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5 NOT FOR PUBLICATION  
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7 UNITED STATES BANKRUPTCY COURT  
8 EASTERN DISTRICT OF CALIFORNIA  
9 FRESNO DIVISION

10 In re ) Case No. 09-13200-B-7  
11 Wade Alan Hanson and )  
12 Gail Judith Hanson, )  
13 Debtors. )  
14

15 Charles Claborn, Steve Espinoza, ) Adversary Proc. No. 09-1139  
16 Helen Gardner and Riverpark )  
17 Associates, LLC, ) DC No. HAR-1  
18 Plaintiffs, )  
19 v. )  
20 Wade Alan Hanson, )  
21 Defendant. )  
22

23 **MEMORANDUM DECISION REGARDING MOTION**  
24 **FOR SUMMARY JUDGMENT**

25 This disposition is not appropriate for publication. Although it may be cited for  
26 whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no  
27 precedential value. See 9<sup>th</sup> Cir. BAP Rule 8013-1.

28 Victoria Bernhardt, Esq., of McCormick, Barstow, Sheppard, Wayte & Carruth,  
LLP, appeared on behalf of the plaintiffs, Charles Claborn, Steve Espinoza, Helen  
Gardner and Riverpark Associates, LLC (the "Plaintiffs").

Justin D. Harris, Esq., of Motschieder, Michaelides & Wishon, LLP, appeared on  
behalf of the defendant/debtor, Wade Alan Hanson ("Hanson").

Before the court is an adversary proceeding to determine the dischargeability  
of a state court judgment entered prior to commencement of the bankruptcy case  
against Hanson. The judgment was entered after a five-day arbitration proceeding

1 which concluded in June 2008 (the “Arbitration Proceeding”). The arbitrator’s  
2 statement of decision with findings of fact and conclusions of law was set forth in a  
3 21-page interim arbitration award followed by a six-page final arbitration award in  
4 September 2008 (the “Arbitration Award”). In December 2008, the state court  
5 entered the judgment based on the Arbitration Award. Hanson commenced this  
6 bankruptcy under chapter 7 in April 2009. The Plaintiffs ask this court to give  
7 collateral estoppel effect to the factual findings and legal conclusions that were  
8 decided in the Arbitration Proceeding and based thereon, have moved for summary  
9 judgment in this adversary proceeding (the “Motion”). For the reasons set forth  
10 below, the Motion will be granted.

11 This memorandum decision contains the court’s findings of fact and  
12 conclusions of law required by Federal Rule of Civil Procedure 52(a), made  
13 applicable to this adversary proceeding by Federal Rule of Bankruptcy Procedure  
14 7052. The court has jurisdiction over this matter pursuant to 28 U.S.C. §1334 and  
15 11 U.S.C. §523.<sup>1</sup> This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

16 **Background.**

17 The background of this case can be summarized from the Arbitration Award,  
18 from the record of this bankruptcy proceeding, and from the undisputed factual  
19 allegations pled in this adversary proceeding.

20 In 2004, Plaintiffs Charles Claborn (“Claborn”), Steve Espinoza  
21 (“Espinoza”), and Helen Gardner (“Gardner”) joined Hanson to form Riverpark  
22 Associates, LLC (the “LLC”). The purpose of the LLC was to acquire and develop  
23 a parcel of commercial property located on Colonial Avenue in Fresno, California

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25 <sup>1</sup>Unless otherwise indicated, all chapter, section and rule references are to the  
26 Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy  
27 Procedure, Rules 1001-9036, as enacted and promulgated on or *after* October 17, 2005, the  
28 effective date of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,  
Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

1 (the “Colonial Property”). Pursuant to the LLC’s operating agreement, Hanson was  
2 named to serve as the managing member of the LLC.

3 At the time, Hanson owned and operated a business known as Lifestyle  
4 Mortgage, Inc., doing business as Bankers First Mortgage (“BFM”). After  
5 formation of the LLC, Hanson on behalf of the LLC, contracted with Claborn to  
6 construct the internal tenant improvements and prepare the Colonial Property for  
7 occupancy. Once the Colonial Property was ready, Hanson moved BFM into the  
8 Property. BFM was the LLC’s primary tenant, occupying approximately 72% of the  
9 space in the Colonial Property. However, Hanson refused to sign a lease with the  
10 LLC and failed to pay any rent for the space occupied by BFM.

