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Transgender Woman's Employment Discrimination Judgment Was Nondischargeable, New York Bankruptcy Court Decides

*By Stuart I. Gordon and Frank P. Izzo**

The U.S. Bankruptcy Court for the Southern District of New York has ruled that a state court judgment for employment discrimination in favor of a transgender woman against a Chapter 7 debtor was nondischargeable under Bankruptcy Code Section 523(a)(6). Here, the authors explore that decision and discuss how it might be affected if the U.S. Supreme Court were to rule this term that the prohibition in Title VII of the Civil Rights Act of 1964 against employment discrimination “because of . . . sex” does or does not encompass discrimination based on an individual’s sexual orientation or transgender status.

A New York bankruptcy court recently issued a notable decision involving the ability of a Chapter 7 debtor to discharge a debt.

In *Fuller v. Rea*,¹ the U.S. Bankruptcy Court for the Southern District of New York, in an opinion by Chief U.S. Bankruptcy Judge Cecelia G. Morris, ruled that a debt in favor of a transgender woman resulting from a state court judgment for employment discrimination was excepted from discharge under Section 523(a)(6) of the Bankruptcy Code² because it was incurred as a result of the debtor willfully and maliciously causing injury to the woman.

The bankruptcy court issued its ruling only months before the opening of the U.S. Supreme Court’s 2019–2020 term, in which the Court has agreed to

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¹ *Fuller v. Rea*, 2019 Bankr. LEXIS 2364 (Bankr. S.D.N.Y. July 29, 2019).

² Bankruptcy Code Section 523 governs exceptions to discharge and provides, in part, that “[a] discharge . . . does not discharge an individual debtor from any debt . . . for willful and malicious injury by the debtor to another entity or to the property of another entity.” 11 U.S.C. § 523(a)(6).

hear cases questioning whether the prohibition in Title VII of the Civil Rights Act of 1964 against employment discrimination “because of . . . sex” encompassed discrimination based on an individual’s sexual orientation and, further, whether “sex” in that context meant “gender identity” and included “transgender status.”

This article discusses the bankruptcy court’s ruling in *Fuller* and explores how it might be affected by the three cases pending before the Supreme Court—if at all.

THE UNDERLYING DEBT

The *Fuller* case arose in October 2010, when Erin Fuller, a transgender woman who had been fired from her job, filed a charge with the New York State Division of Human Rights against her former employer, Advanced Recovery, Inc., and its president and chief operating officer, Mark Rea. Ms. Fuller alleged that her termination was discriminatory against her on the basis of gender and disability.

The Human Rights Division found probable cause for gender and disability discrimination, and hearings were held before an administrative law judge (“ALJ”) in December 2013 and February 2014. The ALJ ultimately recommended that the commissioner of the Human Rights Division find that Ms. Fuller had, in fact, been discriminated against based on gender and disability by Advanced Recovery and Mr. Rea under New York State Human Rights Law Section 296(1)(a).

In April 2015, the commissioner of the Human Rights Division adopted the recommendations of the ALJ in their entirety and ordered Mr. Rea to pay damages to Ms. Fuller for lost wages in the amount of \$14,560, plus interest at the rate of nine percent per year from November 4, 2010, and \$30,000 for mental anguish and humiliation, plus interest at the rate of nine percent per year from April 1, 2015. The ALJ also imposed a civil penalty in the amount of \$20,000, plus interest at the rate of nine percent per year from April 1, 2015, stating that Mr. Rea’s decision to terminate Ms. Fuller’s employment “was direct and deliberate, and it resulted in humiliation.”

Advanced Recovery and Mr. Rea challenged the decision in court. In June 2018, the New York State Appellate Division, Second Department, affirmed the factual and legal conclusions found by the ALJ and adopted by the Human Rights Division, stating that the evidence in the record established a *prima facie*

case of discrimination.³

The Appellate Division also dismissed Mr. Rea's proffered alternative reasons for terminating Ms. Fuller's employment, calling them a "pretext for unlawful discrimination."

On December 17, 2018, Mr. Rea (the "debtor") filed a petition for relief under Chapter 7 of the Bankruptcy Code⁴ and named Ms. Fuller as one of his creditors.

After she received notification of the debtor's bankruptcy filing, Ms. Fuller filed an adversary proceeding seeking to have her judgment excepted from the debtor's Chapter 7 discharge pursuant to Section 523(a)(6) of the Bankruptcy Code.

