

First Circuit

12.17.10

Banco Bilbao v. Wiscovitch-Rentas (In re Net-Velazquez), 2010 U.S. App. Lexis 22678 (1st Cir. 11/2/2010)(Opinion by Appellate Judge Lipez).

Chapter 7 Trustee filed an adversary proceeding challenging defendant's garnishment of funds in the bank account of a corporation wholly owned by the debtor and his wife which the Bankruptcy Court found was a preferential transfer; the District Court affirmed the Bankruptcy Court on appeal, which the First Circuit affirmed as well. Defendant sought to argue on appeal, *inter alia*, that ownership of the garnished funds was properly vested in the bank and thus not property of the estate, which argument was not squarely presented or litigated below and thus waived on appeal.

Parker v. Handy (In re Handy), 624 F. 3d 19 (1st Circuit 10/22/2010)(Opinion by Appellate Judge Lynch).

Parker appealed from the BAP's decision affirming the Bankruptcy Court's order denying his motion for relief from stay. Parker wanted to reopen a Maine state court proceeding against the debtor to pursue an alleged fraudulent transfer. The debtor received her discharge during the pendency of Parker's hearing, which precluded Parker's motion. At the time of the debtor's discharge, Parker had not obtained a favorable judgment from the state court nor a lien against the debtor's property. As such, the Bankruptcy Court properly held that 11 U.S.C. §524(a)(2) precluded Parker from pursuing his action against the debtor.

Guay v. Burack, 2010 U.S. Dist. Lexis 117248 (D.N.H. 10/29/2010)[unpublished].

Judicial estoppel was justified to bar a debtor from pursuing a cause of action in the District Court (debtor asserting claim against a detective and city police department for malicious abuse of process and violation of the Fourth amendment) where the debtor deliberately failed to disclose the pending suit in a prior bankruptcy case.

In re Roy, 210 BNH 31 (Bankr. D.N.H. 11/30/2010)(J. Michael Deasy, Bankruptcy Judge)[unreported cases on Court's web site].

Debtor sought to avoid, in his Chapter 13 case, the wholly unsecured liens of two attachments and two mortgages on a tenanted commercial property. With over \$700,000 in liens, the debtor valued the property at only \$120,000, due in large part for the need of asbestos remediation. Mortgagee's appraisal of \$525,000 did not account for the environmental factors. Because the property would be used by the debtor post-confirmation, the Court looked to its replacement value or fair market value consistent with its proposed use. Valuation would not account for the costs of sale but would account for the expenses necessary for the property to hold or realize its highest and best use. While the Court found the best use for the land was raw, the debtor intended to continue using the building post-confirmation; as such, a value of \$265,000 was determined based on a comparable sale of a wood structure in

below-average condition similar to the debtor's building. The raw land value was almost identical, at \$265,500.

In re Education Resources Institute, Inc., Chapter 11 Case No. 09-12540(Bankr. D. Mass. 12/14/2010)(Henry J. Boroff, Chief Bankruptcy Judge)[unreported cases on Court's web site].

Creditor's motion to interpret a court order, post confirmation (a) did not require an adversary proceeding, (b) presented a ripe controversy and (c) was properly before the court due to a retention of jurisdiction clause in the Chapter 11 plan.

In re R&G Financial Corporation, 2010 Bankr. Lexis 4008 (Bankr. D.P.R. 11/17/2010)(Enrique S. Lamoutte, Bankruptcy Judge).

Court granted debtor's motion to extend the automatic stay under 11 U.S. §362(a) and §105(a), to the debtor's dissolved subsidiary precluding arbitration proceedings against the subsidiary. The dissolved "sub" was the sole shareholder of the debtor, and essentially claims against the sub were claims against the debtor.

Diorio v. Allidri (In re M&L Service, Inc.), Chapter 7 Case No. 08-12745, Adv. Pro. 09-1002 (Bankr. D.R.I. 8/18/2010)(Arthur N. Votolato, Bankruptcy Judge)[unreported cases on Court's web site].

Court dismissed debtor's objection to summary judgment affidavit referencing unaudited financial statements, because such statements are admissible if "best evidence" of the debtor's financial condition, where, as here, the debtor did not have audited financials.

In re Carlucci, 2010 BNH 30 (Bankr. D.N.H. 9/28/2010)(Mark W. Vaughn, Chief Bankruptcy Judge (retired))[unreported cases on Court's web site].

Court in this Chapter 7 case determined that a judicial lien impaired the debtor's exemptions in the property pursuant to 11 U.S.C. §522(f). Here, the creditor held a \$209,000 judicial lien due to a pre-petition writ of execution, which when added to choate tax liens (excluding inchoate tax liens) against the property plus the debtor's maximum exemption in the property absent the presence of liens totaled \$323,000. The property was appraised at \$200,000. Thus, \$323,000 minus the \$200,000 value totaled a \$123,000 "impairment". Subtracting the \$123,000 impairment from the creditor's \$209,000 lien, left the creditor with an \$86,000 judicial lien. Lien creditor was also awarded reasonable costs for having its appraiser appear twice, due to the debtor's lack of preparedness at the first hearing.

Smith v. Wardwell (In re Wardwell), Chapter 7 Case No. 09-11362, Adv. Pro. 10-1001(Bankr. D. Maine 12/8/2010)(Louis H. Kornreich, Chief Bankruptcy Judge)[unreported].

Finding in favor of the Chapter 7 debtor, the Court examined the extent to which a state court default judgment relevant to an alleged fraud claim and given "full faith and credit" will establish a non-dischargeable debt under 11 U.S.C. § 523(a)(2). Since the matter was not litigated, claim preclusion against the debtor would not apply. As for issue preclusion, the facts alleged in the state court complaint were not sufficient to establish a non-dischargeable debt.

Bettano v. Wells Fargo Bank, N.A., (In re Bettano), Chapter 13 Case No. 10-42872, Adv. Pro. 10-4114 (Bankr. D. Mass. 12/14/2010)(Melvin S. Hoffman, Bankruptcy Judge)[unreported cases on Court's web site].

Court granted Wells Fargo's motion to dismiss the adversary proceeding as the debtor's action was untimely and failed to satisfy the statutory amount. Debtor sought to rescind a loan under the Massachusetts counterpart to TILA due to the plaintiff's alleged failure to disclose a \$300 finance charge.

Submitted by:

PATRICIA S. GARDNER, ESQ.

THE GARDNER LAW FIRM

Portsmouth Office: One New Hampshire Ave, Suite 125,
Pease International Tradeport, Portsmouth, NH 03801
Phone: (603) 766 - 4933 Fax: (603) 292 - 5207

Newmarket Office by appointment only. Call (603) 766 - 4933.

All Mail to: PO Box 453, Newmarket, NH 03857

email to: GardnerBusinessLaw@gmail.com

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

In re:

Bk. No. 10-10086-JMD
Chapter 13Raymond U. Roy,
Debtor

*Raymond J. DiLucci, Esq.
Raymond J. DiLucci, P.A.
Concord, New Hampshire
Attorney for Debtor*

*Lizabeth M. MacDonald, Esq.
Donahue, Tucker & Ciandella, PLLC
Exeter, New Hampshire
Attorney for People's United Bank*

MEMORANDUM OPINION

I. INTRODUCTION

The Court has before it three motions filed by the Debtor seeking to determine the secured status of mortgages on the same parcel of real estate and to void wholly unsecured liens under §§ 506(a) and 1322(b)(2) of the Bankruptcy Code. The parcel of real estate involves the property known as 1 Rockingham Street, Exeter, New Hampshire (the "Property"). The three motions pertain to the following liens: (1) the first and second mortgage liens held by People's United Bank (the "Bank"), successor to Ocean Bank (Doc. No. 74) (the "Bank Motion"); (2) the judicial attachment held by Boyd Hines (Doc. No. 75) (the "Hines Motion"); and the attachment lien held by De Lage Landen Financial Services (Doc. No. 76) (the "Landen Motion").

The Court held an evidentiary hearing on November 1 and 16, 2010 at which the parties presented appraisal and other evidence. At the commencement of the hearing, the parties agreed, for the purpose of ruling on the three motions, that the amounts of the liens in question are:

1st lien	Bank Mortgage	\$444,000
2d lien	Bank Mortgage	\$198,000
3d lien	Landen Attachment	\$ 58,500
4th lien	Hines Attachment	<u>\$ 23,300</u>
	Total	\$723,800

Only the Debtor and the Bank presented appraisal evidence at the hearing. At the conclusion of the hearing, the Court took the three motions under submission.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the “Standing 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).

II. FACTS

A. The Property

The Property is a 2.49 acre parcel of land located at 1 Rockingham Street in Exeter, New Hampshire. It is improved with 46,017 square feet of wood frame office, light industrial and storage buildings. The Property is a multi-tenant parcel located in an above average industrial location, but in below average condition.

1. The Debtor’s Appraisal Evidence

The Debtor entered into evidence an appraisal report prepared by The Stanhope Group LLC dated April 29, 2010 and the testimony of Peter Stanhope. Stanhope offered his expert opinion that the value of the Property as of April 29, 2010 was \$120,000. Stanhope testified that

because of the age, poor condition, asbestos and site contamination, the Property would not be attractive to an investor in its current configuration as an income generating property and that its highest and best use would be as land to be used for multi-family housing. The primary reason for his conclusion was that the high costs to renovate and clean up the Property could not be supported by the market rents. He concluded that an investor would buy the Property and continue to derive income from it in its current condition for up to five years before demolition of the buildings, site clean up and reuse of the land.

He examined four comparable land sales and a fifth comparable listing to determine his estimate of the value of the Property as land only. He considered all of the comparable parcels to be located in locations similar to the Property. The mean and median price per acre of the five comparable parcels was \$95,966 and \$93,094, respectively. Because he viewed the Property as inferior to all of the comparable parcels, he used a value of \$85,000 per acre for the 2.49 acre Property to determine a gross land value of \$211,650, which he rounded to \$212,000. He then estimated the pro forma net income from the rental of the Property in its current condition as \$35,278 per year. After application of a discount rate of 8.53%, he determined that the present value of the income stream for five years was \$150,758. Based on consultations with a demolition contractor and an environmental remediation firm, he determined that the cost of demolition and remediation would be \$105,000 and \$150,000, respectively, or a total of \$267,750 after five years. After factoring in assumptions about increased land values over five years and sales costs, he determined that the net proceeds on sale after five years would be (\$47,800), which has a net present value of (\$31,745). After netting this negative value with the net present value of the five year income stream, he derived a value of \$119,013 which he rounded to \$120,000 (the "Stanhope Value").

2. The Bank's Appraisal Evidence

The Bank entered into evidence an appraisal report prepared by Brian W. White dated September 17, 2010 and the testimony of Brian White. White offered his expert opinion that the value of the Property as of January 13, 2010 was \$525,000. White determined that the highest and best use for the Property was as improved for continued use as light industrial space. White examined five parcels of land that he determined were comparable to the Property. The selling prices for the five parcels ranged from \$117,857 to \$258,333 per acre. He gave greater weight to two of the comparable sales that had the lowest net and gross price adjustments to determine that the value of the Property as land was \$175,000 per acre or \$423,500 for the 2.42 usable acres that comprise the Property. He estimated a cost of \$70,000 to demolish and remove the existing buildings resulting in a current market value for the Property, as land, of \$355,000. White made no adjustment for asbestos removal or site remediation because he had no report or estimate, which he viewed as sufficiently reliable, to support the cost of such remediation. He recognized that his valuation assumes no environmental remediation costs which he identified as an "extraordinary assumption."

White also examined six comparable sales of improved properties. He gave greater weight to three of the six comparable sales due to the low number of adjustments made by him and determined that the value of the Property was \$12.50 per square foot or \$575,213 for 46,017 square feet. White recognized that repair and maintenance of a portion of several roof, soffit and fascia areas on the Property were necessary at an estimated cost of \$50,000. After factoring in the repair costs he determined that the Property had a value, as improved, of \$525,000.

III. DISCUSSION

A. The Legal Standard

The question of valuing property in the context of confirmation of a plan of reorganization is a fact-sensitive one; valuation is done on a case-by-case basis. See Fin. Sec. Assurance, Inc. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans Ltd. P'ship), 116 F.3d 790, 799 (5th Cir. 1997); In re Melgar Enter., Inc., 151 B.R. 34, 39 (Bankr. E.D.N.Y. 1993) (“[V]aluation is to be determined on a case-by-case basis.”). However, where a debtor proposes to retain property under a plan of reorganization, the Court must value the property in light of the proposed post-bankruptcy use of the property. Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 962 (1997); Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc.), 50 F.3d 72, 75 (1st Cir. 1995). As a general rule, that value will be the replacement, or fair market value, of the property valued in a manner consistent with the debtor’s use of the property. Rash, 520 U.S. at 963 (citing Winthrop, 50 F.3d at 75). Finally, it is generally agreed that the property should be valued as it stands at the time of the proceeding. See, e.g., In re Tamarack Trail Co., 23 B.R. 3, 5-6 (Bankr. S.D. Ohio 1982).

B. The Appraisal Evidence

In this case, the Debtor is proposing to retain the Property. Accordingly, the fair market value of the Property, without any deduction for costs of sale, but with adjustments for expenses necessary to hold or realize the value of the Property, in light of its highest and best use, is the proper measure of value. Rash, 520 U.S. at 960; Winthrop, 50 F.3d at 75-76 (“Our approach allows the bankruptcy court, using its informed discretion and applying historic principles of equity, to adopt in each case the valuation method that is fairest given the prevailing circumstances.”).

The ultimate conclusions of the two appraisers are materially different. Stanhope valued the Property at \$120,000 while White valued it at \$525,000, a difference of more than 430%. Despite the magnitude of the difference, a closer examination of their respective reports and testimony reveals some common ground. Both appraisers testified that the Property is currently in poor condition. Stanhope's opinion of the highest and best use of the Property was based upon the condition of the Property and his view that the cost to remediate the asbestos and environmental problems on the Property, plus physical repairs, would exceed what market rents could support or justify. Although White was aware of the potential need for environmental remediation, he did not make any adjustment for such potential need because he did not have what he viewed as reliable information on the costs of remediation. He also assumed that repairs of \$50,000 would be necessary simply to improve the Property to below average condition.

1. The Value of the Property as Land

Stanhope valued the Property as raw land at \$212,000, plus a discounted cash flow from income over five years of \$150,728, for a total of \$362,728, before any deductions for costs of sale, demolition or environmental remediation. White valued the Property's land at \$423,500, before demolition or environmental remediation. Therefore, the two appraisers unadjusted value for the Property as raw land differs by only \$60,772, or 16.7%.

However, the adjustments by the two appraisers differ significantly. Stanhope estimates the cost of demolition at \$105,000, while White estimates the cost at \$70,000. Interestingly, both appraisers base their costs on estimates from the same demolition contractor, Lee Danley of Danley Demolition, Inc. Stanhope had an estimate of \$95,000 plus \$10,000 for removal and disposal of paving. White had an estimate of \$65,000 for the existing improvements with the exception of the office building, which White estimated would add \$5,000 in costs. Since the

appraisers utilized the identical source for their estimates, and neither party presented any evidence on the assumptions behind those estimates, the Court shall take the average of the estimates for removal of the improvements plus the estimate for the paving as the cost of demolition, $((\$95,000 + \$70,000)/2 + \$10,000)$, or \$92,500.

Both appraisers recognize that an issue regarding environmental remediation exists on the Property, but disagree how to account for it. White found no reliable evidence for the costs of remediation and, therefore, did not account for any remediation costs. Stanhope obtained an estimate from an environmental remediation company of \$130,000 to \$150,000. The estimate was based on a preliminary survey (Phase I Environmental Site Assessment) for removal and disposal of asbestos, lead paint, and certain hydrocarbons. The estimate used by Stanhope indicates that lead paint remediation would be unnecessary if the buildings were razed and removed. The biggest portion of the cost estimate is \$110,000 to \$130,000 to cover and cap soils with hydrocarbon contamination. However, it is clear from the estimate used by Stanhope that the necessity and extent of remediation for hydrocarbons is uncertain at this time. The cost for asbestos removal is estimated at \$20,000 to \$25,000.

The Court believes that the issue of potential environmental remediation would have a material impact on the value of the Property and that until such costs can be ascertained with greater certainty, the Property may be unmarketable. However, the Court needs to make the best possible determination of value based on the evidence available. The Court finds the need for and the estimated costs of asbestos removal to be sufficiently certain to include it as a factor in the valuation of the Property, even for a short term use of the Property. However, the evidence in the record before the Court is insufficient to establish the necessity or extent of any remediation for hydrocarbon contaminated soils. Accordingly, the Court shall deduct \$25,000

from each appraisal of the raw land value for asbestos remediation, but shall not include costs for lead paint removal, as it is unnecessary in a raw land valuation, or for hydrocarbon remediation, as it is speculative and uncertain on the record before the Court.

