United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

Donna Sears, Brian Sears, et al., Plaintiffs v. Nicholas Kaufman, Defendant
(In re Nicholas Kaufman, Debtor)
Bankruptcy Case No. 96-32625-7, Adv. Case No. 96-3210-7

United States Bankruptcy Court
W.D. Wisconsin, Madison Division

January 28, 1997

Susan V. Kelley, Michael, Best & Friedrich, Madison, WI, for the plaintiffs.
Edward A. Corcoran, Brennan, Steil & Basting, S.C., Madison, WI for the debtor-defendant.

Robert D. Martin, United States Bankruptcy Judge

ORDER FOR SUMMARY JUDGMENT

The Sears (plaintiffs) prevailed in a civil fraud action relating to the debtor's bogus investment scheme. On August 24, 1995, Judge Manning of the U.S. District Court for the Northern District of Illinois found Nicholas Kaufmann violated the Illinois Securities Act and the Illinois Consumer Fraud Act when he persuaded the Sears to invest in a securities scheme known as the "Jesse Fund." The court awarded the Sears damages of $61,500 plus interest and reasonable attorneys' fees. On June 24, 1996, the court granted the Sears' motion for attorneys' fees and costs - $119,884 and $11,053 respectively. Shortly thereafter, the court denied Mr. Kaufmann's motion to alter or amend the judgment. Mr. Kaufmann then filed Chapter 7 on July 1, 1996. The Sears brought this adversary under §523(a)(2)(A) to have their claim for the judgment declared nondischargeable and now move for summary judgment. Rule 56 provides that a motion for summary judgment shall be granted when there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. If

the initial burden is met, the burden shifts to the opposing party to establish the existence of a genuine material factual dispute. The Seventh Circuit requires the nonmoving party to go beyond the pleadings and produce evidence of a genuine issue for trial. Becker v. Tenenbaum-Hill Associates, Inc., 914 F.2d 107, 110 (7th Cir. 1990). Summary judgment is appropriate in the present case because the debtor is collaterally estopped from relitigating the material facts. Collateral estoppel applies in dischargeablility litigation in bankruptcy cases. Grogan v. Garner, 498 U.S. 279, 284-85 n. 11 (1994). Collateral estoppel precludes relitigation of any issue which has been actually and necessarily litigated and finally determined in a prior lawsuit. Klingman v. Levinson, 831 F.2d 1292, 1294 (7th Cir. 1987). The district court finally determined the facts material to §523(a)(2)(A) in the present case.

Under Klingman, four elements must be satisfied for collateral estoppel under federal law to apply: (1) the issue sought to be precluded must be the same as that involved in the prior action; (2) the issue must have been actually litigated; (3) the determination must have been essential to the final judgment; and (4) the party against whom estoppel is invoked must have been fully represented in the prior action. Id. at 1295. In the present case, the debtor, Nicholas Kaufmann was fully represented in the prior action, and he has stipulated that the civil case was "fully tried and litigated." (Pretrial Statement ¶14). Thus, the remaining question is whether the Sears' §523 action raises the same issues as were litigated in the civil case and whether determination of those issues was essential to the district court's final judgment.

A. False misrepresentations

Under §523(a)(2)(A), a creditor must prove by a preponderance that (1) the debtor obtained a debt through misrepresentations she either knew were false or that she made with a reckless disregard for the truth; (2) the debtor intended to deceive the creditor; and (3) the 2

creditor reasonably relied upon the misrepresentations to her detriment. In re West, 163 B.R. 133, 139 (Bankr. N.D, 111. 1993). Regarding the first element, the court found Mr. Kaufmann violated §12 of the Illinois Securities Act, an element of which is to obtain money by giving a false or misleading statement:

> It shall be a violation of the provisions of this Act for any person:
>
> F. To engage in any transaction, practice or course of business in connection with the sale or purchase of securities which tends to *work a fraud or deceit* upon the purchaser or seller thereof....
>
> G. *To obtain money* or property through the sale of securities *by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading*.
>
> J. When acting as an investment adviser, by any means or instrumentality, or directly or indirectly: ...
> (3) To engage in any act, practice or course of business which is *fraudulent, deceptive* or manipulative.

815 ILCS 5/12. In particular, the court found:

> Kaufmann knew that the Jesse Fund was being operated illegally. Kaufmann was advised by Attorney West that the Jesse Fund was not being operated in accordance with the law. . . state or federal. Attorney West advised Kaufmann that Wisneski and Tooley [the debtor's cohorts] should cease taking compensation and return the funds to the investors. Kaufmann admits that he represented to potential investors that he was in the process of completing the legal, regulatory, and business requirements as an investment advisory, when in fact there is no evidence of such efforts.

(Mem. at 36-37). Additionally, the court found the debtor distributed a marketing summary to Mrs. Sears that contained a niisrepresentation. (Finding of Fact ¶8). And, the debtor misrepresented to the Sears the soundness of the investment and told Mrs. Sears she would be "a fool" not to invest. (Finding of Fact ¶9-10). In short, the Illinois district court found the debtor made material false representations

to the Sears, and such false representation was necessary to find Mr. Kaufmann violated the Illinois Securities Act.

B. Intent

Regarding the second element of §523(a)(2)(A), that the debtor intended to deceive, the district court found under the Illinois Securities Act and the Illinois Consumer Fraud and Deceptive Business Practices Act, Mr. Kaufmann had such intent. The district court found "Kaufmann misrepresented or concealed, suppressed or omitted material facts *with intent* that plaintiffs rely on the concealment ... of material facts about the returns, stability and legality of the Jesse Fund." (Mem. at 38) (emphasis added). And, "Kauftnann *intended* for plaintiffs to rely on information in the marketing survey . . . . (Findings of Fact ¶14(4)) (emphasis added). In short, the district court determined that the debtor intended to make false representations to the Sears. The Illinois Securities Act requires evidence of such intent.

C. Actual and Reasonable Reliance

Finally, regarding the third element, that the creditor actually and reasonably relied on the debtor's misrepresentations, the district court found the Sears satisfied that element. Under the "materiality" requirement in the Illinois Securities Act, the Sears had to show a substantial likelihood that a *reasonable* investor would consider the misrepresentations important in deciding whether to invest. (Mem. at 36) (emphasis added). Indeed, the district court found that Mr. Kaufmann's omissions were material and the Sears relied upon them as would any reasonable investor. The district court specifically cited the Jesse Fund "marketing summary" as an example of information upon which Mr. Kaufmann intended that the Sears rely. It found the Sears actually relied and "such reliance was not unreasonable." (Finding of Fact ¶14(4)). Additionally, the district court found the

Sears reasonably relied on Mr. Kaufmann's misrepresentations about the illegal nature of the Jesse Fund. (Mem. at 36). Thus, the district court found the Sears actually and reasonably relied on the debtor's misrepresentations to their detriment, and such reliance was necessary to the district court's judgment in favor of the Sears under the Illinois Securities Act.

In light of the Illinois district court's findings of fact and conclusions of law, the debtor is collaterally estopped from relitigating the same issues under §523(a)(2)(A) in bankruptcy court -- false misrepresentation, intent and reliance. Consequently, the Sears have met their burden that there is no triable genuine issue of material fact. Summary judgment in favor of the Sears is appropriate, and their claim should be declared nondischargeable.

D. Attorney's Fees

The Sears also ask that the district court's prepetition award of attorneys' fees and costs be declared nondischargeable. The Seventh Circuit has held that if attorneys' fees are incurred due to fraud, 'then the perpetrator cannot escape the consequences." Matter of Mayer, 51 F.3d 670 (7th Cir. 1995). In Mayer, the court declared both the claim and the prevailing creditor's attorneys' fees from the bankruptcy litigation nondischargeable because the debtor had agreed by contract to reimburse any fees the creditor incurred in collection. Thus, Mayer does not address whether *prepetition* attorneys' fees are considered under §523. However, in Mayer, the court relied on Matter of Luce, 960 F.2d 1277 (5th Cir. 1992), where the Fifth Circuit found attorneys' fees awarded prepetition by a state or federal court are nondischargeable. "When a bankruptcy court determines that the underlying debt is nondischargeable, then 'attorney's fees awarded by a state court based on state statutory or contractual grounds are [also] nondischargeable.'" Id. at 1285. In the present case, the district court awarded the Sears' attorneys' fees and costs. Those fees and costs are attributable to

the debtor's fraud. Accordingly, they too should be declared nondischargeable under §523.

For the foregoing reasons, it is ordered that the motion of the Sears for summary judgment be granted in all respects and judgment may be so entered by the Clerk.