First Circuit

10.15.10

Perry v. Blum, 2010 U.S. App. Lexis 20222 (1st Cir. 10/1/2010)(Before Judges Thompson, Selya and Dyk, Opinion by Judge Selya). Following a foreclosure sale of large apartment complex in Boston, appellants sought an accounting of both the foreclosure proceeds and all rents collected. The Massachusetts District Court applied the doctrine of *judicial estoppel* to the amount due under the Notes, holding the litigants to the amount claimed in the debtor's bankruptcy case. District Court conducted a bench trial under Federal Question jurisdiction, due to the involvement of the FDIC. Appellants appealed to the First Circuit citing legal error, among other things. The First Circuit concluded the it was legal error for the District Court, under the doctrine of *judicial estoppel,* to limit the appellants' proof as to the amount owed on the Notes because the appellee had not proven the Bankruptcy Court's reliance on the representation as to the value of the Notes. The case was remanded for the District Court to take such further evidence as it deemed appropriate to fix the amount due and rework the accounting.

GARCIA v BANCO BILBAO VIZCAYA ARGENTARIA, 2010 Bankr. Lexis 3371 (Bankr. D.P.R. 9/27/10)(Brian K. Tester, Bankruptcy Judge). Court granted summary judgment to the defendant. Debtor filed a voluntary petition under Chapter 13 and then filed an adversary proceeding alleging that the defendant failed to redact the Debtor's personal and private data in violation of Sections 105(a) and 107(c) of the Bankruptcy Code. Defendant successfully moved for summary judgment asserting that these sections do not create private causes of action, and/or that the Plaintiff has failed to allege damages as a result of any violations committed by the Defendant.

Valentin v. Universidad Interamericana DE Puerto Rico et. al., 2010 Bankr. Lexis 2920 (Bankr. D.P.R. 9/10/10/)(Brian K. Tester, Bankruptcy Judge). Court granted the debtor's motion for summary judgment, in the Chapter 7 adversary proceeding, finding the defendant violated the automatic stay under Section 363(k) of the Bankruptcy Code, scheduling a trial for damages. Debtors alleged, and the defendant did not deny, that the defendant continued collection proceedings after having received notice of the imposition of the automatic stay. Defendant unsuccessfully contended that it should not be held liable for this stay violation because the collection notices were sent due to a clerical error, which the Bankruptcy Court rejected under First Circuit precedent, which precedent rejects the argument that a creditor is immune from liability for stay violations because of its own clerical errors.

Tools-4-Hire v. Wells Fargo Construction, 2010 Bankr. Lexis 3393 (Bankr. D. Mass. 10/5/10)(Frank J. Bailey, Bankruptcy Judge). Bankruptcy Court granted summary judgment to defendant/creditor. In an adversary proceeding, the reorganized Chapter 11 debtor sought to recover: (i) payments totaling $256,580.71 that it made to the defendant during its chapter 11 case and prior to confirmation of its chapter 11 plan as "adequate protection" payments; and (ii) an additional $87,130.00 that the defendant received upon liquidation of collateral that, by the terms of its confirmed plan, the debtor was required to and did turnover to the defendant. Debtor argued that it was entitled to return of the adequate protection payments because defendants's collateral suffered no diminution in value during the case; and, debtor further argued that it was entitled to return of both amounts because these sums together represented the amount by which the total proceeds of defendant's collateral exceeded the value of the collateral at the commencement of this case. In response, creditor argued, *inter alia,* that these claims are precluded by the confirmed plan. On the basis of *res judicata,* the Court held that the debtor's claims were precluded by the order confirming the plan of reorganization, which of necessity determined what the defendant was entitled to receive for the value of its secured claim as of the date of confirmation.

Smith v. Merrill Lynch, 2010 BNH 29; 2010 Bankr. Lexis 3146 (Bankr. D.N.H. 9/21/10)(Mark W. Vaughn, Chief Bankruptcy Judge). Chapter 7 Trustee sought to set aside certain payments made by the debtor to defendant, his employer, on the grounds that they constituted preferential transfers to an insider pursuant to Section 544(b) of the Bankruptcy Code. The employer had been deducting sums from the debtor's pay checks to repay amounts due under a note for a loan the employer made to him. The employer filed a motion to dismiss. The Court could not reasonably infer from the pleadings, that either

the Defendant or Debtor had a conflict of interest when entering into the Note that would have made it a non-arm's length transaction. Consequently, the Court granted the Defendant's motion to dismiss the complaint concerning payments that occurred more than ninety days prior to the filing of the Debtor's petition.

In re Riley, Chapter 7 debtor, 2010 Bankr. Lexis 3154 (Bankr. D. Mass. 9/14/10)(Joan N. Feeney, Bankruptcy Judge). Bankruptcy Court denied creditor's motion to dismiss the debtor's Chapter 7 case under Code Section 707(b). Debtor was an art teacher with two children who lived with her parents and paid them rent. Creditor was debtor's former divorce attorney. Debtor's income was inconsistent, and based on the totality of the circumstances the debtor's need for Chapter 7 relief far outweighed the evidence that she might be able to provide a dividend to her unsecured creditors through a Chapter 13 plan based upon a hypothetical salary increase. Court held that the amount of rent she paid her parents was credible, and the Court was unable to conclude the debtor's child care expenses could have been significantly reduced. Although debtor made mistakes in her schedules and statement of financial affairs, the debtor' explanations for the errors and her subsequent amendments were reasonable and credible.

Fitzgerald v. Gorman, 2010 Bankr. Lexis 3249 (Bankr. D. Mass. 9/15/10)(Frank J. Bailey, Bankruptcy Judge). Plaintiff United States Trustee filed a complaint against the Chapter 7 debtor objecting to his discharge, which the Bankruptcy Court upheld finding fraudulent intent on the part of the debtor. At trial, UST showed that the debtor failed to disclose property of the estate and made false oaths on his schedules and statement of financial affairs (SOFA). The principal issue was whether he made the omissions and false statements with *fraudulent intent.* The Court found the debtor to be financially sophisticated, well educated and experienced in business and finance. The failure to disclose was material. Although the Debtor asserted that he decided not to disclose these interests because he felt they did not have any economic value and therefore nothing could be gained by disclosing their existence, the Court rejected this position. First, the Schedules and SOFA do not limit themselves to the disclosure of entities that have economic value. Nor should they, because those that are relying on disclosure in the schedules and SOFA should have the ability to decide for themselves what value there is in the estate. Second, this argument has been rejected by courts in this district. Valuation is not really the point, as matters are material if pertinent to the discovery of assets, including the history of a bankrupt's financial transactions. It follows that the Debtor's failure to disclose his business interests and bank accounts was material even if they had little current value. Debtor was found to be omitting information to protect his and his sister's interests in the omitted assets. Finally, the debtor's assertions that he was "distracted" by the bankruptcy proceedings or his parent's illnesses excused nothing.

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In re TOOLS-4-HIRE, INC. et al., Debtors; TOOLS-4-HIRE, INC., Plaintiff v. WELLS FARGO CONSTRUCTION, A DIVISION OF WELLS FARGO EQUIPMENT FINANCE, INC., Defendant

Chapter 11, Case No. 06-14004-FJB, Adversary Proceeding No. 07-1455

UNITED STATES **BANKRUPTCY** COURT FOR THE DISTRICT OF MASSACHUSETTS, EASTERN DIVISION

2010 Bankr. LEXIS 3393

October 5, 2010, Decided
October 5, 2010, Filed, Entered

CASE SUMMARY

PROCEDURAL POSTURE: Plaintiff reorganized debtor sought to recover (i) payments totaling $256,580 it made to defendant creditor during its chapter 11 case and prior to confirmation of its plan as "adequate protection," and (ii) an additional $87,130 the creditor received upon liquidation of collateral that, by the terms of its confirmed plan, debtor turned over to the creditor. The creditor counterclaimed. Pending were Fed. R. Civ. P. 56 cross motions.

OVERVIEW: Both of debtor's demands were predicated on its allegation that certain equipment had a value as of the commencement of the **bankruptcy** case of only $1,520,000. The creditor's answer asserted res judicata. With its answer, the creditor also asserted a counterclaim for breach of contract (the "contract" being the confirmed plan) and recovery of rents earned by debtor on the creditor's equipment after confirmation. Debtor's motion for summary judgment failed because, even if debtor's theory were valid, debtor could not prevail on it without establishing the value of the creditor's collateral of the date of the **bankruptcy** filing. Debtor submitted no evidence of value at all. Turning to the creditor's motion for summary judgment on the complaint, the court stated that the claims now being advanced were identical to those that were resolved by the Confirmation Order, which now precluded the relitigation of those issues. The Confirmation Order of necessity determined what the creditor was entitled to receive for the value of its secured claim as of the date of confirmation. As for the creditor's motion for summary judgment on its counterclaim, the creditor failed to brief its own motion.

OUTCOME: The court granted the creditor's motion for summary judgment as to debtor's complaint, denied the same motion as to the creditor's counterclaim, and denied debtor's motion for summary judgment.

CORE TERMS: confirmation, collateral, secured claim, summary judgment, collateral order, confirmed, rents, lender's, counterclaim, rental, security interest, adversary proceeding, commencement, diminution, bankruptcy case, entitled to receive, bankruptcy filing, turnover, genuine, net proceeds, liquidation, totaling, judicata, prevail, stream, res, plan of reorganization, claim preclusion, burden of proof, cause of action

LEXISNEXIS® HEADNOTES

Hide

Civil Procedure > Summary Judgment > Standards > General Overview

Civil Procedure > Summary Judgment > Standards > Genuine Disputes

Civil Procedure > Summary Judgment > Standards > Legal Entitlement

HN1 A party is entitled to summary judgment only upon a showing that there is no genuine issue of material fact and that, on the uncontroverted facts, the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). More Like This Headnote

Civil Procedure > Summary Judgment > Burdens of Production & Proof > Movants

Civil Procedure > Summary Judgment > Burdens of Production & Proof > Nonmovants

Civil Procedure > Summary Judgment > Supporting Materials > General Overview

HN2 On summary judgment, where the burden of proof at trial would fall on the party seeking summary judgment, that party must support its motion with evidence--in the form of affidavits, admissions, depositions, answers to interrogatories, and the like--as to each essential element of its cause of action. The evidence must be such as would permit the movant at trial to withstand a motion for directed verdict under Fed. R. Civ. P. 50(a). If the motion is properly supported, the burden shifts to the adverse party to submit evidence demonstrating the existence of a genuine issue as to at least one material fact. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party. Fed. R. Civ. P. 56(e). More Like This Headnote

Civil Procedure > Federal & State Interrelationships > General Overview

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Res Judicata

HN3 In **bankruptcy** court, where the order for which a party seeks preclusive effect is an order of a federal court, federal preclusion principles apply. The essential elements of claim preclusion are: (1) a final judgment on the merits in an earlier action; (2) an identity of parties or privies in the two suits; and (3) an identity of the cause of action in both suits. Once these elements are established, claim preclusion bars the relitigation of any issue that was, or might have been, raised in respect to the subject matter of the prior litigation. More Like This Headnote

Bankruptcy Law > Reorganizations > Plans > Confirmation > Prerequisites > General Overview

HN4 In order to achieve confirmation of a chapter 11 plan of reorganization, a debtor or other plan proponent must propose a treatment for each secured claim against the assets of the **bankruptcy** estate; and, where a secured creditor objects, the proposed treatment must comport with the requirements of 11 U.S.C.S. § 1129(b).

11 U.S.C.S. § 1129(b)(1), (2) specify requirements for confirmation over objection of an impaired class of secured claims that has not accepted the plan. More Like This Headnote

Bankruptcy Law > Claims > Types > Secured Claims & Liens > Determinations

Bankruptcy Law > Reorganizations > Plans > Confirmation > General Overview

HN5 In the context of chapter 11 **bankruptcy,** the date of valuation of a secured claim for confirmation purposes is the date of confirmation, not the date of **bankruptcy** filing. More Like This Headnote

COUNSEL: **[*1]** For Tools 4 Hire, Plaintiff: Jennifer V. Doran, LEAD ATTORNEY, Hinckley, Allen & Snyder LLP, Boston, MA.

For Wells Fargo, Defendant: Diane N. Rallis, Holland & Knight, LLP, Boston, MA; John J. Monaghan, LEAD ATTORNEY, Holland & Knight, Boston, MA.

For Tools 4 Hire, Counter-Defendant: Jennifer V. Doran, Hinckley, Allen & Snyder LLP, Boston, MA.

JUDGES: Frank J. Bailey, United States **Bankruptcy** Judge.

OPINION BY: Frank J. Bailey

OPINION

MEMORANDUM OF DECISION AND ORDER ON CROSS MOTIONS FOR SUMMARY JUDGMENT

By its complaint in this adversary proceeding, the reorganized debtor, Tools-4-Hire, Inc. ("Tools"),[1] seeks to recover two things: (i) payments totaling $256,580.71 that it made to the defendant, Wells Fargo Construction, a division of Wells Fargo Equipment Finance, Inc. ("Wells Fargo"), during its chapter 11 case and prior to confirmation of its chapter 11 plan as "adequate protection" payments; and (ii) an additional $87,130.00 that Wells Fargo received upon liquidation of collateral that, by the terms of its confirmed plan, Tools was required to and did turnover to Wells Fargo. Tools argues that it is entitled to return of the adequate protection payments because Wells Fargo's collateral suffered no diminution in **[*2]** value during the case; and Tools further argues that it is entitled to return of both amounts because these sums together represent the amount by which the total proceeds of Wells Fargo's collateral exceed the value of Wells Fargo's collateral at the commencement of this case. In response, Wells Fargo argues (among other things) that these claims are precluded by the confirmed plan. The adversary proceeding is before the court on cross motions for summary judgment. On the basis of res judicata, as explained below, the court holds that Tools' claims are precluded by the order confirming the plan of reorganization, which of necessity determined what Wells Fargo was entitled to receive for the value of its secured claim as of the date of confirmation.

FOOTNOTES

[1] At the time of its **bankruptcy** filing, the debtor plaintiff was known as Tools-4-Hire, Inc. After confirmation of its plan of reorganization, the same entity, now the reorganized debtor, changed its name to Equipment-4-Rent, Inc. After the name change, and for reasons unknown to the court, the same entity nonetheless commenced this adversary proceeding under the name Tools-4-Hire, Inc. For simplicity, the Court refers to the plaintiff throughout **[*3]** as simply "Tools."

Facts and Procedural History

The facts and procedural history are largely intertwined and accordingly will be stated here together. Except where noted, the facts are uncontroverted.

On November 1, 2006 (the "Petition Date"), Tools filed a voluntary petition for relief under Chapter 11 of the **Bankruptcy** Code, thereby commencing the present **bankruptcy** case. Prior to its **bankruptcy** filing, Tools was in the business of leasing construction machinery and equipment to its contractor and subcontractor customers. Prior to the Petition Date, Wells Fargo's predecessor in interest, CIT Group/Equipment Financing, Inc. ("CIT"), had financed Tools' acquisition of approximately thirty pieces of construction equipment (the "Wells Fargo Equipment"). Wells Fargo is the successor in interest to CIT. (CIT shall throughout be referred to as Wells Fargo.) As of the Petition Date, Wells Fargo held a properly perfected security interest in the Wells Fargo Equipment then in the possession of Tools (the "Equipment"), which excluded certain pieces of equipment sold prepetition. In addition, Wells Fargo held a properly perfected security interest in all accounts, contract rights, chattel paper, **[*4]** documents, general intangibles and instruments arising from the sale, lease, or rental of the Equipment, and all proceeds thereof (with the Equipment, the "Wells Fargo Collateral").

Prior to the Petition Date, and as a result of financial mismanagement issues that had by then arisen, Tools and its financial advisors implemented an "interim vendor program" ("IVP") through which Tools agreed to pay each equipment lender a portion of the proceeds received by Tools from the rental of such lender's collateral to third-parties during any given month. Wells Fargo received payments from Tools under the IVP, which payments represented a portion of the net rental stream earned by Tools from its leasing of the Wells Fargo Equipment to third parties.

Shortly after the filing, on November 6, 2006, Tools filed a motion for an order authorizing the interim use of cash collateral and granting replacement liens (the "Cash Collateral Motion"). Through the Cash Collateral Motion, Tools sought authority to use cash collateral, including the rents generated by the Equipment, for general operating expenses in accordance with an operating budget. On November 8, 2006, the Court entered an order granting such **[*5]** authority (the "Cash Collateral Order"). Through various extensions and amendments, the Cash Collateral Order remained in effect through the effective date of the confirmed plan. As adequate protection of the secured positions held by the numerous equipment lenders, the Cash Collateral Order granted the "Equipment Lenders," which included Wells Fargo, "[a] continuing post-petition replacement lien and security interest ("Replacement Lien") in the equipment and rental contracts in which they held validly

perfected liens and security interests as of the Petition Date." The Cash Collateral Order also provided as follows:
As set forth in the Cash Collateral Budget, the Debtors[2] shall make monthly adequate protection payments to the Equipment Lenders . . . as to the specific equipment acquired pursuant to the Equipment Notes as defined in the Motion (the "Adequate Protection Payments"). These payments shall be a continuation of the Vendor Payment Plan [the IVP] that had been instituted by the Debtors pre-petition.

This provision obligated Tools "to make monthly adequate protection payments to the Equipment Lenders," including Wells Fargo, according to amounts specified in a budget. Prior **[*6]** to confirmation of Tools' chapter 11 plan and pursuant to this provision of the Cash Collateral Order, Wells Fargo received payments from Tools totaling $256,580.71 ("Payments"). The Payments represented a portion of the net rental stream earned by Tools from its leasing of the Equipment to third parties.

FOOTNOTES

[2] When Tools filed its **bankruptcy** petition, two affiliated entities also filed petitions, and their three cases were jointly administered. References to "Debtors" are to Tools and the two affiliated debtors.

Tools contends that the Cash Collateral Order establishes that "[t]he Payments were intended to provide adequate protection to equipment lenders to mitigate any potential diminution in the value of the equipment pursuant to the **Bankruptcy** Code." Although this inference may be drawn from the Cash Collateral Order, it is not the only possible inference.[3] It is also possible to infer that the Payments were intended at least in part as adequate protection to mitigate any potential diminution in the value of the Equipment Lenders' interests in the rents. This was a cash collateral order, issued on a motion for authority to use cash collateral, and the usual, if not exclusive, purpose **[*7]** of adequate protection in that context is to guard against diminution in the secured creditor's collateral value due to the debtor's use of *cash* collateral, in this instance the rents.

FOOTNOTES

[3] This dispute over the inference to be drawn from the Cash Collateral Order as to its purpose is an issue of fact, but one that, in the final analysis, the Court concludes is not material to disposition of the motions before the court.

During the chapter 11 case and prior to confirmation of Tools' chapter 11 plan, Tools sold four pieces of the Equipment and remitted the net sale proceeds of $236,900.00 to Wells Fargo.

Tools filed its *First Modified Second Amended Plan of Reorganization* (hereinafter the "Plan") on or about September 24, 2007. In the Plan, Tools proposed a common treatment for each

of the equipment lenders that the Plan had classified as Classes 2 through 13. In essence, the Plan provided for the equipment lenders' secured claims to be satisfied through either (i) a payment stream which would be paid over four years, (ii) the surrender of the property subject to a lien that Tools deemed unnecessary for use in its future operations ("Excess Collateral"), or (iii) a combination of the two. **[*8]** Wells Fargo's claim was classified as the Class 2 Claim. At the time the Plan was proposed, Tools was in possession of twenty-one pieces of Equipment. In full satisfaction of Wells Fargo's secured claim, Tools originally stated the intention of retaining eighteen pieces of the Equipment ("Retained Equipment") and surrendering three pieces of Equipment deemed "Excess Collateral." Tools valued that "Retained Equipment" at $1,152,000.00 and proposed to issue Wells Fargo a promissory note that would provide for payment of that amount over a period of four years, with interest. Wells Fargo voted to reject the Plan and objected to confirmation on numerous grounds. In resolution of Wells Fargo's objection, Tools modified the Plan to render Wells Fargo unimpaired. It did this by agreeing to classify all Wells Fargo Equipment as Excess Collateral; the Plan already provided that Excess Collateral would be surrendered to the Equipment Lender whose collateral it constituted.

On September 25, 2007, the Court confirmed Tools' First Modified Second Amended Plan of Reorganization. Upon entry of the Confirmation Order, the terms of the Plan became binding on Tools and its successors. October 9, 2007 **[*9]** was the effective date of the Plan (the "Effective Date").

In Paragraph 29 of the Confirmation Order—which paragraph is in the section of the order setting forth the rulings of law in support of confirmation—the Confirmation Order provides as follows:
Based upon the evidence proffered, adduced, or presented by the Proponent at the Confirmation Hearing, the Plan (i) is fair and equitable with respect to the impaired nonaccepting Classes because, as set forth on the record of the Confirmation Hearing, WFC [Wells Fargo], the holder of the Class 2 - CIT Allowed Secured Claim, and the Debtor agreed that WFC shall receive all of its Collateral from the Debtor. Accordingly, Class 2 - CIT Allowed Secured Claim shall be satisfied in full and shall be deemed unimpaired; provided, that the Debtor shall make all such Collateral available for retrieval by WFC, or its agent, as provided for in Section 4.2(c)(i) of the Plan.

The defined term "Collateral" is found in Article 1.24 of the Plan, which states that "'Collateral' shall mean any property or interest in property of the Estates subject to a Lien to secure the payment or performance of a Claim, which Lien is not subject to avoidance under the **[*10]** **Bankruptcy** Code or otherwise invalid under the **Bankruptcy** Code or applicable law." Furthermore, Article 1.63 of the Plan incorporates by reference the definition of lien found in §101(37) of the **Bankruptcy** Code, which provides that "lien means charge against or interest in property to secure payment of a debt or performance of an obligation."

