

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

In re

Case No. 01-34255

WILLIAM KEN ALEXANDER

Debtor

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DISPOSITION:

1. November 7, 2002, Judge Leon Jordan adopts bankruptcy court's memorandum in its entirety and appeal is overruled.
2. December 6, 2002, Notice of Appeal filed in the United States Court of Appeals for the Sixth Circuit.

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Case No. 01-34255

WILLIAM KEN ALEXANDER

Debtor

**MEMORANDUM ON DEBTOR'S
REQUEST FOR JUDGMENT UNDER 11 U.S.C.A. § 303(i)**

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**RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE**

Petitioning creditor Waddey & Patterson, P.C. (Petitioner) filed an Involuntary Petition against the Debtor under Chapter 7 on August 29, 2001. By a Debtor's Answer to Involuntary Petition Under Chapter 7 filed on September 19, 2001, the Debtor contested the Involuntary Petition.

By an Order entered January 4, 2002, the court granted the Petitioner's November 16, 2001 Motion to Dismiss Involuntary Petition. A hearing was held on April 10, 2002, to determine whether the Debtor is entitled to costs, attorney fees, and/or damages under 11 U.S.C.A. § 303(i) (West 1993). The court heard the testimony of the Debtor and Ira Clinton Waddey, Jr. (Waddey), the Petitioner's director. Thirty-two exhibits were introduced into evidence by the parties.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(A) (West 1993).

I

The Petitioner is a law firm that has represented the Debtor in various patent matters. The Debtor is a self-styled inventor and entrepreneur. In the Involuntary Petition, the Petitioner valued its claim against the Debtor at \$83,079.34, consisting primarily of fees related to litigation between the Debtor and an entity identified as "Ergodyne." The Debtor, although acknowledging that he is indebted to the Petitioner, has contested his billings from the Petitioner for some time.¹

¹ Specifically, the Debtor contests the billing rate in each matter and asserts that the Petitioner told him he would not be charged for certain patent work due to an alleged filing delay by the Petitioner. The Debtor further alleges that the Petitioner improperly retained a \$30,000.00 check offered in partial settlement of the fee dispute.

The dispute relates primarily to the Petitioner's billing for the Ergodyne litigation, which both parties agree was far more involved than originally anticipated. The Petitioner accuses Ergodyne of adopting a "scorched earth" litigation strategy involving the filing of numerous summary judgment motions and counter-complaints. The Debtor
(continued...)

II

As an initial matter, the court must identify the statutory provision under which the present dismissal occurred. The Petitioner's Motion to Dismiss Involuntary Petition provided in material part:

Comes the petitioning creditor . . . and moves the Court pursuant to 11 U.S.C. §305 to dismiss the involuntary petition filed August 29, 2001, and for grounds would show to the Court as follows:

. . . .

2. After conducting discovery and exchanging documents, the petitioning creditor has determined that the matter is essentially a two party dispute between the petitioning creditor and the debtor and that it would be in the best interests of creditors and the debtor to dismiss the involuntary petition pursuant to 11 U.S.C. §305.

Wherefore . . . the petitioning creditor . . . moves the Court to dismiss the involuntary petition pursuant to 11 U.S.C. §305.

Section 305 of the Bankruptcy Code is captioned "Abstention" and directs, in relevant part, that "[t]he court . . . may dismiss a case under this title, or may suspend all proceedings in a case under this title, . . . if the interests of creditors and the debtor would be better served by such dismissal or suspension[.]" 11 U.S.C.A. § 305(a)(1) (West 1993). Courts sometimes use

¹(...continued)
acknowledged the same in a July 15, 2001 letter to attorney John Threadgill, in which he stated:

What really happen[ed] in this case was we were forced to meet the demands of an opposing law firm determined to win by fighting a costly paper war. . . . In the final analysis we were carried forward by our confidence in the case beyond my means of paying for it all. If we would have won and Ergodyne had the ability to pay the royalties I would not be writing this letter [discussing his inability to pay the Petitioner in full].

See Ex. 22 (which the Debtor testified may have been a draft copy).

