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## Recent Developments in Estoppel and Preclusion Doctrines in Consumer Bankruptcy Cases; Volume II of II: Preclusion

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## Recent Developments in Estoppel and Preclusion Doctrines in Consumer Bankruptcy Cases; Volume II of II: Preclusion

### Cover Page Footnote

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RECENT DEVELOPMENTS IN ESTOPPEL AND  
PRECLUSION DOCTRINES IN CONSUMER  
BANKRUPTCY CASES; VOLUME II OF II:  
PRECLUSION\*

K.M. LEWIS, PAUL M. LOPEZ, SCOTT LAWRENCE  
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Since the last major article on estoppel and preclusion doctrines in bankruptcy law was released in 2005,<sup>1</sup> courts have issued a number of decisions affecting the operation of estoppel and preclusion principles in consumer bankruptcy cases. It is imperative that practitioners keep abreast of these developments. If they do not, they run the risk that unclear language in court filings or inadvertent (or advertent) omissions at the beginning of a bankruptcy case will subsequently return to haunt both them and their clients. This danger is especially acute in the bankruptcy context because estoppel and preclusion are partially uncoded common law doctrines that are easy for bankruptcy practitioners, who are understandably accustomed to working within a closed statutory code, to overlook.<sup>2</sup>

It is not enough, however, to know of the existence of these doctrines; the practitioner must also understand the nuances of each and the differences between them.<sup>3</sup> Each has distinct elements, and different policies and theories underlie them. The failure to distinguish between varieties of estoppel or preclusion in court filings may result in the court applying a doctrine the litigant did not intend to plead.<sup>4</sup>

This Article, presented in two volumes, canvasses post-2005 consumer bankruptcy<sup>5</sup> decisions on the subjects of judicial estoppel, equitable

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1. See Honorable Christopher Klein et al., *Principles of Preclusion and Estoppel in Bankruptcy Cases*, 79 AM. BANKR. L.J. 839, 839-40 (2005); see also Theresa M. Beiner & Robert B. Chapman, *Take What You Can, Give Nothing Back: Judicial Estoppel, Employment Discrimination, Bankruptcy, and Piracy in the Courts*, 60 U. MIAMI L. REV. 1 (2005); David Gray Carlson, *The Res Judicata Worth of Illegal Bankruptcy Reorganization Plans*, 82 TEMP. L. REV. 351 (2009); Robert F. Dugas, Note, *Honing a Blunt Instrument: Refining the Use of Judicial Estoppel in Bankruptcy Nondisclosure Cases*, 59 VAND. L. REV. 205 (2006); Eric Hilmo, Note, *Bankrupt Estoppel: The Case for a Uniform Doctrine of Judicial Estoppel As Applied Against Former Bankruptcy Debtors*, 81 FORDHAM L. REV. 1353 (2012); Steven Jackson, Comment, *Heavy Backpacks: Res Judicata and Appropriate Notice to Creditors During a Student Loan Discharge in Bankruptcy*, 12 U. PA. J. BUS. L. 235 (2009); Honorable James D. Walker, Jr. & Amber Nickell, *Judicial Estoppel and the Eleventh Circuit Consumer Bankruptcy Debtor*, 56 MERCER L. REV. 1115 (2005).

2. See Klein et al., *supra* note 1, at 839-40.

3. “Incantations such as *res judicata*, *collateral estoppel*, *judicial estoppel*, or *equitable estoppel*, often lead courts into summary resolution of actions without being precise about the niceties of the doctrines being invoked. Imprecision, while expedient, tends to produce unfortunate consequences in the case at hand and future actions.” *Id.* at 839.

4. See, e.g., *Sharpe v. Wells Fargo Home Mortg.* (*In re Sharpe*), 391 B.R. 117, 164 (Bankr. N.D. Ala. 2008) (“The plaintiffs do not identify the type of estoppel the Court should apply. There are many. Based on the complaint, the Court presumes it is one of the two most frequently raised. Those are ‘judicial estoppel’ and ‘equitable estoppel.’”).

5. For recent developments on these topics in the field of corporate bankruptcy, see, for example, *Travelers Indem. Co. v. Bailey*, 557 U.S. 137 (2009); *Jones v. Estate of Cole*,

estoppel, claim preclusion (also known as *res judicata*),<sup>6</sup> and issue preclusion (also known as collateral estoppel).<sup>7</sup> We have discussed the former two doctrines in an earlier volume;<sup>8</sup> the latter two will be discussed in this volume. Each preclusive doctrine will be treated in a separate section, which will begin by defining the doctrine and distinguishing it from similar but distinct doctrines. Brief summaries of cases of interest will follow, including important takeaways. These takeaways will benefit not only attorneys who practice in the field of consumer bankruptcy, but also nonbankruptcy attorneys who represent consumers who have gone through bankruptcy, are currently in bankruptcy, or who may declare bankruptcy in the future.

### *I. Claim Preclusion (Res Judicata)*

#### *A. Definition*

Before defining the term “claim preclusion,” also known as “*res judicata*,” it is important to note a crucial distinction oft-neglected by courts, commentators, and practitioners alike:

“*Res judicata*” has been used . . . as a general term referring to all the ways in which one judgment will have a binding effect on another. That usage is and doubtless will continue to be common, but it lumps under a single name two quite different effects of judgments. The first is the effect of foreclosing any litigation of matters that have *never* been litigated, because of the determination that they should have been advanced in an earlier suit. The second is the effect of foreclosing relitigation of matters that *have* once been litigated and decided. The first of these, preclusion of matters that were *never* litigated, has gone

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483 F. App'x 468 (10th Cir. 2012); *Adelphia Recovery Trust v. HSBC Bank USA (In re Adelphia Recovery Trust)*, 634 F.3d 678 (2d Cir. 2011); *Logan Med. Found., Inc. v. Hayflich & Steinberg (In re Logan Med. Found., Inc.)*, 346 B.R. 184 (Bankr. S.D. W. Va. 2006).

6. CHARLES ALAN WRIGHT, *THE LAW OF FEDERAL COURTS* 722-73 (5th ed. 1994) (citing Allan D. Vestal, *Rationale of Preclusion*, 9 ST. LOUIS U. L.J. 29 (1964)).

7. *Id.* Some jurisdictions refer to issue preclusion by names other than collateral estoppel, such as “estoppel by judgment.” See *In re Barrett*, 377 B.R. 667, 671 n.3 (Bankr. D. Colo. 2007).

8. K.M. Lewis & Paul M. Lopez, *Recent Developments in Estoppel and Preclusion Doctrines in Consumer Bankruptcy Cases; Volume I of II: Estoppel*, 66 OKLA. L. REV. 459 (2014).

under the name, “true res judicata,” or the names, “merger” and “bar.” The second doctrine, preclusion of matters that *have* once been decided, has usually been called “collateral estoppel.” Professor Allan Vestal has long argued for the use of the names “claim preclusion” and “issue preclusion[,]” [respectively,] for these two doctrines, and this usage is increasingly employed by the courts . . . .<sup>9</sup>

Accordingly, this Article will use the term “claim preclusion” to the exclusion of “res judicata,” with few exceptions.<sup>10</sup>

Claim preclusion means essentially this: when a court has finally adjudicated a claim, a litigant will generally not be allowed to relitigate that claim in the same or another court.<sup>11</sup> Thus, as a general matter, even where the court has committed error in adjudicating the claim in question, the losing party is forbidden from relitigating the claim if “the loser had the opportunity to test the final judgment on appeal.”<sup>12</sup>

As one widely-cited case establishes,<sup>13</sup> claim preclusion generally requires the following elements:

- 1) the prior suit must have ended with a judgment on the merits;<sup>14</sup>

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9. WRIGHT, *supra* note 6, at 722-23 (emphasis added); *see also* Taylor v. Sturgell, 553 U.S. 880, 892 (2008).

10. When referring to principles of finality generally, we may use the term “res judicata principles.” Also, when quoting courts and commentators who use the general term “res judicata,” we will preserve that usage.

11. Carlson, *supra* note 1, at 353 (citing Universal Am. Mortg. Co. v. Bateman (*In re* Bateman), 331 F.3d 821, 830 (11th Cir. 2003)).

12. *E.g.*, Sanders v. Progressive Casualty Ins. Co. (*In re* Sanders), No. AZ-06-1382-PaBMo, 2007 WL 7540961, at \*3 (B.A.P. 9th Cir. Mar. 30, 2007) (citing Paine v. Griffin (*In re* Paine), 283 B.R. 33, 39 (B.A.P. 9th Cir. 2002)).

13. Jackson, *supra* note 1, at 241-42 (citing Nwosun v. Gen. Mills Rests., Inc., 124 F.3d 1255, 1257 (10th Cir. 1997)).

14. For example, a consent decree constitutes a final judgment on the merits for the purposes of claim preclusion unless the decree includes an express reservation of rights. *Munoz v. Sovereign Bank*, 323 F. App’x 184, 187 (3d Cir. 2009) (citing *United States v. Athlone Indus., Inc.*, 746 F.2d 977, 983 n.5 (3d Cir. 1984)).

By contrast, an interlocutory order, such as a temporary restraining order, has no claim preclusive effect. *In re Schwartz*, Bankruptcy No. 07-30508, 2007 WL 3051865, at \*4 (Bankr. S.D. Tex. Oct. 17, 2007).

In some courts, a judgment remains final for the purposes of claim preclusion even where an appeal is pending. *See Rainey v. Davenport* (*In re Davenport*), 353 B.R. 150, 192 (Bankr. S.D. Tex. Feb. 2, 2006) (citing *Scurlock Oil Co. v. Smithwick*, 724 S.W.2d 1, 6 (Tex. 1986)).

- 2) the parties must be identical or in privity;
- 3) the suit must be based on the same cause of action;<sup>15</sup> and
- 4) the plaintiff must have had a full and fair opportunity to litigate the claim in the prior suit.<sup>16</sup>

Some courts consider additional elements, such as whether the prior judgment was “rendered by a court of competent jurisdiction”<sup>17</sup> or whether “the issues in the prior action [were] decided adversely to the plaintiff’s contentions in the instant case.”<sup>18</sup> Some courts deemphasize or remove

By contrast, in some courts, claim preclusion is not applicable to a dismissal on statute of limitations grounds. *See Smyth v. City of Oakland (In re Brooks-Hamilton)*, 271 F. App’x 654, 657-58 (9th Cir. 2008) (applying California law).

Claim preclusion is also inapplicable to a “no change” letter issued by a state’s Franchise Tax Board, because such letters are “not the same as a final judgment issued by a court.” *Franchise Tax Board of the State of Cal. v. Kipperman (In re Adams)*, Nos. SC-07-1283-KMkDo, SC-07-1394-KMkDo, 2008 WL 8444788, at \*9 (B.A.P. 9th Cir. Feb. 7, 2008).

Some courts have noted that the finality element for claim preclusion is more stringent than the finality requirement for issue preclusion. *Allen v. Loughery (In re Loughery)*, No. 09-69033-PWB, 2010 WL 4642131, at \*4 (Bankr. N.D. Ga. Oct. 12, 2010) (quoting *Christo v. Padgett*, 223 F.3d 1324, 1339 (11th Cir. 2000)).

15. To determine whether the suit was based on the same cause of action, many courts utilize the “transactional approach.” *See, e.g., Dye v. Ameriquest Mortg. Co.*, 289 F. App’x 941, 944 (7th Cir. 2008) (applying Wisconsin law); *Humphreys v. EMC Mortg. Corp. (In re Mack)*, Nos. CC-06-1123-MoDK, CC-06-1242-MoDK, 2007 WL 7545163, at \*8 (B.A.P. 9th Cir. Mar. 28, 2007) (citing RESTATEMENT (SECOND) OF JUDGMENTS § 24 (1982)); *Rose v. JP Morgan Chase Bank, N.A.*, 835 F. Supp. 2d 1014, 1018 (D. Or. 2011) (citing *Mpoyo v. Litton Electro-Optical Sys.*, 430 F.3d 985, 987 (9th Cir. 2005)) (applying federal law); *Crowe v. Moran (In re Moran)*, 413 B.R. 168, 178 (Bankr. D. Del. 2009) (citing *LaPoint v. AmerisourceBergen Corp.*, 970 A.2d 185, 193 (Del. 2009)) (applying Delaware law); *Monsour v. Monsour (In re Monsour)*, 372 B.R. 272, 277-78 (Bankr. W.D. Va. 2007). If two claims are derived from a common nucleus of operative fact, they arise from the same transaction. *In re Moran*, 413 B.R. at 178 (citing *LaPoint*, 970 A.2d at 193). This entails a pragmatic consideration of “whether the facts are related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties’ expectations or business understanding or usage.” RESTATEMENT (SECOND) OF JUDGMENTS § 24. For instance, “a contract is [generally] considered to be a single ‘transaction’ for the purpose of claim preclusion.” *In re Moran*, 413 B.R. at 178.

16. *Jackson, supra* note 1, at 241-42 (citing *Nwosun*, 124 F.3d at 1257).

17. *See McDonald v. Redstone Fed. Credit Union (In re McDonald)*, 374 F. App’x 937, 940 (11th Cir. 2010) (applying Alabama law) (quoting *Dairyland Ins. Co. v. Jackson*, 566 So.2d 723, 725 (Ala. 1990)); *see also Dover v. United States*, 367 F. App’x 651, 653 (6th Cir. 2010) (citing *Bittinger v. Tecumseh Prods. Co.*, 123 F.3d 877, 880 (6th Cir. 1997)); *In re Moran*, 413 B.R. at 178; *Bailey v. City of Wilmington*, 766 A.2d 477, 481 (Del. 2001) (applying Delaware law); *Calaway v. Cozart (In re Cozart)*, No. 5:08-bk-73392, 2009 WL 1955294, at \*4-5 (Bankr. W.D. Ark. July 6, 2009) (applying Eighth Circuit federal law).

18. *See In re Moran*, 413 B.R. at 178; *Bailey*, 766 A.2d at 481.



some of the elements listed above.<sup>19</sup> These differences may have dispositive consequences.<sup>20</sup>

Courts have also placed some limits on claim preclusion. “Suits on post-complaint conduct generally are not barred under principles of” claim preclusion.<sup>21</sup> By logical extension, even “facts representing a continuance of the same course of conduct” would not be barred as precluded claims.<sup>22</sup> The burden is on the party asserting claim preclusion to satisfy all applicable elements.<sup>23</sup> However, in some jurisdictions, even if the parties do not formally address the applicability of claim preclusion, a court may apply the doctrine *sua sponte* if all the elements are satisfied.<sup>24</sup>

The general purpose of claim preclusion doctrine is to further “such fundamental policies as promoting finality, economy, consistency, and comity in the judicial process.”<sup>25</sup> However, per the U.S. Supreme Court,

because [claim preclusion] may govern grounds and defenses not previously litigated, . . . it blockades unexplored paths that may lead to truth. For the sake of repose, [claim preclusion] shields

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19. For instance, Wisconsin, North Carolina, New Jersey, and other jurisdictions do not list the “full and fair opportunity to litigate” element in their formulations of claim preclusion. *See, e.g., In re Cozart*, 2009 WL 1955294, at \*4-5; *Bennett v. Smith (In re Smith)*, No. 05-10041, 2006 WL 3333801, at \*10 (Bankr. M.D.N.C. Nov. 16, 2006) (citing *Green v. Dixon*, 528 S.E.2d 51, 53 (N.C. Ct. App. 2000)); *Cotter v. Skylands Cmty. Bank (In re Cotter)*, No. 08-12504 (NLW), 2011 WL 5900811, at \*2 (Bankr. D.N.J. Oct. 24, 2011) (citing *In re Mullarkey*, 536 F.3d 215, 225 (3d Cir. 2008)); *Dye v. Ameriquest Mortg. Co.*, 289 F. App’x 941, 944 (7th Cir. 2008) (citing *Kruckenbergh v. Harvey*, 2005 WI 43, ¶¶ 20-21, 279 Wis. 2d 520, 694 N.W.2d 879, 885).

Georgia state law removes the “full and fair opportunity” element and the “judgment on the merits” element and replaces them with a “court of competent jurisdiction” element. *See, e.g., Omega Cotton Co. v. Sutton (In re Sutton)*, No. 06-60373-JTL, 2008 WL 4527761, at \*2 (Bankr. M.D. Ga. Oct. 2, 2008) (citing *Austin v. Coca-Cola Co.*, 458 S.E.2d 409 (Ga. Ct. App. 1995)).

20. *See In re Barrett*, 377 B.R. 667, 671 n.3 (Bankr. D. Colo. 2007).

21. *Era Franchise Sys. L.L.C. v. Kroeber (In re Kroeber)*, No. 09-32125 (LMW), 2010 WL 4064026, at \*8 (Bankr. D. Conn. Oct. 15, 2010) (citing *Legnani v. Alitalia Linee Aeree Italiane, S.P.A.*, 400 F.3d 139, 141 (2d Cir. 2005)).

22. *Legnani*, 400 F.3d at 141 (citation omitted).

23. *E.g., Caresource, Inc. v. Brooks (In re Brooks)*, No. 11-38159-BKC-AJC, 2012 WL 3781134, at \*4 (Bankr. S.D. Fla. Aug. 31, 2012) (quoting *Kaiser Aerospace Elecs. Corp. v. Teledyne Indus., Inc. (In re Piper Aircraft Corp.)*, 244 F.3d 1289, 1296 (11th Cir. 2001)).

24. *See Wendt v. Hanson (In re Hanson)*, No. 10-19165-MM7, 2011 WL 6148429, at \*2 (Bankr. S.D. Cal. Nov. 21, 2011) (citing *Columbia Steel Fabricators v. Ahlstrom Recovery*, 44 F.3d 800, 802 (9th Cir. 1995)).

25. *In re Barrett*, 377 B.R. at 672.

the fraud and the cheat as well as the honest person. It therefore is to be invoked only after careful inquiry.<sup>26</sup>

Claim preclusion rulings are typically reviewed on appeal *de novo* as mixed questions of law and fact in which legal questions predominate.<sup>27</sup> However, in some (but not all) courts, “[o]nce it is determined that preclusion doctrines are available to be applied, the actual decision to apply them is left to the trial court’s discretion.”<sup>28</sup>

Claim preclusion also raises interesting choice of law issues. “Frequently, properly applying the law of claim . . . preclusion involves an initial step of deciding which jurisdiction’s rules for preclusion apply, a step sometimes ignored in reported cases.”<sup>29</sup> For example, when a federal court must decide whether a prior state court judgment has claim preclusive effect, the full faith and credit statute<sup>30</sup> requires the federal court to give that judgment the same preclusive effect that a court of that state would give.<sup>31</sup> As a result, the federal court must apply the claim preclusion elements of the state in which the judgment was rendered, rather than the law of the state in which the federal court sits.<sup>32</sup> Likewise, in a federal

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26. *Brown v. Felsen*, 442 U.S. 127, 132 (1979).

27. *E.g.*, *Laurance v. Ranger Ins. Co., Inc.* (*In re Laurance*), No. CC-04-1348-KJB, No. SA 01-19470-JB, 2006 WL 6810984, at \*2 (B.A.P. 9th Cir. Feb. 10, 2006); *Alary Corp. v. Sims* (*In re Associated Vintage Grp., Inc.*), 283 B.R. 549, 554 (B.A.P. 9th Cir. 2002)); *cf.* *Wash. Mut. Bank v. Carlson* (*In re Carlson*), 464 F. App’x 845, 848 (11th Cir. 2012) (reviewing a court’s decision whether or not to apply claim preclusion *de novo* as a purely legal question).

28. *Laurance*, 2006 WL 6810984, at \*2; *George v. City of Morro Bay* (*In re George*), 318 B.R. 729, 732-33 (B.A.P. 9th Cir. 2004), *aff’d*, 144 F. App’x 636 (9th Cir. 2005)); *accord* *Int’l Harvester Co. v. Occupational Safety & Health Review Comm’n*, 628 F.2d 982, 986 (7th Cir. 1980) (“[E]ven where the technical requirements of *res judicata* have been established, a court may nonetheless refuse to apply the doctrine.”); *Humphreys v. EMC Mortg. Corp.* (*In re Mack*), Nos. CC-06-1123-MoDK, CC-06-1242-MoDK, 2007 WL 7545163, at \*3 (B.A.P. 9th Cir. Mar. 28, 2007) (citing *Khaligh v. Hadaeagh* (*In re Khaligh*), 338 B.R. 817, 823 (B.A.P. 9th Cir. 2006)); *In re Antonie*, 432 B.R. 843, 850 (Bankr. D. Idaho 2010) (declining to apply claim preclusion solely on the grounds of judicial discretion). *But see, e.g.*, *Dye v. Ameriquist Mortg. Co.*, 289 F. App’x 941, 944 (7th Cir. 2008) (suggesting that under Wisconsin law, claim preclusion automatically applies when all prongs of the test are satisfied).

29. *In re Barrett*, 377 B.R. 667, 671 n.3, 672 (Bankr. D. Colo. 2007).

30. 28 U.S.C. § 1738 (2012).

31. *E.g.*, *Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280, 293 (2005).

32. *See, e.g.*, *Ngo v. Webb* (*In re Webb*), No. 08-bk-743, 2009 WL 1139548, at \*3 (Bankr. N.D. W. Va. Mar. 31, 2009) (applying the preclusion law of California rather than West Virginia).

diversity action, the court must apply the forum state's preclusion rules, rather than federal rules of preclusion, unless the state's rules are incompatible with federal interests.<sup>33</sup> By contrast, "[i]n a federal-question case based on a prior federal judgment, the federal rules of [claim preclusion] apply."<sup>34</sup>

When requesting that a court apply claim preclusion, the party should provide the court with a copy of the pleadings and the final judgment in the prior case and affirmatively explain why the prior judgment should have preclusive effect, lest that party run the risk of waiving his or her claim preclusion argument.<sup>35</sup>

### *B. Illegal Bankruptcy Plans and Claim Preclusion*

Claim preclusion can come into play in consumer bankruptcy proceedings in several respects. "In the mad chaos of the American bankruptcy system, courts unwittingly confirm illegal reorganization plans" (that is, plans that fail to comply with one or more provisions of the Code), "especially in the highly frenetic context of a Chapter 13" consumer debtor case.<sup>36</sup> Nonetheless, "[e]ach reorganization chapter" of the Code contains a finality provision that "includes a sweeping statement to the effect that confirmed plans are *binding*" on the debtor and all creditors.<sup>37</sup> These

33. *Semtek Intern. Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508 (2001); *Munoz v. Sovereign Bank*, 323 F. App'x 184, 187 (3d Cir. 2009) (citing *Taylor v. Sturgell*, 553 U.S. 880, 891 n.4 (2008); *Houbigant, Inc. v. Fed. Ins. Co.*, 374 F.3d 192, 205 (3d Cir. 2004)).

34. *Sommers v. Vaught (In re Wilson)*, No. 05-81190, 2007 WL 1040565, at \*1 (Bankr. S.D. Tex. Mar. 30, 2007) (citing *Reimer v. Smith*, 663 F.2d 1316, 1326 n.10 (5th Cir. 1981)).

35. See, e.g., *Neely v. Johnson (In re Knezek)*, 370 F. App'x 449, 453 (5th Cir. 2010).

36. Carlson, *supra* note 1, at 352; accord Ralph Brubaker, *Supreme Court Upholds "Discharge by Declaration" of Student Loan Debts in Chapter 13 (Or Does It?)*, 30 No. 6 BANKRUPTCY LAW LETTER 1 (Westlaw) (2010).

37. Carlson, *supra* note 1, at 352 (citing 11 U.S.C. §§ 1141, 1327) (2012)). Code § 1141(a) reads as follows:

Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

*Id.* § 1141(a). Similarly, § 1327(a) reads: "The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." *Id.* § 1327(a).

finality sections “generally codif[y] the doctrine of [claim preclusion] with respect to confirmed’ reorganization plans.”<sup>38</sup> Thus,

“[c]onfirmation of a Chapter 13 plan by a bankruptcy court of competent jurisdiction, in accordance with the procedural requirements of notice and hearing of confirmation, is given the same [preclusive] effect as any district court’s final judgment on the merits.” This [preclusive] effect prohibits the collateral attack of a confirmed plan, “bar[ring] litigation not only of every matter which was actually offered and received to sustain the demand, but also of every claim which might have been presented.”<sup>39</sup>

“In sum, the principle of *res judicata* precludes a creditor from waiting until a plan is approved to assert its rights.”<sup>40</sup>

These finality provisions often operate “even if the confirmed bankruptcy plan contains illegal provisions,”<sup>41</sup> and necessarily so: “Were the rule otherwise, no judgment would ever be conclusive, as a party aggrieved by it could endlessly re-litigate errors supposedly committed by the trial court.”<sup>42</sup> However, as an astute commentator has vividly explained, “Common sense requires that exceptions mitigate the absoluteness of [the Code’s finality provisions].”<sup>43</sup> A confirmed plan giving the debtor the right to murder a creditor, for example, is clearly absurd and not enforceable.<sup>44</sup> When, therefore, does an illegal reorganization plan bind the parties, and when must the plain language of the Code’s finality provisions give way to sense and sensibility?

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38. Carlson, *supra* note 1, at 353 (quoting *Hutchinson v. Del. Sav. Bank FSB*, 410 F. Supp. 2d 374, 378 (D.N.J. 2006)).

39. *Clark v. Shapiro & Pickett, L.L.P.*, 452 F. App’x 890, 894 n.7 (11th Cir. 2012) (quoting *Universal Am. Mortg. Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 825 n.4, 830 (11th Cir. 2003)).

40. Albert Togut & Lara R. Sheikh, *The “Absolute Finality” Rule: Confirmation Orders After Travelers v. Bailey and United Student Aid Funds, Inc. v. Espinosa*, 20 NORTON J. BANKR. L. & PRAC. 2 Art. 2 (2011) (Westlaw).

41. *Espinosa v. United Student Aid Funds*, 553 F.3d 1193, 1199 (9th Cir. 2008), *aff’d*, 559 U.S. 260 (2010) (quoting *Great Lakes Higher Educ. Corp. v. Pardee (In re Pardee)*, 193 F.3d 1083, 1086 (9th Cir. 1999)).

42. *Espinosa*, 553 F.3d at 1199.

43. Carlson, *supra* note 1, at 353.

44. *Id.* at 353; *see also* Brubaker, *supra* note 36 (“Notwithstanding the statutory finality attributed to confirmed Chapter 13 plans, the speed with which Chapter 13 plans are filed and confirmed and the less-than-fastidious form and process for many confirmed Chapter 13 plans can test the ultimate binding effect of the plan in many different ways.”).

Since the publication of an illuminating and exhaustively-researched article canvassing the res judicata worth of illegal bankruptcy plans in 2009,<sup>45</sup> there have been several developments that have radically changed the landscape of claim preclusion and illegal plans in the consumer bankruptcy context.

### 1. Student Loans and Claim Preclusion

#### a) Espinosa: *The Supreme Court Giveth Its Blessing to Discharge-by-Declaration of Student Loans, and the Supreme Court Taketh Away*<sup>46</sup>

Student loans are generally nondischargeable under the Code,<sup>47</sup> as your authors are painfully aware. However, the Code provides an exception to the nondischargeability of student loans when “excepting such debt from discharge . . . would impose an *undue hardship* on the debtor and the debtor’s dependents.”<sup>48</sup> “Congress left the courts to define what constitutes an undue burden. . . .”<sup>49</sup> As it happens, it is generally agreed that courts have, on the whole, interpreted the undue hardship standard in a manner that makes it quite difficult for student loan debtors to receive a discharge.<sup>50</sup>

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45. Carlson, *supra* note 1.

46. For further reading, see generally, Brubaker, *supra* note 36; Karen Cordry, Espinosa: *It’s Not So Simple: Part I*, 29 AM. BANKR. INST. J., July/Aug. 2010, at 12 [hereinafter Cordry, *Part I*]; Karen Cordry, Espinosa, *It’s Not So Simple: Part II*, 29 AM. BANKR. INST. J., Sept. 2010, at 12 [hereinafter Cordry, *Part II*]; Janet A. Flaccus, *Revisiting Bankruptcy Discharge of Student Debt by Declaration in a Chapter 13 Plan*, 2010 ARK. L. NOTES 21; James J. Haller, *Creativity Alive in Chapter 13 Plans After Espinosa*, 30 AM. BANKR. INST. J., Apr. 2011, at 40; Gloria J. Liddell & Pearson Liddell, Jr., *Errors in Judgment or How to Get Debts Discharged in Bankruptcy “(Il)legally:” A Matter of Notice*, 5 CHARLESTON L. REV. 193 (2011); Kerry Brian Melear, *The Devil’s Undue: Student Loan Discharge in Bankruptcy, The Undue Hardship Standard, and the Supreme Court’s Decision in United Student Aid Funds v. Espinosa*, 264 ED. L. REP. 1 (2011); Togut & Sheikh, *supra* note 40.

47. 11 U.S.C. §§ 523(a)(8), 1328(a) (2012).

48. *Id.* § 523(a)(8) (emphasis added).

49. Jackson, *supra* note 1, at 239.

50. See, e.g., C. Aaron LeMay & Robert C. Cloud, *Student Debt and the Future of Higher Education*, 34 J.C. & U.L. 79, 83-84 (2007); Rafael I. Pardo & Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L.J. 179, 181 (2009); Richard Fossey, Review of Alan Michael Collinge, *the Student Loan Scam: The Most Oppressive Debt in U.S. History - And How We Can Fight Back*, 38 J.L. & EDUC. 715, 717 (2009) (book review). But see Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard*, 86 AM. BANKR. L.J. 495, 495 (2012) (citing empirical data suggesting that the undue hardship standard is not as unduly burdensome as is often suggested).

Faced with this high hurdle to dischargeability, some consumer debtors began to attempt an end run around the undue hardship requirement: discharge-by-declaration. A debtor would “include[] a declaratory statement in his or her bankruptcy petition that his or her student loan [was] an undue burden” and hope that the lender would not object.<sup>51</sup> If the lender objected, the debtor would be drawn into an adversary proceeding, in which she would have to demonstrate affirmatively that she satisfied the applicable undue hardship elements as articulated by courts in that jurisdiction.<sup>52</sup> If the lender did *not* object, however, and the bankruptcy court confirmed the plan, the debtor could discharge his or her student loans without having to prove an undue hardship, and claim preclusion principles would prevent the lender from challenging the plan for noncompliance with the Code's nondischargeability provisions.<sup>53</sup>

Prior to 2010, discharge-by-declaration met a chilly reception in the courts. Of the circuits that considered the issue, nearly all ultimately<sup>54</sup> concluded “that there must be an adversarial proceeding” pursuant to which the debtor affirmatively demonstrates an undue hardship “for res judicata to apply. . . . [T]hus, a student loan cannot be discharged by mere declaration.”<sup>55</sup> Ruling otherwise, reasoned these courts, would be tantamount to confirming an illegal plan that violated the nondischargeability provisions of the Code.<sup>56</sup> Indeed, discharge-by-declaration was so poorly received by the courts “that use of this tactic had largely died out.”<sup>57</sup>

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51. Jackson, *supra* note 1, at 236.

52. *Id.*

53. *See id.* at 236-43.

54. The Tenth Circuit initially concluded that discharge-by-declaration was acceptable, but subsequently reversed its position. *Id.* at 244 (citing *Educ. Credit Mgmt. Corp. v. Mersmann (In re Mersmann)*, 505 F.3d 1033, 1047-48 (10th Cir. 2007), *abrogated by United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010); *Andersen v. UNIPAC-NEBHELP (In re Andersen)*, 179 F.3d 1253, 1258-59 (10th Cir. 1999), *overruled by In re Mersmann*, 505 F.3d 1033 (10th Cir. 2007)).

55. *Id.* (citations omitted); *accord* Carlson, *supra* note 1, at 412.

56. *See* Jackson, *supra* note 1, at 244; *see also* Carlson, *supra* note 1, at 410-11.