The plaintiff, Tools, is the Reorganized Debtor for purposes of the Plan. With regard to the Equipment, under the Plan, Wells Fargo held the option of either permitting Tools to sell the Equipment in exchange for a fee equal to fifteen percent (15%) of the net proceeds of such sale or removing and disposing of the Equipment without Tools' assistance. Wells Fargo elected to remove the Equipment. Ultimately, upon motion of Wells Fargo, on November 1, 2007 the **Bankruptcy** Court entered an order mandating that Tools permit Wells Fargo to retrieve as much of the Equipment as was on Tools' premises by November 9, 2007, with the balance to be made available "promptly and on a reasonably expedited schedule." Wells Fargo retrieved the majority of the Equipment from Tools' premises on or

about November 9, 2007. From the Effective Date through November 9, **[*11]** 2007, Tools realized rental income from the lease of at least fifteen pieces of Wells Fargo's Excess Collateral in the total amount of $17,650 ("Post-Confirmation Rents"). Tools has not remitted the Post-Confirmation Rents to Wells Fargo.

As reported to the Court on November 30, 2007, Wells Fargo sold fifteen (15) pieces of the Equipment at an auction, generating net proceeds of $779,068. The remaining six pieces of Equipment were returned to their manufacturer, Pettibone/Traverse Lift, LLC ("Pettibone"), generating proceeds of $484,411.63 for such transfer (exclusive of reimbursement for attorneys' fees). In total, Wells Fargo received net funds totaling $1,500,379.63[4] from disposition of the Wells Fargo Equipment during the case—$236,900.00 from the preconfirmation sale of equipment, $779,068 from the postconfirmation sale of equipment, and $484,411.63 for equipment returned to Pettibone—and an additional $256,580.71 under the Cash Collateral Order, for a total of $1,756,961 ("Net Proceeds").[5]

FOOTNOTES

[4] In the statement of agreed facts that they incorporated into their pretrial memorandum, the parties agree that the sum is $1,500,380.30, but this amount is not the sum of three component amounts, **[*12]** which they also agree upon. The Court will use the sum of the components; the 67 cent discrepancy is de minimis.

[5] This total was not received all at once but over time. No one has submitted evidence of the present value, as of the date of the commencement of the **bankruptcy** case, of the stream of payments that yield this total. In our still inflationary economy, the amount is manifestly less than the simple total received. The Court cannot determine how much less.

Tools asks the Court to determine that it is uncontroverted that, "as of the Petition Date, Tools valued the Wells Fargo Equipment in its possession at $1,520,000." As authority for this proposition, it cites paragraph 24 of the Agreed Facts section of their joint pretrial memorandum, but the paragraph in question does not support this determination (and in fact is entirely unrelated). More importantly, Tools has adduced no evidence or admission of any kind to establish the value of the Equipment as of the commencement of the case.

On or about January 3, 2008, Wells Fargo filed an amended proof of claim, asserting an unsecured deficiency claim of $388,197.29, which sum represents the $2,145,158.38 total debt owed to Wells Fargo **[*13]** as of the Petition Date less the Net Proceeds. The time within which to object to that claim has expired, no objection was filed, and therefore, that claim is an allowed claim.

After confirmation of the Plan, Tools filed the complaint commencing this adversary proceeding. By the complaint, Tools seeks to recover from Wells Fargo both (i) the

payments totaling $256,580.71 that it made to Wells Fargo during the chapter 11 case as "adequate protection" payments and (ii) $87,130.00 of the proceeds Wells Fargo received from liquidation of the Equipment that Tools turned over to Wells Fargo pursuant to the confirmed plan. Both demands are predicated on Tools' allegation that the Equipment had a value as of the commencement of the **bankruptcy** case of only $1,520,000. Wells Fargo filed an answer in which it asserts, among other defenses, the affirmative defense of res judicata. With its answer, Wells Fargo also asserts a counterclaim for breach of contract (the "contract" being the confirmed plan) and recovery of rents earned by Tools on Wells Fargo's Equipment after confirmation.

The adversary proceeding is before the Court on Well's Fargo's motion for summary judgment and on Tools' cross-motion **[*14]** for summary judgment. In support of its motion, Wells Fargo relies principally on the argument that the relief sought in the complaint is barred by the doctrine of res judicata: that the matter has been decided preclusively by the Confirmation Order and the plan it confirms. In the alternative, Wells Fargo argues that Tools cannot prevail because the payments in question were made with Wells Fargo's rents, which were themselves collateral, and therefore Wells Fargo cannot have received more than the value of its collateral; rather, everything it has received—the payments (made from rents that were part of Wells Fargo's collateral), the turned-over Equipment, and the proceeds of liquidated Equipment—has been its collateral. Wells Fargo also seeks summary judgment as to its counterclaim.

Standard of Proof on Summary Judgment

HN1 A party is entitled to summary judgment only upon a showing that there is no genuine issue of material fact and that, on the uncontroverted facts, the movant is entitled to judgment as a matter of law. FED. R. CIV. P. 56(c). HN2 Where the burden of proof at trial would fall on the party seeking summary judgment, that party must support its motion with evidence—in the form **[*15]** of affidavits, admissions, depositions, answers to interrogatories, and the like—as to each essential element of its cause of action. The evidence must be such as would permit the movant at trial to withstand a motion for directed verdict under FED. R. CIV. P. 50(a). *Anderson v Liberty Lobby, Inc.*, 477 U.S. 242, 250, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). If the motion is properly supported, the burden shifts to the adverse party to submit evidence demonstrating the existence of a genuine issue as to at least one material fact. If the adverse party does not so respond, "summary judgment, if appropriate, shall be entered against the adverse party." FED. R. CIV. P. 56(e); *Jaroma v. Massey*, 873 F.2d 17, 20 (1st Cir. 1989).

Tools' Motion for Summary Judgment

Under Tools' theory of the case, Wells Fargo must return all value that it received over and above the value that the collateral had at the commencement of the **bankruptcy** case, a value that Tools fixes at $1,520,000. I need not belabor the details of Tools' argument or pass on its merits. It is sufficient to note that, even if Tools' theory were valid, Tools could not prevail on it without establishing that the value of Wells Fargo's collateral as of the date of the **[*16] bankruptcy** filing. Insofar as Tools seeks to recover from Wells Fargo value that was paid and turned over to Wells Fargo pursuant to the confirmed plan and the Cash Collateral Order, Tools bears the burden of proof as to value, but Tools has submitted no evidence of value at all. Having failed to adduce evidence as to this necessary element of its case, Tools cannot prevail on its own motion for summary judgment.

Wells Fargo's Motion for Summary Judgment as to the Complaint

Though Wells Fargo is the defendant and does not bear the burden of proof as to Tools' cause of action, it seeks summary judgment on the basis of an affirmative defense, the doctrine of res judicata, also known as claim preclusion, and therefore bears the burden of adducing evidence in support of that defense. Accordingly, to prevail on its motion, Wells Fargo must adduce evidence of the earlier final order, the Confirmation Order, and of the plan it confirmed to establish that the order in question is preclusive as to Tools' claims in this adversary proceeding. The agreed evidentiary record includes the Confirmation Order and everything needed to determine that it entered and what it adjudicated.

As HN3 the order for **[*17]** which Wells Fargo seeks preclusive effect is an order of a federal court, federal preclusion principles apply. *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 978 (1st Cir. 1995). "The essential elements of claim preclusion are: (1) a final judgment on the merits in an earlier action; (2) an identity of parties or privies in the two suits; and (3) an identity of the cause of action in both suits." *Grella v. Salem Five Cent Savings Bank*, 42 F.3d 26, 30 (1st Cir. 1994). Once these elements are established, claim preclusion "bars the relitigation of any issue that was, or *might have been,* raised in respect to the subject matter of the prior litigation." *Id.*

Here there is no genuine issue of material fact as to the finality of the earlier action: the Confirmation Order is final, binding, and not subject to appeal. Nor is it controverted that the parties to the present proceeding, Wells Fargo and the Debtor, were parties as well to the plan confirmation proceeding and especially to the dispute in that proceeding over the proposed treatment of Wells Fargo's secured claim. These matters are not subject to dispute. At most, there may be a dispute[6] as to the identity between the matters **[*18]** decided in the confirmation proceeding and the claims being advanced here, but there are no genuine issues as to the facts material to the question of identity, and the parties do not contend otherwise. The dispute over the question of identity is entirely one of law.

FOOTNOTES

[6] It is not clear whether there is a dispute as to identity because Tools does not address this issue directly; however, Tools clearly contemplates that the Confirmation Order, whose finality and validity Tools does not dispute, somehow leaves open the possibility of the claims Tools now asserts.

Were the claims that Tools now advances among those that were or might have been adjudicated by the Confirmation Order? The Court must answer that question as to each of the two claims that Tools is now advancing. The first is that Wells Fargo must return the adequate protection payments because those payments were made only to guard against diminution in the value of Wells Fargo's collateral during the case, but, Tools contends, that collateral suffered no diminution in value during the case. The second is that Wells Fargo should be required to remit to Tools both the adequate protection payments and an additional $87,130.00 in **[*19]** proceeds from the liquidation of its collateral, because these together resulted in Wells Fargo's receiving more than the amount that Wells Fargo should have received on account of its secured claim, which amount Tools contends should be the value of Wells Fargo's collateral as of the commencement of the **bankruptcy** case.

Both issues were among those that were decided by the Confirmation Order. HN4 In order to achieve confirmation of a chapter 11 plan of reorganization, a debtor or other plan proponent must propose a treatment for each secured claim against the assets of the **bankruptcy** estate; and, where a secured creditor objects, the proposed treatment must comport with the requirements of § 1129(b) of the **Bankruptcy** Code. See 11 U.S.C. § 1129(b)(1) and (2) (specifying requirements for confirmation over objection of an impaired class of secured claims that has not accepted the plan). By virtue of its security interest, Wells Fargo had a security interest in assets of the estate. Wells Fargo therefore had a secured claim, see 11 U.S.C. § 506(a), and Tools did indeed propose a treatment of that claim. Wells Fargo objected to that treatment, the matter was resolved by agreement, and the agreement **[*20]** was incorporated into the Confirmation Order. By the time the Confirmation Order entered, the Cash Collateral Order had long been entered, and the Debtor had made the now-disputed payments to Wells Fargo pursuant to that order. The adequate protection payments, by their nature, were payments on Wells Fargo's secured claim.[7] The Plan and Confirmation Order were required to and did determine what Wells Fargo was entitled to recover on account of its secured claim as of the date of confirmation. *In re Blake*, 2009 Bankr. LEXIS 3845, 2009 WL 4349787 (Bankr. D. Mass. 2009) (HN5 date of valuation of secured claim for confirmation purposes is date of confirmation, not date of **bankruptcy** filing). That is, insofar as the adequate protection payments may have been relevant to what Wells Fargo was entitled to receive for its secured claim, the Plan's treatment of the secured claim needed to take account of any payments that had been made on that claim as of the date of confirmation. The confirmed plan determined that Wells Fargo's secured claim would be satisfied by turnover of its collateral, a term that both parties agree included at least the equipment (if not also the rents). The Plan as confirmed did not also set a **[*21]** limit on the value of the equipment to be turned over; it did not say, for example, that Tools shall turnover all the equipment *up to but no more than the value of the equipment as of the petition date*. Nor did is specify that, in view of the adequate protection payments that had already been made and credited toward Wells Fargo's secured claim, Tools was entitled to a credit or limitation on the value of the equipment that was to be turned over pursuant to the confirmed plan. If Tools believed itself entitled to a limit on value, or to a credit on account of the adequate protection payments, the time to litigate those issues was during the confirmation proceedings. In short, Tools is now arguing in both counts that Wells Fargo is entitled to less on account of its secured claim than, pursuant to the confirmed plan, Tools, pursuant to the Court's incorporation of Tools' own proposal into the Confirmation Order, was required to and did turnover to Wells Fargo. The issues that Tools now raises are bound up in the question of what Wells Fargo was entitled to receive on account of its secured claim. The claims now being advanced are therefore identical to those that were resolved by the **[*22]** Confirmation Order, which now precludes the relitigation of those issues.

FOOTNOTES

[7] Tools recognizes this when it argues that the adequate protection payments, in combination with the proceeds from the liquidation of Wells Fargo's equipment, resulted in Wells Fargo's receiving more for its secured claim than it was entitled to receive.

Wells Fargo's Motion for Summary Judgment as to its Counterclaim

This leaves only Wells Fargo's Motion for Summary Judgment as to its counterclaim. The counterclaim states three counts. In the first, Wells Fargo seeks damages for breach of the confirmation order by Tools' failure to permit Wells Fargo to retrieve its Equipment immediately after confirmation, for which Wells Fargo argues that it is entitled to damages in the amount (i) the attorneys fees expended to the attorneys fees and costs expended in obtaining prosecuting a motion to compel compliance and (ii) the rental proceeds earned with the detained equipment during the period of improper detention. The second count is one for unjust enrichment, by which it seeks recovery of the rents earned during this period of improper detention. The third count seeks an accounting of the rents generated from Tools' **[*23]** use of Wells Fargo's Equipment after the effective date of the plan.

Wells Fargo seeks summary judgment as to the counterclaim, but in support of this portion of its motion, Wells Fargo makes no reference to any one of these counts; nor does it discuss their requirements or explain how they are satisfied. Neither the court nor the opposing party is required to guess at the contours of a movant's arguments. Where Wells Fargo has failed to brief its own motion, the motion must be denied as to the counterclaim. The Court will reinstate the pretrial order and set the counterclaim for trial.

ORDER

For the reasons set forth above, the Court hereby grants the motion of Wells Fargo for summary judgment as to the Debtor's complaint, denies the same motion as to Wells Fargo's counterclaim, and denies the Debtor's motion for summary judgment.

Date: October 5, 2010

/s/ Frank J Bailey

Frank J. Bailey

United States **Bankruptcy** Judge

In re: Robert A. Lee, Debtor; Timothy P. Smith, Chapter 7 Trustee, Plaintiff v. Merrill Lynch, Pierce, Fenner & Smith Incorporated, Defendant

Bk. No. 08-11243-MWV, Chapter 7, Adv. No. 10-1049-MWV

UNITED STATES **BANKRUPTCY** COURT FOR THE DISTRICT OF NEW HAMPSHIRE

2010 BNH 29; 2010 Bankr. LEXIS 3146

September 21, 2010, Decided
September 21, 2010, Filed

CASE SUMMARY

PROCEDURAL POSTURE: Plaintiff Chapter 7 Trustee sought to set aside certain payments made by the debtor to defendant, his employer, on the grounds that they constituted preferential transfers to an insider pursuant to 11 U.S.C.S. § 547(b). The employer filed a motion to dismiss.

OVERVIEW: The debtor executed a promissory note payable to his employer which provided that the employer would deduct $5,450 from the debtor's monthly paycheck to be

applied as up-front repayments of the amounts owed on the note. The debtor later filed for Chapter 7 **bankruptcy** protection. Within 90 days and one-year prior to the petition date (the preference period), the employer made transfers from the debtor's paychecks. The Trustee instituted an adversary proceeding to avoid the payments made within 90 days of the filing of the **bankruptcy** petition on the grounds that the payments constituted preferential transfers. The Trustee also alleged that the payments made after 90 days but within one year preceding the filing of the **bankruptcy** petition were recoverable as preferences because the employer was an insider of the debtor. The only element of the preference claim in dispute was whether the employer was an insider. The court stated that it could not plausibly find that the transaction was less than arm's length. Consequently, the court granted the employer's motion to dismiss the complaint concerning payments that occurred more than 90 days prior to the filing of the debtor's petition.

OUTCOME: The court granted the employer's motion to dismiss the complaint concerning payments that occurred more than 90 days prior to the filing of the debtor's petition. In addition, the court instructed that the Trustee could amend his complaint.

CORE TERMS: insider, factual allegations, non-statutory, amend, paycheck, preferential transfers, adversary proceeding, general partner, arm's length, leave to amend, transferee, insolvent, closeness, bankruptcy petition, reasonable inferences, legislative history, responsive pleading, arm's, promissory note, amounts owed, repayments, preceding, plausibly, up-front, monthly, deduct

LEXISNEXIS® HEADNOTES

Hide

Bankruptcy Law > Practice & Proceedings > Adversary Proceedings > Defenses, Motions for Judgment & Objections

Civil Procedure > Pleading & Practice > Defenses, Demurrers & Objections > Failures to State Claims

HN1 Under Fed. R. Civ. P. 12(b)(6), made applicable to adversary proceedings in **bankruptcy** by Fed. R. Bankr. P. 7012(b), a party may move to dismiss a claim for failure to state a claim upon which relief can be granted. In ruling on a Rule 12(b)(6) motion to dismiss, courts must accept as true the well-pleaded factual allegations of the complaint and draw all reasonable inferences therefrom in the plaintiff's favor. While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligations to provide the grounds of his entitlement to relief require more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do. More Like This Headnote

Civil Procedure > Pleading & Practice > Defenses, Demurrers & Objections > Failures to State Claims

HN2 Although legal conclusions can provide the framework of a complaint, they must be supported by factual allegations. To survive a Fed. R. Civ. P. 12(b)(6) motion to dismiss, factual allegations in the complaint must be enough to raise a right to relief above the speculative level and cross the line between possibility and plausibility of entitlement to relief. Determining whether a complaint states a plausible claim for relief will be a context-specific task that requires the court to draw on its judicial experience and common sense. The focus of a Rule 12(b)(6) inquiry is not whether a

plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims. More Like This Headnote

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Preferential Transfers > Elements > General Overview

HN3 See 11 U.S.C.S. § 547(b).

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Preferential Transfers > Elements > Debtor Insolvency

HN4 See 11 U.S.C.S. § 101(31)(A).

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Preferential Transfers > Elements > Debtor Insolvency

HN5 An insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor. Persons enumerated in 11 U.S.C.S. § 101(31)(A) are generally referred to as "statutory" insiders. In providing that the term insider "includes" the statutory insiders, Congress made clear that the statutory list is not exhaustive and it is for the courts to define the limits of non-statutory insider status. When faced with an alleged non-statutory insider, courts must look at the closeness of the relationship between the debtor and alleged insider to determine if that closeness prevented the debtor and insider from dealing with each other at arm's length. More Like This Headnote

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Preferential Transfers > Elements > Debtor Insolvency

HN6 "Person in control" is merely one illustrative category of an insider set out in 11 U.S.C.S. § 101(31). More Like This Headnote

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Preferential Transfers > Elements > Debtor Insolvency

HN7 For purposes of 11 U.S.C.S. § 547(b), with respect to alleged non-statutory insiders, courts must analyze not only the relationship but also the transaction between the parties and determine whether there is evidence of a less than an arm's length transaction. More Like This Headnote

Bankruptcy Law > Practice & Proceedings > Adversary Proceedings > General Overview

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > Leave of Court

HN8 Fed. R. Civ. P. 15(a)(1)(A), made applicable to adversary proceedings in

bankruptcy by Fed. R. Bankr. P. 7015, allows a plaintiff to amend the complaint before a responsive pleading is filed. Where the defendant has not yet filed an answer, the plaintiff does not require leave to amend. The fact that a plaintiff sought leave to amend does not enable the court to deny an amendment where a responsive pleading has not been filed. More Like This Headnote

COUNSEL: **[*1]** David P. Azarian, Esq., AZARIAN LAW OFFICE, PLLC, Attorney for Timothy P. Smith.

Joseph A. Foster, Esq., MCLANE, GRAF, RAULERSON & MIDDLETON, Attorney for Merrill Lynch, Pierce, Fenner & Smith Incorporated.

JUDGES: Mark W. Vaughn, Chief Judge.

OPINION BY: Mark W. Vaughn

OPINION

MEMORANDUM OPINION

This matter comes before the Court on two motions to dismiss the complaint filed by Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "Defendant") (Ct. Doc. Nos. 9 and 20). In his complaint, Timothy P. Smith, the Chapter 7 Trustee (the "Plaintiff"), seeks to set aside certain payments made by Robert A. Lee (the "Debtor") to the Defendant on the grounds that they constitute preferential transfers to an insider pursuant to 11 U.S.C. § 547(b) of the **Bankruptcy** Code.[1] On August 24, 2010, the Court held a hearing and took the matters under advisement.

FOOTNOTES

[1] Unless otherwise indicated, the terms " **Bankruptcy** Code," "section" and "§" refer to Title 11 of the United States Code, 11 U.S.C. § 101 et seq. , as amended by the **Bankruptcy** Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8.

JURISDICTION

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing **[*2]** Order of Referral of Title 11 Proceedings to the United States **Bankruptcy** Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

BACKGROUND

The Debtor has been employed as a financial advisor by the Defendant since 2005. At some point in 2005, the Debtor executed a promissory note (the "Note") payable to the Defendant. The Note provided that the Defendant would deduct $5,450.62 from the Debtor's monthly paycheck to be applied as up-front repayments of the amounts owed

under the Note. On May 7, 2008, the Debtor filed for Chapter 7 **bankruptcy** protection. Within ninety days and one-year prior to the petition date (the "preference period"), the Defendant made transfers from the Debtor's paychecks totaling $61,228.68. Additionally, the Defendant also deducted $16,606 from the Debtor's paycheck as prepetition offset payments. The Plaintiff instituted the current adversary proceeding on April 30, 2010, to avoid the payments made to the Defendant within ninety days of the filing of the **bankruptcy** petition on the grounds that the payments constituted preferential transfers. The Plaintiff also alleges **[*3]** that the payments made after ninety days but within one year preceding the filing of the **bankruptcy** petition are recoverable as preferences because the Defendant is an insider of the Debtor.

The Defendant filed its first motion to dismiss (Ct. Doc. No. 9) (the "first motion") on June 22, 2010, and moved the Court to dismiss the complaint because (1) it was devoid of any factual allegations establishing that the Debtor was insolvent during the preference period, and (2) it failed to sufficiently allege the facts necessary to plausibly find that the Defendant was an insider pertaining to the payments made after ninety days but within one year preceding the filing of the **bankruptcy** petition. On July 12, 2010, the Plaintiff filed an amended complaint. Subsequently, the Defendant filed its second motion to dismiss (Ct. Doc. No. 20) (the "second motion"). Since an amended complaint and subsequent motion to dismiss were filed, the first motion is deemed moot and the Court will only discuss the merits of the second motion. In the second motion, the Defendant concedes that the Plaintiff's amended complaint cured the deficiency of establishing that the Debtor was insolvent during the preference **[*4]** period. Thus, the only element of the Plaintiff's preference claim that remains in dispute is whether the Defendant was an insider of the Debtor.

DISCUSSION

HN1 Under Federal Rule of Civil Procedure 12(b)(6), made applicable to adversary proceedings in **bankruptcy** by Federal Rule of **Bankruptcy** Procedure 7012(b), a party may move to dismiss a claim for "failure to state a claim upon which relief can be granted[.]" Fed. R. Civ. P. 12(b)(6); Fed. R. Bankr. P. 7012(b). In ruling on a Rule 12(b)(6) motion to dismiss, courts "must accept as true the well-pleaded factual allegations of the complaint" and "draw all reasonable inferences therefrom in the plaintiff's favor[.]" LaChapelle v. Berkshire Life Ins. Co., 142 F.3d 507, 508 (1st Cir. 1998). "While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligations to provide the 'grounds' of his 'entitle[ment] to relief' require more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 127 S.Ct. 1955, 1964-65, 167 L. Ed. 2d 929 (2007) (internal citations omitted); Damon v. Moore, 520 F.3d 98, 102-03 (1st Cir. 2008).

HN2 "[Although] **[*5]** legal conclusions can provide the framework of a complaint, they must be supported by factual allegations." Ashcroft v. Iqbal, 129 S.Ct. 1937, 1950, 173 L. Ed. 2d 868 (2009). To survive a Rule 12(b)(6) motion to dismiss, factual allegations in the complaint "must be enough to raise a right to relief above the speculative level" and cross the line between "possibility" and "plausibility" of entitlement to relief. Bell Atlantic Corp., 127 S.Ct. at 1965-66; Notinger v. Costa (In re Robotic Vision Sys., Inc.), 374 B.R. 36, 43 (Bankr. D.N.H. 2007). "Determining whether a complaint states a plausible claim for relief will . . . be a context-specific task that requires the . . . court to draw on its judicial experience and common sense." Iqbal, 129 S.Ct. at 1950. The focus of a Rule 12(b)(6) inquiry is not "whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." Gilbert v. Essex Group, Inc., 930 F.Supp. 683, 686

(D.N.H. 1993) (quoting Scheuer v. Rhodes, 416 U.S. 232, 236, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974)).

I.Preferential Transfer by an Insider under § 547(b)

Section 547(b) provides, in relevant part, that HN3 a trustee may avoid, as a preference: any transfer of an interest **[*6]** of the debtor in property -

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made –

. . .

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). Section 101(31)(A) defines the term "insider" as follows:

HN4 (31) "insider" includes

(A) if the debtor is an individual –

(i) relative of the debtor or of a general partner of the debtor;

(ii) partnership in which the debtor is a general partner;

(iii) general partner of the debtor; or

(iv) corporation of which the debtor is a director, officer, or person in control

. . . .

11 U.S.C. § 101(31)(A). According to the legislative history, HN5 "[a]n insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject **[*7]** to closer scrutiny than those dealing at arms [sic] length with the debtor." See S. Rep. No. 95-989, 2d Sess., at 25 (1978); accord H.R. Rep. No. 95-595, 1st Sess., at 312 (1977). U.S. Code Cong. & Admin. News 1977, pp. 5787, 5963. Persons enumerated in section 101(31)(A) are generally referred to as "statutory" insiders. In providing that the term insider "*includes*" the statutory insiders, Congress made clear that the statutory list is not exhaustive and it is for the courts to define the limits of non-statutory insider status. See Schreiber v. Emerson (In re Emerson), 244 B.R. 1, 31 (Bankr. D.N.H. 1999) ("the classification of insiders is not restricted to the statutory definition."). When faced with an alleged non-statutory insider, courts must look at the closeness of the relationship between

the debtor and alleged insider to determine if that closeness prevented the debtor and insider from dealing with each other at arm's length. See In re Emerson, 244 B.R. at 32 ("Cases that have considered the insider issue generally have focused on two factors in making the determination of whether a transferee is an insider: (1) the closeness of the relationship between the transferee and **[*8]** the debtor, and (2) whether the transactions between the transferee and the debtor were conducted at arm's length.").

Both the Plaintiff and Defendant focus on the level of control or influence that the Defendant had over the Debtor as a prerequisite of insider status. This focus is misplaced. HN6 "Person in control" is merely one illustrative category of an insider set out in section 101(31). In this case, the Plaintiff alleges that the Defendant is a non-statutory insider. If the Defendant were a person in control of the Debtor, it would be a statutory insider and no further analysis would be required. The Plaintiff relies heavily on the employer-employee relationship as the basis for alleging that the Defendant is an insider of the Debtor. However, considering the legislative history, HN7 for alleged non-statutory insiders, courts must analyze not only the relationship but also the transaction between the parties and determine whether there is evidence of a less than an arm's length transaction.

Regarding the transaction between the parties, the Plaintiff alleges that the Debtor executed a promissory note in the amount of $279,256 payable to the Defendant with interest at the annual rate **[*9]** of 4.5 percent. Further, the Plaintiff contends that the Note provided that the Defendant would deduct the sum of $5,450.62 from the Debtor's monthly paycheck as up-front repayments to be applied to amounts owed under the Note. Taking these facts as true and drawing all reasonable inferences in favor of the Plaintiff, the Court cannot plausibly find that the transaction was less than arm's length. The Plaintiff does not allege, and the Court cannot reasonably infer from the pleadings, that either the Defendant or Debtor had a conflict of interest when entering into the Note that would have made it a non-arm's length transaction. The fact that the transaction may have been a course of dealing between the parties or an opportunity to gain something only provides an inference of the mere possibility of misconduct, and not a plausible allegation that the Plaintiff is entitled to relief. Consequently, the Court grants the Defendant's second motion to dismiss the complaint concerning payments that occurred more than ninety days prior to the filing of the Debtor's petition.

II. Allowing the Plaintiff to Amend the Complaint

In his objection to the Defendant's motion to dismiss, the Plaintiff **[*10]** requests leave to amend his pleadings in the event the Court grants the motion to dismiss. HN8 Federal Rule of Civil Procedure 15(a)(1)(A) made applicable to adversary proceedings in **bankruptcy** by Federal Rule of **Bankruptcy** Procedure 7015 allows a plaintiff to amend the complaint before a responsive pleading is filed. Since the Defendant has not yet filed an answer, the Plaintiff does not require leave to amend. Correa-Martinez v. Arrillaga-Belendez, 903 F.2d 49, 59 (1st Cir. 1990); Taite v. Peake, 2009 U.S. Dist. LEXIS 2006, 2009 WL 94526 (D.N.H. 2009). The fact that the Plaintiff sought leave to amend does not enable the Court to deny an amendment where a responsive pleading has not been filed. Taite, 2009 U.S. Dist. LEXIS 2006, 2009 WL 94526. Accordingly, the Plaintiff may amend his complaint.

CONCLUSION

For the reasons set out herein, the Court grants the Defendant's motion to dismiss the complaint (Ct. Doc. No. 20) concerning payments that occurred more than ninety days prior to the filing of the Debtor's petition. In addition, the Plaintiff may amend his complaint. This opinion constitutes the Court's findings and conclusions of law in accordance with Federal

Rule of **Bankruptcy** Procedure 7052. The Court will issue a separate order consistent **[*11]** with this opinion.

DATED this 21st day of September 2010, at Manchester, New Hampshire.

/s/ Mark W. Vaughn

Mark W. Vaughn

Chief Judge

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*2010 Bankr. LEXIS 3154, **

In re CHRISTINA C. RILEY, Debtor

Case No. 09-10096-JNF, Chapter 7

UNITED STATES **BANKRUPTCY** COURT FOR THE DISTRICT OF MASSACHUSETTS

2010 Bankr. LEXIS 3154

September 14, 2010, Decided
September 14, 2010, Filed

CASE SUMMARY

PROCEDURAL POSTURE: A creditor filed a motion to dismiss debtor's Chapter 7 case pursuant to 11 U.S.C.S. § 707(b).

OVERVIEW: The debtor was a high school art teacher with two children. She and her children lived with her parents and paid them rent. The creditor was the debtor's former divorce attorney. Her income was inconsistent and was never the same due to her absences from work. The court held that, based upon the totality of the circumstances, the debtor's need for Chapter 7 relief far outweighed the evidence that she might be able to provide a dividend to her unsecured creditors through a Chapter 13 plan based upon a hypothetical salary increase of approximately $4,000. The court held that the amount of rent she paid her parents was credible, particularly in view of the amount of space and number of rooms available to her and her children and the inclusion of heat and other utilities in the amount of the rent. The court was unable to conclude that the debtor's child care expenses could have been significantly reduced. Although the debtor's Schedules and Statement of Financial Affairs were prepared without the requisite care, the court accepted the debtor's explanations for the errors and her subsequent amendments. The court noted that she credibly testified as to her income and expenses.

OUTCOME: The court denied the creditor's motion.

CORE TERMS: monthly, child care, financial affairs, totality, rent, monthly income, salary, repay, school year, child support payments, earnings, divorce proceeding, space, net income, disposable income, pretrial, consumer, divorce, amend, needy, monthly rent, child support, immediately preceding, salary increases, annual salary, canceled checks, rental payments, nonpriority, expenditures, disclose

LEXISNEXIS® HEADNOTES Hide

Bankruptcy Law > Conversion & Dismissal > Liquidations

HN1 11 U.S.C.S. § 707(b)(1) provides that, after notice and a hearing, the court, on its own motion or on motion by the U.S. Trustee, the Chapter 7 trustee (or the **bankruptcy** administrator, if any), or any party in interest, may dismiss a Chapter 7 case filed by an individual debtor whose debts are primarily consumer debts (or, with the debtor's consent, convert such a case to one under Chapter 11 or 13) if the court finds that granting relief would be an "abuse." 11 U.S.C.S. § 707(b)(1). Under § 707(b)(2), a **bankruptcy** court must "presume abuse" if a debtor fails the means test. Form B22A is sometimes referred to as the "means test." The means test for a Chapter 7 debtor is actually the calculations set forth in Parts IV-VII, which are based upon § 707(b)(2), a section which has been called the heart of the means test. Only debtors whose monthly income exceeds the state median for their family size are subject to the means test. The purpose of the means test is to distinguish between debtors who can repay a portion of their debts and debtors who cannot. More Like This Headnote

Bankruptcy Law > Conversion & Dismissal > Lack of Good Faith

Bankruptcy Law > Conversion & Dismissal > Liquidations

Evidence > Procedural Considerations > Burdens of Proof > Preponderance of Evidence

HN2 Under 11 U.S.C.S. § 707(b)(3), even if a debtor passes the means test or rebuts the presumption of abuse under § 707(b)(2), a **bankruptcy** court must dismiss the debtor's case if the debtor filed the petition in bad faith or if the totality of the circumstances of the debtor's financial situation demonstrates abuse. 11 U.S.C.S. § 707(b)(3)(A), (B). The party asserting the existence of abuse has the burden of proof on the issue, and because the elements of bad faith and totality of the circumstances are disjunctive, a party can sustain its burden by proving either element by a preponderance of the evidence. Courts considering dismissal under the "totality of the circumstances" generally consider both pre and postpetition acts and circumstances. Moreover, courts generally refer to pre-**Bankruptcy** Abuse Prevention and Consumer Protection Act of 2005 cases and the factors identified in them to determine whether a case warrants dismissal under the totality of the circumstances. More Like This Headnote

Bankruptcy Law > Conversion & Dismissal > Liquidations

HN3 In determining whether to apply 11 U.S.C.S. § 707(b) to an individual debtor, a court should ascertain from the totality of the circumstances whether he is merely seeking an advantage over his creditors, or is "honest," in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive dealings, and whether he is "needy" in the sense that his financial predicament warrants the discharge of his debts in exchange for liquidation of his

assets. Substantial abuse can be predicated upon either lack of honesty or want of need. More Like This Headnote

Bankruptcy Law > Conversion & Dismissal > Liquidations

HN4 Among the factors to be considered in deciding under 11 U.S.C.S. § 707(b) whether a debtor is needy is his ability to repay his debts out of future earnings. That factor alone may be sufficient to warrant dismissal. For example, a court would not be justified in concluding that a debtor is needy and worthy of discharge, where his disposable income permits liquidation of his consumer debts with relative ease. Other factors relevant to need include whether the debtor enjoys a stable source of future income, whether he is eligible for adjustments of his debts through Chapter 13 of the **Bankruptcy** Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities. More Like This Headnote

Bankruptcy Law > Conversion & Dismissal > Liquidations

HN5 The U.S. Court of Appeals for the First Circuit has adopted the "totality of the circumstances" test largely as it is described in In re Krohn. In so doing, it has rejected any per se rules mandating dismissal for "substantial abuse" whenever the debtor is able to repay his debt out of future disposable income, or forbidding dismissal on that basis alone. Such strict interpretations cannot be squared with the open-textured nature of 11 U.S.C.S. § 707(b) and are inconsistent with § 707(b)'s purpose of guiding, not constraining, **bankruptcy** courts in the exercise of their equitable discretion. A **bankruptcy** court may, but is not required to, find "substantial abuse" if the debtor has an ability to repay, in light of all of the circumstances. More Like This Headnote

COUNSEL: **[*1]** For Christina C. Riley Medford, MA, Debtor: Michael A. Dixon, Law Offices of Michael A. Dixon, Medford, MA.

JUDGES: Joan N. Feeney, United States **Bankruptcy** Judge.

OPINION BY: Joan N. Feeney

OPINION

MEMORANDUM

I. INTRODUCTION

The matter before the Court is the "Creditor's Motion for Dismissal under Rule 707(b)(1)(2)(3)" [sic] filed by Dorothy Driscoll ("Attorney Driscoll"), the former divorce attorney and a creditor of Christina C. Riley (the "Debtor"). The Debtor filed a Response to the Motion and an Objection. The Court heard the matter on June 30, 2009 and deemed it a

contested matter. On July 6, 2009, the Court issued a pretrial order requiring the completion of discovery by August 24, 2009 and the filing of a Joint Pretrial Memorandum by September 24, 2009. At the parties' request, the Court extended the time for filing the Joint Pretrial Memorandum.

On May 18, 2010, the Court conducted an evidentiary hearing at which the Debtor testified and twelve exhibits were admitted into evidence. The Court now makes its findings of fact and conclusions of law in accordance with Fed. R. Bankr. P. 7052.

II. FACTS

The Debtor is a divorced, high school art teacher with two children, ages one and four. She and her children reside **[*2]** with her parents at 56 Traincroft [sic], Medford, Massachusetts. The Debtor was and is engaged in a protracted divorce proceeding in which she was represented by Attorney Driscoll for an undisclosed period of time. The Debtor and her former spouse owned a residence at 11 Boarder Street, Woburn, Massachusetts. The Debtor and her children moved into her parents' home at some point either before or during the divorce proceeding and the Woburn property was sold for a price less than the outstanding liens.

The Debtor filed a voluntary Chapter 7 petition on January 7, 2009. She filed her Schedules, Statement of Financial Affairs, Official Form 22A - - the Chapter 7 Statement of Current Monthly Income and Means-Test Calculation, and Certificate of Counseling, dated September 30, 2008, with her petition. On Official Form 22A, the Debtor reported her annualized current monthly income in the sum of $58,018.68 and set forth the applicable median family income for Massachusetts in the sum of $77,960. Accordingly, she indicated on Official Form 22A that the presumption of abuse under 11 U.S.C. § 707(b)(2) did not arise.

On Schedule A - Real Property, the Debtor disclosed that she owned no real property. **[*3]** On Schedule B - Personal Property, the Debtor disclosed assets worth approximately $67,000, including retirement plans and a 2001 Toyota RAV 4, all of which she claimed as exempt on Schedule C-Property Claimed as Exempt. The Debtor reported that she had no secured or unsecured priority creditors on Schedule D-Secured Creditors and Schedule E - Creditors Holding Unsecured Nonpriority Claims, respectively. On Schedule F - Creditors Holding Unsecured Nonpriority Claims, the Debtor disclosed substantial unsecured debt, including a claim held by Attorney Driscoll in the sum of $35,000. Excluding Attorney Driscoll's claim, the Debtor set forth unsecured, nonpriority claims totaling $77,157.71. The Debtor did not disclose the existence of any executory contracts on Schedule G-Executory Contracts, although on Schedule H-Co-Debtors she listed Robert Emmet Riley as a co-debtor with respect to an unsecured debt owed to Sovereign Bank.

The Debtor also filed Schedules I and J - Current Income and Expenditures of Individual Debtor(s) with her petition. On her original Schedule I, she disclosed monthly gross wages of $4,834.89 and average monthly income of $3,309.56. She failed to list child support **[*4]** on Schedule I and, in response to Question 17 on Schedule I concerning any potential "increase or decrease in income reasonably anticipated to occur within the year following the filing of this document," she answered: "NONE."

On Schedule J, the Debtor represented that her monthly rent was $1,200 and that she incurred monthly child care expenses of $1,700, plus the additional sum of $203 for "Babysitting" and "Pre-School." She reported that her monthly net income was negative in the amount of $1,423.44.

On her Statement of Financial Affairs, the Debtor reported 2006 earnings in the sum of $62,415 and 2007 earnings in the sum of $59,632. She did not report any income from child support payments. In response to Question 3 on the Statement of Financial Affairs, the Debtor checked "None" with respect to "payments on loans, installment purchases of goods or services and other debts . . . within 90 days," as well as with respect to "payments made to within one year immediately preceding the commencement of this case to or for the benefit of creditors who are or were insiders." Similarly, the Debtor checked "None" in response to Question 4 concerning "suits and administrative proceedings to **[*5]** which the debtor is or was a party within one year immediately preceding the filing of the **bankruptcy** case." She also checked "None" in response to Question 10 concerning transfers of property either absolute or as security within two years immediately preceding the commencement of the case, except for transfers in the ordinary course of business or financial affairs of the debtor.

On February 3, 2009, the Chapter 7 Trustee conducted the meeting of creditors pursuant to 11 U.S.C.§ 341. He promptly filed a Report of No Distribution on the same day.

Prior to the expiration of the deadline for filing complaints under 11 U.S.C. §§ 523 and 727, Attorney Driscoll filed numerous motions to extend the time within which to file a complaint objecting to the Debtor's discharge. Additionally, she sought leave to conduct an examination of the Debtor under Fed. R. Bankr. P. 2004.[1] The Court granted Attorney Driscoll's motions, and Attorney Driscoll had until January 11, 2010 to file a complaint under 11 U.S.C. § 727(a). Although Attorney Driscoll conducted a Rule 2004 examination of the Debtor and had over eight months from the original deadline for filing complaints under 11 U.S.C. § 727, she never **[*6]** commenced an adversary proceeding seeking denial of the Debtor's discharge, although, on May 22, 2009, she filed the Motion that is now before the Court.

FOOTNOTES

[1] Attorney Driscoll also filed a Motion for Authority to Take Examination of Deborah Chang, the Debtor's mother, under Rule 2004 on July 16, 2009, which the Court granted.

Following the filing of Attorney Driscoll's Motion for Dismissal, the Debtor, on May 29, 2009, filed a Motion to Amend, together with amended Schedules I and J, an amended Statement of Financial Affairs and an amended Official Form 22A, for the purpose of correcting "[v]arious discrepancies" that were "pointed out" during her Rule 2004 examination by Attorney Driscoll. On her amended Schedule I, the Debtor disclosed monthly gross wages of $5,825.27 and average monthly income of $4,525.98, an increase of $1,216.42 from the average monthly income she reported on her original Schedule I. The increase was attributable, in part, to the inclusion of monthly child support payments in the sum of $650. The Debtor did not change her answer to Question 17 on Schedule I. Although the Debtor amended Schedule J, the only change she made to that schedule was the amount of her monthly **[*7]** net income, which remained negative in the amount of $207. Additionally, the Debtor amended Official Form 22C to restate her monthly income and included monthly child support payments. Despite the changes, the presumption of abuse under 11 U.S.C. § 707(b) did not arise.

On her amended Statement of Financial Affairs, the Debtor, in response to Question 2 about income other than from employment, disclosed receipt of child support in the total amount of $7,800 in 2008. Additionally, in response to Question 3, she indicated that she paid her mother, $300 in 2008 and still owed her parents $50,000. In response to Question 4, she disclosed her pending divorce proceeding. Finally, in response to Question 10, she reported the sale of property located at 11 Border Street, Woburn to Christa Fey and Kristin Sandler on April 1, 2008.

Although the Debtor disclosed her obligation to her parents on her amended Statement of Financial Affairs, she did not amend Schedule F in May of 2009. Three months later, however, on September 30, 2009, the Debtor moved to amend Schedule F and filed an amended Schedule F to include the debt to her parents, Jansen and Deborah Chang, in the sum of $53,179.

At the trial, **[*8]** the Debtor acknowledged receipt of a stipend in the sum of $2,004.68 for her services as an advisor to the Asian Students Association, which she did not disclose in any of her Schedules or Statement of Financial Affairs. She testified that the stipend was not automatic and she only received it once in July of 2008, and thus it is unclear whether she would have had to include the income on Official Form 22A.

The Debtor testified that she omitted child support payments from her original Schedule I through inadvertence. She testified that the omission was the result of a communication problem with her **bankruptcy** attorney. She indicated that he misinterpreted her statement that she was seeking contempt in the divorce proceeding as being attributable to a nonpayment of child support when in fact it related to other nonmonetary matters. Additionally, the Debtor testified that she did not report potential salary increases she was to receive for the 2009-2010 school year on Schedule I, Question 17 "because I hadn't even made what the contract was for the years past." Despite the reported increase in monthly income, the Debtor's monthly expenditures of $4,733, which she did not adjust on amended **[*9]** Schedule J, exceeded her income, and both Schedule J and amended Schedule J revealed that the Debtor has no monthly net income.

