

**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION**

IN RE: DAVID H. FORBES, SR.)
 LUCILLE P. FORBES)
 Debtors.)

Case No. 98-39487-S
Chapter 7

_____)
 Capital Hauling, Inc.)
 Plaintiff.)

Adversary Proceeding No. 00-3108

v.)

David H. Forbes, Sr.)
Lucille P. Forbes)
 Defendants.)

MEMORANDUM OPINION

Hearing was held March 1, 2001, on plaintiff's motion for summary judgment on a complaint to determine dischargeability of debt. At the conclusion of the hearing, the matter was taken under advisement. For the reasons stated, plaintiff's motion for summary judgment is granted as to debtor David Forbes, and his indebtedness to plaintiff will be excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A) and § 523(a)(4).

I. Procedural History.

On July 21, 2000, plaintiff filed an adversary proceeding to determine dischargeability of debt. On August 18, 2000, debtors filed a response to plaintiff's complaint.

On September 6, 2000, a pre-trial conference was conducted and the trial date was originally scheduled for January 18, 2001. By orders dated January 16, 2001, and January 25, 2001, the trial was rescheduled for March 1, 2001.

On February 16, 2001, plaintiff filed a motion for summary judgment and the affidavit of

Richard L. Story, president of plaintiff, in support of the motion.

On February 26, 2001, debtors filed a response to plaintiff's motion for summary judgment.

On March 1, 2001, hearing was held on plaintiff's motion. Plaintiff filed a brief in support of its motion in open court. The trial, scheduled to be heard the same day, was continued pending the court's determination of plaintiff's motion for summary judgment.

II. Collateral Estoppel.

Plaintiff asserts it is entitled to summary judgment due to the collateral estoppel effect of a judgment entered against debtors by the City of Richmond General District Court (state court). Plaintiff's complaint to determine dischargeability of debt alleges that debtors fraudulently converted corporate assets of plaintiff while acting as officers. When debtors failed to repay plaintiff, counsel filed a warrant in debt in state court. Plaintiff's bill of particulars in the state court matter, which was attached to plaintiff's motion for summary judgment, also alleges that debtors defrauded plaintiff by converting assets and that they breached their fiduciary duty to plaintiff. Ultimately, plaintiff obtained a state court judgment against debtors in the amount of \$15,000.00 plus interest. Plaintiff filed an adversary proceeding alleging that the state court judgment was non-dischargeable pursuant to §§ 523(a)(2)(A), (a)(4) and (a)(6).

A motion for summary judgment is governed by Bankruptcy Rule 7056, which incorporates Federal Rule of Civil Procedure 56 in adversary proceedings. *See* FED. R. BANKR. P. 7056. If there is "no genuine issue as to any material fact" then plaintiff is entitled to summary judgment as a matter of law. *See* FED. R. CIV. P. 56.

Collateral estoppel is commonly referred to as issue preclusion. *See In re Wizard*

Software, Inc., 185 B.R. 512, 515 (Bankr. E.D. Va. 1995). Under the doctrine of collateral estoppel, "once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana v. United States*, 442 U.S. 147, 153 (1979).

In order for collateral estoppel to apply, plaintiff bears the burden of proving four elements: (1) that the issue sought to be precluded was the same as that involved in an earlier proceeding; (2) that the issue was actually litigated in an earlier proceeding; (3) that the issue was determined by a valid and final judgment; and (4) that determination of the issue was essential to the prior judgment. *See Rountrey v. Lee (In re Lee)*, 90 B.R. 202 (Bankr. E.D. Va. 1988).

Debtors assert that the first and second elements have not been satisfied, and therefore, that plaintiff is not entitled to summary judgment.

A. Whether The Issues Were Actually Litigated.

In March or April 1998, plaintiff filed a warrant in debt against debtors in state court. On the return date, May 19, 1998, debtors appeared in state court and contested the warrant in debt. At that hearing, the trial date was set for August 31, 1998.

On June 8, 1998, plaintiff filed a bill of particulars. Debtors had twenty-one days to file a grounds of defense. However, they never filed any responsive pleading. On August 31, 1998, plaintiff appeared for trial; however, debtors did not arrive on time, and judgment was entered against them. When debtors finally arrived, the state court denied their motion to re-open the case. Debtors subsequently filed a motion to rehear. On September 9, 1998, hearing was held

on debtors' motion to rehear. Plaintiff and debtors appeared at the hearing, and the motion was denied. No appeal was taken by debtors.

