UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

GREGORY ELIOPOULOS, f/k/a GREGORY G. GENO,

Chapter 7
Case No.: 03-16950

Debtor.

NORTHERN FEDERAL CREDIT UNION,

Plaintiff,

v.

Adv. Pro. No. 04-90063

GREGORY ELIOPOULOS,

Defendant.

APPEARANCES:

Anthony Inserra, Esq.
Attorney for the Debtor/Defendant
531 Washington Street, Suite 3401
Watertown, New York 13601

Antonucci Law Firm
Attorneys for the Plaintiff
12 Public Square
Watertown, New York 13601

David P. Antonucci, Esq.

Hon. Robert E. Littlefield, Jr., United States Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

On July 27, 2004, this court issued a Memorandum-Decision and Order ("Order to Show Cause") directing that (1) the Plaintiff, Northern Federal Credit Union (the "Credit Union"), and its counsel, David P. Antonucci, Esq., show cause why they should not be sanctioned pursuant to Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 9011(b)(1), (3), or § 105 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"), for commencing a frivolous adversary proceeding against Gregory Eliopoulos (the "Debtor"), and (2) Attorney Antonucci show cause why he should not be sanctioned pursuant to Bankruptcy Rule 9011(b)(2) for filing an adversary complaint and later reaffirming to the court and advocating the

positions contained therein without legal justification. The court, having heard sworn testimony and arguments of counsel and having considered all submitted pleadings in this matter, makes the following findings of fact and conclusions of law in accordance with Federal Rule of Civil Procedure 52, as made applicable to this proceeding by Bankruptcy Rule 7052.

JURISDICTION

This is a core proceeding under 28 U.S.C. § 157(b)(2)(J) over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(a), (b)(1), and 1334(b).

FACTUAL AND PROCEDURAL BACKGROUND

The Debtor filed a Voluntary Petition for Chapter 7 relief on October 20, 2003. In his schedules and statements, the Debtor lists the following assets and liabilities: joint checking and savings accounts at Watertown Savings Bank; checking and savings accounts at the Credit Union; a 2002 federal income tax return that he had "used for everyday living expenses;" a 2001 Dodge Intrepid; a 1995 Ford F150 Truck; Construction Power Tools; unsecured nonpriority claims totaling $21,402.63 – including those of the Credit Union in the amount of $3,434.28 and the Dress Barn in the amount of $207.21; net monthly income of $858.10; and total monthly expenses of $1,588.90. (Main Case, Doc. No. 1.[1]) The Debtor does not list any ownership interest in real property. (Schedule A.) The Debtor lists ten monthly expenditures: electricity and heating fuel – $217; telephone – $30; cable – $30; food – $200; laundry and dry cleaning – $50; transportation (not including car payments) – $300; recreation – $75; auto insurance – $114; auto installment payments – $368; and day care expenses – $129.90. (Schedule B.) The Debtor reports his 2002 gross income as $17,987; he received $6,164 in unemployment benefits during 2002. He lists his 2003 expected gross income as $9,000; at the time of filing, he expected to receive $6,000 in unemployment benefits during 2003. (Statement of Financial Affairs, Questions 1, 2.) Finally, the Debtor discloses a September 26, 2003 transfer of $2,000 from the sale of a 1971 Ford Mustang, the fair market value of which was $2,100, and he indicates

[1] All further references to the Debtor's petition, schedules, or statements (collectively, the "Petition") relate back to this docket entry in the main case.

that the funds have been used to pay for a septic system. (*Id.*, Question 10.)

Pursuant to the Bankruptcy Court Clerk's notice, the § 341 meeting of creditors was scheduled for December 10, 2003, *see* 11 U.S.C. § 341, and the deadline to object to discharge was set for February 9, 2004. The § 341 meeting was held and closed on December 10, 2003. The Chapter 7 Trustee, Christian H. Dribusch, Esq., filed a Report of No Distribution requesting discharge and certifying that the estate had been fully administered and had no non-exempt property to distribute. Attorney Antonucci and Joy Shaffer, Senior Credit Solutions Specialist for the Credit Union, appeared at the § 341 meeting where Attorney Antonucci questioned the Debtor about his financial affairs. On January 9, 2004, the Credit Union moved the court for an order allowing a 2004 examination, *see* FED. R. BANKR. P. 2004, and extending the time to file an objection to discharge. On February 10, 2004, an Order was entered on consent granting the Credit Union's motion and extending the deadline to object to discharge to March 15, 2004. Attorney Antonucci, again with Ms. Schaffer present, conducted a 2004 examination of the Debtor on March 2, 2004.

On March 15, 2004, the Credit Union commenced this adversary proceeding by filing a Complaint pursuant to Code § 727. The Complaint did not reference the applicable subsection under which relief was sought, but the substance of the pleading was as follows:

> 14. When questioned at the Bankruptcy Rule 2004 examination, the debtor stated his expenses as set forth in Schedule J of the petition were being met; although Schedule I indicated insolvency and an inability to meet these expenses.
>
> 15. When further questioned, the debtor indicated he shared all expenses with a paramour and resided in her home with her two (2) children.
>
> 16. Further, when questioned, the debtor admitted that many of the debts, expenses and obligations being discharged arose for the sole benefit of the paramour and her real property.
>
> 17. The debtor has not disclosed the income or expenses of the paramour in his Schedules.
>
> 18. The debtor has failed to disclose the income received regularly from the paramour. The income is both monetary and in kind.
>
> 19. Upon information and belief, the Schedules I and J of the debtor [are] false and designed to hinder, defraud or delay creditors.

20. Upon information and belief, the oath which accompanied the schedule was, therefore, also false.

21. It remains obvious the design of the debtor is to incur expenses for a third party with whom he resides, discharge that obligation, and conceal corresponding income received as well as his true financial circumstances.

