AMERICAN BANKRUPTCY INSTITUTE

Mid-Atlantic Bankruptcy Workshop

Ethics: Crime in Bankruptcy

PLENARY SESSION

Anne Eberhardt, Moderator
Gavin/Solmonese LLC | New York

Sean M. Beach
Young Conaway Stargatt & Taylor, LLP | Wilmington, Del.

Michael T. Freeman
Office of the U.S. Trustee | Alexandria, Va.

Samuel A. Newman
Sidley Austin LLP | Los Angeles

Jeffrey T. Testa
McCarter & English, LLP | Newark, N.J.

2022

AMERICAN BANKRUPTCY INSTITUTE

ABI Mid-Atlantic Bankruptcy Workshop

August 4-6, 2022
Cambridge, MD

Crime in Bankruptcy

Today's Panel

Sean Beach
Young Conaway Stargatt & Taylor
Wilmington, DE

Anne Eberhardt
Gavin/Solmonese
New York, NY

Michael Freeman
Office of the U.S. Trustee
Alexandria, VA

Samuel Newman
Sidley Austin
Los Angeles, CA

Jeffrey Testa
McCarter & English
Newark, NJ

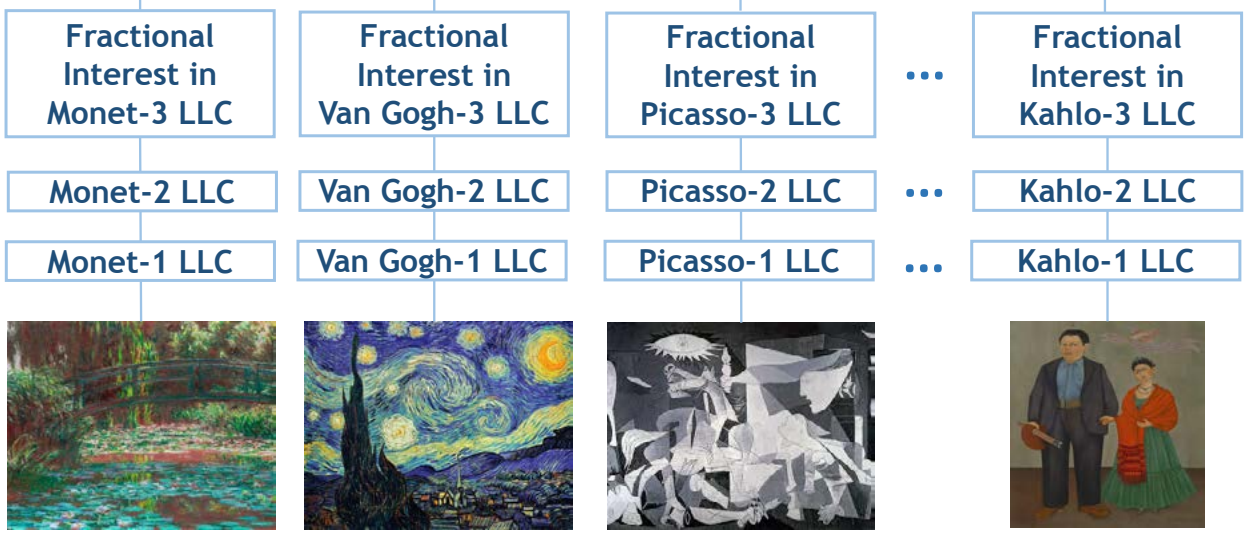
Crime in Bankruptcy

- The crime CAUSED the bankruptcy
- The crime WAS DISCOVERED during the bankruptcy
- The crime OCCURRED during the bankruptcy

Introducing: Alonzo Alfreds

Alfreds Art Investments LLC (AAI LLC)
Via Alfreds Art Marketing LLC Brokerage Firm (AAM LLC)

Alfreds Art Investments LLC (AAI LLC)
Via Alfreds Art Marketing LLC Brokerage Firm (AAM LLC)

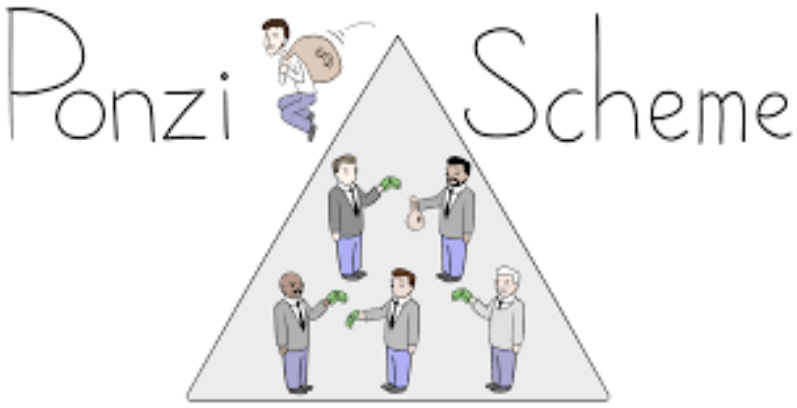


Skeptical Bethany Jones

Pre-bankruptcy Crimes

- Mail fraud
- Wire fraud
- Bank fraud
- Securities fraud

The Ponzi Scheme Presumption



XYZ

VIER, YOUNG, & ZEIG

Bankruptcy Counsel

- Due diligence – client acceptance
- Declining/terminating representation
- Federal Rules of Civil Procedure

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CHECKING SUMMARY

ChaseFargo Total Business Checking

	INSTANCES	AMOUNT
Beginning Balance		**$ 621.38**
Deposits and Additions	1	21,360.00
Electronic Withdrawals	5	-17,489.76
Ending Balance	**6**	**$ 4,491.62**

If you have any questions, please call the number on this statement. We accept operator relay calls.

CHECKING SUMMARY

ChaseFargo Total Business Checking

	INSTANCES	AMOUNT
Beginning Balance		**$ 49,650,326.98**
Deposits and Additions	1	725,035.83
Electronic Withdrawals	5	-38,000,000.00
Ending Balance	**6**	**$ 12,375,362.81**

Original

If you have any questions, please call the number on this statement. We accept operator relay calls.

CHECKING SUMMARY

ChaseFargo Total Business Checking

	INSTANCES	AMOUNT
Beginning Balance		**$ 621.38**
Deposits and Additions	1	21,360.00
Electronic Withdrawals	5	-17,489.76
Ending Balance	**6**	**$ 4,491.62**

Altered

Crimes Committed During Bankruptcy (part 1)

- Concealment of assets; false oaths and claims; bribery
- Embezzlement against the estate
- Bankruptcy fraud
- Perjury


U.S. SECURITIES AND EXCHANGE COMMISSION
MCMXXXIV


DEPARTMENT
OF
JUSTICE

Crimes Committed During Bankruptcy (part 2)

- Concealment of assets; false oaths and claims; bribery
- Embezzlement against the estate
- Bankruptcy fraud
- Perjury
- Money laundering

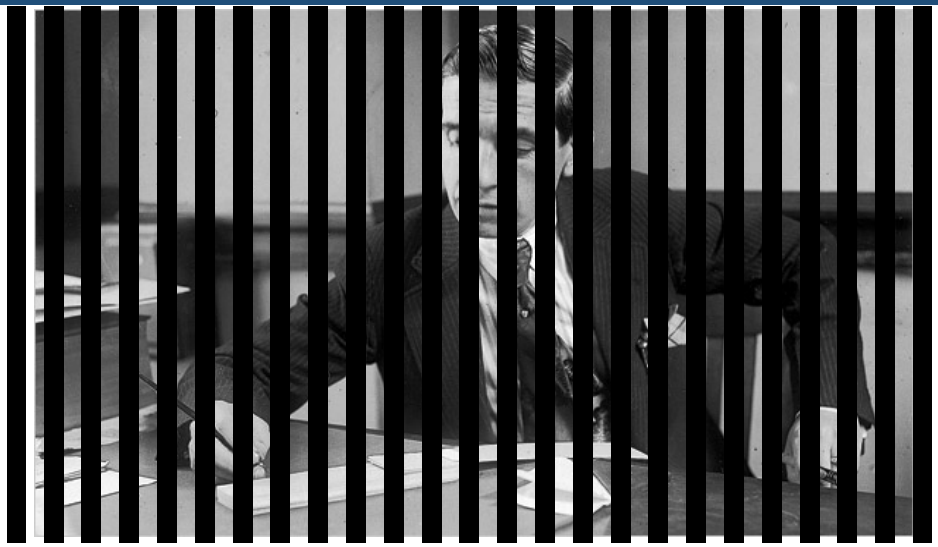
Considerations for Counsel

Committee Member Bill Bradley

Crimes Committed During Bankruptcy (part 3)

- Concealment of assets; false oaths and claims; bribery
- Embezzlement against the estate
- Bankruptcy fraud
- Perjury
- Money laundering
- Bribery

Alonzo Alfreds' Future???



Crime in Bankruptcy

Audience Q&A

ABI Mid-Atlantic 2022: Crime in Bankruptcy Panel

Bankruptcy law, criminal law, and the rules of professional conduct overlap in various ways. The Crime in Bankruptcy panel will discuss crimes that sometimes cause a bankruptcy and those that may be discovered or committed during the bankruptcy. The illustrative hypothetical fact pattern described below will act as a guide to discuss the accompanying statements of law and their practical application to the illustrative facts. The panel will primarily focus on federal law, although state law would most certainly be implicated in a number of the crimes described below and could differ significantly from federal law.

Hypothetical Fact Pattern & Analysis

Pre-Bankruptcy Events

In April 2020, to capitalize on the financial pandemonium caused by the COVID-19 pandemic, Alonzo Alfreds, a fine art collector and investor, saw an opportunity. Retail investors were scrambling for a safer investment, and Alfreds thought he could sell fractional interests in pieces of fine art as a safe investment choice. To get his project off the ground, Alfreds created an enterprise through which Alfreds Art Investments LLC ("AAI") would raise funds as an investment vehicle to purchase artwork. AAI would then purchase art through numerous LLCs that it owned and controlled ("Art Owner LLC").

AAI began raising money in May through a newly formed brokerage firm, Alfreds Art Marketing, LLC ("AAM"). Alfreds promised that investors would own part of the company that directly owned the piece of art in which they chose to invest. To further induce investments, Alfreds guaranteed investors a 10% annual dividend, payable from the revenue stream generated by leasing each work to interested parties. AAM's marketing materials neglected to disclose that AAM would receive a 2% commission on the sale of each interest and that AAI had a security interest on each piece of artwork purchased.

Despite what they were told, the investors did not get any ownership in the artwork, AAI or any Art Owner LLC. Instead, they owned a fractional interest in the parent of the parent of the Art Owner LLC. For example, Monet-1 LLC owned the art, Monet-2 LLC owned Monet-1 LLC, and Monet-3 LLC owned Monet-2 LLC and the investors had a fractional interest in Monet-3 LLC, which only owned the equity of the equity of the Art Owner LLC. In all, Alfreds created 25 Art Owner LLCs, each of which owned one piece of art, but only five were originals—the other 20 were museum-quality reproductions that looked virtually identical to the originals. Of course, Alfreds kept that knowledge to himself.

Investors began pouring in - $1 billion in the first year - for the guaranteed return and ownership of interests in famous works by Van Gogh, Picasso, Monet, and other notable artists. While his leasing program struggled to perform due to the COVID-19 restrictions, Alfreds funded the first guaranteed dividend with funds he received from later investors. As COVID restrictions eased, the leasing program improved, and customers began leasing Alfreds' paintings for display during various high-end social and professional events.

In September 2021, the authenticity of the works owned by Alfreds' LLCs came into question. At a philanthropic event, Bethany Jones—an investor in Alfreds' enterprise and an accomplished art historian—noticed defects in the displayed Van Gogh painting and confronted Alfreds. When Alfreds denied that the work was a duplicate, Jones told him she would be withdrawing her investment and alerting the authorities. Alfreds was confident that his forgeries could withstand an investigation.

The questioned authenticity led to others liquidating their investments and, to make matters worse, the Securities and Exchange Commission (SEC) began an investigation into the propriety of AAM's marketing materials and various lessees commenced lawsuits on the basis that AAI had fraudulently leased prints at rates that would only be appropriate for original works.

Analysis of Applicable Law and Facts

- Mail Fraud, Wire Fraud, Bank Fraud, and Securities Fraud (18 U.S.C. §§ 1341, 1343, 1344, and 1348):
    - Mail Fraud and Wire Fraud statutes share identical language in relevant part (but for use of "mails" or use of "interstate wires" in committing the fraud), and courts apply the same analysis to each statute. Mail and wire fraud require (1) a scheme or artifice to defraud, (2) use of the mails or interstate wires to execute the scheme, and (3) a specific intent to defraud.
        - Congress has not defined either a "scheme" or "artifice," and the "expression has taken on its present meaning from 111 years of case law." *United States v. Lemire,* 720 F.2d 1327, 1335 (D.C. Cir. 1983). "The words 'to defraud' in the mail fraud statute have the common understanding of wrongdoing one in his property rights by dishonest methods or schemes, and usually signify the deprivation of something of value by trick, chicane, or overreaching." *Carpenter v. United States*, 484 U.S. 19, 27 (1987) (internal quotation marks omitted). A "scheme or artifice to defraud" also includes any action to "obtain money or property by means of false or fraudulent pretenses, representations, or promises," which includes false promises and misrepresentations as to the future. 18 U.S.C. § 1341 & & 1343. *See also McNally v. United States*, 483 U.S. 350, 358 (1987) (superseded on other grounds by the enactment of 18 U.S.C. § 1346). "The concept of 'fraud' includes the act of embezzlement, which is the fraudulent appropriation to one's own use of the money or goods entrusted to one's own care by another." *Carpenter*, 484 U.S. at 27. 18 U.S.C. § 1346 has defined "scheme or artifice to defraud" to include (but not be limited to) a scheme or artifice to "deprive another of the intangible right of honest services." This form of mail or wire fraud is typically described as "honest services fraud." *See United States v. Flemming*, 22 F. App'x 117, 122 (3d Cir. 2007). "Materiality of falsehood" is a sub-element of federal mail and wire fraud statutes, although Congress did not use that language in the statutes. *Neder v. United States*, 527 U.S. 1, 25 (1999).

- Mail fraud simply applies to anyone who "for the purpose of executing [a] scheme or artifice [to defraud] . . . places in any post office ... or causes to be delivered by mail ... any ... matter." 18 U.S.C. § 1341. Similarly, wire fraud applies to anyone who "transmits or causes to be transmitted by wire, radio, or television communication in interstate or foreign commerce any writings . . . for the purpose of executing [a] ... scheme or artifice [to defraud]." 18 U.S.C. § 1343. Perpetrating a fraud over the internet is an example of wire fraud. *See U.S. v. Nickens*, 38 F. App'x 721 (3d Cir. 2002).

- The specific intent to defraud requires an intent to (1) deceive, and (2) cause some harm to result from the deceit. "A defendant acts with the intent to deceive when he acts knowingly with the specific intent to deceive for the purpose of causing pecuniary loss to another or bringing about some financial gain to himself." *United States v. Evans*, 892 F.3d 692, 712 (5th Cir. 2018).

- Bank fraud (18 U.S.C. §1344) requires proof of the following elements: (1) Knowingly execute or attempt to execute a scheme or artifice to defraud; and (2) an intention to defraud a financial institution that is insured by the FDIC or chartered by the United States.

  - As stated above, Congress has not defined either a "scheme" or "artifice," and the "expression has taken on its present meaning from 111 years of case law." *United States v. Lemire,* 720 F.2d 1327, 1335 (D.C. Cir. 1983). Case law describing a "scheme or artifice to defraud" in the context of mail or wire fraud is equally applicable to such a scheme or artifice in the context of bank fraud.

  - An intent to defraud a financial institution consists of an intent obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution insured by the FDIC by means of fraudulent pretenses, representations, or promises. A defendant's scheme to obtain money from an account belonging to a customer of the bank was a scheme to deprive the bank of its own property, since the bank had property rights in the funds in the customer's account. *Shaw v. U.S.*, 580 U.S. 63 (2016).

  - The bank fraud statute requires "neither a showing of ultimate financial loss nor a showing of intent to cause financial loss." *Id.*

- *Applying the Facts:*

  - Alfreds' entire business structure represents his scheme to defraud investors. Either on his own, through AAI, or through AAM, Alfreds made materially false statements and misrepresentations regarding: (1) the nature of the interests in which investors were investing; (2) the

authenticity and value of the artwork; and (3) the guaranteed dividend of 10%.

- With respect to the securities, Alfreds or his agents may have used a public or private postal service, or the internet, to issue written materials about the securities in which investors could invest. The written materials contained fraudulent representations, including (i) that the interests marketed by AAM were in the entity owning the artwork; (ii) that the artwork was authentic; and (iii) that investors would receive guaranteed 10% dividends from the leasing of the pieces of art. However, the interests were in entities that held a remote ownership interest in the Art Owner LLCs; the works of art were not authentic; and Alfreds paid the dividend from other investments, not from the leasing proceeds. Alfreds was aware that these facts were false, and with that knowledge, chose to pursue his fraudulent scheme with the intention of receiving money from investors based on their belief that they would hold an ownership interest in the Art Owner LLC.

- With respect to the leasing program, again, Alfreds may have used a public or private postal service to issue written materials regarding the works of art available for lease. The written materials likely contained fraudulent representations regarding the authenticity of the works, which representations induced lessees to engage with Alfreds. Alfreds was aware that the works were forgeries, and pursued his leasing scheme with the intention of receiving money from customers based on their belief that the works were authentic.

- To the extent any of the victims of Alfreds' scheme transferred funds to Alfreds from a federally insured bank, Alfreds is also liable for bank fraud, as he deprived the bank of its possessory interest in its customer's funds.

- Securities Fraud (18 U.S.C. § 1348)

  - Securities fraud occurs when an individual knowingly devises (or willfully participates in) a scheme or artifice to defraud with fraudulent intent, and the scheme or artifice to defraud was developed in connection with a security of a certain issuer or with certain filing requirements.

    - Trading on insider knowledge, where the trades were based on material nonpublic information, and where the defendant had signed a nondisclosure agreement, was a violation of 18 U.S.C. § 1348, as the defendant had misappropriated confidential information for securities trading purposes. *United States v. Chow*, 993 F.3d 125 (2d Cir. 2021).

    - "A fiduciary who pretends loyalty to the principal while secretly converting the principal's information for personal gain dupes or

defrauds the principal." *United States v. O'Hagan*, 521 U.S. 642, 653-54 (1997) (cleaned up).

- *Applying the Facts:*
  - Assuming that the fractional interests being sold are securities, to sell his securities, Alfreds (i) mischaracterized them in his marketing materials as interests in the Art Owner LLC, rather than properly describing them as interests in remote parent LLCs; and (ii) would have had to file mandatory disclosures pursuant to SEC regulations, in which he likely made additional misrepresentations.
  - Each of these misstatements constitute separate forms of securities fraud:
    - The misstatement of fact in marketing materials regarding the securities of Art Owner LLC is a misrepresentation made to induce investors into purchasing the securities with the intention of obtaining investments.
    - The misstatements in SEC filings constitutes a separate fraud subject to criminal prosecution under 18 U.S.C. § 1348.
- A note regarding the "Ponzi Scheme Presumption" – Inapplicable in the criminal context, but helpful in civil fraudulent transfer actions under 11 U.S.C. § 548(a)(1)(A).
  - "A 'Ponzi scheme' typically describes a pyramid scheme where earlier investors are paid from the investments of more recent investors, rather than from any underlying business concern, until the scheme ceases to attract new investors and the pyramid collapses." *Eberhard v. Marcu,* 530 F.3d 122, 132 n.7 (2d Cir.2008). In a criminal prosecution of fraud related to an alleged Ponzi scheme, the government is required to prove each and every element of the applicable statute under which they are prosecuting the fraudster. *See United States v. Burks*, 867 F.2d 795
  - However, where a Ponzi scheme is proven, a debtor or trustee can use the "Ponzi scheme presumption" to satisfy its burden of proof as to "actual fraudulent intent" under section 548(a)(1)(A) of the Bankruptcy Code. *Picard v. Cohen*, 2016 WL 1695296, at *5 (Bankr. S.D.N.Y. Apr. 25, 2016) ("[T]he Trustee is entitled to rely on the Ponzi scheme presumption pursuant to which all transfers are deemed to have been made with actual fraudulent intent." (citing *In re Bernard L. Madoff*, 531 B.R. at 471)). The basis for the presumption is that a Ponzi scheme's operator knows, from the outset, that "[t]he investor pool is a limited resource and will eventually run dry." *Armstrong v. Collins*, 2010 WL 1141158, at *20–21 (S.D.N.Y. Mar. 24, 2010). When it does,

> the operator knows that "the scheme will collapse and that those still invested in the enterprise will lose their money." *In re Bayou Group, LLC*, 439 B.R. 284, 294 n.19 (S.D.N.Y. 2010). One thus "can infer an intent to defraud future undertakers [investors] from the mere fact that a debtor was running a Ponzi scheme." *Armstrong*, 2010 WL 1141158, at *21 (quoting *In re C.F. Foods, L.P.*, 280 B.R. at 110). "The existence of a Ponzi scheme demonstrates actual intent as [a] matter of law because transfers made in the course of a Ponzi scheme could have been made for no purpose other than to hinder, delay or defraud creditors." *In re Bernard L. Madoff Investment Securities LLC*, 12 F.4th 171, 181 (2d Cir. 2021) (holding that the Ponzi scheme presumption applied where the fraudster "admitted in his [criminal] plea allocution that 'for many years up until my arrest I operated a Ponzi scheme,'" and where the parties did not dispute the applicability of the Ponzi scheme presumption.)

Alfreds' Bankruptcy Preparation and Post-Petition Events

Alfreds consulted with the law firm of Xavier, Young, & Zeigler, LLP ("XYZ") to determine whether a chapter 11 bankruptcy filing could be a viable life raft to remedy his enterprise issues and give him some breathing room. Alfreds assured XYZ that he was working with separate counsel to address any regulatory and criminal allegations that his enterprise faces, and produced certificates of authenticity for each of the 25 works of art—twenty of which were forgeries. While XYZ had concerns about the allegations, Alfreds insisted that he was running a legal business and that any regulatory issues were being addressed by regulatory counsel. XYZ agreed to represent Alfreds' enterprise in connection with its restructuring and potential bankruptcy strategy.

Analysis of Applicable Law and Facts

- Declining or Terminating Representation (Rule 1.16 of the Model Rules of Professional Conduct (the "MRPC"))
    - MRPC 1.16 states that "[a] lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if: (1) the representation will result in a violation of the rules of professional conduct or other law. . . . ."
        - Comment 2 to MRPC 1.16 clarifies that a lawyer ordinarily must decline or withdraw from representation if the client "demands" that the lawyer engage in conduct that is illegal or violates the MRPC or other law. However, "[t]he lawyer is not obliged to decline or withdraw simply because the client suggests such a course of conduct; a client may make such a suggestion in the hope that a lawyer will not be constrained by a professional obligation."
- Federal Rule of Civil Procedure 11 (made applicable to all bankruptcy cases by Federal Rule of Bankruptcy Procedure 9011)

- Under FRCP 11, "by presenting to the court a pleading, written motion, or other paper--whether by signing, filing, submitting, or later advocating it--an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances . . . (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery."

    - *Bradgate Assocs., Inc. v. Fellows, Read & Assocs., Inc.*, 999 F.2d 745, 752 (3d Cir. 1993):

      "The objective standard imposed by Rule 11 is firmly established in this circuit. We have consistently noted that the Rule 11 test is 'now an objective one of reasonableness' which seeks to discourage pleadings 'without factual foundation, even though the paper was not filed in subjective bad faith.' . . .

      When a district court examines the sufficiency of the investigation of facts and law, it 'is expected to avoid the wisdom of hindsight and should test the signer's conduct by [asking] what was reasonable to believe at the time the pleading, motion, or other paper was submitted.' In doing so, the court must consider all circumstances surrounding the submission, including the amount of time the signer had to investigate, whether the signing attorney had to rely on a client for information as to the facts, and whether the signer depended on prior counsel or another member of the bar if the case has been transferred."

- *Applying the Facts*

    - XYZ could have been more careful in approaching this representation, but XYZ's decision to represent Alfreds is nevertheless permissible. Alfreds obviously has made no such demand, and even if he were to suggest that XYZ take an improper course of conduct, XYZ would not necessarily have to decline/withdraw from representation.

    - Although XYZ could have potentially obtained independent verification of the "certificates of authenticity," it is debatable whether XYZ's failure to do so would be considered unreasonable under the circumstances, especially in the context of simply accepting an engagement. As new facts come to light and XYZ must make affirmative representations before a court, the analysis of a lawyer's investigation (or lack thereof) into its client takes on a greater importance. But it is clear at this point that XYZ has no actual knowledge of Alfred's misdeeds.

Alfred's Bankruptcy Filing

Alfreds filed chapter 11 petitions for each entity in the enterprise in January 2022. Without XYZ's knowledge, Alfreds doctored certified bank statements and schedules and statements of assets and liabilities to reflect lower cash balances. He thought that if it looked like he had less cash in the bank, litigious parties would not try to get blood from a stone.

Analysis of Applicable Law and Facts

- Concealment of assets; false oaths and claims; bribery (18 U.S.C. § 152)
    - 18 U.S.C. § 152 lists nine types of knowing and fraudulent conduct for which a person may be fined in accordance with 18 U.S.C § 3571 and/or imprisoned up to five years. Such conduct includes (1) concealing assets from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor, or (2) making a false oath or account in or in relation to any case under title 11.
- Embezzlement against estate (18 U.S.C. § 153)
    - A trustee or custodian of estate assets may be fined and/or imprisoned when he or she knowingly and fraudulently appropriates to the person's own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor.
- Bankruptcy Fraud (18 U.S.C. § 157)
    - Like bank fraud discussed above, a person commits bankruptcy fraud when they have devised or intend to devise "a scheme or artifice to defraud," and thereafter, for the purpose of executing or concealing such a scheme or artifice or attempting to do so . . . . (2) files a document in a proceeding under title 11; or (3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title."
- Perjury (18 U.S.C. § 1621)
    - A person commits perjury when, "having taken an oath before a competent tribunal," or "in any declaration," "willfully and contrary to such oath states or subscribes any material matter which he does not believe to be true."
- *Applying the Facts*
    - Alfreds clearly committed a crime when he altered bank records with the specific intention of concealing assets. This type of conduct falls squarely

within several bankruptcy crimes enumerated in 18 U.S.C. §§ 151-157. 18 U.S.C. § 152 (Concealment of assets; false oaths and claims; bribery); *id.* § 153 (embezzlement against estate); *id.* § 157 (bankruptcy fraud). Further, Alfreds also committed perjury under 18 U.S.C. § 1621 since the schedules and statements would have been accompanied by a declaration under penalty of perjury (Form 202).

- Regarding XYZ, it still has no actual knowledge of Alfreds' wrongdoings, but it is now advocating for its client before a court and therefore has come under the auspices of FRCP 11, which is described above, requiring an inquiry "reasonable under the circumstances."

- XYZ's inquiry may require some sort of independent verification of Alfreds' representations. *E.g., In re Parikh*, 508 B.R. 572, 585 (Bankr. E.D.N.Y. 2014) ("Although an attorney may generally rely on objectively reasonable client representations, the attorney must independently verify publicly available facts to determine if the client representations are objectively reasonable.") (internal citations omitted).

The Committee Appointment and Additional Disclosures

Shortly after the filing, the Office of the United States Trustee (the "U.S. Trustee") appointed a committee of unsecured creditors (the "Committee") composed entirely of lessees who were seeking to recover against Alfreds on theories of fraud.

In April 2022, the SEC issued a public statement that Alfreds misled investors into investing in his enterprise on false premises. Shortly thereafter, afraid they could get wrapped up in criminal proceedings, two of Alfreds' associates disclosed to the U.S. Department of Justice (DOJ) that Alfreds had used investor money to pay guaranteed dividends as they came due. Later that month, three art appraisers who examined each of the works in Alfreds' collection issued separate statements reaching the same conclusion—that 20 of the works in Alfreds' collection were high-quality duplicates, not originals. In a private conversation with the lead attorney on the engagement at XYZ, Alfreds whispered "well, I still have $5 million nobody knows about and have been transferring it from AAI to a secret company in the Cayman Islands. And since I own AAI, those secured claims on the legitimate artwork are worth millions to me."

Analysis of Applicable Law and Facts

- Confidentiality of Information (MRPC 1.6) and Truthfulness in Statements to Others (MRPC 4.1)

  - MRPC 1.6(b) allows a lawyer to disclose information related to the representation of a client if the lawyer believes disclosure is necessary to "prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services."

- Similarly, comments to MRPC 4.1 explains that a lawyer may avoid assisting a client's crime or fraud by withdrawing from representation. But, where a crime or fraud involves a misrepresentation, the lawyer is obligated to disclose material facts of which it is aware where disclosure of such facts would prevent assistance with the fraud. Therefore, given that XYZ knows that Alfreds is committing an ongoing crime, it will likely have to disclose that knowledge in some form or fashion.[1]

- Laundering of Monetary Instruments (18 U.S.C. § 1956)

  - A person commits money laundering when they perform a transaction designed "(i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or (ii) to avoid a transaction reporting requirement under State or Federal law."

  - If found guilty of money laundering, the perpetrator could be fined up to $500,000 or twice the value of the property involved in the transaction, whichever is greater, and/or imprisoned for up to twenty years.

- *Applying the Facts*

  - Alfreds continues his crime spree, but can now likely add to his list the crime of money laundering since he has transferred millions of dollars in unlawful gains in order conceal his assets and avoid bankruptcy reporting requirements.

  - XYZ now unquestionably knows that Alfreds has committed a crime, and under MRPC 1.16, it can no longer continue to represent Alfreds if he were to demand that XYZ assist in perpetuating his criminal activity.

  - If XYZ were to withdraw from representation, it would likely have to seek court approval and therefore encounter the difficult balance of explaining withdrawal without betraying privilege. *See* MRPC 1.16 Cmt. 3 ("Court approval or notice to the court is often required by applicable law before a lawyer withdraws from pending litigation. Difficulty may be encountered if withdrawal is based on the client's demand that the lawyer engage in unprofessional conduct. The court may request an explanation for the withdrawal, while the lawyer may be bound to keep confidential the facts that would constitute such an explanation. The lawyer's statement that professional considerations require termination of the representation ordinarily should be accepted as sufficient. Lawyers should be mindful of their obligations to both clients and the court under Rules 1.6 and 3.3.").

[1] Although inapplicable to attorneys representing a debtor in a bankruptcy case, 18 U.S.C. 3057 gives "any judge, receiver, or trustee having reasonable grounds for believing that any violation of . . . the laws of the United States relating to insolvent debtors, receiverships or reorganization has been committed," such officer of the Court "shall report to the appropriate United States attorney all the facts and circumstances of the case, the names of the witnesses and the offense or offenses believed to have been committed."

Chapter 11 Trustee and the Sale

Aware of these allegations, the U.S. Trustee filed a motion for the appointment of a chapter 11 trustee. The chapter 11 trustee was appointed and elected to sell all of the works in Alfreds' collection—including the fakes (albeit at a severely discounted price). Seeking to capitalize on an opportunity, a novice art collector, hedge fund manager, and member of the Committee, Bill Bradley, bid on one of the five original works in Alfreds' collection. As a member of the Committee, Bradley had knowledge of other expressions of interest in the work, and knew that only one bidder – a well-funded museum - could top his bid. To ensure his victory, Bradley contacted the museum, threatened to discontinue any relationship with the museum and use his position as a committee member to block any sale to the museum. The museum withdrew its bid, and Bradley was declared the successful bidder.

Analysis of Applicable Law

- Appointment of Trustee (11 U.S.C. § 1104)
    - Section 1104(a) contains two separate grounds for the appointment of a Chapter 11 trustee.
        - Under section 1104(a)(1), a party in interest may request appointment of a chapter 11 trustee "for cause, including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause." However, the specific instances of "cause" enumerated in section 1104(a)(1) are not an exhaustive list, and bankruptcy courts determine the existence of "cause" on a case by case basis. *In re Skytec, Inc.*, 610 B.R. 14, 22 (Bankr. D.P.R. 2019). There is a strong presumption that a debtor should be permitted to remain in control and possession of its business, and the moving party bears the burden of proving that cause exists under section 1104(a)(1) by either (i) clear and convincing evidence (in a majority of jurisdictions) or (ii) a preponderance of the evidence (in a minority of jurisdictions). *Id.* Courts in the Second Circuit and Third Circuit have adopted the majority position of "clear and convincing evidence." *In re Bayou Group, LLC*, 564 F.3d 541, 546 (2d Cir. 2009); *In re G-I Holdings, Inc.*, 385 F.3d 313, 317-18 (3d Cir. 2004).
        - Alternatively, the standard under section 1104(a)(2) permits appointment of a trustee *without* cause, if "appointment [of a trustee] is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor." In determining whether to appoint a trustee under section 1104(a)(2), courts look to the "practical realities and necessities" of the case. *In re Euro-American Lodging Corp.*, 365 B.R. 421, 427 (Bankr. S.D.N.Y. 2007). This standard is intended to be more flexible, although

certain courts "have articulated certain factors to guide the court . . . [such as] (i) the trustworthiness of the debtor; (ii) the debtor in possession's past and present performance and prospects for the debtor's rehabilitation; (iii) the confidence—or lack thereof—of the business community and of creditors in present management; and (iv) the benefits derived by the appointment of a trustee, balanced against the cost of the appointment." *Id.* (quoting *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990). The movant bears the burden of proving that appointment of a trustee is appropriate under section 1104(a)(2).

- As instructed by section 1104(e), the U.S. Trustee *must* request appoint of a chapter 11 trustee if there are reasonable grounds to believe that any of the parties in control of the debtor "participated in actual fraud, dishonesty or criminal conduct in the management of the debtor or the debtor's financial reporting." However, upon the U.S. Trustee's request for appointment of a trustee under section 1104(e), sections 1104(a)(1) and 1104(a)(2) still guide a court's discretion to appoint a trustee. *See In re The 1031 Tax Group, LLC*, 374 B.R. 78, 87 (Bankr. S.D.N.Y. 2007).

- 18 U.S.C. § 152(6) (Bankruptcy Fraud) subjects a person to fine or imprisonment if he or she "knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11."

- *Applying the Facts*

  - Under the facts above, Bradley has threatened to withhold donations and the hosting of future events from the museum. On the threat of "forbearing" from donating or hosting future events, Bradley sought to gain an advantage in the sale process by forcing the museum to withdraw its bid, thereby committing bankruptcy fraud under 18 U.S.C. § 152.

Alfred's Final Mistake (And Crime)

Realizing that his scheme was quickly crumbling (and no longer represented by counsel because XYZ withdrew), Alfreds called the U.S. Trustee and offered to "donate" AAI's previously undisclosed $5 million to the U.S. Trustee Program if they agreed to drop their bankruptcy investigations.

- Bribery (18 U.S.C. § 152)

  - A person commits bribery when he or she "knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11."

- *Applying the Facts*
    - Despite calling it a donation, Alfreds committed bribery under 18 U.S. Code § 152 when he offered the U.S. Trustee money in exchange for the U.S. Trustee's forbearance from its investigations. Alfreds' final crime of bribery could (and likely did) result in a substantial fine or imprisonment.

Faculty

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