Personal Fiduciary Liability Under ERISA
Your Obligations Can Follow You Into Bankruptcy

By: Sam Henson, J.D.

There are many misconceptions I have heard when speaking to corporate owners, officers and directors about bankruptcy, “all debts are dischargeable,” it’s “always a fresh start” or it’s “a discharge of my fiduciary obligations to the retirement plan.” You would be surprised at just how many believe that last one. As the economic downturn has pummeled employers, many have come into severe financial distress and cannot meet their financial obligations to creditors in a timely manner, including their retirement plan obligations. Employers facing financial challenges are using a variety of means to keep the company open. Sadly, for some this can include the commingling of retirement plan assets with company operating funds, resulting in the delay or complete failure to deposit employee contributions into the retirement plan. As employers are forced into corporate and personal bankruptcy, owners, officers and directors who were plan fiduciaries mistakenly believe that their fiduciary liability ended with the closing of the company doors.

The Employee Retirement Income Security Act (ERISA) was enacted to compel high standards of fiduciary duties with respect to the protection of employee benefit plans. Likewise, the Bankruptcy Code (the Code) was intended to protect those who have been injured by the debtor’s wrongful acts, known as defalcation. When a fiduciary seeks to discharge a defalcated plan debt in a bankruptcy, both the Code and ERISA have been violated. In most jurisdictions, the determination that one is an ERISA fiduciary is sufficient for the determination that one is a fiduciary for the Code. Code §523(a)(4) provides that certain debts are excepted from discharge during a bankruptcy, including those debts arising from fraud or defalcation while acting in a fiduciary capacity for purposes of the Code and ERISA. So what exactly gives rise to defalcation? The answer is not as significant as you might expect. Defalcation for purposes of ERISA covered plans includes misappropriation of plan assets, the failure to forward employee contributions and the stopping of only the fiduciary’s contributions while continuing others.

In the past, bankruptcy allowed fiduciaries to essentially abandon their plan administration duties. The passage of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) dramatically changed the administration of plans of bankrupt sponsors. BAPCPA explicitly imposed plan administration duties on panel trustees and put an end

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1 See Hunter v. Philpott, 373 F.3d 873, 876–77 (8th Cir. 2004) (stating the ERISA statute does not necessarily satisfy fiduciary capacity requirement, and instead analyzing debtor’s relationship to benefit plans without reference to the statute). Contra Blyler v. Hemmeter (In re Hemmeter), 242 F.3d 1186, 1190–91 (9th Cir. 2001) (holding ERISA statute satisfies fiduciary capacity requirement and analyzing whether debtor defalcated while acting as an ERISA fiduciary).
to the abandonment of retirement plans by bankrupt employers. While the fiduciary status of bankruptcy trustees solved the personnel dilemma of the role of plan administrator, an interesting reversal of roles ensued. Most notably BAPCPA allowed the United States Department of Labor (DoL) to change its role in bankruptcy from retirement plan “caretaker” to retirement plan “collector.” In bankruptcies in which employee contributions are missing due to defalcation, the DoL is now using its resources very effectively to recover those missing monies.

Where the DoL has determined that evidence of defalcation exists, it can (and most certainly will) file an adversary complaint to establish the nondischargeability of the retirement plan’s debt under Code §523(a)(4). In addition, the DoL may file a proof of claim on behalf of the plan pursuant to ERISA §502(a), seeking to have the plan debt classified as a priority unsecured claim. When the proof of claim is filed, the fiduciary may be subject to the DoL’s questions under oath during the 341 creditors’ meeting with regard to why those employee contributions never made it to the plan, and more importantly where the money went. A fiduciary should tread very carefully during the creditors’ meeting, as intentionally making a false statement may subject them to criminal prosecution. Assuming the DoL succeeds in discharging the plan’s debt, it will then seek to collect that debt. In those situations where the employer has assets not subject to secured creditors, the DoL may be able to recover monies owed to the retirement plan. However, the surprise comes in those situations in which the employer has no assets and has closed its doors. The DoL may pursue a fiduciary personally under ERISA §409.
ERISA § 409 “Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary …

To be very clear of what this provision of ERISA means, retirement plan fiduciaries with the discretion and control to decide when the company will deposit employee deferral contributions can be held personally liable if the money is not deposited. While it may appear that this is unlikely to happen, it is not uncommon in situations where the employer has shut its doors and has no money to pay its debts. In these situations the DoL will look to ERISA §409 to collect, and may enforce liens on a fiduciary’s personal property, garnishments of future income or offsets of a fiduciary’s own 401(k) account long after the company shut its doors. Even if a plan sponsor has adopted indemnification provisions in the plan’s documents, such provisions are likely unenforceable. A fiduciary must recognize that its actions can expose its personal net worth to restore losses it causes to the plan, in order to satisfy an ERISA fiduciary breach.

The reality is that plan sponsors hit hard times and may not survive. However, the fiduciaries must continue to properly administer the plan even in the toughest of times. If a fiduciary sets aside their duty, they may be held personally responsible for the results. If a plan sponsor goes into bankruptcy the fiduciaries should pay close attention to ensure that plan assets are not commingled with operating assets, no matter what financial distress the company is experiencing. Fiduciaries must know that retirement plan obligations are not equal to corporate obligations. It is strongly advised that any individual who finds himself with discretionary control over the assets of a retirement plan should strongly consider fiduciary liability insurance. Most director/officer liability corporate coverage policies typically exclude ERISA-based claims. Plan fiduciaries should take care in selecting a policy that covers their liability and should consult with an insurer that can meet their needs. Ultimately, a fiduciary should remember that even in the toughest of financial situations, their duties to their plan cannot be set aside.

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2 The Taxpayer Relief Act of 1997 adds IRC §401(a)(13)(C) and ERISA §206(d)(4) to permit the offset of a participant’s benefits under a plan for an amount the participant is required to pay because of: (1) a judgment resulting from conviction for a crime involving such plan, (2) a civil judgment involving ERISA fiduciary rules, or (3) a settlement agreement with DoL.

3 ERISA § 410

4 ERISA § 409(a)