Jacob Sparks
Texas Bar No. 24066126
SPENCER FANE LLP
5700 Granite Parkway, Suite 650
Plano, Texas 75024
Tel: (214) 750-3624
Fax: (214) 750-3612
Email: JSparks@SpencerFane.com

Attorneys for Reorganized Debtors

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re:	§	**Chapter 11**
	§	
SENIOR CARE CENTERS, LLC, *et al*.[1]	§	**Case No. 18-33967-bjh11**
	§	
Debtor.	§	**Jointly Administered**

REORGANIZED DEBTORS' OBJECTION TO MOTION OF COLONIAL LIFE & ACCIDENT INSURANCE COMPANY TO DETERMINE AMOUNT OF A PRIORITY CLAIM PURSUANT TO 11 U.S.C. § 507(A); TO AUTHORIZE PAYMENT OF SUCH CLAIM; AND LIMITED OBJECTION TO CONFIRMATION OF PLAN

Senior Care Centers, LLC ("***SCC***") and its affiliates (before the Effective Date of the Plan, the "***Debtors***," and after the Effective Date of the Plan, the "***Reorganized Debtors***"), object to the Motion of Colonial Life & Accident Insurance Company to Determine Amount of a Priority Claim Pursuant to 11 U.S.C. § 507(a) and to Authorize Payment of Such Claim and Limited Objection to Confirmation of Plan (the "***Motion***") [Docket No. 2746]. In support of its objection, the Reorganized Debtors state as follows:

[1] The Debtors in the Chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are set forth in the *Order (I) Directing Joint Administration of Chapter 11 Cases, and (II) Granting Related Relief* [Doc 569] and may also be found on the Debtors' claims agent's website at https://omnimgt.com/SeniorCareCenters. The location of the Debtors' service address is 600 North Pearl Street, Suite 1100, Dallas, Texas 75201.

BACKGROUND

1. The Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code.

2. Pre-petition, Colonial Life & Accident Insurance Company ("***Colonial***") offered voluntary disability insurance, group accident insurance, group critical illness with cancer insurance, and whole life insurance to Debtors' employees.

3. For those employees who chose to participate, SCC would withhold the premiums from the employees' paychecks and remit them to Colonial.

4. Pursuant to the terms of the contract, the policy would terminate automatically if a premium is not paid within thirty-one days of when due.

5. Debtors last remitted the full premium payments in or around August 2018.

6. On November 27, 2019, Colonial filed the Motion. In the Motion, Colonial asserts that premiums due to Colonial were withheld from employee paychecks but not remitted to Colonial. In the Motion, Colonial seeks to have these unpaid funds allowed as a priority claim under 11 U.S.C. § 507(a)(5) in the amount of $403,387.63. Colonial has since amended its claim and is now requesting $343,606.88 as a priority claim. In addition, Colonial takes the position that the unpaid premiums should be immediately remitted to Colonial as funds held in trust.

7. On December 13, 2019, the Court entered its Findings of Fact, Conclusions of Law, and Order Confirming Third Amended Joint Plan of Reorganization under Chapter 11 of the Bankruptcy Code (the "***Confirmation Order***") [Doc. 2376].

8. On March 30, 2020, Debtors filed their notice advising that on March 27, 2020 (the "***Effective Date***"), all conditions to the occurrence of the Effective Date had been satisfied or waived and the Effective Date of the plan had occurred.

ARGUMENT AND AUTHORITIES

I. 11 U.S.C. § 507(a)(5) DOES NOT APPLY TO COLONIAL'S CLAIM

A. Unpaid insurance premiums are not entitled to priority.

9. The bankruptcy code favors equal treatment among creditors. "Priority claims are granted special treatment; therefore, provisions of the Code granting claims priority are to be narrowly construed." *In re Pilgrim's Pride Corp.*, 421 B.R. 231, 240 (Bankr. N.D. Tex. 2009). Under this narrow construction of the priority provided in 11 U.S.C. § 507(a)(5), insurers are not entitled to priority for unpaid insurance premiums. *See In re Edward W. Minte Co., Inc.*, 286 B.R. 1, 6 (Bankr. D.D.C. 2002); *In re Southern Star Foods, Inc.*, 210 B.R. 838, 841 (B.A.P. 10th Cir. 1997), aff'd, 144 F.3d 712 (10th Cir. 1998); *In re AER-Aerotron, Inc.*, 182 B.R. 725, 726 (Bankr. E.D.N.C. 1995).

10. Section 507(a)(5) provides fifth priority for "contributions to an employee benefit plan arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first" subject to a cap on equal to "the number of employees covered by each such plan multiplied by [the amount allowed in § 507(a)(4)] less the aggregate amount paid to such employees under paragraph (4) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan." 11 U.S.C. § 507(a)(5).

11. First, unpaid insurance premiums do not qualify for priority status under § 507(a)(5). The purpose of § 507(a)(5) was to give "debtor's employees, not third party . . . insurance carriers" priority status. *In re Southern Star Foods, Inc.*, 210 B.R. at 842. Significantly, the statutory cap on the amount of priority for contributions to employee benefit plans refers to the wage priority amount allowed under § 507(a)(4). "If insurance companies were meant to be eligible to claim the [§ 507(a)(5)] priority, the priority would not be limited by the amount that employees may collect under the wage priority." *In re AER-Aerotron, Inc.*, 182 B.R. at 727.

12. Second, an unpaid insurance premium is not a "contribution" to an employee benefits plan arising from "services rendered." *Id.* "Services rendered" is limited to "services rendered" by employees, not services rendered by a third party. *See In re Edward W. Minte Co., Inc.*, 286 B.R. at 9 ("This is consistent with the basic idea that an employee benefit plan suggests that the term "services rendered" means services of "employees," not third parties."). As explained by the Bankruptcy Appellate Panel for the Tenth Circuit:

> [I]nsurance premiums do not arise from 'services rendered' by employees as required under [§ 507(a)(5)]. The rendering of services by employees results in obligations to them, not the insurer. The claim for unpaid premiums does not arise from 'services rendered' but from [debtor's] failure to pay its insurer. This makes it indistinguishable from a typical unsecured claim.

In re Southern Star Foods, Inc., 210 B.R. at 841 (internal citations omitted).

13. Although not expressly stated in the Motion, Colonial's argument appears to be that by fulfilling its contractual obligations, as a third-party insurance administrator, Colonial has rendered "services" which give rise to a priority claim. Such an interpretation would render meaningless the plain language of the statute specifying "employees" as the covered beneficiaries of the priority

provided. In addition, such an interpretation would take the priority claim away from "employees," and give the benefit of § 507(a)(5) to those rendering services to an employee benefit plan, as entity unto itself, within the 180-day period. The net effect of this broad construction of § 507(a)(5)(A), and the bankruptcy court decisions adopting this construction, is that any third party who rendered services to an employee benefit plan during the statutory period—third-party claims administrators, lawyers, actuaries, investment advisors—now stand in the same priority line as the debtor's employees. *See In re Aer-Aerotron, Inc.*, 182 B.R. at 727. Moreover, Colonial's position fails to interpret the Bankruptcy Code as a whole and in effect renders meaningless and incongruent the provisions of § 507(a)(5)(A) (which require that the contribution claim emanate from "services rendered" during the statutory period) and § 507(a)(5)(B)(ii) (which provides for the maximum dollar amount of priority claims relating to an employee's services rendered).

14. Third, even if an insurance company could assert a claim under § 507(a)(5) through subrogation to an employee, it would not be subrogated to an employee's right to a priority claim under § 507(a)(5). *In re AER-Aerotron, Inc.*, 182 B.R. at 727. A subrogated claim is not entitled to priority treatment. 11 U.S.C. § 507(d) ("An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection . . . (a)(5) . . . of this section is not subrogated to the right of the holder of such claim to priority under such subsection.").

B. The insurance provided is not an employee benefits plan.

15. Section 507(a)(5) was enacted to provide priority for wage substitutes to employees. *See Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 659 (2006) ("Beyond genuine debate, the main office of § 507(a)(5) is to capture portions of employee compensation for services

not covered by § 507(a)(4).") The insurance provided by Colonial was not a wage substitute from the Debtors. Rather, the Debtors acted as a pass-through entity to collect insurance premiums from Debtors' employees and pay them to Colonial. Debtors did not make contributions to Colonial on their own behalf or subsidize the insurance premiums owed by the employees.

16. For purposes of the Employee Retirement Income Security Act of 1974 (ERISA), an employee benefit welfare plan does not include group or group-type insurance offered by an insurer to employees under which (**i**) no contributions are made by the employer; (**ii**) participation in the program is completely voluntary for employees; (**iii**) the sole functions of the employer with respect to the program are, without endorsing the program, to permit the insurer to publicize the program to employees, to collect premiums through payroll deductions, and to remit them to the insurer; and (**iv**) the employer receives no consideration in the form of cash or otherwise in connection with the program, other than reasonable compensation, for administrative services rendered. 29 C.F.R. § 2510.3-1.

17. Here, (**i**) Debtors did not make contributions to the insurance policies; (**ii**) employee participation in the insurance policies was voluntary; (**iii**) Debtors' only involvement with Colonial's insurance offerings was to permit Colonial to publicize the program, collect insurance premiums, and remit them to Colonial; and (**iv**) Debtors did not receive consideration for Colonial's insurance policies.

18. While the Supreme Court has found that the definition of an employee benefits plan under 11 U.S.C. § 507(a)(5) is not the same as an employee benefit plan under ERISA, that was in the context of whether priority should be expanded to cover workers compensation insurance. *See*

Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 654 (2006). In *Howard* the Supreme Court declined to adopt ERISA's definition that would have encompassed workers compensation insurance. *Id.* at 660–62. The Court found that workers compensation insurance was not a wage substitute, but a substitute for tort liability. *Id.* at 668. In reliance on the Bankruptcy Code's aim of equal distribution, the Supreme Court took a narrow interpretation § 507(a)(5) and declined to grant priority. *Id.* at 667–68.

19. The Court should apply the same rationale here and apply a narrow construction of an employee benefits plan. Unpaid premiums for insurance coverage that is not even considered an employee benefits plan under ERISA should not be granted priority status.

II. THE INSURANCE PREMIUMS ARE NOT TRUST FUNDS

A. Colonial cannot establish a trust over funds in SCC's account because such request is procedurally improper.

20. Colonial also asserts that the amounts designated for withdrawal from employee paychecks are not property of Debtors' estates, but were held in trust by Debtors on behalf of the employees. Colonial's claim that the premiums are subject to a trust fund theory is not seeking determination of administrative priority under Federal Rule of Bankruptcy Procedure 3012. Rather, Colonial is arguing the premiums are not property of the estate at all, and an adversary proceeding is generally required to determine an interest in property. *See* FED. R. BANKR. P. 7001(2). The relief sought by Colonial must be sought through a complaint, not by motion.

B. Colonial cannot establish a trust over funds in SCC's account because Colonial has not established the funds are held in trust under applicable non-bankruptcy law.

21. Bankruptcy courts start with state law to determine "property of the debtor." *Butner v. United States,* 440 U.S. 48, 55 (1979). And where a trust is alleged, bankruptcy courts look to applicable state law. *See e.g., In re Beveridge*, 416 B.R. 552, 571 (Bankr. N.D. Tex. 2009). The Motion gives very short shrift to the proposition that the premiums are trust funds. Colonial does not cite any Texas (or any other state) law supporting the position that these funds are held in trust (constructive or otherwise), and Colonial's mere citation to the Insurance Motion is insufficient.

22. In addition, Colonial cannot establish a trust over funds in SCC's account because based on Colonial's own allegations, SCC would at best be holding the funds for the benefit of the *employees*, not *Colonial*, as Colonial admits in paragraph 8 of its Motion. Thus, Colonial has no claim to the funds as a beneficiary of the alleged trust. *Diamond Offshore Co. v. Bennu Oil & Gas, LLC (In re ATP Oil & Gas Corp.)*, 540 B.R. 294, 305 (Bankr. S.D. Tex. 2015) ("When a debtor holds property in trust under applicable non-bankruptcy law, the equitable interest in that property belongs to the trust beneficiary, not the debtor. The equitable interest does not become Estate property.").

C. Even if Colonial could establish a trust fund theory, Colonial's recovery is limited by the lowest intermediate balance of the account

23. The withdrawals from employee paychecks were not held in a separate bank account, but were comingled with Debtors' other funds. As such, the lowest intermediate balance rule applies. *See In re Erickson Retirement Communities, LLC*, 497 B.R. 504, 511 (Bankr. N.D. Tex. 2013). "[T]he lowest intermediate balance test creates a legal fiction that, when funds are withdrawn from

a trust account, non-trust funds are withdrawn first." *Id.* If "the balance of the cash on hand on any interim day was less than the amount of the trust fund claims, then the trust fund claims are limited to that 'lowest intermediate balance.'" *Id.* When "all the money is withdrawn, the trust fund is treated as lost, even though later deposits are made into the account. *See In re Fin. Oversight & Mgmt. Bd. for Puerto Rico*, 939 F.3d 340, 351 (1st Cir. 2019).

24. As of the Effective Date, the balance in SCC's operating account dropped to $121,385.27, and on April 2, 2020, the balance dropped to $111,815.82. Accordingly, although the pre-petition employee contributions were not held in trust for the benefit of Colonial, any proven trust fund claim would be limited to the lowest intermediate balance of SCC's account, which was $111,815.82.

CONCLUSION

For the reasons stated herein, the Reorganized Debtors request that this Court enter and order (**i**) denying Colonial's Motion in its entirety, and (**ii**) granting the Reorganized Debtors any other relief the Court deems just and proper.

Respectfully submitted,

By: */s/ Jacob Sparks*
Jacob Sparks
Texas Bar No. 24066126

SPENCER FANE LLP
5700 Granite Parkway, Suite 650
Plano, Texas 75024
Tel: (214) 750-3624
Fax: (214) 750-3612
Email: JSparks@SpencerFane.com

Attorneys for Reorganized Debtors

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing document was served through the Bankruptcy Court's electronic transmission facilities, per N.D. Tex. L.B.R. 9076-1, on March 18, 2021, on persons who have appeared in this case.

By: */s/ Jacob Sparks*
Jacob Sparks