First Circuit Bankruptcy Case Summaries

4.2.10

Riley v. Decoulos (In re Am. Bridge Prods.), 2010 U.S. App. Lexis 5019 (1st Circuit 3/10/10)(Before Circuit Judges Boudin, Stahl & Lipez, Opinion by Boudin).

Defendant was appointed the state court receiver of the debtor 16 years ago, and the case was involuntarily brought as a Chapter 7 bankruptcy case 13 years ago. Chapter 7 bankruptcy trustee brought claims against the receiver for malfeasance (negligence, breach of fiduciary duty) which the receiver argued were time barred under the applicable three-year Massachusetts statute of limitations, not brought within three years of either their occurrence or date of discovery. After trial of an adversary proceeding on the merits of the claims against the receiver, the Bankruptcy Court found the receiver guilty of malfeasance, opining that the Massachusetts statue did not run until the receiver had made a final accounting to the Bankruptcy Court and was discharged by the Bankruptcy Court.

On appeal, the District Court reversed, finding the action was indeed time-barred, the statute running from the discovery of the receiver's alleged bad acts. On further appeal, the Court of Appeals for the First Circuit reversed and remanded, agreeing with the Bankruptcy Court. The First Circuit found that the Bankruptcy Court's ruling did not run afoul of either the *Rooker-Feldman* doctrine (federal court challenge to final rulings of the state court not allowed) or *Barton* doctrine (actions against receiver require approval of state court). Here, there were no final judgments made in the state court relevant to the malfeasance claims, negating any *Rooker-Feldman* challenges or *res judicata* challenges; and, state court permission was not required to sue the receiver because control of the estate had passed to the Bankruptcy Court by virtue of the involuntary chapter 7 proceeding. Further, the receiver had an obligation to account to the Bankruptcy Court as to the property he had held as a receiver and which had subsequently passed to the chapter 7 trustee, per 11 U.S.C. §543(b)(2)(accounting requirement) and §543(c) (surcharge requirement). And, the receiver filed a claim for compensation in the Bankruptcy Court, which would allow a counterclaim against him by the chapter 7 trustee for such compensation due. The receiver could have, but did not, raise a defense of laches; nor, did the receiver show that the Bankruptcy Court's findings were clear error. Court did not decide whether the §543 surcharge power extends to pre-bankruptcy conduct by a prior custodian.

Douglas v. Kosinski (In re Kosinski), 2010 Bankr. Lexis 505 (BAP 1st Cir. 3/1/10)(Before Judges Haines, Vaughn & Tester, Opinion by Vaughn).

Debtor appealed the Bankruptcy Court's finding his debt to a creditor was not discharged per 11 U.S.C. §523(a)(2)(B); and, appealed the Court's grant of the creditor's post-trial motion to amend his complaint to specify alternative counts under §§523(a)(2)(A) [debts obtained by false pretenses, false representations or actual fraud] and 523(a)(2)(B) [debts obtained by fraudulent *written* statements regarding debtor's or insider's financial condition]. The two subsections are distinct in their proofs; the extent to which the creditor altered its position because of the debtor's misrepresentations requires a showing of *"justifiable"* reliance under §523(a)(2)(A); but, under §523(a)(2)(B) mandates the more demanding showing of objectively *"reasonable"* reliance.

Because exceptions to discharge are narrowly construed favoring the debtor's "fresh start", the creditor asserting an exception to discharge must show that its claim comes squarely with an exception enumerated in the Bankruptcy Code. The debtor here had induced the creditor to invest in a startup night club business by showing him financial statements for a night club that had been in the same space several years before, but had since closed; and had promised that the investment would be secured by

hard assets. The night club quickly failed, and the debtor moved out most of the personalty in the dead of night.

On appeal, as to §523(a)(2)(B), the Bankruptcy Appellate Panel found that the creditor had not shown his reliance on the financial projections was objectively *reasonable*, rather than *justifiable*; and to possibly prevail must proceed under §523(a)(2)(A); and, found that the projections were not a statement of financial condition of the debtor.

