UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re	:	Chapter 7
	:	
JAMILA H. STEELE, dba Mobile Wireless Services LLC,	:	Bankruptcy No. 04-14597DWS
	:	
Debtor.	:	
	:	
NORTH PHILADELPHIA FINANCIAL PARTNERSHIP,	:	Adversary No. 04-0731
	:	
Plaintiff,	:	
	:	
v.	:	
	:	
JAMILA H. STEELE,	:	
	:	
Defendant.	:	

MEMORANDUM OPINION

BY: DIANE WEISS SIGMUND, Chief Bankruptcy Judge

Before the Court is the Motion for Summary Judgment (the "Motion") filed by North Philadelphia Financial Partnership ("NPFP") in connection with its Complaint to Determine the Dischargeability of Debt (the "Complaint"). For the reasons that follow, the Motion will be denied.

BACKGROUND

On or about November 25, 1998 NPFP[1] made a loan in the amount of $278,500 (the "Loan") to or for the benefit of Horizon Management Services LLC ("Borrower" or "Horizon"), the payment of which was guaranteed by Debtor. Complaint and Answer ¶ 6. The guarantee was secured by certain real property owned by the Debtor. Id. ¶¶ 8-9; NPFP alleges that Debtor induced it to make the Loan by misrepresenting her assets and material information during the application process. After Borrower defaulted and failed to cure, NPFP took action against Debtor under its guarantee and mortgages. Id. ¶¶ 10-15. On March 19, 2003 NPFP obtained a default judgment against Borrower and Debtor in the amount of $264,096.51. Id. ¶14. Subsequently it secured title to the mortgaged properties through sheriff's sales. Id. ¶ 15.

Concurrently with these civil actions, criminal proceedings were instituted against Debtor in the United States District Court for the Eastern District of Pennsylvania, CR-02-70-02, and on September 20, 2002 judgment was entered based on the Debtor's guilty plea to count 6, 7 and 8 of the indictment. Relevant to the instant Motion are the guilty pleas to count 7 and 8 for theft and embezzlement from an organization receiving federal funds. Exhibit 1.[2] Restitution in the amount of $120,000 was ordered in favor of NPFP.

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[1] NPFP is a federally certified community development lending institution. Complaint and Answer ¶ 1.

[2] In addition to the Loan, the indictment also charged illegal activity with respect to a bogus contract Debtor secured for a shell company known as Orange Systems Consulting pursuant to which she was paid $18,000 from NPFP. The conduct relating to the contract is not part of the Complaint.

Id.[3] The Guilty Plea Agreement which supports the judgment is a sixteen page document signed by the Debtor and her counsel and the United States Attorney, Exhibit 4, and was preceded by a hearing before the Honorable Jay C. Waldman, the notes of which are transcribed and made part of this record. Exhibit 5. In that hearing the Debtor acknowledged under oath the truth of the specific evidence the United States would have proven at a trial but for the guilty plea.

On April 4, 2004 the Debtor filed a petition under Chapter 7 of the Bankruptcy Code. At the time NPFP, which had foreclosed on Debtor's mortgaged properties to satisfy its judgment, was in the process of a fair market value proceeding in order to establish the amount of its deficiency judgment. That action was stayed by the Chapter 7 filing. Thereafter NPFP filed the Complaint in this Court seeking to have its debt in the amount of $267,535.49 plus additional interest and costs determined to be non-dischargeable pursuant to 11 U.S.C. § 523(a)(2), (a)(4) and (a)(6). The Motion addresses two of those counts, either of which if proven would be sufficient grounds to hold the debt non-dischargeable. First, NPFP asserts that proof of embezzlement under § 523(a)(4) may be established by reason of the guilty plea, under the doctrine of collateral estoppel. Second, it contends that no material issue of fact exists with respect to the elements of § 523(a)(2). In response, Debtor argues that collateral estoppel does not apply to a guilty plea as there was no

[3] The document is facially inconsistent. While it sets the restitution at $120,000 consisting of a $90,000 credit for properties transferred plus $30,000 in equal monthly installments over the three years of supervised release, it also notes that NPFP's loss is found to be $279,789.27 and that amount also is ordered as restitution. As the restitution amount does not fix the non-dischargeable debt, the inconsistency is not material to this opinion.

