United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

Carl M. Freeman and Linda A. Freeman, Plaintiffs, v.
Don McGrath, d/b/a McGrath Electric, Defendant.

Carl M. Freeman, Plaintiff, v. McGrath Electric, Inc., Defendant.

(In re Carl M. Freeman and Linda A. Freeman, Debtors)
Bankruptcy Case No. MM11-88-01207
Adv. Case Nos. 88-0193-11 and 89-0050-11

United States Bankruptcy Court
W.D. Wisconsin

February 19, 1990

Robert D. Martin, United States Bankruptcy Judge.

MEMORANDUM DECISION

Defendant McGrath, pursuant to 28 USC § 1927, seeks recovery from Plaintiffs' Attorney, Roger Schnitzler, of $13,011.75 in attorneys fees and disbursements incurred defending adversary proceedings nos. 89-0050-11 and 88-0193-11. The disbursements all relate to adversary proceeding number 89-0050-11. Because costs in that adversary proceeding, in the amount of $493.25, were taxed by this court on September 28, 1989, they are not properly a part of Defendant's motion. Accordingly, this decision is limited to consideration of attorneys fees.

The history of these cases, although short, is complex. On September 30, 1988, Plaintiffs filed adversary complaint no. 88-0193-11 seeking recovery for lost profits from Defendant's alleged refusal to allow Mr. Freeman to complete a construction job. In December, Plaintiffs' new counsel, Roger G. Schnitzler, filed a motion for default judgment due to Defendant's failure to answer, and Defendant filed an "application for dismissal;" in January, 1989, both motions were withdrawn by stipulation of the parties. In due course Defendant filed his answer and alleged that "defendant McGrath was unwilling to advance additional funds until the work, labor or services were actually performed."

On February 27, 1989, Plaintiffs filed adversary complaint no. 89-0050-11 seeking recovery from the Defendant pursuant to 11 USC § 547(b) of allegedly preferential payments to an "insider."

At a pretrial conference on May 9, 1989, parties agreed that discovery could be completed within 60 days. An order to that effect was entered and made controlling in both pending proceedings. The last day for discovery was thus set as July 10, 1989.

On May 24, 1989, and again on June 21, 1989, Defendant served and filed demands for production of documents. Each production demand was captioned with both adversary

proceeding numbers and each sought, inter alia, written calculations or projections showing estimated costs and anticipated profits on the condominiums.

On June 2, 1989, Defendant deposed Mr. Freeman and on July 21, 1989, Defendant deposed Charles DeZwarte, Defendant's accountant.

On July 17, 1989, Defendant filed a motion to consolidate the two adversary proceedings at issue herein and a motion for summary judgment in adversary proceeding no. 89-0050-11. On August 3, 1989 Defendant filed another motion, this one for an order compelling discovery in both cases. The affidavit of Defendant's attorney, Harry J. O'Leary, and copies of the previously filed production demands were attached to the motion. All motions were scheduled to be heard on August 8, 1989.

Attorney Schnitzler was on vacation at the time of the August 8, 1989 hearing. Plaintiff appeared by substitute counsel, who consented to entry of summary judgment for Defendant in adversary proceeding no. 89-0050-11: Plaintiff then withdrew the motion to consolidate. Upon representations of Mr. O'Leary, I ordered, pursuant to FRCP 37, that because of Plaintiffs' failure to produce the requested discovery, Plaintiffs would be limited at trial of adversary proceeding no. 88-0193-11 to the evidence already exchanged. I scheduled for August 23, 1989 a hearing on Defendant's pending motion to dismiss (for failure to comply with discovery). On August 11, 1989, Defendant filed a motion to hold Plaintiffs' counsel liable for excessive costs in both adversary proceedings. That motion was also scheduled for hearing on August 23, 1989.

Attorney Schnitzler appeared at the August 23, 1989 hearing and stated that, pursuant to an agreement with Attorney O'Leary, Attorney Schnitzler had been granted until August 21, 1989 to comply with the discovery requested by serving a profitability analysis upon Attorney O'Leary. Attorney Schnitzler generously, if not sincerely, surmised that Attorney O'Leary had mistakenly believed that the written information which had been provided by Attorney Schnitzler prior to his August vacation was intended to represent all that would be produced, including the promised profitability analysis. In fact, it was not. Attorney O'Leary therefore had filed his motion to compel discovery prior to the August 21, 1989 discovery cutoff agreed to by counsel.

I declined to enforce the attorneys' "side agreement" as it would undermine the future enforcement of discovery orders. Because discovery was due by July 10, 1989, with Attorney Schnitzler's acquiescence, I reaffirmed my earlier order limiting Plaintiffs to the evidence produced by August 8, 1989. I did, however, deny Defendant's motion to dismiss adversary proceeding no. 88-0193-11, as it seemed to violate the lawyers' acknowledged agreement, and deferred Defendant's motion for sanctions to the time of trial on September 7, 1989. Attorney Schnitzler was instructed to inform Attorney O'Leary by August 29, 1989 whether Plaintiffs would voluntarily dismiss adversary proceeding no. 88-0193-11.

On August 29, 1989, Attorney Schnitzler notified Attorney O'Leary of Plaintiffs' intention to dismiss the case. Pursuant to Plaintiffs' motion, an order dismissing the case was signed on September 13, 1989.

Rather than a trial, on September 25, 1989, Defendant's motion for excessive attorneys fees and costs was heard. Attorney Schnitzler did not appear. Defendant was granted ten days to submit affidavits in support of his motion. Attorney O'Leary thereafter submitted an affidavit, a brief, and a transcript of Mr. Freeman's deposition. The motion was taken under advisement.

Defendant seeks recovery of attorneys fees and disbursements pursuant to 28 USC § 1927 (1980) which provides:

Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

In In re TCI, Ltd., 769 F2d 441, 446 (7th Cir 1985), the Seventh Circuit elaborated upon the policy behind 28 USC § 1927:

The principle underlying § 1927 . . . is that in a system requiring each party to bear its own fees and costs, courts will ensure that each party really does bear the costs and does not foist expenses off on its adversaries. One cost of a lawsuit is research. An attorney must ascertain the facts and review the law to determine whether the facts fit within a recognized entitlement to relief. This may be a costly endeavor. Defense against a colorable claim also may be very costly. It would warp the system if a lawyer for a would-be claimant could simply file a complaint and require the adversary to do both the basic research to identify the claim and then the further work needed to craft a response. Suits are easy to file and hard to defend. Litigation gives lawyers opportunities to impose on their adversaries costs much greater than they impose on their own clients. The greater the disparity, the more litigation becomes a predatory instrument rather than a method of resolving honest disputes.

. . . . The best way to control unjustified tactics in litigation is to ensure that those who create costs also bear them.

(emphasis in original).

Regarding application of 28 USC § 1927, the Seventh Circuit has stated:

Section 1927 clearly is punitive and thus must be construed strictly. A court may impose section 1927 fees only to sanction needless delay by counsel. The purpose of section 1927 is to penalize attorneys who engage in dilatory conduct. To be liable under section 1927, counsel must have engaged in "serious and studied disregard for the orderly process of justice."

. . . . . .

. . . before a court may assess fees under section 1927, the attorney must intentionally file or prosecute a claim that lacks a plausible legal or factual basis. The court, however, need not find that the attorney acted because of malice.

Knorr Brake Corp. v Harbil, Inc., 738 F2d 223, 226, 227 (7th Cir 1984) (citations omitted). See also Kapco Mfg. Co. v C & O Enterprises, Inc., 886 F2d 1485, 1491 (7th Cir 1989) ("If a lawyer pursues a path that a reasonably careful attorney would have known, after appropriate inquiry, to be unsound, the conduct is objectively unreasonable and vexatious.").

In adversary proceeding no. 89-0050-11, Plaintiffs sought recovery for allegedly preferential payments to Defendant pursuant to 11 USC § 547(b). Plaintiffs contended that Defendant had taken control over Mr. Freeman's business to such extent that Defendant qualified as an "insider" pursuant to 11 USC § 101(30) and 11 USC § 547(b)(4)(B). 11 USC § 101(30) states:

(30) "insider" includes--

(A) if the debtor is an individual--

(i) relative of the debtor or of a general partner of the debtor;

(ii) partnership in which the debtor is a general partner;

(iii) general partner of the debtor; or

(iv) corporation of which the debtor is a director, officer, or person in control;

That the list is not exhaustive is made apparent by use of the word "includes." The Legislative History accompanying this section indicates that an insider is anyone "who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor."

Had Defendant taken control over Mr. Freeman's business as was alleged in Plaintiffs' complaint, he certainly would have qualified for closer scrutiny than someone dealing with Mr. Freeman at arm's length, and thus would be an "insider" for purposes of 11 USC § 547(b) considerations. That being the case, the longer one year preference period would have applied. 11 USC § 547(b)(4)(B). Accordingly, Plaintiffs' complaint presented a colorable claim which was apparently brought in good faith.

The complaint was filed on February 27, 1989. Plaintiff provided some discovery in response to Defendant's May 24 and June 21, 1989 demands for production of documents, and depositions were taken on June 2 and July 21, 1989. On July 17, 1989, Defendant filed a motion for summary judgment; at the August 8, 1989 hearing on the matter, Plaintiff consented to entry of summary judgment in favor of the Defendant.

Little more than five months passed between Plaintiffs' filing of their complaint and their consenting to entry of summary judgment against them. Presumably, that consent was given on the basis of Plaintiffs' recognition that they lacked the ability to prove their case. Although Plaintiffs failed to provide the requested discovery pertaining to cost and profit projections for the condominium units, those calculations related not to adversary proceeding no. 89-0050-11, but rather to adversary proceeding no. 88-0193-11, and the failure cannot be interpreted as indicative of dilatory conduct in adversary proceeding no. 89-0050-11.

No evidence has been presented which would indicate that Attorney Schnitzler intentionally filed a claim which lacked a plausible factual basis, or that he continued to pursue the claim after appropriate inquiry revealed that claim to be without factual merit. Accordingly, Defendant's Section 1927 motion for counsel's liability for excessive costs, insofar as it pertains to adversary proceeding no. 89-0050-11, must be denied.

In adversary proceeding no. 88-0193-11, the complaint was filed not by Attorney Schnitzler, but by Plaintiffs' then-attorney, Dona J. Merg. Plaintiffs sought recovery for lost profits resulting from Defendant's alleged refusal to allow Mr. Freeman to complete construction of two condominiums he had contracted to build for Defendant subsequent to Plaintiffs' assumption of the contracts pursuant to 11 USC § 365.

Because Mr. Freeman assumed the contracts, Defendant's rights were as set forth therein. Even assuming, as Defendant alleges, that Mr. Freeman stopped work on the condominiums when Defendant refused to advance him additional funds, the contracts did not give Defendant the right to complete construction of the condominiums in the event of default, and his completion thereof may have been a violation of the automatic stay. The filing of a motion for relief from the automatic stay or, in the alternative, for adequate protection, was the appropriate course to follow. 11 USC § 362. Defendant's alternative course created a colorable claim for lost profits on behalf of Plaintiffs, and this court does not doubt the good faith of either Attorney Merg's actions in bringing the complaint, nor Attorney Schnitzler's initial pursuit of the claim advanced therein.

