

MAR 06 2013

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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NOT FOR PUBLICATION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. CC-12-1118-PaMkBe  
2 KEVIN WASKO and CASSONDRA DEHAY, )  
3 Debtors. ) Bankr. No. 07-10845-MT  
4 ) Adv. Proc. 07-01136-MT  
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STUART H. KAPLAN, M.D.;  
MOONDANCE, LLC,  
Appellants,  
v. ) **M E M O R A N D U M**<sup>1</sup>  
KEVIN WASKO; CASSONDRA DEHAY,  
Appellees.

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Argued and Submitted on November 15, 2012,  
at Pasadena, California

Filed - March 6, 2013

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

Honorable Maureen Tighe, Bankruptcy Judge, Presiding

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Appearances: Alan Wayne Forsley of Fredman Knupfer Lieberman LLP  
argued for appellants Stuart H. Kaplan, M.D. and  
Moondance, LLC; Jerome Bennett Friedman of Friedman  
Law Group, P.C. argued for appellees Kevin Wasko  
and Cassandra Dehay.

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Before: PAPPAS, MARKELL and BEESLEY,<sup>2</sup> Bankruptcy Judges.

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<sup>1</sup> 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.

<sup>2</sup> The Honorable Bruce T. Beesley, United States Bankruptcy Judge for the District of Nevada, sitting by designation.

1 The bankruptcy court granted the motion for summary judgment  
2 of appellants Stuart H. Kaplan, M.D. ("Kaplan") and Moondance  
3 LLC,<sup>3</sup> and determined that their claim under a state court judgment  
4 against chapter 7<sup>4</sup> debtors Kevin Wasko and Cassondra Dehay  
5 (collectively "Debtors") for \$1,493,569.06 was excepted from  
6 discharge under §§ 523(a)(2), (a)(4) and (a)(6). The bankruptcy  
7 court declined, however, to grant Kaplan's motion to amend the  
8 summary judgment to include an exception to discharge for the  
9 state court's later award against Debtors of \$495,642.97 in  
10 attorney's fees. Kaplan appeals the denial of that motion. On  
11 this record, we VACATE the bankruptcy court's order and REMAND  
12 this matter for further proceedings.

13 **FACTS**

14 The State Court Action

15 Kaplan is a dermatologist. Debtors jointly operated  
16 nightclubs both before and after their marriage in 2000. Sometime  
17 in 1997 or 1998, Debtors became Kaplan's patients. Their  
18 professional relationships developed into personal friendships.

19 In 2001, Debtors approached Kaplan with a proposal that he  
20 invest in a nightclub they intended to open and and operate in  
21 Marbella, Spain, called Luna Azul (the "Property") through a new  
22 company known as Spanish Investments Network ("SIN"). Debtors  
23

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24 <sup>3</sup> Moondance LLC is a company controlled by Kaplan. For  
25 convenience, we refer to both appellants as Kaplan.

26 <sup>4</sup> Unless otherwise indicated, all chapter, section and rule  
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and  
28 The Federal Rules of Bankruptcy Procedure, Rules 1001-9037.  
The Federal Rules of Civil Procedure are referred to as Civil  
Rules.

1 offered Kaplan a 50 percent ownership interest in SIN if he would  
2 give them \$500,000. Kaplan agreed, and on March 6, 2002, wire  
3 transferred the \$500,000 to the SIN bank account. In early April,  
4 2002, Kaplan transferred an additional \$250,000 to SIN. As the  
5 state court judge would later find, a few months after the funds  
6 were transferred, Debtors "ceased all communication with [Kaplan]  
7 and disappeared, without report on the status of the venture or  
8 any explanation." Statement of Decision, Kaplan v. Wasko, Case  
9 No. SC082177 (Los Angeles Superior Court, November 22, 2010)  
10 (hereafter "SOD").

11 On June 24, 2004, Kaplan filed suit against Debtors in Los  
12 Angeles Superior Court (the "State Court Action"). Kaplan's  
13 complaint, amended twice, alleged eleven causes of action against  
14 Debtors, including fraud and breach of fiduciary duty. Kaplan  
15 sought to recover the \$750,000 investment, plus interest, punitive  
16 damages, attorney's fees and costs.

17 On March 19, 2007, Debtors filed a bankruptcy petition.<sup>5</sup>  
18 Their schedule E listed a contingent, unliquidated, disputed debt  
19 to Kaplan for \$750,000.

20 Shortly thereafter, on March 26, 2007, Debtors caused the  
21 State Court Action to be removed to the bankruptcy court. Despite  
22 Debtors' objection, the bankruptcy court remanded the State Court  
23 Action to the state court on June 7, 2007.

24 Few details concerning the subsequent proceedings in the  
25 State Court Action were included in the appellate record.

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26  
27 <sup>5</sup> While Debtors originally sought relief under chapter 11,  
28 the bankruptcy court granted Debtors' motion to convert the case  
to chapter 7 on October 24, 2011.

1 However, it appears that the state court bifurcated the issues for  
2 trial. The first phase of the bench trial occurred from  
3 February 23 to April 28, 2010, and addressed the liability and  
4 compensatory damage issues. The state court issued a tentative  
5 decision finding in favor of Kaplan and against Debtors on the  
6 liability issues, and determining that Kaplan was entitled to an  
7 award of compensatory damages. While the state court expected to  
8 begin the second phase of the trial concerning Kaplan's claim for  
9 punitive damages on October 27, 2010, the parties stipulated to an  
10 award of \$100,000 in exemplary damages, which the state court  
11 could incorporate in its judgment.

12 The state court then issued a detailed statement of decision,  
13 explaining, in part, that:

14 The evidence at trial of defendants' misconduct, fraud and  
15 breaches of fiduciary duties established that the conduct of  
16 both defendants was willful, and that each of them acted  
fraudulently and with malice.

17 SOD at 39. The state court entered a judgment ("Judgment") for  
18 Kaplan and against Debtors on November 22, 2010. It granted  
19 relief to Kaplan based upon Debtors' negligent misrepresentation;  
20 deceit and fraud in the inducement; breach of fiduciary duty;  
21 money had and received; breach of oral contract; conspiracy; and  
22 embezzlement. The Judgment awarded Kaplan \$750,000 in  
23 compensatory damages from Debtors plus interest. Per the parties'  
24 stipulation, the court also awarded Kaplan \$100,000, plus  
25 interest, in exemplary damages for fraud, breach of fiduciary  
26 duty, conspiracy and embezzlement. Debtors did not appeal the  
27 Judgment.

28 At some later date not clear in the record, Kaplan filed a

1 motion under Cal. Code Civ. Proc. § 2033.420<sup>6</sup> requesting cost-of-  
2 proof sanctions against Debtors for failing to admit certain  
3 Requests for Admissions (the "RFA Motion"). The state court held  
4 a hearing on the RFA Motion on February 9, 2011. A hearing  
5 transcript is not included in our record.

6 After the hearing and supplemental briefing by the parties,  
7 on June 29, 2011, the state court entered an order granting  
8 Kaplan's motion and imposing sanctions against Debtors under the  
9 California statute (the "RFA Sanctions Order"). In the order, the  
10 court found that Debtors had each failed to admit to the Requests  
11 for Admission, and that:

12 these requests sought admission of matters within the  
13 knowledge of [Debtors], and plaintiffs ultimately proved  
14 the subject matter of the requests true at trial.  
15 [Their] failure to admit these requests was in bad faith  
16 and part of a scheme that defendants employed to  
17 wrongfully take and convert plaintiffs' investment.

18 RFA Sanctions Order at 2-3 ¶¶ 1-2. The state court awarded Kaplan  
19 "\$495,642.97, jointly and severally against [Debtors], pursuant to  
20 Code of Civil Procedure section 2033.420 for [his] costs in  
21 proving the subject matter of the requests for admission addressed  
22 by the motion[.]" RFA Sanctions Order at 7 ¶ 24. The state court

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21 <sup>6</sup> **Expenses incurred in proving matters which**  
22 **party to whom request was directed failed to**  
23 **admit; When court to require payment**

24 (a) If a party fails to admit the genuineness of any  
25 document or the truth of any matter when requested to do  
26 so under this chapter, and if the party requesting that  
27 admission thereafter proves the genuineness of that  
28 document or the truth of that matter, the party  
requesting the admission may move the court for an order  
requiring the party to whom the request was directed to  
pay the reasonable expenses incurred in making that  
proof, including reasonable attorney's fees.

CAL. CODE CIV. PROC. § 2033.420.

1 based the amount of the award on the report submitted by Kaplan's  
2 attorney containing "a detailed accounting of the number of hours  
3 spent in proving the matters required to [be] proved solely due to  
4 Defendants' unreasonable – and dishonest – failure to admit these  
5 matters." RFA Sanctions Order at 7 ¶ 21.

6 The Adversary Proceeding

7 In June 2007, shortly after the bankruptcy court remanded the  
8 State Court Action, Kaplan had commenced an adversary proceeding  
9 against Debtors seeking an exception to discharge for his claims  
10 against Debtors under § 523(a)(2)(A), (a)(4) and (a)(6). The  
11 bankruptcy court held this adversary proceeding in abeyance while  
12 the State Court Action proceeded to a conclusion.

13 After the state court's entry of the Judgment and RFA  
14 Sanctions Order, on July 21, 2011, Kaplan filed a motion for  
15 summary judgment in the adversary proceeding. Specifically,  
16 Kaplan argued that there were no genuine issues of fact, and that  
17 both the state court Judgment and RFA Sanctions Order were  
18 preclusive and controlled the disposition of his discharge  
19 exception claims in the adversary proceeding.

20 Debtors filed a limited opposition to the summary judgment  
21 motion on August 19, 2011. Although they did not contest Kaplan's  
22 request for an exception to discharge for the Judgment, they  
23 argued that the RFA Sanctions Order was not yet a final judgment  
24 and that they intended to appeal that order in the state court  
25 system.<sup>7</sup>

26 The bankruptcy court conducted a hearing on the Kaplan  
27

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28 <sup>7</sup> The RFA Sanctions Order was never appealed.

1 summary judgment motion on September 1, 2011. Without opposition,  
2 the court granted Kaplan an exception to discharge under  
3 § 523(a)(2)(A), (a)(4) and (a)(6) for \$1,493,569.06, the damages  
4 awarded to him in the Judgment. Agreeing with Debtors, the  
5 bankruptcy court denied the motion as to the RFA Sanctions Order  
6 because it was not yet a final order of the state court (the  
7 "Summary Judgment Order"). The Summary Judgment Order granted  
8 leave to Kaplan to amend their summary judgment motion when the  
9 RFA Sanctions Order became a final order.

10 On November 15, 2011, Kaplan filed a motion to amend the  
11 Summary Judgment Order<sup>8</sup> to add the award made in the RFA Sanctions  
12 Order, which was now final. To support this motion, Kaplan relied  
13 upon this Panel's decisions in Florida v. Ticor Title Ins. Co.  
14 (In re Florida), 164 B.R. 636 (9th Cir. BAP 1994) and Roussos v.  
15 Michaelides (In re Roussos), 251 B.R. 86 (9th Cir. BAP 2000) which  
16 he contended had held that a debt for a creditor's attorney's fees  
17 and costs awarded under state law should be excepted from  
18 discharge if that obligation arose from the same conduct that gave  
19 rise to the underlying indebtedness. Kaplan argued that the RFA  
20 Sanctions Order arose from the same conduct by Debtors as that  
21 giving rise to the other damages awarded in the nondischargeable  
22 Judgment, and therefore, that the attorney's fees award should  
23 also be excepted from discharge.

24 \_\_\_\_\_  
25 <sup>8</sup> Although the bankruptcy court granted Kaplan leave to  
26 amend the summary judgment motion, Kaplan moved to amend the  
27 Summary Judgment Order. The bankruptcy court did not find this  
28 procedure objectionable, nor do we. In effect, by this motion,  
Kaplan renewed his request for entry of a summary judgment  
determining that the award to Kaplan in the RFA Sanctions Motion  
was excepted from discharge.

1 Debtors responded to Kaplan's motion to amend the Summary  
2 Judgment Order on November 28, 2011. Debtors argued that, unless  
3 there is an underlying statutory or contractual basis for awarding  
4 attorney's fees, then any award, even when ancillary to the  
5 nondischargeable claim, is subject to discharge.

6 The bankruptcy court conducted a hearing on Kaplan's motion  
7 to amend on December 7, 2011. After considering the parties'  
8 arguments, the court continued the hearing so that it could review  
9 the case law.

10 At the continued hearing on February 15, 2012, the bankruptcy  
11 court announced its decision on the record. It denied Kaplan's  
12 motion to amend the summary judgment to include an exception to  
13 discharge for the attorneys fees awarded in the RFA Sanctions  
14 Order because, in the words of the bankruptcy court, those fees  
15 "as they've been awarded below, are not directly consequential  
16 from the nondischargeability issue." Hr'g Tr. 1:22-23,  
17 February 15, 2012.

18 The bankruptcy court's order denying Kaplan's motion was  
19 entered on February 21, 2012 (the "Second Summary Judgment  
20 Order"). Kaplan filed a timely appeal on March 6, 2012.

#### 21 JURISDICTION

22 The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334  
23 and 157(b)(2)(I). We have jurisdiction under 28 U.S.C. § 158.

#### 24 ISSUES

25 Whether the bankruptcy court erred when it denied Kaplan's  
26 motion for to amend the summary judgment and determined that the  
27 award of attorneys fees by the state court in the RFA Sanctions  
28 Order was not excepted from discharge.





1 Civil Rule 56(c)(2), incorporated by Rule 7056; Barboza v. New  
2 Form, Inc. (In re Barboza), 545 F.3d 702, 707 (9th Cir. 2008).  
3 Exceptions to discharge must be strictly construed. Snoke v. Riso  
4 (In re Riso), 978 F.2d 1151, 1154 (9th Cir. 1992) (“[G]iven the  
5 strong fresh start policy in the Code, exceptions to discharge are  
6 strictly construed against an objecting creditor and in favor of  
7 the debtor.”); Ghomeshi v. Sabban (In re Sabban), 384 B.R. 1, 5  
8 (9th Cir. BAP 2008), aff'd, 600 F.3d 1219, 1222 (9th Cir. 2010).  
9 A trial court may grant summary judgment on the basis of issue  
10 preclusion. Granite Rock Co. v. Int'l Bhd. of Teamsters, Local  
11 287, 649 F.3d 1067, 1070 (9th Cir. 2011).

12 In this appeal, the bankruptcy court effectively granted  
13 summary judgment twice. First, without opposition from Debtors,  
14 it determined in the Summary Judgment Order that, based on issue  
15 preclusion, the damages awarded by the state court to Kaplan in  
16 the Judgment were excepted from discharge under §§ 523(a)(2),  
17 (a)(4) and (a)(6). However, in the Summary Judgment Order, the  
18 bankruptcy court declined to allow an exception to discharge of  
19 the attorney’s fees awarded to Kaplan in the RFA Sanctions Order  
20 because, it decided, there was an “issue of contention” as to  
21 whether the RFA Sanctions Order should be “given the same  
22 preclusive effect as that given the Judgment.” Tentative Ruling  
23 (adopted in the Summary Judgment Order) at 2, September 1, 2011.

24 Then, after the RFA Sanctions Order became final, at the  
25 hearing on February 15, 2012, the bankruptcy court not only denied  
26 Kaplan’s motion to amend the Summary Judgment Order to include an  
27 exception to discharge for the RFA Sanctions Order, but the court  
28 effectively held that the attorney’s fees awarded by the state

1 court were indeed discharged. According to the bankruptcy court:

2 [T]he Florida case is actually not controlling here  
3 because the attorney fees, as they've been awarded  
4 below, are not directly consequential from the  
5 nondischargeability issue. . . . And the  
6 dischargeability status depends on the primary debt  
7 that's nondischargeable. . . . [T]his is on [] giving  
8 preclusive effect to an earlier judgment, and the Court  
9 needs to evaluate all the factors on whether it's a fair  
10 and good policy to give preclusive effect. It doesn't -  
11 it's not supported.

12 Hr'g Tr. 1:21-2:11, February 15, 2012.

13 As near as we can discern, the bankruptcy court apparently  
14 decided that issue preclusion should not be applied to the state  
15 court's findings in the RFA Sanctions Order in deciding whether  
16 the attorney's fees it awarded could be discharged. In its oral  
17 ruling, the bankruptcy court did not clearly articulate why it  
18 declined to apply issue preclusion, nor did it identify "all the  
19 factors" it considered in reaching its conclusion. As explained  
20 below, these omissions are problematic.

21 Availability of Issue Preclusion

22 Simply stated, issue preclusion "bars 'successive litigation  
23 of an issue of fact or law that was actually litigated and  
24 resolved in a valid court determination essential to that prior  
25 judgment,' even if the issue recurs in the context of a different  
26 claim." Taylor v. Sturgell, 553 U.S. 880, 892 (2008) (quoting New  
27 Hampshire v. Maine, 532 U.S. 742, 748-49 (2001)). The purpose of  
28 issue preclusion is to conserve judicial resources and foster  
confidence in the outcome of adjudications by providing finality  
and avoiding inconsistent rulings. See Taylor, 553 U.S. at 892.  
It is settled that issue preclusion may be applied in exception to  
discharge proceedings. Grogan v. Garner, 498 U.S. 279, 284-85

1 (1991).

2 The RFA Sanction Order was entered by a California state  
3 court. To determine the preclusive effect of a California state  
4 court's findings in a judgment or order, the bankruptcy court must  
5 first determine if issue preclusion is available under California  
6 preclusion law. 28 U.S.C. § 1738 (the Full Faith and Credit  
7 Statute); Marrese v. Am. Acad. of Orthopaedic Surgeons, 470 U.S.  
8 373, 380 (1985). When state preclusion law controls, the  
9 discretion to apply the doctrine is exercised in accordance with  
10 state and federal law. Khaligh v. Hadeqh (In re Khaligh),  
11 338 B.R. 817, 823 (9th Cir. BAP 2006), aff'd, 506 F.3d 956  
12 (9th Cir. 2007).

13 Under California law, the party asserting issue preclusion  
14 has the burden of establishing the following "threshold"  
15 requirements for its availability:

16 First, the issue sought to be precluded from  
17 relitigation must be identical to that decided in a  
18 former proceeding. Second, this issue must have been  
19 actually litigated in the former proceeding. Third, it  
20 must have been necessarily decided in the former  
21 proceeding. Fourth, the decision in the former  
22 proceeding must be final and on the merits. Finally,  
23 the party against whom preclusion is sought must be the  
24 same as, or in privity with, the party to the former  
25 proceeding.

26 Harmon v. Kobrin (In re Harmon), 250 F.3d 1240, 1245 (9th Cir.  
27 2001) (the "Harmon" requirements).

28 Here, there does not appear to be any dispute that some of  
the Harmon criteria are satisfied by the RFA Sanctions Order. It  
was a final order, and the parties and their adversarial positions  
in state court were the same as in this litigation. What is  
disputed in this appeal, however, is whether the issue decided in

1 state court, i.e., Debtors' liability for attorneys' fees to  
2 Kaplan under Cal. Code Civ. Proc. § 2033.420, was identical,  
3 actually litigated, and necessarily decided in relation to the  
4 issues before the bankruptcy court, i.e., whether that "debt"  
5 arose from conduct of the type giving rise to an exception to  
6 discharge under § 523(a)(2), (a)(4) and/or (a)(6).

7 In reaching its decision, there is no indication in the  
8 record before us that the bankruptcy court conducted a review of  
9 the RFA Sanctions Order to address the three questionable Harmon  
10 factors. Instead, the bankruptcy court appears to have ruled that  
11 issue preclusion would not be applied for reasons of public  
12 policy: "[T]his is on [] giving preclusive effect to an earlier  
13 judgment, and the Court needs to evaluate all the factors on  
14 whether it's a fair and good policy to give preclusive effect [to  
15 the RFA Sanctions Order.] It doesn't – it's not supported." Hr'g  
16 Tr. 27-11, February 15, 2012.

17 In short, the bankruptcy court acknowledges that it was  
18 conducting an issue preclusion analysis of the RFA Sanctions  
19 Order. However, the court did not explain what factors it was  
20 evaluating or why it was not "fair and good policy to give  
21 preclusive effect" to the RFA Sanctions Order. Further, it would  
22 appear that the court conflated whether issue preclusion was in  
23 fact available with the second part of the analysis, whether it  
24 should be applied.

#### 25 Application of Issue Preclusion in Exceptions to Discharge

26 Bankruptcy courts "have exclusive jurisdiction to determine  
27 dischargeability of debts under §§ 523(a)(2) (fraud and  
28 deception); (a)(4) (fiduciary fraud, embezzlement, or larceny);

1 and (a)(6) (willful and malicious injury to person or property)."  
2 Ackerman v. Eber (In re Eber), 687 F.3d 1123, 1128 (9th Cir.  
3 2012); see § 523(c)(1). The effect of this rule is that "the  
4 bankruptcy court is not confined to a review of the judgment and  
5 record in the prior state-court proceedings when considering the  
6 dischargeability of [a creditor's] debt." Brown v. Felsen,  
7 442 U.S. 127, 129-30 (1979). In other words, "final judgments in  
8 state courts are not necessarily preclusive in United States  
9 bankruptcy courts." Sasson v. Sokoloff (In re Sasson), 424 F.3d  
10 864, 872 (9th Cir. 2005).

11 Therefore, although all federal courts have "broad  
12 discretion" in a decision to apply issue preclusion based on a  
13 state court judgment, Parklane Hosiery Co., 439 U.S. at 331, that  
14 discretion is particularly expansive in exceptions to discharge  
15 under § 523(a)(2), (a)(4) and (a)(6). Comer v. Comer  
16 (In re Comer), 723 F.2d 737, 740 (9th Cir. 1984) (holding that a  
17 bankruptcy judge should not "rely solely on state court judgments  
18 when determining the nature of a debt for purposes of  
19 dischargeability, if doing so would prohibit the bankruptcy court  
20 from exercising its exclusive jurisdiction to determine  
21 dischargeability.")

22 The Panel has previously provided guidelines for bankruptcy  
23 courts on how to satisfy their independent responsibility to  
24 determine if the findings of a state court judgment should be  
25 applied to justify an exception to discharge based on issue  
26 preclusion. In re Lopez, 367 B.R. at 99. Observing that, "at its  
27 heart, the decision to apply issue preclusion entails a measure of  
28 discretion and flexibility," id. at 107, the Panel noted that

1 bankruptcy courts are guided by the concepts incorporated in the  
2 Restatement (Second) of Judgments:

3 "the need for flexibility in the operative principles,  
4 and this recognition has served as the basis for the  
5 exceptions to the rule of issue preclusion set forth in  
6 § 28." RESTATEMENT (SECOND) OF JUDGMENTS, Title E,  
7 Introductory Note (1980). The exceptions to the general  
8 rule of issue preclusion that are set out in Restatement  
9 (Second) § 28 include such flexible concepts as: change  
in applicable legal context; avoiding inequitable  
administration of laws; differences in quality or  
extensiveness of procedures; and lack of adequate  
opportunity or incentive to obtain a full and fair  
adjudication in the initial action. Id. §§ 28(2), (3) &  
(5).

10 Id.; see also Parklane Hosiery Co., 439 U.S. at 327 n.6, 330 n.13,  
11 331 n.14, 333 n.21, 353, 354 n.22 (where the Supreme Court cites  
12 the Restatement and Restatement (Second) of Judgments repeatedly  
13 as authoritative on questions of issue preclusion).

14 Although the Lopez panel recognized that application of issue  
15 preclusion in exception to discharge cases is principally a  
16 question of federal law, it understood that, where a state law  
17 judgment is available for issue preclusion, state (California) law  
18 still must be taken into consideration. Fortunately,

19 California law is consistent with federal law on the  
20 question of discretionary application of issue  
21 preclusion. In California, issue preclusion is not  
22 applied automatically or rigidly, and courts are  
23 permitted to decline to give issue preclusive effect to  
24 prior judgments in deference of countervailing  
considerations of fairness. The court balances "the  
need to limit litigation against the right of a fair  
adversary proceeding in which a party may fully present  
the facts." Thus, policy considerations may limit use of  
issue preclusion in any particular instance.

25 In re Lopez, 367 B.R. at 108 (citations omitted); see also,  
26 Khaligh v. Hadaegh (In re Khaligh), 338 B.R. 817, 828 (9th Cir.  
27 BAP 2006), aff'd 506 F.3d 956 (9th Cir. 2007) (noting that the  
28 California courts "take into account the considerations

1 articulated in Restatement (Second) of Judgments.”).

2 In this appeal, our ability to review the bankruptcy court’s  
3 decision is hampered by the brevity of its analysis in its oral  
4 ruling. The court did not engage in an analysis concerning  
5 whether the RFA Sanctions Order satisfied the five Harmon factors.  
6 If the bankruptcy court ruled that issue preclusion was not  
7 available under state law, it was unnecessary to reach the  
8 discretionary question of its application in this case. As noted  
9 above, the court seemingly declined to apply issue preclusion for  
10 policy reasons, but did not explain what factors or considerations  
11 it relied upon for its decision.

12 Given this record, we must remand this matter to the  
13 bankruptcy court with instructions that it conduct an adequate  
14 issue preclusion analysis concerning the state court’s RFA  
15 Sanctions Order. To do so, it should first examine the five  
16 Harmon factors paying particular attention to the three factors in  
17 dispute – whether the issues decided by the state court in the RFA  
18 Sanctions Order were identical, actually litigated, and  
19 necessarily decided in relation to the exception to discharge  
20 issues before the bankruptcy court.<sup>9</sup> Then, if the bankruptcy  
21

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22 <sup>9</sup> To determine if an issue is identical to the issue before  
23 the court deciding preclusion and whether it has been actually  
24 litigated, we are required to examine the record in the prior  
25 court’s case. United States v. Hernandez, 572 F.2d 218, 222 (9th  
26 Cir. 1978). Based on what has been submitted to us, it may be  
27 that the bankruptcy court had an inadequate record to make that  
28 determination. In essence, the bankruptcy court was given only  
the RFA Sanctions Order, which imposed attorney's fees on Debtors  
because of their failure to admit as fact matters specified in the  
RFAs that Kaplan was later required to prove at trial. The RFA  
Sanctions Order lists 27 RFAs that Wasco failed to answer, and 30  
RFAs that Dehay failed to answer. However, the RFA Sanctions

(continued...)



1 court determines that issue preclusion is available, it should  
2 exercise its independent duty to determine if issue preclusion  
3 should apply in this case, guided by the federal and California  
4 guidelines discussed above.

5 In light of the facts of this case and the case law, an issue  
6 preclusion analysis of the RFA Sanctions Order was required.

7 The RFA Sanctions Order and the Summary Judgment Order were  
8 separate orders. In the Summary Judgment Order, based upon  
9 Debtors' prebankruptcy conduct in their dealings with Kaplan, the  
10 bankruptcy court found that the state court had made the necessary  
11 findings of fact to support an exception to discharge in Kaplan's  
12 favor under §§ 523(a)(2)(A), (a)(4) and (a)(6). Debtors have not  
13 challenged the bankruptcy court's decision.

14 On remand, the bankruptcy court must also determine whether  
15 the RFA Sanctions Order preclusively establishes an exception to  
16 discharge. As Debtors note, in contrast to the Summary Judgment  
17 Order, the RFA Sanctions Order resulted solely from their post-  
18 bankruptcy failure to comply with discovery rules in the state  
19 court litigation. In other words, the attorneys fee award in the  
20 RFA Sanctions Order did not directly result from the same conduct

21

22

23 <sup>9</sup>(...continued)  
24 Order did not explain what facts those RFAs specifically  
25 addressed. We have examined the docket and it does not appear  
26 that the bankruptcy court was ever given copies of the RFAs.  
27 Additionally, counsel for Debtors offered to provide the  
28 bankruptcy court with a transcript of the hearing where the state  
court explained its reasons for granting the attorney's fee award  
in the RFA Sanctions Order, but there is no indication that the  
transcript was ever provided, nor does it appear in the court's  
docket. Hr'g Tr. 6:16-20, Dec. 7, 2011. On remand, to perform a  
proper issue preclusion analysis, the bankruptcy court may wish to  
obtain copies of the RFAs and the state court hearing transcript.

1 giving rise to the Judgment. Because the two state court orders  
2 were based ostensibly on conduct occurring at different times in  
3 relation to Debtors' bankruptcy filing, a determination that the  
4 Judgment is excepted from discharge would not necessarily require  
5 that the amounts awarded to Kaplan under the state court's second,  
6 independent order, were also nondischargeable.

7 As noted above, there is a strong bankruptcy policy that  
8 exceptions to discharge are to be strictly construed so as to  
9 effectuate the Congressional policy of permitting debtors a  
10 financial fresh start and against the creditor. In re Riso,  
11 978 F.2d at 1154; In re Rahm, 641 F.2d 755, 756-57 (9th Cir.  
12 1981); In re Sabban, 384 B.R. at 5. Despite this, Kaplan argues,  
13 case law supports his position that "once it is established that  
14 "specific money or property has been obtained by fraud . . . any  
15 debt arising therefrom is excepted from discharge." Kaplan's Op.  
16 Br. at 7 (quoting Cohen v. De la Cruz, 523 U.S. 213, 218 (1998)).  
17 Kaplan's argument implies that, once a bankruptcy court decides to  
18 except a debt from discharge based on issue preclusion, any  
19 attorney's fees associated with that debt are also excepted from  
20 discharge, without the need for a separate issue preclusion  
21 inquiry. We disagree with Kaplan's reading of Cohen that no  
22 separate issue preclusion inquiry is necessary.

23 In Cohen, the Supreme Court held that, for purposes of  
24 § 523(a)(2), "any debt" arising from a judicial determination of  
25 fraud is likewise excepted from discharge, and in that case, "any  
26 debt" included the "treble damages, attorney's fees and other  
27 relief" awarded to the creditor under state law. Id. at 223. In  
28 that case the court agreed with the bankruptcy court that, because

1 the creditor's nondischargeable claim against the debtor arose  
2 under New Jersey's rent control statute, an award to the creditor  
3 under a related statute providing for recovery of attorney's fees  
4 in actions for violations of the statutory rent controls was also  
5 excepted from discharge.<sup>10</sup> Cohen, 523 U.S. at 218. Strictly  
6 speaking, then, the rule announced in Cohen dealt only with  
7 exceptions to discharge for attorney's fees where there was a  
8 connection between a statute authorizing the fee award, and the

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9  
10 <sup>10</sup> The two statutes cited in the Cohen decision were:

11 **N.J. Stat. § 56:8-2. Fraud, etc., in connection with sale or**  
12 **advertisement of merchandise or real estate as unlawful practice**

13 The act, use or employment by any person of any  
14 unconscionable commercial practice, deception, fraud,  
15 false pretense, false promise, misrepresentation, or the  
16 knowing concealment, suppression, or omission of any  
17 material fact with intent that others rely upon such  
18 concealment, suppression or omission, in connection with  
the sale or advertisement of any merchandise or real  
estate, or with the subsequent performance of such  
person as aforesaid, whether or not any person has in  
fact been misled, deceived or damaged thereby, is  
declared to be an unlawful practice[.]

19 **N.J. Stat. § 56:8-19. Action, counterclaim by injured person;**  
**recovery of damages, costs**

20 Any person who suffers any ascertainable loss of moneys  
21 or property, real or personal, as a result of the use or  
22 employment by another person of any method, act, or  
23 practice declared unlawful under this act or the act  
24 hereby amended and supplemented may bring an action or  
25 assert a counterclaim therefor in any court of competent  
26 jurisdiction. In any action under this section the court  
27 shall, in addition to any other appropriate legal or  
28 equitable relief, award threefold the damages sustained  
by any person in interest. In all actions under this  
section, including those brought by the Attorney  
General, the court shall also award reasonable  
attorneys' fees, filing fees and reasonable costs of  
suit.

These are the texts of the statutes in effect in 1998 when  
the Supreme Court issued its decision in Cohen.

1 statutes establishing the debtor's liability for the creditor's  
2 claim.

3 Applying Cohen, four courts of appeals have adopted what the  
4 parties in this appeal describe as a "statutory/contractual basis"  
5 analysis in this context. Under this approach to construing  
6 § 523(a), attorney fee awards are excepted from discharge only  
7 when based on a statute or contract<sup>11</sup> related to the creditor's  
8 underlying claim. Transouth Fin. Corp of Fla. v. Johnson,  
9 931 F.2d 1505, 1509 (11th Cir. 1991); United Merchants and  
10 Manufacturers Inc. v. Equitable Life Assurance Society of the  
11 United States (In re United Merchants and Manufacturers), 674 F.2d  
12 134 (2nd Cir. 1982); Fry v. Dinan (In re Dinan), 448 B.R. 775, 778  
13 (9th Cir. BAP 2011); Florida v. Ticor Title Ins. Co.  
14 (In re Florida), 164 B.R. 636, 639 (9th Cir. BAP 1994).<sup>12</sup>

15 \_\_\_\_\_  
16 <sup>11</sup> As the case law demonstrates, where there is a contractual  
17 basis for the award of attorney's fees awarded in a  
18 nondischargeable judgment, such fees may also be excepted from  
19 discharge. Jordan v. Se. Nat'l Bank (In re Jordan), 927 F.2d 221,  
20 226-28 (5th Cir. 1991) (finding that a debt excepted from  
21 discharge "includes state-approved contractually required  
attorney's fees") (quoting Martin v. Bank of Germantown (In re  
Martin), 761 F.2d 1163, 1168 (6th Cir. 1985)). Because there was  
no written contract between the parties in this case providing for  
an award of attorney fees to the prevailing party, we need not  
consider that case law here.

22 <sup>12</sup> There was also some discussion in the bankruptcy court of  
23 a less numerous, minority line of decisions espousing a so-called  
24 "status-dependent" approach to determine whether attorney's fees  
25 awards are subject to discharge in this context. As explained in  
26 these decisions, whether there is a contractual or statutory basis  
27 for the award of attorney's fees is not determinative. Instead,  
28 "the dischargeability of ancillary obligations such as attorney's  
fees turn[s] on the dischargeability of the underlying debt. . ."  
DuPhily v. DuPhily, 52 B.R. 971, 978 (D. Del. 1985) (citing  
In re Chambers, 36 B.R. 42 (Bankr. D. Wis. 1984); In re Sposa,  
31 B.R. 307 (Bankr. E.D. Va. 1983)). As discussed below, the  
Panel has adopted the statutory/contractual position in our  
(continued...)

1 Both Kaplan and Debtors in this appeal cite to the Panel's  
2 opinion in In re Florida to support their positions. As the  
3 bankruptcy court correctly determined, but for possibly different  
4 reasons than our own, In re Florida is not controlling on the  
5 availability of issue preclusion in this case. However, since  
6 In re Florida was a published opinion, and we are bound by its  
7 holdings, we will examine it in detail.

8 In In re Florida, before bankruptcy, Ticor sued Alvin Florida  
9 in U.S. district court. After a bench trial, the district court  
10 found that Florida, in attempting to sell certain property, had  
11 forged a release of an I.R.S. lien. Because Ticor had insured  
12 title to the property free of the I.R.S. lien, it was forced to  
13 pay its insured when the release was discovered and then revoked  
14 by the I.R.S. The district court found Ticor's actual loss was  
15 \$153,922, trebled these damages pursuant to the RICO statute,  
16 18 U.S.C § 1961 et seq., and awarded attorney's fees of \$124,950  
17 to Ticor pursuant to the remedies provision of RICO, 18 U.S.C.  
18 § 1964(c).<sup>13</sup> Finding that the forgery was "malicious, fraudulent  
19 and oppressive," the district court awarded a coextensive judgment  
20 to Ticor against Florida consisting of \$153,922 in compensatory  
21

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22 <sup>12</sup>(...continued)  
23 published decision In re Florida and thus we do not consider this  
24 alternative view.

25 <sup>13</sup> 18 U.S.C. § 1964(c) provides that:

26 Any person injured in his business or property by reason  
27 of a violation of section 1962 of [the RICO statute] may  
28 sue therefor in any appropriate United States district  
court and shall recover threefold the damages he  
sustains and the cost of the suit, including a  
reasonable attorney's fee[.]

1 damages and \$307,844 in punitive damages, and a small discovery  
2 sanction.<sup>14</sup> The judgment was affirmed on appeal.

3 After Florida filed for bankruptcy, Ticor sought an exception  
4 to discharge of its debt under § 523(a)(2) and (6). Acting on the  
5 creditor's motion for summary judgment, the bankruptcy court  
6 determined the debts to be excepted from discharge in total under  
7 § 523(a)(6), including the amounts representing Ticor's litigation  
8 expenses in the state court suit and the discovery sanction.

9 On appeal to the BAP, Florida challenged the bankruptcy  
10 court's determination that the discovery sanction and attorney's  
11 fees were excepted from discharge. The Panel ruled,

12 Florida contends that all damages awarded under the RICO  
13 claim, including the discovery sanction and attorney's  
14 fees, are punitive. Florida's description of these  
15 elements as punitive damages somewhat mischaracterizes  
16 them. The bankruptcy court found that those portions of  
the claim based on attorney's fees and costs and the  
discovery sanction were debts which were ancillary to  
the underlying debt and partook of its character.

17 Id. at 639.

18 In this case, the parties have differing views about how the  
19 attorney's fees awarded in Florida "partook of the character" of  
20 the nondischargeable debt, and whether that participation  
21 justified exception to discharge for the attorney's fee award.  
22 However, the full context of the Panel's decision reveals that the  
23 attorney's fees were awarded for violation of the RICO statute,  
24 which proscribed conduct that the Bankruptcy Code would consider

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25  
26 <sup>14</sup> Other than noting that the discovery sanction was for  
27 \$15,000, little information about it is provided in the Florida  
28 In re Florida, 164 B.R. at 639, and thus was awarded, like the  
attorney's fees, on the basis of a statute.

1 grounds for an exception to discharge. Therefore, like Cohen,  
2 In re Florida stands for the proposition that violation of a  
3 statute that provides for an award of attorney's fees for conduct  
4 which the Bankruptcy Code considers grounds for exception to  
5 discharge may result in denial of discharge for those attorney's  
6 fees.

7 In this appeal, the statute on which the RFA Sanctions Order  
8 was based, Cal. Code Civ. Proc. § 2033.420, sanctions the failure  
9 to respond to requests for admission of facts that then requires a  
10 party to prove them. In other words, under the statute, an award  
11 of attorney's fees may be made for conduct that a bankruptcy court  
12 may find does not support an exception to discharge.

13 On remand to the bankruptcy court, Kaplan is free to argue  
14 that, like the state court apparently found, Debtors' failure to  
15 respond to the RFAs was part of Debtors' scheme to defraud him.  
16 In that respect, Kaplan may contend that there is an identity of  
17 issues between the FRA Sanctions Order and the bankruptcy court's  
18 determination that the Judgment debt is excepted from discharge  
19 under § 523(a)(2), (a)(4) or (a)(6). However, in light of the  
20 strong policy considerations in bankruptcy law that exceptions to  
21 discharge are narrowly construed, and the issue preclusion case  
22 law discussed above, attorney's fees awarded under a statute will  
23 be excepted from discharge only if that statute proscribes conduct  
24 that violates one of the provisions of § 523(a).<sup>15</sup> Because an

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26 <sup>15</sup> Indeed, In re Florida cautions against recognizing a  
27 remote connection between conduct that results in an exception to  
28 discharge judgment and the conduct resulting in the award of  
attorney's fees: "It may be that the relationship of ancillary to  
(continued...)

1 award of attorney's fees under Cal. Code Civ. Proc. § 2033.420  
2 does not necessarily result from conduct proscribed in the  
3 Bankruptcy Code, an award of attorneys fees under that statute is  
4 not automatically excepted from discharge.

5 **CONCLUSION**

6 The bankruptcy court must conduct an analysis of the  
7 availability and applicability of issue preclusion to the RFA  
8 Sanctions Order. Even if the bankruptcy court determines that  
9 issue preclusion is available, it must then, as a matter of  
10 discretion, decide whether the doctrine should or should not be  
11 applied. Assuming issue preclusion is both available and  
12 applicable, the bankruptcy court must then independently decide  
13 whether the conduct giving rise to the award of attorney's fees to  
14 Kaplan in this case is sufficient to support an exception to  
15 discharge under § § 523(a)(2), (4), or (6).

16 We VACATE the bankruptcy court's order denying Kaplan's  
17 motion to amend the summary judgment order to add an exception to  
18 discharge for the attorneys fees awarded in the RFA Sanctions  
19 Order. We REMAND this matter to the bankruptcy court for further  
20 proceedings consistent with this memorandum.

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26 <sup>15</sup>(...continued)  
27 primary obligations can become so attenuated that it would be  
28 unreasonable to characterize them as integral to the original  
willful and malicious injury." 164 B.R. at 639.