No. 15-cv-557-JLK-AP

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF COLORADO
Judge John L. Kane

IN RE STEVEN E. MUTH,

Debtor.

STEVEN E. MUTH,

Appellant,

v.

KIMBERLY KROHN,

Appellee.

APPELLANT'S BRIEF

INTRODUCTION

Debtor Steven Muth appeals the Chapter 11 bankruptcy court's award of attorney fees. While the bankruptcy court's finding of bad faith may have authorized it to levy sanctions under its inherent power, *Chambers v. NASCO, Inc.*, 501 U.S. 32, 50 (1991), those sanctions could only be compensatory in nature, because the court lacks the power to issue punitive sanctions. Compensatory sanctions are designed to compensate the injured party for losses sustained as a result of misconduct; punitive sanctions are intended to vindicate the authority of the court. Compensatory sanctions may be imposed after providing adequate notice and an opportunity to be heard, as was admittedly provided in this case. Punitive sanctions, in contrast, may be imposed only subsequent to

procedural safeguards that were not afforded in this case. Because the Article I court lacks power to impose punitive sanctions (in the first instance), and because the necessary procedural safeguards for such sanctions were not provided (in the second instance), the factual conclusions upon which the fee award is based are cannot be regarded as non-erroneous and the sanctions levied in this case cannot stand.

FACTUAL AND PROCEDURAL HISTORY

Mr. Muth filed for bankruptcy on August 13, 2012, and his case was dismissed on July 3, 2013, on the basis that Mr. Muth could demonstrate no reasonable likelihood of rehabilitation, 11 U.S.C. § 1112(b)(4)(A), and that the bankruptcy was filed in bad faith. See "Findings of Fact and Conclusions of Law and Order," p. 9. Based on its finding of bad faith, the bankruptcy court further found that attorney fees incurred as a result of the bankruptcy filing "may" be recovered. Findings, p. 14. Mr. Muth appealed that decision to the United States Court of Appeals for the Tenth Circuit's Bankruptcy Appellate Panel. 514 B.R. 719 (May 1, 2014); Doc. No. 8-3.

The decision of the Tenth Circuit's Bankruptcy Appellate Panel was strictly limited to the soundness of the bankruptcy court's dismissal of Mr. Muth's case, *i.e.*, whether there was a sufficient showing of bad faith and whether there was sufficient evidence to support the finding that there was no likelihood of rehabilitation. Affirming, it concluded as follows:

> The bankruptcy court's factual findings, upon which its decision to dismiss Debtor's bankruptcy was based, are not "clearly erroneous." In addition, the decision to dismiss does not amount to an abuse of discretion. Finally, we conclude that Debtor was not denied due process in the bankruptcy court proceedings.

514 B.R. 719, at *16.

The Tenth Circuit's Bankruptcy Appellate Panel made no finding as to whether an award of attorney fees was appropriate or authorized in this case. Ms. Krohn's fee request was held in abeyance during the pendency of the appeal. Doc. No. 226, p.1 (referencing Doc. No. 183).

Subsequently, the bankruptcy court held a hearing on the reasonableness of the attorney fees requested. "An evidentiary hearing in this matter was held over two days, concluding on January 21, 2015." Doc. No. 226, p.1. The court properly examined the reasonableness of their calculation, *see Robinson v. City of Edmond*, 160 F.3d 1275, 1281 (10th Cir.1998) (describing the lodestar calculation as a product of the number of attorney hours reasonably expended and a reasonable hourly rate).

On March 5, 2015, judgment was entered against Mr. Muth in the total amount of $19,546.17, plus interest:

UNITED STATES BANKRUPTCY COURT
DISTRICT OF COLORADO

The Honorable Sidney B. Brooks

In Re:)
) Bankruptcy Case No.: 12-26897
STEVEN E. MUTH,) Chapter 11
Debtor.)

JUDGMENT

This matter came before this Court on Creditor Kimberly Krohn's Motion for Entry of Award of Attorney Fees and Fee Application (Doc. No. 176) and Mr. Muth's objection to the same. In accordance with the Order issued concurrently herewith,

IT IS ORDERED AND ADJUDGED that judgment is hereby entered against Mr. Steven Muth and in favor of Kimberly Krohn in the amount of $19,546.17. This amount shall bear interest at the rate of 8% beginning on February 4, 2015 and continuing until paid in full.

Dated this 5th day of March, 2015.

FOR THE COURT:
Kenneth S. Gardner, Clerk

By: Linda Kimes
Deputy

APPROVED AND ACCEPTED:

By: Sid Brooks
Sidney B. Brooks
U.S. Bankruptcy Judge

For the reasons explained in the brief below, the judgment must be vacated.

ARGUMENT

I. STANDARD OF REVIEW

The imposition of an attorney-fee sanction, whether rooted in statute, rule, or a court's inherent authority, is reviewed for abuse of discretion. *See Johnson v. Smith (In re Johnson)*, 575 F.3d 1079, 1084–85 (10th Cir. 2009). A court abuses its discretion when it (1) fails to exercise meaningful discretion, (2) commits an error of law, or (3) relies on clearly erroneous factual findings. *See Chamber of Commerce v. Edmondson*, 594 F.3d 742, 764 (10th Cir. 2010).

While Mr. Muth contends that abuse of discretion is established under each prong, respectively, his major premise trains on legal error and his minor premise on erroneous facts.

II. LEGAL ERROR REDOUNDS TO THE FACT THAT THE BANKRUPTCY COURT HAD NO POWER TO ISSUE PUNITIVE SANCTIONS AND THE IMPOSITION OF SUCH IS *ULTRA VIRES*

A. The Tenor of the Order Makes Clear That The Bankruptcy Court Intended to Punish Muth

Citing its inherent authority, the bankruptcy court shifted Ms. Krohn's attorney fees to Mr. Muth not as a matter of substantive remedy as, for example, in the case of a compensatory fee award to a prevailing party, but primarily to vindicate its authority and to punish Mr. Muth. As such, it is a punitive sanction. *See Hutto v. Finney*, 437 U.S. 678 (1978) ("We see no reason to distinguish [an] award [of fees for bad faith] from any other penalty imposed to enforce a prospective injunction.").

The punitive nature of the award is accentuated by Paragraph 4, which reads:

Mr. Muth is a veteran *pro se* litigant, having been litigating against his ex-wife for

> many years in their domestic case. He was advised repeatedly by this Court to obtain counsel in this dispute, and given generous amounts of time to do so. He did not.

B. The Sanctions Can Only Be Regarded As Punitive Under the Controlling Legal Standards

Mr. Muth may well be a "veteran *pro se* litigant" and he may well have been given "generous amounts of time" to hire a lawyer, but as applied to the facts in his case, *Chambers* compels the conclusion that the sanctions assessed are punitive:

> [T]he underlying rationale of "fee shifting" is, of course, punitive. The award of attorney's fees for bad faith serves the same purpose as a remedial fine imposed for civil contempt, because it vindicates the District Courts authority over a recalcitrant litigant. That the award has a compensatory effect does not in any event distinguish it from a fine for civil contempt, which also compensates a private party for the consequences of a contemnor's disobedience.

Chambers, 501 U.S. at 53-54.

If anything, the fact that Mr. Muth could not hire a lawyer despite the "generous amounts of time" to do so tends to suggest that he could not afford to do so and his impecunious status should have inveighed against the imposition of fees, or at least fees in a lower amount. But this factor received no consideration in the Article I court's analysis.

C. Bankruptcy Courts Are Limited to Compensatory Sanctions

While the bankruptcy court may have the power to issue compensatory sanctions, it is clear that its authority does not vest it with power to issue punitive sanctions. As an Article I court with limited jurisdiction and resources, the bankruptcy court lacks the ability to impose the same range of possible sanctions as can be imposed by the district court.

D. Reasoning By Analogy To A Parallel Context, Bankruptcy Courts Similarly Lack the Power To Impose Sanctions for Criminal Contempt

1. No Criminal Contempt Power

A bankruptcy court has the ability to sanction a party for civil contempt. *In re Skinner*, 917 F.2d 444, 447 (10th Cir.1990). But that does not mean it also has the authority to impose sanctions for criminal contempt. At one point, Congress expressly prohibited bankruptcy courts from exercising such authority. *See Celotex Corp. v. Edwards*, 514 U.S. 300, 328 n. 15 (1995) (Stevens, J. dissenting) ("Congress also limited the power of bankruptcy courts to 'punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment'"). The law, 28 U.S.C. § 1481, which contained this prohibition was repealed in 1984, and no comparable provision has been enacted.

2. Potential Open Issue in the Tenth Circuit

The Tenth Circuit does not appear to have yet ruled on this issue. Although it found that the bankruptcy court has jurisdiction to threaten incarceration as a remedy for civil contempt, the Tenth Circuit expressly declined to address the question of whether bankruptcy courts have the authority to enter criminal sanctions for contempt. *In re Skinner*, 917 F.2d 444, 447 n. 2 (10th Cir.1990).

3. Authority from Sister Circuit Courts of Appeals

Sister courts of appeal that have ruled on this issue have both held that bankruptcy courts do not possess criminal contempt authority. *Price v. Lehtinen*, 564 F.3d 1052, 1059 (9th Cir. 2009) (bankruptcy court lacks inherent authority to impose punitive sanctions, in part because it cannot provide the due process protections to which a

criminal defendant is entitled, such as jury trial); *Grifith v. Oles*, 895 F.2d 1503, 1515 (5th Cir.1990) (§ 105 does not authorize bankruptcy courts to punish criminal contempt committed outside the court's presence). While not expressly ruling on the issue, two other circuits have also called the bankruptcy court's ability to impose criminal contempt sanctions into question. *Cox v. Zale Delaware, Inc.*, 239 F.3d 910, 916–17 (7th Cir.2001) (noting that although district court may hold a party in criminal contempt, it is unclear whether bankruptcy judges have criminal contempt power); *In re Rager*, 3 F.3d 1174, 1178–79 (8th Cir.1993) (declining to reach the issue of whether bankruptcy courts can enter their own criminal contempt judgments, subject to review only by appeal, but upholding bankruptcy court's order holding an attorney in criminal contempt because the order did not go into effect immediately, but instead provided for de novo review by the District Court if the attorney filed an objection within 10 days).

Based on these rulings, and the Tenth Circuit's refusal to recognize the authority necessary to support the sanctions in this case, the conclusion must be drawn that no such authority exists.

4. Conclusion

The sanctions against Mr. Muth are outside the scope of the bankruptcy court's authority, and as such, they constitute an abuse of discretion that must be vacated. While Mr. Muth certainly does not contend that he was hit with sanctions for criminal contempt, the fees assessed must be vacated because the authority by which they were imposed is as *ultra vires* as if he had been so punished.

II. EVEN IF THE BANKRUPTCY COURT HAD THE POWER TO ISSUE THE SANCTIONS IMPOSED, IT FAILED TO PROVIDE ADEQUATE SAFEGUARDS AND, AS A RESULT, ADDUCED ERRONEOUS FACTS

Where a court sanctions a recalcitrant party for his abuse of process by an award of fees and costs, as in this case, sound principles govern this court's review. *See White v. Gen. Motors Corp.*, 908 F.2d 675, 683–85 (10th Cir.1990) (addressing an attorney-fee sanction imposed pursuant to FED. R. CIV. P. 11). First, the amount of fees and costs awarded must be reasonable. *Id.* at 684. Second, the award must be the minimum amount reasonably necessary to deter the undesirable behavior. *Id*. at 684–85. And third, because the principal purpose of punitive sanctions is deterrence, the offender's ability to pay must be considered. *Id*. at 685. The bankruptcy court may have satisfied the first principle, but it clearly shirked the remaining two.

The bankruptcy court gave no consideration to whether the attorney-fee award in this case was the minimum amount reasonably necessary to deter undesirable behavior. Nor did the court give any consideration to whether the sanctions would have a deterrent effect on Mr. Muth at all. The Court's March 5, 2015 Findings of Fact and Conclusions of Law for Hearing on Attorney Fees (Doc# 226) shows that the only analysis the court made was whether the fees requested were reasonable in light of prevailing rates for this type of law practice in Colorado and for the services rendered.

Reproduced below are the relevant findings of the court in their entirety:

> 5. The Court heard testimony from Joanne P. Underhill, one of Ms. Krohn's attorneys, regarding the reasonableness and necessary of the attorney fees incurred as a result of Mr. Muth's bankruptcy petition. The Court finds her to be credible.
>
> 6. To show fees incurred, counsel for the party claiming the fees has the burden of proving hours to the district court by submitting meticulous, contemporaneous time records that reveal, for each lawyer for whom fees are sought, all hours for which compensation is requested and how those hours were allotted to specific tasks. Case by Case v. Unified School Dist. No. 233, 157 F.3d 1243, 1250 (10th Cir. 1998). Ms. Krohn has met her burden.

7. Ms. Underhill explained that Ms. Krohn hired her law firm to undertake several different matters. Matter 2575.1 was the domestic representation in state court resulting in an award of fees against Mr. Muth for pursuing a frivolous and groundless motion in that case. Matter 2575.2 was the collection of that judgment. Matter 2575.3 was work related to the appeal Mr. Muth filed from this Court's order dismissing his bankruptcy.

8. Ms. Krohn seeks recovery of some, but not all, of the fees incurred in Matter 2. Petitioner's Exhibit 2 was admitted and shows the billing statements actually generated by Ms. Krohn's attorneys for that matter. Some amounts have been redacted. The redactions represent time spent that Ms. Krohn does not seek to recover in this proceeding, as they relate more to the state court proceeding than they do to this bankruptcy.

9. In addition to the redacted entries, Ms. Underhill explained that there were some additional entries that, in fairness to Mr. Muth, would be withdrawn from the request. These amounts include a charge for $30.00 on August 21, 2012, costs in the amount of $166.00 on the same bill, costs in the amount of $146.44 on the May bill, and costs in the amount of $18.32 on the June bill. The total of these entries is $361.28.

10. To accommodate these amounts, Ms. Krohn offered to reduce her total fee request by a flat percentage of 10%. Her original fee request was for $18,609.45. Reduced by 10%, Ms. Krohn's principal fee request at the time of closing argument was $16,718.50.

11. The Court has examined the billing entries on Exhibit 2 and finds that they were necessary as a result of the bad faith bankruptcy filing. There is no evidence of over-billing or duplication of effort. This proceeding was made more complicated than necessary by Mr. Muth's activities and frequent extensions of time. The non-redacted entries represent time necessarily incurred to address Mr. Muth's bankruptcy and issues created by the bankruptcy.

12. To determine the reasonableness of a fee request, this Court must calculate a lodestar amount by multiplying the time reasonably incurred on a matter by a reasonable hourly rate. Hensley v. Eckerhart, 461 U.S. 424 (1983); Meadows at Buena Vista, Inc. v. Ark Valley Publ. Co., 202 U.S. Dist. LEXIS 138131 (D.Colo. 2012), not released for publication.

13. Mr. Muth filed his bankruptcy on August 13, 2012, and it was dismissed on July 3, 2013, about a year later. During the intervening time, Ms. Krohn had to protect her rights by filing, among other things, a proof of claim, an objection to discharge, a motion for Rule 2004 exam of Ms. Sease, a motion to dismiss, and responses to various objections and

motions filed by Mr. Muth. She then had to hire counsel to prepare for and appear at 3 days of trail on the motion to dismiss.

14. For this volume of work, over the course of about a year, 80 hours of combined attorney time would be a reasonable. This would represent two weeks of full-time work on the matter.

15. The billing rate charged by the lead attorney on this case, Mr. Moriarty, is $250.00. The court finds this amount to be reasonable. Similarly, the rate charged by his paralegal, in the amount of $90.00, is reasonable.

16. Multiplying the reasonable time incurred for this matter times a reasonable hourly rate of $250.00 results in a lodestar amount of $20,000.00. Ms. Krohn's request for $16,718.50 is less than this amount. It is reasonable and the Court awards this principal amount.

17. In addition to this amount, counsel for Ms. Krohn spent three hours appearing at hearings on the reasonableness of fees. An award of fees may include compensation for work performed in preparing and presenting the fee application. Case by Case v. Unified School Dist. No. 233, 157 F.3d 1243, 1254 (10th Cir. 1998). This Court therefore awards an additional $750.00 in attorney fees for time incurred at hearing in this matter.

18. Prejudgment interest has accrued on the principal amount sought since the motion was filed on July 17, 2013. 567 days have elapsed since then. At the statutory rate of 8% per annum, applied to the principal of $16,718.50, interest as of February 4, 2015 equals 2,077.67.

19. This Court therefore enters a total judgment in favor of Ms. Krohn and against Mr. Muth in the total amount of $19,546.17. This amount shall accrue interest at the rate of 8% per annum until paid in full.

Simply put, there is no mention of deterrence, a reasonable minimum amount, or Mr. Muth's financial ability to pay the sanctions. In other words, the court failed to satisfy the procedural safeguards required for punitive sanctions. As a correlate, the factual conclusions cannot be regarded as non-erroneous. The judgment must be vacated.

CONCLUSION

For the foregoing reasons, Mr. Muth respectfully requests that this Court vacate the entry of judgment and award of attorney fees and costs.

Respectfully submitted,

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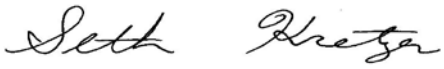

Seth Kretzer

CERTIFICATE OF SERVICE

I certify that this document was served on all counsel of record by filing on the ECF system on this 29th day of July 2015.

Seth Kretzer