2009 bankruptcies.[32] The report indicated that the GAO anticipated GM and Chrysler to return to profitability, enabling both companies to make up the contributions to their respective plans.[33] At the time, GM had to make contributions of $5.9 billion in 2013 and $6.4 billion in 2014. Meanwhile, Chrysler had to make contributions of $400 million in 2010 and in 2012, $930 million in 2013, and $1.25 billion in 2014.[34] If GM and Chrysler had not been able to make those contributions, the PBGC would have been facing liability of around $14.5 billion, which would have "hit [the PBGC] hard both financially and administratively."[35]

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[28] *PBGC's Guarantees for Single-Employer Pension Plans*, PENSION BENEFIT GUARANTY CORP., http://www.pbgc.gov/res/factsheets/page/guar-facts.html (last visited April 1, 2014).
[29] *Id.*
[30] Press Release, *supra* note 25.
[31] *PBGC's Guarantees for Single-Employer Pension Plans*, *supra* note 28.
[32] GOV'T ACCOUNTABILITY OFFICE, TROUBLED ASSET RELIEF PROGRAM: AUTOMAKER PENSION FUNDING AND MULTIPLE FEDERAL ROLES POSE CHALLENGES FOR THE FUTURE (2010), *available at* http://www.gao.gov/new.items/d10492.pdf
[33] *Id.*
[34] *Id.*
[35] *Id.*

While there has been a lot of publicity about underfunded pension plans in the automotive sector, the problem is prevalent in many sectors of the economy.[36] One observer explains that "[t]wo recessions, industry consolidation prompted by deregulation, and an aging workforce have funds facing a $400 billion shortfall that has some near insolvency. Dozens already have failed, affecting 94,000 participants."[37] Recently, Hostess, the well-known maker of Twinkies, went into bankruptcy.[38] Ottenberg's Bakery in Maryland was in a multiemployer pension plan with Hostess when Hostess went bankrupt in 2012; the fund was the Bakery and Sales Drivers Local 33 Pension Fund.[39] With Hostess in bankruptcy with $2 billion liability to its multiemployer plans, Ottenberg's was left to cover the costs of the benefits from the plan.[40] In bankruptcy, secured creditors get paid out first, often leaving nothing to satisfy the pensions and the affected employees.[41] In response, the PBGC, for the third time in history,[42] partitioned the plan to pay out retirement benefits to the 350 affected Hostess employees.[43] According to the

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[36] The problem persists in the public sector too. Bloomberg reports that as of 2012, none of the fifty states were funded at 100%. *Most Underfunded Pension Plans: States*, BLOOMBERG: VISUAL DATA, http://www.bloomberg.com/visual-data/best-and-worst/most-underfunded-pension-plans-states (last visited Mar. 29, 2014). Though many were close (funded at around 90%), thirty-eight states were funded below 80%, with another four funded just more than 80%. *Id.*; *see also* Tim Jones & Brian Chappatta, *Illinois Lawmakers Confront Historic Burden of Pension Futility*, BLOOMBERG (Dec. 3, 2013, 12:00 AM), http://www.bloomberg.com/news/2013-12-03/illinois-lawmakers-confront-historic-burden-of-pension-futility.html. This, like private-sector pension plans, is a growing problem, but given that ERISA applies to private-sector pension plans, the discussion in this Note will be limited to private-sector pension plans.

[37] Woellert, *supra* note 12.

[38] *See* Alana Semuels, Tiffany Hsu & Emily Bryson York, *Hostess Shuttering Doors, Ending Era of Iconic Brand*, CHICAGO TRIB. (Nov. 17, 2012), http://articles.chicagotribune.com/2012-11-17/business/chi-hostess-brands-seeks-court-permission-to-liquidate-20121116_1_hostess-brands-gregory-rayburn-madison-zingers (discussing the Hostess bankruptcy and the conditions leading up to it).

[39] Woellert, *supra* note 12.

[40] *Id.*

[41] *Id.*

[42] The PBGC partitioned pensions "in 1983 to save benefits for restaurant workers and manufacturers in and around Detroit[, and i]n 2010, it split a Chicago plan protecting 3,700 truckers and putting 1,500 on government payouts." Woellert, *supra* note 12.

[43] Press release, Pension Benefits Guaranty Corporation, PBGC Acts to Help Save Multiemployer Pension Fund (Jan. 31, 2014), *available at* http://www.pbgc.gov/news/press/releases/pr14-02.html.

PBGC, the separation was designed to ensure that the plan survives to cover the benefits of the other employees in the multiemployer plan.[44]

> Brad Raymond, General Counsel for the Teamsters, said the union supports PBGC's efforts to preserve benefits. "Overall, we think what PBGC is doing offers the best chance for struggling pension funds to survive in the context of inadequate bankruptcy laws which permit companies to abandon their responsibilities and shift their pension commitments to PBGC, other responsible employers, and their workers. We will continue to work with PBGC to preserve our members' pensions."[45]

As a result of the partition, the Hostess employees now being paid by the PBGC will receive a lesser amount than they would have under the plan—about $520 a month instead of $650 a month.[46] The 360 employees left in the Bakery and Sales Drivers plan have been merged into another plan.[47] Plan mergers like this one have been used "to protect benefits of people in multiemployer plans. This option enables the plans to combine monetary assets and administrative resources so participants have a more secure retirement future."[48] While there was a happy ending for the employees in this pension plan, many others do not have such positive outcomes.

