UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

KEITH PILLICH Case No. 94-10400 K

Debtor

Stanley Nowak
Richard Kwiatowski
Cynthia Kwiatowski
Chester Arczymowicz
Estate of Mary P. Spychalska
Estate of Zeona Spychalska
Clifford Alf

Plaintiffs

v. AP 96-1150 K

Keith Pillich

Defendant

Alan J. Bozer, Esq.
Albrecht, Maguire, Heffern & Gregg, P.C.
2100 Main Place Tower
Buffalo, New York 14202

Attorney for Plaintiffs

Joel Brownstein, Esq.
Borins, Setel, Snitzer & Brownstein
710 Statler Towers
Buffalo, New York 14202

Attorney for Debtor-Defendant

This Court currently has before it two motions in this case. The first is Plaintiffs' Motion Seeking Joinder of Michael Peters as a Plaintiff in the Adversary Proceeding The second is Plaintiffs' Motion for Summary Judgment. Only the latter will be addressed here.[1]

In this Adversary Proceeding, Plaintiffs seek a declaration of non-dischargeability, under 11 U.S.C. § 523(a)(2) and (4), of the Debtor's obligations to them pursuant to judgments which arose from alleged misrepresentations which induced Plaintiffs to invest in certain limited partnerships involving the Debtor, Keith Pillich.

Plaintiffs' Motion for Summary Judgment asks this Court to give *res judicata* effect to judgments entered in four prior state court proceedings (both civil and criminal) and thereby to bar Pillich from "relitigating" the issue of fraud in this dischargeability proceeding.

[1]Summary Judgment is sought not only as to the 11 U.S.C. § 523 cause of action that is the focus of this decision, but also as to a certain 11 U.S.C. § 727 cause of action and yet a third cause of action that is in the nature of a request for a declaration that the Plaintiffs are entitled to judgment on the First and Second Cause as a matter of law. The briefs and arguments focused only on the § 523 cause of action, and the Court hereby denies the Plaintiffs' Motion as to the Second and Third Causes of Action as being without merit.

One of the state court proceedings is a civil case entitled Nowak et al. v. Pillich et al. (Index No. 5920/90). In that action, these same Plaintiffs alleged, among other things, that Pillich and other defendants "fraudulently induced Plaintiffs to give them money in return for limited partnership interests in Manor Homes . . . by making misrepresentations regarding those investments." Fourth Amended Verified Complaint in the State Court case ¶ 29. The parties ended that action after jury selection by a stipulated settlement pursuant to which the defendants were to pay to the various Plaintiffs an aggregate total of $150,000. There were no explicit admissions of fraud in the settlement papers. The settlement papers did, however, contemplate that in case of a default under the agreement, judgments would enter against Pillich in favor of the Plaintiffs for the amounts requested in the Fourth Amended Complaint.[2] The defendants therein, including Pillich, ultimately defaulted under that settlement and the appropriate judgments were entered in State Court in favor of each named Plaintiff. Those are the judgments sought here to be declared non-dischargeable.

[2]The settlement agreement excepted from the default provision the entry of judgment on the Twenty-first cause of action involving alleged RICO violations. Since the other causes in that complaint sounded in fraud, the Plaintiffs ask this Court to conclude that the negotiated settlements' express exclusion of the RICO cause, constituted an implied admission by Pillich of the frauds recited in the other cases. That is simply too tenuous a basis upon which to find non-dischargeability, as discussed later.

Plaintiffs also ask this Court to give issue-preclusive effect to a criminal case instituted against the Debtor and others which case resulted in the Debtor's guilty plea and the entry of a Judgment of Restitution.[3] In that case, Pillich was charged with and pleaded guilty to Offering a False Instrument for Filing, in that he and his co-defendants offered to the New York State Department of Law certain documents "for the purpose of obtaining an exemption . . . permitting defendants to offer and sell securities without having to comply with certain registration and disclosure provisions otherwise required by law," and that defendants knew that these documents contained false statements or information. Some of the current Plaintiffs were identified as "victims" of Pillich's "crime," in the Restitution Order and Judgment.

Next, in a Supplemental Affirmation in support of its Motion for Summary Judgement dated October 1, 1996, Plaintiffs recite the civil cases of Herman v. Pillich et al. (Buffalo City Court, Docket No. W21094, Cal. No. 90-362) and William and Phyllis Marshall v. Pillich et al. (New York State Supreme Court, County of Erie, Index No. 10458/90). In the *Herman* case, Mr. Herman, the sole plaintiff, charged Pillich and others with making false representations which induced Mr. Herman to invest in Manor Homes Limited Partnership. The

[3]The restitution order did not encompass every one of the present Plaintiffs, nor did it reflect the full amount of their present claims against the Debtor. Hence, the Plaintiffs do not rely only on *Kelly v. Robinson*, 479 U.S. 36 (1986). That case held that restitution orders are not dischargeable in a Chapter 7 case. (But state court restitution orders might be discharged in a Chapter 13 case, *see Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552 (1990)). Resort is necessary to 11 U.S.C. § 523(c) as to parties or amounts beyond the restitution order.

case was fully adjudicated and a jury verdict was entered against the Debtor based on the allegations made in the complaint. Mr. Herman is not a present plaintiff.

In the *Marshall* case, William and Phyllis Marshall were the sole plaintiffs. They alleged misrepresentations by Keith Pillich as the sole defendant, which caused them to invest in certain high risk securities in which they otherwise would not have invested. This case was submitted to arbitration and a judgment was entered for the Marshalls upon the findings of the arbitrator. The Marshalls are not plaintiffs before this Court.

In sum, the Plaintiffs want this Court to preclude the Debtor from here litigating ("relitigating," in the Plaintiffs' view) the issue of fraud. They rest upon the aggregate effect of: (1) the agreement entered into by Pillich and these same Plaintiffs as settlement of civil fraud litigation, and the judgments entered upon default thereof; (2) Pillich's plea of guilty in the face of criminal false filing allegations and the resulting award of restitution to his "victims"; (3) a verdict entered against Pillich in a civil case involving fraud, but not involving any one of the Plaintiffs herein; and (4) a judgment entered against him upon an arbitration award which case did not involve any of the Plaintiffs herein.

The Court is of the view that three of the four cases should not be given the broad scope of preclusive effect sought by the Plaintiffs in this dischargeability proceeding, whether considered singly or together. It is possible that a certain degree of preclusion might arise from the guilty plea, and might extend beyond the restitution order, depending upon the record in the criminal court, as described later.

ANALYSIS

Although it is the bankruptcy court that is to determine the dischargeability of debts,[4] this does not mean that state court adjudications of fraud should be disregarded.[5] The Restatement (Second) of Judgments gives guidance as to when issue preclusion is validly given:

> When an issue of fact or law is *actually litigated* and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action *between the parties*, whether on the same or a different claim.

Restatement (Second) of Judgments § 27 (1980) (emphasis added). We must be careful only to consider those judgments coming from prior state court proceedings in which the debtor has had a "full and fair opportunity for litigation in which the issue was actually litigated and necessary to the prior decision."[6] Furthermore, the debtor must have had adequate incentive to defend (as vigorously as he would in a bankruptcy dischargeability proceeding) the allegations

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[4]*See generally* Jeffrey T. Ferriell, *The Preclusive Effect of State Court Decisions in Bankruptcy* (Second Installment), 59 Am. Bankr. L.J. 55 (1985).

[5]The Second Circuit, in *Kelleran v. Andrijevic,* 825 F.2d 692 (2d Cir. 1987), strictly limited this Court's authority to look behind a state court judgment for purposes of the allowance of claims, but that case did not involve dischargeability of debts.

[6]*Stochastic Decisions, Inc. v. DiDomenico*, 995 F.2d 1158, 1169 (2d Cir.), *cert. denied,* 510 U.S. 945 (1993); *Montana v. U.S.*, 440 U.S. 153 (1979); *Allen v. McCurry*, 449 U.S. 90, 95 (1980); *Khandar v. Elfenbein*, 943 F.2d 244 (2d Cir. 1991).

against him.[7]

Once it is determined that such a state court judgment was the result of such litigation, this Court still is required to look behind the judgment at the facts on record to determine whether the level of fraud which has been adjudicated rises to that which is non-dischargeable in bankruptcy.[8]

That being said, the first case that Plaintiffs request be given preclusive effect satisfies neither the Restatement nor the court-enunciated tests quoted above. Contrary to Plaintiffs' assertions, the fact that the Debtor spent considerable time and effort on discovery and motion practice in the Nowak civil case before it was settled, does not dispense with the need for there to have been an "adjudication," if there is to be preclusive effect. The settlement agreement upon which judgment was rendered might have been a different matter, however, had the Debtor expressly admitted defrauding the Plaintiffs as part of that agreement. Then this Court might be persuaded to hold the Debtor to such an admission in this dischargeability proceeding. The Debtor did not make such an admission, and provision in the settlement agreement for entry of a judgment upon default does not, to this Court, constitute an admission or an adjudication of fraud.

