

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

In re

KIMBERLY MARIA LONAS,  
  
Debtor.

No. 98-20517  
Chapter 7

FIDELITY FEDERAL SAVINGS  
BANK OF FLORIDA,

Plaintiff,

vs.

KIMBERLY M. LONAS,  
  
Defendant.

Adv. Pro. No. 98-2088

M E M O R A N D U M

APPEARANCES :

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MARCIA PHILLIPS PARSONS  
UNITED STATES BANKRUPTCY JUDGE

This adversary proceeding, which seeks a determination of nondischargeability under 11 U.S.C. § 523(a)(2)(A) and (B), is before the court on the debtor's motion for judgment on the pleadings and for summary judgment pursuant to Fed. R. Bankr. P. 7012(b) and 7056. The debtor contends that the plaintiff is barred from alleging fraud or false pretenses as a basis for nondischargeability since the state court default judgment held by the plaintiff against the debtor was not based on fraud. Because the United States Supreme Court held to the contrary in *Brown v. Felsen*, 442 U.S. 127, 99 S. Ct. 2205 (1979), the debtor's motion for summary judgment will be denied. The court will, however, grant in part the debtor's motion for judgment on the pleadings because a check does not constitute a statement of financial condition within the meaning of § 523(a)(2)(B) of the Bankruptcy Code. This is a core proceeding. See 28 U.S.C. § 157(b)(2)(I).

I.

The court is able to piece together the following facts from the pleadings, the debtor's pending motion and attached exhibits, and the plaintiff's response thereto. The debtor and her father operated a business known as VIP Motors in Morristown, Tennessee. In connection with this business, on

June 12, 1996, the debtor drew three checks totaling \$21,470.00 payable to the order of John R. Casquilla, Inc. for the purchase of certain automobiles. The principal of the corporation, John R. Casquilla, endorsed and deposited the checks into the corporation's bank account with plaintiff, Fidelity Federal Savings Bank of Florida. As a result of this transaction, the plaintiff bank credited the corporation's account with the bank in the amount of the three checks and upon Mr. Casquilla's request, issued a cashier's check to West Palm Auto Auction in the amount of \$21,470.00. The cashier's check was in turn used to purchase automobiles on behalf of VIP Motors. Thereafter, the plaintiff bank presented the three checks written by Ms. Lonas to her drawee bank, but payment was refused and the checks were dishonored.

On or about September 9, 1996, in order to collect payment of the checks, plaintiff instituted suit against John R. Casquilla, Inc., John R. Casquilla individually, and Kimberly Lonas d/b/a VIP Motors in the Circuit Court for Palm Beach County, Florida. A default judgment was subsequently obtained on April 9, 1997, in the amount of \$24,322.30, representing the amount of the dishonored checks plus prejudgment interest of \$240.68, court costs of \$411.62, and attorney's fees of \$200.00. On November 26, 1997, the plaintiff filed an action to

domesticate its Florida judgment against the debtor in the Chancery Court for Hamblen County, Tennessee. While that action was pending, the debtor filed a chapter 7 bankruptcy petition initiating the underlying bankruptcy case on March 3, 1998.

The instant adversary proceeding against the debtor was commenced by the plaintiff on June 1, 1998. The plaintiff alleges in the complaint that the debtor drew the three checks on her business account knowing that there were insufficient funds in the account to pay the instruments, that the checks constituted a representation of her financial condition upon which the plaintiff relied and that the checks were made with the intent to deceive so that the debtor could acquire several vehicles for her business, VIP Motors. The plaintiff accordingly contends that the judgment debt it holds against the debtor is nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A) and (B).

In the debtor's answer to the complaint filed on June 15, 1998, she denies the fraud allegations and asserts that there was no privity of contract or fiduciary relationship between her and the plaintiff. She notes that the checks were not made payable to the plaintiff and denies that she authorized anyone to cash the checks and place the checks in the hands of the plaintiff bank. The debtor opines in the answer that "cashing

a third party out of state check without that check clearing and issuing a certified check to a fourth party based on that out of state check is patently unreasonable." The debtor does not deny that the plaintiff holds a judgment against her.

The instant motion for judgment on the pleadings and for summary judgment was filed by the debtor on August 19, 1998. Attached to her motion is a copy of the complaint filed by the plaintiff in the state court action. The debtor notes that no mention is made in the complaint of any fraud or misrepresentation. The basis for relief by the plaintiff against John Casquilla was breach of contract, and with regard to the debtor, the state court complaint states only that the debtor owes the plaintiff the sum of \$21,470.00 as the result of the unpaid checks. The debtor contends that because the plaintiff failed to raise the issues of fraud and misrepresentation in the state court action, the plaintiff is now collaterally estopped from asserting these issues in this dischargeability proceeding. The debtor maintains that she is entitled to summary judgment and on the pleadings as a matter of law because "a party will not be allowed to maintain inconsistent positions which is customarily considered a form of equitable estoppel" and that "[t]his rule is applied not only in the course of the same action or proceeding, but also in

proceedings supplemental thereto." Alternatively, the debtor argues that even if the "new fraud theory survives collateral estoppel" the debtor will be unable to prove fraud or misrepresentation.

## II.

A motion for judgment on the pleadings under Fed. R. Civ. P. 12(c), as incorporated by Fed. R. Bankr. P. 7012(b) provides that:

After the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings. If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material facts made pertinent to such a motion by Rule 56.

In considering such a motion, all well-pleaded material allegations contained in the complaint must be accepted as true. See *U.S. v. Moriarty*, 8 F.3d 329, 332 (6th Cir. 1993); *Lavado v. Keohane*, 992 F.2d 601, 605 (6th Cir. 1993). The motion will be granted when no material issue of fact exists and the movant is entitled to a judgment as a matter of law. See, e.g., *Paskvan v. City of Cleveland Civil Serv. Comm'n*, 946 F.2d 1233, 1235 (6th Cir. 1991).

Summary judgment under Fed. R. Civ. P. 56(c), made applicable to bankruptcy adversary proceedings by Fed. R. Bankr. P. 7056, is appropriate where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. See *Celotex Corporation v. Catrett*, 477 U.S. 317, 322, 106 S. Ct. 2548, 2554 (1986). Any inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. See *McCafferty v. McCafferty (In re McCafferty)*, 96 F.3d 192, 195 (6th Cir. 1996)(citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 1356 (1986)).

### III.

Although the debtor cites the legal doctrine of "collateral estoppel" as the basis for her assertion that plaintiff is precluded from raising fraud in this dischargeability proceeding because the state court judgment is not based on fraud, she has confused the legal principle of collateral estoppel with its sister doctrine of *res judicata*. Collateral estoppel or issue preclusion precludes relitigation of only those issues which were actually raised and determined in the earlier proceeding. See *Migra v. Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75, 77 n.1, 104 S. Ct. 892, 894 n.1 (1984); *Brown*, 442 U.S. at 138

n.10, 99 S. Ct. at 2212 n.10. Undisputably, fraud and false pretenses were not actually raised in the state court action and therefore collateral estoppel can not apply. On the other hand, the broader doctrine of *res judicata* or claim preclusion bars further litigation between the same parties or their privies of any claims based on the same cause of action which could have been raised in the initial proceeding regardless of whether they were actually raised. *Id.* Thus, more accurately, the debtor is arguing that because the fraud issue could have been raised in the state court action but was not, the plaintiff is barred from raising this issue in subsequent litigation based on the same cause of action, *i.e.*, *res judicata* bars the present adversary proceeding.

However, the legal principle posited by the debtor is inapplicable to dischargeability proceedings such as the instant one where the bankruptcy court possesses exclusive jurisdiction. The United States Supreme Court has specifically held that *res judicata* does not apply in determining the dischargeability of debts previously reduced to judgment. *See Brown*, 442 U.S. at 138-39, 99 S. Ct. at 2213. The *Brown* case involved a state court action between a creditor, a debtor and a guarantor which action was resolved by stipulated judgment. Thereafter, the debtor filed for bankruptcy protection. As in the present case,

the judgment holder filed a dischargeability action in bankruptcy court asserting that the debt was nondischargeable because it was obtained by false pretenses or false representation. In response, the debtor argued that because the prior state court proceeding had not resulted in a finding of fraud, the dischargeability proceeding was barred. The bankruptcy court agreed and granted the debtor's motion for summary judgment concluding that *res judicata* barred the judgment holder from offering additional evidence to prove the underlying nature of the debt. Both the district court and the United States Court of Appeals for the Tenth Circuit affirmed the bankruptcy court, concluding that in determining the dischargeability of a claim previously reduced to judgment, the lower court had properly limited its review to the record and judgment in the prior state court proceeding. The United States Supreme Court reversed, holding that "the bankruptcy court is not confined to a review of the judgment and record in the prior state court proceedings when considering the dischargeability of ... a debt." *Id.* at 138-139, 99 S. Ct. at 2213. As explained by the court:

Considerations material to discharge are irrelevant to the ordinary collection proceeding. The creditor sues on the instrument which created the debt....

...In the collection suit, the debtor's bankruptcy

is still hypothetical. The rule proposed by [the debtor] would force an otherwise unwilling party to try fraud issues to the hilt in order to protect himself against the mere possibility that a debtor might take bankruptcy in the future. In many cases such litigation would prove, in the end, to have been entirely unnecessary ....

*Id.* at 135, 99 S. Ct. at 2211. Furthermore, stated the court, application of *res judicata* would frustrate the congressional directive that bankruptcy courts have exclusive jurisdiction over the fraud exceptions to discharge. *Id.* at 135-36, 99 S. Ct. at 2211-12.\* See also *Bay Area Factors v. Calvert (In re Calvert)*, 105 F.3d 315, 318 (6th Cir. 1997)(citing *Brown* ("[T]he bankruptcy court may find a debt nondischargeable even though the debt has been reduced to a consent judgment in state court without any reference to fraud.")).

In the instant case, the state court action against the debtor was simply a collection suit to recover on worthless checks. The state court complaint recited that the debtor executed and delivered certain checks payable to the order of

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\*Although the *Brown* decision concerned the fraud dischargeability provisions found in § 17a(2) and (4) of the Bankruptcy Act, rather than those set forth in § 523(a)(2)(A) and (B), (a)(4) and (a)(6) of the current Bankruptcy Code, essentially the same standards apply and the bankruptcy court continues to have exclusive jurisdiction of these determinations. See 11 U.S.C. § 523(c)(1); *Heinold Commodities & Sec., Inc. v. Hunt (In re Hunt)*, 30 B.R. 425, 436 (M.D. Tenn. 1983); 4 COLLIER ON BANKRUPTCY ¶ 523.03 (15th ed. rev. 1998).

John Casquilla, Inc., that the checks were endorsed to the order of Fidelity Federal Savings Bank, that the checks were presented for payment to the drawee bank but payment was refused, that plaintiff holds the checks which remain unpaid, and that the debtor owes the plaintiff \$21,470.00 plus interest from June 13, 1996. As discussed, the absence of any allegation of fraud in the state court action does not preclude the plaintiff from now asserting in this dischargeability proceeding that the indebtedness was procured through fraud. Accordingly, the debtor's motion for judgment on this issue will be denied.

The court next turns to the debtor's alternative argument: that plaintiff will be unable to prove fraud or false representation due to the absence of a relationship between the debtor and the plaintiff, because the debtor herself did not tender the checks to the plaintiff to be negotiated and the property obtained by the debtor in exchange for the checks was received from John Casquilla rather than directly from the plaintiff. Such facts, however, do not preclude a finding of fraud or a determination that the debt represented by the state court judgment was obtained by false pretenses, a false representation or actual fraud within the meaning of § 523(a)(2)(A), or by the use of a materially false written statement respecting the debtor's financial condition as

envisioned by § 523(a)(2)(B). The state court complaint recited that the checks drawn by the debtor "were endorsed to the order of FIDELITY FEDERAL SAVINGS BANK (the plaintiff), and FIDELITY FEDERAL acquired all rights in the checks that payee has or had." Assuming the factual allegation is true, the plaintiff has correctly stated the law. Under Article 3 of the Uniform Commercial Code, transfer of an instrument such as a check "vests in the transferee any right of the transferor to enforce the instrument." See FLA. STAT. ANN. § 673.2031(2); see also *R.J. & B.F. Camp Lumber Co. v. State Sav. Bank*, 59 Fla. 455, 51 So. 543 (1910)(*per curiam*)(indorsee for value of negotiable note becomes holder of legal title and has at least the rights therein that payee had). Thus, upon endorsement of the checks to the plaintiff bank, the bank succeeded to all of the rights held by the original payee of the check, John R. Casquilla, Inc. And as such, plaintiff may properly prosecute this dischargeability proceeding regardless of the alleged lack of privity between the debtor and the plaintiff.

The facts as alleged by the plaintiff in its complaint initiating this adversary proceeding, however, do not state a claim for nondischargeability under § 523(a)(2)(B). Under this subsection, a debt may not be discharged if it was obtained by the "use of a statement in writing ... (i) that is materially

false; (ii) respecting the debtor's ... financial condition; (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and (iv) that the debtor caused to be made or published with intent to deceive." The plaintiff alleges in its complaint that the checks drawn by the debtor "constituted a representation of her financial condition on which the Plaintiff reasonably relied and the checks were issued or made with the intent to deceive." The law is well-settled, however, that a check in and of itself is not a statement of financial condition within the purview of § 523(a)(2)(B). See *Pub. Employees Retirement Sys. v. Gadus (In re Gadus)*, 145 B.R. 235, 237 (Bankr. N.D. Ohio 1992)(endorsement on check does not qualify as a financial statement under § 523(a)(2)(B)); *Charlie Kelton's Pontiac, Cadillac, Oldsmobile & Isuzu Truck, Inc. v. Roberts (In re Roberts)*, 82 B.R. 179, 184 (Bankr. D. Mass. 1987)(check itself is merely an order upon the drawee bank and even if implications from its issuance are considered, the implication would appear to pertain only to one bank account and not the debtor's financial condition); *Doug Howle's Paces Ferry Dodge, Inc. v. Ethridge (Matter of Ethridge)*, 80 B.R. 581, 588 (Bankr. M.D. Ga. 1987) (citing *A.G. Edwards & Sons, Inc. v. Paulk (In re Paulk)*, 25 B.R. 913, 917 (Bankr. M.D. Ga. 1982)(check is evidence of a debt, not a

statement of one's financial condition)); *Sell v. Heath (In re Heath*, 60 B.R. 338, 339 (Bankr. D. Colo. 1986)(check does not equate with a statement of financial condition). Because a check is not a statement of financial condition and the complaint makes no reference to the existence of any other written statement of the debtor's financial condition, the complaint fails to state a claim for relief under § 523(a)(2)(B). Accordingly, the debtor is entitled to judgment in this respect.

As a final note, the court observes that in her motion, the debtor implies that the debt held by the plaintiff against her is deficient because of its default judgment nature. See debtor's motion at ¶s 13 and 14: "Said 'debt' exists only because of a default judgment obtained by the Plaintiff .... ...Debtor avers that absent the judgment no 'debt' exists." Any such insinuations are meritless. A Florida state court has recognized that the debtor is indebted to the plaintiff and this court must give that determination full faith and credit. Although *res judicata* does not prohibit the bankruptcy court's review of the underlying nature of the debt in order to determine its dischargeability, the existence and amount of the judgment and, thus, the amount of the claim is *res judicata* in this court. See *Schaffer v. Dempster (In re Dempster)*, 182 B.R.

790, 799 (Bankr. N.D. Ill. 1995)(amount of debt due judgment creditor as determined by state court judgment was *res judicata* on that issue in bankruptcy court dischargeability proceeding, even though judgment was entered by default in state court); *Coopers & Lybrand, Ltd. v. Gibbs (In re Gibbs)*, 107 B.R. 492, 496 (Bankr. D.N.J. 1989)("When a state court enters a prepetition judgment as to the amount of a claim in the proper exercise of its jurisdiction, such judgment is *res judicata* in bankruptcy as to the amount of the claim, although not as to its dischargeable nature."); *Winkleman v. Fiedler (In re Fiedler)*, 28 B.R. 28, 30 (Bankr. M.D. Pa. 1982)(?The pre-bankruptcy judgment is *res judicata* upon the issue of liability, but not upon the issue of dischargeability of the debt, which constitutes a different cause of action, and which is the ultimate issue in this proceeding.").

#### IV.

For the foregoing reasons, the debtor's motion for judgment on the pleadings will be granted to the extent plaintiff seeks to assert that the judgment debt on the worthless checks is nondischargeable under 11 U.S.C. § 523(a)(2)(B). In all other aspects, the motion for judgment on the pleadings and for summary judgment will be denied. An order to this effect will

be entered contemporaneously with the filing of this memorandum opinion.

FILED: October 16, 1998

BY THE COURT

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MARCIA PHILLIPS PARSONS  
UNITED STATES BANKRUPTCY JUDGE