IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 00-32361

DAVID A. LUFKIN
a/k/a DAVID A. LUFKIN, ATTORNEY

Debtor

ASSETCARE, INC.

Plaintiff

v. Adv. Proc. No. 00-3135

DAVID A. LUFKIN

Defendant

MEMORANDUM ON
DEFENDANT'S MOTION TO RECONSIDER

APPEARANCES: HUNTON & WILLIAMS
John A. Lucas, Esq.
James S. Chase, Esq.
2000 Riverview Tower
900 South Gay Street
Knoxville, Tennessee 37902
HUNTON & WILLIAMS
Maya M. Eckstein, Esq.
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, Virginia 23219
Attorneys for Plaintiff

McGEHEE, NEWTON & WYKOFF, P.C.
John P. Newton, Jr., Esq.
Cynthia T. Lawson, Esq.
Post Office Box 2132
Knoxville, Tennessee 37901
Attorneys for Defendant

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

Before the court is the Defendant's Motion to Reconsider or in the Alternative Renewed Motion for Dismissal of Amended Complaint and/or for Summary Judgment (?Motion to Reconsider") filed on February 2, 2001. By his Motion to Reconsider, the Defendant asks the court to reconsider its Order entered on January 23, 2001, by which the court denied the Defendant's Motion to Dismiss and/or for Summary Judgment (?Motion to Dismiss") filed on December 19, 2000. *See AssetCare, Inc. v. Lufkin (In re Lufkin)*, Ch. 7 Case No. 00-32361, Adv. No. 00-3135, slip op. (Bankr. E.D. Tenn. Jan. 23, 2001). The Motion to Reconsider was accompanied by a supporting brief.[1]

By its Complaint for Determination of Non-Dischargeability (?Complaint"), which was filed on November 20, 2000, as amended by an Amended Complaint for Determination of Non-Dischargeability filed on January 11, 2001, AssetCare, Inc. (AssetCare) seeks a determination that a $165,000.00 obligation of the Defendant obtained pursuant to an agreed Judgment Order entered by the Chancery Court of Sullivan County, Tennessee, on December 7, 1999, is non-dischargeable under 11 U.S.C.A. § 523(a)(2)(A), (4), and (6) (West 1993). These provisions of the Bankruptcy Code direct that certain debts are non-dischargeable when grounded on: ?false pretenses, false representation, or actual fraud" (§ 523(a)(2)(A)); ?fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" (§ 523(a)(4)); or ?willful and malicious injury" (§ 523(a)(6)). The Defendant's Motion to Reconsider advances the argument that the Complaint

[1] Although E.D. Tenn. LBR 7007-1 provides the Plaintiff twenty days within which to respond to the Defendant's Motion to Reconsider, the court does not deem a response necessary and will, accordingly, issue its ruling in advance of the twenty days.

should be dismissed pursuant to the doctrine of res judicata because the § 523 issues of fraud and embezzlement were not raised in AssetCare's original Chancery Court complaint.

I

The Defendant/Debtor, an attorney, previously represented AssetCare, a collection agency, in various debt collection matters. On May 17, 1996, AssetCare filed a Complaint for Declaratory Judgment in the Sullivan County Chancery Court. By that action, AssetCare, focusing on allegations of the Debtor's negligence, sought, *inter alia*, a determination of the damages owed to it by the Debtor.

The trial of the Chancery Court proceeding commenced on December 7, 1999, but was resolved prior to completion by a settlement in which the parties agreed to a $165,000.00 judgment against the Debtor in favor of AssetCare. The settlement was formalized by a Judgment Order entered on December 7, 1999. That Order provides, in its entirety:

> The parties, by their respective counsel, having announced in open court that they have reached an agreement in this case, it is
>
> ORDERED that the Plaintiff, AssetCare, Inc., recover and have judgment against the Defendants, David A. Lufkin, Individually, and David A. Lufkin, P.C., d/b/a The Law Offices of Lufkin & Henley, jointly and severally, in the principal amount of $165,000.00, together with interest at the rate of 10% per annum from the date of this Judgment Order.
>
> Costs are taxed against the Defendants, for which execution may issue, if necessary.

The agreed Judgment Order contains no findings of fact. In addition to copies of the Judgment Order and the Complaint for Declaratory Judgment, also before this court is a transcript of the December 7, 1999 Chancery Court proceedings.[2]

II

Without directly addressing the issue, the Defendant suggests that he raised his res judicata argument in his original Motion to Dismiss. He does so by excerpting two passages from his Brief in Support of Motion to Dismiss and/or for Summary Judgment.[3] However, when viewed in context, those passages show that the res judicata argument was, in fact, not previously raised.

