IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

Richmond Division

WILLIAM MICHAEL LOVERN, et al., Plaintiffs,	)	
v.	)	CIVIL ACTION NO. 82-0637-R
CENTRAL FIDELITY BANK, N.A., et al., Defendants.	)	

MEMORANDUM OPINION

Plaintiffs have filed an action against Central Fidelity Bank, "the Bank", its officers and directors under various theories of conspiracy and fraud. Federal jurisdiction is predicated on 12 U.S.C. §503.[1] See Complaint, ¶¶45-47. Defendants move for summary judgment on the federal claim on two grounds:

> (1) Defendants assert that the facts essential to plaintiffs' claim are identical to the factual theory and issues presented to the jury in Luke and Lovern's previous criminal trial[2] and are therefore collaterally estopped.
>
> (2) Plaintiffs have sustained no recoverable damages, a prerequisite under 12 U.S.C. §503, and therefore have no cause of action under the banking laws.

Defendants also request that the remainder of the complaint be dismissed for lack of jurisdiction. Federal jurisdiction is based on the federal question statute, 28 U.S.C. §1331, and once the federal claim has been disposed of, the remaining state claims can be dismissed.

I. Factual Background

Title 12 U.S.C. §503 provides for liability, under certain circumstances, of officers of member banks of the Federal Reserve System. The complaint alleges a scheme by a former officer of Central Fidelity Bank, Charles Peter Sheehy, "Sheehy", to use Luke and Lovern as unwitting vehicles for manipulating bank funds to disguise his defalcations in handling other loans. Sheehy's alleged misdeeds form the core of the plaintiffs' case. The liability of the remaining defendants stems from their alleged complicity or acquiesence in the Sheehy scheme. For a complete understanding of the subtleties of this civil action, it is necessary to take notice of Luke and Lovern's recent criminal conviction and affirmance of the same by the Fourth Circuit.[3] Luke and Lovern were convicted by a jury on all three counts of an indictment charging: (1) Conspiracy to misapply bank funds and to make false entry in bank records in violation of 18 U.S.C. §§2, 656 and 1005; (2) Aiding, abetting and causing the making of false entry in bank records, a violation of 18 U.S.C. §§2 and 1005; and (3) Aiding, abetting and causing a misapplication of bank funds in contravention of 18 U.S.C. §§2 and 656.[4]

For the purpose of this opinion, the following facts are conclusively established by the Fourth Circuit opinion:

> The affair which concerns us began in mid-1979, by which time Peter Sheehy, an assistant vice president of Central National Bank in Richmond, Virginia, in his capacity as a lending officer, had authorized loans amounting to approximately $275,000 to Mastertrax, Inc., a music recording company owned by Rodney Seagream, and its surrogates. Mastertrax was in its infancy and, in the

opinion of Sheehy's superiors at the bank, constituted a very risky borrower. The bank's management became distressed when it learned that Sheehy had lent $75,000 of the bank's money to Mastertrax. Compounding management's chagrin was the fact that Sheehy, in the view of his superiors, had exceeded his $50,000 lending limit on the Mastertrax account. Management was unaware of the additional $200,000 lent to Mastertrax. Had management known, 'distress' and 'chagrin' would presumably not be adequate terms to describe management's feelings. Sheehy, understandably concerned about his prospects for continued employment at the bank were the full extent of the Mastertrax borrowings revealed, purposely refrained from disclosing the complete $275,000 figure. Sheehy did succeed in temporarily allaying management's fears, however, by assuring his superiors that Mastertrax would be prepared to repay some $30,000 of its deft within a two to four week period.

Sheehy turned to Luke and Lovern for assistance. Appellants knew Sheehy well, for Sheehy already had lent approximately $122,000 to Luke and Lovern, a sum also apparently well in excess of Sheehy's lending authority. The loans were made either to Luke or Lovern personally, or to one of various carpet companies which the appellants owned. Sheehy asked Luke and Lovern, and they agreed, to speak to Seagream about the need for a quick repayment from Mastertrax.

Appellants met with Seagream, stressing to him that 'it was important that Mr. Sheehy be kept whole in his position at the bank.' Seagream was also informed by the appellants that he should not be 'a bit surprised if you should wake up one morning and your loans have been liquidated.... You won't know who or why they were liquidated, but you may find a receipt in the mail indicating that they have been paid in full.'

On the day following their meeting with Seagream, Luke and Lovern paid a visit to Sheehy. They asked Sheehy if there was anything they could do to help him out of his Mastertrax predicament. Sheehy answered affirmatively: the two

> men could 'assume the debt of Mastertrax.' The plan was then sketched out. Rather than structuring a conventional assumption of liability, the three agreed that it would be preferable to get the bank's money to do their work for them. They agreed that $31,000 would be lent to one of the appellants' carpet companies; at the suggestion of one of the appellants, Sun Carpet was denominated the recipient. The proceeds of the loan would be deposited in Luke's personal savings account, which promptly would be debited to make the $30,000 repayment which Sheehy had assured the bank's management was forthcoming from Mastertrax.
>
> The plan was executed accordingly. Luke signed a note from Sun Carpet, a note which made no mention whatsoever of Mastertrax. The money was, as planned, credited to Luke's savings account, and Sheehy made out a debit slip recording the fact that Mastertrax's liability was being paid with funds coming from Luke's account. The debit slip was then placed in a separate file in Sheehy's office, conveniently hidden from management. Sheehy stayed on with the bank for another two and one-half months, authorizing an additional $74,000 in loans to appellants during that period."

The Fourth Circuit found from a review of the evidence adduced at trial that "the loan to Sun Carpet was a 'sham' transaction; the note signed by Luke on behalf of Sun Carpet was consequently a false entry."[5]

The basis of this civil action is that the bank, and its officers and directors perpetrated the fraud and that Luke and Lovern were merely victims of the scheme. Defendants, on the other hand, insist that the factual premise of the civil action is identical to that of the criminal case and contend that this is a "rehash" of the exact issues disposed of by the jury. Plaintiffs have submitted, in camera and under seal, a Proffer of

Testimony and Evidence in support of their contention that this is not a "rehash" of the same issues or facts. In plaintiffs' Memorandum in Support of the Proffer they state:

> As a result of interviews with prospective witnesses and review of available documents, Plaintiffs' counsel can now show that certain officers in the Bank gave false information to the Bank and its directors concerning Luke and Lovern's involvement in the fraudulent Mastertrax loans and Sheehy's admitted frauds upon the Bank. Those officers and directors of the Bank who were not active participants in the wrongdoing are liable in damages for their acquiescence, indifference and omissions.
>
> It is apparent that the officers responsible for the wrongdoing intentionally withheld vital information from the Bank and its officers and directors because any suggestion of fraud, other than the fraud committed by Sheehy as reported to the Regional Administrator of National Banks, would require another similar report under comptroller of the Currency Regulations dealing with reports on suspected fraud. Such report would result in a special federal investigation which would shake the Bank's managing officer corps at its very foundation.
>
> It is also obvious that the responsible officers have failed to advise legal counsel in this case of their efforts to tie the Mastertrax loans and the Luke and Lovern loans together in such a manner that only one claim for $450,000 would be made under the Bank's fidelity bond thereby effectively eliminating the bond's $100,000 deductible for separate claims; or to effectively recover $105,000 on the prospective Luke and Lovern losses which otherwise would not be recovered under the fidelity bond.
>
> This is a case of first impression which factually supports serious allegations of conspiracy and fraud by Bank officers which resulted in:

> (1) False swearing by a senior vice-president of the Bank when the fidelity bond claim for $450,000 was submitted to Aetna Casualty & Surety Company and later supplemented.
>
> (2) False written and verbal statements including the delivery of incomplete, false and misleading documents to the FBI and U.S. Attorney's Office resulting in the indictment and criminal conviction of Luke and Lovern.
>
> (3) Knowingly accepting a gross overpayment of claims from the Bank's fidelity bond carrier resulting from the tying together of the Mastertrax and Luke and Lovern loans when each set of loans was treated as a separate transaction to separate customers of the Bank...
>
> Defendants' collateral estoppel argument does not apply under the facts of this case because the Plaintiffs now contend and allege that the criminal indictment and conviction of Luke and Lovern was the direct result of the Bank's wrongdoing, including fraud, false statements by officers and the publication of false records.

See Plaintiffs' Memorandum in Support of Proffer of Testimony and Evidence at 2-4.

In November of 1982, an order staying discovery for an indefinite period of time was entered.[6] The Proffer of Testimony and Evidence is plaintiffs' attempt to bring new facts before the court without the benefit of discovery. A careful reading of the Proffer, shows that the facts proffered are not substantially different from those raised by plaintiffs in their criminal action.[7] Luke and Lovern's convictions were based upon the theory that each was a willful instrument through which Sheehy moved the Bank's monies from Luke's savings account to the Mastertrax loan account. In the proffer, plaintiffs' do their

best to explain their innocence and Sheehy's guilt. They explore Sheehy's relationship with fellow officers, roommates, Seagream and Drossell.

The question to be decided here is whether or not the issues and theories advanced were tried and conclusively decided at the criminal trial so as to allow this Court to exercise its discretion and grant summary judgment based upon the doctrine of collateral estoppel.

II. Legal Analysis

It has been a traditional rule that a judgment of conviction in a criminal prosecution is no bar to a subsequent civil action arising from the same transaction.[8] The reasoning for this general rule is based on the different rules of evidence, elements of proof and degree of proof required in the two actions. There is, however, a growing tendency to admit a previous criminal record or conviction as proof of the facts upon which it is based. In Emich Motors Corp., et al., v. General Motors Corp., et al., 340 U.S. 558 (1951), the Supreme Court had before it a suit under §4 of the Clayton Act for the recovery of treble damages for injuries sustained by reason of a conspiracy in restraint of trade. One issue before the Court was whether plaintiffs' were entitled to introduce a prior criminal judgment based on a conviction of defendants for the same conspiracy. The Court held: "In a case of a criminal conviction based on a jury verdict of guilty, issues which were essential to the verdict must be regarded as having been determined by the judgment... Accordingly, we think plaintiffs are entitled to introduce the

prior judgment to establish prima facie all matters of fact and law necessarily decided by the conviction and the verdict on which it was based." Id. at 569. The Court goes on to give guidance as to the proper method of evaluating the collateral effect of an underlying criminal judgment. "A general verdict of the jury or judgment of the court without special findings does not indicate which of the means charged in the indictment were found to have been used in effectuating the conspiracy ... Under these circumstances what was decided by the criminal judgment must be determined by the trial judge... upon an examination of the record, including the pleadings, the evidence submitted, the instructions under which the jury arrived at its verdict, and any opinions of the courts." Id.

As a preliminary issue, this court rules that the federal law of collateral estoppel applies to this case, as jurisdiction is founded upon federal question. The federal law of collateral estoppel has been profoundly shaped by two Supreme Court cases, Blonder-Tongue Laboratories v. University of Illinois Foundation, 402 U.S. 313 (1971) and Parklane Hosiery Co., Inc., et al., v. Shore, 439 U.S. 322 (1979). In Blonder-Tongue, the Supreme Court rejected the requirement of mutuality for an estoppel plea. See id. at 326-328. In addition, the Court noted: "Although neither judges, the parties, nor the adversary system performs perfectly in all cases, the requirement of determining whether the party against whom an estoppel is asserted had a full and fair opportunity to litigate is a most significant safeguard." Id. at 329. The doctrine of collateral estoppel was extended even

further in Parklane Hosiery as the court sanctioned its use as an offensive weapon. The Supreme Court advocates a grant of broad discretion to trial courts to determine on a case-by-case analysis whether collateral estoppel is applicable. Parklane Hosiery, supra at 331.

To determine the validity of a collateral estoppel defense, three questions must be addressed:

> Was the issue decided in the prior adjudication identical with the one presented in the action in question? Was there a final judgment on the merits? Was the party against whom the plea is asserted a party or in privity with a party to the prior adjudication?

Bernhard v. Bank of America National Trust & Savings Ass'n., 19 Cal.2d 807, 813, 122 P.2d 892, 895 (1942), quoted in Blonder-Tongue, supra, at 323-24. If as defendants assert all three questions are answered in the affirmative, it necessitates a dismissal of plaintiffs' §503 claim.

First, Luke and Lovern were parties to the earlier criminal prosecution. Thus, a defense of collateral estoppel is applicable. In addition, the corporate plaintiffs are in privity with the individual plaintiffs so as to cause the doctrine to be applicable to them. L. and L. Management Company Berkshire, Ltd. and Waterhaven, Ltd. are owned, operated and within the control of Luke and Lovern. Fairness dictates that the doctrine be applicable to such closely controlled entities.

Second, the prior criminal action ended with a final judgment on the merits. The jury found Luke and Lovern guilty of all three charges in the indictment.[9] The verdict was challenged

on appeal for sufficiency of evidence and the Fourth Circuit upheld the decision of the jurors.

Lastly, a determination must be made as to the similarities between the issues decided in the prior adjudication and those raised in the present case. The Court finds that the issues which defendants seek to preclude were essential to the first judgment. The indictment charges Luke and Lovern with conspiring to embezzle funds from the Bank and for aiding and abetting Sheehy in the offense of making a false entry into a bank record and in the misapplication of the funds.[10] At the criminal trial, the prosecution had to prove that Luke and Lovern knowingly and willfully entered into the conspiracy. The government put forth testimony and evidence in support of the charges in the indictment and in particular of the overt acts. The key evidence in the criminal trial is identical to the factual issues raised by plaintiffs in the instant suit:

(1) The nature of the relationship between Luke, Lovern and Sheehy [Complaint ¶¶19-26, Transcript at 229-232]; (2) The motive behind drafting the Sun Carpet note in the amount of $31,000, and Luke's "acquiescence" in accepting and signing an obligation which he stated was $11,000 over the amount needed for Sun Carpet [Complaint ¶¶27-29, Transcript at 232-233]; (3) Whether Luke and Lovern immediately contacted Sheehy upon their "discovery" that the $31,000 had been withdrawn from Luke's savings account and whether they demanded an explanation and accounting [Complaint ¶¶32-33, Transcript at 235-236]; and (4) Whether Luke and Lovern continued to protest against the

scheme and to demand the cancellation of the Sun Carpet note [Complaint ¶34, Transcript at 236-237]. The transcript reflects that Luke testified before the jury as to these issues and the jury was convinced that Luke and Lovern were not unwitting vehicles of Sheehy's, but rather, accomplices and co-conspirators. Plaintiffs have unconvincingly tried to reframe the above issues by posturing the complaint as an attack on the Bank and its officers. Theses issues, however, have been conclusively decided against Luke and Lovern. If the jury had believed Luke and Lovern's version of the facts, i.e. that they knew nothing of Sheehy's plan, the result would have been an acquittal instead of a conviction. These issues were at the heart of their defense. Judge Merhige's charge told the jurors to consider all of the facts and that they had a choice between the competing versions of the facts.

> Now, this really is not a complicated case, ladies and gentlemen. It seems to me that the Government's theory of the case is that the defendants conspired with Mr. Sheehy to violate two statutes of the United States; one to misapply certain funds of an insured bank, and the other to ... make a false entry in a book, report, and at the same time with intent to injure and defraud the bank. So their theory is that each of these gentlemen allegedly aided and abetted Mr. Sheehy in doing these particular acts, the substantive acts charged in count two and count three. And that these gentlemen conspired together. That is, entered into an agreement as I have described the law of conspiracy, to violate the law...
>
> If you are satisfied that the Government has sustained its burden -- and the burden is always on the Government to prove every essential element of each of the offenses charged beyond a reasonable doubt -- if you are satisfied that they

> have done so as to any one or both of these defendants, then you are dutybound to find the defendant guilty of whichever offense or offenses that you find that the Government has satisfied its burden. On the other hand, if you are not so satisfied, you are under a duty to find that particular defendant or defendants not guilty.

See United States of America v. William Michael Lovern and Kenneth Glen Luke, Crim. No. 82-00023-R (E.D. Va. May 13, 1982) aff'd Crim. Nos. 82-5196, 82-5197 (4th Cir. 1983), Charge to the Jury at 19-20.

While the law on the use of a judgment in a criminal prosecution to collaterally estop relitigation of issues in a civil suit is by no means uniform, the Court is persuaded by Emich Motors, supra, that the most important question is whether the litigants against whom the defense is raised had a full and fair trial on the issues. While some critics of the use of this defense contend that the underlying differences between a criminal and civil trial prevent a full and fair hearing, this court takes comfort in the fact that at the criminal trial the issues sought to be precluded here had to be proven by a more harsh burden of proof. The jury verdict was firmly rooted in a finding that Luke and Lovern knowingly and willfully came to Sheehy's assistance and helped him in the execution of his plan. A review of the underlying record, shows that Luke and Lovern received a full and fair hearing on these issues. Curtailing relitigation of these same factual issues cannot be said to be an affront to fairness.

In Cardillo v. Zyla, 486 F.2d 473 (1st Cir. 1973), the court was faced with a very similar legal argument. The First Circuit held that where plaintiff's civil claims were based on issues whose earlier determination was essential to a prior criminal conviction, plaintiff was collaterally estopped from relitigating the same issues. In Cardillo the plaintiff, who had been convicted of conspiracy and transporting of stolen goods in interstate commerce, sought damages against various individuals who, he alleged, gave or induced others to give perjured testimony. The district court dismissed the complaint for failure to state a claim upon which relief could be granted, "characterizing its allegations as a 'mere rehash of the facts elicited in a criminal case against the complainant.'" Id. at 474. The First Circuit concluded:

> Cardillo's civil claim is barred by collateral estoppel even though the prior adjudication was in a criminal proceeding. Emich Motors Corp. v. General Motors Corp., supra ... and even though it is against individuals who were not "parties" at the criminal trial.

