

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Sandra Joye Hewett and Gary Morgan
Hewett,
Debtors.

Malone Construction,
Plaintiff,

v.

Sandra Joye Hewett and Gary Morgan
Hewett,
Defendants.

C/A No. 03-03757-W

Adv. Pro. No. 03-80246-W

JUDGMENT

Chapter 7

Based upon the Findings of Fact and Conclusions of Law as recited in the attached Order of the Court, the Motions for Summary Judgment are denied.


UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
October 3, 2003.

FILED
at 0 o'clock & 00 min. AM
OCT 3 2003
BRENDA K. ARGOE, CLERK
United States Bankruptcy Court
Columbia, South Carolina (36)

ENTERED

OCT 3 2003

L.O.

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ORDER

Chapter 7

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THIS MATTER comes before the Court upon cross-Motions for Summary Judgment (the "Motions") filed by Malone Construction (the "Plaintiff") and Sandra Joye Hewett and Gary Morgan Hewett (the "Defendants" or "Debtors"). After considering the pleadings filed in the adversary proceeding, the attached materials from the prior litigation presented in support of the Motions, and counsels' arguments, the Court makes the following Findings of Fact and Conclusions of Law pursuant to Federal Rule of Civil Procedure 52, applicable in bankruptcy proceedings by Federal Rule of Bankruptcy Procedure 7052.¹

¹ The Court notes that, to the extent any of the following Findings of Fact constitute Conclusions of Law, they are adopted as such, and, to the extent any Conclusions of Law constitute Findings of Fact, they are so adopted.

FINDINGS OF FACT

The complaint filed by Plaintiff in the matter before the Court (the "Complaint") alleges nondischargeability of a judgment pursuant to 11 U.S.C. § 523(a)(2). In its Motion, Plaintiff alleges that Defendants are estopped from litigating the elements of a § 523(a)(2)(A) cause of action. On December 11, 2002, Plaintiff obtained a judgment (the "Judgment") against Debtors in the State of South Carolina, County of York, Court of Common Pleas (the "State Court Action") in the amount of \$16,500.00. The allegations raised in the complaint filed in the State Court Action alleged breach of contract as well as breach of contract accompanied by a fraudulent act.² The State Court Action was tried before a jury, and a jury verdict form (the "Verdict") was completed by the jury following trial and a judgment was rendered (the "Judgment") (collectively, the "Verdict and Judgment"). The jury answered yes to the following questions, as set forth on the Verdict:

1. Do you find that a valid contract was entered into between the Plaintiff and the Defendants?
2. Do you find that the Defendants breached the contract?
3. If your answer to question 2 is yes, then answer this question. Do you find by clear and convincing evidence that the Defendant breached the contract with fraudulent intent?

The Verdict also provided:

4. If your answer to question 2 or questions 2 and 3 are yes, please state the actual damage, if any, sustained by the Plaintiff.

\$16,500.00.

² Defendants counterclaimed alleging breach of contract and were awarded \$2,500.00. The parties have agreed to treat the \$2,500.00 judgment as a setoff, so that Plaintiff is seeking to have \$14,000.00 of its judgment declared non-dischargeable.

5. If your answer to question 3 is yes and if you have found actual damages sustained by Plaintiff then you would consider punitive damages. Do you find by clear and convincing evidence that Plaintiff is entitled to punitive damages.

“No.”

Additionally, the parties stipulated to the admission of a portion of the transcript from the State Court Action setting forth the judge’s jury instructions (the “Transcript”).³ The Transcript provides with respect to breach of contract accompanied by a fraudulent act, as follows:

[T]he plaintiff must prove by clear and convincing evidence that the defendants breached the contract, that there was a fraudulent intent related to the breach of contract and that there was a fraudulent act directly connected to the breach.

Now . . . I charged you with regard to breach of contract, I charged you with fraudulent – with the cause of action for breach of contract with fraudulent intent accompanied by a fraudulent act and I charged you with regard to actual damages. I charge you that if you find in favor of the plaintiff on the cause of action for breach of contract accompanied by a fraudulent act and if you find that the plaintiff is entitled to actual damages on that cause of action, breach of contract accompanied by fraudulent act, then you could consider punitive damages as well.

