UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF MISSISSIPPI

IN RE: JOHN ALLEN, SR. and HARRIET ALLEN — CASE NO. 05-18043-DWH

CITY AUTO FINANCE, LLC — PLAINTIFF

VERSUS — ADV. PROC. NO. 06-1074-DWH

JOHN L. ALLEN, SR. — DEFENDANT

OPINION

On consideration before the court is a motion for summary judgment filed by the plaintiff, City Auto Finance, LLC, ("City Auto"); a response to said motion having been filed by the defendant/debtor, John L. Allen, Sr., ("Allen"); and the court, having considered same, hereby finds as follows, to-wit:

I.

The court has jurisdiction of the parties to and the subject matter of this adversary proceeding pursuant to 28 U.S.C. §1334 and 28 U.S.C. §157. This is a core proceeding as defined in 28 U.S.C. §157(b)(2)(I).

II.

On November 6, 2003, Allen executed a credit line promissory note in the amount of $100,000.00, in favor of City Auto. The credit line was used to purchase a number of vehicles, the titles to which were to be held by City Auto until the vehicles were sold. The vehicles were then sold, but the sales were never reported and none of the sales proceeds were remitted to City Auto.

On February 16, 2005, City Auto filed a complaint in the Circuit Court of Pontotoc County, Mississippi, charging Allen with fraud. The complaint asserted that Allen had made material false representations regarding his intent to abide by the terms of the credit line note and had failed to report to City Auto the sales of the vehicles which collateralized the note. The complaint further charged that City Auto had reasonably relied upon Allen's representations and inducements in extending the line of credit, and had been financially injured as a direct consequence thereof. Allen was personally served with process, but did not file an answer or responsive pleading to the complaint. On August 1, 2005, a default judgment and a final judgment were taken against Allen in the sum of $94,525.00, plus pre and post-judgment interest and costs. Allen has since been indicted by the Pontotoc County grand jury for the crime of felonious misappropriation of the money and property of City Auto. This criminal case is still pending.

Allen and his wife filed a voluntary petition for relief pursuant to Chapter 7 of the Bankruptcy Code on October 14, 2005. Thereafter, City Auto filed a complaint to determine the dischargeability of the aforesaid debt pursuant to 11 U.S.C. §523(a)(2)(A), which excepts from discharge any debt incurred as a result of false pretenses, a false representation, or actual fraud.

In its motion for summary judgment, City Auto has asserted that Allen's failure to answer the allegations of fraud, which resulted in the final judgment being rendered in the Circuit Court of Pontotoc County, prevents him from now relitigating these issues in this court.

IV.

As noted hereinabove, City Auto relies upon 11 U.S.C. §523(a)(2)(A), which provides as follows:

> (a) A discharge under §727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -
>
> > (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by—
> >
> > > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

As the basis of its motion for summary judgment, City Auto contends that the theories of collateral estoppel and res judicata preclude the relitigation of Allen's fraud, as well as, the amount of its judgment. In addressing the issues of collateral estoppel and res judicata, three authorities must be noted:

First, the Supreme Court case, *Brown v. Felsen*, 442 U.S. 127, 139 note 10, 99 S. Ct. 2205, 2213 note 10, 60 L.Ed.2d 767 (1979), addressed the issue of applicability of collateral estoppel in a bankruptcy dischargeability action as follows:

> If, in the course of adjudicating a state-law question, a state court should determine factual issues using standards identical to those of [§523 of the present Bankruptcy Code], then collateral estoppel, in the absence of counterveiling statutory policy, would bar relitigation of those issues in bankruptcy court.

Id.

Second, in *In re Schuler*, 722 F.2d 1253, 1255 (5th Cir. 1984), the Fifth Circuit stated that collateral estoppel may be invoked in a dischargeability action, but stated that the bankruptcy court is not bound by the earlier determination and, in fact, retains exclusive jurisdiction to determine the ultimate question of the dischargeability of a debt. In addition, the

Schuler decision, citing *White v. World Finance of Meridian, Inc.*, 653 F.2d 147, 151 (5th Cir. 1981), set forth the following test for applying the doctrine of collateral estoppel:

> (i) The issue to be precluded must be identical to that involved in the prior action,
> (ii) the issue must have been actually litigated in the prior action, and
> (iii) the issue determination in the prior action must have been necessary to the resulting judgment.

Schuler, 722 F.2d 1256 n. 2.

In the case of *Pancake v. Reliance Insurance Co. (In re Pancake)*, 106 F.3d 1242 (5th Cir. 1997), Pancake, a bank loan officer, was accused by Reliance of loaning money to borrowers that he knew to be poor credit risks in exchange for kickbacks. Reliance, a surety for the bank, sued Pancake in state court alleging fraud. Pancake filed an answer which was stricken because he had failed to comply with certain discovery orders. Pancake did not appear at trial and a default judgment was entered against him. When Pancake subsequently filed bankruptcy, Reliance filed its complaint to determine the dischargeability of the default judgment. The bankruptcy court granted summary judgment for Reliance. On appeal, the district court reversed, stating that the default judgment was not entitled to preclusive effect. The Fifth Circuit affirmed the district court, concluding that preclusive effect could not be given to the state court judgment because it was unclear from the record whether or not an evidentiary hearing was held in which Reliance was required to meet its burden of proof. "The only indication that the state court held a hearing comes from the final judgment, in which the court states that it heard 'the evidence and arguments of counsel.' That statement alone does not establish that Pancake received a full and fair adjudication on the issue of fraud." *Id.* at 1244. The court went on to state that the nature of a default judgment is immaterial for collateral estoppel purposes so long

as the record reflects that the evidentiary hearing was conducted, and the plaintiff's burden of proof was met.

> For purposes of collateral estoppel...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 Pancake's answer was struck, if Reliance can produce record evidence that the state court conducted a hearing in which Reliance was put to its evidentiary burden, collateral estoppel may be found to be appropriate.

Id. at 1245.

In the proceeding now before this court, City Auto has included, as an exhibit to its motion for summary judgment, the default judgment and the final judgment signed by the state court judge. City Auto has produced no evidence that the state court conducted a hearing in which City Auto was put to its evidentiary burden to establish that fraud was perpetrated by Allen. Since there was apparently no hearing or writ of inquiry to address "on the record" for the trier of fact the alleged fraud on the part of Allen, this court cannot employ the preclusive effect of collateral estoppel. City Auto's motion for summary judgment must be overruled at this time.

Based on the foregoing analysis, the court is of the opinion that there are genuine issues of material fact in this adversary proceeding remaining in dispute. As such, City Auto is not entitled to a judgment as a matter of law, and the motion for summary judgment must be overruled.

An order will be entered consistent with this opinion.

This the 24th day of April, 2007.

/s/ David W. Houston, III
DAVID W. HOUSTON, III
UNITED STATES BANKRUPTCY JUDGE