No. 07-1107

IN THE

Supreme Court of the United States

BOARD OF TRUSTEES OF THE OHIO CARPENTERS PENSION FUND ON BEHALF OF THE OHIO CARPENTERS PENSION FUND, *et al.*, PETITIONERS,

v.

CHARLES S. BUCCI,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether an employer's failure to make contractually required contributions to ERISA-governed employee benefit funds constitutes "acting in a fiduciary capacity" under section 523(a)(4) of the Bankruptcy Code merely because such breach of contract is a fiduciary act under "ERISA's artificial definition of 'fiduciary.'"[1]

[1] *Mertens v. Hewitt Associates*, 508 U.S. 248, 255 n.5 (1993).

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RESPONDENT'S BRIEF IN OPPOSITION

INTRODUCTION

In an attempt to manufacture a reason for further review by this Court, petitioners assert that this case presents the following question:

> Section 523(a)(4) of the Bankruptcy Code provides that a debt "for fraud or defalcation while acting in a fiduciary capacity" is not dischargeable in bankruptcy. ***The question presented in this case is whether that exception to***

> ***the discharge covers a debt for breach of a fiduciary duty imposed by statute***—here, an alleged breach by an ERISA fiduciary of his statutory obligations.

Pet. (i) (emphasis added). Petitioners' overbroad formulation misleadingly suggests that granting certiorari would permit this Court to address whether the term "fiduciary," when used in *any* federal or state statute, is co-extensive with the term "fiduciary capacity" in section 523(a)(4) of the Bankruptcy Code. *See also* Pet. 19-24 (intimating that this case will permit the Court to resolve "widespread disagreement on the application of section 523(a)(4) to statutory fiduciary duties").

In reality, however, the only question presented in this case involves a *particular* fiduciary act under ERISA[2] under *particular* factual circumstances as determined by the lower courts.[3] This narrow and largely fact-bound question can be stated as follows:

> Whether an employer's failure to make contractually required contributions to ERISA-governed employee benefit funds constitutes "acting in a fiduciary capacity" under section 523(a)(4) of the Bankruptcy Code merely be-

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[2] As the Sixth Circuit explained, the breach of fiduciary duty alleged by petitioners was respondent's "breach of his contractual obligation to pay the employer contributions" to the ERISA funds at issue. Pet. App 13a; *see also* Pet. 17-18 (reiterating petitioners' theory of fiduciary breach under ERISA).

[3] The bankruptcy court, the district court, and the Sixth Circuit all agreed that "there is no evidence on the record establishing that [respondent] was the trustee of the employer contributions." Pet. App. 14a

> cause such a breach of contract is a fiduciary act under "ERISA's artificial definition of "fiduciary."[4]

In answering this question, the court of appeals observed that "the key point for bankruptcy purposes [] is that [respondent] had only a *contractual* obligation to pay the employer contributions" and concluded that "[t]his is not enough, for 'the debtor must hold funds in trust for a third party to satisfy the fiduciary relationship element of the defalcation provision of § 523(a)(4)." Pet. App. 14a (citation omitted) (emphasis in original). The decision below is correct and does not conflict with any decision of another court of appeals or of this Court. Further review is unwarranted.

STATEMENT

A. Statutory Background

In an effort to articulate respondent's position clearly and in its proper context, this brief begins with some necessary statutory background.

1. The concept of the bankruptcy discharge

The overriding objective of American bankruptcy law is to give debtors a "fresh start." In the words of this Court:

> the basic purpose of the Bankruptcy Act [is] to give the debtor a "new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt. The various provisions of the bankruptcy act were adopted in the light of that view and

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[4] *Mertens*, 508 U.S. at 255 n.5.

> are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act."

Lines v. Frederick, 400 U.S. 18 (1970) (*per curiam*) (citation omitted).[5] The primary method by which American bankruptcy law permits a debtor to achieve this "fresh start" is through the concept of discharge.[6]

The concept of discharge is simple. As explained by the Administrative Office of the U.S. Courts:

> A bankruptcy discharge releases the debtor from personal liability for certain specified types of debts. In other words, the debtor is no longer legally required to pay any debts that are discharged. The discharge is a permanent

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[5] *See also* Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 Cornell L. Rev. 67 (2006) ("The principal theory of consumer bankruptcy in America is that it provides a 'fresh start' to debtors.") (footnote omitted); Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy,* 48 Ohio St. L.J. 1047, 1047 n.1 (1987) ("The purpose of the consumer bankruptcy system, effectuated by discharge, is to give a fresh start to the 'honest but unfortunate debtor.'") (citing and discussing *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); *Williams v. U.S. Fidelity Co.,* 236 U.S. 549, 554-555 (1915); *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904), and *Neal v. Clark*, 95 U.S. 704, 709 (1877)).

[6] *See, e.g.,* Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law,* 98 Harv. L. Rev. 1393, 1393 (1985) ("Discharge, the doctrine that frees the debtor's future income from the chains of previous debts, lies at the heart of bankruptcy policy."); Porter & Thorne, *supra*, at 67 ("Most frequently, people equate the fresh start with the economic rehabilitation of debtors through bankruptcy's discharge of debt.") (citing Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. 1, at 71, 79-80 (1973)).

> order prohibiting the creditors of the debtor from taking any form of collection action on discharged debts* * * *

Administrative Office of the U.S. Courts Website, *Bankruptcy Basics, The Discharge In Bankruptcy* <www.uscourts.gov/bankruptcycourts/bankruptcybasics/discharge.html>; *see also* 11 U.S.C. 524(a) (describing the effect of a discharge in a bankruptcy case).

2. The scope of the bankruptcy discharge

"That we should have some system of discharge in bankruptcy is a settled question." Howard, *supra*, at 1047. *See also id.* at 1047 n.1 (explaining that "some form of discharge has been part of every American bankruptcy statute"). What is also well-settled, however, is the fact that discharge should only be available to the honest debtor. For this reason, "[s]ection 727 [of the Bankruptcy Code] lists reasons why discharge will be totally denied, almost all of them relating to misconduct by the debtor in the bankruptcy proceeding." *Id.* at 1047 n.3. *See also* 11 U.S.C. 727.

Wholly apart from section 727, section 523 of the Bankruptcy Code specifies nineteen different types of *particular debts* that may not be discharged by an individual debtor in a bankruptcy case. 11 U.S.C. 523(a). As this Court has explained:

> The statutory provisions governing nondischargeability [*i.e.*, section 523 of the Bankruptcy Code] reflect a congressional decision to exclude from the general policy of discharge certain categories of debts-such as child support, alimony, and certain unpaid educational loans and taxes, as well as liabilities for fraud. Congress evidently concluded that the credi-

> tors' interest in recovering full payment of debts in these categories outweighed the debtors' interest in a complete fresh start.

Grogan v. Garner, 498 U.S. 279, 287 (1991).

The issue of non-dischargeability is a question of federal law governed by the terms of the Bankruptcy Code. *See id.* at 286 (citing *Brown v. Felsen*, 442 U.S. 127, 129-130 (1979)). And, as the Sixth Circuit correctly noted, "the general rule [is] that exceptions to discharge in § 523(a) must be narrowly construed." Pet. App. 10a-11a (citations omitted). *See, e.g., Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (rejecting an interpretation of "willful and malicious injury" in 11 U.S.C. 523(a)(6) as encompassing situations where "an act is intentional, but injury is unintended" because under such an interpretation "a 'knowing breach of contract' could [] qualify [and because a] construction so broad would be incompatible with the 'well-known' guide that exceptions to discharge 'should be confined to those plainly expressed'") (quoting *Gleason v. Thaw*, 236 U.S. 558, 562 (1915)).

