UNITED STATES BANKRUPTCY COURT WESTERN DISTRICT OF WISCONSIN

IN RE: IN BANKRUPTCY NO.:

JAMES and LAURA TAFF, 91-31836-7

Debtors. IN ADVERSARY PROCEEDING NO.:

FRED R. NELSON, 91-3180-7

Plaintiff,

v. MEMORANDUM DECISION:

JAMES TAFF,

Defendant.

On May 22, 1991 the debtor, James Taff ("Taff"), filed a petition under chapter 7 of the Bankruptcy Code. On August 29, 1991 the plaintiff, Fred R. Nelson ("Nelson"), filed this adversary proceeding to determine that the state court judgment entered against the debtor on June 21, 1990, in the amount of $1,514,326.20, plus actual costs and attorneys fees of $21,242.00, is nondischargeable pursuant to 11 USC § 523(a)(6). Nelson also requests "judgment against the debtor in the sum of $1,514,326.20, together with interest from June 21, 1990, and such other and further relief as is just." At a November 5, 1991 pre-trial conference, the parties asked that the matters at issue in this adversary proceeding be considered on briefs. The parties were ordered to submit a statement of facts on which the following is based.

The state court jury returned a special verdict determining that: (1) In February of 1979 Taff had either knowingly or recklessly made an untrue representation of fact to Nelson, with

the intent to deceive and induce Nelson to act upon it. Nelson believed such representation to be true and justifiably relied on it to his pecuniary damage; (2) Taff was a member of a conspiracy to induce individuals to invest in the PDT Partnership under the false pretense that their total liability was limited to the loss of their investment. Nelson was induced to invest in the PDT Partnership by the false pretense that his liability was limited to the loss of his investment, and such false pretense was a cause of pecuniary damage to Nelson; (3) Taff engaged in a pattern of racketeering activity. One or more of the predicate acts that Taff committed as part of the pattern of racketeering activity was committed after April 27, 1982. Nelson was damaged as a result of an incident of the racketeering activity; and (4) $399,775.43 would fairly and reasonably compensate Nelson for his pecuniary damages as to judgments entered against him.[1] $105,000.00 would reasonably compensate Nelson for his other damages. Although Taff's conduct was determined to be wilful, wanton, or outrageous, no punitive damages were assessed.

Judgment was entered on the jury's verdict after trebling the verdict amounts as required by the jury's finding that Taff had

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[1]Taff stipulated that $399,775.43 represented a proper element of damages in Nelson's state court action in the event that the jury found Taff to be liable to Nelson. These damages related to a judgment taken against Nelson by trustee in the PDT Partnership bankruptcy. The transcript of the state court proceedings submitted as an exhibit to the plaintiff's statement of facts indicates that this judgment in favor of the PDT Partnership trustee was premised upon the bankruptcy court's determination that Nelson was a general partner of PDT Partnership and was thus personally liable for the debts of the Partnership.

committed violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 USC §§ 1962 et seq. The court accordingly entered judgment in favor of Nelson and against Taff in the amount of $1,514,326.20. The judgment further ordered Taff to pay reasonable attorneys fees in the amount of $21,242.00. Taff's post-verdict motions challenging the legal and factual sufficiency of the jury's special verdict were denied.

Nelson contends that the state court judgment constitutes a debt for willful and malicious injury under 11 USC § 523(a)(6). He argues that the willfulness and maliciousness of the injury were actually litigated and necessarily decided in the state court action, and that the debtor is collaterally estopped from relitigating any issue under Section 523(a)(6). The debtor, however, asserts that collateral estoppel is inapplicable because "[t]he issue of malicious conduct was not litigated in the state court case and the finding of malicious conduct was not a part of the final judgment."

In Klingman v Levinson, the Seventh Circuit Court of Appeals stated:

> Where a state court determines factual questions using the same standards as the bankruptcy court would use, collateral estoppel should be applied to promote judicial economy by encouraging the parties to present their strongest arguments. Thus, if the requirements for applying collateral estoppel have been satisfied, then that doctrine should apply to bar relitigation of an issue determined by a state court.

Klingman v Levinson, 831 F2d 1292, 1295 (7th Cir 1987), citing Spilman v Harley, 656 F2d 224, 228 (6th Cir 1981). In Matter of Wagner, this court stated:

> Marrese dictates that federal courts must determine a preclusive effect of a state court judgment under a two-part test. First, it is necessary to examine state preclusion law in determining the preclusive effect of a state court judgment. "Only if state law indicates that a particular claim or issue would be barred" is it necessary to move to the second part of the test--whether an exception to [28 USC] section 1738 should apply.[2]

Matter of Wagner, 79 BR 1016, 1019 (Bankr WD Wis 1987), citing Marrese v American Academy of Orthopaedic Surgeons, 470 US 373, 386 (1985).

In Wisconsin, four requirements must be met in order for collateral estoppel to be applied:

> 1. The prior judgment must be valid and final on its merits;
> 2. There must be identity of issues;
> 3. There must be identity or privity of parties;
> 4. The issues in the prior action asked to be invoked must have been actually litigated and necessarily determined.

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[2]28 USC § 1738 provides:

> The Acts of the legislature of any State, Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.
>
> The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.
>
> Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

Wagner, 79 BR at 1019-20 (citations omitted).

The parties in the instant proceeding do not dispute that the state court judgment is valid and final on its merits, or that the parties involved are the same in both the state court and the bankruptcy court actions. The parties do, however, dispute the identity of issues and whether those issues have been actually litigated and necessarily determined. "In order to satisfy the identity of issues requirement the paramount considerations and the burdens of proof must be the same in both proceedings." Wagner, 79 BR at 1020 (citation omitted). The debtor erroneously contends that "[t]he burden is on the plaintiff to establish by clear and convincing evidence each element [of Section 523(a)(6)]." The Supreme Court has recently ruled that "the standard of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the ordinary preponderance-of-the-evidence standard." Grogan v Garner, ___ US ___, 111 S Ct 654, 661 (1991).

The trial transcript submitted as an exhibit to the plaintiff's statement of facts indicates that the jurors were instructed by the state court judge, with respect to each question of the special verdict, to find in favor of the party with the burden of proof if the jurors were satisfied "to a reasonable certainty by the greater weight of the credible evidence" that the question should be answered affirmatively. The judge indicated that "'[b]y the greater weight of the evidence' is meant evidence which weighed against that opposed to it has more convincing power." The greater-weight-of-the-evidence standard is equivalent

to the ordinary preponderance-of-the-evidence standard, so the identity of issues is not destroyed due to a differing burden of proof in this adversary proceeding.

11 USC § 523(a)(6) provides:

> (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 word "willful" means "deliberate or intentional," a deliberate and intentional act which necessarily leads to injury.'" Wagner, 79 BR at 1020 (citations omitted). "[A]n injury may be malicious 'if it was wrongful and without just cause or excessive, even in the absence of personal hatred, spite or ill-will.'" Id. "[W]hat is required [in order to establish "malice"] is that the debtor know[s] that his act will harm another and proceed[s] in the face of that knowledge." Matter of Ries, 22 BR 343, 347 (Bankr WD Wis 1982) (citations omitted). "The law implies malice if anyone of reasonable intelligence knows that the act in question is contrary to commonly accepted duties in the ordinary relationships between people and injurious to another." Matter of Donny, 19 BR 354, 359 n 5 (Bankr WD Wis 1982), citing In re Friedenberg, 12 BR 901, 905 (Bankr SD NY 1981).

The jury in the state court suit determined, inter alia, that the debtor was a member of a conspiracy to induce individuals, including Nelson, to invest in the PDT partnership under the false pretense that their total liability was limited to the loss of their investment, and that such false pretense was a cause of

pecuniary damage to Nelson. The debtor does not dispute that in the state court proceeding his actions were determined to be willful, contending only that the issue of malicious conduct was not actually litigated in the state court case. According to the trial transcript, the jury determined that the debtor was a member of a conspiracy after having been instructed by the court that:

> Before you may find that the defendant was a member of a conspiracy, you must be satisfied from the evidence which is clear, satisfactory and convincing that the conspiracy was knowingly formed, and that the defendant together with at least one other person knowingly participated in the unlawful plan with the intent to advance or further some object or purpose of the conspiracy. "To act or participate knowingly" means to act or participate voluntarily and intentionally, and not because of mistake, accident or other reason. . . . [T]he membership of a defendant in a conspiracy must be established by evidence in the case as to his own conduct by what he himself knowingly said or did.

From examination of this jury instruction it is clear that the jury's verdict that the debtor was a member of the conspiracy includes a determination that the debtor "knowingly participated" in the conspiracy. His actions were "voluntary and intentional," and satisfy the "willfulness" requirement of Section 523(a)(6).

In addition, the jury's verdict includes a determination that the debtor knowingly participated in an unlawful plan to induce Nelson to invest in the PDT Partnership by the false pretense that his liability was limited to the loss of his investment, and that Nelson was damaged thereby. As anyone of reasonable intelligence would know, this action was "contrary to commonly accepted duties in the ordinary relationships between people and injurious to another," and the law therefore implies malice. See Donny, supra.

The debtor knew that his action in representing that PDT was a limited, rather than general, partnership, would harm another and proceeded in the face of that knowledge. The "malice" requirement of Section 523(a)(6) has thus been satisfied.

In the state court action, the parties raised and fully litigated all of the factual issues necessary to resolve this Section 523(a)(6) adversary proceeding. The resolution of those issues was necessary to the outcome of the state court action. The four requirements of collateral estoppel under Wisconsin law have therefore been met.

Before collateral estoppel may be applied to preclude relitigation of willfulness and malice in this adversary proceeding, the Marrese analysis requires the court to determine whether an exception to 28 USC § 1738 should apply. In Wagner, also a Section 523(a)(6) case, this court engaged in a balancing of collateral estoppel-versus-exclusive federal jurisdiction policy considerations in order to arrive at its ultimate conclusion that no exception to Section 1738 should apply. The court stated:

> The policy considerations behind collateral estoppel are judicial economy, promoting reliance on judicial decisions, finality, and strengthening comity interests between federal and courts. . . . The policy in favor of exclusive federal jurisdiction is founded on the desire for uniformity and certainty of decisions by experienced courts.
>
> "[W]here the policies behind preclusion are furthered by reliance on the existing judgment, and where the policies supporting exclusive jurisdiction have no application, relitigation should not be permitted." In this case federal policies favoring exclusive federal jurisdiction would not be curtailed if collateral estoppel were to be applied.

Wagner, 79 BR at 1022 (citation omitted). Similarly, in the instant case, the federal policies favoring exclusive federal jurisdiction would not be curtailed if collateral estoppel were to be applied, and no exception to Section 1738 should be deemed to apply. This being the case, the state court judgment must be given preclusive effect in this adversary proceeding. The elements of Section 523(a)(6) having been fulfilled, the debt represented by the state court judgment is accordingly nondischargeable in the debtor's bankruptcy.[3]

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[3]Although not pled as a cause of action, the court notes that the complaint could be amended to assert that the debt represented by the state court judgment is nondischargeable pursuant to 11 USC § 523(a)(2)(A), and the debtor would be collaterally estopped from relitigating the fraud issue. 11 USC § 523(a)(2)(A) provides:

> 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--for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by--false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition[.]

The Seventh Circuit has stated that:

> To succeed on a claim that a debt is nondischargeable under section 523(a)(2)(A), a creditor must prove three elements. First, the creditor must prove that the debtor obtained the money through representations which the debtor either knew to be false or made with such reckless disregard for the truth as to constitute willful misrepresentation. The creditor also must prove that the debtor possessed scienter, i.e., an intent to deceive. Finally, the creditor must show that it actually relied on the false representation, and that its reliance was reasonable.

In re Kimzey, 761 F2d 421, 423 (7th Cir 1985) (citations omitted).

The state court jury's special verdict determined that in February of 1979 the debtor had either knowingly or recklessly made an

The debtor argues that notwithstanding a determination that the debt represented by the state court judgment is nondischargeable, the treble damage portion of the judgment is a penalty which is dischargeable. This argument must be rejected. Section 523(a)(6) excepts from discharge any "debt" for willful and malicious injury. 11 USC § 101(12) provides that under Title 11 of the United States Code, "'debt' means liability on a claim," and 11 USC § 101(5)(A) defines "claim" for Title 11 purposes as a "right to payment." No distinction is made in Section 523(a)(6) between debts representing claims for compensatory damages and debts representing claims for punitive damages.

