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First Circuit

Laboy v. Doral Mortgage Corp., (In re Laboy), 2011 U.S. App. Lexis 10881 (1st Cir. 5/27/11)(Before Circuit Judges Torruella, Lipez and Thompson, Opinion by Thompson). On appeal from the BAP, debtors claim they were deprived of a hearing on damages due to them as a result of the appellee's willful violation of the automatic stay, with which the First Circuit agreed and remanded the case to do so. Creditor recorded a deed to perfect its interest after the Chapter 13 case was filed, and while the automatic stay was in effect. The bankruptcy court initially held that the attempt to perfect its mortgage fell under an exception to the automatic stay, at 11 U.S.C. §363(b)(3), then later reversed itself finding the creditor was aware of the bankruptcy case and the act to perfect was then a violation of the automatic stay. The creditor untimely appealed this decision. Next, the debtors asked for damages for this stay violation, for which the bankruptcy court summarily decided that cancellation of the mortgage was remedy enough. Debtors appealed to the BAP, which affirmed. After winning summary judgment on the issue of liability, the First Circuit held that the debtors had an absolute right to present evidence on the resultant damages. Damages fall under §362(k).

In re LeClair, 2011 Bankr. Lexis 1867 (Bankr. D. Mass. 5/18/11)(Melvin S. Hoffman, Bankruptcy Judge). Chapter 7 trustee objected to debtor's exemption (Chapter 7 case) for an annuity, which was sustained. Although it appeared that the annuity qualified as an individual retirement annuity under I.R.C. Section 408(b), it did not follow automatically that it was entitled to the protection of the Mass. State statute, and debtor used the state exemption scheme.

In re McLaughlin, 2011 BNH 5; 2011 Bankr. Lexis 1656 (Bankr. D.N.H. 5/4/11)(unreported)(J. Michael Deasy, Bankruptcy Judge). Bank and mechanic lienor disputed distribution of proceeds of sale of debtor's real property. In New Hampshire, any person who performs labor or furnished materials to the amount of \$15 or more for erecting a house, by virtue of a contract with the owner, shall have a lien on any material furnished and on said structure, per RSA 447:2. The mechanic's lien arises by operation of law. The contract does not need to be in writing and may be implied from the furnishing of materials which were used in the construction of the building. Once a lien is created, it will expire unless it is perfected in a timely manner after completion of the contract. To perfect a mechanic's lien, a party must acquire an attachment after the contract is completed on the specific property to which it supplied materials. Upon completion of the contract from which the mechanic's lien arose, a single indivisible lien for the whole is created. The mechanic's lien continues for 120 days after completion of delivery of goods or performance of services under the contract. The lien must be perfected before it expires. [RSA 447:9](#). The time starts to run not from the date the mechanic's lien accrues but from when the final bill is sent or the last work is completed under the contract. In order to continue or secure a mechanic's lien, the lien holder must attach the property by writ and return thereon distinctly expressing that purpose, within the 120 day period. [RSA 447:10](#). After the mechanic's lien is validly perfected, it has priority over any interests that were created after. A builder's need for materials is not satisfied until those materials arrive at the construction site. Therefore, the mechanic lienor first furnished materials *when it actually delivered them to the Property*, not when the materials were ordered. As a result, its mechanic's lien arose the day the materials were first furnished. Since its mechanics lien arose seven days after the Bank's attachment, its claim is junior to the Bank.

In re Reitter Corp., 2011 Bankr. Lexis 1801 (Bankr. D.P.R. 5/12/11)(Enrique S. Lamoutte , Bankruptcy Judge). IRS objected to Chapter 11 debtor's use of cash collateral, herein the debtor's health insurance accounts receivables, claiming a lien senior to the bank's on the money. IRS prevailed on the issue of having a superior lien on the money, with an analysis under the FTLA (The Federal Tax Lien Act).

EDWARD ST. PETER, Appellant, v. FREDERICK HUTCHINGS, Appellee., 2011 Bankr. Lexis 2039 (BAP 1st Cir. May 25, 2011)(Before Judges Haines, Votolato and Deasy, Opinion by Deasy). *Pro se* [appellant] judgment creditor sought appellate review of Bankruptcy Court's dismissing the involuntary petition he filed against *pro se* [appellee] Chapter 7 debtor and denying his motion for reconsideration, which was reversed by the BAP on appeal. The petition had been dismissed for the creditor's failure to timely serve the debtor. The creditor correctly claimed that the bankruptcy court committed error related to the service of the summons, having failed to give him the opportunity to re-serve the summons where the deadline for service had not yet expired.

KEVEN A. MCKENNA, P.C., Appellant, v. OFFICIAL COMMITTEE OF UNSECURED CREDITORS, Appellee, 2011 U.S. Dist. Lexis 57985 (D. Mass. May 31, 2011)(Mary M. Lisi, Chief United State District Judge). The Chapter 11 DIP appealed the Bankruptcy Court's order which *sua sponte* appointed a Chapter 11 Trustee. The appeal was denied and the order affirmed. The Bankruptcy Court had held a hearing to determine whether to convert the case to Chapter 7, based upon the motion of the Committee of Unsecured Creditors, the DIP being a law firm. Taking the matter under advisement, the Court undertook the conversion and dismissal analysis, concluding that it would be in the best interests of creditors to appoint a Chapter 11 Trustee, based upon the totality of the circumstances, notably the recalcitrance and conduct of the equity stakeholder in the firm.

IN RE: EVAN S. FILION AND SHELLYE R. BLAKE, 2011 Bankr. LEXIS 1641 (Bankr. D. Mass. May 3, 2011)(William Hillman, Bankruptcy Judge).

Bankruptcy debtors paid the full amount contemplated by their Chapter 13 bankruptcy plan to the trustee two months prior to expiration of the five-year period of their plan. The debtors moved for entry of a bankruptcy discharge. The debtors contended that they paid all amounts due under the plan and thus were entitled to an immediate discharge, even though the plan period had not yet expired. The bankruptcy court held that, while the debtors paid the full amount contemplated by their confirmed plan, they did not do so according to the plan provisions which provided for a term of five years.

In re JAMES M. KANE and SUSAN A. KANE, 2011 Bankr. LEXIS 2007 (Bankr. D. Mass. 5/23/11)(Joan N. Feeney, Bankruptcy Judge).

A creditor objected to the homestead exemption claimed by debtors, on the ground that title to the property was in the name of a Massachusetts limited liability company. The creditor maintained that their homestead was invalid because they were not the owners of the property at the time they recorded the homestead, which objection was sustained.

In re Nichols, Chapter 13 Case # 10-1221 (Bankr. D. Mass. June 7, 2011)(William C. Hillman, Bankruptcy Judge).

Costs and fees incurred in the demolition, post-petition, of barn on debtor's property due to unsafe conditions, were granted administrative priority. Fees limited to reasonable fees, and were thus reduced.

Bererhout and Fiorita v. City of Malden,(In re Bererhout and Fiorita), Chapter 13 Case # 09-18956, Adv. Pro.09-1314(Joan N. Feeney, Bankruptcy Judge).

Debtors proved that City violated automatic stay by placing administrative hold on their vehicle's registration due to unpaid parking tickets, even though on notice of the petition filing. Debtors awarded attorney costs and fees plus \$1000 in emotional distress damages.

Liberty Bay credit Union v. Belforte (In re Belforte), Chapter 13 Case #10-22742, Adv. Pro. 11-1008 (Bankr. D. Mass. 5/24/11)(Joan N. Feeney, Bankruptcy Judge).

Creditor sought to determine its loan was non-dischargeable as a student loan, for which summary judgment could not be granted as there were genuine issues of material fact as to whether the lender fit within the discharge exception i.e. (1) educational loan (2) made as part of a program (3) by a non-profit institution.

Eresian v. Scheffer (In re Scheffer), Chapter 7 Case # 06-41218, Adv. Pro. #11-4008 (Melvin Hoffman, Bankruptcy Judge). Costs and fees awarded to debtors' defense of vexatious litigation by alleged creditor, baselessly seeking revocation of order of discharge.

In re: JOJO'S 10 RESTAURANT, LLC, Debtor. JOJO'S 10 RESTAURANT, LLC, Plaintiff v. DEVIN PROPERTIES, LLC et al, Defendants, 2011 Bankr. LEXIS 2009 (D. Mass. May 20, 2011)(Melvin S. Hoffman, Bankruptcy Judge). Creditor determined not to have a security interest in debtor's assets or liquor license.

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2011 U.S. App. LEXIS 10881, *

IN RE: LUIS G. VÁZQUEZ LABOY; CARMEN D. GARCÍA CALDERÓN, Debtors. LUIS G. VÁZQUEZ LABOY; CARMEN D. GARCÍA CALDERÓN, Appellants, v. DORAL MORTGAGE CORPORATION; DORAL FINANCIAL CORPORATION; EDGARDO CANALES IDRACH d/b/a CANALES LAW OFFICES; ÁNGEL R. ROLÁN PRADO, Appellees.

No. 09-9022

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

2011 U.S. App. LEXIS 10881

May 27, 2011, Decided

PRIOR HISTORY: [*1]

APPEAL FROM THE **BANKRUPTCY** APPELLATE PANEL FOR THE FIRST CIRCUIT.

CORE TERMS: willful violation, summary judgment, deed, final judgment, mortgage deed, conveyance, automatic stay, mortgage, notary's, avoidance, partial, attorneys' fees, actual damages, perfection, bankruptcy case, bankruptcy petition, time limit, order granting, presentation, intermediate, corrected, untimely, jurisdictional, unrecorded, perfect, analogy, present evidence, willfully violated, interlocutory orders, opportunity to prove

COUNSEL: Juan M. Suárez Cobo, with whom Legal Partners, P.S.C. was on brief, for appellants.

Giselle López Soler, with whom Néstor M. Méndez Gómez and Pietrantonio Méndez & Álvarez LLP were on brief, for appellees Doral Mortgage Corporation and Doral Financial Corporation.

Giancarlo Font García, with whom Rivera-Carrasquillo, Martínez & Font was on brief, for appellees Edgardo Canales Idrach d/b/a Canales Law Offices and Ángel R. Rolán Prado.

JUDGES: Before Torruella ▼, Lipez ▼, and Thompson ▼, Circuit Judges.

OPINION BY: THOMPSON ▼

OPINION

THOMPSON ▼, Circuit Judge. Debtors Luis Vázquez Laboy and Carmen García Calderón claim they were unconstitutionally deprived of a hearing on damages due to them as a result of the Appellees' willful violation of the automatic stay in their **bankruptcy** case. Appellees [Doral Mortgage Corporation](#) ▼ — who set in motion the stay violation — and its former attorney-notaries at Canales Law Offices, Edgardo Canales Idrach and Ángel Rolán Prado (collectively, Canales) — who actually carried out the acts that violated the stay — have mounted a broad counter-attack, fighting everything from our jurisdiction to the willfulness of the violation. All [*2] this avails them nothing, however. Avoiding the constitutional issue, we nevertheless find that the Debtors are entitled to present evidence, and we remand so they can do so.

Shenanigans at the Registry

This case's decade-plus of court proceedings all stem from the Debtors' purchase of a property in Corozal, Puerto Rico on December 17, 1996.¹ Not long after the purchase — on December 30, 1996 — the Debtors presented their conveyance deed to the Registry of Property. Under Puerto Rico law, the Registry has sixty days either to record a deed that has been presented or to notify the presenters of any defects. See [30 L.P.R.A. § 2255](#). If a deed's presenters do not correct any defect within sixty days of notification, then the presentation expires and the Registry will reject the deed. See *id.*

FOOTNOTES

1 The Debtors purchased the property from Manuel Angel Vázquez and Margarita Ortiz Bonilla; the notary who effected the transaction was Luis F. Maldonado Rivera.

On February 15, 1997 — before the initial sixty-day period was up, and with the conveyance deed still unrecorded — the Debtors borrowed \$25,000 from Doral, secured by a mortgage on the property. Canales, acting as a notary retained by Doral, promptly [*3] presented the mortgage deed to the Registry.²

FOOTNOTES

2 Under Puerto Rico law, a notary is an attorney specially authorized to execute and give legal effect to certain documents — including deeds — so the documents will reflect the agreement of the parties. See [4 L.P.R.A. §§ 2002](#) (defining notary), [2031](#) (defining "public documents" as including deeds), [2032](#) (notaries responsible for conforming public documents to parties' agreement).

This is where things went awry. First, the Registry informed the Debtors that their conveyance deed was defective. So on May 5, 1997, the Debtors withdrew the deed, as was their right under [30 L.P.R.A. § 2254](#). But the mortgage deed remained in limbo; its presentation expired and it was never recorded. The Registry ought to have informed Doral or Canales that the mortgage deed was defective due to the withdrawal of the conveyance deed, see *id.* [§§ 2255, 2272](#); Doral disputes that the Registry did so. But there is no question that by July 29, 1999, Doral had learned that the conveyance and mortgage deeds remained unrecorded. Nevertheless, it sat on its hands. And in the meantime, on January 31, 2000, the Debtors filed for Chapter 13 **bankruptcy**. Doral learned of the [*4] **bankruptcy** petition in February and entered the case in early March.

Now Doral was in a fix. The **bankruptcy** petition had triggered an automatic stay, forbidding any action to perfect a lien against estate property. See [11 U.S.C. § 362\(a\)\(4\)](#). But this restriction hurt Doral: Doral's interest in the Debtors' property remained unperfected, and its position in the **bankruptcy** proceedings suffered as a result.³ If the mortgage had been recorded then Doral's claim against the **bankruptcy** estate would have been secured by a lien on the property; the unrecorded mortgage, though, left Doral's claim effectively unsecured. So, heedless of the stay, on December 1, 2000, Canales — again acting as a notary retained by Doral — presented the mortgage deed to the Registry anew, this time with a corrected conveyance deed.⁴ See [30 L.P.R.A. § 2275](#) (allowing for a new presentation after the correction of defects). The Debtors, however, did not take this lying down.

FOOTNOTES

³ See, e.g., [In re SPM Mfg. Corp.](#), 984 F.2d 1305, 1312 (1st Cir. 1993) ("If a lien is perfected and not otherwise invalidated by law, it must be satisfied out of the assets it encumbers before any proceeds of the assets are available to unsecured [*5] claimants, including those having priority.").

⁴ Apparently the conveyance deed had already been corrected and re-presented by notary Julio E. C6ra Lopez; Canales obtained a copy of the corrected deed from the Registry and filed this copy with the mortgage deed. The correction and re-filing of the conveyance deed rendered the mortgage deed valid, and the copy of the corrected conveyance deed evidenced this remediation to the Registry.

Adversary Action

On August 22, 2001, the Debtors filed an adversary action against Doral in **bankruptcy** court, claiming that Doral's presentation of the mortgage deed willfully violated the automatic stay and seeking various relief, including damages, costs, and fees.⁵ Doral moved to dismiss the complaint. For their part, the Debtors filed a motion for partial summary judgment on liability. There followed a flurry of filings, including an amended complaint that brought Canales into the case. Canales responded with its own summary judgment motion. Finally, on August 29, 2003 the court dismissed the action, holding that Doral's post-petition attempt to perfect its mortgage fell under an exception to the automatic stay. See [11 U.S.C. § 362\(b\)\(3\)](#).⁶

FOOTNOTES

⁵ The filing [*6] of the corrected conveyance deed did not constitute an act against the **bankruptcy** estate and therefore has never been directly at issue.

⁶ Specifically, [§ 362\(b\)\(3\)](#) provides that a **bankruptcy** petition does not act as a stay against: any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under [[11 U.S.C. § 546\(b\)](#)] or to the extent that such act is accomplished within the period provided under [[11 U.S.C. § 547\(e\)\(2\)\(A\)](#)]. [Section 546\(b\)](#) provides that a trustee's rights and powers are subject to generally applicable laws (A) allowing the perfection of a property interest "to be effective against an entity that acquires rights in such property before the date of perfection" or (B) "provid[ing] for the maintenance or continuation of perfection . . . to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation." [Section 547\(e\)\(2\)\(A\)](#) defines a time period: "at the time [a] transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 30 days [*7] after, such time, except as provided in subsection (c)(3)(B)." [Subsection \(c\)\(3\)\(B\)](#) refers to perfection "on or before 30 days after the debtor receives possession of . . . property." As the body of this opinion notes, the **bankruptcy** court originally found that the exception applies here but then reversed itself. Neither conclusion is now at issue.

The Debtors moved for reconsideration, and after kicking the issue about for three years the court obliged by reversing itself, granting the Debtors' motion for partial summary judgment, and effectively denying Doral and Canales's dispositive motions. The court recognized that Doral had been aware well in advance of the **bankruptcy** petition that its mortgage was unrecorded, and concluded that the attempt to perfect the mortgage had constituted a violation of the automatic stay. As a result, the court ordered Doral to withdraw the mortgage deed and turn it over to the Debtors for cancellation. An untimely appeal by Canales to the **Bankruptcy** Appellate Panel (also "BAP" or "Panel") was swiftly dismissed for want of jurisdiction. See [Fed. R. Bankr. P. 8002\(a\)](#) (establishing time to file); [In re Abdallah](#), 778 F.2d 75, 77 (1st Cir. 1985) (Rule 8002 [*8] time limit is jurisdictional).

Buoyed by their string of successes, the Debtors petitioned the court for damages, which then-[section 362\(h\)](#) authorized following a willful violation of the automatic stay.⁷ The former [11 U.S.C. § 362\(h\)](#) read: "An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." The Debtors explicitly sought both a preliminary conference and a full hearing on damages. The court acceded to the request for a conference, which occurred on June 22, 2007,⁸ but the hearing on damages never happened: on October 8, 2008, the court denied both the hearing and damages, and attorneys' fees to boot, finding that the cancellation of the mortgage was remedy enough. On December 17, 2008, the court entered a final judgment denying damages. The Debtors appealed to the **Bankruptcy** Appellate Panel, which summarily affirmed due to a missing transcript; now they seek our review.

FOOTNOTES

⁷ Damages now fall under [11 U.S.C. § 362\(k\)](#).

8 At the conference, the parties outlined their arguments on the effect and validity of the court's self-reversal, [*9] and the court set a briefing schedule so the parties could lay out their arguments in more detail. The court did not indicate that it would be ruling on the Debtors' damages request; instead, the discussion suggested that the court would sort out the procedural morass that followed its self-reversal.

Jurisdiction

Before reaching the parties' substantive arguments, we must determine whether we have jurisdiction to consider the matter at all. Doral and Canales say we do not, for two reasons. First, they say, the **bankruptcy** court's order on the motion for reconsideration constituted a final judgment, so the Debtors' request for damages and subsequent appeal months later were untimely. And second, they say, even if there were some question as to whether the court's order was a final judgment, the law of the case requires us to hold that it was because the **Bankruptcy** Appellate Panel so held and no one challenged the Panel's determination. Both of these arguments fail. We plainly "have jurisdiction of [timely] appeals from all final decisions, judgments, orders, and decrees" of intermediate **bankruptcy** tribunals. 28 U.S.C. § 158(d)(1). Here, the BAP issued a final decision and judgment in the [*10] form of a summary affirmance. Therefore, we have jurisdiction.

We will, however, address Doral and Canales's jurisdictional arguments as applied to the **bankruptcy** court, because if the **bankruptcy** court had no authority to entertain the Debtors' request for damages then no hearing on damages was necessary and our review can end there.

The first jurisdictional argument, again, goes to timeliness. Specifically, Doral and Canales say that the Debtors' request for damages was functionally equivalent to a motion to alter or amend a judgment under Fed. R. Civ. P. 59(e) because it sought additional relief after the court had already granted summary judgment. As a basis for this argument Doral and Canales say the order granting summary judgment was a "final judgment"; if it was then the motion may be properly characterized as one under Rule 59. And if this is the case then the motion had to be filed within ten days of the original judgment. See Fed. R. Civ. P. 59(e) (amended in 2009 to extend filing period to twenty-eight days). Rule 59's time limit is jurisdictional. *Barrett v. United States*, 965 F.2d 1184, 1187 (1st Cir. 1992). So, Doral and Canales conclude, because the damages request was [*11] not filed within ten days of the summary judgment grant, the **bankruptcy** court had no jurisdiction to entertain it. But if, as the Debtors argue, the motion was something other than one to set aside judgment, then the Rule 59 ten-day window would not apply.

The term "final judgment" is no misnomer — the Supreme Court has held consistently for generations that it applies only to a determination that leaves nothing more for the court to do than to execute judgment. See *Riley v. Kennedy*, 553 U.S. 406, 128 S. Ct. 1970, 1981, 170 L. Ed. 2d 837 (2008) ("A final judgment is 'one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.'") (quoting *Catlin v. United States*, 324 U.S. 229, 233, 65 S. Ct. 631, 89 L. Ed. 911 (1945)). It follows that if the issue of damages was still open when the court resolved the Debtors' motion for partial summary judgment then the court's determination was not final. See *Garzaro v. Univ. of P.R.*, 575 F.2d 335, 337 (1st Cir. 1978) (holding that an order that "leaves open the monetary liability of defendants, is not a 'final' order" and collecting sources). Indeed, the Debtors requested damages in their complaint and the court failed to act on this request — the issue remained [*12] unresolved when the court granted summary judgment. The **bankruptcy** court referred to its conclusion only as an order. No judgment entered after the court's order. And later on, the court itself explicitly held that it had not issued a final judgment. The only thing that might lead us to accept Doral and Canales's contention that the order was a final judgment is a single line in the order: "judgment must enter in favor of the debtors." But this line is not particularly convincing — judgment did not actually enter at all. Given all this, it is abundantly clear that the court did not issue a final judgment before the Debtors filed their motion for damages. There was no motion to alter or amend judgment because there was no final judgment to alter or amend.

Doral and Canales next argue that the law of the case effectively precluded the **bankruptcy** court's exercise of jurisdiction over the motion for damages. This is so, Doral and Canales say, because the BAP dismissed Canales's appeal of the order granting summary judgment on the ground that it lacked jurisdiction due to Canales's untimely filing. According to Doral and Canales, the BAP's dismissal constituted an implicit holding that the [*13] order was a final judgment. However, that is not the case.

"The law of the case doctrine 'posits that when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case.'" *Remexcel Managerial Consultants, Inc. v. Arlequin*, 583 F.3d 45, 53 (1st Cir. 2009) (quoting *Arizona v. California*, 460 U.S. 605, 618, 103 S. Ct. 1382, 75 L. Ed. 2d 318 (1983)). We need not expound on this doctrine in great detail, as it plainly does not apply here. Not only was the **bankruptcy** court's order granting summary judgment not a final judgment, but the BAP did not hold that it was one either. Intermediate **bankruptcy** tribunals have jurisdiction over appeals not only from "final judgments, orders, and decrees," but also from "interlocutory orders and decrees." 28 U.S.C. § 158. Any appeal to an intermediate **bankruptcy** tribunal — whether from a final judgment or an interlocutory order — is subject to the time limit imposed by Rule 8002(a) of the Federal Rules of Bankruptcy Procedure.⁹ Thus, the BAP's generic determination of untimeliness says nothing and implies nothing about whether the unsuccessful appeal was from a final or interlocutory order. For this reason, the law of [*14] the case has no place here.

FOOTNOTES

⁹ Rule 8002(a) imposed a ten-day time limit for appeals until 2009, when the limit was increased to fourteen days.

Doral and Canales propose the last-ditch policy argument that it would be unfair to allow the Debtors an opportunity to appeal when Canales was barred from the same opportunity; this argument is perhaps their least compelling. Let us put it this way: If Doral and Canales were correct that the order granting summary judgment constituted a final judgment, then Canales dug its own appeal's grave by filing fifty-eight days after the court's ruling — not just untimely, but very untimely. But they are not correct on the final judgment issue, which means that when final judgment actually did enter, there was no reason they could not have cross-appealed, fighting summary judgment before the BAP and then before us. See, e.g., *In re Bos. Reg'l Med. Ctr., Inc.*, 291 F.3d 111, 116 n.2 (1st Cir. 2002) (noting that appellees aggrieved by a lower court judgment may cross-appeal); Fed. R. Bankr. P. 8002(a) (establishing time limit for cross-appeals). They have not done so. Doral and Canales have failed to avail themselves of procedures that were readily available [*15] to them; this failure decidedly does not imply that they were unfairly deprived of an opportunity to appeal the order granting summary judgment.

In the end, then, the **bankruptcy** court had jurisdiction over the Debtors' damages motion, and we certainly have jurisdiction over the Debtors' appeal of its denial. We turn now to the merits of the case.

Standard of Review

Before a **bankruptcy** case reaches us, appellants have two options for intermediate review: they may be heard by a district court or a **bankruptcy** appellate panel. *In re Hill*, 562 F.3d 29, 32 (1st Cir. 2009); see also 28 U.S.C. § 158. Whichever option the appellants choose, in conducting our own review we “cede no special deference to the intermediate decision,” focusing instead on the **bankruptcy** court’s decision. *Hill*, 562 F.3d at 32. Our review of the **bankruptcy** court’s decision is de novo, though we will only upset the court’s factual determinations in the case of clear error. *Id.*

Willful Violation

An important premise of the Debtors’ appeal is that the **bankruptcy** court found Doral and Canales to have willfully violated the automatic stay. Without a willful violation, the damages provision of 11 U.S.C. § 362 by its terms would [*16] become irrelevant. Doral and Canales claim that the **bankruptcy** court never found a willful violation. They focus on the absence of the word “willful” anywhere in the court’s analyses. They further argue that there was no willful violation as a matter of fact, precluding partial summary judgment in the Debtors’ favor and therefore precluding damages. We disagree: as the **bankruptcy** court effectively held, there was a willful violation as a matter of undisputed fact. ¹⁰

FOOTNOTES

¹⁰ We also pause to note that, because neither Doral nor Canales cross-appealed, there is no direct challenge before us as to the **bankruptcy** court’s summary judgment grant, including its determination that a willful violation occurred. The willful-violation question remains alive only to the extent that it affects the Debtors’ right to damages. This limitation affects not only our analysis but also the effect of our decision: specifically, the mortgage remains cancelled because no one challenged that result.

A violation is “willful” if a “creditor’s conduct was intentional (as distinguished from inadvertent), and committed with knowledge of the pendency of the **bankruptcy** case.” *In re McMullen*, 386 F.3d 320, 330 (1st Cir. 2004). [*17] Doral and Canales cannot and do not contest that Canales, at Doral’s request, intentionally presented the mortgage deed to the Registry after the Debtors had filed their **bankruptcy** case. Nor is there any dispute that Doral had knowledge of the case while it retained Canales, given that Doral filed a notice of appearance in the underlying **bankruptcy** case months before Canales filed the mortgage deed with the Registry. Doral and Canales each attempt to cast themselves as the guiltless party in the filing of the deed: Doral claims that Canales filed the deed on the basis of Doral’s pre-petition urgings, and Canales claims that it did so without notice from Doral as to the pending **bankruptcy** action. In other words, Doral took no actions once it had knowledge, and Canales did take actions but had no knowledge. Diffusion of responsibility, however, gets them nowhere. See *McMullen*, 386 F.3d at 331 (cataloguing cases of joint willful violations); see also *In re Timbs*, 178 B.R. 989, 995 (Bkrtcy. E.D. Tenn. 1994) (cataloguing cases of joint willful violations by attorney and client). It seems to us that Doral ought to have informed Canales when it learned of the **bankruptcy** petition, and that [*18] Canales — given the notary’s role of giving legal effect to “the will of the parties,” 4 L.P.R.A. § 2002 (emphasis added) — ought to have done more than follow Doral’s word alone. ¹¹ Despite their protestations, Doral and Canales’s acts are not wholly separable from one another, and in the end there is no question that each is responsible for a willful violation as a matter of law. See *McMullen*, 386 F.3d at 331.

FOOTNOTES

¹¹ Indeed, Canales’s argument that it acted not in concert with Doral, but rather in its independent role as a notary — effectively a public officer — is neither carefully advanced nor well-taken. Doral told Canales it wished to foreclose against the Debtors and needed the mortgage deed to be registered properly. By all accounts, Canales asked no questions, did not contact the Debtors, and simply did Doral’s bidding. On the plain-as-day record and the sparse law cited by Canales, the firm acted not independently but rather on Doral’s behalf. Our own research bears out this conclusion. See, e.g., *Chévere v. Cátala*, 115 P.R. Dec. 432, 438, 15 P.R. Offic. Trans. 572 (P.R. 1984) (discussing the notary’s inherent duty to “investigate the facts and data on which the efficacy or validity [*19] of [a] transaction rests”) (emphasis and internal quotation marks omitted).

Doral and Canales argue that the **bankruptcy** court’s determination that “[t]he present case is more like an avoidance action . . . than a common violation of the automatic stay” forecloses a finding of willfulness as a matter of law. They do not, however, explain how this avoidance analogy (which the court used only to support its decision not to award damages) might affect our willfulness analysis. Instead, the analogy seems designed to fit the proverbial round peg (here, a willful violation of the stay) into a square hole (here, an avoidance action), casting this case as something it is not. We have already spelled out what constitutes a willful violation, applied that standard here, and concluded that there was such a violation. In contrast, an avoidance action allows a **bankruptcy** trustee to cancel an improper conveyance or recover for the estate the value of the improperly conveyed property. See 11 U.S.C. §§ 544, 545, 547(b), 548(a), 549(a). Here, the adversary action may indeed have been like an avoidance action in that cancelling an improper conveyance was a portion of the remedy, but it simply was not [*20] one. ¹² Doral and Canales’s analogy to avoidance actions cannot trump the language of the statute that actually applies here and the well-established case law construing that language; as a matter of plainly applicable law, Doral and Canales willfully violated the stay.

FOOTNOTES

¹² The fact of the separate statutory bases for willful violation actions (11 U.S.C. § 362) and avoidance actions (11 U.S.C. § 544) also renders inapposite the **bankruptcy** court’s, and Doral and Canales’s, reliance on *In re Burns*, 322 F.3d 421 (6th Cir. 2003) . *Burns* dealt only with avoidance actions and had nothing whatsoever to say about willful violations.

Hearing on Damages

Now we reach the meat of the appeal: the Debtors' contention that the court erred by denying them a hearing on damages. The parties frame this as an issue implicating the [Fifth Amendment's Due Process Clause](#). But "courts should not decide constitutional issues when this can be avoided," see [United States v. Vilches-Navarrete](#), 523 F.3d 1, 9 n.6 (1st Cir. 2008), and we can address the Debtors' concerns without recourse to the [Fifth Amendment](#).

The opportunity for a plaintiff to present evidence on damages after winning partial summary judgment on liability **[*21]** is a right so fundamental in civil proceedings that it normally goes without saying. See, e.g., [Donahue v. United States](#), 634 F.3d 615, 622 (1st Cir. 2011) (district court "granted partial summary judgment . . . with respect to liability" and then "held a bench trial on the issue of damages"); [In re Rivera Torres](#), 432 F.3d 20, 22 (1st Cir. 2005) ("The **bankruptcy** court entered partial summary judgment in favor of the Debtors, subject to a later hearing on damages."); [Vélez v. Awning Windows, Inc.](#), 375 F.3d 35, 39 (1st Cir. 2004) (district court "granted the plaintiff's motion for partial summary judgment . . . resolv[ing] the issue of liability" and then "convened a damages hearing before a jury"); accord 10B Wright, Miller & Kane, *Federal Practice & Procedure* § 2736 (3d ed. 1998) (noting that "if the court establishes the existence of liability" via partial summary judgment, "the case then will proceed for a determination of the damage issue"). Such an opportunity is necessary here given the **bankruptcy** code's unequivocal mandate of actual damages following a willful violation of an automatic stay. As a reminder, the statute at issue provides: "An individual injured by any willful violation **[*22]** of a stay provided by this section shall recover actual damages, including costs and attorneys' fees." 11 U.S.C. § 362(h) (prior to amendment). There can be no question that, as a general matter, the statute mandates actual damages. And it would be impossible for a court to set the amount of actual damages, costs, and attorneys' fees without taking evidence. Thus, the **bankruptcy** court frustrated both the statute's language and its mandated result by denying the Debtors a chance to prove damages. In order "to enforce [the statute] according to its terms," as both we and the **bankruptcy** court must do, remand is necessary. [Caminetti v. United States](#), 242 U.S. 470, 485, 37 S. Ct. 192, 61 L. Ed. 442 (1917); see also [Mass. Museum of Contemporary Art Found., Inc. v. Buchel](#), 593 F.3d 38, 50 (1st Cir. 2010) (same).

Anticipating our decision's grounding in statutory language, Doral and Canales claim that the court's determination of a willful violation is not enough to trigger a damages inquiry: they say that in order to be statutorily entitled to damages a party must first prove injury, too. See 11 U.S.C. § 362(h) (prior to amendment, establishing right to recovery for "[a]n individual injured by any willful violation," emphasis **[*23]** added). The Debtors claim injury: they have expended court costs and attorneys' fees in order to vindicate the automatic stay, and the statute mandates that they may recover both as actual damages. ¹³ Moreover, in the context of a procedural argument founded on the absence of any opportunity to offer proof of damages, Doral and Canales's contention puts the trailer before the tractor. The Debtors would no doubt welcome an opportunity to prove injury, which is closely intertwined with damages; as it is, they have not had the opportunity to prove anything beyond the willful violation. The Debtors also point out that in each of a plethora of non-binding lower-court cases Doral and Canales cite on this point, the court made its final determination on damages only after reviewing evidence specific to injury and damages. ¹⁴ Thus, contrary to Doral and Canales's contentions, these cases support the Debtors' argument that the statute affords them an opportunity to present evidence. The Debtors have a statutory right to prove damages after a willful violation of the automatic stay, and such a violation is precisely what occurred here.

FOOTNOTES

13 The Debtors have made it plain enough that these are exactly **[*24]** the damages they seek: on appeal, they have waived their right to pursue actual damages other than costs and attorneys' fees except to the extent such damages might be necessary for an award of costs.

14 [In re Heghmann](#), 316 B.R. 395, 399 (1st Cir. B.A.P. 2004) (hearing involving testimony of two witnesses); [In re Dayley](#), 349 B.R. 825, 829 (Bkrcty. D. Idaho 2006) (outlining testimony on damages); [In re Skeen](#), 248 B.R. 312, 319 (Bkrcty. E.D. Tenn. 2000) (hearing involving testimony on, e.g., lost wages); [In re Clayton](#), 235 B.R. 801, 805 (Bkrcty. M.D.N.C. 1998) (full trial on all issues); [In re Sucre](#), 226 B.R. 340, 344 (Bkrcty. S.D.N.Y. 1998) (damages award based in part on review of pay stubs).

The parties spend more energy on the question of whether the **bankruptcy** court already provided adequate opportunity for the Debtors to prove damages. As a starting point, Doral says we cannot review the question at all and must summarily affirm because the Debtors have not produced a transcript of the **bankruptcy** court's conference that was nominally on damages. This might be an issue, except for the undisputed fact that the court never held an evidentiary hearing but, instead, explicitly denied the **[*25]** Debtors' request for one. Cf. [Rodríguez v. Señor Frog's de la Isla, Inc., No. 09-2548](#), 2011 U.S. App. LEXIS 7427, 2011 WL 1364934, at *7 (1st Cir. Apr. 12, 2011) (argument could not succeed absent transcript because there was not "enough raw material so that we [could] do our job"). Moreover, the transcript is readily available through the **bankruptcy** court docket: it shows that the court discussed damages barely if at all and took no evidence. Instead, at the June 22, 2007 status conference, the parties laid out a skeletal version of their legal arguments, and the court ordered further briefing. Between the **bankruptcy** court's rejection of a damages hearing and the easily obtained transcript's showing that the status conference did not allow for the presentation of evidence, there is more than enough for us to conclude, as we do, that the court improperly denied the Debtors an opportunity to prove damages.

Wrapping up, we note that the **bankruptcy** court's decision itself shows why such an opportunity is necessary. The record reveals no clear foundation for the **bankruptcy** court's conclusion that damages were unwarranted. The court only suggested that the adversary proceeding was "like an avoidance action," but did **[*26]** not otherwise support its conclusion that cancellation of the mortgage was a sufficient remedy for the willful violation. And the court gave no explanation for disregarding the statute's language mandating the recovery of costs and attorneys' fees. The court's conclusion is rooted in neither record nor statute, and an analogy unsupported by any evidence is not enough to justify its decision to disregard the statute's mandatory language and deny damages.

Conclusion

For the reasons set forth above, we **reverse** the **bankruptcy** court's denial of a hearing on damages, **vacate** its rejection of damages, and **remand** for the parties to present evidence on damages. Costs are taxed in favor of the appellants.

May 19, 2011, Decided
May 19, 2011, Filed

CASE SUMMARY

PROCEDURAL POSTURE: A Chapter 7 trustee objected to a debtor's claim of an exemption for an annuity.


OVERVIEW: The debtor asserted that her annuity was exempt for its full value under [Mass. Gen. Laws ch. 175, § 119A](#), but the trustee challenged the applicability of that statute. The court determined that the annuity read in its entirety prohibited the assignment of the debtor's ownership interest and did not run afoul of the anti-alienation requirement of [Mass. Gen. Laws ch. 175, § 119A](#). Although it appeared that the annuity qualified as an individual retirement annuity under [I.R.C. § 408\(b\)](#), it did not follow automatically that it was entitled to the protection of the state statute. The court concluded that the annuity did not qualify for protection under [Mass. Gen. Laws ch. 175, § 119A](#) because there was nothing in the annuity that expressly prohibited the commutation or anticipation of the proceeds.


OUTCOME: The court sustained the trustee's objection to the exemption of the annuity pursuant to [Mass. Gen. Laws ch. 175, § 119A](#).


CORE TERMS: annuity, exemption, endorsement, individual retirement, annuity contract, objecting party, beneficiary, exempt, tax law, maturity date, applicable federal, retirement, annuitant, qualify, assign, retirement accounts, anticipation, dictionary, attachment, rollover, amend, retirement plan, supplemental agreement, burden of production, burden of persuasion, produce evidence, evidentiary hearing, anti-alienation, presumptively, post-hearing

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[Bankruptcy Law](#) > [Exemptions](#) > [State Law](#) > [Specific Exemptions](#) 

[Contracts Law](#) > [Types of Contracts](#) > [General Overview](#) 


[Estate, Gift & Trust Law](#) > [Annuities](#) > [General Overview](#) 

HN1  See [Mass. Gen. Laws ch. 175, § 119A](#).


[Bankruptcy Law](#) > [Exemptions](#) > [Claims & Objections](#) 


[Evidence](#) > [Procedural Considerations](#) > [Burdens of Proof](#) > [Allocation](#) 

[Evidence](#) > [Procedural Considerations](#) > [Burdens of Proof](#) > [Preponderance of Evidence](#) 


HN2  A trustee, as an objecting party, has the burden of proof, [Fed. R. Bankr. P. 4003\(c\)](#), and must establish by a preponderance of the evidence that a claimed exemption is improper. [More Like This Headnote](#)

[Bankruptcy Law](#) > [Exemptions](#) > [Claims & Objections](#) 


[Evidence](#) > [Procedural Considerations](#) > [Burdens of Proof](#) > [Burden Shifting](#) 

HN3  A claimed exemption is presumptively valid. Once an exemption has been claimed, it is the objecting party's burden to prove that the exemption is not properly claimed. Initially, this means that the objecting party has the burden of production and the burden of persuasion. The objecting party must produce evidence to rebut the presumptively valid exemption. If the objecting party can produce evidence to rebut the exemption, the burden of production then shifts to the debtor to come forward with unequivocal evidence to demonstrate that the exemption is proper. The burden of persuasion, however, always remains with the objecting party. [More Like This Headnote](#)

[Bankruptcy Law](#) > [Exemptions](#) > [State Law](#) > [Specific Exemptions](#) 

[Estate, Gift & Trust Law](#) > [Annuities](#) > [General Overview](#) 

[Tax Law](#) > [Federal Income Tax Computation](#) > [Retirement Plans](#) > [General Overview](#) 

HN4  Just because an annuity may be characterized as an individual retirement annuity under [I.R.C. § 408\(b\)](#), it does not follow automatically that it is entitled to the protection of [Mass. Gen. Laws ch. 175 § 119A](#). [More Like This Headnote](#)

[Bankruptcy Law](#) > [Exemptions](#) > [State Law](#) > [Specific Exemptions](#) 



HN5 **Mass. Gen. Laws ch. 175 § 119A** is narrowly focused and protects a beneficiary's interest from his or her creditors only where the terms of the policy expressly prohibit the beneficiary from commuting, anticipating, encumbering, alienating or assigning that interest in the policy. In other words, if any one of the enumerated characteristics is not expressly contained in an annuity, it would not be exempt under **§ 119A**. [More Like This Headnote](#)

COUNSEL: **[*1]** For Betty LeClair, Debtor: Ward W Weizel, Shrewsbury, MA.

For Richard P LeClair, Joint Debtor: Ward W Weizel, Shrewsbury, MA.

For David M. Nickless, Nickless, Phillips and O'Connor, Trustee: David M Nickless, Nickless & Phillips, PC, Fitchburg, MA.

JUDGES: Melvin S. Hoffman , U.S. **Bankruptcy** Judge.

OPINION BY: Melvin S. Hoffman

OPINION

MEMORANDUM OF DECISION ON CHAPTER 7 TRUSTEE'S OBJECTION TO EXEMPTIONS

The Chapter 7 trustee has objected to the debtors' claimed exemptions in a vehicle and to Ms. LeClair's claimed exemption in certain retirement assets. The debtors oppose. After a nonevidentiary hearing on the objection, the parties submitted memoranda of law. The trustee challenged the debtors' claimed exemptions in a 2004 Dodge Durango because they failed to provide documentation to establish that the automobile was jointly owned. The trustee asserted that only one of the debtors could properly claim an exemption in the vehicle. The debtors failed to respond to this objection and thus have waived any opposition to it. Furthermore, although Ms. LeClair claimed an exemption in what she described on the debtors' schedule of exemptions (Schedule C of the debtors' schedules of assets and liabilities attached to their **bankruptcy [*2]** petition) as two separate types of retirement assets, namely individual retirement accounts ("IRAs") and an annuity, at the hearing on the trustee's objection he asserted that Ms. LeClair owns only a single annuity. The debtors did not dispute or contradict the trustee's contention. Consequently what remains before me is a dispute over the exemption of Ms. LeClair's annuity.

Background

On July 15, 2008 the debtor Betty LeClair, then age 66, purchased from the John Hancock Life Insurance Company (U.S.A.) for herself as the owner and annuitant what is described in the policy as a "flexible payment deferred combination fixed and variable annuity contract."¹ She made an initial payment of \$86,000 into the annuity. There have been no other premiums paid. The Specifications Page of the annuity contract (appearing at page 5 of the contract) appears to contain a summary of its principal features. It describes the annuity as an "individual retirement annuity" with a maturity date of May 5, 2032.

FOOTNOTES

1 Each party submitted a copy of what each refers to as the annuity contract. They agree that the annuity contract consists of a contract, two endorsements and a rider. The only difference between the two **[*3]** submissions is that the document provided by the trustee contains additional pages not included in the debtor's submission. Specifically, the trustee's copy includes the Specifications Page and the Initial Allocation of Net Purchase Price.

Ms. LeClair listed among her assets on Schedule B of the schedule of assets and liabilities, the John Hancock annuity valued at \$70,460, and three IRAs, all described as "RBC IRA's," along with the account number for each, valued at \$16,217, \$24,676, and \$0, respectively. On Schedule C, the list of exempt assets, the debtors elected the state exemptions and Ms. LeClair claimed an exemption of \$19,950 in what that schedule describes as "IRA John Hancock" pursuant to **Mass. Gen. Laws ch. 168 §§ 41 and 44, ch. 170 § 35, ch. 171 § 84 and ch. 246 § 28**. She also claimed an exemption of "\$0" in what Schedule C describes as an "Annuity" of unknown value. As indicated previously, the trustee objected to both the "IRA John Hancock" and "Annuity" exemptions but at the hearing on the objection he clarified his position because he had determined that there were no IRAs. Although not filing a formal written amendment to Schedule C, Ms. LeClair conceded that there **[*4]** are no IRAs to exempt but pressed her claim of exemption in the John Hancock annuity. She also now claims an entirely different statutory basis for exempting the annuity, **Mass. Gen. Laws ch 175 § 119A**,² which she asserts entitles her to exempt its full value.

FOOTNOTES

2 Rule 1009(a) of the Federal Rules of **Bankruptcy Procedure** permits a debtor to amend a "voluntary petition, list, schedule, or statement" at any time as a matter of course and give notice of such amendment "to the trustee and any other entity affected thereby." **Rule 1009-1** of the Massachusetts Local **Bankruptcy** Rules requires a debtor seeking to amend the schedule of exemptions after the time to object to exemptions has expired to do so by motion to which the amended schedule must be attached. Although the debtors have not filed a motion to amend, I have chosen to treat the debtors' post-hearing memorandum, which reiterates the new basis and value for Ms. LeClair's exemption of the annuity proffered at oral argument, as such a motion to which the trustee's objection will apply.

Discussion

Ms. LeClair seeks to fully exempt the value of her annuity based on **Mass. Gen Laws ch. 175 § 119A** which provides:

HN1 If, under the terms of *any annuity [*5] contract* or policy of life insurance, or under any written agreement supplemental thereto, issued by any life company, the proceeds are retained by such company at maturity or otherwise, no person entitled to any part of such proceeds, or any instalment [sic] of interest due or to become due thereon, shall be permitted to *commute, anticipate, encumber, alienate or assign the same, or any part thereof, if such permission is expressly withheld by the terms of such contract, policy or supplemental agreement*; and if such contract, policy or supplemental agreement so provides, no payments of interest or of principal shall be in any way subject to such person's debts, contracts or engagements, nor to any

judicial processes to levy upon or attach the same for payment thereof. No such company shall be required to segregate such funds but may hold them as a part of its general corporate funds. (Emphasis added).

^{HN2} The trustee, as the objecting party, has the burden of proof, *Fed. R. Bankr. P. 4003(c)*, and must establish by a preponderance of the evidence that the claimed exemption is improper. *In re Gonsalves*, 2010 Bankr. LEXIS 4683, 2010 WL 5342084, *6 (Bankr. D. Mass. 2010). The Ninth Circuit Court of Appeals succinctly **[*6]** delineated the burden shifting framework of *Rule 4003(c)*.

^{HN3} A claimed exemption is presumptively valid.... Once an exemption has been claimed, it is the objecting party's burden ... to prove that the exemption is not properly claimed. Initially, this means that the objecting party has the burden of production and the burden of persuasion. The objecting party must produce evidence to rebut the presumptively valid exemption. If the objecting party can produce evidence to rebut the exemption, the burden of production then shifts to the debtor to come forward with unequivocal evidence to demonstrate that the exemption is proper. The burden of persuasion, however, always remains with the objecting party. *Carter v. Anderson (In re Carter)*, 182 F.3d 1027, 1029 n. 3 (9th Cir.1999) (internal quotation marks and citations removed).

The trustee challenges the applicability of *Mass. Gen Laws ch. 175 § 119A* and in support of his objection relies upon what he identifies as conflicting language in the annuity contract with regard to Ms. LeClair's ability to assign the contract or change its owner or beneficiary at any time before the maturity date. He compares two of the General Provisions with the Individual **[*7]** Retirement Annuity Endorsement. The General Provisions, found in part 2 of the contract, include the following:

Assignment: You may assign this Contract at any time prior to the Maturity Date...

Claims of Creditors: To the extent permitted by law, no benefits payable under this Contract will be subject to your, the Beneficiary's, or the Annuitant's creditors.

The Individual Retirement Annuity Endorsement, which the parties agree is part of the annuity, expressly states that the contract is amended as set forth in the endorsement "to qualify as an Individual Retirement Annuity ... under *Section 408(b) of the Internal Revenue Code*". The Individual Retirement Annuity Endorsement further provides in pertinent part:

The Owner must be one natural person who is the sole Owner and Annuitant. ... Except as otherwise permitted under Section 7 of this Endorsement, and otherwise permitted under applicable federal tax law, neither the Owner nor the Annuitant may be changed....

The Contract is established for the exclusive benefit of the Owner or his or her beneficiaries. The Owner's interest under the Contract is nontransferable, and except as provided by applicable federal tax law, is nonforfeitable. **[*8]** If the Contract contains a part titled LOAN PROVISIONS, this part of the Contract is deleted.³

FOOTNOTES

³ There is no evidence demonstrating that the annuity contract had any section entitled "Loan Provisions" and thus there is no basis to find that paragraph 2 has been deleted.

While the trustee is correct that the assignment language in the General Provisions of the contract is inconsistent with the language of the Individual Retirement Annuity Endorsement, he overlooks the Endorsement's express direction that "[w]here the provisions of this Endorsement are inconsistent with the provisions of the Contract, including the provisions of other endorsements or riders issued with the Contract, the provisions of this Endorsement will control." Thus the annuity read in its entirety prohibits the assignment of Ms. LeClair's ownership interest and does not run afoul of the anti-alienation requirement of *Mass. Gen. Laws ch. 175 § 119A*.

The trustee also argues that the Endorsement must be ignored because, although it states it is amending the contract "to qualify as an Individual Retirement Annuity ... under *Section 408(b) of the Internal Revenue Code*," 26 U.S.C. § 408(b), the facts surrounding the establishment **[*9]** of the contract are inconsistent with § 408(b) of the Internal Revenue Code. First, he asserts that Ms. LeClair exceeded the annual contribution limit of \$6,000 under 26 U.S.C. § 219(b)(5). The trustee is correct that Ms. LeClair's one-time contribution of \$86,000 exceeds the relevant individual retirement account contribution limits. But the trustee overlooks the introductory language of paragraph 3 of the Endorsement which states: A premium or Payment permitted under the Contract may not include any amounts other than a rollover contribution (as permitted by *IRC Sections 402(c), 402(e)(6), 403(a)(4), 403(b)(8), 403(b)(10), 408(d)(3) and 457(e)(16)*), a nontaxable transfer from an individual retirement plan under *IRC Section 7701(a)(37)*, a contribution made in accordance with the terms of a Simplified Employee Pension as described in *IRC Section 408(k)*, and a contribution in cash not to exceed the amount permitted under *IRC Sections 219(b) and 408(b)* (or such other amount provided by applicable tax law.) The trustee has adduced no evidence that the \$86,000 payment was a cash contribution subject to the \$6,000 limitation as opposed to a rollover from some other retirement vehicle.

Second, **[*10]** the trustee notes that the Internal Revenue Code requires that distributions from an individual retirement annuity begin by the time the account owner has reached age 70½. The trustee argues the John Hancock annuity provides for payments beginning only on the maturity date of May 5, 2032, when Ms. LeClair will be approaching 90 years of age. But paragraph 4 of the Individual Retirement Account Endorsement which, as has been observed, supersedes any conflicting contract terms provides that: Notwithstanding any provision of the Contract to the contrary, the distribution of the Owner's interest in the Contract shall be made in accordance with the requirements of *IRC Sections 401(a)(9) and 408(b)(3)* and the regulations thereunder, the provisions of which are incorporated herein by reference.

Paragraphs 5 and 6 of the Endorsement underscore that payments from the annuity will begin in accordance with the tax laws applicable to IRAs by providing:

5. As used in this Endorsement, the term "required beginning date" means April 1 of the calendar year following the calendar year in which the Owner attains age 70½, or such later date provided by applicable federal tax law.

6. (a) Unless otherwise **[*11]** permitted under applicable federal tax law, the Owner's entire interest will commence to be distributed no later than the required beginning date...

It thus appears that Ms. LeClair's annuity qualifies as an individual retirement annuity under § 408(b) of the Internal Revenue Code. But ^{HN4} just because the annuity may be characterized as an individual retirement annuity, it does not follow automatically that it is entitled to the protection of *Mass. Gen. Laws ch. 175 § 119A*.

Although there is scant law interpreting § 119A, as Judge Boroff noted, ^{HN5} "[t]he section is narrowly focused and protects a beneficiary's interest from his or her creditors only where the terms of the policy expressly prohibit the beneficiary from "commut[ing], anticipat[ing], encumber[ing], alienat[ing] or assign[ing]" that interest in the policy. *In re Sloss*, 279 B.R. 6, 13 (Bankr. D. Mass. 2002) (emphasis in the original). In other words, if any one of the enumerated characteristics is not expressly contained in the annuity, it would not be exempt under § 119A. It has been noted previously that Ms.

LeClair's annuity contains an anti-alienation provision thus satisfying one of the requisites of § 119A. It does not, however, [*12] expressly satisfy them all.

According to Webster's Dictionary, "commute" is "to change one thing for another; often to change stream of payments into one lump sum." Webster's Third World Dictionary (3d Ed. 2008). See also *Trucken v. Metropolitan Life Ins. Co.*, 303 Mass. 501, 506 22 N.E.2d 120, 123 (1939). The dictionary defines "anticipation" as "to cause to occur prematurely" or "to realize or actualize before an expected or plausible time" *Id.* There is nothing in the annuity which prohibits the commutation or anticipation of the proceeds. The closest any provision in the annuity comes to such a prohibition is in paragraph 4 of the Individual Retirement Endorsement which provides:

Notwithstanding anything in the Contract to the contrary, the distribution of the Owner's interest in the Contract shall be made in accordance with the requirements of IRC Sections 401(a)(9) and 408(b)(3) and the regulations thereunder, the provisions of which are herein incorporated by reference. But [*13] the Internal Revenue Code does not prohibit the commutation or anticipation of funds held in an individual retirement annuity. The statute merely discourages it by imposing a 10 percent penalty for early withdrawals.⁴ Thus the annuity at issue does not qualify for protection under Mass. Gen. Laws ch. 175 § 119A.

FOOTNOTES

⁴ The amount withdrawn is taxed as ordinary income but in addition, with certain limited exceptions, § 72(t) of the Internal Revenue Code imposes a penalty equal to 10% of the amount withdrawn when an early distribution is taken from a "qualified retirement vehicle," which includes individual retirement annuities under § 408(b) of the Internal Revenue Code such as Ms. LeClair's.

The trustee suggests that Ms. LeClair's annuity would appropriately be subject to exemption under the provisions of Mass. Gen. Laws ch. 235 § 34A. This statute, entitled Exemptions of Annuities, Pensions from Attachment or Execution; Exceptions," is most frequently relied on by debtors claiming state exemptions in retirement plans in Massachusetts. The trustee argues, however, that the last sentence of Mass. Gen. Laws ch. 235 § 34A would exclude from exemption so much of Ms. LeClair's \$86,000 initial annuity [*14] contribution as exceeds seven percent of her applicable income for the five years preceding her **bankruptcy**. This exclusion itself is qualified by a further exclusion limiting its application when the payment was from a qualified rollover transaction. Clearly, an evidentiary hearing is needed before a determination can be made as to the appropriate application of Mass. Gen. Laws ch. 235 § 34A to Ms. LeClair's annuity.⁵

FOOTNOTES

⁵ Although the debtor's post-hearing brief contains an attachment entitled "Exhibit '2' Debtors [sic] Income From Federal Tax Returns (Line 22)," the attachment is not verified and more importantly, suggests that it is a summary of their joint income. Mass. Gen. Laws ch. 235 § 34A requires an examination of the *individual's* income during the applicable five year period.⁵

Conclusion

The trustee's objection to the exemption of both Mr. and Ms. LeClair in the Dodge Durango is sustained. The debtors will be permitted a single exemption in the amount of \$700 in the vehicle. The trustee's objection to the exemption of Ms. LeClair's annuity pursuant to Mass. Gen. Laws ch. 175 § 119A is sustained. The trustee's objection to the exemption of the annuity pursuant to Mass. Gen. Laws ch. 235 § 34A [*15] will be set for an evidentiary hearing.

A separate order will enter.

Dated: May 19, 2011

By the Court,

/s/ Melvin S. Hoffman ▼

Melvin S. Hoffman ▼

U.S. Bankruptcy Judge

In re: Charles Kenneth McLaughlin and Charletta Lee McLaughlin, Debtors, Charles McLaughlin Family Limited Liability Partnership, Debtor, Shamrock Builder, LLC, Debtor

Bk. No. 09-11671-JMD to Bk. No. 09-11673-JMD Jointly Administered, Chapter 11

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF NEW HAMPSHIRE

2011 BNH 5; 2011 Bankr. LEXIS 1656

May 4, 2011, Decided

NOTICE: This is an unreported opinion. Refer to AO 1050-1 regarding citation.

CASE SUMMARY

PROCEDURAL POSTURE: Following the court's entry of an order authorizing the sale of the real property of Chapter 11 debtors, the court directed the debtors to place most of the proceeds in escrow until a dispute between a supplier and a bank was resolved.

OVERVIEW: The supplier contended that it had a valid perfected first priority mechanic's lien on the property as a result of having supplied materials to the debtors for construction on the property. The priority of the supplier's lien over that of the bank rested on when the court determined the materials were furnished pursuant to RSA 447:2. Because a builder's need for materials was not satisfied until those materials arrived at the construction site, the supplier first furnished materials under the statute when it actually delivered them to the property, which was seven days after the bank's attachment, not when the materials were ordered. Because the supplier's mechanic's lien arose after the bank's attachment, its claim was junior to the bank as a matter of law. The amount of the bank's lien exceeded the sale price of the property. Thus, the bank was entitled to all of the dispute proceeds.


OUTCOME: The court would release the disputed proceeds to the bank.

CORE TERMS: mechanic's lien, attachment, perfected, validly, recorded, deed, invoice, perfection, real estate, burden of proof, conveyance, completion, supplied, registry, attach, senior, notice, transferred, state law, operation of law, general rules, furnishes materials, actual notice, furnishing, unrecorded, Mechanic's, supplier, perfect, furnish, entity


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 Hide


Bankruptcy Law > Case Administration > Administrative Powers > Estate Property Lease, Sale & Use > General Overview 

HN1  An entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest. 11 U.S.C.S. § 363(p)(2). [More Like This Headnote](#)


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

HN2  Where Congress is silent on the burden of proof in civil litigation, the preponderance of the evidence standard is applicable. [More Like This Headnote](#)


Bankruptcy Law > Claims > General Overview 

HN3  Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law. [More Like This Headnote](#)

Real Property Law > Nonmortgage Liens > Mechanics' Liens 


HN4  Mechanic's liens are governed by state law. [More Like This Headnote](#)


Real Property Law > Nonmortgage Liens > Mechanics' Liens 

HN5  In New Hampshire, any person who performs labor or furnishes materials to the amount of \$15 or more for erecting a house, by virtue of a contract with the owner, shall have a lien on any material furnished and on said structure. RSA 447:2. The mechanic's lien arises by operation of law when the labor or materials are furnished. [More Like This Headnote](#)


Real Property Law > Nonmortgage Liens > General Overview 

HN6  A lien is a creation of statute, and attaches to the building and the interest of the owner in it by force of statute. [More Like This Headnote](#)


Real Property Law > Nonmortgage Liens > Mechanics' Liens 

HN7  The essential requisites of a lien are furnishing the lumber or materials for the building or appurtenances under a contract with the owner. The contract does not need to be in writing and may be implied from the furnishing of materials which were used in the construction of the building.

Once a lien is created, it will expire unless it is perfected in a timely manner after completion of the contract. [More Like This Headnote](#)

[Real Property Law](#) > [Nonmortgage Liens](#) > [Mechanics' Liens](#) 

HN8 To perfect a mechanic's lien, a party must acquire an attachment after the contract is completed on the specific property to which it supplied materials. Upon completion of the contract from which the mechanic's lien arose, a single indivisible lien for the whole is created. The mechanic's lien continues for 120 days after completion of delivery of goods or performance of services under the contract. The lien must be perfected before it expires. [RSA 447:9](#). The time starts to run not from the date the mechanic's lien accrues but from when the final bill is sent or the last work is completed under the contract. [More Like This Headnote](#)

[Real Property Law](#) > [Nonmortgage Liens](#) > [Lien Priorities](#) 

[Real Property Law](#) > [Nonmortgage Liens](#) > [Mechanics' Liens](#) 


HN9 In order to continue or secure a mechanic's lien, the lien holder must attach the property by writ and return thereon distinctly expressing that purpose, within the 120 day period. [RSA 447:10](#). After the mechanic's lien is validly perfected, it has priority over any interests that were created after the mechanic's lien first arose. [More Like This Headnote](#)

[Real Property Law](#) > [Priorities & Recording](#) > [Recording Acts](#) 


HN10 New Hampshire is a race-notice jurisdiction regarding priority of interests in real property. [More Like This Headnote](#)


[Real Property Law](#) > [Priorities & Recording](#) > [Recording Acts](#) 

HN11 Every deed, conveyance of real estate, or court order that affects title to any interest in real estate shall be recorded in the registry of deeds for the county in which the real estate lies. [RSA 477:3-a](#). A purchaser or creditor has the senior claim if he or she records without notice of a prior unrecorded interest. All creditors are held to be on constructive notice of any properly recorded interest. In addition, creditors cannot have a senior claim where they have actual notice of an unrecorded interest. A party is deemed to have actual notice if an investigation would show the existence of an interest in property. [More Like This Headnote](#)


[Real Property Law](#) > [Nonmortgage Liens](#) > [Lien Priorities](#) 

HN12 The legislature may create an exception to the perfection and priority laws regarding specific types of liens. Where the legislature is silent as to priority, the general rules apply. [More Like This Headnote](#)


[Real Property Law](#) > [Nonmortgage Liens](#) > [Lien Priorities](#) 

[Real Property Law](#) > [Nonmortgage Liens](#) > [Mechanics' Liens](#) 

HN13 Priority amongst several mechanic's liens on the same property is addressed in [RSA 447:11](#) and [447:12](#). Mechanic's liens also have priority over all construction mortgages, regardless of timing. [RSA 447:12-a](#). Furthermore, mechanic's liens are different from judicial liens in that they arise by operation of law and the attachment merely continues or secures the lien. [RSA 447:10](#). Yet, nothing in the mechanic's lien statute exempts mechanic's lien holders from the general rule of first in time first in right against a prior recorded judicial lien. As a consequence, a supplier who provides materials to a property with a properly recorded lien on it is on notice of a senior interest and may be subject to that lien. [More Like This Headnote](#)

[Real Property Law](#) > [Nonmortgage Liens](#) > [Mechanics' Liens](#) 


HN14 Under [RSA 447:2](#), a mechanic's lien arises when a supplier furnishes materials for the construction of a building. [More Like This Headnote](#)

[Governments](#) > [Legislation](#) > [Interpretation](#) 

HN15 The language of a statute must be examined under its plain and ordinary meaning. [More Like This Headnote](#)

[Real Property Law](#) > [Nonmortgage Liens](#) > [Mechanics' Liens](#) 

HN16 A builder's need for materials is not satisfied until those materials arrive at the construction site. [More Like This Headnote](#)


COUNSEL: [***1**] For Charles Kenneth McLaughlin, fdba, McLaughlin Real Estate, LLC - Successor in interest to., Charles McLaughlin Family Limited Liability Partnership, Shamrock Builders, LLC (09-11671-JMD), Debtors: [Peter V. Doyle](#) , Shaines & McEachern, Portsmouth, NH.

For Charletta Lee McLaughlin, Joint Debtor: [Peter V. Doyle](#) , Shaines & McEachern, Portsmouth, NH.

For Office of the U.S. Trustee, U.S. Trustee: UST, [Geraldine Karonis](#) , Office of U.S. Trustee, Manchester, NH.

For Charles McLaughlin Family Limited Liability Partnership (09-11673-JMD), Debtor: Peter V. Doyle , Shaines & McEachern, Portsmouth, NH.

For Office of the U.S. Trustee, U.S. Trustee: UST, Geraldine Karonis , Office of U.S. Trustee, Manchester, NH.


JUDGES: J. Michael Deasy , Bankruptcy Judge.

OPINION BY: J. Michael Deasy 

OPINION

MEMORANDUM OPINION

I. INTRODUCTION

On November 23, 2010, the Court authorized the sale of Charles McLaughlin's and Charletta McLaughlin's (the "Debtors") property located at 389 Witchtrot Road, Wakefield, NH (the "Property") for \$60,000.00 (Doc. No. 320) (the "Order"). The sale was approved over the objection of [Middleton Building Supply, Inc.](#)  ("Middleton") (Doc. No. 310) (the "Objection"). In its Objection, Middleton claimed it has a validly perfected **[*2]** first priority mechanic's lien on the Property and is entitled to \$15,229.16 in proceeds from the sale (the "Disputed Proceeds"). People's United Bank f/k/a Ocean Bank (the "Bank") responded to the Objection (Doc. No. 311) (the "Response") disputing Middleton's claim to priority over the Bank with respect to any portion of the Disputed Proceeds.

Prior to the **bankruptcy**, the Bank obtained a \$500,000.00 attachment on the Debtors' and their related entities' real property located in Carroll County. As a result, the Bank states that it is entitled to all of the proceeds of the sale, including the Disputed Proceeds.¹ Because the parties were only questioning the rights to the Disputed Proceeds and not the merits of the sale itself, the Court entered the Order authorizing the sale and directed the Debtors to place the Disputed Proceeds in escrow until resolution of the dispute between Middleton and the Bank.

FOOTNOTES

1 The Bank agreed to disburse 20% of the proceeds to the Debtors. The Disputed Proceeds are part of the remaining 80%.

The Court directed the parties to file a joint motion and a proposed procedural order regarding the resolution of the rights to the Disputed Proceeds (Doc. No. 318). The **[*3]** Court scheduled a two-hour evidentiary hearing on February 17, 2011 (Doc. No. 329), which was continued to March 10, 2011 (Doc. No. 357). At the hearing, the parties made oral arguments and stipulated to Middleton's submission of seven exhibits as evidence. The questions before the Court are: 1) did Middleton establish a mechanic's lien on the Property; 2) did Middleton validly perfect a mechanic's lien on the Property; 3) does any validly perfected mechanic's lien have priority over the Bank's lien; and 4) was Middleton prevented from perfecting a mechanic's lien by the automatic stay.

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

On April 10, 2009, the Bank obtained a \$500,000.00 writ of attachment from Carroll County Superior Court which was perfected as to real estate the same day. See Doc. No. 34 Ex. A. The attachment covered all bank accounts and real property in Carroll County **[*4]** owned by the Debtors, Muffy, Wakefield, LLC, Balch Lake Dockominiums Association, McLaughlin Family Revocable Trust, Charles K. McLaughlin and Charletta L. McLaughlin, Trustees. In the Bank's petition for attachment, the Bank claimed that the Debtors fraudulently transferred the property to Muffy.² The Bank alleges that Muffy voluntarily transferred the Property back to the Debtors on June 15, 2009, due to the fraudulent conveyance.³ On July 7, 2009, the Debtors filed a motion to avoid the Bank's attachment (Doc. No. 34) as a preference. The Court denied the Debtors' motion in an order and memorandum opinion dated September 3, 2009 (Doc. Nos. 64 & 66).

FOOTNOTES

2 Middleton submitted exhibit 7, which is a copy of a warranty deed that transferred the Property from the Debtors to Muffy on March 24, 2009.

3 The **[*5]** record is void of any evidence that proves the transfer of the Property from Muffy back to the Debtors. However, Middleton does not disagree with the Bank's allegation and the question of the conveyance is not material to a resolution of the dispute between Middleton and the Bank.

Accordingly, for the purposes of this opinion, the Court shall assume that the Property was conveyed to the Debtors.

Middleton claims to hold a valid perfected mechanic's lien on the Property as a result of having supplied the Debtors materials for construction on the Property in April of 2009. Middleton submitted sixteen invoices in exhibit 1 as evidence of the value and dates it supplied materials. One of the sixteen invoices reflects an order on April 8, 2009, two days before the perfection of the Bank's attachment. The fifteen remaining invoices were for orders placed after April 10, 2009. The invoices reveal that materials were delivered between April 17, 2009 and May 6, 2009. The last invoice was dated April 30, 2009.

On May 15, 2009, Middleton allegedly perfected its mechanic's lien on the Property by obtaining a writ of attachment from the Carroll County Superior Court and recording it in the Carroll **[*6]** County Registry of Deeds. Middleton submitted exhibits 3-6 as evidence of the valid perfection of its mechanic's lien. Exhibit 4 includes the ex parte petition for attachment, the writ of summons, and the sheriff's return of service. The petition for attachment requests attachment of property at "2074 Witchtrot Road, Wakefield, NH for purposes of a mechanic's lien, as recorded at the Carroll County Registry of Deeds in Book 2772, page 0905." The Property is located on Witchtrot Road in Wakefield, New Hampshire, but not at 2074 Witchtrot Road. However, the book and page reference in the petition to attach correctly identifies the deed for the Property. The sheriff's return of service states that she attached all of the property of Muffy in Carroll County and more specifically the property at "Witchtrot Road in Wakefield, New Hampshire as described in Book 2772, Page 0905."

Middleton insists it has a validly perfected mechanic's lien on the Property. Middleton also claims its mechanic's lien has priority over the Bank's lien and thus Middleton is entitled to the Disputed Proceeds. The Court took the matter under advisement.

III. DISCUSSION

The current dispute involves competing interests [*7] over a portion of the proceeds from the sale of the Property by the Debtors. ^{HN1} An "entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest." 11 U.S.C. § 363(p)(2).

^{HN2} Where Congress is silent on the burden of proof in civil litigation, the preponderance of the evidence standard is applicable. *Grogan v. Garner*, 498 U.S. 279, 286, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991). Also, ^{HN3} "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law." *Butner v. U.S.*, 440 U.S. 48, 54, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979). The Bank's lien was previously scrutinized by the Court in a dispute with the Debtors (see Doc. No. 64) and the perfection of the lien has not been challenged by Middleton. The issue before the Court is whether, under New Hampshire law, Middleton's mechanic's lien was properly created and perfected and if so, does the mechanic's lien have priority over the Bank's lien. The burden of proof is on Middleton to prove its right to the Disputed Proceeds. The value of the Bank's lien exceeds the total proceeds from the sale of the Property. Accordingly, Middleton's mechanic's lien must have priority over the Bank's lien if Middleton [*8] is to recover any of the Disputed Proceeds.

^{HN4} Mechanic's liens are governed by state law. ^{HN5} In New Hampshire, any person who performs labor or furnishes materials to the amount of \$15 or more for erecting a house, by virtue of a contract with the owner, shall have a lien on any material furnished and on said structure. NH RSA 447:2. The mechanic's lien arises by operation of law when the labor or materials are furnished. *Couillard v. O'Connor*, 97 N.H. 89, 91, 81 A.2d 205 (1951); *Pike v. Rackley*, 60 N.H. 469 (1881) (^{HN6} "The lien is a creation of statute, and attaches to the building and the interest of the owner in it by force of statute"); see also *Whitefield Vill. Fire Dist. v. Bobst*, 93 N.H. 229, 231, 39 A.2d 566 (1944). ^{HN7} "The essential requisites of the lien are furnishing the lumber or materials for the building or appurtenances under a contract with the owner . . ." *Pike*, 60 N.H. at 469. The contract does not need to be in writing and may be implied from the furnishing of materials which were used in the construction of the building. *Diamond Match Co. v. Hobbs' Trust*, 98 N.H. 97, 95 A.2d 142 (1953). Once a lien is created, it will expire unless it is perfected in a timely manner after completion of the contract.

^{HN8} To perfect a [*9] mechanic's lien, a party must acquire an attachment after the contract is completed on the specific property to which it supplied materials. Upon completion of the contract from which the mechanic's lien arose, a single indivisible lien for the whole is created. *Boullia-Gorrell Lumber Co. v. East Coast Realty*, 84 N.H. 174, 148 A. 28 (1929). The mechanic's lien continues for 120 days after completion of delivery of goods or performance of services under the contract. The lien must be perfected before it expires. NH RSA 447:9. The time starts to run not from the date the mechanic's lien accrues but from when the final bill is sent or the last work is completed under the contract. *Tolles-Bickford Lumber Co. v. Tilton Sch.*, 98 N.H. 55, 58, 94 A.2d 374, (1953); *Pike*, 60 N.H. at 469. ^{HN9} In order to continue or secure the mechanic's lien, the lien holder must attach the property by "writ and return thereon distinctly expressing that purpose," within the 120 day period. NH RSA 447:10. After the mechanic's lien is validly perfected, it has priority over any interests that were created after the mechanic's lien first arose.

^{HN10} New Hampshire is a race-notice jurisdiction regarding priority of interests in real property. *In re Chase*, 388 B.R. 462, 467 (Bankr. D.N.H. 2008); [*10] *Amoskeag Bank v. Chagnon*, 133 N.H. 11, 14, 572 A.2d 1153 (1990). ^{HN11} Every deed, conveyance of real estate, or court order that affects title to any interest in real estate shall be recorded in the registry of deeds for the county in which the real estate lies. NH RSA 477:3-a. "[A] purchaser or creditor has the senior claim if he or she records without notice of a prior unrecorded interest." *Amoskeag*, 572 A.2d at 1155. All creditors are held to be on constructive notice of any properly recorded interest. Id. In addition, creditors cannot have a senior claim where they have actual notice of an unrecorded interest. Id. A party is deemed to have actual notice if an investigation would show the existence of an interest in property. Id.

^{HN12} The legislature may create an exception to the perfection and priority laws regarding specific types of liens. *Whitefield*, 39 A.2d at 567. Where the legislature is silent as to priority, the general rules apply. Id. at 568. For example, ^{HN13} priority amongst several mechanic's liens on the same property is addressed in NH RSA 447:11 and 447:12. Mechanic's liens also have priority over all construction mortgages, regardless of timing. NH RSA 447:12-a. Furthermore, mechanic's liens [*11] are different from judicial liens in that they arise by operation of law and the attachment merely continues or secures the lien. NH RSA 447:10. Yet, nothing in the mechanic's lien statute exempts mechanic's lien holders from the general rule of first in time first in right against a prior recorded judicial lien. As a consequence, a supplier who provides materials to a property with a properly recorded lien on it is on notice of a senior interest and may be subject to that lien. The Court shall examine the date of priority of Middleton's lien, assuming that it is properly perfected.

^{HN14} Under the statute, a mechanic's lien arises when a supplier furnishes materials for the construction of a building. Here, the supplies were first ordered on April 8, 2009, but the items were first delivered on April 17, 2009. The priority of Middleton's lien rests on when the Court determines the materials were furnished. The New Hampshire Supreme Court has repeatedly stated that ^{HN15} the language of a statute must be examined under its plain and ordinary meaning. *City of Rochester v. Corpening*, 153 N.H. 571, 573, 907 A.2d 383 (2006); *Carignan v. N.H. Int'l Speedway*, 151 N.H. 409, 419, 858 A.2d 536 (2004). Thus, the Court will look to the [*12] plain meaning of the term "furnish."

According to Webster's Dictionary, to furnish means "to provide or supply with what is needed." Webster's Third International Dictionary 922 (1981). To supply is defined as "the act, process, or an instance of filling a want or need or of providing someone or something." Id. at 2297. ^{HN16} A builder's need for materials is not satisfied until those materials arrive at the construction site. Therefore, Middleton first furnished materials when it actually delivered them to the Property, not when the materials were ordered. As a result, Middleton's mechanic's lien arose the day the materials were first furnished or April 17, 2009. Since Middleton's mechanic's lien arose seven days after the Bank's attachment, its claim is junior to the Bank.

IV. CONCLUSION

Middleton presented arguments and evidence to the Court that it is entitled to the Disputed Proceeds because it has a validly perfected first priority mechanic's lien. However, as a matter of law, Middleton mechanic's lien, even if validly perfected, would be junior because it arose after the Bank attached and recorded its lien. The amount of the Bank's lien exceeds the sale price of the Property. Thus, the [*13] Bank is entitled to all of the Dispute Proceeds. Accordingly, the Debtors shall release the Disputed Proceeds to the Bank. The remaining issues are moot. This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. The Court will issue a separate order consistent with this opinion.

ENTERED at Manchester, New Hampshire.

Date: May 4, 2011

/s/ J. Michael Deasy

J. Michael Deasy

Bankruptcy Judge

2011 Bankr. LEXIS 1801, *

IN RE: REITTER CORPORATION D/B/A HOSPITAL SAN GERARDO, Debtor

CASE NO. 10-07152 (ESL), CHAPTER 11

May 13, 2011, Decided

CASE SUMMARY

PROCEDURAL POSTURE: A hearing was held regarding the Internal Revenue Service's (IRS's) motion to prohibit use of cash collateral and the opposition by a competing lienholder and debtor. At the hearing the court made rulings. It also ordered debtor, the creditor, and the IRS to file briefs on the remaining issue for adjudication: whether the creditor or the IRS was the senior lien holder over debtor's cash collateral (accounts receivables), as of March 1, 2010.

OVERVIEW: The particular issue was whether debtor acquired the cash collateral within 45 days after the filing of the notice of the federal tax lien. This issue hinged upon whether the cash collateral ("qualified property"), namely, the accounts receivables (generated on or after March 1, 2010), constituted "contract rights" or "accounts receivables" which originated from the bank's secured interest in the mortgage deed which extended to the fruits of the mortgaged parcels (including debtor's income, revenue, and profits) and from the financing statements which provided the bank a secured interest in debtor's present and future contract rights (debtor's healthcare services contracts with various health insurance companies) as well as in its accounts receivables. The court found that debtor's health insurance accounts receivables were a collateral categorized as an account pursuant to P.R. Laws Ann. tit. 19, § 2006 because the accounts receivables were generated for healthcare services which had been rendered by debtor. The IRS was the senior lienholder under 26 U.S.C.S. §§ 6321, 6322, 6323.

OUTCOME: Debtor's health insurance accounts receivables were a collateral categorized as an account and not a general intangible under P.R. Laws Ann. tit. 19, § 2006, I.R.C. § 6323(c), and pertinent regulations. Thus, the IRS was the senior lien holder over debtor's accounts receivables which were generated on or after March 1, 2010.

CORE TERMS: accounts receivables, collateral, tax liens, security interests, contract rights, financing, patient, notice, provider, holder, commercial transactions, qualified property, medicare, right to payment, senior lien, personal property, accounting, safe harbor, health insurance, receivables, healthcare, interim, security agreement, reimbursement, mortgage, services rendered, secured claim, real property, adversary proceeding, contractual

LEXISNEXIS® HEADNOTES

Hide

Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > General Overview

Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Duration

Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Time Lien Arises

HN1 The Federal Tax Lien Act of 1966, as amended (FTLA), 26 U.S.C.S. § 6321 et seq., provides for a federal tax lien to be created in favor of the United States Federal Government against any taxpayer who fails to pay federal taxes. 26 U.S.C.S. § 6321. This tax lien encumbers all property and rights to property, whether real or personal, belonging to such person. 26 U.S.C.S. § 6321. The FTLA also establishes the rights of private creditors with respect to a federal tax lien. 26 U.S.C.S. §§ 6321-6326. The federal tax lien is created upon the Internal Revenue Service's assessment and remains until such tax liability is satisfied or the same becomes unenforceable due to lapse of time. 26 U.S.C.S. § 6322. However, for federal liens to be valid against holders of a security interest, notice of such liens must be filed in conformity with state recordation law. 26 U.S.C.S. § 6323(a), (f). [More Like This Headnote](#)

Civil Procedure > Federal & State Interrelationships > General Overview

Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > General Overview

HN2 The nature of the legal interest which the taxpayer holds in the property is established by state law but federal law dictates the priority of competing liens asserted against the taxpayer's property or rights to property. Accordingly, the effects, priority, enforcement, and extinguishment of a tax lien are federal concerns. The Internal Revenue Code creates no property rights but merely attaches consequences, federally defined, to rights created under state law. [More Like This Headnote](#)

Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Amount of Lien

HN3 See I.R.C. § 6321.


Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Time Lien Arises

HN4 See I.R.C. § 6322.


Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority

HN5 See I.R.C. § 6323(a).


Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority 

HN6  The Federal Tax Lien Act of 1966, as amended (FTLA), 26 U.S.C.S. § 6321 et seq., altered to a certain extent the common-law principles that first in time is first in right, and establishes that federal tax liens are superior to inchoate liens by incorporating 26 U.S.C.S. § 6323(c) and affording certain commercial transactions financing agreements with a 45 day safe harbor period. An interest is choate when there is nothing more to be done to have a choate lien--when the identity of the lienor, the property subject to the lien, and the amount of the lien are established. Notwithstanding, the FTLA did not eliminate the choateness doctrine since the same is incorporated in 26 U.S.C.S. § 6323(h) which defines the term "security interest" for purposes of 26 U.S.C.S. §§ 6323, 6324. [More Like This Headnote](#)


Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority 

HN7  The term "security interest" means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth. 26 U.S.C.S. § 6323(h). [More Like This Headnote](#)


Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority 

HN8  I.R.C. § 6323(c) provides certain commercial transactions financing agreements priority over federal tax liens subject to satisfying the following requirements: (1) the security interest must be in "qualified property;" (2) this "qualified property" must be covered by the terms of a written agreement entered into before the federal tax lien filing; (3) this written agreement must constitute a commercial transactions financing agreement (CTFA); and (4) the security interest must be protected under state law against a judgment out of an unsecured obligation. 26 U.S.C.S. § 6323(c). [More Like This Headnote](#)


Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority 

HN9  A commercial transactions financing agreement (CTFA) is defined as an agreement (entered into by a person in the course of his trade or business)--(i) to make loans to the taxpayer to be secured by commercial financing security acquired by the taxpayer in the ordinary course of his trade or business, or (ii) to purchase commercial financing security (other than inventory) acquired by the taxpayer in the ordinary course of his trade or business; but such an agreement shall be treated as coming within the term only to the extent that such loan or purchase is made before the 46th day after the date of tax lien filing or (if earlier) before the lender or purchaser had actual notice or knowledge of such tax lien filing. 26 U.S.C.S. § 6323(c)(2)(A). [More Like This Headnote](#)

Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority 


HN10  A commercial transactions financing agreement (CTFA) pursuant to 26 U.S.C.S. § 6323(c)(2)(A) must be executed prior to or within 45 days of the federal tax lien filing or before the lender had actual knowledge of the tax lien filing (if this is earlier than 45 days). A CTFA secured by "commercial financing security" is considered "qualified property" if the same consists of the following: (i) paper of a kind ordinarily arising in commercial transactions; (ii) accounts receivable; (iii) mortgages on real property; and (iv) inventory. 26 U.S.C.S. § 6323(c)(2)(C). Treasury Regulations clarify that the term "paper of a kind ordinarily arising in commercial transactions" under § 6323(c)(2)(C)(i) includes written documents which give contract rights such as chattel paper, documents of title to personal property, and negotiable instruments or securities. 26 C.F.R. § 301.6323(c)-(1)(c). The Treasury Regulations define the term "contract rights" under § 6323(c) as, any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper. 26 C.F.R. § 301.6323(c)(1)(c)(2)(i). A contract right is acquired by the taxpayer when the contract is made. [More Like This Headnote](#)


Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority 

HN11  The Treasury Regulations define the term accounts receivable under I.R.C. § 6323(c) as, any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper. 26 C.F.R. § 301.6323(c)-(1)(c)(2)(ii). Accounts receivables are acquired by the taxpayer at the time, and to the extent, a right to payment is earned by performance. 26 C.F.R. § 301.6323(c)(1)-(d). The Treasury Regulations provide that, identifiable proceeds, which arise from the collection or disposition of qualified property by the taxpayer, are considered to be acquired at the time such qualified property is acquired if the secured party has a continuously perfected security in the proceeds under local law. The term "proceeds" includes whatever is received when collateral is sold, exchanged, or collected. 26 C.F.R. § 301.6323(c)(1)-(d). Thus, if the "qualified property" (collateral) is a contract right, the proceeds generated from those rights are acquired by the taxpayer at the time the contract is made. However, if the "qualified property" is comprised of accounts receivables, then the proceeds are acquired when the service is performed. [More Like This Headnote](#)

Tax Law > Federal Tax Administration & Procedure > Tax Credits & Liabilities > Liens (IRC secs. 6320-6327) > Federal Tax Lien Priority 

HN12  See I.R.C. § 6323(c).

Contracts Law > Secured Transactions > Application & Construction > Definitions 

HN13  P.R. Law Ann. tit. 19, § 2006, a provision of the Puerto Rico Commercial Transactions Act, defines the term "account" as any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance; and the term "general intangibles" is defined as any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds of written letters of credit, and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts. P.R. Laws Ann. tit. 19, § 2006. [More Like This Headnote](#)

COUNSEL: [*1] For REITTER CORPORATION, dba HOSPITAL SAN GERARDO, Debtor: ALEXIS FUENTES HERNANDEZ, FUENTES LAW OFFICES, SAN JUAN, PR.

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

JUDGES: Enrique S. Lamoutte.

OPINION BY: Enrique S. Lamoutte

OPINION

OPINION AND ORDER

The issue before the court is whether [Banco Popular de Puerto Rico](#) (hereinafter referred to as "BPPR") or the United States Internal Revenue Service (hereinafter referred to as the "IRS") is the senior lien holder over Debtor's cash collateral, in particular, the Debtor's accounts receivables generated on or after March 1, 2010, in accordance with [26 U.S.C. §§6321, 6322 and 6323](#) (Docket Nos. 97 & 135). The IRS and BPPR have filed legal memoranda (Docket Nos. 117 & 124) regarding this particular issue and their respective replies to the same (Docket Nos. 124 & 125). Debtor has joined BPPR's legal position (Docket No. 188). For the reasons stated herein, this court finds that the IRS is the senior lien holder over Debtor's accounts receivables which were generated on or after March 1, 2010.

Facts and Procedural Background

Reitter Corporation filed a **bankruptcy** petition under Chapter 11 of the **Bankruptcy** Code on August 6, 2010. The **[*2]** Debtor included the IRS in its "List of Creditors Holding 20 Largest Unsecured Claims" in the amount of \$1,887,946.42. (Docket No. 23). Debtor also listed in its Schedule E, Creditors Holding Unsecured Priority Claims, the IRS' claim for taxes, interest and penalties in the amount of \$1,887,946. The only secured creditor Debtor included in its Schedule D, Creditors Holding Secured Claims, was BPPR's claim for general hospital specializing, accounts receivable, equipment & fixtures and escrow account in the amount of \$10,182,258.63. Debtor's Schedule A, Real Property, includes its fee simple interest in the property described as, "general hospital specializing in acute and skill nursing services located at km 0.5, State Road 844, Cupey Ward, San Juan, PR" which has a current value of \$13,130,000.00 (without deducting any secured claim or exemption) subject to a secured claim in the amount of \$7,679,999.47 (Docket No. 23). Debtor in its Schedule B, Personal Property, included accounts receivables in the amount of \$2,502,259.16 (Docket No. 23).

On September 8, 2010, the IRS filed proof of claim #4-1 in the amount of \$2,941,703.11, of which it claims \$1,380,978.52 to be secured, \$459,713.61 **[*3]** to be unsecured, and the remainder \$1,101,010.98 as an unsecured priority tax claim under [11 U.S.C. §507\(a\)\(8\)](#). On December 10, 2010, BPPR filed a secured proof of claim #33-1 in the amount of \$11,674,291.63, which is broken down in the following manner: (i) \$10,155,841.48 of principal as of August 6, 2010; (ii) \$84,765.37 of interest accrued up to August 6, 2010; (iii) \$233,684.78 of interest accrued between August 7, 2010 and December 10, 2010; and (iv) \$1,200,000.00 of liquidated damages.

On September 1, 2010, Debtor and BPPR filed an Urgent Joint Motion and Stipulation for Interim Use of Cash Collateral, Adequate Protection and for Other Relief by which BPPR allowed Debtor the interim use of certain of its cash collateral to satisfy certain necessary operating expenses until November 4, 2010. The additional adequate protection the Debtor granted BPPR for the limited use of the Cash Collateral **[*4]** as defined in the Stipulation, amongst other things, was to grant BPPR a valid perfected post-petition super priority claim in an amount equal to any diminution of value of BPPR's interest in the Cash Collateral, resulting from Debtor's limited use of the Cash Collateral in the amounts provided **[*4]** in the Budget (Docket No. 28, IV. Stipulation, paragraphs 18-21). The court granted the same on September 8, 2010 (Docket No. 33). Subsequently, on October 26, 2010, BPPR and Debtor filed a Joint Motion Amending Stipulation for Interim Use of Cash Collateral, Adequate Protection and for Other Relief by which the parties requested the Court to enter an Order approving the Amendment to Stipulation retroactively (Docket No. 44). On November 8, 2010, the Court granted the request retroactively as of the date of the filing of the stipulation (Docket No. 56). On November 4, 2010 BPPR and Debtor filed an Urgent Motion for Entry of Order Extending Stipulation, as Amended, for the interim use of Banco Popular's Cash Collateral until December 6, 2010, by which BPPR and Debtor have agreed, on an emergency basis, to amend the Stipulation to extend all of the terms and conditions contained in the same until December 6, 2010 (Docket No. 55). On November 15, 2010 the court granted BPPR and Debtor's unopposed request for the interim use of Banco Popular's Cash Collateral until December 6, 2010 (Docket No. 58).

FOOTNOTES

1 Cash Collateral is defined in the Stipulation as, "Debtor further acknowledges that Banco **[*5]** Popular is entitled to all cash, cash equivalents, rents, issues, revenues and income arising from the Property, and all profits resulting from the collection of its account receivables, in any form received, as it constitutes Banco Popular's cash collateral as defined in [11 U.S.C. §363\(a\)](#) (collectively hereinafter the "Cash Collateral")" (Docket No. 28, III. Recitals, paragraph 8).

On December 6, 2010, the IRS filed a motion to prohibit the use of cash collateral requesting: (i) the court to enter an Order prohibiting Debtor's use of cash collateral pursuant to [11 U.S.C. §363\(c\)\(2\)](#) and (e) and [Fed. R. Bankr. P. 4001\(a\)](#) due to the IRS secured creditor status pursuant to [26 U.S.C. §§6321, 6322 and 6323](#); (ii) the court to vacate the prior Orders (Docket Nos. 33, 56 & 58) by which it granted Debtor and BPPR's request for the use of cash collateral due to insufficient service of process of the three (3) joint motions pursuant to [Fed. R. Bankr. P. 9014\(b\)](#), [4001\(b\)](#), [7004\(b\)\(5\)](#), and P.R. LBR 4001-2 and; (iii) the court to order BPPR to disgorge any payments of cash collateral it has received from Debtor (Docket No. 74). On the same date, Debtor and BPPR filed an Urgent Motion for Entry of Order **[*6]** Extending Stipulation For the Interim Use of Banco Popular's Cash Collateral until January 4, 2011. On December 7, 2010, the court denied BPPR and Debtor's Urgent Motion for Entry of Order Extending Stipulation For the Interim Use of Banco Popular's Cash Collateral (Docket No. 75) and ordered the Debtor to reply within seven (7) days to the IRS' Motion to Prohibit the Use of Cash Collateral **[*7]** (Docket No. 76).

FOOTNOTES

2 A hearing regarding this matter was scheduled for December 28, 2010 (Docket No. 76). On December 9, 2010, Debtor, BPPR and the IRS filed an Emergency Joint Motion and Stipulation regarding the use of cash collateral from December 7, 2010 until December 28, 2010 (Docket No. 77). On December 14, 2010, the court granted the Emergency Joint Motion and Stipulation between the Debtor, BPPR and the IRS to allow Debtor to use cash collateral from December 7, 2010 until December 28, 2010 (Docket No. 80).

On December 14, 2010, BPPR filed its Opposition to the IRS' Motion to Prohibit Use of Cash Collateral arguing the following: (i) the joint motions requesting use of cash collateral were correctly notified to the IRS in conformity with [Fed. R. Bankr. P. 9014 \(b\)](#), [4001\(d\)](#) and P.R. LBR 4001-2; **[*7]** (ii) the IRS is estopped, barred and impeded by the law of the case, its own acts and estoppel doctrines from objecting to the BPPR stipulations since the IRS had both actual and constructive notice of BPPR's stipulations; (iii) the IRS failed to evidence its alleged liens and security interests over Debtor's cash collateral, thus Debtor is unable to determine the date upon which the same became enforceable; (iv) BPPR's liens and security interests have priority

over the IRS' alleged liens and security interest as they are first in time; (v) the IRS' liens and security interests are subordinated to BPPR's liens and security interests, thus until BPPR's claim has been fully satisfied, all of Debtor's real property and certain personal property, including cash and cash collateral may not be used to satisfy the IRS' claim or provide adequate protection; and (vi) "[a]ll of Debtor's real property and certain personal property, including cash and cash collateral, constitute proceeds from contract rights and fruits from the mortgaged property, which, respectively, constitute commercial financing security, 26 U.S.C. §6323(c)(2)(C)(i) and §6323(c)(2)(C)(iii), which were acquired by the taxpayer [*8] before the alleged filing of the NFLTs, 26 USC §6323(c)(2)(B), and which secure a commercial financing security agreement. 26 USC §6323(c)(2)(A). See also, *Plymouth Savings Bank v. United States Internal Revenue Service*, 187 F. 3d 203, 206-207 (1999)." (Docket No. 84). On December 24, 2010, the Debtor filed its Opposition to the IRS' Motion to Prohibit the Use of Cash Collateral by which it joined BPPR's position (Docket No. 95).

On December 28, 2010, a hearing was held regarding the IRS' motion to prohibit the use of cash collateral and the opposition by BPPR and Debtor (Docket No. 97). At the hearing the court made the following rulings: (1) IRS is a secured creditor over Debtor's cash collateral pursuant to 26 U.S.C. §6321, irrespective of which party is the senior lien holder of Debtor's accounts receivables. The IRS' proof of claim and Exhibit A (Certifications of the filing of the tax liens) are sufficient evidence and support to establish that the documents were indeed registered with the District Court; and (2) the IRS was not given due notice of the Stipulation between BPPR and Debtor in conformity with Fed. R. Bankr. P. 9014, 4001(b) and 7004(b)(5). Thus, the IRS is not bound [*9] by the Agreement (Stipulation). The court further emphasized that irrespective of whether or not the IRS is junior to BPPR or not, the IRS holds a lien over Debtor's cash collateral. Consequently, any motion or agreement entered into by BPPR and the Debtor may not affect the rights of the IRS over the cash collateral. The court found that the only pending issue remaining to be adjudicated is whether BPPR or the IRS is the senior lien holder over Debtor's cash collateral (accounts receivables), as of March 1, 2010. The court ordered Debtor, BPPR and the IRS to file simultaneous briefs on or before January 14, 2011 (Docket Nos. 97 & 135). On December 29, 2010, BPPR filed its Notice of Appeal from the two rulings included in the Order entered on December 28, 2010 and its election to have said appeal heard by the District Court (Docket Nos. 98, 99 & 100).

Parties' Legal Arguments- Priority of Liens

On January 14, 2011, the IRS filed its legal memorandum presenting the following arguments: (i) the IRS perfected its earliest tax lien on the Debtor's personal property (cash collateral) in conformity with 26 U.S.C. §6323(f) on January 14, 2010, by properly filing notices of such federal tax [*10] liens (other notices of federal tax liens were filed on February 1, 2010 and April 20, 2010); (ii) "...under 26 U.S.C. §6323(c), Banco Popular's interest in the Debtor's cash collateral is superior to the United States' federal tax liens only if (1) the security agreement was entered into prior to the tax lien filing; (2) the loan to the Debtor was extended without Banco Popular's having prior knowledge of the United States' federal tax liens, and prior to the filing of the federal tax lien or within 45 days afterward; and (3) the Debtor acquired the cash collateral at issue within 45 days after the filing of the notice of federal tax lien. Of these elements, only the third is at issue here;" (iii) "Courts have consistently held that even in the face of a previously recorded security interest, after 45 days, the United States' federal tax liens become the senior lien over the newly acquired cash collateral;" (iv) "Debtor's latest operating report (for the period of November 2010) states that of its current accounts receivable balance of \$2,678,882.27, the amount of accounts receivable aging 90 days or less was \$2,164,043.54, or 80.8% of all accounts receivable (See Doc. #111 at 4). [*11] This means that at least 80.8% of the Debtor's accounts receivable were generated after March 1, 2010. Not only does the United States have a senior secured claim over all new accounts receivable from March 1, 2010, but it appears from this latest operating report that the United States has a senior secured claim over most, if not all, of the Debtor's current aging accounts receivable;" and (v) Banco Popular's reliance on *Plymouth Savings Bank v. United States*, 187 F. 3d 203, is misplaced because in this case the bank's secured interest was found to be senior to the IRS' tax liens over the rights acquired through the contract due to the fact that the taxpayer's contract for services was entered into during the 45 day safe harbor period provided by 26 U.S.C. §6323. (Docket No. 116).

On January 14, 2010, BPPR filed its legal memorandum arguing the following: (i) the IRS did not file an adversary proceeding as required by Fed. R. Bankr. P. 7001(2) and (9) and 9014 to determine whether BPPR or the IRS is the senior lien holder of certain cash collateral; (ii) BPPR's liens and security interest have absolute and exclusive priority over the IRS' alleged liens and security interests because [*12] they came into existence long before the IRS' alleged liens and security interests; (iii) BPPR's secured interest in Debtor's cash collateral is evidenced by the following: (a) a mortgage deed which extends to the fruits of the encumbered real estate, including Debtor's income, revenue and profits, whether due or to become due, arising from or related to parcels 7,423 and 4,003 which constitute part of Debtor's cash collateral and various other contracts related to the mortgage deed (Docket No. 117, pgs. 16-17-list of contracts); (b) various financing statements duly filed with the Puerto Rico State Department which include the following: (1) October 2, 2001 (#2001072636), encumbering all present and future accounts receivables; (2) February 27, 2006 (#2006021009), amended April 21, 2006, encumbering all present and future contract rights and accounts receivables, among others; (3) June 7, 2007 (#2007028651), encumbering all present and future contract rights and accounts receivables, among others; and (4) December 18, 2008 (#2008029274), amended March 26, 2009, encumbering all present and future contract rights and accounts receivables, among others; (iv) BPPR's interest in Debtor's [*13] cash collateral arises from various contracts related to the mortgage deed (Docket No. 117, pg. 17-list of contracts); (v) Debtor granted BPPR an interest in its contract rights as defined in 26 C.F.R. §301.6323(c)-1(d), and thus, acquired the same when the contracts were executed between Debtor and the various Health Insurance Companies, which was prior to the dates the notices of federal tax liens ("NFLT") were filed (Docket No. 117, p. 22-list of contracts between Debtor and Health Insurance Companies); (vi) "... the proceeds of contract rights in which Debtor granted BPPR an interest pursuant to the Security Agreements for which the Financing Statements were filed were also in existence before the security agreements were filed, which was prior to the dates in which the NFLT's were allegedly filed;" since such proceeds are acquired on the date the contract is executed pursuant to 26 C.F.R. §301.6323(c)-1(d) and *Plymouth Savings Bank v. United States*, 187 F. 3d at 208 (Docket No. 117, pgs. 24, 31); (vii) "[p]roceeds of Debtor's contract rights include accounts receivables generated by Debtor's performance of services contemplated under the corresponding contracts. *Plymouth Savings Bank v. United States*, 187 F. 3d at 208 [*14] (Docket No. 117, p. 31);" (viii) BPPR's interest in Debtor's cash collateral became protected under local law against a subsequent judgment lien arising out of an unsecured obligation on the date in which BPPR's financing statements were duly filed; (ix) BPPR's liens and security interests fall within the safe harbor of 26 U.S.C. §6323 because they constitute commercial financing security provided before the filing of the NFLTs to secure a commercial transactions financing agreement; (x) BPPR's liens and security interests arise out of a commercial financing agreement pursuant to 26 U.S.C. §6323(c)(2)(A); and (xi) Debtor's cash collateral constitutes qualified property in conformity with 26 U.S.C. §6323(c)(2)(B) and (C) (Docket No. 117). On January 14, 2011, Debtor filed a motion whereby it joins BPPR's position in its memorandum of law (Docket No. 118).

Subsequently, the IRS on January, 28, 2011 filed its reply in opposition to BPPR's memorandum of law presenting the following arguments: (i) BPPR is incorrectly interpreting *Plymouth Savings Bank v. United States*, 187 F. 3d 203, because it is confusing its own mortgage and financing agreements with separate and future contracts for services; [*15] (ii) in the *Plymouth Savings Bank v. United States* case there were two contractual agreements: (a) the first was a financing agreement between the debtor and the bank that, "...specifically granted the bank [a secured interest in]: all cash, non-cash proceeds resulting or arising from the rendering of services by Dionne; all general intangibles including proceeds of other collateral; and all inventory, receivables, contract rights or other personal property of Dionne;" (b) the second contractual agreement was a contract for services between the debtor and a third party that was entered into before the expiration of the 45-day safe harbor, but a portion was paid much later; (iii) in *Am. Inv. Fin. v. United States*, 2007 U.S. App. LEXIS 20512 (10th Cir.), "[t]he district and appellate courts both agreed that although a commercial transactions financing agreement (as defined under 26 U.S.C. §6323(c)(2)(A)) between the bank and the medical facility was present, the United States' tax liens had priority after 45 days because 'a right to payment arose when identifiable care was rendered to a patient, and a specific account receivable was thus created;" and (iv) an adversary proceeding to resolve [*16] the issue as to whether BPPR or the IRS is the senior lien holder of the cash collateral is inappropriate because (1) BPPR was the party that raised the issue of priority of the IRS' tax liens when it filed its brief on December 14, 2010 (Docket No. 84); (2) since BPPR first raised the issue of priority, the IRS was then required to inform BPPR about the applicability of the 45-day rule at the hearing held on December 29, 2010; (3) a determination as to the validity, priority or extent of a lien can come about through a variety of procedural routes other than as a result of an adversary proceeding; and (4) the commencement of an adversary proceeding would cause undue delay and would be prejudicial to the Debtor (Docket No. 124).

On January 28, 2011, BPPR filed its reply to the IRS' memorandum of law by which it argues the following: (i) BPPR liens and security interests over Debtor's cash collateral fall under the safe harbor provisions of 26 U.S.C. §6323(c) because Debtor's accounts receivables "...constitute 'qualified property' as proceeds of Debtor's Rights in Debtor's Healthcare Services Contracts (as it is the contracts with the insurance companies which give Debtor the right [*17] to submit invoices to said companies for payment) which came into existence on the date in which the Debtor entered into Debtor's Healthcare Services Contracts with the corresponding health insurance companies (all of which occurred before the Debtor entered into the BPPR Security Agreements) and therefore, BPPR's Security Interests were superior liens entitled to complete priority of the IRS' alleged Liens and Security Interests"

(Docket No. 125, p. 5); (ii) the accounts receivable aging report in which the IRS relied to allege that certain accounts receivables were generated on or after March 1, 2010 does not provide the information necessary to determine when the accounts receivable came into existence since it fails to disclose on which day the Debtor acquired the right to be paid given that, "...in this case the actual date in which the right to be paid was acquired will vary according to the specific terms agreed by Debtor and the corresponding health insurance company" (Docket No. 125, pgs. 7-8); (iii) the IRS has not met its evidentiary burden since it has not submitted into evidence documents which evince the dates in which the IRS alleges the Debtor acquired the accounts receivable in question; (iv) all of Debtor's accounts receivables are proceeds of contract rights since all the customers listed in the accounts receivable aging (such as ACAA, American Health, AMPR, C.F.S.E., Cigna, First Plus, Global Health, Humana, IMC, Map[f]re, MCS, Medicare Optimo, Medicare Selecto, MMM, Option Health, Palic, PMC, Privado, Tricare, SSS, and US Border Protection) are entities which entered into the Debtor's Healthcare Services Contracts with Debtor before the IRS filed the NFTLs; (v) the choateness doctrine is inapplicable to security interests as defined in 26 U.S.C. §6323 because to be protected under 26 U.S.C. §6323(a), a security interest must only meet the requirements established in the definition of an existing security interest in 26 U.S.C. §6323(h)(1), whether or not in all other regards they are definite and complete at the time notice of the tax lien is filed; (vi) even if the choateness doctrine is applicable, BPPR's liens and security interests were choate at the time of the alleged filing of the NFTLs because they satisfied the three (3) requirements under the choateness doctrine; (vii) Section 6323(a) of the IRC is the only section which applies [*19] to security interests that came into existence before the filing of a notice of federal tax lien and does not contain any 45 day limitation as further explained by 26 C.F.R. §301.6323(d)-1(a); (viii) Sections 6323(c) and (d) of the IRC are inapplicable to security interests that existed prior to the date in which the NFTLs were filed by the IRS; (ix) BPPR's liens and security interests satisfy all the requirements of 26 U.S.C. §6323(h), which establish whether a security interest was in existence at the time the NFTLs were filed; (x) the Tenth Circuit's holding in *Am. Inv. Fin. v. United States*, 476 F. 3d 810, is inapplicable in this case; and (xi) "[i]t is the public interest for the courts to recognize the priority of holders of previously existing security interests in accounts receivable, proceeds of contracts rights and/or mortgaged property composed of the fruits of mortgaged real estate, including the income, revenue and profits thereof" (Docket No. 125).

Applicable Law & Analysis

^{HNT} The Federal Tax Lien Act of 1966, as amended (the "FTLA"), 26 U.S.C. §§6321-6326, provides for a federal tax lien to be created in favor of the United States Federal Government against any taxpayer who fails [*20] to pay federal taxes. 26 U.S.C. §6321³. This tax lien encumbers, "...all property and rights to property, whether real or personal, belonging to such person." Id. The FTLA also establishes the rights of private creditors with respect to a federal tax lien. 26 U.S.C. §§ 6321-6326. The federal tax lien is created upon the IRS' assessment and remains until such tax liability is satisfied or the same becomes unenforceable due to lapse of time. 26 U.S.C. §6322⁴. However, for federal liens to be valid against holders of a security interest, notice of such liens must be filed in conformity with state recordation law. 26 U.S.C. 6323(a) and (f).⁵ ^{HN2} The nature of the legal interest which the taxpayer holds in the property is established by state law but federal law dictates the priority of competing liens asserted against the taxpayer's property (cash collateral, particularly accounts receivables) or rights to property (contract rights, specifically rights to the Healthcare Services Contracts). See *Aquilino v. United States*, 363 U.S. 509, 513-14, 4 L. Ed. 2d 1365, 80 S. Ct. 1277, 1960-2 C.B. 477 (1960); *Rodriguez v. Escambron Dev. Corp.*, 740 F. 2d 92, (1st Cir. 1984) ("A federal tax lien is wholly a creature [*21] of federal law. It is one of the 'formidable arsenal of collection tools' necessary 'to ensure the prompt and certain enforcement of the tax laws in a system relying primarily on self reporting.' *United States v. Rodgers*, 461 U.S. 677, 103 S. Ct. 2132, 2137, 76 L. Ed. 2d 236 (1983). Accordingly, the effects, priority, enforcement, and extinguishment of a tax lien are federal concerns. The Internal Revenue Code 'creates no property rights but merely attaches consequences, federally defined, to rights created under state law.' *United States v. Bess*, 357 U.S. 51, 55, 78 S. Ct. 1054, 2 L. Ed. 2d 1135, 1958-2 C.B. 934(1958).").

FOOTNOTES

³ Section 6321 of the IRC provides, ^{HNS} "[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." 26 U.S.C. §6321.

⁴ Section 6322 of the IRC provides, ^{HN4} "[u]nless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the [*22] assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time." 26 U.S.C. §6322.

⁵ Section 6323(a) provides: ^{HNS} "[p]urchasers, holders of security interests, mechanic's lienors, and judgment lien creditors.— The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary." 26 U.S.C. §6323(a).

^{HN6} The FTLA altered to a certain extent the common-law principles that first in time is first in right, and establishes that federal tax liens are superior to inchoate liens by incorporating 26 U.S.C. § 6323(c) and affording certain commercial transactions financing agreements with a 45 day safe harbor period. See *Bremen Bank & Trust Co. v. United States*, 131 F. 3d 1259, 1263 (8th Cir. 1997); *Rodriguez v. Escambron Dev. Corp.*, 740 F. 2d at 97 fn. 7 ("The Tax Lien Act does not, however, provide for every type of lien, and choateness continues to be a consideration in [*23] tax lien cases"); *J.D. Court, Inc. v. United States*, 712 F. 2d 258, 263 (7th Cir. 1983). "An interest is choate when 'there is nothing more to be done to have a choate lien— when the identity of the lienor, the property subject to the lien, and the amount of the lien are established'" *Rodriguez v. Escambron Dev. Corp.*, 740 F. 2d at 98 citing *United States v. Pioneer American Insurance Co.*, 374 U.S. 84, 89, 83 S. Ct. 1651, 10 L. Ed. 2d 770 (1963). Notwithstanding, the FTLA did not eliminate the choateness doctrine since the same is incorporated in 26 U.S.C. § 6323(h) which defines the term "security interest" for purposes of 26 U.S.C. §§ 6323 and 6324. ^{HN7} The term "security interest" means:

"...any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth." 26 U.S.C. §6323(h).

^{HN8} Section 6323(c)⁶ of the IRC [*24] provides certain commercial transactions financing agreements priority over federal tax liens subject to satisfying the following requirements: (1) the security interest must be in "qualified property;" (2) this "qualified property" must be covered by the terms of a written agreement entered into before the federal tax lien filing; (3) this written agreement must constitute a commercial transactions financing agreement ("CTFA"); and (4) the security interest must be protected under state law against a judgment out of an unsecured obligation. 26 U.S.C.

§6323(c). ^{HN9} A CTFA is defined as, "an agreement (entered into by a person in the course of his trade or business)--

- (i) to make loans to the taxpayer to be secured by commercial financing security acquired by the taxpayer in the ordinary course of his trade or business, or
- (ii) to purchase commercial financing security (other than inventory) acquired by the taxpayer in the ordinary course of his trade or business;

but such an agreement shall be treated as coming within the term only to the extent that such loan or purchase is made before the 46th day after the date of tax lien filing or (if earlier) before the lender or purchaser had actual [*25] notice or knowledge of such tax lien filing." 26 U.S.C. §6323(c)(2)(A).

Thus, ^{HN10} a CFTA pursuant to Section 6323(c)(2)(A) must be executed prior to or within 45 days of the federal tax lien filing or before the lender had actual knowledge of the tax lien filing (if this is earlier than 45 days). A CFTA secured by "commercial financing security" is considered "qualified property" if the same consists of the following: (i) paper of a kind ordinarily arising in commercial transactions; (ii) accounts receivable; (iii) mortgages on real property; and (iv) inventory. 26 U.S.C. §6323(c)(2)(C). Treasury Regulations clarify that the term "paper of a kind ordinarily arising in commercial transactions" under Section 6323(c)(2)(C)(i) includes written documents which give contract rights such as chattel paper, documents of title to personal property, and negotiable instruments or securities. 26 C.F.R. §301.6323(c)-1(c). The Treasury Regulations define the term "contract rights" under Section 6323(c) as, "any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper." 26 C.F.R. §301.6323(c)-1(c)(2)(i). A contract right is acquired by the taxpayer [*26] when the contract is made.

^{HN11} The Treasury Regulations also define the term "accounts receivable under Section 6323(c) as, "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper." 26 C.F.R. §301.6323(c)-1(c)(2)(ii). Accounts receivables are, "...acquired by the taxpayer at the time, and to the extent, a right to payment is earned by performance. 26 C.F.R. §301.6323(c)-1(d). The Treasury Regulations provide that, "[i]dentifiable proceeds, which arise from the collection or disposition of qualified property by the taxpayer, are considered to be acquired at the time such qualified property is acquired if the secured party has a continuously perfected security in the proceeds under local law. The term "proceeds" includes whatever is received when collateral is sold, exchanged, or collected." Id. Thus, if the "qualified property" (collateral) is a contract right, the proceeds generated from those rights are acquired by the taxpayer at the time the contract is made. See *Plymouth Savings Bank v. United States*, 187 F. 3d 203, 208; *Am. Inv. Fin. v. United States*, 2007 U.S. App. Lexis 20512. However, if the "qualified [*27] property" is comprised of accounts receivables, then the proceeds are acquired when the service is performed.

FOOTNOTES

6 Section 6323(c) provides;

^{HN12} (1) In general.— To the extent provided in this subsection, even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which—

(A) is in qualified property covered by the terms of a written agreement entered into before tax lien filing and constituting—

(i) a commercial transactions financing agreement, or

(ii) a real property construction or improvement financing agreement, or

(iii) an obligatory disbursement agreement, and

(B) is protected by local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation." 26 U.S.C.

§6323(c)(1).

The IRS concedes that BPPR's security agreement was entered prior to the tax lien filing and that the loan to the Debtor was extended without BPPR having knowledge of the IRS' tax liens, and prior to the filing of the federal tax lien or within 45 days afterward. The only pending issue in the instant case is whether the Debtor acquired the cash collateral within [*28] 45 days after the filing of the notice of the federal tax lien. This issue hinges upon whether the cash collateral ("qualified property"), namely, the accounts receivables (generated on or after March 1, 2010), constitute "contract rights" or "accounts receivables" which originated from BPPR's secured interest in the mortgage deed which extends to the fruits of the mortgaged parcels (including Debtor's income, revenue and profits) and from the financing statements duly filed with the Puerto Rico Department of State which provided BPPR a secured interest in Debtor's present and future contract rights (Debtor's Healthcare Services Contracts with various health insurance companies) as well as in its accounts receivables. The difficulty in categorizing the "qualified property" is that accounts receivables may constitute the proceeds of contract rights. See *State Bank of Fraser*, 861 F. 2d 954, 965 (6th Cir. 1988).

^{HN13} Section 2006 of the Puerto Rico Commercial Transactions Act defines the term "account" as, "... any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance;" and [*29] the term "general intangibles" is defined as, "... any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds of written letters of credit, and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts." 19 L.P.R.A. §2006. Pursuant to these definitions, the court finds that the healthcare insurance receivables fall under the term "accounts" pursuant to the Puerto Rico Commercial Transactions Act because the accounts receivables are generated for healthcare services which have been rendered by Debtor. The contract rights fall under the term "general intangibles" because the same are defined as any personal property, which specifically exclude accounts.

This court agrees with the Tenth Circuit's analysis in *Am. Inv. Fin. v. United States*, 476 F. 3d 810, regarding the characterization (categorization) of whether the accounts receivables generated by provider contracts which were executed between the taxpayer (Nighttime Pediatrics Clinics, Inc.) and various insurance [*30] companies prior to the filing of the federal tax liens constituted "accounts receivables" or "contract rights" pursuant to 26 U.S.C. §6323(c) and C.F.R. 301.6323(c)-1(c)(2)(i) and (ii) and 301.6323(c)-1(d). The Tenth Circuit's analysis of the characterization of the cash collateral (accounts receivables) is based on the contractual provisions of the provider contracts, particularly focusing on the following elements: (a) the provider contracts did not guarantee a definite right to payment prior to the performance of service; (b) the provider contracts ensured a certain rate of reimbursement that the insurance company would pay Nighttime Pediatrics Clinics, Inc. (hereinafter referred to as the "Clinic") if certain conditions were satisfied; (c) the provider contracts did not guarantee that the Clinic would receive payment, given that it was not certain whether qualifying patients would come to the Clinic for services that would entitle it to payment; (d) no capitation clauses were in place that would guarantee a certain level of payment regardless of whether any covered patients came to the Clinic; (e) the right to payment in the provider contracts hinged upon the actions of third [*31] parties, namely the Clinic's performance of services for patients; (f) the Clinic has no enforceable payment rights under the provider contracts until a covered patient came into the Clinic, generated an account receivable and the insurance company was billed; and (g) the provider contracts did not list specific services that the Clinic was required to complete at some point in the future, nor do the contracts specify payments that the insurance companies were required to make at some point in time. *Am. Inv. Fin. v. United States*, 476, F. 3d 810, 815-816.

In the instant case, the court finds that the key element which differentiates whether the accounts receivables in controversy are "contract rights" or "accounts receivables" is simply that the health care insurance receivables are generated upon the rendering of services by the Debtor to an unrelated third party (patients) not privy to the contract, rather than arising directly from the provider contract. Note-2, Summary of Significant Accounting Policies, of the audited balance sheet, related statement of operations and deficit and cash flows for the year ended as of June 30, 2009 discloses the following regarding the organization [*32] and nature of operations: "Reitter, Corp. D/B/A Hospital San Gerardo is a domestic corporation organized under the laws of the Commonwealth of Puerto Rico, to operate a health care institution in the San Juan Municipality. A large part of hospital services are for patients whose bills are paid in whole or in part by third-party payors, such as Medicare, Blue Cross, SSS and other private insurance carriers." (Docket

No. 151, Exhibit H). Note 3- Net Patient Service Revenue of the Financial Statements, disclose the following: "The Hospital has agreements with third-party payors that provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third payors."⁷ (Docket No. 151, Exhibit H).

FOOTNOTES

⁷ The remaining portion of Note 3-Net Patient Service Revenue reads as follows: "A summary of the basis with mayor third-party payor follows:

Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to **[*33]** a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services, outpatient services, and defined capital cost related to Medicare beneficiaries are paid based upon a cost reimbursement methodology. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of an annual cost report by the Hospital and an audit by the Medicare fiscal intermediary. The hospital's medicare cost reports have been audited by a medicare fiscal intermediary through year 2007, the cost report for year ended June 30, 2009, is subject to the medicare fiscal intermediary examination.

SSS, Blue Cross, ACAA

Inpatient and outpatient services rendered to subscribers are reimbursed at an all-inclusive per diem rate. The prospectively determined per diem rates are not subject to retroactive adjustment. The Hospital has also entered into reimbursement agreements with certain commercial insurance carriers, health maintenance organization, and preferred provider organizations. The basis for reimbursement under these agreements includes prospectively determined rates per discharge, discounts from established **[*34]** charges, and prospectively determined per diem rates." (Docket No. 151, Exhibit H).

This court also agrees with the Tenth Circuit's analysis in *Am. Inv. Fin. v. United States*, 476 F. 3d 810 regarding certain pivotal differences between the provider contracts in the instant case and the type of contract which was at play in *Plymouth Savings Bank v. United States*, 187 F. 3d 203. The Tenth Circuit analysis in *Am. Inv. Fin. v. United States*, 476 F. 3d at 816 is based on whether the contract involved is between a taxpayer and another party, where the taxpayer was to perform a specified service for that party in exchange for a specified payment. The Tenth Circuit notes that, "Plymouth, for example, involved a contract between a taxpayer and a hospital. The taxpayer was to help the hospital to obtain a license, and in return the hospital was to pay the taxpayer \$300,000 in several installments. At the time the IRS filed a lien in that case, the taxpayer had not yet obtained the license for the hospital, and she did not procure the license within the 45-day safe harbor. See *Plymouth*, 187 F. 3d at 206. However, she had been paid two installments, and was awaiting the final balance. The Plymouth **[*35]** court held that the taxpayer obtained a contract right to be paid for the work she agreed to do, and that the money paid to her resulted from that contract right. Thus, because the contract had been entered into before the expiration of the safe harbor, the private security interest in that case prevailed over the federal tax lien." *Am. Inv. Fin. v. United States*, 476 F. 3d at 816.

BPPR argues that the accounts receivable aging report in which the IRS relied on to allege that certain accounts receivables were generated on or after March 1, 2010 does not provide the information necessary to determine when the accounts receivable came into existence since it fails to disclose on which day the Debtor acquired the right to be paid alleging that, "...in this case the actual date in which the right to be paid was acquired will vary according to the specific terms agreed by Debtor and the corresponding health insurance company" (Docket No. 125, pgs. 7-8). The court finds this allegation to be unsound and contrary to U.S. Generally Accepted Accounting Principles and the Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, **[*36]** issued by the Financial Accounting Standards Board which establish the basis for accrual accounting. Under accrual accounting, revenue is recognized when it is earned and when it is realized or realizable. Revenue is earned when products are delivered or services are provided. Revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. Realized means cash is received, and realizable means that it is reasonable to expect that cash will be received in the future.⁸ Thus, in the instant case when services are provided by the Debtor hospital to patients, the account receivables account should be debited and revenue recognized by crediting a service revenue account. Once the cash is received, then the account receivable is credited and the cash received is debited. Note 2, Summary of Significant Accounting Policies, included as part of the audited balance sheet, related statement of operations and deficit and cash flows for the year ended as of June 30, 2009 disclose the following regarding Patient Accounts Receivable: "[p]atient accounts receivable are presented net of the allowance **[*37]** for doubtful accounts. The Company provides an allowance for doubtful collections based upon a review of outstanding receivables, historical collection information, and existing economic conditions. Receivables past due more than 1 year are considered doubtful. Doubtful receivables are written off based on individual credit evaluation and specific circumstances of the patient and third party payors." (Docket No. 151, Exhibit H). At the end of the day, the account receivable may not be considered a current asset of the Debtor if the same has not earned (or rendered the services) the patient service revenue associated with that account receivable. The insurance providers contracts guarantee the payment on the accounts receivables generated by the services rendered by the medical provider (the Debtor). The right to payment accrued when the services were rendered and not when the contracts were granted.

FOOTNOTES

⁸ "Revenue recognition-general guidelines. In terms of currently enforceable guidance, under long-established GAAP, revenue, whether from the sale of product or provision of services, is to be recognized only when it has been earned. According to CON 5, *Recognition and Measurement in Financial* **[*38]** *Statements of Business Enterprises*,

... (a)n entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues.

In other words, in order to be recognized revenue must be realized or realizable, and it must have been earned. CON 5 notes that 'the two conditions (being realized or realizable, and being earned) are usually met by the time product or merchandise is deliver or services are rendered to customers,

and revenues from manufacturing and selling activities and gains and losses from sales or other assets are commonly recognized at time of sale (usually meaning delivery).’ Moreover, ‘if services are rendered or rights to use assets extend continuously over time (for example, interest or rent), reliable measures based on contractual prices established in advance are commonly available, and revenues may be recognized as earned as time passes.’ In other words, for most traditional and familiar types of transactions, [*39] the point at which it is appropriate to recognize revenue will be quite clear.” Barry J. Epstein, Ralph Nach & Steven M. Bragg, Wiley GAAP 2010, Interpretation and Application of Generally Accepted Accounting Principles: Evolving Principles And Specialized Applications, p. 378 (2010).

Lastly, BPPR and Debtor argue that the issue of lien priority over certain cash collateral (account receivables) must be brought by way of adversary proceeding pursuant to Fed. R. Bankr. P. 7001(2) and (9) and 9014. The court notes that the issue of lien priority was first raised by BPPR in its Opposition to the IRS’ Motion to Prohibit Use of Cash Collateral (Docket No. 84, pgs. 16-17) and further discussed at the December 28, 2010 hearing (Docket Nos. 97 & 135). BPPR failed to follow the appropriate procedural mechanism established in Fed. R. Bankr. P. 7001(2) to determine the priority of a lien or other interest in property, and may not at this juncture demand from the IRS a procedural vehicle it did not follow. There are no critical facts in dispute. The issue hinges on applicable law. In any event, the court for the sake of expediency and judicial economy, will entertain the issue of lien priority [*40] as a contested matter pursuant to Fed. R. Bankr. P. 9014.

Conclusion

In view of the foregoing, the court finds that Debtor’s health insurance accounts receivables are a collateral categorized as an account and not a general intangible under the Puerto Rico Commercial Transactions Act, 19 L.P.R.A. §2006, Section 6323(c) of the IRC, 26 U.S.C. §6323(c) and pertinent regulations. Thus, the IRS is the senior lien holder over Debtor’s accounts receivables which were generated on or after March 1, 2010.

SO ORDERED.

In San Juan, Puerto Rico, this 13th day of May 2011.

/s/ Enrique S. Lamoutte

Enrique S. Lamoutte

United States **Bankruptcy** Court