IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re KINGSPORT, LIMITED, A California Limited Partnership, d/b/a SILVER LAKE ESTATES EIN 33-0198222, Debtor.	No. 99-21346 Chapter 11

M E M O R A N D U M

This case came before the court for hearing on June 29, 1999, upon a motion for sanctions filed by William R. Van Liere and the William Van Liere Community Trust. A notice of appeal having been filed by Dean Greer and David Darnell on July 13, 1999, taking exception to the court's ruling on the motion as contained in the order entered July 6, 1999, the court issues the following findings of facts and conclusions of law. This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(A).

I.

The petition initiating this chapter 11 case was filed on May 24, 1999, in order to stop a foreclosure sale scheduled for noon that same day. The petition was signed, purportedly on behalf of the debtor, by David Darnell, Esq. as the authorized agent for "V. David Ott, General Partner." Mr. Darnell is an

attorney associated with Dean Greer, Esq., who signed the petition as debtor's counsel. Accompanying the petition was a master address list, a list of the debtor's twenty largest unsecured creditors, and a disclosure of compensation evidencing that Mr. Greer had received a retainer in the amount of $5,000.00.

On June 1, 1999, Mr. Greer moved "to withdraw as counsel to the 'Debtor' and/or V. David Ott." For grounds, Mr. Greer stated that "I have come to the conclusion that V. David Ott is not a general partner of [the debtor] and did not have the authority to employ me on behalf of the partnership nor did he have the authority to file this Chapter 11 proceeding in the name of the partnership." That same day, the U.S. trustee filed a motion to dismiss and to compel appearances of Messrs. Ott and Darnell to show cause why the case should not be dismissed for lack of authority of either to file the bankruptcy case on behalf of the debtor. The trustee additionally alleged that this was the debtor's third bankruptcy filing and that "[t]he repetitive filing of this case appears to be an effort to hinder or delay, which is unreasonable under the circumstances, and is prejudicial to creditors."

On June 14, 1999, William R. Van Liere, a limited partner of the debtor and secured creditor, and the William Van Liere

Community Trust, a co-owner of the debtor's real property, filed a motion for sanctions against Messrs. Ott, Darnell and Greer pursuant to Fed. R. Bankr. P. 9011. Movants alleged that the commencement of this bankruptcy case "was for the sole purpose of stopping a foreclosure sale for a second time" in violation of Rule 9011(b)(1), which provides that "by presenting to the court (whether by signing, filing, submitting, or later advocating) a petition ..., an attorney ... is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, ... it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation." Movants also alleged that because it was represented in the petition that Messrs. Ott and Darnell had the authority to commence this case on behalf of the debtor, subsections (2) and (3) of Rule 9011(b) were violated as the petition was not "warranted by existing law" and the "allegations and other factual contentions [did not] have evidentiary support." Movants contend that if Messrs. Greer and Darnell had undertaken a reasonable investigation prior to filing the petition, such as by reviewing the previous bankruptcy filing in this district by Mr. Ott on behalf of the debtor or telephoning either the U.S. trustee or Fred Leonard,

Esq., debtor's previous bankruptcy counsel, to inquire why it had been dismissed, they would have learned that Mr. Ott was not a general partner and could not authorize the filing of the petition. Movants averred that they have "incurred considerable expense in the preparation and processing of two foreclosure proceedings as well as the cost incurred for representation in the two Tennessee bankruptcy cases" and requested "sanctions pursuant to Rule 9011 in the amount of $2,500.00 to compensate them for the cost incurred in the bad faith filing of this bankruptcy petition.... from the funds paid to Greer as a retainer."

II.

Mr. Greer stated at the hearing that his first contact with Mr. Ott was on Thursday afternoon, May 20, 1999, when he received a telephone call. Mr. Ott told him that he had not been able to obtain bankruptcy representation, that he was a general partner of the debtor, and that a foreclosure sale was scheduled for Monday at noon, May 23, 1999. Mr. Greer requested that Mr. Ott furnish him with information showing he was the general partner and had the authority to commence the bankruptcy case, and that a retainer of $5,000.00 be provided along with the filing fee of $800.00. Mr. Greer was also informed by Mr.

Ott that the debtor had two previous bankruptcy filings, including a recent one filed in this court which had been dismissed for failure to file a plan. Mr Greer advised Mr. Ott that no action would be taken until the retainer was received.

Mr. Greer stated that the next day, Friday, May 21, he did nothing else with respect to the case with the exception of "some background checking" and preparing some "simple documents" since he was waiting for the retainer to be wired to his account. That afternoon, at 2:45 p.m., Mr. Greer faxed a message to Mr. Ott advising that only $3,895.00 had been received and the case would not be filed until the full amount was received. Mr. Greer also requested that the information which was discussed the night before be sent immediately. Mr. Ott later called Mr. Greer and stated that the rest of the retainer would be wired on Monday morning and sent the requested information. At that point, Mr. Greer agreed to file the case. Mr. Greer explained that the reason Mr. Darnell signed the petition was because he had no way of obtaining Mr. Ott's signature. As a result, Mr. Greer decided to have Mr. Ott authorize Mr. Darnell, as agent, "to execute any and all documents necessary to file [a] Chapter 11 bankruptcy on behalf of Kingsport Limited."

III.

> Under Bankruptcy Rule 9011, sanctions shall be imposed on the debtor and/or the attorney who signed the bankruptcy petition if, to the best of the attorney's or debtor's knowledge, information, and belief formed after reasonable inquiry, the petition is not well grounded in fact and warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law. Fed. R. Bankr. P. 9011(a). Additionally, sanctions shall be imposed if the petition is "interposed for any improper purpose, such as to harass or to cause unnecessary delay, or needless increase in the cost of litigation or administration of the case."*...*
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> Clearly, a petition filed in "bad faith" is one not "warranted by existing law" or the modification of law.

MRL Residential Leasing, Inc. v. Investaid Corp. (In re MRL Residential Leasing, Inc.), 1997 WL 453163 at *3 (6th Cir. Aug. 8, 1997). In the present case, as far as Mr. Ott was concerned, it is clear that the filing was not made in good faith: the petition was not well grounded in fact or warranted by existing law because Mr. Ott undisputedly had no authority to commence this bankruptcy case on behalf of the debtor. Thus, sanctions against Mr. Ott are undeniably appropriate.

With respect to whether sanctions should be imposed against attorneys Greer and Darnell, the test in this circuit for imposition of Rule 11 sanctions is "whether the individual attorney's conduct was reasonable under the circumstances." *Silverman v. Mutual Trust Life Ins. Co. (In re Big Rapids Mall*

Assoc.), 98 F.3d 926, 930 (6th Cir. 1996). An attorney has a duty to conduct a reasonable inquiry to ascertain an individual's authority to act on behalf of a debtor. *See In re AT Engineering, Inc.*, 142 B.R. 990, 992 (Bankr. M.D. Fla. 1992). As stated by the Sixth Circuit Court of Appeals:

> The determination of whether an attorney conducted "reasonable inquiry" is judged by objective norms of what reasonable attorneys would have done....
>
> In determining whether an attorney had or had not conducted a reasonable inquiry, a court undoubtedly should consider a variety of pre-filing factors....[F]or example, what information about the client's business did the attorneys have? Was the information verified? How involved had these attorneys been in their client's business? For how long? Were other professionals, such as accountants or bankers consulted? What independent investigation, if any, did the attorneys undertake prior to the filing? What did their clients tell them? Were they justified in believing what their clients told them? Did a time problem exist when a decision to file was made? What was the business (and legal) sophistication of the clients and the attorneys?

In re Big Rapids Mall Assoc., 98 F.3d at 930.

In arguing that sanctions against him and Mr. Darnell are not appropriate, Mr. Greer cited the exigencies of the facts at the time: that he was contacted by telephone on a Thursday afternoon by a general partner in California who was seeking to stop a scheduled foreclosure sale on the following Monday. Mr. Greer also noted that Mr. Ott presented himself as a legitimate businessman with a plan for reorganizing the debtor, that Mr.

Ott gave an adequate explanation of what had taken place in the debtor's two previous bankruptcy cases, and that because Mr. Ott paid the requested retainer, there was no indication that Mr. Ott was not who he said he was.

Nonetheless, it is undisputed that neither Messrs. Greer and Darnell made any effort to verify the information given them by Mr. Ott or to conduct any independent investigation prior to the bankruptcy filing. Mr. Greer did state that he did some "background checking" on the case on Friday morning, but offered no detail as to what that involved. Mr. Greer admitted that he made no attempt to contact the debtor's prior bankruptcy counsel or the U.S. trustee concerning the debtor's previous filing in this district. Nor did Messrs. Greer and Darnell make any effort to review the debtor's prior bankruptcy case file in the clerk of the court's office. Had counsel reviewed this file, they would have discovered that the debtor's last chapter 11 case was dismissed on January 15, 1999, upon the U.S. trustee's motion for failure of Mr. Ott to cooperate in submitting financial records, file monthly operating reports, and pay the mandatory fees to the U.S. trustee. Counsel would also have seen movants' motion to dismiss filed December 18, 1998, which averred that Mr. Ott was not a general partner and was "without the authority to place this entity in bankruptcy."

While clearly a time problem existed and the court does not doubt that Mr. Ott sounded credible in his telephone conversations with Mr. Greer, it was not reasonable under the circumstances for counsel to rely solely on Mr. Ott's unverified word. Given the fact that Messrs. Greer and Darnell did not know Mr. Ott prior to his Thursday telephone call and never met him face to face, that they were asked over the telephone on the eve of a foreclosure to file a bankruptcy case for single asset entity with a history of dismissals of two previous bankruptcy cases, including one here in the Eastern District of Tennessee, and the fact that additional information regarding the debtor and Mr. Ott could have been easily and readily attained by either reviewing the court file or contacting debtor's previous local counsel or the attorney for the U.S. trustee, Messrs. Greer and Darnell did not conduct a reasonable inquiry prior to their filing of the chapter 11 case.

The court makes this conclusion based on the Rule 9011 obligations imposed on Messrs. Greer and Darnell as attorneys who signed the chapter 11 petition. The court adds, however, that in situations such as this, where the purported officer authorized to commence the case does not even sign the petition, the attorney who does sign on behalf of the debtor is under a heightened duty to ensure that the filing is in good faith.

That duty was not met in this case.

The court having concluded that Rule 9011 was violated by the filing of the present chapter 11 case, sanctions are appropriate. Under subsection (c)(2) of Rule 9011, sanctions may consist of "an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation." Movants' counsel stated that not including her fee, $2,200.00 in expenses had been incurred in connection with the two attempts to foreclose and that additional foreclosure expenses will now have to be incurred for the third attempt due to the bad faith filing. Accordingly, the court awards movants sanctions against Messrs. Ott, Greer and Darnell in the amount of $2,500.00 which shall be paid out of the $5,000.00 retainer transferred by Mr. Ott to Mr. Greer.

FILED: August 25, 1999

BY THE COURT

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE