

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

In Re:	)	
	)	<b>JUDGE RICHARD L. SPEER</b>
James Smithey	)	
	)	Case No. 10-3129
Debtor(s)	)	
	)	(Related Case: 10-30310)
Frost & Co., Inc., et al	)	
	)	
Plaintiff(s)	)	
	)	
v.	)	
	)	
James Smithey	)	
	)	
Defendant(s)	)	

**DECISION AND ORDER**

This cause comes before the Court on the Motion for Summary Judgment filed by the Defendant/Debtor, James Lee Smithey. (Doc. No. 38). The Defendant’s Motion for Summary Judgment is filed against the Plaintiffs’ Complaint to Determine Dischargeability. (Doc. No. 1). On the matter of the Defendant’s Motion for Summary Judgment, each of the Parties submitted extensive arguments and exhibits in support of their respective positions. The Court has now had the opportunity to review these materials, and based upon this review, the Court finds, for the reasons set forth herein, that the Defendant’s Motion for Summary Judgment should be Denied.

## **BACKGROUND**

The Defendant, James Lee Smithey, is before this Court, having filed a petition for relief under Chapter 7 of the United States Bankruptcy Code on January 22, 2010. On May 13, 2010, the Plaintiffs brought this action, seeking a determination that they hold a claim against the Defendant/Debtor and that their claim is a nondischargeable debt. For their assertion of nondischargeability, the Plaintiffs rely on two provisions of the Bankruptcy Code: (1) 11 U.S.C. § 523(a)(2), excepting from discharge a debt arising from a false pretense, a false representation, or actual fraud; and (2) 11 U.S.C. § 523(a)(4), excepting from discharge a debt arising from fraud, embezzlement, larceny or defalcation while acting in a fiduciary capacity.

The Plaintiffs in this matter consist of four parties: (1) Frost & Co. Inc.; (2) Frost Mechanical, Inc.; (3) John T. McCormick; and (4) Dick Nagel Electric, Inc. Each of these Parties filed a proof of claim in the Defendant's bankruptcy case. Each of their filed claims was listed in an amount yet to be determined based upon a pending lawsuit. The only party-in-interest to timely object to the Plaintiffs' proofs of claim was the Chapter 7 Trustee, Bruce French.

Subsequently, however, the Trustee withdrew his objection to the Plaintiffs' claims as a part of an order entered by the Court, approving a Global Motion to Compromise brought by the Trustee. The relationship between the Plaintiffs and the Defendant was previously described by the Court in the decision approving the Compromise. *In re Smithey*, 2011 WL 3102308 (Bankr.N.D.Ohio). The following background information is partially drawn from this prior decision.

For a number of years, the Defendant, James Lee Smithey, and a partner, John McCormick, each owned a 50% interest in a business named Frost & Co., Inc. In turn, this business entity operated as a holding and parent company for these three subsidiaries: (1) Frost Mechanical, Inc.,

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which operated as an HVAC contractor; (2) Frost Roofing, Inc., which conducted business as a roofing contractor; and (3) Dick Nagel Electric, Inc., which operated as an electrical contractor.

In 2007, the Debtor purchased the second subsidiary, Frost Roofing, Inc., from the holding company of Frost & Co., thereby divesting John McCormick of his ownership interest in the business. Related to this transaction were a number of different agreements, including: (1) a stock purchase agreement signed on January 12, 2007, but backdated to become effective on September 30, 2006; (2) two Memoranda of Understanding; and (3) an Agreement of Reorganization, dated May 23, 2008. In the Reorganization Agreement, the Plaintiff, John McCormick, redeemed from the Defendant the shares of stock of Frost & Co. Inc. and its subsidiaries.

As a part of their transactions, the Defendant also entered into an employment agreement with Frost & Co. As an employee and principal of Frost & Co., the information provided to the Court shows that the Defendant had considerable discretionary authority with the business, including the ability to write checks for large sums of money from the company account. On numerous occasions, the Debtor exercised this authority.

