AMERICAN BANKRUPTCY INSTITUTE

2018 Winter Leadership Conference

Ethics Update: Show Me the Money! How to Get Paid Ethically

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CONCURRENT SESSION

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Ethics 'Deal or No Deal': Bankruptcy Edition

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Ethical issues abound when a committee counsel's own financial interest conflicts with its client's interests.

Ninth Circuit Requires Explicit Objection to Avoid Forfeiting an Appeal

Ostensibly to avoid a conflict with its own client, the attorneys for a creditors' committee forfeited the right to appeal because the firm did not explicitly lodge an objection on its own behalf to a structured dismissal that left the estate with nothing to pay fees.

In an opinion on July 25, the Ninth Circuit expounded on a circuit split the appeals court had widened on May 29 in deciding *Harkey v. Grobstein (In re Point Center Financial Inc.)*, 890 F.3d 1188 (9th Cir. May 29, 2018); rehearing and rehearing *en banc* denied July 12, 2018. To read ABI's discussion of *Point Center*, click here.

The proposed settlement before the Ninth Circuit in the new appeal may have been defective under *Czyzewski v. Jevic Holding Corp*., 137 S. Ct. 973 (2017). To lodge and preserve a *Jevic* objection, counsel for the committee might have been required first to withdraw as attorneys for the creditors, then oppose a transaction that was beneficial to its former clients. Laudably more loyal to unsecured creditors than to its own financial interest, the committee's counsel did not withdraw and did not object on their own behalf, thus losing the ability to appeal, according to the Ninth Circuit.

The New Ninth Circuit Case

A chapter 11 trustee had been appointed for a corporate debtor that owned valuable real estate. The trustee negotiated a so-called structured dismissal where the lender would take title to the property in exchange for secured debt. The lender agreed to carve out $150,000 for distribution to unsecured creditors and another $350,000 to pay the trustee and his professionals.

With dismissal the eventual result, the estate would have nothing to pay other chapter 11 administrative expenses, such as fees earned by counsel for the debtor and the committee. The $350,000 was couched as a surcharge against the lender's collateral under Section 506(c). By skipping over administrative claimants, the $150,000 payment to unsecured creditors had no similar statutory justification.

The bankruptcy court approved the sale before the Supreme Court handed down *Jevic*.

At the hearing to approve the sale, counsel for the debtor and committee filed objections for their clients. However, the firms did not file written objections on their own behalf. At the hearing, both firms stated that they were representing their clients and never said they objected to the sale in their own right as administrative creditors.

After the bankruptcy court approved the sale, the two firms filed notices of appeal on their own. No appeal was filed on behalf of the debtor or the committee. There being no stay pending appeal, the sale closed.

On a first appeal, the district court dismissed the appeal, finding that the two firms did not have standing because they had not appeared and objected on their own in bankruptcy court.

Point Center

While the appeal was pending from the district court's dismissal, the Ninth Circuit decided *Point Center*. On a circuit split, the Ninth Circuit took the side holding that attendance or objection are not prerequisites to being an aggrieved person with standing to appeal. Although the appellant had standing, the Ninth Circuit held in *Point Center* that the appellant's failure to object in bankruptcy court nevertheless could result in waiver or forfeiture. The circuit court remanded the case for the lower courts to determine whether the appellant had forfeited the right to appeal.

Forfeiture Found in the New Case

On the question of whether the firms had forfeited their right to appeal, the opinion for the Ninth Circuit by Sixth Circuit Judge John M. Rogers, sitting by designation, said that neither firm had "explicitly objected" to the sale in bankruptcy court. Ordinarily, he said, the circuit would remand for the lower court to determine whether there was forfeiture.

According to Judge Rogers, the case at hand was "unusual" because the elements of forfeiture had been thoroughly briefed and argued, albeit in the context of "attendance and objection" in bankruptcy court. The record, he said, was therefore "sufficient" for deciding whether there had been forfeiture.

Although the bankruptcy court on its own was concerned with how other administrative claims would be paid, Judge Rogers said there was no "clear indication" at the approval hearing that the two firms were appearing or objecting on their own behalf. He said there was a "total failure to inform the bankruptcy court that they intended to pursue their own interests."

Despite the bankruptcy judge's concern that committee counsel would not be paid, Judge Rogers said that the "contextual evidence . . . is simply not enough to undo what the record makes clear: the law firms were at the hearing and objecting on behalf of their clients."

