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In re 15375 Memorial Corp.: One More Look

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This article is in response to a recent Straight & Narrow article[2] and looks more closely at the decision handed down in that case. My reasons for this article have nothing to do with the subject matter of the decision—the issuance of sanctions. Rather, it is because I have appeared many times before the judge who wrote the opinion, and the criticisms of it suggest an unfair appraisal of the judge, but academic criticism of judicial decisions are certainly fair game. However, upon reading the Straight & Narrow article, I was troubled because the criticisms were fundamentally inconsistent with my prior experiences with the judge. This response results from an independent review of the record in the case.

In *Santa Fe Minerals Inc. v. BEPCO LP (In re 15375 Memorial Corp.)*,[3] the bankruptcy court made the "unpleasant and painful" decision to impose monetary sanctions against the nondebtor parent companies of the chapter 11 debtors for their role in orchestrating and prosecuting bankruptcy filings (found on appeal not to have been filed in good faith) by their subsidiaries that prejudiced the nondebtor party, BEPCO LP, in certain nonbankruptcy litigation and caused it to incur significant additional legal fees. The Straight & Narrow article contends that the court's decision is "troubling from any number of perspectives." First, the article questions whether it was "fair...to include [in the sanctions award] legal fees incurred by BEPCO" during the case, given that the court's decision not to dismiss was reversed on appeal.[4] Second, the Straight & Narrow article argues that the court learned "nothing" new after reversal, and therefore, the sanctions award "was a bit 'draconian.'" Lastly, the article contends that no clear standard was articulated as to when the line between aggressive representation and vexatious litigation is crossed, and that "the only clear thing is that the bankruptcy court's award of sanctions...will likely result in increased challenges, on 'bad faith' grounds, to the filing of chapter 11 cases accompanied by contentious litigation." These are serious criticisms. However, given the case's unique circumstances, the decision was warranted and well within the court's discretion.

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In originally deciding not to dismiss the bankruptcy cases, the court accepted the argument that the debtors would use the bankruptcy cases to benefit creditors.[5] According to the court, "[t]he actions taken by Debtors after commencement of the cases have benefitted Debtors' estates" and the "Debtors are working to provide additional value to creditors, which is a legitimate and valid bankruptcy purpose for the Bankruptcy Cases."[6] Further, in its opinion denying reconsideration, after restating its conclusions that the Bankruptcy Rule 9019 settlement between the debtors and their parent entities and the plan proposed by the debtors and sponsored by the parent entities could not be approved, the court stated that "there is a reasonable likelihood that a revised plan can be confirmed and, in any event, the Court is unable and unwilling to find that Debtors will be unable to propose a confirmable plan."[7]

Thereafter, the conduct of the parties becomes relevant for assessing whether to impose sanctions. The Straight & Narrow article asks, "what did the bankruptcy court know on May 17, 2010 (the date of the sanctions order), that it did not know on Feb. 15, 2008 (the date of its decision not to dismiss the debtors' cases)?"[8] The article suggests that the answer is "nothing."[9] The record, however, suggests otherwise.

First, Judge **Kevin Gross** pointedly did not fail to exercise independent judgment on the sanctions issue. In rejecting the imposition of sanctions against counsel, he wrote:

> The Court, which on several occasions ruled that the Debtors had filed their bankruptcy petitions in good faith, does not find that any of the attorneys, law firms or Faure violated Rule 9011. The Court fully recognizes and respects the District Court's and the Third Circuit's findings that the Court erred in not dismissing the cases. The attorneys and Faure did not mislead or make misrepresentations or dissemble. The Court simply made

1 The views expressed herein are those of the author and do not necessarily reflect the views of Richards, Layton & Finger or its clients.
2 *See* Kathy Yeatter, "*In re 15375 Memorial Corp.*: Bad-Faith Filing Leads to Huge Sanctions," *ABI Journal*, October 2010.
3 430 B.R. 142 (Bankr. D. Del. 2010) (hereinafter, "*Memorial V*").
4 Straight & Narrow at 94. BEPCO had reserved its rights to pursue sanctions arising from the filing and prosecution of the bankruptcy cases prior to the district court or Third Circuit decisions. *See In re 15375 Memorial Corp.*, 400 B.R. 420 (D. Del. 2009) ("*Memorial III*"), *aff'd, In re 15375 Memorial Corp.*, 589 F.3d 605 (3d Cir. 2009) ("*Memorial IV*").
5 *In re 15375 Memorial Corp.*, 382 B.R. 652, 685 (Bankr. D. Del. 2008) ("Memorial I"), *reconsideration denied*, 386 B.R. 548 (Bankr. D. Del. 2008) ("*Memorial II*").
6 *Memorial I*, 382 B.R. at 685 .
7 *Memorial II*, 386 B.R. at 553.
8 Straight & Narrow at 94.
9 *Id.*

> the wrong decision. The opinions of the District Court and the Third Circuit could not be clearer or more emphatic that the Court simply made the wrong decision. In the absence of misconduct toward the Court, it would be disingenuous were the Court, having sustained the cases, to impose Rule 9011 sanctions on the attorneys or parties who filed or were otherwise involved in the cases.[10]

Thus, it is clear that the court believed something more than the appellate courts' determination that there was no proper bankruptcy purpose served by the cases was required to impose sanctions.

Given that the "District Court and the Third Circuit both concluded that BEPCO was damaged," and having determined that he could not impose sanctions on the parties pursuant to Bankruptcy Rule 9011, the bankruptcy court was left with the daunting task of determining "from whom and in what amount" BEPCO would recover for its damages.[11] The court relied on its well-settled "inherent authority to impose sanctions for abuses in bankruptcy cases."[12] The "voluminous filings in support of and in opposition to the motion for sanctions belie the relative simplicity of the issue."[13] "Reviewing the case, and with the benefit of the rulings by the District Court and the Third Circuit, the Court recognize[d] the vexatious conduct by [the sanctioned parties] directly or through their control of Debtors."[14]

Thus, when the bankruptcy court issued its sanctions order, it was aware of other facts relevant to the determination of the subjective and objective good or bad faith of the parties. After the appeal of the denial of the motion to dismiss, the bankruptcy cases did not remain static. As the court found, the parent entities, either "directly or through their control of Debtors," engaged in impermissible and vexatious tactics, including the following:

> • "The Debtors' tactical filing of a motion for summary judgment seeking to compel BEPCO to litigate in [Bankruptcy] Court the merits of its claims against Santa Fe arising from the Tebow Action. The summary-judgment motion was filed three days after the conclusion of trial on BEPCO's motion to dismiss the bankruptcy cases and was timed to distract BEPCO from post-trial briefing, which was then ongoing."[15]
> • "The Debtors' filing of multiple versions of a plan...while BEPCO's appeal...was pending, including one that the Court held to be facially unconfirmable. Each of the plans filed by the Debtors would have fully released the GSF Entities from the alter ego claims, and other claims, that BEPCO sought to assert and would have provided BEPCO, at most, nominal consideration."[16]
> • "The Debtors' filing, again during the pendency of BEPCO's appeal, of a motion to approve an insider settlement with the GSF Entities that was entered into without the involvement of any non-insider creditors and, like the plans, purported to release the GSF Entities from alter-ego type claims."[17]
> • "The failure and refusal of the Debtors' professionals to timely file fee applications, which increased BEPCO's cost, delayed the progress of proceedings by forcing it to seek such information in discovery and hid the extent of the estates' administrative insolvency from the Court."[18]
> • "The Debtors' filing and prosecution of a motion to estimate BEPCO's claims, which was presented only after the Court had modified the automatic stay to allow BEPCO to liquidate those claims in the Louisiana Court and pursue recoveries from insurance proceeds."[19]
> • "The opposition of the Debtors and the GSF Entities to BEPCO's request to this Court to stay certain proceedings in the bankruptcy cases while its appeal...was pending."[20]
> • "The request of the Debtors and the GSF Entities to 'abate' the bankruptcy cases, which was made only after it became clear that this Court, prior to the resolution of the appeals, would not allow them to proceed with their agendas of (i) forcing BEPCO to litigate the merits of its claims in this Court and (ii) trying to go forward with plans and settlements that would have released the alter ego claims and denied BEPCO access to insurance proceeds without providing BEPCO reasonable compensation for its claims."[21]

The court's dissatisfaction with the sanctioned parties' conduct that occurred after its February 2008 decision is further evident from an examination of the underlying record. At an August 2008 hearing, when the court ruled that the parent entity-sponsored plan was facially unconfirmable, the court expressed its frustration as follows:

> Disclosure statement hearings are not ordinarily the time to argue the merits of the plan, and disclosure statement objections are by and large resolved by additional or modified disclosures with everyone reserving confirmation issues for the confirmation hearing. ["]Normally["] and ["]ordinarily["] are terms [that] do not describe this case. And the Court has given the Debtors every benefit of the doubt on the good faith of their bankruptcy filings. The disclosure statement and the second amended joint plan of liquidation have created serious questions about the Debtors' good faith. And the Court, on the basis of the objections to the disclosure statement finds that the plan is unconfirmable on its face, a finding which the case law not only permits the Court to make, but in circumstances such as these, may mandate. The Court allowed these bankruptcy cases to proceed because it believed that having filed its cases the bankruptcy setting was the best opportunity for Debtors to resolve claims, and in particular the claims of BEPCO and the estates. The Debtors have not been able to do so, and now in the proposed plan, the Debtors have not proposed a confirmable plan.[22]

At the sanctions hearing, following the Third Circuit's mandate, the court also granted BEPCO's motion to vacate the automatic stay pending the sanctions decision.[23] Soon after, the parent entities petitioned for relief in Texas state court, seeking declarations of the parent entities' nonliability to BEPCO on claims that were the mirror image of those that BEPCO had been trying to pursue in Louisiana state court where related litigation against one of the debtors was

10 *Memorial V*, 430 B.R. at 151.
11 *Id.* at 151, 149.
12 *Id.* at 152.
13 *Id.* at 149.
14 *Id.* at 152.
15 *Id.* at 153.
16 *Id.*
17 *Id.*
18 *Id.*
19 *Id.*
20 *Id.*
21 *Id.*
22 *In re 15375 Memorial Corp.*, Case No. 06-10859 (KG), Hrg. Tr., Aug. 19, 2008, at 48:12-49:07.
23 *See In re 15375 Memorial Corp.*, Case No. 06-10859 (KG), Hrg. Tr., March 10, 2010.

already pending.[24] Stay relief having been granted, BEPCO filed its petition asserting alter-ego claims against the parent entities in Louisiana state court the following day.[25]

The record also reflects that the parent entities had tried the very same tactic at least once before during the pendency of the bankruptcy cases and related appeals.[26] In January 2009, the district court issued its opinion reversing the bankruptcy court's decision and ordering that the case be remanded to the bankruptcy court to be dismissed for lack of good faith.[27] The bankruptcy court then dismissed the cases as instructed by the district court, thereby causing the automatic stay to terminate.[28] Thereafter, the district court granted a motion of the debtors for a stay pending appeal.[29] As a result, the bankruptcy court vacated its dismissal order and the automatic stay was reimposed.[30] More than a year later, the court was informed that the parent entities filed (but never served) an almost identical petition for declaratory relief in Texas state court minutes after the bankruptcy court entered its order dismissing the cases for the first time in February 2009.[31] While pursuing their appeals in the Third Circuit and the bankruptcy cases continued, it appears that the debtors never disclosed the petition to the bankruptcy court or the Third Circuit.[32]

All of this came to light before the issuance of the sanctions opinion.[33] The court alluded to this machination when it remarked in that "[t]he Court understands BEPCO's frustration and agrees that the [sanctioned] Entities have once more exhibited gamesmanship with the judicial system."[34]

Considering the record before it, the court concluded within its discretion that sanctionable conduct occurred.[35] When it comes to the imposition of sanctions, substantial deference should be afforded to a trial court because that "court has tasted the flavor of the litigation and is in the best position to make these kinds of determinations."[36]

It is also unlikely that the decision will result in an increase in the number of challenges on "bad faith" grounds to the filing of the chapter 11 cases where the parties are involved in contentious litigation. Precedent already exists to make such arguments, and *Memorial V* is, of course, not binding precedent.[37] The decision also turns on the unique record in the case. The court clearly took very seriously the "unpleasant and painful" task of deciding the sanctions issue, and it was only after a painstaking review of the case's pivotal history and the voluminous record that the court reached its decision.

With the benefit of the full flavor of the record, Judge Gross's assessment of the sanctioned parties' conduct did have a basis in the record and, though unpleasant, was within the Court's discretion. Moreover, given the unique circumstances before the court, it is unlikely that *Memorial V* will result in an increase in the number of bad-faith challenges. ■

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24 *See In re 15375 Memorial Corp.*, Case No. 06-10859 (KG) [Doc. No. 571 at 4-5 and Ex. 1].
25 *Id.*
26 *See In re 15375 Memorial Corp.*, Case No. 06-10859 (KG) [Doc. No. 577 at 2-3 and Ex. 1] ("Supp. Motion for Leave").
27 *Memorial III.*
28 *See In re 15375 Memorial Corp.*, Case No. 06-10859 (KG) [Doc. No. 514].
29 *See In re 15375 Memorial Corp.*, C.A. No. 08-313 (SLR) (Mem. Order) [Docket No. 56].
30 *See In re 15375 Memorial Corp.*, Case No. 06-10859 (KG) [Doc. No. 522].
31 *See* Supp. Motion for Leave at 6.
32 *See* Supp. Motion for Leave, Exh. 1 at 3-4). See 3d Cir. L.A.R. 33.2 (presumably requiring such disclosure as part of Civil Appeal Information Statement by appellant).
33 *Memorial V*, 430 B.R. at 154-55.
34 *Memorial V*, 430 B.R. at 155.
35 *Id.* at 154 ("[T]he GSF Entities manipulated and side-tracked the bankruptcy process for their own benefit, as nondebtors, and to keep BEPCO on the defensive.").
36 *Westmoreland v. CBS Inc.*, 770 F.2d 1168, 1174 (D.C. Cir. 1985).
37 *See Threadgill v. Armstrong World Indus.*, 928 F.2d 1366, 1371 (3d Cir. 1991).