IT IS ORDERED as set forth below:

Date: October 10, 2010

Paul W. Bonapfel
U.S. Bankruptcy Court Judge

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN THE MATTER OF:	:	CASE NUMBER: 09-69033-PWB
KEVIN LOUGHERY, JR.,	:	
	:	IN PROCEEDINGS UNDER
	:	CHAPTER 7 OF THE
Debtor.	:	BANKRUPTCY CODE
SPENCER R. ALLEN, JR., and THOMAS J. DAVIS,	:	
Plaintiffs	:	
v.	:	ADVERSARY PROCEEDING
	:	NO. 09-6380
KEVIN LOUGHERY, JR.,	:	
Defendant.	:	

ORDER DENYING MOTION FOR JUDGMENT ON THE PLEADINGS

The Plaintiffs seek judgment on the pleadings that their $476,338.42 judgment against the Debtor is excepted from discharge pursuant to 11 U.S.C. § 523(a)(19). For the reasons stated

herein, the Plaintiffs' motion is denied.

For purposes of this motion, the relevant facts are not disputed. On October 17, 2005, the Plaintiffs brought an action against the Debtor, an officer and director of 3D Pipeline Simulation Corporation, in the United States District Court alleging various violations of the Securities Act of 1933, 15 U.S.C. § 77a *et seq*., and the Georgia Securities Act of 1973, O.C.G.A. 10-5-1 *et seq*.[1] The Plaintiffs sought rescission of the sale of 3D stock and return of $450,000 paid as consideration.

On March 23, 2007, the District Court entered an Order granting in part and denying in part the Plaintiffs' motion for summary judgment (the "Summary Judgment Order"). In particular, the District Court concluded in the Summary Judgment Order that the Debtor was liable for the sale of unregistered stock to the Plaintiffs in violation of the Federal Securities Act. After entry of the Summary Judgment Order, the parties reached a settlement of the District Court action. As part of the settlement, the Defendant issued the Plaintiffs a promissory note in the amount of $320,000. The Settlement Agreement contained a "Non-Admission of Liability" clause that states that the Agreement does not constitute an admission that any party has any liability to any other party or that any conduct was in violation of any federal or state statute, regulation, or common law. No final judgment was ever entered in the District Court action and it was dismissed with prejudice.

The Debtor defaulted on the promissory note executed as part of the Settlement Agreement. As a result, the Plaintiffs obtained a consent judgment against the Debtor in the amount of $476,338.42 plus post-judgment interest in the Fulton County Superior Court.

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[1] *Spencer R. Allen, Jr. and Thomas J. Davis v. Loughery et al.*, Civil Action No. 1:05-CV-2685-TWT. In addition to the Debtor, 3D, KLM Investments, and Donald Sallee were named as defendants in this action.

The Plaintiffs contend that their debt is excepted from discharge pursuant to § 523(a)(19) as a matter of law because it arises from the Debtor's violation of the federal securities laws and results from a settlement agreement entered into by the Debtor. The Debtor contends that the Plaintiffs have failed to establish as a matter of law that the Debtor violated federal securities laws since no final judgment was ever entered in the District Court action and the Debtor made no admission of liability in the Settlement Agreement.

Judgment on the pleadings is appropriate when there are no material facts in dispute and the moving party is entitled to judgment as a matter of law. *Douglas Asphalt Co. v. Qore, Inc.*, 541 F.3d 1269, 1273 (11th Cir. 2008). All facts alleged in the complaint must be accepted as true and viewed in the light most favorable to the nonmoving party. *Id*. In this case, the Court must determine whether the Plaintiffs have established all requisite elements of § 523(a)(19) and that, based upon the undisputed record, they are entitled to a finding of nondischargeability.

Section 523(a)(19) provides that an individual debtor may not discharge in chapter 7 a debt that--

> (A) is for--
>
> (i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or
>
> (ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, before, on, or after the date on which the petition was filed, from--

> (i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

> (ii) any settlement agreement entered into by the debtor; or
>
> (iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

In order to be nondischargeable, a plaintiff must satisfy the requirements of both (a)(19)(A) and (B). Thus, in order for the Plaintiffs to prevail on their motion, the Plaintiffs must demonstrate that their "debt" (1) is for violation of securities laws (§ 523(a)(19)(A)); and (2) results from a judgment, order, consent order, decree or settlement agreement (§ 523(a)(19)(B)).

The Debtor does not dispute that the Settlement Agreement resolved the issues in the District Court action and, in fact, the Debtor "concedes that the Settlement Agreement may be sufficient for purposes of meeting the requirement of 11 U.S.C. 523(a)(19)(B)." (Debtor's Brief, Doc. 10, at 7). However, the Debtor contends that the Settlement Agreement and the District Court's Summary Judgment Order are not sufficient to establish the requirements of § 523(a)(19)(A) to permit entry of judgment as a matter of law.

Thus, the Court must determine whether the Plaintiff has established as a matter of law that the debt owed to them by the Debtor is for the violation of securities laws. In order to answer this question the Court must consider (1) whether the execution of a Settlement Agreement in which the debtor made no admission of liability alters the nature of the debt; and (2) whether principles of issue preclusion apply to the District Court's Summary Judgment Order.

A. The Effect of the Settlement Agreement

The Debtor contends that the state court judgment was a result of the Debtor's default on the Settlement Agreement, not any securities law violations. Essentially, the Debtor contends

that the debt is dischargeable because the Debtor breached a contract with the Plaintiffs (the Settlement Agreement), not because he violated federal securities laws when he took the Plaintiffs' money.

The settlement of the Debtor's liability to the Plaintiff whereby the Debtor makes no admission of liability does not change the nature of the debt or preclude a finding that the debt is one for the violation of securities laws. In *Archer v. Warner*, 538 U.S. 314 (2003), the United States Supreme Court concluded that the settlement and release of a state law fraud claim could nevertheless be a debt "arising from fraud" for purposes of § 523(a)(2). For purposes of § 523(a)(19), the result is the same.

In *Archer*, the Warners sold a company to the Archers. A few months later, the Archers sued the Warners in state court on multiple counts including fraud connected with the sale. Ultimately, the parties entered into a settlement agreement whereby the Warners paid the Archers $200,000 and executed a promissory note for the remaining $100,000. The Archers executed releases discharging the Warners from all other claims except those under the promissory note. The releases stated that the parties did not admit any liability or wrongdoing and that the settlement was a "compromise of disputed claims, and that the payment was not to be construed as an admission of liability." A few days later the Archers voluntarily dismissed the state court lawsuit with prejudice. *Archer*, 538 U.S. at 317.

After the Warners defaulted on payment of the promissory note, the Archers sued for payment in state court. The Warners then filed a chapter 7 bankruptcy petition. The Bankruptcy Court rejected the Warners' contention that their debt was one obtained by fraud and held the debt discharged. *Id*. at 318.

Relying on its previous holding in *Brown v. Felsen*, 442 U.S. 127 (1979), the Supreme Court reversed, concluding that the debt for money promised in a settlement agreement accompanied by the release of state law tort claims could still be a debt for money obtained by fraud for purposes of bankruptcy dischargeability. *Archer*, 538 U.S. at 319-322.

Archer is directly applicable to this case. The parties' execution of a Settlement Agreement does not act as a novation to change the original nature of the debt and does not preclude a finding that the debt owed by the Debtor to the Plaintiffs is one arising from the violation of securities laws.

Nevertheless, the Debtor makes no admission of liability with respect to the Plaintiffs' claims in the Settlement Agreement or the Consent Judgment entered after the Debtor's default. Thus, even though the Settlement Agreement satisfies the requirement of § 523(a)(19)(B), the terms of the Settlement Agreement itself do not establish as a matter of law that the debt results from the violation of the securities laws. The Court, therefore, must consider whether the District Court's Summary Judgment Order in which it found that the Debtor was liable for the sale of unregistered stock to the Plaintiffs in violation of the Federal Securities Act is entitled to preclusive effect for purposes of § 523(a)(19)(A).

B. The Effect of the District Court's Summary Judgment Order

The Plaintiff contends that, based on principles of issue preclusion, § 523(a)(19)(A)'s requirement that the debt is for the violation of federal securities laws is conclusively established because the District Court found that the Debtor was liable for the sale of unregistered stock to the Plaintiffs in violation of the Federal Securities Act in its Summary Judgment Order. The Debtor contends that because the Summary Judgment Order was not a final order, issue preclusion does

not apply.

