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Ethics: Have I Gone Too Far?

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PLENARY SESSION

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CRIMINAL STATUTES AND REPRESENTATIVE CASE LAW RELATING TO BANKRUPTCY LAW PRACTICE

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I. INTRODUCTION

It goes without saying that, as attorneys, we have a duty to uphold the law. We are officers of the court and our rules of ethics require that we both comply with the law and duly report non-compliance. The Preamble to the ABA's Model Rules of Professional Conduct observes that "[a] lawyer's conduct should conform to the requirements of the law, both in professional service to clients and in the lawyer's business and personal affairs.[1] Consistent with this, the Model Rules specifically provides:

> It is professional misconduct for a lawyer to:
>
> (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;
>
> (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;…[2]

The rules of professional conduct of most, if not all, state and local jurisdictions contain similar provisions.

Balanced against this Rule is the oft-cited ethical requirement that an attorney represent his or her client zealously. For example, Rule 1.3(a) of the D.C. Rules of Professional Conduct states that "[a] lawyer shall represent a client

[1] ABA Model Rules of Professional Conduct, Preamble ¶ 5.
[2] *Id*., Rule 8.4.

zealously and diligently within the bounds of the law."[3] Sometimes, however, zealous representation can lead an attorney to act outside the bounds of the law, particularly in the arena of bankruptcy law, where financial pressure on clients is often at its greatest and where both the temptation and opportunity to engage in acts of questionable legality are heightened. It can arise in one of two ways: Clients who have committed criminal acts sometimes resort to filing for bankruptcy, and bankruptcy clients, out of desperation, are sometimes tempted to commit criminal acts. Under either scenario, there is a concomitant opportunity for bankruptcy counsel to "cross the line" while representing his client, the result being not just civil, but criminal, liability.

II. RELEVANT CRIMINAL STATUTES

There are numerous statutes defining what constitutes a crime in the context of bankruptcy proceedings. They fall conveniently into two distinct categories – those that relate specifically to bankruptcy cases and those that are general in nature. Between the two groups, there is a fair degree of overlap in what constitutes criminal conduct. Collectively, the statutes provide a frightening number of ways in which a bankruptcy attorney can end up on the wrong side of the law in the course of representing a client.[4]

A. <u>Bankruptcy-specific statutes</u>

Title 18 of the United States Code represents the codification of most of the laws relating to federal crimes and federal criminal procedure. Chapter 9 of title 18 relates specifically to bankruptcy matters; sections 152 through 157 of this chapter identify what are commonly referred to as "bankruptcy crimes." As expected, these statutes focus in large part on the actions of the debtor (as defined in section 152); however, it is clear that the actions of counsel for the debtor, and of creditors and other parties in interest as well as their counsel, are likewise within the scope of these statutes. Each of the "bankruptcy crimes" is discussed briefly below.

1. <u>Section 152</u>

[3] District of Columbia Rules of Professional Conduct 1.3(

[4] Of course, there are also a number of reported cases where the debtor in the bankruptcy case is also the attorney who is subject to the statutes discussed hereon. This discussion, however, is limited to those instances where the attorney is not the debtor.

Section 152 of Title 18 contains the nine commandments of bankruptcy. It identifies those actions that are forbidden in the context of any bankruptcy case filed under title 11. Each requires that the act in question be taken "knowingly and fraudulently" to be treated as a criminal violation. These nine forbidden actions are as follows:

a. concealing from a trustee, the U.S. Trustee, creditors, etc. property of the estate;

b. making a false oath or account in a case or in relation to a bankruptcy case;

c. making a false declaration, certificate, verification, or statement under penalty of perjury in a case or in relation to a bankruptcy case ;

d. presenting or using a false claim against the estate;

e. receiving property from the debtor with the intent to defeat the provisions of the Bankruptcy Code;

f. giving, receiving, offering, or attempting to obtain any form of compensation for acting or forbearing to act in a bankruptcy case;

g. concealing property in contemplation of a bankruptcy case;

h. concealing, destroying, or falsifying recorded information relating to the property or financial affairs of a debtor, either in contemplation of a bankruptcy case or after it is filed; and

i. withholding recorded information relating to the property or financial affairs of a debtor from a trustee, etc. after the filing of a bankruptcy case.

For the most parts, these prohibited acts are the same acts that, if committed by the debtor, would support a denial of discharge under section 727 of the Bankruptcy Code. While denials of discharge under such circumstances are commonplace, criminal prosecution for these same prohibited acts is not. The explanation may lie in the fact that, as noted above, all nine of the bankruptcy crimes require proof of both knowledge and fraudulent intent. For an act to be done "knowingly", it is not necessary that the party know the act is illegal; it is only necessary that the act be done voluntarily and intentionally, rather than by mistake or inadvertence. *See, e.g., United States v. Zehrbach*, 47 F.3d 1252, 1258 (3rd Cir. 1995), *cert. denied*, 115 S. Ct. 1699.

Moreover, most of the bankruptcy crimes of section 152 require that the wrongdoer know of the contemplated or pending bankruptcy case. *See, e.g., United States v. Yasser*, 114 F.2d. 558 (3d Cir. 1940)("The essence of the crime [of concealment of estate assets] is knowingly and fraudulently to conceal from the receiver or trustee in bankruptcy. It must, therefore, appear that the defendant had actual knowledge of the existence of a receiver or trustee in bankruptcy or that he willfully closed his eyes to facts which made the existence of such an officer obvious. *Rachmil v. United States*, 9 Cir., 43 F.2d 878, *certiorari denied*, 283 U.S. 819, 51 S. Ct. 344, 75 L. Ed. 1434"). Proving the requisite knowledge beyond a reasonable doubt can therefore be challenging. *See, e.g., U.S. v. Heavrin*, 144 F. Supp. 2d 769 (W.D. Ky. 2001).

In addition, there must be proof of fraudulent intent, that is, an actual intent to deceive, ordinarily for the purpose either causing some financial loss to another or bringing about some financial gain to oneself. *United States v. Zehrbach*, 47 F.3d at 1253. Circumstantial evidence is sufficient to prove fraudulent intent and support a conviction. *U.S. v. Webster*, 125 F.3d 1024, 1034 (7th Cir. 1997). Nevertheless, and while the "badges of fraud" will often be sufficient to meet the heavy burden of proving fraudulent intent in a criminal prosecution, there are many instances where that burden cannot be met. *See, e.g., U.S. v. Knight*, 25 F. Supp. 3d 1104 (W.D. Ark. 2014).

In *U.S. v. Knight*, one of the more recent Circuit level decisions, the challenge for prosecutors to meet the burden of establishing the defendant acted knowingly and fraudulently was highlighted despite the facts. 800 F.3d 491 (8th Cir. 2015). Knight acted as counsel to an eventual Chapter 7 debtor pre- and post-bankruptcy. Initially, a jury convicted Attorney Knight, of bankruptcy crimes, under 18 U.S.C. §§ 371 and 157 for conspiracy to commit bankruptcy fraud, 18 U.S.C. §§ 157(2) and (7) for aiding and abetting fraud, 18 U.S.C. § 152(3) for aiding and abetting the making of a false statement in relation to a bankruptcy case, and 18 U.S.C. § 1957 for five counts of aiding and abetting money laundering. The charges related to a series of pre-bankruptcy transactions wherein Attorney Knight permitted the debtor to deposit proceeds of various real estate transactions into his IOLTA account and then be disbursed at the debtor's direction from that account. In the subsequent, Chapter 7 case of Knight's client, the client's discharge was denied for failure to disclose material information in the bankruptcy filings and concealing monies by transferring them through certain business accounts the debtor controlled and Attorney Knight's IOLTA account. A criminal referral related to the debtor's misstatements and omissions in the bankruptcy case was made. The government also pursued Knight on the theories described above. Despite the jury's decision, the District Court granted a new trial on all but one count and acquitted Knight on another due to insufficient evidence finding that debtor's use of the IOLTA account alone did not provide sufficient evidence of assistance to Barber in fraudulently concealing funds prior to bankruptcy. *But see, U.S. v. Kubick,* USTP Press Release (March 6, 1998) (convictions for bankruptcy fraud and aiding and abetting were obtained against the attorney in part based on running proceeds through the trust account). The Eighth Circuit affirmed (although it overturned the acquittal and instead granted a new trial on the false statement count) stating, for example, with regard to the evidence of the bankruptcy fraud, i.e., concealment of assets of debtor in Knight's IOLTA account the Court stated the evidence "was highly circumstantial, tenuously connected, and 'largely invited only speculation and conjecture.'" The Court did not find the evidence Knight intended to defraud debtor's creditors or knowingly assisted debtor in making false statements in debtor's bankruptcy filings. Knight obtained a new trial amounting to an acquittal (the government dismissed the indictment against Knight) despite emails from Knight stating "[w]e don't want Enterprise to know that there are funds available" and other emails implying efforts to evade creditors.

<u>Other Representative Case Law – Title 18, Section 152(1) – Concealment of Assets</u>

The concealment of assets by debtors and the assistance by counsel in concealing such assets is often grounds for criminal convictions. *See, e.g., U.S. v. Smithson,* 49 F.3d 138 (5th Cir. 1995) (debtor and his counsel convicted for concealing two real estate option contracts from Chapter 7 trustee but remanding on sentencing because restitution order did not reflect actual value of options at time of bankruptcy filing).

The concealment of assets can be established even if the concealment consists only of withholding assets for which the trustee should be told and even if the concealment occurred before the appointment of the trustee. *U.S. v. Sullivan*, 522 F.3d at 976. In *Sullivan*, executives at Focus Media with the assistance of their counsel sought to defraud creditors and, with respect to all three defendants, conceal assets from the eventual bankruptcy trustee for the company. The Ninth

Circuit upheld the conviction against the attorney defendant representing the debtor company finding the evidence of multiple misrepresentations regarding the source of retainer funds paid to the bankruptcy counsel he assisted in retaining and omissions with respect to the bankruptcy trustee of the existence of funds and other improper transfers of company funds permitted an inference of an intent to conceal assets from the trustee. The Court further found the attorney had knowingly involved himself in the fraudulent scheme and assisted in the concealment of company assets. *U.S. v. Sullivan*, 522 F.3d at 977-78.

In *Dolan*, the Eighth Circuit upheld the conviction of Attorney Gary Dolan pursuant to Title 18, Sections 152 and 371 for aiding and abetting the concealment of a Ferrari with equity and receipt of proceeds from a settlement of $1.9 million during the pendency of the Chapter 11 proceedings and conspiracy to conceal same. In this instance, the bankruptcy filings omitted these assets and the cause of action that generated the settlement proceeds even though the attorney was counsel of record in the litigation, the attorney negotiated settlements with creditors without disclosing the assets, and the attorney went so far as to try to negotiate a stipulated stay order and subsequent sale of the Ferrari to a third party in order to permit the debtor to retain the equity in order to avoid the turnover of the equity to the bankruptcy creditors. *U.S. v. Dolan*, 120 F.3d 856 (8th Cir. 1997). Dolan sought to overturn the conviction on the basis of the statute of limitations – 5 years from the last overt act in furtherance of the conspiracy and/or end of concealment. *Id.* at 865-66, 868. Additionally, he argued sufficiency of the evidence essentially arguing his mere representation of the debtor could not support a conviction. The challenge failed as the Court noted that Dolan affirmatively participated in the fraud by misrepresenting the availability of the settlement proceeds for the debtor's creditors throughout the bankruptcy proceeding. *Id.* at 870.

In *Ledee,* the First Circuit upheld the conviction of an attorney representing the debtor, her brother, for conspiring with him to conceal and fraudulently transfer his assets in misleading bankruptcy court regarding the debtor's assets and generally violation of the bankruptcy laws. The indictment against the lawyer fell under 18 U.S.C. §§ 371, 152(1) and (7). The attorney acted as counsel in the transactions pre-bankruptcy to conceal assets, signed petitions and schedules failing to disclose those assets and did not correct misstatements she knew to be false at the creditors' meeting. Debtor, postpetition, further sought to conceal assets by fraudulently transferring the property that had not been disclosed and concealing the proceeds via a series of cashier's checks to persons that had not financial interest in the transaction. Both counsel and debtor served prison time. *U.S. v. Ledee*, 772 F.3d 21 (1st Cir. 2014).

Representative Case Law – Title 18, Section 152(3) – False Oaths

To prove a violation of Title 18, Section 152(3), often the charge levied against counsel to debtors, the government must establish beyond a reasonable doubt "(1) the existence of the bankruptcy proceedings; (2) that statement under penalty of perjury was made therein, or in relation thereto; (3) that the statement was made as to a material fact; (4) that the statement was false; and (5) that the statement was knowingly and fraudulently made." *U.S. v. Sullivan,* 522 F.3d 967 (9th Cir. 2008) (quoting *U.S. v. Lindholm,* 24 F.3d 1078, 1082-83 (9th Cir. 1994)). The Court in *Sullivan* upheld convictions of an attorney to the company debtor and/or its principals for making false declarations to the bankruptcy court related to the source of the funds he used to pay the bankruptcy counsel's retainer. Similarly, his conviction for withholding information under Title 18, Section 152(9) from the trustee was upheld as the attorney defendant and his co-defendants erased financial records and provided incomplete information to delay discovery of certain transfers and the source of funds. *U.S. v. Sullivan*, 522 F.3d at 989-90. Similarly, in *U.S. v. Kubick,* the debtor and their attorney were convicted of bankruptcy fraud for assisting the debtor in the scheme to conceal proceeds from real estate transactions, in part, by running such funds through the attorney trust account and aiding the failure to disclose various business interests that the attorney had assisted in preparing. USTP Press Release (March 6, 1998) (prisons sentences issued).

Chapter 7 debtor counsel, Leslie Webster, found himself convicted of aiding and abetting the fraudulent concealment by his debtor clients of an interest in a bar. Counsel had assisted the debtors in preparing their petition and schedules excluding the interest in the company that owned the bar and coached them in avoiding discussion of the bar at the meeting of creditors. The Court found there was sufficient evidence that Counsel intended to conceal the interest in the bar based on his prior involvement in documenting the purchase of the interest in the bar, including incorporation of the entity holding the interest, the testimony of one of the debtors against him and the subsequent efforts to collect the insurance on the bar when it burned to the ground less than a year after the debtors' discharge. The insurance adjuster noted that debtors did not claim an interest in the bar in their bankruptcy filings and debtors testified in deposition to the insurance company that they lied with the assistance of counsel and did own the bar. Taken together the conviction was upheld and the attorney served fifteen (15) months in jail. Because of inconsistent and false testimony by the attorney, he also received an enhancement at the district court level for obstruction of justice. *U.S. v. Webster*, 125 F.3d 1024.

