IN THE SUPREME COURT OF MISSISSIPPI

EMC MORTGAGE CORPORATION **APPELLANT**

VS. **2008-IA-00170-SCT**
CONSOLIDATED WITH 2008-IA-324

BETTYE C. CARMICHAEL **APPELLEE**

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representations are made in order that the Justices of this Court may evaluate possible disqualification or recusal.

1. EMC Mortgage Corporation, Appellant.

2. Bettye C. Carmichael, Appellee.

3. J. Chase Bryan, C. York Craig, III, Mandie B. Robinson, and the law firm of Forman Perry Watkins Krutz & Tardy LLP, attorneys for Appellants.

4. Roy J. Perilloux, James E. Renfroe, and the law firm of Perilloux & Associates, P.A., attorneys for Appellants.

C. York Craig, III

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1. Whether the circuit court erred when it ruled that Plaintiff's claims were not barred by *res judicata?*

2. Whether the circuit court erred when it ruled that EMC waived its right to arbitration?

STATEMENT OF THE CASE

Bettye C. Carmichael ("Plaintiff") entered into a mortgage loan with United Companies Lending Corporation ("UCLC") on November 27, 1998. (R. 54; R.E. B). The principal amount of the loan was $80,000. *Id.* In exchange for this consideration, Plaintiff granted UCLC a security interest in the real property located at 711 Willow Street, D'Lo, Mississippi. *Id.* EMC Mortgage Corporation ("EMC") was not a party to this transaction. *Id.*

Plaintiff filed her initial complaint on April 7, 1999, in the Circuit Court for the First Judicial District of Hinds County, Mississippi, Civil Action Number 251-99-319-CIV. (R. 5; R.E. C). She asserted various causes of action related to the November 1998 mortgage. *Id.* Her claims included allegations of misrepresentation and fraud by UCLC. *Id.* As a consequence of the alleged misrepresentation and fraud, Plaintiff demanded that the deed of trust she executed be declared null and void. *Id.*

On May 1, 1999, UCLC filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the District of Delaware, Case No. 99-453(MFW). Plaintiff filed a proof of claim in UCLC's bankruptcy, attaching a copy of her state court complaint. (R. 268; R.E. D).[1] UCLC objected to the proof of claim, and the bankruptcy court granted its objection on August 30, 2000. (R. 108-125; R.E. E). In doing so, the bankruptcy court specifically held that Plaintiff's claims were "expunged" and "disallowed ***in their entirety***." (R. 108; R.E. E)(emphasis added). Plaintiff did not appeal this order to the district court.[2]

Thereafter, the bankruptcy court approved the terms and conditions of an asset purchase agreement between UCLC and EMC (the "Asset Purchase Agreement") on September 13, 2000.

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[1] Plaintiff's proof of claim, including exhibit, is attached as Exhibit 1 to EMC's March 8, 2007 Reply in Support of Motion to Dismiss, or In the Alternative, Motion to Compel Arbitration. (R. 268; R.E. D). For reasons unknown to EMC, the copy of this filing included in the record on appeal did not contain the exhibit to Plaintiff's proof of claim. Consequently, EMC is filing a Motion to Correct Record on Appeal in order to substitute the complete copy of Plaintiff's proof of claim.

[2] *See* 28 U.S.C. § 158(a)(1).

(R. 126–52; R.E. E). Plaintiff's mortgage loan was included in this sale. Significantly, the bankruptcy court expressly stated that EMC took the servicing rights "free and clear of any and all liens, mortgages, pledges, security interests, restrictions, prior assignments, liabilities, obligations, encumbrances, charges and claims of any and every kind, nature and description whatsoever ..." (R. 138; R.E. E). That same day, the bankruptcy court entered its order confirming UCLC's reorganization plan. (R. 153-247; R.E. E). Plaintiff also did not appeal either of these bankruptcy rulings to the district court.

Notwithstanding the bankruptcy court's order expunging and disallowing her claims, Plaintiff continued her efforts to prosecute those claims by filing an amended complaint in the circuit court on November 26, 2001, in which she substituted EMC for UCLC as a defendant. (R. 14; R.E. F). In the amended complaint, she also demanded that the underlying note and deed of trust be "declared void and unenforceable." (R. 21; R.E. F). Plaintiff never issued a summons to EMC and never served EMC with process. Ultimately, EMC filed a motion to dismiss for insufficiency of process and insufficiency of service of process, which the circuit court denied. (R. 38; R.E. G). EMC thereafter filed its answer to the amended complaint. (R. 39; R.E. H). In its answer, EMC raised numerous defenses, including: (a) that Plaintiff's claims are barred under principles of *res judicata*; (b) that EMC purchased the servicing rights to Plaintiff's loan free and clear of all claims, liabilities, and encumbrances; and (c) that Plaintiff's claims are subject to mandatory mediation and arbitration. (R. 39-53; R.E. H). Thereafter, EMC did not participate in any discovery or otherwise direct any litigation-related activity toward Plaintiff.

