UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

SHELLY S. EMMETT — CASE NO. 04-61064

Debtor — Chapter 7

JONATHAN N. REITER

Plaintiff

vs. — ADV. PRO. NO. 04-80148

SHELLY S. EMMETT

Defendant

APPEARANCES:

JONATHAN N. REITER
Pro Se Plaintiff
2732 McConnell Dr.
Los Angeles, CA 90064

SCHLATHER & BIRCH — ROBERT W. BIRCH, ESQ.
Attorney for Defendant
192 Main St., P.O. Box 391
Cooperstown, NY 13326

Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Presently before the Court is a motion ("Motion") filed by Shelly S. Emmett ("Debtor" or "Defendant") on August 5, 2004, seeking to vacate a judgment by default ("Judgment"), signed on July 22, 2004, pursuant to Rule 55(c) of the Federal Rules of Civil Procedure ("Fed.R.Civ.P."), which incorporates Fed.R.Civ.P. 60(b). Opposition to the Motion was filed by

Jonathan N. Reiter, Esq. ("Plaintiff" or "Reiter") on August 17, 2004.

The Motion was originally scheduled to be heard on August 31, 2004, and was adjourned to September 28, 2004, on the consent of both parties. The parties agreed that the matter would be considered without oral argument on submission of papers as of September 28, 2004.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 1334, 157(a), (b)(1) and (b)(2)(A), (I), and (O).

FACTS

The Debtor filed a voluntary petition ("Petition") pursuant to chapter 7 of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"), on February 23, 2004. Listed in her schedules accompanying the Petition is a debt owed to Reiter in the amount of $17,591.20. *See* Schedule F. According to the Debtor, the debt arose as a result of several personal loans made to her by Reiter.

According to the notice sent to all creditors, including Reiter, the last day to file a complaint objecting to the Debtor's discharge or objecting to the dischargeability of a particular debt was May 21, 2004. On May 19, 2004, Reiter commenced an adversary proceeding pursuant to Code § 523(a)(2) seeking a determination that the debt owed to him was nondischargeable. A summons was issued by the Bankruptcy Court Clerk on May 19, 2004, and it, along with the

complaint, was served on the Debtor and her counsel on May 25, 2004. *See* Certificate of Service, sworn to on May 25, 2004 (Adv. Pro. Doc. No.4). On June 2, 2004, the Court signed an Order discharging the Debtor ("Discharge Order").

The Debtor failed to serve an answer on the Plaintiff within the 30 days after the issuance of the summons pursuant to Rule 7012 of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P."). On July 20, 2004, the Clerk entered default and on July 22, 2004, the Court signed the Judgment in favor of Reiter and against the Debtor. Debtor's counsel acknowledges having been served with a copy of the Notice of Entry of Default on August 2, 2004.

On August 5, 2004, the Debtor filed the Motion which is now before this Court, seeking to vacate the Judgment. In seeking this relief, Debtor's counsel asserts a defense of excusable neglect on his part. He explains that he believed "that the Discharge Order of the Court superseded the adversary complaint filed by Mr. Reiter and that, therefore, his debt also had been determined by the Court to be discharged." *See* Motion at ¶ 6. Accordingly, he determined that it was unnecessary to file an answer. *Id.* at ¶ 7. Debtor's counsel makes the argument that the default was "solely due to my misinterpretation of the effect of the Discharge Order issued by the Court on 2 June 2004 and was not due to any default or negligence of defendant Shelly S. Emmett." *Id.* at ¶ 9.

It is the Debtor's position that she has a meritorious defense to Plaintiff's allegations of misrepresentation regarding her financial status at the time he loaned her the monies. She contends that at the time Reiter loaned her the monies, he was aware of the provisions of a Separation Agreement, which had been incorporated in her Judgment of Divorce, with respect to certain mortgage indebtedness covering her former marital residence in Oneonta, New York.

She also asserts that he was also aware of her financial status as he requested "oversight of all aspects of her finances . . . ." Affidavit of Debtor, sworn to August 4, 2004, at ¶ 16.

In opposition to the Motion, Reiter argues that "[i]t is unfathomable that a practicing bankruptcy lawyer would have 'misinterpreted' the standard, unequivocal notice set forth in a Discharge Order issued by this Court in the ordinary course . . . ." *See* Reiter's Opposition, filed on August 17, 2004, at 3-4. Reiter contends that Debtor's counsel has been practicing law for over 20 years and that he holds himself out to the public as a practicing bankruptcy lawyer according to information found on both his firm's website (www.laywers.com/schlatherbirch) and his listing on the Martindale Hubbell website (www.martindale.com/xp/Martindale/home.xml). *Id.* at 3. Reiter contends that Debtor's failure to respond to his complaint was but one more example of her disregard for the processes of this Court, citing to the fact that she failed to object to his motion seeking relief from the automatic stay pursuant to Code § 362(d) in order to proceed with foreclosure on the former marital residence.[1]

With respect to the Debtor's assertion that she has a meritorious defense, Reiter acknowledges that he scanned the Debtor's Judgment of Divorce, which required the Debtor's ex-spouse either to refinance the mortgage on the former marital residence in his own name or to obtain a release from the mortgagee of the Debtor's obligation on the existing mortgage at the time of the separation agreement/judgment of divorce in exchange for the Debtor's transfer of her interest in the residence. Reiter asserts that he relied on representations allegedly made by

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[1] The Court signed an Order on May 4, 2004, terminating the automatic stay and allowing Reiter to enforce a judgment and related lien against real property located at 24 Luther Street, Oneonta, New York (Case Doc. No. 8).

the Debtor that she believed that she was no longer indebted on the mortgage on the former marital residence.

DISCUSSION

Fed.R.Bankr.P. 7055, which incorporates Fed.R.Civ.P. 55, grants the Court authority to set aside a judgment by default in accordance with Fed.R.Civ.P. 60(b). Such relief is left to the Court's sound discretion, keeping in mind the strong policy favoring the resolution of disputes on their merits. *See American Alliance Ins. Co. Ltd., v. Eagle Insur. Co.*, 92 F.3d 57, 62 (2d Cir. 1996). Indeed, "the extreme sanction of a default judgment must remain a weapon of last, rather than first, resort." *Meenan v. Snow*, 652 F.2d 274, 277 (2d Cir. 1981).

In making a determination whether to grant a defaulting party such relief, courts generally examine three factors: "(1) whether the default was willful; (2) whether the defendant demonstrates the existence of a meritorious defense, and (3) whether, and to what extent, vacating the default will cause the nondefaulting party prejudice." *SEC v. McNulty*, 137 F.3d 732, 738 (2d Cir. 1998); *see also American Alliance*, 92 F.3d at 59.

Willfulness

The Court of Appeals for the Second Circuit has made it clear that in considering whether the default was willful, the courts are to "look for bad faith, or at least something more than mere negligence, before rejecting a claim of excusable neglect based on an attorney's or a litigant's error." *Id.* at 60. Furthermore, given the subjectiveness of any inquiry into willfulness it is

important that this factor be considered not in a vacuum but weighed along with that of the other two factors. *Id.* at 61; *see also Wagstaff-EL v. Carlton Press Co.*, 913 F.2d 56, 57-8 (2d Cir. 1990) (affirming the district court's granting of the motion to vacate the default judgment despite having found the default as willful because of compelling reasons, including a finding that the plaintiff's claims were "utterly unsupported" and the calculation of damages "preposterous." The Court concluded that "[a]llowing the default judgment to stand would, therefore, have constituted a serious miscarriage of justice."); *compare Action S.A. v. Marc Rich & Co., Inc.*, 951 F.2d 504, 507 (2d Cir. 1991) (stating that "[a] default judgment should not be set aside when it is found to be willful").

In this case, Debtor's counsel, Robert Birch, Esq. ("Birch"), indicates that he failed to serve an answer to Reiter's complaint because he believed that the debt had been discharged under the terms of the Discharge Order. The Discharge Order states that "[t]he debtor is granted a discharge under section 727 of title 11, United States Code . . . ." At the bottom of the Order is the direction "See the Back of this Order for Important Information." On the back of the Order is a statement that debts that are <u>not</u> discharged include those that the bankruptcy court "will decide in this bankruptcy case are not discharged." There is no specific mention, however, of pending dischargeability actions pursuant to Code § 523(a).

The Court has considered Reiter's assertion that it is "unfathomable" that a lawyer with Birch's bankruptcy experience would not understand the limited effect of a discharge order while nondischargeability actions are pending in the case. Upon reviewing the Electronic Bankruptcy Court Filings in the Northern District of New York between January 30, 1992 and October 1,

2004, the Court found eight-three entries of cases in which Birch was involved as an attorney.[2] Approximately a dozen of those entries involved chapter 13 cases; the other seventy or so involved chapter 7 cases. Of the chapter 7 cases, only two adversary proceedings were filed in them, one of which is the adversary proceeding now before this Court. The other adversary proceeding, which was ultimately settled, was commenced on April 5, 2004, seeking a determination of nondischargeability of a debt pursuant to Code § 523(a)(15). *See Bates v. Keto (In re Keto),* Case No. 04-60026; Adv. Pro. No. 04-80116. In that case, the deadline for filing such a complaint was April 9, 2004. In his answer to that complaint, Birch asserted as an affirmative defense that the complaint had been untimely filed due to the fact that the debtor had received a discharge on April 12, 2004. Thus, it would appear that Birch's understanding of the effect of a discharge order was in error in that case and it also appears that it is consistent with what he has represented to the Court herein. Therefore, despite holding himself out as a "practicing bankruptcy attorney," it is clear that Birch does not fully understand the scope of an order of discharge. Accordingly, the Court concludes that his failure to timely file an answer on behalf of the Debtor was not in bad faith and was not willful under the standard applied in this Circuit.

Meritorious Defense

> In order to make a sufficient showing of a meritorious defense in connection with a motion to vacate a default judgment, the defendant need not establish his defense conclusively, but he must

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[2] A bankruptcy judge may take judicial notice of the court's records. *See Matter of Holly's, Inc.*, 172 B.R. 545, 553 n.5 (Bankr. W.D.Mich. 1994); *see also In re Calder*, 907 F.2d 953, 955 n.2 (10th Cir. 1990).

> present evidence of facts that, "if proven at trial, would constitute a complete defense."

McNulty,, 137 F.3d at 740, quoting *Enron Oil Corp. v. Diakuhara*, 10 F.3d 90, 98 (2d Cir. 1993). In this case, the complaint asserts two causes of action, one based on Code § 523(a)(2)(A) and one based on Code § 523(a)(2)(B). Pursuant to Code § 523(a)(2)(A), the Plaintiff must establish the following:

> (i) The debtor made a false representation;
>
> (ii) At the time the representation was made, the debtor knew it was false;
>
> (iii) The debtor made the representation with the intention of deceiving the creditor;
>
> (iv) The creditor justifiably relied on the representation; and
>
> (v) The creditor sustained loss or damage as the proximate consequence of the false, material misrepresentation.

In re Giuffrida, 302 B.R. 119, 123 (Bankr. E.D.N.Y. 2003). If the Debtor is able to establish Reiter's familiarity with her financial situation, as she has alleged, she may have a meritorious defense to his assertions that he was justified in his reliance on her representations.

Code § 523(a)(2)(B) is to be distinguished from Code § 523(a)(2)(A) in two ways. While both are based on representations made by a debtor, Code § 523(a)(2)(B) requires that the representations be in the form of a financial-type statement written or signed by the debtor or adopted by the debtor concerning his/her assets and liabilities or overall net worth. *See In re Alicea*, 230 B.R. 492, 502-3 (Bankr. S.D.N.Y. 1999). The second distinguishing factor is that the creditor's reliance on the information in the financial statement must be reasonable, rather than justifiable. *Id.* at 503. In this case, the Debtor has asserted that Reiter had requested oversight of all aspects of her finances and was fully familiar with them when she executed the

promissory notes in connection with the loans made by Reiter to her. The extent to which he may have been familiar with her net worth, including both her assets and liabilities, impacts on whether his reliance on any written financial statements concerning the Debtor was reasonable.

The Court concludes that the Debtor has alleged sufficient facts which, if proven, would be sufficient to defeat both causes of action asserted by Reiter.

Prejudice to the Plaintiff

Plaintiff has not asserted that granting the Motion would substantially prejudice him. The Debtor's Motion was filed within two weeks of the Court having signed the Judgment. There is no evidence that this minimal delay has resulted in a loss of evidence or increased any difficulties associated with discovery. The fact that the Plaintiff currently resides in California does not constitute prejudice to him in having to litigate the action in this Court in New York because he was well aware of that possibility at the time he commenced the action against the Debtor approximately five months ago on May 19, 2004.

The Court concludes that the Debtor has established sufficient cause for the Court to vacate the Judgment of Default, signed on July 22, 2004.

Based on the foregoing, it is hereby

ORDERED that the Debtor's Motion seeking to vacate the Judgment of Default is granted; it is further

ORDERED that all discovery be completed by January 3, 2005 and that a trial[3] be held on February 3, 2005 at 9:00 at the U.S. Bankruptcy Court, 10 Broad St., Utica, NY.

Dated at Utica, New York

this 1st day of November 2004

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

[3] According to the docket in the adversary proceeding, the Debtor filed an answer on August 5, 2004, the same day she filed the Motion presently under consideration. Therefore, the Court finds no reason for there to be a delay in scheduling the trial.