In 2007, Frost and Co., and its subsidiaries Frost Mechanical and Dick Nagel Electric, started to experience cash flow problems. Thereafter, the financial difficulties of these businesses were further compounded when Dick Nagel Electric became over budget and behind schedule on a major contractual obligation involving a municipal school project. Because of the deficiencies with the school project, both the Defendant and his partner, John McCormick, became personally and jointly liable on a surety bond issued by the Ohio Farmers Insurance Company. The amount of this joint liability totaled \$338,000.00.

On August 24, 2009, Ohio Farmers Insurance Company brought a suit in state court against the Defendant on its claim. Also named as defendants in this lawsuit were John McCormick, Frost

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& Co., Frost Mechanical and Dick Nagel Electric, all of whom were co-obligors on the surety bond. Subsequently, the Defendant entered into agreement with the Ohio Farmers Insurance Company.

Under the terms of their Agreement, executed at the end of 2009, the Defendant agreed to pay to the Ohio Farmers Insurance Company the sum of \$169,000.00, representing half the total liability on the surety bond. In return, Ohio Farmers Insurance Company agreed not to sue the Defendant for the remaining liability. Within 90 days of filing his bankruptcy case, the Debtor made the \$169,000.00 payment to the Ohio Farmers Insurance Company.

Although the timing is not exactly clear, by the end of 2008, the Defendant and John McCormick ceased doing business together. Thereafter, John McCormick continued to operate his business interests – *i.e.*, Frost & Co., Frost Mechanical and Dick Nagel Electric. After their business relationship ended, the Defendant and Mr. McCormick each commenced separate legal actions against the other in state court.

The first law suit, commenced on December 30, 2008, was brought by the Defendant against Frost & Co. and Frost Mechanical. In this lawsuit, the Defendant obtained a judgment in the amount of \$115,000.00 based on a cognovit note. Largely, because of this judgment, the Defendant's bankruptcy estate currently has in its possession the sum of \$119,558.44. At the time the Defendant filed his bankruptcy case, the defendants in this suit were seeking to have the judgment set aside. After the Defendant filed his bankruptcy case, this action was removed to this Court. (Case No. 10-3127).

The second lawsuit, commenced on May 29, 2009, was brought by John McCormick, and his business interests – *i.e.*, Frost & Co., Frost Mechanical and Dick Nagel Electric – against the Defendant. Also named as a defendant in this action was Frost Roofing, the business purchased by the Defendant. The gravamen of this lawsuit involved allegations that the Defendant, while a

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principal in the business of Frost & Co., breached his fiduciary duties, and committed acts of fraud, by misappropriating business assets for his own benefit. As the basis for their position, the Plaintiffs called attention to a number of irregularities, including the circumstances surrounding transfers being made by the Defendant to close family members, as well as raising questions as to how and from where the Defendant obtained the requisite funds to purchase Frost Roofing Inc.

In their Complaint, the Plaintiffs also alleged that the Defendant breached his employment agreement with Frost & Co. by failing to disclose expenditures outside the ordinary course and by failing to inform John McCormick of deficiencies in the operation of the business which eventually lead to the suit brought by the Ohio Farmers Insurance Company to recover on its surety bond. After the Defendant filed for bankruptcy relief, this lawsuit was also removed to this Court. (Case No. 10-3100).

In addition to the removal of the above lawsuits, a fraudulent transfer action was brought against the Defendant, as well as two family members of the Defendant. (Case No. 10-3135). Pursuant to the order entered by the Court, approving the Trustee's Global Motion to Compromise, the Trustee's rights in this fraudulent transfer were assigned to the Plaintiffs. An appeal of this order, filed by the Defendant, is currently pending.

**DISCUSSION**

In this adversary proceeding, the Plaintiffs seeks to have their claims against the Debtor/Defendant held to be nondischargeable debts. A proceeding brought to determine the dischargeability of a particular debt is deemed to be core proceedings pursuant to 28 U.S.C. § 157(b)(2)(I). Accordingly, this Court has the jurisdictional authority to enter final orders and judgments in this matter. 28 U.S.C. § 157(b)(1); § 1334.