EMC filed the motions at issue in this appeal on January 31, 2007, seeking alternatively: (a) an order dismissing the circuit court action based on *res judicata*; or (b) an order compelling arbitration. (R. 79; R.E. E). In response to EMC's motion to dismiss, Plaintiff conceded that

EMC acquired her loan free and clear of all claims and liabilities. (R. 256; R.E. I). Notwithstanding that concession, however, and without citation to any legal authority, Plaintiff argued that she is nevertheless entitled to challenge the validity of her deed of trust by way of recoupment.[3] (R. 256-57; R.E. I). In response to EMC's arbitration motion, Plaintiff asserted that she could not be compelled to arbitrate her claims for numerous reasons. (R. 256-59; R.E. I).

On January 7, 2008, the circuit court entered its order denying EMC's motion to dismiss, and its alternative request to compel arbitration. (R. 316; R.E. J). The circuit court cited no reason for the denial of the motion to dismiss. *Id.* With regard to the motion to compel arbitration, the court erroneously found that EMC had waived its right to arbitration. *Id.* EMC timely filed a notice of appeal with respect to the arbitration ruling, and also filed a petition for permission to appeal with respect to the denial of the motion to dismiss. (R. 317; R.E. K). This Court granted EMC permission to appeal the denial of the motion to dismiss and consolidated the two appeals. (R.E. A).

[3] Significantly, recoupment is merely a defense to a claim, and not an affirmative cause of action. *See* 20 AM. JUR. 2D COUNTERCLAIM § 5 (1995) ("As a defense, recoupment cannot be used to obtain affirmative relief.").

SUMMARY OF THE ARGUMENT

The Circuit court erred when it ruled that Plaintiff's claims are not barred by *res judicata.* The claims asserted by Plaintiff in UCLC's bankruptcy were identical to those she has asserted in this action. In denying the proof of claim, the bankruptcy court unequivocally ordered that her proof of claim was to be "expunged and the claims asserted therein [] disallowed ***in their entirety***." (R. 109)(emphasis added). The disallowance of her claim in bankruptcy is *res judicata* for purposes of this state court litigation that involves the very same claims. *See, e.g., Walsh Trucking Co., Inc. v. Insurance Company of North America,* 838 F.2d 698, 701 (3d Cir. 1988). Thus, the circuit court erred by failing to dismiss the claims against EMC.

The same holds true with respect to the bankruptcy court's approval of the Asset Purchase Agreement. An order approving the sale of a debtor's assets is a final adjudication on the merits for *res judicata* purposes. *See, e.g., Bank of Lafayette v. Baudoin*, 981 F.2d 736, 742 (5th Cir. 1993). Thus, the bankruptcy court's order approving the Asset Purchase Agreement was final and preclusive. Therefore, the circuit court erred by failing to dismiss EMC based upon the bankruptcy court order approving the Asset Purchase Agreement.

The circuit court also erred in denying the motion to compel arbitration. While the circuit court held – without explanation – that EMC waived its right to arbitration, Plaintiff offered no evidence that EMC had invoked the judicial process to her detriment. Plaintiff had the burden of proof on that issue and she failed to meet it. The motion to compel arbitration should therefore have been granted. *See, e.g., Univ. Nursing Assoc., PLLC v. Phillips*, 842 So. 2d 1270, 1276 (Miss. 2003).

ARGUMENT

I. THE CIRCUIT COURT ERRED WHEN IT DENIED EMC'S MOTION TO DISMISS BECAUSE PLAINTIFF'S CLAIMS ARE BARRED BY *RES JUDICATA*.

Whether *res judicata* bars a claim is a question of law that this Court reviews *de novo*. *Swaney v. Swaney*, 962 So. 2d 105, 108 (Miss. Ct. App. 2007). EMC moved for dismissal of Plaintiff's claims under Rule 12(b)(6), or alternatively, Rule 56, based on *res judicata*. (R. 79; R.E. E). The circuit court denied EMC's motion without explanation. (R. 317; R.E. K). Reversal of the denial of a Rule 12(b)(6) motion is required where there are no facts that would afford relief to the plaintiff. *Durham v. University of Mississippi*, 966 So. 2d 832, 835 (Miss. Ct. App. 2007). For the reasons that follow, the bankruptcy court's order expunging and disallowing Plaintiff's proof of claim and the order approving the Asset Purchase Agreement bar the Plaintiff's claim based on *res judicata*.

