UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT

Filed & Entered
On Docket
January 3, 2014

In re:
Carol Jeanne Scafuro, **Chapter 13**
Debtor. **Case # 12-10902**

Carol Jeanne Scafuro,
Plaintiff, **Adversary Proceeding**
vs. **# 13-1006**
PennyMac Loan Services, LLC,
PennyMac Corp., Wells Fargo,
and CitiBank, N.A.,
Defendants.

ORDER

GRANTING DEFENDANTS' MOTION FOR ATTORNEY'S FEES, DENYING DEFENDANTS' MOTION FOR SANCTIONS UNDER RULE 9011, DENYING DEFENDANTS' MOTION FOR SANCTIONS UNDER 28 U.S.C. § 1927, AND SETTING SCHEDULE FOR PARTIES TO FILE DOCUMENTS REGARDING AMOUNT OF ATTORNEY'S FEES

On April 26, 2013, Carol Jeanne Scafuro (the "Plaintiff") commenced this adversary proceeding (the "AP") by filing a complaint challenging the validity of a proof of claim ("POC") filed in her bankruptcy case (doc. # 1) (the "Complaint"). On June 19, 2013, PennyMac Loan Services and PennyMac Corporation (collectively, the "Defendants") filed a motion to dismiss the proceeding, alleging that the Plaintiff had failed to state a claim upon which relief could be granted (doc. # 7) (the "Dismissal Motion"). The Plaintiff responded that the Court should deny the Dismissal Motion because she had pled her claims sufficiently to warrant relief (doc. # 9). On September 4, 2013, the Court granted the Dismissal Motion in its entirety, finding that none of the Plaintiff's claims were colorable in law or supported by arguable facts (doc. # 11).

In its order granting the Dismissal Motion, the Court found Count One of the complaint, that PennyMac "did not exist" and lacked the right to file a proof of claim, was without merit. The former argument was belied by the Plaintiff's subsequent assertion that PennyMac was made up of various corporate entities.[1] As to the latter argument, although the Defendants' POC lacked an affidavit affirming it had possession of the note on the date of the petition, on May 22, 2013, the Defendants permissibly amended their POC to so state. Thus, the Defendants had met their burden of proving entitlement to collect the debt. See In re Parker, 445 B.R. 301, 306 (Bankr. D. Vt. 2011); U.S. Bank Nat'l Ass'n v. Kimball, 2011 VT 81, ¶ 13, 190 Vt. 210, 27 A.3d 1087 (Vt. 2011). Finally, the Court found any argument that the Defendants lacked the right to enforce the note due to irregularities in mortgage assignments was wholly unavailing, as controlling law is clear that mortgages are merely "incident to the note." See Kimball, 2011 VT 81, ¶ 13.

The Court also rejected the Plaintiff's claims in Count Two of the Complaint – that the Defendants were liable under a predatory lending cause of action for granting the Plaintiff a loan she could not afford, and that the Plaintiff was entitled to rescind the transaction because the lender had failed to provide her with the required Truth in Lending disclosures. The predatory lending claim failed because the Plaintiff did not articulate a legal or statutory basis for that relief. The Court determined that the only conceivable source for such relief was the Vermont's Unfair and Deceptive Trade Practices Act ("UDTPA"), 9 V.S.A. § 2453 *et seq.*, and since the Plaintiff specifically identified a separate UDTPA cause of action in Count Three, the Court did not further address this claim in its analysis of Count Two. With respect to the Plaintiff's claim of a right to rescind, the Court ruled that the statute of limitations was clear and the Plaintiff's right to rescind had expired in 2010, three years after the loan transaction, long before the Plaintiff filed the instant AP. See Beach v. Ocwen Federal Bank, 523 U.S. 410, 417 (1998).

In Count Three of the Complaint, the Plaintiff alleged the Defendants had violated the UDTPA and the covenant of good faith and fair dealing. The Court held that the Plaintiff could not state a right to relief under these allegations because (1) the UDTPA does not provide for derivative liability, and none of the Defendants were the original lender; and (2) the covenant of good faith and fair dealing is a contractual obligation, and the Plaintiff had no contract with the Defendants, nor were the Defendants successors-in-interest to the original lender, as required to establish derivative liability under such a claim. See Harsch Props., Inc. v. Nicholas, 2007 VT 70 ¶ 18, 182 Vt. 196, 203, 932 A.2d 1045, 1051 (2007); Repucci v. Lake Champagne Campground, Inc., 251 F.Supp.2d 1235, 1241 (D. Vt. 2002); Metropolitan Life Ins. Co. v. Robertson-Ceco Corp., 879 F. Supp. 407, 410 (D. Vt. 1995).

On September 9, 2013, five days after the Court granted the Dismissal Motion, the Defendants filed a motion for sanctions pursuant to Federal Rule of Bankruptcy Procedure 9011 and 28 U.S.C.

[1] In their Dismissal Motion, the Defendants stated that the Plaintiff's attorney had agreed to withdraw the unfounded allegation that PennyMac did not exist. However, the Plaintiff's attorney never did so.

§ 1927, against the Plaintiff's attorney, Rebecca Rice, Esq. (doc. #14) (the "Sanctions Motion"). The thrust of the Plaintiff's attorney's response was that she did not amend or withdraw the Complaint after she received the initial Rule 9011 notice because, although she realized there were inaccuracies in the Complaint, she believed it would be futile to amend or withdraw the Complaint once the Defendants had filed the Dismissal Motion (doc. #15) (the "Response").[2]

Rule 9011 provides in pertinent part that sanctions may be awarded against an attorney who submits papers to a court containing "claims, defenses, and other legal contentions therein [which] are [not] warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law." See Fed.R.Bankr.P. 9011(b)(2), (c). Rule 9011 parallels Federal Rule of Civil Procedure 11, containing only such modifications as are appropriate in bankruptcy matters. In re Highgate Equities, Ltd., 279 F.3d 148, 151 (2d Cir. 2002). Accordingly, application of Rule 9011 is informed by Rule 11 jurisprudence. Id. The determination of whether to impose Rule 11 sanctions is committed to the court's sound discretion, Storey v. Cello, 347 F.3d 370, 387 (2d Cir. 2003), and courts should reserve Rule 11 sanctions for extreme cases of misconduct, see, e.g., Krauth v. Executive Telecard, Ltd., 870 F.Supp. 543, 548–49 (S.D.N.Y. 1994). In other words, the imposition of sanctions pursuant to Rule 11 is a dramatic measure. Knipe v. Skinner, 19 F.3d 72, 78 (2d Cir.1994).

In exercising its discretion as to whether sanctions are warranted under Rule 11, the Supreme Court has instructed that courts must focus not upon the attorney's subjective good faith belief, but rather upon whether the attorney's conduct was objectively reasonable under the circumstances. Business Guides v. Chromatic Communications Enters, Inc., 498 U.S. 533, 551 (1991). In cases where it is clear that a party's attorney should have known that there was no possibility of prevailing on the merits given the precedent against the claims, sanctions are necessary to deter such counsel from wasting the time and resources of the adversaries as well as the court. Cohen v. Bane, 853 F.Supp. 620, 629 (E.D.N.Y. 1994).

Here, the Plaintiff's attorney should have realized that the claims raised in the Complaint were barred by established law. For example, the Plaintiff's attorney should have known that the Plaintiff's claim of a right to rescind based on an alleged TILA violation was time-barred, as she raised this same issue in a different case recently – and this Court granted her adversary's motion to dismiss, on June 10, 2013, specifically because the claim was time-barred. See CM/ECF, Monty v. U.S. Bank, N.A., et al., Case No. 13-1004, doc. # 12 at 6-7. This factor is one she should have explored prior to filing the

[2] The parties acknowledged at the October 15th hearing that the Defendants served the Plaintiff's attorney with the notice required by Rule 9011(c)(1)(A) on June 18, 2013, and then filed the Dismissal Motion the next day, on June 19, 2013 (the last day for filing a timely response to the Complaint (see doc. # 5)). At that same hearing, the Court offered the parties an opportunity to supplement their pleadings and set a date for oral argument on the Sanctions Motion.

Complaint. An attorney's pre-filing investigation must include determining whether any obvious affirmative defenses, including a statute of limitations, bar the claim. White v. General Motors Corp., 908 F.2d 675, 682 (10th Cir. 1990). Sanctions are appropriate where the validity of an affirmative defense was so apparent that a plaintiff could not have advanced his or her position in good faith. See McLaughlin v. Bradlee, 803 F.2d 1197, 1205 (D.C. Cir. 1986); Cannon v. Loyola University of Chicago, 784 F.2d 777, 782 (7th Cir. 1986). In sum, the Plaintiff's attorney should not have filed claims that were barred by the applicable statute of limitation, unless she specified a basis for modifying current law, which she did not. Considering this standard, and given her experience in this area of the law, generally, and with the specific issues that have arisen in recent cases, the Plaintiff's attorney should have been aware that each of her claims was barred by either clear case law or a statute of limitations. Thus, her actions in this proceeding were not objectively reasonable.

It is also clear that an attorney's obligations under Rule 11 continue throughout the litigation. Thus, an attorney has a duty to withdraw claims that may have been tenable at the time of filing, if subsequent developments demonstrate that the claim is no longer viable. See Zola v. Gordon, 685 F.Supp. 354, 378 (S.D.N.Y. 1988); see also Nemeroff v. Abelson, 704 F.2d 652, 660 (2d Cir. 1983). Likewise, an attorney must withdraw a claim if he or she becomes aware of facts that undercut her client's right to relief under that claim. Hence, it was a violation of her duty to exercise due diligence for the Plaintiff's attorney not to have withdrawn claims once she had information categorically showing the Defendants exist, and again, after the POC was amended to include an affidavit of possession. That duty was not annulled when the Defendants filed the Dismissal Motion.

The Court also takes into account whether the attorney's conduct in this case appears to be an isolated event or part of a pattern of subpar conduct. Sadly, this is not an isolated event. Though prior incidents did not give rise to motions under Rule 9011, the Court granted motions holding the Plaintiff's attorney liable for her adversaries' attorney's fees in two other cases in just the last 11 months. See Green Mt Bureau v. McCoy (AP # 12-1024, doc. # 25) (motion for sanctions granted against this attorney for failing to comply with discovery order; she was required to pay opposing counsel's fees in the amount of $1,419.00); In re Wade (chapter 13 # 11-11008, doc. # 86) (motion for sanctions granted against this attorney for failing to timely perform items set out in Court's order; she was required to pay opposing counsel's fees in the amount of $687.50).

In addition to considering whether the attorney's conduct was objectively reasonable, whether she fulfilled her ongoing duty to ensure the claims had merit both prior to and after filing them, and whether the subject conduct is an isolated occurrence, this Court must also balance the severity of the sanction to be imposed against the gravity of the violation, mindful that Rule 9011 sanctions are to punish egregious misconduct that cannot be effectively addressed with a less severe penalty. See, e.g., Krauth, 870 F.Supp. at 548–49. While consideration of the objective factors suggests that a 9011 sanction may be warranted here, the Court must weigh subjective considerations in discerning whether a Rule 9011 penalty is necessary to deter this conduct in the future.

The Plaintiff's attorney has a well deserved reputation in this District as an excellent lawyer and a zealous advocate for her clients. The Court interprets her exasperation with the irregularities of the mortgage assignments underlying the POC in this case to be attributable to her deep concern for the financial well-being of her clients.[3] The purpose of Rule 11 sanctions is clearly circumscribed: it is to deter repetition of the deficient performance of professional responsibilities by this attorney, and by other similarly situated attorneys. See Fed.R.Bankr.P. 9011(c)(2). This is consistent with the general rule that courts should not impose sanctions any more severe than is reasonably necessary to achieve deterrence in the future. See, e.g., Kleehammer v. Monroe County, No. 09-6177, 2013 WL 1182968 (W.D.N.Y., March 20, 2013). This Sanctions Motion presents a close call on the issue of whether to impose Rule 9011 sanctions. To determine on which side of the line this case falls, the Court gives significant weight to its conclusions that the Plaintiff's attorney genuinely (though mistakenly) believed she could not withdraw or amend the Complaint after the Defendants filed the Dismissal Motion, she did not act in bad faith or motivated by a desire to harass the PennyMac Defendants, and her misconduct was not egregious. Additionally, since this is the first instance, of which the Court is aware, of the Plaintiff's attorney's conduct falling short of the requirements of Rule 9011, and since the aggrieved Defendants are publicly and aggressively seeking monetary redress from her, the Court believes something less than the imposition of a Rule 9011 sanction is necessary to deter this attorney from engaging in this type of conduct in the future. Thus, the Court will decline to impose Rule 9011 sanctions. The Court exercises its discretion in favor of the Plaintiff's attorney in this proceeding with an unequivocal admonition to her that if she engages in similar conduct in the future, the Court will interpret that as a signal that this award of only attorney's fees was not a sufficient deterrent and that it needs to impose Rule 9011 sanctions at that time.

The Defendants also seek damages under 28 U.S.C. § 1927, which provides "[a]ny attorney ... who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to

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[3] The Court is aware of the many difficulties debtors' attorneys frequently face when attempting to resolve their clients' payment or default disputes with some mortgage lenders, and when seeking to obtain clear, up-to-date documentation as to the ownership of mortgage notes. The instant proceeding may well be a situation of an attorney acting out of frustration against an industry whose sloppiness is having dire financial consequences on people who often cannot afford to enforce their rights. However, that frustration alone does establish a proper basis for commencing litigation.

satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct." To impose sanctions under 28 U.S.C. § 1927, a court must find clear evidence that the offending party's claims were entirely without color, and the claims were brought in bad faith – that is, motivated by improper purposes such as harassment or delay. Eisemann v. Greene, 204 F.3d 393, 396 (2d Cir. 2000); In re Costello, No. 03-11517, 2004 WL 2931665 at *6 (Bankr. D. Vt., November 18, 2004). The record does not support a finding that the Plaintiff's attorney brought the claims in this AP in bad faith, as required for relief under 28 U.S.C. § 1927.

By contrast, the record does demonstrate cause to grant the Defendant's motion for an award of compensatory attorney's fees because the Defendants incurred additional legal fees as a direct result of (1) the Plaintiff's attorney's assertion of claims that lacked a basis in law and/or were barred by an applicable statute of limitations, and (2) her failure to withdraw or amend the Complaint when she learned of facts that negated her clients' right to some of the relief sought in the Complaint. The Court will set the award of attorney's fees at a figure it deems sufficient to both reimburse the Defendants for the reasonable legal fees they incurred as a direct result of the Plaintiff's attorney's offending conduct, and to deter the Plaintiff's attorney from engaging in similar conduct in the future.

Accordingly, IT IS HEREBY ORDERED that:

1) the Defendants' Sanctions Motion is DENIED with respect to the request for sanctions under Rule 9011;
2) the Defendants' Sanctions Motion is DENIED with respect to the request for sanctions under 29 U.S.C. § 1927;
3) the Defendants' Sanctions Motion is GRANTED with respect to the request for compensatory relief, in the form of attorney's fees, in an amount yet to be determined;
4) by noon on January 9, 2014, the Defendants shall file an affidavit of fees and costs, supported by reliable evidence, pertaining to its defense of the Complaint and filing of the Sanctions Motion in this adversary proceeding, in a form consistent with the requirements of the Local Rules;
5) by noon on January 13, 2014, the Plaintiff's attorney shall file any objection she has to the reasonableness, scope, or amount of the fees and costs the Defendants seek pursuant to this Order; and
6) if the Court determines oral argument is necessary with respect to the amount of the fees to be awarded, and sets a hearing on the Sanctions Motion, the parties shall appear at that hearing at the U.S. Bankruptcy Court, in Burlington, Vermont, on January 14, 2014 at 2:30 p.m.

SO ORDERED.

January 3, 2013
Burlington, Vermont

Colleen A. Brown
United States Bankruptcy Judge