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**WRITTEN DECISION - FOR PUBLICATION**

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CLERK, U.S. BANKRUPTCY COURT SOUTHERN DISTRICT OF CALIFORNIA BY _____ DEPUTY

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF CALIFORNIA

In re: James Douglas Tills  Debtor.	}	Bankruptcy No. 08-13210-LT7 Adversary No. 09-90054-LT
Elizabeth Mollasgo  Plaintiff,  v. James Douglas Tills  Defendant.	}	AMENDED <sup>1</sup> MEMORANDUM DECISION

Plaintiff Elizabeth Mollasgo ("Creditor") asserts pre-petition claims against Defendant James Tills ("Debtor," and together with Creditor, the "Parties") based on California securities law violations and common law fraud and negligent misrepresentation in connection with the sale of a security (collectively and as ultimately evidenced by the settlement agreement discussed below, the "Creditor's Claim"). In connection therewith, the Parties entered into a pre-petition Settlement Agreement and Mutual General Release (the "Settlement Agreement") that includes a recital providing that the Parties entered into the

<sup>1</sup> The Memorandum Decision signed and entered on October 5, 2009 is hereby amended to correct a non-substantive typing error in the second sentence in section C.1.

1 Settlement Agreement "[w]ithout conceding any fault or liability." Post-settlement and  
2 prior to any payment under the Settlement Agreement, Debtor initiated a chapter 7  
3 bankruptcy (the "Debtor's Bankruptcy"). Creditor now asserts that Creditor's Claim is non-  
4 dischargeable in Debtor's Bankruptcy as a result of 11 U.S.C. § 523(a)(19)<sup>2</sup> and seeks  
5 summary judgment in her non-dischargeability action. Thus, the Court must determine  
6 whether summary judgment is appropriate in a case where a settlement agreement resolves  
7 allegations of security law violations, but also contains an express denial of any fault or  
8 liability by the Debtor.

9  
10 **FACTS<sup>3</sup>**  
11

12 Prior to his bankruptcy, Debtor and Richard A. Calderone began Jacoba Enterprises,  
13 LLC ("Jacoba"). Jacoba was an umbrella organization that purchased apartment buildings,  
14 converted them into condominiums, and formed a separate limited liability company in  
15 connection with each condo conversion project. Jacoba Taft, LLC ("Jacoba Taft") is the  
16 holder of the condo conversion project involved in this case.

17 In order to obtain a "partner" for a project, Jacoba, through Mr. Calderone, placed an  
18 ad in the San Diego Union Tribune seeking a serious LLC partner and requiring a  
19 \$100,000.00 minimum investment in connection with the 38 unit condo conversion project.  
20 Creditor, individually or through her real estate agent daughter, responded to the ad.  
21 Creditor allegedly considered several Jacoba condo conversion projects, but ultimately  
22 invested in Jacoba Taft.

23 Unfortunately, Jacoba Taft was unsuccessful, and Creditor lost the investment. In  
24 May of 2008, Creditor initiated an arbitration proceeding against Debtor and claimed therein  
25

26 \_\_\_\_\_  
27 <sup>2</sup> Hereinafter references to code sections refer to Title 11 of the United States Code, also referred to  
as the "Bankruptcy Code" unless otherwise specified.

28 <sup>3</sup> The factual recitations set forth herein are based on the Declarations of Richard A. Calderone,  
Elizabeth Mollasgo, and James Swiderski, and undisputed statements in other documents filed by  
the Parties and/or advanced at hearing.

1 that Debtor violated California Corporations Code §§ 25501 and 25504 and committed  
2 fraud and made negligent misrepresentations in connection with her investment.

3 Immediately prior to the November 11, 2008 arbitration hearing, counsel for Creditor  
4 offered the Settlement Agreement to Debtor. The Settlement Agreement terms, in most  
5 relevant detail, are as follows:

- 6 1. Neither of the Parties admitted fault or liability;
- 7 2. Debtor agreed to pay Creditor \$241,000 plus all of Creditor's arbitration and  
8 court expenses incurred to date in connection with the arbitration. This equated to full  
9 payment of amounts claimed as damages in the arbitration;
- 10 3. Creditor's counsel agreed not to undertake representation of other Jacoba  
11 investors;
- 12 4. Creditor agreed not to pursue any collection efforts against the separate  
13 property of Debtor's wife, with the exception of any community property if transferred to  
14 her as a means of hindering Creditor's collection efforts;
- 15 5. The Parties exchanged mutual releases; and
- 16 6. The Parties agreed that any disputes arising out of or relating to the Settlement  
17 Agreement would be resolved through arbitration.

