

**UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT**

BAP No. RI 00-019

**IN RE: ROBERT T. SPIGEL,
Debtor.**

**GLENN O. McCRORY and ANN McCRORY,
Plaintiffs/Appellees,**

v.

**ROBERT T. SPIGEL,
Defendant/Appellant.**

**Appeal from the United States Bankruptcy Court
for the District of Rhode Island
(Hon. Arthur N. Votolato, U.S. Bankruptcy Judge)**

**Before
GOODMAN, LAMOUTTE, AND FEENEY, U.S. Bankruptcy Judges**

**Marty C. Marran, for the Appellant.
James A. Currier, for the Appellees.**

July 13, 2000

Per Curiam.

I. Introduction

The matter before the Panel for determination is the appeal of the Chapter 7 Debtor, Robert T. Spigel (the "Debtor" or "Spigel"), from an Order of the United States Bankruptcy Court for the District of Rhode Island granting summary judgment for Glenn O. McCrory and Ann McCrory (the "McCrorys"), declaring the debt owed by the Debtor to the McCrorys nondischargeable in the Debtor's bankruptcy case, and denying the Debtor's Cross-Motion for Summary Judgment. The Panel conducted oral argument on May 18, 2000 and took the appeal under advisement. Upon consideration of the entire record of proceedings in this case, and a review of applicable legal principles, the Panel reverses the order of the bankruptcy court.

II. Facts and Procedural Background

The facts and procedural background necessary to decide this appeal are uncontroverted. The McCrorys held a license issued by the State of Rhode Island to sell motor vehicles and to do business as Frenchtown Auto Sales. By agreement with the McCrorys, the Debtor used their license to sell vehicles. Without the knowledge of the McCrorys, the Debtor sold three motor vehicles, provided to him from his nephew, which were stolen. The Debtor denies knowledge that the vehicles were stolen. The Rhode Island Motor Vehicles Dealers Commission ordered the McCrorys to make restitution.

The McCrorys filed a civil action against Spigel in Rhode Island Superior Court. The complaint contained two counts. In Count 1, the McCrorys sought to enjoin Spigel from using the name Frenchtown Auto Sales, from holding himself out as their representative, and from selling motor vehicles under their license. In Count 2, the McCrorys alleged that Spigel sold vehicles utilizing their license number which he knew or should have known were stolen, that they were required to make restitution to the purchasers of the vehicles, and demanded judgment against Spigel for compensatory and punitive damages in an unspecified amount, attorney's fees and other recoverable costs. Contrary to the averment of the McCrorys in their Statement of Issues filed in this appeal, their state court complaint did not allege that Spigel committed fraud.

The McCrorys moved for summary judgment in the superior court action. A trial justice of the Superior Court granted their motion for summary judgment based upon the theory of equitable indemnity, reasoning that Spigel had apparent authority to sell vehicles under the McCrorys' business name and license, that both Spigel and the McCrorys would be liable to the purchaser, and as between the parties, equity warranted that Spigel be required to satisfy the obligation because the McCrorys were blameless in the questionable sales. The superior court made no findings of fraud, misrepresentation, false pretenses or deceit.

Spigel appealed the superior court judgment to the Rhode Island Supreme Court, which affirmed.¹ During the pendency of the appeal, Spigel filed a voluntary Chapter 7 petition in the United States Bankruptcy Court for the District of Rhode Island. Also during the pendency of the appeal, the McCrorys filed an adversary complaint against the Debtor entitled "Complaint Objecting to Discharge of the Debtor and to Determine Dischargeability of Certain Debts Pursuant to 11 U.S.C. § 727(2) [sic] and § 523 (2) (A) [sic]."² In their complaint, the McCrorys alleged: 1) that they were licensed by the State of Rhode Island to sell motor vehicles;

¹The parties stipulated that the appeal could be decided during the pendency of the Debtor's bankruptcy case.

² The McCrorys' complaint did not request denial of the Debtor's discharge although the caption of the complaint referenced "Section 727(2)" which is clearly a typographical error and inaccurate citation. See 11 U.S.C. §727(2). Furthermore, since the McCrorys and the Debtor discussed fraud in their summary judgment pleadings and briefs before this Panel, we presume that the intended reference in the caption of the Complaint was Section 523(a)(2)(A), which 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 to the debtor's or an insider's financial condition; ...

