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NONDISCHARGEABILITY AND DISCHARGE INJUNCTION VIOLATION

Husky Int'l Elecs., Inc. v. Ritz, & *Taggart v. Lorenzen*: What, if anything, has changed?

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Abstract: *These materials explore the ramifications of two U.S. Supreme Court decisions: Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581, 1586, 194 L. Ed. 2d 655 (2016) ("Husky") and Taggart v. Lorenzen, 139 S. Ct. 1795, 1799, 204 L. Ed. 2d 129 (2019) ("Taggart"). To summarize, in Husky, the Supreme Court addressed the standards for nondischargeability under 11 U.S.C. § 523(a)(2)(A) and held that "forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation" are nondischargeable under § 523(a)(2)(A). Husky, 136 S. Ct. at 1586. Taggart clarified the standards for holding a creditor in civil contempt for violating the discharge injunction of 11 U.S.C. § 524(a)(2). The question presented here concerns the criteria for determining when a court may hold a creditor in civil contempt for attempting to collect a debt that a discharge order has immunized from collection. Taggart, 139 S. Ct. at 1799. The Supreme Court rejected both strict liability and a subjective standard. Rather, the Supreme Court held that a creditor may be held in civil contempt for violating a discharge order if there is "no fair ground of doubt"as to whether the order barred the creditor's conduct. Phrased differently, "civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful. Id.*

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I. *Husky*: Its Progeny, Ramifications, and Open Questions

A. *In Re Gaddy*, 977 F.3d 1051, 1057 (11th Cir. 2020), *cert. denied sub nom. SE Prop. Holdings, LLC v. Gaddy*, No. 20-1076, 2021 WL 1520807 (U.S. Apr. 19, 2021). In *Gaddy*, the 11th Circuit held that the money or property giving rise to the debt must have been 'obtained by' fraud, actual or otherwise." Using dictum from *Husky*, the creditor argued that if a recipient of a fraudulent transfer "later files for bankruptcy, any debts 'traceable to' the fraudulent conveyance will be nondischarg[e]able under § 523(a)(2)(A)." *Husky*, 136 S. Ct. at 1589 (citation omitted). The Gaddy court observed fraudulent acts created or potentially created the very debts at issue. *See Husky*, 136 S. Ct. at 1585 (describing debtor's "drain[ing]" of corporate assets).

B. *Mills v. Seawright*, 2021 WL 785105, at *4 (S.D. Miss. Mar. 1, 2021) (denying a motion to dismiss relying on *Husky* for propositions such as section 523(a)(2)(A) options are disjunctive, may overlap, and the creditor need only prove one option).

C. In re Bonnett, No. 2:18-AP-00223-EPB, 2020 WL 4371881, at *4 (B.A.P. 9th Cir. July 30, 2020), *appeal filed by Jeaneen Bonnett v. Moirbia Scottsdale, LLC* (August 26, 2020, 9th Cir.) Recognizing that Husky did not set forth the elements that a creditor must prove under Section 523(a)(2)(A) to establish a fraudulent transfer scheme, but adopting the following test:

> 1) the transferor conveyed the property with the intent to hinder or delay his creditors; and 2) the transferee was a participant in the fraud, such that it could be said that the debtor engaged in "deceit,

> artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another.

Id. at *5 (*citing Fisher v. Quay* (*In re Quay*), 2005 WL 6488242, at *9 (Bankr. N.D. Ga. 2005) (*citing McClellan v. Cantrell, 217 F.3d 890, 893 (7th Cir. 2000)*.

D. *In re Garcia*, 2020 WL 5203201, at *10, n. 9 (B.A.P. 9th Cir. Sept. 1, 2020) (The 9th Circuit BAP refused to extend *Husky* to garden-variety conversion, constructive fraud damages, or "implied fraud". The 9th Cir. BAP still requires requires proof of intent to deceive to support a claim under § 523(a)(2)(A). *Id. See Am. Express Travel Related Servs. Co. v. Hashemi (In re Hashemi*), 104 F.3d 1122, 1125 (9th Cir. 1996) (*citing Britton v. Price (In re Britton*), 950 F.2d 602, 604 (9th Cir. 1991)).

E. *In re Martin*, 2021 WL 825142, at *3 (B.A.P. 9th Cir. Mar. 3, 2021), appeal filed by In re Paul Martin v. Kevin Hunter, (Apr. 7, 2021 9th Cir. 2021) (expanding *Husky* to include converted collateral where the seller failed to inform the lienholder, remit any proceeds, and knew the unauthorized sale was wrong. Based upon these facts (and that it was a Porsche), the 9th Circuit BAP held that the bankruptcy court did not err in inferring the requisite fraudulent intent (i.e., concealment and hindrance).

F. *In re Wigley*, 620 B.R. 87, 91 (B.A.P. 8th Cir. 2020). Affirming the bankruptcy court's determination that the debtors' fraudulent transfers fit within the exception of Section 523(a)(2)(A) and endorsing the lower court's use of application of the following three elements: (1) the transferor transferred assets with the actual intent to hinder, delay, or defraud the

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transferor's creditors; (2) in receiving the assets, the transferee possessed actual fraudulent intent; and (3) as a result of these actions, the creditor was injured or suffered damages.

G. *In re Savage*, 625 B.R. 641, 647 (Bankr. N.D.W. Va. 2021) (distinguishing *Husky* as Plaintiff was attempting to except a judgment lien from the Debtors' Chapter 7 discharge after the West Virginia State Court found that the Debtors engaged in fraud by conveying assets beyond the Plaintiff's reach and not a debt and that "subtle difference" was sufficiently distinguishable for the bankruptcy court).

H. *In re Fusion Connect, Inc.*, 617 B.R. 36, 45 (Bankr. S.D.N.Y. 2020) (granting motion to dismiss against the government and in favor of the debtor where the FCC tried to pigeonhole FCC penalties in as Section 523(a)(2)(A) claims using *Husky*).

I. *In re Rivera*, 2020 WL 4018986, at *2 (Bankr. S.D. Fla. July 16, 2020) (dismissing the bank's complaint with prejudice where the bank's pre-petition judgment did not arise from fraud and the debtor's post-petition activity did not convert the claim into a nondischargeable claim under Section 523(a)(2)(A).

J. The "Obtained by" Problem.

1. The Bankruptcy Code prohibits debtors from discharging debts "**obtained** by ... false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A).

2. In a fraudulent transfer, the "debt" is not "obtained by" fraud. *Husky*, 136 S. Ct. at 1589. (the majority opinion concedes that "[i]t is of course true that the transferor does not 'obtai[n]' debts in a fraudulent conveyance."). Rather, by participating in the fraudulent scheme, the recipient receives assets. *Id.*

3. *Husky* was decided by an 8-1 majority with Justice Thomas dissenting based upon the plain language of the Section 523(a)(2)(A) and the inability to reconcile the "obtained by" language of the U.S. Bankruptcy Code with the nature or structure of a fraudulent transfer. More particularly, Justice Thomas is concerned that by including fraudulent transfers under actual fraud, the majority writes out the phrase "obtained by" and the element of causation. *Husky* 136 S. Ct. at 1590–91.

4. Who is the rightful defendant? The Supreme Court even acknowledged the problem that if the scheme gives rise to liability, then both the transferor and transferee could be held liable and the debt be found nondischargeable. The Supreme Court called such a scenario "rare" as such a "person who receives fraudulently conveyed assets is not necessarily (or even likely to be) a debtor on the verge of bankruptcy." *Id.* at 1589.

5. How do you determine damages? What if the amount fraudulently transferred is "X" but the amount defendant lost was less than "X"?

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6. On remand, the bankruptcy court declined to grant avoidance of the fraudulent transfer to Husky because Husky did not plead for this relief in the Pre–Trial Statement; it did not reference § 550 in the Pre–Trial Statement; nor did it sue the recipients of the fraudulently transferred funds. It was, however, in the Complaint in the prayer for relief. *In re Ritz*, 567 B.R. 715, 765 (Bankr. S.D. Tex. 2017).

7. *See* Hon. Deborah L. Thorne, *What's Next After Husky v. Ritz: Has Pandora's Box Been Opened*?, 35 Amer. Bankr. Inst. J. 20 (Aug. 2016).

8. *See In re Vanwinkle*, 562 B.R. 671 (Bankr. E.D. Ky. 2016) (plaintiff must allege that purported non-dischargeable debt was "obtained by" actual fraud).

K. Practice Pointer Question: Drafting the Complaint – After *Husky*, do you include a count or claim for fraudulent transfer or fraudulent scheme?

1. *Husky* involved a "transfer scheme designed to hinder the collection of debt." Husky, 136 S. Ct. at 1586.

2. "Anything that counts as 'fraud' and is done with wrongful intent is 'actual fraud.'" *Id.*

3. Misrepresentation is not a defining feature/element (or even a feature oftentimes) of a fraudulent transfer. Rather, look for concealment and hindrance. *Id.* at 1587.

4. Do I need to sue under Section 550 as well and name the transferor and transferee in the nondischargeability complaint?

5. See Hon. William Houston Brown, Lawrence R. Ahern, III, 9B *West's Legal Forms, Debtor & Creditor Bankruptcy* § 39:2 (5th ed.) (good practice pointers for drafting complaint for determination that debt is nondischargeable).

II. *Taggart*: The Move to Objectivity

A. As a refresher, *Taggart* addressed the "legal standard for holding a creditor in civil contempt when the creditor attempts to collect a debt in violation of a bankruptcy discharge order." *Taggart*, 139 S. Ct. at 1801. The Supreme Court held that "a court may hold a creditor in civil contempt for violating a discharge order if there is *no fair ground of doubt* as to whether the order barred the creditor's conduct. In other words, civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful." *Id.* at 1799. The Court's conclusion rested on the interpretive principle that when a term is transplanted from another source it brings with it the "old soil" with it. *Id.*, at 1801.

B. *In re Roth*, 935 F.3d 1270, 1278 (11th Cir. 20190 (determining that under *Taggart* that the creditor's monthly informational statement did not violate § 524 as the "no fair ground of doubt" standard for § 105 was not satisfied).

C. *In re DiBattista*, 615 B.R. 31, 39 (S.D.N.Y. 2020). Applying *Taggart* to the old burdens of proof and concluding that the debtor need not prove that the creditor acted willfully to be subject to a contempt order. Moreover, the

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district court was unsure which party carries the burden on a motion for contempt, "though it is likely still on the movant." Regardless, the district court found clear and convincing evidence that servicer of debtor's mortgage loan made more than 30 telephone calls to the debtor and that was sufficient to support a finding of contempt.

D. *Taggart* involved civil contempt for violating discharge injunction. Cf. violating automatic stay under 11 U.S.C. § 362(k). *See In re Franklin,* 614 B.R. 534, 547 (Bankr. M.D.N.C. 2020) (recognizing the difference between the standards for imposing sanctions for a contemptuous violation of the discharge injunction under §§ 105(a) and 524 and imposing sanctions for a willful violation of the stay under § 362(k) and noting that the Court in Taggart also observed the differences); *In re Sundquist*, 580 B.R. 536, 545 (Bankr. E.D. Cal. 2018) (applying, among other statutes, Section 362(k)).

E. *In re Ajasa*, 627 B.R. 6 (Bankr. E.D.N.Y. 2021). After debtors received a discharge, they brought putative class action to recover for lender's alleged violations of the discharge injunction. Lender moved strike class allegations citing, among other cases, *Taggart*. Bankruptcy court held that *Taggart* and its "old soil" does not address whether class certification is appropriate in an individual debtor's case, or in a district-wide class, or, in a putative nationwide class. *Id.* at 32.

F. *In re LeGrand*, 612 B.R. 604, 613 (Bankr. E.D. Cal. 2020). Judge Klein held that the judgment creditor and creditor's attorney willfully violated the automatic stay when they waited 19 days after receiving communication

from debtor's counsel to terminate dormant wage garnishment, despite having knowledge of the bankruptcy. Judge Klein applied *Taggart*'s objective standard to find civil contempt, but looked to subjective good or bad faith to help determine the size of the range of losses attributable to noncompliance. The Court awarded actual damages for wages improperly withheld, reasonable attorney fees, and emotional distress damages, and punitive damages in the amount of $25,000. Damages were imposed on creditor and its attorneys, both of which were sophisticated debt collectors.

G. *See* Jay Brown & Katie Fackler, *"Old Soil": Supreme Court Sets Straight the Standard for Civil Contempt of A Discharge Order,* Am. Bankr. Inst. J., November 2019, at 18.

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THE PRECLUSIVE EFFECT OF PREPETITION STIPULATED FINDINGS IN NONDISCHARGEABILITY PROCEEDINGS: THE NINTH CIRCUIT SAYS YES

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A common fact pattern: Plaintiff sues Defendant for breach of contract and fraud. Prior to trial, Plaintiff and Defendant enter into a settlement agreement that includes the following provisions:

1. Defendant executes a consent judgment for the amount demanded, with an agreement the consent judgment will be held by Plaintiff but can be recorded and enforced if the Defendant defaults on the settlement agreement.

2. Defendant, in the consent judgment, settlement agreement or related document, admits to the allegations in the complaint or otherwise makes representations that track the elements of fraud under applicable law.

3. Defendant stipulates that Plaintiff's claim will be nondischargeable in any subsequent bankruptcy and that Defendant will not seek to discharge the claim in any subsequent bankruptcy.

Defendant files a bankruptcy, Plaintiff files a nondischargeability complaint, Defendant answers and disavows the representation of fraud, and Plaintiff files a motion for summary judgment based on the preclusive effect of Defendant's representations.

What should be the result? The issue is complicated, because giving effect to prepetition stipulated facts demanded to negate the discharge conflicts with public policy that renders prepetition waivers of the discharge unenforceable. In a recent series of unpublished decisions, the Ninth Circuit Court of Appeals has shown little interest in the complexity of the issue and instead summarily held that preclusion applies. Because the decisions were unpublished, the

issue will continue to be litigated until the Court of Appeals decides to publish a decision that will be binding on lower courts.

A. *Stipulated Findings In Consent Judgment Do Not Normally Satisfy The Elements Of Issue Preclusion*

Typically, to obtain summary judgment that a debt is nondischargeable, the creditor will be required to reply on the preclusive effect of a prior judgment. Claim preclusion is not available, because nondischargeability can only be raised in a bankruptcy case. *Brown v. Felsen*, 442 U.S. 127, 133-139 (1979); *Archer v. Warner*, 538 U.S. 314 (2003). Therefore, the creditor must rely on issue preclusion to satisfy the applicable elements of nondischargeability. *Grogan v. Garner*, 498 U.S. 279 (1991). The preclusive effect of a judgment in a nondischargeability proceeding is governed by the law of the jurisdiction where the judgment was entered. *Gayden v. Nourbakhsh (In re Nourbakhsh)*, 67 F.3d 798, 800 (9th Cir. 1995).

While the elements of issue preclusion vary slightly from state to state, the law in most jurisdictions is consistent with the Restatement 2d of Judgments. Section 27 of the Restatement provides that "[w]hen 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 a different claim."

By definition, stipulated findings in consent judgments are not "actually litigated." Furthermore, detailed findings are usually not required for the enforceability of a consent judgment, so the findings are extraneous and not "essential to the judgment." Therefore, as a general rule, courts state that stipulated findings in consent judgments are not issue preclusive. *See, e.g., Howard v. Sandoval (In re Sandoval),* 126 Nev. 136, 140 (2010) ("When a judgment is entered by confession, consent, or default, none of the issues is actually litigated, and therefore, the issues may be litigated in a subsequent action.").

B. *The "Intent" Exception To The Rule*

While stipulated findings do not satisfy the elements of issue preclusion, courts have found consent judgment to be issue preclusive if the parties "intend" for the judgment to be preclusive. *See, e.g., Cal. State Auto. Ass'n Inter-Ins. Bureau v. Superior Court,* 50 Cal. 3d 658, 664 (1990) ("[A] stipulated judgment may properly be given collateral estoppel effect, at least when the parties manifest an intent to be collaterally bound by its terms.").

This exception is referenced in comment e. to Section 27 of the Restatement: "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. The judgment may be conclusive, however, with respect to one or more issues, if the parties have entered an agreement manifesting such an intention."

C. *The Problem In Applying The "Intent" Exception In Nondischargeability Proceedings*

As general policy, the "intent" exception makes sense. If the parties mutually agree that a stipulated fact will be binding in a subsequent proceeding, the parties should be held to that

agreement. But the exception is difficult in concept and application. Is "actually litigated" to judgment an element of issue preclusion or not? Presumably, all agreements are intended to be conclusive, so the exception swallows the rule.

Furthermore, are stipulated findings trustworthy? Typically, the findings are agreed to after the defendant previously disputed the allegations, frequently under oath, and reflect the leverage that a creditor may have in the specific circumstance. In *Isbell v. Cnty. of Sonoma*, 21 Cal. 3d 61 (1978), the California Supreme Court held that California's statutory scheme governing confessions of judgment violated due process because the scheme provided insufficient safeguards to assure that the debtor in fact executed a voluntary, knowing and intelligent waiver. The Court noted that the confessed judgment "strongly suggests a substantial disparity in bargaining position and implies overreaching on the part of the creditor." *Id.* at 70.[1]

But the exception is especially problematic with respect to nondischargeability proceedings. There is a general consensus that because the bankruptcy discharge reflects fundamental public policy, a prepetition waiver of the discharge is unenforceable. *Hayhoe v. Cole (in Re Cole)*, 226 B.R. 647 (BAP 9th Cir. 1998) (collecting cases). For purposes of implementing the policy against discharge waivers, the fact that there is evidence that the parties "intended" to waive the discharge is entirely irrelevant, because the policy trumps the parties' intent. *Bank of China v. Huang (In re Huang)*, 275 F.3d 1173, 1177 (9th Cir. 2002) ("This prohibition of prepetition waiver has to be the law; otherwise, astute creditors would routinely require their debtors to waive.").