Tr. at 18 -19. The judge further instructed the jury with respect to the jury form, instructing the jury regarding each question. Tr. at 25-27. There is no dispute that the Judgment was final. Approximately three and one-half months following entry of the Judgment, on March 27, 2003, Defendants filed their Voluntary Petition seeking relief under Chapter 7 of the Bankruptcy Code.

CONCLUSIONS OF LAW

A. Standard for Summary Judgment

Rule 56(c) of the Federal Rules of Civil Procedure, applicable to adversary proceedings under the Bankruptcy Code by Federal Rule of Bankruptcy Procedure 7056, provides that summary judgment shall be granted “if the pleadings, depositions, answers to interrogatories and admissions

³ In addition, the complaint from the State Court Action is appended to Defendants’ Motion and response to Plaintiff’s Motion.

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. Summary judgment is appropriate “if the evidence is such that a reasonable jury could not return a verdict for the nonmoving party.” Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). In determining whether summary judgment is appropriate, the court must view all evidence in the light most favorable to the nonmoving party. See Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986).

The moving party has the initial burden to show that there is no genuine issue as to any material fact and that it is entitled to judgment as a matter of law. Celotex Corp v. Catrett, 477 U.S. 317, 332 (1986). Once this initial showing is made, the burden of production shifts to the nonmoving party. The Court should grant summary judgment “against a party who fails to make a showing sufficient to establish the evidence of an element essential to that party’s case, and on which that party will bear the burden of proof at trial.” Dunes Hotel Assoc., 194 B.R. 967, 976 (Bankr. D.S.C. 1995) (citing Celotex, 477 U.S. at 322).

B. Application of the Summary Judgment Standard to the Motion

For purposes of these Motions, the only matter before the Court is the collateral estoppel effect of the Judgment as it relates to Plaintiff’s nondischargeability action. Plaintiff urges the Court to apply collateral estoppel and grant its Motion pursuant to Federal Rule of Bankruptcy Procedure 7056 and declare that the debt owed to it is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2).

Plaintiff argues that it is entitled to summary judgment because § 523(a)(2) provides that a debt for actual fraud is not discharged, and that the jury determined that the debtor committed fraud

when it made a finding by clear and convincing evidence that there was a breach of contract by fraudulent act.⁴ Therefore, Plaintiff contends that it is entitled to summary judgment because Defendants are barred from relitigating the issue.⁵ Defendants argue that the jury's finding was limited and is not a finding of the type of fraud encompassed by § 523(a)(2).

The United States Supreme Court has stated that the principles of collateral estoppel apply in bankruptcy dischargeability proceedings. Grogan v. Garner, 498 U.S. 279, 284 n.11 (1991). “Collateral estoppel precludes relitigation of an issue decided previously in judicial or administrative proceedings provided the party against whom the prior decision was asserted enjoyed a full and fair opportunity to litigate that issue in an earlier proceeding.” See Hagan v. McNallen (In re McNallen), 62 F.3d 619, 624 (4th Cir. 1995). When applying the principle of collateral estoppel, the Court applies the forum state's law of collateral estoppel. See Pahlavi v. Ansari (In re Ansari), 113 F.3d 17, 19 (4th Cir. 1997); McNallen, 62 F.3d at 624.

When considering whether to apply collateral estoppel to a jury verdict, the Court must use “particular care” in making the determination. “Federal policies underlying discharge and its statutory exceptions require . . . that the bankruptcy judge must make a careful and considered determination that the issue was actually litigated and necessary to the earlier decision.” Combs v. Richardson, 838 F.2d 112, 116 (4th Cir. 1988) (citations omitted). A creditor seeking to have a debt

⁴ Although Plaintiff briefly references in its Motion the nondischargeability of the debt owed pursuant to the Judgment under § 523(a)(6), Plaintiff only pled in its Complaint with respect to § 523(a)(2) and the parties arguments to the Court are consistent with a request for a determination as to § 523(a)(2).

⁵ Plaintiff's Motion argues that Defendants are barred by res judicata. However, it is clear that Plaintiff is referring to issue preclusion, i.e., collateral estoppel.

excepted from discharge must prove the nondischargeability of the debt by a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279 (1991).