11 U.S.C. § 523(a)(2)(A).

2) the Debtor "illegally, unlawfully and without authorization" used their license to sell motor vehicles he knew or should have known were stolen; 3) the state ordered the McCrorys to make restitution to the purchasers of a vehicle and insurer; 4) that the McCrorys brought a civil action seeking indemnification from the Debtor in the Rhode Island Superior Court; and 5) that the McCrorys had obtained summary judgment in the state court action. The McCrorys requested in their complaint that the bankruptcy court order the Debtor's liability from the superior court judgment be excepted from discharge and that they be awarded compensatory and punitive damages, interest, costs and attorneys' fees. The McCrory's prayer for relief did not make any request for a judgment denying the Debtor's discharge in general.

The Debtor answered the complaint and a pretrial order was issued. After the filing of the parties' response to the joint pretrial order, which included certain stipulated facts, the McCrorys filed a Motion for Summary Judgment accompanied by a Memorandum. Through their summary judgment pleadings, the McCrorys argued that the allegations of the state court complaint and the discharge complaint are the same and that accordingly, the Debtor's obligation to the McCrorys is nondischargeable under 11 U.S.C. § 523 (2) (A) [sic]. The McCrorys' motion for summary judgment was not accompanied by any affidavits.

The Debtor filed an objection to the motion for summary

judgment, an amended objection, a Memorandum, and a Cross-Motion for Summary Judgment, accompanied by a Memorandum. The Debtor's summary judgment pleadings were not accompanied by any affidavits. In the Debtor's summary judgment pleadings, he argued that the findings of the state superior court did not warrant summary judgment on the issue of nondischargeability because the state court merely decided the Debtor's liability to the McCrorys under the theory of equitable indemnification, which was not tantamount to a finding of fraud. Furthermore, the Debtor maintained that he was entitled to summary judgment on the McCrory's complaint because: 1) their claim was exclusively one for indemnification; 2) their claim was not premised upon any fraud or misrepresentation by the Debtor which would except the debt from discharge under Section 523(a)(2)(A); and 3) that even if the McCrorys were entitled to prosecute a claim on behalf of the vehicle purchaser of the vehicle, the McCrorys had not submitted any evidence of the Debtor's intent to defraud.

The McCrorys filed an objection to the Debtor's cross motion for summary judgment with a reply memorandum, in which they argued that since the superior court found that the vehicle sales did not "... bear any indicia of legitimacy ...," its decision should be res judicata as to the issues of false pretenses, false representation, or actual fraud within the meaning of Bankruptcy Code Section 523(a)(2)(A).

The bankruptcy court held a hearing and on January 11, 2000, issued the following order: "For the reasons argued by the Plaintiffs in their Motion for Summary Judgment, which are adopted and incorporated herein by reference, the Plaintiffs' Motion for Summary Judgment is GRANTED. The cross Motion for Summary Judgment filed by the Defendant is DENIED. Enter Judgment consistent with this Order." This appeal followed.

III. Discussion

The issues presented are whether the Bankruptcy Court erred in granting summary judgment for the McCrorys, and whether the Bankruptcy Court erred in denying summary judgment for the Debtor. In reviewing decisions on summary judgment motions, appellate courts are required to review summary judgment de novo on all issues. Printy v. Dean Witter Reynolds, Inc., 110 F.3d 853, 854 (1st Cir. 1997). The Panel must review the evidence in a light most favorable to the party against whom judgment was entered to determine whether there are genuine issues of material fact and whether the lower court correctly applied the law to the undisputed facts. See Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1272 (5th Cir. 1994).

A. Allowance of Summary Judgment for the McCrorys

Although the bankruptcy court's reasons are not expressly stated in the order granting summary judgment, since the court incorporated the McCrorys' arguments into its order, presumably the

bankruptcy court allowed the motion on the theory that the the prior state court judgment was res judicata and determinative of the issues in the adversary proceeding. The preclusive effect of prior state court judgments in nondischargeability proceedings based upon res judicata or collateral estoppel principles has been the subject of numerous decisions.

In Brown v. Felsen, the Supreme Court of the United States reversed a bankruptcy court's grant of summary judgment in a nondischargeability action alleging the debtor's fraud where the basis for summary judgment was a prior state court collection proceeding in which the debtor had agreed to a judgment which did not result in a finding of fraud. 442 U.S. 127 (1979). Rejecting the creditor's argument that res judicata barred relitigation of the debtor/creditor dispute, the Supreme Court observed that discharge exception issues are not in issue in collection actions under state law, and thus the bankruptcy court was not confined to a review of the judgment and record in the prior state court proceeding when considering the dischargeability of a debt. Id. at 138-139. The Supreme Court left undecided the question of whether the narrower principle of collateral estoppel would apply to questions actually and necessarily decided in a prior suit, but commented that collateral estoppel would bar relitigation in the bankruptcy court of any factual issues determined by a state court using standards identical to those of the fraud discharge

exception. Id.

In Grogan v. Garner, 498 U.S. 279, 285 (1991) the Supreme Court clarified that "... collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to §523(a)." Considering whether a prior state court judgment collaterally estopped the Debtor from challenging the nondischargeability of his debt to the creditor under Section 523 (a)(2)(A) and the appropriate burden of proof in discharge actions, the Court observed, "[i]f the preponderance standard also governs the question of nondischargeability, a bankruptcy court could properly give collateral estoppel effect to those elements required for discharge and that were actually litigated and determined in the prior action." Id. at 284 (emphasis added).

Collateral estoppel bars relitigation where: 1) the issue sought to be precluded is the same as that involved in the prior action; 2) the issue has been actually litigated; 3) the issue has been determined by a valid and binding final judgment; and 4) its determination has been essential to the judgment. Grella v. Salem Five Cent Savings Bank, 42 F.3d 26, 30 (1st Cir. 1994).

A prior state court judgment should only be given preclusive effect in a bankruptcy nondischargeability proceeding if the state court has actually litigated and determined the same factual issues necessary to determine the discharge action using the standards identical to the Bankruptcy Code. Hamilton v. Nolan (In re Nolan),

220 B.R. 727, 731 (Bankr. D. Colo. 1998); In re Dubian, 77 B.R. 332, 335 (Bankr. D. Mass. 1987); American Express Travel Related Services Co., Inc. v. Hernandez (In re Hernandez), 195 B.R. 824, 828 (Bankr. D. P.R. 1996) (facts developed during state court action for breach of contract supported exception to discharge warranting preclusive effect of consent judgment). In Commonwealth of Massachusetts v. Hale, the First Circuit Court of Appeals upheld a bankruptcy court's denial of a creditor's motion for summary judgment premised upon a state court default judgment for unfair and deceptive trade practices in violation of a state statute where the standards for nondischargeability under bankruptcy law were narrower than state law and the state court complaint lacked any allegation of the existence of the intent and knowledge that were a prerequisite to an exception to discharge for fraud. 618 F.2d 143, 146 (1st Cir. 1980). Before applying estoppel principles, it is necessary to review the entire record of proceedings that culminated in the previous court judgment to determine if the issues necessary for a discharge exception were actually litigated. See Spilman v. Harley, 656 F.2d 224, 228 (6th Cir. 1981).

Applying these principles to the present case and having reviewed the McCrorys' state court action and their nondischargeability action, we find that the state court judgment did not resolve the issue of fraud necessary to except a debt from

discharge. The essential elements of an exception to discharge under Section 523(a)(2)(A), false representations, false pretenses, or actual fraud, were not plead, litigated in, or determined by the state court. The McCrorys' state court complaint does not mention fraud, false representations, false pretenses, misrepresentation or deceit as a basis for indemnification. Moreover, neither party, in the summary judgment pleadings and in oral argument before the state court, argued fraud. The findings of fact and rulings of law made by the state court on the motion for summary judgment were that the Debtor was more at fault than the McCrorys in selling vehicles to a third party to whom both were liable, and accordingly, the Debtor was required to indemnify the McCrorys. The judgment of the state court established the Debtor's liability under equitable indemnification principles, not fraud. The state court did not determine fraud within the meaning of Section 523(a)(2)(A) and we find neither res judicata or collateral estoppel was appropriate in this case. Thus, the McCrorys were not entitled to summary judgment on their complaint in the bankruptcy court, and the bankruptcy court erred in granting the motion for summary judgment. The order of the bankruptcy court granting the McCrorys' motion for judgment is reversed.

B. Denial of the Debtor's Cross Motion for Summary Judgment

Bankruptcy Code Section 523(a)(2)(A) applies to credit actually obtained by fraud or deceit. Field v. Mans, 157 F.3d 35,

44 (1st Cir. 1998); The Aetna Casualty and Surety Co. v. Markarian (In re Markarian), 208 B.R. 249 (B.A.P. 1st Cir. 1997). To sustain an exception to discharge on fraud grounds, the creditor must prove that: 1) the debtor made a false representation; 2) the debtor did so with fraudulent intent, i.e. scienter; 3) the debtor intended to induce the creditor to rely on the misrepresentation; 4) the misrepresentation induced reliance; 5) the reliance was justifiable; and 6) damage was proximately caused as a result. Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997) (the standard for "actual fraud" under Section 523(a)(2)(A) is analogous to the standard for fraud under the common law of torts). "A cause of action lies under § 523(a)(2)(A) if the [sic] alleges facts, if true, would support a finding of false pretenses, a false representation or actual fraud 'other than a statement respecting the debtor's or an insider's financial condition'..." In re Barrack, 217 B.R. 598, 606 (B.A.P. 9th Cir. 1998).

Fed. R. Bankr. P. 7008 and 7009 set forth the standards for notice pleading. Whereas Rule 7008(a) requires "a short and plain statement of the claim showing that the pleader is entitled to relief ...," Rule 7009(b) requires "[i]n all averments of fraud ..., the circumstances constituting fraud ... shall be stated with particularity." Discharge complaints must "state with particularity the underlying facts and the wrong alleged so that the broad policy of the federal rules to fairly apprise parties of

the complaint against them in sufficient detail to allow them to adequately answer and prepare their defense is ensured." In re Englander, 92 B.R. 425, 426 (B.A.P. 9th Cir. 1988), quoting In re Jenkin, 83 B.R. 733, 735 (B.A.P. 9th Cir. 1988). A discharge complaint that merely alleges that the debt is nondischargeable under the broad nondischargeability section of § 523(a) which does not set forth specific factual allegations in support of an exception to discharge for fraud fails to state a claim. Englander, 92 B.R. at 412.

A review of the complaint filed by the McCrorys in the bankruptcy court reveals that they did not plead the essential elements of a claim under any subsection of Section 523(a), even assuming all allegations of the complaint are true.³ The gravamen of the complaint was indemnification. The allegations did not meet the requirements of pleading a case under Section 523 (a) (2) (A) or any subsection of Section 523. Indeed, like the McCrorys' state court complaint, the eight-paragraph discharge complaint does not mention the words fraud, false pretenses or false representation. Where the discharge complaint failed to state a claim upon which relief could be granted, the bankruptcy court erred in denying the Debtor's Cross Motion for Summary Judgment. Accordingly, we vacate

³ The Plaintiffs' complaint and the Debtor's answer which were filed in the bankruptcy court were not originally included in the record on appeal. At the request of the Panel at oral argument, the Debtor supplemented the record with a copy of the complaint and the Debtor's answer.

the order denying the Cross Motion for Summary Judgment and grant summary judgment for the Debtor.⁴

IV. CONCLUSION

In accordance with the foregoing, the order of the bankruptcy court granting the McCrorys' motion for summary judgment is reversed, the order denying Debtor's cross motion for summary judgment is vacated and summary judgment is granted for the Debtor Defendant. SO ORDERED.

⁴ The Panel will not grant the Plaintiffs an opportunity to amend their complaint. Where the Plaintiffs asserted no facts which would support their claim of nondischargeability, they are not entitled to add additional or new grounds by way of amendment after the deadline for discharge complaints has passed. See In re Perez, 173 B. R. 284 (Bankr. E.D.N.Y. 1994).