Plaintiff's position is that the bill of particulars filed in state court alleged all of the necessary elements to except the judgment debt from debtors' discharge under §§ 523(a)(2)(A) and (a)(4). Plaintiff also asserts that debtors' failure to file a responsive pleading and failure to appear at trial, resulted in a finding by the state court that the allegations contained in the bill of particulars were confessed by debtors. Consequently, debtors would be collaterally estopped from relitigating these same issues in the bankruptcy court.

Counsel for debtors contends that plaintiff is not entitled to the benefit of collateral estoppel because the issues raised in this case were not actually litigated in state court due to debtors failure to appear in time for the trial. Moreover, there is no record of what transpired during the trial.

The phrase "actually litigated," however, would not necessarily require debtors presence at the trial. Rather, "[c]ollateral estoppel can not apply when the party against whom the earlier decision is asserted did not have a 'full and fair opportunity' to litigate that issue in the earlier case." *Allen v. McCurry*, 449 U.S. 90, 95 (1980).

Counsel for debtors relies on *M & M Transmissions, Inc. v. Raynor (In re Raynor)*, 922 F.2d 1146 (4th Cir. 1991), to stand for the proposition that a state court default judgment does not have collateral estoppel effect. *Raynor*, which was decided under North Carolina law, is both factually and legally distinguishable from this adversary proceeding.

In *Raynor*, debtor's counsel did not file a formal appearance or answer. *See Raynor*, 922 F.2d at 1147. On the day of the trial, debtor's attorney filed a motion to withdraw, which was

granted by the court. *See id.* Debtor, therefore, had no notice of the trial and was not represented. *See id.* As a result, default judgment was entered against him. *See id.*

In the present case, debtors appeared to contest the warrant in debt on the return date and received notice of the trial. Debtors appeared at the trial, albeit late, and judgment was entered against them; their motion to re-open was denied.

Unlike the present adversary proceeding, North Carolina law governed in *Raynor*. Therefore, not only is *Raynor* factually distinguishable from the instant case, it is legally distinguishable as well. Furthermore, the Fourth Circuit's analysis of collateral estoppel in *Raynor* was significantly refined by the Fourth Circuit in *Pahlavi v. Ansari (In re Ansari)*, 113 F.3d 17 (4th Cir. 1997).

In *Ansari*, 113 F.3d 17, the Fourth Circuit considered the application of collateral estoppel under Virginia law and reached a result different from *Raynor* due to a difference between North Carolina and Virginia law. The court found that "North Carolina, unlike Virginia, has never rejected the majority view stated in the Restatement that "[a] default judgment cannot be used for collateral estoppel purposes, because no issues are "actually litigated."" *Ansari*, 113 F.3d at 20, quoting *United States v. Ringley*, 750 F. Supp. 750, 759 (W.D. Va. 1990), citing RESTATEMENT (SECOND) OF JUDGMENTS § 27 cmt. e (Main Vol. 1980). The Virginia Supreme Court has expressly rejected the Restatement¹ and has concluded that "Virginia law does not support a blanket exemption from the application of collateral estoppel in

¹ Comment "e" of the Restatement states: "In the case of a judgment entered by confession, consent, or default, none of the issues is actually litigated. Therefore, the rule of this Section does not apply with respect to any issue in a subsequent action." RESTATEMENT (SECOND) OF JUDGMENTS § 27 cmt. e (Main Vol. 1980).

the case of a default judgment." *Id.* citing *Transduller Center, Inc. v. Sharma*, 472 S.E. 274 (Va. 1996).

Other courts have given collateral estoppel effect to state court default judgments. *See McCart v. Jordana (In re Jordana)*, 216 F.3d 1087 (10th Cir. 2000); *Litwak v. Oscar Prod. (In re Litwak)*, 217 F.3d 845 (9th Cir. 2000); *Nestorio v. Associates Commercial Corp.*, 250 B.R. 50 (D. Md. 2000).

Although debtors failed to appear at the state court trial, they had a "full and fair opportunity" to litigate their case. While debtors actively participated in some parts of the state court litigation they failed to take advantage of other opportunities to defend themselves. Plaintiff, therefore, has satisfied the second element of the collateral estoppel test.

B. Whether The Same Issues Were Decided By The State Court.

The more difficult question is whether plaintiff satisfied the first element of the test: whether the issues sought by plaintiff to be precluded by collateral estoppel are the same as those involved in the state court suit that resulted in plaintiff's judgment against debtors. Debtors' counsel has argued that this element has not been met because there is nothing in the present record that establishes the actual basis for the state court judgment against debtors.

