Original

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

In re: FRANK BUSHMAN and HEATHER BUSHMAN, Debtors.	Bankruptcy Number: 01-26116 Chapter 7

MEMORANDUM DECISION

Following the debtors' receipt of a Chapter 7 discharge in a no asset case, a creditor filed suit against the debtors in state court seeking to collect on a pre-petition guaranty that one of the debtors executed related to the debtor's corporation. Despite the debtors' efforts to raise discharge in bankruptcy as a defense in the state court action, the creditor continues to prosecute the debtors because, it asserts, the debtors have continuing liability on the guaranty, the debt did not exist as of the date of filing, and the debtors remain obligated because the creditor was not listed on the debtors' schedules. As a result, the debtors filed the instant motion for sanctions against the creditor for willful violation of the discharge injunction imposed by 11 U.S.C. § 524.[1]

[1] Future references are to Title 11 of the United States Code unless otherwise noted.

After careful review of the evidence presented, including the credibility of the witness, proffered testimony, the arguments of counsel, and having made an independent review of applicable case law, the Court issues the following memorandum decision.

I. FACTS

Frank and Heather Bushman (the "Debtors") filed a Chapter 7 voluntary petition on April 26, 2001 (the "Petition Date"). The Debtors failed to name Staker & Parson Companies (Staker/Parson) on their statements and schedules as having a claim, and also failed to list Staker/Parson as a creditor on their matrix. The Chapter 7 trustee filed a report of no assets, the Debtors were issued an order of discharge on August 1, 2001, and the case closed. Because Staker/Parson was not a listed creditor, it did not receive written notice of the Debtors' bankruptcy filing until June 2, 2003. The case was reopened to hear this motion for sanctions on January 5, 2004.

In 1995, Frank Bushman began operating a construction business under the d.b.a. Frank J. Bushman Construction (Bushman Construction). In December 1997, Frank Bushman organized Bushman Construction as a Utah limited liability company (the "LLC"). His wife, Heather Bushman, was a member of the LLC but did not participate in the daily operation of the business. The LLC was dissolved in writing on July 12, 1999. The dissolution went into effect with the Utah Division of Corporations on September 10, 1999. Shortly thereafter on August 18, 1999, Frank J. Bushman Construction, Inc., (the "Corporation") was incorporated. Heather Bushman

was not involved in the Corporation and the registered office of the Corporation changed from that of the LLC.[2]

On September 20, 1999, after the Corporation was formed, Frank Bushman completed a credit application (the "Application") with Staker/Parson[3] to open a revolving credit account (the "Account") on behalf of the Corporation. Staker/Parson disputes the identity of the entity that opened the Account. The Application was completed in the name of "Frank J. Bushman Construction" without designation in the name as either a corporation or an LLC. However, the business address listed matches the registered office of the Corporation. In addition, the Application requests the applicant to check either "LLC," "Corporation," "Partnership," or "Sole Proprietor," and the box next to "Corporation" is checked and the date of incorporation is listed as August 1999 in the state of Utah. Frank J. Bushman is listed as a corporate officer. Even Staker/Parson's credit manager testified that nothing in the Application was inconsistent with a determination that the applicant was a corporation at the time it completed the Application, and that the Application was completed for the Corporation, not Bushman Construction or the LLC. Staker/Parson's assertion that an entity other than the Corporation executed the Application is, therefore, not supported by the evidence.

As part of the Application, Frank Bushman signed a personal guaranty (the "Guaranty") of credit wherein he agreed to be responsible for debts owed by the Corporation. The language

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[2] The LLC registered office was 945 North 1140 West, Mapleton, Utah 84664. The Corporation's registered office is 1467 West Center Street, Orem, Utah 84058.

[3] The Application was completed with Jack B. Parson Companies which at some later date became Staker and Parson Company. However, for purposes of this memorandum, the entity will be referred to as Staker/Parson.

of the Guaranty specifically designates the Guaranty as a "continuing guaranty" wherein Frank Bushman agrees that the Corporation will "fully and promptly perform its present and future obligations" to Staker/Parson and, in the event of default, Frank Bushman will "pay all balances due."[4] Frank Bushman also agreed to waive protest, notice of delinquency and/or demand. Heather Bushman was not a party to the Application with Staker/Parson, nor did she guaranty the Corporation's debt. The only signature that appears on the Application is that of Frank Bushman. There is no proof or even an allegation by Staker/Parson that the Debtors engaged in any conduct in relation to the execution of the Application that would be actionable under §§ 523 or 727.

