# *First Circuit*
# *July 2012*

**Hann v. Educational Credit Management Corporation (BAP 1st Cir. August 7, 2012)( Before Judges Hillman, Feeney and Hoffman, Opinion by Hoffman).**

Affirmed:

The Bankruptcy Appellate Panel affirmed the Bankruptcy Court in holding that the claims allowance process in the bankruptcy case was to determine the amount and *validity* of debt, disagreeing with educational lender's position that in context of claims allowance the Bankruptcy Court determines only what the estate will pay and cannot bind creditors post-discharge. The Bankruptcy Court's order disallowing a claim is a final order and to be given preclusive effect.

Summary:

The Chapter 13 debtor averred she paid her loan in full, pre-petition. Thus, she objected to the lender's proof of claim filed in the chapter 13 bankruptcy case. The Bankruptcy Court set a hearing for the debtor's objection to the lender's proof of claim, which the lender did not attend. The Bankruptcy Court sustained the debtor's objection to claim and fixed the amount at $zero.

The debtor successfully completed her Chapter 13 plan and received a discharge of debts (an order of discharge). Thereafter the Chapter 13 case closed, the lender tried to collect the student loan, post-discharge, taking the position that the alleged balance due was not discharged, as student loans are non-dischargeable. Lender argued that while they were not paid under the debtor's Chapter 13 plan, they could still pursue the debt, post-discharge.

Hann reopened her bankruptcy case to sue the lender for attempting to collect a discharged debt, including counts for damages and attorney fees. Lender unsuccessfully argued that the Chapter 13 disallowance of the lender's claim did not extinguish a non-dischargeable debt and thus did not collaterally estop subsequent collection of the debt.

Lender unsuccessfully argued that in addition to disallowance of the claim in the bankruptcy case, that the debtor should have filed an adversary proceeding to determine the debt to be non-dischargeable. The debtor's position was, why would she file suit on a debt that was zero?

The Bankruptcy Court found for the debtor and also awarded the debtor her legal costs and fees as sanction against the lender for violating the discharge injunction.Lender appealed and BAP AFFIRMED the Bankruptcy Court.

**RNPM, LLC, by and through Operating Partners Co., Inc., Appellant, v. VIRGEN P. MERCADO ALVAREZ, Appellee, (1st Cir. BAP 6/28/12)(Before Judges Boroff, Deasy & Bailey, Opinion by Bailey).**

AFFIRMED:

The Bankruptcy Appellate Panel affirmed the Bankruptcy Court i.e. the record supported the bankruptcy court's determination that there was a lack of proportion between the amount the LLC requested for costs and fees under the loan documents and the amount of unpaid principal and interest the debtor owed.

SUMMARY:

Appellant LLC filed a proof of claim against in debtor's Chapter 13 case, seeking payment of principal and interest the debtor owed on a note that was secured by a mortgage on her residence and $7,600 in attorney's fees under a penalty clause in the mortgage. The U.S. Bankruptcy Court for the District of Puerto Rico awarded the LLC only $2,000 under the penalty clause, and the LLC appealed.
OVERVIEW: The debtor executed a note in the amount of $76,000 in favor of a mortgage company in 2003, that was secured by a mortgage on her residence, and the mortgage company assigned the note and mortgage to an LLC. Debtor defaulted on her obligations under the note and mortgage, pre-petition. LLC's POC sought, *inter alia*, $7,600 that was allowed under a penalty clause. The bankruptcy court allowed the LLC's request for payment of attorney's fees in the amount of $2,000, and the LLC appealed. The appellate panel found that the bankruptcy court had not abused its discretion. Although 11 U.S.C.S. § 1322(e) allowed the LLC to recover attorney's fees because Puerto Rico law recognized the use of penalty clauses and the mortgage contained a penalty clause, the bankruptcy court had the power under P.R. Laws Ann. tit. 31, § 3133 to reduce the amount allowed under the penalty clause if it found that the amount was excessive.

**In re: Richall, 2012 BNH 3 (Bankr. D.N.H. 5/12/12)(J. Michael Deasy, Bankruptcy Judge).**

DENIED: Bankruptcy Court denied Ch. 13 trustee's motion to dismiss the CH. 13 case.

SUMMARY: A chapter 13 trustee filed a motion to dismiss debtors' case on the grounds that, notwithstanding their compliance with 11 U.S.C.S. § 1325(b), their plan was not filed in good faith under 11 U.S.C.S. § 1325(a)(3) because it did not provide plan payments as calculated pursuant to11 U.S.C.S. § 1325(b)(2). The proposed plan payments provided for full payment of unsecured claims; however, the plan payments were substantially lower than the debtors' monthly disposable income.

The trustee believed that the plan should have provided for payment of all monthly disposable income until the allowed claims were paid in full, which would be sooner than the 60 months proposed in the plan. The trustee also argued that the debtors lacked good faith. The court concluded that the plan complied with 11 U.S.C.S. § 1325(b)(1)(A) because it provided for payment of all unsecured claims in full during a five year term through payments of one-half of their disposable income. They were not required to pay off their unsecured creditors in a shorter time by contributing all of their monthly disposable income to payments under the plain unambiguous language of the statute. The trustee failed to show that the debtors acted did not act in good faith under § 1325(a)(3) because Congress did not indicated that factors such as the time value of money and the risks to creditors in a stretched out plan were to be considered in a "good faith" analysis.

**In re: HOLLY ANNE SEELING, (Bankr. D. Mass. 5/24/12)(Henry J. Boroff, Bankruptcy Judge).**

OVERRULED:

Trustee's objection to debtor's exemption in an inherited Individual Retirement Account (IRA) was overruled and exemption allowed.
SUMMARY:

The Bankruptcy Court decided that a debtor could employ 11 U.S.C. §522(d)(12) to exempt an individual retirement account whose proceeds had been inherited. To qualify for this exemption, the relevant property (1) must constitute retirement funds; and (2) be held in an account exempt from taxation under I.R.C. § 401, I.R.C. § 403, I.R.C. § 408, I.R.C. § 408A, I.R.C. § 414, I.R.C. § 457, or I.R.C. § 501(a). The validity of a claimed exemption was presumed. Therefore, it was the Trustee's burden to prove otherwise. IRAs were tax exempt under I.R.C. § 408 and accordingly were exempt under the Bankruptcy Code, pursuant to § 522(d)(12). The Bankruptcy Code required no forensic analysis in order to determine from where those funds arose. All that the Bankruptcy Code required was that the funds sought to be invested have been placed in a particular form

of a retirement investment vehicle in order to be exempt from taxation. The subject IRA being among the kinds of investment vehicles referenced in §522(d)(12), there was no statutory basis for imposing additional conditions for its bankruptcy exemption. Trustee's objection was overruled. Debtor could exempt the full value of the IRA pursuant to 11 U.S.C.S. § 522(d)(12).

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**2012 BNH 003**

# UNITED STATES BANKRUPTCY COURT
# DISTRICT OF NEW HAMPSHIRE

In re: Bk. No. 11-12767-JMD
Chapter 13

Donald Richall and Selena Richall,
Debtors

*Kelly L. Ovitt Puc, Esq.*
*Cornell and Ovitt Puc, PLLC*
*Concord, New Hampshire*
*Attorney for Debtor*

*Lawrence P. Sumski, Esq.*
*Manchester, New Hampshire*
*Chapter 13 Trustee*

## MEMORANDUM OPINION

## I. INTRODUCTION

Lawrence P. Sumski, the chapter 13 trustee (the "Trustee"), filed a motion to dismiss the case (Doc. No. 18) (the "Motion to Dismiss") on the grounds that, notwithstanding the Debtors' compliance with 11 U.S.C. § 1325(b),[1] the Debtors' Chapter 13 Amended Plan dated December 8, 2011 (Doc. No. 24) (the "Plan") was not filed in good faith under § 1325(a)(3) because it does not provide plan payments as calculated pursuant to § 1325(b)(2). The Debtors counter that their failure to dedicate their entire monthly disposable income to the Plan alone is insufficient to demonstrate lack of good faith when the Plan proposes to pay creditors in full. After notice and

[1] Unless otherwise indicated, in this opinion the terms "Bankruptcy Code," "section" and "§" refer to title 11 of the United States Code, 11 U.S.C. §§ 101-1532, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, effective in cases commenced on or after October 17, 2005.

a hearing, the Court took confirmation of the Debtors' Plan and the Trustee's Motion to Dismiss under advisement.

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

The parties do not dispute the material facts involved in this case. The Debtors filed for chapter 13 bankruptcy on July 19, 2011. They submitted their Plan on December 30, 2011. The Debtors' Schedules I and J show a monthly net income of $886.42. Additionally, Form B22C provides that the Debtors are "above median" debtors. Accordingly, their disposable income is determined under § 1325(b)(2) and (3). That calculation provides that the Debtors' monthly disposable income is $1,756.21. In the Plan, the Debtors propose to make monthly plan payments of $835.00 over a term of five months and $855.00 over a term of fifty-five months for a total plan commitment period of sixty months. The Debtors' proposed plan payments provide for full payment of their unsecured claims; however, the plan payments are substantially lower than the Debtors' monthly disposable income. If the Debtors proposed a plan that committed their entire monthly disposable income of $1,756.21, that plan would provide for full payment of their unsecured claims over a period of approximately thirty-months or one-half of the term in their Plan.

## III. DISCUSSION

Section 1325(b)(1) provides that:

> [i]f the trustee or the holder of an allowed unsecured claim objects to confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan --
>
> (A) the value of the property to be distributed under the plan on account of such claims is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C. § 1325(b)(1). The Trustee objects to confirmation of the Plan and moves to dismiss the case because he believes the Plan should provide for payment of all of the Debtors' monthly disposable income, or $1,756.21 per month, until the expected allowed claims are paid in full, which will be sooner than stretching payments over sixty months as proposed in the Debtors' Plan. The Trustee also argues that the Debtors lack good faith under § 1325(a)(3) because they are failing to use their best efforts and failing to protect creditors against the time value of deferring payment of their claims. The Debtors disagree and contend that the Trustee's view would require debtors to satisfy both § 1325(b)(1)(A) and (B) thereby rendering § 1325(b)(1)(A) superfluous.

### A. BAPCPA and Section 1325(b)

Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), § 1322(d) specified that a "plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years" regardless of whether the

debtor was above or below median.[2] 11 U.S.C. § 1322(d) (1994) (emphasis added). Prior to the enactment of BAPCPA, § 1325(b) prohibited approval of a chapter 13 plan over the objection of the trustee or the holder of an allowed claim unless the debtor was paying all unsecured claims in full, or was paying all of the debtor's disposable income over the full term of the plan. 11 U.S.C. § 1325(b) (1998). Accordingly, the Court would have no cause to approve a plan term longer than three years for any debtor, regardless of the amount of disposable income, if the debtor could pay unsecured creditors in full within three years.

After the enactment of BAPCPA, the Bankruptcy Code differentiated the minimum and maximum term for a chapter 13 plan, based on the amount of a debtor's disposable income, by adding subsections (d)(1) and (d)(2) to § 1322. Thus, in BAPCPA, Congress changed the manner in which the mandatory term of a chapter 13 plan is determined to ensure that debtors who could afford to do so (i.e. debtors with above median disposable income) paid more to their creditors.

In the case of above median debtors, § 1322(d)(1) now proscribes that "the plan may not provide for payment over a period that is longer than 5 years." 11 U.S.C. § 1322(d)(1). In effect, BAPCPA eliminated any minimum term of a plan for above median debtors. All above median debtors are now subject to a uniform term of five years for a chapter 13 plan with only one exception: the term of the plan, or the commitment period, may be less than five years if creditors are paid in full. 11 U.S.C. § 1325(b)(1)(A) and (b)(4). However, BAPCPA did not change the minimum or maximum plan term for below median debtors not paying creditors in

[2] Prior to the enactment of BAPCPA, the terms "above median" and "below median" were not part of the Bankruptcy Code. All debtors, regardless of the amount of their disposable income, were subject to the same statutory limitations on the minimum and maximum term for a chapter 13 plan.

full. It remains a minimum of three years, absent cause for a longer term, which cannot exceed five years, unless creditors can be paid in full in a shorter period of time. 11 U.S.C. §§ 1322(d)(2) and 1325(b)(1)(B); see also 11 U.S.C. § 1325(b)(4)(B). Consequently, after BAPCPA, courts may deny confirmation of a chapter 13 plan proposed by a below median debtor, which stretches beyond a three year period and pays creditors in full but does not commit all disposable income, because a court could find that no cause exists to extend the plan longer than three years when a debtor can payoff creditors within the commitment period. See 11 U.S.C. § 1322(d)(2)(C). After BAPCPA, the same is not true for above median debtors.