The New York Times recently ran a story on a widow whose survivor benefits were terminated after the death of her husband.[49] Carol Cascio was counting the days before she would be able to start collecting his survivor benefits from her husband's pension plan; she had even "borrowed against the promised pension to pay for her daughter's education."[50] Before that day came, her husband's benefits were terminated. This drastic cut used to be outlawed under the anticutback rule, which provided that employers could freeze assets but not terminate them all together. That rule was suspended in 2006, "permitting the weakest plans to stop paying certain

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[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] *Id.*
[49] Walsh, *supra* note 17.
[50] *Id.*

benefits to people who had not yet retired, including disability stipends, lump-sum distributions, recent pension increases, death benefits and early retirement benefits."[51] Multiemployer plans were once thought to be the safest, but now those are even struggling to stay afloat. With the PBGC's multiemployer program collecting only about $110 million in premiums, "[a]ll it would take is the failure of one big plan to wipe out the whole program."[52]

II. ERISA AND ESTABLISHING A FIDUCIARY RELATIONSHIP

Before evaluating the Bankruptcy Code and its applicability to pensions, it is necessary to have a basic understanding of the Employee Retirement Income Security Act and subsequent action taken by Congress regarding pension plans. Section A reviews the history and structure of ERISA, and Section B looks at the Pension Protection Act and how Congress tried to use it to fix the gaps in ERISA.

A. ERISA Overview

In 1974, Congress enacted the Employee Retirement Income Security Act (ERISA) to ensure the protection of employee pension plans and other retirement devices.[53] Congress recognized that "the growth in size, scope, and numbers of employee benefit plans in recent years ha[d] been rapid and substantial," so this expansive Act was developed to provide standardized procedures and regulations.[54] ERISA provides minimum standards for any private-sector employer who sponsors a pension plan.[55] Among other things, ERISA sets reporting and disclosure requirements,[56] participation and vesting requirements,[57] funding requirements,[58] and fiduciary responsibility requirements.[59]

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[51] *Id.*
[52] *Id.*
[53] Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified at 29 U.S.C. §§ 1001-1461 (2006)).
[54] *Id.* § 1001.
[55] *See* 29 U.S.C. § 1003 (providing that ERISA does not apply to government plans or other public-sector plans).
[56] *See* 29 U.S.C. §§ 1021-31.

Most relevant here, ERISA provides that fiduciaries of covered plans are liable for a breach of fiduciary duty.[60] Under ERISA, a party can be deemed a fiduciary if they are a "named fiduciary"[61] or if they satisfy the informal requirements under § 1002(21)(A). Named fiduciaries are required on every plan or trust instrument; that named person is a fiduciary under ERISA.[62] Further, a person can be considered a fiduciary, even if not specifically named. Pursuant to ERISA:

> a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.[63]

Once a person is determined to be a fiduciary, that person is individually liable for a breach of any obligations imposed by ERISA and is liable "to make good to such plan any losses to the plan resulting from each such breach."[64] Significantly, the Act limits liability to only those breaches that occur *after* the person has become a fiduciary.[65] But, the Act does not clearly define "assets," leaving the courts to determine whether unpaid contributions constitute assets of the plan.

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[57] *See id.* §§ 1051-61.
[58] *See id.* §§ 1081-86.
[59] *See id.* §§ 1101-14.
[60] *See id.* § 1109 (providing liability for breach of fiduciary duty).
[61] *See id.* § 1102(a)
[62] *Id.* § 1103(a).
[63] *Id.* § 1002(21)(A).
[64] *Id.* § 1109(a).
[65] *Id.* § 1109(b). This is particularly important given the circuit spilt in the bankruptcy arena. If one does not become a fiduciary under the defalcation exception until after the money is deposited in the pension plan, the defalcation exception necessarily cannot apply to except an individual from discharge for failing to deposit funds into the pension plan. *See infra* Sections III.B-D for further discussion.

B. The Pension Protection Act

In 2000, the PBGC had a surplus of $9.7 billion; that surplus drastically declined between 2001 and 2005 when the PBGC paid out nine of its ten largest claims.[66] Those "claims accounted for 63% of the total dollar value of claims made on the PBGC since the agency began operating in 1975."[67] Those claims left the PBGC with a funding deficit of $22.7 billion.[68] In light of the growing pension problem and the growing deficit of the PBGC, Congress enacted the Pension Protection Act (PPA) in August 2006.[69]

More specifically, the PPA was designed to address very pointed shortfalls of ERISA. First, under ERISA, underfunded plan sponsors were not required to make additional contributions to increase the funding of the plan if the plan was at least 90% funded.[70] Moreover, because of the accounting process used, the assets and liabilities of plans were not accurately calculated under ERISA.[71] Also, sponsors were sometimes able to extend amortization out for as long as thirty years.[72] Lastly, when sponsors made extra contributions in years prior, they were not required to make the same level of additional contribution to amortize the fund.[73] In other words, if a sponsor was below the minimum level of funding, it was required to contribute a

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[66] PURCELL, *supra* note 21, at CRS-2.
[67] *Id.*
[68] *Id.* This was up slightly from the $23.3 billion deficit in 2004. *Id.* See also *Id.* at 5 tbl.1 for the top ten largest claims paid out by the PBGC from 1975 to 2005.
[69] Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (codified in scattered sections of 29 U.S.C.); PURCELL, *supra* note 21, at CRS-4.
[70] PURCELL, *supra* note 21, at CRS-1.
[71] *Id.* ("Because the interest rates used to calculate current pension plan liabilities were averaged over a four-year period and asset values used to calculate minimum funding requirements could be averaged over five years, neither plan assets nor liabilities were measured accurately.").
[72] *Id.*
[73] *Id.* ("Some sponsors of underfunded pensions were able to avoid making contributions to their plans for several years because they had made contributions beyond the required minimum in the past. The use of these so-called 'credit balances' led to greater underfunding of pension plans, according to the Administration's analysis.").

minimum amount each year. If the sponsor contributed more than the minimum amount in one year, the sponsor's minimum contribution in the next year would be reduced.[74]

Under the PPA, plan sponsors have a shorter time, only seven years, to amortize an underfunded plan.[75] As under ERISA, plan sponsors can still offset the repayment amount using credit balances,[76] but only once the plan is funded at 80% or more. In addition, the value of the credit balance must be "adjusted to reflect the changes in the market value of the plan assets since the date of the contributions that created the credit balances were made."[77]

New provisions for multiemployer plans were also implemented. At the beginning of the plan year, the plan sponsors must certify the funding status of the plan for the year and project the funding status for the next six years.[78] Under the new provisions, plans can be characterized as being in "critical status," whereby sponsors have a year to develop a rehabilitation plan and have ten years to move out of critical status.[79] The PPA provides similar provisions for plans categorized as "endangered"[80] and "seriously endangered."[81]

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[74] *See Credit Balances in Defined Benefit Pension Plans*, ERISA INDUS. COMM. (June 29, 2005), http://www.eric.org/forms/uploadFiles/37B400000002.filename.Credit_Balance_Document.pdf.

[75] *Id.* at CRS-3.

[76] The credit balance is the amount of the contribution a sponsor makes in excess of the minimum contribution. *Credit Balances in Defined Benefit Pension Plans*, *supra* note 74.

[77] PURCELL, *supra* note 21, at CRS-4.

[78] *Id.* at CRS-10.

[79] *Id.* at CRS-11. A plan is considered to be in critical status if:

> (1) it is less than 65% funded and has a projected funding deficiency within five years or will be unable to pay benefits within seven years; (2) it has a projected funding deficiency within four years or will be unable to pay benefits within five years (regardless of its funded percentage; or (3) its liabilities for inactive participants are greater than its liabilities for active participants, its contributions are less than carrying costs, and a funding deficiency is projected within five years.

Id. at CRS-11. Plan sponsors have ten years to rehabilitate the plan "from the earlier of (1) two years after adoption of the rehabilitation plan or (2) the first plan year after the beginning of collective bargaining agreements covering 75% of active participants." *Id.* at CRS-12.

[80] *Id.* at CRS-11. A plan is considered to be endangered if it is "less than 80% funded *or* if the plan is projected to have a funding deficiency within seven years." *Id.* Sponsors have one year to implement an improvement plan and ten years to improve funding. *Id.*

[81] *Id.* A seriously endangered plan are one that that "less than 80% funded *and* is projected to have a funding deficiency within seven years." *Id.* These plans must improve funding within fifteen years.

> They must improve their funding percentage by one-fifth of the difference between 100% funding and the plan's funded percentage from the earlier of (1) two years after the adoption of the funding

III. DISCHARGE IN BANKRUPTCY

Bankruptcy has long been a refuge for debtors. Bankruptcy is designed to provide discharge of prepetition debts for debtors—to give debtors a "fresh start." Bankruptcy protects debtors from creditors in the event that they cannot repay their debts. On the other hand, the rights of creditors need to be protected by the Bankruptcy Code to ensure stability of our economy.

A. Basic Overview of Bankruptcy

A debtor, whether an individual or a corporation, can seek refuge in bankruptcy under either Chapter 7 or Chapter 11.[82] Chapter 7 is the liquidation chapter. A debtor liquidates all of his or her assets, minus any exempt property, to pay off all of the debtor's creditors. Often times, the debtor will not be able to pay off all of the creditors, but the unpaid debt is discharged in bankruptcy. In a Chapter 7 case, the pension plan ceases to exist because all assets are liquidated and the company ceases to exist.[83] In a Chapter 11 case, the debtor can reorganize the business or liquidate it. The debtor often remains in possession of the company and continues operating it during the bankruptcy. To be granted discharge, the debtor must propose a plan that is acceptable to the creditors.[84] Holders of claims in an impaired class must accept the plan or be entitled to payment of as much as the holder would have received under Chapter 7, also known as the best interest of the creditors test.[85] If the plan impairs multiple classes of claims, at least one

> improvement plan or (2) the first plan year after the expiration of collective bargaining agreements that cover at least 75% of the plan's active participant.

Id.

[82] 11 U.S.C. § 109(b), (d) (2006); *see also* Toibb v. Radloff, 501 U.S. 157 (1991) (providing that individuals may file under 11). Given the scope of this Note, the discussion will be limited to bankruptcy cases in either Chapter 7 or Chapter 11. Chapter 13 is also an option for individual debtors who wish to reorganize. But, Chapter 13 is not applicable to corporations, so under the circumstances discussed in this Note, Chapter 13 is not relevant.

[83] *Fact Sheet: Your Employer's Bankruptcy—How Will It Affect Your Employee Benefits?*, U.S. DEP'T LABOR, http://www.dol.gov/ebsa/newsroom/fsbankruptcy.html (last visited Mar. 3, 2014). For more on collection, liquidation, and distribution of the bankruptcy estate, see 11 U.S.C. §§ 721-27.

[84] 11 U.S.C. § 1129.

[85] *Id.* § 1129(a)(7).

noninsider class must accept the plan before it can be confirmed as a consent plan.[86] If the plan is not accepted by all of the classes of creditors, the cramdown provisions must be satisfied.[87] The plan must be fair and equitable with the secured creditor cramdown, and the absolute priority rule applies with an unsecured creditor cramdown.[88] In a Chapter 11 case, the pension plan may continue through reorganization.[89]

When properly funded and maintained, pension plans are not at risk in bankruptcy because payments made by the employee or withheld by the employer for an employee-benefit plan are not considered assets in the bankruptcy estate.[90] The bankruptcy estate does not include employee contributions to a qualified defined-benefit plan, "even if the contributions have not yet been deposited with the plan."[91] But, it is not clear whether employer contributions become part of the bankruptcy estate,[92] raising an issue regarding the defalcation exception.

B. Defalcation Exception

The Bankruptcy Code provides some protection for creditors in § 523.[93] Section 523 as a whole prevents debtors from discharging certain kinds of debts. Some of the exceptions from discharge in § 523 are based on the nature of the debt, while others are based on bad conduct by

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[86] *Id.* § 1129(a)(10); CHRISTOPHER STRICKLAND & W. HOMER DRAKE, JR., CHAPTER 11 REORGANIZATIONS § 14:12 (2d ed. 2013).
[87] 11 U.S.C. § 1129(b).
[88] *Id.*; *see also* Richard F. Hahn & Jasmine Ball, *Plan Formation and Confirmation*, *in* COLLIER GUIDE TO CHAPTER 11: KEY TOPICS AND SELECTED INDUSTRIES ¶ 1.12(1)(C) (Alan N. Resnick & Henry J. Sommer eds., 2013) (explaining that the "court must find that the plan is 'fair and equitable' with respect to the dissenting class and that it does not discriminate unfairly against the dissenting class"). The absolute priority rule requires the parties in the dissenting class to "receive in full the allowed amounts of their claims if any class junior to the dissenting class receives or retains any property on account of their claims or interests." *Id.*
[89] *Fact Sheet: Your Employer's Bankruptcy—How Will It Affect Your Employee Benefits?*, *supra* note 83; 11 U.S.C. § 1141 (detailing the effect of plan confirmation).
[90] 11 U.S.C. § 541(b)(7).
[91] Lee T. Polk, *Benefits Related Litigation: Specific Settings and Selected Topics*, ERISA PRAC. & LITIGATION § 12:21 (2013); 11 U.S.C. § 541(b)(7) (providing that amounts withheld by the employer from an employee for defined benefit plan are not part of the bankruptcy estate).
[92] Polk, *supra* note 91.
[93] 11 U.S.C. 523.

the debtor.[94] One of the many exceptions to discharge is defalcation. Bankruptcy Code § 523(a)(4) specifically provides an exception to discharge to an individual debtor if the debtor is involved in "fraud or defalcation while acting in a fiduciary capacity."[95] Defalcation is colloquially defined as "the act or an instance of embezzling" or "a failure to meet a promise or an expectation."[96] But, the Bankruptcy Code does not provide a definition for defalcation or provide any guidance as to what constitutes defalcation under the code. As a result, the lower courts have established their own standards and principals to handle defalcation cases.

Notably, § 523(a)(4) is currently only applicable to *individual* debtors, rather than corporations. Thus, the applicability of this exception is relatively limited, given that most employers who have any obligation to make payments are typically not individuals. But, this is applicable to individual debtors operating as sole proprietors or individual debtors who assume individual liability for the plan. For example, individuals may assume liability to make payments under a collective bargaining agreement.[97] Once an individual assumes liability to make payments, that person may be subject to the defalcation exception if the individual goes into bankruptcy with the company.

Beyond that, courts struggled for years to determine the meaning of "defalcation" and, specifically, the state of mind required to constitute defalcation. Several courts differed on the state of mind needed to constitute defalcation. In *Bullock v. BankChampaign*, the Supreme Court answered that question, finding that a heightened standard is required.[98] Prior to *Bullock*, courts

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[94] An additional protection for creditors can be found in 11 U.S.C. § 727. While § 523 provides that specific debts are non-dischargeable, § 727 applies globally, meaning that if the requirements are satisfied, all of the debtors debt will be non-dischargeable.
[95] 11 U.S.C. 523(a)(4).
[96] MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/defalcation (last visited Apr. 20, 2014).
[97] *See, e.g.*, *In re* Tsikouris, 340 B.R. 604 (N.D. Ind. 2006) (detailing an individual's contractual obligation to make payments to a pension plan); Trustees of the Conn. Pipe Trades Local 777 Health Fund v. Nettleton Mechanical Contractors, Inc., 478 F. Supp. 2d 279, 281 (D. Conn. 2007).
[98] Bullock v. BankChampaign, N.A., 133 S. Ct. 1754, 1759 (2013).

applied three different standards for defalcation. The Fourth, Eighth, and Ninth Circuit Courts adopted a negligence standard, the lowest standard adopted by the courts.[99] The First and Second Circuits applied a scienter or extreme recklessness standard, the highest standard adopted by the courts.[100] Lastly, the Fifth, Sixth, Seventh, and Eleventh Circuits applied an intermediate standard requiring objective recklessness.[101] The *Bullock* Court resolved this issue by holding that in the absence of "bad faith, moral turpitude, or other immoral conduct, the term [defalcation] requires an intentional wrong."[102] More specifically, the Court stated:

> 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. Thus, we include reckless conduct of the kind set forth in the Model Penal Code. 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."[103]

In short, defalcation requires an intentional wrong or a conscious disregard of a "substantial and unjustifiable risk" involving a gross deviation from the standard of conduct required of a person.[104] This decision will undoubtedly restrict the application of the defalcation exception globally, but particularly with regard to the pension problem.

C. What Is a Fiduciary Relationship?

Before a claim can be deemed nondischargable under the defalcation exception, there must be a fiduciary relationship. In *Davis v. Aetna Acceptance Co.*, the Supreme Court explained

[99] *In re* Sherman, 658 F.3d 1009 (9th Cir. 2011); *In re* Uwimana, 274 F.3d 806 (4th Cir. 2001).
[100] *See, e.g.*, *In re* Hyman, 502 F.3d 61, 69 (2d Cir. 2007) (stating that this standard "has the virtue of ease of application since the courts and litigants have reference to a robust body of securities law examining what these terms mean"); *In re* Baylis, 313 F.3d 9 (1st Cir. 2002).
[101] *See, e.g.*, *In re* Felt, 255 F.3d 220 (5th Cir. 2001).
[102] *Bullock*, 133 S. Ct. at 1759.
[103] *Id.* at 1760 (emphasis added) (internal citations omitted).
[104] *Id.*

that the meaning of this term is both fixed by judicial construction and interpreted narrowly.[105] Moreover, the Court stressed that "the statute 'speaks of technical trusts, and not those which the law implies from the contract," so "[t]he scope of the exception was to be limited accordingly."[106] Given that, § 523(a)(4) is relevant to determine whether a person is a fiduciary for the purposes of the Bankruptcy Code, but state law determines whether a trust relationship is established. For example, a trust and fiduciary relationship can be created when parties enter "into an agency agreement under which the debtor's agency [is] appointed and authorized to be an issuing agent for the creditor and where such agreement establishe[s] an express trust under state law."[107] Additionally, the courts have addressed a variety of contexts in which a fiduciary relationship can be created when the debtor is "engaged in the sale, purchase, or lease of goods or services, other than financial, investment, or banking services or products."[108] Importantly, in order for a person to be considered a fiduciary, the person "must have been a trustee before the wrong" occurred.[109] Similarly, a label alone is not enough; the substance of a relationship is the key to establishing a fiduciary relationship.[110]

