

## Preclusive Effect of Pre-Petition State Court Judgments in Nondischargeability Proceedings

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### Introduction

A central purpose of the Bankruptcy Code is to provide a “fresh start” for the “honest but unfortunate debtor.”<sup>1</sup> Subject to various exceptions, section 727 of the Bankruptcy Code provides that the court shall grant the debtor a discharge, which permanently enjoins the debtor’s creditors from attempting to collect any prepetition debts.<sup>2</sup> This “fresh start” policy is not absolute, however, and section 523 of the Bankruptcy Code lists various types of debts that are nondischargeable.<sup>3</sup> Under section 523(a)(2), (4), and (6), a debtor will not be discharged from debts which are “(2) . . . obtained by-- (A) false pretenses, a false representation or actual fraud . . .” and “(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . .” and “(6) for willful and malicious injury by the debtor to another entity or to the property of another entity[.]”<sup>4</sup> Yet, the types of debts specified in section 523(a)(2), (4), and (6)

<sup>1</sup> See *Grogan v. Garner*, 498 U.S. 279, 286–87 (1991).

<sup>2</sup> See 11 U.S.C. § 727(a), (b) (2012).

<sup>3</sup> See Anthony M. Sabino, *Preventing an Alchemy of Evil: Preserving the Nondischargeability of a Debt Obtained by Fraud*, 12 J. BANKR. L. & PRAC. 99, 100 (2003) (“[D]ebtors cannot use the bankruptcy process to extinguish debts for which they should be compelled to pay, regardless of the circumstances.”).

<sup>4</sup> 11 U.S.C. § 523(a) (2012).

will be automatically discharged unless the creditor obtains a judgment from a bankruptcy court that the debt is nondischargeable.<sup>5</sup>

Nondischargeability actions are adversary proceedings and often involve legal issues that have previously been litigated by the parties.<sup>6</sup> Therefore, to avoid re-litigating matters already decided prior to bankruptcy, a party, often the creditor, may seek to apply collateral estoppel.<sup>7</sup> Collateral estoppel “treats as final only those questions actually and necessarily decided in a prior suit[,]”<sup>8</sup> and prevents parties from re-litigating matters already subject to a judicial decision.<sup>9</sup> Bankruptcy courts have split as to whether collateral estoppel applies in a nondischargeability action if the prior court issued a consent or default judgment.

While many bankruptcy courts will apply collateral estoppel in such situations,<sup>10</sup> some will not,<sup>11</sup> and other courts will apply collateral estoppel only if there is a showing that the parties intended the consent judgment to be binding.<sup>12</sup> This Article will discuss the different approaches courts take to determine the applicability of collateral estoppel in nondischargeability actions, focusing on stipulations in connection with a non-bankruptcy proceeding. Part I will briefly discuss the background of collateral estoppel and its potential application in a nondischargeability proceeding. Additionally, it will discuss the types of state court judgments

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<sup>5</sup> See § 523(c)(1).

<sup>6</sup> 4 COLLIER ON BANKRUPTCY, ¶ 523, 523-22 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009).

<sup>7</sup> *Id.*

<sup>8</sup> *Brown v. Felsen*, 442 U.S. 127, 139 n.10 (1979).

<sup>9</sup> See 4 COLLIER ON BANKRUPTCY, *supra* note 6. Collateral estoppel is intended to promote judicial economy, reduce litigation and protect litigants from repetitive litigation by “ensur[ing] that a winning ‘party [does] not have to fight anew a battle it has already won’ . . . .” Eli J. Richardson, *Taking Issue With Preclusion: Preventing Collateral Estoppel*, 65 MISS. L.J. 41, 46 (1995).

<sup>10</sup> See, e.g. *Baldwin v. Kilpatrick (In re Baldwin)*, 249 F.3d 912, 915 (9th Cir. 2001) (holding collateral estoppel applied to a state court default judgment).

<sup>11</sup> See, e.g., *Spilman v. Harley*, 656 F.2d 224, 228 (6th Cir. 1981) (stating collateral estoppel cannot apply to state court default judgments because the actually litigated requirement would not be satisfied); *In re Olson*, 170 B.R. 161, 167 (Bankr. D.N.D. 1994).

