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IN THE UNITED STATES BANKRUPTCY COURT DISTRICT OF UTAH 350 South Main Street, Salt Lake City, Utah 84101	
IN RE: [PARTY NAME REDACTED] [PARTY NAME REDACTED] Debtors.	Case No. Judge William T. Thurman Chapter 13 FILED ELECTRONICALLY ON 7/8/05
OBJECTION AND MEMORANDUM IN OPPOSITION TO [PARTY NAME REDACTED]'S MOTION FOR SUMMARY JUDGMENT	

[PARTY NAMES REDACTED], debtors in the above-captioned Chapter 13 case, hereby object to the Motion of [PARTY NAME REDACTED] (the "Movant") for Summary Judgment (the "Motion"), and pursuant to Local Rules 7056-1 and 9013-1, submit the following memorandum in opposition to the motion.

STATEMENT OF ADDITIONAL AND CONTESTED FACTS

1. The debtors do not dispute the Movant's statement of undisputed material facts set forth in paragraphs 1 through 11 and 14 through 20 of the Motion.

2. With respect to the facts alleged in paragraph 12 and 13 of the Motion, the debtors note that the full text of the order dismissing the adversary proceeding states as follows:

> "The parties having failed to comply or alternatively, having filed a response but citing no objection to the Court's Order to Show Cause, it is hereby ORDERED that this adversary proceeding be dismissed."

The dismissal order itself cites no basis for the dismissal other than there being no objection on file to the Order to Show Cause.

3. As of the date of the Order to Show Cause issued in the adversary proceeding, the debtors as plaintiffs therein had not provided the defendants, including the Movant, with service of process as required under F.R.C.P. 4 and Fed.R.Bankr.P. 7004.

4. The Order to Show Cause was dated 130 calendar days after the filing of the adversary proceeding complaint.

ARGUMENT

A. Dismissal of Prior Adversary Proceeding does not bar the present motion for sanctions.

The Movant's argument that the dismissal of the prior adversary proceeding filed against it by the debtors was a dismissal with prejudice is not supported by the terms of the dismissal or by the Federal Rules.

The Movant argues that the dismissal of the adversary proceeding occurred pursuant to F.R.C.P. 41(b), arguing that such dismissal would therefore be a dismissal with prejudice. In so doing, however, the Movant ignores both the fact that service of process was not accomplished upon the defendants in the adversary proceeding and the subsequent dismissal requirements of F.R.C.P. 4(m).

Rule 4(m) provides as follows:

> "Time Limit For Service. If service of the summons and complaint is not made upon a defendant within 120 days after the filing of the complaint, the court, upon motion or its own initiative after notice to the plaintiff, shall dismiss the action without prejudice as to that defendant, or direct that service be effected within a specified time; provided that if the plaintiff shows good cause for the failure, the court shall extend the time for service for an appropriate period."

Subdivision (m) was originally added to Rule 4 in the Federal Rules of Civil Procedure Act of 1983 as subdivision (j) and became subdivision (m) through 1993 amendments to the federal rules. In its 1983 legislative statement, Congress indicated that one purpose of this amendment was to leave a plaintiff whose complaint was dismissed for lack of service of process "in the same position as if the action had never been filed." (See *Legislative Statement, 1983 Amendment* in *Bankrupcty Code, Rules and Forms*, Thompson-West Publishing, 2003).

Other discussions of Rule 4(m) also indicate that failure to effect service within the rule's 120-day period will result in dismissal without prejudice. *See*, Thomas A. Coyne, *Federal Rules of Civil Procedure,* II31-33, (2d ed. 2004). The only concerns expressed in the authorities cited

above as to whether a complaint dismissed under Rule 4(m) could be filed again involved applicable statutes of limitations.

Rules of statutory construction require the court to interpret the Order to Show Cause and the dismissal order entered in the adversary proceeding as falling under Rule 4(m), rather than Rule 41(b) as the Movant argues. Rule 4(m) states that the court shall dismiss the case without prejudice if service is not accomplished within the 120-day time period, if the party responsible for the service does not show good cause to require an extension and the court determines not to allow a permissive extension of time.

