

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
EASTERN DIVISION**

IN RE:

JAMES FREDERICK POMEROY, II,

DEBTOR.

CHAPTER 7
CASE NO. 05-23127-WCH

INTERNATIONAL STRATEGIES GROUP, LTD.,

PLAINTIFF,

v.

ADVERSARY PROCEEDING
NO. 06-01064

JAMES FREDERICK POMEROY, II,

DEFENDANT.

MEMORANDUM OF DECISION

I. Introduction

The matter before the Court is the motion of International Strategies Group, Ltd. (“ISG”) for summary judgment filed in the above-captioned adversary proceeding in which ISG objects to the discharge of an alleged debt owed by James Frederick Pomeroy, II (“Pomeroy”) under 11 U.S.C. § 523(a)(2)(A). ISG contends that it is entitled to judgment because Pomeroy’s fraud cannot be relitigated under issue or claim preclusion as it was established by a default judgment entered as a discovery sanction in a federal district court proceeding concerning the same debt. Pomeroy opposes the motion for summary judgment alleging that because the previous judgment

was entered by default, the issue of fraud was not actually litigated. For the reasons stated below, I will enter an order granting the motion for summary judgment.

II. Background

The facts are drawn from the pleadings of the parties and are not in dispute except where noted herein. Before 1998, Pomeroy formed and managed several corporations, one of which was known as the Corporation of the BankHouse, Inc. (“COB”). Pomeroy was the founder and chief executive officer of COB. Although it is not clear from the record, the parties apparently agree that COB engaged in structuring certain types of merchant banking transactions for its clients, and used its clients’ funds for investment in various ventures. In or around 1998, ISG voluntarily gave COB the amount of \$4,000,000.00 for investment.

In March 2002, after unsuccessful demands for the return of the funds, ISG initiated a diversity lawsuit against Pomeroy, COB and SB Global¹ in the United States District Court for the District of Massachusetts (the District Court Matter”). In its complaint, ISG alleged fraud, intentional misrepresentation, breach of contract, conversion, breach of fiduciary duty and violation of Mass. Gen. Laws ch. 93A.²

Pomeroy initially, by his counsel, filed an answer and asserted numerous affirmative defenses in the District Court Matter. Pomeroy apparently responded to some of the requests for production of documents. Pomeroy’s counsel participated in conversations with counsel for ISG

¹ISG’s complaint alleges that SB Global was a “Pomeroy-controlled corporation,” an allegation that Pomeroy denies. See Plaintiff’s Complaint Objecting to Discharge, ¶ 15 (the “Complaint”).

²The parties do not dispute the facts regarding the District Court Matter. ISG provided a copy of the docket and many of the pleadings. I may take judicial notice of any further pleadings contained in that docket. *In re Marrama*, 345 B.R. 458, 463 n.9 (Bankr. D. Mass. 2006).

regarding this discovery.

ISG sought a preliminary injunction which Pomeroy opposed. The parties then stipulated to an order regarding the injunction and the court accepted the stipulation and entered the order in July 2002.³ The order froze certain bank accounts and assets. The order also provided that the defendants, including Pomeroy, would conduct an accounting within five days of the date of the order. The order lastly permitted Pomeroy to withdraw from his bank accounts an amount of money for living expenses. In April 2003, ISG moved for an accounting as a result of the failure of the defendants to comply with that portion of the preliminary injunction. Pomeroy's counsel attended the court conference regarding the motion. In May 2003, Judge Zobel granted the motion for an accounting.⁴

Thereafter, Pomeroy failed to respond to two detailed sets of requests for admissions,⁵ which totaled 553 requests, despite the fact that each set purported to establish ISG's version of the facts as well as the factual foundation for an adverse finding under Mass. Gen. Laws ch. 93A and request for treble damages. In September 2003, ISG filed a motion for sanctions under Fed. R. Civ. P. 37 against the defendants including Pomeroy. In the motion, ISG alleged that the defendants had failed to comply with the terms of the stipulation, order on the preliminary

³The stipulation referred to and adopted a portion of the preliminary injunction which had entered in another Pomeroy matter before Judge Zobel. *See supra* note 6. The stipulation specified that a termination of that proceeding would not have the effect of terminating the preliminary injunction in the District Court Matter absent an order of the court or the consent of the parties.

⁴The docket in the District Court Matter does not provide a copy of the motion for an accounting or a copy of the order. According to ISG in its motion for sanctions, as a result of the motion and order, the defendants were once again ordered to provide an accounting under oath.

⁵ISG served the first set in September 2003 and the second set in March 2004.

injunction and order granting the motion for an accounting. Specifically, the motion alleged that the defendants had failed to provide an accounting, monthly reports and the disclosure of assets. ISG also argued the defendants had failed to comply with discovery. ISG sought an order of contempt, attorneys' fees, an order transferring the defendants' interest in certain bank accounts and an order requiring the defendants to comply with discovery.

Judge Zobel held a show cause hearing on October 30, 2003 at which time she considered the motion for sanctions. Pomeroy's counsel attended that hearing. In January 2004, Judge Zobel entered two orders regarding the motion for sanctions. In one order, Judge Zobel found the defendants to be in contempt of court and assigned certain assets to ISG and ordered other assets to be held in escrow. In another order she allowed the motion for sanctions.

After the show cause hearing, ISG moved for a default and a real estate attachment on Pomeroy's real estate. Pomeroy was defaulted in January 2004. In early 2004, ISG served its second set of requests for admissions, request for treble damages under Mass. Gen. Laws ch. 93A and motion for entry of judgment. The Debtor did not oppose these pleadings.

Judge Zobel held a hearing on the motion for entry of judgment and ordered ISG to file a revised judgment and supporting papers. She consequently entered findings of fact concerning Mass. Gen. Laws ch. 93A, describing, *inter alia*, Pomeroy's knowing and willful misrepresentation, solicitation and conversion of ISG's funds. In June 2004, Judge Zobel entered a final amended judgment finding Pomeroy and the other defendants liable to ISG in the amount of \$10,468,106 on the basis of fraud, intentional misrepresentation, breach of contract, conversion, breach of fiduciary duty, federal and state securities violations and violation of Mass. Gen. Laws ch. 93A. The docket reflects, and Pomeroy does not dispute, that Pomeroy received

notice of all of the foregoing motions and hearings.

Pomeroy filed his chapter 7 bankruptcy case on October 14, 2005. ISG timely filed the Complaint. ISG then filed its motion and memorandum for summary judgment, together with its exhibits and statement of undisputed facts. Pomeroy filed his response and memorandum in opposition to the motion for summary judgment. Pomeroy also responded to ISG's statement of undisputed facts. I also allowed the parties to file supplemental statements and memoranda.

In its motion, ISG alleges that as a result of the findings and judgment entered in the District Court Matter, it is entitled to summary judgment. Specifically, ISG argues that because Pomeroy had a full and fair opportunity to defend against the litigation in the district court, the findings of the district court are entitled to issue preclusive effect in this adversary proceeding. ISG cites cases which warn of circumstances in which a litigant so utilizes the court system that a court must conclude that the matter has been actually litigated such that a default judgment would be entitled to preclusive effect. *See Treglia v. MacDonald*, 430 Mass. 237, 242, 717 N.E.2d 249 (1999) (citing *Gober v. Terra + Corp. et al. (In re Gober)*, 100 F.3d 1195 (5th Cir. 1996); *Bush v. Balfour Beatty Bahamas, Ltd. (In re Bush)*, 62 F.3d 1319, 1324 (11th Cir. 1995)). Alternatively, ISG argues that the doctrine of claim preclusion also would render the judgment in the District Court Matter binding in this adversary proceeding.

In response to ISG's motion for summary judgment, Pomeroy points to the general principle that a default judgment does not have preclusive effect on an issue in a subsequent action because the issues have not been actually litigated. *Treglia*, 430 Mass. at 241; 717 N.E.2d 249 (citing Restatement (Second) of Judgments § 27 comment e, at 257 (1982)). To explain why he failed to continue in defense of the District Court Matter, Pomeroy alleges that due to his

numerous legal problems, he ran out of funds during the District Court Matter.⁶ Pomeroy also argues that the admissions deemed admitted against him in the District Court Matter were binding for that proceeding only under Fed. R. Civ. P. 36. As a result, Pomeroy argues that the default judgment cannot entitle ISG to summary judgment because a critical element of issue preclusion, namely actual litigation, is not met.

In support of his defense, Pomeroy submitted a single affidavit by his former counsel. In it his counsel states that Pomeroy ran out of funds to defend the various issues with which he was confronted. He further states that Pomeroy instructed him in the summer 2002 only to respond to what was required of him by the district court. His counsel further states that by June 2003, Pomeroy stopped defending the action.

I held a hearing on the motion for summary judgment. I then took the matter of the preclusive effect of the default judgment, either under issue or claim preclusion, under advisement.

Thereafter, the parties sought and received authority to submit supplemental briefs. ISG submitted information regarding the payments which Pomeroy made to his former law firm during the course of the District Court Matter, which between 2001 and 2004 totaled \$133,000. The payments between late summer 2002 and March 2004 totaled \$58,000.

⁶Pomeroy's pleadings and affidavits by his former attorney reflect that during the District Court Matter, Pomeroy was a defendant in another district court lawsuit before Judge Zobel. This lawsuit was commenced in November 2001 and voluntarily dismissed in October 2002 with mutual releases. Pomeroy asserts that during this litigation and the District Court Matter, he had other legal problems including being the subject of criminal investigations by the United States Department of Justice. A criminal charge was filed against him in Florida in April 2004. Pomeroy plead guilty in May 2004 and was sentenced in July 2004. Pomeroy was not fined in that case.

Pomeroy responded to the supplemental brief with another affidavit of his former counsel. In it he states that Pomeroy sought to marshal his assets “in a way designed to defend himself where he could afford to do so.”⁷ He explains that he required Pomeroy to pay for the Florida defense by way of an “up-front retainer.” He believes that Pomeroy is still indebted to his former firm. Pomeroy’s attorney further states that he believes that the payments made to his firm in 2002 were loans from family and friends. The payments which he itemized in his affidavit total \$55,000. All but \$15,000 were submitted prior to the period during which ISG demonstrated the firm received \$58,000.

III. Analysis

1. Summary Judgment Standard

Summary judgment should only be granted when “the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Fed. R. Bankr. P. 7056 (incorporating Fed. R. Civ. P. 56(c)). All reasonable inferences from the facts must be drawn in the manner most favorable to the nonmovant. *Desmond v. Varasso (In re Varrasso)*, 37 F.3d 760, 763 (1st Cir. 1994). Once the movant has averred “an absence of evidence to support the nonmoving party’s case,” the nonmovant, to avoid summary judgment, must establish the existence of at least one question of fact that is both “genuine” and “material.” *Id.* at 763 n.1. The failure of the nonmovant to come forward with sufficient evidence to generate an issue worthy for trial warrants summary judgment for the

⁷See *Defendant’s Response to Plaintiff’s Motion for Leave to File Supplemental Statement of Undisputed Material Facts*, Docket No. 31, *Further Affidavit of Gary C. Crossen*, p. 1, ¶ 2.

moving party. *McCrorry v. Spigel (In re Spigel)*, 260 F.3d 27, 31 (1st Cir. 2001) (quoting *Ralar Distribs., Inc. v. Rubbermaid, Inc.*, 4 F.3d 62, 67 (1st Cir. 1993)). The evidence of the nonmovant cannot be merely colorable or conclusory but rather must be supported and significantly probative. *Rivera-Cotto v. Rivera*, 38 F.3d 611, 613 (1st Cir. 1994).

2. Issue Preclusion (Collateral Estoppel)

In their pleadings, the parties assume that the law of Massachusetts applies with respect to the issue of claim preclusion. Because the United States District Court for the District of Massachusetts entered the default judgment, however, the elements of federal collateral estoppel are applicable. See *Fleet National Bank v. Gray et al. (In re Bankvest Capital Corp.)*, 375 F.3d 51, 70 (1st Cir. 2003) (citing *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 978 (1st Cir. 1995)); *Combs v. Richardson*, 838 F.2d 112 (4th Cir. 1988)); see also *Johnson v. SCA Disposal Servs. of New England, Inc.*, 931 F.2d 970, 974 (1st Cir. 1991) (in diversity cases, federal law governs the preclusive effect of a prior federal judgment).

Under the federal standard of issue preclusion, a party must establish four essential elements: (1) the issue sought to be precluded must be the same as that involved in the prior action; (2) the issue must have been actually litigated; (3) the issue must have been determined by a valid and binding final judgment; and (4) the determination of the issue must have been essential to the judgment. *Bankvest*, 375 F.3d at 70; *Grella v. Salem Five Cent Sav. Bank*, 42 F.3d 26, 30 (1st Cir. 1994). The principles of collateral estoppel apply in dischargeability proceedings in bankruptcy. *Grogan v. Garner*, 498 U.S. 279, 284 n.11 (1991).

In this proceeding, the undisputed material facts demonstrate that all but one element has been satisfied. First, in the District Court Matter, ISG alleged, *inter alia*, fraud and intentional

misrepresentation, the exact same issues alleged in the Complaint. Second, as the judgment entered against Pomeroy in the District Court Matter was not appealed, it stands as a valid and binding final judgment. Third, the elements of fraud and intentional misrepresentation, required elements under 11 U.S.C. § 523(a)(2)(A), were essential to the judgment, as demonstrated by the findings of fact in the District Court Matter. The only question remaining is whether the proceedings leading to the default judgment in the District Court Matter constitute actual litigation on the issues of Pomeroy's fraud and intentional misrepresentation.

It is within my discretion to apply collateral estoppel to the default judgment. *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 331 (1979). I recognize, however, that default judgments are generally not given collateral estoppel effect because the court issuing the judgment was not able to decide the issue in an adversarial context.⁸ *Bush*, 62 F.3d at 1323.

Several federal courts, however, have articulated an exception to this general rule. *Cornwell v. Loesch (In re Cornwell)*, 109 Fed.Appx. 682 (5th Cir. 2004);⁹ *Herbstein v.*

⁸The First Circuit recognized but did not address this issue in *Commonwealth of Mass. v. Hale*, 618 F.2d 143, 146 (1st Cir. 1980) (declining to decide whether collateral estoppel can be applied to a default judgment in a dischargeability matter). In two cases in this district, the courts declined to apply collateral estoppel to state court judgments under state collateral estoppel. See *Staniunas v. Delisle (In re Delisle)*, 281 B.R. 457 (Bankr. D. Mass. 2002) and *Phalon v. Varrasso (In re Varrasso)*, 194 B.R. 537 (Bankr. D. Mass. 1996). In a matter involving collateral estoppel and a state court judgment issued after an unopposed motion for summary judgment, Judge Laskar explained that in order to determine if a matter was actually litigated a court needs to look at the defendant's good faith excuse. *Polechronis v. Cape Code Needleworks, Inc. (In re Polechronis)*, 186 B.R. 1, 4 (D. Mass. 1995). If the defendant's lack of objection was tactical, it would be appropriate to consider the matter actually litigated. *Id.* None of these decisions, however, are on point or binding with respect to the matter before this Court.

⁹This decision is an unpublished decision pursuant to Rule 47.5.4 of the local rules of the Fifth Circuit.

Bruetman, 32 Fed.Appx. 158 (7th Cir. 2002);¹⁰ *Wolstein v. Docteroff (In re Docteroff)*, 133 F.3d 210, 215 (3rd Cir. 1997); *Bush*, 62 F.3d at 1324; *FDIC v. Daily (In re Daily)*, 47 F.3d 365, 367 (9th Cir. 1995); *McCart v. Jordana (In re Jordana)*, 232 B.R. 469, 472 (B.A.P. 10th Cir. 1999) *aff'd* 216 F.3d 1087 (10th Cir. 2000).¹¹ Those courts have ruled that if a party substantially participates in litigation prior to the entry of a default judgment, a federal court can apply collateral estoppel and prevent that party from relitigating the issues decided by the judgment. *See, e.g., Bush*, 62 F.2d at 1323; *Daily*, 47 F.3d at 368; *but see Federal Ins. Co. v. Gilson (In re Gilson)*, 250 B.R. 226, 233- 235 (Bankr. E.D. Va. 2000) (rejecting exception set forth in *Bush* and *Daily* after concluding standard too unclear).

Given that a majority of courts of appeal have found an exception to the general rule that collateral estoppel does not apply to a default judgment, I will adopt such an exception. Accordingly, if I find that Pomeroy substantially participated in the District Court Matter, I will apply collateral estoppel with respect to the that judgment in this adversary proceeding. Exactly what constitutes substantial participation, however, is not defined. Accordingly, a review of the facts of the foregoing cases is instructive.

In *Cornwell*, the debtor appealed the decision of the bankruptcy court that applied

¹⁰The Seventh Circuit affirmed in an order that was not published pursuant to its local rules that provide that orders are not to be published.

¹¹Recently, the Second Circuit declined to decide whether to adopt this exception. *Mishkin v. Gurian (In re Adler, Coleman Clearing Corp.)*, No. 05-6245-BK, 2006 WL 2374238 *1 n.2 (2nd Cir. 2006). In a nonbankruptcy setting, the Sixth Circuit affirmed the district court ruling that applied collateral estoppel to a default judgment. *Overseas Motors Inc. v. Import Motors Ltd., Inc.*, 375 F.Supp. 499, 516, *aff'd* 519 F.2d 119 (6th Cir. 1975). The Fourth Circuit has decided this issue but in the context of a dischargeability matter based upon a state court judgment. *Pahlavi v. Ansari (In re Ansari)*, 113 F.3d 17 (4th Cir. 1997) (applying Virginia law, used collateral estoppel where default judgment was product of evidentiary damages hearing).

collateral estoppel to a federal district court decision. 109 Fed.Appx. at 683. Prior to reaching the Fifth Circuit, the United States District Court for the Northern District of Texas, which had to address the sufficiency of the evidence before the bankruptcy court, explained the nature of the judgment issued against the debtor by the district court in Kansas as follows:

In essence, the Kansas Court's judgment amounts to a post-answer default judgment against the Appellants, issued as a sanction for their gross failure to comply with orders of the court. Perhaps the best evidence for this is the Motion for Judgment filed by the Appellees. The Appellees did not move for summary judgment under Federal Rule of Civil Procedure 56(c). Rather, in their Motion, the Appellees sought entry of "[j]udgment against Defendants Rober W. Cornwell [and] Joel Stanley . . . on the grounds that they have flagrantly failed to comply with [the] Court's Scheduling Order of October 30, 2001." Record at 152. It is undisputed that the record . . . fully details the 'discovery abuses and dilatory tactics' of the Appellants, as well as the sanctionary nature of its judgment.

Cornwell v. Loesch, No. Civ.A. 3:03-CV-2826P, 2004 WL 614848, *5 (N.D. Tex. 2004).

The court went on to explain that the debtors had failed to comply with court orders and discovery deadlines and failed to file required disclosures despite having been warned to do so. *Id.* The debtors avoided contempt based upon agreements to comply with discovery but failed to so proceed. *Id.*

On appeal, the Fifth Circuit recognized that it has repeatedly applied collateral estoppel to a default judgment which a state court issued. 109 Fed.Appx. at 684.¹² The court then went on to conclude:

If there was evidence for the bankruptcy court to conclude that the Kansas judgment was a post-answer default entered as a sanction for discovery violations, it could conclude that the issue was 'actually litigated' and issue

¹²One such case to which it and many other cases cite regarding the application of collateral estoppel to a default judgment is *Gober v. Terra + Corp. (In re Gober)*, 100 F.3d 1195 (5th Cir. 1996). In that case, the Fifth Circuit decided the matter by looking to the law of Texas.