The Appellate Panel also found the Bankruptcy Court's grant of the post-trial motion was permissible under Fed. R. Bankr. Pro. 7015(b) to plead in the alternative from §523(a)(2)(B) to §523(a)(2)(A); and, such motions fall within either (1) trial by consent or implied consent when an issue not contained in the pleadings is tried, or (2) over the parties objection when the court exercises its discretionary authority when the opponent does not show undue delay or prejudice in the grant of such motion.

Thus the §523(a)(2)(B) finding was reversed, the motion to amend was upheld, and the §523(a)(2)(A) claim was remanded for the Bankruptcy Court to make determinations relevant to §523(a)(2)(A), because it did not do so in the record below.

In re Rodger, Chapter 13 Debtors, 2010 BNH 12 (Bankr. D.N.H. 2/26/20)(Judge J. Michael Deasy).

Debtors ("below median" debtors) moved under Fed. R. Civ. Pro.59 to alter or amend the prior order of the Bankruptcy Court requiring the debtors to pay their disposable income not only during the first three years of their Chapter 13 plan, but for the entire duration of their 60-month plan, which motion was denied. The Court did not find any manifest error of law in its original decision.

In re Corbett, 2010 BNH 14 (Bankr. D.N.H. 3/8/10)(Judge J. Michael Deasy).

Debtor field a motion to reopen her no-asset Chapter 7 case under 11 U.S.C. §350(b) to add additional creditors that she inadvertently failed to list on her original schedule F, to which the Bankruptcy Court directed she file an amended motion consistent with the recent First Circuit decision of *Colonial Surety Co. v. Weizman*, 564 F. 3rd 526 (1st Cir. 2009)(Burden on the debtor to demonstrate cause to reopen; to show that the omission was innocent and that the law and equities justify the relief, absent which the debt will remain undischarged).

Going forward then in the District of NH, a debtor filing a motion to reopen must submit either a verified motion or include an affidavit signed by the debtor providing facts sufficient for the Court to find that the debtor has met the burden of showing that (1) the omission was innocent and (2) the equities justify reopening the case to list the omitted creditor(s). If established, the Court will then issue an order, largely consistent with "Walker" Orders [*See In re Walker*, 195 B.R. 187 (Bankr. D.N.H. 1966)], that provide the omitted creditor with notice and on opportunity to object.

In re Huntington, 2010 Bankr. Lexis 627 (Bankr. D. R.I. 3/1/10)(Judge Arthur N. Votolato).

Relief from the automatic stay denied to creditor, who sought to record a post-petition attachment against certain escrowed funds generated from the debtor's royalty fees. Pre-petition, debtor's wife obtained family court relief designating the payments as support obligations. At the same time, a creditor obtained judgment against the debtor. Thereafter, the debtor filed chapter 7, and on the same day as the filing the judgment creditor obtained an attachment for the funds. Bankruptcy Court determined that the judgment creditor was no more than a general unsecured creditor, whose status was not properly perfected to secured status due to the bankruptcy petition filing. Stay relief was then denied to the

creditor to pursue these funds. The automatic stay was not applicable to these funds being used for the support obligation such as for tuition, per §362(b)(2)(B).

U.S. v. Strohmeyer, 2010 U.S. Dist. Lexis 19195 (D. Maine 3/2/10)(Chief Judge John A. Woodcock, Jr.)

District Court granted summary judgment to the government on the debt owed to it by the doctor, due to Dr. Strohmeyer's failure to pay his HEAL [educational] loan. Defendant failed to answer plaintiff's summary judgment motion, but the Court nonetheless looked to the defendant/doctor's answer to the complaint regarding his defenses, where he averred statute of limitations defenses and that the debt had been discharged by his prior bankruptcy. As a matter of law, 42 U.S.C. §292(f)(i) bars the statute of limitations defense; and, 42 U.S.C. §292(f)(g) would allow discharge of the HEAL loan only if (1) after the expiration of the seven-year period beginning on the first date when repayment of such loan is required, (2) upon a finding of the Bankruptcy Court that the nondischarge of such debt would be *unconscionable* and (3) upon the condition that the Secretary shall not have waived the Secretary's right to apply subsection (f) to the borrower and the discharged debt.

