SO ORDERED.

SIGNED this 24 day of June, 2005.

LARRY E. KELLY
UNITED STATES CHIEF BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
EL PASO DIVISION

IN RE:	§	
	§	
RONNIE LEE MORGAN,	§	**CASE NO. 00-32072-LK**
	§	
Debtor.	§	**Chapter 7**
JOHN MICHAEL VERLANDER and SHARON VERLANDER,	§	
	§	
Plaintiff	§	
	§	
v.	§	**ADV. NO. 00-3051**
	§	
RONNIE LEE MORGAN,	§	
	§	
Defendant.	§	

FINDINGS OF FACT AND CONCLUSIONS OF LAW
IN SUPPORT OF ORDERS
GRANTING IN PART, AND DENYING IN PART,
PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT
AND DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Both parties in this matter filed Motions for Summary Judgment. One Motion for Summary Judgment was filed on February 8, 2005, on behalf of the Plaintiffs, John Michael and Sharon Verlander ("Plaintiffs"), and the other Motion for Partial Summary Judgment was filed

on October 6, 2004, on behalf of the Debtor and Defendant herein, Ronnie Lee Morgan ("Defendant").

SUMMARY OF RELIEF REQUESTED

The court has reviewed the Motions and responses thereto, as well as the summary judgment evidence submitted by the parties. In particular, the court has considered:

date filed	docket entry no.	document
10/06/2004	4	Defendant's Motion for Partial Summary Judgment
10/12/2004	15	Exhibits to Defendant's Motion for Partial Summary Judgment
10/26/2004	16	Plaintiffs' Response, with exhibits, to Defendant's Motion for Summary Judgment
11/08/2004	22	Defendant's Brief/Memorandum of Law in Support of his Motion for Partial Summary Judgment
2/08/2005	27	Plaintiffs' Motion For Summary Judgment, with exhibits
2/24/05	33	Defendant's Response to Plaintiffs' Motion For Summary Judgment
3/14/05	35	Plaintiffs' Reply to Defendant's Response to Plaintiffs' Motion for Summary Judgment

The court issued orders providing that no hearing on the Motions would be conducted, but rather that they would be determined on the pleadings and evidence submitted. The court now makes its findings of fact and conclusions of law in support of its Orders Denying in Part and Granting in Part Plaintiffs' Motion for Summary Judgment and Defendant's Motion for Partial Summary Judgment, entered contemporaneously herewith. This court has jurisdiction pursuant to 28 U.S.C. § 1334. This is a core proceeding over which the court has jurisdiction under 28 U.S.C. § 157(b).

Plaintiffs request in their Motion that the court enter summary judgment in their favor and against the Defendant, holding that, the Defendant is collaterally estopped from contesting, and they are therefore entitled to judgment as a matter of law declaring, that the Plaintiffs' claim against Defendant, in the amount of $1,306,261.06, with interest thereon at the rate of 10% per annum, compounded annually from and after September 19, 2000, plus post-judgment attorneys

fees, is fully non-dischargeable under 11 U.S.C. § 523(a)(2), (4) and/or (6).[1] In support, Plaintiffs offer (among other things) a Final Judgment (the "Judgment") entered in the 210th Judicial District Court of El Paso County (the "State Court"), awarding them judgment in those amounts.

Defendant in his Motion for Partial Summary Judgment addresses the exact same issue (and argues the converse, of course), requesting that the court "hold that Plaintiffs' state court judgment is not entitled to collateral estoppel effect in this litigation." In addition, this court construes Defendant's Motion for Partial Summary Judgment as his request for summary judgment on his affirmative defense, against the Plaintiffs' use of collateral estoppel, of extrinsic fraud in the procurement of the Judgment.

LEGAL ANALYSIS

Summary Judgment Standard

Bankruptcy Rule 7056 applies Rule 56(c) of the Federal Rules of Civil Procedure to adversary proceedings. Summary judgment is appropriate "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." Fed.R.Civ.P. 56(c); **Celotex Corp. v. Catrett**, 477 U.S. 317, 322-23 (1986).

In deciding whether to grant summary judgment, the court views the evidence in the light most favorable to the party opposing summary judgment and indulges all reasonable inferences in favor of that party. **Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.**, 475 U.S. 574, 587 (1986); **Allen v. Rapides Parish School Board**, 204 F.3d 619, 621 (5th Cir. 2000). Once a movant has come forward with sufficient evidence to support summary judgment, the burden is on the non-movant to "go beyond the pleadings and designate specific facts in the record showing there is a genuine issue for trial." **Wallace v. Texas Tech University**, 80 F.3d 1042, 1047 (5th Cir. 1996); **Mississippi River Basin Alliance v. Westphal**, 230 F.3d 170, 174 (5th Cir. 2000) (citing **Anderson v. Liberty Lobby, Inc.**, 477 U.S. 242, 248-49 (1986)). A fact question is "material" if it involves "disputes over facts that might effect the outcome of the suit." **Anderson**, 477 U.S. at 248. To meet this burden, the nonmovant must set forth specific facts, by affidavits or otherwise, showing that there is a genuine issue for trial. **Topalian v.**

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[1] It is important to note that Plaintiffs have *not* requested that the court grant them summary judgment on the grounds that, upon review of the evidence submitted in the State Court suit (much of which, such as all the testimony, has been submitted in support of the Plaintiffs' Motion for Summary Judgment), there exists no genuine issue as to any material fact relevant to their causes of action under 11 U.S.C. § 523(a)(2), (4) and (6), and they are for that reason entitled to judgment as a matter of law. Rather, the Plaintiffs have limited their argument to one of collateral estoppel.

Ehrman, 954 F.2d 1125, 1132 (5th Cir.), *cert. denied*, 506 U.S. 825 (1992). "Unsubstantiated assertions, improbable inferences, and unsupported speculation are not sufficient to defeat a motion for summary judgment." **Brown v. City of Houston**, 337 F.3d 539, 541 (5th Cir. 2003). Additionally, "[g]uesswork and speculation simply cannot serve as a basis" for sending a case to trial. **Brown v. CSC Logic**, 82 F.3d 651, 658 (5th Cir. 1996).

"After the non-movant has been given the opportunity to raise a genuine factual issue, if no reasonable juror could find for the non-movant, summary judgment will be granted." **Id.** (citing **Celotex,** 477 U.S. at 322, and Fed.R.Civ.P. 56(c)); **River Prod. Co., Inc. v. Baker Hughes Prod. Tools, Inc.**, 98 F.3d 857, 859 (5th Cir. 1996). To the extent facts are undisputed, a court may resolve a case as a matter of law. **Celotex**, 477 U.S. at 323; **Blackwell v. Barton**, 34 F.3d 298, 301 (5th Cir. 1994). The Fifth Circuit Court of Appeals has stated "[t]he standard of review is not merely whether there is a sufficient factual dispute to permit the case to go forward, but whether a rational trier of fact could find for the non-moving party based upon the evidence before the court." **James v. Sadler**, 909 F.2d 834, 837 (5th Cir. 1990) (citing **Matsushita Elec.,** 475 U.S. at 586).

Should the Judgment Be Given *Any* Preclusive Effect?

The initial issue presented for decision is whether the state court judgment should be given any preclusive effect. In that regard the court has to determine: (1) whether the facts were "actually litigated" since the Defendant's pleadings had been stricken and he was not present during the trial; (2) whether the Defendant has shown a triable issue on his allegation that the state court judgment was procured by extrinsic fraud; and (3) whether the facts found by the jury were essential to the state court judgment.

The threshold issue however is the principle of preclusion. "[C]ollateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a)." **Grogan v. Garner**, 498 U.S. 279, 284 n.11 (1995). "Our inquiry into the preclusive effect of a state court judgment is guided by the full faith and credit statute which provides that the 'judicial proceedings of any court of any . . . state shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken.'" **In re Garner**, 56 F.3d 677, 679 (5th Cir. 1995)[2] (citing 28 U.S.C. § 1738 and **Marrese v. American Academy of Orthopaedic Surgeons**, 470 U.S. 373, 380 (1985)). As the Supreme Court has noted:

> This statute directs a federal court to refer to the preclusion law of the State in which judgment was rendered. "It has long been established that § 1738 does not allow federal courts to employ their own rules of res judicata in determining the effect of state judgments. Rather, it goes beyond the common law and commands

[2] *Overruled on other grounds by* **Kawaauhau v. Geiger**, 523 U.S. 57, ____, 118 S.Ct. 974, 977 (1998).

> a federal court to accept the rules chosen by the State from which the judgment is taken."

Marrese, 470 U.S. at 380 (quoting **Kremer v. Chemical Constr. Corp.**, 456 U.S. 461, 481-82 (1982)).

In particular, a bankruptcy court must "look to the state that rendered the judgment [at issue] to determine whether the courts of that state would afford the judgment preclusive effect." **Gober v. Terra + Corporation (In re Gober)**, 100 F.3d 1195, 1201 (5th Cir. 1996). Here, the State Court Judgment was entered by a Texas court; this court must therefore look to Texas law on collateral estoppel. **Id.**; *accord,* **Gupta v. Eastern Idaho Tumor Institute (In re Gupta)**, 394 F.3d 347, 351 n.4 (5th Cir. 2004) (Texas state rules governing collateral estoppel applied where state court judgment was rendered by a Texas court, applying Texas law), *citing* **In re Schwager v. Fallas (In re Schwager)**, 121 F.3d 177, 181 (5th Cir. 1997).

