United States Bankruptcy Court
District of New Mexico

Document Verification

Case Title: **Daniel Krupiak**
Case Number: **99-10304**
Chapter : **7**
Judge Code: **SA**
First Meeting Location: **Albuquerque**
Reference Number: **7 - 99-10304 - SA**

Document Information

Number: 289

Description: Memorandum On Liability Phase of Claim of former Alleded Debtor for Attorney's Fees, Costs, Damages and Punitive Damages Pursuant to 11 U.S.C. Section 303(i) and Bankruptcy Rule 9011.

Size: 32 pages (51k)

Date Received: 10/10/2001 09:09:18 AM	**Date Filed:** 10/10/2001	**Date Entered On Docket:** 10/10/2001

Court Digital Signature View History

4a 21 11 9c a2 84 97 33 eb 56 ca 55 d9 ef 49 5b c6 1f 57 3a 98 71 da 78 0a b6 16 13 9f 10 58 31 bd c0 d3 ae a4 3f 68 af 65 46 4c 2f ce d8 3e af 83 00 60 91 7d 26 e2 ad 72 7c bd a8 96 90 41 80 37 19 d8 b5 b1 db 48 5d 34 07 f6 ca 9b 38 66 38 40 63 02 c4 da e1 20 15 aa 5d f7 28 a6 dd 5c fb 60 18 82 e2 b2 ca f3 d3 c9 e9 47 65 47 77 f5 14 80 96 a6 f4 ae 24 55 ec 80 d3 72 27 d5 6c 4b 3c

Filer Information

Submitted By:

Comments: Memorandum Opinion on Liability Phase of Claim of Former Alleged Debtor for Attorney's Fees, Costs, Damages and Punitive Damages Pursuant to 11 U.S.C. Section 303(i) and Bankruptcy Rule 9011

Digital Signature: The Court's digital signature is a verifiable mathematical computation unique to this document and the Court's private encryption key. This signature assures that any change to the document can be detected.

Verification: This form is verification of the status of the document identified above as of *Wednesday, December 22, 2004*. If this form is attached to the document identified above, it serves as an endorsed copy of the document.

Note: Any date shown above is current as of the date of this verification. Users are urged to review the official court docket for a specific event to confirm information, such as entered on docket date for purposes of appeal. Any element of information on this form, except for the digital signature and the received date, is subject to change as changes may be entered on the Court's official docket.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
DANIEL KRUPIAK,
Alleged Debtor. No. 7-99-10304 SA

MEMORANDUM ON LIABILITY PHASE OF CLAIM OF FORMER ALLEGED DEBTOR FOR ATTORNEY'S FEES, COSTS, DAMAGES AND PUNITIVE DAMAGES PURSUANT TO 11 U.S.C. §303(i) AND BANKRUPTCY RULE 9011

This case commenced with the filing of an involuntary petition by creditors David Grosjean ("Grosjean"), Robert Munn, and William Bemis on January 20, 1999. Subsequently Apodaca Earthmoving, Inc. and Scott Graff dba Pacific Mutual Door Co. ("Graff" or "PMD") joined as petitioning creditors. The parties agreed to bifurcate the trial of the involuntary petition, in order to determine first whether the petition should be granted, and then afterward, in a separate hearing with separate discovery, to determine any issues of costs, attorney fees or damages. On October 20, 1999, following the first phase of the trial, the Court entered its Order dismissing the involuntary petition and reserving jurisdiction to determine all §303(i) issues (docket 147). On December 8, 1999 the former alleged debtor ("Krupiak") filed an amended motion for award of attorney fees and costs (docket 177)[1], for

[1] Krupiak filed partial withdrawals of the Motion for Fees and Costs (docket numbers 184 and 185) as a result of settlements with Bemis and Munn.

an award of compensatory and punitive damages against petitioners for filing the petition in bad faith; he also seeks an award under Bankruptcy Rule 9011 against Eastham, Johnson, Monnheimer & Jontz, P.C. ("EJMJ")(the attorneys for Grosjean, Bemis, Munn and Graff)(docket 178)(collectively 177 and 178 will be referred to as the "Motion").[2]

EJMJ, Graff, and Grosjean filed a Motion for Summary Judgment (docket 232) on the grounds that Krupiak's Rule 9011 claims were untimely. They filed another Motion for Summary Judgment (docket 241) that their claims were warranted by the law; and another Motion for Summary Judgment (docket 244) that their claims were supported by the evidence. Before beginning the trial on the merits of the issues of liability and attorney fees under §303(i), the Court issued an oral ruling denying all three of the summary judgment motions.

Beginning October 25, 2000, and following the parties' unsuccessful mediation effort, the Court conducted an evidentiary hearing on the liability of Grosjean, Graff and EJMJ[3] (collectively "Petitioners") for an award of costs or

---

[2] Paragraphs 30, 38, 46 and 55 of the Motion allege that petitioners also violated Rule 9011, but the prayer for relief seeks no relief against them.

[3]Apodaca Earth Moving, Bemis and Munn have resolved their issues with Krupiak.

attorneys fees pursuant to §303(i)(1) and for an award of compensatory and punitive damages pursuant to §303(i)(2), and on the liability of EJMJ pursuant to Rule 9011. The Court had previously ordered that it would schedule discovery and try the liability issues before scheduling discovery and trying any damages issues. Interim Scheduling Order, docket 195. The Court had also issued an Amended Memorandum Opinion on Setoff, ruling that any claims of Petitioners could not be set off against costs and attorney fees awarded to Krupiak or his counsel pursuant to §303(i)(1), but reserving decision on the issue as to an award of compensatory damages or punitive damages pursuant to §303(i)(2). Docket 270.

RELEVANT STATUTE AND RULE

Section 303(i) of the Bankruptcy Code provides:

> 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.

Federal Bankruptcy Rule 9011(b) provides:

> 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; and
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

ATTORNEY'S FEES AND COSTS

Section 303(i)(1), which awards costs or a reasonable attorney's fee, does not require a showing of bad faith. In re Whiteside, 240 B.R. 762, 765 (Bankr. W.D. Mo. 1999); In re Mundo Custom Homes, Inc., 179 B.R. 566, 569 (Bankr. N.D. Il. 1995). Section 303(i)(1) is intended to reimburse an alleged debtor for the expenses necessarily incurred in successfully defending an improper involuntary petition. Whiteside, 240 B.R. at 765; In re Leach, 102 B.R. 805, 808 (Bankr. D. Ks. 1989). An award under 303(i)(1) is discretionary with the Bankruptcy Court, Mundo Custom Homes, 179 B.R. at 569, however

the "majority approach" typically imposes fees and costs on the unsuccessful petitioning creditor. In re Silverman, 230 B.R. 46, 50 (Bankr. D. N.J. 1998); Leach, 102 B.R. at 808 ("[S]ection 303(i)(1) routinely contemplates the award of costs and attorney's fees to the debtor.") Section 303(i)(1) raises a rebuttable presumption in favor of the debtor that fees and costs are authorized. In re Ballato, 252 B.R. 553, 558 (Bankr. M.D. Fl. 2000). See also 2 Collier on Bankruptcy, ¶ 303.15[3] (15th Ed. rev.)("Given the policy behind section 303(i) and the effort to balance the competing rights of debtors and creditors under section 303 as a whole, the better argument is that the presumption for the award of costs and fees should be in favor of the debtor."); In re Landmark Distributors, Inc., 189 B.R. 290, 307 (Bankr. D. N.J. 1995)(Petitioners should generally anticipate the award of fees upon dismissal of an involuntary petition, but it is within Court's discretion after consideration of reasonableness of the petitioner's actions, their motivation and objectives, and the merits of their view that the petition was sustainable.) Once the involuntary debtor establishes that the amounts requested are reasonable, the burden shifts to the petitioning creditors to establish that factors overcome the presumption and support the disallowance of fees and costs. Id.

In this case, the Court finds that an award of a reasonable attorney's fee under Section 303(i)(1) is appropriate. The clear policy behind 303(i)(1) is to reimburse an alleged debtor for costs and fees incurred in the successful defense of an involuntary petition. As the Court discusses below, the Court finds that the petition was not substantially justified under its facts or under the current state of the law in New Mexico or the Tenth Circuit. Specifically, the Court finds that plainly there was a bona fide dispute over Krupiak's liability to the petitioning creditors. Therefore, under either a presumption or analysis of the facts of this case, fees will be awarded.

DAMAGES AND PUNITIVE DAMAGES

Section 303(i)(2), which awards damages or punitive damages, requires a showing of bad faith. Whiteside, 240 B.R. at 765. Neither the Bankruptcy Code nor its legislative history provides guidance regarding the content of the bad faith standard. General Trading Corporation v. Yale Materials Handling Corporation, 119 F.3d 1485, 1501 (11th Cir. 1997); In re K.P. Enterprise, 135 B.R. 174, 179 (Bankr. D. Me. 1992).

There is a presumption in favor of the petitioning creditors that they have filed the petition in good faith. Ballato, 252 B.R. at 558; In re ABQ-MCB Joint Venture, 153 B.R.

338, 342 (Bankr. D. N.M. 1993); In re Caucus Distributors, Inc., 106 B.R. 890, 923 (Bankr. E.D. Va. 1989). Therefore, the burden is on the alleged debtor to show that the petitioning creditors have filed in bad faith. Atlas Machine & Iron Works, Inc. v. Bethlehem Steel Corporation, 986 F.2d 709, 716 n.9 (4th Cir. 1993); Caucus Distributors, Inc., 106 B.R. at 923; Petralex Stainless, Ltd. v. Bishop Tube Division of Christiana Metals (In re Petralex Stainless, Ltd.), 78 B.R. 738, 743 (Bankr. E.D. Pa. 1987).

