

Arbitration
Categorical harm
Collateral estoppel
Damages
Issue preclusion
Malice
Punitive damages
Res judicata
Summary judgment
Unclean hands
Willful injury
FRCP 56(a)
11 USC § 101(12)
11 USC § 523(a)(6)

Bergemann v. Brion & Higgins
(In re Clay Willard Brion, III, Case # 10-37631-tmb7)
(In re Daniel Richard Higgins, Case # 10-37632-rld7)

Adv. # 10-3281-tmb (lead case)
10-3282-tmb

June 22, 2011

TMB

2011 WL _____

Defendants filed separate Chapter 7 petitions. Plaintiff filed separate adversary proceedings against each Defendant seeking a determination that damages awarded in a prior arbitration, later confirmed by a U.S. District Court (for the District of Oregon) judgment, were excepted from discharge under §§ 523(a)(4) and (6). Plaintiff also sought a declaratory judgment that injunctive relief awarded in the arbitration could not be discharged. Plaintiff moved for summary judgement in each adversary, which were then consolidated for all purposes. Defendants cross-moved. A similar non-dischargeability action was filed against a third defendant in the arbitration, who had filed Chapter 7 in the United States Bankruptcy Court for the Southern District of Alabama. There, in a written opinion and order, the Alabama Bankruptcy Court ruled in Plaintiff's favor on summary judgment. The Court in deciding the cross motions incorporated the Alabama Bankruptcy Court's findings of fact.

Defendants were former employees of Plaintiff. In the arbitration, Plaintiff's main contention was that Defendants formed and operated a company to compete with Plaintiff, while still in Plaintiff's employ. Plaintiff also alleged Defendants used certain of Plaintiff's confidential and proprietary information. The arbitrator issued interim and supplemental letter opinions and incorporated same in an arbitration award, wherein Plaintiff prevailed on claims for, amongst others, breach of fiduciary duty, intentional interference with contract, and intentional interference with prospective economic advantage. Plaintiff also prevailed on all of Defendants' affirmative defenses. Identical damages were awarded on each of Plaintiff's successful claims consisting of half of the compensation and benefits received by each Defendant while wrongfully competing with Plaintiff. Despite request, no punitive damages were awarded.

In the instant § 523 action, as to the declaratory relief sought, Defendants conceded

Plaintiff could enforce the injunctive relief specified in the award/judgment after Defendants' general discharge.

As to the dischargeability issues, both Plaintiff and Defendant relied on the preclusive effect of the arbitration award/judgment. The Court held that because the judgment was entered in federal court, the federal law of issue preclusion controlled. It also held that arbitration awards such as the one at bar were entitled to preclusive effect. The Court then examined the elements of issue preclusion, in particular whether the identical issues raised in Plaintiff's § 523 claims were actually litigated and necessarily decided in the arbitration.

On the § 523(a)(6) claim the Court held the arbitration award was preclusive in Plaintiff's favor. It found the arbitrator's findings and conclusions that Defendants intentionally interfered with contract and prospective economic advantage as well as intentionally breached their fiduciary duty by usurping a corporate opportunity, were sufficient to meet § 523(a)(6)'s "willful" standard. The Court discussed the doctrine of "categorical harm," where intent to injure is implied from certain intentionally wrongful conduct. The Court also found the arbitration award preclusive in Plaintiff's favor as to § 523(a)(6)'s "malicious injury" requirement. In contrast, it found the arbitrator's refusal to award punitive damages was not preclusive in Defendants' favor on the "malice" element, noting that a punitive damages award under Oregon law is discretionary so the failure to award same could not have been "necessary" to a "no malice" finding. Further Oregon law had a higher standard of proof on malice than § 523(a)(6) required. The Court held the arbitration damages (half salary while wrongfully competing) sufficiently evidenced a "debt for" Defendants' willful and malicious injury.

As to Defendants' affirmative defenses asserted in the § 523 action, the Court held that several were attempted collateral attacks on the arbitration award/judgment and were thus barred by the doctrine of res judicata. It further held that the arbitrator's refusal, despite request, to make a determination as to the award's dischargeability in bankruptcy was not preclusive in Defendants' favor, as the arbitrator made a specific finding that dischargeability was not before him. Finally, the Court held that although an "unclean hands" defense was in general available in dischargeability proceedings, it did not apply in the case at bar because the conduct alleged to form the basis of the defense had no specific nexus to the conduct of which Plaintiff complained.

Because Plaintiff's motion was granted under § 523(a)(6), the Court did not take up the § 523(a)(4) claim.

Below is an Opinion of the Court.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26


TRISH M. BROWN
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In re)	Bankruptcy Case
)	No. 10-37631-tmb7
CLAY WILLARD BRION, III)	
_____)	
Debtor.)	
DANIEL RICHARD HIGGINS,)	
_____)	Bankruptcy Case
Debtor.)	No. 10-37632-rld7
CLYDE BERGEMANN, INC.,)	
)	
Plaintiff,)	Adversary Proceeding
)	No. 10-3281-tmb
v.)	
CLAY WILLARD BRION, III and)	
DANIEL RICHARD HIGGINS,)	
_____)	
Defendants.)	
CLYDE BERGEMANN, INC.,)	Adversary Proceeding
)	No. 10-3282-tmb
Plaintiff,)	
)	
v.)	MEMORANDUM OPINION
DANIEL RICHARD HIGGINS,)	
_____)	
Defendant.)	

///

1 This matter comes before the court on the Parties' cross motions for summary judgment. Plaintiff
2 was represented by David W. Hercher. Defendants were represented by S. Ward Greene.

3 PROCEDURAL BACKGROUND

4 Defendants Clay Brion III and Daniel Higgins (Defendants) filed Chapter 7 petitions on August 10,
5 2010. On September 30, 2010, Plaintiff Clyde Bergemann, Inc., dba Anthony-Ross Company ("ARC") filed
6 separate adversary proceedings on identical theories based on common facts against each Defendant seeking
7 a determination that damages awarded in a prior arbitration were excepted from discharge under 11 U.S.C.
8 § 523¹ (First Claim for Relief). ARC also sought a declaratory judgment that injunctive relief awarded in
9 the arbitration could not be discharged (Second Claim for Relief). Defendants answered denying the
10 material allegations and asserting six affirmative defenses each.

11 Plaintiff moved for summary judgment in each adversary. The adversaries were consolidated for all
12 purposes by amended order entered December 10, 2010. Defendants opposed Plaintiff's motions and cross-
13 moved for summary judgment. Plaintiff in turn opposed the cross-motions and objected to Defendants'
14 declarations tendered in opposition to its motions.

15 After oral argument on March 9, 2011, I ruled on a portion of the evidentiary objections. I then took
16 the motions and the remaining evidentiary objections under advisement. At the parties' request, I delayed my
17 decision on the motions pending a settlement conference. That conference was unsuccessful. The motions
18 were put back on the docket and are now ripe for decision.

19 A similar non-dischargeability action was filed against a third defendant, Eugene Sullivan
20 ("Sullivan"), in the United States Bankruptcy Court for the Southern District of Alabama, Case No. 10-
21 04384-WSS, Adv. Proc. No. 10-00094. On May 20, 2011, the Honorable William S. Shulman ruled on
22 ARC's motion for summary judgment and Sullivan's cross motion for summary judgment in favor of ARC
23 (Order on Cross-Mot. for Summ. J., Doc. 55).

24
25
26 ¹ Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §
101-1532, and to the Federal Rules of Bankruptcy Procedure ("FRBP"), Rules 1001-9037.

1 In reaching my decision, I have carefully reviewed the motions, documents in support thereof and
2 opposition thereto, the pleadings, and other submissions in the file. I also have read applicable legal
3 authorities, both as cited to me and as located through my own research. I have considered carefully the oral
4 arguments presented and have read counsels' submissions in detail. The following findings of fact and legal
5 conclusions constitute the court's findings under Federal Rule of Civil Procedure ("FRCP") 52(a), applicable
6 in this proceeding under FRBP 7052. To the extent any findings of fact constitute conclusions of law, they
7 are adopted as such. To the extent that any of the conclusions of law constitute findings of fact, they are
8 adopted as such.

9 FACTS

10 Judge Shulman's Findings of Fact in his Order on Cross Motions for Summary Judgment are
11 incorporated herein. A copy of his opinion is attached to this Memorandum Opinion.

12 I supplement the Findings of Fact as follows:

13 The references to Sullivan in the first full paragraph on page 2 of Judge Shulman's Order include
14 references to the present Defendants Brion and Higgins.

15 The Arbitration Award against Clay Brion III was \$131,891.89 and the Award against Daniel
16 Higgins was \$142,426.34.

17 LEGAL ANALYSIS

18 1. Summary Judgment Standards

19 On a motion for summary judgment, the moving party has the burden to show there is no genuine
20 issue as to any material fact and that it is entitled to judgment as a matter of law. FRCP 56(a) (made
21 applicable by FRBP 7056). Material facts are such facts as may affect the outcome of the case. Anderson v.
22 Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). "A dispute about a material fact is genuine 'if the evidence is
23 such that a reasonable jury could return a verdict for the nonmoving party.'" FreecycleSunnyvale v.
24 Freecycle Network, 626 F.3d 509, 514 (9th Cir. 2010) (quoting Anderson, 477 U.S. at 248).

25 With regard to its own claims or defenses, (i.e. those elements for which the moving party bears the
26 burden of proof at trial), the movant must support its motion with evidence that would entitle it to a directed

1 verdict if not controverted at trial. C.A.R. Transp. Brokerage Co., Inc. v. Darden Restaurants, Inc., 213 F.3d
2 474, 480 (9th Cir. 2000). If the movant makes the requisite affirmative showing, the non-movant may not
3 simply rely on allegations and denials in its own pleadings. FRCP 56(c). Instead, the non-moving party
4 must produce significant probative evidence (or point to such evidence already before the court), showing
5 specific facts which demonstrate the existence of a genuine issue for trial. Intel Corp. v. Hartford Accident &
6 Indem. Co., 952 F.2d 1551, 1558 (9th Cir. 1991) (internal citation omitted).

7 All reasonable doubts as to the existence of genuine issues of material fact should be resolved against
8 the moving party. Crosswhite v. Jumpking, Inc., 411 F.Supp.2d 1228, 1230 (D. Or. 2006) and all rational or
9 reasonable inferences drawn from the underlying facts must be viewed in the light most favorable to the non-
10 moving party. T.W. Electrical Service, Inc. v. Pacific Elec. Contractors Ass'n, 809 F.2d 626, 630 (9th Cir.
11 1987).

12

13 2. Claim for Declaratory Judgment

14 Plaintiff's Second Claim for Relief seeks a declaration that it may enforce the injunctive relief
15 specified in the Judgment entered on August 11, 2010, in the United States District Court for the District of
16 Oregon ("Judgment") after Defendants' general discharges in these cases. Defendants conceded this issue.
17 Plaintiff is thus entitled to summary judgment declaring that its right to enforce the injunction, including the
18 right to seek monetary sanctions based on post-petition breach thereof, against both Defendants is not a
19 claim subject to discharge.

20 3. Issue Preclusion

21 In their motions and cross motions on the § 523(a) claims both parties contend that the elements
22 necessary to grant summary judgment in their favor were conclusively established in the underlying
23 litigation.

24 Issue preclusion, sometimes referred to as collateral estoppel, is a viable tool in § 523 litigation.
25 Grogan v. Garner, 498 U.S. 279 (1991). Because the Judgment was entered in federal court, the federal law
26

1 of issue preclusion controls. McQuillion v. Schwarzenegger, 369 F.3d 1091, 1096 (9th Cir. 2004).

2 Although the federal elements of issue preclusion have been stated various ways, the Bankruptcy Appellate
3 Panel for the Ninth Circuit succinctly boiled them down to the following:

- 4 1) The issue sought to be precluded from relitigation must be identical to that
5 decided in a former proceeding;
- 6 2) The issue must have been actually litigated in the former proceeding;
- 7 3) It must have been necessarily decided in the former proceeding;
- 8 4) The decision in the former proceeding must be final and on the merits; and
- 9 5) The party against whom preclusion is sought must be the same as, or in
10 privity with, the party to the former proceeding.

11
12 Kelly v. Okoye (In re Kelly), 182 B.R. 255, 258 (9th Cir. BAP 1995). Arbitrations can meet this criteria.

13 Because they provide “an opportunity for presentation of evidence, the determination of issues in an
14 arbitration proceeding should generally be treated as conclusive in subsequent proceedings, just as
15 determinations of a court would be treated.” Greenblatt v. Drexel Burnham Lambert, Inc., 763 F.2d 1352,
16 1360 (11th Cir. 1985) (citing Restatement (Second) of Judgments § 84(3) and comment c (1982)).

17 “The party asserting preclusion bears the burden of showing with clarity and certainty what was
18 determined by the prior judgment.” Clark v. Bear Sterns & Co., Inc., 966 F.2d 1318, 1321 (9th Cir. 1992).
19 “Any reasonable doubt as to what was decided by a prior judgment should be resolved against allowing the
20 collateral estoppel effect.” Kelly, 182 B.R. at 258 (citations omitted).

21 There is no dispute the Judgment is final and on the merits and the same parties are involved. The
22 issue, therefore, is whether the identical issues raised in Plaintiff’s § 523(a) claims were actually litigated and
23 “necessarily decided” in the arbitration.

24 4. Plaintiff’s Claims of Non-Dischargeability

25 Plaintiff seeks to except the Judgment from discharge under §§ 523(a)(4) and (6).
26

1 "A primary objective of the Bankruptcy Code is to provide a fresh start for debtors
2 overburdened by debts they cannot pay. Accordingly, I start from the proposition that the
3 discharge exception provisions of the Bankruptcy Code are interpreted narrowly in favor of
4 debtors.

5 The party seeking to except its claim from the debtor's discharge bears the burden of proof to
6 establish that its claim is nondischargeable . . . the burden of proof standard for actions to
7 except a creditor's claim from the debtor's discharge is preponderance of the evidence. In
8 other words, in spite of the Bankruptcy Code's policy bias in favor of the debtor's discharge, a
9 party seeking to except an obligation from discharge under § 523(a) will prevail if the
10 evidence establishes that it is more likely than not that the creditor's cause of action is
11 justified."

12 Vans Inc. v. Rosendahl (In re Rosendahl), 307 B.R. 199, 214 (Bankr. D. Or. 2004) (citations omitted).

13 a. Plaintiff's Claims Under Section 523(a)(6)

14 Section 523(a)(6) excepts from discharge debts "for willful and malicious injury by the debtor to
15 another entity or to the property of another entity."

16 "The malicious injury requirement is separate from the willful injury requirement. A 'willful'
17 injury is a 'deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads
18 to injury.' A 'malicious' injury involves (1) a wrongful act, (2) done intentionally, (3) which
19 necessarily causes injury, and (4) is done without just cause or excuse."

20 Barboza v. New Form, Inc. (In re Barboza), 545 F.3d 702, 706 (9th Cir. 2008) (citations omitted) (emphasis
21 in original); see also Ormsby v. First American Title Co. (In re Ormsby), 591 F.3d 1199, 1206 (9th Cir. 2010).

22 (1) Was there Sufficient Evidence to Establish Willfulness?

23 In order to meet the "willful" prong, the court must find a "deliberate or intentional *injury*, not
24 merely a deliberate or intentional *act* that leads to injury." Kawaauhau v. Geiger, 523 U.S. 57, 61 (1998)
25 (emphasis in original). Debts or losses that arise from injury inflicted recklessly or negligently do not give
26 rise to liability. Id. A debtor must have a subjective motive to inflict injury or believe that injury is
substantially certain to result from his own conduct. Ormsby, 591 F.3d at 1206. It is not sufficient that
viewed objectively, there was a substantial certainty that the debtor's conduct would cause harm. Carrillo v.
Su (In re Su), 290 F.3d 1140 (9th Cir. 2002). In making a § 523(a)(6) determination, the debtor is charged
with the natural consequences of his actions. Ormsby, 591 F.3d at 1206.

1 To establish willfulness, Plaintiff relies mainly on case law supporting the doctrine of “categorical
2 harm.” That is, if a defendant intentionally engages in certain wrongful conduct, intent to harm the object of
3 such conduct is necessarily implied. See Smith v. Entrepreneur Media, Inc. (In re Smith), 2009 WL 6058677,
4 *9-10 (9th Cir. BAP 2009)² (intentional infringement of trademark under federal law was categorically
5 harmful); Star’s Edge Inc. v. Braun (In re Braun), 327 B.R. 447, 450-51 (Bankr. N.D. Cal. 2005) (intentional
6 infringement of federal copyright laws was categorically harmful).

7 In Braun, the court explained the doctrine as follows:

8 “*Geiger* holds that a debt attributable to an injury that results from recklessness
9 or negligence is dischargeable even if the act that caused the injury was
10 performed intentionally. *Su* holds that the court must apply either a subjective
11 test when determining whether an act was performed with the intent to injure, or
12 determine with substantial certainty that injury would occur. *Geiger* and *Su* both
13 involve conduct that can result in more than one outcome. *Geiger* determines
14 the dischargeability of a debt incurred in a medical malpractice judgment while
15 *Su* involves a debt for a personal injury resulting from an auto accident.
16 Performing a medical procedure and driving an automobile are activities that
17 can be executed intentionally, but in a manner that is reckless or negligent with
18 regard to the outcome. On the other hand, activities such as filing a frivolous
19 lawsuit (as the debtor did in *Zelis*) or infringing a copyright (as Debtor did
20 here) do not have uncertain or variable outcomes. While a medical procedure
21 can result in either healing or harm, and a physician may cause harm by
22 negligence, copyright infringement is a categorically harmful activity. One
23 cannot commit intentional copyright infringement and, through his negligence,
24 cause financial harm to the copyright holder. Rather, harm necessarily follows
25 from the act of infringing regardless of the infringer's state of mind when
26 creating the infringing material.”

19 Id. at 450-51.

20 The arbitrator found for Plaintiff on its claims for interference with contract and interference with
21 economic advantage as well as its claims for breach of fiduciary duty and misappropriation of trade secrets. A
22 person cannot interfere with a contract or a prospective economic advantage without causing harm to the
23 party against whom he interferes. Likewise, one cannot intentionally breach a fiduciary duty by usurping a
24 corporate opportunity (here, the Jambi contract), without by necessity harming the corporation. See, e.g.,

25
26 ² Although Smith has been designated as “Not for Publication,” it may be cited for its persuasive value. FRAP
32.1

1 Digital Commerce Ltd. v. Sullivan (In re Sullivan), 305 B.R. 809, 822-23 (Bankr. W.D. Mich. 2004)
2 (usurping a corporate opportunity, even if the specific motivation was not to harm the corporation, is a “zero-
3 sum game” that is, the usurper can only gain if the corporation loses.) Accordingly, by finding for Plaintiff on
4 the intentional interference and breach of fiduciary duty issues, the arbitrator necessarily decided that
5 Defendants acted willfully.

6 (2) Was there Sufficient Evidence to Establish Malice?

7 Section 523(a)(6) also requires a finding of “malice.” Malice under § 523(a)(6) does not equate to
8 “biblical malice,” that is personal hatred, spite or ill will. Thiara v. Spycher Brothers (In re Thiara), 285 B.R.
9 420, 434, n.15 (9th Cir. BAP 2002). “Malice may be inferred based on the nature of the wrongful act.”
10 Ormsby, 591 F.3d at 1207, if it is first established the tortious conduct was willful. Id.

11 Plaintiff contends that the first three elements required for a finding of “malice,” i.e. a wrongful act
12 done intentionally which necessarily causes harm, are met by the finding that the Defendants intended to
13 injure Plaintiff. I agree. Accordingly, I must determine whether the Defendants acted without just cause or
14 excuse. Defendants argue that their motives were not to harm Plaintiff. However, even an arguably benign
15 motive does not justify or excuse behavior that is otherwise wrongful. Murray v. Bammer (In re Bammer)
16 131 F.3d 788, 793 (9th Cir. 1997), abrogated in part on other grounds by, Kawaauhau v. Geiger, 523 U.S. 57
17 (1998). The arbitrator found that Defendants “were motivated to a large degree by personality and business
18 differences” with Plaintiff’s CEO. However, the arbitrator also recognized that the personality differences
19 were not an excuse for the Defendants’ conduct. Further, he overruled all of the Defendants’ affirmative
20 defenses. In interfering with Plaintiff’s contractual and prospective business relationships and in breaching
21 their fiduciary duties as discussed above, Defendants acted without just cause or excuse. Accordingly, I find
22 that they acted with the requisite “malice” required to support a finding of nondischargeability under
23 § 523(a)(6).
24
25
26

1 Defendants argue that the Judgment is preclusive in their favor on the issue of malice because the
2 arbitrator refused to award punitive damages against the Defendants. However, I do not find that fact
3 determinative on the issue of whether Defendants acted with “malice” within the meaning of § 523(a)(6).

4 Under Oregon law, punitive damages may be awarded if the defendant “acted with malice or has
5 shown a reckless and outrageous indifference to a highly unreasonable risk of harm and has acted with a
6 conscious indifference to the health, safety and welfare of others.” ORS 31.730(1). An award of punitive
7 damages under Oregon law is discretionary. “[T]he jury has entire discretion to refrain from giving any
8 punitive damages at all even though all the elements of malicious and damaging misconduct may have been
9 established.” Van Lom v. Schneiderman, 187 Or. 89, 108 (1949), abrogated on other grounds, Oberg v.
10 Honda Motor Co., Ltd., 320 Or. 544, 548 (1995) (citations omitted). Further, the standards of proof under
11 Oregon law and § 523 are different. Oregon law requires “clear and convincing” evidence to award punitive
12 damages, ORS 31.730(1), while § 523(a)(6) requires merely a preponderance to find “malice.” Grogan, 498
13 U.S. at 291. When the standard of proof for the judgment sought to be used as preclusive based on a party’s
14 failure to meet that standard, is higher than the standard in the case in which preclusion is sought, the former
15 judgment has no preclusive effect. Clark, 966 F.2d at 1322. Accordingly, the fact that the arbitrator declined
16 to award punitive damages does not mean that he found that Defendants acted without malice.