Avoiding a conflict was also used against the committee's counsel. Like the district court, Judge Rogers doubted that the committee's counsel would have created a conflict with its own client by raising an objection that the money earmarked for unsecured creditors instead should be applied to chapter 11 administrative expenses. The "logical conclusion," Judge Rogers said, was that the firm was appearing and objecting only on behalf of the committee, which believed that the sale price was too low.

For Judge Rogers, the dispositive fact was the lack of "any evidence" that someone appeared or objected in bankruptcy court on behalf of the firms or "otherwise informed the bankruptcy court" that someone was representing the two firms.

Having decided that the firms forfeited their objection, Judge Rogers added belt and suspenders by reaching the merits and finding no clear error by the bankruptcy court in ruling that the trustee and his professionals were entitled to payment under Section 506(c), which allows a surcharge against a lender's collateral. He also ruled that the settlement was in the best interests of unsecured creditors because the trustee had been unsuccessful in selling the property to anyone aside from the secured lender.

The Unresolved *Jevic* Question

Were the committee's counsel oblivious to a conflict with its own clients, the firm could have argued that earmarking for unsecured creditors violated the principle that *Jevic* later ratified.

Here are ethics questions that are left unresolved: (1) During negotiations on the sale, how could the committee's counsel have avoided an ethical problem by negotiating on the firm's own behalf and seeking to redirect some or all of the $150,000 to the payment of administrative expenses?; (2) Since the committee was objecting to the sale price as inadequate, could the firm have objected on *Jevic* grounds without violating an ethical obligation?; (3) After the deal was struck, could the firm have withdrawn as counsel for the creditors' committee before the approval hearing and opposed a settlement that was beneficial to its own former client? (N.B.: The bankruptcy judge, according to Judge Rogers, refused to allow committee counsel to withdraw alongside filing an appeal.); and (4) Did appealing violate an ethical obligation to the committee?

The opinion is *Reed & Hellyer APC v. Laski (In re Wrightwood Guest Ranch LLC)*, 16-56856 (9th Cir. July 25, 2018).

Firm allowed to drop a creditor-client and represent the debtor in chapter 11.

New York Judge Takes a Forgiving View of 'Actual Conflict' in Section 327(c)

Bankruptcy Judge Michael E. Wiles of New York allowed a debtor's counsel to avoid an "actual conflict" by resigning the simultaneous representation of a creditor. Although he invoked the so-called hot potato rule to bar debtor's counsel from becoming adverse to its soon-to-be former client, the judge approved the firm's retention as general bankruptcy counsel for the chapter 11 debtor in possession.

According to Prof. Nancy Rapoport, the July 6 opinion was "Solomonic, given that [the debtor's counsel] was already deeply involved in the case." Prof. Rapoport is the Garman Turner Gordon Professor of Law at the Univ. of Nevada at Las Vegas William S. Boyd School of Law, where she is an expert on legal ethics.

The firm in question had represented Netflix Inc. in several matters over the years. Relativity Media LLC selected the firm to be its bankruptcy counsel. At the time of the filing of the chapter 11 petition, the firm was representing Netflix in a patent litigation in federal district court.

Disputes regarding a contract between Netflix and the debtor predated the chapter 11 filing. In bankruptcy court, Netflix initiated an adversary proceeding to declare that the debtor was in default and determine the amount of damages.

The firm answered the complaint on behalf of the debtor, contended there was no default, and asserted counterclaims. The litigation was not merely a claim dispute, because the debtor intended to assume, assign and sell the Netflix contract to a third-party buyer.

The U.S. Trustee opposed the firm's retention, contending that the firm was disqualified under Section 327(c) as the result of an "actual conflict" resulting from the concurrent representations of Netflix and the debtor. According to Judge Wiles, Netflix only sought to preclude the firm from representing the debtor in matters involving Netflix.

After bankruptcy, the firm evidently moved to withdraw as counsel for Netflix in the patent litigation. Judge Wiles was unsure whether the withdrawal had become effective.

Addressing the firm's disqualification, Judge Wiles said in his bench opinion that the case turned on the interpretation of Section 327(c), which he characterized as meaning that "representing a creditor is not inherently disabling, unless there is an actual conflict of interest."

Judge Wiles said there are two schools of thought about the meaning of "actual conflict." Some courts, he said, employ an objective test that "'excludes any interest or relationship, however slight, that would even faintly color the independence and impartial attitude,'" quoting *In re Granite Partners*, 219 B.R. 22, 33 (Bankr. S.D.N.Y. 1998).