Issue preclusion prevents relitigation of an issue of fact or law that has been litigated and determined in a prior action. The Eleventh Circuit has recognized four requirements for the application of issue preclusion: (1) the issue at stake must be identical to the one in the prior action; (2) the issue must have been actually litigated in the prior action; (3) the determination of the issue must have been a critical and necessary part of the judgment in that action; and (4) the party against whom issue preclusion is asserted must have had a full and fair opportunity to litigate the issue in the earlier proceeding." *I.A. Durbin, Inc. v. Jefferson Nat'l Bank*, 793 F.2d 1541, 1549 (11th Cir.1986).

Thus, although the Eleventh Circuit's standard contemplates that the issue was a critical and necessary part of the judgment in that action, it does not explicitly contain a "finality" requirement. Indeed, the Eleventh Circuit has recognized that "the finality requirement is less stringent for issue preclusion than for claim preclusion." *Christo v. Padgett*, 223 F.3d 1324, 1339 (11th Cir. 2000).

In *Christo v. Padgett*, 223 F.3d 1324 (11th Cir. 2000), the Eleventh Circuit examined whether a preliminary order was entitled to preclusive effect in a subsequent proceeding. *Christo v. Padgett's* complicated factual background - ten years of civil, criminal, and bankruptcy proceedings - is critical to an understanding of the Eleventh Circuit's ruling.

Christo begins in the early 1990s with the Christo family and their multiple bank investments. Florida Bay Bank & Trust ("FBB") owned all of the outstanding stock of Bay Bank & Trust ("Bay Bank"). The majority of FBB's stock, in turn, was owned by a family trust established by John Christo, Jr. and an employee stock ownership plan. Christo, Jr., owned 97%

of FBB's preferred stock and Christo, Jr.'s three children were beneficiaries of the trust and owned additional stock as well.

When FBB defaulted on a loan owed to SouthTrust Bank secured by all of FBB's stock in Bay Bank, the Christos and SouthTrust entered into a settlement agreement providing for a court-ordered sale of the Bay Bank stock. Meanwhile, the Christos' ongoing negotiation with Union Planters Corporation for a stock purchase of Bay Bank was threatened by the impending auction because it could not complete a due diligence report prior to the auction. *Christo*, 223 F.3d at 1328-1329.

On the eve of the auction, Christo, Jr. arranged for Kenneth Padgett to attend the auction and purchase the Bay Bank stock with the understanding that Padgett would assign his bid to Union Planters if he was the successful bidder. Padgett was the successful bidder; however, later he contended there was no such agreement and he was acting for his profit alone. SouthTrust then filed pleadings before the district court judge who had presided over the SouthTrust litigation and settlement seeking to have the sale set aside based on collusion between Christo, Jr. and Padgett which would foreclose regulatory approval. Padgett testified he was acting on his own and the Christos did not present contrary evidence. The district court denied the motion to set aside the sale. *Id*. at 1329.

Three months later, in February 1994, Christo, Jr., filed a chapter 7 bankruptcy. The bankruptcy trustee brought a four count complaint against Padgett for breach of the oral contract to turn over control of Bay Bank to the Christos (the "bankruptcy litigation"). The trustee dismissed two counts, lost on two counts and filed a notice of intent to abandon the dismissed claims. Padgett objected to the abandonment, and the trustee and Padgett settled all claims related

to the Bay Bank stock sale contingent on the court finding that the trustee had succeeded to any claim related to Padgett's alleged agreement to buy the bank on behalf of the Christos. *Id*.

On November 14, 1997, the Christo family filed a breach of contract action against Padgett in Florida state court (the Christo litigation). Padgett removed the action to federal court and it was transferred to the judge who had heard the original SouthTrust litigation. The Christos filed a motion to remand. *Id*. at 1329-1330.

