No. 07-952

IN THE

Supreme Court of the United States

G. HALLETT DENTON, as Executor of the Estate of GEORGE W. DENTON,

Petitioner,

v.

ANDREW A. HYMAN,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether Petitioner has presented compelling reasons to grant the Petition, where the decision below relied, and is fully defensible, on an independent state law ground – in this case, the New York law of collateral estoppel.

2. Whether Petitioner has presented compelling reasons to grant the Petition, where, apart from the independent state law ground of collateral estoppel, this case can be decided on other alternative grounds without reaching the alleged conflict in Circuit Court decisions relied on by Petitioner.

3. Whether Petitioner has presented compelling reasons to grant the Petition, where the alleged conflict in Circuit Court decisions relied on by Petitioner does not implicate the facts of this case, and where, contrary to Petitioner's argument, no Circuit has adopted a blanket rule that no degree of wrongdoing is ever required to establish the defalcation exception under Bankruptcy Code § 523(a)(4).

TABLE OF CONTENTS

TABLE OF CITED AUTHORITIES

Cited Authorities

Cited Authorities

Page

Statutes:

STATEMENT OF THE CASE

A detailed statement of the facts is set forth in the "Background" section of the opinion of the Second Circuit (3a-8a)[1], which is incorporated by reference here. Briefly:

The underlying adversary proceeding in this case arose out of a decision of the Surrogate's Court, Westchester County, New York, dated December 31, 2002 (the proceeding in the Surrogate's Court having been commenced in 1994), in which the Surrogate awarded a judgment of $2,734,832.04 against Respondent, Andrew A Hyman ("Respondent" or "Hyman") and the Andrew A. Hyman Agency, Inc. in favor of the Denton-Hyman Agency, Inc., a company owned 50% each by Hyman and the estate of the decedent, George Denton. Petitioner, G. Hallett Denton ("Petitioner" or "Denton"), is the son of George Denton and the executor of his estate.

Following the Surrogate's Court decision, Hyman filed for bankruptcy protection in the United States Bankruptcy Court for the Southern District of New York. Petitioner commenced an adversary proceeding seeking an order declaring the Surrogate's Court judgment non-dischargeable under various sections of the Bankruptcy Code, including § 523(a)(4), alleging defalcation while acting in a fiduciary capacity.

Petitioner moved for summary judgment on the ground that Respondent's alleged defalcation was established, as a matter of law, by application of the New

1. This and similar references are to the Appendix to the Petition.

York doctrine of collateral estoppel. Respondent cross-moved for summary judgment. In a preliminary opinion issued on the record from the bench, the Bankruptcy Court (Judge Adlai S. Hardin, Jr.) denied both motions for summary judgment, concluding that both sides should have the opportunity "to present evidence at a trial necessary to establish, and defend against, plaintiff's claim of non-dischargeability under Section 524(a)(4)" (42a). Despite originally indicating to the Bankruptcy Court that he would proceed to trial, on the eve of trial, Petitioner made the tactical decision to seek a voluntary dismissal, with prejudice, of his fourth cause of action under Section 523(a)(4). Accordingly, Petitioner affirmatively waived a trial and decided, instead of proceeding to trial, to rely solely on the New York doctrine of collateral estoppel (42a-43a).

Petitioner having waived a trial, the Bankruptcy Court issued a final written decision addressing Petitioner's collateral estoppel argument. In rejecting that argument, Judge Hardin, held, *inter alia*, that the issues in the adversary proceeding were not the same issues decided by the Surrogate's Court. In so holding, Judge Hardin stated:

> This conclusion is underscored when one attempts to understand what it was that Hyman did or did not do after Denton's death that could fairly be characterized as a defalcation or as intentionally wrongful, illicit or reprehensible, such as to justify denial of Hyman's discharge. *There is no finding of fact by the Surrogate, and no claim by the plaintiff in this adversary proceeding, that Hyman*

> *took money or property of Denton-Hyman Agency, NPS or NPA without accounting for it – i.e. no claim of defalcation in the ordinary dictionary sense of that word* (original italics) (68a).
>
> *****
>
> During oral argument on the summary judgment motions, this Court repeatedly asked the attorneys for plaintiff, including the Executor's counsel in the Surrogate's Court proceeding, to specify precisely what it was that Hyman did that was illicit, morally reprehensible or otherwise wrongful, other than the fact that he ultimately did not reach agreement with the Executor as to the amount to be paid in a buy-out of the Denton Estate's 50% interest in Denton Hyman. . . . Despite repeated opportunities to answer these questions, plaintiff's counsel never identified any specific conduct on the part of Hyman which could be characterized as a defalcation, or any conduct of any kind that was wrongful, illegal or morally reprehensible, other than the fact that the parties ultimately did not reach agreement on a buy-out. Nor did the Surrogate in his Decision (71a-72a).

Petitioner appealed the decision of the Bankruptcy Court to the District Court. The sole issue on appeal was whether the Bankruptcy Court properly determined that, applying the New York law of collateral estoppel, the alleged findings and conclusions of the Surrogate

were not sufficient to establish that Hyman had engaged in defalcation within the meaning of Section 523(a)(4).[2]

2. In its Petition to this Court (pp. 4-5), Petitioner misleadingly argues that (i) the Surrogate rejected Hyman's contention that he was acting in good faith by operating NPS (one of the companies in issue) to preserve and maximize commissions and (ii) the Surrogate found that Denton had not consented and acquiesced in Hyman's actions. In fact, neither of these findings was made by the Surrogate.

As to first, the Surrogate did not address the issue of Hyman's good faith, holding only that the proof did not support a finding that the continued operation of NPS was "essential" to protect and maximize commissions (91a). Such a holding did not detract from Hyman's good faith belief that it was "helpful" for that purpose – a belief shared by several witnesses at trial, including one of Denton's own witnesses.

As to the second, Judge Conner noted that in proffering the argument that the Surrogate made such a finding, Denton relied on a single sentence in the conclusion section of the Surrogate's decision: "The Court has considered the balance of the respondent's arguments and finds them unpersuasive and wholly unsupported by even a sympathetic reading of the evidence adduced at trial." In that regard, Judge Conner stated:

> The Bankruptcy Court questioned the extent to which this language permitted collateral estoppel on an issue decided at best implicitly. As do we. . . . [W]e cannot say that the Bankruptcy Court's determination regarding [Denton's] 'knowledge and acquiescence' of Debtor's actions was clearly erroneous given the overwhelming evidence in the record indicating [Denton's] acknowledgement of and willingness to allow the continuation of the business.

(35a). In this same vein Judge Hardin had observed during oral argument, that not only was such a finding absent from the Surrogate's Court's decision, it would be "confounded by the testimony of the executor."

The District Court (Senior Judge William Conner) affirmed the Bankruptcy Court's decision.

Petitioner appealed from the District Court's judgment to the Second Circuit – again on the sole issue of collateral estoppel. In affirming the judgment below, the Second Circuit noted that this case presented "unique circumstances" and, relying on principles of New York law governing application of the doctrine of collateral estoppel, stated:

> In view of these complexities, we are loath to conclude that an identical issue was necessarily decided or that Hyman had a full and fair opportunity to contest his state of mind. In addition to the murkiness of the law, the harsh consequences that follow a finding of nondischargeability and the requirement that the exceptions be narrowly construed both counsel against precluding a plenary trial in Bankruptcy Court, had the [Denton] estate not voluntarily agreed to forego one here. Accordingly, we conclude that collateral estoppel does not attach.

Following the Second Circuit decision, Petitioner moved for panel rehearing and rehearing *en banc*. His motions were denied, the Second Circuit noting that not one judge had requested that a vote be taken on the *en banc* request (82a).

This Petition followed.

REASONS FOR DENYING THE PETITION

I. The decision below relied, and is fully defensible, on an independent state law ground.

The sole issue raised by Petitioner below was whether or not the decision of the Surrogate, in and of itself, under the New York law of collateral estoppel, was sufficient to establish that Respondent engaged in defalcation while acting in a fiduciary capacity within the meaning of the Bankruptcy Code. Thus, this case turns on the interpretation of state law.

This was expressly recognized by the Second Circuit at the outset of its legal discussion, where, citing a decision of this Court, it stated: "To determine whether collateral estoppel applies to the Surrogate's Court's judgment, we look to New York law" (8a).

As a review of the Second Circuit's decision confirms, its discussion of the issue of defalcation, and various Circuit Court decisions relating to that issue, was undertaken to address, as New York law requires, "whether a 'defalcation while acting in a fiduciary capacity' under § 523(a)(4) of the Bankruptcy Code was identical to the factual and legal determinations necessarily decided in the prior Surrogate's Court action" (9a-10a).[3]

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3. As noted by the Second Circuit, under New York law, collateral estoppel bars relitigation of an issue if, among other requirements, the *identical issue* necessarily was decided in the prior action (8a-9a).

As noted, in concluding that collateral estoppel did not apply, the Second Circuit pointed to the following considerations: (i) the "murkiness" of the law regarding defalcation, (ii) the harsh consequences that follow a finding of nondischargeability, (iii) that the exceptions to discharge must be narrowly construed and (iv) that Petitioner had voluntarily agreed to forego a plenary trial (18a). Taking these considerations into account, in determining that collateral estoppel did not attach, the Second Circuit applied principles of New York law – including, that "collateral estoppel is a flexible doctrine and whether to apply it in a particular case depends on 'general notions of fairness involving a practical inquiry into the realities of the litigation'" (9a).

Under these circumstances, any clarification by this Court, at this late juncture, with respect to the meaning of defalcation, would, it is respectfully submitted, in no way change the result under New York law concerning the applicability of collateral estoppel. It is the murkiness of the law at the time that collateral estoppel was invoked by Petitioner that would be one of the relevant factors to be considered under New York law.[4]

In short, since the decision of the Second Circuit essentially turned on New York law, for this reason alone, Petitioner has failed to present any compelling ground to grant *certiorari.*

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4. Indeed, the fact that Petitioner chose voluntarily to waive a plenary trial precluded the development of a full record on which this Court might have reviewed the issue sought to be presented, if it were otherwise appropriate to do so.

II. The existence of further alternative grounds for affirming the decision below negates any compelling reason to grant certiorari.

No compelling reason to grant the Petition is presented where, as here, there exist a number of alternative grounds, separate and apart from the New York law of collateral estoppel, for affirming the decision of the Second Circuit, without the need to reach the alleged conflict in Circuit Court decisions relied on by Petitioner. *See, e.g., The Monrosa v. Carbon Black Export, Inc.*, 359 U.S. 180, 184 (1959):

> While this Court decides questions of public importance, it decides them in the context of meaningful litigation. Its function in resolving conflicts among the Courts of Appeals is judicial, not simply administrative or managerial. Resolution here of the *** [issue in conflict among the circuits] can await a day when the issue is posed less abstractly.[5]

Among the alternative grounds for affirmance presented by the record (which the Second Circuit did not find it necessary to address) are the following:

(a) Hyman was not a fiduciary for section 523(a)(4) purposes. It has been recognized repeatedly that "fiduciary capacity contemplated under Section 523(a)(4) applies only to technical or express trusts and not to

5. The exceedingly abstract context in which Petitioner seeks review by this Court is underscored, once again, by the fact that Petitioner waived a plenary trial through which a full record could have been developed and presented to this Court.

trusts *ex maleficio*." *See, e.g., Sandak* v. *Dobrayel (In re Dobrayel)*, 287 B.R. 3, 14 (Bankr. S.D.N.Y. 2002); *Adamo* v. *Scheller (In re Scheller)*, 265 B.R. 39, 52 (Bankr. S.D.N.Y. 2001).

Under New York law, corporate officers and directors are not treated as trustees of their company's assets, except for the benefit of creditors *if their corporation becomes insolvent*. *Clarkson Co. Ltd.* v. *Shaheen*, 660 F.2d 506 (2d Cir. 1981). Otherwise, the fiduciary obligations of corporate officers and directors, as codified in the New York Business Corporation Law, are based on the common law of agency. *See Pereira* v. *Centel Corp. (In re Argo Communications Corp.)*, 134 B.R. 776, 789 (Bankr. S.D.N.Y. 1991) ("Fiduciaries such as officers and directors are essentially agents of the corporation").

Since under New York law Hyman was not a trustee of the corporate assets,[6] his common law and statutory fiduciary obligations as a corporate *agent* are not sufficient to give rise to an express or technical trust as required under section 523(a)(4). *See Cal-Micro, Inc.* v. *Cantrell (In re Cantrell)*, 329 F.3d 1119 (9th Cir. 2003), in which the Ninth Circuit analyzed a California corporation statute analogous to New York's and

6. This is confirmed by the very decision of the Surrogate's Court on which Petitioner relied. In that proceeding, Petitioner asserted a claim for the imposition of a constructive trust based on Hyman's alleged breach of fiduciary duty. However, in the Surrogate's decision, this claim was dismissed on the ground that "[p]etitioner has failed to identify a fund or asset that can be secured for the benefit of the corporations by the imposition of a constructive trust" (98a).

concluded that "[b]ecause under California law a corporate officer is not a fiduciary within the meaning of § 523(a)(4), . . . Cantrell [the debtor] is entitled to summary judgment [dismissing] Cal-Micro's non-dischargeability claims." *Id.* at 1128. The same conclusion is warranted in this case.

(b) Even if it were to be assumed, *arguendo*, that Hyman was a fiduciary for purposes of section 523(a)(4), he was not "acting in a fiduciary capacity" within the meaning of the Bankruptcy Code with respect to the matters in issue. *See Zohlman* v. *Zoldan (In re Zoldan)*, 221 B.R. 79, 87 (Bankr. S.D.N.Y. 1998), *aff'd*, 226 B.R. 767 (S.D.N.Y. 1998): "The mere *existence* of a fiduciary relationship is not sufficient to deny dischargeability under Section 523(a)(4). The Court must also make a finding that the debtor-defendant was '*acting* in a fiduciary capacity' with respect to the particular conduct giving rise to the liability which is claimed to be non-dischargeable" (emphasis in original).

The underlying conduct relating to this point, and the relevant legal authorities, are discussed in Judge Hardin's opinion (76a-79a).

(c) Petitioner's voluntary dismissal *with prejudice* of the fourth claim for relief contained in the petition in the Surrogate's Court, constituted a final determination on the merits in Hyman's favor with respect the issue of non-dischargeability under section 523(a)(4). As such, the dismissal was *res judicata* and constituted a bar to Petitioner's seeking a judgment on the identical claim under any theory, including collateral estoppel under New York law, the theory set forth in Petitioner's first

claim for relief. *See Beard v. Sheet Metal Workers Union, Local 150*, 908 F.2d 474, 477 n.3 (9th Cir. 1990); *Matter of Energy Cooperative, Inc.*, 814 F.2d 1226, 1230-31 (7th Cir. 1987).

Petitioner's appeal is based solely on his first claim for relief, which did nothing more than assert collateral estoppel as a *legal theory of liability* supporting non-dischargeability under section 523(a)(4). The underlying facts – the basis for the fourth claim for relief – are what constituted Petitioner's claim, not the legal theory of collateral estoppel. Therefore, when Petitioner voluntarily relinquished his fourth claim by consenting to an adverse determination on the merits, with prejudice, he gave up any substantive claim he had under section 523(a)(4). *See Sure-Snap Corp. v. State Street Bank and Trust Co.*, 948 F.2d 869, 874 (2d Cir. 1991); *Expert Electric, Inc. v. Levine*, 554 F.2d 1227, 1234 (2d Cir. 1977).

III. Certiorari is not warranted where, as here, the alleged conflict in Circuit Court decisions does not implicate the facts of the case.

Petitioner contends that three Circuit Court cases, *In re Uwimana*, *In re Cochrane* and *In re Hemmeter* (in the Fourth, Eighth and Ninth Circuits, respectively) conflict with the decision of the Second Circuit in this case (and with decisions of First, Fifth, Sixth, Seventh, Tenth and Eleventh Circuits, all of which require some element of wrongdoing to find defalcation) (Petition, pp. 8-11).[7] However, the alleged conflict relied on by

7. It appears that the Third Circuit has not addressed this issue.

Petitioner does not implicate the facts of this case in that each of the cases relied on by Petitioner involved a technical or express trust – *i.e.*, the misappropriation or failure to account for trust funds. In the present case, unlike those cases, Hyman was held liable for breaching his fiduciary duty as a corporate officer and director, not by taking trust funds, but by allegedly using assets to obtain profits for himself.

As Judge Hardin held: "*There is no finding of fact by the Surrogate, and no claim by the plaintiff in this adversary proceeding, that Hyman took money or property of Denton-Hyman Agency, NPS or NPA without accounting for it. . . .*" (original emphasis). Similarly, the Surrogate held: "Hyman and the Hyman Agency are accountable and liable for the net profits realized in breach of their fiduciary duty . . ." (93a).[8]

While there may be differences in the majority of the Circuits as to the *degree* of wrongdoing required to establish defalcation under Section 523(a)(4), clarification of that issue would not impact the outcome of this case, and would, in effect, constitute an advisory opinion, since it is Petitioner's position is that *no* degree of wrongdoing or bad faith is ever required – a position that no Circuit has adopted. Indeed, such a holding would be wholly inconsistent with this Court's observation that the basic policy animating the Bankruptcy Code is to afford the "honest but unfortunate" debtor a fresh start. *Marrama v. Citizens Bank of Mass.* (127 S. Ct. 1105, 1107 (2007); *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991).

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8. As previously noted, the Surrogate denied Denton's application for a constructive trust because Denton had failed to identify a fund or asset upon which a constructive trust could be applied.

IV. Apart from the reasons discussed, the Petition should be denied for various additional reasons.

(a) Petitioner's argument (Petition, pp. 14-18) that the Second Circuit's decision undermines common law remedies against self-dealing corporate offices and directors is baseless. Petitioner's argument is summarized in his assertion that "[i]n New York, at least, corporate fiduciary judgment debtors now need only repair to the Bankruptcy Court to obtain complete exoneration" (*Id.* at 17).

Apart from the fact that state court judgments could, unlike in the present case, be based on findings that might support the application of collateral estoppel, it was Petitioner in this case who made the tactical decision to waive a trial on the issue of defalcation (perhaps recognizing the weakness of his position), relying instead on the application of collateral estoppel to the wholly inadequate findings of fact made by the Surrogate below. The decision of the Second Circuit in no way would have prevented Petitioner from seeking to establish, at a plenary trial, facts that might have supported his argument that the judgment against Hyman was non-dischargeable under Section 523(a)(4). Petitioner voluntarily chose not to avail himself of that opportunity.

(b) Petitioner's argument that the Second Circuit's decision below is inconsistent with its own decisions in *In re Hammond* and *Central Hanover Bank & Trust Co. v. Herbst* (Petition, pp. 11-13) is similarly baseless. Petitioner made the same argument below, and the Second Circuit addressed the argument and concluded that its present decision was not inconsistent with either

of those earlier decisions (11a-13a). In any event, even if there were an inconsistency among the various decisions of the Second Circuit, such inconsistencies are generally not the basis for granting *certiorari*. Instead, they are ordinarily settled through *en banc* review. Here, as noted, not one judge requested that a vote be taken on Petitioner's application for *en banc* review (82a).

(c) Finally, this case was correctly decided by the Bankruptcy Court, the District Court and the Second Circuit, all taking into account (i) the good faith conduct of Respondent, (ii) the philosophical and practical centerpiece of the Bankruptcy Code affording the "honest but unfortunate" debtor a "fresh start," (iii) the corollary principle that exceptions to discharge must be narrowly construed and (iv) the proper application of the flexible doctrine of collateral estoppel, under New York law, in a manner which comports with "general notions of fairness involving a practical inquiry into the realities of the litigation."

CONCLUSION

For the reasons stated, Petitioner has not established any compelling reason for this Court to grant *certiorari*. Therefore, Respondent respectfully requests that the Petition be denied.

Respectfully submitted,

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