Section 1325(b) was substantially changed by BAPCPA to create a bright line test to determine whether a debtor is committing sufficient income to the plan. In re Jones, 374 B.R. 469, 469 (Bankr. D.N.H. 2007). "Section 1325(b)(2) was amended to alter the method of determining a debtor's income and § 1325(b)(3) was added to require above median debtors to calculate their reasonably necessary expenses using the means test formula in § 707(b)(2)(A) and (B)." Id. Section 1325(b)(1) requires compliance with subsection (A) or (B), but not both. Jones, 374 B.R. at 469. Accordingly, above median debtors now have an election to either pay all of their disposable income for five years, or until creditors are paid in full, § 1325(b)(1)(B), or to pay less than their disposable income over five years, if such lower payments will pay unsecured creditors in full. 11 U.S.C. § 1325(b)(1)(A). The Debtors' Plan provides for payment of all unsecured claims in full during a five year term through payments of approximately one-half of their disposable income. Thus, the Debtors' Plan complies with § 1325(b)(1)(A). While the Debtors could pay off their unsecured creditors in a shorter period of time if they contributed all of their monthly disposable income to plan payments, they are not required to do so under the plain unambiguous language of the Bankruptcy Code.

The Court believes that this result is contrary to the intent of Congress in enacting BAPCPA. The Court also does not understand why a debtor would elect to remain in a chapter 13 proceeding any longer than necessary. However, this result is mandated by the clear and unambiguous language in §§ 1322(d)(1) and 1325(b)(1) of the Bankruptcy Code. If this statutory anomaly does not reflect the intent of Congress, it is the responsibility of Congress, not the courts, to correct the statute. The Court does not have the authority to require above median debtors to reduce their plan term from five years, if they are paying all unsecured claims in full.

**B. Good Faith under 11 U.S.C. § 1325(a)(3)**

The Trustee contends that the Debtors' Plan was filed in bad faith because the Debtors do not commit all of their disposable income to the Plan. Pursuant to § 1325(a)(3), a chapter 13 plan is entitled to confirmation if "the plan has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3). The Debtors bear the burden of demonstrating that a plan has been proposed in good faith. Sullivan v. Solimini (In re Sullivan), 326 B.R. 204, 2011 (B.A.P. 1st Cir. 2005). "The term 'good faith' has been left undefined. In the First Circuit, good faith is determined on a case-by-case basis using the totality of the circumstances test." In re Culcasi, No. 10-14735-JMD, 2011 WL 4005451, at *5, *6 (Bankr. D.N.H. Sept. 7, 2011) (citing Sullivan, 326 B.R. at 204). Courts generally employ a fact-sensitive assessment of whether a plan was proposed in good faith in which they consider the following non-exclusive factors:

> (1) debtor's accuracy in stating her debts and expenses, (2) debtor's honesty in the bankruptcy process, including whether she has attempted to mislead the court and whether she has made any misrepresentations, (3) whether the Bankruptcy Code is being unfairly manipulated, (4) the type of debt sought to be discharged, (5) whether the debt would be dischargeable in a Chapter 7, and (6) debtor's motivation and sincerity in seeking Chapter 13 relief.

Sullivan, 326 B.R. at 212. In employing the totality of the circumstances analysis, courts do not place too much weight on any single factor, but rather examine how a number of factors in any given case operate together to expose a plan proposed in bad faith. In re O'Neill Miranda, 449 B.R. 182, 195 (Bankr. D.P.R. 2011) see also In re Trikeenan Tileworks, Inc., Nos. 10-13725-JMD, 10-13726-JMD, 10-13727-JMD, 2011 WL 2898955, *6, *8 (Bankr. D.N.H. Jul. 14, 2011) (interpreting a good faith plan to achieve results consistent with the purposes and objectives of the Code). Based on the factors of the totality of the circumstances test, finding that a proposed chapter 13 plan is lacking in good faith should be reserved for cases in which debtors exhibit serious misconduct or abuse or unfair manipulation of the Code.

The meaning of "good faith" should not be expanded beyond the meaning intended by Congress. In re Keach, 243 B.R. 851, 867-68 (B.A.P. 1st Cir. 2000). Since Congress specifically addresses a debtor's ability to pay and the commitment of disposable income in § 1325(b), a "good faith" analysis under § 1325(a)(3) need not require consideration of the amount of a debtor's payments unless the proposed payments otherwise contribute to a finding of serious misconduct or abuse or unfair manipulation of the Code. See id. 243 B.R. at 867-70 (discussing the meaning of "good faith" after Congress' creation of § 1325(b)(1) and (b)(2)). To do so would require this Court to create yet another test to determine the appropriate plan length for debtors who can afford to pay unsecured creditors in full over a term less than the applicable commitment period. The application of any such test in this case would necessarily result in a judicially created amendment to the provisions of § 1325(b)(1). This Court does not have the authority to create any such amendment. Any such amendment necessary to implement the intent of Congress is within the sole authority of Congress to impose.

The Trustee has not alleged any facts to suggest that the Debtors have inaccurately stated their debts and expenses, that the Debtors have been less than honest in the bankruptcy process, or that the Debtors have misled the Court. Although the Court understands the Trustee's concerns regarding the time value of money and the risks to creditors in a stretched out plan, Congress has not indicated that such factors be considered under a § 1325(a)(3) "good faith" analysis. See 11 U.S.C. § 1325(a)(4) (evaluating time value issues as part of "best interests of creditors test"). Because the Court cannot find any lack of good faith in the proposal of Debtors' Plan, the Trustee's Motion to Dismiss shall be denied.

## IV. CONCLUSION

For the reasons set forth above, the Trustee's Motion to Dismiss shall be denied, and the Court shall confirm the Debtors' Plan. 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 11, 2012

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

# UNITED STATES BANKRUPTCY COURT
# DISTRICT OF MASSACHUSETTS
# WESTERN DIVISION

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|---|---|---|
| In re: | ) | Chapter 7 |
| | ) | Case No. 11-30957 |
| HOLLY ANNE SEELING | ) | |
| Debtor. | ) | |

## MEMORANDUM OF DECISION

Before the Court is the "Trustee's Objection to Debtor's Exemption in an Inherited IRA" (the "Trustee's Objection"). The Court must here decide whether a debtor may employ 11 U.S.C. § 522(d)(12)[1] to exempt an individual retirement account whose proceeds have been inherited – a question that appears to be one of first impression in this Circuit.

## I. FACTS AND TRAVEL OF THE CASE

The parties have stipulated to all of the relevant facts.

Holly Anne Seeling (the "Debtor") was the named beneficiary of 50% of a Tax Deferred Annuity Account (the "Annuity") maintained by Fidelity Investments on behalf of Charles Carroll ("Carroll"), pursuant to 26 U.S.C. § 403(b). On May

[1] All references to the "Bankruptcy Code" or to Code sections are to the Bankruptcy Code unless otherwise specified. 11 U.S.C. §§ 101 et seq.

21, 2007, Carroll passed away, leaving the Debtor the designated funds.[2] In light of Carroll's death, the proceeds of the Annuity were required to be distributed, and, in 2007, the Debtor requested that the portion she had inherited be rolled over into an IRA to be maintained by HD Financial Services, a subsidiary of Wells Fargo & Company, in the name of Carroll for her benefit (the "IRA").[3]

On May 20, 2011, the Debtor filed a voluntary Chapter 7 petition with this Court. On her Schedule B—Personal Property, the Debtor listed the IRA and its then current balance of $52,975.08. On her Schedule C—Property Claimed as Exempt, the Debtor claimed an exemption for the full value of the IRA, pursuant to 11 U.S.C. § 522(d)(12). The Chapter 7 trustee (the "Trustee") timely objected to the Debtor's claim of exemption to the IRA and the Debtor timely responded.

After a hearing on the Trustee's Objection, and upon the parties' assurance that no material facts were in dispute, the Court took the matter under advisement, ordered the filing of a stipulation of relevant facts and afforded the parties a further opportunity for briefing.

## II. POSITIONS OF THE PARTIES

The Trustee contends that the IRA does not meet the two requirements necessary to claim an exemption under § 522(d)(12). First, the Trustee argues

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[2] As of June 21, 2007, the balance of the Annuity was $121,660.38, one-half of which the Debtor inherited.

[3] When the Debtor established the IRA, she was required to begin taking the minimum distributions immediately without regard to her age or employment status. See 26 U.S.C. § 401(a)(9)(B). The Debtor received distributions in 2008 in the amount of $1,745.25; in 2009 in the amount of $1,161.24; and in 2010 in the amount of $5,755.84.

that the funds held in the Debtor's IRA are not "retirement funds" as contemplated by the statute because the Debtor did not herself contribute the funds for purposes of her own retirement. Second, the Trustee disputes that the inherited IRA is exempt from taxation under 26 U.S.C. § 408(e), one of the qualifying sections under § 522(d)(12). Instead, the Trustee asserts that the inherited IRA is exempt from taxation under 26 U.S.C. § 402(c)(11)—a section of the Internal Revenue Code (the "IRC") not included in § 522(d)(12)'s exhaustive list of applicable IRC sections.

The Debtor disagrees. Citing to the language of § 522(b)(4)(C), the Debtor explains that the direct transfer of funds from the Annuity to the IRA does not disqualify the IRA from exempt status under § 522(d)(12). To further support this contention, the Debtor cites to other courts who have examined this type of transfer and looked to the character of the account *from which* the funds were transferred and not the other way around. The Debtor concludes that the IRA met the two requirements for exemption under § 522(d)(12), and does not cease to qualify for the exemption just because the proceeds were inherited rather than earned by the Debtor.

## III. DISCUSSION

The moment a bankruptcy petition is filed, the debtor's bankruptcy estate is created. A bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The debtor is, however, entitled to exempt certain property from the

bankruptcy estate. See 11 U.S.C. § 522. The Debtor here seeks to exempt the full value of the IRA pursuant to § 522(d)(12). Section 522(d)(12) permits a debtor to exempt from her bankruptcy estate

> [r]etirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

11 U.S.C. § 522(d)(12). Thus, to qualify for this exemption, the relevant property (1) must constitute retirement funds; and (2) be held in an account exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the IRC. The validity of a claimed exemption is presumed. See § 522(l). Therefore, as the objecting party, it is the Trustee's burden to prove otherwise. See Fed. R. Bankr. P. 4003(c).

**A. Retirement Funds**

"Retirement funds," as that phrase is used in § 522(d)(12), is not defined in that subsection or anywhere else in the Code. In such instances, courts look to a term's "ordinary meaning." Rousey v. Jacoway, 544 U.S. 320, 321 (2005). Merriam Webster's Tenth New Collegiate Dictionary, defines *retirement* as "withdrawal from one's position or occupation or from active working life" and *funds* as "a sum of money or other resources whose principal or interest is set apart for a specific objective" 1000, 472 (10th ed. 1993). Together, the statutory language simply amounts to a description of money set apart for retirement. That the Annuity was a retirement fund is not in dispute. However, the statutory language does not specify for *whose* retirement the money must be set apart to

qualify for the exemption. The Trustee maintains that the funds comprising the Annuity lost their character as "retirement funds" when they were rolled over into the IRA and no longer "set apart" for *Carroll's* retirement. The Debtor disagrees, noting that § 522(d)(12) does not require that the retirement funds originally have been set apart by the *Debtor* in contemplation of the *Debtor's* retirement, and pointing out that § 522(b)(4)(C) specifically provides that transfers of this very type do not disqualify IRAs from eligibility for exemption under § 522(d)(12).[4]

Indeed, the Fifth Circuit Court of Appeals has recently noted that "[m]ost of the courts that have analyzed this issue have concluded that inherited IRAs are 'retirement funds' as that phrase is used in § 522(d)(12)," In re Chilton, 674 F.3d 486, 489 (5th Cir. 2012) (citing In re Nessa, 426 B.R. 312, 314 (8th Cir. BAP 2010); *accord*, In re Kutcha, 434 B.R. 837, 843-44 (Bankr. N.D. Ohio 2010); In re Tabor, 433 B.R. 469, 476 (Bankr. M.D. Pa. 2010); In re Thiem, 443 B.R. 832, 843-44 (Bankr. D. Ariz. 2011); In re Weilhammer, No. 09-15148-LT7, 2010 WL 3431465, at *4-*6 (Bankr. S.D. Cal. August 30, 2010); In re Stephenson, 2011 WL 6152960, at *2-*3); See also In re Hamlin, 465 B.R. 863, 872 (9th Cir. BAP (Ariz.) 2012). Those cases which have decided otherwise have not survived appellate review. See In re Chilton, 426 B.R. 612, 616 (Bankr. E.D. Tex. 2010), *rev'd*, 444 B.R. 548 (E.D. Tex. 2011), *aff'd*, 674 F.3d 486; In re Clark, 450 B.R. 858 (Bankr. W.D. Wis. 2011), *rev'd*, 466 B.R 135 (W.D. Wis. 2012) (interpreting

[4] § 522(b)(4)(C) provides:

> A direct transfer of retirement funds from 1 fund or account that is exempt from taxation under section 401, 403, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986 … shall not cease to qualify for exemption under … subsection (d)(12) by reason of such direct transfer.

analogous provision 11 U.S.C. § 522(b)(3)(C)); In re Stephenson, 2011 WL 6152960 (E.D. Mich. Dec. 12, 2011).