"actual litigation" and with respect to § 523(a)(2), that genuine issues of material fact exist pertaining to the reasonableness of NPFP's reliance on Debtor's representations.

DISCUSSION

I.

A motion for summary judgment is governed by Federal Rules of Civil Procedure ("Fed.R.Civ.P.") 56, applicable in this proceeding pursuant to Federal Rule of Bankruptcy 7056. Summary judgment, "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories and admissions on file, and affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c).

The party moving for summary judgment must overcome the initial burden of demonstrating the absence of a material question of fact. Celotex v. Catrett, 477 U.S. 317, 325 (1986). The substantive law will determine which facts are material. Anderson v. Liberty Lobby, 477 U.S. 242, 248 (1986). A court's function is not to weigh the evidence and determine the truth of the matter, but to determine whether there is a genuine issue for trial. Id. at 255. A court must find that the motion alleges facts which, if proven at trial, would require a directed verdict. 6 J. Moore, Moore's Federal Practice, ¶ 56.26 (2d ed. 1988). If so, the respondent "must set forth specific facts showing there is a genuine issue for trial," and may not "rest upon the mere allegations or denials of the pleading." Fed.R.Civ.P. 56(e). If the non-movant's evidence "is merely colorable, or is not significantly

probative, summary judgement may be granted. Anderson, 477 U.S. at 250. However, as it is the moving party's burden to demonstrate the absence of genuine issues of material fact, even if the opposing party fails to file contravening affidavits or other evidence that establishes a genuine issue of material fact, summary judgment must still be warranted and will be denied where the movant's own papers demonstrate the existence of material factual issues. Drexel v. Union Prescription Centers, Inc., 582 F.2d 781, 790 (3d Cir. 1978) (*citing* Adickes v. S.H. Kress & Co., 398 U.S. 144, 159-61 (1990) citations omitted). See Maldonado v. Ramirez, 757 F.2d 48, 51 (3d Cir. 1985). The absence of a genuine issue for trial is evident where the record, taken as a whole, could not lead a rational trier of fact to find for the non-moving party. Mashusita Electrical Industrial Co. v. Zenith Radio Corp., 475 U.S. 574, 586 (1986).

With that legal standard in mind, I turn to the two counts at issue in this Motion to determine whether summary judgment is appropriate as to either so as to warrant denial of the Debtor's discharge at this juncture. I undertake this examination mindful that "[t]he overriding purpose of the Bankruptcy Code is to relieve debtors from the weight of oppressive indebtedness and provide them with a fresh start, and for this reason, exceptions to discharge are strictly construed against creditors and liberally interpreted in favor of debtors. Local Loan Co. v. Hunt, 292 U.S. 234, 244, 54 S.Ct. 695, 699 (1934); Insurance Co. of America v. Cohn (In re Cohn), 54 F.3d 1108, 1113 (3d Cir. 1995).

II.

Section 523(a)(4) excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4).[4] The terms embezzlement and larceny are to de determined under federal common law. Nassau Suffolk Limonsine Association v. Jardula (In re Jardula), 122 B.R. 649, 653 (Bankr. E.D. N.Y. 1990). Embezzlement is defined by federal common law as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." Moore v. United States, 160 U.S. 268, 269, 16 S.Ct. 294, 295 (1895).[5] NPFP contends that the elements of embezzlement are established by reason of the Guilty Plea Agreement and the findings made by Judge Waldman in accepting the plea. It thus seeks summary judgment based on the principle of collateral estoppel.

The application of collateral estoppel to dischargeability proceedings is well accepted. Grogan v. Garner, 498 U.S. 279, 284 n.11, 111 S.Ct. 654, 658 (1991); Brown v. Felsen, 442 U.S. 127, 139 n.10, 99 S.Ct. 2205, 2213 (1979) ("If in the course of adjudicating a state-law issue, a state court should determine factual issues using standards identical to those of § 17 [dischargeability provision of former Bankruptcy Act] then collateral estoppel, in the absence of countervailing statutory policy, would bar relitigation of those issues in the bankruptcy

[4] It is well established that fiduciary capacity need only be proven with fraud or defalcation and is not an element of embezzlement or larceny. Fox v. Shervin (In re Shervin), 112 B.R. 724, 730 (Bankr. E.D. Pa. 1990).

[5] Larceny differs only from embezzlement in the manner in which the property comes into the hands of the person charged with fraudulently appropriating it. Embezzlement, not larceny, is the act for which Debtor pled guilty.

court."). See also Wolstein v. Docteroff, 133 F.3d 210, 214 (3d Cir. 1997); Graham v. Internal Revenue Service, 973 F.2d 1089, 1099 (3d Cir. 1992).

The party seeking to invoke collateral estoppel must prove: (1) the issue sought to be precluded is 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. Graham v. Internal Revenue Service, 973 F.2d at 1097. Debtor questions the occurrence of the second element arguing that a guilty plea does not equate to actual litigation. I respectfully disagree.

The courts in this and other jurisdictions have held that a guilty plea supported by appropriate factual findings by the court may satisfy the requirement of litigation. E.g., Blackman v. Gaebler (In re Gaebler), 88 B.R. 62 (E.D. Pa. 1988) (§ 523(a)(6)); United States v. Summers (In re Summers), 266 B.R. 292 (Bankr. E.D. Pa. 2001) (§ 523(a)(1)); Simone v. United States (In re Simone), 252 B.R. 302 (Bankr. E.D. Pa. 2000) (same); United States v. Bryant (In re Bryant), 248 B.R. 805 (Bankr. E.D. Ark. 2000) (§ 523(a)(4)); Nassau Suffolk Limonsine Association v. Jardula (In re Jardula), 122 B.R. 649 (Bankr. E.D. N.Y. 1990) (§ 523(a)(4); Gualtieri v. Goux (In re Goux), 72 B.R. 355 (Bankr. N.D.N.Y. 1987) (§ 523(a)(4)). While the Third Circuit has not addressed the issue in the context of a guilty plea establishing the elements of § 523, I conclude that it would follow the prevailing lower court view based on Graham v. Internal Revenue Service in which it stated that "[w]hen the factual findings necessary to a judgment are incorporated into a consent decree,

they satisfy the actually litigated element of issue preclusion and are given preclusive effect." 973 F.2d at 1097. The dispositive issue is not the fact of the guilty plea itself but what the plea has established. In situations involving the collateral estoppel effects of criminal judgments, the trial court in the subsequent civil proceeding must examine the entire record to determine exactly what was decided in the criminal proceeding. Emich Motors v. General Motors, 340 U.S. 558, 569, 71 S.Ct. 408, 414 (1951). This is so because there can be no collateral estoppel effect as to matters not specifically determined or which were not otherwise essential to the determination of guilt. De Cavalcante v. Commissioner of Internal Revenue, 620 F.2d 23, 28 n. 10 (3d Cir. 1980) (citations omitted). Stated in the words of the Graham Court, are the elements of the crime which have been admitted by the consent agreement sufficient to establish the elements of non-dischargeability? To answer this question it is necessary to turn to the transcript of the plea hearing to ascertain if the elements of embezzlement as defined by the Supreme Court have been established.

The facts established on the record of the guilty plea agreement as pertains to the Loan are as follows. Debtor and Jamal Hassin Cato ("Cato")[6] formed the limited liability company named Horizon Management Services for the purpose of seeking and obtaining a $278,000 loan from NPFP. The Loan was induced by materially false representations concerning the Debtor's financial condition, including a false statement of her net worth on the loan application and the provision of other false documentation. Upon questioning by Judge

[6] Cato was the executive director of NPFP, a fact of which Debtor was aware. The indictment also charged conspiracy.

Waldman, Debtor admitted that at the time she made statements that she owned real estate worth at least $300,000 and a life insurance policy with a $350,000 cash surrender value, and had a trust fund, she knew they were untrue and that she did not own such real estate and had no such life insurance or trust fund. Exhibit 6 at 42-43. She also admitted that she submitted a doctored or false tax return which was inflated, by almost double her then current wages. Id. Debtor used the Loan proceeds to purchase a property in her own name. Upon questioning by Judge Waldman, she admitted that within several weeks of the Loan closing, she purchased a property at 2800 Poplar Street, Philadelphia (the "Poplar Property") for $55,000 which she titled in her own name and that the source of the $55,000 was the $278,000 Loan.[7] Moreover she admitted that additional funds from the Loan proceeds were used to rehabilitate the Poplar Property which she then rented, and that rental proceeds were paid to her personally and also deposited in the Horizon account. She also admitted that she used certain other of the Loan proceeds for personal purposes. Id. at 45-48.

As noted above, embezzlement under § 523(a)(4) is the fraudulent appropriation of property by a person into whose hands it has lawfully come. NPFP must therefore prove that Debtor received the Loan legally but subsequently misappropriated it for her own benefit with a fraudulent intent or to deceive. Estate of Harris v. Dawley (In re Dawley), 312 B.R. 765, 779 (Bankr. E.D. Pa. 2004); KV Pharmaceceutical Co. v. Harland (In re Harland), 235 B.R. 769, 780 (Bankr. E.D. Pa. 1999).

[7] Debtor presented a check at closing drawn on Horizon's account which she controlled as sole owner of Horizon. Id. at 46.

The record at the guilty pleas hearing establishes that the Debtor fraudulently misrepresented her financial condition to secure the Loan. The Loan proceeds lawfully came into her possession as the sole owner of Horizon, the nominal borrower. However, in order to establish a claim of embezzlement, Debtor must also be shown to have misappropriated the property, i.e., the Loan proceeds. There are findings to this effect as well. The proceeds of the Loan were used to buy a $55,000 rental property titled in Debtor's name as to which she collected rents for her own and Horizon's account and to make improvements in an unstated amount to the property which inured to her benefit as owner presumably by its increased value. Certain unquantified Loan proceeds were acknowledged to have been used by Debtor for other personal purposes. A requirement of § 523(a)(4) is that the creditor prove the damages resulting from the embezzlement. Harland, 235 B.R. at 780. However, there are no findings that the amount of the debt arising from the embezzlement is the amount of the debt sought to be held non-dischargeable. Indeed I can only find $55,000 non-dischargeable on this record. NPFP has been unable to establish on this record that its debt is non-dischargeable and therefore summary judgment cannot be awarded under § 523(a)(4).

III.

Section 523(a)(2)(B) is also advanced as a basis to except the amount due under the guaranty by Debtor to NPFP. The creditor must prove four elements for a debtor's obligation to be excepted from discharge under this section: (1) the debtor made a written statement regarding his financial condition; (2) that was materially false; (3) upon which the creditor

reasonably relied; and (4) with the intent to deceive the creditor. Insurance Co. of America v. Cohn (In re Cohn), 54 F.3d 1108, 1114 (3d Cir. 1995). The creditor must prove these elements by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 287-88, 111 S.Ct. 654, 659-60 (1991).

Debtor only challenges one of the elements required to prove grounds under § 523(a)(2)(B), i.e., that NPFP reasonably relied on the written statements made by Debtor in support of the granting of the $278,000 Loan.[8] In Insurance Co. of America v. Cohn, supra, the Third Circuit Court of Appeals explained that "the reasonableness of a creditor's reliance under § 523(a)(2)(B) is judged by an objective standard, i.e., that degree of care which would be exercised by a reasonably cautious person in the same business transaction under similar circumstances." 54 F.3d at 1117. The Court articulated the three factors to be considered when making a determination of the reasonableness of the reliance:

> (1) the creditor's standard practices in evaluating credit-worthiness (absent other factors, there is reasonable reliance where the creditor follows its normal business practices); (2) the standards or customs of the creditor's industry in evaluating credit-worthiness (what is considered a commercially reasonable

[8] While not argued in her Memorandum, the heading of the section that relates to § 523(A)(2) states that "The Elements of 11 U.S.C. §523(A)(2) Have Not Already Been Decided and Genuine Issues of Material Fact Exist as to Whether NPFP's Reliance on Debtor's Alleged Misrepresentations was Reasonable." (Emphasis added). Debtor's Memorandum in Opposition to Motion. Thus, I conclude that Debtor's argument that the guilty plea hearing has no consequences to her liability under § 523(a)(4) is intended to apply to § 523(a)(2) as well. I see no need to repeat my collateral estoppel analysis here other than my conclusion that to the extent the Court made findings in that proceeding, the Debtor will be bound by them here. I have already concluded that there was a finding that Debtor submitted written statements (loan application, tax returns) that were materially false in overstating her assets and income in connection with NPFP's extension of the Loan. However, as I agree with Debtor that there are material issues of fact as to NPFP's reliance, I will leave for trial when a full record is made whether they are sufficient to meet NPFP's burden of proof.

> investigation of the information supplied by debtor); and (3) the surrounding circumstances existing at the time of the debtor's application for credit (whether there existed a "red flag" that would have alerted an ordinarily prudent lender to the possibility that the information is inaccurate, whether there existed previous business dealings that gave rise to a relationship of trust, or whether even minimal investigation would have revealed the inaccuracy of the debtor's representations).

Id.

NPFP argues that it relied on Debtor's representations regarding her assets and income and had it been aware of her true financial condition, it would not have extended the Loan because her guaranty was a material factor in making its credit decision. Debtor contends that there are material issues of fact with respect to the reasonableness of NPFP's reliance on the misstatements made by Debtor regarding her financial condition. Debtor points out evidence in the summary judgment record of several "red flags" that either did or should have alerted NPFP to the inaccuracy of the Debtor's representations about her financial condition as well as evidence that NPFP did not have the information it claims to have relied upon at the making of the Loan. Specifically, Debtor notes the inconsistency between two valuations provided with respect to her partial interest in real estate ($320,000 and $160,000) and the range between $0 and $100,000 provided for her interest in a "restricted trust." While there may be explanations as to why these disclosures did not raise a red flag to NPFP, Debtor nonetheless has identified a disputed factual issue that requires clarification at trial. Debtor also challenges the affidavit of Margaret A. Cobb, NPFP's current Executive Director, that NPFP's standard practice for evaluating loan applications was followed in this instance by pointing to NPFP's statement in its Memorandum in Support of Motion that the

Loan was only conditionally approved subject to the provision of additional collateral. If that is so, then query whether the Loan was granted based on the representations of the Debtor concerning her assets and income. Testimony is necessary to harmonize NPFP's legal position with its statement concerning the conditional approval of the Loan. In short, I find that I cannot on this record grant summary judgment in NPFP's favor on this count either.

An order consistent with this Memorandum Opinion shall be entered. As the pendency of the Motion suspended certain of the other dates set in this Court's Pretrial Order dated August 25, 2004, a further Order shall also prescribe the amended pretrial schedule.

Diane W. Sigmund

DIANE WEISS SIGMUND
Chief U.S. Bankruptcy Judge

Dated: January 28, 2005

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re	:	Chapter 7
	:	
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Debtor.	:	
	:	
NORTH PHILADELPHIA FINANCIAL PARTNERSHIP,	:	Adversary No. 04-0731
	:	
Plaintiff,	:	
	:	
v.	:	
	:	
JAMILA H. STEELE,	:	
	:	
Defendant.	:	

ORDER

AND NOW, this 28th day of January 2005, upon consideration is the Motion for Summary Judgment (the "Motion") filed by North Philadelphia Financial Partnership ("NPFP") in connection with its Complaint to Determine the Dischargeability of Debt after notice and hearing, and for the reasons stated in the accompanying Memorandum Opinion;

It is hereby **ORDERED** that:

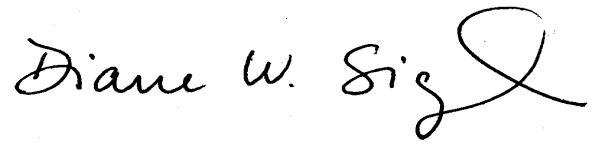
1. The Motion is **DENIED**;

2. The Pretrial Order dated August 25, 2004 is amended as follows:

   a. A pretrial statement shall be filed by **March 1, 2005**.

   b. A pretrial hearing shall be held on **March 29, 2005 at 2:20 p.m.**

Except for the new dates, all other provisions of the August 25 Order shall remain in full force and effect.



DIANE WEISS SIGMUND
Chief U.S. Bankruptcy Judge

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