11 In April 2007, the Plaintiffs filed an action in the state court in an attempt,  
12 *inter alia*, to evict BFM from the Colonial Property. Claborn asserted personal  
13 claims against Hanson based on his contract to perform work on the Colonial  
14 Property (“the Claborn Claims”). The remainder of the claims was asserted against  
15 Hanson on behalf of the LLC (“the Derivative Claims”). Hanson opposed the  
16 litigation and used his position as managing member of LLC to frustrate and defeat  
17 the eviction proceeding. BFM finally moved out of the Colonial Property in  
18 February 2008.

19 During May and June 2008, the parties engaged in the Arbitration Proceeding  
20 wherein witnesses were called and evidence was presented. Both Hanson and  
21 Claborn were represented by counsel. Hanson finally resigned as managing  
22 member of the LLC on May 14, 2008. On the same date, the LLC, on motion of  
23 Claborn, Espinoza, and Gardner, was added as a nominal respondent in the  
24 Arbitration Proceeding for the purpose of the Plaintiffs’ Derivative Claims. On July  
25 7, 2008, the Arbitrator issued an interim arbitration award. The final Arbitration  
26 Award was rendered on September 12, 2008. On December 11, 2008, the  
27 Arbitration Award was confirmed by the Fresno County Superior Court (the  
28 “Judgment”).

1     ///

2  
3     **The Claborn Judgment.**

4             At the conclusion of the Arbitration Proceeding, Hanson was determined to  
5     be personally liable to Claborn based on the Claborn Claims for intentional  
6     misrepresentation and intentional breach of fiduciary duty. The Judgment included  
7     an award in favor of Claborn in the total amount of \$27,203.03, with interest at 10%  
8     per annum from December 11, 2008 (the “Claborn Judgment”).

9     **The LLC Judgment.**

10            Hanson was also determined to be liable to the LLC based on the Derivative  
11     Claims for intentional breach of his fiduciary duty relating to BFM’s occupancy of  
12     the Colonial Property. In addition, Hanson was found liable for damages due to  
13     conversion of the LLC’s funds, intentional breach of fiduciary duties, and misuse of  
14     the LLC’s funds to purchase furniture and to pay for tenant improvements. It was  
15     also determined that Hanson intentionally breached fiduciary duties owing to the  
16     LLC by using its funds to pay Hanson’s share of the real property taxes due on  
17     another property Hanson owned known as the Pitt property. The Judgment included  
18     an award in favor of the LLC and against Hanson in the total amount of  
19     \$368,809.58, to bear interest at the rate of 10% per annum from December 11, 2008  
20     (the “LLC Judgment”).

21            Punitive damages were assessed against Hanson in favor of the LLC in the  
22     amount of \$125,000. The Arbitrator made findings that Hanson engaged in  
23     numerous and continuing breaches of fiduciary duty owed to the LLC. Hanson  
24     admitted knowing that (1) he owed a fiduciary duty to the LLC and its members, (2)  
25     he was prohibited from acting to the detriment of the LLC and its members, and (3)  
26     it would be a breach of fiduciary duty to use LLC money to benefit himself or to  
27     benefit his solely owned corporation, BFM. The Arbitrator found by clear and  
28     convincing evidence that Hanson intentionally breached his fiduciary duties to the

1 LLC and intentionally converted LLC monies to his personal benefit as well as to  
2 the benefit of BFM. In awarding punitive damages under Cal.CodeCiv.P.  
3 3294(c)(1), the Arbitrator found that Hanson acted with malice involving despicable  
4 conduct with a willful and conscience disregard of the rights of others. The  
5 Arbitrator awarded punitive damages after considering evidence relating to  
6 Hanson's personal financial condition.

7 **The Attorneys' Fees and Costs.**

8 Finally, the Judgment included an award in favor of Claborn, Espinoza, and  
9 Gardner, for attorneys' fees, recoverable costs, and arbitrator's fees, in the amount  
10 of \$85,036.69, to bear interest at the rate of 10% per annum from December 11,  
11 2008.

12 **Hanson's Defense in the Arbitration Proceeding.**

13 By stipulation of the parties, Hanson's capital contribution to the LLC was  
14 determined to be \$150,000 and his ownership interest in the LLC was determined to  
15 be 28%. The Arbitrator determined that Hanson had a claim against the LLC in the  
16 amount of \$51,652.74 for monies advanced by Hanson to the LLC. However,  
17 Hanson did not file a counterclaim in the state court proceedings for affirmative  
18 relief. Hanson did assert this claim as a defense or offset to the Derivative Claims.  
19 The Arbitrator decided that an offset of Hanson's claims against the LLC was not  
20 appropriate because Hanson's advances to the LLC were not currently recoverable  
21 under the terms of the LLC's operating agreement. The Arbitrator declined, without  
22 prejudice, to issue an order to dissolve the LLC.

23 **Issues Presented.**

24 The Plaintiffs already have the Judgment against Hanson, supported by the  
25 Arbitration Award, for compensatory and punitive damages. That Judgment was  
26 not appealed and is now final. The Plaintiffs are not asking this court to enter a new  
27 judgment for damages against Hanson. Their claims are already liquidated. The  
28 Plaintiffs are only asking this court to rule that Hanson's bankruptcy does not

1 discharge the existing Judgment. Whatever rights Hanson may have to seek  
2 modification of, or relief from, the Judgment under California law will be preserved  
3 and will not be affected by this court's determination regarding the dischargeability  
4 of that Judgment.

5 This court has only two issues to decide: whether the facts and legal  
6 conclusions specified in the Arbitration Award are entitled to collateral estoppel,  
7 and whether those facts and conclusions of law support the legal conclusion that all  
8 or some part of the Judgment is nondischargeable in this bankruptcy proceeding.

9 **A. Applicable Law.**

10 **1. Summary Judgment Standard.**

11 The Plaintiffs ask this court to rule in their favor by summary judgment, *i.e.*,  
12 without a full trial on the issues which will determine the dischargeability of their  
13 Judgment. Summary judgment is appropriate, "if the pleadings, depositions,  
14 answers to interrogatories, and admissions on file, together with the affidavits, if  
15 any, show that there is no genuine issue as to any material fact and that the moving  
16 party is entitled to a judgment as a matter of law." (Fed.R.Civ.P. 56(c) (made  
17 applicable in this adversary proceeding by Fed.R.Bankr.P. 7056)).

18 A material fact is one that might affect the outcome of the suit under the  
19 governing law and irrelevant or unnecessary factual disputes will not be considered  
20 in a motion for summary judgment. *Anderson, et al. v. Liberty Lobby, Inc., et al.*,  
21 477 U.S. 242, 248, 106 S.Ct. 2505 (1986).

22 The moving party bears the burden of showing that there is no genuine  
23 dispute as to each issue of material fact. *Celotex Corporation v. Catrett*, 477 U.S.  
24 317, 325, 106 S.Ct. 2548, 2554 (1986). However, the party adverse to a motion for  
25 summary judgment cannot simply deny the pleadings of the movant; the adverse  
26 party must designate "specific facts showing that there is a genuine issue for trial."  
27 Fed.R.Civ.P. 56(e). More precisely, "[i]t is not enough that the nonmoving party  
28 point to disputed facts; rather, they must make a sufficient showing to establish the

1 existence of a triable issue of material fact as to an element essential to the moving  
2 party's case." *In re Powerburst Corporation*, 154 B.R. 307, 309-310  
3 (Bankr.E.D.Cal. 1993), citing *Lake Nacimiento Ranch v. San Luis Obispo County*,  
4 830 F.2d 977, 979-980 (9<sup>th</sup> Cir.1987), cert. denied 488 U.S. 827, 109 S.Ct. 79, 102  
5 L.Ed.2d 55 (1988).

