

AUG 21 2012

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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

1 In re:) BAP No. NC-10-1208-BaJuH
2 ANTHONY A. MALFATTI,)
3 Debtor.) Adv. Pro. No. 09-04318
4 _____)
5 ANTHONY A. MALFATTI,)
6 Appellant,)
7 v.) **MEMORANDUM**¹
8 BANK OF AMERICA, N.A.;)
9 MBNA AMERICAN BANK, N.A.,)
10 Appellees.)
11 _____)

Submitted on May 11, 2011
at San Francisco, California

Filed - August 21, 2012

Appeal from the United States Bankruptcy Court
for the Northern District of California

Honorable Edward D. Jellen, Bankruptcy Judge, Presiding

Appearances: William F. Abbott, Esq. argued for Appellant;
Douglas Boven, Esq. of Reed Smith LLP argued for
Appellees.

Before: JURY, HOLLOWELL, and BARRECA², Bankruptcy Judges.

¹ This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

² Hon. Marc L. Barreca, Bankruptcy Judge for the Western District of Washington, sitting by designation.

1 The bankruptcy court granted Plaintiffs' motion for summary
2 judgment, ruling that the judgment owed by Debtor-Defendant to
3 Plaintiffs was non-dischargeable under Code § 523(a)(6) on the
4 basis of issue preclusion.³ Debtor appealed.

5 The underlying judgment was entered as a penalty default
6 judgment as a discovery sanction in an Alabama state court
7 proceeding. The bankruptcy court applied issue preclusion on the
8 premise that an Alabama state court would have treated the issues
9 as "actually litigated."⁴ As there was no controlling Alabama
10 case law on this question, the Panel certified it to the Supreme
11 Court of Alabama. That court answered in the negative.

12 Accordingly, we REVERSE and REMAND.

14 I. FACTS

15 Malfatti was one of three principals of TA Financial Group
16 ("TAF"), a Nevada corporation, purportedly designed to assist
17 credit card holders in arbitration of disputes with the card
18 issuers. The arbitration providers were selected by the card
19 holders from a list provided by TAF. Among the arbitration
20 providers was Arbitration Forum of America, Inc. ("AFOA"), an

21
22 ³ Absent contrary indication, all "Code," chapter and section
23 references herein are to the Bankruptcy Code, 11 U.S.C. §§ 101-
1532.

24 ⁴ The Supreme Court has applied the Restatement (Second) of
25 Judgments' substitution of the terms "claim preclusion" and
26 "issue preclusion" for the terms "res judicata" and "collateral
27 estoppel," respectively. George v. City of Morro Bay, 318 B.R.
28 729, 733 (9th Cir. BAP 2004), aff'd, 144 Fed. Appx. 636 (9th Cir.
2005). Thus, although the parties and Alabama jurisprudence
commonly use the term "collateral estoppel," the term "issue
preclusion" is used herein.

1 Alabama corporation. Once an arbitration award was entered, a
2 separate company, TAG Services, an Alabama limited liability
3 company, would file the awards in the Circuit Court of Jackson
4 County, Alabama, and then reduce the awards to judgments. In
5 fact, AFOA was not conducting legitimate arbitrations, but
6 instead was a sham. Every arbitration resulted in an award in
7 favor of the card holder, which was then reduced to judgment.
8 Malfatti claims he was unaware that AFOA's practices and the
9 judgments stemming therefrom were illegitimate.

10 At some time after the card-issuing banks involved learned
11 of the judgments, they filed cross-complaints against the card
12 holders in the Circuit Court of Jackson County, Alabama to set
13 aside the judgments as fraudulently obtained. In September 2005,
14 the banks, including Bank of America, N.A. (USA) and MBNA America
15 Bank, N.A.(together, "Banks" or "Appellees"), filed Amended Third
16 Party Complaints against, among others, Malfatti and TAF,
17 alleging tortious interference with contract, abuse of process,
18 wantonness, and civil conspiracy, and seeking an injunction
19 against further arbitrations. Malfatti and TAF were served with
20 the complaints in November 2005, and answered the complaints in
21 January 2006.

22 Malfatti and TAF actively participated in the state court
23 proceedings, vigorously contesting personal jurisdiction. They
24 consistently refused to cooperate with discovery, failing to
25 respond to interrogatories and requests for production and
26 failing to appear for noticed depositions. They also failed to
27 comply with various discovery orders issued by the court.

28

1 On March 6, 2007, the court granted the Banks' motion for
2 default judgment as a sanction for failure to cooperate with
3 discovery. On October 4, 2007, the court entered an order
4 denying Malfatti and TAF's motion to set aside the defaults, and
5 after a hearing on the Banks' motion for damages and injunctive
6 relief, judgment was entered against Malfatti and TAF on
7 February 19, 2008.

8 The court found Malfatti and TAF to be jointly and severally
9 liable for compensatory damages, awarded punitive damages against
10 Malfatti, and found Malfatti to be liable for punitive damages
11 awarded against TAF under the alter ego doctrine. Damages
12 against Malfatti totaled \$513,270.35 (the "Judgment"). Malfatti
13 and TAF moved to "amend, alter, vacate or set aside" the Judgment
14 and filed for summary judgment on their claims against the Banks.
15 The court denied both motions.

16 Malfatti filed for chapter 7 bankruptcy on April 27, 2009.
17 On July 30, 2009, the Banks filed an adversary proceeding
18 alleging the debt owed to them by Malfatti was nondischargeable
19 pursuant to § 523(a)(6). On March 3, 2010, the Banks moved for
20 summary judgment, alleging that the Alabama Judgment was
21 nondischargeable by virtue of issue preclusion. Malfatti opposed
22 the summary judgment on the basis that the Judgment was a default
23 judgment, arguing that Alabama law does not grant issue
24 preclusive effect to default judgments. The bankruptcy court
25 granted summary judgment, finding all amounts owed to the Banks
26 to be nondischargeable.

27 The bankruptcy court applied issue preclusion on the premise
28 that an Alabama state court would do so when the prior proceeding

1 was resolved by a penalty default judgment, as opposed to a
2 simple default judgment. As there was no controlling precedent
3 under Alabama law, the Panel certified the following question to
4 the Supreme Court of Alabama:

5 In Alabama, is a "default" judgment premised upon
6 discovery sanctions or other post-answer conduct of the
7 defendant sufficient to support the application of
8 issue preclusion in a later proceeding?

9 That court issued its opinion on June 29, 2012, answering
10 this question in the negative.

11 **II. JURISDICTION**

12 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
13 § 1334 and § 157(b)(1) and (b)(2)(I). The Panel has jurisdiction
14 pursuant to 28 U.S.C. § 158(c).

15 **III. ISSUE**

16 Whether the bankruptcy court erred in granting summary
17 judgment on the basis of issue preclusion where the underlying
18 Alabama state court judgment was issued by "default" premised
19 upon discovery sanctions.
20

21 **IV. STANDARD OF REVIEW**

22 A bankruptcy court's order granting summary judgment is
23 reviewed de novo. Abdul-Jabbar v. General Motors Corp.,
24 85 F.3d 407, 410 (9th Cir. 1996); Jung Sup Lee v. TCAST Commc'n.,
25 Inc., 335 B.R. 130, 135 (9th Cir. BAP 2005). Viewing the
26 evidence in the light most favorable to the non-moving party, the
27 Panel must determine whether there are genuine issues of material
28

1 fact and whether the bankruptcy court correctly applied relevant
2 substantive law. See Bishop, Baldwin, Rewald, Dillingham, &
3 Wong, Inc. v. Brooks, 819 F.2d 214, 215 (9th Cir. 1987).

4 5 **V. DISCUSSION**

6 Issue preclusion may be applied in non-dischargeability
7 proceedings under Bankruptcy Code § 523(a). Grogan v. Garner,
8 498 U.S. 279, 284-85, 111 S. Ct. 654, 658 n.11 (1991). A state
9 court judgment is entitled to issue preclusive effect in a
10 subsequent federal court proceeding to the same extent that it
11 would be entitled to issue preclusive effect in a court of the
12 state which entered the judgment. Gayden v. Nourbakhsh, 67 F.3d
13 798, 800 (9th Cir. 1995). Thus, the bankruptcy court, and this
14 Panel, must look to state law to determine whether application of
15 issue preclusion is appropriate.

16 In Alabama,

17 Collateral estoppel operates where the subsequent suit
18 between the same parties is not on the same cause of
19 action. Requirements for collateral estoppel to
20 operate are (1) issue identical to one involved in
21 previous suit; (2) issue actually litigated in prior
action; and (3) resolution of the issue was necessary
to the prior judgment. . . . If these elements are
present, the prior judgment is conclusive as to those
issues actually determined in the prior suit.

22 Wheeler v. First Alabama Bank of Birmingham, 364 So. 2d 1190,
23 1199 (Ala. 1978) (emphasis added).

24 Here, there is no dispute that the parties are the same, the
25 issues are the same, and the resolution of the issues was
26 necessary to the prior judgment. Further, Malfatti does not
27 dispute that the factual elements needed to prove a willful and
28 malicious injury per § 523(a)(6) were at issue in the Alabama

1 litigation. Indeed, punitive damages were awarded against
2 Malfatti and TAF in a separate, contested evidentiary hearing.
3 Malfatti argues on appeal that because a default was entered
4 against him on the basis of procedural sanctions, the "actually
5 litigated" requirement has not been satisfied, and therefore
6 issue preclusion cannot be applied under Alabama law.

7 The Supreme Court of Alabama agrees. That court, while
8 acknowledging other jurisdictions' application of an exception to
9 the general rule that default judgments are not entitled to
10 preclusive effect, concluded that its precedents leave no room
11 for such an exception:

12 For purposes of determining whether an issue is
13 precluded by the doctrine of collateral estoppel,
14 Alabama law makes no distinction between a simple
15 default and a penalty default. There are "clear
16 controlling precedents in the decisions," Rule 18, Ala.
17 R. App. P., of this Court adhering to the traditional
18 federal view denying preclusive effect to all default
19 judgments on the ground that preclusive effect should
20 not be given to claims that were not actually litigated
21 in a prior action. Accordingly, we answer the question
22 certified to us by the BAP in the negative.

23 Malfatti v. Bank of America, N.A., ___ So. 3d ___, 2012 WL
24 2477945, at *6 (Ala. June 29, 2012) (citations omitted).

25 VI. CONCLUSION

26 Because the bankruptcy court incorrectly applied the
27 relevant substantive law, it erred in granting summary judgment
28 on the basis of issue preclusion. We REVERSE and REMAND for
further proceedings in accordance with this disposition.