17 (3) Did the Damages Result from Defendants’ Conduct?

18 Defendants contend that regardless of whether the court finds that they acted willfully and
19 maliciously the debts they owe to Plaintiff are nonetheless dischargeable because they are not damages
20 suffered by Plaintiff as a result of Defendants’ conduct. I disagree.

21 The arbitrator awarded judgment in favor of Plaintiff equal to one half of the salary paid to each
22 Defendant while the Defendant was actively engaged in competing with Plaintiff. Those damages create a
23 “debt” as defined by § 101(12). In turn, § 523 excepts from discharge “debts for” various proscribed
24 conduct. That phrase means that the “debt” must only be “the result of,” “with respect to” or “by reason of”
25 the proscribed conduct. Cohen v. de la Cruz, 523 U.S. 213, 220 (1998). Here, the disgorgement damages
26

1 meet that test. As stated in Smith, 2010 WL 6058677, *11: “[A]ny liability duly imposed as a direct, but-for
2 result of the defendant’s nondischargeable conduct constitutes a nondischargeable debt, regardless of
3 whether the liability reflects the actual damages incurred by the plaintiff.” See also, Spring Works, Inc. v.
4 Sarff (In re Sarff), 242 B.R. 620, 628 (6th Cir. BAP 2000) (disgorgement of compensation for breach of
5 fiduciary duty sufficiently tied to willful and malicious conduct to constitute injury or damages).

6 5. Defendants’ Affirmative Defenses.

7 Defendants have alleged six affirmative defenses. The first, failure to state a claim is without merit.
8 The second, third, and fourth allege respectively that the arbitrator disregarded the law, abused his authority,
9 and refused to hear evidence. These affirmative defenses are attempted collateral attacks on the merits of the
10 Judgment and are barred by the doctrine of res judicata. Orion Tire Corp. v. Goodyear Tire & Rubber Co.,
11 Inc., 268 F.3d 1133, 1136 (9th Cir. 2001) (“[A] judgment merely voidable because based upon an erroneous
12 view of the law is not open to collateral attack, but can be corrected *only by a direct review* and not by
13 bringing another action upon the same cause.”) (quoting Federated Dep’t Stores, Inc. v. Moitie, 542 U.S.
14 394, 398 (1981) (emphasis in original).

15 In their fifth affirmative defense, Defendants argue that the arbitrator’s refusal to make a finding that
16 his award would be nondischargeable in bankruptcy preclusively establishes that the award is dischargeable.
17 (Defs’ Answer at 4). The arbitrator, however, made clear he would not rule on the dischargeability issue
18 because that issue was not before him. Accordingly, the arbitrator’s refusal to make a determination of
19 dischargeability has no bearing on whether the Judgment is, in fact, dischargeable.
20

21 For their last affirmative defense, Defendants allege that a finding of nondischargeability is
22 inappropriate because Plaintiff acted with unclean hands. Specifically, they allege: “Plaintiff has no interest
23 or need to collect money from defendants, but instead is attempting to eliminate competition and restrain
24 defendants from continuing to develop new and improved equipment and processes for application in the
25 pulp & [sic] paper industry.” (Def’s Answer at 5).
26

1 Courts have recognized “unclean hands” as a defense to § 523 actions. See, e.g., OSB Manufacturing,
2 Inc. v. Hathaway, II (In re Hathaway, II), 364 B.R. 220 (Bankr. E.D. Va. 2007); Hooper v. Everett (In re
3 Everett), 364 B.R. 711 (Bankr. D. Az. 2007). However, “[i]t is fundamental to [the] operation of the doctrine
4 that the alleged misconduct by the [party] relate directly to the transaction concerning which the complaint is
5 made. [U]nclean hands does not constitute misconduct in the abstract, unrelated to the claim to which it is
6 asserted as a defense.” Seller Agency Council, Inc. v. Kennedy Center for Real Estate Educ., Inc. 621 F.3d
7 981, 986-87 (9th Cir. 2010) (internal quotation omitted) (citations omitted).

8 “Case law requires that in order to invoke the affirmative defense of unclean hands, there
9 must be a specific nexus between the alleged misconduct of the moving party and the
10 transaction of which he is complaining [While t]he moving party’s hands must be clean
11 with respect to the specific transaction to which he seeks relief [, h]e is not required to come
12 to court with generally clean hands.”

13 Hathaway, 364 B.R. at 243-44.

14 Here, Plaintiff’s alleged misconduct arose after the transaction of which it is complaining and has no
15 specific nexus to that transaction. Accordingly, Defendants’ unclean hands defense has no merit.

16 Based on the foregoing, I grant Plaintiff’s motion for summary judgment as to dischargeability under
17 § 523(a)(6) on the basis of collateral estoppel and having found that Plaintiff’s claim is nondischargeable
18 under § 523(a)(6), its claim for nondischargeability under § 523(a)(4) is moot.

19 EVIDENTIARY ISSUES

20 In opposition to Plaintiff’s motion, Defendants have proffered four declarations, one from each of the
21 Defendants, one from Sullivan, and one from Todd Hill, a former employee of Plaintiff. To summarize, they
22 basically profess Defendants’ innocence of wrongdoing, especially any intent to harm Plaintiff. Also
23 included are statements supporting the unclean hands affirmative defense. Because, as discussed above, I
24 find the Judgment preclusive on the § 523(a)(6) claim, consideration of the statements in the declarations as
25 to matters relating thereto is precluded, and as such, Plaintiff’s objections are sustained.
26

CONCLUSION

Plaintiff's motion for summary judgment on its claim for declaratory relief and its claim for a determination of nondischargeability under § 523(a)(6) will be granted and judgment in Plaintiff's favor will be entered. Defendants' cross motions will be denied.

Plaintiff's counsel is to prepare the appropriate order and judgment, which should be lodged within ten (10) days of entry of this opinion.

###

cc: David W. Hercher
S. Ward Greene

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

IN RE:

EUGENE SULLIVAN,

Debtor.

CASE NO. 10-04384-WSS

Chapter 7

CLYDE BERGEMANN, INC.,
d/b/a ANTHONY-ROSS COMPANY,

Plaintiff,

v.

ADV. PROC. NO. 10-00094

EUGENE SULLIVAN,

Defendant.

ORDER ON CROSS MOTIONS FOR SUMMARY JUDGMENT

David W. Hercher, Counsel for the Plaintiff
Matthew C. McDonald, Counsel for the Plaintiff
S. Ward Greene, Counsel for the Defendant
Terrie S. Owens, Counsel for the Defendant

This matter is before the Court on the Plaintiff's motion for summary judgment and the Defendant's motion for summary judgment. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. After due consideration of the pleadings and arguments of counsel, the Court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

The Plaintiff, Clyde Bergeman, Inc. d/b/a Anthony-Ross Company ("ARC"), is a company in the business of modifying and improving its clients' industrial boilers. The

Defendant, Eugene Sullivan, is a former employee of ARC. On February 8, 2008, ARC filed an action against Sullivan, two other former employees, Clay William Brion, III, and Daniel Richard Higgins, and their company, Sullivan, Higgins & Brion, PPE LLC (“SHB”), in the U.S. District Court in Oregon. The District Court granted the Defendants’ motion to arbitrate the claims against them, and ARC filed an arbitration demand with the American Arbitration Association in May 2008. Richard Spier of Portland, Oregon was appointed as arbitrator.

The main contention of ARC’s complaint was that Sullivan, Higgins and Brion formed and operated SHB to compete for business with ARC, such as the Jambi bark boiler project in Indonesia, while they were still employed with ARC. ARC also alleged that the three employees used ARC’s confidential and proprietary information, specifically the Lotus Notes database and the Master Proposal List, and kept copies of the information after they left ARC. Sullivan denied the allegations, and asserted that ARC had previously disclosed or not properly protected the alleged proprietary information. Further, Sullivan stated that SHB did not compete for business with ARC because ARC was only interested in projects within the United States, and the Jambi bark boiler project was not a project that ARC would have pursued. Finally, Sullivan maintained that the members of SHB worked diligently for ARC during their employment and took no action to harm ARC’s business.

ARC’s amended arbitration complaint contained the following claims for relief: (1) breach of contract; (2) breach of fiduciary duty/duty of loyalty; (3) misappropriation of trade secrets- Oregon Trade Secrets Act, ORS 646.461 et seq.; (4) Computer Fraud and Abuse Act, 18 U.S.C. §1030; (5) injunctive relief; (6) unjust enrichment; (7) interference with contract; (8) interference with prospective economic advantage; (9) aiding and abetting/acting in concert; and (10)

racketeering. Sullivan and the defendants responded with several affirmative defenses¹ and counterclaimed for attorney fees and breach of contract. After an eight-day evidentiary hearing followed by post-arbitration briefs and hearings, Spier issued an Interim Memorandum Decision (“Interim Decision”) on March 15, 2010, and a Supplemental Memorandum of Decision (“Supplemental Decision”) and an Arbitration Award on July 15, 2010.

In the Interim Decision, Spier found that ARC should recover from Sullivan and the other respondents one half of the compensation and benefits that they received while competing with ARC, plus interest. For Sullivan, the amount was ultimately determined to be \$246,589.27.² The awards were separate, not joint and several. Spier found that the respondents misappropriated ARC’s trade secrets, the Lotus Notes database and the Master Proposal List. Interim Decision, p. 3. Sullivan admits retaining the Master list after leaving ARC. Respondent’s brief, p. 5. All claims and defenses (including punitive damages) that were not expressly allowed were deemed to be overruled. Interim Decision, p. 4.

Spier found that while the evidence showed that the respondents “actively discouraged Claimant [ARC] from seeking [the Jambi project] while they were pursuing it for themselves (while still employed)”, ARC failed to show that it would have profited from the Jambi project and obtained other profitable projects based on the project’s success. Therefore, the arbitrator found that ARC failed to meet its burden of proof on the lost profit damages, and awarded only a return of the portion of the respondents’ wages. The arbitrator also found that Brion indicated in

¹The Defendants’ affirmative defenses included: (1) failure to state a claim; (2) waiver-trade secrets and confidential information; (3) equitable estoppel; (4) waiver-independent business activities; (5) illegality; (6) not secret/in public domain; (7) independent development.

²Arbitration Award, para. 5.

an October 22, 2007 email that no one at ARC knew what Higgins, Sullivan and he were doing, and that the group needed to “keep it that way.” Interim Decision, p 5. Spier indicates that this desire to keep the respondents’ activities secret was joined by Sullivan. He also found that the Master List and the Lotus Notes database were protected information. “It is clear under the evidence that the Master Proposal List (Cl. Ex.177) contains protected information, even though its genesis was a listing that Mr. Sullivan brought with him years before.” Interim Decision, p. 6. In his supplemental memorandum, Spier found that ARC met its burden of proof for unauthorized use of trade secrets under ORS 646.461(2)(b) only as to the Lotus Notes database and the Master Proposal List. Supplemental Memorandum, p. 2.

The actual Arbitration Award found that ARC prevailed on its claims for breach of contract (first claim); breach of fiduciary duty/duty of loyalty (second claim); misappropriation of trade secrets (third claim); injunctive relief (fifth claim); unjust enrichment (sixth claim); interference with contract (seventh claim); interference with prospective economic advantage (eighth claim); and aiding and abetting/acting in concert (ninth claim). ARC also prevailed on all of the respondents’ affirmative defenses and claims. Sullivan and the other respondents prevailed on ARC’s claim under the Computer Fraud and Abuse Act (fourth claim); the racketeering claim (tenth claim); and ARC’s request for punitive damages. The monetary relief was awarded under ARC’s claims for Breach of Contract (First Claim), Breach of Fiduciary Duty/Duty of Loyalty (Second Claim), Misappropriation of Trade Secrets (Third Claim), Unjust Enrichment (Sixth Claim), Interference with Contract (Seventh Claim), and Interference with Prospective Economic Advantage (Eight Claim). Arbitration award, para. 5. The respondents were also ordered to return or destroy all original and copies in their possession of the Lotus Notes database and the

Master Proposal List.

The District Court entered a judgment confirming the arbitration award on August 11, 2010. Sullivan filed the present chapter 7 proceeding on September 22, 2010. Sullivan and the other respondents filed a petition to vacate or correct the arbitration award on October 7, 2010, and a motion for relief from judgment on October 19, 2010 in the District Court. This Court lifted the automatic stay to allow ARC to participate in the Oregon District Court proceeding by its orders of October 29, 2010 and November 9, 2010.

CONCLUSIONS OF LAW

ARC filed this adversary proceeding seeking to have the Oregon District Court judgment declared nondischargeable under 11 U.S.C. §523(a)(4) and (a)(6). The complaint also seeks a declaratory judgment regarding the effect of Sullivan's bankruptcy discharge on the injunction imposed by the District Court order; however, ARC noted in its brief that Sullivan stipulated in his response brief that the injunction is not a claim that may be discharged in bankruptcy. Defendant's Response Brief to Plaintiff's Summary Judgment, p. 24. Both parties rely on the collateral estoppel effect of the arbitration proceeding and the District Court judgment as the basis for their respective motions for summary judgment. The doctrine of collateral estoppel does apply in discharge exception actions under §523(a)³ if the parties can show that: (1) the issue in the previous action and the present action is identical; (2) the issue was actually litigated in the prior action; (3) resolution of the issues was critical and necessary to the earlier judgment. The burden of proof in the prior action must be at least by a preponderance of the evidence, as required for

³*Grogan v. Garner*, 498 U.S. 279, 284 n. 11 (1991).

§523(a) dischargeability actions. *Grogan v. Garner*, 498 U.S. 279, 291 (1991).⁴

Under 11 U.S.C. §523(a)(4), a debtor cannot discharge a debt incurred by “fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” ARC maintains that Sullivan’s actions amount to embezzlement under this section. The Ninth Circuit defines “embezzlement” under §523(a)(4) as:

‘the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come.’ *Moore v. United States*, 160 U.S. 268, 269 (1885). Embezzlement, thus, requires three elements: ‘(1) property rightfully in the possession of the nonowner; (2) nonowner’s appropriation of the property to a use other than which [it] was entrusted; and (3) circumstances indicating fraud.’

In re Littleton, 942 F.2d 551, 555 (9th Cir. 1991) (citations omitted).

The arbitrator’s interim and supplemental decisions found that Sullivan and the other respondents misappropriated the Lotus Notes database and the Master Proposal List. Sullivan had the Master Proposal List for use during his employment with ARC. The arbitrator found that the Master Proposal list contained protected information, and that Sullivan misappropriated it for use in his own business, SHB. In his reply to the Plaintiff’s response brief, Sullivan’s counsel admits that “the arbitrator did find that the defendants used the plaintiff’s Lotus Notes database and Master Proposal List without authorization. However, his conclusory finding was contrary to the evidence which showed that the defendants did not use this material for their own purposes.” Defendant’s reply to Plaintiff’s response brief, p. 5, n.1. Even though Sullivan disagrees with the

⁴In its brief in support of its motion for summary judgment, p. 7, ARC acknowledges that it had the same preponderance of the evidence standard in both the arbitration proceeding and this adversary. Sullivan acknowledges the preponderance standard in his response to the summary judgment, p. 8, and relies on issue preclusion in support of his motion for summary judgment. The parties appear to agree that the preponderance of the evidence standard was the same for the arbitration proceeding and the present adversary proceeding.

arbitrator's ultimate findings, the arbitrator heard the evidence regarding Sullivan's use of the Master Proposal List, and found in favor of ARC that Sullivan misappropriated the list. Thus, ARC has established the first two elements of embezzlement under §523(a)(4).

Sullivan maintains that ARC cannot rely on the arbitrator's decision for proof of the final element of embezzlement, "circumstances indicating fraud", because fraud was not an element in any of the plaintiff's claims, and therefore was not presented to the arbitrator, and was not a necessary and critical part of the arbitration award. The arbitration award granted relief to ARC on its third claim for Misappropriation of Trade Secrets under ORS 646.461. Under the Oregon Statute 646.461(2)(a), "misappropriation" means: (a) Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means." In turn, the statute defines "improper means" as "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy or espionage through electronic or other means." ORS 646.461(1) (emphasis added). The Oregon Statute put the issue of misrepresentation before the arbitrator, and the issue was necessary and critical to the arbitrator's findings in the interim and supplemental decisions. The arbitrator found it "telling that Mr. Sullivan discouraged Mr. Garton (Respondents' ultimate superior within the company division) from pursuing the Jambi park boiler opportunity, while Respondents' actively and secretly sought this business." Interim decision, p. 4. Further, in an October 22, 2007 email, Sullivan's business partner Brion stated "Nobody at [Claimant] has any idea what we are doing and we need to keep it that way." Interim decision, p. 5. In determining circumstances of fraud under §523(a)(4), "[i]ntent may properly be inferred from the totality of the circumstances and the conduct of the person accused." *In re Ormsby*, 591 F.3d 1199, 1206 (9th Cir. 2010) (citing *Kaye v. Rose (In re*

Rose), 934 F.2d 901, 904 (7th Cir. 1991). The arbitrator's decision to grant relief to ARC under the misappropriation of trade secrets claim indicates that he did find misrepresentations by Sullivan and the other respondents. Those same facts lead this Court to conclude that Sullivan appropriated the Lotus Notes database and the Master Proposal List⁵ under circumstances of fraud. Therefore, the Court finds that ARC has established the elements for embezzlement under §523(a)(4).

Sullivan asserts in his cross motion for summary judgment and in opposition to ARC's motion for summary judgment that ARC's claims under §523(a)(4) and (a)(6) fail due to the arbitrator's findings that ARC did not prove damages related to lost profits or business opportunity related to the Jambi project. Sullivan maintains that the monetary award is not related to any harm suffered due to the misappropriation of trade secrets or interference with a corporate opportunity. Looking to the interim decision, it is apparent that Spier found that the evidence showed that Sullivan and the respondents were competing with their employer for business opportunities, taking care to keep their actions secret, and misappropriating protected information. He first noted that the respondents did not "dispute that they would have been obligated to present a bark boiler opportunity for a North America customer [to ARC]. However, to justify their secret effort to obtain the Jambi opportunity in Indonesia for themselves, while still working for [ARC], cuts too fine a distinction." Interim decision, p. 4. Spier continues that it was "telling" that Sullivan discouraged his supervisor from pursuing the Jambi project while going after the business himself. Having observed Sullivan's demeanor at the hearing, Spier believed

⁵The parties raised the issue of whether the Jambi project as a corporate opportunity was a property right protected under §523(a)(4). Having based its findings on the misappropriation of the Lotus Notes database and the Master Proposal List, the Court makes no finding on this issue.

that Sullivan would have been “persuasive and effective” in discouraging ARC from pursuing the project even though his own company was trying to get the project. Interim decision, p. 4. Spier concluded that it was likely that ARC would have pursued the Jambi project if Sullivan had recommended it, and that it was likely that ARC would have gotten the project based on SHB’s success. Interim decision, p. 4. The problem lay with proof that the project would have earned a profit and led to other profitable projects; the arbitrator found that ARC failed to provide evidence on these points. This finding does not mean that there was no damage, because the arbitrator ultimately ruled for ARC on the misappropriation claim. Rather, he chose to measure ARC’s damages by the respondents’ salaries during the period that they were competing with ARC. Interim decision, p. 4. Paragraph 5 of the Arbitration Award makes it clear that the monetary relief is awarded under ARC’s claims for breach of contract, breach of fiduciary duty, misappropriation of trade secrets, unjust enrichment, interference with contract and interference with prospective economic advantage. See *In re Janssens*, ___ B.R. ___, 2010WL6501984 (Bankr. D. Md.), aff’d and remanded on other grounds *In re Janssens*, 2011WL 1642575 (D. Md.) (bankruptcy court measured employer’s damages by employee’s salary when employer failed to prove lost profit in an adversary to determine a debt nondischargeable under §523(a)(4) for breach of fiduciary duty and embezzlement). As a result, the Court does not accept Sullivan’s argument that ARC failed to prove damages related the misappropriation claim.

Based on the foregoing, the Court finds that ARC’s motion for summary judgment as to dischargeability under §523(a)(4) is due to be granted on the basis of collateral estoppel, and having found that ARC’s debt is nondischargeable under §523(a)(4), its claim for nondischargeability under §523(a)(6) is moot. As stated above, Sullivan stipulated in his response

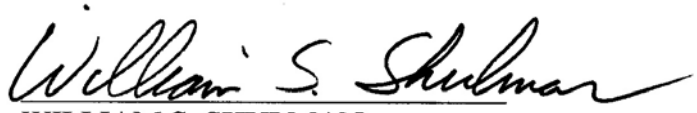
brief that the injunction is not a claim that may be discharged in bankruptcy. Sullivan's motion for summary judgment is due to be denied. It is hereby

ORDERED that the Plaintiff, Clyde Bergeman, Inc. d/b/a Anthony-Ross Company, motion for summary judgment is **GRANTED** pursuant to 11 U.S.C. §523(a)(4), and a separate judgment shall be entered in the amount of TWO HUNDRED FORTY-SIX THOUSAND FIVE HUNDRED EIGHTY-NINE AND 27/100 (\$246,589.27) DOLLARS in favor of the Plaintiff and against the Defendant, Eugene Sullivan; and it is further

ORDERED that the injunction in the District Court order is not a claim that may be discharged in bankruptcy; and it is further

ORDERED that Eugene Sullivan's motion for summary judgment is **DENIED**.

Dated: May 20, 2011


WILLIAM S. SHULMAN
U.S. BANKRUPTCY JUDGE