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EMPLOYEE'S LIABILITY FOR IMPROPER USE OF EMPLOYEE HEALTH PLAN CONTRIBUTIONS IS NOT DISCHARGEABLE IN BANKRUPTCY

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Practices & Industries

Employee Benefits

In a recent case, the United States Bankruptcy Appellate Panel for the Eighth Circuit held that the CEO of a defunct company who used employee health care contributions to pay personal expenses and other corporate debts could not avoid his fiduciary liability by filing for bankruptcy.

In this case, the company was the ERISA Administrator of the company-sponsored health plan. Employees paid 100% of the premiums via payroll deduction. The company withheld the premiums from the employees' paychecks and held them in the company's general operating account from which other corporate expenses were paid. The CEO had signatory authority on the general operating account, payroll account, and other company accounts and, in his capacity as CEO, had the authority to determine which company debts to pay. The court found that employee contributions earmarked for the payment of premiums were used to pay other corporate debts and certain personal expenses of the CEO. The Secretary of the Department of Labor filed a lawsuit against the CEO on the grounds that the premiums that were withheld from employees' paychecks were "plan assets." Because the CEO had exercised authority and control with respect to the disposition of the plan's assets, he was a fiduciary and had breached his fiduciary duties by using plan assets to pay corporate creditors and personal expenses. The United States Department of Labor obtained a judgment against him in the amount of $67,840.

The CEO (Debtor) then filed a Chapter 7 bankruptcy case with the expectation that the judgment obtained by the Department of Labor would be discharged. The Department of Labor objected, citing an exception under bankruptcy law that would prevent a bankruptcy debtor from discharging a debt resulting from "fraud or defalcation while acting in a fiduciary capacity." The court ruled that "defalcation" includes either (a) an intentional misappropriation of trust funds, or (b) a misappropriation of trust funds undertaken with conscious disregard to the substantial and justifiable risk that doing so would result in a breach of fiduciary duty. In the court's view, the Debtor committed "defalcation" when he knowingly failed to remit employee contributions to the health insurer and instead knowingly used those funds to pay for other expenses, including personal expenses.

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Corporate owners, officers and directors, and their business advisors need to take careful note of the court's decision in this case. When companies in severe financial distress cannot meet their obligations, company employees establish payment priorities that, more often than one would think, do not include the prompt deposit of employee contributions into the company retirement or health plan accounts. As this case demonstrates, owners, officers and directors of a company who are plan fiduciaries would be quite wrong in assuming that they have no personal liability for putting personal and corporate debts ahead of employee contributions to company benefit plans, and that their personal liability can be discharged in bankruptcy. *DOL v. Harris (In re. Harris) (B.A.P. 8th Cir. 2017)*