South Carolina has adopted the general rule of collateral estoppel as set forth in the Restatement (Second) of Judgments § 27 (1982) which states: "When an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or different claim." State v. Bacote, 331 S.C. 328, 330, 503 S.E.2d 161, 162 (S.C. 1998). See also Nelson v. OHG of South Carolina, Inc., 354 S.C. 290, 305, 580 S.E.2d 171, 179 (S.C. Ct. App. 2003) ("relitigation of those issues actually and necessarily litigated and determined in the first suit are precluded as to the parties and their privies in any subsequent action based upon a different claim.") (citations omitted).

In the matter before the Court, the only issues concern whether actual fraud was *determined* by the State Court, and whether that determination was *essential* to the Judgment. Plaintiff relies upon the Transcript, Verdict and Judgment to meet its burden of proving that Defendant is estopped from relitigating the elements of § 523(a)(2)(A). Furthermore, the Court has reviewed the complaint and answer from the State Court Action appended to Defendants' Motion.

a. Actually litigated and determined

There appears to be no dispute that the cause of action for breach of contract accompanied by a fraudulent act was actually litigated, at least in the sense that there was a trial held and Judgment was rendered. See State v. Bacote, 331 S.C. 328, 331, 503 S.E.2d 161, 163 (S.C. 1998) (citing cases that judgments rendered upon some preliminary or technical point or by default may call into question whether issue was actually litigated). However, the question remains whether the elements

of a § 523(a)(2)(A) cause of action were determined in the State Court Action. In order to ascertain whether an issue was determined in a prior action, the Court may examine the record in the prior case including “pleadings and other materials,” and if the record is inconclusive, extrinsic evidence. Watergate at Landmark Condominium Unit Owners Ass’n v. Wauben (In re Wauben), No. 96-1427, 1997 WL 436936, at **3 (4th Cir. 1997). A review of the entire transcript may not be necessary where the jury instructions and other relevant pleadings are sufficient. Combs v. Richardson, 838 F.2d at 117.

The United States Supreme Court has stated that § 523(a)(2)(A) incorporates the general common law of torts rather than the law of any particular State. Field v. Mans, 516 U.S. 59, 70 n.9 (1995). In order to establish that a debt is nondischargeable pursuant to § 523(a)(2)(A), the following elements must be proven:

- (1) That the Debtor made a representation;
- (2) That at the time the representation was made, the Debtor knew the representation was false;
- (3) That the Debtor made the false representation with the intention of deceiving the creditor;
- (4) That the creditor relied on such representation; and
- (5) That the creditor sustained the alleged loss and damage as the proximate result of the false representation.

Tompkins v. Whitenack (In re Whitenack), 235 B.R. 819, 824 (Bankr. D.S.C. 1998). See also Fowler v. Garey (In re Garey), 258 B.R. 356, 361 (Bankr. E.D. Va. 2000).

In an unpublished 1995 decision, this Court held under the facts of that case, that a judgment entered against a debtor for breach of contract accompanied by fraudulent act was nondischargeable.

Mallas v. Rainwater (In re Rainwater), No. 94-8234, 1995 WL 1930445, at *3.

In order to prove breach of contract accompanied by a fraudulent act under South Carolina law, three elements must be proven:

- (1) a breach of contract,
- (2) fraudulent intent relating to the breaching of the contract and not merely to its making, and
- (3) a fraudulent act accompanying the breach.

Conner v. City of Forest Acres, 348 S.C. 454, 465-66, 560 S.E.2d 606, 612 (S.C. 2002). The finding of all three elements is necessary, and punitive damages may be awarded upon proof of breach of contract accompanied by fraudulent intent. Floyd v. Country Squire Mobile Homes, Inc., 287 S.C. 51, 53-54, 336 S.E.2d 502, 503-04 (S.C. Ct. App. 1985) (“mere breach of contract, even if wilful or with fraudulent purpose, is not sufficient to entitle a plaintiff to go to the jury on the issue of punitive damages.”). See also Edens v. Goodyear Tire & Rubber Co., 858 F.2d 198, 201-02 (4th Cir. 1988) (noting that South Carolina courts have sustained demurrers to complaints where plaintiffs failed to allege one of the elements) (citing cases).

