10-1565-bk (L)
Smith v. Silverman

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2010

(Argued: April 5, 2011 Decided: May 20, 2011)

Docket Nos. 10-1565-bk (L), 10-1655-bk (con)

IN RE: RICHARD A. SMITH,

Debtor.

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RICHARD A. SMITH, CAROLE ANN CARUSO, and NELSI SMITH,

Appellants,

v. Nos. 10-1565-bk (L), 10-1655-bk (con)

KENNETH P. SILVERMAN and LIBERTY MUTUAL INSURANCE COMPANY,

Appellees.[*]

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Before: WINTER, WALKER, and CABRANES, *Circuit Judges*.

Appellants Richard A. Smith, Carole Ann Caruso, and Nelsi Smith appeal two orders of the United States District Court for the Eastern District of New York (Joanna Seybert, *Judge*), dated March 24, 2010, and March 30, 2010, affirming orders of the United States Bankruptcy Court for the Eastern District of New York (Dorothy T. Eisenberg, *Judge*), dated January 26, 2009, and May 13, 2009. The Bankruptcy Court orders denied appellants' motion to reopen Richard Smith's bankruptcy case and dismissed a complaint filed by appellants against the trustee of the bankruptcy estate and the trustee's bondholders. We hold that the District Court properly determined that the Bankruptcy Court (1) did not abuse its discretion in denying appellants' motion to reopen and (2) properly dismissed appellants' complaint. Accordingly, the orders of the District Court are **AFFIRMED**.

[*] The Clerk of Court is directed to amend the caption to read as shown above.

Additionally, in light of the frivolous nature of this appeal, appellants and their counsel are ordered to show cause why sanctions should not be imposed under Federal Rule of Appellate Procedure 38, 28 U.S.C. § 1927, and the inherent power of this Court.

THOMAS J. MCGOWAN, Meltzer, Lippe, Goldstein & Breitstone, LLP, Mineola, NY, *for appellants*.

ANTHONY C. ACAMPORA, Silverman Acampora LLP, Jericho, NY, *for appellee* Kenneth P. Silverman.

CAROLYN K. FIORELLO (David Westermann, Jr., *on the brief*), Uniondale, NY, *for appellee* Liberty Mutual Insurance Company.

PER CURIAM:

Richard A. Smith ("Smith" or "debtor"), his wife Nelsi Smith, and his sister Carole Ann Caruso (jointly, "appellants"), seek to reopen debtor's Chapter 7 bankruptcy case for the purpose of pursuing an adversary proceeding against Kenneth P. Silverman ("Silverman" or "trustee"), who was the Chapter 7 trustee of debtor's estate, and Liberty Mutual Insurance Company ("Liberty"), one of the trustee's bondholders. The United States Bankruptcy Court for the Eastern District of New York (Dorothy T. Eisenberg, *Judge*) denied appellants' motion to reopen, *In re Smith*, 400 B.R. 370, 372 (Bankr. E.D.N.Y. 2009), and the United States District Court for the Eastern District of New York (Joanna Seybert, *Judge*) affirmed this judgment, *In re Smith*, 426 B.R. 435, 437 (E.D.N.Y. 2010).

BACKGROUND

The bankruptcy proceeding that appellants seek to reopen commenced on January 12, 1996, when debtor filed for relief under Chapter 13 of the Bankruptcy Code. The case was later converted to a Chapter 7 proceeding, and on April 29, 1997, Silverman was appointed trustee of debtor's estate.

The only potential sources of recovery for the trustee were pending civil suits that debtor, along with his wife, had initiated several years prior to the commencement of the bankruptcy proceeding. On July 11, 1990, nearly seven years before Silverman was appointed as trustee, the Smiths filed two separate lawsuits in the Supreme Court of the State of New York relating to a dispute with debtor's former company, Meadow Mechanical Corp. ("Meadow"). One suit was a "dissolution action" brought by debtor and his wife—who owned 22.5% and 5% of Meadow stock, respectively—against Meadow's remaining shareholders following the discharge of debtor as president of Meadow. The defendants in that suit initially served their notice of election to buy out the Smiths' shares pursuant to New York law, *see* N.Y. Bus. Corp. Law § 1118(a),[1] but then subsequently sought to revoke this election. The Appellate Division, Second Department thwarted these efforts by holding the defendants to their election; additionally, the Second Department ordered that the defendants post a $750,000 security bond as the parties continued to negotiate an acceptable share price. *See Smith v. Russo*, 646 N.Y.S.2d 711 (2d Dep't 1996).

In a separate action (the "note action"), the Smiths sought to recover on a $275,000 promissory note that Meadow had issued to Richard Smith. The Smiths unsuccessfully sought summary judgment, with the Second Department concluding that material issues of fact remained concerning whether the conditions for payment on the note had been satisfied. *Smith v. Meadow Mech. Corp.*, 610 N.Y.S.2d 76 (2d Dep't 1994).

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[1] In relevant part, § 1118(a) states:

> In any proceeding brought pursuant to section eleven hundred four-a of this chapter, any other shareholder or shareholders or the corporation may, at any time within ninety days after the filing of such petition or at such later time as the court in its discretion may allow, elect to purchase the shares owned by the petitioners at their fair value and upon such terms and conditions as may be approved by the court . . . .

N.Y. Bus. Corp. Law § 1118(a).

Neither the dissolution action nor the note action had been resolved by the time Silverman took over as trustee of the bankruptcy estate of Smith in 1997. After investigating these claims, the trustee concluded that Meadow had a negative value as of the date of the dissolution action, and thus attempted to settle the dissolution action for $350,000. Debtor and his wife vigorously opposed this proposal on the grounds that this sum was insufficient. The Bankruptcy Court rejected the proposed settlement in 2004.

The following year, debtor moved to have the Bankruptcy Court compel the trustee to prosecute the dissolution action and the note action and to commence a handful of related claims arising out of the same underlying business dispute. In response, "[t]he Trustee informed the court that the estate was administratively insolvent, and any litigation on the derivative claims that the Debtor sought to compel the Trustee to bring would have cost between $50,000 and $100,000 in litigation costs without any assurance of a significant award to the estate." *In re Smith*, 400 B.R. 370, 374 (Bankr. E.D.N.Y. 2009). Acting on this information, the Bankruptcy Court denied debtor's motion; debtor did not appeal that order.

On July 14, 2005, at debtor's request, the Bankruptcy Court authorized the trustee to abandon to debtor the dissolution action, the note action, and any related claim that debtor may have wished to pursue. *Id.* Now back in control of his own claims, debtor moved in state court to amend the dissolution action to add some related claims. This motion was denied by the Supreme Court, Queens County (Kelly, J., Oct. 18, 2006, Index No. 11882/90), on the grounds that the relevant statute of limitations had run in 2000. *Id.* at 374-75.

After the trustee filed a no-asset report on February 7, 2007, the bankruptcy case was closed on February 13, 2007, and the trustee was duly discharged. On July 2, 2008, appellants filed a motion to reopen the bankruptcy proceedings so that appellants could commence an adversary proceeding against

the discharged trustee's counsel for malpractice stemming from a failure to pursue debtor's claims against Meadow. *Id.* at 375. The Bankruptcy Court denied the motion because, the Court concluded, appellants failed to establish privity with the trustee's counsel. *Id.*

On October 24, 2008—more than 18 months after the final decree closing the case had been entered—appellants filed yet another motion to reopen debtor's bankruptcy case in the Bankruptcy Court. Appellants[1] sought to reopen the bankruptcy case in order to commence adversary proceedings against the trustee himself, as well as the insurers who issued his surety bond. Appellants' underlying complaint, which was filed with the Clerk of the Bankruptcy Court on the same day as the motion to reopen, alleged, in pertinent part, that the trustee breached his fiduciary duty by negligently failing to pursue and investigate the dissolution action, the note action, and related claims belonging to the bankruptcy estate, and that the insurance companies, including Liberty Mutual, who had issued blanket trustee surety bonds, failed to ensure the trustee's faithful performance of his duties. The Bankruptcy Court denied appellants' motion to reopen and then subsequently granted Liberty's motion to dismiss appellants' underlying complaint.

On appeal from the judgment of the Bankruptcy Court, the District Court affirmed both orders in separate opinions. *See In re Smith*, 426 B.R. 435, 437 (E.D.N.Y. 2010) (affirming the denial of appellants' motion to reopen); *In re Smith*, No. 09-cv-2563, 2009 U.S. Dist. LEXIS 126366 (E.D.N.Y. Mar. 30, 2010) (affirming the granting of Liberty's motion to dismiss). In addition to affirming the orders of the Bankruptcy Court, the District Court *sua sponte* considered whether sanctions would be appropriate under either Rule 11 of the Federal Rules of Civil Procedure or 28 U.S.C. § 1927, in light of appellants' apparent desire to prolong needlessly the litigation. As the District Court explained:

[1] Nelsi Smith and Carole Ann Caruso each have standing to pursue these claims, along with Richard Smith, regardless of the merit of the claims, *vel non*, because each separately purchased claims held by debtor's creditors.

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