

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF)	
)	
TRACY LEE WARD and)	CASE NO. 02-32798 HCD
CHRISTINE MARIE WARD,)	CHAPTER 7
DEBTORS.)	
)	
)	
FEDERAL INSURANCE COMPANY and)	
BAYER FEDERAL CREDIT UNION,)	
PLAINTIFFS,)	
vs.)	PROC. NO. 03-3047
)	
CHRISTINE MARIE WARD,)	
DEFENDANT.)	

Appearances:

Peter A. Velde, Esq., attorney for plaintiffs, Kightlinger & Gray, LLP, 151 North Delaware Street, Suite 660, Indianapolis, Indiana 46204; and

Neil E. Holbrook, Esq., attorney for defendant, Holbrook Law Offices, P.O. Box 828, Goshen, Indiana 46527-0828.

MEMORANDUM OF DECISION

At South Bend, Indiana, on March 5, 2004.

Before the court is the Plaintiffs' Motion for Summary Judgment filed on December 2, 2003, by the plaintiffs Federal Insurance Company ("Federal") and Bayer Federal Credit Union ("Bayer") (collectively, "plaintiffs"). It seeks summary judgment of the Complaint to Determine Dischargeability of Debt which the plaintiffs filed on April 2, 2003. The plaintiffs claim that the debt owed to them by the debtor Christine Marie Ward ("defendant") is excepted from discharge as a matter of law under the doctrine of collateral estoppel, pursuant to 11 U.S.C. § 523(a)(4) and (a)(6). The court established a briefing period for the response to the plaintiffs' summary judgment motion. The defendant did not respond to the motion. At the end of the briefing period the court took the matter under advisement.

Jurisdiction

Pursuant to 28 U.S.C. § 157(a) and Northern District of Indiana Local Rule 200.1, the United States District Court for the Northern District of Indiana has referred this case to this court for hearing and determination. After reviewing the record, the court determines that the matter before it is a core proceeding within the meaning of § 157(b)(2)(I) over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1) and 1334. This entry shall serve as findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52, made applicable in this proceeding by Federal Rules of Bankruptcy Procedure 7052 and 9014. Any conclusion of law more properly classified as a factual finding shall be deemed a fact, and any finding of fact more properly classified as a legal conclusion shall be deemed a conclusion of law.

Background

The underlying undisputed facts have been presented to the court through the affidavits of Greg McCoy, the assistant branch manager of Bayer, and of Suzanne Hirzel, fidelity examiner of Federal, the insurance company that covered Bayer's loss under its bond policy of insurance. Christine Ward had been an employee of Bayer. On or before December 6, 2000, the defendant exerted unauthorized control over funds owned by Bayer, in the amount of \$52,474.80. On November 30, 2001, the defendant pleaded guilty in federal district court to one count of bank embezzlement by a bank officer or employee under 18 U.S.C. § 656. She was sentenced to a term of imprisonment and was ordered to pay restitution in the amount of \$52,474.80. *See* Judgment in a Criminal Case, R.28, Ex. 1.

Tracy Lee Ward and Christine Marie Ward filed a voluntary chapter 7 bankruptcy case on May 13, 2002. They were granted a discharge on August 19, 2002. Upon the request of the plaintiffs, the debtors' case was reopened. On April 2, 2003, the plaintiffs filed a complaint to determine the dischargeability of Christine

Ward's debt to them. On May 2, 2003, the defendant responded to the complaint by letter.¹ She stated to the court that she was making restitution payments in full awareness that, at the time she and her husband filed bankruptcy, "this debt would not be discharged." R. 5. She did not dispute the debt and was current on her restitution payments, she stated. *Id.* The plaintiffs thereafter filed a summary judgment motion.

The plaintiffs allege in the motion that the defendant willfully and maliciously converted those funds to her own benefit and use. Bayer claims entitlement to \$10,562.50 from the defendant and Federal, as subrogee and insurer of Bayer, claims entitlement to \$41,912.30 from her. According to the plaintiffs, the debt, for embezzlement and willful and malicious conversion, is nondischargeable pursuant to 11 U.S.C. § 523(a)(4) and (a)(6) as a matter of law under the doctrine of collateral estoppel. The defendant did not respond to the summary judgment motion.

Discussion

The issue in this case is whether the debt owed to the plaintiffs by the defendant is excepted from discharge as a matter of law, based on the doctrine of collateral estoppel. The Plaintiffs rely on § 523(a), the Bankruptcy Code provision stating that a debtor's discharge "does not discharge an individual debtor from any debt –

(a)(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny; (or)

(a)(6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

¹ On May 8, 2003, Neil E. Holbrook, Esq., the debtors' attorney in the main case, filed an Answer to the plaintiffs' complaint, denying the essential allegations of the complaint. However, on November 21, 2003, he filed a Verified Application to Withdraw as Attorney of Record in Adversary Proceeding. He stated that his client had not responded when he attempted to contact her or when he advised her of his intention to withdraw. The court granted his application on January 15, 2004.

Under Rule 56(c) of the Federal Rules of Civil Procedure, made applicable in this court by Rule 7056 of the Federal Rules of Bankruptcy Procedure, summary judgment is proper “if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Fed. R. Civ. P. 56(c); see *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986); *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 585-86 (1986). In order to avoid trial, the moving party bears the burden of showing that no genuine issue of material fact is in dispute. See *Anderson*, 477 U.S. at 248. “To avoid summary judgment . . . the nonmoving party [is] required to set forth ‘specific facts showing that there is a genuine issue for trial,’ Fed. R. Civ. P. 56(e), and, further [has] to produce more than a scintilla of evidence in support of his position.” *Silk v. City of Chicago*, 194 F.3d 788, 798 (7th Cir. 1999). In order to demonstrate that real factual disputes exist, the nonmovant must produce evidence of the disputes rather than relying solely on the allegations or denials in its pleadings. See *Barber v. United States (In re Barber)*, 236 B.R. 655, 659 (Bankr. N.D. Ind. 1998); N.D. Ind. L. B. R. B-7056-1. Summary judgment must be granted “against a party who fails to make a showing sufficient to establish the existence of an element essential to that party’s case, and on which that party will bear the burden of proof at trial.” *Celotex*, 477 U.S. at 322.

The use of a summary judgment determination generally is appropriate under the doctrine of collateral estoppel (also commonly called issue preclusion) when all the material factual issues in a pending proceeding were resolved in a prior action. The prior determination in this case was a criminal judgment rendered on a plea of guilty taken in the United States District Court for the Northern District of Indiana. The plaintiffs contend that the defendant’s debt to them is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4) and (a)(6), as a matter of law, because the material factual issues were determined by the federal judgment based on Ward’s guilty plea.

Collateral estoppel principles apply in dischargeability proceedings. *See Grogan v. Garner*, 498 U.S. 279, 285 n.11, 111 S. Ct. 654, 658 n.11, 112 L.Ed.2d 755 (1991).

Collateral estoppel refers to a judgment's effect of foreclosing litigation in a subsequent action involving those issues actually and necessarily decided in a prior suit. It is a doctrine which protects litigants from the burden of re-litigating identical issues with the same party or privy, and promotes judicial economy by preventing unnecessary litigation.

Herbstein v. Bruetman (In re Bruetman), 259 B.R. 649, 660-61 (Bankr. N.D. Ill. 2001) (citations omitted).

The elements of collateral estoppel that must be demonstrated are “(1) the issue sought to be precluded must be the same as that involved in the prior action; (2) the issue must have been actually litigated; (3) the determination of the issue must have been essential to the final judgment; and (4) the party against whom estoppel is invoked must be fully represented in the prior action.” *Id.* at 661. In this case, the second and fourth factors are satisfied: The defendant was represented by an attorney in the criminal proceeding, and in this circuit “a guilty plea may be used to establish issue preclusion in a subsequent civil suit.” *Appleby v. West*, 832 F.2d 1021, 1026 (7th Cir. 1987). The court finds, therefore, that, with respect to the facts admitted in her guilty plea, the defendant's criminal conviction has a conclusive effect and constitutes estoppel as to the matters determined by the judgment. To determine whether the first and third factors are met, the court examines the factual and statutory basis of the defendant's plea and compares the issues under consideration in the criminal context with those here in the bankruptcy nondischargeability action.