Id. at 475.

This Court follows the reasoning espoused by the First Circuit in Cardillo, which appears to be the growing trend amongst the Circuits.[11]

Lastly, defendants assert, as grounds for summary judgment, that because plaintiffs have sustained no recoverable damages as a consequence of a violation of 18 U.S.C. §1005, they do not state a claim cognizable under 12 U.S.C. §503. In view of the Court's decision on the applicability of the

doctrine of collateral estoppel, it is not necessary to reach a determination on this prong of defendants' motion for summary judgment.

Since none of the remaining state claims have any characteristics that support litigation in a federal forum, the Court declines to exercise its discretion to retain jurisdiction. United Mineworkers v. Gibbs, 383 U.S. 715 (1966). The pendent state claims are therefore dismissed.

For the above reasons the defendants' motion for summary judgment is granted and the original complaint is dismissed.

Let the Clerk of the Court send copies of this Memorandum Opinion and the attached order to all counsel of record.

DATE: April 27, 1983

Richard L. Williams
UNITED STATES DISTRICT JUDGE

FOOTNOTES:

[1] 12 U.S.C. § 503 states in full:

> If the directors or officers of any member bank shall knowingly violate or permit any of its agents, officers, or directors of any member bank to violate any of the provisions of this section or regulations of the board made under authority thereof, or any of the provisions of sections 217, 218, 219, 220, 655, 1005, 1014, 1906, or 1909 of Title 18 United States Code, every officer participating in or assenting to such violation shall be held liable in his personal and individual capacity for all damages which the member bank, its shareholders, or any other persons shall have sustained in consequence of such violation.

[2] United States of America v. William Michael Lovern and Kenneth Glen Luke, Crim. No. 82-00023-R (E.D. Va. May 13, 1982) aff'd Crim. Nos. 82-5196, 82-5197 (4th Cir. March 3, 1983).

[3] Id.

[4] Id. at 2, and see id. Indictment and Judgment and Commitment Order.

[5] United States of America v. William Michael Lovern and Kenneth Glen Luke, Crim. Nos. 82-5196, 82-5197 (4th Cir. March 3, 1983) at 10.

[6] This case was originally assigned to and handled by Judge Merhige, who also presided over the criminal trial. Sensing a conflict, Judge Merhige transferred the civil case to this Court in January of 1983.

[7] See, e.g. Proffer of Testimony and Evidence at 5-8. Plaintiffs recount how the relationship with Sheehy got started, the manner in which they got the Sun Carpet loan in the amount of $31,000, and how the subsequent handling of the funds was out of their control. In particular, Luke and Lovern insist that they knew nothing of the Mastertrax loan, nor of Sheehy's plan to use the Sun Carpet loan to pay off a portion of the Mastertrax debt. This scenerio is identical to that presented to the jury in the criminal trial. The jury rejected this version of the facts.

[8] See 29 Am. Jur.2d Evidence §334 and 46 Am. Jur.2d Judgments §§614-620.

[9] See supra n. 2, the Judgment and Commitment Order.

[10] Id.

[11] See also, Von Lusch v. C & P Telephone Co., 457 F. Supp. 814 (D. Md. 1978), holding that state court criminal conviction which by definition involved litigation and adverse resolution of any allegation in defendant's subsequent civil rights action that there was a conspiracy to prosecute him in violation of his civil rights precluded him from raising the alleged constitutional deprivations in such civil rights suit; and see Securities and Exchange Commission v. Kelly, Andrews & Bradley, Inc., 385 F. Supp. 948 (S.D. N.Y. 1974).

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Plaintiffs,	)	
v.	)	Civil Action No. 82-0637-R
CENTRAL FIDELITY BANK, N.A., et al.,	)	
Defendants.	)	

ORDER

This matter is before the Court on defendants' Motion for Summary Judgment pursuant to Rule 56 (b), Federal Rules of Civil Procedure. For the reasons stated in the accompanying Memorandum Opinion, the motion is GRANTED and accordingly, the original complaint is DISMISSED WITH PREJUDICE.

Let the Clerk send a copy of this Order and the accompanying Memorandum Opinion to all counsel of record.

DATE: April 27, 1983

Richard L. Williams
UNITED STATES DISTRICT JUDGE