57. Cordry, *Part I*, *supra* note 46, at \*12.

The first point of note about *Espinosa* is that it is an anachronism. The tactic of “discharge by declaration” began in the early 1990s as a way of avoiding the requirements of Rule 7001. . . . [A]s such provisions blossomed, courts began to look for them (either on their own, or based on creditors' objections), roundly condemned the tactic, ordered broad remedial measures for pending cases, and threatened significant sanctions against debtors' counsel who persisted in using

By contrast, the Ninth Circuit took the increasingly lonely position that a discharge-by-declaration was perfectly acceptable if the creditor did not object.<sup>58</sup> This result was criticized by a number of commentators,<sup>59</sup> and when the Supreme Court granted certiorari to consider the issue,<sup>60</sup> many confidently predicted that the Court would reverse the Ninth Circuit as a poorly-reasoned outlier.<sup>61</sup>

That prediction was wrong. In *United Student Aid Funds, Inc. v. Espinosa*,<sup>62</sup> decided in 2010, the Supreme Court unanimously affirmed the Ninth Circuit, thereby abrogating the case law of numerous other circuits.<sup>63</sup> The Court held that although the bankruptcy court confirmed a Chapter 13 debtor's bankruptcy plan providing for a discharge of his student loans "without . . . an adversary proceeding . . . or making a finding of undue hardship,"<sup>64</sup> the confirmation order was nonetheless not void.<sup>65</sup> According to the Court, a confirmation order is void, and therefore not binding,<sup>66</sup> *only*

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them. The result was that use of this tactic had largely died out by the middle of this decade.

*Id.*

58. See, e.g., *Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193 (9th Cir. 2008), *aff'd*, *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010).

59. See, e.g., Carlson, *supra* note 1, at 410-12; Jackson, *supra* note 1, at 247-56.

60. *Espinosa*, 557 U.S. 903 (2009).

61. See Jackson, *supra* note 1, at 250-52 ("[T]he Supreme Court is leaning toward the requirement of an adversarial proceeding to show undue hardship. . . . [the Ninth Circuit] will likely be overturned. . . ."); see also Flaccus, *supra* note 46, at \*21 ("I thought (dumb me) there was only a slim chance the Supreme Court would affirm the Ninth Circuit and overturn all of the circuits on the opposite side, but that is what the Supreme Court did!").

62. 559 U.S. 260 (2010).

63. See *Educ. Credit Mgmt. Corp. v. Mersman (In re Mersmann)*, 505 F.3d 1033, 1047-48 (10th Cir. 2007); *In re Hanson*, 397 F.3d 482, 486 (7th Cir. 2005); *Ruehle v. Educ. Credit Mgmt. Corp. (In re Ruehle)*, 412 F.3d 679, 682-84 (6th Cir. 2005); *Whelton v. Educ. Credit Mgmt. Corp.*, 432 F.3d 150, 155 (2d Cir. 2005); *Banks v. Sallie Mae Servicing Corp. (In re Banks)*, 299 F.3d 296, 302-03 (4th Cir. 2002).

64. *Espinosa*, 559 U.S. at 265.

65. *Id.* at 272.

66. The Supreme Court did not frame its holding in terms of res judicata principles, and the Ninth Circuit expressly denied that res judicata principles were even implicated at all:

[W]hat we have here is not a question of res judicata—giving the judgment in the bankruptcy case preclusive effect in another case. . . . A discharge injunction does not operate by way of res judicata; it is, rather, an equitable remedy precluding the creditor, on pain of contempt, from taking *any* actions to enforce the discharged debt. . . . There was no second lawsuit in our case . . . . Res judicata thus has no application to a case like ours . . . .

*Espinosa v. United Student Aid Funds*, 553 F.3d 1193, 1200 (9th Cir. 2008).

in the exceptional circumstances where either (1) “the court that rendered judgment lacked even an ‘arguable basis’ for jurisdiction”<sup>67</sup> or (2) “a violation of due process . . . deprives a party of notice or the opportunity to be heard.”<sup>68</sup> Granting a discharge-by-declaration was not a jurisdictional defect that would render the confirmation order void.

First, [Code section] 523(a)(8)'s statutory requirement that a bankruptcy court find undue hardship before discharging a student loan debt is a precondition to obtaining a discharge order, not a limitation on the bankruptcy court's jurisdiction. Second, the requirement that a bankruptcy court make this finding in an adversary proceeding derives from . . . [Rule 7001(6)], which [is a] “procedural rule[] adopted by the Court for the orderly transaction of its business” [and is] “not jurisdictional.”<sup>69</sup>

Nor was the lender's constitutional right to due process violated by the confirmation order; the lender “received *actual* notice of the filing and contents of [the debtor's] plan,” which “more than satisfied [the lender's] due process rights” even though the debtor “fail[ed] to serve a summons and complaint” as would be required in an adversary proceeding.<sup>70</sup>

However, the Supreme Court did not accept the Ninth Circuit's reasoning wholesale. The Ninth Circuit stated in its opinion below:

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Notwithstanding the Supreme Court's silence and the Ninth Circuit's denials, *Espinosa* does indeed implicate res judicata principles insofar as it relates to whether a party can attack a plan provision that could have or should have been attacked in a prior proceeding. As one commentator explains:

Extinguishment of a claim pursuant to a plan simply means that the student loan creditor has no cause of action once the plan is complete. This would have been the case even if a court refused to issue a discharge order pursuant to § 1328(a). Therefore, contrary to the Ninth Circuit's opinion, the case turned on res judicata of the plan after all. The plan itself does not give rise to the discharge injunction. Only a discharge order could do so.

Carlson, *supra* note 1, at 409. *But see* Brubaker, *supra* note 36 (arguing that res judicata principles are not implicated in *Espinosa*).

67. *Espinosa*, 559 U.S. at 271 (quoting *Nemaizer v. Baker*, 793 F.2d 58, 65 (2d Cir. 1986)).

68. *Id.*

69. *Id.* at 271-72.

70. *Id.* at 272. For further reading on the notice and procedural analysis in *Espinosa*, see generally, Cordry, *Part I*, *supra* note 46; Cordry, *Part II*, *supra* note 46; Liddell & Liddell, *supra* note 46.



[S]tudent loan debts can be discharged by way of a Chapter 13 plan if the creditor does not object, after receiving notice of the proposed plan, and that such notice [sic] is not constitutionally inadequate. We find it highly unlikely that a creditor whose business it is to administer student loans will be misled by the customary bankruptcy procedures or somehow be bamboozled into giving up its rights by crafty student debtors. If the creditor is notified and fails to object, it is doubtless the result of a careful calculation that this course is the one most likely to yield repayment of at least a portion of the debt. In such circumstances, bankruptcy courts have no business standing in the way.<sup>71</sup>

To this, the Supreme Court responded:

This, we think, was a step too far.

. . . [C]ontrary to the [Ninth Circuit's] assertion, the Code makes plain that bankruptcy courts have the authority—indeed, the obligation—to direct a debtor to conform his plan to the requirements of [Code sections] 1328(a)(2) and 523(a)(8). . . . [T]he bankruptcy court must make an independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding.<sup>72</sup>

Thus, the Supreme Court gave claim preclusive effect to the discharge-by-declaration before it, notwithstanding “the Bankruptcy Court's failure to find undue hardship before confirming Espinosa's plan was a legal error.”<sup>73</sup> The Court immediately followed with the announcement that bankruptcy courts would henceforth have the obligation to be vigilant and deny confirmation of plans that seek to skirt the undue hardship standard.<sup>74</sup>

Ultimately, the takeaway from *Espinosa* for bankruptcy courts is unclear. *Espinosa* saddles courts with the obligation, but not the incentive, to extirpate discharges-by-declaration from proposed Chapter 13 plans. Courts may “deny confirmation of [a] posited, uncontested discharge-by-declaration plan without something more (e.g., some evidentiary showing or proffer at confirmation regarding undue hardship).”<sup>75</sup> Beyond that,

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71. *Espinosa*, 553 F.3d at 1205 (citations omitted).

72. *Espinosa*, 559 U.S. at 276-78.

73. *Id.* at 275.

74. *Id.* at 276-77.

75. Brubaker, *supra* note 36.

however, given that “Chapter 13 procedure is so accelerated that the opportunity for error is much increased,”<sup>76</sup> courts are unlikely to comb through every Chapter 13 plan in search of offending provisions unless guided by a creditor's objection, especially if the plan will be given claim preclusive effect under *Espinosa* even if the debtor sneaks in an illegal term.<sup>77</sup> Incentives aside, there is also “no clear answer as to whether courts have the resources to oversee compliance with the provisions that violate the Code.”<sup>78</sup>

Instead, courts are increasingly turning to local rules and model plans for Chapter 13 debtors that help to curtail some of the more challenging tactics debtors employed to work around nondischargeable debts.<sup>79</sup> In Colorado, for example, debtors are required under the local rules to include provisions in their plans that bind the debtors to file a modification to deal with priority or secured claims post-confirmation.<sup>80</sup> This provision has proven controversial, but does achieve the goal of giving creditors more effective notice of unusual or unexpected provisions in Chapter 13 plans.

The takeaway for creditors is that the onus remains on them to vigilantly police proposed plans for illegal provisions. “Despite the court's duty, creditors should not rely on the bankruptcy courts to police a debtor's plan, as there is no clear answer as to whether courts have the resources to” police every proposed Chapter 13 plan.<sup>81</sup>

Although the debtor's counsel's ethical duties should deter such illegal provisions, creditors cannot sleep on their rights or bury their heads in the sand. From the creditor's perspective, in light of *Espinosa*, objecting to plan provisions that appear to be contrary to the . . . Code is the prudent course of action. The alternative could mean malpractice. Creditor's counsel should

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76. Carlson, *supra* note 1, at 355.

77. See Flaccus, *supra* note 46, at 24 (“A question remains whether the bankruptcy judges will start scrutinizing Chapter 13 plans.”).

78. Faiq Mihlar & Heather Giannino, *Creativity in Chapter 13 Has Limits After Espinosa*, AM. BANKR. INST. J., Apr. 2011, at 41, 95. Mihlar and Giannino suggest that this duty could be delegated to the Chapter 13 trustee, but express doubt as to whether trustees have the resources to perform the task either. *See id.*

79. Karen Cordry, *Claims Bar Dates and Confirmation Orders: Can't We All Just Get Along?*, 31 AM. BANKR. INST. J., Mar. 2012, at 12, 72 [hereinafter Cordry, *Claims Bar Dates*].

80. *Id.*

81. Mihlar & Giannino, *supra* note 78, at 95.

not rely on the courts or the trustee to police for or be a caretaker of the creditor.<sup>82</sup>

Some creditors, particularly taxing authorities, have therefore evinced an increased willingness to scour plans for illegal terms and aggressively seek sanctions for violations of the Code.<sup>83</sup>

One bit of good news for creditors appeared in the United States Bankruptcy Court for the Eastern District of Wisconsin in the case *In re Anderson*.<sup>84</sup> There, a court refused to confirm a plan containing illegal provisions on the objection of a secured creditor.<sup>85</sup> The case is notable, however, because the decision simultaneously found the creditor to lack standing to make the objection.<sup>86</sup> Picking up on the Supreme Court's admonition in *Espinosa*, the bankruptcy court refused to ignore the issues raised by the creditor after becoming aware of them and refused to confirm the debtors' plan sua sponte.<sup>87</sup>

At the same time, however, "creditor[s]' counsel should also be looking out for the practical aspects and cost/benefits to [their] clients."<sup>88</sup> Paying associates to read every word of every Chapter 13 plan that comes across a creditor's desk would be significantly burdensome, especially on large lenders with millions of clients. Thus,

[g]iven today's environment, the uncertainty as to how courts will handle plans containing provisions in contravention of the

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82. *Id.*

83. One commentator explained the development this way:

[T]he states are politely putting debtors' counsel on notice—the days of “anything goes” in a plan are over, as are the days of carving out the loudest voices and keeping the provisions in for everyone else. If debtors' counsel continue to include such provisions, they can expect the states' response to escalate up to and including requests for sanctions under Rule 9011. Thus far, the State of Texas has convinced a number of debtors to voluntarily remove problematic provisions from their plans entirely; other states are expected to follow suit. They trust that soon, like discharge by declaration, improper provisions will disappear from plan proposals. If they do not, the Supreme Court made clear that bankruptcy courts have means at their disposal to police these problems. The states intend to ensure that the courts are apprised of when they need to exercise those means.

Cordry, *Part II*, *supra* note 46, at 12.

84. 458 B.R. 494 (Bankr. E.D. Wis. 2011).

85. *Id.* at 503.

86. *Id.*

87. *Id.*

88. Mihlar & Giannino, *supra* note 78, at 95.

Code, and the ethical considerations surrounding the same, it would be advisable to creditor's counsel and its client to stay vigilant and practical at the same time. There may not be a universal or simple answer; each case will need to be evaluated on a case-by-case basis.<sup>89</sup>

What is the takeaway for consumer debtors' attorneys? Has it suddenly become easier to discharge student loan debts and other nondischargeable debts?<sup>90</sup> Should debtors with student loans attempt discharge-by-declaration after *Espinosa*? Despite the relative unlikelihood that courts will independently sift through Chapter 13 plans looking for illegal provisions, we believe attorneys would be well-advised not to attempt discharge-by-declaration in the future.<sup>91</sup> The Supreme Court intimated in *Espinosa* that “[d]ebtors and their attorneys face penalties” for “bad-faith attempts to discharge student loan debt without the undue hardship finding Congress required.”<sup>92</sup> Even if courts are unlikely to catch the illegal provisions, a creditor's attorney vigilantly fulfilling his or her duty to zealously represent his or her client might,<sup>93</sup> which could lead to sanctions against debtor's counsel. Such penalties “should cause debtor[s] counsel to think twice about proposing plan provisions that do not conform to the . . . Code.”<sup>94</sup> That said, the Supreme Court also suggested that other end-runs around the undue hardship standard remain viable: “Neither the Code nor the Rules prevent the parties from stipulating to the underlying facts of undue hardship, and neither prevents the creditor from waiving service of a

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89. *Id.*

90. See Kurtis K. Wiard, Comment, *Brunner's Folly: The Road to Discharging Student Loans Is Paved with Unfounded Optimism*, 52 WASHBURN L.J. 357, 389-90 (2013) (arguing that *Espinosa* may “foreshadow[] a ‘return to an era’ when student loans are more easily discharged”); Brendan Baker, Comment, *Deeper Debt, Denial of Discharge: The Harsh Treatment of Student Loan Debt in Bankruptcy, Recent Developments, and Proposed Reforms*, 14 U. PA. J. BUS. L. 1213, 1215 (2012) (arguing that *Espinosa* is a signal of a return to an era of more lenient treatment of student loans in bankruptcy).

91. Flaccus, *supra* note 46, at \*23. (“[I]t would be foolish to try to discharge student debt by declaration in the Chapter 13 plan.”). *But see* Brubaker, *supra* note 36 (arguing that discharge-by-declaration will retain its vitality post-*Espinosa* in jurisdictions where the “local legal culture” permits it).

92. *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 278 (2010) (citing FED. R. BANKR. P. 9011); see also Haller, *supra* note 46, at 94 (citing MODEL RULES OF PROF'L CONDUCT 3.1); Liddell & Liddell, *supra* note 46, at 195 (citing 18 U.S.C. § 152 (2006); Mihlar & Giannino, *supra* note 78).

93. See Mihlar & Giannino, *supra* note 78, at 95.

94. *Id.*

summons and complaint.”<sup>95</sup> We therefore advise debtors' attorneys to seek stipulations from creditors but avoid clandestine discharges-by-declaration. Some practitioners have proposed other ways that debtors' attorneys “can be creative” in “proposing new and innovative solutions in [C]hapter 13 plans” for their clients “while also being ethical,”<sup>96</sup> but other attorneys have questioned these proposals.<sup>97</sup>

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95. *Espinosa*, 559 U.S. at 278 (citing FED. R. BANKR. P. 7004; FED. R. CIV. P. 4(k)).

96. Haller, *supra* note 46, at \*94. Mr. Haller makes the following recommendations when attempting to utilize “a non-standard proposal for repayment”:

1. Do not include issues in a chapter 13 plan that are listed as adversary proceedings under Bankruptcy Rule 7001;
2. When filing plans with alternative treatment, make the proposed treatment clear and obvious. Identify the language in bold, CAPS and underline. Include in the plan the language of the statute or case you are relying on for the alternative treatment. This will put the creditor on notice and give the court a better understanding of your proposed treatment;
3. Ask your local bankruptcy court whether it would insert a paragraph in the uniform plan (if applicable) that identifies proposed treatment under 11 U.S.C. § 1325(a)(5)(A);
4. Send a letter to the creditor upon filing with a description of your proposed treatment in the plan and request a response;
5. Contact creditor's counsel, if any, to discuss the treatment before confirmation; and
6. Keep your client advised of the potential likelihood of success.

*Id.*

97. *See* Mihlar & Giannino, *supra* note 78, at 95. Mihlar and Giannino respond to Haller's proposals as follows:

Debtor's counsel may propose creative solutions including questionable provisions in a chapter 13 plan. For instance, debtor's counsel may attempt to put the creditor on notice by highlighting the alternative treatment in the plan through changes in font—bolding, italicizing, underlining or capitalizing. However, this does not solve the fact that debtor's counsel is proposing language contrary to the Code.

Let's assume that debtor's counsel sends a letter to the creditor with the proposed alternative treatment in the plan and requests a response. What, if anything, does this do to mitigate liability under Bankruptcy Rule 9011 or 11 [sic — this should refer to Chapter 28] U.S.C. § 1927? Does making the proposed treatment clear and conspicuous provide an answer, or does this still fly in the face of debtor's counsel's ethical duties as a [sic] an attorney? As a practical matter, it may mitigate the potential Rule 9011 or § 1927 issues, but it does not get debtor's counsel “off the hook” in terms of legal and ethical obligations. Identifying provisions in bold, sending letters or calling the creditor's counsel does not make it OK to propose illegal provisions. This presumes that debtor's counsel can propose terms that violate the . . . Code and

Ultimately, whether discharge-by-declaration is appropriate, *Espinosa* sends “mixed signals” that some commentators believe “will likely perpetuate extreme nonuniformity” in the case law going forward.<sup>98</sup>

*b) Espinosa in the Trenches: Post-Espinosa Lower Court Decisions*

Many courts have now grappled with the Supreme Court’s decision in *Espinosa*. Some have followed the Court’s directive to excise illegal plan provisions *sua sponte*,<sup>99</sup> while others have applied the decision’s preclusive logic in contexts beyond student loans.<sup>100</sup> Enough time has passed since *Espinosa* that many Circuit Courts have now issued opinions in this area.<sup>101</sup> In most cases examined below, a bankruptcy court confirmed a plan that discharged a debt not normally subject to discharge, just as in *Espinosa*. Subsequently, a suddenly attentive creditor, dissatisfied with its treatment under the plan, made an effort to appeal the confirmed plan on the grounds that the plan contained illegal provisions. In some cases, the language has been ambiguous or the crucial terms have been absent, leaving the parties to squabble over interpretation. As one might expect, debtors and their attorneys have been impressively inventive in their efforts to minimize debtors’ post-confirmation burdens. Perhaps surprisingly, however, courts have not uniformly thrown open the gates to illegal discharges, as the following cases will demonstrate.

*(1) Educational Loan Debt*

*In re Wright*, decided shortly after *Espinosa*, concerns a case with closely analogous facts.<sup>102</sup> In *In re Wright*, the debtor’s confirmed plan contained a provision that purported to discharge her student loan debt as a hardship.<sup>103</sup> The trustee made a mistake reviewing the plan and did not object to the student loan discharge provision, despite lodging other objections to the

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Ethical Rules as long as he or she puts all parties on notice. Surely, this was not the intended result.

*Id.*

98. Brubaker, *supra* note 36.

99. *In re Donson*, 434 B.R. 471, 475 (Bankr. S.D. Tex. 2010) (requiring a debtor to raise objections to the dischargeability of a debt not as claim objections but as assertions in an adversary proceeding on the same subject previously filed by the creditor, even though neither party had requested such an order).

100. *See, e.g.*, Fla. Dep’t of Rev. v. Diaz (*In re Diaz*), 647 F.3d 1073, 1091-93 (11th Cir. 2011) (denying the discharge of domestic support obligations by declaration).

101. *See, e.g., id.*

102. *In re Wright*, 444 B.R. 883 (Bankr. S.D. Ind. 2010).

103. *Id.* at 884.

plan.<sup>104</sup> The debtor's attorney claimed that the debtor intended to file an adversary proceeding to obtain a finding of undue hardship, but had never gotten around to actually doing so.<sup>105</sup> The court assumed the trustee's motion to set aside the plan was predicated on Federal Rule of Civil Procedure 60(1), which deals with mistaken judgment, not Rule 60(4) like in *Espinosa*.<sup>106</sup> The court decided that the trustee's oversight was not excusable and refused to set aside the plan.<sup>107</sup> Like *Espinosa* before her, Wright succeeded in discharging her student loan debts by declaration.<sup>108</sup>

In its decision, the *Wright* court emphasized the language in *Espinosa* urging bankruptcy courts to issue sanctions against attorneys engaging in improper conduct.<sup>109</sup> The court offered the following thoughts:

[T]he Court . . . takes an extremely dim view of [the debtor's plan's] inclusion of the Student Loan Provision. Counsel insisted that he included the provision in order to treat "every claim" in the plan. If that were true, then the plan presumably could have merely stated only that Debtors intended to file an adversary proceeding to seek discharge of their student loan obligation as an undue hardship. . . .

. . . .

. . . Debtors' counsel and the consumer bar are well advised to take heed of [Rule 9011 sanctions] and to exercise more care in how they treat student loans within Chapter 13 plans; otherwise they could, and probably should, be looking down the barrel of a Rule 9011 motion for sanctions.<sup>110</sup>

Of course, not all cases are so straightforward. In *Hann v. Educational Credit Management Corp. (In re Hann)*, the United States Court of Appeals for the First Circuit considered a debtor with student loan debts that she claimed she had already paid.<sup>111</sup> Although her creditor filed a proof of claim, the lender did not appear at the hearing on the debtor's objection.<sup>112</sup> The court, unsurprisingly, found in the debtor's favor, allowing the claim

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104. *Id.* at 884-85.

105. *Id.* at 885.

106. *Id.* at 886.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.* at 886-87.

111. 711 F.3d 235, 237 (1st Cir. 2013).

112. *Id.*

for zero dollars, and the lender never appealed.<sup>113</sup> After the debtor's bankruptcy case ended in 2010, her lender continued to try to collect on the putative debts under the belief that its claim was not dischargeable in bankruptcy and therefore survived it in whole.<sup>114</sup> The debtor re-opened her bankruptcy case, but the original judge had retired, leaving a lingering question: Had the claim been conclusively adjudicated and reduced to zero dollars, precluding further collection efforts, or had the bankruptcy court meant only to exclude the creditor from recovering against the estate, leaving the debt recoverable post-discharge?<sup>115</sup>

The Bankruptcy Appellate Panel in *Hann* held that *Espinosa* did not apply and was not a factor; the court rejected the lender's argument that the claim allowance for zero dollars left its claim intact.<sup>116</sup> Instead, the Panel found that the claim allowance and objection process did not merely signify that the lender would not collect in bankruptcy, but rather that the claim was paid in full.<sup>117</sup> The Panel concluded that the bankruptcy court's allowance in the amount of zero dollars was "tantamount to disallowance."<sup>118</sup> Thus, *Hann* was able to avoid any arguments about discharge before the Panel, because the Panel was convinced that there was no existing debt to discharge.

The First Circuit followed suit, noting "the fact that [the debtor] squarely raised the issue of whether she had repaid her loans distinguish[ed] th[e] case" from cases involving discharge by declaration.<sup>119</sup> The First Circuit instead likened *Hann*'s case to one in which an appellate court must decide whether a factual issue is a necessary component of an unexplained judgment.<sup>120</sup> Because *Hann*'s argument that she had repaid her loans was her "central" argument against her lender, and because the bankruptcy court

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113. *Id.*

114. *Id.* at 238.

115. *Id.*

116. *Hann v. Educ. Credit Mgmt. Corp.* (*In re Hann*), 476 B.R. 344, 357 (B.A.P. 1st Cir. 2012).

117. *See, e.g., id.* (reasoning that *Espinosa* did not apply because "discharge is not currently the issue").

118. *Id.*

119. *In re Hann*, 711 F.3d at 241 (citing Fla. Dep't of Rev. v. Diaz (*In re Diaz*), 647 F.3d 1073 (11th Cir. 2011)).

120. *Id.* (citing *Hoult v. Hoult*, 157 F.3d 29, 32-33 (1st Cir. 1998) and concluding that a jury verdict that didn't expressly state a central contention of a woman's tort lawsuit against her father, who had raped her, nonetheless undeniably rested on the premise that the rapes did occur, so as to support the woman's affirmative defense of truth against her father's subsequent defamation lawsuit; the issue "was resolved by the jury at the first trial").



indisputably had jurisdiction to determine the amount of the claim, the court conclusively determined the debt to have been paid in full.<sup>121</sup>

Ultimately, the First Circuit decided that this case hinged on the proper interpretation of an inartfully drafted order,<sup>122</sup> so the narrow lesson for debtor's counsel is simple — offer the judge an order that disallows a creditor's claim, not one that allows it for zero dollars. More broadly, Hann's case makes clear that, if a debtor can show that she has already paid the creditor what she owed, the proper place to raise that issue is in the claims allowance process. *Espinosa* does not reach into the claims allowance process, and because courts apply *Espinosa* unevenly, parties should resolve disputed claims without relying on it. As such, debtors should only make an effort to take refuge under the *Espinosa* umbrella when they lack the evidence and testimony to prove repayment of a debt during the claims allowance process.

To provide some contrast to the *Hann* decision, *Greer v. Healthcare Financial Services (In re Greer)* involved a debtor whose efforts to discharge her student loans without holding an “undue hardship hearing” were unsuccessful.<sup>123</sup> The debtor included her student loan debts in her bankruptcy schedules, but mislabeled them as unsecured medical debts, not educational loan debt.<sup>124</sup> The student loan debts were listed among the debtor's unsecured debts but were not designated as non-dischargeable student loans.<sup>125</sup> The confirmation order treated the debtor's education lender simply as an unsecured creditor.<sup>126</sup> After plan confirmation, the creditor continued to pursue its collection efforts, which led the debtor to initiate an adversary proceeding against the student loan creditor for allegedly violating the automatic stay.<sup>127</sup>

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121. *Id.* (citing *In re Hann*, 476 B.R. at 357).

122. *Id.* at 240 (“At the outset, we can agree with ECMC that it is far better for bankruptcy courts that disallow claims on the ground that the underlying debt is satisfied to say so in clear language. We think this case would not be before us if the Claim Order simply said ‘ECMC's claim is disallowed because the underlying loans have been repaid.’ But the onus of avoiding ambiguity in these situations does not rest solely with bankruptcy judges. The Claim Order was submitted by Hann's counsel as a proposed order; had Hann's counsel proposed clearer language, this entire second proceeding most likely would have been unnecessary.”).

123. *Greer vs. Healthcare Fin. Servs., LLC (In re Greer)*, 498 B.R. 98, 111 (Bankr. S.D. Miss. 2013).

124. *Id.*

125. *Id.* at 111.

126. *Id.* at 101.

127. *Id.*

The court assumed that the debtor was attempting to discharge her debts by declaration, but ruled that her failure to properly categorize the debts on her schedules resulted in insufficient notice to her student loan creditor of her intention to discharge the student loan.<sup>128</sup> Even under the relaxed standards of *Espinosa*, a debtor cannot discharge a student debt without affording her creditor due process, and to do so, the discharge declaration must make it specifically clear which debts are subject to discharge.<sup>129</sup>

In a similar case, *Haney v. Educational Credit Management Corp. (In re Haney)*, a Chapter 13 debtor listed her student loan as an unsecured, nonpriority claim.<sup>130</sup> After paying the student loan creditor over the course of the administration of her plan, the debtor's student debt remained significantly in arrears.<sup>131</sup> Some seven years after the conclusion of plan payments, the educational lender's successor in interest began attempting to collect the unpaid portion of the debts.<sup>132</sup> The debtor responded by reopening her long dormant case in an effort to enforce the stay.<sup>133</sup> The result in *In re Haney*, however, was not a discharge, because unlike in *Espinosa*, the debtor's plan did not contain "an express provision purporting to discharge the [d]ebtor's student loan debt."<sup>134</sup> Taken together, *In re Haney* and *In re Greer* give clear guidance to student loan debtors seeking a discharge: the discharge order must be clear that it discharges the student debt. So clear, it seems, that a creditor would have ample opportunity to screen the illegal provision out beforehand, otherwise it will not be effective.

Student loan cases are relatively rare, perhaps for a variety of reasons. Courts are often able to decide student loan cases on preliminary matters and, therefore, rarely reach the preclusion issue.<sup>135</sup> Nevertheless, the few cases surveyed above make it clear that *Espinosa* is no open floodgate of student loan discharges. Instead, courts have taken a reasoned and narrow

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128. *Id.* at 111.

129. *See id.*

130. No. 97-70937, 2011 WL 6000886, at \*1 (Bankr. E.D. Ky. Nov. 30, 2011).

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.* at \*3.

135. *See, e.g., Smyth v. Edamerica, Inc. (In re Smyth)*, 470 B.R. 459, 462 (B.A.P. 6th Cir. 2012) (holding that *Espinosa* has no application to bankruptcy cases filed under Chapter 7); *In re McKinnie*, 501 B.R. 344, 345 (Bankr. E.D. Mich. 2013) (same); *Educ. Credit Mgmt. Corp. v. Pulley*, Case No. 3:14cv00864-HEH, 2015 WL 2146903 at \*11-12 (E.D. Va. Apr. 30, 2015) (holding that lender's accidental rejection of trustee's plan payments did not estop lender from pursuing debtor for unpaid student loans).

approach to apply *Espinosa* in the realm of nondischargeable student loans. Thus, the best practice is to draft a discharge order with the clear aim of discharging a student loan, or else even the best laid schemes of mice and men may go awry, leaving the debtor naught but grief and pain for promised joy.<sup>136</sup>

(2) “*Whose Child Is This?*”: Domestic Support Obligations After *Espinosa*

The courts have been hesitant to apply the reasoning of *Espinosa* to certain varieties of debt, such as domestic support obligations. For instance, in the case of *Florida Department of Revenue v. Diaz (In re Diaz)* a Chapter 13 debtor who had completed his plan and received a discharge argued that the child-support agencies of various states violated the discharge injunction by attempting to collect past-due child support.<sup>137</sup> The bankruptcy court had granted the debtor’s objection to one of the agency’s claims as unopposed and had thereby reduced the claim to cover only unpaid principal and not interest.<sup>138</sup> The bankruptcy court then confirmed the debtor’s plan, which provided for the payment in full of only the reduced portion of the agency’s claim.<sup>139</sup> The debtor then completed the plan and received a discharge order.<sup>140</sup> Following the discharge, the agencies attempted to collect the full amount of child support owed, including the interest the bankruptcy court had disallowed.<sup>141</sup>

The Eleventh Circuit, notwithstanding *Espinosa*’s holding that the Code’s plan-finality provisions may result in the discharge of an otherwise nondischargeable debt, held that the agencies did not violate the discharge injunction by attempting to collect the child support because “the bankruptcy court’s discharge order did not discharge [the debtor’s] child-support obligation.”<sup>142</sup> First, the court seized upon language in *Espinosa* that—unlike student loan debt, which is dischargeable if the debtor makes

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136. See ROBERT BURNS, *To a Mouse, on Turning Her Up in Her Nest, with the Plough*, in POEMS, CHIEFLY IN THE SCOTTISH DIALECT 138, 148 (Kilmarnock ed. 1786).

137. Fla. Dep’t of Rev. v. Diaz (*In re Diaz*), 647 F.3d 1073, 1081 (11th Cir. 2011).

138. *Id.* at 1080.

139. *Id.*

140. *Id.* at 1081.

141. *Id.*

142. *Id.* at 1089-93. However, the court also concluded that sovereign immunity did not categorically bar the debtor’s claims for violations of the discharge injunction. *Id.* at 1086-88.

the difficult showing of undue hardship—”child-support debt is ‘not dischargeable under *any* circumstances’ in Chapter 13 proceedings.”<sup>143</sup>

Secondly, the court emphasized that a bankruptcy court’s disallowance of a debt has no bearing on whether that debt is discharged once the debtor completes his or her plan. “Although a creditor whose claim is disallowed may not collect from the bankruptcy estate, ‘disallowance of a claim does not necessarily discharge [the underlying] debt’ and eliminate the debtor’s personal liability outside of bankruptcy.”<sup>144</sup> In other words, the debtor remained liable to the creditor for the amount of the domestic support obligation not settled during the bankruptcy case.<sup>145</sup> Thus, the debtor’s completion of his plan did not discharge the child-support debt.