Accordingly, there is a complex analytical problem where the parties stipulate that findings contained in a consent judgment will be preclusive in a nondischargeability proceeding, What controls: (1) the general rule that stipulated findings are not issue preclusive, (2) the exception that stipulated findings are preclusive if the parties "intend" the findings to be preclusive, or (3) the public policy that waivers of the discharge are unenforceable notwithstanding the parties' intent?

D. *Klingman v. Levinson*

In *Klingman v. Levinson*, 831 F.2d 1292 (7th Cir. 1987), the plaintiff and defendant entered into a consent judgment concerning a dispute alleging dissipation of trust assets. As part of the consent judgment, the defendant stipulated that in disregard of his fiduciary duties, he failed to conserve the trust assets and instead, through misappropriation and defalcation, caused the dissipation of trust assets. The defendant further stipulated his intent that the judgment not be dischargeable in a bankruptcy and that the allegations in the complaint and statements stipulated in the consent judgment may be taken as true and correct without further proof in any subsequent proceeding.

[1] In response to the decision, California enacted California Code of Civil Procedure § 1132, which requires that an attorney sign a certificate that the attorney has examined the confessed judgment and advised the defendant with respect to the waiver of rights and defenses that will result.

After the defendant filed for bankruptcy, the bankruptcy court granted summary judgment that the debt was nondischargeable, holding that the debtor was barred by issue preclusion from relitigating the issue of defalcation. On appeal, the Seventh Circuit Court of Appeals affirmed, holding that while issue preclusion normally requires the issue be actually litigated, it is sufficient if "the parties intended that the issue be foreclosed in other litigation." The Court then stated in a footnote that while a debtor may not contract away the right to a discharge, "a debtor may stipulate to the underlying facts that the bankruptcy court must examine to determine whether a debt is dischargeable."

Author's comment: While the holding of the case is clear enough, the Court did not cite any authority for the statement in the footnote or provide any further analysis. The Court effectively begged the question, which is whether the debtor's agreement that stipulated facts be binding in a subsequent nondischargeability proceeding should be given effect in view of the bankruptcy policy?

E. *In re Cole and In re Huang*

In *Hayhoe v. Cole (in Re Cole)*, 226 B.R. 647 (BAP 9th Cir. 1998), and *Bank of China v. Huang (In re Huang)*, 275 F.3d 1173 (9th Cir. 2002), the BAP and Ninth Circuit addressed settlement agreements in which the defendant stipulated that the claim arising from the settlement agreement would not be dischargeable in a subsequent bankruptcy. The BAP and Ninth Circuit both held that the stipulation was as an unenforceable discharge waiver.

Because neither case involved stipulated factual findings, neither opinion was required to address whether stipulated findings intended to negate the discharge are preclusive, but each opinion intimated that the result might be different if the defendant had stipulated to fraud. In dicta, the BAP in *Cole* favorably cited *Klingman* that a stipulation to facts will be given preclusive effect. In *Huang*, the Court noted that the debtor had repudiated the settlement shortly after entering into it, but that the Court had not been asked to judge the debtor's "good faith" or the circumstances of the settlement agreement and bankruptcy filing.

Author's comment: While rarely cited directly, the discussion in *Huang* concerning the debtor's "good faith" in repudiating promises made in the settlement agreement may explain in significant part why courts give effect to stipulated findings. Regardless of legal technicalities, courts are uncomfortable with litigants who settle litigation and then attempt to use bankruptcy to maintain the benefits but not the burdens of the settlement.

F. *In re Wank*

The BAP squarely addressed the preclusive effect of stipulated findings in *Wank v. Gordon (In re Wank)*, 505 B.R. 878 (BAP 9th Cir. 2014). The plaintiff sued the defendant for various causes of action, including fraud. The parties then entered into a settlement agreement. The defendant agreed that if he defaulted on the settlement, plaintiff could enter a judgment against him in state court. The agreement contained a provision that all obligations arising under the agreement shall be nondischargeable. The agreement also required the defendant to execute a declaration under penalty of perjury, attached to the agreement, in which the defendant made factual statements concerning the transaction, including that he had made false statements to

induce the plaintiff to invest. The declaration provided that the purpose of the declaration was to provide a factual basis to ensure the nondischargeability of the debt. The original, executed declaration was kept in a sealed envelope only to be unsealed if the defendant defaulted and filed bankruptcy.

The defendant defaulted, the consent judgment was entered, and the defendant filed bankruptcy. The plaintiff filed a nondischargeability complaint and then moved for summary judgment based on the defendant's admissions in the declaration. The defendant opposed summary judgment, repudiating the statements and arguing that the declaration was intended to defeat his right to a discharge. The defendant alleged he had signed the declaration under duress and sole reason for signing was to obtain the benefit of the settlement agreement.

After declaring that it was disregarding references to the discharge in the settlement agreement and declaration, the bankruptcy court concluded that the opposition to the summary judgment motion did not negate the admissions in the declaration, so summary judgment was entered.

After a discussion of *Huang* and *Cole*, the BAP held that "when viewed in light of the strong public policy prohibiting debtors from contracting with creditors to forego the protections of a bankruptcy filing, Wank's statements in the First Declaration must, at a minimum, be viewed with great skepticism." The BAP noted that the sole purpose of the declaration was to negate the discharge, because the evidence of the debt was separately achieved by the settlement agreement. The BAP noted that the declaration was a stand alone document that was never intended to be submitted in state court, only bankruptcy court. In summary, while the declaration was evidence to be considered at trial, the evidence was disputed, so summary judgment could not be entered.

The *Wank* decision was followed in *Yaikian v. Yaikian (In re Yaikian)*, 508 B.R. 175, 185 (Bankr. S.D. Cal. 2014). The plaintiff sued the defendant for breach of contract and fraud. The parties then entered into a stipulated judgment on both the breach and fraud claims, and stipulated that the judgment would be nondischargeable. The fraud admission was conclusory. The bankruptcy court held the judgment was not issue preclusive in the nondischargeability proceeding, because the stipulated fraud claim was not actually litigated, and had no intended impact outside of a future nondischargeability proceeding. The Court emphasized that, unlike a default judgment, the state court did not independently review the fraud allegations, it simply "accepted" the stipulated judgment.

Author's comment: The *Wank* decision acknowledged the reality that stipulated findings are negotiated precisely to effectuate a discharge waiver, and then held that the public policy against waiver trumps the fact that the parties intended at the time for the findings to be conclusive. If read broadly, *Wank* would effectively negate the preclusive effect of stipulated findings contained in consent judgments where there was evidence that the findings were included to negate the discharge.

G. *The Ninth Circuit Cancels Wank*

In 2019, 2020 and 2021, three different cases dependent on *Wank* reached the Ninth Circuit. In each, the Court issued a cursory unpublished opinion decided without oral argument holding that summary judgment was properly granted in favor of the creditor.

1. *In re Johnson*

Johnson was sued prepetition for fraud and other causes of action. The parties entered into a settlement agreement that included a stipulated judgment admitting to the facts alleged in the complaint. The settlement included the following language:

> [Defendants] have further expressly agreed to and understand that all such obligations under the Agreement and the Stipulated Judgment shall be fully and entirely nondischargeable and shall survive any liquidation proceeding, receivership proceeding, conservatorship proceeding, bankruptcy proceeding and/or any other similar proceeding."

The settlement terms, including the waiver of the discharge, were put on the record, and Johnson indicated at the hearing that he understood the terms of the settlement was willing to be bound by its terms.

Johnson defaulted, the judgment was entered, and Johnson filed bankruptcy. The bankruptcy court, upheld by the BAP, granted summary judgment that the debt was nondischargeable. The bankruptcy court did not rely on the waiver of the discharge, but found that Johnson intended to be bound by the stipulated facts. The bankruptcy court distinguished *Wank* because Johnson's stipulation to facts was relied upon by the state court when it entered judgment. Comparatively, in *Wank* the declaration admitting facts was only to be sealed and presented if the debtor filed for bankruptcy.

In a three paragraph unpublished opinion decided without oral argument, the Ninth Circuit affirmed, holding that the bankruptcy court correctly held that the parties intended for the stipulated facts to be binding, and that *Wank* was distinguishable because the stipulated facts were relied upon by the state court when it entered the judgment. *Johnson v. W3 Invs. Partners, L.P. (In re Johnson)*, 784 F. App'x 529 (9th Cir. 2019).

Author's comment: While a circumscribed reading of *Wank*, it is relevant that the settlement terms were disclosed in open court and Johnson represented in open court he understood the terms and agreed to be bound by the terms. *Accord, Son v. Park*, 2010 U.S. Dist. LEXIS 123068 (N.D. Cal. Nov. 18, 2010) (stipulated facts admitting to fraud preclusive where debtor admitted to the facts in open court at the hearing to approve the settlement). The result in *Johnson* is not dissimilar to the postpetition standard for a waiver of the discharge, which requires bankruptcy court approval to ensure that the debtor is aware of the consequences of waiving the discharge and the stipulation is not made under duress. 11 U.S.C. §§ 524(c) and 727(a)(10).

2. *In re Morabito*[2]

Morabito was sued for fraud and other causes of action. At trial, the state court found that Morabito committed a fraud. After Morabito appealed, the parties entered into a settlement agreement. Morabito agreed to make a settlement payment conditioned on the fraud judgment being vacated, which occurred. Morabito agreed to a consent judgment in which he made representations that he committed a fraud and waived the discharge. The consent judgment was held by the creditor pending a default on the settlement agreement. Unlike in *Johnson*, Morabito made no representations concerning the settlement in open court.

Morabito defaulted, the consent judgment was recorded, and the creditor then filed an involuntary bankruptcy, and an order for relief was eventually entered. The creditor filed a nondischargeability complaint, Morabito answered denying fraud, and the creditor then filed for summary judgment, relying entirely on the preclusive effect of the representations included in the consent judgment. In opposition, Morabito submitted a declaration under penalty of perjury disavowing any fraud and submitted supporting documentation.

The consent judgment was recorded in Nevada, which has a simple process that permits the judgment to be recorded without court review, so the *Johnson* rationale was not applicable. Also, unlike California, Nevada does not have case law supporting the "intent" exception for the preclusive effect of consent judgments. Nevertheless, the bankruptcy court entered summary judgment on two different grounds. First, preclusion should apply because the stipulated findings were consistent with the vacated findings made by the state court. And second, Morabito's disavowal of the stipulated findings could be disregarded based on the "sham affidavit" rule, which permits a trial court to disregard a declaration submitted in opposition to summary judgment that contradicts prior sworn testimony. *See generally, Kennedy v. Allied Mut. Ins. Co.*, 952 F.2d 262, 266 (9th Cir. 1991).

In a six paragraph unpublished opinion decided without oral argument, the Ninth Circuit affirmed. *JH, Inc. v. Morabito (In re Morabito)*, 804 F. App'x 860 (9th Cir. 2020). First, the Court held the bankruptcy court did not abuse its discretion in disregarding Morabito's disavowal of fraud in opposing summary judgment, because the disavowal directly contradicted the stipulated findings, which were verified before a notary. Second, the Court agreed that the stipulated facts satisfied the "actually and necessarily litigated" elements because the facts were identical to the factual findings made by the state court. And third, the Court held that the stipulated findings were not an unenforceable waiver. Citing *Cole*, the Court held that "[a]lthough debtors may not "contract away the right to a discharge in bankruptcy," they ordinarily may stipulate to the factual basis for an exception to discharge." Notably, unlike the decision in *Johnson*, the decision made no reference to *Wank*.

Author's comment: The brief Ninth Circuit decision does not do justice to the Morabito case, which would make an excellent law school exam. At summary judgment, there were two key undisputed facts: (1) Morabito had strenuously denied committing a fraud, including under

[2] The author represented Morabito in the nondischargeability proceeding and subsequent appeals.

oath, multiple times, and (2) the sole reason the creditor required the stipulated findings as part of the settlement agreement was to negate the discharge. There was no controlling precedent under Nevada law holding that the findings should be given preclusive effect, so presumably Morabito should have been afforded the opportunity to dispute the fraud claim at trial. However, based on the history of the dispute, which was quite complicated, the bankruptcy court had no interest in conducting a new trial, and was adamant that Morabito was not entitled to another bite at the apple, so the Court struggled to distinguish *Wank* and find a legal justification to grant summary judgment.

On appeal, the Court failed to address the key issues that were thoroughly briefed: (1) there was no precedent for applying the "sham affidavit" rule, because the stipulated findings, while verified in front of a notary, were not "sworn" under Nevada law, unlike the declaration submitted in opposition to summary judgment, and there was no evidence that Morabito had manufactured the dispute to oppose summary judgment, and (2) the state court judgment was vacated, and vacatur eliminates any preclusive effect. *See generally, Camreta v. Greene*, 563 U.S. 692, 713 (2011); *Schlang v. Key Airlines*, 158 F.R.D. 666, 671 (D. Nev. 1994) ("The most significant cost associated with vacatur is the elimination of the judgment's preclusive effect.").

And once again, with respect to the waiver of the discharge, the Court begged the question. Yes, a stipulation to facts that is issue preclusive under applicable law may be issue preclusive in a nondischargeability proceeding, but to the extent issue preclusion is dependent under applicable law on the debtor's intent to be bound in a nondischargeability proceeding, why should that intent be given effect in view of the public policy against discharge waivers?

3. *In re Jun Ho Yang*

Yang was sued prepetition for fraud and other causes of action. The parties entered into a settlement agreement that included a stipulation for entry of judgment admitting to the facts alleged in the complaint. The settlement included the following language:

> Yang stipulates to the facts supporting the claims made against him and that said facts and claims allege liability for, that he is admitting liability for and that the facts and claims are within the meaning of 11 U.S.C.A. 523 . . . . Yang agrees that this stipulation can be used in favor of FMI or its assignees and against Yang in any action in which Yang or a business entity owned and controlled by Yang is a party to an action for protection under the Bankruptcy Code.

Yang defaulted and filed bankruptcy. The bankruptcy court, upheld by the BAP, granted summary judgment that the debt was nondischargeable. The bankruptcy court did not rely on the waiver of the discharge or that Yang was precluded by the settlement from seeking a discharge. Instead, the bankruptcy court ruled that Yang was bound by his admission of facts, so summary judgment was appropriate.

In Yang's first appeal to the Ninth Circuit, the Court reversed. *Jun Ho Yang v. Fund Mgmt. Int'l, LLC (In re Jun Ho Yang)*, 698 F. App'x 374 (9th Cir. 2017). The Court first stated

that there is no basis other than issue preclusion to hold facts stipulated in one case are binding in another case. The Court then noted that under California law, stipulated facts are only preclusive "when the parties manifest an intent to be collaterally bound by its terms." Because Yang had submitted a declaration that he did not intend the stipulated facts to have a preclusive effect, the declaration, even if self-serving, created a genuine issue of material fact, so summary judgment was inappropriate. The decision included a footnote that because the Court was reversing based on the intent dispute, the Court would not address whether Yang's stipulation to facts amounted to a prepetition waiver of the discharge.

On remand, the bankruptcy court held, as a matter of fact, that Yang intended to be bound by the stipulated facts. On the second appeal to the Ninth Circuit, the Court affirmed. *Jun Ho Yang v. Fund Mgmt. Int'l, LLC*, 847 F. App'x 419 (9th Cir. 2021). In an unpublished opinion decided without oral argument, the Court held that the bankruptcy court's factual finding was not clearly erroneous, as evidenced by the terms of the settlement agreement stipulating to the facts. Further, the Court held that while a debtor may not waive the discharge, "[c]ollateral estoppel is an exception to that rule." Notably, like in *Morabito*, the Court made no reference to *Wank*.

Author's comment: In the brief opinion, the only referenced evidence of the parties' "intent" to be bound in a subsequent proceeding was the written agreement itself. If the language of the agreement is sufficient to establish intent, why did the Court reverse and remand the first time, and on what basis could a party prove that the language of the agreement should not control? And with respect to the policy against waiver of the discharge, the Court once again begged the question. Yes, a debtor may be bound by facts as a result of issue preclusion, but where the facts are only issue preclusive under applicable law if the debtor "intended" the facts to be preclusive in a nondischargeability proceeding, why would that intent be given effect in light of the public policy against waivers of the discharge?

H. *Conclusion*

There is a tension between two important policies: (1) the settlement of litigation, and (2) the discharge of debts and fresh start in bankruptcy. In many cases, the tension is irreconcilable. If the bankruptcy policy trumps the settlement of litigation, the inevitable result would be an increase in litigation in both the state and bankruptcy courts, as creditors refuse to settle before trial in state court, and bankruptcy courts will be required to conduct evidentiary trials as opposed to ruling on summary judgment based on preclusion. While the BAP in *Wank* appeared to hold that the bankruptcy policy takes precedence, the bankruptcy courts have generally not agreed, and as evidenced by the recent triumvirate of appellate decisions, *Wank* has been cancelled, never to be mentioned again.

Faculty

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