

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE: *
* CASE NUMBER 04-41352
RANDALL JOSEPH HAKE and *
* MARY ANN HAKE, *
* CHAPTER 11 *
* Debtors. *
* HONORABLE KAY WOODS *
*

ORDER IMPOSING SANCTIONS IN RESPONSE TO
ORDER TO APPEAR AND SHOW CAUSE

On December 7, 2005, this Court held a hearing (the "Hearing") on its Order to Appear and Show Cause ("Show Cause Order") directed to Buckeye Retirement Co., L.L.C., Ltd. and its legal counsel (collectively, "Buckeye Retirement"). The Show Cause Order was issued for Buckeye Retirement to show cause why it should not be sanctioned for filing Motion for Leave of Court to File Adversary Proceeding and Memorandum in support thereof (the "Motion for Leave"), which had been filed on October 28, 2005. Buckeye Retirement appeared at the Hearing and was represented by F. Dean Armstrong. Buckeye Retirement presented testimony through Victor O. Buente, Jr. ("Mr. Buente"), in-house legal counsel for Buckeye and the counsel that had filed the Motion for Leave.

In the Motion for Leave, Buckeye Retirement sought leave of this Court to initiate an adversary proceeding to recover alleged property of the estate, namely, certain contributions that Debtor Randall J. Hake ("Debtor") had made to a 401(k) account. The Motion for Leave alleged that contributions in the amount of Two Thousand Five Hundred Dollars (\$2,500.00) had been made to a 401(k) account and that such contributions constituted property of the estate. In support of the Motion for Leave, Buckeye Retirement relied on

11 U.S.C. § 541(a)(7) and 11 U.S.C. § 1115.

A hearing was held on the Motion for Leave on November 16, 2005. At that time, this Court denied the Motion for Leave, citing 11 U.S.C. § 541(a)(6) as exempting the Chapter 11 Debtor's post-petition earnings from property of the estate and stating that 11 U.S.C. § 1115 was not applicable to the instant proceedings since it was a new statute encompassed within the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") that was applicable only to cases filed on or after October 17, 2005. The Court also noted that the Motion for Leave failed to show why Buckeye Retirement was entitled to have leave granted, as set forth by the Sixth Circuit Court of Appeals in *Canadian Pacific Forest Products Ltd. v. J.D. Irving, Ltd. (In re The Gibson Group)*, 66 F.3d 1436, 1438-39 (1995). Buckeye Retirement had been apprised of this Court's requirement that it follow *The Gibson Group* test in filing motions for leave to bring adversary proceedings on behalf of the estate because the test was expressly explained in this Court's Memorandum Opinion and Order dated September 30, 2005 in *Buckeye Retirement Co., L.L.C., Ltd. v. Randall J. Hake, et al.* (the "September 30, 2005 Order"), Case No. 04-4189, a companion adversary case to this Chapter 11 case.

At the Hearing, Mr. Buente identified himself as an attorney licensed to practice in Ohio, Pennsylvania and West Virginia. He said that he had practiced approximately twenty-five (25) years as an attorney, and that he had worked for Buckeye Retirement Co. L.L.C., Ltd. and its affiliates for the past thirteen (13) years. Mr. Buente testified that he had reviewed the Debtors' operating reports and observed that Debtor was receiving regular

payroll checks from Cedarwood Development. He stated that at some time he noticed Five Hundred Dollar (\$500.00) deductions were being taken from the payroll checks and being deposited in a 401(k) account for Debtor. Mr. Buente testified that he conducted legal research for a "full day" or perhaps two full days, which led him to form a belief that the deductions were improper because Debtor's earnings from Cedarwood Development were property of the estate.

Mr. Buente further testified that, based on his research, he believed that 11 U.S.C. § 541(a)(7) applied to make Debtor's payroll checks property of the bankruptcy estate and that he did not believe that § 541(a)(6) applied. Mr. Buente stated that he formed this belief because of his "literal" reading of § 541(a)(6). Mr. Buente further testified that he also "looked" at § 1115 of BAPCPA in forming this belief.

