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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	)	CHAPTER 7
MICHAEL L. DAVENPORT, DEBORAH N. DAVENPORT,	)	CASE NO. 05-76748-MHM
Debtors.	)	
NATIONAL AIR TRAFFIC CONTROLLERS ASSOCIATION, BARRY BARBER, DANIEL J. ELLENBERGER, JIMMY DALE WRIGHT, JR., MATTHEW MURAWSKI, MARK BERG, ROGER MATHIEU, and THOMAS HAYS,	)	**ADVERSARY PROCEEDING**
Plaintiffs,	)	**NO. 05-9179**
v.	)	
MICHAEL L. DAVENPORT, DEBORAH N. DAVENPORT,	)	
Defendants.	)	

ORDER GRANTING IN PART CROSS MOTIONS FOR SUMMARY JUDGMENT

Plaintiffs allege that Debtors improperly used assets from plans qualified under Title 29, Chapter 18, the Employee Retirement Income Security Act, 29 U.S.C. §1001 *et seq.* ("ERISA") to satisfy tax obligations, general operating expenses, and for other purposes.

They assert that Debtors' conduct constitutes defalcation under 11 U.S.C. § 523(a)(4), so that the debts are nondischargeable. Plaintiffs also assert that Debtors breached a fiduciary duty to ensure the financial solvency of another ERISA-qualified plan. The parties have filed cross-motions for summary judgment.

STATEMENT OF FACTS

Debtors' business, Dental Plans, Inc. ("DPI") was engaged in the insurance brokerage business. Debtor Deborah Davenport was the sole shareholder, director, and president of DPI. Debtor Michael Davenport was DPI's vice president and treasurer. Both Debtors were insurance agents licensed by the State of Georgia.

The National Air Traffic Controllers Association ("NATCA") is a labor union that sponsors employee benefit plans such as those in this adversary proceeding. From 2001 to 2004, DPI provided administrative services for two employee benefit plans established for the benefit of members of NATCA. The participants in these two benefit plans were not identical, *i.e.*, some NATCA members participated in one plan but not the other and vice versa. NACTA chose, hired and terminated DPI; provided plan forms and information to employees; and exercised discretionary control or authority over the plan's assets. The premiums collected from the NATCA employees for these two benefit plans were held in accounts of DPI.

The first employee benefit plan administered by DPI was a group long-term disability insurance policy issued by UNUM Life Insurance Company of America (the

"Disability Plan"). NATCA employees who participated in the Disability Plan could pay the premiums directly or elect to have them deducted from their paychecks. The majority of the participating employees elected payroll deduction. The employer (the FAA) deducted the premiums from the employee's salary and forwarded the funds to a designated allottee. That allottee would then forward the premiums to DPI, who was then responsible for forwarding the premiums to UNUM. DPI's fees and commissions were paid separately from the premiums that were to be forwarded to UNUM.

Between 2001 and 2004, DPI collected premiums to be forwarded to UNUM totaling $2,796,424.37. Of that amount, DPI forwarded only $2,411,074.97 to UNUM. DPI refunded (for a reason unrelated to the issues in this adversary proceeding) $101,093.45 to NATCA members participating in the Disability Plan. The remainder, $284,255.85, was diverted by Deborah Davenport to other DPI bank accounts: $53,682.62 was deposited in one or more of DPI's operating accounts; $133,296.84 was deposited to accounts used by DPI to pay claims for another NATCA employee benefit plan (described below); and $154,682.39 was deposited in one or more other unidentified accounts. Michael Davenport had no knowledge of and did not participate in the diversion of funds intended as premiums for UNUM. In January, 2005, NATCA terminated DPI and Debtors as administrators of the Disability Plan.

The second employee benefit plan administered by DPI was a self-funded dental benefits plan (the "Dental Plan"). NATCA members who chose to participate in the Dental

Plan had funds deducted from their salary and forwarded to DPI. Those funds were held by DPI in an account from which claims were to be paid. The NATCA members who chose to participate in the Dental Plan were not necessarily the same members who chose to participate in the Disability Plan.

Almost from the beginning, the Dental Plan was underfunded. Fewer than expected NATCA members chose to participate in the Dental Plan, resulting in cash flow problems that worsened as time passed with membership in the Dental Plan remaining less than optimal. Debtors informed NATCA of the problem but NATCA refused to allow an increase in the premiums. Because of the worsening problems with payment of dental claims caused by the underfunded Dental Plan, Debtor Deborah Davenport diverted some of the funds received for payment of the Disability Plan premiums to the Dental Plan for payment of dental claims.

On January 5, 2004, the Internal Revenue Service ("IRS") levied on the Dental Plan's accounts and seized $54,632.20. The IRS applied the funds seized to DPI's payroll withholding tax debt, which relieved (in the amount of the funds seized) Debtors' personal liability for that tax debt.[1] Debtors allege, without evidentiary support or citation to the record, that Debtor Michael Davenport obtained a loan to partially replace the funds seized by the IRS and employed a tax attorney to contest the seizure. Debtors presented no financial records to show the funds seized were replaced and presented no evidence or

[1] Under the Internal Revenue Code, as "responsible persons," Debtors were personally liable for DPI's payroll withholding tax obligations.

explanation about why they were unsuccessful in achieving a return of any of the funds seized by the IRS. The Dental Plan terminated and has no assets. More than $500,000 in dental claims remain unpaid.

Plaintiffs assert that Debtors had a statutory fiduciary duty under both the Georgia insurance statutes and ERISA, and that the diversion of funds that should have been paid as premiums for the Disability Plan constituted defalcation regardless of Debtors' motives for diverting those funds. Plaintiffs also assert that when Debtors allowed the IRS to seize funds from the Dental Plan account, because that seizure conferred a benefit to Debtors, *i.e.*, relieving them of the personal liability for the unpaid payroll withholding taxes, the transfer of funds to the IRS also constituted defalcation. Finally, Plaintiffs assert that Debtors are responsible for the insolvency of the Dental Plan and their failure to prevent or alleviate that insolvency constituted a breach of fiduciary duty, giving rise to a nondischargeable debt for the unpaid Dental Plan claims.

Debtors seek summary judgment as to the Dental Plan issues on the grounds that the Dental Plan paid more funds to satisfy claims than it received in premiums. Debtors also contend that NATCA lacks standing under ERISA to proceed against Debtors.[2] Debtors assert Plaintiffs have failed to prove damages because Plaintiffs failed to show any employee was denied benefits by UNUM. Finally, Debtors contend that Plaintiffs have

[2]Debtors also assert that NATCA failed to prove any rights to subrogation to the employees by failing to establish any amounts that NATCA advanced to UNUM to prevent the UNUM disability policy from lapsing. In reply, Plaintiffs show that NATCA advanced $193,064 to prevent the UNUM policy from lapsing.

failed to state a claim under §523(a)(4) because any fiduciary duty was owed by DPI and any liability of Debtors arose only as a result of their alleged wrongful acts.

CONCLUSIONS OF LAW

Standing

As a threshold matter, Debtors assert that Plaintiff NATCA lacks standing to pursue Debtors for violation of their fiduciary duties under ERISA. ERISA's standing provision provides that a civil action may be brought by a participant, beneficiary, or fiduciary. Without dispute, individuals within the meaning of "participant" are among the plaintiffs in this adversary proceeding.

NATCA is a labor union that sponsors the employee benefit plans such as those in this adversary proceeding. Under ERISA, a labor union that establishes or maintains an employee benefit plan is a "sponsor." 29 U.S.C. § 1002(16)(B). ERISA also provides the following definition of a "fiduciary":

> 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.

29 U.S.C. §1002(21). Thus, a plan sponsor becomes a fiduciary to the extent that it retains or exercises "any discretionary authority" over the management or administration of a plan. *Coyne & Delaney Co. v. Selman,* 98 F. 3d. 1457 (4th Cir. 1996); *Hope Center, Inc. v. Well America Group, Inc.*, 196 F. Supp. 2d 1243 (S.D. Fla. 2002).

NACTA exercised such discretionary authority. It chose Debtors and DPI to administer the Disability Plan and the Dental Plan. It disseminated information to its members about the Plans. It had the authority to terminate Debtors and DPI as administrators of the Plans. It had the authority to refuse DPI's request to increase the premiums for the Dental Plan. Therefore, as a fiduciary, NACTA has standing to pursue this adversary proceeding against Debtors.

Summary Judgment

Pursuant to FRCP 56(c), incorporated in Bankruptcy Rule 7056, a party moving for summary judgment is entitled to prevail if no genuine issue as to any material fact exists and the moving party is entitled to judgment as a matter of law. The burden of proof is on the moving party to establish that a genuine issue of material fact is absent. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144 (1970); *Clark v. Coats & Clark, Inc.*, 929 F. 2d 604 (11th Cir. 1991). "[I]n ruling on a motion for summary judgment, the judge must view the evidence presented through the prism of the substantive evidentiary burden." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 254. The actual quantum and quality of proof necessary to support a finding in favor of the plaintiff must be considered to determine whether a genuine dispute of fact exists. *Id.*

Dischargeability

The burden of proof is upon the creditor to show by a preponderance of the evidence that the debt is nondischargeable. *Grogan v. Garner,* 111 S. Ct. 654, 59 (U.S.

1991). Exceptions to discharge are construed liberally in favor of a debtor. *Guerra v. Fernandez-Rocha*, 451 F.3d 813, 816 (11th Cir. 2006).

Pursuant to 11 U.S.C. §523(a)(4), a debt based on "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" is nondischargeable. The U.S. Supreme Court has consistently interpreted "fiduciary" as used in §523(a)(4) narrowly, holding that the trust upon which the fiduciary relationship relies must be an express or technical trust. *Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934).[3] The trust must have existed before and not as a result of the defalcation. *Id.*; *Lewis v. Short,* 818 F.2d 693 (9th Cir. 1987); *Murphy & Robinson Investment Co. v. Cross,* 666 F.2d 873 (5th Cir. Unit B 1982);[4] *Angelle v. Reed,* 610 F.2d 1335 (5th Cir. 1980).[5] The majority of courts, including the Eleventh Circuit Court of Appeals, have concluded that express statutory trusts may create such a preexisting fiduciary relationship.[6] *See Quaif v. Johnson*, 4 F.3d 950, 954 (11th Cir. 1993).

Plaintiffs assert two sources of this necessary fiduciary relationship. First, they point to the fiduciary relationship created under Georgia insurance law. O.C.G.A. § 33-23-35(b).

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[3] The *Davis* case was decided under §17(a)(4) of the Bankruptcy Act, which was transmuted virtually unchanged to §523(a)(4).

[4] Decisions of Unit B of the former Fifth Circuit are binding precedent in the Eleventh Circuit. Section 9, Public Law 96-452 (1980).

[5] *Bonner v. City of Prichard,* 661 F.2d 1206 (11th Cir. 1981), renders decisions of the Fifth Circuit issued prior to September 30, 1981, binding precedent for the Eleventh Circuit.

[6] Trusts need not be limited to statutory and common law trusts either. Court imposed trusts can create a defalcation-ready fiduciary relationship. *See In re Eichelberger*, 100 B.R. 861, 865 (Bankr. D. Tex. 1989).

Georgia insurance statutes create an express statutory trust, and misappropriation occurring after creation of such a statutory trust constitutes defalcation. *See Quaif v. Johnson*, 4 F.3d 950, 954 (11th Cir. 1993). Additionally, O.C.G.A. 33-23-1 provides that only an individual, not a corporation, may be licensed as an agent. *Id.* At 953. Therefore, Debtors are not relieved of personal liability because they did business through their corporation. As Georgia registered insurance agents, Debtors had a preexisting fiduciary relationship to insured plan participants. O.C.G.A. § 33-23-35(b). Debtors, although acting under the authority of their corporation, DPI, were insurance agents. They, independent of DPI, are fiduciaries.

Second, Plaintiffs rely upon the fiduciary responsibility of administrators of ERISA qualified plans. 29 U.S.C. § 1002(21)(A)(i). While the Eleventh Circuit has not specifically addressed ERISA under § 523(a)(4), other courts have decided that an entity who acquires fiduciary status in connection with an ERISA plan is a fiduciary within the meaning of §523(a)(4). *Blyler v. Hemmeter*, 242 F.3d 1186, 1190 (9th Cir. 2001); *In re Luna*, 406 F.3d 1192, 1201 (10th Cir. 2005); *Morgan v. Musgrove*, 187 B.R. 808, 814 (Bankr. N.D. Ga. 1995)(J. Drake). *But see Hunter v. Philpot*, 373 F.2d 873 (8th Cir. 2004); *Carpenters' Pension Fund v. Bucci*, 2007 WL 1891736 (6th Cir. 2007). ERISA creates a fiduciary duty prior to the acts that constitute a defalcation, satisfying the standard established in *Davis* (293 U.S. 328 (1934)). For purposes of § 523(a)(4), ERISA establishes the same sort of statutory trust as the Georgia insurance statute.

ERISA specifies a number of ways an individual may become a fiduciary. The most obvious is to name the fiduciary in the plan instrument. 29 U.S.C. § 1102. "Such

instrument shall provide for one or more named fiduciaries." *Id.* It can be assumed that the fiduciary specified by NACTA in the plan instrument was DPI.

Parties may also become fiduciaries by "exercis[ing] the fiduciary functions set forth in ERISA...including the providing of investment advice, administrative control over a plan, advising on whom to retain as legal or investment advisors to a plan, and ultimately, how to invest plan assets." *Navarre v. Luna*, 406 F.3d 1192, 1201 (10th Cir. 2005). If a corporation is a plan fiduciary, the individuals who actually perform the fiduciary functions are fiduciaries of the plan. *Eavenson v. Ramey,* 243 B.R. 160 (N.D. Ga. 1999)(J. O'Kelley). The defalcation–the conduct that is the basis for the complaint–must have been undertaken while *exercising* such fiduciary functions. *Pegram v. Herdrich*, 530 U.S. 211, 225-226 (2000). "[T]he threshold question is not whether the actions of some person employed to provide services under a plan adversely affected a plan beneficiary's interest, but whether that person was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to complaint." *Id.*

The Disability Plan

Debtors were fiduciaries under both ERISA and the Georgia insurance statutes within the meaning of §523(a)(4). Defalcation is a failure by a fiduciary to produce funds entrusted to that fiduciary. *Quaif*, 4 F.3d at 955. While all defalcations are failures to produce funds, however, not all failures to produce funds are defalcations. A purely innocent mistake by a fiduciary may not constitute defalcation. *Central Hanover Bank & Trust Co. v. Herbst,* 93 F. 2d 510 (2d. Cir. 1937)(J. Hand). To constitute defalcation,

conduct need not rise to the level of fraud, but it must be intentional, not negligent. *Eavenson,* 243 B.R. 160. *See also Quaif,* 4 F. 3d at 955.

The evidence in this proceeding establishes that Debtor Deborah Davenport used funds remitted for payment of premiums to UNUM for purposes other than payment of those premiums. Her failure to remit the premiums to UNUM for the Disability Plan was neither negligent nor innocent. The use of a portion of those funds to bail out another plan, one with different participants, is not a justification for and does not excuse the breach of her fiduciary duty. Michael Davenport, however, appears to have had no knowledge of nor participation in the diversion of the funds intended for premiums to UNUM. Therefore, as to Michael Davenport, Plaintiffs have failed to establish defalcation.

Debtors' assertion that Plaintiffs have failed to prove damages because Plaintiffs failed to show any participant or beneficiary was denied benefits is without merit. Additionally, any amount that NACTA may have paid to prevent the UNUM policy from lapsing is irrelevant. The measure of damages is the amount of the funds Debtors should have but failed to remit to UNUM as premiums. That amount is established as $284,255.85, and that amount is nondischargeable under §523(a)(4) as to Deborah Davenport.

The Dental Plan

As discussed above, with respect to both the Disability Plan and the Dental Plan, Debtors were fiduciaries within the meaning of §523(a)(4). Plaintiffs' assertions of defalcation, however, do not include the clear-cut failure to remit premiums as with the

Disability Plan. Plaintiffs allege two different types of conduct which they contend constitutes defalcation. First, Plaintiffs contend that when Debtors allowed the IRS to seize $54,632.20 to be applied to DPI's payroll withholding tax debt, relieving Debtors of their personal responsibility for that tax debt, that involuntary transfer of funds constituted defalcation by Debtors.[7]

The IRS seizure of the Dental Plan funds seems to fall in between the intentional conduct required for defalcation by *Eavenson* and the innocent or negligent conduct that would not constitute defalcation. In the case of *Hearn v. Goodwin*, 355 B.R. 337 (Bankr. M.D. Fla. 2006)(J. Jennemann), an ERISA fiduciary had invested pension plan assets in a risky condominium project in which he was personally liable as guarantor. When financial difficulties with the project ensued, he conveyed the assets to the lender by a deed in lieu of foreclosure, thus relieving himself of liability as guarantor, and depriving the pension fund of assets. The court held his conduct constituted defalcation.

In the case of *Blyler v. Hemmeter*, 242 F. 3d 1186 (9th Cir. 2001), the court concluded defalcation had not occurred when the pension fund declined in value due to bad investments by the fiduciary. Defalcation "does not embrace the normal acts within the business judgment of the fiduciary that, however flawed, do not involve failure to account for or produce a beneficiary's funds." *Id.* at 1191.

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[7] Debtors alleged that Michael Davenport borrowed funds to replace part or all of the funds seized by the IRS. The extent to which Debtors, from their personal resources, replaced the funds seized by the IRS would seem to negate the assertion of defalcation, but Debtors have failed to allege a specific amount that was replaced, or to present evidence of such a replacement.

Debtors have produced no evidence that they replaced the funds seized by the IRS or that they made any concerted effort to protect the funds from seizure or to regain the funds from the IRS by showing that the funds were held in trust on behalf of the Dental Plan. Debtors received a quantifiable benefit from the seizure because their personal liability for the payroll taxes was reduced in direct proportion to the amount seized. Debtors' failure to account for these funds constitutes defalcation in the amount of $54,632.20 and that amount is nondischargeable under §523(a)(4).

Plaintiffs also allege that a shortfall of funds in the Dental Plan left approximately $500,000 in valid dental claims unpaid. Plaintiffs allege Debtors breached a duty to ensure the financial solvency of the Dental Plan and that such breach renders the unpaid claims a nondischargeable debt under §523(a)(4). The financial insolvency of the Dental Plan, however, resulted not from Debtors' mismanagement or misappropriation of the funds but from the simple fact that an insufficient number of NACTA members chose to participate in the Dental Plan, with the result that the risk pool was too small to provide adequate funding of the plan. When Debtors approached NACTA to increase the premiums for the Dental Plan, NACTA exercised its discretion to refuse such an increase.

Not all violations of a fiduciary duty constitute a defalcation. Only failures of a duty to account for funds held in a fiduciary capacity will constitute a defalcation. Debtors' explanation of the path of the Dental Plan to insolvency, undisputed by Plaintiffs, shows the lack of funds in the Dental Plan was not due to any defalcation by Debtors. Debtors did not fail to produce or account for funds entrusted to them with respect to the Dental Plan because Debtors paid out in claims all the funds that had been funds entrusted

to them. Without an alternative theory of nondischargeability, an ERISA-created duty to maintain the plan's solvency does not constitute a defalcation. *See, Blyler v. Hemmeter,* 242 F. 3d 1186 (9th Cir. 2001).

Accordingly, it is hereby

ORDERED that Plaintiffs' motion for summary judgment is ***granted, in part***:

- The unremitted premiums for the Disability Plan in the amount of $284,255.85 is nondischargeable under §523(a)(4) as to Deborah Davenport; and
- The amount seized from the Dental Plan in the amount of $54,632.20 is nondischargeable under §523(a)(4) as to both Debtors.

The remainder of Plaintiffs' motion for summary judgment is ***denied.*** Except as set forth above, Defendants's motion for summary judgment is ***denied.***

The Clerk, U.S. Bankruptcy Court, is directed to serve a copy of this order upon Plaintiffs' attorney, Defendants' attorney, and the Chapter 7 Trustee.

IT IS SO ORDERED, this the 6th day of September, 2007.

MARGARET H. MURPHY
UNITED STATES BANKRUPTCY JUDGE