Attorney Schnitzler's subsequent conduct was, however, far short of commendable. In discovery demands first filed with this court on May 26, Defendant specifically requested written calculations or projections showing estimated costs and anticipated profits on the condominiums. Attorney Schnitzler failed to supply the requested information within the time originally required. No formal extension was granted. Therefore, when Defendant's August 3, 1989 motion for an order compelling discovery was heard on August 8, 1989, I ordered that Plaintiffs would be limited at trial to the evidence which was timely exchanged. And, when I instructed Attorney Schnitzler to inform Attorney O'Leary by August 29, 1989 (approximately one week before the September 7, 1989 trial date), whether Plaintiffs would voluntarily dismiss the proceeding, perhaps unsurprisingly, Attorney Schnitzler waited until August 29, 1989 before advising Attorney O'Leary of Plaintiffs' intention to dismiss the case.

It is conduct such as that engaged in by Attorney Schnitzler that 28 USC § 1927 was designed to redress. Attorney Schnitzler failed to ascertain or produce in response to Defendant's discovery the facts pertinent to Plaintiffs' cause of action. With discovery time running for both sides, Attorney Schnitzler failed to grant the Defendant's request for cost estimates and profit calculations. Defendant attempted to protect itself by deposing Mr. Freeman and its own accountant, Charles DeZwarte, thereby requiring Defendant to do the basic research to identify the claim. See In re TCI, Ltd., supra. Attorney Schnitzler's dilatory conduct apparently resulted in his continuing to pursue a claim that "a reasonably careful attorney would have known, after appropriate inquiry, to be unsound." Kapco Mfg. Co., 886 F2d at 1491. His conduct, although by no means the worst I have observed, was "objectively unreasonable and vexatious." The Defendant is thus entitled, pursuant to 28 USC § 1927, to the recovery of reasonable attorneys fees incurred as a result of the unreasonable conduct.

Defendant is entitled to recovery of attorneys' fees incurred in defending adversary proceeding no. 88-0193-11 only subsequent to the time at which Attorney Schnitzler, had he engaged in appropriate inquiry into his clients' cause of action, should have known that cause of action to be factually unsound. Because of the relationship between the two adversary proceedings at issue herein, Attorney Schnitzler should have acquired sufficient familiarity with the facts relevant to adversary proceeding no. 88-0193-11 by the time of the May 9, 1989 pretrial conference in adversary proceeding no. 89-0050-11 to suspect that adversary proceeding no. 88-0193-11 was factually unsound. However, there is nothing to suggest that the deficiency was known previously. There is no basis, therefore, for awarding fees incurred in defending adversary proceeding no. 88-0193-11 prior to and including May 9, 1989.

Because the discovery in this case related to both adversary proceedings, and because Attorney O'Leary failed to allocate his fees to one or the other of the two adversary proceedings by charging them to a particular file, I am forced to guess how the discovery time should be divided.

Whatever fees may constitute an appropriate sanction, they will not include the fees attributable to hearings on August 8 and August 23, 1989. At the hearing on August 8, 1989 Attorney O'Leary made a substantial misrepresentation to this court. Attorney O'Leary, in Attorney Schnitzler's absence, stated that Attorney Schnitzler had failed to comply with discovery requests to provide cost estimates and profit projections for the condominium contracts, but neglected to inform the court that Attorney O'Leary and Attorney Schnitzler had agreed that Attorney Schnitzler would have until August 21, 1989 to provide these materials. Attorney Schnitzler informed this court of the "side agreement" at the August 23, 1989 hearing. While this court cannot enforce attorneys' "side agreements" that extend past the court's discovery deadline, it need not compensate Defendant for the costs incurred due to his attorney's misrepresentation to the court. Indeed, such misrepresentations may well be sanctionable conduct

themselves.

In addition to the limitations just described, fees requested for services related not to the adversary proceedings, but rather to the main bankruptcy case, will not be made part of the award, nor will fees related to Defendant's motion to dismiss filed with this court on September 8, 1989 be awarded, as this motion was required to be filed by Plaintiffs and was so filed only three days later.

Pursuant to 28 USC § 1927, and in accordance with this opinion, Defendant may recover from Attorney Schnitzler the amount of $500.00.