Based on the information included with plaintiff's motion for summary judgment, the record reflects that the Richmond General District Court, a state court not of record, entered judgment against debtors after they failed to timely appear for trial. In that suit, plaintiff had filed a bill of particulars prior to trial that set out plaintiff's allegations in support of a judgment for fraud and breach of fiduciary duty (conversion). Plaintiff's position in the motion for summary judgment is that the state court judgment therefore must have been based on the

allegations set forth in the bill of particulars.

Aside from the bill of particulars, the only other evidence available to this court regarding entry of the judgment is the affidavit of Richard Larry Story, plaintiff's president. Mr. Story's affidavit contains the following statement relative to the trial: "On August 31, 1998, the Defendants [debtors] failed to appear at the appointed time for trial and on Plaintiff's motion, judgment as sued for in the Warrant in Debt and as alleged in the Bill of Particulars was entered in favor of Capital Hauling, Inc."

In the absence of other documentation, it becomes necessary for this court to examine the bill of particulars in detail to determine what options were available to the state trial judge in granting a money judgment to plaintiff. If this pleading in and of itself establishes that the judgment must have been based on nondischargeable fraud or breach of fiduciary duty committed by debtors, the "same issue" element of collateral estoppel should be satisfied.

In summary, the bill of particulars alleges as follows:

(1) That debtor David Forbes was a stockholder, director and the president of plaintiff, and debtor Lucille Forbes was corporate secretary;

(2) That debtor David Forbes, without the knowledge or consent of the other stockholders or directors of plaintiff, fraudulently designated himself as sole signatory of plaintiff's bank accounts by executing fraudulent director resolutions;

(3) That debtor David Forbes fraudulently converted \$9,533.97 of plaintiff's funds;

(4) That debtor David Forbes fraudulently used funds of plaintiff to purchase plaintiff's common stock from several stockholders without the knowledge or consent of the remaining stockholders or the corporate board of directors; in this connection debtor fraudulently sold a

total of 2,100 shares of plaintiff's capital stock to various individuals for a total price of \$2,100.00, which funds debtor converted;

(5) That debtor David Forbes fraudulently used plaintiff's funds to purchase corporate stock of plaintiff from several original stockholders, which shares debtor transferred to another corporation formed by debtor for this purpose; these transactions were without the knowledge or consent of the remaining stockholders or the corporate board of directors;

(6) That subsequently, debtor David Forbes, without knowledge or consent of the remaining stockholders or the corporate board of directors, sold the shares of plaintiff's capital stock held by debtor's corporation to another stockholder for \$6,000.00, which proceeds debtor converted; and

(7) That as a result, a balance remains due to plaintiff in excess of \$15,000.00.

As noted, all of the allegations of fraud and conversion outlined in the bill of particulars were directed only at debtor David Forbes. The only allegation in the bill of particulars concerning Lucille Forbes is that she signed various corporate resolutions as corporate secretary of plaintiff.

After carefully considering the bill of particulars, this court finds that the state court judgment was based on the same issues that are present in the instant adversary proceeding. The bill of particulars was grounded only in fraud and conversion, and it is reasonable to conclude that any judgment entered on this pleading must necessarily have been so derived.

The doctrine of collateral estoppel on the issues of fraud and breach of fiduciary duty (conversion) is therefore applicable as to David Forbes. However, because these allegations were not specific as to Lucille Forbes, the court is unwilling to find that she is estopped to

oppose plaintiff's dischargeability complaint.

III. Dischargeability of Judgment.

No argument has been made by debtors that the plaintiff's judgment under the bill of particulars would in any event be a dischargeable debt. Accepting the allegations of this pleading as proved, the court finds as follows:

(1) Debtor David Forbes defrauded plaintiff by taking corporate funds without intent to repay, and his conduct meets the requirements for excepting his indebtedness to plaintiff from discharge under § 523(a)(2)(A). *See Western Union Corp. v. Ketaner (In re Ketaner)*, 154 B.R. 459, 464 (Bankr. E.D. Va. 1992).

(2) Debtor David Forbes converted cash of plaintiff in breach of his fiduciary duty to plaintiff under Virginia law, which debt must be excepted from discharge under § 523(a)(4). *See* 4B MICHIE'S JURISPRUDENCE, CORPORATIONS § 195 (Repl. Vol. 1999); *Ansari*, 113 F.3d at 20.

A separate order consistent with this memorandum opinion will be entered granting plaintiff's motion for summary judgment as to David H. Forbes, Sr., and denying the motion as to Lucille P. Forbes.

Signed this 12th day of March, 2001.

DOUGLAS O. TICE, JR.
CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT

The Clerk is directed to forward a copy of this Memorandum Opinion to:

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