3. The section 523(a)(4) exception for "defalcation while acting in a fiduciary capacity"

The discharge exception that is involved in this case is found in section 523(a)(4) of the Bankruptcy Code. Like its predecessor statute, it bars the discharge of those debts incurred through "defalcation

while acting in a fiduciary capacity." 11 U.S.C. 523(a)(4).[7]

There is no definition of the term "fiduciary" or the phrase "acting in a fiduciary capacity" in either the Bankruptcy Code or any of its predecessor statutes. In a series of 19th Century cases, however, this Court unambiguously and repeatedly held that the phrase was intended by Congress to have an extremely narrow scope. As this Court remarked in 1934:

> The respondent contends that * * * the petitioner is within the exception [to the bankruptcy discharge] declared by subdivision 4; his liability arising, it is said, from his fraud or misappropriation while acting in a fiduciary capacity. ***The meaning of these words has been fixed by judicial construction for very nearly a century*** * * * [T]he statute "speaks of technical trusts, and not those which the law implies from the contract." The scope of the exception [to bankruptcy discharge] was to be limited accordingly.

Davis v. Aetna Acceptance Co., 293 U.S. 328, 333 (1934) (emphasis added). As explained below, this Court's

[7] The immediate predecessor statute of the Bankruptcy Code was the Bankruptcy Act of 1898 (the "1898 Act"). Section 17(a)(4) of the 1898 Act provided that

> A discharge in bankruptcy shall release a bankrupt from all of his provable debts * * * except such as * * * were created by his fraud, embezzlement, misappropriation or defalcation while acting * * * in any fiduciary capacity.

11 U.S.C. 35(a)(4), repealed and reenacted as amended (by Pub.L. No. 95-598, 92 Stat. 2590 (1978)) at 11 U.S.C. 523(a)(4).

limited construction of the phrase "acting in a fiduciary capacity" in section 523(a)(4) is both sensible and necessary.

Several provisions within section 523(a) of the Bankruptcy Code except from discharge various debts caused by the misconduct of *any* debtor (*i.e.*, regardless of fiduciary status). For example,

- section 523(a)(6) excepts from discharge any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity," 11 U.S.C. 523(a)(6), and
- section 523(a)(2)(A) excepts from discharge any debt "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by * * * false pretenses, a false representation, or actual fraud* * *" 11 U.S.C. 523(a)(2)(A).[8]

Unlike these provisions which require bad faith to have a debt excepted from discharge, section 502(a)(4) does not necessarily require bad faith for one to incur nondischargeable debt through "*defalcation* while acting in a fiduciary capacity." In the words of Learned Hand:

> Colloquially perhaps the word "defalcation," ordinarily implies some moral dereliction, but in this context [its use in the first Bankruptcy

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[8] In the words of this Court,

> The Bankruptcy Code has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an "honest but unfortunate debtor." Section 523(a)(2)(A) continues the tradition * * * *

Cohen v. de la Cruz, 523 U.S. 213, 217 (1998) (citations omitted).

> Code] it may have included innocent defaults, so as to include all fiduciaries who for any reason were short in their accounts* * * * Whatever was the original meaning of "defalcation," it must here [in the Bankruptcy Act of 1867] have covered other defaults than deliberate malversations, else it added nothing to the words, "fraud or embezzlement."

Central Hanover Bank & Trust Co. v. Herbst, 93 F.2d 510 (CA2 1937). Put simply, a narrow interpretation of the phrase "acting in a fiduciary capacity" makes sense so as to counterbalance the broad notion of defalcation.[9]

B. Proceedings Below

The relevant procedural history of this case is as follows: in 2003, respondent Charles S. Bucci signed a collective bargaining agreement requiring his company to make monthly payments (employer contributions) to ERISA-governed employee-benefit funds. Pet. App. 2a.

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[9] Put another way:

> a liberal reading of the defalcation requirement serves to counterbalance the strict, limited construct of the fiduciary relationship as espoused by the United States Supreme Court in *Chapman v. Forsyth* and *Davis v. Aetna Acceptance Co*. In other words, having established that a fiduciary relationship exists based upon a technical or express trust, a difficult criterion to satisfy, it is enough to simply establish that the "underlying trust was used for a purpose other than that contemplated by the trust to constitute defalcation."

Michael D. Sousa, *Are You Your Produce Vendor's Keeper? The Perishable Agricultural Commodities Act and § 523(a)(4) of the Code,* 15 J. Bankr. L. & Prac. 6 (2006) (footnotes and citations omitted).

For over a year, respondent failed to make these contractually required employer contributions and, in 2005, he filed for bankruptcy. *Id.*

The various ERISA funds (petitioners before this Court) sought a declaration in the bankruptcy court that respondent's debt to them could not be discharged because, *inter alia,* his failure to make employer contributions was a "defalcation while acting in a fiduciary capacity" under section 523(a)(4) of the Bankruptcy Code. *Id.*

The bankruptcy court held that the debt to petitioners for the unpaid employer contributions was dischargeable because "there was no evidence demonstrating [that respondent] acted as a fiduciary of the monies owed to the funds." Pet. App. 2a. Petitioners appealed that ruling; the district court affirmed. *Id.;* Pet. App. 19a-29a. Petitioners appealed that ruling as well. Relying on this Court's long line of cases interpreting 11 U.S.C. 523(a)(4), the Sixth Circuit affirmed. Pet. App. 2a. Refusing to treat respondent's "status as an ERISA fiduciary as alone being sufficient to create an express or technical trust for purposes of 523(a)(4)," (Pet App. 13a), the panel examined the evidence of the actual relationship between the parties and agreed with the bankruptcy and district courts that "there [was] no evidence on the record establishing that [respondent] was the trustee of the employer contributions." Pet. App. 14a.

REASONS FOR DENYING THE WRIT

The court of appeals' decision is correct and does not conflict with any decision of another court of appeals or this Court. Further review is unwarranted.

Petitioners' primary contention is that the Sixth Circuit deepened a "square and acknowledged split among the courts of appeals" (Pet. 3) over whether "ERISA fiduciary status is sufficient to satisfy the fiduciary capacity requirement of 11 U.S.C. § 523(a)(4)" (Pet. 9). Petitioners are wrong. There is no square conflict on the facts of this case. In any event, review is not warranted at this time because the purported circuit conflict is undeveloped and may resolve itself.

Petitioners' secondary contention is that "the Sixth Circuit misapplied this Court's precedent when it concluded that respondent was not "acting in a fiduciary capacity" for purposes of federal bankruptcy law. *See* Pet. 15 (arguing that "the Sixth Circuit erred in its application of the *Davis* [*v. Aetna Acceptance Co.*,] principles").[10] Again, petitioners are mistaken. The Sixth Circuit's decision is a faithful application of this Court's long-settled interpretation of section 523(a)(4) of the Bankruptcy Code.

I. THIS CASE DOES NOT IMPLICATE A CIRCUIT CONFLICT

No disagreement among the circuits exists that would justify granting certiorari in this case. To date, only one court of appeals – other than the Sixth Circuit panel below – has addressed the true question presented: *Hunter v. Philpott*, 373 F.3d 873 (CA8 2004) (*Philpott*). The two courts are in agreement. Despite this fact, petitioners maintain that

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[10] Even if petitioners' claim were true (which it is not), it hardly justifies a grant of certiorari. *See* Supreme Court Rule 10 ("A petition for a writ of certiorari is rarely granted when the asserted error consists of * * * the misapplication of a properly stated rule of law.").

> the courts of appeals have now divided 2-1 on []
> whether a claim for breach of an ERISA fiduciary duty is a claim for "defalcation while in a fiduciary capacity" within the meaning of Section 523(a)(4) of the Bankruptcy Code.

Pet. 13. Petitioners' assertion of a split relies upon an overbroad reading of the Ninth Circuit's decision in *In re Hemmeter*, 242 F.3d 1186 (CA9 2001) (*Hemmeter*).

In *Hemmeter*, the debtor was a member of the Board of Directors of the sponsor of an ERISA plan. The Board, in turn, was a named fiduciary of the plan. The debtor, by virtue of his being a member of the Board, was alleged to have breached his fiduciary duties to the plan by improperly monitoring the investment of pension assets *already placed in a formal trust*. Unsurprisingly, the Ninth Circuit concluded that the debtor was "acting in a fiduciary capacity" with respect to *those assets*.

Unlike in *Hemmeter*, the instant case and *Philpott* both involve debtors who failed to make contractually required payments to an ERISA pension plan from general corporate assets. This is an essential distinction for the following reason: whether one's contractual failure to contribute unsegregated funds to the formal trust res of an ERISA plan creates—*for purposes of federal bankruptcy law*—an express trust with respect to a matching portion of that individual's personal assets is a question that the Ninth Circuit had no reason to reach in *Hemmeter*.[11] It is that very question that

[11] As explained in Section III, *infra*, this Court's precedents compel that the question be answered in the negative.

the Ninth Circuit must answer before a square conflict could emerge.

II. In Any Event, Immediate Review Is Not Warranted Because The Purported Conflict Is Undeveloped And May Resolve Itself

Even if this Court is troubled by the fact that the decision below is in tension with the Ninth Circuit's decision in *Hemmeter*, review is not warranted at this time because the purported conflict has not fully developed and may be resolved without this Court's intervention.

Only three circuits have weighed in (even generally) on the question of whether "ERISA fiduciary status is sufficient to satisfy the fiduciary capacity requirement of 11 U.S.C. § 532(a)(4)." Pet. 3. This Court should decline review until other circuits have had an opportunity to consider the reasoning of the Sixth, Eighth, and Ninth Circuits and come to their own conclusions. Indeed, petitioners claim that numerous district courts and bankruptcy courts have addressed the issue in the First, Second, Fourth, Fifth, Seventh, Tenth, and Eleventh Circuits. *See* Pet. 14 n.1 (collecting cases). This Court's resolution of the issue would benefit from additional percolation in the courts of appeals, especially in those circuits with a more substantial portion of the federal courts' bankruptcy and ERISA cases.

Even in the absence of percolation, there is a significant possibility that the purported conflict will be eliminated without this Court's intervention. As explained above, the scope of the meaning of the phrase "fiduciary capacity" in section 523(a)(4) is necessarily affected by the scope of the meaning given to the term

"defalcation."[12] This Court recently called for the views of the Solicitor General in *Denton v. Hyman* (07-952), a case presenting a 4-3 circuit split over the meaning of "defalcation" in 11 U.S.C. 523(a)(4). *See Denton v.* Hyman, __ S.Ct. __, 2008 WL 1775020 (U.S.). If this Court elects to resolve the deep circuit split over the meaning of "defalcation" in section 502(a)(4), any disagreement over the meaning of "fiduciary capacity" may well disappear. *See generally Note, Bankruptcy – The Defalcation Exception to Discharge: Should a Fiduciary's Mistake Prohibit a Discharge From Debt?,* 27 W. New Eng. L. Rev. 93 (2005) (discussing and analyzing the circuit split).

III. THE DECISION BELOW IS A FAITHFUL APPLICATION OF THIS COURT'S INTERPRETATION OF 11 U.S.C. 523(A)(4)

Petitioners contend that "the Sixth Circuit erred in its application of the *Davis* principles" (Pet. 15) when it concluded that respondent

> was not a fiduciary within the meaning of *Davis* because '[t]he act that created the debt—[respondent's] breach of his contractual obligations to pay the employer contributions—is also

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[12] For example, the Ninth Circuit in *Hemmeter* took a broad view of the phrase "fiduciary capacity" but then permitted discharge by adopting a restrictive definition of "defalcation." *Hemmeter*, 242 F.3d at 1190-91. By contrast, the Sixth Circuit's more narrow view of "fiduciary capacity" in undoubtedly influenced by its sweeping view of "defalcation." *See, e.g., In re Johnson*, 691 F.2d 249, 256 (CA6 1982) ("[C]reating a debt by breaching a fiduciary duty is a sufficiently bad act to invoke [the predecessor to 523(a)(4)] even without [proof of] a subjective mental state evidencing intent to breach a known fiduciary duty or bad faith in doing so.").

> the exercise of control' that rendered him a fiduciary under ERISA.

Pet. 16 (quoting Pet. App. 13a). According to petitioners, the court of appeals erred in reaching this conclusion because respondent "was unquestionably an ERISA fiduciary *prior* to breaching that fiduciary duty." Pet. 16.

