

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF MISSOURI  
EASTERN DIVISION

In re )  
 ) Adv. No. 04-4091-172  
Michael J. Binns )  
Mary Ann Binns )  
 ) Case No. 03-56535-172  
Debtors. )  
 )  
Karen Jacobus ) Chapter 7  
 )  
Plaintiff, )  
 )  
vs. )  
 )  
Michael J. Binns )  
Mary Ann Binns )  
 )  
Defendants. )

**MEMORANDUM**

The Plaintiff filed a motion for summary judgment (Motion 18) requesting the Court to hold an Illinois judgment debt in the amount of \$ 799,006.75, obtained by the Plaintiff by default, to be nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A) and (B) under the doctrine of collateral estoppel. The Defendants opposed the motion on the basis that collateral estoppel does not apply where a judgment is obtained by default, that the failure to defend was a result of the Debtors' lack of funds, and that the Debtors had a defense against the allegations of fraud in that the Debtors alleged that the financial statements provided were not material and that the Plaintiff did not reasonably rely on the information they provided.

This is a core proceeding pursuant to Section 157(b)(2)(I) of Title 28 of the United States Code. The Court has jurisdiction over the parties and this matter pursuant to 28 U.S.C. Sections 151, 157 and 1334, and Rule 81-9.01 of the Local Rules of the United States District Court for the Eastern District of Missouri.

If the pleadings, depositions, answers to interrogatories, and admissions 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, judgment upon a motion for summary judgment shall be rendered forthwith. **Rule 56, Fed.R.Civ.P., as incorporated by Rule 7056, FRBP.**

It is generally believed, although not with universal enthusiasm, that the federal rule is that default judgments are not entitled to collateral estoppel effect. **See In re Catt**, 368 F. 3d 789, 792 (7<sup>th</sup> Cir. 2004). However, under the Full Faith and Credit Act, federal courts shall give a state court judgment the same preclusive effect as it would have in the forum state. **28 U.S.C. § 1738**. So long as due process is satisfied by the opportunity for a full and fair hearing, a state court judgment will be given preclusive effect. **See 50 C.J.S. Judgments § 1006** *citing Haring v. Prosise, Va.*, 462 U.S. 306, 103 S. Ct. 2368, L. Ed. 2d 595 (1983); **Gahr v. Trammel**, 796 F. 2d 1063, 1066 (8<sup>th</sup> Cir. 1986). When state court judgments are obtained by confession or default, if the state would give such judgments preclusive effect the Full Faith and Credit Act instructs the federal court to do the same. **See 50 C.J.S. Judgments § 1005**. The United States Supreme Court has instructed that, as a matter of full faith and credit, bankruptcy courts are to apply the forum state's law of collateral estoppel in dischargeability proceedings. **Grogan v. Garner**, 498 U.S. 279, 284 & n.11, 111 S. Ct. 654, 658 n. 11, 112 L. Ed. 2d 755 (1991).

#### Issue preclusion by collateral estoppel

Issue preclusion is a multi-step process. First, the Court must determine if the state law on the doctrine of collateral estoppel would preclude relitigation of the issue. If so, then the Court must determine if the party seeking to avoid preclusion had a full and fair opportunity to litigate the claim or issue. **Gahr**, 796 F. 2d at 1066. Finally, the Court must determine whether the state court determination is sufficiently consistent with bankruptcy law so as to entitle the party asserting collateral estoppel to preclude further litigation of dischargeability in bankruptcy court.

### Illinois law on the preclusive effects of a default judgment

In Illinois, a default judgment may have preclusive effect where it can be shown, either upon the face of the record or by extrinsic evidence that the precise question was raised and determined in a prior suit. **Sawyer, et al v. Nelson**, 160 Ill 629, 630, 43 N.E. 728, 729 (1896) also see 23 A Ill. Law & Prac. Judgments § 365 (2004).

Here, the Judgment (Exhibit A to File Document No. 20), entered July 30, 2002 after a hearing on damages, made specific findings of intentional actions of fraud to support an award of punitive damages. The Bankruptcy Court finds and concludes that the findings of fraud on the record of the Illinois circuit court satisfy the requirement that the precise question of fraud was raised and determined in the prior suit.

### Full and Fair Opportunity to Litigate

The Defendants do not dispute that they were aware of the litigation filed against them in Illinois (File Document No. 25). They stated they did not respond to the suit due to lack of financial resources. The Defendants were served with the Illinois complaint on November 20, 2001 and a default was entered on February 1, 2002. After a hearing on damages, the Judgment was entered on July 30, 2002. The amount in controversy in Illinois was actual damages of \$597,890.00. In addition, the Plaintiff prayed for punitive damages and was awarded \$200,000.00. The Defendants did not seek to vacate the default or appeal the judgment. The Court finds and concludes that the Defendants had a full and fair opportunity to litigate the claims against them and chose not to do so. "If, whether by allowing himself to be defaulted or otherwise, a party has forfeited his right to such a hearing, he cannot complain;..." **Catt**, 368 F. 3d at 792. Further, in light of the specific findings of fraud made by the Illinois court, the Rooker-Feldman Doctrine prevents this Court from relitigating a final state court judgment. **In re Raffel**, 283 B.R. 743 (8<sup>th</sup> Cir. B.A.P. 2002).

### Fraud-Illinois Law

The elements for fraudulent misrepresentation under Illinois law are: 1) a false statement of material fact; 2) defendant's knowledge that the statement was false; 3) defendant's intent that the statement induced the plaintiff to act; 4) plaintiff's reliance upon the truth of the statement; and 5) plaintiff's damages resulting from reliance on the statement. **W.W. Vincent and Company v. First Colony Life Insurance Co.**, 351 Ill. App. 3d 752, 761, 814 N.E. 2d 960, 969, 286 Ill. Dec. 734, 743 (Ill. App. Ct. 2004) *citing* **Connick v. Suzuki Motor Co., Ltd.**, 174 Ill. 2d 482, 496, 221 Ill. Dec. 389, 675 N.E. 2d 584 (1996). The Court finds and concludes that the Illinois judgment determined that the elements of fraud had been satisfied.

### 11 U.S.C. § 523(a)(2)

Generally referred to as the fraud exception to discharge, Section 523(a)(2) excepts from discharge any debt for money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained by (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition, or (B) the use of a statement in writing that is materially false respecting the debtor's or an insider's financial condition, on which the creditor to whom the debtor is liable for such money, property, services or credit reasonable relied and that the debtor caused to be made or published with intent to deceive. **11 U.S.C. §523(a)(2)(A) and (B)**. The Code does not set out the elements of fraud for the purposes of bankruptcy dischargeability. Bankruptcy courts look to state law to determine fraud and apply the bankruptcy provisions of nondischargeability where appropriate. **O'Melveny & Myers v. F.D.I.C.**, 512 U.S. 79, 83, 114 S. Ct. 2048, 5053 (1994).

### The State Court Judgment

Attached as Exhibit "A" to the Plaintiff's motion for summary judgment is the judgment filed in the Twentieth Judicial Circuit of Illinois, Randolph County, Illinois on July 30, 2002. The judgment

recites the factual determinations that Binns & Binns Company, Inc. entered a general appearance in the State Court proceeding, but failed to file a responsive pleading within the time ordered; and that Michael and Mary Ann Binns, the Defendants in the adversary proceeding here, were regularly served with process but failed to appear, plead or otherwise defend. A default was entered against the three defendants, jointly and severally, on February 1, 2002. Thereafter, upon the request of the plaintiff, a hearing was held on the issue of damages.

Upon hearing the evidence the Court found that the plaintiff, Karen Jacobus, was entitled to compensatory damages in the amount of \$597,890.00 and awarded a judgment to the plaintiff in that amount. The court specifically referenced unanswered allegations in the complaint to find that the defendants admitted intentionally overstating the 1999 gross sales amount of the business known as Marilyn's Hallmark; and that Michael Binns provided false financial records to the plaintiff to induce the plaintiff's purchase of Marilyn's Hallmark. The state court record indicated that the evidence presented included the Defendants' use of one or more writings to perpetrate the fraud. These actions satisfy the requirements for nondischargeability under 11 U.S.C. § 523(a)(2)(B). There is no evidence from the state court record however, that the provisions of 11 U.S.C. §532(a)(2)(A) were satisfied.

The court then assessed \$200,000.00 for punitive damages based upon its determination that the fraudulent actions were intentional. The court also awarded costs of the suit against the defendants in the amount of \$1,116.75. The defendants did not move to vacate the default nor did they appeal the judgment.

Under Illinois law, a determination of fraud is to be based upon clear and convincing evidence. **Cwikla v. Sheir**, 345 Ill. App. 3d 23, 30, 280 Ill. Dec. 158, 165, 801 N.E. 2d 1103, 1110 (Ill. App. Ct. 2003) citing **In re Application of Rosewell**, 106 Ill. 2d 311, 318-19, 88 Ill. Dec. 28, 478 N.E. 2d 343 (Ill. 1985). Punitive damages, being penal in nature, are disfavored. Courts are

instructed to proceed cautiously to insure that such awards are not improperly or unwisely awarded. **Deal v. Blyford**, 127 Ill. 2d, 197, 203-04, 130 Ill. Dec. 200, 205, 537 N.E. 2d 267, 272 (Ill. 1989). An award of punitive damages for fraud cannot be supported by deceit alone. **See Home Savings and Loan Association of Joliet v. Schneider, et al**, 108 Ill. 2d 277, 284, 483 N.E. 2d 1225, 1228, 91 Ill. Dec. 590, 593 (1985). Punitive damages may be allowed where the false representations are wantonly and designedly made, or where the wrong involves some violation of duty springing from a relation of trust or confidence, or where the fraud is gross, or the case presents other extraordinary or exceptional circumstances clearly showing malice and willfulness. **Id.**; **See also Berman v. Dempsey**, 257 Ill. App. 3d 496, 629 N.E. 2d 720, 196 Ill. Dec. 175 (Ill. App. Ct. 1994).

For purposes of this Adversary Proceeding, the Court finds and concludes that the Illinois default judgment satisfies the doctrine of collateral estoppel to preclude the Defendants here from relitigating the issue of fraud in this dischargeability proceeding. Both the state court suit and the Bankruptcy dischargeability suit involve the same parties, and arise from the same transaction, incident, or factual situation. The issue of fraud was actually litigated, and was necessarily determined by the state court after the hearing on punitive damages. The state court found that the elements of fraud had been established and awarded a judgment for damages based upon the fraudulent conduct. Under Illinois law, the imposition of punitive damages for fraud required the court to hear evidence and determine not only that the elements of fraud were satisfied, but further, that the evidence supported a finding of intentional actions of fraud greater than deceit alone, such that punitive damages were justified.

The Defendants had notice of the state court proceedings but chose not to respond or defend. The Defendants were afforded a full and fair opportunity to defend. In Illinois, collateral estoppel operates to bar relitigation of an issue even if the judgment was the result of a default, so long as the party against whom it is being asserted had a full and fair opportunity to contest the

issue which was necessarily determined in the prior proceeding. **See Rogers**, 297 Ill. App. 3d at 755, 697 N.E. 2d at 1197, 232 Ill. Dec. at 268. Nothing in the record suggests that the Defendants will suffer an injustice by the application of the doctrine of collateral estoppel in this matter.

The state court finding that the Defendants intentionally overstated the gross sales amount of Marilyn's Hallmark in 1999, and that Michael Binns provided false financial records to induce the Plaintiff to purchase the business satisfies the bankruptcy code elements to establish nondischargeability under Section 523(a)(2)(B). A debt is not dischargeable to the extent it was obtained by the use of a statement in writing respecting the debtor's or an insider's<sup>1</sup> financial condition that was materially false on which the creditor reasonably relied, and which the debtor caused to be made or published with intent to deceive. Therefore, by separate order the Court will grant the Plaintiff's motion for summary judgment and enter judgment for the Plaintiff and against the Defendants. The debt of the Plaintiff will be held to be nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(B) in the amount of \$ 799,006.75.

DATED: February 11, 2005

St. Louis, Missouri



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James J. Barta  
Chief U. S. Bankruptcy Judge

Copy mailed to:

Office of the United States Trustee  
Thomas F. Eagleton U.S. Courthouse  
111 South 10th Street, Suite 6.353  
St. Louis, MO 63102

Edward Renshaw  
Feirich/Mager/Green/Ryan  
Attorney for Plaintiff  
2001 W. Main St., PO Box 1570  
Carbondale, IL 62903

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<sup>1</sup>Under Section 101(31)(A)(iv), if the debtor is an individual, "insider" includes a corporation of which the debtor is a director, officer, or person in control.

Michael J. Binns  
Mary Ann Binns  
Debtors/Defendants  
4628 Idecker Drive  
Saint Louis, MO 63129

Timothy H. Battern  
Attorney for Debtors  
4121 Union Road, Suite 211  
St. Louis, MO 63129

Stuart J. Radloff  
Chapter 7 Trustee  
7733 Forsyth Blvd., Suite 2000  
St. Louis, MO 63105



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EASTERN DIVISION

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Karen Jacobus	)	Chapter 7
	)	
Plaintiff,	)	
	)	
vs.	)	
	)	
Michael J. Binns	)	
Mary Ann Binns	)	
	)	
Defendants.	)	

**ORDER**

Upon consideration of the record as a whole, and consistent with the determinations in the Memorandum entered herewith,

**IT IS ORDERED** that this matter is concluded; and that the motion for summary judgment filed by Karen Jacobus, Plaintiff, is granted; and that judgment in this Adversary Proceeding is entered in favor of said Plaintiff and against Michael J. Binns and Mary Ann Binns, Defendants, as set out here; and that the debt owed by the Defendants to the Plaintiff in the amount of \$799,006.75, as described in this matter is not dischargeable in this Bankruptcy case under 11 U.S.C. § 523(a)(2)(B); and

That all other requests in this matter are denied.

DATED: February 11, 2005



James J. Barta

St. Louis, Missouri

Chief U. S. Bankruptcy Judge

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111 South 10th Street, Suite 6.353  
St. Louis, MO 63102

Michael J. Binns  
Mary Ann Binns  
Debtors/Defendants  
4628 Idecker Drive  
Saint Louis, MO 63129

Stuart J. Radloff  
Chapter 7 Trustee  
7733 Forsyth Blvd., Suite 2000  
St. Louis, MO 63105

Edward Renshaw  
Feirich/Mager/Green/Ryan  
Attorney for Plaintiff  
2001 W. Main St., PO Box 1570  
Carbondale, IL 62903

Timothy H. Battern  
Attorney for Debtors  
4121 Union Road, Suite 211  
St. Louis, MO 63129