<sup>12</sup> See, e.g., *Halpern v. First Georgia Bank (In re Halpern)*, 810 F.2d 1061, 1064–65 (11th Cir. 1987) (applying collateral estoppel to state court consent judgment where there was clear evidence that the parties intended the consent judgment to be a final adjudication of factual issues).

that bankruptcy courts consider when determining if collateral estoppel applies. Part II will examine the different approaches courts use when determining whether collateral estoppel applies to a prior consent or default judgment obtained in state court. Finally, Part III will suggest some methods creditors' and debtors' attorneys can use to ensure their clients are protected in a nondischargeability proceeding.

### **I. Background Information on Collateral Estoppel**

In *Brown v. Felsen*,<sup>13</sup> the Supreme Court held that the doctrine of *res judicata* does not apply in a nondischargeability action and that a “bankruptcy court is not confined to a review of the judgment and record in the prior state-court proceedings when considering the dischargeability of [a debtor’s] debts.”<sup>14</sup> In a footnote, the Court noted that this case concerned only *res judicata*, “and not the narrower principle of collateral estoppel.”<sup>15</sup> Later, in *Grogan v. Garner*,<sup>16</sup> the Supreme Court clarified that “collateral estoppel principles do indeed apply to discharge proceedings pursuant to [section] 523(a).”<sup>17</sup>

The precise requirements for application of collateral estoppel differ depending on the state, but there are generally four elements that must be satisfied: (1) the causes of action are the same; (2) the issue was actually litigated in the prior action; (3) resolution of the issue was necessary to the prior judgment; and (4) the litigants are the same parties.<sup>18</sup> Based on the Supreme Court’s decision in *Grogan*, it would seem that if the elements are met, a bankruptcy court will apply collateral estoppel. Yet, there remain competing views as to when collateral estoppel applies in nondischargeability proceedings.

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<sup>13</sup> 442 U.S. 127 (1979).

<sup>14</sup> *Id.* at 138–39.

<sup>15</sup> *Id.* at 139 n.10.

<sup>16</sup> 498 U.S. 279 (1991).

<sup>17</sup> *Id.* at 284 n.11.

<sup>18</sup> See *In re Mercer*, 2013 WL 3367253, at \*3 (Bankr. M.D. Ala. July 5, 2013).

Under the Full Faith and Credit Act,<sup>19</sup> a bankruptcy court is required to “give effect” to state court judgments.<sup>20</sup> Furthermore, “the preclusive effect of a state court judgment in a subsequent bankruptcy proceeding is determined by the preclusion law of the state in which the judgment was issued.”<sup>21</sup> Therefore, if the relevant state would have granted collateral estoppel, the bankruptcy court may give preclusive effect to that court’s prior judgment.<sup>22</sup> Also, “before applying . . . collateral estoppel the bankruptcy court must determine if the issue was actually litigated and was necessary to the decision in state court.”<sup>23</sup> To do so, the bankruptcy court should look at the entire record of the prior state proceeding.<sup>24</sup>

In some instances, the state court will have issued a consent or default judgment. A consent judgment is essentially “a contract acknowledged in open court and ordered to be recorded . . . .”<sup>25</sup> “[C]onsent judgments . . . are perfunctorily entered as a reflection of the agreement of the parties and, therefore, differ substantially from a fully litigated judgment.”<sup>26</sup> Alternatively, a default judgment is “[a] judgment entered against a defendant who has failed to plead or otherwise defend against the plaintiff’s claim.”<sup>27</sup> Whereas a consent judgment requires agreement between the parties, a default judgment may be issued when one party has not even participated in the proceedings. While both a consent and default judgment constitute a final judgment, neither require that the issues be actually litigated, which is an element for application of collateral estoppel.

## II. Approaches to Application of Collateral Estoppel in Nondischargeability Actions

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<sup>19</sup> 28 U.S.C. § 1738 (2012).

<sup>20</sup> See 4 COLLIER ON BANKRUPTCY, *supra* note 6.

<sup>21</sup> Baldwin v. Kilpatrick (*In re Baldwin*), 249 F.3d 912, 917 (9th Cir. 2001).

<sup>22</sup> See *id.*

<sup>23</sup> Spilman v. Harley, 656 F.2d 224, 228 (6th Cir. 1981).

<sup>24</sup> See *id.*

<sup>25</sup> BLACK’S LAW DICTIONARY 918 (9th ed. 2009).

<sup>26</sup> *In re Olson*, 170 B.R. 161, 167 (Bankr. D.N.D. 1994).

<sup>27</sup> BLACK’S LAW DICTIONARY 480 (9th ed. 2009).

## A. First Approach—No Preclusive Effect Given to a Consent or Default Judgment

Some courts give no preclusive effect to consent or default judgments. This approach is premised on the fact that federal courts have exclusive jurisdiction to determine the dischargeability of claims arising under section 523(a)(2).<sup>28</sup> “[A] bankruptcy court must make a determination regarding the dischargeability of a [section] 523(a)(2) claim notwithstanding a state court stipulated judgment or prepetition agreement that . . . determine[s] the dischargeability of a debt.”<sup>29</sup> Therefore, while a state court may determine the facts surrounding the existence of a debt, attempts to bind the bankruptcy court to that determination are void for lack of subject matter jurisdiction.<sup>30</sup> Additionally, under this approach, in the context of consent or default judgments, courts have found that the requirements for collateral estoppel simply are not met.

### 1. Consent Judgments

Consent judgments reflect the parties’ agreement and are entered into to avoid litigation; hence, courts have found that the “actually litigated” requirement of collateral estoppel is not met.<sup>31</sup> “Logic dictates that because nothing is ‘adjudicated’ between parties to a consent judgment, the essential requirement of ‘actual litigation’ necessary to issue preclusion cannot be satisfied . . . .”<sup>32</sup>

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<sup>28</sup> See, e.g., *Hayhoe v. Cole (In re Cole)*, 226 B.R. 647, 653 (B.A.P. 9th Cir. 1998); *In re Rahm*, 641 F.2d 755, 757 (9th Cir. 1981); *In re Olson*, 170 B.R. at 165 (noting collateral estoppel may be applied to dischargeability proceedings only with “great care”).

<sup>29</sup> See *In re Cole*, 226 B.R. at 653.

<sup>30</sup> See *In re Mercer*, 2013 WL 3367253, at \*3 (Bankr. M.D. Ala. July 5, 2013).

<sup>31</sup> See *Arizona v. California*, 530 U.S. 392, 414 (2000) (“In the case of a judgment entered by . . . consent . . . none of the issues is actually litigated.”); see also *In re Durling*, 500 B.R. 96, 101–02 (Bankr. D. Utah 2013) (finding as a general rule, “consent judgments are not . . . entitled to preclusive effect”); Kristin L. Ballobin, *Line Drawing and the Bankruptcy Discharge: Why Prepetition Stipulations Are Enforceable but Prepetition Waivers Are Not*, 59 KAN. L. REV. 369, 384 (2011) (positing “the actually litigated requirement bars collateral estoppel application to consent judgments containing factual stipulations”).

<sup>32</sup> *In re Olson*, 170 B.R. at 167.

For example, in *In re Bachinski*,<sup>33</sup> the bankruptcy court in the Southern District of Ohio discussed whether a consent judgment is deemed actually litigated under Ohio state law.<sup>34</sup> The *Bachinski* court noted that the Supreme Court, as a matter of federal law, has concluded that consent judgments are not actually litigated and thus, not entitled to preclusive effect.<sup>35</sup> However, as a matter of state law, the *Bachinski* court noted that courts, including the courts in Ohio, are split on the issue.<sup>36</sup> Ultimately, the *Bachinski* court found the pre-petition state court consent judgment did not contain adequate findings of fact or conclusions of law and therefore, was not entitled to preclusive effect in a subsequent nondischargeability proceeding.<sup>37</sup>

## 2. Default Judgments

Similarly, some courts have also refused to apply collateral estoppel where a default judgment was entered against the debtor.<sup>38</sup> For example, in *In re Raynor*,<sup>39</sup> the Fourth Circuit considered whether a prior default judgment was a sufficient basis for applying collateral estoppel in a nondischargeability proceeding.<sup>40</sup> Upon carefully examining the record of the state court proceedings, the Fourth Circuit found that the issue of fraud was not litigated in the prior state court proceeding because the debtor was not aware of the proceeding, there was no cross-examination of witnesses and the burden of proof was improperly placed on the debtor.<sup>41</sup>

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<sup>33</sup> 393 B.R. 522 (Bankr. S.D. Ohio, 2008).

<sup>34</sup> *Id.* at 536.

