UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re

ANDREW T. GREGOIRE — Case No. 00-11564

Debtor

AYERST EMPLOYEES FEDERAL
CREDIT UNION

Plaintiff

-against- — Adv. Proc. No. 00-90164

ANDREW THOMAS GREGOIRE

Defendant

APPEARANCES:

MARK A. SCHNEIDER, ESQ.
Attorney for Debtor
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Plattsburgh, New York 12901

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Hon. Robert E. Littlefield, Jr., U.S. Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

The two matters currently before the court are: (1) whether F.R.B.P. 9011 has been violated; and (2) whether costs and attorney's fees should be awarded to the Defendant pursuant to 11 U.S.C. §

523(d).[1] The court has jurisdiction via 28 U.S.C. §§157(a), 157(b)(1), 157(b)(2)(I) and 1334(b).

FACTS

The court issued a decision on August 1, 2002 ("Decision") on the § 523 (a)(2)(A) and (B) complaint filed by Ayerst Employees Federal Credit Union ("Plaintiff" or "Creditor") against Andrew Thomas Gregoire ("Debtor" or "Defendant"). The court assumes familiarity with that decision and the facts therein.

ARGUMENTS

The Plaintiff argues the standard a creditor must meet to defeat a § 523(d) request is "not a stringent one... It is only where the creditor has no chance of success that its claim will fall into the unjustified category." (Plaintiff's Memorandum of Law on Substantial Justification ("Plaintiff's Memorandum") unnumbered p.3.)

The Plaintiff further states, " a creditor's case which is based upon a cognizable legal theory, supported by elemental facts and is ultimately resolved at trial based upon credibility issues, necessarily is substantially justified for purposes of § 523(d)." (Plaintiff's Memorandum, unnumbered p.4.)

The Plaintiff also argues that because the court denied Defendant's motion to dismiss at trial, the complaint was necessarily substantially justified. It asserts various positions of law and fact that, it argues, indicate reasonableness and substantial justification.

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[1]11 U.S.C. § 523 is entitled "Exceptions to discharge" and subsection (d) ponders, "If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust."

Even if substantial justification does not exist, the Plaintiff claims there are special circumstances that would make any fee award unjust, including:

> (1) even though no fraudulent intent on the part of the Debtor was found, the court could have found such fraudulent intent; and
> (2) if any of Plaintiff's various legal theories are sustained, that would mandate no fee award.

The Defendant responds by reiterating the Plaintiff was not substantially justified and its due diligence was required prior to filing the complaint. He refutes Plaintiff's assertions of the standard of law to apply and its argument and that any case that withstands directed verdict is substantially justified. Also, the Defendant denies the existence of any special circumstances mitigating the Plaintiff's behavior and claims adequate records for the attorney's fees requested.

DISCUSSION

I. F.R.B.P. 9011.

On August 21, 2002, the court read an oral decision finding the Plaintiff's attorney violated F.R.B.P. 9011.[2] The court assumes familiarity with that decision and reaffirms the violation found therein.

II. Section 523(d).

The intent of Congress in enacting Section 523(d) was to "discourage creditors from initiating meritless actions based on § 523(a)(2) in the hope of obtaining a settlement from an honest debtor anxious to save attorneys' fees." *In re Williams*, 224 B.R. 523, 529 (B.A.P.2d Cir. 1998)(citation omitted). That concern "must be balanced against the risk that imposing the expense of the debtor's

[2]The court informed the parties that it would incorporate the oral decision in this decision for purposes of F.R.B.P. 8002(a).

attorney's fees and costs on the creditor may chill creditor efforts to have debts that were procured through fraud declared nondischargeable." *Id.* at 530. The creditor must be substantially justified at all times through the trial to be insulated from paying attorneys' fees under § 523(d). *Id*. Under § 523(d), the debtor must prove that a creditor unsuccessfully sued for the discharge of a consumer debt. Then the burden shifts to the creditor to show that its position was substantially justified. *Id*. at 529. However, this standard should not be read to raise a presumption that the creditor was not substantially justified simply because it lost. *In re Carolan*, 204 B.R. 980, 987 (B.A.P.9th Cir.1996)(citations omitted).

When analyzing whether a complaint is "substantially justified," the test is one of reasonableness and courts have looked at the following criteria: (1) a reasonable basis in law for the theory it propounds; (2) a reasonable basis in truth for the facts alleged; and (3) a reasonable connection between the facts alleged and the legal theory advanced. *Id*. at 530 (citation omitted). In other words, substantial justification means "justified to a degree that could satisfy a reasonable person." *In re Poirier*, 214 B.R. 53 (Bankr. D. Conn. 1997). This analysis permits a trial court to examine a variety of factors including, but not limited to, whether the creditor attended the § 341 meeting or conducted an examination under Rule 2004, as well as the extent of it pre-trial investigation. *Williams*, 224 B.R. at 531. Although a comprehensive pre-filing investigation is not necessary, a creditor must do enough pre-filing investigation to ensure that the complaint is substantially justified. *In re Mack*, 219 B.R. 311, 314 (Bankr. N.D. Fla. 1998). No finding of bad faith on the part of the plaintiff is required, only that the plaintiff went past a point where it knew or should have known that it could not carry its burden of proof. *In re Williams*, 217 B.R. 387, 389 (Bankr. D. Conn. 1996)(citations omitted).

CHRONOLOGY OF THE PLAINTIFF'S COMPLAINT

The complaint before the court at trial bore no resemblance to the one initially filed. The court's docket reflects the following:

A. July 7, 2000 complaint ("Complaint 1")

This one and one-half page document, consisting of 10 decretal paragraphs, based jurisdiction on § 523(a)(2)(A).[3] The gravaman of the complaint though relies on the presumption of § 523(a)(2)(C).[4] However, as discussed in the Decision, many of the factual allegations and the conclusions drawn from them were inaccurate. The Plaintiff stated that the Defendant used certain of its loan proceeds to pay off a Key Bank debt collateralized by a security interest in a car owned by Corrine Rust, the Debtor's girlfriend.

Plaintiff asserted that by doing so, he conferred a gift to Ms. Rust while having no intent to repay the Plaintiff's loan. Ultimately, any theory of liability based on § 523(a)(2)(C) was repudiated by the Plaintiff as discussed later in this decision.[5]

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[3]11 U.S.C. § 523(a)(2) excepts from discharge a debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by -

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's on an insider's financial condition;...

[4]11 U.S.C. § 523(a)(2)(C) states, in relevant part:

> for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregataing more than $1,150 for "luxury goods or services" incurred by an individual debtor on or within 60 days before the order for relief under this title, or cash advances aggregating more than $1,150 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief under this title, are presumed to be nondischargeable...

[5]*See n.* 9.

B. September 13, 2000 complaint ("Complaint 2")

The two page document consisting of 11 decretal paragraphs is substantially similar to Complaint 1. It amends Complaint 1 by deleting any reference to Ms. Rust's car and by alleging that the Key Bank loan was signed by both the Debtor and Ms. Rust. It also states the filing of the adversary was substantially justified.

C. October 20, 2000 complaint ("Complaint 3")

Complaint 3 is a duplicate filing of Complaint 2.[6]

D. November 28, 2000 complaint ("Complaint 4")

Complaint 4, consisting of nine pages and 54 decretal paragraphs, radically altered the Plaintiff's theory of liability. The Plaintiff expanded its (a)(2)(A) theory to include not only an (a)(2)(C) presumption based on the paying off of the debt owed by Ms. Rust, but also an (a)(2)(A) non-presumptive liability.[7] Additionally, the Plaintiff, for the first time, alleged liability pursuant to § 523(a)(2)(B)[8] premised on the loan application submitted by the Defendant that understated his

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[6]The court's recollection is that Complaint 3 was filed due to alleged improper service of Complaint 2. However, the court's docket is silent on the issue.

[7]The Plaintiff does not specify whether this liability is based on false pretenses, a false representation or actual fraud.

[8]11 U.S.C. § 523(a)(2)(B) excepts from discharge a debt for money, property, services or an extension, or see Note 2 start

(B) use of a statement in writing -

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive;...

monthly rent obligation.

E. April 26, 2001 complaint ("Complaint 5")

Complaint 5 was filed with leave of court and consists of nine pages and 53 decretal paragraphs. It mirrors Complaint 4 with the exception that paragraph 34 of Complaint 4, the paragraph invoking § 523(a)(2)(C), is removed from Complaint 5.[9] Thus, the entire legal theory behind Complaints 1, 2 and 3 suddenly disappear.

SUBSTANTIAL JUSTIFICATION

The Defendant prevailed at trial; all of the obligations owed by Defendant to Plaintiff were discharged. The burden now shifts to Plaintiff to show substantial justification or the existence of special circumstances. In determining whether special circumstances exist that would make an award of attorney's fees unjust, courts have consistently recognized that the guiding considerations should be equitable principles balanced with the goal of deterring creditors from filing unwarranted exceptions to discharge. This line of authority holds that it would be inequitable to allow dishonest debtors to recover their costs and attorney's fees. *In re Mack*, 219 B.R. at 315-316 (citations omitted). In addition, in a nondischargeability proceeding in which a creditor asserts multiple bases for excepting debt from discharge based on debtor's fraud, only if the creditor's position on all causes of action is not substantially justified will fees be awarded. *In re Stockard*, 216 B.R. 237, 239 (Bankr. M.D. Tenn. 1997).

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[9]Even though paragraph 37 of Complaint 5 references § 523(a)(2)(C), the Plaintiff subsequently filed a reply to the Defendant's counterclaim, stating that it asserted no cause of action pursuant to that section. Thus, the court finds that if not withdrawn, the Plaintiff abandoned any theory of liability based on subparagraph C.

11 U.S.C. § 523(a)(2)(C)

Because the Plaintiff did not attend the section 341 meeting of creditors, did not conduct a F.R.B.P. 2004 examination and then retracted the underpinning of Complaints 1, 2 and 3 and that portion of Complaint 4 that alleges § 523(a)(2)(C) liability, the court concludes that the Plaintiff was not substantially justified in filing those complaints. Ultimately, as noted above, the Plaintiff abandoned or withdrew any § 523(a)(2)(C) cause of action. Additionally, although the Plaintiff offers two theories for a finding of special circumstances, the court does not agree and thus finds no special circumstances permitting the filings.

11 U.S.C. § 523(a)(2)(B)

Similarly, regarding Complaints 4 and 5, Plaintiff's § 523(a)(2)(B)'s cause of action was not substantially justified. The thrust of Plaintiff's argument was the Defendant's rent was understated by $100 and his debt to income ratio was artificially low at 45%. It argued that had it known the actual ratio of 49%, it would have denied the loan because a 45% ratio was the "maximum ratio which would permit Plaintiff to approve the loan." (Complaint 5 paragraph 48.) However, its own records belie that. As indicated in the Decision, the Plaintiff's own written loan policy states that with a debt to income ratio of 45% to 55% other factors, such as attendance records, savings habits and credit report histories should be evaluated prior to granting a loan.[10] Its complaint does not mention any factors, pro or con, other than the ratio. Thus, there was no reasonable connection between the facts alleged and

[10] Defendant's exhibit 3, the Plaintiff's written loan policy further states that if a loan is granted that exceeds "the above mentioned limit" (45% to 55%), a written statement why the loan was granted must be placed in the member's file. Thus, by its own written policy no arbitrary disqualifying ratio percentage exists.

the legal theory advanced. As indicated in the Decision, from 1998 - 2000 the Plaintiff granted 1632 loans and denied only 14, none based solely on the debt to income ratio. With no other factual or legal basis offered, other than the mere existence of a 49% debt to income ratio, the Plaintiff should have realized it would be unable to carry their burden on a § 523(a)(2)(B) cause of action.

11 U.S.C. 523(a)(2)(A).

As regards the § 523(a)(2)(A) allegation in Complaints 4 and 5, the court concludes that the Plaintiff was not substantially justified in pursuing that cause of action either. Put in the best light, when the Debtor filed his petition, the Plaintiff only knew that approximately one and one-half months had elapsed between the loan date and the filing date. Yet the first three § 523(a)(2)(A) complaints alleged impropriety because either the Defendant paid off Ms. Rust's car loan or it was a gift to Ms. Rust. In either scenario, according to the Plaintiff, the debt was nondischargeable pursuant to the presumptive liability contained in § 523(a)(2)(C).

Months later, the court allowed the Plaintiff to amend the complaint in an effort to decide the proceeding on the merits. The Plaintiff then, in addition to adding the § 523(a)(2)(B) cause of action discussed above, provided a more traditional § 523(a)(2)(A) analysis. In addition to relying on the $100 rent differential, the relationship with Ms. Rust and the short period between the loan and the filing, the Plaintiff made general remarks about the Defendant such as his failure to obtain credit counseling and his failure to change his lifestyle. However, as with the § 523(a)(2)(B) cause of action, the Plaintiff does not give a reasonable connection between the facts alleged and the legal theory advanced. After the deposition conducted on October 31, the Plaintiff should have simply

withdrawn the complaint.[11] As Plaintiff said, "The case was overblown and litigated beyond the point of reason..." (Plaintiff's Memorandum, unmarked p. 19.) The court agrees.

DAMAGES

Once the court determines that the complaint was not substantially justified, the award of reasonable fees and costs is mandatory. *In re Stockard*, 216 B.R. at 240. The Debtor's attorney has requested $60,609.38 calculated as follows: $45,687.50 based on the records submitted with his "affidavit in support of petition for attorney's fees" dated August 22, 2002;[12] $2,800.00 for "[a]dditional work in replying to Plaintiff's opposition to Debtor's fee application..." (Debtor's Affidavit in Reply to Plaintiff's Opposition to Motion for Attorney's Fees dated October 1, 2002 ("Debtor's Affidavit")); plus a 25% fee enhancement[13] "[b]ecause of the excellent results obtained by Debtor's attorney, because of the delay in being paid, and because of Plaintiff's unreasonable refusal to settle prior to trial." (Debtor's Affidavit, p. 15.)

Attorney's fees in the amount of $60,609.38 for this adversary complaint, even if overblown and overlitigated, is not reasonable. As indicated in the Decision, the time records submitted are inadequate and incomplete; they are vague and lumped. In addition, some of the entries are for time

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[11] If the complaint had been withdrawn, presumably the misplaced motion to dismiss pursuant to 11 U.S.C. § 707(a) would never have been made which would have negated the need for the F.R.B.P. 9011 hearing. Even though the dismissal motion was made in the main case, it exacerbated the overblown and overlitigated atmosphere in the adversary proceeding.

[12] $717.50 represents work performed by local counsel which was denied in the Decision.

[13] It is unclear whether the enhancement includes just the basic fee request ($45,687.50) or the additional $2,800.00 for the work performed on the fee request. The court assumes the latter and calculates the total fee requests as $45,687.50 + $2,800 = $48,487.50 x 25% = $60,609.38.

expended for the § 707 motion in the main case and not the adversary proceeding. Finally, even if all of the above problems did not exist, the time spent was far in excess of what should have been necessary to defend this adversary.

In this court's experience, $6,000 would be at the upper end of reasonableness for the defense of a § 523 complaint. The court will enhance that amount by 25% to compensate the Debtor's attorney for the multiple pleadings and amendments filed. This results in a fee of $7,500.

The court will also allow $750 for work required on the § 523(d) submission and $1,800 for the travel time which appears reasonable. From this, $1,800 must be subtracted as already having been awarded in the Decision.[14] The court thus allows fees in the amount of $8,250.

It is so ORDERED.

Dated: February 14, 2003

Hon. Robert E. Littlefield, Jr.
U.S. Bankruptcy Judge

[14] As discussed in the Decision, the $1,800 was to compensate the Defendant's attorney for his work done in connection with the final amendment to the complaint.