

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION**

IN RE: Allan Patrick and Margie Marlene MARX

**NO. 2:12-bk-71217
Ch. 7**

Victor and Regina COLOSO

PLAINTIFFS

vs.

2:12-ap-7056

Allan Patrick and Margie Marlene MARX

DEFENDANTS

ORDER GRANTING PARTIAL SUMMARY JUDGMENT

Before the Court are a motion for summary judgment with attachments that was filed by the plaintiffs, Victor and Regina Coloso, on June 4, 2012; a motion for summary judgment that was filed by the debtors, Allan and Margie Marx, on July 12, 2012, apparently in response to the Colosos' motion for summary judgment; and a response to the debtors' motion for summary judgment filed by the Colosos on July 26, 2012. The Court has jurisdiction over these matters under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(I). For the reasons stated below, the Court (1) finds there are no remaining issues of material fact relating to the plaintiffs' § 523(a)(2) cause of action against Margie Marx under the doctrine of collateral estoppel, (2) grants in part the plaintiffs' motion for summary judgment, and (3) denies the debtors' motion for summary judgment.

The debt in question relates to a judgment the plaintiffs obtained against the debtors after a trial on the merits in 2009 in the Circuit Court of Sebastian County, Arkansas. The primary subject matter of the state court trial was a Real Estate Disclosure form provided to the plaintiffs by the debtors on behalf of the debtors' company, Marx Real Estate

Investment, LLC [MREI].¹ According to the state court, the disclosure form was prepared by Margie Marx on behalf of MREI. (Op. and J., p.2.) After finding that the disclosure form contained false representations of material facts, the court found that Margie Marx's actions were fraudulent. The court also recognized that "[t]he establishment of a limited liability corporation does not shield individuals from liability for fraudulent acts" and found that "MREI was nothing more than a straw man in the purchase of the home" (Op. and J., p.15.) As a result, the court pierced the corporate veil of MREI and found that Margie Marx and MREI were liable to the plaintiffs in the amount of \$56,574.35. (Op. and J., p.15.) The state court did not make such a finding against Allan Marx. The debtors subsequently appealed the trial court's decision to the Arkansas Court of Appeals, which affirmed the circuit court's decision in June 2011. The debtors filed their voluntary chapter 7 bankruptcy petition on March 27, 2012, and the plaintiffs filed their *Complaint to Determine Dischargeability of Debt* under 11 U.S.C. § 523(a)(2)(A) on May 29, 2012.

Summary Judgment

Federal Rule of Bankruptcy Procedure 7056 provides that Federal Rule of Civil Procedure 56 applies in adversary proceedings. Rule 56 states that summary judgment shall be rendered "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(a). The burden is on the moving party to establish the absence of material fact and that it is

¹ The Court obtained the facts recited in this order from the Opinion and Judgment in civil case number CV-2008-14 from the Circuit Court of Sebastian County, Arkansas, Fort Smith District, dated May 26, 2009 [Opinion and Judgment]. The subsequent decision from the appellate court is reported at *Marx Real Estate Invest., LLC v. Coloso*, 2011 Ark. App. 426, (Ark. Ct. App. 2011). Neither party provided the Court with a specific statement of undisputed material facts; however, the plaintiffs did provide the Court with a copy of the state trial court's and appellate court's respective opinions and incorporated the opinions by reference as the plaintiffs' statement of undisputed facts. The debtors did not object to incorporating the opinions by reference. In accordance with Federal Rule of Bankruptcy Procedure 7056 and Federal Rule of Civil Procedure 56(e)(2), the Court will consider the incorporated facts that are memorialized in the state court's *Opinion and Judgment* undisputed by the parties for purposes of the competing motions for summary judgment.

entitled to judgment as a matter of law. *Canal Ins. Co. v. ML & S Trucking, Inc.*, No. 2:10-CV-02041, 2011 WL 2666824, at *1 (D.W.D. Ark. July 6, 2011); *see also Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986) (citing to former Fed. R. Civ. P. 56(c)). The burden then shifts to the non-moving party, who must show “that the materials cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact.” Fed. R. Civ. P. 56(c)(1)(B). The non-moving party is not required to present a defense to an insufficient presentation of facts by the moving party. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 161 (1970) (quoting 6 J. Moore, Fed. Prac. 56.22(2), pp. 2824-25 (2d ed. 1966)). However, if the non-moving party fails to address the movant’s assertion of fact, the court may consider the fact undisputed. Fed. R. Civ. P. 56(e)(2).

When ruling on a summary judgment motion, the Court must view the facts in the light most favorable to the non-moving party and allow that party the benefit of all reasonable inferences to be drawn from the evidence. *Canada v. Union Electric Co.*, 135 F.3d 1211, 1212-13 (8th Cir. 1997); *Ferguson v. Cape Girardeau Cty.*, 88 F.3d 647, 650 (8th Cir. 1996).

Collateral Estoppel

Both parties pray that the Court apply the doctrine of collateral estoppel regarding issues previously litigated in state court.² The doctrine of collateral estoppel precludes a court

² The plaintiffs’ motion initially states correctly the law that is recognized in Arkansas with regard to collateral estoppel but then later misstates the last three elements without offering any argument: the judgment was on the merits, the parties were the same in the state court action, and the debtors had a full and fair opportunity to litigate the matter. These appear to be the elements required for *res judicata*, not collateral estoppel.

Unfortunately, the debtors’ motion is more confusing. After alleging there is no genuine issue of material fact, the debtors state they are entitled to a judgment *of dismissal* as a matter of law. According to the debtors, the language of the state court opinion is “far from focused, direct, resolute and clear on the question of fraud by the debtors.” The debtors suggest the trial court was “bedeviled by the ambiguities” and finally “came down
(continued...)

from conducting further proceedings on issues that have been litigated and ruled upon previously. *Fischer v. Scarborough (In re Scarborough)*, 171 F.3d 638, 641 (8th Cir. 1999). The appropriate standard of proof under 11 U.S.C. § 523 for dischargeability exceptions in the code is the ordinary preponderance of the evidence standard. *Grogan v. Garner*, 498 U.S. 279, 291 (1991). According to the Supreme Court, “if nondischargeability must be proved only by a preponderance of the evidence, all creditors who have secured fraud judgments, the elements of which are the same as those of the fraud discharge exception [in bankruptcy], will be exempt from discharge under collateral estoppel principles.” *Id.* at 285. Therefore, if the elements required under § 523(a)(2)(A) have been proved in state court, the Court must grant the plaintiffs’ motion for summary judgment.

In determining whether the state court judgment is entitled to preclusive effect, the Court must apply Arkansas law. *Scarborough*, 171 F.3d at 641 (stating that the court must look to the substantive law of the forum state in applying collateral estoppel). In Arkansas, there are four elements required to establish collateral estoppel: “(1) the issue sought to be precluded must be the same as that involved in the prior litigation; (2) that issue must have been actually litigated; (3) the issue must have been determined by a valid and final judgment; and (4) the determination must have been essential to the judgment.” *Riverdale Dev. Co. v. Ruffin Bldg. Sys., Inc.*, 146 S.W.3d 852, 855 (Ark. 2004). If the four elements are established with regard to the plaintiffs’ § 523(a)(2)(A) action, the Court is precluded from relitigating the case and the state court findings control. If the findings entitle the plaintiffs to judgment as a matter of law under § 523(a)(2)(A), summary judgment must be granted.

² (...continued)

more clearly on the side of culpability based on negligence than a culpability based on intentional misrepresentation.” This is the apparent premise upon which the debtors based their arguments for not only collateral estoppel, but *res judicata*, the Rooker-Feldman doctrine, and law of the case. The Court has reviewed the state court opinion in detail and disagrees entirely with the debtors’ characterization. Because the debtors’ motion is based on this erroneous conclusion, the Court will not consider their related arguments.

(1) Issue Must be the Same

The plaintiffs argue that the state court judgment awarded in their favor and against the debtors is excepted from discharge under § 523(a)(2)(A). Under this section, a discharge is not available to a debtor for any debt for money, property, or services obtained by “false pretenses, false representation, or actual fraud, other than a statement respecting the debtor’s or insider’s financial condition.” 11 U.S.C. § 523(a)(2)(A). To prevail, the plaintiffs must prove by a preponderance of the evidence the following:

1. that the debtor made a representation;
2. that at the time the debtor knew that the representation was false;
3. that the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor;
4. that the creditor justifiably relied on such representation; and
5. that the creditor sustained the alleged loss and damage as a proximate result of result of the representation having been made.

Merchants Nat’l Bank of Winona v. Moen, (In re Moen), 238 B.R. 785, 790 (B.A.P. 8th Cir. 1999) (quoting *Thul v. Ophaug*, 827 F.2d 340 (8th Cir. 1987)). Unless there is sufficient proof as to each element, judgment cannot be entered for the plaintiffs.

The state court litigation involved the disclosure of information on a Real Estate Disclosure form that the debtors provided to the plaintiffs prior to the plaintiffs’ purchase of a residence from the debtors. According to the circuit court, to resolve the dispute it had to undertake the following analysis:

1. Were the defendants [debtors] guilty of fraud?
2. If so, was the four prong test set forth in *Ballard v. Carroll* met?
3. If so, is rescission the appropriate remedy?

Opinion and Judgment, p.2. The court’s first analysis is determinative in this Court’s opinion. After reviewing the various disclosures or representations, the court stated the following:

The Court views this matter as essentially a fraud and/or fraud in the inducement case and rescission will rise or fall on those claims. To establish such a claim, Plaintiffs must prove the following essential propositions:

- (1) They have sustained damages.
- (2) A false representation of a material fact was made by Defendants.

- (3) Defendants either knew or believed the representation was false or that they did not have a sufficient basis of information to make the representation.
- (4) Defendants intended to induce Plaintiffs to act on reliance upon the misrepresentation.
- (5) Plaintiffs justifiably relied upon the representation in acting and as a result sustained damages.

In the Court's view, *each of the above elements have been clearly established by the evidence.*

Opinion and Judgment, p.9 (emphasis added).

The third proposition or element stated by the state court represents the only difference between the elements required under § 523(a)(2)(A) and the elements that the state court found to have been clearly established by the evidence. According to element (3), above, the defendants either knew the representation was false or they did not have a sufficient basis of information to make the representation. According to *Moen*, “[f]or purposes of section 523(a)(2)(A), a ‘misrepresentation’ denotes ‘not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth.’” *In re Moen*, 238 B.R. at 791 (quoting *In re Melancon*, 223 B.R. 300, 308-09 (Bankr. M.D. La. 1998)). Based on the state court’s detailed comparison and analysis of the substantive differences between the disclosures made by the debtors to the plaintiffs and the disclosures that were made earlier to the debtors by a third party, the Court finds that the debtors had a sufficient basis of information from which to make the representations, satisfying the requirement under *Moen* that they knew that the representations were false. Ergo, the Court finds that the issue sought to be precluded in this adversary proceeding--a determination whether the actions of the debtors that resulted in a judgment in favor of the plaintiffs were the result of “false pretenses, false representation, or actual fraud”--was the same issue as that involved in the state court action and which was found to have been clearly established by the state court.

However, the state court made its findings of fraud based on the disclosure statement prepared by Margie Marx. There is no evidence before this Court that Allan Marx was responsible for, or made, the false representations. Regardless of the state court’s finding

that the debtors' company was liable for the debt and that the corporate veil was pierced, there is no finding by the state court that Allan Marx made a representation that he knew was false and that he made the representation deliberately and intentionally with the intention and purpose of deceiving the plaintiffs--the first three elements under *Moen*. Accordingly, the Court finds that the plaintiffs have met the first element required to establish collateral estoppel as to Margie Marx but not as to Allan Marx. Because of this, the Court holds that the doctrine of collateral estoppel does not apply to Allan Marx and denies the plaintiffs' motion for summary judgment against Allan Marx. The remainder of this opinion will be in reference to Margie Marx, individually.

(2) Actually Litigated

The second element of collateral estoppel is that the issue must have been actually litigated. As stated above, the first analysis the state court had to undertake was whether the debtors were guilty of fraud, which means that the issue that is currently before this Court was directly in front of the state court. The state court impaneled a jury to hear the case; however, at the conclusion of the plaintiffs' case, the plaintiffs elected the remedy of rescission and the court dismissed the jury and continued with a bench trial. *Marx Real Estate Invest., LLC v. Coloso*, 2011 Ark. App. 426, *4-5 (Ark. Ct. App. 2011) (discussing the proceedings at circuit court trial). The state court entered its Opinion and Judgment on May 26, 2009. Accordingly, the Court finds that the plaintiffs have met the second element required to establish collateral estoppel.