Another decision, also from New York, found no "actual conflict" absent "'an active competition between two interests, in which one interest can only be served at the expense of the other,'" citing *In re Empire State Conglomerates Inc.,* 546 B.R. 306, 315 (Bankr. S.D.N.Y. 2016).

Judge Wiles took the less stringent approach, that the "faint color" test "would automatically disqualify counsel who has a concurrent representation" and "would effectively negate the clear language of Section 327(c)."

Given the firm's impending withdrawal as counsel for Netflix in the patent suit, Judge Wiles concluded that the firm was not disqualified altogether because discharging the general duties thrust on a debtor's counsel would not be adverse to Netflix or impinge on the firm's independence and loyalty.

Finding the firm not disqualified from serving as debtor's counsel, Judge Wiles turned to the question of whether the firm could represent the debtor in matters adverse to Netflix, given that the withdrawal as Netflix's counsel in the patent suit was imminent.

The so-called hot potato rule came into play, which Judge Wiles described as meaning that "counsel who face conflicts based on concurrent representations are not permitted to solve the problem by just dropping one of the two clients." Dropping a "client so that the law firm can be adverse to the client is just as much a breach of that duty of loyalty as if the firm were to become adverse to a current client," he said.

Strictly speaking, Judge Wiles did not rule on whether the firm would be disqualified from becoming adverse to Netflix, although he did say that disqualification from being adverse to Netflix was "likely."

Judge Wiles resolved the disputed retention application by allowing the firm to serve as debtor's bankruptcy counsel as long as the debtor engaged another firm to handle matters involving Netflix.

In the process, Judge Wiles ruled that prospective conflict waivers in the firm's engagement agreements with Netflix did not apply to the case at hand. In that respect, Prof. Rapoport said she agreed "wholeheartedly that these blanket advance waivers, even with sophisticated clients, don't get rid of the issues that Netflix raised."

Judge Wiles did say that the firm was "a bit reckless" in forging ahead "with full awareness of the risks." The judge also said it was "absurd" for the firm to contend that the potential conflict was unforeseeable when the disputes with Netflix "were apparent long ago and prior to the bankruptcy filing."

Prof. Rapoport said she understood the "U.S. Trustee's point that the debtor's counsel knew about Netflix way ahead of time (or should have), which is why the U.S. Trustee tried to disqualify [the firm] completely." In her message to ABI, she said the result was "a close call, but the 'already in too deep' argument wins a lot of the time."

Prof. Rapoport added that she was "was charmed by [Judge Wiles'] writing style. Sardonic, clear, pithy."

The opinion is *In re Relativity Media LLC*, 18-11358 (Bankr. S.D.N.Y. July 6, 2018).

New York bankruptcy judge approves retention of a crisis manger under Section 363(b) who might be disqualified under Section 327(a).

U.S. Trustee Criticized for Dumping the 'Jay Alix Protocol'

A palpably angry bankruptcy judge excoriated the U.S. Trustee in New York for abandoning the so-called Jay Alix Protocol by contending that management consultants hired before bankruptcy cannot fill executive roles after a chapter 11 filing if the firm does not satisfy the strictures of the disinterestedness test.

However, a spokeswoman for the Department of Justice told ABI that the U.S. Trustee Program has not changed its policy.

In her July 2 opinion, Bankruptcy Judge Shelley C. Chapman of Manhattan said that forcing the debtor to jettison crisis managers who had been on board for four years before bankruptcy "would put the success of the entire reorganization at risk," producing "an absurd result, to say the least."

Four years before filing under chapter 11, Nine West Holdings Inc., formerly known as Jones Apparel Group, had hired Alvarez & Marsal North America LLC to provide the company with an interim chief executive and other management personnel. At the time, the company had given no thought to bankruptcy. Judge Chapman said that A&M was to provide "vital management services" and oversee "virtually all aspects of their day-to-day operations."

Before bankruptcy, the chief executive provided by A&M had served as a director for several of the company's subsidiaries. He was not a director of the parent company.

On filing under chapter 11, the company submitted an application to retain A&M under Section 363(b) to continue managing the debtor's daily operations. Section 363(b) gives a debtor in possession the power to use, sell or lease property of the estate.

The U.S. Trustee objected, contending that A&M could only be retained as a professional under Section 327(a). The U.S. Trustee evidently believed that the firm was not disinterested under Section 101(14) and thus did not qualify for retention under Section 327(a), perhaps on account of the CEO's service as a director of subsidiaries.

Creditors up and down the capital structure uniformly opposed the U.S. Trustee and urged the court to approve A&M's retention, Judge Chapman said.

In her 31-page opinion designated for publication, Judge Chapman overruled the U.S. Trustee's objection and approved A&M's retention under Section 363(b) to provide the debtor with an interim CEO and additional managerial personnel.

Judge Chapman focused her opinion on the Jay Alix Protocol, promulgated in the Southern District of New York 14 years ago. It appears on the website of the U.S. Trustee Program. To read the Protocol, click here.

Judge Chapman explained that the Protocol, now national policy, was developed to allow chapter 11 debtors to retain their pre-petition crisis managers by engaging the firms under Section 363(b), rather than under Section 327(a), where they might fail the disinterestedness test. The Protocol has four principal requirements: (1) The firm may serve in only one capacity; (2) the retention must be under Section 363(b), and the retained firm must disclose all relationships to show that it is not otherwise disinterested; (3) the firm must file monthly reports subject to court review; and (4) the persons providing services must be approved by and act under an independent board of directors.

Until the Nine West case, Judge Chapman said the U.S. Trustee had not objected to dozens if not hundreds of retentions over the last 14 years "where such consultants have purportedly followed the Protocol." She said the U.S. Trustee's objection "fails to mention the Protocol at all, let alone A&M's compliance in all material respects with each of its requirements." Instead, she said that the U.S. Trustee "makes the unequivocal statement that . . . '[a] debtor cannot use Section 363(b) to employ a professional person.'"

Judge Chapman said that the purpose of the Protocol "has not been violated by A&M here," because the CEO provided by the firm had not been a director of the parent corporation and thus was not in a position to approve his or his colleagues' pre- or postpetition retention and compensation.

For 14 years, Judge Chapman said, "the crisis and interim management industry has relied on the implicit consent of the U.S. Trustee that such firms can be retained . . . pursuant to Section 363 rather than Section 327 if they meet the requirements of the Protocol." By suddenly objecting in the Nine West case, she said the U.S. Trustee is "implying that there was clear error in every case in which a bankruptcy court has in the past approved" retentions under the Protocol.

"The only explanation" for the "stunning reversal of policy," Judge Chapman said, was the chief executive's "*de minimis* board service; the economic disruption that his departure would

cause is of no concern to the U.S. Trustee." Blocking the firm's engagement, she said, "could . . . put the success of the entire reorganization at risk."

The Protocol, according to Judge Chapman, has allowed the "[e]ngagement of management consultancy firms prior to a bankruptcy filing and their continuing retention postpetition [to enable] companies to achieve business continuity during their darkest hour." If only Section 327 and its strict disinterestedness requirement were available, she said that "previously provided firm personnel . . . must be jettisoned when a company files chapter 11 . . . ."

Having decided that Section 327(a) was not the only pigeonhole, Judge Chapman ended her opinion by finding that A&M was not providing services of a professional because "they could have been performed by existing company personnel." Since the engagement also satisfied the business-judgment rule, she approved the retention under Section 363(b).

In response to an inquiry from ABI, Nicole Navas Oxman, a spokeswoman for the Department of Justice, said in an email that the "U.S. Trustee Program has not changed its legal position as reflected in the Jay Alix Protocol." A "key provision" in the Bankruptcy Code, she said, "requires that professionals not have served on the Board of Directors. As stated in court, we believe that provision was violated in this case."

The opinion is *In re Nine West Holdings Inc.*, 18-10947 (Bankr. S.D.N.Y. July 2, 2018).

Judge Barnes won't allow a chapter 13 debtor's counsel to be paid at the expense of secured creditors.

Chicago Judge Refuses to Confirm a 'Step' Chapter 13 Plan

On an issue where the courts are divided, Bankruptcy Judge Timothy A. Barnes of Chicago decided he will not permit chapter 13 debtors in his court to confirm so-called step plans, where debt service to secured creditors is diminished in the initial months after confirmation to permit accelerated payment of the debtor's counsel's fees.

While not allowing a step plan to put counsel ahead of secured creditors, Judge Barnes did say there "are other, more legitimate, uses of step plans."

The Step Down by Secured Lenders

In the case at bar, plan payments to two non-mortgage secured creditors would have been $166 and $20 in the initial months after confirmation. Later, the payments would rise to $775 and $104 a month, respectively, a difference of almost $700 a month in the initial months.

In his September 14 opinion, Judge Barnes said the $700-a-month difference "would presumably" go to the payment of counsel fees.

Significantly, the lenders did not object to confirmation of the plan, but the chapter 13 trustee did.

Had the lenders objected, the debtor's counsel admitted that he would have amended the plan to eliminate the smaller initial payments, because the plan would not have complied with the requirement in Section 1325(a)(5)(B)(iii)(I) that payments to secured creditors be in "equal monthly amounts."

Andrews and Implied Acceptance

In response to the trustee's objection, the debtor's counsel contended that the trustee lacked standing to raise an objection that was personal to the lenders. On the merits, the debtor's counsel cited the Ninth Circuit for the proposition that a lender's lack of objection amounts to acceptance of the plan, permitting confirmation under Section 1325(a)(5)(A). *Andrews v. Loheit (In re Andrews)*, 49 F.3d 1404 (9th Cir. 1995).

In *Andrews*, the Ninth Circuit held that the bankruptcy court properly denied confirmation of a chapter 13 plan for failure to provide adequate protection. In the process, the appeals court held that the chapter 13 trustee had standing to pursue an objection under Section 1325(a)(5), the same statute governing the case at bar.

In terms of influence on later cases, the holding in *Andrews* has paled in comparison to *dicta*, where the Ninth Circuit said, "In most instances, failure to object translates into acceptance of the plan by the secured creditor." *Id*. at 1409.

Judge Barnes Rejects the *Andrews Dicta*

Judge Barnes attacked the *Andrews dicta* head-on. He characterized the statement as "contrary to the basic principles of legal jurisprudence, the nature of the Bankruptcy Code itself, and the functions of trustees in bankruptcy matters." He said that the *dicta* "is unpersuasive" and that, in any event, Ninth Circuit authority is not binding in the Seventh Circuit.

Equating silence with acceptance in chapter 13 is "wrong on a number of levels," Judge Barnes said. "Even in chapter 11, . . . [creditors'] silence does not equate to affirmative acceptance of a plan. To conclude that in chapter 13, where creditors have even less of a say, that their silence is of greater effect, is more than problematic."

Most persuasively, Judge Barnes built on *United Student Aid Funds Inc. v. Espinosa*, 559 U.S. 260 (2010), where the Supreme Court held that a plan provision contrary to law is nonetheless binding as a final order.

Judge Barnes latched onto the admonition by Justice Thomas that bankruptcy courts have an independent duty to examine a chapter 13 plan and determine whether it meets the confirmation requirements in Section 1325(a). *Id*. at 276-277.

Citing the Tenth Circuit and the Bankruptcy Appellate Panels for the First and Ninth Circuits, Judge Barnes candidly admitted that some courts have continued following the *dicta* in *Andrews* despite *Espinosa*. Others have not, he said, and some courts have never equated silence with acceptance.

Although silence might equal acceptance in chapter 13 in some circumstances, Judge Barnes declined to hold that the secured creditors were deemed to have accepted the plan, especially "in light of the objection from the chapter 13 trustee.

Standing and Good Faith

In the absence of an objection from the lenders, the debtor contended that the trustee lacked standing to lodge an objection on behalf of the secured creditors. Judge Barnes held that the

trustee had standing to object because Section 1302(b)(2)(B) gives the trustee the right to appear and be heard with regard to confirmation.

In addition to finding that the plan failed to comply with Section 1325(a)(5)(B)(iii)(I), Judge Barnes ruled that the plan was not filed in good faith, as required by Section 1325(a)(3). He said that a step plan "is not fundamentally fair." He noted the admission by the debtor's counsel that he would have amended the plan had a lender objected.

Judge Barnes also said that the debtor's counsel had "prioritized [his] desire to be paid over the best interests of the debtor, [his] client." By reducing payments to secured creditors, he said that the plan "could leave the debtor in a worse position than had it not filed bankruptcy."

Finding "no valid bankruptcy purpose" in a step plan, Judge Barnes said it was not filed in good faith and failed confirmation on that score as well.

The opinion is *In re Shelton*, 17-35941 (Bankr. N.D. Ill. Sept. 14, 2018).

Multiple ethical violations may occur with the use of so-called appearance counsel in consumer bankruptcies.

New York Judge Rails Against the Use of 'Appearance Counsel'

It began with a letter to the judge from a chapter 7 debtor complaining that his lawyer was filing documents without his authorization and ended with an August 3 opinion by Bankruptcy Judge Sean H. Lane of Manhattan, where he railed against "the apparently widespread (and increasing) use of appearance counsel in chapter 7 cases."

Judge Lane directed the debtor's attorney to return the $900 fee.

The case was not "unusually difficult," but "difficulties arose almost immediately," Judge Lane said. At the first meeting of creditors under Section 341, the debtor told the panel trustee that his schedules contained incorrect information and that the "petition contained a version of his signature that did not match the signature he affixed to the petition and original schedules," according to the judge.

The debtor's attorney did not attend the original creditors' meeting. Instead, the attorney sent a so-called appearance counsel who was not an employee at the debtor's attorney's firm and "was not at all familiar with the debtor's case," Judge Lane said. At the adjourned creditors' meeting, the debtor's attorney sent a different appearance counsel, who was unaware of "the issues relating to the debtor's filings."

Judge Lane said that the use of appearance counsel "effectively left the debtor without representation at his meeting of creditors."

At the first creditors' meeting, the debtor had said there were mistakes in his schedules. Among other things, the schedules said he had filed bankruptcy eight years earlier when he had not. The schedules listed student loans when there were none. At the second creditors' meeting, the debtor said that his attorney had not amended the schedules correctly.

Judge Lane said that the case "highlights the perils of the use of appearance counsel," who "often know little or nothing about the case." He added that "debtors are usually unaware that an appearance counsel will be representing them."

Judge Lane said that the debtor's counsel violated several provisions in New York's Rules of Professional Responsibility. Among other things, he referred to the requirement that a client

must give informed consent to the scope of representation and that a supervising lawyer must ensure that the supervised lawyer conforms with the Professional Rules.

Applying Section 329(b), Judge Lane said he "easily" concluded that the attorney should be required to repay the $900 fee to the debtor, who had scrimped for eight months to pay the fee in installments before filing. (The disabled debtor was living on monthly income of less than $1,500.) Section 329(b) permits the court to compel repayment of a fee to the debtor if "such compensation exceeds the reasonable value of any such services . . . ."

In the case at hand, the chapter 7 panel trustee urged Judge Lane "to bar the use of appearance counsel in its entirety for 341 meetings." The judge noted that several districts have local rules dealing with appearance counsel.

Judge Lane said that "the entire Court should first consider the wisdom of enacting a local rule to address these issues." In the meantime, the judge said, "the Court will be exceedingly vigilant on this issue." He encouraged the reporting of "any instances where a counsel is failing to meet his or her obligations to a debtor, including, but not limited to, failing to personally appear with the debtor at a 341 meeting."

Ethical problems may remain for the debtor's attorneys. In one footnote, Judge Lane observed that the appearance counsel had not filed statements under Section 329(a) and Bankruptcy Rule 2016(b) disclosing the compensation they were to receive. The debtor's retained attorney had failed to disclose fee-sharing arrangements with the appearance counsel, as required by Section 329(a).

Although he did not make any findings on the issue, Judge Lane said in another footnote that counsel for the debtor may have filed documents without the signature or approval of the debtor. He cited cases for the proposition that affixing a client's electronic signature, when unauthorized, is equivalent to forging the client's signature.

The case also highlights a systemic shortcoming in consumer bankruptcy: It's simply too expensive for many debtors. This debtor, living on $1,500 a month, needed eight months to pay the fee in installments. A fee of $900, in turn, may be inadequate for counsel to appear at multiple creditors' meetings and cover the costs when problems arise.

Congress should consider creating an administrative agency to process bankruptcies at no cost for debtors living in the vicinity of the poverty line. (The foregoing is the opinion of this writer, not of the American Bankruptcy Institute.)

The opinion is *In re D'Arata*, 18-10524 (Bankr. S.D.N.Y. Aug. 3, 2018).

Law firm suspended 90 days for multiple violations of rules of professional conduct.

Sanctions Upheld Against 'Nationwide' Law Firm for Violating Section 526

A district judge in Shreveport, La., upheld sanctions imposed by the bankruptcy court against a self-described "national consumer law firm." The significance of the opinion lies in coercing compliance with state rules of professional conduct and Section 526, regulating "debt relief agencies."

According to the September 24 opinion by District Judge Elizabeth Erny Foote, the parties agreed that the case was "horribly screwed up." Based on findings in other cases, the firm advertises nationally, has non-attorneys perform intake over the telephone, has the client sign a retainer agreement, collects the retainer, and assigns the case to an attorney presumably admitted to practice where the debtor will file bankruptcy.

The shortcomings in the particular debtor's case included initially assigning a local counsel not licensed to practice in Louisiana, later assigning a local attorney located 350 miles from the chapter 7 debtor, never sending the debtor a retainer agreement signed by a lawyer admitted to practice in the state, employing a retainer agreement violating the Louisiana Rules of Professional Conduct, making oral representations that contradicted the written retainer agreement, repeatedly breaking promises to the debtor, and failing to supervise the local attorney properly.

With regard to the local counsel, the bankruptcy judge found that she "consistently" failed to contact the debtor, delayed filing the first petition, negligently allowed the first petition to be dismissed, falsely "indicated" that the debtor had signed the second petition, and allowed the second petition to be dismissed by failing to file required documents.

Judge Foote said the bankruptcy court found "professional negligence on the part of both [the nationwide firm] and [the local counsel], including multiple, continuous violations of the Louisiana Rules of Professional Conduct."

With regard to the nationwide firm, sanctions imposed by the bankruptcy court included disgorgement of fees paid by the debtor, suspension from practice in the district for 90 days, precluding the firm from accepting a retainer until the client had consulted with a lawyer in the district, requiring the retainer agreement to comply with Louisiana's Rules of Professional Conduct, requiring the client's wet signature on all documents filed in court that purport to bear

the client's signature, requiring the client's wet signature on the engagement agreement, precluding the firm from accepting a retainer before the client signs the engagement agreement, and requiring local counsel to obtain a separate PACER login for cases where the attorney is representing a client though the nationwide firm.

The nationwide firm appealed, without success.

The firm argued that the 90-day suspension did not comply with Federal Rule 65(d) governing injunctions. Judge Foote ruled that courts have power to determine who may practice before them independent of Rule 65, based on Fifth Circuit authority. Furthermore, she said, a suspension is not an injunction.

Judge Foote found jurisdiction in the bankruptcy court to impose the sanctions, even though she said that nothing other than the 90-day suspension was a sanction or discipline. She also found no violation of the firm's due process rights.

Judge Foote rejected the notion that the bankruptcy court was required to make specific findings of bad faith based on clear and convincing evidence. With regard to state rules of professional conduct, she said the Fifth Circuit had held that a bad faith finding is not required to exercise authority under local rules.

Findings in the bankruptcy court's order required the nationwide firm's retainer agreement to include the provision of "all services integral to a chapter 7 filing." The firm argued that the order was not clearly defined and violated the specificity requirements under Rule 65.

Judge Foote said that "services integral to a chapter 7 filing" was not "ambiguous" when read in context with the bankruptcy court's opinion.

The firm objected to being characterized by the bankruptcy court as a "referral service" or a "marketer of legal services."

Judge Foote said that the statements were not intended as findings of fact, but if they were, "they are not clearly erroneous."

The opinion is *Law Solutions Chicago LLC v. U.S. Trustee*, 18-216 (W.D. La. Sept. 24, 2018).

Ninth Circuit gives short shrift to a man who continues defying an order to turn over $1.4 million of estate property.

Bankruptcy Court's Contempt Power Includes Incarceration for More Than Three Years

A Ninth Circuit opinion on June 21 means that the bankruptcy court's contempt power includes incarcerating someone for more than three years.

A man defied a turnover order by refusing to cough up $1.4 million belonging to the estate. Until he purged his contempt, Bankruptcy Judge Theodore C. Albert of Santa Ana, Calif., sent him to jail in May 2015. In addition, the bankruptcy judge imposed civil contempt sanctions of $1.4 million and $1,000 a day until the man complied.

The Ninth Circuit in substance upheld all the sanctions in July 2017, including what was then more than two years of incarceration.

Noting that the contemnor had been in jail for 26 months, the circuit court noted, however, that the $1,000 in daily sanctions "at some point" will have ceased to be coercive and would become punitive, requiring release from jail under "due process considerations." *Gharib v. Casey (In re Kenny G Enterprises LLC)*, 692 Fed. Appx. 950, 953 (9th Cir. July 28 2017); rehearing denied May 8, 2018. To read ABI's discussion of the opinion and the denial of rehearing, click here and here.

Rather than seek his freedom from the Supreme Court, the man brought more appeals in district court, where he lost again in December 2017. He argued that his civil incarceration had become criminal because the passage of almost three years in jail had proven coercion to be futile.

Upholding incarceration a second time, the district judge paraphrased the bankruptcy court as describing how the man "defied a court order though a series of shady transfers to various shell companies." With regard to futility, the district judge said that the only evidence in support of the claim was the man's own uncorroborated testimony that he had transferred his "entire net worth to unknown foreign investors" and that his bank accounts had been cleaned out after he was jailed.

The district judge upheld the bankruptcy court's finding that the man's unsupported testimony did not show futility in further imprisonment.

Next, the man argued that incarceration for more than two years by itself made his confinement punitive, noting that he had been jailed longer than the minimum mandatory sentence for obstruction of justice.

The district court turned down the argument, finding no "authority for the proposition that length of confinement, on its own, renders contempt punitive and criminal, as opposed to civil and coercive."

The man appealed once again to the Ninth Circuit and lost again in a nonprecedential, *per curiam* opinion on June 21. The appeals court said that the bankruptcy court "did not clearly err" by finding that the man failed to carry his burden by showing his inability to comply.

Because the man's incarceration for noncompliance "remained coercive at the time of enforcement," the Ninth Circuit rejected his due process argument.

In the new opinion, the appeals court said nothing about sanctions becoming punitive "at some point."

The opinion is *Gharib v. Casey (In re Kenny G. Enterprises LLC)*, 18-55027 (9th Cir. June 21, 2018).

Although the debtor only intended to halt eviction, the Seventh Circuit enhanced the sentence to reflect the claims of all creditors.

Serial Bankruptcy Filings Can Result in a Conviction for Bankruptcy Fraud

Someone who contemplates pulling out all the stops to avoid foreclosure should consider the following: Filing serial bankruptcy petitions to avoid foreclosure can result in a conviction for bankruptcy fraud, as shown by a Seventh Circuit opinion upholding a debtor's four-year prison sentence for filing five chapter 13 petitions.

Here's another warning: The lender isn't the only victim when it comes to sentencing. The debtor's sentence was enhanced to reflect the claims of the debtor's other creditors.

The debtor owned a condominium. She filed five chapter 13 petitions to stop the condominium association from evicting her. The filings followed the same pattern, according to the June 6 opinion by Circuit Judge Joel M. Flaum.

Similar to many individuals who use bankruptcy to forestall foreclosure, the debtor would file a chapter 13 petition, but the bankruptcy court would dismiss when she failed to make plan payments.

There was more to the scheme, though. On one occasion, she temporarily transferred title of the unit to a friend for no consideration. The friend then filed his own chapter 13 petition, which was dismissed for nonpayment.

The government indicted both the debtor and her friend for bankruptcy fraud. The friend took a plea to a misdemeanor and cooperated with the government. After a week-long trial, the jury convicted the debtor on all five counts.

Agreeing with the government, the district court imposed a 10-level enhancement because the victims' losses totaled more than $150,000. The district court imposed an additional two-level enhancement because there were more than 10 victims. Although the guidelines would have meant 51 to 63 months in prison, the district judge was lenient and imposed a 47-month sentence.

The debtor appealed her 47-month prison sentence, although it was below the sentencing guidelines. Judge Flaum upheld the sentence.

The loss calculation was erroneous, the debtor argued, because the condominium association was the only victim and its losses were only $46,000. Judge Flaum disagreed, employing the clear error standard for reviewing the sentence.

Between her first and fifth bankruptcy filings, the claims of the debtor's creditors increased by $193,000, thus justifying the finding that losses exceeded $150,000.

The debtor contended that the district court should have included only the losses incurred by the condominium association because her other debts were not the result of criminal or unlawful conduct. Again, Judge Flaum disagreed.

The debtor's crime was filing "multiple chapter 13 bankruptcy petitions in bad faith." Counting other creditors' claims was not error, Judge Flaum said, because the fraudulent bankruptcy filings automatically precluded the other creditors from collecting their debts.

Judge Flaum also rejected the idea that the condominium association was the only victim. According to the sentencing guidelines, a "victim" is someone who sustains an "actual loss."

Again, the enhancement was not erroneous, Judge Flaum said, because the automatic stay applied to all creditors, not just the condominium association.

The opinion is *U.S. v. Williams*, 17-2244 (7th Cir. June 6, 2018).