UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

THE BENNETT FUNDING GROUP, INC.	CASE NO. 96-61376
	Chapter 11
Debtors	Substantively Consolidated

RICHARD C. BREEDEN, TRUSTEE FOR
THE BENNETT FUNDING GROUP, INC., et al.

Plaintiff

vs. ADV. PRO. NO. 98-42914A

RAPID COPY EQUIPMENT CO.

Defendant

RICHARD C. BREEDEN, TRUSTEE FOR
THE BENNETT FUNDING GROUP, INC., et al.

Plaintiff

vs. ADV. PRO. NO. 98-42697A

MAGIC VALLEY BUSINESS SYSTEMS

Defendant

RICHARD C. BREEDEN, TRUSTEE FOR
THE BENNETT FUNDING GROUP, INC., et al.

Plaintiff

vs. ADV. PRO. NO. 98-42839A

KAWEAH OFFICE SUPPLIES

Defendant

RICHARD C. BREEDEN, TRUSTEE FOR
THE BENNETT FUNDING GROUP, INC., et al.

Plaintiff

vs. ADV. PRO. NO. 98-42855A

RED RIVER ELECTRONICS

Defendant

RICHARD C. BREEDEN, TRUSTEE FOR
THE BENNETT FUNDING GROUP, INC., et al.

Plaintiff

vs. ADV. PRO. NO. 98-43216A

MIAMI MAILING EQUIPMENT

Defendant

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

Presently before the Court are motions filed on behalf of the defendants ("Defendants") in the above-referenced adversary proceedings seeking sanctions against Richard C. Breeden, chapter 11 trustee ("Trustee") of the consolidated estates of The Bennett Funding Group, Inc. (collectively, the "Debtors")[1] and his counsel pursuant to Rule 9011 of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P.") in connection with the above-referenced adversary proceedings commenced by the Trustee pursuant to Code § 547.[2] The motions were heard on February 11, 1999, in Utica, New York and adjourned to March 11, 1999, for a decision by the Court.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1), (b)(2)(A) and (O).

FACTS

Sometime prior to March 29, 1998, the Trustee commenced approximately 1,100

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[1] The Debtors are eight related entities which filed for bankruptcy under chapter 11 of the United States Bankruptcy Code (11 U.S.C. §§ 101-1330) ("Code") between March 29, 1996, and July 25, 1997, when the estates were consolidated pursuant to an Order of this Court. The entities within the Consolidated Estate include The Bennett Funding Group, Inc. ("BFG"), Bennett Receivables Corporation; Bennett Receivables Corporation II, Bennett Management & Development Corporation, The Processing Center, Inc., Resort Service Company, Inc.; American Marine International, Ltd. and Aloha Capital Corporation.

[2] Because the basic factual allegations are similar and all Defendants are represented by the same counsel, the Court will treat the motions as consolidated for purposes of this decision.

adversary proceedings to recover preference payments allegedly made by the Debtors to various trade vendors. Although the complaints in the proceedings now before this Court were filed prior to March 29, 1998, the complaints were not served on the Defendants until between May and July 1998. According to the Trustee, the actions are based on a report prepared listing all checks and other payments made to vendors during the 90 day period prior to the commencement of the Debtors' cases. Unbeknownst to the Trustee, the computer program used to generate the report failed to exclude checks that had not cleared the Debtors' bank account. *See* Affidavit of Debra A. Brazier, Manager of Information Systems for The Bennett Funding Group, Inc., sworn to March 4, 1999, and attached as Exhibit "A" to Further Opposition of Richard C. Breeden, as Trustee, to Rule 11 Motion by Defendant ("Trustee's Further Opposition"), filed March 8, 1999. Counsel for the Defendants notified the Trustee that the transfers, which were the subject of the complaints, had not occurred in that the checks in all cases never cleared the Debtors' bank and no payments were received by any of the Defendants during the 90 day prepetition period.

On or about December 3, 1998, Trustee's counsel transmitted a proposed stipulation ("Proposed Stipulation") to Defendants' counsel with respect to the proceedings against Miami Mailing Equipment and Red River Electronics.[3] The Proposed Stipulation provides for the discontinuance of each action with prejudice "without costs or sanctions to either party against each other." In response, on or about December 8, 1998, Defendants' counsel submitted a modified form of the stipulation ("Modified Stipulation"), dismissing the adversary proceeding "without prejudice, however, to the right of the Defendant to seek sanctions under FRBP 9011,"

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[3] Trustee's counsel submitted similar stipulations in connection with the other three adversary proceedings on or about January 17, 1999.

on behalf of Miami Mailing Equipment and Red River Electronics. A similar stipulation was submitted by counsel on or about January 6, 1999, on behalf of the remaining three defendants.

The Trustee refused to execute the Modified Stipulation. In response to the motions herein, the Trustee contends that Fed.R.Bankr.P. 9011, as revised and made effective December 1, 1997, provides the Trustee with a "safe harbor" in which he had 21 days from the date of service of the Defendants' motions[4] to withdraw the complaints. Trustee asserts that its offers to dismiss the actions with prejudice constituted an informal withdrawal of the complaints. Furthermore, it is the Trustee's position that the Defendants' imposition of a condition retaining the right to seek 9011 sanctions in the Modified Stipulation is improper under the circumstances. The Trustee contends that "[i]f such reservation of rights had been included, the defendant's attorney could argue to the Court that the Trustee consented to the defendant's preservation of its right to seek sanctions or at least waived Trustee's right to object to sanctions under Rule 9011." See Trustee's Further Opposition at ¶ 10. The Defendants contend that by including the condition in each Proposed Stipulation that costs or sanctions against either party are not to be sought that the Trustee has not actually withdrawn the complaint, informally or formally.

DISCUSSION

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[4] It is alleged that the Defendants' counsel served the Trustee with the five motions herein on December 18, 1998, and then, as an overabundance of caution again served the Trustee on January 8, 1999, filing the motions with the Court on January 11, 1999. For purposes of the "safe harbor" provision, the Court will treat December 18, 1998, as the "date of service."

Defendants' motions are brought pursuant to Fed.R.Bankr.P. 9011 ("Rule 9011"). Rule 9011 was amended in 1997 to conform to the 1993 changes to Rule 11 of the Federal Rules of Civil Procedure ("Fed.R.Civ.P."), which took effect on December 1, 1993. As noted by the Court of Appeals for the Second Circuit,

> The new Rule liberalizes the standard for compliance and provides procedural safeguards to enable parties to avoid sanctions . . . . Of particular relevance here, the 1993 amendment establishes a 'safe harbor' of 21 days during which factual or legal contentions may be withdrawn or appropriately corrected to avoid sanction.

Hadges v. Yonkers Racing Corp., 48 F.3d 1320, 1327-28 (2d Cir. 1995) (citations omitted).

Amended Rule 9011 took effect on December 1, 1997 and governs "all proceedings in bankruptcy cases thereafter commenced and, insofar as just and practicable, all proceedings in bankruptcy cases then pending." *See* Order of the U.S. Supreme Court, dated April 11, 1997, attached as Exhibit "K" to Trustee's Further Opposition. In this case, the adversary proceedings were all commenced in March of 1998 and were served on the Defendants between May and July 1998. Therefore, the Court concludes that it is just and practicable to apply Rule 9011, as amended, to the matters herein.

As was found by U.S. District Court Judge Scheindlin in *Succession Picasso v. Spedding*, 1997 WL 65911 at *2 (S.D.N.Y. 1997) ("Picasso I") (citation omitted), "an offer to voluntarily dismiss the action with prejudice, should be construed as an informal withdrawal pursuant to Rule 11. Accordingly, Rule 11 sanctions are not warranted." In the matter before this Court, the Trustee made such an "offer" to the Defendants. However, he attached "strings" to his offer by providing that he would discontinue the actions as long as the Defendants agreed not to seek costs or sanctions. The question is whether placing the condition in the Proposed Stipulation somehow negates what in the *Picasso I* case was interpreted to be an informal withdrawal of the complaint and results in a failure by the Trustee to avail himself of the "safe harbor."

Rule 11, as well as Rule 9011, require litigants to "stop and think' before making legal or factual contentions." The Advisory Committee Notes to the 1993 Amendments to Fed.R.Civ.P. 11. Furthermore, it subjects them to sanctions "for insisting upon a position after it is no longer tenable and by *generally providing protection* against sanctions if they withdraw or correct contentions after a potential volation is called to their attention." *Id.* (emphasis added).

In this case, the Defendants apprised the Trustee of the fact that the checks issued to them by the Debtors never cleared the bank. In response, the Trustee offered to withdraw the complaints. However, by including the additional condition in the Proposed Stipulation, the Trustee, for all practical purposes, is asking for more than the "generally provid[ed] protection" afforded him by the "safe harbor." He is asking the Defendants to waive their right to pursue other remedies available to them; otherwise, apparently he intends to pursue his causes of action against the Defendants despite the fact that there is no factual basis for them.

As indicated in The Advisory Committee Notes to the 1993 Amendments to Fed.R.Civ.P. 11, "Rule 11 is not the exclusive source for control of improper presentations of claims, defenses or contentions. It does not supplant statutes permitting awards of attorney's fees to prevailing parties or alter the principles governing such awards. It does not inhibit the court in punishing for contempt, in exercising its inherent powers, or in imposing sanctions, awarding expenses, or directing remedial action authorized under other rules . . . ."; *see also* Edward D. Cavanagh, *Rule 11 of the Federal Rules of Civil Procedure: The Case against Turning Back the Clock*, 162

F.R.D. 383, 399 (1995) (noting that "Rule 11 is not the only bow[5] in the sanctions quiver. Sanctions may also be imposed in appropriate cases pursuant to 28 U.S.C. § 1927 and the Court's inherent powers."); *In re U.S. Voting Mach., Inc.*, 224 B.R. 165, 170 (Bankr. D. Colo. 1998) (stating that "Rule 11 is not, nor can it be, the only means available to a court to impose sanctions against a party."); *In re Nichols,* 221 B.R. 275, 279 (Bankr. N.D. Okla. 1998) (quoting *In re Weiss*, 111 F.3d 1159, 1171 (4th Cir. 1997), that "[a] court may invoke its inherent power in conjunction with, or instead of, other sanctioning provisions such as Rule 9011.").

The Court makes no finding that the Defendants have a basis for seeking sanctions and/or costs and attorneys' fees as an alternative to Rule 9011. Indeed, imposing sanctions pursuant to the court's inherent power or under 28 U.S.C. 1927 requires that the movant seeking sanctions make a "'clear showing of bad faith.'" *Picasso I*, 1997 WL 65911 at *3, citing *Oliveri v. Thompson*, 803 F.2d 1265, 1273 (2d Cir. 1986) (quoting *Kamen v. AT&T*, 791 F.2d 1006, 1010 (2d Cir. 1986) (citation omitted)); *see also U.S. Voting Mach.*, 224 B.R. at 169 (noting that the imposition of monetary sanctions requires a determination by the court that the conduct was "abusive, unwarranted or in bad faith."). So too, pursuant to Fed.R.Civ.P. 41(a)(2), incorporated by reference in Fed.R.Bankr.P. 7041, "a court may award attorneys' fees and costs as 'terms and conditions' of permitting a plaintiff to withdraw an action voluntarily if it is determined that an action was commenced 'in bad faith, vexatiously, wantonly or for oppressive reasons.'" *Succession Picasso v. Spedding*, 1997 WL 107462 at *2 (S.D.N.Y. 1997) ("*Picasso II"),* quoting *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 129, 94 S.Ct. 2157,

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[5] The Court believes this to be a misstatement and that the commentator actually meant to refer to "arrow" rather than bow in the "sanctions quiver."

40 L.Ed.2d 703 (1974); *Dow Chemical Pacific Ltd. v. Rascator Maritime S.A.*, 782 F.2d 329, 343-44 (2d Cir. 1986)). While there has been no suggestion by the Defendants in the context of this motion that the commencement of the adversary proceedings was done in bad faith, it was inappropriate for the Trustee to require that the Defendants waive their right to make that argument before the Court, if warranted, as a condition to withdrawal. The fact that under Rule 9011, the Defendants are left with one less "arrow in their sanctions quiver" if the Trustee withdraws his complaint within the time provided by the "safe harbor" does not mean that the Trustee should be able to walk away scot-free if it was established that the filing of the complaints against the Defendants was clearly in bad faith. The Trustee seeks more than a safe harbor; he seeks a shield to protect himself from the wounds that may be inflicted by those other "arrows." This the Court will not allow.

The Court concludes that the Trustee and his counsel have failed to avail themselves of the safe harbor provisions of Rule 9011 by imposing a condition to their withdrawal of the complaints herein. Even the court in *Picasso I*, a case relied on by the Trustee in support of his Proposed Stipulation, acknowledged the alternative relief available to the plaintiff. *See Picasso* I, 1997 WL 65911 at *3. The condition proposed by the Trustee would preclude the Defendants from pursuing those remedies, if appropriate. Accordingly, the Court finds that sanctions are warranted under the circumstances based on a finding that the allegations made in the complaints asserting preferential transfers have no evidentiary support because the alleged payments by the Debtors were never made to any of the Defendants.

The Court is cognizant of the fact that the purpose of Rule 9011 sanctions is to deter rather than compensate the party seeking sanctions. *See* Cavanagh at 395 (noting that "[w]hile it is true that the abused party may have gone to some expense, which in certain circumstances may have been considerable, in defending against a baseless claim, the goal of compensation under Rule 11 is secondary to deterrence."); *see also* The Advisory Committee Notes to the 1993 Amendments to Fed.R.Civ.P. 11 (indicating that "if a monetary sanction is imposed, it is ordinarily paid into court as a penalty. However, under unusual circumstances, particularly for (b)(1) violations, deterrence may be ineffective unless the sanction not only requires the person violating the rule to make a monetary payment, but also directs that some or all of this payment be made to those injured by the violation."). There are no allegations that the complaints were filed to harass or to cause unnecessary delay or to needlessly increase the cost of litigation even though that may have been the effect. Accordingly, the Court finds no basis on the facts before it to make a monetary award to the Defendants pursuant to Rule 9011.

However, the Court deems it appropriate to require that counsel for the Trustee, which includes in this case both Simpson, Thacher & Bartlett and Saperston & Day, P.C.,[6] account separately to the Court for the time spent in preparing, serving and filing the five complaints at issue, as well as the time spent in defending these motions. The fees charged or to be charged to the Debtors' Estate in connection with those services will be disallowed in counsels' fee applications next filed with this Court, following submission of the accounting, pursuant to Code

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[6] In *imposing* sanctions, "[t]he person signing, filing, submitting or advocating a document . . . in most situations is the person to be sanctioned . . . ." See The Advisory Committee Notes to the 1993 Amendments to Fed.R.Civ.P. 11. This includes a law firm. In this case, the complaints were signed not by the Trustee but by either M.O.Sigal, Jr., Esq. or, in one instance, by Kathrine A. McLendon, Esq., of the law firm of Simpson, Thacher and Bartlett. The summons issued in connection with each complaint identifies plaintiff's attorneys as Saperston & Day, P.C. Indeed, the Proposed Stipulation was executed by Roy Z. Rotenberg, Esq. from Saperston & Day, P.C., and the papers filed in opposition to the Defendants' motion are signed by Kenneth M. Alweis, Esq. of Saperston & Day, P.C.

§ 330 or 331.

IT IS SO ORDERED.

Dated at Utica, New York

this 19th day of March 1999

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge