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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case
)	No. 08-63556-fra13
JOSEPH J. LUPO,)	
)	
<u>Debtor.</u>)	
)	Adversary Proceeding
UNITED SERVICES ASSOCIATED, Inc.,)	No. 08-6196-fra
)	
Plaintiff,)	
vs.)	
)	
JOSEPH J. LUPO,)	MEMORANDUM OPINION
)	
<u>Defendant.</u>)	

I. INTRODUCTION

The Debtor, Joseph Lupo, Jr., is a former employee of United Services Associated, Inc., which does business in Oregon as(Steamway) Disaster Restorations ("SDR"). Plaintiff claims that the Defendant, who is the Debtor in the underlying bankruptcy case, is indebted to it on account of a series of misappropriations of funds, and that these claims should be excepted from discharge in bankruptcy. A trial was held beginning on April 20, 2009, at the conclusion of which the matter was taken under advisement. The Court finds for the Plaintiff on some, but

1 not all, of its claims, and holds that the claims that are established
2 are excepted from discharge.

3 II. PROCEDURAL POSTURE

4 Plaintiff brought an action for damages against Defendant in
5 the Circuit Court for Linn County, Oregon. On the eve of trial,
6 Defendant filed a petition for relief in this Court under Chapter 13 of
7 the Bankruptcy Code. Shortly thereafter, the Debtor/Defendant removed
8 the State Court proceeding to this Court. Plaintiff filed an amended
9 complaint setting out its original claims, with additional counts
10 alleging that its claims against Defendant are excepted from discharge
11 under 11 U.S.C. § 523. At trial, Plaintiff's attorney moved to
12 substitute Plaintiff's claim for nondischargeability, originally made
13 under § 523(a)(6), to one under § 523(a)(4).¹

14 The Court finds that this adversary proceeding is a core
15 proceeding, and subject to trial and entry of judgment by the Bankruptcy
16 Court. 28 U.S.C. § 157(b)(2).

17 The Court has considered the testimony, exhibits and arguments
18 of the parties, and now issues this memorandum opinion as its findings of
19 fact and conclusions of law.

20 III. FACTS

21 Defendant was originally employed by Plaintiff in November
22 1998. He entered into a written employment agreement (Exhibit 2) which
23 included a provision that "during the term of employment [Defendant]
24 agrees not to become engaged with or in any company, industry or business

25
26 ¹A claim of the type described by § 523(a)(4) is nondischargeable in chapter 13 pursuant to § 1328(a)(2).

1 in competition with employer." Also in the agreement was a provision
2 whereby the Debtor undertook not to compete with the Plaintiff's business
3 within a 50 mile radius of the Plaintiff's territory for a period of one
4 year after termination of the employment.

5 The Plaintiff's relations with its employees and the employees'
6 duties and obligations are spelled out in considerable detail in an
7 employment guide provided to each employee (Exhibit 5). Of particular
8 importance to the company were policies prohibiting conflicts of
9 interest. The company strongly discouraged outside employment, and
10 flatly prohibited employment in competition with Plaintiff's business.

11 While not prohibited, the company strongly discouraged
12 overtime, preferring to end an employee's workweek as soon as it reached
13 40 hours. This policy was applied to all employees, including the
14 Defendant, even after the Defendant took on enhanced duties as a
15 supervisor.

16 Defendant was originally employed at \$10 per hour. Eventually
17 his salary reached \$16 an hour, supplemented by frequent bonuses.
18 Defendant's tax returns reflect total wages and salaries of over \$50,000
19 in 2003 and 2004, the last two full years of employment.

20 Defendant did well in the early years of his employment, and by
21 the year 2000 had been entrusted with considerable responsibilities. As
22 the company's production manager, he was generally charged with the
23 initiation and supervision of most of its business projects. However,
24 the relationship was not free from tension. Defendant believed that he
25 was underpaid, a position that Plaintiff disputed on several occasions.
26 Defendant repeatedly requested Plaintiff to adopt, in writing, an

1 expansive bonus provision for company employees, of which Defendant would
2 be the principal beneficiary. Plaintiff just as resolutely resisted
3 these demands.

4 Commencing in 2003, Defendant, taking advantage of his position
5 with the company, began diverting funds from the corporation. In several
6 instances, he induced the company's customers to make payments by way of
7 checks addressed to the Defendant, often by representing that he was a
8 partner in the enterprise. In others he contacted potential clients of
9 the company, noted on the company's records that the proposed job had
10 been declined, and then undertook to do the work, using the company's
11 employees, in his own name or under his own assumed business name.

12 These practices continued until July of 2005, at which time the
13 schemes were revealed to Plaintiff by other employees. Defendant was
14 immediately terminated. Plaintiff then undertook a painstaking review of
15 its files, accumulating several hundred pages of evidence of misdirected
16 jobs and/or payments.

17 All told, Defendant received payments from customers of money
18 that should have been paid to the Plaintiff, or received money from jobs
19 diverted from the Plaintiff, totaling \$118,403.93 (see Exhibits 73
20 through 75).

21 IV. ANALYSIS

22 The principal duty of the Bankruptcy Court in this matter is to
23 determine the applicability of the Bankruptcy Code, and specifically
24 whether the Plaintiff's claims are excepted from discharge. In order to
25 do so, the Court must liquidate the claim. The Plaintiff must establish
26 the validity of its claim by a preponderance of the evidence, and

1 likewise must establish by a preponderance of the evidence that the
2 claim, once liquidated, is excepted from discharge.

3 Defendant does not dispute the receipt of the funds or that he
4 undertook to do the jobs originally available to the Plaintiff. He
5 insists that, with respect to each job, it was undertaken with the
6 Plaintiff's knowledge and consent. The rationale behind the undertaking
7 was that the Plaintiff, in its efforts to limit overtime by its crew, had
8 many hands left with nothing to do by midweek. Defendant claims that he
9 convinced Plaintiff to give its permission to these side jobs in order to
10 keep the employees working after their 40 hour per week limits had been
11 reached.

12 Defendant's arguments are not persuasive. Use of company
13 personnel, and of the company's contractor's license, equipment, and
14 other assets, is contrary to every aspect of the corporation's culture
15 and operations presented at trial. The amount of cash that ultimately
16 flowed to the Defendant belies Defendant's assertion that the projects
17 could not have been profitable to the Plaintiff.

18 The Defendant states that in 2003 he approached David Brown,
19 Plaintiff's president, and suggested that he could use SDR's employees on
20 their off-duty hours to do small jobs that would not be profitable to SDR
21 and that SDR was turning down for one reason or another. He told Mr.
22 Brown that a number of SDR's skilled employees were unhappy with SDR's
23 failure to provide raises or award promised bonuses and were considering
24 quitting. The crew could earn extra money on their off-time and SDR
25 would profit by not losing valuable employees. Defendant states that Mr.

26 // // //

1 Brown agreed to allow the Defendant to start up his side business, but
2 that he did not want SDR to incur any expense whatsoever.

3 Plaintiff denies that any such agreement was made with the
4 Defendant. The Defendant did not have a Construction Contractor's
5 License (CCL), essential to performing the sort of work SDR engages in.
6 In order to engage in his side-business, the Defendant used SDR's
7 Contractor's License when dealing with customers. Customers of the
8 Defendant, then, would expect that in the event they had a claim against
9 the Defendant for work done, they could file it with the Construction
10 Contractor's Board and be compensated out of the mandatory bond required
11 of licensees. It is not likely that Plaintiff would allow Defendant to
12 use its CCL for work over which it had no control or knowledge,
13 especially given the testimony and documentary evidence showing the
14 control Plaintiff exerts over every aspect of its work and associated
15 expenses.

16 A. Funds Diverted from Plaintiff to Defendant

17 Plaintiff's Exhibits 73 and 74 detail jobs performed using SDR
18 crews and equipment in which either the entire payment or a partial
19 payment from the customer was made to the Defendant rather than to SDR.
20 These were SDR jobs in which the costs were incurred by SDR and the full
21 payment should have been made to SDR. These diverted payments total
22 \$81,502.82, and essentially constitute a theft of funds.

23 B. Projects Diverted from Plaintiff to Defendant

24 Plaintiff's Exhibit 75 shows payments made to the Defendant on
25 projects that would have gone to SDR, but that Defendant diverted to
26 himself. He hired and paid SDR's employees to work on the jobs and

1 otherwise incurred the costs of the jobs himself. The payments for these
2 projects total \$45,333.53.

3 Under Oregon law, the wrongful diversion of another business's
4 potential customers constitutes a claim for "intentional interference
5 with economic relations," an intentional tort. A claim includes the
6 following elements:

7 (1) the existence of a professional or business
8 relationship [i.e. between the plaintiff and the
9 customer] (which could include, e.g. a contract or a
10 prospective economic advantage), (2) intentional
11 interference with that relationship, (3) by a third
party, (4) accompanied through improper means or for
an improper purpose, (5) a causal effect between the
interference and damage to the economic relationship,
and (6) damages.

12 Douglas Medical Center, LLC v. Mercy Medical Center, 203 Or.App. 619,630,
13 125 P.3d 1281,1287 (2006)(internal citation omitted). In the present
14 case, Defendant used his position within SDR to divert business to
15 himself that would have otherwise gone to SDR. Potential customers
16 sought the services of SDR through SDR's advertising or by word of mouth,
17 but the project was instead taken by the Defendant. Had the potential
18 business instead been directed to SDR, the profits from the diverted
19 projects would have accrued to SDR. Elements 1 - 5 of the intentional
20 tort have thus been established.

21 A recovery may be had in tort actions for loss of profits
22 "provided their loss is the proximate result of the defendant's wrong and
23 they can be shown with reasonable certainty." Marr v. Putnam, 213 Or.
24 17,38, 321 P.2d 1061,1072 (1958). "The fact that a plaintiff may not be
25 able to fix its lost profits with precision will not preclude recovery of
26 damages, but courts require a 'reasonably accurate and fair basis for the

1 computation of alleged lost profits.'" Shalley et al. v. Borough of Sea
2 Bright et al., 2009 WL 1324024, p.5 (N.J.Super.A.D. 2009)(internal
3 citation omitted).

4 A reasonably accurate and fair basis for determining lost
5 profits for diverted projects in the circumstances of this case is to
6 multiply the gross receipts received by the Defendant from diverted
7 projects by the average gross profit percentage obtained by the Plaintiff
8 over the years at issue (2003 to 2005). Using the average gross profit
9 percentage as calculated from Plaintiff's tax returns provides lost
10 profits from diverted projects of: \$45,333.53 X 61% = \$27,653.45.

11 C. File Reconstruction and Research Costs

12 Plaintiff seeks damages of \$111,629.19 as compensation for the
13 cost of research and the reconstruction of files incurred by Plaintiff in
14 determining the amount of losses borne by Plaintiff due to the actions of
15 the Defendant. The costs were incurred in the years 2005 to 2008, with
16 the bulk of the work done in 2006 and 2007. The largest single charge is
17 for David Brown, the principal of the Plaintiff, in the amount of \$69,060
18 for 479 hours at \$140/\$150 per hour. Staff time at \$48/hour makes up
19 \$31,056 of the amount. A charge for consultants of \$9,696 and for "print,
20 photocopy, postage, etc." of \$1,817 makes up the remainder.

21 The Court is of the opinion that these costs were incurred²

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25 ²There is no evidence beyond the summary sheet for Exhibit 64 that the majority of
26 these costs were in fact paid by the Plaintiff, or that they were reasonable in amount.
There is also some evidence that questionable expenses for transportation and meals and
entertainment have been included.

1 primarily in anticipation of litigation in the Oregon courts³ rather than
2 damages directly related to the injury suffered. They also do not qualify
3 as "costs and disbursements" under Or.R.Civ.P. 68A(2)⁴ or O.R.S. Chapter
4 20, which may be awarded to the prevailing party. As such, these amounts
5 will not be allowed.

6 D. Dischargeability Under Section 523(a)(4)

7 Plaintiff asks the court to declare its claim against the
8 Defendant to be nondischargeable under 11 U.S.C. § 523(a)(4). That
9 provision excepts from discharge any debt "for fraud or defalcation while
10 [the debtor was] acting in a fiduciary capacity, embezzlement, or
11 larceny." Because the fiduciary capacity described by § 523(a)(4)
12 requires the existence of an express or technical trust, Ragsdale v.
13 Haller, 780 F.2d 794, 796 (9th Cir. 1986), not present in the present
14 case, we are left with embezzlement or larceny.

15 The exception from discharge for debts from embezzlement or
16 larceny "excepts from discharge debts resulting from the fraudulent
17 appropriation of another's property, whether the appropriation was
18 unlawful at the onset, and therefore a larceny, or whether the
19

20 ³Prior to the filing of the current action in the Linn County Circuit Court, which
21 was subsequently removed to the bankruptcy court, Plaintiff caused to be filed a
criminal complaint against the Defendant in state court.

22 ⁴"Reasonable and necessary expenses incurred in the prosecution or defense of an
23 action other than for legal services, and include the fees of officers and witnesses;
24 the expense of publication of summonses and notices, and the postage where the same are
served by mail;...the compensation of referees; the expense of copying of any public
25 record, book, or document admitted into evidence at trial; recordation of any document
where recordation is required to give notice of the creation, modification or
26 termination of an interest in real property; a reasonable sum paid a person for
executing any bond, recognizance, undertaking, stipulation or other obligation therein;
and any other expense specifically allowed by agreement, by these rules, or by any
other rule or statute...."

1 appropriation took place unlawfully after the property was entrusted to
2 the debtor's care, and therefore was an embezzlement." 4 Collier on
3 Bankruptcy ¶ 523.10[2] (15th ed. rev'd 2008).

4 The claims for lost profits from diverted jobs and the claim
5 for diverted funds constitute claims resulting from the unlawful
6 appropriation of the Plaintiff's property. In the case of the diverted
7 funds, a job was completed by the Plaintiff, but the payment by the
8 customer was made to the Defendant at Defendant's direction. In the case
9 of the diverted jobs, the Defendant used his position with the Plaintiff
10 to take customers and the resulting profits that rightfully belonged to
11 Plaintiff, with the intent of depriving the Plaintiff of same. The claim
12 for \$109,156.27 is nondischargeable under § 523(a)(4).

13 E. Plaintiff's Claim for Punitive Damages

14 The Complaint asks for an award of punitive damages in the
15 amount of \$100,000. Because the claim for damages arises under Oregon
16 law, the law of Oregon governs punitive damages in this case. See Dixie
17 Farms Market v. Dye, 28 Fed.Appx 673, 2002 WL 24573 (9th Cir. 2002).
18 Punitive damages are recoverable in a civil action in Oregon if it is
19 proven by clear and convincing evidence that the party against whom
20 punitive damages are sought has acted with malice.⁵ O.R.S. 31.730(1).
21 Malice, as used as a basis for punitive damages, signifies a "wrongful
22 act done intentionally, without just cause or excuse." 2-D's Logging,
23 Inc. v. Weyerhaeuser Co., 53 Or.App. 677,686, 632 P.2d 1319,1325 (1981).

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25
26 ⁵Or "has shown a reckless and outrageous indifference to a highly unreasonable risk of harm and has acted with a conscious indifference to the health, safety and welfare of others."

1 "Punitive damages can only be justified on the theory of
2 deterrent....It is only in those instances where the violation of
3 societal interests is sufficiently great and of a kind that sanctions
4 would tend to prevent, that the use of punitive damages is proper."
5 Hicks v. Lilly Enterprises, Inc., 45 Or.App. 211,216, 608 P.2d 186,189
6 (1980)(citing Noe v. Kaiser Foundation Hosp., 248 Or. 420,425, 435 P.2d
7 306,308 (1967)). "Punitive damages are not a substitute for compensatory
8 awards nor an offset against litigation expense," and have never been
9 viewed by Oregon courts "as an entitlement or right protected by the
10 Oregon Constitution." DeMendoza v. Huffman, 334 Or. 425,444, 51 P.3d
11 1232,1243 (2002)(internal citations omitted). "[T]he jury has entire
12 discretion to refrain from giving any punitive damages at all even though
13 all the elements of malicious and damaging misconduct may have been
14 established." Van Lom v. Schneiderman, 187 Or. 89,108, 210 P.2d 461
15 (1949).

16 "In a case where punitive damages are alleged, the wealth of
17 the defendant is pertinent to the issue, and material and necessary."
18 State of Oregon v. Dooley, 270 Or. 37,42, 526 P.2d 563,566 (1974).

19 In the present case, the Court is satisfied by clear and
20 convincing evidence that the Defendant acted with the requisite
21 "malice" in his actions toward the Plaintiff. That being said, the Court
22 will not award punitive damages.⁶ While there was no evidence presented
23 at trial regarding the financial condition of the Defendant, the Court
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25 ⁶Any award of punitive damages would be subject to O.R.S. 31.735 which requires
26 that 60% of any punitive damages award be paid over to the Oregon Department of
Justice. See DeMendoza v. Huffman at 431-32.

1 has the benefit of Defendant's bankruptcy schedules, of which judicial
2 notice will be taken. The schedules reveal that the Defendant has minimal
3 net worth and a modest income supporting several elderly family members
4 and his wife. Moreover, given Debtor's income and lack of net worth, the
5 sizable judgment to be awarded in this adversary proceeding and the fact
6 that it may not be discharged in Debtor's present or any future
7 bankruptcy provides sufficient deterrent value in itself.

8 F. Defendant's Counterclaims

9 Defendant claims that the Plaintiff is indebted to him for
10 additional compensation in an amount alleged at trial to be between
11 \$318,713 and \$337,384. The basis of the claim is an alleged agreement
12 whereby Plaintiff would pay to all its employees bonuses equal to 25% of
13 the company's gross operating revenues, and that Defendant would receive
14 45% of this pool. Plaintiff steadfastly denies that any such arrangement
15 was agreed to, and Defendant presents no evidence to corroborate his
16 claim. Financial information presented at trial suggests that any such
17 arrangement would have eliminated any trace of profit for the
18 corporation's owners. Quite simply, the Defendant fails to sustain his
19 burden of proof with respect to the alleged bonus agreement.

20 At the close of the evidence, the Defendant amended his
21 counterclaim, with the Court's consent, to allege an entitlement to the
22 money he claims on the basis of *quantum meruit*. To calculate the
23 additional amount required to make Defendant whole under this theory, the
24 Defendant used the same bonus formula discussed above, but applied it
25 against a calculation of *net profit* (i.e. gross profit reduced by a
26 "fair" calculation of overhead), which produces the amount of \$172,909.

1 While the Defendant was entitled to make the amendment, the claim is not
2 supported by the evidence.

3 *Quantum meruit* provides damages "in an amount considered
4 reasonable to compensate a person who has rendered services in a quasi-
5 contractual relationship." Blacks Law Dictionary 1276 (8th ed. 2004). A
6 quasi-contractual relationship is one implied-in-law where an *actual*
7 contract does not exist. The Plaintiff argues that the Defendant's
8 original employment contract was in force throughout the time that
9 Defendant was employed by Plaintiff, even though his duties and rate of
10 pay had changed. Defendant argues that a new contract was formed, albeit
11 an oral one, when the Defendant was promoted to production manager, and
12 that the new oral contract included the bonus formula. Defendant then
13 argues that if the new contract is not enforceable due to ambiguity, a
14 fair measure of *quantum meruit* damages would be to use the bonus formula
15 against a "fair" calculation of net income.

16 Assuming, *arguendo*, that a new oral, but unenforceable,
17 employment contract was formed when Defendant was promoted, or that
18 Defendant worked under no contract, Defendant has not provided evidence
19 showing that he was under-compensated for the services he provided.
20 Evidence was presented showing that profits increased substantially
21 during Defendant's tenure and Defendant testified that he had referred a
22 fair amount of work to Plaintiff from his friends and family and that he
23 worked overtime and on weekends. Mrs. Brown, as a principal and employee
24 of the Plaintiff, testified and provided documentation showing that the
25 Defendant's total compensation (i.e wages, bonuses, and company-provided
26 benefits for health, pension and vehicle) substantially exceeded the

1 average for his position in comparable companies. While Defendant may
2 have provided valuable services to the Plaintiff, the evidence indicates
3 he was adequately compensated for those services.

4 V. CONCLUSION

5 The Court will enter a money judgment for the Plaintiff in the
6 amount of \$109,156.27⁷, with a declaration that it is excepted from
7 discharge under 11 U.S.C. §§ 523(a)(4) and 1328(a)(2). Defendant's
8 counterclaim is denied in its entirety.

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11 FRANK R. ALLEY, III
12 Bankruptcy Judge
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25 ⁷ \$81,502.82 + \$27,653.45. Plaintiff also submitted its Exhibit 76 showing
26 additional alleged minor defalcations totaling \$11,804.78. Evidence of these alleged
defalcations is either inconclusive or unpersuasive.