Summary judgment granted because (1) defendant failed to answer the motion and (2) the defenses in his Answer were either unavailable as a matter of law or unproven as a mater of fact.

Maroun v. NY Mortgage Co., LLC (In re Maroun), 2010 BNH 7 (Bankr. D.N.H. 2/11/10)(Chief Judge Vaughn("Maroun #1").

Court abstained from hearing the adversary proceeding as against lender Fremont, who objected to the jurisdiction of the Bankruptcy Court to hear the adversary proceeding. Defendant Fremont moved to dismiss the complaint against it for lack of subject matter jurisdiction. The debtor sought to rescind her mortgage and collect damages pursuant to N.H. Rev. Stat Ann. Section 358-A:2, 15 U.S.C. §§1635, 1638 & 1639, and assert common law claims of [predatory lending] breach of contract, intentional misrepresentation, breach of the covenant of good faith and fair dealing, unjust enrichment and fraud.

Court held a hearing and took the motion under advisement, reviewing the jurisdictional issues raised as "core" versus "noncore". Core jurisdiction would encompass cases that arise under specific sections of the Bankruptcy Code, or arise in title 11 proceedings that would not exist outside of the Bankruptcy Court. Non-core proceedings relate to the title 11 case if the actions could have an affect on the administration of the bankruptcy estate, but preclude the Bankruptcy Court from entering final judgment in the matter (unless the parties consent to the Court to adjudicate the matter), and allow the Court the discretion to abstain from hearing them. Here, the causes of action were not created by the Bankruptcy Code and could exist outside of a bankruptcy proceeding, but they were related to the pending case, so would be a "non-core" "related to" proceedings. Finding the claims here were largely state-law and could be adjudicated more properly and efficiently in another forum, the Court abstained.

Maroun v. NY Mortgage Co., LLC (In re Maroun), 2010 BNH 8, (Bankr. D.N.H. 2/11/10)(Chief Judge Vaughn("Maroun #2").

Plaintiff failed to set forth the jurisdictional statement in her adversary proceeding complaint. Neither party raised the issue of jurisdiction nor requested *prior to judgment* that the proceeding be declared "non-core". Consent to the treatment of this proceeding as "core" was implied by the actions of the parties i.e. plaintiff filed the complaint before the Bankruptcy Court and defendant New York Mortgage Company, LLC ("NYC LLC") moved for a final judgment in the form of dismissal of the complaint via a

judgment on the pleadings before the Bankruptcy Court (once a defendant files an answer, a party may file a motion for judgment on the pleadings, which is treated in the same manner as a Rule 12(b)(6) motion to dismiss).

The counts asserting NYC LLC violated the NH Consumer Protection Act were dismissed as the defendants are excepted from that statute through their governance by the NH Bank Commissioner. As for the NYC LLC's alleged TILA violations, these were dismissed as well because NYC LLC was not a "creditor" as defined under TILA (NYC LLC is a mortgage broker) and only creditors under TILA can be liable for damages and rescission for failure to comply with TILA's terms. NYC LLC was pled to be an agent of lender Fremont, so counts related to this agency were not dismissed such as the alleged breach of covenant of good faith and fair dealing or breach of contract. Plaintiff pled with sufficient particularity to survive dismissal on the alleged fraud counts.

Dismissal was denied on the count of unjust enrichment, because although the general rule under New Hampshire law is that unjust enrichment cannot exist where there is a valid contract, it may be available to contracting parties where the contract was breached.

Finally, as to abstention which the Court raised *sua sponte* after ruling on the dismissal motion, [which abstention was previously done in the case of lender Fremont] the Bankruptcy Court abstained from hearing the remainder of the surviving claims against NYC LLC as such claims would largely mirror the claims and defenses in the *Fremont* case, and the debtor claimed the lender and broker had acted in concert.