Professional Declarations under Bankruptcy Rule 2014

The interplay between Title 18, Section 152(3) and the commandment against making a false oath or account in a case or in relation to a bankruptcy case can impact estate professionals in the context of required disclosures establishing "disinterestedness" under Section 327 and Bankruptcy Rule 2014. One of the earliest commercial bankruptcy related criminal convictions arose out of the 1994 Chapter 11 bankruptcy proceedings of Bucyrus-Erie Company. The government indicted Attorney Gellene, then a partner at a prominent law firm, under Title 18, Section 152(3) for knowingly and fraudulently making false oaths in a bankruptcy proceeding related to his failure in his Bankruptcy Rule 2014 declarations supporting his application for retention to disclose certain client and other relationships as required and under and 18 U.S.C. § 1623 on one count of perjury for using the second 2014 declaration in a hearing, under oath in support of payment of his fee applications. Gellene had tried to argue that he could not be convicted because he did not have the intent to defraud, i.e., specific intent to alter or impact the distribution of a debtor's assets, and not merely to deceive. The Seventh Circuit upheld the convictions stating, that 18 U.S.C. § 152 is designed to protect the integrity and administration of the bankruptcy case and "prevent and redress abuses of the bankruptcy system." The Court further noted that the requirement that debtor's counsel establish counsel is a "disinterested person" "goes to the heart of the integrity of the administration of the bankruptcy estate. The Court also found direct evidence of Attorney Gellene's intent to fraudulently omit information in the Rule 2014 applications. In sum, it is a seminal case for the importance of thorough and complete disclosures in Chapter 11 bankruptcy proceedings.

In a seemingly similar context, where commercial bankruptcy counsel failed to make adequate disclosures under Bankruptcy Rule 2014, the Bankruptcy Court imposed significant monetary sanctions but did not disqualify the firm and there were no criminal charges. *In re Leslie Fay Companies,* 175 B.R. 525 (Bankr. S.D.N.Y. 1994). Notably, an examiner was appointed during the bankruptcy proceedings and Debtor's counsel cooperated with the examiner and did not, unlike Gellene, continue to omit material information.

Almost twenty years after *Gellene* and *Leslie Fay*, the Bankruptcy Court again faced a troubling lack of disclosure by debtor's professionals and particularly their financial advisory and investment banking firm, which generally refused to acknowledge its disclosure failures. *In re GSC Group, Inc.,* 502 B.R. 673 (S.D.N.Y. 2013). Once again, the professionals usurped the role of the Court and the U.S. Trustee regarding what may and may not be a required disclosure. Nevertheless, and despite significant reductions in fees and other sanctions for both debtor's counsel and other estate professionals, there were no criminal charges for omissions as in the *Gellene* case.

Title 18, Section 152(4) – Filing of false claims

In *U.S. v. Connery,* counsel assisted Daniel Overmeyer in filing a false proof of claim in the D.H. Overmeyer Telecasting Company Inc. Chapter 11 proceeding. Additionally, there was a finding that counsel in fact assisted in changing corporate records of the entity for which Overmeyer filed the claim to support the claim. The jury had convicted, the District Court had overturned the verdict, and the Sixth Circuit reinstated the verdict. 867 F.2d 929 (6th Cir. 1989)

2. Section 153

Section 153 of title 18 addresses acts of embezzlement against the bankruptcy estate. It is directed at parties, including attorneys, who have access to the property or documents of the bankruptcy estate, and it prohibits such parties from knowingly and fraudulently (i) appropriating, embezzling, spending, etc., the estate's property, or (ii) secreting or destroying the estate's documents. *See, e.g.,* U.S. v. Hutton, 8:16-cr-514-T-27TGW, U.S. District Court for the Middle District of Florida (attorney disbarred and indictment charged 18 U.S.C. §§ 153 and 157 and plead to 18 U.S.C. §157).

3. Section 154

Section 154 of title 18 is intended, in part, to prevent insider dealings between a trustee and the bankruptcy estate[5]. It provides that a trustee will be subject to fines and removal from office if the trustee knowingly purchases, directly or indirectly, property of the bankruptcy estate to which the trustee is appointed. Notably, section 154 also extends to any other "officer of the court" which, as one court has noted, includes counsel for the debtor. *In re Exennium,*

[5] Section 154(a) deals with the issue of asset sales involving trustees and other fiduciaries of the estate. Section 154(b) and (c) are seemingly unrelated to subsection (a); they expose the trustee to fines and possible removal if the trustee refuses to offer the U.S. Trustee or parties in interest a reasonable opportunity to inspect the books and records of the debtor.

Inc., 23 B.R. 782 (9th Cir. BAP.1982). Unlike the other bankruptcy crime statutes, section 154 does not include the threat of imprisonment.

4. Section 155

Section 155 of title 18 focuses on undisclosed fee arrangements that would impact the bankruptcy estate and escape Bankruptcy Court review. It prohibits any party in interest in a case, including an attorney, from knowingly and fraudulently entering into a fee agreement with any other party in interest where the compensation would be paid from the assets of the bankruptcy estate. Unlike the bankruptcy crimes dealt with in sections 152 and 153, violations of section 155 are treated as misdemeanor offenses rather than felonies.

5. Section 156

Section 156 of title 18 is also a misdemeanor statute. It deals solely with bankruptcy petition preparers. It imposes criminal liability on bankruptcy petition preparers who files a bankruptcy case that is subsequently dismissed because the preparer knowingly tried to disregard the requirements of the Bankruptcy Code or Bankruptcy Rules.

6. Section 157

Section 157 of title 18 is entitled “Bankruptcy fraud”, which would suggest it may be duplicative of many of the previously described statutes which address actions taken with fraudulent intent. However, section 157 differs from these other statutes in a significant way. The other statutes address fraudulent conduct that occurs in the course of a bankruptcy case or in contemplation of the case, and thus undermines the integrity of the bankruptcy process. By contrast, section 157 deals with schemes that are themselves fraudulent and that in some way utilize the bankruptcy process either to perpetrate the fraud or to conceal it. It criminalizes fraudulent schemes in which the bankruptcy case is an instrumentality of the fraud. There must be a scheme to defraud and the scheme must attempt to execute or conceal the fraudulent scheme by (i) filing a bankruptcy petition, (ii) filing a document in the bankruptcy case, or (iii) making a false or fraudulent representation, claim, or promise relating to the case. This provision is applicable to a transfer or concealment of “any of [a debtor’s] property or the property of [any] other person or corporation” with the intent to defeat the provisions of the Bankruptcy Code, i.e., the statute reaches beyond the bankruptcy estate itself. *U.S. v. Ledee*, 772 F.3d 21 (1st Cir. 2014)

An example of the type of fraud that section 157 is designed to address was present in *U.S. v. White*, 737 F.3d 1121 (7th Cir. 2014). In furtherance of a classic mortgage fraud scheme, one of the criminal defendants obtained financing for straw purchasers to buy properties from homeowners who were facing foreclosure, the true goal being not to assist the homeowners, but rather to strip the equity from their properties. A second defendant pretended to serve as the real estate closing agent. The third defendant was an attorney who purported to represent the homeowners during the closings, but then perpetrated a cover-up of the fraudulent scheme by representing the homeowners in their subsequent bankruptcy filings. For the bankruptcy-related actions, the attorney was convicted of bankruptcy fraud under section 157.

Similarly, and in perhaps the most recent use of this statute, a Florida attorney plead guilty to 18 U.S.C. § 157(7) and 2 for concealing assets of a client/debtor, specifically proceeds of a settlement check from the bankruptcy trustee. He deposited the funds in his attorney trust account, failed to disclose the funds in the bankruptcy petition and then embezzled the funds for personal use. He received six months in prison, six months house arrest, probation for three years after release and a restitution order of $93,255.27. *U.S. v. Hutton*, 8:16-cr-514-T-27TGW, (M.D.Fl. 2016). The approach, while not very creative, similarly undermined the integrity of the bankruptcy process while also implicated the embezzlement statute.

B. <u>Generally applicable criminal statutes</u>

The bankruptcy crimes provisions of 18 U.S.C. §§ 152 through 157 present bankruptcy practitioners with more than enough ways to land themselves in jail for actions taken on behalf of their clients. Unfortunately, the risk of criminal exposure in bankruptcy practice is not limited to these bankruptcy-specific statutes. There are plenty of other ways that bankruptcy attorneys can end up facing criminal prosecution, whether through their own actions or by acting in concert with the clients. The general criminal statutes that a bankruptcy practitioner must be mindful of include the following:

1. <u>18 U.S.C. § 2 – Principals</u>

An attorney may be found guilty as a principal if (a) he "aids, abets, counsels, commands, induces or procures" the commission of offense; or (b) he willfully cause an act to be done which would be criminal if he did the act himself. *See, e.g., U.S. v. Knoll,* 16 F.3d 1313, 1322-1323 (upholding conviction for aiding and abetting a false financial statement submitted by Knoll's client to the Department of Justice because the jury could reasonably find he was a principal that caused the offense described).

2. <u>18 U.S.C. § 3 – Accessory after the fact</u>

If an attorney knows that an offense has been committed and he receives, relieves, comforts or assists the wrongdoer (presumably his client) in order to hinder or prevent apprehension, trial or punishment, the attorney may be found guilty as an assessor after the fact.

3. <u>18 U.S.C. § 4 – Misprision of felony</u>

If you see something, say something. If an attorney has knowledge of the commission of a felony and either conceals it or does not report the crime, he may be guilty of misprision.

4. <u>18 U.S.C. § 371 –Conspiracy to commit offense or to defraud United States</u>

An attorney may be found guilty of criminal conspiracy under section 371 of title 18 if the following three elements exist:

i. Two or more people conspire;
ii. The goal of the conspiracy is to commit an offense against, or to defraud, the United States or a U.S. agency; and
iii. One of the parties to the conspiracy does an act in furtherance of the conspiracy.

See, e.g., U.S. v. Sullivan, 522 F.3d at 978-79. A conspiracy can be established if the defendant doesn't have knowledge of all the details of the conspiracy or all members and even if the connection is slight as long as it is established beyond a reasonable doubt. *U.S. v. Brown*, 943 F.2d 1246, 1250 (10th Cir. 1991). It cannot be established by mere knowledge or association. *Id.* at 1251. In *Brown*, the Court overturned convictions of an attorney (the associate working with the senior partner that was convicted on additional counts) for conspiracy, bankruptcy fraud and mail fraud delivered by a jury, but the Tenth Circuit reversed the District Court and remanded for new trial. The Tenth Circuit found sufficient circumstantial evidence that the attorney knowingly and actively participated in the conspiracy to defraud the United States.

5. 18 U.S.C. § 1001 – Statements or entries generally

An attorney may be found criminally liable if, in an executive, legislative, or judicial proceeding, he knowingly and willfully

i. falsifies or conceals by trick or scheme a material fact;
ii. makes a materially false, fictitious or fraudulent statement or representation; or
iii. makes or uses a false writing knowing it to be materially false.

The statute expressly carves out statements, representations and documents submitted to a judge by a party to the proceeding or his counsel. This would cover most situations involving bankruptcy counsel. However, it does not protect attorneys who make false statements on behalf of non-parties, such as witnesses or § 363 bidders, or on their own behalf.

6. 18 U.S.C. § 1341 – Frauds and swindles

An attorney may be found guilty of any scheme to defraud, to obtain money or property by false pretenses, or to deal in counterfeit objects, if the scheme in question utilizes interstate commerce, such as the U.S. mail.

7. 18 U.S.C. § 1503 – Obstruction of justice

Pursuant to section 1503 of title 18, an attorney may be found guilty of attempting to influence, intimidate, or impede a U.S. court or the due administration of justice by corrupt means or by threats or force.

8. 18 U.S.C. § 1621 – Perjury generally

If an attorney, while under oath, willfully testifies as to any material matter in a manner that he does not believe to be true, he may be found guilty of perjury.

9. 18 U.S.C. § 1622 – Subornation of perjury

Hand in hand with section 1621 of title 18 relating to perjury, section 1622 makes it a federal offense if an attorney procures another person to commit perjury.

10. 18 U.S.C. § 1623 – False declarations before grand jury or court

Overlapping with some of the other criminal statutes, section 1623 makes it a criminal offense for an attorney, while under oath before a U.S. court, to knowingly make a false material declaration or use knowingly false evidence.

11. 18 U.S.C. § 1956 – Laundering of monetary instruments

Under section 1956, an attorney may be found guilty of knowingly participating in a financial transaction involving the proceeds of unlawful activity with the intent to conceal the source of the proceeds.

As the above makes clear, while enforcement actions against bankruptcy attorneys may relatively uncommon, there exists a formidable arsenal of statutes that can be utilized by the Justice Department when the facts warrant criminal prosecution for bankruptcy-related wrongdoing.

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Criminal Contempt Authority of Bankruptcy Judges

Sara C. Temes

I. History of Contempt Authority of Bankruptcy Courts

Prior to the enactment of the Bankruptcy Reform Act of 1978[1], the United States Supreme Court adopted Rules of Bankruptcy Procedure that permitted bankruptcy courts a limited power of contempt.[2] Rule 920 provided that a bankruptcy referee could punish both civil and criminal contempt, including acts prohibited by section 41(a) of the Bankruptcy Act of 1898 (repealed 1978), without certification to the district judge, so long as the offenses were committed in the referee's presence, and the fine did not exceed $250. Bankruptcy referees were required to certify any more substantial fine or imprisonment to the district court for final order.[3]

a. Impact of *Northern Pipeline v. Marathon* on Contempt Powers

Before 1983, "the United States Bankruptcy Courts, as constituted under the Bankruptcy Reform Act of 1978, were courts of law, equity, and admiralty with an inherent contempt power."[4] However, in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co*., 458 U.S. 50 (1982), the Supreme Court found the jurisdictional scheme established by the Bankruptcy Reform Act of 1978 to be unconstitutional.