<sup>35</sup> *See id.* at 536 (citing *Arizona v. California*, 530 U.S. 392, 414 (2000)).

<sup>36</sup> *Id.* at 536.

<sup>37</sup> *See id.* at 536–37.

<sup>38</sup> *See* 4 COLLIER ON BANKRUPTCY, *supra* note 6; *see also* *Spilman v. Harley*, 665 F.2d 224, 228 (6th Cir. 1981) (“If the important issues were not actually litigated in the prior proceeding, as is the case with a default judgment, then collateral estoppel does not bar relitigation in the bankruptcy court.”).

<sup>39</sup> 922 F.2d 1146 (4th Cir. 1996).

<sup>40</sup> *Id.* at 1147.

<sup>41</sup> *Id.* at 1149.

Consequently, the *Raynor* court found that collateral estoppel did not apply to the default judgment.<sup>42</sup>

**B. Second Approach—Preclusive Effect May Be Given to a Consent Judgment if the Parties Intended the Judgment to be Binding**

Some courts will apply collateral estoppel to a consent or stipulated judgment if it finds the parties intended the judgment to have a preclusive effect.<sup>43</sup> A consent judgment without more detail, however, will not satisfy collateral estoppel elements, particularly the element requiring final adjudication of factual issues. However, if the parties expressly state in the consent judgment that they intend to be bound by certain facts in the consent judgment, these courts will apply collateral estoppel to bar re-litigation of those facts.<sup>44</sup>

For example, in *In re Halpern*,<sup>45</sup> the parties had entered into a consent judgment in the underlying state court action stating: “[T]hese [f]indings of [f]act and [c]onclusions of [l]aw will collaterally estop [the debtor] from denying any of the facts or law established herein . . . .”<sup>46</sup> In a subsequent nondischargeability proceeding, the bankruptcy court found that from the text of the agreement it was clear both parties intended the “consent judgment [to] operate as a final adjudication of the factual issues.”<sup>47</sup> Hence, on appeal, the Eleventh Circuit found that the bankruptcy court properly applied collateral estoppel to the prior state court’s factual findings.<sup>48</sup>

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<sup>42</sup> *Id.* at 1150.

<sup>43</sup> *See, e.g., In re Hauck*, 466 B.R. 151, 167 (Bankr. D. Co. 2012) (“For collateral estoppel to apply to a stipulation, the parties must have manifested their intent to do so.”).

<sup>44</sup> *See In re Shaw*, 210 B.R. 992, 998 (Bankr. W.D. Mich. 1997).

<sup>45</sup> 810 F.2d 1061 (11th Cir. 1987).

<sup>46</sup> *Id.* at 1062.

<sup>47</sup> *Id.* at 1064; *see also In re Hauck*, 466 B.R. at 168 (“Collateral estoppel may only be applied to consent decrees if the parties could reasonably have foreseen the conclusive effect of their actions.”) (internal quotations omitted).

<sup>48</sup> *In re Halpern*, 810 F.2d at 1064.

Similarly, in *Klingman v. Levinson*,<sup>49</sup> the Seventh Circuit focused on the parties' intent upon entering into a stipulation as part of a consent judgment.<sup>50</sup> There, the stipulation in the consent decree provided that the debt owed would "not be dischargeable in any bankruptcy . . . proceeding[.]"<sup>51</sup> The *Klingman* court found it "reasonable to conclude that the parties understood the conclusive effect of their stipulation . . ." and held the consent judgment should be given preclusive effect.<sup>52</sup>

This approach does not apply if the creditor obtained a default judgment because, unlike a consent judgment, a default judgment does not rely on the two parties' agreement. Instead, a default judgment is often entered where one party is not even present to the proceedings; hence, it is impossible for the parties' intentions align.

### **C. Third Approach—Preclusive Effect Given To a Consent or Default Judgment**

A majority of courts apply collateral estoppel where "the first court has made specific, subordinate, factual findings on the identical dischargeability issue in question . . ."<sup>53</sup> regardless of whether the parties' intended to be bound by the consent judgment. Adherents of this approach apply collateral estoppel only as to "those elements of the claim that are identical to the elements required for discharge."<sup>54</sup>

#### **1. Consent Judgments**

For example, in *In re Baumhaft*,<sup>55</sup> the bankruptcy court applied collateral estoppel to a state court consent judgment because it found that the debtor's stipulation of facts entered into in the state court proceeding fully established the elements of the plaintiff's nondischargeability

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<sup>49</sup> 831 F.2d 1292 (7th Cir. 1987).

<sup>50</sup> *See id.* at 1296.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *See Dennis v. Dennis (In re Dennis)*, 25 F.3d 274, 278 (5th Cir. 1994).

<sup>54</sup> *Grogan v. Garner*, 498 U.S. 279, 284 (1991).

<sup>55</sup> 271 B.R. 517 (Bankr. E.D. Mich. 2001).

claim.<sup>56</sup> Although it violates public policy for a debtor to waive his right to discharge in a bankruptcy proceeding, he “may stipulate to the underlying facts that the bankruptcy court must examine to determine whether a debt is dischargeable[.]”<sup>57</sup> The *Baumhaft* court concluded that each element of the nondischargeability claim was properly stipulated to in the prior state court proceeding and thus, collateral estoppel was proper.

Alternatively, in *Sung Ho Cha v. Rappaport (In re Sung Ho Cha)*,<sup>58</sup> the Ninth Circuit held that a pre-petition judgment was preclusive as to damages, but not as to whether the amount was dischargeable.<sup>59</sup> There, the Ninth Circuit found that when the state court issued a judgment “in a specific amount, both the obligee and the amount of damages are determined but issues related to section 523 [were] not necessarily determined. Therefore, the [s]tate [c]ourt [j]udgment [wa]s binding [only] as to the former . . . .”<sup>60</sup>

## 2. Default Judgments

Under this third approach, a court may apply collateral estoppel to a default judgment entered in state court if the state in which the default judgment was rendered gives preclusive effect to a default judgment.<sup>61</sup> For example, in *In re Wilson*,<sup>62</sup> the bankruptcy court found that the actually litigated requirement of collateral estoppel was met even though the prior state court judgment was a default judgment.<sup>63</sup> The *Wilson* court found the lower state court’s findings of facts satisfied the elements of a nondischargeability claim under section 523(a)(2)(A) and that the debtor had a full and fair opportunity to defend himself in the prior action and chose not to.<sup>64</sup>

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<sup>56</sup> *See id.* at 522–23.

<sup>57</sup> *Id.* at 521 (quoting *Klingman v. Levinson*, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987)).

<sup>58</sup> 483 B.R. 547, 552 (B.A.P. 9th Cir. 2012).

<sup>59</sup> *See id.*

<sup>60</sup> *Id.*

<sup>61</sup> *See Bay Area Factors v. Calvert (In re Calvert)*, 105 F.3d 315, 317 (6th Cir. 1997).

<sup>62</sup> 72 B.R. 956 (Bankr. M.D. Fla. 1987).

<sup>63</sup> *Id.* at 959.

<sup>64</sup> *Id.*

Provided the elements of collateral estoppel are satisfied, these courts will give a prior consent and default judgment preclusive effect in a dischargeability proceeding

### **III. How to Ensure the Preclusive Effect of a State Court Judgment**

The majority of courts have found that pre-petition stipulations of nondischargeability are unenforceable.<sup>65</sup> If courts held otherwise, creditors would consistently require that a debtor waive his right to seek the discharge of a debt, thereby contravening the Bankruptcy Code's purpose to give honest debtors a fresh start. However, there are steps that creditors' attorneys can take to make sure that a consent judgment or default judgment is given preclusive effect. Similarly, there are steps that debtors' attorneys can take to protect their clients.

For a creditor to successfully argue that collateral estoppel applies, the state-court judgment must include the same elements as the nondischargeability claim.<sup>66</sup> A stipulation may be given preclusive effect if it includes the underlying facts that establish that the debt was nondischargeable.<sup>67</sup> For example, in *In re Huang*,<sup>68</sup> the creditor alleged that a pre-petition settlement entered into by the debtor and creditor collaterally estopped the debtor from claiming the debt was dischargeable.<sup>69</sup> The Ninth Circuit looked to the prior proceeding to see if the fraud allegedly committed by the debtor was actually litigated.<sup>70</sup> The settlement agreement contained no mention of fraud, which the court found especially persuasive considering the creditor was "advised by experienced counsel" who should have known "what was required to constitute

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<sup>65</sup> See, e.g., *Hayhoe v. Cole (In re Cole)*, 226 B.R. 642, 651–54 (B.A.P. 9th Cir. 1998); *In re Mercer*, 2013 WL 3367253, at \*4 (Bankr. M.D. Ala. July 5, 2013).

<sup>66</sup> See *In re Mercer*, 2013 WL 3367253, at \*4.

<sup>67</sup> See *In re Detrano*, 266 B.R. 282, 291 (E.D.N.Y. 2001).

<sup>68</sup> 275 F.3d 1173 (9th Cir. 2002).

<sup>69</sup> *Id.* at 1174–75.

<sup>70</sup> *Id.* at 1178.

collateral estoppel.”<sup>71</sup> Based on these findings, the Ninth Circuit did not apply collateral estoppel.<sup>72</sup>

As *Huang* demonstrates, a creditor should think ahead and litigate the relevant elements of a dischargeability proceeding in the initial state-court action.<sup>73</sup> Similarly, a creditor should require that any pre-petition stipulation that the parties enter into include the relevant elements of the nondischargeability proceeding. In particular, the creditor should draft the stipulation to include each element of the section 523(a) claim.<sup>74</sup> For good measure, the stipulation should include that it is the parties’ intent that the stipulation is binding as to certain allegations.

A creditor should take a similar approach when obtaining a default judgment. Since attorneys draft most of the orders that are eventually signed by a judge and become final judgments, a creditor’s attorney should include the elements necessary to prove that the creditor’s debt is nondischargeable in the order granting the default judgment and request that the court make a specific finding as to each element. If the court has made specific findings as to each element of a nondischargeability claim, the creditor would then likely be able to successfully argue collateral estoppel in a subsequent nondischargeability proceeding.

In contrast, debtors’ attorneys should also take certain steps to protect their clients from being collaterally estopped from arguing that their debts are dischargeable as a result of a consent judgment. First and foremost, an attorney representing a debtor in a state-court action should advise his client to not agree to any consent judgment that includes the elements necessary to prove a nondischargeability claim or that includes language indicating that the parties intend that the consent judgment will have preclusive effect or will be a final adjudication

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<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> See Katherine S. Kruis, *Is Your Prepetition Judgment Worth Anything? Prebankruptcy Planning for the Litigator*, 27 CAL. BANKR. J. 5, 5 (2003).

<sup>74</sup> See Ballobin, *supra* note 31, at 379–80.

of the factual issues. Finally, a debtor may want to refuse to consent to any factual findings, especially those that would establish a nondischargeability claim.

Since some bankruptcy courts give default judgments preclusive effect, a debtor's attorney should take certain steps to protect the debtor. First, the attorney should advise the debtor to remain active in the state court proceeding. By doing so, the debtor will prevent a default judgment from being issued against him. This result is important for two reasons. First, the debtor will not be bound by a default judgment in a subsequent nondischargeability proceeding. Second, and perhaps more importantly, although the state court may ultimately issue a judgment against a debtor who participates in the state-court action, if the debtor does not default he will not have a final judgment for damages entered against him without a fight. Moreover, the debtor may be able to obtain a favorable settlement if he participates in the state court litigation.

Further, if the debtor has already defaulted in the state-court action, the debtor's attorney should consider filing a motion to vacate the default judgment. While the debtor will need to satisfy the requirements for vacating the default judgment, if he is successful, he will avoid being bound by the default judgment. Moreover, the debtor will also be able to get the benefits associated with participating in the state-litigation that are discussed above.

### **Conclusion**

The competing policy concerns of giving debtors a fresh start and promoting judicial economy have led courts to adopt different approaches regarding the applicability of collateral estoppel in nondischargeability actions. The first approach, which affords no preclusive effect to a consent or default judgment, is a narrow view and is not the majority viewpoint. In considering the parties' intent, the second approach is more lenient. Yet, the third approach is

arguably the most effective and fair. This approach gets to the heart of the problem and balances the competing concerns of the parties.

As a practical matter, a creditor and a debtor can both take steps during the state-court litigation to protect their respective interests in a subsequent nondischargeability action. A creditor can prepare for a possible nondischargeability action by including the elements of the potential claim in the consent judgment or order granting the default judgment. Likewise, providing specifics will put the debtor on notice about what he is admitting. The debtor should not admit or consent to something that could potentially foreclose his ability to discharge the debt.