A. Federal Common Law Principles of *Res Judicata* Apply and Preclude Plaintiff's Claims.

It is axiomatic that federal law determines the preclusive effects of a federal court judgment based upon an issue of federal law. *Taylor v. Sturgell*, 128 S. Ct. 2161, 2171 (2008) ("For judgments in federal-question cases . . . federal courts participate in developing 'uniform federal rule[s]' of res judicata, which this Court has ultimate authority to determine and declare."); *Russell v. SunAmerica Securities, Inc.*, 962 F.2d 1169, 1172 (5th Cir. 1992) ("Federal law determines the *res judicata* effect of a prior federal court judgment."); RESTATEMENT (SECOND) OF JUDGMENTS § 87 (2008). Bankruptcy law is necessarily a federal question. *See* U.S. CONST. ART I, § 8, cl. 4; *Rivet v. Regions Bank of Louisiana, FSB*, 108 F.3d 576, 588 (5th Cir. 1997) ("Bankruptcy is a quintessential federal question"), *reversed on other grounds by*, 522 U.S. 470 (1998).

Under federal law, the four elements of *res judicata* are: "(1) the parties are identical or in privity; (2) the judgment in the prior action was rendered by a court of competent jurisdiction; (3) the prior action was concluded by a final judgment on the merits; and (4) the same claim or cause of action was involved in both actions." *Test Masters Educational Servs., Inc. v. Singh*, 428 F.3d 559, 571 (5th Cir. 2005). All four elements of *res judicata* were satisfied in the instant case.

1. EMC is in privity with UCLC.

The first element – identity of parties – merits little discussion. Plaintiff did not, and indeed cannot, dispute that EMC is in privity with UCLC. A successor-in-interest is in privity with its predecessor for purposes of *res judicata*. *Russell,* 962 F.2d at 1173 ("A non-party defendant can assert res judicata so long as it is in 'privity' with the named defendant."); *Howell Hydrocarbons, Inc. v. Adams,* 897 F.2d 183, 188 (5th Cir. 1990) (holding that privity exists with "successor in interest to the party's interest in the property"). Plaintiff asserts her claims against EMC in its capacity as the purchaser and assignee of the servicing rights of her mortgage loan. Those servicing rights are the by-product of the Asset Purchase Agreement approved by the bankruptcy court. (R. 126-52; R.E. E). By virtue of the Asset Purchase Agreement, EMC succeeded to UCLC's interests in Plaintiffs' mortgage loan and is in privity with UCLC as the amended complaint conceded.

2. The bankruptcy court had jurisdiction to disallow Plaintiff's Proof of Claim and approve the Asset Purchase Agreement.

The second element of *res judicata* – an order from a court of competent jurisdiction – is likewise beyond dispute. Bankruptcy courts are expressly authorized to "enter appropriate orders and judgments" providing for the "allowance or disallowance of claims against the estate," as well as those "approving the sale of property." 28 U.S.C. § 157(b)(2)(B) & (N). Thus, the

bankruptcy court unquestionably had jurisdiction to rule on Plaintiff's proof of claim and to approve the Asset Purchase Agreement. Consequently, this element was clearly satisfied.

3. The bankruptcy court's orders constituted final judgments on the merits.

The third element – a final adjudication on the merits – is also satisfied. "Several types of bankruptcy orders are final and appealable – for example, orders allowing or denying claims; orders denying relief from a stay; decisions involving property ownership; exemptions; sanctions; appointments of trustees; judicial sales orders; and confirmation of a bankruptcy plan." *In re Wade,* 991 F.2d 402, 406 (7th Cir. 1992). Both the August 30 and the September 13, 2000 orders entered by the bankruptcy court were final judgments with preclusive effect as to the claims asserted below.

A bankruptcy court's disallowance of a proof of claim constitutes a final adjudication on the merits. *In re Los Gatos Lodge, Inc.*, 278 F.3d 890, 894 (9th Cir. 2002) (holding that "bankruptcy court's allowance or disallowance of a proof of claim is a final judgment."); *Bank of Layafette v. Baudoin,* 981 F.2d 736, 742 (5th Cir. 1993) (holding that bankruptcy court order resolving proof of claim was "a final judgment."); *Walsh Trucking Co., Inc. v. Insurance Company of North America,* 838 F.2d 698, 701 (3d Cir. 1988) (holding that "order expunging a creditor's claim in an ongoing bankruptcy proceeding is a final order immediately appealable to the district court"); *DiSaia v. Capital Industries, Inc.*, 320 A.2d 604, 607 (R.I. 1974) ("The allowance or disallowance of a claim in bankruptcy should be given like effect as any other judgment of a competent court, in a subsequent suit against the bankruptcy or anyone in privity with him."(quoting 3 Collier, Bankruptcy 57.14(7), 221-23 (14th ed. 1974)). Thus, the order denying Plaintiff's proof of claim was "final" and binding.

Likewise, an order approving the sale of a debtor's assets is a final adjudication on the merits for *res judicata* purposes. *Rivet v. Regions Bank of Louisiana, FSB;,* 108 F.3d 576, 588

("An order by a bankruptcy court authorizing or approving the sale of an asset of the bankruptcy estate is a final judgment on the merits for res judicata purposes"); *Baudoin*, 981 F.2d at 742 ("Our precedent clearly establishes that bankruptcy court orders authorizing the sale of part of the estate or confirming such sale are final judgments on the merits for *res judicata* purposes"). Accordingly, the bankruptcy court's order approving the Asset Purchase Agreement and the sale of the servicing rights to Plaintiff's mortgage "free and clear" of all claims was equally "final" and preclusive.

4. Plaintiff's claims in this case are identical to those disallowed by the bankruptcy court.

Finally, there can be no reasonable dispute that the fourth element – identity of claims – is satisfied. "Under this test, the critical issue is whether the two actions are based on the same nucleus of operative facts." *Baudoin,* 981 F.2d at 743 (internal quotation marks, ellipsis, alterations and citation omitted). In the bankruptcy proceedings, Plaintiff filed a proof of claim for $3,320,000.00, attaching her state court complaint against UCLC. (R. 113; R.E. E and R. E. D). When the bankruptcy court expunged and disallowed her claim in its entirety, Plaintiff simply amended the state-court complaint that was attached to her proof of claim by substituting EMC for UCLC. (R. 14; R.E. F). Thus, the claims asserted in the circuit court against EMC arise from precisely the same "nucleus of operative facts" as those that were expunged and disallowed by the bankruptcy court.

B. The Order Approving the Asset Purchase Agreement is Preclusive.

The bankruptcy court's order approving the Asset Purchase Agreement states unambiguously that EMC took UCLC's rights to Plaintiff's loan "free and clear of any and all liens, mortgages, pledges, security interests, restrictions, prior assignments, liabilities, obligations, encumbrances, charges and claims ***of any and every kind, nature and description whatsoever, including, without limitation, claims arising out of pending litigation ....***" (R.

138; R.E. E) (emphasis added). Under federal bankruptcy law, all such orders are "self-executing," in order to further "the [Bankruptcy] Code's emphasis on the finality of sales." *Regions Bank of Louisiana v. Rivet,* 224 F.3d 483, 491 (5th Cir. 2000); *In re Statepark Building Group, Ltd.,* 316 B.R. 466, 477 (Bankr. N.D. Tex. 2004) (finding that bankruptcy court "has the power under the Bankruptcy Code to approve the sale of assets free and clear of interest."). In light of the finality afforded orders approving asset sales in bankruptcy, the bankruptcy court's order approving the sale to EMC operates to preclude re-litigation of the claims asserted by Plaintiff in the circuit court.

II. THE CIRCUIT COURT ERRED WHEN IT RULED THAT EMC WAIVED ITS RIGHT TO ARBITRATION.

A trial court's denial of a motion to compel arbitration is subject to *de novo* review by this Court. *Equifirst Corp. v. Jackson,* 920 So.2d 458, 461 (Miss. 2006) ("The decision to grant or deny a motion to compel arbitration is reviewed by this Court de novo.").

A. The Law Disfavors Waiver of Arbitration.

The circuit court erred when it ruled that EMC waived its right to arbitration. The Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, *et seq.,* establishes "a body of federal substantive law of arbitrability" under which "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language or an allegation of ***waiver***, delay, or a like defense to arbitrability." *Moses H. Cone Memorial Hosp. v. Mercury Construction Corp.,* 460 U.S. 1, 24-25 (1983) (emphasis added). Consistent with the FAA, this Court has expressed an "intention to uphold arbitration agreements if at all possible under the circumstances." *See Univ. Nursing Assoc., PLLC v. Phillips*, 842 So. 2d 1270, 1276 (Miss. 2003). With respect to waiver of arbitration, this Court has stated:

> Waiver of arbitration is not a favored finding, and there is a presumption against it; this is particularly true when the party seeking arbitration has included a demand for arbitration in its

> answer, and the burden of proof then falls even more heavily on the party seeking to prove waiver."

Id. Unless the party seeking arbitration has actively participated in the litigation to the prejudice of the other party, he will not be found to have waived arbitration. *Id.*; *see also IP Timberlands Operating Co. v. Denmiss Corp.*, 726 So. 2d 96, 104 (Miss. 1998) (finding that "[a]rticles of agreement to arbitrate ... are to be liberally construed so as to encourage the settlement of disputes and the prevention of litigation, and every reasonable presumption will be indulged in favor of the validity of arbitration agreements."). Consistent with this presumption, this Court has held that "serving an answer and filing a motion to dismiss does ***not*** constitute a waiver of arbitration by participation in litigation ...." *University Nursing Assoc.*, 842 So. 2d at 1276 (citing 6 C.J.S. Arbitration § 37 (1975)).[4] Furthermore, delay standing alone is insufficient to establish waiver of arbitration. *Virginia College, LLC v. Moore*, 974 So. 2d 269, 273 (Miss. Ct. App. 2008) (citing *MS Credit Center, Inc. v. Horton*, 926 So. 2d 167, 180 (Miss. 2006) ("[A] party who seeks to compel arbitration after a long delay will not ordinarily be found to have waived the right where there has been no participation in, or advancement of, the litigation process."). This Court has stated further that, given the presumption in favor of arbitration, a circuit court errs in denying arbitration in the absence of "proof of detriment and/or prejudice." *Century 21*, 965 So. 2d at 1038.

B. Plaintiff Failed to Meet Her Burden With Regard to Waiver.

As the party resisting arbitration, Plaintiff bore the burden of proving waiver. *Green Tree Financial Corp.—Alabama v. Randolph,* 531 U.S. 79, 91 (2000) (holding that "party resisting

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[4] EMC is mindful that in *Century 21 Maselle and Assoc. v. Smith*, 965 So. 2d 1031 (Miss. 2007), this Court stated that on a going-forward basis, the proper way to seek an arbitration order is to file a "Motion to Compel Arbitration and to Stay Proceedings Pending Arbitration" prior to filing a responsive pleading. Significantly, the Court in that case did not apply the new procedural requirements retroactively, and found that Century 21 did not waive its right to arbitration. Like Century 21, EMC followed Mississippi law and procedure in effect at the time; therefore, EMC cannot be found to have waived its right to arbitration as a consequence of the mere filing of its answer before a motion to compel arbitration.

arbitration bears the burden of proving that the claims at issue are unsuitable for arbitration"). Plaintiff failed to meet her burden of proving that EMC waived its right to arbitration by invoking the judicial process to Plaintiff's detriment or prejudice. In fact, she made no attempt at all to establish detriment or prejudice, and there is no such evidence apparent in the record. To the contrary, EMC merely filed an answer and requested that it be dismissed under Rule 12 – which it was entitled to do under Mississippi law. Since the filing of its answer, which contains a prominent demand for arbitration, EMC has not undertaken any activity that advanced this litigation. Indeed, EMC has not propounded discovery, responded to discovery, subpoenaed witnesses and/or documents, taken depositions, or otherwise invoked the judicial process in any respect. Certainly, EMC did not advance this litigation to Plaintiff's detriment, and Plaintiff failed to establish otherwise in the circuit court, as was her burden. *See Randolph,* 531 U.S. at 91.

The FAA and this Court impose a presumption against waiver of arbitration when the moving party has included an arbitration demand in its answer, which EMC did, and when the moving party has not invoked the judicial process to the detriment or prejudice of the non-moving party. Plaintiff failed to refute that presumption below. Consequently, the trial court erred in denying EMC's motion to compel arbitration.

CONCLUSION

Plaintiff's claims are barred by *res judicata* based on the bankruptcy court orders denying her proof of claim and approving the Asset Purchase Agreement. Consequently, the circuit court erred in denying EMC's motion to dismiss, and its decision must be reversed.

Alternatively, if the Court finds that Plaintiff's claims are not barred by *res judicata*, those claims are subject to binding arbitration, and the circuit court erred in denying EMC's motion to compel arbitration.

This the 14th day of November, 2008.

Respectfully submitted,

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CERTIFICATE OF FILING AND SERVICE

I hereby certify that I have filed an original and three copies of Appellant's brief and have served a true and correct copy of the foregoing document via United States mail, postage prepaid, on the following:

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Dated this 14th day of November, 2008.

C. York Craig, III

APPENDIX OF AUTHORITIES

Cases

Statutes

Other