"Under Texas law, collateral estoppel 'bars relitigation of any ultimate issue of fact actually litigated and essential to the judgment in a prior suit, regardless of whether the second suit is based upon the same cause of action.'" **Garner**, 56 F.3d at 679 (citing **Bonniwell v. Beech Aircraft Corp.**, 663 S.W.2d 816, 818 (Tex. 1984)). Texas law sets forth the elements necessary for collateral estoppel:

> A party seeking to invoke the doctrine of collateral estoppel must establish (1) the facts sought to be litigated in the second action were fully and fairly litigated in the prior action; (2) those facts were essential to the judgment in the first action; and (3) the parties were cast as adversaries in the first action.

Garner, 56 F.3d at 680; *accord,* **Gupta**, 394 F.3d at 351 n.4.

Plaintiffs assert that all of these elements are present in this case, and bears the burden of proof of that assertion. **Fielder v. King (In re King)**, 103 F.3d 17, 19 (5th Cir. 1997) ("The party asserting issue preclusion bears the burden of proof."). Defendant does not dispute that the third element–that the parties were adversaries in the state court action–is satisfied. However, as discussed in detail below, he does argue that neither of the other two elements are met, for any of the causes of action alleged by Plaintiffs in this adversary proceeding.

Whether the Facts Were "Actually Litigated," Since the Defendant's Pleadings Were Struck by the State Court and He Was Not Present at the Damages Trial

Defendant's first argument is that because his pleadings were struck by the State Court as a sanction for discovery abuses, the issue of whether he was liable on the Plaintiffs' causes of action was not tried in the State Court; thus, facts which are material to the Plaintiffs' non-dischargeability actions were not "actually litigated" in the prior litigation, as required for the principles of collateral estoppel to apply.

The **Garner** court delineated the factors that Texas courts find necessary to determine whether issues were "actually" or "fully and fairly" litigated in the first action, when a party has failed to appear in part or all of that action:

> According to Texas law, a default judgment is a judgment entered after no answer has been filed. By contrast, the Texas Supreme Court has described the "judgment where a defendant has answered but fails to appear for trial" as a "post-answer 'default' judgment." In a simple default judgment, "it is said that the non-answering party has 'admitted' the facts properly pled and the justice of the opponent's claim." The Texas Supreme Court has described a different situation for a post-answer default, which "constitutes neither an abandonment of defendant's answer nor an implied confession of any issues thus joined by the defendant's answer." Accordingly, "[i]n a post-answer default, the defendant's answer places the merits of the plaintiff's cause of action at issue." Thus, in a post-answer default judgment situation, "[j]udgment cannot be entered on the pleadings, but the plaintiff in such a case must offer evidence and prove his case as in a judgment upon a trial."

Garner, 56 F.3d at 680 (citations omitted); *see also* **In re Pancake**, 106 F.3d 1242, 1244 (5th Cir. 1997) ("[W]here the defendant files an answer but fails to appear at trial, the court may not enter judgment based solely upon the pleadings; the plaintiff must present evidence sufficient to satisfy the traditional evidentiary burden.").

In **Garner**, the defendant answered the petition, but failed to respond to the plaintiff's request for admissions. The defendant failed to appear for trial, but the court heard evidence, including the Plaintiff's testimony, and entered a judgment in favor of the plaintiff. In that judgment, the state court expressly stated, among other things, that "[b]ased on the testimony presented, . . . [the d]efendants acted with spite, ill-will and malice" and it awarded actual damages as well as punitive damages, attorneys fees, and pre- and post-judgment interest. The bankruptcy court later gave that judgment preclusive effect in the plaintiff's non-dischargeability action, granting the plaintiff's request for summary judgment, and the Fifth Circuit Court of Appeals upheld the bankruptcy court's decision.

In this case, unlike in **Garner**, the court *struck* the Defendant's answer, making the situation, at least on its face, similar to a simple default judgment, or "no-answer default" as it was described by the court in **Pancake,** 106 F.3d at 1244. In **Pancake** the Fifth Circuit Court of Appeals did address this "stricken-answer default" situation. There the defendant had filed an answer which, as in this case, the court struck because the defendant had failed to comply with discovery orders. Also like this case, the defendant did not appear at trial and the court entered a default judgment against him. While acknowledging that the entry of the judgment after the striking of the answer created a situation similar to the no-answer default, the Court of Appeals distinguished the situation, and held that in some instances a stricken answer default may satisfy the "fully and fairly litigated" element of collateral estoppel and be given preclusive effect:

> For purposes of collateral estoppel, however, the critical inquiry is not directed at the nature of the default judgment but, rather, one must focus on whether an issue was fully and fairly litigated. Thus, even though [the defendant's] answer was struck, if [the plaintiff] can produce record evidence demonstrating that the state

> court conducted a hearing in which [the plaintiff] was put to its evidentiary burden, collateral estoppel may be found to be appropriate.

Pancake, 106 F.3d at 1244-45. The Court of Appeals then ruled that the creditor in that case had failed to establish that the requisite evidentiary showing had been made in state court, and so the bankruptcy court erred in giving collateral estoppel effect to the state court judgment.

Even more than in the **Pancake** case, the facts addressed by the Fifth Court of Appeals in **In re Gober** are similar to those in this case. *See* **Gober**, 100 F.3d 1195. The bankruptcy court there, after a hearing at which the defendant and his counsel purposely did not appear, struck his answer for failure to respond to discovery, and entered a default judgment. The court then specifically found, "after hearing the evidence and arguments of counsel," that the defendant had "'embezzled, converted, appropriated and . . . stole[ ] . . . $307,284.96' from [the plaintiff] and that he 'acted with fraudulent intent' and 'acted maliciously and willfully.'" **Id.** at 1205. It awarded judgment for the plaintiff that included actual damages, exemplary damages, attorney's fees, and post-judgment interest. More than eight years later, the defendant filed bankruptcy, and the plaintiff filed a motion for summary judgment declaring the entire debt to be non-dischargeable under § 523(a)(2), (4) and/or (6), as the Plaintiffs have done in this case.

The Court of Appeals first noted that punitive damages could not have been awarded by default under Texas law, which necessarily required a specific finding of conduct that was wanton and malicious, and/or done with malice or fraud. **Id.**, *citing* **Sunrizon Homes, Inc. v. Fuller**, 747 S.W.2d 530, 534 (Tex.App.–San Antonio1988, writ denied) ("to sustain an award of additional damages in this default judgment, appellees must both plead knowing conduct and present evidence that the extent of appellant's knowledge warrants additional damages. . . . Punitive damages are not regarded as admitted by the default."); *see also* **Fleming Mfg. Co., Inc. v. Capitol Brick, Inc.**, 734 S.W.2d 405 (Tex.App.–Austin 1987, writ ref'd, n.r.e.) (the award of additional damages under Texas DTPA, like punitive damages, is discretionary; therefore, although defendant admitted by his default that his conduct was knowing, whether that conduct was sufficient to support the amount of additional damages that were awarded was not admitted by default but must be proven by the plaintiff). In **Gober**, the state trial court in fact had expressly made a such finding, that the debtor had acted maliciously and willfully, after a trial at which he was entitled to appear and contest the extent of his culpability, if not his liability *per se*. Therefore, the Court of Appeals held, the plaintiff had been required to meet its

evidentiary burden of proof on the issue of whether the debtor's conduct was willful and malicious for purposes of non-dischargeability under § 523(a). **Id.**

While the Court of Appeals in **Gober** declined to establish a *per se* rule that a default judgment that includes punitive damages must be given preclusive effect, the Court did hold that preclusive effect was permissible and appropriate in light of the procedural safeguards that the debtor in that case had been afforded, noting that he had actively participated in the litigation and "did not simply give up at the outset [and choose] not to litigate for reasons that have nothing to do with the merits of the case . . .." **Id.** Instead, the Court pointed out, the debtor's pleadings had been struck only after he "had repeatedly impeded the course of the proceedings by refusing to comply with discovery and by defying court orders." **Id**. at 1205-06. Such facts, the Court felt, bolstered a conclusion that the state court judgment should be given preclusive effect. **Id.** at 1206 (agreeing with the Restatement [Second] that "even if [an issue] was not litigated, the party's reasons for not litigating in the prior action [were] such that preclusion would be appropriate").

In this case, the circumstances supporting giving preclusive effect to the Judgment are more compelling than those present in **Garner**, **Pancake**, and even **Gober**. The Defendant's answer was struck because of *egregious* discovery abuses, which the evidence showed and the court expressly found he *personally* had engaged in. The trial judge in his Supplemental Order for Sanctions stated:

> Based upon the testimony introduced at the trial and other exhibit evidence presented, as well as the arguments of counsel, the Court finds that Defendant intentionally manufactured and fabricated false evidence and thereafter attempted to tamper with the authentic business records of Classics by CBI (after Classics by CBI had been subpoenaed to produce their business records) and Design Directions (where, upon complying with the subpoena to produce their records, provided documents that clearly came from Defendant's possession and were not business records maintained by the deponent). . . . Defendant's conduct was flagrantly [sic] and in bad faith.