Following *Marathon*, there was confusion as to whether contempt powers (civil or criminal) could only be exercised by an Article III court. Congress quickly enacted 28 U.S.C. § 1481 as a transitional statute which explicitly prohibited bankruptcy courts from exercising criminal contempt powers where contempt was not committed in the presence of a bankruptcy judge.[5] This emergency measure was removed as part of the 1984 Amendments to the Bankruptcy Code.[6] Congress responded to *Marathon* by enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984, which (i) confirmed that bankruptcy courts could be maintained as Article I entities and (ii) established a distinction between bankruptcy courts' authority in core and noncore proceedings.

b. Bankruptcy Rule 9020

The version of 9020 of the Federal Rules of Bankruptcy Procedure (as amended, the "Bankruptcy Rules") in effect between 1987 and 2001 provided explicit parameters for the contempt authority of bankruptcy judges:

Rule 9020. Contempt Proceedings[7]

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[1] 11 U.S.C. § 101, *et seq.* (as amended, the "Bankruptcy Code").
[2] Bankr.R., 411 U.S. 989, 93 S. Ct. 3081, 37 L. Ed. 2d XXXI (1973).
[3] "The New Bankruptcy Rules" Louis W. Levit. *Marquette Law Review*, Vol. 57:1 (1973).
[4] Federal Rule of Bankruptcy Procedure 9020, Notes of Advisory Committee on Rules—1987 Amendment.
[5] Federal Rule of Bankruptcy Procedure 9020, Notes of Advisory Committee on Rules – 1983 Amendment.
[6] Section 112 of the Bankruptcy Reform Act of 1984 (Pub. L. No. 98-353).
[7] Fed. R. Bankr. P. 9020 (as amended Mar. 30, 1987, eff. Aug. 1, 1987; Apr. 30, 1991, eff. Aug. 1, 1991.)

> *(a) Contempt Committed in Presence of Bankruptcy Judge*
> Contempt committed in the presence of a bankruptcy judge may be determined summarily by a bankruptcy judge. The order of contempt shall recite the facts and shall be signed by the bankruptcy judge and entered of record.
> *(b) Other Contempt*
> Contempt committed in a case or proceeding pending before a bankruptcy judge, except when determined as provided in subdivision (a) of this rule, may be determined by the bankruptcy judge only after a hearing on notice. The notice shall be in writing, shall state the essential facts constituting the contempt charged and describe the contempt as criminal or civil and shall state the time and place of hearing, allowing a reasonable time for the preparation of the defense. The notice may be given on the court's own initiative or on application of the United States attorney or by an attorney appointed by the court for that purpose. If the contempt charged involves disrespect to or criticism of a bankruptcy judge, that judge is disqualified from presiding at the hearing except with the consent of the person charged.
> *(c) Service and Effective Date of Order; Review*
> The clerk shall serve forthwith a copy of the order of contempt on the entity named therein. The order shall be effective 10 days after service of the order and shall have the same force and effect as an order of contempt entered by the district court unless, within the 10 day period, the entity named therein serves and files objections prepared in the manner provided in Rule 9033(b). If timely objections are filed, the order shall be reviewed as provided in Rule 9033.
> *(d) Right to Jury Trial*
> Nothing in this rule shall be construed to impair the right to jury trial whenever it otherwise exists.

Bankruptcy Rule 9020 was amended in full in 2001, removing all explicit contempt provisions. Its current form provides only that "Rule 9014 governs a motion for an order of contempt made by the United States trustee or a party in interest." Fed. R. Bankr. P. 9020 (as amended Apr. 23, 2001, eff. Dec. 1, 2001.)

c. Criminal Contempt Authority of Federal Courts

There is explicit statutory authority that district and circuit courts may issue criminal contempt awards:

> A court of the United States shall have the power to punish by fine or imprisonment, or both, at its discretion, such contempt of its authority, and none other, as –
> (1) Misbehavior of any person in its presence or so near thereto as to obstruct the administrative of justice; (2) Misbehavior of any of its officers in their official transactions; (3) Disobedience or resistance to its lawful writ, process, order, rule, decree, or demand.

18 U.S.C. § 401. As discussed in greater detail herein, in many instances bankruptcy courts are not treated as "courts of the United States" for purposes of 18 U.S.C. § 401.

Rule 42(a) of the Federal Rules of Criminal Procedure implements 18 U.S.C. § 401 and provides restrictions and procedural protections (such as a right to a jury trial) with regard to contempt occurring within a proceeding, as opposed to in the presence of a court. Rule 42(b) provides for summary disposition in the case of contempt committed in the presence of the judge and provides specific limits on sanctions that can be imposed by a magistrate judge:

> (b) *Summary Disposition.* Notwithstanding any other provision of these rules, the court (other than a magistrate judge) may summarily punish a person who commits criminal contempt in its presence if the judge saw or heard the contemptuous conduct and so certifies; a magistrate judge may summarily punish a person as provided in 28 U.S.C. § 636(e). The contempt order must recite the facts, be signed by the judge and be filed with the clerk.

Fed. R. Crim Pro. 42(b) (as amended Mar. 9, 1987, eff. Aug. 1, 1987; Apr. 29, 2002, eff. Dec. 1, 2002.)

d. *Marathon* and *Stern* Debates Regarding Limitations of Bankruptcy Court Power Generally

The question of whether bankruptcy courts are empowered to impose criminal sanctions has been considered alongside the greater debate of the powers of bankruptcy courts in general beginning with *Northern Pipeline v. Marathon* in 1982 and more recently, *Stern v. Marshall*, 564 U.S. 462 (2011); *Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165 (2014); and *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015).

Despite the confusion created in the wake of *Stern* initially, the *Executive Benefits* and *Wellness* decisions in 2014 and 2015 confirmed that bankruptcy judges have the power to enter final judgment for core bankruptcy matters. *Exec. Benefits*, 134 S.Ct. at 2172; *Wellness*, 135 S.Ct. 1944-45. Several Circuit Courts have cited Article III concerns in holding that a bankruptcy court is not entitled to impose criminal sanctions.[8] It remains to be seen whether the clarifications provided in the later Supreme Court decisions discussing *Stern* will have an impact on whether criminal sanctions can be appropriately delivered by bankruptcy courts.

II. Origin of Bankruptcy Court Power to Issue Sanctions

a. 11 U.S.C. § 105(a) and Inherent Power

Courts have held that there are two possible origins of bankruptcy court authority to issue sanctions. The first of these is derived from 11 U.S.C. § 105(a), which provides that bankruptcy courts have authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." However, section 105(a) does not provide limitless

[8] *See, e.g., In re John Richards Homes Building Co.*, LLC, 552 F.App'x 401, 415 (6th Cir. 2013); *In re Hanshaw*, 244 F.3d 1128 (9th Cir. 2001); *In re Hipp*, 895 F.2d 1503 (5th Cir. 1990).

power and specifically "does not allow the bankruptcy court to override explicit mandates of the Bankruptcy Code." *Law v. Siegel*, 134 S.Ct. 1188, 1194 (2014), citing 2 Collier on Bankruptcy ¶ 105.01[2].

The Supreme Court in *Chambers v. NASCO, Inc*., 501 U.S. 32, 44 (1991) also considered that contempt is an inherent power of all courts, but did not define the scope of that power (especially with regard to criminal contempt). The Supreme Court has in recent years confirmed that Bankruptcy Courts do have some inherent powers with regard to issuing contempt orders. Bankruptcy Courts "may also possess 'inherent power … to sanction 'abusive litigation practices." *Law v. Siegel*, 134 S.Ct. at 1194, citing *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 375-76 (2007).

In *Marrama*, the Court confirmed the existence of inherent power of bankruptcy courts even without an explicit statutory basis and held that bankruptcy courts may "use statutory and equitable authority to craft various remedies for a range of bad faith conduct; requiring accounting or reporting of assets; enjoining debtors from alienating estate property; penalizing counsel; assessing costs and fees; or holding the debtor in contempt." But the Court went on to emphasize that "whatever steps a bankruptcy court may take pursuant to § 105(a) or its general equitable powers, a bankruptcy court cannot contravene the provisions of the Code." *Id.* at 383.

Although *Law v. Siegel* denied the applicability of punitive sanctions as contrary to specific statutory provisions of title 11 in that case, the details of which are described in greater detail below, it provided in dicta "[o]ur decision today does not denude bankruptcy courts of the essential 'authority to respond to debtor misconduct with meaningful sanctions.'" *Id*. at 1198 (internal citations omitted). The Court went on to refer to bankruptcy courts' power to sanction abusive tactics under Federal Rule of Bankruptcy Procedure 9011 and left open the possibility that "[t]he court may also possess further sanctioning authority under either § 105(a) or its inherent powers." *Id*.

b. Distinction between Criminal Contempt and Civil Contempt

Criminal contempt may be distinguished from civil contempt by considering the goal sought to be accomplished by the imposition of sanctions. The Fifth Circuit explained the difference as follows:

> A contempt order or judgment is characterized as either civil or criminal depending upon its primary purpose. If the purpose of the sanction is to punish the contemnor and vindicate the authority of the court, the order is viewed as criminal. If the purpose of the sanction is to coerce the contemnor into compliance with a court order, or to compensate another party for the contemnor's violation, the order is considered purely civil.

Ingalls v. Thompson (In re Bradley), 588 F.3d 254, 263 (5th Cir. 2009).

The Supreme Court in *Gompers v. Buck's Stove & Range Co.*, 221 U.S. 418, 441 (1911) recognized that civil and criminal contempt "are essentially different, and are governed by different rules of procedure." Specifically, the Court recognized that "[i]n criminal proceedings for contempt, the party against whom the proceedings are instituted is entitled to the protection of the constitutional provisions against self-incrimination." *Id.*

III. Representative Decisions

a. Circuit Court Decisions prior to *Law v. Siegel*

***In re John Richards Homes Bldg.*, 552 F. Appx. 401 (6th Cir. 2013)**

The Sixth Circuit in *In re John Richards Homes Bldg.*, 552 F. Appx. 401 (6th Cir. 2013) reversed the bankruptcy court's imposition of $2.8 million in punitive damages, but upheld the award of costs and attorneys' fees under Bankruptcy Code section 303(i) for services rendered in collateral proceedings after dismissal of the underlying involuntary petition. The Court determined that without explicit statutory authority, bankruptcy courts "do not have a general statutory power to impose serious noncompensatory punitive damages" (*Id.* at 415), relying, in part, on due process concerns and risk of abuse:

> Serious noncompensatory punitive damages require greater procedural protections than mild noncompensatory punitive damages because, by their nature, they carry greater risk of abuse … 'the imposition of a sufficiently substantial punitive sanction requires that the person sanctioned receive the procedural protections appropriate to a criminal case.

Id. at 415-16. The Court went on to say that risk of abuse concerns are "magnified for bankruptcy courts, which have limited jurisdiction, are less capable of providing the necessary procedural protections than district courts, and are not Article III courts." *Id.*

***Knupfer v. Lindblade (In re Dyer)*, 322 F.3d 1178 (9th Cir. 2003)**

In its 2003 decision, *In re Dyer*, 322 F.3d 1178, 1193 (9th Cir. 2003), the Ninth Circuit allowed a bankruptcy court to impose only "relatively mild" fines, voicing due process concerns as a basis for concerns about constitutionality of criminal sanctions. In *Dyer*, the court referred back to its 2001 decision in *F.J.. Hanshaw Enters., Inc. v. Emerald River Dev., Inc.,* 244 F.3d 1128 (9th Cir. 2001) which highlighted "fundamental constitutional questions" involved in allowing bankruptcy courts to impose criminal sanctions under Article III and called bankruptcy courts "ill-equipped" to protect due process rights such as the right to a jury trial. Despite raising due process and Article III issues, the Hanshaw court declined to set "the precise limit for a serious sanction entitling an individual to a jury trial." *Id.* at 1140 n. 10.

In *Dyer*, the Court considered both § 105(a) and the bankruptcy court's inherent power as possible sources for the authority to impose punitive sanctions and came to the conclusion that neither theory supported the award of serious, non-compensatory damages. *Id.* at 1197. The Court declined to define what would constitute "'relatively mild' non-compensatory fines," stating "[a]s we did in Hanshaw, we leave for another day the development of a precise definition of the term 'serious' punitive (criminal) sanctions." Id. at 1192-93.

***Cox v. Zale Delaware, Inc.*, 239 F.3d 910, 917 (7th Cir. 2001)**

In *Cox v. Zale Delaware, Inc.*, 239 F.3d 910, 917 (7th Cir. 2001), the Seventh Circuit declined to impose criminal contempt sanctions for a violation of section 524 of the Bankruptcy Code. In so doing, the court addressed the lack of an explicit provision for sanctions in section 524 (as opposed to section 362). The court, although recognizing that the law is unsettled as to whether bankruptcy courts may award criminal contempt sanctions, declined to enter into the analysis.

The Seventh Circuit noted that if a statutory injunction is violated, the appropriate district court could hold a party in contempt, if the requirements for such sanctions are met: "[i]t is peripheral to the issue of the adequacy of criminal contempt as a remedy for violations of that section, since the district court, the court with primary jurisdiction in bankruptcy as we noted, can hold a party in criminal contempt for violating a statutory injunction." *Id. citing United States v. Guariglia*, 962 F.2d 160, 162-63 (2d Cir. 1992).

***Fellheimer, Eichen & Braverman v. Charter Technologies*, 57 F.3d 1215 (3d Cir. 1995)**

The Third Circuit in *Fellheimer, Eichen & Braverman v. Charter Technologies*, 57 F.3d 1215 (3d Cir. 1995) affirmed the imposition of sanctions by a bankruptcy court in the form of the complete denial of attorneys' fees as sanctions allowable under the bankruptcy court's inherent powers. Notably, the bankruptcy court imposed sanctions under Rule 11 (as applicable in bankruptcy cases through Bankruptcy Rule 9011). The district court recognized that Rule 11 was inapplicable (as case law supported only Rule 11 sanctions against the attorney who signed the relevant documents) but added its own justification for the bankruptcy court's actions through the bankruptcy court's inherent powers, and this justification was adopted by the Third Circuit.

After addressing the fact that Rule 11 sanctions could not be applied here, and adopting the district court's alternative grounds through inherent powers, the Third Circuit distinguished between the standard for granting Rule 11 sanctions and inherent power sanctions as follows: "Rule 11 sanctions and inherent power sanctions do, of course, differ markedly in at least one aspect pertinent to this case: Invocation of a federal court's inherent power to sanction requires a finding of bad faith. The imposition of Rule 11 sanctions, on the other hand, requires only a showing of objectively unreasonable conduct." *Id.* at 1225.

***In re Ragar*, 3 F.3d 1174 (8th Cir. 1993)**

The Eighth Circuit in *In re Ragar*, 3 F.3d 1174, 1180 (8th Cir. 1993) affirmed the bankruptcy court's right to impose criminal sanctions of $950 on an attorney who continued to represent and filed pleadings on behalf of a client in violation of a court order. The *Ragar* court used a broad reading of section 105(a), and held that decisions found to be "necessary or appropriate in the execution of the court's duties under Title 11" are core matters within the bankruptcy court's powers.

The Eighth Circuit held that the bankruptcy court "took action to enforce or implement its order of disqualification" and that its order holding the attorney in contempt "was, in the Court's judgment, necessary or appropriate to carry out the provisions of Title 11." In its decision, the court also recognized that its decision was at odds with the Fifth Circuit's statement in *In re Hipp* that "[c]riminal contempt is not 'necessary or appropriate to enforce or implement' the court's rules or orders, but is instead intended to vindicate the authority of the court" and confirmed its disagreement with the Fifth Circuit's analysis:

> With all respect, we think this is simply wrong. If a bankruptcy court can decide the qualification of attorneys to represent parties before it, which no one denies, and if such decisions are necessary or appropriate in the execution of the court's duties under Title 11, which again no one denies, it is likewise necessary or appropriate for the court to enforce its own orders.

In re Ragar, 3 F.3d at 1180, *citing In re Hipp*, 895 F.2d 1503, 1515.

***In re Hipp*, 895 F.2d 1503 (5th Cir. 1990)**

The Fifth Circuit in *In re Hipp* reversed a bankruptcy court's imposition of criminal contempt, at a time when the 1987 version of Bankruptcy Rule 9020 was in effect, holding that neither section 105(a), 28 U.S.C. § 157 nor Bankruptcy Rule 9020 gives bankruptcy courts power to preside over 18 U.S.C. § 401(3) criminal contempt trials.

The court specifically addressed the presence of Bankruptcy Rule 9020 that, at the time, set forth a procedure for criminal contempt at the bankruptcy court level: "…the bankruptcy rules are intended to be procedural, rather than substantive, in character … [a]nd inferior federal court jurisdiction is generally a matter with the Constitution, subject to the constraints of Article III, commits to Congress … These considerations strongly militate against finding that Rule 9020 purports to grant bankruptcy courts a jurisdiction which we have held that Congress did not expressly or impliedly authorize for them." *Id.* at 1519.

b. 2014 Supreme Court Decision in *Law v. Siegel*

***Law v. Siegel*, 134 S. Ct. 1188 (2014)**

In an appeal from the Ninth Circuit Court of Appeals, the Supreme Court considered an award of a surcharge against a debtor's homestead exemption as an award of trustee's attorneys' fees for opposing a fraudulently disclosed lien against a debtor's homestead. The Ninth Circuit upheld the surcharge imposed by the bankruptcy court under its "inherent authority" but the Supreme Court unanimously held that the bankruptcy court exceeded the limits of its authority in surcharging the homestead exemption to pay the trustee's attorney fees.

In so ruling, the Supreme Court reiterated that the broad authority of the bankruptcy court to carry out the provisions of title 11 and its inherent power to sanction abusive litigation practices did not extend to surcharging the exemption, since the surcharge contravened the specific prohibition under 11 U.S.C. § 522(k) and the homestead exemption was not available for payment of the attorney fees as an administrative expense. Further, since the trustee did not timely object to the exemption, it became final before the surcharge was imposed and could not be challenged or negated by the trustee through the surcharge. The court specifically recognized the authority of bankruptcy courts to impose sanctions (although did not address whether sanctions that rise to the level of criminal contempt could be imposed by bankruptcy courts) but reiterated that "whatever other sanctions a bankruptcy court may impose on a dishonest debtor, it may not contravene express provisions of the Bankruptcy Code by ordering that the debtor's exempt property be used to pay debts and expenses for which that property is not liable under the Code." *Id.* at 1198.

c. Recent Decisions

Geltzer v. Brizinova (In re Brizinova), 565 B.R. 488 (Bankr. E.D.N.Y. 2017)

In *Brizinova*, the chapter 7 trustee sought contempt and sanctions against debtor's counsel pursuant to §105(a), the court's inherent authority, and Bankruptcy Rules 9014 and 9020 on grounds that the attorney violated a stipulated order in another case, a mediation order in another case, and the New York Rules of Professional Conduct. The Bankruptcy Court for the Eastern District of New York held that, to the extent that the chapter 7 trustee sought an order of contempt for a violation of a stipulated order and mediation order by debtor's counsel, the motion was denied without prejudice to a request for such relief in the case in which those orders were entered.

The bankruptcy court also held that the trustee failed to show that sanctions were warranted under 11 U.S.C. § 105 and the court's inherent authority, as he did not show that counsel acted in bad faith, or that his conduct was entirely meritless and undertaken for improper purposes. In denying the request to impose sanctions, the court held that "[s]ection 105(a) is an important tool for courts and parties in the bankruptcy process, but it does not, standing alone, provide a basis for courts to issue sanctions or other relief. Rather, it permits the bankruptcy court to issue those orders that may be required in the context of a bankruptcy case as necessary to 'carry[] out the provisions of the Bankruptcy Code'" Id. at 497.

The Brizinova decision reconfirms the Second Circuit standard that sanctions under the court's inherent authority "must be supported by a finding of bad faith similar to that necessary to invoke the court's inherent power". *Id.* Further, the court articulated that in order to sanction under the bankruptcy court's inherent authority, a court must find clear evidence that (1) the offending party's claims were entirely meritless and (2) the party acted for improper purposes." *Id.* at 504-05.

***Ettinger & Assocs. LLC v. Miller (In re Miller)*, 529 B.R. 73 (Bankr. E.D. Pa. 2015)**

The Bankruptcy Court for the Eastern District of Pennsylvania awarded sanctions of $75,000 against the plaintiff in a non-meritorious non-dischargability action brought against the debtor, citing as justification "(1) my inherent powers, (2) Rule 9011(c)(1)(B), (3) 11 U.S.C. § 105(a), and (4) 28 U.S.C. §1927." *Id.* at 96.

The bankruptcy court in the *Miller* case concluded that the award of sanctions against both the attorney (in the amount of $20,000) and the plaintiffs (in the amount of $75,000) was appropriate due to a finding of sufficient evidence of abuse of the judicial system, and explicit findings of willful misconduct and bad faith. Importantly, the award amount was determined as fair and appropriate due to the fact that it was less than three quarters of the current fee statement presented by the debtor (and possibly two thirds of the final fee statement), which may place the sanctions in the category of compensatory civil contempt, not criminal contempt. However, the court's explanation of the purpose of the sanctions includes elements of criminal contempt language: "[s]anctions should not be imposed solely to make the injured party whole. Rather, sanctions should be awarded (1) to insure specific and general deterrence, and (2) to preserve the integrity of the Bankruptcy Code and the judicial process." *Id.* at 94-95.

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An Overview On Sanctions in Bankruptcy Court

By: Brett D. Fallon and Brenna A. Dolphin

Courts may issue sanctions pursuant to statute, rule of procedure, or inherent power. We begin with a short review of the American Rule, the prism through which any discussion of sanctions must be viewed. Then, we review the elements of 28 U.S.C. § 1927, a statute that authorizes the imposition of sanctions, whether bankruptcy courts may issue sanctions pursuant to its grant, the legal standards used to identify the conduct it targets, and the identity of whose conduct it governs. Next, a discussion of Rule 9011 of the Federal Rules of Bankruptcy Procedure, the conduct it targets, the procedural requirements, its limitations and a comparison between § 1927 and Rule 9011. We will quickly review the inherent power doctrine and § 105 of the Bankruptcy Code. Finally, we discuss whether courts may employ any of these methods to sanction pro se litigants.

American Rule – Historical Backdrop

The American rule embodies the principles that each party bears its own attorneys' fees and litigation expenses and that attorneys' fees ordinarily are not among the costs that a prevailing party may recover.[1] Narrow exceptions to the American Rule exist.[2] Courts may impose sanctions pursuant to statute, procedural rule, or the court's inherent power.[3] Under these narrow exceptions, a court may assess attorneys' fees as a sanction.[4] A sanction may properly have a punitive aspect, in addition to its compensatory effect.[5]

Counsel's Liability for Excessive Costs: 28 U.S.C. § 1927

"Any attorney or person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct."[6] The Supreme Court notes, that § 1927 does not distinguish between winners and losers, or between plaintiffs and defendants; it is indifferent to the equities of a dispute and to the values advanced by substantive law because it is concerned only with limiting the abuse of court processes.[7] The purpose of sanctions under § 1927 is to deter dilatory litigation practices, to punish aggressive tactics that far exceed zealous advocacy[8], and to deter intentional and unnecessary delay in proceedings.[9]

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[1] *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y,* 421 U.S. 240, 247, 258-59 (1975).
[2] *Id.* at 247.
[3] *Chambers v. NASCO, Inc.,* 501 U.S. 32, 46-48 (1991).
[4] *Id.* at 45.
[5] *Id.* at 53.
[6] 28 U.S.C. § 1927.
[7] *Roadway Exp., Inc. v. Piper*, 447 U.S. 752, 762 (1980).
[8] *In re Royal Manor Mgmt., Inc.*, 525 B.R. 338, 364-65 (6th B.A.P. Cir. 2015).
[9] *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90, 101 (3d Cir. 2008)(citing *Zuk v. E. Pa. Psychiatric Inst. of the Med. Coll. of Pa.*, 103 F.3d 294, 297 (3d Cir. 1996)).

9401915/

A sanctioned attorney is thus required to satisfy personally the excess costs attributable to the attorney's conduct.[10] Costs, expenses and attorneys' fees may be assessed personally against an attorney for engaging in frivolous litigation because § 1927 aims to discourage dilatory litigation practices and advocacy designed to burden the opponent without chilling aggressive litigation and good faith assertions of colorable claims.[11] Any award under § 1927 is limited to the "excess" – only to those costs, expenses or attorney fees incurred as a result of the unreasonable and vexatious multiplication of the proceedings.[12] Further, a court may award fees-on-fees; the sanctions awarded under § 1927 may include those costs, expenses, and attorney fees that the awarded party incurred in obtaining the award.[13]

Bankruptcy Courts: Who May Award § 1927 Sanctions?

Courts are divided as to whether bankruptcy courts have jurisdiction to award sanctions under 28 U.S.C. § 1927.[14] The analysis of the question typically turns on whether a bankruptcy court is a jurisdictionally separate "court of the United States" or whether, for jurisdictional purposes, there is only one court – the district court – of which the bankruptcy court is an arm.[15] Case law is split as to whether bankruptcy courts are "courts of the United States" and, therefore, whether bankruptcy courts may impose sanctions under § 1927.[16] The definition of the term "courts of the United States" refers to 28 U.S.C. § 451, which reads in pertinent part:

> The term "court of the United States" includes the Supreme Court of the United States, courts of appeals, district courts constituted by chapter 5 of Title 28, including the Court of International Trade and any court created by Act of Congress the judges of which are entitled to hold office during good behavior.[17]

The Ninth[18], Tenth[19] and Eleventh[20] Circuits hold that given the definition of court of the United States in § 451, a bankruptcy court does not have the authority to impose sanctions under § 1927 nor to grant relief under other sections of Title 28 because a bankruptcy court is simply

[10] *In re Ruben*, 825 F.2d 977, 983 (6th Cir. 1987).
[11] *Matter of Capitol-York Constr. Corp.*, 52 B.R. 317 (S.D.N.Y.1985)(citing *Piljan v. Michigan Dep't of Soc. Servs.*, 585 F.Supp. 1579, 1583 (E.D. Mich. 1984)); *Lipsig v. Nat'l Student Mktg. Corp.,* 663 F.2d 178, 180-81 (D.C. Cir. 1980).
[12] 28 U.S.C. § 1927. *In re Ruben*, 825 F.2d at 984.
[13] *Norelus v. Denny's, Inc.*, 628 F.3d 1270, 1298 (11th Cir. 2010).
[14] *MJS Las Croabas Props., Inc.,* 545 B.R. 401, 418 (1st Cir. B.A.P. Cir. 2016)(recognizing the division among the courts).
[15] *In re Schaefer Salt Recovery, Inc.,* 542 F.3d at 102.
[16] *In re Royal Manor Mgmt. Inc.*, 525 B.R. at 364-65 (recognizing that case law is split as to whether bankruptcy courts are "courts of the United States" and, therefore, whether bankruptcy courts may sanction counsel under § 1927).
[17] 28 U.S.C. § 451.
[18] *Perroton v. Gray (In re Perroton)*, 958 F.2d 889, 893-96 (9th Cir. 1992)(finding the bankruptcy court lacked authority to waive filing fees under 28 U.S.C. § 1915(a) because it was not a court of the United States); *Miller v. Cardinale (In re Deville)*, 280 B.R. 483, 494 (B.A.P. 9th Cir. 2002)(holding the bankruptcy court had no authority to award fees under 28 U.S.C. § 1927).
[19] *Jones v. Bank of Santa Fe (In re Courtesy Inns, Ltd., Inc.)*, 40 F.3d 1084, 1086 (10th Cir. 1994)(holding the bankruptcy court had no authority to impose sanctions under 28 U.S.C. § 1927).
[20] *Gower v. Farmers Home Admin (In re Davis)*, 899 F.2d 1136, 1138-40 (11th Cir. 1990)(holding that the bankruptcy court is not a court of the United States in the context of 28 U.S.C. § 2412).
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not a court of the United States.[21] They reason that the definition of "court of the United States" is limited to Article III courts because the judges of the court must "hold office during good behavior" – in other words, the judges must be appointed for life, assuming "good behavior."[22] Bankruptcy judges are appointed for terms of fourteen years [23] and receive salaries that are not immune from diminution by Congress[24], therefore, do not fit within the definition of "court of the United States" contained within § 451.[25]

The Second[26], Third[27], Sixth[28] and Seventh[29] Circuits find that bankruptcy courts have the authority to issue sanctions under § 1927.[30] The Second and Seventh Circuit holdings did not contain any discussion, but find, at least implicitly, that a bankruptcy court is a "court of the United States."[31] The Third Circuit reasons that bankruptcy courts are not separate from, but rather, are units of the district court and thus, by analogy, "courts of the United States," that derive their jurisdiction from 28 U.S.C. § 157(a), which grants a district court permission to refer bankruptcy matters to the bankruptcy courts.[32] Therefore, as a unit of the district court, the bankruptcy court comes within the scope of § 451 and pursuant to § 157 may hear Title 11 cases as well as any and all proceedings necessary to hear and decide those cases, and has the authority to impose sanctions under § 1927.[33] In an unpublished decision the Fourth Circuit adopted the same reasoning to allow a bankruptcy court to impose sanctions under § 1927 against a Virginia attorney who was admitted *pro hac vice* to appear before the Bankruptcy Court for the Western District of North Carolina.[34] The Fourth Circuit relied on the plain language of § 1927, which states that it applies to anyone "admitted to conduct cases in any court of the United States."[35]

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[21] *In re Perroton*, 958 F.2d at 893-96; *In re Courtesy Inns, Ltd., Inc.*, 40 F.3d at 1086; *In re Davis*, 899 F.2d at 138-40.
[22] *In re Schaefer Salt Recovery, Inc.*, 501 F.3d at 103 (discussing, but declining to follow, the reasoning of sister circuits).
[23] 28 U.S.C. § 152(a)(1).
[24] *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.,* 458 U.S. 50, 61 (1982).
[25] *In re Courtesy Inns*, 40 F.3d at 1086.
[26] *Baker v. Latham Sparrowbush Assoc. (In re Cohoes Indus. Terminal, Inc.)*, 931 F.2d 222, 230 (2d Cir. 1991).
[27] *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90, 105 (3d Cir. 2008).
[28] *Maloof v. Level Propan Gasses, Inc.*, 316 Fed.Appx. 373, 376 (6th Cir. 2008)(affirming the bankruptcy court's imposition of § 1927 sanctions without discussing jurisdiction); *In re Royal Manor Mgmt., Inc.*, 525 at 364-365 (affirming bankruptcy court's award of § 1927 sanctions and stating that the Sixth Circuit finds bankruptcy courts have authority to issue sanctions under that section).
[29] *Volpert v. Ellis (In re Volpert)*, 177 B.R. 81, 88-89 (Bankr. N.D.Ill 1995), *aff'd*, 186 B.R. 240 (N.D.Ill 1995), *aff'd on other grounds*, 110 F.3d 494 (7th Cir. 1997).
[30] *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90 (3d Cir. 2008).
[31] *In re Cohoes Indus. Terminal, Inc.*, 931 F.2d at 230 (affirming the bankruptcy court's imposition of § 1927 sanctions with no discussion of jurisdiction); *Adair v. Sherman*, 230 F.3d 890, 895, n. 8 (7th Cir. 2000)(stating bankruptcy courts also have the authority to sanction attorneys under § 1927 without discussing jurisdiction).
[32] *In re Schaefer Salt Recovery, Inc.*, 542 F.3d at 104 (citing *D & B Countryside, L.L.C. v. Newell (In re D & B Countryside, L.L.C.)*, 217 B.R. 72, 76, n. 5 (Bankr. E.D. Va. 1998)); *Volpert v. Ellis (In re Volpert)*, 177 B.R. 81, 88-89 (Bankr. N.D. Ill. 1995), *aff'd on other grounds*, 110 F.3d 494, 500-01 (7th Cir. 1997)(noting that the bankruptcy court had ample authority to sanction misbehavior under 11 U.S.C. § 105, Rule 9011 and the court's inherent power, but declining to reach the question of whether the bankruptcy court could also impose sanctions under § 1927)).
[33] *In re Schaefer Salt Recovery Inc.*, 542 F.3d at 105.
[34] *Mitchell v. Sonies*, 56 F.3d 61 (4th Cir. 1995)(citing *U.S. v. Guariglia*, 962 F.2d 160, 163 (2d Cir. 1992)(holding that the bankruptcy court is a unit of the district court)).
[35] *Id.* (quoting 28 U.S.C. § 1927).
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Similarly, the Bankruptcy Court for the Eastern District of Virginia also found that the bankruptcy court is a unit of the district court and can, therefore, grant costs under § 1920.[36]

Targeted Conduct § 1927

Section 1927 focuses on behavior that 1) multiplies the proceedings… 2) in an unreasonable and vexatious manner; and 3) thereby increases the costs of the proceedings.[37] It explicitly targets acts that multiply the proceedings, for conduct to be sanctionable, it must have an effect on an already initiated proceeding.[38] Implicitly, § 1927 cannot cover an initial pleading, because proceedings cannot be multiplied until there is a case.[39] Courts disagree over whether a fourth element is required to establish liability under § 1927; this disagreement involves a dispute over whether § 1927 requires a showing of bad faith.[40] Courts are in agreement that a showing of an attorney's bad faith will always justify sanctions under § 1927.[41]

Multiplies the Proceedings

Section 1927 requires that the conduct multiply the proceedings.[42] It focuses on the conduct of the litigation and not on the merits.[43] Unless proceedings are multiplied, sanctions will not be awarded under § 1927.[44]

Unreasonably and Vexatiously

Courts do not interpret the "unreasonably" requirement of § 1927 to be the equivalent of negligent conduct.[45] Some courts interpret "unreasonably" to require a finding of more than mere negligence, something akin to recklessness.[46] Other courts find that although, mere negligence is not sufficient, that a showing of recklessness is not required because that word does not appear within § 1927.[47] Some courts hold that the word vexatiously requires a finding that an attorney acted in bad faith as a predicate for liability under § 1927.[48]

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[36] *In re D & B Countryside, L.L.C.*, 217 B.R. at 76, n. 5.
[37] 28 U.S.C. § 1927.
[38] *Jensen v. Phillips Screw Co.,* 546 F.3d 59, 64 (1st Cir. 2008).
[39] *In re Schaefer Salt Recovery*, 542 F.3d at 101.
[40] *McKenzie v. Norfolk Southern Ry. Co.*, 497 Fed.Appx. 305, 312, n. 5 (4th Cir. 2012)(discussing the circuit split regarding whether imposing sanctions under § 1927 requires a showing of bad faith). *See Rentz v. Dynasty Apparel Indus., Inc.*, 556 F.3d 389, 396 (6th Cir. 2009).
[41] *Cambridge Toxicology Group, Inc. v. Exnicios*, 495 F.3d 169 (5th Cir. 2007); *Cruz v. Savage*, 896 F.2d 626, 631-32 (1st Cir. 1990).
[42] 28 U.S.C. § 1927.
[43] *Lightspeed Media Corp. v. Smith*, 830 F.3d 500 (7th Cir. 2016); *Baca v. Berry*, 806 F.3d 1262 (10th Cir. 2015).
[44] *Peterson v. BMI Refractories*, 124 F.3d 1386, 1396-97 (11th Cir. 1997)(even if conduct is in bad faith, sanctions are not warranted unless there is a causal connection between the conduct and the continuation of the proceedings).
[45] *In re Gil-De la Madrid*, 817 F.3d 371 (1st Cir. 2016); *Schwartz v. Millon Air, Inc.*, 341 F.3d 1220 (11th Cir. 2003).
[46] *Dal Pozzo v. Basic Machinery Co., Inc.*, 463 F.3d 609 (7th Cir. 2006)(reckless indifference to the law qualifies as a basis for sanctions under § 1927); *Clark v. United Parcel Serv., Inc.*, 460 F.3d 1004 (8th Cir. 2006)(sanctions are permitted under § 1927 when the conduct viewed objectively demonstrates either intentional or reckless disregard of an attorney's duties to the court).
[47] *Baca v. Berry,* 806 F.3d 1262 (10th Cir. 2015); *LaPrade v. Kidder Peabody & Co. Inc.*, 146 F.3d 899 (D.C. Cir. 1998)(no finding of recklessness or bad faith; sanctions will be affirmed if there is evidence of recklessness, bad faith or improper motive).
[48] *Jensen*, 546 F.3d at 64; *In re Prosser*, 777 F.3d 154 (3d Cir. 2015).
9401915/

<u>*Bad Faith*</u>

Some circuits require a showing of bad faith before authorizing an imposition of sanctions under § 1927.[49] Some construe the "unreasonably and vexatiously" language of § 1927 to require a finding of subjective bad faith as a predicate to the imposition of sanctions.[50] Other courts impose an objective standard when assessing whether an attorney's conduct may be sanctioned under § 1927.[51]

The Third Circuit instructs that sanctions may not be imposed under § 1927 for conduct that results from misunderstanding, bad judgment, or well-intentioned zeal.[52] A finding of "willful bad faith on the part of the offending lawyer" is required.[53] "[U]nder § 1927, an attorney's conduct must be of an egregious nature, stamped by bad faith that is violative of recognized standards in the conduct of litigation."[54] The party requesting the imposition of sanctions must show by clear and convincing evidence that sanctions are warranted.[55] Before attorneys' fees and costs may be imposed under § 1927, there must be a finding of willful bad faith on the part of the offending attorney.[56]

First, a court must make a finding of bad faith on the part of the person to-be-sanctioned.[57] Some indication of an intentional advancement of a baseless contention made for an ulterior purpose, such as harassment or delay, may be indicative of bad faith.[58] Second, a court must balance the equities between the parties and may award attorney fees whenever overriding considerations indicate the need for such a recovery.[59] Thus, a court may refuse to award attorney fees even where it finds the existence of bad faith, if after balancing the equities, it nevertheless determines that an award does not serve the interests of justice.[60] To ensure a court does not abuse its discretion, the court must "determine whether the party or attorney who has been found to have acted in bad faith has satisfied the burden of proving that mitigating factors and circumstances warrant the exercise of discretion against the award to attorney fees."[61]

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[49] *See Grider v. Keystone Health Plan Cent., Inc.*, 580 F.3d 119 (3d Cir. 2009); *McKenzie v. Norfolk Southern Ry. Co.*, 497 Fed.Appx. 305 (4th Cir. 2012); *Edwards v. Gen. Motors Corp.*, 153 F.3d 242, 246 (5th Cir. 1998); *Pacific Dunlop Holdings, Inc. v. Barosh*, 22 F.3d 113 (7th Cir. 1994); *NAACP-Special Contribution Fund v. Atkins*, 908 F.2d 336 (8th Cir. 1990).
[50] *MJS Las Croabas Props., Inc.,* 545 B.R. 401, 419 (1st Cir. B.A.P. Cir. 2016)(recognizing this fact, but declining to adopt this requirement).
[51] *See Cruz v. Savage*, 896 F.2d 626 (1st Cir. 1990); *Nemeroff v. Abelson*, 620 F.2d 339 (2d Cir. 1980); *Rentz v. Dynasty Apparel Indus., Inc.*, 556 F.3d 389 (6th Cir. 2009); *Steinert v. Winn Group, Inc.*, 440 F.3d 1214 (10th Cir. 2006).
[52] *Grider*, 580 F.3d at 142 (citation omitted).
[53] *In re Prudential Ins. Co. Am. Sales Practice Litig. Agent Actions*, 278 F.3d 175, 181 (3d Cir. 2002)(citation omitted).
[54] *Grider,* 580 F.3d at 142 (internal quotation marks omitted).
[55] *Cardionet, LLC v. Mednet Healthcare Techs., Inc.*, 146 F.Supp.3d 671, 699 (E.D. Pa. 2015)(citation omitted).
[56] *Ford v. Temple Hosp.*, 790 F.2d 342, 347 (3d Cir. 1986)(citing *Baker Indus., Inc. v. Cerberus, Ltd.*, 764 F.2d 204, 209 (3d Cir. 1985)).
[57] *Ford*, 790 F.2d at 347.
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *Id.* (citing *Perichak v. Int'l Union of Elec. Radio*, 715 F.2d 78, 81 (3d Cir. 1983)).
9401915/

The Third Circuit approved of a bankruptcy court's imposition of § 1927 sanctions where debtor's counsel multiplied the proceedings and created new issues for the court and trustee in filing an adversary complaint, a request for referral to the United States Attorney, multiple fee objections, and a conflicts motion. [62] The multiple filings prompted by deposition testimony, which was quickly clarified on the record were unreasonable and vexatious due to the abject failure of debtor's counsel to engage in any reasonable inquiry to ensure the existence of any factual basis for subsequent accusations.[63] Debtor counsel's repeated filings based on a single fact delayed and increased the cost of the bankruptcy proceedings – the parties and court expended significant time and resources addressing tangential issues rather that the merits of the bankruptcy case.[64] The entire record demanded a finding of bad faith where debtor counsel made bribery accusations, issued press releases, requested referral to law enforcement, and filed motions, objections and an adversary complaint, in order to etch nefarious motives onto an unremarkable event.[65]

Judge Walrath awarded § 1927 sanctions against debtors who for more than five years sought to avoid the consequences of a District Court order that obligated the debtors to arbitrate.[66] The debtors opposed all motions to send the disputes at issues to arbitration; each attempt at avoiding arbitration via motion practice failed because the bankruptcy court ruled against the debtors.[67] Then, the debtors sought to obtain discovery in the bankruptcy court that the debtors would not be entitled to within the required arbitration.[68] After a five year delay, the debtors made a last ditch effort and sought relief in the bankruptcy court from the District Court order that compelled arbitration.[69] The court imposed sanctions under § 1927 for unduly multiplying the proceedings in an effort to convince the debtors "to cease this improper activity, which wastes not only counsel's time but the Court's as well."[70] A basic tenant of our court system, or our jurisprudence, is that "once you have an answer to a question that you raise… you cannot continue to come back to assert those issues again, and again, and again."[71]

The Delaware Bankruptcy court imposed sanctions under § 1927, but limited them to costs incurred after a failed mediation and did not award attorney fees.[72] There, the trustee and counsel increased costs and unreasonably multiplied avoidance action proceedings when counsel

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[62] *In re Prosser*, 777 F.3d at 162.
[63] *Id.* (noting debtor's counsel could have simply inquired into a fee arrangement and resolved any confusion without initiating an adversary proceeding, filing motions and objections, or alleging a vast bribery scheme).
[64] *Id.* at 163.
[65] *Id.*
[66] *In re Kaiser Group Intern., Inc. v. Nova Hut, a.s. (In re Kaiser Group Intern., Inc.)*, 445 B.R. 361, 369 (Bankr. D. Del. 2011).
[67] *Id.*
[68] *Id.*
[69] *Id.* (noting that the debtors' motion mischaracterized the legal positions of its opponent).
[70] *Id.*
[71] *In re Genesis Health Ventures, Inc.*, 362 B.R. 657, 662 (D. Del. 2007)(affirming the bankruptcy court's finding of bad faith and agreeing that the case presented the quintessential case for the application of sanctions where a *pro se* litigant raised the issue more than once at confirmation and on appeal in various junctures over the course of years, only to receive the same response each time – that he is not entitled to have the estate pay for representation of equity).
[72] *In re American Remanufacturers, Inc. v. AutoZone Texas, L.P. (In re American Remanufacturers, Inc.)*, 453 B.R. 235, 242 (Bank. D. Del. 2011).
9401915/

refused to discuss the merits of the case, failed to participate in any meaningful way at the Court-ordered mediation, conducted extensive bad faith discovery after knowing that the avoidance action was meritless, offered no proof at trial that either supported the avoidance action or derogated from the affirmative defenses.[73]

The Fourth Circuit has repeatedly stated that bad faith on the part of the attorney is a precondition to imposing fees under § 1927.[74] No sanction may be imposed under § 1927 without a finding of bad faith.[75] Courts may find bad faith where an attorney engages in reckless behavior that demonstrates a conscious disregard for a foreseeable risk that proceedings will be unreasonably and vexatiously multiplied.[76] A corporate officer refused to waive a corporate-debtor's attorney-client privilege to allow litigation involving the corporate-debtor to proceed; further, when the bankruptcy trustee waived the attorney-client privilege on behalf of the corporate-debtor, the corporate officer contested the trustee's authority in numerous motions and an appeal to the Fourth Circuit.[77] After commenting that "while [the corporate officer] may not take no for an answer, he will have to pay for his obstinac[y]," the court awarded sanctions under § 1927 and made a finding that the corporate officer's behavior manifested an improper motive and bad faith.[78] The sanctions awarded attorney fees incurred after the court order that required the corporate officer to comply with the trustee's waiver of the corporate-debtor's attorney-client privilege.[79] Then, in a consumer matter, sanctions were awarded under § 1927 against an attorney who failed to appear routinely without cause whose failure to appear wasted the resources of the court and debtors' counsel.[80]

The Seventh and Eighth Circuits interpret the word vexatiously depending on the circumstances to require either subjective bad faith or objective bad faith[81] For example, if the conduct objectively has a colorable basis, then a showing of subjective bad faith is required.[82]

The Fifth Circuit interprets § 1927 as requiring evidence of bad faith, improper motive, or reckless disregard of the duty owed to the court.[83] But, it cautions that § 1927 is strictly construed so that the legitimate zeal of an attorney representing a client is not dampened.[84] The Fifth Circuit instructs that § 1927 should be sparingly applied except when the entire course of proceedings were unwarranted and should neither have been commenced nor persisted in, and

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[73] *Id.* at 238, 241, 242 (noting that the court already fined trustee's counsel $100,000 for the bad faith discovery campaign).
[74] *McKenzie*, 497 Fed.Appx. at 312 (citing *E.E.O.C. v. Great Steaks, Inc.*, 667 F.3d 510, 522 (4th Cir. 2012)).
[75] *Great Steaks*, 667 F.3d at 522-23.
[76] *E.I. Dupont de Nemours & Co. v. Kolon Indus., Inc.*, 911 F.Supp.2d 340, 344 (E.D. Va. 2012).
[77] *In re Amerilink, Ltd.,* 2015 WL 4210872 at * 2 (Bankr. E.D. N.C. July 10, 2015).
[78] *Id.* at 3.
[79] *Id.*
[80] *In re Ulmer*, 363 B.R. 777, 784 (Bankr. D. S.C. 2007)(considering the attorney's three-year membership to the bar and lack of supervision mitigating factors).
[81] *Pacific Dunlop Holdings, Inc. v. Barosh*, 22 F.3d 113 (7th Cir. 1994); *NAACP-Special Contribution Fund v. Atkins*, 908 F.2d 336 (8th Cir. 1990).
[82] *Dal Pozzo v. Basic Machinery Co., Inc.*, 463 F.3d 609 (7th Cir. 2006).
[83] *Edwards v. Gen. Motors Corp.*, 153 F.3d 242, 246 (5th Cir. 1998).
[84] *Citizens Bank & Trust Co. v. Case (In re Case)*, 937 F.2d 1014, 1023 (5th Cir. 1991)(citing *Browning v. Kramer*, 931 F.2d 340, 344 (5th Cir. 1991)).
9401915/

even then, an award under § 1927 may not shift the entire financial burden of an action's defense.[85]

Other circuits do not require a showing of bad faith. The First Circuit provides that litigation conduct qualifies as vexatious within the meaning of § 1927, if it is harassing or annoying, regardless of whether it is intended to be so.[86] To impose sanctions under § 1927, the First Circuit does not require a finding of subjective bad faith.[87] In assessing whether an attorney acted unreasonably and vexatiously, the First Circuit instructs courts to apply an objective standard.[88] Common sense suggests that the court must be accorded wide latitude in drawing inferences as to when multiplication of the proceedings crosses the line between what is acceptable, if tedious, and what is unreasonable and vexatious.[89] "Distinguishing between vigorous but reasonable attempts at salvaging a case that is going badly and a stubborn capricious attempt to gain advantage by prolonging matters is not easy," but the unique position occupied by the trial court gives it an intimate familiarity with the ebb and flow of the cases on its docket.[90] Appellate courts recognize, therefore, that they must defer in large measure to the trial court's first-line authority for case ma`nagement decisions.[91]

The Tenth Circuit focuses its § 1927 inquiry on whether the proceedings have been unreasonably and vexatiously multiplied[92] and recognizes that the applicability of § 1927 may only become apparent at or after litigation has run its course and ended.[93]

The Sixth Circuit explains that sanctions under § 1927 are warranted if counsel "falls short of the obligations owed by a member of the bar to the court and which, as a result, causes additional expense to the opposing party."[94] Sanctions require more than negligence or incompetence, but something less than subjective bad faith.[95] Section 1927 may not be utilized to impose sanctions because a claim was ultimately unsuccessful and an attorney who reasonably believes that the attorney's claim is meritorious is not subject to sanctions.[96] The Sixth Circuit recommends that discrete acts of vexatious conduct should be identified and a determination made whether they were done in bad faith or, even if bad faith was not present, whether they multiplied the proceedings pursuant to § 1927.[97] In the absence of a bad faith showing, sanctions may be imposed "at least when an attorney knows or reasonably should know that a claim pursued is frivolous, or that the attorney's litigation tactics will needlessly obstruct the litigation of non-frivolous claims.[98] Liability under § 1927 extends solely to those excessive costs that

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[85] *FDIC v. Calhoun,* 34 F.3d 1291, 1297 (5th Cir. 1994)(citing *Browning*, 931 F.2d at 345).
[86] *Lamboy-Ortiz v. Ortiz-Velez*, 630 F.3d 228, 245 (1st Cir. 2010).
[87] *Cruz v. Savage*, 896 F.2d 626, 631-32 (1st Cir. 1990).
[88] *Id.*
[89] *Jensen*, 546 F.3d at 67.
[90] *Id.*
[91] *Id.*
[92] *Steinert v. Winn Group, Inc.*, 440 F.3d 1214, 1223 (10th Cir. 2006).
[93] *Id.*
[94] *Rentz v. Dynasty Apparel Indus., Inc.*, 556 F.3d 389, 396 (6th Cir. 2009).
[95] *Hall v. Liberty Life Assurance Co. of Boston,* 595 F.3d 270, 276 (6th Cir. 2010).
[96] *Ridder v. City of Springfield*, 109 F.3d, 297-98 (6th Cir. 1997).
[97] *Riddle v. Egensperger*, 266 F.3d 542, 556 (6th Cir. 2001)(citing *In re Ruben*, 825 F.2d at 990).
[98] *Ridder*, 109 F.3d at 298.
9401915/

result from the violative conduct.[99] A sanction is generally improper where a successful motion could have avoided any additional legal expenses by the party requesting the imposition of sanctions.[100]

In the Second Circuit, a court must decide whether a reasonable attorney could have concluded that facts supporting the claim might be established and not whether such facts actually had been established when determining the issue of bad faith.[101] The "reasonable belief" standard does not require a showing of subjective bad faith, but only that a competent attorney could not have formed a reasonable belief that the pleading is well grounded in fact.[102] A bankruptcy court may impose sanctions under § 1927 if it finds that an "attorney's actions are so completely without merit as to require the conclusion that they must have been undertaken for some improper purpose such as delay."[103]

<u>*Application to Law Firms*</u>

Similarly, a division exists over whether a court may impose liability on law firms as a whole, in addition to an individual attorney within the firm under § 1927.[104] The First[105], Second[106], Third[107], Eighth[108], Eleventh[109] and D.C.[110] Circuit Courts authorize the imposition of sanctions against a law firm. The statutory provision's reference to any attorney "or other person admitted to conduct cases" reflects a legislative intent to regulate entities that "conduct cases" – a category into which law firms naturally fall.[111]

Ninth[112], Seventh[113] and Sixth[114] Circuits do not sanction law firms pursuant to § 1927 for the conduct of the firms' attorneys. The Ninth Circuit explains that if Congress had intended to permit federal courts to impose sanctions against law firms under § 1927, it would have included an express authorization to do so.[115] While the Seventh Circuit takes the position that liability under § 1927 is direct, not vicarious[116] and that only individual lawyers are admitted to

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[99] *In re Ruben*, 825 F.2d at 984.
[100] *Id.* at 988.
[101] *Nemeroff v. Abelson*, 620 F.2d 339, 348 (2d Cir. 1980).
[102] *Eastway Constr. Corp. v. City of New York*, 762 F.2d 243, 254 (2d Cir. 1985).
[103] *In re Cohoes Indus. Terminal, Inc)*, 931 F.2d at 230 (quoting *Oliveri v. Thompson*, 803 F.2d 1265, 1273 (2d Cir. 1986)).
[104] *MJS Las Croabas Props., Inc.,* 545 B.R. 401, 420 (1st B.A.P. Cir. 2016)(recognizing the division among the courts).
[105] *Id.*
[106] *Enmon v. Prospect Capital Corp.*, 675 F.3d 138, 147 (2d Cir. 2012).
[107] *Baker Indus., Inc. v. Cerberus Ltd.,* 764 F.2d 204, 212 (3d Cir. 1985).
[108] *Lee v. First Lenders Ins. Servs., Inc.*, 236 F.3d 443 (8th Cir. 2001).
[109] *Smith v. Grand Bank & Trust of Fla.*, 193 Fed.Appx. 833, 838 (11th Cir. 2006).
[110] *LaPrade v. Kidder Peabody & Co.*, 146 F.3d 899, 907 (D.C. Cir. 1998).
[111] *Brignoli v. Balch Hardy & Scheinman, Inc.*, 735 F.Supp. 100, 101-02 (S.D.N.Y. 1990).
[112] *Kaass Law v. Wells Fargo Bank, N.A.*, 799 F.3d 1290, 1295 (9th Cir. 2015).
[113] *FM Indus., Inc. v. Citicorp Credit Servs., Inc.,* 614 F.3d 335, 340 (7th Cir. 2010).
[114] *Rentz v. Dynasty Apparel Indus., Inc.*, 556 F.3d 389, 396, n. 6 (6th Cir. 2009)(finding that § 1927 does not authorize the imposition of sanctions on a represented party, nor does it authorize the imposition of sanctions on a law firm).
[115] *Kaass Law*, 799 F.3d at 1295.
[116] *FM Indus., Inc.,* 614 F.3d at 340.
9401915/

practice, not law firms, therefore it declines to impose § 1927 liability on law firms.[117] The Sixth Circuit holds that § 1927 does not authorize the imposition of sanctions on a law firm.[118]

The Fourth Circuit has not taken a definite position, but expressed that it was "doubtful" that the sanction theory would "support sanctions against an entire firm rather than against the individual lawyer who acted improperly".[119] However, the South Carolina Bankruptcy Court found that the routine failure of an individual attorney to appear for matters before the court violated § 1927 and subjected her employer, a law firm, to sanctions.[120]

Federal Rule of Bankruptcy Procedure 9011; Federal Rule of Civil Procedure 11

Bankruptcy Rule 9011 provides for imposition of sanctions against persons who present a pleading for an "improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of the litigation."[121] Rule 9011 emphasizes the responsibility of an attorney who signs a pleading, motion or other paper to conduct a reasonable inquiry into the validity of the document being signed.[122] An attorney's signature is an assertion that to the best of the attorney's knowledge, information, and belief, formed after reasonable inquiry it is well grounded in fact and not interposed for any improper purpose.[123] Rule 9011 is in most respects a twin of Rule 11 of the Federal Rules of Civil Procedure, tweaked for the bankruptcy setting, and acts as the equivalent sanctions rule under the Bankruptcy Code.[124] It is clear that Rule 9011, discourages in bankruptcy proceedings the same conduct proscribed by Rule 11; the purpose of Rule 9011 is two-fold, to deter litigation abuse that results from the filing of a particular paper and, thus, streamline litigation and to deter future baseless filings.[125]

A bankruptcy court may impose sanctions under Rule 9011 on motion of an aggrieved party, however, the rule contains no explicit time limit for a sanctions motion and neither does it specific a time limit for the court's decision on a motion for the imposition of sanctions.[126] A bankruptcy court may impose Rule 9011 sanctions on its own initiative.[127] The court may enter an order that describes the specific conduct that appears sanctionable and may direct the attorney, law firm, or party to show cause why it has not violated the rule.[128]

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[117] *Claiborne v. Wisdom*, 414 F.3d 715, 723 (7th Cir. 2005).
[118] *Rentz*, 556 F.3d at 396, n. 6.
[119] *Blue v. U.S. Dept. of Army*, 914 F.2d 535, 549 (4th Cir. 1990)(reversing an order that required a law firm to pay sanctions under § 1927, but declining to answer definitively whether law firms may be sanctions under this power).
[120] *In re Ulmer*, 363 B.R. 777, 784 (Bankr. D. S.C. 2007)(containing no discussion of any case law regarding law firm liability under § 1927).
[121] Fed. R. Bankr. P. 9011(b)(1). Note, this decision pre-dated amendments to Rule 11 and Rule 9011 that allow for the imposition of sanctions against law firms.
[122] *Matter of Capitol-York Constr. Corp.*, 52 B.R. at 321.
[123] *Id.*
[124] *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90, 97, 99 (2008)(citing *Stuebben v. Gioioso (In re Gioioso)*, 979 F.2d 956, 960 (3d Cir 1992)).
[125] *Id.*
[126] Fed. R. Bankr. P. 9011(c)(1)(A).
[127] Fed. R. Bankr. P. 9011(c)(1)(B). *See In re Sanford*, 403 B.R. 831 (Bankr. D. Nev. 2009).
[128] Fed. R. Bankr. P. 9011(c)(1)(B).
9401915/

Rule 9011 imposes an objective standard of reasonable inquiry, which does not require, as a prerequisite to imposing sanctions, a finding of bad faith.[129] A court may sanction "any attorney, law firm, or party that violates Rule 9011(b) or is responsible for the violation," after providing notice and a reasonable opportunity to respond.[130] When evaluating whether a filing warrants sanctions, a court "must apply an objective standard of reasonableness under the circumstances."[131] Rule 9011 allows the imposition of sanctions for filing frivolous documents or filing documents for an improper purpose such as delay or harassment.[132] Documents include petitions, pleadings, motions and other papers served or filed in a bankruptcy case.[133] Rule 9011 sets forth a two-pronged objective test for determining whether sanctions should be imposed.[134]

First, the frivolous prong of the test requires that a paper be filed or served only after a reasonable inquiry into the facts and existing law.[135] Before filing a document, the party or attorney doing the filing, must make a reasonable investigation into the facts and law and determine whether there is a basis for filing the particular document.[136] A reviewing court will resolve any ambiguity in favor of the filing party when examining whether a filing is frivolous.[137]

Second, under the improper purpose prong, a court reviews whether a document has been filed or served for an improper purpose – for example, to harass or cause unnecessary delay or needless increase in the cost of litigation or administration of the case.[138] An improper purpose may be inferred when the effect of a pleading or motion is to delay the proceedings.[139] Similarly, an improper purpose may be found when a pleading, motion or other paper has been filed in the context of a persistent pattern of clearly abusive litigation.[140] There is disagreement over whether sanctions may be imposed for filing a well-founded document for an improper purpose.[141]

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[129] *Bus. Guides, Inc. v. Chromatic Commc'n Enters., Inc.*, 498 U.S. 533, 548-49 (1991)(interpreting Rule 11).
[130] Fed. R. Bankr. P. 9011 (c).
[131] *Mary Ann Pensiero, Inc. v. Lingle*, 847 F.2d 90, 94 (3d Cir. 1988).
[132] Fed. R. Bankr. P. 9011(a). *In re Cohoes Indus. Terminal, Inc.*, 931 F.2d at 227.
[133] Fed. R. Bankr. P. 9011(a).
[134] *Bus. Guides, Inc. v. Chromatic Commc'ns Enters., Inc.* 498 U.S. 533 (1991)(interpreting Rule 11); *Smyth v. City of Oakland (In re Ralbert Rallington Brooks-Hamilton)*, 329 B.R. 270, 283 (B.A.P. 9th Cir. 2005)("in considering sanctions under Rule 9011, the court measures the attorney's conduct objectively against a reasonableness standard, which consists of a competent attorney admitted to practice before the involved court.").
[135] *Pierce v. F.R. Tripler & Co.,* 955 F.2d 820 (2d Cir. 1992); *Townsend v. Holman Consulting Corp.*, 929 F.2d 1358 (9th Cir. 1991); *Cruz v. Savage*, 896 F.2d 626 (1st Cir. 1990); *In re Ralbert Rallington Brooks-Hamilton*, 329 B.R. at 277-83 (B.A.P. 9th Cir. 2005).
[136] *In re Taylor*, 655 F.3d 274, 283-84 (3d Cir. 2011)(defining "reasonableness" as an objective knowledge or belief at the time of the filing of a challenged paper that the claim was well-grounded in law and fact).
[137] *Oliveri v. Thompson*, 803 F.2d 1265 (2d Cir. 1986).
[138] *Gilmore v. Shearson/American Express, Inc.*, 811 F.2d 108 (2d Cir. 1987); *Smith v. Nat'l Health Care Servs.*, 934 F.2d 95 (7th Cir. 1991).
[139] *Lieb v. Topston Indus., Inc.*, 788 F.2d 151, 157 (3d Cir. 1986); *Zaldivar v. Los Angeles*, 780 F.2d 823 (9th Cir. 1986); *In re Dental Profile, Inc.*, 446 B.R. 885, 900 (Bankr. N.D. Ill. 2011).
[140] *Aetna Life Ins. Co. v. Alla Med. Servs., Inc.*, 855 F.2d 1470, 1476 (9th Cir. 1988).
[141] *Sussman v. Bank of Israel*, 56 F.3d 450 (2d Cir. 1995); *Nat'l Ass'n of Gov't Employees v. Nat'l Fed'n of Fed. Employees,* 844 F.2d 216 (5th Cir. 1988)(holding that the filing of a well-founded document is not sanctionable).
9401915/

A court may award the prevailing party reasonable expenses and attorney's fees incurred in making or opposing the Rule 9011 motion for sanctions, however, the award of fees and expenses is not automatic – the court "may" make such an award if warranted.[142] The sanction must be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated.[143] Courts are generally cautious about imposing sanctions and resolve all doubts in favor of the signer.[144] Sanctions are to be applied only in the exceptional circumstance where a claim or motion is patently unmeritorious or frivolous.[145] Rule 11 must not be used as an automatic penalty against an attorney or party advocating the losing side of a dispute.[146] To impose a Rule 9011 sanction, a bankruptcy court must find that an attorney has submitted a claim that has no chance of success under existing precedents and that fails to advance a reasonable argument to extend, modify or reverse the law as it stands.[147] A court may sanction an attorney who violates or is responsible for a violation of the certification requirements of Rule 9011.[148] A law firm may be sanctioned for a violation of Rule 9011.[149] A represented party may not be sanctioned for the assertion of frivolous legal argument or contention.[150] However, imposition of sanctions against an attorney does not preclude imposition of sanctions against a client.[151] Before a bankruptcy court may impose sanctions, the parties and attorneys must receive proper notice and a reasonable opportunity to respond.[152] When imposing Rule 9011 sanctions, a court will consider the sanctionable conduct as well as the offending party's ability to pay.[153] Monetary sanctions ordinarily consist of an order to pay a penalty into court.[154]

Both Rule 9011 includes safe harbor provisions which explicitly place greater restrictions on the imposition of sanctions and include a significant change in the timing of and decision on Rule 9011 motions.[155] A party cannot file or submit a motion for sanctions if the challenged paper, claim, defense, contention, or denial is withdrawn or corrected within twenty-one days after service of the motion for sanctions on the offending party.[156] If the twenty-one day grace period is not provided, the motion must be denied.[157] The safe harbor is designed to give parties the opportunity to correct their errors with "the practical effect being that a party cannot delay serving its Rule 9011 motion until conclusion of the case or judicial rejection of the offending contention."[158] Further, the safe harbor reduces Rule 9011 volume while simultaneously

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142 10 *Collier on Bankruptcy* ¶ 9011.08[3], p. 9011-22-3 (16th ed. 2017).
143 Fed. R. Bankr. P. 9011(c)(2).
144 *Knipe v. Skinner*, 19 F.3d 72 (2d Cir. 1994); *Rodick v. City of Schenectady*, 1 F.3d 1341, 1351 (2d Cir. 1993).
145 *Ario v. Underwriting Members of Syndicate 53 at Lloyds for the 1998 Year of Account*, 618 F.3d 277, 297 (3d Cir. 2010)(citation omitted).
146 *Id*.
147 *Mareno v. Rowe*, 910 F.2d 1043, 1047 (2d Cir. 1990).
148 Fed. R. Bankr. P. 9011(c).
149 *Id.*
150 Fed. R. Bankr. P. 9011(c)(2)(A).
151 *Collins v. Walden*, 834 F.2d 961 (11th Cir. 1987).
152 Fed. R. Bankr. P. 9011(c); *In re Ames Dep't Stores*, 76 F.3d 66, 71 (2d Cir. 1996).
153 *Krim v. First City Bancorporation of Texas, Inc. (In re First City Bancorporation of Texas, Inc.)*, 282 F.3d 864 (5th Cir. 2002); *Runfola & Assocs., Inc. v. Spectrum Reporting II, Inc.*, 88 F.3d 368 (6th Cir. 1996).
154 10 *Collier on Bankruptcy* ¶ 9011.08 [2], p. 9011-21 (16th ed. 2017).
155 *In re Schaefer Salt Recovery,* 542 F.3d at 99.
156 Fed. R. Civ. P. 11(c)(2); F. R. Bankr. P. 2011(c)(1).
157 *In re Schaefer Salt Recovery,* 542 F.3d at 99.
158 *Id.* (citing Fed. R. Civ. P. 11 advisory committee notes to 1993 amendments).
9401915/

accomplishing the goal of the Rule – streamlining litigation by eliminating proscribed abuses – and does so without burdening the court.[159] No safe harbor applies when the Court considers whether to impose Rule 9011 sanctions on its own initiative.[160]

The Delaware Bankruptcy Court denied a former noteholder's request for sanctions against the trustee's counsel under Rule 9011 related to an avoidance action because there was no evidence that the complaint was frivolous, legally unreasonable, without factual foundation or that the trustee intended to abuse the bankruptcy system with its filing.[161] The Court emphasized the importance of considering the reasonableness of the trustee's belief at the time the pleading was filed and not in hindsight and underscored that Rule 9011 is not intended to chill an attorney's enthusiasm or creativity in pursuing factual or legal theories."[162]

The South Carolina Bankruptcy Court relied on Rule 9011 when it sanctioned an attorney and law firm for presenting documents that were not properly executed and that the attesting attorney did not review prior to filing in consumer matters; it emphasized that the amount of the sanction must be limited to the amount necessary and appropriate to compensate the injured party, deter the conduct, or punish the offender.[163] The court acknowledged that in consumer cases the stay relief process involves a high fast-paced volume of motions and applications, but that it had to remain mindful of the serious stakes involved – the jeopardy of the family homestead.[164] The court sanctioned the law firm $500 per violation to deter future infractions with funds to be paid to the court.[165] During its analysis the court considered mitigating factors, which included the law firm's acknowledgment of mistakes and assurances of its commitment to correcting them.[166]

<u>Difference between § 1927 and Rule 9011</u>

While Rule 11 and § 1927 overlap to some extent, they sanction different actions, require the application of disparate standards of proof, permit the sanctioning of different persons, and differ in the procedures that the sanctioning court must follow.[167] Unlike Rule 11 and Bankruptcy Rule 9011, which are lengthy and impose specific procedural requirements with which a party seeking sanctions must comply, § 1927 is short and clear.[168] Rule 11 sanctions focus on particular papers, while § 1927 sanctions address a course of conduct.[169]

Section 1927 is different from Rule 11 in that § 1927 is designed to have those counsel who engage in unreasonable and vexatious conduct, pay the excess costs, expenses and attorney

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[159] *In re Schaefer Salt Recovery*, 542 F. 3d at 99 (citation omitted).
[160] Fed. R. Bankr. P. 9011
[161] *In re Aphton Corp. v. SF Capital Partners (In re Aphton Corp.)*, 423 B.R. 76, 97 (Bankr. D. Del. 2010).
[162] *Id.* at 96 (citations omitted).
[163] *In re Ulmer*, 363 B.R. at 784 (citing *In re A.H. Robins Co., Inc.*, 133 F.3d 913 (4th Cir. 1998)).
[164] *Id*. at 785.
[165] *Id.* (noting the individual attesting attorney was fined $500 under § 1927 for her failures to appear in Court to prosecute her cases).
[166] *Id.* at 785-86.
[167] *Fuqua Homes, Inc. v. Beattie*, 388 F.2d 618, 623 (8th Cir. 2004).
[168] *In re Schaefer Salt Recovery, Inc.,* 542 F.3d 90, 101 (3d Cir. 2008)(citing 28 U.S.C. § 1927).
[169] *Bowler v. U.S. Immigration and Naturalization Serv.*, 901 F.Supp. 597, 605 (S.D.N.Y. 1995).
9401915/

fees incurred because of such conduct.[170] The determination for § 1927 purposes of the true excess costs, expenses and attorney fees cannot be made until the close of the litigation.[171] Establishing entitlement to § 1927 sanctions may prove difficult because courts generally examine the course of conduct to determine whether it smacks of bad faith.[172] Section 1927 explicitly provides for the award of attorneys' fees and even allows for the recovery of fees-on-fees.[173]

Rule 11 does not require such a protracted scrutiny because it focuses only on a challenged pleading, written motion or paper.[174] A party seeking sanctions under Rule 9011 for a frivolous bankruptcy petition, generally must show that on the filing date there was no reasonable likelihood that the debtor intended to reorganize, no reasonable probability that the debtor would eventually emerge from bankruptcy proceedings, and that under the totality of the circumstances substantial evidence indicates the debtor made a bad faith filing.[175] Rule 9011 is not a fee-shifting provision and does not allow for the award of fees[176] – unless that is the singular method of deterring undesirable conduct. Awarding attorney fees in the Rule 9011 context is a departure from the American rule, and, therefore, will only be done under unusual circumstances such as when a position is taken only for an improper purpose.[177]

Inherent Judicial Power and Section 105 of the Bankruptcy Code

The inherent powers of federal courts are those which "are necessary to the exercise of all others."[178] Courts of justice are universally acknowledged to be vested by their very creation with power to impose silence, respect, and decorum in their presence, and submission to their lawful mandates.[179] These powers are governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.[180] The most prominent of these inherent powers, the contempt sanction, which "a judge must have and exercise in protecting the due and orderly administration of justice and in maintaining the authority and dignity of the Court"[181] – is a power that reaches both conduct before the court and that beyond the court's confines because its underlying concern includes not only the disruption of court proceedings but also disobedience to judicial orders regardless of whether the disobedience interfered with the conduct of trial.[182] The inherent powers must be exercised with restraint and discretion because they are shielded from

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[170] *In re Schaefer Salt Recovery*, 542 F.3d at 102.
[171] *Id.*
[172] *See In re Prudential Ins. Co. Am. Sales Practice Litig.*, 278 F.3d 175; *McKenzie*, 497 Fed.Appx. at 312.
[173] 28 U.S.C. § 1927. *See Norelus v. Denny's, Inc.*, 628 F.3d 1270, 1298 (11th Cir. 2010).
[174] *Id*.
[175] *Carolin Corp. v. Miller*, 886 F.2d 693, 698-702 (4th Cir. 1989); *In re Coffee Cupboard, Inc.*, 119 B.R. 14, 17-18 (E.D.N.Y. 1990); *In re Marion Street P'ship*, 108 B.R. 218, 223 (Bankr. D. Minn. 1989).
[176] *Doering v. Union County*, 857 F.2d (3d Cir. 1988).
[177] *Kirk Capital Corp. v. Bailey*, 16 F.3d 1485 (8th Cir. 1994); *In re McNichols*, 258 B.R. 892, 902-03 (Bankr. N.D. Ill. 2001).
[178] *Roadway Exp., Inc. v. Piper*, 447 U.S. 752, 764 (1980)(quoting *U.S. v Hudson*, 3 L.Ed. 259 (1812)).
[179] *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43 (1991)(citing *Anderson v. Dunn*, 5 L.Ed. 242 (1821)).
[180] *Chambers*, 501 U.S. at 43 (citing *Link v. Wabash R. Co.,* 370 U.S. 626, 630-31 (1962)).
[181] *Roadway*, 447 U.S. at 764 (quoting *Cook v. U.S.*, 267 U.S. 517, 539 (1925)).
[182] *Chambers*, 501 U.S. at 44 (citing *Young v. U.S.*, 481 U.S. 787,798 (1987)).
9401915/

direct democratic controls.[183] In narrowly defined circumstances federal courts have inherent power to assess attorney's fees against counsel.[184]

It is a well-acknowledged inherent power of a court to levy sanctions in response to abusive litigation practices.[185] The American Rule does not apply when the opposing party has acted in bad faith and the Supreme Court recognizes the inherent power of courts to:

> "assess attorneys' fees for the willful disobedience of a court order… as part of the fine to be levied on the [offending litigant] or when the losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons."[186]

The bad faith exception for the award of attorneys' fees is not restricted to cases where the action is filed in bad faith.[187] The inherent power of a court over members of its bar is at least as great as its authority over litigants.[188] Like other sanctions, attorneys' fees should not be assessed lightly without fair notice and an opportunity for a hearing on the record, however, in a proper case, such sanctions fall within the ambit of a court's inherent power.[189]

The court should ordinarily rely on the Rules or statutory authority rather than the inherent power, when there is bad-faith conduct in the course of litigation that could be adequately sanctioned under the Rules or statute.[190] However, there is nothing in other sanctioning mechanisms or case law that warrants concluding that a federal court may not, as a matter of law, resort to its inherent power to impose attorneys' fees as a sanction for bad-faith conduct.[191] This is especially true where the conduct at issue is not covered by one of the other sanctioning provisions, like Rule 11 or § 1927.[192] If in the informed discretion of the court, neither statute nor rules are up to the task of meting out appropriate punishment, then the court may safely rely upon its inherent power.[193] Importantly, a court is not forbidden to sanction bad-faith conduct by means of its inherent power simply because the conduct could also be sanctioned under statute or rule.[194]

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[183] *Roadway*, 447 U.S. at 764 (citing *Gompers v. Bucks Stove & Range, Co.,* 221 U.S. 418, 450-51 (1911), *Green v. U.S.*, 356 U.S. 165, 193-94 (1958)).
[184] *Roadway*, 447 U.S. at 765.
[185] *Id.* (citing *Link v. Wabash R. Co.,* 370 U.S. 626, 632 (1962)).
[186] *Alyeska Pipeline Co.*, 421 U.S. at 258-59 (internal quotations omitted)(citations omitted).
[187] *Roadway*, 447 U.S. at 766. However, bad faith may be found not only in the actions that led to the lawsuit but also in the conduct of the litigation. *Id.* (citing *Hall v. Cole*, 412 U.S. 1, 15 (1973)).
[188] *Id.* (reasoning that if a court may assess counsel fees against a party who has litigated in bad faith, then the court may certainly assess those expenses against counsel who willfully abuse judicial process).
[189] *Id.*
[190] *Chambers*, 501 U.S. at 50.
[191] *Id*. (explaining that where the other mechanisms reach only certain individuals or conduct, the inherent power extends to a full range of litigation abuses and at the very least, must continue to exist to fill in the interstices).
[192] *Id*.
[193] *Id*. (noting that these other mechanisms, alone or together, are no substitute for the inherent power, for that power is both broader and narrower than other means of imposing sanctions).
[194] *Id*.
9401915/

Section 105 of the Bankruptcy Code provides that the Bankruptcy Court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code]" and the Court may "sua sponte tak[e] 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."[195] Sanctions issued under the bankruptcy court's inherent powers requires a finding of bad faith[196] and are appropriate when a party "shows bad faith by delaying or disrupting the litigation."[197] Bankruptcy courts, too, are imbued with inherent powers.[198] The Supreme Court cautions that a court must "exercise caution" when invoking its inherent power and "ordinarily should rely on the Rules."[199] However, if neither statute nor rule is up to the task, the court may safely rely on its inherent power.[200] At times, sanctions are necessary to protect the integrity of the Bankruptcy Code as well as the judicial process.[201]

Recently, the Fourth Circuit affirmed an award of sanctions pursuant to § 105, but remanded for a reconsideration of the amount of the sanctions that the bankruptcy court imposed.[202] There, an insurer violated its disclosure obligations when it failed to notify the debtor that the debtor's counterclaims and an unresolved class action in a different forum were identical and that the insurer's successful pursuit of the class action settlement prevented the debtor from pursuing its counterclaims due to *res judicata*.[203] Although the bankruptcy court properly concluded that sanctions were warranted, the sanctions imposed were disproportionate to the severity of the insurer's misconduct.[204] The Fourth Circuit reversed the dismissal with prejudice of the insurer's adversary action and remanded the matter for a reduction in the dollar figure awarded as sanctions to the debtor, which included attorneys' fees.[205]

Pro Se Litigants

There is a split among the circuit courts on the issue of whether a pro se litigant appearing in court is an "other person admitted to conduct cases" for purposes of § 1927 and, therefore, sanctionable under the statute.[206] Within dicta in a case that did not involve any pro se

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[195] 11 U.S.C. § 105(a).
[196] *Runfola & Assoc. v. Spectrum Reporting II*, 88 F.3d 368, 385 (6th Cir. 1996).
[197] *Chambers*, 501 U.S. at 46 (citing *Hutto v. Finney*, 437 U.S. 678, 689, n. 14 (1978)).
[198] *Mapother & Maphother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 478 (6th Cir. 1996)(citing *Chambers*, 501 U.S. at 44 (1991)).
[199] *Chambers,* 501 U.S. at 50.
[200] *Id.*
[201] *In re Silver*, 46 B.R. 772, 773-74 (Bankr. D. Co. 1985)(citing *In re Perez*, 43 B.R. 530 (Bankr. S.D. Tex. 1984)).
[202] *In re Jemsek Clinic*, 850 F.3d 150, 153 (4th Cir. 2017)(setting aside the sanction of dismissal with prejudice of the insurer's adversary action).
[203] *Id.* at 156 (criticizing the insurer for undermining the integrity of the judicial process in using the court's resources to litigate claims it knows another court has already resolved and for wasting scarce judicial resources).
[204] *Id.* at 158. Procedurally, the bankruptcy court issued proposed findings of fact and conclusions of law, and recommended entry of final judgment; the insurer moved to vacate the bankruptcy court sanctions order, but the district court denied its motion and entered final judgment after adopting the bankruptcy court's proposed findings of fact and conclusions of law. *Id.* at 156.
[205] *Id.* at 158-160.
[206] *Inst. for Motivational Living, Inc. v. Doulos Inst. for Strategic Consulting, Inc.*, 110 Fed.Appx. 283, 286 (3d Cir. 2004).
9401915/

litigant the Supreme Court noted that § 1927 "says nothing about a court's power to assess fees against a party."[207]

The Second Circuit finds that § 1927 does not apply to pro se litigants.[208] The pro se litigant is not a person admitted to conduct cases; the word admitted in this context suggests application to those, who like attorneys, gain approval to appear in a lawyerlike capacity.[209] Parties have a right to appear *pro se*.[210] One basic principles of the American legal system is that the courthouse door is open to everyone, even those who choose to litigate their cases without the assistance of counsel.[211] The Northern District of West Virginia agrees with the Second Circuit and holds that § 1927 does not apply to *pro se* litigants because on its face it only applies to licensed attorneys.[212]

The Ninth and Tenth Circuits find that § 1927 does apply to *pro se* litigants whose behavior evidences bad faith in multiplying the proceedings unreasonably and vexatiously.[213] The Third and Seventh Circuit recognize the existence of a split, but decline to take sides on this circuit split.[214]

Recently, Judge Gross denied a party's request to impose its fees and expenses on a *pro se* litigant incurred during litigation that spanned just short of four years in a matter that traveled from the Delaware Bankruptcy Court to the Third Circuit and back, where all of the *pro se* litigant's initial allegations were time barred by applicable statutes of limitation, and all of the *pro se* litigant's subsequent allegations were barred by the law of the case doctrine, *res judicata*, and collateral estoppel.[215] Although the *pro se* party "litigated beyond reason, the Court does not find that he pursued his case with intent to harass, or to cause delay or a needless increase in the cost of litigation", however "barring [the *pro se* litigant] from future filings without the Court's permission will suffice as an appropriate sanction."[216]

In contrast, a party who is not represented by counsel may be sanctioned for violating Rule 9011.[217] Unrepresented parties who repeatedly file frivolous lawsuits may be prohibited from bringing any more civil actions without benefit of counsel or leave of court.[218]

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207 *Chambers*, 501 U.S. at 48.
208 *Sassower v. Field,* 973 F.2d 75, 80 (2d Cir. 1992).
209 *Id.*
210 *Id.*
211 28 U.S.C. § 1654. *NAACP v. Meese*, 615 F.Supp. 200, 205-06 (D.D.C. 1985).
212 *Balcar v. Bell and Assocs., LLC*, 295 F.Supp.2d 635, 639 (N.D. W.Va. 2003)(citing *Sassower v. Field*, 973 F.2d 75 Cir. 1992)).
213 *Wages v. Internal Revenue Serv.,* 915 F.2d 1230, 1235-36 (9th Cir. 1990); *Poll v. Paulson*, 251 Fed.Appx. 573, 577 (10th Cir. 2007).
214 *Alexander v. U.S.,* 121 F.3d 312, 316 (7th Cir. 1997); *Feingold v. Graff*, 516 Fed.Appx. 223 229, n. 9 (3d Cir. March 22, 2013).
215 *Kennedy. v. Skadden Arps Meager & Flom LLP (In re Radnor Holdings, Corp.)*, 2016 WL 1644499 at * 229 3, 5, 6 (Bankr. D. Del. Apr. 22, 2016).
216 *Id.* at *6. The opinion contained no discussion of whether the court had authority to sanction a *pro se* litigant pursuant to § 1927.
217 *McGahren v. First Citizens Bank & Trust Co. (In re Weiss)*, 111 F.3d 1159 (4th Cir. 1997)(cautioning that Rule 9011 does not exempt *pro se* litigants from its operation; a *pro se* litigant has the same duties under the rule as an attorney).
9401915/

Bankruptcy Court Sanctions Post-Stern v. Marshall

Case law on sanctions in the bankruptcy context contains few references to the impact, if any, of *Stern v. Marshall*.[219] The Bankruptcy Court for the Southern District of Ohio[220] and for the Southern District of Texas[221] hold that bankruptcy courts retain the constitutional authority to impose sanctions for contempt of a court order after *Stern v. Marshall*. The Bankruptcy Court for the District of Columbia highlights that post-*Stern* in deciding whether a bankruptcy court has constitutional authority to exercise statutory authority to decide a core proceeding the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.[222] A motion for sanctions can unquestionably be a proceeding that stems from the bankruptcy itself.[223] The Court also notes that the bankruptcy court's constitutional authority necessarily includes taking steps to enforce its own orders – for example: enforcing the protections of the estate provided for by the automatic stay.[224] The District Court for the District of New Jersey declined a *pro se* litigant's invitation to conduct a *Stern*-inspired plenary review of the bankruptcy court's findings after the bankruptcy court sanctioned the *pro se* litigant for improperly filing a complaint against the bankruptcy trustee of the debtor, who was also the *pro se* litigant's wife, and counsel for the bankruptcy trustee.[225] The District Court found that the *pro se* litigant's request for a *de novo* review was meritless because substantively the challenged sanctions order concerned a core bankruptcy matter where a bankruptcy court may enter final judgment.[226] There, the *pro se* litigant complained about the actions taken by the bankruptcy trustee and his counsel that were based on services provided during the bankruptcy and that would not exist but for the bankruptcy.[227]

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[218] *Kristan v. Turner (In re Kristan)*, 395 B.R. 500 (B.A.P. 1st Cir. 2008); *Schramek v. Jones*, 161 F.R.D. 119 (M.D. Fla. 1995).
[219] 564 U.S. 462 (2012). *See* Robin Russell, *A Survey of Sanctions in Bankruptcy Courts: The Fifth Circuit and Beyond*, 55 S. Tex. L. 583, 599-603 (2014).
[220] *In re Bavelis*, 519 B.R. 707, 708 (Bankr. S.D. Ohio 2014).
[221] *In re Brown*, 511 B.R. 843, 848 (Bankr. S.D. Tex. 2014).
[222] *In re Hardy*, 2017 WL 2491497 at *6 (Bankr. D. D.C. June 8, 2017).
[223] *Id.*
[224] *Id.*
[225] *In re Lin*, 2015 WL 1736500 at * 6 (D. N.J. Apr. 16, 2015)(assuming that the litigant had not waived the argument by consenting to the jurisdiction of the bankruptcy court because he never challenged the authority of the bankruptcy court to enter a final order in the matter).
[226] *Id.* (citing 28 U.S.C. § 157(a), (b)(1).
[227] *Id.* at *7.
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