There are three main kinds of trusts: express, constructive, and statutory. These trusts are treated differently under the Bankruptcy Code, and courts have not agreed on how bankruptcy applies to each.[111] First, express trusts are generally found to create a fiduciary relationship,

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[105] 293 U.S. 328, 333 (1934) (explaining that the court must ask whether the petitioner "[w]as a trustee in that strict and narrow sense").
[106] 293 U.S. 328, 333 (1934) (citations omitted).
[107] Ann K. Wooster, Annotation, *Who Is Acting in "Fiduciary Capacity" Within Meaning of Fraud or Defalcation Discharge Exception in Bankruptcy*, 15 A.L.R. FED. 2d 337 (2006).
[108] *Id.* Some of the industries where such a relationship has been found include (1) transportation (motor vehicles, aviation and marine, and freight services); (2) construction and heavy machinery/building supplies; (3) petroleum; (4) agriculture; (5) food and beverage; (6) consumer goods and services; (7) computer equipment supplies; (8) health and pharmaceutical; (9) travel, recreation, and leisure; (10) insurance; (11) real estate. *Id.*
[109] Davis v. Aetna Acceptance Co., 293 U.S. 328, 333 (1934).
[110] *Id.*
[111] Deborah L. Thorne & Kevin G. Collins, *Are All Trusts Equal Under § 523(a)(4)? An Examination of PACA and Other Statutorily Created Trusts*, ABI JOURNAL, Dec.-Jan. 2013 at 80 (providing sources for the split on this issue).

potentially allowing for a claim for nondischargeability under § 523(a)(4).[112] To establish an express trust, the plaintiff must show the following: "(1) an intent to create a trust; (2) a trustee; (3) a trust res; and (4) a definite beneficiary."[113] Constructive trusts are "found to be implied by the court only as a result of existing debts and not prior to the debt being incurred."[114] Because the fiduciary relationship must arise *before* the act of defalcation, constructive trusts are generally not sufficient under § 523(a)(4).[115] While express trusts are generally treated as "actual" trusts in bankruptcy, statutory trusts have not uniformly been dealt with by the lower bankruptcy courts.[116] Courts are split on whether the obligation under a statutory trust arises before any wrongdoing or only after the payment obligation matures and is wrongfully withheld.[117] Specifically, "[o]nce a statutory trust intersects with the Bankruptcy Code, [statutory trusts] can be disturbed by courts determining that the relationship, even though called a 'trust,' does not amount to a fiduciary relationship or that the failure to pay is not defalcation."[118]

D. Does a Fiduciary Relationship Exist for Pension Sponsors?

Courts across the country have not uniformly agreed that the establishment of a fiduciary relationship under ERISA is sufficient to establish a fiduciary relationship for the purpose of the defalcation exception under the Bankruptcy Code. For example, in *In re Tsikouris*, the

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[112] *Id.*
[113] *In re* Blaszak, 397 F.3d 386, 391-92 (6th Cir. 2005).
[114] Thorne & Collins, *supra* note 111, at 81.
[115] *See, e.g.*, *In re* Hemmeter, 242 F.3d 1186, 1189 (9th Cir. 2001) ("From 1884 to present, courts have construed 'fiduciary' in the bankruptcy discharge context as including express trusts, but excluding trusts *ex maleficio, i.e.,* trusts that arose by operation of law upon wrongful act."); Davis v. Aetna Acceptance Co., 293 U.S. 328, 333 (1934).
[116] Some of the confusion, however, stems from courts classifying trusts established under ERISA differently. For example, some courts say that these are express trusts; others classify them as statutory trusts. *See, e.g.*, *In re* Engleman, 271 B.R. 366, 368 (Bankr. W.D. Mo. 2001) (holding that a statutory trust is not sufficient to create a fiduciary capacity under § 523(a)(4)); *In re* Parker, 388 B.R. 11, 18 (Bankr. N.D.N.Y. 2008) (providing that an express trust is necessary, but finding that the ERISA plans constitute trusts for purpose of § 523(a)(4)).
[117] Thorne & Collins, *supra* note 111, at 81.
[118] *Id.*; *see also In re* Hemmeter, 242 F.3d 1186, 1189 (9th Cir. 2001) (explaining that fiduciary relationships created by statute can satisfy the fiduciary requirement under § 523(a)(4) "if the statute: (1) defines the trust res; (2) identifies the fiduciary's fund management duties; and (3) imposes obligations on the fiduciary prior to the alleged wrongdoing").

Bankruptcy Court for the Northern District in Indiana held that there was no fiduciary relationship before pension-plan funds were deposited.[119] In other words, because the funds had never been deposited into the pension plan, there was no trust res at the time of the bankruptcy and therefore no fiduciary relationship.[120] So, even though the debtor was individually obligated by contract to make payments into the pension plan, the court held that § 523(a)(4) was inapplicable, and the debt was dischargeable.[121] Likewise, the Sixth Circuit Court of Appeals has held that the defalcation exception does not apply in a situation where the debtor, the president and sole shareholder of his company, enters into a collective bargaining agreement that contractually obligates him to make contributions to a pension plan.[122] Later, in *In re Halpin*, the Second Circuit, relying on informal opinions from the Department of Labor, came to the conclusion that "'employer contributions become an asset of the plan only when the contribution has been made.'"[123] The court stated:

> Moreover, if unpaid employer contributions were plan assets, the employer would automatically become an ERISA fiduciary once it failed to make the payments. As such, the employer would owe the plan undivided loyalty at the expense of competing obligations—some fiduciary—to the business, and to others such as employees, customers, shareholders and lenders, and an undifferentiated portion of the company's assets would be held in trust for the plan. It is difficult to envision how proprietors could ever operate a business enterprise under such circumstances. It is highly unlikely—indeed inconceivable—that Congress intended such a result.[124]

