No. _______

In The

Supreme Court of the United States

♦

TKC AEROSPACE INC.,

Petitioner,

v.

CHARLES TAYLOR MUHS,

Respondent.

♦

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

♦

PETITION FOR WRIT OF CERTIORARI

♦

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QUESTION PRESENTED

Under 11 U.S.C. § 523(a)(6), a debt may not be discharged in bankruptcy if it arises from a "willful and malicious injury by the debtor to another." In *Kawaahua v. Geiger*, 523 U.S. 57, 61-64 (1998), this Court held that this exception to discharge only applies when the debtor acted with "the **actual intent** to cause injury" (emphasis added). Since *Geiger*, this Court has offered no further guidance on the evidence needed to meet this "actual intent" requirement. Interpreting *Geiger*, nearly all circuits considering this issue have held that a debtor's actions qualify as causing a "willful and malicious" injury where he or she acted with (1) actual, subjective intent to cause injury, or (2) "substantial certainty" that injury would result from the debtor's conduct. However, circuits are split over whether this "substantial certainty" prong requires proof of the debtor's *subjective* belief that injury was certain or whether proof of the *objective* certainty that an injury would result from the debtor's acts satisfies the intent requirement. At last count, three circuits—the Fifth, the Seventh, and the Fourth (in an opinion predating the opinion below in this case) have held that proof of objective certainty is sufficient. The Ninth and Tenth Circuits disagree with that approach.

The question presented is:

Whether a debtor's conduct qualifies as causing a "willful and malicious" injury under Section 523(a)(6) when the debtor's acts were *objectively certain* to result in the injury giving rise to the debt.

CORPORATE DISCLOSURE STATEMENT

Tumeq, LLC owns 100% of the stock of TKC Aerospace, Inc.

RELATED CASES

- *TKC Aerospace, Inc. v. Muhs*, No. 3:11-cv-0189-HRH, United States District Court for the District of Alaska. Judgment entered March 7, 2016.

- *TKC Aerospace, Inc. v. Phoenix Heliparts, Inc., et al.*, No. CV 2011-018889, Superior Court of Arizona in Maricopa County. Judgment entered January 30, 2015.

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PETITION FOR WRIT OF CERTIORARI

TKC Aerospace, Inc. ("TKCA") respectfully petitions this Court for a *writ of certiorari* to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

INTRODUCTION

Under 11 U.S.C. § 523(a)(6), a debt "for willful and malicious injury by the debtor to another" is nondischargeable in bankruptcy. In the case at bar, the debtor inflicted injury on TKCA when the debtor "willfully and maliciously" stole TKCA trade secrets as part of a scheme to take TKCA's business. Despite the debtor's willful and malicious theft in violation of the Uniform Trade Secrets Act, the Fourth Circuit relied on this Court's prior ruling in *Kawaahua v. Geiger*, 523 U.S. 57, 61-64 (1998) to find that the debtor may not have had the required intent to injure to render the debt nondischargeable.

In *Geiger*, this Court held that the exception to dischargeability under Section 523(a)(6) covers only "acts done with the **actual intent** to cause injury" and not "debts arising from recklessly or negligently inflicted injuries" (emphasis added).

In the twenty years since *Geiger*, courts have struggled to define the *scienter* necessary for "actual intent." Nearly all circuits considering this issue post-*Geiger* have held that an action qualifies as "willful and malicious" for purposes of Section 523(a)(6) where a debtor acted with (1) actual, subjective intent to cause injury, or (2) certainty or "substantial certainty" that injury would result. While formulations of this test vary between the circuits in a number of respects,[1] an intractable circuit split has arisen with respect to one critical issue—whether the "substantial certainty" prong requires proof of the debtor's subjective thought process (i.e., requiring subjective belief that injury is "substantially certain") or whether proof of the objective certainty that the debtor's conduct would cause injury is sufficient to meet the willful and malicious threshold.

The Fifth Circuit has held in *In re Miller*, 156 F.3d 598, 603 (5th Cir. 1998), and confirmed in numerous subsequent opinions, that the "substantial certainty" test does not require proof of subjective intent to injure, but can be satisfied where injury is objectively certain to result from a debtor's actions, based on the totality of the circumstances. The Fourth Circuit, in an opinion predating the judgment below, has adopted the *Miller* test. The Seventh Circuit, although not citing *Miller* specifically, has also announced that it follows an objective approach. In contrast, the Ninth and Tenth Circuits disagree with *Miller* and have instead held that proof of the debtor's subjective intent to injure is required.

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[1] Indeed, while not the subject of this petition, courts are also divided as to whether "willful" and "malicious" should be treated as separate elements. *See, e.g., In re Ausley*, 507 B.R. 234, 240 (Bankr. W.D. Tenn. 2014) (observing that "[s]ubsequent to *Geiger*, the Circuits are split as to whether the 'willful and malicious' requirements are to be addressed separately, or whether the § 523(a)(6) inquiry is an integrated test."). This question is secondary to the more fundamental issue of whether *Geiger* demands proof of *subjective* intent to cause harm, or is satisfied where harm is *objectively* certain to result from the debtor's actions.

This growing circuit split has been recognized for years at both the circuit court and district court levels. *See, e.g., In re Monson*, 661 Fed. Appx. 675, 684 (11th Cir. 2016) ("As we recently noted, our sister Circuits are split as to whether the 'substantially certain' prong of the standard requires a subjective or objective standard."); *In re Margulies*, 566 B.R. 318, 329 (S.D.N.Y. 2017), *aff'd*, 721 Fed. Appx. 98 (2d Cir. 2018) ("[T]here is a long-standing Circuit split regarding the 'substantial certainty' test, and whether it ought be judged subjectively or objectively . . . . That split persists."); *In re Smithey*, 03-64290, 2005 WL 6490601, at *4 (Bankr. N.D. Ga. Feb. 9, 2005) ("A post-*Geiger* split amongst Circuit and Bankruptcy Courts illustrates that the scope of the requisite intent needed to establish willful conduct continues to be unclearly defined.").

For debtors and creditors litigating whether a debt is dischargeable, the stakes are considerable. Debtors found liable for egregious acts, like those involved in the instant case (i.e., the theft or misuse of trade secrets), routinely seek to discharge in bankruptcy what amounts to millions of dollars of debts owed for injuries flowing from the debtors' wrongful conduct. As the law currently stands, bankruptcy courts tasked with resolving disputes over the dischargeability of those debts must navigate a web of inconsistent precedent. Courts within those circuits that have not yet weighed in on the subjective/objective debate face even greater uncertainty, as some district courts within nearly all of those circuits have been forced to decide whether a debt is dischargeable without a defined standard to guide those courts through the adjudication process.

In the case at bar, two courts—the United States District Court for the District of Alaska and the Superior Court of Arizona in Maricopa County—found that Respondent Charles Taylor Muhs ("Muhs") *willfully and maliciously* stole trade secrets from his employer, Petitioner TKC Aerospace, Inc. ("TKCA"), as part of a plan to divert on-going contracting opportunities to a competitor. Based upon the findings that Muhs willfully and maliciously stole trade secrets, a judgment in excess of $20 million was entered against him. Departing from the Fifth Circuit, the Seventh Circuit, and its own prior precedent, and ignoring a mountain of facts detailing Muhs' betrayal of his employer's trust and brazen use of TKCA trade secrets to aid a competitor and harm TKCA, the Fourth Circuit granted Muhs' appeal and held it was not clear that Muhs' theft of TKCA's trade secrets and assisting a competitor constituted inflicting a "willful and malicious" injury upon TKCA sufficient to render his debt non-dischargeable. In its ruling, the court declined to consider whether Muhs' conduct satisfied the objective "substantial certainty" test, although it was *objectively* certain that injury to TKCA would result from Muhs' theft of TKCA trade secrets and his handing them to a competitor. In granting Muhs' appeal and requiring TKCA to establish Muhs' *subjective* intent to injure, despite the objective certainty that injury to TKCA would result from Muhs' misappropriation of TKCA trade secrets, the Fourth Circuit deepened the circuit split over the measure of proof needed to establish the intent to cause a "willful and malicious injury" under the Bankruptcy Code.

Moreover, the decision below constitutes an unprecedented attack on the Uniform Trade Secrets Act ("UTSA") and the Bankruptcy Code's protections for creditors who have suffered a willful and malicious misappropriation of trade secrets. Until the Fourth Circuit's decision that is the subject of this appeal, no court had held that that a debtor found liable for a willful and malicious theft of trade secrets under the UTSA could escape the Bankruptcy Code's prohibition on discharging debts arising from a "willful and malicious injury by the debtor to another".

As a result, the Fourth Circuit's opinion threatens to undermine the UTSA and make it more difficult for victims of trade secret misappropriation to protect their rights. An objective test for "willfulness" is necessary in order to prevent debtors like Muhs, whose well-documented actions against his employer would undoubtedly create an objective "substantial certainty" of harm, from discharging judgments against them in bankruptcy. In both reasoning and result, the Fourth's Circuit's decision is flawed.

This Court should not allow that decision to stand. The writ should be granted, and the Fourth Circuit's judgment should be reversed.

OPINIONS BELOW

The Fourth Circuit's decision below is reported at 923 F.3d 377 and reproduced at App. 1a. The Order of the United States Bankruptcy Court for the Eastern District of Virginia, granting TKCA's motion for summary judgment on the issue of nondischargeability, is reproduced at App. 34a, and the opinion of the United States District Court for the Eastern District of Virginia, affirming that decision on appeal (before it was reversed by the Fourth Circuit), is reproduced at App. 30a.

While not the subject of this petition, a prior Order of the bankruptcy court and opinion of the district court in this case—in which the district court ultimately ruled that the doctrine of collateral estoppel barred re-litigation of the facts in the Alaska case and, therefore, that any decision as to nondischargeability of the judgment against Muhs should be made based on the record in those earlier proceedings—are reproduced at App. 48a and App. 38a, respectively. The district court opinion is also available at 2017 WL 4638588.

The Fourth Circuit's judgment denying rehearing in this case is reproduced at App. 50a.

JURISDICTION

The Fourth Circuit entered judgment on May 8, 2019. Petitioner filed a timely petition for *rehearing en banc*, which was denied on June 4, 2019. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

11 U.S.C. § 523(a)(6) provides as follows:

> (a) 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 . . . . .

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

STATEMENT OF THE CASE

I. Two Courts Have Found Muhs Liable for Willful and Malicious Theft of Trade Secrets.

Two courts, the United States District Court for the District of Alaska and the Superior Court of Arizona in Maricopa County, found that Muhs willfully and maliciously stole trade secrets from his employer, TKCA, as part of a plan to divert on-going contracting opportunities to a competitor.

From TKCA's inception in 2005 until 2011, Muhs acted as TKCA's Vice President of Business Development. TKCA specialized in aircraft procurement, logistics, and support. App. 3a–4a. In that role, Muhs had access to TKCA's proprietary information, which enabled TKCA to pursue and win aviation-related contracts with the Department of State ("DoS"). *Id.* Given his key role and access to confidential information, TKCA and Muhs agreed to a non-disclosure/non-compete agreement prohibiting him from disclosing TKCA proprietary information to third parties and competing against TKCA. *Id.*

In disregard of his agreement with TKCA, Muhs secretly began working with a competitor of TKCA, Phoenix Heliparts, Inc. ("PHP"), funneling confidential TKCA information and documents to enable PHP to steal TKCA work. *Id.* Ultimately, in September 2011, Muhs and PHP used TKCA information to win a $24 million DoS Dash 8 (Aircraft) Contract that DoS would have awarded to TKCA absent Muhs' theft of TKCA trade secrets and Muhs' efforts to thwart TKCA's attempts to bid for that work. App. 139a–140a.

Upon discovering the Muhs/PHP scheme, TKCA filed two lawsuits in the fall of 2011: one against Muhs, individually, in the District of Alaska and a second against PHP in the Superior Court of Arizona in Maricopa County. App. 4a–5a. In both actions, TKCA sought relief under the UTSA, as adopted by Arizona and Alaska, arising from Muhs and PHP's misappropriation of TKCA's trade secrets. *Id*. In response to TKCA's suit, Muhs moved to stay the Alaska action, in favor of the Arizona state court action, arguing that both cases sought identical relief and involved the same factual and legal issues—the "fundamental linchpin of both being the alleged wrongdoing of Muhs" (i.e., through his misuse of TKCA confidential information to assist a competitor). App. 56a–57a. If TKCA prevailed in the Arizona case against PHP, Muhs admitted, "then [he] would be collaterally estopped from arguing differently" in the Alaska case. App. 5a. Despite TKCA's opposition to the motion to stay the action against Muhs, the Alaska court decelerated its schedule to allow the Arizona court to proceed to trial on whether PHP and Muhs conspired to steal TKCA trade secrets and take TKCA's work. *Id*.

Following a **40-day bench trial**, the Arizona state court entered judgment in favor of TKCA and against PHP on the Arizona UTSA claim. App. 6a. The court entered Judgment in the total amount of $20,295,782.58, including $13,530.521.72 in exemplary damages on account of the court's finding that PHP engaged in "willful and malicious misconduct," and "willfully and maliciously misappropriated TKCA's trade secrets" to pursue and win the $24 million DoS Dash 8 contracting opportunity.[2] *Id.* Among other findings, the Arizona court held that **"PHP formed an agency relationship" with Muhs and "[b]ecause of th[is relationship], this court will attribute [Muhs'] acts to PHP."** *Id.* (emphasis added). It was Muhs, PHP's agent, who "*acted with an evil mind intending to injure* TKCA by intentionally interfering with TKCA's contracts and opportunities, and then using TKCA's proprietary information to misappropriate those opportunities." App. 9a (emphasis in original). He was the one with access to TKCA's trade secrets, and he was the one who passed those trade secrets on to PHP to enable PHP to take TKCA's business.

The Arizona court did not stop there as it detailed Muhs' plan to misappropriate TKCA trade secrets so that PHP could steal TKCA work. The evidence established that Muhs uploaded approximately 1600 TKCA documents, including many that had been marked "strictly confidential," onto PHP's server, including:

- TKCA proposals to DoS
- TKCA Business Plans
- TKCA pricing information
- TKCA statements of work
- TKCA Evaluation Notices

[2] The Arizona statute specifically provides that exemplary damages are available only "[i]f willful and malicious misappropriation exists." App. 6a, n. 2 (quoting Ariz. Rev. Stat. Ann. § 44-403(B)).

App. 80a–90a, 143a–144a, 149a–150a. On at least one occasion, Muhs diverted a signed letter of intent sent to TKCA by an aircraft manufacturer (which contained confidential information about DoS needs, the aircraft that met those needs, pricing, terms, and conditions) to PHP. App. 79a–80a. Through the use of the information contained in these documents, PHP was able to successfully bid on a $24 million DoS contract that it never could have otherwise won. *Id.* As part of the plan to assist TKCA's new competitor, PHP, Muhs also "withheld vital information from TKCA so that PHP could establish a material and temporal advantage [over TKCA] in preparing a successful proposal in response to the DoS solicitation." App. 149a. The Arizona court even found that PHP, through its agent Muhs, **"acted with an evil mind intending to injure TKCA by intentionally interfering with TKCA's contracts and opportunities and then using TKCA's proprietary information to misappropriate those opportunities."** App. 9a. (emphasis added).[3] As was evident from the detailed findings in the Arizona court's sixty-one page decision, Muhs and PHP successfully schemed to use TKCA trade secrets to allow PHP to steal the DoS Dash 8 contracting opportunity, which naturally "harmed" TKCA. App. 140a–156a.

On October 22, 2015, after reviewing the Arizona court's record, the Alaska court applied collateral and equitable estoppel to grant TKCA's motion for summary judgment, holding that Muhs

[3] The record detailed countless additional acts of misconduct by Muhs and his confederates at PHP, including destruction of documents. App. 96a–100a.

stole TKCA trade secrets, and then awarded exemplary damages to TKCA under the Alaska UTSA, based on Muhs' willful and malicious misappropriation of TKCA trade secrets. App. 10a, 51a-53a.

II. Muhs Has Sought to Discharge the Alaska Judgment in Bankruptcy, and the Fourth Circuit's Latest Decision May Allow Him To Do So.

On July 1, 2016, and shortly after the Alaska Judgment had been domesticated in Fairfax County, Virginia, Muhs filed a bankruptcy petition under Chapter 7 of Title 11 of the United States Code in the Bankruptcy Court for the Eastern District of Virginia in an effort to discharge the Alaska judgment. App. 11a. On October 11, 2016, TKCA filed an adversary proceeding against Muhs alleging that the Alaska Judgment is not dischargeable in Bankruptcy under 11 U.S.C. §§ 523(a)(2), (4), and (6).[4] App. 11a–12a. In its complaint, TKCA represented that the Alaska and Arizona courts' findings—including a finding that Muhs willfully and maliciously misappropriated trade secrets in violation of the UTSA—precluded Muhs from discharging the judgment in Bankruptcy.

On November 3, 2017, after an interlocutory appeal to the district court, the bankruptcy court entered summary judgment in TKCA's favor, holding that Muhs' debt to TKCA is nondischargeable under 11 U.S.C. § 523(a)(6). App. 34a–37a. The court held:

[4] The bankruptcy court had jurisdiction over that adversary proceeding pursuant to 28 U.S.C § 1334.

> The Alaska court, adopting the findings of the Superior Court of Arizona, necessarily found that [Muhs'] misappropriation of trade secrets rose to the level of willful and malicious when it awarded exemplary damages under its version of the Uniform Trade Secrets Act. Necessary to proving nondischargeability under Section 523(a)(6) is that the plaintiff prove the injury resulted from willful and malicious conduct.

Id. at 36a.

On March 12, 2018, the United States District Court for the Eastern District of Virginia affirmed the bankruptcy court's ruling, holding that the nondischaregeability determination was "entirely consistent with the facts underlying the Alaska judgment, with the findings of the United States District Court for the District of Alaska, with the law of the case, with the mandate of this Court, and with applicable bankruptcy law." App. 33a. Muhs subsequently appealed that ruling to the Fourth Circuit, and on May 8, 2019, a Fourth Circuit panel, contrary to the rulings of a United States District Judge, a United States Bankruptcy Judge, and an Arizona state court, reversed the district court's ruling. The Fourth Circuit panel held that it was not clear that Muhs' conduct was "willful and malicious," rendering his debt to TKCA nondischargeable in bankruptcy, because **"whether Appellant specifically had the requisite intent to injure TKCA was neither actually decided in, nor essential to, the Alaska Action."** App. 26a (emphasis added). The court remanded this case for further proceedings, which will likely now involve a trial to re-litigate the facts already found in the Arizona and Alaska actions.

Petitioner subsequently filed a petition for *rehearing en banc*, which the Fourth Circuit denied on June 4, 2019. App. 50a.

REASONS FOR GRANTING THE PETITION

In the twenty years since *Geiger*, courts have struggled to define the state of mind that must be proven in order to establish that a debtor's conduct was "willful and malicious" for purposes of nondischargeability under Section 523(a)(6) of the Bankruptcy Code. Three circuits—the Fifth Circuit, the Seventh Circuit, and the Fourth Circuit (in an opinion predating the decision below) have held that it is sufficient to prove harm was objectively "substantially certain" to result from debtor's conduct. The Ninth and Tenth Circuits disagree with that approach, instead requiring proof of the debtor's subjective intent to cause harm or subjective belief that injury was "substantially certain" to result from his or her conduct in order for a judgment to be nondischargeable. This Court's intervention is needed to resolve an intractable division between the circuits on this question of significant economic and legal importance.

Moreover, this Court's intervention is needed in order to protect the rights of victims of "willful and malicious" trade secret thefts. The Fourth Circuit's decision makes plain that adoption of a purely subjective test for "willfulness" under Section 523(a)(6) allows Muhs and others like him, whose brazen misconduct created an objective "substantial certainty" of harm, to still seek discharge because the debtor's state of mind was not detailed in the trial court's finding of a "willful and malicious" trade secret misappropriation.

Had the Fourth Circuit applied the objective test adopted by the Fifth Circuit, the Seventh Circuit, and its own prior precedent, Muhs' debt would certainly have been classified as the result of a "willful and malicious" injury and, therefore, nondischargeable under Section 523(a)(6), as there is no objective doubt as to whether the willful and malicious theft of TKCA's trade secrets to assist a TKCA competitor constituted a "willful and malicious injury" under Bankruptcy Code Section 523(a)(6). Because of the egregiousness of Muhs' conduct, the deepening of this circuit split, and the Fourth Circuit's refusal to reconsider its position, this is an ideal case in which to settle this ongoing dispute, and resolve the split in authority.

Certiorari should be granted.

I. There is a Clear Circuit Split Over Whether Conduct *Objectively* "Substantially Certain" to Result in Injury Qualifies as "Willful and Malicious" Under Section 523(a)(6).

Nearly all circuits have held that a debtor's conduct qualifies as "willful and malicious" for purposes of Section 523(a)(6) where he or she acted with (1) actual, subjective intent to cause injury, or (2) certainty or "substantial certainty" that injury would result. However, the circuits are sharply divided as to whether the "substantial certainty" prong requires proof of the debtor's subjective beliefs (i.e., requiring subjective belief that injury is "substantially certain") or whether proof of the *objective* certainty that the debtor's conduct would cause injury is sufficient. This split has been widely acknowledged, has deepened, and requires this Court's intervention.

A. The Fifth Circuit, the Seventh Circuit, and the Fourth Circuit (in a Decision Predating the Opinion Below) Have Adopted an *Objective* "Substantial Certainty" Test.

Three circuits—the Fifth Circuit, the Seventh Circuit, and the Fourth Circuit (in a decision predating the opinion below) have adopted an objective test for "willful and malicious injury" under Section 523(a)(6).

1. The Fifth Circuit in *In re Miller*, 156 F.3d 598, 606 (5th Cir. 1998) was the first circuit to formally adopt an objective test for "willfulness" under Section 523(a)(6), and that decision remains one of the most thorough discussions of the issue by any Circuit Court of Appeals. Similar to Muhs, Miller was found liable in state court for "misappropriate[ing] proprietary information or misus[ing] trade secrets" of his former employer, and a $1 million judgment was entered against him in favor of that company. *Id*. at 601. When Miller sought to discharge his debt in bankruptcy, his former employer initiated an adversary proceeding seeking a determination that the judgment was nondischargeable under Section 523(a)(6), among other grounds. *Id*. The bankruptcy court granted

the employer's motion for summary judgment, holding that the debt was nondischargeable, although not under Section 523(a)(6) specifically. *Id.* On appeal, the district court held that the debt was also nondischargeable under Section 523(a)(6), reasoning that the "the jury's finding that Miller had misappropriated proprietary information or misused trade secrets for his own advantage to the detriment of [his employer]" qualified as a "willful and malicious injury" for purposes of that section, and that Miller was collaterally estopped from arguing otherwise. *Id.*

The matter was then appealed to the Fifth Circuit. As *Geiger* had been decided only months earlier, the Fifth Circuit took this opportunity to opine on the post-*Geiger* mental state that must be proven for a debtor's conduct to qualify as "willful and malicious." Noting that *Geiger* "certainly eliminates the possibility that 'willful' encompasses negligence or recklessness," but rather requires "actual intent" to cause injury, the court went on to consider three options. *Id.* at 603. The court reasoned that "[t]he standard might be met by **any tort generally classified as an intentional tort, by any tort substantially certain to result in injury, or any tort motivated by a desire to inflict injury."** *Id.* (emphasis added). The court rejected the possibility that all "intentional torts" should be considered "willful" under *Geiger*, explaining that the label "intentional tort" has grown too broad and encompasses acts which, although wrongful, are not always certain to result in harm. *Id.* at 604. "[R]ather than allow the general classification of a tort to be a talisman," the court wisely chose to adopt a two-part test which had itself served as an early definition of "intentional tort." *Id*. (citing Kenneth J. Vandevelde, *A History of Prima Facie Tort: The Origins of a General Theory of Intentional Tort*, 19 Hofstra L. Rev. 447, 447 (1990)). That test, which the court thus adopted, is as follows: "an injury is 'willful and malicious' where there is either an objective substantial certainty of harm or a subjective motive to cause harm." *Id*. at 606. As for Miller, the court held that the state court jury failed to find either the "objective substantial certainty of harm" or "subjective motive to cause harm" needed to sustain the district court's judgment. *Id*.[5] The matter was remanded for further proceedings. *Id*.

The Fifth Circuit has reaffirmed its commitment to an objective "substantial certainty" test in numerous decisions following *In re Miller*. In *In re Williams*, 337 F.3d 504, 511-12 (5th Cir. 2003) the Fifth Circuit held, among other issues on appeal, that a judgment against the debtor Williams for "purposefully and willfully" violating a court's Agreed Final Judgment and Decree was nondischargeable in bankruptcy. The court confirmed that conduct that is objectively "substantially certain" to cause harm, regardless of subjective intent, satisfies the test for nondischargeability under Section 523(a)(6), reasoning that "[e]ven if Williams did not intend to injure the Union, the Agreed Judgment made him

[5] In contrast, an Arizona judge issued a sixty-one page opinion thoroughly detailing Muhs' misconduct, and the harms that befell TKCA as a direct and reasonably foreseeable result. Under the *objective* "substantial certainty" test, those findings undoubtedly qualify Muhs' conduct as "willful and malicious," and therefore render the judgment against him nondischargeable as a matter of law.

substantially certain that his acts would inflict injury. The bankruptcy court properly found that Williams's violation of the Agreed Judgment resulted in a willful and malicious injury." *Id*. at 512.

Likewise, the Fifth Circuit confirmed the objective "substantial certainty" test in *In re Vollbracht*, 276 Fed. Appx. 360, 361 (5th Cir. 2007). There, the court considered whether a judgment against the debtor for civil assault was nondischargeable under Section 523(a)(6). *Id*. The bankruptcy court held that it was dischargeable, but specifically failed to consider whether the debtor's conduct satisfied the "objective" test. *Id*. at 362. The district court affirmed, but the Fifth Circuit reversed the judgment below and remanded the case for consideration of the "objective test," explaining that "[e]ven if Vollbracht subjectively did not intend any harm, his conduct may still be objectively willful and malicious." *Id*. at n.6.

More recently, the Fifth Circuit has applied the objective "substantial certainty" test in *In re Shcolnik*, 670 F.3d 624, 630 (5th Cir. 2012). In that case, the court considered whether a $50,000 judgment against the debtor Shcolnik for attorneys' fees, pursuant to a Texas statute authorizing an award of attorneys' fees by an arbitrator, was nondischargeable in bankruptcy under Section 523(a)(6). While the bankruptcy court granted summary judgment for the debtor, holding as a matter of law that the debt was dischargeable, the Fifth Circuit, applying *Miller*, reversed and remanded the case for further proceedings. Even though "Texas law may allow the arbitrator to assess attorneys' fees in favor of a party without specifically finding a willful and malicious injury," the court held that was not conclusive and Shcolnik may still have "acted so as to create 'an objective substantial certainty of harm.' " *Id.* at 629-630.

2. The Seventh Circuit in *Gerard v. Gerard*, 780 F.3d 806, 811 (7th Cir. 2015), although not citing *Miller* specifically, has also adopted an objective test for "willful and malicious" injury under Section 523(a)(6). In *Gerard*, the court announced that "willfulness is judged by an objective standard: it 'can be found either if the 'debtor's motive was to inflict the injury, or the debtor's act was substantially certain to result in injury.''" *Id.* The issue before the court in *Gerard* was whether a judgment against the debtor for slander of title was nondischargeable under Section 523(a)(6). *Id.* at 811-12. While both the bankruptcy court and the district court held that "the state court jury's slander of title findings preclusively established" that the debtor acted "willfully" under Section 523(a)(6), the Seventh Circuit remanded the case for further proceedings because there was a possibility that the jury's verdict was based on the debtor's mere "negligence." *Id.*

3. The Fourth Circuit in *In re Parks*, 91 Fed. Appx. 817, 819 (4th Cir. 2003), an unpublished opinion predating the decision below in this case, specifically adopted the *Miller* test for "willful and malicious" conduct under Section 523(a)(6). The debtor in that case, Parks, was found liable for tortiously injuring (shooting) a man who entered his store. *Id.* A money judgment was entered against Parks, which he subsequently sought to discharge in bankruptcy. *Id.* The bankruptcy court held that the

judgment was nondischargeable under Section 523(a)(6), the district court vacated that judgment, then the Fourth Circuit vacated the judgment of the district court and remanded the case with instructions to reinstate the bankruptcy court's order. *Id*. at 819-820. The Fourth Circuit considered all of the facts in the record surrounding Parks' conduct, including that "Parks never claimed that the shooting was a mistake or an accident" and that that the victim's mother "testified that her other son [victim's brother] had a hostile encounter with Parks sometime before the shooting, suggesting a possible motive." It ultimately determined that the victim satisfied the test for "willful and malicious" conduct under *Miller*, and that the judgment against Parks was therefore nondischargeable. *Id*.

Since *Parks*, courts within the Fourth Circuit have accepted as settled law that the Fourth Circuit follows the two-part subjective intent and objective substantial certainty test set out in *Miller*, including as recently as this year. *See In re Anderson*, CV TDC-18-0977, 2019 WL 1227925, at *10 (D. Md. Mar. 15, 2019); *In re Cassidy*, 595 B.R. 507, 513–14 (Bankr. W.D. Va. 2019). As explained by the United States Bankruptcy Court for the District of Maryland in *In re Abell*, No. 17-00314, 2018 WL 3624462, at *7 (Bankr. D. Md. July 26, 2018):

> "Subsequently, the Fourth Circuit has adopted the so-called **"objective substantial certainty test" or "subjective motive" test.** In sum, the test "is whether the debtor acted with 'substantial certainty [that] harm [would result] or a subjective motive to

> cause harm.' " *In re Parks*, 91 Fed. Appx. at 819 (citations omitted; emphasis added).

In its opinion below, the Fourth Circuit panel in this case did not follow the two-part test announced in *Parks*, ignoring the objective certainty test adopted in that decision, despite the detailed record evidence here that Muhs' behavior would satisfy the objective certainty test. In reversing the district court and the bankruptcy court, the panel employed a limited definition of willfulness that fails to address the objective element adopted in *Parks* and followed by courts in the Fourth Circuit. For these and other reasons discussed herein, that decision is flawed.

4. Although no other circuits have directly adopted an *objective* test for "wilfullness" under Section 523(a)(6), numerous district courts within those Circuits have opted to follow the objective test. *See, e.g., In re White*, 551 B.R. 814, 822 (Bankr. S.D. Ohio 2016) ("'[A]n injury is willful and malicious where there is either an objective substantial certainty of harm or a subjective motive to cause harm.' ") (quoting *In re Shcolnik*); *In re Shelmidine*, 519 B.R. 385, 392 (Bankr. N.D.N.Y. 2014) ("To establish that a debt is one that arises from a willful injury, a plaintiff must make a showing of debtor's subjective intent to cause injury or debtor's objective knowledge that his acts were substantially certain to cause injury."); *In re Swasey*, 488 B.R. 22, 38 (Bankr. D. Mass. 2013) ("In the First Circuit, many courts, including this Court, have adopted the objective test without recognizing the split of authority among several circuits.").

B. The Ninth and Tenth Circuits Disagree with *Miller* and the *Objective* Approach and Have Instead Required Proof that a Debtor *Subjectively* Believed Injury was "Substantially Certain" to Occur.

In contrast, two circuits—the Ninth and Tenth Circuits—have directly rejected the objective test, holding instead that a debtor's conduct only qualifies as "willful and malicious" for purposes of Section 523(a)(6) if a debtor (1) subjectively intended to cause harm or (2) subjectively believed that injury was "substantially certain" to result from his or her conduct.

1. The Ninth Circuit's decision in *In re Su*, 290 F.3d 1140, 1145–46 (9th Cir. 2002) is one of the few published opinions to specifically reject the objective approach followed by the Fifth Circuit and others. The debtor Su in that case had injured another driver after running a red light. *Id*. at 1141. A jury found that he was liable for negligence and "malice by clear and convincing evidence" and entered a money judgment against him in favor of the injured driver. *Id*. The issue before the court was whether the judgment against Su was nondischargeable under Section 523(a)(6) of the Bankruptcy Code.

There had been some confusion among the lower courts as to the standard for "willfulness" applied in the Ninth Circuit for purposes of Section 523(a)(6). In *In re Su*, the Ninth Circuit confirmed that it follows a *purely subjective* test for "willfulness" under Section 523(a)(6), and provided limited explanation for its rejection of the objective approach. In the opinion of the Ninth Circuit, "§ 523(a)(6) renders debt nondischargeable when there is either a subjective intent to harm, or a subjective belief that harm is substantially certain." *Id*. at 1144. "By its very terms," the court reasoned, "the objective standard disregards the particular debtor's state of mind and considers whether an objective, reasonable person would have known that the actions in question were substantially certain to injure the creditor." *Id*. at 1145. According to the Ninth Circuit, the objective standard resembles too closely the "reckless disregard" standard used in negligence, which is not intended to fall within the scope of Section 523(a)(6). *Id*. at 1145-46. "The subjective standard," the court has explained, "correctly focuses on the debtor's state of mind and precludes application of § 523(a)(6)'s nondischargeability provision short of the debtor's actual knowledge that harm to the creditor was substantially certain." *Id*. at 1146. The Ninth Circuit remanded the case for further consideration in light of this newly articulated *subjective* standard.

2. The Tenth Circuit, in the unpublished opinion *In re Englehart*, 229 F.3d 1163 (10th Cir. 2000), has likewise expressed disagreement with the objective test. According to the Tenth Circuit, "the 'willful and malicious injury' exception to dischargeability in § 523(a)(6) turns on the state of mind of the debtor, who must have wished to cause injury or at least believed it was substantially certain to occur . . . . [w]hen injury was 'neither desired nor in fact anticipated by the debtor,' it is outside the scope of the statute." *Id*.

The Tenth Circuit in *Englehart* concluded that those courts adopting the objective test are "not only at odds with . . . *Geiger*," but also "internally inconsistent." *Id.* The court expressed its opinion that the Fifth Circuit in *Miller* misinterpreted the traditional definition of "intentional torts"—which the Fifth Circuit cited and adopted as its test for "willfulness" under Section 523(a)(6)—suggesting that it is in fact a *subjective* test, not an *objective* test. *Id.* However, the court provided no basis for this contention and offered no further justification as to why a purely subjective test is more desirable than the objective test or more in keeping with the spirit of the Bankruptcy Code or this Court's *Geiger* opinion.

The *Englehart* opinion further illustrates the fundamental weakness of a purely subjective approach: rendering "substantial certainty" a purely subjective inquiry essentially collapses that second prong of the "willfulness" test into the first prong—subjective intent to injure. The debtor in that case had failed to pay her husband's substantial medical expenses despite having received insurance proceeds for such expenses. *Id.* The question before the court was whether her resultant debt to the local medical center was nondischargeable in bankruptcy under Section 523(a)(6). *Id.* The bankruptcy court held that it was dischargeable because the debtor lacked subjective intent to cause harm. The court failed to even consider the second prong of the "willfulness" inquiry post-*Geiger*—whether there was a "substantial certainty" of harm. *Id.* The Tenth Circuit, because it had classified that second prong as a *subjective* inquiry, essentially conceded in its opinion that the second prong was, therefore, redundant of the first and affirmed the decision of the district court, affirming the bankruptcy court. *See id.* ("[W]hile the bankruptcy court did not specifically address the question of substantial certainty, **given the subjective character of that inquiry, the court's broad findings regarding the absence of evidence concerning state of mind suffice to settle that question as well."**) (emphasis added).

3. While not specifically rejecting the objective approach, or even discussing the circuit split, the Sixth Circuit in *In re Markowitz*, 190 F.3d 455, 464 (6th Cir. 1999) and the Eighth Circuit in *In re Patch*, 526 F.3d 1176, 1180–81 (8th Cir. 2008) have also articulated their own form of *purely subjective* tests for "willfulness" under Section 523(a)(6).

II. Resolving this Circuit Split in Favor of the *Objective* "Substantial Certainty" Test is of Considerable Importance

Individuals found liable for committing egregious acts, including theft of trade secrets, routinely seek to discharge what amounts to millions of dollars in judgments entered against them through bankruptcy. As the law currently stands, bankruptcy courts tasked with resolving disputes over the dischargeability of those debts must navigate a web of inconsistent precedent. Courts within those circuits that have not weighed in on the subjective/objective debate face even greater uncertainty, as some district courts within nearly all of those circuits have issued conflicting decisions identifying the proof needed to find that the debtor's acts caused a willful and malicious injury.