Testimony of Staker/Parson's credit manager revealed that credit was extended and paid off by the Corporation on the revolving account many times, but as of the Petition Date the account reflected a zero balance. The Corporation thereafter incurred debt under the Application between May 26, 2001 and September 30, 2001; a period after the Debtors' Petition Date extending to a point after the Debtors' discharge was issued. Staker/Parson's Exhibit 1 is a series of invoices as well as an overall account statement with charges and credits from June to September 2001. The statement indicates that payments were credited to the account during the time period. The Account was not entirely in default throughout the time period and appears to have had a positive balance in June and August of 2001. Apparently, an amount of $18,311.93 eventually was unpaid by the Corporation. No evidence was presented by either party that Staker/Parson took any action to terminate or rescind the Account's underlying 1999 contract which included the Guaranty under Utah state law or in accordance with bankruptcy law.

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[4] Drs' Mem. Supp. Sanctions Ex. D.

In November 2002, Staker/Parson sued the Debtors in the Third District Court (the "State Court Litigation") for doing business as a dissolved Utah limited liability company, alleging the Debtors did business as a general partnership. The suit alleged breach of contract and breach of Frank Bushman's Guaranty. Heather Bushman was named as a defendant, even though she did not sign a personal guaranty and is not and has never been an officer or director of the Corporation. The Debtors were not represented by counsel and a default judgment was entered against them in the amount of $24,292.94 on June 2, 2003. It is unclear from the evidence what the status is of the State Court Litigation, although it appears from the record that the Debtors, through counsel, have taken some measures to have the default judgment set aside including written notice on June 2, 2003 from the Debtors' counsel of the bankruptcy discharge and alleged violation of the § 524 injunction. The Debtors' memorandum asserts the default judgment was set aside on October 29, 2003, but that Staker/Parson continues to conduct discovery in the State Court Litigation.

Staker/Parson's credit manager testified that had Staker/Parson been aware of the Debtors' personal bankruptcy it would have closed the Account, filed for mechanic's liens and enlisted attorneys to send out demand letters. Staker/Parson argues that Frank Bushman's failure to inform it of his bankruptcy filing gives rise to some kind of a cause of action under § 523, but such conduct would, of course, have occurred postpetition and not when the Application was made. Staker/Parson's credit manager also indicated that it did not matter whether it was an individual, a corporate entity or a partnership that filed bankruptcy, Staker/Parson terminated any related entity's account. The Court finds this conduct in general to be potentially in violation of §§ 362, 1301 and 1201.

The Debtors did not testify at the hearing and failed to present any evidence of the costs they expended in relation to the State Court Litigation, or in bringing this motion. The only allegation of harm is a statement in the Debtors' brief that "Debtors have been forced to employ counsel, incur costs and endure the aggravation and heartache of Staker & Parson's collection efforts."[5] The Debtors' counsel chose to rely solely on the Debtors' affidavits for testimony and the affidavits are silent on the issue of damages. Although certain documentation purports to show Parson/Staker's ability to satisfy a sanction award, no evidence received supports an award of actual damages.

II. ANALYSIS

The Debtors are seeking sanctions against Staker/Parson for its alleged willful violation of the discharge injunction imposed by § 524. This Court has jurisdiction to adjudicate this dispute under 28 U.S.C. § 157(b)(2)(O). The Debtors assert Staker/Parson continues to prosecute a lawsuit against both Frank and Heather Bushman despite knowledge of the Debtors' bankruptcy and despite having been asked to cease prosecution of a lawsuit which seeks to collect money based upon a pre-petition personal liability.

The Court must first determine whether the entity applying for credit was a corporation or some other entity when it completed the Application with Staker/Parson, in order to determine if there has been a violation of § 524. Then, the Court will analyze the effect of bankruptcy on the continuing personal guaranty signed by Frank Bushman and whether collection attempts against him under the Guaranty were permitted by the Code. Finally, the Court will determine if a violation of § 524 has occurred and whether sanctions are appropriate.

