

The Sixth Circuit holds that bankruptcy courts lack the inherent power to award “serious non-compensatory punitive damages”

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Nearly 30 years after enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984 and establishment of the current bankruptcy court structure, courts are still struggling to understand the bounds of a bankruptcy court’s jurisdiction and power. Unfortunately for one recent appellant, a bankruptcy court’s power to enter punitive damages is not as great as it had hoped.

In *Adell v. Honigman, Miller, Schwartz & Cohn, LLP (In re John Richards Homes Building Company, LLC)*, Case Nos. 12-2012, 12-2013, 12-2014, and 12-2015 (6th Cir. Nov. 20, 2013) (unpublished),¹ the Sixth Circuit held that neither 11 U.S.C. § 105 nor the inherent powers of a bankruptcy court permit a bankruptcy court to enter “serious noncompensatory punitive damages.”² The bankruptcy court in *Adell* had entered an award of sanctions in the amount \$2.8 million as a consequence of a party’s continuing pattern of abuse of the judicial process in evading a prior monetary judgment entered against him by the bankruptcy court. As the bankruptcy court had found, this pattern of abuse included repeated instances of perjury, active participation with related entities in falsely responding to garnishments and filing an “unnecessary and abusive bankruptcy petition.”

In reversing the punitive damage award, the Sixth Circuit held that though 11 U.S.C. § 105 empowers a bankruptcy court to “issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title [and to take] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process,” the provision is “prospective rather than retrospective; as such [Section 105] is best read not to encompass a power to award criminal-like punitive sanctions.” The Sixth Circuit further explained that a bankruptcy court does not have the inherent power to issue substantial non-compensatory punitive sanctions, because such an inherent power would be inconsistent with “due process concerns” that arise in part from the bankruptcy courts’ limited jurisdiction and require greater procedural protections (i.e., jury trials) than bankruptcy courts can provide.

Accordingly, the Sixth Circuit reversed the bankruptcy court’s award of sanctions. Though the Sixth Circuit did not set forth a test for differentiating between serious and non-serious punitive awards, it did note that “[a] \$5,000 sanction is not considered a serious punitive sanction.” *But see, International Union, United Mine Workers of America v. Bagwell*, 512 U.S. 821, 828-29 (1994) (“Where a fine is not compensatory, it is civil only if the contemnor is afforded an opportunity to purge. Thus, a ‘flat, unconditional fine’ totaling even as little as \$50 announced after a finding of contempt is criminal if the contemnor has no subsequent opportunity to reduce or avoid the fine through compliance.”). Notably, the court in *Adell*

did not hold that bankruptcy courts lack the power to award serious non-compensatory sanctions where these sanctions are expressly provided for in the bankruptcy code (e.g. 11 U.S.C. §§ 303(i) (for improper involuntary bankruptcy petition), 362(k)(1) (automatic stay violations), and 363(n) (collusion in a bankruptcy sale)).

In practice, bankruptcy courts rarely attempt to enter serious non-compensatory damages awards. Nonetheless, some bankruptcy courts have been willing to enter such awards in cases of willful or grossly negligent violations of a discharge injunction. This willingness to enter punitive sanctions for violation of a discharge injunction might be because of the fact that these types of sanctions afford a remedy for a discharge injunction similar to the statutorily authorized remedy of punitive damages for violations of the automatic stay. Assuming the Sixth Circuit's bankruptcy courts follow Adell's lead, however, contempt awards resulting from violations of a discharge injunction will be limited to compensatory damages (including legal fees) and will not include serious non-compensatory punitive awards.