The question before this Court is profoundly important, as it will directly impact victims suffering a loss arising from a debtor's willful and malicious acts. Courts across the country have observed that whether a subjective or objective test applies in the "willful and malicious" analysis under Section 523(a)(6) has the potential to directly affect the outcome of dischargeability determinations. *See, e.g., In re Rezykowski*, 493 B.R. 713, 722 n.16 (Bankr. E.D. Pa. 2013) ("The use of a subjective standard, as opposed to an objective standard, may materially effect the outcome of a dischargeability proceeding."); *In re Cardin*, 11-52077, 2013 WL 1092118, at *8 (Bankr. E.D. Tenn. Jan. 31, 2013) ("Whether the substantial certainty test is an objective or subjective inquiry can determine the outcome of a dischargeability determination.").

Here, Muhs' scheme to steal business directly from TKCA—the details of which were thoroughly documented in a sixty-one page opinion issued by the Arizona state court—would qualify as "substantially certain" to cause injury to TKCA under an objective analysis, and would therefore be nondischargeable under Section 523(a)(6). As set forth above, Muhs uploaded to a competitor's network approximately 1600 TKCA documents, including many that had been marked "strictly confidential," including TKCA proposals to DoS, TKCA Business Plans, TKCA pricing information, TKCA statements of work, and TKCA Evaluation Notices. App. 80a–90a, 143a–144a, 149a–150a. Through the use of the information contained in these documents and through Muhs' assistance in preparing the PHP proposal to DoS, PHP was able to win a $24 million DoS contract. *Id*. As part of the plan to assist TKCA's new competitor, PHP, Muhs also "withheld vital information from TKCA so that PHP could establish a material and temporal advantage [over TKCA] in preparing a successful proposal in response to the DoS solicitation." App. 149a. But, because the Fourth Circuit panel determined that the record below didn't sufficiently detail Muhs' intent to injure TKCA when he stole TKCA trade secrets to steer a $24 million contract to a competitor, that ruling might allow Muhs to wipe away this debt forever.

The case before this Court is also considerably important because the decision below constitutes an unprecedented attack on the Uniform Trade Secrets Act and, in particular, the Bankruptcy Code's protections for creditors who have suffered a willful and malicious misappropriation of trade secrets. Neither counsel, nor any of the lower courts, have identified any published opinions by any bankruptcy court holding that a debtor who was found liable for willful and malicious trade secret misappropriation may discharge that debt in bankruptcy.

The bankruptcy court below (affirmed by the district court, but later reversed by the Fourth Circuit) correctly found that the "Alaska court's findings satisfy the standard for nondischargeability" under Section 523(a)(6). App. 35a. The Alaska court found that Muhs injured TKCA through a willful and malicious misappropriation of trade secrets when it awarded TKCA exemplary damages. That ruling is consistent with all other rulings from the Fourth Circuit, and beyond, holding that a finding of willful and malicious misappropriation prevents discharge under Section 523(a)(6).

The decision of the United States Bankruptcy Court for the Middle District of North Carolina in *In re Peterson*, No. 17-10066, 2018 WL 5883913, at *7 (Bankr. M.D.N.C. Nov. 6, 2018) is instructive. In that case, under facts very similar to those here, the court held that a debt arising from a willful and malicious theft of trade secrets was **not dischargeable**. The debtor in *Peterson* was found liable by a Maryland court for conducting a business in direct competition with his employer, in violation of North Carolina's version of the UTSA. *Id*. at 1-2. The court awarded the employer (Evapco) exemplary damages "as the Defendants had willfully and maliciously violated the North Carolina Trade Secrets Act." *Id*. at 2. Following entry of judgment against him, the debtor then filed for bankruptcy in North Carolina. *Id*. Because "the findings of the Maryland Judgment [we]re sufficient to establish that the Defendant's conduct was both willful and malicious with respect to the $993,950 award of punitive damages for purposes of § 523(a)(6)," the North Carolina Bankruptcy Court held that the debtor was collaterally estopped from arguing otherwise and ordered that the debt was nondischargeable. *Id*. at 7.

Similarly, the Eastern District of Virginia reached the same conclusion in *La Bella Dona Skin Care, Inc. v. Harton (In re Harton)*, Ch. 13 Case No. 12-36221-KRH, Adv. No. 13-03028-KRH, 2013 WL 5461832, at *4 (Bankr. E.D. Va. Oct. 1, 2013). Like this case, *Harton* was an adversary proceeding that addressed the dischargeability of a judgment stemming from willful and malicious misappropriation of trade secrets under the UTSA.

Id. at 1. In *Harton*, the court applied collateral estoppel to a larceny claim under Section 523(a)(4), while acknowledging that Harton's conduct "shares all of the elements of the kind excepted from discharge under 11 U.S.C. § 523(a)(6)," on account of Harton's "willful and malicious" conduct, which was "actually litigated in State Court." *Id*. at 4. The court held that the judgment was nondischargeable. As in *Harton*, the Alaska court's finding in this matter that Muhs willfully and maliciously misappropriated trade secrets should prevent discharge under Section 523(a)(4) and (6).

The Fourth Circuit's opinion, reversing the bankruptcy court and district court, breaks with this well-established line of cases and threatens to undermine the UTSA's protections for victims of the theft of trade secrets. Judgment creditors should not be required to prove that a debtor *subjectively intended* to cause harm or *subjectively believed* harm was certain to follow his or her actions in order for a judgment to be ruled nondischargeable under section 523(a)(6) in cases where it was *objectively certain* that harm would result from the debtor's actions.

An objective test for "willfulness" provides a bright-line test and is necessary in order to prevent debtors like Muhs, whose well-documented actions against his employer would undoubtedly pose an objective "substantial certainty" of harm, from discharging judgments against them in bankruptcy. If not, the second prong of the "willfulness" test, adopted by nearly all courts post-*Geiger*, would be rendered virtually meaningless.

In both reasoning and result, the Fourth's Circuit's decision is fatally flawed. This Court should reverse the decision of the Fourth Circuit below and resolve the circuit split in favor of the objective "substantial certainty" analysis adopted by the Fifth Circuit in *Miller*, the Seventh Circuit, and the Fourth Circuit in its own prior opinion. Because of the egregiousness of Muhs' conduct here, the deepening of this circuit split, and because the Fourth Circuit has refused to reconsider its position, this is an ideal case in which to settle this ongoing dispute.

CONCLUSION

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

Respectfully submitted,

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September 3, 2019

APPENDIX

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[ENTERED: May 8, 2019]

PUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 18-1372

In re: CHARLES TAYLOR MUHS,

Debtor.

TKC AEROSPACE INC.,

Plaintiff - Appellee,

v.

CHARLES TAYLOR MUHS,

Defendant - Appellant.

Appeal from the United States District Court for the Eastern District of Virginia, at Alexandria. Liam O'Grady, District Judge. (1:17-cv-01304-LO-TCB)

Argued: March 19, 2019 Decided: May 8, 2019

Before MOTZ, KING, and THACKER, Circuit Judges.

Reversed and remanded by published opinion. Judge Thacker wrote the opinion, in which Judge Motz and Judge King joined.

ARGUED: Richard George Hall, Annandale, Virginia, for Appellant. Douglas Clark Proxmire, VENABLE LLP, Tysons Corner, Virginia, for Appellee. **ON BRIEF:** Stephen K. Gallagher, Kevin W. Weigand, VENABLE LLP, Tysons Corner, Virginia, for Appellee.

THACKER, Circuit Judge:

At the root of this appeal is a provision in the United States Bankruptcy Code stating that a debt "for *willful and malicious injury* by the debtor to another entity" is nondischargeable in Chapter 7 bankruptcy. 11 U.S.C. § 523(a)(6) (emphasis supplied). In 2016, Charles Taylor Muhs ("Appellant") filed for Chapter 7 bankruptcy and attempted to discharge a judgment in excess of $20 million entered by an Alaska district court against him and in favor of TKC Aerospace, Inc. ("TKCA"). TKCA, however, claims that the judgment is nondischargeable because the damages award was based on Appellant's willful and malicious misappropriation of TKCA's trade secrets.

The bankruptcy court, applying collateral estoppel principles, concluded that Alaska's award of damages to TKCA necessarily meant that Appellant willfully and maliciously injured TKCA for purposes of § 523(a)(6), granted summary judgment in favor of TKCA, and determined that the entire judgment award was nondischargeable. The district court affirmed.

We reverse. The Supreme Court has held that § 523(a)(6) requires "a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury." *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998) (emphases in original). Likewise, this court has held that a creditor challenging dischargeability under § 523(a)(6) must prove that the debtor had an "inten[t] to injure." *In re Duncan*, 448 F.3d 725, 730 (4th Cir. 2006). Because neither the Alaska district court, nor the bankruptcy court, determined the precise issue of whether Appellant intended to injure TKCA, collateral estoppel and summary judgment were inappropriate. Therefore, we remand to the district court with instructions to remand to the bankruptcy court for further proceedings.

I.

A.

Background

In 2007, Appellant became Vice President of Business Development for TKCA, an Alaska corporation specializing in aircraft procurement, logistics, and support. In that capacity, Appellant had access to TKCA's proprietary information, and his contract with TKCA prohibited him from disclosing confidential information to any third party or competing with TKCA for six months after his employment terminated. From 2009 to 2011, TKCA competed for and won Department of State ("DOS") contracts for Bombardier Dash 8 aircrafts, modified to meet DOS needs. As part of this process, TKCA would -- with the help of Appellant -- submit proposals to DOS describing how it would perform such modifications.

On March 28, 2011, Appellant left his position with TKCA to accept a position with Knowledge International in Alexandria, Virginia, although he continued to work for TKCA on a part-time basis. Appellant also began to work closely with Phoenix Heliparts, Inc. ("PHP"), an Arizona corporation and (at the time) a competitor of TKCA, to secure aircraft and develop bids for possible DOS solicitation. On August 5, 2011, DOS issued a solicitation for up to two more Dash 8 aircrafts, and PHP submitted a proposal. DOS awarded the contract to PHP.

B.

The Alaska and Arizona Actions

1.

Parallel Litigation

On September 26, 2011, TKCA filed a lawsuit in the District of Alaska against Appellant, alleging breach of contract, breach of implied covenant of good faith and fair dealing, breach of fiduciary duty, unjust enrichment, tortious interference with prospective business, fraud, and violation of the Alaska Uniform Trade Secrets Act (the "Alaska Action"). *See* Compl., *TKC Aerospace, Inc. v. Muhs*, No. 3:11-cv-189 (D. Alaska filed Sept. 26, 2011), ECF No. 1, at 12–17. Specifically, the complaint alleged that Appellant "stole a corporate business opportunity from TKCA and delivered it to a competitor, using TKCA proprietary information." *Id*. at 2.

On October 20, 2011, TKCA filed a parallel suit against PHP in the Superior Court for Maricopa County, Arizona, alleging misappropriation of trade secrets under the Arizona Uniform Trade Secrets Act, intentional interference with business expectancy, unfair competition, and conversion. *See TKC Aerospace, Inc. v. Phoenix Heliparts, Inc.*, No. CV2011-128889 (Ariz. Sup. Ct. filed Oct. 20, 2011) (the "Arizona Action"). Although he was a witness in the Arizona Action, Appellant was not named as a party. The Alaska Action and the Arizona Action carried on simultaneously.

On February 21, 2012, Appellant filed a motion to stay the Alaska Action. In support of the motion, Appellant's counsel -- the same counsel representing PHP in the Arizona Action -- stated that the Arizona Action "involv[ed] the same plaintiff . . . and same factual and legal issues as those in the Alaska Action," and "[t]he underlying factual allegations in [both complaints] are virtually verbatim, the gravamen of the claims are identical, and the relief requested is virtually identical." J.A. 193.[1] The request for stay also stated, "this pending action is . . . substantially similar to and significantly parallels the Arizona Action," *id*. at 199, and "[i]f TKCA prevails in the Arizona Action, . . . then [Appellant] would be collaterally estopped from arguing differently in this Court," *id*. at 214 n.3 (alterations omitted). The Alaska court denied the motion to stay. After granting summary judgment on some claims, however, on March 8, 2013, the Alaska court deferred further scheduling until the Arizona Action was complete.

[1] Citations to the "J.A." refer to the Joint Appendix filed by the parties in this appeal.

2.

The Arizona Judgment

Meanwhile, from March 2012 to October 2013, the Arizona state court conducted a bench trial for over 40 days on the issue of PHP's liability regarding TKCA's trade secrets and PHP's misconduct. Ultimately, on January 30, 2015, the Arizona state court entered judgment in favor of TKCA and against PHP on the Arizona Uniform Trade Secrets Act claim, the tortious interference claim, and the common law unfair competition claim, in the total amount of $20,295,782.58. This amount was broken down as follows: $2,883,055.86 in lost profits; $3,882,205 in research and development costs; and $13,530,521.72 in exemplary damages. As to the latter, the Arizona state court stated, "PHP [must] pay exemplary damages pursuant to A.R.S. § 44–403(B)[[2]] in an amount double awarded to TKCA for its lost profit and research and development costs." J.A. 105. The Arizona court found that PHP engaged in "willful and malicious misconduct," *id*. at 59, and "PHP willfully and maliciously misappropriated TKCA's trade secrets," *id*. at 66. It also found that "PHP formed an agency relationship with [Appellant]," and "[b]ecause of th[is relationship], this court will attribute [Appellant's] acts to PHP." *Id*. at 74, 75.

But even though the Arizona state court attributed Appellant's actions to PHP, the Arizona

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[2] This statute provides, "If willful and malicious misappropriation exists, the court may award exemplary damages in an amount not exceeding twice any award [for actual loss from misappropriation and unjust enrichment]." Ariz. Rev. Stat. Ann. § 44-403(B).

Action was not based *solely* on the actions of Appellant. Indeed, the Arizona court also found the following regarding Tina Cannon, president of PHP at the relevant time, and her husband Darrin Cannon, who was vice-president:

- "[T]he Cannons wiped their computers after receiving a litigation hold letter and after trial started. The court has rarely, if ever in a civil matter, witnessed a party engage in such flagrant misconduct and act with such disregard for the truth and such profound disrespect for the law." J.A. 60;

- "This court finds that Darrin Cannon installed and ran CCleaner with the intent to delete any evidence that PHP had misappropriated TKCA's trade secrets and proprietary and confidential information and also to conceal PHP's efforts to delete relevant and material evidence of its misconduct." J.A. 60–61;

- "During trial, Tina Cannon and [Appellant] provided improbable explanations when confronted with overwhelming evidence of PHP's efforts to secure the award of the D[O]S contract." J.A. 65; and

- Tina Cannon "induced [Appellant] to violate his non-compete agreement with TKCA and disclose TKCA trade

> secrets in further breach of his employment contract." J.A. 80.

Accordingly, when assessing whether exemplary damages were appropriate pursuant to A.R.S. § 44–403(B) for willful and malicious misappropriation, the Arizona court stated the following, inter alia:

> Attempts to conceal wrongful conduct with respect to trade secrets provide evidence of willful and malicious misappropriation. . . .
>
> [T]he following are just a few examples that establish PHP willfully and maliciously engaged in misconduct. Despite knowing [Appellant's] contract with TKCA had a non- compete clause, the Cannons induced [Appellant] to misappropriate TKCA's trade secrets in order to compete directly with TKCA. [Appellant], on behalf of PHP, withheld vital information from TKCA so that PHP could establish a material and temporal advantage in preparing a successful proposal in response to the D[O]S solicitation. Tina Cannon knew that [Appellant] had uploaded TKCA proprietary documents to PHP's servers and PHP knowingly used the uploaded documents to prepare its bid. PHP further knew that using the uploaded documents would harm TKCA. . . .
>
> PHP intentionally wip[ed] company servers after learning of a subpoena,

> erasing company laptops in the evening and early morning hours before court-ordered forensic imaging started. . . .

J.A. 87. After awarding exemplary damages, the Arizona court noted that TKCA also satisfied its burden of proof on punitive damages, explaining, "This court finds by clear and convincing evidence that *PHP* engaged in outrageous conduct and *acted with an evil mind intending to injure* TKCA by intentionally interfering with TKCA's contracts and opportunities and then using TKCA's proprietary information to misappropriate those opportunities." *Id*. at 88–89 (emphases supplied). The court made no specific finding, however, that Appellant (who, again, was not a party to the Arizona Action) intended to injure TKCA.[3]

3.

The Alaska Judgment

Based on the Arizona judgment, on June 12, 2015, TKCA filed a motion for summary judgment in the Alaska Action. Without holding a hearing, the Alaska court granted the motion on October 22, 2015. It reasoned that, even though Appellant was not a party to the Arizona Action, the Arizona court's conclusion and award of damages were based on "findings that [Appellant] worked with PHP to compete for the D[O]S contract, that [Appellant] provided TKCA documents to PHP, and that

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[3] PHP filed for Chapter 11 bankruptcy on September 18, 2015, staying any potential appeal of the Arizona Action. *See* 11 U.S.C. § 362(a)(1) (bankruptcy petition acts as a stay to the "continuation . . . of a judicial . . . proceeding against the debtor" that was commenced before bankruptcy).

[Appellant] worked on PHP's D[O]S Dash 8 proposal." J.A. 30–31. Then the Alaska court applied principles of equitable estoppel and quasi-estoppel to reach the conclusion that "[Appellant] agreed to be bound by the decision in the Arizona Action and thus he was in privity with PHP. Because [Appellant] was in privity with PHP, [he] is collaterally estopped from relitigating TKCA's claims against him." *Id*. at 38.

Accordingly, the Alaska court held that TKCA was entitled to judgment against Appellant for breach of contract, breach of implied covenant of good faith and fair dealing, breach of fiduciary duty, tortious interference with prospective economic benefit, and violation of the Alaska Trade Secrets Act. Per the Alaska court, TKCA was entitled to the following:

a. Lost Profits: $2,883,055.86

b. Research and Development: $3,882,205.00

c. Exemplary Damages: $13,530,521.72.

J.A. 42. Thus, Appellant was liable for $20,295,782.58, the same amount imposed on PHP in the Arizona Action.

As noted above under "c.," the Alaska court awarded exemplary damages in the amount of $13,530,521.72 to TKCA. In awarding these damages, the Alaska court dropped a footnote that stated, "Per AS 45.50.915(b)," with no further analysis. J.A. 42 n.37. Section 45.50.915(b) is part of the Alaska Uniform Trade Secrets Act and provides:

> (a) In addition to or in lieu of injunctive relief, a complainant may recover

> damages for the actual loss caused by misappropriation. A complainant also may recover for the unjust enrichment caused by misappropriation that is not taken into account in computing damages for actual loss.
>
> (b) *If wilful and malicious misappropriation exists*, the court may award exemplary damages in an amount not exceeding twice the damages awarded under (a) of this section.

AS § 45.50.915 (emphasis supplied). Like the Arizona court, the Alaska court made no specific finding that Appellant intended to injure TKCA.[4]

C.

<u>Federal Bankruptcy Proceedings</u>

On July 1, 2016, Appellant filed a petition for Chapter 7 bankruptcy in the Bankruptcy Court for the Eastern District of Virginia and sought to discharge the Alaska judgment. *See* Petition, *In re Muhs*, No. 16-12288 (Bankr. E.D. Va. filed July 1, 2016), ECF No. 1. TKCA then filed an adversary complaint in the bankruptcy court, alleging that the Alaska judgment was nondischargeable pursuant to 11 U.S.C. § 523(a)(2) (any debt for "money . . . to the extent obtained by . . . false pretenses [or] actual fraud" is nondischargeable in Chapter 11 proceedings); § 523(a)(4) (same for any debt "for fraud

[4] The Alaska judgment has been appealed to the Court of Appeals for the Ninth Circuit, but the appeal was administratively closed in May 2017 pending bankruptcy proceedings.

or defalcation while acting in a fiduciary capacity, embezzlement, or larceny"); and § 523(a)(6) (same for any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity"). *See* Compl., *In re Muhs*, No. 16-01192 (Bankr. E.D. Va. filed Oct. 11, 2016).

1.

TKCA's First Motion

On December 19, 2016, TKCA filed a motion for judgment on the pleadings based on the Alaska judgment. It contended:

> This court should estop [Appellant] from re-litigating the same facts and issues that two other courts have already addressed. To do so, the Court should apply collateral estoppel to the findings of the Arizona and Alaska Courts and hold that [Appellant's] debt from the Alaska Judgment is not dischargeable under 11 U.S.C. §§ 523(a)(2) [false pretenses or fraud], (a)(4) [fraud or defalcation in a fiduciary capacity, embezzlement, or larceny], and (a)(6) [willful and malicious injury].

Mot. J. Pleadings, *In re Muhs*, No. 16-01192 (Bankr. E.D. Va. filed Dec. 19, 2016), ECF No. 7, at 9. The bankruptcy court held a hearing on this motion. There, TKCA contended, "[The] Alaska and Arizona [courts] awarded exemplary damages, which under their statutes . . . exemplary damages can only be awarded if there is willful and malicious misappropriation." Trans., *In re Muhs*, No. 16-01192

(Bankr. E.D. Va. March 9, 2017), ECF No. 22, at 10–11. The bankruptcy court denied the motion, explaining in open court:

> [T]his is a Court of equity, so I am going to use my power to apply equitable estoppel in this case in order for a trial to go on. I'm not saying that [Appellant] has a prayer of winning. What I am saying is that it is clear by the judgment in the Arizona Court that [Appellant's] attorney was not working in the best interests from time to time of either of its clients, PHP or [Appellant]. . . . I think that there definitely are some disputed facts, and I want to know what they are. I want to hear both sides.

Id. at 37–38.

TKCA then moved for leave to appeal the bankruptcy court's interlocutory order to the district court. *See* Mot. Leave to Appeal, *TKC Aerospace, Inc.*, No. 1:17-cv-372 (E.D. Va. Mar. 29, 2017), ECF No. 1. The district court granted the motion for leave to appeal and reversed the bankruptcy court, explaining that it erred in "finding that collateral estoppel did not apply to [the Alaska court's] grant of summary judgment." J.A. 222. The district court explained that the issues in the Alaska Action and bankruptcy proceeding were "identical," but it did not determine whether the Alaska court found that Appellant had an intent to injure TKCA. *Id*. at 227. Instead, the district court made the general proclamation that a judgment "resulting from . . . willful and malicious injury against another [is] barred from discharge in a bankruptcy proceeding." *Id*. (citing 11 U.S.C. § 523). Thus, it concluded "[t]he doctrine of collateral estoppel bars re-litigation of the facts in the Alaska case." *Id*. at 229. The district court remanded for further proceedings.

2.

TKCA's Second Motion

On November 2, 2017, in the bankruptcy court once again, TKCA filed a renewed motion for judgment on the pleadings. The very next day, the bankruptcy court entered an order granting summary judgment to TKCA, concluding that the Alaska judgment was nondischargeable pursuant to § 523(a)(6) only. It explained, "With the district court's guidance in mind, applying principles of collateral estoppel, this Court finds that the Alaska court's findings satisfy the standard for nondischargeability under 11 U.S.C. § 523(a)(6)." J.A. 236. It did not address § 523(a)(2) or (a)(4).

Appellant appealed to the district court. *See* Notice of Appeal, *Muhs v. TKC Aerospace Inc*., 1:17-cv-1304 (E.D. Va. filed Nov. 16, 2017), ECF No. 1. The district court affirmed the bankruptcy court as to nondischargeability under § 523(a)(6). It held that because the Alaska judgment "awarded exemplary damages to [TKCA] for Appellant's violation of Alaska's Uniform Trade Secrets Act," which are "only for willful and malicious conduct," then the Alaska judgment is nondischargeable under § 523(a)(6). J.A. 310. Appellant timely noted this appeal. We possess jurisdiction pursuant to 28 U.S.C. § 1291 and § 158(d).

II.

This court "review[s] the judgment of a district court sitting in review of a bankruptcy court de novo, applying the same standards of review that were applied in the district court." *In Re Biondo*, 180 F.3d 126, 130 (4th Cir. 1999). Specifically, we review the factual findings of the bankruptcy court for clear error, while we review questions of law de novo. *See id*. "Although collateral estoppel may well preclude a bankruptcy court from relitigating previously-decided issues, the ultimate issue of dischargeability is a legal issue, and exceptions to discharge are narrowly construed." *In re McNallen*, 62 F.3d 619, 625 (4th Cir. 1995) (citations omitted).

III.

In this appeal, we are asked to decide whether Appellant is collaterally estopped from arguing in bankruptcy court that the Alaska judgment is dischargeable under § 523(a)(6), because the Alaska court awarded exemplary damages to TKCA based on willful and malicious misappropriation under Alaska law. As the party challenging the dischargeability of a debt, TKCA bears the burden of proving the debt nondischargeable by a preponderance of the evidence. *See Grogan v. Garner*, 498 U.S. 279, 287, 291 (1991).

TKCA contends that the "Alaska court's findings satisfy all the requisite elements for 'willful and malicious' injury to TKCA under 11 U.S.C. § 523(a)(6)," and "[t]here is no meaningful difference in the definition of 'willful and malicious' under Alaska law and [§ 523(a)(6)]." Appellee's Br. 9–10. Appellant, however, maintains that "in a proceeding involving 11 U.S.C. § 523(a)(6), 'willful and malicious' conduct requires a finding of a specific intent to injure," and there was no such finding made in the Alaska Action. Appellant's Br. 9. We agree with Appellant.

A.

Collateral Estoppel

In *Grogan v. Garner*, the Supreme Court concluded that principles of collateral estoppel apply in dischargeability proceedings in bankruptcy. 498 U.S. at 284 & n.11. But we must first address which jurisdiction's estoppel rules apply. As a general matter, "[t]he preclusive effect of a federal-court judgment is determined by federal common law." *Taylor v. Sturgell*, 553 U.S. 880, 891 (2008). When a federal court exercises diversity jurisdiction over a state law claim, as in the Alaska Action, the federal rule "is to apply 'the law that would be applied by state courts in the State in which the federal diversity court sits' as long as the state rule is not 'incompatible with federal interests.'" *Hately v. Watts*, 917 F.3d 770, 777 (4th Cir. 2019) (quoting *Semtek Int'l, Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 509 (2001)). Finding no reason why Alaska collateral estoppel law would be incompatible with federal interests, we apply the following test:

> Collateral estoppel prohibits relitigation of issues *actually decided* in earlier proceedings where: (1) the party against whom the preclusion is employed was a party to or in privity with a party to the first action; (2) the issue precluded from relitigation is *identical* to the issue decided in the first action; (3) the issue was resolved in the first action by a final

> judgment on the merits; and (4) the determination of the issue was *essential* to the final judgment.

Strong v. Williams, 435 P.3d 872, 875 (Alaska 2018) (emphases supplied). Accordingly, first, we will assess the issue Appellant wants to litigate in the bankruptcy court (i.e., whether the debt is for a willful and malicious injury for purposes of § 523(a)(6)). Next, we will evaluate whether collateral estoppel precludes litigation of that issue in bankruptcy court.

B.

Bankruptcy Requirement: Intent to Injure

The statue at issue here -- § 523(a)(6) -- provides that a debt is not dischargeable in a Chapter 7 proceeding if it is a 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). The Supreme Court and this court have decided that a debt arising from an injury attributable to mere negligent or reckless conduct does not satisfy the "willful and malicious" requirement of (a)(6); in addition, it is not enough that the conduct underlying the injury was intentional. Rather, the debtor must have engaged in such conduct with the actual intent to cause injury. *See Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998); *In re Duncan*, 448 F.3d 725, 729 (4th Cir. 2006).

1.

Kawaauhau v. Geiger

In *Geiger*, Margaret Kawaauhau sought treatment from Dr. Paul Geiger for a foot injury. *See*

523 U.S. at 59. Dr. Geiger knew intravenous penicillin would be most effective to decrease the risk of infection, but he prescribed oral penicillin because Kawaauhau wished to keep the cost down. Then, he left town and placed her in the care of other physicians, who decided she should be transferred to a specialist. But when Dr. Geiger returned, he disagreed and cancelled her transfer because he thought the infection had subsided; however, Kawaauhau's condition worsened, resulting in the amputation of her right leg below the knee. *See id.*

Kawaauhau and her husband sued Dr. Geiger for malpractice, and a jury awarded them $355,000 in damages. Dr. Geiger did not carry malpractice insurance and ended up filing for bankruptcy and seeking to discharge the judgment against him under § 523(a)(6). *See Geiger*, 523 U.S. at 59–60. The bankruptcy court decided the debt was nondischargeable because the doctor's "treatment fell far below the appropriate standard of care and therefore ranked as 'willful and malicious.'" *Id.* at 60.

The Eighth Circuit, sitting en banc, reversed the bankruptcy court and held that the debt was dischargeable, and the Supreme Court affirmed. The Supreme Court explained:

> We confront this pivotal question concerning the scope of the "willful and malicious injury" exception: 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* (as the Eighth Circuit ruled)? The words of

> the statute strongly support the Eighth Circuit's reading.

Geiger, 523 U.S. at 61 (emphasis supplied). The Court reasoned, "The word 'willful' in (a)(6) modifies the word 'injury,' indicating that nondischargeability takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury." *Id*. (emphases supplied). Moreover, "the (a)(6) formulation triggers in the lawyer's mind the category 'intentional torts,' as distinguished from negligent or reckless torts. Intentional torts generally require that the actor intend 'the *consequences* of an act,' not simply 'the act itself.'" *Id*. at 61–62 (quoting Restatement (Second) of Torts § 8A) (emphasis in *Geiger*). The Court rejected the notion that a willful and malicious injury should encompass "a wide range of situations in which an act is intentional, but injury is unintended, i.e., neither desired nor in fact anticipated by the debtor," such as a "knowing breach of contract." *Id*. at 62. In the end, "to be nondischargeable, the judgment debt must be for willful and malicious *injury*," and "[n]egligent or reckless acts . . . do not suffice to establish that a resulting injury is willful and malicious." *Id*. at 63–64 (emphasis in original).

2.

<u>*In re Duncan*</u>

This court has applied the *Geiger* principle in only one published decision, *In re Duncan*, 448 F.3d 725 (4th Cir. 2006). There, a mother ("Jacqueline") was found liable for the wrongful death of her adopted child, after her child drowned in the bathtub while in Jacqueline's care. Because the child had subdural hemorrhaging and cerebral edema, the wrongful death lawsuit filed by the child's father alleged that Jacqueline either abused and assaulted the child and then left her in the bathtub unattended to drown, or intentionally drowned her to obscure evidence of the abuse. *See id*. at 727. The jury in the wrongful death suit awarded the child's estate (the "Estate") $15,000 in compensatory damages, and $500,000 in punitive damages, which was later reduced. *See id*. Because the jury awarded punitive damages, it necessarily decided that Jacqueline engaged in "willful and wanton" conduct, which was defined as:

> *acting consciously in disregard of [the child] or acting with a reckless indifference to the consequences to [the child]* when the Defendant is aware of her conduct and is also aware, from her knowledge of existing circumstances and conditions, that her conduct would probably result in injury to [the child].

Id. at 729 (emphasis supplied).

Jacqueline thereafter filed a Chapter 7 bankruptcy petition and listed the wrongful death award as a dischargeable debt. *See Duncan*, 448 F.3d at 727. The Estate argued that it was not dischargeable under § 523(a)(6), and, based on the wrongful death judgment and punitive damages award, Jaqueline was collaterally estopped from arguing that the injury was not willful or malicious. *See id*.

Applying Virginia law (because the wrongful death judgment originated in Virginia state court), we held that collateral estoppel did not apply to the willful and malicious issue because whether Jacqueline "intended to injure" her daughter was neither identical to, nor necessary to, the issue litigated in the wrongful death proceedings. *Duncan*, 448 F.3d at 730. Indeed, Virginia law allowed for an award of punitive damages for conscious disregard or reckless indifference, neither of which rose to the level of intent to injure under *Geiger*. And because the Estate was not required "to prove that Jacqueline Duncan intended to injure [the child] . . . , the wrongful death judgment did not involve an identical issue to the controlling issue here." *Id*. at 730. We concluded, "At bottom, neither the wrongful death nor the punitive damages award in the state court involved the issue of whether Jacqueline Duncan intended to injure [the child] that controls resolution of this adversary proceeding." *Id*. Thus, we held that collateral estoppel did not apply in the bankruptcy proceedings.

Therefore, based on this case law, the controlling issue in the adversary bankruptcy proceeding has to be whether Appellant intended to injure TKCA. With this in mind, we turn to an analysis of the Alaska court's decision.

C.

Alaska Judgment

We now determine whether, based on the Alaska judgment, Appellant is collaterally estopped in the adversary proceeding from arguing that the debt to TKCA is not for a willful and malicious injury for purposes of § 523(a)(6). Under Alaska law, collateral estoppel prohibits relitigation of an issue "actually decided in earlier proceedings" if TKCA can demonstrate that (1) Appellant was a party to the Alaska Action; (2) the issue precluded from relitigation is identical to the issue decided in the Alaska Action; (3) the issue was resolved by a final judgment on the merits; and (4) the determination of the issue was essential to the final judgment. *Strong*, 435 P.3d at 875. Because Appellant was a party in Alaska, and the Alaska judgment was final, we turn to an analysis of whether the issues are identical, were actually decided in Alaska, and were essential to the Alaska judgment.

1.

Identical Issues

First, Alaska law requires that the issue to be precluded from relitigation "is identical to the issue decided in the first action." *Strong*, 435 P.3d at 875. However, TKCA has not demonstrated -- and we cannot conclude -- that the meaning of "willful and malicious" under Alaska law is identical to the meaning of "willful and malicious" under the Bankruptcy Code.

As explained above, § 523(a)(6) requires intent to injure, and does not encompass mere negligent or reckless conduct. Alaska has adopted the Uniform Trade Secrets Act ("UTSA"), and neither Alaska's version of the UTSA, nor the UTSA itself, defines the terms willful and malicious. We cannot conclude that just because the words are the same, the meaning is also the same. In fact, many states adopting the UTSA have developed definitions of willful and malicious that fall below the *Geiger* standard. *See, e.g.*, *Mattern & Assocs., L.L.C. v. Seidel*, 678 F. Supp. 2d 256, 271 (D. Del. 2010) (analyzing award of exemplary damages under the Delaware UTSA, explaining, "Delaware courts have defined willfulness as an awareness, *either actual or constructive*, of one's conduct and a realization of its probable consequences, and malice as *ill-will, hatred* or intent to cause injury." (citation and internal quotation marks omitted) (emphases supplied)); *Mangren Research & Dev. Corp. v. Nat'l Chem. Co.*, 87 F.3d 937, 946 (7th Cir. 1996) (analyzing award of exemplary damages under the Illinois UTSA, reasoning that the definition of willful and malicious "surely must include an intentional misappropriation *as well as a misappropriation resulting from the conscious disregard of the rights of another*" (emphasis supplied)); 12 Pa. C.S.A. § 5302 (Pennsylvania UTSA defining "willful and malicious" as "[s]uch intentional acts *or gross neglect of duty* as to evince a *reckless indifference* to the rights of others on the part of the wrongdoer, and an entire want of care so as to raise the presumption that the person at fault is conscious of the consequences of his carelessness" (emphasis supplied)); *see also HTS, Inc. v. Boley*, 954 F. Supp. 2d 927, 959 (D. Ariz. 2013) (noting that the Arizona UTSA does not define "willful and malicious" but adopting Pennsylvania's definition, explaining "the Court considers as instructive decisions from other jurisdictions that have adopted substantially the same provision of the UTSA").

Indeed, TKCA's attempts to define "willful and malicious" in Alaska's version of the UTSA as identical to § 523(a)(6) fall short of its burden. It refers to an Alaska Supreme Court decision stating, "[a]n act is willful if it is done intentionally and purposefully, rather than accidentally or inadvertently." *Walt's Sheet Metal v. Debler*, 826 P.2d

333, 336 (Alaska 1992). It then contends that the Alaska court necessarily determined that Appellant "intentionally and purposefully misappropriated TKCA's trade secrets, which is sufficient to meet the Fourth Circuit standard for willfulness." Appellee's Br. 11. But *Geiger* and *Duncan* specifically instruct that it is not enough to have "a deliberate or intentional *act* that leads to injury." *Geiger*, 523 U.S. at 61. Rather, a bankruptcy court must specifically find a deliberate and intentional *injury*. Therefore, even if TKCA is correct that the Alaska court decided Appellant intentionally and purposefully misappropriated TKCA's trade secrets, that is still not enough. It must have taken the additional step of finding that Appellant, in so doing, intended for TKCA to be injured by that misappropriation.

Therefore, we simply cannot affirm the district court and bankruptcy court's conclusion that the issue Appellant seeks to argue in bankruptcy court is identical to the issue presented in the Alaska Action.

2.

Actually Decided and Essential

Moreover, the issue of whether Appellant intended to injure TKCA was neither "actually decided in," nor "essential to" the Alaska Action. *Strong*, 435 P.3d at 875. The Alaska court never decided whether Appellant intended to injure TKCA, as required by *Geiger* and *Duncan*. Indeed, the only critical determination the Alaska court made was that Appellant was in privity with PHP based on equitable and quasi-estoppel, and therefore, he was collaterally estopped from "relitigating TKCA's claims against him" in Alaska. J.A. 38. TKCA maintains that the Alaska court necessarily made a determination of willfulness and maliciousness in its award of exemplary damages, indicated in a footnote with no analysis. But as mentioned above, the Alaska court made no decision whatsoever that it based those damages on a finding that Appellant intended to injure TKCA. Indeed, the district court's decision on appeal here recognizes this fact. It states that the Alaska judgment awarded exemplary damages for violation of Alaska's UTSA, which can "only [be awarded] for willful and malicious *conduct*." J.A. 310 (emphasis supplied). As explained above, Appellant's conduct is not the issue; rather, it is his intent to injure that matters.

TKCA also points to a portion of the Arizona court's decision regarding the award of punitive damages, which states, "This court finds by clear and convincing evidence that PHP engaged in outrageous conduct and acted with an evil mind *intending to injure* TKCA by intentionally interfering with TKCA's contracts and opportunities and then using TKCA's proprietary information to misappropriate those opportunities." J.A. 88–89 (emphasis supplied). Then, TKCA contends that although Appellant was not a party to the Arizona Action, this "evil mind" is attributable solely to Appellant because in the Alaska Action, Appellant's counsel acknowledged "TKCA's claims of wrongdoing by PHP are entirely based on the alleged wrongdoing of [Appellant]." Appellee's Br. 16 n.2 (quoting J.A. 200 (motion to stay Alaska Action)).

But crucially, the Alaska court did not take the additional step of finding that Appellant had the requisite intent to injure (or was estopped from arguing to the contrary) *in the Alaska Action*. Nor would such a finding have been essential to the Alaska court's decision that Appellant was in privity with PHP and thus, he was collaterally estopped from relitigating the issues determined in the Arizona Action.

Therefore, whether Appellant specifically had the requisite intent to injure TKCA was neither actually decided in, nor essential to, the Alaska Action.

3.

For these reasons, collateral estoppel was inappropriate in this case. We reverse the district court and bankruptcy court's reliance on collateral estoppel to determine the nondischargeability of the Alaska judgment, and remand for further proceedings.[5]

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[5] TKCA argues in its response brief that we could affirm based on other nondischargeability provisions in the Bankruptcy Code, specifically, § 523(a)(2) and (a)(4). These arguments were raised to the bankruptcy court; however, the bankruptcy and district courts relied only on (a)(6) in the immediate judgments on appeal. These are determinations best left to the bankruptcy court in the first instance. *See In re FirstPay, Inc.,* 391 F. App'x 259, 269 n.7 (4th Cir. 2010) ("Whether FirstPay converted and misappropriated some of its clients' funds in order to make payments to the IRS on behalf of other clients, among other issues, will have to be determined by the bankruptcy court in the first instance."); *In re Biondo*, 180 F.3d 126, 134 (4th Cir. 1999) ("The Biondos' state of mind is a question of fact to be determined in the first instance by the bankruptcy court . . . ."); *In re Pucci Shoes, Inc.*, 120 F.3d 38, 42 (4th Cir. 1997) (remanding to bankruptcy court for determination of the value of a line of credit because "neither this court nor the district court is authorized to make . . . factual determinations in the first instance"). On remand, the bankruptcy court is free to entertain these possibilities.

IV.

For the foregoing reasons, we reverse the judgment of the district court, with instructions to remand to the bankruptcy court for proceedings consistent with this opinion.

REVERSED AND REMANDED

[ENTERED: May 8, 2019]

FILED: May 8, 2019

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 18-1372
(1:17-cv-01304-LO-TCB)
(16-12288)
(16-01192)

In re: CHARLES TAYLOR MUHS

Debtor

TKC AEROSPACE INC.

Plaintiff - Appellee

v.

CHARLES TAYLOR MUHS

Defendant - Appellant

J U D G M E N T

In accordance with the decision of this court, the judgment of the district court is reversed. This case is remanded to the district court for further proceedings consistent with the court's decision.

This judgment shall take effect upon issuance of this court's mandate in accordance with Fed. R. App. P. 41.

/s/ PATRICIA S. CONNOR, CLERK

[ENTERED: March 12, 2018]

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA Alexandria Division

CHARLES TAYLOR MUHS, *Appellant*, v. TKC AEROSPACE, INC., *Appellee.*	)	Civil Action No. 1:17-cv-01304

MEMORANDUM OPINION AND ORDER

This matter comes before the Court on appeal from the United States Bankruptcy Court for the Eastern District of Virginia. The appeal is fully briefed and the Court dispensed with oral arguments. For the reasons below and for good cause shown, the Court **AFFIRMS** the bankruptcy court.

Appellant assigns error to the bankruptcy court's summary judgment ruling that Appellee's judgment against Appellant, obtained in the District Court for the District of Alaska (the Alaska judgment), is non-dischargeable under 11 U.S.C. § 523(a)(6). This Court has jurisdiction under 28 U.S.C. §§ 158(a)(3) and 158(c)(1).

These parties were previously before this Court in October 2017. In that matter, TKC Aerospace appealed from the Bankruptcy Court's denial of summary judgment in its favor. *TKC Aerospace, Inc. v. Muhs*, 2017 WL 4638588 (E. D. Va. Oct. 16, 2017). The Court incorporates here the recitation of facts in that decision. In its October order, the Court reversed the bankruptcy court and held that the bankruptcy court improperly peered behind the Alaska judgment. In the Alaska judgment, the district court held that Appellant was estopped from re-litigating issues resolved by an Arizona state court proceeding. *Id.* at *2-3. In this Court's ruling, it instructed the bankruptcy Court to look solely at the Alaska judgment and the findings in support of that judgment in order to analyze dischargeability of the judgment under 11 U.S.C. § 523. *Id.*

In this appeal, Appellant implicitly seeks this Court to overturn its own prior ruling in this case, arguing that the § 523 analysis must examine in detail the decision in the Arizona state court case and applicable Arizona law. Appellant contends that 1) the Arizona judgment used a definition of "'willful and malicious" that does not squarely fit § 523's definition; 2) the bankruptcy court based its ruling on an incorrect assumption that the damages awarded under the Arizona judgment were for violation of Arizona's trade secrets act; and 3) the Arizona judgment did not contain sufficient findings of fact to support a conclusion that Appellant's conduct was willful and malicious so as to bar dischargeability under § 523.

Appellant's arguments are refuted on the face of the record. In the ruling at issue, the bankruptcy court found that "'[t]he Alaska court, adopting the findings of the Superior Court of Arizona, necessarily found that [Muhs'] misappropriation of trade secrets rose to the level of willful and malicious when it awarded exemplary damages under [Alaska's] version of the Uniform Trade Secrets Act." Appellee's App'x K. This finding serves as the foundation for the bankruptcy court's holding that the Alaska judgment, arising from willful and malicious trade secret violation, is non-dischargeable under § 523. *Id.* Thus, the bankruptcy court, following the law of the case and the mandate of this Court, never examined Arizona's definition of ""willful and malicious," never made an assumption at all about why certain damages were awarded in the Arizona case, and never examined the findings of fact in the Arizona case. Appellant assigns error to findings the bankruptcy court never made.

As the bankruptcy court correctly observed, the Alaska judgment awarded exemplary damages to Appellee for Appellant's violation of Alaska's Uniform Trade Secrets Act. As this Court noted in its October 17. 2017 order, exemplary damages under that statute are awardable only for willful and malicious conduct. *See* ALASKA STAT. ANN. § 45.50.915(b) (West 2017). The District Court for the District of Alaska made this plain in its summary judgment order. *TKC Aerospace, Inc. v. Muhs*, 2015 WL 6394481, at *7 n. 37 (D. Alaska Oct. 22, 2015) (footnoting the court's exemplary damages award with "Per 45.50.915(b)"). This Court can find no evidence and Appellant has not contended that the "willful and malicious" standard applicable under ALASKA STAT. ANN. § 45.50.915(b) is inconsistent with *Duncan v. Duncan*, 448 F.3d 725, 729 (4th Cir. 2006). The bankruptcy court then correctly concluded that the Alaska judgment arose from Appellant's willful and malicious conduct and was thus non-dischargeable under § 523. *See, e.g. In re Harton*, No. 12-36221-KRH, 2013 WL 5461832, at *1 (Bankr. E.D. Va. Oct. 1, 2013) (judgment arising from willful and malicious appropriation of trade secrets non-dischargeable under § 523).

The Court finds no error with the bankruptcy court's decision. It is entirely consistent with the facts underlying the Alaska judgment, with the findings of the United States District Court for the Di strict of Alaska, with the law of the case, with the mandate of this Court, and with applicable bankruptcy law. For these reasons and for good cause shown, the ruling by the bankruptcy court is **AFFIRMED.**

It is so **ORDERED.**

/s/
Liam O'Grady
United States District Judge

March 12, 2018
Alexandria, Virginia

[ENTERED: November 3, 2017]

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

In re:	:	
	:	
CHARLES TAYLOR MUHS,	:	Case No.
	:	16-12288-KHK
Debtor.	:	(Chapter 7)
	:	
TKC AEROSPACE, INC.,	:	
	:	
Plaintiff,	:	
	:	
vs.	:	Adv. Proc. No.
	:	16-01192
CHARLES TAYLOR MUHS,	:	
	:	
Defendant.	:	
	:	

ORDER

This CASE is before the Court pursuant to a Memorandum Opinion and Order of the District Court for the Eastern District of Virginia reversing this Court's Order Denying Summary Judgment in the above captioned adversary proceeding, and remanding to this Court for further disposition consistent with that Opinion. In particular, this Court must decide whether the findings of fact foundational to the judgment in the Alaska case satisfy the standard for nondischargeability under 11 U.S.C. § 523(a)(6). This Order assumes familiarity with the facts ofthe case as laid out in the District

Court's Memorandum Opinion and Order. [Docket No. 39].

With the District Court's guidance in mind, applying principles of collateral estoppel, this Court finds that the Alaska court's findings satisfy the standard for nondischargeability under 11 U.S.C. § 523(a)(6).

Summary judgment is appropriate where there is no genuine dispute as to any material fact, and the moving party is entitled to judgment as a matter of law. Fed. R. Bankr. P. 7056. The moving party has the initial burden of showing that there are no material facts in dispute and that it is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-24 (1986). When the moving party has met its initial burden, the burden then shifts to the non-moving party to present specific facts demonstrating that there is a genuine issue for trial. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574,586-87 (1986). Whether a fact is material or not depends on the substantive law at issue in the case. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment. Factual disputes that are irrelevant or unnecessary will not be counted." *Id.*

With the District Court having held that collateral estoppel bars re-litigation of the facts in the Alaska case, the only question before this Court is whether the findings in the Alaska case satisfy the standard under 11 U.S.C. § 523(a)(6). For the reasons stated below, this Court finds that they do.

The Alaska court, adopting the findings of the Superior Court of Arizona, necessarily found that Defendant's misappropriation of trade secrets rose to the level of willful and malicious when it awarded exemplary damages under its version of the Uniform Trade Secrets Act. Necessary to proving nondischargeability under section 523(a)(6) is that the plaintiff prove the injury resulted from willful and malicious conduct. 11 U.S.C. § 523(a)(6). Bankruptcy Courts in the Eastern District of Virginia and numerous other districts have acknowledged that a finding of willful and malicious misappropriation of trade secrets under the Uniform Trade Secrets Act satisfies the standard for nondischargeability under 11 U.S.C. § 523(a)(6). *See La Bella Dona Skin Care, Inc. v. Harton (In re Harton)*, 2013 Bankr. LEXIS 4113, *11, 2013 WL 5461832 (Bankr. E.D. Va. Oct. 1, 2013) (acknowledging that willful and malicious appropriation of trade secrets under the Virginia version of the Uniform Trade Secrets Act satisfies the standard under 11 U.S.C. § 523(a)(6); *see also Read & Lundy, Inc. v. Brier (In re Brier)*, 274 B.R. 37, 45 (Bankr. D. Mass. 2002) (acknowledging that numerous courts have held that a finding of willful and malicious injury under the Uniform Trade Secrets Act satisfy the nondischargeability standard of **11** U.S.C. § 523(a)(6)); *see also Clearview Designs, Inc. v. Angelilli (In re Angelilli)*, 463 B.R. 37, 45 (Bankr. N.D. Ohio 2012) (granting summary judgment for 523(a)(6) action for a debt that arose from willful and malicious appropriation under Ohio's version of the Uniform Trade Secrets Act).

Accordingly, this Court finds that the Defendant's debt to the Plaintiff was the product of willful and malicious injury within the meaning of section 523(a)(6) of the Bankruptcy Code and it is ORDERED:

1. Summary Judgment is GRANTED in favor of the Plaintiff.

2. Defendant's debt to Plaintiff is nondischargeable pursuant to 11 U.S.C. § 523(a)(6).

DONE at Alexandria, Virginia, this 3rd day of November.

Nov 3 2017 **/s/ Klinette Kindred**

Klinette H. Kindred
United States Bankruptcy Judge
Entered on Docket:
November 3, 2017

Copies to:
Stephen K. Gallagher
Lindsay Ruffner Heitger
Richard G. Hall

[ENTERED: October 16, 2017]

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

TKC AEROSPACE, INC.,	)	
Appellant,	)	Civil Action No. 1:17-cv-00372
v.	)	
CHARLES TAYLOR MUHS,	)	
Appellee.	)	

MEMORANDUM OPINION AND ORDER

This matter comes before the Court on appeal from the United States Bankruptcy Court for the Eastern District of Virginia. Appellant assigns error to the bankruptcy court's denial of Appellant's motion for judgment on the papers. That denial was based on the bankruptcy court's finding that collateral estoppel did not apply to a district court's grant of summary judgment that led to the final judgment at issue before the court. For the reasons stated below, the Court finds that collateral estoppel applies. Accordingly, the decision of the Bankruptcy Court for the Eastern District of Virginia is **REVERSED** and **REMANDED** for further disposition consistent with this opinion.

I. BACKGROUND

In September 2011, TKC Aerospace, Inc. (TKC) sued Charles Taylor Muhs, a former employee, in United States District Court in the District of Alaska (the Alaska case) for theft of trade secrets. Appellant Br. 4. In October 2011, TKC sued Phoenix Heliparts, Inc. (PHP) in the Superior Court of Arizona for Maricopa County (the Arizona case), based on Muhs' provision of those trade secrets to PHP, his new employer. *Id.* at 5. Muhs moved for and was granted a stay in the Alaska case until the Arizona case was resolved, asserting that the cases raised the same factual and legal issues, claims, and prayers for relief, and would ultimately collaterally estop the Alaska case. *Id.*

The Arizona case resolved in favor of TKC, with the court finding that PHP had willfully and maliciously misappropriated TKC's trade secrets through Muhs. *Id.* at 6. The Arizona case resolved, the district court in Alaska found that Muhs was equitably estopped from denying the preclusive effect of the Arizona case because of his assertions in his motion to stay. Consequently, the court found Muhs collaterally estopped from re-litigating the Arizona case, granted summary judgment for TKC, and entered a judgment against Muhs in the amount of $20,726,198.35, a figure that included exemplary damages. *Id.* Specifically, the district court found Muhs liable for breach of contract, breach of implied covenant of good faith and fair dealing, breach of fiduciary duty, tortious interference with prospective economic benefits, and violation of the Alaska Uniform Trade Secrets Act. Appellant Br. Ex. E, at

17. The court dismissed counts for unjust enrichment and common-law fraud. *Id.*

Importantly, by applying collateral estoppel to the Alaska case, the district court adopted the findings of the Superior Court of Arizona. Appellant Br. Ex. E, at 15. These included findings that Muhs committed conversion by stealing TKC confidential documents and uploading them to PHP servers, and that the trade secret theft clearly and convincingly rose to the level of "willful and malicious" under the Uniform Trade Secret Act, justifying an award of exemplary damages. Appellant Br. Ex. F.

Shortly after the district court entered the judgment against Muhs, Muhs filed for Chapter 7 bankruptcy protection and attempted to discharge the judgment. TKC timely filed an adversary complaint against Muhs to preclude discharge of the judgment, arguing that 11 U.S.C. § 523 bars discharge of a judgment that resulted from a) fraud, b) breach of fiduciary duty, or c) willful and malicious conduct. Appellant Br. Ex. A. TKC moved for judgment on the pleadings/summary judgment on the basis that Muhs is collaterally estopped from re-litigating the facts underlying the judgment and that the findings of the District Court for the District of Alaska settle the question of whether the judgment stemmed from conduct barring discharge under 11 U.S.C. § 523. Appellant Br. Ex. 1.

In his response to the Motion for Summary Judgment, Muhs attacked the performance of his counsel in the Arizona case and the application of collateral estoppel by the district court, arguing that the district court erred in estopping Muhs from relitigating issues settled by the Arizona case. Appelllant Br. Ex. J. Muhs also denied that any of the bars enumerated in 11 U.S.C. § 523 were applicable. *Id.*

On March 9, 2017, the bankruptcy court held a hearing on TKC's Motion for Judgment on the Pleadings/Summary Judgment. The court denied the motion. In ruling from the bench, the Court stated:

> ... [T]his is a Court of equity, so I am going to use my power to apply equitable estoppel in this case in order for a trial to go on. I'm not saying that Mr. Muhs has a prayer of winning. What I am saying is that it is clear by the judgment in the Arizona Court that Mr. Muhs's attorney was not working in the best interests from time to time of either of its clients, PHP or Mr. Muhs. I think that there are facts that are in dispute here, and they cannot be addressed at this stage on a Summary Judgment motion, so I think we should just proceed as though we're going to have a trial. . . I think that there definitely are some disputed facts, and I want to know what they are.

Appellant Br. Ex. C, at 96-97. The court subsequently issued a written order denying summary judgment, citing to the reasons stated in the record. Appellant Br. Ex. D.

TKC has timely appealed the bankruptcy court's denial to this Court. The appeal is proper under 28 U.S.C. §§ 158(a)(3) and (c)(1) and Rules 8002 and 8004 of the Federal Rules or Bankruptcy Procedure.

II. STANDARD OF REVIEW

Bankruptcy courts' legal conclusions are reviewed *de novo* and findings of fact are reviewed ror clear en·or. *Wells Fargo Bank, N.A. v. AMH Roman Two NC, LLC*, 859 F.3d 295, 299 (4th Cir. 20 17). Application of collateral estoppel is a question of law. *L&R Assocs. v. Curtis*, 194 B.R. 407, 409 (E.D. Va. 1996); *see also Reliance Ins. Co. v. Miller*, 144 Fed. Appx. 966, 973 (4th Cir. 2005).

III. DISCUSSION

The bankruptcy court was presented with two questions -- first, whether a judgment rendered in the District of Alaska met the collateral estoppel rules so as to bar Appellee's attempt to re-litigate the same issues, and second, whether that judgment met the criteria enumerated in 11 U.S.C. § 523 to bar discharge. The bankruptcy court, by holding that the Alaska case did not preclude re-litigation, never reached the second question. For the reasons set forth below, this holding was in error and the case is now remanded for the bankruptcy court to narrowly consider whether the findings of fact foundational to the judgment in the Alaska case fit the criteria in 11 U.S.C. § 523 so as to bar the discharge of the judgment.

As a matter of law, it was improper for the bankruptcy court to look behind the Alaska case and opine on whether the Arizona case should have had a preclusive effect on the outcome of the Alaska case. That question was not before the bankruptcy court and was not an unanswered question - the district court in the Alaska case had already conducted that collateral estoppel analysis and found that the Arizona case precluded re-litigation. Before the bankruptcy court was the narrow question of whether the Alaska case had preclusive effect on the discharge proceeding. A bankruptcy court's collateral estoppel analysis must apply the estoppel rules of the state in which the earlier judgment was rendered - here, Alaska. *See In re Duncan*, 448 F.3d 725, 728 (4th Cir. 2006). Alaska's collateral estoppel rules give preclusive effect to final judgments on the merits where the precluded issue is essential to the final judgment and is identical to the issue in the action at bar. *Stewart v. Elliott*, 239 P.3d 1236, 1241-42 (Alaska 2010). The party against whom the issue is being asserted must have been a party to or in privity with a party to the earlier action. *Id.* at 1240.

Bankruptcy law bars the discharge of judgments that arise from defalcation in breach of fiduciary duty or from willful and malicious conduct against the person or property of another. 11 U.S.C. § 523 (2010). Defalcation in breach of fiduciary duty occurs when a fiduciary appropriates company property to his benefit. *See United Va. Bank v. Fussell*, 15 B.R. 1016, 1020 (E.D. Va. 1981). Willful and malicious conduct against the person or property of another is established where the claim that gave rise to the judgment establishes "deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." *Duncan*, 448 F.3d at 729 (quoting *Kawaauhau v. Geiger*, 523 U.S. 57. 61 (1998)). Where a judgment required a finding of willful and malicious conduct. that is sufficient under

11 U.S.C. § 523(a)(4) to bar discharge. *See Duncan*, 448 F.3d at 728.

Applying the facts at hand to Alaska's collateral estoppel framework, Muhs was the defendant in the Alaska case, mooting the question of privity. The district court's decision, a grant of summary judgment, was a final judgment on the merits. *See. e.g. Lyman v. Slate*, 824 P.2d 703, 705 (Alaska 1992) (holding that summary judgment was a final judgment on the merits, even while pending appeal). The question of whether Muhs defalcated in breach of a fiduciary duty and/or engaged in willful and malicious conduct was essential to that judgment, since the district court found Muhs liable, *infer alia*, for breach of fiduciary duty (Count III of the suit) and for violating the Alaska Uniform Trade Secrets Act (Count VII of the suit) with an award of exemplary damages. *See* Pet. Br. Ex. E, 18; *see also*, ALASKA STAT. ANN. § 45.50.915(b) (West 2017) (exemplary damages only available for violations of the Alaska Trade Secrets Act where defendant engaged in willful and malicious misappropriation of trade secrets). Finally. the issues are identical, since judgments resulting from defalcations by a fiduciary and willful and malicious injury against another are barred from discharge in a bankruptcy proceeding. *See* 11 U.S.C. § 523 (2010).

By inquiring into the preclusive effect of the Arizona case, the bankruptcy court substituted its fact finding and judgment for those of the District Court of the District of Alaska. In peering behind the Alaska judgment, the bankruptcy court engaged in an improper and apparently *de novo* review of the di strict court's conclusive findings. The proper avenue for review or the district court's analysis would be through direct appeal to the Ninth Circuit, not through a collateral attack via a bankruptcy court. The bankruptcy court is bound to recognize that the preclusive effect of the Arizona case had already been decided and that the only issue before the court was the preclusive effect of the Alaska case. With such a properly narrowed focus, the court should have engaged in the equitable estoppel analysis under Alaska law - an analysis for which no additional facts are required. The court treated the judgment of the District Court for the District of Alaska as an advisory opinion. *C.f* Appellant Br. Ex. C, at 37 (the Bankruptcy Court questioning the performance of Muhs' counsel in the Arizona case) with Appellant Br. Ex. E, at 12-13 (the District Court for the District of Alaska rejecting Muhs' arguments on the same point).

Rationalizing this review of the preclusive effect of the Arizona case. the bankruptcy court then cited to the doctrine of equitable estoppel. Equitable estoppel will bind a party where (1) that party had actual or constructive knowledge of the truth of a matter; (2) that party misrepresented or concealed material facts to another party; (3) that party intended or expected the other party to rely upon those misrepresentations or concealments; (4) that the other party did so act; and (5) that the other party's reliance was both reasonable and detrimental. *Sari v. America's Home Place, Inc.*, 129 F. Supp. 3d 317, 328 (E.D. Va. 2015). The Court finds no legal or factual foundation in the record for applying equitable estoppel to bar the application of collateral estoppel. The only equitable estoppel properly raised in this case was where the District Court for the District of Alaska found Muhs equitably estopped from both moving for a stay on the grounds that the Arizona case would settle all the issues in the Alaska case and then denying the preclusive effect of the Arizona case after it resolved in TKC's favor. *See* Appellant Br. 22-24; Appellant Br. Ex. E, at 12-14.

Appellee concedes the bankruptcy court's reference to equitable estoppel is unclear. *See* Appellee Br. 8 (reasoning, "whether the Bankruptcy Court used the correct term for its decision, equitable estoppel, instead of judicial estoppel, or the Court's broad equitable power under 11 U.S.C. 105(a), or whether the Court was referring to the necessary element of privity which must be proven before for the application of collateral estoppel. the result was based ... "). However, a bankruptcy court's equitable powers are limited. *See Educ. Credit Mgmt. Corp. v. Pulley*, 532 B.R. 12, 26 (E.D. Va. 2015) (finding that "the contours of [a bankruptcy court's] decision are confined to the provisions of the Bankruptcy Code and related jurisprudence"); *Law v. Siegel*, 134 S. Ct. 1188, 1197 (2014) ("Equitable considerations [do not] permit a bankruptcy court to contravene express provisions of the Code."); *see also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) ("[W]hatever equitable powers remain in the bankruptcy court must and can only be exercised within the confines of the Bankruptcy Code.").

IV. CONCLUSION

The Court finds that the doctrine of collateral estoppel bars re-litigation of the facts in the Alaska case. Accordingly, the decision of the United States Bankruptcy Court for the Eastern District of Virginia is **REVERSED.** As the bankruptcy court never reached an analysis of whether the Alaska court's findings implicate the statutory discharge bars in 11 U.S.C. § 523, the Court **REMANDS** the case to the bankruptcy court for further proceedings consistent with this opinion and the opinion of the District Court for the District of Alaska in rendering its final judgment in the estopping matter, including findings in the Arizona case that the district court necessarily adopted in rendering its judgment.

It is so **ORDERED.**

/s/
Liam O'Grady
United States District Judge

October 16, 2017
Alexandria, Virginia

[ENTERED: March 15, 2017]

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

In re:	:	
	:	
CHARLES TAYLOR MUHS,	:	Case No.
	:	16-12288-KHK
Debtor.	:	(Chapter 7)
	:	
TKC AEROSPACE, INC.,	:	
	:	
Plaintiff,	:	
	:	
vs.	:	Adv. Proc. No.
	:	16-1192
CHARLES TAYLOR MUHS,	:	
	:	
Defendant.	:	
	:	

ORDER DENYING MOTION FOR SUMMARY JUDGMENT AND CONTINUING PRE-TRIAL

THIS CASE was before the court on March 9, 2017, on the Plaintiffs Motion for Summary Judgment (Docket Entry 7). For the reasons stated on the record, it is:

ORDERED:

1. The motion be and is hereby denied.

2. **PRE-TRIAL CONFERENCE.** The pre-trial conference will be continued to **September 11, 2017, at 9:30 a.m.**

3. **DISCOVERY.** Initial disclosures shall be made no later than 25 days from entry of this order. The parties shall make expert witness disclosures no later than 75 days from entry of this order. Rebuttal expert witness disclosures shall be made no later than 105 days from entry of this order. All discovery shall be concluded by July 28, 2017.

4. **EXHIBITS, FINAL WITNESS LIST AND OBJECTIONS THERETO.** All exhibits and witness lists shall be filed and exchanged on or before August 17, 2017. All exhibits shall be properly bound, tabbed, indexed, and the pages numbered. The parties should provide the court with the original and two (2) copies. The plaintiff's exhibits shall be numbered. The defendant's exhibits shall be lettered. Objections to exhibits shall be filed on or before August 24, 2017. Any exhibit not objected to shall be admitted into evidence except upon good cause shown. (*See* Local Bankruptcy Rule 9070-1).

DONE at Alexandria, Virginia, this 9th day of March, 2017.

Mar 15 2017 **/s/ Klinette Kindred**
Klinette H. Kindred
United States Bankruptcy Judge

Entered on Docket:
November 3, 2017

Copies electronically to:

Stephen K. Gallagher
Richard G. Hall

[ENTERED: June 4, 2019]

FILED: June 4, 2019

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 18-1372
(1:17-cv-01304-LO-TCB)
(16-12288)
(16-01192)

In re: CHARLES TAYLOR MUHS

Debtor

TKC AEROSPACE INC.

Plaintiff - Appellee

v.

CHARLES TAYLOR MUHS

Defendant - Appellant

O R D E R

The petition for rehearing en banc was circulated to the full court. No judge requested a poll under Fed. R. App. P. 35. The court denies the petition for rehearing en banc.

For the Court

/s/ Patricia S. Connor, Clerk

[ENTERED: March 7, 2016]

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

TKC AEROSPACE, INC.,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	No.
	)	3:11-cv-0189-HRH
CHARLES TAYLOR MUHS,	)	
	)	
Defendant.	)	
	)	

Judgment in a Civil Case

This action came before the court. The issues have been duly considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED:

that plaintiff TKC Aerospace, Inc. have judgment against and recover from defendant Charles Muhs as follows:

1. As to TKCA's claims under Count I (breach of contract), Count II (breach of implied covenant of good faith and fair dealing), Count III (breach of fiduciary duty), and Count V (tortious interference with prospective economic benefit), TKCA is entitled to judgment against

Muhs for lost profits in the amount of $2,883,055.86.[1]

2. As to TKCA's Count IV (unjust enrichment) and Count VI (fraud), the court has entered summary judgment in favor of Muhs,[2] and these claims are dismissed with prejudice.

3. As to TKCA's Count VII (Alaska Trade Secret Acts), TKCA is entitled to judgment against Muhs in the amount of:

   a. Lost Profits: $2,883,055.86

   b. Research and Development: $3,882,205.00

   c. Exemplary Damages: $13,530,521.72.[3]

4. In order to avoid double recovery, plaintiff shall recover the judgment entered herein on Counts I, II, III, and V only in the event that the judgment entered on Count VII is vacated.

5. TKCA is entitled to attorneys' fees in the amount of $430,415.77, for a total judgment against Muhs of $20,726,198.35.

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[1] TKCA's prayer for relief did not include a request for punitive damages.

[2] Docket No. 195.

[3] Per AS 45.50.915(b).

6. The judgment shall bear interest at the rate of .66% per annum from the entry hereof until paid.

7. The court retains jurisdiction of this case for purposes of reviewing the court's order of October 22, 2015[4] and this judgment in the event that the judgment in favor of TKCA in the Arizona Action is reversed on appeal.

DATED at Phoenix, Arizona, this 7th day of March, 2016.

/s/ H. Russel Holland
United States District Judge

[4] Docket No. 296.

[ENTERED: October 22, 2015]

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

TKC AEROSPACE, INC., Plaintiff, vs. CHARLES TAYLOR MUHS, Defendant.	)	No. 3:11-cv-0189-HRH

ORDER

Motion for Summary Judgment and Sanctions

Plaintiff moves for summary judgment or in the alternative for sanctions.[1] This motion is opposed.[2] Oral argument has not been requested and is not deemed necessary.

Facts

Plaintiff is TKC Aerospace, Inc. (TKCA). Defendant is Charles Taylor Muhs.

TKCA, an Alaska Native Corporation 8(a) contractor, specializes in aircraft procurement and leasing and aerospace logistics support and professional staffing for government and private

[1] Docket No. 286.

[2] Docket No. 292.

concerns. Muhs was employed by TKCA as its Vice President of Business Development. During Muhs' employment, TKCA supplied six Dash 8 aircraft to the Department of State (DoS). Muhs was significantly involved in all six Dash 8 sales.

In March 2011, Muhs resigned his employment with TKCA to begin working for Knowledge International. Muhs later agreed to continue to work part-time for TKCA. During this general time frame, Muhs learned that there might be another DoS Dash 8 solicitation. Muhs began working with Phoenix Heliparts, Inc. (PHP) to find aircraft and develop a bid for this possible solicitation. After the DoS issued the solicitation, Muhs continued to help PHP and PHP eventually was the successful bidder. TKCA was unable to submit a bid because it did not have an aircraft to propose and because by the time the bid was due, it knew Muhs was working with PHP.

On September 26, 2011, TKCA commenced this action. TKCA asserted seven claims against Muhs in its complaint: 1) breach of contract, 2) breach of the implied covenant of good faith and fair dealing, 3) breach of fiduciary duties, 4) unjust enrichment, 5) interference with prospective business relationships, 6) fraud, and 7) misappropriation of trade secrets. TKCA also moved for a preliminary injunction,[3] which was granted on October 14, 2011.[4] The preliminary injunction generally enjoined Muhs from assisting PHP with the Dash 8 solicitation.

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[3] Docket No. 7.

[4] Docket No. 43.

On October 20, 2011, TKCA commenced an action against PHP in Arizona State court. Although filed later, the Arizona Action progressed far more rapidly than this case.

On February 21, 2012, Muhs moved to stay this case pending resolution of the Arizona Action.[5] At this time, Muhs was represented in this matter by the same counsel that was representing PHP in the Arizona Action.[6]

In the memorandum in support of his motion to stay, Muhs stated that the Arizona Action "involve[d) the same plaintiff ... and [the] same factual and legal issues as those in the Alaska Action" and that "[t]he underlying factual allegations in the respective Verified Complaints in the two actions are virtually verbatim, the gravamen of the claims are identical, and the relief requested is virtually identical."[7] Muhs further stated "this pending action is so substantially similar to and significantly parallels the Arizona Action [as] reflected in the overwhelming overlap of TKCA's factual and legal arguments in the Arizona Action Preliminary Injunction('PI') Hearing Brief and its Summary Judgment ('SJ') Motion Brief in this court-the fundamental linchpin of both being the

[5] Docket No. 61.

[6] Muhs avers that he "was never fully advised of the conflict of interest, the risks of joint representation and never signed a written waiver." Declaration of Charles Taylor Muhs at 4,118, Exhibit 1, Defendant's Response in Opposition to Plaintiff TKC Aerospace, Inc.'s Motion for Summary Judgment, Docket No. 292.

[7] Memorandum of Law in Support of Defendant's Motion for a Temporary Stay at 2, Docket No. 62.

alleged wrongdoing of Muhs."[8] Muhs stated that it was "a distinction without a difference" that he was the "sole defendant" because "TKCA's claims of wrongdoing by PHP are entirely based on the alleged wrongdoing of Muhs."[9] Muhs also pointed out that "all parties in the two cases have entered into a stipulation and agreed that any discovery and trial testimony from the Arizona Action can be used as evidence in this case," which Muhs suggested was further evidence of "the substantial similarity between the two cases...."[10] In his reply brief, Muhs stated that "[a] resolution of the Arizona Action in TKCA's favor will dispose of any remaining liability and damage questions in the Alaska Action (again, but for the $20,000 wage claim)."[11] Muhs also stated "[i]f TKCA prevails in the Arizona Action, ... then Muhs would be collaterally estopped from arguing differently in this Court."[12]

On March 8, 2012, the court denied Muhs' motion for a stay.[13] In doing so, however, the court observed that "Muhs' relationship to TKC[A] and his conduct as regards PHP is the keystone to all of the claims of substance in both the Alaska federal suit and the Arizona state suit."[14] The court also observed that

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[8] Id. at 8 (internal citations omitted).

[9] Id. at 9.

[10] Id. at 10, n.4.

[11] Reply Memorandum of Law in Support of Defendant's Motion for a Temporary Stay at 9-10, Docket No. 75.

[12] Id. at 6, n.3.

[13] Docket No. 76.

[14] Order re Motion for Stay at 2, Docket No. 76.

> it is reasonably clear that the Arizona litigation will not necessarily resolve the whole of this litigation. That said, the Arizona litigation has the prospect of materially affecting this litigation. Because Muhs' conduct is at the heart of all the claims in this court and in Arizona, there is the prospect for substantial duplicative litigation even though the defendants in the respective cases are different.[[15]]

On May 2, 2012, TKCA and Muhs filed simultaneous motions for summary judgment.[16] All of the evidence offered in support of the motions for summary judgment had been developed in the Arizona Action as no discovery had yet taken place in this case. On January 17, 2013, the court denied TKCA's motion for summary judgment and granted Muhs' motion in part.[17] Muhs was granted summary judgment on TKCA's unjust enrichment claim and fraud claim and on portions ofTKCA's breach of contract and trade secrets claims.[18]

The court thereafter deferred any further scheduling in this case until the Arizona Action was completed. The proceedings in the Arizona Action were finally completed on January 30, 2015. The Arizona court concluded

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[15] Id. at 4.

[16] Docket Nos. 85 and 91.

[17] SEALED Order re Motions for Summary Judgment at 53, Docket No. 195.

[18] Id. at 53-54.

> that PHP misappropriated TKCA's bid proposal, [Statements of Work] and labor rates in violation of the fArizona Uniform Trade Secrets Act]. PHP profited from its misappropriation to TKCA's detriment and is ordered to pay TKCA the sum of the profits TKCA would have received under the DoS contract.... It is further ordered that PHP pay TKCA the calculated research and development cost[s].... It is further ordered that PHP pay exemplary damages pursuant to A.R.S. §44-403(B) in an amount double awarded to TKCA for its lost profit and research and development costs. In addition, with respect to the common law claims, TKCA is awarded its lost profits and punitive damages.... It is also ordered that TKCA submit its applications for the amount awarded in sanctions (reasonable fees and expenses) and for reasonable attorney's fees pursuant to A.R.S. § 44-404 and A.R.S. § 12.349.[[19]]

The Arizona court's conclusion was based on findings that Muhs worked with PHP to compete for the DoS contract, that Muhs provided TKCA documents to PHP, and that Muhs worked on PHP's DoS Dash 8 proposal.[20] The Arizona court entered judgment against PHP in the amount of $20,295,782.58.[21]

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[19] Under Advisement Ruling at 59, Attachment A, Authenticating Affidavit of Peter Scully, Docket No. 288.

[20] Id. at 4-11.

[21] Id. at 60.

TKCA now moves for summary judgment on all of its remaining claims against Muhs on the grounds that Muhs is collaterally estopped from relitigating TKCA's claims against him. In the alternative, TKCA moves for entry of a default judgment as a sanction. *TKCA* also moves for an award of attorney fees and costs.

Discussion

Summary judgment is appropriate when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c).

"For an issue in a separate action to have preclusive effect under the doctrine of collateral estoppel, the party against whom the issue is being asserted must have been a party to the earlier action." Stewart v. Elliott, 239 P.3d 1236, 1240 (Alaska 2010). "But if one was not a party to the earlier action, that non-party may nonetheless be bound if in privity with the party in the earlier action." Id.

"In addition to the party/privity requirement, collateral estoppel requires that the judgment be final and on the merits; that the precluded issue be identical in both actions; and that the issue be essential to the final judgment in the first action." Id. at 1241-42. "In addition, ... the issue to be collaterally estopped must have been 'actually and fully litigated in the first action.' In other words, the precluded party must have had 'a fair opportunity procedurally, substantively, and evidentially to contest the issue.'" Chilton-Wren v. Olds, 1 P.3d 693, 697 (Alaska 2000) (quoting Murray v. Feight, 741 P.2d 1148, 1153 (Alaska 1987)).

There is no dispute that the Arizona judgment is final and on the merits. There is also no dispute that the issues in this action are identical to those in the Arizona Action and that these issues were essential to the final judgment in the Arizona Action. The dispute here focuses on whether Muhs was in privity with PHP.

Under Alaska law, "[p]rivity exists where 'the non-party (1) substantially participated in the control of a party's presentation in the adjudication or had an opportunity to do so; (2) agreed to be bound by the adjudication between the parties; or (3) was represented by a party in a capacity such as trustee, agent, or executor.'" Stewart, 239 P.3d at 1241 (quoting Powers v. United Servs. Auto. Ass'n, 6 P.3d 294, 297-98 (Alaska 2000)). "Privity 'is a shorthand way of expressing assurance that the non-party has had adequate notice and opportunity to be heard, and that its rights and interests have been protected." Id. (quoting Alaska Foods, Inc. v. Nichiro Gyogyo Kaisha, Ltd., 768 P.2d 117, 121 (Alaska 1989)). "In effect, privity assures that it is fair to legally bind the non-party to the actions of the party in the earlier action." Id.

As set out above, Muhs represented to this court that the issues in this case and the Arizona Action were almost identical, and he expressly stated that if TKCA were to prevail in the Arizona Action, he would be collaterally estopped from arguing differently in this court. In other words, Muhs represented that he was agreeing to be bound by what happened in the Arizona Action. Muhs, however, argues that he was not aware of the breadth and potential effect of his former counsel's statements to this court. Muhs offers his declaration in support of this argument. Muhs avers that he

> was told and I believed that nothing that was done, agreed to, or said in the Arizona Matter would damage my case in Alaska. I was told and believed I would still be able to defend myself in Alaska, including conducting discovery, but some parts of the Arizona Matter might be used in Alaska as evidence.[22]

Muhs further avers that he "recognize[s] that my former attorneys made statements regarding the applicability of the Arizona Action to this matter, but I was unaware of the scope, breadth and potential effect of those statements."[23] Muhs also avers that he

> never knowingly agreed to be bound by the results in the Arizona Action and thereby take away my ability to argue my case in Alaska. Everything I agreed to and anything I signed, was done because I was told it was necessary for the trial in Arizona to move forward. I would not have agreed to or signed anything that I knew would take my ability to defend myself away.[24]

Muhs also avers that he "retained the legal services of Dickstein Shapiro ... to represent me in my role as

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[22] Muhs Declaration at 3, ¶ 5, Exhibit 1, Defendant's Response in Opposition to Plaintiff TKC Aerospace, Inc.'s Motion for Summary Judgment, Docket No. 292.

[23] Id. at 4, ¶ 9.

[24] Id. at 5, ¶ 15.

solely a witness in the Arizona Action.[[25]] Although for a time Dickstein Shapiro was my counsel in this matter, it was always my understanding that I was being represented as a witness."[26]

Muhs argues that his declaration makes clear that he never intended to relinquish his rights to a trial or to conduct discovery in this matter. Muhs points out that while "courts look with favor on stipulations designed to simplify, shorten or settle litigation, or to save costs, they "will not give such stipulations a forced construction" or "construe [a] stipulation to waive rights not plainly intended to be relinquished." DeNardo v. Calista Corp., 111 P.3d 326, 332 (Alaska 2005) (citations omitted). Thus, Muhs argues that his attorneys' statements should not be construed to mean that he relinquished his rights to a trial or to conduct discovery in this case.

Muhs also argues that his counsel's statements should give way to his due process rights. Muhs contends that the Supreme Court has made clear that sometimes application of collateral estoppel violates due process. He cites to Blonder Tongue Laboratories, Inc. v. University of Illinois Foundation, 402 U.S. 313 (1971), in support of this contention. There, the Court observed that

[25] This averment is in direct conflict with the fact that three Dickstein Shapiro lawyers applied for permission to appear and participate as co-counsel. for Muhs in this case. Docket Nos. 23-25.

[26] Muhs Declaration at 2, 13, Exhibit 1, Defendant's Response in Opposition to Plaintiff TKC Aerospace, Inc.'s Motion for Summary Judgment, Docket No. 292.

> [s]ome litigants-those who never appeared in a prior action-may not be collaterally estopped without litigating the issue. They have never had a chance to present their evidence and arguments on the claim. Due process prohibits estopping them despite one or more existing adjudications of the identical issue which stand squarely against their position.

Id. at 329. Muhs argues that this is a case in which due process should prevent resolving this matter through collateral estoppel because TKCA is asking the court to enter judgment against him in excess of twenty million dollars without allowing him the opportunity to develop evidence. Muhs also argues that to bind him to the outcome of the Arizona Action would violate his due process rights because while he had involvement in the Arizona Action, it was only as a witness and not as a party. As a witness, he contends that he never had the right to call his own witnesses, conduct discovery, or otherwise assert a defense. Thus, he argues that he never received a fair hearing on the claims asserted against him by TKCA and that he should be allowed such a hearing now. Muhs now argues that while the discovery conducted by PHP in the Arizona Action might have been similar to discovery Muhs would conduct in this matter, it was not identical. For example, Muhs avers that he will seek discovery from and call as witnesses "Mike Weems, Brian Blake, Ron Lee and Robert Kessler[,]"[27] who were presumably not witnesses in the Arizona Action. Muhs also contends that he will retain

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[27] Id. at 3, 11. 10.

experts in the area of government contracts in order to demonstrate the effect of TKCA's decision to not bid on the Dash 8 solicitation and that he will also seek discovery of documents from the DoS to demonstrate that TKCA's decision not to bid had little to do with his actions. Muhs reminds this court that the Alaska Supreme Court has "recognized that it is not always possible to resolve a case through collateral estoppel, even if that case arises from the same underlying facts and theory as prior litigation." Powercorp Alaska, LLC v. Alaska Energy Auth., 290 P.3d 1173, 1182 (Alaska 2012). And he insists that this is one of those times.

This court disagrees. Muhs is equitably estopped from now asserting that he did not understand that he was agreeing to be bound by whatever happened in the Arizona Action.

> Alaska recognizes two separate estoppel doctrines. The elements of equitable estoppel are the assertion of a position by conduct or word, reasonable reliance thereon by another party, and resulting prejudice. Neither ignorance nor reliance, however, are essential elements of quasi estoppel. Quasi estoppel appeals to the conscience of the court and applies where the existence of facts and circumstances mak[es] the assertion of an inconsistent position unconscionable. This court has instructed trial courts to consider the following factors in determining whether the doctrine of quasi estoppel is applicable: whether the party asserting

> the inconsistent position has gained an advantage or produced some disadvantage through the first position; whether the inconsistency was of such significance as to make the present assertion unconscionable; and, whether the first assertion was based on full knowledge of the facts.

Wright v. State, 824 P.2d 718, 721(Alaska 1992) (internal citations omitted). Either doctrine applies here. Equitable estoppel applies because TKCA reasonably relied on Muhs' numerous assertions that the Arizona decision would bind the parties in this case and TKCA would be prejudiced if it were to have to retry this case now.

Quasi estoppel also applies because Muhs gained an advantage by representing that he would be bound by the Arizona Action and allowing him to change course now would be unconscionable. Muhs' former counsel formally appeared for him and thus "was authorized to speak and act for him." Lane v. Ballot, 330 P.3d 338, 342 (Alaska 2014). Muhs' counsel represented to this court that Muhs agreed to be bound by whatever happened in the Arizona Action. The court simply must be able to rely upon commitments of counsel made on behalf of their clients in answers, motion papers, and procedural matters such as the interrelationship between the Arizona Action and this case. If parties are free to question or challenge decisions made by counsel in the course of litigation after the court has received and relied upon representations of counsel, the court's ability to effectively manage litigation would be very substantially degraded. Indeed, there would need to be a wholesale revision of the way in which the court and counsel for parties interact.

In short, Muhs agreed to be bound by the decision in the Arizona Action and thus he was in privity with PHP. Because Muhs was in privity in with PHP, Muhs is collaterally estopped from relitigating TKCA's claims against him.[28]

If the court decides that collateral estoppel applies here, which it has, Muhs argues that it should only apply to liability and that he should still have an opportunity to conduct discovery as to whether TKCA's damages were proximately caused by his conduct. Muhs contends that given the enormity of the judgment that TKCA seeks to have entered against him and the fact that TKCA already has a judgment in excess of $20 million against PHP, he should be permitted to conduct discovery to ensure that damages are not assessed against him for the actions of PHP or for conduct for which TKCA has already been compensated.

Muhs, however, represented to this court that "the alleged damages [in the two actions] are the same";[29] that "the liability <u>and</u> damage components of the two actions are more than 'sufficiently parallel';[30] that the "damages are essentially identical in both

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[28] Because the court concludes that Muhs agreed to bound by the outcome of the Arizona Action, the court need not consider TKCA's argument that Muhs substantially participated in the control of PHP's defense. The court also need not consider TKCA's alternative motion for sanctions.

[29] Memorandum of Law in Support of Defendant's Motion for a Temporary Stay at 4, Docket No. 62.

[30] <u>Id.</u> at 12.

cases;"[31] and that "[a] resolution of the Arizona Action in TKCA's favor will dispose of any remaining liability and damage questions in the Alaska Action...."[32] Thus, Muhs' contention that the damages that were decided in the Arizona Action might not be attributable to him is meritless. Muhs is collaterally estopped from relitigating both liability and damages, and TKCA is entitled to summary judgment as to both liability and damages.

TKCA also contends that it is entitled to its attorney fees and expenses. First, TKCA argues that Muhs is liable for the attorney fees and expenses that it has incurred in this case. The court will entertain TKCA's motion for an award of attorney fees and expenses incurred in connection with this case. Such motion shall be filed on or before November 23, 2015.

Second, TKCA argues that Muhs is liable under his employment agreement for its attorney fees and expenses incurred in the Arizona Action. Muhs' employment agreement provides:

> If Executive breaches any of the covenants set forth in Paragraph 6, 7 or 8 of this Agreement, Executive agrees to pay all costs (including reasonable attorney's fees) incurred by the Company in establishing that breach and in otherwise enforcing any of the covenants or provisions of this Agreement.[33]

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[31] Reply Memorandum of Law in Support of Defendant's Motion for a Temporary Stay at 6, n.3, Docket No. 75.

[32] Id. at 9-10.

[33] Exhibit A at 10, 19, Verified Complaint, Docket No. 1.

TKCA contends that this provision is broad enough to encompass its attorney fees and costs in the Arizona Action and argues that had it not established that Muhs breached his agreement in the Arizona Action, it would have had to do so here. Thus, TKCA insists that Muhs is liable for the Arizona attorney fees ($4,596,865.06) and taxable costs ($113,321.37).

TKCA has offered no authority that suggests that Muhs' employment contract should be interpreted to include attorney fees directed at establishing Muhs' liability but incurred in litigation in which he was not a named party. The court had substantial doubt that Muhs' employment contract is broad enough to cover such fees. With what is presently before it, the court denies TKCA's request for fees incurred in the Arizona Action. The court will, however, reconsider the matter if TKCA can offer any authority to support its contention that it is entitled to the fees incurred in the Arizona Action.

Next, there is the matter of Muhs' stay request. Muhs argues that if the court decides that TKCA is entitled to summary judgment, it should stay the current matter until the appeal filed by PHP in the Arizona Action is decided.[34] If PHP's appeal is successful, in whole or in part, the judgment on which TKCA is basing its current motion for summary judgment will be vacated in whole or in part. If this were to happen, Muhs argues that an incongruous result would occur: the judgment against .PHP would be vacated and yet the judgment against him would still exist.

[34] PHP filed Chapter 11 bankruptcy on September 18, 2015, so any appeal is presumably now stayed.

The court is not inclined to leave this matter open until an Arizona appeal and bankruptcy proceeding are concluded, but there are other ways for the parties to deal with the problem which would arise if the Arizona judgment were to be reversed. For example, a protective notice of appeal could be filed in this case and held in abeyance pending resolution of the Arizona appellate proceedings. Or, the parties could agree that judgment in this case be reopened if an Arizona appeal is successful, agree not to execute on this court's judgment, and this court could retain jurisdiction of this matter for purposes of post-judgment proceedings in the event that the Arizona judgment were to be reversed. The parties can and should consider an appropriate post-judgment agreement with respect to the foregoing matters, which the court will take up at the same time it is finalizing a judgment in this case.

Finally, there is the matter of the relief to which TKCA is entitled. What follows is this court's tentative view of what the final judgment in this case should be:

> As to TKCA's claims under Count I (breach of contract), Count II (breach of implied covenant of good faith and fair dealing), Count III (breach of fiduciary duty), and Count V (tortious interference with prospective economic benefit), TKCA is entitled to judgment against

Muhs for lost profits in the amount of \$2,883,055.86.[35]

As to TKCA's Count IV (unjust enrichment) and Count VI (fraud), the court has entered summary judgment in favor of Muhs,[36] and these claims are dismissed with prejudice.

As to TKCA's Count VII (Alaska Trade Secret Acts), TKCA is entitled to judgment against Muhs in the amount of:

a. Lost Profits: \$2,883,055.86

b. Research and Development: \$3,882,205.00

c. Exemplary Damages: \$13,530,521.72[37]

TKCA is entitled to taxable costs of \$_________ and attorney fees and non-taxable costs in the amount of \$_______.

The judgment shall bear interest at ____% per annum from the date of this judgment until paid.

The court retains jurisdiction of this case for purposes of reviewing the court's order of ________________________

[35] TKCA's prayer for relief did not include a request for punitive damages.
[36] Docket No. 195.
[37] Per AS 45.50.915(b).

> and this judgment in the event that the judgment in favor of TKCA in the Arizona Action is reversed on appeal.

Conclusion

TKCA's motion for summary judgment is granted. TKCA is granted summary judgment as to its remaining claims against Muhs. As set out above, TKCA may serve and file a motion for attorney fees and costs incurred in this action. And, TKCA shall serve and file a proposed judgment on or before November 23, 2015. Muhs shall respond on or before December 7, 2015; and any reply by TKCA shall be served and filed within seven days of Muhs' response.

DATED at Anchorage, Alaska, this 22nd day of October, 2015.

/s/ H. Russel Holland
United States District Judge

[ENTERED: January 30, 2015]

Michael K. Jeanes, Clerk of Court
*** Electronically Filed ***
02/02/2015 8:00AM

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2011-018889 01/30/2015

CLERK OF THE COURT
C. Keller
Deputy

HON. SALLY SCHNEIDER DUNCAN

T K C AEROSPACE INC

BRIAN D MYERS

v.

PHOENIX HELIP ARTS INC, et al.

SHARON A URIAS

HOWARD R CABOT

UNDER ADVISEMENT RULING

This case involves statutory and common law claims brought by Plaintiff, TKCA Aerospace, Inc. ("TKCA"), against Defendant, Phoenix Heliparts, Inc. ("PHP"), for misappropriation of trade secrets under A.R.S. § 44-401 *et. seq.*, the Arizona Uniform Trade Secret Act ("AUTSA"), intentional interference with business expectancy, unfair competition, and conversion.[1] More specifically, TKCA alleges that

[1] PHP has filed counterclaims against TKCA that are not the subject of this ruling.

PHP colluded with a TKCA employee, Charles Muhs ("Muhs") to misappropriate protected, confidential and proprietary information to compete for and secure a government contract that would have otherwise been awarded to TKCA but for PHP's misconduct. PHP argues that TKCA's failure to submit a bid precludes TKCA's claims. PHP also maintains that the information it misappropriated and used in its bid proposal was publicly available through a Freedom of Information Act ("FOIA") request or other public means, i.e., the internet. TKCA seeks relief under AUTSA in the form of head-start damages, research and development costs, and lost profits and also seeks relief for the common law claims including a request for punitive damages.

In addition to addressing the claims raised by TKCA in its Complaint, this ruling also addresses the misconduct that PHP engaged in during trial which expanded the proceedings from a trial projected to last four days to one that exceeded 40 days and included a hearing under *Zimmerman v. Shakman,* 204 Ariz. 231, 62 P.3d 976 (App. 2003)("*Zimmerman"*).[2]

For ease of reference, the parties and significant witnesses involved in this case are as follows:

- TKCA – Plaintiff Aerospace Contractor
    - o Sam Boyle – TKCA President
    - o Charles Muhs – Former TKCA Vice-President for Business Development

[2] The *Zimmerman* hearing exrunined whether PHP engaged in misconduct; if so, whether the misconduct was material; if so, whether the misconduct was prejudicial; if so, who was at fault: PHP, its counsel or both.

  - Tim Summerrow – TKCA Director of Airborne Programs
  - Race McCleery – TKCA Chief Financial Officer
- PHP – Defendant Aerospace Contractor
  - Tina Cannon – PHP President
  - Darin Cannon – PHPs Vice President of Operations and Tina Cannon's husband
  - Don Nichols – Part owner of PHP
  - Ed Brown – Part owner of PHP
- Communication Concepts, Inc. (CCAZ) – PHP's outside information technology ("IT") provider
  - Robert Jones – CCAZ employee
- Bombardier, Inc. – Canadian Civil Aircraft Manufacturer
  - Jonathan Cree – Bombardier representative
- Doug Asslet – Director of Maintenance for the Department of State ("DoS") Bureau of International Narcotics and Law Enforcement Affairs–TKCA's primary point of contact
- Dennis Allen – TKCA Damages Expert
- Thomas Day – TKCA Computer Forensics Expert
- Dr. Dov Frishberg – PHP Damages Expert
- Stroz Friedberg, LLC – PHP Computer Forensics experts

  - o Kenneth Mendelson – Stroz Friedberg representative

- Knowledge International – A United Arab Emirates ("UAE") company and Charles Muhs' putative employer
- EAI – The UAE parent-company of Knowledge International
- Dickstein Shapiro, LLC – PHP Counsel
  - o Victoria Kummer – PHP counsel
- Sharon Urias – Local counsel retained to assist Dickstein Shaprio
- Air Nostrum – A Spanish Airline whom Bombardier acted as an agent for in the sale of its Dash 8 fleet.
- Theo Von Wyl – An independent contractor TKCA had used in Spain to inspect and monitor Air Nostrum's Dash 8's before delivery

I. FACTS

A. Facts Common to all Claims

This court finds and relies upon, but is not limited to, the following facts in its ruling.

TKCA is an Alaskan corporation specializing in aircraft procurement, support, and logistics. TKCA Compl., ¶ 1. In 2005, Charles Muhs signed a two-year contract to serve as TKCA's Vice President. Ex. 194 TKCA_PHP 000001. In 2007, Muhs entered into a new agreement pursuant to which he would become the Vice President of Business Development. Ex. 1.

The contract included a clause that prohibited Muhs from disclosing confidential information to any third party or competing with TKCA for six months after his employment terminated. Ex. 1. Section 7 of Muhs' employment contract with TKCA provides that the executive will not "disclose to any third party or entity any trade secrets or other proprietary or confidential information" without the company's written consent. Ex. 1C at TKCA_PHP_000009-10. The contract defined company trade secrets as "compilation[s] of information or data related to or concerning Company's business, contract strategies ... [or] existing contracts and contracts under negotiation ..." *Id.* This contract represents the type that TKCA required all of its executive employees to sign. TKCA's employee handbook also included a section on confidentiality regarding company information. January 11, 2012 Tr. 34:4-7. As Vice President of Business Development, Muhs had access to TKCA's confidential and proprietary information, as well as trade secrets.

During Muhs' employment, he was personally, directly, and significantly involved in securing several large contracts between TKCA and DoS. January 11, 2012 Tr. 40:21 – 42:20. In September 2009, TKCA subcontracted with PHP to fulfill a Department of State order for the purchase and retrofit of MD-530 helicopters. Ex. 52 at ¶ 27. Muhs was the primary liaison for TKCA's business with PHP. PHP is an Arizona corporation licensed, authorized, and conducting business in Maricopa County. Ex. 52 at ¶ 2. Prior to its work on the MSN 560, PHP's sole expertise was in MD helicopter maintenance. The company had never performed work on a fixed-wing aircraft. March 12, 2012 Tr. 95:4-20.

From December 2009 to February 2011, DoS issued solicitations for six Dash 8 aircraft. Each time, DoS selected TKCA as the successful bidder. January 11, 2011 Tr. 39:20 – 40:3; 40:21 – 42:20. The original solicitation issued by DoS did not specify the type of aircraft a contractor should use. Instead, based on its fixed-wing experience, research and planning, TKCA selected the Dash 8 as the aircraft best suited to meet DoS's immediate and long-term needs. January 11, 2012 Tr. 44:4 – 18. The Dash 8 is a large, fixed-wing turbo prop aircraft manufactured by Bombardier, the world's largest civil aircraft manufacturer. Ex. 172. There is a limited supply of Dash 8 aircraft because Bombardier no longer manufactures them. January 11, 2012 Tr. 40:4-20. Over time, TKCA purchased six Dash 8 aircraft from Bombardier to fulfill DoS solicitations. *Id.* at 44:19 – 45:20. To satisfy DoS and to secure its position as the successful bidder, TKCA invested significant time, money and resources modifying the Dash 8 aircraft.

Upon learning of DoS's requirements, Muhs would contact Bombardier to select a suitable Dash 8. January 11, 2012 Tr. 37:20 – 39:19, 40:4-10, 44:19 – 45:20, 62:12-19; Ex. 30 at 17:11 – 18:9. After entering into a letter of intent with Bombardier, TKCA would submit a proposal to DoS identifying the aircraft and describing how it planned to modify the Dash 8 to meet DoS needs. January 11, 2012 Tr. 44:19 – 45:6, 46:17 – 48:11, 68:23 – 69:3; Ex. 30 at 17:18 – 18:9; Ex. 31 at 69:25 – 70:22.

On March 28, 2011, Muhs unexpectedly resigned without cause to pursue employment with Knowledge International, a UAE company. Ex. 2. Muhs assured TKCA that his new duties would not be competitive with TKCA. *Id.* Three weeks later, Muhs agreed to continue part-time for TKCA while working for his new employer. In breach of his contractual obligations, Muhs then began to work closely with PHP to secure aircraft and develop a bid for a possible DoS solicitation by providing it with the necessary business relationships, trade secrets, and confidential information.

On August 5, 2011, DoS issued a solicitation specifically for a seventh Dash 8 aircraft and an option for an eighth. Ex. 29 at 1. On September 9, 2011, PHP submitted its Proposal to DoS in response to the Solicitation. Ex. 133 and 888; January 17, 2013 Tr. 74:2 – 77:10. DoS awarded PHP the contract. PHP's and Muhs' illicit alliance directly and adversely impacted TKCA's ability to prepare and submit a successful bid in response to the DoS solicitation. On September 26, 2011, TKCA filed a lawsuit in the United States District Court for the District of Alaska, suing Charles Muhs for breach of contract. Ex. 53. On October, 20, 2011, TKCA filed this action.

B. Facts Relevant to Common law and Statutory Claims

1. PHP and Muhs worked together to compete for the DoS contract

On April 22, 2011, Doug Asslet, Muhs' contact at DoS, called him to request market research on any available Dash 8's. March 12, 2012 Tr. 148: 20-149:14. Muhs immediately contacted Jonathan Cree at Bombardier about any available Dash 8's. *Id.* at 149:16-20. Cree emailed Muhs specifications on the MSN 560, 582, and 586 and identified the MSN 560 as the best option based on its specifications and price. Ex. 85. On the same day, Muhs forwarded the specifications to Doug Asslet and Race McCleery. Ex. 287. On May 27, 2011, Bombardier sent Muhs, as a TKCA representative, a signed letter of intent ("LOI") for the sale of the MSN 560. Ex. 12. If signed by TKCA, the LOI would have bound TKCA and Bombardier. January 11, 2012 Tr. 68:23 – 69:25; Ex. 31 at 69:25 – 70:22. Without TKCA's knowledge and consent, Muhs sent the LOI to Tina Cannon, PHP's President, resulting in the unauthorized disclosure of information about customer's needs, the aircraft that met those needs, as well as sale's pricing, terms, and conditions. Ex. 240; January 11, 2012 Tr. 66:4 – 69:14. On May 31, 2011, Muhs emailed Doug Aslett of DoS: "I've done some market research on the available Dash 8s. Attached you will find a draft LOI for two aircraft for your review." Ex. 15 at TKCA_PHP_KI_164. Muhs and Tina Cannon then emailed each other, following up on the Muhs-Aslett email, about the TKCA LOI:

> Cannon to Muhs: "Chuck, I noticed that they (Bombardier) sent it (the LOI) to the TKCA e-mail address and to you at TKC? If your [sic?] around later I do need to talk to you. Tina"
>
> Muhs to Cannon: "Tina, that is what the letter said but it was sent to my Knowledge International email address. TKCA has not gotten it yet. Regards, Chuck"
>
> Cannon to Muhs: "Oh, it looked really strange. I returned your call. If your

> [sic?] available, I give you a call in about 10 minutes if not we can talk in the morning."

Ex. 15; January 11, 2012 Tr. 159:3 – 163:22; March 13, 2012 Tr. 139:23 – 143:9; March 15, 2012 Tr. 99:9 – 102:12, *(Brackets not in the original).* Tina Cannon denied looking at the attachment, which was the TKCA LOI. March 15, 2012 Tr. 97:19-21; 99:24 – 100:1; 100:9-12. This court finds Tina Cannon's testimony strains credibility on this point and many others. Tina also testified that she knew that Muhs "was bound by a noncompete with TKCA." March 15, 2012 Tr. 85:20-86:11. Because TKCA never learned of the LOI, it did not respond and the LOI lapsed. January 11, 2012 Tr. 66:1 – 69:21, 160:11 – 163:22. On July 1, 2011, PHP and Bombardier entered into a LOI for the sale of MSN 560. Ex. 4. PHP knew DoS had awarded TKCA contracts for the previous six aircraft. March 15, 2012 Tr. 86:8-22.

Muhs continued to act as PHP's liaison. He introduced Tina and Darin Cannon to his contacts at Bombardier, Air Nostrum, and to Theo Von Wyl. Bombardier was the sales agent for Air Nostrum, a Spanish aviation company that was selling its fleet of Dash 8s as it transitioned to a different type of aircraft to serve its passengers. January 11, 2012 Tr. 41: 8-18. TKCA had developed a close relationship with representatives from Bombardier. *Id.* at 43:25-45:13. Theo Von Wyl is an independent contractor who performed preliminary inspections for TKCA on the Dash 8's it previously sold to DoS. March 13, 2012 Tr. 168:7 – 169:10. TKCA had also developed a close relationship with Theo Von Wyl. January 11, 2012 Tr. 178: 18-24. Muhs recommended that PHP use Theo

Von Wyl to provide oversight at Air Nostrum. March 13, 2012 Tr. 168:11 – 169:9. PHP named Theo Von Wyl's as its representative providing project oversight at Air Nostrum in the DoS proposal. Ex. 133 at PHP 003343.

Throughout the bid drafting process, Muhs and the Cannons continuously consulted each other. A chain of emails dated August 8, 2011 provides an example of their communications and their consciousness of TKCA's role as a competitor, which serves to underscore why Muhs and the Cannons went to such great lengths to conceal their efforts from TKCA. In the highlighted email exchange, Darin, Tina, and then later Muhs discuss the aircraft selection process for the DoS Dash 8 solicitation. Ex. 120. Darin and Tina communicated with each other about a Dash 8 that had been in a hard landing accident, and they expressed concern that Doug Asslet, DoS's point of contact, would not accept the aircraft. Later that day in an email Darin sent to Muhs and Tina, he stated, "I don't think the contract distinguished this. It's a million plus cheaper and may give TKCA an advantage." *Id.* Darin Cannon testified that he wrote "may give TKCA [an] advantage" because he was conscious of TKCA as a competitor for this solicitation. March 12, 2012 Tr. 107:5 – 108:13.

2. Muhs provided, and PHP used TKCA documents

On June 2, 2011, Muhs uploaded approximately 1600 TKCA documents onto PHP's FTP server. March 14, 2012 Tr. 4:10 – 6:2; Ex. 283. After Muhs stopped uploading these documents, he informed Tina and Darin Cannon that he "downloaded some files to the FTP [server] on both the Dash 8 and 1900D," and that "there are Initial Provisioning Lists that are included in both files." Ex. 420; July 26, 2012 Tr. 151:22 – 153:4. Initial Provisioning Lists (IPL) identify the parts and equipment needed for a project. Tina Cannon claims she never knew Muhs uploaded documents to the FTP server, and denies seeing any TKCA documents. April 24, 2013 Tr. 59:1-10. Ten days later, Muhs met with PHP's Owners, Ed Brown and Don Nichols, and the Cannons in Costa Mesa, California, for a business development meeting. Muhs gave a presentation titled "Business Development Process Prepared by Charles Muhs in June of 2011 for Phoenix Heliparts." March 12, 2012 Tr. 132:1-24; January 14, 2013 Tr. 58:16 – 61:23; Ex. 430. In the meeting, Muhs identified Dash 8's as a business opportunity target. Ex. 430 at PHP 44253. Later that month, in an email with the subject line of "Dash 8 Program," Don Nichols wrote Muhs and stated "Chuck you are the man of the moment and without you we'd never think of entering this program." Ex. 258; March 15, 2012 Tr. 136:3- 137:13. At trial Muhs testified that while he was still under contract with TKCA he "took the TKCA proposal, put it under PHP for GAL, yes, and they used that." March 13, 2012 Tr. 97:11-12.[3]

[3] "GAL" refers to Global Aerospace Logistics, LLC, which is a company based in Abu Dhabi, the capital of the UAE. PHP maintains that Muhs and the Cannons were actually working on a "GAL proposal" and not the DoS solicitation. The GAL proposal will be discussed in more detail below but it bears noting that this Court finds the GAL proposal to be a fraud, and at no time did Muhs give confidential Dash 8 information to PHP with any intent other than to assist with the DoS proposal.

On August 17, 2011, Muhs sent the Cannons an email with the subject line "First Draft" and told the Cannons he would "send more stuff." Ex. 455. Tina Cannon responded: "Looks good! Freaks me out seeing TKCA's name though." Ex. 455. Tina Cannon clearly understood that she was intentionally and knowingly appropriating TKCA's trade secrets and confidential and proprietary information. Another version of the August 17, 2011, "First Draft" email contained an attachment titled "PHP DoS Dash 8-315 Proposal v1_0.docx." Ex. 1045. Five days later Muhs forwarded to the Cannons emails between TKCA and Bombardier containing almost 200 pages of TKCA's Initial Provisioning Recommendation (IPR) for Dash 8 aircraft. Ex. 6; March 13, 2012 Tr. 69:19-25. Much like IPLs, IPRs contain a detailed list of parts and equipment TKCA believes will be necessary to complete the contract. TKCA negotiated this IPR with Bombardier in connection with TKCA's sale of the sixth Dash 8 to DoS. *Id.*; January 12, 2012 Tr. 8:25 – 13:22. PHP used the information in the IPR to complete the PHP proposal by seeking a price quote from Bombardier for the parts on the list. Ex. 124.

On August 25, 2011, Tina Cannon sought a quote from Bombardier on the "Initial Provisioning Recommendation" list necessary for inclusion in its proposal to DoS. Ex. 124 at PHP 1954-1955; April 23, 2013 Tr. 132:2-3. Tina Cannon needed this pricing information and list of required spare parts to complete PHP's proposal on time. Ex. 124. Bombardier responded in pertinent part: "Since you have a very specific list of parts that appear to have come from a document supply to a separate company I would like to be cautious and make sure that those are the correct parts for the aircraft you are provisioning for, current configuration and current pricing." Ex. 124 at PHP 1953; Tina Cannon confirmed to Bombardier that this transaction was similar to the six previous Dash 8s sold to DoS. Ex. 124 at PHP 1949-1952. Bombardier followed up with Tina Cannon by saying: "We need to re-run the document to make sure this list is accurate ... [t]o generate a new document to support your request will take our IP team 2 weeks." Ex. 124 at PHP 1949-1952; April 23, 2012 Tr. 133:4 – 134:1. Tina Cannon responded: "Could you please just quote the list as given. We cannot wait 2 weeks. However, after quoting the list as is could you then provide the re-run?" Ex. 124 at PHP 1949-1950. At trial, Tina Cannon admitted she used TKCA's IPR in the proposal PHP submitted to DoS. April 23, 2012 Tr.140:14-23. PHP's use of the TKCA IPR provided PHP with past IPL proposal information. Absent this information, PHP would have been unable to respond timely to the DoS Solicitation.

There are more examples of the thoughtless and brazen manner in which PHP engaged in misconduct. For instance, identical typographical errors and language exclusive to TKCA appeared in both PHP's proposal and TKCA's March 2011 proposal.[4] PHP's proposal also contained the Blue

[4] The PHP Proposal and the TKCA Proposal have the same typo under Aircraft Market Research – "Performance on unimproved runways, hot and high performance necessary for the meeting the condition within the theatre of operations ...." [The unnecessary "the" before "meeting" appears in both documents]. Ex. 133 at PHP 003353; Ex. 9 at TKCA_PHP 983. "Manufactures" should be "manufacturers" in both proposals. Ex. 133 at PHP 003366; Ex. 9 at TK.CA_PHP 994. The word "Proposes" is improperly capitalized in both proposals. Ex 133 at

Falcon Tracker Data and Evaluation Notices that appeared in the draft form of TKCA's sixth Dash 8 proposal. April 25, 2012 Tr. 19:23 – 23:13; April 26, 2012 Tr. 40:3-57:5. In addition, PHP copied large portions of the proposal that TKCA had selected out of Bombardier technical manuals. Ex. 66; March 13, 2012 Tr. 105:10 – 106:2. Bombardier only gives technical information of that kind to customers and prospective vendors. January 11, 2012 Tr. 55: 14-22. DoS requires prospective vendors to provide "past experience" as part of the bid process. PHP had no prior fixed-wing aircraft experience but fallaciously claimed past experience delivering Dash 8 aircraft, and highlighted Muhs' involvement as overseer and "Director of Special Programs." Ex. 133 at PHP 003343. PHP poached TKCA's trade secrets, confidential and proprietary information and past performance to position itself competitively in the bid process.

An Evaluation Notice ("EN") is a request by DoS to a contractor for a technical clarification relating to a contractor's proposal. January 12, 2012 Tr. 18:18- 23:5; Ex. 19. DoS generates these notices as part of the dialogue between the DoS contracting officer and a prime contractor such as TKCA. Ex. 19. The DoS ENs are not publicly available. January 12,2012 Tr. 23:1 -23:4. Appendix E to PHP's proposal is an EN provided by Bombardier to TKCA and DoS during one of the prior TKCA Dash 8 sales. March 13,

PHP 003379; Ex. 9 at TKCA_PHP 1007 Two different acronyms for the same organization ("INL/A" and "INL-A" for International Narcotics and Law Enforcement Office of Aviation) mistakenly appear in both proposals, in the same sections. Ex. 133 at PHP 003377-78, 3380; Ex. 9 at TKCA PHP 1005, 1007, 1009.

2012 Tr. 114:20 – 115:20; Ex. 133 at PHP 3479. In this EN, Bombardier responded to a DoS request regarding the operating characteristics of a Dash 8 aircraft at 58 degrees Celsius. March 13, 2012 Tr. 117:6-9. TKCA labeled every page of the EN as "strictly confidential." March 13, 2012 Tr. 117:10-13. Muhs testified that he gave this EN to PHP. March 13, 2012 Tr. 118:5-10. PHP used this EN in its proposal to DoS. March 13, 2012 Tr. 118:5-10; Ex. 133 at PHP 003480 – 84. TKCA provided ENs regarding the "Extra Baggage Compartment" and "Beta Lockout" in the TKCA Proposal. Ex. 19. PHP included these two ENs in its proposal to DoS. *Compare* Ex. 19 and Ex. 133 at PHP 003488-99 and 3510-12. The DoS solicitation for the seventh Dash 8 did not require the "Extra Baggage Compartment" or "Beta Lockout." Ex. 29. Nevertheless, PHP's proposal included these ENs because PHP blindly copied TKCA's prior proposal without taking the time to ensure that its proposal satisfied DoS's solicitation.

PHP also misappropriated and used at least two of TKCA Statements of Work ("SOWs").[5] January 12,2012, Tr. 29:24-30:1. TKCA produces and submits SOWs along with its proposals in response to government issued RFPs. January 12, 2012 Tr. 28: 4-6. TKCA had submitted one in connection with a prior Dash 8 contract and the other as a part of the UH-1 proposal in which TKCA had used PHP as a subcontractor. Exs. 21 and 22. The SOWs enable the government to see how TKCA plans to meet the

[5] TKCA executive, Summerrow examined PHP's Dash 8 SOW and testified that "it appears our statement of work has been taken as a draft and used to produce this document." PHP was afforded an opportunity to test this claim but did not question Mr. Summerrow on this point. January 12, 2012 Tr. 29:24 – 30:1.

requirements of the RFP by identifying TKCA's subcontractors and the terms of their work. The SOWs mirror the requirements established in the RFP and provide additional technical and managerial instructions on how to execute the work. *Id.* at 31 :6-9. Different aircraft may need different modifications to satisfy the requirements of the RFPs. Accordingly, TKCA developed individualized SOWs. Indeed, TKCA hires employees who work solely on drafting and refining SOWs. Their efforts produce a work product unique to TKCA. TKCA crafted each SOW to give the company a competitive advantage. *Id.* at 31:14-22. Notably, the government does not always award a contract to the lowest bidder. The quality of the work is equally important. Through the SOWs, a contractor can demonstrate how its proposed solution will result in the best product. *Id.* at 31:21-22. When PHP misappropriated TKCA's SOWs, PHP reduced its overhead costs and increased its competitive advantage by avoiding the costs and expenses associated with developing SOWs. January 12, 2012 Tr. 30:1-11. On August 17, 2011, Muhs sent an email to the Cannons with a subject line of "SOW to vendors." Ex. 456. The email contained an attachment with "INL/A Dash 8 AC integrator" as its file name. The document itself was titled "STATEMENT OF WORK FOR AIRCRAFT MODIFICATIONS ON BOMBARDIER DHC 8-300 AIRCRAFT QUICK RESPONSE CONTRACT." *Id.* Muhs admitted that he violated his employment contract when he disclosed TKCA's SOWs to PHP. January 14,2013 Tr. 114:18 – 115:3, 116:1-4.

TKCA gives its SOWs to subcontractors to describe the work they will perform. January 12, 2012 Tr. 28: 4-6. Before delivering an SOW, TKCA requires subcontractors to sign a nondisclosure agreement. January 11, 2012 Tr. 95:8; 128:24 – 130:60. TKCA marks every page of an SOW as confidential before releasing the document to a subcontractor. Exs. 21 and 22. TKCA took similar precautions with its Dash 8 proposal. Every page refers to this restricted data notice placed on the front of the document. The notice provides:

> This proposal, quotation, plan or manual includes data that will not be disclosed outside the Government and will not be duplicated, used, or disclosed-in whole or in part- for any purpose other than to evaluate or implement this proposal, quotation, plan or manual for the benefit of TKC Aerospace, Inc. If, however, a contract is awarded to this offeror or quoter as a result of-or in connection with the submission of this data, the Government will have the right to duplicate, use, or disclose the data to the extent provided in the resulting contract. This restriction does not limit the Government's right to use information contained in this data if it is obtained from another source without restriction. The data subject to this restriction are contained in sheets so identified. Ex. 9 at 1.

Uncontradicted trial testimony substantiates TKCA's claim that PHP used TKCA labor rates and other proprietary information to prepare its proposal. *See, e.g.,* an August 17, 2011 email between Muhs, Tina and Darin Cannon with an attached file named

"DHC 8-315 Costing Sheet by CLIN.xlsx." July 26,2012 Tr. 164:16 – 167:1;[6] On August 22,2011, Muhs gave PHP a copy of TKCA's pricing information and a list of required spare parts from TKCA's sale of the sixth Dash 8 to DoS. Both of the attached documents include the prefix "Q300 TKCA Aerospace" in their file names. Ex. 6; March 13, 2012 Tr. 69:7-25; March 14, 2012 Tr. 53:9-54:2. When PHP misappropriated TKCA's labor rates, the General Service Administration ("GSA") had not posted the rates so they remained confidential until the GSA posted them in November, 2011.[7] October 9, 2013 Tr. 18:18 – 23:5; October 9, 2013 Tr. 79:9 – 90:25; 94:7 – 95:1; Ex. 1123. TKCA's labor rates were not public information at any time prior to November 2011. TKCA's March 2011 Proposal identified 28 labor categories with 10 corresponding labor rates. Ex. 395 at TKCA_PHP 6862. PHP's proposal uses 28 identical labor categories with different corresponding labor rates in nearly all categories. Ex. 133 at PHP 003403, 003405. Even though the hours projected for labor differ, both parties still list the hourly rate of a Program Manager at $91.77. *See* Ex. 395 at TKCA_PHP_006862 *with* Ex. 133 at PHP 003403.

3. Muhs worked on the PHP proposal

DoS initially required that contractors submit their proposals by September 2, 2011. DoS extended

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[6] See, e.g. Ex. 574. TK.CA neglected to move this exhibit into evidence. However, Summerrow's testimony substantiates this fact.

[7] The GSA schedule allows companies like TKCA to post their labor rates as a means of attracting prospective customers. October 9, 2013 Tr. 85: 8-12.

the deadline until September 9, 2011. Communications, between Tina Cannon and Muhs show that Muhs worked on PHP's DoS proposal up through the extended submission deadline. Indeed, reviewing all of the Cannons' and Muhs' activities in August and September, 2011, establishes that they diligently worked together to meet the DoS deadline and not a deadline for a fabricated GAL proposal. On August 23, 2011, Tina Cannon stated to Don Nichols and Ed Brown that "we have been working on the Dash 8 proposal that is due September 2nd." Chuck Muhs is cc'd on the email. Ex. 460; January 14, 2013 Tr. 127:12-25. Then on September 2, Muhs emailed the Cannons, "Subject: Latest Version Dash 8," "Attach: PHP DoS Dash 8-315 Proposal v1_6.docx": "Here is the latest version for your files. Trying to finalize before departure to UAE." Ex. 469; July 27, 2012 Tr. 61:3 – 62:8. PHP failed to produce this attachment. July 27, 2012 Tr. 61:3 – 62:8; January 14, 2013 Tr. 136:3 – 138:9. Tina Cannon responded to Muhs [Exhibit 469] with an email stating in the subject line: "Thank you" and then adding: "...I will go through the Dash 8 proposal and get back to you ASAP." Ex. 470; January 14, 2013 Tr. 140:3 – 141:17. Tina Cannon testified on this point and claimed that Muhs had made an error in naming the file. July 27, 2012 Tr. 61:1 – 62:12. Muhs testified that he was actually working on formatting PHP's DoS Dash 8 proposal. January 14, 2013 Tr. 136:3 – 21. In another email dated Friday, September 2, 2011, Muhs tells Tina Cannon, "[t]hanks so much for the hospitality and friendship ... need to win at least one of these!" Ex. 471; January 14, 2013 Tr. 142:17 – 143:17.

Early on Tuesday, September 6, 2011, Muhs emailed Darin and Tina Cannon stating that he was "[w]orking on the pricing and Gantt Chart. That's about it." Ex. 473; January 14, 2013 Tr. 144:17 – 146:6; July 27, 2012 Tr. 64:25 – 65:11. This version of the September 6 email references "PHP DoS Dash 8-315 Proposal v1_7.docx" as an attachment. "Docx" indicates the attachment was a Word document. Neither PHP nor Muhs has produced this attachment. (Exhibit 474, another version of this same email, bears the subject "Dash 8 Proposal-Final" but does not reference an attachment). On September 7 (9:32pm), Muhs informed Tina Cannon that he was "able to get another $250,000.00 [c]redit from Bombardier on the aircraft which should cover the overhaul of the MLG [main landing gear]. I'll forward you a copy of the discount for your files." Ex. 483 at PHP 44299; January 14, 2013 Tr. 154:13-22. At 10:44 p.m. on September 7, Muhs forwarded to Tina and Darin Cannon an email exchange with Jonathan Cree of Bombardier, time stamped 9:32pm, where Cree wrote, "Hi Chuck, [h]ave been talking with Rod with regard to the current DOS tender and Rod has been able to find and approve some funds that we can put against the PA. A discount/price reduction of $250,000 will be made available for aircraft 560 being bid by Phoenix Heliparts to the US DoS." Ex. 267; June 17, 2013 Tr. 103:12 – 104:10. Tina Cannon's email of September 8, 2011 (Ex. 267) to PHP's owners confirms that Muhs included the discount in PHP's DoS Dash 8 proposal: "I think Chuck and I have the Dash 8 Proposal nailed down, I will be sending it in today and the UH-1 proposal. Please see below, we have received a $250K discount on the dash 8." "Below" refers to the Cree-Muhs email of September 7. Ex. 267. Tina Cannon notified Muhs eight minutes after PHP submitted its proposal to DoS. Ex. 128;

March 14, 2012 Tr. 64:55 – 65:11. Tina Cannon emailed Ed Brown, cc'ing Darin Cannon and Don Nichols: "...I guess TKC asked DoS for another extension this morning and they were told no. Sam is mad!!!!!" Ex. 128.

4. TKCA Efforts to Develop its Proposal

TKCA invested considerable resources in researching DoS's turboprop needs, identifying an aircraft that could meet those needs, and preparing proposals that resulted in the award of DoS contracts. January 11, 2012 Tr. 43:25 – 44:19; January 12, 2012 Tr. 121:1–122:7; Exs. 136 and 151. Muhs' salary and bonuses accounted for a substantial portion of that investment. Ex. 154. Muhs helped secure and oversaw the work related to fulfilling all six Dash 8 contracts. This work was a "big part" of his duties. March 13, 2012 Tr. 153:4 – 156:25. In the last year of his employment, TKCA paid Muhs $400,000 for his role in directing the program. March 12, 2012 Tr. 138:6 – 139:2.

Preparing successful proposals required TKCA to undertake a company-wide effort involving the President, the Chairperson, the CFO, the Controller, contracts managers, the director of airborne programs, consultants, and the director of engineering. January 11, 2012 Tr. 48:12 – 49:8. Muhs led the TKCA team that drafted several sections of the proposal, compiling specifications from several technical manuals. March 12, 2012 Tr. 140:2-15; March 13, 2012 Tr. 87:1-7. TKCA's March 9, 2011 bid proposal for the sixth DoS Dash 8 aircraft represents six years of time, money and effort that TKCA devoted to developing and refining its secret, proprietary and confidential work product. January 11, 2012 Tr. 29:11 – 34:14; 42:21 – 44:8; 68:3 – 69:6. The proposal included significant original draftsmanship, the distillation of an estimated 89,000 words from both proprietary documents (sources of TKCA's own making and those made available to it through its business relationships[8]) and some information available in the public domain.[9] Ex. 406; April 25, 2012 Tr. 19:17 – 22. Accounting for thousands of personnel hours, preparing the sixth Dash 8 proposal and its predicesors cost well over one million dollars. January 11, 2012 Tr. 175:9 – 177:16; January 12, 2012 Tr. 121:1 – 122:7. Ex. 151. The Dash 8 DoS contracts TKCA won with its proposals accounted for $72,191,281 in total revenue and a profit of $6,315,903. Ex. 890 at exhibit B. TKCA's damage expert, Dennis Allen, reported on the past earnings and future losses TKCA suffered as a result of PHP's misconduct. This court finds that Dennis Allen is a qualified and reliable expert and adopts most of Mr. Allen's findings with respect to TKCA's damages.

The evidence makes clear that preparing technical solutions for government contracts is complicated. A contractor cannot simply take requirements from an RFP and plug them into a bid proposal. January 11, 2012 Tr. 169:20 – 170:18. Often when a government entity issues a RFP, the agency

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[8] This kind of information includes the flight manuals for the Dash 8 aircraft. Bombardier only provides this kind of information to qualified customers, or prospects they have done business with in the past. January 11, 2012 Tr. 55:14-22.

[9] Even though the proposal contained information available to the public, TKCA applied its expertise to this information to determine what it should include in its bid.

states what it wants in broad terms and leaves the details to the bidding contractors to develop proposals that meet the identified needs. *Id.* The contractor then crafts unique solutions and proposes specific modifications and components necessary for the project. *Id.* at 170:19 – 171:25. In this case, once a contractor locates a suitable aircraft for the project, the contractor can start innovating modifications, locating necessary components, reaching out to experienced subcontractors, and narrowing down project costs. This process can take thousands of personnel hours to complete and can differ drasticly depending on the condition of the particular aircraft selected for the bid. *Id.* at 175:9 – 176:17. Significantly, early in its contracting relationship with DoS, TKCA identified the Dash 8 aircraft as a proposed solution to a DoS solicitation over other avalible aircraft. *Id* at 44:4-18. TKCA spent hours working closley with DoS modifying the aircraft and adjusting the proposal to meet DoS's needs. *Id* at 43:11 – 18. TKCA representatives testified that drafting a proposal is an ongoing and continuous process. The Sixth Dash 8 proposal represented a culmination of all of TKCA's work on prior Dash 8 contracts including the leasons learned from the company's other bid-related failures and sucesses. January 24,2013 Tr. 38:15 – 39:10.

C. Facts Relevant to Sanctions, Punitive, and Exemplary Damages- Destruction of Evidence

This ruling cannot adequately account for or describe the full magnitude of PHP's misconduct. Just as brazenly as PHP intentionally and knowingly misappropriated TKCA's trade secrets, confidential and proprietary information, it sought as brazenly to destroy evidence of its misconduct even after the trial in this matter had started. The court has selected material and relevant facts that represent the type and scope of behavior that warrant relief.

In considering whether to impose sanctions for the destruction of evidence or award punitive or exemplary damages, the court focused on PHP's willful and malicious misconduct. This analysis would not be complete without also mentioning Dickstein's extreme carelessness in managing electronic discovery and maintaining electronic devices and its disregard for timely fulfilling its disclosure obligations. However, only PHP's acts and omissions have any bearing on the court's decision to award exemplary and punitive damages. Dickstein and its client's relative degrees of culpability are discussed in detail below when the court considers whom it will sanction and to what extent for the serious discovery violations that occurred in this case.

1. Destruction of Evidence

Tina Cannon received a litigation hold letter from Dickstein Shapiro on September 30, 2011, informing her that TKCA requested third party discovery from PHP in its lawsuit against Muhs.[10] Ex. 691; October 8, 2013 Tr. 97:23 – 98:20. On October 20, 2011, TKCA filed this lawsuit. Two weeks later Darin Cannon installed Drivescrubber 3 on his work

[10] Although this hold letter related to another matter, the Cannons knew of the looming litigation with TKCA.

laptop.[11] Ex. 582 ¶56 at TKCA_9862, ¶58 at TKCA_9863.

On February 24,2012, after trial was underway, TKCA's counsel emailed PHP's counsel a copy of the subpoena it planned to serve on PHP's IT provider, CCAZ. Ex. 1177. Due to an error identifying the correct entity, CCAZ never received the first subpoena.[12] The following day PHP counsel informed Tina Cannon of the subpoena. Ex. 1035; June 24, 2013, Tr. 101:23 – 112:3. Tina Cannon responded to counsel about the subpoena on the same day. Ex. 1035. Both emails had the subject line "RE: TKCA v. PHP: CCAZ.COM LLC subpoena." *Id.* Two days later, on February 26, Darin Cannon requested that CCAZ look into products that would ensure documents deleted from his personal computer could not be recovered. October 8, 2013 Tr. 76:12 – 78:1. On February 26, 2012, Darin Cannon sent his contact at CCAZ, Robert Jones, a link to the software that he eventually had Jones use to wipe the server. Ex. 676. Later that day, Darin Cannon instructed CCAZ to run the Eraser[13] program on PHP's system hard drive (PHP's FTP server).[14] CCAZ ran the program and

[11] Drive Scrubber, Eraser, and CCleaner are computer programs that erase evidence of deleted files from computer systems, preventing recovery. Ex. 625 ¶45 at PHP 107139

[12] Even though the subpoena had an incorrect corporate name, PHP and its counsel knew the identity of the intended recipient. Eventually CCAZ received a corrected subpoena.

[13] This program overwrites information on deleted flies and prevents recovery of the deleted information.

[14] This is the same server Muhs uploaded around 1600 TKCA documents to, including the draft proposal for the sixth Dash 8 aircraft. The FTP server has no connection to the Cannon's personal computers. It is a remote server for data storage.

overwrote evidence of deleted files on PHP's server. January 16, 2013 Tr. 18:8-24; Ex. 582 17:13 – 22:1. Jones testified that he would not have run the Eraser program on the FTP server if he had known about the subpoena. October 8, 2013 Tr. 56:14 – 57:3. PHP asserts that it wiped its servers in an effort to solve vaguely described computer malfunctions and remove viruses from Darin Cannon's personal computer. None of the complaints about the personal computers or servers justifies such extreme measures. CCAZ, through Jones, testified that the tools PHP used did not serve Darrin Cannon's stated goals. October 8, 2013 Tr. 75:25 –76:21. The timing of PHP's request to CCAZ is not a coincidence. PHP's acted with the intent to destroy relevant evidence. Specifically, this court finds that PHP elected to wipe its server because it knew of the CCAZ subpoena and wanted to avoid exposing its egregious misconduct.

After trial started and after questions surfaced regarding questionable and missing electronic evidence, the parties retained forensic computer experts to examine PHP's electronic evidence, server, and other electronic devices. TKCA retained Thomas Day and PHP retained a forensic imaging company, Stroz Friedberg ("Stroz"). Kenneth Mendelson supervised the services Stroz provided PHP. The day before Stroz technicians arrived at PHP's headquarters to conduct court-ordered forensic imaging, Darin Cannon purchased a license for CCleaner. Ex. 582 at TKCA PHP 009860. Darin Cannon installed and ran CCleaner on his laptop before Stroz imaged it. Ex. 582 at TKCA_PHP_009861; July. 26, 2012 Tr. 80:20 – 84:6. Further forensic investigation showed that CCleaner had been run on Tina Cannon's computer to delete and overwrite data one month earlier on March 19, 2012.[15] Ex. 582 at TKCA_PHP_009856; July. 26, 2012 Tr. 72:16 – 73:16. Importantly, the Cannons wiped their computers after receiving a litigation hold letter and after trial started. The court has rarely, if ever in a civil matter, witnessed a party engage in such flagrant misconduct and act with such complete disregard for the truth and such profound disrespect for the law. This court finds that Darrin Cannon installed and ran CCleaner with the intent to delete any evidence that PHP had misappropriated TKCA's trade secrets and proprietary and confidential information and also to conceal PHP's efforts to delete relevant and material evidence of its misconduct.

When TKCA's expert, Thomas Day, arranged to evaluate PHP's server, laptops and other electronic evidence, Stroz, did not provide him a mirror image of the electronic data even though the parties had entered into an elaborate series of protective orders that included a layer of protection for experts' eyes and attorneys' eyes only. As a consequence, TKCA's expert had to conduct a more limited analysis at the office of PHP's experts. Ex. 582 ¶¶17-20 (explaining the agreement between the parties about inspecting the images at PHP's expert's offices), and ¶¶29-43 (describing the bad computer hardware and inadequate working conditions for inspecting the

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[15] Tina Cannon refused to offer any testimony commenting on why CCleaner was run on her computer other than that she did not physically do it. July 27, 2012 Tr. 96:8 – 97:1. Tina was also unable to offer any explanation for PHP's failure to produce thousands of emails and documents related to the Dash 8 opportunity. Nor was she able to provide an explanation for why so many email attachments to and from Muhs could not be recovered. *Id.* at 97:8 - 98:4.

records). PHP had exclusive control of the missing, lost, or destroyed evidence and insisted on maintaining tight control of the computer images even after the court ordered their production. *Id.* at ¶ 17-18, 30. PHP should have produced the information as part of routine discovery. The fact that the stonewalling continued even after the court issued its orders is inexcusable.

2. Laptops and Other Devices

Muhs gave Dickstein a laptop on October 13, 2011. June 24, 2013 Tr. 32:1 – 36:10. Dickstein has no written record of its receipt of that laptop. June 24,2013 Tr. 32:17 – 33:18. Contrary to Dickstein's assertion, the email contained in Ex. 1164 makes no reference to Muhs' "old Mac", or any other laptop. Dickstein offered as proof of its efforts to record receipt of Muhs' electronic devices a single email sent to Victoria Kummer. The relevant part of the email reads, "ALS will run a file report on both the thumb drive and larger hard drive tomorrow Friday, Otober 13, 2011." Ex. 1164 at PHP 122684-122685. Dickstein offered no additional documentation. Ex. 1164 is insufficient to show that Dickstein properly safeguarded the devices entrusted to its care. Muhs' declaration dated November 12, 2011, did not mention delivery of any electronic media or devices to Dickstein. Ex. 114. Dickstein apparently did not record the laptop's serial number or any other identifying information. Dickstein also did not maintain a chain of custody for the laptop after it took possession of the device.

Dickstein also knew and had possession of Muhs' external hard drive before TKCA filed this lawsuit. Dickstein took possession of Muhs' external hard drive on October 13, 2011. Ex. 1164; June 24, 2013 Tr. 32:17 – 33:18. Dickstein and PHP did not identify the external hard drive or an additional thumb drive in the first disclosure statement served on November 18, 2011. Other than Ex. 1164, Dickstein offered no evidence providing a further description of these devices. June 24, 2013 Tr. 32:17 – 33:18.

On April 13, 2012, and August 7, 2012, this court ordered all communications from all relevant parties disclosed regardless of the source or device. "If they had laptop [sic], home desktop computers, other computers from which they were working on work-related matter [sic], that's ... discoverable." April 13, 2012 Telephonic Tr. 8:7-17; August 7, 2012 Telephonic Tr. 9:15 to 10:8. Despite the April 13 telephonic conference, Dickstein did not disclose electronic information from Muhs' external hard drive until after the August 7 telephonic conference with the court. Only then did TKCA learn the electronic devices existed. TKCA's counsel confronted Dickstein about Muhs' possession of relevant electronic media. Dickstein sent this response on December 21, 2012:

> "[Muhs] removed all TKCA documents from his computer and put them onto an external hard drive after completing the delivery of MSN 589, in order to rid himself of them, and he handed that hard drive to us (Dickstein Shapiro) in October 2011. That hard drive remained in Dickstein's possession until we turned it over to Stroz Friedberg for them to image in connection with their searches

> of Muhs' various media this past summer, and it remains with Stroz Friedberg to this day. The TKCA documents that have been produced from Muhs' media came from that external drive, which has been out of his possession since early October 2011." Ex. 1112.

Forensic imaging and analysis of that external hard drive show multiple folders with last access dates of November 1, 2011. Ex. 1044. These folders included "Outlook for Mac Archive," documents from the TKCA's Alaska suit against Muhs, and TKCA's aircraft delivery of Dash 8 MSN589. The following files bear a "Last Accessed Date" ofNovember 1, 2011: "Outlook for Mac Archive.olm," "Litigation Dickson[sic] Shapiro.pdf," "MEMO OF POINTS & AUTHORITY IN SUPPORT OF PI APP.pdf," "VERIFIED COMPLAINT.pdf," and "TKCA Aircraft Delivery Dash 8 MSN 589-final.pdf." June 24, 2012 Tr. 82:9 – 83:20; Ex. 1044. Dickstein kept no record of who accessed the device. Ex. 1044. Forensic analysis of the hard drive produced evidence of backdated files. The hard drive contained legal documents served to Muhs on September 27, 2011, but bore a file created date of August 20, 2011. *Id.*; Ex. 582 at ¶¶105-106. A Dickstein document created September 29, 2011 also bore a file created date of August 20, 2011. June 24, 2012 Tr. 64:12 – 65:6. Despite possessing the external hard drive from the outset of this matter, Dickstein failed to produce its contents until the end of November 2012.

On June 18, 2013, Dickstein made the court aware of a thumb drive Muhs gave the law firm in

October of 2011. June 18, 2013 Tr. 5:7- 8:23. This disclosure occurred more than one and one-half years after TKCA filed its lawsuit, well after electronic devices and data surfaced as a significant issue and at the end of a trial that had exponentially exceeded the parties' repeated estimates. The email reflecting Dickstein's receipt of a "thumb drive" does not identify the thumb drive by make, model or serial number. Ex. 1164. Because Dickstein failed to make a record of or disclose the thumb drive Muhs had previously turned over there is no way to determine whether the "thumb drive" identified in Ex. 1164 is the same thumb drive that Dickstein disclosed it had on June 18, 2013.

There were three known laptops and one unidentified laptop used by Muhs during the time period relevant to this lawsuit: Muhs' "old Mac," "new Mac," the "loaner," and the unidentified laptop. September 13, 2013 Tr. 148:5- 152:16. Muhs testified that he deleted the "old" Mac's user partition at his new employer's direction sometime in the middle of August 2011. *Id.* Muhs' took possession of the "new Mac" on October 1, 2011. Ex. 1024; June 17, Tr. 2013 135:6 – 17.

Muhs testified that he received a "loaner" laptop from his new employer's parent company, EAI, on August 24, 2011 and returned it before September 20, 2011. June 17, 2013 Tr. 33:9. PHP and Dickstein never retrieved the "loaner" laptop from EAI. Muhs first disclosed the existence of the "loaner" laptop on September 13, 2012. June 17, 2013 Tr. 38: 18 – 39:3. At the time, he thought that the laptop was a Mac. *Id.* In an email dated August 29, 2011 (cc'd to Muhs), Darin Cannon instructed Robert Jones to connect

"Chuck's new laptop" to the PHP network. Ex. 925. PHP asserts that CCAZ configured the "loaner" laptop to PHP's network on August 31, 2011. January 15, 2013 Tr. 21:8 – 28:25. In response to Darin Cannon's email, CCAZ sent an invoice for connecting a Sony laptop to PHP's network. Ex. 935; January 16, 2013 Tr. 4:8 – 12:13 and 15:19 – 17:22. During that period, Muhs continued to send emails originating from MacOutlook, indicating the presence of an unidentified laptop, or that the user partition on the "old Mac" was still intact. PHP and Dickstein never imaged the "loaner" laptop. January 15, 2013 Tr. 29:1-8. PHP never clarified for the court from which laptop Muhs sent the MacOutlook emails. The court finds that PHP and Muhs intentionally made it difficult, if not impossible, for TKCA and the court to track Muhs' use of any specific device to avoid exposing their misconduct.

D. Facts Relevant to PHP's GAL Defense

In its defense, PHP claimed that it planned to submit a proposal for a Dash 8 opportunity with GAL.[16] PHP argued that it had no intention of competing with TKCA because TKCA did not compete in the UAE market. PHP further claimed if Muhs disclosed and PHP used any TKCA trade secrets, that PHP used the information to develop the GAL and not the DoS proposal. PHP also posited that the timing of the two solicitations was merely coincidental. Notwithstanding assertions to the contrary, PHP plainly diverted Bombardier's LOI for the sale of a Dash 8 in order to submit a bid to DoS. Muhs advised

[16] *See* footnote 3.

the Cannons of his discussions with his contact at Bombardier about securing "Preferred Supplier" status in connection with the DoS INL-A. Ex. 423. January 14, 2013 Tr. 40:17-41:2. PHP completed a "know your customer" (KYC) form to qualify as a "Preferred Supplier." On June 9, 2011, Tina Cannon asked Muhs to review the KYC form before sending it to his contact at Bombardier. Ex. 425. When PHP submitted the form to Bombardier, it identified DoS as the end buyer for the MSN 560. Ex. 3 at TKCA_BOMBARDIER_31. The following day Bombardier contacted Muhs about reviewing PHP's KYC. Ex. 427. Bombardier treated Muhs as a PHP contact.

When the Cannons and Muhs met with PHP's co-owners, Ed Brown and Chris Nichols, in Costa Mesa, California in June, 2011 to pitch business development opportunities, none of the materials referenced a GAL proposal, but the DoS Dash 8 solicitation figured prominently in the materials and discussions. In email exchanges leading up to the meeting, no one refers to the UAE or GAL. Exs. 255, 429, and 430 at PHP 44250.

PHP submitted a single copy of its GAL proposal into evidence. Ex. 129. PHP claims Muhs uploaded the proposal to the FTP server sometime in June or July, 2011. The GAL proposal first appeared on PHP's servers on September 30, 2011, with the file name PHP GAL Dash 8-315 Proposal v1_8.docx. Ex. 582 at TKCA_PHP_9874. This draft proposal makes references to material and entities specific to DoS and TKCA: this includes seven references to INL-A, an agency of DoS; Dos beta lock-out requirements specific to DoS and derived from TKCA's prior EN;

identical paint schemes identified by DoS; and an FAA Flight Certification (UAE aircraft are subject to European Aviation Safety Agency rules). *Id.* at PHP 964. 978, 990, and 993. The GAL proposal also contains references and ratings of aircraft derived from information PHP did not receive until August 26, 2011. Ex. 253 at PHP 1960. Specifically the "accident/incident" report on the MSN 556, which also appears in the PHP DoS proposal. Compare Ex. 132 at PHP 3354-3356, and Ex. 253 at 1960-1961. Forensic evaluation showed the GAL proposal had a "Last Printed Date" of September 2, 2011 but a "Last Saved Date" of July 29, 2011. Ex 625 at PHP 107145. PHP experts stated that a "Last Printed Date" would necessarily change the document's last saved date, and that discrepancies like this could indicate document backdating. *Id.* at PHP 107145 and 107146. TKCA's expert Thomas Day concluded that metadata tampering occurred and the GAL file had been backdated. Ex. 582 at TKCA_PHP_009874; Ex. 661 at 5-8. Metadata attached to the GAL proposal shows a file creation date of September 30, 2011, but a last written date of over a month earlier on August 23, 2011. *Ex.* 582 at TKCA_PHP_009874.

PHP submitted a small number of emails to an unknown and redacted recipient with a GAL address. Ex. 76-82. The email chains are brief and contain few references to the Dash 8 opportunity. Compared to the surviving emails between PHP and Muhs about the DoS Dash 8 contract, these emails are shockingly sparse in content and few in number. Tina Cannon could not recall exchanging a single email between herself and Muhs regarding the GAL opportunity. March 15, 2012 Tr. 155:6-17. During trial, Tina Cannon and Chuck Muhs provided improbable explanations when confronted with overwhelming evidence of PHP's efforts to secure the award of the DoS contract. Tina Cannon testified that she deliberately misled PHP co-owners, Nichols and Brown, about the true purpose of securing the MSN 560 aircraft because, according to Cannon, the company was having cash flow problems and she did not think Nichols and Brown would support the UAE opportunity. March 14, 2012 Tr. 162:9 – 164:25. In an email dated June 29, 2011, Muhs explained to the Cannons and a Bombardier representative that "DOS has got to get the contract awarded prior to the end of September with delivery before the end of the year." Ex. 4 at TKCA_BOMBARDIER_000078. March 14, 2012 Tr. 12:14 – 14:8. At trial, Muhs testified that he wanted to create an impression that DoS was the end buyer. *Id.*

In order to believe Muhs' and the Cannons' trial testimony, the court would have to accept that sophisticated business executives routinely lie to their business partners as well other contracting parties. Such a proposition strains all credibility. In addition, the court cannot envision any scenario in which a company would have little-to-no evidence of its efforts to enter a new market or to draft a proposal for a first-time multi-million dollar project.

II. LEGAL DISCUSSION

A. Standing

Arizona's Constitution does not contain a provision analogous to the Federal Constitution's "case or controversy" requirement. *State v. Bar Enterprise*, 649 P.2d 978, 980 fn.2 (Ariz. 1982). The Arizona Supreme Court has found that principles of judicial restraint govern questions of standing. *Id.* The function of judicial restraint in this context operates to prevent courts from issuing mere advisory opinions, deciding moot cases, and ensures that cases develop fully in an adversarial proceeding. *Armory Park Neighborhood Ass'n v. Episcopal Cmty. Servs. in Arizona*, 712 P.2d 914, 919 (Ariz. 1985). "The issue in Arizona is whether, given all the circumstances in the case, [the party] has a legitimate interest in an actual controversy." *Id.*

Arizona law does not require that a party act in futility. *Minderman v. Perry*, 437 P.2d 407, 410 (Ariz. 1968), (The Supreme Court did not enforce a contractual agreement between husband and wife to will property to minor son when the son predeceased parents). Nor can Arizona statutes be read to require a futile act. *Pinal Vista Properties, L.L.C. v. Turnbull*, 91 P.3d 1031, 1036 (Ariz. Ct. App. 2004); *and Hosea v. City of Phoenix Fire Pension Bd.*, 229 P.3d 257, 263 (Ariz. Ct. App. 2010).

Despite the fact that TKCA failed to submit a bid, this is not a moot case. TKCA suffered actual harm from PHP's misappropriation, unfair competition, and interference with business expectancies. Because of the advantage PHP now has from its own past performance as well as TKCA's, it will be a competitive threat in the marketplace. Absent PHP's misconduct, TKCA would have submitted a bid, and all evidence indicates that DoS would have awarded it the contract. Because of the circumstances and the stakes at issue in these proceedings, both parties had a sufficient interest in the controversy to litigate this matter fully. It does not violate principles of judicial restraint to entertain TKCA's claim.

Furthermore, any attempt by TKCA to bid would have been an exercise in futility. Because Muhs withheld the Bombardier LOI for the MSN 560, TKCA could not acquire the aircraft. Jonathan Cree compared the MSN 560, 582, and 586, identifying the MSN 560 as the best option from a specifications and price standpoint. Ex. 85. The record shows that no other competitive aircraft were available in the used fixed-wing market. PHP's own bid proposal makes this clear. Ex. 133 at PHP 00354-55. Any Dash 8 TKCA could have secured would have made TKCA's bid significantly less competitive than a bid including the MSN 560. Once PHP tied up the MSN 560, PHP effectively eliminated TKCA as a competitor because the remaining Dash 8's were unsuitable for a competitive bid.[17] TKCA did not need to incur needless expense and waste valuable time drafting and submitting a doomed proposal to give it standing to bring this lawsuit.

B. Liability

For the reasons set forth below, this court finds that PHP willfully and maliciously misappropriated TKCA's trade secrets – the TKCA Proposal, TKCA's pricing information/labor rates, and TKCA's SOWs-in violation of the Arizona Uniform Trade Secrets Act,

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[17] PHP's proposal identified the MSN 560 as the best option and explained that its location and structural damage precluded other available aircraft from serving as PHP's primary selection. Ex. 133 at PHP 003354 – 003355.

A.R.S. § 44-401 et seq. (AUTSA).[18] "To establish a claim for misappropriation oftrade secrets, the claimant must first prove a legally protectable trade secret exists." *Calisi v. Unified Fin. Servs., LLC*, 302 P.3d 628, (Ariz. Ct. App. 2013).

1. Trade Secrets

Whether a trade secret exists is a mixed question of law and fact. *Id.* at 631. AUTSA defines "trade secret" as "information, including a formula, pattern, compilation, program, device, method, technique or process" which satisfies a two-part test. A.R.S. § 44-401(4). First, the information must "derive independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use." A.R.S. § 44-401(4)(a). Second, the holder must exercise reasonable efforts to maintain the information's secrecy. A.R.S. § 44-401(4)(b).

a. Novelty and Independent Value

Implicit in the first prong of AUTSA is a requirement of novelty. "[N]ot only must the subject matter of the trade secret be secret, it must be of such a nature that it would not occur to persons in the trade or business." *Enterprise Leasing Co. v. Ehmke*, 3 P.3d 1064, 1069 (Ariz. Ct. App. 1999) *("Enterprise")*

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[18] TKCA does not argue that its network of subcontractors, the May 27, 2011 LOI from Bombardier, or the ENs are trade secrets, and therefore this court will not entertain a discussion on their merits. Even had TKCA maintained such a position this court would not have found that they qualified as trade secrets under AUTSA.

(citing Wright v. Palmer, 464 P.2d 363, 366 (Ariz. Ct. App. 1970)). "[T]he subject matter of a trade secret need not rise to the level of novelty necessary to qualify for a patent, but must be sufficiently novel that it is not readily ascertainable to the competitors in an industry." *Enterprise*, 3 P.3d at 1069 (*citing Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 476 (1974)). If an "idea is so common or widely known that it lacks all novelty, uniqueness and originality, it necessarily lacks the element of privacy required to make it legally cognizable as a trade secret." *Enterprise*, 3 P.3d at 1069 (*citing Cockerham v. Kerr-McGee Chemical Corp.*, 23 F.3d 101, 105 (5th Cir. 1994)).

A compilation of information merits trade secret protection when it results in a slight advancement over common knowledge. *Enterprise*, 3 P.3d at 1070. In *Enterprise*, the court looked to the common law definition of trade secrets for guidance to determine whether a trade secret exists, specifically: "(1) the extent to which the information is known outside of the business; (2) the extent to which it is known by employees and others involved in its business; (3) the extent of measures taken by the business to guard the secrecy of its information; (4) the value of the information to the business and its competitors; (5) the amount of effort or money expended by the business in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. Restatement of Torts § 757 cmt. b." *Enterprise*, 3 P.3d at 1069, fn. 6. The court, in *Enterprise,* noted that by definition "a trade secret may consist of a compilation of information that is continuously used or has the potential to be used in one's business and that gives one an opportunity to obtain an advantage over competitors who do not know of or use it."[19] *Id.* at 1068. Despite the fact that "matters of general knowledge cannot be appropriated as secret," combining elements from multiple sources of public knowledge in an original way can create a competitive advantage for its composer and amounts to a trade secret. *Id.* at 1069. In order to determine whether or not a compilation is considered a trade secret under AUTSA, the end product must be the "effective, successful and valuable integration of those public elements." *Id.* at 1069-70. A document comprised from readily available sources is not a trade secret if it does not "[represent] a selective accumulation of detailed, valuable information... that naturally would not occur to persons in the trade or business." *Calisi*, 302 P.3d

[19] In *Enterprise,* an employee, subject to a nondisclosure agreement, had access to confidential and proprietary information regarding his employer's, Enterprise Leasing Co.'s ("Enterprise"), business strategy and financial data. When the employee left Enterprise, he took confidential documents with him and used the confidential information to compete with his former employer. Enterprise brought a claim for misappropriation of trade secrets for the employee's use of the company's worksheets. The employee defended himself on the ground that the worksheets were composed of public information, and did not constitute a trade secret. The court noted that when individual elements of the documents were taken out of context, the employee's defense might work. But, taken together and in context the information represented substantial market research and advancement over the original work product. "The Worksheet includes market attributes; office appearance and traffic flow-exterior and interior; personnel attributes; leadership attributes in delegation, planning, organization and management; car condition and preparation..." *Enterprise*, 3 P.3d at 1068, fn. 5.

at 630.[20] Evidence of time, money, and other resources expended on developing public information is necessary to prove that it cannot be readily duplicated by a competitor and provides a demonstrable competitive advantage. *Id.* at 632.

Whether or not government bid proposals qualify as trade secrets within the meaning of AUTSA is a matter of first impression. There is limited guidance from other jurisdictions on this specific question. A Pennsylvania Federal District Court applying Illinois law, addressed this issue in the context of Illinois' adoption of The Uniform Trade Secret Act ("UTSA"). In *First Health Group Corp. v. Nat'l Prescription Adm'rs, Inc.*, 155 F. Supp. 2d 194 (M.D. Pa. 2001), a Pennsylvania District Court concluded that Illinois' version of UTSA protected Frist Health's government bid proposal. The court found that the proposal was a compilation of elements that individually did not merit protection, but taken as a whole and in context constituted a trade secret. *Id.* at 225. Even though government bid proposals do not have a special status or receive special protection under UTSA or AUTSA, there is also no reason not to apply the same rigor in analyzing whether a bid proposal qualifies for the same protection as any other contested information.

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[20] Upon leaving United Financial Services (UFS) and taking up work for a competing firm, Calisi mass emailed over 2000 potential clients, several of which were clients of UFS. UFS sued Calisi for misappropriation of trade secrets, namely the list of UFS clients. The court found that UFS had done nothing to collect and develop their client list and personal information beyond what was readily available to a competing firm.

The same problem exists when considering whether SOWs qualify for trade secret protection under AUTSA. There is little guidance on the subject so the court turned to related areas of law. In particular, courts have found that exemption 4[21] under FOIA and The Trade Secret Act overlap and, therefore, FOIA cases are instructive when deciding whether AUTSA protects TKCA's SOWs. More specifically, in *Honeywell Tech. Solutions, Inc. v. Dep't of Air Force*, 779 F. Supp. 2d 14,20 (D.D.C. 2011), the court noted that "[f]or disclosure purposes, the Trade Secrets Act's scope is 'at least co-extensive with that of Exemption 4 of FOIA.'" *Citing CNA Fin. Corp. v. Donovan*, 830 F.2d 1132, 1151 (D.C.Cir.1987), *cert. denied*, 485 U.S. 977 (1988).[22] The court added, when considering whether a contractor's SOW was exempted from disclosure under FOIA, the Trade Secrets Act prohibits disclosure of information covered by Exemption 4. In *Honeywell Tech.*

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[21] Trade secret and confidential or privileged information qualified for FOIA Exemption 4 when its disclosure would likely 1) "impair the Government's ability to obtain necessary information in the future; or 2) ...cause substantial harm to the submitter's competitive position." *National Parks & Conservation Ass'n v. Morton*, 498 F.2d 765, 770 (D.C. Cir. 1974).

[22] *See also Venetian Casino Resort, L.L.C. v. E.E.O.C.* 530 F.3d 925, 931(C.A.C.D. 2008) ("We have long held the Trade Secrets Act ... is 'at least coextensive with ... Exemption 4 of FOIA.' *CNA Fin. Corp. v. Donovan*, 830 F.2d 1132, 1151 (D.C.Cir.l987). The upshot is that, unless another statute or a regulation authorizes disclosure of the information, the Trade Secrets Act requires each agency to withhold any information it may withhold under Exemption 4 of the FOIA. *Bartholdi Cable Co., Inc. v. FCC*, 114 F.3d 274, 281 (D.C.Cir.l997)"); *See also Canadian Commercial Corp. v. Department of Airforce*, 514 F.3d 37, (C.A.D.C. *2008)*;*McDonnel Douglas Corp. v. U.S. Dept. of the Air Force*, 375 F.3d 1182 (C.A.D.C. 2004).

Solutions, Inc. v. Dep't of Air Force, Honeywell had competed for and won an Air Force contract to service a satellite support network. A third party filed a FOIA request seeking disclosure of the contract and bid proposal material, including the SOW Honeywell prepared in response to the solicitation. Honeywell objected to disclosure of the SOW citing its proprietary and confidential nature under FOIA. The *Honeywell* court relied, in part, on The Trade Secret Act when analyzing exemption 4 under FOIA. This court finds that to the extent that exemption 4 under FOIA protects TKCA's SOWs from disclosure, the SOWs also qualify for protection under AUTSA.

Labor rates and other pricing information may also be protected as trade secrets under AUTSA. Like other questions raised by this case, Arizona law does not provide clear answers, making it necessary to look to other jurisdictions for guidance. Courts have routinely held that pricing information qualifies as a trade secret where its economic value depends on secrecy. *See PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1270 (7th Cir. 1995)(Pepsi's marketing, pricing and distribution information found to be a trade secret); *Black, Sivalls & Bryson, Inc. v. Keystone Steel Fabrication, Inc.*, 584 F.2d 946, 952 (10th Cir. 1978)("confidential data regarding operating and pricing policies can also qualify as trade secrets"); *Brocade Comm. Sys. V. AJO Networks, Inc.*,873 F. Supp.2d 1192, 1214 (N.D. Cal. 2012)(pricing guidelines "routinely given trade secret protection"). In *Sw. Stainless, LP v. Sappington*, 582 F.3d 1176, 1189 (10th Cir. 2009), the court found that, under Oklahoma's trade secret act, pricing information was a trade secret. The Oklahoma legislator's version of UTSA is identical to the Arizona Act in how it defines trade secrets. Okla. Stat. tit. 78, § 85. The same rubric applies to pricing information as to all other categories of trade secrets. Courts look to see if the information itself actually gives its holder a competitive edge and derives value from not being generally known. When a business has its competitor's confidential pricing information the business can anticipate the competitor's moves and project bids. *Pepsi Co, Inc.*, 54 F.3d at 1265; *Keystone Steel Fabrication, Inc.*, 584 F.2d at 952. This court finds other courts' reasoning persuasive. Accordingly, the court will apply the same standards to pricing information as it does to all other categories of trade secrets.

i. Novelty of Proposal for the Dash 8

TKCA's March 9, 2011 bid proposal for the sixth DoS Dash 8 aircraft represented the cumulative effort of six years of development, refinement and experience. January 11, 2012 Tr. 29:11 – 34:14; 42:21 – 44:8; 68:3-69:6. The proposal consisted of hundreds of hours of original draftsmanship and the distillation of an estimated 89,000 words from both proprietary documents (sources of TKCA's own making and those made available to them through their business relationships[23]) and information in the public domain. Ex. 406; April 25, 2012 Tr. 19:17-22. Accounting for personnel hours and out-of-pocket expenses, preparing the sixth Dash 8 proposal and its predicesors cost upwards of one million dollars.

[23] This kind of information includes the flight manuals for the Dash 8 aircraft. Bombardier provides this kind of information only to qualified customers, or prospects they have done business with the company in the past. January 11, 2012 Tr. 55: 14-22.

January 11, 2012 Tr. 175:9 – 177:16; January 12, 2012 Tr. 121:1 – 122:7. Ex. 151. TKCA produced a final product that was the “effective, successfull and valuable integration of those public elements” alongside original proprietary information that the company combined to create an original document Unlike the information at issue in *Calisi*, there is no question that TKCA invested time, effort, and money to create a valuable asset not readily reproducible by its competitors.

TKCA created a novel proposal, consisting of a compilation, protectable as a trade secret under AUTSA. TKCA’s bid included selective public information combined with information unique to TKCA.[24] The fact that TKCA included information available to the public when drafting its proposal does not change the compilation analysis under *Enterprise.* The process by which TKCA selected and incorporated information from publicly avalible information goes well beyond the “slight advancement” in common knowledge required by the court. The advancement TKCA possesed as a result of selection and development provided the company with the competitive advantage necessary for trade secret protection. PHP argues that TKCA never had a competitive advantage because no other 8(a) companies[25] bid for the first Dash 8 contracts. This argument is unpersuasive. The first four aircraft were part of an Indefinate Delivery, Indefinate Qualintity (IDIQ) contract with DoS. January 11, 2012 Tr. 42:9

[24] This includes the TKCA Blue Falcon Tracker Data, previous Dash 8 proposals.

[25] 8(a) is a designation DoS uses to indicate a minority owned small business.

– 20. When DoS issues an IDIQ it works with a company to develop a product that meets its needs, and then issues that company a task order for the aircraft. January 11, 2012 Tr. 42:2-8. From the beginning of the relationship DoS intended to move the program out of the IDIQ phase and into a standard competitive model. *Id. at* 42:9-20. Knowing that the program would eventually move in this direction, TKCA had every incentive to continue devloping a bid proposal in keeping with a competitive process. DoS did eventually open the program for competitive bidding from other 8(a) companies, and then, with the seventh aircraft, to the broader category of small businesses.

Like the proposal at issue in *First Health,* TKCA's bid is a kind of compilation covered by this State's version of UTSA. Portions of the proposal, taken out of context, are public knowledge as PHP claims. However, TKCA's selction, integration, and refinement represent a substantial effort resulting in an advancement well beyond common knowledge. Together, and in context, TKCA's compilation is sufficiently novel.

ii. Independent Economic Value of TKCA's Proposal

Mere secrecy and novelty does not make something valuable. Value can be inferred when the holder "show[s] that the information confers upon it an economic advantage over others in the industry." *Enterprise*, 3 P.3d at 1070, *citing Rivendell Forest Products, Ltd. V. Georgia-Pacific Corp.* 28 F.3d 1042, 1046 (10th Cir. 1994). The bid TKCA submitted had "economic value, actual [and] potential"[26] as demonstrated by the $72 million in revenue Dash 8 contracts generated for the company and the money invested in its development, which includes Muhs salary. The proposal's potential value is clearly evidenced by the subsequent DoS RFP, and PHP's ability to secure the contract using TKCA's information. TKCA's proposal also has inferred value because PHP could have invested the same amount of time and money developing a bid, but PHP spared itself the expense by misappropriating TKCA's confidential and proprietary information.

iii. TKCA's Statements of Work are novel and possess independent value

TKCA presented evidence that proves the novel nature of its SOWs. The SOWs were products of original draftsmanship unique to each subcontractor. TKCA employed individuals to write SOWs in response to bid solicitations to explain contractual obligations to subcontractors as well as to define the project elements for DoS's review. The SOWs are analogous to the Worksheets determined to be trade secrets in *Enterprise*; they instruct subcontractors on personnel attributes, planning, organization and management, and preparation.

As discussed above, the Dash 8 contracts resulted in $72 million in revenue for TKCA. Much like the value of the Dash 8 proposal, the actual and potential value of TKCA's SOWs is tied to the company successfully securing the award of a series of DoS contracts and positioning itself to bid

[26] A.RS. § 44-401(4)(a).

successfully on future contracts. The SOWs' value is inferred from the competitive advantage it gives to TKCA. *Enterprise*, 3 P.3d at 1069-70. Because of the time, effort, and money expended on the creation of SOWs, TKCA had an advantage over competitors who had not previously developed one for a DoS Dash 8 solicitation. New comers like PHP would have to invest substantial time and money creating their own work product. Misappropriating another company's SOWs saves on the overhead cost of competing for a contract, giving the misappropriating party an advantage. The SOWs represent an orchestrated effort by TKCA to secure business opportunities, and under the totality of circumstances, this court finds that the SOWs have independent economic value as a part of that effort.

iv. TKCA Labor Rates

TKCA's labor rates are novel because they are unique to TKCA. At the time PHP acquired the information, the public did not have access to it. In *Pepsi, Sappington, and Black*, the courts found that pricing information has independent value because of the competitive edge it gives companies by not being generally known or available. The *Black* court reasoned that value can be "reasonably inferred" when the misappropriating company possessed the information and secured the business opportunity. The court determined that the company's success might have been partially due to having the information. *Black, 584 F.2d* at *952*. This court finds that TKCA's labor rates had "independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use." A.R.S. §44-401(4)(a). Regardless of how much of a competitive edge the labor rates gave TKCA, these rates were an integral part of the company's successful Dash 8 proposals.

b. Secrecy

Including confidentiality provisions in high level employee contracts is a reasonable measure to secure trade secret information from public dissemination. In order to meet the second prong of AUTA's definition, it must be shown that the holder of a trade secret has taken "reasonable efforts" to maintain its secrecy, "absolute secrecy is not required." *Enterprise*, 3 P.3d at 1070; *citing K-2 Ski Co. v. Head Ski Co.*, 506 F.2d 471, 474 (9th Cir.1974). Any requirements demanding a higher level of secrecy would act as a disincentive to business development and deprive the holder of any competitive advantage. In *Enterprise*, the company did not forgo trade secret protection by giving confidential and proprietary information to its employees. *Id., citing Metallurgical Indus. Inc. v. Fourtek, Inc.*, 790 F.2d 1195, 1200 (5th Cir. 1986). The court found that the anti-disclosure provisions contained in the company's employment contracts and handbook represented reasonable efforts to maintain secrecy. *Enterprise, 3 P.3d* at 1070.

Measures taken within the company to maintain confidentiality are insufficient if the information is disclosed without qualification to outside parties. In *Sw. Stainless, LP v. Sappington*, 582 F.3d 1176, 1189 (10th Cir. 2009), the court found that, under Oklahoma's trade secret act, the pricing information at issue was not a trade secret despite reasonable measures taken to maintain its confidentiality. Precautions included requiring employees to sign a nondisclosure agreement, password requirements to access company files, and regular reminders to employees about the confidential nature of company information. *Id.* However, the company submitted price quotes to customers and vendors without any notice of confidentiality. *Id.* at 1190. The court determined that even though the information in question met the Act's requirements in every other regard, its unqualified disclosure to customers removed it from the realm of trade secrets and protection under the Act. *Id.* at 1189.

TKCA made reasonable efforts to maintain the secrecy of its confidential information including its SOWs, labor rates, and bid proposals. These efforts also include, but are not limited to, employment contracts signed by Muhs and other TKCA executives, employee handbook commentary on confidential information, restricted data notices on documents, and nondisclosure agreements with subcontractors. Contrary to PHP's argument, the labor rates did not become public knowledge until TKCA submitted the rates for the GSA schedule in November 2011. By securing information in its transactions with its subcontractors, TKCA took the steps necessary to avoid the result reached in *Sappington*. Furthermore, in *Enterprise* the court found that these kind of precautions satisfied A.R.S. § 44-401(4)(b)'s secrecy requirement. *Enterprise*, 3 P.3d at 1071.

2. **Misappropriation**

"Misappropriation" means either:

(a) Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means;

(b) Disclosure or use of a trade secret of another without express or implied consent by a person who either:

i. Used improper means to acquire knowledge of the trade secret.

ii. At the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was derived from or through a person who had utilized improper means to acquire it, was acquired under circumstances giving rise to a duty to the person seeking relief to maintain its secrecy or limit its use or was derived from or through a person who owed a duty to the person seeking relief to maintain tis secrecy or limit its use.

iii. Before a material change of his position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.[27]

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[27] A.RS. § 44-401(2)

a. PHP Misappropriated TKCA's Dash 8 Proposal

i. PHP formed an agency relationship with Muhs

PHP formed an agency relationship with Muhs, and this court attributes his actions to the company. The agency relationship further satisfies AUTSA's requirement that the misappropriating party "[a]t the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was derived from or through a person who had utilized improper means to acquire it." A.R.S. § 44-401(2)(b)(ii). An agency relationship can derive from either actual or apparent authority. *Ruesga v. Kindred Nursing Centers, L.L.C.*, 161 P.3d 1253, 1261 (Ariz. Ct. App. 2007). Express contract or "proof of facts implying such contract or ratification thereof" establish actual authority. *Corral v. Fid. Bankers Life Ins. Co.*, 630 P.2d 1055, 1058 (Ariz. Ct. App. 1981). Apparent authority exists when "the principal has intentionally or inadvertently induced third persons to believe that such a person was its agent although no actual or express authority was conferred on him as agent." *Ruesga v. Kindred Nursing Centers, L.L.C.*, 161 P.3d 1253, 1261 (Ariz. Ct. App. 2007), *quoting Premium Cigars Int'l, Ltd. v. Farmer-Butler-Leavitt Ins. Agency*, 96 P.3d 555, 565, *quoting Curran v. Indus. Comm'n*, 752 P.2d 523, 526 (Ariz. Ct. App.1988). "Agency is susceptible of proof as is any other fact and may be established from the circumstances, such as the relation of the parties to each other and to the subject matter, their acts and conduct." *Phoenix W. Holding Corp. v. Gleeson,* 500 P.2d 320, 325-26 (Ariz. Ct. App. 1972).

TKCA did not present evidence of a contract establishing an agency relationship between Muhs and PHP. However, there is no doubt that Muhs had actual authority to act on behalf of PHP. Muhs acted as the liaison with Air Nostrum, Bombardier, and DoS on PHP's behalf. PHP configured his personal laptop for its company network. Ex. 925; January 15, 2013 Tr. 21:8 – 28:25. Muhs presented PHP with a business development plan that specifically identified the DoS Dash 8 as a potential target. March 12, 2012 Tr. 132:1-24; January 14, 2013 Tr. 58:16 – 61:23; Ex. 430. PHP owners acknowledged that without Muhs' help they would not have attempted to bid on the Dash 8 contract. Ex. 258; March 15, 2012 Tr. 136:3 – 137:13. Muhs never made an effort to correct PHP when he was included and referenced in emails about the DoS Dash 8 proposal. PHP included compensation for Muhs' work on the proposal in it its 2011 budget. March 15, 2012 Tr. 85:20 – 86:7; Ex. 1017; February 14, 2013 Sealed #2 Tr. 33:11 – 35:23. Muhs took part in drafting PHP's proposal, and collaborated closely with Tina and Darin Cannon on proposal specifics and pricing information. Finally, PHP identified Muhs as its project manager for the Dash 8 program in the DoS proposal. Ex. 10 at PHP 001694. This court finds that based on Muhs' involvement with PHP in developing the proposal and his efforts to broker its relationships with necessary suppliers, Muhs had actual authority to act on PHP's behalf in this matter. The circumstances, relation of the parties to one another and the subject matter, and their conduct further confirm a finding of agency. In sanction for PHP's deliberate destruction of evidence, this court also draws any necessary inferences to establish an agency relationship in the absence of an express contract. Because of the agency relationship between Muhs and PHP, this court will attribute Muhs' acts to PHP.

ii. PHP's GAL proposal is not a defense

It strains all credibility for PHP to raise the GAL proposal as a defense. In light of the voluminous discovery and dearth of any material evidence that substantiates the existence of the GAL proposal, this court gives little to no weight to the evidence PHP presented with respect to this defense. The court questions the authenticity of some of the documents due to evidence of backdating and finds that that the meager number of marginally relevant emails produced by PHP to an unknown recipient do little to convince the court. The court further finds suspicious that PHP could not produce earlier drafts of what appears to be the 8th version of the GAL proposal. What possible realistic explanation exists for not retaining all, or at least some, earlier versions of a document as important as a first-time proposal to enter a new market as a fixed-wing aircraft prime contractor? PHP claims it completed the work on the GAL proposal by the end of July 2011. However, evidence of backdated computer files and metadata tampering show a created date of September 30, 2011. If true, the proposal was created after TKCA served Muhs with the complaint in the Alaska lawsuit for breach of contract. Beyond tending to prove the disingenuous nature of the GAL proposal, the backdating calls into question the veracity of any email communication between Muhs and the unnamed GAL representative which provided some of the limited evidence that supported PHP's defense.

PHP's communications with Bombardier, DoS, Muhs and in-house indicate that PHP and Muhs created the GAL proposal in connection with and in anticipation of litigation. Significantly, no communication exists between PHP and Bombardier, or Air Nostrum that ever references GAL or the UAE. PHP incredibly claims that many of these references to a DoS contract reflect mistakes or admitted lies to representatives of valued business partners like Bombardier and members of the Cannons' own company. Muhs' testified to these facts at trial. Tina Cannon could not recall a single email between Muhs and herself regarding the GAL opportunity. Even had PHP presented more evidence establishing the GAL, the effort would have been unproductive, as this court would strike it as a sanction for PHP's egregious discovery violations.

iii. The Freedom of Information Act does not render TKCA's March Proposal publicly available

When TKCA submitted its Dash 8 bid proposal to DoS, a federal agency, it placed those documents and the information contained therein under the control of several federal statutes. *See, e.g.,* the Freedom of Information Act (5 U.S. C. § 552) and the Trade Secret Act (18 U.S.C. § 1905). Accordingly, unlike some AUTSA claims, which exclusively rely on interpreting Arizona's statutes and case law, this court, has considered federal law and regulations when necessary.

Under the AUTSA, information cannot constitute a trade secret if it is "readily ascertainable by proper means" by those who can benefit from its disclosure or use. A.R.S. § 44-401(4)(a). The Freedom of Information Act provides an avenue for lawful public access to information from the government, and may therefore prevent trade secret protection under Arizona law in some circumstances. FOIA places an obligation on government agencies to make information available to the public and sets forth methods of disclosure for certain categories of information. 5 U.S.C. § 552(a); *Chrysler Corp. v. Brown*, 441 U.S. 281, 291-92 (1979). "Agency" includes "any executive department, military department ... or other establishment in the executive branch of the Government." 5 U.S.C. § 552(f)(1). An agency's mandate to disclose is not absolute, however. FOIA provides several exemptions that relieve an agency's obligation to comply with a FOIA request. 5 U.S.C. § 552(b). These exemptions should be construed narrowly, as the purpose of FOIA is to pierce the veil of administrative secrecy. *Dep't of the Air Force v. Rose*, 425 U.S. 352, 361 (1976). PHP claims a FOIA request would have made TKCA's information available to it and other competitors thereby depriving it of trade secret status deserving protection under AUTSA. This court finds PHP's argument unpersuasive.

FOIA's fourth exemption precludes trades secrets and commercial or financial information from mandatory disclosure "when obtained from a person[28] and privileged and confidential." 5 U.S.C.

[28] The Supreme Court has clarified that a "person" under FOIA is any non-government entity, rendering the "person" requirement a non-issue in all but the most exceptional cases. *Fed. Open Mkt. Comm. of Fed. Reserve Sys. v. Merrill*, 443 U.S. 340, 360 (1979).

§ 552(b)(4). The exemption is discretionary but becomes a bar to disclosure when combined with other statutes, specifically 18 U.S.C. § 1905 (the Trade Secret Act). *Chrysler*, 441 U.S. at 295. The Trade Secret Act ("TSA") criminalizes government disclosure "to any extent not authorized by law" of trade secrets and other confidential information[29] made known to the government employee or agent during the course of their duties. FOIA and TSA are co-extensive with one another. *9 to 5 Org. for Women Office Workers v. Bd. of Governors of Fed. Reserve Sys.*, 721 F.2d 1, 12 (1st Cir. 1983). Since FOIA permissively authorizes disclosure of information under its exemptions, a plain reading of TSA's language "not authorized by law" would suggest that it does not prohibit disclosure merely because it falls under FOIA's exemption. Nevertheless, courts have read the Trade Secrets Act, in light of *Chrysler,* to prohibit disclosure of any information falling under FOIA Exemption 4. *Id.*; *Pacific Architects and Engineers Inc. v. U.S. Dept. of State*, 906 F.2d 1345, 1347 (9th Cir. 1990), ("If, however, release of requested information is barred by some other statute or regulation, the agency does not have discretion to release it. The Supreme Court in Chrysler held that the Trade Secrets Act... qualifies as a baring statute."); *Canadian Commercial Corp. v. Department of Airforce*, 514 F.3d 37, 39 (C.A.D.C. 2008); ("We have long held the Trade Secrets Act, 18 U.S.C. § 1905, a criminal statute that prohibits Government

[29] "…trade secrets, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, profits, losses, or expenditures of any person, firm, partnership, corporation, or association ..." 18 U.S.C.A. § 1905.

personnel from disclosing several types of confidential information unless "authorized by law," is "at least coextensive with ... Exemption 4 of FOIA.")(*citations omitted).*

In *National Parks & Conservation Ass'n v. Morton,* 498 F.2d 765, (D.C. Cir. 1974), the court determined that information was "confidential or privileged" and qualified FOIA for Exemption 4 when its disclosure would likely 1) impair the Government's ability to obtain necessary information in the future; or 2) ...cause substantial harm to the submitter's competitive position. *Id.* at 770. Any part of the information that meets this test may be excised and the non-confidential portions disclosed. The *National Parks* test for determining whether information is confidential or privileged under Exemption 4 has been widely accepted in the majority of jurisdictions, including the 9th Circuit. *See, e.g. Watkins v. U.S. Bureau of Customs and Border Protection*, 643 F.3d 1189, 1194 (9th Cir. 2011).

A decade after the D.C. Circuit made their ruling in *National Parks;* the court amended the test in order to afford more protection for confidential information provided to the government on a voluntary basis. The D.C. Circuit ruled in *Critical Mass* that when trade secrets or commercial and financial information has been submitted voluntarily, its confidential status must be determined under another rubric. *Critical Mass* asks if the information "would customarily not be released to the public by the person from whom it was obtained." *Critical Mass Energy Project v. Nuclear Regulatory Comm'n*, 975 F.2d 871, 879 (D.C.Cir.1992)(en *banc*). This standard encourages the voluntary production of more information by setting a lower bar for confidentiality. *Critical Mass* has not received the wide spread reception enjoyed by *National Parks,* and to date has not been adopted by another Circuit. This court finds that *National Parks* is the appropriate test to determine whether information is confidential under FOIA. Functionally, any information that meets the *National Parks* standard would reach the same result under a *Critical Mass* analysis.

Bid Proposals are only exempt from disclosure to the extent that the information contained therein falls into a 552(b) exemption. Making any sort of judgment about whether trade secrets and commercial or financial information falls under TSA and FOIA requires a decision on the definition of the terms in those federal statutes. No existing Arizona case law provides precedent for this court to follow. A decision on the terms necessarily determines the outcome of this defense. The inquiry ends and disclosure is prohibited if the information requested qualifies as a trade secret. *Pub. Citizen Health Research Group v. Food & Drug Admin.*, 704 F.2d 1280, 1283 (D.C. Cir. 1983); *Nat'l Parks & Conservation Ass'n v. Morton*, 498 F.2d at 766. A handful of federal district courts outside Arizona have adopted a narrow definition of trade secrets within FOIA and TSA. "A trade secret is an unpatented, commercially valuable plan, appliance, formula, or process, which is used for the making, preparing, compounding, treating, or processing of articles or materials which are trade commodities." *Pub. Citizen Health Research Grp*, 704 F.2d at 1287, *internal quotations omitted.* Under *Public Citizen*, certain trade secrets under state versions of UTSA would lose protection once submitted in a bid to the government.

In order to avoid subverting Arizona law, this court will interpret the terms as defined within the broad parameters shared by UTSA and the Restatement of Torts. *See* section *(II)(1)(a)* addressing *Novelty and Independent Value*.[30] Forty-six states have adopted UTSA, including Arizona. TKCA's bid proposal, SOWs, and labor rates are trade secrets within AUTSA, UTSA, and the Restatement of Torts. This court finds that they are trade secrets within the meaning of FOIA and TSA, and are barred from disclosure under§ 552(b)(4).

Alternately, this court reaches the same decision under Exemption 4's provision for "commercial or financial" information. Although little discussion of the terms exists, courts have consistently held that the "commercial and financial" should be given their ordinary meaning. *Pub. Citizen Health Research Group v. Food & Drug Admin.*, 704 F.2d at 1290; *Washington Post Co. v. US. Dep't of Health & Human Serv.*, 690 F.2d 252, 266 (D.C. Cir. 1982); *Bd. of Trade v. Commodity Futures Trading Comm'n*, 200 U.S. App. D.C. 339, 627 F.2d 392, 403 (D.C. Cir. 1980). The same *National Parks* test used to establish the privileged and confidential status of

[30] The Restatement defines a trade secret as "any formula, pattern, device, or compilation of information which is used in one's business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it." 4 RESTATEMENT OF TORTS § 757 cmt. b (1939). The Uniform Trade Secrets Act closely tracks the language of the Restatement and includes any "information, including a formula, pattern, compilation, program, device, method, technique or process," that "derives independent economic value, actual or potential, from not being generally known ... [or] ascertainable by proper means," and "is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." A.R.S. § 44-401(4).

trade secret information applies. A party claiming that the information is confidential need not show actual competitive harm; evidence showing actual competition and the likelihood of substantial competitive injury is sufficient. *GC Micro Corp. v. Def Logistics Agency*, 33 F.3d 1109, 1115 (9th Cir. 1994); *citing Gulf & Western Indus. v. United States*, 615 F.2d 527, 530 (D.C. Cir. 1979). This court finds that TKCA's bid proposal, SOW, and labor rates are "commercial or financial" information and that the record shows TKCA suffered actual competitive harm from the information's disclosure.

The final relevant FOIA exemption is § 552(b)(3), which exempts from mandatory disclosure information required by another statute to be withheld from the public. TKCA argues that the Procurement Integrity Act ("PIA"), 41 U.S.C. § 2102(2012)) is such a statute. §2102(a)(1) limits exemption to proposal information before the award of the "contract to which the information relates." A plain reading of this section would not prohibit disclosure since DoS had already awarded TKCA the fourth Dash 8 contract. However, when considered in conjunction with the Federal Acquisition Regulations ("FAR") §3.104-4, further parameters are placed on what government agencies may not discloses under 41 U.S.C. § 2102. FAR §3.104 implements the PIA and prohibits the "release of information after award of a contract or cancellation of a procurement if such information is contractor bid or proposal information or source selection information that pertains to another procurement." 48 C.F.R. § 3.104-4(f)(3). Muhs began funneling TKCA's trade secrets to PHP after DoS asked him to conduct market research on available Dash 8's. This is a clear indicator that DoS was considering another procurement solicitation. Under Exemption 3, TKCA's bid proposal would have been barred from disclosure under FOIA by 41 U.S.C. § 2102(a)(1) and 48 C.F.R. § 2.104-4(f)(3) for its relevance to another procurement. PHP's FOIA defense fails because a FOIA request would not have otherwise made available to PHP the documents the company acquired from Muhs.

iv. PHP Knew or had Reason to Know that TKCA's Proposal was Acquired by Improper Means and used it in Preparation of its own Proposal.

"Improper means includes theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy or espionage through electronic or other means." A.R.S. § 44-401(1)(*internal quotations omitted*). Testimony at trial and numerous emails exchanged between the Cannons and Muhs show that PHP knew Muhs was providing the company TKCA's proprietary and confidential information. Specifically the August 17 "First Draft"/"1'11 send more stuff' email that "freak[ed]" out Tina Cannon when she saw TKCA's name on the attachment substantiates this fact. Exs. 455 and 1045. Tina Cannon refused to acknowledge that she ever looked at the attachment, or that she was referring to anything she had read when she sent Ex. 455. June 25, 2013 Tr. 175:17 – 178:4. In addition, an August 22, 2011 email exchange containing TKCA's IPR requirements for the Dash 8 provides further proof. Tina Cannon also knew that Muhs was subject to a non-compete agreement with TKCA until October

2011, and that using TKCA's bid proposal would be wrong. Ex. 6; April 24, 2012 Tr. 6:18-23, 28:10-21.