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[7]*See* Restatement (Second) of Judgments § 28 (1980).

[8]Ferriell, *supra* note 4, at 360-62.

This must be made clear. Even if it were true that the judgment that resulted from the breach of the settlement agreement was a judgment on the underlying fraud allegations (and it is not, as discussed below) there is nothing pointed out to the Court by which that fact, *vel non*, constituted an admission of fraud. While it is possible that Pillich presumed that he would lose at trial, it would be equally as plausible to infer that Pillich was willing to enter the settlement agreement precisely to avoid admitting fraud or suffering an adjudication of fraud.[9] The type of clear implication that Plaintiffs wish to draw simply is not there. No matter how much work was done by Pillich defending the suit up to the point of settlement, nothing in the settlement or the subsequent judgment speaks of admission or defeat to the point that Pillich should be denied his day in court here on the dischargeability of debts in excess of the restitution order.

In that regard, the fact that the action was settled distinguishes this case decisively from *Bush v. Balfour Beatty Bahamas, Ltd.* (*In re Bush*), 62 F.3d 1319 (11th Cir. 1995), which was cited by the Plaintiffs. After much pre-trial skirmishing, Mr. Bush absented himself in an apparent effort to avoid putting the question of fraud before the Court. Here the issue was not put before the Court because the parties so agreed.

Moreover, it is not true that the subsequent judgments were rendered "on causes

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[9]Other possibilities have nothing to do with Pillich's state of mind. For example, it may be inferable that the Plaintiffs were willing to accept the settlement in order to avoid the risks and expense of having to prove fraud, which must be established by clear and convincing evidence in state court, but requires only a preponderance here, *Grogan v. Garner*, 498 U.S. 279 (1991).

of action for fraud and defalcation," as Plaintiffs argue. Rather, Paragraph 4 of the Stipulation of Settlement merely provided for entry of judgments "for the amounts demanded" in the complaint. The judgments, therefore, were not an adjudication on the merits. In sum, then, this case cannot be likened to one in which a defendant, after vigorous participation that has put the plaintiffs to substantial expense, confesses judgment on the merits or absents himself from trial.

As a separate matter, Paragraph 10 of Plaintiffs' September 13, 1996 Reply Affirmation hints that the Settlement Stipulation itself was fraudulent, when it refers to Pillich's "false promise in the stipulation." If that is offered as a basis for preclusion, it must be rejected. Entering into an agreement that one had no intention of keeping might be a fraud giving rise to a non-dischargeable debt, but that would be a separate cause of action that must be litigated. The fact that the agreement was breached does not of itself preclude the breaching party from attempting to convince the finder of fact that he had every intention of performing the agreement.

Very importantly, one case offered by the Plaintiffs is a criminal case that ended in a guilty plea and a restitution order. A guilty plea in a criminal proceeding in which persons are identified as "victims," may be *res judicata* as to non-dischargeability, but not beyond the limits of the restitution order.

Restitution orders are always non-dischargeable in Chapter 7 cases for specific reasons. "[R]estitution orders . . . operate 'for the benefit of' the State [and] . . . are not assessed 'for . . . compensation' of the victim. The sentence following a criminal conviction necessarily considers the penal and rehabilitation interests of the State. Those interests are sufficient to place restitution orders within the meaning of § 523(a)(7)." *Kelly v. Robinson*, 479 U.S. 36, 53

(1986) (footnote omitted).

Even if it were not non-dischargeable under 11 U.S.C. § 523(a)(7), the criminal court's finding that those persons who were recited in the restitution order were "victims" of Pillich's crime of filing a false instrument with intent to defraud the State, would likely be *res judicata* in a dischargeability proceeding here under 11 U.S.C. § 523(a)(2), (4) or (6).

Notably, the Plaintiffs here wish that fact to compel a directed verdict for people and amounts in excess of the criminal court's finding. That does not follow in logic or in law unless there is something further in the criminal court record to support it. That possibility will be addressed at the end of this decision.

The next preclusion issue raised here is whether the Plaintiffs in this case should be permitted to utilize the judgments entered against the Debtor in the *Herman* and *Marshall*[10] cases. None of the present Plaintiffs were party to either of those proceedings. Although third party issue preclusion is recognized in New York, its applicability in dischargeability proceedings in this Court is problematic. First, in some New York case law in which third party issue preclusion was allowed, it is clear that the separate law suits in question arose out of the same occurrence. *See Koch v. Consolidated Edison*, 62 N.Y.2d 548 (1984). Here that is not so clear. Although it very well might be uncovered that the Debtor's fraudulent scheme was so uniform across various "investments" and various "victims," that the facts and circumstances surrounding each and every transaction are identical, this Court doubts that such is the case (in light of the likelihood that different creditors relied on different factors in deciding whether to invest with Pillich), and in any event this Court cannot "presume" that they were. (Indeed, Debtor's counsel insists on his client's behalf (in an Affidavit vigorously challenged by Plaintiffs' counsel) that they were not.)

Even if the facts and circumstances were identical, the policies and principles supporting a debtor's right to defend a dischargeability proceeding in bankruptcy is hard to reconcile with third-party issue preclusion. Issue preclusion is, in general, a rule of convenience used to avoid unnecessary litigation where the parties have already had their "day in court."

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[10]Because the effect of the *Marshall* case is treated under a third party issue preclusion analysis, this Court need not, and does not here, rule on the advisability of granting preclusive effect to an arbitration ruling.

Tight reins should be kept on any rule of convenience in proceedings involving consequences so harsh as the non-dischargeability of a debt in bankruptcy.

In the aggregate, the various prior proceedings establish nefarious conduct by the Debtor toward some people in some "deals," but that should not preclude the Debtor from his day in court on current accusations by these people as to these "deals" except to the extent that the restitution order has already established his frauds.

CONCLUSION

Other than the guilty plea and restitution order, the prior judgments upon which Plaintiffs rely for Summary Judgment are not the type of prior state court judgments which should be given preclusive effect in a bankruptcy dischargeability proceeding.

In pleading guilty, Pillich admitted a fraudulent intent toward the State of New York, but the State Court Judge (with Pillich's assent) found certain persons, including some of these Plaintiffs, to be "victims" thereof. It is not known to this Court how those victims were identified, what "deals" they invested in, or how the restitution dollar amounts were fixed by the Judge. To the extent that the "deals" are the same as are the subject of the Complaint here, and to the extent that the people are the same people, and to the extent that the State Court Judge might not have been aware of the full scope of those persons' losses on those particular "deals," Pillich should now be precluded from "relitigating" anything but the extended amount of claimed losses. If, on the other hand, the people and amounts and deals currently before this Court were

also before the criminal court, but were rejected by the State Court Judge and thus not included in the restitution order, then Pillich may defend,[11] just as he may fully defend as to any people or "deals" of which the State Court Judge was not aware.

The Plaintiffs' Motion for Summary Judgment must be denied in the absence of such a record, but Plaintiffs will be permitted to offer up such a record, if it exists.

In light of Pillich's imprisonment, further pre-trial conference will be on the record, and is set for November 27, 1996 at 10:00 a.m. in Part I, U.S. Bankruptcy Court, 310 U.S. Courthouse, 68 Court Street, Buffalo, New York, to determine whether such a criminal court record exists, and for further scheduling, including briefing on the Motion to add a party-plaintiff and scheduling on all three causes of action recited in the Complaint.[12]

SO ORDERED.

Dated: Buffalo, New York
November , 1996

/s/Michael J. Kaplan

U.S.B.J.

[11]Pillich is not entitled to preclude any Plaintiffs here because they were not parties to the criminal proceeding.

[12]It seems to the Court that the Third Cause of Action is identical to a Motion for Direct Verdict on the First and Second Causes. Earlier in this decision, Summary Judgment on that Third Cause was denied. How to proceed with that Cause also will be discussed on the record.