Plaintiffs' Exh. D, page 1. *See also* Plaintiffs' Exh. H, vol, 6, pp. 22-23 (where the State Court judge noted at trial that, "considering all that [evidence introduced by Plaintiffs] and the - silence of the defendant, we're talking about - we're not talking about his lawyers; they've worked as hard as they could, but the defendant himself could have certainly come into Court and - and - and - looked everyone in the eye and rebutted that.").

Defendant, while not personally present at the original sanctions hearing, participated fully in it through his counsel, even filing a post-hearing brief with supporting evidence. *See* Defendant's Exh. 8, Motion for New Trial, Exhibit A thereto ("Defendant's Response to Plaintiffs' Brief in Support of Striking Defendant's Pleadings"). In addition, there was a full jury trial, lasting four days,[3] of which Defendant had proper notice. As discussed above, the jury's award of punitive damages, after they considered the evidence presented at the trial, necessarily means that they found that the conduct the Plaintiffs alleged the Defendant had engaged in, had in fact occurred. Moreover, the transcript shows that the Defendant vigorously defended the suit.

In particular, although the Defendant may have personally been absent, he testified by deposition [Plaintiffs' Exh. H, vo.5, pp. 51-135], and his counsel fully participated in the trial by: cross-examining witnesses [Plaintiffs' Exh. G, pp. 131-170, 192-194, Exh. H, vol. 4, pp. 100-136, 221-228, Exh. H, vol. 5, pp. 156-162, 166]; objecting to testimony [Plaintiffs' Exh. G, pp. 93, 103, 105, 190, Exh. H, vol. 4, pp. 60-61, 63, 65, 73, 82-83, 89, 90, 92, 94, 99; Exh. H, vol. 5, pp. 115, 123-125] and to documentary evidence [Plaintiffs' Exh. H, vol. 4, pp. 209-10, vol. 6, p. 16]; and even offering the Defendant's own exhibits [Plaintiffs' Exh. G, pp. 10-17; Exh. H, vol. 4, pp. 10, 102, and vol. 5, pp. 11, 157, 170] and witness [Plaintiffs' Exh. H, vol. 5, pp. 209-218, 221-222]. His counsel "invoked the rule" [Plaintiffs' Exh. G, pp. 42-43], and moved for both mistrials [Plaintiffs' Exh. G, p. 177, Exh. H, vol. 6, p. 110] and directed verdicts [Plaintiffs' Exh. H, vol. 5, pp.172-92, vol. 6, pp. 25-30] on more than one occasion. Finally, Defendant's counsel made extensive arguments objecting to the State Court's charge to the jury and requesting his own submissions to that charge [Plaintiffs' Exh. H, vol. 6, pp. 30-66], most which were, admittedly, denied but some of which were granted.

Based on the foregoing and the transcript of the trial taken as a whole, it is clear that the Plaintiffs were "put to their evidentiary burden" at the trial.[4] This was not a case where a

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[3] August 21, and September 6-8, 2000. *See* Plaintiffs' Exhs. G and H, trial transcript.

[4] These facts alone justify this court's holding that the Judgment should be given preclusive effect despite its default nature. Certain facts even more strongly indicate that the issues were "actually litigated" in this case. In particular, the documents and trial transcript show that after both sides had rested, the State Court judge was asked by Defendant's counsel to reconsider his order striking the Defendant's pleadings. Plaintiffs' Exh. H, vol. 5, pp. 179, 195-97, vol. 6, pp. 19-21. The judge allowed Defendant's counsel to file a "supplemental pleading," asserting new defenses, although admittedly stating that he did so only so that he could strike

defendant had no notice of what issues were to be tried, and/or no incentive to litigate those issues. Rather, he not only knew what was at issue, but actively and fully participated through counsel. If, for "strategic" reasons, the Defendant and his counsel decided that he should absent himself from the trial, he should not now be able to hide behind that decision to escape the consequences of a properly noticed and conducted jury trial. *See* **Gober**,100 F.3d 1195, 1202 (5th Cir. 1996) ("Where [the defendant/debtor] received notice of all hearings that were conducted but chose not to appear, he did so at his peril.").

Based on the foregoing, then, it appears that despite the default nature of the Judgment, the facts were "actually litigated" in the state court suit.

Whether Defendant Has Shown a Triable Issue as to Whether the State Court Judgment Was Procured by Extrinsic Fraud

Defendant's second position argues, however, that Texas law would still not give the judgment preclusive effect, because his reasons for absenting himself from the trial were not merely strategic but rather were the result of extrinsic fraud perpetrated on him by his own counsel. He asserts that the facts were not "fully and fairly litigated" because his state court counsel, Glen Aaron, advised him not to appear at the sanctions hearing, not to appear at trial,

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that pleading as well, "commenting that 'after hearing the full trial, I'm more convinced than ever that my ruling was correct in the first instance." *See* Defendant's Exh. 5, Memorandum Opinion of the Court of Appeals, page 6, citing to transcript at Plaintiffs' Exh. H, vol. 6, p. 15).

The trial court's second sanctions order itself (entered on the last day of trial, after the close of evidence) expressly provides that the judge's decision to again strike all of the Defendant's pleadings was made *after* the trial was conducted, and the transcript shows that the judge considered the Defendant's request to reconsider the sanctions in light of *all* the evidence presented at trial. *See* Plaintiffs' Exh. D, Supplemental Order for Sanctions (providing that it was "[b]ased upon the evidence introduced at trial of the above-referenced cause, as well as Defendant's attempt during the trial to file additional pleadings, assert additional defenses, and seek the submission of jury issues and/or instructions").

The judge clearly saw the Defendant's failure to effectively rebut the evidence presented at trial as his voluntary choice and/or as indicative of the weakness of his case, not as due to some procedural disadvantage resulting from the earlier sanctions order. In granting the Plaintiffs' motion for directed verdict on liability after both sides rested, the judge told Defendant's counsel that his client had had "the opportunity to marshal more evidence on the issue of those invoices and what happened or appeared to happen and so on not only for the Court's benefit but for the jury's benefit because some of this came out in front of the jury. And then you could have rebutted it, if you could. . . . And I also think the defendant could have appeared at trial to explain his side of it, but he chose not to for whatever reason." Plaintiffs' Exh. H, vol. 6, pp. 21; *see also* p. 22 (where the judge further commented that, "looking at all of the evidence and everything that happened[,] the defendant was the one in a position to come forward with more evidence to clarify whether he was[,] let's say[,] not guilty, we didn't do these things, but he chose to remain silent in regard to this . . ..").

and in general failed to represent him adequately, all as part of a fraudulent scheme to cause him to suffer the judgment,

> presumably to put his client in a bind and in need of legal services which Aaron could provide and thereby make himself look like a hero. Aaron knew Morgan was planning to marry Jackie Spencer and that Mrs. Spencer had significant financial assets. Aaron wanted access to those assets.
>
> Defendant's Motion for Partial Summary Judgment, p. 9.

The Defendant argues that Aaron failed to obtain testimony, hire accountants, and organize the evidence in a way that would have explained the transactions at issue, and did not challenge the sanctions order. According to Defendant, Aaron directed him not to appear at the sanctions hearing nor at the trial, when Defendant's testimony was necessary to avoid the striking of his pleadings and to prevail at trial. Prior to trial, he argues, his counsel also acted unreasonably and provokingly in his dealings with opposing counsel, which prevented a mediated settlement, and did not transmit to the Defendant a settlement offer that was made. These acts all resulted in the entry of the State Court Judgment, which in turn provided Aaron the opportunity to advise the Defendant to file bankruptcy, and to then provide, after that filing, "asset protection services" to the Defendant. Aaron set up trusts naming himself as primary beneficiary, and managed several of Defendant's and/or his wife's assets, allegedly for his own (Aaron's) financial benefit. These activities, Defendant alleges, led to Aaron's arrest and conviction for conspiracy to commit bankruptcy fraud and conspiracy to commit money laundering.

Defendant claims Aaron's actions amounted to "extrinsic fraud," that caused the Judgment to be entered against him and, therefore, under Texas law the Judgment is void and should be given no collateral estoppel effect. *See generally,* **Williams v. White**, 223 S.W.2d 278 (Tex.Civ.App.–San Antonio 1949, writ refused) ("Ordinarily a judgment which has been taken to the highest court of the State will operate as an estoppel under the rules of res judicata. However, a judgment which is void or has been set aside upon a direct equitable attack will not be operative."); **King Ranch, Inc. v. Chapman**, 118 S.W.3d 742, 751-52 (Tex. 2003), *cert. denied,* **Chapman v. King Ranch, Inc.**, _____ U.S. _____,124 S.Ct. 2097 (2004) (defining a bill of review as "an equitable proceeding to set aside a judgment that is not void on the face of the record but is no longer appealable or subject to a motion for new trial" and noting that "[o]nly extrinsic fraud will support a bill of review.").