## 6 **2. Application of Collateral Estoppel.**

7 The Plaintiffs contend that summary judgment is appropriate here because all  
8 of the material facts and conclusions of law relevant to this adversary proceeding,  
9 *i.e.*, relevant to the dischargeability issues, have been necessarily and actually  
10 litigated in the Arbitration Proceeding. In support of that, the Plaintiffs have filed  
11 with this court copies of both the Arbitration Award and the Judgment. The  
12 Plaintiffs ask this court to apply the doctrine of collateral estoppel to each fact and  
13 conclusion of law set forth in the Arbitration Award. If collateral estoppel applies,  
14 then it is not necessary for the Plaintiffs to relitigate those facts and legal issues in  
15 the bankruptcy court.

16 Resolution of this dispute begins with an analysis of the rulings and  
17 determinations recited in the Arbitration Award. This court must decide, based on  
18 that record, whether the Arbitrator has already conclusively decided each material  
19 fact and legal issue required to prove the Plaintiffs' claims in this adversary  
20 proceeding. Under the federal Full Faith and Credit statute, federal courts must give  
21 state court judgments the same preclusive effect that those judgments would receive  
22 from another court of the same state. 28 U.S.C. § 1738. The bankruptcy court has  
23 original jurisdiction to hear the dischargeability complaint, but it is not a court of  
24 appeal for issues that have already been decided in the Arbitration Proceeding.

25 Collateral estoppel, or issue preclusion, prevents parties from relitigating an  
26 issue of fact or law if the same issue has already been determined in prior litigation.  
27 *See R.T.C. v. Keating*, 186 F.3d 1110, 1114 (9<sup>th</sup> Cir. 1999). "Mutual" collateral  
28 estoppel involves subsequent litigation between the same parties or their privies. It

1 has the “dual purpose of protecting litigants from the burden of relitigating an  
2 identical issue with the same party or his privy and of promoting judicial economy  
3 by preventing needless litigation.” *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S.  
4 322, 326 (1979). Collateral estoppel applies in bankruptcy dischargeability  
5 proceedings. *See Grogan v. Garner*, 498 U.S. 279, 284 & n.11 (1991).

6 California law determines the preclusive effect which this court must give to  
7 the Arbitration Award. California courts will apply collateral estoppel only if  
8 certain threshold requirements have been met, and then only if application of issue  
9 preclusion furthers the public policies underlying the doctrine. *Harmon v. Kobrin*  
10 (*In re Harmon*), 250 F.3d 1240, 1245 (9<sup>th</sup> Cir. 2001), citing *Lucido v. Superior. Ct.*,  
11 51 Cal.3d 335, 341, 272 Cal. Rptr. 767 (1990). The public policies underlying  
12 collateral estoppel are (1) the preservation of the integrity of the judicial system, (2)  
13 promotion of judicial economy, and (3) the protection of litigants from harassment  
14 by vexatious litigation. *Lucido*, 51 Cal.3d at 343.

15 There are five threshold requirements which must be established before  
16 collateral estoppel of any issue will apply:

17 First, the issue sought to be precluded from relitigation must be *identical* to  
18 that decided in a former proceeding.

19 Second, this issue must have been *actually litigated* in the former  
20 proceeding.

21 Third, it must have been *necessarily decided* in the former proceeding.

22 Fourth, the decision in the former proceeding must be *final and on the merits*.

23 Finally, the party against whom preclusion is sought must be the *same*  
24 [*party*] as, or in privity with, the party to the former proceeding.

25 *Id.* at 341 (emphasis added and citations omitted).

26 Here, there is no dispute concerning the application of collateral estoppel to  
27 any of the issues resolved in the Arbitration Award. The issues pertinent to the  
28 dischargeability determination have been adjudicated in the Arbitration Proceeding.  
The Plaintiffs and Hanson were the same adverse parties in the prior Arbitration



1 Proceeding and the Judgment is final on the merits because Hanson did not appeal  
2 it. The second and third requirements for collateral estoppel are interrelated. The  
3 second requirement, the “actually litigated” element, applies, even in the context of  
4 a default judgment, where the record shows an express finding upon the allegation  
5 for which issue preclusion is sought. *Cal-Micro, Inc. v. Cantrell (In re Cantrell)*,  
6 329 F.3d 1119, 1124 (9<sup>th</sup> Cir. 2003), citing *Williams v. Williams (In re Williams’*  
7 *Estate)*, 36 Cal. 2d, 289, 297 (1950). However, the “express finding” requirement  
8 can be waived if the court in the prior proceeding necessarily decided the issue.  
9 *Cantrell*, 329 F.3d at 1124, citing *In re Harmon*, 250 F.3d at 1248. In such  
10 circumstances, an express finding is not required “if an issue was necessarily  
11 decided in a prior proceeding, it was actually litigated.” *Id.*

12 Hanson offers no evidence in this proceeding to suggest that any of the  
13 separate determinations and rulings in the Arbitration Award were not actually and  
14 necessarily litigated. Further, there is no dispute that Hanson had a full and fair  
15 opportunity to litigate his defense of the Plaintiffs’ claims, and any counterclaims he  
16 may have had against the Plaintiffs in the Arbitration Proceeding.

17 **B. Elements of Plaintiffs’ Claims for Relief.**

18 The plaintiffs seek alternative relief under § 523(a)(2)(a) (false pretenses or  
19 actual fraud), § 523(a)(4) (fraud or defalcation while acting in a fiduciary capacity),  
20 and § 523(a)(6) (willful and malicious injury). The plaintiffs need only satisfy the  
21 elements of one of their claims in order to receive the relief prayed for.

22 **1. Section 523(a)(4): Fraud or Defalcation While Acting as a Fiduciary.**

23 The Plaintiffs contend that Hanson committed fraud or defalcation while  
24 acting as a fiduciary. If the Plaintiffs can make that showing, then their Judgment  
25 against Hanson based on that conduct will be nondischargeable under § 523(a)(4).  
26 To prevail, the Plaintiffs must show the existence of a fiduciary relationship and that  
27 the debt is attributable to wrongful conduct in connection with that relationship. “A  
28 debt is nondischargeable under 11 U.S.C. § 523(a)(4) where ‘1) an express trust

1 existed, 2) the debt was caused by fraud or defalcation, and 3) the debtor acted as a  
2 fiduciary to the creditor at the same time the debt was created.”” *Otto v. Niles (In re*  
3 *Niles)*, 106 F.3d 1456, 1459 (9<sup>th</sup> Cir. 1997).

4 An action under § 523(a)(4) requires an express or statutory trust relationship  
5 between the parties. For example, in *In re Niles*, 106 F.3d 1456, debtor Niles, a real  
6 estate agent, managed property owned by Otto. Otto filed an adversary action  
7 against Niles in her bankruptcy alleging Niles misappropriated rents collected from  
8 Otto’s property. The court ruled that Niles did have a *fiduciary obligation* in  
9 connection with the funds she collected and that she was required to deposit those  
10 funds into Otto’s property management account pursuant to an express or statutory  
11 trust under California law. As a result, Niles bore the burden of accounting for  
12 those funds with which she had been entrusted.

13 Here, the Arbitrator specifically found the following: (1) as the manager of  
14 Riverpark Associates, LLC, Hanson owed the same fiduciary duty to the LLC and  
15 to its members as a partner owes to a partnership and to its partners, pursuant to  
16 Cal.Corp.Code § 17153; (2) Hanson breached his fiduciary duty, and (3) the  
17 Plaintiffs were damaged as set forth in the Judgment. Those are the same issues that  
18 the Plaintiffs need to prove to prevail on their § 523(a)(4) claim. Hanson offers no  
19 evidence to suggest that those issues were not necessarily and actually litigated in  
20 the Arbitration Proceeding. Accordingly, collateral estoppel is appropriate to  
21 preclude relitigation of those issues in this adversary proceeding.

22 Under California law partners are trustees over the assets of the partnership  
23 within the meaning of § 523(a)(4) and a debt from the debtor to his partner based on  
24 the debtor having taken more than his rightful share is not dischargeable. *Ragsdale*  
25 *v. Haller*, 780 F.2d 794 (9<sup>th</sup> Cir. 1986). The Judgment pertaining to both the  
26 individual claim of Claborn (the Claborn Judgment) and the derivative claims of the  
27 LLC (the LLC Judgment) are, therefore, nondischargeable.

28 **2. Section 523(a)(2)(A) Fraud–Promise Without Intent to Pay.**

1 The Plaintiffs contend that Hanson made promises which he had no intent to  
2 honor. The arbitrator specifically found that it was more likely than not that Hanson  
3 did intend to perform the promises he made and this claim was dismissed. The  
4 Plaintiffs are collaterally estopped from relitigating this claim here.

5 **3. Section 523(a)(6): Willful and Malicious Injury.**

6 The Plaintiffs also contend that Hanson's conduct was "willful and  
7 malicious" and ask the court to determine that the Judgment is nondischargeable  
8 under § 523(a)(6). A debt is excepted from discharge under § 523(a)(6) where it  
9 results from "willful and malicious injury by the debtor to another entity or to the  
10 property of another entity." Exceptions to discharge should be strictly construed in  
11 favor of the debtor. *County of El Dorado v. Crouch (In re Crouch)*, 199 B.R. 690,  
12 691 (9<sup>th</sup> Cir. BAP 1996), citing *In re Klapp*, 706 F.2d 998, 999 (9<sup>th</sup> Cir. 1983). This  
13 court is convinced that the LLC Judgment satisfies the § 523(a)(6) elements, while  
14 Claborn's Judgment does not.

15 In 1998, the United States Supreme Court decided *Kawaauhau v. Geiger*,  
16 523 U.S. 57 (1998), resolving a conflict among the circuits about the requirements  
17 for a debt to be nondischargeable under § 523(a)(6). A doctor treated his patient's  
18 foot injury with oral penicillin, though he knew that intravenous penicillin would  
19 have been more effective. He then left on a business trip. While he was absent,  
20 other physicians transferred the patient to an infectious disease specialist, which  
21 transfer the doctor cancelled upon his returned. He also discontinued all antibiotics.  
22 The patient's condition worsened and eventually her leg was amputated below the  
23 knee. She received a malpractice judgment against the doctor, who then filed a  
24 chapter 7 case and sought a discharge of the judgment.

25 In the patient's § 523(a)(6) complaint, the bankruptcy court held the debt was  
26 nondischargeable; the district court affirmed; but the Eighth Circuit reversed in  
27 favor of the debtor. The Circuit held that the exemption from discharge of  
28 § 523(a)(6) "is confined to debts based on what the law has for generations called an

1 intentional tort.” *Id.* at 59 (citations and internal quotations omitted).

2       Upon appeal, the Supreme Court phrased the issue as follows: “Does  
3 § 523(a)(6)’s compass cover acts, done intentionally, that cause injury . . . , or only  
4 acts done with the actual intent to cause injury (as the Eighth Circuit ruled)?” *Id.* at  
5 61. In affirming the Circuit’s decision, the court noted that the word “willful” in  
6 § 523(a)(6) modifies the word “injury.” In order to be nondischargeable, there must  
7 be a deliberate or intentional injury, not merely a deliberate or intentional act that  
8 leads to injury. The court concluded, “[w]e hold that debts arising from recklessly  
9 or negligently inflicted injuries do not fall within the compass of § 523(a)(6).” *Id.* at  
10 63.

11       After the Supreme Court ruling in *Kawaauhau*, lower courts and appellate  
12 courts have endeavored to apply it in particular circumstances. The Fifth Circuit  
13 Court of Appeals, in *Miller v. J.D. Abrams, Inc. (Matter of Miller)*, 156 F.3d 598  
14 (5<sup>th</sup> Cir. 1998), held that an employer with a million-dollar judgment against a  
15 former employee, who had misappropriated proprietary information from the  
16 employer, could not prevail in its § 523(a)(6) complaint after the former employee  
17 filed a chapter 7 case. The court said that “willful” cannot mean negligence or  
18 recklessness. *Id.* at 603. Either objective substantial certainty of harm, or  
19 subjective motive to harm, meets the Supreme Court’s definition of “willful . . .  
20 injury” in section 523(a)(6). *Id.* at 603.

21       In a Sixth Circuit Court of Appeals case, *Markowitz v. Campbell (In re*  
22 *Markowitz)*, 190 F.3d 455 (6<sup>th</sup> Cir. 1999), a former client obtained a malpractice  
23 Judgment for \$300,000 against her attorney, Markowitz. Markowitz filed a chapter  
24 7 bankruptcy and the former client filed a complaint to determine the  
25 dischargeability of the Judgment. The Sixth Circuit held, “from the Court’s  
26 language and analysis in *Geiger*, we now hold that unless the actor desires to cause  
27 consequences of his act or believes that the consequences are substantially certain to  
28 result from it . . . he has not committed a willful and malicious injury as defined

1 under section 523(a)(6).” *Id.* at 464 (citations and internal quotations omitted).

2 The Ninth Circuit Court of Appeals addressed the issue in *Petralia v. Jercich*  
3 (*In re Jercich*), 238 F.3d 1202 (9<sup>th</sup> Cir. 2001). In that case, an employer deliberately  
4 chose not to pay his employee and instead used the “payroll” money for personal  
5 investments. A state court held that the employer’s conduct was “willful and  
6 oppressive” under California Civil Code § 3294. *Id.* at 1204. The bankruptcy court  
7 ruled that the employee’s claim was dischargeable under § 523(a)(6) and the  
8 Bankruptcy Appellate Panel affirmed. However, the Ninth Circuit reversed, holding  
9 that, under § 523(a)(6), it must be shown that the debtor inflicted the injury willfully  
10 and maliciously rather than recklessly or negligently. *Id.* at 1207. “[U]nder  
11 *Geiger*, the willful injury requirement of § 523(a)(6) is met when it is shown either  
12 that the debtor had a subjective motive to inflict the injury *or* that the debtor  
13 believed that the injury was substantially certain to occur as a result of his conduct.”  
14 *Id.* at 1208 (emphasis in original). The state court had found that the employer  
15 knew he owed the wages to his employee and that injury was substantially certain if  
16 the wages were not paid. The employer had the money and the ability to pay the  
17 employee as required by California law, but he intentionally chose not to pay the  
18 wages due. An act is malicious within the meaning of § 523(a)(6), where it is (1) a  
19 wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is  
20 done without just cause or excuse. *Id.* at 1209.

21 The ruling in *In re Jercich* should be read narrowly in light of the court’s  
22 subsequent decision in *Lockerby v. Sierra*, 535 F.3d 1038 (9<sup>th</sup> Cir. 2008), where it  
23 held that, “an intentional breach of contract cannot give rise to non-dischargeability  
24 under § 523(a)(6) unless it is accompanied by conduct that constitutes a tort under  
25 state law.” *Id.* at 1040. In *Lockerby*, an attorney and his client settled a malpractice  
26 suit and the attorney decided to breach that agreement by not paying the former  
27 client as had been agreed. The bankruptcy court, affirmed by the district court,  
28 decided the debt was nondischargeable under § 523(a)(6) because “Sierra possessed

1 the ‘subjective intent of harming Lockerby.’” *Id.* The Ninth Circuit reversed that  
2 decision in favor of the debtor and held that the debt was not excepted from the  
3 debtor’s discharge. Following *Kawaauhau*, the court held that “[i]ntentional torts  
4 generally require that the actor intend ‘the consequences of an act,’ not simply ‘the  
5 act itself . . . .” *Id.* at 1041 (internal citations omitted). The court went on to  
6 explain that the Supreme Court, in *Kawaauhau*, “specifically rejected the notion that  
7 a ‘knowing breach of contract’ could trigger exception from discharge under  
8 § 523(a)(6).”

9 Here, the Arbitrator specifically found, *inter alia*, that (1) Hanson  
10 misappropriated partnership property for his own use or for the use of his solely-  
11 owned corporation, (2) Hanson was aware of his fiduciary duty to the Plaintiffs, and  
12 (3) Hanson’s actions were willful and malicious. Although the Arbitrator did not  
13 specifically find in so many words that Hanson “intended to cause injury” to the  
14 Plaintiffs, this court can infer that intent based on the totality of the circumstances.  
15 *Washington Mutual Bank v. Dubovoy (In re Dubovoy)*, 377 B.R. 705, 710 (Bankr.  
16 M.D. Fla. 2006).

17 Based on the Arbitrator’s determination that Hanson acted with malice  
18 involving despicable conduct with a willful and conscience disregard of the rights of  
19 others, and by the award of punitive damages in favor of the LLC on the derivative  
20 claims, this court is persuaded that Hanson’s conduct was willful and malicious and  
21 done with intent to injure the LLC.<sup>2</sup> The LLC Judgment is excepted from discharge  
22 under §523(a)(6). However, the Claborn Judgment does not meet the elements of  
23 § 523(a)(6). No punitive damages were awarded to Claborn, nor did the Arbitrator  
24

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25  
26 <sup>2</sup>Under California Civil Code § 3294(a), punitive damages may only be awarded  
27 where it is proven by clear and convincing evidence that the defendant has been guilty of  
28 “oppression, fraud or malice.” The court can infer from an award of punitive damages that  
one or all of the elements of § 3294(a) have been proven. See *In re Cantrell*, 329 F.3d at  
1125.

1 make a determination that Hanson's conduct was willful or malicious in connection  
2 with Claborn's Judgment.

3 **Hanson's Defense.**

4 In defense of this adversary proceeding, Hanson argues again that his 28%  
5 interest in the LLC may be offset against the Judgment. In addition, Hanson  
6 contends that the attorney fees and arbitration fees incurred in the Arbitration  
7 Proceeding should not be excepted from discharge, and that he is entitled to an  
8 offset for the advances he made to the LLC. Notably, Hanson does not specifically  
9 deny that he committed the acts set forth in the findings and conclusions recited by  
10 the Arbitrator. Neither does Hanson contend that there is any triable issue of  
11 material fact as to any of the funding in the Arbitration Proceeding.

12 Hanson raised these arguments in the Arbitration Proceeding and the  
13 Arbitrator has already determined that Hanson could not exercise a right of offset.  
14 This court is bound by federal law to accept the Arbitrator's findings and  
15 conclusions as a final adjudication of Hanson's offset rights. Hanson did not bring a  
16 cross-motion or counterclaim in the Arbitration Proceeding or in this adversary  
17 proceeding. This court is not being asked to liquidate the Plaintiffs' claims against  
18 Hanson. That has already been done in the Judgment. This court is just being asked  
19 to determine whether that Judgment should be excepted from discharge. Further,  
20 Hanson lacks standing to assert this interest in property which now belongs to his  
21 bankruptcy estate and which will be administered by the trustee according to the  
22 Bankruptcy Code. S 541(a)(1), *In re Tippet*, 338 B.R. 82, 86 (9th Cir.BAP, 2006).  
23 Accordingly, Hanson's request for an offset to the Judgment will be denied.

24 Finally, Hanson argues that attorneys' fees and costs in the instant  
25 proceeding are not recoverable by the Plaintiffs. This issue is governed by  
26 *Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co.*, 549 U.S. 443-  
27 48-49 (2007), which provides that if those fees and costs are recoverable under state  
28 law or pursuant to agreement or contract, then they are recoverable in a bankruptcy

1 proceeding. The Arbitrator found that the Operating Agreement provided for  
2 attorneys' fees and costs. Hanson is barred by the doctrine of issue preclusion from  
3 relitigating that issue.

4 **Conclusion.**

5 Based on the foregoing, the court finds and concludes that Plaintiffs already  
6 hold a Judgment for compensatory and punitive damages against Hanson. That  
7 Judgment is final and cannot be appealed or relitigated in this bankruptcy court.  
8 However, this court can determine whether the Judgment is nondischargeable under  
9 §§ 523(a)(4) and (a)(6). It appears that the factual issues necessary to establish  
10 Plaintiffs' nondischargeability claims have already been fully litigated in the  
11 Arbitration Proceeding and are applicable here by the doctrine of collateral estoppel.

12 There are no remaining issues of material fact which can be, or need to be,  
13 litigated in this court and Plaintiffs are entitled to judgment in this adversary  
14 proceeding as a matter of law. Accordingly, Plaintiffs' motion for summary  
15 judgment will be granted. Judgment will be entered in favor of Claborn on his  
16 claim under § 523(a)(4). Judgment will be entered in favor of the LLC on its claims  
17 under §§ 523(a)(4) and (a)(6). The Plaintiffs shall submit a proposed judgment  
18 consistent with this ruling.

19 Dated: June 25, 2010

20  
21 /s/ W. Richard Lee  
22 W. Richard Lee  
23 United States Bankruptcy Judge  
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