Muhs gave PHP TKCA's proposal for the sixth Dash 8 aircraft, and PHP copied it for use in its final submission to DoS. March 13, 2012 Tr. 97:11-12. The presence of the following incongruities and similarities confirm that PHP used the information Muhs disclosed; identical typographical errors, "cut and paste" sections of Bombardier's technical manuals, errors only found in earlier TKCA drafts, and original TKCA source material found nowhere else. March 13, 2012 Tr. 105:10 – 106:2; April 26, 2012 Tr. 45:3 – 47:5. Portions of Bombardier technical manuals are relevant here for two reasons. First, TKCA did not place entire technical manuals in its proposal, but rather excerpted the relevant portions to suit its needs. Second, Muhs was unable to offer testimony at trial as to where the public could access this information. January 15, 2013 Tr. 91:9 – 92:5. The court might consider one instance a coincidence but, under the totality of circumstances in this case, the court finds that PHP knowingly acquired TKCA's proposal by improper means.

As mentioned earlier, Tina Cannon induced Muhs to violate his non-compete agreement with TKCA and disclose TKCA trade secrets in further breach of his employment contract. March 15, 2012 Tr. 85:20 – 86:7. As a start, PHP intended to pay Muhs no less than $48,000. February 14,2013 Sealed #2 Tr. 33:11- 35:23; Ex. 1117.Tina testified that she budgeted $16,600 per-month for the last three months of 2011 to pay Muhs for his efforts. *Id.*

Regardless of whether PHP actually saw Muhs' non-compete agreement, the Cannons knew that TKCA's Proposal was a valuable asset. As experienced business executives, they understood that Muhs could not freely disseminate TKCA's confidential and proprietary information without authorization, particularly with a "Restricted Data Notice" referenced on every page. To the extent Tina Cannon denies knowing that Muhs had no right to give PHP TKCA's proposal, this court finds that denial entirely incredible. This court also finds that PHP acquired TKCA's proposal by "improper means" when the Cannons induced Muhs to breach his contract. Whether or not PHP ever compensated Muhs for his work is irrelevant. It is unfathomable that Muhs, at great personal risk, performed these services for free. Because PHP and Muhs denied any misconduct, little evidence exists that documents the precise terms of their business relationship. However, the court knows that PHP identified Muhs as a project manager in its proposal which makes clear that PHP and Muhs anticipated having an ongoing business relationship. Ex. 133 at PHP 003343.

b. PDP Misappropriated TKCA's Labor Rates

PHP misstates the facts related to TKCA's claim regarding labor rates. TKCA only claimed that the Proposal had 28 labor rate categories, not that PHP used 28. All but ten of the labor rates were left blank in TKCA's proposal. Ex. 395 at TKCA_PHP 6862. Each one of the labor rate categories used in TKCA's proposal appears in PHP's proposal. Ex. 133 at PHP 003403, 003405. PHP points out that only three of the hourly rates used in its proposal match

TKCA's labor rates. PHP incorrectly believes this fact somehow supports its defense. PHP's argument ignores the purpose of protecting this type of information from misappropriation. *Pepsi, Keystone,* and *Sappington,* all emphasize the preemptory advantage a company gains from possessessing its competitors' pricing information. With this information, a company can project its competitor's bid and undercut it. The fact that PHP only used three of TKC's labor rates is, at best, a neutral fact, but taken together with the other evidence in this case, this court finds that PHP's use of any of TKCA's labor rates proves it possessed the rates.

PHP argued that it can explain the presence of matching labor rates and fields based on working with TKCA in 2010 on the UH-1 and through TKCA's public GSA schedule listing. June 25, 2013 Tr. 63:5 – 64:19. Significantly, TKCA provided PHP this information in connection with the UH-1 project pursuant to a non-disclosure agreement, and even then only six of the fields found in PHP's pricing proposal were used for the UH-1 project. October 9, 2013 Tr. 84:7-18. PHP could have found the other four rates only in TKCA's Dash 8 proposal. *Id.* Moreover, GSA did not post TKCA's labor rates until November, 2011, well after PHP drafted and submitted its bid, making PHP's public availability argument factually impossible.

c. PHP Misappropriated TCKA's SOWs

The record establishes the value of TKCA's SOWs in terms of development cost, competitive advantage, and their contribution to the overall success of TKCA's bid proposals. Muhs admitted to giving PHP TKCA's SOWs for the DoS quick response contract in violation of his non-disclosure agreement. His August 17, 2011 emails corroborate his admission, and in court testimony points to the fact that PHP used TKCA's SOWs to create its own proposal. Ex. 456. TKCA took reasonable efforts to maintain the confidentiality of its SOWs by marking them as confidential and requiring subcontractors to sign a nondisclosure agreement. January 11, 2012 Tr. 95:8; 128:24 – 130:60; Exs. 21 and 22. TKCA executive, Tim Summerrow, examined PHP's Dash 8 SOWs and testified that "it appears our statement of work has been taken as a draft and used to produce this document." PHP was afforded an opportunity to test his claim but did not question Mr. Summerrow on this point. January 12, 2012 Tr. 29:24 – 30:1. TKCA has met its burden of proof. The court further infers PHP's intent to misappropriate TKCA's trade secrets from its willful destruction of evidence. This court finds PHP liable to TKCA for the misappropriation its SOWs in violation of AUTSA.

3. **Damages**

For the reasons stated below, this court finds that TKCA met its burden of proof establishing damages for lost profits, business development and research damages, and exemplary damages in accordance with A.R.S. § 44-403(B).[31] TKCA has established its entitlement to damages under § 44-403(A) by proving PHP's misappropriation. Once actual damage is established, a lesser degree of certainty is required. *Short v. Riley*, 724 P.2d 1252,

[31] "If willful and malicious misappropriation exist, the court may award exemplary damages in an amount not exceeding twice any award made under subsection A." 44 A.R.S. § 44-403(B).

1254 (Ariz. Ct. App. 1986). Furthermore, TKCA has provided a reasonable basis for determining damages from the evidence contained in the record.[32]

As an initial matter, TKCA suffered actual damages resulting from PHP's misappropriation. This court finds that absent misappropriation and breach of contract by Muhs and PHP, TKCA would have competed for and won the DoS contract.[33] TKCA provided DoS with all previous Dash 8 aircraft, established an experienced network of contractors and suppliers, including Bombardier, and would have secured the MSN 560. Without Muhs, TKCA's trade secrets, and the MSN 560, PHP would not have been capable of submitting a competitive bid. TKCA's failure to bid does not hinder its claim when PHP's willful and malicious misappropriation prevented TKCA from competing. PHP's expert did not understand or appreciate this fact fully when he testified and calculated damages. When Muhs diverted Bombardier's LOI for the MSN 560 to PHP

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[32] *Surowiec v. Capital Title Agency, Inc., 190* F.Supp.2d 997, 1002 (Ariz. 2011), the plaintiff must present a "reasonable basis for computing the amount of damage and must do so with such precision as, from the nature of his claim and the available evidence, is possible." Inherently, allotting damages in this case requires some degree of speculation but absolute certainty is not required. The circumstances surrounding the parties and the nature of the market each business operates in necessitates a reasonable degree of speculation. This approach is bolstered by *W.L. Gore Associates, Inc. v. GI Dynamics, Inc.*, 872 F.Supp.2d 883, 891 (Ariz. 2013); *Telex Corp. v. Int'l Bus. Mach. Corp.*, 510 F.2d 894, 931 (10th Cir. 1975).

[33] Without TKCA's trade secrets and Muhs' assistance, PHP would not have been able to compete for the DoS contract. The fact that PHP prevailed over other bidders while using TKCA's bid proposal indicates that it was a winning proposal.

from TKCA, PHP successfully prevented TKCA from competing meaningfully for the contract. Jonathan Cree, Bombardier's representative, had identified the MSN 560 as the best Dash 8 available on the market based on aircraft specifications and price. Ex. 85. In its proposal, PHP identified the MSN 560 as the best option among an increasingly shrinking pool of aircraft, and by default the most competitive option. Ex. 133 at PHP 003354. PHP also cited structural damage as a problem that ruled out the available MSN 556.[34] With the best aircraft taken off the market, TKCA had no chance to submit a successful bid.

TKCA and PHP both put forth well-credentialed expert witnesses for the damages portion of these proceedings. However, PHP's expert, though knowledgeable in some areas, was not sufficiently familiar with government contracting and all the nuances involved in securing and overseeing the performance of the work involved. During testimony, PHP's expert consistently demonstrated a lack of understanding about the bidding process and the factual history relevant to calculating damages in this case.

a. Lost Profits from the Dash 8 Contract

"Reasonable certainty as to the amount of lost profits can be shown by books of account, records or

[34] "Taking into consideration the fact of the damage and the non-routine inspection involved, the being [sic] aircraft out of service for approximately five (5) years and the unknown cost of maintenance to return the aircraft to service and receive the required airworthiness certificate, PHP elected not to offer this aircraft to DoS INLA." Ex. 133 at PHP 003354 and 003355.

previous transactions..." *Felder v. Physiotherapy Associates*, 158 P.3d 877, 887 (Ariz. Ct. App. 2007). TKCA hired outside accountants to run a yearly audit on its books. January 22, 2013 Tr. 19:20 – 20:10. The court accepts the reliability of TKCA's audits and finds that the audited years "present fairly in all material respects the financial position of TK.CA." Ex. 897 at TKCA_MIKUNDA_761; January 22,2013 Tr. 22:13-26:23. Accordingly, the Court has relied on TKCA's financial records when calculating damages. In 2010 and 2011, DoS awarded TKCA four separate contracts through which TKCA delivered six Dash 8 aircraft. January 11, 2012 Tr. 39:20 – 40:3; Ex. 993 and 890. TKCA's gross profit percentage on those contracts ranged from 7.5% to 9.7% of total contract value. Ex. 993 at table 1(updated); January 29, 2013 Tr. 91:20 – 96:23.[35] TKCA earned a profit of $3,041,287.90 on its third Dash 8 contract, a profit margin of 9.0%. Ex. 993 at table 1(update) and table 2(update)[36]; Ex. 890.04; Ex. 945 at TKCA_PHP_18204. Much like the August 2011 DoS solicitation in this case, TKCA's third contract was for multiple aircraft and provides a reasonable basis from which to calculate its lost profits.

TKCA provided the court with a cost estimate following a nearly identical format to its previous successful proposals, but used the MSN 560 Dash 8 in calculating its cost. Ex. 244 at PHP 4239-4240 (Cost proposal for the third DoS contract). Based on this

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[35] Dennis Allen testified about his initial profit calculations.

[36] Dennis Allen repeatedly supplemented his findings and modified his calculations for TKCA's profits. When calculating damages, the court has selected a profit margin of 9% as the most reasonable and reliable figure.

proposal, TKCA would have proposed a price of $32,033,954 in response to the DoS August 2011 solicitation. January 22, 2013 Tr. 46:24 – 47:24; Exs. 932 and 946. Applying the profit percentage as TKCA's third DoS Dash 8 contract, TKCA is entitled to lost profits totaling $2,883,055.86 ($32,033,954 X 9.0%).

b. Unjust Enrichment

A.R.S. § 44-403 permits damages to "include both the actual loss caused by misappropriation and the unjust enrichment caused by misappropriation that is not taken into account in computing actual loss." Disgorgement is an alternative to recovery for lost profits. In the context of UTSA cases, the profits flowing from misappropriation serve as a measure of unjust enrichment. *Ajaxo, Inc. v. E * Trade Financial Corporation*, 187 Cal. App. 4th 1295, 1305 (Cal. App. 6th Dist. 2010); *Pro-Comp Management, Inc. v. R.K. Enterprises LLC*, 372 Ark. 190, 198, 272 S.W. 3d 91 (2008); *Sonoco Products Co. v. Johnson*, 23 P. 3d 1287, 1289 (Colo. App. 2001). As of the date of PHP's most recently produced Dash 8 contract profit and loss statement (December 31, 2012), PHP reportedly received $24,658,285 in Dash 8 contract revenues and anticipate a profit less than TKCA's. Ex. 989 at PHP 121193. In calculating damages, consistent with § 44-403(A), the court will not disgorge PHP of its profits in lieu of awarding TKCA's its lost profits.[37]

[37] It is reasonable to assume that TKCA's profits from the DoS contract would have yielded a higher profit margin. TKCA's prior experience would ensure that overhead cost were well below PHP's

c. Research and Development Cost

The amount of development costs a defending party saves by misappropriating trade secrets is a measure for calculating damages. *W.L. Gore Associates, Inc.* v. *GI Dynamics, Inc.*, 872 F.Supp.2d 883, 892 (Ariz. 2013). TKCA invested significant time and financial resources in developing its bid, business relationships, and past performance. The salaries of TKCA employees account for some of the investment cost. From 2005 through 2011, Muhs received a salary from TKCA totaling $1,450,762. Exs. 890.15 and 890.16. When Muhs left his position as TKCA Vice President for Business Development, he spent 80% to 90% of his time each year developing TKCA's fixed-wing aircraft business; this included drafting proposals, and working with DoS representatives on TKCA's behalf. January 11, 2012 Tr. 28:9 – 29:2; 35:10-23; 48:12 – 49:1; 50:15-23; January 24, 2013 Tr. 17:13-18; 19:2-14; 25:18 – 26:9; Ex. 982. This represents a $1,199,688 investment on business development. January 24, 2013 Tr. 17:13-18; 19:2-14; 25:18-26:9. TKCA's investments include but are not limited to the following salaries of full time and contractor employees between 2005 and 2011: $688,933 supporting Sam Boyle's fixed-wing development and proposal preparation efforts, $208,357 for Dave Alderman as "systems engineer," $113,062 for Mike Nelson to support TKCA's business development, $315,023 to Thomas Kind for fixed-wing business development, and $102,242 to Robert Kessler as TKCA's contract manager. Ex. 892. January 24, 2013 Tr. 24:24 – 26:9, 27:3-23, 27:24 – 28:13, 9:15-30:5, 30:18 – 31:17. TKCA produced and the court received into evidence the payroll records establishing the amount that TKCA paid to each individual who worked on the proposal and business development. Exs. 890.15, 890.16, and 890.17. TKCA's damage expert calculated these investments, in conjunction with other development expenses, amount to a total expenditure of $3,882,205. Ex. 892.

PHP misappropriated TKCA's trade secrets rather than investing in costly development of its own work product and immediately benefited from TKCA's labor by securing a $35 million contract. When PHP submitted its bid, not only did it copy TKCA's format and information, it used TKCA's past performance and business relationships as a selling point. In the proposal, PHP highlights Muhs role in overseeing the program and claims a successful Dash 8 delivery in the past 12 months. Ex. 10 at PHP 001694. It appears that PHP disingenuously claimed Muhs' prior experience delivering Dash 8's as its own. TKCA's investment over the six years it took for the company to develop and hone the misappropriated trade secrets totaled $3,882,205. Ex. 892; January 22, 2013 Tr. 16:15 – 17:3.[38] PHP would have had to make a similar investment of time and money to acquire the knowledge, technical expertise, relationships, and business acumen TKCA accrued to produce its bid. This court awards TKCA damages for its total

[38] Developing and submitting a first bid this complex can cost a company upwards of $1 million. January 12, 2012 Tr. 121:1 – 122:7. The research and development figure calculated by TKCA is comprised of 35% proposal preparation efforts, and of 65% customer, supplier and industry relationship building necessary to pursue government contracts. PHP plainly claimed Muhs' prior experience delivering Dash 8's as its own past performance because by the time PHP submitted its bid, Muhs was working for the company.

investment in proposal preparation and client development.[39]

d. Head-Start Damages

The "monetary recovery for trade secret misappropriation is appropriate only for the period in which information [is] entitled to protection as a trade secret ..." *Uniform Trade Secret Act* 3 cmt. (*amended* 1985). This is the head-start period and encompasses the time it would have taken the misappropriating party to develop similar information on its own. *Sensormatic Electronics Corp. v. TAG Co. US, LLC*, 632 F. Supp. 2d 1147, 1187 (S.D. Fla. 2008) *aff'd in part sub nom.*; *Remier Lab Suply, Inc. v. Chemlex Industries, Inc.*, 94 So.3d 640, 644-45 (Fla. Dist. Ct. App. 4th Dist. 2012).

Prior to August 2011, PHP had no fixed-wing aircraft experience. March 15, 2012 Tr. 78:22 – 79:14. This contract represented PHP's first attempt to act as a prime contractor in the fixed-wing market. March 12, 2012 Tr. 95:21-24. The company had no substantial prior relationships with vendors or suppliers to support the Dash 8 proposal. PHP part owner, Don Nichols, let Muhs know that, without his assistance, PHP would have never thought of

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[39] It is appropriate to include the cost of business development in the value ofTKCA's proposal despite the fact that business relationships do not qualify as trade secrets. The court understands that preparing a successful proposal includes developing reliable business partners. The business relationships necessary for the success of the project have actual value. Without business relationships like TKCA had with, for example, Bombardier, AirNostrum, and its subcontractors, the written proposal would not necessarily have materialized or otherwise been successful.

entering the program and that he was "the man of the hour." Ex. 258; March 15, 2012 Tr. 136:3 – 137:13. Nichols and the rest of PHP's management clearly knew that the company had not yet developed the relationships, information, or expertise necessary to compete for the August 5, 2011 DoS contract. Using TKCA as a model for business development in the fixed-wing market, this court finds that PHP gained a three-year head start and was able to compete for and secure a fixed-wing contract long before it would have otherwise.

A three-year head-start period based on the time it took for TKCA to develop a profitable fixed-wing business model and bid is the appropriate period for calculating head-start damages. It is reasonable to assume, based on the evidence, that PHP could have developed a competitive bid and business model for the fixed-wing market in that amount of time.[40] Tina Cannon testified that PHP planned to pursue fixed-wing aircraft opportunities in the future and that PHP would rely on its Dash 8 experience. Feb. 14, 2013 Sealed #2 Tr. 37:23 – 38:1. PHP pursued a DoS 1900D opportunity in 2012 until dissuaded by threat of litigation from TKCA. October 8, 2013 Tr. 22:1-23. However, TKCA did not present a reasonable method for calculating PHP's profits. Additionally, TKCA did not produce evidence that PHP actually secured additional DoS contracts during the three-year window, most of which overlapped with this case's trial. TKCA's expert, Dennis Allen, used three methods for quantifying PHP's future profits on this

[40] TKCA's experience contracting with government agencies for fixed-wing aircraft provides a reasonable business model to calculate damages.

matter. Ex. 890 at TKCA_PHP_8893; January 25, 2013 Tr. 71:25 – 74:1. All three depend on TKCA's past performance as a market norm to project future revenue and profit margins. PHP's head-start profits were calculated using a two-step process which first established PHP's profit margin for the period and then projected PHP's total revenue. To project PHP's profit margin on future DoS contracts, Dennis Allen averaged TKCA's profits from its 2010 and 2011 DoS contracts and arrived at a profit margin of 8.7%. Ex. 890 at TKCA_PHP_8897 (Exhibit A-1); January 25, 2013 Tr. 63: 8 – 64:1. The court agrees with this method of calculating PHP's future profit margin. However, the court does not agree with the method Dennis Allen used to calculate total revenue for the head-start period. Specifically, the court finds no support for his projection of revenue from DoS contracts. Dennis Allen added together TKCA's DoS revenue from 2010 and 2011 to arrive at a single year average of $40 million to calculate the first year of the head-start period. January 25, 2013 Tr. 62:21 – 63:3. He then added a 5% increase in revenue to reach a total of $42 million for the second year *Id.* at 63:4-10.

Awarding damages for future profits requires some degree of speculation. *See Electronics Corp. v. TAG Co. US, LLC*, 632 F. Supp. 2d 1147, 1187 (S.D. Fla. 2008). However, even though it is reasonable to base some calculations on a sample from a company's internal performance figures, the same is not true for factors outside the company's control. When Dennis Allen made his revenue projections, he assumed that PHP would continue to secure DoS contracts at the same rate as TKCA without any evidence that DoS would issue similar solicitations. The availability of this business opportunity is entirely outside of either

PHP's or TKCA's control. It is unreasonable to base damages off of guesswork and sheer speculation. The market for DoS acquisition and maintenance contracts is not like a market for regularly traded commodities with data points that allow for more reasonable speculation on future earnings. Dennis Allen's method for calculating PHP's future earnings, though not without some support, does not provide a sufficiently reliable basis for this court to award head-start damages. Accordingly, the court finds that TKCA did not meet its burden of proof and, therefore, the court will not award TKCA head-start damages.

e. Exemplary Damages

Finally, TKCA seeks exemplary damages pursuant to A.R.S. § 44-403(B) for the willful and malicious misappropriation of trade secrets. AUSTA does not define "willful and malicious" nor does scant Arizona case law offer insight into the meaning of this statutory term, but other jurisdictions that have adopted UTSA provide guidance. The Pennsylvania Uniform Trade Secret Act defines "willful and malicious" as "[s]uch intentional acts or gross neglect of duty as to evince a reckless indifference to the rights of others on the part of the wrongdoer, and an entire want of care so as to raise the presumption that the person at fault is conscious of the consequences of his carelessness." *HTS, Inc.* v. *Boley*, 954 F.Supp.2d 927, 959 (D. Ariz. 2013); *citing* 12 Pa.C.S.A. § 5302; *see Learning Curve Toys, Inc. v. Playwood Toys, Inc., 342 F.3d 714, 730 (7th Cir. 2003)(* the court noted that willful and malicious misappropriation includes "intentional misappropriation as well as a misappropriation resulting from the conscious disregard of the rights of another.") Attempts to conceal wrongful conduct with respect to trade secrets provide evidence of willful and malicious misappropriation. *HTS, Inc.*, 954 F.Supp.2d at 959-60.[41]

As previously discussed, the following are just a few examples that establish PHP willfully and maliciously engaged in misconduct. Despite knowing Muhs' contract with TKCA had a non-compete clause, the Cannons induced Muhs to misappropriate TKCA's trade secrets in order to compete directly with TKCA. Muhs, on behalf of PHP, withheld vital information from TKCA so that PHP could establish a material and temporal advantage in preparing a successful proposal in response to the DoS solicitation. Tina Cannon knew that Muhs had uploaded TKCA proprietary documents to PHP's servers and PHP knowingly used the uploaded documents to prepare its bid. PHP further knew that using the uploaded documents would harm TKCA. Also, presenting a fabricated document, namely the GAL proposal, in support of a fictitious defense further supports a finding of willful and malicious conduct.

The evidence establishes that PHP engaged in the type of misconduct that justifies awarding exemplary damages. Incredibly, PHP continued to act in a willful and malicious manner and in bad faith even after the trial started. The court has rarely

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[41] In *HTS, Inc.* an employee deleted emails pertaining to the misappropriation of company trade secrets and his intention to use the documents in competition. This employee copied company trade secrets from a laptop computer which he had in his possession for several days after leaving his employment with HTS. *HTS, Inc.*, 954 F.Supp.2d at 959-60.

witnessed such egregious misconduct. Examples include but are not limited to PHP intentionally wiping company servers after learning of a subpoena, erasing company laptops in the evening and early morning hours before court-ordered forensic imaging started, presenting a fraudulent GAL proposal, and backdating computer files before disclosure. Late production of relevant emails and missing attachments amounted to far more than any court could consider acceptable or a mistake. This behavior constitutes circumstantial evidence of the willful and malicious state of mind necessary for exemplary damages under AUTSA. This court further infers from the scope, nature and extent of the misconduct that PHP intentionally destroyed evidence that would have provided additional support for making this finding.[42]

This court has the option of awarding exemplary damages under AUTSA and punitive damages stemming from TKCA's common law claims. Exemplary damages under AUTSA's willful and malicious standard require a lower burden of proof than the proof necessary to award punitive damages for the common law claims. "Unlike other statutes, § 44-403(B) does not adopt the common law or impose a heightened standard of proof for a punitive damage award." *Orca Commc'ns Unlimited, LLC v. Noder*, 236 Ariz. 180, 337 P.3d 545, 548 (Ariz. Sup. Ct. 2014). "Clear and convincing evidence establishing an "evil mind" is required to establish punitive damages." *Id.* Since the weight of the evidence meets the "clear and

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[42] In the *Zimmerman* section of this ruling, the court addresses additional consequences that result from PHP's and Muhs' misconduct. *See Section II(D).*

convincing" requirement, this court awards punitive damages in the alternative. Even though the amounts awarded for punitive and exemplary damages can differ, TKCA cannot receive a double recovery. Because the maximum amount allowable under A.R.S § 44-403(B) is the amount best supported by the evidence under either theory for recovery, the court adopts this measure for awarding exemplary and/or punitive damages.

TKCA has met its burden of proof under AUTSA, meriting an award of exemplary damages. A.R.S. § 44-403(B), caps exemplary damages under the statute at double the total amount of compensatory damages awarded. The court does not consider awarding punitive damages a minor matter, especially the damages awarded in this ruling. However, considering PHP's absolute and complete disregard for the truth, disrespect for the court and disregard for the opposing party, nothing but the most severe damages are appropriate. In light of all of the facts, TKCA has more than met its burden. This court finds by clear and convincing evidence that PHP acted in a willful and malicious manner and with an evil mind and, therefore, awards exemplary damages in the amount of $13,530,521.72 (double the total compensatory damages of $6,765,260.86)[43].

For the sake of consolidating this discussion in part, the court notes that under the common law claims addressed below, counts II and ill, the court finds alternative grounds for granting punitive damages. In Arizona, "punitive damages are awarded

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[43] Compensatory damages is comprised of lost profits ($2,883,055.86) plus research and development ($3,882,205).

only in the most egregious of cases, where it is proved by clear and convincing evidence that the defendant engaged in reprehensible conduct and acted with an evil mind ...." *Security Title Agency, Inc. v. Pope*, 498, 200 P.3d 977, 995 (Ariz. Ct. App. 2008) *(citations and quotations omitted).* A defendant acts with the requisite evil mind "when he intends to injure or defraud, or deliberately interferes with the rights of others, consciously disregarding the unjustifiable substantial risk of significant harm to them." *Security Title Agency, Inc.*, 200 P.3d at 995. "The critical inquiry is whether an award of punitive damages is appropriate to penalize a party for outwardly aggravated, outrageous, malicious, or fraudulent conduct that is coupled with an evil mind." *Id., quoting Medasys Acquisition Corp v. SDMS, P.C.*, 424, 55 P.3d 763, 767 (Ariz. 2002) (*en banc*) and *Linthicum v. Nationwide Life Ins. Co*, 723 P.2d 675, 680 (Ariz. 1986)(en *banc*). This court finds by clear and convincing evidence that PHP engaged in outrageous conduct and acted with an evil mind intending to injure TKCA by intentionally interfering with TKCA's contracts and opportunities and then using TKCA's proprietary information to misappropriate those opportunities. *Security Title Agency, Inc.*, 200 P.3d at 995. TKCA has more than satisfied its burden of proof to qualify for an award of punitive damages. In lieu of exemplary damages under § 44-403(B), this court alternatively awards TKCA punitive damages in the amount of $5,766,111. 72. Although the court finds a basis to award exemplary damages under AUTSA and punitive damages under the common law claims, the court will only order the payment of the statutory damages because the conduct giving rise to the award of exemplary and punitive damages is the same.

This court awards TKCA damages for lost profits, research and business development, and exemplary damages under AUTSA an amount totaling $20,295,782.58. This court further invites TKCA's petition for consideration of reasonable attorney's fees to be determined at a later date pursuant to A.R.S. § 44-404.

C. Common Law Claims

TKCA's claim under AUTSA does not displace its common law claims in their entirety. Like other UTSA jurisdictions, AUTSA creates a unified cause of action, displacing conflicting common law claims based on misappropriation of trade secrets. However, it "does not displace common law claims based on alleged misappropriation of confidential information that is not a trade secret" under the Act. *Orca, 337 P.3d at 546.* For the following reasons this court finds that TKCA has met its burden of proof establishing PHP's intentional interference with valid business expectancies and unfair competition by a preponderance of the evidence. Because of the nature of the documents involved, this court finds that TKCA did not meet its burden on the conversion claim.

1. Interference with Business Expectancies

TKCA alleges in count two of its complaint that PHP intentionally interfered with its business expectancies in the seventh Dash 8 solicitation. To establish intentional interference with business expectancy, a plaintiff must demonstrate:

(a) existence of a valid ... business expectancy;

(b) the interferer's knowledge of the ... expectancy;

(c) intentional interference inducing or causing a breach or termination of the expectancy; and

(d) resultant damage to the party whose ... expectancy has been disrupted.

(e) In addition, the interference must be improper as to motive or means before liability will attach.

Neonatology Assocs., Ltd., v. Phoenix Perinatal Assoc. Inc., 164 P.3d 691, 693 (Ariz. Ct. App. 2007) (*citations omitted*).

As set forth below, this court finds that TKCA has satisfied all five elements.

i. TKCA Had a "Valid Business Expectancy" In the Seventh DoS Dash 8 Solicitation

This court finds that TKCA had a valid business expectancy in the seventh DoS Dash 8 Solicitation. "A claim for tortious interference with business expectancy is insufficient unless the plaintiff alleges facts showing the expectancy constitutes more than a mere 'hope.'" *Dube v. Likins*, 167 P.3d 93, 99-100 (Ariz. Ct. App. 2007) (*citations omitted*). Further, the intentional interference must be a "[w]rongful interference [that] rests on improper conduct by the defendant ... not on whether a breach [or termination of the expectancy] followed." *Id. citing Bar J Bar Cattle Co. v. Pace*, 763 P.2d 545, 547 (Ariz. Ct. App. 1988).) "To prevail on a claim of tortious interference with a business relationship, when the relationship is prospective, there must be a reasonable assurance that the contract or relationship would have been entered into but for the interference." *S. Union Co. v. Sw. Gas Corp.*, 180 F.Supp.2d 1021, 1048 (D. Ariz. 2002).

This court finds that TKCA had far more than a "mere 'hope'" in winning the seventh DoS Dash 8 Solicitation. In the two years before this seventh Solicitation, TKCA had modified and sold six Dash 8 aircraft to DoS in three different transactions. Further bolstering TKCA's "expectancy" is that DoS had never otherwise purchased Dash 8 aircraft. Bombardier's issuance of the TKCA LOI lends further support to TKCA's claim that it had a valid expectancy in the seventh Dash 8 Solicitation. Having sold TKCA the first six Dash 8s that TKCA modified and sold to DoS, Bombardier obviously assumed TKCA would submit another bid. The fact that Doug Aslett of DoS called Muhs, on the same cell phone Muhs had conducted TKCA business on for years, also supports TKCA's claim of a valid expectancy in the seventh Dash 8 transaction. January 13,2012 Tr. 138:19 – 139:6.

This court finds that TKCA easily meets that standard. It is hard to imagine a more compelling set of facts than those presented here: TKCA sold DoS the only Dash 8s DoS ever had purchased, TKCA obtained them all from Bombardier, which issued an LOI to TKCA for the very aircraft that PHP used in its proposal; and this all began with a call from DoS to Muhs, TKCA's contact with DoS for the first six Dash 8 transactions, on Muhs' TKCA cell phone.

ii. PHP Knew ofTKCA's Valid Business Expectancy in the Seventh DoS Dash 8 Solicitation

Next, this court concludes that PHP knew of TKCA's business expectancy in the Dash 8 contract. Tina Cannon testified that she knew that TKCA had sold all of the previous Dash 8 aircraft to DoS. March 15, 2012 Tr. 86:8-22. PHP's awareness went beyond knowing of TKCA's relationship with DoS. Throughout its preparation of its proposal, PHP expressed its own expectation of TKCA's involvement in the DoS Dash 8 Solicitation. March 12, 2012 Tr. 107:5 – 108:13. In his August 8, 2011 email, Darin Cannon suggested to Tina Cannon that PHP consider a cheaper aircraft because that aircraft "may give TKC advantage." *Id.* Darin Cannon testified that he was "conscious of TKCA as a competitor for this solicitation." Tina Cannon's "Sam is mad" email further demonstrates this fact. Ex. 128.

This court finds that PHP was well aware of TKCA's expectancy in the seventh DoS Dash 8 Solicitation. Furthermore, this court finds that PHP is chargeable with Muhs' obvious knowledge of TKCA's expectancy because PHP named Muhs in its proposal and worked closely with him preparing the PHP Proposal. This court finds that Muhs knew of

TKCA's expectancy based on his experience with TKCA during the first six transactions.

iii. PHP's Intentional Interference Terminated TKCA's Expectancy

This court finds that PHP intentionally and improperly interfered with TKCA's expectancy in the DoS contract. PHP first learned of DoS's seventh Dash 8 opportunity from Muhs before it became public and while TKCA still employed him as a part-time employee subject to a non-compete agreement.

PHP learned of the availability of MSN 560 because Muhs concealed from TKCA Bombardier's LOI and then shared it with PHP, in violation of his TKCA Employment Agreement ¶ 6.1. Ex. 1. The agreement required Muhs to disclose to TKCA "any and all Trade Secrets, Confidential, or Proprietary Information, or other works to which Executive becomes privy by reason of his employment with the Company." Although the TKCA LOI is not a trade secret, it was Confidential Information under paragraph 6.4 of Muhs' TKCA Employment Agreement.

It is undisputed that neither PHP nor Muhs notified TKCA of the existence of the LOI before it expired (or after). This court finds Muhs intentionally concealed the LOI from TKCA so that PHP would have an opportunity to secure the MSN 560. Ex. 240; January 11, 2012 Tr. 66:4 – 69:14. This court rejects Muhs' testimony that somehow Bombardier should have contacted TKCA directly. Bombardier had no such responsibility but, in fact, did just that when a representative reached out to Muhs.

PHP interfered with TKCA's expectancy by obtaining from Muhs (in violation of his TKCA Employment Agreement) and using proprietary TKCA documents such as the IPL and the ENs. This court finds that these documents were not TKCA trade secrets, but are "Confidential Information" as defined in paragraphs 6.4 and 7 of Muhs' TKCA Employment Agreement. Muhs possessed these documents because of TKCA's six prior purchases of Dash 8 aircraft from Bombardier and subsequent resale of those aircraft after modification to DoS.

This court further finds that PHP was aware of Muhs' obligations not to disclose these items of Confidential Information to PHP. Furthermore, this court finds that PHP knew that it was using TKCA Confidential Information when it used TKCA's IPL in negotiating the PHP LOI with Bombardier and when it used TKCA's ENs in the PHP proposal to DoS. *See Brooks Fiber Communications of Tucson, Inc. v. GST Tucson Lightwave, Inc.*, 992 F.Supp. 1124, 1131 (D. Ariz. 1997) (noting that "improper means" encompasses fraudulent, illegal or inequitable conduct).

iv. PDP's Intentional Interference Resulted in Damage to TKCA

This court finds that PHP's intentional interference resulted in damage to TKCA, by effectively denying TKCA the opportunity to bid on the DoS Dash 8 Solicitation with the MSN 560. This court finds that MSN 560 was the best Dash 8 available for the DoS Dash 8 Solicitation. PHP avowed to this fact in its own Proposal. This court finds that had Muhs not diverted this opportunity and the TKCA LOI, in particular, to PHP, TKCA would have secured the MSN 560.

This court further concludes that TKCA has proven, based on the entire record, that with the MSN 560 TKCA would have submitted a timely proposal to DoS, and would have had "reasonable assurance" of succeeding. *See S. Union Co. v. Sw. Gas Corp.*, 180 F.Supp.2d 1021, 1048 (D. Ariz. 2002).

Thus, this court finds that TKCA suffered "resultant damage" from the termination of its expectancy in the seventh Dash 8 contract, in the form of lost profits.

This court concludes that but for PHP's wrongful interference that deprived TKCA of the opportunity to purchase the MSN 560 aircraft, TKCA was reasonably assured of competing for and winning the seventh DoS Dash 8 contract award.

As to each element of this count, to the extent there is any question about the sufficiency of TKCA's evidence, this court infers that such evidence would have existed but for PHP's destruction of evidence.

2. Unfair Competition

TKCA's third claim against PHP is for violation of the common law doctrine of Unfair Competition. "The general purpose of the doctrine is to prevent business conduct that is contrary to the honest practice in industrial or commercial matters." *Fairway Constructors, Inc. v. Ahern*, 970 P.2d 954, 956 (Ariz. Ct. App. 1998), *citing House of Westmore, Inc. v. Denney*, 151 F.2d 261, 265 (3d Cir.1945); *and*

Metropolitan Opera Ass'n v. Wagner-Nichols Recorder Corp., 199 Misc. 786, 101 N.Y.S.2d 483, 488 (1950)(*internal quotations omitted*). In *Fairway Construction, Inc.*, the court placed heavy emphasis on misrepresentation and confusion in the market place, saying that 'palming off' or 'passing off' is the central tort of the claim. *Id.* Palming off is the act of representing to the buyer a counterfeit object as the product of a competitor. *Id.* The *Fairway* court included the torts of misappropriation, trademark infringement, and false advertising in its description of the claim. *Id.*

Fairway Construction, Inc., relied heavily on *Kaibab Shop v. Deser Son, Inc.*, 662 P.2d 452, 452-53 (Ariz. Ct. App. 1982), as the prior Arizona case dealing with "palming off." In *Kaibab*, the defendant produced and sold boots that looked like boots made by the plaintiff. The court observed that "... palming off is simply a direct and more flagrant means of misleading purchasers as to the source of the product. Both palming off and creating confusion as to source can easily lap over into misappropriation of the property or goodwill of a competitor." *Kaibab., 662 P.2d* at 454, fn. 1.

TKCA's "palming off" theory of unfair competition fails. PHP certainly intended to benefit from TKCA's experience and past work. PHP's bid proves this fact. The bid highlights Muhs' involvement, PHP's use of the same network of subcontractors, and PHP's reliance on TKCA's past experience through Muhs delivering Dash 8's. However, this case is not similar to a case involving a counterfeiter passing off imitation designer boots. PHP did not claim to be selling a product produced by its competitor. To be sure, PHP's claim of past performance was dishonest, but the conduct does not amount to "palming off." *Kaibab* specifically mentions "overlapping," which seems to indicate that there must still be an element of confusion as to the source of the goods on the part of the buyer. DoS is a savvy participant in the market. There was no chance DoS would have been confused as to the source of the product. Any goodwill PHP misappropriated does not overlap enough, if at all, with the confusion element necessary to establish unfair competition on a 'palming off' theory.

Additionally, TKCA argues this claim based on the misappropriation of trade secrets. TKCA's AUTSA claim displaces the common law claim under this theory. Since the documents at issue qualify as trade secrets under AUTSA, they cannot serve as the basis for a common law claim. *Orca*, 337 P.3d at 546.

TKCA also argued this claim falls under a loosely defined and poorly supported theory of inducement to breach contract. The Arizona Supreme Court declined to rule on the scope of unfair competition in *Orca. Id.* at 547. Instead, the Court directed the reader to compare *Fairway Construction, Inc.*, and the Restatement (Third) of Unfair Competition§ 1 cmt. g (1995) (which was much broader in scope than *Fairway's* description), and Restatement (Second) of Agency §§ 395, 396 1958) (which also included an agent's improper use of confidential information). *Id.* Plaintiff's point is well taken that the history of the common law claim emphasizes protection against unfair business practices, and that due to the nature of human creativity there are innumerable ways in which this claim can arise. However, unfair business practices, according to *Fairway,* relate to market confusion and obfuscating the source of goods. *Fairway* has stood since 1998, and this court will follow its lead. PHP is not liable for unfair completion under this theory.

Among the torts *Fairway* identified at the core of unfair competition, misappropriation of confidential information forms the only surviving basis for relief on this particular claim. *Fairway Construction, Inc.*, 970 P.2d at 956. "Misappropriation involves the unfair taking for profit, at little or no cost, of property acquired by another through investment of substantial time and money." *Id.* at , (*Fairway's* misappropriation claim was preempted by federal copyright law). "It is normally invoked in an effort to protect something of value that is not covered either by patent or copyright law ..." *Id.* at 957, *citing International News Service v. Associated Press*, 248 U.S. 215 (1918).

The record firmly establishes, and inferences drawn from the wanton destruction of evidence confirms, that PHP acquired by improper means confidential TKCA information, the EN's and IPL's. The confidential information represents part of TKCA's overall investment and preparation for the bid proposals it submitted to DoS. PHP used the confidential information to prepare its own bid in competition against TKCA, profiting from the information without investing in its development. TKCA's AUTSA claim displaces the SOWs, and PHP's actions regarding the March 11 Bombardier LOI does not constitute misappropriation because PHP did not create or invest in its production. The document was the sole property of Bombardier. Nevertheless, this court finds that PHP unfairly competed with TKCA by misappropriating confidential TKCA ENs and IPLs.

3. Conversion

TKCA further claims that PHP wrongfully converted TKCA property for use in its efforts to secure the DoS solicitation. Specifically, TKCA asserts that PHP converted its IPL, ENs, LOI, and the opportunity to bid on the contract.

Arizona has adopted the Restatement's definition of conversion: "Conversion is an intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the full value of the chattel." *Focal Point, Inc. v. U-Haul Co. of Ariz.*, 746 P.2d 488, 489 (Ariz. Ct. App. 1986); *Miller v. Hehlen*, 104 P.3d 193, 203 (Ariz. Ct. App. 2005); Restatement (Second) of Torts § 222A(1) (1965). A claim of conversion lies with tangible property, or intangible property merged into a document, like a stock certificate. *Miller*, 104 P.3d at 203. After finding each element, a court must further consider the seriousness of the interference and whether the offending party must pay full value. *See* Restatement (Second) of Torts§ 222A(2).

This court concludes that TKCA's LOI, the subsequent opportunity to bid on the DoS contract, ENs, and IPLs do not constitute chattel within the meaning of the Restatement. All of the aforementioned are intangibles, and have not been merged into a document in the same way as a stock certificate. TKCA certainly had a business interest in the LOI, but it did not have a possessory interest.

Bombardier created the document and exercised control over it. If TKCA had received the LOI, as Bombardier no doubt intended it to, TKCA would have been free to sign it, or let it lapse. However, TKCA could not freely transfer the document and therefore could not exercise complete dominion or control over it. Nor did the LOI represent the merger of an intangible into a document as explained in *Miller*. Consequently, the opportunity to bid on the DoS contract fails as a conversion claim.

The ENs and IPL, though entirely different in substance from the LOI or business opportunity, fair no better. Although TKCA drafted both documents for business use, they are not the kind of intangible asset that *Miller* found supported an action for conversion. TKCA made no showing that intangible property had been merged into this document, in the same way that a stock certificate merges with an interest in a company. For these reasons, TKCA's claim against PHP for conversion fails.

4. Damages for Common Law Claims

In calculating damages under these claims, this court incorporates by reference the damages analysis under TKCA's AUTSA claim. TKCA will not receive a windfall from identical damages under AUTSA and the common law. Rather, this analysis provides an alternative basis for relief including an award for punitive damages.

The proper measure of damages under TKCA's Intentional Interference with Business Expectations is "the pecuniary harm resulting from loss of the benefits of the relation..." Restatement (Second) of

Torts § 766B (1979). PHP's intentional interference prevented TKCA from forming a contractual relationship with DoS and reaping the profits from that contract. Under these circumstances, this measure is particularly appropriate because TK.CA's prior experience would have resulted in lower overhead expenses. Naturally, PHP's costs were going to be higher and it does not serve the purposes of equity to reduce TKCA's recovery because of PHP's inexperience. TKCA is entitled to lost profits totaling $2,883,055.86.

Because of the infrequency with which unfair competition claims arise in Arizona courts, instructions are vague for calculating relief for the misappropriation of confidential or proprietary information. *Fairway* found that Plaintiffs would have been free to argue for "damages plus any profits realized by defendants through their misappropriation of Plaintiffs' design." *Fairway Construction, Inc.*, 970 P.2d at 958. However, the *Fairway* court gives little guidance for how to calculate these "damages". In more recent cases, claims for misappropriation arise routinely in circumstances where the claim is inextricably intertwined with statutory trade secret misappropriation and copyright infringement causes of action; therefore, looking to those lines of cases provides guidance. Damages in misappropriation cases can take several forms: the value of plaintiffs lost profits, the defendant's actual profits from the use of the secret ... [or] the development costs the defendant avoided incurring ..." *Bohnsack v. Varco, L.P.*, 668 F.3d 262, 280 (5th Cir. 2012)., *Citing Univ. Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, 535 (5th Cir. 1974) (finding it the general practice in trade secret misappropriation cases to look to copyright infringement for the proper measure of damages.). *Bohnsack* states the methods of relief in the injunctive. Double recovery is not permitted. "The copyright owner can sue for his losses of for the infringer's profits, but not for the sum of the two amounts ..." *Bucklew v. Hawkins, Ash, Baptie* & *Co.*, 329 F.3d 923, 931 (7th Cir. 2003).

TKCA offered no testimony supporting the specific development cost of its ENs or IPLs. Outside the context of TKCA's overall proposal development costs, no reasonable basis has been established to value the expenses PHP avoided by misappropriating TKCA's ENs and IPLs. Damages cannot be awarded on that basis. However, but for PHP's misappropriation of confidential information, PHP would not have been able to submit a timely bid, compete against TKCA, or secure the DoS contract. TKCA's estimated profits are higher than PHP's and are the correct value of damages. *See Damages analysis under the A UTSA claim*. PHP should not recover less than it reasonably anticipated earning from the contract because of PHP's inexperience. TKCA is entitled to lost profits totaling $2,883,055.86. The court has previously found support for punitive damages (*See Section II(B)(3)(e))* and awards punitive damages for the common law claims in the amount $5,766,111.72.

D. Discovery Violations: The Zimmerman/Culprit Hearing

This court understands the gravity of considering whether to impose sanctions on a party and/or counsel for discovery violations or misconduct.

The court also understands its role in safeguarding the integrity of judicial proceedings. The court finds in this case that the acts and/or omissions committed in large part by PHP and, to a lesser extent by counsel, warrant relief.[44]

TKCA attempted to alert the court to its concerns regarding missing attachments to emails, late disclosure and possible destruction of evidence. Initially the court minimized the problem not understanding its full magnitude. Over time, however, the court could no longer ignore evidence of misconduct and, therefore, set an evidentiary hearing pursuant to *Zimmerman*, Rule 37 Ariz. R. Civ. P., A.R.S. § 12-349, and A.R.S. § 12-350[45] to determine

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[44] Upon considering counsels' role in this matter, the court has determined that local counsel for PHP, Sharon Urias, was only minimally involved directing discovery and its disclosure. Accordingly, the court finds that Ms. Urias was not responsible for the discovery abuses and violations that occurred.

[45] The court has taken into consideration the factors set forth in A.R.S. § 12-350 when making its finding under A.R.S. § 12-349. More specifically, pursuant to A.R.S. § 12-350, the court analyzed, where appropriate:

> 1. The extent of any effort made to determine the validity of a claim before the claim was asserted.
>
> 2. The extent of any effort made after the commencement of an action to reduce the number of claims or defenses being asserted or to dismiss claims or defenses found not to be valid.
>
> 3. The availability of facts to assist a party in determining the validity of a claim or defense.
>
> 4. The relative financial positions of the parties involved.

whether discovery violations occurred, who was responsible and if sanctions are appropriate. *Zimmerman*, 62 P.3d at 980. Little could the court have known that the time spent on the *Zimmerman* hearing would eclipse the time spent on the merits of the case. The court also could not anticipate that the evidence presented during the *Zimmerman* hearing would become so inextricably intertwined with the court's findings on exemplary and punitive damages.

The court will first examine PHP's and Muhs' conduct and then consider whether Dickstein shares any responsibility for its client's acts. Before imposing sanctions rising to the level of a default judgment for discovery violations, a court must consider:

1) Whether a discovery violation occurred;

2) Whether the information is material;

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5. Whether the action was prosecuted or defended, in whole or in part, in bad faith.

6. Whether issues of fact determinative of the validity of a party's claim or defense were reasonably in conflict.

7. The extent to which the party prevailed with respect to the amount and number of claims in controversy.

8. The amount and conditions of any offer of judgment or settlement as related to the amount and conditions of the ultimate relief granted by the court.

The court understands that when awarding attorneys' fees as a sanction, the court must set for the specific reasons for the findings. *Rogane v. Correia*, 335 P.3d 1122, 1129 (Ariz. Ct. App. 2014).

3) Whether the opposing party has suffered any prejudice[46]; and

4) Whether, and to what extent, a party or counsel, or both are at fault.[47]

1. Client Misconduct: PBP engaged in Misconduct in Violation of Arizona Rules of Civil Procedure and Sanctions are Warranted

Arizona Rules of Civil Procedure 26 establishes the scope, duty and timing of disclosure of relevant information after a lawsuit is commenced. More specifically, "[p]arties may obtain discovery regarding *any* matter, not privileged, which is relevant to the subject matter in the pending action...." Ariz. R. Civ. P. 26(b)(1)(A)(*emphasis added*). Parties have a continuing duty to make seasonable disclosures "whenever new or different information is discovered or revealed." Ariz. R. Civ. P. 26.1(b)(2). The rules also establish the sanctions available when a party violates the rules. When disclosure has been ordered and a party does not comply, Rule 37(b)(2)(C) provides for sanctions that include striking pleadings, dismissing actions or any part of a proceeding, and rendering a default judgment against a disobedient party. In addition, sanctions are available when a party fails to timely disclose information. Ariz. R. Civ. P. 37(c). This Rule provides that "[a] party or attorney

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[46] *Roberts* 235 P.3d at 272, *citing Zimmerman v. Shakman,* 62 P.3d at 980.

[47] *Roberts*, 235 P.3d at 276-77 (Ariz. Ct. App. 2010)(court addressed joint and several liability when considering Rule 11 sanctions).

who makes a disclosure pursuant to Rule 26.1 that the party or attorney knew or should have known was inaccurate or incomplete and thereby causes an opposing party to engage in investigation or discovery, shall be ordered by the court to reimburse the opposing party for the cost, including attorney's fees of such investigation or discovery. In addition to or in lieu of these sanctions, the court on motion of a party or on the court's own motion, and after affording an opportunity to be heard, may impose other appropriate sanctions" including "payment of reasonable expenses, including attorney's fees, caused by the failure." Ariz. R. Civ. P. 37(c)(1). Rule 37(d) further provides that, "[a] party's or attorney's knowing failure to timely disclose damaging or unfavorable information shall be grounds for imposition of serious sanctions in the court's discretion up to and including dismissal of the claim or defense." Ariz. R. Civ. P. 37(d).

If a party engages in misconduct, the court understands that it must exercise restraint and impose only those sanctions necessary to address the conduct in question and only those sanctions authorized by the Rules. Courts have imposed a variety of sanctions. For example, the failure to disclose the substance of an expert's testimony in a medical malpractice action that unreasonably expanded or delayed the proceedings warranted the imposition of monetary sanctions. *Solimeno v. Yonan*, 227 P.3d 481 (Ariz. Ct. App. 2010). When a client willfully destroys evidence, the court has a great deal of leeway in determining the appropriate sanction with a preference for sanctions that still allow adjudication on the claim's merits. *Allstate Ins. Co. v.*

O'Toole, 896 P.2d 254, 257 (1995).[48] Evidence of bad faith and intentional destruction of evidence by one of the parties can justify a default judgment. *Roberts v. City of Phoenix*, 235 P.3d 265, 272 (Ariz. Ct. App. 2010)(*quoting Rivers v. Solley*, 177 P.3d 270, 272 (Ariz. Ct. App. 2008)); *Poleo v. Grandview Equities, Ltd.*, 692 P.2d 309, 312 (Ariz. App. 1984) (*Internal quotations omitted*). In *Roberts*, plaintiff sued the City of Phoenix for its police officer's targeted discrimination of patrons leaving gay bars. During subsequent litigation, the city repeatedly withheld and destroyed relevant documents after the plaintiff submitted requests for disclosure. *Roberts, 235 P.3d* at 268-69 and 271-72. The Court of Appeals affirmed the trial court's order striking the city's answer and entering judgment for the plaintiff as a proper sanction. *Id.* at 273. When a party destroys evidence, the party must act willfully and in bad faith for the court to impose a sanction as extreme as dismissal; "innocent failure to preserve evidence does not warrant" this level of sanction. *Id.*; *See also Souza v. Fred Carries Contracts, Inc.*, 955 P.2d 3, 5 (Ariz. Ct. App. 1997). In *Souza*, Plaintiff purchased a used car from Defendant. The vehicle had repeated problems which Defendant failed to remedy and ultimately resulted in an accident, totaling the car and injuring

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[48] The courts has considered the following non-exclusive factors in its ruling on the discovery violations at issue in this case:

> (1) the reason for the failure to properly disclose evidence; (2) the willfulness or inadvertence of a party's (or attorney's) conduct; (3) prejudice to either side that may result from excluding or allowing the evidence; (4) the opposing party's (or attorney's) action or inaction in attempting to resolve the dispute short of exclusion; and (5) the overall diligence with which a case has been prosecuted. *Allstate* 896.P2d at 258.

the plaintiff. *Souza*, 955 P.2d at 5. Defendant moved the car to a salvage lot where it was destroyed before either party had an opportunity to inspect it when litigation began two years later. *Id.* The Court of Appeals reversed dismissal because both parties failed to inspect the car and neither party purposefully destroyed evidence. *Id.* Sanctions can also include drawing adverse inferences and an order requiring the offending party to pay costs. *Zubulake v. UBS Warburg LLC*, 229 F.R.D. 422, (S.D.N.Y. 2004). Importantly, sanctions for discovery violations including the destruction of evidence must be reasonable and proportionate to the violations. *Roberts*, 235 P.3d at 272.

This case does not involve innocent or excusable behavior. Indeed, the misconduct reflects precisely the type of conduct that the Arizona Rules of Civil Procedure protect against. PHP directly violated its obligation under *Ariz. R. Civ. P. 26.1 (a), (b)* and *Ariz. R. Civ. P. 37(c)* and *(d)*. PHP withheld and/or deliberately destroyed relevant and discoverable information and substantially interfered with the integrity of the proceedings. The conduct included not only delaying disclosure but wiping the company's server after receiving a subpoena and key laptops hours before forensic imaging was scheduled to begin. This court finds PHP acted willfully and in bad faith, granting this court broad leeway to craft an appropriate sanction under *Allstate*. Unlike *Souza*, this case does not involve either innocent or inadvertent destruction of evidence. This case more closely resembles *Roberts* and *Rivers* where the party's deliberate misconduct prevented the disclosure of unfavorable information. In further contrast to *Souza,* a third party did not destroy the evidence after the parties had an opportunity to prevent its destruction and inspect it. PHP had exclusive control over the devices it wiped; TKCA never had the opportunity to inspect in a timely manner the servers or computers. The spoliation, concealment, and fabrication of evidence occurred at the outset of this matter and continued after trial commenced. As the court has already mentioned, the conduct at issue far exceeds the bounds of decency. Moreover, Muhs acted as PHP's agent. Therefore, his conduct is attributed to PHP as well. Muhs failed to disclose the "loner laptop," deleted "old Mac's" user partition, and helped fabricate the GAL proposal. Despite the fact that the misconduct in this case warrants the most severe sanction, striking PHP's answer, the court plans to impose less severe sanctions because sufficient evidence survived to decide the case on its merits.

It is impossible to know with absolute certainty how much PHP's misconduct prejudiced TKCA, but absolute certainty is not required. Circumstantial evidence and inferences drawn from the record support this court's finding. In sanction, this court draws adverse inferences from PHP's misconduct to fill in evidentiary holes created by spoliation and finds by clear and convincing evidence that PHP misappropriated TKCA's trade secrets and committed the common law torts of Unfair Competition and Intentional Interference with a Valid Business Expectancy.

The court has found that PHP committed sanctionable discovery violations by withholding and destroying material evidence that prejudiced TKCA.

2. Attorney Misconduct

The court must still consider whether Dickstein shares any responsibility for what happened. The court finds Dickstein bears some of the blame. The law firm failed to implement basic safeguards when receiving and handling discovery turned over by its clients. By the time the court learned that Dickstein had another undisclosed device, a Muhs thumb drive, in June of 2013, no one seemed surprised, least of all the court, based on the history of late and nondisclosure that plagued the proceedings. Even though Dickstein kept track of some of the electronic devices its clients provided the firm, Dickstein mismanaged the devices and compromised the integrity of important information. More specifically, for example, Muhs turned over his external hard drive to Dickstein on October 13, 2011, but forensic analysis of the metadata shows a last access date on some folders of November 1, 2011. Ex. 1044. Dickstein presented no record of who accessed the folders and provided no reasonable explanation for its failure to maintain such records. In a case involving electronic discovery, particularly where "anomalies" surface, lawyers need to proceed with extreme caution handling and maintaining evidence. Importantly, "[a] party's discovery obligations do not end with the implementation of a 'litigation hold'-to the contrary, that's only the beginning. Counsel must oversee compliance with the litigation hold, monitoring the party's efforts to retain and produce the relevant documents. Proper communication between a party and her lawyer will ensure (1) that all relevant information (or at least all sources of relevant information) is discovered, (2) that relevant information is retained on a continuing basis; and

(3) that relevant non-privileged material is produced to the opposing party." *Zubulake, 229 F.R.D.* at 432. In *Zubulake,* the court added that "[c]ounsel must take affirmative steps to monitor compliance so that all sources of discoverable information are identified and searched." *Id.*

Notwithstanding Dickstein's negligence, the court remains convinced that Dickstein did not engage in intentional and willful misconduct; however the court cannot ignore the firm's regular disregard for complying with the rules, specifically untimely disclosure. *See Ariz. R. Civ. P.* 37(c). Moreover, lawyers have a responsibility to protect the integrity of judicial proceedings. In this case, it appears that the lawyers lost sight of the difference between fulfilling their obligation to advocate ethically for a client and blind advocacy in disregard of counsels' obligations as officers of the court. Of great concern is the fact that Dickstein never wavered representing its client, at times an admirable trait, even after PHP's egregious misconduct started to surface. Understandably, mistakes happen even more than once in a complex proceeding. However, once the full magnitude of PHP's and Muhs' misconduct started emerging, the law firm had an obligation to take remedial action to protect the administration of justice up to and including moving to withdraw from representing its client. Because of PHP's and Dickstein's actions, these proceedings were needlessly protracted and resulted in both parties amassing uncontainable discovery costs. Despite all the difficulties with discovery in this case, there is no evidence connecting Dickstein to PHP's willful destruction of evidence.

3. Asserting the GAL Defense did not violate Rule 11, but continuing to argue the GAL Defense violated A.R.S. § 12-349.

Rule 11 requires a reasonable inquiry into the facts before filing a motion or pleading. *Ariz. R. Civ. P. 11 (a).* "[I]n any civil action . . . the court shall assess reasonable attorney fees, [and] expenses . . . against an attorney . . . if the attorney . . . does any of the following: (1) Brings or defends a claim without substantial justification; (2) Brings or defends a claim solely or primarily for delay or harassment; (3) Unreasonably expands or delays the proceeding; (4) Engages in abuse of discovery." *Ariz. Rev. Stat. Ann. §12-349(A).* "[W]ithout substantial justification means that the claim or defense is groundless and is not made in good faith." *Ariz. Rev. Stat. Ann. § 12-349(F).* The court must factually determine by a preponderance of the evidence that an asserted defense was "groundless, in bad faith and harassing." *Phoenix Newspapers, Inc. v. Dep't of Corr., State of Ariz.*, 934 P.2d 801, 808 (Ariz. Ct. App. 1997). A lawyer is obligated to provide an "honest, uninflated appraisal" of the case even when doing so negatively affects his client. *James, Cooke & Hobson, Inc. v. Lake Havasu Plumbing & Fire Prot.*, 868 P.2d 329, 334 (Ariz. Ct. App. 1993) (*Judge Gerber concurring*) (There, defendant's attorney violated Rule 11 for filing an answer denying a debt he knew to be factually true at the time.). When questioning the veracity of a motion or pleading, the court applies an objective standard to determine what the lawyer knew or should have known. *Id.* An asserted defense cannot be "insubstantial, frivolous, groundless or otherwise unjustified." *Id.* at 332. In determining the reasonableness of an asserted claim, the court should consider the "situation existing, the facts known, the amount of time available for investigation, the need for reliance upon the client or others for obtaining facts, the plausibility of the claim, and other relevant factors." *Boone v. Superior Court In & For Maricopa Cnty.*, 700 P.2d 1335, 1341 (Ariz. 1985). Attorneys must continually evaluate their case based on the facts available so as not to pursue frivolous or unsupported claims. *Standage v. Jaburg & Wilk, P.C.*, 866 P.2d 889, 898 (Ariz. Ct. App. 1993), (The court did not find the lawyer necessarily acted in bad faith in filing a frivolous malpractice claim on his clients behalf. The attorney's conduct became sanctionable when he failed to "review and reevaluate his client's position as the facts of the case developed." *Id.* at 897). The court "evaluate[s] an attorney's conduct under an objective standard of reasonableness." *Cooke* 868 P.2d at 332.

Dickstein did not violate Rule 11 of Arizona Civil Procedure by asserting the GAL defense in the original answer to TKCA's complaint. Unlike *Cooke,* Dickstein was not aware of the facts indicating that its client's claim was unsubstantiated when the law firm filed an answer. Nor had any prior court made findings of facts that formed the basis of the claims like in *Standage.* Even though Dickstein had access to the electronic data that PHP subsequently deleted, a lawyer has an obligation to conduct an investigation that is reasonable under the circumstances. *Ariz. R. Civ. P. 11 (a).* A lawyer cannot possibly possess all relevant information at the beginning of a lawsuit. Dickstein could not have reasonably been expected to have reviewed hundreds, indeed thousands of documents, forensically imaged and examined its clients' servers and laptops and read innumerable emails before answering TKCA's complaint. Rule 11 does not create such an unrealistic standard or impose such a burden. Initially, Dickstein reasonably relied on PHP's affidavits and statements when preparing to defend the lawsuit. However, as time passed and new evidence came to light, Dickstein could no longer justifiably continue to advance the GAL defense.

The record reflects a complete absence of reliable evidence substantiating the authenticity of the GAL proposal. Indeed, as the trial progressed, evidence to the contrary mounted. During trial, the court learned that the GAL proposal appeared to be backdated, that the document contained typographical errors identical to TKCA's misappropriated proposal, and that the proposal also contained information unique to DoS. In addition, over time the wanton and repeated destruction of evidence came to light. When a client testifies, like Tina Cannon, that she lied as part of the defense, a lawyer might want to, indeed must, reconsider the client's veracity when considering the evidence under the totality of circumstances. Would a reasonable lawyer have continued to advance the GAL defense in this situation? The court finds that any reasonable attorney would have questioned the defense and found it lacking. Dickstein neglected its duty to continually evaluate and reevaluate its client's case based on all the facts available. This court finds that Dickstein continued to argue the frivolous GAL defense in bad faith, violating Ariz. Rev. Stat. Ann. § 12-349(A)(1). This court further finds Dickstein also violated § 12-349(A)(2) for failing to reevaluate the case when, over time, the evidence made clear that it was objectively unreasonable to continue asserting the GAL defense.

4. Dickstein violated Rule 37 by failing to disclose Muhs' devices

"A party or attorney who makes a disclosure pursuant to Rule 26.1 that the party or attorney knew or should have known was inaccurate or incomplete and thereby causes an opposing party to engage in investigation or discovery, shall be ordered by the court to reimburse the opposing party for the cost, including reasonable attorney's fees of such investigation or discovery. In addition to or in lieu of these sanctions, the court on motion of a party or on the court's own motion, and after affording an opportunity to be heard, may impose other appropriate sanctions." *Ariz. R. Civ. P. 37(c).* "A party's or attorney's knowing failure to timely disclose damaging or unfavorable information shall be grounds for imposition of serious sanctions in the court's discretion up to and including dismissal of the claim or defense." *Ariz. R. Civ. P. 37(d).* The court can only dismiss a claim or defense if the offending conduct was by the party; conduct by the lawyer is not sufficient. *Poleo*, 692 P.2d at 312.

As discussed above, in *Laptops and other Devices (section (I)(C)(2)),* Dickstein failed to disclose, evidently lost track of, and then found one of Muhs' thumb drives in a file over one year after its receipt. June 18, 2013 Tr. 5:7 – 8:23; June 24, 2013 Tr. 84:4 – 85:11. Because of Dickstein's poor record keeping, there is no way to tell whether this is the thumb drive referenced in Ex. 1164, or another thumb drive delivered to the firm on a different date. Moreover, Dickstein's haphazard disclosure of other devices and their contents demonstrates conscious awareness of them as shown by Victoria Kummer's December 21, 2012 email concerning the external hard drive Muhs gave Dickstein in October 2011. "...[H]e handed that hard drive to us (Dickstein Shapiro) in October 2011. That hard drive remained in Dickstein's possession until we turned it over to Stroz Friedberg for them to image in connection with their searches of Muhs' various media this past summer ..." Ex. 1112. Forensic imaging of that external hard drive contained documents relevant to this litigation and showed signs of metadata tampering and backdating. Ex. 582 at ¶¶105-106; June 24, 2012 Tr. 64:12 – 65:6. Despite possessing the device at the time of disclosure, Dickstein admits it was not included in initial discovery. *Dickstein reply to motion for sanctions 58:6-7.* Last access dates show that someone had seen or accessed the relevant material on that hard drive prior to the commencement of litigation but after Dickstein took possession of it in October 2011. June 24, 2012 Tr. 82:9 – 83:20; Ex. 1044.

Earlier disclosure of the external the hard drive, and "old" mac may have alerted TKCA and the court to the spoliation issues sooner and helped prove Muhs wrongfully possessed TKCA's files. Earlier disclosure may have even prevented the destruction of some of the records. While the missing evidence may not have answered all the questions in this case or revealed the extent of PHP's efforts to conceal its misconduct, the deleted user partition on the "old Mac" and the TKCA files on the external hard drive would have certainly helped TKCA establish its claims. Dickstein argues that even though it did not disclose the existence or its possession of Muhs' "old Mac," external hard drive, and flash drive, the firm did "promptly [begin] scanning the devices and producing documents from them." *Dickstein reply to motion for sanctions 58:6-7.* Dickstein's argument has no merit considering that Dickstein knew the devices existed but failed to disclose them for almost one year after the trial had started.

Examining the facts in the light most favorable to Dickstein, the court still finds that the firm should have disclosed the devices far earlier than it did. By March 2012, the court and TKCA had started raising questions about spoliation and the backdating of material documents. The parties retained forensic experts to image laptops and servers in April 2012 in attempt to locate evidence of spoliation and backdating. Dickstein should have at least disclosed the external hard drive, "old" mac, and thumb drive referenced in Ex. 1164 well before the forensic imaging started. Based on all of the misconduct, the court further finds that the deleted user partition in Muhs' "old Mac" is inherently suspect. Dickstein has no reasonable explanation for why it delayed disclosure. When Dickstein disclosed the devices in December 2012, the firm, by then, had knowingly withheld evidence for 8 months that would have negatively impacted PHP and would have necessarily helped TKCA. The court finds there is no excuse for such conduct. Sanctions are warranted when considering all of the facts and circumstances.

5. Dickstein's initial Rule 11 motion was filed absent reasonable inquiry into the facts and is sanctionable

Finally, TKCA argued that Dickstein should be sanctioned for its initial Rule 11 motion filed November 2011. This court agrees. An attorney's signature on its motion or pleading is an affirmation that "after reasonable inquiry" the claims are grounded in fact and not for improper purposes like harassment or delay of litigation. *Ariz. R. Civ. P. 11(a)*. Just like with the GAL defense, Dickstein had an obligation not to file a motion or pleading that it knew "or should have known, by a reasonable investigation of fact and of law that an asserted defense is insubstantial, frivolous, groundless or otherwise unjustified." *Cooke*, 868 P.2d at 332-33. The same reasonableness standard applies here. Like counsel in *Standage*, who filed a complaint despite possessing knowledge of facts disproving its contentions, Dickstein filed a Rule 11 motion for sanctions while in possession of documents that, at a minimum, demonstrated the potential validity of TKCA's complaint. Unlike the GAL defense, which would have required Dickstein to investigate the matter beyond a reasonable degree to ascertain its validity, a reasonable attorney's investigation into the material provided by Muhs would have made Dickstein aware of a Rule 11 motion's frivolous nature. A reasonable investigation would have shown that Muhs was in possession of TKCA trade secrets. In the alternative, Dickstein failed to amend the motion when it learned of facts that destroyed the motion's validity like counsel in *Standage*. The deletion of the user partition on the "old Mac" in concert with the rest of PHP's misconduct should have put Dickstein on notice that it should withdraw or amend its original Rule 11 motion. There is no objectively reasonable explanation for Dickstein's behavior with respect to the Rule 11 motion. Dickstein's appears to have avoided learning the truth about its client's veracity which the court can only describe as the civil law equivalent of deliberate ignorance.[49] The court cannot imagine how experienced lawyers failed to evaluate the evidence more objectively especially as the evidence consistently exposed the magnitude of their client's misconduct.

For pursuing a Rule 11 motion in bad faith as well as violating A.R.S. § 12-349 and pursuant to Rule 37, this court finds that an appropriate sanction is for Dickstein to share with PHP a portion of the reasonable attorney fees and expenses incurred by TKCA as a direct result of the misconduct. The court further finds that PHP is responsible for 80% of the fees and expenses because not only did the company act in a willful and malicious manner but it bears the bulk of the responsibility for having violated the rules. Dickstein will pay the remaining 20% of the reasonable fees and expenses incurred for its violations of the rules.

III. <u>CONCLUSION</u>

This court finds that PHP misappropriated TKCA's bid proposal, SOWs, and labor rates in violation of AUTSA. PHP profited from its misappropriation to TKCA's detriment and is ordered to pay TKCA the sum of the profits TKCA would have received under the DoS contract in accordance with the discussion above. It is further ordered that PHP pay TKCA the calculated research and development cost as described above. It is further ordered that PHP

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[49] Knowledge can be established when the defendant was aware of the high probability of misconduct, but acted with conscious purpose to avoid learning the truth of the matter. *State v. Fierro,* 206 P.3d 786, 788 (Ariz. Ct. App. 2008).

pay exemplary damages pursuant to A.R.S. § 44-403(B) in an amount double awarded to TKCA for its lost profits and research and development costs. In addition, with respect to the common law claims, TKCA is awarded its lost profits and punitive damages as set forth above. It is also ordered that TKCA submit its applications for the amount awarded in sanctions (reasonable fees and expenses) and for reasonable attorney's fees pursuant to A.R.S. § 44-404 and A.R.S. § 12-349.

Accordingly,

With respect to TKCA's AUTSA claims,

IT IS ORDERED awarding TKCA damages as follows:

(1) Lost Profits: $2,883,055.86 ($32,033,954 x 9.0%)

(2) Research and Development: $3,882,205

(3) Exemplary Damages: $13,530,521.72 (double the total compensatory damages of $6,765,260.86)

(4) Reasonable attorneys' fees

Total AUTSA Damages: This court awards TKCA an amount totaling $20,295,782.58 for lost profits, research and business development and exemplary damages and TKCA's reasonable attorneys' fees.

Alternatively, with respect to TKCA's common law claims, specifically intentional interference with valid business expectancies and unfair competition,[50]

IT IS ORDERED awarding TKCA damages as follows:

(1) Lost Profits: $2,883,055.86 ($32,033,954 x 9.0%)

(2) Punitive Damages: $5,766,111.72

With respect to *Zimmerman,* Ru1e 37, Ru1e 11, and A.R.S. §12-349.

IT IS ORDERED awarding TKCA sanctions as follows:

1) PHP shall pay 80% of the reasonable fees and expenses as set forth in this ruling

2) Dickstein shall pay 20% of the reasonable fees and expenses as set forth in this ruling

IT IS FURTHER ORDERED that TKCA shall file its application for reasonable fees and expenses consistent with this order under AUTSA, and as sanctions, no later than March 2, 2015. PHP shall file its response no later than April 6, 2015. TKCA shall file its reply no later than April 30, 2015.

IT IS FURTHER ORDERED scheduling oral argument on May 15,2015 at 1:30 p.m. in a courtroom that shall be determined.

IT IS FURTHER ORDERED that PHP shall be permitted to pursue its counterclaims effective immediately.

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[50] To avoid double recovery, the court is ordering payment of damages only under AUTSA.