In response to this argument, Plaintiffs raise the preliminary issue of whether Defendant should be estopped to make this "extrinsic fraud" argument because he didn't raise it on appeal of the Judgment. *See* Plaintiffs' Response to Defendant's Motion for Partial Summary Judgment, pp. 30-31. Clearly, if Defendant had *actually* raised the issue on appeal and if the appellate courts had rejected the argument, then Defendant would be barred by collateral estoppel, or issue preclusion, from raising the argument again. *See* **Browning v. Navarro**, 826

F.2d 335, 342 (5th Cir. 1987) (bankruptcy court may not review a judgment of another court to determine if it was void for lack of jurisdiction or because procured by fraud, if those issues had already been determined by a prior judgment).[5] However, there is no indication from the appellate opinions or any other summary judgment evidence that the extrinsic fraud issue was "actually litigated" in the appeal, and in fact Plaintiffs' contentions are that it was *not* raised on appeal. *See* Plaintiffs' Exhs. I (Memorandum Opinion of the Eighth Court of Appeals), J (Defendant's Petition to the Texas Supreme Court for Review), and K (Texas Supreme Court's Order Denying Petition for Review).

The Plaintiffs do not expressly argue that res judicata, or claim preclusion, should also or instead bar the Defendant's extrinsic fraud defense to their use of collateral estoppel, but their reasoning is consistent with that argument. Unlike collateral estoppel, "[r]es judicata, or claims preclusion, prevents the relitigation of a claim or cause of action that has been finally adjudicated, as well as related matters that, with the use of diligence, should have been litigated in the prior suit." **Barr v. Resolution Trust Corp.**, 837 S.W.2d 627, 628 (Tex. 1992), *citing* **Gracia v. RC Cola-7-Up Bottling Co.**, 667 S.W.2d 517, 519 (Tex. 1984) and **Bonniwell v. Beech Aircraft Corp.**, 663 S.W.2d 816, 818 (Tex. 1984). The Plaintiffs appear to argue that Defendant should have known about the alleged extrinsic fraud in time to raise it before the trial or appellate courts, but never did. Plaintiffs' Response to Defendant's Motion for Partial Summary Judgment, p. 31. (It may be that the Plaintiffs merely argue that Defendant has not met his burden, required to overturn a judgment for extrinsic fraud, of showing that he used diligence in challenging the Judgment. The elements of res judicata and this "diligence" element of the extrinsic fraud defense do overlap to some extent. The Defendant's showing of diligence is discussed further below.)

It is unlikely that Texas law, which permits extrinsic fraud to be raised in a bill of review proceeding after a judgment is final and non-appealable, would find that the matter is one that "should have been litigated in the prior suit." To the extent **Miller v. Meinhard-Commercial Corp.**, 462 F.2d 358, 361 (5th Cir. 1972), cited by Plaintiffs, indicates otherwise, that case is distinguishable because it applied federal, not Texas, law and because the discussion of the issue was only *dicta*, since the Court there found that the allegations did not amount to extrinsic fraud (and so clearly could not have been raised in a collateral attack on the prior order).

In any event, the summary judgment evidence here is inconclusive on whether Defendant's extrinsic fraud claim was known or should have been known to him during the appeal and so *could have been* raised during the appeal. There is only evidence of the date of the

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[5] Although the Court of Appeals in **Browning** refers to the "res judicata" effect of the prior judgment, it appears from the opinion that in the prior litigation, the court had actually expressly addressed and ruled on the extrinsic fraud issue the Court of Appeals was being asked to rule on. The Court of Appeals was therefore considering collateral estoppel, i.e., issue preclusion, rather than res judicata or claim preclusion.

last appellate decision, July 9, 2004 (*see* Plaintiffs' Exh. K, Order of the Supreme Court denying Defendant's Motion for Rehearing of the Order Denying his Petition for Review), as compared to the Defendant's general statements that sometime "after the trial" he learned that a settlement offer had been made but not relayed to him, and that in "early 2003" and "late 2003" he learned of the true terms of the Trusts set up by Aaron. *See* Defendant's Exh. 9, Affidavit of Ronnie Lee Morgan. Based on this slim record, the court is unable to say that no genuine issue of material fact exists as to what Defendant knew or should have known at the relevant times, and so concludes that res judicata, even if legally applicable, does not bar the extrinsic fraud defense presented by Defendant's Motion for Partial Summary Judgment.

That is not to say that there are *no* limitations on an extrinsic fraud defense. In order to set aside a judgment that is not void on the face of the record and that is no longer appealable or subject to a motion for new trial, a party "must ordinarily plead and prove (1) a meritorious defense to the cause of action alleged to support the judgment, (2) that the [party] was prevented from making by the fraud, accident or wrongful act of his or her opponent, and (3) the [party] was not negligent." **King Ranch, Inc. v. Chapman**, 118 S.W.3d 742, 751-52 (Tex. 2003), *cert. denied,* **Chapman v. King Ranch, Inc.**, _____ U.S. _____,124 S.Ct. 2097 (2004), *quoting* **Alexander v. Hagedorn**, 148 Tex. 565, 568-69, 226 S.W.2d 996, 998 (1950). The Defendant, as the movant requesting summary judgment on an affirmative defense (such as extrinsic fraud), has the burden of conclusively establishing that defense. *See* **Rhone-Poulenc, Inc. v. Steel,** 997 S.W.2d 217, 223 (Tex. 1999) (applying rule to affirmative defense of limitations).

Defendant argues at length that his attorney engaged in fraud, but does not even describe, let alone offer summary judgment evidence to show, that he had a meritorious defense to the Plaintiffs' claims, which he was prevented from presenting because of the alleged fraud. At most, he merely asserts that his attorney: (1) did not present certain evidence that would have "explained" a duplicate invoice (with no indication of what that explanation would have been, other than a reference to an affidavit of a witness obtained after trial, that provides little more than "I don't remember . . ." "I don't know why . . .," and the assertion that "certainly Ron Morgan did not tell me what to put on the invoice"); (2) did not hire an accountant to organize the evidence that would have "made sense of" that evidence (with no indication of what that "sense" would have been, and ignoring that the Defendant himself did hire an accountant, whose testimony at trial was that he was unable to "explain" duplicate invoices or comment on apparent overcharges); and (3) instructed the Defendant not to attend the court proceedings, when "the only defense . . . was Morgan's side of the story" (which "side of the story" is not even hinted at).

This summary judgment evidence offered by the Defendant is insufficient to establish there is a genuine issue of material fact as to a defense he would have presented if the alleged "extrinsic fraud" of his counsel had not occurred.

In addition, contrary to Defendant's assertions in his Motion for Partial Summary Judgment,[6] Texas courts *have* expressly held that misconduct–even fraud–by *one's own* counsel (in contrast to an action by the opposing party or his counsel) does not constitute extrinsic fraud that would permit a court to void a final judgment. *See e.g.*, **King Ranch,** 118 S.W.3d at 52 ("[A]llegations of fraud or negligence on the part of a party's attorney are insufficient to support a bill of review [to set aside a final judgment]. . . . Thus, a bill of review petitioner who alleges that the wrongful act of his or her attorney caused an adverse judgment is not excused from the necessity of pleading and proving his or her opponent's extrinsic fraud."); *accord*, **Transworld Financial Services Corp. v. Briscoe**, 722 S.W.2d 407, 407-08 (Tex. 1987). Here, Defendant has made not even made an allegation, let alone offered any evidence, that Plaintiffs had *anything* to do with, or even knew of, the actions he says amounted to extrinsic fraud resulting in the State Court Judgment.

Finally, the Defendant has offered no evidence whatsoever on the third and last requirement for establishing a right to relief from the judgment: that he was not negligent in allowing the fraud to take place. *See also* **King Ranch,** 118 S.W.3d at 52 ("A bill of review is proper where . . . there remains no . . . adequate legal remedy still available because, *through no fault of the bill's proponent*, fraud, accident, or mistake precludes presentation of a meritorious claim or defense.") (emphasis added).

Moreover, even if all Defendant had to show was his attorney's fraudulent conduct in order to void the State Court Judgment, the court finds that the evidence that Defendant has provided on the issue is inadequate to raise a genuine issue of fact. In support of his allegations of extrinsic fraud, Defendant offers as summary judgment evidence his own Affidavit (Defendant's Exh. 9), a "Judgment in a Criminal Case" against Glen Aaron (Defendant's Exh. 3), the Trust Agreements creating the "657 Trust" and on the "Ronnie Lee and Jackie Spencer Morgan Trust" (Defendant's Exh. 10, 11), and a letter from Aaron to opposing counsel, with a copy to the state court judge, requesting mediation (Defendant's Exh. 7).