This Court finds itself in agreement with what appears to be a consensus. Individual retirement accounts are tax exempt under 26 U.S.C. § 408 and accordingly are exempt under the Bankruptcy Code, pursuant to § 522(d)(12). The Bankruptcy Code requires no forensic analysis in order to determine from where those funds arose. All that the Bankruptcy Code requires is that the funds sought to be invested have been placed in a particular form of a retirement investment vehicle in order to be exempt from taxation. The subject IRA being among the kinds of investment vehicles referenced in § 522(d)(12), there is no statutory basis for imposing additional conditions for its bankruptcy exemption.

**B. Exempt from Taxation**

The Trustee further argues that the operative section of Internal Revenue Code which governs the subject IRA is 26 U.S.C. § 402(c)(11)(A)[5] (which is not

[5] 26 U.S.C. § 402(c)(11)(A) provides:

> If, with respect to any portion of a distribution from an eligible retirement plan described in paragraph (8)(B)(iii) of a deceased employee, a direct trustee-to-trustee transfer is made to an individual retirement plan described in clause (i) or (ii) of paragraph (8)(B) established for the purposes of receiving the distribution on behalf of an individual who is a designated beneficiary (as defined by section 401(a)(9)(E)) of the employee and who is not the surviving spouse of the employee—
>
> > (i) the transfer shall be treated as an eligible rollover distribution,
> >
> > (ii) the individual retirement plan shall be treated as an inherited individual retirement account or individual retirement annuity (within the meaning of section 408(d)(3)(C)) for purposes of this title, and

referenced in § 522(d)(12)), and not 26 U.S.C. § 408(e). This Court respectfully disagrees. As the Fifth Circuit Court of Appeals explained in In re Chilton, the transfer *itself* (of funds from one tax exempt vehicle to another) is exempt from taxation under 26 U.S.C. § 402(c)(11)(A). Chilton, 674 F.3d at 490. But, once transferred, the funds are exempt under § 408(e).[6] Id.

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> (iii) section 401(a)(9)(B) (other than clause (iv) thereof) shall apply to such plan.

[6] 26 U.S.C. § 408(e) provides:

> (1) Exemption from tax--Any individual retirement account is exempt from taxation under this subtitle unless such account has ceased to be an individual retirement account by reason of paragraph (2) or (3). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc. organizations)

Included in the statute's definition of an "individual retirement account" are inherited IRAs. See 26 U.S.C. § 408(a) ("For purposes of this section, an 'individual retirement account' means a trust created or organized in the United States for the exclusive benefit of an individual *or his beneficiaries*…") (emphasis supplied).

IV. CONCLUSION

The Debtor's IRA meets the two requirements necessary to claim an exemption under § 522(d)(12). The Trustee has failed to persuade to the contrary. Accordingly, the Debtor may exempt the full value of the IRA pursuant to § 522(d)(12); the Trustee's Objection is, accordingly, OVERRULED.

An order consistent with the memorandum shall issue accordingly.

DATED: May 24, 2012

By the Court,

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Henry J. Boroff
United States Bankruptcy Judge

**FOR PUBLICATION**

# UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

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**BAP NO. PR 11-080**

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**Bankruptcy Case No. 10-07374-ESL**

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**VIRGEN P. MERCADO ALVAREZ,**
**a/k/a Virgen Mercado Alvarez, a/k/a Virgen P. Mercado,**
**a/k/a Virgen Mercado,**
**Debtor.**

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**RNPM, LLC, by and through**
**Operating Partners Co., Inc.,**
**Appellant,**

**v.**

**VIRGEN P. MERCADO ALVAREZ,**
**Appellee.**

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**Appeal from the United States Bankruptcy Court**
**for the District of Puerto Rico**
**(Hon. Enrique S. Lamoutte, U.S. Bankruptcy Judge)**

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**Before**
**Boroff, Deasy, and Bailey,**
**United States Bankruptcy Appellate Panel Judges.**

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**Charles P. Gilmore, Esq., and Lucas A. Córdova-Ayusa, Esq., on brief for Appellant.**
**Jose M. Prieto Carballo, Esq., on brief for Appellee.**

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**June 28, 2012**

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**Bailey, U.S. Bankruptcy Appellate Panel Judge.**

RNPM, LLC, by and through Operating Partners Co., LLC ("RNPM"), appeals from the bankruptcy court's order reducing its claim for attorney's fees imposed under its mortgage's "penalty clause," as that term is used in Puerto Rico law, against the debtor, Virgen P. Mercado Alvarez ("the Debtor"), on account of her default under the terms of the Note, defined below. For the reasons set forth below, the Panel **AFFIRMS**.

## BACKGROUND

On November 7, 2003, the Debtor executed a note in favor of R&G Mortgage Corporation ("R&G") in the original principal amount of $76,000.00 ("the Note"), which Note was secured by a first mortgage ("the Mortgage") on her residence located in Ceiba, Puerto Rico. Thereafter, R&G assigned the Note and Mortgage to RNPM. The Mortgage expressly provided that, in addition to the Note, it secured:

> an amount of ten percent of the original principal amount of the Note to cover costs, expenses and attorney's fees in the event the holder of the Note is required to foreclose this Mortgage or seek judicial collection, or collection in any proceeding in bankruptcy of the Borrower, which amount shall be considered liquid and payable by the sole act of filing the complaint and shall be in addition to the principal amount of the Note. . . .

("the Penalty Clause").

The Debtor eventually defaulted in her obligation to make monthly payments under the Note. On account of this default, RNPM filed a complaint to foreclose the Mortgage ("the Complaint") in November 2009. According to RNPM, the Debtor owed a principal balance of $70,450.65 pursuant to the Note at the time the Complaint was filed.

On August 13, 2010, the Debtor filed a petition for relief under chapter 13 of the Bankruptcy Code,[1] together with her schedules and chapter 13 plan ("the Plan"). On the schedule of secured claims that she filed with her petition, the Debtor listed Operating Partners, Inc. as the holder of a secured claim in the amount of $79,000.00. In the Plan, the Debtor proposed to cure the Mortgage arrearage through the Plan and to maintain regular payments to RNPM.[2] On September 15, 2010, RNPM filed a proof of secured claim in the amount of $77,589.67. On September 27, 2010, RNPM filed another proof of secured claim ("the Claim"), this time in the amount of $7,600.00, which, according to RNPM, represented attorney's fees due under the Note. On the same date, RNPM also filed an objection to confirmation of the Plan ("the Confirmation Objection").

On October 5, 2010, the Debtor filed an objection to the Claim ("the Claim Objection"), asserting that the amount of attorney's fees claimed therein was excessive and unwarranted by the mere filing of the Complaint. She also challenged RNPM's failure to "provide a detailed description of services rendered, number of hours worked and hourly rate" to support the Claim, as required by Bankruptcy Rule 2016.[3] Accordingly, the Debtor requested that the court order

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[1] Unless otherwise indicated, the terms "Bankruptcy Code," "section" and "§" refer to Title 11 of the United States Code, 11 U.S.C. §§ 101 et seq., as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 37. All references to "Bankruptcy Rule" are to the Federal Rules of Bankruptcy Procedure, and all references to "Rule" are to the Federal Rules of Civil Procedure.

[2] The docket reflects that the Plan has not been confirmed. See Kowalski v. Gagne, 914 F.2d 299, 305 (1st Cir. 1990) ("It is well-accepted that federal courts may take judicial notice of proceedings in other courts if those proceedings have relevance to the matters at hand.").

[3] Bankruptcy Rule 2016(a) provides, in pertinent part, that

> An entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate shall file with the court an application setting forth a detailed statement of (1) the services rendered, time expended and

RNPM to provide evidence of the Claim; alternatively, the Debtor asked the court to disallow the Claim in the event of RNPM's refusal to produce such evidence.

The court conducted a confirmation hearing on October 6, 2010, which it then continued to December 1, 2010. Prior to the continued hearing on confirmation, on November 5, 2010, RNPM filed a response to the Claim Objection ("the Response"), in which it contended: "[U]nder the relevant [M]ortgage agreement, the total amount of $7,600.00 became due and payable upon the filing of the [C]omplaint [ ] and is not subject to a reasonableness determination." RNPM further claimed that the subject attorney's fees "became due and payable pre-petition and constitute[d] an integral component of [the D]ebtor's pre-petition arrearage that must be cured through the [P]lan."

In further defense of the Claim, RNPM asserted numerous arguments in the Response as "affirmative defenses," including *inter alia*: (1) pursuant to § 1322(e), applicable state law and the terms of the underlying mortgage agreement determine the default cure amount when a chapter 13 plan provides for the curing of a default and the maintenance of payments to a creditor whose claim is secured only by a security interest in real property that is the debtor's principal residence; (2) because § 1322(e) overrides § 506(b), the default cure amount is the same regardless of whether a claim is undersecured or oversecured; (3) § 1322(e) is not limited to interest but is equally applicable to costs, expenses, and attorneys' fees; and (4) the anti-modification provision of § 1322(b)(2) precluded the Debtor from modifying RNPM's rights under the Mortgage.

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expenses incurred, and (2) the amounts requested.

Fed. R. Bankr. P. 2016(a).

On November 16, 2010, the bankruptcy court entered an order sustaining the Claim Objection without prejudice to RNPM's ability to file a detailed fee application. Relying on In re Pan Am. Gen. Hosp., LLC, 385 B.R. 855, 876 (Bankr. W.D. Tex. 2008), the court concluded that "[t]he reasonableness of post-petition fee claims is tested under federal law." The court reasoned:

> The purpose of the [§] 506(b) reasonableness requirement is to prevent over-secured creditors from drawing a "blank check" to cover their own expenses incurred at the peril and expense of the estate and other creditors. . . . This court has generally followed and applied the lodestar approach when awarding reasonable fees to professionals. . . . The only actual services rendered as of this date, other than defending the fee application, are relative to the filing of the proof of claim. There is no evidence that legal services were actually performed. Consequently, as of this date, there are no reasonable fees to be claimed as part of the secured claim.

Thereafter, on November 23, 2010, RNPM filed a supplemental objection to confirmation of the Plan ("the Supplemental Confirmation Objection"), asserting that the Plan could not be confirmed because it did not provide for payment of the Claim, as required under § 1322(e). RNPM further argued that Bankruptcy Rule 2016 and § 506(b) were "inapposite," and that § 1322(e) required the Debtor to pay attorney's fees in accordance with the terms of the Mortgage. It added that "the [M]ortgage provisions here in question are typically found in mortgage agreements executed in our jurisdiction" and have been upheld by the Supreme Court of Puerto Rico and many other lower courts of Puerto Rico.[4]

[4] Although RNPM argued both in the proceedings below and on appeal that Puerto Rico lower court decisions have upheld clauses identical to the Penalty Clause in this case, the cases which it cited in support of this proposition are not published in English, and RNPM has failed to supply translations. See 1st Cir. BAP L.R. 8008-1(b) ("The BAP will disregard any document(s) not in the English language unless a translation(s) is furnished.").

RNPM also asserted in the Supplemental Confirmation Objection that the Debtor could reinstate the Mortgage, as an alternative "to chapter 13 cure." In support of this argument, it specifically pointed to language contained in paragraph 19 of the Mortgage, which permitted the Debtor to cure the total arrearage in one lump sum. According to RNPM, "under a contractual mortgage reinstatement scenario, [it] would only be entitled to recover the costs, expenses and attorneys' fees reasonably incurred to enforce the" Mortgage. At the December 1, 2010 continued hearing on confirmation of the Plan, the chapter 13 trustee recommended confirmation, while RNPM re-asserted its objection. The court granted the Debtor 21 days to respond to the Supplemental Confirmation Objection and indicated that it would thereafter take the matter under advisement.

The Debtor filed a supplemental objection to the Claim on January 11, 2011 ("Supplemental Claim Objection"). In the Supplemental Claim Objection, the Debtor reiterated her request for an order directing RNPM to provide a detailed description of legal services rendered, number of hours worked, and hourly rate; alternatively, the Debtor again sought an order disallowing RNPM's claim should it fail to provide such information. The Debtor also argued:

> Creditors, in their supplemental motion, allege that this Honorable Court has no discretion and has to accept their claim was filed, without taking into consideration that the burden that their position takes on the [D]ebtor. In the particular case, the claim in attorney fees is about the same amount in dollars as the arrears of the [D]ebtor. This position makes it almost impossible for [the] [D]ebtor to retain [her] residential property, MAIN REASON FOR FILING THE BANKRUPTCY CASE.

RNPM filed a response to the Supplemental Claim Objection in which it essentially repeated the substance of its earlier arguments. For example, it again argued that the Bankruptcy

Code did not permit the court to modify the rights of holders of claims secured only by a security interest in a residential property that constitutes a debtor's principal residence. Accordingly, RNPM asked the court to overrule the Supplemental Claim Objection. On September 9, 2011, without a hearing, the court entered the Opinion and Order (the "Order") which is the subject of this appeal, ruling as follows:

> . . . [T]he court finds that 11 U.S.C. § 1322(e) is the controlling section for determining the amount of pre-petition mortgage arrearages and that the procedure to determine the reasonableness of attorney's fees pursuant to Fed. R. Bankr. P. 2016 is not applicable in the instant case. This court also finds that pursuant to Article 1108 of the Puerto Rico Civil Code, 31 L.P.R.A. § 3133, there are grounds for equitable intervention regarding the above referenced penal clause and as such finds that the penalty for attorney's fee[s] should be equitably reduced to $2,000.00.