Ms. Fuller moved for summary judgment to except her claim against the debtor from discharge. She asserted that the debt owed to her was not dischargeable as her termination was willful and malicious within the meaning of Section 523(a)(6).

Ms. Fuller argued that the findings of fact, opinion, and order of the ALJ, adopted by the Human Rights Division and affirmed by the Appellate Division, showed as a matter of law that her termination by the debtor was willful and malicious. Ms. Fuller contended that the issues were entitled to collateral estoppel effect and could not be re-litigated in the bankruptcy court.

In opposition, the debtor argued that the bankruptcy court had to engage in a "careful inquiry" when determining whether the application of collateral estoppel was appropriate in dischargeability actions. The debtor contended that even if the bankruptcy court applied collateral estoppel, the record only showed that Ms. Fuller's termination constituted unlawful discrimination rather than a "willful and malicious" injury.

The debtor further argued that a "careful inquiry" of the evidence would reveal the absence of willfulness and malice. In addition, the debtor also argued that the fact that the Human Rights Law⁵ empowered the ALJ to assess fines

³ *Matter of Advanced Recovery, Inc. v. Fuller*, 162 A.D.3d 659 (N.Y. App. Div. 2d Dep't 2018).

⁴ *See In re Rea*, No. 18-37081(CGM) (Bankr. S.D.N.Y. filed Dec. 17, 2018).

⁵ The provision of the New York State Human Rights Law, found at New York Executive Law § 297(4)(c)(vi), provides, in part:

Within one hundred eighty days after the commencement of such hearing, a determination shall be made and an order served as hereinafter provided. If, upon all the evidence at the hearing, the commissioner shall find that a respondent has engaged in any unlawful discriminatory practice as defined in this article, the commissioner shall state findings of fact

higher than the \$20,000 imposed was proof that malice did not exist in this case.

THE BANKRUPTCY COURT'S DECISION

The bankruptcy court granted Ms. Fuller's motion.

In its decision, the bankruptcy court explained that it had to determine whether the debtor's discriminatory termination of Ms. Fuller was "willful and malicious" for purposes of dischargeability under Section 523(a)(6) and whether the debtor was collaterally estopped from challenging the factual and legal findings adopted by the Human Rights Division in imposing liability under New York law. Although it had to separately examine whether the debtor had caused the injury to Ms. Fuller "willfully" and "maliciously," the bankruptcy court indicated that a finding of malice informed whether the intentional act of termination had been performed for the purposes of causing injury.⁶

The bankruptcy court pointed out that relying on the doctrine of collateral estoppel (also known as issue preclusion) was within its powers and that the doctrine could be applied in dischargeability actions.⁷ The bankruptcy court held that in determining whether the state court judgment had a preclusive effect in the debtor's federal bankruptcy proceeding, it would turn to state preclusion laws.⁸

and shall issue and cause to be served on such respondent an order, based on such findings and setting them forth, and including such of the following provisions as in the judgment of the division will effectuate the purposes of this article: . . . (vi) assessing civil fines and penalties, in an amount *not to exceed* fifty thousand dollars, to be paid to the state by a respondent found to have committed an unlawful discriminatory act, or *not to exceed* one hundred thousand dollars to be paid to the state by a respondent found to have committed an unlawful discriminatory act which is found to be willful, wanton or malicious[.]

N.Y. Exec. Law § 297(4)(c)(vi) (emphasis added).

⁶ See *Rocco v. Goldberg*, 487 B.R. 112, 127 (Bankr. E.D.N.Y. 2013) (requiring an unlawful discriminatory animus to act as a nexus between deliberate discrimination and the intent to cause injury).

⁷ See *Grogan v. Garner*, 498 U.S. 279, 284 (1991).

⁸ See *Migra v. Warren City School District Board of Education*, 465 U.S. 75, 81 (1984) (stating that, "[A] federal court must give to a state-court judgment the same preclusive effect as would be given that judgment under the law of the [s]tate in which the judgment was rendered."); see also *Allen v. McCurry*, 449 U.S. 90, 96 (1980) (stating that, "[T]hough federal courts may look to the common law or to the policies supporting res judicata and collateral estoppel in assessing the preclusive effect of decisions of other federal courts, Congress has specifically required all federal courts to give preclusive effect to state-court judgments whenever the courts of the [s]tate

In that regard, the bankruptcy court indicated that New York courts employed a two-part test:

- A party was estopped from relitigating an issue when that issue was necessary to the resolution of the prior action; and
- The party against whom estoppel was invoked had a full and fair opportunity to contest that issue in the previous litigation.⁹

The Debtor's Actions Were "Willful"

The bankruptcy court first considered whether the debtor's actions in terminating Ms. Fuller were willful.

