IT IS ORDERED as set forth below:

Date: January 5, 2012

Mary Grace Diehl

Mary Grace Diehl
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

In re:	:	Case No.:10-43405-MGD
	:	
MORAN LAKE CONVALESCENT CENTER, LLC,	:	Chapter 7
	:	
Debtor.	:	Judge Diehl
	:	

ORDER DENYING CHAPTER 7 TRUSTEE'S MOTION FOR SANCTIONS AGAINST SAS-MORAN LAKE, INC., SAS-MORAN LAKE HOLDING LLC, AND JAMES B. BOONE

Both the attorneys for the Trustee and the attorneys for the creditors have zealously advocated on behalf of their clients. However, the behavior of the attorneys in this case has not been a model of civility. Lack of civility, while undesirable and counterproductive, does not serve as the basis for an award of sanctions where the conduct sought to be sanctioned does not rise to the level of bad faith. The Trustee's Motion for Sanctions is denied.

I. Factual Background

Before the Court is the Chapter 7 Trustee's Motion for Sanctions against SAS Moran Lake,

Inc., SAS Moran Lake Holding LLC, and James B. Boone. (Docket No. 113). A hearing on the Motion was held September 9, 2011. The factual background of the case is relevant to the Motion.

This Chapter 7 case began as a Chapter 11 case, which was filed on the eve of the entry of a large verdict against Debtor Moran Lake Convalescent Center, LLC ("Debtor"). The United States Trustee moved to dismiss or convert the case, and an Order converting the case to Chapter 7 was entered on September 23, 2010. (Docket Nos. 18 & 24). Tracey L. Montz was appointed as Interim Trustee and qualified as Trustee. (Docket Nos. 25 & 26). The §341(a) meeting of creditors was not concluded until March 3, 2011, and the Trustee filed a Report of Assets and a Request to Set a Claim Deadline. (Docket No. 62).

Debtor owned real estate and a facility, which operates as a nursing home. Debtor does not operate the nursing home. The operator is SAS-Moran Lake, Inc. ("SAS Inc."). SAS-Inc. has not filed a Proof of Claim in this case. At the time the bankruptcy case was filed, the real estate was encumbered by a security deed in favor of Roswell Holdings Mortgage, LLC. ("Roswell Mortgage"). Roswell Mortgage subsequently assigned its claim to SAS-Moran Lake Holding LLC ("SAS-Holding"). SAS-Holding filed a $4.1 million secured proof of claim as assignee of Roswell Holdings Mortgage, LLC). (Claim No. 4).

Initially, Trustee was authorized to employ and did employ John C. Pennington as her attorney. (Docket Nos. 31 & 36). Mr. Pennington filed a Motion to Use Cash Collateral on behalf of the Trustee and the motion was granted without opposition from Roswell Mortgage or SAS-Holding. (Docket Nos. 56 & 64). The use of the cash collateral was limited to the employment of an appraiser and a title examiner.

The Rome, Georgia law firm of Brinson, Askew, Berry, Seigler, Richardson & Davis, LLP first filed a notice of appearance for the SAS entities. (Docket No. 45). Thomas Richardson of that

firm and Mr. Pennington began discussions about the potential sale of the nursing home property and the general progress of the case. Later, a Notice of appearance for SAS-Inc. and SAS-Holding was filed by Richard Wolfe, a Georgia attorney. (Docket No. 70). A substitution of counsel, withdrawing Brinson, Askew, Berry, Seigler, Richardson & Davis, LLP as counsel of record, was then filed. (Docket No. 73). Subsequently, Mr. James Boone, an attorney from Weston, Florida who represents the SAS entities joined the discussion which appears to have taken place substantially through letters which were mailed and faxed among the relevant parties. Mr. Boone was admitted *pro hac vice* with Mr. Wolfe as designated local counsel and Mr. Boone then began filing documents and pleadings on behalf of the SAS entities. (Docket Nos. 72, 78 & 80). Mr. Boone's first filing was the notice of hearing for Mr. Richardson's objection to the Trustee's employment of consultant John F. McMullan. (Docket Nos. 71 & 80).

Just before Mr. Boone began filing pleadings on behalf of the SAS Parties in April 2011, the law firm of Alston & Bird LLP was selected by the Trustee to assist and ultimately to replace Mr. Pennington as her counsel. (Docket Nos. 74 & 82). The Court entered its standard order approving the employment, subject to objection of any party in interest within 21 days. (Docket No. 76). On behalf of the SAS Parties, Mr. Boone filed an objection to the employment of Alston & Bird (Docket No. 84) and also advocated the objection to the Trustee's employment of Mr. McMullan as a consultant. The Court held a hearing on these matters on May 18, 2011 and overruled the objections of the SAS parties. (Docket Nos. 92 & 93).

On June 10, 2011, the Trustee filed a Motion for a Rule 2004 examination of the SAS entities, and Mr. Boone filed an objection to the motion. (Docket Nos. 96, 97 & 98). The matter was heard by the Court on July 20, 2011. (Docket Nos. 101 & 102). Just prior to that hearing, on

July 18, 2011, the Trustee filed this Motion for Sanctions. (Docket No. 113). At the July 20, 2011 hearing, the Court overruled the objections of the SAS entities and granted the Trustee's Motion for 2004 examination. (Docket No. 114).

Before the hearing on the Trustee's sanctions motion was held, the Court also conducted a telephonic status conference to resolve a Confidentiality Order and extended the time for the SAS Parties to produce documents related to the Rule 2004 exam. (Docket Nos. 120 & 125).

A hearing on the Trustee's Motion for Sanctions was held September 9, 2011. (Docket No. 116). A response and reply were filed by the parties and considered by the Court. (Docket Nos. 129 & 132).

II. Factual Basis for Motion

The Trustee bases her motion for sanctions on the actions of the SAS entities and their attorney, Mr. Boone, in connection with (1) the objections made to employment applications of Alston & Bird LLP and the health care consultant, Mr. McMullan; (2) the objections to the 2004 examination of the SAS entities; and (3) the conduct of the SAS entities to effectuate lease payments made by SAS-Inc. (under its lease with Debtor) directly to SAS-Holding.

With respect to the objections to the Alston & Bird employment application, Trustee asserts that certain arguments made in pleadings and advocated by the SAS entities were frivolous. These include the argument that individual attorneys at Alston & Bird who were working on the engagement by the Trustee were required to file individual affidavits of their disinterestedness to satisfy 11 U.S.C. § 327(a). The SAS entities also argued that the hourly rates charged by Alston & Bird were excessive and asserted that the evidence in support of the typical hourly rate for attorneys in the Rome Division pursuing fraudulent conveyance litigation was largely hearsay.

With respect to the employment of Mr. McMullan, the SAS entities argued that Mr. McMullan had a conflict of interest. The Trustee asserts this argument was also frivolous because it was not supported by any facts.

As to the objections to the Rule 2004 examination, the Trustee takes issue with numerous legal and factual statements in the SAS pleadings. Specifically, the Trustee highlights Mr. Boone's threat of filing a Rule 9011 motion without complying with the "safe harbor" provision; failure to comply with Local Rule 2004-1, N.D. Ga.; the assertion in a pleading that a lease was "confidential" when it has apparently been filed of record; and the argument that the lease has been assumed by the conduct of the Trustee.

II. Legal Standard for Sanctions

The Trustee moves for sanctions under three legal theories. The Trustee seeks sanctions against SAS-Inc., SAS-Holding, and Mr. Boone pursuant to § 105 of the Bankruptcy Code and the Court's inherent powers. Sanctions against Mr. Boone only are sought pursuant to 28 U.S.C. § 1927. The legal standard under these bases differs, yet all require a finding by the Court of "bad faith" on the parties against whom sanctions are sought. *U.S. v. Shaygan*, 652 F.3d 1297, 1314 (11th Cir. 2011) (28 U.S.C. § 1927); *Byrne v. Nezhat*, 261 F.3d 1075, 1123 (11th Cir. 2001) (the court's inherent power, including those in 11 U.S.C. § 105). The Trustee notes in her Motion that sanctions are not sought under Rule 9011.

This Court has the inherent power to impose sanctions under appropriate circumstances. *See, e.g., Chambers v. NASCO*, 501 U.S. 32, 111 S. Ct. 2123, 115 L. Ed. 2d 27 (1991). This Court also may impose civil sanctions pursuant to § 105(a) of the Bankruptcy Code, which authorizes the issuance of any order necessary or appropriate to carry out the provisions of the Bankruptcy Code.