In the Order, the court concluded that: (1) § 1322(e) determines the amount of pre-petition arrearages, including pre-petition attorney's fees; (2) § 506(b)'s reasonableness requirement for curing arrearages was inapplicable in the instant case; (3) Bankruptcy Rule 2016, which governs the procedure for determining the reasonableness of pre-petition fees, was also inapplicable, because the substantive law of Puerto Rico does not employ a reasonableness standard; (4) consistent with In re Plant, 288 B.R. 635, 642-44 (Bankr. D. Mass. 2003), bankruptcy courts are required to look to state law in order to determine a mortgagee's entitlement to attorney's fees; and (5) Article 1108 of the Puerto Rico Civil Code, 31 L.P.R.A. § 3133,[5] permits the modification of penal clauses in extraordinary circumstances in order to mitigate their onerous consequences. For these reasons, the court sustained the Supplemental Claim Objection and "equitably reduced" the Claim to $2,000.00.

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[5] References to "31 L.P.R.A. §§ 3131-3134" are to P.R. Laws Ann. Tit. 31, §§ 3131-3134 (2009).

The court further wrote:

> After thoroughly reviewing the totality of the circumstances in the instant case, this court finds that there are grounds for equitable intervention pursuant to Article 1108 of the Puerto Rico Civil Code, 31 L.P.R.A. § 3133. The Debtor has partly fulfilled her mortgage payment obligations under the [ ] [N]ote since January 2004, and she . . . intends to cure the [M]ortgage arrears . . . and continue making her monthly mortgage payments through her Chapter 13 plan. The court is aware that at the time of Debtor's bankruptcy petition filing she had not made any mortgage payments to RNPM for over a year. [The Plan] details $6,400 of arrears to Operating Partners (Docket No. 2) and Debtor's Chapter 13 Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income (Form B22C) lists monthly mortgage payments of $491 (Docket No. 1). In the instant case, RNPM's collection action in state court proceeded up to the point of the filing of the complaint by RNPM.
>
> This court finds that the penalty of $7,600.00 for attorney's fees in a case which proceeded only up to the point of the filing of the complaint by RNPM lacks proportion to the circumstances present in the instant case, wherein an individual intends to cure the mortgage payment arrears and continue making the monthly mortgage payments through a chapter 13 plan. Moreover, this court finds that the imposition of the $7,600 penalty for attorney's fees for initiating a collection of monies action would result [in] inequitable unfair consequences, namely the creditor's attorney getting a windfall at the expense of the unsecured debtors [sic] and negating the honest but unfortunate debtor its fresh start. Thus, this court modifies the penalty for attorney's fee[s,] [which] should be equitably reduced to $2,000.00.

On October 7, 2011, RNPM filed a Notice of Appeal.[6] RNPM identified three issues on appeal:

> A. Whether the [b]ankruptcy [c]ourt weighed the appropriate factors under state law before it determined that a downward modification of the amount set out as due as contained in the [M]ortgage [ ] was warranted.

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[6] On September 15, 2011, RNPM filed a motion to extend the time for filing an appeal by 21 days, which the bankruptcy court granted the following day. Accordingly, we may consider this appeal timely.

> B. Whether the [b]ankruptcy [c]ourt committed an error of law by disregarding Puerto Rico law which dictates that the compensation arising from the infringement of a penal cause should both provide compensation to the affected party for actual loss *and* serve to dissuade breach of the contractual agreement.
>
> C. Whether the [b]ankruptcy [c]ourt committed an error of law and/or abused its discretion when it failed to delineate the factors it took in[to] consideration as required by controlling state law when reducing the amount due under the penal clause and whether the [c]ourt properly weighed those factors [in] reaching its decision.

(emphasis in the original).

## JURISDICTION

A bankruptcy appellate panel is "duty-bound" to determine its jurisdiction before proceeding to the merits, even if not raised by the litigants. Boylan v. George E. Bumpus, Jr. Constr. Co., Inc. (In re George E. Bumpus, Jr. Constr. Co., Inc.), 226 B.R. 724, 725-26 (B.A.P. 1st Cir. 1998). The bankruptcy appellate panel has jurisdiction to hear appeals from "final judgments, orders, and decrees" pursuant to 28 U.S.C. § 158(a)(1), "or with leave of the court, from interlocutory orders and decrees" pursuant to 28 U.S.C. § 158(a)(3). Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998) (internal quotations omitted). An order on an objection to claim is a final order. See Neal Mitchell Assocs. v. Braunstein (In re Lambeth Corp.), 227 B.R. 1, 6 (B.A.P. 1st Cir. 1998); see also Miller v. Miller (In re Miller), 284 B.R. 734, 736 (B.A.P. 10th Cir. 2002) (holding that "order disposing of an objection to a claim is a final order"). Although the Order arose in the context of a hearing on confirmation of the Plan, it effectively sustained the Debtor's Supplemental Claim Objection. Thus, we are satisfied that the Order is final and that we have jurisdiction to hear this appeal.

## STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. See Lessard v. Wilton-Lyndeborough Coop. School Dist., 592 F.3d 267, 269 (1st Cir. 2010). The Panel reviews an order disallowing a claim for abuse of discretion, particularly where, as here, the disallowance involved "an exercise of the court's general equitable powers." In re Lambeth Corp., 227 B.R. at 6. An abuse of discretion occurs when the court "ignored a material factor deserving significant weight, relied upon an improper factor, or made a serious mistake in weighing proper factors." Id. at 7 (internal quotations and citations omitted).

## POSITIONS OF THE PARTIES

On appeal, RNPM concedes that the Puerto Rico Civil Code grants the bankruptcy court discretion to modify penal clauses which it determines to be excessive. It argues that in exercising its discretion in this case, however, the bankruptcy court failed to: (1) consider the "compensatory" and "dissuasive" functions of penalty clauses; (2) recognize that penalty clauses similar to the one in this case are the "industry standard" in Puerto Rico and have been upheld by the Supreme Court of Puerto Rico; (3) justify the amount of the reduction in light of the Debtor's failure to pay the Mortgage for over a year; and (4) recognize that the attorney's fees were not a payment to creditor's counsel but, rather, a payment to the creditor itself. Moreover, RNPM contends that the amount of the sanction imposed by the Penalty Clause in this case appropriately reflects that "legal proceedings are usually long and the costs associated with them are unpredictable."

The Debtor counters that the bankruptcy court properly exercised its discretion to equitably modify the Penalty Clause after consideration of the totality of circumstances, including her financial condition. She also argues that, contrary to RNPM's assertion, the bankruptcy court sufficiently elaborated its concerns and the applicable law in the Order. In support of her argument for mitigation of the effect of the Penalty Clause, she emphasized the onerousness of its consequences, stating:

> In the present case, the application of the [Penalty] [C]lause will have [a] devastating effect on the [D]ebtor, since the [D]ebtor will have to amend the [Plan] in the chapter 13 in order to make a provision to pay the $7,600.00 of the [Penalty] [C]lause, which will increase the payment plan in an additional $150.00 a month basis. This additional $150.00 will be really hard on the [D]ebtor['s] income, making it almost impossible on the [D]ebtor to retain its property.

## DISCUSSION

The essential facts underlying this appeal are not in dispute. The parties agree that the Mortgage provision in issue constitutes a "penal clause" within the meaning of Puerto Rico law. They also agree that § 1322(e) controls the determination of the amount of pre-petition attorney's fees which may be included in a secured creditor's mortgage arrearage claim. Thus, the only issue facing the Panel is whether the bankruptcy court abused its discretion when it reduced RNPM's claim for attorney's fees by the sum of $5,600.00.

### I. Applicable Standards

#### A. State Law and the Determination of Attorney's Fees

Section 1322(e) provides that

> Notwithstanding subsection (b)(2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

11 U.S.C. § 1322(e). Accordingly, a Massachusetts bankruptcy court ruled that:

> For agreements signed after [the] section's effective date [of October 22, 1994], . . . interest and other charges on arrearages cured through a Chapter 13 plan are allowed only if they are (1) required under the original agreement and (2) not prohibited by state law.

In re Plant, 288 B.R. at 642 (citing In re Landrum, 267 B.R. 577, 580 (Bankr. S.D. Ohio 2001); In re Lake, 245 B.R. 282, 285 (Bankr. N.D. Ohio 2000)). Other courts agree that § 1322(e) permits recovery of attorney's fees and expenses only if allowed by applicable nonbankruptcy law. See, e.g., In re Gagne, 378 B.R. 439, 443 (Bankr. D.N.H. 2007) (holding when debtor seeks to cure pre-petition default or arrearage on long-term debt through chapter 13 plan, amount of arrearage to be cured is determined by § 1322(e), which in turn requires courts to look to agreement and state law); In re Gordon-Brown, 340 B.R. 751, 757 (Bankr. E.D. Pa. 2006) (holding state law governs allowance of attorney's fees for pre-petition services in a proof of claim for mortgage arrears for mortgage transactions after October 22, 1994). In view of the foregoing authority, we conclude that the bankruptcy judge was correct in determining that the law of Puerto Rico controls the enforceability of the Penalty Clause.

**B. Penal Clauses in Puerto Rico**

The Civil Code of Puerto Rico specifically permits the use of penal clauses in 31 L.P.R.A. § 3131, which states:

> In obligations with a penal clause the penalty shall substitute indemnity for damages and the payment of interest in case of nonfulfillments, should there be no agreement to the contrary.
>
> This penalty can only be enforced when it is demandable in accordance with the provisions of this title.

31 L.P.R.A. § 3131.[7] Thus, under the law of Puerto Rico, "it is possible to agree upon obligations with penal clauses." Rochester Capital Leasing Corp., 3 P.R. Offic. Trans. at 227. The validity of the penal clause depends on the validity "of the principal obligation." 31 L.P.R.A. § 3134; see also Rochester Capital Leasing Corp., 3 P.R. Offic. Trans. at 234.

The Puerto Rico Civil Code does not specify what constitutes a "penal clause." Rochester Capital Leasing Corp., 3 P.R. Offic. Trans. at 234. The Supreme Court of Puerto Rico has stated, however, that the "function" and "impact" of a particular clause supersede the language employed in the determination of whether the clause is penal in nature. Id.

"'[T]he two most important functions of a penalty clause are to guarantee the performance of an obligation . . . and . . . to evaluate in advance the damages which may be caused to the creditor by the improper nonperformance of the obligation . . . .'" Id. (citations omitted); see also Consol. Mortgage & Fin. Corp. v. Cooley, 3 P.R. Offic. Trans. 9, 14 (P.R. 1974) (stating purpose of penal clause is to relieve creditor from proving damages). Thus, a "penal clause is not aimed to repair the damages suffered by the creditor but in addition it fulfills a coercive and punitive purpose." Rochester Capital Leasing Corp., 3 P.R. Offic. Trans. at 226. The punitive portion of damages imposed under a penal clause

> acts . . . as a pressure on the debtor to impel him to the specific performance of the obligation before the threat of having to pay an indemnity which would exceed the pecuniary equivalent of the obligation to which he is bound.

Id. (citation omitted).

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[7] This provision is "equivalent to articles 1152 to 1155 of the Spanish Civil Code." Rochester Capital Leasing Corp. v. Williams Int'l Ltd., 3 P.R. Offic. Trans. 226, 233 (P.R. 1974).

### C. Modification of Penal Clauses under Puerto Rico Law

"Precisely because of" their coercive and punitive purpose, penal clauses in Puerto Rico are "subject to the principle of moderation" under Puerto Rico law. Id. at 234. "As a remedy in equity against the strictness or the excessive burden of the penal clause, the Civil Code [of Puerto Rico] provides for the mitigation of the penalty" in 31 L.P.R.A. § 3133. Jack's Beach Resort, Inc. v. P.R. Tourism Dev. Co., 12 P.R. Offic. Trans. 430, 437 (P.R. 1982). That statute provides:

> The court o[r] judge shall equitably modify the penalty if the principal obligation should have been partly or irregularly fulfilled by the debtor.

31 L.P.R.A. § 3133. As stated by the Supreme Court of Puerto Rico, "[t]his is one of the rare cases where the [Civil] Code [of Puerto Rico] incorporates equity into positive law . . . ." Jack's Beach Resort, Inc., 12 P.R. Offic. Trans. at 437. The Supreme Court of Puerto Rico warned, however, that:

> The [judicial] power of mitigation should be used only with great caution and notorious justification. . . . The result of curbing the absolute preeminence of the autonomy of the will, either mitigating the effects of the contracts or limiting their obligatoriness according to rules of good faith, must be arrived at only in extraordinary circumstances as a means of mitigating its excessive onerousness for the obligee, or the alarming lack of proportion.

Id. at 438 (citation omitted).

Thus, in Jack's Beach Resort, Inc., the Supreme Court of Puerto Rico determined that moderation of the penal clause was warranted because "[t]he conditions of oppression, lack of proportion in the penalty, and its extremely unfair consequences [were] present . . . ." Id. at 439. In Jack's Beach Resort, Inc., the subject mortgage secured a $3,200,000.00 indebtedness and provided for acceleration in the event of a default in a single monthly installment, plus an

assessment of costs, expenses, and attorney's fees in the amount of $320,000.00 – i.e., the equivalent of 10 percent of the principal. Upon the mortgagor's default, the mortgagee commenced an action for foreclosure of the mortgage, claiming an unpaid principal balance in excess of $3,000,000.00, interest at the rate of 8 percent annually, and the sum of $320,000.00 for attorney's fees. The lower court entered judgment in favor of the mortgagee, granting the total amount claimed, including attorney's fees. On appeal, the Supreme Court of Puerto Rico refused to enforce either the acceleration clause or the $320,000.00 penalty. Instead, the court allowed the debtor "a term to bring its payments up to date," and reduced the penalty to $10,000.00. Id. at 440. The court reasoned:

> With regard to the $320,000 for attorney's fees agreed upon, which are also part of the penal design to press and oblige the debtor to pay under penalty of serious economic damage, its mitigation should not be taken to the point of a *quantum meruit* fixing, because then it would not be a modification, but the abolition of the agreement. It should be geared to an adjustment that, without eliminating the penal nature of the clause, reduces the penalty to make it proportional to the degree of fault and the magnitude of the harm caused. In the peculiar circumstances of the case before us, the penalty in the area of attorney's fees should be equitably reduced to ten thousand dollars ($10,000).
>
> In view of the foregoing, *the petition for review is granted and the judgment appealed is reversed, with a 30-day term within which the defendant . . . shall bring its payments up to date; and also pay its creditor . . . a $10,000 penalty for costs, expenses, and attorney's fees*.

Id. at 440-41 (emphasis in original).

In Rochester Capital Leasing Corp., the matter at issue was the enforceability of a penalty clause in an equipment lease that imposed fees and costs equal to15 percent of the amount due under the contract (or $3,452.79). The Supreme Court of Puerto Rico upheld the trial court's refusal to moderate the ostensibly harsh penal clause on the grounds that the defendant lessee

failed to establish that the resulting penalty caused it harm. Explaining its rationale for affirming the trial court's imposition of the penalty in the full amount, the Supreme Court of Puerto Rico stated:

> In the case at bar the Superior Court was not placed in condition of estimating the proper degree of moderation of the penalty and it correctly did not attenuate it. It does not appear of record whether or not the collator [sic] was sold and for how much. The difference if any, between the selling price, if the sale was carried out, and the value which the property would have had at the end of the agreed lease term is unknown. It is known that the machine was worth $4,650 at the moment of its lease, and that in Puerto Rico an offer was received for only two hundred dollars for it after lessee's breach of contract. *Lessee did not offer evidence, at the trial, of the damages which the lessor's actions may have caused to it. Neither did it explore whether lessor received an excessive profit or establish, as was its obligation, the grounds to request the moderation of the penalty.* Under such circumstances, there is no basis in [the] record to disturb the judgment.

Rochester Capital Leasing Corp., 3 P.R. Offic. Trans. at 236 (emphasis added).

In Rochester Capital Leasing Corp. , the Supreme Court of Puerto Rico acknowledged that trial courts have wide latitude when applying the "doctrine of [ ] moderation of the penalty." It cautioned, however, that:

> . . . [T]he moderation of the penalty should not reach the point of requiring from the creditor to return that received in excess of the damage suffered . . . , but in certain situations the penalty can be reduced to a very little bit more than that basis.

Id. at 237.

After Jack's Beach Resort, Inc. and Rochester Capital Leasing Corp., the Supreme Court of Puerto Rico again, in Levitt & Sons of P.R., Inc. v. D.A.C.O., 5 P.R. Offic. Trans. 248 (P.R. 1976), emphasized the need for courts to consider the proportionality of harms when determining whether to enforce a contract's penal clause. There, the defendant defaulted on its contractual

obligation to purchase a house. The underlying contract provided for the seller's retention of the buyer's $500.00 deposit (the equivalent of 2 percent of the $29,780.00 purchase price) as a penalty for such breach.[8] The trial court upheld an administrative decision of the Department of Consumer Affairs, ordering the seller to return all but $10.00 of the deposit. On appeal, the Supreme Court of Puerto Rico reversed the decision of the trial court, concluding that

> [The] mitigating judicial function does not come into play in the instant case since the penalty (2% of $29,780) keeps a just proportion with the foreseeable damages caused by the nonfulfillment, without imposing a punitive onerous burden.

Id. at 261.

## II. Analysis

From the foregoing, it is clear that in Puerto Rico, a court's discretion to modify penal clauses is broad but not unfettered. In reviewing a court's exercise of this discretion, the Supreme Court of Puerto Rico strives to strike a balance between the punitive and remunerative functions of penal clauses. Courts have placed the burden of demonstrating lack of proportion between the breach and the penalty on the debtor. In the instant case, the Debtor demonstrated that the $7,600.00 penalty imposed under the Mortgage exceeded the $6,400.00 Mortgage arrearage. Thus, she effectively established a lack of proportion between the penalty and the default of the sort frowned upon by Puerto Rico courts. She also argued that if upheld, a penalty of this magnitude would jeopardize her chances of success in chapter 13, thereby satisfying the element of onerousness required to justify moderation of a penal clause.

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[8] The penalty in Levitt & Sons of P.R., Inc. was incorporated in the subject contract pursuant to the terms of a Puerto Rico statute providing for the liquidation of damages in certain purchase and sale contracts. See Levitt & Sons of P.R., Inc., 5 P.R. Offic. Trans. at 262 n.6.

Furthermore, contrary to RNPM's assertion, the record also indicates that the bankruptcy court made detailed findings, sufficient to satisfy the requirement of "notorious justification" established by the Supreme Court in Jack's Beach Resort, Inc. Specifically, the court found that the Debtor had partly fulfilled her obligations under the Note since January 2004, and that although she had not made any payments to RNPM for over a year, the Debtor intended to cure the arrearage through the Plan.

The record further reveals that the bankruptcy court considered the Debtor's financial condition and the potential impact of the Penalty Clause when it adjusted the amount of the penalty. It is clear from the Order that the bankruptcy judge weighed the Debtor's Statement of Currently Monthly Income and Calculation of Commitment Period and Disposable Income against the extent of RNPM's collection efforts. As the court observed, those efforts merely "proceeded up to the point of the filing of the [C]omplaint." The court further noted that the Plan contemplated curing the Mortgage arrearage and monthly mortgage payments in the amount of $491.00. In this manner, the court endeavored to strike the necessary balance between the penalty and the magnitude of harm to RNPM, as required by the law of Puerto Rico. While the court did not specify a formula or otherwise indicate how it arrived, mathematically, at a reduction equal to $5,600.00, the case law does not require this level of precision or specificity in the exercise of a court's discretion. Indeed, the overarching principles articulated in the line of cases highlighted by Jack's Beach Resort, Inc., Rochester Leasing Corp., and Levitt & Sons of P.R., Inc. are balance and fairness, and no formulaic approach to penalty reductions is prescribed. Thus, based on the controlling principles enunciated by the Supreme Court of Puerto Rico, RNPM's argument that the bankruptcy court failed to take into account lending industry

standards or to substantiate the amount of its reduction is unpersuasive.[9] Consequently, we conclude that the bankruptcy court did not abuse its discretion when it reduced the Claim from $7,600.00 to $2,000.00.

## CONCLUSION

The bankruptcy court properly exercised its discretion when it reduced the attorney's fees due from the Debtor to RNPM under the Penalty Clause. Accordingly, the Order is **AFFIRMED**.

[9] Because we conclude that the bankruptcy court properly weighed the onerous consequences of the Penalty Clause on the Debtor against the prospect of harm to RNPM, the court's passing reference to any impact of the Penalty Clause upon RNPM's counsel does not alter our conclusion. Moreover, the parties do not dispute that any sums due pursuant to the Claim will be paid to RNPM, directly, rather than to RNPM's counsel.

**FOR PUBLICATION**

# UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

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**BAP NO. NH 11-084**

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**Bankruptcy Case No. 04-13901-JMD**
**Adversary Proceeding No. 11-01046-JBH**

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**BARBARA J. HANN,**
**Debtor.**

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**BARBARA J. HANN,**
**Plaintiff-Appellee,**

**v.**

**EDUCATIONAL CREDIT MANAGEMENT CORPORATION,**
**Defendant-Appellant.**

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**Appeal from the United States Bankruptcy Court**
**for the District of New Hampshire**
**(Hon. James B. Haines, Jr., U.S. Bankruptcy Judge)**

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**Before**
**Hillman, Feeney, and Hoffman,**
**United States Bankruptcy Appellate Panel Judges.**

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**Christopher J. Pyles, Esq., and Adam C. Trampe, Esq., on brief for Defendant-Appellant.**

**Richard D. Gaudreau, Esq., on brief for Plaintiff-Appellee.**

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**August 7, 2012**

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**Hoffman, U.S. Bankruptcy Appellate Panel Judge.**

Educational Credit Management Corporation ("ECMC") appeals from the following determinations of the United States Bankruptcy Court for the District of New Hampshire: (1) the October 20, 2011 order granting the motion of Barbara J. Hann ("Hann") for summary judgment against ECMC based on its post-discharge efforts to collect a fully paid student loan obligation; (2) the October 20, 2011 order denying ECMC's cross-motion for summary judgment; and (3) the November 18, 2011 Final Judgment imposing sanctions on ECMC in the amount of $9,134.72, pursuant to Bankruptcy Code § 105[1] (collectively "the Orders"). For the reasons discussed below, the Orders are **AFFIRMED**.

## BACKGROUND

Hann filed a voluntary petition for chapter 13 bankruptcy relief on November 2, 2004.[2] On Schedule F accompanying her petition, she listed National Asset Management as the holder of a disputed, contingent claim in the approximate amount of $55,000.00. She described the consideration for the claim as "Student Loans 1990-1993 Law School." In February 2005, ECMC filed a proof of unsecured claim in the approximate amount of $55,000.00 ("the Claim"), based on Hann's allegedly unpaid student loans. ECMC attached three $7,500.00 Stafford Loan promissory notes ("the Stafford Notes") as exhibits to the Claim, which notes were executed by

[1] Unless otherwise indicated, the terms "Bankruptcy Code," "section" and "§" refer to Title 11 of the United States Code, 11 U.S.C. §§ 101, et seq., as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 37.

[2] She had previously filed a chapter 7 case and received a discharge in 1995.

Hann on May 10,1990, April 30, 1991, and May 20, 1992, respectively.[3] ECMC also attached to the Claim its calculation of Hann's indebtedness, which purported to demonstrate that Hann owed a principal balance of approximately $31,000.00 on the Stafford Notes, plus collection costs of approximately $10,000.00, and unpaid interest of approximately $12,000.00.

In November 2005, Hann filed and served on ECMC an objection to the Claim ("the Claim Objection"), together with a proposed order and notice of hearing indicating a hearing date of January 10, 2006.[4] In the Claim Objection, Hann asserted both that ECMC failed to adequately document the Claim, and that, in any event, she had already paid more than what was due under the Stafford Notes. Accordingly, in her prayer for relief, she asked the court to disallow the Claim, or, to allow it in an amount proved by ECMC's payment history records.

ECMC neither filed a response to the Claim Objection, nor attended the January 10, 2006 hearing. Despite the absence of a response, the bankruptcy court held an evidentiary hearing. Hann, who was represented by counsel at the hearing, testified at length regarding her payment history and her efforts to obtain an account reconciliation from ECMC in 1998 and 1999. She testified that between November 1998 and June 1999, she wrote to ECMC six times, informing it that she "thought [its] numbers were wrong." She testified further that ECMC ignored her

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[3] The lender identified on each of the Stafford Notes is Ameritrust Company National Association. In the proceedings below, ECMC claimed that it received an assignment of the Stafford Notes from the United States Department of Education in February 2005, when the notes were allegedly in default. This representation conflicts with Hann's assertion in the bankruptcy court proceedings that the original holder was actually Society Bank. In any event, she has not challenged ECMC's assertion that it was the holder of the Stafford Notes.

[4] ECMC concedes that it received the Claim Objection and the notice of hearing on the Claim Objection.

communications, that in September 1999, it garnished her federal tax refund, and that her subsequent efforts to resolve the dispute regarding the amount of the indebtedness were equally unsuccessful. In order to facilitate the disposition of the Claim Objection, the court asked Hann to submit an affidavit. She, in turn, offered to explain her payment history, "loan by loan." In the context of this exchange, the court made the observation which, at least in part, fuels this dispute: ". . . to the extent there's anything out there, it's still excepted from discharge."

The affidavit which Hann subsequently furnished ("the 2006 Hann Affidavit") showed that from September 1990 to April 1993, she had borrowed a total of $84,089.00 in various student loans to fund law school tuition and related expenses. According to Hann, only $34,500.00 of that amount represented Stafford loans, which were originally obtained from Society Bank and later assigned to ECMC. In the 2006 Hann Affidavit, Hann chronicled her complicated student loan payment history. Significantly, she averred that on May 16, 1995 ("the May 1995 correspondence"), she received correspondence from Society Bank stating that the Stafford Notes had been paid. In the May 1995 correspondence, Society Bank enclosed one $7,500.00 Stafford Note marked "paid," and a lost note affidavit from Society indicating that another note in the amount of $15,000.00, although lost, had been "settled in full."[5] What emerges with clarity from the 2006 Hann Affidavit is her contention that she paid all of her student loans, including those arising from the Stafford Notes, in full prior to the commencement of her chapter 13 case.

[5] It is unclear how or whether the lost note affidavit and the note marked "paid" relate to the three $7,500.00 Stafford Notes appended to Claim, which Hann claims to have paid in full. It seems likely that the lost note affidavit combined two of the Stafford Notes.

On June 9, 2006, after due consideration, the bankruptcy court entered an order which provided, without explanation: "Debtor's [O]bjection to Claim [ ] 1 filed by ECMC is sustained. This [c]ourt allows the claim of ECMC in the amount of $0.00" ("the June 2006 Order").[6] ECMC did not appeal the June 2006 Order.

On March 2, 2010, Hann received a discharge after completion of her confirmed chapter 13 plan ("the Plan").[7] The discharge order specifically provided, in pertinent part:

> The chapter 13 discharge order eliminates a debtor's legal obligation to pay a debt that is discharged. Most, but not all, types of debts are discharged if the debt is provided for by the chapter 13 plan or is disallowed by the court pursuant to [§] 502 of the Bankruptcy Code.

The discharge order further indicated that "[d]ebts for most student loans" are excepted from discharge. Shortly thereafter, on May 28, 2010, the court entered an order closing Hann's chapter 13 case.

On April 12, 2010, less than a month after the entry of the discharge order, ECMC wrote to Hann, advising her that it had received an assignment of three of her student loans, and that the loans were not discharged. The letter demanded that Hann establish a repayment schedule immediately. On April 22, 2010, Hann received another demand from ECMC. By letter of even date, Hann's counsel informed ECMC that Hann had completed her plan payments and had

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[6] The Hon. Mark W. Vaughn presided over the January 10, 2006 hearing and issued the June 2006 Order. Upon Judge Vaughn's subsequent retirement, the main case was reassigned to the Hon. J. Michael Deasy. The Hon. James B. Haines, Jr., was assigned to the adversary proceeding.

[7] The Plan was not included in the record, so it is impossible to confirm Hann's treatment of ECMC's debt. The bankruptcy court docket, however, reveals that the court confirmed the Plan on October 18, 2005, absent objection by ECMC. See Aja v. Emigrant Funding Corp. (In re Aja), 442 B.R. 857, 861 n.7 (B.A.P. 1st Cir. 2011) (holding Panel may take judicial notice of the bankruptcy court proceedings).

received her discharge, and requested ECMC to cease collection activity. In May 2010, ECMC wrote to Hann yet again, this time warning that her "prolonged refusal to establish a repayment schedule on [her] defaulted student loan(s) [could] not continue." In March 2011, Hann received notice from the Department of the Treasury that her social security payments had been applied to her student loan debt.

On February 8, 2011, Hann filed a motion to reopen her bankruptcy case, which the court granted the following day. Two months later, she filed a four-count adversary complaint against ECMC ("the Complaint").

In Count I of the Complaint, Hann sought injunctive relief, barring ECMC from continuing collection efforts on the subject student loans; in Count II, she sought a declaratory judgment that the June 2006 Order precluded ECMC from collecting the Stafford Notes; in Count III, she requested a finding of contempt pursuant to § 105; and in Count IV, she sought a determination that ECMC violated the automatic stay, thereby causing her "emotional damages."[8] In her prayer for relief, she requested, *inter alia*, a finding that ECMC was in contempt of the June 2006 Order and sought an award of actual damages in the amount of $15,000.00, punitive damages, attorneys' fees, costs, and other appropriate relief.

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[8] In the prefatory language set forth in the Complaint, Hann represented, without specifying which order was violated, that the Complaint constituted:

> a petition for injunctive relief, declaratory judgment and other relief pursuant to [§] 105, and [§] 362. See Bessette v. Avco Fin. Servs., Inc., 230 F.3d 439 (1st Cir. 2000) (action under [§] 105 for contempt for violation of the discharge injunction).

In her prayer for relief, however, she stated that she was seeking damages for ECMC's violation of the June 2006 Order.

In its answer, ECMC challenged the accuracy of the 2006 Hann Affidavit and denied that the June 2006 Order reflected or included a specific finding that Hann owed ECMC nothing. ECMC admitted that it continued to send Hann post-discharge collection letters, contending that the June 2006 Order did not discharge Hann's obligations under the Stafford Notes.

In September 2011, Hann filed a motion for summary judgment on the limited issue of liability ("Summary Judgment Motion"), in which she framed the underlying issue as follows: "[I]s ECMC entitled to continue to collect student loans after conclusion of her chapter 13 in which Judge Vaughn after an evidentiary hearing ruled that ECMC was owed $0.00." Answering her own question in the negative, she argued:

> [ ] To the extent ECMC seeks to now raise the possibility of a payment dispute in opposition to this motion, that ship has sailed . . . The only issue for the court here is whether Judge Vaughn's orders were dispositive, and entitled to collateral estoppel effect.

In her accompanying memorandum of law, Hann further argued that the Plan specifically provided that "unsecured claims would only be paid if they were 'allowed' claims," and that "ECMC's claim was not allowed as the amount owed was $0.00." She also raised the four elements of collateral estoppel articulated in Keystone Shipping Co. v. New England Power Co., 109 F.3d 46, 51 (1st Cir. 1997). While Hann did not address the application of all of those elements, she focused on the "actually litigated" requirement, maintaining that her presentation of "ample evidence" during the claims objection process satisfied that element.

ECMC filed an opposition to the Summary Judgment Motion and a cross-motion for summary judgment ("the Cross-Motion"), together with a supporting memorandum of law. In the Cross-Motion, ECMC asserted the position that dominates this appeal, namely, that

"[c]hapter 13 disallowance does not extinguish a nondischargeable debt, and does not collaterally estop subsequent collection of the full amount." It also argued that the discharge order of March 2010 similarly failed to discharge Hann's student loan debt.

In its supporting memorandum, ECMC asserted that the bankruptcy court previously acknowledged the distinction between disallowance and discharge of a claim at the hearing on the Claim Objection, when it stated, ". . . to the extent there's anything out there, it's still excepted from discharge." Disallowance of a claim, ECMC argued, does not determine the amount owed on a pre-petition obligation, but merely deprives a claimant of payment through the plan. Under this argument, "student loan obligations survive disallowance and a general [c]hapter 13 discharge." ECMC also challenged Hann's collateral estoppel argument, contending that the issues were neither identical, nor "necessarily and actually litigated."

Hann responded with an opposition to the Cross-Motion, again pressing for the application of collateral estoppel. She noted that the proceedings on the Claim Objection were far from summary and that, therefore, the June 2006 Order merited preclusive effect. Additionally, she represented that the Plan called for payment of only allowed claims and fixed the amount of her student loan debt at zero.[9] She did not address, however, ECMC's "identity of issues" argument.

[9] Because the Plan was not included in the record on appeal, it is impossible to verify this assertion; nor is such verification necessary, as we are not relying on this representation in reaching our decision.

In its reply to Hann's opposition to the Cross-Motion, ECMC continued to emphasize the distinction between claims allowance and dischargeability by arguing:

> To just scratch the surface, the claims allowance process deals exclusively with the rights of [a] creditor against assets of a debtor['s] bankruptcy estate. By contrast, a dischargeability determination concerns whether a creditor may, after the entry of a bankruptcy discharge, continue to pursue the enforcement of its debt as a personal liability against the debtor.

(quoting Gregory v. U.S. Dep't of Educ. (In re Gregory), 387 B.R. 182, 188 (Bankr. N.D. Ohio 2008)).

The bankruptcy court conducted a hearing on the Summary Judgment Motion and the Cross-Motion on October 20, 2011, at which Hann and ECMC appeared by counsel. Hann's counsel summarized her position as follows: "I believe the issue has been actually litigated. It isn't a discharge issue. It is an issue about whether zero was owed at the time of the proof of claim order." He rejected the notion that Hann was required to file a complaint seeking a determination of dischargeability arguing: "[w]hy would she file one when she believes she owes zero?" ECMC countered:

> [ ] [T]he fundamental fact of the matter is that when [Hann] filed for a [c]hapter 13 proceeding and objected to the proof of claim she sought a disallowance of the claim. She did not seek discharge of her student loan debt.
>
> And as the cases show from Cruz [v. Educ. Credit Mgmt. Corp. (In re Cruz), 277 B.R. 793 (Bankr. M.D. Ga. 2000)] and Bell [v. Educ. Credit Mgmt. Corp. (In re Bell), 236 B.R. 426 (N.D. Ala. 1999)] and others, in a [c]hapter 13 proceeding, even where there is a finding on the claim, that as in Cruz for example, that the claim had been paid in full, that does not impact the underlying non-dischargeable debt . . . .

The court then inquired, "If there is a finding that nothing is owed, but the claim's not dischargeable, what's the practical import for the creditor?" ECMC's counsel replied:

> That under the [c]hapter 13 plan . . . there is no repayment to the creditor. . . . But the creditor holding a non-dischargeable debt can then collect on that debt at the conclusion of the [c]hapter 13 plan.

The court responded by noting that Judge Vaughn had undertaken "a fairly arduous examination and supplementation to determine whether or not this debtor was obligated to pay something under [the P]lan on account of student loan debt that wouldn't go away[.]" On three separate occasions, the bankruptcy judge asked ECMC's counsel if there was any money owed. Each time, his answer was unresponsive; ECMC's counsel was seemingly unable to identify or quantify a surviving obligation. Accordingly, the court announced it would grant the Summary Judgment Motion, stating:

> [ ] I have asked counsel repeatedly to point to some portion of obligation that was not within Judge Vaughn's scrutiny at the time of the claims objection.
>
> The creditor submitted a proof of claim. There was a duly-noted objection to claim. The [c]ourt found that the obligation on that claim, which was comprised of the student loan obligation, was zero. It was therefore treated as zero under the [P]lan. The debtor got a discharge of the claims that were treated under the plan.
>
> *There has been nothing pointed to me that shows that there is a substance of a claim, an obligation owing, outside that which was scrutinized after an evidentiary hearing by Judge Vaughn, within his jurisdiction, in connection with the claims objection process.*
>
> As a consequence, there's two things: One: it was paid 100 [percent] of zero under the [P]lan, and is therefore discharged. Or alternatively -- alternatively, *the amorphous student loan obligation may remain undischarged in ECMC's mind in the amount that is collaterally estopped to be zero.*
>
> As a consequence the [ ] [C]ross-[M]otion . . . is denied. . . .
>
> And the [S]ummary [J]udgment [M]otion is granted. . . .

> I just can't countenance a process with a debtor having done - - she did more than seek to have her debt discharged as undue hardship. She said, "Yeah, I -- I've owed them money, and I've been obliged to pay it; but I paid it back. Just determine that, Judge." And he did.

(emphasis added).

Hann's counsel then represented that his client only sought a ruling that ECMC was barred from future collection of the alleged student loan debt, together with fees and costs incurred in connection with his efforts to obtain such a ruling. He further indicated that Hann waived her remaining claims.[10] The court concluded the hearing by granting Hann a period of fourteen days to file an affidavit of fees and costs, and ECMC another fourteen days thereafter to object.

On October 20, 2011, the bankruptcy court entered an order ("the October 2011 Order"), wherein it stated that it granted the Summary Judgment Motion on Counts I (for injunctive relief), II (for declaratory judgment), and III (for contempt under § 105). On the same day, the court entered a separate order denying the Cross-Motion. ECMC filed a timely notice of appeal from both orders.

Thereafter, Hann filed an affidavit of fees and costs, in which she requested an award in the aggregate amount of $9,134.72, for professional services and expenses. She further represented that such fees were "reasonable and necessary." ECMC challenged Hann's request for fees and costs, on the grounds that there was no bankruptcy court "finding of contempt . . . , or even a hearing on any such claim." ECMC also contended that Hann had either waived or withdrawn her claim for fees and costs.

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[10] We understand this waiver to amount to a waiver of Count IV, the only Count which Hann excluded from the Summary Judgment Motion.

On November 18, 2011, without further hearing, the court entered a Final Judgment,[11] awarding Hann $9,134.72, the full amount requested, "as a remedial sanction for [ECMC's] violation of the Bankruptcy Code's discharge injunction." In the Final Judgment, the court elaborated as follows:

> Following my grant of summary judgment on October 20, 2011, the plaintiff waived all other claims and indicated that in addition to confirming that her obligation to the defendant had been determined to be satisfied and, in any event, discharged, she sought only an award of attorney's fees in consequence of the defendant's violation of the discharge injunction. Consistent with my direction, the plaintiff has filed an affidavit of fees and costs and the defendant has responded.
>
> I have reviewed [Hann's] affidavit of fees and costs and [ECMC's] response thereto. [ECMC] does not take issue with the reasonableness of the fees and costs sought, nor their relation to [Hann's] successful attempt to enforce compliance with the discharge injunction. Rather, [ECMC] contends that there has been no finding of a violation of [t]he discharge injunction, enforceable [through] this court's contempt powers under § 105.
>
> I reject [ECMC's] argument. I determined as a matter of law that [ECMC] was aware of [Hann's] discharge and that, following the discharge, *it took actions seeking to enforce a discharged obligation (indeed, an obligation that had been finally determined to have nothing owing on it before the discharge even entered)*.[12] On these critical points there is, and can be, no factual dispute.

(emphasis added).

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[11] Although the Final Judgment indicates that the court granted summary judgment on Counts II and III, only, the omission of Count I appears to be a scrivener's error, as both the October 2011Order and the transcript of the proceedings on the Summary Judgment Motion clearly indicate that the granting of summary judgment also encompassed Count I.

[12] Although the court stressed ECMC's violation of the discharge injunction in the Final Judgment, the Final Judgment also included a determination that ECMC attempted to collect an obligation on which nothing was owed. This determination falls well within the scope of Count III and supports a finding of contempt, as discussed, *infra*.

ECMC subsequently amended its notice of appeal to include the Final Judgment, and identifies the following two issues in its appellate brief:

> (1) [ ] Absent express language discharging student loan debts, does an order sustaining a claim objection operate as a matter of law to also discharge the underlying nondischargeable debts?
>
> (2) Did the bankruptcy court err when it summarily issued contempt sanctions against ECMC for violating a discharge order without any contempt hearing and without findings on disputed issues of material fact relating to ECMC's knowledge, willfulness, and good faith?

## JURISDICTION

A bankruptcy appellate panel is "duty-bound" to determine its jurisdiction before proceeding to the merits, even if the litigants do not raise the issue. George E. Bumpus, Jr. Constr. Co. v. Boylan (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724, 725-26 (B.A.P. 1st Cir. 1998) (internal quotations and citation omitted). A panel "may hear appeals from final judgments, orders, and decrees [pursuant to 28 U.S.C. § 158(a)(1)], or with leave of the court, from interlocutory orders and decrees [pursuant to 28 U.S.C. § 158(a)(3)]." Fleet Data Processing Corp v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998) (internal quotations omitted).

The Panel has previously ruled that "an order granting summary judgment is a final order where no counts against any defendants remain." Correia v. Deutsche Bank Nat'l Trust Co. (In re Correia), 452 B.R. 319, 322 (B.A.P. 1st Cir. 2011) (citation omitted). Conversely, partial summary judgments limited to the issue of liability "are by their terms interlocutory, . . . and where assessment of damages or awarding of other relief remains to be resolved have never been

considered to be final. . . . " Liberty Mut. Ins. Co. v. Wetzel, 424 U.S. 737, 744 (1976) (internal quotations and citations omitted); see also Vasquez Laboy v. Doral Mortg. Corp. (In re Vasquez Laboy), 647 F.3d 367, 372 (1st Cir. 2011) (ruling that for judgment to be final, the issue of monetary liability must be resolved). Here, where the court granted summary judgment on Counts I, II and III, the remaining count has been waived, and the issue of damages resolved, the Orders are final. Accordingly, we have jurisdiction to hear this appeal.

## STANDARD OF REVIEW

A bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*. See Lessard v. Wilton-Lyndeborough Coop. School Dist., 592 F.3d 267, 269 (1st Cir. 2010). The Panel applies a *de novo* standard of review to bankruptcy court orders granting summary judgment. Backlund v. Stanley-Snow (In re Stanley-Snow), 405 B.R. 11, 17 (B.A.P. 1st Cir. 2009).

## POSITIONS OF THE PARTIES

On appeal, ECMC argues that: (1) the disallowance of a student loan claim does not preclude later collection of the full amount of the subject debt; and (2) a sustained claim objection does not discharge student loan debts. Accordingly, ECMC maintains that it remained legally entitled to seek to collect the full amount of Hann's alleged student loan debt and, therefore, urges the Panel to reverse the Orders.

Hann, on the other hand, contends that: (1) the June 2006 Order means what it says - - that ECMC is owed $0.00; (2) the 2006 Order precludes re-litigation of the amount of ECMC's

claim under principles of collateral estoppel; and (3) the bankruptcy court properly enforced the June 2006 Order through a finding of contempt, pursuant to § 105. She asks the Panel to affirm the Orders.

## DISCUSSION

In both the summary judgment proceedings below and on appeal, ECMC attempts to frame the underlying issue in terms of dischargeability. Yet this appeal stems not from a dischargeability proceeding but, rather, from an objection to a proof of claim, and more specifically, from the June 2006 Order sustaining Hann's objection to ECMC's claim and allowing the claim in the amount of $0.00. Resolution of this appeal turns on the effect accorded that order and consequently, our analysis is governed by the standards applicable to summary judgment and the process for objecting to claims prescribed by the Bankruptcy Code.

### I. The Summary Judgment Standard

"In bankruptcy, summary judgment is governed in the first instance by Bankruptcy Rule 7056." Desmond v. Varrasso (In re Varrasso), 37 F.3d 760, 762 (1st Cir. 1994). "By its express terms, the rule incorporates into bankruptcy practice the standards of Rule 56 of the Federal Rules of Civil Procedure."[13] Id. (citations omitted). "It is apodictic that summary judgment should be bestowed only when no genuine issue of material fact exists and the movant has successfully demonstrated an entitlement to judgment as a matter of law." Id. at 763 (citing Fed. R. Civ. P. 56(c)). "As to issues on which the nonmovant has the burden of proof, the movant

[13] Fed. R. Civ. P. 56(a) provides, in pertinent part, that "[t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law. The court shall state on the record the reason for granting or denying the motion." Fed. R. Civ. P. 56(a).

need do no more than aver an absence of evidence to support the nonmoving party's case." Id. at 763 n.1 (citation and internal quotations omitted). "The burden of production then shifts to the nonmovant, who, to avoid summary judgment, must establish the existence of at least one question of fact that is both genuine and material." Id. (citations and internal quotations omitted). The "mere existence of *some* alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no *genuine* issue of *material* fact." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 (1986) (emphasis in the original).

## II. Section 502 and Disallowance of Claims

Section 502(a) provides that

> [a] claim or interest, proof of which is filed under [§] 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

11 U.S.C. § 502(a). The Bankruptcy Code defines a "claim" as a "right to payment," 11 U.S.C. § 101(5)(A), "usually referring to a right to payment recognized under state law." Travelers Cas. and Sur. Co. of America v. Pac. Gas and Elec. Co., 549 U.S. 443, 451 (2007). The Bankruptcy Code defines the term "debt" as the "liability on a claim." 11 U.S.C. § 101(12). The reflexive definitions of "claim" and "debt" reveal "Congress' intent that the[ir] meanings . . . be coextensive." Pennsylvania Dept. of Pub. Welfare v. Davenport, 495 U.S. 552, 558 (1990).

"A proof of claim is deemed valid and is allowed unless objected to by an interested party." In re Goldberg, 297 B.R. 465, 466 (Bankr. W.D.N.C. 2003) (citing § 502(a); Fed. R. Bankr. P. 3001(f)). Pursuant to Fed. R. Bankr. P. 3007(a), "[a]n objection to the allowance of a claim shall be in writing and filed." See Fed. R. Bankr. P. 3007(a). Section 502(b) provides that

if such an objection is made, "the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount." 11 U.S.C. § 502(b).

Section 502(b) itemizes nine grounds upon which a claim may be disallowed. See 11 U.S.C. § 502(b). Section 502(b)(1) is particularly relevant here as it provides for the disallowance of a claim that is unenforceable under "applicable law." See 11 U.S.C. § 502(b)(1). Courts apply the standards articulated in § 502(b) if there is an objection to a proof of claim. Hon. Joan N. Feeney, Bankruptcy Law Manual § 6:11 (5th ed. 2012). As observed by the court in In re Dow Corning Corp., 215 B.R. 346, 354 (Bankr. E.D. Mich. 1997), the Supreme Court has long recognized that the process of claims allowance includes dual determinations of both validity and the amount of the claim. See, e.g., Katchen v. Landy, 382 U.S. 323, 329 (1966) ("This power to allow or to disallow claims includes 'full power to inquire into the validity of any alleged debt or obligation of the bankrupt upon which a demand or a claim against the estate is based.'") (citing Lesser v. Gray, 236 U.S. 70, 74 (1915)); Vanston Bondholders Prot. Comm. v. Green, 329 U.S. 156, 170 (1946) ("[T]he threshold question for the allowance of a claim is whether a claim exists. . . . If there was no valid claim before bankruptcy, there is no claim for a bankruptcy court either to recognize or to reject."); Pepper v. Litton, 308 U.S. 295, 305 (1939) ("[A] bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence."). Thus, upon an objection to claim, the bankruptcy court has the power under § 502(b) to determine the validity and amount of the claim. See, e.g., In re Goldberg, 297 B.R. at 465; In re Dow Corning Corp., 215 B.R. at 354.

One bankruptcy court within this circuit has stated that "[§] 502(b) requires the bankruptcy court to undertake a two-part analysis." In re Leroux, 216 B.R. 459, 468 (Bankr. D. Mass. 1997). "First the court must determine the amount of [a creditor's claim] as of the date of the filing of the petition . . . [.]" Id. (brackets and ellipsis in the original) (internal quotations omitted). "This figure then forms the basis for the second part of the analysis, wherein the court determines how much of the claim should be allowed." Id. "Disallowance of a claim negates its validity and existence[.] A claim should be rejected and disallowed [ ] when it has no basis in fact or law, is non-existent or illegal." Diasonics, Inc. v. Ingalls, 121 B.R. 626, 630 (Bankr. N.D. Fla. 1990) (citation omitted).

While the practical effect of disallowance may be to preclude a claimant from "recover[ing] anything from the debtor," id. at 631, we are mindful that there are cases upon which ECMC relies in which courts have ruled that the holder of a nondischargeable debt whose claim has been disallowed by the bankruptcy court may nevertheless attempt to collect from the debtor personally after a discharge has been granted. See, e.g., Florida Dep't of Rev. v. Diaz (In re Diaz), 647 F.3d 1073, 1088-89 (11th Cir. 2011) (state child support authority could pursue debtor for full amount of child-support arrearages despite partial disallowance of the claim during chapter 13 case); In re Bell, 236 B.R. at 429 (partial disallowance of a student loan debt did not bar ECMC from collecting any sum in excess of that paid through the debtor's chapter 13 plan); In re Cruz, 277 B.R. at 795 (order disallowing ECMC's claim did not discharge debtor's liability to ECMC on account of that claim); In re Klassen, 227 B.R. 187, 190 (Bankr. D. Kan. 1998) (in the absence of evidence negating the existence of the debtor's liability on a claim,

disallowance was not a final adjudication of the debtor's liability). It is incontestable "that the disallowance of a claim does not necessarily discharge that debt." In re Cruz, 277 B.R. at 795. Indeed, "'disallowance of a claim and nondischargeability are separate issues.'" In re Diaz, 647 F.3d at 1090 (quoting Zich v. Wheeler Wolf Att'ys (In re Zich), 291 B.R. 883, 886 (Bankr. M.D. Ga. 2003)).

We respectfully disagree with the cases upon which ECMC relies, to the extent that they hold, or rely for their holding on the proposition that in the context of claims allowance, the bankruptcy court determines only what the estate will pay and cannot bind creditors post-discharge. Those courts have concluded that where § 523(a) precludes discharge of the debt, disallowance of the claim has no effect on the debtor's personal liability post-discharge. In Diaz, for example, the United States Court of Appeals for the Eleventh Circuit extended the reasoning of several circuit level tax cases that held confirmation of a chapter 11 plan did not conclusively determine the amount of a nondischargeable tax claim and held that "[t]he [Bankruptcy] Code similarly makes clear that a [c]hapter 13 discharge does not *fix* child-support liabilities made nondischargeable under [ ] § 523." In re Diaz, 647 F.3d at 1092 (citing United States v. Gurwitch (In re Gurwitch), 794 F.2d 584, 585 (11th Cir. 1986); DePaolo v. United States (In re DePaolo), 45 F.3d 373, 376 (10th Cir. 1995); Fein v. United States (In re Fein), 22 F.3d 631, 633 (5th Cir. 1994)) (emphasis added); see also Florida. Dep't of Rev. v. Davis (In re Davis), No. 11-15040, 2012 WL 2039914 (11th Cir. June 6, 2012). This rationale, however, conflates disallowance of the claim and dischargeability. The Bankruptcy Code does not use the word "fix" in the context of discharge but instead states that "the court shall grant the debtor a

discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt . . . of the kind specified in . . . [certain paragraphs] of section 523(a)." 11 U.S.C. § 1328(a)(2). Faced with the argument that § 1328(a) mandates that the disallowed portion of a nondischargeable domestic support obligation passes through bankruptcy unaffected, one court observed:

> For debts that are dischargeable, it is perfectly logical and understandable that the discharge which a debtor obtains after successfully completing his or her confirmed chapter 13 plan will be effective as to both debts which have been provided for in such plan and also those which have been "disallowed." Therefore, it may not be appropriate to try to apply this language across-the-board with respect to debts which are both non-dischargeable and disallowed. Even if one attempts to do just that, however, there is a meaningful interpretation for such language. . . . To re-use an example already noted in this opinion, § 502(b)(2) provides for disallowance of unmatured interest as of the filing date. Accordingly, post-petition interest on a non-dischargeable debt would be disallowed by § 502, but even so would be excepted from the scope of a chapter 13 discharge. *Such a construction of the language is not only entirely reasonable, but it also avoids the absurd situation which would be presented by a construction which would except from discharge child support or educational loan debts which had been disallowed as valid claims against the debtor or the bankruptcy estate on a basis such as payment in full. In short, there is no need to except from discharge a debt which no longer exists.*

Fort v. Florida Dep't of Rev. (In re Fort), 412 B.R. 840, 853 (Bankr. W.D. Va. 2009) (emphasis added).

By merging disallowance and dischargeability, the cases relied on by ECMC miss a subtle distinction. The issue is not whether a nondischargeable debt can be discharged by virtue of its disallowance, but whether there is a debt at all where the claim has been disallowed on the grounds of pre-petition payment in full. By definition, where there is no claim, there is no debt and nothing is discharged. See 11 U.S.C. § 101(5)(A) and (12). Other courts have reached the

same conclusion. See In re Fort, 412 B.R. at 854 ("reject[ing] the contention that a bankruptcy court's determination of any claim's allowed amount can have no effect apart from the bankruptcy case"); In re Goldberg, 297 B.R. at 466-67 (disallowing claim for a student loan obligation for failure of consideration and concluding that in the absence of a valid claim, there can be no debt to discharge); In re Girard, 243 B.R. 894, 896 (Bankr. M.D. Ala. 1999) (where debtor objected to student loan creditor's claim on the grounds that it was incorrect, ECMC was not entitled to any nondischargeable deficiency after full payment of the allowed claim through the debtor's chapter 13 plan); see also Belton v. Educ. Credit Mgmt. Corp. (In re Belton), 337 B.R. 471, 474 (Bankr. W.D.N.Y. 2006) (noting that while ECMC was not barred from collecting costs omitted from the proof of claim and not provided for in the debtor's plan, the result might have been different had the debtor objected to the claim); In re Klassen, 227 B.R. at 190 (noting that had the debtor presented evidence strong enough to negate his liability on the student loan claim with his objection, the court "would then have had to address the vexing question of its power to decide with finality state law liability issues in the context of claim allowance."). Moreover, discharge is not currently the issue, as neither party ever properly presented it to the court below by commencing an adversary proceeding for that purpose. United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1376 (2010). Therefore, we find the nature of the objection to be of critical importance to determining what effect it will be accorded outside of bankruptcy.

In light of the foregoing, this Panel concludes that by filing the Claim Objection, Hann invoked the appropriate procedural mechanism provided by the Bankruptcy Code to obtain a

determination of both the validity and amount of the Claim. The record reflects that the bankruptcy court conducted a thorough review of the Claim Objection and the Claim, which review included consideration of Hann's testimony as well as the 2006 Hann Affidavit. This process yielded a ruling that the amount of the Claim on the date of Hann's bankruptcy petition was zero. Accordingly, the court allowed the Claim in that amount, which we conclude is tantamount to disallowance. In light of the nature of her objection, namely, that the Claim had been paid pre-petition, we are unpersuaded by ECMC's contention that the June 2006 Order lacks sufficient specific factual findings to support the conclusion that the bankruptcy court found that there was no obligation. The court having concluded that there is no extant claim, there can be no liability on a claim and hence no debt within the meaning of § 101(12). Thus, the June 2006 Order which is the subject of this appeal effectively precluded any further attempt by ECMC to collect on the alleged student loan debt.

In addition to finding ECMC's legal theory unsound, the Panel is struck by the waste of judicial resources that would be occasioned by ECMC's position. Once ECMC filed its proof of claim, Hann was required to object to it in order to avoid having to pay any portion of it through her plan. Her only basis for objection was the fact that the debt had been paid in full pre-petition. The bankruptcy court took evidence and, in disallowing the Claim, necessarily determined that it had, in fact, been paid in full. Nevertheless, ECMC wants a "do over" because, it argues, the wrong procedural mechanism was used. ECMC, however, does not suggest a better mechanism, particularly in light of the fact that Hann was not seeking a discharge of her student loans because of undue hardship.

## III. Res Judicata[14]

"The doctrine of res judicata bars a party from bringing a claim if a court of competent jurisdiction has rendered a final judgment on the merits of the claim in a previous action involving the same parties or their privies." Siegel v. Fed. Home Loan Mortg. Corp., 143 F.3d 525, 528 (9th Cir. 1998) (internal quotations citation and omitted). The United States Court of Appeals for the First Circuit has stated that the essential elements of claim preclusion are:

> (1) a final judgment on the merits in an earlier action; (2) an identity of parties or privies in the two suits; and (3) an identity of the cause of action in both suits.

Grella, 42 F.3d at 30 (citation omitted). "Once these elements are established, claim preclusion also bars the re[-]litigation of any issue that was, or *might have been*, raised in respect to the subject matter of the prior litigation." Id. (citation omitted) (emphasis in the original).

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[14] Although Hann's argument entails an assertion of the doctrine of collateral estoppel, res judicata is the applicable preclusion doctrine here. As the Panel recently explained:

> Traditionally, res judicata was the umbrella term for both claim preclusion and collateral estoppel. Grella v. Salem Five Cent Sav. Bank, 42 F.3d 26, 30 (1st Cir. 1994). In modern nomenclature, collateral estoppel is now referred to as issue preclusion and res judicata as claim preclusion. Eastern Pilots Merger Comm. v. Continental Airlines, Inc. (In re Continental Airlines, Inc.), 279 F.3d 226, 232 (3rd Cir. 2002). The two terms replace "a more confusing lexicon" but may continue to be "collectively referred to as 'res judicata.'" Taylor v. Sturgell, 553 U.S. 880, 892 (2008). "Claim preclusion generally refers to the effect of a prior judgment in foreclosing successive litigation. . . . Issue preclusion generally refers to the effect of a prior judgment in foreclosing successive litigation of an issue . . . actually litigated and resolved in a valid court determination essential to the prior judgment. . . ." New Hampshire v. Maine, 532 U.S. 742, 748-49 (2001).

B.B. v. Bradley (In re Bradley), 466 B.R. 582, 586 n.4 (B.A.P. 1st Cir. 2012).

Courts within this circuit have held that for res judicata purposes, "a default judgment is a final judgment as to the claims raised by the prevailing party." See In re Stanley-Snow, 405 B.R. at 19 ("most federal courts of appeal have recognized an exception to the general rule that collateral estoppel does not apply to a default judgment," where party chooses not to defend in prior action); see also New England Ins. Co. v. Sylvia, 783 F. Supp. 6, 9 (D.N.H. 1991); Maslar v. Martin (In re Martin), 468 B.R. 479, 483 n.8 (Bankr. D. Mass. April 12, 2012). The Panel has previously ruled that a bankruptcy court's order on an objection to claim is a final order. Neal Mitchell Assoc. v. Braunstein (In re Lambeth), 227 B.R. 1, 6 (B.A.P. 1st Cir. 1998). Other appellate courts have reached the same conclusion. See Siegel, 143 F.3d at 529 ("the allowance or disallowance of a claim in bankruptcy is binding and conclusive on all parties or their privies, and . . . furnishes a basis for a plea of res judicata") (internal quotations and citation omitted). As stated by the United States Court of Appeals for the Ninth Circuit, "the allowance or disallowance of a claim in bankruptcy should be given like effect as any other judgment of a competent court, in a subsequent suit against the bankrupt or any one in privity with him." Id. (internal quotations and citation omitted).

Here, the record reflects a final judgment and an obvious identity between the parties. Thus, two of the three elements required for the application of res judicata are satisfied. ECMC essentially challenges the existence of the third element, identity of causes of action, by arguing that claim allowance and discharge are separate issues and therefore neither res judicata nor collateral estoppel apply. We disagree. The adequacy of notice is undisputed, and Hann, by her

Claim Objection, clearly challenged the Claim in its entirety. Under these circumstances, ECMC "was not free blithely to forgo its full and fair opportunity" to defend the Claim on the grounds of an alleged distinction between claim allowance and claim discharge. Factors Funding Co. v. Fili (In re Fili), 257 B.R. 370, 372 (B.A.P. 1st Cir. 2001) (holding that under principles of res judicata, a creditor on notice that his claim will be disallowed in total and discharged under chapter 13 plan may not ignore confirmation process and later assert a claim). As we have previously stated, "[a] creditor who disregards a procedurally proper and plain notice that its interests are in jeopardy does so at its own risk." Id. at 374.

By couching its argument in discharge terms, ECMC attempts to circumvent the principles of res judicata for purposes of re-litigating an objection to claim which it initially ignored in the proceedings below. Because the June 2006 Order, however, was a final, binding order for res judicata purposes, it follows that ECMC's efforts to re-litigate its claim are precluded and that, therefore, the amount of Hann's debt to ECMC must stand, conclusively, at zero.

## IV. Sanctions Under § 105

Section 105(a) permits the court to

> issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a). Section 105(a) "provides the bankruptcy court broad authority to exercise its equitable powers--where necessary or appropriate--to facilitate the implementation of other

Bankruptcy Code provisions." Nosek v. Ameriquest Mortg. Co. (In re Nosek), 544 F.3d 34, 43 (1st Cir. 2008) (internal quotations and citations omitted). Because this statute also "gives courts [the] power to ensure compliance with its own orders, [the First Circuit has] referred to it as conferring statutory contempt powers which inherently include the ability to sanction a party." Id. at 43-44 (internal quotations and citation omitted). The inherent ability to sanction a party includes "the power to order monetary relief, in the form of actual damages, attorney fees, and punitive damages." Bessette v. Avco Fin. Servs., Inc., 230 F.3d at 445. The First Circuit has warned, however, that the court's equitable powers pursuant to § 105 must be exercised cautiously:

> [S]ection 105(a) does not provide bankruptcy courts with a roving writ, much less a free hand. The authority bestowed thereunder may be invoked only if, and to the extent that, the equitable remedy dispensed by the court is necessary to preserve an identifiable right conferred elsewhere in the Bankruptcy Code.

Jamo v. Katahdin Fed. Credit Union (In re Jamo), 283 F.3d 392, 403 (1st Cir. 2002) (citations omitted).

As found by the court below, ECMC repeatedly telephoned Hann, issued threatening demand letters, and garnished her property, all in utter disregard of the judicial determination that Hann had no liability to ECMC. This conduct is not the only example of ECMC's disregard of the bankruptcy process and the court's authority. From the inception of Hann's bankruptcy case, ECMC was on notice that she disputed ECMC's claim by virtue of her indication on Schedule F that its debt was disputed. When ECMC filed the Claim, Hann responded with the Claim Objection. Despite the fact that it was properly served with the Claim Objection and with

notice of the opportunity to be heard, ECMC chose not to respond or appear at the hearing. The bankruptcy court docket reflects that ECMC also remained silent regarding the Plan. Even after the entry of the June 2006 Order, ECMC failed to avail itself of the appropriate remedies afforded to parties aggrieved by a claim disallowance order, namely a motion to reconsider under § 502(j).[15] Five years later, when pressed by the court during the summary judgment hearing to demonstrate the existence of an amount owed, ECMC remained unready, unwilling, and unable to do so. The record reflects that ECMC studiously ignored every opportunity to be heard regarding the merits of the Claim and then flouted the June 2006 Order through which the court declared its debt nonexistent. Under these circumstances, ECMC's argument that student loan debts are nondischargeable is misleading and irrelevant; it cannot be permitted to divert attention from its violation of the June 2006 Order.

The Panel concludes that ECMC's continued collection activities notwithstanding the court's determination that nothing was owed constituted an abuse of the bankruptcy process and defiance of the court's authority, such that the imposition of attorney's fees as a sanction was warranted, on those grounds alone.[16] Furthermore, we conclude that the court acted well within its authority when it imposed the sanctions without scheduling an additional hearing. See

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[15] Section 502(j) provides, in pertinent part, that "[a] claim that has been allowed or disallowed may be reconsidered for cause." 11 U.S.C. § 502(j).

[16] Although it appears from the Final Judgment that the court focused on ECMC's violation of the discharge injunction as the primary basis for its imposition of sanctions, we are free to affirm the bankruptcy court's ruling "on any ground supported in the record even if the issue was not pleaded, tried, or otherwise referred to in the proceedings below." Baybank-Middlesex v. Ralar Distribs., Inc., 69 F.3d 1200, 1202 (1st Cir. 1995) (citation omitted). In this instance, however, Hann specifically requested an award of sanctions for ECMC's violation of the June 2006 Order. Accordingly, we may affirm the Orders on the bankruptcy court based on ECMC's violation of that order.

Walton v. LaBarge (In re Clark), 223 F.3d 859, 864-65 (8th Cir. 2000) (upholding imposition of § 105 sanctions without further hearing where individual already received notice that sanctions were being considered and had an opportunity to be heard).

## CONCLUSION

For all of the foregoing reasons, the Orders are **AFFIRMED**.