In the instant case, the Verdict and Judgment do not find each of the necessary elements. The jury clearly found two elements -- breach of contract and breach of contract with fraudulent intent. However, there was no finding of the necessary third element - a fraudulent act. In addition, neither the complaint from the State Court Action nor the Transcript (i.e. the jury instructions) sufficiently clarify this discrepancy. The complaint alleges a “fraudulent breach of contract.” Additionally, the judge in the State Court Action clearly instructed the jury that proof of all three elements was necessary to award damages on the cause of action for breach of contract accompanied by a fraudulent act -- breach of contract, fraudulent intent, and separately, a fraudulent act directly connected to the breach. Tr. at 18 - 19. However, the crucial third element is missing from the Verdict and Judgment. Thus, taking the evidence in the light most favorable to Defendant on

Plaintiff's Motion, the elements of § 523(a)(2)(A) were not determined in the State Court Action.⁶

b. Essential or necessary to the judgment.

Even if Plaintiff succeeded in proving by a preponderance of the evidence that the elements of § 523(a)(2)(A) were actually litigated and determined, in order for collateral estoppel to apply, Plaintiff must prove that the finding was “essential” or “necessary” to the Judgment. If a judgment is based on alternative findings, there is a “real question” whether the finding relied upon was necessary to the judgment. Watergate at Landmark Condominium Unit Owners Ass’n v. Wauben (In re Wauben), No. 96-1427, 1997 WL 436936, at **3 (4th Cir. 1997). “If a judgment of a court of first instance is based on determinations of two issues, either of which standing independently would be sufficient to support the result, the judgment is not conclusive with respect to either issue standing alone.” Schwager v. Fallas (In re Schwager), 121 F.3d 177 (5th Cir. 1997) (Where jury found both breach of an agreement and breach of fiduciary duty, the court ruled that it was impossible to determine the basis for the damages award). See also Dimmitt & Owens Fin’l, Inc. v. Green (In re Green), 262 B.R. 557, 567 (Bankr. M.D. Fla. 2001) (“Where the prior final judgment made only a single monetary award with respect to a multi-count complaint, and it cannot be determined which of the allegations were essential to the judgment, the doctrine of collateral estoppel should not be applied. . . .”); Spires v. Gregg (In re Gregg), 268 B.R. 295, 300 (Bankr. N.D. Fla. 2001) (if fraud

⁶ The jury’s answer to whether it would award punitive damages is also not dispositive. The jury responded “no,” which does not confirm whether the jury considered the matter and chose not to award punitive damages, or whether they could not find punitive damages because they did not find all three elements of breach of contract accompanied by a fraudulent act, as is required to award punitive damages relating to a breach of contract and as instructed by the judge.

and breach of contract are both alleged in the complaint, and the basis for the award is not clearly indicated, neither action may have been essential to the judgment).

In the matter before the Court, the question to the jury regarding the issue of damages requested that the jury state any actual damages award if they found *either* breach of contract *or* breach of contract with fraudulent intent. The complaint from the State Court Action alleges both breach of contract and fraudulent breach of contract, and it is impossible to determine from the Verdict and Judgment upon which cause of action the damages award is based. Additionally, the Transcript does not eliminate this possibility since the judge clearly instructed the jury that a finding of breach of contract can give rise to a damages award. Therefore, Plaintiff also did not meet its burden of proving that the finding of breach of contract with fraudulent intent was necessary to the Judgment.

CONCLUSION

The undisputed material facts indicate that the elements of collateral estoppel pursuant to South Carolina law are not satisfied. Plaintiff's Motion will be denied because it did not prove the applicability of collateral estoppel to the issues determined in the State Court Action for purposes of nondischargeability. Further, because Plaintiff is nonetheless entitled to a trial on the issue of discharge of the debt owed to it pursuant to § 523(a)(2)(A), Defendants' Motion will be likewise denied. For the above stated reasons, it is hereby

ORDERED that the Motions for summary judgment are denied. An order scheduling the matter for trial will be issued forthwith.

AND IT IS SO ORDERED.

Columbia, South Carolina,
October 3, 2003.


UNITED STATES BANKRUPTCY JUDGE