The Judgment in a Criminal Case contains no information as to the factual basis for the conviction, except a recital of the dates when the conduct occurred, December 21, 1999, to January 26, 2004, which dates do include the time period during which the State Court suit was litigated and appealed, and Debtor's bankruptcy case was on file. However, there is no other

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[6] *See* Page 9, where it is stated, without authority, that:

> Extrinsic fraud is typically described in terms of actions by the other party. The discussion of extrinsic fraud, however, does not indicate, suggest or require one to prove fraud solely by the acts of the opposing party. Rather, case law indicates the fraud need be collateral to the issues actually tried and be sufficiently harmful to prevent one from receiving a fair trial."

evidence to support Defendant's claim that the Criminal Judgment relates to the conduct of which he accuses Aaron.

Both Trust Agreements provide for the transfer of property by Defendant to Aaron as trustee, both documents are signed by the Defendant as Trustor, and both are dated in March of 2001. Although Aaron is named in both instruments as a secondary beneficiary, the Defendant is named as the primary beneficiary in both. Plaintiffs point out that the Defendant's wife later sued both him and Aaron and obtained a judgment declaring the 657 Trust void *ab initio* and ordering the assets turned over to Defendant's wife. *See* Plaintiffs' Exh. H to their Response to Defendant's Motion for Partial Summary Judgment. The plain language of the Trust documents, and the signatures and dates on them (which the Defendant has not claimed were forged or altered or otherwise not accurate), contradict the Defendant's statements that he and his wife:

> did not understand until early 2003 that Mr. Aaron had named himself as the residual beneficiary of the 657 Trust nor did we understand the significance of that designation. In addition, I learned in late summer 2003 that Mr. Aaron had also set up the Ronnie Lee and Jackie Spencer Morgan Trust in which he named himself as trustee and residual beneficiary.

Affidavit of Ronnie Lee Morgan, Defendant's Exh. 9, page 2.

Finally, the Defendant offers Mr. Aaron's letter regarding mediation as evidence that he purposefully provoked the other attorneys (and the State Court, by copying it on the letter) as part of his "scheme" to defraud his client. The court finds this evidence to be insufficient to establish (or even corroborate) any such "scheme."

One final comment on the Defendant's claim that Mr. Aaron's representation of him in the litigation with the Plaintiffs was part of that attorney's fraud perpetrated on the Defendant: he complains in his Motion for Partial Summary Judgment only about Mr. Aaron, not mentioning that he was represented by at least two other lawyers during the litigation. Mr. Dickey represented the Defendant at his deposition, and Mr. Cohen, as co-counsel and second chair at trial, in Mr. Aaron's own words had "been there throughout the entire trial." Plaintiffs' Exh. G, p. 99, Exh. H, vol. 5, p. 80 and vol. 6, p. 18. The court notes that as late as February 24, 2004, Mr. Cohen served as the Defendant's *only* counsel of record (to the exclusion of Mr. Aaron) in his Petition to the Texas Supreme Court for review of the Judgment, and that Petition makes no mention of Mr. Aaron's "fraud." *See* Plaintiffs' Exh. J, Defendant's Petition for Review. Defendant makes no allegations, let alone provides any evidence, that these other attorneys' representation of him was inadequate, or improper in any way, or that they were in some way complicitous in Mr. Aaron's "scheme."

On the whole, the court finds that the summary judgment evidence that the Defendant has provided fails to corroborate the conclusory and self-serving statements in his Affidavit regarding the alleged "extrinsic fraud" by which he claims the State Court Judgment against him was obtained. He has failed to establish that there is a genuine issue of material fact as to this affirmative defense on which he bears the burden of proof. Even if the evidence he has provided

were viewed in the light most favorable to him, the court finds that that evidence falls far short of the "significant probative evidence" he would be required to produce to survive a summary judgment. **Anderson v. Liberty Lobby, Inc.**, 477 U.S. 242, 249 (1986); *see also* **Southmark Properties v. Charles House Corp.**, 742 F.2d 862, 877 (5th Cir. 1984) ("Appellees made a prima facie showing of entitlement to summary judgment, and hence appellants, to prevent such a judgment against them, were 'required to bring forward "significant probative evidence" demonstrating the existence of a triable issue of fact.'") (citations omitted).

In **Southmark Properties**, the Court of Appeals found that there was "'no evidence from which reasonable persons might draw' an inference that appellants were the victims of duress" in the prior litigation, and therefore affirmed the trial court's granting of a summary judgment based on the preclusive effect of the judgment entered in that litigation. **Id.** at 873. Similarly, in this case the court finds that Defendant has provided no evidence from which a reasonable person could infer that he was the victim of extrinsic fraud so as to avoid the preclusive effect of the State Court Judgment.

That having been said, the court must still determine which, if any, of the facts decided by the Judgment are conclusive as to issues presented in this § 523(a) action, and what other issues, if any, remain to be tried herein.

Whether the Facts Found by the Jury Were Essential to the State Court Judgment

This is the third point raised by the Defendant in his argument that the State Court Judgment should not be given any preclusive effect. At the outset this court finds and the parties do not appear to dispute that the Judgment is preclusive as to the *existence* and *total amount* of the Plaintiffs' claim against the Defendant. What is at issue here is what preclusive effect does the Judgment have with respect to how much, if any, of that claim is non-dischargeable under 11 U.S.C. § 523(a).

The Defendant argues that because the Judgment was based on multiple causes of action (breach of contract, DTPA, and common law fraud), it "does not establish any specific fact finding for purposes of collateral estoppel" on the question of the non-dischargeability of the Plaintiffs' claim.[7] Defendant's Motion for Partial Summary Judgment, page 6. In essence, he argues that no specific finding that is relevant to non-dischargeability was essential to the

[7] To the extent that the Defendant also argues that, even if the jury found that he did the acts complained of, those findings were not essential to the Judgment because his liability was based not on those findings but on the court's *default* judgment, this argument has effectively been addressed above. After considering the evidence presented at that trial, the jury specifically found that additional, punitive damages should be awarded against the Defendant. As discussed above, in order to find that additional damages were warranted, the jury *must* have found that the Defendant committed the acts complained of, and did so with the requisite intent. They necessarily had to have found, therefore, that Defendant was liable. Those findings of liability thus as a group *were* essential to the Judgment (even though, as discussed in detail below, their alternative nature may have prevented any one of from being essential to the Judgment).

Judgment because it was based on conjunctive theories of liability. In support, he cites **Schwager v. Fallas (In re Schwager)**, 121 F.3d 177 (5th Cir. 1997).

Specifically, the Defendant points out that the jury found identical amounts of compensatory and/or consequential damages resulting not only from Defendant's fraud (*see* Jury's Answers to Question 5), but also from his breach of contract (*see* Jury's Answers to Question 1) and from his violation of the Texas DTPA (*see* Jury's Answers to Question 2). Similarly, the amount of punitive damages awarded in the Judgment ($1,000,000) is identical both to the amount found by the jury for the DTPA violation ($1,000,000, *see* Jury's Answers to Questions 3 and 4) and to the amount found by the jury based on other causes of action involving malice or fraud ($1,000,000, *see* Jury's Answer to Question 12, and Answers to Questions 5-11).

It is true that the Judgment does not specify the theory on which the Court awarded actual and punitive damages. The sanctions orders, however, struck the Defendant's answer and had the effect of deeming him to have admitted *all* of the Plaintiff's allegations. **In re Pancake,** 106 F.3d at 1244 (5th Cir. 1997) (where the court enters judgment after striking defendant's answer, under Texas law the defendant is deemed to admit the plaintiff's pleadings). The sanctions orders operated as a partial default judgment on the issue of the Defendant's liability on *all* causes of action pleaded. The Plaintiffs pleaded causes of action for an accounting, for a declaratory judgment regarding the parties' rights under the contract, for violation of the Texas DTPA, for fraud, for negligent misrepresentation, for breach of warranty, and for intentional infliction of emotional distress. *See* Defendant's Exh. 1, Plaintiffs' Second Amended Original Petition, and Exh. 2, Plaintiffs' First Trial Amendment to Plaintiffs' Second Amended Petition. The partial default judgment was incorporated in and made final by the Judgment. *See generally* **Pan Am. Petroleum Corp. v. Texas Pac. Coal & Oil Co.**, 159 Tex. 550, 324 S.W.2d 200 (Tex. 1959) (stating general rule that a party against whom an interlocutory judgment has been rendered "will have his right of appeal when and not before the same is merged in a final judgment disposing of the whole case"). Thus, although not expressly stated in the Judgment, the Defendant's liability on *each and every* cause of action pleaded by Plaintiffs is incorporated in the Judgment. Unlike the situation in **Schwager**, where the court in its judgment found liability on only *one, unspecified* cause of action out of several (and awarded damages on that one, unspecified cause of action), the Judgment here implicitly (but clearly) holds the Defendant liable on *each* cause of action (although, as discussed below, it awards damages on fewer than all causes of action). Because as a matter of law the Judgment assessed liability on each cause of action pleaded, all of the elements (other than damages) of all of the Plaintiffs' causes of action are conclusively established by the Judgment. This court therefore concludes that, to the extent

those elements are the same as the elements of any of the § 523(a) causes of action pleaded by Plaintiffs here, Defendant is collaterally estopped from from re-litigating those issues.[8]

However, unlike liability, the damages awarded in the Judgment were not determined by the partial default judgment. Instead, the damages depend solely on the jury's findings. As to the damages, therefore, the court must address the Defendant's argument that the Judgment is ambiguous because it is based on multiple causes of action and does not specify to which cause of action the damages relate.