§ 305(a)(1) to dismiss or abstain from matters that are essentially two-party disputes, particularly if other factors favoring abstention or dismissal are present. *See, e.g., In re Long Bay Dunes Homeowners Ass'n, Inc.*, 246 B.R. 801, 806 (Bankr. D.S.C. 1999).² Abstention/dismissal under § 305 is “an extraordinary remedy that should be used sparingly and *not as a substitute for a motion to dismiss under other sections of the Bankruptcy Code.*” 2 KING, COLLIER ON BANKRUPTCY ¶ 305.02, at 305-4 (15th ed. rev. 2002) (emphasis added). Section 305 does not contain a provision authorizing damages against the petitioning creditor.

Conversely, § 303, which governs involuntary cases, does authorize sanctions for cases dismissed under that section. *See* 11 U.S.C.A. § 303(i) (West 1993). Section 303(j) specifically addresses dismissal of involuntary petitions:

Only after notice to all creditors and a hearing may the court dismiss a petition filed under this section—

(1) on the motion of a petitioner;

² Factors useful in determining the applicability of § 305(a) include:

1. economy and efficiency of administration;
2. whether another forum is available to protect the interests of both parties or there is already a pending proceeding in a state court;
3. whether federal proceedings are necessary to reach a just and equitable solution;
4. whether there is an alternative means of achieving the equitable distribution of assets;
5. whether the debtor and the creditors are able to work out a less expensive out-of-court arrangement which better serves all interests in the case;
6. whether a non-federal insolvency has proceeded so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process; and
7. the purpose for which bankruptcy jurisdiction has been sought.

In re Fax Station, Inc., 118 B.R. 176, 177 (Bankr. D.R.I. 1990).

- (2) on consent of all petitioners and the debtor; or
- (3) for want of prosecution.

11 U.S.C.A. § 303(j) (West 1993).

A split of authority exists regarding whether § 303(i) sanctions are available in cases dismissed under § 305. See *Koffman v. Osteoimplant Tech., Inc.*, 182 B.R. 115, 127 (D. Md. 1995) (collecting cases). Under the majority view, which relies upon the legislative history of § 303, such sanctions are not available. See *id.*; see also *Glinka v. Dartmouth Banking Co. (In re Kelton Motors, Inc.)*, 121 B.R. 166, 185 n.18 (Bankr. D. Vt. 1990); 2 KING, ¶ 303.15[11], at 303-104 (quoting H. R. REP. NO. 95-595, at 324 (1977); S. REP. NO. 989, at 34 (1978)); but see *In re Kidwell*, 158 B.R. 203, 216 n.22 (Bankr. E.D. Cal. 1993). Therefore costs, attorney fees, and damages are potentially available to the present Debtor only if his involuntary bankruptcy was dismissed under § 303.

III

After reviewing the January 3, 2002 hearing and the Motion to Dismiss Involuntary Petition, the court concludes that this case was a “§ 305(a) dismissal” in form only. The Petitioner had standing to move for dismissal under § 303(j)(1). Cf. 2 KING, ¶ 303.16[1], at 303-107 (Although § 305 should be employed sparingly, one potential application is where the party seeking dismissal is neither the debtor nor the petitioner and therefore lacks standing under § 303(j)).

At the dismissal hearing, the Petitioner consented to the court’s continuing damages jurisdiction. Such jurisdiction is “paradoxical” and inconsistent with abstention under § 305(a):

The legislative history makes clear that abstention under section 305 "is of jurisdiction over the entire case." It would be paradoxical for the bankruptcy court to refuse to exercise jurisdiction on the grounds that the parties' interests are best served by the court's non-involvement, yet then to entertain a suit for damages stemming from the same bankruptcy proceedings. The parties can either resolve the issues surrounding an involuntary bankruptcy petition in the bankruptcy court or they can resolve them on their own outside the bankruptcy court. They cannot, however, have it both ways.

Koffman, 182 B.R. at 127 (internal citations omitted).

Further, § 305(a) relief is appropriate where such abstention/dismissal would better serve the interests of both the debtor and the creditor[s]. See 11 U.S.C.A. § 305(a)(1). As a party who has planned all along to seek § 303(i) damages, the Debtor's interests were not "better served" by abstention.

In sum, the court cannot find that this is "the extraordinary case in which [§ 305] abstention [was] warranted." See *In re 801 South Wells St. Ltd. Partnership*, 192 B.R. 718, 726 (Bankr. N.D. Ill. 1996). Dismissal, in substance, occurred under the standard provisions of § 303(j). Costs, attorney fees, and damages are therefore potentially available to the Debtor.

IV

The judgment provisions of § 303(i) represent congressional recognition of the harm that can result from the filing of an unjustified involuntary petition. *See In re Cadillac by DeLorean*, 265 B.R. 574, 580 (Bankr. N.D. Ohio 2001).³ Section 303(i) directs that:

(i) If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—

(1) against the petitioners and in favor of the debtor for—

(A) costs; or

(B) a reasonable attorney's fee; or

(2) against any petitioner that filed the petition in bad faith, for—

(A) any damages proximately caused by such filing; or

(B) punitive damages.

11 U.S.C.A. § 303(i) (West 1993). Use of the term “or” in subsections 303(i)(1) and (2) does not limit a debtor’s available remedies. *See* 11 U.S.C.A. § 102(5) (West 1993) (“[O]r” is not exclusive[.]”).

3

The filing of an involuntary bankruptcy petition is, to say the least, a serious matter. Such a filing is a public statement by creditors that the alleged debtor is in enough financial difficulty that the power of a federal bankruptcy court is appropriately invoked to force the debtor to address the problems. In a commercial setting, an involuntary filing may have a number of consequences, ranging from plummeting employee morale, to lost customers, credit problems, and damage to a businesses' [sic] reputation. In a filing made against an individual, many of the same concerns exist, coupled with embarrassment on both a personal and a professional level. Because of this, [t]he filing of an Involuntary Petition should not be lightly undertaken. Even the good-faith filing of such a petition creates onerous circumstances for a debtor.”

Cadillac by DeLorean, 265 B.R. at 580 (citation omitted).

Section 303(i) sets three preconditions, each of which exists in the present case. The Involuntary Petition has been dismissed, the Debtor did not waive his right to judgment, and the dismissal was not based upon the Debtor's consent. *See R. Eric Peterson Constr. Co., Inc. v. Quintek, Inc. (In re R. Eric Peterson Constr. Co., Inc.)*, 951 F.2d 1175 (10th Cir. 1991) (A debtor does not "consent to dismissal" for purposes of § 303(i) merely by not actively objecting to the dismissal, particularly where he expresses an intention to pursue damages.).

(a) Actual and Punitive Damages

Actual and/or punitive damages may be awarded to the debtor "against any petitioner that filed the petition in bad faith[.]" 11 U.S.C.A. § 303(i)(2). The debtor bears the burden of proof. *See Cadillac by DeLorean*, 265 B.R. at 582.

The term bad faith is not defined by the Code. As a result, courts have used different standards to determine whether a petition was filed in bad faith for purposes of § 303(i). These approaches include: (1) an "improper use" test under which bad faith is found based on creditor attempts to obtain disproportionate advantage by means of an involuntary filing; (2) an "improper purpose" test under which bad faith is found when an involuntary filing is made based on ill-will, malice, or a desire to embarrass or harass the alleged debtor; and (3) a bad faith inquiry based on the standards set forth in Bankruptcy Rule 9011.

Id. (citing *Lubow Mach. Co. v. Bayshore Wire Prods. Corp. (In re Bayshore Wire Prods. Corp.)*, 209 F.3d 100, 105-06 (2d Cir. 2000); *Gen. Trading Inc. v. Yale Materials Handling Corp.*, 119 F.3d 1485, 1501-02 (11th Cir. 1997)).

In view of the Debtor's representations to Waddey in the weeks preceding the Involuntary Petition, the court cannot find under any standard that the Petitioner acted in bad faith. In a June 16, 2001 letter, the Debtor told Waddey that he had not paid the Petitioner because he had

"spent all my savings and retirement funds" and that the Ergodyne litigation had been "financially devastating." See Ex. 20. In a July 7, 2001 letter to Waddey, the Debtor described himself as "financially devastated . . . currently unemployed and without any immediate prospects of finding employment." See Ex. 3. In a July 13, 2001 facsimile to Waddey, the Debtor discussed filing bankruptcy as a solution to his "financial crisis." See Ex. 4 ("I do not see another solution.").

Waddey testified that after the Debtor received \$100,000.00 of the Ergodyne settlement proceeds on or around May 30, 2001, he still did not pay the Petitioner and that:

He [the Debtor] was tracking the same line that he was saying in his written correspondence; that he did not have enough money to pay all of his creditors; that he had outstanding bills that he owed to [expert witnesses] Bohn and Hughes.

