

**UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF OHIO**

In Re:)	
)	CHIEF JUDGE RICHARD L. SPEER
Steven Price)	
)	Case No. 99-3263
Debtor(s))	
)	(Related Case: 99-34658)
Vefa Erol)	
)	
Plaintiff(s))	
)	
v.)	
)	
Steven C. Price)	
)	
Defendant(s))	

DECISION AND ORDER

The instant case comes before the Court upon the Plaintiff's Complaint to Determine the Dischargeability of a Debt. The statutory grounds upon which the Plaintiff bases his Complaint is 11 U.S.C. § 523(a)(6), which provides that:

(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[.]

The underlying debt which gives rise to this dispute stems from a default judgment rendered by a Texas State Court against the Defendant for the intentional tort of defamation.

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On April 5, 2000, the Court conducted a Pre-trial Conference on this matter at which time the Plaintiff asserted that the doctrine of collateral estoppel should prevent the Defendant from litigating, in this Court, the issue as to whether he acted “willfully and maliciously” in accordance with § 523(a)(6). In support thereof, the Plaintiff pointed to the fact that in the underlying state court action he personally gave testimony as to the Defendant’s willful and malicious conduct, and from this testimony, the Texas State Court awarded the Plaintiff exemplary damages. The Defendant, however, contests the applicability of the collateral estoppel doctrine on the basis that the judgment rendered against him was accomplished by default, and thus the “actually litigated” requirement of the collateral estoppel doctrine has not been met. In addition, the Defendant contends that the service of process rendered upon him by the Plaintiff was improper under the Due Process Clause of the United States Constitution, and therefore the Texas State judgment rendered against him is void.

After hearing these arguments, the Court, at the Pre-trial Conference held on the matter, directed the Parties to submit briefs in support of their respective legal positions. Thereafter, the Court received from the Plaintiff a “Memorandum in Support of Preclusive Effect of Texas Judgment Entry,” which was then followed by the Defendant submitting to the Court a “Memorandum in Opposition to Preclusive Effective [sic] of Texas Default Judgment.” In addition, in reply to the Defendant’s Memorandum, the Plaintiff submitted a “Reply Memorandum to Defendant’s Memorandum in Opposition.” After reviewing these memoranda, the Court, with respect to the legal arguments raised by the Parties, finds that the following facts constitute a reliable picture of the events which transpired in this case:

The Plaintiff operates a business in the State of Texas selling and servicing computers, computer parts, and computer equipment. As a part of his business, the Plaintiff placed advertisements and conducted sales through the online service known as America Online (AOL). The Defendant was one of the Plaintiff’s customers, who, for reasons not relevant to this proceeding, became dissatisfied with the quality of the Plaintiff’s merchandise and services. As a result, the

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Plaintiff caused to be posted on the Internet some “correspondences” regarding the Plaintiff’s merchandise and services. In response to these “correspondences,” the Plaintiff filed a lawsuit in a Texas State Court alleging that the Defendant had defamed both him and his business over the Internet. In his prayer for relief, the Plaintiff asked for both monetary damages and injunctive relief.

On September 9, 1997, the Plaintiff’s petition against the Defendant was served by the Secretary of the State of Texas by certified mail. The process thereto, however, was returned to the Secretary of State on September 29, 1997, unclaimed. Notwithstanding, the Texas State Court, with jurisdiction over the Plaintiff’s case, deemed service against the Defendant properly perfected, and thus after the Defendant did not answer or otherwise respond to the Plaintiff’s Complaint, a default judgment was entered on the issue of the Defendant’s liability for defamation. A hearing was then scheduled for July 8, 1998, to determine damages. At this hearing, which the Defendant did not attend, the Texas State Court, in addition to awarding injunctive relief, awarded the Plaintiff Twenty Three Thousand Seven Hundred Twelve and 50/100 dollars (\$23,712.50) in compensatory damages, plus an additional Thirty Thousand dollars (\$30,000.00) in exemplary damages.

On August 24, 1999, the Plaintiff filed in an Ohio State Court a Proof of Notice of Filing of Foreign Judgment. Not long after the occurrence of this event, the Defendant petitioned this Court for relief under Chapter 7 of the United States Bankruptcy Code, naming the Plaintiff as the holder of a general unsecured debt. The Plaintiff then brought, in conformance with Bankruptcy Rule 7001, a timely Complaint to hold this obligation nondischargeable on the basis that the debt arose from the Defendant’s “willful and malicious” conduct.

LEGAL ANALYSIS

The Plaintiff in this action seeks to have this Court invoke, in his favor, the legal doctrine known as collateral estoppel so as to preclude the necessity of a trial. This doctrine, which is

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sometimes referred to as issue preclusion, provides that “a right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction . . . cannot be disputed in a subsequent suit between the same parties or their privies.” *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979). With respect to the Plaintiff’s request, the Court begins by noting that it is clear that collateral estoppel principles can be used in a nondischargeability action under 11 U.S.C. § 523(a)(6) so as to prevent the re-litigation of issues that were already decided in a state court. *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991); *Murray v. Wilcox (In re Wilcox)*, 229 B.R. 411, 415-16 (Bankr. N.D. Ohio 1998). Although, when applying collateral estoppel principles from a state court judgment to a nondischargeability proceeding, the Supreme Court of the United States has held that the federal common law does not apply. *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 374, 105 S.Ct. 1327, 1328, 84 L.Ed.2d 274 (1985); *Bay Area Factors, Inc. v. Calvert (In re Calvert)*, 105 F.3d 315, 317 (6th Cir. 1997). Instead, a bankruptcy court, pursuant to the full faith and credit principles of 28 U.S.C. § 1738, must give the same issue preclusion effect to a state court judgment as it would be given under that state’s law. Accordingly, in the present case, as the judgment rendered against the Defendant was issued by a Texas state court, this Court will look to the law of Texas to determine whether the doctrine of collateral estoppel is applicable under the particular facts of this case.

Texas law requires that three elements be met for the doctrine of collateral estoppel to apply:

- (1) the facts sought to be litigated in the second action were fully and fairly litigated in the prior action;
- (2) those facts were essential to the judgment in the first action; and
- (3) the parties were cast as adversaries in the first action.

Garner v. Lehrer (In re Garner), 56 F.3d 677, 680 (5th Cir. 1995), citing *Bonniwell v. Beech Aircraft Corp.*, 663 S.W.2d 816, 818 (Tex. 1984). In opposition to the applicability of these elements, the

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Defendant, as previously pointed out, has raised a number of defenses; foremost among them is the Defendant's contention that because the underlying judgment is a default judgment, the facts sought to be determined in this action were not fully and fairly litigated in the Texas State Court action. (See element one, above). The Plaintiff, however, disagrees, arguing instead that the issue of the Defendant's willful and malicious conduct was actually litigated at the hearing held by the Texas State Court to determine damages. In support thereof, the Plaintiff calls this Court's attention to the fact that after personally testifying to the Defendant's willful and malicious conduct, the Texas State Court awarded him exemplary damages. Thus, given these arguments concerning the applicability of the collateral estoppel doctrine, the issue that must be initially decided by the Court can be framed as this: Under Texas law, can a default judgment operate to collaterally estop a party from litigating a matter in a latter proceeding, and if so, do the circumstances of this particular case call for the application of the collateral estoppel doctrine?

Conceptually speaking, a default judgment occurs when an entity subject to an affirmative pleading fails in any way to respond to that pleading. *See* FED. R. CIV. P. 55(a).¹ Thus, normally the doctrine of collateral estoppel, by definition, cannot apply to a default judgment as no issues are actually litigated in the underlying proceeding. Notwithstanding this general rule, Texas law has not hesitated to apply the collateral estoppel doctrine to a default judgment when a court enters a default judgment after conducting a hearing or trial at which time the plaintiff is put to his evidentiary burden. *State Farm Fire and Cas. Co. v. Fullerton*, 118 F.3d 374, 382 (5th Cir. 1997); *Pancake v. Reliance Ins. Co. (In re Pancake)*, 106 F.3d 1242, 1244 (5th Cir. 1997). To understand how and why this would occur, a brief overview of Texas' law on default judgments is appropriate.

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This Rule states that, “[w]hen a party against whom a judgment for affirmative relief is sought has failed to plead or otherwise defend as provided by these rules and that fact is made to appear by affidavit or otherwise, the clerk shall enter the party’s default.”

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Under Texas law, two types of default judgment are recognized: a simple-default judgment and a post-answer default judgment.² A simple default judgment occurs when a defending party, although properly served, does not enter an answer in the proceeding or otherwise make an appearance. See TEX. R.CIV. P. 239. In this type of situation, the defendant is deemed to have admitted the plaintiff's pleadings, and thus judgment may be entered on those pleadings. *Garner v. Lehrer (In re Garner)*, 56 F.3d 677, 680 (5th Cir.1995), citing *Stoner v. Thompson*, 578 S.W.2d 679, 682 (Tex.1979). Further, in this type of situation, the collateral estoppel doctrine will generally not be applicable, as the plaintiff was not put to his evidentiary burden. *In re Garner*, 677 F.3d at 680. On the other hand, the Texas Supreme Court recognizes a different type of situation for a post-answer default, which occurs when the defendant files an answer, but fails to appear at the trial. According to the Texas Supreme Court, this type of situation "constitutes neither an abandonment of defendant's answer nor an implied confession of any issues thus joined by the defendant's answer." *Stoner*, 578 S.W.2d at 682. As a result, a judgment in a post-answer default situation may only be entered once the Plaintiff has met his evidentiary burden, which in turn means that in appropriate circumstances, the doctrine of collateral estoppel may be properly applied in a subsequent case involving that defendant.

In this case, neither Party contests the fact that the Debtor has neither filed an answer nor made an appearance in the Texas state court proceedings. Thus, it is clear that the judgment rendered against the Defendant can be categorized as a simple-default judgment. Therefore, it would initially appear that the collateral estoppel doctrine is inapplicable in this case as the plaintiff was not put to his evidentiary burden. Notwithstanding, in the *In re Pancake* case, the Fifth Circuit Court of Appeals

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Actually Texas law recognizes a third type of default judgment: the default judgment nihil dicit which occurs where no answer placing the merits of the case in issue is on file, though the defendant has entered a dilatory pleading. See *Stoner v. Thompson*, 578 S.W.2d 679, 682-83 (Tex. 1979) (distinguishing default judgment, post-answer default judgment, and judgment nihil dicit).

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has seemingly moved away from a simple-default/post-answer default distinction for purposes of conducting a collateral estoppel analysis, and has instead held that the “critical inquiry is not directed at the nature of the default judgment but, rather . . . on whether an issue was fully and fairly litigated.” 106 F.3d at 1244-45. Such a determination is, in turn, based upon whether the underlying record of the state court proceeding establishes that the plaintiff was put to his evidentiary burden. *Id.* at 1245. Two cases, which involve bankruptcy debtors and which essentially involve simple-default judgments, are illustrative of this point.

In *Gober v. Terra + Corporation (In re Gober)*, 100 F.3d 1195 (5th Cir.1996), the debtor had been a party to a state court suit in which it was alleged that he had embezzled funds from Terra. The debtor defended the suit for two years, but was found to have engaged in discovery abuses. The plaintiff then moved to strike the debtor’s answer and contemporaneously filed a motion for a default judgment. At a subsequent hearing held on the matter, at which the debtor deliberately decided not to attend, Terra’s requests were granted. Compensatory and punitive damages were then awarded at that hearing upon the plaintiff presenting evidence about the nature of its case and the debtors actions. In this respect, the judge explicitly found that the debtor’s conduct was fraudulent, willful, and malicious. Several years later, the debtor filed for bankruptcy and Terra asked that its debt be declared nondischargeable based upon the state court judgment. The Fifth Circuit agreed, holding that while under state law a default judgment in which a party in no way responds or otherwise makes an appearance might not be sufficient to sustain the applicability of the collateral estoppel doctrine, a judgment entered after the debtor had responded and participated in the case was sufficient, particularly where the default judgment was entered as a sanction for discovery abuse. The Court also went on to hold that where punitive damages are awarded following a presentation of evidence that convinced the state court of the willful and malicious nature of the debtor’s activities, that this consideration was very relevant in establishing that the debt was of the type that should not be discharged under 11 U.S.C. § 523(a)(6).

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Similarly in *In the Matter of Pancake (Pancake v. Reliance Insurance Company)*, 106 F.3d 1242 (5th Cir. 1997), the debtor, who was sued in state court, had his answer struck for discovery abuse and, after not appearing at the trial, had a default judgment entered against him. The debtor then filed for bankruptcy relief, after which time the creditor moved for summary judgment on its fraud judgment. Under these facts, the Fifth Circuit Court of Appeals, in applying Texas law and after observing that striking an answer creates a situation similar to that where no answer is filed (i.e., a simple-default judgment), held that the collateral estoppel doctrine was not applicable because there was nothing to show from the prior state court proceeding that the plaintiff had proved his case. Although this holding would initially seem to be opposed to the *In re Gober* case, the Court in *In re Pancake* hinged its holding upon the observation that:

[t]he only indication that the state court held a hearing comes from the final judgment, in which the court states that it heard the evidence and arguments of counsel. [However, t]hat statement alone does not establish that the [debtor] received a full and fair adjudication on the issue of fraud.”

Id. at 1244 (internal quotations omitted). By comparison, the underlying record in the *In re Gober* case was sufficiently developed so that the findings in the first action could be applied to the latter proceeding. Thus, what these two cases show is that although the collateral estoppel doctrine may apply to simple-default judgments, the record of the underlying state court action must clearly demonstrate that the plaintiff has met his evidentiary burden, especially when, as now, no answer was entered in the underlying case.

In applying this standard to this case, however, the Court simply cannot find that the Plaintiff has sustained his burden. This is because the underlying state court record of this case, like the state court record in the *In re Pancake* case, simply does not show that an actual finding was made by the Texas State Court that the Defendant acted both willfully and maliciously. In particular, the record of this case shows that after the Plaintiff presented his evidence in the state court proceeding, the Texas State Court simply stated that, “[t]he Court’s going to render judgment in favor of plaintiff in

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the amount of \$23,712.50 cents as compensatory damages, \$30,000 exemplary damages.” (At pg. 8 from the Transcript from the case of Vera Erol v. Steve Price, Case No. 97-43516, District Court of Harris County, Texas 113th Judicial District). No specific mention, however, is made by the Texas State Court of the Debtor’s “willful and malicious” conduct, and in the absence of such a finding, this Court will not infer that one exists. Moreover, the mere fact that the Plaintiff may have testified to the Defendant’s supposed willful and malicious conduct does not change this result, as the collateral estoppel doctrine only applies to those findings actually made by the trier-of-fact. *James Talcott, Inc. v. Allahabad Bank, Ltd.*, 444 F.2d 451, 460-61 (5th Cir. 1971).

In coming to the foregoing conclusion, the Court was also guided by a decision rendered by the Fifth Circuit Court of Appeals shortly after the *In re Pancake* case decided. In *State Farm Fire & Cas. Co. v. Fullerton*, the Fifth Circuit Court of Appeals held that the following three factors are especially important in analyzing the question as to whether an issue, under Texas law, was fully and fairly litigated for purposes of applying the collateral estoppel doctrine: (1) whether the parties were fully heard; (2) whether the court supported its decision with a reasoned opinion, and (3) whether the decision was subject to appeal or was in fact reviewed on appeal. 118 F.3d 374, 377 (5th Cir. 1997), citing *Rexrode v. Bazar*, 937 S.W.2d 614, 617 (Tex.App. Amarillo 1997, no writ). In this case, even a cursory examination of the facts shows that none of these considerations are present.

Accordingly, based upon the foregoing analysis, the Court cannot find that the Defendant is precluded, under Texas’ doctrine of collateral estoppel, from litigating in this Court the issue as to whether his debt to the Plaintiff arose from his “willful and malicious” conduct. Having come to this conclusion, the Court, at this time, declines to address the Defendant’s arguments relating to the Plaintiff’s service of process in the state court action. In reaching the conclusions found herein, the Court has considered all of the evidence, exhibits and arguments of counsel, regardless of whether or not they are specifically referred to in this Decision.

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Accordingly, it is

ORDERED that this matter be, and is hereby, set for a further Pre-Trial on Wednesday, November, 8, 2000, at 11:00 A.M., in Courtroom No. 1, Room 119, United States Courthouse, 1716 Spielbusch Avenue, Toledo, Ohio.

Dated:

Richard L. Speer
Chief Bankruptcy Judge