Ward pleaded guilty to the crime of “embezzlement by bank employee” found at 18 U.S.C. § 656.² The elements that must be established in order to obtain a conviction under § 656 are: (1) that the defendant is or was an officer, director, agent or employee of a bank; (2) that the bank was a federally insured bank; (3) that the defendant misapplied more than \$100 of the bank’s funds; (4) that the defendant willfully misapplied those funds; and (5) that the defendant acted with the intent to injure or defraud the bank. *See United States v. Crabtree*, 979 F.2d 1261, 1266 (7th Cir. 1992), *cert. denied*, 510 U.S. 878 (1993). The defendant’s guilty plea has established beyond a reasonable doubt that she willfully committed the acts charged, misapplication of bank money, with intent to defraud the bank.

For collateral estoppel to apply, the court must find that the issues in the criminal proceeding were identical to those in the dischargeability proceeding in this court and were necessary to support the final judgment entered in the first action. *See Haring v. Prosise*, 462 U.S. 306, 315, 103 S. Ct. 2368, 76 L.Ed.2d 595 (1983). It turns therefore to the issues that must be proven by a preponderance of the evidence under § 523(a)(4) and § 523(a)(6).

The plaintiffs alleged that the debt was nondischargeable under § 523(a)(4) for embezzlement (Count I) and for larceny (Count II). However, they did not pursue Count II in their summary judgment motion. The plaintiffs did not demonstrate that the defendant’s debt to them was a wrongful and fraudulent taking of another’s property without the consent of the owner, as larceny is defined. *See Urological Group, Ltd. v. Petersen (In*

² 18 U.S.C. § 656, “Theft, Embezzlement, or Misapplication by Bank Officer or Employee,” provides, in pertinent part:

Whoever, being an officer, director, agent or employee of . . . any Federal Reserve bank, member bank, depository institution holding company, national bank, insured bank . . ., embezzles, abstracts, purloins or willfully misapplies any of the moneys, funds or credits of such bank . . ., shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

re Petersen), 296 B.R. 766, 786 (Bankr. C.D. Ill. 2003). The court therefore denies summary judgment as to Count II of the complaint.

Section 523(a)(4) also provides that a debtor may not discharge any debt for embezzlement. Embezzlement is defined in this circuit as the “fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come.” *In re Weber*, 892 F.2d 534, 538 (7th Cir. 1989); *see also In re Bruetman*, 259 B.R. at 661; *Trane Federal Credit Union v. Conder (In re Conder)*, 196 B.R. 104, 110 (Bankr. W.D. Wisc. 1995). The following elements must be proven to demonstrate that the debtor committed embezzlement under § 523(a)(4): “(1) the debtor appropriated funds for his or her own benefit; and (2) the debtor did so with fraudulent intent or deceit.” *In re Weber*, 892 F.2d at 538.

The court finds that the same facts comprised the basis of the criminal judgment and of the dischargeability complaint in this adversary proceeding. The defendant’s admission of misapplication of funds, with intent to defraud the bank, was essential to her guilty plea. The criminal conviction based upon that plea conclusively established the defendant’s criminal conduct of embezzlement. This court finds that embezzlement, under § 523(a)(4), requires the same elements of fraudulent appropriation of funds in this bankruptcy proceeding. The determination of embezzlement was actually and necessarily decided in the prior action and was essential to the final judgment. For that reason, the court determines that the Judgment in a Criminal Case, based on the defendant’s guilty plea, has a collateral estoppel effect in this adversary proceeding. Three cases that compared the same issues under 18 U.S.C. § 656 and 11 U.S.C. § 523(a)(4) have so found. *See Federal Deposit Ins. Corp. v. Johnson (In re Johnson)*, 108 B.R. 129, 134 (Bankr. W.D. Tex. 1989) (finding that the elements of embezzlement under § 523(a)(4) were “identical to those involved in the Criminal Case, that they were actually litigated in the Criminal Case, and that their determination was necessary to the resulting judgment”); *Federal Deposit Ins. Corp. v. Wright (In re Wright)*, 87 B.R. 1011, 1020 (Bankr. D.S.D. 1988) (finding that the debtor’s defalcation under § 523(a)(4) and the criminal conviction of misapplication of bank funds were the same); *St.*

Paul Fire & Marine Ins. Co. v. Magnafici (In re Magnafici), 16 B.R. 246, 254 (Bankr. N.D. Ill. 1981) (finding that the embezzlement criminal conviction was “essentially the same” as the embezzlement condition of § 523(a)(4)). The court therefore grants summary judgment to the plaintiffs pursuant to § 523(a)(4).

Having found that the debt was excepted from discharge under § 523(a)(4), the court need not consider the plaintiffs’ other theory of recovery under § 523(a)(6). However, a brief comment is required. Subsection (a)(6) provides that a debtor may not discharge a debt “for willful and malicious injury by the debtor to another entity or to the property of another entity.” The Supreme Court has made clear that “[t]he word ‘willful’ in (a)(6) modifies the word ‘injury,’ indicating that nondischargeability takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury.” *Kawaauhau v. Geiger*, 523 U.S. 57, 61, 118 S. Ct. 974, 977, 140 L.Ed.2d 90 (1998).

The court finds that, by her guilty plea, the defendant admitted that she willfully or intentionally misapplied the bank’s funds. The intent to injure is an element of the crime of embezzlement under 18 U.S.C. § 656. However, the crime does not have, as one of its elements, malice or malicious injury. Malice, under the common law, requires that the defendant acted in conscious disregard of his or her duties or without just cause. *See Lynn v. Cline (In re Cline)*, 227 B.R. 828, 832 (Bankr. S.D. Ind. 1998). Two cases have considered whether proof of “willful and malicious injury by the debtor” was actually and necessarily litigated in a criminal embezzlement conviction. Both were decided by bankruptcy courts before the Supreme Court’s interpretation of § 523(a)(6) in *Kawaauhau v. Geiger*, and both had criminal records based upon trials on the merits. One case found that the jury instruction at trial contained substantially the same phrase “in conscious disregard of one’s duties” and therefore found the § 656 debt nondischargeable under § 523(a)(6). *See In re Johnson*, 108 B.R. at 135. The other case found, again after a full jury trial, that there was “nothing in the indictment or the jury’s required findings to show that the debtor acted with malice.” *In re Wright*, 87 B.R. at 1020. Because malice

was not actually litigated in the criminal proceeding, the bankruptcy court did not apply collateral estoppel to preclude litigation of the debtor's malicious injury to the bank. *Id.*

In this case, however, the criminal judgment resulted from a plea of guilt and there is no underlying trial record for this court to review. The plaintiffs asserted that the defendant's injury to the bank was deliberate and intentional, but they did not demonstrate the "malice" element required under § 523(a)(6). On this record, the court cannot find that the defendant's criminal conviction required proof of malicious conduct. Because the issue of malice was not involved in the prior action, the court finds that collateral estoppel is not applicable and thus that summary judgment under § 523(a)(6) must be denied.

The court notes that the debt to the plaintiffs clearly originated from the defendant's embezzlement. She pleaded guilty to the conduct in federal district court; in this adversary proceeding, she affirmed that she did not dispute the validity of the debt. *See In re Short*, 176 B.R. 886, 887 (Bankr. S.D. Ind. 1995). Indeed, in a letter to the court she acknowledged the nondischargeable nature of the debt and declined to respond to the summary judgment motion. The restitution the defendant is paying, in the amount of \$52,474.80, was derived from the plaintiffs' claims of injury in the criminal proceeding. The court finds that the defendant has not contested the facts established by the criminal conviction or the legal arguments raised in this adversary. It determines that the facts are sufficient to satisfy all the requirements under § 523(a)(4), and therefore that the criminal judgment is entitled to collateral estoppel effect on Count I of the complaint. Summary Judgment is granted with regard to § 523(a)(4).

Conclusion

Based on the foregoing factual findings and legal conclusions, the court finds that the plaintiffs Federal Insurance Company and Bayer Federal Credit Union are entitled to summary judgment on Count I of the Complaint to Determine Dischargeability of Debt but are not entitled to summary judgment on Counts II and III

of the Complaint. It has determined that the embezzlement conviction of the defendant Christine Marie Ward is entitled to collateral estoppel effect and that the restitution award resulting from the embezzlement conviction is nondischargeable under 11 U.S.C. § 523(a)(4).

Accordingly, the court grants summary judgment on Count I of the plaintiffs' complaint, denies summary judgment on Counts II and III of the complaint, and determines that the debt of the defendant to the plaintiffs in the amount of \$52,474.80, being paid according to the terms of restitution set forth in the criminal judgment, is nondischargeable under 11 U.S.C. § 523(a)(4).

SO ORDERED.



HARRY C. DEES, JR., CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT