NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT

In re:	
Elena Maria Stevens,	**Chapter 7 Case**
Debtor.	**# 98-11181**
Raymond Obuchowski, Trustee,	
Elana Maria Stevens, and	
Pro Paving, Inc.,	
Plaintiffs,	**Adversary Proceeding**
vs.	**# 99-01040**
Poulin Grain, Inc., Jeffrey Poulin,	
Gary Phillips, David Redmond,	
and Lyndonville Savings Bank,	
Defendants.	

Counsel:	Lisa Chalidze, Esq. Miller, Faignant & Whelton, P.C. Rutland, Vermont *Attorneys for Trustee/Plaintiff*	John C. Gravel, Esq. Bauer, Anderson & Gravel Burlington, Vermont *Attorneys for Movant Defendants*

MEMORANDUM OF DECISION DENYING DEFENDANTS' MOTIONS FOR SANCTIONS

The matter before the court is the *Motion for Sanctions Pursuant to Bankruptcy Rule 9011* filed on May 18, 2000 by the defendants Lyndonville Savings Bank and Trust Co., David Redmond, Gary Phillips, and Jeffrey Poulin; and the request for excess costs, expenses and attorneys fees pursuant to 28 U.S.C. § 1927 set forth in the *Objection to Plaintiff's Motion to Amend Complaint* filed on April 10, 2000, by all of the defendants. For the reasons set forth below, both motions are denied.

JURISDICTION

This court has jurisdiction over the matter presented pursuant to 28 U.S.C. §§157 and 1334.

BACKGROUND

The debtor filed a petition seeking relief under chapter 7 of Title 11 U.S.C. ("the Bankruptcy Code") on August 7, 1998. On June 15, 1999, an adversary proceeding was commenced by Elana Stevens and Pro Paving, Inc. against Poulin Grain, Inc., Jeffrey Poulin, Gary Phillips, David Redmond and Lyndonville Savings Bank by the filing of a complaint under 28 U.S.C. § 1343, a federal civil rights statute, challenging the nature, extent and validity of a debt and related lien claimed by Lyndonville Savings Bank. The complaint also presented causes of action against one or more defendants for lender liability, contractual bad faith, breach of contract, negligence, deprivation of civil rights under 42 U.S.C. § 1983, punitive damages, and equitable subordination; and also included an allegation that a secured creditor violated its duty to act in a commercially reasonable manner.

After an *Answer and Affirmative Defenses* was filed on behalf of Jeffrey Poulin, Gary Phillips, David Redmond and Lyndonville Savings Bank, the plaintiffs filed a *Motion to Amend Complaint* on July 21, 1999, indicating that the "amendments are sought to clarify the party status of various interested persons and the claims they are asserting, as well as the statutory basis of jurisdiction." The Amended Complaint proposed to add Raymond Obuchowski, Trustee, as a party plaintiff, to delete any reference to 28 U.S.C. § 1343 and the civil rights claim under 42 U.S.C. § 1983, to modify certain underlying factual allegations, and to add a demand for jury trial. The Motion to Amend did not disclose that the jury demand being asserted in the Amended Complaint was untimely. The defendants' timely objection to the belated jury demand was sustained by the court (Krechevsky, J.), which otherwise allowed the amended pleading. Responsive pleadings filed by the defendants, denied any wrongdoing and raised various affirmative defenses.

On January 18, 2000, the plaintiffs, Trustee Raymond Obuchowski and Elana Maria Stevens, filed a *Motion to Dismiss without Prejudice and to Strike Adversary Proceeding Based on Lack of Jurisdiction Or In The Alternative Based on Doctrines of Federal Abstention* [Dkt. 38-1] (herein "Motion to Dismiss"). The plaintiffs' motion challenged the existence of their own adversary proceeding. It was set for hearing on March 14, 2000. In the interim, defendants filed their *Opposition* in response to the plaintiffs' Motion to Dismiss [Dkt. 44-1; 45-1] on or about February 1, 2000, and the defendants Jeffrey Poulin, Gary Phillips, David Redmond and Lyndonville Savings Bank, filed a *Motion for Summary Judgment* [Dkt. 46-1] on March 9, 2000. It is the motion papers and proposed pleadings arising from the hearing on the Motion to Dismiss that underlie the defendants' request for sanctions against plaintiff's counsel.

Pursuant to the March 14th hearing, this court (Krechevsky, J.) issued an Order simply and succinctly indicating that the motion to dismiss was "denied" [Dkt. 50-1]. The transcript of the proceedings is filed of record [Dkt. 63-1] and reflects that this court directed that the two original plaintiffs, Elana Maria Stevens and Pro Paving, Inc., should be dropped as parties to this adversary proceedings and that this court had jurisdiction over the dispute between the trustee and the various defendants. Plaintiff's counsel agreed to "reform the pleadings along those lines." [Tr., at p. 12]. Thereafter, the trustee plaintiff filed a *Motion to Amend Complaint Per Court Request Re: Inappropriate Parties* (herein "Motion to Amend Complaint") [Dkt. 52-1] and proposed *Second Amended Complaint* [Dkt. 51-1] on March 17, 2000. The Motion to Amend Complaint states that Judge Krechevsky "instructed plaintiff to conform the claims to the jurisdictional parameters identified by the court at the hearing on March 14, 2000."

In opposition to the Motion to Amend Complaint, the defendants filed their *Objection to Plaintiff's Motion to Amend Complaint* [Dkt. 56-1; 57-1], contending that in the motion and proposed pleading plaintiff's counsel (i) improperly attempted to materially alter the substance of plaintiff's claims against the various defendants by 38 new allegations, eliminating 7 prior allegations, altering 5 existing allegations, and removing the equitable subordination claim in an effort to overcome purported

shortcomings in the existing Amended Complaint and to undermine the defendants' pending summary judgment motion, (ii) titled the motion in a way that reflected a deliberate attempt to mislead the court and to conceal the substantial alterations in the proposed pleadings well beyond merely removing the inappropriate parties, (iii) substantively revised the complaint with allegations that were knowingly false, (iv) proposed a Second Amended Complaint that was untimely and did not comply with the applicable Bankruptcy Rules and Federal Rules of Civil Procedure, and (v) filed the motion and pleading in bad faith. Defendants requested that the Motion to Amend be denied and sought sanctions against plaintiff's counsel pursuant to Rule 11, FRCP, as well as an award of excess costs, expenses and attorneys fees allegedly resulting from counsel's unreasonable and vexatious tactics, pursuant to 28 U.S.C. § 1927.

Following the hearing held on May 9, 2000 to consider the Motion to Amend Complaint and the defendants' opposition thereto, I entered an Order denying the Motion to Amend Complaint except to the extent it deleted the two plaintiffs [Dkt. 75-1]. I noted on the record that I was "very disturbed by what appears to be, at best, unclear disclosure or lack of disclosure in the motion papers as to the changes that were presented" in the proposed Second Amended Complaint. [Dkt. 69-1, at pp. 13-14] However, I denied without prejudice defendant's request for sanctions under Rule 11 as contained within Defendants Objection to Plaintiff's Motion to Amend Complaint, on the grounds that it was procedurally defective (because the request for sanctions was not set forth in a separate document). [Dkt. 69-1 at p.14].

On May 18, 2000, the defendants filed a *Motion for Sanctions Pursuant to Bankruptcy Rule 9011* [Dkt. 71-1] (herein "Motion for Sanctions") restating the allegations outlined above and concluding that the filing of the Motion to Amend Complaint and proposed Second Amended Complaint by plaintiff's counsel was frivolous and constituted a deliberate attempt to deceive the court, in violation of Rule 9011. The Motion for Sanctions was not served upon plaintiff's counsel 21 days before it was filed with or presented to this court as required by the "safe harbor" provision of Rule 9011(c)(1)(A). Defendants' counsel contend that they should be relieved of the 21-day requirement in this instance because prior notice

was effected pursuant to their previous [unsuccessful] request for Rule 11 sanctions and because the need for any further notice is obviated by this previous notice and the denial of Plaintiff's Motion to Amend Complaint. Defendants also filed an accompanying *Affidavit of Counsel in Support of Defendants' Motion for Sanctions Under Rule 9011* [Dkt. 72-1] seeking an attorney's fee award against plaintiff's counsel in the amount of $3,900.

In response, plaintiff filed an *Opposition to Defendants' Motion for Sanctions* [Dkt. 77-1] (herein "Plaintiff's Opposition") on May 30, 2000, and also filed a *Restated Motion to Amend Complaint Per Court Request Re: Inappropriate Parties and Amendments to Conform to the Evidence* [Dkt. 78-1] (herein "Restated Motion to Amend") on June 2, 2000, within 21 days after service of the Motion for Sanctions. In an attempt to support the previous Motion to Amend Complaint and the proposed Second Amended Complaint, plaintiff's counsel states *inter alia* that despite his denial of the Motion to Dismiss on jurisdictional and other grounds, during the March 14th hearing "Judge Krechevsky agreed that this court lacked jurisdiction over much of the suit, and indicated that deletion of the inappropriate parties was necessary." [Plaintiff's Opposition, at pp. 2-3]. Plaintiff's Opposition brief also states that "counsel had no alternative but to file the Second Amended Complaint in the Bankruptcy Court." Plaintiff's counsel contends that despite the fact that the original Motion to Amend Complaint stated that the proposed amendments would promote conformity "by removing extraneous material from the instant proceeding" and never referenced the various new allegations and other substantive changes contained in the proposed amended pleading, "plaintiff's counsel was meticulous in revising and amending the complaint in such a way that it did not mislead the court." [Plaintiff's Opposition, at p. 26].

Plaintiff's Restated Motion to Amend indicates that plaintiff seeks to amend the complaint in accordance with Rule 15 FRCP and the court's ruling at the March 14th hearing, and to cure the alleged defects in its prior motion papers identified by the defendants' Motion for Sanctions, within the 21-day safe harbor provisions of Rule 9011. The Restated Motion expressly provides that in addition to deleting the

two original plaintiffs, "plaintiff also seeks to amend the factual allegations and counts in the complaint to conform to evidence adduced during discovery." [Restated Motion, at para. 4]. This assertion is new and is what distinguishes this pleading from one that violates Rule 9011.

Defendants filed an *Objection to Restated Motion to Amend Complaint Per Court Request Re: Inappropriate Parties and Amendments to Conform to the Evidence* [Dkt. 81-1] (herein "Objection to Restated Motion") on June 15, 2000 incorporating by reference their prior Objection, and also indicating that the prior Motion to Amend Complaint had been denied and that the Restated Motion provided no new basis for allowing the proposed Second Amended Complaint.

A hearing was held on June 20, 2000 regarding the Motion for Sanctions and Restated Motion to Amend. The hearing transcript is filed of record [Dkt. 87-1] and reflects that I denied the Restated Motion on the merits, based upon my prior ruling on the original Motion to Amend. I also acknowledged on the record that it was clear to me that the Restated Motion to Amend was only filed to cure the allegedly offending defects identified in the Defendants' Rule 9011 motion and to comply with the Rule 9011 safe harbor provision. I reserved decision on the request for sanctions. On July 24, 2000, plaintiff filed a *Supplemental Memorandum in Opposition to Defendant's Motion for Sanctions* [Dkt. 86-1] reasserting plaintiff counsel's defense of the subject Motion to Amend Complaint and proposed Second Amended Complaint and attempting to distinguish cases relied upon by defendants.

DISCUSSION

Bankruptcy Rule 9011(c)(1)(A) provides:

> The motion for sanctions may not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected...

This so-called "safe harbor" provision is a mandatory procedural prerequisite for seeking sanctions under the rule and sanctions imposed without compliance with this provision are subject to reversal. *See* Hadges v. Yonkers Racing Corp., 48 F.3d 1320 (2nd Cir. 1995); Photo Circuits Corp. v. Marathon Agents, Inc., 162 FRD 449 (E.D.N.Y. 1995); *see also* In re Coones Ranch, 7 F.3d 740 (8th Cir. 1993)(law interpreting Rule 11 is applicable to Rule 9011 cases). In this matter, the defendants failed to comply with the Rule 9011 safe harbor provision before filing the subject Motion for Sanctions. Since compliance with this requirement is mandatory, an award of sanctions herein is impermissible, regardless of the merits of the sanction request. While plaintiff's counsel indicated at the June 20, 2000 hearing that she might waive the 21-day safe harbor requirement as it pertains to the *Second Amended Complaint* and her trial counsel indicated that plaintiff's counsel "will not press an objection to not getting the Safety Harbor [sic] 21 days," this does not persuade me that plaintiff's counsel was waiving all rights to protection under the safe harbor provisions. *See* Transcript of Hearing, at pp. 9-10. In light of the need for compliance with the procedural safeguards of the safe harbor provision before the imposition of sanctions in this circuit, *see* Hadges v. Yonkers Racing Corp., 48 F.3d 1320 (2nd Cir. 1995), I will require strict compliance with Rule 9011in the interests of due process and fundamental fairness as a prerequisite to the awarding of sanctions in this court. In this case the Plaintiff's Restated Motion to Amend, which was filed during the safe harbor period, clearly indicates that the proposed Amended Complaint would amend the complaint by dropping inappropriate parties and altering existing counts and factual allegations. This latter disclosure is what was so conspicuously absent from the original Motion to Amend. Thus, the defendants' notice to plaintiff's counsel was efficacious. In fact, the purpose of the safe harbor provisions, namely to obviate the need for sanction proceedings, might have been accomplished prior to the hearing if the defendants' had properly served its 9011 motion.[1]

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[1] Defendants' counsel indicated at the May 9th hearing that they did not intend to actually make a request for sanctions under Rule 11 but rather to provide this court with the grounds it might rely upon so that the court could impose sanctions. Thus, the defendants thereafter found themselves in a situation where they felt they had given plaintiff's counsel notice without ever actually filing a request for sanctions themselves. The more appropriate

The Order denying the Motion to Amend Complaint and the prior unsuccessful request for sanctions, which was not made separately from other motions nor served 21 days in advance in accordance with Rule 11 and Bankruptcy Rule 9011, cannot provide the basis for excusing the requisite notice as the prior sanction request itself was defective. *See* Corley v. Rosewood Care Center, Inc., 142 F.3d 1041, 1058 (7th Cir. 1998)(reversing Rule 11 sanction award where motion neither complied with safe harbor requirements nor was presented in a separate motion). However, I want to emphasize that it was not an exercise in futility for the defendants to file the 9011 Motion for Sanctions (in a separate document and in compliance with the the Rule 9011 requirements) because clearly there were serious questions raised here which appeared to fit within the scope of 9011 and if the plaintiff's counsel had not remedied the lack of disclosure, defendants may well have prevailed. Moreover, it should be made clear that the filing of a defective motion for sanctions does not mean that sanctions must be denied *de facto*, but rather that the rule's procedural safeguards must be complied with and that sanctions can be awarded only in those instances where after being given the 21 day opportunity counsel does not retract or remedy the filed document with the Rule 9011 defect.

While this court certainly may impose appropriate sanctions on its own initiative, *see* Morley v. Ciba-Geigy Corp., 66 F.3d 21 (2nd Cir. 1995); Rule 9011(c)(1)(B), the fact that the plaintiff's counsel eventually did remedy the offensive format of the original Motion to Amend Complaint within the time frame set forth in Rule 9011, once she had the requisite notice of the Motion for Sanctions, mitigates against the imposition of sanctions by the court under Rule 9011.[2] *See* Tri-Tech Machine Sales, Ltd. v. Artos Engineering Co., 928 F.S. 836, 840 (E.D.Wis. 1996)(appropriate correction of a challenged filing

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procedure would have been for the defendants to comply with Rule 9011 from the outset, but the court recognizes that the procedural posture was indeed awkward after the filing of the pleading which appeared to request Rule 11 sanctions.

[2] While Defendants apparently also seek to impose sanctions upon Plaintiff's counsel for filing the proposed Second Amended Complaint in conjunction with the Motion to Amend, the Motion to Amend was the operative motion and the Amended Complaint never became effective as a pleading.

within safe harbor period shields against sanctions); *see also* Cowle v. Paine Webber, Inc., 1999 U.S. Dist. LEXIS 4702 (S.D.N.Y., Apr. 6, 1999)(denying sanctions request and refusing to sanction on court's own motion where moving party failed to comply with safe harbor provision).

Defendants also seek sanctions in the form of an award of excess costs, expenses and attorneys fees, pursuant to 28 U.S.C. § 1927. However, this specific relief may not be available in bankruptcy court. *See* In re Courtesy Inns, 40 F.3d 1084 (10th Cir. 1994); In re Volpert, 110 F.3d 494 (7th Cir. 1997); *but see* In re Kliegl Bros., 238 BR 531 (Bankr. E.D.N.Y. 1999). Even if relief under §1927 for unreasonably and vexatiously multiplying proceedings is available in bankruptcy court, the record in this matter does not support a finding that the Motion to Amend Complaint and proposed Second Amended Complaint are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose such as delay. *See* In re Cohoes Industrial Terminal, Inc., 931 F.2d 222 (2nd Cir. 1991).

Similarly, while 11 U.S.C. § 105 also provides a possible basis for the type of relief that the defendants seek, the authority for the imposition of sanctions by this court under § 105 generally applies prospectively to empower bankruptcy courts to take action "to prevent an abuse of process" rather than retroactively. *See* In re Kliegl Bros., 238 BR 531 (Bankr. E.D.N.Y. 1999). Moreover, while the conduct of plaintiff's counsel in this case has often been on the borderline of ethical propriety, it is my position that the extraordinary equitable powers under §105 should only be utilized to impose sanctions not available under Rule 9011 in those instances where conduct is unequivocally over the line. It would also appear inappropriate to invoke §105 in these particular circumstances in light of the remedial motion paper filed by the plaintiff. Hence, the sanctions the defendants seek will not be awarded under §105 either.

In summary, my determination that the Defendants' Motion for Sanctions must be denied because it fails to meet the procedural requirements of Rule 9011(c)(1)(A), §1927 and §105 should not be read as an indication that the sanction request lacked substantial merit or that I am not otherwise very troubled by the manner in which the proposed amendments were presented. The original notice of motion, at the very

least, failed to provide appropriate or even minimally sufficient disclosure. However, defendants' right to sanctions must defer to plaintiff's counsel's right to fundamental due process.

CONCLUSION

Based upon the defendants' failure to initially provide plaintiff's counsel with the "safe harbor" notice required under Rule 9011 and in light of the satisfactory remedial pleading ultimately filed by plaintiff's counsel, both the *Motion for Sanctions Pursuant to Bankruptcy Rule 9011* filed by the defendants Lyndonville Savings Bank and Trust Co., David Redmond, Gary Phillips, and Jeffrey Poulin, and the request for excess costs, expenses and attorneys fees pursuant to 28 U.S.C. § 1927 set forth in the *Objection to Plaintiff's Motion to Amend Complaint* filed by all defendants, are denied.

January 16, 2001
Rutland, Vermont

Colleen A. Brown
United States Bankruptcy Judge