After the adjustments above, the raw land valuations by each appraiser are:

	Stanhope	White
Gross Land Value	\$362,728	\$423,500
Less: Demolition Costs	\$92,500	\$92,500
Asbestos Removal	\$25,000	\$25,000
Net Land Value	\$245,228	\$306,000

Both appraisers had difficulty finding good comparative land sales due to a diminished real estate market and the somewhat unique in-town location lacking frontage on a road with a significant traffic count. The Court finds that Stanhope's comparable land sales were more representative than White's comparable sales. White's comparable sales all had frontage on or visibility from high traffic roads, a characteristic the Property lacks. Accordingly, the Court shall give double weight to Stanhope's net land value, as computed above. For the reasons discussed above, the Court finds the value of the Property as raw land to be \$265,500.¹

3. The Value of the Property as Improved

Stanhope found that market rents would not support his rough estimates for environmental remediation and building renovations. Therefore he concluded that the highest and best use for the Property was as raw land. White used a comparable sales approach to determine a per foot valuation for the improvements on the Property and determined that the highest and best use for the Property was rental of the current improvements after some

¹ $((2 \times \$245,228) + \$306,000)/3 = \$265,485$, rounded to \$265,500.

renovation. Based on his sales comparison analysis, he valued the Property at \$575,000, with a reduction of \$50,000 for deferred maintenance, for a net value of \$525,000. White encountered difficulty finding sales of comparable parcels even within two years of his appraisal date. His report identifies six comparable sales which ranged in value from \$6.84 to \$23.04 per square foot. White gave increased weight to three of the six comparable sales because in his analysis they had smaller adjustments and determined a value of \$12.50 per square foot for the Property. The Court finds his comparable sales to be significantly different than the Property. While all six of his comparable sales have uses similar to the Property, only one of them has similar wood frame construction. The other five are constructed from some combination of steel, brick and concrete. The only wood frame comparable sale was sold in the middle of 2006 and was evaluated by White as in below average condition. The Court notes that White is of the opinion that if \$50,000 of roof renovations were completed on the Property, it would still be in below average condition. The only wood frame building sale used by White from four years ago was also the lowest value per square foot at \$6.84, or 55% of the weighted per square foot cost used in his valuation for the Property. The Court does not find the comparable sales constructed with more durable and lower maintenance construction and in a better overall condition than the Property to be comparable in any meaningful sense of that word. While the Court is suspect of using a four year old sale for valuation purposes, it is the only acceptable comparable sale data in evidence. White's valuation analysis, using the value of the one wood frame sale from 2006, would be:

$$46,017 \text{ square feet} \times \$6.84 \text{ per square foot} = \$314,756 - \$50,000 = \$264,756$$

Rounded to \$265,000

C. The Value of the Property for Confirmation

Based on the Court's analysis of the appraisal evidence, the Property is essentially worth the same as raw land or as improved. However, the Debtor contemplates holding and using the property in its current condition, as improved. Accordingly, the Court finds that the value of the Property, for purposes of confirmation, to be \$265,000.

IV. CONCLUSION

Having determined the value of the Property under § 506(a) of the Bankruptcy Code, the Court will issue separate orders on the Bank Motion, the Hines Motion and the Landen Motion consistent with this opinion. This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

ENTERED at Manchester, New Hampshire.

Date: November 30, 2010

/s/ J. Michael Deasy
J. Michael Deasy
Bankruptcy Judge

IN RE: R&G FINANCIAL CORPORATION, Debtor

CASE NO. 10-04124 (ESL), CHAPTER 11

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF PUERTO RICO

2010 Bankr. LEXIS 4008

November 17, 2010, Decided


CASE SUMMARY


PROCEDURAL POSTURE: A bankruptcy debtor assumed the liabilities of its dissolved subsidiary, including claimants' actions for alleged violations of securities laws by the subsidiary. The debtor moved to extend the automatic bankruptcy stay to the claimants' arbitration proceedings against the subsidiary.


OVERVIEW: The debtor contended that the arbitration should be stayed because it was in effect an action against the debtor. The claimants argued that their claims were against the subsidiary rather than the debtor, and that arbitration was required by securities regulations. The bankruptcy court held that extending the stay to the arbitration was warranted. The debtor, as the subsidiary's sole stockholder, was statutorily the only party that could be potentially liable to the claimants and thus the arbitration proceeding against the subsidiary was essentially and statutorily against the debtor. Further, since the subsidiary had no assets, the debtor would be required to use its limited resources to defend the subsidiary in the arbitration, and requiring the debtor to participate in the arbitration would hamper the debtor's attempt for a successful reorganization. Also, the exemption from the automatic stay for certain securities transactions did not apply to the claims for violations of securities laws, and the debtor was not itself subject to the securities regulations requiring arbitration to which the subsidiary was subject.


OUTCOME: The debtor's motion to extend the automatic bankruptcy stay to the arbitration was granted.

CORE TERMS: claimants', arbitration proceedings, arbitration, automatic stay, FINRA Rules, automatic stay provisions, dissolved, entity, liquidation, stockholder, customer, preliminary injunction, membership, prong, reorganization, subsidiary, arbitrate, conformity, injunctive relief, irreparable harm, dissolution, distributed, injunction, broker, terminated, sole stockholder, compel arbitration, managerial, requesting, commodity


Bankruptcy Law > Case Administration > Administrative Powers > Stays > Coverage > General Overview 

Bankruptcy Law > Practice & Proceedings > Adversary Proceedings > Causes of Action 


HN1  A request for extension of the automatic bankruptcy stay provisions of 11 U.S.C.S. § 362(a) to a non-debtor constitutes an action for injunctive relief and should be initiated by an adversary proceeding. Fed. R. Bankr. P. 7001(7). More Like This Headnote


Bankruptcy Law > Case Administration > Administrative Powers > Stays > Coverage > General Overview 


Bankruptcy Law > Case Administration > Court Powers 


HN2  The power of a bankruptcy court to enjoin certain actions not subject to the automatic stay, such as an action against non-debtor parties, is recognized when such action is interfering improperly with the purposes of the bankruptcy law or the bankruptcy debtor's reorganization efforts. Although called an extension of the automatic stay provisions of the Bankruptcy Code to non-debtor parties, these are in fact injunctions issued by the bankruptcy court under 11 U.S.C.S. § 105(a), after determining that the situation requires it in order to protect the interests of the bankruptcy estate. More Like This Headnote


Bankruptcy Law > Case Administration > Court Powers 


Civil Procedure > Remedies > Injunctions > Preliminary & Temporary Injunctions 


HN3  Under the Bankruptcy Code, broad injunctive power is available under 11 U.S.C.S. § 105, and the issue is directed to the discretion of the bankruptcy court rather than to its jurisdiction. A preliminary injunction is an extraordinary and drastic remedy which should only be granted when the movant has carried its burden through clear and convincing evidence. Thus, the broad injunctive power under § 105(a) should be used sparingly. More Like This Headnote


Bankruptcy Law > Case Administration > Administrative Powers > Stays > Coverage > General Overview 


Bankruptcy Law > Case Administration > Court Powers 


Civil Procedure > Remedies > Injunctions > Preliminary & Temporary Injunctions 


HN4  A bankruptcy court, in analyzing whether to extend the protection of the automatic stay to non-debtors, must determine if the requirements of both 11 U.S.C.S. §§ 105(a), 362(a) are satisfied in order to grant a preliminary injunction extending the provisions of § 362(a) to non-debtors. More Like This Headnote

Bankruptcy Law > Case Administration > Administrative Powers > Stays > Coverage > General Overview 


Bankruptcy Law > Case Administration > Administrative Powers > Stays > Coverage > Claims Against Debtors 

HN5  11 U.S.C.S. § 362(a)(1) operates as a stay, applicable to all entities, of the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against a bankruptcy debtor that was or could have been commenced before the commencement of the bankruptcy case, or to recover a claim against the debtor that arose before the commencement of the case. § 362(a)(1). The scope of the protection of the automatic stay is broad, but it only stays actions against the debtor, hence the protections of the stay do not extend to entities such as sureties, guarantors, co-obligors, or others with a similar legal or factual nexus to the debtor. However, the protection of the automatic stay may be extended to non-debtors if unusual circumstances are found such as; (i) the non-debtor and the debtor enjoy such an identity of interests that a suit of the non-debtor is essentially a suit against the debtor; or (ii) the third-party action will have an adverse impact on the debtor's ability to accomplish reorganization. More Like This Headnote


Business & Corporate Law > Corporations > Dissolution & Receivership > Termination & Winding Up > Limited Survival 

HN6  P.R. Laws Ann. tit. 14, § 3708 establishes that all dissolved corporations shall continue to exist as a corporate entity for three years from the date of dissolution and further provides that if any proceeding is commenced before the three-year period lapses, the corporation shall continue as a corporate body. P.R. Laws Ann. tit. 14, § 3712 provides that a stockholder of a dissolved corporation, whose assets were distributed, will be liable the lesser of his or her pro

rata share of the claim or of the amount actually distributed by the corporation, if the proceeding is commenced prior to the three-year term referenced in § 3708. More Like This Headnote


Business & Corporate Law > Corporations > Dissolution & Receivership > Termination & Winding Up > Limited Survival 


HN7  See P.R. Laws Ann. tit. 14, § 3708.

Business & Corporate Law > Corporations > Dissolution & Receivership > Termination & Winding Up > Limited Survival 


HN8  See P.R. Laws Ann. tit. 14, § 3712.

Bankruptcy Law > Case Administration > Court Powers 


Civil Procedure > Remedies > Injunctions > Preliminary & Temporary Injunctions 

HN9  A movant requesting a preliminary injunction in a bankruptcy case under 11 U.S.C.S. § 105(a) must satisfy a four-factor test which consists of the following (1) that the bankruptcy debtor would suffer irreparable injury if the injunction were not granted; (2) that such injury outweighs any harm which granting injunctive relief would inflict on a defendant; (3) that the debtor has exhibited a likelihood of success on the merits; and (4) that the public interest will not be adversely affected by the granting of the injunction. Evidence that goes beyond the unverified allegations of the pleadings and motion papers must be presented to support or oppose a motion for a preliminary injunction. More Like This Headnote

Civil Procedure > Remedies > Injunctions > Elements > General Overview 


HN10  The basis of injunctive relief in the federal courts is irreparable harm and inadequacy of legal remedies. The sine qua non is whether the movants are likely to succeed on the merits. However, the degree of likelihood of success is not determinative as it must be balanced with the hardships caused to the parties if the injunction is not granted. If the movant's showing of probable success on the merits is uncertain, he may be entitled to a preliminary injunction if he demonstrates a strong probability that he will be injured if the court fails to act. To establish irreparable harm, the movant does not need to show that the injunctive relief will


be fatal to the business, only that its legal remedies are inadequate. If the movant suffers a substantial injury that is not accurately measurable or adequately compensable by money damages, irreparable harm is a natural sequel. The key word in this consideration is irreparable. Mere injuries, however substantial, in terms of money, time, and energy necessarily expended in the absence of a stay, are not enough. The possibility that adequate compensatory or other corrective relief will be available at a later date, in the ordinary course of litigation, weighs heavily against a claim of irreparable harm. More Like This Headnote


[Bankruptcy Law > Case Administration > Administrative Powers > Stays > Coverage > General Overview](#) 

[Bankruptcy Law > Case Administration > Court Powers](#) 


[Civil Procedure > Remedies > Injunctions > Elements > Likelihood of Success](#) 


HN11  The second prong of the preliminary injunction test, likelihood of success, is defined for the purposes of an injunction in a bankruptcy case as the probability of a successful reorganization. The second prong is related to the first prong, given that it would contravene the protections afforded to a bankruptcy debtor under 11 U.S.C.S. § 362, namely to provide a breathing spell by halting all collection efforts and harassment by creditors while permitting the debtor to attempt a plan of reorganization. More Like This Headnote


[Bankruptcy Law > Case Administration > Administrative Powers > Stays > Coverage > Exceptions > General Overview](#) 

HN12  11 U.S.C.S. § 362(b)(6) exempts from the automatic bankruptcy stay the exercise by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency of any contractual right (as defined in 11 U.S.C.S. §§ 555 or 556) under any security agreement or arrangement or other credit enhancement forming a part of or related to any commodity contract, forward contract or securities contract, or of any contractual right (as defined in §§ 555 or 556) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more contracts, including any master agreement for such contracts. § 362(b)(6). The Financial Netting Improvements Act of 2006 clarifies that this stay exception includes the exercise by such entities of any contractual right (as defined in §§ 555 or 556) under any security agreement, arrangement, or other credit enhancement in or related to any commodity contract, forward contract, or securities contract. More Like This Headnote


Banking Law > Regulatory Agencies > General Overview 


Civil Procedure > Alternative Dispute Resolution > Arbitrations > General Overview 

Securities Law > Blue Sky Laws > Administration & Enforcement 


HN13  Financial Industry Regulatory Authority Rule 13200 provides that: (a) except as otherwise provided in the Puerto Rico Code of Arbitration Procedure for Industry Disputes, a dispute must be arbitrated under the Code if the dispute arises out of the business activities of a member or an associated person and is between or among members, members and associated persons, or associated persons; and (b) disputes arising out of the insurance business activities of a member that is also an insurance company are not required to arbitrate under the Code. More Like This Headnote

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HN14  For purposes of the Puerto Rico Code of Arbitration Procedure for Industry Disputes, the term "member" means any broker or dealer admitted to membership in the Financial Industry Regulatory Authority (FINRA), whether or not the membership has been terminated or cancelled, and any broker or dealer admitted to membership in a self-regulatory organization that, with FINRA consent, has required its members to arbitrate pursuant to the Code and/or to be treated as members of FINRA for purposes of the Code, whether or not the membership has been terminated or cancelled. The term "associated person" or "associated person of a member" means a person associated with a member. The term "person associated with a member" means: (1) a natural person who is registered or has applied for registration under the Rules of FINRA; or (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA. FINRA Rule 13100(a), (f), (o), (r). More Like This Headnote

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HN15  Parties must arbitrate a dispute under the Puerto Rico Code of Arbitration Procedure for Industry Disputes if arbitration under the Code is either: required by a written agreement or requested by a customer, the dispute is between a customer and a member or associated person of a member; and the dispute arises in connection with the business activities of the member or the associated person, except disputes involving the insurance business activities of a member that is also an insurance company. Financial Industry Regulatory Authority Rule 12200. More Like This Headnote

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HN16  A claim by or against a member in one of the following categories is ineligible for arbitration under the Puerto Rico Code of Arbitration Procedure for Industry Disputes unless a customer agrees in writing to arbitrate after the claim arises: a member whose membership is terminated, suspended, cancelled or revoked; a member that has been expelled from Financial Industry Regulatory Authority; or a member that is otherwise defunct. More Like This Headnote


COUNSEL: [*1] For R&G FINANCIAL CORPORATION, Debtor: BRENT MCILWAIN , ROBERT W JONES  , PATTON BOGGS LLP, DALLAS, TX; BRENT R McILWAIN  ; JORGE I. PEIRATS , PIETRANTONI, MENDEZ & ALVAREZ, HATO REY, PR.

JUDGES: Enrique S. Lamoutte, United States Bankruptcy Judge.

OPINION BY: Enrique S. Lamoutte

OPINION

OPINION AND ORDER

This case is before the court upon Debtor's motion to determine whether the automatic stay provisions of 11 U.S.C. §§362(a) and 105(a) of the Bankruptcy Code may be extended to R&G Investments Corporation ("RGIC"), a duly dissolved subsidiary of R&G Financial Corporation  (hereinafter referred to as "RGFC" or "Debtor"), in relation to certain arbitration proceedings before the Financial Industry Regulatory Authority ("FINRA") (Docket No. 27). On July 16, 2010, Rebecca A. Diaz-Cruz, Lourdes R. Diaz-

Antommattei and Jose Morales-Steinman (hereinafter referred to as the "FINRA claimants") jointly filed their brief and memo in opposition to Debtor's emergency motion for extension of the automatic stay provisions to RGIC arguing that FINRA Rule 13200 governs mandatory application of arbitration proceedings and that the claims in controversy in the FINRA arbitration proceedings are non-core matters unrelated to Debtor's bankruptcy [*2] and thus, are governed by the Federal Arbitration Act ("FAA") (Docket No. 77). For the reasons stated herein, Debtor's request for the provisions of the automatic stay to be extended to its duly dissolved subsidiary is hereby granted.

Facts and Procedural Background

RGFC filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code on May 14, 2010. On May 21, 2010, the Clerk of the Court gave notice to creditors, amongst other pertinent information, of the date of the meeting of creditors and of the bar date for all creditors (except a governmental unit) to file a proof of claim, that is, September 21, 2010 (Docket No. 11). RGFC in its original schedules failed to include the claims of the FINRA claimants (Docket Nos. 51). Debtor in line item number four (4) of its Statement of Financial Affairs included the FINRA arbitration proceedings (Docket No. 50). On June 8, 2010, Debtor filed an urgent motion to determine that the provisions of the automatic stay should be extended to Debtor's dissolved subsidiary, RGIC and thus, stay the FINRA arbitration proceedings based on the following grounds: (i) RGFC, the sole shareholder of RGIC, has assumed liability for all RGIC claims, thus [*3] any action against RGIC would be an action against RGFC in conformity with 14 L.P.R.A. §§3008 & 3012; (ii) resolving the FINRA claimants rights in the arbitration proceeding, rather than in the bankruptcy proceeding, will consume the Debtor's limited financial and managerial resources; since preparation for a complex and technical FINRA arbitration proceeding would entail Debtor to deplete estate assets in the preparation of a proper defense for said arbitration, and such arbitration proceedings would significantly drain its scarce managerial resources; (iii) Debtor will have to bear 100% of all costs since RGIC has no available assets to satisfy the defense costs or any potential indemnification obligations which result from the FINRA arbitration proceedings; and (iv) the arbitration proceeding seeks to adjudicate a core matter, namely the allowance or disallowance of the FINRA claimants claims (Docket No. 27). Debtor also filed a motion requesting an emergency hearing to determine that the automatic stay applies to arbitration proceedings (Docket No. 28). Subsequently, the court entered an interim/bridge order enjoining FINRA claimants from further prosecuting the FINRA arbitration [*4] against the Debtor and RGIC, until a final order is entered, and scheduled a hearing for July 6, 2010 (Docket No. 31).

The 341 meeting of creditors was held on June 23, 2010, and closed on July 7, 2010 (Docket Nos. 56 & 71). On July 5, 2010, the attorneys representing the FINRA claimants filed a Notice of Appearance and Request of Notices (Docket No. 69). On July 6, 2010, a hearing was held regarding the extension of the automatic stay provisions to RGIC in which the court granted the FINRA claimants ten (10) days to file a legal memorandum in opposition to Debtor's motion to extend the provisions of the automatic stay to RGIC (Docket Nos. 70 & 75).

On July 16, 2010, the FINRA claimants filed their opposition to Debtor's motion to determine that the

automatic stay should be extended to RGIC by which they argue the following: (i) FINRA Rule 13200 governs mandatory application of arbitration proceedings; (ii) the claims presented to FINRA arise from a contract amongst the FINRA claimants and RGIC; (iii) the claims in controversy in the FINRA arbitration proceedings are non-core matters unrelated to Debtor's bankruptcy which do not interfere with the Bankruptcy Code, thus the same are governed [*5] by the FAA and courts must enforce the same; (iv) the claims in controversy in the FINRA arbitration proceedings are excepted from the provisions of the automatic stay pursuant to 11 U.S.C. §362(b)(6) because they arose "from securities and investments;" and (v) the arbitration process is the most cost efficient and expedited mechanism to solve the specific and highly specialized controversies (Docket No. 77). Subsequently, Debtor filed its supplemental brief in support of its position on July 26, 2010 (Docket No. 89) by which it argues that the automatic stay provisions should be extended to RGIC based on the following: (i) the arbitration plaintiffs have failed to establish that RGFC is required to participate in the arbitration proceedings in conformity with the FINRA rules or that it has consented to arbitrate before FINRA; (ii) RGIC has no assets or resources, thus any action against RGIC would effectively be an action against Debtor, who has assumed liability for all RGIC claims; (iii) resolving the FINRA plaintiffs' rights in the arbitration proceedings, rather than in bankruptcy court will consume Debtor's limited financial and managerial resources; (iv) the arbitration plaintiffs [*6] have failed to establish "cause" for lifting the automatic stay to permit the arbitration to proceed against Debtor; and (v) the arbitration plaintiffs through the arbitration proceedings are litigating a "core" bankruptcy matter, namely the allowance of a prepetition claim against the Debtor's estate which should be administered by the bankruptcy court (Docket Nos. 27& 89).

On September 10, 2010, Debtor filed an amended Schedule F-Creditors Holding Unsecured Nonpriority Claims whereby it includes the following claims: (i) creditor Rebecca Diaz Cruz is listed as having a contingent, unliquidated and disputed claim in the amount of \$0.00; (ii) creditor Lourdes A. Diaz Antommattei is listed as having a contingent, unliquidated and disputed claim in the amount of \$0.00; and (iii) creditor Jose Morales Steinman is listed as having a contingent, unliquidated and disputed claim in the amount of \$0.00, namely the claims of the FINRA claimants (Docket No. 130). On September 10, 2010, Debtor also filed a Notice of Amendment to Schedules of Assets and Liabilities by which it informed those creditors which were added in the amended schedules that in conformity with PR LBR 1009-1(c) they had ninety [*7] (90) days from the date of service of this document to file a proof of claim, hence the bar date is December 9, 2010 (Docket No. 132). The court notes that as of the issuance of this Opinion and Order the FINRA claimants have not filed proof of claims in the instant case.

Uncontested Material Facts

1. On June 29, 2007, RGFC and RGIC executed an Agreement and Plan of Liquidation and Dissolution ("Liquidation Agreement") of its subsidiary (Docket No. 27, Exhibit A).
2. Pursuant to the terms of the Liquidation Agreement, RGIC was to transfer certain assets to RGFC, and the latter was to assume certain liabilities of RGIC, including "...any contingent liabilities for lawsuits or claims made by customers of the Subsidiary" (Docket No. 27, Exhibit A).

3. On August 14, 2007, RGIC was duly dissolved per Certification of the Secretary of State of the Commonwealth of Puerto Rico (Docket No. 27, Exhibit B).
4. On March 1, 2010, the FINRA claimants filed their claims against RGIC, RGFC, Myrsa Acevedo and UBS Financial Services Incorporated of Puerto Rico before FINRA in an arbitration proceeding (Docket No. 77).
5. On May 19, 2010, FINRA informed the Debtor that the FINRA arbitration would be stayed [*8] as to RGFC and RGIC and that arbitration would proceed against UBS Financial Services Incorporated of Puerto Rico and Myrsa Acevedo.
6. On May 25, 2010, FINRA issued a letter of correction informing that the FINRA arbitration proceedings would be stayed with respect to the Debtor, but would proceed against RGIC absent a court ordered stay or agreement of the parties.

Applicable Law & Analysis

Extension of automatic stay to Non Debtors pursuant to §§362(a) & 105(a) Procedure & Requirements

Procedure

HN1 A request for extension of the automatic stay provisions of Section 362(a) to a non debtor constitutes an action for injunctive relief and should be initiated by an adversary proceeding. In re Bora Bora, 424 B.R. 17, 24-25 (Bankr. D.P.R., 2010); Fed. R. Bankr. P. 7001(7); See also ; Alan N. Resnick and Henry J. Sommer, 3 Collier on Bankruptcy, ¶1362.04[1] (16th ed. 2010)("Rule 7001(7) provides that a request for injunctive relief is governed by part VII of the Bankruptcy Rules. This will mean that when the automatic stay of section 362 does not apply, injunctive relief will have to be sought by filing a complaint initiating an adversary proceeding and then seeking a temporary restraining order").

HN2 "The [*9] power of the bankruptcy courts to enjoin certain actions not subject to the automatic stay, such as an action against non debtor parties, has been recognized, when such action is interfering improperly with the purposes of the bankruptcy law or the debtor's reorganization efforts." In re Bora Bora Inc., 424 B.R. 17, 23 (Bankr. D.P.R. 2010) citing A.H. Robins Co., Inc. v. Piccinin, 788 F. 2d 994 (4th Cir. 1986). "Although called an extension of the automatic stay provisions of the Bankruptcy Code to non-debtor parties, these are in fact injunctions issued by a bankruptcy court under 11 U.S.C. §105(a), after determining that the situation requires it in order to protect the interests of the bankruptcy estate." Id. citing In re Cincom iOutsource, Inc., 398 B.R. 223, 227 (Bankr. S.D. Ohio, 2008). "Under the Bankruptcy Act, it was believed that the bankruptcy court lacked jurisdiction to issue such an injunction. HN3 Under the Code, broad injunctive power is available under section 105, and the issue appears to be one directed to the discretion of the court rather than to its jurisdiction." Alan N. Resnick and Henry J. Sommer, 3 Collier on Bankruptcy, ¶1362.04 (16th ed. 2010). A preliminary injunction [*10] is an extraordinary and drastic remedy which should only be granted when the movant has carried its burden

through clear and convincing evidence. *Mazurek v. Armstrong*, 520 U.S. 968, 972, 117 S. Ct. 1865, 138 L. Ed. 2d 162 (1997). Thus, the broad injunctive power under Section 105(a) should be used sparingly. In *re Lazarus Burman Assoc.*, 161 B.R. 891, 901 (Bankr. E.D.N.Y. 1993).

HN4 The court in analyzing whether to extend the protection of the automatic stay to non debtors, must determine if the requirements of both Sections 362(a) and 105(a) are satisfied in order to grant a preliminary injunction extending the provisions of Section 362(a) to non debtors. In *re Bora Bora Inc.*, 424 B.R. at 24 referencing *In re Philadelphia Newspapers, LLC*, 407 B.R. 606 (E.D. Pa. 2009). The court notes that the Debtor failed to follow the appropriate procedural mechanism established in Fed. R. Bankr. P. 7001(7) to request an extension of the automatic stay to a nondebtor. Nonetheless, the court for the sake of expediency, will entertain Debtor's request as a contested matter. Fed. R. Bankr. P. 9014.

Requirements under Section 362(a)

HN5 Section 362(a)(1) operates as a stay, "...applicable to all entities, of the [*11] commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title." 11 U.S.C. §362(a)(1). The scope of the protection of the automatic stay is broad, but it only stays actions against the debtor, hence the protections of the stay do not extend to entities such as, "sureties, guarantors, co-obligors, or others with a similar legal or factual nexus to the ... debtors." *McCartney v. Integra Nat'l Bank N.*, 106 F. 3d 506, 509-510 (3rd Cir. 1997) quoting *Maritime Elec. Co. v. United Jersey Bank*, 959 F. 2d 1194, 1204 (3rd Cir. 1991). However, the protection of the automatic stay may be extended to non debtors if "unusual circumstances" are found such as; "(i) the non debtor and debtor enjoy such an identity of interests that the suit of the non-debtor is essentially a suit against the debtor; or (ii) the third-party action will have an adverse impact on the debtor's ability to accomplish reorganization." [*12] *In re Philadelphia Newspapers, LLC*, 407 B.R. at 616.

In the instant case, a Liquidation Agreement was executed on June 29, 2007 between RGFC and its subsidiary RGIC. RGFC at the time of the Liquidation Agreement was the sole stockholder of RGIC. The Liquidation Agreement discloses that RGIC's assets are approximately \$10,851,000, its liabilities are approximately \$59,000 and its stockholder's equity is approximately \$10,792,000. Clause 1.1. of the Liquidation Agreement established that RGIC would transfer to RGFC all the assets (as defined in the Liquidation Agreement) in exchange for the assumption by RGFC of all of the liabilities (as defined in the Liquidation Agreement) namely, the accrued expenses and other liabilities of RGIC and any contingent liabilities for lawsuits or claims made by customers of RGIC; the cancellation of the intercompany advance agreement (defined as "...the agreement executed by the Stockholder and the Subsidiary to evidence the advance made to the Stockholder, dated June 7, 2007, in the amount of \$8,000,000.00."); and the complete redemption and cancellation of all the shares. Clause 1.2 of the Liquidation Agreement also establishes that on the effective [*13] date (June 29, 2007), RGIC shall declare and pay a dividend to RGFC in the amount of \$3,092,516.

The Department of State of the Commonwealth of Puerto Rico issued RGIC's Certificate of Dissolution on August 14, 2007. HN6 Article 9.08 of the General Corporations Law of 2009, as amended, of the Commonwealth of Puerto Rico, 14 L.P.R.A. §3708 1 establishes that all dissolved corporations shall continue to exist as a corporate entity for three (3) years from the date of dissolution and it further provides that if any proceeding is commenced before the three (3) year period lapses, the corporation shall continue as a corporate body. Article 9.12 of the General Corporations Law, 14 L.P.R.A. §3712 2 provides that a stockholder of a dissolved corporation, whose assets were distributed, will be liable the lesser of his or her pro rata share of the claim or of the amount actually distributed by the corporation, if the proceeding is commenced prior to the three (3) year term referenced in Article 9.08. This court concludes that RGFC as RGIC's sole stockholder in conformity with the General Corporations Law of 2009, as amended of the Commonwealth of Puerto Rico, is statutorily the only party that may [*14] be potentially liable to the FINRA claimants depending on the outcome of their claims.

FOOTNOTES

1 Article 9.08 of the General Corporations Law of 2009, as amended, provides: HN7 "[a]ll corporations, whether they expire by their own limitation or are otherwise dissolved, shall continue to exist as corporate entity for a period of three (3) years from the date of extinction or dissolution, or for any such longer period which the Court of First Instance (Superior Part) may, in its discretion, direct for purposes of advancing any suits initiated by the corporation and continuing the defense of the suits pending against it, whether civil, criminal or administrative, as well as for purposes of liquidating and terminating the business of the corporation, of complying with its obligations and distributing the remaining assets to the stockholders. The legal entity shall not continue for the purpose of continuing the business for which the corporation was organized.

With respect to any action, suit or proceeding filed or initiated by or against the corporation before its extinction, or within the period of three (3) years following its extinction or dissolution, the corporation shall continue as a corporate [*15] body after the three (3) year term, and until all judgments, orders or decrees with respect to the aforementioned actions, suits or proceedings are fully executed, without the need for any special provision to that effect by the Court of First Instance (Superior Part)." 14 L.P.R.A. §3708.

2 Article 9.12 of the General Corporations Law of 2009, as amended, provides: HN8 "(a) [a] stockholder of a dissolved corporation whose assets were distributed, to the stockholders shall not be liable for any claim against the corporation in an amount in excess of his pro rata share of the claim or of the amount distributed to him by the corporation, whichever is less.

(b) A stockholder of a dissolved corporation whose assets were distributed to the stockholders shall not be liable for any claim against the corporation in which such action, suit or proceeding is not begun prior to the expiration of the term provided in §3708 of this title.

(c) The total liability of a stockholder of a dissolved corporation for claims filed against the dissolved corporation shall not exceed the amount distributed to the stockholder in the dissolution." 14 L.P.R.A. §3708.

In the instant case, the arbitration proceedings against [*16] RGIC are essentially and statutorily against the Debtor, given that their identity of interests are in essence merged into RGFC, as its sole stockholder, and as the real party in interest RGFC will have to prepare and incur all legal defense fees and may ultimately be liable depending on the outcome of the FINRA claimants claims. Thus, the "unusual circumstances" to extend the protection of the automatic stay pursuant to Section 362(a) are present.

Requirements under Section 105(a)

HN9 The movant requesting the preliminary injunction under Section 105(a) must satisfy the four (4) factor test which consists of the following (1) that the debtor would suffer irreparable injury if the injunction were not granted; (2) that such injury outweighs any harm which granting injunctive relief would inflict on a defendant; (3) that the debtor has exhibited a likelihood of success on the merits; and (4) that the public interest will not be adversely affected by the granting of the injunction. In re Codfish, 97 B.R. 132, 135 (Bankr. D.P.R. 1987) citing In re Supermecado Gamboa, 68 B.R. 230, 232 (Bankr. D.P.R. 1986). "Evidence that goes beyond the unverified allegations of the pleadings and motion papers [*17] must be presented to support or oppose a motion for a preliminary injunction." 11A Wright, Miller & Kane, Federal Practice and Procedure: Civil 2d §2949 at 214.

The Supreme Court has stated that, HN10 "the basis of injunctive relief in the federal courts has always been irreparable harm and inadequacy of legal remedies." Sampson v. Murray, 415 U.S. 61, 88, 94 S. Ct. 937, 952, 39 L. Ed. 2d 166, 185 (1974) (quoting Beacon Theatres, Inc. v. Westover, 359 U.S. 500, 506-507, 79 S. Ct. 948, 3 L. Ed. 2d 988 (1959)). "The sine qua non is whether the [movants] are likely to succeed on the merits." Acevedo-Garcia v. Vera-Monroig, 296 F. 3d. at 16 (quoting Weaver v. Henderson, 984 F. 2d 11, 12 (1st Cir. 1993)); New Comm Wireless Services, Inc. v. Sprintcom, Inc., 287 F. 3d 1, 9 (1st Cir. 2002). However, the degree of likelihood of success is not determinative as it must be balanced with the hardships caused to the parties if the injunction is not granted. If plaintiff's showing of probable success on the merits is uncertain, he may be entitled to a preliminary injunction if he demonstrates a strong probability that he will be injured if the court fails to act. 11A Wright, Miller & Kane, Federal Practice [*18] and Procedure: Civil 2d § 2948.3 at 189 & 194-195. To establish irreparable harm, the movant does not need to show that the injunctive relief will be fatal to the business, only that its legal remedies are inadequate. Ross-Simons of Warwick, Inc. v. Baccarat, Inc., 102 F. 3d 12, 15 (1st Cir. 1996). "If the plaintiff suffers a substantial injury that is not accurately measurable or adequately compensable by money damages, irreparable harm is a natural sequel." Id. The Supreme Court has defined the concept of irreparable harm as follows, "[t]he key word in this consideration is irreparable. Mere injuries, however substantial, in terms of money, time and energy necessarily expended in the absence of a stay, are not enough. The possibility that adequate compensatory or other corrective relief

will be available at a later date, in the ordinary course of litigation, weighs heavily against a claim of irreparable harm." *Sampson v. Murray*, 415 U.S. at 90 (quoting *Virginia Petroleum Jobbers Association v. FPC*, 104 U.S. App. D.C. 106, 259 F.2d 921 (D.C.Cir. 1958)).

In the instant case this court finds that Debtor would sustain irreparable harm or injury if the continuation of proceedings against [*19] RGIC (a defunct entity with no assets) is not stayed, since as already explained herein, Debtor would be the entity legally and financially responsible in providing not only all the legal costs of RGIC's defense in the FINRA arbitration proceedings but also its limited managerial resources would also be diverted in assisting towards the preparation for such proceedings, meaning that its automatic stay protections under Section 362(a)(1) would in essence be violated. Moreover, at this juncture, the FINRA claimants have not requested from this court to lift the automatic stay with respect to the Debtor in order to proceed with the arbitration proceedings.

HN11 The second prong of the preliminary injunction test, "likelihood of success," has been defined for the purposes of an injunction in a bankruptcy case "as the probability of a successful reorganization." *Lazarus Burman Assocs. v. National Westminster Bank USA (In re Lazarus Burman Assocs.)*, 161 B.R. 891, 901 (Bankr. E.D.N.Y. 1993). The second prong is related to the first prong, given that it would contravene the protections afforded to debtors under Section 362, namely to provide the same a breathing spell by halting all collection efforts [*20] and harassment by creditors while permitting the debtor to attempt a plan of reorganization. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977); S. Rep. No. 989, 95th Cong. 2d Sess. 54-55 (1978), reprinted in App. Pt. 4(d)(i) and 4(e)(i) *infra*. ("The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy"). Thus, this court finds that Debtor meets the second prong of the preliminary injunction test because it would hamper its attempt for a successful reorganization if the protections of the automatic stay were not provided to Debtor.

The third prong of the preliminary injunction test, the relative harm to be suffered or the balance of relevant positions, is met by the Debtor because the degree of harm that would be imparted to the Debtor and its estate outweighs the harm that the FINRA claimants would face if a preliminary injunction were not issued, given that [*21] the preliminary injunction will not invalidate the alleged rights of the FINRA claimants but it will simply delay the enforcement of those rights. See *In re Lazarus Burman Assocs.*, 161 B.R. at 901.

Lastly, the fourth prong of the test, the public interest in the context of a bankruptcy proceeding, consists in promoting a successful reorganization. *Id.* at 901. This court concludes that the public interest is best protected if the Debtor continues to work in their reorganization rather than having to face immediate adverse economic consequences stemming from legal fees in the arbitration proceedings and the syphoning off of its limited managerial resources in such proceedings.