18 It is not disputed that prior to signing the Settlement Agreement, Debtor informed  
19 Creditor that Debtor intended to file bankruptcy. Creditor's attorney does not argue that he  
20 discussed section 523(a)(19) in response, but Debtor concedes that the attorney made clear  
21 Creditor's intention to pursue Debtor notwithstanding a bankruptcy filing.

22 Debtor also stated at the summary judgment hearing that prior to signing the  
23 Settlement Agreement, he consulted an attorney who assured him that the Settlement  
24 Agreement would yield a dischargeable debt.

25 Debtor signed the Settlement Agreement on November 11, 2008. Creditor signed it  
26 on November 12, 2008.

27 Debtor made no payments to Creditor and on December 23, 2008, filed a voluntary  
28 chapter 7 petition. Creditor initiated this adversary proceeding against Debtor on

1 February 5, 2009 and seeks a determination of non-dischargeability under  
2 section 523(a)(19).

3 Creditor now seeks summary judgment. Creditor argues that section 523(a)(19)  
4 requires that the Court find Creditor's Claim non-dischargeable as it arises from a settlement  
5 agreement that settled allegations of violations of securities laws and common law fraud  
6 and/or negligent misrepresentation in connection with the sale of a security (generally  
7 herein, "securities violations"). Creditor maintains that summary judgment is appropriate  
8 because no genuine issues of material fact exist.

9 Debtor insists that, notwithstanding the Settlement Agreement, section 523(a)(19)  
10 requires a factual finding that Debtor committed securities violations, that disputed material  
11 facts in this area exist, and therefore summary judgment is inappropriate. Debtor expressly  
12 denies that he committed securities violations and provides support for his alleged  
13 innocence in the form of the Calderone Declaration.

14 The Court allowed limited post-hearing briefing and the matter is now ready for  
15 decision.

16 The Court has jurisdiction of this matter pursuant to 28 U.S.C. §§ 1334, 157(b)(1),  
17 and 157(b)(2)(I).

### 18 19 **SUMMARY JUDGMENT STANDARD**

20  
21 Federal Rule of Civil Procedure 56(c) (incorporated by Federal Rule of Bankruptcy  
22 Procedure 7056) provides that a party may move for summary judgment when there is no  
23 genuine issue as to a material fact and the moving party is entitled to a judgment as a matter  
24 of law. A "genuine issue" is one where, based on the evidence presented, a fair-minded jury  
25 could return a verdict in favor of the non-moving party on the issue in question.

26 *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986); *Lang v. Retirement Living Pub.*  
27 *Co.*, 949 F.2d 576, 580 (2d Cir. 1991). A "material fact" is one for which the resolution  
28 could affect the outcome of the case. *Anthes v. Transworld Systems, Inc.*, 765 F. Supp 162,

1 165 (D. Del. 1991). All justifiable inferences must be drawn in favor of the non-moving  
2 party. *Anderson*, 477 U.S. at 255. Likewise, all evidence must be viewed in the light most  
3 favorable to the non-moving party. *Lake Nacimiento Ranch Co. v. County of San Luis*  
4 *Obispo*, 841 F.2d 872, 875 (9<sup>th</sup> Cir. 1987).

## 6 DISCUSSION

### 8 **A. The Settlement Agreement Is Valid Notwithstanding This Court's** 9 **Determination As To The Applicability Of Section 523(a)(19).**

10 Whether Debtor can discharge Creditor's Claim depends first on the validity of the  
11 Settlement Agreement. This Court applies state law when resolving contract disputes. *In re*  
12 *Qintex Entertainment, Inc.*, 950 F.2d 1492, 1497 (9<sup>th</sup> Cir. 1991).

13 A contract tainted by mistake is voidable by an innocent mistaken party. *Oubre v.*  
14 *Entergy Operations, Inc.*, 522 U.S. 422, 425 (1998). Here, Debtor argues that he would not  
15 have signed the Settlement Agreement but for his belief that bankruptcy would discharge his  
16 debt and that Creditor knew of Debtor's belief. Creditor clearly believes that the Settlement  
17 Agreement creates a non-dischargeable obligation under section 523(a)(19). Obviously, one  
18 of the Parties is mistaken as to the impact of bankruptcy law on the Creditor's Claim. The  
19 Court determines, however, that the Settlement Agreement is a valid contract that binds  
20 Debtor notwithstanding the Court's determination regarding the availability of discharge as a  
21 result of section 523(a)(19).

22 Here, Debtor clearly understood and appreciated the material terms of the Settlement  
23 Agreement – he knew he agreed to pay the Creditor's Claim and that he waived and released  
24 all defenses to payment of the same. Where a contracting party understands the material  
25 elements of a contract and is only mistaken about a collateral matter, the contract is not  
26 voidable. *See Bellwood Discount Corp. v. Empire Steel Bldgs. Co.*, 175 Cal. App. 2d 432,  
27 435 (1959).

1 In this case, non-dischargeability is not a material element of the Settlement  
2 Agreement terms, and, indeed, is not discussed therein. Instead, it may be a collateral  
3 consequence of Debtor's Bankruptcy. Thus, even if the Parties entered into the Settlement  
4 Agreement based on a misunderstanding regarding the implications of section 523(a)(19),  
5 the Settlement Agreement remains valid, and the Parties remain bound by its terms.

6 **B. The Settlement Agreement Fully And Finally Liquidates The Creditor's Claim.**

7 There is also no question that the Settlement Agreement created a payment  
8 obligation, Creditor's Claim, that must be paid in full to the extent estate assets are sufficient  
9 to do so. The Court must interpret the Settlement Agreement to give effect to the Parties'  
10 mutual intent. *See* Cal.Civ.Code § 1636. To do so, the Court, first and foremost, looks to  
11 the language of the Settlement Agreement. *See* Cal.Civ.Code § 1639. Here it is clear to the  
12 Court that the Parties completely and finally expressed their intentions in the Settlement  
13 Agreement and that the Settlement Agreement is an integrated contract. *See Renwick v.*  
14 *Bennett (In re Bennett)*, 298 F.3d 1059, 1064 (9<sup>th</sup> Cir. 2002). As a result, the Court would  
15 consider extrinsic evidence only to interpret existing terms that are "ambiguous." *Id.* A  
16 resort to extrinsic evidence is unnecessary in this case.

17 At the outset, paragraph 2 of the Settlement Agreement recitals provides that neither  
18 of the Parties concedes "any fault or liability." The title, "Settlement Agreement and Mutual  
19 General Release," signals finality. The release provides that it is "mutual" and "general,"  
20 precludes any further action on the underlying claims by either of the Parties, and extends to  
21 all possible issues, claims, and defenses notwithstanding the discovery of new facts as it  
22 contains a standard California Civil Code section 1542 waiver.

23 The Court finds that the Settlement Agreement fully and finally resolves all disputes  
24 as to the Debtor's monetary liability, fully liquidates the Creditor's Claim, and is effective to  
25 prohibit any further litigation as to the amount of Creditor's Claim even in a bankruptcy  
26 context. As a result, Debtor cannot assert any defense to the payment of Creditor's Claim  
27 from the assets of his chapter 7 estate (the "Estate"). Unfortunately, however, this provides  
28 no comfort to Creditor. Debtor claims the loss of significant assets prior to bankruptcy, and,

1 consistent with this assertion, his schedules evidence that the Estate has no ability to pay the  
2 Creditor's Claim. Thus, Creditor's only possible avenue for recovery is through post-  
3 bankruptcy pursuit of the Debtor; and such pursuit is possible only if the Creditor's Claim is  
4 not dischargeable in Debtor's Bankruptcy.

5 **C. Section 523(a)(19) Analysis.**

6 Creditor asserts that the determinations discussed above lead inexorably to a  
7 conclusion that the Creditor's Claim is non-dischargeable. As noted, the Debtor argues to  
8 the contrary. In order to resolve this dispute, the Court reviews section 523(a)(19).

9 **1. The Plain Language Of Section 523(a)(19) Requires That The Non-**  
10 **Dischargeable Debt Result From Securities Violations.**

11 To discern the requirements of section 523(a)(19), this Court begins its inquiry with  
12 the statutory language itself. *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004). "It  
13 is well established that 'when the statute's language is plain, the sole function of the courts –  
14 at least where the disposition required by the text is not absurd – is to enforce it according to  
15 its terms.'" *Id.* (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*,  
16 530 U.S. 1, 6 (2000)).

17 Section 523 lists debts that are not dischargeable and at (a)(19) provides that a debt is  
18 not discharged if it:

19 (A) is for –

20 (i) the violation of any of the Federal securities laws . . . , any of the State  
21 securities laws, or any regulation or order issued under such Federal or State  
22 securities laws; or

22 (ii) common law fraud, deceit, or manipulation in connection with the  
purchase or sale of any security; and

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

24 (ii) any settlement agreement entered into by the debtor . . .

25 11 U.S.C. § 523(a)(19).

26 Section 523(a)(19) has two separate conditions for non-dischargeability separated by  
27 a semicolon and the word "and." The statute, thus, plainly indicates that the conditions must  
28 be independently satisfied – securities violations must have occurred **and** a settlement (or

1 other final resolution of the claim) must be completed. *Peterman v. Whitcomb (In re*  
2 *Whitcomb)*, 303 B.R. 806, 810 (Bankr. N.D. Ill. 2004) (debt dischargeable under  
3 section 523(a)(19) if two conditions met.)

4 This interpretation also is consistent with the canon of statutory construction  
5 requiring that the Court must give meaning to each word and must assume that Congress  
6 does not include any word unnecessarily. *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883).  
7 The word "violation" is rendered meaningless if a settlement based on mere allegations of  
8 securities violations is non-dischargeable without any consideration of culpability.

9 Additionally, the text associated with section 523(a)(19) in the Corporate and  
10 Criminal Fraud Accountability Act of 2002 (the "Act") supports the interpretation that  
11 requires an actual securities violation in addition to the settlement of securities violation  
12 allegations. The Act targets fraudulent actors and the title of section 803 of the Act, which  
13 amended section 523(a) to include subsection (19) reads: "Debts Nondischargeable If  
14 Incurred In **Violation** Of Securities Fraud Laws." 107 Pub. L. 204, 116 Stat. 745, 801, 802  
15 (2002) (emphasis added). Thus, the exception to discharge focuses on securities violations  
16 rather than resolutions of allegations of securities violations.

17 **2. A Review Of Committee Reports Indicates That Congress Intended**  
18 **Section 523(a)(19) To Require Culpability Of The Debtor.**

19 When statutory language is plain, the Court may still look to legislative history to  
20 ensure that the result of the Court's interpretation comports with the statutory purpose.  
21 *Carpenters Health & Welfare Trust Funds v. Robertson (In re Rufener Constr.)*, 53 F.3d  
22 1064, 1067 n. 7 (9<sup>th</sup> Cir. 1995). The Court largely limits its legislative history query to  
23 official committee reports. *In re Kelly*, 841 F.2d 908, 912 n.3 (9<sup>th</sup> Cir. 1988) (*citing*  
24 *Garcia v. United States*, 469 U.S. 70, 76 (1984)). The Senate committee report for the Act  
25 (the "Report") stated that section 523(a)(19): ". . . would . . . make judgments and  
26 settlements arising from state and federal securities law *violations* brought by state and  
27 federal regulators and private individuals non-dischargeable. Current bankruptcy law may  
28 permit *wrongdoers* to discharge their obligations under court judgments or settlements

1 based on securities *fraud* and securities law *violations*." S. Rep. 107-146 (2002) (emphasis  
2 added). The Report speaks of debts arising from "violations" and aims at eliminating  
3 loopholes in bankruptcy law that permit "wrongdoers" to discharge debts. The Report  
4 focuses on resolved securities violations, rather than on settled claims of securities  
5 violations.

6 The section by section analysis and discussion of the Act submitted by Senator  
7 Patrick Leahy, author of the Act, provides that section 523(a)(19) would "prevent  
8 wrongdoers from using the bankruptcy laws as a shield and [would] allow defrauded  
9 investors to recover as much as possible . . . . The provision applies to all judgments and  
10 settlements arising from state and federal securities laws violations . . . ." 148 Cong Rec S  
11 7418 at 7418 (2002). This discussion and analysis are in concert with the Report's focus on  
12 culpable debtors and wronged creditors. Defrauded investors can avoid losses through  
13 section 523(a)(19). *Id.* at 7419. The Report and the Act's author thus support the  
14 conclusion that section 523(a)(19) is intended to target securities laws violators, not to  
15 generally penalize all debtors who settle allegations of securities violations.

16 **3. In Appropriate Cases The Terms Of A Settlement Agreement May Allow**  
17 **The Court To Assume That A Securities Violation Actually Occurred**  
18 **And That Section 523(a)(19) Is Satisfied.**

19 Section 523(a)(19) allows a court in appropriate circumstances to base a finding of  
20 securities violations on the debtor's entry into a settlement agreement. What is at issue here  
21 is whether the Court is required to do so in all cases.

22 A 2007 article provides context for this discussion as it outlines drafting tips  
23 designed to render a claim under a pre-petition securities fraud settlement agreement non-  
24 dischargeable under section 523(a)(19). See Menton, James P., Jr., *Sarbanes-Oxley and the*  
25 *New Nondischargeable Debt: Drafting Tips for Pre-Bankruptcy Settlements*, 8 Comm. &  
26 Bus. Lit. 9 (2007). The author suggests that such a settlement agreement identify securities  
27 fraud claims, provide factual foundation supporting the claims, specifically indicate that  
28 settlement agreement payments resolve losses from securities fraud, and contain agreements

1 that the debt is nondischargeable and that the settlement agreement satisfies the  
2 requirements of section 523(a)(19). *Id.* While such careful drafting seemingly assures the  
3 desired non-dischargeability finding, the Court stops short of finding that all or any of these  
4 provisions are required. Indeed, a settlement agreement that settles allegations of securities  
5 violations and is silent as to fault may be sufficient. But in this case, the Settlement  
6 Agreement contains no discussion of the basis for non-dischargeability and, instead,  
7 contains a provision expressly stating that fault and liability are not conceded. The Court  
8 thus finds that the Settlement Agreement does not independently establish that Debtor  
9 committed securities violations and does not independently satisfy section 523(a)(19)(A).

10 Clearly, Congress provided that settlement agreements can independently satisfy  
11 section 523(a)(19). But it is also clear that Congress required that the settling party be a  
12 wrongdoer. Here, Creditor drafted the Settlement Agreement and obtained an agreement to  
13 pay the Creditor's Claim in full. But Creditor also made a concession to obtain this  
14 agreement – and took a risk in connection therewith – as she did not obtain any agreement  
15 regarding fault or non-dischargeability and allowed the Debtor to maintain his position that  
16 he had not committed a securities violation as required section 523(a)(19). She, thus,  
17 obtained an agreement that cannot form the sole basis for a determination that Debtor  
18 committed securities violations.

19 **4. Section 523(a)(19)(B) Expands The Use of Collateral Estoppel To**  
20 **Resolution of Securities Violations Through Settlement, But Not Under**  
21 **The Narrow Circumstances Of This Case.**

22 As discussed above, legislative history contains comments from Senator Leahy  
23 making clear a Congressional intent that section 523(a)(19) give settlement agreements a  
24 collateral estoppel effect similar to judgments. Creditor, thus, argues that Congress intended  
25 to preclude debtors from contesting liability if they settled claims of securities violations  
26 notwithstanding language in any such agreement indicating that fault and/or liability are not  
27 conceded. The Court, however, finds no evidence in the legislative history indicating that  
28

1 Congress intended such a broad result and such a drastic alteration of the doctrine of  
2 collateral estoppel.

3 Typically, five threshold requirements must be satisfied before courts apply issue  
4 preclusion. *Khaligh v. Hadaegh (In re Khaligh)*, 338 B.R. 817, 824 (BAP 9<sup>th</sup> Cir. 2006).  
5 The issue as to which preclusion is sought must have been resolved through a prior  
6 determination that: (1) resolved an identical issue; (2) actually litigated the identical issue;  
7 (3) necessarily decided the identical issue; (4) is final and resolved the issue on its merits;  
8 and (5) occurred between parties in privity to one another, in the former proceeding. *Id.*  
9 Additionally, the Court must consider whether preclusion would be fair and consistent with  
10 public policy in light of the circumstances of each case. *Id.* at 824-825. In  
11 section 523(a)(19), Congress clearly intended to alter the "actually litigated" requirement so  
12 that a settlement agreement has a preclusive effect not otherwise available. There is,  
13 however, ample evidence that Congress did not abrogate the requirement that the issue  
14 necessarily be decided and that violation be established.

15 A settlement agreement is fully capable of necessarily deciding an issue; as the  
16 article cited above notes, a settlement agreement can include an express agreement as to  
17 both fault and liability. Even if a settlement agreement is silent as to fault and liability, an  
18 argument could be made that the issues were necessarily decided based on the facts  
19 surrounding the settlement process. But here, no such argument is available as the  
20 Settlement Agreement expressly provides that fault and liability are not conceded. There is  
21 absolutely no basis for applying principals of issue preclusion where the issue is expressly  
22 not resolved by the settlement agreement in question.

23 Further, as noted above, a court considering issue preclusion must also consider the  
24 broad implications of public policy prior to applying the doctrine. Here public policy  
25 weighs against Creditor. First, there is a strong public policy in favor of settlement. *See e.g.*  
26 *Delta Air Lines, Inc. v. August*, 450 U.S. 346 (1981); *see also Evans v. Jeff D.*, 475 U.S. 717  
27 (1986). Creditor takes the position that as a result of 523(a)(19) all securities litigation  
28 settlements are non-dischargeable, which this Court believes would result in discouragement

1 of settlement agreements. This strident position is irresponsible. If Congress wished to  
2 deviate so completely from the public policy favoring settlements it easily could have done  
3 so. Instead of referencing a "violation" of securities law, Congress could have required non-  
4 dischargeability as to any settlement arising from a complaint alleging such violations.  
5 Given the strong public policy in favor of settlements, it is reasonable to assume that  
6 Congress would be completely clear if it intended to render it impossible to settle without  
7 resultant non-dischargeability. Thus, the Court concludes that Congress provided plaintiffs  
8 with a valuable tool in securities litigation, but also allowed the parties to avoid de facto  
9 non-dischargeability through settlement agreement language that expressly avoids any  
10 concession of fault or liability.

11       Such a view is also consistent with Supreme Court authority generally allowing a  
12 court to "look behind" a settlement agreement in non-dischargeability proceedings. In  
13 *Archer v. Warner*, 538 U.S. 314 (2003)<sup>4</sup>, the Supreme Court held that a settlement  
14 agreement settling a creditor's claims against a debtor does not bar the creditor from raising  
15 those claims for purposes of section 523. Prior to *Archer*, the Supreme Court had cautioned  
16 that "res judicata shields the fraud and the cheat as well as the honest person. It, therefore,  
17 is to be invoked only after careful inquiry." *Brown v. Felsen*, 442 U.S. 127, 132 (1979).  
18 Following *Brown*, the Supreme Court, thus, determined that a settlement agreement should  
19 not be available as a shield if it arises from an otherwise non-dischargeable debt. *Archer*,  
20 538 U.S. at 323. The *Archer* analysis similarly suggests that a settlement agreement should  
21 not be used as a cudgel to force a determination of non-dischargeability as to an allegedly  
22 innocent debtor unless Congress expressly so states or the settlement agreement so provides.

23  
24 \_\_\_\_\_  
25 <sup>4</sup> Congress is presumed to be aware of relevant case law and "if Congress intends for legislation to  
26 change the interpretation of a judicially created concept, it makes that intent specific". *Midlantic*  
27 *Nat. Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 501 (1986). Although  
28 the original date of enactment for section 523(a)(19) predated *Archer*, Congress has since amended  
the statute and, in light of *Archer*, did not amend section 523(a)(19)(A) to include language that  
would cover unproved and denied claims of violations of securities laws and common law fraud,  
deceit, or manipulation in connection with the purchase or sale of any security. Therefore, *Archer* is  
particularly relevant to this Court's interpretation of Congress' intent and the effect of the statutory  
language.

1           The strong bankruptcy policy in favor of the debtor's fresh start underscores the  
2 appropriateness of this determination. *See Grogan v. Garner*, 498 U.S. 279, 286 (1991). As  
3 a result of this policy, creditors carry the burden of proving that a section 523 exception to  
4 discharge applies. *Id.* at 291. Here Creditor urges the Court to ignore the burden she bears,  
5 Debtor's argument that he is an honest but unfortunate debtor entitled to the fresh start that  
6 is a central purpose of the Bankruptcy Code, and a defense to non-dischargeability that  
7 Debtor implicitly reserved in the Settlement Agreement. Creditor could have bargained for  
8 language that satisfied her burden and waived Debtor's right to argue that he did not commit  
9 securities violations. In enacting section 523(a)(19), Congress clearly intended to preclude  
10 re-litigation of stipulated facts establishing a prima facie case for securities violations or re-  
11 litigation of admitted securities violations in settlement agreements. There is no evidence,  
12 however, that Congress intended to preclude litigation over securities violations where the  
13 Debtor bargained for and obtained the right to contest fault in the very settlement agreement  
14 at issue.

15           **5. Section 523 (a)(11) Compels The Court To Read Section 523(a)(19) To**  
16           **Require Actual Securities Violations.**

17           When interpreting a statute, the Court will not look solely at the provision, but to  
18 other provisions of the same code to maintain internal harmony among related provisions.  
19 *See Perlman v. Catapult Entertainment (In re Catapult Entertainment)*, 165 F.3d 747, 751  
20 (9<sup>th</sup> Cir. 1999). Analysis of section 523(a)(11) offers interpretive insight when analyzing  
21 section 523(a)(19) and contrary to the argument of Creditor supports the position advanced  
22 by Debtor in this case.

23           Section 523(a)(11) provides in pertinent part that "[a debt] provided in any final  
24 judgment, unreviewable order, or consent order . . . or contained in any settlement  
25 agreement entered into by the debtor, arising from any act of fraud or defalcation while  
26 acting in a fiduciary capacity . . . with respect to any depository institution or insured credit  
27 union" is non-dischargeable. Subsections 523(a)(11) and (4) apply to the same debts to the  
28 extent the creditor is a depository institution or insured credit union, except that

1 section 523(a)(11) allows non-dischargeability of a debt not previously liquidated through a  
2 judgment. *Meyer v. Rigdon*, 36 F.3d 1375, 1379 (7<sup>th</sup> Cir. 1994).

3 In *Meyer*, the Seventh Circuit interpreted section 523(a)(11) to extend the collateral  
4 estoppel doctrine to preclude re-litigation of issues after default judgments, settlement  
5 agreements, and administrative agency decisions. *Id.* at 1380. It noted further that  
6 section 523(a)(11) alters collateral estoppel doctrine by giving preclusive effect to decisions  
7 and agreements not "actually litigated." *Id.* at 1379. The court adopted this interpretation to  
8 avoid rendering the added language in section 523(a)(11) meaningless and the section  
9 completely duplicative of section 523(a)(4). *Id.* at 1381.

10 Because section 523(a)(11) extends preclusive effect to settlement agreement  
11 determinations, cases involving section 523(a)(11) and settlement agreements offer insight  
12 into the proper analysis of section 523(a)(19). *See Commissioner v. Keystone Consol.*  
13 *Indust.*, 508 U.S. 152, 159 (1993) ("identical words used in different parts of the same act  
14 are intended to have the same meaning" (*quoting Atlantic Cleaners & Dyers, Inc. v.*  
15 *United States*, 286 U.S. 427, 433 (1932))). Creditor insists that the *Meyer* decision requires  
16 that this Court preclude Debtor from litigating securities violations claims in a non-  
17 dischargeability context. The Court agrees that subsections 523(a)(11) and (19) expand the  
18 Court's ability to utilize issue preclusion, but concludes that this expansion is not as broad as  
19 Plaintiff suggests.

20 In considering the appropriateness of collateral estoppel this Court applies California  
21 law. *Gayden v. Nourbakhsh (In re Nourbakhsh)*, 67 F.3d 798, 800 (9<sup>th</sup> Cir. 1995); *Lee v.*  
22 *TCAST Communications, Inc. (In re Lee)*, 335 B.R. 130, 136 (9<sup>th</sup> Cir. BAP 2005). As  
23 discussed above, California law extends preclusive effect only to issues "necessarily  
24 decided" and "actually litigated" in a former proceeding. *Khaligh*, 338 B.R. at 824. The  
25 *Meyer* court held that Congress intended to extend preclusive effect to proceedings that did  
26 not "actually litigate" issues. In fact, in a hypothetical provided by the *Meyer* court, it  
27 stated, "[b]efore Congress enacted section 523(a)(11), a bank officer could enter into a  
28 private settlement agreement . . . , admit that he had committed acts of fraud, and still have

1 the debt arising from his fraud discharged in bankruptcy." *Meyer*, 36 F.3d at 1380. Thus,  
2 the *Meyer* court contemplated a scenario where either a Debtor admitted to fault or a  
3 settlement agreement conceded fault. *Id.* Notwithstanding, the *Meyer* court, in the default  
4 judgment context, looked behind the default judgment to the text of the complaint to  
5 determine whether the findings required for non-dischargeability were sufficiently pled to  
6 have been necessarily decided for application of cash estoppel. *Id.* at 1385.

7 If one analogizes section 523(a)(19) to 523(a)(11) as interpreted by the *Meyer* court,  
8 one must conclude that while Congress intended to extend issue preclusion to cover  
9 settlement agreements for purposes of section 523(a)(19), it does not follow that Congress  
10 intended settlement agreements to have preclusive effect on issues not "necessarily  
11 decided." And, again, the Settlement Agreement here did not necessarily decide securities  
12 violations issues – it expressly provides that these issues were not conceded and therefore  
13 not determined. Thus, to the extent case law under section 523(a)(11) and cited by Creditor  
14 is relevant, it supports a denial of issue preclusion in this case.

15 **6. A Review Of Case Law Identifies No Case Supportive Of Creditor's**  
16 **Position.**

17 The Creditor supplies no case law finding a debt non-dischargeable under  
18 section 523(a)(19) where the underlying settlement agreement contained an express  
19 statement that fault and liability were not conceded. The case on which Creditor relies most  
20 strongly is the *Whitcomb* case. *Whitcomb*, however, is clearly distinguishable from the case  
21 at hand. First, *Whitcomb* involves a plaintiff's unopposed motion for judgment on the  
22 pleadings in a section 523(a)(19) action. *Whitcomb*, 303 B.R. at 809-10. The lack of  
23 opposition allowed the Court considerable latitude in regards to the plaintiff's liability  
24 allegations. Having said this, however, the *Whitcomb* court carefully discussed the two  
25 requirements of section 523(a)(19) liability in reaching its determination. *Id.* at 810. While  
26 the record is not detailed and it does not appear that the *Whitcomb* settlement agreement  
27 contained detailed admissions, the *Whitcomb* court found that: "the agreed judgment order  
28 provided that the Debtor agreed that he damaged the Petermans." *Id.* at 808. In this case the

1 Debtor has admitted neither fault nor liability. And unlike the *Whitcomb* defendant, the  
2 Debtor expressly reserved his right to assert innocence through Settlement Agreement  
3 language providing that entry into the settlement was **not** to be read as conceding fault or  
4 liability.

5 Similarly, in *Hodges v. Buzzeo (In re Buzzeo)*, 365 B.R. 578 (Bankr. W.D. Pa. 2007),  
6 the court found a claim non-dischargeable under section 523(a)(19) where it was based on a  
7 settlement agreement arising from allegations of securities violations and where the plaintiff  
8 did not admit the allegations of Count I (fraud in connection with the sale of securities) but  
9 did agree that the debt would be non-dischargeable under section 523(a)(2) and that: ". . .  
10 in any subsequent proceeding to which the [plaintiffs] and Buzzeo are parties, all of their  
11 allegations set forth in Count I may be taken as true and correct . . . [and that] the stipulated  
12 judgment will collaterally estop [*Buzzeo*] . . ." 365 B.R. at 580-581. Here, Debtor has not  
13 agreed to non-dischargeability.

14 In short, the Creditor seeks to extend the reach of section 523(a)(19) in a manner not  
15 endorsed by any previous judicial decision. The absence of supporting case law is not  
16 dispositive, but it is strongly supportive of this Court's determinations herein.

## 18 CONCLUSION

19  
20 Congress intended section 523(a)(19) to limit the opportunities for those violating  
21 securities laws to escape the consequences of their malfeasance. Where such a violation  
22 occurs, the debt is non-dischargeable notwithstanding its liquidation through litigation,  
23 arbitration, or settlement. Having said this, however, non-dischargeability is still reserved  
24 for those who, in fact, have violated securities laws. A material issue of fact exists in this  
25 case as to that first critical element of section 523(a)(19). The Settlement Agreement  
26 expressly states that the Debtor settled without acknowledging any fault or liability. The  
27 Settlement Agreement contains not a single concession or factual recitation whereby the  
28 Debtor concedes any fault or damages. The Debtor, while not providing an alternative

1 theory for entry into the Settlement Agreement except through argument, provided the  
2 Declaration of Mr. Calderone and ardently argued his innocence. The Court finds that the  
3 ambiguity in the Settlement Agreement on this point coupled with the Calderone declaration  
4 are sufficient to create a triable issue of material fact as to whether securities violations exist  
5 in this case. Thus, Creditor's motion for summary judgment is DENIED.

6  
7 DATED: November 5, 2009

  
LAURA S. TAYLOR, JUDGE  
United States Bankruptcy Court

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