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SulmeyerKupetz attorney David J. Richardson thinks it's great that you won a multimillion dollar judgment, but he asks if you took the necessary steps during trial to protect that judgment from your adversary's possible bankruptcy. Because losing it all in the defendant's bankruptcy is a real possibility, Richardson proposes ways to protect the judgment. Among other things, he suggests that you spend some time familiarizing yourself with Section 523(a) of the Bankruptcy Code, and that you get in your trial record specific findings that your client's injuries were willful and malicious.

Congratulations on Your Victory at Trial: But Is Your Multimillion Dollar Judgment Protected From Bankruptcy?

BY DAVID J. RICHARDSON

The jury has just awarded your client millions in damages. Congratulations! Surely that's a moment for celebration.

But if you haven't thought ahead to the defendant's potential bankruptcy case, those millions may disappear with a bankruptcy discharge that might have been avoidable.

A little forethought during the litigation, and appropriate findings of fact entered by the trial court, could be the difference between millions and pennies. And on a less dramatic level, it could be the difference between needing another trial in Bankruptcy Court to protect the judgment, or resolving the issue on summary judgment.

In many cases, such as a defendant found liable on an ordinary contract debt, a bankruptcy discharge or reorganization could erase most, if not all, of the damages awarded at trial.

But Section 523(a) of the Bankruptcy Code provides that damages arising from certain types of claims are not discharged in bankruptcy, but survive the bankruptcy case as if no petition had been filed.

The key is proving to the Bankruptcy Court that your judgment involves such a claim, and it is a task that might be far easier to prove if some planning is carried out during trial.

Claims Excepted From Discharge

Section 523(a) provides a list of 19 categories of debts that are excepted from a bankruptcy discharge, using descriptions that do not perfectly line up with state law causes of action. Those categories can be sorted into the following general groups:

> (1) certain taxes or customs duties, and certain fines, penalties or forfeitures owed to government entities or federal depository institutions;
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> (2) a debt arising from the debtor's ''false pretenses, a false representation, or actual fraud'' (with certain restrictions on fraud arising from a misleading financial state-

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ment), fraud while acting in a fiduciary capacity, embezzlement or larceny;

(3) willful and malicious injury caused by the debtor to a person or property;

(4) known claims that the debtor did not list in this case, or an earlier case;

(5) domestic support obligations and claims arising from a separation or divorce decree;

(6) student loans;

(7) death or personal injury claims arising from the debtor's intoxicated operation of a motor vehicle, vessel or aircraft;

(8) criminal restitution, violation of federal securities laws, and certain fees imposed on prisoners;

(9) certain fees or assessments arising from condominium ownership; and

(10) repayment of loans made under pension, profit-sharing, stock bonus or related plans.

In a commercial litigation setting, the types of nondischargeable claims that are most likely to be at issue are claims for fraud, for breach of fiduciary duty, and for willful and malicious injury.

Often, a Bankruptcy Court will find on summary judgment that a state court judgment for claims of fraud or breach of fiduciary duty plainly satisfies Section 523(a), for collateral estoppel purposes, because the elements of the state law claims for fraud or breach of fiduciary duty match the requirements for a nondischargeable fraud or fiduciary duty claim under Section 523(a).

But in cases that involve other causes of action, such as claims for tort or contract damages, there are no categories under Section 523(a) that naturally require a showing of the same elements.

In such cases, creditors will often argue that the damages arising from the contract breach or tort constitute ''willful and malicious'' injury under Section 523(a)(6). But the potential for success under Section 523(a)(6) depends largely on the evidence offered at trial, and the findings that the state court did, or did not, make in the course of entering judgment.

A little planning during trial can mean a substantial difference in collection costs, and a substantial difference in the ultimate recovery.

What Is ''Willful and Malicious Injury?''

Section 523(a)(6) provides an exception to discharge for damages that arise from ''willful and malicious injury by the debtor to another entity or to the property of another entity.'' In order to satisfy the standard, a judgment creditor must demonstrate that its damages arise from injury caused by the debtor that was both willful *and* malicious.

An injury is ''willful'' under Section 523(a)(6) if the debtor intends the consequences of their actions. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998) (''willful'' indicates ''a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury.'').

The focus is on the debtor's state of mind at the time the injurious action is taken: either the debtor must have the subjective intent to cause harm, or have the subjective belief, i.e., actual knowledge, that harm is substantially certain to result. *Carrillo v. Su (In re Su)*, 290 F.3d 1140, 1145-46 (9th Cir. 2002). Subjective intent or substantial certainty may be inferred from all of the facts and circumstances established. *Id.* at 1146 n.6.

The ''malicious'' injury prong focuses more on the act and its consequences, and requires proof of ''(1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse.'' *Petralia v. Jercich (In re Jercich)*, 238 F.3d 1202, 1209 (9th Cir. 2001).

In some cases, findings of fact that mirror these terms may naturally arise in litigation.

There is nothing particularly unique about findings that the defendant acted with an intent to cause harm, or that the act was wrongful, necessarily caused injury, or was done without just cause. But where any of these elements are not addressed in the prior litigation with specific findings of fact that will support a motion for summary judgment, then a trial is likely to be required in Bankruptcy Court.

For reasons of cost and expediency, it could be far easier to ensure that the elements of nondischargeability are clearly addressed at the initial trial, not merely as a matter of verbiage in findings of fact, but as an issue that was proven at trial.

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While it would certainly aid a motion for summary judgment if the state court were to enter findings that actually address the ''willful'' and ''malicious'' requirements with the same terminology that a Bankruptcy Court would apply, a judgment may still have collateral estoppel effect in Bankruptcy Court if the prior court made sufficient findings to show that the two elements were met by the debtor's conduct, regardless of the specific language chosen by the court. *See W. Reserve Area Agency on Aging v. Mitchell (In re Mitchell)*, 2014 BL 329957 (Bankr. N.D. Ohio Nov. 21, 2014) (claim for prepetition discovery abuse sanctions were awarded under state law standards, but were ''essentially the same'' as the standards under Section 523(a)(6)); *Elbing v. Blair (In re Blair)*, 359 B.R. 233, 238 (Bankr. E.D. Wis. 2007) (''The state court's findings with respect to the intentional nature of the defendant's conduct, while not couched in the same words nevertheless as a matter of law meets the test for a finding of willfulness.'').

On the other hand, where a state court's findings of fact include the proper terms ''willful and malicious,'' but the issue was not actually litigated, the findings may be accorded no collateral estoppel effect. *See Osborn v. Miller (In re Miller)*, 2010 BL 144870 (Bankr. D. Kan. June 16, 2010).

More critically, a state court's findings that a defendant/debtor acted in a manner that would be inconsistent with willful or malicious conduct will collat-

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erally estop a Section 523(a) action. *See Commander v. LoGuidice*, 2013 BL 343698 (D.N.J. Dec. 12, 2013).

Thus, the focus should be on ensuring that the issues of fact required to prove a claim under Section 523(a) are actually litigated in favor of the plaintiff, with terminology that adheres as closely to the requirements of a claim under Section 523(a) as can be obtained.

But, while it may not be necessary to have a state court use the precise terms ''willful'' or ''malicious,'' the precise findings that are implicated by those two terms must be addressed.

For example, a finding that a defendant intentionally converted a neighbor's trees to sell as lumber might not establish an intent to injure the neighbor's creditors who were looking to the value of the same trees to pay their claims, even if that might be appear to be an obvious result of the conversion. A finding of wantonness, which suggests an intent to carry out the act, might not establish an intent to cause the injury unless such injury is an obvious and natural consequence of the defendant's actions. And, a finding of an intentional breach of contract might not establish either willfulness or maliciousness.

Finally, while findings of fact may be binding in a subsequent Section 523(a) action, a state court's conclusion of law that the damages awarded will be nondischargeable in bankruptcy will not be enforceable in a future Section 523(a) proceeding, as a Bankruptcy Court has exclusive jurisdiction to determine whether a claim is excepted from discharge under Section 523(a). *See St. Laurent v. Ambrose (In re St. Laurent)*, 991 F.2d 672, 676 (11th Cir. 1993).

At the very least, if the nature of the litigation suggests that a future judgment might qualify under Section 523(a) if the defendant were to file a bankruptcy petition, then counsel should be familiar with the standard that will apply to that proceeding and ensure that the necessary issues have been litigated at trial and addressed in the findings of fact.

David Richardson is Senior Counsel at SulmeyerKupetz, a premier business, financial restructuring and litigation firm in California. He has a wide range of experience in corporate restructuring, commercial litigation and appellate practice, and can be reached at drichardson@sulmeyerlaw.com or (213) 617-5222.