As a consequence, Mr. Buente stated that he sent three letters to counsel for Debtors in which he demanded that Debtor stop making contributions to the 401(k) account and that Debtor obtain the return of the contributions previously made. The first of these letters, which was dated August 24, 2005, requested a response by August 31, 2005. The August 24, 2005 letter contained only one case citation, *i.e.*, to *In re Keating*, 298 B.R. 104 (Bankr. E.D. Mich. 2003), which is a Chapter 13 case rather than a Chapter 11 case. When no response was forthcoming, Mr. Buente sent a second letter dated September 16, 2005 making the same demand. The September 16, 2005 letter was sent to counsel for Debtors by fax at 1:55 p.m. that day. This letter contained no statutory or case citation and merely referenced the fact that the Debtors had "disregarded" his request in the first letter. This letter also requested a reply within one

week (by September 23, 2005). Approximately an hour later (letter faxed at 3:07 p.m. on September 16, 2005) counsel for Debtors responded by stating that Debtor had not made any further contributions to the 401(k) plan since Mr. Buente had sent the first letter. The response did not address the issue of seeking return of the contributions already made. On September 21, 2005, Mr. Buente sent a third letter to counsel for Debtors, which stated that cessation of the 401(k) contributions was a "step in the right direction," and urged Debtor to "endeavor" to retrieve the contributions already made. Mr. Buente asked counsel to inform him if Debtor was going to seek return of those contributions. Unlike the first two letters, the third letter did not demand a response by a specified date, nor did it say that Buckeye would "bring this matter to the Court's attention" if a response was not forthcoming. In the third letter, Mr. Buente stated that: "[Debtor's] post-petition earnings are property of the estate under 11 U.S.C. §115(a)(2)." Mr. Buente did not refer to any other statutory or case citation.

Mr. Buente testified that he viewed the September 16 response from Debtors' counsel as "acknowledging" the correctness of Buckeye Retirement's position. Mr. Buente stated that there was no response to the third letter and that at no time did counsel for Debtors cite to him any legal authority that was contrary to Buckeye Retirement's position. Based on what he characterized as three demands and no response, Mr. Buente testified that he filed the Motion for Leave on October 28, 2005. Prior to filing the Motion for Leave, Mr. Buente said that he showed a draft to Peter Barta¹

¹Mr. Barta is employed by Buckeye Retirement as an account manager, but he is not an attorney.

and Mr. Armstrong.²

Mr. Buente testified that the Motion for Leave was not filed for any improper purpose and not for the purpose of harassing the Debtors or to cause unnecessary delay. Mr. Buente further testified that, although he did not refer to or address all of the elements of *The Gibson Group* test, three of the four elements were addressed in either the motion itself or the exhibits thereto.

Despite not citing or referring to *The Gibson Group*, Mr. Buente insisted that he did not ignore or disregard the applicable test. He stated that he considered all of the factors, but he "simply did not think to address the cost benefit analysis." Mr. Buente testified that it was a matter of "instinct" or "training" for Buckeye Retirement to go after someone that has

²At the Hearing, Mr. Armstrong told the Court that Buckeye Retirement looked to him for litigation strategy (even though at the relevant times in question, he had not made an appearance on behalf of Buckeye Retirement with this Court) and that he had reviewed that Motion for Leave prior to it being filed. As a consequence, Mr. Armstrong suggested that if anyone should be sanctioned for the Motion for Leave, it should be him rather than Mr. Buente. Mr. Armstrong failed to address the fact that Mr. Buente, rather than himself, was the signatory on the Motion for Leave.

"wronged" Buckeye Retirement. As a consequence, Mr. Buente stated that Buckeye Retirement would shoulder the cost of the litigation that it sought leave to file. Because Buckeye Retirement was not going to seek attorney's fees in the proposed litigation, Mr. Buente stated that he didn't think there would be any cost to the estate.³ Mr. Buente further stated that, if he had it to do over again, he would include a cost benefit analysis in the Motion for Leave and state therein that Buckeye Retirement would pay the costs of such litigation. Mr. Buente testified that he addressed three of the four elements in *The Gibson Group*, i.e., there was a colorable claim, Buckeye Retirement had made a demand, and Debtor had unjustifiably refused to comply with the demand. Mr. Buente insisted that the only element missing from the Motion for Leave was the cost benefit analysis.

Mr. Buente testified that the response from counsel for Debtors did not mention any Rule 11 violation and that such counsel did not provide him with any contrary authority.⁴

Although the Court stated that cases that had not been cited by Buckeye Retirement in the Motion for Leave were not relevant to the Show Cause Hearing, Mr. Armstrong argued that *In re Herberman*, 122 B.R. 273 (Bankr. W.D. Texas 1990) and *In re Harp*, 166 B.R. 740 (Bankr. N.D. Ala. 1993) provided the basis that the argument in the Motion for Leave was "nonfrivolous" and, thus,

³This statement is belied by the draft Complaint attached as Exhibit H to the Motion for Leave in which Buckeye Retirement prays for an award of attorney's fees. Mr. Buente also overlooked the fact that Debtor would be the defendant in this action and would likely hire legal counsel to defend him. Since this Chapter 11 case involves Debtors, as individuals, any litigation costs of the Debtors would have an impact on the Chapter 11 estate.

⁴Counsel for Debtors stated that he didn't research and provide authority in response to the letters from Buckeye Retirement because he was trying to minimize the cost to the Debtors' estate.

sanctions were not warranted under FED. R. CIV. P. 11 (made applicable to these proceedings through FED. R. BANKR. P. 9011).

Having reviewed the pleadings in this case, and having heard arguments of counsel and testimony of the witness, this Court does not find Mr. Buente to be credible. Although he states that he had a good faith belief in the legal position underlying the Motion for Leave, the authority on which such position is based fails to support it. First, as pointed out by the Court in the Order Denying Motion of Buckeye Retirement Co., L.L.C., Ltd. for Leave to File Adversary Proceeding for Turnover of Property (the "Denial Order"), 11 U.S.C. § 1115 doesn't apply to the case at bar. Accordingly, reliance on this statute cannot form a good faith basis for Buckeye Retirement's legal position. Second, Buckeye Retirement cites 11 U.S.C. § 541(a)(7) in contending that the post-petition paychecks of the Debtor are property of the bankruptcy estate. Although not cited in the Motion for Leave, Buckeye Retirement now contends that Mr. Buente relied on *Herberman* and *Harp* in forming the opinion that property of the estate encompassed all of Debtor's post-petition earnings. Mr. Armstrong argued that the *Herberman* and *Harp* bankruptcy judges were wise and learned and, thus, Mr. Buente was justified in relying on their opinions. The problem is that neither of these cases provides the support needed to find that the Motion for Leave is not frivolous. In *Herberman*, Judge Leif Clark generally held that post-petition income from a sole proprietorship came within the definition of property of the estate, as set forth in § 541(a)(7).⁵ However, in explaining his analysis,

⁵This case has been generally criticized and one of only two cases to follow it is *In re Harp, supra*.

Judge Clark specifically stated:

In fact, the approach is easiest in the case in which the debtor is *not* a sole proprietor, for there, the debtor is *not* working for the estate, but for some third party. In that case, *all* of the debtor's income is insulated from "property of the estate" because it is not the debtor's business being operated by the estate. Section 541(a)(7) is thus not implicated.

Herberman at 286, n.19 (emphasis in original).

The instant facts are exactly as spelled out in Judge Clark's footnote. Here the Debtor is not working for the estate, but is working for a third party - Cedarwood Development - and, according to *Herberman*, all of Debtor's post-petition earnings would fall outside the definition of property of the estate. Accordingly, § 541(a)(7) - the section Buckeye Retirement relies on in the Motion for Leave - is not implicated. *In re Harp* relies heavily on the *Herberman* analysis and adopts Judge Clark's "well-reasoned and well-articulated" analysis, which presumably includes footnote 19. *In re Harp* at 753. Moreover, the facts in *Herberman* and *Harp* are distinguishable from the facts in the instant case. Thus, this Court cannot find that Buckeye Retirement had (i) a good faith belief for its position in the Motion for Leave or (ii) a colorable claim in asserting that all of Debtor's post-petition earnings were property of the bankruptcy estate.

Mr. Buente is also not credible in stating that the Motion for Leave was not interposed for the purpose of harassment or delay. Taking the case as a whole, the conduct of Buckeye Retirement amounts to harassment. So far in this case, Buckeye Retirement has (i) filed almost fifty (50) motions for Rule 2004 exams;

(ii) objected to Debtors setting a bar date; (iii) objected to the extension of the Debtors' exclusivity period; (iv) sought the imposition of a Chapter 11 trustee; (v) filed duplicative claims; (vi) filed, without leave of this Court, adversary proceedings allegedly on behalf of the estate seeking to avoid allegedly fraudulent transfers; and (vii) objected to every fee application filed by counsel for the Debtors. It is interesting to note that Mr. Buente attempts to shift the burden to counsel for the Debtors to inform him of contrary authority when Buckeye Retirement objects to every fee application. If, in response to the demand letters, counsel for Debtors had provided case authority to Buckeye Retirement in opposition to the Motion for Leave, Buckeye Retirement would likely have objected to the attorney's fees that were incurred in such effort.⁶ Furthermore, since Mr. Buente's demand letters cited only a Chapter 13 case and § 1115 - neither of which was applicable authority to the demand being made - counsel for Debtor had no obligation to refute the demand letters with counter authority.

Mr. Buente states that the failure to cite to a cost benefit analysis as required by *The Gibson Group* is not fatal because the motion and exhibits encompass three of the four elements of *The Gibson Group* test.⁷ This argument also fails. At best, Buckeye Retirement addressed one and one-half of *The Gibson Group*

⁶As noted by counsel for Debtors, he tried to minimize fees to the estate. On the same day that the Motion for Leave was heard by the Court, Buckeye Retirement objected to the interim compensation that Debtors' counsel was seeking.

⁷The Court set forth the relevant factors to consider in determining if there was a "colorable claim that would benefit the estate" in the September 30, 2005 Order. These factors were: "(1) whether the party against whom the claim is sought is collectible; (2) the cost to the estate to defend the action; and (3) the cost to the estate to pursue the action There is no benefit to the estate if the avoidance recovery is completely depleted by the cost of the action and the cost of collection." (September 30, 2005 Order, n.3.)

elements. Buckeye Retirement established it made a demand and that Debtors refused to comply with half of the demand (Debtor stopped making future contributions, but did not address the issue of seeking return of the contributions already made). As set forth above, there is no showing that Buckeye Retirement had a colorable claim. Nor is there any showing that Debtors' refusal to comply was not justified. Under the circumstances, Debtors' refusal to comply was based on sound law and is justified. Buckeye Retirement admits that it failed to include the necessary cost benefit analysis, but even the rationale for doing so is not consistent with the facts. Buckeye Retirement states that it intended to pay for the cost of litigation, but the proposed Complaint included a demand for attorney's fees. Moreover, there is no reason to think that, if Buckeye Retirement was successful in its efforts, it wouldn't seek compensation as an administrative expense under § 503(b)(3).

After reviewing all of the pleadings and hearing arguments of counsel and the testimony at the Hearing, this Court finds that sanctions are appropriate. As set forth below, this Court imposes sanctions in the amount of Debtors' attorney's fees in responding to the Motion for Leave and appearing at the Hearing on such motion. Debtors' counsel is directed to submit and file an itemized statement of such fees; the Court will review as to reasonableness and enter a further order regarding the amount of the sanctions.

IT IS SO ORDERED.

**HONORABLE KAY WOODS
UNITED STATES BANKRUPTCY JUDGE**