Petitioners' argument misses the mark. The relevant question is not whether respondent was a fiduciary *under ERISA* prior to the act giving rise to the debt. The relevant question is whether respondent was a fiduciary *for purposes of bankruptcy law* (*i.e.,* under the principles of *Davis* and this Court's related 19th Century cases).[13]

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[13] Judge Posner has cogently analyzed this issue as follows:

> The key * * * is the distinction stressed in *Davis* * * * between a trust or other fiduciary relation that has an existence independent of the debtor's wrong and a trust or other fiduciary relation that has no existence before the wrong is committed. [Certain fiduciary duties] preexist[] any breach of that duty, while in the case of a constructive or resulting trust there is no fiduciary duty until a wrong is committed. ***The intermediate case, but closer we think to the constructive or resulting trust pole, is that of a trust that has a purely nominal existence until the wrong is committed. Technically, [defendant] became a trustee as soon as she received her license to sell lottery tickets. Realistically, the trust did not begin until she failed to remit ticket receipts.*** For until then she had no duties of a fiduciary character toward the Department of Lottery or anything or anyone else. Until then, she was just a ticket agent. The state, afraid that she might be a disloyal agent, required her to keep the proceeds of her ticket sales separate from her

In order to appreciate this point, one need look no further than petitioners' own explanation of why respondent obtained fiduciary status under ERISA. According to petitioners:

> once [respondent]'s contributions to the Plan became due, and he failed to pay them, they immediately became "plan assets" under the terms of the Trust Agreements and under ERISA. At that point, [respondent] held plan assets in his personal bank account and indisputably exercised control over them* * * * Unless and until [respondent] made the required payment over to the trust, ERISA imposed a statutory trust on his assets, requiring that they be held for the benefit of the Funds.

Pet. 17-18. It is this argument—not the decision of the Sixth Circuit—that cannot be reconciled with this Court's precedents.

Almost 120 years ago, this Court squarely held that one is a fiduciary for purposes of section 523(a)(4) only

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> other funds and threatened her with criminal punishment if she did not. These were devices by which the state sought to establish and enforce a lien in the proceeds, the better to collect them securely. The analogy is to "floor planning," where a bank insists that the proceeds of any sale from inventory be remitted to the bank to pay down the principal of the loan as soon as the sale is made. ***Such arrangements, held not to come within the scope of section 523(a)(4) in*** **Davis** ***and*** **Long*****, are remote from the conventional trust or fiduciary setting*** * * * *

In re Marchiando, 13 F.3d 1111, 1115-16 (CA7 1994) (emphases added).

with respect to specific property that has been entrusted to the debtor to be held in trust:

> The finding of the jury that the agreement of the plaintiff [] was to collect the money and keep it until the defendants [] called for it cannot be taken to imply an obligation to keep and deliver to them the identical bills or coins. Even if the agreement between the parties might be construed as creating a trust in some sense, ***it was clearly not such a trust as comes within the provisions of the bankrupt act.***

Noble v. Hammond, 129 U.S. 65, 70 (1889) (emphasis added). And, as this Court explicitly clarified in *Davis,* a debtor's contractual promise to hold property "in trust" for another does not convert a contractual duty into a fiduciary one:

> The trust receipt [*i.e.*, contract] may state that the debtor holds the car as the property of the creditor; in truth, it is his own property, subject to a lien * * * The resulting obligation is not turned into one arising from a trust because the parties to one of the documents have chose to speak of it as a trust.

Davis, 293 U.S. at 334. Under petitioners' contrary logic, any party who breaches a contractual obligation to pay money to an ERISA plan will incur a debt that is not dischargeable under section 523(a)(4) of the Bankruptcy Code *merely because the ERISA plan documents provide that monies owed under such contract immediately become "plan assets" upon breach.* As the Sixth Circuit correctly recognized, that is precisely the result prohibited by this Court in *Davis*.

CONCLUSION

For the reasons stated herein, respondent respectfully requests that the petition be denied.

Respectfully submitted.

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