Attorney Driscoll submitted evidence as to the salary that the Debtor earned as an art teacher at Burlington High School. Assuming the Debtor worked full time, for the 20082009 school year, she was entitled to an annual salary of $74,133 ($6,177.75 gross per month); for the 2009-2010 school year, she was entitled to an annual salary of $76,357 ($6,363.08 gross per month); and for the 2010-211 school year she is entitled to an annual salary of $78,266 ($6,522.17 gross per month). The 2010-2011 salary represents an annual salary increase of $4,133 from 2008-2009. The Debtor testified, however, that her salary was inconsistent as it was reduced if she missed work to attend court hearings in conjunction with her divorce or **bankruptcy** cases or if she missed work because of the illnesses of her children. Indeed, she testified that one of her children was ill with the H1N1 flu, and that, as a result, she was unable to teach in order to take care of him.

Attorney Driscoll also submitted Financial Statements which the Debtor provided to the Middlesex Probate and Family **[*10]** Court, Department of the Trial Court. The Financial Statement executed by the Debtor on November 18, 2008 reflected base weekly pay of $1,211 or $4,844 per month and net weekly income of $963.74 or $3,852 per month. The Financial Statement also reflected that the Debtor incurred child care expenses of $463 per week or $1,852 per month. Additionally, the Financial Statement reflected that the Debtor's parents had made personal loans to her totaling $50,000. The November 18, 2009 statement was signed by Attorney Chin. An earlier Financial Statement, dated March 5,

2008, was signed by Attorney Driscoll. It reflected weekly child care expenses of $466 or $1,864 per month.

In addition to challenging the legitimacy of the Debtor's reported income, Attorney Driscoll questioned the Debtor about her monthly expenses, submitting canceled checks to support her contention that the Debtor's actual child care and rent expenses were less that those set forth on Schedule J. The Debtor pays monthly rent to her parents in the sum of $1,200. She formerly had paid them approximately $300 per month.

Attorney Driscoll, through her examination of the Debtor at trial, intimated that the rental payments and **[*11]** child care payments made by the Debtor to her parents were disguised loan repayments. The Debtor testified, however, that she utilizes a significant portion of her parents' home and that the amount she pays for rent was negotiated once she determined to permanently reside in their home. She also indicated that the rent was fair under the circumstances given the expenses of the household. She stated that she reached an agreement with her parents to pay them $1,200 in monthly rent after it became clear to her that she and her small children would be residing with her parents for the foreseeable future. She testified:
I discussed it [the amount of rent] with my parents, looked at what the expenses were, the home, electricity, water, gas - - the space, the amount of space that we were using in the home, and decided, you know, that it was going to be a permanent residence for me and the two children. . . . We have two bedrooms. The kids have a playroom downstairs. There's a family room. Kitchen, bath - - we have our own bath just for myself and the kids.
Nevertheless, canceled checks and check stubs submitted by Attorney Driscoll establish that the Debtor began attempting to make $1,200 per **[*12]** month rental payments to her parents in September when she first consulted with her **bankruptcy** attorney and obtained a credit counseling briefing. She failed to make full rent payments to her parents in February and March of 2009, but that she made full rental payments to them in May, June and July, 2009. The Debtor did not produce a written lease agreement with her parents, and she pays them bi-monthly in varying amounts.

With respect to her child care expenses, Attorney Driscoll produced evidence that the Debtor paid various child care providers, including her mother, the total sum of $16,176 in 2008 or $1,348 per month, rather than the $1,700 reported by the Debtor on Schedule J. Additionally, for the first four months of 2009, the Debtor paid a total of $6,055 for child care, or an average of $1,513.75 per month.

On her Statement of Financial Affairs, the Debtor failed to disclose a transfer of $7,500 to Attorney Merril Chin ("Attorney Chin"), her current divorce lawyer. The Debtor retained Attorney Chin in September of 2008. The Debtor testified that her parents advanced her the sum of $7,500 to pay Attorney Chin's retainer and that she repaid them within a few days from a loan **[*13]** from her teacher's pension. She stated that she did not consider it a loan and that it was not documented as a loan.

IV. DISCUSSION

A. Applicable Law

HN1 Section 707(b)(1) of the **Bankruptcy** Code provides that, after notice and a hearing, the court, on its own motion or on motion by the U.S. Trustee, the Chapter 7 trustee (or the **bankruptcy** administrator, if any), or any party in interest, may dismiss a Chapter 7 case filed by an individual debtor whose debts are primarily consumer debts (or, with the debtor's consent, convert such a case to one under Chapter 11 or 13) if the court finds that

granting relief would be an "abuse." 11 U.S.C. § 707(b)(1).[2] Under § 707(b)(2), a **bankruptcy** court must "presume abuse" if a debtor fails the means test. As Judge Rosenthal observed in In re Boule, 415 B.R. 1 (Bankr. D. Mass. 2009), "Form B22A is sometimes referred to as the 'means test.' The means test for a Chapter 7 debtor is actually the calculations set forth in Parts IV-VII, which are based upon § 707(b)(2), a section which has been called the heart of the means test.'" Id. at 4 (citing In re Singletary, 354 B.R. 455, 460 (Bankr. S.D. Tex. 2006)). Only debtors whose monthly income exceeds the state **[*14]** median for their family size are subject to the means test. *See* Morse v. Rudler (In re Rudler), 576 F.3d 37, 40 (1st Cir. 2009). The purpose of the means test "is to distinguish between debtors who can repay a portion of their debts and debtors who cannot." *See* Ross-Tousey v. Neary (In re Ross-Tousey), 549 F.3d 1148, 1151 (7th Cir. 2008). According to the First Circuit in Rudler, BAPCPA "was designed to lessen the resort to Chapter 7 filings by, among other measures, amending section 707(b) of the **Bankruptcy** Code to relax the standard for dismissing a Chapter 7 case. . . ." 576 F.3d at 40.

FOOTNOTES

[2] The **Bankruptcy** Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") made four major changes to section 707(b) . The four major changes are that "substantial abuse" was changed to "abuse;" creditors, the case trustee, and other parties in interest now have standing to make such a motion; the court may dismiss or, with the debtor's consent, convert the case to a Chapter 11 or Chapter 13; and, finally, there is no presumption in favor of granting Chapter 7 relief. *See generally* Nancy C. Dreher and Joan N. Feeney, **Bankruptcy** Law Manual, § 10:18 (June 2010).

HN2 Under § 707(b)(3), even if a debtor **[*15]** passes the means test, as the Debtor has in the instant case, or rebuts the presumption of abuse under section 707(b)(2), a **bankruptcy** court must dismiss the debtor's case if the debtor filed the petition in bad faith or if "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(A), (B). The party asserting the existence of abuse has the burden of proof on the issue, and because the elements of bad faith and totality of the circumstances are disjunctive, a party can sustain its burden by proving either element by a preponderance of the evidence. *See, e.g.,* In re Perelman, 419 B.R. 168, 177-78 (Bankr. E.D.N.Y. 2009); In re Baker, 400 B.R. 594, 597 (Bankr. N.D. Ohio 2009); In re Perrotta, 378 B.R. 434, 437 (Bankr. D. N.H. 2007); In re Oot, 368 B.R. 662 (Bankr. N.D. Ohio 2007).

Courts considering dismissal under the "totality of the circumstances" generally consider both pre and postpetition acts and circumstances. *See* In re Goble, 401 B.R. 261, 276 (Bankr. S.D. Ohio 2009). Moreover, courts generally refer to pre-BAPCPA cases and the factors identified in them to determine whether a case warrants dismissal under the totality **[*16]** of the circumstances. For example, in In re Boule, the court stated:

HN3 In determining whether to apply § 707(b) to an individual debtor, . . . a court should ascertain from the totality of the circumstances whether he is merely seeking an advantage over his creditors, or is "honest," in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive dealings, and whether he is "needy" in the sense that his financial predicament warrants the discharge of his debts in exchange

for liquidation of his assets. Substantial abuse can be predicated upon either lack of honesty or want of need.

* * *

HN4 Among the factors to be considered in deciding whether a debtor is needy is his ability to repay his debts out of future earnings. That factor alone may be sufficient to warrant dismissal. For example, a court would not be justified in concluding that a debtor is needy and worthy of discharge, where his disposable income permits liquidation of his consumer debts with relative ease. Other factors relevant to need include whether the debtor enjoys a stable source of future income, whether he is eligible for adjustments of his debts through Chapter 13 of the **Bankruptcy [*17]** Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities.
In re Boule, 415 B.R. at 5-6 (quoting In re Krohn, 886 F.2d 123, 126-27 (6th Cir. 1989) (citations omitted)).

In First USA v. Lamanna (In re Lamanna), 153 F.3d 1 (1st Cir. 1998), HN5 the First Circuit adopted "the 'totality of the circumstances' test largely as it is described in Krohn." Id. at 4. It added:
In so doing, we reject any per se rules mandating dismissal for "substantial abuse" whenever the debtor is able to repay his debt out of future disposable income, or forbidding dismissal on that basis alone. Such strict interpretations cannot be squared with the open-textured nature of § 707(b) and are inconsistent with § 707(b)'s purpose of guiding, not constraining, **bankruptcy** courts in the exercise of their equitable discretion. We hold that a **bankruptcy** court may, but is not required to, find "substantial abuse" if the debtor has an ability to repay, in light of all of the circumstances.
Id. at 4-5.[3]

FOOTNOTES

[3] In **[*18]** In re Lorenca, 422 B.R. 665 (Bankr. N.D. Ill. 2010), the court observed that pre-BAPCPA six courts of appeal had interpreted "totality of circumstances" using open ended, multi-factor tests. *See* In re Stewart, 175 F.3d 796 (10th Cir.1999); In re Lamanna, 153 F.3d 1 (1st Cir.1998); In re Green, 934 F.2d 568, 570 (4th Cir.1991); In re Krohn, 886 F.2d 123, 125-26 (6th Cir.1989); In re Walton, 866 F.2d 981, 983 (8th Cir.1989); In re Kelly, 841 F.2d 908, 914 (9th Cir.1988). It stated:
Except for the Fourth Circuit in In re Green, 934 F.2d 568 (4th Cir.1991), these courts agreed that the primary factor in determining what the pre-BAPCPA version of the statute called "substantial abuse" (rather than merely "abuse") was the debtor's ability to repay his debts. *See* Costello, 2002 U.S. Dist. LEXIS 14421, 2002 WL

1821663, at *4 . These courts of appeals also concluded that an ability to repay debts standing alone could be sufficient to warrant dismissal, although other factors might be relevant. Id.

Lorenca, 422 B.R. at 671-72 .

B. Analysis

Although the Court must look to the totality of the circumstances, it is not appropriate to conflate the standards for evaluating a motion to dismiss for abuse under section 707(b)(3) with **[*19]** the grounds for denial of a discharge under 11 U.S.C. § 727(a)(4) due to the Debtor's errors and omissions on her original Schedules and Statement of Financial Affairs. Based upon the evidence presented, the Court finds that Attorney Driscoll failed to establish that the Debtor's past and future financial circumstances warrant dismissal for abuse. The Debtor credibly testified that her income was inconsistent and was never the same as the Burlington Public School's Salary Schedule due to her absences from work. At the Debtor's current salary, she has negative monthly disposable income. Her potential salary for the 2010-2011 school year is $4,133 more than the salary to which she was entitled at the time she filed her petition. Even if she were to earn a higher salary, it is unclear how much she would net after the payment of taxes and other deductions coupled with overall increases in the cost of living. Thus, although her income is stable and she is eligible to be a debtor in a Chapter 13 case, this Court cannot find that she has the ability to repay creditors out of future earnings, unless her expenses on Schedule J either are overstated or are likely to be reduced, particularly **[*20]** due to the pre-school ages of her children.

The Debtor's testimony as to the amount of rent she pays her parents was credible, particularly in view of the amount of space and number of rooms available to her and her children and the inclusion of heat and other utilities in the amount of the rent. Were the Debtor to move to an apartment or consider buying a home with a comparable amount of space with utilities included, it is highly unlikely that she would be able to reduce her monthly expenditures for housing and utilities. The Court takes judicial notice that in Middlesex County the Local Housing and Utilities Standards for use on Official Form 22A for non-mortgage and mortgage/rent expense after March 15, 2010 for a family of three are $658 and $1,638, respectively.[4]

FOOTNOTES

[4] Housing and Utilities standards include mortgage or rent, property taxes, interest, insurance, maintenance, repairs, gas, electric, water, heating oil, garbage collection, telephone and cell phone.

The Debtor's child care expenses are the most open to question as the $1,700 figure which the Debtor utilized on Schedule J and amended Schedule J are not supported by canceled checks. The Debtor testified that she spends approximately **[*21]** that sum of money on child care each month. At present, the Debtor pays individual providers, including her

mother, to watch her children. Although the Debtor's checks and the amount set forth on Schedule J were not reconciled, Attorney Driscoll did not submit evidence that the Debtor could reduce her child care expenses significantly. Moreover, in the Middlesex Probate and Family Court, both Attorney Driscoll and the Debtor signed Financial Statements showing child care expenses of $466 per week or $1,864 per month. Based upon the equivocal evidence, the Court is unable to conclude that the Debtor's child care expenses could be significantly reduced.

Based upon the totality of the circumstances, the Court finds that the Debtor's need for Chapter 7 relief far outweighs the evidence that she might be able to provide a dividend to her unsecured creditors through a Chapter 13 plan based upon a hypothetical salary increase of approximately $4,000. Although the Debtor's Schedules and Statement of Financial Affairs were prepared without the requisite care, the Court accepts the Debtor's explanations for the errors and her subsequent amendments. She credibly testified as to her income and **[*22]** expenses, and the totality of her circumstances justifies Chapter 7 relief.

V. CONCLUSION

In view of the foregoing, the Court shall enter an order denying the Creditor's Motion for Dismissal.

By the Court,

/s/ Joan N. Feeney

JOAN N. FEENEY

UNITED STATES **BANKRUPTCY** JUDGE

Dated: September 14, 2010

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*2010 Bankr. LEXIS 3249, **

In re DAVID C. GORMAN, Debtor; JOHN P. FITZGERALD, ACTING UNITED STATES TRUSTEE, Plaintiff v. DAVID C. GORMAN, Defendant

Chapter 7, Case No. 08-13736-FJB, Adversary Proceeding No.08-1296

UNITED STATES **BANKRUPTCY** COURT FOR THE DISTRICT OF MASSACHUSETTS, EASTERN DIVISION

2010 Bankr. LEXIS 3249

September 15, 2010, Decided
September 15, 2010, Filed

CASE SUMMARY
PROCEDURAL POSTURE: Plaintiff United States Trustee (UST) filed a complaint against defendant Chapter 7 debtor objecting to his discharge pursuant to 11 U.S.C.S. § 727(a)(2)(B) and (a)(4)(A).

OVERVIEW: At trial, the stipulated facts and exhibits established the UST's claims that the debtor failed to disclose property of the estate and made false oaths on his schedules and statement of financial affairs (SOFA). Thus, the principal issue was whether he made the omissions and false statements with fraudulent intent. The court found the debtor to be financially sophisticated, as he was well educated and experienced in business and finance. The UST established that the debtor knowingly and fraudulently made false statements on his schedules and SOFA by failing to disclose his interests and positions in various corporations. The failure to disclose was material. Several of the entities were operating as of the petition date, and it was the duty of the trustee to determine whether there was value in the interests for the estate. The debtor's failure to disclose the existence of the omitted entities was done with fraudulent intent. He was attempting to protect his sister, who was the co-owner of some of his real estate interests, by keeping the properties out of the **bankruptcy** proceeding. His parents' illnesses were not an excuse for his omissions.

OUTCOME: Because the UST sustained his burden under § 727(a)(4)(A), the court did not address the counts under § 727(a)(2)(B). The court entered a judgment in favor of the UST, denying the debtor a discharge.

CORE TERMS: entity, tax returns, failed to disclose, disclosure, false oaths, bank accounts, disclose, non-operating, accounting, failure to disclose, real estate, ownership, credit union, distraction, distracted, checking account, knowingly, omission, federal income, economic value, failing to disclose, fraudulently, pretrial, partner, fraudulent intent, preponderance, concealed, discovery, defraud, plainly

LEXISNEXIS® HEADNOTES

Hide

Bankruptcy Law > Discharge & Dischargeability > Liquidations > Denial of Discharge > General Overview

HN1 See 11 U.S.C.S. § 727(a).

Bankruptcy Law > Discharge & Dischargeability > Liquidations > Denial of Discharge > False Accounts & Oaths

Evidence > Procedural Considerations > Burdens of Proof > Allocation

Evidence > Procedural Considerations > Burdens of Proof > Burden Shifting

HN2 A debtor can be refused his discharge under 11 U.S.C.S. § 727(a)(4)(A) only if he (1) knowingly and fraudulently made a false oath, (2) relating to a material fact. Once it reasonably appears that the debtor made a false oath, the burden shifts to the debtor to establish that he or she did not commit the offense or has a valid excuse for doing so. Nonetheless, the ultimate burden of proof remains on the party objecting to discharge. More Like This Headnote

Bankruptcy Law > Discharge & Dischargeability > Liquidations > Denial of Discharge > General Overview

HN3 While the statutory right to a discharge is to be liberally construed in favor of a debtor, the reason for 11 U.S.C.S. § 727 is to ensure that those who seek protection

under the **Bankruptcy** Code do not play fast and loose with their assets or with the reality of their affairs. The statutes are designed to insure that complete, truthful, and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on the facts rather than fiction. Neither a trustee nor the creditors should be required to engage in a laborious tug of war to drag the simple truth into the glare of daylight. More Like This Headnote

Bankruptcy Law > Discharge & Dischargeability > Liquidations > Denial of Discharge > False Accounts & Oaths

HN4 The standard to determine whether an omission is material for purposes of 11 U.S.C.S. § 727(a)(4)(A) is generally whether the subject matter bears a relationship a bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property. Valuation is not really the point. Matters are material if pertinent to the discovery of assets, including the history of a bankrupt's financial transactions. More Like This Headnote

Bankruptcy Law > Debtor Benefits & Duties > Debtor Duties

HN5 11 U.S.C.S. § 521(e)(2)(A) obligates a debtor to provide a copy of his or her most recent federal income tax return to a trustee. More Like This Headnote

COUNSEL: **[*1]** For David C Gorman, Lexington, MA, Debtor: Richard N. Gottlieb, Law Offices of Richard N. Gottlieb, Boston, MA.

For John O. Desmond, Framingham, MA, Trustee: Christopher Lee, New London, NH.

JUDGES: Frank J. Bailey, United States **Bankruptcy** Judge.

OPINION BY: Frank J. Bailey

OPINION

MEMORANDUM OF DECISION

INTRODUCTION

In this adversary proceeding the United States Trustee (the "U.S. Trustee") objects to the receipt by debtor David C. Gorman (the "Debtor") of a discharge in this chapter 7 case. The bases for objection to discharge are 11 U.S.C. §§ 727(a)(2)(B) and 727(a)(4)(A). The court held a trial at which three witnesses testified. Those witnesses were John Desmond ("Desmond"), who is the chapter 7 trustee, Linda Rogers, a licensed CPA employed as a **bankruptcy** analyst in the U.S. Trustee's office, and the Debtor himself. In addition, in the parties' pretrial memorandum, they stipulated to certain facts that were set forth in eighty-two separate paragraphs. Further, the parties agreed to the admissibility of sixty-five documentary exhibits. The stipulated facts and exhibits essentially establish the Trustee's claim that the debtor failed to disclose property of the estate and that he made false oaths on his schedules **[*2]** and statement of financial affairs. Accordingly, the principal issue at

trial was whether the Debtor made these omissions and false statements with fraudulent intent. Following are the findings of fact and conclusions of law required by FED.R.BANKR. P. 7052.

FACTS

The Debtor filed a voluntary petition (the "Petition") for relief under Chapter 7 of the **Bankruptcy** Code on May 22, 2008 (the "Petition Date"). On the same day, the Debtor filed his schedules of assets ("Schedules") and statement of financial affairs ("SOFA"), each of which he signed under the penalties of perjury, and Desmond was appointed chapter 7 trustee.

The Debtor is well educated and experienced in business and finance. He holds a Bachelor of Science degree and a Masters degree, both in accounting. He has worked as a controller for four different companies. In that role he has prepared financial statements for use in the businesses. He has also prepared a payroll and tax returns for corporate employees. When not employed by a company, the Debtor has owned and operated a professional services company that provides accounting and tax services to a variety of clients, both individuals and businesses. In all of these positions **[*3]** the Debtor either prepared financial reports and required financial forms or he arranged for their preparation. In short, and I find, the Debtor is financially sophisticated.

In addition to his work in accounting and finance, the Debtor has been engaged in numerous business ventures, principally in real estate development and investment. At the time the petition was filed, he owned equity interests in no fewer than ten closely-held corporations, with those interests ranging from twenty to one hundred percent of the equity in the entity. The entities in which the Debtor had an ownership interest included the following (collectively referred to as the "Operating Entities"):
1. Expert Tax Solutions, Inc. ("ETS"), through which the Debtor provided tax and accounting services;

2. Gordon Realty Partners, LLC ("GRP"), which owned real estate investments;

3. D&C Realty Partners, LLC ("D&CRP"), which owned real estate investments;

4. Boston Solar Living, Inc. ("BSL"), which sold passive solar energy systems; and

5. 69-71 Academy Street Realty Partners, LLC ("69-71 ASRP"), which owned real estate investments.
Each of these entities continued to operate after the Petition Date. The Debtor also owned **[*4]** interests in several non-operating entities (the "Non-Operating Entities"), mostly involved in real estate development. Finally, the Debtor owned an interest in Gorman and Silvano Construction ("GSC"), a construction company that had ceased to operate before the Petition Date.

Several of the Operating Entities reported net operating income on contemporaneously filed tax returns for the years immediately preceding the Petition Date. The Debtor maintained accounting information systems and prepared financial statements for the Operating Entities. Certain of the Operating Entities maintained web sites both before and after the Petition Date. Each of GRP, D&CP and 69-71 ASRP owned and operated apartment buildings in Fitchburg, Massachusetts. Those entities were operating at a net loss immediately before the Petition Date but were mostly current on their mortgage payments; at most they were in technical default on their loan agreements, meaning that there were past due tax and

water and sewer charges on the properties securing the loans, but there were no monetary defaults to the lenders. BSL appears to have been operating at a loss on or immediately before the Petition Date. Each of the **[*5]** real estate operating entities maintains an account at a federal credit union, and their rents were deposited into those accounts. The Debtor had signing authority on two of those accounts. The Debtor also prepared tax returns for each of the Operating Entities as well as for several of the Non-Operating Entities.

One Operating Entity, ETS, was the entity through which the Debtor operated his accounting practice. In 2008, the year the petition was filed, the Debtor prepared at least 250 tax returns for clients of ETS. According to a profit and loss statement prepared by the Debtor, ETS had net income in the first half of 2000 in the amount of $10,307.74. ETS maintained a checking account at a federal credit union, and the Debtor had sole check signing authority on the ETS checking account.

As noted above, the Debtor filed his Schedules and SOFA at the time he filed the Petition. Schedule B, the schedule of personal property, at Question 13 directs the Debtor to disclose his "[s]tock and interests in incorporated and unincorporated businesses." Question 14 seeks disclosure of "[i]nterests in partnerships or joint ventures." In response to Question 13 the Debtor indicated that he had "None." **[*6]** In response to Question 14 the Debtor disclosed his interest in one Non-Operating Entity, GSC, and he stated its value was "0.00." The parties have stipulated that in response to Questions 13 and 14 the Debtor failed to disclose his ownership interests in GRP, D&CR, 69-71 ASRP, ETS, and BSL.

The SOFA seeks, among other things, disclosure of information regarding a debtor's businesses. It defines "[i]n business" broadly, as including, for debtors who are individuals, any instance in which, in the prior six years, the debtor has been an officer, director, managing executive, or owner of five percent or more of the voting or equity securities of a corporation. It also includes in its definition any instance in which the debtor is a partner or a sole proprietor or is self-employed full time or part time. It expressly includes situations where the work is to "supplement income from the debtor's primary employment." The SOFA at Question 18 requires a debtor to disclose the name, address, and nature of any such business. The parties stipulate that the Debtor failed to disclose his ownership interests in GRP, D&CR, 69-71 ASRP, ETS, and BSL in response to Question 18. The Debtor did disclose **[*7]** his interest in GSC.

Question 2 in the SOFA requests that the Debtor list bank accounts in which he has any interest. As to bank accounts, the Debtor admitted that he used the ETS bank account at the credit union to pay personal expenses and that he made deposits to that account. In fact, he paid his **bankruptcy** counsel from that account. The Debtor agrees that he failed to disclose the ETS bank account in response to Schedule "B." The U.S. Trustee argues that it should have been disclosed because funds in the account were the debtors and being held for the debtor by ETS; Schedule B, in its initial instructions, expressly required the Debtor to list all of his assets, even those being held for him by another.[1] In addition the Debtor admitted in the Pretrial Memorandum that at the time of his **bankruptcy** filing, he maintained a personal bank account at the Somerville Municipal Credit Union, which account was not disclosed in the Schedules and SOFA.

FOOTNOTES

[1] It states: "List all property of the debtor of whatever kind. . . . If the property is being

held for the Debtor by someone else, state that person's name and address[.]"

Ms. Rogers, the **bankruptcy** analyst called as a witness by the U.S. Trustee, **[*8]** testified that she reviewed the financial records of ETS, the wholly-owned entity that the Debtor used to operate his accounting practice. She testified that ETS generated $18,000 in cash from April 2008 through December 2008 through its operations.

The Debtor testified at trial that he failed to disclose the existence of the Operating and Non-Operating Entities except GSC because, in his view, none of the entities had any equity or value. The Debtor also conceded on cross-examination that he disclosed his interest in GSC even though it had no equity or value. He explained that he failed to disclose the ETS checking account, as well as another account at Somerville Municipal Credit Union, because he determined that the accounts together had only slightly more than $2,000.00 in funds, which he viewed as "immaterial."

He also emphasized at the trial that, although he has education and experience as an accountant, he has no experience in **bankruptcy.** In fact, he suggested that his confusion and misunderstanding about what he had to disclose on his Schedules and SOFA was attributable to his accounting background, which he contends taught him to recognize assets only if they have economic **[*9]** value. Finally, the Debtor testified that at the section 341 meeting, the first meeting of creditors, he disclosed the existence of several of the Operating and Non-Operating Entities. He also says that he provided tax returns to Mr. Desmond that revealed his interests in those entities.

On another note, the Debtor testified that at the time he was completing his Schedules and SOFA, he was highly distracted. The Debtor's parents, with whom he lived at the time he filed his petition, were both terminally ill, and he was their primary caretaker. This caused him great stress and worry. Thus, he maintains that he was unable to focus on properly completing the Schedules and SOFA so as to make the necessary disclosures, if in fact such disclosures were indeed necessary. I find that whatever distraction the Debtor may have suffered on the basis of his parents' illnesses had no affect on his decision not to disclose the omitted entities and positions.

The Debtor contends that he cured any deficiency in his disclosures when he attended the section 341 meeting of creditors and produced tax returns that listed the entities that he had failed to disclose. The evidence shows the following. A couple **[*10]** of days before the meeting of creditors, the Debtor provided a partial copy of his 2007 personal federal income tax return to Mr. Desmond. The return contained some information about the omitted entities. The Debtor supplied this tax return pursuant to 11 U.S.C.§ 521(e)(2)(A), which obligates a debtor to provide a copy of his or her most recent federal income tax return to the trustee. He did not also provide tax returns for the various entities and provided no additional information regarding those entities until that information was specifically requested by Mr. Desmond. It was also established at the trial that the Debtor failed to attend a Rule 2004 examination of the Debtor that Mr. Desmond had scheduled after the section 341 meeting itself, to make further inquiry about the omitted entities. On these facts, it appears that the only disclosure the Debtor made at the first meeting of creditors was that which he made by complying with his obligation to supply the tax return.

POSITIONS OF THE PARTIES

The Trustee argues that the Court should deny the Debtor's discharge because the Debtor

made false oaths in his schedule "B," the schedule of personal property, at questions 2, 13, and **[*11]** 14 and in his SOFA at question 18 by failing to disclose estate property, namely his interests in the omitted entities and the two bank accounts. The Trustee points out that the Debtor admitted in the Pretrial Memorandum that he failed to disclose his interests in GRP, D&CRP, 69-71 ASRP, ETS, and BSL. The Trustee points out that in the Pretrial Memorandum, the Debtor admitted that in personal income tax returns that he had filed shortly before he completed his Schedules and SOFA, he had reported income or losses related to many of the entities that he omitted from his **bankruptcy** filings. This, he argues, establishes that the Debtor knowingly failed to disclose those entities in his **bankruptcy** filings. As to bank accounts, the Trustee argues that the Debtor's failure to list the ETS bank account and the Somerville Municipal Credit Union Bank Account in response to Question 2 on Schedule "B" constituted a knowing failure to disclose.

The Debtor advances essentially four defenses to the Trustee's complaint. First, he argues that he believed he only had to list entities in which he had an interest that had actual economic value and that the Trustee bears the burden of establishing that **[*12]** the entities he omitted had "substantial value." Second, he states that he misunderstood the questions that were posed in the Schedules and SOFA. Third, the Debtor argues that he cured any deficiency in his disclosures when he attended the 341 meeting and produced tax returns that listed the entities that he had failed to disclose. And finally, as noted above, the Debtor says that his failures should be excused because, at the time he was preparing his **bankruptcy** disclosures, he was "distracted" by personal losses and challenges.

DISCUSSION

The **Bankruptcy** Code provides at 11 U.S.C. § 727(a) in relevant part as follows:
HN1(a) The court shall grant the debtor a discharge, unless
(2) the debtor, with intent to hinder, delay or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—
(B) property of the estate, after the date of the filing of the petition . . . [or]

(4) the debtor knowingly and fraudulently, in or in connection with the case—
(A) made a false oath or account[.]
11 U.S.C. § 727(a). The U.S. Trustee argues **[*13]** that the court should deny the Debtor a discharge because he has established by a preponderance of the evidence that the Debtor has concealed property of the estate and has done so with the intent to hinder, delay, or defraud his creditors and the chapter 7 trustee. 11 U.S.C. § 727(a)(2)(B). Alternatively, the U.S. Trustee argues that the court should deny the Debtor a discharge because he has established by a preponderance of the evidence that the Debtor made false oaths by failing to disclose estate property in his Schedules and SOFA. 11 U.S.C. § 727(a)(4)(A).

False Oaths under § 727(a)(4)(A)

I begin with the false oaths count under § 727(a)(4)(A). The leading case in this Circuit on interpretation and application of § 727(a)(4)(A) is the case of *Boroff v. Tully (In re Tully),* 818 F.2d 106 (1st Cir. 1987). In *Tully,* the court set forth a two-part test: HN2"the debtor can be refused his discharge only if he (i) knowingly and fraudulently made a false oath, (ii) relating to a material fact." *Id.* at 110. Once it reasonably appears that the debtor made a false oath, the burden shifts to the debtor to establish that he or she did not commit the offense or has a valid excuse for doing so. *In re Mascolo,* 505 F.2d 274, 276 (1st Cir. 1974).

[*14] Nonetheless, the ultimate burden of proof remains on the party objecting to discharge. *Tully*, 818 F.2d at 110; *In re Burgess*, 955 F.2d 134, 136 (1st Cir. 1992).

HN3 While the statutory right to a discharge is to be liberally construed in favor of the debtor, the *Tully* court underscored that the reason for § 727 is to ensure that those who seek protection under the **Bankruptcy** Code do not play "fast and loose" with their assets or with the reality of their affairs. *Tully* at 110. "The statutes are designed to insure that complete, truthful, and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on the facts rather than fiction." *Id.* "Neither the trustee nor the creditors should be required to engage in a laborious tug of war to drag the simple truth into the glare of daylight." *Id.* (citations omitted).

The Trustee has established, and the court finds, that the Debtor knowingly and fraudulently made false oaths on his Schedules and SOFA by failing to disclose his interests and positions in the Operating and Non-Operating Entities. In the face of clear and unambiguous directions on the Schedules and SOFA calling **[*15]** for disclosure of the identities of his stock ownership in corporations, the Debtor failed to disclose the identity of several corporations in which he had an interest as of the Petition Date. I find not credible the Debtor's testimony that, by virtue of his training as an accountant and the alleged lack of value of his interests in the omitted entities, he did not appreciate the need to disclose these entities in his schedules. However, even if this testimony were true, he also inexplicably failed to disclose the corporate offices and ownership positions that he held in those entities, as required by the SOFA. In fact, as of the Petition Date, the Debtor owned twenty percent of each of GRP, D&CRP and 69-71 ASRP, one hundred percent of ETS, and thirty percent of BLS, but he failed to reveal these interests. The fact that the Debtor had recently identified his interests in many of these entities in his personal tax returns, coupled with his less than convincing testimony about this subject at the trial, establishes that his omission of these entities was knowing and intentional. In addition, the Debtor failed to reveal that he held corporate offices and positions in several of the Operating **[*16]** and Non-Operating Entities, which information was called for plainly and directly by the SOFA. Again, the Debtor did not credibly establish that he was unaware of these positions and did not explain why he left them off of his SOFA.

I also find that failing to disclose these interests was material. Several of these entities were operating as of the Petition Date. The real estate entities owned apartment buildings and were not in financial default. Although the real estate may have declined in value in the months and years in advance of the Petition Date, it nonetheless was the duty of the chapter 7 trustee to determine whether there was value in these interests for the estate, and he was denied that opportunity when the Debtor elected not to disclose them. Similarly, the Debtor's interests in ETS and BLS should have been disclosed. Although ETS is a professional services company offering only the services of the Debtor, disclosure of that entity could well have led to the identification of other assets, for example receivables, in which the estate may have had an interest. And although BLS was no longer operating, the Debtor's interest in that entity may well have had value if that **[*17]** entity had any assets. Again, it was the chapter 7 trustee's job to make a determination of the value of BLS, but he could not make that determination because its existence was not disclosed.

The Debtor responds that he decided not to disclose these interests because he felt they did not have any economic value and therefore nothing could be gained by disclosing their existence. The Debtor argues that the failure to disclose such assets could not be material. The Court rejects this position for a variety of reasons. First, the Schedules and SOFA do not limit themselves to the disclosure of entities that have economic value. Nor should they,

because those that are relying on disclosure in the schedules and SOFA should have the ability to decide for themselves what value there is in the estate. Second, this argument has been rejected by the courts in this district. Most recently, when addressing a debtor's argument that his failure to disclose was immaterial, the First Circuit **Bankruptcy** Appellate Panel responded as follows: HN4"[t]he standard to determine whether an omission is material is generally whether the 'subject matter bears a relationship the bankrupt's business transactions or **[*18]** estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property.'" *McClure v. Cormier (In re Cormier)*, BAP No. MW 10-002, 2010 Bankr. LEXIS 2322 (1st Cir. BAP 2010), citing *In re Tully*, 818 F.2d at 111. The corporate interests and bank accounts that the Debtor failed to disclose in this case plainly involve the Debtor's business dealings, his estate, and his business transactions. Finally, in the *Tully* case the debtor disputed the value of certain of the assets that he failed to disclose, arguing that those assets had no value and were therefore not material. *Id.* at 111 n.4. The court responded that "valuation is not really the point." *Id.* "Matters are material if pertinent to the discovery of assets, including the history of a bankrupt's financial transactions[.]" *Mascolo*, 505 F.2d at 277-78. It follows that the Debtor's failure to disclose his business interests and bank accounts was material even if they had little current value. This is equally true of the Debtor's failure to identify his corporate positions and ownership rights in the SOFA. Again, disclosure of these positions and interests may have been the source of inquiry that could have led to additional **[*19]** assets or rights.

I also find that the Debtor's failure to disclose the existence of the omitted entities was done with fraudulent intent. Certain of these entities owned potentially valuable real estate. The Debtor admitted at trial that if the market recovers for such real estate interests, these entities will indeed be valuable and, depending on appraisals of value at the time of filing, may have current value. The Debtor testified that his sister was the other owner of the real estate in question and that he felt obligated to protect her interests in the real estate. From his testimony I conclude that he was plainly attempting to protect her by keeping these properties out of the **bankruptcy** proceeding, which he was not entitled to do.

As for the Debtor's excuse that he was distracted by his personal circumstances at the time he prepared the Schedules and SOFA, the Court cannot credit that excuse. Most, if not all, consumer debtors suffer from distraction when they file their **bankruptcy** petitions. The distractions suffered by the Debtor in this case, though different in kind from the ordinary economic stresses affecting debtors in **bankruptcy,** nonetheless did not affect his deliberation **[*20]** about which assets and positions to disclose. His distraction did not cause him to omit his assets and positions by inadvertence. His distractions notwithstanding, the Debtor's omissions from the Schedules and SOFA were knowing and deliberate, not inadvertent. Here, the Debtor says he failed to disclose certain business interests because he was distracted, but he did in fact remember to disclose his interest in the GSC business. That business, according to the Debtor, had no value at the time he filed his case. Thus, it is difficult to distinguish GSC from the many entities that the Debtor failed to disclose, many of which held potentially valuable interests in real estate. Distraction under the circumstances of this case does not begin to excuse the Debtor's failure to disclose multiple business interests that may have led to the discovery of valuable assets.

In addition, the Debtor's two alleged excuses—(i) that he omitted these entities because they had no value and (ii) that he omitted the entities because he was distracted—are inconsistent with each other. According to the first, he made a considered decision not to list the entities; according to the second, he was too distracted **[*21]** to remember them or to recognize the need to list them. He has made no effort to reconcile the two. As they are offered in tandem, each is made suspect by the other.

Finally, the Debtor's argument that he cured his failure to disclose the aforementioned information by revealing the omitted information at his first meeting of creditors, the so-called "section 341 meeting," is not tenable. The evidence shows that a couple of days before the meeting of creditors, the Debtor provided a partial copy of his 2007 personal federal income tax return to Mr. Desmond; and the return contained some information about the omitted entities. The Debtor supplied this tax return pursuant to HN5 11 U.S.C.§ 521(e)(2)(A), which obligates a debtor to provide a copy of his or her most recent federal income tax return to the trustee. He did not also provide tax returns for the various entities and provided no additional information regarding those entities until that information was specifically requested by Mr. Desmond. It was also established at the trial that the Debtor failed to attend a Rule 2004 examination of the Debtor that Mr. Desmond had scheduled after the section 341 meeting itself, to make further **[*22]** inquiry about the omitted entities. In sum, I conclude that the Debtor's disclosures at the first meeting of creditors were limited and, in effect, compelled by § 521(e)(2)(A) and not the kind of full and voluntary disclosures that might tend to show that his omission of the entities and positions from the Schedules and SOFA were not made with fraudulent intent.

From the evidence adduced, the Court may and does infer that, in making his numerous false oaths as to the omitted entities and his positions with those entities, the Debtor acted knowingly and fraudulently. The evidence he has adduced in rebuttal is unavailing. I conclude by a preponderance of the evidence that the Debtor made his numerous false oaths with knowledge of their falsity and intent to defraud. The U.S. Trustee is therefore entitled to a judgment of denial of discharge.

The above conclusion is based exclusively on the Debtor's false oaths as to the omitted entities and as to the Debtor's positions with those entities. The Court does not rely on the alleged false oaths as to two checking accounts. In view of the above conclusion, the court deems it unnecessary to address the counts based on the checking accounts and **[*23]** to address the U.S. Trustee's separate counts under § 727(a)(2)(B).

CONCLUSION

In light of the Court's determination that the U.S. Trustee has sustained his burden under § 727(a)(4)(A), the Court will enter a separate judgment denying the Debtor a discharge.

Date: September 15, 2010

/s/ Frank J. Bailey

Frank J. Bailey

United States **Bankruptcy** Judge

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*2010 U.S. App. LEXIS 20222, **

MICHAEL PERRY AND CONDOMINIUM HOUSING, INC., Plaintiffs, Appellees, v. STEVEN BLUM, AS TRUSTEE OF MOORINGS NOMINEE TRUST, ET AL., Defendants, Appellants.

No. 09-1977

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

2010 U.S. App. LEXIS 20222

October 1, 2010, Decided

PRIOR HISTORY: [*1]
APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS. Hon. Nancy Gertner, U.S. District Judge.
Perry v. Blum, 2008 U.S. Dist. LEXIS 118524 (D. Mass., Oct. 31, 2008)

DISPOSITION: Affirmed in part, reversed in part, vacated, and remanded. All parties shall bear their own costs.

CASE SUMMARY

PROCEDURAL POSTURE: Following a foreclosure sale, appellants cross-claimed against appellee debtor for an accounting of both the foreclosure proceeds and all rents collected in a 16-year period. The United States District Court for the District of Massachusetts held a bench trial. Before the court made final accounting, the parties moved for reconsideration of an earlier case and to alter or amend the judgment. The court denied the motions. Appellants sought review.

OVERVIEW: The controversy emerged in commercial dealings that ended in a foreclosure sale of the real property securing certain negotiable notes, the proceeds of which were to be divided between various parties. Appellants insisted that the district court erred in (i) invoking judicial estoppel, (ii) miscalculating the equity of redemption, and (iii) adding one of them as defendants after the trial ended. The appellate court concluded that the district court erred as a matter of law in invoking the doctrine of judicial estoppel to limit the appellants' proof as to the amount owed on the notes. In turn, this holding required vacation of the judgment. The district court would have to determine the actual amount due on the notes at the relevant time and rework the accounting. The appellate court took no view as to the amount due on the notes; although appellants asserted that the amount due was $ 7,494,435, the appellees fiercely disputed the basis for that figure. The other rulings appealed from were affirmed, and further proceedings in the district court were to be conducted consistent with this opinion. On remand, the district court could take such further evidence as it deemed appropriate.

OUTCOME: The appellate court reversed as to the application of judicial estoppel, vacated the judgment, affirmed as to all remaining issues and remanded for further proceedings consistent with this opinion.

CORE TERMS: judicial estoppel, foreclosure, settlement, equity of redemption, accounting, equitable, mortgage, foreclosure sale, joinder, holder, preliminary injunction, personal defenses, reach-and-apply, uncollectible, estoppel, estopped, owed, cross-claim, surplus, offset, bankruptcy proceedings, calculating, calculation, noteholder, straw, abuse of discretion, extinguished, foreclosed, unrelated, join

LEXISNEXIS® HEADNOTES

Hide

Civil Procedure > Jurisdiction > Subject Matter Jurisdiction > Supplemental Jurisdiction > General Overview

Civil Procedure > Federal & State Interrelationships > Erie Doctrine

HN1 Where a federal court proceeds under supplemental jurisdiction it is obliged to apply federal procedural law and state substantive law. To the extent that procedural issues loom, the Federal Rules of Civil Procedure provide the beacon by which the court must steer. More Like This Headnote

Civil Procedure > Federal & State Interrelationships > Choice of Law > General Overview

Civil Procedure > Federal & State Interrelationships > Erie Doctrine

HN2 Where the parties and the district court all assume that federal standards of judicial estoppel govern, and the case has been briefed and argued on the same assumptions, the court may hold the parties to their plausible choice of law, whether or not that choice is correct. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

HN3 An appellate court reviews for abuse of discretion a district court's application of judicial estoppel. Within that rubric, the appellate court accepts the trial court's findings of fact unless they are clearly erroneous and evaluate its answers to abstract questions of law de novo. More Like This Headnote

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

Civil Procedure > Appeals > Standards of Review > Fact & Law Issues

HN4 An appellate court treats a material mistake of law as a per se abuse of discretion. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN5 The doctrine of judicial estoppel is equitable in nature. It operates to prevent a litigant from taking a litigation position that is inconsistent with a litigation position successfully asserted by him in an earlier phase of the same case or in an earlier court proceeding. The purpose of the doctrine is to protect the integrity of the judicial process. It is typically invoked when a litigant tries to play fast and loose with the courts. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN6 The contours of judicial estoppel are hazy. But even though its elements cannot be reduced to a scientifically precise formula, courts generally require the presence of

three things before introducing the doctrine into a particular case. First, a party's earlier and later positions must be clearly inconsistent. Second, the party must have succeeded in persuading a court to accept the earlier position. Third, the party seeking to assert the inconsistent position must stand to derive an unfair advantage if the new position is accepted by the court. Ordinarily, the party against whom judicial estoppel is invoked must be the same party who made the prior (inconsistent) representation. Courts normally refuse to apply judicial estoppel to one party based on the representations of an unrelated party. Nevertheless, courts sometimes have allowed judicial estoppel when the estopped party was responsible in fact for the earlier representation, or when the estopped party was the assignee of a litigation claim or assumed the original party's role. More Like This Headnote

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Enforcement > Defenses & Claims

HN7 Under Massachusetts law, negotiable instruments are governed by Article III of the Uniform Commercial Code (U.C.C.). Mass. Gen. Laws ch. 106, § 3-102. The U.C.C. states that a noteholder's right to enforce a note is subject to certain defenses. Mass. Gen. Laws ch. 106, § 3-305(a). These defenses include those enumerated in Mass. Gen. Laws ch. 106, § 3-305(a)(1) (often termed real defenses), defenses specifically listed elsewhere in Article III, and defenses that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract (often termed personal defenses). If a noteholder qualifies as a holder in due course, his right to enforce the note is subject only to real defenses. § 3-305(b). More Like This Headnote

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Enforcement > Holders in Due Course > General Overview

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Enforcement > Holders in Due Course > Defenses

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Enforcement > Holders in Due Course > Exceptions

HN8 Where parties do not presume to be holders in due course, they are subject to the axiom that the rights of a transferee who is not a holder in due course rise no higher than the rights of the transferor. It follows that transferees are subject to the trilogy of defenses described in Mass. Gen. Laws ch. 106, § 3-305(a) to the same extent that those defenses would have been available against the transferor. In essence a holder who is not a holder in due course is treated under Massachusetts law as the assignee of a contract. This does not mean, however, that the transferor and the transferee are to be treated as one and the same for all purposes. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Enforcement > Defenses & Claims

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Enforcement > Holders in Due Course > Defenses

HN9 Judicial estoppel does not fit comfortably within any of the trilogy of defenses

described in Mass. Gen. Laws ch. 106, § 3-305(a). Judicial estoppel is certainly not a real defense within the provision of the statute, nor is it a defense specifically listed anywhere in Article III of the U.C.C. This leaves only the category of personal defenses. Personal defenses typically are thought to be those based on common law contract principles. Mass. Gen. Laws ch. 106, § 3-305(a) cmt. 2. Personal defenses, such as failure of consideration and usury are defenses or claims stemming from the underlying transaction. Judicial estoppel does not fit seamlessly into the taxonomy of personal defenses, as it is not a defense aimed directly at either the validity or the enforceability of a contract. Rather, it is a judge-made doctrine designed to protect the integrity of the judicial system. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Enforcement > Holders in Due Course > General Overview

HN10 The boundaries of judicial estoppel are hazy. It is conceivable that cases may arise in which the doctrine can be considered a personal defense, used to prevent a noteholder from playing fast and loose with the courts through, say, engaging a straw to assert a payoff amount contradictory to one earlier put forth by the noteholder himself. Courts will apply judicial estoppel to neutralize threats to judicial integrity however they may arise. The combinations of possible circumstances are infinitely varied, and a flat holding that judicial estoppel can be circumvented simply by transferring property to a third party would be folly. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN11 The party proposing an application of judicial estoppel must show that the relevant court actually accepted the other party's earlier representation. Judicial estoppel is not implicated unless the first forum accepted the legal or factual assertion alleged to be at odds with the position advanced in the current forum. Acceptance in this context is a term of art. In order to satisfy this prerequisite, a party need not show that the earlier representation led to a favorable ruling on the merits of the proceeding in which it was made, but must show that the court adopted and relied on the represented position either in a preliminary matter or as part of a final disposition. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN12 On a judicial estoppel analysis, the showing of judicial acceptance must be a strong one. The need for a strong showing derives from the maxim that judicial estoppel is applied with caution to avoid impinging on the truth-seeking function of the court because the doctrine precludes a contradictory position without examining the truth of either statement. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN13 The need for a strong showing derives from the maxim that judicial estoppel is applied with caution to avoid impinging on the truth-seeking function of the court because the doctrine precludes a contradictory position without examining the truth of either statement. The insistence upon a court having accepted the party's prior inconsistent position ensures that judicial estoppel is applied in the narrowest of circumstances. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN14 A proponent of judicial estoppel must affirmatively show, by competent evidence or inescapable inference, that the prior court adopted or relied upon the previous inconsistent assertion. More Like This Headnote

Civil Procedure > Settlements > Settlement Agreements > General Overview

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN15 Generally speaking, settlement neither requires nor implies any judicial endorsement of either party's claims or theories. So viewed, an unexplained settlement does not provide the prior success necessary for judicial estoppel. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN16 Judicial estoppel is not meant to be a trap for the unwary and should be employed sparingly when there is no evidence of intent to manipulate or mislead the courts. More Like This Headnote

Civil Procedure > Judgments > Preclusion & Effect of Judgments > Estoppel > Judicial Estoppel

HN17 Conjecture, without more, cannot support the application of judicial estoppel. Put another way, remote possibilities are not enough. More Like This Headnote

Civil Procedure > Remedies > Equitable Accountings > General Overview

Governments > Courts > Authority to Adjudicate

HN18 The calculation of an equitable accounting is, within broad limits, committed to the district court's discretion. Accordingly, an appellate court will not disturb such a calculation unless it rests on clearly erroneous findings of fact, incorrect legal standards, or a meaningful error in judgment. Because the district court is in a considerably better position to bring the scales into balance than an appellate tribunal, an appellate court will not normally find an abuse of discretion unless, upon whole-record review, it is convinced that the district court committed a significant error in judgment. More Like This Headnote

Real Property Law > Financing > Mortgages & Other Security Instruments > Redemption > General Overview

HN19 Under basic principles of property law, the holder of the equity of redemption does not have a property interest in foreclosure proceeds unless and until all outstanding liens on the property have been extinguished. More Like This Headnote

Real Property Law > Nonmortgage Liens > Equitable Liens

HN20 A junior lienholder has an equitable lien, transferred from the foreclosed premises, that attaches to the foreclosure surplus. More Like This Headnote

Civil Procedure > Remedies > Equitable Accountings > General Overview

HN21 An accounting is not a rote exercise in arithmetic. To the contrary, it is an equitable remedy, and equitable remedies are flexible tools to be applied with the focus on fairness and justice. More Like This Headnote

Civil Procedure > Remedies > Equitable Accountings > General Overview

HN22 In performing an equitable accounting, the district court is not a mere scrivener, charged with carrying out a ministerial task. Instead, the court is charged with tempering arithmetic with equity, or, as the United States Court of Appeals for the First Circuit has phrased it, bringing the scales into balance. More Like This Headnote

Civil Procedure > Parties > Joinder > General Overview

Civil Procedure > Appeals > Standards of Review > Abuse of Discretion

Civil Procedure > Appeals > Standards of Review > De Novo Review

Civil Procedure > Appeals > Standards of Review > Fact & Law Issues

HN23 An appellate court reviews an order joining a party under Fed R. Civ. P. 21 for abuse of discretion. Within that rubric, embedded legal questions are reviewed de novo. More Like This Headnote

Civil Procedure > Parties > Joinder > General Overview

HN24 Former Fed R. Civ. P. Rule 21 states that parties may be dropped or added by order of the court on motion of any party or of its own initiative at any stage of the action and on such terms as are just. Although the rule permits joinder at any stage of the proceedings, joinder in a particular case must comport with the strictures of due process. These strictures include notice and an opportunity to be heard at a meaningful time and in a meaningful manner. More Like This Headnote

Civil Procedure > Parties > Joinder > General Overview

HN25 For obvious reasons, joinder of a defendant after trial is disfavored. More Like This Headnote

Constitutional Law > Bill of Rights > Fundamental Rights > Procedural Due Process > Scope of Protection

HN26 A party who claims to be aggrieved by a violation of procedural due process must show prejudice. More Like This Headnote

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JUDGES: Before Thompson, Selya and Dyk, * Circuit Judges.

* Of the Federal Circuit, sitting by designation.

OPINION BY: SELYA

OPINION

SELYA, *Circuit Judge*. This appeal requires us to sort through a complicated set of commercial machinations and evaluate the soundness of an equitable accounting through which the lower court divided the surplus proceeds of a multi-million-dollar foreclosure sale. To solve this conundrum, we must answer three loosely related questions. The first concerns the applicability of the doctrine of judicial estoppel, the second concerns the way in which the methodology for calculating the equity of redemption fits within the framework of a judicial accounting, and **[*2]** the third concerns the propriety of a post-trial joinder of additional defendants. After careful consideration of these questions, we reject the district court's proposed application of the doctrine of judicial estoppel but uphold its treatment of the equity of redemption and its joinder order. When all is said and done, we affirm in part, reverse in part, vacate the judgment, and remand for further proceedings consistent with this opinion.

I. BACKGROUND

Although there is a long, convoluted, and sometimes Machiavellian history involving the protagonists, we relate here only those facts relevant to the issues presented on appeal. We supplement this account in connection with our discussion of particular issues. Throughout, we accept the district court's factual findings to the extent that they are not clearly erroneous. *Limone v. United States*, 579 F.3d 79, 94 (1st Cir. 2009); *Cumpiano v. Banco Santander P.R.*, 902 F.2d 148, 152 (1st Cir. 1990); Fed. R. Civ. P. 52(a).

Michael Perry and Stephen Yellin each hold a fifty percent interest in Condominium Housing, Incorporated (CHI), which owned a large apartment complex in Boston, Massachusetts, known as "the Fenmore." CHI purchased the Fenmore **[*3]** from Harold Brown in 1985. The purchase price included two promissory notes, with an aggregate face value of approximately $ 11,000,000 (the Notes), executed by Perry and Yellin as co-makers. The Notes were secured by first and second mortgages on the property.

Over time, Perry and Yellin made payments on the Notes. But when the Boston real estate market cratered in the late 1980s, they defaulted on several obligations, including not only the Notes but also an array of loans from their primary lender, Capitol Bank (which, among other things, held a third mortgage on the Fenmore). By 1990, Perry and Yellin owed Capitol Bank more than $ 7,000,000. They negotiated a settlement with the bank in July of that year, but the settlement proved to be illusory. The bank subsequently repudiated it, and Perry and Yellin were forced to sue for specific performance in a Massachusetts state court.

During the currency of that suit, the Federal Deposit Insurance Corporation (FDIC) took over Capitol Bank as its receiver and liquidating agent. The FDIC sought to collect Perry's and Yellin's indebtedness to the bank, claiming that they owed roughly $ 19,000,000 in principal and accrued interest on various **[*4]** loans. As part of its collection effort, the FDIC disavowed the earlier settlement and, in January of 1999, filed an amended counterclaim in the state court suit.

The amended counterclaim named as defendants Perry, Yellin, and a number of their relatives. These additional defendants (whom we shall call the "Perry Parties" and the "Yellin Parties") were allegedly involved in Perry's and Yellin's real estate enterprises as "straws." In due season, the FDIC removed the state court action to the federal district court. *See* 12 U.S.C. § 1819(b)(2)(B).

Brown's fortunes also had been adversely affected by the slumping real estate market. In 1991, he filed for **bankruptcy.** The **bankruptcy** proceedings dragged on and, in August of 1996, he submitted an affidavit to the **bankruptcy** court in which he represented that the Notes had an unpaid balance of $ 902,662 and were uncollectible. The **bankruptcy** court granted Brown a discharge from **bankruptcy** in September of 1996 and permitted him to retain ownership of the Notes.

CHI went into **bankruptcy** in April of 1996. After Brown emerged from his own **bankruptcy,** he intervened in CHI's **bankruptcy** and requested relief from the automatic stay, 11 U.S.C. § 362, **[*5]** so that he could foreclose on the Fenmore. Brown represented that the Notes had a principal balance of $ 902,662 and past-due interest of $ 950,620. The **bankruptcy** court granted Brown's motion to lift the stay in December of 1996. Instead of foreclosing, however, Brown agreed to sell the Notes to Yellin for $ 950,000. Yellin effectuated this purchase behind Perry's back and through a straw: Steven Blum, in his capacity as trustee of Moorings Nominee Trust. The sole beneficiary of the trust was North Shore Renewal, Inc., a shell corporation wholly owned by Yellin's wife, Elaine. Yellin, acting through Blum, then took control of the Fenmore as a mortgagee-in-possession and began collecting rents.

In June of 1997, Perry, on behalf of CHI, sued the Yellins and Blum, individually and as trustee of Moorings Nominee Trust, in a Massachusetts state court. The suit alleged an alphabet of wrongdoing, including breach of fiduciary duty, fraud, and conversion, stemming from the purchase of the Notes. In October of 1998, after Perry failed to attend a pretrial conference, the state court dismissed the suit for want of prosecution. *CHI v. Blum*, No. 97-

3007 (Mass. Dist. Ct. Oct. 7, 1998) (unpublished **[*6]** order).

In late 1997, Yellin, acting through Blum, commenced foreclosure proceedings with respect to the Fenmore. The FDIC, which held junior mortgages on the property as the receiver for Capitol Bank, responded by bringing an action in the federal district court. In the action, the FDIC sought to enjoin any foreclosure sale. The district court granted a preliminary injunction blocking the foreclosure sale. Later, it consolidated the action in which it had granted the injunction with the action that the FDIC had removed from the state court.

In 2002, Yellin and the Yellin Parties settled with the FDIC for $ 5,000,000. Under the terms of the settlement, the FDIC permitted Yellin, acting through Blum, to foreclose on the Fenmore and use the first $ 5,000,000 of the foreclosure proceeds to fund the settlement. The district court thereafter dissolved the existing injunction and Blum foreclosed on the Fenmore. The apartment complex was sold at auction for $ 9,450,000 (ironically, to Brown). The FDIC and the Yellin Parties then jointly moved to dismiss all claims inter sese. The district court granted that motion on June 10, 2002. [1]

FOOTNOTES

[1] The FDIC settled separately with the Perry Parties in November **[*7]** of 2005. The settlement totaled $ 6,625,000.

Following the foreclosure sale, Perry, on behalf of himself and CHI, cross-claimed against Blum for an accounting of both the foreclosure proceeds and all rents collected between 1996 and 2002. Perry alleged that, as an equal partner in CHI, he was entitled to one-half of the Fenmore's equity of redemption.

In February and March of 2005, the district court held a bench trial on the cross-claim. The Notes were secured by first and second mortgages on the Fenmore, so Blum, as the noteholder and as a straw for Yellin, had a priority claim to the foreclosure proceeds. Not surprisingly, then, one of the main issues at trial concerned the amount due on the Notes. Blum contended that $ 7,494,435 was due. Perry contended that the amount due was much less. The district court determined that Blum was estopped from asserting that the amount due was anything other than what Brown, Blum's predecessor-in-interest, had represented in the **bankruptcy** court, namely, $ 1,853,282. *Perry v. Blum (Perry I)*, No. 99-12194, 2008 U.S. Dist. LEXIS 118524, *26 (D. Mass. Oct. 31, 2008). [2] Even though the trial had ended years earlier, the court granted Perry's motion to join the Yellins **[*8]** as reach-and-apply defendants. 2008 U.S. Dist. LEXIS 118524 at *32.

FOOTNOTES

[2] The district court also addressed Perry's argument that the Notes were discharged (and, thus, the amount due was zero). The court held that this argument was barred by res judicata: the dismissal of CHI's state court action precluded Perry from litigating the discharged claim. *Perry I*, 2008 U.S. Dist. LEXIS 118524 at *7-*14 . This ruling is not

challenged on appeal.

Before the court actually made a final accounting, Blum and the Yellins moved for reconsideration of *Perry I*, arguing that the court had erred in applying judicial estoppel and in joining the Yellins after trial. The court denied the motion, *Perry v. Blum (Perry II)*, No. 99-12194, slip op. at 2 (D. Mass. June 2, 2009). The court then prepared the accounting and entered judgment for Perry against Blum and the Yellins in the sum of $ 4,347,126, plus pre-judgment interest. The appendix to this opinion delineates the manner in which the court calculated this amount.

Blum and the Yellins moved to alter or amend the judgment, Fed. R. Civ. P. 59(e), protesting that the court had erred in excluding from its calculation of the equity of redemption an offset for the $ 5,000,000 payment that the Yellins **[*9]** had made to the FDIC -- an offset that would have had the effect of reducing Perry's award by $ 2,500,000. The district court denied the motion, reasoning that it would be inequitable to allow Yellin to settle his personal debts by using foreclosure proceeds that otherwise would have to be split with Perry. *Perry v. Blum (Perry III)*, No. 99-12194 (D. Mass. June 18, 2009) (unpublished order). Blum and the Yellins filed a timely motion of appeal from both the final judgment and the denial of their Rule 59(e) motion.

II. ANALYSIS

Like a milking stool, this appeal rests on three legs. The appellants (Blum and the Yellins) insist that the district court erred in (i) invoking judicial estoppel, (ii) miscalculating the equity of redemption, and (iii) adding the Yellins as defendants after the trial had ended. We discuss each of these arguments separately. Before doing so, however, we pause to make a point about choice of law.

Due to the FDIC's involvement, this case had its roots in federal question jurisdiction. 12 U.S.C. § 1819(b)(2)(A); 28 U.S.C. § 1331. But the FDIC has departed from the scene, and the remaining claims are cognizable only under supplemental jurisdiction. 28 U.S.C. § 1367. **[*10]** HN1 Where, as here, a federal court proceeds under supplemental jurisdiction, it is obliged to apply federal procedural law and state substantive law. *Hoyos v. Telecorp Commc'ns, Inc.*, 488 F.3d 1, 5 (1st Cir. 2007). To the extent that procedural issues loom, the Federal Rules of Civil Procedure provide the beacon by which we must steer.

Most of the components of the appellants' asseverational array raise substantive questions and, thus, require us to apply Massachusetts law. Withal, one of the issues presents a thorny problem of classification, which this court has not resolved: Is judicial estoppel procedural (and, thus, governed by federal law) or substantive (and, thus, governed by state law)?

This is an interesting Rubik's cube, but we need not provide a definitive answer here. The parties and the district court all assumed that federal standards of judicial estoppel governed, and the case has been briefed and argued on the same assumption. HN2 In such circumstances, we may hold the parties to their plausible choice of law, whether or not that choice is correct. *See Thore v. Howe*, 466 F.3d 173, 181 n.1 (1st Cir. 2006); *Alt. Sys. Concepts, Inc. v. Synopsys, Inc.*, 374 F.3d 23, 32 (1st Cir. 2004). **[*11]** We follow that prudential course and apply federal law in discussing this issue.

A. *Judicial Estoppel*.

The appellants insist that the district court erred in invoking judicial estoppel to preclude them from showing that the amount due on the Notes was anything other than what Brown had represented in a prior **bankruptcy** proceeding. HN3 We review for abuse of discretion a district court's application of judicial estoppel. *Global NAPs, Inc. v. Verizon New Engl. Inc.*, 603 F.3d 71, 91 (1st Cir. 2010). Within that rubric, we accept the trial court's findings of fact unless they are clearly erroneous, *see Limone*, 579 F.3d at 94; *Cumpiano*, 902 F.2d at 152, and evaluate its answers to abstract questions of law de novo, *see San Juan Cable LLC v. P.R. Tel. Co.*, 612 F.3d 25, 29 (1st Cir. 2010). HN4 We treat a material mistake of law as a per se abuse of discretion. *Rosario-Urdaz v. Rivera-Hernandez*, 350 F.3d 219, 221 (1st Cir. 2003).

HN5 The doctrine of judicial estoppel is equitable in nature. It operates to prevent a litigant from taking a litigation position that is inconsistent with a litigation position successfully asserted by him in an earlier phase of the same case or in an earlier court proceeding. *InterGen N.V. v. Grina*, 344 F.3d 134, 144 (1st Cir. 2003). **[*12]** The purpose of the doctrine is to protect the integrity of the judicial process. It is typically invoked when a litigant tries to play fast and loose with the courts. *New Hampshire v. Maine*, 532 U.S. 742, 749-50, 121 S. Ct. 1808, 149 L. Ed. 2d 968 (2001); *Alt. Sys. Concepts*, 374 F.3d at 33; *Patriot Cinemas, Inc. v. Gen. Cinema Corp.*, 834 F.2d 208, 212 (1st Cir. 1987).

HN6 The contours of judicial estoppel are hazy. But even though its elements cannot be reduced to a scientifically precise formula, *New Hampshire*, 532 U.S. at 750, courts generally require the presence of three things before introducing the doctrine into a particular case. First, a party's earlier and later positions must be clearly inconsistent. *Id.; Alt. Sys. Concepts*, 374 F.3d at 33. Second, the party must have succeeded in persuading a court to accept the earlier position. *New Hampshire*, 532 U.S. at 750; *Alt. Sys. Concepts*, 374 F.3d at 33. Third, the party seeking to assert the inconsistent position must stand to derive an unfair advantage if the new position is accepted by the court. *New Hampshire*, 532 U.S. at 751; *Alt. Sys. Concepts*, 374 F.3d at 33.

Ordinarily, the party against whom judicial estoppel is invoked must be the same party who made the prior **[*13]** (inconsistent) representation. *See InterGen*, 344 F.3d at 144 (explaining that judicial estoppel "prevents a litigant from pressing a claim that is inconsistent with a position taken by that litigant" in the same or an earlier proceeding); *Brewer v. Madigan*, 945 F.2d 449, 455 (1st Cir. 1991) (explaining that judicial estoppel prevents "a party from taking a position inconsistent with one successfully and unequivocally asserted by that same party in a prior proceeding"). Courts normally refuse to apply judicial estoppel to one party based on the representations of an unrelated party. *See, e.g., Parker v. Wendy's Int'l, Inc.*, 365 F.3d 1268, 1272 (11th Cir. 2004); *Bethesda Lutheran Homes & Servs., Inc. v. Born*, 238 F.3d 853, 858 (7th Cir. 2001); *Tenn. ex rel. Sizemore v. Surety Bank*, 200 F.3d 373, 381-82 (5th Cir. 2000); *see also* 18B Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure § 4477, at 618-19 (2d ed. 2002). Nevertheless, courts sometimes have allowed judicial estoppel when the estopped party was responsible in fact for the earlier representation, *see, e.g., Ladd v. ITT Corp.*, 148 F.3d 753, 756 (7th Cir. 1998), or when the estopped party was **[*14]** the assignee of a litigation claim or assumed the original party's role, *see* 18B Wright et al., *supra*, § 4477, at 618-19.

In the case at hand, the district court determined that the appellants (Blum and the Yellins) should be judicially estopped from asserting that the amount due on the Notes was $ 7,494,435 because a third party, Brown, had represented in his own **bankruptcy** proceeding that the unpaid balance was a mere $ 902,662, and had represented in CHI's

bankruptcy that the total amount due on the Notes (including accrued interest) was $ 1,853,282. *Perry I*, 2008 U.S. Dist. LEXIS 118524 at *26. The court bound the appellants to Brown's earlier representations primarily on the theory that the appellants, as purchasers of the Notes, were subject to any defenses that Perry and CHI could have asserted against Brown himself. 2008 U.S. Dist. LEXIS 118524 at *40 & n.15. [3] The court reasoned that because Brown would be judicially estopped from contradicting his prior representations anent the amount due on the Notes, his assignees should be similarly estopped. 2008 U.S. Dist. LEXIS 118524 at *41-*45. The appellants say that Brown's representations cannot be imputed to them and that, therefore, judicial estoppel was incorrectly invoked.

FOOTNOTES

[3] The district court also **[*15]** mentioned approvingly the Fifth Circuit's decision in *In re Coastal Plains, Inc.*, 179 F.3d 197 (5th Cir. 1999), for the proposition that a third party's misrepresentation may be used to estop an unrelated party. *Perry II*, slip op. at 11. *Coastal Plains* did not involve unrelated parties, *see* 179 F.3d at 203, 213, and in any event, its authority on this specification is suspect. *See, e.g.*, *Biesek v. Soo Line R.R. Co.*, 440 F.3d 410, 412-13 (7th Cir. 2006) (declining to follow *Coastal Plains*); *In re Riazuddin*, 363 B.R. 177, 188 & n.53 (B.A.P. 10th Cir. 2007) (same). Indeed, the Fifth Circuit itself has distinguished *Coastal Plains*, based on its unique facts. *See* *Kane v. Nat'l Union Fire Ins. Co.*, 535 F.3d 380, 387 (5th Cir. 2008).

In examining these competing contentions, we take the underlying substantive law C the law of negotiable instruments C from Massachusetts. HN7 Under Massachusetts law, negotiable instruments, such as the Notes, are governed by Article III of the Uniform Commercial Code (U.C.C.). *See* Mass. Gen. Laws ch. 106, § 3-102. The U.C.C. states that a noteholder's right to enforce a note is subject to certain defenses. *Id*. § 3-305(a). These defenses include those enumerated **[*16]** in section 3-305(a)(1) (often termed "real defenses"), defenses specifically listed elsewhere in Article III, and defenses "that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract" (often termed "personal defenses"). *Id*. If a noteholder qualifies as a holder in due course, his right to enforce the note is subject only to real defenses. *Id*. § 3-305(b).

HN8 The appellants do not presume to be holders in due course. *See Perry II*, slip op. at 12. Thus, they are subject to the axiom that the rights of a transferee who is not a holder in due course rise no higher than the rights of the transferor. *See* 2 James J. White & Robert S. Summers, Uniform Commercial Code § 17-11, at 226 (5th ed. 2008). It follows that the appellants, as transferees, are subject to the trilogy of defenses described in section 3-305(a) to the same extent that those defenses would have been available against the transferor (Brown). *See id.; see also* 25 Herbert Lemelman, Massachusetts Practice § 3:150, at **[*17]** 428 (3d ed. 2002) (stating in essence that a holder who is not a holder in due course is treated under Massachusetts law as the assignee of a contract).

This does not mean, however, that the transferor and the transferee are to be treated as one and the same for all purposes. Of particular pertinence for present purposes, HN9 judicial estoppel does not fit comfortably within any of the trilogy of defenses described in section 3-305(a). Judicial estoppel is certainly not a "real defense" within the provision of the statute, nor is it a defense specifically listed anywhere in Article III of the U.C.C. This leaves only the category of "personal defenses."

Personal defenses typically are thought to be "those based on common law contract principles." Mass. Gen. Laws ch. 106, § 3-305(a) cmt. 2; *see* *FDIC v. Wood*, 758 F.2d 156, 160 (6th Cir. 1985) ("'Personal' defenses, such as failure of consideration and usury . . . are defenses or claims stemming from the underlying transaction."). Judicial estoppel does not fit seamlessly into the taxonomy of personal defenses, as it is not a defense aimed directly at either the validity or the enforceability of a contract. Rather, it is a judge-made doctrine **[*18]** designed to protect the integrity of the judicial system. *See* *New Hampshire*, 532 U.S. at 749. This seeming incongruence gives us some pause about trying to ram the square peg of judicial estoppel into the round hole of personal defenses.

Still, we recognize that HN10 the boundaries of judicial estoppel are hazy. It is conceivable that cases may arise in which the doctrine can be considered a personal defense, used to prevent a noteholder from playing fast and loose with the courts through, say, engaging a straw to assert a payoff amount contradictory to one earlier put forth by the noteholder himself. *See* *G-I Holdings, Inc. v. Reliance Ins. Co.*, 586 F.3d 247, 262 (3d Cir. 2009) ("We will apply [judicial estoppel] to neutralize threats to judicial integrity however they may arise."); *cf.* *FDIC v. Gulf Life Ins. Co.*, 737 F.2d 1513, 1518 (11th Cir. 1984) (suggesting that, for negotiable instruments, general estoppel may constitute a personal defense, "to which a holder in due course would be impregnable"). The combinations of possible circumstances are infinitely varied, and a flat holding that judicial estoppel can be circumvented simply by transferring property to a third party would be folly. **[*19]** *See generally* *Sandstrom v. ChemLawn Corp.*, 904 F.2d 83, 87-88 (1st Cir. 1990) (emphasizing utility of judicial estoppel as a means of preventing a party from obtaining an unfair advantage).

Here, however, we need not grapple with the admittedly difficult question of whether judicial estoppel may ever qualify as a personal defense. In our view, the district court's application of judicial estoppel suffers from a different infirmity: Perry has failed to satisfy the second requirement for judicial estoppel. He has not shown that the **bankruptcy** court actually accepted Brown's representation of the value of the Notes.

HN11 The party proposing an application of judicial estoppel must show that the relevant court actually accepted the other party's earlier representation. *See* *Gens v. Resolution Trust Corp.*, 112 F.3d 569, 572 (1st Cir. 1997) ("Judicial estoppel is not implicated unless the first forum *accepted* the legal or factual assertion alleged to be at odds with the position advanced in the current forum . . . ." (emphasis in original)). "Acceptance" in this context is a term of art. In order to satisfy this prerequisite, a party need not show that the earlier representation led to a favorable **[*20]** ruling on the merits of the proceeding in which it was made, but must show that the court adopted and relied on the represented position either in a preliminary matter or as part of a final disposition. *See, e.g.*, *Pennycuff v. Fentress Cnty. Bd. of Educ.*, 404 F.3d 447, 453 (6th Cir. 2005); *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 364 F.3d 274, 294 (5th Cir. 2004); *see also* *Global NAPs*, 603 F.3d at 90 (finding that court accepted party's first representation by relying on it in granting temporary restraining order); *Alt. Sys. Concepts*, 374 F.3d at 34 (explaining that because court relied on party's initial position in denying motion to dismiss, party "derived a direct (if temporary) benefit from its original position").

HN12 The showing of judicial acceptance must be a strong one. *See* SBT Holdings, LLC v. Town of Westminster, 547 F.3d 28, 37 & n.8 (1st Cir. 2008) (rejecting judicial estoppel argument because record was unclear as to whether court accepted plaintiff's prior position); *cf.* United States v. Pakala, 568 F.3d 47, 60 (1st Cir. 2009) (upholding judicial estoppel when it was "clearly obvious" that the original trial court, in granting a motion, "necessarily **[*21]** adopted" the position that the movant later sought to contradict); United Nat'l Ins. Co. v. Spectrum Worldwide, Inc., 555 F.3d 772, 779 (9th Cir. 2009) (authorizing judicial estoppel when trial court "clearly accepted and relied upon [the party's] assertions" when it denied preliminary injunction). HN13 The need for a strong showing derives from the maxim that "[j]udicial estoppel is applied with caution to avoid impinging on the truth-seeking function of the court because the doctrine precludes a contradictory position without examining the truth of either statement." Teledyne Indus., Inc. v. NLRB, 911 F.2d 1214, 1218 (6th Cir. 1990); *accord* Lowery v. Stovall, 92 F.3d 219, 224 (4th Cir. 1996) ("The insistence upon a court having accepted the party's prior inconsistent position ensures that judicial estoppel is applied in the narrowest of circumstances.").

It follows that HN14 a proponent of judicial estoppel must affirmatively show, by competent evidence or inescapable inference, that the prior court adopted or relied upon the previous inconsistent assertion. *See* United Steelworkers of Am. v. Ret. Income Plan for Hourly-Rated Emps. of ASARCO, Inc., 512 F.3d 555, 563-64 (9th Cir. 2008) (finding **[*22]** that failure to demonstrate judicial acceptance precludes application of estoppel where "the district court never *held*" the notion urged by the party) (emphasis in original); United States v. Levasseur, 846 F.2d 786, 794 (1st Cir. 1988) (rejecting "illogical surmise" about what prior court might have accepted as a basis for judicial estoppel). Perry has not made the requisite showing here.

There are only two possible actions taken by the **bankruptcy** court that Brown's representation might have affected. First, in Brown's **bankruptcy** proceeding, the court allowed him to retain the Notes after he stated the amount due and represented that the Notes were uncollectible. Second, in the CHI **bankruptcy** (in which Brown intervened), the court lifted the automatic stay, allowing Brown to foreclose on the Fenmore. There is no evidence that either action was premised on Brown's statements about the amount owed on the Notes, and it is implausible to infer any such nexus.

We examine these two actions in reverse order. It defies logic to deduce that the **bankruptcy** court granted Brown relief from the automatic stay on the basis of the amount owed on the Notes. A larger figure would not have supported **[*23]** keeping the stay in place C if anything, a greater amount owed would have created an additional incentive for the court to allow the foreclosure to proceed post-haste.

Similarly, it is utterly speculative to suggest that the **bankruptcy** court, in approving Brown's global settlement and allowing him to retain the Notes, accepted each and every one of his figures. HN15 Generally speaking, settlement "neither requires nor implies any judicial endorsement of either party's claims or theories." In re Bankvest Capital Corp., 375 F.3d 51, 60 (1st Cir. 2004) (quoting Bates v. Long Island R.R. Co., 997 F.2d 1028, 1038 (2d Cir. 1993)). So viewed, an unexplained settlement does not provide the prior success necessary for judicial estoppel. *See* C & M Props., LLC v. Burbidge, 377 B.R. 677, 685 (D. Utah 2007) (noting that "[t]he the fact that [debtor] obtained confirmation of its [plan] does not demonstrate that the **bankruptcy** court was misled" and thus finding that second element of judicial estoppel was not satisfied), vacated on other grounds by In re C & M Props., L.L.C., 563 F.3d 1156, 1168 (10th Cir. 2009).

Perry surmises, but offers no semblance of proof, that a **bankruptcy** court would treat uncollectible **[*24]** notes worth over $ 7,000,000 differently than uncollectible notes worth roughly $ 1,000,000. It is, of course, possible that, in particular circumstances, a **bankruptcy** court might indulge in such differential treatment. Here, however, the surmised inference is simply not plausible. By definition, an uncollectible note is an uncollectible note (and, thus, worthless). In any event, either of these figures pales in comparison to $ 134,105,736 C the sum of the claims of Brown's creditors at the time of the settlement. In this case, then, the variation in amount is a distinction that makes no difference. [4]

FOOTNOTES

[4] We note that one court has treated settlements in ordinary litigation and those arising in the context of **bankruptcy** proceedings differently. *Reynolds v. Comm'r*, 861 F.2d 469, 473 (6th Cir. 1988) (explaining that **bankruptcy** may give rise to greater judicial acceptance of the parties' positions because the court there "is charged with an affirmative obligation to apprise itself of the underlying facts and to make an independent judgment as to whether the compromise is fair and equitable"). We need not comment upon the correctness of this approach as Perry has offered nothing more than **[*25]** speculation to suggest that the **bankruptcy** court was motivated by the amount due on the Notes, rather than their uncollectible status. *Cf.* *id.* at 473-74 (noting that the accepted representation "was *essential* to the **bankruptcy** judge's approval of the parties' compromise") (emphasis supplied).

For what it may be worth, Brown himself neither explicitly nor implicitly contradicted his original representation as to the amount due on the Notes. He placed that figure at $ 902,662 and later sold the Notes for a figure in the same ballpark C $ 950,000. These events do not support a suggestion that he was attempting to defraud or mislead the **bankruptcy** court. This is potentially important because HN16 judicial estoppel is not meant to be a trap for the unwary and should be employed sparingly when "there is no evidence of intent to manipulate or mislead the courts." *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.*, 81 F.3d 355, 365 (3d Cir. 1996).

To say more on this issue would be to paint the lily. HN17 Conjecture, without more, cannot support the application of judicial estoppel. *See* *SBT Holdings*, 547 F.3d at 37 & n.8. Put another way, remote possibilities are not enough. Consequently, we hold that **[*26]** the district court committed legal error (and, thus, abused its discretion) in judicially estopping the appellants, based on a third party's earlier representation, from attempting to prove that the amount due on the Notes was more than $ 1,853,282.

In an effort to repair this hole in the fabric of their argument, Perry and CHI urge that the appellants should be judicially estopped based on Yellin's prior representation. The district

court rejected this alternative theory, *Perry II*, slip op. at 10, and so do we.

The salient facts are as follows. In 1997, Perry, on behalf of CHI, sued the appellants in a Massachusetts state court. He moved for a preliminary injunction to prevent foreclosure on the Fenmore. As part of his opposition, Yellin filed an affidavit indicating, in its background recitals, that the amount due on the Notes was $ 1,900,000. The state court denied Perry's motion. Perry did not appeal the denial, and the court subsequently dismissed the case for want of prosecution.

In the court below, Perry and CHI advanced an alternative claim of judicial estoppel premised on Yellin's affidavit. The district court did not bite, reasoning that the state court "took no action in reliance **[*27]** on [the $ 1.9 million] figure" and "ultimately dismissed the case for lack of prosecution." *Id*. Perry and CHI challenge this holding. Noting that the state court accepted the filing of Yellin's affidavit and denied the preliminary injunction, they say that no more was exigible to ground a subsequent claim of judicial estoppel. We do not agree.

Based on the facts recounted above, the first element needed for judicial estoppel is satisfied. The representation about the Notes' value, as expressed by the appellants in the district court, is inconsistent with the earlier representation that Yellin made in the state court.

Once again, however, the second element is more problematic. There is absolutely no basis for believing that the state court adopted or relied on the $ 1,900,000 figure contained in Yellin's affidavit. The absence of any evidence to that effect is fatal. *See* *SBT Holdings*, 547 F.3d at 37 & n.8; *Levasseur*, 846 F.2d at 794.

Perry and CHI suggest that the state court may have relied on Yellin's representation in denying the motion for preliminary injunction. But this suggestion is woven entirely out of gossamer strands of speculation and surmise. In addition, the suggestion is **[*28]** counterintuitive. Perry and CHI sought the preliminary injunction to prevent foreclosure on the Fenmore, and the amount of the indebtedness had virtually nothing to do with the question raised in that motion. In other words, whether the balance owed was $ 1,900,000 or $ 7,000,000 or some figure in between had no apparent bearing on whether the foreclosure should (or should not) be enjoined. *Cf.* *Ross-Simons of Warwick, Inc. v. Baccarat, Inc.*, 102 F.3d 12, 15 (1st Cir. 1996) (listing factors relevant to preliminary injunction inquiry). There is simply no plausible basis for supposing that Yellin's representation about the amount due factored into the state court's decisional calculus.

B. *Equity of Redemption*.

Given our previous conclusion, *see supra* Part II(A), the district court's accounting will have to be reworked. Once the amount due on the Notes is established and subtracted C after all, the Notes were secured by first and second mortgages on the Fenmore and, thus, give rise to a high-priority equitable lien on the foreclosure proceeds C the question becomes how the court should treat the $ 5,000,000 paid to settle the FDIC's claims against the Yellin Parties. The appellants argue **[*29]** that this payment extinguished the third and fourth mortgages and, thus, should be offset *before* calculating the equity of redemption. The district court made no such offset. The appellants assign error to this step in the progression.

HN18 The calculation of an equitable accounting is, within broad limits, committed to the district court's discretion. *Tamko Roofing Prods., Inc. v. Ideal Roofing Co.*, 282 F.3d 23, 39

(1st Cir. 2002). Accordingly, "we will not disturb [such a calculation] unless it rests on clearly erroneous findings of fact, incorrect legal standards, or a meaningful error in judgment." *Id.; see* *In re Blinds to Go Share Purchase Litig.*, 443 F.3d 1, 8 (1st Cir. 2006) ("Because the district court 'is in a considerably better position to bring the scales into balance than an appellate tribunal,' we will not normally find an abuse of discretion unless, upon whole-record review, we are convinced that the district court committed a significant error in judgment." (quoting *Rosario-Torres v. Hernandez-Colon*, 889 F.2d 314, 323 (1st Cir. 1989) (en banc))).

As co-owners of the foreclosed Fenmore, Perry and Yellin are jointly entitled to the equity of redemption. Stripped of rhetorical **[*30]** flourishes, the appellants' contention is that calculating this figure is a purely mechanical exercise, which requires that payments made to extinguish liens on the property be subtracted before the co-owners can divide the remaining foreclosure surplus. Building on this foundation, the appellants posit that the district court erred in refusing to offset the $ 5,000,000 payment that they made to the FDIC because that payment extinguished the third and fourth mortgages on the Fenmore.

This argument has a patina of plausibility. HN19 Under basic principles of property law, the holder of the equity of redemption does not have a property interest in foreclosure proceeds unless and until all outstanding liens on the property have been extinguished. *See* *First Colonial Bank for Sav. v. Bergeron*, 38 Mass. App. Ct. 136, 646 N.E.2d 758, 759 (Mass. App. Ct. 1995); *see also* Restatement (Third) of Prop.: Mortgages § 7.4 (1997) ("When the foreclosure sale price exceeds the amount of the mortgage obligation, the surplus is applied to liens and other interests terminated by the foreclosure in order of their priority and the remaining balance, if any, is distributed to the holder of the equity of redemption."). HN20 A junior lienholder **[*31]** has an equitable lien, transferred from the foreclosed premises, that attaches to the foreclosure surplus. *See* *New Haven Sav. Bank v. Follins*, 431 F. Supp. 2d 183, 196 (D. Mass. 2006); *see also* Restatement (Third) of Prop.: Mortgages § 7.4, cmt. a (1997) (explaining that the "surplus stands in the place of the foreclosed real estate, and the liens and interests that previously attached to the real estate now attach to the surplus").

The appellants take these abecedarian property law principles to mean that because they settled with the FDIC and thereby extinguished the FDIC's equitable lien on the foreclosure proceeds, the $ 5,000,000 settlement amount must come off the top before the equity of redemption is calculated. The district court instead treated the $ 5,000,000 as a part of the distribution of the appellants' share of the equity of redemption. *See* Appendix.

The appellants' construct reflects a kind of tunnel vision. It fails to take into consideration that the challenged calculations are not entries on a closing sheet at a foreclosure but, rather, are calculations made in the context of a judicial accounting. This matters because HN21 an accounting is not a rote exercise in arithmetic. **[*32]** To the contrary, it is an equitable remedy, *see* *Braunstein v. McCabe*, 571 F.3d 108, 122 (1st Cir. 2009) (citing *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 49 n.7, 109 S. Ct. 2782, 106 L. Ed. 2d 26 (1989)), and equitable remedies "are flexible tools to be applied with the focus on fairness and justice." *Demoulas v. Demoulas*, 428 Mass. 555, 703 N.E.2d 1149, 1169 (Mass. 1998) (citing 1 Dan B. Dobbs, Law of Remedies § 2.1(3), at 63 (2d ed. 1993)).

The district court understood this distinction. It refused to offset the $ 5,000,000 settlement before calculating the equity of redemption. The court based this determination on a finding that the primary purpose of the settlement was not to extinguish the FDIC's lien, but to release the Yellins from personal liability on a wide range of loans (many of which were completely unrelated to the Fenmore). *See Perry III*, slip op. at 1. In effect, Yellin used

money that otherwise would have had to be shared with Perry to defray his personal obligations, leaving Perry to settle separately with the FDIC using his own resources. *See supra* note 1. In the district court's words, Yellin "ha[d] Blum conduct the Fenmore foreclosure sale and hand over the first $ 5 million in proceeds to the FDIC" to satisfy **[*33]** Yellin's personal obligations. *See Perry III*, slip op. at 1. The court found that arrangement to be "the product of precisely the improper relationship and underhanded dealings" that characterized the appellants' course of conduct. *Id.; see also Perry I*, 2008 U.S. Dist. LEXIS 118524 at *10.

This finding is eminently supportable. The only reason why Yellin was able to use foreclosure proceeds to fund his personal settlement was because of his relationship with Blum, who, as a straw for Yellin, held the senior mortgages on the Fenmore.

HN22 In performing an equitable accounting, the district court is not a mere scrivener, charged with carrying out a ministerial task. Instead, the court is charged with tempering arithmetic with equity, or, as we phrased it in *Rosario-Torres*, 889 F.2d at 323, "bring[ing] the scales into balance." In this context, we think that the district court acted within the sphere of its discretion in preventing Yellin from unjustly enriching himself, to the detriment of his quondam partner, by what the district court warrantably found were underhanded dealings. *See* 1 Dobbs, *supra*, § 4.3(5), at 610 (explaining that an accounting "forces the fiduciary defendant to disgorge gains received from **[*34]** improper use of the plaintiff's property or entitlements"). Accordingly, we hold that the district court neither erred nor abused its discretion in refusing to subtract the $ 5,000,000 payment before calculating the equity of redemption.

C. *Joinder*.

The Yellins claim that the district court violated the Due Process Clause by joining them as reach-and-apply defendants after the trial had ended. A few additional facts are needed to bring the claim into perspective.

When the FDIC originally filed a claim in the underlying litigation, it named the Yellins, among others, as defendants. But following the settlement of the FDIC's claims against them, the Yellins were dropped from the suit on June 10, 2002. Two days later, Perry brought Blum, as trustee of Moorings Nominee Trust, back into the case by filing a cross-claim against him. The cross-claim did not specifically name the Yellins, but it did name "John Doe" as a reach-and-apply defendant. "John Doe" was described as "a person or persons, or an entity or entities, to whom funds generated by the foreclosure sale of the Fenmore have been transferred by Blum, for less than full consideration."

Almost two years later, Perry sought to amend **[*35]** his cross-claim to add the Yellins as reach-and-apply defendants. The district court referred this motion to a magistrate judge. *See* Fed. R. Civ. P. 72(a). On November 29, 2004, the magistrate judge denied it. Perry moved unsuccessfully for reconsideration but did not appeal that denial to the district judge.

The cross-claim was tried to the court in early 2005. During trial, Perry again moved to join the Yellins as reach-and-apply defendants. The district court suggested that Perry file a written motion to conform the pleadings to the proof. *See* Fed. R. Civ. P. 15(b). Perry filed such a motion on June 24, 2005. The district court took the entire case (including the motion) under advisement for over three years.

On October 31, 2008, the court issued its written decision. In that rescript, the court granted the motion to join the Yellins as reach-and-apply defendants. *Perry I*, 2008 U.S.

Dist. LEXIS 118524 at *26. The Yellins sought reconsideration, to no avail. *Perry II*, slip op. at 19.

The district court premised its order on Federal Rule of Civil Procedure 21. [5] HN23 We review an order joining a party under Rule 21 for abuse of discretion. *See Cornelius v. Hogan*, 663 F.2d 330, 335 (1st Cir. 1981). Within that **[*36]** rubric, embedded legal questions are reviewed de novo. *See United States v. Platte*, 577 F.3d 387, 391 (1st Cir. 2009).

FOOTNOTES

[5] Rule 21 was amended in 2007, but the changes were merely stylistic. *See* Fed. R. Civ. P. 21 advisory committee's note. Consequently, we refer here to the rule as it stood at the time of the trial.

HN24 Rule 21 stated that "[p]arties may be dropped or added by order of the court on motion of any party or of its own initiative at any stage of the action and on such terms as are just." Although the rule permits joinder at any stage of the proceedings, joinder in a particular case must comport with the strictures of due process. *Moore v. Knowles*, 482 F.2d 1069, 1075 (5th Cir. 1973). These strictures include notice and an opportunity to be heard at a meaningful time and in a meaningful manner. *Eakins v. Reed*, 710 F.2d 184, 186-87 (4th Cir. 1983).

HN25 For obvious reasons, joinder of a defendant after trial is disfavored. *See, e.g.*, *Cabrera v. Mun'y of Bayamon*, 622 F.2d 4, 6 (1st Cir. 1980). In such a situation, concerns about possible prejudice to the late-joined party loom large. 7 Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure' 1688.1, at 510 **[*37]** (3d ed. 2001).

The case at bar, however, is highly idiosyncratic. First, the Yellins originally were parties to the action. Second, they were on notice of Perry's desire to add them as defendants by reason of both his pretrial motion to do so and his mid-trial motion to that effect. Third, in his original cross-claim, Perry named a "John Doe" reach-and-apply defendant, describing "John Doe" in terms that fit the Yellins to a "T." These circumstances gave the district court an adequate basis for finding that the Yellins had notice sufficient to satisfy the requirements of due process. *See Insituform Techs., Inc. v. CAT Contracting, Inc.*, 385 F.3d 1360, 1375 (Fed. Cir. 2004) (rejecting defendant's due process argument against post-trial joinder because plaintiffs had made pretrial attempts to join him).

Similarly, the record permits a conclusion that the Yellins had a meaningful opportunity to be heard. Blum was a party all along, and the district court supportably found that he was a stand-in for the Yellins. *Perry I*, 2008 U.S. Dist. LEXIS 118524 at *3-*4. As such, Blum had substantially the same interests as the Yellins. Blum was their proxy and, as befits a proxy, he and the Yellins shared the same counsel. **[*38]** [6]

FOOTNOTES

[6] This is not a situation in which, as in *Eakins*, 710 F.2d at 187, a late-joined party and a

timely-joined party shared the same counsel but had interests that were not "sufficiently identical." In this instance, the identity of interests is palpable.

To add to the picture, the Yellins testified extensively at the trial. Consequently, their narrative accounts of the central issues in the case were before the court. That is an important consideration in the due process equation. *See* *Fromson v. Citiplate, Inc.*, 886 F.2d 1300, 1304 (Fed. Cir. 1989) (upholding post-judgment joinder where interests of late-joined defendant and timely-joined defendants were "virtually complete").

To cinch matters, HN26 a party who claims to be aggrieved by a violation of procedural due process must show prejudice. *See* *Amouri v. Holder*, 572 F.3d 29, 36 (1st Cir. 2009); *United States v. Saccoccia*, 58 F.3d 754, 770-71 (1st Cir. 1995). The Yellins have not identified any evidence which, had they been joined earlier, they could have introduced; nor have they made any other showing of actual prejudice. [7]

FOOTNOTES

[7] In all events, any possible prejudice can be avoided here. If the Yellins have any evidence that bears on the accounting, **[*39]** the present posture of this case affords the district court the flexibility, when the case is returned to it, to reopen the case and provide the Yellins with an opportunity to supplement the record.

III. CONCLUSION

This is a complicated, hard-fought case. Both sides are represented by highly proficient counsel, but objective appraisals of the facts are to some extent held hostage to the parties' rancor. The district judge has demonstrated patience and skill in sorting out what really happened and navigating through a legal minefield. We are reluctant to prolong a case that already has lingered for a decade, but there is no other principled course available to us. Perhaps, given the passage of time and the large sums already spent on litigation, the parties have reached a point at which a negotiated resolution of their remaining differences is possible. One can only hope.

We need go no further. For the reasons elucidated above, we conclude that the district court erred as a matter of law in invoking the doctrine of judicial estoppel to limit the appellants' proof as to the amount owed on the Notes. Thus, we reverse that ruling. In turn, this holding requires vacation of the judgment. The **[*40]** district court will have to determine the actual amount due on the Notes at the relevant time and rework the accounting. We take no view as to the amount due on the Notes; although the appellants assert that the amount due is $ 7,494,435, Perry and CHI fiercely dispute the basis for that figure.

The other rulings appealed from are affirmed, and further proceedings in the district court shall be conducted consistent with this opinion. On remand, the district court may take such further evidence as it deems appropriate.

***Affirmed in part, reversed in part, vacated, and remanded*. All parties shall bear their own costs**.

Appendix

The district court entered a judgment in favor of Perry in the amount of $ 4,347,126. This amount was calculated as follows:

*2*Combined Proceeds from the Fenmore:	
Proceeds from foreclosure sale	$ 9,450,000
Net rents collected on the Fenmore	$ 1,660,797
Net combined proceeds	$ 11,110,797
*2*Credits, Adjustments, and Amount Due on Notes:	
Costs of foreclosure	$ 154,440
Amount due on Notes as of foreclosure date	$ 2,262,105
Total credits and adjustments	$ 2,416,545
*2*Equity of Redemption:	
Net combined proceeds	$ 11,110,797
Less credits and adjustments	-$ 2,416,545
Fenmore's equity of redemption	$ 8,694,252
Perry's 50% share	$ 4,347,126

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*2010 Bankr. LEXIS 3371, **

IN RE: CARMEN ELENA GONZALEZ GARCIA, Debtor(s); CARMEN ELENA GONZALEZ GARCIA, Plaintiff v BANCO BILBAO VIZCAYA ARGENTARIA, Defendant(s)

CASE NO. 09-03418 BKT, CHAPTER 13, ADVERSARY NO. 09-0143

UNITED STATES **BANKRUPTCY** COURT FOR THE DISTRICT OF PUERTO RICO

2010 Bankr. LEXIS 3371

September 27, 2010, Decided
September 27, 2010, Filed and Entered

CORE TERMS: summary judgment, private causes of action, substantive right, personal information, material fact, invoke, genuine issue, necessary to preserve, redact

COUNSEL: **[*1]** For CARMEN ELENA GONZALEZ GARCIA, aka KATTY GONZALEZ, dba KATTY GONZALEZ CENTRO DE ESTILISMO, aka CARMEN ELENA GONZALEZ, aka CARMEN GONZALEZ, aka CARMEN GONZALEZ GARCIA, aka CARMEN E GONZALEZ GARCIA, aka CARMEN E GONZALEZ, Debtor: CARLOS JUAN TEISSONNIERE RODRIGUEZ, URB BUENA

VISTA, PONCE, PR; JUAN MANUEL SUAREZ COBO, LEGAL PARTNERS PSC, SAN JUAN, PR.

For JOSE RAMON CARRION MORALES, Trustee: JOSE RAMON CARRION MORALES (LL), CHAPTER 13 TRUSTEE, SAN JUAN, PR; JOSE M PRIETO CARBALLO, JPC LAW OFFICE, SAN JUAN, PR.

U.S. Trustee: MONSITA LECAROZ ARRIBAS, OFFICE OF THE US TRUSTEE (UST), SAN JUAN, PR.

JUDGES: Brian K. Tester, U.S. **Bankruptcy** Judge.

OPINION BY: Brian K. Tester

OPINION

DECISION AND ORDER

This proceeding is before the Court upon the Defendant's motion for summary judgment [Dkt. No. 37] and Plaintiff's opposition to summary judgment [Dkt. No. 40]. For the reasons set forth below, the Defendant's motion for summary judgment is GRANTED.

I. FACTUAL BACKGROUND:

On April 30, 2009, the Debtor filed a voluntary petition under Chapter 13 of the **Bankruptcy** Code. On July 30, 2009, the Debtor filed the instant adversary proceeding alleging that Defendant Banco Bilbao Vizcaya Argentaria Puerto Rico (BBVA) failed to redact the **[*2]** Debtor's personal and private data in violation of sections 105(a) and 107(c) of the **Bankruptcy** Code [Dkt. No. 1]. On August 20, 2010, the Defendant filed the instant motion for summary judgment alleging that these sections do not create private causes of action, and/or that the Plaintiff has failed to allege damages as a result of any violations committed by the Defendant [Dkt. No. 37]. On September 17, 2010, the Plaintiff filed her opposition to summary judgment [Dkt. No. 40].

II. SUMMARY JUDGMENT STANDARD:

Under Federal Rule of Civil Procedure 56(c), made applicable in **bankruptcy** by Federal Rule of **Bankruptcy** Procedure 7056, summary judgment is available 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 judgment as a matter of law. Fed. R. Civ. P. 56(c); Borges ex rel. S.M.B.W. v. Serrano-Isern, 605 F.3d 1, 4 (1st Cir. 2010). As to issues on which the movant, at trial, would be compelled to carry the burden of proof, it must identify those portions of the pleadings which it believes demonstrates that there is no **[*3]** genuine issue of material fact. In re Edgardo Ryan Rijos & Julia E. Cruz Nieves v. Banco Bilbao Vizcaya & Citibank (In re Rijos), 263 B.R. 382, 388 (B.A.P. 1st Cir. 2001). A fact is deemed "material" if it potentially could affect the outcome of the suit. Borges at 5. Moreover, there will only be a "genuine" or "trial worthy" issue as to such a "material fact," "if a reasonable fact-finder, examining the evidence and drawing all reasonable inferences helpful to the party resisting summary judgment, could resolve the dispute in that party's favor." Id. at 4. The Court must view the evidence in a light most favorable to the nonmoving party. Alt. Sys. Concepts, Inc. v. Synopsys, Inc., 374 F.3d 23, 26 (1st Cir. 2004). Therefore, summary judgment is "inappropriate if inferences are necessary for the judgment and those

inferences are not mandated by the record." Rijos at 388.

III. LEGAL ANALYSIS AND DISCUSSION:

The Plaintiff's Amended Complaint, alleging violations of sections 105(a) and 107(c) of the **Bankruptcy** Code, depends upon the existence of a private cause of action under these sections. The First Circuit has specifically held that section 105 does not itself create a private cause **[*4]** of action, but a court may invoke section 105(a) in equity if necessary to preserve a right provided elsewhere in the Code. Noonan v. Secretary of Health and Human Servs., 124 F.3d 22, 28 (1st Cir. 1997). Section 107(c) also creates rights enforceable only by the **bankruptcy** court, as indicated by the text of the code itself: "The **bankruptcy** court, for cause, may [...]." 11 U.S.C. § 107(c). Had congress intended to create a private cause of action under this section, it could have used the terminology in section 107(b): "*On request of a party in interest*, the **bankruptcy** court shall, and on the **bankruptcy** court's own motion, the **bankruptcy** court may [...]." 11 U.S.C. § 107(b) (emphasis added).

Thus neither section 105(a) nor 107(c) creates a private cause of action. However, according to the Court in Noonan, a litigant may compel the Court to invoke section 105(a) to protect a substantive right provided elsewhere in the Code. The Plaintiff may be able to compel this Court to impose sanctions under section 105(a) to preserve rights under section 107(c) if she can show that the Defendant's actions have violated her substantive rights regarding the privacy of her personal information. The **[*5]** record indicates that the Defendant in this proceeding has already redacted the offending portions of its proof of claim, and the Plaintiff has not alleged any actual damages accruing from the Defendant's temporary failure to redact her personal information. Accordingly, the Plaintiff's claim under section 105(a) is not necessary to preserve a substantive right to which she is entitled under the code. If the Plaintiff can show that the personal information disclosed by the Defendant actually caused her some measurable amount of damages, then she may amend her complaint to compel the Court to enforce section 105(a) to redress such damages.

Having determined (1) that the Plaintiff has no private cause of action under section 107(c); (2) that the Court need not invoke section 105(a) to protect the Plaintiff's substantive rights under the Code; and (3) that there are no other material facts in dispute, this Court determines that the Defendant has met the burden for summary judgment.

WHEREFORE, IT IS ORDERED that the Defendant's motion for summary judgment shall be, and it hereby is, GRANTED.

Judgment will be entered accordingly.

SO ORDERED.

San **[*6]** Juan, Puerto Rico, this 27 day of September, 2010.

/s/ Brian K. Tester

Brian K. Tester

U.S. Bankruptcy Judge

IN RE: NOEL RUIZ SOTO VANESSA MEDINA VALENTIN, Debtor(s); NOEL RUIZ SOTO VANESSA MEDINA VALENTIN, Plaintiffs; UNIVERSIDAD INTERAMERICANA DE PUERTO RICO; JACQUELINE C. RODRÍGUEZ DÍAZ dba J.C. RODRÍGUEZ DÍAZ; AND WILFREDO SEGARRA MIRANDA, CHAPTER 7 TRUSTEE, Defendant(s)

CASE NO. 08-04983 BKT, CHAPTER 7, ADVERSARY NO. 08-00172

UNITED STATES **BANKRUPTCY** COURT FOR THE DISTRICT OF PUERTO RICO

2010 Bankr. LEXIS 2920

September 10, 2010, Decided
September 10, 2010, Filed and Entered

CORE TERMS: summary judgment, material fact, automatic stay, clerical error, collection, partial, genuine issue, received notice, pretrial

COUNSEL: **[*1]** For NOEL RUIZ SOTO, VANESSA MEDINA VALENTIN, Plaintiffs (08-00172-BKT): FREDERIC CHARDON DUBOS, LEAD ATTORNEY, FREDERIC CHARDON DUBOS LAW OFFICE, MOCA, PR.

For UNIVERSIDAD INTERAMERICANA DE PR, Defendant (08-00172-BKT): SYLVIA C. LUGO SOTOMAYOR, LUGO SOTOMAYOR LAW OFFICE, SAN JUAN, PR.

WILFREDO SEGARRA MIRANDA, Defendant (08-00172-BKT), Pro se, SAN JUAN, PR.

For NOEL RUIZ SOTO, Debtor (08-04983-BKT7): FREDERIC CHARDON DUBOS, FREDERIC CHARDON DUBOS LAW OFFICE, MOCA, PR.

For VANESSA MEDINA VALENTIN, Joint Debtor (08-04983-BKT7): FREDERIC CHARDON DUBOS, FREDERIC CHARDON DUBOS LAW OFFICE, MOCA, PR.

Trustee (08-04983-BKT7): WILFREDO SEGARRA MIRANDA, SAN JUAN, PR.

U.S. Trustee (08-04983-BKT7): MONSITA LECAROZ ARRIBAS, OFFICE OF THE US TRUSTEE (UST) OCHOA BUILDING, SAN JUAN, PR.

JUDGES: Brian K. Tester, U.S. **Bankruptcy** Judge.

OPINION BY: Brian K. Tester

OPINION

DECISION AND ORDER

This proceeding is before the Court upon the Chapter 7 Debtors' motion for partial summary judgment [Dkt. No. 21], Defendant UNIVERSIDAD INTERAMERICANA DE PR's ("UIPR") opposition to partial summary judgment [Dkt. No. 25] and Debtors' opposition to the Defendant's reply [Dkt. No. 31]. For the reasons set forth below, the Debtors' motion for summary judgment **[*2]** [Dkt. No 21] is GRANTED.

I. FACTUAL BACKGROUND:

On July 31st, 2008, the Debtors filed a voluntary petition under chapter 7 of the **Bankruptcy** Code. On December 12, 2008, the Debtors filed the instant adversary proceeding alleging that Defendant UIPR continued to attempt to collect the debt owed to it in violation of the automatic stay pursuant to section 362(k) of the **Bankruptcy** Code. On March 15th, 2010, the Debtors moved for partial summary judgment on the issue of the Defendant's liability for violation of the automatic stay. The next day, the Court held a pretrial hearing wherein the Court bifurcated the issues of liability and damages, with liability to be decided first. The matter is submitted [Dkt. No. 22].

This Court has jurisdiction over the subject matter and the parties pursuant to 28 U.S.C. §§1334 and 157(a) and the General Order of referral of Title 11 Proceedings to the United States **Bankruptcy** Court for the District of Puerto Rico dated July 19, 1984 (Torruella, C.J.). This is a core proceeding in accordance with 28 U.S.C. §157(b).

II. SUMMARY JUDGMENT STANDARD:

Under Federal Rule of Civil Procedure 56(c), made applicable to **bankruptcy** cases by virtue of Federal Rule of **Bankruptcy** Procedure 7056, **[*3]** summary judgment is available "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 judgment as a matter of law." Fed. R. Civ. P. 56(c); Celotex Corporation v. Catrett, 477 U.S. 317, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986) (citing Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)). As to issues on which the movant, at trial, would be compelled to carry the burden of proof, it must identify those portions of the pleadings which it believes demonstrates that there is no genuine issue of material fact. In re Edgardo Ryan Rijos & Julia E. Cruz Nieves v. Banco Bilbao Vizcaya & Citibank (In re Rijos), 263 B.R. 382, 388 (B.A.P. 1st Cir. 2001). A fact is deemed "material" if it potentially could affect the outcome of the suit. Cortes-Irizarry v. Corporación Insular, 111 F.3d 184, 187 (1st Cir. 1997). Moreover, there will only be a "genuine" or "trial worthy" issue as to such a "material fact," "if a reasonable fact-finder, examining the evidence and drawing all reasonable inferences helpful to the party resisting summary judgment, could resolve the **[*4]** dispute in that party's favor." Id. The Court must view the evidence in a light most favorable to the nonmoving party. In re Rijos, 263 B.R. at 388. Therefore, summary judgment is "inappropriate if inferences are necessary for the judgment and those inferences are not mandated by the record." Id.

III. LEGAL ANALYSIS AND DISCUSSION:

The Debtors allege, and the Defendant does not deny, that the Defendant continued collection proceedings after having received notice of the imposition of the automatic stay pursuant to section 362 of the **Bankruptcy** Code [Dkt. No. 1]. Indeed, the Defendant explicitly admits to having continued collection proceedings after having received notice of the stay in the "sworn statement" attached as Exhibit #1 to the Defendant's opposition to summary judgment [Dkt. No. 1]. The Defendant contends that it should not be held liable for this stay violation because the collection notices were sent due to a clerical error [Dkt. No. 25]. In support of this contention, the Defendant relies on the case of In re Hamrick 175 B.R. 890 (W.D.N.C. 1994), which held that, under certain circumstances, a defendant may not be held liable for stay violations caused by its own clerical **[*5]** errors. Id. at 893-4. However, this case does not constitute controlling precedent in the District of Puerto Rico. Rather, our case is governed by Fleet Mortgage Group, Inc. v. Kaneb, 196 F.3d 265, 268

(1st Cir. 1999), which explicitly rejected the argument that a creditor is immune from liability for stay violations because of its own clerical error.

Having determined that the violation of section 362 of the **Bankruptcy** Code is not a material fact in dispute, and having found no other material facts in dispute, this Court determines that the Debtors have met the burden for summary judgment as to the Defendant's liability under section 362(k) of the **Bankruptcy** Code. A separate pretrial order will be entered accordingly for the determination and measure of damages, if any.

WHEREFORE, IT IS ORDERED that the Debtors' motion for summary judgment shall be, and it hereby is, GRANTED.

SO ORDERED.

San Juan, Puerto Rico, this 10 day of September, 2010.

/s/ Brian K. Tester

Brian K. Tester

U.S. **Bankruptcy** Judge