No. _____ 07-952 JAN 17 2008

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

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a state court judgment holding a corporate fiduciary liable for the inherently willful misappropriation and exploitation of corporate assets for personal gain, without any additional finding of "intent," is dischargeable in bankruptcy (as appears to be the law in the First, Fifth and Seventh Circuits), or is within the purview of the "fiduciary defalcation" exception to discharge of Bankruptcy Code § 523(a)(4) (as appears to be the law in the Fourth, Sixth, Eighth and Ninth Circuits)?*

The Second Circuit, citing the "persistent confusion" and "debate among the Circuits," opted to join the former group and held such a debt dischargeable.

2. Whether the express findings of a state court that a corporate officer and director has breached his fiduciary duty by "co-opting [a corporate] enterprise for . . . his own personal enrichment," by . . . "exploiting the [corporations'] assets" and by "misappropriat[ing their] . . . tangible assets and goodwill" for personal gain, are sufficient, under principles of collateral estoppel, held applicable to Bankruptcy Court proceedings in *Grogan v. Garner*, 498 U.S. 279, 284 n. 11, 111 S. Ct. 654 (1991), to establish a "defalcation while acting in a fiduciary capacity" under Section 523(a)(4) of the Bankruptcy Code?

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* The Ninth Circuit is unique. Reflecting California law it has excluded corporate officers from fiduciary status. *In re Cantrell*, 329 F.3d 1119 (9th Cir. 2003). *But cf.*, *F.D.I.C. v. Jackson*, 133 F.3d 694 (9th Cir. 1998) (applying Arizona law, negligence claim against corporate director under Bankruptcy Code § 523(a)(4) upheld).

The Second Circuit declined to apply collateral estoppel in these circumstances, concluding that issues unique to the Bankruptcy Code were not necessarily decided by the state court, effectively rendering collateral estoppel inapplicable in Bankruptcy Court proceedings involving the dischargeability of state court judgments holding corporate officers and directors liable for self-dealing.

PARTIES

The parties to this proceeding are:

1. Petitioner G. Hallett Denton, as Executor of the Estate of George W. Denton.

2. Respondent Andrew A. Hyman, a Chapter 7 Bankruptcy Debtor.

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OPINIONS AND ORDERS BELOW

The Opinion of the United States Court of Appeals for the Second Circuit (1a-19a) is reported at 502 F.3d 61 (2d Cir. 2007). The Opinion and Order of the United States District Court for the Southern District of New York (20a- 38a) is reported at 335 B.R. 32 (S.D.N.Y. 2005). The Decision of the United States Bankruptcy Court for the Southern District of New York (39a- 81a) is reported at 320 B.R. 493 (Bankr. S.D.N.Y. 2005).

The Decision of the Surrogate's Court, Westchester County, dated December 31, 2002, and its Decree, dated April 23, 2003, are not reported and are annexed, respectively at 84a- 99a and 100a-105a. The unanimous affirmance of the Appellate Division, Second Department (106a-109a) is reported at 6 A.D.3d 531, 774 N.Y.S.2d 424 (2d Dep't 2004), and the two denials of further appeals by the New York Court of Appeals (110a-111a, 112a-113a) are reported at 3 N.Y.3d 656, 782 N.Y.S.2d 695 (2004) and 5 N.Y.3d 714, 806 N.Y.S.2d 165 (2005).

JURISDICTION

The Judgment of the United States Court of Appeals for the Second Circuit sought to be reviewed was entered on September 6, 2007. On September 20, 2007, Petitioner timely filed his Petition for Rehearing and Rehearing En Banc, which was denied by Order of the United States Court of Appeals for the Second Circuit entered on October 23, 2007 (82a-83a). The jurisdiction of

this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the provisions of the Bankruptcy Code, 11 U.S.C. § 523(a)(4), Article IV, § 1 of the U.S. Constitution and 28 U.S.C. § 1738, as follows:

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (4) for fraud or *defalcation while acting in a fiduciary capacity*, embezzlement, or larceny; 11 U.S.C. § 523(a)(4) (emphasis added);
>
> Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State, And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof. U.S. Const. Art. IV § 1; and
>
> Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken. 28 U.S.C. § 1738

STATEMENT OF THE CASE

Petitioner ("Creditor") is the Executor of the Estate of his late father, George W. Denton ("Decedent"). Prior to his death in February 1989, Decedent and Respondent Andrew A. Hyman ("Debtor") were equal shareholders in three corporations[1] which Decedent and Debtor successfully operated as a unified enterprise (85a). Their success was based upon Denton-Hyman's marketing, through NPS and NPA, of Denton-Hyman's agents as pension consultants who, after obtaining entree to potential clients by offering pension design and administration services, could then sell insurance and mutual funds for which Denton-Hyman would be paid commissions (88a-89a).

When Decedent died in February 1989, Debtor, the Corporations' sole surviving officer and director, continued to exploit NPS and NPA to generate profits solely for himself (86a, 90a), while continuing to subsidize NPS and NPA with Denton-Hyman funds (90a, 93a).

When it became clear that Debtor was never going to pay for these assets, in March 1994, Creditor commenced a proceeding in the New York Surrogate's Court. Following a nine-day trial, the Surrogate found Debtor and his wholly-owned Hyman Agency liable for profits diverted as a result of his multiple breaches of fiduciary duty. Specifically, the Surrogate found that:

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[1] Denton-Hyman Agency, Inc. ("Denton-Hyman"), National Pension Service, Inc. ("NPS") and National Pension Actuaries ("NPA") (collectively, the "Corporations").

(a) "[a]s a 50% shareholder, officer and director of Denton-Hyman, NPS and NPA, Hyman [Debtor] owed a fiduciary duty to those corporations" which he violated by "co-opting the Denton-Hyman, NPS and NPA enterprise for the benefit of the Hyman Agency [his 100% owned corporation] and for his own personal enrichment" (92a);

(b) "that Hyman [Debtor] exploited the assets of NPS and NPA to obtain profits for himself" (90a); and

(c) that "his actions constituted a misappropriation of the tangible assets and goodwill of Denton-Hyman, NPS and NPA" (92a-93a).

The Surrogate rejected the Debtor's contentions that he was only operating the Corporations in good faith for the purpose of "preserving" and "maximizing" the stream of overriding commissions due Denton-Hyman[2] to repay debt which had been incurred by the parties in their operation of the enterprise prior to Decedent's death (the "Denton-Hyman Debt") (91a-92a).[3] With regard to Debtor's defenses that Creditor had "consented to and acquiesced" in his actions, the Surrogate found:

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[2] Denton-Hyman received overriding commissions on life insurance policies written prior to Decedent's death for nine years following the sale of each policy.

[3] Debtor and Creditor were jointly and severally liable for repayment of this debt, as Debtor and Decedent had personally guaranteed its repayment.

> . . . them unpersuasive and wholly unsupported by even a sympathetic reading of the testimony and evidence adduced at trial

(88a, 98a), and "dismissed" [them] . . . in their entirety." (*Id.*)

Following Debtor's bankruptcy filing,[4] the Appellate Division, Second Department, unanimously affirmed, holding that:

> . . . the evidence presented at trial established that the appellant Andrew A. Hyman [Debtor] breached his fiduciary duty to the [Corporations]. Accordingly, we discern no basis in the record to disturb the Surrogate's Court's credibility determination (108a).

The New York Court of Appeals twice rejected further appellate review (110a-113a).

Despite the fact that these issues were actually litigated in the state courts and necessarily resolved against Debtor, the Bankruptcy Court declined to accord collateral estoppel effect to the Surrogate's findings when Petitioner sought to have Debtor's debt declared nondischargeable under Bankruptcy Code § 523(a)(4),[5] as a "defalcation while acting in a fiduciary capacity." The Bankruptcy Court ignored the Surrogate's explicit findings in favor of its own more chari-

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[4] Debtor filed his petition under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the Southern District of New York on January 29, 2003, and his case was converted to a Chapter 7 case on July 6, 2004.

[5] The Bankruptcy Court had jurisdiction of Creditor's adversary proceeding to declare Debtor's debt nondischargeable under 28 U.S.C. §§ 1334 and 157.

table view of the facts[6]—a determination which it plainly was not entitled to make under the doctrine of collateral estoppel and the Full Faith and Credit Clause.

The Bankruptcy Court also rejected (albeit *sub silencio*) Creditor's contention that, under the Second Circuit's prior decision in *In re Hammond*, 98 F.2d 703 (2d Cir.), *cert. denied*, 305 U.S. 646 (1938), where a corporate fiduciary has been adjudicated to have breached his duty of loyalty to his corporation, no "conscious wrongdoing" need be shown.[7]

The District Court endorsed the Bankruptcy Court's conclusion that Creditor had failed to show that Debtor had done anything wrongful in operating the enterprise and declined to apply collateral estoppel to the state court's findings.

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[6] Included in this view was the erroneous assumption that Debtor contributed to the repayment of the Denton-Hyman Debt by his continued operation of the Corporations (46a, 69a). It is undisputed that Debtor never used any of the income derived from his continued operation of the enterprise for this purpose. The debts were paid entirely from Denton-Hyman overrides and other Denton-Hyman funds (which belonged 50% to Creditor), while Debtor diverted 100% of the profits through the Hyman Agency (115a-116a, 118a, 119a-120a).

[7] The debtor in *Hammond* was found liable for profits made on the sale of stock purchased with personal funds to enable the corporation to obtain access to valuable patents; the corporation was unable to do so, but benefitted from the purchase. The Second Circuit rejected the debtor's claim that his debt should be discharged because his actions were innocent because "animated by a desire to . . . benefit [the corporation] and he "had no intention of despoiling his cestui." 98 F.2d at 705.

The District Court also rejected Creditor's contention that *In re Hammond* was controlling. Directly contrary to the state court's findings, it concluded that "Debtor's conduct throughout was fully consistent with a good faith effort to preserve the business for the [parties'] mutual benefit" (34a).[8]

In affirming, the Second Circuit once again considered Debtor's claim of "good faith" and accepted, as evidence thereof, the Bankruptcy and District Courts' assumption that Debtor had contributed to repayment of the Denton-Hyman Debt. Recognizing "persistent confusion" (15a) and "debate among the Circuits" (10a), it concluded that the majority require "some level of wrongful conduct" in order to find a "defalcation" under Bankruptcy Code § 523(a)(4) (13a)[9]. Accordingly, the Second Circuit imposed a "scienter" requirement on the fiduciary defalcation exception, citing *In re Baylis*, 313 F.3d 9 (1st Cir. 2002), and declined to give collateral estoppel effect to the state court's findings. In the Second Circuit's view, the Surrogate "had neither the ability nor the incentive to apply [this standard]" (17a), which is not required under state law in corporate fiduciary self-dealing cases.

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[8] Like the Bankruptcy Court, the District Court predicated this conclusion on the erroneous assumption that Debtor had retired the Denton-Hyman Debt using profits of the Hyman Agency (25a, 34a).

[9] An erroneous conclusion given the Sixth Circuit's holding in *In re Johnson*, 691 F.2d 249 (6th Cir. 1982), described below.

REASONS FOR GRANTING THE PETITION

I. This Court Should Resolve the "Debate Among the Circuits" (10a) and "Persistent Confusion" (15a) as to Whether the Fiduciary Defalcation Exception to Dischargeability Under Bankruptcy Code § 523(a)(4) Requires Affirmative Findings of "Intent" or "Scienter" in Corporate Officer and Director Self-Dealing Cases, Findings Not Generally Required by State Law. A Uniform National Standard Eliminating These Non-Statutory Requirements From the Bankruptcy Code Would Effectively Enhance Common Law Remedies in Such Cases

The Second Circuit describes at some length the "debate" and "confusion" now prevailing in the Federal Circuit Courts of Appeal with respect to the fiduciary defalcation exception to dischargeability (10a-14a). On its face, the statute excepts from dischargeability in bankruptcy debts resulting from a "defalcation while acting in a fiduciary capacity." Bankruptcy Code § 523(a)(4). The application of that seemingly simple concept is anything but.

The Second Circuit's decision conflicts with those Circuits which apply an objective standard in such cases, holding that a finding of subjective wrongful intent is not required to satisfy the statutory standard of defalcation, provided only

that the debtor breached his fiduciary duty. *In re Uwimana*, 274 F.3d 806, 811 (4th Cir. 2001) ("Negligence or even an innocent mistake which results in misappropriation or failure to account is sufficient."); *In re Hemmeter*, 242 F.3d 1186, 1190 (9th Cir. 2001) ("Even innocent acts of failure to fully account for money received in trust will be held as non-dischargeable defalcations."); *In re Cochrane*, 124 F.3d 978, 984 (8th Cir. 1997) ("Defalcation includes the innocent default of a fiduciary who fails to account fully for money received.").