Jiminez-Vidal v. RG Mortg. Corp., 2010 U.S. Dist. Lexis 22599 (D.P.R. 3/11/10)(Judge Salvador E. Casellas).

After analyzing a very tortured procedural background through two Chapter 13 cases and multiple claims related to debtor's hearing impairment, the Court undertook a thorough analysis of mandatory versus permissive withdrawal of the reference, and denied the debtor's motion for withdrawal of the reference finding that whether the automatic stay was in effect is a core issue which is better left for the Bankruptcy Court to decide and in the present case it had already been decided by said forum.

In re Maali, 2010 U.S. Dist. Lexis 18420 (D. Mass. 3/1/10)(Judge Richard G. Stearns).

District Court affirmed dismissal of the debtor's Chapter 13 case. Debtor failed to appear at the 11 U.S.C. §341 first meeting of creditors (required by §343) or provide medical documentation for his failure to appear; debtor made no plan payments within 30 days of filing his plan (failure to comply with §1326) nor did he seek an order to extend the deadline; debtor did not confirm a plan due to his failure to cooperate with the Chapter 13 trustee which made it impossible for the trustee to recommend confirmation. Dismissal was then proper under §1307(c)(1) due to debtor's unreasonable delay that was prejudicial to creditors. Motions to dismiss are reviewed under the "abuse of discretion" standard; abuse occurs if the Bankruptcy Court did not apply the correct law, or rest its decision on a clearly erroneous finding of material fact; a finding of fact is clearly erroneous even though there may be some evidence to support it, when the reviewing court, after careful examination of all of the evidence is left with the definite and firm conviction that a mistake has been committed. No abuse of discretion was found here.

HSBC Bank USA v. Bank of NY Trust Co., et. al., 2010 U.S. Dist. Lexis 24127 (D. Mass. 3/15/10)(Judge Joseph L. Tauro).

Judgment of the Bankruptcy Court affirmed because the Court's factual findings were supported by a reasonable view of the record. Senior Indentures objected to payment of Junior Indentures until the

Seniors were paid post-petition interest. After an examination of the intent of the parties in contract drafting under the NY law applicable at the time of the drafting, the Bankruptcy Court held that the Junior Indenture Trustees successfully established that the Senior Indenture Trustee's right to interest ceased on the filing of the Chapter 7 bankruptcy proceeding. District Court affirmed, opining that "it is clear that for a claim to post-petition interest to survive the Rule of Explicitness, a subordination agreement must specifically reference the entitlement of the Senior Debt holders to such interest." The "Rule of Explicitness" is an equitable doctrine that requires a subordination agreement to show clearly that the general rule that interest stops on the date of the filing of the petition is to be suspended.

Youssef v. Fogarty (in re Fogarty), 2010 Bankr. Lexis 716 (Bankr. D. Mass. 3/10/10)(Judge Joan N. Feeney).

Plaintiff sued the debtor contractor to determine the debt was not discharged, per 11 U.S.C. §523 (a)(2)(A), and alleging the debtor's breach of construction contract was so egregious as to cause damage to property and emotional distress rising to the level of willful and malicious nondischargeable injury under §523 (a)(6). Plaintiff alleged that he was duped to have the debtor construct a house that was so shoddy, so lacking in building code compliance as to be a fraud, false pretenses for promised services.

However, under any of the case-law tests, §523(a)(2)(A) requires proof of *scienter* regarding false representations or actual fraud, and the plaintiff did not sustain his burden of proof with respect to that element. Further, plaintiff did not prove that the debtor did not intend to properly perform the contract *at the time it was signed*, even though in actual execution he did not. Further, plaintiff came to the debtor through a referral, he was not *solicited by the debtor*. Moreover, plaintiff did not establish *justifiable reliance* in that plaintiff knew the house was being constructed improperly yet he contained to pay the debtor installment payments for more work.

Applying §523(a)(6), acts that are reckless or negligent do not fall within it; the words of the statute strongly support acts done with the *actual intent to cause injury*. To prevail on this count, the plaintiff had to present evidence, not that the debtor's actions were intentional or voluntary, but that the debtor *intended to injure the plaintiff's property*.

While the Court noted the debtor's actions were egregious, they did not support an exception to discharge. [In a footnote, the Court observed that plaintiff's counsel failure to call the debtor and debtor's agent as a witness during trial may have adversely affected the outcome of the case. Debtor was present in the courtroom during the trial.]

In re Everest Crossing, LLC, Chapter 11 Debtor, Case No. 09-16664-FJB, (Bankr. E.D. Mass. 2/24/10)(Judge Frank J. Bailey)

(Unpublished Memorandum of Decision available on the Court's web site).

Debtor moved to assume the lease of nonresidential real property out of which it operated it business (a restaurant). Landlord objected. At issue was (1) the amount of default to be cured, (2) whether the debtor provided adequate assurances of prompt cure and (3) whether the debtor provided adequate assurances of future performance. Pre-petition, the debtor invested $1.5 million in the build out and establishment of his restaurant. For purposes of the motion, the Court estimated the landlord's claims. As for rental arrearages, the debtor proposed to cure them over 18 months out of operating revenues and submitted a budget to support that; and his sister provided cash to secure some of the performance with loan promises from others if needed, plus the landlord was still holding a security deposit of $36,000 of the debtor's. Landlord objected to the cure taking 18 months, but the Court found if sufficient on the facts

of the case as well as a "prompt" cure; the debtor was in the fifth year of a ten-year lease, with lease extensions for up to ten more years.

As for adequate assurance of future performance of the lease, the debtor had made substantial changes to its business in the seven months since its bankruptcy filing, had effectuated substantial savings and efficiencies in several areas, had hired new personnel, adjusted pricing and expanded capacity. While the debtor had not yet filed a plan, assumption of the lease and cure of certain arrearages was his biggest hurdle and with that accomplished there was a reasonable likelihood to confirm a plan and continue performing under the lease.

In re Massillion, 2010 Bankr. Lexis 714 (Bankr. E.D. Mass. 3/10/10)(Judge Frank. J. Bailey).

Chapter 7 trustee objected to the debtor wife's exemption of about $62,000 in a testamentary spendthrift trust governed by NY law. At issue was whether 11 U.S.C. §541(c)(2) excluded her rights to distributions from the bankruptcy estate rendering them exempt under 11 U.S.C. §522(d)(5) or whether the exemption was limited. Court found it was limited.

As a trust beneficiary, the debtor received distributions and was entitled to distribution of remaining principal in two installments of $31,000 each, which the debtor claimed as exempt under 11 U.S.C. §522(d)(5) to the extent any of the trust was part of the bankruptcy estate. Both parties agreed it was a valid and enforceable spendthrift trust, as the debtor could not alienate the trust assets or control their disposition. The trust *assets* were consequently excluded from the estate under §541(c)(2). The issue was whether the *distributions* from the trust to the debtor were part of the bankruptcy estate, which were generally available to creditors under NY law. The Bankruptcy Court found that the future distributions are an asset of the estate, exempt under §522(d)(5) to the extent of $11,200 (not $20,950 as claimed by the debtor since the co-debtor husband had no interest in the trust, only his co-debtor wife).

§522(d)(5) allows the debtor to exempt up to $1075 in any property plus up to $10,125 of any unused amount of the exemption provided in paragraph (1) of this subsection - for a grand total of $11,200 allowed as exempt.

In re Jennings, 2010 BNH 010 (Bankr. D. N.H. 2/25/10) (Judge J. Michael Deasy)(Not for publication).

Debtor sought a mortgage and priming lien per 11 U.S.C. §364(d) on certain properties to pay professionals retained in his chapter 11 case. Motion was denied because the debtor was unable to show the secured creditor would be adequately protected. The First Circuit allows a professional to hold a mortgage to secure the payments of fees that may be allowed by a Bankruptcy Court, per *In re Martin*, 817 F.2d 175 (1st Cir. 1987). The Court here found that the mortgage, if granted, would not be a conflict of interest for the professionals at issue. However, the value of the properties at issue was disputed, the value of which was largely dependent on future development, precluding a finding of adequate protection to affected creditors.

Total Pride Landscaping, Inc., [Chapter 11 Debtor], v. Continental Paving, Inc., et. al., 2010 BNH 015 (Bankr. D. N.H. 3/15/10((Judge J. Michael Deasy).

(Unreported Memorandum Opinion available on Court's web site).

This is a case about compost. Debtor stored his compost on the defendant's property in exchange for providing landscaping services to it. At some point in time, the relationship deteriorated and the debtor attempted to remove his compost, but the property owner was not satisfied with the manner of removal

and stopped him. Debtor sought an order of turnover, per 11 U.S.C. §542 of the compost as property of the estate or pay for its fair value. Debtor failed to originally list the compost on his schedules, and amended to include it at the time of the adversary proceeding. The Court found the compost had some value to the bankruptcy estate. Debtor also alleged that the property owner violated the automatic stay by failing to allow the debtor access to retrieve his compost, and the Bankruptcy Court agreed. Debtor sought costs and fees, actual and punitive damages for the stay violation.

Courts are split over whether a corporate debtor may take advantage of §362(k)(1). However, since the debtor here failed to prove his damages (burden is on the debtor by a preponderance of evidence to prove he suffered damages from the stay violation) regarding allegation of lost profits due to the missing compost, they would not be awarded. Also, this was not the egregious case warranting the imposition of punitive damages.

No witnesses were provided to prove timber trespass by the debtor, so no statutory damages were assessed against the debtor for allegedly cutting some trees to access his compost, but the debtor was required to pay restoration costs for the disturbed area on the land. Defendants also failed to prove any rental value to be charged while the debtor's compost was on their land.

Smith v. Indymac Fed. Bank, F.S.B. (In re Winter), 2010 BNH 003 (Bankr. D.N.H. 2/3/10)(Chief Judge Mark W. Vaughn)

The chapter 7 debtor(wife) and her husband purchased real property; but only the husband executed a promissory note. However, both the husband and debtor/wife signed the mortgage to secure payment of the promissory note. The debtor sought to avoid the mortgage as a preferential transfer under 11 U.S.C. §§ 447 and 550. Court found that the debtor's failure to sign the note does not void the mortgage; the mortgage may be foreclosed against the entire property but no deficiency claim may be pursued against the person, herein the debtor, who did not sign the note. Since the transfer, or mortgage, was not for or on account of an antecedent debt owed by the *debtor*, there can be no preferential transfer. Summary judgment on the preference issue was granted in favor of the defendant bank.

Gembitsky v. DeSteph, 2010 BNH 002 (Bankr. D.N.H. 1/25/10)(Chief Judge Mark W. Vaughn)(Not for publication).

Chapter 13 defendant/debtor filed a motion to dismiss under 12(b)(6) asserting the claims against her were time barred. However, that motion could only be asserted *before* the defendant filed an answer as once an answer is filed the pleadings are closed, but then a party may file a motion for judgment on the pleadings. As a motion for judgment on the pleadings, the Court partially dismissed the breach of contract counts on statute of limitations grounds, leaving the remainder of the contract counts where the payments fell within the statute of limitations – when an obligation is to be paid in installments the statute of limitations runs only against each installment as it becomes due. The breach of contract occurs then each time the borrower fails to tender a monthly payment and the lender is aware that she did not receive payment.

Court dismissed the three counts for violation of the SEC Act and violations of the NH Uniform Securities Act and Conversion because those claims were time barred. Further, the Court ordered the plaintiff to produce certain documents relating to the debtor's discovery request, the debtor having satisfied its burden to show relevance of the requested documents.

Submitted by:
Patricia S. Gardner, Esq.