The Eleventh Circuit further rejected the debtor’s argument that general principles of claim preclusion barred the agencies from attempting to collect the child-support debt.<sup>146</sup> The debtor argued that the agencies were attempting to re-litigate the amount of the child-support debt; the bankruptcy court’s order granting the claim objection and reducing the allowed claim had already adjudicated the total amount of the child-support debt.<sup>147</sup> The Eleventh Circuit rejected the debtor’s argument:

“The agencies are not attempting to *re*litigate this issue, as it was never litigated . . . . [T]he only issue before the bankruptcy court . . . was the amount of the child-support debt that would be paid *by the bankruptcy estate* through [the debtor’s] Chapter 13 plan, not the total amount.”<sup>148</sup> The Eleventh Circuit found further support for its conclusion by referring to pre-*Espinosa* cases holding that claim preclusion does not “prevent a creditor who holds a nondischargeable tax debt from arguing that the amount of the debt exceeds the payment that the creditor received during bankruptcy.”<sup>149</sup> Thus, concluded the court, the debtor’s remaining child-support debt was never discharged, and the agencies did not violate the discharge injunction by attempting to collect it.<sup>150</sup>

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143. *Id.* at 1089-90 (quoting *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 274 n.10 (2010)); *see also* 11 U.S.C. § 523(a)(5), (8), (15) (2012).

144. *In re Diaz*, 647 F.3d at 1090 (quoting *Cruz v. Educ. Credit Mgmt. Corp. (In re Cruz)*, 277 B.R. 793, 795 (Bankr. M.D. Ga. 2000)).

145. *Id.*

146. *Id.* at 1090-92. The court also concluded that issue preclusion did not bar the agencies from attempting to collect the debt either. *See id.*

147. *See id.* at 1091.

148. *Id.* (citing *Bell v. Educ. Credit Mgmt. Corp. (In re Bell)*, 236 B.R. 426, 429 (N.D. Ala. 1999)).

149. *Id.* at 1091-92.

150. *Id.* at 1092.

The court cautioned, however, that while the agencies could collect the interest that had been disallowed in the debtor's bankruptcy, the agencies were not permitted to double-collect the allowed principal that the debtor had already paid through his bankruptcy plan.<sup>151</sup> The court further cautioned that its decision did not finally adjudicate the total amount of remaining child support the debtor owed; that was a decision left for a state court with proper jurisdiction.<sup>152</sup>

Although the *In re Diaz* court could have rested its decision on the idea that disallowance of a debt is not tantamount to a discharge (a direct split from the First Circuit's reasoning in *In re Hann*),<sup>153</sup> the tone of the opinion is much more sweeping. The thrust of the opinion—as well as that of a subsequent Eleventh Circuit decision, *Florida Department of Revenue v. Davis (In re Davis)*—is that child-support obligations are never dischargeable, even if a confirmed plan included a provision explicitly discharging, rather than merely disallowing, the debt.<sup>154</sup>

If this interpretation is correct, then *Diaz* and *Davis* sharply limit the applicability of *Espinosa*. *Espinosa* explicitly reserved the question of whether debts that are categorically nondischargeable—such as child-support debts, certain types of tax debts, and debts arising from incidents of driving while intoxicated—can nonetheless be discharged if a confirmed plan so provides.<sup>155</sup> The Eleventh Circuit approach resolves this question in the negative: the plan-finality sections of the Code only trump the nondischargeability provisions when the Code provides an exception to the general rule of nondischargeability, like the undue hardship discharge for student loans.<sup>156</sup> Because child support obligations—and, by extension,

151. *Id.* at 1093.

152. *Id.* (citing *Harrell v. Sharp (In re Harrell)*, 754 F.2d 902, 907 n.9 (11th Cir. 1985)).

153. *See Hann v. Educ. Credit Mgmt. Corp. (In re Hann)*, 476 B.R. 344, 357 (B.A.P. 1st Cir. 2012).

154. *See State of Fla. Dep't of Rev., Child Support Enforcement v. Davis (In re Davis)*, 481 F. App'x 492, 495 (11th Cir. 2012); *In re Diaz*, 647 F.3d at 1089-92; *see also De Boer v. Talsma (In re Talsma)*, 496 B.R. 828, 835 (Bankr. N.D. Tex. 2013) (“[U]nlike the student loan debt in *Espinosa*, the domestic support obligation is not dischargeable under any circumstances.”).

155. *United Student Aid Funds v. Espinosa*, 559 U.S. 260, 273-74 n.10 (2010) (“Sections 1328(a) and 523(a)(8) [of the Code] provide that student loan debt is dischargeable in a Chapter 13 proceeding if a court makes a finding of undue hardship. In contrast, other provisions in Chapter 13 provide that certain other debts are not dischargeable under any circumstances. We express no view on the conditions under which an order confirming the discharge of one of these types of debt could be set aside as void.”) (citations omitted).

156. *In re Diaz*, 647 F.3d at 1089-90 (analyzing *Espinosa*, 559 U.S. 260, 273 n.10).

almost all of the categories of nondischargeable debts enumerated in Code section 523(a)—do not contemplate exceptions to the general rule of nondischargeability, a provision in a confirmed plan purporting to discharge them has no preclusive effect.<sup>157</sup>

Some courts in other jurisdictions have generally agreed with the Eleventh Circuit's approach. One bankruptcy court in the Northern District of Texas held squarely that domestic support obligations "are not dischargeable under any circumstances."<sup>158</sup>

Purely as a matter of policy, *In re Diaz* seems sound. The result in *In re Diaz* protects federalism: "If bankruptcy courts could fix a debtor's personal liability for child—support through rulings [and orders], this would often result in de facto modification of state child-support orders. Federal bankruptcy courts have no business becoming embroiled in state domestic relations to such a degree."<sup>159</sup>

*In re Diaz* fares less well as a matter of logic. The thrust of *Espinosa* is that even illegal provisions of a confirmed plan bind creditors and that otherwise nondischargeable debts may be discharged in bankruptcy if the court confirms a plan that provides for their discharge.<sup>160</sup> Yet, there is no particular reason why this rule would apply to student loans but not to other types of obligations, including child-support debts.

*In re Diaz* picks up on *Espinosa*'s footnote 10 and uses it to distinguish student loans from child-support debts. Whereas the Code makes student loans nondischargeable *unless* the court finds that repayment would constitute undue hardship, the Code specifies that a child-support debt is *never* dischargeable.<sup>161</sup> That analysis is not entirely accurate, however. Code section 1322(a)(2) permits courts to confirm a plan that does not provide for full payment of child-support obligations where the holder of the child-support claim agrees.<sup>162</sup> Just as a plan could contain a provision that a student loan poses an undue hardship even where no hardship

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157. *Id.* at 1091-92.

158. *In re Talsma*, 496 B.R. at 838.

159. *In re Diaz*, 647 F.3d at 1092 n.16 (citing *Carver v. Carver*, 954 F.2d 1573, 1579 (11th Cir. 1992); *Harrell v. Sharp (In re Harrell)*, 754 F.2d 902, 907 (11th Cir. 1985)).

160. *Espinosa*, 559 U.S. at 275-78.

161. *Diaz*, 647 F.3d at 1089-90 (citing *Espinosa*, 559 U.S. at 273 n.10).

162. 11 U.S.C. §§ 507(a)(1), 1322(a)(2) (2012) ("The plan . . . shall provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim.") Domestic support obligations are included in the category of claims entitled to priority. *See id.* § 507(a)(1); *see also* *Burnett v. Burnett (In re Burnett)*, 646 F.3d 575, 580-82 (8th Cir. 2011).

determination has occurred,<sup>163</sup> so too could a plan contain a provision stating that a domestic-support creditor agrees to reduced (or zero) payments.<sup>164</sup> If the creditor fails to object, and if the court fails to catch the objectionable plan provision in its independent review, then the logic of *Espinosa* would give that plan preclusive effect as well, but for the *Espinosa* court's dicta that child-support obligations are never dischargeable.<sup>165</sup>

Indeed, one court has examined the tension inherent between *Espinosa* and *Diaz* regarding the distinction between debts that are “not dischargeable under any circumstances”<sup>166</sup> and debts like student loans, which the Supreme Court considered to be dischargeable under some circumstances, specifically upon a finding of undue hardship.<sup>167</sup> Intriguingly, the *In re Moore* court found the distinction between the types of debts to be illusory at best, pointing out that “[c]hild support obligations, . . . tax debts, . . . , and student loan obligations that do not impose an undue hardship are all always nondischargeable.”<sup>168</sup> Ultimately, the *Moore* court followed the Eleventh Circuit decision in *In re Diaz*, concluding that the precedent's logic was most applicable to the tax debts at stake in *Moore* and finding that the Eleventh Circuit's intention was for claims-allowance processes to have no preclusive effect on non-dischargeable debts outside of bankruptcy.<sup>169</sup>

The *Moore* court made a salient point. Unfortunately, the Bankruptcy Code is not well-equipped to shed light on which types of debts are *really* nondischargeable, like those the Supreme Court enumerated in its tenth footnote to *Espinosa*.<sup>170</sup> Ideally, section 523 of the Code would list detailed descriptions of nondischargeable debts in parallel construction and without sub-exceptions or conditional language. For student loans, the proposed language of section 523(a)(8) would be something like:

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163. *Espinosa*, 559 U.S. at 276.

164. Unlike *In re Diaz*, both *In re Davis* and *In re Talsma* were Chapter 11 cases. Title 11 U.S.C. § 1123(a)(1) does not contemplate full payment of domestic support claims as § 1322(a)(2) does and therefore does not contemplate agreements between parties. Still, all three courts denied debtors' efforts to reduce their domestic support obligations.

165. See *In re Burnett*, 646 F.3d at 580-82; see also *Espinosa*, 559 U.S. at 273 n.10.

166. *Espinosa*, 559 U.S. at 273 n.10.

167. *In re Moore*, No. 08-40118-JTL, 2013 WL 4017936, at \*7 (Bankr. M.D. Ga. Aug. 6, 2013).

168. *Id.* at \*9 (emphasis added).

169. *Id.* at \*9-10.

170. See 11 U.S.C. § 523(a) (2012); *Espinosa*, 559 U.S. at 273 n.10.

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(8) that does not impose an undue hardship on the debtor and the debtor's dependents and that is

(A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.

By removing the conditional language, the confusion among courts evident in the *Moore* decision<sup>171</sup> would, if not disappear, at least diminish. Without conditional language or exceptions, section 523(a) would be a simple list of absolute circumstances in which a debtor would be unable to discharge a debt, and footnote 10 of *Espinosa* would create fewer questions than in its current form.

The absurdity of the categorical framework developed in *Espinosa* and criticized in *In re Moore* has opened the door for the *In re Diaz* court and others to pick and choose which types of debt are protected from discharge by declaration and which ones are not, based principally on whether the applicable subsection of section 523 contains conditional language or exceptions. As a basis for resolving a split between circuit courts, hair-splitting a statute based upon the presence or absence of a protasis is an especially weak approach. In its next revisions to the Code, Congress should reword section 523 in the general style suggested above to avoid this confusion.

As a result of the absurd approach the Supreme Court adopted, not all courts follow the *In re Diaz* approach. For example, in *In re Burnett*, the Eighth Circuit considered a confirmed plan that, contrary to Code section 523(a)(5), did not provide for the full payment of accrued interest on

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171. *Moore*, 2013 WL 4017936, at \*9.



spousal support incurred pre-petition.<sup>172</sup> Although the Eighth Circuit emphasized that the bankruptcy court should have independently refused to confirm the plan, even though no creditor objected to the offending provision, the Eighth Circuit, citing *Espinosa*, other applicable Supreme Court precedent, and Code section 1322(a)(2), held that the plan-finality provisions gave the illegal plan binding and claim-preclusive effect.<sup>173</sup> Contrast the *In re Burnett* decision with *Hart v. Luckman (In re Luckman)*, in which a court, in part, refused to give a plan preclusive effect against further collections because it did not explicitly purport to discharge the domestic support obligation at issue.<sup>174</sup>

The *Burnett* approach is superior because it does not subscribe to the kind of arbitrary ordering of nondischargeable debts that *In re Diaz* and *In re Luckman* do, but instead faithfully applies the *Espinosa* precedent in a logical way—equally to all debts that are not dischargeable under the Code. Assuming that amending the Code is not high on the list of congressional priorities, it will be up to the courts to fashion a consensus surrounding the reasonable approach developed in *In re Burnett* that treats all nondischargeable debts the same.

### (3) Taxes

As one might imagine, debtors have continued to try to use *Espinosa* to their advantage, and those efforts have not been confined to the realm of student loans and domestic-support obligations. Other “nondischargeable” debts such as taxes and secured loans have proven to be fertile grounds for litigation in the wake of the *Espinosa* decision. “Nondischargeable” is in irony-denoting quotation marks because, as discussed above, the Supreme Court sowed the seeds of confusion by implying in a footnote an arbitrary preference for nondischargeable debt categories that are written into the Code without conditional language or exceptions.<sup>175</sup> Unfortunately for

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172. *Burnett v. Burnett (In re Burnett)*, 646 F.3d 575, 577, 581 (8th Cir. 2011). However, the *In re Burnett* court held that the creditor could nonetheless recover on *post*-petition child and spousal support, as well as interest incurred *post*-petition, because a bankruptcy plan can only dispose of claims that existed as of the petition date. *Id.* at 582-83 (citations omitted). *But see Hart v. Luckman (In re Luckman)*, No. 12-60036-13, 2012 WL 6708586, at \*9 (Bankr. D. Mont. Dec. 26, 2012) (finding that confirmation order language specifically discharging a pre-petition domestic support obligation was necessary to achieve such a discharge).

173. *In re Burnett*, 646 F.3d at 580-81 (citing *United Student Aid Funds v. Espinosa*, 559 U.S. 260, 269-70 (2010); *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 152 (2009)).

174. *In re Luckman*, 2012 WL 6708586, at \*9.

175. *See Espinosa*, 559 U.S. at 273 n.10.

debtors with tax debts, the Code provisions that describe the dischargeability of tax debts are riddled with such exceptions and conditional language,<sup>176</sup> so the stage is set for similarly contradictory results as described above in the section on domestic-support obligations.<sup>177</sup>

For instance, in *United States v. Monahan (In re Monahan)*, a debtor filed, and the court confirmed, a plan to pay in full the allowed claim of the Internal Revenue Service (IRS).<sup>178</sup> The IRS was unsatisfied with the plan's payment of its allowed claim in full and sent numerous notices of intent to levy upon the debtor for interest accrued on its claim post-petition.<sup>179</sup> The debtor argued that, because she paid the claim in full and the claim did not include any provision for interest accruing post-petition, the IRS was precluded from continuing to try to collect said interest.<sup>180</sup>

The *In re Monahan* court was thus faced with deciding whether the plan's treatment of the claim was a final settlement of the IRS's claim, including all interest pre- and post-petition. "The overwhelming majority of [C]hapter 13 plans do not provide for post-petition interest on unsecured claims . . . [because] a Chapter 13 plan can only provide for allowed claims . . . [and section] 502(b)(2) prohibits a claim from including unmatured interest."<sup>181</sup> Yet, section 1322(b)(10) provides an exception to the rule and allows for the payment of post-petition interest on unsecured claims that are nondischargeable, but only if the plan otherwise makes full payment on all allowed claims.<sup>182</sup> The type of tax debt at issue in *In re Monahan* was of the type described in Code section 507(a)(8)(C), which is not dischargeable even if paid in full.<sup>183</sup> Regarding such debts, "the debtor remains liable for any unpaid portion of the claim, including any interest

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176. See, e.g., 11 U.S.C. § 523(a)(1)(A) (2012) (allowing an exception from discharge debts "for a tax or a customs duty of the kind . . . specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed"); *id.* § 507(a)(8)(C) (describing a category for debts that are "tax[es] required to be collected or withheld and for which the debtor is liable in whatever capacity"). The exception appears not in these provisions, but in section 1328(a)(2), which says that such debts may not be discharged at all in Chapter 13. *Id.* The Code's labyrinthine construction here provides fertile ground for courts to apply *Espinosa's* tenth footnote in contradictory ways.

177. See *supra* Part II.B.1.b.2.

178. 497 B.R. 642, 644 (B.A.P. 1st Cir. 2013).

179. *Id.*

180. *Id.*

181. *Id.* at 648.

182. *Id.*

183. *Id.* at 648-49 (citing 11 U.S.C. §§ 507(a)(8)(C), 1328(a)(2) (2012)).

that accrues on the claim post-petition.”<sup>184</sup> Taxing authorities regularly collect such post-petition interest after a Chapter 13 debtor completes plan payments despite the automatic stay under the authority of *Bruning v. United States*.<sup>185</sup> The only new issue to examine, then, was whether *Espinosa* overturned a half-century of widely settled law.<sup>186</sup>

As expected, the IRS prevailed because the court held that the plan simply satisfied the pre-petition debt but did not discharge it.<sup>187</sup> The critical difference between the plan in *In re Monahan* and the plan in *Espinosa* was that Monahan did not expressly state that her plan would discharge the IRS debt.<sup>188</sup> As explained above, such a provision would have been illegal because the tax debt at issue in *In re Monahan* was not dischargeable even if paid in full under the plan.<sup>189</sup> Without an express declaration of discharge, the IRS was not on notice of any discharge, illegal or otherwise, and thus retained its right to collect post-petition interest.<sup>190</sup>

In *In re Brown*, another post-*Espinosa* bankruptcy court dealt with *Espinosa's* footnote ten as it applies to tax debts.<sup>191</sup> The *In re Brown* court held that dischargeability of tax debts is governed by 11 U.S.C. § 523(a)(7) and that, in accordance with *Espinosa's* tenth footnote, tax debts are never dischargeable.<sup>192</sup> The court so held despite various IRS actions in the debtors' favor, including that the IRS voluntarily bifurcated its claim into priority and general unsecured categories, did not object to the debtors' plan that left much of the general unsecured claims pool unpaid, encouraged the

184. *In re Monahan*, 497 B.R. at 648-49 (citing *In re Spolito*, 359 B.R. 423, 428 (Bankr. D.P.R. 2006); *Tashjian v. IRS*, 325 B.R. 56, 59 (D. Mass. 2005)).

185. 376 U.S. 358, 362 (1964).

186. See *In re Monahan*, 497 B.R. at 650-51 (listing a large sample of cases across many circuits indicating the extension of the *Bruning* principle into the Code era and into all areas of nondischargeable debts).

187. *Id.* at 652.

188. *Id.*

189. See 11 U.S.C. § 1328(a)(2) (2012).

190. *In re Monahan*, 497 B.R. at 652. The *In re Monahan* decision cited three popularly cited cases with significant discussions on the issue of notice to creditors as it relates to *Espinosa*-style discharges: *In re Brodeur*, 434 B.R. 348, 351 n.2 (Bankr. D. Vt. 2010); *In re Deavila*, 431 B.R. 178, 179 (Bankr. W.D. Mich. 2010); *In re McLemore*, 426 B.R. 728, 744 (Bankr. S.D. Ohio 2010); see also *In re Carlin*, Case no. 11-11784 (ALG), 2014 WL 5023653 at \*2 (Bankr. S.D.N.Y. Oct. 7, 2014) (slip op.) (requiring plan to expressly state discharge of tax debt to achieve discharge). But see *In re Ryan*, 504 B.R. 686, 704 (Bankr. D. Mass. 2013) (distinguishing *In re Monahan*).

191. No. 8:09-bk-27844-CED, 2015 WL 2437913 at \*3-4 & n.24 (Bankr. M.D. Fla. May 20, 2015) (citing *United Student Aid Funds v. Espinosa*, 559 U.S. 260, 273 n.10 (2010)).

192. *Id.*

debtors to seek a hardship discharge, and never indicated that it intended to seek to collect the unsecured portion of its claim after the hardship discharge.<sup>193</sup> Put another way, even in such a heavily-pro-debtor set of facts, IRS conduct heavily implying consent to discharge cannot override the Bankruptcy Code.<sup>194</sup>

Overall, the IRS has been very successful in the post-*Espinosa* world at avoiding impermissible discharges in consumer debtor plans.

#### (4) Secured Debts

Contrast the *In re Monahan* court's conclusion with that of the bankruptcy court in *In re Franklin*.<sup>195</sup> There, a secured residential mortgage creditor claimed, after the claims bar date and plan confirmation, that the debtor owed it roughly \$1,700.00 more in arrearages than provided for in the plan.<sup>196</sup> The secured creditor argued that since § 1322(b) specifically prohibits Chapter 13 debtors from modifying the rights of residential home mortgage holders, and since secured lienholders are generally not bound by plan provisions that modify their rights without initiating a contested matter, the debtor's confirmed plan should not be permitted to reduce the debtor's liability to the secured creditor.<sup>197</sup> The Court, notwithstanding pre-*Espinosa* Fifth Circuit case law that supported the creditor's position, ruled that *Espinosa* compelled a ruling in the debtor's favor that the arrearages were not collectable.<sup>198</sup> Since the creditor in *In re Franklin* had received notice and been afforded an opportunity to object to the debtor's plan, the creditor was now bound, notwithstanding that the debtor unilaterally modified his liability on a secured home mortgage debt.<sup>199</sup>

The distinction in this case can be found in the specific exceptions to discharge contained in Code section 1328(a). Section 1328(a)(1) excepts from discharge a secured debt which is not paid in full under the plan.<sup>200</sup> In this case, however, the secured debt was to be paid in full and thus be discharged.<sup>201</sup>

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193. *Id.* at \*2.

194. *Id.* at \*4.

195. *In re Franklin*, 448 B.R. 744 (Bankr. M.D. La. 2011).

196. *Id.* at 746.

197. *Id.* at 747.

198. *Id.* at 748.

199. *Id.*

200. 11 U.S.C. § 1328(a)(1) (2012) (referencing 11 U.S.C. § 1322(b)(5)).

201. *In re Franklin*, 448 B.R. at 747-48.

In light of cases such as *Diaz* that applied *Espinosa* narrowly and decided in favor of creditors, the result in *In re Franklin* may seem somewhat counterintuitive. Indeed, the Fifth Circuit has indicated that debtors can do only so much with seemingly innocuous language in their plans.<sup>202</sup> In a recent Chapter 11 case, *Acceptance Loan Co. v. S. White Transportation, Inc. (In re S. White Transportation, Inc.)*, a secured creditor who had participated throughout the bankruptcy and litigated its secured claim pre-petition remained silent as the debtor submitted a plan for confirmation that provided no recovery for the secured creditor.<sup>203</sup> When the secured creditor objected post-confirmation, belatedly realizing that section 1141(c) might very well void its asserted lien, the debtor argued in part that *Espinosa* altered Fifth Circuit precedent on this issue.<sup>204</sup> The Fifth Circuit, however, construed *Espinosa* very narrowly as simply a case that dealt with Federal Rule of Civil Procedure 60(b) concerning void judgments and held that secured creditors may still sit idly on the sidelines of a bankruptcy without participating, and continue to look to their lien for satisfaction.<sup>205</sup>

One commentator has suggested that the Fifth Circuit's decision here permits creditors to "spring awake and strip debtors of finality" post-confirmation.<sup>206</sup> There is certainly tension between the rights of creditors to ignore bankruptcy and the ability of debtors to modify secured creditors' rights with a simple statement in a plan.<sup>207</sup> The Ninth Circuit Bankruptcy Appellate Panel addressed this tension by shutting the door on secured creditors, construing silence as acceptance of even an arguably illegal

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202. *Acceptance Loan Co. v. S. White Trans., Inc. (In re S. White Trans., Inc.)*, 725 F.3d 494 (5th Cir. 2013).

203. *Id.* at 495-96.

204. *Id.* at 497-98 n.1.

205. *Id.*

206. Liana-Marie Lien, Note, "Asleep at the Switch"? *The Need to Hold Sophisticated Creditors to Higher Standards in Chapter 11*, 8 *BROOK. J. CORP. FIN. & COM. L.* 557, 580 (2014).

207. *See* 11 U.S.C. § 1141(c) (2012). A debtor must presumably provide notice to the creditor of its intention to discharge the secured debt and strip the lien; otherwise *Espinosa's* due process requirements would not be met. *See* *United Student Aid Funds v. Espinosa*, 559 U.S. 260, 272 (2010); *see also In re St. Louis*, No. 10-11933-TMD, 2013 WL 4498986 at \*5-6 (Bankr. W.D. Tex. Aug. 21, 2013) (holding service of an objection that putatively sought to challenge a lien but that did not initiate an adversary proceeding was not sufficient notice to afford a secured creditor due process).

plan.<sup>208</sup> Other courts have found that even when a secured creditor had already completed a foreclosure pre-petition, because the secured creditor failed to object to confirmation of the debtor's plan to cure arrearage and resume mortgage payments, the creditor was stuck with the plan and the debtor's retention of the property.<sup>209</sup> Yet another court held that a secured creditor was stuck with plan treatment impermissible under section 1325's "hanging paragraph" because the secured creditor failed to object.<sup>210</sup>

Despite the differences among varying debt categories, courts are applying *Espinosa* so as to settle tensions its footnote 10 created, even in the context of secured debts, as the previously cited cases demonstrate.<sup>211</sup> The same Bankruptcy Rule, 7001, that requires a debtor to use an adversary hearing to prove undue hardship also requires an adversary hearing to determine the validity, priority, or extent of a lien.<sup>212</sup> To deal with secured loans, courts should simply impose the same notice requirements discussed in *Espinosa*<sup>213</sup> to secured claimants.<sup>214</sup> In the absence of the hearing required to contest a lien, a plan in which the debtor stripped a lien under section 1141(c) or 1322(b)(2) is procedurally defective, in no relevant way distinct from a student loan discharge-by-declaration.<sup>215</sup> As such, secured creditors need to pay attention and object to confirmation of plans, even when they believe their rights are being improperly or illegally affected.

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208. *Bronitsky v. Bea (In re Bea)*, Nos. NC-14-1376-DKiTa & 14-41272-MEH13, 2015 WL 3441169 at \*8 (B.A.P. 9th Cir. May 29, 2015). The Panel went on to find, however, that the code did not plainly state that the proposed plan treatment was illegal. *See id.*

209. *In re Best*, No. 14-30692, 2014 WL 3700698, at \*5 (Bankr. N.D. Ohio July 24, 2014); *In re Ulrey*, 511 B.R. 401, 407-08 (Bankr. W.D. Va. 2014).

210. *In re Ross*, No. 11-04792-HB, 2015 WL 3781074, at \*4 (Bankr. D.S.C. June 16, 2015) (slip op.).

211. *See, e.g., In re Best*, 2014 WL 3700698, at \*5; *In re Ulrey*, 511 B.R. at 408.

212. FED R. BANKR. P. 7001(2),(6).

213. *See United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 272 (2010) (quoting *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) (requiring notice "to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections")).

214. *See* FED. R. BANKR. P. 7001(2), (6).

215. Potentially, 11 U.S.C. § 506(d) may be of additional interest to secured creditors in this position, but it only applies if a secured creditor filed a claim which was not allowed. *See* Ralph Brubaker, *Lien Voiding or Lien Pass-Through Upon Confirmation of Chapter 11 Plan? (Part II): The (Ir)Relevance of Secured Creditor Participation* 34 No. 1 BANKRUPTCY LAW LETTER NL1 (Westlaw), at nn.59, 60 (2014) (providing more analysis on the application of *Espinosa* to secured debts).

Tension arises (or should arise) when courts attempt to square their pre-*Espinosa* precedents with that decision's new notice requirements.<sup>216</sup> Many Circuit Courts, including the Fifth, had previously developed the concept of "creditor participation,"<sup>217</sup> which generally requires the creditor to do more than passively make an appearance and receive bankruptcy court notices and documents to "participate."<sup>218</sup> Creditor participation is generally a required element for a debtor to avail itself of the lien modification provisions of section 1141(c), though courts differ on what constitutes participation.<sup>219</sup> At least one court has defined participation to be no more than receiving notice of the plan and an opportunity to object.<sup>220</sup> That is consistent with minimal *Espinosa* notice, in which actual, even informal, notice of a debtor's plan to illegally discharge a debt was held to be sufficient to foreclose a creditor's subsequent effort to object.<sup>221</sup>

The Fifth Circuit in *In re S. White Transportation* held, however, that secured creditors must do more than simply receive the plan and an opportunity to object.<sup>222</sup> As a result, yet more nuances have been introduced into the world of preclusion in the wake of *Espinosa*, as secured creditors in the Fifth Circuit must now do more than receive notice to have their rights impacted by a debtor's illegal plan provision. A student loan lender, domestic support creditor, or a taxing authority does not receive that same level of protection—if they simply receive a copy of the debtor's proposed plan and don't object, *Espinosa's* notice requirement is satisfied. It is appropriate for secured lenders to receive this additional protection in light of the long tradition protecting their right to remain aloof of bankruptcy

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216. The Fifth Circuit in *In re S. White Transportation* appears not to have experienced any *Espinosa*-related reservations when holding that it changed nothing with regard to secured creditor participation precedents. 725 F.3d 494, 497-98 (5th Cir. 2013).

For an excellent discussion of the participation requirement in a post-*Espinosa* world, see James N. Duca, *Now Where Did That Mortgage Not Go? A Two-Act Play Under U.C.C. § 3-301 and 11 U.S.C. § 1141(c)*, 16 HAW. B.J. 71, 82-92 (2013).

217. See, e.g., *In re S. White Transp.*, 725 F.3d at 498; *Universal Suppliers v. Reg'l Bldg. Sys., Inc. (In re Reg'l Bldg. Sys., Inc.)*, 254 F.3d 528, 530 (4th Cir. 2001); *FDIC v. Union Entities (In re Be-Mac Transp. Co.)*, 83 F.3d 1020, 1023 (8th Cir. 1996); *In re Penrod*, 50 F.3d 459, 461-62 (7th Cir. 1995).

218. See, e.g., *Elixir Indus., Inc. v. City Bank & Trust Co. (In re Ahern Enters., Inc.)*, 507 F.3d 817, 822 (5th Cir. 2007); *In re Penrod*, 50 F.3d at 462.

219. *In re S. White Transp.*, 725 F.3d at 497.

220. *In re Reg'l Bldg. Sys., Inc.*, 251 B.R. 274, 287 (Bankr. D. Md. 2000).

221. *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 277 (2010).

222. *In re S. White Transp.*, 725 F.3d at 498.

proceedings. The Fifth Circuit should simply have made its position clearer vis-à-vis *Espinosa*.

(5) *Espinosa Analysis*

As the preceding cases show, *Espinosa* can be an exceedingly powerful decision in favor of debtors who manage to put their creditors on notice of their illegal plans without attracting an objection; they can often preclude their creditors from challenging their discharge of otherwise nondischargeable debts. The threat of sanctions against debtors' attorneys that attempt this gambit clearly dampens the practice. Still, enough divisions remain between jurisdictions on these preclusion issues to afford debtors' attorneys some cover if they decide to risk submitting a plan with a so-called "discharge by declaration." Until the precedents solidify and the Supreme Court resolves the circuit split regarding *Espinosa*'s footnote ten, plenty of ambiguity will remain. Such a situation, in which debtors and creditors do not know what to expect, will undoubtedly lead to more "shooting for the moon" from debtors. This practice, even when unsuccessful, ultimately works out to the detriment of creditors, who are charged under *Espinosa* with remaining extra vigilant, always anticipating how an order may be interpreted in the future, especially by other judges. Only a much more strenuous effort by courts to achieve some level of uniformity in decision-making or to distribute sanctions to debtors that propose such discharges in bad faith will effectively discourage debtors' efforts to circumvent Congress's priority debt structure.

*C. Peeking Behind the Curtain: Brown, Archer, and Exceptions to Claim Preclusion in Bankruptcy*

As the foregoing demonstrates, claim preclusion is generally applicable in consumer bankruptcy. As will be described below, however, the Supreme Court, in *Brown v. Felsen*<sup>223</sup> and *Archer v. Warner*,<sup>224</sup> established categorical exceptions to the applicability of claim preclusion in the context of dischargeability proceedings.

Nevertheless, the lure of claim preclusion remains strong, and practitioners have continually requested lower courts to find exceptions to the exceptions: instances in which claim preclusion applies notwithstanding Supreme Court precedent. As will also be described below, lower courts have largely rejected these requests in recent years and held that the

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223. 442 U.S. 127 (1979).

224. 538 U.S. 314 (2003).



Supreme Court meant what it said in *Brown* and *Archer*: claim preclusion generally does not apply in dischargeability proceedings. However, a few important recent cases suggest that claim preclusion may apply in certain limited circumstances.

### 1. Dischargeability Proceedings in Bankruptcy

Before discussing the holdings of *Brown* and *Archer*, a word about dischargeability in bankruptcy is necessary to orient the uninitiated. The following analysis applies equally in consumer and nonconsumer bankruptcies under various chapters of the Code, but given this article's focus on consumer bankruptcy cases, for the sake of brevity and clarity the article will analyze the issue from the perspective of a consumer reorganization under Chapter 13 of the Code.

A Chapter 13 debtor that completes her bankruptcy plan<sup>225</sup> is afforded a discharge of many of her debts.<sup>226</sup> However, this discharge is not absolute. Congress opted to deem certain categories of debts nondischargeable in bankruptcy.<sup>227</sup> These include, inter alia, debts for domestic support obligations,<sup>228</sup> debts for willful and malicious injury to persons or property,<sup>229</sup> debts incurred through fraud or defalcation,<sup>230</sup> certain tax debts,<sup>231</sup> and so forth. A creditor may obtain a determination that a certain debt is nondischargeable by initiating an adversary proceeding in the debtor's bankruptcy case pursuant to Rule 4007.<sup>232</sup>

Commonly, the debt that a creditor seeks to declare dischargeable is based on a judgment obtained in state or federal court. The question in such circumstances is this: to what extent is that prior judgment given claim preclusive effect in the subsequent dischargeability proceeding?

#### a) *Brown v. Felsen*

In 1979, the Supreme Court decided *Brown v. Felsen*, a case brought under the prior Bankruptcy Act (the Act).<sup>233</sup> The facts of that case were as

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225. A bankruptcy court may also grant a discharge to a debtor who has not completed her plan, but only under very limited circumstances. See 11 U.S.C. § 1328(b) (2012).

226. *Id.* § 1328(a).

227. See, e.g., *id.* § 1328(a), 1328(c).

228. *Id.* § 523(a)(5); see also *id.* § 523(a)(15).

229. *Id.* § 523(a)(6).

230. *Id.* § 523(a)(2)(A), (a)(4).

231. *Id.* § 523(a)(1), (a)(7), (a)(14), (a)(14A).

232. See FED R. BANKR. P. 4007.

233. 442 U.S. 127, 128-29 (1979) (citing 11 U.S.C. §§ 17a, 32 (1975)).

follows: Mark Paul Felsen (Felsen) owned a car dealership.<sup>234</sup> Felsen obtained a bank loan to finance his dealership<sup>235</sup> and induced G. Garvin Brown III (Brown) to guarantee the bank loan.<sup>236</sup> Brown later sued Felsen in Colorado state court, alleging that Felsen obtained the guarantee from Brown ““by misrepresentations and non-disclosures of material facts.””<sup>237</sup>

Brown and Felsen then settled the state court case by a stipulation providing that the bank would recover jointly and severally against Brown, Felsen, and the dealership, and that Brown would, in turn, have judgment against Felsen and the dealership.<sup>238</sup> Neither the judgment nor the stipulation specified the cause of action upon which Felsen’s liability to Brown was based.<sup>239</sup> Notably, because Brown and Felsen settled the case, the state court never admitted a sworn deposition by Felsen into the record.<sup>240</sup>

Felsen then filed bankruptcy and sought discharge of his debt to Brown.<sup>241</sup> Brown argued that the bankruptcy court should declare the state court judgment a nondischargeable debt because Felsen obtained it by fraud, deceit, and malicious conversion.<sup>242</sup> Felsen responded that because the state court proceeding did not result in a finding of fraud, claim preclusion barred the bankruptcy court from redetermining the nature of the debt.<sup>243</sup> He advanced this argument even though the dischargeability provisions of the Act had not been at issue in the state court proceeding because he had not yet declared bankruptcy.<sup>244</sup>

The bankruptcy court, following Tenth Circuit precedent requiring the court to apply claim preclusion in dischargeability proceedings,<sup>245</sup> “somewhat reluctantly confined its consideration to the judgment,

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234. *Id.* at 128.

235. *Id.*

236. *Id.*

237. *Id.* Specifically, Brown alleged that Felsen “had prepared false title certificates, sold automobiles out of trust, and applied the proceeds” of the bank loan “to private purposes.” *Id.* at 129.

238. *Id.* at 128.

239. *Id.*

240. *Id.*

241. *Id.*

242. *Id.* at 129.

243. *Id.*

244. *Id.*

245. *See In re Nicholas*, 510 F.2d 160, 160-61 (10th Cir. 1975), *abrogated by* Resolution Trust Corp. v. McKendry (*In re McKendry*), 40 F.3d 331 (10th Cir. 1994).

pleadings, exhibits, and stipulation which were in the state-court record.”<sup>246</sup> It declined to hear other evidence, including Felsen’s deposition, which the state court had never admitted into the record.<sup>247</sup> The bankruptcy court concluded that, because neither the judgment nor the state court record showed that the judgment followed from Felsen’s fraud, Brown failed to establish that the debt was nondischargeable under the Act.<sup>248</sup>

The district court and the court of appeals, both applying claim preclusion, affirmed, holding that “the prior consent decree was conclusive as to the nature of [Felsen]’s liability.”<sup>249</sup> The courts concluded that because neither the stipulation nor the judgment mentioned fraud, the debt was dischargeable.<sup>250</sup>

The Supreme Court granted certiorari to resolve a conflict between the Tenth Circuit, which applied claim preclusion in dischargeability proceedings, and “every other Court of Appeals that ha[d] considered the question,” which “rejected [claim preclusion] and held that extrinsic evidence may be admitted in order to determine accurately the dischargeability . . . of a debt previously reduced to judgment in state court.”<sup>251</sup> The Supreme Court unanimously concluded that claim preclusion was inapplicable because “neither the interests served by [claim preclusion], the process of orderly adjudication in state courts, nor the policies of the [Act] would be well served by foreclosing [Brown] from submitting additional evidence to prove his case.”<sup>252</sup> Unlike most situations in which a party raises claim preclusion, Brown was not attempting to “assert a new ground for recovery” or “attack the validity of the prior judgment” in the dischargeability proceeding.<sup>253</sup> Instead, Brown was attempting to meet the “new defense of bankruptcy” that Felsen had “interposed between [Brown] and the sum determined to be due him.”<sup>254</sup> By declaring bankruptcy and attempting to discharge the debt owed to Brown, Felsen had “upset the repose that would justify treating the prior state-court

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246. *Brown*, 442 U.S. at 130.

247. *Id.*

248. *Id.*

249. *Id.*

250. *Id.* at 130-31.

251. *Id.* at 131 (citing *Houtman v. Mann (In re Houtman)*, 568 F.2d 651, 653-54 (9th Cir. 1978); *In re McMillan*, 579 F.2d 289, 293 n.6 (3d Cir. 1978); *Bailey v. Wright (In re Wright)*, 584 F.2d 83, 84 (5th Cir. 1978); *Hovermale v. Pigge (In re Pigge)*, 539 F.2d 369, 371-72 (4th Cir. 1976); *Raley v. Nicholas (In re Nicholas)*, 510 F.2d 160 (10th Cir. 1975)).

252. *Brown*, 442 U.S. at 132.

253. *Id.* at 133.

254. *Id.*

proceeding as final, and it would hardly promote confidence in judgments to prevent [Brown] from meeting [Felsen]'s new initiative."<sup>255</sup>

The Supreme Court further reasoned that Congress, in enacting the dischargeability provisions of the Act, intended for bankruptcy courts, not state courts, to make dischargeability provisions in the first instance.<sup>256</sup> The legislative history of the Act suggested that the bankruptcy court's review of the dischargeability of debts should be exclusive and plenary.<sup>257</sup> Additionally, state law elements of fraud and the like are not necessarily identical to the federal prerequisites for nondischargeability.<sup>258</sup> Furthermore, Congress, "in the interest of justice and honest dealing and honest conduct," intended for all debts incurred through "offenses against good morals" to be excepted from discharge, even those reduced to a stipulated judgment.<sup>259</sup>

Most importantly, when a plaintiff seeks a state court judgment against a defendant, the defendant has oftentimes not yet declared bankruptcy; "the debtor's bankruptcy is still hypothetical."<sup>260</sup> Dischargeability determinations are thus "not directly in issue" at the state court level, and as a result "neither party has a full incentive to litigate them."<sup>261</sup> If state court judgments were entitled to claim preclusive effect in a subsequent bankruptcy proceeding, it "would force an otherwise unwilling party to try [dischargeability] questions to the hilt in order to protect h[er]self against the mere possibility that a debtor might take bankruptcy in the future."<sup>262</sup> If the defendant does not subsequently declare bankruptcy, then the state court and the litigants would have unnecessarily wasted time and resources arguing the dischargeability issue.<sup>263</sup> In sum, "[i]t makes little sense . . . to resolve a federal dischargeability question according to whether or not the

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255. *Id.* at 133-34.

256. *Id.* at 134-39. Note, however, that there may be categories of debts over which "[b]ankruptcy courts and state courts share concurrent jurisdiction." *Monsour v. Monsour* (*In re Monsour*), 372 B.R. 272, 278 (Bankr. W.D. Va. 2007). *Monsour* is discussed in greater detail below.

257. *Brown*, 442 U.S. at 134-39.

258. *Id.* at 135 (citing *Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934)).

259. *Id.* at 138 (quoting H.R. REP. NO. 1698, at 3, 6 (1902); 36 CONG. REC. 1375 (1903)).

260. *Id.* at 135.

261. *Id.* at 134-35.

262. *Id.* at 135.

263. *Id.*

parties in state court waived their right to engage in hypothetical litigation in an inappropriate forum.”<sup>264</sup>

Thus, the Supreme Court rejected Felsen’s claim preclusion argument.<sup>265</sup> “[T]he mere fact that a conscientious creditor has previously reduced h[er] claim to judgment should not bar further inquiry into the true nature of the debt.”<sup>266</sup> The Court therefore reversed the judgment of the Tenth Circuit and held 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 debtor’s debt.<sup>267</sup> Instead, the bankruptcy court was permitted to “weigh all the evidence,”<sup>268</sup> including additional evidence not admitted into the record during the state court proceeding.<sup>269</sup> As a result of *Brown*, bankruptcy courts, when tasked with the responsibility of determining whether a prior judgment falls within a statutory exception to dischargeability, independently determine whether the type of action predicated the judgment is the sort of action that Congress intended to be exempt from discharge in bankruptcy.<sup>270</sup>

However, the Supreme Court stressed in a footnote that even though *claim* preclusion was inapplicable in the dischargeability proceeding, the Court would not reach the question of whether or not the state court’s factual determinations would be accorded *issue* preclusive effect.<sup>271</sup> However, the Court strongly suggested that if a state court determines factual issues using standards identical to those of the Act’s dischargeability provisions in the course of adjudicating a state law question, then issue preclusion would bar relitigation of those issues in the bankruptcy court in

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264. *Id.* at 137. After all, one of the purposes of claim preclusion is judicial economy. Incentivizing parties to litigate potentially irrelevant issues in inappropriate fora would stymie rather than further that purpose.

265. *Id.* at 138.

266. *Id.* (citing *Hargadine-McKittrick Dry Goods Co. v. Hudson*, 111 F. 361, 362-63 (E.D. Mo. 1901), *aff’d*, 122 F. 232, 235-36 (8th Cir. 1903)).

267. *Id.* at 138-39.

268. *Id.* at 138.

269. *Id.* at 132. The Supreme Court did note, however, that the bankruptcy court was permitted to “take into account whether or not [Brown’s] failure to press these allegations at an earlier time betrays a weakness in his case on the merits.” *Id.* at 138. This statement is somewhat at odds with its argument that Brown lacked a full incentive to litigate these issues at the prior stage of the litigation.

270. *See, e.g., Bennett v. Smith (In re Smith)*, No. 05-10041, 2006 WL 3333801, at \*2, \*8-13 (Bankr. M.D.N.C. Nov. 16, 2006) (assessing whether a judgment based on North Carolina’s Unfair and Deceptive Trade Practices Act satisfies the Code’s statutory prerequisites for fraud).

271. *Brown*, 442 U.S. at 139 n.10.

the absence of some countervailing statutory policy.<sup>272</sup> As explained below, this is because issue preclusion, unlike claim preclusion, affords preclusive effect only to questions actually and necessarily decided in a prior proceeding. The Supreme Court subsequently recognized in *Grogan v. Garner* that issue preclusion is indeed applicable in nondischargeability proceedings.<sup>273</sup>

b) *Archer v. Warner*

In 2003, the Supreme Court decided *Archer v. Warner*,<sup>274</sup> which built upon *Brown v. Felsen*. The Court summarized the facts of *Archer* as follows:

- 1) *A* sues *B* seeking money that (*A* says) *B* obtained through fraud;
- 2) the parties settle the lawsuit and release related claims;
- 3) the settlement agreement does not resolve the issue of fraud, but provides that *B* will pay *A* a fixed sum;
- 4) *B* does not pay the fixed sum;
- 5) *B* enters bankruptcy; and
- 6) *A* claims that *B*'s obligation to pay the fixed settlement sum is nondischargeable because, like the original debt, it is for [money obtained by fraud.]<sup>275</sup>

Therefore, the question at issue was the dischargeability of the settlement debt.<sup>276</sup>

The bankruptcy court, district court, and court of appeals all concluded that the debt was dischargeable.<sup>277</sup> The Fourth Circuit reasoned that the settlement “had worked a kind of ‘novation’”<sup>278</sup> that eliminated the original potential debt for money obtained by fraud and replaced it with a new debt.<sup>279</sup> The Fourth Circuit reasoned that, because this new debt was not for

272. *Id.*

273. *Grogan v. Garner*, 498 U.S. 279, 285 n.11 (1991) (citations omitted); *accord, e.g.*, *Leventhal v. Schenberg*, 484 B.R. 731, 734 (N.D. Ill. 2012); *Kyte v. Clifton (In re Clifton)*, No. 10-43681-drd-7, 2011 WL 2224631, at \*3-4 (Bankr. W.D. Mo. June 7, 2011).

274. *Archer v. Warner*, 538 U.S. 314 (2003).

275. *Id.* at 316-17 (quoting 11 U.S.C. § 523(a)(2)(A) (2000)).

276. *Id.* at 316.

277. *Id.* at 318.

278. A novation is “[t]he act of substituting for an old obligation a new one that either replaces an existing obligation with a new obligation or replaces an original party with a new party.” BLACK’S LAW DICTIONARY 1168 (9th ed. 2009).

279. *Id.* (citing 283 F.3d 230 (4th Cir. 2002)).

money obtained by fraud, but rather obtained as part of a settlement, it was dischargeable in bankruptcy.<sup>280</sup>

The Supreme Court granted certiorari to resolve a circuit split on this issue.<sup>281</sup> In a 7-2 decision,<sup>282</sup> the Court reversed and remanded.<sup>283</sup> The Court agreed with the Fourth Circuit that the settlement agreement amounted to a novation that fully addressed all underlying state law claims and created a new debt.<sup>284</sup> The Court nonetheless concluded that the new settlement debt amounted to a debt for money obtained by fraud that could be adjudged nondischargeable.<sup>285</sup>

The Court reasoned that this result flowed inexorably from *Brown*.<sup>286</sup> Both the stipulated judgment in *Brown* and the settlement agreement in *Archer* effected a novation, pursuant to the agreement of the parties, of a previous potential debt.<sup>287</sup> If the bankruptcy court in *Brown* was permitted—and indeed required—to look behind the face of the stipulated judgment to determine the true nature of the underlying debt, there was no reason the bankruptcy court could not and should not do the same in *Archer*; “[a] debt embodied in the settlement of a fraud case ‘arises’ no less ‘out of’ the underlying fraud than a debt embodied in a stipulation and consent decree.”<sup>288</sup> In other words, “if reducing a fraud claim to settlement definitively changed the nature of the debt for dischargeability purposes,” then “the nature of the debt in *Brown* would have changed similarly, thereby rendering the debt dischargeable.”<sup>289</sup>

The Court further noted that “[p]olicies that favor the settlement of disputes, like those that favor ‘repose,’” were “neither any more nor any less at issue” in *Archer* than in *Brown*.<sup>290</sup>

In *Brown*, the doctrine of [claim preclusion] itself ensured ‘a blanket release’ of the underlying claim of fraud, just as the contractual releases did here . . . what has *not* been established

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280. *Id.* (citing 283 F.3d 230 (4th Cir. 2002)).

281. *Id.* (citing *United States v. Spicer*, 57 F.3d 1152, 1155 (D.C. Cir. 1995); *In re West*, 22 F.3d 775, 778 (7th Cir. 1994)).

282. Justice Thomas wrote a dissent joined by Justice Stevens. *Id.* at 323-28 (Thomas, J., dissenting).

283. *Id.* at 323.

284. *Id.* at 318-19.

285. *Id.* at 319.

286. *Id.* at 319-22 (citing *Brown v. Felsen*, 442 U.S. 127 (1979)).

287. *Id.* at 320.

288. *Id.* at 320-21.

289. *Id.* at 320.

290. *Id.* at 321.

here, as in *Brown*, is that the parties meant to resolve the *issue* of fraud or, more narrowly, to resolve that issue for purposes of a later claim of nondischargeability in bankruptcy.<sup>291</sup>

Indeed, as in *Brown*, the issue of dischargeability was not—and could not—have been raised in the state court fraud litigation, because dischargeability determinations are for the bankruptcy court to resolve in the first instance.<sup>292</sup>

Thus, the Court ruled that claim preclusion did not bar the creditors from arguing that the settlement debt was nondischargeable.<sup>293</sup> As in *Brown*, the *Archer* Court did not reach questions of *issue* preclusion; those were left for the Fourth Circuit on remand.<sup>294</sup>

By solely relying on *Brown* (a case decided under the Act) to resolve *Archer* (a case decided under the Code), the *Archer* Court reaffirmed that *Brown*'s holding survived the enactment of the Code.<sup>295</sup> However, *Archer* went further than merely reaffirming the applicability of *Brown*; it also widened the exception to claim preclusion in dischargeability proceedings. The *Archer* Court took seriously *Brown*'s admonition that “the mere fact that a conscientious creditor has previously reduced h[er] claim to judgment,” settlement agreement, or, presumably, to any other form, “should not bar further inquiry into the true nature of the debt” in a nondischargeability proceeding.<sup>296</sup> “Congress intended the fullest possible inquiry” to ensure that “all debts arising out of” fraud are “excepted from discharge,” no matter what their form,<sup>297</sup> and courts should not apply claim preclusion in a manner that would flout this congressional will. This is true even where, as in *Archer*, “[t]he parties . . . executed a blanket release, rather than entered into a consent judgment.”<sup>298</sup>

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291. *Id.* at 321-22.

292. *Id.* at 321.

293. *Id.* at 323.

294. *Id.* at 322-23. Interestingly, the Court also left for the Fourth Circuit the ability to decide *other* questions involving *claim* preclusion. *See id.* at 322. However, given the overall thrust of *Brown* and *Archer* — that claim preclusion generally does not apply in dischargeability proceedings — it is unlikely that the Court left much for the Fourth Circuit to do in this area.

295. Indeed, the *Archer* Court's reference to the “Code” when discussing *Brown* suggests the Court may not have been aware that *Brown* was decided under a different statutory regime at all. *See id.* at 321.

296. *Id.* at 320-21 (internal quotation marks omitted) (quoting *Brown v. Felsen*, 442 U.S. 127, 138 (1979)).

297. *Id.* at 321.

298. *Id.* at 324 (Thomas, J., dissenting).



In sum, when faced with opportunities to apply claim preclusion in the dischargeability context, the Supreme Court has exhorted lower courts to elevate function over form: if a later debt has its genesis in a previous debt that would otherwise be nondischargeable in bankruptcy, the court may, notwithstanding claim preclusion, look below the surface of the document creating the later debt and determine whether the later debt is also nondischargeable.

Thus, in practice, creditors need not litigate allegations of fraud to the hilt in state court out of concern that the debtor may declare bankruptcy in the future:

[O]ftentimes . . . the creditor can easily establish the debtor's liability based on a promissory note or other loan document simply by proving the debtor executed the document and failed to pay the debt, not bothering to present the more extensive evidence necessary to prove the debtor also committed fraud or other misconduct in connection with the debt. *Brown v. Felsen* means such a creditor is free to take the easy route to a state court judgment on the debt, and wait until the debtor actually files for bankruptcy before trying to prove the same debt also involved misconduct that makes it nondischargeable.<sup>299</sup>

*c) Recent Developments: Brown and Archer in the Trenches*

Since 2005, lower courts have issued countless opinions interpreting *Brown* and *Archer*. The majority of these cases are simply straightforward applications of the two cases.<sup>300</sup> In an unsettling number of cases, the practitioner simply did not know that *Brown* and *Archer* existed, or, at the very least, did not fully appreciate or understand the consequences of their

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299. *Frontier Farm Credit, PCA v. Norris (In re Norris)*, No. 05-43551-7, 2007 WL 1946547, at \*2 (Bankr. D. Kan. June 29, 2007).

300. *See, e.g., Wash. Mut. Bank v. Carlson (In re Carlson)*, 464 F. App'x 845, 848 (11th Cir. 2012); *JHK Venture Capital Ltd. P'ship v. Wellens (In re Wellens)*, No. 11-35835 ABC, 2012 WL 2871666, at \*1 (Bankr. D. Colo. July 12, 2012); *Voss v. Pujdak (In re Pujdak)*, 462 B.R. 560, 569-70 (Bankr. D.S.C. 2011); *Era Franchise Sys. L.L.C. v. Kroeber (In re Kroeber)*, No. 09-32125 (LMW), 2010 WL 4064026, at \*10 (Bankr. D. Conn. Oct. 15, 2010); *Allen v. Loughery (In re Loughery)*, No. 09-69033-PWB, 2010 WL 4642131, at \*2-3 (Bankr. N.D. Ga. Oct. 12, 2010); *V2R, LLC v. Schneider (In re Schneider)*, No. 05-2382-JNF, 2006 WL 1431603, at \*1 (Bankr. D. Mass. May 23, 2006); *Rainey v. Davenport (In re Davenport)*, 353 B.R. 150, 193-95 (Bankr. S.D. Tex. Feb. 2, 2006).

holdings.<sup>301</sup> This demonstrates this article's importance to educate practitioners of the applicable law.

In the more interesting cases, the practitioner was aware of *Brown* and *Archer* and tried to distinguish them. As will be described below, most of these attempts have failed, even though many of them exhibited deep engagement with the cases and clever reasoning. In other words, the lower courts have largely reaffirmed that *Brown* and *Archer* mean what they say. The upshot for practitioners is that attempts to sidestep these cases, even well reasoned ones, are likely to fail. In the most interesting cases, however, the attempt worked. Thus, there are times, albeit very few of them, where, notwithstanding *Archer* and *Brown*, claim preclusion is applicable in dischargeability proceedings. Finally, a few courts have extended the holdings of *Brown* and *Archer* beyond the nondischargeability context.

(1) *Brown and Archer Mean What They Say*

It is worth briefly mentioning the various ways in which courts have reaffirmed the essential holdings of *Brown* and *Archer*.

Although *Brown* and *Archer* only dealt with debts arising out of fraud, Code section 523(a) exempts from discharge debts from other categories, some of which are listed above. Following *Archer*, "numerous courts have applied the Supreme Court's holding to other categories of nondischargeability actions under section 523(a)."<sup>302</sup> Courts have also extended the *Brown/Archer* rule beyond the nondischargeability provisions

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301. See, e.g., *West Coast Rentals, Inc. v. Perez (In re Perez)*, 415 B.R. 546, 552 (Bankr. D.N.M. 2009); *Frontier Farm Credit, PCA v. Norris (In re Norris)*, No. 05-43551-7, 2007 WL 1946547, at \*1-2 (Bankr. D. Kan. June 29, 2007).

Some of this ignorance might stem more from the unfortunate tendency of some practitioners to lump claim preclusion (which, under *Brown* and *Archer*, generally does not apply in dischargeability proceedings) together with issue preclusion (which may apply in dischargeability proceedings) under the single umbrella term "res judicata." See, e.g., *Ngo v. Webb (In re Webb)*, No. 08-bk-743, 2009 WL 1139548, at \*3 (Bankr. N.D. W. Va. Mar. 31, 2009).

Additionally, some of these cases involved pro se litigants, who understandably might not be familiar with Supreme Court precedent. See, e.g., *Wendt v. Hanson (In re Hanson)*, No. 10-19165-MM7, 2011 WL 6148429, at \*2-3 (Bankr. S.D. Cal. Nov. 21, 2011); *Tomlin v. Crownover (In re Crownover)*, 417 B.R. 45, 50-51 (Bankr. E.D. Tenn. 2009).

302. *Bauer v. Colokathis (In re Colokathis)*, 417 B.R. 150, 158 (Bankr. D. Mass. 2009) (citing *Giaimo v. DeTrano (In re DeTrano)*, 326 F.3d 319, 322 (2d Cir. 2003) (applying *Archer* to "willful and malicious injury" prong)).

of section 523(a) to the nondischargeability provisions of Chapter 13 of the Code.<sup>303</sup>

Additionally, *Brown* and *Archer* permit the bankruptcy court to look behind the terms of a settlement agreement even where that agreement explicitly releases the debtor-defendant from the plaintiff-creditor's fraud claims,<sup>304</sup> or where the settlement agreement contains a provision that purports to preclude the creditor from pursuing a nondischargeability determination in the debtor's bankruptcy case.<sup>305</sup> "Regardless of any release which may have been executed by the creditor, or any potential novation, if the particular debt arose out of fraud, then [the bankruptcy court] may find the debt to be nondischargeable, no matter its current form."<sup>306</sup>

Likewise, the bankruptcy court may look behind the terms of a settlement agreement or judgment to determine whether the debt truly arises out of fraud, even where the settlement agreement explicitly states that the debt *is indeed* predicated on fraud and is therefore nondischargeable.<sup>307</sup> "If it is permissible for a bankruptcy court to look behind a state court judgment to find a debt is *not* dischargeable, the reverse is also true, and the court may look behind the judgment and conclude a debt *is* dischargeable."<sup>308</sup>

Courts have held that claim preclusion does not apply in a dischargeability proceeding, even where the plaintiff attempts to give preclusive effect to a default judgment that contains explicit findings that the debtor perpetrated a fraud.<sup>309</sup> Thus, claim preclusion generally does not apply in a nondischargeability proceeding, even where the parties agree that

303. See *League v. Lowther (In re Lowther)*, No. 10-04155-8-JRL, 2011 WL 61603, at \*1-2 (Bankr. E.D.N.C. Jan. 4, 2011).

304. See *Weilert v. Parker (In re Weilert)*, No. CC-07-1448-MkMOD, 2008 WL 8462953, at \*1-5 (B.A.P. 9th Cir. Sept. 2, 2008); *OSB Mfg., Inc. v. Hathaway (In re Hathaway)*, 364 B.R. 220, 242-43 (Bankr. E.D. Va. 2007).

305. See *In re Weilert*, 2008 WL 8462953, at \*5.

306. *In re Hathaway*, 364 B.R. at 242.

307. See *Simmons Capital Advisors, Ltd. v. Bachinski (In re Bachinski)*, 393 B.R. 522, 529-34, 540-42 (Bankr. S.D. Ohio 2008).

308. *Hackney v. Hackney (In re Hackney)*, No. 07-40952-JJR-11, 2008 WL 4830040, at \*10 (Bankr. N.D. Ala. Oct. 10, 2008) (emphasis added).

309. See *Bublitz Mach. Co. v. Brewer (In re Brewer)*, No. 05-51960, 2006 WL 1109409, at \*1 (Bankr. W.D. Mo. Apr. 17, 2006).

The *Bublitz* Court further held that issue preclusion did not apply because a default judgment is not a judgment on the merits. *Id.* at \*1-2. This is not true in all jurisdictions, however; in some courts, "[i]t is well-established that default judgments may be entitled to a preclusive effect under the theory of res judicata." See *Voss v. Pujdak (In re Pujdak)*, 462 B.R. 560, 568-69 (Bankr. D.S.C. 2011) (citations omitted).

the debtor committed fraud; the bankruptcy court must look behind the record to determine the true nature of the debt.

Following *Brown*'s admonition that dischargeability determinations are the exclusive province of the bankruptcy court,<sup>310</sup> some state appellate courts have reversed state trial court rulings that purport to declare a debt nondischargeable in a defendant's bankruptcy.<sup>311</sup>

Some courts, interpreting *Archer*, have held that when a debt subject to a dischargeability proceeding has previously been reduced to a settlement, the court "need only look to the underlying civil action"—that is, to "the underlying complaint and the allegations contained in it"—"to determine whether [the] claim is nondischargeable."<sup>312</sup>

## (2) Failed Attempts to Sidestep *Brown* and *Archer*

Many practitioners have tried and failed to distinguish *Brown* and *Archer*.<sup>313</sup> In *Simmons Capital Advisors, Ltd. v. Bachinski (In re Bachinski)*, for example, a judgment creditor "attempt[ed] to turn the tables and make offensive use of the novation doctrine" discussed in *Archer*.<sup>314</sup> Specifically, the creditor argued that because "the contractual doctrine of novation does not operate so as to alter the nature of a debt for dischargeability purposes," it follows that "a debt allegedly arising from fraudulent conduct, which is made the subject of a settlement agreement, is ipso facto nondischargeable

310. Note, however, that there may be categories of debts over which "[b]ankruptcy courts and state courts share concurrent jurisdiction." *Monsour v. Monsour (In re Monsour)*, 372 B.R. 272, 278 (Bankr. W.D. Va. 2007). *Monsour* is discussed in greater detail below.

Moreover, some courts hold "that, when a debtor fails to schedule a debt, the debtor loses the benefit of the bankruptcy court's exclusive jurisdiction," such that "the bankruptcy court may share jurisdiction" with a state court "for dischargeability issues, but only to the extent that the bankruptcy court in its discretion remands or abstains from hearing the matter." *Cotter v. Skylands Cmty. Bank (In re Cotter)*, No. 08-12504 (NLW), 2011 WL 5900811, at \*4 (Bankr. D.N.J. Oct. 24, 2011) (citing *In re Strano*, 248 B.R. 493, 502-03 (Bankr. D.N.J. 2000)). Thus, there are instances where a state court may decide dischargeability issues. *See id.* at \*4-5.

311. *See, e.g., Birry v. Birry*, No. 256627, 2006 WL 2457488, at \*1 (Mich. Ct. App. Aug. 24, 2006).

312. *Bauer v. Colokathis (In re Colokathis)*, 417 B.R. 150, 158 (Bankr. D. Mass. 2009) (citing *Giaimo v. DeTrano (In re DeTrano)*, 326 F.3d 319, 322 (2d Cir. 2003)).

313. *See, e.g., V2R, L.L.C. v. Schneider (In re Schneider)*, No. 05-2382-JNF, 2006 WL 1431603, at \*1 (Bankr. D. Mass. May 23, 2006).

For instance, *Brown* and *Archer* apply even when the debtor argues that following them would produce an unfair result in a given case. *See Rainey v. Davenport (In re Davenport)*, 353 B.R. 150, 195 (Bankr. S.D. Tex. Feb. 2, 2006).

314. 393 B.R. 522, 541 (Bankr. S.D. Ohio 2008).

under [Code section] 523(a)(2)(A).”<sup>315</sup> The bankruptcy court agreed with the creditor’s premise regarding the inapplicability of novation in a nondischargeability proceeding, but disagreed with the creditor’s conclusion that the debt in question was necessarily nondischargeable.<sup>316</sup> The bankruptcy court explained: “*Archer* permits a creditor to demonstrate that the debt underlying a settlement arises out of fraud, false pretenses or false representation, but it does not relieve a creditor of meeting its burden under [Code section] 523(a)(2)(A)” to show that the debt is nondischargeable.<sup>317</sup>

In *Sukola v. Nader*, the debtor argued that the bankruptcy court could not look beyond a settlement agreement to determine whether a debt was nondischargeable under Code section 523(a)(2)(A),<sup>318</sup> because, unlike in *Brown* and *Archer*, the settlement agreement was made between the plaintiffs and “the [d]ebtor’s wholly owned company, rather than directly between the [p]laintiffs and the [d]ebtor.”<sup>319</sup> The bankruptcy court concluded that this “difference is not determinative as a matter of law” and therefore rejected the debtor’s argument.<sup>320</sup> The court reasoned that “[t]o find *Brown* and *Archer* inapplicable would undermine the purpose of [Code] section 523 and the Supreme Court’s reasoning.”<sup>321</sup> Therefore, the court concluded that further inquiry into the true nature of the debt was proper.<sup>322</sup>

Claim preclusion does not apply in a dischargeability proceeding even if “the underlying fraud is *twice* removed from [the] disputed debt,” unlike the once removed settlement agreement as in *Brown* and *Archer*.<sup>323</sup> For instance, in *Star High Yield Investment Management Corp. v. Schwartz* (*In*

315. *Id.* at 541-42.

316. *Id.*

317. *Id.* at 542 (citing *Archer v. Warner*, 538 U.S. 314, 323 (2003); *Burrell-Richardson v. Mass. Bd. of Higher Educ. (In re Burrell-Richardson)*, 356 B.R. 797, 802 (B.A.P. 1st Cir. 2006)).

318. *Sukola v. Nader (In re Nader)*, No. 11-13042 (DHS), 2012 WL 1614856 (Bankr. D.N.J. May 9, 2012). Section 523(a)(2)(A) of the Code renders nondischargeable any debt “for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition.” 11 U.S.C. § 523(a)(2)(A) (2012).

319. *In re Nader*, 2012 WL 1614856, at \*4.

320. *Id.*

321. *Id.*

322. *Id.*

323. *Star High Yield Inv. Mgmt. Corp. v. Schwartz (In re Schwartz)*, No. 07-30508, 2007 WL 3051865, at \*3 (Bankr. S.D. Tex. Oct. 17, 2007) (emphasis added).

*re Schwartz*), the creditor held a debt that arose “from a state court judgment, which arose from breach of a promissory note, which arose from a settlement of alleged fraudulent conduct.”<sup>324</sup> The creditor commenced an adversary proceeding to declare the debt nondischargeable.<sup>325</sup> The debtor argued he was “entitled to summary judgment because” the creditor’s claim arose “from a promissory note, not fraudulent conduct.”<sup>326</sup> The court ruled that “[l]iable parties can not [sic] erase the history of a debt’s origin through a settlement and subsequent breaches of the settlement.”<sup>327</sup> Because *Archer* and *Brown* require bankruptcy courts to inquire into “the conduct from which the debt originally arose,” the number of steps between the original fraud and the debt the creditor seeks to enforce is irrelevant.<sup>328</sup> At least one other case accords with this result.<sup>329</sup>

The form of the debt that the creditor seeks to declare nondischargeable is also generally irrelevant. For instance, *Brown* and *Archer* apply “the same whether the stipulation arises out of a consent judgment or simply an agreement between the parties.”<sup>330</sup> Likewise, *Brown* and *Archer* apply even where the award that the creditor seeks to declare nondischargeable is the product of an arbitration rather than a judicial proceeding.<sup>331</sup>

A clever litigant may not sidestep *Brown* and *Archer* “by narrowly defining the claim subject to preclusion as fraud” or another basis for dischargeability.<sup>332</sup> “The claim is the debtor’s right to discharge, not the creditor’s objection, based on fraud, to discharge.”<sup>333</sup>

### (3) *Exceptions to the Exceptions*

Notwithstanding the foregoing, courts have recognized several exceptions to *Brown* and *Archer*. First, courts have emphasized that *Brown* and *Archer* stand only for the proposition that claim preclusion does not

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324. *Id.*

325. *Id.* at \*1-2.

326. *Id.* at \*2.

327. *Id.* at \*3.

328. *Id.*

329. *See* *Hodges v. Buzzeo (In re Buzzeo)*, 365 B.R. 578, 580-83 (Bankr. W.D. Pa. 2007).

330. *Infinity Grp. LLC v. Lucas (In re Lucas)*, 477 B.R. 236, 246 (Bankr. M.D. Ala. 2012) (citing *Archer v. Warner*, 538 U.S. 314 (2003)).

331. *See Data Mountain Solutions, Inc. v. Giordano (In re Giordano)*, 472 B.R. 313, 323-24, 335 (Bankr. E.D. Va. 2012).

332. *Crowe v. Moran (In re Moran)*, 413 B.R. 168, 179 (Bankr. D. Del. 2009) (citing *Graham v. IRS (In re Graham)*, 973 F.2d 1089, 1096 (3d Cir. 1992)).

333. *Id.* at 180.

apply in *dischargeability* proceedings; they do *not* stand for the proposition that claim preclusion does not apply in bankruptcy proceedings generally.<sup>334</sup> For instance, “several circuits have recognized that *Brown* applies to the federal dischargeability issue, but not to issues of definition of property in the estate, in which Congress has given the states a key role.”<sup>335</sup>

*Colorado ex rel. Salazar v. Jensen (In re Jensen)* exemplifies another exception to *Brown* and *Archer*.<sup>336</sup> In that case, the State of Colorado and its Attorney General obtained a default judgment against the debtor in state court.<sup>337</sup> The State then commenced an adversary proceeding against the debtor-defendant seeking to declare this debt nondischargeable.<sup>338</sup> The debtor-defendant attempted to challenge the validity of the underlying judgment by arguing that she had not in fact violated the law that gave rise to the default judgment.<sup>339</sup> The bankruptcy court, notwithstanding *Brown* and *Archer*, held that claim preclusion barred the debtor-defendant from contesting the validity and amount of the debt in the nondischargeability proceeding.<sup>340</sup> The court reasoned that, although “a bankruptcy court is not bound by the state court judgment or record when considering the *dischargeability* of the debt under federal bankruptcy principles,” claim preclusion “may prevent the bankruptcy court from reexamining matters other than the dischargeability aspect, such as the validity and the amount of the debt.”<sup>341</sup> The court therefore ruled that the debtor-defendant was “precluded” from asking the court “to redetermine the validity and amount of the debt” by “alleging that she did not violate the law, and signed an admission of violation only under duress.”<sup>342</sup> Other decisions recognize this exception.<sup>343</sup>

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334. See McGarry v. Chew (*In re Chew*), 496 F.3d 11, 18 (1st Cir. 2007).

335. *Id.* (citing Comer v. Comer (*In re Comer*), 723 F.2d 737, 740 (9th Cir. 1984); Goss v. Goss, 722 F.2d 599, 603 (10th Cir. 1983); Collateral Control Corp. v. Deal (*In re Covington Grain Co.*), 638 F.2d 1357, 1360-61 (5th Cir. 1981)).

336. 395 B.R. 472 (Bankr. D. Colo. 2008).

337. *Id.* at 479.

338. *Id.*

339. *Id.* at 491.

340. *Id.*

341. *Id.* (citing Griego v. Padilla (*In re Griego*), 64 F.3d 580, 584 (10th Cir. 1995); Dennis v. Dennis (*In re Dennis*), 25 F.3d 274, 278 (5th Cir. 1994); Comer v. Comer (*In re Comer*), 723 F.2d 737, 740 (9th Cir. 1984)).

342. *Id.*

343. See Davidson v. Investors Title Ins. Co., No. 3:08-cv-00243-FDW, 2008 WL 4426142, at \*3 (W.D.N.C. Sept. 25, 2008).

This exception is sound. Allowing a debtor-defendant to contest the underlying debt by raising a new defense in a nondischargeability proceeding would upset principles of finality. Unlike dischargeability, the parties have the opportunity and incentive to debate the defense to the underlying cause of action in the state court. The state court also has the authorization and the expertise to determine the merits of the defense, which it does not necessarily have in the dischargeability context.

Another exception applies when the creditor lost in the prior action. The creditors in *Archer* and *Brown* had each obtained a victory of sorts in the prior state court action—a settlement in the former, and a consent judgment in the latter. Where, however, the creditor *loses* completely and entirely in the prior state court action, claim preclusion may apply in a dischargeability proceeding notwithstanding *Archer* and *Brown*. In *Gleason v. Gleason (In re Gleason)*, the plaintiff had previously sued the defendant in state court for fraud, embezzlement, and theft.<sup>344</sup> The state court ruled that the plaintiff failed to produce sufficient evidence to support his claims, and therefore granted summary judgment to the defendant.<sup>345</sup> The plaintiff then brought a dischargeability complaint in the defendant's bankruptcy case on the same fraud, embezzlement, and theft claims.<sup>346</sup> The bankruptcy court applied claim preclusion and dismissed the adversary proceeding.<sup>347</sup> Unlike in *Brown* and *Archer*, the putative creditor in *Gleason* did not ask the court to determine whether an existing debt was nondischargeable. The state court had “fully and finally determined that [the p]laintiff ha[d] no claim against [the d]efendant.”<sup>348</sup> Because no debt existed, there was “no purpose . . . in proceeding with a dischargeability complaint to determine whether that non-existent debt would theoretically be dischargeable.”<sup>349</sup>

Thus, claim preclusion applied even though the plaintiff alleged that the defendant procured the state court judgment by fraudulent evidence.<sup>350</sup> The bankruptcy court explained that, if the defendant had done so, the plaintiff should have moved the state court to reconsider the judgment and/or appealed the judgment to the state appellate courts.<sup>351</sup> The plaintiff did

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344. No. 08-41471, 2009 WL 982154, at \*1 (Bankr. D. Kan. Mar. 27, 2009).

345. *Id.*

346. *Id.*

347. *Id.* at \*1-3.

348. *Id.* at \*2.

349. *Id.*

350. *Id.*

351. *Id.*



neither, and therefore could not use the bankruptcy court as an avenue for appellate review of a state court judgment.<sup>352</sup>

*Gleason* is also an obviously correct exception to *Brown* and *Archer*. When a creditor has already lost in state court, all of the interests normally served by finality are present (namely, economy of resources and repose for the defendant), while all of the countervailing interests set forth in *Brown* and *Archer* are absent. Applying claim preclusion to bar a state court loser from relitigating her claim in a dischargeability proceeding will not cause state courts to make (and state court litigants to defend) premature and wasteful dischargeability determinations outside their authority and expertise. Nor will applying claim preclusion prevent the searching inquiry into the nature of debts envisioned by Congress when enacting the dischargeability provisions; that searching inquiry has already been made in the state court when the claim was litigated to a conclusion. Nor will applying claim preclusion allow debtors to get away with offenses against good morals; the state court has already conclusively determined that no such offense occurred. Thus, the exception to claim preclusion should only apply when a court has determined that debt actually exists.

Likewise, claim preclusion may apply in a nondischargeability proceeding when a bankruptcy court, in an adversary proceeding in a previous bankruptcy case involving the same debtor, has entered a judgment deeming the debt in question nondischargeable.<sup>353</sup> If a bankruptcy court deemed a debt nondischargeable in a debtor's first bankruptcy, the debtor cannot challenge the prior court's determination in his or her second bankruptcy.<sup>354</sup> Similar results obtain where the parties settle the issue of dischargeability in a prior nondischargeability proceeding, and the bankruptcy court dismisses the nondischargeability proceeding on the basis of that settlement.<sup>355</sup> "In other words, once nondischargeable, always nondischargeable,"<sup>356</sup> and vice versa.<sup>357</sup>

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352. *Id.* The bankruptcy court added in a footnote that the *Rooker-Feldman* doctrine prohibits such tactics by state court losers. *Id.* at \*2 n.9 (citing *Johnson v. De Grandy*, 512 U.S. 997, 1005-06 (1994); *Abboud v. Abboud (In re Abboud)*, 237 B.R. 777, 780 (B.A.P. 10th Cir. 1999)); see also *Dist. of Columbia Court of Appeals v. Feldman*, 460 U.S. 462 (1983); *Rooker v. Fidelity Trust Co.*, 263 U.S. 413 (1923).

353. See *Sanders v. Progressive Cas. Ins. Co. (In re Sanders)*, No. AZ-06-1382-PaBMo, 2007 WL 7540961, at \*1-3 (B.A.P. 9th Cir. Mar. 30, 2007).

354. See *id.*

355. See *Hackney v. Hackney (In re Hackney)*, No. 07-40952-JJR-11, 2008 WL 4830040, at \*\*1-2, 3-5, 10-12 (Bankr. N.D. Ala. Oct. 10, 2008).

356. *In re Sanders*, 2007 WL 7540961, at \*3 (citing *Paine v. Griffin (In re Paine)*, 283 B.R. 33, 37 (B.A.P. 9th Cir. 2002)).

This exception too seems obviously correct. The importance of finality counsels against allowing a debtor to repeatedly relitigate a nondischargeability determination by filing successive bankruptcies. Moreover, unlike a state or federal court that initially issues the judgment giving rise to the debt in question, the bankruptcy court is uniquely authorized and qualified to determine the dischargeability of that debt. When a bankruptcy court has previously determined that a particular debt is nondischargeable, it has done so in an adversary proceeding where the issue was squarely presented to the bankruptcy court, and where the parties had a full and fair opportunity to litigate it. Indeed, because of *Brown* and *Archer*, the original bankruptcy court has likely already looked behind the facts leading to the judgment to determine whether the debt is nondischargeable. Thus, claim preclusion does—and should—apply to a bankruptcy court’s prior determination that a debt is nondischargeable, even in a subsequent nondischargeability proceeding.

Not all exceptions to *Brown* and *Archer* are as obvious as those discussed above. *Calaway v. Cozart (In re Cozart)*, for example, is an odd case in which the bankruptcy court found *Brown* and *Archer* inapplicable.<sup>358</sup> The creditors sued the debtor, along with the debtor’s related corporate entities, for fraud and other causes of action in state court.<sup>359</sup> Specifically, the creditors alleged that the defendants had induced them to purchase a poorly constructed residence through fraud and other wrongdoing.<sup>360</sup> Because the creditors never served the individual debtor, however, the state court ruled that it had no jurisdiction over the debtor.<sup>361</sup> The state court accordingly entered judgment against the corporate entities but not the debtor.<sup>362</sup> While the case was on appeal, the defendants, including the individual debtor, entered into a settlement agreement, notwithstanding the state court’s prior ruling that the creditors had never properly served the individual debtor.<sup>363</sup> The debtor then declared bankruptcy.<sup>364</sup> The creditors then commenced an adversary proceeding, seeking a declaration that the state court debt was nondischargeable.<sup>365</sup>

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357. See *In re Hackney*, 2008 WL 4830040, at \*\*1-2, 3-5, 10-12.

358. Bankruptcy No. 5:08-bk-73392, 2009 WL 1955294, at \*4-5 (Bankr. W.D. Ark. July 6, 2009).

359. *Id.* at \*1.

360. *Id.*

361. *Id.*

362. *Id.*

363. *Id.*

364. *Id.* at \*2.

365. *Id.* at \*1.

The bankruptcy court, notwithstanding *Brown* and *Archer*, ruled that it could not look behind the settlement agreement.<sup>366</sup> It noted that, unlike in *Archer* and *Brown*, there existed no underlying debt that initially resulted from a lawsuit resolved by a settlement or stipulation.<sup>367</sup> Although a settlement agreement existed in the case, it did not arise from an underlying debt; the creditors obtained a judgment from the debtor's related corporate entities, but did not obtain a judgment against the individual debtor.<sup>368</sup> Because the court had dismissed the individual debtor from the underlying lawsuit, the debt against the debtor first arose in the settlement agreement itself.<sup>369</sup>

The bankruptcy court therefore reasoned that, “[w]ithout an underlying debt,” it could not “look beyond the settlement agreement; there was no debt owed by [the debtor] prior to his entering into the settlement agreement.”<sup>370</sup> As a result, rather than looking at whether the debtor induced the creditors to purchase a shoddy house through fraud, the court considered whether the debtor induced the creditors to enter the settlement agreement through fraud, false pretenses, or false representations.<sup>371</sup>

However, not all courts follow the reasoning of *Cozart*. For instance, in *Hodges v. Buzzeo (In re Buzzeo)*, the codebtor, like the debtor in *Cozart*, was “not a party” to the prior litigation and “was not named as a defendant,” but nonetheless “join[ed] as a party to the [s]ettlement [a]greement” that was the subject of a nondischargeability proceeding.<sup>372</sup> The bankruptcy court, rather than inquiring whether the codebtor committed fraud in entering the settlement agreement, instead inquired whether the underlying debt had its genesis in fraud, and denied summary judgment because the factual record was insufficient to reach that conclusion.<sup>373</sup>

*Monsour v. Monsour (In re Monsour)* is another case with unusual facts in which a bankruptcy court concluded that claim preclusion was applicable in a dischargeability proceeding notwithstanding *Brown* and *Archer*.<sup>374</sup> The plaintiff-debtor and the defendant-creditor were spouses who filed for

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366. *Id.* at \*4-5.

367. *Id.* at \*5.

368. *Id.*

369. *Id.*

370. *Id.*

371. *Id.* at \*5-6.

372. 365 B.R. 578, 583 (Bankr. W.D. Pa. 2007).

373. *Id.* at 583-85.

374. 372 B.R. 272, 277-79 (Bankr. W.D. Va. 2007).

divorce in state court.<sup>375</sup> The plaintiff-debtor declared bankruptcy and received a discharge before the state court entered a spousal support award, but after the state court had entered a final decree of divorce.<sup>376</sup>

After the plaintiff-debtor received his discharge, a state court commissioner in chancery recommended that the plaintiff-debtor pay a lump sum alimony payment to defendant-creditor in order to pay the parties' joint debts.<sup>377</sup> The plaintiff-debtor filed exceptions to the commissioner's report in which he "asserted that he received a discharge of the lump sum obligation" in the bankruptcy case because "the lump sum obligation constituted a property settlement," which may be dischargeable in bankruptcy, "and not spousal support," which is generally nondischargeable.<sup>378</sup> The state court overruled the plaintiff-debtor's exceptions.<sup>379</sup> The plaintiff-debtor then moved to reopen his bankruptcy case and commenced an adversary proceeding seeking a declaration that the lump sum obligation had been discharged.<sup>380</sup>

The bankruptcy court, with minimal discussion of *Brown* and *Archer*, ruled that claim preclusion prevented the plaintiff-debtor from relitigating whether the lump sum was dischargeable.<sup>381</sup> The bankruptcy court noted that although "bankruptcy courts have exclusive jurisdiction to decide exceptions to discharge that arise under" some subsections of Code section 523(a), "[b]ankruptcy courts and state courts maintain concurrent jurisdiction to decide all other exceptions to discharge arising under Section 523(a), including Section 523(a)(5), which excepts from discharge any debt to a spouse for alimony, support or maintenance made in connection with a divorce decree."<sup>382</sup> The court stated that the plaintiff-debtor "had an opportunity to fully litigate dischargeability and any exceptions arising under Section 523(a)(5) in state court proceedings because he filed bankruptcy and received his discharge before the [state court] entered its [d]ecree."<sup>383</sup> Indeed, as noted above, the plaintiff-debtor "did, in fact, raise the issue of dischargeability in the state court proceeding" in his challenge

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375. *Id.* at 275.

376. *Id.*

377. *Id.* at 276.

378. *Id.*

379. *Id.*

380. *Id.*

381. *See id.* at 277-79.

382. *Id.* at 278 (citing 11 U.S.C. §§ 523(a), 523(a)(5) (1996); *In re Crawford*, 183 B.R. 103, 107 (Bankr. W.D. Va. 1995); FED. R. BANKR. P. 4007(a)).

383. *Id.* (citing *Davis v. Dall. Area Rapid Transit*, 383 F.3d 309, 314 (5th Cir. 2004)).

to the commissioner's report.<sup>384</sup> Therefore, the court held that claim preclusion barred the plaintiff-debtor from relitigating whether the lump sum was dischargeable in the adversary proceeding.<sup>385</sup>

Thus, *Monsour* suggests that claim preclusion may apply in a dischargeability proceeding, notwithstanding *Brown* and *Archer*, where the exception to discharge at issue is one over which state courts share concurrent jurisdiction with bankruptcy courts, and where the debtor receives a discharge before the state court entered its judgment giving rise to the debt in question.<sup>386</sup> However, even though the *Monsour* court ruled it "need not determine the dischargeability of the lump sum obligation on [its] merits,"<sup>387</sup> the court nevertheless proceeded to analyze the merits of whether the debt was dischargeable in the plaintiff-debtor's bankruptcy,<sup>388</sup> which suggests that the court's claim preclusion ruling may be dicta. Moreover, the Court did not explicitly analyze how its decision was consistent with the *Brown* and *Archer*'s holdings that claim preclusion is generally inapplicable in dischargeability proceedings.<sup>389</sup> Therefore, time will tell whether *Monsour* represents a robust exception to *Brown* and *Archer*.

#### (4) Extensions of *Brown* and *Archer*

*Brown* and *Archer* hold that claim preclusion is generally inapplicable in nondischargeability proceedings, but a nondischargeability proceeding is only one of many types of adversary proceedings a litigant may commence in a bankruptcy case. Interestingly, a few courts have extended *Brown* and *Archer* beyond the nondischargeability context by ruling that claim preclusion may be inapplicable in other types of adversary proceedings.

In *Vineyard v. Vineyard (In re Vineyard)*, the plaintiff filed an adversary proceeding in the defendant-debtor's bankruptcy case "seeking a declaration that [the plaintiff was] the owner of certain property in the possession of [the d]efendant or, in the alternative, imposition of a constructive trust on assets of the [d]efendant."<sup>390</sup> The plaintiff and the defendant had previously engaged in state court litigation over certain life insurance proceeds, and had entered into two settlement agreements

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384. *Id.* at 282.

385. *Id.* at 278.

386. *Id.* at 277-79.

387. *Id.* at 278.

388. *Id.* at 279-82.

389. *Id.* at 277-78.

390. No. 10-63518-fra13, 2011 WL 306068, at \*1 (Bankr. D. Or. Jan. 27, 2011).

throughout the course of the litigation.<sup>391</sup> The bankruptcy court noted that the plaintiff was “seeking a determination of the ‘nature and extent of property of the estate’” in the adversary proceeding, and observed that such determinations are “a fundamental core bankruptcy function.”<sup>392</sup> The bankruptcy court, “analog[izing] to the holding in *Archer v. Warner*,” ruled that it could “look ‘beyond the state-court record and the documents terminating the state-court proceeding’ to determine [the p]laintiff’s interest in property alleged by [the d]efendant to be property of the estate.”<sup>393</sup> By ruling that the bankruptcy court could look behind the terms of the settlement agreements, the *Vineyard* court extended *Brown* and *Archer* beyond the nondischargeability context into other adversary proceedings that implicate a “fundamental core bankruptcy function.”<sup>394</sup> Time will tell whether other courts follow the reasoning of *Vineyard* and expand *Brown* and *Archer* beyond its original domain.

#### *D. Intervening Change in the Law*

As we have previously noted, claim preclusion bars not only claims that were brought in a subsequent proceeding, but also claims that could have and should have been brought in that prior proceeding. What happens when a judicial decision comes down in between the two proceedings that arguably provides the litigant with a new legal argument that was not available or viable during the prior proceeding? Should claim preclusion bar the litigant from raising that new argument?

In *Dover v. United States (Dover II)*,<sup>395</sup> the United States Court of Appeals for the Sixth Circuit said claim preclusion should indeed apply in such a situation. *Dover* pled guilty to defrauding Sunbelt Federal Savings (Sunbelt), a savings and loan institution.<sup>396</sup> He was sentenced to two years probation and ordered to pay \$19.6 million in criminal restitution to the FDIC.<sup>397</sup> *Dover* then filed a voluntary bankruptcy petition under Chapter 7

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391. *Id.* at \*\*1, 3.

392. *Id.* at \*4.

393. *Id.*

394. *Id.*

395. 367 F. App'x 651 (6th Cir. 2010). Hereinafter this decision will be cited as *Dover II*, for clarity. “*Dover*,” unitalicized, shall refer to the plaintiff-appellant in *Dover II*. We note that as an unpublished decision, the precedential value of *Dover II* is limited. However, the issues that it raises are of great interest, and its reasoning is sufficiently persuasive that other courts may adopt the decision’s logic.

396. *Id.* at 651.

397. *Id.* at 651-52. This is admittedly an oversimplification for the sake of clarity. Initially, “[r]estitution was to be paid to the District Court Clerk for disbursement to” an

of the Code.<sup>398</sup> “Instead of listing a governmental entity as the judgment creditor on the schedules filed with the bankruptcy petition, Dover listed [Sunbelt] in the amount of \$19.6 million.”<sup>399</sup> The bankruptcy court entered a discharge and closed the case.<sup>400</sup>

When Dover made no payments toward the criminal restitution, the FDIC brought suit to collect the judgment<sup>401</sup> (*Dover I*<sup>402</sup>). Dover sought to avoid the FDIC’s collection efforts by arguing that the expiration of his probation period relieved him of his duty to pay restitution, and that the FDIC could not collect the criminal restitution levied against him because he and the FDIC settled the civil judgment against him based on the same acts.<sup>403</sup> The Sixth Circuit “rejected both arguments and granted the FDIC summary judgment in the enforcement action, thereby holding that the FDIC was entitled to execute on its nineteen million dollar restitution order against Dover.”<sup>404</sup>

Following *Dover I*, “Dover again sought to stop the attempts to collect the restitution by filing a Complaint for Declaratory Judgment against the FDIC and the United States. Dover claimed this time that the criminal restitution was discharged in his bankruptcy proceedings—a question that was not specifically adjudicated in” *Dover I*.<sup>405</sup> The Sixth Circuit in *Dover II* concluded that Dover could have raised the discharge issue in *Dover I* but did not; therefore, Dover was barred by claim preclusion from raising it in *Dover II*.<sup>406</sup>

Dover argued, inter alia, that he could not have brought the discharge argument in *Dover I* because an “argument regarding discharge was not a viable argument until the Sixth Circuit rendered its decision in *Hughes v. Sanders* several months after *Dover I*.”<sup>407</sup> In *Hughes*, the Sixth Circuit

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entity known as “the Resolution Trust Corporation as a receiver for Sunbelt,” but “[l]ater, by statute, the Federal Deposit Insurance Corporation (‘FDIC’) succeeded to the Resolution Trust Corporation’s interest in restitution.” *Id.* at 652 (citing 12 U.S.C. § 1441a(m)(1) (2006)).

398. *Id.* at 652.

399. *Id.*

400. *Id.*

401. *Id.* Again, we have simplified the procedural posture somewhat for clarity. *See id.*

402. FDIC v. Dover (*Dover I*), 453 F.3d 710 (6th Cir. 2006).

403. *Dover II*, 367 F. App’x at 652.

404. *Id.* (citing *Dover I*, 453 F.3d at 710).

405. *Id.*

406. *Id.* at 651-54.

407. Brief of Appellant at 10-11, *Dover v. United States*, 367 F. App’x 651 (6th Cir. 2010) (No. 08-6196), 2009 WL 1683546 [hereinafter *Dover II* Brief].

interpreted Code section 523(a)(7), which renders any “fine, penalty, or forfeiture payable to and for the benefit of a governmental unit” that is “not compensation for actual pecuniary loss,” other than certain tax penalties, nondischargeable in Chapter 7 liquidations.<sup>408</sup> The *Hughes* court held that a default judgment entered against a Chapter 7 debtor in a legal malpractice action did not fall within section 523(a)(7)'s exception to dischargeability because it constituted compensation for actual damages and was payable to the plaintiff rather than to a governmental entity.<sup>409</sup> Dover argued that his criminal restitution order was no different than the judgment deemed dischargeable in *Hughes*, and therefore was discharged in his Chapter 7 case.<sup>410</sup> Dover further argued that *Hughes* marked a change or clarification in the law that could not have been anticipated.<sup>411</sup> Therefore, concluded

408. 469 F.3d 475, 477 (6th Cir. 2006).

409. *Id.* at 476-79.

410. *Dover II* Brief, *supra* note 407, at 7-8.

The *Hughes* Court held that [Code] § 523(a)(7) only provides an exception to discharge for restitution orders that are payable both to and for the benefit of a governmental unit. The *Hughes* Court further determined that when a judgment amount is explicitly calculated to compensate the complainant for its damages, such a judgment does not fall within the exception to discharge because it is compensation for actual pecuniary loss.

In [Dover's] criminal case, the restitution was ordered payable to and for the benefit of the defrauded victim . . . which was not a governmental unit. Also, the restitution was compensation for actual pecuniary loss because it is the precise amount of damages alleged by the victim.

*Id.* (citations omitted).

411. *Id.* at 12, 14, 18, 20.

In order to understand why Mr. Dover's claim that the restitution obligation was discharged in bankruptcy is a valid claim and is a claim that was not available in the prior litigation, it is important to first analyze the case that provides the basis for that claim. The *Hughes* case is an interpretation and application of the United States Supreme Court's decision in *Kelly v. Robinson* . . . .

. . . .  
 Courts have taken the *Kelly* decision in many different directions. With respect to the requirement that the restitution be “payable to and for the benefit of a governmental unit,” some courts have adopted *Kelly*'s very broad interpretation and have concluded that all restitution is, to some degree, for the benefit of the state and, therefore, meets this criteria. Other courts have rejected the *Kelly* approach, opting instead for a literal reading of the statute's requirements. Some courts have determined that *Kelly* only applies to *state* restitution orders. . . .

. . . .  
 In summary, the decision in *Hughes* marked the first time the Sixth Circuit had decided to narrowly interpret *Kelly* and [Code section] 523(a)(7) in such a



Dover, he could not have raised this dischargeability argument in *Dover I*, “because the *Hughes* decision had not been rendered and, accordingly, the defense was not available, or ‘ripe’ for presentation.”<sup>412</sup>

The *Dover II* court rejected Dover's argument. Although the Sixth Circuit acknowledged that a change in the *factual* basis underlying a litigant's claim can deprive a prior judgment of claim preclusive effect,<sup>413</sup> the Sixth Circuit, citing an influential treatise, concluded “that a clarification in the *law*” is *not* “the same as a change in facts . . . . [A] change in the law is *not* a sufficient justification to avoid the *res judicata* effect of the earlier judgment.”<sup>414</sup> Because the facts had not changed, *Dover I* and *Dover II* involved identical causes of action, so the dischargeability issue could have and should have been litigated in *Dover I*.<sup>415</sup>

Alternatively, the *Dover II* court argued that *Hughes* did not actually effect a change in the law at all:

[T]he law has not changed. At most, *Hughes* fills a small gap in the law regarding *federal* restitution orders left by the Supreme Court decision in *Kelly v. Robinson*, which held that *state* criminal restitution orders are not dischargeable in federal bankruptcy. Dover himself acknowledges that *Hughes* is “an interpretation and application” of the *Kelly* decision. . . .

Additionally, the *Kelly* decision was handed down years before Dover defended against the FDIC enforcement action, as were the other Courts of Appeals cases cited by Dover on this point. Consequently, Dover had a full and fair opportunity to litigate his discharge defense at that time. The *Hughes* decision

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way as to support the argument that a federal restitution order can be discharged in bankruptcy. For the first time, the Sixth Circuit endorsed an interpretation of 523(a)(7) that comported with its plain language and that, arguably, embraced the dissent in *Kelly*. . . .

. . . . Prior to *Hughes*, Mr. Dover did not have such a defense available to him because that was not the state of the law in the Sixth Circuit.

*Id.* (citations omitted).

412. *Id.* at 10.

413. *Dover II*, 367 F. App'x at 653 (citing *Rawe v. Liberty Mut. Fire Ins. Co.*, 462 F.3d 521, 529-30 (6th Cir. 2006); *Kane v. Magna Mixer Co.*, 71 F.3d 555, 560 (6th Cir. 1995); *Katt v. Dykhouse*, 983 F.2d 690, 694 (6th Cir. 1992)).

414. *Id.* at 653-54 (emphasis added) (citing 18 CHARLES A. WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4415 (2d ed. 2009)).

415. *Id.*

does not excuse Dover's failure to make this argument in *Dover I*.<sup>416</sup>

The *Dover II* court therefore concluded that *Dover's* declaratory judgment action was barred by claim preclusion.<sup>417</sup>

## II. Issue Preclusion (*Collateral Estoppel*)

### A. Definition

Many practitioners are familiar with the terms “collateral estoppel” and “issue preclusion” because the two labels have historically been used interchangeably.<sup>418</sup> As the latter is the more accurate term, this article will exclusively utilize the term “issue preclusion” in lieu of the more antiquated “collateral estoppel.” The Restatement (Second) of Judgments defines the doctrine as follows:

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 a different claim.<sup>419</sup>

The doctrine is intended to conserve judicial resources and to protect the adversaries of a party—and sometimes a non-party—from the expense and vexation of facing multiple lawsuits.<sup>420</sup> In other words, issue preclusion prevents issues of ultimate fact from being re-litigated in a future lawsuit if those issues have already been determined by a valid and final judgment.<sup>421</sup> This treatment effectively denies litigants a second bite at the apple, conserving judicial resources and promoting consistency in judicial decisions.<sup>422</sup> The “actually litigated” requirement of issue preclusion differs from the claim preclusion doctrine, which prevents the litigation of an issue

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416. *Id.* at 654.

417. *Id.*

418. *Yeager v. United States*, 557 U.S. 110, 119 n.4 (2009) (citing RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1980)).

419. RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1980). It should be noted that while the Restatement (Second) of Judgments provides the general rule for issue preclusion, the application of these elements vary depending from which underlying court the prior judgment came as discussed below. Therefore, this rule, while certainly persuasive, is not authoritative in all jurisdictions.

420. *Berry v. Vollbracht (In re Vollbracht)*, 276 F. App'x 360, 365 (5th Cir. 2007).

421. *Vines v. Univ. of La. at Monroe*, 398 F.3d 700, 705 (5th Cir. 2005).

422. *Melnor, Inc. v. Corey (In re Corey)*, 583 F.3d 1249, 1251 (10th Cir. 2009).

or cause of action that has never been litigated.<sup>423</sup> In other words, whereas claim preclusion bars the relitigation of any *claim* that *was* or *could have been* litigated in a prior proceeding, issue preclusion bars any claim based on *facts* that *were actually* litigated.<sup>424</sup>

In *Grogan v. Garner*, the Supreme Court, while holding that a preponderance of the evidence was the correct burden of proof under 11 U.S.C. § 523, clarified that the issue preclusion doctrine applies in bankruptcy proceedings.<sup>425</sup> While this was the Court's first formal acknowledgment regarding the doctrine's applicability to bankruptcy proceedings, the Court noted that it was not inconsistent with prior holdings under the Code and the former Bankruptcy Act.<sup>426</sup> This holding is also consistent with the Full Faith and Credit Act,<sup>427</sup> which requires all federal courts to give the same preclusive effect to state court judgments that those judgments would receive in the courts of the state from which such judgments emerged.<sup>428</sup> Likewise, federal courts must give deference to judgments from an underlying federal court.

For judgments in diversity cases, "federal law incorporates the rules of preclusion applied by the State in which the rendering court sits."<sup>429</sup> Federal common law governs the preclusive effect of a judgment issued by a federal court sitting in diversity.<sup>430</sup> While bankruptcy courts are required to give preclusive effect to final judgments entered by a state court, the bankruptcy court retains exclusive jurisdiction to determine whether a debt is dischargeable.<sup>431</sup> In the consumer bankruptcy context, the issue preclusion

423. *Id.*

424. Carlson, *supra* note 1, at 353.

425. 498 U.S. 279, 285 n.11 ("We now clarify that collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a).").

426. *Id.* (citing *Kelly v. Robinson*, 479 U.S. 36, 48 n.8 (1986); *Brown v. Felsen*, 442 U.S. 127, 139 n.10 (1979); *Heiser v. Woodruff*, 327 U.S. 726, 736 (1946)).

427. 28 U.S.C. § 1738 (2012); *see also* U.S. CONST. art. IV, § 1.

428. *Grogan*, 498 U.S. at 284 n.11; *Marciano v. Chapnick (In re Marciano)*, 708 F.3d 1123, 1133 (9th Cir. 2013); *Capital City Ins. Co. v. Hurst*, 632 F.3d 898, 903 (5th Cir. 2011) (citing *Raju v. Rhodes*, 7 F.3d 1210, 1214 (5th Cir. 1993)).

429. *Taylor v. Sturgell*, 553 U.S. 880, 892 n.4 (2008) (citing *Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508 (2001)).

430. *Semtek Int'l Inc.*, 531 U.S. at 508.

431. 11 U.S.C. § 158(d) (2012); *Grogan*, 498 U.S. at 283–85, 291; *Gupta v. E. Idaho Tumor Inst., Inc. (In re Gupta)*, 394 F.3d 347, 349 (5th Cir. 2004) (holding that a bankruptcy court may apply issue preclusion to prevent re-litigation of findings relevant to dischargeability, but the ultimate determination of whether a debt is dischargeable is a federal question); *Caton v. Trudeau (In re Caton)*, 157 F.3d 1026, 1028 (5th Cir. 1998)

doctrine arises most frequently in situations involving a debtor's discharge.<sup>432</sup>

### *B. Recent Developments*

This section will discuss the current state of the issue preclusion doctrine with particular focus on current developments as it applies to consumer bankruptcy cases. When initiating an issue preclusion analysis, it is necessary to first determine in which court the underlying judgment originated to establish the specific elements needed to satisfy the rule. While federal common law—as well as the majority of states—generally rely on the Restatement (Second)'s interpretation of issue preclusion, a body of common law has since developed based on unique jurisdictional interpretations of the general rule.<sup>433</sup>

#### *1. The Underlying Judgment: What Elements Apply?*<sup>434</sup>

The first step in an issue preclusion analysis is to determine from which jurisdiction the underlying judgment stems. This step is important to establish the required elements in an issue preclusion argument. For example, the preclusive effect of a federal-court judgment is determined by

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(“[Issue preclusion] applies in bankruptcy dischargeability proceedings, but the bankruptcy court retains exclusive jurisdiction to determine whether a debt is dischargeable.”).

432. In particular, adversary proceedings objecting to a debtor's discharge pursuant to 11 U.S.C. § 523(a)(2), (4), and (6).

433. In addition to common law interpretations, some states have codified their rendition of the issue preclusion doctrine. It is imperative to adhere strictly to the preclusion rule adopted by the state that issued the underlying judgment when conducting an issue preclusion analysis. The occasional misstatement of an applicable preclusion rule creates conflicting case law and misleads the court.

To illustrate, at least two Louisiana appellate courts declined to recognize the doctrine of issue preclusion at all. *Regions Bank v. Weber*, 2010-1169, pp. 8-9 n.4 (La. App. 4 Cir. 12/15/10); 53 So. 3d 1284, 1290 n.4 (“We distinguish equitable estoppel and [issue preclusion], and emphasize that Louisiana law does not recognize the doctrine of [issue preclusion].”); *Alonzo v. Louisiana*, 2002-0257, p. 9 (La. App. 4 Cir. 9/8/04); 884 So. 2d 634, 639 (“With regards to [issue preclusion], it is imperative that we restate that Louisiana law does not recognize this doctrine.”). But “Louisiana Revised Statute 13:4231 embraces the broad usage of the phrase ‘res judicata’ to include both claim preclusion (res judicata) and issue preclusion (collateral estoppel).” *Williams v. Williams*, 2006-1471, p. 3 (La. App. 1 Cir. 2/9/07); 2007 WL 437767, at \*3; *see also* LA. REV. STAT. ANN. § 13:4231(3) (2012); *Foley v. Entergy La., Inc.*, 06-0983, p. 15 n.4 (La. 11/29/06); 946 So. 2d 144, 156 n.4 (“While it is true that LSA-R.S. 13:4231(3) adopts issue preclusion in Louisiana, its application is strictly limited to narrowly defined circumstances.”).

434. In this section, we will attempt to bring clarity to the complexity of the doctrine and the confusion associated with its application.

federal principles of issue preclusion,<sup>435</sup> whereas particular state-court requirements may differ by jurisdiction. Indeed, federal common law governs the preclusive effect of a prior decision rendered by a federal court sitting in diversity.<sup>436</sup> As discussed above, federal common law on issue preclusion generally conforms to the rule outlined in the Restatement (Second) of Judgments.<sup>437</sup> Thus, a bankruptcy court's final order should warrant the same preclusive effect in subsequent proceedings whether it be a bankruptcy proceeding or otherwise.<sup>438</sup>

The finality of a particular bankruptcy order depends on the proceeding or controversy that it was designed to resolve, rather than its effect on the entire bankruptcy proceeding. The "flexible finality" of a bankruptcy order is not a concept that is easily grasped.<sup>439</sup> In fact, the flexible finality rule may ultimately become a rigid reality for a party that elects to delay the appellate process.<sup>440</sup>

It is well-settled that federal courts must give state court judgments the same preclusive effect they would have in the courts of the rendering

435. *Taylor v. Sturgell*, 553 U.S. 880, 891 (2008) (citing *Semtek Int'l Inc.*, 531 U.S. at 507-08); *Foster v. City of El Paso*, 308 F. App'x 811, 812 (5th Cir. 2009) (citing *San Antonio Indep. Sch. Dist. v. McKinney*, 936 S.W. 2d 279, 281 (Tex. 1996)); *Ball v. A.O. Smith Corp.*, 451 F.3d 66, 69 (2d Cir. 2006).

436. *Smith v. Bayer Corp.*, 131 S. Ct. 2368, 2376 n.6 (2011) (citing *Semtek Int'l Inc.* with approval); *Rabo Agrifinance, Inc. v. Terra XXI, Ltd.*, 583 F.3d 348, 353 (5th Cir. 2009) (citing *Reimer v. Smith*, 663 F.2d 1316, 1325 n.9 (5th Cir. 1981)).

437. A judgment is preclusive in federal court if: (1) the prior or federal decision resulted in a judgment on the merits; (2) the same fact issue was litigated in that court; and (3) the issue's disposition was necessary to the prior action's outcome. *Taylor*, 553 U.S. at 891; *Ball*, 451 F.3d at 69 (citing *Purdy v. Zeldes*, 337 F.3d 253, 258 n.5 (2d Cir. 2003)); *Fin. Acquisition Partners LP v. Blackwell*, 440 F.3d 278, 284 (5th Cir. 2006) (citing *Am. Home Assur. Co. v. Chevron, USA, Inc.*, 400 F.3d 265, 272 (5th Cir. 2005)).

438. While this statement seems axiomatic as to the preclusive effect of bankruptcy court orders, the Supreme Court's recent decisions in *Stern v. Marshall*, *Executive Benefits Insurance Agency v. Arkison*, and *Wellness International Network, Ltd. v. Sharif* present a potential problem. *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015); *Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165 (2014); *Stern v. Marshall*, 131 S. Ct. 2594 (2011); see also *infra* Part IV.D. Hence, as will be discussed, perhaps "may warrant" is a more appropriate statement.

439. A problem Part IV.C.1 *infra* seeks to remedy.

440. *Bank of N.Y. Trust Co. NA, v. Pac. Lumber Co. (In re SCOPAC)*, 624 F.3d 274, 281 (5th Cir. 2010), *opinion modified on denial of reh'g*, 649 F.3d 320, 322 (5th Cir. 2011) (discussing whether it is prudent to upset a chapter 11 plan of reorganization thereby affecting third-party rights when a period of time has passed after its implementation) (citations omitted).

state.<sup>441</sup> The preclusive effect of prior state court proceedings on federal proceedings is determined by the treatment the state court judgment would receive in the courts of the state in which those prior proceedings were held.<sup>442</sup> So while it may be true that most circuit courts (and federal courts for that matter) follow the Restatement (Second) of Judgment's approach to determine the preclusive nature of a prior judgment, it is important to remember that state courts within a circuit may base their decision to preclude an issue using a slightly different approach to the general rule, which, as mentioned above, will govern even the highest of federal courts.<sup>443</sup>

Therefore, a prudent practitioner should be careful not to instinctively cite a case from an otherwise mandatory authority when making an issue preclusion argument without first determining to which forum's law the court is adhering. This initial determination is not only important to establish the correct rule of law but also to shed light on the relative weight an underlying jurisdiction may lend to a particular element in an issue preclusion analysis. It is for these reasons that each element of issue preclusion and their current interpretations are discussed in detail below.

## 2. *Valid and Final Judgment*

The determination of whether an issue must be precluded from litigation in a subsequent action is dependent on the existence of a "valid and final" judgment, regarding the same subject matter, issued by a previous court.<sup>444</sup> A judgment is "valid" if a court of competent jurisdiction<sup>445</sup> renders a decision affecting an entity that has either submitted to the jurisdiction of the court or has been given adequate notice and the court has territorial

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441. 28 U.S.C. § 1738 (2012); *Grogan v. Garner*, 498 U.S. 279, 284 n.11 (1991); *Interwest Nat'l Bank v. Welch*, 491 F. App'x 322, 325 (3d Cir. 2012); *Vasquez v. YII Shipping Co.*, 692 F.3d 1192, 1196 (11th Cir. 2012); *White v. City of Pasadena*, 671 F.3d 918, 926 (9th Cir. 2012); *Capital City Ins. Co. v. Hurst*, 632 F.3d 898, 903 (5th Cir. 2011) (applying Mississippi law to determine the preclusive effect of a prior Mississippi state court conviction on subsequent bankruptcy proceedings); *Plunk v. Yaquinto (In re Plunk)*, 481 F.3d 302, 307 (5th Cir. 2007) (applying Texas law to determine the preclusive effect of a Texas state court judgment on subsequent bankruptcy proceedings); *Raspanti v. Keaty (In re Keaty)*, 397 F.3d 264, 270 (5th Cir. 2005) (holding that because the underlying judgment was from a Louisiana state court, Louisiana issue preclusion rules must apply).

442. *B.B. v. Bradley (In re Bradley)*, 466 B.R. 582, 586 (B.A.P. 1st Cir. 2012); *Honkanen v. Hopper (In re Honkanen)*, 446 B.R. 373, 382 (B.A.P. 9th Cir. 2011); *Norris v. Hearst Trust*, 500 F.3d 454, 460-61 (5th Cir. 2007).

443. See *Grogan*, 498 U.S. at 284 n.11.

444. *Vines v. Univ. of La. at Monroe*, 398 F.3d 700, 705 (5th Cir. 2005).

445. See *infra* Part II.D for another issue involving the competency of bankruptcy courts.

jurisdiction over the action.<sup>446</sup> A judgment is “final” if the prior adjudication of an issue is determined to be *sufficiently firm* to be accorded conclusive effect.<sup>447</sup> A judgment is “sufficiently firm” if:

[T]he court should determine that the decision to be carried over was adequately deliberated and firm, even if not final in the sense of forming a basis for a judgment already entered. Thus preclusion should be refused if the decision was avowedly tentative. On the other hand, that the parties were fully heard, that the court supported its decision with a reasoned opinion, that the decision was subject to appeal or was in fact reviewed on appeal, are factors supporting the conclusion that the decision is final for the purpose of preclusion. The test of finality, however, is whether the conclusion in question is procedurally definite and not whether the court might have had doubts in reaching the decision.<sup>448</sup>

The standards for determining the finality of bankruptcy court orders differ from those applicable to orders stemming from litigation outside the bankruptcy context.<sup>449</sup> Indeed, “[f]inality is a fairly strict concept in most federal litigation,”<sup>450</sup> such that a federal-court action is treated “as a ‘single judicial unit’ from which only one appeal can be made.”<sup>451</sup> Generally, parties “must wait for the entire case to be disposed of before taking an appeal.”<sup>452</sup> However, bankruptcy courts are not so constrained.<sup>453</sup>

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446. RESTATEMENT (SECOND) OF JUDGMENTS § 1 (1982).

447. *Id.* § 13 (emphasis added).

448. *Haber v. Biomet, Inc.*, 578 F.3d 553, 556 (7th Cir. 2009) (citing RESTATEMENT (SECOND) OF JUDGMENTS § 13 (1982) with approval); *Greenway Ctr., Inc. v. Essex Ins. Co.*, 475 F.3d 139, 148 (3d Cir. 2007) (same).

449. *Ades-Berg Investors v. Breeden (In re Bennett Funding Grp., Inc.)*, 439 F.3d 155, 160 (2d Cir. 2006) (quoting *Sonnax Indus., Inc. v. Tri Component Prods. Corp. (In re Sonnax Indus., Inc.)*, 907 F.2d 1280, 1283 (2d Cir. 1990)).

450. *In re McKinney*, 610 F.3d 399, 401 (7th Cir. 2010).

451. *Pinpoint IT Servs., LLC v. Rivera (In re Atlas IT Exp. Corp.)*, 761 F.3d 177, 181 (1st Cir. 2014) (quoting *In re Saco Local Dev. Corp.*, 711 F.2d 441, 443 (1st Cir. 1983)).

452. *In re McKinney*, 610 F.3d at 401-02 (citing *Mohawk Indus., Inc. v. Carpenter*, 558 U.S. 100 (2009)).

453. *In re Atlas IT Exp. Corp.*, 761 F.3d at 182 (“[I]n the world of bankruptcy, ‘final’ does not just describe the last order entered at the case’s end—you know, the one ‘that ultimately disposes of all the debtor’s assets on the basis (perhaps) of the results of many individual proceedings and controversies taking place over many years within the context of the overall bankruptcy case.’”) (quoting *Tringali v. Hathaway Mach. Co.*, 796 F.2d 553, 558 (1st Cir. 1986)).

The need for different standards arises because a bankruptcy case is an umbrella under which several contested matters and adversary proceedings may be litigated simultaneously. Proceedings between two third parties may come within the bankruptcy court's subject-matter authority based upon only a tangential relationship to the debtor.<sup>454</sup> Even so, the outcome in such cases may affect the overarching bankruptcy case sufficiently to delay an appeal of a final order.<sup>455</sup> Conversely, even if the debtor litigates such a proceeding as a named party, a decision may be unreviewable if appellate jurisdiction exists only at the conclusion of the bankruptcy proceeding.<sup>456</sup> These two situations comport with the general "finality" requirement in federal law, but because bankruptcy cases, quote, often live on for many years, courts "take a flexible approach to finality . . . giving that requirement a 'practical' rather than a 'technical' construction."<sup>457</sup>

An area of finality peculiar to bankruptcy is plan confirmation. The Supreme Court's recent decision in *Bullard v. Blue Hills Bank* resolved a split among circuit courts by holding that an order denying plan confirmation is not "final" for purposes of appeal.<sup>458</sup> In doing so, the Supreme Court noted that while an ordinary civil litigation case in federal

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454. *In re Bennett Funding Grp, Inc.*, 439 F.3d at 160 (quoting *In re Sonmax Indus., Inc.*, 907 F.2d at 1283). Such third parties may be caught in the "large net case by 'related to' jurisdiction," which exists if "the outcome of that proceeding could *conceivably* have any effect on the estate being administered in bankruptcy." *Frisia Hartley, L.L.C. v. Wells Fargo Bank, N.A. (In re Talsma)*, 509 B.R. 535, 542 (Bankr. N.D. Tex. 2014) (quoting *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 n.6 (1995)).

455. Or, as is often the case, the appeal of the district court's final order after *de novo* review of the bankruptcy court's proposed findings of fact and conclusions of law. *See* 28 U.S.C. § 157(c) (2012); *Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2173 (2014). Such a stay may be available under the bankruptcy court's broad authority under 11 U.S.C. § 105(a). *Cf. Celotex*, 514 U.S. at *passim*.

456. *See In re Bennett Funding Grp.*, 439 F.3d at 160.

457. *In re Atlas IT Exp. Corp.*, 761 F.3d at 182 (quoting *In re Parque Forestal, Inc.*, 949 F.3d 504, 508 (1st Cir. 1991), *overruled in part on other grounds by Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000); *Gillespi v. U.S. Steel Corp.*, 379 U.S. 148, 152 (1964), *overruled in part on other grounds by Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000)) (internal punctuation omitted).

As examples of the longevity of bankruptcy cases, the bankruptcy case of chemical maker W.R. Grace & Co. was filed on April 2, 2001, and remained open for more than twelve years. Peg Brickley, *5 Takeaways From the W.R. Grace Bankruptcy*, WALL ST. J. BLOG (Feb. 3, 2014, 6:03 PM), <http://blogs.wsj.com/briefly/2014/02/03/5-takeaways-from-the-w-r-grace-bankruptcy/>. Likewise, the chapter 11 bankruptcy case for Mirant Corp., filed in July 2003, remains open as of the date of publication. *In re Mirant Corp.*, No. 03-46590-dml11 (Bankr. N.D. Tex filed July 14, 2003).

458. 135 S. Ct. 1686 (2015).



district court typically culminates in a final decision, at which point a district court disassociates itself from such case, a bankruptcy case involves “an aggregation of individual controversies” that stand independent of the larger case itself.<sup>459</sup> One such “individual controversy” is an order denying confirmation. The Court held that the denial of confirmation with leave to amend “changes little” in terms of a debtor’s bankruptcy case. “The automatic stay persists. The parties’ rights and obligations remain unsettled. The trustee continues to collect funds from the debtor in anticipation of a different plan’s eventual confirmation. The possibility of discharge lives on. ‘Final’ does not describe this state of affairs.”<sup>460</sup>

The Supreme Court noted that 11 U.S.C. § 158(a) authorizes appeals “as of right not only from final judgments in cases but from ‘final judgments, orders, and decrees . . . in cases and proceedings,’” which demonstrates the difficulty in applying a rigid formula of finality in the bankruptcy context.<sup>461</sup> It is for this reason that the “valid and final” judgment requirement is slightly more flexible for purposes of bankruptcy court orders.<sup>462</sup> Accordingly, the Federal Rules of Bankruptcy Procedure afford bankruptcy courts discretion to grant an appeal taken by leave of court.<sup>463</sup> Given this “flexible” standard, a final judgment does not have to dispose of all matters involved in a bankruptcy proceeding in order to have a preclusive effect.<sup>464</sup> This flexibility is especially important because it provides finality to bankruptcy court orders for purposes of appeal or preclusion prior to the disposition of the entire case, which may take years.<sup>465</sup> Although the concept of finality “still suffers from a lack of clarity”<sup>466</sup> in the bankruptcy context, the Seventh Circuit has noted that:

While perhaps a contradiction in terms, the concept of flexible finality is based both on the traditional approach to bankruptcy

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459. *Id.* at 1691-92.

460. *Id.*

461. *Id.* at 1692 (citing 11 U.S.C. § 158(a) (2012)).

462. The “valid and final” judgment requirement is also more flexible in an issue preclusion analysis than it is under a claim preclusion analysis. *See Klein, supra* note 1, at 853; *cf. supra* Part I.

463. FED. R. BANKR. P. 8001(b); *see also* 28 U.S.C. § 158(a)(3) (2012).

464. *Pye v. Dep’t of Transp. of Ga.*, 513 F.2d 290, 292 (5th Cir. 1975); *Guion v. Sims (In re Sims)*, 479 B.R. 415, 421 (Bankr. S.D. Tex. 2012).

465. Additionally, a bankruptcy court order may be considered a “valid and final” judgment even if such order is pending on appeal. *See In re Sims*, 479 B.R. at 421 (citing *Pye*, 513 F.2d at 292); *cf. S.P. Auto Sales, Inc. v. Benites (In re Benites)*, No. 11-35444-SGJ-7, 2012 WL 4793469, at \*1 (Bankr. N.D. Tex. Oct. 9, 2012).

466. *In re Comdisco, Inc.*, 538 F.3d 647, 651 (7th Cir. 2008).

proceedings and the commonsense understanding that the breadth of bankruptcy cases necessitates an approach that allows for the efficient resolution of certain discrete disputes that may arise in a given bankruptcy.<sup>467</sup>

The importance of this initial element of an issue preclusion argument should not be overlooked. Indeed, failing to properly establish whether a “valid and final” judgment exists could be detrimental to a practitioner’s argument. Therefore, when developing an issue preclusion argument, practitioners should be mindful of the flexible nature of bankruptcy court orders and tailor their arguments accordingly. Moreover, as is often argued, practitioners should be mindful of the overlay of powers available under § 105(a) of the Code for a court to fashion equitable relief.<sup>468</sup>

### 3. *The Litigation Requirement*

Inherent to the doctrine of issue preclusion is the requirement that an individual be afforded the opportunity to be heard prior to the rendering of a judgment to which he or she may later be bound. Thus, as a matter of practice, certain judgments will not support the application of issue preclusion in subsequent litigation because the issues were never “actually litigated” in the first place.<sup>469</sup>

While an issue need not be thoroughly litigated to satisfy this requirement, a showing must be made that “the parties disputed the issue and the trier of fact resolved it.”<sup>470</sup> This determination may seem like a formality at first blush, but this term of art has been interpreted and applied differently depending on the jurisdiction. Indeed, the litigation requirement has become particularly relevant in circumstances when an issue of fact or law has been previously waived or when addressing judgments previously entered by confession, consent, or default.

#### a) *Waiver*

Waiver is a developing topic within the “actually litigated” requirement. In *Clark v. Zwanziger (In re Zwanziger)*, the Tenth Circuit considered the “novel question” of whether a bankruptcy court must give preclusive effect to a district court’s final determination that a party waived an issue.<sup>471</sup> In

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467. *In re McKinney*, 610 F.3d 399, 402 (7th Cir. 2010).

468. 11 U.S.C. § 105(a) (2012).

469. Klein, *supra* note 1, at 854.

470. *Gambino v. Koonce*, 757 F.3d 604, 608 (7th Cir. 2014) (quoting *Harmon v. Gordon*, 712 F.3d 1044, 1055 n.4 (7th Cir. 2013)).

471. 741 F.3d 74, 75 (10th Cir. 2014).

that case, plaintiffs sued their former employer for fraud and violations of certain state wage laws and requested additional damages for emotional distress.<sup>472</sup> The plaintiffs' included their request for damages based on emotional distress in their complaint but failed to list such damages in the final pretrial order.<sup>473</sup> Notwithstanding the omission, the jury ruled in favor of plaintiffs and ultimately awarded them a combined sum of \$573,000.<sup>474</sup>

On appeal, the Tenth Circuit affirmed the jury's verdict on liability, but held that the plaintiffs waived their right to damages for emotional distress by failing to include them in the pretrial order.<sup>475</sup> In so holding, the court noted that it could not determine what portion of the award was attributable to damages for emotional distress and remanded the case back to the district court to re-calculate damages.<sup>476</sup> Before the district court could recalculate damages, the defendant filed for chapter 7 bankruptcy.<sup>477</sup> Shortly thereafter, the plaintiffs filed an adversary in the defendant-debtor's bankruptcy case to determine how much of the liability was nondischargeable.<sup>478</sup>

The bankruptcy court determined that it was not bound by the remand instructions and awarded plaintiffs \$181,300 in nondischargeable damages of which \$50,000 was attributable to damages for emotional distress.<sup>479</sup> The defendant-debtor appealed to the Bankruptcy Appellate Panel (BAP) arguing that claim preclusion prevented the bankruptcy court from including damages for emotional distress.<sup>480</sup> The BAP determined that the issue of whether plaintiffs waived emotional distress damages was fully and finally litigated in the circuit court and therefore binding on any subsequent court.<sup>481</sup> On appeal, the Tenth Circuit reversed the BAP decision and held that "[a] finding that an issue of fact or law is waived *is not* a decision on the merits" and therefore not afforded preclusive effect in a subsequent case.<sup>482</sup>

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472. *Id.* at 76.

473. *Id.*

474. *Id.*

475. *Id.* (citing *Hamilton v. Water Whole Int'l Corp.*, 302 F. App'x 789, 797 (10th Cir. 2008) ("[D]amages not included in the pretrial order are waived even if they appeared in the complaint.")).

476. *Id.*

477. *Id.*

478. *Id.*

479. *Id.*

480. *Id.* The BAP held that claim preclusion did not apply, but determined that issue preclusion did. *Id.*

481. *Id.*

482. *Id.* at 77 (emphasis added).

Although the case law is scant, *Zwanziger* represents a logical approach to the preclusive nature of a prior court's determination that a party waived his or her argument. That is, "[w]here there has been no hearing [on the merits], and therefore no findings, there can be no issue preclusion."<sup>483</sup> Thus, "waiver as a general matter is a procedural determination that governs only the case in which it is made—not another case—except in the rare instance when waiver is imposed as a sanction intended to preclude future litigation of that substantive issue."<sup>484</sup>

*b) Settlement Agreements and Consent Judgments*

Compared to the evolving authority on waiver, settlement agreements and consent judgments are typically favored by courts as a means of resolving costly disputes. Indeed, such agreed decisions are "useful device[s] to resolve disputes and are as much of an adjudication for purposes of applying the principle of judgment preclusion as any other final judgment."<sup>485</sup> Courts will often look to the intent of the parties to determine whether such agreement or judgment should be afforded preclusive effect.<sup>486</sup> Thus, to attain preclusive effect, settlement agreements and consent judgments must also satisfy the "actually litigated" requirement.

The majority of courts have held that an agreed judgment is afforded the same preclusive effect that a judgment on the merits entered at the end of a trial is afforded.<sup>487</sup>

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483. *Id.* at 78 (quoting *Borges Colon v. Roman-Abreu*, 438 F.3d 1, 19 (1st Cir. 2006)).

484. *Id.* (citing *Melnor, Inc. v. Corey (In re Corey)*, 583 F.3d 1249, 1252 (10th Cir. 2009)).

485. *Bowers v. Bd. of Appeals*, 448 N.E.2d 1293, 1296 (Mass. App. Ct. 1983).

486. *Blacksmith Invs., Inc. v. Woodford (In re Woodford)*, 418 B.R. 644, 652 (B.A.P. 1st Cir. 2009) ("[W]hen considering a consent judgment founded upon an agreement of the parties, the court must examine the issue of 'intention' when determining whether the 'actually litigated' requirement of [issue preclusion] has been fulfilled.").

487. *Plunk v. Yaquinto, Jr. (In re Plunk)*, 481 F.3d 302, 308 (5th Cir. 2007) (stating that agreed judgments in Texas have the same degree of finality and binding force as judgments reached at the end of adversary proceedings); *Diamond Fields, L.L.C. v. Rankin Cnty.*, No. 3:09-CV-00451, 2011 WL 8198518, at \*6 (S.D. Miss. Sept. 30, 2011) ("[C]onsent judgments receive the same force as regular judgments, in binding parties under [issue preclusion]."); *Chaisson v. Cent. Crane Serv.*, 2010-0112, p. 5 (La. App. 1 Cir. 7/29/10); 44 So.3d 883, 886 (noting that while the doctrine of issue preclusion is ordinarily premised on a final judgment on the merits, it also applies where the opposing parties enter into a compromise or settlement of a disputed matter).

*c) Traditional v. Post-Answer Default Judgments*

The preclusive effect of a default judgment generally hinges on the parties' level of participation in the initial lawsuit that gave rise to the default judgment. A traditional default judgment contains no specific findings but simply an unopposed judgment. In most jurisdictions, such a naked default judgment does not satisfy the "actually litigated" requirement. Indeed, the majority of courts have held that a traditional default judgment lacks the "actually litigated" prong because it is not a "judgment on the merits" and therefore has no preclusive effect on subsequent hearings.<sup>488</sup>

Despite this majority position, a bankruptcy court may be forced to reach a different result where the underlying state law dictates that a traditional default judgment has preclusive effect. Some state appellate courts have suggested that a default judgment "imports absolute verity, and is as effectual and binding as if pronounced upon a trial upon the merits."<sup>489</sup> Courts following this approach place less emphasis on whether an issue was "actually litigated" and instead focus on whether a default judgment constitutes a final judgment on the merits.<sup>490</sup>

Post-answer default judgments are less controversial. Courts generally afford preclusive effect to a post-answer default judgment. For example, in *Harrison v. Kiwi Services, Inc.*, the Fifth Circuit held that issue preclusion was proper "where the defendant's answer places the merits of the plaintiff's cause of action at issue, where judgment cannot be entered on the pleadings, and therefore, where a plaintiff in such a case must offer evidence to prove his case is more than just a garden variety default judgment."<sup>491</sup> In fact, the majority of courts agree that a post-answer default

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488. See, e.g., *Gessin v. Taitano (In re Gessin)*, Nos. 12-1330-JuKiD, NV-11-51818, 2013 WL 829095, at \*5-6 (B.A.P. 9th Cir. Mar. 4, 2013) (noting that default judgments are generally not entitled to preclusive effect). But see *Clarke v. Latimer (In re Latimer)*, No. 14-0004, 2014 WL 2441469, at \*2 (Bankr. D. Haw. May 29, 2014) (noting that Idaho law gives preclusive effect to unopposed default judgments); *Voss v. Pujdak (In re Pujdak)*, 462 B.R. 560, 568-69 (Bankr. D.S.C. 2011).

489. *TransDulles Ctr., Inc. v. Sharma*, 472 S.E.2d 274, 276 (Va. 1996) (quoting *Neale v. Utz*, 75 Va. 480, 488 (1881)); see also *Jackson v. R.G. Whipple, Inc.*, 627 A.2d 374, 379 (Conn. 1993).

490. *Dominquez v. Elias (In re Elias)*, 302 B.R. 900, 912 (Bankr. D. Idaho 2003) (quoting *Olson v. Kirkham*, 720 P.2d 217, 220 (Idaho 1986)).

491. 180 F. App'x 485, 487 (citing *Garner v. Lehrer (In re Garner)*, 56 F.3d 677, 680 (5th Cir. 1995), *abrogated on other grounds by Kawaauhau v. Geiger*, 523 U.S. 57 (1998)).

judgment should be afforded preclusive effect.<sup>492</sup> When the default occurs post-answer, the litigant has engaged the judicial process sufficiently to invoke the “fully and fairly litigated” prong.<sup>493</sup>

#### 4. Same Facts and Legal Standard

In addition to a “valid and final” judgment, that was “actually litigated” in a prior hearing, the underlying facts and legal standard used to assess those facts must be the same in both proceedings for an issue to be afforded preclusive effect.<sup>494</sup> Thus, while the underlying factual setting in both matters may be the same, if the legal standard to be applied is different in each, the issues are not identical and issue preclusion should not apply.<sup>495</sup> Most courts appear to agree with the underlying rule, although some courts are stricter than others in its application.

A prior court’s determination regarding a defendant’s liability (or, in a criminal proceeding, culpability) stemming from a cause of action or charge will not result in per se preclusivity, regardless of whether the underlying cause of action is identical in name to one that appears in the Code (e.g., fraud, embezzlement, or larceny).<sup>496</sup> Indeed, bankruptcy courts within the Fifth Circuit have consistently applied a narrow interpretation of certain elements and causes of action.<sup>497</sup>

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492. *Gamble-Ledbetter v. Andra Grp., L.P.* (*In re Gamble-Ledbetter*), 419 B.R. 682, 694 (Bankr. E.D. Tex. 2009) (holding that a consent or agreed judgment is effectively a written agreement and adjudication of an issue between parties and is as conclusive as any other judgment); *Gilleyn v. Evans* (*In re Evans*), 252 B.R. 366, 371 (Bankr. N.D. Miss. 2000) (“In Mississippi, the application of the doctrine of [issue preclusion] can clearly be predicated on a previous default judgment.”); *Crain v. Limbaugh* (*In re Limbaugh*), 155 B.R. 952, 956 (Bankr. N.D. Tex. 1993).

493. *In re Limbaugh*, 155 B.R. at 955–57.

494. *Fin. Acquisition Partners L.P. v. Blackwell*, 440 F.3d 278, 284 (5th Cir. 2006); *see also Grogan v. Garner*, 498 U.S. 279, 288–91 (1991).

495. *Grogan*, 498 U.S. at 284–85 (noting that if a clear-and-convincing standard, and not a preponderance-of-the-evidence standard, is applied in nondischargeability proceedings, “the prior judgment could not be given collateral estoppel effect”); *S.P. Auto Sales, Inc. v. Benites* (*In re Benites*), No. 11-35444-SGJ-7, 2012 WL 4793469, at \*1 n.4 (Bankr. N.D. Tex. Oct. 9, 2012) (citing *RecoverEdge L.P. v. Pentecost*, 44 F.3d 1284, 1291 (5th Cir. 1995)).

496. *Gupta v. E. Idaho Tumor Inst., Inc.* (*In re Gupta*), 394 F.3d 347, 349–50 (5th Cir. 2004) (holding that a bankruptcy court may apply preclusion to findings relevant to dischargeability, but the ultimate determination of whether a debt is dischargeable, is a federal question).

497. *See, e.g., Guerra & Moore Ltd., L.L.P. v. Cantu* (*In re Cantu*), 389 F. App’x 342, 345 (5th Cir. 2010) (“Despite similarities in the language used to describe an injury under [s]ection 523(a)(6) and intentional torts, [s]ection 523(a)(6) creates a narrower category of

Issue preclusion may also not apply when a prior court fails to designate the legal standard used to determine the underlying judgment. At least one bankruptcy court has declined to apply preclusion of a state court judgment because the state court did not specifically list findings of fact or which legal standard was used to support a judgment.<sup>498</sup> Such a conclusion is logical because the later court cannot discern whether the earlier court determined if even a minimal burden was satisfied.

What make less sense are the decisions where the earlier court applied a higher legal standard. While it would seem logical for a court to give deference to a prior court's decision that was determined using a higher burden of proof than is needed in a subsequent proceeding, the results have been mixed. Several courts have concluded that a prior judgment decided by a higher legal standard may not satisfy a strict interpretation of the "same legal standard" test in a subsequent proceeding.<sup>499</sup>

Therefore, creditors' attorneys should fully investigate both the facts and legal standard used to determine whether a prior judgment may preclude a debtor from re-litigating facts that may be helpful to attaining a nondischargeable debt. Debtors' attorneys or trustees would be served by scrutinizing prior judgments to look for broad interpretations and differing standards of law.

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tortious conduct.") (quoting *Williams v. Int'l Bhd. of Elec. Workers Local 520 (In re Williams)*, 337 F.3d 504, 509 (5th Cir. 2003)); *see also* *Miller v. J.D. Abrams Inc. (In re Miller)*, 156 F.3d 598, 602 (5th Cir. 1998) ("While the definition of 'fiduciary' under § 523(a)(4) is controlled by federal common law rather than Texas law, it is clear that the federal common law definition is even narrower than the Texas definition.").

498. *In re Benites*, 2012 WL 4793469, at \*1 ("[S]ince there were no findings or reasoning whatsoever set forth in the State Court Judgment . . . there was no basis to allow the court to conclude, as a matter of law, that the State Court Judgment was nondischargeable . . .").

499. *See, e.g.*, *AT&T Mobility L.L.C. v. Prince (In re Prince)*, No. 09-43627, 2011 WL 861114, at \*3 (Bankr. E.D. Tex. Mar. 9, 2011) (finding that application of the issue preclusion doctrine was warranted when a prior court found fraud using a "beyond a reasonable doubt" standard while bankruptcy proceedings, in contrast, only require the lower standard of preponderance of evidence). *Cf.* *Knott v. Donahoe*, No. 3:11-CV-00256-CWR-FKB, 2011 WL 6399920, at \*3 n.29 (S.D. Miss. Dec. 20, 2011) ("[T]here is a different burden of proof (beyond a reasonable doubt) in the criminal proceeding from the burden of proof (preponderance) to be employed in these civil proceedings resulting from the instant Complaint. That fact alone precludes the application of the doctrine of collateral estoppel.") (citing *Lanier v. Oktibbeha Cnty. Hosp.*, No. CIV.A.1:95CV206-D-D, 1996 WL 671361, at \*4 n.7 (N.D. Miss. Sept. 26, 1996)).

### 5. *The Facts Were Essential to the Prior Judgment*

In addition to being the same facts as in the earlier judgment, the facts must also have been essential to the outcome of the earlier judgment. A subsequent judgment would expand the holding of an earlier judgment if preclusive effect were given to dicta and other irrelevant facts. Courts have historically required a clear and coherent holding from the prior court for such judgment to be afforded preclusive effect.<sup>500</sup> This substantive evaluation usually amounts to a fact-specific determination made by the reviewing court.

Such determinations may become increasingly complex where both a civil and criminal proceeding predate the bankruptcy court's determination of whether a debt is nondischargeable. The decision in *Fitch v. Fitch (In re Fitch)* provides an interesting example.<sup>501</sup> There, the bankruptcy court had to determine whether to afford preclusive effect to a no-answer default judgment or a criminal restitution order in a nondischargeability proceeding brought under 11 U.S.C. § 523(a)(4) and (7).<sup>502</sup>

The facts in *Fitch* are relatively straightforward. The debtor-defendant entered into agreement to sell his late mother's house for \$150,000 to a company owned by his business partner.<sup>503</sup> Around the same time, the business partner contracted to sell the house to a third party for \$275,000.<sup>504</sup> Both transactions closed on January 7, 1997.<sup>505</sup> Almost three years later, in August 2000, the brother of the debtor-defendant became guardian of his late-mother's estate (the Guardian) and sued the debtor-defendant in probate court over the house transactions alleging fraud and breach of fiduciary duty.<sup>506</sup> The debtor-defendant failed to respond, and the probate court entered a no-answer default judgment in favor of the plaintiff.<sup>507</sup> In doing so, the probate court awarded damages for breach of fiduciary duties,

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500. *Tex. Pig Stands, Inc. v. Hard Rock Cafe Int'l, Inc.*, 951 F.2d 684, 691 (5th Cir. 1992) (declining to give preclusive effect to a prior decision that "wallows in a pig sty of confusion"); *see also* *Olstowski v. Petroleum Analyzer Co., L.P. (In re ATOM Instrument Corp.)*, 478 B.R. 252, 261 (Bankr. S.D. Tex. 2012) (holding that where there are alternative plausible bases for a prior decision, issue preclusion will not bar the relitigation of the same).

501. 349 B.R. 133 (Bankr. N.D. Tex. 2006).

502. *Id.* at 135-36.

503. *Id.* at 136. Prior to her death, the mother of the debtor-defendant had executed a power of attorney appointing the debtor-defendant as her agency with respect to the mother's property, including her house. *Id.*

504. *Id.*

505. *Id.*

506. *Id.*

507. *Id.*



constructive fraud, and statutory fraud (the Default Judgment).<sup>508</sup> Shortly thereafter, the State of Texas brought a criminal complaint against the debtor-defendant relating to the house transactions.<sup>509</sup> As part of a plea bargain, the debtor-defendant pled guilty to second-degree theft and was ordered to pay \$150,000 in restitution (the Restitution Order).<sup>510</sup>

Two years after the Restitution Order, the debtor-defendant filed for chapter 7 bankruptcy, listing the Default Judgment as being contingent and of an unknown amount.<sup>511</sup> The Guardian-brother filed an adversary proceeding on behalf of his mother's estate to declare the Default Judgment to be non-dischargeable.<sup>512</sup> The Guardian filed a motion for summary judgment, arguing that the debtor-defendant's guilty plea to second degree theft "involved the same conduct which formed the basis" for the damages awarded in the Default Judgment.<sup>513</sup> Thus, the Guardian argued, the finding of second-degree theft was equivalent to common law larceny in federal courts, which is nondischargeable under 11 U.S.C. § 523(a)(4).<sup>514</sup>

Effectively, the Guardian attempted to bolster the Default Judgment with the Restitution Order to bootstrap his § 523(a)(4) claim.<sup>515</sup> But the bankruptcy court segregated the two earlier judgments and analyzed them separately.<sup>516</sup> While controversy existed as to whether the Restitution Order was "actually litigated," the bankruptcy court declined to afford the Default Judgment preclusive effect.<sup>517</sup> Breach of fiduciary duty, constructive fraud, and statutory fraud all require different elements than the criminal charge to which the debtor-defendant pled guilty.<sup>518</sup> As a result, the Guardian could not demonstrate that the elements of larceny under § 523(a)(4) were essential to the probate court's findings of fraud and breach of fiduciary duty.<sup>519</sup> Accordingly, the Default Judgment—aside from being a no-answer

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508. *Id.*

509. *Id.* at 136-37.

510. *Id.* at 137.

511. *Id.*

512. *Id.* at 137-38.

513. *Id.* at 137-39.

514. *Id.* at 138.

515. *Id.* at 136.

516. *Id.* at 136-38.

517. *Id.* at 141-42.

518. *Id.* at 143.

519. *Id.*

default judgment—had no preclusive effect with respect to fraud for the purpose of dischargeability.<sup>520</sup>

*Fitch* demonstrates several critical steps in the preclusion analysis. First, the decision shows that a prior judgment cannot be used to establish the preclusive effect of a subsequent judgment without a showing that the facts are essential to the court's determination of the second judgment. Second, the analysis shows the difficulty of aligning fraud elements under state law and federal law concerning dischargeability. And, finally, although not directly on-point, the decision also demonstrates a situation where a criminal judgment (the Restitution Order) may provide grounds for a subsequent nondischargeability action, assuming the elements align and the court will afford preclusive effect to the higher burden of proof.

As to this second lesson from *Fitch*—the difficulty of aligning elements under state and federal law—a line of cases under § 523(a)(6) provides another example. Section 523(a)(6) of the Code excepts from discharge any debt for “willful and malicious injury by [a] debtor to another entity or to the property of another entity.”<sup>521</sup> The Supreme Court has defined a “willful” injury as “a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury.”<sup>522</sup> The authority has split as to what level of culpability *Geiger* requires under § 523(a)(6).<sup>523</sup>

The split of authority turns on from whose perspective “willful and malicious” is adjudged. The Sixth and Tenth Circuits have interpreted *Geiger* to require a subjective standard—that is, the debtor “must have wished to cause injury or at least believed it was substantially certain to

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520. *Id.* Ultimately, the parties agreed that the Restitution Order was non-dischargeable. *Id.* at 138. The bankruptcy court held that the mother's estate was entitled to recover the \$150,000 under the Restitution Order. *Id.* at 143.

521. 11 U.S.C. § 523(a)(6) (2012).

522. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998).

523. *Compare* *Via Christi Reg'l. Med. Ctr. v. Englehart* (*In re Englehart*), No. 99-3339, 2000 WL 1275614, at \*3 (10th Cir. Sept. 8, 2000) (adopting a subjective standard); *Markowitz v. Campbell* (*In re Markowitz*), 190 F.3d 455, 465 n.10 (6th Cir. 1999) (same); *Johnson v. Davis* (*In re Davis*), 262 B.R. 663, 670-71 (Bankr. E.D. Va. 2001) (same); and *KMK Factoring, L.L.C. v. McKnew* (*In re McKnew*), 270 B.R. 593, 634-41 (Bankr. E.D. Va. 2001) (same); *with* *Miller v. J.D. Abrams Inc.* (*In re Miller*), 156 F.3d 598, 606 (5th Cir. 1998), *cert. denied*, 526 U.S. 1016 (1999) (adopting an objective standard); *Baldwin v. Kilpatrick* (*In re Baldwin*), 245 B.R. 131, 136 (B.A.P. 9th Cir. 2000) (same); and *J. Bowers Constr. Co. v. Williams* (*In re Williams*), 233 B.R. 398, 405 (Bankr. N.D. Ohio 1999) (same); *see also* RESTATEMENT (SECOND) OF TORTS § 8A (1965) (adopting a subjective standard).

occur.”<sup>524</sup> By contrast, the Fifth Circuit has adopted a lesser standard, requiring only that the injury have been made with “either an objective substantial certainty of harm or a subjective motive to cause harm.”<sup>525</sup> Thus, “[t]he key difference between the *Miller* and *Markowitz* holdings is that *Markowitz* followed the Restatement’s requirement that the debtor *believe* that his actions will with substantial certainty cause injury, while in *Miller* the subjective belief of the debtor as to the certainty of the harm was not controlling.”<sup>526</sup>

The difficulty with aligning the elements required by fraud under state law and under § 523(a)(6) comes from this circuit split. For example, consider the common interaction between a state court judgment of fraud under the Texas Deceptive Trade Practices Act (DTPA)<sup>527</sup> and § 523(a)(6).<sup>528</sup> The DTPA includes a so-called “laundry list” of fraudulent actions that include “[f]alse, misleading, or deceptive acts or practices in the conduct of any trade or commerce . . . .”<sup>529</sup> Moreover, the DTPA defines “intentionally” as “actual awareness of the falsity, deception, or unfairness of the act or practice . . . coupled with the specific intent that the consumer act in detrimental reliance on the falsity or deception or in detrimental ignorance of the unfairness.”<sup>530</sup> And intentionality may be inferred by objective circumstances.<sup>531</sup>

Despite the specificity of these state statutes, it is still possible even in the Fifth Circuit that the objective-intent paradigm for interpreting *Geiger* from *Miller* represents an independent element. That result is likely even more secure under a state following the *Markowitz* or subjective-intent standard of *Geiger*. As a result, even a valid and final state court judgment in which the DTPA was actually litigated, and which turned on the same facts and legal standard, may not itself establish fraud under § 523(a)(6).

#### 6. Mutuality of Parties

Generally, if all the other elements of issue preclusion are met, mutuality is not required. In such situations, the parties need not have been

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524. *In re Englehart*, 2000 WL 1275614, at \*3 (citing *In re Markowitz*, 190 F.3d at 465 n.10).

525. *In re Miller*, 156 F.3d at 606.

526. *Su v. Carrillo (In re Su)*, 259 B.R. 909, 913 (B.A.P. 9th Cir. 2001).

527. TEX. BUS. & COM. CODE ANN. §§ 17.41-17.63 (West 2013).

528. 11 U.S.C. § 523(a)(6) (2012).

529. TEX. BUS. & COM. CODE ANN. § 17.46(a).

530. *Id.* § 17.45(13).

531. *Id.*

adversaries in a previous cause of action for an issue to be precluded from re-litigation in a subsequent cause of action. Indeed, under the approach of the Restatement (Second) of Judgment approach, the application of issue preclusion does not require strict mutuality of parties.<sup>532</sup> Not all courts agree with the relaxed standard proposed by the Restatement (Second) of Judgments.

In *Taylor v. Sturgell*, the Supreme Court held that federal common law does not extend the preclusive effect of a judgment to a non-party in a subsequent case.<sup>533</sup> In so holding, the Court determined that “one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process.”<sup>534</sup> The Court noted that the application of issue preclusion to non-parties “runs up against the ‘deep-rooted historic tradition that everyone should have his own day in court.’”<sup>535</sup> Nonetheless, the rule against nonparty preclusion is subject to recognized exceptions that can be grouped into six categories.

First, “[a] person who agrees to be bound by the determination of issues in an action between others is bound in accordance with the terms of his agreement.”<sup>536</sup>

Second, nonparty preclusion may be justified based on a variety of pre-existing “substantive legal relationship[s]” between the person to be bound and a party to the judgment.<sup>537</sup>

Third, we have confirmed that, “in certain limited circumstances,” a nonparty may be bound by a judgment because she was “adequately represented by someone with the same interests who [wa]s a party” to the suit.<sup>538</sup>

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532. RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1982).

533. 553 U.S. 880, 893 (2008).

534. *Id.* (quoting *Hansberry v. Lee*, 311 U.S. 32, 40 (1940)).

535. *Id.* at 892-93 (quoting *Richards v. Jefferson Cnty.*, 517 U.S. 793, 798 (1996)).

536. *Id.* at 893 (alteration in original) (quoting RESTATEMENT (SECOND) OF JUDGMENTS § 40). A common example of binding parties by agreement is where two different plaintiffs sue a common defendant, and the parties all agree that the defendant’s liability, if any, will be determined by one of the cases. *Id.*

537. *Id.* at 894 (alteration in original) (quoting DAVID L. SHAPIRO, CIVIL PROCEDURE: PRECLUSION IN CIVIL ACTIONS 75-92 (2001)).

538. *Id.* at 894 (alteration in original) (quoting *Richards*, 517 U.S. at 798). This exception binds parties in privity with one another, such as binding the ward or beneficiary of the trust

Fourth, a nonparty is bound by a judgment if she “assume[d] control” over the litigation in which that judgment was rendered.<sup>539</sup>

Fifth, a party bound by a judgment may not avoid its preclusive force by relitigating through a proxy.<sup>540</sup>

Sixth, in certain circumstances a special statutory scheme may “expressly foreclos[e] successive litigation by nonlitigants . . . if the scheme is otherwise consistent with due process.”<sup>541</sup>

When determining the preclusive effect of a state court judgment, bankruptcy courts must look to the underlying state law regarding mutuality. In this regard, most states have held that, unlike claim preclusion, issue preclusion does not require strict mutuality of parties.<sup>542</sup> Although strict mutuality may not be required, the party asserting issue preclusion must have been in privity with the adverse party in the prior action for the doctrine to apply.<sup>543</sup> Privity may be established between two parties where the subsequent party (1) controlled the first action if she was not a party to it, (2) had her interest represented by a the earlier party’s actions, or (3) was a successor-in-interest to the earlier party.<sup>544</sup>

Practitioners should be aware that while the Fifth Circuit will apply the relaxed rule outlined in the Restatement (Second) when determining mutuality of parties arising from a federal judgment, state courts might be less permissive.

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when the guardian or trustee litigates an issue in his official capacity. *Richards*, 517 U.S. at 798.

539. *Taylor*, 553 U.S. at 895 (quoting *Montana v. United States*, 440 U.S. 147, 154 (1979)).

540. *Id.* Related to third exception, this fifth exception binds the principal where the agent litigated as the principal’s proxy. *Id.*

541. *Id.* (quoting *Martin v. Wilks*, 490 U.S. 755, 762 n.2 (1989), *superseded by statute as stated in Landgraf v. USI Film Prods.*, 511 U.S. 244 (1994)).

542. *See, e.g.*, *Livingston v. Transnation Title Ins. Co. (In re Livingston)*, 372 F. App’x 613, 617 (6th Cir. 2010) (“Michigan courts have instructed that an issue ‘must be identical to that determined in the prior action’ to have been actually litigated.”); *Vines v. Univ. of La. at Monroe*, 398 F.3d 700, 705 (5th Cir. 2005) (citing *Terrell v. DeConna*, 877 F.2d 1267, 1270 (5th Cir. 1989)).

543. *Vines*, 398 F.3d at 705; *Limon v. Berryco Barge Lines, L.L.C.*, 779 F. Supp. 2d 577, 583 (S.D. Tex. 2011).

544. *Fitch v. Fitch (In re Fitch)*, 349 B.R. 133, 141 (Bankr. N.D. Tex. 2006) (citing *McCoy v. Hernandez*, 203 F.3d 371, 379 (5th Cir. 2000)).

C. A “New” Problem Potentially Plaguering the Preclusive Effect of Bankruptcy Court Orders

A corollary issue to the “valid and final judgment” element of issue preclusion may be brewing following the Supreme Court’s decisions in *Stern v. Marshall*<sup>545</sup> and *Executive Benefits Insurance Agency v. Arkison*.<sup>546</sup> We note pejoratively that this problem is “new.” *Stern* and *Executive Benefits* are the latest in a line of cases from the Supreme Court spanning over three decades, beginning in 1982 with *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,<sup>547</sup> that limit the constitutional authority of bankruptcy courts following congressional overreach. In *Stern*, the Court identified one type of proceeding—and implicated others—over which bankruptcy courts have statutory subject-matter jurisdiction but lack constitutional final-order authority.<sup>548</sup> The relevant statute authorized the bankruptcy court to enter a final order whereas the Constitution reserved such final-order authority for a judge clothed in Article III powers.<sup>549</sup>

A slew of decisions following the decision coined such situations “*Stern* claims.” The Court adopted the moniker in *Executive Benefits* and provided a temporary field dressing to bandage the constitutional infirmity.<sup>550</sup> But the potential problem arises when a court must decide whether a bankruptcy court’s final order in a *Stern* claim merits preclusive effect in a subsequent case. After all, as the district court in *Kirschner v. Agoglia* observed,

If there is no appeal, the [bankruptcy court’s] grant of the motion to dismiss for failure to state a claim is a final judgment dismissing the claim and is given [claim preclusion] and [issue preclusion] effect. But this cannot be proper unless the bankruptcy court had the power to render final judgment in the first place.<sup>551</sup>

This section explores that dilemma and the potential cure posed most recently by the Supreme Court’s decision in *Wellness International Network, Ltd. v. Sharif*.<sup>552</sup>

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545. 131 S. Ct. 2594 (2011).

546. 134 S. Ct. 2165 (2014).

547. 458 U.S. 50 (1982).

548. *Stern*, 131 S. Ct. at 2608.

549. *Id.*

550. *Exec. Benefits*, 134 S. Ct. at 2172.

551. 476 B.R. 75, 79 (S.D.N.Y. 2012) (citations omitted).

552. 135 S. Ct. 1932 (2015).

### 1. From the 1978 Amendments to Stern

To explore the problem, an overview is necessary of the statutory and constitutional issues and the direction provided in *Stern*, *Executive Benefits*, and *Wellness International*.<sup>553</sup> Article III of the U.S. Constitution vests “the judicial Power of the United States” in judges with salary protection and life tenure.<sup>554</sup> Federal district courts are empowered under Article III; bankruptcy courts are created pursuant to Congress’s powers “[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.”<sup>555</sup> Without guaranteed protections as to his salary and tenure, a bankruptcy judge’s ability to exercise “the judicial Power of the United States” is limited to those matters that lie “at the core of federal bankruptcy power.”<sup>556</sup>

As Congress bears the responsibility for enacting bankruptcy laws, Congress causes an authority problem by over-allocating authority to bankruptcy courts. For example, in *Northern Pipeline*, the Court struck down the allocation of authority between the district and bankruptcy courts

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553. For a more in-depth discussion of the constitutional authority of bankruptcy courts, see Ralph Brubaker, A “Summary” *Statutory and Constitutional Theory of Bankruptcy Judges’ Core Jurisdiction After Stern v. Marshall*, 86 AM. BANKR. L.J. 121 (2012); Timothy S. Springer, *Two and a Half Hurdles Between Eurozone Debts and U.S. Courts: How Recent Distressed Foreign Deals Could Soon Be Unwound Domestically*, 38 BROOK. J. INT’L L. 1109 (2013); Omar J. Alaniz, *A Survey of Cases Interpreting the Stern Decision*, BANKR. LITIG. (ABA Bankr. & Insolvency Litig. Comm.), Winter 2012, at 2, available at <http://apps.americanbar.org/litigation/committees/bankruptcy/articles/winter2012-survey-interpreting-stern.html>; Omar J. Alaniz, *A Survey of Cases Interpreting the Stern Decision, Part II*, BANKR. LITIG. (ABA Bankr. & Insolvency Litig. Comm.), Spring 2012, at 4; Omar J. Alaniz, *A Survey of Cases Interpreting the Stern Decision, Part III*, BANKR. LITIG. (ABA Bankr. & Insolvency Litig. Comm.), Summer 2012, at 2; Omar J. Alaniz, *A Survey of Cases Interpreting the Stern Decision, Part IV*, BANKR. LITIG. (ABA Bankr. & Insolvency Litig. Comm.), Fall 2012, at 2, available at <http://apps.americanbar.org/litigation/committees/bankruptcy/articles/fall2012-1212-survey-cases-interpreting-stern-decision-part-iv.html>; Omar J. Alaniz, *A Survey of Cases Interpreting the Stern Decision, Part V*, BANKR. LITIG. (ABA Bankr. & Insolvency Litig. Comm.), Winter 2013, at 2, available at <http://apps.americanbar.org/litigation/committees/bankruptcy/articles/winter2013-0313-survey-cases-interpreting-stern-decision-part-v.html>; Omar J. Alaniz, *A Survey of Cases Interpreting Stern v. Marshall, Part VI*, BANKR. LITIG. (ABA Bankr. & Insolvency Litig. Comm.), Spring 2013, at 2, available at <http://apps.americanbar.org/litigation/committees/bankruptcy/articles/spring2013-0613-survey-cases-interpreting-stern-decision-part-vi.html>.

554. U.S. CONST. art. III, § 1.

555. U.S. CONST. art. I, § 8, cl. 4.

556. *N. Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 71 (1982) (plurality op.).

Congress had enacted in 1978.<sup>557</sup> The initial version of the Code dispensed with the former “summary/plenary” powers scheme and granted bankruptcy courts—directly and exclusively—broad jurisdiction over all matters arising under title 11 or arising in or related to cases under title 11.<sup>558</sup> These powers included final-order authority over the breach of contract claim at issue in *Northern Pipeline*, which the Court held should have been reserved for Article-III determination.<sup>559</sup> The Court stayed the effect of its ruling to give Congress two years to fix the problem.<sup>560</sup>

In response, Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA), amending title 28 of the U.S. Code to include sections 157 and 1334.<sup>561</sup> Section 1334 grants district courts “original and exclusive jurisdiction of all cases under title 11” and original, but not exclusive, jurisdiction “of all civil proceedings arising under title 11, or arising in or related to cases under title 11.”<sup>562</sup> By way of section 157, the district court may refer “any or all” bankruptcy cases and proceedings to their respective district’s bankruptcy judges.<sup>563</sup> The district court may exercise this broad authority itself, or, as is often the practice by local rule, the district court may refer this power to the bankruptcy court.<sup>564</sup> Even upon referral, the district court keeps a continuing, albeit passive, oversight role pursuant to its ability to withdraw the reference to the bankruptcy of any case or proceeding court at any time.<sup>565</sup>

Unlike the broad powers permitted in 1978, a bankruptcy court’s authority upon referral under § 157 today depends on the type of matter or

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557. *Id.* at 86-87.

558. *Id.* at 52-53; *see also* H.R. REP. NO. 95-595, at 46 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6008 (“The withdrawal from state and federal district courts of jurisdiction of the so-called plenary proceedings, when coupled with the establishment of uniform federal standards and rules . . . should eliminate a source of uncertainty and division of authority which has characterized bankruptcy law.”).

559. *N. Pipeline*, 458 U.S. at 87 (“We conclude that 28 U.S.C. § 1471, as added by § 241(a) of the Bankruptcy Act of 1978, has impermissibly removed most, if not all, of ‘the essential attributes of the judicial power’ from the Art. III district court, and has vested those attributes in a non-Art. III adjunct. Such a grant of jurisdiction cannot be sustained as an exercise of Congress’ power to create adjuncts to Art. III courts.”).

560. *Id.* at 88 (“This limited stay will afford Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication, without impairing the interim administration of the bankruptcy laws.”).

561. Pub. L. No. 98-353, §§ 101, 104, 98 Stat. 333, 333, 340-41.

562. 28 U.S.C. § 1334(a)-(b) (2006).

563. *Id.* § 157(a).

564. *Id.*

565. *Id.* § 157(d).



proceeding. Dispensing with the “summary/plenary” distinction of authority, Congress adopted the language used by the Supreme Court in *Northern Pipeline* and created “core” and “non-core” authority.<sup>566</sup> The Court in *Executive Benefits* succinctly summarized the procedural distinction between core and non-core matters and proceedings, stating:

Put simply: If a matter is core, the statute empowers the bankruptcy judge to enter final judgment on the claim, subject to appellate review by the district court. If a matter is non-core, and the parties have not consented to final adjudication by the bankruptcy court, the bankruptcy judge must propose findings of fact and conclusions of law. Then, the district court must review the proceeding *de novo* and enter final judgment.<sup>567</sup>

“Core” proceedings include “arising under” and “arising in” proceedings.<sup>568</sup> In comparison, “related to” jurisdiction exists if “*the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.*”<sup>569</sup>

Constitutional concerns arise, as in *Stern*, where § 157 authorizes a bankruptcy court to enter a final order but the Constitution does not. “*Stern* involved a dispute over a considerable inheritance, and a widow’s attempt to recover in bankruptcy court for a tort claim against her late husband’s son.”<sup>570</sup> The tort counterclaim arose neither under title 11 nor exclusively in

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566. *Id.* § 157(b)-(c); *N. Pipeline*, 458 U.S. at 71 (“But the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case.”) (emphasis added).

567. *Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2172 (2014); *see also* 28 U.S.C. § 157(c)(1) (requiring a *de novo* standard of review for a bankruptcy court’s proposed findings of fact and conclusions of law); FED. R. BANKR. P. 8013 (requiring a clear error standard of review for a bankruptcy court’s factual findings).

568. 28 U.S.C. § 157(b)(1); *Stern v. Marshall*, 131 S. Ct. 2594, 2605 (2011). “‘Arising under’ jurisdiction involves causes of action created or determined by a statutory provision of title 11. ‘Arising in’ jurisdiction is ‘not based on a right expressly created by title 11, but is based on claims that have no existence outside of bankruptcy.’” *Frisia Hartley, L.L.C. v. Wells Fargo Bank, N.A. (In re Talsma)*, 509 B.R. 535, 541 (Bankr. N.D. Tex. 2014).

569. *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 n.6 (1995) (quoting *Pacor, Inc. v. Higgins*, 743 F. 2d 984, 994 (1984)). “That state law may affect a proceeding’s resolution cannot be the sole basis by which a proceeding is excluded from the otherwise large net cast by ‘related to’ jurisdiction.” *In re Talsma*, 509 B.R. at 542 (citing 28 U.S.C. § 157(b)(3)).