Exemption from the Automatic Stay under §362(b)(6)

HN12 Section 362(b)(6) exempts from the automatic stay, "...the exercise by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency of any contractual right (as defined in section 555 or 556) under any security agreement or arrangement or other credit enhancement forming a part of or related to any commodity contract, forward contract or securities contract, or of any contractual right (as [*22] defined in section 555 or 556) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more contracts, including any master agreement for such contracts." 11 U.S.C. §362(b)(6). "The Financial Netting Improvements Act of 2006 clarifies that this stay exception includes the exercise by such entities of any contractual right (as defined in section 555 or 556) under any security agreement, arrangement or other credit enhancement in or related to any commodity contract, forward contract or securities contract." Alan N. Resnick and Henry J. Sommer, 3 Collier on Bankruptcy, ¶362.05[6] (16th ed. 2010).

The FINRA claimants argue that they are exempted from the automatic stay pursuant to the provisions of Section 362(b)(6), but their reliance is misplaced given that such section allows for setoffs, which involve mutual debts and claims, which in turn originate from short-term contracts (such as securities and commodities contracts which involve margin calls) and entered into by certain entities described in said section. The court in the instant case, is simply not before this type of scenario (transaction), rather the [*23] FINRA claimants causes of actions arise from alleged violations of securities laws which occurred with respect to RGIC before the same was liquidated on June 29, 2007.

The FINRA claimants citing *In re Coachworks Holdings, Inc.*, 418 B.R. 490 (Bankr. M.D. Ga. 2009) and *Smith v. Tricare Rehabilitation Sys. (In re Tricare Rehabilitation)*, 181 B.R. 569 (Bankr. N.D. Ala. 1994) argue that the existence of pending litigation against the debtor in a non-bankruptcy case may constitute case for lifting the automatic stay. The court in both of these cases was presented with motions for relief from the automatic stay pursuant to Section 362(d)(1). This issue is simply not before the court, given that the FINRA claimants have not filed before the court a motion requesting relief from the automatic stay pursuant to Section 362(d)(1) and (g).

Mandatory Arbitration under FINRA Rules

FINRA claimants argue that FINRA Rule 13200 establishes mandatory application of arbitration proceedings. FINRA Rule 13200 must be employed in conformity with the Code of Arbitration Procedure for Industry Disputes. HN13 FINRA Rule 13200 provides,

" (a) Except as otherwise provided in the Code, a dispute must be arbitrated under [*24] the Code if the dispute arises out of the business activities of a member or an associated person and is between or among: Members; Members and Associated Persons; or Associated Persons.

(b) Disputes arising out of the insurance business activities of a member that is also an insurance company are not required to arbitrate under the Code." FINRA Rule 13200.

FINRA Rule 13100 defines the following terms:

"(f) Code-The term 'Code' means the Code of Arbitration Procedure for Industry Disputes. For disputes involving customers, see the FINRA Code of Arbitration Procedure for Customer Disputes.

(o) HN14 Member-For purposes of the Code, the term 'member' means any broker or dealer admitted to membership in FINRA, whether or not the membership has been terminated or cancelled, and any broker or dealer admitted to membership in a self-regulatory organization that, with FINRA consent, has required its members to arbitrate pursuant to the Code and/or to be treated as members of FINRA for purposes of the Code, whether or not the membership has been terminated or cancelled.

(a) Associated Person-The term 'associated person' or 'associated person of a member' means a person associated with a member, as that [*25] term is defined in paragraph (r).

(r) Person Associated with a Member-The term 'person associated with a member' means:

- (1) A natural Person who is registered or has applied for registration under Rules of FINRA; or
- (2) A sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA." FINRA Rule 13100(a), (f), (o) and (r).

In the instant case, the FINRA claimants are citing FINRA Rule 13200 which is used for industry disputes amongst members of FINRA or persons that are associated with a FINRA member. The dispute in this case is between RGIC (a former FINRA member) and the FINRA claimants which are not FINRA members. Thus, the applicable FINRA Rules would be those in conformity with Code of Arbitration Procedure for Customer Disputes. FINRA Rule 12200 provides the following:

HN15 Parties must arbitrate a dispute under the Code if: [*26] Arbitration under the Code is either:

- (1) Required by a written agreement, or
- (2) Requested by the customer 3

The dispute is between a customer and a member 4 or associated person 5 of a member; and
The dispute arises in connection with the business activities of the member or the associated person, except disputes involving the insurance business activities of a member that is also an insurance company." FINRA Rule 12200.

FOOTNOTES

3 FINRA Rule 12100(i) defines customer as, "[a] customer shall not have include a broker or dealer."

4 FINRA Rule 12100(o) defines member as follows; "[f]or purposes of the Code, the term 'member' means any broker or dealer admitted to membership in FINRA, whether or not the membership has been terminated or cancelled; and any broker or dealer admitted to membership in a self regulatory organization that, with FINRA consent, has required its members to arbitrate pursuant to the Code and/or to be treated as members of FINRA for purposes of the Code, whether or not the membership has been terminated or cancelled."

5 FINRA Rule 12100(a) defines associated person as follows; "[t]he term 'associated person' or 'associated person of a member means a person associated with a member, [*27] as that term is defined in paragraph (r)." FINRA Rule 12100(r) defines person associated with a member as follows; "[t]he term 'person associated with a member' means: (1) A natural person who is registered or has applied for registration under the Rules of FINRA; or (2) A sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA. For purposes of the Code, a person formerly associated with a member is a person associated with a member."

RGIC is a defunct entity which was duly dissolved on August 14, 2007. 6 FINRA Rule 12202 provides the following regarding claims against inactive members:

HN16 [a] claim by or against a member in one of the following categories is ineligible for arbitration under the Code unless the customer agrees in writing to arbitrate after the claim arises:

A member whose membership is terminated, suspended, [*28] cancelled or revoked;

A member that has been expelled from FINRA; or

A member that is otherwise defunct."

FOOTNOTES

6 However, without making any factual findings the court assumes that RGIC's membership with FINRA terminated or the same withdrew its application with FINRA on June 26, 2007 pursuant to an online FINRA BrokerCheck Report.

In the instant case, the entity that would be incurring in the costs of legally representing RGIC in the arbitration proceedings would be RGFC, because RGIC has no assets since it was liquidated on June 29, 2007. RGFC is not a former or a current FINRA member, or a natural person associated with a member. Thus, FINRA may not oblige RGFC to arbitrate in said arbitration proceedings.

However, this issue does not control the outcome because this court has ordered the provisions of the automatic stay to be extended to RGIC. Moreover, even if RGFC were obligated by the FINRA Rules to participate in said arbitration proceedings, the FINRA claimants would have had to file a motion to compel arbitration before this court, and they have not as of this date.

The Federal Arbitration Act & Bankruptcy⁷

FOOTNOTES

⁷ The parties do not dispute that the FAA applies to arbitration proceedings brought [*29] before FINRA.

The Federal Arbitration Act ("FAA"), 9 U.S.C.S. §1 et seq., requires federal courts to enforce arbitration agreements and to stay litigation that contravenes it. See 9 U.S.C. §§ 2 & 3; *Burns v. New York Life Ins. Co.*, 202 F. 3d 616, 620 (2d Cir. 2000). The FAA represents a "congressional declaration of a liberal federal policy favoring arbitration agreements," and "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 23, 74 L. Ed. 2d 765, 103 S. Ct. 927 (1983). However, "like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command." *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 226, 96 L. Ed. 2d 185, 107 S. Ct. 2332 (1987).

A bankruptcy court presented with a motion to compel arbitration must apply a four (4) prong test which consists of the following: (i) whether the parties agreed to arbitrate; (ii) the scope of the agreement; (iii) if federal statutory claims are asserted, it must consider whether Congress intended those claims to be nonarbitrable; and (iv) if the court concludes that some, but not all, [*30] of the claims in the case are arbitrable, it must then decide whether to stay the balance of the proceedings pending arbitration. *Togut v. RBC Dain Correspondent Servs. (In re S.W. Bach & Co.)*, 425 B.R. 78, 87 (Bankr. S.D.N.Y. 2010) (citing *Bethlehem Steel Corp. v. Moran Towing Corp. (In re Bethlehem Steel Corp.)*, 390 B.R. 784, 789 (Bankr. S.D.N.Y. 2008) (quoting *Oldroyd v. Elmira Sav. Bank, FSB*, 134 F. 3d 72, 75-76 (2d Cir. 1998)).

In the instant case, the court has not been presented with a motion to compel arbitration by the FINRA claimants, thus it would be premature for the court to enter into the four prong test analysis and make a determination as to whether the FINRA claimants' claims are core or non-core, and whether the same are arbitrable or non-arbitrable.

Conclusion

In view of the foregoing, the court finds and concludes as follows: (1) RGFC, as RGIC's sole stockholder in conformity with the General Corporations Law of 2009, as amended of the Commonwealth of Puerto

Rico, is statutorily the only party that may be potentially liable to the FINRA claimants depending on the outcome of their respective claims. Thus, the arbitration proceedings against RGIC are essentially and statutorily [*31] against the Debtor, given that RGFC as its sole stockholder, and as the real party in interest will be ultimately liable to the FINRA claimants; (2) the "unusual circumstances" to extend to RGIC the protection of the automatic stay pursuant to Section 362(a) are present in the instant case; (3) the exemption from the automatic stay provided by Section 362(b)(6) is simply inapplicable because this particular section allows for setoffs, that involve mutual debts and claims, which in turn originate from short-term contracts (such as securities and commodities contracts which involve margin calls) and entered into by certain entities described in said section. The court is not before this type of transaction, rather the FINRA claimants causes of actions arise from alleged violations of securities laws which occurred prior to the June 29, 2007 liquidation date of RGIC; (4) furthermore, this court finds that the FINRA claimants' argument regarding that the existence of pending litigation against a debtor in a non-bankruptcy forum may constitute cause for lifting the automatic stay is misplaced. The FINRA claimants have not filed before this court a motion requesting relief from the automatic [*32] stay pursuant to Section 362(d)(1) and (g); (5) in the instant case, FINRA pursuant to either the Code of Arbitration Procedure for Industry Disputes or the Code of Arbitration Procedure for Customer Disputes may not oblige RGFC to appear in the arbitration proceedings because they have not as of this date filed a motion to compel arbitration before this court; and (6) given that the FINRA claimants have not presented to this court a motion to compel arbitration, it would be premature for this court to enter into the four (4) prong test analysis to determine whether the FINRA claimants' claims are core or non-core and whether the same are arbitrable or non-arbitrable.

In summary, this court concludes that Debtor has satisfied the requirements pursuant to Sections 362(a) and 105(a) for the extension of the automatic stay to be extended to its duly dissolved subsidiary, namely RGIC. Consequently, the Debtor's motion requesting the provisions of the automatic stay to be extended to RGIC is hereby GRANTED.

In San Juan, Puerto Rico, this 17th day of November 2010.

/s/ Enrique S. Lamoutte

Enrique S. Lamoutte

United States Bankruptcy Court

IN RE: MANUEL E. NET-VELÁZQUEZ, Debtor. BANCO BILBAO VIZCAYA ARGENTARIA, Defendant, Appellant, v. NOREEN WISCOVITCH-RENTAS, as Trustee for the Estate of Manuel Enrique Net-Velázquez, Plaintiff, Appellee.

No. 09-1816

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

2010 U.S. App. LEXIS 22678; Bankr. L. Rep. (CCH) P81,876; 53 Bankr. Ct. Dec. 243

November 2, 2010, Decided

PRIOR HISTORY: [*1]

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO, Hon. Gustavo A. Gelpí, U.S. District Judge.

Banco Bilbao Vizcaya Argentaria v. Wiscovitch-Rentas, 2009 U.S. Dist. LEXIS 39393 (D.P.R., May 8, 2009)


CASE SUMMARY


PROCEDURAL POSTURE: Plaintiff bankruptcy trustee filed an adversary proceeding challenging defendant's garnishment of funds in the bank account of a corporation wholly owned by the Chapter 7 debtor and his wife. Defendant appealed from the U.S. District Court for the District of Puerto Rico's affirmance of a bankruptcy court judgment in favor of the bankruptcy trustee.


OVERVIEW: The district court had held that defendant's garnishment of funds was a preferential transfer of estate property avoidable under 11 U.S.C.S. § 547(b). Defendant sought to argue on appeal, under a number of theories, that ownership of the garnished funds was properly vested in the bank and not the debtor. Because defendant neglected to squarely raise these arguments before the bankruptcy court, it had waived them. Simply noting an argument in passing without explanation was insufficient to avoid waiver. Save in exceptional cases, only those issues that were squarely presented and litigated in the trial court could be raised on appeal. The court determined that the equities did not heavily preponderate in favor of allowing the new arguments because the miscellaneous issues raised were not of great public moment, and defendant had other remedies available.

OUTCOME: The judgment of the district court was affirmed.


CORE TERMS: attachment, bank account, sales proceeds, garnished, parcel, garnishment, ownership, legal theories, transferred, earmarked, squarely, deposit, bankruptcy estate, preferential transfer, check issued, pretrial, waived, owed, bankruptcy trustee, adversary proceeding, property interest, failure to raise, exceptional cases, preponderate, purchaser's, financing, preserved, withhold, newly, waiver rule


Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Preferential Transfers > Evidence & Procedure 


HN1  11 U.S.C.S. § 547(b) grants a bankruptcy trustee the power to invalidate so-called "preferential transfers" of property from the bankruptcy estate to a creditor within a 90-day period prior to the filing of a bankruptcy petition. The rationale for allowing such transfers to be recovered is one of fairness, as a creditor who receives property from the estate prior to bankruptcy may obtain, at the expense of other creditors, a greater share of estate property than the creditor would in bankruptcy. More Like This Headnote

Bankruptcy Law > Practice & Proceedings > Appeals > Standards of Review > Clear Error Review 


Bankruptcy Law > Practice & Proceedings > Appeals > Standards of Review > De Novo Review 

HN2  Appellate courts review a bankruptcy court's findings of fact for clear error and its conclusions of law de novo, granting no special deference to the intermediate decision of the district court on appeal. More Like This Headnote

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Preferential Transfers > Evidence & Procedure 


HN3  Under 11 U.S.C.S. § 547(b), the trustee of an estate in bankruptcy may avoid any transfer of an interest of the debtor in property' made (1) to a creditor, (2) on account of an antecedent debt, (3) while the debtor was insolvent, (4) during the 90-day period preceding the filing of the petition, which (5) allowed such creditor to receive more than it would have under Chapter 7. 11 U.S.C.S. § 547(b). More Like This Headnote


Bankruptcy Law > Practice & Proceedings > Appeals > Procedures 


HN4  The bankruptcy court acts as the trial court in bankruptcy proceedings. Thus, arguments must be presented in the bankruptcy court to be preserved; the district court acts solely as an intermediate appellate tribunal. More Like This Headnote


Bankruptcy Law > Practice & Proceedings > Appeals > Procedures 


Civil Procedure > Appeals > Reviewability > Preservation for Review 


HN5  Absent the most extraordinary circumstances, legal theories not raised squarely in the lower court cannot be broached for the first time on appeal. Though sometimes severe in effect, this raise-or-waive rule is founded upon important considerations of fairness, judicial economy, and practical wisdom. [More Like This Headnote](#)


[Bankruptcy Law > Practice & Proceedings > Appeals > Procedures](#) 

[Civil Procedure > Appeals > Reviewability > Preservation for Review](#) 


HN6  A defense or legal theory may not be preserved by bare reference in a pleading if it is thereafter abandoned until, freshly discovered on appeal, it is raised anew. Simply noting an argument in passing without explanation is insufficient to avoid waiver. Save in exceptional cases, only those issues that are squarely presented and litigated in the trial court may be raised on appeal. [More Like This Headnote](#)

[Civil Procedure > Pretrial Matters > Conferences > Pretrial Orders](#) 


[Civil Procedure > Appeals > Reviewability > Preservation for Review](#) 


HN7  The Rules of Civil Procedure are structured to winnow the issues presented by the pleadings as a case progresses, so that only relevant, non-frivolous theories and defenses reach trial and are preserved for our review. Rule 16 in particular encourages the parties and the court, through the pretrial conference process, to formulate and simplify the issues, and eliminate frivolous claims or defenses. Fed. R. Civ. P. 16(c)(2)(A). Because the resulting pretrial order issued under Fed. R. Civ. P. 16 is intended to shape the contours of the ensuing trial by setting forth the legal theories upon which the parties intend to rely, claims or defenses omitted from the pretrial order are waived, whether or not properly raised in the pleadings. [More Like This Headnote](#)


[Civil Procedure > Appeals > Reviewability > Preservation for Review](#) 


HN8  The rule of waiver for arguments not squarely presented below is a matter of discretion and admits of an occasional exception. The bar, however, is high for such an exercise of discretion; a new argument will be considered on appeal only when the equities heavily preponderate in favor of such a step. [More Like This Headnote](#)


[Civil Procedure > Appeals > Reviewability > Preservation for Review](#) 

HN9  Courts have applied various criteria to aid in identifying the exceptional case where relief from waiver of arguments not squarely presented below is appropriate. A nonexhaustive list of factors relevant to this determination includes: (1) whether the litigant's failure to raise the issue has deprived the court of appeals of useful factfinding, or whether the issue was of a purely legal nature; (2) whether the omitted argument raises an issue of constitutional magnitude; (3) whether the argument was highly persuasive and failure to reach it would threaten a miscarriage of justice; (4) whether considering the issue would cause prejudice or inequity to the adverse party; (5) whether the failure to raise the issue was inadvertent and provided no tactical advantage; and (6) whether the issue implicates matters of great public moment. More Like This Headnote

Civil Procedure > Appeals > Reviewability > Preservation for Review 

HN10  It is typically only in cases involving issues of "great public moment" or "constitutional magnitude" that courts are inclined to disregard the waiver of arguments not squarely presented below rule. More Like This Headnote

Civil Procedure > Appeals > Reviewability > Preservation for Review 

HN11  Appellate courts will only consider new arguments on appeal where the equities heavily preponderate in favor of such a step. More Like This Headnote

COUNSEL: María S. Jiménez Meléndez, with whom Wanda I. Luna Martínez and Montañez & Alicea Law Office were on brief, for appellant.



Noreen Wiscovitch-Rentas, with whom Enrique N. Vela Colón was on brief, for appellee.

JUDGES: Before Torruella  and Lipez , Circuit Judges, and Barbadoro, * District Judge.

* Of the District of New Hampshire, sitting by designation.

OPINION BY: LIPEZ 

OPINION

LIPEZ , Circuit Judge. This appeal arises from a bankruptcy court adversary proceeding challenging Appellant Banco Bilbao Vizcaya Argentaria's (BBVA) garnishment of funds in the bank account of a

corporation wholly owned by a Chapter 7 debtor and his wife. BBVA appeals the district court's affirmance of a bankruptcy court judgment in favor of the bankruptcy trustee, holding that BBVA's garnishment of funds was a preferential transfer of estate property avoidable under 11 U.S.C. § 547(b). BBVA seeks to argue in this court, under a number of theories, that ownership of the garnished funds was properly vested in the bank and not the debtor. Because BBVA neglected to squarely raise these arguments before the bankruptcy court, it [*2] has waived them and we therefore affirm.

I.

In 2004, BBVA brought suit in a commonwealth court against Manuel Enrique Net-Velàzquez, his wife, and an associated business partnership, resulting in an attachment in the amount of \$300,000 on several parcels of real property owned by the couple. BBVA filed the attachment order in the Puerto Rico Registry of Property in June 2005.

In August 2005, Net-Velàzquez and his wife sold one of the attached properties, a parcel located in Paseo de la Fuente, Puerto Rico. As it happened, the purchasers arranged for financing through BBVA. Though BBVA ordered a title report prior to the closing, the report omitted (for reasons that are in dispute and not material here) BBVA's \$300,000 attachment. The personnel in charge of the financing at BBVA were apparently unaware of the attachment and remained so until after the closing.

Upon sale of the parcel, BBVA issued a manager's check to Net-Velàzquez and his wife in the amount of \$354,373.30, the entire proceeds of the sale. Net-Velàzquez, who admitted at trial that he was aware of the attachment order, may or may not have been surprised at the amount of the check and BBVA's failure to withhold any portion [*3] of the proceeds to satisfy its attachment, but he did not raise the issue with BBVA. 1

FOOTNOTES

1 Net-Velàzquez testified at trial that he had previously sold another parcel subject to an attachment by BBVA, and in that transaction BBVA and the purchaser had directly negotiated to reduce the amount of the attachment. Net-Velàzquez said that when he received the check for the full proceeds from the sale of the Paseo de la Fuente parcel, he believed that some similar arrangement must have been reached.

Net-Velàzquez and his wife deposited the check for \$354,373.30 into a newly created bank account at a third-party bank. The account was opened in the name of Code Inspector and Management Corp. (Code Inspector), a closely-held corporation created by the couple in 2004. Net-Velàzquez and his wife were the sole shareholders and officers of Code Inspector, and each had full control over the funds held in Code Inspector's bank account.

Two weeks after the closing, having belatedly become aware of the failure to withhold a portion of the Paseo de la Fuente sales proceeds to satisfy its attachment, BBVA garnished all of the available funds in

the Code Inspector bank account. 2 At the time, the account contained [*4] \$351,383.10. BBVA was unaware that the account was maintained in Code Inspector's name, believing it to be Net-Velázquez's personal account. 3

FOOTNOTES

2 The authority by which BBVA garnished the funds is not clearly disclosed by the record, but it appears that BBVA obtained, on an expedited basis, an order from a local court.

3 A bank official testified that BBVA traced the account based upon the endorsed copy of the check returned to BBVA after deposit. Because Net-Velázquez did not sign the check over to Code Inspector but merely deposited the check into the corporate account, there was no indication of the account's ownership.

In December 2005, Net-Velázquez filed a petition for bankruptcy under Chapter 7 of the Bankruptcy Code. The bankruptcy schedules accompanying Net-Velázquez's petition listed the Code Inspector bank account as property of the bankruptcy estate.

II.

The bankruptcy trustee responsible for the Net-Velázquez estate initiated this adversary proceeding against BBVA in September 2006, asserting that the bank's garnishment of funds in the Code Inspector bank account amounted to a preferential transfer under 11 U.S.C. § 547(b). 4 The trustee sought to recover the full \$351,383.10 [*5] garnished by BBVA. 5

FOOTNOTES

4 HN1 Section 547(b) grants a bankruptcy trustee the power to invalidate so-called "preferential transfers" of property from the bankruptcy estate to a creditor within a ninety-day period prior to the filing of a bankruptcy petition. The rationale for allowing such transfers to be recovered is one of fairness, as a creditor who receives property from the estate prior to bankruptcy may obtain, at the expense of other creditors, a greater share of estate property than the creditor would in bankruptcy.

5 For clarity's sake, we note that the amount garnished was less than the full amount of the check issued by BBVA to Net-Velázquez (\$354,373.30), as the balance of the Code Inspector account had declined to \$351,383.10 at the time of the garnishment. The garnishment exceeded, however, the amount to which BBVA was entitled by virtue of the attachment (\$300,000); BBVA has conceded that it had no right to the \$51,383.10 garnished in excess of the \$300,000 attachment.

The bankruptcy court held a bench trial in May 2008. After hearing testimony from Net-Velázquez and a

representative of BBVA, the court ordered further briefing on the core issue that emerged at trial: whether Net-Velázquez [*6] had transferred his interest in the sales proceeds to Code Inspector by depositing them in Code Inspector's bank account, effectively removing those funds from the bankruptcy estate. In an opinion and order issued on October 27, 2008, the court found that Net-Velázquez had retained ownership of the funds in the Code Inspector account, and therefore that BBVA's garnishment of funds constituted an avoidable, preferential transfer of property from the estate.

BBVA appealed to the district court, see 28 U.S.C. § 158(a)(1), arguing that the bankruptcy court had erred in finding that the funds in the Code Inspector bank account were owned by Net-Velázquez. BBVA also raised several new defenses under Puerto Rico's Negotiable Instruments Law, and argued as well that half of the proceeds from the sale of the Paseo de la Fuente parcel belonged to Net-Velázquez's wife and not to the estate. The district court affirmed, adopting the reasoning of the bankruptcy court and rejecting BBVA's newly asserted defenses as waived because BBVA had failed to raise them in the bankruptcy court. Responding to BBVA's remaining argument, the court held that the sale proceeds constituted community property of Net-Velázquez [*7] and his spouse and thus were properly included in the bankruptcy estate.

This timely appeal followed. HN2 We review a bankruptcy court's findings of fact for clear error and its conclusions of law de novo, granting no special deference to the intermediate decision of the district court on appeal. See *Stornawaye Fin. Corp. v. Hill (In re Hill)*, 562 F.3d 29, 32 (1st Cir. 2009).

III.

HN3 Under section 547(b) of the Bankruptcy Code, the trustee of an estate in bankruptcy may avoid "'any transfer of an interest of the debtor in property' made (1) to a creditor, (2) on account of an antecedent debt, (3) while the debtor was insolvent, (4) during the 90-day period preceding the filing of the petition, which (5) allowed such creditor to receive more than it would have under Chapter 7." *Advanced Testing Techs., Inc. v. Desmond (In re Computer Eng'g Assocs.)*, 337 F.3d 38, 45 (1st Cir. 2003) (quoting 11 U.S.C. § 547(b)). The only contested element in this adversary proceeding is whether the garnished funds were "an interest of the debtor in property," that is, whether Net-Velázquez had a property interest in the funds on deposit in Code Inspector's bank account when they were garnished by BBVA.

In the proceedings [*8] before the bankruptcy court, BBVA sought to establish that Net-Velázquez had no property interest in the funds on the theory that the deposit into Code Inspector's bank account converted the funds from personal property subject to bankruptcy procedures into corporate property. 6 This contention placed BBVA in the somewhat awkward position of arguing that it had garnished funds from an entity that owed BBVA no debt. Indeed, BBVA necessarily conceded that, if its theory of the case were correct, Code Inspector might have a cause of action against BBVA. The bankruptcy court rejected this ill-advised argument, and BBVA does not challenge the bankruptcy court's holding here.

FOOTNOTES

6 BBVA also argued that \$300,000 of the \$354,373.30 check issued to Net-Velázquez was "earmarked" for BBVA to satisfy its attachment and thus that the garnishment was not a preferential transfer. The thrust of this "earmarking" argument is that the transfer to a debtor of funds that are "earmarked" for a third party does not vest ownership in the debtor; thus, the subsequent transfer of those funds to the third party for which they are earmarked will not constitute a preferential transfer of "an interest of the debtor [*9] in property." See *Collins v. Greater Atl. Mortg. Corp. (In re Lazarus)*, 478 F.3d 12, 15 (1st Cir. 2007). The bankruptcy court rejected this argument, citing the absence of any evidence that BBVA had "earmarked" the funds transferred to Net-Velázquez and his wife. The court found, to the contrary, that Net-Velázquez had left the closing "cash-in-hand," with no restrictions on the sales proceeds imposed by BBVA. BBVA has not challenged this holding on appeal.

In fact, BBVA has wholly abandoned on appeal each of the arguments it made before the bankruptcy court. Instead of arguing that Net-Velázquez's deposit of the sales proceeds transferred ownership to Code Inspector, as it did below, BBVA offers here an array of new legal arguments contending that a valid property interest in the funds never even passed from BBVA to Net-Velázquez. First, BBVA raises a defense it styles "payment by mistake," contending that Net-Velázquez never obtained a right to the sale proceeds because the proceeds were transferred to him due to error — namely, that BBVA failed to withhold funds sufficient to satisfy the attachment because that encumbrance was erroneously omitted from the title report. In support [*10] of this argument BBVA primarily relies on Article 1795 of the Puerto Rico Civil Code. 7 See P.R. Laws Ann. tit. 31, § 5121.

FOOTNOTES

7 Article 1795 provides: "If a thing is received when there was no right to claim it and which, through an error, has been unduly delivered, there arises an obligation to restore the same." P.R. Laws Ann. tit. 31, § 5121. BBVA also relies on section 418(b) of the Negotiable Instruments Law, which extends the foregoing principle to financial instruments paid or delivered by mistake. See *id.* tit. 19, § 668.

Second, BBVA offers a somewhat obscure argument under two sections of the Puerto Rico Civil Code that relate to the extinguishment of debt owed concurrently by two parties each to the other, referred to by BBVA as "set-off." See P.R. Laws Ann. tit. 31, §§ 3221, 3228. Under this theory, Net-Velázquez's obligation to BBVA was extinguished by operation of law upon the closing of the sale of the Paseo de la Fuente parcel, at which moment BBVA and Net-Velázquez each owed a debt to the other — Net-Velázquez for the preexisting attachment, and BBVA, as the purchaser's financing agent, for the sale price. The thrust of this argument, never fully elucidated by BBVA, appears [*11] to be that the sale proceeds were automatically applied to the \$300,000 attachment, and thus \$300,000 of the \$354,373.30 check issued to Net-Velázquez and his wife represented an overpayment to which they had no legal entitlement.

Third, BBVA argues, under several provisions of Puerto Rico's Negotiable Instruments Law, that BBVA had the right to rescind the manager's check issued to Net-Velázquez because Net-Velázquez did not take the instrument in good faith and therefore did not qualify as a holder in due course. See P.R. Laws Ann. tit. 19, §§ 451, 602, 605, 606. Fourth, BBVA contends that the Paseo de la Fuente parcel and the proceeds from its sale were "in custodia legis" (literally, in the custody of the law) at all points subsequent to the issuance of the attachment order, barring Net-Velázquez from obtaining a legal interest in the sale proceeds.

As set forth below, we hold that BBVA has forfeited its chance to be heard on these arguments never presented to the bankruptcy court. 8

FOOTNOTES

8 The fact that portions of the arguments presented here were raised before the district court has no impact on our analysis. HN4 The bankruptcy court acts as the trial court in bankruptcy proceedings. Thus, [*12] arguments must be presented in the bankruptcy court to be preserved; the district court acts solely as an intermediate appellate tribunal. See *Evergreen Credit Union v. Woodman* (In re Woodman), 379 F.3d 1, 3 n.1 (1st Cir. 2004).

IV.

The proposition is well established that, HN5 "absent the most extraordinary circumstances, legal theories not raised squarely in the lower court cannot be broached for the first time on appeal." *Teamsters, Chauffeurs, Warehousemen & Helpers Union, Local No. 59 v. Superline Transp. Co.*, 953 F.2d 17, 21 (1st Cir. 1992); see also *Iverson v. City of Boston*, 452 F.3d 94, 102 (1st Cir. 2006) (collecting cases and describing the circuit's "echolalic regularity" in applying the waiver rule). Though sometimes severe in effect, this raise-or-waive rule "is founded upon important considerations of fairness, judicial economy, and practical wisdom." *Nat'l Ass'n of Soc. Workers v. Harwood*, 69 F.3d 622, 627 (1st Cir. 1995).

It is undisputed that three of BBVA's arguments on appeal were not raised in the bankruptcy court and are subject to waiver: the "set-off" argument, the argument under Puerto Rico's Negotiable Instruments Law, and the characterization of the Paseo de la [*13] Fuente parcel as "in custodia legis." BBVA protests, however, that it properly raised its fourth argument, the "payment by mistake" defense, by including it in its answer to the adversary complaint. We have closely examined BBVA's answer and find it, at best, debatable whether "payment by mistake" was actually raised as a defense. As it turns out, however, we need not resolve the question because of BBVA's subsequent inattention to the defense.

HN6 A defense or legal theory may not be preserved by bare reference in a pleading if it is thereafter abandoned until, freshly discovered on appeal, it is raised anew. Cf. *DiMarco-Zappa v. Cabanillas*, 238 F.3d 25, 34 (1st Cir. 2001) ("Simply noting an argument in passing without explanation is insufficient to

avoid waiver."). Save in exceptional cases, only those issues that are squarely presented and litigated in the trial court may be raised on appeal. See Iverson, 452 F.3d at 102 (litigants must "spell out their legal theories face-up and squarely in the trial court" to avoid waiver). Indeed, HN7 the Rules of Civil Procedure are structured to winnow the issues presented by the pleadings as a case progresses, so that only relevant, non-frivolous theories [*14] and defenses reach trial and are preserved for our review. Rule 16 in particular encourages the parties and the court, through the pretrial conference process, to "formulat[e] and simplify[the issues, and eliminat[e] frivolous claims or defenses." Fed. R. Civ. P. 16(c)(2)(A). Because the resulting pretrial order issued under Rule 16 is "intended to shape the contours of the ensuing trial by setting forth the legal theories upon which the parties intend to rely," *Correa v. Hosp. San Francisco*, 69 F.3d 1184, 1195 (1st Cir. 1995), claims or defenses omitted from the pretrial order are waived, whether or not properly raised in the pleadings. See *Rodriguez-Garcia v. Miranda-Marin*, 610 F.3d 756, 774 (1st Cir. 2010).

Here, the record reflects that BBVA failed to pursue or even raise the "payment by mistake" defense at any point subsequent to its answer. The parties' joint pretrial report contained no mention of BBVA's "payment by mistake" defense, identifying only two legal theories that BBVA intended to present at trial: first, that the ownership of the sales proceeds passed to Code Inspector upon their deposit in its bank account, and second, that the sales proceeds were "earmarked" for [*15] BBVA when transferred to Net-Velázquez, and thus were outside the action of 11 U.S.C. § 547(b).⁹ No argument in support of a "payment by mistake" defense was made at the subsequent trial, nor was one included in BBVA's post-trial briefing on ownership of the sales proceeds — which focused solely on the argument that Code Inspector was the rightful owner of the funds. Thus, even assuming BBVA did plead the substance of its "payment by mistake" defense in the answer, such defense was unambiguously waived for want of prosecution.

FOOTNOTES

⁹ See *supra* note 6.

BBVA's last-ditch argument seeks to cast this appeal as the "exceptional case" warranting relief from waiver. It is true that HN8 the rule of waiver for arguments not squarely presented below "is a matter of discretion" and "admits of an occasional exception." *Harwood*, 69 F.3d at 627. The bar, however, is high for such an exercise of discretion; a new argument will be considered on appeal only when "the equities heavily preponderate in favor of such a step." *Id.*

HN9 We have applied various criteria to aid in identifying the exceptional case where relief from waiver is appropriate. A nonexhaustive list of factors relevant to this determination includes: [*16] (1) whether the litigant's failure to raise the issue has deprived the court of appeals of useful factfinding, or whether the issue was of a purely legal nature; (2) whether the omitted argument raises an issue of constitutional magnitude; (3) whether the argument was highly persuasive and failure to reach it would threaten a miscarriage of justice; (4) whether considering the issue would cause prejudice or inequity to

the adverse party; (5) whether the failure to raise the issue was inadvertent and provided no tactical advantage; and (6) whether the issue implicates "matters of great public moment," *id.* at 628. See *Montalvo v. Gonzalez-Amparo*, 587 F.3d 43, 48-49 (1st Cir. 2009); *Harwood*, 69 F.3d at 627-28.

Of those criteria, a few seem to weigh slightly in BBVA's favor here. First, BBVA's newly raised arguments are largely legal in nature, and thus BBVA's failure to raise them below does not appear to have substantially "deprived the court of appeals of useful factfinding." *Harwood*, 69 F.3d at 627. Second, allowance of the arguments would present "no special prejudice or inequity to the plaintiffs," other than possibly to further protract litigation that has now drawn on for over four [*17] years. *Id.* at 628. Third, the omission of the arguments below appears attributable to inadvertence rather than a play for tactical advantage by BBVA. See *id.*

On the other hand, both the number and diversity of legal theories pressed by BBVA on appeal mark these arguments as the precise species our waiver rule is designed to deter: transparent afterthoughts and alternative defenses burnished for appeal after the defendant's primary arguments failed at trial. HN10 It is typically only in cases involving issues of "great public moment" or "constitutional magnitude" that we are inclined to disregard our waiver rule. See *id.* at 628. There can be no question that the miscellaneous issues raised in BBVA's appeal are of no such lofty stature.

Moreover, BBVA has other remedies available, as it filed a third-party complaint for contribution against the title search company that prepared the erroneous title report. If the contribution claim fails, BBVA will simply end up on equal footing with other unsecured creditors of the Net-Velázquez estate, and may yet recover some portion of the \$300,000 owed by Net-Velázquez. While we do not suggest that there is nothing at stake for BBVA here, the consequences [*18] of foreclosing BBVA's tardily raised arguments fall far short of a miscarriage of justice.

As noted, HN11 we will only consider new arguments on appeal where the "equities heavily preponderate in favor of such a step." *Harwood*, 69 F.3d at 627. Having identified and weighed the criteria we deem most relevant to BBVA's request to have its arguments heard for the first time on appeal, we conclude that the equities do not heavily preponderate in favor of allowing these new arguments. Therefore, we affirm the judgment of the district court.

So ordered.

IN RE MICHELLE J. HANDY, Debtor. CHRISTOPHER PARKER, Appellant, v. MICHELLE J. HANDY, Appellee.

No. 09-9021

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

624 F.3d 19; 2010 U.S. App. LEXIS 21897; Bankr. L. Rep. (CCH) P81,871

October 22, 2010, Decided

PRIOR HISTORY: [*1]

ON APPEAL FROM THE **BANKRUPTCY** APPELLATE PANEL FOR THE FIRST CIRCUIT.
[Parker v. Handy \(In re Handy\)](#), 2009 Bankr. LEXIS 3220 (B.A.P. 1st Cir., Oct. 23, 2009)

CASE SUMMARY

PROCEDURAL POSTURE: Appellant claimant appealed from a **Bankruptcy** Appellate Panel for the First Circuit (BAP) decision affirming a **bankruptcy** court order denying his motion for relief from stay. The claimant's objective was to reopen a Maine state court proceeding against appellee debtor, brought pursuant to Maine's version of the Uniform Fraudulent Transfer Act, [Me. Rev. Stat. Ann. tit. 14, § 3571 et seq.](#)


OVERVIEW: The claimant had obtained a judgment against debtor's ex-husband, and claimed that debtor had purchased a residence with the assistance of funds from the ex-husband. However, at the time of discharge, the claimant had obtained neither a favorable judgment from the state court, nor a lien against debtor's property. The claimant argued that he could maintain an in rem claim because he requested a constructive trust. The court agreed that the claimant's request for a constructive trust did not of itself give rise to a cause of action in rem. Constructive trusts were not substantive rights that conferred a cause of action; they were remedial devices employed by courts once liability was found and where equity required. Without more, the claimant could not transform a request for a remedy in rem into a cause of action in rem. It followed that before debtor's **bankruptcy** petition, the claimant's unsuccessful claims against debtor were only in personam. The claimant had waived his claim that an unsecured creditor could pursue a fraudulent conveyance claim against a debtor's property post-discharge consistent with [11 U.S.C.S. § 524](#).


OUTCOME: The decision of the BAP was affirmed.


CORE TERMS: rem, constructive trust, unsecured creditors, action in rem, post-discharge, attachment, fraudulent conveyance, injunction, personam, defraud, seizure, confer, provisional remedy, homestead exemption, exempt property, ex-husband


LEXISNEXIS® HEADNOTES


 **Hide**


[Bankruptcy Law](#) > [Discharge & Dischargeability](#) > [Liquidations](#) > [Denial of Discharge](#) > [Concealment & Fraudulent Transfer](#) 


HN1  The Uniform Fraudulent Transfer Act (UFTA) seeks to protect the debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors." UFTA § 3, cmt. 2. It forbids a debtor from making two types of transfers: (1) those with actual intent to hinder, delay, or defraud any creditor and (2) those in which the debtor does not receive a reasonably equivalent value in exchange in light of his financial circumstances. UFTA § 4(a). [More Like This Headnote](#)


[Bankruptcy Law](#) > [Discharge & Dischargeability](#) > [Liquidations](#) > [Denial of Discharge](#) > [Concealment & Fraudulent Transfer](#) 


HN2  Under the Uniform Fraudulent Transfer Act (UFTA), the presence of "actual intent" to defraud a creditor may be assessed in light of whether the transfer was to an "insider" like a "relative of the debtor." UFTA §§ 4(b)(1); 1(7)(i)(A). [More Like This Headnote](#)


[Bankruptcy Law](#) > [Discharge & Dischargeability](#) > [Effects of Discharge](#) > [Protection](#) 


HN3  Under 11 U.S.C.S. § 524(a)(2), a discharge from **bankruptcy** operates as an injunction against in personam claims against a debtor. [More Like This Headnote](#)


[Bankruptcy Law](#) > [Practice & Proceedings](#) > [Appeals](#) > [Standards of Review](#) > [Clear Error Review](#) 


[Bankruptcy Law](#) > [Practice & Proceedings](#) > [Appeals](#) > [Standards of Review](#) > [De Novo Review](#) 


HN4  Appellate courts review appeals from a **Bankruptcy** Appellate Panel (BAP) under the same standards of review as the BAP reviews appeals from the **bankruptcy** court. Appellate courts review the **bankruptcy** court's legal conclusions de novo and its factual findings for clear error. [Fed. R. Bankr. P. 7052 cmt. 11](#). [More Like This Headnote](#)

[Civil Procedure](#) > [Jurisdiction](#) > [Personal Jurisdiction & In Rem Actions](#) > [In Rem Actions](#) > [General Overview](#) 

HN5  An action in rem may proceed when the property is brought under the court's control either by seizure or some equivalent act. Subsequent decisions have held that a court may not exercise jurisdiction over an action quasi in rem absent an attachment or garnishment. In actions purely in rem, however, it appears that the rule in Pennoyer still applies. [More Like This Headnote](#)

[Civil Procedure](#) > [Jurisdiction](#) > [Personal Jurisdiction & In Rem Actions](#) > [In Rem Actions](#) > [General Overview](#) 

[Estate, Gift & Trust Law](#) > [Trusts](#) > [Constructive Trusts](#) 


HN6  A request for a constructive trust does not of itself give rise to a cause of action in rem. Constructive trusts are not substantive rights that confer a cause of action; they are remedial devices employed by courts once liability is found and where equity requires. [More Like This Headnote](#)

COUNSEL: Stanley Greenberg for appellant.

JUDGES: Before Lynch ▼, Chief Judge, Torruella ▼ and Howard ▼, Circuit Judges.

OPINION BY: LYNCH ▼


OPINION


LYNCH , Chief Judge. Christopher Parker appeals from a **Bankruptcy** Appellate Panel (BAP) decision affirming a **bankruptcy** court order denying his motion for relief from stay. Parker's objective is to reopen a Maine state court proceeding against Michelle J. Handy brought pursuant to Maine's version of the Uniform Fraudulent Transfer Act (UFTA). [Me. Rev. Stat. tit. 14, § 3571 et seq.](#) During the state court proceeding, Handy filed for **bankruptcy**, staying Parker's state action against her.


Parker filed a motion in **bankruptcy** court for relief from stay. Handy received discharge during a hearing, which included Parker's motion. At the time of discharge, Parker had obtained neither a favorable judgment from the state court, nor a lien against Handy's property. The **bankruptcy** court held that [11 U.S.C. § 524\(a\)\(2\)](#) precludes Parker from pursuing his action against Handy, and the BAP affirmed. We affirm.

I.

Parker sued Handy in a Maine state district court, alleging that Handy purchased a residence with funds conveyed to her by her **[*2]** ex-husband in violation of the UFTA. He sought both money damages and the imposition of a constructive trust on the residence. Parker also filed a *lis pendens*, but he has abandoned the claim that this created a lien on the residence. The state court entered judgement for Handy, and Parker timely appealed to the Maine Supreme Judicial Court. His appeal was stayed when Handy filed for **bankruptcy** under Chapter 7.

^{HN1} Promulgated in 1984, the UFTA seeks "to protect the debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors." UFTA § 3, cmt. 2; [In re Jackson, 459 F.3d 117, 121 n.3 \(1st Cir. 2006\)](#). It forbids a debtor from making two types of transfers: (1) those "with actual intent to hinder, delay, or defraud any creditor" and (2) those in which the debtor does not receive a "reasonably equivalent value in exchange" in light of his financial circumstances. UFTA § 4(a).

In his state court action, Parker alleged that Handy received funds in a forbidden transfer of the first type. On or about April 10, 2003, Parker obtained a judgment against Handy's ex-husband, Walter Loeman. Parker did not receive payment. He alleged that while Handy and Loeman were still married, **[*3]** Handy purchased a residence with the assistance of \$26,410.12 in funds from Loeman. ^{HN2} Under the UFTA, the presence of "actual intent" to defraud a creditor may be assessed in light of whether the transfer was to an "insider" like a "relative of the debtor." UFTA §§ 4(b)(1); 1(7)(i)(A).

With his state court appeal stayed, Parker filed a motion in **bankruptcy** court for relief from stay. ^{HN3} Under [11 U.S.C. § 524\(a\)\(2\)](#), a discharge from **bankruptcy** operates as an injunction against in personam claims against a debtor. Parker argued that his requested relief in state court included an order of sale of Handy's residence and that "[t]o this extent," his claim against Handy was a claim in rem. He asserted that Handy's discharge in

bankruptcy would not affect this in rem claim even though he was an unsecured creditor. Handy filed an objection, arguing that as an unsecured creditor Parker did not hold an in rem claim for purposes of [11 U.S.C. § 524\(a\)\(2\)](#).

The **bankruptcy** court denied Parker's motion. During the course of the proceedings, Handy received a discharge. In an oral decision, the **bankruptcy** court held that Parker could not proceed against Handy's property because he did not have a claim in rem. **[*4]** It held that Parker had not established an interest in the property by either attachment or a provisional remedy. Parker's request for a constructive trust, it held, did not give rise to a cause of action in rem. The **bankruptcy** court also held that Parker had failed to object to Handy's invocation of Maine's homestead exemption, and that as an unsecured creditor he could not pursue that exempt property.

The BAP affirmed, rejecting Parker's arguments that (1) he held an in rem claim because he had sought a constructive trust in his state court action, (2) he could pursue his claims post-discharge even though he did not obtain an attachment prior to **bankruptcy**, and (3) he did not need to object to Handy's homestead claim. As to the first, the BAP reiterated the **bankruptcy** court's holding that a constructive trust is a remedy, not a status. As to the second, it held that Parker cited no authority supporting his contention that the **Bankruptcy** Code allows him to proceed post-discharge. As to the third, the BAP held that Parker could not proceed against the exempt property because he did not possess a claim in rem.

II.

HN4 This court reviews appeals from the BAP under the same standards of review **[*5]** as the BAP reviews appeals from the **bankruptcy** court. ¹ We review the **bankruptcy** court's legal conclusions de novo and its factual findings for clear error. [Fed R. Bankr. P. 7052](#) cmt. 11; [In re Marrama](#), [430 F.3d 474, 477 \(1st Cir. 2005\)](#). Parker raises the same purely legal questions before us that he raised before the BAP.

FOOTNOTES

¹ Handy has failed to appear or file a brief on appeal. We allowed Parker's attorney to present oral argument, nonetheless.

Parker first asserts that his state court action included a cause of action in rem against Handy's residence. He argues that claims under the UFTA sound in rem and that an action that seeks to impose a constructive trust is an in rem action. In making this claim, Parker relies upon [Pennoyer v. Neff](#), [95 U.S. 714, 24 L. Ed. 565 \(1877\)](#), for the proposition that an action may confer in rem jurisdiction on a court even in the absence of a pre-judgment attachment of the property in question. *Id.* at 724 (citing [Boswell's Lessee v. Otis](#), [50 U.S.](#)

(9 How.) 336, 13 L. Ed. 164 (1850)). He cites no Maine law in support of his argument.

In *Pennoyer*, the Supreme Court held that ^{HN5} an action in rem may proceed when the property is brought under the court's control either by "seizure or some equivalent [*6] act." 95 U.S. at 727. Subsequent decisions have held that a court may not exercise jurisdiction over an action quasi in rem absent an attachment or garnishment. *Pennington v. Fourth Nat'l Bank*, 243 U.S. 269, 272, 37 S. Ct. 282, 61 L. Ed. 713 (1917). In actions purely in rem, however, it appears that the rule in *Pennoyer* still applies. 4A Wright & Miller, *Federal Practice and Procedure* § 1070, at 292 (3d ed. 2002). ²

FOOTNOTES

² A preliminary seizure is unnecessary in suits that concern a valid lien. *Roller v. Holly*, 176 U.S. 398, 405, 20 S. Ct. 410, 44 L. Ed. 520 (1900).

It does not follow that Parker has stated a claim in rem. He concedes that he did not obtain a lien, attachment, or provisional remedy. He does not argue that the state district court exercised control over Handy's residence. Parker argues only that he can maintain an in rem claim because he requested a constructive trust.

No Maine case supports this argument and our view, like that of the BAP, is that ^{HN6} Parker's request for a constructive trust did not of itself give rise to a cause of action in rem. Constructive trusts are not substantive rights that confer a cause of action; they are remedial devices employed by courts once liability is found and where equity requires. See *Yavuz v. 61 MM, Ltd.*, 576 F.3d 1166, 1176 (10th Cir. 2009); [*7] *Mayo v. Hartford Life Ins. Co.*, 354 F.3d 400, 409 (5th Cir. 2004). Without more, Parker cannot transform a request for a remedy in rem into a cause of action in rem. It follows that before Handy's **bankruptcy** petition, Parker's unsuccessful claims against Handy were only in personam.

Next, Parker asserts that he may pursue his fraudulent conveyance claims post-discharge. He makes two related arguments, one summarily. First, Parker claims that he retains a pre-**bankruptcy** claim in rem that survives the **bankruptcy** discharge injunction under 11 U.S.C. § 524. Second, relying on a Massachusetts **bankruptcy** decision, *In re Palumbo*, 353 B.R. 37 (Bankr. D. Mass. 2006), Parker claims that an unsecured creditor may pursue a fraudulent conveyance claim against a debtor's property post-discharge consistent with 11 U.S.C. § 524.

Both of these claims fail. Parker's first claim fails because he did not hold an in rem claim pre-discharge. Parker's second claim is not properly before this court. He did not raise it before the **bankruptcy** court, so he may not raise it on appeal. *Fish Mkt. Nominee Corp. v. Pelofsky* 72 F.3d 4, 6 (1st Cir. 1995). In any event, this claim is doubly waived because Parker also [*8] failed to adequately present it on appeal. *United States v. Zannino*, 895

F.2d 1, 17 (1st Cir. 1990). [Palumbo](#) does not bind us, and Parker makes no argument as to why an unsecured creditor may proceed post-discharge consistent with [11 U.S.C. § 524\(a\)\(2\)](#).

Finally, Parker asserts that the **bankruptcy** court erred in holding that he was obliged to object to Handy's claim of a homestead exemption. Because Parker does not possess a claim in rem against Handy's residence, this claim is also not properly before us.

III.

The judgment of the **Bankruptcy** Appellate Panel is affirmed.

KEVIN GUAY, Plaintiff, v. THOMAS BURACK, et al., Defendants, LORRAINE GUAY, Plaintiff, v. THOMAS BURACK, et al., Defendants; LORRAINE GUAY Plaintiff, v. THOMAS BURACK, et al., Defendants

Civil No. 1:09-cv-217-DBH,Civil No. 1:09-cv-253-DBH

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW HAMPSHIRE

2010 U.S. Dist. LEXIS 117248

October 29, 2010, Decided

NOTICE: NOT FOR PUBLICATION.

SUBSEQUENT HISTORY: Adopted by, Summary judgment granted by [Guay v. Burack](#), 2010 U.S. Dist. LEXIS 122269 (D.N.H., Nov. 16, 2010)

PRIOR HISTORY: [Guay v. Burack](#), 2010 U.S. Dist. LEXIS 27724 (D.N.H., Mar. 23, 2010)

CASE SUMMARY

PROCEDURAL POSTURE: Plaintiff asserted claims against defendants, a detective and a city police department, for malicious abuse of process and violation of the [Fourth Amendment](#). Defendants' motion for summary judgment was referred to a magistrate judge for the issuance of a recommended decision.

OVERVIEW: Although plaintiffs had been alerted to the defense of judicial estoppel, plaintiffs did not mount any argument for not applying the doctrine of judicial estoppel to their claims, and plaintiffs had not amended their **bankruptcy** petition to list the instant lawsuits as assets. Judicial estoppel was justified to bar a debtor from pursuing a cause of action in district court where that debtor deliberately failed to disclose the pending suit in a **bankruptcy** case. The magistrate judge determined that plaintiffs failed to take advantage of their opportunity to show why their failure to list the instant actions in their **bankruptcy** case was not an unacceptable abuse of judicial process. The magistrate judge held that defendants were entitled to judgment in their favor because plaintiffs presented neither a factual case nor a legal argument as to why their claims were not barred due to their failure to list the assets as part of their **bankruptcy** estate.


OUTCOME: The magistrate judge recommended that judgment be entered in favor of defendants.

CORE TERMS: judicial estoppel, recommended, summary judgment, recommendation, estoppel, lawsuit, estoppel defense, real party in interest, tangential, abuse of process, infliction of emotional distress, bankruptcy petition, bankruptcy proceeding, de novo review, unacceptable, dispositive, collecting, malicious, forwarded, deferred, estopped, fresh, backwards, notice

LEXISNEXIS® HEADNOTES

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

HN1  Judicial estoppel is justified to bar a debtor from pursuing a cause of action in district court where that debtor deliberately fails to disclose the pending suit in a **bankruptcy** case. [More Like This Headnote](#)

COUNSEL: [***1**] Kevin Guay (1:09-cv-00217), Plaintiff, Pro se, Concord, NH.




For Thomas Burack, NH Attorney General, other, Kelly Ayotte, Defendants: Nancy J. Smith, LEAD ATTORNEY, Office of Attorney General, Concord, NH.

