

The Legal Intelligencer

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Developer Cannot Sue in Federal Court to Challenge State Court Judgment

Alan Nochumson And R. July Simpson
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In *Flannery v. Mid Penn Bank*, the U.S. District Court for the Middle District of Pennsylvania rejected a judgment debtor's attempt to essentially challenge, in federal court, the validity of a state court judgment obtained against him related to a failed real estate development venture.

In 2004, four individuals formed a real estate development company to own commercial real estate in Harrisburg, Pa., according to the opinion. Each of the individuals had a 25 percent ownership interest in the company. The plaintiff in *Flannery* subsequently purchased the full interest of one of the original members and half of the interest of another member.

The company performing the construction work on the property was owned and operated by one of the members of the real estate development company, the opinion noted.

The following year, Mid Penn Bank extended a \$500,000 loan to a prospective tenant, according to the opinion. The bank extended the loan so the prospective tenant could pay the general contractor for the construction work being performed on the commercial property. The real estate development company, the plaintiff and his wife and the remaining two members of the real estate development company, among others, personally guaranteed the loan.

When the tenant eventually defaulted under the loan, the bank sought judgment by confession against the tenant, the plaintiff and his wife and the other members of the real estate development company, among others, the opinion noted.

Afterward, the bank not only agreed to release one of the other members of the real estate development company as a personal guarantor under the loan but to also assign its interest in all of the judgments obtained by the bank to that member. According to the plaintiff, the bank agreed to do so because the member had substantial business and personal investments with the bank.

Rather than attempt to strike or open the confessed judgment entered against him by the bank which was now in the possession of the member who had obtained that judgment from the bank, the plaintiff instead decided to sell his interest in the real estate development company to that member in order to satisfy the judgment levied against him, the opinion noted.

The plaintiff then filed a complaint in federal district court against the bank and some of its officers.

The complaint was fundamentally based upon the theory that the bank and its officers colluded with that member to defraud the plaintiff out of his interest in the real estate development company.

The defendant then filed a motion to dismiss the complaint, which was based primarily upon the grounds that the *Rooker-Feldman* doctrine barred all of the claims contained in the complaint, according to the opinion.

Under the *Rooker-Feldman* Doctrine, "federal district courts lack subject matter jurisdiction over challenges that are the functional equivalent of an appeal of a state court judgment ... even if those challenges allege that the state court's action was unconstitutional."

A claim is determined to be the "functional equivalent of an appeal" if that claim is either a claim that was actually litigated in state court or if the claim is "inextricably intertwined" with the state court adjudication.

According to the federal district court in *Flannery*, the promissory note signed by all the loan guarantors contained a confession of judgment clause, which "permits the creditor or its attorney simply to apply to the court for judgment against the debtor in default without requiring or permitting the debtor or guarantors to respond at that juncture."

As noted by the federal district court, after a confessed judgment is obtained, the defendant may petition the court to strike or open the judgment.

Because the plaintiff did not petition the state court to strike or open the confessed judgment obtained against him, the federal district court concluded that there was no adversarial proceeding in which the merits of any defenses were adjudicated and, therefore, the claims contained in the complaint were not actually litigated.

After determining that the claims contained in the complaint were not actually litigated in state court, the federal district court next addressed whether the claims were "inextricably intertwined" with the state court proceedings.

The federal district court reasoned that, if it had to decide that the state court was wrong, or if it had to act in a way that would make the state court's judgment ineffectual, then the claims contained in the complaint would be considered "inextricably intertwined."

The federal district court ultimately found its lack of jurisdiction over the claims contained in the complaint because "[f]or the court to find that [d]efendants procured the guaranty by fraud would necessarily imply that the state court erroneously entered the confession of judgment."

LESSONS LEARNED

The federal district court's ruling in *Flannery* illustrates why litigants must exhaust all of their legal and equitable rights and remedies in state court rather than perform the proverbial "end-run-around" in federal court.

In *Flannery*, the plaintiff could, and now knows should, have challenged the validity of the confessed judgment obtained against him in state court. Rather than doing so, he allowed his business partner, who had purchased the bank's interest in that judgment, to, in his mind, steal the real estate development company out from under him.

Noticeably absent from the federal court proceedings is the inclusion of the former business partner as a party defendant. The plaintiff likely did not sue him either because he already waived any claims he had or would have had against him when he agreed to sell his interest in the company to him in exchange for the satisfaction of the judgment by confession or the plaintiff knew that the applicability of the *Rooker-Feldman* Doctrine would only be strengthened if he included him as a party defendant. Either way, the federal district court, through its ruling, merely reinforces why the plaintiff should have litigated his claims against the former business partner, the bank, and others within the state court proceedings. •

Alan Nochumson is the sole shareholder of Nochumson P.C. where his primary practice areas consist of real estate, litigation, employment and labor and land use and zoning. He is also president of Bear Abstract Services where he offers comprehensive title insurance, title examination and closing services. He may be reached by telephone at 215-399-1346 or by e-mail at alan.nochumson@nochumson.com.

R. July Simpson, a second-year student at Drexel University's Earle Mack School of Law, is interning with the firm for the winter and spring quarters. She can be reached by telephone at 215-399-1346 or by e-mail at july.simpson@nochumson.com.