Section 105 provides bankruptcy courts with the same inherent powers as federal district courts to sanction abusive conduct. *DeLauro v. Porto (In re Porto)*, 645 F.3d 1294, 1304 n.6 (11th Cir. 2011). The key to awarding sanctions under a court's inherent powers is a finding of bad faith by the sanctioned person. *Id.* at 1304. Bad faith exists where an attorney "knowingly or recklessly raises a frivolous argument." *In re Evergreen Sec., Ltd.*, 570 F.3d 1257, 1273 (11th Cir. 2009) (quoting *In re Walker*, 532 F.3d 1304, 1309 (11th Cir. 2008)). Bad faith exists where an attorney "argues a meritorious claim for the purpose of harassing an opponent." *In re Porto*, 645 F.3d at 1303 (quoting *In re Evergreen Sec., Ltd.*, 570 F.3d at 1273). A party also demonstrates bad faith by delaying or disrupting the litigation or hampering enforcement of a court order. *In re Walker*, 532 F.3d at 1309.

"While bad faith is the key to unlocking the court's inherent power, a court must do more than conclude that a party acted in bad faith; it should make specific findings as to the party's conduct that warrants sanctions." *Byrne v. Nezhat*, 261 F.3d 1075, 1123 (11th Cir. 2001) ("a conclusory finding of bad faith is not sufficient to withstand appellate review") (citations omitted). Bad faith filings must not be confused with losing arguments and positions. The Supreme Court has warned of a broad bad faith interpretation:

> [I]t is important that courts not engage in post hoc reasoning by concluding that, because a plaintiff did not ultimately prevail, his action must have been unreasonable or without foundation. This kind of hindsight logic could discourage all but the most airtight claims, for seldom can a prospective plaintiff be sure of ultimate success.

Cordoba v. Dillard's, Inc., 419 F.3d 1169, 1181-82 (11th Cir. 2005) (quoting *Christiansburg Garment Co. v. EEOC*, 434 U.S. 412, 421-22, 98 S.Ct. 694, 700, 54 L. Ed. 2d 648 (1978)).

28 U.S.C. § 1927 authorizes federal courts to require any attorney "who so multiplies the

proceedings in any case unreasonably and vexatiously . . . to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct." "[T]he provisions of § 1927, being penal in nature, must be strictly construed." *Peterson v. BMI Refractories*, 124 F.3d 1386, 1395 (11th Cir. 1997). A federal court can sanction a private attorney for "unreasonably and vexatiously" multiplying a proceeding under 28 U.S.C. § 1927 "only when the attorney's conduct is so egregious that it is 'tantamount to bad faith.'" *Amlong & Amlong, P.A. v. Denny's, Inc.*, 500 F.3d 1230, 1239 (11th Cir. 2007) (quoting *Avirgan v. Hull,* 932 F.2d 1572, 1582 (11th Cir. 1991)). Bad faith turns not on the attorney's subjective intent, but on the attorney's objective conduct. *Id.*; *Norelus v. Denny's, Inc.*, 628 F.3d 1270, 1282 (11th Cir. 2010) ("The standard is an objective one . . . .").

Section § 1927 contains three essential requirements: (1) unreasonable and vexatious conduct; (2) that conduct must multiply the proceedings; and (3) the amount of the sanction must bear a "financial nexus to the excess proceedings." *Peterson v. BMI Refractories*, 124 F.3d at 1396.

III. Application of Law to Facts

The record and the Trustee's arguments do not provide a sufficient factual basis to evidence bad faith by the SAS Parties or Mr. Boone. Mr. Boone's personal actions have not risen to the level of sanctionable conduct and do not demonstrate objective bad faith. Because the threshold requirement of bad faith has not been met, the facts raised by the Trustee against the SAS Parties and Mr. Boone will generally not be distinguished. In determining whether bad faith exists, it is not sufficient that the Court ultimately overruled the objections raised by the SAS entities. As the Supreme Court directs, the Court should not use hindsight and rely on whether the plaintiff prevailed to support a finding of bad faith. *Christiansburg Garment Co. v. EEOC*, 434 U.S. at 421-22. The

objections themselves must be frivolous or designed merely to multiply the litigation. The Trustee fails to set forth a factual basis to meet either of these standards. The Court's independent review of the record and the proceedings do not show that Mr. Boone's actions multiplied the proceedings or that the positions asserted by the SAS Parties or Mr. Boone were frivolous or vexatious.

The Court will address each factual basis that the Trustee relies on in support of her request for sanctions. First, with respect to the employment objections, SAS's objection to the employment of Alston & Bird and consultant Mr. McMullan were not objectively made in bad faith. SAS's objections to the employment of Alston & Bird were a legitimate inquiry. In fact, the Court required Mr. Connolly to supplement the record orally to indicate the exact procedure utilized by the firm concerning the affidavit of disinterestedness before making a ruling. The SAS Parties' position that disinterestedness required individual attorneys to execute separate statements with respect to disinterestedness was novel, as far as the Court is aware, but, as one argument raised in an objection, the Court does not think it rises to the level of a frivolous or bad faith claim.

Similarly, the objection to the proposed hourly rates was worthy of inquiry. Mr. Boone correctly noted that the rates sought by Trustee's counsel are significantly higher than the rates charged by most, if not all, of the lawyers who regularly practice in the Rome Division of this Court. While the court affirmed the Trustee's choice of counsel, other courts have held that a court may disapprove a trustee's choice of counsel if the proposed rate of compensation is not reasonable as compared to local rates for attorney compensation. *E.g.*, *In re Kurtzman*, 220 B.R. 538, 542 (S.D.N.Y. 1998).

The Court notes that the Trustee's argument that the SAS entities lack standing to objection to employment, which was intended to preclude the Court from hearing the SAS Parties' objection

to employment of Alston & Bird, was functionally overruled by the Court. The Court allowed Mr. Boone to make the argument. Mr. Boone represents both a secured creditor and the counterparty to the Debtor under a lease and thus has a right to be heard on these matters.

Second, the SAS Parties' objection to Mr. McMullan's employment was a proper area of inquiry, even though it was overruled. Although the objection lead to a hearing on the application to employ, the objection can not be characterized as reckless, vexatious or objectively filed in bad faith. The Court would note that Mr. Richardson, SAS's former counsel, brought the original objection. Both Mr. Richardson and Mr. Boone, as advocates for the SAS Parties, thought it was worthy to raise an objection based on Mr. McMullan's position with a competitive nursing home operator. The Trustee asserts that the objection was without factual basis. The objection relied upon Mr. McMullan's verified statement, which was submitted as part of the Trustee's application to employ. Mr. McMullan's role as director and consultant to nursing homes operated in Debtor's immediate surrounding area is a non-frivolous, factually based objection.

The SAS Parties' objections did not result in a multiplication of the proceedings. The objections were filed, a hearing was held, and orders were entered to resolve the matter. Without insinuating that SAS would not be entitled to move for reconsideration, no further motions were filed by the SAS Parties following the Court's ruling and entry of order. The objections were not vexatious, frivolous, or harassing. The Trustee's desire for her motions to be unopposed does not mean the objections are harassing. The objections do not evidence sanctionable conduct or bad faith.

Third, the objections to the Motion for Rule 2004 examination, while overruled, likewise were not totally lacking in substance to be reckless, frivolous or vexatious. The Trustee emphasizes the meaning of Local Rule 2004 in her pleadings and in the presentation to the Court on this Motion.

The Court found that the Trustee's reading of the rule which requires a good faith conference to precede only an objection or other protective motion – not the Motion itself – to be correct. However, the first sentence subsection (a) does require that parties make a good faith effort to resolve disputes concerning a 2004 examination by agreement. That sentence could be read to suggest that a person proposing a 2004 exam confer prior to filing a motion with the court. It is not totally without merit to suggest that the local rule required the Trustee to confer with the Rule 2004 deponents.

The Trustee also emphasizes SAS's mention of Rule 9011 sanctions as bad faith conduct. The pleadings regarding the 2004 examination objection included this threat. Yet, the threat never materialized. It is true that Mr. Boone did not follow the procedure for a Rule 9011 motion, but he never actually filed one. Threatening to file such a motion is not, in and of itself, sanctionable, although it could be considered a factor in an overall assessment of a party's conduct.

In addition to not finding any objective bad faith by the SAS Parties or Mr. Boone with respect to the objections filed to the 2004 examinations, it seems the timing of the Trustee's sanctions motion may have, itself, multiplied the proceedings more than any other act by either party over the course of this case.

Fourth, the Trustee also asserts that the SAS entities' lease assumption argument was frivolous and without merit. Section 365(d)(4) governs nonresidential real property leases where the debtor is the lessee. SAS-Inc. asserted in the objection to the 2004 exam that the Trustee assumed the lease agreement between debtor and SAS-Inc. by her conduct. Bad faith can be evidenced by a party recklessly or knowingly raising a frivolous argument. *In re Evergreen Sec., Ltd.*, 570 F.3d at 1273.

The Trustee's motion for sanctions states that the relevant law is contrary to this position and clearly states that an unexpired lease may only be assumed by a formal motion or oral request at a hearing. Mr. Boone provided a sufficient explanation of the position and supporting authority at the hearing on the Motion. Mr. Boone cited to several cases that support his position that a lease can be assumed by conduct. He acknowledged that this position is not a majority position taken by courts. Without ruling on the merits of whether the Trustee could have assumed the lease by conduct, the Court notes the following excerpt from *USPG Portfolio Two, LLC v. Sportsman's Link, Inc. (In re Sportsman's Link, Inc.)*, 2007 Bankr. LEXIS 4740 (Bankr. S.D. Ga. Oct. 31, 2007):

> A few courts have held that a debtor can assume or reject a lease without filing a formal motion by communicating its intent to the lessor in an unequivocal manner. *See In re 1 Potato 2, Inc*., 58 B.R. 752, 755 (Bankr. D. Minn. 1986) (holding that a debtor in possession may assume or reject an unexpired lease by clearly communicating in an unequivocal manner its intentions to do so to the lessor, the debtor "must manifest an unconditional and unambiguous decision"); *see also In re Re-Trac Corp.*, 59 B.R. 251, (Bankr. D. Minn. 1986) (finding that a phone call from the debtor's chief executive officer and payment of rent was not an unequivocal act demonstrating its intent to assume; *see also Vilas and Summer, Inc. v. Mahoney (Matter of Steel Ship Corp.)*, 576 F.2d 128, 132 (8th Cir. 1978) (holding that "[a]n assumption may be shown by word or by deed consistent with the conclusion that the trustee intended to assume").

Id. at 6-7. The Court is not convinced that these cases are applicable to this case, yet Mr. Boone's ability to support his position with caselaw demonstrates that the argument is not reckless. Further, there is no evidence that the argument was made to harass or delay. It is also noteworthy that the assumption argument by the SAS Parties was not the basis for its own motion. Instead, it was included in the objections to the 2004 examination. The Court addressed this tangential argument to the extent necessary during the hearing on the Trustee's motion for a 2004 exam. This argument does not present any conduct that amounts to objective bad faith.

Fifth, the Trustee also relies on the tone of the letters received from Mr. Boone to support her request for sanctions. She attaches these selected letters to her motion. The Court would first note that the Trustee's use of the letters as exhibits contravenes Local Rule 7.4, N.D. Ga., which directs that counsel not provide the Court with copies of correspondence between them on a disputed matter. While this is not an absolute prohibition, the rule was written to prevent the escalation of tensions by publishing to the Court matters which were not intended for such publication. While complaining that Mr. Boone was writing letters with the intent of creating leverage, the Trustee does substantially the same thing in using them in this manner. The Court cautions use of out-of-court correspondence as the basis for a sanctions motion absent exceptional egregious circumstances.[1]

The Trustee seems to rely upon correspondence with Mr. Boone to evidence a pattern of misconduct. The letters submitted with the Trustee's Motion only seem to demonstrate that both parties and their counsel engaged in corrosive behavior. Objective bad faith, delay tactics, and harassment are not clear from the selected letters presented to the Court. Perhaps the method of communication - written, formal correspondence – escalated the disputes between the parties and effected delay. As instructed from the bench at the close of the sanctions hearing, counsel and their clients should attempt direct telephone communication in the future to resolve substantive disputes without engaging in a letter writing battle that delays the administration of the estate and any other related proceedings.

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[1] Correspondence between parties may serve as the basis for sanctions. *See, e.g., In re Catholic Bishop of Spokane*, 2010 U.S. Dist. LEXIS 116208 (E.D. Wash. Oct. 28, 2010) (reversing award of sanctions based on the bankruptcy court's ruling that an email between the attorney for the Spokane Diocese, the bankruptcy Debtor, to the Plan Trustee attorney constituted contempt of court).

Finally, the Trustee also mentions the actions taken by SAS-Inc and SAS-Holding in connection with allegedly diverting the rent payments due to the Debtor to the mortgage holder. Mr. Boone responds in terms of the requirements of the lease and the Trustee's breach of same. No evidence has been submitted with respect to the underlying facts and neither party has filed a motion with respect to this apparent lease dispute. The propriety of either party's actions is not properly before the Court. No substantive determination as to the lease and its relevant provisions will be made within the context of this request for sanctions.

IV. Conclusion

Sanctions are not warranted is this case. There is no evidence of bad faith. Instead, the conduct of both the Trustee, her counsel, the SAS Parties, and their counsel, demonstrates zealous, contentious advocacy that unfortunately deteriorated into a lack of civility and sub-standard professionalism. For these reasons, it is

ORDERED that the Chapter 7 Trustee's Motion for Sanctions in hereby **DENIED.**

The Clerk is directed to mail a copy of this Order on the Chapter 7 Trustee, her counsel, Mr. Boone, and the United States Trustee.

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