Even though Local Rule 7041-1(b) allows the court to issue "at any time" an order to show cause why an adversary proceeding should not be dismissed for lack of prosecution, and though the Order to Show Cause included the language "for lack of prosecution," the more precisely applicable Rule 4(m) should apply, and the dismissal should be without prejudice, because of the plain language of the rule. See *Scott v. Hern*, 216 F.3d 897, 216 F.3d 897 (10th Cir. 06/06/2000), but see also *King Vision Pay-per-view V. Spice Restaurant*, 244 F.Supp.2d 1173 (D.Kan. 01/21/2003). A Rule 4(m) dismissal can never be with prejudice. See *Bann v. Ingram Micro, Inc.*, 108 F.3d 625.

Rule 41(b) on the other hand, uses more permissive language. Nothing in the rule requires the court, sua sponte, to issue a dismissal order either with or without prejudice.

Dismissal with prejudice, as the Movant argues occurred in the adversary proceeding if the proceeding was dismissed under rule 41(b), is a drastic sanction against the party affected.

The Tenth Circuit, in *Ehrenhaus v. Reynolds*, 965 F.2d 916 (10th Cir. 05/29/1992), indicated that a dismissal with prejudice "represents an extreme sanction appropriate only in cases of wilful misconduct" and outlined five factors a court should ordinarily consider in considering whether to impose such a sanction. Those factors include (1) the degree of actual prejudice to the defendant; (2) the amount of interference with the judicial process; (3) the culpability of the litigant, (4) whether the court warned the party in advance that dismissal of the action would be a likely sanction for noncompliance, and (5) the efficacy of lesser sanctions.

In reviewing those factors in light of the record in the adversary proceeding, it seems unlikely that the court would have intended to impose a dismissal with prejudice. The defendant, not knowing of the adversary proceeding and not having expended any resources in response thereto could hardly have been prejudiced, there was arguably little if any interference with the judicial process, nor could there have been a significant burden on the court in the management of its docket. The debtor, while having failed to serve the defendant or respond to the Order to Show Cause had hardly engaged in any behavior for which the term "culpable" could reasonably apply. The Court had warned the debtors that a dismissal would occur, but had not specifically indicated that the dismissal would be with prejudice. Finally, lesser sanctions, namely dismissal without prejudice would arguably have been more appropriate and effective. Of the five factors, none clearly weigh in favor of the imposition of the drastic sanction of dismissal with prejudice, and the debtors do not believe that was the intention of the court in dismissing the adversary proceeding.

"Because dismissal with prejudice "defeats altogether a litigant's right to access to the courts, it should be used as 'a weapon of last, rather than first, resort.' " *Meade v. Grubbs*, 841 F.2d 1512, at 1520 (10th Cir. 1988). "Only when the aggravating actors outweigh the judicial system's strong predisposition to resolve cases on their merits is dismissal an appropriate sanction." *Meade*, at 1521.

There appears to be little if any support for the idea that a dismissal with prejudice simply for failure to complete service within the 120-day requirement is warranted, and such an order based on the facts in this case would have arguably have been an abuse of discretion under the *Ehrenhaus* test. The record does not suggest that the court intended a dismissal with prejudice. Even though the language "for lack of prosecution" was included in the Order to Show Cause, such language is sufficiently generic to have allowed the debtors to believe that the court was referring to the lack of service, especially given that the Order was issued shortly after Rule 4(m)'s 120-day deadline. The record contains none of the other types of activity involving prejudice to the other party that are hallmarks of an involuntary dismissal with prejudice under Rule 41(b).

