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WHAT'S INSIDE

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HAS BANKRUPTCY CODE SECTION 523(A)(6) BECOME THE WILDCARD FOR NONDISCHARGEABILITY?

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Most lawyers recognize that bankruptcy is about a fresh start for a debtor burdened by obligations he or she can no longer afford to repay. This fresh start comes from the Bankruptcy Code's broad discharge of prepetition debts. The Bankruptcy Code lays out twenty-one (or so) very specific exceptions to discharge, covering a variety of policy-based exclusions – including debts incurred by fraud and driving under the influence of alcohol, among others.[2]

These exceptions are all grounded in sound policy, to prevent a debtor from escaping the consequences of particularly bad behavior. Exceptions to discharge are also intended to be construed narrowly, in favor of the debtor. One of those exceptions, however, has become something of a wildcard, due to the vagaries of statutory interpretation, combined with a series of cases with compelling facts – the "intentional harm" exception of section 523(a)(6).

Section 523(a)(6) excepts from discharge debts "for *willful* and malicious injury by the debtor to another entity or to the property of another entity."[3] Section 523(a)(1)(C) excepts from discharge any debt with respect to which the debtor "*willfully* attempted in any manner to evade or defeat tax."[4]

The Ninth Circuit has held that section 523(a)(6) willfulness requires only a showing that the debtor was "substantially certain" injury would result.[5] In the more recent case of *Hawkins v. Franchise Tax Board*, however, the Ninth Circuit held that "willful" in section 523(a)(1)(C) requires a heightened showing of "specific intent."[6]

Whether the "substantially certain" standard remains good law in light of *Hawkins* is an open question, which issue is currently pending at the Ninth Circuit Court of Appeals.[7]

1 The author would like to thank Paul J. Leeds, bankruptcy partner at Higgs Fletcher & Mack, LLP, for his editorial contributions to this article.

2 11 U.S.C. § 523(a).

3 11 U.S.C. § 523(a)(6).

4 11 U.S.C. § 523(a)(1)(C).

5 *Petralia v. Jercich (In re Jercich)*, 238 F.3d 1202 (9th Cir. 2001) ("*Jercich*").

6 *Hawkins v. Franchise Tax Board of California*, 769 F.3d 662, 666 (9th Cir. 2014) ("*Hawkins*").

7 *Hamilton v. Elite of Los Angeles, Inc. (In re Hamilton)*, No. 18-60027 (9th Cir. filed May 1, 2018). The debtors are currently represented by Higgs Fletcher & Mack, LLP.

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Willful Injury Under Section 523(a)(6)

The story begins at the United States Supreme Court, in the seminal case of *Kawaauhau v. Geiger*.[8] In *Geiger*, Kawaauhau sued Dr. Geiger for medical malpractice claims arising out of his treatment of a foot injury, which ultimately resulted in an amputation.[9] Dr. Geiger admitted that he intentionally departed from the appropriate standard of care in order to save on treatment costs, including prescribing a less-effective antibiotic and cancelling the patient's treatment with an infectious disease specialist. The jury found Dr. Geiger liable for medical malpractice, and awarded the Kawaauhaus over $350,000 in damages.[10]

Dr. Geiger then petitioned for bankruptcy, and the Kawaauhaus sought to except the debt under section 523(a)(6).[11] The bankruptcy court agreed with the Kawaauhaus, but the Eighth Circuit reversed, holding that, because the debt was based on negligent or reckless conduct, rather than intentional conduct, it remained dischargeable.[12]

The Supreme Court affirmed the ruling of the Eighth Circuit, and reiterated that exceptions to discharge should be narrowly construed in favor of the debtor's fresh start.[13] The Court specifically framed the issue as follows: "Does § 523(a)(6)'s compass cover acts, done intentionally, that cause injury (as the Kawaauhaus urge), or only acts done with the actual intent to cause injury ...?"[14]

The Court held that section 523(a)(6) covers "only acts done with the actual intent to cause injury."[15] The Court explained: "The word 'willful' ... modifies the word 'injury,' indicating that nondischargeability takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury."[16] Thus, "debts arising from recklessly or negligently inflicted injuries do not fall within the compass of § 523(a)(6)."[17]

What Is "Actual Intent"?

It is clear then, under *Geiger,* a finding of section 523(a)(6) willfulness requires actual intent to injure. Otherwise, as the Supreme Court explained, every traffic accident stemming from an intentional act, and any knowing breach of contract, could meet the definition of willfulness.[18] This result would be at odds with the overarching policy that exceptions to discharge are to be narrowly construed.

The question then becomes, what is "actual intent"? A few courts have argued that *Geiger* neither defined nor articulated the precise state of mind necessary for a finding of willfulness.[19] On the other hand, in interpreting both federal criminal statutes and the Bankruptcy Code, courts often use the terms "actual intent and "specific intent" interchangeably.[20] A few bankruptcy courts have concluded, that by using the term "actual intent," *Geiger* in fact imposed a specific intent requirement.[21]

Courts Have Held That Section 523(a)(6) "Willfulness" Requires Only "Substantial Certainty of Harm"

Despite the *Geiger* court's holding that section 523(a)(6) willfulness requires "actual intent to injure," several Courts of Appeal have held that a deliberate act, with knowledge that the act is substantially certain to cause injury, is sufficient to establish willfulness under section 523(a)(6). One notable example is the Ninth Circuit case of *In re Jercich*.[22] In *Jercich*, Petralia sued his employer (Jercich) for various statutory violations, including for unpaid wages, and punitive damages.[23] The court granted judgment in favor of Petralia, finding that Jercich had the clear ability to pay Petralia's wages, but chose not to do so, instead using company funds to pay for a wide variety of personal investments, including a horse ranch.[24] Jercich filed for bankruptcy, and Petralia sought to except the judgment from discharge pursuant to section 523(a)(6).[25] The bankruptcy court found that the debt was dischargeable, and the district court affirmed.[26]

The Ninth Circuit panel reversed. In analyzing the "willful" requirement of section 523(a)(6), the court posited that *Geiger* had not defined the "precise state of mind required to satisfy section 523(a)(6)'s

8 *Kawaauhau v. Geiger*, 523 U.S. 57 (1998) ("*Geiger*").
9 *Id.* at 59.
10 *Id.*
11 *Id.* at 60.
12 *Id.*
13 *Id.*, at 62. *See also United States v. Sotelo,* 436 U.S. 268, 280 (1978).
14 *Id.* at 61.
15 *Id.*
16 *Id.* (emphasis in original).
17 *Id.* at 64.
18 *Id.* at 63.
19 *See e.g., Jercich*, 238 F.3d at 1202.
20 *See e.g., United States v. Nicklas*, 713 F.3d 435, 439 (8th Cir. 2013) (equating "actual intent" to "specific intent"); *Little v. Trombley*, 443 F. App'x 989, 991 (6th Cir. 2011) (specific intent crime requires proof of an actual intent); *In re Schifano*, No. ADV 96-1350-WCH, 2003 WL 26085845, at *10 (B.A.P. 1st Cir. Sept. 26, 2003) ("the creditor must prove that the act was done with *actual intent* to hinder, delay or defraud a creditor; absent *specific intent* to defraud creditors, a discharge should not be denied. . ."); *In re Howard*, 73 B.R. 694, 702–03 (Bankr. N.D. Ind. 1987) (equating actual intent with specific intent in the context of false financial statement); *Scherber v. Online Auctions, LLC*, No. 3:13CV530, 2014 WL 3908114, at *3 (N.D. Ohio July 3, 2014), citing *Paul's Auto World v. Boyd,* 881 F.2d 1077 (6th Cir. 1989) (claim required "actual intent" to defraud: i.e., "a willful act done with specific intent to deceive a purchaser of the mileage on a car."); *Benavente v. Hedgpeth*, No. 1:08-CV-00085JMD(HC), 2010 WL 2196008, at *5 (E.D. Cal. May 26, 2010), *objections overruled*, No. 1:08-CV-00085JMD, 2010 WL 2850790 (E.D. Cal. July 19, 2010), citing *Briceno v. Scribner*, 555 F.3d 1069, 1078-79 (9th Cir. 2009) ("it is not acceptable to prove specific intent absent some direct or circumstantial evidence of the petitioner's actual intent.").
21 *See e.g., In re Tomlinson*, 220 B.R. 134, 137–38 (Bankr. M.D. Fla. 1998) (*Geiger* imposed a specific intent requirement); *In re Jenkins*, 258 B.R. 251, 257 (Bankr. N.D. Ala. 2001) (same).
22 *Jercich*, 238 F.3d at 1204.
23 *Id.*, at 1204.
24 *Id.*
25 *Id.*
26 *Id.*

'willful' standard."[27] The court, therefore, looked to a pre-Bankruptcy Act Supreme Court conversion case, *McIntyre v. Kavanaugh*.[28] To define "willful" under §17(2) of the Bankruptcy Act of 1898, the predecessor of section 523(a)(6), *McIntyre* quoted a prior Supreme Court case, *Tinker v. Colwell*.[29]

Tinker stated that "[a] willful disregard of what one knows to be his duty, an act which is against good morals and wrongful in and of itself, and which *necessarily* causes injury and is done intentionally, may be said to be done willfully and maliciously, so as to come within the exception [under §17(2).]"[30] One court noted that *Tinker's* use of the word "necessarily" requires that the "act itself inevitably produce the injury in all circumstances."[31] The Ninth Circuit in *Jercich* reasoned, however, that this language supported a conclusion that willful injury requires a deliberate act with knowledge that the act is substantially certain to cause injury.[32]

Notably, in enacting section 523(a)(6) of the Bankruptcy Code, the Legislature expressly stated that *Tinker* has been overruled to the extent it has been interpreted to apply a lesser standard than "deliberate or intentional."[33]

Jercich also relied upon the Restatement of Torts for its definition of "intent." In *Geiger,* after the Court defined willfulness to mean acts done with "actual intent to cause injury," it cited to the Restatement *only* to support the analogy referenced by the Eighth Circuit: the "(a)(6) formulation triggers in the lawyer's mind the category 'intentional torts,' which generally require that the actor intend the *consequences* of an act, not simply the act itself."[34] Despite the fact that the *Geiger* Court did not adopt the latter portion of the Restatement regarding the more encompassing "substantial certainty" of harm, *Jercich* concluded that it meant to do so.[35] Notably, *Jercich* is not alone – as other circuit courts have similarly adopted the broad substantial certainty of harm standard.[36]

The Ninth Circuit Defined "Willful" in Section 523(a)(1)(C) as Requiring Specific Intent

The Ninth Circuit recently looked to *Geiger* to define the term "willful" in the context of section 523(a)(1)(C), which excepts from discharge any debt with respect to which the debtor "willfully attempted in any manner to evade or defeat tax."[37]

As the old saying goes, bad facts make for bad law. Not true in this case – perhaps recognizing the problematic expansion of nondischargeability associated with the bad facts of *Hawkins*, the Ninth Circuit held a principled line.

The debtor/taxpayer, Hawkins, had received an undergraduate degree in Strategy and Applied Game Theory from Harvard University, and an M.B.A. from Stanford. He was one of the earliest employees at Apple, and later left to co-found Electronic Arts, Inc., and his net worth rose to $100 million. The IRS alleged that he and his wife, Lisa, enjoyed the "trappings of wealth," such as a private jet, private school for their children, an ocean-front condo in La Jolla, California, and a large private staff.

Hawkins also created a variety of business entities and offshore accounts, specifically designed to generate large losses on his federal tax returns. Ultimately, Hawkins owed over $40 million in unpaid taxes and penalties to the FTB and IRS.[38] After Hawkins filed for bankruptcy, the FTB and IRS claimed their tax debts were nondischargeable pursuant to section 523(a)(1)(C).[39] The primary argument was that the Hawkinses' maintenance of a rich lifestyle after their living expenses exceeded their income constituted a willful attempt to evade taxes. The bankruptcy court found that the Hawkinses' personal living expenses during the period of insolvency were "truly exceptional," in that they exceeded their income by $516,000 to $2.35 million. The bankruptcy court therefore held that the debts were nondischargeable.[40] The district court affirmed.[41]

The Ninth Circuit reversed, and set to define "willful" in section 523(a)(1)(C).[42] The Court argued that "philosophy of the Bankruptcy Code argues for a stricter interpretation of 'willfully' than an expansive definition."[43] The *Hawkins* Court cited to *Geiger* both

27 *Jercich,* at 1207.

28 *Id.* at 1207-08, citing *McIntyre v. Kavanaugh*, 242 U.S. 138 (1916) ("*McIntyre*"). §17(2) of the 1898 Bankruptcy Act provided: "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except ... judgments in actions for ... willful and malicious injuries to the person or property of another."

29 *See McIntyre*, 242 U.S. at 142-43, citing *Tinker v. Colwell,* 193 U.S. 473 (1902).

30 *Tinker,* 242 U.S. at 485, emphasis added.

31 *See e.g., In re Cobham*, 551 B.R. 181, 193 (E.D.N.C.), *aff'd*, 669 F. App'x 171 (4th Cir. 2016). ("*McIntyre's* requirement than an injury necessarily result from the occurrence of a bad act, in essence, requires that the act itself *inevitably produce the injury in all circumstances*," emphasis added), citing *Oxford English Dictionary*.

32 *Id.*

33 "Paragraph (6) excepts debts for willful and malicious injury by the debtor to another person or to the property of another person. Under this paragraph, 'willful' means deliberate or intentional. To the extent that *Tinker v. Colwell,* 193 U.S. 473 (1902), held that a looser standard is intended, *and* to the extent that other cases have relied on *Tinker* to apply a 'reckless disregard' standard, they are overruled." H.R. REP. 95-595, 365, 1978 U.S.C.C.A.N. 5963, 6320-21. *See also In re Plyam*, 530 B.R. 456, 464 (B.A.P. 9th Cir. 2015) (*Geiger* excluded from the definition of willfulness "all degrees of reckless conduct, whether arising from recklessness simple, heightened, or gross; conduct that is reckless merely requires an intent to act, rather than an intent to cause injury as required under *Geiger*. To the extent that *Tinker* [] held that a looser standard is intended, and to the extent that other cases have relied on *Tinker* to apply a 'reckless disregard' standard, they are overruled.")

34 *Geiger*, 523 U.S. at 61-62 (internal quotation marks omitted).

35 *Id.* at 62; *Jercich*, 238 F.3d at 1208.

36 *See e.g., In re Levasseur*, 737 F.3d 814, 818 (1st Cir. 2013); *In re Miller*, 156 F.3d 598, 604 (5th Cir. 1998); *Gerard v. Gerard*, 780 F.3d 806, 811 (7th Cir. 2015); *Roussel v. Clear Sky Properties, LLC*, 829 F.3d 1043, 1048 (8th Cir. 2016).

37 *Hawkins*, 769 F.3d at 666 (9th Cir. 2014).

38 *Id.* at 664-65.

39 *Id.* at 665.

40 *Id.* at 665-666.

41 *Id.* at 666.

42 *Id.*

43 *Id.* at 666–67.

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for the proposition that courts must narrowly interpret exceptions to the broad presumption of discharge, and that "willful" in section 523(a)(6) requires "a deliberate or intentional injury." Ultimately, *Hawkins* squarely held that the term willful in section 523(a)(1)(C) "requires a showing of *specific intent*."[44]

Is *Jercich* Still Good Law After *Hawkins*?

One of the most well-recognized canons of statutory interpretation is that the same word in the same statute has the same meaning.[45] Currently, however, in the Ninth Circuit, the word "willful" in Bankruptcy Code section 523(a) has two different meanings.

Hawkins held that "willful" in section 523(a)(1)(C) as requiring specific intent, which comports with *Geiger's* requirement of actual intent.

Jercich, however, defined section 523(a)(6) willfulness to mean something less than actual, or specific intent. The similar facts in *Jercich* and *Hawkins* highlight the conflict in the outcome. *Jercich* involved a knowing violation of a statutory duty to pay money. Jercich knew wages were owed to Petralia and failed to pay them. In *Hawkins*, the debtor knew he owed over $25 million in tax debt, that he was insolvent, and continued to fund a lavish (and unnecessary) lifestyle knowing he would be unable to pay his tax debt.[46] Under the "substantially certain" standard articulated in *Jercich*, *Hawkins'* debt would, arguably, be nondischargeable.

This issue is currently pending at the Ninth Circuit – which has the opportunity to clarify the meaning of willful in section 523(a). Otherwise, section 523(a)(6) will remain as the wildcard in nondischargeability law.

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44 *Id.*
45 *Envtl. Def. v. Duke Energy Corp.*, 549 U.S. 561, 584 (2007).
46 The Bankruptcy Court found that several of the expenses represented, or could represent, an effort to prevent the collection of tax. *In re Hawkins*, 430 B.R. 225, 238 (Bankr. N.D. Cal. 2010), *aff'd sub nom. Hawkins v. Franchise Tax Bd.*, 447 B.R. 291 (N.D. Cal. 2011), *rev'd sub nom. Hawkins v. Franchise Tax Bd. of California*, 769 F.3d 662 (9th Cir. 2014).