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UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT

In Re:
DAVID H. SAGERMAN and
ESTER M. SAGERMAN,
Debtors

Chapter 7 Case
#99-10536

DAVID H. SAGERMAN and
ESTER M. SAGERMAN,
Plaintiffs,
vs.
WALTER HERRMANN and
INGRID HERRMANN
Defendants.

Adversary Proceeding
#00-1052

INGRID HERRMANN,
Plaintiff,
vs.
DAVID H. SAGERMAN,
ESTER M. SAGERMAN, and
UNITED STATES OF AMERICA,
Defendants.

Appearances of Counsel:

James B. Anderson, Esq.
Rutland, VT
Counsel for Mr. & Mrs. Hermann

Christopher O' C. Reis, Esq.
Randolph, VT
Counsel for the Debtors

Douglas Wolinsky, Esq.
Burlington, VT
Chapter 7 Trustee

MEMORANDUM OF DECISION
DENYING DEFENDANTS' MOTION TO AMEND PLEADINGS

The cause before the Court is the *Motion to Amend Pleadings* (hereafter "Motion to Amend") [Dkt. 9-1] dated January 2, 2001 filed by the Defendants in Adversary Proceeding No. 00-1068, which has been consolidated herein. The Plaintiff, Ingrid Herrmann, filed a *Memorandum in Opposition to Motion to Amend* (hereafter "Opposition Memorandum") [Dkt. 16-1] dated January 4, 2001. A hearing was held on January 9,

2001 and this Court reserved ruling. Based upon the matters filed of record, arguments of counsel and applicable law, the Motion to Amend is denied.

Jurisdiction

This Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 157 and 1334.

Facts

On or about December 19, 1997, the Plaintiff, Ingrid Herrmann, filed a Complaint for Foreclosure against the Defendants, David H. Sagerman, Ester M. Sagerman, and the United States of America in the Windham County Superior Court in the State of Vermont. The Complaint alleged that the Sagermans were in default under the terms of a certain Mortgage Deed and Promissory Note pertaining to real property owned by the Sagermans. The Complaint sought relief in the form of a judgment of foreclosure of the equity of redemption of the Defendants in the real estate and an award of a deficiency judgment, in the event the sums recovered by the foreclosure sale were insufficient to satisfy the debt. The Defendants served an Answer essentially admitting the material allegations and asserting various defenses to the foreclosure sale, denying Plaintiff's entitlement to a deficiency claim, requesting leave to invoke a power of sale in the mortgage, requesting a full six month redemption period, and requesting any other relief found just and equitable by the state court. The Defendants did not raise as affirmative defenses any right to a set-off based upon alleged violations of consumer statutes or the automatic stay, nor any violation of Vermont's Licensed Lenders Statute.

According to the record, on or about March 9, 1998, the Defendants stipulated to a Judgment of Foreclosure, which issued on July 29, 1998. On April 7, 1999, the Defendant filed a motion in state court requesting an injunction against the pending public sale of the property and a revival and extension of the right of redemption for an additional 90 days. The state court denied the motion and noted that the Defendant had failed to set forth any facts which might call into question the validity of the stipulated judgment or demonstrate any inequity resulting from the conclusion of the sale as previously ordered. A Certificate of Non-Redemption and Writ of Possession was entered on April 19, 1999. The Order confirming the sale of the subject property to the Plaintiff Mortgagee was ultimately entered on May 3, 1999.

The Debtors, David H. Sagerman and Ester M. Sagerman, filed a voluntary petition under chapter 13 of Title 11 U.S.C. ("the Bankruptcy Code") on April 15, 1999, i.e., 4 days prior to the entry of the Certificate of Non-Redemption and Writ of Possession; the Debtors filed a chapter 13 Plan on April 26, 1999, and that Plan was confirmed, as amended, on July 30, 1999. The Chapter 13 Plan provided that the subject real property

would be marketed and sold within one year or that Ingrid Herrmann would be entitled to lift stay relief to sell the property, under 11 U.S.C. §362. The case was converted to chapter 7 on or about November 15, 2000. On December 1, 2000, the Debtors filed a Notice of Removal removing the state court foreclosure action to Bankruptcy Court, thereby instituting adversary proceeding no. 00-1068. On January 19, 2001, this Court entered its Order consolidating that proceeding with the pending adversary proceeding no. 00-1052.

In the Motion to Amend, the Debtors seek to amend their prior responsive pleading in the state court foreclosure action on the ground that the Debtors were without sufficient funds to retain counsel in the underlying action and thus had to defend the suit *pro se*. The Debtors contend that through the discovery conducted in the bankruptcy case and upon advice of counsel, they have additional claims and defenses which they now seek to assert in the foreclosure action. The Debtors' Motion to Amend seeks to change their responses so as to deny certain allegations that they admitted in their original Answer and to assert for the first time affirmative defenses claiming a right of set-off for alleged violations of unidentified consumer statutes, the automatic stay, and Vermont's Licensed Lenders law.

In her Opposition Memorandum, the Plaintiff Ingrid Herrmann objects to the Motion to Amend as misleading, untimely, illegal and unwarranted. The gravamen of the objection is that the requested amendments are barred by the principles of *res judicata* and that neither the Chapter 13 Plan nor the Judgment Order and Decree of Foreclosure entitle the Debtors to amend their responsive pleading in the foreclosure action at this late date.

Discussion

In support of their Motion to Amend, the Defendants argue that the proposed amendments are meritorious and that the principles of *res judicata* do not preclude allowing amendments to their Answer and Affirmative Defenses previously filed in the prior state court action after entry of final judgment and the passage of time. Defendants also assert that the applicable rules and case law indicate that leave to amend pleadings should be freely given. The Plaintiff opposes the proposed amendment as lacking merit and barred by *res judicata.*[1]

[1] It should be noted that the parties each assert that their opponent is raising claims or defenses that are not actually raised in the legal memoranda filed by the parties regarding the motion to amend. Additionally, while the Defendants' Motion to Amend seeks leave to assert "affirmative defenses and counterclaims" against the Plaintiff, no counterclaims are discussed in the Defendants' brief nor contained in the proposed Amended Responsive Pleading. This Court will not consider claims or defenses that are not contained in the pleadings before the Court.

While this Court agrees that a confirmed plan of reorganization is generally binding upon the parties and *res judicata* to subsequent challenges by debtors and creditors, *see* Sure-Snap Corp. v. State Street Bank, 948 F.2d 869 (2nd Cir. 1991), it is also well established that when Chapter 13 debtors convert their case to Chapter 7, the Chapter 13 plan is no longer in effect and the doctrine of *res judicata* does not bar further legal action. *See* In re Burba,, 42 F.3d 1388 (6th Cir. 1994); In re Pearson, 214 B.R. 156, 160 (Bankr.N.D.Ohio 1997); In re Peters, 44 B.R. 68, 73 (Bankr. M.D.Tenn. 1984); In re Doyle, 11 B.R. 110 (Bankr.E.D.Penn. 1981). However, a determination that the prior Chapter 13 plan does not bar the instant action pursuant to principles of *res judicata* does not undermine the preclusive effect of the prior state court judgment.

The doctrine of *res judicata* holds that a final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action. *See* Monahan v. New York City Department of Corrections, 214 F.3d 275, 284-85 (2nd Cir. 2000). It is well settled in this Circuit that "r*es judicata* is a salutary doctrine, judicial in origin, that reflects 'considerations of economy of judicial time and public policy favoring the establishment of certainty in legal relations.' " *See* Teltronics Services, Inc. v. Ericsson Telecommunications, 642 F.2d 31, 36 (2nd Cir. 1981), *quoting* Mitchell v. National Broadcasting Co., 553 F.2d 265, 268 (2nd Cir. 1977). Moreover, "Congress has specifically required all federal courts to give preclusive effect to state court judgments whenever the courts of the State from which the judgments emerged would do so." Kelleran v. Andrijevic, 825 F.2d 692, 694 (2nd Cir. 1987). This mandate extends to bankruptcy courts. Id. at 694. A state court judgment is thereby accorded the same preclusive effect in federal court as it would have within the state's courts under its laws. Id. Generally, a bankruptcy court may look behind a state court judgment only if that judgment was procured by fraud or collusion, or where the rendering court lacked jurisdiction. Id.; *see also* In re Slater, 200 B.R. 491, 495 (E.D.N.Y. 1996)(res judicata barred relitigating of state court foreclosure judgment).

To establish *res judicata*, a party must show that (1) the previous action involved an adjudication on the merits; (2) the previous action involved the same parties or their privies; and (3) the claims asserted in the subsequent action were, or could have been, raised in the prior action. Monahan v. New York City Department of Corrections, 214 F.3d at 285. Moreover, to determine the effect of a state court judgment, federal courts are required to apply the preclusion law of the rendering state. *See* Conopco, Inc. v. Roll International, 231 F.3d 82, 87 (2nd Cir. 2000). Indeed, the State of Vermont similarly recognizes and applies the doctrine of *res judicata* to bar relitigating claims or defenses that were or should have been raised in the previous litigation. *See* Russell v. Atkins, 679 A.2d 333, 335 (Vt. 1996). Based upon the record in this instance, it appears that the state court final judgment constitutes an adjudication on the merits, between the same parties or their privies, and that the

claims and defenses being proposed were or could have been raised in the prior action.

Of particular importance here is the fact that the Defendants seek to interpose claims and defenses that were available to them in state court under Vermont law. This is not an instance where a debtor or trustee seeks to raise defenses that were not available in the initial forum. *See, e.g.* In re American Sweeteners, Inc., 248 B.R. 271 (Bankr.E.D.Penn. 2000); *see also* In re Crispo, 1997 WL 258482 (Bankr.S.D.N.Y. May 13, 1997)(trustee precluded from challenging state court foreclosure judgment regarding defenses that were available in prior state court proceedings). Nor do the Defendants assert that the underlying stipulated final judgment was procured by fraud or collusion, or that the state court lacked jurisdiction over the foreclosure dispute. Rather, the Defendants assert that they did not raise the proposed defenses because they lacked sufficient funds to hire legal counsel to represent their interests fully. However, courts in this Circuit take a "dim view" of a party's efforts to avoid *res judicata* effects of a prior judgment on the grounds that it did not adequately present the case initially. *See* Teltronics Services, Inc. v. Ericsson Telecommunications, 642 F.2d at 35. Under both state and federal law applicable here, the Defendants are precluded from relitigating claims and defenses that were available to them in the underlying state court action.

Even assuming *arguendo* that principles of *res judicata* were inapplicable to this proceeding, the proposed amendments remain untimely and inconsistent with applicable law. This court recognizes that a liberal policy favoring amendments exists under the rules of this court and the civil procedure rules of the State of Vermont when a proposed pleading is legally sufficient. *Compare* In re Deltacorp, Inc., 179 B.R. 773, 776 (Bankr.S.D.N.Y. 1995) *and* Desrochers v. Perrault, 535 A.2d 334 (Vt. 1987). However, it is likewise a policy shared by both courts that a court's discretion to grant proposed amendments should be governed by concerns regarding undue delay, bad faith, futility of amendment and prejudice to the opposing party. *See* Browning Debenture Holders' Committee v. DASA Corp., 560 F.2d 1078 (2nd Cir. 1977); *see also* Perkins v. Windsor Hospital Corp., 455 A.2d 810 (Vt. 1982).

In the instant case, the Defendants seek to amend their Answer and Affirmative Defenses in the removed state court proceedings over two years after entry of the final judgment on July 30, 1998 and after their efforts to modify the effects of the final judgment by injunctive relief were denied by the state court in April, 1999. It is well settled that leave to amend a pleading after judgment is entered is not permissible until the judgment is set aside or vacated pursuant to relief from judgment rules. *See* National Petrochemical Company of Iran v. The M/T Stolt Sheaf, 930 F.2d 240, 244 (2nd Cir. 1991); Helm v. RTC, 84 F.3d 874 (7th Cir. 1996)(absent a meritorious and successful motion for relief from judgment, a motion to amend pleadings should not be considered); *see also* Premo v. Martin, 119 F.3d 764 (9th Cir. 1997)(motion to amend pleadings denied where movant had ample

opportunity to file amended pleading before court issued its final judgment); Patterson-Stevens, Inc. v. International Union of Operating Engineers, 164 FRD 4 (W.D.N.Y. 1995)(absent successful motion to vacate prior judgment, motion to amend pleading denied).

Therefore, for the foregoing reasons, the Motion to Amend is denied.

Rutland, Vermont
February 1, 2001

/s/ Colleen A. Brown
Colleen A. Brown
United States Bankruptcy Judge