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[119] 340 B.R. 604, 614 (Bankr. N.D. Ind. 2006).
[120] *Id.* (explaining that "there must be a 'res' in existence *before* the designated 'fiduciary' relationship truly arises[, so] because there was no 'res' prior to that time, Tsikouris did not act in a 'fiduciary capacity' in any manner with respect to the 'debt' which the Plaintiffs seek to exempt from discharge"); *see also In re* Halpin, 566 F.3d 286 (2d Cir. 2009) (holding that unpaid contributions are not assets of the plan under ERISA and only become sets of the plan once they are paid—not once they are due).
[121] *In re Tsikouris*, 340 B.R. at 614.
[122] *In re* Bucci, 493 F.3d 635 (6th Cir. 2007).
[123] *In re Halpin*, 566 F.3d at 292 (quoting Employee Benefits Sec. Admin., U.S. Dep't of Labor, *Field Assistance Bulletin 2008–1*, at 1-2 (Feb. 1, 2008)).
[124] *In re Halpin*, 566 F.3d at 292.

So, even though the plan documents required the employer to make a contribution, the court held that the document did not create an interest in the funds not yet deposited into the pension fund.[125]

On the other hand, some circuits have found that the plan sponsors, or those who meet ERISA's functional test[126] for fiduciary status, do meet the fiduciary requirement under § 523(a)(4).[127] The Ninth Circuit Court of Appeals explicitly stated that fiduciaries under ERISA are also fiduciaries within the meaning of § 523(a)(4).[128] The *Hemmeter* court explained that "a statutory fiduciary is considered a fiduciary for the purposes of § 523(a)(4) if the statute: (1) defines the trust res; (2) identifies the fiduciary's management duties; and (3) imposes obligations on the fiduciary prior to the alleged wrongdoing."[129] The plan sponsor in *Hemmeter* had discretion to control the assets of the plan, the plan identified the trust res when the trust was created, and ERISA defined the fiduciary's duties; therefore, the sponsor was a fiduciary under both the Bankruptcy Code and ERISA.[130] The *Hemmeter* court, though not limiting its decision, did not specifically address unpaid employer contributions to the pension plan, but instead addressed the declining balance of a pension plan.[131] Still, the court found that a statutory fiduciary was also a fiduciary under the defalcation exception. The court's conclusion that an ERISA fiduciary satisfies the fiduciary requirement under § 523(a)(4) suggests that this rationale

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[125] *Id.* at 289.
[126] *See* Mertens v. Hewitt Assocs., 508 U.S. 248, 262 (1993) (explaining that ERISA defines a fiduciary "not in terms of formal trusteeship, but in *functional* terms of control and authority over the plan").
[127] Emil Khatchatourian & Brendan M. Gage, *Unpaid ERISA Contributions and Fiduciary Liability Under § 523(a)(4)*, ABI J., Nov. 2013, at 52; *see also* Jennifer Liotta, Comment, *ERISA Fiduciaries in Bankruptcy: Preserving Individual Liability for Defalcation*, 22 EMORY BANKR. DEV. J. 725, 733-41 (2006) (discussing the functional fiduciary under ERISA).
[128] *See In re* Hemmeter, 242 F.3d 1186, 1188 (9th Cir. 2001).
[129] *Id.* at 1190.
[130] *Id.*
[131] *See generally id.*; Khatchatourian & Gage, *supra* note 127.

and analysis could also be applied in an underfunded pension case. In fact, other courts have similarly held that ERISA plans meet the requirements for express trusts.[132]

Some courts have held that unpaid contributions can be plan assets if the trust agreement specifically defines them as such. For example, in *Trustees of the Connecticut Pipe Trades Local 777 Health Fund v. Nettleton Mechanical Contractors, Inc.*, the court allowed an action to recover the employer's unpaid contributions to the plan.[133] In *Nettleton*, the pensioners sued both the company and its president Romaniello for failure to pay required contributions.[134] Romaniello entered into a collective bargaining agreement in which he agreed to pay contributions into a multiemployer plan.[135] The terms of the agreement specifically provided that the plan assets included "'sums of money that have been or *shall be* paid to the Pension Fund by the Employers as contributions required by'" the agreement.[136] Given the unambiguous terms of the agreement, the Court held that the unpaid contributions were in fact plan assets.[137] The court distinguished the facts in *Nettleton* from those in a Tenth Circuit case, explaining that there was no ambiguity in the plan agreement that would prevent the unpaid contributions from being considered plan assets.[138] Ultimately, the court held Romaniello liable for the breach of fiduciary duty stemming from his decision to pay other creditors instead of the pension fund.[139]

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[132] *See, e.g.*, *In re* Fahey, 482 B.R. 678, 689 (B.A.P. 1st Cir. 2012); *In re* Duncan, 331 B.R. 70, 78 (Bankr. E.D.N.Y 2005); Eavenson v. Ramey, 243 B.R. 160, 166 (Bankr. N.D. Ga. 1999).
[133] 478 F. Supp. 2d 279 (D. Conn. 2007).
[134] *Id.* at 281.
[135] *Id.*
[136] *Id.* (emphasis added).
[137] *Id.* at 283; *see also* Trustees of the Southern California Pipe Trades Health & Welfare Trust Fund v. Temecula mech., Inc., 438 F. Supp. 2d 1156, 1163 (C.D. Cali. 2006) (explaining that the general rule that contributions are not plan assets until paid "gives way to the face of language in the plan document identifying unpaid employer contributions as plan assets").
[138] *Nettleton*, 478 F. Supp. 2d at 283; *In re* Luna, 406 F.3d 1192 (10th Cir. 2005) (applying the common definition of asset, the court held that there was only a contractual right to collect the unpaid contributions, but the unpaid contributions were not plan assets).
[139] *Nettleton*, 478 F. Supp. 2d at 284 ("Thus, when Nettleton experienced financial difficulty, Romaniello breached his fiduciary duty when he exercised his authority to pay other creditors instead of National Funds.").

IV. WHAT DOES THIS ALL MEAN?

In reflecting on the continued problem of underfunded pension plans and the inconsistent approach by the lower courts, it is time a consistent, comprehensive approach be taken to remedy the situation. Overly simplifying the issue, if an employer is on the brink of bankruptcy, the likelihood that that employer is maintaining his or her pension fund is slim. Once the employer goes into bankruptcy, the majority of courts have said that the employer is not liable for having underfunded that pension plan. Employees are then left to pick up the pieces, having relied on their pension plans being fully funded. But how can the legislature and the courts remedy this situation without making it impossible for employers to utilize the "fresh start" so deeply engrained in the bankruptcy system? Remember, Chapter 11 requires plan confirmation. Plan confirmation may be more difficult if unpaid contributions are treated as nondischargeable debt. Alternatively, if the employer is entirely off the hook for the underfunded portion, the system incentivizes employers to underfund their pension plans knowing they can avoid paying the contributions through a bankruptcy procedure—all the while leaving the employees out in the cold. The remaining pages of this Note addresses this very tension in hopes of suggesting an alternative system that would better protect the employees who have paid into and relied on their pension plans and that would carry out the overarching goals of the bankruptcy system.

To address this tension, the courts and the legislature ought to create a presumption of fiduciary capacity under the Bankruptcy Code for pension-plan sponsors who satisfy the requirements to be considered a fiduciary under ERISA. Next, the courts should consider unpaid pension funds to be plan assets if the plan documents include such in their terms. Then, the courts should apply the heightened standard set out in *Bullock* to determine whether a defalcation has occurred when the plan sponsor fails to fully fund a pension plan. Before going any further, it is important to reiterate that the defalcation exception will only be applicable in a limited number of situations. Because defalcation applies only to *individuals*, this resolution will only be applicable in situations where a debtor–sponsor goes into bankruptcy with the company. But, this proposal balances the interests of all parties involved and could reduce the strain on the PBGC and the affected employees.

A. Unpaid, but Due, Contributions Should Be Considered Plan Assets

Before a fiduciary responsibility can be created, there must be plan assets available. As the court in *Halpin* recognized, "if unpaid employer contributions were plan assets, the employer would automatically become an ERISA fiduciary once it failed to make the payments."[140] But not all courts agree that unpaid contributions constitute plan assets. Given that ERISA does not specifically define "assets" to be only monies paid, courts like the *Halpin* court should start incorporating unpaid contributions into their definition of "assets." First, it may be overreaching to suggest that unpaid contributions should *always* be considered to be plan assets. For example, if the plan documents provide that an employer can make discretionary payments into the pension plan, then it might be conceivable that those discretionary payments not be considered plan assets. But, when the plan documents specifically state that plan assets include amounts that *shall* be paid by the plan sponsor, then the court should uniformly find that unpaid contributions are assets under ERISA. Courts that have not found such payments to be plan assets have looked at the dictionary and common law definitions of "asset."[141] But, when the parties specifically contract to include something else in the definition of asset, the court ought to apply the terms as contracted by the parties, especially given that "asset" is not specifically defined in ERISA.

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[140] *In re* Halpin, 566 F.3d 286, 292 (2d Cir. 2009); *see also supra* notes 123-125 (discussing this case).
[141] *See, e.g.*, *In re Halpin*, 566 F.3d at 289 (providing that "[i]n the absence of a formal rule or regulation, the Department has informally advised that 'the assets of a plan generally are to be identified on the basis of ordinary notions of property rights under non-ERISA law'").

The resulting problem is that employers may make pension plans discretionary. In other words, employers may draft their pension plans to provide that all employer contributions are discretionary, thereby exempting them from this presumption. At that point, the courts will be forced to reevaluate this standard to ensure equitable distribution. Alternatively, and probably more likely, the court could just evaluate discretionary funding decisions more carefully under the *Bullock* standard.[142] For multiemployer plans, however, this likely will not create a problem. Since multiemployer plans are funded by several different companies, each individual sponsor wants the contributions from every other sponsor to be mandatory to ensure that no one sponsor bears the weight of funding the entire plan.

B. A Fiduciary Under ERISA Should Satisfy the Fiduciary Requirement Under § 523(a)(4)

The next step to implementing this proposal is to establish that a fiduciary under ERISA is a fiduciary under the Bankruptcy Code. As discussed above, courts have disagreed on this issue. Applying the *Davis* standard, which requires the courts interpret the term "fiduciary" under the Bankruptcy Code very narrowly, some courts have refused to find a presumption of fiduciary responsibility under the Bankruptcy Code when a party is a fiduciary under ERISA. But, other courts have not had such a difficult time. These courts, looking at the actual requirements for the creation of a fiduciary relationship under the Bankruptcy Code, find that each of the elements is satisfied by the creation of the plan. To create a fiduciary relationship, there must be a trust. The following requirements must be included for a trust to be created: it must "(1) define[] the trust res; (2) identif[y] the fiduciary's management duties; and (3) impose[] obligations on the fiduciary prior to the alleged wrongdoing."[143] Every pension plan could be found to satisfy each of the elements. In creating a pension plan, the creators must

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[142] Bullock v. BankChampaign, N.A., 133 S. Ct. 1754, 1759 (2013).

[143] *In re* Hemmeter, 242 F.3d 1186, 1190 (9th Cir. 2001); *see also In re* Blaszak, 397 F.3d 386, 391-92 (6th Cir. 2005).

develop a plan agreement in writing.[144] In that agreement, plan creators can specify the trust res. Specifically, ERISA requires the plan set out a procedure to establish and carry out a funding policy and "specify the basis on which payments are to be made to and from the plan."[145] Additionally, the plan document must set out managerial responsibilities.[146] Moreover, ERISA establishes the duties of the fiduciary, as required to create a fiduciary relationship under the Bankruptcy Code.[147] Further, ERISA specifically provides that benefits shall be held in trust.[148] While not conclusive that this rationale transfers over to the bankruptcy arena, the presence of an express trust should carry over to bankruptcy and the defalcation exception.

Some courts, however, have interpreted the fiduciary duty under ERISA in a way that prohibits a presumption like the one suggested. The Fourth Circuit has said:

> [F]iduciary status is an all-or-nothing concept. However, the inclusion of the phrase "to the extent" in § 1002(21)(A) means that a party is a fiduciary only as to the activities which bring the person within the definition. The statutory language plainly indicates that the fiduciary function is not an indivisible one. In other words, a court must ask whether a person is a fiduciary with respect to the particular activity at issue.[149]

Given this language, it is possible that a court would be hesitant to apply a presumption in favor of finding a fiduciary duty regarding unpaid plan assets without further inquiring into the specific activities at issue. But, with regard to unpaid contributions when a trust document unambiguously provides that such payments must be made, the court should be able to classify

[144] 29 U.S.C. § 1102(a)(1) (2006) ("Every employee benefit plan shall be established and maintained pursuant to a written instrument.").
[145] *Id.* § 1102(b)(1), (4). Moreover, the plan must "describe any procedure under the plan for allocation of responsibilities for the operation and administration of the plan" and provide procedures for amending the plan. *Id.* § 1102(b)(2)-(3).
[146] *Id.* § 1102; *see also supra* note 145 (detailing the requirements for a plan).
[147] *Id.* § 1104.
[148] *Id.* § 1103 (2006) ("[A]ll assets of an employee benefit plan shall be held in trust by one or more trustees. . . . [T]he trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan.").
[149] Coleman v. Nationwide Life Ins. Co., 969 F.2d 54, 61 (4th Cir. 1992).

these situations alike by applying a presumption.[150] Such presumption is necessary because courts have not treated unpaid assets alike, even when the trust document unambiguously provides that unpaid, but due, contributions are plan assets.

Courts and bankruptcy scholars alike may, however, be hesitant to impose such a strong presumption for fear that it would ultimately undermine the purpose of bankruptcy. For example, Emil Khatchatourian and Brendan M. Gage explain, "Broadly construing 'fiduciary capacity' undermines the 'fresh start' policy that Congress sought to give to the 'honest but unfortunate debtor.'"[151] Even though the debtor acted in good faith in the time before bankruptcy and through plan confirmation, trying to pay off all of its debts, there may be fear that the court could still deny discharge of the pension-plan liability, undermining the fresh start policy. If a presumption were applied, some may argue that the courts will be free to refuse discharge for any debtor, regardless of wrongdoing.

This concern, however, is quelled by the Court's recent decision in *Bullock*. The *Bullock* Court solidified a heightened standard for defalcation. As a result, the ability of pensioners to establish a defalcation will be limited to only those cases where the fiduciary engages in intentional wrongdoing or consciously disregards the risk; that is a high standard to satisfy.[152] Applying this standard strictly would allow the courts to punish plan sponsors who wrongfully withhold funds from the pension plan. It would also curtail the sponsor's practice of always paying creditors rather than the pension plan.

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[150] *See, e.g.*, ITPE Pension Fund v. Hall, 334 F.3d 1011 (11th Cir. 2003) (suggesting that had the agreement unambiguously provided that unpaid employer contributions were plan assets, the employer would be considered a fiduciary).

[151] Khatchatourian & Gage, *supra* note 127, at 53.

[152] See *supra* notes 102-104 and accompanying text for more on the *Bullock* decision.

Perhaps more troubling is the possibility that this presumption would create "potentially irreconcilable fiduciary obligations."[153] Upon insolvency, a fiduciary may owe a fiduciary duty to its general creditors under state law.[154] Judge Kornreich reflected upon this problem in his dissenting opinion in *Fahey* after the court found a plan sponsor was a fiduciary under the Bankruptcy Code with regard to unpaid contributions.[155] Judge Kornreich explained:

> The majority decision places the responsible officer of an insolvent corporation in jeopardy of violating a state law fiduciary duty if he or she chooses to distribute corporate assets to employee benefit funds in an effort to avoid a judgment under § 523(a)(4). Ironically, such a distribution could give rise to a sustainable, nondischargeable claim under § 523(a)(4) for breach of a state law duty.[156]

But, as a matter of policy, should we accept that it is of greater importance to pay off one's other creditors while neglecting the employees who make the company what it is? We have come to accept that it is okay to put the employees' benefits and well-being to the side to ensure financial gain for the company. While that is one of the basic necessities of a capitalistic society, it has also become so engrained in us that we forget to reflect on the other options. To maintain our economy and to ensure employees have gainful employment, we obviously need successful companies. But, that does not explain our willingness to discount an employer's obligation to its employees, evidenced in a written pension-plan agreement, when compared to the company's obligations to the employer's other creditors.

CONCLUSION

ERISA and the PPA were both enacted to protect pensioners from underfunded and failed pension plans. Even with the amendments to ERISA and the enactment of the PPA, pension-plan sponsors continue to underfund pension plans. While both of these acts have significantly

[153] Khatchatourian & Gage, *supra* note 127, at 53.
[154] *Id.*; *see also In re* Fahey, 482 B.R. 678, 697 (B.A.P. 1st Cir. 2012) (Kornreich, J., dissenting). Upon impending bankruptcy, some courts hold that common law fiduciary duties are owed to a company's creditors.
[155] *See generally In re Fahey*, 482 B.R. 678.
[156] *Id.* at 697 (Kornreich, J., dissenting); *see also* Khatchatourian & Gage, *supra* note 127, at 53 & n.38.

advanced the protections afforded to pensioners, more can be done to protect employees from underfunded plans and to encourage employers to fully fund their pension plans. To do that, courts ought to apply a uniform framework, generally finding that a fiduciary under ERISA is a fiduciary under § 523(a)(4) with respect to underfunded pension plans. To protect the integrity and purpose of the Bankruptcy Code, the courts should rely on *Bullock*'s mental state requirement to reduce the number of debtors who are unable to confirm a plan in bankruptcy. Applying the heightened standard in *Bullock* will reduce the applicability of the defalcation exception, leaving it applicable only in the most serious cases of impropriety. Ultimately, this new system will protect more employees, reduce strain on the PBGC, and create an incentive for employers to prioritize funding their pension plans.