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The Plaintiffs' Complaint to Determine Dischargeability is brought under two statutory provisions: 11 U.S.C. § 523(a)(2)(A); and 11 U.S.C. § 523(a)(4). Respectively, these provisions provide:

(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—

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[.]

In order to prevail on their Complaint, the Plaintiffs must establish the applicability of at least one of these provisions. For this burden, the evidentiary standard, as with other exceptions to dischargeability, is a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991) (preponderance-of-the-evidence standard of proof applies to all of 523(a)'s exceptions).

Against the Plaintiffs' Complaint to Determine Dischargeability, the Defendant filed a Motion for Summary Judgment. The standard for summary judgment is set forth in Rule 56(a) of the Federal Rules of Civil Procedure, as made applicable to this Court by Bankruptcy Rule 7056. Under Rule 56(a), it is provided that the "court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Where, as here, the party moving for summary judgment does not carry the burden of proof on the substantive cause of action, the movant may establish its entitlement to summary judgment by "offering affirmative evidence that negates an element of the non-moving party's claim

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or by pointing to an absence of evidence to support the non-moving party's claim." *Joostberns v. United Parcel Servs., Inc.*, 166 F. App'x 783, 787 (6<sup>th</sup> Cir.2006).

In their Complaint, the Plaintiffs make two demands for relief: (1) the entry of a judgment in their favor; and (2) a determination that their judgment is nondischargeable. In his Motion for Summary Judgment, the Defendant attacks both of these demands, setting forth that "[n]ot only has the Plaintiff [sic] failed to show that it is owed a legitimate claim but they have failed to set forth any facts that would allow this Court to make a determination that the claim should be found non-dischargeable." (Doc. No. 38, at pg. 24).

On the Defendant's first point, the absence of any claim held by the Plaintiffs, it is black letter law that the *sine qua non* of any dischargeability determination is the existence of a claim – or from the debtor's perspective, the existence of a debt<sup>1</sup> – held by the creditor seeking the determination of nondischargeability. *See, e.g., In re Bundick*, 303 B.R. 90 (Bankr. E.D. Va. 2003) (first step in determining dischargeability of debt is to decide whether creditor has established that debt was in fact owed by debtor). Thus, the matter of whether the Plaintiffs hold a claim will be addressed first.

For purposes of bankruptcy law, a "claim" is defined as any "right to payment." 11 U.S.C. § 101(5)(A). This, the Supreme Court has explained, "is nothing more nor less than an enforceable obligation." *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 559, 110 S.Ct. 2126, 2131, 109 L.Ed.2d 588 (1990). The Bankruptcy Code's meaning of a "claim" is coextensive with a debt in bankruptcy which the Code defines as any "liability on a claim." 11 U.S.C. § 101(12). *See also In re Rifkin*, 124 B.R. 626, 628 (Bankr. E.D.N.Y.1991) ("The terms 'debt' and 'claim' are coextensive, 'flip sides to the same coin.'").

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11 U.S.C. § 101(12) ("The term "debt" means liability on a claim.").

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When applying the meaning afforded to a “claim” under bankruptcy law, the Defendant’s position, that the Plaintiffs do not hold any claims, cannot stand up to scrutiny. The first impediment to the Defendant’s position stems from what is known as the law of the case doctrine. This doctrine holds that a court is ordinarily precluded from reexamining an issue previously determined in the same case. *See Consolidation Coal Co. v. McMahon*, 77 F.3d 898, 905 (6<sup>th</sup> Cir.1996) (“Under the law of the case doctrine, a court is ordinarily precluded from reexamining an issue previously decided by the same court, or a higher court in the same case.”).

In this matter, a determination has already been made that the Plaintiffs hold valid claims against the Defendant. On July 25, 2011, this Court entered an order, approving a Motion brought by the Chapter 7 Trustee to Compromise All Pending Matters. As a part of this Order, the Trustee withdrew his objections to the proofs of claim filed by the Plaintiffs. Pursuant to § 502(a) of the Bankruptcy Code, it is provided that a proof of “claim . . . is deemed allowed, unless a party in interest . . . objects.” Resultantly, without any objection currently pending to the proofs of claim filed by the Plaintiffs, and with the time for filing objections having passed, such claims must be recognized as valid in this case.

To be sure, the allowed claims held by the Plaintiffs are not liquidated, being contingent on the lawsuits currently pending between the Parties at this time. Thus, it is possible that the claims held by the Plaintiffs may be ultimately determined to have no value. However, insofar as it concerns this proceeding to determine dischargeability, a determination as to the specific amount of the Plaintiffs’ claims is not a necessary prerequisite.

In defining a “claim” as a “right to payment,” the Bankruptcy Code goes on to specify that a claim will exist “whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.” 11 U.S.C. § 101(5)(A). Therefore, in a dischargeability proceeding, all the law requires is that a claim



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exist. The fact that, as here, a plaintiff's claim may be contingent, unliquidated or not reduced to judgment does not prevent the Court from making a ruling as to the dischargeability of the claim. *In re Black*, 95 B.R. 819, 823 (Bankr. M.D.Fla.1989).

This is not to say that the Court, as a part of a proceeding to determine dischargeability, cannot undertake to determine the amount of a plaintiff's claim. *Longo v. McLaren (In re McLaren)*, 3 F.3d 958, 965 (6<sup>th</sup> Cir.1993) (as a part of a dischargeability proceeding, bankruptcy court can enter a monetary judgment). However, such a determination is not mandatory. Moreover, even if the Court were inclined in this case to determine the amount of the Plaintiffs' claims, such a determination cannot be made at this time.

Under this Court's order, approving the Trustee's Global Motion to Compromise, the Trustee assigned to the Plaintiffs his rights in a fraudulent transfer action. Depending, therefore, on the outcome of this matter, a reassessment of the Plaintiffs' claims may be necessary. This Court's order, assigning the Trustee's rights to the Plaintiffs, however, is currently on appeal, depriving this Court of jurisdiction over the matter, including a determination of the Defendant's liability. *See Griggs v. Provident Consumer Discount Co.*, 459 U.S. 56, 58-59, 103 S.Ct. 400, 74 L.Ed.2d 225 (1982) (per curiam) ("The filing of a notice of appeal is an event of jurisdictional significance-it confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal").

Moreover, it is recognized that the Defendant potentially holds claims against the Plaintiffs. The first of these asserted claims totals \$115,000.00, and represents funds paid on a prepetition judgment obtained by the Defendant against the Plaintiffs, Frost & Co. and Frost Mechanical. These funds are now held by the Chapter 7 Trustee. The second claim asserted by the Defendant against the Plaintiffs is in the amount of \$169,000.00, and represents the Defendant's payment on the surety bond to the Ohio Farmers Insurance Company.

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Therefore, to liquidate the claims held by the Plaintiffs, the potential claims held by the Defendant against the Plaintiffs would also have to be determined. At this time, however, it would appear to be premature for the Defendant to assert the merits of these claims since they belong to the Trustee and at least one of his claims, representing the \$115,000.00 judgment obtained by the Defendant, is currently being administered by the Trustee. *See* 11 U.S.C. § 323 & 704 (empowering Chapter 7 trustee to administer property of the estate).

Notwithstanding these impediments, the Defendant takes the position that the Reorganization Agreement executed by the Parties on May 23, 2008, is dispositive, and shows that any claims asserted by the Plaintiffs have no basis. In this Agreement, the Plaintiffs and the Defendant executed mutual releases of the other concerning their prior transactions, including the Defendant's purchase of Frost Roofing Inc. as well as Mr. McCormick's redemption from the Defendant of the stock of Frost & Co. Inc. and its subsidiaries.

The Defendant's reliance on the Reorganization Agreement, however, falters upon a close examination of the language contained in the Agreement. Particularly, while the Agreement does afford the Parties a release of liability against each other, the Agreement makes this release specifically contingent on the lack of any fraud. As specified in the Agreement, "[t]his release shall not apply if Smithey committed fraud in the negotiation of this Agreement. . . ." (Doc. No. 44, Ex. E, ¶ 2.6).

Consequently, it is fair to state that the Defendant's reliance on the Parties' Reorganization Agreement, as the basis for his position that the Plaintiffs do not hold any claims, is necessarily intertwined with the second aspect of the Parties' dispute: Whether any claims held by the Plaintiffs are nondischargeable for purposes of either § 523(a)(2) or § 523(a)(4)? The Court, thus, now turns to address this matter.

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Sections 523(a)(2) and 523(a)(4) of the Bankruptcy Code serve to except from discharge any debt which arises on account of a dishonest or otherwise wrongful act committed by a debtor. Accordingly, to prevail on their Complaint, the Plaintiffs will be placing before the Court questions concerning the Defendant's mental state. As this Court observed in a previous decision involving the same statutory exceptions to discharge:

With the exception of defalcation under § 523(a)(4), each of the statutory exceptions to dischargeability cited by the Plaintiff have a commonality: scienter—that is, a specific intent to actually do the harm, whether it is an intent to defraud/deceive under § 523(a)(2), an intent to misappropriate another's property under § 523(a)(4);

*Double v. Cole (In re Cole)*, 428 B.R. 747, 752 (Bankr. N.D. Ohio 2009).

Determinations concerning a person's state of mind, however, normally require a subjective assessment of that person's intentions which often can only be made by the trier-of-fact after it has had the opportunity to assess the credibility and the demeanor of witnesses who testify at trial during both direct and cross examination. *PNC Bank v. Laskey (In re Laskey)*, 441 B.R. 853 856 (Bankr. N.D. Ohio 2010). Consequently, the adjudication of a person's mental state is not normally appropriate on a motion for summary judgment. This case is no exception, with there existing material issues regarding whether the Defendant was entirely honest in all his dealings with the Plaintiffs.

To start with, there exists the question from where did the Defendant obtain the funds to purchase Frost Roofing Inc.? The transfers made by the Defendant to close family members, particularly in the period leading up to his bankruptcy filing, also cast doubt on the Defendant's forthright conduct. Further questions also need to be answered such as the Defendant's knowledge

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concerning the losses incurred on the municipal school project. As well, a full accounting for the checks written by the Defendant while an employee of Frost & Co. would be in order.

In deciding a motion for summary judgment, a court is not to weigh the evidence to resolve factual disputes, make credibility determinations, or choose which inferences to draw from the facts. In determining whether a factual dispute requiring trial exists, the court must view the record in the case and the summary judgment submissions in the light most favorable to the nonmovant. Moreover, if the evidence supports inferences, the court must draw all reasonable inferences in the nonmovant's favor. Simply put, summary judgment is never to be used merely to cut short a trial where factual issues should be explored. *Drexel Heritage Furnishings, Inc. v. U.S.*, 4 Cl.Ct. 162, 168 (Cl.Ct.1983).

Given the questions outlined, as well as others, the Court finds that, contrary to the Defendant's protestations, a determination of whether the Defendant acted with the requisite mental state for purposes of either § 523(a)(2) or § 523(a)(4) needs to be made at trial where the respective allegations made by the Parties may be subject to both direct and cross examination. As such, the Defendant is not entitled to summary judgment on the matter of whether the claims held by the Plaintiffs are nondischargeable.

In summation, the Court finds that the Plaintiffs hold, within the meaning of the Bankruptcy Code, a "claim" against the Defendant. Although the claim is not yet determinate, this deficiency does not preclude the Plaintiffs from proceeding with their Complaint to Determine Dischargeability. In addition, the Court finds that material factual issues exist regarding the merits of the Plaintiffs' causes of action, as brought under §§ 523(a)(2) and 523(a)(4), so as preclude the entry of summary judgment in the Defendant's favor. 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 the Motion for Summary Judgment filed by the Defendant/Debtor, James Smithey, be, and is hereby, DENIED.

**IT IS FURTHER ORDERED** this matter be, and is hereby, set for a further PreTrial on Thursday, February 16, 2012, at 12:30 P.M., in Courtroom No. 1, Room 119, United States Courthouse, 1716 Spielbusch Avenue, Toledo, Ohio.

Dated: January 10, 2012

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Richard L. Speer  
United States  
Bankruptcy Judge