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[5] Drs' Mem. Supp. Sanctions at ¶ 24.

A. The Applicant's Legal Status – LLC or Corporation

Staker/Parson asserts that the Application was not executed by "Frank J. Bushman Construction, Inc." but rather it was completed by "Frank J. Bushman, LLC." Staker/Parson further argues that since the LLC was expired at the time the Corporation completed the Application, the business was operating as a dissolved Utah LLC and actually doing business as a general partnership. This assertion is Staker/Parson's sole basis for bringing suit against Heather Bushman. Staker/Parson claims there are inconsistencies in the Application rendering it ambiguous. The inquiry of whether or not a contract is ambiguous "always begins with the language of the instrument and, where that language is clear and unambiguous, interpretation of the contract is a matter of law."[6]

The Application is not ambiguous as to the form of entity referenced. It is clear from the four corners of the document that the Application was made on behalf of the Corporation. The box marked "corporation" is checked and under the title "Names of Corporate Officers" Frank Bushman's name is listed as President as well as a date of incorporation. Staker/Parson's credit manager testified that there was nothing inconsistent on the Application with the Corporation as the applicant.

Staker/Parson cannot hold the Debtors liable for the debts of the Corporation without executing on a personal guaranty or piercing the corporate veil. While Staker/Parson does have a

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[6] *First Security Bank of Utah v. Gillman*, 158 B.R. 498, 505 (D. Utah 1993). *See also, Vermejo Park Corp. v. Kaiser Coal Corp. (In re Kaiser Steel Corp.)*, 998 F.2d 783, 789 (10th Cir. 1993) ("Interpretation of an unambiguous contract is a question of law . . . . The determination of ambiguity of a contract is similarly a question of law."); *Teton Exploration Drilling, Inc. v. Bokum Resources Corp.*, 818 F.2d 1521, 1526 (10th Cir. 1987) ("The determination whether a contract provision is ambiguous is a matter of law.").

personal guaranty from Frank Bushman, there is nothing in evidence indicating Heather Bushman can be held liable for debts of a corporation with which she is not affiliated. Heather Bushman is neither an officer nor a director of the Corporation and did not sign a guaranty regarding the debt with Staker/Parson. Therefore, Staker/Parson's only claim arises as a result of the Guaranty.

B. Effect of Bankruptcy Filing on Personal Guaranty

Staker/Parson puts forth three arguments to support its theory that the debt incurred through the personal guaranty of Frank Bushman survives the Chapter 7 discharge. First, Staker/Parson insists the debt at issue was incurred post-petition and is thus not avoided by a discharge. Second, Staker/Parson theorizes that the Guaranty is a contract which remains intact for future business between the parties. And third, Staker/Parson claims the Debtors' failure to give notice of the bankruptcy prior to discharge prevents discharge of Frank Bushman's liability. The question upon which each of these theories turns is what effect does the filing of a bankruptcy petition have on a personal guaranty.

1. Personal guaranty obligations as post-petition liability.

The Tenth Circuit has explained "[a] fundamental tenet of bankruptcy law is that a petition for bankruptcy operates as a 'cleavage' in time. Once a petition is filed, debts that arose before the petition may not be satisfied through post-petition transactions."[7] This creates a dividing line between pre- and post-petition debts. Staker/Parson is correct in characterizing the debt owed by the Corporation as post-petition because a creditor's claim is determined as of the

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[7] *Ashland Petroleum Co. v. Appel, (In re B&L Oil Company)*, 782 F.2d 155, 158 (10th Cir. 1986).

date of filing of the petition.[8] As of the Petition Date, the Corporation did not have an outstanding balance due Staker/Parson under the Application, the Corporation had not defaulted, and hence Staker/Parson did not have a matured right to collect payment from Frank Bushman. However, that does not mean that Frank Bushman's liability under the Guaranty is not impacted by the bankruptcy filing. Debt is defined as "liability on a claim."[9] A "claim" is broadly defined in the Bankruptcy Code (the "Code") as follows:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured;[10]

The Supreme Court has further clarified the definition of claim by explaining that "Congress intended by this language to adopt the broadest available definition of 'claim.' . . . [The] 'right to payment' [means] nothing more nor less than an enforceable obligation."[11] The Tenth Circuit Bankruptcy Appellate Panel (the "BAP") has further explained the "central issue for a bankruptcy court is whether a claim as defined by the Bankruptcy Code existed pre-petition. . . . [P]ursuant to the plain language of the statute, a claim will exist if some pre-petition conduct has occurred that will give rise to liability."[12]

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[8] *See* § 502(b).

[9] § 101(12).

[10] § 101(5)(A)-(B).

[11] *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991) (internal citations omitted).

[12] *Watson v. Parker (In re Parker)*, 264 B.R. 685, 697 (10th Cir. BAP 2001).

The pre-petition conduct giving rise to Frank Bushman's liability is the execution of the Guaranty. Staker/Parson correctly characterizes the Guaranty as a "continuing guaranty . . . 'which contemplates a series of credit transactions.'"[13] A guaranty has been called "a classic illustration of a contingent claim."[14] Under the Guaranty, Frank Bushman is contingently liable for any debt incurred and not paid by the Corporation. Frank Bushman's personal liability under the Guaranty arose when he executed the contract pre-petition, creating the contingent liability. The liability liquidates or matures once the Corporation incurs debt and fails to pay it. All of the Corporation's debt was incurred post-petition between May and September 2001. Staker/Parson therefore held only a contingent claim at the date of filing. The contingent claim did not mature into Frank Bushman's liquidated liability until the Corporation placed orders on the line of credit post-petition and then defaulted. Similar to the circumstance where an action for indemnification does not accrue until the indemnitee has suffered an actual loss,[15] in this case an action against Frank Bushman could not mature until the Corporation incurred debt and then defaulted. However, both instances are covered by the automatic stay and the discharge injunction because both constitute a contingent or unmatured claim within the purview of § 101(5)(A).

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[13] Cr.'s Mem. Opp. Sanctions at 6.

[14] *In re Barnett*, 42 B.R. 254, 257 (Bankr. S.D.N.Y. 1984).

[15] *In re Black*, 80 B.R. 645, 651 (Bankr. D. Ut.1986) (concluding that the broad interpretation of claim under the Code is more expansive than any right to payment cognizable under state law at the date of filing).

2. Personal guaranty as an executory contract.

Even if Frank Bushman's liability under the Guaranty was not discharged under the rationale set forth above, his contractual obligations under the Guaranty would be unenforceable after he filed his chapter 7 petition because the Guaranty was executory and terminated upon filing. Staker/Parson argues that the obligation owed to it arises from a contract, not a debt, which is continuing and must be enforced for post-petition obligations, or properly revoked under Utah law.[16] Staker/Parson mischaracterizes the alternatives. The question is not necessarily how Utah law treats the Guaranty contract, but how the Guaranty contract is treated by the Bankruptcy Code.[17]

The legislative history of § 365 defines an executory contract as "a contract on which performance remains due to some extent on both sides."[18] Professor Vern Countryman has further defined and clarified the definition of an executory contract: "the obligation of both the bankrupt and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."[19] Staker/Parson's own argument slots the Guaranty firmly into the Countryman definition. A

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[16] *See* Cr.'s Mem. Opp. Sanctions at 6, citing *Mule-Hide Products Co., Inc. v. White*, 40 P.3d 1155, 1159 (Utah App. 2002) ("Where [a] guaranty is a continuing guaranty, which contemplates a series of credit transactions, the guarantor may revoke the guaranty at any time upon proper notice.").

[17] "Because the Bankruptcy Code expressly delineates the boundaries of the term claim, the issue of whether a claim is valid under state law is not the primary inquiry for a bankruptcy court when determining whether a claim against a debtor is a bankruptcy claim under the Code." *Parker*, 264 B.R. at 697.

[18] *In re Streets & Beard Farm Partnership*, 882 F.2d 233, 235 (7th Cir. 1989) (quoting S.Rep. No. 989, 95th Cong., Sess. 58 and H.Rep. No. 595, 95th Cong., 1st Sess. 347, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5844).

[19] Vern Countryman, *Executory Contracts in Bankruptcy: Part 1*, 57 Minn.L.Rev. 439, 460 (1974).

personal guaranty is an executory contract due to the nature of the liability and the fact that it is subject to cancellation.[20] There is always an issue as to the future performance due given the constant change in the credit extended with each order. There is a continuing obligation to perform on each side – Staker/Parson must continue to extend credit and deliver goods to the Corporation, and Frank Bushman must continue to obligated himself to guaranty payment on the debt, if unpaid, until the Guaranty is properly revoked.

Once a debtor files bankruptcy, an executory contract to which the debtor is a party must either be assumed or rejected in compliance with the applicable provision of the Code. Section 365(c)(2) explains that a trustee may *not assume* an executory contract if it "is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."[21] The term "financial accommodation" has not been defined by the Code, nor is it clarified by legislative comments. However, one court has narrowly defined it as "[t]he obligation to pay money on the obligation of another."[22] A personal guaranty fits squarely within this definition, as acknowledged by Staker/Parson's credit manager. Under the Guaranty, Frank Bushman is obligated to pay money on the obligation of the Corporation.

At least one other bankruptcy court has found that a personal guaranty is no longer effective on unapproved post-petition advances.[23] In determining that the personal guaranty is

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[20] *See Stanton*, 239 B.R. at 230.

[21] § 365(c)(2).

[22] *In re Adana Mortgage Bankers, Inc.*, 12 B.R. 977, 987 (Bankr. N.D. Ga. 1980).

[23] *Stanton*, 239 B.R. at 227. In addition to a personal guaranty, *Stanton* involved a deed of trust to secure the guaranty. *Stanton* was subsequently overruled by the Ninth Circuit in its determination that the deed of trust did not secure post-petition advances in accord with Washington state law. *See*

extinguished in bankruptcy, the *Stanton* court stated: "[a]ny other interpretation of the effect of the bankruptcy filing on pre-petition agreements and documentation would negate the principles of discharge, fresh start and court supervision and control of the estate, all of which are cornerstones of bankruptcy law."[24] In addition, *Adana Mortgage Bankers*[25] similarly disallowed the assumption of guaranty agreements under § 365(c)(2) wherein a third party was obligated to pay money on the obligation of the debtors. Despite the reversal of roles, the policy underlying the prohibition against assumption is still upheld. Section 365(c)(2) is "not only [for the] protection of the non-debtor party to the financial accommodation but also [for the] protection of the unsecured creditors."[26] Had the Debtors or Staker/Parson sought to assume the Guaranty through the court, the request would have been denied based upon the prohibition found in § 365(c)(2).

To eliminate any doubt as to whether an executory contract for financial accommodation can be assumed, Congress included § 365(e)(2)(B) which contains nearly identical language in describing when a contractual termination clause may be given effect. "The reason for this apparently unnecessary repetition is to make it clear that not only may a nonassumable contract or a commitment to lend money not be assumed . . . but that the obligations of the other party

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Beeler v. Jewell (In re Stanton), 303 F.3d 939 (9th Cir. 2002). However, the Ninth Circuit's determination that a mortgage lien was not avoidable as unauthorized post-petition transfer simply because creditor continued to advance money post-petition, increasing debt secured by the mortgage, does not effect the bankruptcy court's reasoning that a personal guaranty is extinguished as of the date of petition.

[24] *Stanton*, 239 B.R. at 227.

[25] 12 B.R 977.

[26] *Stanton*, 239 B.R. at 230.

may be terminated . . . ."[27] The Utah District Court has clarified the interplay between these two sections of the Code:

> Reading § 365(c)(2) and (e)(2)(B) together, it is clear that Congress intended to protect creditors who have entered into pre-petition agreements to extend financial accomodations to a debtor from being required to extend money or accommodations to it post-petition if the contract that it entered into was totally or partially unperformed when the debtor filed bankruptcy.[28]

Although the factual scenario in this case places Staker/Parson in the position of extending credit under the mistaken idea that the Guaranty can be assumed, the underlying legislative intent cannot be altered to correct the error. Ironically, Staker/Parson's policy of immediately terminating financial accommodations upon notice of bankruptcy acknowledges the business application of the Code's policy.

The Guaranty was extinguished and ceased to function in relation to new debt incurred by the Corporation as of the Petition Date. Because it is impossible for the trustee or debtors to assume an executory contract for financial accommodations, it is deemed rejected upon filing of the petition. Hence, the Guaranty was a "prepetition obligation that was discharged"[29] in the instant bankruptcy. There was not a personal guaranty in place when the Corporation incurred the debt owed Staker/Parson; therefore, no post-petition liability exists.[30]

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[27] 3 COLLIER ON BANKRUPTCY ¶ 365.07[1] (15th ed. 2003).

[28] *In re TS Industries, Inc.*, 117 B.R. 682, 686 (D. Utah 1990).

[29] *Motley v. Equity Title Co. (In re Motley)*, 268 B.R. 237, 240 (Bankr. C.D. Calif. 2001).

[30] *See also In re Turner*, 101 B.R. 751, 754 (Bankr. D. Utah 1989) (finding "debtor's personal liability on [homeowner's association's] right, albeit unmatured or contingent, to payment of common expenses was clearly discharged in this case").

3. Unscheduled claims.

Staker/Parson also raises the argument that the Debtors were obligated to include Staker/Parson as a creditor and provide notice of the bankruptcy.[31] The Tenth Circuit has ruled that

> the Debtor receives a discharge from all debts that arose before the date of the order for relief under Chapter 7, regardless of whether a proof of claim based on any such debt or liability is filed . . . [and] § 523(a)(3)(A) does not apply because the Debtor's Chapter 7 case was a no asset case with no claims bar date set . . . .[32]

The Debtors were similarly granted a discharge in a no asset case where no claims bar date was set. Staker/Parson was not prejudiced in the bankruptcy by the Debtors' failure to schedule the claim. Staker/Parson claims Debtors were obligated to include them as a creditor under § 523(a)(3)(A); however, Staker/Parson fails to plead or even allege a claim of the type found in § 523(a)(2), (4), (6) or (15) which would require notice of the bankruptcy under *Parker*.

C. Violation of Discharge Injunction

The Debtors received a discharge under § 727, which states:

> Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all *debts* . . . and *any liability on a claim* that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed . . . and whether or not a claim based on any such debt or liability is allowed . . . .[33]

The plain language of § 727(b) discharges pre-petition "debts" and "any liability on a claim." As discussed above, Staker/Parson had only a contingent claim as of the Petition Date in that the

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[31] *See* Cr.'s Mem. Opp. Sanctions at 9.

[32] *Watson v. Parker (In re Parker)*, 313 F.3d 1267, 1268-69 (10th Cir. 2002).

[33] § 727(b) (emphasis added).

Corporation did not have an outstanding balance due on the Account at the time. This contingent claim was discharged. Frank Bushman's personal liability was likewise discharged by operation of the extinguishment of the Guaranty. It does not matter that the charges made by the Corporation on the Account accrued post-petition: by the time the debt was incurred and liquidated, the Guaranty was gone. The Supreme Court has stated "a bankruptcy discharge extinguishes . . . an action against the debtor *in personam* . . . ."[34] There was no Guaranty in place when the Corporation defaulted on its payment obligations, therefore, due to Frank Bushman's *in personam* discharge, he was no longer personally liable for debts to Staker/Parson.

> The injunction that results from a discharge is explained in § 524(a)(2):
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> (a) A discharge in a case under this title —
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> . . . .
>
> (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived;[35]

Staker/Parson is enjoined from commencing or continuing any action to hold the Debtors personally liable on a discharged debt. "The discharge injunction is permanent. It survives the bankruptcy case, and applies forever with respect to every debt that is discharged."[36] Staker/Parson violated the discharge injunction when it commenced the State Court Litigation.

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[34] *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991).

[35] § 524(a)(2).

[36] *Motley*, 268 B.R. at 241.

"The intent of this post-discharge injunction is to protect debtors . . . in their financial 'fresh start' following discharge."[37]

Staker/Parson had no grounds whatsoever to pursue a cause of action against Heather Bushman in state court. As explained above, Heather Bushman did not sign a personal guaranty with Staker/Parson, and she was not affiliated with the Corporation. Staker/Parson's prosecution of Heather Bushman is not only a violation of her discharge but is completely frivolous. There is no basis to hold her liable for debts of the Corporation, and even Staker/Parson's credit manager's interpretation of the Application precludes any claims against her. Even after numerous letters from Debtors' counsel to counsel for Staker/Parson explaining the injunction imposed after discharge, Staker/Parson continued its attempts to recover the discharged debt.

The state court had no ability to hold either of the Debtors liable under the Guaranty. The Debtors did not have an obligation to defend the State Court Litigation that violated their discharge injunction. The entire action was void and a nullity.[38] The Supreme Court has clarified that "[i]t is for the court of first instance to determine the question of the validity of the law, and until its decision is reversed for error by orderly review, either by itself or by a higher court, its orders based on its decision are to be respected."[39] If a party wishes to challenge an injunction, the proper procedure is to first request relief from the Bankruptcy Court and "[i]f dissatisfied with the Bankruptcy Court's ultimate decision, respondents can appeal . . . ."[40] Here,

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37 *Walker v. Wilde (In re Walker)*, 927 F.2d 1138, 1142 (10th Cir. 1991).

38 *Motley*, 268 B.R. at 242.

39 *Celotex Corp. v. Edwards*, 514 U.S. 300, 313 (1995) (internal citations omitted).

40 *Id.*

Staker/Parson chose to circumvent the authority of this Court by first pursuing the State Court Litigation and then by its continuing resistance to abide by the automatic injunction imposed by this Court in conjunction with the Debtors' discharge. In prosecuting the Debtors in the State Court Litigation and obtaining a default judgment against them, Staker/Parson violated the discharge injunction.

D. Sanctions

Unlike § 362(h), which statutorily provides both an intent level – "willful violation" – and a remedy for the parallel injunction of the automatic stay, the language of § 524(a)(2) provides neither an intent level nor a remedy for violations of the injunction.[41] Some courts have developed a civil contempt remedy to grant actual damages, punitive damages and fees to cure

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[41] Section 362(h) expressly states that "[a]n individual injured by any *willful* violation of a stay . . . shall recover actual damages . . . and in appropriate circumstances, may recover punitive damages." (emphasis added). Conversely, § 524(a)(2) does not include any language as to a remedy or the intent required to be found in violation of the injunction. Both the District Court of Utah and the Tenth Circuit BAP have examined the definition of "willful" for purposes of § 362(h). *Compare Jardine's Prof. Collision Repair, Inc. v. Gamble,* 232 B.R. 799, 803 (D. Utah 1999) (finding "the word 'willful' modifies the words 'violation of a stay.' . . . In § 362(h) the specified sanctions require an intentional or deliberate *violation* of the stay.") (emphasis in original), *with Diviney v. Nationsbank of Texas, NA (In re Diviney),* 225 B.R. 762, (10th Cir. BAP 1998) (adopting the D.C. Bankruptcy Court's definition of willful:

> A "willful violation" does not require a specific intent to violate the automatic stay. Rather, the statute provides for damages upon a finding that the defendant knew of the automatic stay and that the defendant's actions which violated the stay were intentional. Whether the party believes in good faith that it had a right to the property is not relevant to whether the act was "willful" or whether compensation must be awarded.

quoting *INSLAW, Inc., v. United States (In re INSLAW, Inc.),* 83 B.R. 89, 165 (Bankr. D.D.C. 1988)). While it does not appear that a showing of willfulness is required for a finding of civil contempt for failure to comply with the discharge injunction, both Staker/Parson's actions in prosecuting the State Court Litigation and the testimony of their credit manager clearly indicate a willful violation of the injunction under either of these definitions.

such violations.[42] "Congress has granted [bankruptcy courts] civil contempt power by statute. This statutory authority derives from 11 U.S.C. § 105."[43] The Tenth Circuit BAP has stated "[a] creditor who attempts to collect a discharged debt is in contempt of the bankruptcy court that issued the discharge order. The bankruptcy court has the power to impose civil sanctions on those in contempt of its orders."[44]

The Tenth Circuit has outlined a three part test for prosecuting a civil contempt proceeding.[45] The moving party has the burden of proving by clear and convincing evidence "[1] that a valid court order existed, [2] that the defendant had knowledge of the order, and [3] that the defendant disobeyed the order."[46] Each element has been met. On August 1, 2001, a discharge order was entered by this Court relieving the Debtors from *in personam* liability on all pre-petition claims. Although Staker/Parson did not receive contemporaneous written notice of the discharge order, the evidence indicates Staker/Parson received written notice of the Debtors' bankruptcy discharge order no later than June 2, 2003. Despite knowledge of the Debtors'

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[42] *See Vogt v. Dynamic Recovery Services (In re Vogt)*, 257 B.R. 65, 68 (Bankr. D. Co. 2000). There is some debate as to whether § 524 impliedly creates a private right of action for violations of the discharge injunction or whether the remedy lies in contempt proceedings. The Debtors' motion is styled "Motion for Sanctions," however, the content of their brief moves for and cites standards for a finding of civil contempt. *See* Drs' Mem. Supp. Sanctions at 17. Therefore, it is unnecessary to address this debate at this time because the Debtors are requesting relief under § 105.

[43] *Mountain America Credit Union v. Skinner (In re Skinner)*, 917 F.2d 444, 447 (10th Cir. 1990).

[44] *In re Schott*, 282 B.R. 1, 5-6 (10th Cir. BAP 2002) (internal citations omitted); *accord Armstrong v. Rushton (In re Armstrong)*, 2004 WL 213808 *4 (10th Cir. BAP, Jan. 27, 2004) (bankruptcy courts have statutory authority pursuant to 11 U.S.C. § 105 to issue civil contempt orders).

[45] *See Reliance Insur. Co. v. Mast Construction Co.*, 159 F.3d 1311, 1315 (10th Cir. 1998).

[46] *Id.*

discharge, Staker/Parson continues to violate the discharge order by prosecuting the State Court Litigation.

In addition, this Court finds the testimony of Staker/Parson's credit manager disturbing. He acknowledged that the Corporation executed the Application. Why, then, did Staker/Parson pursue Heather Bushman if not to attempt to improperly leverage collection of the Corporate debt? Such willful conduct and overzealous prosecution is entirely inappropriate. While there might be some argument, given the complexities of the issues regarding the Guaranty, that Staker/Parson's conduct was willful as to Frank Bushman, the prosecution of Heather Bushman is clearly premised upon an attorney created legal theory having no basis in fact.

However, the Court is troubled by the Debtors' complete lack of evidence of actual damages suffered. The only testimony offered by the Debtors was admitted via affidavits. The affidavits do not allege any damages, costs or attorney's fees incurred in relation to Staker/Parson's violation of their discharge. Instead, the Debtors spent much of their briefing efforts and affidavits on laying groundwork for an award of punitive damages. The Court cannot award monetary sanctions for civil contempt without evidence of actual damages. And "[f]ailure to prove the existence of actual damages means that no punitive damages may be recovered."[47] While Staker/Parson is clearly in contempt for its disregard of the discharge injunction, this Court cannot sanction Staker/Parson because there is no evidence of damages incurred by the Debtors.

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[47] *Lowell Staats Mining Company, Inc. v. Pioneer Uravan, Inc.*, 878 F.2d 1259, 1267 (10th Cir. 1989). *See also* U.C.A. § 78-18-1(a) (2003) (stating "[e]xcept as otherwise provided by statute, punitive damages may be awarded only if compensatory or general damages are awarded"); *BMW of North America v. Gore*, 517 U.S. 559, 580 (1996) (discussing the relation between actual and punitive damages).

III. CONCLUSION

Based on the foregoing, the Court finds Staker/Parson has acted in violation of the injunction imposed by § 524 when it pursued its collection action against the Debtors in the State Court Litigation. Heather Bushman has no affiliation with the Corporation that completed the Application. Staker/Parson had no basis of recovery whatsoever against her. The personal Guaranty executed by Frank Bushman is an executory contract for financial accommodation which is extinguished as of the date of petition. While the actions taken by Staker/Parson to collect against the Debtors is a violation of the injunction following discharge, this Court cannot sanction them without proof of actual damages from the Debtors. Therefore, although the Court finds Staker/Parson in civil contempt, no sanctions will be assessed for lack of evidence. A separate order shall issue.

DATED this 17 of February 2004.

Judge Judith A. Boulden
United States Bankruptcy Judge

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SERVICE LIST

Service of the **Memorandum Decision** should be made by the Bankruptcy Noticing Center upon the following:

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