AssetCare's original Complaint was supported only by an attached copy of the Judgment Order. The central focus of the Defendant's Motion to Dismiss was his argument that the

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[2] The transcript was attached to AssetCare's Amended Complaint for Determination of Non-Dischargeability.

[3] The two cited paragraphs, in full, state as follows:

> The Plaintiff in its statement of facts admits that the Sullivan County Judgment was entered by agreement of the parties and attaches a copy of the Judgment to the Complaint. The Chancellor in that case made no findings of fact. There is nothing to show that the Debtor did anything other than say he agreed that a Judgment should be entered against him for $165,000. The Complaint in the State Court lawsuit alleges that the Debtor acted negligently in his duties, it does not allege fraud, misrepresentation or willful and malicious injury.

Brief in Support of Motion to Dismiss and/or for Summary Judgment, at 6.

> There is no genuine issue as to any material facts with regard to Count I of the [C]omplaint and it should be dismissed as a matter of law since it fails to assert any facts supporting a claim for relief. The State Court Complaint filed by the Plaintiff states that Mr. Lufkin's services were terminated on December 8, 1995. This termination occurred before the State Court Complaint was filed and therefore any damages which were owed to Plaintiff were encompassed in the December 7, 1999 Judgment. The Plaintiff attached a copy of the December 7, 1999 Judgment which shows that the parties agreed and announced in open court that the Debtor owed the Plaintiff $165,00[0].00, together with interest at the rate of 10% per annum [from] the date of the Judgment Order. The Chancellor in Sullivan County made no findings of fact, therefore there are no findings that fraud, false representation, false pretenses, malicious and willful injury, embezzlement, larceny or fraud while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union.

Brief in Support of Motion to Dismiss and/or for Summary Judgment, at 9-10.

Judgment Order, as the sole documentation provided by AssetCare, was insufficient to support AssetCare's claims. In the excerpted passages, the Defendant merely asserts that the Judgment Order, on its face, was inadequate support for AssetCare's § 523 claims because the Judgment Order contains no findings regarding fraud, embezzlement, or other § 523 elements.

Nowhere in the Defendant's December 19, 2000 Motion to Dismiss did he claim that res judicata bars the present Complaint due to AssetCare's failure to raise § 523 issues in the Sullivan County Chancery Court suit. The court will nonetheless consider the res judicata issue in the context of the Defendant's Motion to Reconsider.

III

The doctrine of res judicata directs that **?**a final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action." *Allen v. McCurry*, 101 S. Ct. 411, 414 (1980). Res judicata **?**relieve[s] parties of the cost and vexation of multiple lawsuits, conserve[s] judicial resources, and, by preventing inconsistent decisions, encourage[s] reliance on adjudication." *Id.* at 415. Federal courts accord the preclusive effect of res judicata to state court decisions. *See id.*

Res judicata should not be confused with the related issue of collateral estoppel or issue preclusion. *See Sanders Confectionary Prods., Inc. v. Heller Fin., Inc.*, 973 F.2d 474, 480 (6th Cir. 1992). Collateral estoppel **?**precludes relitigation of issues of fact or law actually litigated and decided in a prior action between the same parties and necessary to the judgment, even if decided as part of a different claim or cause of action." *Gargallo v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 918 F.2d 658, 661 (6th Cir. 1990). As previously noted, the Defendant

acknowledges that the § 523 elements presently at issue were not actually litigated or decided in the state court action. Collateral estoppel, therefore, is not relevant to the present case.

This court is required to give the same preclusive effect to a state court judgment as would another court from the same state. *See Allen*, 101 S. Ct. at 415; *see also Rosenbaum v. Cummings (In re Rosenbaum)*, 150 B.R. 990, 992 (Bankr. E.D. Tenn. 1992). Tennessee courts consider res judicata to have four elements:

1. A final decision on the merits in the first action by a court of competent jurisdiction;
2. The second action involves the same parties, or their privies, as the first;
3. The second action raises an issue which was or could have been litigated in the first action;
4. An identity of the claims, demands, or causes of action.

Richardson v. Tennessee Bd. of Dentistry, 913 S.W.2d 446, 459 (Tenn. 1995).

In the present case, the second element is clearly satisfied as AssetCare and the Defendant are the parties to each action. The first element is satisfied as well, as the Supreme Court of Tennessee has recognized the res judicata effect of agreed judgments, even when the prior judgment involves no findings of fact or law. *See Third Nat'l Bank v. Scribner*, 370 S.W.2d 482, 486 (Tenn. 1963). The third and fourth elements of the res judicata test, however, are fatal to the Defendant's position. These elements were addressed by the United States Supreme Court in *Brown v. Felsen*, 99 S. Ct. 2205 (1979), a case with facts similar to those presently before the court.