(Compl. at 3.)

On March 29, 2004, the Debtor filed an Answer denying all substantive allegations of the Complaint and interposing the affirmative defense of failure to state a claim upon which relief could be granted. The court immediately issued a standard Scheduling Order on March 30, 2004 requiring, *inter alia*, that all motions be filed, served, and made returnable on or before July 29, 2004. On April 4, 2004, the Debtor moved to dismiss the adversary proceeding and to recover attorney's fees. This motion was heard at the court's regular motion term on May 6, 2004, and the court, by oral ruling, dismissed the adversary proceeding with prejudice. An Order Dismissing the Adversary Proceeding with Prejudice in conformance with the court's oral ruling was entered on August 10, 2004. The court predicated its dismissal of the Complaint on a finding that there was no plausible evidence of fraud in this case and, thus, the Credit Union could not possibly have sustained its burden.[2] But the court reserved its decision on attorney's fees and issued the July 27, 2004 Order to Show Cause in compliance with Bankruptcy Rule 9011(c)(1)(B).[3] [4]

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[2] The court would be remiss not to mention the deficiencies of the Complaint under Federal Rules of Civil Procedure 8 and 9, as made applicable to this proceeding by Bankruptcy Rules 7008(a) and 7009, respectively, but any in depth discussion is prohibited because the record in this proceeding references only dismissal under Federal Rule of Civil Procedure 12(b)(6). For present purposes, it suffices to acknowledge that the Complaint was so ineloquently plead that it could have been dismissed on grounds other than frivolousness, which speaks to the apparent reasonableness, or lack thereof, of the pleading.

[3] Bankruptcy Rule 9011 provides two procedural vehicles for invoking the court's sanctioning powers: (1) by motion; or (2) on the court's own initiative. *Compare* FED. R. BANKR. P. 9011(c)(1)(A) *with* (c)(1)(B). Absent resort to its inherent equitable powers, the court could not immediately consider the Debtor's request for attorney's fees because it was not made by separate motion as required by subsection (c)(1)(A). In order to dispense with due process concerns and as required by subsection (c)(1)(B), the court issued the Order to Show Cause describing the specific conduct that appears to have violated Bankruptcy Rule 9011(b) and directing Attorney Antonucci and the Credit Union to appear on September 14, 2004 and show cause why they have not violated Bankruptcy Rule 9011(b) with respect thereto. As made clear in the Order to Show Cause, the nature of the possible sanction in this case is limited to attorney's fees and expenses and does not include directives of a nonmonetary nature or an order to pay a penalty into the court. *See* FED. R. BANKR. P. 9011(c)(2) (sanctions may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into the court, or an order directing payment to the movant of some or

In response to the Order to Show Cause, Attorney Inserra submitted an affidavit and a consolidated, itemized time-sheet on September 9, 2004. Attorney Antonucci did not respond.[5] The court held the show cause hearing on September 14, 2004.[6] At the hearing, Attorney Antonucci presented arguments on his own behalf and Ms. Shaffer presented sworn testimony in defense of the Credit Union.

Attorney Antonucci argues that neither he nor the Credit Union should be sanctioned for their conduct and strategy in this case because they believe the Debtor's schedules and statements are untruthful, and because the case presents a novel legal issue of whether, or to what extent, a paramour's income and expenses should be included on the schedules of an individual Chapter 7 debtor. (9/14/04 Tr. at 4-8.) He further states that he and his client believe there are assets, transfers, and "other factual events with the paramour that also [need] to be disclosed beyond income." (*Id.* at 9.) Mainly, however, Attorney Antonucci contends that the Debtor fraudulently or recklessly (1) understates his income by failing to include his fiancee's income, or a portion thereof, on Schedule I, and (2) overstates his expenses by including more than 50% of the monthly household expenses on Schedule J.

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all of the reasonable attorney's fees and other expenses incurred as a direct result of the violation).

[4] Review of the docket in this case shows that both the court's July 27, 2004 and August 10, 2004 orders have been appealed by the Credit Union. (*See* Notices of Appeal, Doc. Nos. 19, 24.) It is this court's opinion that the July 27, 2004 Order to Show Cause is interlocutory and, thus, not ripe for appeal. But that determination is best left to the presiding Judge of the United States District Court for the Northern District of New York. There is, however, no stay pending appeal to prevent this court from issuing a final decision on the merits of the Order to Show Cause.

[5] The court's docket does, however, reflect that Attorney Antonucci previously submitted a Memorandum of Law in opposition to the Debtor's request for attorney's fees on June 21, 2004 in response to the Debtor's Motion to Dismiss. (Mem. of Law of Northern Federal Credit Union in Opp'n to Request for Counsel Fees of the Debtor/Def., Doc. No. 13.) Among other things, Attorney Antonucci argued that sanctions in this proceeding were not merited as a matter of law because "[t]he action was commenced in good faith and with reasonable basis in law and fact." (*Id.* at 1.) The court considered Attorney Antonucci's arguments prior to issuing the Order to Show Cause, but it obviously did not find them to be persuasive.

[6] At the show cause hearing, the court advised the parties that it would decide whether the Credit Union or Attorney Antonucci had a reasonable, good-faith basis for bringing the adversary proceeding and, if not, then the court would entertain further submissions and issue a subsequent decision determining the appropriate amount of attorney's fees to be awarded in this matter. (9/14/04 Tr. at 77-78.) This decision is therefore limited to whether sanctions must be imposed for Attorney Antonucci and the Credit Union's behavior in this proceeding.

Attorney Antonucci acknowledges that omissions made without fraudulent intent are insufficient as a matter of law to carry the Credit Union's burden, but that the Credit Union's purpose in bringing this adversary proceeding was to press the issue of when "errors become more than minor or excusable omissions" and, thus, constitute grounds for denial of discharge pursuant to Code § 727(a)(4)(A). (*Id.* at 4.) Attorney Antonucci and Ms. Shaffer feel that the alleged errors or omissions make it impossible to decipher the Debtor's true financial condition and, therefore, at a minimum, evidence a "reckless disregard for the truth."

On several occasions, the court asked Attorney Antonucci to explain how the alleged omissions could rise to the level of fraud necessary to justify the Complaint:

> *Q*. My concern, Mr. Antonucci, would be that dealing with the numbers in this case – net income of approximately $800 a month, and expenses of $1,500 or $1,600 a month, leaving the debtor in the red $700 a month – using these modest numbers, how could you ever carry your burden to show, based on whatever factual background you're operating under, that the death penalty of bankruptcy would be appropriate in this case? How could you ever have a good faith basis to bring a 727(a)(4) on a theory that the paramour was not listed when you admittedly say that at the time you brought this there was no case law?
>
> *A*. Your Honor, if one backs out the transfers and the things that were not actually being paid by the debtor – and it's difficult to tell, because I don't have all the financial records – this debtor may be solvent.
>
> If he had the $4,000 or $5,000 that he put into her home, I'm not sure that this debtor might not have had an ability to repay. The problem is it becomes difficult to go much further, because all I have is two tax returns in this intermingling of assets and debt. If this was just simply a matter – which is why I don't refine it to that – of the paramour's income, I might not have brought it, but it's also a matter of the transfers. It's also a matter of the fact that somebody else is paying his auto payment. It's a fact that some of his property is obviously at least, to some extent, in her possession.

(*Id.* at 10-12.)[7]

> *Q*. To prove an (a)(4), you would have to show a deliberate intent to deceive. This money he was getting from his paramour [to help meet monthly expenses], I assume there's no argument that she had any legal obligation to do that for him. If she wants to give him money every month, she can do that but it's not enforceable.
>
> *A*. I would assume not.

[7] The original text has been modified to remove superfluous language wherever possible without materially altering the dialogue. The court notes, however, that page 10, line 13 of the transcript erroneously denotes the speaker as Mr. Inserra; it should read "the court."

Q. It's akin to a gift. How could we possibly twist and turn these facts, or how could you have in your analysis twisted and turned these facts? Where is the intent to deceive the court or creditors by not listing some income that he's receiving on a voluntary basis from a paramour that may amount to a couple hundred dollars a month? How could he harbor an intent to deceive? How does it ever rise to the level of an (a)(4)?

A. Because I think that one can clearly infer from the petition and schedules that there is a methodology here to hiding what is going on with the paramour.

When we start looking at the big picture, what you have is thousands of dollars of transfers to her and a whole economic relationship that is simply not disclosed.

When you look at it all, your Honor, the Court may not agree with the inference, but I think the inference can be made that the entire petition is replete with these sorts of problems, and what we're seeing is I'm going to take a whole bunch of credit, pour it into her house and the relationship, and then discharge, because it's all going upstream to her, but no gifts or transfers or preferences are scheduled.

I think the fraud and what is going on there can be inferred in good faith. It is a factual issue for a trier of fact after hearing testimony as to whether or not fraud occurred. I think what the Court needs to look at is could the fraud have been inferred? Could the intent have been there? And I think it clearly could have.

(*Id.* at 13-17.)

Q. What could he have been hiding? What could've been running through his mind when he said, "I'm going to play fast and loose. I'm not going to talk about this because . . . ?" What's the because? Without a because, there wouldn't be any reason for the intent to begin with.

A. Right. I think there are two reasons: (1) I'm going to go stiff my creditors; and (2) I'm going to have my cake and eat it too.

Q. But once again, trying to be reasonable here, we have a debtor that makes $800 – nets $800 a month. He's residing with his significant other. He's contributing toward the rent. He's contributing toward this. He's contributing toward that to the extent of his income, which is $800 a month. He gets a tax refund of $2,000 a month. He puts that into the home where he resides. How could we ever come out of this with an (a)(4)? How do we ever come out of this on any basis with a finding that this man doesn't deserve a discharge?

A. What can easily be inferred is that he's diverting income and all his money and property to the paramour, is then going to discharge his debt, be debt free, and they're going to go on and have the best of both worlds. I firmly believe that can be inferred.

(*Id.* at 17-21.)

Based on Attorney Antonucci's continued assertions that the Debtor diverted assets and that the Debtor's fiancee's financial status is material to the truthfulness of the Debtor's petition, the court asked whether Attorney Antonucci knew of any case law from any jurisdiction where a debtor's discharge had been

denied on similar facts. In response, Attorney Antonucci offered *In re Christiansen*, 2004 Bankr. LEXIS 7 (Bankr. W.D. Miss. 2004). He also relied upon *In re Mastromarino*, 197 B.R. 171 (Bankr. D.Me. 1996), although the court previously rejected *Mastromarino* as justification for the Complaint in this instance. (*Id.* at 23-24.) Attorney Antonucci admits that he advised the Credit Union not to proceed on similar causes of action in other bankruptcy cases despite the Credit Union's own research and trade information (*id.* at 28-29, 36), and he acknowledges that this case raises "some dangerous issues," but he nonetheless agreed to commence the adversary proceeding because he thinks that this case has merit, even after the court's dismissal (*id.* at 37).

Ms. Shaffer's testimony established that the Credit Union was an involved, aggressive client; Ms. Shaffer reviewed the petition and schedules; she attended the § 341 meeting (*id.* at 49); she brought it to Attorney Antonucci's attention that the Debtor's expenses, in her opinion, appeared to be inflated (*id.*); she requested that Attorney Antonucci seek an order compelling the Debtor to appear at a 2004 examination; and she attended the 2004 examination. Ms. Shaffer is knowledgeable and experienced in the field of consumer bankruptcy; she has been employed by the Credit Union for a period of four years and currently holds the position of Senior Credit Solutions Specialist or head collection officer; prior to joining the Credit Union, she worked at various law firms in New York and Kentucky as a Collections Officer for approximately seven years; she owned her own collection agency for approximately two years (*id.* at 48); she frequently reads bankruptcy articles from a newsletter which the Credit Union subscribes to (*id.* at 54); and she and her husband filed a *pro se* petition for Chapter 13 relief in this court (*id.* at 60).

Having established that Ms. Shaffer was instrumental in the Credit Union's decision-making process, Attorney Antonucci asked her a series of questions about the Credit Union's general procedures and, more specifically, her reasoning in this case:

> *Q.* Why did you ask our office to conduct all these 2004 examinations?
>
> *A.* We felt on further examination from the 341 meeting and what we discovered there, with what was in our files, and credit bureaus that there were questions still that remained – that

needed further examination. That we could form an informed answer by having other documents like utility bills or bank statements . . . .

Q. As a result of the Eliopoulos 2004 examination, did the Credit Union make any further decisions about how to act in the case?

A. Yes, we did.

Q. And what decisions did you make?

A. That we should proceed with an adversarial proceeding according to the recommendations of our attorney.

Q. And what was your goal in commencing the adversarial proceeding?

A. Our goal was just – to determine the facts and to determine if there was a fraud filed in this case.

Q. Did you feel there was a fraud?

A. I felt there was an intent, yes.

Q. What did you feel the fraud was, and what do you think the debtor attempted to gain by the fraud?

A. I thought there was a possibility he was hiding income . . . . I thought it was possible that his expenses were inflated, and he was looking to discharge his debts.

(*Id.* at 52-53.)

On cross-examination, Ms. Shaffer indicated that she had not been satisfied with the Debtor's document production at the 2004 examination. But she did not ever advise Attorney Inserra's office of her dissatisfaction, and no further documents were requested or obtained by the Credit Union prior to commencing the adversary proceeding. (*Id.* at 61-62.) When asked to identify the expenses that she believed to have been inflated, Ms. Shaffer pointed to the Debtor's electric and telephone bills. She later acknowledged, however, that the Debtor's alleged inflated expenses could be offset by other line items, such as rent, which the Debtor listed as "zero." (*Id.* at 62.)

On direct-examination, Ms. Shaffer spoke directly to the question of good faith:

Q. Do you believe this adversary proceeding was commenced in good faith by the Credit Union?

A. Yes, I do.

Q. And why do you believe that?

A. I believe that the debtor, for one reason or another, intended to or at least thought about defrauding the Credit Union and all of his creditors.

(*Id.* at 55.) On examination by the court, however, Ms. Shaffer admitted that "[t]here were not enough facts evident to form an informed decision regarding what [the Debtor's intent was]." (*Id.* at 67.) She further testified that, even after the 2004 examination, "the issues that were brought up still were not clear, and that there were further issues that an adversarial proceeding warranted." (*Id.* at 68.)

Ms. Shaffer also testified that the Credit Union does not have a policy of commencing adversary proceedings to try to extort settlements (*id.* at 54), and that the Credit Union has elected to proceed with only four or five adversary proceedings out of approximately fifty cases that she had reviewed during the prior year (*id.* at 53-54).

At the conclusion of the evidentiary hearing, Attorney Antonucci was given until October 15, 2004 to submit a post-hearing memoranda of law; Attorney Inserra was given until November 12, 2004 to reply; and Attorney Antonucci was given until November 22, 2004 to file any final submission. On October 19, 2004, the court received a letter from Attorney Inserra advising that Attorney Antonucci had failed to supplement the record and, on that basis, requesting that the court consider the matter fully submitted and issue its decision. Attorney Inserra's letter was so ordered and the matter was taken under advisement on October 19, 2004. (Inserra Letter of 10/19/04, Doc. No. 39.)

DISCUSSION

This proceeding began as a routine objection to the Debtor's discharge, but it obviously did not remain so. Because this is an unusual ruling, one which the court does not issue lightly, certain general observations that bear on the court's decision must be set forth before the court can address whether cause exists for the imposition of sanctions. First, the court faces the difficult challenge of having to recount and

articulate in a sensible manner arguments that are themselves nonsensical. While the court is instantly reminded of the adage about placing "a square peg in a round hole," it must decipher, to the maximum extent possible, attorney Antonucci and the Credit Union's arguments to ensure sound judicial reasoning. Second, the court must be mindful to judge the Credit Union's actions independently under a standard of objective reasonableness and to apportion liability to the Credit Union for sanctions awarded, if any, in spite of Attorney Antonucci's advice, and not because of it. A client who has been penalized once by ill advice should not be punished a second time by the court if his or her reliance on counsel's advice was reasonable under the circumstances.

In determining whether sanctions are in fact warranted under Bankruptcy Rule 9011 or Code § 105, the court focuses, *inter alia*, on the type and severity of the relief sought by the Credit Union, the scope of Rule 9011, and the narrow circumstances giving rise to sanctions under the court's inherent equitable powers.

I. "The Death Penalty of Bankruptcy"

Discharge is the ultimate goal of individuals who voluntarily seek bankruptcy relief. *See, e.g., In re Arcuri*, 116 B.R. 873, 877 (Bankr. S.D.N.Y. 1990) (citing *In re Shapiro*, 59 B.R. 844, 847 (Bankr. E.D.N.Y. 1986) (the discharge provisions of the Bankruptcy Code are the "'cornerstone' of the debtor's economic rehabilitation")). Those who enter the bankruptcy system with clean hands enjoy the privilege of a discharge and, thus, a fresh start. *See Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (the Bankruptcy Code is meant to give the honest but unfortunate debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt").

"Lying at the 'heart' of the fresh start provisions of the Bankruptcy Code is Section 727." *In re Arcuri,* 116 B.R. at 877. Code § 727 "imposes an extreme penalty for wrongdoing," *In re Chalasani*, 92 F.3d 1000, 1310 (2d Cir. 1996); *accord In re Halperin*, 215 B.R. 321, 328 (Bankr. E.D.N.Y. 1997), by denying the sought-after shelter of the Code. *See In re Arcuri*, 116 B.R. at 878 ("This provision is designed to prevent a dishonest debtor from utilizing the law's protection to shield wrongdoing.") Unlike Code § 523 which

simply bars discharge of specific debts for fraud, Code § 727 is a blanket prohibition of a debtor's discharge. In a prior decision, this court has acknowledged that "[a] denial of discharge is an extremely drastic and harsh sanction; it is the death penalty of bankruptcy." *In re Raymonda*, Case No. 99-13523, Adv. Pro. No. 91-91199, slip. op. at 4 (Bankr. N.D.N.Y. Feb. 16, 2001).

Because the overriding objective of the Code is to allow the honest debtor a fresh start, the party objecting to the granting of a discharge bears the ultimate burden of persuasion in an adversary proceeding pursuant to Code § 727(a), *see* FED. R. BANKR. P. 4005, and objections must be construed liberally in favor of the debtor. *E.g., In re Chalasani*, 92 F.3d at 1310. "The rationale for construing discharge objections liberally in the debtor's favor is that 'the filing of a bankruptcy petition would be of little aid to debtors in need of a 'fresh start' if creditors could easily attack the granting of a discharge.'" *In re Arcuri*, 116 B.R. at 878 (quoting *In re Woerner*, 66 B.R. 964, 971 (Bankr. E.D. Pa. 1986)).

A. Code § 727(a)(4)(A)

In order to support a court's denial of discharge under Code § 727(a)(4)(A), the objecting party must establish by a preponderance of the evidence, *Grogan v. Garner*, 498 U.S. 279, 287 (1991), that: (1) the debtor made a statement under oath; (2) such statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. *In re Frommann*, 153 B.R. 113, 118 (Bankr. E.D.N.Y. 1993). Statements made in a bankruptcy petition or schedules fall under Code § 727(a)(4), as do statements made during § 341 meetings and 2004 examinations. *See In re Butler*, 260 B.R. 622, 631 (Bankr. D. Conn. 2001).

It was against the weight of the foregoing precedent, and notwithstanding the seriousness of the relief sought, that Attorney Antonucci and the Credit Union chose to initiate this proceeding.

II. Bankruptcy Rule 9011

Bankruptcy Rule 9011 is analogous to Federal Rule of Civil Procedure 11; therefore, Rule 11 jurisprudence is instructive with respect to its application. *Klein v. Wilson, Elser, Moskowitz, Edelman &*

Dicker (In re Highgate Equities, Ltd.), 279 F.3d 148, 151 (2d Cir. 2002). Bankruptcy Rule 9011 provides in pertinent part that:

> By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, –
>
> **(1)** 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;
>
> **(2)** the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> **(3)** the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery.

FED. R. BANKR. P. 9011(b)(1)-(3). "The goal of the sanctions remedy under Bankruptcy Rule 9011 is to deter unnecessary filings, prevent the assertion of frivolous pleadings, and require good faith filings." *In re Firnhaber*, 2004 WL 2211686, at *3 (Bankr. S.D. Ill. 2004). Bankruptcy Rule 9011 is not intended as a fee-shifting rule which would require the losing party to pay costs. *Id*.; *see also* 10 Collier on Bankruptcy ¶ 9011-09[3], at 9011-25 to 9011-26 (Lawrence P. King et al. eds., 15th ed. rev. 2004) (Because Rule 9011 is not intended as a fee-shifting statute, attorney's fees may be imposed only under "unusual circumstances," such as where a position is taken for an improper purpose.). Thus, the Rule focuses on the conduct of the parties and not on the outcome of the litigation. *In re Firnhaber*, 2004 WL 2211686, at *3. The standard for determining violations of Bankruptcy Rule 9011 is an objective one: reasonableness is measured by what a competent attorney would have done given the circumstances presented. *E.g., In re Butler*, 260 B.R. at 633.

Clearly, a bankruptcy court may sanction an attorney who violates the certification requirements of Rule 9011. But the "[i]mposition of sanctions against an attorney does not preclude imposition of sanctions against the client." 10 Collier on Bankruptcy ¶ 9011.08[3][a], at 9011-23 (footnote omitted); *see also, e.g., In re Ksenzowski*, 56 B.R. 819, 837 (Bankr. E.D.N.Y. 1985) (sanctions imposed on plaintiffs and

their attorney who were found jointly and severally liable for a violation of Bankruptcy Rule 9011). A represented party may also be sanctioned if the court determines that they are "responsible for the violation." FED. R. BANKR. P. 9011(c); *but see* FED. R. BANKR. P. 9011(c)(2)(A) ("Monetary sanctions may not be awarded against a represented party for a violation of subdivision (b)(2)."). Responsibility for a violation depends "on the extent of the client's involvement in the management of litigation and the decisions that resulted in a violation of the rule." 10 Collier on Bankruptcy ¶ 9011.08[3][a], at 9011-23 (footnote omitted).