"Good faith" and "bad faith" are not defined by the Bankruptcy Code. Caucus Distributors, Inc., 106 B.R. at 923. The Court of Appeals for the Tenth Circuit has not ruled on what constitutes "bad faith" for purposes of Section 303(i)(2). Generally the Courts agree that bad faith is a factual issue. See, e.g., ABQ-MCB Joint Venture, 153 B.R. at 342 (citing In re Advance Press & Litho, Inc., 46 B.R. 700, 703 (Bankr. D. Co. 1984)); Caucus Distributors, Inc., 106 B.R. at 923 (citing cases). As with many other bankruptcy terms, the Courts have devised various tests[4] to determine whether a petition was filed in bad faith. See Lubow Machine Co., Inc. v. Bayshore

[4]See e.g., Flygare v. Boulden, 709 F.2d 1344 (10th Cir. 1983)(test for "good faith" for chapter 13 confirmation purposes); Brunner v. New York State Higher Education Services Corp. (In re Brunner), 831 F.2d 395, 396 (2nd Cir. 1987)(test for "undue hardship" for student loan discharge purposes).

Wire Products Corp. (In re Bayshore Wire Products Corp.), 209 F.3d 100, 105-06 (2nd Cir. 2000):

> Some courts have used an "improper use" test, which "finds bad faith when a petitioning creditor uses involuntary bankruptcy procedures in an attempt to obtain a 'disproportionate advantage' for itself, rather than to protect against other creditors obtaining disproportionate advantages, particularly when petitioner could have advanced its own interests in a different forum." In re K.P. Enter., 135 B.R. 174, 179 n. 14 (Bankr. D. Me. 1992); see also In re Better Care, Ltd., 97 B.R. 405, 410-11 (Bankr. N.D.Ill. 1989). Other courts have applied an "improper purpose" test, where bad faith exists if the filing of the petition was motivated by ill will, malice, or a desire to embarrass or harass the alleged debtor. See, e.g., In re Camelot, Inc., 25 B.R. 861, 864 (Bankr. E.D. Tenn. 1982). A third line of cases employs an objective test for bad faith based on "what a reasonable person would have believed." Jaffe v. Wavelength, Inc. (In re Wavelength, Inc.), 61 B.R. 614, 620 (9th Cir. 1986)(internal quotation marks omitted). Finally, as the Eleventh Circuit has observed, a number of courts have sought to model the bad faith inquiry on the standards set forth in Bankruptcy Rule 9011. See General Trading, Inc., 119 F.3d at 1501-02; In re Fox Island Square Partnership, 106 B.R. 962, 967-68 (Bankr. N.D. Ill. 1989).

See also Wavelength, Inc., 61 B.R. at 619-20:

> One line of cases holds that bad faith exists when a petition is ill advised or motivated by spite, malice or a desire to embarrass the debtor. A second line of authority looks to whether the creditor's actions were an improper use of the Bankruptcy Code as a substitute for customary collection procedures. Whether a party has acted in bad faith is essentially a question of fact. Bad faith should be measured by an objective test that asks what a reasonable person would have believed.

(Citations and internal punctuation omitted.) Some Courts have applied combinations of the above tests, and others have noted that the tests overlap, exploring different facets of the same concept. Silverman, 230 B.R. at 51; K.P. Enterprise, 135 B.R. at 180[5]. See also In re Apache Trading Group, Inc., 229 B.R. 891, 893 (Bankr. S.D. Fl. 1999)(discussing the five traditional tests[6] plus the "nose test".[7])

The Court finds that the best approach to the issue of bad faith is close to, but not quite the same as, the Rule 9011 test, also called the combined test.[8] Both objective and subjective factors are relevant to any determination of bad faith. K.P. Enterprises, 135 B.R. at 180. "Petitioning

---

[5]The K.P. Enterprise court provides an excellent discussion of the various tests. 135 B.R. at 179 nn. 14, 15, 16, 17 and 18.

[6]The five tests are: (1) the subjective test; (2) the improper purpose test; (3) the objective test; (4) the improper use test; and (5) the combined test. 229 B.R. at 893.

[7] "[I]f it smells like bad faith, it's got to be bad faith." In re Better Care, Ltd., 97 B.R. at 409. The "nose test" has all the precision (and usefulness) of Justice Brennan's reputed test for pornography; to wit, "I know it when I see it." See also United States v. Dolese, 605 F.2d 1146, 1154 (10th Cir. 1979) ("There is a principle of too much; phrased colloquially, when a pig becomes a hog, it is slaughtered.")

[8] Of course, Rule 9011 is applicable as such to the filing of any papers in the case, independent of the separate inquiry of determining bad faith.

creditors who have already submitted a signed and verified petition in accordance with Rule 9011 should be held to the standard created by that Rule: a dual subjective and objective test for good faith." Petralex Stainless, Ltd. 78 B.R. at 743. "To determine bad faith, a court examines whether a reasonable person would have filed the petition (objective test) as well as the motivations of the petitioner (subjective test.)" Atlas Steel & Iron Works, Inc., 986 F.2d at 716. See also Subway Equipment Leasing Corporation v. Sims (In re Sims), 994 F.2d 210, 222 (5th Cir. 1993)("[C]reditors conducted a reasonable inquiry into the facts and the law prior to filing the petitions, as required by Bankruptcy Rule 9011."); In re Turner, 80 B.R. 618, 623 (Bankr. D. Ma. 1987)("[B]ad faith under §302(i)(2) should be measured by the subjective and objective standards contained in Bankr.R. 9011."); In re Alta Title Company, 55 B.R. 133, 140 (Bankr. D. Ut. 1985)("The good faith test is analogous to the duty imposed by Rule 11.")

The Court believes that the following standards/methodology should be applied to decide this question:

1. The first and primary standard for measuring creditor conduct is the statute itself. For example, if the creditors are successful in obtaining relief on an involuntary petition

(other than by fraud on the court, obviously), then there is no need to consider the issue of bad faith. 11 U.S.C. §303(i) ("If the court dismisses the petition...."); but see Petralex, 78 B.R. at 742-44 (court orders relief on involuntary petition and then considers alleged bad faith of filing creditors); Sims, 994 F.2d at 222 (order for relief properly entered on findings that statutory grounds were met and creditors conducted a reasonable inquiry before filing). Thus, it would seem that even if the petitioning creditor has completely improper motives for filing the petition, the entry of an order for relief precludes the need or opportunity to inquire into those motives, at least in the limited context of §303(i).[9]

2. Assuming the dismissal of the petition, and assuming the former alleged debtor asserts a claim for bad faith, the court must determine, in the circumstances at the time of the filing of the petition, what a "reasonable creditor" would have done. That entails at least a twofold factual examination: (a) what investigation was done beforehand, and then (b) given the

[9] The issue of motives might come up in other contexts. For example, even though relief may be ordered, a court could invoke the provisions of §305 to dismiss or suspend the proceedings. E.g., Matter of Win-Sum Sports, Inc., 14 B.R. 389, 394 (Bankr. D. Conn. 1981). Notwithstanding the foregoing citation, the Court expresses no opinion about whether a consideration of the motives for the filing of the case would be relevant to a §305 inquiry.

information available, what did the creditor do with it?[10] Breaking the inquiry down into constituent parts provides some definition of the "reasonable creditor" standard.

What investigation was done should then be compared with what investigation should have been done, given the circumstances at the time. Similarly, what the creditor did with the information available to it should be compared with what a reasonable creditor, sufficiently informed of the provisions of the Bankruptcy Code and rules[11], would have done with the information. A failure to conduct any (or an insufficient) factual investigation, when that investigation would likely have disclosed facts that would preclude the filing of the petition, would constitute one example of bad faith. "The absence of such a prefiling inquiry [into both the facts and the law] will generally support a finding of bad faith in single petitioning creditor cases." In re Alta Title

---

[10] Obviously this inquiry closely parallels a Rule 9011 inquiry, specifically subsections (b)(2) and (b)(3).

[11] Subsection (b)(2) requires that the creditor have a sufficient knowledge of the Code and the rules to weigh the facts appropriately. While there may well be occasions in which a creditor cannot obtain as many facts as it needs to make a completely informed decision (versus a sufficiently informed decision), there should be less difficulty ascertaining what the relevant provisions are in the Code, the rules and the case law. Of course, the Court is not suggesting that application of the law to the facts is always easy.

Company, 55 B.R. at 141 (footnote omitted). On the other hand, a creditor could conduct an investigation and based on what facts appeared, reasonably file a petition which would nevertheless be dismissed because the court finds the facts differently than the creditor perceived them, e.g., Bayshore Wire Products Corp., 209 F.3d at 106-07, or interprets the law differently than did the creditor. E.g., General Trading Corporation v. Yale Materials Handling Corporation, 119 F.3d at 1504-05 ("Yale had a good faith and reasonable basis under the law to believe that its claims were not subject to a bona fide dispute.... To hold Yale liable because it lost the bona fide dispute argument would be inappropriate.") In other words, as the statute makes clear, the mere fact that the petition is dismissed does not mean the creditor acted in bad faith. §303(i).

What facts were available to the creditor (whether by investigation or otherwise), and what the creditor did with those facts, is the second half of the inquiry. Here, the most pointed inquiry would be what the petition alleged (including the number of creditors, the existence or not of good faith disputes and contingent claims, and whether the debtor was paying its debts as they became due) and what the court finds at the end of the trial. The surrounding circumstances,

including for example the need for haste in making a decision to file, should be taken into account. E.g., In re Turner, 80 B.R. at 627 ("Although the need for speed would surely not justify a frivolous petition, the press of time is properly a factor in assessing the reasonableness of counsel's investigation of the law and facts."). A failure to meet the standards of this second factor is sufficient to constitute bad faith, even without the existence of any ulterior motives or "improper purposes".

3. Also assuming that the petition is dismissed, the next inquiry should be what the motives of the creditor were.[12] But judging what motives are proper and what improper in this context is more difficult than making the determination for the second inquiry. There is first of all the practical difficulty of prying into a creditor's mind to determine her or his intentions. In re Caucus Distributors, Inc., 106 B.R. 890, 926 (Bankr. E.D. Va. 1989)("It is quite apparent that a determination of the subjective motivations of a petitioning

[12] But in making this inquiry part of the methodology for determining whether bad faith exists, the Court does not mean to preclude an argument that the only test is whether the requirements of the Code are met, and motives are irrelevant. See In re Caucus Distributors, Inc., 106 B.R. 890, 924 n. 44 (Bankr. E.D. Va. 1989) ("The earlier decisions addressing the issue of bad faith stated that the motivations of creditors were irrelevant.") (Citations omitted.)

creditor is a most difficult task.") And while courts have cited a variety of motives or behaviors as improper or constituting bad faith, e.g., In re K.P. Enterprise, 135 B.R. at nn. 14 and 15, a closer analysis of those cases raises questions about why the cited behavior should be considered to constitute bad faith. For example, one court stated unequivocally that "[d]ebt collection is not a proper purpose of bankruptcy." It would seem that collecting on a debt would be the primary, and legitimate, reason that most involuntary petitions are filed.[13] And even those courts that assert that a petition should not be filed when other collection procedures are available, e.g., In re Better Care, Ltd., 97 B.R. at 410-11 (announcing the "disproportionate advantage" theory), fail to analyze how the creditor's seeking to have the issues resolved in the bankruptcy court offends the bankruptcy process. Indeed, for the most part it would also seem that if a creditor decides to attempt to collect a debt by invoking the Bankruptcy Code, the creditor should be allowed to do so (1) if the creditor can meet the requirements of §303 and (2) is bound by

---

[13] Atlas Machine & Iron Works, Incorporated, 986 F.2d 709, 716, n. 11 (4th Circuit 1993). (Citations omitted.) In fairness to the Fourth Circuit, the context of the statement was a case in which the creditor filed the petition because it was the only creditor not getting paid. 986 F.2d at 716, n. 10.

the limitations that the Code imposes, most obviously by being required to abide by the equal distribution policy of the Code. See also, In re Beaucrest Realty Associates, 4 B.R. 166, 168 (Bankr. E.D. N.Y. 1980)(Petitioning creditors would be equitably estopped from seeking termination of automatic stay.)

Other courts have ruled explicitly that it is not bad faith for a debtor to litigate in state court and then turn to the bankruptcy court to avoid the consequences of that litigation, e.g., In re Petralax Stainless, Ltd., 78 B.R. at 744, n. 17 (filing to prevent foreclosure). Filing a petition in order to obtain control of a corporation or to prevent its dissolution is cited as an instance of bad faith, e.g., In re Better Care, Ltd., 97 B.R. at 410-11, but if the voluntary filing of a petition results in control of the debtor by a trustee (or increased influence and oversight by a creditors' committee), or in the preservation of a corporation for reorganization or liquidation purposes, or the ending of an entity's business activities before it dissipates the only assets available for paying creditors, it is not clear why an involuntary petition filed for the same purposes should be improper. That is, given the rights bestowed on a creditor by the Code, should not the decision whether the creditor avails itself of the alternate forum (or more "traditional" avenues of

relief) be left to the creditor, at the same time enforcing on the creditor the consequences of the forum or avenue it has chosen? That is certainly the treatment accorded/required of a debtor which chooses to file bankruptcy. E.g., Rule 3015(b) (Chapter 13 debtor must file plan within fifteen days of filing petition); §109(g)(1) (debtor may not refile for 180 days if case dismissed for debtor's failure to obey court orders).

Perhaps the only motives that can categorically be determined to be bad faith are those specified in Rule 9011(b)(1) ("[petition] 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"), or those based on factors such as race, gender or exercise of political rights. For example, establishing that an involuntary petition was filed solely because the debtor was of a particular religious persuasion should be strong evidence of bad faith.[14] Indeed, prosecuting a petition on the basis of race, religion or similar factors may be comprehended at least minimally by the term "harassment" in Rule 9011(b)(1).

FACTS

[14] The Court expresses no opinion about whether granting the petition might moot even that issue.

On October 14, 1999, the Court entered Findings of Fact and Conclusions of Law on the involuntary petition (docket 139). Those facts and conclusions are incorporated here, and the Court assumes familiarity with them. The Court also makes the following findings based on the evidence presented at the trial of the Section 303(i) issues.

1. Calvin Carstens, attorney for Creditor Bemis, testified that he filed a complaint against Krupiak in state court in November, 1998. After that time he was contacted by an attorney at EJMJ and told that they were looking for people to join in an involuntary bankruptcy petition. He does not recall discussing the distinction between Krupiak and Krup Korp with the EJMJ attorneys before filing the petition. He also did not talk to EJMJ about any possible harm an involuntary petition would cause.

2. Mr. Grosjean testified that he had entered a contract with Krup Korp. This contract was the basis of both a state court action and the involuntary petition. In the state court action Grosjean had received, read, and understood the answer and counterclaims filed by Krupiak and Krup Korp. He understood that Krup Korp did not admit any liability; he perceived the answer and counterclaim as

"one more lie" by Krupiak. He also understood that Krupiak personally denied any liability[15]. Despite this knowledge, on the involuntary petition Grosjean listed his claim as "breach of contract" for $250,000. Grosjean knew by the date of the involuntary petition that his claim was against Krup Korp, and that his only possible recovery against Krupiak was by piercing the corporate veil.

Grosjean believed that Krupiak was insolvent and not paying his bills, and that one of his assets was Krup Korp. He believed that Krup Korp was also not paying its bills. Grosjean was concerned with being able to collect his claim against Krup Korp. Grosjean believed Krup Korp owned 50% of the Albuquerque subdivision, but was unaware of any other assets owned by the corporation.

In December, 1998 and January, 1999 the parties were preparing for a March 2, 1999 trial of the state court action. Grosjean was trying to obtain discovery from Krupiak and co-defendants Greg and Devon Frost. At a preliminary hearing on the involuntary petition one of Grosjean's attorneys stated that the involuntary bankruptcy was filed in an attempt to get discovery that

---

[15] See also Findings of Fact 45-51 filed Oct. 14, 1999 (docket 139).

had not been forthcoming in the state court case. On the other hand, at trial Grosjean did not explain satisfactorily why the information obtained in the state court case, such as it was, was not used to insure against an improper filing of an involuntary petition.

Grosjean was asked what kind of investigation he did before filing the involuntary petition. He said that he had been to the house that was being built for him, and found that it was only 50% complete but that 85% of the cost had been paid. He claimed that Krup Korp was unlicensed and could not pay its bills, but he had no documents to back up this claim. Grosjean also testified that Krupiak and his wife were driving new cars and living in a $300,000 house, and in December, 1998 Krupiak acquired a new large truck. Grosjean also claimed that Krupiak went on a cruise when construction of his house was behind schedule. Grosjean also testified, however, that he did not investigate the ownership of the vehicle(s) or house.

Grosjean outlined his concerns to his attorneys and "they put it [the involuntary petition] together." One reason the involuntary petition was filed against Krupiak individually was that Grosjean did not want to interfere

with any other contracts Krup Korp may have had with others. He also testified that he understood that Krup Korp was not in good standing at the time[16], Grosjean also testified that at the time of the petition he was aware that to file an involuntary petition: (1) one must be a creditor and (2) the debtor need not be insolvent, but must be not paying his or her bills. He did not know of the bona fide dispute exception for an involuntary petition.

It was very clear to the Court that Grosjean knew, by the time of the filing of the involuntary petition, 1) that his contract was with Krup Korp, 2) that Krup Korp disputed the debt owed to him, 3) that Krupiak disputed owing Grosjean anything, and 4) that the filing of an involuntary petition would have adverse consequences for the alleged debtor.

3. Dennis Jontz, an attorney at EJMJ testified about a meeting he had with John Baugh (Frosts' attorney) and Grosjean in late 1998 or early 1999. He told Baugh that

[16] Exhibit G55 from the trial on the involuntary petition, the State Corporation Commission certificate (now the Public Regulation Commission) that showed the cancellation of Krup Korp's certificate of incorporation, was dated March 18, 1998. Krup Korp's status of incorporation was not reinstated prior to the filing of the involuntary petition.

they were considering an involuntary bankruptcy against Krupiak. He also testified that he and Grosjean "knew things were going on" such as distributions out of the corporation. He testified that Krupiak's attorney had mentioned the possibility of a voluntary bankruptcy and Jontz thought that an involuntary petition would have no worse an impact on the trial date set for the state court proceeding than would a voluntary filing.

4. John Baugh, attorney for Frosts, testified. He was involved in the state court litigation. He met with Jontz and Grosjean in December, 1998 or January, 1999, purportedly to discuss the lawsuit, but in fact they discussed an involuntary petition against Krupiak. Jontz and Grosjean announced they intended to file the involuntary bankruptcy now because of their belief that Krupiak would file a voluntary petition on the eve of the March trial. They were filing the petition now to enable them to get the automatic stay lifted before the March trial. Jontz also said that Krupiak was going to move assets, but did not describe which assets or what his exact concern was relative to this.

Baugh was very familiar with the status of the state court litigation. He stated that both Krupiak and Krup

Korp were absolutely and vigorously disputing the claims at every level. In Baugh's opinion, the purpose of the involuntary petition was to prejudice Frosts (Krupiak's co-defendants) in the state court trial, by impeding the subdivision process and causing additional expense by increasing litigation costs. He believed the involuntary petition was a tactic to increase litigation in the state court. Baugh testified that at the time it was clear that Krupiak had no prospects and no assets other than his interest in the subdivision, which was partly owned by Krup Korp. The subdivision property was jointly owned by Krup Korp and Frosts. Because nothing could have been gained from the involuntary against Krupiak, Baugh concluded that the purpose was to harm Frosts by discarding Krupiak from the case. Baugh also concluded that the filing of the involuntary petition was done with reckless disregard of Krupiak's rights; he thought the result was foreseeable and that there was no purpose to be gained from the filing. The Court found Mr. Baugh's testimony credible and convincing.

5. Ted Lambert, the Manager for Pacific Mutual Door ("PMD") testified. PMD joined as a petitioning creditor on April 15, 1999 (docket 85). Krupiak filed an answer to

the involuntary petition on February 11, 1999 (docket 24). Lambert understood that the requirements to be a petitioning creditor were that 1) you were owed money, and 2) the debtor did not dispute it. He believed the purpose of bankruptcy was to pool a debtors' assets so that the creditors could be paid. Lambert claimed that Krupiak ordered materials from PMD and did not pay. The evidence of this was that one cash transaction shows that "Dan" picked up the goods, the order was paid for by check drawn on Krup Korp, Inc., and that the Krup Korp, Inc. check was returned NSF. PMD filed a complaint in state court naming Krupiak, Krup Korp, Inc. and Krupiak Homes. The complaint had not been answered by the time the involuntary petition was filed.

DISCUSSION

The involuntary petition was dismissed, so the Court should examine the Section 303(i) elements with respect to Grosjean and Pacific Mutual Door. First, however, the Court finds that the applicable law is reasonably settled. Bartmann v. Maverick Tube Corporation, 853 F.2d 1540, 1543 (10th Cir. 1988) sets the standard for determining whether a debt is disputed. The Tenth Circuit's test for determining the existence of a bona fide dispute does not require the Court to

"determine the probable outcome of the dispute, but merely whether one exists." Id. at 1544. As discussed in the Findings of Fact and Conclusions of Law on the Involuntary Petition (docket 139), a bona fide dispute clearly existed about Krupiak's liability.

A. Grosjean

Grosjean knew that Krupiak was denying liability in the state court case[17]. Grosjean had opinions about Krupiak's lifestyle, but had little or no hard information to back up these opinions. It appears to the Court that he relied on his attorneys, but he did not raise this specifically as a defense at trial. Grosjean was in a position to obtain information

[17] Grosjean cites In re Onyx Telecommunications, Ltd., 60 B.R. 492, 497 (Bankr. S.D. N.Y. 1985) and In re Elsa Designs, Ltd., 155 B.R. 859, 869 (Bankr. S.D. N.Y. 1993) for the proposition that the mere existence of a contested state court proceeding does not render the claim subject to a bona fide dispute. In Onyx Telecommunications, however, the alleged debtor did not deny that a debt of at least $750,000 was owing; it only disputed the total amount of some $2.8 million claimed by the creditor. Onyx, 60 B.R. at 497-98. Similarly, in Elsa Designs, Ltd. the alleged debtor "does not deny that it is indebted to MTB." Elsa Designs, 155 B.R. at 869. In this case, Krupiak had denied both the existence and amount of any personal liability in the state court case. The fact that the state court jury later found that Krupiak was personally liable does not alter the fact that at the time the petition was filed, Krupiak's personal liability was subject to bona fide dispute.

through discovery in the state court case[18]. Despite allegations that Krupiak had claimed the 5th Amendment privilege and refused to produce documents, there was no evidence presented that Grosjean needed any specific information that was not ultimately available; and there was evidence that Krupiak had withdrawn his 5th Amendment claims and consented to a deposition, by letter dated November 27, 1998 (Exhibit C-39), almost two months before the involuntary petition was filed. The Court finds that Grosjean made an insufficient effort to obtain information before filing. Furthermore, from the scant information that was available, the Court finds that Grosjean should have been aware that the involuntary proceeding was not warranted because Krupiak's debt was subject to a bona fide dispute. Finally, the Court obviously cannot know Grosjean's exact intent in filing the petition. From the testimony of John Baugh, however, the Court finds that the likely motive behind the involuntary petition was an attempt to increase others' litigation costs in the state court proceeding, and to further impede the subdivision

[18] Grosjean cites In re Bayshore Wire Products Corp., 209 F.3d 100, 106-07 (2nd Cit. 2000) for the proposition that an involuntary petition is proper when the alleged debtor cannot provide financial information. In Bayshore the lack of information went to the issue of not paying debts as they became due, id. at 106, not the existence of a bona fide dispute.

process.[19] And despite filing the petition, neither Grosjean nor his counsel intended to follow through with the procedure dictated by the Code. Rather, in addition to using the Code to obtain information for the state court case, Grosjean and his counsel wanted to preclude Krupiak from filing a petition and invoking the Code's automatic stay protections shortly before the state court trial was to begin.[20] Under the circumstances, the Court finds that Grosjean acted in bad faith in filing the involuntary petition.

B. Pacific Mutual Door

---

[19] Grosjean himself had refused to sign off on the subdivision plat.

[20] Exhibit C-39 is a letter from Mr. Hays to the state-court litigation counsel waiving the assertion of the Fifth Amendment and making Mr. Krupiak "immediately available" for a deposition. Exhibit C-40 is a stipulation and order entered in the state court litigation that Krupiak waives his Fifth Amendment defense and will provide access to requested documents within ten days of the date of the order. The order is file stamped December 14, 1998. Exhibit C-42 is a cover letter from Mr. Dawe setting Krupiak's deposition for January 26, 1999, six days as it turns out after the involuntary petition was filed. The timing suggests that Grosjean's counsel intended to file the involuntary petition and then seek stay relief to continue the discovery in state court. And in fact on January 20, 1999, the same day as the filing of the involuntary petition, Grosjean filed a motion for stay relief, to continue the state court action, docket 2, together with a motion to shorten Krupiak's time to respond to the motion for stay relief "in order to preserve existing State Court deadlines and a March 6, 1999 jury trial date...." Docket 3.

Ted Lambert, agent for PMD, knew that PMD had filed a lawsuit against Krupiak and that, in that lawsuit, Krupiak had not answered or denied liability. PMD's debt was not being paid. But it was also the case that even the evidence recited in PMD's complaint was such that there were serious questions about Krupiak's personal liability. Lambert's testimony was uncontradicted that PMD joined in the petition in an attempt to marshal Krupiak's assets so PMD could be paid along with other creditors. The Court finds it reasonable that Lambert could have read the involuntary petition filed by the other creditors and taken its allegations as true. But the Court is quite troubled that it appears that Lambert had not read the answer to the involuntary petition before joining in the filing. It was unreasonable for Lambert (1) to have read the petition and not to have asked whether there was a response by Krupiak, (2) if there was, what the response was, and (3) how the petition and the response complied with the law of filing involuntary petitions. Any reasonable or prudent person would have done so, even without legal advice, for the filing of an involuntary petition against a person is a matter of considerable gravity, or ought to be considered to be such.[21] And the Court is also

[21] PMD also did not raise advice of counsel as a legal defense, so this Court has no need to discuss that issue.

troubled that the evidence easily showed that the debt was owed by Krupiak Homes or Krup Korp, not by Krupiak invidually. Therefore the Court finds that Lambert acted unreasonably in joining in the petition, and therefore in bad faith in the context of §303(i)(2). Graff is thus liable to Krupiak for compensatory damages. However, because Graff was such a minor player in the general scheme of events, the Court will not award punitive damages against Graff. Graff joined an ongoing dispute, and did not cause the petition to be filed, and was brought in merely to keep the petition alive. It is clear that his role in the case arose more out of negligence or carelessness, rather than from any specific intent to misuse the Bankruptcy Code and Court.

KRUPIAK'S RULE 9011 MOTION

The standards for awarding Rule 9011 sanctions are the same as for Rule 11. Findlay v. Banks (In re Cascade Energy & Metals Corporation), 87 F.3d 1146, 1150 (10th Cir. 1996).

> The focus of Rule 11 is narrow. It relates to the time of signing of a document and imposes an affirmative duty on each attorney and each party, represented or pro se, to conduct a reasonable inquiry into the validity and accuracy of a document before it is signed.

Eisenberg v University of New Mexico, 936 F.2d 1131, 1134 (10th Cir. 1991). The Court must apply an objective standard, and decide whether a reasonable and competent attorney would

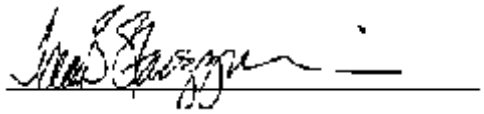
believe in the merit of an argument. Dodd Insurance Services, Inc. v. Royal Insurance Company of America, 935 F.2d 1152, 1155 (10th Cir. 1991).

The Court finds that at the time of the signing of the involuntary petition Grosjean's attorneys knew that Krupiak's debt was subject to a bona fide dispute, and finds that the petition was filed for the improper purpose of using the Bankruptcy Code to gain advantage in other litigation, and without the intention of carrying through with the administration of the estate thereby created. The Court further finds that a reasonable person would not have filed the involuntary petition at the time. The Court further finds that EJMJ violated Rule 9011 and that it should consider sanctions under Rule 9011 against EJMJ.

SUMMARY

The Court finds that David Grosjean and Scott Graff (dba Pacific Mutual Door Co.) are liable to Daniel Krupiak for costs and a reasonable attorney fee under 11 U.S.C. § 303(i)(1). The funds representing the attorney fee, and the costs incurred by Krupiak's attorney Brad Hays, shall be earmarked for payment to Hays, except to the extent such funds have already been paid or reimbursed to Hays by Krupiak. David Grosjean and Scott Graff are also liable to Daniel Krupiak for compensatory damages, and

David Grosjean for punitive damages, under 11 U.S.C. § 303(i)(2). Finally, Eastham, Johnson, Monnheimer & Jontz, P.C. is liable for filing the involuntary petition in violation of Bankruptcy Rule 9011. The attorney fees and costs may not be set off against any obligation that Krupiak may owe to Grosjean or Graff. The Court will enter a judgment consistent with this Memorandum Opinion, and will issue further orders scheduling the damages phase of this contested matter.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that, on the date file stamped above, a true and correct copy of the foregoing was either electronically transmitted, faxed, mailed, or delivered to the listed counsel and parties.

R. Thomas Dawe
PO Box 1276
Albuquerque, NM 87103-1276

Dennis E. Jontz
PO Box 1276
Albuquerque, NM 87103

Mr. Brad L. Hays
PO Box 15520
Rio Rancho, NM 87174-520

Robert Munn
PO Box 91492
Albuquerque, NM 87199

C. Calvin Carstens
505 Roma NW
Albuquerque, NM 87102

Robert H. Jacobvitz
500 Marquette NW #650
Albuquerque, NM 87102

Chris W. Pierce
PO Box 6
Albuquerque, NM 87103

Allan L. Wainwright
920 Lomas NW
Albuquerque, NM 87102

Stephen P. Curtis
2701 San Pedro NE
Albuquerque, NM 87110

P. Diane Webb
PO Box 1156
Albuquerque, NM 87103-1156

Office of the United States Trustee
PO Box 608
Albuquerque, NM 87103-0608