The Sixth Circuit,[10] although having nominally asserted that a defalcation cannot be predicated on "mere negligence," has applied an objective standard in assessing the conduct of a fiduciary, holding that "creating a debt by breaching a fiduciary duty is a sufficiently bad act to invoke [§ 523(a)(4)'s predecessor] even without [proof of] a subjective mental state evidencing intent to breach a known fiduciary duty or bad faith in doing so." *In re Johnson*, 691 F.2d 249, 256 (6th Cir. 1982) (involving a trustee, not a corporate fiduciary).

This view applies with special force where, as here, a corporate fiduciary has been found liable for misappropriating corporate property for his personal benefit. *In re Hammond*, 98 F.2d 703 (2d Cir.), *cert. denied*, 305 U.S. 646 (1938); *see also In re Uwimana*, *supra*; *In re Cochrane*,

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[10] In an unreported decision the Sixth Circuit has also ruled that a debt resulting from the breach of a fiduciary duty by a corporate officer not involving the misappropriation of corporate assets is dischargeable. *In re Sullivan*, 19 Fed. Appx. 180 (6th Cir. 2001).

supra; *In re Johnson*, *supra*. As the Sixth Circuit observed in *Johnson*, "the requisite 'badness,' to conform with the spirit of the bankruptcy laws, is supplied by an individual's special legal status with respect to another, with its attendant duties and high standards of dealing, and the act of breaching these duties." 691 F.2d at 256. Nothing more should be required.

Those Circuits taking a contrary view are not unanimous in their articulation of the applicable standard. The Fifth Circuit has held that a "willful neglect" of a debtor's fiduciary duty must be shown to establish a defalcation under § 523(a)(4), which it has characterized as essentially a "recklessness standard." *In re Schwager*, 121 F.3d 177, 184-85 (5th Cir. 1997). The Seventh Circuit, although holding that a "mere negligent" breach of fiduciary duty is insufficient, *see Meyer v. Rigdon*, 36 F.3d 1375, 1384-85 (7th Cir. 1994), does not appear to have settled on the "something more" that is required to establish defalcation—whether it be a willful disregard of that duty, "recklessness" or otherwise.[11]

The First Circuit, whose position the Second Circuit has now adopted (15a), holds that a defalcation can be established only upon a "showing of extreme recklessness"—a showing of "scienter" as required "in the context of securities fraud." *In re Baylis*, 313 F.3d 9, 20 (1st Cir. 2002) (holding,

[11] The Seventh Circuit did not have to resolve the issue in *Meyer v. Rigdon*, because the default judgment against the debtor/bank president in a prior federal court action, on which the Seventh Circuit based its finding of "defalcation," had been based on allegations that he had "knowingly breached" his fiduciary duty to the bank.

nevertheless, that a debt arising from the use of trust funds for personal expenses was non-dischargeable because "[d]efalcation may be presumed from [a fiduciary's] breach of the duty of loyalty"). As articulated by these Circuits, a defalcation by a corporate fiduciary can be established only by "a showing of conscious misbehavior or extreme recklessness (15a)," requirements which do not appear in the statute or its legislative history.[12]

Neither the First nor Second Circuit has offered any statutory justification for taking this view, other than the assertion that, because the term "defalcation" appears in the same section as the words "fraud," "larceny" and "embezzlement," it should be construed as requiring the same, or nearly the same level of wrongful intention.[13]

The Second Circuit's adoption of a "scienter" requirement in this case is irreconcilable with *Hammond*. Indeed, in *Hammond*, the Second Circuit had held that a prior adjudication that a corporate director had breached his duty of loyalty to a corporation, was sufficient to establish a "misappropriation"under Section 17(a)(4) of the

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[12] "The Tenth Circuit's standard is not entirely clear . . . *** [and] [t]he Eleventh Circuit also has yet to adopt a clear standard" (14a).

[13] The dictionary certainly does not support this view. As the Second Circuit acknowledged:

> Defalcation is defined in Black's Law Dictionary (8th ed. 2004), as "loosely, the failure to meet an obligation" and "*a non-fraudulent* debt." *Id.* at 427; see Oxford English Dictionary 389 (2d ed. 1989) ("a monetary deficiency *through breach of trust* by one who has the management or charge of funds") (11a) (emphasis added).

Bankruptcy Act (now Bankruptcy Code § 523(a)(4)); no showing of any "conscious purpose . . . to defraud" or other "conscious wrongdoing" was necessary to render the debt nondischargeable. 98 F.2d at 704, 705.[14] Claims that the self-dealing fiduciary acted in "good faith" and "had no intention of despoiling his cestui," have been and should be rejected. *See Hammond*, 98 F.2d at 705; *Johnson*, 691 F.2d at 254, 257.

Ironically, it was Justice Learned Hand's analysis of the predecessor to Bankruptcy Code § 523(a)(4) in *Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510 (2d Cir. 1937), that laid the groundwork for the view that even innocent defaults could constitute a defalcation under this section.

> Colloquially perhaps the word "defalcation," ordinarily implies some moral dereliction, but in this context [the first reference to defalcation in the Bankruptcy Code] it may have included innocent defaults, so as to include all fiduciaries who for any reason were short in their accounts. . . . Whatever was the original meaning of "defalcation," it must here [in the Bankruptcy Act of 1867] have covered other defaults than deliberate

[14] As previously noted, the debtor in *Hammond* was found liable for profits made on the sale of stock which he purchased to enable the corporation to obtain access to valuable patents, notwithstanding the acknowledged benefit to the corporation. It was undisputed that he made the purchase, along with his co-directors, with their own funds, because the corporation was unable to do so, and that the corporation benefitted from the purchase.

> malversations, else it added nothing to the words, "fraud or embezzlement." . . . .
>
> * * *
>
> We must give the words different meanings so far as we can, especially when a contrary interpretation would wrest "defalcation," if not from its original meaning, at least from that which it must have had in the Act of 1867.

93 F.2d at 511-12. Significantly, in *Herbst*, the Second Circuit held that a receiver had committed a defalcation solely because he had spent and was unable to repay a previously awarded supplemental fee, after the award was reversed on appeal—hardly the kind of intentional misconduct or "extreme recklessness" the Second Circuit has decreed in this case.

Plainly, the dischargeability of a judgment against a corporate fiduciary based on self-dealing should not depend on the jurisdiction in which it was rendered. Nor should it depend on the vagaries of the various Bankruptcy Courts' views on whether such a finding imports "intentional," "reckless" or "innocent" behavior. We can conceive of no case where a corporate fiduciary would be found to have engaged in self-dealing for personal gain, without having acted intentionally, whether or not he is specifically found to have intended to do so. His intentions (as in the case at bar) are inherent in the conduct for which he has been held liable. The "misappropriation" and "exploitation" of corporate assets for personal gain is never unintentional.

From time immemorial protestations of "good faith" or "good intentions" have been rejected as a defense to fiduciary self-dealing; the law governing discharge in bankruptcy should be no different.

II. Review Should Also Be Granted Because the Second Circuit's Decision Necessarily Undermines Common Law Remedies Against Self-Dealing Corporate Officers and Directors.

In the case at bar, the Surrogate's findings could not have been clearer:

> (a) "[a]s a 50% shareholder, officer and director of Denton-Hyman, NPS and NPA, Hyman [Debtor] owed a fiduciary duty to those corporations" which he violated by "co-opting the Denton-Hyman, NPS and NPA enterprise for the benefit of the Hyman Agency [his 100% owned corporation] and for his own personal enrichment" (92a);
>
> (b) "that Hyman [Debtor] exploited the assets of NPS and NPA to obtain profits for himself" (90a); and
>
> (c) that "his actions constituted a misappropriation of the tangible assets and goodwill of Denton-Hyman, NPS and NPA" (92a-93a).[15]

He likewise rejected Debtor's "good faith" and ratification defenses (88a, 98a), which were "dismissed . . . in their entirety." (*Id.*).

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[15] If these findings do not constitute "defalcation" for Bankruptcy Code purposes, what would?

The common law of New York holds corporate officers and directors to a higher standard "... than the morals of the marketplace." *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1926). As the Appellate Division, First Department, explained in *Foley v. D'Agostino*, 21 A.D2d 60, 66-67, 248 N.Y.S.2d 121, 128 (1st Dep't 1964):

> 'Directors and officers shall discharge the duties of their respective positions in good faith ***'. They may not assume and engage in the promotion of personal interests which are incompatible with the superior interests of their corporation. 'Officers and directors of a corporation owe to it their undivided and unqualified loyalty. *** They should never be permitted to profit personally at the expense of the corporation. Nor must they allow their private interests to conflict with the corporate interests. These are elementary rules of equity and business morality. Courts of equity must ever enforce strict compliance with these rules.' [citations omitted] In fact, 'When it appears that the trustee or officer has violated the moral obligation to refrain from placing himself in relations which ordinarily produce a conflict between self-interest and integrity, there is in equity a presumption against the transaction, which he is required to explain.' (*Sage v. Culver*, 147 N.Y. 241, 247, 41 N.E. 513, 514.) So it follows that an officer or director who actively engages in a rival or competing business to the detriment of his corporation, must answer to the corporation for the injury it thereby sustains.

Accord Matter of Greenberg, 206 A.D.2d 963, 964, 614 N.Y.S.2d 825, 827 (4th Dep't 1994) (officer's or director's "dealings with respect to corporate assets are subject to close scrutiny and must be characterized by absolute good faith; he may not appropriate corporate assets or opportunities to himself or to a new corporation formed for that purpose").

In state court litigation against such corporate fiduciaries, specific findings that such persons intended to self-deal are unlikely to be made because, under the applicable common law they are neither pleaded, proven nor necessary to the court's determination; they are inherent in the very nature of the fiduciary's acts. One does not "unintentionally" self-deal.

It is axiomatic that the Full Faith and Credit Clause of the Constitution (Article IV, § 1), as implemented by 28 U.S.C. § 1738, "requires federal courts to give the same preclusive effect to State court judgments that those judgments would be given in the courts of the state from which the judgments emerged." *Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 466, 102 S. Ct. 1883 (1982). *Accord Parson Steel, Inc. v. First Alabama Bank*, 474 U.S. 518, 523, 106 S. Ct. 768 (1986). This "statute has long been understood to encompass the doctrines of res judicata, or "claim preclusion," and collateral estoppel, or "issue preclusion." *San Remo Hotel, L.P. v. City and County of San Francisco*, 545 U.S. 323, 336, 125 S. Ct. 2491 (2005), *citing Allen v. McCurry*, 449 U.S. 90, 94-96 101 S. Ct. 411 (1980). This Court has specifically recognized the applicability of collateral estoppel in claims for non-discharge-

ability under Bankruptcy Code § 523(a). *Grogan v. Garner*, 498 U.S. 279, 284 n. 11, 111 S. Ct. 654 (1991).

Those Circuits who insist on findings of "conscious misbehavior" or "extreme recklessness" amounting to the same have laid a trap for the unwary state court judgment creditor. Despite findings against a corporate fiduciary for self-dealing, such creditors will find their judgments effectively nullified, if such specific, and unnecessary, findings are not made by the state courts. In New York, at least, corporate fiduciary judgment debtors now need only repair to the Bankruptcy Court to obtain complete exoneration.

Moreover, under the Second Circuit's rationale, even if a state court makes the findings it now requires, any resulting judgment will be insufficient to support a claim of nondischargeability under § 523(a)(4). The Second Circuit premised its decision on the theory that because under New York law "good faith or innocent motives" are not a defense to a claim of breach of fiduciary duty, the state court was not required to, and thus did not necessarily, find that Debtor acted with culpable intent (16a-18a). Thus, even if the state court made the "appropriate findings of conscious misbehavior or recklessness" (16a), such findings, being "unnecessary" for the court's decision under state law, could not serve as a basis for collateral estoppel, which only accords preclusive effect to "necessary" findings. The "defalcation" exception to dischargeability, in the context of corporate fiduciary self-dealing, is now

rendered nugatory, Bankruptcy Code § 523(a)(4) to the contrary notwithstanding.

This gross inequity can be avoided if this Court rules, as in *Johnson* and *Hammond*, that any claimed ignorance of the law or alleged "good faith" by a corporate fiduciary is not a defense to nondischargeability, consistent with the common law, and the plain wording of the Bankruptcy Code. It is enough, as noted in the passage cited by the Second Circuit from New York Jurisprudence, that "the directors know that the use they are making of the assets is not for the benefit of the company, but for the use and benefit of other enterprises in which they are interested" (17a, quoting 14A N.Y. Jur.2d, Business Relationships § 695 (2006)).

CONCLUSION

For all of the foregoing reasons, a writ of certiorari should be granted.

Dated: New York, New York
January 17, 2008

Respectfully submitted,

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