Brown involved the res judicata effect of a pre-petition state court action between a debtor and creditor. *See id.* at 2207-08. The underlying action was resolved by an agreed order granting

judgment in favor of the creditor. *See id*. at 2208. Neither the settlement nor the agreed order indicated the legal theory on which the judgment was based. *See id*.

Shortly thereafter, the debtor filed a voluntary bankruptcy petition under the Bankruptcy Act. *See id*. The creditor then petitioned the bankruptcy court to have the judgment debt declared non-dischargeable under the Bankruptcy Act's fraud, deceit, and malicious conversion provisions. *See id*. The debtor responded by moving for summary judgment on the grounds that, since the prior action did not result in a finding of fraud, res judicata barred relitigation of the nature of the debt. *See id*. The bankruptcy court granted summary judgment in favor of the debtor, and the district court and Tenth Circuit Court of Appeals affirmed. *See id*. at 2209.

The Supreme Court reversed. *See id*. at 2213. The Court began its analysis by noting:

> Because res judicata may govern grounds and defenses not previously litigated, however, it blockades unexplored paths that may lead to truth. For the sake of repose, res judicata shields the fraud and the cheat as well as the honest person. It therefore is to be invoked only after careful inquiry.

Id. at 2210. The Court went on to note that the creditor **?**readily concedes that the prior decree is binding." *Id*. The creditor was not advancing a new ground for recovery or attacking the validity of the prior judgment, the Court noted. *See id*. Instead, the creditor was attempting to meet **?**the new defense of bankruptcy which [the debtor] has interposed between [the creditor] and the sum determined to be due him." *Id*.

As in the present case, the debtor in *Brown* argued that questions of fraud and other misconduct should have been raised and resolved in the state court proceeding. *See id*. at 2211. The Supreme Court disagreed, stating that to require the dischargeability issues to be resolved in the prior action would **?**undercut a statutory policy in favor of resolving [dischargeability] questions

in bankruptcy court, and would force state courts to decide these questions at a stage when they are not directly in issue and neither party has a full incentive to litigate them." *Id.; see also Spilman v. Harley*, 656 F.2d 224, 227 (6th Cir. 1981) (it would be unreasonable to require that state court litigants anticipate future bankruptcy proceedings). The *Brown* Court continued by stating that such state court litigation would often be unnecessary and unfair to plaintiffs and would usurp the authority of bankruptcy courts. *See Brown*, 99 S. Ct. 2211-12. The Court's holding was then summarized as follows:

> Refusing to apply res judicata here would permit the bankruptcy court to make an accurate determination whether respondent in fact committed the deceit, fraud, and malicious conversion which petitioner alleges. These questions are now, for the first time, squarely in issue. They are the type of question Congress intended that the bankruptcy court would resolve. That court can weigh all the evidence, and it can also take into account whether or not petitioner's failure to press these allegations at an earlier time betrays a weakness in his case on the merits.

Id. at 2212.

On the authority of *Brown*, this court rejects the Defendant's res judicata argument. The prior state court action and the current proceeding to answer the Defendant's **?**defense of bankruptcy" are not the same cause of action. *See id.* at 2210. Additionally, the dischargeability elements of § 523(a)(2)(A), (4), and (6) were not issues necessary to AssetCare's pre-bankruptcy Chancery Court action. State court plaintiffs cannot be compelled to litigate **?**to the hilt in order to protect [themselves] against the mere possibility that a debtor might take bankruptcy in the future."[4] *Brown*, 99 S. Ct. at 2211.

[4] This is not to say that the amount of the Defendant's liability to AssetCare is in dispute. Principles of collateral estoppel preclude both the Defendant and AssetCare from relitigating the amount of AssetCare's claim as set forth in the December 7, 1999 Chancery Court Judgment Order. *See National City Bank v. Plechaty (In re Plechaty)*, 213 B.R. 119, 129 (B.A.P. 6th Cir. 1997).

The Defendant's Motion to Reconsider will be denied. An appropriate order will be entered.

FILED: February 8, 2001

BY THE COURT

/s/

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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Defendant

O R D E R

For the reasons stated in the Memorandum on Defendant's Motion to Reconsider filed this date, the court directs that the Motion to Reconsider or in the Alternative Renewed Motion for Dismissal of Amended Complaint and/or for Summary Judgment filed by the Defendant on February 2, 2001, asking the court to reconsider its January 23, 2001 Order denying the Defendant's Motion to Dismiss and/or for Summary Judgment filed December 19, 2000, is DENIED.

SO ORDERED.

ENTER: February 8, 2001

BY THE COURT

/s/

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE