UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re: BKY 3-93-2420

Patricia A. Kluge,

Debtor

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Rose Mary Boyd, ADV. 3-93-162

Plaintiff,

vs. MEMORANDUM ORDER

Patricia A. Kluge,

Defendant.

This matter came before the Court on January 13, 1994 on Defendant's motion for summary judgment. Paul J. DesHotels appeared on behalf of the Plaintiff Rosemary Boyd ("Boyd"). Cass S. Weil appeared on behalf of the Defendant Patricia Kluge ("Kluge"). Based upon all the files and records in this case, being fully advised in the premises, the Court now makes the following Memorandum Order pursuant to the Federal and Local Rules of Bankruptcy Procedure.

FACTS

The following facts are not in dispute: In the spring of 1992, Boyd and Kluge, through their respective agents, entered into negotiations for the sale to Boyd of Kluge's property at 1654 Hillcrest Ave., St. Paul, Minnesota ("Property"). On May 11, 1992, Boyd and Kluge signed a Purchase Agreement ("Purchase Agreement").(FN1) The Purchase Agreement contained a clause providing for arbitration in the event of disputes including, without limitation, claims of fraud, misrepresentation, warranty and negligence. The closing took place on or about June 30, 1992. However, shortly after she took possession, Boyd noticed a number of defects which she alleges were not disclosed in the Real Estate Disclosure Statement and the Truth-in-Sale of Housing Disclosure Report.(FN2) True copies of the Real Estate Transfer Disclosure Statement and the Truth-in-Sale of Housing Disclosure Report were not filed with this Court. The Purchase Agreement, signed and initialed by both Boyd and Kluge, indicates that the seller did not have water problems, either in the basement or the roof.(FN3) In her Demand for Arbitration, Boyd asserted that the

house suffered from, among other things, a leaking roof alleged to be six months old, extensive water damage in the basement, a four-to-six year old carpenter ant infestation, diseased trees, a faulty fireplace and furnace and a defective washing machine.

On October 1, 1992, Boyd commenced an action under the arbitration clause of the Purchase Agreement against Kluge, Pat Kaplan (Kluge's real estate agent) and Murray Casserly (City of Truth-in-Sale of Housing Inspector). Boyd claimed that she purchased the Property based on the representations made in the Real Estate Transfer Disclosure Statement, the Truth-in-Sale of Housing Disclosure Report and also on the oral representations of Kluge and Kaplan. The arbitrator heard the case and ordered rescission in an award dated April 21, 1993 ("Award").(FN4) The Award stated that recission was to be accomplished as of June 1, 1993. The arbitrator also found that Boyd had not established a case against either the selling agent or the listing agent. However, with respect to Boyd's claim against Kluge, the arbitrator found the following:

> The buyer did establish that the seller was not frank in her responses in the real estate disclosure statement. The neighbor, Deb Bachrach, testified that the seller was always doing repairs, and always complaining about water in the walls. The seller not only did not refute this testimony but admitted that she did not disagree with the neighbor's testimony. In addition, she misstated that the roof was only 6 months old. While the pitched portion may have been recently replaced, the flat portion had not been replaced, and it was the flat portion that became the problem. The buyer was certainly entitled to rely and not have the roof inspected if it were only 6 months old. Then there is the problem with the fireplace. While it may be that it was built to code before the seller owned the house, the seller also caulked it in such a way that it became dangerous.
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> Rescission is a drastic remedy to be allowed only in extreme circumstances. This case is one of these extreme circumstances. What the seller has done was not done deliberately. Nonetheless, there is no doubt [sic] that the buyer was misled.

In a letter dated May 12, 1993, Boyd's former attorney,(FN5) contacted the American Arbitration Association requesting, among other things, that the arbitrator clarify the Award on the issue of Ms. Kluge's intent. Boyd's former attorney indicated that he needed this information to prepare for an adversary proceeding since his office received notice that Kluge was preparing to declare bankruptcy. On May 15, 1993, Kluge filed a voluntary petition seeking discharge of her debts under Chapter 7 of the Bankruptcy Code. Kluge listed her debt to Boyd in the amount of $45,450.(FN6) In a letter dated June 23, 1993, the arbitrator advised the parties that he would not clarify the Award.

On July 27, 1993, Boyd initiated this adversary proceeding requesting relief pursuant to Sections 523(a)(2)(A)(7), 523(a)(2)(B), 727(a)(2) and 727(a)(5). On Boyd's motion, the Court dismissed the claims under Sections 727(a)(2) and 727(a)(5). See Order entered November 8, 1993.

On December 27, 1993, Kluge moved for summary judgment on the ground that Boyd had failed to establish that Kluge had acted

with the intent necessary to state a claim under Section 523(a)(2)(A). Kluge asserted that Boyd was collaterally estopped from relitigating the issue of intent by virtue of the arbitrator's prior determination that "[w]hat the seller has done was not done deliberately." The Court heard oral arguments on the summary judgment motion on January 13, 1993.

DISCUSSION

FED. R. BANKR. P. 7056 incorporates FED. R. CIV. P. 56, and outlines the standards for summary judgment. "The judgment sought shall be rendered forthwith if 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. CIV. P. 56(c). The moving party bears the initial burden of proving there is no genuine issue as to any material fact. Celotex Corp. v. Cartrett, 477 U.S. 317, 323 (1986). This burden may be discharged, however, by alerting the court that there is an absence of evidence to support the non-moving party's claim, Id. at 322.

Kluge requests summary judgment on the ground that Boyd has failed to establish an essential element of her Section 523(a)(2)(A) claim. The issue before this Court is whether the arbitrator's finding on the debtor's intent should be given collateral estoppel effect on the issue of intent in Boyd's Section 523(a)(2)(A) claim, which would entitle Kluge to summary judgment.

To obtain an exception from discharge under Section 523(a)(2)(A), a creditor must prove that:

1. The debtor made false representations;
2. That at the time he knew they were false;
3. That he made them with the intention and purpose of deceiving the creditor;
4. That the creditor relied on such representations; and
5. That the creditor sustained the alleged loss and damage as the proximate result of the representations having been made.

Thul v. Ophaug, (In re Ophaug), 827 F.2d 340, 342, n.1 (8th Cir. 1987). The creditor must prove his claim by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (1991). The creditor need not prove that his reliance on the debtor's representations was reasonable. Thul, 827 F.2d at 342. The intent to deceive under Section 523(a)(2)(A) consists of the intent to induce a creditor to rely and act upon the misrepresentation or misrepresentations in question. Snydergeneral Corp. v. Starns, (In re Gibson), 149 B.R. 562, 572 (Bankr. D. Minn. 1993).

Collateral estoppel principles apply in determinations of dischargeability under Section 523(a). Grogan v. Garner, 498 U.S. at 284-285, n.11 (1991). Basically, collateral estoppel is a way of conserving judicial resources by preventing the same issue from being litigated twice. Lane v. Peterson, 899 F.2d 737, 741 (8th Cir. 1990). The party asserting collateral estoppel has the burden of showing the following:

1. The issue sought to be precluded must be the same as that involved
in the prior action;

2. The issue must have been determined by a valid and final judgment;
3. The issue must have been actually litigated in the prior action; and
4. The determination must have been essential to the prior judgment.

In re Miller, 153 B.R. 269, 273 (Bankr. D. Minn. 1993) The party against whom the earlier decision is being asserted must have had a "full and fair" opportunity to litigate the issue in the prior adjudication. Id. at 273.

Under Minnesota law, an arbitration award is a prior adjudication and may be considered a final judgment for the purposes of collateral estoppel. Aufderhar v. Data Dispatch, Inc., 437 N.W.2d 679, 681 (Minn. Ct. App. 1989). Federal courts must accord the same respect to state court judgments as those judgments would receive in the state in which they were rendered. 28 U.S.C. Section 1738. Therefore, if Minnesota state courts would consider the Award a final judgment, a federal bankruptcy court should as well. However, a bankruptcy court may apply collateral estoppel only to those issues in the final judgment that have been directly and necessarily adjudicated. Brown v. Felsen, 442 U.S. 127, 139, n.10 (1970). The requirement that the determination on the issue of intent was essential to the prior judgment operates to prevent dicta from triggering the doctrine of collateral estoppel. Snydergeneral Corp., 149 B.R. at 576. Neither party directly addressed whether the determination on the issue of intent was essential to the prior arbitration.(FN8) This court declines to give collateral estoppel effect to the arbitrator's finding as to Kluge's intent because the Award is ambiguous and permits an interpretation that rescission was granted without determining Kluge's intent.

Both Boyd and Kluge argue that rescission may only be granted on the grounds of mistake or fraud and that the arbitrator must have granted rescission on either one of those grounds. This argument is incorrect for two reasons. First, rescission may be granted on grounds other than mistake or fraud.(FN9) Second, the Award does not indicate what rationale, legal or otherwise, the arbitrator used to arrive at a decision as to intent and whether his decision as to intent had any bearing on his decision to grant rescission. Arbitrators derive their powers from the parties. Zelle v. Chicago & Norwest R.R. Co., 65 N.W.2d 583, 589 (Minn. 1989). If the parties do not specify that their disputes must be settled according to certain law, the arbitrator may resolve the dispute as he or she sees fit in the interests of justice without reference to applicable state law. Id. The Purchase Agreement signed by the parties indicates that disputes are to be settled "by binding arbitration in accordance with the rules, then in effect, adopted by the American Arbitration Association and the Minnesota Association of Realtors." However, neither party cites nor puts into evidence any of the rules of the American Arbitration Association or the Minnesota Association of Realtors which set the parameters of the arbitrator's powers. The only evidence before this Court is the text of the Award itself which provides few clues of the basis for its finding on Kluge's intent and the relationship, if any, to the decision to grant rescission. If the arbitrator was, by some agreement between the parties, allowed only to grant rescission on the basis of fraud or mistake, it was up to Kluge to provide the Court with evidence of this limitation on the

arbitrator's decision-making.

It is probable that issues other than Kluge's intent compelled the arbitrator's decision to grant rescission. The arbitrator may also have considered the willingness of both parties to rescind the contract and the type of evidence presented. Here, the buyer was eager to rescind and the seller was willing to take the house back. See Award at 2. The evidence set forth was adequate only for the remedy of rescission, not damages. A determination as to fraudulent intent was not essential to the Award. The arbitrator may have merely facilitated an agreement between the parties to rescind, and a finding as to Kluge's intent was immaterial to the conclusion.

Because the Award itself is ambiguous on the issue of intent, and because Kluge has not proved that a determination of intent, fraudulent or otherwise, was essential to the prior arbitration Award, Kluge's motion for summary judgment on the grounds of collateral estoppel is denied. In light of this, there is no need to address Boyd's equitable estoppel defense.

CONCLUSION

Based on the foregoing, IT IS HEREBY ORDERED:
That the Defendant's motion for summary judgment is denied.

Dated: 3/11/94

Dennis D. O'Brien
United States Bankruptcy Judge

(FN1) The Purchase Agreement appears as Exhibit 1 of Kluge's Memorandum of Law in Support of Debtor's Motion.

(FN2) Boyd's allegations are stated in her Demand for Arbitration which appears as Exhibit 2 of Kluge's Memorandum of Law Supporting Debtor's Motion.

(FN3) Lines 127-33 of the Purchase Agreement provide as follows:

Buyer acknowledges that no oral representations have been made by either seller or agent(s) regarding possible problems of water in the basement, or damage caused by water or ice build-up on the roof of the property and buyer relies solely in that regard on the following statement by the seller:
Seller has not had a wet basement and has not had roof, wall or ceiling damage caused by water or ice build-up. Buyer has received a Real Estate Transfer Disclosure Statement. Buyer has received the Truth in Housing Inspection Report, if required by municipality. Buyer has received the well disclosure statement required by Minnesota Statutes sec. 103I.235.

The initials of the Buyer (Boyd) and Seller (Kluge) are on line 134.

(FN4) The Award appears as Exhibit 3 of Kluge's Memorandum of Law in Support of Debtor's Motion.

(FN5) Boyd was formerly represented by Jon R. Hawks, Esq. Mr. Hawks filed a notice of withdrawal as Boyd's counsel on November

16, 1993.

(FN6) The Award requires Kluge to pay Boyd $44,790 for the amount of out-of-pocket costs attributed to the purchase (taking into account fair rental of the house) as well as $660 for administrative fees paid by Boyd to the American Arbitration Association. This totals $45,450. However, the Award also ordered Kluge to relieve Boyd of the remaining obligation on the mortgage "either by paying it off or by assuming it, or in any other way that absolves BUYER of any further responsibility." Neither Boyd nor Kluge address what action, if any, has occurred with regard to the debt remaining on the mortgage.

(FN7) 523(a)(2)(A) provides that "[a] discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt--...for money, property, services or an extension, renewal, or refinancing of credit, to the extent obtained by...false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or insider's financial condition."

(FN8) Both Boyd and Kluge used the following test to determine whether collateral estoppel applied:

1) The issue was identical to one in a prior adjudication;
2) There was a final judgment on the merits;
3) The estopped party was a party or in privity with the party to the prior adjudication; and
4) The estopped party was given a full and fair opportunity to be heard on the adjudicated issue.

McNeil v. Nat'l Football League, 790 F.Supp 71 (D. Minn. 1992); Held v. Mitsubishi Aircraft International, Inc., 672 F.Supp. 369, 386-7 (D. Minn. 1987).

(FN9) The authority both parties use to support this proposition, Cool v. Hubbard, 199 N.W.2d 510 (1972), actually deals with the permissible grounds for granting reformation of a contract, not rescission. Rescission can occur in circumstances other than where there is fraud or mistake. For example, a party can request rescission when there has been a material breach of the contract, Liebsch v. Abbott, 122 N.W.2d 578, 581 (1963), or where it is impossible for one party to perform the contract without unjustly enriching the other party. Central Baptist Theological Seminary v. Entertainment Comm, Inc., 356 N.W.2d 785 (Minn. Ct. App. 1984). In addition, parties can enter an agreement to rescind. Abdallah, Inc. v. Martin, 65 N.W.2d 641.