For Concord Police Department, Concord, City of, Defendants: [Charles P. Bauer](#)  , [Erik Graham Moskowitz](#)  , Gallagher Callahan & Gartrell PC, Concord, NH.

For Lorraine Guay, Concord, NH (1:09-cv-00253), Plaintiff: [Richard N. Foley](#)  , LEAD ATTORNEY, Foley Law Office, Portsmouth, NH.

Kevin Guay, Consol Plaintiff, Pros se, Concord, NH.

For Thomas Burack, NH Attorney General, other, Kelly Ayotte, Defendants: Nancy J. Smith, Office of Attorney General, Concord, NH.

For Concord Police Department, Sean Ford, Concord, City of, Defendants: [Charles P. Bauer](#)  , LEAD ATTORNEY, [Erik Graham Moskowitz](#)  , Gallagher Callahan & Gartrell PC, Concord, NH.

JUDGES: [Margaret J. Kravchuk](#)  , U.S. Magistrate Judge.

OPINION BY: [Margaret J. Kravchuk](#) 

OPINION

RECOMMENDED DECISION ON MOTION FOR SUMMARY JUDGMENT

(Doc. No 57)

Lorraine and Kevin Guay of Concord, New Hampshire, have each brought suit alleging malicious abuse of process, conspiracy, intentional infliction of emotional distress, and negligent infliction of emotional distress in conjunction with the defendants' [*2] roles in obtaining and executing search warrants and in conducting searches at three separate premises in Concord, New Hampshire in March 2009. The state defendants and the municipal defendants previously filed separate motions to dismiss the complaints. As a consequence of that round of dispositive motions I recommended that the Court grant the dismissal except for the claims that pertained to Kevin Guay's state tort claim for malicious abuse of process against Detective Ford and his employer, Concord/Concord Police Department and Lorraine's and Kevin's [Fourth Amendment](#) constitutional claim against Detective Sean Ford in his personal capacity. (Doc. No. 46.) Judge Hornby affirmed, explaining that the resolution of the defense of judicial estoppel was deferred pending further action by the remaining parties. (Doc. No. 52.)

Discussion

In their motion for summary judgment the defendants reassert that the Guays should be judicially estopped from bringing these complaints and have argued that they are entitled to judgment on the merits. They have also forwarded an affidavit by Ford that thoroughly describes his investigation in the pending environmental crime prosecution in state court and [*3] supports the conclusion that everything about the investigations and searches was on the up-and-up. ¹ Lorraine Guay, who still has counsel of record, has not filed anything in response to the pending motion for summary judgment. Kevin Guay has responded pro se: "Plaintiff has provided enough evidence over the course of this lawsuit that clearly dispute the statements in Detective Sean Ford's affidavit so that this case needs the court to determine what the facts are depending on the evidence submitted thus far." (Resp. Summ. J. at 1, Doc No. 59.) Kevin Guay criticizes the movants for relying on similar arguments to those argued in the motion to dismiss but he has not presented any factual record to overcome the defendants' case for application of the doctrine of judicial estoppel and for summary judgment on the merits of the [Fourth Amendment](#) and state law claim. In fact, the only exhibits filed by Kevin Guay during the course of this litigation are a deed filed in support of an objection to a motion to dismiss (see Doc. No. 35-1) and a **bankruptcy** filing — a report on unpaid Chapter 11 obligations — filed in support of his objection to my recommended decision (see Doc. No. 49-1). His [*4] response to this dispositive motion does not even mention the looming, preserved, question of judicial estoppel.

FOOTNOTES

¹ According to the defendants, Kevin Guay's trial on these charges was to commence on October 18, 2010.

Although certainly alerted to the issue over the course of this litigation, the Guays have not, in response to the pending motion, mounted any argument for not applying this doctrine to their cases and they have still not amended their **bankruptcy** petition to list these lawsuits as assets. ² I previously addressed the judicial estoppel aspect of this case in my February 2010 recommended decision, see [Guay v. Burack, Civil Nos. 1:09-cv-217-DBH, 1:09-cv-253-DBH, 2010 L 716104, 2010 U.S. Dist. LEXIS 27675, *1-*3 \(D.N.H. 2010\)](#) (recommended decision), and the parties and the Court are fully familiar with that analysis. Too simplify, I suggested at that time that the law applicable to the Guays's attempt to

receive a judgment on these two complaints outside of the **bankruptcy** proceeding was in the defendants' favor but that the somewhat irregular progression of this case warranted not immediately deciding the case on that ground. This Court affirmed that recommendation noting: "Resolution of the defense of judicial **[*5]** estoppel is deferred pending further action by the remaining parties." 2010 U.S. Dist. LEXIS 27724, 2010 WL 1233807, 1 (D.N.H. 2010) (Hornby, Dist. J).

FOOTNOTES

2 As of this date, the most recent activity of import in the case is the approved requests by the Chapter 7 trustee in May 2010 to examine records of four financial entities towards tracking transfers made by the Guays in the two years prior to the **bankruptcy** petition. (See D.N.H.Bankr.No. 08-12786-MWV, Doc Nos. 319-326.)

I have done a fresh review of the precedents underpinning that discussion, see [Payless Wholesale Distribs., Inc. v. Alberto Culver \(P.R.\) Inc.](#), 989 F.2d 570 (1st Cir.1993); see also [Cannon-Stokes v. Potter](#), 453 F.3d 446, 448 (7th Cir.2006); [Jethroe v. Om nova Solutions, Inc.](#), 412 F.3d 598, 600 (5th Cir.2005); [Burnes v. Pemco Aeroplex, Inc.](#), 291 F.3d 1282, 1287-88 (11th Cir.2002); [In re Coastal Plains, Inc.](#), 179 F.3d 197, 208 -209 & n. 7 (5th Cir.1999); [Jeffrey v. Desmond](#), 70 F.3d 183, 187 (1st Cir.1995); [Oneida Motor Freight, Inc. v. United Jersey Bank](#), 848 F.2d 414, 416 (3d Cir.1988); [Locapo v. Colsia](#), 609 F. Supp.2d 156, 159 n. 5 (D.N.H.2009); [PSA, Inc. v. P.R.Telephone Co.](#), 336 F. Supp. 2d 173, 178 (D.P.R.2004); [Howell v. Town of Leyden](#), 335 F.Supp.2d 248 (D.Mass.2004), **[*6]** and there has not been a shift in the law in favor of the Guays since that recommendation issued. In fact, the District of Columbia Court of **Appeals** has issued a decision in the interim which cites [Payless Wholesale Distributors, Inc.](#) as an example of the majority view, stating: "It appears that every circuit that has addressed the issue has found that ^{HNT} judicial estoppel is justified to bar a debtor from pursuing a cause of action in district court where that debtor deliberately fails to disclose the pending suit in a **bankruptcy** case." [Moses v. Howard University Hosp.](#), 606 F.3d 789, 798 (D.C. Cir. 2010) (collecting cases). I note once more that the First Circuit observed in [Payless Wholesale Distributors, Inc.](#): The basic principle of **bankruptcy** is to obtain a discharge from one's creditors in return for all one's assets, except those exempt, as a result of which creditors release their own claims and the bankrupt can start fresh. Assuming there is validity in [Payless's](#) present suit, it has a better plan. Conceal your claims; get rid of your creditors on the cheap, and start over with a bundle of rights. This is a palpable fraud that the court will not tolerate, even passively. See, e.g., **[*7]** [In re H.R.P. Auto Center, Inc.](#), 130 B.R. 247, 253-54 (Bankr.N.D.Ohio 1991) (collecting cases). [Payless](#), having obtained judicial relief on the representation that no claims existed, cannot now resurrect them and obtain relief on the opposite basis. This may not be strictly equitable estoppel, as the court observed. Indeed, defendants may have a windfall. However, it is an unacceptable abuse of judicial proceedings.

989 F.2d at 571 (emphasis added).

The reason for not granting judgment in the defendants' favor at the motion to dismiss stage had little to do with questions about the applicability of the asserted defense and

everything to do with the procedural quirks of this litigation's history as it related to the Guays's **bankruptcy**.³ It is fair to describe that approach as reaching over backwards to allow the Guays to make an adequate showing as to why their failure to list these assets in the **bankruptcy** was no an unacceptable abuse of judicial process as described by Payless Wholesale Distributors, Inc.⁴ The Guays have not taken advantage of this opening left by the court's backwards arch (perhaps because they could make no legitimate showing to contravene the defense).

FOOTNOTES

³ In reaching [*8] a conclusion that I could not arrive at a recommendation on the defense at that juncture, I reflected:

I acknowledge that Lorraine Guay views the defendants' judicial estoppel argument as "tangential" and faults them for raising it for the first time in response to the order to supplement. (L. Guay's Reply Defs.' Suppl. Br. at 1.) Based on the discussion of the procedural history of this case and the legal precedents addressed above, I disagree with Lorraine Guay on the "tangential" issue. As Payless Wholesale Inc. demonstrates by deciding the issue on the estoppel defense rather than on the district court's review of the merits of the claims, there is nothing tangential about this type of judicial estoppel claim in cases postured as are these two. And as for the question of this theory being a Johnny-come-lately interjection, the defendants' argument could not have been effectively forwarded until the resolution of the very related issues of standing and real party in interest, and it is only with the resolution of those issues by the trustee's notice of abandonment, that the estoppel defense was asserted. The motion to dismiss based upon failure to join the real party in interest [*9] has lost its legs. It is somewhat ironic for the Guays to feel put-out by the lack of early clarity on this question. There is an inescapable connection between their failure to bring these lawsuits within the fold of their **bankruptcy** proceedings and the requirement that this court affirmatively reach-out for some determination by the Chapter 7 trustee as to the status of the estate's interest in the claims in order to adjudicate the motions to dismiss, which after all sought dismissal of the actions because the apparent real party in interest had not been joined. I agree with defendants that they are entitled to an early resolution of their judicial

estoppel defense, but I am not convinced that I can make a definitive recommendation on that issue in the context of the two pending motions to dismiss that have been referred to me for recommended decision.

2010 U.S. Dist. LEXIS 27675 , 2010 WL 716104 at 4.

4 I acknowledge that this cautious approach resulted in an extra burden on the remaining defendants in the form of generating a summary judgment record on the underlying merits of the Guays's claims. Counsel for these defendants has been diligent and courteous in presenting the defense argument in response to the [*10] somewhat amorphous litigation techniques of the plaintiffs.

Conclusion

I recommend that the Court grant judgment in favor of these remaining defendants, Concord Police Department, the City of Concord, and Detective Sean Ford, because the plaintiffs have presented neither a factual case nor a legal argument as to why their claims are not barred due to their failure to list the assets as part of their **bankruptcy** estate. ⁵

FOOTNOTES

5 It would be possible to articulate an alternative recommendation because the summary judgment record set forth by the defendants and left uncontested in any meaningful way by the plaintiffs justifies concluding that there was no federal or state law violation. Given the history of this litigation I think the exercise is unnecessary. Should either or both of the Guays object to this recommendation based on an unfair application of the asserted defense, they might run headlong into another estoppel doctrine and be "estopped by silence": "Estoppel that arises when a party is under a duty to speak but fails to do so." BLACK'S LAW DICTIONARY 630 (9th Ed. 2009). The Guays have presented nothing by way of evidentiary material that would suggest there are any disputed material [*11] facts as to the merits of these claims that would warrant proceeding to trial in any event.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to [28 U.S.C. § 636\(b\)\(1\)\(B\)](#) for which *de novo* review by the district court is sought, together with a supporting memorandum, within fourteen (14) days of being served with a copy thereof. A responsive memorandum shall be filed within fourteen (14) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to *de novo* review by the district court and to **appeal** the district court's order.

/s/ [Margaret J. Kravchuk](#) ▼

U.S. Magistrate Judge

October 29, 2010

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF RHODE ISLAND

- - - - -x

In re: :

M&L POWER SERVICE, INC., : BK No. 08-12745
Debtor : Chapter 7

JOSEPH M. DIORIO, :
CHAPTER 7 TRUSTEE :
Plaintiff :

v. : A.P. No. 09-1002

NATASHA ALLIDRI :
Defendant :

- - - - -x

ORDER GRANTING SUMMARY JUDGMENT

Heard on the Plaintiff's Amended Motion for Summary Judgment pursuant to Fed. R. Bankr. P. 7056, against Defendant Natasha Allidri on Counts I and II of the Complaint, to avoid check transfers from the Debtor to the Defendant as fraudulent, under 11 U.S.C. § 548. Attached to the Motion is the Affidavit of Craig Jalbert.

The Defendant bases her objection solely on the argument that the Motion "is not supported by admissible evidence," i.e., that the financial statements relied upon by Mr. Jalbert were unaudited. The United States Court of Appeals for the First Circuit, however, has held explicitly that "unaudited financial statements may be admissible as the best available evidence." *Consove v. Cohen (In re Roco Corp.)*, 701 F.2d 978, 983 (1st Cir. 1983) (citations

omitted). The Debtor does not have audited financial statements for 2007, so the unaudited monthly balance sheet that is relied on in Craig Jalbert's affidavit is the best available evidence of the Debtor's financial condition.

Therefore, based on the pleadings, the exhibits, and the Jalbert affidavit, the Plaintiff's Amended Motion for Summary Judgment is **GRANTED**. The hearing scheduled for August 19, 2010 at 10:00 a.m. is **VACATED**.

Enter Judgment consistent with this Order.

Dated at Providence, Rhode Island, this 18th day of August, 2010.



Arthur N. Votolato
U.S. Bankruptcy Judge

Entered on docket: 8/18/10

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

In re:

Bk. No. 10-13115-MWV
Chapter 7

Donna L Carlucci and
Kenneth P. Carlucci,
Debtors

Mary F. Stewart, Esq.
MARY STEWART LAW, PLLC,
Attorney for Debtors

Timothy E. Britain, Esq.
CLEVELAND, WATERS AND BASS, P.A.
Attorney for Brian and Sandra Bilodeau

MEMORANDUM OPINION

This matter comes before the Court on a motion to avoid lien (the “motion”) (Ct. Doc. No. 47) filed by Donna L Carlucci and Kenneth P. Carlucci (the “Debtors”) and objection thereto filed by Brian Bilodeau and Sandra Bilodeau (the “Bilodeaus”). The Debtors seek to avoid a judicial lien held by the Bilodeaus pursuant to 11 U.S.C. § 522(f) of the Bankruptcy Code.¹ The Court held hearings on September 15 and September 23, 2010, and took the matter under advisement.

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 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).

¹Unless 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.

BACKGROUND

On September 28, 2004, the Bilodeaus obtained a writ of attachment against Donna L. Carlucci and recorded it in the Carroll County Registry of Deeds. Subsequently, on April 6, 2009, the Bilodeaus received a final judgment for total damages in the amount of \$209,886.59 against Donna L. Carlucci. On May 12, 2009, and April 16, 2010, the Bilodeaus obtained and recorded a Writ of Execution and an Alias Writ of Execution, respectively. Both documents state that the amount of the judgment against Donna L. Carlucci is \$209,886.59. On July 20, 2010, the Debtors filed for Chapter 7 bankruptcy protection. The Debtors now seek to avoid the Bilodeaus' lien in part pursuant to 11 U.S.C. § 522(f). The Bilodeaus contest the following in the Debtors' motion: (1) the fair market value of the Debtors' property, (2) the amount of the Bilodeaus judicial lien, and (3) the ability of the Debtors' to include the statutory lien obtained by the Town of Sandwich on April 15, 2010, in the Debtors' 11 U.S.C. § 522(f) calculation. The Bilodeaus also request the Court to order the Debtors to compensate the Bilodeaus' appraiser for his time in appearing on September 15, 2010, since the hearing was continued at the fault of the Debtors.

The Court held a hearing on the matter on September 15, 2010 at which time the Bilodeaus appraiser appeared to testify as to his valuation of the Debtors' property. However, the Debtors were not ready to proceed, and the Court continued the hearing until September 23, 2010. At the continued hearing, the Court heard testimony from both the Debtors' and Bilodeaus' appraiser regarding the fair market value of the property.

DISCUSSION

I. Fair Market Value of the Debtors' Property

The equalized assessed tax value of the Debtors' property provides a valuation of \$237,800 (Ct. Doc. No. 14). Kevin Fritschy, the Debtors' appraiser, testified that based on his physical analysis, analysis of the location, and economic analysis, he believed the Debtors' property to have a value of \$171,000 (Ex. 101). On the other hand, Brian Underwood, the Bilodeaus' appraiser, conducted his own analysis and determined the Debtors' property to have a value of \$210,000 (Ex. 3). Having heard ample

testimony and being provided with extensive exhibits as to valuation, the Court is inclined to lend more weight to the appraisal of Mr. Underwood with a few adjustments.

Mr. Fritschy's appraisal adjusted comparable sales prices downward based on the date the comparable sales took place (Ex. 112). Mr. Fritschy explained this adjustment as a way to account for the downturn in the housing market. Mr. Underwood did not adjust either positively or negatively for the date of sale (Ex. 3). Mr. Underwood testified that he believed the housing market to be in a stable condition and that it has been so since early 2009. The Court agrees with Mr. Underwood that the housing market is more stable at present and does not believe the value of the Debtors' property should be affected for such condition.

Mr. Fritschy's appraisal is also well under the tax assessed value of the Debtors' property. Mr. Fritschy testified that the tax assessment should be given little weight, because several other factors needed to be taken into account when determining value. While it is true that tax assessments may not be one-hundred percent accurate, this Court believes that they provide a very reliable estimate as to the value of certain property. Mr. Underwood's appraisal seems to have taken into account the other factors that would adjust the value of the tax assessment and provide a more accurate value of the Debtors' property.

Both appraisals used the property located at 238 Whittier Highway, Sandwich, NH (the "Whittier property"), as a comparable sale. There is a considerable difference, approximately \$22,000, between Mr. Fritschy's valuation and Mr. Underwood's valuation of the Whittier property. Mr. Underwood made considerable positive adjustments to the value of the Whittier property based on the location and view of the Debtors' property. On the other hand, Mr. Fritschy made no adjustments either positively or negatively for location and view. The Court believes the adjustments as made by Mr. Underwood are necessary since the Whittier property is both located on a highway and has no view. Because the Debtors' property is located away from the highway and has an actual view, the Debtors' property should be valued higher than the Whittier property.

Although the Court finds that Mr. Underwood's appraisal is a better indicator of valuation, adjustments do need to be made. Kenneth P. Carlucci testified that the current roof is leaking and will require a replacement. Further, Mr. Carlucci stated that the septic system also needs repairs. Mr. Carlucci, however, did not provide an estimated cost necessary to remedy these conditions. Mr. Fritschy also testified that Debtors' property did not have permanent flooring, and the bath did not work. Mr. Underwood's appraisal did not list any physical deficiencies to the property (Ex. 3). A downward adjustment in valuation is appropriate due to the unavoidable costs associated with replacement of the roof, repairs, and other construction necessary on the Debtors' property. Accordingly, the Court believes the proper valuation for the Debtors' property should total \$200,000.

II. The Proper Amount of the Bilodeaus Judicial Lien

On September 19, 2004, the Carroll County Superior Court granted the Bilodeaus a prejudgment attachment in the amount of \$175,000 in the Debtors' property. The Debtors contend that this is the amount of the Bilodeaus' judicial lien. The Bilodeaus argue that their recorded Writ of Execution and Alias Writ of Execution state the amount of their final judgment as \$209,886.59, and that this is the correct amount of their judicial lien. The Court finds that the judicial lien is created through the filing of the Writ of Execution. As such, the judicial lien must consort with the amount that is actually recorded, and that amount is \$209,886.59.

III. The Statutory Lien of the Town of Sandwich for 2010 Property Taxes

In performing the lien avoidance calculation under 11 U.S.C. § 522(f), the Debtors include \$2,144 for property taxes owed in 2010. This amount is an estimate of the assessment since the Town of Sandwich does not actually conduct its assessment until December of this year. The Bilodeaus argue that the Debtors have not been billed yet for their 2010 taxes, and thus cannot include that in their § 522(f) calculation. The Debtors counter that the 2010 property taxes should be included in their calculation, because the statutory lien held by the Town of Sandwich for property taxes arises in April of the tax year.

New Hampshire law provides that “[i]n April of each year, a lien arises by force of law to secure the payment of property taxes for that year” First NH Bank v. Town of Windham, 639 A.2d 1089, 1091 (N.H. 1994); N.H. Rev. Stat. Ann. § 72:6; N.H. Rev. Stat. Ann. § 80:19. While it is true that a lien was created in April 2010 in favor of the Town of Sandwich for property taxes, that lien is inchoate and merely serves as to notice that the Town has a right to perfect that lien. The lien, however, does not become choate for purpose of § 522(f) until the amount is established. In this case, that will not occur until December 2010 when the Town of Sandwich conducts a property assessment. Accordingly, the Debtors cannot include in their lien avoidance calculation the statutory lien of the Town of Sandwich for 2010 property taxes.

IV. The Debtors’ Motion to Avoid Lien pursuant to 11 U.S.C. § 522(f)

Pursuant to 11 U.S.C. § 552(f), “a lien shall be considered to impair an exemption to the extent that the sum of – (i) the lien; (ii) all other liens on the property; and (iii) the amount of the exemption that the debtor could claim if there were no liens on the property; exceeds the value that the debtor’s interest in the property would have in the absence of any liens.” 11 U.S.C. § 522(f)(2)(A). The Debtors’ property is subject to the following mortgages, judicial liens and/or non-possessory, non-purchase-money security interests:

1. Statutory Lien obtained by the Town of Sandwich on April 28, 2009, in the amount of \$3,050.20.
2. Statutory Lien obtained by the Town of Sandwich on May 5, 2010, in the amount of \$2,448.38.
3. Judicial Lien obtained by the Bilodeaus recorded on April 16, 2010, in the amount of \$209,886.59.

The Debtors are entitled to an exemption in the property in the amount of \$100,000 pursuant to N.H. Rev.

Stat. Ann. § 480:1² and \$8,000 pursuant to N.H. Rev. Stat. Ann. § 511:2(XVIII). The Debtors' property has a fair market value of \$200,000. Following the formula set forth above:

1. The lien being tested for avoidance \$209,886.59, added with all other liens \$5,498.58 and the maximum exemption allowable in the absence of liens \$107,813.74 provides a sum of \$323,198.91.
2. From the sum above, \$323,198.91, subtracting the value of the property in the absence of liens, \$200,000, the Court finds that the extent of the impairment is \$123,198.91.

Since the extent of the impairment is less than the entire value of the Bilodeaus' lien, the lien can only be avoided to the extent of the impairment, preserving the Bilodeaus' lien in the amount of \$86,687.68.

V. Compensation for Mr. Underwood's Appearance at the September 15, 2010 Hearing

The Bilodeaus request this Court to award them fees for Mr. Underwood's time in preparing for and attending the hearing on September 15, 2010, since Mr. Underwood was required to return on September 23, 2010, as a result of the Debtors' lack of preparedness. The Bilodeaus request compensation for Mr. Underwood in the amount of \$900 (Ct. Doc. No. 62). While the Court agrees that Mr. Underwood should be compensated by the Debtors, \$900 is unreasonable. Under the Court's broad powers pursuant to 11 U.S.C. § 105, the Court finds that the Debtors are required to pay the Bilodeaus the amount of \$500 for Mr. Underwood's unnecessary appearance at the September 15, 2010, hearing.

CONCLUSION

For the reasons set out herein, the Court grants the Debtors' motion to avoid lien in the amount of \$123,198.91, but preserves the Bilodeaus' judicial lien in the amount of \$86,687.68. In addition, the Bilodeaus are awarded fees for Mr. Underwood's unnecessary appearance at the September 15, 2010, hearing in the amount of \$500. 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

²The Court previously denied Mr. Carlucci's right to use his homestead exemption, because the Bilodeaus' lien fixed on the Debtors' property before Mr. Carlucci acquired an ownership interest in the property.

consistent with this opinion.

DATED this 28th day of September 2010, at Manchester, New Hampshire.

/s/ Mark W. Vaughn
Mark W. Vaughn
Chief Judge

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MAINE**

In re:)	
Mikk Wardwell,)	Chapter 7
)	Case No. 09-11362
Debtor)	
_____)	
)	
William and Lori Smith,)	
)	
Plaintiffs)	
)	Adv. Pro. No. 10-1001
v.)	
)	
Mikk Wardwell,)	
)	
Defendant)	

MEMORANDUM OF OPINION

This matter comes before the court on a stipulated record. At issue is the extent to which a state court default judgment entered for, among other reasons, fraud, will suffice to establish the nondischargeability of the debt in this §523(a)(2) action.¹ For the reasons which follow, judgment will enter for the Defendant. This memorandum will constitute my findings of fact and conclusions of law.

The Defendant contracted to construct a home for the Plaintiffs. After disagreement arose concerning the Defendant’s performance, the Plaintiffs brought a seven count complaint in the Maine Superior Court. One count of that complaint asserted fraud. When the Defendant failed to answer the complaint, a default

¹ The complaint also asserts a claim under §523(a)(11), which concerns fraud “while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union.” That provision is not factually implicated in this action, and is not pursued by the parties in their written submissions.

entered against him. The Defendant also failed to appear for the damages hearing, and judgment entered against him. The Plaintiffs seek to use that state court judgment to prove the nondischargeability of their claim in this adversary proceeding.

Under the full faith and credit statute, 28 U.S.C. §1738, a federal court should award the same preclusive effect to a state court judgment that the state would give it. See In re Slosberg, 225 B.R. 9, 13 (Bankr. D. Me 1998).

The doctrine of res judicata is a court-made collection of rules designed to ensure that the same matter will not be litigated more than once. The doctrine has developed two separate components, issue preclusion and claim preclusion. Issue preclusion, also referred to as collateral estoppel, prevents the relitigation of factual issues already decided if the identical issue was determined by a prior final judgment, and the party estopped had a fair opportunity and incentive to litigate the issue in a prior proceeding. Claim preclusion bars relitigation if (1) the same parties or their privies are involved in both actions; (2) a valid final judgment was entered in the prior action; and (3) the matters presented for decision were, or might have been litigated in the first action.

Machias Savings Bank v. Ramsdell, 689 A.2d 595, 599 (Me. 1997). As the dischargeability of the debt was not litigated in the state court, claim preclusion will not apply. See Slosberg, 225 B.R. at 13, n. 3. We are therefore left with the question of the extent to which issue preclusion will permit the Plaintiff to prevail. In Maine, it is uncertain whether issue preclusion would apply to issues determined by default. In Irving Pulp & Paper Ltd v. Kelly, 654 A.2d 416, 418 (Me. 1995), the Law Court noted that “A judgment by default is just as conclusive on the rights

of the parties as a judgment on a demurrer or verdict.” That case, however, involved claim preclusion as opposed to issue preclusion. On the question whether a default judgment is entitled to issue preclusive effect, this court can either make its best guess as to how the state’s highest court would determine the issue, or certify the question to that court. See Boston Gas Co. v. Century Indem. Co., 529 F.3d 8, 13 (1st Cir. 2008). In this case, however, that issue need not be decided because, as will be seen below, less than all issues necessary to a nondischargeability finding were determined in the state court.

A defendant is not entitled to discharge under §523(a)(2) if

(1) he makes a false representation , (2) he does so with fraudulent intent, i.e. with “scienter,” (3) he intends to induce the plaintiff to rely on the misrepresentation, and (4) the misrepresentation does induce reliance, (5) which is justifiable, and (6) which causes damage (pecuniary loss).

Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997).

There is no evidence in the record of any factual findings accompanying the state court judgment. In the absence of such findings, one may assume that the state court found the facts as asserted in the complaint. See In re Sutherland-Minor, 345 B.R. 348, 356 (Bankr. D. Col. 2006). The state court complaint, as it relates to fraud, alleges that “[t]he Defendant agreed to furnish all labor and materials for construction of the house for the Plaintiffs”, “Plaintiffs relied on the Defendant (sic) assurances, representations and guarantees that he would construct

the house pursuant to the parties' agreement", and that "[t]he Defendant failed to construct the house pursuant to the agreement, failed to provide materials as agreed, failed to perform services as agreed, failed to complete construction in a timely manner, and as agreed in the contract and forced the Plaintiffs to pay additional sums of money". From the default judgment based upon these allegations, it is impossible to conclude that the statements made by the Defendant were false at the time they were made, or that they were made with fraudulent intent. Moreover, there is no allegation in the complaint from which such inferences may be drawn. Therefore, the full weight of the default judgment, based upon the allegations of the state court complaint, is insufficient to establish all the facts necessary for a conclusion of nondischargeability. As the parties rest upon that state court record, judgment will enter for the Defendant. A separate judgment will issue.

DATED: December 8, 2010

A handwritten signature in cursive script, reading "Louis H. Kornreich". The signature is written in dark ink on a light-colored background.

Louis H. Kornreich, Chief Judge
United States Bankruptcy Court

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION**

In re:)	
)	
VINCENT P. BETTANO and)	Chapter 13
BARBARA A. BETTANO)	Case No. 10-42872-MSH
)	
Debtors.)	
)	
VINCENT P. BETTANO and)	
BARBARA A. BETTANO,)	
)	
Plaintiffs)	Adv. Pro. No. 10-04114
)	
v.)	
)	
WELLS FARGO BANK, N.A.,)	
AS TRUSTEE FOR AEGIS 2-3-03,)	
)	
Defendant.)	
)	

MEMORANDUM OF DECISION ON DEFENDANT’S MOTION TO DISMISS

The defendant, Wells Fargo Bank, N.A., as Trustee for Aegis 2-3-03, has moved to dismiss this adversary proceeding pursuant to Fed. R. Civ. P. 12(b)(6), made applicable by Fed. R. Bankr. P. 7012, for failure of the plaintiffs to state a claim. For the reasons discussed below I will allow the motion.

Background

On September 16, 2003, the plaintiffs, who are the Debtors in the main bankruptcy case, refinanced their home mortgage loan with Aegis Lending Corp. The plaintiffs allege that Aegis required them to pay a “title search” fee of \$300 which was not included in the “finance charge” that is required to be disclosed to borrowers by the Massachusetts Consumer Credit Cost Disclosure Act, Mass. Gen. Laws. ch. 140D, (the “MCCCDA”), the Massachusetts counterpart to

the federal Truth in Lending Act. The plaintiffs allege that the omitted disclosure is a violation of the MCCCDA entitling them to rescind the loan transaction.

On May 17, 2010, the plaintiffs sent letters to the defendant, as successor to Aegis, in which they purported to rescind the loan transaction. On June 4, 2010, the plaintiffs filed a petition for relief under Chapter 13 of the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and subsequently initiated this adversary proceeding to enforce their right to rescind the loan.

Analysis

In deciding a motion to dismiss under Rule 12(b)(6), a court must review the complaint to determine if the complaint contains sufficient facts, accepted as true, to state a claim to relief that is plausible on its face. Bell Atlantic v. Twombly, 550 U.S. 544, 570, 127 S. Ct. 1955, 1966, 167 L. Ed. 2d 929 (2007); Rederford v. U.S. Airways, Inc., 589 F.3d 30, 35 (1st Cir. 2009). A court must accept as true the factual allegations of the complaint but not the legal conclusions, even if couched as facts. Ashcroft v. Iqbal, -- U.S. --, 129 S. Ct. 1937, 1947, 173 L. Ed.2d 868 (2009). Recitations of the elements of a cause of action supported only by legal conclusions are insufficient to withstand a motion to dismiss. Id.

In certain consumer loan transactions, a borrower may rescind the loan until midnight of the third business day after receiving certain disclosure and rescission forms from the lender. MCCCDA § 10(a). Typically, these documents are provided to the borrower at the loan closing, which gives the borrower until three business days thereafter to rescind. If, however, the documents are not provided or are inaccurate to a degree that exceeds the statutorily-established tolerance for error, then the rescission period extends until three days after a compliant disclosure form is eventually provided to the borrower. Id.; see McKenna v. First Horizon Home Loan

Corp., 475 F.3d 418, 421 (1st Cir. 2007) (explaining the extended right to rescind in federal TILA cases, and that the rescission process is the same under the MCCCDA).

This extended rescission period does not continue indefinitely, however. MCCCDA § 10(f) provides that the right of rescission “shall expire four years after the date of consummation of the transaction or upon the sale of the property.” A borrower may not, therefore, bring an action under the MCCCDA to rescind a loan that is more than four years old. Notwithstanding this limitation, however, a borrower may seek rescission even after the four year period by asserting the right of recoupment, which typically allows a litigant to assert claims defensively that are otherwise time-barred. MCCCDA § 10(i)(3) explicitly recognizes this right by providing that “[n]othing in this section shall be construed so as to affect a consumer’s right of recoupment under the laws of the commonwealth.”

In this case, the plaintiffs’ attempted rescission occurred well after the four year statute of limitations had expired so they have based their claims on the right of recoupment. The defendant argues that notwithstanding MCCCDA § 10(i)(3) there is no right of recoupment recognized under Massachusetts law. I need not rule on whether recoupment is available to the plaintiffs here, or whether, as the defendant argues, recoupment no longer exists under Massachusetts law, because the plaintiffs cannot sustain a claim for rescission in either event.

The plaintiffs allege that in connection with their loan the finance charge was understated by \$300. The MCCCDA provides that a disclosed finance charge is generally deemed to be accurate if it is not understated by more than one half of one percent of the loan amount. Because the alleged \$300 error is far less than one half of one percent of the plaintiffs’ \$280,500 loan, the plaintiffs rely on MCCCDA § 10(i)(2), which reduces the relevant tolerance for error to a mere

\$35 in situations where, as here, the borrower attempts to rescind a loan after a foreclosure proceeding has begun. While it is true that the initiation of foreclosure drops the floor for understated disclosures in a loan transaction from one half of one percent of the loan amount to \$35, a borrower's right to avail himself of this reduction is subject to the four year statute of limitations contained in MCCCDA § 10(f). Section 10(i)(2) provides that

Notwithstanding the provisions of subsection (f) of section four, **and subject to the time period provided in subsection (f)** of this section, for the purposes of exercising any rescission rights after the initiation of any judicial or nonjudicial foreclosure process on the principal dwelling of the obligor securing an extension of credit, the disclosure of the finance charge and other disclosures affected by any finance charge shall be treated as being accurate for the purposes of this section if the amount disclosed as the finance charge does not vary from the actual finance charge by more than thirty-five dollars or is greater than the amount required to be disclosed under this chapter.

(emphasis added). In establishing the reduced tolerance for error when a foreclosure is pending, the statute makes clear that the time in which this lower floor is available is limited to the four year rescission period in MCCCDA § 10(f). Put another way, even though § 10(i)(3) acknowledges a borrower's right of recoupment, which may extend beyond the four year rescission period, the legislature in § 10(i)(2) mandated that if a borrower attempts to assert that right after the rescission period expires, he may not rely on the reduced \$35 threshold. To interpret the statute otherwise would render the phrase "subject to the time period provided in subsection (f)" in § 10(i)(2) meaningless. Section 10(f) establishes the four year rescission period and § 10(i)(2) reduces the tolerance level for certain rescissions without addressing any other time limitations. Since the time limit on rescission is clearly set out in § 10(f), the only possible explanation for referencing the same limit in § 10(i)(2) is to establish that the \$35 threshold is available only to borrowers who attempt to rescind their loans before the four year rescission period expires, and to exclude those who attempt to rescind later by exercising their right of recoupment.

Because they alleged only a \$300 understatement of their finance charge to support a rescission claim after the period established by MCCCDA § 10(f) had expired, the plaintiffs have failed to state a claim for rescission under the MCCCDA. I will, therefore, allow the defendant's motion to dismiss. A separate order shall enter.

Dated: December 14, 2010

By the Court,

A handwritten signature in cursive script, appearing to read "Melvin S. Hoffman", written over a horizontal line.

Melvin S. Hoffman
U.S. Bankruptcy Judge