(3) Valid and Final Judgment

The third element is that the issue discussed above--a determination whether the actions of the debtors that resulted in a judgment in favor of the plaintiffs were the result of "false pretenses, false representation, or actual fraud"--must have been determined by a valid and final judgment. The plaintiffs attached a copy of the Opinion and Judgment that was entered by the state court and filed of record on May 26, 2009. Additionally, the debtors appealed the state court's decision raising issues concerning the state court's handling of the plaintiffs' election of remedies, the damages awarded to the plaintiffs, and the award

of attorney fees. The plaintiffs cross-appealed relating to the state court's dismissal of a third party. The Arkansas Court of Appeals delivered its opinion on June 15, 2011, affirming the state circuit court on the direct appeal and the cross-appeal. *Marx Real Estate Invest., LLC v. Coloso*, 2011 Ark. App. 426, (Ark. Ct. App. 2011). No further action is pending in state court. Because the issue before this Court was resolved by a valid and final judgment in the state court, the Court finds that the plaintiffs have met the third element required to establish collateral estoppel.

(4) Essential to the Judgment

Finally, the fourth element requires that the determination by the state court that the debtor's actions were fraudulent must have been essential to the judgment in the state court case. The state court order states without equivocation that the matter before it was essentially a fraud and/or fraud in the inducement case. The appellate court also recognized that the state trial court "concluded that the Marx defendants had made fraudulent misrepresentations." *Id.* at *5. No other cause of action was discussed by either the trial court or the appellate court despite the debtors' rather remarkable statement that the trial court "finally came down more clearly on the side of culpability based on negligence than a culpability based on intentional misrepresentation." As a result, the Court finds that the debtor's misrepresentations and fraud were essential to the state court judgment and that the plaintiffs have met the fourth element required to establish collateral estoppel.

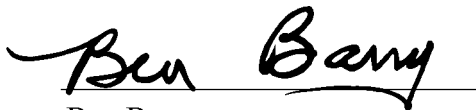
Because the four elements of collateral estoppel have been satisfied with regard to Margie Marx, this Court is precluded from relitigating the above issues decided by the Sebastian County Circuit Court as they relate to Margie Marx. Because the issues were determined in the plaintiffs' favor and when taken together show that there are no remaining issues of material fact remaining under § 523(a)(2)(A), the plaintiffs are entitled to judgment as a matter of law and the entry of an order granting their motion for summary judgment against the debtor, Margie Marx.

Conclusion

For the reasons stated above, the Court grants the plaintiffs' motion for summary judgment against Margie Marx but denies the plaintiffs' motion for summary judgment against Allan Marx. The Court finds that the debt as determined by the Circuit Court of Sebastian County, Arkansas, from Margie Marlene Marx to Victor Coloso and Regina Coloso, in the amount of \$56,574.35, plus attorney fees in the amount of \$51,612.46, and costs in the amount of \$215.00, all accruing post-judgment interest in accordance with 28 U.S.C. § 1961, less any amounts previously paid in satisfaction of the judgment, is excepted from discharge in the debtors' bankruptcy case pursuant to § 523(a)(2)(A). The plaintiffs' request for payment of their costs to bring this adversary proceeding is granted in accordance with Federal Rule of Bankruptcy Procedure 7054(b); however, their request for post-petition attorney fees is denied. The plaintiffs provided no basis under the law for the award of attorney fees in this case.

The Court will enter its judgment as stated above in a separate document pursuant to Federal Rule of Bankruptcy Procedure 9021. The Court will take no action on the plaintiffs' request to modify the automatic stay under § 362(d) that was included in the concluding paragraph of their motion for summary judgment until a proper motion is before the Court.

IT IS SO ORDERED.


Ben Barry
United States Bankruptcy Judge
Dated: 08/07/2012

cc: Jon R. Sanford, attorney for the debtors
Glenn E. Kelley, attorney for the plaintiffs
William M. Clark Jr., chapter 7 trustee