In In re Britton the Ninth Circuit Court of Appeals stated:

> We have held that "both compensatory and punitive damages are subject to findings of nondischargeability pursuant to section[] 523(a)(6). . . ." Moraes v. Adams (In re Adams), 761 F.2d 1422, 1423, 1428 (9th Cir.1985). In Adams, the court rejected the debtor's argument that only the punitive portion was nondischargeable under this section. It noted, "The exception is measured by the nature of the act, i.e., whether it was one which caused willful and malicious injuries. All liabilities

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untrue representation of fact to Nelson, with the intent to deceive and induce Nelson to act upon the representation, and that Nelson believed such representation to be true and justifiably relied on it to his pecuniary damage. The verdict thus establishes knowing or reckless misrepresentation, intent to deceive, and actual and reasonable reliance--all three elements of Section 523(a)(2)(A). In the state court action, the parties raised and fully litigated all of the factual issues necessary to resolve a Section 523(a)(2)(A) cause of action, and the resolution of those issues was necessary to the outcome of the state court action. There is no dispute as to identity of parties or validity and finality of the state court judgment. Collateral estoppel would therefore be satisfied under the requirements of Wisconsin law. For the reasons stated above, no exception to Section 1738 would be deemed to apply, and the debt represented by the state court judgment would accordingly be nondischargeable in the debtor's bankruptcy pursuant to Section 523(a)(2)(A).

> resulting therefrom are nondischargeable.'" Id. (quoting Coen v. Zick, 458 F.2d 326, 329-30 (9th Cir.1972).

In re Britton, 950 F2d 602, 606 (9th Cir 1991) (emphasis added in Adams). Similarly, in Wagner, this court stated that "[u]nder section 523(a)(6) the nature of the act gives rise to nondischargeability[.]" Wagner, 79 BR at 1021. Although the issue of the dischargeability of punitive damages was not decided in Wagner, the court cited liberally from Adams as it quoted Coen, including that passage stating that "[b]oth types of liability [for compensatory and punitive damages] are within the statute as 'liabilities' for 'willful or malicious injuries to the person or property of another.'" Wagner, 79 BR at 1021.

The debtor argues that to find that punitive damages are nondischargeable "would result in an unfair windfall to plaintiff and would conflict with the fresh start policies of the Code." The Britton court rejected a similar "fresh start" argument, stating:

> [A]s the Supreme Court has noted, while the "fresh start" is "a central purpose of the [Bankruptcy] Code," this opportunity is limited to the "'honest but unfortunate debtor.'" Grogan v. Garner, ___ U.S. ___, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991) (citation omitted). The Bankruptcy Code has other goals, such as protecting certain classes of creditors; among such creditors are those whom the debtor has harmed by egregious conduct.

Britton, 950 F2d at 606. The Code's interest in protecting the debtor's "fresh start" does not exceed its interest in protecting victims of willful and malicious injury. Accordingly, the debt represented by the state court judgment is nondischargeable in toto

in the debtor's bankruptcy.[4] The plaintiff's additional request for entry of judgment against the debtor in the amount of $1,514,326.20 plus interest from June 21, 1990 is denied, as the state court judgment is itself entitled to full faith and credit in the debtor's bankruptcy proceeding.

Dated May 6, 1992.

ROBERT D. MARTIN
UNITED STATES BANKRUPTCY JUDGE

[4]The debtor makes an additional argument that "Nelson may only recover from Taff those damages which could not be mitigated through the exercise or reasonable care," and asserts that "[r]easonable care to mitigate those damages would have included attempting to settle his case with the [PDT] Trustee prior to receiving judgment [in the state court proceeding] against Taff." This argument is without legal merit and is therefore rejected without further discussion.

UNITED STATES BANKRUPTCY COURT WESTERN DISTRICT OF WISCONSIN

IN RE:

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Debtors.

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91-31836-7

IN ADVERSARY PROCEEDING NO.:

91-3180-7

FRED R. NELSON,

Plaintiff,

v.

JAMES TAFF,

Defendant.

FILED

MAY 6 1992

CLERK, U.S. BANKRUPTCY COURT

CASE NO.

ORDER:

The court having this day entered its memorandum decision in the above-entitled matter,

IT IS HEREBY ORDERED that the state court judgment entered against the debtor on June 21, 1990, in the amount of $1,514,326.20, plus actual costs and attorneys fees of $21,242.00, is nondischargeable pursuant to 11 USC § 523(a)(6).

Dated May 6, 1992.

Robert D. Martin

ROBERT D. MARTIN
UNITED STATES BANKRUPTCY JUDGE

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MEMORANDUM DECISION AND ORDER:

Copies of this Memorandum Decision and Order were mailed to the following parties on May 6, 1992:

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