After the trustee and Padgett moved the district court to approve the settlement in the bankruptcy litigation, Padgett objected, and the district court held an evidentiary hearing, applicable both to the bankruptcy litigation and the Christo litigation concerning the existence of the oral contract. The court's order and notice setting the matter for hearing stated "this proceeding could result in an order granting the motion to approve settlement, and, ultimately, preclusion of any parties from pursuing claims against Kenneth Earl Padgett regarding his purchase of Bay bank and Trust Company and/or his failure to assign any interests therein." *Christo*, 223 F.3d at 1339 n.48. In a July 13, 1998 Order, in which it stated it was making "preliminary findings," the court found that there was no enforceable agreement and even if there were, Christo's interest would have passed to his bankruptcy estate. The district court then referred the proposed settlement to the bankruptcy court for report and recommendation on whether, in light of the district court's findings, the settlement was in the best interests of the estate. *Id*. at 1330.

On October 1, 1998, the district court denied the Christos' motion to remand the Christo litigation and dismissed it on the grounds of issue preclusion based on findings in the July 13 Order. The bankruptcy court recommended approving the proposed settlement and the district court adopted the recommendation and approved the settlement of the bankruptcy litigation

between Padgett and the bankruptcy trustee. *Id*.

On appeal, the Christos argued that the July 13 Order could not have preclusive effect because it was not a final judgment. The Eleventh Circuit rejected this argument, concluding that the "July 13 Order satisfied [issue preclusion's] limited standard for finality." *Christo*, 223 F.3d at 1339. The court pointed to the Restatement (Second) Judgments which states that "for purposes of issue preclusion . . ., 'final judgment' includes any prior adjudication of an issue in another action that is determined to be sufficiently firm to be accorded conclusive effect." *Christo*, 233 F.3d at1339 n.47 (*quoting* RESTATEMENT (SECOND) JUDGMENTS § 13).

The point of the labored recitation of the *Christo v. Padgett* facts is to illustrate the complexity of the litigation in multiple forums that eventually came to a head in an evidentiary hearing involving both the bankruptcy litigation and the removed state court litigation before the district court. The district court in its scheduling order put the parties on notice of the potentially preclusive effect and finality of the evidentiary hearing. It conducted a full evidentiary hearing with participation by the parties. It issued an order intended to resolve the issues for both sets of litigation. As the Eleventh Circuit observed, both the district court and the bankruptcy court considered the findings in the July 13 Order final. *Id*. at 1339. Given the facts of the case and the procedural history, the Eleventh Circuit's conclusion that the "finality" requirement of issue preclusion was satisfied by the July 13 Order is understandable and appropriate.

But similar facts do not exist in the case before the Court. Though the District Court issued an extensive order granting the Plaintiffs' partial summary judgment in which it made findings of fact and conclusions of law after weighing the arguments and evidence of the parties, the Order is still an interlocutory, not a final, order. While *Christo v. Padgett permits* a finding of

finality even where an order is not "final," it does not *require* such a finding unless the factual and procedural history support it. The Eleventh Circuit's detailed recitation of the factual and procedural history in *Christo* indicates that a court should thoughtfully consider the nature of the proceedings, the terms of an order, and the procedural posture of the case in determining whether a non-final order is entitled to preclusive effect.

Commentary to the Restatement (Second) Judgments provides guidance for determining whether an order is final for purposes of issue preclusion. Comment *g* provides:

> [T]he court should determine that the decision to be carried over was adequately deliberated and firm, even if not final in the sense of forming a basis for a judgment already entered. Thus, preclusion should be refused if the decision was avowedly tentative. On the other hand, that the parties were fully heard, that the court supported its decision with a reasoned opinion, that the decision was subject to appeal or was in fact reviewed on appeal, are factors supporting the conclusion that the decision is final for the purpose of preclusion. The test of finality, however, is whether the conclusion in question is procedurally definite and not whether the court might have had doubts in reaching the decision.

There is no dispute here that the parties were heard and the District Court supported its decision with a reasoned opinion. However, the Court must also consider whether the order was "subject to appeal or was in fact reviewed on appeal." If the "test of finality . . . is whether the conclusion in question is procedurally definite," the Court must conclude that the Order of the District Court granting partial summary judgment does not satisfy the finality requirement of issue

preclusion.

Pursuant to 28 U.S.C. § 1291, a party may only appeal a final decision of the district court. "Federal appellate jurisdiction generally depends on the existence of a decision by the District Court that ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 467 (1978). As a result, "[a]n order granting partial summary judgment is not a final appealable order under section 1291, because it does not dispose of all claims raised." *CAE Screenplates, Inc. v. Heinrich Fiedler GmbH & Co. KG*, 224 F.3d 1308, 1314 (11th Cir. 2000); *see Winfield v. St Joe Paper Company*, 663 F.2d 1031 (11th Cir. 1981).

An order granting a motion for partial summary judgment is not a final judgment subject to appeal unless the court directs entry of final judgment and "expressly determines that there is no just reason for delay." FED. R. CIV. P. 54(b). Rule 54(b) further provides, "Otherwise, any order or other decision, however designated, that adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties *does not end the action as to any of the claims or parties and may be revised at any time* before the entry of a judgment adjudicating all the claims and all the parties' rights and liabilities." *Id*. (emphasis added).

The Debtor had no absolute right to appeal the Summary Judgment Order issued by the District Court. Although the Debtor *could have* requested the court certify its order on partial summary judgment for interlocutory appeal, it was not required to do so, and the Court declines to draw a negative inference from the Debtor's failure to seek a discretionary appeal. *See Vardon Golf Co., Inc. v. Karsten Manufacturing Corp.*, 294 F.3d 1330, 1334 (Fed. Cir. 2002) (existence of "speculative methods of preserving the right to appeal" a partial summary judgment order,

including pursuing an interlocutory appeal, do not "render a nonfinal judgment preclusive for the purposes of collateral estoppel").

The Plaintiffs argue that finality is also demonstrated by the District court's order denying the Debtor's unopposed motion to vacate the Summary Judgment Order on May 17, 2007, approximately two months after the Summary Judgment Order was entered. The Order states, "The Court is not inclined in such cases to allow the withdrawal of prior orders to be used as currency in settlement negotiations. Withdrawal of the Order may affect the rights of others not before the Court. This is not an exceptional case which warrants the relief requested."[2] The Debtor's motion is not attached and the Plaintiffs do not state the reasons that the Debtors sought this relief or why they did not oppose the motion. The Court notes that the order was entered three days after the parties executed the Settlement Agreement. The Court concludes that the Order does not render the Summary Judgment Order final for purposes of issue preclusion.

Because the District Court's order was interlocutory in nature, it did not end the action and was subject to revision at any time before entry of final judgment. FED. R. CIV. P. 54(b). For this reason, the Court concludes that the Summary Judgment Order was not final for purposes of issue preclusion.

Finally, the Plaintiffs argue that the Debtor "admits that he was found liable to Plaintiffs in the District Court Action for the sale of unregistered stock in violation of the Securities Act of 1933, a Federal securities law. See Answer to Complaint ¶ 15." (Plaintiff's Brief, Doc. 9, at 7). This is not an accurate statement. Paragraph 15 of the Complaint states, "On March 23, 2007, the court entered an Order (the "District Court Order") in the District Court Action granting Plaintiff's

[2]Plaintiff's Reply Brief (Doc. 13), Exhibit 2.

motion for summary judgment in part and finding Defendant liable for the sale of unregistered stock in violation of the Securities Act of 1933. A copy of the District Court Order is attached hereto as Exhibit "1," and made a part hereof by reference." (Complaint, Doc. 1, ¶ 15). The Debtor's answer is "Debtor/defendant admits the allegations contained in paragraph no. 15 of the Complaint." (Answer, Doc. 8, ¶ 15). The Debtor has not admitted liability; the Debtor has admitted the allegation that the District Court entered an Order.

In summary, the Court concludes that because the District Court's Summary Judgment Order is not a final judgment and, therefore, not entitled to preclusive effect, the Plaintiff has failed to establish as a matter of law that the debt at issue arises from the violation of securities laws as required by § 523(a)(19)(A). The Court further concludes that the Settlement Agreement satisfies the requirements of § 523(a)(19)(B). Accordingly, it is

ORDERED that the Plaintiffs' motion for judgment on the pleadings is denied. It is

FURTHER ORDERED that the Court shall hold a status conference on November 2, 2010, at 10:30 a.m., in Courtroom 1401, U.S. Courthouse, 75 Spring Street, S.W., Atlanta, Georgia.

End of Order

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