NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. CC-07-1027-MoDMc
SOO HYUN CHA and BO YOUNG CHA,	Bk. No. SV-05-20625-GM
Debtors.	Adv. No. SV-06-01081-GM
ANDREW E. SMYTH,	
Appellant,	
v.	**M E M O R A N D U M**[1]
SOO HYUN CHA,	
Appellee.	

Argued and Submitted on July 26, 2007
at Pasadena, California

Filed - August 16, 2007

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Geraldine Mund, Bankruptcy Judge, Presiding

Before: MONTALI, DUNN and McMANUS,[2] Bankruptcy Judges.

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[1]This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

[2]Hon. Michael S. McManus, Chief Bankruptcy Judge for the Eastern District of California, sitting by designation.

The bankruptcy court imposed sanctions against an attorney pursuant to its inherent powers. The attorney appealed. While we understand the bankruptcy court's frustration with sloppy lawyering, we REVERSE and REMAND because the attorney was denied due process and because the court did not make an explicit finding of bad faith.

I. FACTS

On January 10, 2007, the bankruptcy court entered a memorandum decision explaining why it was imposing sanctions against appellant Andrew E. Smyth ("Smyth"). For the purposes of this appeal, Smyth did not dispute the court's recitation of facts underlying the imposition of sanctions and adopted them in his opening brief. Accordingly, we accept and incorporate the bankruptcy court's timeline of activities and conduct leading to its sanctions award.

On January 27, 2006, Smyth (acting on behalf of his client Jeonghwan Koh ("Koh")) filed an adversary complaint against appellee Soo Hyun Cha ("Debtor") pursuant to 11 U.S.C. §§ 727 and 523(a).[3] Smyth mailed a copy of the complaint to Debtor and Debtor's counsel, Mark Jessee ("Jessee"), but did not include a copy of the summons. A summons was issued on February 1 but was mailed to Debtor on February 17 without a copy of the complaint, even though Rule 7004(e) requires the summons and complaint to be

[3]Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as enacted and promulgated prior to the effective date of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

deposited in the mail within ten days of the issuance of the summons.

On February 21, Smyth filed an amended complaint adding co-debtor Bo Young Cha ("Spouse") as a defendant; Smyth did not obtain a summons for the first amended complaint. Smyth mailed a copy of the first amended complaint (without a summons) to Debtor and Jessee on February 23 although the proof of service appended to the amended complaint showed a mailing date of February 8 (thirteen days prior to the actual filing date).

On March 9, Smyth mailed a proof of service alleging that the summons and complaint were served on February 17. On March 13, Smyth filed a request for entry of default alleging that the first amended complaint was served by mail on February 1; the court returned the request to Smyth on March 16 because it did not contain a Return of Service for the summons. On March 13, Smyth also filed a proof of service of an amended alias summons, although the alias summons appended to the proof of service was not issued by the bankruptcy court and did not contain pertinent information such as the status conference date.

On March 28, Smyth filed a second request for default with respect to the initial complaint filed on January 27, claiming mail service on the latter date. The proof of service alleges service on both Debtor and Spouse, although Spouse was not a defendant in the initial complaint. On March 29, Smyth filed a motion for default judgment alleging the same service.

At a hearing on the motion for default judgment, the bankruptcy court indicated that it would grant a judgment under sections 523 and 727 against Debtor, but not against Spouse (for

lack of evidence). The next day (May 25), the court entered the default judgment against Debtor and an order dismissing Spouse from the adversary proceeding.

On May 30, Debtor filed a motion to set aside the default judgment setting forth the errors in service, including the failure to serve a summons within ten days of issuance. Smyth filed an opposition to the motion to set aside the default; according to the bankruptcy court, "it is clear from the opposition that Smyth never reviewed the documents to see whether a summons was issued and served on the First Amended Complaint or whether he had properly served the original complaint."

The court issued a tentative ruling granting the motion to set aside the default judgment, stating "In all, [Smyth] did a horrendous job of service and of paper management. I do not find this to be an intentional act to "sneak up" on defendant. But it is gross negligence. And the fact that [Smyth] would actually continue to assert that he has a right to a default judgment is incomprehensible." (Emphasis added). The court adopted its tentative ruling at a hearing on June 21 and entered the order granting the motion to set aside default on the same date.

On June 28, Smyth filed a request for the court to issue an alias summons. The alias summons was issued by the court on June 29 and mailed with the original complaint to Debtor on July 7, 2006. On August 4, Debtor filed a motion to dismiss the complaint, noting inter alia that the summons was attached to the original complaint which was superseded by the first amended complaint.

On August 15, Smyth filed a response to the motion to dismiss and a second amended complaint.[4] In the response and accompanying declarations, he claimed that his secretary served the alias summons with the first amended complaint but accidentally attached the original complaint to the alias summons and proof of service filed with the court on July 11, even though Debtor stated that the original complaint was mailed with the summons.

On August 30, the court held a hearing on Debtor's motion to dismiss the first amended complaint but Smyth did not appear. In its tentative ruling, the court stated "I am appalled by Mr. Smyth's mishandling of the rather simple procedural aspects of this case. Once again he did an improper service. This is obviously not meant to ambush the defendant, but there is no excuse for this continued violation of the service rules." (Emphasis added.)

At the hearing on the motion to dismiss, the court sua sponte raised the possibility of awarding attorneys' fees to Debtor. No notice of such sanctions was given to Smyth in the tentative ruling or before the court's imposition of the fee award. Debtor's own counsel was "caught [] off guard" by the court's suggestion. On September 5,[5] the court entered an order

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[4]The second amended complaint named Spouse as a defendant, even though the court had entered an order dismissing her as a defendant.

[5]This order was filed on September 1, although it was entered and served on September 5. In his motion for reconsideration, Smyth referred to this order as the "August 30 order" although August 30 was the date of the hearing and not the order.

directing Koh to file a third amended complaint by a certain date to avoid dismissal and ordering Smyth to pay Debtor's attorneys' fees (with the amount to be fixed at a later date).[6] The order incorporated its tentative ruling.

On September 6, Smyth filed a Motion for Rehearing to Modify Order of August 30, 2006, to Remove Provision that [Smyth] Pay Attorney Fees to [Debtor's] Counsel; and to Grant Extra Time to File Fourth Amended Complaint" (the "motion for reconsideration"). Smyth noted that the court had not made a "bad faith" finding in support of its award of sanctions and that the court did not provide adequate notice of its intent to impose sanctions. Smyth also filed supplemental points and authorities in support of his motion for reconsideration arguing that the service of the complaint was not defective, while Debtor opposed the motion for reconsideration.

On October 4, the court issued a tentative ruling stating that "the lack of warning about possible sanctions does not require that Mr. Smythe [sic] get another opportunity to explain his incompetence to the court" in light of his failure to attend the hearing on Debtor's motion to dismiss. The tentative ruling refers to Smyth's "incompetence," "half-truths," "procedural tragedy" and "blunders," but it does not explicitly state that Smyth acted in bad faith.

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[6]The order provided that "Mr. Smyth is ordered to pay defense counsel Mr. Jesse [sic] a reasonable fee, within thirty days of entry of this order, for the legal expenses Mr. Jesse [sic] incurred, on behalf of his client, to draft, serve, and prosecute both a motion to set aside default and a motion to strike answer." Jessee was to provide to Smyth information on the costs and fees associated with those two motions within one week of the order.

The court held a hearing on the motion for reconsideration on October 4, 2006. On January 10, 2007, no doubt frustrated with a woeful example of carelessness by Smyth and perhaps desiring to put an end to such conduct, the court entered a memorandum decision indicating that it was not only imposing monetary sanctions against Smyth, but was also requiring Smyth to file a declaration of legal validity of and with all pleadings filed for a two-year period. The court did not provide advance notice of the possibility of this additional sanction before issuing the memorandum decision. In the memorandum decision, the court referred to the "gross negligence" of Smyth but did not make an explicit finding of bad faith.

On January 10, the court entered an order consistent with its memorandum decision; the order imposed monetary sanctions in favor of Debtor in the amount of $5,525.00 (representing Debtor's counsel's reasonable attorneys' fees)[7] against Smyth and additionally required Smyth to submit a declaration of compliance with rules and laws when filing papers with the court over a two-year period. Smyth filed a timely notice of appeal on January

[7]Jessee sought $12,200 in fees and $262.07 in costs as sanctions. The court stated in its memorandum decision that it did "not find Mr. Jessee completely innocent in this matter" and that "Mr. Jessee had an obligation to call Mr. Smyth before filing the motion to dismiss and advise him of the issues." The court therefore did not award fees for work done "from 5/25/06 through 5/31/06 as a simple call to ask that default be vacated may have well resolved the matter." The court similarly adjusted fees relating to the second motion to dismiss. In the end, the court awarded only $5,525 in fees plus $119.92 in costs. Jessee did not cross-appeal.

17, 2007.[8]

II. ISSUES

Did the bankruptcy court err in imposing sanctions against Smyth?

(a) Did the court provide sufficient notice of its intent to impose sanctions to satisfy due process concerns?

(b) Did the court make the requisite finding of bad faith?

III. STANDARD OF REVIEW

We review an award of sanctions and the terms of a disciplinary order for abuse of discretion. Price v. Lehtinen (In re Lehtinen), 332 B.R. 404, 411 (9th Cir. BAP 2005). Whether due process has been accorded is a question of law that we review de novo. Id.; see also Miller v. Cardinale (In re DeVille), 280 B.R. 483, 492 (9th Cir. BAP 2002), aff'd, 361 F.3d 539 (9th Cir. 2003) ("Whether [sanctioned] Appellant's due process rights were violated is a question of law, which we review de novo.").

IV. JURISDICTION

A. Core vs. Non-Core Nature of Sanctions

Smyth argues that the bankruptcy court lacked jurisdiction to enter a final order requiring him to file a declaration (with all papers he files with that court for a two-year period) certifying compliance with applicable laws and rules. Citing Sheridan v. Michels (In re Sheridan), 362 F.3d 96 (1st Cir. 2004), Smyth contends that the imposition of sanctions was not a core matter under 28 U.S.C. § 157.

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[8]On January 26, 2007, we granted Smyth's motion for a stay pending appeal upon deposit of $7,000 into the registry of the bankruptcy court.

We disagree. First, Sheridan is distinguishable. The sanctions imposed in Sheridan arose out of an omnibus proceeding involving multiple bankruptcy cases and not out of one particular bankruptcy case, as here.[9] Furthermore, as we noted in Lehtinen, we adopt the "ably and reasonably articulated" dissent in Sheridan. Lehtinen, 332 B.R. at 411. The dissent in Sheridan concluded:

> Finally, I disagree with the majority's conclusion that the proceeding against [the attorney] was non-core. In my view, the only interpretation of [28 U.S.C. §] 157 that is consistent with the purposes of the federal bankruptcy laws and Congress's intent in the 1984 bankruptcy amendments is that the disciplinary proceeding against [the attorney], which arose out of misconduct occurring in indisputably core proceedings, constituted a core proceeding.

Sheridan, 362 F.3d at 121 (Lynch, J., dissenting). Because Smyth's actions took place in the course of his representation of a plaintiff in a core adversary proceeding under 28 U.S.C. § 157(b)(2)(I) and (J), the disciplinary sanctions fit

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[9]In Sheridan, the First Circuit reversed the suspension of an attorney from practice before a bankruptcy court. The First Circuit held that where a disciplinary proceeding is omnibus in nature, does not arise in the context of an open bankruptcy case, is predicated upon ethical rule violations proscribed by state law and has only a remote or overly speculative effect upon closed bankruptcy cases, a bankruptcy judge has only non-core jurisdiction.

The dissent in Sheridan addressed and disputed each of the grounds asserted by the majority in support of its reversal, but in particular noted that the bankruptcy court's "imposition of sanctions on Sheridan did in fact 'concern[ ] the administration of the estate' in each of the underlying bankruptcy cases within the meaning of [28 U.S.C. §] 157(b)(2)(A). That section conspicuously does not require that the proceeding in question contemporaneously affect the ongoing administration of the estate; the matter must simply 'concern[ ]' the administration of the estate." Sheridan, 362 F.3d at 128 (Lynch, J., dissenting).

"comfortably within the ambit of a core proceeding." Lehtinen, 332 B.R. at 411.

B. Leave to Proceed With Interlocutory Appeal

In his opening brief, Debtor notes that the sanctions order is interlocutory in nature, citing Cunningham v. Hamilton County, 527 U.S. 198, 200 (1999) (holding that order imposing sanctions on attorney for her discovery abuses was not "final"). See also Stanley v. Woodford, 449 F.3d 1060, 1062 (9th Cir. 2006) (extends Cunningham to sanction orders imposed pursuant to court's inherent powers and overrules prior conflicting cases applying the collateral order doctrine). Debtor also concedes, however, that we may grant leave to file an interlocutory appeal.

Even though the order does not appear to be final, we can grant leave to appeal pursuant to Rule 8003(c). Under 28 U.S.C. § 158(a)(3), an appellant must obtain leave of court to appeal an interlocutory order. Smyth did not do so. Nonetheless, if an order is interlocutory, and no motion for leave to appeal has been filed, we can consider a timely notice of appeal to be a motion for leave. See Fed. R. Bankr.P. 8003(c); Pfeiffer v. Couch (In re Xebec), 147 B.R. 518, 522 (9th Cir. BAP 1992). We do so here.

Granting leave to appeal is left to the discretion of the panel. Roderick v. Levy (In re Roderick Timber Co.), 185 B.R. 601, 604 (9th Cir. BAP 1995). Leave to appeal is appropriate here because Smyth, who was not a party in the adversary proceeding, is affected by ongoing disciplinary sanctions which have a two-year limitation; it is feasible that this time period may expire well before any appellate review (if any) of the final

disposition of the adversary proceeding. If that sanction was imposed in error, it may escape appellate review by becoming moot. Therefore, we grant leave to appeal.

V. DISCUSSION

The bankruptcy court did not impose its sanctions pursuant to Rule 9011,[10] but pursuant to its inherent powers under section 105.[11] "A court must, of course, exercise caution in invoking its inherent power, and it must comply with the mandates of due process, both in determining that the requisite bad faith exists and in assessing fees." Chambers v. NASCO, 501 U.S. 32, 50 (1991).

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[10]If the bankruptcy court had relied on Rule 9011 in imposing its fee-shifting sanctions, it would have erred:

> It is clear that attorneys' fees and expenses incurred as a result of violating Bankruptcy Rule 9011 can be shifted only at the motion of one of the parties, and only after the rule-offending party has been given the benefit of the Rule's 21-day safe harbor. Fed. R. Bankr. P. 9011(c)(1)(A) and (c)(2) (2001); see Barber v. Miller, 146 F.3d 707, 710-11 (9th Cir. 1998) (so interpreting the same language in Fed. R. Civ. P. 11).

Markus v. Gschwend (In re Markus), 313 F.3d 1146, 1151 (9th Cir. 2002) (emphasis added). Debtor did not file a motion for sanctions, so the court could not order payment of attorneys' fees pursuant to Rule 9011. Id.; see also DeVille, 361 F.3d at 545-46 (under Rule 11, "the court may not shift attorneys' fees and costs on its own motion").

[11]At oral argument, Smyth incorrectly stated that the bankruptcy court imposed sanctions pursuant to 28 U.S.C. § 1927. The bankruptcy court, however, specifically and correctly noted that section 1927 did not apply as the bankruptcy court was not a court of the United States as defined by 28 U.S.C. § 451, citing Perroton v. Gray (In re Perroton), 958 F.2d 889 (9th Cir. 1992). Instead, the court invoked its inherent powers to sanction Smyth.

A. Due Process

Here, the bankruptcy court did not inform Smyth that it was contemplating sanctions before entering the order imposing them. In fact, the court initiated the discussion of monetary sanctions at a hearing on a motion to dismiss the first amended complaint where Smyth was not present and then incorporated the monetary sanctions in an order resolving that motion. Smyth had no notice of the monetary sanctions until he received that order. Furthermore, the sanctions governing the filing of future pleadings was not imposed until after Smyth filed his motion for reconsideration of the monetary sanctions. No prior notice was provided.

The Ninth Circuit Court of Appeals has held that procedural due process "guarantees [an] attorney a 'hearing, if requested' before sanctions may be imposed." Kirshner v. Uniden Corp. of America, 842 F.2d 1074, 1082 (9th Cir. 1988) (emphasis added), citing Miranda v. S. Pac. Transp. Co., 710 F.2d 516, 523 (9th Cir. 1983); see also Weissman v. Quail Lodge, Inc., 179 F.3d 1194, 1195 (9th Cir. 1999) (trial court abused its discretion in imposing sanctions and filing restrictions on attorney without prior notice);[12] Cole v. U.S. Dist. Court of Idaho, 366 F.3d 813,

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[12]Like the bankruptcy court here, the trial court in Weissman imposed sanctions in the context of a hearing on another matter where the sanctioned attorney failed to appear. The Ninth Circuit observed that his non-attendance did not excuse the lack of notice:

> The fact that [the attorney] did not attend the hearing at which the district court addressed his objections to the proposed settlement does not alter the conclusion

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821 (9th Cir. 2004) ("It is axiomatic that procedural due process requires notice of the grounds for, and possible types of, sanctions.") (emphasis added).

In holding that the imposition of a $250 sanction constituted the taking "of a significant property interest" and required advance notice and a hearing, the Ninth Circuit stated that "[a]bsent extraordinary circumstances, procedural due process requires notice and hearing before any governmental deprivation of a significant property interest." Miranda, 710 F.2d at 522 (emphasis added). As noted by the Ninth Circuit in Tom Growney Equip., Inc. v. Shelley Irrigation Dev., Inc., 834 F.2d 833, 835 (9th Cir. 1987):

> In considering the imposition of a penalty upon attorneys, the Supreme Court has cautioned that like "other sanctions, attorney's fees certainly should not be assessed lightly or without fair notice and an opportunity for a hearing on the record." Roadway Express, Inc. v. Piper, 447 U.S. 752, 767, 100 S.Ct. 2455, 2464, 65 L.Ed.2d 488 (1980).
>
> We have required notice and an opportunity to be heard in sanctioning attorneys pursuant to authority other than Rule 11. See T.W. Elec. Service, Inc. v. Pacific Electric Contractors, 809 F.2d 626, 638 (9th Cir. 1987)

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[12](...continued)
> that the district court did not provide him with notice or an opportunity to be heard on the issue of the sanctions. At the hearing at which he did not appear, [the attorney] had notice and an opportunity to be heard only on the merits of his objections, and not on the propriety of restricting his right to file objections to future settlement agreements.

Weissman, 179 F.3d at 1195 n.4. Therefore the bankruptcy court's finding in its October 4 tentative ruling that Smyth's failure to attend the hearing on the motion to dismiss the complaint somehow obviated the necessity for advance notice of sanctions is incorrect.

("Notice and a hearing should precede imposition of a sanction under [28 U.S.C.] § 1927"); F.T.C. v. Alaska Land Leasing, Inc., 799 F.2d 507, 510 (9th Cir. 1986) ("Due process further requires that parties subject to sanctions have sufficient opportunity to demonstrate that their conduct was not 'undertaken recklessly or wilfully'" (quoting Toombs v. Leone, 777 F.2d 465, 472 (9th Cir. 1985)); Miranda, [710 F2d at 522] (due process requires opportunity to prepare defense and explain questionable conduct at a hearing); United States v. Blodgett, 709 F.2d 608, 610 (9th Cir. 1983) (same).

In Tom Growney, the trial court sua sponte issued monetary sanctions against an attorney even though there was "no hint in the record that [the attorney] had any notice sanctions were being considered." Id. at 834. As in the case here, the attorney filed a motion for reconsideration of the sanctions, after which the trial court issued a memorandum decision explaining the basis of its sanctions. Id. at 835. The Ninth Circuit reversed and vacated the award of sanctions, explicitly stating that the subsequent hearing on the motion for reconsideration did not give the attorney sufficient opportunity to oppose the sanctions before their imposition and therefore did not satisfy due process requirements. Id. at 836. We likewise hold that the hearing on Smyth's motion for reconsideration does not cure the due process deficiencies arising from the absence of prior notice of the sanctions.

In DeVille, the bankruptcy court issued an order to show cause why sanctions should not be imposed which detailed the conduct which was the basis for sanctions imposed after the notice (i.e., the order to show cause) was given. The Ninth Circuit held that the sanctioned attorney and party were "provided with sufficient, advance notice of exactly which

conduct was alleged to be sanctionable and, furthermore . . . [were] aware that [they] stood accused of acting in bad faith." DeVille, 361 F.3d at 549. In other words, advance notice of the nature of the conduct and the accusation of bad faith is requisite to the imposition of sanctions under the court's inherent power. That was not provided here. While the bankruptcy court may have had sufficient justification for sanctioning Smyth, it unfortunately did not provide him with the prior notice required by due process. We therefore must REVERSE and REMAND for proper notice and opportunity for hearing.

B. Finding of Bad Faith

"Invocation of a federal court's inherent power to sanction requires a finding of bad faith." DeVille, 361 F.3d at 548, citing Chambers, 501 U.S. at 49. Such a finding must be "explicit." Knupfer v. Lindblade (In re Dyer), 322 F.3d 1178, 1196 (9th Cir. 2003) ("Before imposing sanctions under its inherent sanctioning authority, a court must make an explicit finding of bad faith or willful misconduct. . . . With regard to the inherent sanction authority, bad faith or willful misconduct consists of something more egregious than mere negligence or recklessness"). While a finding of bad faith may be warranted where an attorney "knowingly or recklessly raises a frivolous argument,"[13] the "bad faith requirement sets a high threshold"

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[13]As noted by the Ninth Circuit in Fink v. Gomez, 239 F.3d 989, 993-94 (9th Cir. 2001):

> [M]ere recklessness, without more, does not justify sanctions under a court's inherent power. But the cases discussed above make clear that sanctions are

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and the Ninth Circuit "insist[s] on the finding of bad faith." Primus Auto. Fin'l Servs. v. Batarse, 115 F.3d 644, 649 (9th Cir. 1997) (reversing and remanding where district court did not make explicit finding of bad faith, even though the court labeled the attorneys' arguments "frivolous" and their conduct as "outrageous," "inexcusable," and appall[ing]").

In its memorandum decision, the bankruptcy court did not make an explicit finding that Smyth acted in bad faith, but instead referred to his "gross negligence." While the conduct by Smyth described in the memorandum decision may indeed constitute bad faith, the bankruptcy court is the fact finder who must determine -- explicitly -- bad faith. This is particularly true when the court's own tentative (and adopted) rulings, which are the only findings pre-dating the initial imposition of sanctions, indicate that Smyth did not mean "to ambush" Debtor and that his conduct was not an "intentional act." We therefore remand for an explicit determination of whether Smyth acted in bad faith. Primus, 115 F.3d at 649.

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[13](...continued)
available if the court specifically finds bad faith or conduct tantamount to bad faith. Sanctions are available for a variety of types of willful actions, including recklessness when combined with an additional factor such as frivolousness, harassment, or an improper purpose. Therefore, we hold that an attorney's reckless misstatements of law and fact, when coupled with an improper purpose, such as an attempt to influence or manipulate proceedings in one case in order to gain tactical advantage in another case, are sanctionable under a court's inherent power. We take no position on whether these conditions are present in this case or whether sanctions should be imposed, a determination that rests in the sound discretion of the district court.

VI. CONCLUSION

We are sympathetic with the bankruptcy court's concerns about Smyth's poor handling of the underlying adversary proceeding. At oral argument before us, Smyth acknowledged that a successful appeal could lead to a remand and more sanctions. Still, he pleaded for, and we agree that he is entitled to, fair warning about what confronts him. We express no opinion as to how the court should deal with his conduct, other than to note that due process is essential and an explicit finding of bad faith is necessary when sanctions are imposed pursuant to the court's inherent powers. Accordingly, and for the foregoing reasons, we REVERSE and REMAND.