He told me that his mother was sick and was going to have to go into a nursing home. And I already said this before, but basically that he was having -- he told me he had to prepay six months worth of her nursing home care to get her in a place; that he was doing that.

And he had to repay money to his retirement account; that he just didn't have the money to pay me.

Trans. at 197-8. As to the Debtor's other creditors, Waddey testified that he asked the Debtor "who do you owe money to," but that the Debtor "would not tell me anything about that." *Id.* at 198.

Waddey testified that the Debtor later told him that he had repaid the loan on his retirement account; that he had made a payment to the nursing home for his mother; and that he had paid the two expert witnesses in the Ergodyne litigation. See Trans. at 201. All of these payments were made without any payment being made on the Debtor's obligation to the Petitioner.

Regarding the Petitioner's motivation for filing the Involuntary Petition against the Debtor,

Waddey testified on direct examination:

Q Why did you believe it was appropriate to file the involuntary petition on August 29, 2001?

A I knew that the settlement on April the 30th required the first payment of a hundred thousand dollars in thirty days, which would have been May the 30th. And ninety days from May the 30th would have been June, July, and August. So by the end of August, that would have been ninety days from the time that he first received a major lump sum payment in settlement.

He was telling me that he was making these preferential payments and fraudulent transfers; and I felt like that if I waited past the August 29th date those things, as I understand it, cannot be set aside if they're over ninety days old.

And I -- from what he was telling me, he was making those payments and I wanted it to go into the hands of a court or trustee to monitor -- if he didn't have enough money to pay his creditors, I wanted a court or trustee to monitor how that money was going to be distributed rather than him just putting me at the back of the line and paying everybody else and pay me what's left.

Q At the time that you filed, what did you think could be accomplished in a bankruptcy case involving Mr. Alexander concerning his assets and his liabilities?

A Well, I thought a trustee would monitor what he had paid and determine whether they were preferences and bring that money back into the estate and then distribute that money fairly among his creditors.

Trans. at 202-4.

Given the Debtor's representations and actions, actual and/or punitive damages are not warranted by the facts of this case.

(b) Costs and Attorney Fees

Employing a totality of the circumstances analysis, courts have broad discretion in awarding costs and attorney fees under § 303(i)(1). See *Cadillac by DeLorean*, 265 B.R. at 580-81. There exists a presumption that such costs and fees should be awarded. 2 KING, COLLIER ON BANKRUPTCY ¶ 303.15[3], at 303-96 (15th ed. rev. 2002). After a debtor demonstrates the reasonableness of the requested sanctions, the burden then shifts to the petitioning creditor to establish “that factors exist which overcome the presumption[] and support the disallowance of fees.” *In re Ballato*, 252 B.R. 553, 558 (Bankr. M.D. Fla. 2000). In reaching its decision, the court must consider “such factors as the reasonableness of petitioners’ actions, petitioners’ motives and objectives, and the merits of petitioners’ view that filing was appropriate.” *Cadillac by DeLorean*, 265 B.R. at 581.

After weighing the above factors, the court has determined that it is not appropriate to award the Debtor costs and fees in this case. To a large degree, the Debtor is the author of the August 29, 2001 Involuntary Petition filed against him by the Petitioner. His declarations to Waddey of “financial devasta[tion]” and “financial crisis,” his representations regarding other creditors, his payment on loans and other debt without any payment on his obligation to the Petitioner, and his suggestion to Waddey in the July 13, 2001 letter that he saw no solution to his financial problems other than bankruptcy led Waddey to arrive at a single conclusion: to place the Debtor in involuntary bankruptcy would allow a trustee to evaluate the payments the Debtor was making to his creditors in the context of the Bankruptcy Code’s avoidance provisions. Only in this

manner did Waddey feel like the Petitioner would be placed on an equal footing with those creditors the Debtor was paying. The court cannot fault Waddey's rationale.

For the above reasons, the Debtor's request for costs and attorney fees under § 303(i) will be denied. An appropriate order will be entered.

FILED: July 3, 2002

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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

In re

Case No. 01-34255

WILLIAM KEN ALEXANDER

Debtor

ORDER

For the reasons set forth in the Memorandum on Debtor's Request for Judgment Under 11 U.S.C.A. § 303(i), the court directs that the Debtor's request for a judgment under 11 U.S.C.A. § 303(i) (West 1993) is DENIED.

SO ORDERED.

ENTER: July 3, 2002

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE