

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

In re:)	Case No. 03-18531
)	
LARRY D. COLLINS,)	Chapter 7
Debtor.)	
)	Adversary Proceeding No. 03-1394
ARTHUR DEAN WHEELER,)	
Plaintiff,)	Judge Arthur I. Harris
)	
v.)	
)	
LARRY D. COLLINS,)	
Defendant.)	

MEMORANDUM OF OPINION

The plaintiff, Arthur Dean Wheeler, filed this adversary proceeding on September 29, 2003, seeking a determination that claims entered in a state court judgment dated July 30, 2001, in his favor and against the debtor-defendant, Larry D. Collins, are not dischargeable under 11 U.S.C. § 523. On March 23, 2004, the plaintiff filed a motion for summary judgment (Docket # 16), asserting that summary judgment is appropriate based on the doctrine of collateral estoppel, also known as issue preclusion. The debtor did not file a response to the motion. For the reasons that follow, the plaintiff's motion for summary judgment is granted in part and denied in part. Specifically, the entire state court judgment is deemed nondischargeable under 11 U.S.C. § 523, with the exception of the \$608.16 claim involving the Addison Road property. The dischargeability of this smaller claim

will be the subject of further proceedings in the event the plaintiff notifies the Court in writing within the next 20 (twenty) days that he wishes to pursue such proceedings.

BACKGROUND

The claims for which the plaintiff seeks a determination of nondischargeability relate to two failed real estate transactions in 1997. Prior to April of 1997, the plaintiff owned real property at 8203-09 Cedar Avenue, Cleveland, Ohio, which the defendant wanted to purchase. Throughout negotiations for the purchase of this property, the debtor held himself out as an attorney.¹ In order for the debtor to finance this purchase, the parties agreed that the defendant would provide the plaintiff with (i) a \$15,000 down payment at the time of contracting, and (ii) a mortgage to secure the balance of the purchase price. This agreement was embodied in the parties' "Agreement to Sell Real Estate" dated April 1, 1997 – or so the debtor led the plaintiff to believe.

The debtor made approximately eight installment payments of \$499.93 to the plaintiff, presumably in accordance with the agreement of April 1, 1997. After that, the debtor defaulted. When the plaintiff attempted to enforce the mortgage

¹In his bankruptcy schedules, the debtor declared that he has worked as a teacher in the Cleveland Municipal School District for the three years preceding his bankruptcy filing.

encumbering the property, he learned that the April 1 agreement did not in fact grant him a security interest. On January 4, 1999, the debtor obtained a loan of \$64,800 from Delta Funding Corporation and used the Cedar Avenue property as collateral. This resulted in Delta Funding Corporation having a valid and perfected first lien on the property, while the plaintiff was left with no security interest at all.

The second failed real estate transaction involved property owned by the debtor at 1488-90 Addison Road, Cleveland, Ohio. The two parties negotiated terms and a price for the sale of the property to the plaintiff, and on July 2, 1997, the plaintiff signed an offer to purchase the property from "MBL Properties," an entity owned and/or controlled by the debtor. In connection with the offer to purchase, the plaintiff provided the debtor with a down payment of \$500.00. The debtor, however, never formally accepted the offer to purchase and never returned the \$500.00 to the plaintiff.

On May 4, 2000, the plaintiff filed suit against the debtor in the Cuyahoga County Court of Common Pleas (Common Pleas Case # CV-00-407376) alleging, in pertinent part, that the debtor defrauded him in connection with breach of contract for the Cedar Avenue property and that the debtor wrongfully retained possession of plaintiff's \$500.00 down payment for the sale of the Addison Road

property. The debtor filed an answer on July 6, 2000, and asserted a counterclaim.² After that, the case was stayed as a result of the debtor's bankruptcy filing under Chapter 13 on August 25, 2000 (Bankruptcy Case # 00-16372), but that bankruptcy case was ultimately dismissed on January 24, 2001, due to a lack of funding. The Court of Common Pleas restored the state court case to its active docket on February 1, 2001, and set a case management conference for February 13, 2001.

When neither the debtor nor his counsel appeared at the February 13 case management conference, the Common Pleas Court set an additional pretrial hearing for May 14, 2001. When the debtor and his counsel failed to appear for the May 14 pretrial conference, the Court scheduled trial for June 14, 2001. Again, the debtor did not make an appearance when the Common Pleas Court called the case for trial on June 14, 2001. Nonetheless, the plaintiff presented evidence to the Court, and the Court rendered judgment in favor of the plaintiff, issuing findings of fact and conclusions of law on July 30, 2001. The Court also denied a motion from the debtor to vacate the "judgment entry of default," based on the fact that a judgment had not been entered at the time the debtor had filed his

²The debtor's counterclaim was eventually dismissed on July 31, 2001, as a result of the debtor's failure to prosecute.

motion to vacate.

The findings of fact and conclusions of law of July 30, 2001, state that with respect to the transactions for the Cedar Avenue property the debtor "committed a fraud [against the plaintiff]." The court awarded the plaintiff (i) \$56,816.00 including 10% interest from April 1, 1999, based on the debtor's breach of contract for the Cedar Avenue property, (ii) \$608.16 including interest at 10% from April 1, 1999, based on the debtor's wrongful retention of the \$500.00 deposit for the Addison Road property, and (iii) all court costs. Importantly, the state court did not make a finding of fact or issue a conclusion of law regarding fraud in connection with the transactions for the Addison Road property. The debtor did not appeal or otherwise seek relief from the state court's judgment of July 30, 2001.

On September 29, 2003, the plaintiff filed the instant adversary proceeding seeking a determination that his claims against the debtor as identified in the state court judgment of July 30, 2001, are nondischargeable pursuant to 11 U.S.C. § 523. The debtor answered the complaint on January 16, 2004, denying any fraudulent conduct on his part and admitting that he did not defend against the plaintiff's claims while in state court (Docket # 9). On March 23, 2004, the plaintiff filed the instant motion for summary judgment, to which the debtor never

responded.

DISCUSSION

The Court has jurisdiction in this adversary proceeding pursuant to 28 U.S.C. § 1334(b) and Local General Order No. 84, entered on July 16, 1984, by the United States District Court for the Northern District of Ohio. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

Summary Judgment Standard

The standards for a court to award summary judgment are contained in Federal Rule of Civil Procedure 56(c), as made applicable to bankruptcy proceedings by Rule 7056 of the Federal Rules of Bankruptcy Procedure.

According to Civil Rule 56(c), a court shall render summary judgment

if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

The party moving the court for summary judgment bears the burden of showing that "there is no genuine issue as to any material fact and that [the moving party] is entitled to judgment as a matter of law." *Jones v. Union County*, 296 F.3d 417, 423 (6th Cir. 2002). *See generally Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Once the moving party meets that burden, the nonmoving party "must identify specific facts supported by affidavits, or by

depositions, answers to interrogatories, and admissions on file that show there is a genuine issue for trial." *Hall v. Tollett*, 128 F.3d 418, 422 (6th Cir. 1997).
See, e.g., Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 252 (1986) ("The mere existence of a scintilla of evidence in support of the plaintiff's position will be insufficient; there must be evidence on which the jury could reasonably find for the plaintiff.") In determining the existence or nonexistence of a material fact, a court will view the evidence in a light most favorable to the nonmoving party. *See Tennessee Department of Mental Health & Mental Retardation v. Paul B.*, 88 F.3d 1466, 1472 (6th Cir. 1996).

Nondischargeability and Collateral Estoppel

The plaintiff asserts that, based on the state court judgment and the doctrine of collateral estoppel, this Court is required to enter a finding of nondischargeability as a matter of law. The facts of this case that are dispositive for the purposes of collateral estoppel and summary judgment are straightforward and not in dispute.

Section 523(a)(2)(A) of the Bankruptcy Code implements the strong bankruptcy policy of only permitting an honest debtor to receive a discharge of his

or her debts.³ *See Cohen v. de la Cruz*, 523 U.S. 213, 217-18 (1998). Section 523 provides in pertinent part:

(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.

The doctrine of collateral estoppel, also known as issue preclusion, prevents the same parties or their privies from relitigating facts and issues in a subsequent

³Although the plaintiff refers to 11 U.S.C. § 523(a)(4) in his complaint and his motion for summary judgment, the complaint is sounded generally under 11 U.S.C. § 523. Therefore, the Court will construe the complaint as if it had specifically invoked the nondischargeability provisions of 11 U.S.C. § 523(a)(2)(A). *See* FED. R. BANKR. P. 1001 (stating that bankruptcy rules "shall be construed to secure the just, speedy, and inexpensive determination of every case and proceeding"); FED. R. BANKR. P. 7008 (permitting notice pleading by incorporating FED. R. CIV. P. 8). *See generally Fuller v. Johannessen (In re Johannessen)*, 76 F.3d 347, 349 (11th Cir. 1996) (noting that procedural rules require only a "short plain statement of the claim that will give the defendant fair notice of what the plaintiff's case is and the grounds upon which it rests") (internal quotes omitted), *citing Conley v. Gibson*, 355 U.S. 41, 47 (1957). The discharge exception contained in 11 U.S.C. § 523(a)(4) applies only in situations involving fraudulent malfeasance by a fiduciary, embezzlement, or larceny. The plaintiff has not presented evidence in his motion for summary judgment sufficient for the Court to make findings of fraudulent malfeasance by a fiduciary, embezzlement, or larceny.

suit that were fully litigated in a prior suit. *See In re Fordu*, 201 F.3d 693, 704 (6th Cir. 1999). It is well established that collateral estoppel principles apply to bankruptcy proceedings and can be used in nondischargeability actions to prevent relitigation of issues that were already decided in a state court. *See, e.g., Grogan v. Garner*, 498 U.S. 279, 284 n.11 (1991)("We now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a)."); *Stone v. Kirk*, 8 F.3d 1079, 1090 (6th Cir. 1993)("That 'Congress intended the bankruptcy court to determine the final result – dischargeability or not – does not require the bankruptcy court to redetermine all the underlying facts.' [*Spilman v. Harley*, 656 F.2d 224, 227 (6th Cir. 1981)]").

The Supreme Court has held that federal common law is not invoked when applying collateral estoppel principles from a state court judgment to a nondischargeability proceeding. *See Marrese v. American Acad. of Orthopaedic Surgeons*, 470 U.S. 373, 374 (1985). Instead, in a nondischargeability proceeding, a bankruptcy court must, pursuant to the full faith and credit principles of 28 U.S.C. § 1738, give the same issue preclusion effect to a state court judgment as it would be given under that state's law. *See id.* at 374. Accordingly, in this case the Court will apply Ohio's law on collateral estoppel, since all events giving rise to the plaintiff's complaint transpired in Ohio.

Under Ohio law, the doctrine of collateral estoppel or issue preclusion

applies when a fact or issue "(1) was actually and directly litigated in the prior action, (2) was passed upon and determined by a court of competent jurisdiction, and (3) when the party against whom [issue preclusion] is asserted was a party in privity with a party to the prior action."

In re Fordu, 201 F.3d at 704 (quoting *Thompson v. Wing*, 70 Ohio St.3d 176, 183, 637 N.E.2d 917, 923 (1994). Accord *In re Sweeney*, 276 B.R. 186 (B.A.P. 6th Cir. 2002) (applying "actually and directly litigated" element of Ohio issue preclusion law);⁴ *In re Rebarchek*, 293 B.R. 400, 405 (Bankr. N.D. Ohio 2002)(same).

With respect to these requirements, the facts of this case show that the debtor, after being given fair notice of the trial in the state court litigation, was the

⁴ In *Sweeney*, the Bankruptcy Appellate Panel applied a slightly different definition of collateral estoppel under Ohio law: [W]e find that there are four prerequisites to the application of collateral estoppel under Ohio law:

1) A final judgment on the merits in the previous case after a full and fair opportunity to litigate the issue; 2) The issue must have been actually and directly litigated in the prior suit and must have been necessary to the final judgment; 3) The issue in the present suit must have been identical to the issue in the prior suit; 4) The party against whom estoppel is sought was a party or in privity with the party to the prior action. 276 B.R. at 190 (quoting *In re Moffitt*, 252 B.R. 916, 921 (B.A.P. 6th Cir. 2000)). Although this definition is slightly different from the definition used in *Fordu* and *Thompson*, this Court's analysis and ultimate conclusion that the prerequisites for collateral estoppel have been established with respect to the Cedar Avenue claim are the same, regardless which definition is used.

party against whom a final judgment was entered. Thus, no further discussion is merited concerning the second and third elements as enunciated in *Fordu* (or the first and fourth elements as enunciated in *Sweeney*). Turning to the first element of the collateral estoppel test as enunciated in *Fordu* (or the second element as enunciated in *Sweeney*), the question raised in this case is whether an issue can be considered actually and directly litigated in a prior suit when the party against whom the judgment was rendered did not appear at the trial in the prior suit.

This precise legal issue was addressed in a thoughtful decision by Judge Speer of this Court in *In re Rebarcek*. As Judge Speer explained:

When a defendant fails to appear at trial, there has been considerable confusion as to whether any judgment rendered therefrom may be considered actually litigated for purposes of the collateral estoppel doctrine. In particular, many defendants have argued that such judgments should not be given preclusive effect because the judgment was, in essence, rendered by default, and thus no issue could have been actually litigated. . . .

Under Ohio Rule of Civil Procedure 55, however, a default judgment may only be rendered when a defendant "has failed to plead or otherwise defend." Thus, in a technical sense, a default judgment is not proper, in a situation such as this, where the defendant simply fails to show up at the trial. As was explained in great detail by the Ohio Supreme Court in *Ohio Valley Radiology Assoc., Inc. v. Valley Hosp. Assn.*:

a default by a defendant arises only when the defendant has failed to contest the allegations raised in the complaint and it is thus proper to render a default judgment against the defendant as liability has been admitted or "confessed" by the omission of statements refuting the plaintiff's claims. It is only when the party against whom a claim is sought fails to contest the opposing party's allegations by either

pleading or otherwise defending that a default arises. . . .

. . . .

Conversely, once a case is at issue, it is improper for a court to enter judgment against a defendant without requiring proof of the plaintiff's claim.

The proper action for a court to take when a defending party who has pleaded fails to show for trial is to require the party seeking relief to proceed *ex parte* in the opponent's absence. Such a procedure, which requires affirmative proof of the essential elements of a claim, is diametrically opposed to the concept of default, which is based upon admission and which therefore obviates the need for proof. This is because *ex parte* trials, when properly conducted, are truly trials in the sense of the definition contained in R.C. 2311.01. That is, they are "judicial examinations of the issues whether of law or of fact, in an action or proceeding." "Issues" are defined in R.C. 2311.02 as follows: "Issues arise on the pleadings where a fact or conclusion or law is maintained by one party and controverted by the other." It is clear that any judgment based upon a *ex parte* trial is a judgment after trial pursuant to [Ohio] Civ. R. 58, and not a default judgment under [Ohio] Civ. R. 55.

28 Ohio St.3d 118, 121-22, 502 N.E.2d 599, 602-03 (1986)(internal citations and punctuation pertaining thereto omitted).

Nevertheless, many judgments are wrongly labeled as default judgments simply on the basis that the defendant failed to appear at trial. Thus, given the fact that some judgments are mislabeled, this Court, on past occasions, has found it more beneficial, in the context of applying the collateral estoppel doctrine, to concentrate on the actual substance of the judgment instead of the technical label given to the judgment. In this regard, this Court has set forth the following standard to determine whether an issue in a prior judgment—whether the judgment was rendered by default or on the merits—was actually and directly litigated for purposes of the collateral estoppel doctrine:

First, the plaintiff must actually submit to the state court admissible evidence apart from his pleadings. In other words, a plaintiff's complaint, standing alone, can never provide a sufficient

basis for the application of the collateral estoppel doctrine. Second, the state court, from the evidence submitted, must actually make findings of fact and conclusions of law which are sufficiently detailed to support the application of the collateral estoppel doctrine in the subsequent proceeding. In addition, given other potential problems that may arise with applying the collateral estoppel doctrine to default judgments (e.g., due process concerns), this Court will only make such an application if the circumstances of the case would make it equitable to do so.

In re Robinson, 242 B.R. 380, 387 (Bankr. N.D. Ohio 1999). Later, in *In re Sweeney*, the Bankruptcy Appellate Panel for the Sixth Circuit adopted this position and further elaborated on it by stating this:

Thus, the rule established in *Robinson* is that the state court must decide the merits of the case, and the court being asked to give preclusive effect to a default judgment in a subsequent litigation must have some reliable way of knowing that the decision was made on the merits. The best evidence would be findings of fact and conclusions of law by the court entering the default judgment. These need not be entered in any special or formal way, but the default court must state what findings and conclusions, if any, it has reached in arriving at the judgment. Those findings and conclusions will have preclusive effect.

276 B.R. 186, 194 (B.A.P. 6th Cir. 2002).

293 B.R. at 405-07.

As it pertains to the above standards, it is clear that the issue of the debtor's fraud involving the Cedar Avenue property was both actually and directly litigated in the prior state court litigation. The court required the plaintiff to present evidence in support of the allegations in his complaint. The court issued Findings of Fact and Conclusions of Law based on the evidence submitted. These were

express findings based on the evidence offered in support of the plaintiff's complaint and resulted in an express adjudication of fraud, at least with respect to the transactions involving the Cedar Avenue property.

In light of the debtor's participation, with counsel, in the Common Pleas case, including the filing of an answer and a counterclaim, it would be inequitable not to enforce the preclusive effect of the Cuyahoga County judgment. Thus, the plaintiff has established the "actually and directly litigated" element of issue preclusion (*i.e.*, part of the first element as enunciated in *Fordu* and the second element as enunciated in *Sweeney*).

The last issue to address concerns whether, under the first prong of the collateral estoppel test as enunciated in *Fordu* (or the third prong as enunciated in *Sweeney*), the issues involved in the present suit are identical to those issues involved in the plaintiff's state court action. In *In re Francis*, 226 B.R. 385 (B.A.P. 6th Cir. 1998), the Bankruptcy Appellate Panel for the Sixth Circuit addressed precisely this issue – namely, whether the elements required to prove fraud under Ohio law are the same as the elements required under § 523(a)(2)(A). After reciting the elements required to prove fraud under Ohio law, 226 B.R. at 389 (*citing Gaines v. Preterm-Cleveland, Inc.*, 33 Ohio St.3d 54, 514 N.E.2d 709, 712 (1987)), and the elements required to prove nondischargeability under

§ 523(a)(2)(A), 226 B.R. at 389 (*citing In re Rembert*, 141 F.3d 277, 280-81 (6th Cir. 1998)), the Bankruptcy Appellate Panel concluded that the elements are "virtually identical" and that the bankruptcy court properly applied collateral estoppel in determining that the debt was nondischargeable due to the state court's finding of fraud. 226 B.R. at 389. *Accord In re Foster*, 280 B.R. 193, 205 (Bankr. S.D. Ohio 2002)(giving issue preclusive effect to finding of fraud under Ohio law in dischargeability proceeding); *In re Henderson*, 277 B.R. 889, 892 (Bankr. S.D. Ohio 2002)(same); *In re Brown*, 215 B.R. 844, 847-48 (Bankr. E.D. Ky. 1998) (same); *In re McLaren* 136 B.R. 705, 710 (Bankr. N.D. Ohio 1991)("The facts required to prove nondischargeability under section 523(a)(2)(A) of the Bankruptcy Code are substantially the same as those required to prove fraud under Ohio law."), *subsequently affirmed* 3 F.3d 958 (6th Cir. 1993).

For purposes of the motion for summary judgment, the Court sustains the motion only with respect to the portion of the state court judgment involving the debtor's breach of contract for the Cedar Avenue property. The Court denies summary judgment with respect to the portion of state court judgment involving the debtor's wrongful retention of the \$500.00 deposit for the Addison Road property. The difference between the two transactions is that the state court specifically found that the debtor committed fraud only in connection with the

Cedar Avenue property. *See* Findings of Fact and Conclusions of Law of July 7, 2001, from Cuyahoga County Court of Common Pleas (Case CV-00-407376) at 5.

The state court's Findings of Fact and Conclusions of Law, together with the related Judgment Entry, establish each of the elements required for those findings to have issue preclusive effect as to the plaintiff's action for nondischargeability under § 523(a)(2)(A) with respect to the Cedar Avenue property. Not only do they demonstrate that the Judgment was rendered after a trial at which evidence was presented but they are supported by Findings of Fact and Conclusions of Law. The elements of common law fraud were specifically decided on the merits. Because these elements also satisfy the requirements of nondischargeability under § 523(a)(2)(A), the state court judgment precludes the debtor from relitigating this issue. Thus, the plaintiff has sustained his burden of showing that, as applied to his cause of action under § 523(a)(2)(A), the doctrine of collateral estoppel is applicable in this case.

CONCLUSION

For the foregoing reasons, the plaintiff's motion for summary judgment (Docket # 16) is granted in part and denied in part. The plaintiff's fraud claims against the debtor stemming from the Cedar Avenue transactions are

nondischargeable under § 523(a)(2)(A); however, based upon the current record, the Court cannot grant summary judgment against the debtor with respect to the dischargeability of the \$608.16 claim involving the Addison Road property. The dischargeability of this smaller claim will be the subject of further proceedings in the event the plaintiff notifies the Court in writing within the next 20 (twenty) days that he wishes to pursue such proceedings. and the plaintiff's claims stemming from the Addison Road property are not nondischargeable for the purposes of the motion for summary judgment.

A separate order shall be entered in accordance with this Memorandum of Opinion.

/s/ Arthur I. Harris 06/09/2004
Arthur I. Harris
United States Bankruptcy Judge