The bankruptcy court noted that the U.S. Supreme Court has held that "willful" for purposes of Section 523(a)(6) meant "a deliberate and intentional injury, not merely a deliberate or intentional act that leads to injury."¹⁰ Moreover, the bankruptcy court continued, the term "willful" according to the Supreme Court necessarily modified "injury" in that an "injury" under Section 523(a)(6) had to be one that was "intended to cause the injury—not merely perform the act which caused it."

According to the bankruptcy court, although a showing of intent was not required for the Human Rights Division to find that unlawful discrimination had taken place, intent was "clearly implicit in the determination."¹¹

It then considered whether the debtor was collaterally estopped from relitigating the issue of willfulness.

In analyzing that issue, the bankruptcy court observed that the ALJ's finding of discrimination, adopted in its entirety by the Human Rights Division and affirmed by the Appellate Division, was grounded in the finding that the debtor had terminated Ms. Fuller during a meeting that was held a few hours after the debtor received notice of Ms. Fuller's legal name change. The bankruptcy court added that the ALJ further found that during the meeting in which Ms. Fuller was terminated, the debtor told her, "Now I have a problem with your

from which the judgments emerged would do so[.]").

⁹ See *PenneCom B.V. v. Merrill Lynch & Co.*, 372 F.3d 488, 491 (2d Cir. 2004); see *Metromedia Co. v. Fugazy*, 983 F.2d 350, 355 (2d Cir. 1992) (stating that, "[C]ollateral estoppel bars a party from relitigating in a second proceeding an issue of fact or law that was litigated and actually decided in a prior proceeding, if that party had a full and fair opportunity to litigate the issue in the prior proceeding and the decision of the issue was necessary to support a valid and final judgment on the merits."); see also *Rocco v. Goldberg*, 487 B.R. 112, 121 (Bankr. E.D.N.Y. 2013); *Gaiimo v. Detrano*, 266 B.R. 282, 291 (Bankr. E.D.N.Y. 2001).

¹⁰ *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998).

¹¹ *Rocco v. Goldberg*, *supra* note 9, 487 B.R. at 127.

condition. I have to let you go.” The bankruptcy court also noted that the ALJ went on to state that the debtor’s “decision to terminate [Ms. Fuller’s] employment was direct and deliberate.”

The bankruptcy court held that Ms. Fuller’s termination was intentionally discriminatory and motivated by unlawful discriminatory animus, the animus being the debtor’s statement of his “problem with [Ms. Fuller’s] condition.” In the bankruptcy court’s view, the findings of discrimination by the Human Rights Division established that the debtor had been motivated by discriminatory factors and had deliberately caused the adverse employment action and, therefore, were predicated on material and necessary factual findings that were sufficient to support a finding of “willful injury.”

Simply put, the bankruptcy court held that “discriminatory termination” was the injury Ms. Fuller suffered and that the judgment finding that the debtor had intentionally caused that injury, particularly when an unlawful discriminatory animus was apparent, was sufficient to meet the prong of willfulness under Section 523(a)(6).

The bankruptcy court then analyzed whether the judgment in favor of Ms. Fuller met the “full and fair opportunity to litigate” requirement for an issue to be precluded by collateral estoppel.

The bankruptcy court first found that the debtor’s participation in the state proceeding had been “significant.” The bankruptcy court pointed out that the debtor was a named respondent in the proceeding, was represented by counsel in the original hearing as well as the appeal, testified at the hearing, and submitted post-hearing briefs.

The bankruptcy court added that the forum, though conducted in an administrative court, was a trial, and that the “importance of the claim and the incentive and initiative to litigate” was illustrated by the debtor’s hiring of attorneys to represent him in the trial. In the bankruptcy court’s opinion, the “entire administrative process” showed “extensive litigation” and the record reflected the debtor’s “full and diligent participation” in that litigation.

The bankruptcy court held that a finding of “willfulness” was necessary to the resolution of the state action as the judgment was predicated on “material and necessary factual findings” that were sufficient to support a finding of “willful injury.” The debtor “had a full and fair opportunity to litigate the issue of willfulness” as his participation in the state action was “extensive” and the record outlining the reason for the ALJ determination was “robust.” As such, the bankruptcy court concluded, the debtor was collaterally estopped from re-litigating the issue of willfulness and held that the debtor had acted willfully when discriminating against and terminating Ms. Fuller.

The Debtor's Actions Were Malicious

The bankruptcy court then considered whether the issue of malice—meaning “wrongful and without just cause or excuse, even in the absence of hatred, spite, or ill-will”¹²—could not be relitigated based on collateral estoppel under the same two-part test it used to examine whether the debtor's actions had been willful.

As it did for the prong of willfulness, the bankruptcy court found that the judgment under Human Rights Law Section 296(1)(a) was predicated on material and necessary factual findings that were sufficient to support a finding of “malicious” injury under Bankruptcy Code Section 523(a)(6).

According to the bankruptcy court, the findings of fact, opinion, and order of the ALJ, adopted in their entirety by the Human Rights Division and affirmed by the Appellate Division, indicated that the debtor had acted maliciously, as the opinion explicitly stated that his decision to terminate Ms. Fuller's employment was “direct and deliberate.” The Human Rights Division found that the debtor's problem with Ms. Fuller's “condition” motivated her termination, that her name was never changed on her pay stub despite a court order to that effect, and that Ms. Fuller repeatedly was told that she could have her job back if she wore men's clothing.

The bankruptcy court added that the debtor's “incredulous assertion” that his “sympathetic and supportive behavior” showed an absence of malice was “not supported by the record of the ALJ, which found that [the debtor] had acted with unlawful discriminatory animus.”

According to the bankruptcy court, these findings of acts and the conduct of the debtor in the context of the surrounding circumstances also supported a finding of malice. It observed that the ALJ, although choosing to impose a civil penalty less than what was allowed for discriminatory acts explicitly found to be “willful, wanton, or malicious,” nevertheless imposed a civil penalty. Therefore, the bankruptcy court found malice to be implied by the state court finding of deliberate discrimination, the acts and conduct of the debtor in the context of the surrounding circumstances, and the imposition of a civil penalty.¹³

¹² *Ball v. A.O. Smith Corp.*, 451 F.3d 66, 70 (2d Cir. 2006) (quoting *Navistar Fin. Corp. v. Stelluti*, 94 F.3d 84, 87 (2d Cir. 1996)).

¹³ Relying on prior precedent, the bankruptcy court extracted an implication of malice from the ALJ's finding of deliberate discrimination, thereby satisfying the first prong in its collateral estoppel analysis. See *Rocco v. Goldberg*, 487 B.R. 112, 129 (Bankr. E.D.N.Y. 2013) (“It would defy logic to find that an overt act constituting disparate treatment discrimination, that is, discrimination aimed at an individual, could occur absent a malicious intent to harm. . . .”); *Basile v. Spagnola*, 473 B.R. 518, 524 (Bankr. S.D.N.Y. 2012) (quoting *Ball v. A.O. Smith Corp.*,

The bankruptcy court was not persuaded by the debtor's argument that the amount of the civil penalty proved the absence of malice. It reasoned that, in his introduction to the recommended civil penalty, the ALJ cited additional factors he considered for the appropriate civil penalty amount: "the goal of deterrence, the nature and circumstances of the violation, any relevant history of [the debtor's] actions, [the debtor's] financial resources, and other matters as justice may require." The bankruptcy court added that the ALJ did not provide an explicit breakdown of the factors he weighed when making his calculation. As a result, according to the bankruptcy court, it could not be inferred that the dollar amount of the civil penalty unequivocally *disproved* malice as much as one could not infer that it unequivocally *proved* malice. The bankruptcy court ruled that the civil penalty, however, did act as a "persuasive basis for malice implicit" in the "direct and deliberate" discrimination found by the ALJ.

Finally, the bankruptcy court also decided that the debtor had a "full and fair opportunity" to litigate the "malice" prong of the Section 523(a)(6) exception to discharge, just as he had a full and fair opportunity to litigate with regard to the "willfulness" prong. The debtor "sufficiently participated in the prior litigation" and the record of the prior litigation was "robust," the bankruptcy court noted.

It added that determining "malice" was necessary to the resolution of the prior action as the judgment was predicated on material and necessary factual findings that were sufficient to support a finding of "maliciousness."

As such, the bankruptcy court ruled, the debtor was collaterally estopped from re-litigating the issue of malice and it found that the debtor had acted maliciously when discriminatorily terminating Ms. Fuller.

The bankruptcy court held that the findings of fact, opinion, and order of the ALJ, adopted by the Human Rights Division and affirmed by the Appellate Division, were entitled to preclusive effect because the debtor had a full and fair opportunity to litigate the issues, and the issues litigated were necessary to the resolution of the state court action. Therefore, the debtor was collaterally estopped from re-litigating those findings.

Accordingly, it concluded that the debtor's actions were willful and malicious, and Ms. Fuller's claim was excepted from discharge pursuant to Section 523(a)(6).

The Supreme Court Cases

The U.S. Supreme Court has granted certiorari in three cases that, at least in

451 F.3d 66, 69 (2d Cir. 2006) (acts that are "so morally reprehensible and degrading to one's personal dignity that the [actor's] conduct cannot possibly be considered anything other than 'wrongful and without just cause or excuse.'").

the debtor's view, should have impacted the bankruptcy court's decision: *Altitude Express v. Zarda*, *Bostock v. Clayton County, GA*; *Bostock v. Clayton County, Georgia*; and *R.G. & G.R. Harris Funeral Homes v. Equal Employment Opportunity Commission*.¹⁴ The debtor contended that, in deciding these cases, the Court would have to resolve a split among circuits regarding whether termination due to transgender status constituted a civil rights violation, arguably negating malice in such a termination if it did not. In essence, the debtor argued that if a transgendered person did not belong to a protected class, then there was no deliberate discrimination from which malice could be inferred in his case.

The bankruptcy court found the debtor's argument on this point to be "without merit."

It explained that, in rendering its judgment, the ALJ found that Ms. Fuller was transgender, that her gender dysmorphia constituted a disability, and that she was deliberately discriminated against on the basis of disability. The bankruptcy court added that it found that implied malice existed by the debtor's "deliberate discrimination" and based on the surrounding circumstances as well as by virtue of the civil penalty imposed on the debtor.

The bankruptcy court then declared that a ruling by the U.S. Supreme Court that transgendered persons were not members of a protected class for the purposes of Title VII of the Civil Rights Act "would not change the finding of malice in the [debtor's] case." The bankruptcy court reasoned that the judgment it found to be subject to the exception to discharge was a state court judgment, implementing the New York State Human Rights law, not federal civil rights laws. The bankruptcy court noted that a New York trial court has found that gender identity disorder was a disability under the New York State Human Rights Law,¹⁵ and that, as a federal bankruptcy court, it was required to give "full faith and credit to valid state court judgments."¹⁶

¹⁴ The three cases are set to be heard by the Supreme Court in its 2019–2020 term and question whether the prohibition in Title VII of the Civil Rights act of 1964 against employment discrimination "because of . . . sex" encompassed discrimination based on an individual's sexual orientation. See Petition for Writ of Certiorari, *Altitude Express v. Zarda*, No. 17-1623 (U.S. filed May 29, 2018), Petition for Writ of Certiorari, *Bostock v. Clayton County, Georgia*, No. 17-1618 (U.S. filed May 25, 2018), Petition for Writ of Certiorari, *R.G. & G.R. Harris Funeral Homes Inc. v. Equal Employment Opportunity Commission*, No. 18-107 (U.S. filed July 20, 2018). *R.G. & G.R. Harris Funeral Homes* also asks whether "sex" means "gender identity" and includes "transgender status." Petition for Writ of Certiorari, *R.G. & G.R. Harris Funeral Homes Inc.*, No. 18-107.

¹⁵ See *Doe v. Bell*, 194 Misc.2d 774, 778 (N.Y. Sup. Ct. 2003).

¹⁶ See U.S. Const. art. IV § 1; 28 U.S.C. § 1738.

The bankruptcy court concluded that, in the event that the U.S. Supreme Court decided that transgendered individuals were not members of a protected class for purposes of Title VII of the Civil Rights Act, Ms. Fuller “would still belong to a protected class for the purposes of New York State Human Rights Law and her state court judgment would still be valid.” As a result, the bankruptcy court found that the debtor’s actions against Ms. Fuller still would be considered “malicious” for dischargeability purposes.

CONCLUSION

The New York bankruptcy court’s decision finding that the state court judgment in favor of Ms. Fuller was nondischargeable was a significant ruling about the effects of gender discrimination in bankruptcy cases. Whether it will be followed by bankruptcy courts around the country considering other state anti-discrimination laws remains to be seen. Likewise, time will tell whether a Supreme Court ruling that transgendered individuals are or are not members of a protected class will impact other court decisions applying the willful and malicious standards in determining exceptions to dischargeability under Section 523(a)(6).

Stay tuned.