570. *Springer*, *supra* note 553, at 1139. The son filed an adversary against the widow for alleged defamation, along with an attendant proof of claim for the damages, and the

cases under title 11, thus § 157(c) should have limited the bankruptcy court to proposed findings of fact and conclusions of law.<sup>571</sup> But “counterclaims by the estate against persons filing claims against the estate” is a category included in the non-exhaustive example list of core proceedings under § 157(b)(2),<sup>572</sup> so the bankruptcy court entered a final order.<sup>573</sup>

As it had in *Northern Pipeline*, the Court held the offending authority statute unconstitutional, although limiting its decision to § 157(b)(2)(C).<sup>574</sup> While the core/non-core labels allocated statutory authority, the Court distilled the constitutional authority to “the question [of] whether the action at issue stems from the bankruptcy [case] itself or would necessarily be resolved in the claims allowance process.”<sup>575</sup>

## 2. *From Stern to Executive Benefits*

The Court provided little guidance beyond saying the decision was limited. As a result, “the maelstrom surrounding *Stern* . . . created considerable consternation among bankruptcy courts and practitioners trying to grapple with [the decision’s] implications.”<sup>576</sup> Among the many questions left after the decision was the question of this section: What of the final orders already in place in *Stern* claims? Could a bankruptcy court’s final order in a *Stern* claim—that is, one in which the Constitution denies a bankruptcy court final-order authority—be considered valid and due preclusive effect in subsequent proceedings? And what about consent, whether express or implied by litigation conduct? Section 157(c)(2) authorizes a bankruptcy court to enter a final order in a “related to” proceeding with the consent of all parties.<sup>577</sup> Does the consent of the parties elucidate a navigable path around the constitutional concerns identified by *Stern* and its progeny?

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bankruptcy estate counterclaimed for tortious interference with a gift. *Stern*, 131 S. Ct. at 2601.

We underplay the trappings of the *Stern* facts by using generic terms of “widow” and “son.” Vickie Lynn Marshall, the widow, was known to the public as Anna Nicole Smith. *Id.* at 2601. The *Stern* decision was the second by the Supreme Court in the saga, much of which was publicized in the tabloids as well as the Supreme Court Reporter. *See* Marshall v. Marshall, 547 U.S. 293, 300-05 (2006).

571. *See* 28 U.S.C. § 157(c)(1).

572. *Id.* § 157(b)(2)(C).

573. *Stern*, 131 S. Ct. at 2602.

574. *Id.* at 2619-20.

575. *Id.* at 2618.

576. Springer, *supra* note 553, at 1141.

577. 28 U.S.C. § 157(c)(2).

The problem is not limited to final orders pursuant to § 157(b)(2)(C), but rather all claims potentially reached by the sweeping reasoning in *Stern*. Following fractured dissections of the decision by district and bankruptcy courts,<sup>578</sup> the circuit courts of appeals began to divide on what qualified as a “*Stern* claim” and, more importantly, what to do with such claims. The Fifth, Sixth, and Seventh Circuits have read *Stern* broadly as delivering a debilitating blow to bankruptcy courts’ authority.<sup>579</sup> Despite the self-limiting language in *Stern*,<sup>580</sup> these circuits have extrapolated the sweeping reasoning employed by the *Stern* Court to question sharply the limits of bankruptcy court power.<sup>581</sup> Additionally, these three circuits followed the Court’s analysis in *Commodities Futures Trading Commission v. Schor*<sup>582</sup> of private rights versus structural interests implicated by the separation of powers, concluding that *Stern* claims implicate structural concerns beyond the curing power of private litigants’ consent.<sup>583</sup> Given the broad reasoning employed by the *Stern* Court, these circuits followed the inference that concern for structure protections eclipses any tongue-and-cheek declaration that the status quo remains unchanged.<sup>584</sup>

In comparison, the Ninth Circuit took a more practical approach in *In re Bellingham Insurance Agency, Inc.*<sup>585</sup> There, Executive Benefits Insurance Agency (EBIA), the target a fraudulent transfer claim brought by the

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578. See generally Alaniz, *supra* note 553.

579. *BP RE, L.P. v. RML Waxahachie Dodge, L.L.C. (In re BP RE, L.P.)*, 735 F.3d 279, 290-91 (5th Cir. 2013); *Frazin v. Haynes & Boone, L.L.P. (In re Frazin)*, 732 F.3d 313, 324-25 (5th Cir. 2013); *Wellness Int’l Network, Ltd. v. Sharif*, 727 F.3d 751, 775-76 (7th Cir. 2013), *rev’d*, 135 S. Ct. 1932 (2015); *Waldman v. Stone*, 698 F.3d 910, 918-21 (6th Cir. 2012).

580. *Stern*, 131 S. Ct. at 2620 (“We conclude today that Congress, in one isolated respect, exceeded that limitation in the Bankruptcy Act of 1984.”).

581. See *supra* note 579.

582. 478 U.S. 833 (1986).

583. *In re BP RE, L.P.*, 735 F.3d at 286-87 (citing *Schor*, 478 U.S. at 850); *Wellness Int’l*, 727 F.3d at 769-70 (same); *Waldman*, 698 F.3d at 917-18 (same); see also *Frazin*, 732 F.3d at 320 n.3 (noting same in dicta).

584. See George W. Kuney, *Stern v. Marshall: A Likely Return to the Bankruptcy Act’s Summary / Plenary Distinction in Article III Terms*, 21 NORTON J. BANKR. L. & PRAC. 1 Art. 1 (2012) (Westlaw) (“Justice Breyer may not have been able to command a majority of the court and thus be ‘constitutionally correct,’ but he has definitely been right about one thing: Justice Roberts’s statement that as a ‘practical matter’ the *Stern v. Marshall* decision ‘does not change all that much’ was either tongue-in-cheek or decidedly incorrect.”). Cf. *Stern*, 131 S. Ct. at 2620 (“If our decision today does not change all that much, then why the fuss?”).

585. 702 F.3d 553 (9th Cir. 2012).

chapter 7 trustee, argued that the bankruptcy court lacked constitutional authority to determine a fraudulent transfer claim.<sup>586</sup> The Ninth Circuit agreed, holding that *Stern* and the Court's earlier decision in *Granfinanciera, S.A. v. Nordberg*<sup>587</sup> required an Article III court to determine fraudulent transfer claims.<sup>588</sup> But the Ninth Circuit concluded that the power to "hear and determine" includes the power to issue proposed findings and conclusions.<sup>589</sup> Because "Congress enumerated the examples of core proceedings in § 157(b)(2) with 'a view toward expanding the bankruptcy court's jurisdiction to its constitutional limit,'"<sup>590</sup> the panel reasoned that Congress intended for a bankruptcy court to be "vested with as much adjudicatory power as the Constitution will bear."<sup>591</sup> By this logic, where Article III concerns are implicated, the bankruptcy court may exercise discretion to issue proposed findings and conclusions under § 157(b) rather than issuing a final order.<sup>592</sup>

The Supreme Court granted certiorari following the Ninth Circuit's decision in *Executive Benefits*, providing the Court its first opportunity to revisit *Stern*. The Court affirmed the decision of the Ninth Circuit.<sup>593</sup> Writing for a unanimous Court, Justice Thomas assumed without deciding that *Stern* infected fraudulent transfer claims, holding that a de novo review of the bankruptcy court's proposed findings of fact and conclusions of law cured any constitutional deficiency.<sup>594</sup> This holding closed the so-called "statutory gap" debated among the circuit and lower courts.<sup>595</sup> Moreover, the Court directed bankruptcy courts, upon identifying a *Stern* claim, to

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586. *Id.* at 561-65.

587. 492 U.S. 33 (1989).

588. *In re Bellingham Ins. Agency, Inc.*, 702 F.3d at 565-66.

589. *Id.*

590. *Id.* at 565 (quoting *Duck v. Munn (In re Mankin)*, 823 F.2d 1296, 1301 (9th Cir. 1987), *overruled by Exec. Benefits*, 702 F.3d at 561).

591. *Id.*

592. *Id.* at 566.

593. *Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2174 (2014).

594. *Id.* at 2174-75.

595. *Compare Waldman v. State*, 698 F.3d 910, 921 (6th Cir. 2012) (holding that a bankruptcy court could not issue proposed findings of fact and conclusions of law when determining a core proceeding under § 157(b)(2) because it would violate the separation of powers), *with In re Bellingham Ins. Agency, Inc.*, 702 F.3d at 565-66 (holding that no statutory gap existed because the power to "hear and determine" a proceeding under § 157(b)(2) encompassed the power to merely hear and submit proposed findings of fact and conclusions of law to a district court).

issue proposed findings of fact and conclusions of law to be reviewed de novo by the district court.<sup>596</sup>

### 3. Executive Benefits *to Wellness International and Beyond*

The court in *Executive Benefits* expressly left unanswered “whether Article III permits a bankruptcy court, with the consent of the parties, to enter final judgment on a *Stern* claim.”<sup>597</sup> Instead the Court “reserve[d] that question for another day.”<sup>598</sup> Soon thereafter, the Court set a date to answer that question, granting certiorari to the Seventh Circuit in *Wellness International*<sup>599</sup> and certifying a question squarely addressing whether consent by litigation conduct can authorize a bankruptcy court to exercise “the judicial Power of the United States.”<sup>600</sup> So practitioners and courts needed only to wait one term for the next round of the heavyweight bout between articles I and III of the U.S. Constitution.

The facts of *Wellness International* are familiar to many practitioners who are “chasing” information from debtors. The eventual debtor, Sharif, sued its former business partner, Wellness International Network (Wellness), for breach of contract in the Northern District of Texas.<sup>601</sup> Sharif ignored numerous discovery requests, ultimately resulting in a default judgment for Wellness and a \$650,000 sanction for attorneys’ fees against Sharif.<sup>602</sup> To stave off collection efforts, Sharif filed for chapter 7 bankruptcy in the Northern District of Illinois.<sup>603</sup> Wellness, as a creditor and party in interest, requested documentation that the now-debtor Sharif was obligated to provide under 11 U.S.C. § 521.<sup>604</sup> Again, Sharif balked at the request.

In response, Wellness filed a five-count adversary proceeding, seeking, among other things, a denial of Sharif’s discharge in bankruptcy and a declaration that a trust Sharif set up was Sharif’s alter ego and, therefore, was property of the estate under § 541(a).<sup>605</sup> In his answer, Sharif, as

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596. *Exec. Benefits Ins. Agency*, 134 S. Ct. at 2173.

597. *Id.* at 2070 n.4.

598. *Id.* at 2070.

599. *Wellness Int’l Network, Ltd. v. Sharif*, 134 S. Ct. 2901, 2901 (2014).

600. Brief for Respondent at 41, *Wellness Int’l*, 134 S. Ct. 2901 (No. 13-935).

601. *Wellness Int’l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1940-42 (2015).

602. *Id.* at 1940.

603. *Id.*

604. *See id.*

605. *Id.* Notably, while many academics awaited the result of the bankruptcy authority question in *Wellness International*, many consumer practitioners waited an answer on the § 541 question. That answer did not come, at least this time, because the Court only reached

required by Federal Rule of Bankruptcy Procedure 7012, admitted the adversary proceeding was a “core proceeding” under 28 U.S.C. § 157(b).<sup>606</sup> Following additional discovery violations and sanctions, the bankruptcy court entered a final order denying Sharif’s discharge and, importantly, determining that the trust was Sharif’s alter ego and, therefore, property of the estate under § 541.<sup>607</sup> Following an appeal to the district court, the Seventh Circuit reversed and held that the bankruptcy court lacked constitutional authority to enter a final judgment on the trust issue, which the Seventh Circuit designated a *Stern* claim.<sup>608</sup>

On certiorari, the Supreme Court reversed the Seventh Circuit, holding that Sharif’s consent to bankruptcy court’s jurisdiction over the “core proceeding” was knowing and voluntary.<sup>609</sup> Speaking in categories, the justices in the minority in *Stern* carried a majority in *Wellness International*. And the new majority could not leave the flip-flop unannounced. Justice Sotomayor, writing for the majority, quelled any concerns that “the world will end not in fire or ice, but in a bankruptcy court.”<sup>610</sup> Moreover, Justice Sotomayor downplayed formerly colorful rhetoric about article III judges forgoing their constitutional birthrights too easily.<sup>611</sup>

Instead, the majority’s analysis emphasized the practical implications of the decision and the need for relying not on “formalistic and unbending rules,” but instead acting “with an eye to the practice effect that the practice will have on the constitutionally assigned role of the federal judiciary.”<sup>612</sup> First, the majority distinguished *Stern* by reemphasizing the explicitly narrow scope of *Stern*.<sup>613</sup> Next, the majority reasoned that *Stern* did not

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the authority question on certiorari. So debtor’s attorneys must continue to wait for instruction of whether the alter ego theories asserts in *Wellness International* will affect the debtor’s requirements for scheduling assets under § 521.

606. *Id.*

607. *Id.*

608. *Wellness Int’l Network, Ltd. v. Sharif*, 727 F.3d 751, 773 (7th Cir. 2013).

609. *Wellness Int’l*, 135 S. Ct. at 1947-49.

610. *Id.*

611. *Compare id.* at 1947 (noting that reaffirming adjudication based on litigant consent “poses no great threat to anyone’s birthrights, constitutional or otherwise”), *with* Transcript of Oral Argument at 51, *Exec. Benefits Ins. Agency v. Arkison*, No. 12-1200 (Jan. 14, 2014) (Roberts, C.J.), available at [http://www.supremecourt.gov/oral\\_arguments/argument\\_transcripts/12-1200\\_5f57.pdf](http://www.supremecourt.gov/oral_arguments/argument_transcripts/12-1200_5f57.pdf) (“[T]he authority to decide cases, which is our constitutional birthright, we said in *Stern* that Congress can’t take that away from us. And your position is that two parties who come in off the street, if they agree, and take that away from us.”).

612. *Wellness Int’l*, 135 S. Ct. at 1944.

613. *Id.* at 1946-47.

apply because that narrow focus meant consent to adjudication by a bankruptcy court was unsettled.<sup>614</sup> Finally, the majority aligned its decision on constitutional consent in bankruptcy court with the well-settled constitutional consent in other article I courts, including magistrate courts.<sup>615</sup>

Six justices agreed that knowing and voluntary express consent is sufficient for a bankruptcy court to enter a final order. Perhaps more importantly, particularly for the issue of appellate jurisdiction, five justices agreed that “[t]he implied consent standard articulated in *Roell* supplies the appropriate rule for adjudication by bankruptcy courts under § 157.”<sup>616</sup> Accordingly, a majority of the Court agreed that implied consent will allow a bankruptcy court to enter a final order so long as the consent was knowing and voluntary.<sup>617</sup> The Court also noted that, a previously noted in *Executive Benefits*, obtaining express statements of consent or nonconsent remains “good practice.”<sup>618</sup>

The Court’s decision in *Executive Benefits* settled some of the concern about “valid and final judgments” in *Stern* claims—at least going forward. When in doubt, practitioners can plead *Stern* and obtain from the district court either a de novo review or a stern reprimand. Either way, the result will validate a bankruptcy court order for preclusive effect.

But the question remained, at least after *Executive Benefits*, for bankruptcy courts’ final orders in *Stern* claims where the appeals deadline has expired and a district court blessing is unavailable. One bankruptcy commentator has noted that “[i]f the *Stern* right can’t be waived, then presumably the issue can be raised months or even years later, perhaps with the effect that the same dispute can be litigated once again, even between the same parties in a different court.”<sup>619</sup>

Now, after *Wellness International*, the Supreme Court has clarified that district-court adjudication of a *Stern* claim can be waived.<sup>620</sup> So the Supreme Court’s holding in *Wellness International* settles waiver concerns in theory.

614. *Id.*

615. *Id.* at 1947 n.11.

616. *Id.* at 1948 (citing *Roell v. Withrow*, 538 U.S. 580 (2003)).

617. *Id.* at 1948-49.

618. *Id.* at 1948 n.13.

619. Bill Rochelle, *Supreme Court Opening Another Constitutional Can of Worms*, BLOOMBERG L. (June 26, 2013), available at [https://utcle.org/ecourses/OC4719/get-asset-file/asset\\_id/31329](https://utcle.org/ecourses/OC4719/get-asset-file/asset_id/31329) (emphasis added).

620. *Wellness Int’l*, 135 S. Ct. at 1946-49. Express consent carried six votes, while implied consent garnered only three. See *id.* at 1944-49; *id.* at 1949-50 (Alito, J., concurring); *id.* at 1950-60 (Roberts, C.J., dissenting).

Bankruptcy courts will have to interpret *Wellness International* and import the *Roell* line of cases concerning implied waiver into bankruptcy jurisprudence.<sup>621</sup> As to express waiver, practitioners should secure consent to a bankruptcy court's final order wherever possible to avoid the unnecessary expense of litigating the issue. To that end, two early developments are worth noting. Initially, continuing a trend begun after *Stern*, districts and individual bankruptcy courts are using local rules and case management orders to require litigants to file statements of consent by set deadlines after the filing of an adversary proceeding.<sup>622</sup>

At present, Federal Rules of Bankruptcy Procedure 7008 and 7012 only require statements of consent in *non-core* proceedings.<sup>623</sup> Long term, Rules 7008 and 7012 of the Federal Rules of Bankruptcy Procedure may soon require a statement of consent in all adversary proceedings, not merely non-core proceedings.<sup>624</sup> But, until proposed rules requiring consent in all adversary proceedings take effect, local rules and scheduling orders may be before the norm regarding consent.

Another area to which issues with the preclusive effect of final orders in *Stern* claims may extend is bankruptcy appeals. Appeals from a bankruptcy court are normally taken first to the district court or, in some circuits, to a Bankruptcy Appellate Panel (BAP or BAPs, as appropriate).<sup>625</sup> A BAP is composed of three bankruptcy judges of a different district within the circuit than from which the appeal was taken.<sup>626</sup> Alternatively, for novel issues of law of public importance that require an immediate disposition, the bankruptcy court may certify, and the circuit court may authorize, a direct appeal to the circuit court.<sup>627</sup>

Two problems arise. First, a BAP is composed of article I judges—that is, no judge whose “birthright” is to exercise “the judicial Power of the United States.”<sup>628</sup> Even a *de novo* review would suffer from the same

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621. *See id.* at 1947-48.

622. *E.g.*, Order Requiring Statement Regarding Consent, *El Paso Children's Hosp. Corp. v. El Paso Cnty. Hosp. Dist.* (In re *El Paso Children's Hosp. Corp.*), No. 15-3005-hcm (Bankr. W.D. Tex. June 5, 2015).

623. FED. R. BANKR. P. 7008(a), 7012(b).

624. Report of the Judicial Conference, Committee on Rules of Practice and Procedure, at 6-7, 9 (Sept. 2013).

625. 28 U.S.C. § 158(a)-(b) (2012).

626. *Id.* § 158(b)(1), (5).

627. *Id.* § 158(d)(2)(A).

628. *Id.* § 157(b)(1); *see also* Transcript of Oral Argument, *supra* note 611, at 51:1-51:5 (“[T]he authority to decide cases, which is our Constitutional birthright, we said in *Stern* that



constitutional infirmities identified in *Stern*. So error at the bankruptcy level may actually be compounded at the appellate level in circuits authorizing BAPs. Second, even the federal courts of appeals—clearly composed of article III judges—may face similar problems. Following the logic of flawed bankruptcy court authority, the decision of an appellate court reviewing a direct appeal from a bankruptcy court’s final order in a *Stern* claim may likewise be plagued with issues of “valid and final judgment.”<sup>629</sup>

In *Ortiz*, the Seventh Circuit recognized this second problem while deciding an appeal that had been pending when *Stern* was decided. After considering the parties’ additional briefing about *Stern*’s effect on the bankruptcy court’s final order, the Seventh Circuit concluded that the bankruptcy court lacked constitutional authority to enter the final order authorized for the core claims by 28 U.S.C. § 157(b).<sup>630</sup> As a result, the panel concluded that the bankruptcy court’s lack of constitutional authority stripped the circuit court of its power to authorize a direct appeal under 28 U.S.C. § 158(d)(2)(A).<sup>631</sup> The panel reasoned that the bankruptcy court’s orders “[could not] be considered interlocutory under 28 U.S.C. § 158(a)(3), or final decisions, judgments, orders, or decrees within the meaning of 28 U.S.C. § 158(d)(1).”<sup>632</sup> Yet the direct appeal provision in § 158(d)(2)(A) requires a final order, not proposed findings of fact or conclusions of law, which in turn requires either a core matter or proceeding under § 157(b) or a consensual related-to proceeding under § 157(c)(2).<sup>633</sup> Thus, the panel had an order that had to be considered final or else the court lacked appellate jurisdiction. The Seventh Circuit opted for the later determination, dismissing the appeal and remanding the proceeding to the bankruptcy court.<sup>634</sup>

Of course, the question of bankruptcy appeals may likewise be solved under the construct in *Wellness International*. Although article I judges comprise BAPs, knowing and voluntary consent to appellate jurisdiction may likewise cure the constitutional deficiency without threatening anyone’s birthright.<sup>635</sup> The Seventh Circuit did not address waiver in *Ortiz*,

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Congress can’t take that away from us. And your position is that two parties who come in off the street, if they agree, they can take that away from us.”)

629. *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 665 F.3d 906, 908-09 (7th Cir. 2011).

630. *Id.* at 914.

631. *Id.* at 915.

632. *Id.*

633. *Id.* at 909, 915.

634. *Id.* at 915.

635. *See Wellness Int’l*, 135 S. Ct. at 1947.

so the precedential value of that case as to bankruptcy appeals is unsettled. Even so, bankruptcy courts, BAPs, or circuit courts will likely have to address whether *Wellness International* reaches this area of article I judge authority.

These lingering questions potentially undermine the preclusive effect of bankruptcy court orders in *Stern* claims. Practitioners can ensure preclusive effect by seeking the district court's blessing of a bankruptcy court's order, in accordance with the procedure Justice Thomas outlined in *Executive Benefits*. Further developments in consent requirements by court, local, or federal rule will also clarify the effect of article I adjudication on the issue preclusion doctrine.

#### *D. Offensive and Defensive Uses of Issue Preclusion*

Assuming an order merits preclusive effect, the doctrine may be used both offensively and defensively. The Restatement (Second) does not specifically distinguish between offensive and defensive issue preclusion,<sup>636</sup> but case law has established slightly different approaches in the offensive and defensive application. Offensive use of issue preclusion is when a plaintiff seeks to preclude a defendant from re-litigating an issue, which the defendant previously litigated and lost in a suit involving another party. Defensive use of issue preclusion is claimed when a plaintiff has previously litigated and lost an issue against another defendant. Although parties may come to an agreement that the issue preclusion doctrine does not apply in the case at hand, the application of issue preclusion is a matter of law, not of agreement.<sup>637</sup>

In light of the due process implications and potential consequences that are associated with non-mutual or "offensive" issue preclusion, the Restatement (Second) has provided a secondary set of factors to assist courts in determining whether preclusion would lead to unjust results.

A party precluded from re-litigating an issue with an opposing party, in accordance with sections 27 and 28, is also precluded from doing so with another person, unless the fact that he lacked full and fair opportunity to litigate the issue in the first action or other circumstances justify affording him an opportunity to re-litigate the issue. The circumstances to which

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636. The Restatement (Second) does, however, suggest additional safeguards when applying issue preclusion to a non-party. RESTATEMENT (SECOND) OF JUDGMENTS § 29 (1982); see *supra* Part II.F ("Exceptions to Issue Preclusion") for a more in depth discussion on offensive and defensive issue preclusion.

637. *Gamble-Ledbetter v. Andra Group, L.P.* (*In re Gamble-Ledbetter*), 419 B.R. 682, 694 (Bankr. E.D. Tex. 2009).

considerations should be given include those enumerated in § 28 and also whether:

- (1) Treating the issue as conclusively determined would be incompatible with an applicable scheme of administering the remedies in the actions involved;
- (2) The forum in the second action affords the party against whom preclusion is asserted procedural opportunities in the presentation and determination of the issue that were not available in the first action and could likely result in the issue being differently determined;
- (3) The person seeking to invoke favorable preclusion, or to avoid unfavorable preclusion, could have effected joinder in the first action between himself and his present adversary;
- (4) The determination relied on as preclusive was itself inconsistent with another determination of the same issue;
- (5) The prior determination may have been affected by relationships among the parties to the first action that are not present in the subsequent action, or apparently was based on a compromise verdict or finding;
- (6) Treating the issue as conclusively determined may complicate determination of issues in the subsequent action or prejudice the interests of another party thereto;
- (7) The issue is one of law and treating it as conclusively determined would inappropriately foreclose opportunity for obtaining reconsideration of the legal rule upon which it was based;
- (8) Other compelling circumstances make it appropriate that the party be permitted to relitigate the issue.<sup>638</sup>

#### *E. Exceptions to Issue Preclusion*

Notwithstanding the successful application of all elements required for issue preclusion, a bankruptcy court may still decline to afford a prior judgment preclusive effect in subsequent proceedings under the following circumstances:

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638. RESTATEMENT (SECOND) OF JUDGMENTS § 29.

(1) The party against whom preclusion is sought could not, as a matter of law, have obtained review of the judgment in the initial action; or

(2) The issue is one of law and (a) the two actions involve claims that are substantially unrelated, or (b) a new determination is warranted in order to take account of an intervening change in the applicable legal context or otherwise to avoid inequitable administration of the laws; or

(3) A new determination of the issue is warranted by differences in the quality or extensiveness of the procedures followed in the two courts or by factors relating to the allocation of jurisdiction between them; or

(4) The party against whom preclusion is sought had a significantly heavier burden of persuasion with respect to the issue in the initial action than in the subsequent action; the burden has shifted to his adversary; or the adversary has a significantly heavier burden than he had in the first action; or

(5) There is a clear and convincing need for a new determination of the issue (a) because of the potential adverse impact of the determination on the public interest or the interests of persons not themselves parties in the initial action, (b) because it was not sufficiently foreseeable at the time of the initial action that the issue would arise in the context of a subsequent action, or (c) because the party sought to be precluded, as a result of the conduct of his adversary or other special circumstances, did not have an adequate opportunity or incentive to obtain a full and fair adjudication in the initial action.<sup>639</sup>

### *III. Practice Tips*

What practice tips can attorneys take away from the foregoing other than those the article has already identified? First, it is crucial to understand the difference between claim and issue preclusion. As demonstrated above, the two doctrines serve different purposes and have different elements. As a result, there will be cases where only one of the two doctrines will apply. The practitioner must therefore argue the correct branch of preclusion, lest she risk the possibility that the court will construe her argument to plead the

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639. *Id.* § 28.

incorrect form of preclusion. This is particularly important in dischargeability proceedings, where, as described extensively above, claim preclusion is generally inapplicable.<sup>640</sup> Sometimes the court will consider both types of preclusion when a practitioner pleads the wrong form of preclusion,<sup>641</sup> but sometimes the court will deem the correct argument waived if not explicitly pleaded.<sup>642</sup> Therefore, the practitioner should not rely on the court to make her legal argument for her.

#### IV. Other Related Doctrines for Practitioners to Consider

Several doctrines related to the preclusion doctrines described above and the estoppel doctrines discussed in the prior volume of this article also come into play in consumer bankruptcies. These include the *Rooker-Feldman* doctrine,<sup>643</sup> law of the case,<sup>644</sup> promissory estoppel,<sup>645</sup> standing (particularly with respect to reservation of rights provisions),<sup>646</sup> quasi-estoppel,<sup>647</sup> laches,<sup>648</sup> *in pari delicto*,<sup>649</sup> and others.<sup>650</sup> While there is not

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640. See, e.g., *Rustin v. Rustin (In re Rustin)*, No. 04-50890-NPO, 2011 WL 5443067, at \*6 (Bankr. S.D. Miss. Nov. 9, 2011); *Rahman v. Park (In re Park)*, No. 09-78622-dte, 2011 WL 1344495, at \*4, \*4 n.3 (Bankr. E.D.N.Y. Apr. 8, 2011).

641. See, e.g., *In re Park*, 2011 WL 1344495, at \*4; *Forrest v. Bressler (In re Bressler)*, 387 B.R. 446, 455 (Bankr. S.D.N.Y. 2008); *Bublitz Mach. Co. v. Brewer (In re Brewer)*, No. 05-51960, 2006 WL 1109409, at \*1 (Bankr. W.D. Mo. Apr. 17, 2006); cf. *Davis Oil Co. v. Vann (In re Vann)*, No. 08-11824-DHW, 2009 WL 1311592, at \*2 (Bankr. M.D. Ala. May 11, 2009) (reconstructing plaintiff's judicial estoppel argument as a claim preclusion argument).

642. See, e.g., *In re Rustin*, 2011 WL 5443067, at \*6 (citing *Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168, 172 (5th Cir. 1985)).

643. D.C. Ct. App. v. *Feldman*, 460 U.S. 462 (1983); *Rooker v. Fid. Trust Co.*, 263 U.S. 413 (1923). For recent cases applying the *Rooker-Feldman* doctrine in the consumer bankruptcy context, see, for example, *Newman v. Johnson (In re Johnson)*, 473 B.R. 447 (Bankr. D. Utah 2012).

644. See, e.g., *Kaufman v. Robinson Prop. Group*, 661 F. Supp. 2d 622, 625-26 (N.D. Miss. 2009), *motion to amend denied*, No. 2:07CV048-P-A, 2009 WL 3003261 (N.D. Miss., Sept. 16, 2009), *aff'd* 373 F. App'x 494 (5th Cir. 2010).

645. See, e.g., *Aceves v. U.S. Bank, N.A.*, 120 Cal. Rptr. 3d 507, 513-19 (Ct. App. 2011).

646. See, e.g., *Dynasty Oil & Gas, L.L.C. v. Citizens Bank (In re United Operating, L.L.C.)*, 540 F.3d 351 (5th Cir. 2008).

647. See, e.g., *Forman v. Amboy Nat'l Bank (In re Price)*, 361 B.R. 68, 78-82 (Bankr. D.N.J. 2007) (holding that although judicial and equitable estoppel were both inapplicable, quasi-estoppel barred chapter 11 trustee from seeking recovery of fees paid to mortgage lender upon closing on debtors' real property); see also *Hall v. Hopkins (In re Jacobs)*, No. 04-42387, 2006 WL 4451566, at \*5 (Bankr. D. Idaho, Feb. 10, 2006) (distinguishing quasi-estoppel from equitable estoppel).

space in this article to define these doctrines and discuss their application in detail, we urge practitioners to familiarize themselves with these doctrines and brainstorm ways to utilize them against their opponents—or at least prevent them from being used against their clients.

### V. Conclusion

“[S]hame on the poor lawyer who has a case dismissed sua sponte by a court on . . . grounds that the lawyer has never even heard of.”<sup>651</sup> As these once obscure doctrines become increasingly important in the consumer bankruptcy realm, it is incumbent upon practitioners to familiarize themselves with the nuances and tensions of estoppel and preclusion law. We have attempted to catalogue, as exhaustively as possible, the most crucial post-2005 developments in these areas. We encourage attorneys to also familiarize themselves with the articles written on developments that occurred prior to 2005.

As the foregoing has demonstrated, with few exceptions, the doctrines of estoppel and preclusion are in a state of flux. There is plenty of wiggle room for creative practitioners to develop these doctrines in innovative ways that serve their clients, be they debtors or creditors, plaintiffs or defendants, or trustees.<sup>652</sup> We hope that this article can assist that development in ways that are sensible, coherent, and consistent.

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648. See, e.g., *In re Hawkins*, 377 B.R. 761, 768-71 (Bankr. S.D. Fla. 2007) (finding both (1) creditor's equitable lien claim and (2) creditor's attempt to reclassify debt as secured barred by laches due to creditor's lack of diligence).

649. See, e.g., *Jones v. Wells Fargo Bank, N.A.*, 666 F.3d 955, 965-68 (5th Cir. 2012).

650. See, e.g., *Franchise Tax Bd. v. Kipperman (In re Adams)*, Nos. SC-07-1283-KMkDo, SC-07-1394-KMkDo, 2008 WL 8444788, at \*7-9 (B.A.P. 9th Cir. Feb. 7, 2008) (discussing the rule/duty of consistency, “which is in the nature of an estoppel”); *Cotter v. Skylands Cmty. Bank (In re Cotter)*, No. 08-12504 (NLW), 2011 WL 5900811, at \*5-6 (Bankr. D.N.J. Oct. 24, 2011) (discussing the “entire controversy doctrine,” a preclusive doctrine that exists under New Jersey law, in the context of a bankruptcy case); *In re Hawkins*, 377 B.R. at 771-72 (applying “general principles of equity”).

651. Eric A. Schreiber, Comment, *The Judiciary Says, You Can't Have It Both Ways: Judicial Estoppel—A Doctrine Precluding Inconsistent Positions*, 30 LOY. L.A. L. REV. 323, 324 (1996).

652. That said, of course, we caution against the abusive use of preclusive doctrines. One should only plead them if they are supportable. See FED R. BANKR. P. 9011(b)-(c); see also FED. R. CIV. P. 11(b)-(c). Estoppel and preclusion should not become stock, knee-jerk arguments that are employed every time an opposing party is haled into court against its will, in the way that *Stern v. Marshall* objections are often reflexively raised in bankruptcy courts nowadays.