

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE**

In re:

Bk. No. 01-12829-JMD
Chapter 11River Valley Fitness One, L.P.,
Debtor

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MEMORANDUM OPINION

I. INTRODUCTION

This dispute arises from the Debtor's First Objection to Claims dated December 1, 2003 (Doc. No. 595) (the "Objection"), which included an objection to Claim No. 59 filed by Laconia Savings Bank (the "Bank") in the amount of \$3,962,801.43 (the "Claim"). In its Objection the Debtor objects to \$262,010.30 of the Bank's Claim as a late fee imposed on the entire loan balance after acceleration contrary to law and the terms of the loan documents. The Bank filed a response to the Objection on December 11, 2003 (Doc. No. 601), contending that the balance due on the loan was not due to acceleration but was on account of the loan maturing in accordance with its terms. The Bank also argues that the loan documents permit it to impose a late fee on the balance due as a final installment payment.

After a hearing on the Objection, the parties obtained several continuances while they attempted to resolve the dispute over the amount of the Bank's allowed claim. On April 16, 2004, Woodrow Fitness LLC, successor by merger to River Valley Fitness One, L.P., (hereinafter the "Debtor") and the Bank filed a stipulation agreeing that the amount of the disputed late charge was \$256,198.70 (Doc. No. 639) (the "Stipulation"). The parties agreed that the Bank's allowed claim would be \$3,960,872.15 if the disputed late charge was allowed and that the allowed claim would be \$3,704,673.45 if the disputed late charge was not allowed. Under the terms of the Stipulation, the parties agreed that the Court could decide the matter based upon the pleadings, memoranda and documents filed with the Court without the need for an evidentiary hearing.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. FACTS

On January 30, 2003, the Court valued the Bank's collateral for purposes of confirmation of a plan at \$2,218,878.00. See In re River Valley Fitness One, L.P., 2003 BNH 004. On April 18, 2003, the Bank elected under section 1111(b)(2) of the Bankruptcy Code¹ to have its allowed claim treated as a secured claim (Doc. No. 326) (the "Election"). On September 29, 2003, the Court entered an order confirming the Debtor's Third Amended Plan of Reorganization dated March 7, 2003 (Doc. No. 572) (the "Confirmation Order").

¹ In this opinion the words "Bankruptcy Code," "Code" or "section" and the symbol "§" shall refer to Title 11, United States Code, unless the context indicates otherwise.

The Debtor's obligation to the Bank arose out of a promissory note dated July 16, 1997 (the "Note"). Under the terms of the Note the Debtor could borrow up to \$3,600,000.00 in order to construct a fitness club facility in Lebanon, New Hampshire. Under the terms of the Note the Debtor would pay interest on a monthly basis until the completion of construction or May 1, 1998, whichever occurred first. If construction was not completed on or before May 1, 1998, the entire principal amount and any accumulated interest and cost was immediately due and payable. Upon the completion of the construction phase, and upon funding by the U.S. Small Business Administration of a term loan in the amount of \$970,000.00 (the "SBA Loan"), the Note would convert to a term loan of up to \$2,630,000.00 with monthly payments of principal and interest amortized over twenty years.

The Note provided:

In addition, the Lender may impose upon the Borrower a delinquency charge at the rate of 7% on each installment of principal or interest not paid before five (5) calendar days after such installment is due.

At the time the Note was executed the Bank provided the Debtor with a Statement of Finance Charges in accordance with the requirements of NH RSA 399-B (the "Disclosure"). The Disclosure contained the following statement:

2. Late Charges not to exceed seven percent (7%) of any installment of interest and principal, or any other amount due to Lender which is not paid or reimbursed within five (5) days of the due date thereof as more particularly provided in the Promissory Note of even date.

The parties do not dispute that the SBA Loan was never made and that the Note never converted to a term note in accordance with its provisions. Therefore, the Note became due on May 1, 1998, and on May 6, 1998, the Bank imposed a late charge of \$255,302.19 on the outstanding balance. The Debtor made a monthly payment of interest on May 22, 1998, and the

late charge was waived by the Bank on May 26, 1998. The Debtor continued to make monthly payments of interest. On August 31, 1998, the parties executed an agreement extending the maturity of the Note to February 28, 1999. The Debtor made monthly payments of interest through February 26, 1999. On March 5, 1999, the Bank imposed a late charge in the amount of \$253,884.82, but waived it on March 29, 1999, contemporaneously with the execution of a second agreement extending the Note's maturity to June 30, 1999. The Debtor resumed monthly payments on March 31, 1999. On July 29, 1999, the maturity of the Note was extended to February 29, 2000. On February 18, 2000, the maturity of the Note was extended until February 29, 2001, and on February 28, 2000, the Bank's notation "Note Renewal" was entered in the Bank's ledger. The Debtor then commenced monthly payments of principal and interest plus escrow payments to the Bank. Finally on November 27, 2000, the maturity of the Note was extended to February 28, 2002.

On March 9, 2001, the Debtor advised the Bank that the payment due March 10, 2001, and all future payments, would not be made. On March 19, 2001, the Bank sent a notice of default to the Debtor (the "Notice of Default"). The Notice of Default set forth requirements for the Debtor to comply with to avoid foreclosure and expressly provided that if the Debtor failed "to comply with the foregoing two (2) requirements or either of them, the Bank will declare the Promissory Note to be immediately due and payable" (emphasis added). On April 20, 2001, the parties entered into a Forbearance Agreement wherein the Bank agreed, subject to the provisions of the agreement, to forbear from exercising its rights until July 30, 2001, in order to allow the Debtor to attempt to sell the collateral (the "Forbearance Agreement"). Section 5.1.5 of the Forbearance Agreement expressly provided that "[t]he prior notice of default from Bank dated March 19, 2001 shall be continuing." On August 6, 2001, the Bank assessed the \$256,198.70 disputed late charge. On September 11, 2002, the Debtor filed its bankruptcy petition.

III. DISCUSSION

The Bank advances several arguments in support of the validity of the disputed late charge. First, the Bank contends that under Fed. R. Bankr. P. 3001(f) its proof of claim establishes a presumptive validity of its claim which the Debtor must rebut with “substantial evidence.” Even if the Bank is correct in its statement of the law, the Debtor is challenging the disputed late fee based upon the provisions of the loan documents and applicable law. The parties have agreed that the amount of the disputed late fee was correctly computed by the Bank and included in its proof of claim. The Debtor has presented a substantial argument questioning the lawful imposition of the disputed late charge and has overcome any presumption of validity.

The Bank argues that this case is different from most, if not all, of the cases cited by the Debtor because in this case the Note matured in accordance with its terms and not by acceleration. However, the stipulated record does not support the Bank’s argument. It is clear that the Bank and the Debtor extended the maturity or renewed the Note with the last extended date of maturity being February 28, 2002, or nearly seven months after the Bank imposed the disputed late charge. The Notice of Default threatened that “the Bank will declare” the Note to be immediately due and payable if the Debtor did not perform certain actions. However, the Debtor must have performed in a manner satisfactory to the Bank because one month after the Notice of Default the Bank entered into the Forbearance Agreement with the Debtor. The Forbearance Agreement expressly continued the terms of the Notice of Default, but did not alter the maturity of the Note. Upon the expiration of the term of the Forbearance Agreement, the Bank considered the entire balance of the Note due and payable although the Forbearance Agreement did not so provide and no evidence of an exercise of the right to accelerate the Note was provided in the stipulated record. Based upon the record before the Court, the Note became due on account of acceleration by the Bank.

Finally, the Bank argues that the laws of the State of New Hampshire apply to interpretation of the loan documents and that section 506(b) of the Bankruptcy Code has no application to its claim. The Bank is correct in its argument on applicable law. Because of the Election, the Bank's claim will be treated as a secured claim under section 506(a). The amount of the Bank's allowed claim will determine its interest in certain property of the Debtor's estate under the terms of both the confirmed plan and section 1111(b)(2). However, that allowed claim will be calculated as of the petition date. Therefore, section 506(b) does not apply to the determination of the Bank's allowed claim. However, section 502(b) requires that the elements of the Bank's allowed claim, including the disputed late charges, be enforceable in accordance with the agreement between the parties and applicable law. In this case, applicable law is the law of the State of New Hampshire and neither party has cited any New Hampshire statute nor case which would prohibit the collection of late fees in the manner claimed by the Bank. Therefore, the question is whether the agreement between the parties permits the Bank's claim for the disputed late charge.

The Bank points to the language in the Disclosure which provides that the late charge applies to any "installment of interest and principal, or any other amount due to Lender which is not paid or reimbursed within five (5) days of the due date" (emphasis added), and argues that the language cited contemplated the amount due upon maturity of the Note. However, the Bank's attempt to find support for its position in the language of the Disclosure is misplaced. The Disclosure is simply a document required under New Hampshire law to disclose to the borrower the terms of the agreement between the parties. It is not part of the agreement itself.² The terms of

² Neither party signed the Disclosure or otherwise adopted it as part of their agreement regarding the loan. Although the Disclosure was signed on behalf of the Debtor, the language immediately above that

the agreement between the parties regarding late charges must be found, if at all, within the four corners of the Note.

The language in the Note does not include the words “or any other amount” or any reference to reimbursement of or payment of anything other than installments of principal or interest. The parties have not directed the Court, and the Court has not found, any New Hampshire statute or case that either permits or prohibits the collection of late fees in the manner advanced by the Bank in its memorandum of law. However, cases in other jurisdictions construing substantially similar language have denied recovery of late charges on an accelerated balance. Some of those cases have been based upon the wording of the agreement between the parties and some have been based upon a conclusion that the imposition of late charges after a default constitutes an uncollectible penalty. See Security Mut. Life Ins. Co. of New York v. Contemporary Real Estate Assoc., 979 F.2d 329 (3d Cir. 1992) (holding Pennsylvania state law would apply and finding that the state supreme court would likely adopt the reasoning of In re Tavern Motor Inn, Inc.); In re Tavern Motor Inn, Inc., 69 B.R. 138 (Bankr. D. Vt. 1986) (holding that state law and the terms of the agreement prohibited the collection of late charges after default and acceleration); In re Rolfe, 25 B.R. 89, 94 (Bankr. D. Mass. 1982), aff’d on other grounds, 710 F.2d 1 (1st Cir. 1983) (finding that late charges after default unrelated to any added costs are an uncollectible penalty); LHD Realty Corp. v. Nat’l Life Ins. Co. (In re LHD Realty Corp.), 20 B.R. 722, 724-25 (Bankr. S.D. Indiana 1982), aff’d in part and reversed in part, 726 F.2d 327, 332 (7th Cir. 1984) (holding that late charges were permitted prior to default and acceleration, but not afterwards); Centerbank v. D’Assaro, 600 N.Y.S.2d 1015 (1993) (applying New York law in finding that after demand and

signature makes it clear that the Debtor was only acknowledging receipt of a copy of the Disclosure, not agreeing to any terms beyond those contained in the Note or other loan documents.

acceleration the debtor's right to make installment payments was terminated and no late charges on delinquent installments were collectible).

The language in the Note is substantively similar to the language in the promissory note in Tavern. The creditor in that case was oversecured and the bankruptcy court found that late charges would be allowable under section 506(b) of the Bankruptcy Code and were not prohibited under state law. Tavern, 69 B.R. at 141. Therefore, the decision was controlled by the agreement between the bank and the debtor in that case.³ Id. The bankruptcy court found that after default and acceleration the debtor was no longer required, or had the right, to pay monthly installments, but instead was required to pay the entire amount of the outstanding debt. The bank's position that it had the right to both accelerate the entire balance due on the promissory note and charge a late fee when that accelerated balance was not timely paid was found to be inconsistent with the terms of the agreement. Id.

The Court finds that the facts of this case are not distinguishable from those in Tavern and there is no provision of New Hampshire law which would dictate a different result based upon the agreement between the parties contained in the Note. Accordingly, the Debtor's objection to the Claim shall be sustained.

³ The promissory note in Tavern provided:

Borrower shall pay to the Note Holder a later (sic) charge of four (4) per cent of any installment not received by the Note Holder within fifteen (15) days after the installment is due.

IV. CONCLUSION

The Court shall enter a separate order sustaining the Debtor's Objection and allowing the Claim as a secured claim in the amount of \$3,704,673.45.

This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. The Court will issue a separate order consistent with this opinion.

ENTERED at Manchester, New Hampshire.

Date: May 5, 2004

/s/ J. Michael Deasy
J. Michael Deasy
Bankruptcy Judge