UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

JUDGE BRENDAN LINEHAN SHANNON

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April 26, 2019

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Re: *In re Alex O. and Gladys C. Dahman*
Case No. 18-12199 (BLS) (Chapter 13)

Dear Counsel:

Before the Court is a dispute relating to a claim held by Tuoni Investments LLC ("Tuoni") against the Debtors Alex and Gladys Dahmen. Tuoni filed a proof of claim in the Debtors' Chapter 13 bankruptcy and the Debtors objected to that claim [Docket No. 17] (the "Objection"). Tuoni then filed a response [Docket No. 25], the Court held a hearing on the matter on March 26, 2019, and took the matter under advisement. For the reasons that follow, the Court will overrule the Objection.

In 1997, Tuoni lent the Debtors $40,000. The Debtors signed a Bond and Mortgage that gave Tuoni a security interest in their home [Claim No. 4] (the "Bond"). The Bond charged a 24% interest rate, repayable over ten years with a balloon payment coming due on the maturity date. Over the following ten years, the Debtors represent that they consistently made the $800 monthly payments, but they did not pay the $40,000 balloon in 2007. Because the payments only covered the accruing interest, the balance on the principal never decreased.

In 1999 the Debtors filed their first Chapter 13 petition. Tuoni filed a claim in that case for about $66,000 and the Debtors did not object.[1] The Court then confirmed the Debtors' Plan.[2] Two years later, the Debtors moved to convert the case to Chapter 7.[3] The Court granted the motion and

[1] Case No. 99-03577, Claim Number 4.
[2] Case No. 99-03577, Docket No. 27.
[3] Case No. 99-03577, Docket Nos. 41 and 43.

the case was converted. The Chapter 7 Trustee then filed a Notice of Abandonment of the Debtors' home.[4] Shortly thereafter, the Court granted a discharge and closed the case.[5] Again, over the course of the Chapters 13 and 7, no one objected to Tuoni's claim and the Debtors continued making payments. In all, they claim they have paid over $73,000 and have surrendered at least one car to satisfy the debt. They stopped payments altogether in 2007.

Nearly two decades after the original petition, the Debtors filed this Chapter 13 case. Tuoni again filed a proof of claim, this time seeking payment of the $40,000 principal on the same claim. The Debtors objected to the claim. They argue the interest rate in the Bond is illegal under Delaware's usury statute. They add that the statute capped the interest rate at 10% and, applying that rate over the ten-year period, the Debtors were only liable for about $64,000. Because they have paid more than that, they argue they are no longer liable for the claim. In reply, Tuoni argues the Debtors cannot raise the usury issue. It insists that because the Debtors did not object to the claim in the former bankruptcy, they cannot raise the usury defense now under principles of collateral estoppel and res judicata.

Res judicata bars a party from re-litigating an issue that was decided in a previous suit. To successfully invoke res judicata, Tuoni must establish three elements: "(1) a final judgment on the merits in a prior suit involving (2) the same parties . . . and (3) a subsequent suit based on the same cause of action." *Duhaney v. Attorney Gen. of U.S.*, 621 F.3d 340, 347 (3d Cir. 2010). Res judicata bars claims that were actually brought and those that could have been brought. *Id.* There is no dispute that the parties involved here are the same as in the last bankruptcy and that this dispute centers on the same claim. The only issue, therefore, is whether the claim in the former bankruptcy is a final judgment on the merits.

Under 11 U.S.C. § 502, a claim is deemed allowed unless a party in interest objects. A handful of courts have addressed questions similar to the one presented here: whether a claim is binding as res judicata when it passed through the former bankruptcy without an objection. Those courts considered whether a claim that had been deemed allowed for lack of an objection was "actually litigated," as necessary to give it res judicata effect.

By and large, courts have concluded that these types of claims are in fact binding.[6] In *Siegel v. Fed. Home Loan Mortg. Corp.*, the leading case on this issue, the 9th Circuit held that a claim that has been deemed allowed for lack of an objection has the same effect as one that has been allowed through a formal court order. It postulated: "what else can 'deemed allowed' mean? It must mean deemed allowed by the court."[7] The *Siegel* court admitted that there is some doubt about the finality of a claim when it could still be contested at a later time. However, it reasoned that those doubts "dissipate where, as here, the debtor has received [a] discharge and the bankruptcy has closed."[8]

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[4] Case No. 99-03577, Docket No. 47.
[5] Case No. 99-03577, Docket No. 50.
[6] *Siegel v. Fed. Home Loan Mortg. Corp.*, 143 F.3d 525, 529 (9th Cir. 1998); *EDP Med. Computer Sys., Inc. v. United States*, 480 F.3d 621, 626 (2d Cir. 2007); *Trustees of Operating Engineers Local 324 Pension Fund v. Bourdow Contracting, Inc.,* 919 F.3d 368, 381 (6th Cir. 2019).
[7] *Siegel*, 143 F.3d at 530.
[8] *Id.*

Consistent with the majority of other courts that have addressed this question, the Court finds that an uncontested proof of claim that has been allowed under section 502(a) is a final judgment on the merits for purposes of res judicata. The Court is persuaded by the reasons articulated by the 9th and 6th Circuits, which have observed that it would be "peculiar if the effect was that uncontested and allowed claims have less dignity for res judicata purposes than a claim which at least one party in interest thought was invalid."[9] The Debtors could have asserted a usury defense in the prior bankruptcy and they chose not to. When an affirmative defense, such as usury, is not timely set forward, courts generally deem the defense to be waived.[10]

The Court is profoundly sympathetic with the Debtors, who are on the unfortunate end of a likely unlawful windfall to Tuoni. To the extent there is a remedy or relief for Mr. and Mrs. Dahman, it may lie with state regulators or the Attorney General, but not with this Court.

The Court notes for the record that Tuoni's *in personam* claim against the Debtors was discharged in the Chapter 7. Tuoni therefore does not have a right to collect against the Debtors, but it does still hold a lien on their home.[11] Per the terms of Tuoni's Proof of Claim, the claim is capped at $40,000 and will not accrue any interest. The Court is bound to find that the claim from the former bankruptcy is binding for purposes of res judicata and that the usury defense has been waived. The Court notes for the avoidance of doubt, and notwithstanding § 1325, that the interest rate is fixed at 0% and the amount is capped at $40,000. For those reasons, the Objection to Tuoni's proof of claim is overruled. An appropriate order will issue.

Very truly yours,

Brendan Linehan Shannon
United States Bankruptcy Judge

cc: Michael B. Joseph, Esquire
Kathy Jennings, Attorney General of the State of Delaware

BLS/cmw

[9] *Local 324 Pension Fund*, 919 F.3d at 382.
[10] *Charpentier v. Godsil*, 937 F.2d 859, 863 (3d Cir. 1991); *see Fed. Deposit Ins. Corp. v. Ramirez-Rivera*, 869 F.2d 624, 626 (1st Cir. 1989) ("The defense of usury is an affirmative defense.").
[11] The Court recognizes that this may be cold comfort to the Debtors who paid a plainly usurious interest rate for ten years.