As the Defendant argues, a judgment that "is based upon determination of two issues, either of which standing independently would be sufficient to support the result, . . . is not conclusive with respect to either issue standing alone." **Restatement (Second) of Judgments** § 27, Comment *i.* The jury's findings award damages for several causes of action, including some (such as breach of contract or breach of warranty or DTPA) that both parties agree are not *per se* non-dischargeable. *See* Plaintiffs' Response to Defendant's Motion for Partial Summary Judgment, p. 15, fn. 6 ("Plaintiffs agree and have not attempted to use the jury's findings on Plaintiffs' DTPA claims for any preclusive effect."); *see also* **Ragupathi v. Bairrington (In re Bairrington)**, 183 B.R. 754 (Bankr.W.D. Tex. 1995) (where this court held that collateral estoppel could not be used to establish nondischargeability of a judgment debt based on state court's finding that debtors violated Texas DTPA because elements were not identical to actual fraud or to willful and malicious act). Thus, with respect to damages, the Judgment does appear on its face to be based upon determination of several issues.

The Plaintiffs disagree because, they argue, *not every one* of those issues–the jury's damage awards–would be sufficient to support the Judgment. Rather, *only* the damages awarded by the jury for fraud would support Judgment, they assert. The Plaintiffs contend that, because liability for fraud can be inferred from a punitive damages award for fraud, and because only their fraud theory supports the full amount of punitive damages awarded, the Judgment *must* have been based solely on fraud. Therefore, they reason, the Defendant is precluded from re-litigating both the actual damages and the punitive damages awarded.[9]

Plaintiffs are correct that, generally, it is "possible to infer a finding of liability for fraud from a punitive damage award where the only other cause of action was breach of contract [or

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[8] Exactly which are the same is discussed below on pp. 24-29, in the section titled "Which, If Any, Dischargeability Issues Have Been Conclusively Determined by the State Court Judgment of Liability?"

[9] Alternatively, the Plaintiffs contend that the Defendant should be barred from relitigating at least those punitive damages ($378,088.00) that are in excess of the greatest amount that could have been awarded under any or all of the other theories. This would leave the compensatory damages and $621,912.00 of the punitive damages awarded under the Judgment as open to relitigation in this adversary proceeding.

other cause of action] for which punitive damages are not available . . .." **Go Partners, Ltd. v. Poynor,** 2001 WL 167828, *3 (N.D. Tex.), *citing* **Shelton Ins. Agency v. St. Paul Mercury Ins. Co.**, 848 S.W.2d 739 (Tex.App.–Corpus Christi 1993, writ denied 1993). Plaintiffs concede that, other than their fraud theory, their Texas DTPA cause of action alone would have supported an award of punitive damages. Plaintiffs' Response to Defendant's Motion for Partial Summary Judgment, p. 17, ¶ 32; Tex. Bus. & Com. Code § 17.50(b)(1) (2005). As mentioned above, the Plaintiffs also concede that a debt based on the Texas DTPA is not *per se* non-dischargeable.

It is true that the amount of punitive damages available under the DTPA is limited to three times the actual damages awarded. Id. According to Plaintiffs' logic, since that figure would have been substantially less than the amount of punitive damages awarded in the Judgment, the actual punitive damages[10] awarded *must* have been based on something other than the DTPA damages–i.e., must have been based on the only other findings that could have supported punitive damages, the fraud findings.

Plaintiffs' argument is premised upon the assumption that the State Court *correctly* applied the law in rendering judgment based on the jury's findings. This in fact is the general rule under Texas law. *See e.g.*, **Gough v. Jones**, 212 S.W. 943 (Tex. Comm'n App. 1919, judgm't adopted) (when the language of a decree is susceptible of two constructions, from one of which it follows that the law has been correctly applied to the facts, and from the other that the law has been incorrectly applied, that construction should be adopted which correctly applies the law); **Keton v. Clark**, 67 S.W.2d 437 (Tex.Civ.App.–Waco 1933, writ ref'd) (judgment susceptible of several interpretations should be given that interpretation which will render it more reasonable, effective, and conclusive, and will make it harmonize with facts and law of case.); **Austin v. Conaway**, 283 S.W. 189 (Tex.Civ.App.–Eastland 1926, writ dism'd) (interpretation of judgment which makes it correct will be adopted in preference to one which makes it erroneous).

This court might be inclined to agree with the Plaintiffs and apply this presumption of correctness if, in construing the Judgment the court were limited to its language and the supporting findings. However, the Judgment was appealed by the Defendant, and the Court of Appeals wrote an eighteen-page Memorandum Opinion that provides further insight. On page 10 of that Memorandum Opinion, the Court addresses the Defendant's challenge to the sufficiency of the evidence supporting the punitive damages. Specifically, the Court upholds the award of punitive damages based on the evidence that the Defendant's conduct was "knowing or intentional." This is the standard under the DTPA for additional damages, and is insufficient to support punitive damages for fraud. *See* **Go Partners,** *supra* at *3 (punitive damages under

[10] Or at least the portion of those punitive damages ($378,088.00) that exceed the amount available under the DTPA.

Texas DTPA "are available for violations committed knowingly or intentionally–fraud is not required"), *citing* Tex. Bus. & Com. Code § 17.50(b).

Only if the State Court is presumed to have applied the law correctly can even a portion of the damages awarded in the Judgment be construed with any certainty to be attributable solely to fraud. However, the Texas Appellate Court has directly contradicted that presumption of correctness, by treating the Judgment as awarding DTPA damages, which are ordinarily dischargeable. Therefore, it appears that, as to damages, the Judgment can be construed as based on the DTPA and/or fraud, or even on the DTPA alone. Thus at best it is "based on determinations of two issues, either of which standing independently would be sufficient to support the result," and in such cases Texas law generally holds that such a judgment "is not conclusive with respect to either issue standing alone." **Schwager**, 121 F.3d 177 (5th Cir. 1997), *citing* **Eagle Properties, Inc. v. Scharbauer**, 807 S.W.2d 714, 722 (Tex. 1991), quoting the **Restatement (Second) of Judgments** § 27, Comment *i*.

Moreover, under Texas law, courts may consider the overall fairness of applying collateral estoppel. *See e.g.*, **Sysco Food Services, Inc. v. Trapnell,** 890 S.W.2d 796, 804 (Tex. 1994) ("Application of collateral estoppel also involves considerations of fairness not encompassed by the 'full and fair opportunity' inquiry."); **Benson v. Wanda Petroleum Co.,** 468 S.W.2d 361, 363 (Tex. 1971) ("It has been said that the rule rests upon equitable principles and upon the broad principles of justice."); *see also* **Parklane Hosiery Co., Inc. v. Shore**, 439 U.S. 322, 331 (1979) (applying federal rule that "trial courts [are granted] broad discretion to determine when it should be applied. . . . The general rule should be that in cases where . . . the application of offensive estoppel would be unfair to a defendant, a trial judge should not allow the use of offensive collateral estoppel."). Based on the foregoing and on concern for fairness, this court would construe the Judgment, being in the alternative, to not be conclusive as to the amount of the claim that is non-dischargeable.

Plaintiffs argue that even if the Judgment, if considered by itself, were not conclusive on the amount of non-dischargeable damages, the appellate review exception to the collateral estoppel rule discussed in **Schwager** applies and, because the Court of Appeals affirmed the Judgment, relitigation of issues regardings damages should be barred.

In **Schwager**, the Fifth Circuit Court of Appeals was also faced with a judgment that was based on more than one cause of action, where only one was non-dischargeable. The Court there found an exception to the general rule that the judgment was conclusive as to neither cause of action:

> If the judgment of the court of first instance was based on a determination of two issues, either of which would be sufficient to support the result, and the appellate court upholds both of these determinations as sufficient and accordingly affirms the judgment, the judgment is conclusive as to both determinations.

Schwager, 121 F.3d at 183, quoting the **Restatement (Second) of Judgments** § 27, Comment *o*. The Court elaborated, finding that this exception was narrowly applied, "only . . . as to those issues specifically passed upon by the appellate court." **Id.**, at 183-84, *quoting* **Hicks v. Quaker Oats Co.,** 662 F.2d 1158, 1168 (5th Cir. Unit A 1981) (applying federal law of collateral estoppel), *and citing* **Arab African International Bank v. Epstein**, 958 F.2d 532, 537 (3rd Cir. 1992) (applying New Jersey law on collateral estoppel and concluding that previous state court judgment did not have preclusive effect on legal malpractice claims because the state appellate court did not specifically address the reliance element of those claims).

In this case, the Court of Appeals did not consider the punitive damages award as based on fraud. The accepted rule is that "once an appellate court has affirmed on one ground and passed over another, preclusion does not attach to the ground omitted from its decision." **Winters v. Diamond Shamrock Chemical Co.,** 149 F.3d 387, 394 (5th Cir. 1998), *discussing and quoting* **Dow Chemical v. U.S. E.P.A.**, 832 F.2d 319, 323 (5th Cir.1987). The court therefore concludes that the appellate review exception to the collateral estoppel rule does not apply in this case. Thus the Judgment does not bar re-litigation in this adversary proceeding regarding punitive damages based on fraud.

Nor does it bar re-litigation of actual and consequential damages based on fraud. For if it cannot be determined with certainty that the punitive damages awarded in the Judgment were based on fraud, then there can be no inference from the Judgment that the actual and consequential damages awarded therein were also based on fraud.

Based on all of the foregoing, the court holds that the Defendant is not barred from contesting issues related to damages–i.e., the amount of any particular non-dischargeable claim.

Which, If Any, Dischargeability Issues
Have Been Conclusively Determined by the State Court Judgment of Liability?

Having found that the Judgment is preclusive only as to the Defendant's liability on the causes of action pleaded by Plaintiffs, the court now determines which, if any, of the specific issues necessarily determined in deciding that liability are also relevant to the issues presented in this adversary proceeding to determine dischargeability of the claim.

> "Collateral estoppel applies in bankruptcy courts only if, inter alia, the first court has made specific, subordinate, factual findings on the identical dischargeability issue in question--that is, an issue which encompasses the same prima facie elements as the bankruptcy issue--and the facts supporting the court's findings are discernible from that court's record."

In re Dennis, 25 F.3d 274, 278 (5th Cir. 1994), *citing* **In re Davis**, 3 F.3d 113, 115 (5th Cir.1993); *see also* **In re Hayden**, 248 B.R. 519, 523 (Bankr. N.D. Tex. 2000) ("The scope of the collateral estoppel doctrine is circumscribed by the particularized findings of the jury."), *citing* **Marine Shale Processors, Inc. v. EPA**, 81 F.3d 1371, 1379 (5th Cir. 1996).

The Plaintiffs had pleaded that the Defendant's debt to them is non-dischargeable under § 523(a)(2), (4) and/or (6). Each of those causes of action has distinct elements that the Plaintiffs must prove. They assert that their burden of proving each of those elements is satisfied by applying collateral estoppel to the Judgment.

Section 523(a)(2)(A): Actual Fraud

By the partial default judgment, the Defendant was deemed to have committed fraud, and the jury found that the Plaintiffs had suffered damages as a result of the Defendant's fraud. *See* Plaintiffs' Second Amended Original Petition, pp. 4-5, and First Trial Amendment thereto, p. 4; Jury's Answer to Question 5. "Fraud" is defined in the jury's Charge[11] as occurring when:

a. a party makes a material representation
b. the misrepresentation is made with knowledge of its falsity or made recklessly without any knowledge of the truth and as a positive assertion.
c. the misrepresentation is made with the intention that it should be acted on by the other party, and
d. the other party acts in reliance on the misrepresentation and thereby suffers damages.

Charge of the Court, page 5, Definition 11. The definition further provides that fraud also occurs when:

a. a party conceals or fails to disclose a material fact within the knowledge of that party,
b. the party knows that the other party is ignorant of the fact and does not have an equal opportunity to discovery [sic] the truth,
c. the party intends to induce the other party to take some action by concealing or failing to disclose the fact, and
d. the other party suffers injury as a result of acting without knowledge of the undisclosed fact.

Section 523(a)(2)(A) provides:

[11] This court assumes that the State Court Judge used substantially the same definitions in issuing his partial default judgment as were provided the jury for their use.

> 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 . . ..

"Actual fraud" in the context of § 523(a)(2)(A) requires proof that: "(1) the debtor made representations; (2) at the time they were made the debtor knew they were false; (3) the debtor made the representations with the intention and purpose to deceive the creditor; (4) that the creditor relied on such representations; and (5) that the creditor sustained losses as a proximate result of the representations." **In re Bercier**, 934 F.2d 689, 692 (5th Cir.1991) (citation and internal quotation marks omitted). This definition on its face differs from the one provided in the Charge of the Court because, unlike the Charge, it does not include a "misrepresentation . . . made recklessly without any knowledge of the truth and as a positive assertion." Rather, it appears to require *actual knowledge* of the falsity of the representation. However, an examination some of the case law construing § 523(a)(2)(A) shows that it also includes the "reckless indifference" standard that was contained in the Charge of the Court here.

First, according to the Supreme Court, the meaning of "actual fraud" can be found in the "general common law of torts." **Field v. Mans**, 516 U.S. 59, 69 (1995) ("The operative terms in § 523(a)(2)(A) . . ., 'false pretenses, a false representation, or actual fraud,' carry the acquired meaning of terms of art. They are common-law terms, and . . . they imply elements that the common law has defined them to include."). The Supreme Court looked to the Restatement (Second) of Torts (1976) for the definition of those elements at the time § 523(a)(2)(A) was enacted. The Restatement provides:

> One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

Restatement (Second) of Torts § 525 (2005). "Fraudulently" is further defined as:

> A misrepresentation is fraudulent if the maker
>
> (a) knows or believes that the matter is not as he represents it to be,
>
> (b) does not have the confidence in the accuracy of his representation that he states or implies, or
>
> (c) knows that he does not have the basis for his representation that he states or implies.

Restatement (Second) of Torts § 526 (2005). The Comments to this section further explain that:

> In order that a misrepresentation may be fraudulent it is not necessary that the maker know the matter is not as represented. Indeed, it is not necessary that he should even believe this to be so. It is enough that being conscious that he has neither knowledge nor belief in the existence of the matter he chooses to assert it as a fact. Indeed, since knowledge implies a firm conviction, a misrepresentation of a fact so made as to assert that the maker knows it, is fraudulent if he is conscious that he has merely a belief in its existence and recognizes that there is a chance, more or less great, that the fact may not be as it is represented. *This is often expressed by saying that fraud is proved if it is shown that a false representation has been made without belief in its truth or recklessly, careless of whether it is true or false*.

Id., Comment *e* (emphasis added). The Fifth Circuit Court of Appeals has indicated its acceptance of this common law definition:

> "A misrepresentation is fraudulent if the maker . . . knows or believes . . . the matter is not as" represented, or "does not have the confidence in the accuracy of his representation" as stated or implied, or "knows ... he does not have the basis for his representation" as stated or implied. Restatement (Second) of Torts § 526 (emphasis added).

In re Mercer, 246 F.3d 391, 407 (5th Cir. 2001). Accordingly, this court finds that the definition in the Charge of the Court (and presumably used by the State Court Judge in his partial default judgment), which includes the "reckless indifference" standard, is the same as is applicable under § 523(a)(2)(A). This court therefore concludes that the Defendant is precluded from re-litigating the dischargeability (as opposed to the amount) of any damages that the Plaintiffs may establish as attributable to the Defendant's actual fraud.

Section 523(a)(4): Fiduciary Fraud and Larceny

The Plaintiffs argue that the Judgment also establishes that the Defendant breached a fiduciary relationship with the Plaintiffs. Section 523(a)(4) 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 fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . ..

Breach of fiduciary duty was not pleaded by the Plaintiffs, however, and there is no Question or Definition in the jury's Charge regarding a fiduciary relationship between the parties, and therefore no finding relating to that issue. *See* Plaintiffs' Second Amended Original Petition and First Trial Amendment thereto. Accordingly, the court concludes the Judgment has

no preclusive effect regarding any element of a cause of action under § 523(a)(4) for breach of a fiduciary duty.

The partial default judgment also established the Defendant as having:

> [c]ommitted theft of property in an amount of $20,000 or greater in the form of Plaintiffs' money paid in excess of the amount actually incurred by Defendant to purchase furnishings for Plaintiffs and taking Plaintiffs' personal belongings without permission and without returning same . . ..

Plaintiffs' First Trial Amendment to Plaintiffs' Second Amended Petition, p. 4. The jury found that the Defendant had committed theft and that the value of the stolen property was $20,000 or greater. Jury's Answer to Question 11. "Theft" is defined in the jury's Charge as follows:

> "Theft" means that a person unlawfully appropriates property with the intent to deprive the owner of property. Appropriating property is unlawful if it is without the owner's consent.

In comparison, for purposes of § 523(a)(4),

> [l]arceny has been defined as "the fraudulent and wrongful taking and carrying away of the property of another with the intent to convert it to the taker's use and with intent to permanently deprive the owner of such property." **RAI Credit Corp. v. Patton (In re Patton)**, 129 B.R. 113, 116 (Bankr. W.D. Tex. 1991), quoting **First National Bank of Midlothian (In re Harrell)**, 94 B.R. 86, 90 (Bankr. W.D. Tex. 1988). **Collier on Bankruptcy** defines larceny similarly: "Larceny is the fraudulent and wrongful taking and carrying away of the property of another with the intent to convert the property to the taker's use without the consent of the owner." 4 **COLLIER ON BANKRUPTCY** ¶ 523.10[2] (15th ed. 1999) (emphasis added). See also **Weinreich v. Langworthy (In re Langworthy)**, 121 B.R. 903, 907 (Bankr. M.D. Fla. 1990).

In re Hayden, 248 B.R. 519, 526-27 (Bankr. N.D. Tex. 2000).

The definitions of "theft" under Texas law and as used by the jury, and "larceny" under § 523(a)(4), are essentially identical and the court therefore concludes that the Judgment is preclusive on all issues pertaining to the Defendant's non-dischargeable liability for "larceny" under § 523(a)(4). As discussed above, however, it cannot be determined from the Judgment (nor even from the jury's findings, which merely state that the stolen property's value was $20,000 or greater) what the amount of that non-dischargeable claim is, and therefore the Defendant is not precluded from litigating that issue at trial in this adversary proceeding.

Section 523(a)(6): Willful and Malicious Injury

Section 523(a)(6) 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 willful and

> malicious injury by the debtor to another entity or to the property of another entity . . ..

The Plaintiffs' allegations, established by the partial default judgment, did not expressly include a cause of action for "willful and malicious injury to another entity or property." Instead, the Plaintiffs alleged both that the Defendant committed certain specified acts "intentionally or . . . from malice and/or fraud" and that those specified acts[12] "were the result [of] fraud as well as specific intent . . .." Plaintiffs' First Trial Amendment to Plaintiffs' Second Amended Original Petition, p. 4. These allegations and findings of liability at best were stated in the alternative: (1) done intentionally, or (2) done with malice, or (3) done with fraud, or (4) done with malice *and* fraud. As discussed above, **Schwager** is controlling, so that the Judgment's determination of liability (based on the partial default judgment)[13] is not be sufficient to establish the single issue, standing alone, of "malice" for purposes of a malicious injury under § 523(a)(6). Accordingly, the court concludes that the Defendant is not precluded from re-litigating in this adversary proceeding whether he owes a non-dischargeable debt to the Plaintiffs "for willful and malicious injury . . . to another entity or to the property of another entity."

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[12] Those specified acts (alleged and established by the partial default judgment) were that the Defendant:

> a. Secured the execution of a document by deception, including the invoice from Classics by CBI;
> b. Altered his own as well as vendor invoices with the intent to defraud or harm Plaintiffs;
> c. Committed forgery of vendor invoices with the intent to defraud or harm Plaintiffs; and
> d. Committed theft of property in an amount of $20,000 or greater in the form of Plaintiffs' money paid in excess of the amount actually incurred by Defendant to purchase furnishings for Plaintiffs and taking Plaintiffs' personal belongings without permission and without returning same . . ..

Plaintiffs' First Trial Amendment to Plaintiffs' Second Amended Original Petition, p. 4.

[13] The jury's findings only further confuse, rather than clarify, the "malice" issue. Similar (but not identical) to the allegations in the Plaintiffs' pleadings, the jury found that the Plaintiffs had suffered damages from fraud and had suffered damages from negligent misrepresention, and that the harm from one *or* both of those was the result of malice *or* fraud. Jury's Answers to Questions 5, 6, and 7. While these Answers can be interpreted as finding that the fraudulent acts of Defendant were committed with malice (there being little sense in a finding that negligent misrepresentations were made with malice or by fraud), it *is* possible (and not unreasonable) that the jury was merely being consistent with its previous finding of fraud damages, by repeating that those damages resulted from fraud.

Attorneys Fees and Interest

Two final "pieces" of the Judgment warrant attention: whether the Judgment is preclusive as to the amount and dischargeabilty of the attorneys fees and interest awarded therein.

It is clear that attorneys fees and interest related to a non-dischargeable debt are also non-dischargeable. *See e.g.,* **Cohen v. De La Cruz**, 523 U.S. 213 (1998) (in addition to the value of money that was actually obtained by fraud, treble damages, attorneys' fees and costs to fall under the discharge exception for actual fraud pursuant to § 523(a)(2)(A)); **Bruning v. United States**, 376 U.S. 358 (1964) (post-petition interest on a non-dischargeable debt is non-dischargeable); **In re Gober**, 100 F.3d 1195, 1208 (5th Cir. 1996) (the dischargeability status of ancillary obligations such as attorney's fees and interest depends on that of the primary debt).

What is not clear at this point, however, is whether and the extent to which the interest and attorneys fees awarded in the Judgment relate to a dischargeable debt (*e.g.*, one under the DTPA), or a non-dischargeable debt (*e.g.*, one for fraud). The dischargeability of the attorneys fees and interest will depend, as a matter of law, upon the determination of the dischargeability of the debt to which they relate. Therefore, these issue are open to re-litigation *only* with respect to their relation to a non-dischargeable debt–the Plaintiffs need not present evidence regarding, and the Defendant may not challenge, the amount or dischargeability of the attorneys fees and interest except to show how much of each relates to an underlying claim that is itself shown to be non-dischargeable.

SUMMARY

Based on the foregoing, this court has determined that the Plaintiffs' Motion for Summary Judgment, and the Defendant's Motion for Partial Summary Judgment, should each be granted in part and denied in part.

The court finds and concludes that the Judgment bars re-litigation of the following issues, which the court hereby determines as follows:

(1) the total amount of the Plaintiffs' claim against the Defendant, which is $1,306,261.06, plus post-judgment attorneys fees of $62,000, plus interest on such sums at the rate of 10% per annum compounded annually from and after September 19, 2000;

(2) the non-dischargeability of the Plaintiffs' claim, to the extent the damages that were awarded are proven by them to be damages for fraud (under § 523(a)(2)(A)) and/or theft (under § 523(a)(4)); and

(3) the non-dischargeability of the interest and attorneys fees awarded that relate to a claim proven by Plaintiffs to be non-dischargeable.

On the other hand, the court finds and concludes that the Judgment does *not* bar re-litigation of:

(1) the amount of damages awarded that are damages resulting from the Defendant's fraud;

(2) the amount of damages that are damages resulting from the Defendant's theft;

(3) whether the Defendant's conduct was also a breach of a fiduciary relationship with the Plaintiffs, under § 523(a)(4) and, if so, the amount of damages caused by such breach;

(4) whether the Defendant's conduct also resulted in "willful and malicious injury" to the Plaintiffs or their property under § 523(a)(6) and, if so, the amount of damages caused by such injury;

(5) the amount of interest and attorneys fees that relate to the Plaintiffs' fraud claim; and

(6) the amount of interest and attorneys fees that relate to their theft claim.

In other words, the Plaintiffs need not prove again that the Defendant defrauded them and stole from them. The Defendant may not contest those findings. No evidence regarding the Defendant's conduct is required for purposes of the Plaintiffs' non-dischargeable claim under § 523(a)(2)(A) for actual fraud and (a)(4) for larceny. Only if, after considering the court's ruling on their Motion for Summary Judgment, the Plaintiffs still desire to pursue their causes of action under § 523(a)(4) for breach of fiduciary duty and (a)(6) for willful and malicious injury, would any evidence regarding the Defendant's conduct be necessary.

Federal Rule of Bankruptcy Procedure 7056, incorporating F.R.C.P. 56, provides a procedure for narrowing issues at trial after denial of a motion for summary judgment, and provides, in pertinent part:

> **(d) Case Not Fully Adjudicated on Motion.** If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if practicable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. It shall thereupon make an order specifying the facts that appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

The court recognizes that virtually no issues in this case seem to be beyond dispute, at least in the parties' pleadings if not as shown by the evidence submitted thus far. Therefore, on its face, Rule 7056 does not itself apply here. However, in the spirit of the Rule and in an effort to save the parties needless effort and expense, it seems desirable to comment on the issues remaining for trial and the conduct of this court's trial of those issues.

With respect to the Plaintiffs' § 523(a)(2)(A) fraud and (a)(4) theft claims, therefore, the only evidence required is that regarding the amount, if any, damages the Plaintiffs suffered as a result of that conduct. This court has carefully considered the testimony from the trial of the State Court Suit (as set forth in the transcript submitted as Plaintiffs' Exhs. G and H herein), and finds and concludes that it establishes a strong prima facie case for (1) damages resulting from fraud in the amount awarded ($207,307.00 actual damages plus punitive damages of $1,000,000), plus (2) pre-judgment attorneys fees of $62,250.00 and pre-judgment interest of $36,704.06, both relating to the fraud claim, plus (3) post-judgment attorneys fees of $62,000, plus (4) post-judgment interest on all of the foregoing total. The Plaintiffs therefore need present no other evidence (beyond introducing the trial transcript) to establish these amounts as non-dischargeable (other than some evidence to establish the exact amount of post-judgment interest, since that will depend in part upon exactly when the post-judgment attorneys fees were incurred).

The Defendant may of course present his own evidence in rebuttal.[14]

The court will enter orders on the Plaintiffs' Motion for Summary Judgment and on the Defendant's Motion for Partial Summary Judgment in accordance with these Findings of Fact and Conclusions of Law.

[14] It may be worth mentioning that, since the court has determined that collateral estoppel applies with respect to certain issues, the Defendant's extrinsic fraud defense has been overruled and may not raised again at trial with respect to those issues. With respect to all other issues, which the court has determined are not subject to collateral estoppel and so are open to re-litigation, the Defendant's extrinsic fraud claim is no longer relevant and so there is no need to raise it again at trial.