Finally, Movants argument that these claims "may not be raised again, in any court" is simply incorrect under the U.S. Supreme Court's opinion in *Semtek International Inc. v. Lockheed Martin Corporation*, 121 S.Ct. 1021, 128 Md.App. 39, 531 U.S. 497, 531 U.S. 497, 736 A.2d 1104, 149 L.Ed.2d 32, 149 L.Ed.2d 32 (U.S. 02/27/2001) . In that opinion, the Court ruled that the language "adjudication on the merits" included in Rule 41(b) does not necessarily

mean "dismissal with prejudice," nor does it necessarily have claims preclusive effect. The court held that a claim dismissed in one court was not barred by res judicata and could be refiled in another if not otherwise barred. The court was clearly supporting the judicial system's strong predisposition to resolve cases on their merits. This ruling is intriguing in light of litigation options available to debtors before the bankruptcy court. The F.R.C.P. 2 provides that in the federal district courts there shall be "one form of action." In matters involving sanctions under Section 362(h) of the bankruptcy code, however, a debtor or plaintiff has two methods of bringing the cause of action before the court for adjudication. A Section 362(h) claim can either be presented as an adversary proceeding or brought as a simple motion or contested matter within the pending bankruptcy case. It is possible to construe the logic in the *Semtek* case regarding the claims preclusive effect of a Rule 41(b) adjudication on the merits as still allowing an alternate form of action in the same court, as is happening before the court in the present matter.

It seems highly unlikely that the court intended to impose the drastic sanction of dismissal with prejudice on the debtors in dismissing the adversary proceeding. At best, it is unclear how one can reach a permissive dismissal with prejudice under Rule 41(b) when Rule 4(m) requires a dismissal without prejudice under the facts present in the adversary proceeding. It follows then that in the adversary proceeding, there was neither a Rule 41(b) adjudication on the merits nor a dismissal with prejudice and the current motion of the debtors is not barred by the doctrine of res judicata. The case was dismissed under Rule 4(m), leaving the debtors in the same position as if the complaint had never been filed.

B. An Order Confirming a Chapter 13 plan does not bar the a motion for sanctions arising out of a post-petition, pre-confirmation violation of the automatic stay.

The Movant presents an interesting, though flawed, argument in support of its contention that the entry of a confirmation order creates a bar through the doctrine of res judicata that precludes the pursuit of damages arising from a post-petition, pre-confirmation stay violation if the matter was not litigated prior to or preserved in the confirmation order.

The argument is based on 11 U.S.C. §1327, which states that "the provisions of a confirmed plan bind the debtor and each creditor," and the fact that the claims filed by the Movant were allowed and provided for in the order confirming the debtors' plan of reorganization.

As indicated in the facts outlined in the motion, the confirmed plan does provide for bifurcated, partially secured and partially unsecured claims of the Movant. The bifurcated nature of the claims is barely relevant, however, given that the plan will provide a 100% return to unsecured creditors at 6% interest, a rate higher than the contract rate being paid on the secured portion of the claims.

As required by 11 U.S.C. §502, those claims amounts and their inclusion in the confirmed chapter 13 plan are derived from the Proofs of Claim filed by the Movant stating the amounts of those claims as of the petition date. Those claims are automatically allowed unless an interested party objects. Post-petition claims are only included in the plan if they meet the requirements of 11 U.S.C. §1305, which allows post-petition claims for taxes and for consumer debts necessary

for the debtor's performance under the plan. A post-petition claim may not be allowed in a plan unless they meet the requirements of Section 1305. An underlying principle of the bankruptcy code and all Chapter 13 reorganization plans is that claims can only be treated as they existed on the petition date. See 11 U.S.C. §§101 and 502 and *Collier on Bankruptcy* §502.03[1][b] at 502-21. This principle directly contradicts Movants argument that a pre-petition claim must have been mitigated, or met with a post-petition, pre-confirmation counterclaim, prior to confirmation. Such a requirement would be all but unworkable in practice and in many cases would cause delay in distributions under the plan and thus prejudice other creditors.

Claims are automatically allowed unless an objection is filed. There is no deadline, either in the bankruptcy rules or the local rules for the District of Utah for filing an objection to a claim. See *In re Morton,* 298 B.R. 301 (6th Cir.BAP 2003). Even after a claim is allowed, it clearly can be reconsidered under 11 U.S.C. §502(j). The mere fact that Movant's claims were allowed as filed does not create make the claim unassailable as a matter of res judicata at a later date, nor does it bar the debtor from raising a counterclaim against the creditor at a later date. If one were to adopt the principles that would be involved in an adversary proceeding relating to the allowance of a claim, neither Bankruptcy Rule 7013 nor Federal Rule 13 would have imposed a mandatory counterclaim on the facts alleged in this case. No rule sets a deadline for filing an objection to a claim, nor is there a requirement that the debtor asserts any counterclaims it may have prior to the allowance of the claim.

Three courts have considered the question of whether the filing of an uncontested and therefore automatically allowed proof of claim can have preclusive effects on a debtor's subsequent attempt to bring a tort action against the party who filed the claim. The Ninth Circuit, in *Siegel v. Federal Home Loan Mortgage Corp.*, 145 F.3d 1340 (9th Cir. 05/05/1998) held that once a mortgage creditors post-foreclosure claims had been deemed allowed, res judicata applied and the debtor/plaintiff could not pursue counterclaims against the creditor. On the other hand, the Fourth Circuit held in *County Fuel Co. v. Equitable Bank Corp.*, 832 F.2d 290 (4th Cir. 11/02/1987) that

> "the better and decidedly majority view is that the failure to interpose such an available 'counterclaim' does not, as a matter of res judicata, bar its subsequent assertion as an independent claim for relief. See Restatement (Second) Judgments § 22(a). It is doubtful that the 'automatic allowance' under 11 U.S.C. § 502(a) of a claim not objected to constitutes a 'final judgment' of the type that gives rise to 'bar' or 'claim preclusion' under strict res judicata principles. See Restatement (Second) Judgments §§ 13, 19, comment a. Under relevant bankruptcy law, objections may be made and allowed after automatic allowance of a claim, see Advisory Committee Note to Bankruptcy Rule 3007, and indeed a claim allowed by order may be later disallowed upon reconsideration. 11 U.S.C. § 502(j). Additionally, the 'automatic allowance' provided by § 502(a) was not 'final' for purposes of appellate review, another test, though not decisive, of its 'finality' for res judicata purposes. See Restatement (Second) Judgments § 13, comment b."

The Fourth Circuit's reasoning was adopted by the Eastern District of Pennsylvania in *In re Giordano*, 234 B.R. 645 (Bankr.E.D.Pa. 1999), and specifically rejected the *Siegel* holding.

In support of its proposition that a confirmation order is res judicata on all issues that were or that could have been raised before plan confirmation, it is important to note that many of the cases cited by Movant involved situations where not only had the plan been confirmed, but

had also been completed, discharged and closed. These include *In re Andersen*, 179 F.3d 1253, 136 Ed. Law Rep. 135 (10th Cir. 06/07/1999), and *Mayflower Capital co. v. Hyuck, III, (In re Hyuck,III)* 252 B.R. 509 (Bankr.D.Colo.2000). In reading these cases, it is clear that the reasons for upholding res judicata had more do to with creditor inaction in asserting their rights or that the plans were completed, discharges had been granted and the cases closed than with the entry of a confirmation order and the effect of Section 1327. Res judicata is easier to apply in these cases as well because once a plan has been completed the modification provisions of 11 U.S.C. §1329, which necessarily create an exception to any res judicata effect of a confirmation order, no longer apply. Prior to completion of the plan however, a plan may be freely modified under the provisions of Section 1329.

Other cases cited by the Movant involve Chapter 11 cases, including *In re Adams*, 218 B.R. 597 (Bankr.D.Kan. 1998), *Slone v. M2M International, Inc., (In re G-P Plastics, Inc.),* 320 B.R. 698 (E.D.Mich. 2005), and *In re Kelly,* 199 B.R. 698 (9th Cir.BAP 1996). The inclusion of these Chapter 11 cases weakens the Movant's argument because of the drastically different effect of confirmation in a Chapter 11 as opposed to a Chapter 13 case. Confirmation acts as a discharge in Chapter 11 cases, while confirmation in a Chapter 13 case merely fixes the terms upon which pre-petition claims are to be settled subject to possible modification by the court and later discharge. Further, in Chapter 11 cases there is a great deal more negotiation regarding the nature and extent of claims between the debtor and his creditors because of the need to have

creditor approval for confirmation. Negotiation and often litigation of claims is a necessary prerequisite of chapter 11 confirmation. The same is not the case under Chapter 13.

A more persuasive and relevant Chapter 11 case is *In re Auto West, Inc.* 43 B.R. 761 (Bankr.D.Utah. 1984). In that case, a creditor argued that res judicata barred the employment of counsel to pursue an pre-petition claim against it. The claim had not been disclosed prior to confirmation. In that case, the court stated the principle argued by the Movant here that "res judicata is binding on all parties to the plan and all questions that could have been raised pertaining to the plan are res judicata." 43 B.R. 761, 763. However, the court went on to say that "that general principle, however, is certainly not dispositive of the issue presented here. ... There is nothing in section 1141 or the legislative history that indicates that confirmation of the plan was to have the additional effect of barring the trustee or debtor in possession from pursuing undisclosed assets of the estate. Indeed, a review of other Code provisions indicates a contrary intent." Arguably, the same can be said for Sections 1322, 1325, and 1327. The *Auto West* court went on to say that "waiver of a chose in action that could benefit all creditors to the detriment of one creditor, is inconsistent with the fiduciary obligation of the debtor in possession." 43 B.R. 761, 764.

The common law principle of res judicata does not apply to "when a statutory purpose to the contrary is evident." *In re Witkowski*, 16 F.3d 739 (7th Cir. 02/14/1994), citing *Astoria Federal Sav. and Loan Ass'n v. Solimino*, 501 U.S. 104, 115 L. Ed. 2d 96, 111 S. Ct. 2166, 2170 (1991), quoting *Isbrandtsen Co. v. Johnson*, 343 U.S. 779, 72 S. Ct. 1011, 1014, 96 L. Ed. 1294

(1952). Even though Section 1327 makes the provisions of the plan binding on the debtor and creditors, at least two statutory frameworks for altering those provisions exist, limiting the application of res judicata the aspects of the plan at issue here. The first scheme is the claims reconsideration process provided for in Section 502(j). Clearly the allowance of a claim can have no res judicata effect where the bankruptcy code itself provides for the reconsideration of a claim. Another provision is the plan modification process provided for in 11 U.S.C. §1329. While the motion for sanctions before the court does not specifically incorporate either of those provisions, relying instead on Section 362(h), they certainly are in play here because if the debtors prevail, the claim will effectively have been reconsidered and the plan modified. The *Witkowski* court went so far as to say that the inclusion of Section 1329 "makes it clear that Congress did not intend the common law doctrine of res judicata to apply to Section 1329 modifications." 16 F.3d 739 at 744-745.

Section 362(h) itself creates another framework for altering the provisions of a confirmed plan. That section provides that "an individual injured by any willful violation of [the automatic stay] shall recover actual damages...." There is no limitation or deadline under which Section 362(h) damages may be sought. There is no cross reference between Sections 362(h) and Section 1327. There is no indication that Section 1327 was intended as a bar on Section 362(h) claims, although Congress could have addressed the matter if it so desired. Neither Section 1327 or the doctrine of res judicata bar the assertion of the present claim for relief through a motion for sanctions.

CONCLUSION

The court should deny the Motion for Summary Judgment on each of the grounds argued by the Movant. Dismissal of the prior adversary proceeding was clearly pursuant to Federal Rule 4(m), rather than Rule 41(b) as Movant asserts and therefore the dismissal was without prejudice. The entry of the order confirming the debtor's chapter 13 plan does not act as a bar on filing a Section 362(h) motion, nor does it bar the reconsideration of the Movant's claims. The Court should deny the Motion for Summary Judgment and allow a full hearing on the claims of the debtors.

DATED: July 8, 2005

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/S/ David W.M. Snow
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