UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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January 5, 1990

Jerry C. Rachetto, Esq.
Post Office Box 392
Deadwood, South Dakota 57732

Mr. Richard Kiefer
1228 Fullton Street
Rapid City, South Dakota 57701

Re: Kevin George Klein
Chapter 7 89-50131
Adversary 89-5032

Gentlemen:

The Court has before it debtor Kevin George Klein's motion for summary judgment in the above-captioned adversary proceeding. After considering the evidence, briefs and arguments presented, the Court will grant debtor's motion.

The undisputed facts are as follows: In January 1986, Kiefer sold Klein a house in Lead, South Dakota. The house was purchased for $16,000.00 on a contract for deed. Under the terms of the contract, Klein was to commence payments the following month. Klein began to remodel the house shortly after the contract was executed. Kiefer was aware of the remodeling project and did not object to it. The remodeling project was extensive, including rewiring, replumbing, removal of inside walls and insulating the premises. Klein failed to make any payments on the contract for deed and Kiefer brought a successful foreclosure action against him. Kiefer later brought an action for damages against Klein to recover for the diminution of the value of the house in its unfinished condition. Kiefer hired an appraiser who estimated the value of the house in its unfinished condition at $1,000.00.

On January 26, 1987, the Circuit Court for the Eighth Judicial Circuit in Lawrence County, South Dakota entered a default judgment in favor of Kiefer. The judgment awarded Kiefer $15,000.00 in compensatory damages and an additional $15,000.00 punitive damages for "fraud, deceit, misrepresentation, willful and/or malicious conduct[.]" Subsequent efforts to vacate the default judgment were denied by the trial court. The trial court's judgment was appealed

to the South Dakota Supreme Court which summarily affirmed the decision. See *Kiefer v. Klein*, 442 N.W.2d 272 (S.D. 1989).

Klein filed for protection under Chapter 7 of the United States Bankruptcy Code on June 12, 1989. On September 1, 1989, Kiefer filed the present adversary action to determine the dischargeability of the state court default judgment entered against Klein. On November 21, Klein filed his motion for summary judgment and memorandum in support thereof. A hearing on Klein's motion was held December 11, 1989. Klein was represented by Attorney Rachetto and Mr. Kiefer, who was previously represented by Attorney Robert Warder but later terminated Mr. Warder's representation, appeared pro se. After hearing arguments from both parties, the Court took this matter under advisement.

Summary judgment is authorized by Federal Rule of Civil Procedure 56 and by Bankruptcy Rule 7056 when there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. Summary judgment should not be viewed as a disfavored procedural shortcut1 but rather as an important method to be used to secure the just, speedy and inexpensive determination of every action. *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The burden is on the movant to demonstrate that no genuine issue of material fact exists, and the non-moving party is entitled to all reasonable inferences to be taken from the evidence. *Savage v. Snow*, 575 F. Supp. 828 (S.D.N.Y. 1983).

Having reviewed the pleadings and Mr. Kiefer's deposition, it does not appear that there are any questions of material fact; however, an interesting legal question exists concerning the state trial court's default judgment and its correlation with 11 U.S.C. § 523(a), which states:

> A discharge under section 727, 1141, 1228, 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –
>
> (6)for willful and malicious injury by the debtor to another entity or to the property of another entity[.]

The legal question presented by the state court's judgment is whether the doctrines of res judicata or collateral estoppel prevent this Court from reviewing the judgment to determine whether Klein's actions were sufficiently willful and malicious to render the judgment nondischargeable.

The phrases "res judicata" and "collateral estoppel" have been assigned a variety of meanings by the courts in many different

contexts and their use has often resulted in only increasing the confusion as to when these doctrines are properly applicable. As set forth by the United States Supreme Court in *Migra v. Warren City School Dist. Bd. of Educ.*, 465 U.S. 75, 77 n.1, 104 S.Ct. 892, 894 n.1, 79 L.Ed.2d 56 (1984):

> The preclusive effects of former adjudication are discussed in varying and, at times, seemingly conflicting terminology attributable to the evolution of preclusion concepts over the years. These effects are referred to collectively by most commentators as the doctrine of 'res judicata'. Res judicata is often analyzed further to consist of two preclusion concepts: issue preclusion' and 'claim preclusion1. Issue preclusion refers to the effects of a judgment in foreclosing relitigation of a matter that has been litigated and decided. This effect is also referred to as direct or collateral estoppel. Claim preclusion refers to the effect of a judgment in foreclosing litigation of a matter that has never been litigated, because of a determination that it should have been advanced in an earlier suit. Claim preclusion therefore encompasses the law of merger and bar. Th~5 court on more than one occasion has used the term 'res judicata' in a narrow sense, so as to, exclude issue preclusion or collateral estoppel. When using that formulation, 'res judicata', becomes virtually synonymous with 'claim preclusion.' In order to avoid confusion resulting from the two uses of 1res judicata', this opinion uses the term 'claim preclusion' to refer to the preclusive effect of a judgment in foreclosing relitigation of matters that should have been raised in an earlier suit. (citations omitted)

See also *In re Rudd*, 104 B.R. 8, 10-11 n.2 (Bankr. N.D. Md. 1987).

The rule of claim preclusion provides that when a court of competent jurisdiction has entered a final judgment on the merits of a cause of action, the parties to the suit and their privies are thereafter bound "not only as to every matter which was offered and received to sustain or defeat the claim or demand1 but as to any other admissible matter which might have been offered for that purpose." *Commissioner v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715, 92 L.Ed. 898 (1948), (quoting *Cromwell v. County of Sac*, 94 U.S. 351, 352 (1876)).

Issue preclusion, as opposed to claim preclusion, prevents litigation by parties to a previous action of issues that have been actually and necessarily determined by a court of competent jurisdiction. *Montana v. United States*, 440 U.S. 147, 154, 99 5. Ct. 970, 974, 59 L.Ed.2d 210 (1977).

The Supreme Court in *Brown v. Felsen*, 442 U.S. 127, 99 S.Ct. 2205, 60 L.Ed.2d 767 (1979), has denied claim preclusion effect to state court judgments in bankruptcy dischargeability litigation. The issue in *Brown* was whether the bankruptcy court could consider evidence extrinsic to the judgment and record of a prior state court action to recover monies when determining whether indebtedness previously reduced a judgment was dischargeable under 35 of the former Bankruptcy Act (now 11 U.S.C. 523(a)(2)(A)). The state court judgment was settled by stipulation. The creditor in the bankruptcy action sought to establish that the debtor's judgment was nondischargeable on the grounds of fraud and malicious conversion. The debtor argued that res judicata barred relitigation of his debt. The Court held that the doctrine of res judicata (claim preclusion) does not prevent a bankruptcy court from going behind a state court judgment to determine whether a debt is nondischargeable. It noted that Congress intended the bankruptcy court resolve dischargeability issues and that by limiting the application of claim preclusion, the bankruptcy court would weigh the evidence and make a final determination as to whether the debtor committed fraud or conversion. 422 U.S. at 138, 99 S.Ct. at 2212, 60 L.Ed.2d at 775. The Court further noted that if res judicata was to apply, it would force the consolidation of claims in state court which would "undercut a statutory policy of resolving 17 [nondischargeability) questions in bankruptcy court, and would force state courts to decide these questions at a stage when they are not directly in issue and neither party has a full incentive to litigate them." 442 U.S. at 134, 99S.Ct. at 2211, 60 L.Ed.2d at 773.

It should be noted that Brown did not involve the question of whether issue preclusion (collateral estoppel) would prevent a Bankruptcy court from re-examining a prior state court judgment when making a nondischargeability determination. The court however indicated that collateral estoppel could be applicable:

> this case concerns res judicata only, and not the narrower principle of collateral estoppel. Whereas res judicata forecloses all that which might have been litigated previously, collateral estoppel treats as final only those questions actually and necessarily decided in the prior suit. If, in the course of adjudicating a state law question, a state court should determine factual issues using standards identical to those of 17

> [nondischargeability], then collateral estoppel, in the absence of countervailing statutory policy, would bar relitigation of those issues in the bankruptcy court.

442 U.S. at 139 n.10, 99 S.Ct. at 2213 n.10, 60 L.Ed.2d at 776 n.10 (citations omitted). See also *Rudd*, supra at 12-13.

When considering the concept of issue preclusion one must recall that Art. I, Sec. 8, Cl. 4 of the United States Constitution mandates that Congress establish uniform laws on the subject of bankruptcy throughout the United States. To implement that clause, Congress enacted 11 U.S.C. § 523(c), which grants to the Bankruptcy Court exclusive jurisdiction over exceptions to discharge based on 11 U.S.C. § 523(a) (2), (a) (4), and (a) (6). The purpose of granting exclusive jurisdiction in this area was to ensure the consistency of application of federal law that would be obtained by having judges with expertise in bankruptcy law pass on dischargeability questions and to further the bankruptcy court "fresh start" policy by protecting debtors against harassing lawsuits initiated by creditors after bankruptcy and perhaps to protect unwitting waivers of a debtor's discharge. See *Farrell*, The Preclusive Effect of State Court Decisions in Bankruptcy, Second Installment, 59 Am. Bankr. L.J. 55, 56-59 (1985).

Where the prior lawsuit to be considered was initiated in state court, the full faith and credit clause of the United States Constitution also must be examined. The determination of state issue preclusion rules is very difficult and complicated, as Chief Justice Burger noted in his concurrence in *Marrese v. Academy of Orthopaedic Surgeons*, 470 U.S. 373, 105 S.Ct. 1327, 84 L.Ed.2d 274 (1985). In the bankruptcy context, however, In re Ross, 602 F.2d 604 (3d Cir. 1979), sets out a four point test to determine whether the doctrine of issue preclusion can bar the relitigation of a dischargeability issue:

> 1. The issue sought to be precluded must be the same as that in the prior action;
>
> 2. The 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.

Id. at 608.

One potential difficulty in giving a state court judgment preclusive effect in a bankruptcy court's dischargeability proceeding is that the e1ements of a state cause of action involving

willful or malicious conduct may be different than those necessary to have a claim determined nondischargeable under § 523. In South Dakota, conduct that is willful and wanton requires something more than negligence:

> It describes conduct which transcends negligence and is different in kind and characteristics. It is conduct which partakes to some appreciable extent, though not entirely, of the nature of a deliberate and intentional wrong. There must be facts that would show defendant intentionally did something . . . which he should not have done or intentionally failed to do something which he should have done under the circumstances that it can be said that he cbnsciously realized that his conduct would in all probability, as distinguished from possibility, produce the precise result which it did produce and would bring harm to plaintiff. Willful and wanton misconduct demonstrates an affirmative, reckless state of mind or deliberate recklessness on the part of the defendant[.]

Barger v. Cox, 372 N.W.2d 161, 166 (S.D. 1:985) (citing *Brewer v. Mattern*, 85 S.D. 356, 182 N.W.2d 327 (1970)).

Malice is defined in South Dakota as a wish to intentionally vex, annoy or injure another person. See S.D.C.L. 22-1-2(1)(a). When used in defining the intent of one who maliciously damages property, it is insufficient to show that such injury was done willfully; rather such must be done willfully and for the purpose of avenging some real or imaginary wrong. *State v. Tarleton*, 22 S.D. 495, 118 NW. 706 (1908). It should be noted, however, that South Dakota's malicious damage to property statute since has been amended to only require that such damage be intentional rather than malicious. See S.D.C.L. 22-34-1.

Under § 523 of the Bankruptcy Code, a somewhat different standard for willful and malicious conduct exists. A malicious act must tend toward conduct which is targeted at the creditor at least in the sense that the conduct is certain or almost certain to cause a creditor harm. *In re Burke*, 83 B.R. 716 (Bankr. D.N.D. 1988). See also Gregor v. Ertz, 28 B.R. 1020 (Bankr. D.S.D. 1983) and *In re Gonsor*, 95 B.R. 123 (Bankr. D.S.D. 1988). In *Gonsor*, this Court held that where a debtor commits an intentional act without justification which causes injury to another party, such constitutes a willful and malicious injury.

The difference between the state court and bankruptcy court elements in determining whether a debtor's action is willful and

malicious for purposes of determining nondischargeability leads this Court to conclude that it has exclusive jurisdiction to determine whether the state court judgment is dischargeable and that the state court's judgment is not res judicata and does not have collateral estoppel effect. See *In re DiNoto*, 46 B.R. 489 (B.A.P. 9th Cir. 1984). See also *Matter of Wintrow*, 57 BR. 695 (Bankr. S.D.Oh. 1986); *In re Bishop*, 55 B.R. 687 (Bankr. W.D.Ky. 1985); *In re Davis*, 47 BR. 599 (Bankr. S.D.Fla. 1985); *In re Goodman*, 25 BR. 932 (Bankr. N.D.Ill. 1982); *Matter of Poss*, 23 B.R. 487 (Bankr. E.D.Wis. 1982); *In re Bursh*,, 14 B.R. 702 (Bankr. D.Az. 1981); and *In re Peterson*, 9 BR. 835 (Bankr. D.Nev. 1981).

Having determined that this Court has exclusive jurisdiction over this matter, it will now analyze whether Klein's conduct was willful and malicious and thus nondischargeable. The United States Court of Appeals for the Eighth Circuit has made it clear that the elements of willfulness and malice as used in 523(a) (6) are two distinct characteristics which should not be lumped together, but which should be analyzed separately. See In re Long, 774 F.2d 875 (8th Cir. 1985). Willfulness for the purpose of the Bankruptcy Code simply means a deliberate or intentional action as opposed to one occurring by reason of negligence or accident. See *In re Burke*, supra at 722. Malice goes beyond mere willfulness and requires a higher degree of culpability. As stated earlier, it must tend toward conduct which is targeted at the creditor at least in the sense that the conduct is certain or almost certain to cause the creditor harm. See *Burke, Gregor, & Gonsor*, supra.

Under the standards set forth in *Gonsor* this Court does not believe that Klein's actions were willful and malicious. While it is true that Klein's actions were willful in the sense that he intended to substantially alter the property, those actions were justifiable and were not intended to inflict injury on Kiefer. Rather, Klein's actions were designed to improve the property and it is not beyond the realm of possibility that Klein's remodeling project could have increased the value of the property if his financial difficulties and the foreclosure action had not intervened. It must also be noted that Kiefer was aware of Klein's project and knew from the outset of the project that Klein's intention was to remodel the premises rather than destroy it. Kiefer has never alleged that Klein's action was aimed at destroying the property. Considering the undisputed facts in the light most favorable to Kiefer, the Court finds as a matter of law that Klein's action was not willful and malicious and that the state court judgment is dischargeable under § 727. Klein's motion for summary judgment thus will be granted.

This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(J). This memorandum shall constitute the Court's conclusions of law. Findings of fact are not required on dispositions of motions for summary judgment. B.R. 7052(a). The Court will enter an order granting summary judgment in Klein's favor.

Very truly yours,

Irvin N. Hoyt
Chief Bankruptcy Judge

INH/sh

CC: Bankruptcy Clerk

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA

IN RE:	)	CASE NO. 89-50131
	)	
KEVIN GEORGE KLEIN,	)	ADVERSARY NO. 89-5032
	)	
Debtor.	)	
	)	
RICHARD F. KIEFERand CAROL L. KIEFER,	)	
	)	
Plaintiffs,	)	ORDER GRANTING
	)	SUMMARY JUDGMENT
v.	)	
	)	
KEVIN GEORGE KLEIN,	)	
	)	
Defendant.	)	

Pursuant to the memorandum decision filed in this matter and executed this same date

IT IS HEREBY ORDERED that the motion for summary judgment filed by debtor Kevin G. Klein hereby is granted.

Dated this 5th day of January, 1990.

BY THE COURT:

_____
Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy Clerk

(SEAL)