1st Circuit

***SHARFARZ, Appellant, v. GOGUEN [Debtor], Appellee*, 691 F.3d 62 (1st Cir. 2012) (Before Justices Boudin, Souter, Thompson, Opinion by Thompson).**

"What happened in this bankruptcy case is probably every homeowner's worst nightmare."

HELD: First Circuit vacated the BAP's judgment and remanded to that tribunal with directions that it, in turn, remand the case to the bankruptcy court for further proceedings consistent with this opinion.

SUMMARY: The First Circuit agreed with the Bankruptcy Court that the construction debt at issue was not discharged per Section 523(a)(2)(A). While the BAP found that creditor failed to satisfy the cause-in-fact rule that the chapter 7 debtor's misrepresentations induced him to enter into the construction *contract*, the First Circuit disagreed and found the focus to be broader, examining the *transaction*. Examining the transaction, the First Circuit found that the creditor satisfied its proof as to cause-in-fact and legal cause. Thus, the creditor showed that the debtor's lies led to a loss that might reasonably have been expected to result from the reliance i.e.as the debtor (pre-petition) strung the creditor along with lies about the permit application relevant to the projected construction project, the debtor could have reasonably foreseen that his deceit would delay the project, which would lead to the project pouring concrete in cold weather, which in turn would lead to the concrete foundation cracking. So, to put the point in "Restatement" terms, creditor's reliance on debtor's misrepresentations resulted in a "loss" that could "reasonably" have been "expected" to occur "from the reliance" — indeed the loss here was expected. Creditor prevails because he adequately proved causation and debtor did not bear his burden of showing an intervening or superseding cause. Consequently, the First Circuit reversed the BAP's decision which BAP decision reversed the bankruptcy court. Finally, the amount not discharged will be determined upon remand to the bankruptcy court.

See Attachment: ***SHARFARZ, Appellant, v. GOGUEN [Debtor], Appellee***

***MATOS [Debtor], Appellant, v. RIVERA, Chapter 13 Trustee, Appellee*, BAP NO. PR 11-074, (BAP 1st Circuit Sept. 26, 2012) (Before Judges Boroff, Deasy, and Bailey) (Opinion by Deasy).**

HELD: Bankruptcy Appellate Panel reversed the bankruptcy court's determination that the income tax refund at issue was not property of the estate. BAP found that the income tax refund was property of the chapter 13 bankruptcy estate and thus could be exempted on Schedule C. As such, the Chapter 13 trustee's objection to the debtor's exemption in the refund is overruled.

For a similar ruling, see ***SANTIAGO, MORALES, Appellants, v. RIVERA, Chapter 13 Trustee, Appellee*, BAP NO. PR 11-075 (BAP 1st Circuit September 26, 2012) (Before Boroff, Deasy, and Bailey, Opinion by Deasy).**

See Attachment: ***BAP Matos***

***PRUDENTIAL INSURANCE COMPANY OF AMERICA, Appellant / Cross-Appellee, v. CITY OF BOSTON, Appellee, and SW BOSTON HOTEL VENTURE, LLC, et al., Appellees / Cross-Appellants [Debtors],* BAP NO. MB 11-079, (BAP 1st Circuit October 1, 2012) (Before Haines, Deasy, and Tester, Opinion by Deasy).**

HELD: BAP AFFIRMS the Default Rate Calculation, REVERSES the 506(b) Order and the Prudential Claim Order, and REMANDS.

SUMMARY: The BAP held that they will follow the "flexible" approach rather than a fixed date for valuation of collateral for purposes of Section 506(b), and in so doing the creditor's debt was determined to be oversecured and the creditor entitled to be paid then post-petition interest, said interest paid at the contract's default rate and compounded.

See Attachment: ***BAP NO. MB 11-079***

***PRUDENTIAL INSURANCE COMPANY OF AMERICA, Appellant / Cross-Appellee, v. CITY OF BOSTON, Appellee, and SW BOSTON HOTEL VENTURE, LLC, et al., Appellees / Cross-Appellants [Debtors]*, BAP NO. MB 11-087, BAP 1st Circuit October 1, 2012) (Before Haines, Deasy, and Tester, Per Curiam).**

Prudential Insurance Company of America appealed from the bankruptcy court's decision and accompanying order confirming the Debtors' Modified First Amended Joint Plan of Reorganization and the order overruling Prudential's objection to confirmation of the Plan. Because the BAP's above opinion and reversal altered the landscape dramatically, its practical result is a significant increase in the amount of Prudential's claim, which, in turn, impacts the evaluation of the Plan's terms under §1129. Thus, the BAP vacated the Confirmation Orders, so as to afford the Debtors an opportunity to amend the Plan's terms to account for the increased amount of Prudential's claim (per the above opinion) and the resulting pay out to Prudential and/or for the bankruptcy court to fashion alternative forms of relief for Prudential that would not unravel the reorganization.

See Attachment: ***BAP NO. MB 11-087***

***GONSALVES, Plaintiff-Appellant, v. BELICE [Debtor], Defendant, Appellee*, BAP NO. MB 11-048, (BAP 1st Cir. October 15, 2012) (Before Lamoutte, Haines, and Deasy, Opinion by Haines) [No brief filed for Appellee, Appellant Pro Se].**

Gonsalves, a *pro se* creditor, appealed: (1) the order granting the motion of the debtor to dismiss Gonsalves' adversary complaint; and (2) the order denying Gonsalves' motion for relief from judgment. As the BAP concluded that the dismissal was not only beyond the scope of their prior remand but was also legal error, they VACATED the orders and REMANDED the matter for further proceedings consistent with this opinion. In a prior opinion, the BAP found that the debtor's notice to the creditor was so defective as to defeat notice of the bankruptcy case or discharge bar date, allowing then the creditor to go forward on one of his two counts challenging the dischargability of his debt, with the Section 727 count being time barred but the §523(a) count not. Thus, the bankruptcy court's dismissal of the §523(a) count exceeded the scope of the prior remand i.e. BAP had concluded in its prior opinion that the creditor's complaint presented a plausible case for relief under §523(a)(3). Therefore, it was error for the bankruptcy court to dismiss this claim on the grounds that he failed to state a claim upon which relief can be granted. On remand, debtor again

sought dismissal under Rule 12(b)(6), this time based on his argument that creditor had failed to file the §523(a)(3) count within one year of his discharge, despite having received notice a month prior to that anniversary. Debtor erroneously contended that the one year limitation set by §727(e) for discharge revocation actions applied to the creditor's §523(a)(3) claim. Creditor argued that because the BAP's remand confined the bankruptcy court to consideration of the merits of his §523(a)(3) count, it was error to expand its scope to include a request for dismissal based on timeliness. He contends that it was also error to dismiss his complaint for failure to file a response to the dismissal motion when he had, in fact, filed an objection. He lastly reiterates that his complaint was not time-barred. The BAP agreed.

See Attachment: ***BAP Gonsalves v Belice***

***BELLAS PAVERS, LLC, Plaintiff-Appellant, v. STEWART [Debtor], Defendant-Appellee*, BAP NO. MB 12-017, (Before Lamoutte, Kornreich, and Cabán, Opinion by Cabán) (BAP 1st Circuit October 18, 2012).**

This case arises out of an adversary proceeding brought by Bellas Pavers, LLC seeking to except from discharge a debt owed by Stewart for masonry services. The bankruptcy court conducted a trial, and at the close of Bellas' case, Stewart moved for a judgment on partial findings pursuant to Fed. R. Civ. P. 52(c), which the Court granted and entered judgment in favor of Stewart. Thereafter, Bellas filed a motion pursuant to Fed. R. Civ. P. 59(a) requesting a new trial, or in the alternative, that the bankruptcy court reopen the original trial, enter new findings of facts and conclusions of law, find in Bellas' favor on all counts, and enter a judgment of non-dischargeability. The bankruptcy court denied the motion for a new trial, and Bellas appealed. Controversy centers on the construction of a stone patio and retaining wall where the debtor failed to pay a sub-contractor even though the debtor was paid for the job. The bankruptcy court conducted a trial. After plaintiff put on two witnesses, Stewart moved for a judgment on partial findings pursuant to Rule 52(c), asserting three grounds: (1) lack of personal liability for Premier's actions (the agreement was between Bellas and Premier, not Stewart); (2) lack of evidence that Stewart had fraudulent intent when he entered into the agreement with Bellas on Premier's behalf; and (3) lack of evidence that Bellas had reasonably relied on Stewart's representations. As to the question of fraudulent intent, the bankruptcy court stated as follows: It's perfectly consistent [with] the evidence that Mr. Stewart did, in fact, intend when he entered into the contract with Bellas on behalf of Premier to have Bella[s] paid. I have nothing in my record that indicates that that was a lie. . . I don't know what happened that Premier/Stewart didn't pay Bellas Pavers. Maybe they just ran out of money. I don't know what they did with the money, but that doesn't prove that it should be a debt [sic] will be – which would be nondischargeable in bankruptcy." Given these facts, the bankruptcy court granted Stewart's motion under Rule 52(c), and entered judgment in his favor. Thus, based upon the record, we conclude that the bankruptcy court did not err by not inferring fraudulent intent from the totality of the circumstances.

HELD: AFFIRMED.

MOTION FOR COSTS AND FEES DENIED: Stewart filed a separate motion under Bankruptcy Rule 8020 seeking damages, including attorneys' fees and costs, incurred in defending this appeal. Bellas objects to the motion. Bankruptcy Rule 8020 provides: If a . . . bankruptcy appellate panel determines that an appeal . . . is frivolous, it may, after a separately filed motion . . . and reasonable opportunity to respond, award just damages and single or double costs to the appellee. While there is no formula for determining whether an appeal is frivolous, courts generally consider several

factors, including: the appellant's bad faith, whether the argument presented on appeal is meritless *in toto*, and whether only part of the argument is frivolous. A court may consider whether the appellant's argument addresses the issues on appeal, fails to cite any authority, cites inapplicable authority, makes unsubstantiated factual assertions, asserts bare legal conclusions, or misrepresents the record. However, "[Bankruptcy] Rule 8020 is far from a strict liability model. More than just a losing argument is necessary to support a conclusion that an appeal is frivolous. An appeal is frivolous if the result is obvious or the arguments supporting the appeal are wholly without merit. Such is not the case herein.

See Attached: ***BAP Bellas Pavers***

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691 F.3d 62 (1st Cir. 2012)

In re Peter J. GOGUEN, Debtor.

David M. Sharfarz, Appellant,

v.

Peter J. Goguen, Appellee.

No. 11-9004.

United States Court of Appeals, First Circuit.

August 15, 2012

Heard March 7, 2012.

Ashley S. Whyman, with whom Stephen F. Gordon, Todd B. Gordon, and The Gordon Law Firm LLP were on brief, for appellant.

Paul R. Chomko, with whom Alford & Bertrand, LLC was on brief, for appellee.

Before BOUDIN, Circuit Judge, SOUTER, Associate Justice,[*] and THOMPSON, Circuit Judge.

THOMPSON, Circuit Judge.

LAYING THE GROUNDWORK

What happened in this bankruptcy case is probably every homeowner's worst nightmare. We start, naturally, with the facts, which are either undisputed or based on the bankruptcy judge's not-clearly-erroneous findings.

Having just moved with his 14-year-old son from Anchorage, Alaska to Acton, Massachusetts, David Sharfarz started talking to contractors in the summer of 2006 about building an addition to his new home. Sharfarz ended up hiring Peter Goguen, who drafted up a contract. Stripped to its essentials, the contract specified different construction phases, requiring Goguen to pour the foundation by October 15, 2006, for example. It required Goguen to obtain the necessary town permits too. It also required Sharfarz to make progress payments to Goguen totaling roughly $171,000. And it set a completion date of March 15, 2007.

Sharfarz made no secret of the fact that he needed Goguen to start the project right away, for these reasons: first, he wanted his son to settle into his new life as quickly as possible, and second, he wanted the foundation poured before winter because he feared that a cold-weather concrete pouring could cause the foundation to crack. Sitting in Sharfarz's living room, the two signed the contract and Sharfarz handed Goguen a $25,693 check as the first installment payment. And Sharfarz again stressed why sticking to the schedule was so important to him.

A week or so later Goguen emailed Sharfarz that he had " filed" a building-permit application with the town and was " in wait mode." But that was not true, and Goguen did his best to keep Sharfarz from finding that out. Over the next couple of months, for example, every time a worried Sharfarz asked him for a permit update, Goguen blamed the delay on foot-dragging town bureaucrats. And when Sharfarz offered to talk to the town manager or a member of the board of selectmen, a nervous Goguen called it " the worst thing we could do." No need to " aggravate" the

building inspector by going over the inspector's head, Goguen said. We just have sit tight until the town acts, he added.

That did little to calm Sharfarz, who had a gnawing belief that project delays would expose him to the risk of concrete damage due to the onset of winter. One of Sharfarz's November 2006 emails to Goguen made this perfectly plain: " I would ... like a better understanding as to how we will keep the foundation warm" to help the concrete strengthen and harden after a cold-weather pouring, he wrote. " I know there are ways to do it, but I assume that they all cost money." " This," he wrote, " is pretty much the only aspect of a wintertime start-up that is concerning me." Goguen replied that " weather protection [won't be] an issue until night time temperatures" dip below freezing.

With the cold season fast approaching, Goguen did little to advance the project. Misled into thinking that the town was at fault for the permit holdup and still convinced that they would be inviting trouble if they poured concrete in the cold, Sharfarz proposed the following solution: They

would shut down the project for now. Goguen would keep $5,000 of the $25,693 payment for his " troubles" and refund the remaining money to Sharfarz. When the warm weather returned, they would restart the project, and Goguen would get back the rest of the initial payment. This made good " sense," Sharfarz said. But not to Goguen. He assured Sharfarz that the foundation would not crack from a cold-weather pouring, explaining that " New England is a lot warmer than Alaska" and that " we put additives" in the concrete to prevent cracking. Cold-weather pourings are done " routinely" throughout New England all winter long— it's no big deal, Goguen said (or words to that effect). And rather than give Sharfarz any money back, Goguen instead offered a 5-year warranty against " structural defect[s]" in the " new footing and concrete foundation." All of this persuaded Sharfarz to continue with the contract. Goguen " was the expert," Sharfarz later explained, " and I just relented."

Goguen finally applied for the building permit on November 29, 2006— two months *after* he said he had— and he asked the town to " expedite[ ]" things so that he could " move forward on the foundation before the cold of winter sets in." He knew that it gets " tougher and tougher" to pour concrete with each passing winter day, you see. The town issued the permit 12 days later, on December 11. Critically, had Goguen not duped Sharfarz into thinking that he had filed the application way back in September 2006, Sharfarz would have confronted Goguen and (depending on how that went) either canceled the contract or put the project off to the spring. But not knowing the truth, Sharfarz let Goguen pour the concrete around Christmas 2006, despite the " very cold weather." Unfortunately, the foundation would eventually crack— just as Sharfarz feared it would. And Sharfarz did and does blame Goguen and his cold-weather concrete pouring for this.

In any event, Sharfarz continued making progress payments, even though Goguen made little progress: Goguen would start a new phase of the project, ask for and receive money without finishing the work, and then do the same thing over and over again— all the while trying to keep Sharfarz in the dark. At one point Goguen asked Sharfarz for more money so that he could hire another worker to get the project back on track. Sharfarz ponied up the extra money, but Goguen

never hired extra help. Goguen also recommended that Sharfarz upgrade the home's electrical service. Sharfarz came up with the additional cash for the upgrade, but Goguen never did the work.

Things went from bad to worse for Sharfarz. By November 2007 he had paid Goguen the full contract price, and then some. Yet Goguen threatened not to finish the project unless he got more money. Sharfarz said no. Goguen walked. And Sharfarz had to pay other contractors $88,000 to finish the job.

Sharfarz sued Goguen in Massachusetts state court, relying on certain consumer-protection laws. *See* Mass. Gen. Laws ch. 93A; Mass. Gen. Laws ch. 142A. Goguen did not appear. After entering a default judgment against him, a state judge held an evidentiary hearing to assess damages. Sharfarz testified there. But Goguen was a no-show, despite being notified about the proceeding.

As part of his findings of fact and conclusions of law (a document admitted as an exhibit at the bankruptcy trial), the state judge wrote that Goguen was " both deceptive and unfair, almost from the beginning and to the end," and that his " violations" had been " willful and knowing." Turning

to the concrete issue, the state judge found that

[t]he concrete foundation walls for the basement and the garage ... were poured Christmas week, in very cold weather, and subsequently cracked. They admitted a substantial amount of water, which— because Goguen had not poured the concrete floors— drained into the gravel subfloors.

" There is a particularly aggravated character to several of Goguen's violations," the state judge said, pointing to (among other things) Goguen's " [d]elaying the building permit application for nearly three months and lying about it, thereby delaying the start date till the onset of winter...." The state judge also found that Sharfarz had spent close to $63,000 " on contractors and suppliers" to complete most of the work that Goguen had " left undone." And, the state judge added, Sharfarz would have to spend another $25,000 to finish the project. So the state judge set Sharfarz's damages at $88,000, which he trebled to $264,000 as state law allowed, and set Sharfarz's attorney fees and costs at $8,745.50. Ultimately, then, the state judge awarded Sharfarz judgment in the amount of $272,745.50.

At some point Goguen filed for bankruptcy under Chapter 7 of the Bankruptcy Code. Quite predictably, Sharfarz reacted by petitioning to have his judgment against Goguen declared nondischargeable, relying on a Bankruptcy Code provision that bars discharge of " any debt ... for money ... to the extent obtained by ... false pretenses, a false representation, or actual fraud...." 11 U.S.C. § 523(a)(2)(A).[1]

Both Sharfarz and Goguen (who represented himself) took the stand during the trial before the bankruptcy judge. Sharfarz testified in line with the facts as we have presented them. Goguen disagreed with pretty much everything Sharfarz said, and he blamed the project's failure on his misestimating what it would cost to do the job. And he owned up to some project mismanagement too. No one else testified.

Having heard from them and examined the exhibits, the bankruptcy judge sided with

Sharfarz. His reasoning ran this way. Accurately stating the law, the bankruptcy judge stressed that a creditor must establish six things to exclude a debt from discharge under this provision: 1) the debtor made a knowingly false representation or one made in reckless disregard of the truth, 2) the debtor intended to deceive, 3) the debtor intended to induce the creditor to rely upon the false statement, 4) the creditor actually relied upon the false statement, 5) the creditor's reliance was justifiable, and 6) the reliance upon the false statement caused damage. *In re Spigel,* 260 F.3d 27, 32 (1st Cir.2001) (footnote omitted) (explaining that the first two components of this " test describe conduct and scienter required to show fraudulent conduct generally" while " the last four embody the requirement that the claim of

the creditor arguing nondischargeability in an adversary proceeding must arise as a direct result of the debtor's fraud"). Moving on, the bankruptcy judge found that Sharfarz had made it crystal clear to Goguen how important " the timing of construction was ... to him." But Goguen still " lied" to Sharfarz about the building-permit status to keep Sharfarz from cancelling the contract. Had Goguen not " lied," the bankruptcy judge added, Sharfarz " would have canceled" the agreement and " received all or most of his initial payment." And, according to the bankruptcy judge, Goguen's " false representations" about the permit— which Sharfarz justifiably relied on— kept Sharfarz from doing just that. Ultimately, Sharfarz incurred $88,000 in damages because of " Goguen's breach of the construction contract, damages which [he] incurred because ... Goguen [had] lied to him in September 2006" to keep him from " cancelling the contract." All of this made the $88,000 nondischargeable, the bankruptcy judge ruled, though he did not say what part of the $88,000 went to fixing the foundation (Sharfarz simply testified that the fix cost " thousands of dollars") and what part went to finishing the project. Also, the judge did not say why he deemed only $88,000 nondischargeable and not the rest of Sharfarz's $272,745.50 claim— a number reached (we remind the reader) after the state judge trebled the $88,000 in damages and awarded attorney fees and costs. *See Cohen v. de la Cruz,* 523 U.S. 213, 215, 223, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998) (holding that " § 523(a)(2)(A) prevents the discharge of all liability arising from fraud," stressing that this provision applies to treble damages and to attorney fees and costs). More on that a little later.

Goguen (now represented by counsel) appealed to the Bankruptcy Appellate Panel (" BAP"), which reversed. The whole case turned on causation— no one contested the other elements, the BAP said. And, the BAP correctly observed, causation here has two components. The first is cause in fact, which means that Goguen's misrepresentations must have " played a substantial part," and so were " a substantial factor," in affecting Sharfarz's " course of conduct that result[ed] in his loss." *See* Restatement (Second) of Torts § 546 & cmt. b. [2] The second is legal cause, which means that Sharfarz's " loss" must have been one " reasonably ... expected to result from" his " reliance" on Goguen's misrepresentations. *See id.* § 548A. Foreseeability is the watchword. *See id.* § 548A cmt. a.[3]

The bankruptcy judge did not differentiate between cause in fact and legal cause, the BAP noted. Noting that a comment to the Restatement says that " [i]f the misrepresentation has not in fact been relied upon by the recipient in entering into a transaction in which he suffers pecuniary

loss, the misrepresentation is not in fact a cause of the loss under the rule stated," *id.* § 546 cmt. a., the BAP held that the cause-in-fact rule required that Sharfarz show that Goguen's permit misrepresentations induced him to enter into the construction contract. True, the timing of the project " was critical to Sharfarz," and Goguen's lies " might have prevented Sharfarz from canceling the contract," the BAP wrote. But Goguen's misrepresentations " post-dated" the contract's signing and " so ...

could not possibly have induced Sharfarz to enter into the contract in the first instance." Cause in fact was " absent" then. Same for legal cause, the BAP added, since Goguen could not have " foreseen" that Sharfarz would have to pay an extra $88,000 over the original contract price because he (Goguen) had " misrepresented the status of the permit application for a ten-week period" after the contract's signing-and, as a fallback, it was " foreseeable" that Goguen could have finished the project " in a timely, workman-like manner, even after lying about the permit, thereby preventing Sharfarz's pecuniary" loss. Wrapping up, the BAP explained that Goguen's " negligence in under-estimating" the project's cost and the resulting " breach of contract" may have " caused Sharfarz harm," but, the BAP said, debts arising from situations like that are not excepted from discharge under 11 U.S.C. § 523.

Sharfarz now appeals to us.

HIGHLIGHTING SOME LEGAL PRINCIPLES

In cases like this one we zero in on the bankruptcy judge's ruling, affording clear-error review to any fact-bound challenges and *de novo* review to any legal ones. *See, e.g., In re Bank of New Eng. Corp.,* 364 F.3d 355, 361 (1st Cir.2004); *In re Werthen,* 329 F.3d 269, 272 (1st Cir.2003). We give the BAP's decision no formal deference, but we do draw on its expertise in bankruptcy matters. *See, e.g., In re Bank of New Eng. Corp.,* 364 F.3d at 361; *In re BankVest Capital Corp.,* 360 F.3d 291, 295 (1st Cir.2004).

The parties' dispute here centers on causation, and we review a bankruptcy judge's causation finding for clear error— unless he applied the wrong legal standard, in which case our review is *de novo. See Clement v. United States,* 980 F.2d 48, 53 (1st Cir.1992); *see also In re Am. Bridge Prod., Inc.,* 599 F.3d 1, 8 (1st Cir.2010). Also, because one of the Bankruptcy Code's chief aims is to give the deserving debtor a " fresh start," we read exceptions to dischargeability " narrowly." *See, e.g., In re Spigel,* 260 F.3d at 32 (internal quotation marks omitted). That means that a person in Sharfarz's shoes must show that his claim fits " squarely" within a specific exception set out in the Bankruptcy Code. *See, e.g., id.* (internal quotation marks omitted). And as the party seeking an exception to discharge, Sharfarz had the burden of proving nondischargeability by a preponderance of the evidence. *See, e.g., Grogan v. Garner,* 498 U.S. 279, 281, 287-88, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

WORKING THROUGH THE ISSUES

An admittedly confusing concept, *see United States v. Hatfield,* 591 F.3d 945, 947 (7th Cir.2010) (Posner, J.), causation is composed of cause in fact and legal cause, as we said earlier. In the typical case, the causal relation between the defendant's conduct and the plaintiff's injury need only be probable. *See, e.g., Samos Imex Corp. v. Nextel Commc'ns, Inc.,* 194 F.3d 301, 303

(1st Cir.1999) (explaining that tort causation requires that the " plaintiff ... show that it is more probable than not that the injury was caused by the action or event (or a combination of them) for which the defendant is responsible"). Of course, a " superseding cause" (something that intervenes between the defendant's wrongful act and the plaintiff's injury, " snap[ping] the causal chain" that links the act to the injury) can " wip[e] out the defendant's liability" — but the burden of proving this " is on the defendant." *BCS Servs., Inc. v. Heartwood 88, LLC,* 637 F.3d 750, 757 (7th Cir.2011) (Posner, J.) (citation and internal quotation marks omitted); *accord*

Wojciechowicz v. United States, 582 F.3d 57, 67 (1st Cir.2009) (declaring that " [p]roximate cause is not proven if the defendant can show the occurrence of an intervening cause that was foreseeable"); *Parker v. Gerrish,* 547 F.3d 1, 14 (1st Cir.2008) (noting that the defendant has the " burden of showing an independent intervening event").

The bankruptcy judge in his opinion did not home in on the differences between cause in fact and legal cause. Neither does Sharfarz in his brief. But our *de novo* review leads us to conclude that Sharfarz satisfied his causation burden.

Cause in Fact

The cause-in-fact issue is fairly easy, given the bankruptcy judge's factual finding: had Goguen not lied to Sharfarz about the building-permit status, the judge stressed after canvassing the evidence, Sharfarz " would have canceled the construction contract" and gotten back " all or most" of the initial $25,693 payment. Of course, we must accept this finding unless clearly erroneous— a formidable standard, requiring a " strong, unyielding belief" that the bankruptcy judge made a mistake. *See Cumpiano v. Banco Santander P.R.,* 902 F.2d 148, 152 (1st Cir.1990). Viewing the record as a whole, as we must, *see, e.g., id.,* we see nothing resembling clear error here. And given this finding, we have no trouble concluding that Goguen's deliberately-deceitful conduct played a " substantial" role, and thus was " a substantial factor," in shaping " the course of conduct that result[ed]" in Sharfarz's " loss" — meaning that we can put a check mark next to cause in fact on the causation list. *See* Restatement (Second) of Torts § 546 & cmt. b.

Wait a minute, says Goguen. Echoing the very Restatement comment that the BAP had quoted— that if a party " has not in fact" relied on the " misrepresentation ... in *entering into a* ***transaction*** in which he suffers pecuniary loss," then " the misrepresentation is not in fact a cause of the loss," *id.* § 546 cmt. a (emphases added)— Goguen implies that the construction contract here is an example of what the comment refers to as a transaction. And, arguing in crescendo, he notes that the complained-of misrepresentations occurred after the parties had signed that document, which, he says, undercuts any cause-in-fact ruling. We think not, for a simple reason. " Transaction ... is a broader term than ‘ contract.’ " *Black's Law Dictionary* 1496 (6th ed. 1990). It includes not only an " agreement" — like the initial contract between Sharfarz and Goguen— but also " an act" or " several acts or agreements between or among parties whereby a cause of action or alteration of legal rights occur." *Id.* Numerous cases bear out this view. [4] Understood this way (and, critically, Goguen gives us no reason to doubt this well-established understanding), the " transaction" here is Sharfarz's staying the course, allowing Goguen to proceed with the concrete pouring and continuing to pay Goguen even after Goguen repeatedly lied to him.

Consequently, Goguen's
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pouncing on the fact that the lies came after the contract's formation gains him nothing. *See generally Field v. Mans,* 157 F.3d 35, 39, 42-46 (1st Cir.1998) (indicating in a post-contract-formation case that fraud that induces the creditor not to exercise a right arising from the contract may make the debtor's debt nondischargeable).

Legal Cause

Having dealt with cause in fact, we now turn to legal cause, which is a trickier matter. As we explained earlier, legal cause is largely a question of foreseeability— a concept that " shape[s] and delimit[s] a rational remedy: otherwise the chain of causation could be endless." *Sys. Mgmt., Inc. v. Loiselle,* 303 F.3d 100, 104 (1st Cir.2002). Hindsight is always 20/20. And when events have run their course, it is easy to label " ‘ foreseeable’ " everything " that has in fact occurred" — but this we cannot do. *See In re Kinsman Transit Co.,* 338 F.2d 708, 723 (2d Cir.1964) (Friendly, J.). Instead, taking our cue from the Restatement, we must see whether Sharfarz showed that Goguen's lies led to a " loss" that " might reasonably" have been " expected to result from the reliance." *See* Restatement (Second) of Torts § 548A. We conclude that he has.

At oral argument we pressed Sharfarz's lawyer hard to explain how her client had met the legal-cause requirement, and she said this: As he strung Sharfarz along with lies about the permit application, Goguen could have reasonably foreseen that his deceit would delay the project, which would lead to his pouring the concrete in cold weather, which in turn would lead to the foundation's cracking. And there is something to that, given: (a) From September 2006 through November 2006, Goguen conned Sharfarz into thinking that he (Goguen) had applied for a building permit when in reality he had not. (b) During this 10-week stretch, Sharfarz worried almost to the point of obsession that project delays would result in Goguen's pouring the concrete in the cold, which, he feared, would result in the foundation's cracking if proper precautions were not taken. (c) Goguen also surely knew the risks related to pouring concrete in cold weather— a point plainly inferable both from his saying that contractors had to take prophylactic measures to prevent cracking in situations like the one here (recall that he talked about how one could add chemicals to the concrete mix) and from his asking the town to speed up its plan review so that he could deal with the foundation before winter's cold arrived. (d) Common sense (not to mention judicial notice, if that were needed) confirms the danger of pouring concrete in cold weather— a danger recognized by courts and those in the field with some regularity and for years.[5] (e) Goguen
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actually poured the concrete in " very cold weather," as the state judge found in a comprehensive rescript, which was an exhibit at the bankruptcy trial.[6] And (f) the foundation in fact later cracked— all because of Goguen's cold-weather concrete pouring, which is the gist of Sharfarz's testimony below (testimony that Goguen did not— and does not— challenge as improperly received by the bankruptcy judge).

The net result of this is that Sharfarz made a *prima facie* case for legal cause: again (and at the risk of trying the reader's patience), we stress that Sharfarz foresaw that, without adequate precautions, pouring concrete in cold weather could lead to cracking, and the record, fairly read,

shows that Goguen did too; common knowledge and common sense (not contradicted by the evidence) suggest that Sharfarz's fear was reasonable; and his fear (according to his testimony, received without objection) ultimately became a reality. So, to put the point in Restatement terms, Sharfarz's reliance on Goguen's misrepresentations resulted in a " loss" that could " reasonably" have been " expected" to occur " from the reliance" — indeed the loss here was expected, at least absent any chemical additive or other precautionary measure. *See* Restatement (Second) of Torts § 548A.

Of course, Goguen's vague comment below that one *could* add chemicals to concrete mix to forestall cracking cannot carry the day for him. After all, he has never said that he did that here. Nor has he ever said that he took any other preventative steps. And if he wanted to argue that he had or that the obvious cause was not the actual cause, he had to contribute something more than nothing. *See Wojciechowicz,* 582 F.3d at 67; *Parker,* 547 F.3d at 14; *see also generally BCS Servs., Inc.,* 637 F.3d at 757 (stressing that a " plaintiff doesn't have to prove a series of negatives," adding that " he doesn't have to offer evidence which positively excludes

every other possible cause") (alterations, citations, and internal quotation marks omitted).

Which brings us full circle. Sharfarz wins because he adequately proved causation and Goguen did not bear his burden of showing an intervening or superseding cause. Consequently, we reverse the BAP's decision reversing the bankruptcy judge's order. That leaves one loose end, however— and a serious one to boot.

The Nondischargeable Amount

At least *some* portion of Sharfarz's $88,000 in actual damages is attributable to the foundation's cracking. But we do not know what that number is, because (the reader will remember) the bankruptcy judge made no findings on that score, which is not surprising given that Sharfarz simply offered a ballpark estimate for the foundation-repair costs (" thousands of dollars," he said), providing no precise figures. On this issue a remand is necessary. But for a variety of reasons we do not think that Sharfarz's recovery should be capped at that amount, whatever it is.

For starters, Sharfarz claimed that he paid Goguen extra money for an additional worker who was never hired; that he made progress payments to Goguen for work that Goguen said he had done but that was in fact not done; and that he paid Goguen for an electrical upgrade that was never performed. The bankruptcy judge made no findings regarding these allegations. But Sharfarz has not waived them (indeed, he explicitly raises them here), and the bankruptcy judge could well decide on remand that some part of Sharfarz's damages is traceable not to the foundation's cracking but to other reasonably-foreseeable consequences of Goguen's lies.

Also, and importantly, the bankruptcy judge may have erred when he discharged the amount of Goguen's debt attributable to the state judge's trebling of damages and awarding of attorney fees and costs. *See Cohen,* 523 U.S. at 215, 223, 118 S.Ct. 1212. True, Sharfarz has not appealed on this point. But given that Goguen will be free on remand to show that the nondischargeable amount is really less than $88,000, we see no reason why Sharfarz should not be allowed to show that the nondischargeable number is really more.

Moreover, we have a fair amount of elbow room " to shape a remand in the interests of

justice." *See, e.g., United States v. Merric,* 166 F.3d 406, 412 (1st Cir.1999) (citing 28 U.S.C. § 2106). And exercising this authority, we explicitly give the bankruptcy judge the go-ahead to take these matters up on remand.

FINISHING UP

Our work complete, we vacate the BAP's judgment and remand to that tribunal with directions that it, in turn, remand the case to the bankruptcy court for further proceedings consistent with this opinion.

***Vacated* and *remanded* with instructions. No costs.**

Notes:

[*] The Hon. David H. Souter, Associate Justice (Ret.) of the Supreme Court of the United States, sitting by designation.

[1] In the interest of completeness, we note that Sharfarz also relied on another provision of section 523, one that excludes from discharge debts arising from " willful and malicious injury by the debtor to another entity or to the property of another entity." *See* 11 U.S.C. § 523(a)(6). But the bankruptcy judge found that Sharfarz did not meet his burden of showing that Goguen's " lies" were intended to injure him (Sharfarz) or his property. *See Kawaauhau v. Geiger,* 523 U.S. 57, 61, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998) (stressing that " ‘ willful’ in (a)(6) modifies the word ‘ injury,’ indicating that nondischargeability takes a deliberate or intentional *injury,* not merely a deliberate or intentional *act* that leads to injury"). Because neither side says anything about that here, we will focus on, and limit our attention to, the § 523(a)(2)(A)-related issues.

[2] For convenience, we will sometimes refer to the Restatement (Second) of Torts as the " Restatement."

[3] By the way, the Supreme Court tells judges that it is okay to use the Restatement when dealing with 11 U.S.C. § 523(a)(2)(A). *See Field v. Mans,* 516 U.S. 59, 69-70, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995).

[4] *See, e.g., U.S. Hoffman Mach. Corp. v. Ebenstein,* 150 Kan. 790, 96 P.2d 661, 663 (1939) (explaining that " a transaction, while it may embrace a contract, may also relate to matters entirely in tort"); *Bozied v. Edgerton,* 239 Minn. 227, 58 N.W.2d 313, 316 (1953) (stressing that " [a] contract is a transaction but a transaction is not necessarily a contract"); *Artophone Corp. v. Coale,* 345 Mo. 344, 133 S.W.2d 343, 348 (1939) (noting that " [t]he word ‘ transaction’ may and often does have a broader meaning than ‘ contract’ "); *cf. Moore v. N.Y. Cotton Exch.,* 270 U.S. 593, 610, 46 S.Ct. 367, 70 L.Ed. 750 (1926) (emphasizing that " ‘ [t]ransaction’ is a word of flexible meaning," adding that " [i]t may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship").

[5] *See generally Hiddleson v. Grand Island,* 115 Neb. 287, 212 N.W. 619, 621 (1927) (noting that " [i]t is a matter of common knowledge ... that the pouring of concrete in severely cold weather is undesirable, because it may freeze and be rendered worthless," adding that " [i]t is likewise common knowledge, of which this court will take judicial notice, that freezing and sub-zero weather frequently occurs in the winter season in this latitude"); Am. Concrete Inst., Cold Weather Concreting, ACI 306R-88, at 3, http:// www. ccagc. org/ pdfs/ ACI_ 306 R- 88_ Cold_ Weather_

Concreting. pdf (emphasizing that " [n]eglect of protection against early freezing can cause immediate destruction or permanently weakened concrete," adding that " if cold weather concreting is performed, adequate protection from low temperatures and proper curing is essential"); *see also generally Ohio Bell Tel. Co. v. Pub. Util. Comm'n of Ohio,* 301 U.S. 292, 301, 57 S.Ct. 724, 81 L.Ed. 1093 (1937) (stressing that " [c]ourts take judicial notice of matters of common knowledge" — *e.g.,* that there " has been a depression, and that a decline of market values is one of its concomitants," though " [h]ow great the decline has been for this industry or that, for one material or another, in this year or the next, can be known only to the experts, who may even differ among themselves"); *United Steelworkers of Am., AFL-CIO v. Textron, Inc.,* 836 F.2d 6, 8 (1st Cir.1987) (repeating that courts can " take as true ... generally believed facts" — *e.g.,* that " most retired union members are not rich" — and adding that " [c]ommon sense suggests that generally believed facts (or something like them) are true"); *Grinnell Corp. v. Hackett,* 475 F.2d 449, 460 (1st Cir.1973) (explaining that courts can take into account what is " common knowledge" — *e.g.,* that " consumer payment obligations in our increasingly credit-dependent society are monthly").

[6] A quick word about " cold weather." The industry seems to define that term as " a period when, for more than 3 consecutive days ... the average daily air temperature is less than 40 F ... and the air temperature is not greater than 50 F ... for more than one-half of any 24-hour period," with " the average daily temperature" being " the average of the highest and the lowest temperatures occurring during the period from midnight to midnight." Am. Concrete Inst., *Cold Weather Concreting, in Manual of Concrete Practice* 306R-1, 30bR-2 (reapproved 2002), *available at* http:// www. ccagc. org/ pdfs/ ACI_ 306 R- 88_ Cold_ Weather_ Concreting. pdf. Goguen claims that he finished the concrete pouring on December 12, 2006, though that seems unlikely since the permit was not even issued until December 11. The state judge, on the other hand, found that Goguen poured the concrete around Christmas time of that year. But it really does not matter which timeline we use: publicly-available weather records for the area show that temperatures during either period were either in or very close to the range deemed " cold weather" by the American Concrete Institute. *See* Weather Underground, Inc., *History for Bedford, MA: Month of December, 2006,* http:// www. wunderground. com/ history/ airport/ KBED/ 2006/ 12/ 1/ Monthly History. html (last visited August 7, 2012). And, tellingly, Goguen never said that the temperatures did not require his taking appropriate precautions.

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FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. PR 11-074

Bankruptcy Case No. 10-10289-ESL

DAMIAN GARCIA MATOS,
a/k/a Damian Garcia, a/k/a D. Garcia,
a/k/a D. Garcia Matos,
Debtor.

DAMIAN GARCIA MATOS,
Appellant,

v.

ALEJANDRO OLIVERAS RIVERA, Chapter 13 Trustee,
Appellee.

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

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

Juan M. Suárez Cobo, Esq., and Manuel Casellas, Esq., on brief for Appellant.
Miriam D. Salwen Acosta, Esq., on brief for Appellee.

September 26, 2012

Deasy, U.S. Bankruptcy Appellate Panel Judge.

Damian Garcia Matos (the "Debtor") appeals from the bankruptcy court's order sustaining the chapter 13 trustee's (the "Trustee") objection to the exemption he claimed in an income tax refund (the "Refund"), and the order denying his motion for reconsideration. The Debtor contends that it was error to sustain an exemption objection that was based upon an unrelated statute governing plan confirmation. For the reasons set forth below, we conclude that the Trustee failed to sustain his burden in objecting to the exemption and therefore, **REVERSE**.

BACKGROUND

In October 2010, the Debtor filed a chapter 13 petition, along with his schedules and Statement of Financial Affairs. On his Schedule B, the Debtor listed the Refund with a value of $9,424.00. He further described it as follows:

> Estimated accumulated excess tax paid to P.R. Treasury Department during 2010, that will normally be refunded to debtor. We are taking refund for 2009 as reference.

On Schedule C, he claimed an exemption in the Refund under § 522(d)(5). At the time of the bankruptcy filing, the Debtor had not yet filed his income tax return for 2010 as the calendar year had not yet concluded.

In November 2010, the Debtor filed a chapter 13 plan, which he amended two weeks later. Both versions provided the following with respect to tax refunds:

> **TAX REFUNDS**: Income Tax refunds will be devoted each year, as periodic payments, to the plan's funding until plan completion. The tender of such payments shall deem the plan modified by such amount, increasing the base thereby without the need of further notice, hearing or Court order. In [sic] need be for the use by debtor(s) of a portion of such refund, debtor(s) shall seek Court's authorization prior to any use of funds.

The Trustee filed an objection to the Debtor's claim of exemption in the Refund (the "Objection"). As grounds, the Trustee argued that it was not property of the estate because, as of the petition date, the Debtor was not yet entitled to receive a tax refund for the 2010 tax year. The Trustee

also opposed the exemption on the grounds that it was inconsistent with the Debtor's proposal to pay into the plan the tax refunds received during the life of the plan. Finally, the Trustee argued that "tax refunds received during the life of the plan, including the one for the 2010 tax period is disposable income [] to be devoted into the plan as per the chapter 13 case of In re Padilla, Bankruptcy No. 07-07495-ESL."

In March 2011, the Debtor filed an amended Schedule B, to amend the value of the Refund to $9,269.00. The Debtor did not file an amended Schedule C. On that same day, the Debtor filed another amended plan (the "March Plan"), proposing to increase his plan payments by applying that portion of the Refund that was attributable to post-petition income. In addition, the March Plan provided:

> **TAX REFUNDS**: Income Tax refunds, that have not been exempted and thus property of the estate, will be devoted each year, as periodic payments, to the plan's funding until plan completion. The tender of such payments shall deem the plan modified by such amount, increasing the base thereby without the need of further notice, hearing or Court order. In [sic] need be for the use by debtor(s) of a portion of such refund, debtor(s) shall seek Court's authorization prior to any use of funds.

The Debtor then filed an opposition to the Objection. He first argued that the Refund constituted property of his estate, and therefore was properly included on Schedule B. He also asserted that there was no inconsistency between the plan provisions and the claimed exemption, because the March Plan provided that all *non-exempt* tax refunds would be paid into the plan. Finally, the Debtor argued that the March Plan complied with In re Padilla, because it provided for payment of all "future" tax refunds that accumulate during the life of the plan. According to the Debtor, the Refund was properly exempted and he was not required to fund the March Plan with the exempt funds.

On March 16, 2011, the bankruptcy court issued an order sustaining the Objection (the "Exemption Order"). The bankruptcy court reasoned as follows:

> In a Chapter 13 case all property and earnings acquired by the debtor after the commencement of the case but before the case is closed, dismissed or converted is property of the estate. 11 U.S.C. §1306. Post petition tax refunds are income of the debtor and property of the estate while the debtor is in chapter 13. When the trustee or an unsecured creditor object [sic] the confirmation of the plan, the debtor must provide all of the projected disposable income during the applicable

> commitment period to fund the plan. 11 U.S.C. § 1325(b)(1). The income tax refunds, as projected disposable income, are subject to the deductions in sections 1325(b)(2,3), but may not be exempt as the same are not property of the estate under 11 U.S.C. § 541(a). Exempt property may be retained by the debtor and generally is not liable for any prepetition debt. In a chapter 13 case the post petition income, less applicable expenses, may not be retained by the debtor but must be paid to fund the plan. If debtor would prevail on the claimed exemption, then the court would have to deny confirmation for failure to meet the requirements of section 1325(b)(1) as the debtor would not be providing all of its disposable income to fund the plan. Such a result is not consonant with BAPCPA's intent to have chapter 13 debtors pay as much as they can to creditors. Consequently, the trustee's objection to exemptions is hereby granted.

On March 29, 2011, the Debtor filed a motion to alter or amend the Exemption Order (the "Reconsideration Motion"), arguing that the Trustee had not provided any valid reasons to support the Objection and the bankruptcy court sustained the same simply because otherwise it would have to deny confirmation of the plan. The Debtor argued that the bankruptcy court's reasoning was problematic because the Trustee had not filed an objection to confirmation, and even if the bankruptcy court raised an objection sua sponte, the Debtor was not given an opportunity to respond. The Debtor asserted that the Trustee's arguments related not to the validity of the Debtor's exemption but rather to the Trustee's potential objection to plan confirmation and that the former did not have any impact on the latter.

In response, the Trustee filed an objection to confirmation of the March Plan, arguing that it failed the disposable income test set forth in § 1325(b). He also filed an opposition to the Reconsideration Motion, arguing that it did not meet the strict standard for relief under Fed. R. Civ. P. 59(e). In addition, the Trustee argued that an analysis of the applicable legal principles mandated a conclusion that the Refund constituted income of the Debtor and that it was improper for a chapter 13 debtor to claim an exemption in income.

On June 8, 2011, the Debtor filed another amended plan (the "June Plan") which provided for the application of the entire amount of the Refund to his plan payments and also provided that non-exempt

tax refunds would be applied to fund the plan. He also filed a response to the Trustee's objection to confirmation of the March Plan, asserting that the June Plan resolved the concerns raised by the Trustee. Thereafter, the Trustee filed a favorable recommendation for confirmation of the June Plan, based upon his understanding that the Reconsideration Motion and the Trustee's opposition thereto were now moot.

On June 22, 2011, the bankruptcy court held a hearing on confirmation of the June Plan, the Reconsideration Motion, and the Trustee's objection thereto. At the hearing, the parties noted that although the June Plan provided for the entire amount of the Refund to be devoted to the plan and the issue was essentially moot, the Debtor still desired a ruling on the Reconsideration Motion. It was for only this reason that the Trustee had amended his recommendation regarding plan confirmation to an unfavorable one.

Addressing the Reconsideration Motion, the Debtor argued that his interest in the Refund existed on the petition date because at that time, there was already an "overpayment of taxes." Moreover, the Debtor asserted that the Refund was not post-petition income because he earned the income pre-petition and the Refund was simply a refund of an overpayment of taxes. He urged the bankruptcy court not to confuse cash with income, arguing that just because property can be converted to cash does not make it income. Conversely, the Trustee argued that it is well established that tax refunds are income, pointing to In re Padilla. He also argued that because this case was filed on October 10, 2010, and the Debtor had not yet filed a tax return for 2010 due to the remaining months in the calendar year, the Debtor was not entitled to a refund as of the petition date and, therefore, could not claim it as exempt. At the conclusion of the hearing, the bankruptcy court took the Reconsideration Motion under advisement, and continued the hearing on confirmation of the June Plan.

On September 14, 2011, the bankruptcy court issued an order stating simply that "Trustee's sur-reply to Debtor's motion to supplement oral argument & objection to confirmation (docket #78) is

hereby granted" (the "Reconsideration Order"). This appeal followed.

JURISDICTION

Before addressing the merits of an appeal, the Panel must determine that it has jurisdiction, even if the issue is not raised by the litigants. See Boylan v. George E. Bumpus, Jr. Constr. Co. (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724 (B.A.P. 1st Cir. 1998). The Panel has jurisdiction to hear appeals from: (1) final judgments, orders, and decrees; or (2) with leave of court, from certain interlocutory orders. 28 U.S.C. § 158(a); Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998). A bankruptcy court's order granting or denying a debtor's claimed exemption is a final order. See Stornawaye Fin. Corp. v. Hill (In re Hill), 387 B.R. 339, 345 (B.A.P. 1st Cir. 2008), aff'd, 562 F.3d 29 (1st Cir. 2009); Aroesty v. Bankowski (In re Aroesty), 385 B.R. 1, 3 (B.A.P. 1st Cir. 2008); Hildebrandt v. Collins (In re Hildebrandt), 320 B.R. 40, 42-43 (B.A.P. 1st Cir. 2005). Moreover, an order denying reconsideration is final if the underlying order is final and together the orders end the litigation on the merits. See Schwartz v. Schwartz (In re Schwartz), 409 B.R. 240, 245 (B.A.P. 1st Cir. 2008); Eresian v. Koza (In re Koza), 375 B.R. 711, 716 (B.A.P. 1st Cir. 2007). As the Exemption Order and Reconsideration Order meet these criteria, the Panel has jurisdiction over this appeal.

STANDARD OF REVIEW Appellate courts apply the clearly erroneous standard to findings of fact and *de novo* review to conclusions of law. See Lessard v. Wilton-Lyndeborough Coop. School Dist., 592 F.3d 267, 269 (1st Cir. 2010). There are no disputed facts involved in the bankruptcy court's decision to sustain the Objection; therefore, the Panel's review of the Exemption Order is *de novo*. See, e.g., Pasquina v. Cunningham (In re Cunningham), 513 F.3d 318, 323 (1st Cir. 2008); Newman v. White (In re Newman), 428 B.R. 257, 261 (B.A.P. 1st Cir. 2010); In re Hill, 387 B.R. at 345; In re Hildebrandt, 320 B.R. at 43. The Panel's review of the Reconsideration Order is for abuse of discretion. See In re

Koza, 375 B.R. at 717 (citing Mariani-Giron v. Acevedo-Ruiz, 945 F.2d 1, 3 (1st Cir. 1991)). A bankruptcy court abuses its discretion if it ignores a material factor deserving of significant weight, relies upon an improper factor, or makes a serious mistake in weighing proper factors. See id. (citations omitted).

DISCUSSION

On appeal, the Debtor first claims it was error to sustain the Objection by ruling that the Refund is property of the estate under § 1306 rather than § 541. The Debtor further claims that it was error to rule that he cannot exempt the Refund, particularly given the facts of this case and the provisions of the June Plan. According to the Debtor, the Refund is a pre-petition

asset of the bankruptcy estate which he should be able to exempt under § 522(d)(5) free from a projected disposable income analysis under § 1325(b).

I. Property of the Estate

In a chapter 13 proceeding, property may become property of the estate through two separate provisions of the Bankruptcy Code. Section 541 defines what is, and is not, property of the estate as of the date the bankruptcy petition is filed. See 11 U.S.C. § 541(a)(1) (providing bankruptcy estate is comprised of "all legal and equitable interests of the debtor in property as of the commencement of the case."). "Section 541 is construed broadly to bring in any and all of the debtor's property rights within the bankruptcy court's jurisdiction and the umbrella of protections granted by the Bankruptcy Code, and to promote the goal of equality of distribution." Abboud v. The Ground Round, Inc. (In re The Ground Round, Inc.), 335 B.R. 253, 259 (B.A.P. 1st Cir. 2005) (citing U.S. v. Whiting Pools, Inc., 462 U.S. 198, 205 n.9 (1983)), aff'd, 482 F.3d 15 (1st Cir. 2007). Section 541 only applies to the interests of a debtor

in property as of the petition date, subject to the three inapplicable limited exceptions in § 541(a)(5).

Any interest in property, described in § 541, that a chapter 13 debtor acquires post-petition becomes property of the estate under § 1306, including any "earnings from services performed by the debtor." 11 U.S.C. § 1306(a)(1) & (a)(2). Property included in the bankruptcy estate by § 1306, however, is "*in addition* to the property specified in section 541." 11 U.S.C. § 1306(a) (emphasis added).

The Supreme Court has ruled that tax refunds arising from pre-petition earnings or losses are generally considered property of the estate under § 541, as they are "sufficiently rooted in the bankruptcy past" and do "not relate conceptually to future wages and it is not the equivalent of future wages." Kokoszka v. Belford, 417 U.S. 642 (1974) (rejecting a chapter 7 debtor's claim under the Bankruptcy Act that a tax refund on pre-petition earnings received postpetition were part of the debtor's fresh start); see also Segal v. Rochelle, 382 U.S. 375 (1966) (ruling tax refund from loss-carryback refund claims on account of taxes paid prepetition was property of the chapter 7 estate). Although Segal and Kokoszka were both decided under the Bankruptcy Act, the results have not changed under the Bankruptcy Code. Thus, and as the Trustee concedes on appeal, a debtor's right to a tax refund that originates from pre-petition earnings is property of the bankruptcy estate even when a debtor files for bankruptcy before the end of the tax year.

All tax refunds received by a chapter 13 debtor *after* the bankruptcy filing are also property of the estate pursuant to § 1306(a). See In re LaPlana, 363 B.R. 259, 262 (Bankr. M.D. Fla. 2007) ("A debtor's future federal income tax refund is easily included in the comprehensive definition of 'property of the estate' under . . . §§ 541(a) and 1306(a) and (b)"). Therefore, "[a] tax refund is property of the Chapter 13 estate under 11 U.S.C. §§ 541(a) and 1306(a) whether it accrues before or after the petition." Keith M. Lundin & William Brown, Chapter 13 Bankruptcy, 4th Edition, § 236.1 (2004); see also In re Schiffman, 338 B.R. 422, 429 (Bankr. D. Ore. 2006) (recognizing both pre- and post-petition tax refunds

as property of the chapter 13 estate).

Accordingly, the Refund is property of the estate. On appeal, however, the Trustee argues that this conclusion does not alter the outcome because any tax refund received after the commencement of a chapter 13 case is disposable income that must be paid into the plan pursuant to § 1325(b) and, therefore, it cannot be subject to a claim of exemption. The Debtor disagrees.

II. The Exemption and the Objection

To facilitate the "fresh start" and to protect dependents, a debtor may exempt certain property from the bankruptcy estate under applicable federal or state law. See 11 U.S.C. § 522(b). The Bankruptcy Code establishes the types of property debtors may claim as exempt as well as the maximum value of the exemptions a debtor may claim in certain assets. See §§ 522(b) and (d). An exemption claim is prima facie valid, and will be excluded from the bankruptcy estate, absent a timely objection. See Shamban v. Perry (In re Perry), 357 B.R. 175, 178 (B.A.P. 1st Cir. 2006). As the party objecting to the validity of a claimed exemption, the Trustee had the burden of proving that the Debtor was not entitled to exempt the Refund. See Fed. R. Bankr. P. 4003(c); see also McNeilly v. Geremia (In re McNeilly), 249 B.R. 576, 579 n.9 (B.A.P. 1st Cir. 2000).

The Debtor claimed an exemption in the Refund pursuant to § 522(b)(5). Section 522(d)(5) allows a debtor to claim a general exemption of up to $1,150 ($2,300 in joint cases), plus up to $10,825 ($21,650 in joint cases) of any unused portion of the homestead exemption. See 11 U.S.C. § 522(d)(5). This is commonly called the "wild card" exemption because it can be used to protect any kind of property whatsoever.

In the Objection, the Trustee raised three arguments. First, the Trustee argued that because the Debtor was not yet entitled to receive a tax refund for the 2010 tax year as of the petition date, the

Refund was not property of the estate subject to a claim of exemption. As explained above, this argument is unavailing because it is contrary to long established Supreme Court precedent and was abandoned by the Trustee at oral argument. Second, the Trustee asserted that the Debtor's claimed exemption should not be allowed as it was inconsistent with his proposal to pay into the plan the tax refunds received during the life of the plan. This, too, is unavailing as the Debtor has volunteered to apply all of the Refund toward the June Plan.

Lastly, the Trustee argued that "tax refunds received during the life of the plan, including the [Refund] is disposable income [] to be devoted into the plan as per the chapter 13 case of In re Padilla, Bankruptcy No. 07-07495-ESL." Although it did not address the first two arguments, in the Exemption Order the bankruptcy court agreed with the Trustee's final argument, concluding that the Debtor could not exempt the Refund because it constituted "disposable income" that he was required to pay into the plan pursuant to §§ 1322(a)(1) and 1325(b)(1)(B). Both below and on appeal, the Debtor argues that the bankruptcy court erred in considering and adopting the Trustee's arguments, because the issue before the court was the validity of an exemption and not confirmation of his plan.

In support, the Debtor relies on Schwab v. Reilly, 130 S. Ct. 2652 (2010), for the proposition that there are only three factors a bankruptcy court can apply to evaluate an objection to a claimed exemption. This Panel, however, recently stated that: "Schwab . . . stands for the . . . limited proposition that the time limits for objecting to an exemption do not apply if the claimed exemption is valid on its face," and the three factors are directed to trustees who are considering whether to object to an exemption. See Massey v. Pappalardo (In re Massey), BAP No. 11-060, 2012 Bankr. LEXIS 756, at *15-16 (B.A.P. 1st Cir. Feb. 27, 2012).

That is not to say, however, that the bankruptcy court's consideration of § 1325(b) was

appropriate under the facts of this case. Consideration of issues raised in § 1325(b), a statute addressing whether a chapter 13 debtor is devoting all projected disposable income to the plan, arises only after the trustee or the holder of an allowed unsecured claim *objects to the plan*. See 11 U.S.C. § 1325(b) (emphasis added). Although the Trustee had not filed a plan objection by the time he filed the Objection, perhaps he raised the issue of projected disposable income in the Objection based upon case law that explains that by objecting to an exemption, the issue is preserved until a plan objection is filed. See, e.g., In re Springer, 338 B.R. 515, 519 (Bankr. N.D.Ga. 2005) (holding that reviewing courts can consider whether exempt property is disposable income if objecting party files timely objection to debtor's exemption claim); In re Stephens, 265 B.R. 335, 338 n.1 (Bankr. M.D. Fla. 2001) (noting that an objecting party's timely objection to debtor's exemption claim preserves the issue of whether exempt property constitutes disposable income); In re Graham, 258 B.R. 286, 292 n.1 (Bankr. M.D. Fla. 2001) (ruling exempt asset could not be included in disposable income but explaining "rule may not control situations where an objection to a claimed exemption has been timely filed.").

Even if an exemption objection based on § 1325(b) were a necessary placeholder, a procedural issue not before us, it would serve to reserve the issue until the chapter 13 trustee or unsecured creditor interposes an objection to the proposed plan. In this case, because the Trustee had not filed an objection to the March Plan, he had not activated the provisions of § 1325(b) by the time the bankruptcy court ruled on the Objection. Accordingly, at the time the court ruled on the Objection, the issue of whether the Debtor was devoting all of his projected disposable income to the March Plan was a hypothetical argument unrelated to whether the Debtor was entitled to claim an exemption in the Refund.

This conclusion is highlighted, as the Debtor has urged, by the facts in this case. By the time the Trustee filed an objection to the March Plan, after the Debtor sought reconsideration of the Exemption

Order, the March Plan contained a general pledge of all non-exempt tax refunds and a specific pledge of the prorated portion of the Refund attributable to post-petition earnings. Thereafter, the Debtor filed the June Plan in which he provides for payment of the full amount of the Refund. As a result, even if the Trustee were to file an objection to confirmation of the now pending June Plan on the basis that it did not comply with § 1325(b), the objection would be unnecessary and moot as there would be no unaccounted for disposable income.

Because an objection based upon § 1325(b) was not ripe when the bankruptcy court issued the Exemption Order and we can discern no other basis upon which the Trustee objected to the Debtor's exemption in the Refund, the Trustee failed to sustain his burden with respect to the Objection and the Exemption Order cannot stand. See, e.g., Vargas v. Boyajian (In re Vargas), 2012 WL 2450170, *3-4 (B.A.P. 1st Cir. Jun. 8, 2012).

III. Motion for Reconsideration

In his Motion for Reconsideration, the Debtor sought to alter or amend the Exemption Order pursuant to Fed. R. Civ. P. 59(e) ("Rule 59(e)"), which is made applicable to bankruptcy proceedings by Bankruptcy Rule 9023. Reconsideration of a judgment under Rule 59(e) is an extraordinary remedy, which is used sparingly and only when the need for justice outweighs the interests set forth by a final judgment. In re Schwartz, 409 B.R. at 250.

"To meet the threshold requirements of a successful Rule 59(e) motion, the motion 'must demonstrate the reason why the court should reconsider its prior decision and must set forth facts or law of a strongly convincing nature to induce the court to reverse its earlier decision.'" Id. (citations omitted). The moving party cannot use a Rule 59(e) motion to cure its procedural defects or to offer new evidence or raise arguments that could and should have been presented originally to the court. Id. (citations omitted). In order to be successful on a Rule 59(e) motion, the moving party must establish a

manifest error of law or fact or must present newly discovered evidence. Id. (citations omitted); see also Kansky v. Coca-Cola Bottling Co. of New Eng., 492 F.3d 54, 60 (1st Cir. 2007). Rule 59(e) motions are generally denied because of the narrow purpose for which they are intended. Id.

The Trustee argues that the Debtor failed to meet his burden under Rule 59(e) because he "failed to discuss, much less elaborate, what is the manifest error of law that warrants the reversal of the Order granting appellee's objection to exemptions and of the Order denying appellant's motion for reconsideration." The Debtor, however, argued that it was error to sustain the Objection because the ruling was premised upon a projected disposable income analysis of the March Plan despite the lack of a plan objection having been filed. We agree with the Debtor and therefore conclude that the bankruptcy court abused its discretion in denying reconsideration.**CONCLUSION**

For the reasons set forth herein, we **REVERSE** the Exemption Order and Reconsideration Order.

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UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NOS. MB 11-079, MB 11-082, MB 11-085, MB 11-086

Bankruptcy Case No. 10-14535-JNF
(Jointly Administered)

SW BOSTON HOTEL VENTURE, LLC, et al.,
Debtors.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA,
Appellant / Cross-Appellee,

v.

CITY OF BOSTON,
Appellee,

and

SW BOSTON HOTEL VENTURE, LLC, et al.,
Appellees / Cross-Appellants.

Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. Joan N. Feeney, U.S. Bankruptcy Judge)

Before Haines, Deasy, and Tester,
United States Bankruptcy Appellate Panel Judges.

Gina L. Martin Esq., and Emanuel C. Grillo, Esq., on brief for Appellant/ Cross-Appellee.
Joseph F. Ryan, Esq., and E. Kate Buyuk, Esq., on brief for Appellee, City of Boston.
Harold B. Murphy, Esq., Charles R. Bennett, Jr., Esq., and John C. Elstad, Esq., on brief for Appellees/ Cross-Appellants.

October 1, 2012

Deasy, U.S. Bankruptcy Appellate Panel Judge.

The Prudential Insurance Company of America ("Prudential") appeals from the following orders of the bankruptcy court: (1) the October 4, 2011 order (the "506(b) Order") granting, in part, and denying, in part, the Motion of The Prudential Insurance Company of America for an Order Authorizing the Application of Payments Received during the Chapter 11 Cases to Payment of Postpetition Interest Pursuant to Section 506(b) of the Bankruptcy Code; and (2) the Order Fixing Amount of Allowed Prudential Secured Claim as of October 4, 2011 (the "Prudential Claim Order") entered by the bankruptcy court on October 20, 2011. The Debtors filed cross-appeals with respect to both orders, arguing that the bankruptcy court erred by awarding Prudential interest at the default rate (the "Default Rate Calculation"). For the reasons set forth below, we **AFFIRM** in part, **REVERSE** in part, and **REMAND** both orders for further proceedings consistent with this opinion. **BACKGROUND**

In 2007, the Debtors, a group of affiliated companies run by Carol Sawyer Parks, sought financing for the development of certain property located at 100 Stuart Street, Boston, Massachusetts (the "Property"). See In re SW Boston Hotel Venture, LLC, 449 B.R. 156, 159 (Bankr. D. Mass. 2011) (reciting stipulated facts in connection with Prudential's motion to lift stay) (the "Lift Stay Decision"). This development became the "W" Hotel and Residences, a mixed-use property located in Boston's downtown theater district, consisting of a hotel (the "Hotel"), residential condominiums (the "Residences"), a parking garage, restaurant, lobby bar, retail store, spa, and theme bar. Id. SW Boston was formed to own and operate the Debtors' main assets, the Hotel and Residences.

A. The Prudential Loan

After financing with another lender fell through, Prudential agreed to finance the construction of the project. In January 2008, Prudential and SW Boston entered into a Construction Loan Agreement, whereby Prudential agreed to provide up to $192.2 million in financing to SW Boston (the "Prudential Loan"). See Lift Stay Decision, 449 B.R. at 160. The Construction Loan Agreement provided for the

payment of interest at the rate of 9.5% per annum, and that after the occurrence of an event of default (as defined therein), the interest rate would increase to a default rate of 14.5%. In addition to scheduled debt service payments, the Debtors were required to pay Prudential 92% of the proceeds of each Residence sale as it occurred.

1. Prudential's Collateral

To secure SW Boston's obligations under the Construction Loan Agreement, SW Boston granted Prudential, among other things, a first priority mortgage and security interest on SW Boston's real and personal property, and all proceeds from the sale of the foregoing. See Lift Stay Decision, 449 B.R. at 160. SW Boston also executed pledge agreements and account control agreements in favor of Prudential with respect to two accounts in SW Boston's name at Sovereign Bank. In addition to the collateral provided by SW Boston, certain of the Debtors other than SW Boston (the "Affiliated Debtors") provided guarantees and pledged additional collateral as security. See Lift Stay Decision, 449 B.R. at 160-61.

2. Letter of Credit

Under the Construction Loan Agreement, one of the Affiliated Debtors, Frank Sawyer Corporation, was required to arrange for the issuance of a letter of credit for Prudential's benefit as additional security for the loan. As a result, two of the Debtors' non-debtor affiliates, SE Berkeley Street, LLC and SW McClellan Highway, LLC, obtained from Sovereign Bank a letter of credit in favor of Prudential in the approximate amount of $17.3 million (the "Letter of Credit"). See Lift Stay Decision, 449 B.R. at 161.

B. The City Loan

After construction of the project was underway, the City of Boston agreed to lend SW Boston an additional $10.5 million under the terms of a Subordinate Loan Agreement (the "City Loan") to complete construction of certain amenities and facilities. See Lift Stay Decision, 449 B.R. at 161. As

security for the City Loan, the Debtors granted to the City of Boston a second priority security interest and mortgage on much of the same collateral on which Prudential had a first lien. Id. Prudential and the City of Boston entered into an Intercreditor and Subordination Agreement, under which the City of Boston agreed, among other things, to subordinate its liens against, and right to payment from, the collateral pledged to both of them. See In re SW Boston Hotel Venture, LLC, 460 B.R. 4, 17 (Bankr. D. Mass. 2011) (the "506(b) Decision").

C. The Commencement of Bankruptcy Proceedings

On April 28, 2010 (the "petition date"), SW Boston and four of the Affiliated Debtors filed chapter 11 petitions. The other Affiliated Debtors filed chapter 11 petitions on June 4, 2010. Shortly after the petition date, Prudential drew the full amount of the Letter of Credit ($17.3 million), and applied the funds to the principal balance due on the Prudential Loan.

1. The Debtors' Use of Cash Collateral

From the inception of the cases, the Debtors requested authority from the bankruptcy court to use Prudential's cash collateral, i.e. Hotel-related revenue and the proceeds of the sale of the Residences. Although Prudential objected in most instances, the bankruptcy court regularly allowed the Debtors to use cash collateral.

2. The Lift Stay Motion

In August 2010, Prudential filed a Motion for Relief from the Automatic Stay pursuant to §§ 362 (d)(1) and (d)(2) (the "Lift Stay Motion") so that it could enforce its rights and remedies under the loan documents. Prudential argued that it was entitled to relief from stay because, among other things, SW Boston did not have sufficient Residence sales, had not completed the theme bar, could not close existing Residence sales or obtain new sales, and did not have the ability to emerge successfully from

chapter 11. The Debtors opposed the motion asserting, among other things, that Prudential's interest in the Hotel and Residences was more than adequately protected by its collateral and by SW Boston's continued operation of the Hotel and sales and leases of the Residences. According to the Debtors, Prudential's interest in the Hotel and Residences was being enhanced by the completion of the spa and theme bar using the proceeds of the City Loan, and the Debtors' successful reorganization was in progress.

In November 2010, the bankruptcy court conducted a three-day evidentiary hearing on the Lift Stay Motion that involved multiple expert witnesses and extensive exhibits. See Lift Stay Decision, 449 B.R. at 158-59. At the hearing, the bankruptcy court heard expert testimony as to the value of the Hotel and Residences, and admitted into evidence competing appraisals of the Hotel and Residences, and stipulated values for other collateral. See id. On January 28, 2011, the bankruptcy court entered an order denying Prudential's Motion for Relief from the Automatic Stay. In the bankruptcy court's extensive Lift Stay Decision, the bankruptcy court scrutinized the competing valuation evidence submitted by the parties, and ultimately found that the Hotel was worth $65,600,000 and the unsold Residences were worth $88,000,000. Id. at 172-173. The bankruptcy court also accepted the stipulated value of the other collateral as $14,754,000, for an aggregate collateral value of $168,354,000. Id. at 171-73. The bankruptcy court found the value of Prudential's claims to be $154,000. Id. at 161-62.

In denying relief from stay, the bankruptcy court concluded that Prudential had not demonstrated cause for relief from stay due to lack of adequate protection under § 362(d)(1). Noting that Prudential did not introduce evidence of lack of adequate protection at trial and did not address it in its brief, the bankruptcy court stated: "Given the total value of the collateral package, an equity cushion exists with respect to Prudential's claim in an amount in excess of $19 million." Id. at 176. The bankruptcy court

also noted that the Debtors were reducing the amount of debt owed to Prudential from the proceeds of the Residence sales, and that the value of the collateral was not declining. The bankruptcy court concluded, therefore, that Prudential did not lack adequate protection. Id.

The bankruptcy court also held that Prudential was not entitled to relief from stay under § 362(d)(2). In its analysis, the bankruptcy court found that SW Boston lacked equity in the Hotel and Residences, even though the "total value of the collateral package" provided Prudential with an equity cushion. Id. at 176 and 178. However, the bankruptcy court also found that the Debtors had sustained their burden of demonstrating that a plan of reorganization was in prospect, and, therefore, that the Property was necessary for their reorganization.

3. The Hotel Sale

On March 28, 2011, the Debtors filed a motion requesting approval of a purchase and sale agreement to sell the Hotel and Residences and certain other related facilities to an unrelated third party for $89.5 million (the "Hotel Sale"). This amount was substantially more than the opinions expressed by both parties' appraisers and the value determined by the bankruptcy court when denying the Lift Stay Motion. See Lift Stay Decision, 449 B.R. at 162-173. The bankruptcy court entered an order approving the Hotel Sale on May 24, 2011. The Hotel Sale closed on June 8, 2011, and the $83,322,017 net proceeds of the Hotel Sale were paid to Prudential, thereby reducing the amount of outstanding principal balance of Prudential's claim.

4. The Plan

On March 31, 2011, prior to the closing on the Hotel Sale, the Debtors filed a Joint Plan of Reorganization and a Disclosure Statement. Prudential objected to the Disclosure Statement and, on May 5, 2011, the Debtors filed a First Amended Joint Plan of Reorganization, with an Amended

Disclosure Statement. On May 24, 2011, the bankruptcy court approved the Amended Disclosure Statement and scheduled a confirmation hearing. On June 24, 2011, Prudential filed an objection to the First Amended Plan, and, on June 27, 2011, the Debtors filed a Modified First Amended Joint Plan of Reorganization (the "Plan").

The Plan divided creditors and other interests into nine classes and proposed to pay in full all allowed claims filed by non-insiders, using income generated by the Debtors' operations, the sale of the remaining residences in the ordinary course of SW Boston's business, and the liquidation of certain assets of the Debtors. The Plan defined Prudential's allowed secured claim as "$180,803,186.86 less all payments made to, or received by, Prudential on account of its Claims against the Debtors from the Petition Date through the Effective Date . . ." or such other amount as determined by the bankruptcy court. According to the Plan, Prudential's allowed Class 2 claim would be paid in full prior to March 31, 2014, with post-confirmation interest at a rate of 4.25%, or such other rate as determined by the bankruptcy court. The Plan also proposed that Prudential would retain its prepetition liens on the Debtors' property and it would be paid the "Residence Net Sales Proceeds," the sales price of the condominiums, less 8% for closing costs and the amount necessary to pay outstanding real estate taxes and condominium fees, as well as budgeted operating expenses. Prudential also would receive, on a monthly basis, the aggregate of the Debtors' cash in excess of working capital amounts.

In its objection, Prudential asserted numerous flaws with the Plan, including that the Plan failed to satisfy multiple provisions of § 1129, such as §§ 1129(a)(3), (a)(7), (a)(11) and (b)(2). Prudential also argued that the Plan fixed its claim at an amount vastly below what the circumstances and the Bankruptcy Code require because it failed to calculate properly the postpetition interest to which Prudential was entitled, and because the Plan allowed payments on Prudential's claims to be made over

time at a below-market rate of interest.

5. The 506(b) Motion

On April 15, 2011, Prudential filed a Motion of The Prudential Insurance Company of America for an Order Authorizing the Application of Payments Received During the Chapter 11 Cases to Payment of Postpetition Interest Pursuant to Section 506(b) of the Bankruptcy Code (the "506(b) Motion"). In the 506(b) Motion, Prudential sought a declaration that it was oversecured and, therefore, entitled under § 506(b) to recover postpetition interest from the petition date at the default rate set forth in loan documents executed by the parties, as well as attorneys' fees, costs, and charges. Prudential also sought to apply all postpetition payments received during the chapter 11 proceedings first to postpetition interest and then to the principal balance of its claim. The Debtors opposed the 506(b) Motion, asserting that Prudential's claim was undersecured as to SW Boston until the closing of the Hotel Sale on June 8, 2011, and as such, Prudential was not entitled to postpetition interest, fees and costs from the petition date. Furthermore, the Debtors asserted that the default rate of interest should not be allowed as it was an unreasonable penalty and would be inequitable under the circumstances. The Official Committee of Unsecured Creditors and the City of Boston also filed objections to the 506(b) Motion.

D. The Combined Hearing

On June 27-29, 2011, the bankruptcy court held a combined evidentiary hearing (the "Combined Hearing") on Prudential's 506(b) Motion and confirmation of the Plan. At the Combined Hearing, Joanna Mulford ("Ms. Mulford"), a Vice President of Prudential, testified on behalf of Prudential. Her Declaration was introduced into evidence as her direct testimony, and she was cross-examined by Debtors' counsel pursuant to an agreement of the parties. Ms. Mulford indicated that the principal amount of Prudential's loan had been reduced from $180.8 million to $163.5 million by application of

$17.3 million attributable to the Letter of Credit proceeds. She also reported that the Debtors had paid Prudential approximately $22.2 million from the sale of Residences. She compared the amount due Prudential for postpetition interest, as of April 25, 2011, prior to the sale of the Hotel in June of 2011, using the non-default contract rate of interest and the default rate of interest. Using the 9.5% contract rate, Ms. Mulford calculated interest owed at $16,209,512.78. Using the 14.5% default rate of interest, she calculated interest owed at $24,740,835.30. Ms. Mulford, however, did not explain how she actually computed those figures.

Ms. Mulford testified that she was responsible for the loan after it was originated and that another group, "[o]n the portfolio side," actually originated the loan. She also testified that the rates of interest set forth in the Construction Loan Agreement were predicated on similar loans in the market at the time of the loan's origination, "whether it be a loan that we're originating or a loan that we're actually taking out on one of our properties." She added that she did not engage in any analysis with respect to the anticipated costs, or losses, that Prudential might sustain as a result of a default, or whether the 5% spread between the non-default and default rates reasonably anticipated Prudential's costs or expenses in the event of a default. In fact, she admitted that she made no inquiries to determine on what basis they established the default rate of interest. On redirect examination, Ms. Mulford re-emphasized that interest rates in the Construction Loan Agreement were similar to those in situations where Prudential had acted as either a lender or a borrower.

F. The 506(b) Decision

On October 4, 2011, the bankruptcy court entered its 506(b) Order granting, in part, and denying, in part, the 506(b) Motion. In its accompanying 506(b) Decision, the bankruptcy found that Prudential first became oversecured and entitled to accrue postpetition interest from June 8, 2011, the date of the

closing of the Hotel Sale, through confirmation, at the default rate of interest. In so holding, the bankruptcy court, following precedent set forth by the Fifth Circuit in T-H New Orleans, infra, applied a flexible approach as to the timing of the determination of Prudential's secured status for § 506(b) purposes. The bankruptcy court rejected Prudential's argument that it was entitled to postpetition interest from the petition date, finding that Prudential had not established that it was a fully secured creditor from the petition date forward. Instead, the bankruptcy court found that the date of the closing of the Hotel Sale was the appropriate time for fixing Prudential's oversecured status because, on that date, it was unequivocally established and beyond dispute that Prudential was an oversecured creditor.

The bankruptcy court also determined that Prudential was entitled to postpetition interest at the default rate of 14.5% and that such rate was not a penalty as contended by the Debtors. In ruling that Prudential was entitled to the default rate of interest, the bankruptcy court relied on testimony at the Combined Hearing that the non-default and default rates of interest set forth in the applicable loan documents were similar to and predicated upon those set forth in other loans in the market at that time.

As to Prudential's request under § 506(b) for reasonable attorneys' fees, costs, and other charges, the bankruptcy court determined that Prudential had not met its burden of establishing that the fees and charges were authorized by the applicable loan documents, or that they were necessary and reasonable. In so holding, the bankruptcy court pointed out that Prudential had not introduced into evidence the applicable promissory note or mortgage that allegedly entitled it to recover fees, costs, and other charges, nor did it provide a statement or itemization of its fees and costs.

Thereafter, on October 20, 2011, the bankruptcy court entered the Prudential Claim Order determining, based on the 506(b) Decision, that Prudential had an allowed secured claim as of October 4, 2011, in the amount of $51,835,721. In determining the amount of Prudential's allowed secured

claim, the bankruptcy court determined that Prudential was not entitled to postpetition interest computed on a compounded basis as the Construction Loan Agreement did not provide for compound interest.

Prudential appealed both the 506(b) Decision and the Prudential Claim Order, and the Debtors filed cross-appeals relating to both orders. Neither party sought a stay of either order pending appeal.

G. Plan Confirmation

On November 14, 2011, the bankruptcy court entered an order and accompanying decision confirming the Plan (the "Confirmation Decision"), and an order overruling Prudential's objection to confirmation of the Plan (the "Confirmation Order"). Prudential appealed the Confirmation Order and Decision, and that appeal is currently pending before the Panel. Prudential sought a stay of the Confirmation Order pending appeal from both the bankruptcy court and the Panel, both of which were denied. Without a stay, the Plan became effective on December 1, 2011.

While these appeals were in briefing, the Debtors filed motions to dismiss, arguing that the appeals should be dismissed as moot as the Debtors' confirmed Plan has been substantially consummated and appellate relief cannot be granted without "eviscerating" the Debtors' reorganization, completely undoing multiple consummated transactions made in reliance on the confirmed Plan's finality, and causing harm to third parties not before the court. In orders dated March 12, 2012, the Panel denied the motions to dismiss, reasoning that although the Plan has been substantially consummated, Prudential is willing to accept alternative forms of relief that would not require an unraveling of the reorganization, and reversal of the Plan confirmation would not adversely affect any innocent third parties.

JURISDICTION

Before addressing the merits of an appeal, the Panel must determine that it has jurisdiction, even if the issue is not raised by the litigants. See Boylan v. George E. Bumpus, Jr. Constr. Co. (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724 (B.A.P. 1st Cir. 1998). The Panel has jurisdiction to hear

appeals from: (1) final judgments, orders, and decrees; or (2) with leave of court, from certain interlocutory orders. 28 U.S.C. § 158(a); Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998). A decision is considered final if it "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment," id. at 646 (citations omitted), whereas an interlocutory order "'only decides some intervening matter pertaining to the cause, and . . . requires further steps to be taken in order to enable the court to adjudicate the cause on the merits.'" Id. (quoting In re American Colonial Broad. Corp., 758 F.2d 794, 801 (1st Cir. 1985)).

The underlying decisions and orders of the bankruptcy court determined whether and in what amount Prudential was entitled to postpetition interest pursuant to § 506(b). Generally, a bankruptcy court order regarding a secured creditor's entitlement to postpetition interest pursuant to § 506(b) is a final, reviewable order. See, e.g., Fin. Sec. Assur. Inc. v. T-H New Orleans Ltd. P'ship (In re T-H New Orleans Ltd. P'ship), 116 F.3d 790 (5th Cir. 1997) (reviewing bankruptcy court's ruling that appellant was not entitled to postpetition interest from the petition date).

STANDARD OF REVIEW The Panel applies the clearly erroneous standard to findings of fact and *de novo* review to conclusions of law. See Lessard v. Wilton-Lyndeborough Coop. School Dist., 592 F.3d 267, 269 (1st Cir. 2010).

DISCUSSION

Prudential argues that the bankruptcy court erred by awarding postpetition interest only from the date of the Hotel Sale, and that it was entitled to postpetition interest from the petition date because: (1) it was oversecured at confirmation; and/or (2) it was oversecured throughout the bankruptcy proceedings, as evidenced by the bankruptcy court's findings in the Lift Stay Decision. Prudential also argues that the bankruptcy court erred by concluding that it was not entitled to accrue postpetition interest on a compounded basis. In their cross-appeals, the Debtors argue that the bankruptcy court erred by awarding Prudential postpetition interest at the default rate.

I. Whether Prudential Was Entitled to Accrue Postpetition Interest From the Petition Date.

A. Prudential's entitlement to postpetition interest

Section 506(b) governs a creditor's entitlement to postpetition interest, and provides that:

> To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

11 U.S.C. § 506(b). As the U.S. Supreme Court has made clear, under § 506(b), a creditor is unqualifiedly entitled to postpetition interest on its oversecured claim, whether or not the loan documents upon which the claim is based provide for such interest. See United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989); see also Rake v. Wade, 508 U.S. 464 (1993). According to § 506(b)'s express terms, a secured creditor can only accrue postpetition interest on its claim if it is oversecured and then only to the extent it is oversecured. See United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 372-73 (1988). Thus, the first inquiry under § 506(b) is usually a determination of whether the creditor is oversecured. In re T-H New Orleans, 116 F.3d at 797. The creditor who claims entitlement to postpetition interest bears the burden of proving, by a preponderance of evidence, that its claim is oversecured, "to what extent, and for what period of time." T-H New Orleans, 116 F.3d at 798 (citing Heritage Bank Tinley Park v. Steinberg (In re Grabill Corp.), 121 B.R. 983, 991-92 (Bankr. N.D. Ill. 1990)).

A creditor is considered to be oversecured when the value of its collateral exceeds the amount of the creditor's allowed claim. See Ron Pair Enters., 489 U.S. at 239; see also Baybank-Middlesex v. Ralar Distribs., Inc., 69 F.3d 1200, 1202 (1st Cir. 1995). Section 506(a) establishes the extent to which an allowed claim is a secured claim. "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property. . . ." 11 U.S.C. § 506(a). Valuations under § 506(a) are to be

made "in light of the purpose of the valuation and of the proposed disposition or use of" the collateral. Id.

The parties do not dispute that Prudential is entitled to some amount of postpetition, pre-confirmation interest on its claim. They disagree, however, as to the appropriate time for the valuation determination under § 506(a), and when Prudential's right to postpetition interest accrued. Prudential argues that it is entitled to postpetition interest from the petition date either because it was oversecured *at confirmation*, or because the bankruptcy court's earlier findings prove that it was oversecured throughout these proceedings. The Debtors argue that Prudential was not entitled to postpetition interest from the petition date because Prudential had not met its burden of establishing that it was oversecured on that date. Thus, the question here is when should the valuation of the collateral and the claim occur for the purpose of determining a secured creditor's entitlement to postpetition interest under § 506(b)?

B. The valuation determination

As the bankruptcy court remarked:

> The timing of the comparison between the amount of debt and the value of the collateral required by § 506(a) and (b) is crucial in determining the allowed amount of the secured claim and whether the secured creditor is oversecured. The bankruptcy court must determine the appropriate date for assessing the value of collateral, as values may decrease, increase or fluctuate over time during the pendency of the case, as evidenced by what has transpired in the Debtors' cases where both the amount of debt and the value of the collateral have declined due to payments to Prudential and sales of the Hotel and Residences, respectively. Thus, the application of § 506(a) and (b) often presents difficulties in the context of determining a secured creditor's entitlement to postpetition interest during the pendency of the [c]hapter 11 case (often referred to as "pendency interest") where a debtor has made significant payments to the secured creditor and substantially paid down the balance owed to the creditor during the case due to sales of assets or the appreciation of the value of the secured creditor's collateral during the case.

506(b) Decision, 460 B.R. at 26.

Neither the Bankruptcy Code nor the Bankruptcy Rules define or establish the appropriate point

in a reorganization proceeding for the valuation determination under § 506(a), and, as a result, several approaches have emerged. See Official Comm. of Unsecured Creditors v. Liberty Sav. Bank, FSB (In re Toy King Distribs., Inc.), 256 B.R. 1 (Bankr. M.D. Fla. 2000) (discussing different approaches). Some courts have held that a creditor's secured claim is always determined on a specific date, i.e., either the petition date or the confirmation date. Courts applying this "single valuation approach" rely on the Supreme Court's ruling in Timbers, supra, that an undersecured creditor whose collateral is not declining during the pendency of a bankruptcy case is not entitled to postpetition interest. Accordingly, under this approach, if a secured claim is not fully secured on the specific date, the secured creditor will not be entitled to any postpetition interest under § 506(b).

Other courts utilize a "dual valuation approach," determining a creditor's secured status twice, once at the petition date and once at the hearing on plan confirmation. Those courts reason that it is necessary to determine secured status through valuation at the outset of the case for adequate protection purposes, and at confirmation for the purpose of determining treatment under the plan and reducing the amount of the secured claim by any payments made by the debtor. "If the collateral package at the time of confirmation exceeds the amount of the creditor's total prepetition claim, the creditor is entitled to interest and costs under [§] 506(b) to the extent of the surplus." In re Addison Props., 185 B.R. at 784.

The majority of courts, however, use a more flexible approach, looking to the circumstances of each case and the purpose of the valuation. They do not pick a specific point in time for the debt/value comparison, focusing instead on the matter before the court. This flexible approach was adopted by the Fifth Circuit in T-H New Orleans, supra. In that case, the bankruptcy court made a finding early in the case that the secured creditor was substantially undersecured, but because of subsequent adequate protection payments and an increase in the value of the creditor's collateral, the creditor became oversecured prior to the effective date of the plan. 116 F.3d at 794-95. On appeal, the Fifth Circuit addressed the issue of whether courts must utilize a fixed point in the reorganization proceeding, such as the petition date or the date of plan confirmation, for the purposes of valuing secured collateral to determine whether a creditor is entitled to postpetition interest under § 506(b). Declining to follow the single point in time approach, the Fifth Circuit stated:

> . . . [W]e conclude that for purposes of determining whether a creditor is entitled to accrue interest under § 506(b) in the circumstance where the collateral's value is increasing and/or the creditor's allowed claim has been or is being reduced by cash collateral payments, such that at some point in time prior to confirmation of

> the debtor's plan the creditor may become oversecured, valuation of the collateral and the creditor's claim should be flexible and not limited to a single point in time, such as the petition date or confirmation date.

Id. at 798. Thus, the Fifth Circuit held that the secured creditor's entitlement to accrue postpetition interest under § 506(b) begins at that point in time when it becomes oversecured. Id. at 799.

> The measuring date on which the status of a creditor's collateral and claim are compared is determinative of a creditor's right to accrue interest under § 506(b). Thus, a secured creditor's entitlement to accrue interest under § 506(b) matures at that point in time where the creditor's claim becomes oversecured.

Id.

Citing T-H New Orleans with approval, the bankruptcy court in In re Urban Communicators PCS Ltd. P'ship, 379 B.R. 232 (Bankr. S.D.N.Y. 2007), aff'd in part and rev'd in part on other grounds, 394 B.R. 325 (S.D.N.Y. 2008), similarly held that bankruptcy courts have flexibility in determining whether a secured creditor is entitled to postpetition interest under § 506(b). As that court reasoned:

> Recognition of that flexibility is, after all, consistent with attention to the needs and concerns of junior creditors, and, more significantly, language in [§] 506(a) that bankruptcy courts engage in any analysis of collateral value "in light of the purpose of the valuation and the proposed disposition or use of such property." The statutory guidance appearing as part of [§] 506(a) is the antithesis of a hard-and-fast rule, and instead embodies a more functional approach.

Id. at 243. As mandated by § 506(a), the Urban Communicators court considered both the "disposition or use of the property" (the eventual sale of the property) and the "purpose of the valuation" (the allowance of a secured creditor's claim – specifically, whether the extent to which the creditor should be able to collect its contractual entitlement from the proceeds of the collateral). Id. at 242. The court went on to say, however, that where collateral is actually sold during the pendency of the case, and the sale price was fair and the result of an arm's length transaction, courts should use the actual sale price, and not some earlier "hypothetical" valuation, to determine whether a creditor is oversecured and thus entitled to postpetition interest. Id. (citing Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 870 (4th Cir.

1994)). The court remarked:

> But acknowledging, as this Court does, that a bankruptcy court has flexibility in making a collateral valuation decision does not mean that the Court should disregard the best evidence of collateral value – what the collateral actually fetched. Rather, that flexibility should permit this Court's resort to the best available evidence of collateral value except where the circumstances dictate a different approach . . . . This flexible approach, the Fifth Circuit noted [in T-H New Orleans], ensures that "any increase over the judicially determined valuation during the bankruptcy rightly accrues to the benefit of the creditor, and not to the debtor."
>
> Importantly, in T-H New Orleans, there had not been an actual sale of the underlying secured asset. In this case, . . . the secured asset has been sold in a good faith and arm's length transaction. This distinction is critical. It is settled law that the sale price in an arm's length transaction is the best evidence of an asset's market value. T-H New Orleans does not disturb this conclusion. While this Court endorses the "flexible approach" outlined in T-H New Orleans, the Court believes that in instances where an actual post-petition sale of a secured asset has occurred, the flexibility provided to bankruptcy courts is usually best employed by utilizing the sale price in a good faith transaction as the value of a secured asset – and that in any event, such an approach is the most sensible here.

Id. at 243-44(footnotes omitted).

We agree with the flexible approach espoused in T-H New Orleans and as applied by Urban Communicators. This case is similar to Urban Communicators in that the value of the secured collateral (primarily the Hotel and Residences) fluctuated during the case and the debt was reduced by adequate protection payments. In addition, an actual postpetition sale of a substantial portion of Prudential's collateral occurred in an arm's length transaction. Although the bankruptcy court cited both T-H New Orleans and In re Urban Communicators with approval in holding that the Hotel Sale was evidence establishing Prudential's oversecured status, it did not follow the reasoning of Urban Communicators in applying that evidence under a flexible approach to determine the point in time to apply the evidentiary determination. We find that the bankruptcy court erred in not doing so. Under the rationale set forth in Urban Communicators, the Hotel Sale price is the best evidence of the value of the Hotel and establishes that Prudential was oversecured throughout these bankruptcy proceedings.

In addition, whether the hypothetical stay relief value is used, or the actual later sale value is used, it appears that Prudential was fully secured from the petition date under the rationale in Urban Communicators, and by the statements of the bankruptcy court in the 506(b) Decision. See 460 B.R. at 26 ("all collateral . . . is considered"), 30-31 (adopting Urban Communicators where a sale of the collateral has occurred). Although the values used in the stay relief hearing, other than the Hotel value, were stipulated by the parties solely for the purpose of that hearing, the bankruptcy court adopted the stipulated values for purposes of the § 506(b) hearing without objection. See 460 B.R. at 32-33. The values found by the bankruptcy court at the § 506(b) hearing support Prudential being fully secured as of the petition date.

C. Prudential's argument

Prudential argues, that because the Plan provides for Prudential to receive deferred cash payments over time, § 1129(b)(2)(A)(i)(II) precludes the bankruptcy court from applying a flexible approach and requires that Prudential's collateral be valued at the confirmation date. However, Prudential's argument has no support in the language of the Bankruptcy Code and is inconsistent with the holdings in T-H New Orleans, and other cases, that the right to accrue postpetition interest under § 506(b) begins at that point in time when a secured creditor becomes oversecured. See T-H New Orleans, 116 F.3d at 799.

The bankruptcy court has flexibility regarding when the valuation is made. Where there has been an arm's length sale of collateral during the course of the bankruptcy case, that sale value is the best evidence of the collateral's value. See Urban Communicators, 379 B.R. at 243-44. Thus, Prudential was fully secured and, for the reasons discussed above, is entitled to postpetition interest from the petition date.

II. Whether the Bankruptcy Court Erred in Concluding that Prudential Was Not Entitled to

Postpetition Interest Computed on a Compounded Basis.

"Compound interest is the periodic calculation of additional interest on the interest that has already come due." Aceta v. Robinson, 2000 Mass. App. Div. 155, 157 (Mass. App. Div. 2000).

Prejudgment interest rates are governed by state law. See Loft v. Lapidus, 936 F.2d 633, 639 (1st Cir. 1991) (citations omitted). The general rule in Massachusetts is that in the absence of statutory or express agreement by the parties, interest is presumed to be simple interest. See, e.g., Cherokee Nation v. United States, 270 U.S. 476, 490 (1926) ("The general rule, even as between private persons, is that, in the absence of a contract therefor or some statute, compound interest is not allowed to be computed upon a debt."); Berman v. B.C. Assocs., 219 F.3d 48, 50 (1st Cir. 2000); Coupounas v. Madden, 514 N.E.2d 1316, 1321 (Mass. 1987); Shapiro v. Bailen, 199 N.E. 315, 316 (Mass. 1936); D'Annolfo v. D'Annolfo Constr. Co., Inc., 654 N.E.2d 82, 85 (Mass. App. Ct. 1995) ("[C]ompounding cannot be done in the absence of express agreement"); Thomas's Case, 519 N.E.2d 786, 788 (Mass. App. Ct. 1988) (disallowing compound interest except in certain proceedings in equity or by express statutory language); Infolink Partners Ltd. P'ship v. Treasurer & Receiver Gen. of the Commonwealth of Massachusetts, 2002 Mass. Super. LEXIS 563 (Mass. Super. Ct. May 1, 2002); see also S.R. Fulton, "Interest On Money Damages For Periods Before And After Judgment: A Guide For The Massachusetts Practitioner," 85 Mass. L. Rev. 146, 152 and n. 46-50 (2001). In Berman v. B.C. Assocs., the First Circuit stated:

> In Massachusetts, compound interest is generally disfavored. See Ellis v. Sullivan, 241 Mass. 60, 134 N.E. 695, 697 (1922) (recognizing an "'ancient unwillingness to allow compound interest'" (quoting Lewin v. Folsom, 171 Mass. 188, 50 N.E. 523, 524 (1898))). As early as 1906, the Supreme Judicial Court of Massachusetts decreed that interest is simple, "unless there is an express agreement to the contrary." Inhabitants of Tisbury v. Vineyard Haven Water Co., 193 Mass. 196, 79 N.E. 256, 257 (1906); see also Coupounas v. Madden, 401 Mass. 125, 514 N.E.2d 1316, 1321 (1987); Von Hemert v. Porter, 52 Mass. 210, 218, 11 Metc. 210 (Mass. 1846); D'Annolfo v. D'Annolfo Constr. Co.[, Inc.], 39 Mass. App.

> Ct. 189, 654 N.E.2d 82, 85 (1995). Consequently, compound interest is only permitted in certain proceedings in equity or by express statutory or contractual authority. See Dunne v. City of Boston, 41 Mass. App. Ct. 922, 671 N.E.2d 518, 520 (1996); see also Shapiro v. Bailen, 293 Mass. 121, 199 N.E. 315, 316 (1936) (recognizing exception in equity); Ellis, 134 N.E. at 697 (same).

219 F.3d at 50. It added that "the overwhelming majority of Massachusetts cases equate an interest rate 'per annum,' whether in a contract or a statute, with simple interest." Id. (citations omitted).

In the Prudential Claim Order, the bankruptcy court, citing Berman, denied compound interest because it found that the Construction Loan Agreement, which is governed by Massachusetts law, does not provide for compound interest either at the default rate or the non-default rate of interest. Prudential argues that the bankruptcy court erred because the Construction Loan Agreement expressly provides for compound interest in the definition of "Applicable Interest Rate," which is incorporated into the definition of "Default Rate."

Prudential did not introduce into evidence the applicable promissory note or mortgage, so the only loan document before the bankruptcy court was the Construction Loan Agreement. Section 1.1 of the Construction Loan Agreement is entitled "Definitions" and includes the following: **"Applicable Interest Rate"** shall mean 9.50% per annum, *compounding monthly.*

(emphasis added).

Section 2.2 of the Construction Loan Agreement is entitled "Interest Rate" and provides, in relevant part, as follows:

> **2.2.1 Applicable Interest Rate.** Except as herein provided with respect to interest accruing at the Default Rate, interest on the principal balance of the Loan outstanding from time to time shall accrue from the Closing Date up to and including the Maturity Date at the Applicable Interest Rate.
>
> **2.2.2 Interest Calculation.** Interest on the outstanding principal balance of the Loan shall be calculated by multiplying (a) the actual number of days elapsed in the period for which the calculation is being made by (b) a daily rate based on a three hundred sixty (360) day year (that is, the

> Applicable Interest Rate or the Default Rate, as then applicable, expressed as an annual rate divided by 360) by (c) the outstanding principal balance.

Section 2.3 of the Construction Loan Agreement is entitled "Loan Payments" and the relevant subsection provides, in pertinent part:

> **2.3.3 Interest Rate and Payment After Default.** In the event that, and for so long as, any Event of Default shall have occurred and be continuing, the outstanding principal balance of the Loan and, to the extent permitted by applicable Legal Requirements, overdue interest in respect of the Loan, shall accrue interest at the Default Rate, calculated from the date the Default occurred which led to such Event of Default; provided, however, if such Event of Default consists of a failure to pay interest due on the Loan in accordance with the Loan Documents, then interest at the Default Rate shall not begin to accrue on the Loan on account of such Default until such Default remains uncured for more than fifteen (15) days. . . .

The Debtors argue that these sections do not expressly provide that overdue interest shall be added to the outstanding principal balance at the default rate of interest, resulting in compond interest at the default rate. Thus, the Debtors claim, the agreement is ambiguous as to compound interest, and, because that right is not expressly stated in the agreement, Prudential is not entitled to compound interest. The Debtors are correct that neither of these sections uses the term "compound interest." However, section 2.2.1 provides that interest shall accrue at the "Applicable Interest Rate," and "Applicable Interest Rate" is defined as "9.50% per annum, *compounding monthly*." (emphasis added). Furthermore, "Default Rate" is defined as "a rate per annum equal to the lesser of (i) the maximum rate permitted by applicable law, or (ii) five percent (5%) above the Applicable Interest Rate." Clearly, the definition of "Default Rate" incorporates the definition of "Applicable Interest Rate." Together, these definitions require that both non-default and default interest be computed on a compounded basis. Section 1.1 of the Construction Loan Agreement defines the term "Loan Documents" to include "this Agreement, the Note," and other documents executed in connection with the loan. Section 2.1.3 of the Construction Loan Agreement describes the Note as the document evidencing the loan to be "repaid in

accordance with the terms of this Agreement, the Note, and the other Loan Documents." Neither Prudential nor the Debtors submitted any further documentary evidence to support their arguments on the calculation of interest. Accordingly, the Construction Loan Agreement is the only evidence of the agreement between the parties regarding the calculation of interest and is sufficient evidence of an express agreement between the parties that compound interest would accrue on the Prudential Loan. The Debtors argue and cite authority that it is within a court's discretion to *allow* compound interest in the absence of an express agreement if warranted by equitable considerations. However, the Debtors cite no authority for the assertion that a court has the discretion to *deny* compound interest where, as in this case, it is expressly provided for in the applicable contract between the parties.

Consequently, we conclude that the bankruptcy court erred in finding that the Construction Loan Agreement did not expressly provide for compound interest and in holding that Prudential was not entitled to postpetition interest computed on a compounded basis.

III. Whether the Bankruptcy Court Erred in Awarding Prudential Postpetition Interest at the Default Rate.

In their cross-appeals, the Debtors argue that the bankruptcy court erred in granting Prudential postpetition interest at the default rate set forth in the Construction Loan Agreement because the default rate constituted an unenforceable penalty under applicable Massachusetts law.

Although § 506(b) entitles Prudential to recover postpetition interest on its claim, § 506(b) and the accompanying legislative history are silent as to the appropriate rate of interest. Bradford v. Crozier (In re Laymon), 958 F.2d 72, 74 (5th Cir. 1992). Thus, the appropriate rate of postpetition interest is within the limited discretion of the bankruptcy court. See Key Bank Nat'l Ass'n v. Milham (In re Milham), 141 F.3d 420, 423 (2d Cir. 1998). Most courts hold that entitlement to default interest is a matter of federal law. See, e.g., In re Route One West Windsor Ltd. P'ship, 225 B.R. 76, 86 (Bankr. D.N.J. 1998); see also Urban Communicators, 379 B.R. at 254 & n.76; In re Consol. Properties Ltd. P'ship, 152 B.R. 452, 456 (Bankr. D. Md. 1993). In Route One West, the court observed:

> The allowance of interest on claims in bankruptcy has long been

> determined by federal law. Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 162-63, 67 S. Ct. 237, 91 L. Ed. 162 (1947). The touchstone of such decisions "has been a balance of equities between creditor and creditor or between creditors and the debtor." Id. at 165, 67 S. Ct. 237. The continuing validity of these principles under the Code was acknowledged in United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 248, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989).

225 B.R. at 86.

Under federal bankruptcy law, there is a presumption that an oversecured creditor is entitled to postpetition interest at the contractual default rate, provided that there are no equitable considerations that would compel a different result. See The Southland Corp. v. Toronto- Dominion (In re The Southland Corp.), 160 F.3d 1054, 1059-60 (5th Cir. 1998) (citing In re Terry Ltd. Partnership, 27 F.3d 241, 243-44 (7th Cir. 1994)); Hassen Imports P'ship v. KWP Fin. VI (In re Hassen Imports P'ship), 256 B.R. 916, 924 (B.A.P. 9th Cir. 2000); Florida Asset Fin. Corp. v. Dixon (In re Dixon), 228 B.R. 166, 172-73 (W.D. Va. 1998); Riley v. Tencara, LLC (In re Wolverine, Proctor & Schwartz), 449 B.R. 1, 5 (Bankr. D. Mass. 2011); In re South Canaan Cellular Invs., Inc., 427 B.R. 44, 77 (Bankr. E.D. Pa. 2010); Urban Communicators, 394 B.R. at 338; In re Route One West, 225 B.R. at 86. We agree with those decisions.

"The effect of the rebuttable presumption in favor of the contract rate is to impose upon the debtor the burden of proving that the equities favor allowing interest at a different rate." In re Route One West, 225 B.R. at 87 (citation omitted). As set forth above, the Loan Construction Agreement establishes a non-default rate of 9.50% and a default rate of 5% above the non-default rate. Section 2.3 of the Construction Loan Agreement provides that if an event of default (as defined in the agreement) has occurred, interest shall accrue at the default rate. There is no dispute that an event of default occurred. Therefore, there is a rebuttable presumption that Prudential is entitled to postpetition interest at the default rate, unless the Debtors can prove that there are equitable considerations that compel a

different result.

Although there is "no clear, emerging, definite enumeration of [the] special circumstances or equitable considerations" which would justify an "equitable deviation" from the contractual default interest rate, see In re Dixon, 228 B.R. at 173, several courts have identified a list of factors which may be considered. For example, in General Growth Properties, the court stated:

> 11 U.S.C. § 506(b) requires payment of post-petition interest to an oversecured creditor . . . and a rebuttable presumption exists favoring the payment of such interest at the contractual rate. Courts in this and other circuits have been reluctant to modify private contractual arrangements imposing default interest rates — particularly in cases involving a solvent debtor — except where: (i) there has been creditor misconduct; (ii) application of the contractual interest rate would cause harm to unsecured creditors; (iii) the contractual interest rate constitutes a penalty; or (iv) its application would impair the debtor's fresh start.

See In re General Growth Props., Inc., No. 09-11977, 2011 WL 2974305, *4 (Bankr. S.D.N.Y. July 20, 2011) (citations omitted); see also In re Jack Kline Co., Inc., 440 B.R. 712, 745 (Bankr. S.D. Tex. 2010) (identifying seven factors to be considered). "The power to modify the contract rate based on notions of equity should be exercised sparingly and limited to situations where the secured creditor is guilty of misconduct, the application of the contractual interest rate would harm the unsecured creditors or impair the debtor's fresh start or the contractual interest rate constitutes a penalty." In re 785 Partners LLC, 470 B.R. 126 (Bankr. S.D.N.Y. 2012) (citing Urban Communicators, 394 B.R. at 338; General Growth, 451 B.R. at 328; In re P.G. Realty Co., 220 B.R. 773, 780 (Bankr. E.D.N.Y. 1998)). The debtor bears the burden of rebutting the presumption that the contract rate applies postpetition. Id. (citing In re The Southland Corp., 160 F.3d at 1059-60; Urban Communicators, 394 B.R. at 338; In re Vest Assocs., 217 B.R. 696, 702 (Bankr. S.D.N.Y. 1998)).

The Debtors have not satisfied this burden. The bankruptcy court in this case employed the four equitable factors outlined in General Growth Properties, supra, and found that the contractual default

interest rate of 14.5% was the appropriate rate for Prudential's postpetition interest. In making its determination, the bankruptcy court noted that SW Boston was in default under the Loan Construction Agreement as of the petition date. It also found that because the Debtors proposed to pay all creditors in full, other creditors would not be harmed by the payment of postpetition interest at the default rate. Moreover, the bankruptcy court found that although Prudential was litigious during these cases, there was no evidence of misconduct by Prudential. In finding that the default rate was not a penalty, the bankruptcy court pointed to unrebutted evidence through the testimony of Ms. Mulford to the effect that the default interest rate in the Construction Loan Agreement was consistent with the default rates in other loans made and obtained by Prudential. Finally, the bankruptcy court found that allowance of interest at the default rate would not impair the Debtors' ability to reorganize because under the Plan, the Debtors are paying all creditors in full in a relativly short period of time. Thus, the bankruptcy court concluded that a default rate which is 5% higher than the non-default rate was neither a penalty nor inequitable.

Here, there is no cognizable basis in law to disturb the parties' bargain. The Debtors and Prudential were sophisticated parties that entered into a $192.2 million loan agreement. Each was represented by counsel, and there is no evidence of overreaching. They agreed to allocate the risk of default by, among other things, including an unambiguous provision that increased the non-default rate by 5% in the event of a default. The Debtors' appeal to equitable considerations has no merit.

Consequently, we conclude that the bankruptcy court did not err in awarding Prudential postpetition interest at the default rate set forth in the Construction Loan Agreement.**CONCLUSION**

For the reasons set forth above, we **AFFIRM** the Default Rate Calculation, **REVERSE** the 506 (b) Order and the Prudential Claim Order, and **REMAND** both orders for further proceedings consistent

with this opinion.

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UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. MB 11-087

Bankruptcy Case No. 10-14535-JNF
(Jointly Administered)

SW BOSTON HOTEL VENTURE, LLC, et al.,
Debtors.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA,
Appellant,

v.

SW BOSTON HOTEL VENTURE, LLC, et al.,
Appellees.

Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. Joan N. Feeney, U.S. Bankruptcy Judge)

Before Haines, Deasy, and Tester,
United States Bankruptcy Appellate Panel Judges.

Gina L. Martin, Esq. and Emanuel C. Grillo, Esq., on brief for Appellant.
Harold B. Murphy, Esq., Charles R. Bennett, Jr., Esq., and John C. Elstad, Esq., on brief for Appellees SW Boston Hotel Venture, LLC, et al.

October 1, 2012

Per Curiam.

The Prudential Insurance Company of America ("Prudential") appeals from the bankruptcy court's decision and accompanying order confirming the Debtors' Modified First Amended Joint Plan of Reorganization (the "Plan") and the order overruling Prudential's objection to confirmation of the Plan. At issue on appeal is whether the bankruptcy court erred in holding that: (1) the Plan complied with the requirements of § 1129 for confirmation; (2) the consolidation of the Debtors' estates for distribution purposes was proper; and (3) the City of Boston's assignment of voting rights which sought to alter substantive rights of creditors under the Bankruptcy Code is unenforceable.

For the reasons set forth below, we **VACATE** and **REMAND** the Confirmation Orders for further proceedings consistent with this opinion.

BACKGROUND

On April 28, 2010, SW Boston and three of its affiliated debtors filed voluntary chapter 11 petitions. The other debtors filed voluntary chapter 11 petitions on June 4, 2010. Prudential has a first priority security interest in and lien on essentially all of the assets of the Debtors (with a limited exception). The City of Boston (the "City") has a second priority lien on most (but not all) of the same assets on which Prudential has a lien. Prudential and the City are parties to an intercreditor agreement pursuant to which the City subordinated its liens against, and right to payment from, the collateral pledged to both of them. This subordination agreement also contemplates the assignment of voting rights from the City to Prudential.

The Debtors filed the Plan in June 2011. The Plan divided creditors and other interests into nine classes and proposed to pay, in full, all allowed claims held by non-insiders using income generated by the Debtors' operations and the sale of SW Boston's condominiums in the ordinary course of business. Prudential filed an objection in which it asserted numerous flaws with the Plan, including that the Plan failed to satisfy multiple provisions of 11 U.S.C. § 1129, such as §§ 1129(a)(3), (a)(7), (a)(11), and (b)(2). Prudential also argued that the bankruptcy court fixed its claim at an amount vastly below what the

Bankruptcy Code requires because it failed to calculate properly the postpetition interest to which Prudential is entitled, and because the Plan allowed payments on Prudential's claims to be made over time at a below-market rate of interest. Prudential was the only party to object to and vote against the Plan.

The bankruptcy court conducted a three-day trial on confirmation of the Plan, combined with a hearing on the "Motion of The Prudential Insurance Company of America for an Order Authorizing the Application of Payments Received during the Chapter 11 Cases to Payment of Postpetition Interest Pursuant to Section 506(b) of the Bankruptcy Code" (the "506(b) Motion"). On October 4, 2011, the bankruptcy court entered an order and accompanying memorandum granting, in part, and denying, in part, the 506(b) Motion (the "506(b) Decision"). See In re SW Boston Hotel Venture, LLC, 460 B.R. 4 (Bankr. D. Mass. 2011). In the 506(b) Decision, the bankruptcy court held that Prudential had failed to establish that it was oversecured at any time prior to the date of SW Boston's sale of the "W" Hotel and, therefore, was entitled to postpetition interest only from June 8, 2011. Based on the 506(b) Decision, the bankruptcy court entered an order (the "Prudential Claim Order") fixing Prudential's allowed secured claim as of October 4, 2011, in the amount of $51,835,721. Prudential appealed both the 506(b) Decision and the Prudential Claim Order, and the Debtors filed cross-appeals relating to both orders.

On November 14, 2011, the bankruptcy court entered the Confirmation Orders confirming the Plan and overruling Prudential's objections to the Plan. See In re SW Boston Hotel Venture, LLC, 460 B.R. 38 (Bankr. D. Mass. 2011). With respect to Prudential's secured claim, the bankruptcy court determined that, pursuant to the 506(b) Decision and the Prudential Claim Order, Prudential was owed around $52 million. The Plan provided for payment of the full amount of Prudential's allowed secured claim, by March 31, 2014. Upon the evidence and witness testimony accepted at trial, adopting the United States Supreme Court's "formula approach" as set forth in Till v. SCS Credit Corp., 541 U.S.

465 (2004), the bankruptcy court also found that the interest rate of 4.25% for the cramdown loan would compensate Prudential for the risk attendant to the restructured loan. Also, Prudential was to retain its lien and receive payments with interest at an appropriate rate from the sale of the condominiums, until its allowed secured claim is paid in full. Finally, the Debtors intended to satisfy Prudential's lien in a relatively short period of time, no later than March 31, 2014. Consequently, the bankruptcy court found that Debtors' proposed treatment of Prudential's allowed secured claim was fair and equitable, did not unfairly discriminate, and met the requirements for a cramdown under § 1129(b)(2)(A). Moreover, the bankruptcy court found that the Plan provided Prudential with the indubitable equivalent of its claim and that the treatment complied with the requirements of § 1129(b)(2)(A)(i) and (iii).

Prudential appealed the Confirmation Orders, and sought a stay pending appeal from both the bankruptcy court and the Panel. Both of those requests were denied. Without a stay, the Plan became effective on December 1, 2011. The Debtors assert that the Plan became substantially consummated shortly thereafter.

On February 14, 2012, the Debtors filed with the Panel a motion to dismiss this appeal, arguing that the appeal is equitably moot because the Plan had been substantially consummated and no effective relief could be granted to Prudential that would not completely undo the Debtors' reorganization and require the unraveling of the consummated transactions. They argued that because the 506(b) Decision and the Prudential Claim Order are "inextricably intertwined" with the Confirmation Orders and the implementation of the Debtors' reorganization, the decisions are "all part of a whole and one cannot be undone without undoing the others." Prudential opposed the motion to dismiss, arguing that the appeal was not moot as the Plan had not been substantially consummated and because effective relief could still be granted to Prudential without unwinding the Plan. In an order dated March 12, 2012, the Panel denied

the motion to dismiss, concluding that the Debtors had failed to carry their burden of showing that the appeal is equitably moot, in part because Prudential is willing to accept alternative forms of relief that would not require an unraveling of the reorganization.

The motion to dismiss having been denied, both this appeal and the appeals relating to the 506(b) Decision and the Prudential Claim Order proceeded to oral argument.

DISCUSSION

The Plan provided for payment in full of all allowed, non-insider claims, plus post-confirmation interest, and proposed to pay these claims using income generated from the Debtors' operations, the sale of the remaining condominiums in the ordinary course of SW Boston's business, and the liquidation of certain assets of the Debtors. As set forth above, the bankruptcy court's 506(b) Decision and the Prudential Claim Order fixing the amount of Prudential's secured claim played an integral part in the confirmation of the Plan. According to the bankruptcy court, allowance of Prudential's claim in the amount originally asserted by Prudential would have rendered the Plan unconfirmable as the stipulated value of the Debtors' assets was substantially less than the amount of Prudential's secured claim.

In a decision entered this date, we have affirmed in part, and reversed in part, the 506(b) Decision and the Prudential Claim Order, and remanded both orders for further proceedings. In our decision, we concluded that the bankruptcy court: (1) erred in holding that Prudential was entitled to accrue postpetition interest only from the date of the hotel sale, as the values found by the bankruptcy court at the hearing on the 506(b) Motion showed that Prudential was fully secured as of the petition date; (2) erred in holding that Prudential was not entitled to postpetition interest computed on a compounded basis; and (3) did not err in awarding Prudential postpetition interest at the default rate set forth in the applicable loan agreement. Such a reversal alters the landscape dramatically. Its practical

result is a significant increase in the amount of Prudential's claim, which, in turn, impacts the evaluation of the Plan's terms under § 1129. Thus, we will vacate the Confirmation Orders, and afford the Debtors an opportunity to amend the Plan's terms to account for the increased amount of Prudential's claim and the resulting pay out to Prudential and/or for the bankruptcy court to fashion alternative forms of relief for Prudential that would not unravel the reorganization.

CONCLUSION

For the reasons set forth above, we **VACATE** the Confirmation Orders and **REMAND** to the bankruptcy court for proceedings consistent with this opinion.

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UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. MB 11-048, MB 12-005

Bankruptcy Case No. 08-11927-WCH
Adversary Proceeding No. 09-01241-WCH

ABEL BELICE,
a/k/a Belice Abel,
Debtor.

SANDON GONSALVES,
Plaintiff-Appellant,

v.

ABEL BELICE,
Defendant-Appellee.

Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. William C. Hillman, U.S. Bankruptcy Judge)

Before
Lamoutte, Haines, and Deasy
United States Bankruptcy Appellate Panel Judges

Sandon Gonsalves , *pro se*, on brief for Appellant.

No brief filed for Appellee.

Dated: October 15, 2012

Haines, U.S. Bankruptcy Appellate Panel Judge.

Sandon Gonsalves, a *pro se* creditor, appeals: (1) the order granting the motion of Abel Belice to dismiss Gonsalves' adversary complaint; and (2) the order denying Gonsalves' motion for relief from judgment. As we conclude that the dismissal was not only beyond the scope of our prior remand but was also legal error, we will **VACATE** the orders and **REMAND** the matter for further proceedings consistent with this opinion.

BACKGROUND

I. The Bankruptcy Petition

In 2006, Gonsalves and his partner obtained a state court judgment against Belice, their landlord. See Appeal I, 2011 WL 4572003, at *1. Shortly thereafter, Gonsalves was incarcerated. In March 2008, Belice filed his chapter 7 petition listing 26 George St., New Bedford, MA as his mailing address. Belice listed Gonsalves as a creditor and provided the George Street address for him**,** as well**.** He misspelled both Gonsalves' first and last names. The bankruptcy court sent all notices for Gonsalves to the George Street address, including the bar date for filing proofs of claims. The bankruptcy court entered Belice's discharge order on June 27, 2008.

II. Procedural History of Gonsalves' Adversary Proceeding

A. Bankruptcy Court

On July 30, 2009, Gonsalves commenced an adversary proceeding seeking revocation of Belice's discharge under §§ 727(c), (d), and (e) or, alternatively, a determination that his claim survived discharge via § 523(a)(2). Gonsalves alleged he first learned of Belice's bankruptcy on May 18, 2009, after commencing a collection action in state court. Gonsalves further alleged that when Belice filed for relief, he was aware that Gonsalves was not living at George Street as he had by then been incarcerated. He asserted that Belice had even tried to contact him to negotiate payment of the judgment. Gonsalves alleged that, but for the lack of notice, he would have participated in Belice's bankruptcy case.

Belice moved to dismiss the complaint pursuant to Rule 12(b)(6), asserting that he had notified Gonsalves of his bankruptcy petition and that Gonsalves' complaint was untimely. Gonsalves objected, reiterating that he first received notice of Belice's bankruptcy on May 18, 2009 (too late to file a proof of claim or to file a timely dischargeability action). After hearing, the bankruptcy court overruled Gonsalves' objection and granted the motion to dismiss.

B. Appeal I: Reversal and Remand

Gonsalves appealed to the Bankruptcy Appellate Panel. He contended that his complaint, which asserted that Belice committed fraud by listing him at an address he knew to be incorrect, stated a claim. We explained that the count for relief under § 727(d), which Gonsalves filed thirteen months after Belice's discharge, was time-barred pursuant to § 727(e)(1). We therefore affirmed the bankruptcy court's dismissal on the discharge revocation count. With respect to Gonsalves' request for relief under § 523(a), we first addressed why we concluded he had stated a claim under § 523(a)(3). We then articulated the applicable standard for such a count:

> When he filed for relief, [Belice] was required to file a list of creditors with their names and addresses. See 11 U.S.C. § 521(a)(1)(A) and Fed. R. Bankr. P. 1007(a)(1). The bankruptcy clerk uses this list to provide notice to all creditors and parties in interest of, *inter alia*, the order for relief, meeting of creditors, the bar date to file claims, and the deadlines for objecting to a discharge. See Fed. R. Bankr. P. 2002(f). As we have previously explained, the list of creditors "submitted by the debtor must therefore contain information reasonably calculated to provide notice to the creditor." Vicenty v. San Miguel Sandoval (In re San Miguel Sandoval), 327 B.R. 493, 507 (B.A.P. 1st Cir. 2005); see also Anderson v. Richards (In re Anderson), Case No. 07–1328, 2009 WL 4840871 (Bankr. D. Mass. Dec. 10, 2009) (explaining debtor obligated to provide proper deliverable address if debtor knows it); Oxford Video, Inc. v. Walker (In re Walker), 125 B.R. 177, 180 (Bankr. E.D. Mich.1990) ("We conclude that a creditor has been duly scheduled and listed if the address provided by the debtor is sufficiently accurate to permit delivery by the United States Postal Service to the appropriate party."); In re Gray, 57 B.R. 927, 931 (Bankr. D.R.I. 1986) ("Case law is clear and consistent; the debtor is held to a standard of reasonable diligence in ascertaining and listing all creditors.").
>
> "The burden is on the debtors to use reasonable diligence in completing their schedules and lists . . . . If a creditor proves that an address is incorrect, the debtor must justify the inaccuracy in preparing his schedules." Lubeck v. Littlefield's Restaurant Corp.(In re Fauchier), 71 B.R. 212, 215 (B.A.P. 9th Cir. 1987) (ruling "[a]ddresses that are two years old do not constitute reasonable diligence."); see also Hill v. Smith, 260 U.S. 592, 595 (1923) (". . . [I]f the debtor would avoid the effect of his omission of a creditor's name from his schedules he must prove the facts upon which he relies."); In re Walker, 125 B.R. at 180 ("If the creditor is able to show that the address was inadequate for the purpose intended, the burden then shifts to the debtor to show that, notwithstanding the incorrect address, the 'creditor had [timely] notice or actual knowledge of the case.'").
>
> On his petition, [Belice] used George Street both as his mailing address and the mailing address for Gonsalves. As Gonsalves' on-site landlord, it is likely that he knew Gonsalves had vacated the apartment. Claiming that George Street was valid because it was a "last known address" does not satisfy [Belice's] burden of reasonable diligence under the present factual scenario.
>
> Accepting the facts Gonsalves set forth in his complaint and further pleadings as true, the address [Belice] used for Gonsalves was not reasonably calculated to provide notice. As

> such, we conclude that Gonsalves' complaint presented a plausible case for relief under § 523(a)(3). Therefore, it was error to dismiss this claim on the grounds that he failed to state a claim upon which relief can be granted.

In re Belice, 2011 WL 4572003, at *4-5.

The Panel reversed and remanded the matter "for consideration of the request for relief under § 523(a)(3)." Id. at *5.

C. Bankruptcy Court, On Remand

On remand, Belice again sought dismissal under Rule 12(b)(6), this time based on his argument that Gonsalves had failed to file the § 523(a)(3) count within one year of his discharge, despite having received notice a month prior to that anniversary. He erroneously contended that the one year limitation set by § 727(e) for discharge revocation actions applied to Gonsalves' § 523(a)(3) claim. He also offered, somewhat opaquely, that "[w]e do not need to get to section 523 as notice is determined to have been given." Gonsalves opposed the dismissal motion, acknowledging that he learned of the bankruptcy on May 18, 2009, but disputed the assertion that his complaint was untimely.

Counsel for Belice was the only party to appear at the brief hearing on the motion to dismiss. After a brief question to counsel, the court granted Belice's motion stating, "not having heard from the plaintiff – and we know where he is, and he could be in touch in any number of ways, I am going to grant [the] motion to dismiss."

Gonsalves timely appealed and obtained an order from the Panel staying the appeal until he could seek reconsideration of the dismissal under Rules 60(a) and (b).

Gonsalves moved for relief from judgment arguing that the dismissal was in error because he had, in fact, timely filed an opposition. The bankruptcy court denied his motion and, in a written

opinion, held that although it indeed failed to consider Gonsalves' opposition, such error was harmless because Gonsalves had failed to address the basis for Belice's dismissal request. In re Belice, 08-11927-WCH, 2012 WL 441875, at *1 (Bankr. D. Mass. Feb. 10, 2012). The bankruptcy court went on to recognize that Gonsalves' allegation as to when he received notice would support his prayer for relief. Ultimately, however, the court explained it could not grant relief because Rule 60(a) and Rule 60(b) are not applicable to errors of law. Gonsalves timely appealed the order denying reconsideration.

JURISDICTION

Before considering the merits of the appeal, we are duty-bound to determine whether we have jurisdiction, even if the litigants have not raised the issue. See Boylan v. George E. Bumpus, Jr. Constr. Co. (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724, 725-26 (B.A.P. 1st Cir. 1998). The Panel has jurisdiction to hear appeals from "final judgments, orders, and decrees" pursuant to 28 U.S.C. § 158 (a)(1). Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998). An order granting a motion to dismiss an adversary proceeding is a final order. Burrell-Richardson v. Mass. Bd. of Higher Ed. (In re Burrell-Richardson), 356 B.R. 797, 799 (B.A.P. 1st Cir. 2006). Generally, an order denying relief from judgment under Rule 60 is considered a final, appealable order. Balzotti v. RAD Inv. (In re Shepherds Hill Dev. Co., LLC), 316 B.R. 406, 413 (B.A.P. 1st Cir. 2004). The order granting dismissal and denying relief from that dismissal are final orders and the Panel has jurisdiction to hear these appeals.

STANDARD OF REVIEW

"A bankruptcy court's determination that a proceeding should be dismissed is a legal conclusion subject to *de novo* review." In re Burrell-Richardson, 356 B.R. at 800 (citing In re Colonial Mortgage Bankers Corp., 324 F.3d 12, 15 (1st Cir. 2003)). The denial of a motion for relief from judgment is

reviewed for abuse of discretion. In re Shepherds Hill Dev. Co., LLC, 316 B.R. at 414.

DISCUSSION

Gonsalves argues that because our remand confined the bankruptcy court to consideration of the merits of his § 523(a)(3) count, it was error to expand its scope to include a request for dismissal based on timeliness. He contends that it was also error to dismiss his complaint for failure to file a response to the dismissal motion when he had, in fact, filed an objection. He lastly reiterates that his complaint was not time-barred. We agree.

On remand, a party may not raise issues that "it could and should have litigated on the original appeal. . . ." United States v. Bryant, 643 F.3d 28, 33 (1st Cir. 2011) (citation omitted). With little exception, a court is required on remand to address only that which has been remanded. See, e.g., Kotler v. Am. Tobacco Co., 981 F.2d 7, 13 (1st Cir. 1992), *vacated on other grounds*, 505 U.S. 1215 (1992); Biggins v. Hazen Paper Co., 899 F.Supp. 809 (D. Mass. 1995) (applying First Circuit remand precedent to district court); Hermosilla v. Hermosilla (In re Hermosilla), 450 B.R. 276 (Bankr. D. Mass. 2011) (recognizing lower court must follow the "the letter and [the] spirit of the mandate, taking into account the appellate court's opinion and the circumstances it embraces.") (quoting U.S. v. Moored, 38 F.3d 1419, 1421 (6th Cir. 1994)), *aff'd* In re Hermosilla, No. MB 11-045, 2011 WL 6034487 (B.A.P. 1st Cir. Nov. 14, 2011), *aff'd* In re Hermosilla, No. 11-9008 (1st Cir. Sept. 24, 2012).

In Appeal I, we accepted the facts Gonsalves averred in his complaint as true and concluded that he had effectively alleged that Belice had used an incorrect address for him and, as a result, he had stated a plausible cause of action arising under § 523(a)(3). We remanded the matter for consideration of the merits of that count. We had no reason to address the timeliness of the § 523(a)(3) claim because there is no pertinent filing deadline for it. As the remand was confined to consideration of the merits of

the § 523(a)(3) count, the bankruptcy court's entertainment of a motion to dismiss based on timeliness violated the spirit, if not the letter of the remand, and was contrary to the law of the case.

Thus, we must again reverse the order granting dismissal and remand the matter for consideration of the merits of Gonsalves' § 523(a)(3) claim. On remand the bankruptcy court must determine the factual underpinnings of Gonsalves' allegations regarding the address Belice provided and the sufficiency of the notice thereby provided.

CONCLUSION

For the foregoing reasons, we **VACATE** and **REMAND** the orders for proceedings consistent with the instructions set forth herein.

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UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. MB 12-017

Bankruptcy Case No. 09-16251-WCH
Adversary Proceeding No. 09-01329-WCH

SCOT P. STEWART and
LISA F. PERRONE,
Debtors.

BELLAS PAVERS, LLC,
Plaintiff-Appellant,

v.

SCOT P. STEWART,
Defendant-Appellee.

Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. William C. Hillman, U.S. Bankruptcy Judge)

Before
Lamoutte, Kornreich, and Cabán,
United States Bankruptcy Appellate Panel Judges.

Peter Cole, Esq., on brief for Plaintiff-Appellant.

Richard N. Gottlieb, Esq. and Alex R. Hess, Esq., on brief for Defendant-Appellee.

October 18, 2012

Cabán, U.S. Bankruptcy Appellate Panel Judge.

This case arises out of an adversary proceeding brought by Bellas Pavers, LLC ("Bellas") seeking to except from discharge a debt owed by Scot P. Stewart ("Stewart") for masonry services. The bankruptcy court conducted a trial, and at the close of Bellas' case, Stewart moved for a judgment on partial findings pursuant to Fed. R. Civ. P. 52(c) ("Rule 52(c)"). The bankruptcy court granted that motion and entered judgment in favor of Stewart. Thereafter, Bellas filed a motion pursuant to Fed. R. Civ. P. 59(a) ("Rule 59(a)") requesting a new trial, or in the alternative, that the bankruptcy court reopen the original trial, enter new findings of facts and conclusions of law, find in Bellas' favor on all counts, and enter a judgment of nondischargeability. The bankruptcy court denied the motion for a new trial, and Bellas appealed.

For the reasons discussed below, we **AFFIRM.**

BACKGROUND

A. Factual Background

Stewart was the sole manager of Premier Building & Window, LLC ("Premier"), a now defunct company organized under the laws of Massachusetts. In July 2007, Michael Coffin ("Coffin") hired Premier to construct a stone patio and retaining wall on his property in Stoughton, Massachusetts ("Property"). Coffin paid two initial deposits of $5,000.00 and $1,346.00 to Premier.

On July 23, 2007, Stewart sent Bellas a fax, on Premier's letterhead, asking Bellas to work as a subcontractor performing masonry services at the Property. The fax identified the job as the "paving stone project," and concluded with the following statement: "With Premier, you will get paid one week after the job is completed and the customer signs off. What a difference!" Bellas began its work on the paving stone project on July 24, 2007, and finished on August 2, 2007.

Shortly after the paving stone project was completed, Coffin contacted Stewart complaining that the stones were discolored and threatening legal action. In an email dated August 15, Coffin stated that there was a "**VERY** serious problem" with the stones installed on his Property and that if he did not receive an immediate response, Coffin would "turn the matter over to [his] lawyers and proceed accordingly." Stewart responded by email, requesting pictures of the stones. In an email dated August 17, Stewart informed Coffin that a representative from the manufacturer, Cambridge Pavers, wanted to stop by the Property to inspect the stones. On August 18, Coffin sent another email insisting that the stones were defective and demanding a remedy. In November 2007, Coffin's attorneys sent a demand letter pursuant to Mass. Gen. Laws ch. 93A, § 9, addressed to Stewart, as manager of Premier, recounting all of Coffin's payments, the work performed by Premier and Bellas, and detailing Coffin's dissatisfaction with the work. Stewart, as manager of Premier, responded to the demand letter, denying its allegations and stating that Coffin was "absolutely thrilled with the work . . . and paid in full upon completion" and that he "repeatedly complimented the level of professionalism and quality of work as it was being performed." Coffin never filed suit against either Stewart or Premier concerning the paving stone project.

In the meantime, after completing the paving stone project, Bellas made several attempts to contact Stewart to request payment for its masonry services, and on August 8, 2007, it sent Stewart an invoice in the amount of $6,867.74. No payment was made, and Bellas' attempts to obtain payment continued from mid-August through December 2007. Although Coffin paid Premier in full, neither Stewart nor Premier ever paid Bellas anything for the paving stone project.

B. The Bankruptcy Proceedings

In July 2009, Stewart and Lisa F. Perrone filed a joint chapter 7 petition, and Bellas brought an

adversary proceeding against Stewart claiming that the outstanding debt to Bellas should not be discharged because it was based on fraud. Specifically, Bellas claimed that Stewart, when hiring Bellas as a masonry subcontractor, never intended to pay Bellas. Although Bellas did not identify any specific Bankruptcy Code sections in its complaint, its allegations of fraud suggested a claim under § 523(a)(2)(A).

1. The Trial

The bankruptcy court conducted a trial on March 23, 2012.

(a) Eduardo Pereira

Bellas' first witness was Eduardo Pereira ("Pereira"), the owner and manager of Bellas. Pereira testified that he first became acquainted with Stewart when Bellas worked as a subcontractor for a company named Master, which was based in New York. Stewart was Master's manager in Massachusetts.

Pereira stated that he received a fax communication from Premier soliciting Bellas' services for a paving stone project. Pereira testified that he believed the statement contained in the fax dated July 23, 2007, sent from Premier to Bellas, which indicated: "With Premier you will get paid one week after the job is completed and the customer signs off. What a difference!"

Bellas began work on the paving stone project the next day. The work involved installation of a patio around a swimming pool, "coping," i.e., creation of a border to the patio, and construction of a retaining wall between the pool and a driveway. Pereira described in detail the work of excavation, placement of layers of sand and gravel, and the placement of paving stones on the surface.

According to Pereira, a week into the job, he called Stewart to tell him he needed some additional materials. He testified that Stewart instructed Pereira to buy the necessary materials and that Bellas would be reimbursed. Bellas bought glue, grout, and rubber gloves with which to apply them, as

evidenced by the copies of Bellas' receipts for the purchases.

Pereira testified that on the day Bellas finished its work, Coffin opened a bottle of champagne to celebrate because the work was "awesome." Pereira then described Bellas' attempts to obtain payment from Premier. He testified that he tried to contact Stewart numerous times, and on August 8, 2007, Bellas faxed Stewart an invoice totaling $6,867.74 for the paving stone project.

In the months that followed, Pereira made several attempts to contact Stewart regarding payment of the invoice. At one point, Stewart told him that Premier was expecting a payment from Master, and would pay Bellas after receiving it. At another point, Pereira went to the Boston address listed on Premier's letterhead; he saw a receptionist, but did not see Stewart. On December 21, 2007, Bellas sent Stewart another fax asking for payment. After sending the fax, Pereira had no more contact with Stewart.

(b) Michael Coffin

After Pereira's testimony, Bellas read into the record excerpts from a deposition of Coffin, taken on February 24, 2012. However, the bankruptcy court expressed that the excerpts read into the record about whether or not Coffin complained about the paving stones "[h]ad nothing to do with" whether Stewart entered into an agreement with Bellas intending not to pay. Bellas' counsel continued to read into the record excerpts detailing Coffin's complaints about the paving stones.

2. The Motion for Judgment on Partial Findings

Bellas rested its case on the testimony from Pereira and Coffin, and the exhibits authenticated by the witnesses. Stewart then moved for a judgment on partial findings pursuant to Rule 52(c), asserting three grounds: (1) lack of personal liability for Premier's actions (the agreement was between Bellas and Premier, not Stewart); (2) lack of evidence that Stewart had fraudulent intent when

he entered into the agreement with Bellas on Premier's behalf; and (3) lack of evidence that Bellas had reasonably relied on Stewart's representations.

Bellas responded to the first point by citing case law as to personal liability for fraud committed on behalf of a business entity. As to the second point, Bellas argued that Stewart's intent to deceive Bellas could be inferred, emphasizing the short time frame between when Stewart made the promise to pay and the time he broke it. As to the third ground, Bellas pointed out that it had had problems getting paid from another company, Masters, in the past, and Stewart's statement that Premier would pay within a week was designed to tempt Bellas with the belief that it would get paid. Bellas claimed that this prompted its reasonable reliance.

In its decision, the bankruptcy court found that Bellas relied upon the statement that it would get paid, and that it was damaged by not getting paid. It rejected Stewart's first argument, stating that an agent who commits fraud on behalf of a principal may face personal liability. As to the question of fraudulent intent, the bankruptcy court stated as follows:

> But what I can't get over is a complete lack of evidence that the initial statement that you're going to get paid was false, I don't think – I know I can't do what Mr. Cole wants me to do, which is to say that since the evasion of payment started only ten days after completion of the work, that Mr. Stewart was a bad guy from the beginning. I don't think I can do that. It's perfectly consistent [with] the evidence that Mr. Stewart did, in fact, intend when he entered into the contract with Bellas on behalf of Premier to have Bella[s] paid. I have nothing in my record that indicates that that was a lie.
>
> Now, I don't know what happened. It wasn't Mr. Coffin's complaints because that came further down the road, but I don't know what happened that Premier/Stewart didn't pay Bellas Pavers. Maybe they just ran out of money. I don't know what they did with the money, but that doesn't prove that it should be a debt [sic] will be – which would be nondischargeable in bankruptcy.

Given these facts, the bankruptcy court granted Stewart's motion under Rule 52(c), and entered judgment in his favor.

3. The Motion for a New Trial

Bellas timely filed a motion requesting a new trial pursuant to Rule 59(a)(1), or in the alternative, that the bankruptcy court reopen the original trial, enter new findings and conclusions, find in Bellas' favor on all counts, and enter a judgment of nondischargeability pursuant to Rule 59(a)(2). As grounds, Bellas argued that the bankruptcy court committed reversible error by allowing Stewart's Rule 52(c) motion when Bellas had made out a prima facie claim, presented unimpeached evidence, and offered credible testimony. The bankruptcy court, without a hearing, denied the motion for a new trial. Bellas then appealed the order denying the motion for a new trial. It did not appeal the underlying judgment.

JURISDICTION

Before addressing the merits of an appeal, we must determine whether we have jurisdiction, even if the issue is not raised by the litigants. See Boylan v. George E. Bumpus, Jr. Constr. Co. (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724 (B.A.P. 1st Cir. 1998).

A. Scope of Appeal

On appeal, Bellas essentially challenges the bankruptcy court's underlying decision to grant Stewart's Rule 52(c) motion and enter judgment in favor of Stewart on the nondischargeability of the debt. Bellas did not, however, list the judgment on its notice of appeal.

In some circumstances, we have limited the scope of the appeal where the notice of appeal only names the post-judgment order and not the underlying judgment. See, e.g., Aguiar v. Interbay Funding, LLC (In re Aguiar), 311 B.R. 129, 134-35 (B.A.P. 1st Cir. 2004); see also Zukowski v. St. Lukes Home Care Program, 326 F.3d 278, 282 (1st Cir. 2003) ("[A]ppellant's notice of appeal seeks review of only the district court's denial of her motion for reconsideration . . . and our review is accordingly limited to the court's refusal to reopen the case."); Mariani-Giron v. Acevedo-Ruiz, 945 F.2d 1, 3 (1st Cir. 1991) ("[A]n appeal from the denial of a Rule 59(e) motion is not an appeal from the underlying judgment.").

Where the appellant's intent to appeal the underlying judgment is clear, appellate courts in this circuit generally treat the appeal as encompassing both orders. See, e.g., Wilson v. Wells Fargo Bank, N.A. (In re Wilson), 402 B.R. 66, 69 (B.A.P. 1st Cir. 2009); Devila Vicenty v. San Miguel Sandoval (In re San Miguel Sandoval), 327 B.R. 493, 504 (B.A.P. 1st Cir. 2005); see also Marie v. Allied Home Mortgage Corp., 402 F.3d 1, 8 (1st Cir. 2005) (explaining that the First Circuit has been "liberal" in determining subject of appeals and that determination is based on appellant's intent, record as whole and whether appellee has been misled by unclear notice of appeal); Zukowski, 326 F.3d at 283 n.4 (explaining that notice of appeal may be read to include underlying order and not simply order denying reconsideration when it "can be fairly inferred from the notice" that appellant intended to appeal underlying order).

Here, both parties addressed the underlying judgment in their briefs, and Stewart's counsel agreed at oral argument that we could and should review the merits of the nondischargeability action. Moreover, as the bankruptcy court gave no explanation for its denial of Bellas' motion for a new trial under Rule 59(a), we have no reasonable basis for reviewing that decision and can reasonably infer that the bankruptcy court was simply affirming its prior judgment. Therefore, we consider both the order denying the motion for a new trial and the underlying judgment.

B. Finality

We have jurisdiction to hear appeals from: (1) final judgments, orders and decrees; or (2) with leave of court, from certain interlocutory orders. 28 U.S.C. § 158(a); Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998). A decision is considered final if it "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment," id. at 646 (citations omitted), whereas an interlocutory order "only decides some intervening matter pertaining to the cause, and . . . requires further steps to be taken in order to enable

the court to adjudicate the cause on the merits." Id. (quoting In re American Colonial Broad. Corp., 758 F.2d 794, 801 (1st Cir. 1985)).

An order denying a motion for a new trial under Rule 59 is a final, appealable order. See Robinson v. Watts Detective Agency, Inc., 685 F.2d 729 (1st Cir. 1982) (reviewing district court's denial of motion for new trial); Janas v. Marco Crane & Rigging Co. (In re JWJ Contr. Co., Inc.), 287 B.R. 501 (B.A.P. 9th Cir. 2002) (reviewing bankruptcy court's denial of motion for new trial). In addition, a bankruptcy court's judgment regarding the nondischargeability of a debtor's obligations under § 523(a)(2) is a final appealable order. Aoki v. Atto Corp. (In re Aoki), 323 B.R. 803, 811 (B.A.P. 1st Cir. 2005). Thus, we have jurisdiction to hear this appeal.

STANDARD OF REVIEW

Appellate courts apply the clearly erroneous standard to findings of fact and *de novo* review to conclusions of law. Rockwood v. SKF USA Inc., 687 F.3d 1, 10 (1st Cir. 2012). An order denying a motion for a new trial pursuant to Rule 59(a) is reviewed for abuse of discretion. Cantellops v. Alvaro-Chapel, 234 F.3d 741, 744 (1st Cir. 2000); Robinson v. Watts Detective Agency, Inc., 685 F.2d 729, 740 (1st Cir. 1982). An abuse of discretion occurs when the trial court ignores a material factor deserving significant weight, relies upon an improper factor, or assesses all proper and no improper factors, but makes a serious mistake in weighing them. Torres Lopez v. Consejo de Titulares del Condominio Carolina Court Apts. (In re Torres Lopez), 405 B.R. 24, 30 (B.A.P. 1st Cir. 2009) (citation omitted).

A bankruptcy court's determination of whether a requisite element of a nondischargeability claim under § 523(a)(2) is present is a factual determination which is reviewed for clear error. Palmacci, 121 F.3d at 785; Fee v. Eccles (In re Eccles), 407 B.R. 338 (B.A.P. 8th Cir. 2009). "A finding of fact is clearly erroneous, although there is evidence to support it, when the reviewing court, after carefully

examining all of the evidence, is 'left with the definite and firm conviction that a mistake has been committed.'" Palmacci, 121 F.3d at 785 (quoting Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 573 (1985)). Deference to the bankruptcy court's factual findings is particularly appropriate on the intent issue "[b]ecause a determination concerning fraudulent intent depends largely upon an assessment of the credibility and demeanor of the debtor." Commerce Bank & Trust Co. v. Burgess (In re Burgess), 955 F.2d 134, 137 (1st Cir. 1992) (citation and internal quotations omitted), abrogated on other grounds by Field v. Mans, 516 U.S. 59 (1995).

DISCUSSION

A. The Motion for a New Trial

A motion for new trial is governed by Rule 59(a), made applicable to bankruptcy cases by Bankruptcy Rule 9023. This rule provides that a court may grant a new trial after a nonjury trial "for any reason for which a rehearing has heretofore been granted in a suit in equity in federal court." Fed. R. Civ. P. 59(a)(1). Furthermore, it provides that after a nonjury trial, a court may, on motion for a new trial, "open the judgment if one has been entered, take additional testimony, amend findings of fact and conclusions of law or make new ones, and direct the entry of a new judgment." Fed. R. Civ. P. 59(a)(2). "A motion for a new trial in a nonjury case . . . should be based upon manifest error of law or mistake of fact, and a judgment should not be set aside except for substantial reasons." C. Wright, A. Miller, and M. Cane, 11 Federal Practice and Procedure § 2804 (2d ed. rev. 2012); see also Jiminez v. Pabon Rodriguez (In re Pabon Rodriguez), 233 B.R. 212, 227 (Bankr. D.P.R. 1999) (quoting 11 Federal Practice and Procedure § 2804). "Courts do not grant new trials unless it is reasonably clear that prejudicial error has crept into the record or that substantial justice has not been done, and the burden of showing harmful error rests on the party seeking the new trial." Sibley v. Lemaire, 184 F.3d 481, 487

(5th Cir. 1999); see also Burdick v. Dold (In re Lemasurier), No. 08-4161, 2009 Bankr. LEXIS 4181 (Bankr. D. Mass. Dec. 18, 2009) (citing Sibley v. Lemaire). A motion for a new trial should not be "a vehicle for raising issues or citing authorities a party could have or should have presented prior to the court's ruling . . . or for rehashing arguments previously made or for refuting the court's prior ruling." Foxborough Sav. Bank v. Ballarino (In re Ballarino), 180 B.R. 343, 349-50 (D. Mass. 1995) (citations and internal quotations omitted). Thus, granting a motion for a new trial under Rule 59(a)(2) is appropriate only if the moving party demonstrates: (1) a manifest error of fact; (2) a manifest error of law; or (3) newly discovered evidence. In re JWJ Contr. Co., 287 B.R. at 514 (citing Brown v. Wright, 588 F.2d 708, 710 (9th Cir. 1978)).

Here, the bankruptcy court denied Bellas' motion for a new trial without any explanation and we infer that the bankruptcy court simply affirmed its prior ruling. Thus, we must determine whether the bankruptcy court erred in granting Stewart's Rule 52(c) motion and entering judgment in his favor on Bellas' dischargeability complaint.

B. The Motion for Judgment on Partial Findings

Rule 52(c) of the Federal Rules of Civil Procedure, made applicable to bankruptcy proceedings pursuant to Bankruptcy Rule 7052, provides:

> If a party has been fully heard on an issue during a nonjury trial and the court finds against the party on that issue, the court may enter judgment against the party on a claim or defense that, under the controlling law, can be maintained or defeated only with a favorable finding on that issue. The court may, however, decline to render any judgment until the close of the evidence. A judgment on partial findings must be supported by findings of fact and conclusions of law as required by Rule 52(a).

Fed. R. Civ. P. 52(c).

A court should, therefore, enter a judgment under Rule 52(c) "[w]hen a party has finished

presenting evidence and that evidence is deemed by the [judge] insufficient to sustain the party's position." Morales Feliciano v. Rullan, 378 F.3d 42, 59 (1st Cir. 2004). "A motion for judgment on partial findings should be granted, 'where the plaintiff fails to make out a prima facie case, or despite a prima facie case, the court determines that the preponderance of evidence goes against the plaintiff's claim.'" Giza v. Amcap Mortg., Inc. (In re Giza), 458 B.R. 16, 24 (Bankr. D. Mass. 2011) (quoting Mosher v. Evergreen Mgmt., Inc. (In re Mosher), 432 B.R. 472, 475 (Bankr. D.N.H. 2010)); see also In re Marine Risks, Inc., 441 B.R. 181, 199 (Bankr. E.D.N.Y. 2010) (citations omitted) (holding that court may allow Rule 52(c) motion if plaintiff has failed to make out prima facie case). The court is not required to "'draw any special inferences in the nonmovant's favor, or consider the evidence in the light most favorable to the nonmoving party. Instead, the court must [weigh] the evidence, resolv[e] any conflicts, and decid[e] where the preponderance lies.'" In re Giza, 458 B.R. at 24 (quoting Mosher, 432 B.R. at 475).

C. The § 523(a)(2)(A) Exception to Discharge

Section 523(a)(2)(A) excepts from discharge a debt of an individual debtor "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A). To establish that a debt is nondischargeable under this section, a creditor must prove actual fraud, rather than mere fraud implied in law. Lawrence P. King, 3 Collier on Bankruptcy ¶ 523.08[1] (15th ed. rev. 2002). The First Circuit has held that the elements of actual fraud include:

> (1) the debtor made a knowingly false representation or one made in reckless disregard of the truth;
> (2) the debtor intended to deceive;
> (3) the debtor intended to induce the creditor to rely upon the false statement;
> (4) the creditor actually relied upon the misrepresentation;
> (5) the creditor's reliance was justifiable; and

(6) the reliance upon the false statement caused damage.

McCrory v. Spigel (In re Spigel), 260 F.3d 27, 32 (1st Cir. 2001) (citing Palmacci, 121 F.3d at 786).

The first two elements of this test describe the conduct and scienter required to show the debtor's fraudulent conduct generally. Id. The last four elements embody the requirement that the creditor's claim must arise as a direct result of the debtor's fraud. Id. The standard of proof of each element of a § 523 claim is by a preponderance of the evidence, and the burden of proof on each element lies with the party contesting the dischargeability a particular debt. Palmacci, 121 F.3d at 787.

Bellas argues that the bankruptcy court erred in granting Stewart's Rule 52(c) motion because it had met its burden of establishing all the elements for fraud. Stewart contends that the bankruptcy court correctly ruled against Bellas because there was insufficient evidence with respect to the first two elements of fraud, false representation and fraudulent intent. We must review the bankruptcy court's findings regarding the elements of fraud for clear error, with special deference to its factual findings as to Stewart's intent. Palmacci, 121 F.3d at 785.

With respect to the first element – false representation – the First Circuit has stated that the concept of a false representation includes a misrepresentation as to one's intention, such as a promise to act. Id. at 786. As the court explained:

> A representation of the maker's own intention to do . . . a particular thing is fraudulent if he does not have that intention at the time he makes the representation . . . . [A] promise made without the intent to perform it is held to be a sufficient basis for an action of deceit. On the other hand, if, at the time he makes a promise, the maker honestly intends to keep it but later changes his mind or fails or refuses to carry his expressed intention into effect, there has been no misrepresentation. This is true even if there is no excuse for the subsequent breach. A debtor's statement of future intention is not necessarily a misrepresentation if intervening events cause the debtor's future actions to deviate from previously expressed intentions.
>
> The test may be stated as follows. If, at the time he made his promise, the debtor did not *intend to perform*, then he has made a false representation (false as to his intent) and the debt that arose as a result thereof is not dischargeable (if the other elements of § 523(a)(2)(A) are met). If he did so intend at the time he made his promise, but subsequently decided that he could not or would not so perform, then his initial representation was not false when made.

Id. at 786-87 (citations, footnotes and quotation marks omitted).

Thus, if a debtor enters into a contract with the intent not to pay, the contract may provide a basis for an exception to discharge on the grounds of fraud if the other remaining elements are established. However, a debtor's "mere failure to perform is not sufficient evidence of scienter nor is subsequent conduct contrary to the original representation necessarily indicative of fraudulent intent." Fowler v. Lane (In re Lane), 50 F.3d 1, 1995 U.S. App. LEXIS 5510, at *8-9 (1st Cir. 1995) (citation omitted).

The issue of whether a debtor knowingly made false representations is closely linked to the second element – intent to deceive. Boyuka v. White (In re White), 128 Fed. Appx. 994, 998 (4th Cir. 2005). With respect to the second element, the First Circuit has stated that "[f]raudulent intent requires an actual intent to mislead, which is more than mere negligence." Palmacci, 121 F.3d at 788 (citations omitted). However, a debtor will rarely, if ever, admit to acting with an intent to deceive. Therefore, a debtor's fraudulent intent can be inferred if the totality of the circumstances presents a picture of deceptive conduct by the debtor.

> Thus, while fraud may not be implied in law, it may be inferred as a matter of fact. The finder of fact may "infer[] or imply[] bad faith and intent to defraud based on the totality of the circumstances when convinced by a preponderance of the evidence." Among the circumstances from which scienter may be inferred are: the defendant's insolvency or some other reason to know that he cannot pay, his repudiation of the promise soon after made, or his failure even to attempt any performance.

Id. at 789 (citations omitted). "The focus, however, should be on whether the surrounding circumstances or the debtor's actions 'appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve the debtor." Id. (citation omitted).

As noted above, the bankruptcy court found that Bellas had failed to provide sufficient evidence that, at the time Premier engaged Bellas' services, Stewart's representation that Bellas would get paid was false or that he intended to deceive or defraud Bellas when he made the promise to pay. Clearly, there is no direct proof of Stewart's state of mind at the time he entered into a contract with Bellas on Premier's behalf.

Bellas argues, however, that the bankruptcy court should have inferred Stewart's fraudulent intent from the totality of the circumstances. As noted above, "[a] court may infer the existence of the

debtor's intent not to pay if the facts and circumstances of a particular case present a picture of deceptive conduct by the debtor." In re Hashemi, 104 F.3d 1122, 1125 (9th Cir. 1996).

Furthermore, Bellas argues that the evidence showed a close temporal proximity between Stewart's promise that Premier would pay, and his refusal to pay upon completion of the project ten days later. Bellas contends that this short time frame shows that from the start, Stewart never intended to pay Bellas and, therefore, his promise to pay was false. In support, Bellas cites a few cases in which fraud was inferred where a debtor made a representation which was followed by a contrary action. See, e.g., Palmacci, 121 F.3d at 789 (noting that intent to defraud can be inferred from the totality of the circumstances, and among the circumstances from which it may be inferred is a debtor's "repudiation of the promise soon after made"). As Bellas acknowledges, however, a short time frame between an allegedly fraudulent statement and a later inconsistent statement or act does not, standing alone, provide a sufficient factual basis for inferring fraudulent intent. See Yourish v. Calif. Amplifier, 191 F.3d 983, 997 (9th Cir. 1999) (stating that temporal proximity of allegedly fraudulent statement or omission and later disclosure cannot, without more, prove fraudulent intent). Bellas urges us to also consider Stewart's subsequent conduct which, it claims, shows that Stewart lacked any good faith basis for not paying Bellas and establishes a pattern of deceptive behavior. Bellas points to the fact that although Coffin paid Premier in full, Stewart refused to pass on the portion of the payment owed to Bellas, offering a string of excuses for not paying. Based on this evidence, Bellas argues, "[a]ny reasonable person would conclude that Stewart never intended to honor the commitments he made a few days earlier on Premier's behalf."

The bankruptcy court determined that it simply could not find fraudulent intent because Stewart's evasion of payment started ten days after completion of the work, not from the beginning as required. There was nothing else in the record to indicate that Stewart's promise was false, and the short

time frame between the promise to pay and the completion of the project was not enough for the bankruptcy court to infer fraudulent intent. The evidence is consistent with the bankruptcy court's finding that when Stewart entered into the contract with Bellas on behalf of Premier, he did, in fact, intend to pay Bellas. Moreover, Stewart's subsequent conduct does not establish his fraudulent intent at the time he entered the contract. Although he failed to pay after the completion of the project, there is no evidence in the record that his lack of payment was based on a prior intention from the beginning not to pay. Thus, based upon the record, we conclude that the bankruptcy court did not err by not inferring fraudulent intent from the totality of the circumstances.

Bellas also urges us to reverse the bankruptcy court because it "refused to look at the entire record when assessing fraudulent intent" – i.e., that the bankruptcy court did not consider the totality of the circumstances. To Bellas, the bankruptcy court "put on blinders and looked only at whether an unmistakable sign of fraudulent intent appeared in the first ten days." When issuing its decision, however, the bankruptcy court stated that it was based on "a complete lack of evidence that the initial statement that you're going to get paid was false." This implies that the bankruptcy court considered and weighed all the evidence and found that, as a whole, it was insufficient to establish fraudulent intent. Furthermore, Bellas argues that the bankruptcy court erred by requiring it to "prove a negative" – to prove that no other reason existed for Stewart not to pay. Although the bankruptcy court stated that it did not know why Premier did not pay Bellas, and gave hypothetical possibilities for it, the bankruptcy court did not require Bellas to "prove a negative." The bankruptcy court's decision is not based on why Premier refused to pay Bellas; rather, it turned on Bellas' failure to present sufficient evidence of Stewart's fraudulent intent at the time the contract was made.

Thus, for the reasons set forth above, we conclude that the bankruptcy court did not make any

clearly erroneous findings of facts or manifest errors of law when granting the Rule 52(c) motion and entering judgment in Stewart's favor.

D. The Motion for Damages and Costs

Stewart has filed a separate motion under Bankruptcy Rule 8020 seeking damages, including attorneys' fees and costs, incurred in defending this appeal. Bellas objects to the motion.

Bankruptcy Rule 8020 provides:

> If a . . . bankruptcy appellate panel determines that an appeal . . . is frivolous, it may, after a separately filed motion . . . and reasonable opportunity to respond, award just damages and single or double costs to the appellee.

Fed. R. Bankr. P. 8020.

Imposing sanctions under Bankruptcy Rule 8020 is a "two-step process." Lumb v. Cimenian (In re Lumb), 401 B.R. 1, 9 (B.A.P. 1st Cir. 2009) (citing Maloni v. Fairway Wholesale Corp. (In re Maloni), 282 B.R. 727, 734 (B.A.P. 1st Cir. 2002)). We must determine: (1) whether the appeal is frivolous; and (2) whether the moving party has fulfilled the procedural requirements of Bankruptcy Rule 8020. Id.

1. Procedural Requirements

Bankruptcy Rule 8020 requires that a party must request sanctions in a separately filed motion and that the person or party targeted by the motion or notice must be given notice and an opportunity to respond. Fed. R. Bankr. P. 8020. Stewart filed a separate motion, served it on Bellas, and provided it with an opportunity to respond, which it did. Thus, the procedural requirements have been met.

2. Frivolous Appeal

While there is no formula for determining whether an appeal is frivolous, courts generally consider several factors, including: the appellant's bad faith, whether the argument presented on appeal

is meritless *in toto*, and whether only part of the argument is frivolous. Great Road Serv. Ctr., Inc. v. Golden (In re Great Road Serv. Ctr., Inc.), 304 B.R. 547, 552 (B.A.P. 1st Cir. 2004). A court may consider whether the appellant's argument addresses the issues on appeal, fails to cite any authority, cites inapplicable authority, makes unsubstantiated factual assertions, asserts bare legal conclusions, or misrepresents the record. Id. However, "[Bankruptcy] Rule 8020 is far from a strict liability model. More than just a losing argument is necessary to support a conclusion that an appeal is frivolous." Berliner v. Kusek (In re Kusek), 461 B.R. 691, 698 (B.A.P. 1st Cir. 2011) (citations omitted). An appeal is frivolous if the result is obvious or the arguments supporting the appeal are wholly without merit. Cronin v. Town of Amesbury, 81 F.3d 257, 261 (1st Cir. 1996) (citations omitted).

This appeal is based on Bellas' contention that the bankruptcy court failed to properly weigh the evidence before it on the issue of Stewart's intent at the time he entered into the contract with Bellas on Premier's behalf. The bankruptcy court's finding regarding Stewart's intent was based on the record developed in this case, and Bellas had a good faith basis to seek appellate review of that factual determination. Thus, we conclude that Bellas' appeal, though unsuccessful, was not patently meritless, and that sanctions are not warranted. In addition, we find no basis for granting Bellas' request for attorneys' fees incurred in defending the motion for sanctions. **CONCLUSION**

For the reasons set forth above, we conclude that the bankruptcy court did not abuse its discretion in denying the motion for a new trial, and that the bankruptcy court's findings with respect to § 523(a)(2)(A) were not clearly erroneous. Therefore, we **AFFIRM** both the order denying the motion for a new trial and the judgment in favor of Stewart. We also **DENY** Stewart's motion for sanctions.