A. "Warranted By Existing Law or a Good Faith Argument"

The court begins with the second prong of Bankruptcy Rule 9011, because "under most circumstances a nonfrivolous document cannot be said to have been filed for an improper purpose." *In re HBA East, Inc.,* 101 B.R. 411, 415 (Bankr. E.D.N.Y. 1989) (analyzing Bankruptcy Rule 9011 and Civil Rule 11 as amended in 1983, and finding a corollary relationship between the two warranties that the document was (1) legally tenable and (2) not interposed for an improper purpose); *but cf., In re Butler*, 260 B.R. at 633 ("Even if a party submits a pleading that is well grounded in the law, 'the plain language of Rule 9011 provides that a party can be sanctioned for filing a factually and legally well-grounded paper for improper purposes.'") (quoting *In re KTMA Acquisition Corp.*, 153 B.R. 238, 266 (Bankr. D. Minn. 1993)).

"A legal position is unwarranted by law only where, after reasonable inquiry, an attorney would recognize that it is patently clear that the position has absolutely no chance of success." *Id.* at 415 (adopting the Rule 11 analysis and "patently clear" language of the Second Circuit in *Eastway Construction Corp. v. City of New York*, 762 F.2d 243 (2d Cir. 1985)); *see also* 10 Collier on Bankruptcy ¶ 9011.04[7][a] at 9011-12 ("A legal contention is not warranted by existing law if it is based on legal theories that are plainly foreclosed by well-established legal principles and authoritative precedent, unless the advocate plainly states that he or she is arguing for a reversal or change of law and presents a nonfrivolous argument in support of that position." (footnote omitted)).

A plethora of substantive case law has developed under Code § 727(a). The court should therefore

be able to determine with relative ease whether a certain legal position has "absolutely no chance of success" under Code § 727(a)(4)(A). In this case, however, the court's inquiry is muddled by Attorney Antonucci's poorly plead Complaint and his continuously evolving justifications for the commencement of the adversary proceeding. The Complaint on its face offers only one possible legal basis for its filing: the Debtor's fiancee's income should have been included on Schedule J, and the Debtor's failure to do so constitutes a false oath. At the September 14, 2004 hearing, Attorney Antonucci seemingly presented an alternate case for substantial abuse under Code § 707(b) – in theory, but not in fact due to the raw numbers involved in the case – and he suggested that the Complaint was also warranted because he believes the Debtor has surplus, undisclosed income which would allow him to repay creditors. Because the court must determine whether the Complaint was objectively reasonable at the time of filing, however, the court will limit its discussion to the contentions contained therein.[8]

In counsel's own words, this case raises "issues that had not been addressed before" either by this court or the Second Circuit (9/14/04 Tr. at 4); specifically, it raises the "novel" issue of whether a paramour's income and expenses are subject to inclusion on a debtor's schedules (*id.* at 5). Yet, counsel acknowledges that, despite his extensive search, he cannot find a single case to support his theory that the Debtor's fiancee's income should be included on Schedule I. Moreover, he agrees that the Debtor's fiancee is under no obligation to assist the Debtor financially and, thus, any monies provided to the Debtor constitute a gift.

The Code does not define "income," *see* 11 U.S.C. § 101, but the common definition is easily

[8] Attorney Antonucci's reliance on Code § 707(b) is particularly bizarre since only the United States Trustee can move for relief thereunder, and the issues presented in that instance are not even remotely similar to those presented under Code § 727. Moreover, based on the income-expense ratio drawn from the Petition, it is highly unlikely that this Debtor would ever be subject to a "substantial abuse" review by the United States Trustee; Attorney Antonucci's suggestion to the contrary is yet another example of the absurd positions taken by him throughout this proceeding. *See* 11 U.S.C. § 707(b) ("[T]he court, on its motion or on a motion by the United States trustee, . . . may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter."); *see also In re Kornfield*, 164 F.3d 778, 781 (2d Cir. 1999) (section was added to the Bankruptcy Code in 1984 to address congressional concern "that debtors who could over time easily pay their creditors might resort to Chapter 7 to erase their legitimate obligations" and thereby obtain an "inequitable discharge at the expense of [their] creditors"). The United States Trustee's Office in this District diligently pursues Code § 707(b) dismissals when appropriate, and it hardly bears mentioning that it did not make such a motion in this case.

obtainable: "The return in money from one's business, labor, or capital invested: gains, profits, salary, wages, etc.," BLACK'S LAW DICTIONARY 763 (6th ed. 1990). Schedule J is expressly labeled "Current Income of *Individual* Debtor(s)," and it directs the filer to complete the column labeled "*Spouse*" "in all cases filed by *joint debtors* and by a *married debtor* in a chapter 12 or 13 case whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed." (Official Form 6I) (emphasis added). It is implicit that a joint petition may only be filed by married individuals. Clearly, the financial resources of a live-in paramour or a fiancee are not available to creditors or subject to inclusion on Schedule J; any argument to the contrary is simply preposterous.[9] Thus, Attorney Antonucci's legal contentions with respect to the financial information of the Debtor's fiancee are not warranted by existing law, or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law.

When it became apparent that Attorney Antonucci had exhausted the "concealed income" theory in defense of his filing and continued advocacy of the Complaint, he argued that the Complaint was legally warranted on alternate grounds of undisclosed, fraudulently concealed assets or preferential transfers. This newly developed "transfer theory" is not properly within the court's Bankruptcy Rule 9011 inquiry. The Rule 11 inquiry is limited to those legal theories advanced in the signed pleading; Civil Rule 11 does not encompass possible amendments to the pleading that a party never sought leave to file. *See In re Film Ventures Int'l, Inc.*, 89 B.R. 80, 84 (B.A.P. 9th Cir. 1988).[10]

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[9] The *Christiansen* case cited by Attorney Antonucci as a basis for inclusion of the Debtor's fiancee's income provides no help to him under the particular facts and circumstances of this case. *See In re Christiansen*, 2004 Bankr. LEXIS 7. The court in *Christiansen* specifically addressed a non-filing ex-spouse's complaint to determine dischargeability of a debt pursuant to Code § 523(a)(15), and it held that for purposes of a disposable income analysis, the court may consider any income earned by a spouse or live-in companion. *Id.* at 11 (citing cases). This court agrees. That section requires the court to determine in part whether the debtor's own income truly is "necessary" for the support of the debtor and his or her own dependents. 11 U.S.C. § 523(a)(15)(A). Contrary to Attorney Antonucci's assertion, however, principles applicable to a question of law under Code §§ 523(a)(15) or 1325(b)(2) cannot be extended to one arising under Code § 727(a)(4)(A). A logical comparison cannot be made between an "ability to pay" and fraud; any argument to the contrary can only be seen as one more attempt by Attorney Antonucci to avoid sanctions in this case.

[10] Even if the court were to consider this newly developed theory, the Complaint would nonetheless violate Bankruptcy Rule 9011(b)(3) because the claim, even under this theory, lacks evidentiary support. Even after conducting the 2004 examination of the Debtor, there was absolutely no evidence that the Debtor made a pre-petition fraudulent transfer. The single legal authority cited by Attorney Antonucci on this point, *Williamson v. Fireman's*

Based on the foregoing, the court finds that Attorney Antonucci violated Bankruptcy Rule 9011(b)(2). Consequently, he is subject to sanctions thereunder, for which he is personally liable.

B. "Evidentiary Support"

The third prong of Bankruptcy Rule 9011(b) focuses on the conduct of the attorney rather than on the merits of his or her work product; at a minimum, it requires that the attorney conduct a reasonable, pre-filing inquiry to ensure that the document is factually supportable. *See* FED. R. BANKR. P. 9011(b)(3). After conducting this inquiry, the attorney must then certify that there is, or is likely to be, evidence enabling a trier of fact to find that the alleged facts are true. Thus, this subsection of Bankruptcy Rule 9011 assumes that attorneys will act in conformity with their findings, and will therefore not file papers that are known or likely to be unwarranted by fact. The 1993 amendments to Bankruptcy Rule 9011 take this obligation one step further by requiring that the attorney withdraw from positions which are no longer tenable. Under this subsection, a duty of reasonableness is also imposed on represented parties since they may be held accountable if they are responsible for their attorney's violation of the Rule.

The court initially notes its earlier determination that the Credit Union's claim was legally untenable does not moot out the Bankruptcy Rule 9011(b)(3) inquiry; rather, the court must determine whether at the time the Complaint was filed and assuming the claim to have been arguable, the Credit Union possessed sufficient evidence, or a likelihood of unearthing sufficient evidence, of fraudulent intent.

The court need look no further than the September 14, 2004 transcript; on at least 5 occasions, Attorney Antonucci freely admitted that he and his client did not have all the information necessary to reach an informed decision. (9/14/04 Tr. at 11, 18, 20, and 34.) In Attorney Antonucci's own words, he did not "have enough information" to conclude that the Debtor was "tak[ing] a bunch of money and a bunch of

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Fund Ins. Co., 828 F.2d 249, 251 (4th Cir. 1987), involved three false oaths by the debtor, including non-disclosure of multiple lump sum monetary gifts to the debtor's fiancee, including one in the amount of $15,000 that the fiancee then used to pay her divorce lawyer. Not only is *Fireman's Fund Ins. Co.* distinguishable, but any weight given to it must fall against the Credit Union, because it is decided on such egregious facts that are clearly unmatched by the facts of the case *sub judice*.

income, pour[ing] it into the paramour's home, pour[ing] it into living expenses for her children, because [he] would rather do that and have that into the future than pay [his] bills" (*id*. at 17-18), yet that is the exact allegation made. In fact, at the September 14, 2004 hearing, he used the phrase "shoot in the dark" and acknowledged that he "ha[d] nothing" in terms of financial records, and then stated that what the Credit Union was doing in this case was "figuring out what *might* have been, what should've been." (*Id*. at 34 (emphasis added).) Similarly, Ms. Shaffer testified that the Credit Union's purpose was "just – to determine the facts and *to determine if there was a fraud* filed in this case." (*Id.* at 52 (emphasis added).) In her opinion, she thought it was "*possible*" that the Debtor was hiding income (*id.* (emphasis added)), and that he "intended to or *at least thought about* defrauding the Credit Union and all of [his] creditors" (*id.* at 55 (emphasis added)). Ultimately, Ms. Shaffer admitted that "[t]here were not enough facts evident to form an informed decision regarding what the [Debtor's intent was]." (*Id.* at 67.) Because the Debtor was supposedly unwilling to give the Credit Union the information that it felt entitled to, the Credit Union commenced the adversary proceeding. (*Id.* at 69.)

While Bankruptcy Rule 9011(b)(3) permits an attorney to make and rely upon good faith inferences, it does not permit an attorney to present pure speculation as fact and hope that the same can be proven during the course of trial. It follows then that Bankruptcy Rule 9011(b)(3) certainly does not allow the more reprehensible behavior of ignoring undisputed, relevant evidence, which disproves the claim or cause of action, as Attorney Antonucci and the Credit Union have done here. For example, at the 2004 examination, Attorney Antonucci asked the Debtor whether he had "any information or any reason to believe that [Schedules I and J were] inaccurate in any way, (3/2/04 Tr. at 17, Mot. to Dismiss Adversary Proceeding, Doc. No. 17, Ex. A), and twice the Debtor answered, "No," (*id.* at 18). Further, the Debtor exceeds the scope of disclosure required by the Petition; for example, he lists transfers that pre-date the relevant fraudulent or preferential transfer periods. That the Credit Union did not have sufficient evidence of fraudulent intent even after reasonable investigation should have raised a red flag to alert Attorney Antonucci and the Credit Union

of the frivolousness of the adversary proceeding that the Credit Union was about to file. The court can only surmise that the obviousness of the Credit Union's position accounted for no further discovery attempts by the Credit Union, which leads the court to infer, as discussed in greater detail *infra*, that the reason for filing was improper.

Unfortunately for Attorney Antonucci, this case does not exemplify good lawyering; unfortunately for the Credit Union, it was not objectively reasonable for it to rely upon such poor legal advice. The Credit Union's initiation of this proceeding despite its knowledge that it had no case against the Debtor constitutes a violation of Bankruptcy Rule 9011(b)(3) by both the Credit Union and its counsel. As such, they are jointly and severally liable for any sanction to be awarded by a final order of this court.

C. "Improper Purpose"

The lack of fraudulent intent in this matter is so apparent that the Credit Union and its counsel cannot escape the clear inference that the Complaint was filed and prosecuted for an improper purpose, such as to harass the Debtor, delay the finality of the Debtor's bankruptcy case, unnecessarily increase the Debtor's cost to obtain bankruptcy relief, or to coerce a settlement. The only readily apparent explanation for Attorney Antonucci and the Credit Union's conduct is that they were testing their belief that debtors and bankruptcy counsel ought to be preparing petitions in a manner suitable to the Credit Union. Importantly, because of its bizarre conduct in this case and its frequent appearance as a litigant before this court, it seems that the Credit Union sought by way of example to send a message to its broad customer base that any bankruptcy filing will be highly scrutinized.[11]

Accordingly, the court finds that Attorney Antonucci and the Credit Union have also violated Bankruptcy Rule 9011(b)(1), thereby inviting further cause for sanctions.

IV. Code § 105

[11] The court does not wish to chill the Credit Union's participation in future bankruptcy proceedings, but it cannot tolerate or condone the conduct of Attorney Antonucci and the Credit Union in this proceeding; such conduct violates the spirit of the Bankruptcy Code and is the very conduct that Bankruptcy Rule 9011 intends to prevent.

Apart from Bankruptcy Rule 9011, a bankruptcy court may in certain situations sanction parties or counsel for misconduct pursuant to its inherent equitable powers. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 46 (1991) (the sanctioning scheme of statutes and rules does not displace the court's inherent power to impose sanctions for bad-faith conduct); *see also Eastway Construction Corp.,* 762 F.2d at 253; *In re Zinni*, 261 B.R. 196, 203 (B.A.P. 6th Cir. 2001) (citing *Schwartz v. Kujawa (In re Kujawa)*, 256 B.R. 598, 610-12 (B.A.P. 8th Cir. 2000)); *In re Butler*, 260 B.R. at 634; *In re Kriss*, 217 B.R. 147, 159 (Bankr. S.D.N.Y. 1998) (citing cases)); *In re 72nd Street Realty Assocs., Inc.*, 185 B.R. 460, 475 (Bankr. S.D.N.Y. 1995). The court's inherent power to sanction parties stems from its authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [Title 11]." 11 U.S.C. § 105(a). Code § 105, however, allows for fee-shifting only where the unsuccessful litigant has been found to have '"acted in bad faith, vexatiously, wantonly, or for oppressive reasons.'" *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y,* 421 U.S. 240, 258-59 (1975) (quoting *F.D. Rich Co. v. United States*, 417 U.S. 116, 129 (1974)). For the court to invoke its inherent equitable powers, "there must be 'clear evidence' that the claims are 'entirely without color *and* made for reasons of harassment or delay or for other improper purposes.'" *Eastway Construction Corp.,* 762 F.2d at 253 (citing *Browning Debenture Holders' Comm. v. DASA Corp.,* 560 F.2d 1078, 1088 (2d Cir. 1977)).

Code § 105 imposes a higher standard than Bankruptcy Rule 9011 for the imposition of sanctions. *See Chambers v. NASCO, Inc.*, 501 U.S. at 44 ("Because of their very potency, inherent powers must be exercised with restraint and discretion."). While an inference of bad faith may support a sanction under Bankruptcy Rule 9011(b)(1), the court is unconvinced that it would do so under Code § 105. In any event, the court need not issue a conclusive ruling under Code § 105, because the result is the same no matter how it is achieved. The court's ruling is clear; the type of conduct exhibited by Attorney Antonucci and the Credit Union in this proceeding will not be tolerated.

Conclusion

"Sanctions pursuant to Rule 9011(b) cannot be entered lightly and must be reserved for only those circumstances where pleadings are clearly frivolous and a lack of good faith has been shown." *In re Firnhaber*, 2004 WL 2211686, at *4. For the reasons discussed *supra*, sanctions are particularly appropriate here, as is joint and several liability of Attorney Antonucci and the Credit Union.

Sanctions imposed for violation of Bankruptcy Rule 9011 "shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated," FED. R. BANKR. P. 9011(c)(2); as stated in the Order to Show Cause, sanctions are limited in this case to reasonable attorney's fees and costs incurred by the Debtor in defense of this adversary proceeding and in response to the Order to Show Cause.

Accordingly, it is hereby

ORDERED that Attorney Inserra shall file and serve updated time records on or before May 13, 2005; and it is further

ORDERED, that if the parties cannot reach an agreement on the reasonableness of fees and costs to be awarded pursuant to this Memorandum-Decision and Order, Attorney Antonucci shall file and serve his response thereto on or before May 27, 2005; and it is further

ORDERED that Attorney Inserra shall file and serve his reply, if any, on or before June 10, 2005.

Dated: 5/5/05
Albany, New York

/s/ Robert E. Littlefield, Jr.

Hon. Robert E. Littlefield, Jr.
United States Bankruptcy Judge