

Attorney Fees  
11 USC § 303(i)  
Defense of Involuntary Petition

Fountainhead Global Trust, Case No. 604-69908-fra7

08/25/2005 FRA

Unpublished

Petitioning Creditors filed an involuntary petition against the Debtor which was defended at trial. The petition was dismissed, with the court finding that the Petitioning Creditors were not eligible, as each of their claims was subject to a bona fide dispute. See Memorandum Opinion E05-8 (7/1/2005). Debtor thereafter applied to the court for an award of attorneys fees pursuant to Code § 303(i) and Petitioning Creditors objected on a number of grounds.

The court cited Ninth Circuit case law holding that once an alleged debtor demonstrates that the fees requested under § 303(i) are reasonable, the burden shifts to the petitioning creditors to establish a totality of circumstances justifying disallowance of fees.

In finding that the fees requested were reasonable, the court stated that fees are reasonable if they apply to charges for legal services reasonably required as a consequence of the petition. The Petitioning Creditors cited what they considered to be an ethical violation by Debtor's attorney as grounds for denial of fees. The court stated that conduct which plainly violates ethical standards should not be compensated, but that the record did not establish that an ethical violation had occurred. Any discipline for conduct alleged to have violated the Oregon Bar's Code of Professional Responsibility must be taken up with the Oregon State Bar and the Oregon Supreme Court.

Given the totality of the circumstances, including the Debtor's pre-petition bad conduct, Petitioning Creditors did not meet their burden justifying disallowance of fees.

**AUG 25 2005**

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

IN RE )  
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FOUNTAINHEAD GLOBAL TRUST, ) Case No. 604-69908-fra7  
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Alleged Debtor. ) MEMORANDUM OPINION

Petitioning creditors object to the alleged Debtor's application for an award of attorneys fees following dismissal of their involuntary petition for relief.<sup>1</sup> For the reasons set forth in this opinion, the objections to the Debtor's application will be denied and Debtor will be awarded attorneys fees in the sum of \$15,657.

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<sup>1</sup> Code § 303(i): If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—

- (1) against the petitioners and in favor of the debtor for—
  - (A) costs; or
  - (B) a reasonable attorney's fee; or
- (2) against any petitioner that filed the petition in bad faith, for—
  - (A) any damages proximately caused by such filing; or
  - (B) punitive damages.

1 I: BACKGROUND

2 The case was commenced by way of an involuntary petition  
3 filed on December 22, 2004. The petition was not the creditors'  
4 first attempt: an earlier involuntary petition was filed and  
5 dismissed after trial in 2004. In addition, the Debtor  
6 successfully defended an attempt by the trustee in a related case  
7 to take control of its assets by way a motion to substantively  
8 consolidate the estates of the Debtor and the debtor in the other  
9 case.

10 The initial service was quashed because the summons was  
11 served without a copy of the Petition itself. Adequate service  
12 was finally accomplished in April. Trial on the petition was  
13 convened on June 14. The Court thereafter issued a written  
14 opinion stating its finding that the petitioning creditors did  
15 not qualify under §303 because each of their claims was subject  
16 to a bona fide dispute. See §303(b)(1).

17 There was considerable activity involving the petition and  
18 the trial, falling roughly into three categories: management of  
19 legal issues related to the bankruptcy, but not defense of the  
20 petition itself; attempts to resolve the parties' dispute short  
21 of trial; and defense of the matter on the merits.

22 In the first category, counsel for the alleged Debtor  
23 rendered advice and services in connection with, among other  
24 things: the contemplated sale of real property owned by the  
25 Debtor, efforts to negotiate with (and eventually sue) the  
26 Internal Revenue Service respecting federal tax liens on the

1 subject property, and defense of a motion for relief from the  
2 automatic stay filed by a secured creditor.

3 The second category involves efforts to persuade the  
4 petitioning creditors to change their minds.. This involved  
5 direct discussion between the alleged Debtor's trustee and a Mr.  
6 Turner, one of the petitioning creditors. Eventually, Debtor's  
7 attorney was brought into the discussions. He obtained consent  
8 to speak with Mr. Turner from Mr. Turner's personal attorney -  
9 however, the attorney of record for the petitioning creditors was  
10 not consulted by Debtor's counsel, nor, evidently, by Mr. Turner.

11 At his client's direction, Debtor's counsel prepared a  
12 document for the signature of each of the petitioning creditors  
13 which would withdraw the creditor's petition in this proceeding.  
14 These were to be presented to the petitioning creditors by the  
15 Debtor's trustee as part of her efforts to persuade them to  
16 relent. Although he knew the documents were intended for  
17 presentation to the petitioning creditors, Debtor's counsel did  
18 not advise counsel for the creditors that the documents had been  
19 prepared, and were to be circulated to his clients.

20 The case was not settled, and went to trial. Debtor  
21 prevailed, and now seeks payment of its legal fees. The services  
22 for which fees are claimed include defense of the petition, and  
23 the activities described above. The petitioning creditors object  
24 to payment for services not directly related to the defense of  
25 the petition. In addition, they ask that the application for  
26 fees be denied because Debtor's counsel's contact with

1 petitioning creditors was in violation of disciplinary rules  
2 governing the conduct of Oregon attorneys.

### 3 II. ISSUES

4 The issues presented are:

- 5 1. Do the circumstances of the case support an award of  
6 attorneys fees under §303(i)?
- 7 2. Is the amount claimed appropriate?
- 8 3. Should the fees be limited to defense of the petition?  
9 Conversely, may the fees awarded include fees for services  
10 related to other aspects of the bankruptcy case?
- 11 4. Was Debtor's counsel's contact with petitioning  
12 creditors inappropriate? If so, should fees be denied, or  
13 reduced, because of it?
- 14 5. Should fees be denied because of the Debtor's conduct?

### 15 III. DISCUSSION

16 The plain language of Code §303 provides that, if the  
17 petition is dismissed for any reason other than on the  
18 petitioning creditors' and the debtor's consent, the court "may"  
19 award reasonable attorneys' fees. The court, in other words,  
20 must exercise its discretion in determining whether, and in what  
21 amount, fees should be allowed. Higgins, et al . v. Vortex  
22 Fishing Systems, Inc., (In re Vortex Fishing Systems,  
23 Inc.) (Vortex II) 379 F.3d 701, 707 (9<sup>th</sup> Cir. 2004).

24 In Vortex II, the Court of Appeals for the Ninth Circuit  
25 held that the trial court should consider the totality of the  
26 circumstances in determining whether fees should be awarded. The

1 Court states that a finding of bad faith on the part of the  
2 petitioners is not a prerequisite, pointing to the fact that the  
3 statute itself provides for enhanced penalties where bad faith is  
4 present. (No claim to that effect is made in this case.) The  
5 Court of Appeals notes, however, that adoption of the totality of  
6 the circumstances test does not alter the premise that the  
7 petitioner in an unsuccessful involuntary case should expect to  
8 be liable for debtor's legal fees. Vortex II, 379 F.3d at 707.  
9 Code §303(i) gives rise to a rebuttable presumption that  
10 reasonable fees and costs are authorized; once the alleged debtor  
11 demonstrates that the fees requested are reasonable, the burden  
12 shifts to the petitioning creditors to establish a totality of  
13 circumstances justifying disallowance of fees. *Id.*

14 1. The fees claimed are reasonable

15 Generally, fees should be allowed based on the hourly rate  
16 charged by debtor's attorneys and the amount of time spent on  
17 various matters, not unreasonable in light of local standards,  
18 the issues presented, or the complexity of the tasks.

19 Creditors argue that counsel's activities not directly  
20 related to defense of the petition, such as advice regarding  
21 management of the debtor's assets in light of the petition,  
22 cannot be allowed. The court disagrees. Filing an involuntary  
23 petition implicates many aspect of the Code, such as the  
24 automatic stay imposed by §362 and, if the court so orders, the  
25 restriction on the use of property under §363. In addition, of  
26 course, the debtor must be prepared for what lies in store if the

1 petition is allowed. It would be unreasonable to hold that fees  
2 allowable under §303(i) cannot include charges for all legal  
3 services reasonably required as a consequence of the petition.

4 Petitioners object in particular to three activities of  
5 Debtor's counsel: coordination with Debtor's other attorneys who  
6 were seeking to remove a federal tax lien from property owned by  
7 the Debtor; arrangements for the sale of the property; and  
8 communications with petitioning creditors, including direct  
9 discussions with Mr. Turner. The first two are clearly  
10 compensable. An entity subjected to an involuntary petition may  
11 expect counsel to participate in a wide array of legal responses,  
12 and the petitioning creditors should not complain if payment for  
13 such services is demanded. Attorneys fees awardable under these  
14 circumstances are not "damages" for actual injury, and it is not  
15 necessary to prove that the expenditures were necessary to  
16 prevent injury. It is sufficient if it appears that the  
17 activities of counsel were related to a prudent response to the  
18 circumstances created by the petition, including efforts to  
19 liquidate assets to mollify claimants.<sup>2</sup>

20 Likewise, it is to be expected that someone subject to an  
21 involuntary petition will be interested in communicating with  
22 creditors (petitioning or otherwise) in an effort to reach a  
23 settlement. It is equally to be expected that counsel will  
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25 <sup>2</sup>It follows that attorneys fees for incidental but necessary legal  
26 expenses are not limited to cases in which the petitioning creditors have  
acted in bad faith, §303(i)(2).

1 advise the debtor on such matters. It cannot be said that  
2 Congress intended to discourage settlement discussions by denying  
3 compensation to attorneys advising clients engaged in such  
4 efforts. This is not to say that counsel should not be mindful  
5 of ethical responsibilities. Attorneys are not permitted to  
6 initiate or suffer communications with parties represented by  
7 others in the matter at hand, unless the other attorney consents.  
8 See Oregon Rules of Professional Conduct 4.2. In this case, Mr.  
9 Turner's personal attorney in Lane County advised counsel for the  
10 Debtor that he consented to direct discussions with Mr. Turner.  
11 It may have been preferable if the petitioning creditors'  
12 attorney of record had been consulted as well, if not for the  
13 client's protection, then for the sake of greater professionalism  
14 and avoidance of misunderstanding as discussions progressed.  
15 Likewise, preparation of documents for circulation by one's  
16 client to other represented parties ought not take place without  
17 notice to (if not consent from) opposing counsel. The Court does  
18 not, however, find that the professional lapses in this case  
19 justify reduction, much less denial, of attorneys fees. This is  
20 particularly so with respect to Mr. Turner, who agreed to direct  
21 discussions with Debtor's attorney after consulting with his own.  
22 If the creditors' attorney of record was left in the dark, the  
23 responsibility is as much his as the Debtor's counsel's.

24       Creditors maintain that Debtor's attorney's conduct violated  
25 the Oregon State Bar's Code of Professional Responsibility, and  
26 that this court is duty bound to enforce the code by denying fees



1 as a sanction. The Oregon Supreme Court has held that attorney  
2 discipline in Oregon is the province of the Oregon State Bar and  
3 the Supreme Court itself, and not the trial courts. See Brown v.  
4 Oregon State Bar, 293 Or. 446, 648 P.2d 1289 (1982). This court  
5 agrees with the general proposition that conduct which plainly  
6 violates ethical standards should not be compensated; however,  
7 the record here does not establish that a violation took place.  
8 However, in light of the rule in Brown, it should be understood  
9 that this opinion is not to be construed as making any finding  
10 respecting compliance or noncompliance with the Bar's  
11 disciplinary rules.

12 2. Fees should not be disallowed

13 Conceding that the totality of the circumstances test "can  
14 be somewhat amorphous," the Vortex II Court sets out four non-  
15 exclusive criteria to consider:

16 (1) the merits of the involuntary petition; (2) the  
17 role of any improper conduct on the part of the alleged  
18 debtor; (3) the reasonableness of the actions taken by  
19 the petitioning creditors; and (4) the motivation and  
20 objectives behind the filing of the petition.

21 Vortex II, 379 F.3d at 707 (Internal citations and quotation  
22 marks omitted.) The opinion also suggests that the good faith of  
23 the petitioners may be taken into account. *Id.* at 708. While  
24 the bankruptcy court may consider other relevant facts in  
25 exercising its discretion, the list is "definitive in most  
26 cases." *Id.*

27 The Vortex II criteria look to not only the merits of the  
28 case, but also the conduct and motivations of the contending

1 parties. The question is: does the misconduct of the alleged  
2 debtor so outweigh the errors of the petitioners in conducting  
3 the case? If so, is any imbalance in the creditors' favor  
4 sufficient, or is more required to overcome the presumption that  
5 fees should be allowed?

6 The petition was dismissed because the court found that  
7 there was a bone fide dispute between the alleged Debtor and each  
8 of the petitioning creditors over the validity of the creditor's  
9 claim. Specifically, the alleged Debtor asserted that, in each  
10 case, the claim was barred by the applicable statute of  
11 limitations. Code §303(b)(1)<sup>3</sup>; Higgins, et al . v. Vortex  
12 Fishing Systems, Inc., (In re Vortex Fishing Systems, Inc.)  
13 (Vortex I) , 277 F. 3d 1057, 1064 (9<sup>th</sup> Cir. 2001). The defense  
14 had been raised in prior cases, and the creditors cannot have  
15 been unaware of it at the time they filed their petition, much  
16 less by the time the matter was tried.

17 The involuntary petition was filed on December 22, 2004.  
18 Trial on the merits did not take place until June 13, 2005. A  
19 review of the record indicates that much of the delay is  
20 attributable to the petitioners:

21 Service of the summons was delayed for nearly three months  
22 because petitioners waited until February 21 to notify the court

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24 <sup>3</sup> (b) An involuntary case against a person is commenced by the filing  
25 with the bankruptcy court of a petition under chapter 7 or 11 of this title—  
26 (1) by three or more entities, each of which is either a holder of  
a claim against such person that is not contingent as to liability or the  
subject of a bona fide dispute ....

1 that the summons issued on December 22 had not been received.  
2 The summons issued on March 1 was served on March 14, without a  
3 copy of the petition, in violation of Fed. R. Bankr. P. 1010.  
4 The alleged Debtor filed a motion to quash, which was allowed.  
5 Service in the manner required by the Rules of Procedure was not  
6 accomplished until April 19, 2005, four months after the petition  
7 was filed. The delay caused by petitioners' conduct of the case  
8 after the petition was filed contributed significantly to  
9 Debtor's expenses in defending the petition and managing other  
10 matters related to the case.

11 While the petition proved to be lacking in legal merit, it  
12 cannot fairly be said that the petitioners acted unreasonably or  
13 out of any improper motive. Each of them lost a considerable  
14 amount of money without adequate explanation and their persistent  
15 - albeit untimely - pursuit of a remedy does not, by itself, lend  
16 much to the Debtor's case.

17 As the court noted in its previous opinion, Debtor's  
18 principal business has been the acquisition of other peoples'  
19 money with promises of extravagant returns and implausible tax  
20 benefits. *At the very least*, on this record, the Debtor can be  
21 found to have squandered, without excuse, the creditors' money on  
22 a ponzi scheme; at worst, debtor is itself such a scheme. Even  
23 the most charitable interpretation of the facts in this case  
24 leads to the conclusion that the Debtor's conduct towards its  
25 customers - or victims - has been unlawful, unjust and  
26 unconscionable.

1 Viewed in isolation, Debtor's conduct leading up to the  
2 petition might easily justify denial of fees, or any other  
3 equitable or discretionary relief. When weighed against  
4 petitioners' problematic prosecution of the case, Debtor's  
5 behavior is plainly the greater of two evils. However, more is  
6 required than a simple balancing of equities. As the Court of  
7 Appeals has found, Code §303(i) creates a presumption in favor of  
8 an award of attorneys fees to a debtor who successfully defends  
9 an involuntary petition for relief. The presumption approach  
10 advances the statute's purposes, which are to compensate those  
11 forced to defend improper or unfounded petitions, and to deter  
12 the filing of such petitions in the first place. As the Court of  
13 Appeals put it: "[The] presumption helps reinforce the idea that  
14 the filing of an involuntary petition should not be lightly  
15 undertaken" and "serve[s] to discourage inappropriate and  
16 frivolous filings." Vortex II, 379 F.3d at 706 (Internal  
17 citations and quotation marks omitted.) To deny fees because the  
18 debtor's misdeeds are found to be greater than the petitioners'  
19 undermines the statute by handing a free shot to creditors to  
20 file meritless petitions. If Congress had intended to authorize  
21 such penalty kicks, it would have done so explicitly.

22 The petitioner's lack of legal merit in light of a bona fide  
23 dispute to claims, and the delays in prosecution of the petition,  
24 prevent rebuttal of the presumption that fees will be awarded,  
25 notwithstanding Debtor's pre-petition conduct.


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1 IV. CONCLUSION

2 There is a rebuttable presumption that the alleged debtor,  
3 having successfully defended the involuntary petition, is  
4 entitled to an award of reasonable attorneys fees. The  
5 petitioning creditors have not overcome this presumption. The  
6 fees requested by the Debtor are not unreasonable. Judgment  
7 shall be awarded in favor of Karla Prescott, as trustee of  
8 Fountainhead Global Trust, in the sum of \$15,657 against each of  
9 the petitioning creditors, jointly and severally.

10 This Memorandum Opinion constitutes the Court's findings of  
11 fact and conclusions of law. Counsel for the alleged Debtor  
12 shall prepare a form of judgment consistent with this opinion.

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16 FRANK R. ALLEY, III  
17 Bankruptcy Judge  
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