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Monday, October 29

9:15 - 10:30 AM | CC Lila Cockrell Theatre

Broken Bench Awards Show: The Best Little Show in Texas

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Broken Bench Awards Show: The Best Little Show in Texas

Hon. Pamela Pepper, U.S. District Court, E.D. Wis.
Prof. Troy McKenzie, New York University School of Law
Prof. Nancy Rapoport, William S. Boyd School of Law, University of Nevada

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CIRCUIT SPLITS AND BACKFLIPS*

I. Can Arbitration be Compelled on a Bankruptcy Issue?

***Anderson v. Credit One Bank, N.A.* (*In re Anderson*), 884 F.3d 382 (2d Cir. 2018), *petition for cert. filed,* (U.S. June 8, 2018) (No. 17-1652)**

Orrin Anderson opened a credit card with Credit One Bank. The credit card agreement contained an arbitration clause which permitted either party to force the other into "mandatory, binding arbitration" if a dispute arose. Anderson defaulted and Credit One sold the account to a third-party debt buyer. It also reported to the major credit reporting agencies that Anderson's debt had been "charged off," meaning that the bank had changed the status of the debt from a receivable to a loss in its accounting books.

Anderson filed a Chapter 7 petition and received his discharge, including the debt owed to Credit One. Anderson then called Credit One, requesting that it report to the credit reporting agencies that the debt had been discharged, rather than "charged off." Credit One refused.

Anderson reopened his bankruptcy case and filed a class-action complaint against Credit One, alleging that it had adopted a policy of refusing to update credit information for discharged debts because it enhanced the price that a debt purchaser would pay for the discharged debt. Anderson also alleged that Credit One urged debtors who called for the change in credit reporting to pay the debt in order to remove the "charged off" status and improve their credit scores, in violation of the discharge injunction. Credit One's refusal to change the reporting status allegedly adversely effected the debtors' ability to obtain postpetition credit, housing, and employment.

Credit One moved to remove the dispute from the bankruptcy court to binding arbitration pursuant to the arbitration clause in the credit card agreements. The bankruptcy court denied the motion, and the district court affirmed. Credit One appealed to the Second Circuit.

The Second Circuit set out a two-step procedure for determining whether a dispute in a bankruptcy case is subject to arbitration. First, the court must determine whether the dispute is core or non-core. If it is non-core, the analysis ends and the bankruptcy court must stay the litigation in favor of arbitration. If the dispute is core, the court moves to the second step, which involves engaging in a "particularized inquiry into the nature of the claim and the facts of the specific bankruptcy." If the arbitration would create a "severe conflict" with the purposes of the Bankruptcy Code, the court has discretion to conclude

* Materials prepared by Erica M. Garrett, Law Clerk to Chief Bankruptcy Judge Cynthia A. Norton, Western District of Missouri.

that "Congress intended to override the Arbitration Act's general policy favoring the enforcement of arbitration agreement."

The parties agreed that this was a core proceeding and so the Second Circuit proceeded to the second step. Although the Federal Arbitration Act, 9 U.S.C. § 1 *et seq*., "establishes a federal policy favoring arbitration," that preference is not absolute, the court said. The burden is on the party opposing arbitration to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue. That intent may be discerned through the text or legislative history, "or from an inherent conflict between arbitration and the statute's underlying purposes."

Emphasizing that violations of the discharge injunction damage the foundation on which a debtor's "fresh start" is built, the Second Circuit held that arbitration of a claim based on an alleged violation of § 524 of the Bankruptcy Code would "seriously jeopardize a particular core bankruptcy proceeding." That was because: 1) the discharge injunction is integral to the bankruptcy court's ability to provide debtors with the fresh start, which is the very purpose of the Code; 2) Anderson's claim regarded an ongoing bankruptcy matter that required continuing court supervision; and 3) the equitable powers of the bankruptcy court to enforce its own injunctions are central to the structure of the Code. Moreover, the fact that Anderson's claim came in the form of a putative class action did not undermine this conclusion, the Circuit held.

Having concluded that there was an inherent conflict between arbitration of Anderson's claim and the Bankruptcy Code, the Circuit then had to analyze whether the bankruptcy court had abused its discretion in declining to enforce the arbitration clause. Because the bankruptcy court had properly considered the conflicting policies in accordance with the law, the bankruptcy court did not abuse its discretion by denying Credit One's motion to compel arbitration in this case.

In its Petition for Certiorari, Credit One argues that the *Anderson* decision is squarely at odds with the Supreme Court's recent decision in *Epic Systems Corp. v. Lewis*, 138 S.Ct. 1612 (2018) (holding that the National Labor Relations Act did not reflect a clearly expressed and manifest congressional intent to displace the Federal Arbitration Act and outlaw class and collective action waivers), and asks that the Supreme Court clarify the confusion that has come from the courts of appeals which, according to Credit One, "have taken a range of divergent approaches to determining the arbitrability of claims arising in bankruptcy – none of which reflects a straightforward application of [the Supreme Court's] precedent."

For example, in *In re Mintze*, 434 F.3d 222, 231 (3d Cir. 2006), the Third Circuit held that, regardless of whether the proceeding is core, where an applicable arbitration clause exists, a bankruptcy court lacks the authority and discretion to deny its enforcement, "*unless* the party opposing arbitration can establish congressional intent . . . to preclude waiver of judicial remedies for the statutory rights at issue." Moreover, the Third Circuit held, there is no "inherent conflict" between the Bankruptcy Code and arbitration of federal claims that were not "created by the Bankruptcy Code."

In *In re National Gypsum Co.*, 118 F.3d 1056 (5th Cir. 1997), the Fifth Circuit held that a debtor's action to enforce the discharge injunction – a core proceeding – was not subject to arbitration because it raised no issues under the pre-bankruptcy contract which contained the arbitration clause but was, instead, "restricted entirely to the adjudication of federal bankruptcy issues."

The Fourth and Ninth Circuit hold that, with respect to core bankruptcy proceedings, arbitration is inconsistent with bankruptcy's centralized decision making and improperly defers decisions concerning the debtor-creditor relationship to an arbitrator rather than bankruptcy judges. *In re White Mountain Mining Co.*, 403 F.3d 164 (4th Cir. 2005); *In re Thorpe Insulation Co*, 671 F.3d 1011 (9th Cir. 2012); *In re EPD Inv. Co.*, 821 F.3d 1146 (9th Cir. 2016) (holding that arbitration agreement was unenforceable as to claims of fraudulent conveyance, subordination, and disallowance).

II. Rejection of Intellectual Property Under § 365(n)

***In re Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018), *petition for cert. filed,* (U.S. June 12, 2018) (17-1657)**

Debtor Tempnology, LLC made specialized products such as towels, socks, and headbands, which were designed to remain cool, even when used during exercise. The products were marketed under the "Coolcore" and "Dr. Cool" brands. An intellectual property portfolio, consisting of two issued patents, four pending patents, research studies, and a multitude of registered and pending trademarks, supported the products.

In 2012, the debtor and Mission Product Holdings, Inc. entered into a Co-Marketing and Distribution Agreement. The agreement gave Mission three categories of rights:

First, the debtor granted Mission distribution rights to certain of its products – called "Cooling Accessories" – within the United States. These Cooling Accessories were divided into two categories: (i) "Exclusive," which consisted of various items the debtor agreed it would not license or sell to anyone other than Mission during the term; and (ii) "Non-Exclusive," which consisted of various items for which the debtor reserved for itself the "right to sell . . . to vertically integrated companies as well as customers that are not Sports Distributors or retailers in the Sporting Channel."

Second, the debtor granted Mission a "non-exclusive, irrevocable, royalty-free, fully paid-up, perpetual, worldwide, fully-transferable license . . . to sublicense (through multiple tiers), use, reproduce, modify, and create derivative work based on and otherwise freely exploit" debtor's products—including Cooling Accessories—and its intellectual property. This irrevocable license, however, expressly excluded any rights to the debtor's trademarks.

The third category consisted of the debtor's trademarks. The parties' agreement granted Mission a "nonexclusive, non-transferable, limited license . . . to use [the debtor's] trademark and logo" for the limited purpose of performing its obligations and exercising its rights under the agreement. However, the license forbade Mission from using the trademarks in a manner that was disparaging, inaccurate, or otherwise inconsistent with the terms of the agreement. The agreement required Mission to comply with any written trademark guidelines and gave the debtor the right to review and approve of all uses of its marks, except for certain pre-approved uses.

The agreement permitted either party to terminate it without cause and, on June 30, 2014, Mission exercised this option, triggering a "wind-down period" of two years. The debtor, in turn, issued a notice of immediate termination for cause on July 22, 2014, claiming that Mission's hiring of the debtor's former president violated the agreement's restrictive covenants. Pursuant to the agreement, Mission's challenge to the debtor's immediate termination for cause went to arbitration. The arbitrator ruled in favor of Mission, and, thus, the agreement remained in effect until the expiration of the wind-down period, meaning that Mission was contractually entitled to retain its distribution and trademark rights until July 1, 2016, and its nonexclusive intellectual property rights in perpetuity.

In the meantime, the debtor filed a Chapter 11 petition on September 1, 2015. The following day, it moved to reject seventeen of its contracts, including the agreement with Mission, pursuant to § 365(a).

Generally speaking, § 365(a) permits a debtor-in-possession to reject any executory contract that, in the debtor's business judgment, is not beneficial to the company. The debtor argued that Mission's exclusive distribution rights under the agreement caused it to file bankruptcy in the first place, and would prevent it from reorganizing. Mission objected, arguing that § 365(n)(1)(B), which provides that if the trustee (or DIP) rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee may elect to retain its rights to the intellectual property as such rights existed immediately before the bankruptcy commenced for the duration of the contract. Section 101(35A) defines "intellectual property" as meaning one of six enumerated categories, none of which include trademarks.

The bankruptcy court granted the motion to reject and held that § 365(n) did not cover either the trademark license or the exclusive distribution rights. The BAP agreed with respect to the exclusive distribution rights and also agreed that § 365(n) failed to protect Mission's rights to the trademarks, but reversed as to the effect of that conclusion – holding that Mission's rights with respect to the trademarks were not necessarily eliminated by the rejection. A split panel of the First Circuit disagreed with the BAP and affirmed the bankruptcy court's decision.

With regard to the exclusive distribution rights, the First Circuit held that the language in § 365(n)(1)(B) – that Mission be allowed "to retain its rights (including a right to enforce any exclusivity provision of such contract . . .) under such contract . . . to such intellectual property" – protected, for example an exclusive license to use a patent, but did not protect an exclusive right to sell a product merely because that right appeared in a contract that also contained a license to use intellectual property.

With regard to the trademarks, the Court concluded that § 365(n) does not apply. In so holding, the majority of the First Circuit panel disagreed with the Seventh Circuit's decision in *Sunbeam Prods., Inc. v. Chicago American Manuf.*, 686 F.3d 372 (7th Cir. 2012). According to the First Circuit, *Sunbeam* rested on the unstated premise that it was possible to free a debtor from any continuing performance obligations under a trademark license even while preserving the licensee's right to use the trademark. However, the First Circuit said, "[c]areful examination undercuts that premise because the effective licensing of a trademark requires that the trademark owner – here Debtor, followed by any purchaser of its assets – monitor and exercise control over the quality of the goods sold to the public under cover of the trademark." The dissenting panel member would have followed *Sunbeam* (and would have affirmed the BAP) in finding that Mission's right to use the trademark did not vaporize as a result of the rejection.

See also Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985) (holding, prior to the addition of § 365(n) to the Code, that the term "executory contract" in § 365(a) encompassed intellectual property licenses and that, under § 365(g), the effect of rejection was to terminate an intellectual property license; Congress thereafter enacted § 365(n), apparently to deal with the *Lubrizol* holding).

III. Does the Absolute Priority Rule Apply in Individual Chapter 11 Cases?

***Zachary v. California Bank & Trust*, 811 F.3d 1191 (9th Cir. 2016)**

Currently, all five circuits to consider the issue hold that the absolute priority rule under § 1129(b)(2)(B)(ii) continues to apply in individual Chapter 11 cases, despite BAPCPA amendments apparently intended to deal with that question. Those include the Fourth, Fifth, Sixth and Tenth Circuits. *Ice House America, LLC v. Cardin* (*In re Cardin*), 751 F.3d 734 (6th Cir. 2014); *In re Lively*, 717 F.3d at 406 (5th Cir. 2013); *Dill Oil Co., LLC. v. Stephens* (*In re Stephens*), 704 F.3d 1279 (10th Cir. 2013); *In re Maharaj*, 681 F.3d 558 (4th Cir. 2012).

In *Zachary v. California Bank & Trust*, 811 F.3d 1191 (9th Cir. 2016), the Ninth Circuit joined those circuits. As *Zachary* pointed out, however, there still remains a significant split of authority in the lower courts following the enactment of BAPCPA, with two conflicting positions emerging: the "broad view" and the "narrow view." Courts adopting the broad view hold that:

> by including in § 1129(b)(2)(B)(ii) a cross-reference to § 1115 (which in turn references § 541, the provision that defines the property of a bankruptcy estate), Congress intended to include the entirety of the bankruptcy estate as property that the individual debtor may retain, thus effectively abrogating the absolute priority rule in Chapter 11 for individual debtors.

Maharaj, 681 F.3d at 563. "Under this view, an individual debtor is entitled to retain most prepetition and postpetition property and nonetheless cram down a plan over an unsecured creditor's objection." *Zachary*, 811 F.3d at 1196.

Courts adopting the narrow view hold that "the BAPCPA amendments merely have the effect of allowing individual Chapter 11 debtors to retain property and earnings acquired after the commencement of the case that would otherwise be excluded under § 541(a)(6) and (7)." *Maharaj*, 681 F.3d at 563. "Under this view, an individual debtor may not cram down a plan that would permit the debtor to retain prepetition property that is not excluded from the estate by § 541, but may cram down a plan that permits the debtor to retain only postpetition property." *Zachary*, 811 F.3d at 1196.

Prior to the Ninth Circuit's *Zachary* decision, the Ninth Circuit BAP had adopted the broad view in *In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir. 2012), holding that BAPCPA eliminated the absolute priority rule in individual Chapter 11 cases. In a relatively-rare move, bankruptcy judge Thomas C. Holman of Sacramento, California disagreed with the BAP's *Friedman* decision, holding that the absolute priority rule remains. Judge Holman also certified the case for direct appeal to the Ninth Circuit.

The Ninth Circuit Court of Appeals vindicated Judge Holman and became the fifth circuit to conclude that "the BAPCPA amendments do not impliedly repeal the long-standing absolute priority rule." *Zachary*, 811 F.3d at 1199.

There remain a few lower courts who have said the absolute priority rule does not apply post-BAPCPA, but most have been abrogated by the relevant circuit decision or have disagreeing BAP opinions in their relevant circuit. *See, e.g.*, *In re O'Neal*, 490 B.R. 837 (Bankr. W.D. Ark. 2013) (holding that the absolute priority rule does not apply in individual Chapter 11 cases post-BAPCPA); *In re Woodward*, 537 B.R. 893 (B.A.P. 8th Cir. 2015) (holding that the absolute priority rule applied in individual Chapter 11 case).

SUPREME COURT BANKRUPTCY DIGEST*

I. *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018)

A. Introduction

Section 546(e) of the Bankruptcy Code provides a safe harbor from avoidance for certain otherwise avoidable transfers "made by or to (or for the benefit of)" financial institutions and other types of entities listed in the statute. 11 U.S.C. § 546(e). Earlier this year, the Supreme Court unanimously held that if the transfer to be avoided was not made *by, to, or for the benefit of* entities described in § 546(e), then the transfer is not shielded from avoidance even if it was made *through* one or more of those entities. *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018). *Merit Management* affirmed a decision of the Seventh Circuit, which had joined the Eleventh Circuit as the only other court of appeals to hold that § 546(e) does not protect transfers made to non-covered entities through covered intermediaries. *See FTI Consulting, Inc. v. Merit Mgmt. Grp., LP*, 830 F.3d 690 (7th Cir. 2016); *In re Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996). *Merit Management* also effectively overruled contrary decisions of the Second, Third, Sixth, Eighth and Tenth Circuits, which had held that the safe harbor applies even if the entity covered by the statute was participating in the transaction only as an intermediary. *See In re Quebecor World (USA) Inc.*, 719 F.3d 94 (2d Cir. 2013); *In re Resorts Int'l, Inc.*, 181 F.3d 505 (3d Cir. 1999); *In re QSI Holdings, Inc.*, 571 F.3d 545 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981 (8th Cir. 2009); *In re Kaiser Steel Corp.*, 952 F.2d 1230 (10th Cir. 1991).

B. Background

This case came to the Supreme Court "from the world of competitive harness racing." *Merit Mgmt.*, 138 S. Ct. at 890. Several years before commencing its Chapter 11 case, Valley View Downs, LP was competing with another company, Bedford Downs Management Corporation, for the last available harness-racing license in Pennsylvania, which was required (along with a separate gaming license) to operate a racetrack casino, or "racino," in the Commonwealth. *Id.* The competition between Valley View and Bedford Downs ended when the two companies entered into an agreement under which Valley View would purchase all of Bedford Downs' stock for $55 million if Valley View obtained the harness-racing license. After Valley View acquired the license, a branch of Credit Suisse financed the stock purchase price by wiring $55 million to a third-party escrow agent, Citizens Bank of Pennsylvania. Citizens Bank made disbursements to the shareholders of Bedford Downs in exchange for their stock, including two disbursements in the aggregate amount of $16.5 million to one of the shareholders, Merit Management Group, LP. "Notably, the closing statement for the transaction reflected Valley View as

* Materials prepared by Brian L. Gifford and Laura F. Atack, law clerks to the Hon. John E. Hoffman, Jr., with special help from Jake Denham (Ohio State '20), judicial extern.

the 'Buyer,' the Bedford Downs shareholders as the 'Sellers,' and $55 million as the 'Purchase Price.'" *Id.* at 891.

After Valley View failed to secure the separate gaming license required to operate a racino, it commenced a Chapter 11 case and ultimately obtained confirmation of a Chapter 11 plan. In its capacity as the trustee of a litigation trust established by the plan, FTI Consulting, Inc. commenced a lawsuit in the district court, seeking to avoid the transfer of $16.5 million from Valley View to Merit as a constructive fraudulent transfer. According to FTI, "Valley View was insolvent when it purchased Bedford Downs and 'significantly overpaid' for the Bedford Downs stock." *Id.* Merit moved for judgment on the pleadings under Rule 12(c) of the Federal Rules of Civil Procedure and in so doing relied on § 546(e), which states:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment . . . or settlement payment . . . made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, . . . commodity contract, . . . or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e).

In short, § 546(e) provides a safe harbor protecting certain transfers—including constructive (but not actual) fraudulent transfers—if two requirements are met. First, the transfer sought to be avoided must be a margin payment, a settlement payment, or a transfer in connection with a securities contract, commodity contract, or forward contract. Second, the transfer must be made by, to, or for the benefit of a financial institution or other protected entity. Merit argued that the safe harbor applied because it had received a transfer made by or to or for the benefit of Credit Suisse and Citizens Bank, which undisputedly were financial institutions covered by § 546(e). *Merit Mgmt.*, 138 S. Ct. at 891–92. The district court agreed, granting Merit's Rule 12(c) motion on the basis that it was entitled to the protection of the safe harbor because Credit Suisse and Citizens Bank were financial institutions covered by § 546(e) and because those protected entities transferred or received funds in connection with a "settlement payment" or "securities contract." *FTI Consulting, Inc. v. Merit Mgmt. Grp., LP*, 541 B.R. 850, 858 (N.D. Ill. 2015). The Seventh Circuit reversed, holding that the § 546(e) safe harbor does not shield otherwise avoidable transfers that are made through financial institutions or other protected entities if those entities are serving only as intermediaries. *See Merit Mgmt.*, 830 F.3d at 691.

The Supreme Court granted certiorari to resolve the conflict among the circuits and to "determine how the safe harbor operates in the context of a transfer that was executed via one or more transactions, *e.g.*, a transfer from A → D that was executed via B and C as intermediaries, such that the component parts of the transfer include A → B → C → D." *Merit Mgmt.*, 138 S. Ct. at 888. As the Supreme Court put it:

> If a trustee seeks to avoid the A → D transfer, and the § 546(e) safe harbor is invoked as a defense, . . . [w]hen determining whether the § 546(e) securities safe harbor saves the transfer from avoidance, should courts look to the transfer that the trustee seeks to avoid (*i.e.*, A → D) to determine whether that transfer meets the safe-harbor criteria, or should courts look also to any component parts of the overarching transfer (*i.e.*, A → B → C → D)?

Id.

C. The Supreme Court's Decision

In a unanimous decision authored by Justice Sotomayor, the Supreme Court began its analysis with a review of the text of § 546(e). Section 546(e)'s opening clause states that it applies "notwithstanding" certain of the Bankruptcy Code's avoidance provisions. This clause indicates that § 546(e) "operates as an exception to the avoiding powers afforded to the trustee" and makes clear that the exception applies to "the transfer that the trustee seeks to avoid as an exercise of those powers." *Id.* at 893. Support for this reading also appears in § 546(e)'s "very last clause" ("except under section 548(a)(1)(A) of this title"), which creates "an exception to the exception" for actually fraudulent transfers. *Id.* "By referring back to a specific type of transfer that falls within the avoiding power, Congress signaled that the exception [to avoidance provided by § 546(e)] applies to the overarching transfer that the trustee seeks to avoid, not any component part of that transfer." *Id.* While it acknowledged that "section headings cannot limit the plain meaning of a statutory text," the Court pointed out that § 546's section heading—"Limitations on avoiding powers"—"demonstrates the close connection between the transfer that the trustee seeks to avoid and the transfer that is exempted from that avoiding power pursuant to the safe harbor." *Id.* Continuing its analysis of the statutory text, the Court noted that § 546(e) provides that "the trustee may not avoid" certain transfers, thereby pointing back to the transfers that "the trustee may avoid." *Id.* at 893–94. The Court completed its textual analysis of § 546(e) by observing that the subsection protects "'a transfer that *is*' either a 'settlement payment' or made 'in connection with a securities contract,'"—"[n]ot a transfer that involves [and] [n]ot a transfer that comprises" them. *Id.* at 894. Based on this statutory analysis, the Court concluded that "the statutory language and the context in which it is used all point to the transfer that the trustee seeks to avoid as the relevant transfer for consideration of the § 546(e) safe-harbor criteria." *Id.*

According to the Supreme Court, this conclusion is bolstered by the statutory structure of the Bankruptcy Code. Given that the Code "creates both a system for avoiding transfers and a safe harbor from avoidance" and that "logically these are two sides of the same coin" (quoting 830 F.3d at 694), the Court found that "it is only logical to view the pertinent transfer under § 546(e) as the same transfer that the trustee seeks to avoid pursuant to one of its avoiding powers." *Id.* Although a defendant in an avoidance action "is free to argue that the trustee failed to properly identify an avoidable transfer under the Code," Merit did not argue that FTI had improperly identified the transfer of $16.5 million by Valley View to Merit as the transfer to be avoided. *Id.* at 894–95. Rather, Merit contended that the component parts of the entire transaction could not be ignored. But "[i]f a trustee properly identifies an avoidable transfer . . . the court has no reason to examine the relevance of component parts when considering a limit to the avoiding power, where that limit is defined by reference to an otherwise avoidable transfer, as is the case with § 546(e)." *Id.* Thus, the transfers by Credit Suisse and Citizens Bank were "simply irrelevant to the analysis under § 546(e)." *Id.* at 895.

In reaching this conclusion, the Supreme Court rejected two of Merit's textual arguments. Merit first argued that a 2006 amendment adding the parenthetical "or for the benefit of" to § 546(e) abrogated *Munford,* in which the Eleventh Circuit had held that § 546(e) did not apply to transfers involving financial institutions acting only as intermediaries. According to Merit, the amendment abrogated *Munford* by clarifying that it is not necessary for a financial institution to have a beneficial interest in the transfer in order for the safe harbor to apply, but that it instead is sufficient for the transfer to be "by or to" a financial institution (or other protected entity). Finding nothing in the text or legislative history to suggest that Congress intended the addition of the parenthetical to abrogate *Munford*, the Supreme Court explained that there is a "simpler explanation for Congress' addition of this language that is rooted in the text of the statute as a whole and consistent with the interpretation of § 546(e) the Court adopts." *Id.* As the Court pointed out, several sections of the Bankruptcy Code provide for the avoidance of transfers made to "or for the benefit of" certain entities, and by adding the same language to § 546(e) Congress intended to make "the scope of the safe harbor match[] the scope of the avoiding powers." *Id.* As a result of the amendment, for example, it is clear that "a trustee seeking to avoid a preferential transfer under § 547 that was made 'for the benefit of a creditor,' where that creditor is a covered entity under § 546(e), cannot now escape application of the § 546(e) safe harbor just because the transfer was not 'made by or to' that entity." *Id.*

Merit also relied on § 546(e)'s inclusion of securities clearing agencies as protected entities. In order to avoid superfluity, Merit argued, the statute must be interpreted to apply to transactions involving intermediaries, because securities clearing agencies are defined in the Bankruptcy Code by reference to the Securities Exchange Act of 1934 to include "intermediar[ies] in payments or deliveries made in connection with securities transactions." *Id.* at 896. But the Court also rejected this argument, holding that "[i]f the transfer that the trustee seeks to avoid was made 'by' or 'to' a securities clearing agency . . . then § 546(e) will bar avoidance, and it will do so without regard to whether the entity acted only as an intermediary." *Id.* Likewise, § 546(e) would "bar avoidance if the transfer was made 'for the benefit of' that securities clearing agency, even if it was not made 'by' or 'to' that entity." *Id.* Thus, the Court found that its interpretation of § 546(e) did not result in any superfluity.

Finally, Merit argued that its approach to interpreting § 546(e) furthered what it saw as the statute's purpose—advancing the interests of parties in the finality of securities and commodities transactions. *Id.* In this regard, Merit contended that "[t]here is no reason to believe that Congress was troubled by the possibility that transfers *by* an industry hub could be unwound but yet was unconcerned about trustees' pursuit of transfers made *through* industry hubs." *Id.* The Court, however, found that this purported purpose was inconsistent with the plain language of § 546(e), which "saves from avoidance . . . transactions 'made by or to (or for the benefit of)' covered entities," while "[t]ransfers 'through' a covered entity . . . appear nowhere in the statute." *Id.* at 897.

For all these reasons, the Supreme Court concluded that "the relevant transfer for purposes of the § 546(e) safe harbor is the same transfer that the trustee seeks to avoid pursuant to its substantive avoiding powers." *Id.* The Court then found that this approach to the statute "yields a straightforward result. FTI, the trustee, sought to avoid the $16.5 million Valley View–to–Merit transfer" and "not . . . the component transactions by which that overarching transfer was executed. . . . Because the parties do not contend that either Valley View or Merit is a 'financial institution' or other covered entity, the transfer falls outside of the § 546(e) safe harbor." *Id.*

Given the Court's decision in *Merit Management*, certain transfers that would have been protected by the safe harbor under the law of the Second, Third, Sixth, Eighth, and Tenth Circuits will now be subject to avoidance. Representatives of bankruptcy estates will rely on the decision as a basis to initiate avoidance actions that they might not previously have brought. Conversely, defendants that are not entities protected by § 546(e) will have an incentive to argue that the plaintiffs bringing those actions have improperly defined the transfer to be avoided.

II. *U.S. Bank Nat'l Ass'n v. Vill. at Lakeridge, LLC*, 138 S. Ct. 960 (2018)

A. Introduction

Several sections of the Bankruptcy Code use the term "insider," which is defined by the Code in such a way that it "includes" certain enumerated categories of persons. 11 U.S.C. § 101(31). Recognizing that the use of the word "includes" signifies that the statutory list is not exclusive, courts have developed various tests for determining whether a person is a "non-statutory insider" of a debtor. Under the Ninth Circuit's test, a person is a non-statutory insider if: "(1) the closeness of [the person's] relationship with the debtor is comparable to that of the enumerated insider classifications in § 101(31), and (2) the relevant transaction is negotiated at less than arm's length." *U.S. Bank N.A. v. Vill. at Lakeridge, LLC (In re Vill. at Lakeridge, LLC)*, 814 F.3d 993, 1001 (9th Cir. 2016). The bankruptcy court's ruling regarding the arm's-length nature of the transaction was appealed in *Lakeridge*, and one issue that arose was whether the *de novo* or clear-error standard of review applied. Affirming the Ninth Circuit's judgment, the Supreme Court unanimously held that the clear-error standard is the appropriate standard of review for determining whether a person transacted with the debtor at arm's length. *U.S. Bank Nat'l Ass'n v. Vill. at Lakeridge, LLC*, 138 S. Ct. 960 (2018).

B. Background

In its Chapter 11 case, The Village at Lakeridge, LLC sought to restructure debt it owed to two creditors: (1) U.S. Bank, which held a fully secured claim in the approximate amount of $10 million; and (2) MBP Equity Partners, LLC, the sole member of Lakeridge, which held a $2.76 million unsecured claim. Lakeridge proposed a reorganization plan that placed the two creditors in separate classes, impairing both. In order to obtain confirmation of a plan with an impaired class of claims, at least one impaired class needed to accept the plan, "determined without including any acceptance of the plan by an insider." 11 U.S.C. § 1129(a)(10).

In light of § 1129(a)(10), both of Lakeridge's creditors presented obstacles to confirmation: U.S. Bank was not going to accept the plan, and MBP, which controlled Lakeridge, undisputedly was a statutory insider. 11 U.S.C. § 101(31)(B)(iii). So Kathleen Bartlett, a member of MBP's board and an officer of Lakeridge, caused MBP to transfer its $2.76 million claim for $5,000 to Robert Rabkin, a third party with whom she had a romantic relationship. Rabkin's acceptance of the plan would satisfy § 1129(a)(10) as long as he was not an insider. U.S. Bank moved to disallow Rabkin's claim for purposes of voting on the plan, arguing, among other things, that Rabkin was a non-statutory insider of Lakeridge. The bankruptcy court found that Rabkin was not a non-statutory insider, a finding affirmed by the bankruptcy appellate panel and by the Ninth Circuit under the clear-error standard of review. Although the case presented other questions as well, the Supreme Court granted certiorari to decide one issue: "Whether the Ninth Circuit was right to review for clear error (rather than *de novo*) the Bankruptcy Court's determination that Rabkin does not qualify as a non-statutory insider because he purchased MBP's claim in an arm's-length transaction." *Lakeridge*, 138 S. Ct. at 965.

C. The Supreme Court's Decision

Writing for the unanimous Court, Justice Kagan began her analysis by describing the three legal and factual issues that courts must address in order to decide whether someone is a non-statutory insider. First, courts must decide which test to use. The bankruptcy court had used the test required by Ninth Circuit law, and the Supreme Court declined U.S. Bank's request to "address the correctness of [that] legal test." *Id.* Instead, the Court took "that test as a given in deciding the standard-of-review issue. . . ." *Id.* at 965–66. Second, the trial court must make findings that are relevant to the test used. For example, under the Ninth Circuit test, "the facts found may relate to the attributes of a particular relationship or the circumstances and terms of a prior transaction." *Id.* at 966. Those factual findings undisputedly are "reviewable only for clear error." *Id.* Third, the bankruptcy court must "determine whether the historical facts found satisfy the legal test chosen for conferring non-statutory insider status." *Id.*

As the Court noted, it was at the third step—resolving the "so-called 'mixed question' of law and fact at the heart of [the] case"—that the parties disagreed as to the appropriate standard of review. *Id.* U.S. Bank argued that, because the Ninth Circuit's test was "very general," the bankruptcy court could not merely apply the law to the facts, but instead would need to enunciate legal principles, making *de novo* review appropriate. To the contrary, Lakeridge contended that clear-error review was appropriate because "the ultimate law-application question is all 'bound up with the case-specific details of the highly factual circumstances below.'" *Id.*

Pointing out that not all mixed questions of law and fact are the same, the Supreme Court found that the appropriate standard of review will depend on "the nature of the mixed question . . . and which kind of court (bankruptcy or appellate) is better suited to resolve it." *Id.* The kind of mixed question that requires the trial court to "amplify[] or elaborat[e] on a broad legal standard" and thereby "develop[e] auxiliary legal principles of use in other cases" should receive *de novo* review. *Id.* at 967. By contrast, a mixed question that requires the trial court to address "case-specific factual issues" that "utterly resist generalization"—for example, by making decisions based on credibility judgments—typically should be reviewed under the clear-error standard. *Id.*

Applying this approach in the case before it, the Court concluded that clear error was the appropriate standard under which to review the bankruptcy court's determination that Rabkin purchased MBP's claim in an arm's-length transaction. All the bankruptcy court had to do was "plug[] in the widely (universally?) understood definition of an arm's-length transaction [as] a transaction conducted as though the two parties were strangers" and "the mixed question [became]: Given all the basic facts found, was Rabkin's purchase of MBP's claim conducted as if the two were strangers to each other?" *Id.* at 967–68. According to the Supreme Court, "[t]hat is about as factual sounding as any mixed question gets," *id.* at 968, requiring the bankruptcy court to do nothing more than make a "factual inference[] from undisputed basic facts," *id.* (quoting *Comm'r v. Duberstein*, 363 U.S. 278, 291 (1960)). Because there was no need to "elaborate on the established idea of a transaction conducted as between strangers," the Court rejected U.S. Bank's argument that the bankruptcy court would need to "devise a supplemental multi-part test" in order to decide whether Rabkin and MBP conducted themselves as though they were strangers. The involvement of the appellate courts would not "clarify legal principles or provide guidance to other courts resolving other disputes"; thus, "the issue is not of the kind that appellate courts should take over" by conducting *de novo* review. *Id.*

After *Lakeridge*, so long as a bankruptcy court properly applies the controlling law governing the analysis of the arm's-length nature of a transaction, the role of an appellate court will be limited to deciding whether the "bankruptcy court committed clear error in finding that a transaction was arm's length (or not)." *Id.* at 968 n.7. But an appellate court applying *de novo* review also will continue to be able to "correct any legal error infecting a bankruptcy court's decision"—if the bankruptcy court, for example, "devise[s] some novel multi-factor test for addressing" the arm's length issue. *Id.* And "if an appellate court someday finds that further refinement of the arm's-length standard is necessary to maintain uniformity among bankruptcy courts, it may step in to perform that legal function." *Id.*

Justice Sotomayor pointed out in her concurrence that the Court's decision addressed the appropriate standard of review for one prong of a two-pronged test, the correctness of which is open to debate. *Id.* at 969–73 (Sotomayor, J., concurring). Accordingly, the decision is narrow, so much so that "if the proper inquiry did not turn solely on an arm's-length analysis but rather involved a different balance of legal and factual work, the Court may have come to a different conclusion on the standard of review." *Id.* at 970. That said, the decision still provides appellate courts a framework for determining the appropriate standard of review for mixed questions of fact and law.

III. *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752 (2018)

A. Introduction

Certain debts "for money, property, services, or an extension, renewal, or refinancing of credit" may be excepted from discharge under the first two subsections of § 523(a)(2) of the Bankruptcy Code. The first subsection applies to such debts to the extent they were obtained by "false pretenses, a false representation, or actual fraud," but only if the debtor committed the fraud using something "other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A). The second subsection reaches statements respecting the debtor's or an insider's financial condition, but only if, among other things, the statements were "in writing." 11 U.S.C. § 523(a)(2)(B). Put differently, a debt incurred through a fraudulent oral statement respecting the debtor's financial condition is not excepted from discharge under either subsection of § 523(a)(2). In *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S. Ct. 1752 (2018), the Supreme Court addressed the meaning of the phrase "a statement respecting the debtor's financial condition." Resolving a circuit split,[1] the Court held that a statement about a single asset can qualify as "a statement respecting the debtor's financial condition" and therefore fall outside the scope of § 523(a)(2)(A) entirely and outside § 523(a)(2)(B) if it is made orally.

B. Background

R. Scott Appling fell more than $60,000 behind on legal fees owed to the law firm of Lamar, Archer & Cofrin, LLP, which represented him in certain business litigation. During meetings to discuss the status of the litigation and the nonpayment of the fees, Appling orally assured Lamar that he was expecting to receive a six-figure tax refund that would enable him to pay his current and anticipated legal bills. Relying on this representation, Lamar continued to represent Appling. But upon receiving a tax refund of

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[1] *Compare Bandi v. Becnel (In re Bandi)*, 683 F.3d 671, 676 (5th Cir. 2012) (holding that misrepresentations regarding particular assets are not statements respecting the debtor's financial condition) *and Cadwell v. Joelson (In re Joelson)*, 427 F.3d 700, 714 (10th Cir. 2005) (same), *with Appling v. Lamar, Archer & Cofrin, LLP (In re Appling)*, 848 F.3d 953, 960 (11th Cir. 2017) (holding that misrepresentations regarding particular assets can be statements respecting the debtor's financial condition) *and Engler v. Van Steinburg (In re Van Steinburg)*, 744 F.2d 1060, 1061 (4th Cir. 1984) (same).

approximately $60,000, Appling spent it all on his business and later told Lamar that he had not yet received the refund. Relying on that statement, Lamar completed the pending litigation and delayed collection of the fees that Appling owed the firm. After several years of nonpayment, however, Lamar sued Appling and obtained a judgment of nearly $105,000. Appling responded with a voluntary Chapter 7 petition. *Lamar*, 138 S. Ct. at 1757.

Lamar thereafter initiated an adversary proceeding alleging that Appling's false representations about his tax refund made its claim for the past due legal bills nondischargeable under § 523(a)(2)(A). *Id.* at 1757–58. Appling moved to dismiss, asserting that his statements about the tax refund were statements "respecting [his] financial condition" that, because they were made orally, could not support a declaration of nondischargeability. *Id.* at 1758. The bankruptcy court disagreed, denying the motion to dismiss, 500 B.R. 246 (Bankr. M.D. Ga. 2013), and concluded after a trial that the debt was nondischargeable under § 523(a)(2)(A), 527 B.R. 545 (Bankr. M.D. Ga. 2015). The district court affirmed. *Appling v. Lamar, Archer & Cofrin, LLP*, No. 3:15-CV-031 (CAR), 2016 WL 1183128 (M.D. Ga. Mar. 28, 2016). The Eleventh Circuit, however, reversed, holding that (1) a statement about a single asset can qualify as a "statement respecting the debtor's financial condition" and (2) because Appling's statements were not reduced to writing, his debt to Lamar was dischargeable. *Appling*, 848 F.3d at 960.

The Supreme Court granted certiorari to resolve the conflict among the circuits and to answer the following question: "Does a statement about a single asset qualify [as a "statement respecting the debtor's financial condition"], or must the statement be about the debtor's overall financial status?" *Lamar*, 138 S. Ct. at 1757.

C. The Supreme Court's Decision

In *Lamar*, the Supreme Court held that "a statement about a single asset can be a 'statement respecting the debtor's financial condition' under § 523(a)(2) of the Bankruptcy Code." *Id.* at 1764. Writing for the unanimous Court, Justice Sotomayor began her analysis of the Bankruptcy Code "where all such inquiries must begin: with the language of the statute itself." *Id.* at 1759 (quoting *Ransom v. FIA Card Servs., N. A.*, 562 U.S. 61, 69 (2011)). Because the Bankruptcy Code does not define the key terms at issue—"statement," "respecting," and "financial condition"—the Court looked to the words' ordinary meanings. *Id*. There was no disagreement as to the meaning of "statement" or "financial condition." *Id*. The Court defined "statement" as: "the act or process of stating, or presenting orally or on paper; something stated as a report or narrative; a single declaration or remark." *Id.* (quoting *Webster's Third New Int'l Dictionary* 2229 (1976)). And the parties, along with the United States as *amicus curiae*, agreed that "financial condition" refers to "one's overall financial status." *Id*.

The Court's ruling accordingly turned on the meaning of the term "respecting" as used in § 523(a)(2)(A). The Court first looked at the ordinary usage of the term, citing multiple dictionaries to define "respecting" as: "in view of: considering; with regard or relation to: regarding; concerning,"[2] "[i]n relation to; concerning,"[3] "regarding; concerning,"[4] and "concerning; about; regarding; in regard to; relating to."[5] Lamar conceded that the "related to" definition could lead to a broad interpretation of "respecting" but argued that definitions like "concerning," "about," "as regards," and "with reference to" indicate that its scope could be "more limited." *Id.* If a statement is "about" the debtor's overall financial state, Lamar reasoned, then only detailed accounting records and big-picture statements about someone's general financial health—such as "Don't worry, I am above water" or "I am in good financial shape"—would qualify. *Id.* The Court rejected this argument, pointing out the "overlapping and circular" nature of the definitions, "with each one pointing to another in the group." *Id*.

As the Court explained, the term "respecting" traditionally has a broadening effect when used in a legal context, as do phrases like "relating to" (one of the definitions of "respecting"). *Id.* at 1760 (citing multiple Supreme Court cases describing "relating to" and its variants as "broad" and "expansive"). Had Congress intended to limit § 523(a)(2)(B) to big-picture items such as asset and liability statements, there are several ways for it to have done so. *Id*. at 1761. But Congress chose to use the term "respecting," and "Lamar's preferred statutory construction—that a 'statement respecting the debtor's financial condition' means only a statement that captures the debtor's overall financial status—must [therefore] be rejected, for it reads 'respecting' out of the statute." *Id*. Instead, agreeing with the "expansive approach" advanced by Appling and by the United States with a "slightly different formulation,"[6] the Court held that a statement about a single financial asset has a "direct relation to and impact on aggregate financial condition" because it "help[s] indicate whether a debtor is solvent or insolvent [and] able to repay a given debt or not." *Id.* A statement regarding a single asset therefore can be considered a "statement respecting the debtor's financial condition." *Id*.

The Court found that the phrase's statutory history "corroborate[d] [its] reading" of the provision. *Id*. at 1762. Indeed, prior to the enactment of the Bankruptcy Code in 1978, courts of appeals consistently construed the phrase "statement respecting the debtor's financial condition" as encompassing statements about particular assets, and "[w]hen Congress used the materially same language in § 523(a)(2), it presumptively was aware of the longstanding judicial interpretation of the phrase and intended for it to retain its

[2] *Webster's Third New Int'l Dictionary* 1934.

[3] *American Heritage Dictionary* 1107 (1969).

[4] *Random House Dictionary of the English Language* 1221 (1966).

[5] *Webster's New Twentieth Century Dictionary* 1542 (2d ed. 1967).

[6] Appling argued that a "statement respecting the debtor's financial condition" means a statement that "has a direct relation to, or impact on the balance of all of the debtor's assets and liabilities or the debtor's overall financial status" or, phrased differently, one that "describes the existence or value of a constituent element of the debtor's balance sheet or income statement." *Id*. According to the United States, a statement respecting the debtor's financial conditions includes "a representation about a debtor's assets that is offered as evidence of ability to pay." *Id*. The Court noted that the parties' agreed that their formulations "are functionally the same and lead to the same results." *Id.* at 1760–61.

established meaning." *Id.* The Court's broad reading of the statute was further bolstered by the fact that, in its view, Lamar's limited approach "would yield incoherent results":

> A misrepresentation about a single asset made in the context of a formal financial statement or balance sheet would constitute a "statement respecting the debtor's financial condition" and trigger § 523(a)(2)(B)'s heightened nondischargeability requirements,[[7]] but the exact same misrepresentation made on its own, or in the context of a list of some but not all of the debtor's assets and liabilities, would not.

Id. at 1761.

Finally, after quickly disposing of the argument that the Court's interpretation of § 523(a)(2)(B) would mean that there was little left for § 523(a)(2)(A) to cover, Justice Sotomayor addressed Lamar's contention that Appling's (and the Court's) reading of the statute is "inconsistent with the overall principle that the Bankruptcy Code exists to afford relief only to the 'honest but unfortunate debtor.'" *Id.* at 1763. Lamar asserted that, by allowing oral misrepresentations about single assets to give rise to dischargeable debts, the Court was opening the door for "fraudsters" to obtain money, property or services by lying about their finances orally and then secure a discharge of the debt they incurred through the fraud. *Id*. The Court disagreed, reasoning that Congress structured the nondischargeability provisions to handle the historical abuses made by both debtors and creditors, explaining, as it had before:

> The House Report on the [Bankruptcy Reform Act of 1978] suggests that Congress wanted to moderate the burden on individuals who submitted false financial statements, not because lies about financial condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their claims from discharge.

Id. at 176–64 (quoting *Field v. Mans*, 516 U.S. 59, 76–77 (1995)).[8]

According to the House Report, loan officers either encouraged the borrowers to lie about their current debts on the loan forms or constructed the forms in such a manner that would make full disclosure of all debts difficult if not impossible. *Id*. at 1764. When

[7] As the Court noted, § 523(a)(2)(B) does not just require that the representation be made in writing, but it also "requires a creditor to show reasonable reliance," while § 523(a)(2)(A), "by contrast, requires only the lesser showing of 'justifiable reliance.'" *Id.* at 1763 n.6 (citing *Field v. Mans*, 516 U.S. 59, 70–75 (1995)).

[8] Justices Thomas, Alito, and Gorsuch did not join in this part of the opinion.

the debtor eventually filed for bankruptcy, the creditor would then claim that the debtor made misrepresentations and threaten litigation over dischargeability, which was "'often enough to induce the debtor to settle for a reduced sum,' even where the merits of the nondischargeability claim were weak." *Id.* (quoting H.R. Rep. No. 95–595, p. 131 (1977)). Lamar's interpretation of "statement respecting the debtor's financial condition," the Court noted, would not prevent the very scenario that Congress intended to address, "because those debts-only statements said nothing about assets and thus did not communicate fully the debtor's overall financial status." *Id*.

The *Lamar* decision has brought much-needed clarity to § 523(a)(2). Furthermore, in keeping with the Bankruptcy Code's policy of a "fresh start," and the premise that exceptions to discharge should be strictly construed in favor of the debtor, the Court has now broadened (at least in some circuits) the discharge. The Court, however, did not view its decision as providing debtors a "get-out-of-fraud-free" card. Indeed, in order to avoid that result, Justice Sotomayor ended the Court's opinion by reminding creditors of the importance of having debtors make representations about their financial condition in writing:

> [Creditors] can still benefit from the protection of § 523(a)(2)(B) so long as they insist that the representations respecting the debtor's financial condition on which they rely in extending money, property, services, or credit are made in writing. Doing so will likely redound to their benefit, as such writings can foster accuracy at the outset of a transaction, reduce the incidence of fraud, and facilitate the more predictable, fair, and efficient resolution of any subsequent dispute.

Id. Given the breadth of the phrase "respecting the debtor's financial condition," creditors would do well to heed the Court's reminder.

BEST ETHICS RANT*

I. *Sundquist v. Bank of America, N.A.*, 566 B.R. 563 (Bankr. E.D. Cal. 2017) (Sundquist I).

The bankruptcy court awarded $1 million in actual damages and $45 million in punitive damages for multiple and egregious automatic stay violations. The court also directed that the majority of the punitive damages be delivered to public service entities engaged in education on consumer law and delivery of legal services to consumers. Notable quotes from the case include:

> "Franz Kafka lives. This automatic stay violation case reveals that he works at Bank of America. The mirage of promised mortgage modification lured the plaintiff debtors into a kafkaesque nightmare of stay-violating foreclosure and unlawful detainer, tardy foreclosure rescission kept secret for months, home looted while the debtors were dispossessed, emotional distress, lost income, apparent heart attack, suicide attempt, and post-traumatic stress disorder, for all of which Bank of America disclaims responsibility." *Id.* at 570-71.
>
> "There comes a point at which this case is reminiscent of Watergate: the denial and cover-up becomes worse than the crime." *Id*. at 591.
>
> "The key circumstance is Bank of America's institutional obstinance and dishonesty (including lying to the CFPB regarding the status of the state-court litigation) in refusing all recompense after the Sundquists discovered that Bank of America had secretly restored them to title after they moved and was demanding that they pay for damages resulting from Bank of America's incompetent stewardship of its illegally-acquired property." *Id.* at 595.

II. *Sundquist v. Bank of America, N.A.*, 580 B.R. 536 (Bankr. E.D. Cal. 2018) (Sundquist II)

After the sanctions award above, Bank of America and the debtors mediated and moved the court to vacate and expunge the published opinion. Although the court vacated the damage component of the judgment based on the settlement, it denied the request to expunge the published opinion. Notable quote:

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* Materials prepared by Erica M. Garrett, Law Clerk to Chief Bankruptcy Judge Cynthia A. Norton, Western District of Missouri.

> “Requests by losers of lawsuits to ‘buy and bury’ adverse judgments once rendered and to erase the public record are viewed with caution,” and “[t]his case implicates sufficient public interest that this court is reluctant to exercise its discretion to seep the matter under the carpet because the parties in a secret compromise are agreeing not to appeal.” *Id.* at 544-45.

III. *In re Gravel*, 556 B.R. 561 (Bankr. D. Vt. 2016)

In three separate Chapter 13 cases, the trustee filed a motion for contempt and sanctions against mortgage servicer PHH Mortgage Corporation based on its failure to comply with court orders and Rule 3002.1 governing notice relating to claims secured by the debtors’ residences. In sum, PHH had repeatedly sent the debtors erroneous mortgage statements which included postpetiton fees for which the required notices had not been filed. The court disallowed all the charges and awarded sanctions of $25,000 in each of the three cases. It awarded an additional $200,000 in one of the three cases and $100,000 in another, for a total sanction of $375,000. The court directed that the $375,000 in sanctions be paid to a nonprofit legal services entity. Notable quotes:

> “Thus, not only did PHH violate the instant Debtors Current Orders, but it also violated the Sanctions Order in [the] Gravel [case]. This persistence in assessing the charge after entry of the Sanctions Order manifests a lack of respect for this Court's orders, an abuse of the bankruptcy process, a disregard for the imperatives of Chapter 13 and Rule 3002.1, and a serious threat to Debtors' rights to a true fresh start. These are exactly the types of derelictions § 105 is intended to redress.” *Id.* at 577.

> “[T]he Court must take into account that PHH is a sophisticated commercial lender and an entity of substantial financial means. According to the public statements on its website, PHH is a top-ten originator and servicer of residential mortgages in the United States, boasting ‘approximately $41 billion in mortgage financing and maintained an average servicing portfolio of approximately 1.1 million loans’ in 2015 alone. PHH has the expertise and experience to be charged with knowledge of the Bankruptcy Rules, of its duty to comply with court orders, and of its obligation to fulfill the commitments it makes to courts and debtors.”

IV. *In re Lynch*, 2017 WL 416782 (Bankr. N.D. Ok. Jan. 17, 2017)

The debtors filed a motion requiring their attorney to disgorge fees they paid to her. The debtors had hired the attorney to attempt to set aside a compromise they had reached in a § 523 action in their earlier bankruptcy case. Among other things, the attorney filed an improvident appeal of the settlement order (623 days after it was entered). She failed to respond to the bankruptcy judge's request for additional information. She then sued the bankruptcy judge as a strategy to collaterally attack the settlement order. She engaged in profanity-laced diatribes to the court and accused people of corruption. She also took advantage of the fact that the debtor's fees were being paid by a wealthy benefactor. When the attorney got into trouble, she found a lawyer on craigslist to represent her. The court ordered her to disgorge all but $22,000 of the fees paid to her. Notable quote:

> "[T]he Court was appalled that after Lynch [the debtor] terminated [the attorney's] representation of him, Hyde [the attorney] filed a criminal complaint with the Department of Justice against two highly respected and competent attorneys. These are not the reasonable actions of a competent attorney." *Id.* at 11.

V. *Baek v. Halvorson* (*In re Halvorson*), 581 B.R. 610 (Bankr. C.D. Cal. 2018)

A judgment creditor and the debtor were involved in litigating a nondischargeability action. The bankruptcy court ordered the parties (who were in-laws) to mediation. The creditor arranged (at great effort) to have the debtor arrested when he appeared for the court-ordered mediation. The bankruptcy court held that the doctrine of unclean hands – based in large part on the arrest – barred the creditors from obtaining any relief in the nondischargeability action. Notable quote:

> "Here, however, the transgression in question—the pre-planned and considered sabotage of a mediation ordered by this Court, along with the intentional humiliation of Mr. Halvorson in front of his attorneys and family—is hardly trivial. To the contrary, the acts of Mr. Tolliver are such as to shock the conscience of this Court and, if allowed to stand, would undermine public confidence in mediation and therefore seriously implicate both public and private interests. The Court determines that the serious nature of the transgression by the Baeks through their attorney outweighs the substance of the rights they are asserting in these adversary proceedings." *Id.* at 643.

VI. *In re Johnson*, 580 B.R. 766 (Bankr. S.D. Ohio 2018)

In a willful violation of the stay case which involved significant discovery and other problems, the court ordered the violating creditor to pay the debtor $422,373.16 in attorney fees plus $100,000 in punitive damages. Notable quotes:

> "It is therefore clear that the unnecessarily contentious approach that RFF took to this litigation multiplied the fees incurred by the Debtor considerably. And RFF cannot be heard to complain about the amount of fees incurred by the Debtor when its own litigation conduct caused the fees to be so high." *Id.* at 797.

> “Making yet another attempt to deflect responsibility from itself, RFF argues that ‘the fact that the Debtor did not seek expedited consideration of the [Enforcement] Motion so it could be determined before the state court hearing on the [A]rbitration [A]ward needlessly increased the fees. . . . This objection to the Debtor's request for attorneys' fees “consists largely of what fairly may be characterized as either misdirection, or blaming the victim, or both.” *Id.* at 797-98.

> “Taking the scattershot approach it has often used during the Debtor's bankruptcy case, RFF next contends that ‘[f]ees with respect to the appeal should be disallowed for policy reasons.’ . . . . Of course, it does not identify the policy, and its contention is contrary to the law.” *Id.* at 798.

VII. *Robbins v. Dalafield* (*In re Williams*), 2018 WL 832894 (Bankr. W.D. Va. Feb. 2, 2018)

This is one of at least two notable sanctions case involving Upright Law coming out this year. According to the court, it “involves yet another collision between traditional methods of providing – and policing – legal services to consumers for bankruptcy matters and attempts by attorneys and creative online marketers to tap into that market on a high-volume, multi-jurisdictional basis.” *Id.* at *1. Here, the court focused on the “new car custody program” offered by Upright, which provided for a national towing company to take possession of cars debtors wished to surrender in exchange for paying the debtor’s bankruptcy fees and costs. Under the scheme, the towing company would tow cars out of the debtors’ home states to storage lots in Nevada, Mississippi, or Indiana, which allow liens for storage fees to prime secured lenders. The court also criticized the Upright model of allowing non-attorneys providing legal advice. The court revoked Upright’s ability to practice in the district for five years, and barred the two local attorneys for twelve and eighteen months, respectively. Upright was sanctioned $250,000, its principal was sanctioned $50,000 and each of the local attorneys was sanctioned $5,000. Notable quotes:

> “The integrity of the bankruptcy process was a distant thought in these cases.” *Id.* at *32.

> “The pursuit of the next dollar,” and not representation of debtors, “was the primary consideration here, by Sperro, LSC/Upright, its organizers, and its local partners.” *Id.*

> “As can be seen by a multitude of exhibits, including the Sales Playbook and scripts, the leadership of Upright constantly had its concerns on cash flow. The fact that this Program was offered or suggested to debtors before they even had the chance to speak to an attorney makes it all the more egregious.” *Id.* at *27.

> "Making this proposal to cash-strapped debtors was essentially offering them a Hobson's choice—one the debtors had to make without legal advice—all while Upright was offering its services under the guise of helping them make the proper decisions to reach their 'financial independence.' Upright preyed upon some of the most vulnerable in our society—as the Williamses demonstrated—while they were under great stress." *Id.* at *28.

VIII. *See also In re Banks*, 2018 WL 735351 (Bankr. W.D. La. Feb. 6, 2018)

Another notable Upright Law case, awarding numerous forms of sanctions against Upright and its local attorney, including suspension of practice.

> "The Court finds no value in the services UpRight provided to Banks. To the contrary, UpRight's actions harmed Banks by causing her to file two bankruptcies instead of one, and allowing a judgment to be entered against Banks when such judgment could have been avoided. In both bankruptcy cases, Augustus [the local attorney] failed to submit basic required documents, despite Banks having provided her those same documents. When the proceedings were dismissed, Augustus and UpRight failed to correct the mistakes in either proceeding and failed to communicate with Banks for months at a time. In this case, Augustus filed identical schedules and statements to those filed in the first case, with no updated financial information and without Banks having reviewed or signed them." *Id.* at 19.

> "UpRight and Augustus never kept Banks appropriately informed of the status of her case. Augustus repeatedly failed to communicate with Banks in violation of the Louisiana Rules of Professional Conduct. Banks was often unaware of what was happening in her bankruptcy cases. Further, UpRight representative[s] had an appalling lack of knowledge regarding what was occurring in these two bankruptcy cases." *Id.* at 17.

ESSAY

THROUGH GRITTED TEETH AND CLENCHED JAW: COURT-INITIATED SANCTIONS OPINIONS IN BANKRUPTCY COURTS*

NANCY B. RAPOPORT**

I. INTRODUCTION

I'm a former Chapter 11 bankruptcy lawyer, and I study the behavior of lawyers in Chapter 11 cases. As such, I'm lucky enough not to have

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encountered too many bad[1] or incompetent[2] lawyers, either in practice or in my research, but I know that they're out there.

So do bankruptcy courts. These courts see more bad and incompetent lawyers than they'd wish to see,[3] and they have only a few options for dealing with problem lawyers. A court could punish a bad lawyer by finding a procedural or substantive irregularity in the lawyer's pleadings, but that choice also penalizes the lawyer's client, who may have chosen the lawyer by happenstance. A court could rule against the lawyer, choosing not to believe the lawyer—an application of the "fool me once, shame on you; fool me twice, shame on me" theory. Again, though, that strategy punishes the lawyer's client, who might be an innocent bystander. Alternatively, nothing stops a judge from giving a bad lawyer a dressing-down in court. The transcript would reveal that the court was unhappy with the lawyer's performance, but unless someone else ordered a copy of the transcript, no particular ramifications would come of that dressing-down. (My educated guess is that most misbehavior in court gets the dressing-down treatment, as a court's way of enforcing norms quickly and efficiently.)

In addition, a court could decide to hand down a sanctions opinion, either because one party requests that the court consider sanctions or

1. By "bad," I mean lawyers who behave in ways that subvert the legal system: lawyers who are malicious for the sake of maliciousness. Lawyers are not supposed to, among other things, torment third parties. *See* MODEL RULES OF PROF'L CONDUCT R. 4.4 (2009) (stating that a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person). In addition, lawyers should not lie to the opposing side or obstruct its access to evidence. *See* MODEL RULES OF PROF'L CONDUCT R. 3.4 (2009) (stating that a lawyer shall not unlawfully obstruct another party's access to evidence and shall not falsify evidence or assist a witness to testify falsely). Also, lawyers should not lie to the court. *See* MODEL RULES OF PROF'L CONDUCT R. 3.3 (2009) (stating that a lawyer shall not make a false statement of fact or law to a tribunal). Finally, lawyers should not behave dishonestly. *See* MODEL RULES OF PROF'L CONDUCT R. 8.4 (2009) (stating that it's professional misconduct for a lawyer to engage in conduct involving dishonesty, fraud, deceit, or misrepresentation).

2. Lawyers who are incompetent just flat-out don't know what they are doing. *See* MODEL RULES OF PROF'L CONDUCT R. 1.1 (2009) (declaring that a lawyer shall provide competent representation to a client). Sometimes, even competent lawyers are not diligent, often because they are overworked. *See* MODEL RULES OF PROF'L CONDUCT R. 1.3 (2009) (stating that a lawyer shall act with reasonable diligence and promptness in representing a client). However, just because the pace of work is often crushingly hard, that does not excuse lawyers from the basics of diligence, such as returning clients' phone calls and emails and from filing pleadings on time.

3. For a recent scandal, see Mark Hamblett, *Former Mayer Brown Partner Gets 7 Years for Refco Fraud*, 241 N.Y. L.J. 11 (2010), *available at* 2010 WLNR 1116436 (describing the conviction and sentencing of a lawyer who defrauded investors out of $2.4 million, enriching his own firm in the process).

because the court, on its own motion, believes that a lawyer's behavior is serious enough to merit a written order. In this essay, I address that subset of sanctions opinions that arise from this latter alternative: when a court, on its own motion, decides to discipline a lawyer for serious misbehavior.

I will explore the types of behavior that trigger court-initiated sanctions opinions and what happens to some of these opinions on appeal. Based on my non-exhaustive review of court-initiated sanctions orders, I believe that most of these orders are written after the lawyer in question has stepped so far over the line of "reasonable lawyer behavior" that he can't even see "reasonable behavior" in his rear-view mirror.[4] Some of these sanctions orders will cover one-shot mistakes that the lawyer—had he or she been thinking clearly—would have realized were genuinely awful things to do. Other sanctions orders will discuss cumulative egregious misbehavior by lawyers.[5] On appeal, the treatment of these court-initiated sanctions orders tend to fall into the categories of "good point but bad procedure" remands or reversals, "I don't understand bankruptcy law" remands or reversals, or orders affirming the bankruptcy court's sanctions order.

There are countless ways to organize these cases, but because this Symposium issue is likely to go to print around the time of Passover, I'm going to organize the cases around the theme of the "four children" (originally known as the "four sons"),[6] a classic component of the

4. *Cf.* JURASSIC PARK (Universal Pictures 1993) (depicting a scene in which Tyrannosaurus Rex is chasing a car and appears in the car's side-view mirror above the warning, "Objects in mirror are closer than they appear").

5. Most ethics rules require a lawyer who witnesses misconduct to report that conduct to the state bar. *See* MODEL RULES OF PROF'L CONDUCT R. 8.3 (2009) (stating that if a lawyer knows of another lawyer who has committed a violation of the Model Rules and has questionable honesty, trustworthiness, or fitness, she should inform the appropriate authorities). Yet, it seems as if lawyers who sit in court watching their colleagues step way over the ethical line often forget their own duty to report. *Cf.* Joel Cohen & Katherine A. Helm, *A New Year's Resolution for Lawyers,* Jan. 4, 2010, http://www.law.com/jsp/article.jsp?id=1202437340930 (suggesting lawyers have a collective obligation to keep the profession responsible and ethical).

6. *See, e.g.*, Dovid Gottlieb, *The Four Sons,* http://ohr.edu/yhiy/article.php/805 (last visited Mar. 3, 2010) (analyzing who exactly the four sons really are). Here is a version of the "four sons" part of the Seder:

> The Torah spoke about four sons, one wise, one wicked, one simple and one who cannot formulate a question.
>
> What does the wise son say? "What do the testimonies, and the statutes, and the judgments, mean, which Hashem our God has commanded you?" You should also say to him the laws of the [Korban] Pesach, [up to the law] that we do not eat any dessert after the Pesach.
>
> What does the wicked son say? "What does this Avodah (worship) mean Lakhem (to you)"?

Passover Seder. Shortly after the youngest child at the Seder asks the Four Questions,[7] initiating the retelling of the Passover story, there is a segment of the Seder at which four different children ask, in essence, why are we going through this whole rigamarole? There's a wise child, a wicked child, a simple (untutored) child, and a child who doesn't even know to ask.[8] (Yes, if you're paying attention, there are three children asking and one child for whom we're voluntarily telling the story.)

For the wise child, we retell the facts of Passover, and not just the laws associated with it, because facts are important to the understanding of why we celebrate the holiday—a mere understanding of the rules, without an understanding of the facts giving rise to the rules, cheats us (and the child) of the richness of the story.[9] For the wicked child, who wants to know what Passover means to everyone else at the table, but not to him, we're supposed to relate an understanding of what it means to be in the group that is affected by, and follows, the rules.[10] Because the wicked child has deliberately excluded himself from the group, we're supposed to exclude him from that same group in the retelling.[11] For the untutored child, we're supposed to help her understand the story, perhaps not at the same level of sophistication that the wise child

> "To you" [meaning] and "not to him". Since he excluded himself from the community, he has denied the basic principle. You should also set his teeth on edge and say to him: "It is on account of this that Hashem did for me when I left Egypt" "for me" and not "for him"—had he been there, he would not have been redeemed.
>
> What does the simple son say? "What is this?" "[T]hat you shall say to him, By strength of hand Hashem brought us out from Egypt, from the house of slavery;"
>
> Regarding the one who cannot formulate a question, you must open up the discussion, as it says: "And you shall tell your son in that day, saying, This is done because of that which Hashem did to me when I came forth out of Egypt."

Yitzchak Etshalom, Haggadah Shel Pesach (II): The "Four Sons," http://www.torah.org/advanced/mikra/5757/va/dt.60.3.04.html (last visited Mar. 3, 2010).

7. *See, e.g.*, Tracey R. Rich, Pesach Seder: How Is This Night Different?, http://www.jewfaq.org/seder.htm (last visited Mar. 3, 2010) (explaining how the youngest person at the table usually asks, "Why is this night different from all other nights?" in an attempt to understand the Seder).

8. Dovid Gottlieb, The Four Sons, http://ohr.edu/yhiy/article.php/805 (last visited Mar. 3, 2010).

9. *See* Tracey R. Rich, Pesach Seder: How Is This Night Different?, http://www.jewfaq.org/seder.htm (last visited Mar. 3, 2010) (discussing how the Haggadah deliberately provokes young children to question the rituals of the Pesach Seder in order to differentiate it from other holidays).

10. Dovid Gottlieb, The Four Sons, http://ohr.edu/yhiy/article.php/805 (last visited Mar. 3, 2010).

11. *See id.* (stating the wicked son is excluded from the retelling because he is too proud and that discussing the story with him is pointless).

would understand it, but to the best of her ability to understand.[12] For the child who doesn't know to ask, we begin the retelling without needing to be prompted at all.[13]

How does this analogy[14] play out when reading bankruptcy sanctions opinions? The lawyers who don't get into trouble are like the "wise child"—they "get" the ethics rules, and so perhaps they read sanctions opinions, if at all, to make sure that they don't run afoul of anything unusual. My guess is that most good attorneys don't spend a lot of time reading sanctions opinions unless they happen to know the lawyer(s) involved.

The lawyers who do get into trouble will fall into one of two camps: the "wicked child" or the "child who doesn't know to ask." The "wicked child" thinks that the rules don't apply to him, while the "child who doesn't ask" doesn't even know what he doesn't know. I tend to write for those who know the rules and just need some support for what they want to say (the "wise child" lawyers) or for those who have an idea of what's right and wrong but who need some help getting through the steps (the "simple child" lawyers). Judges who write sanctions opinions are writing for the "wicked child" or the "child who does not know to ask."

When judges write sanctions opinions, they're writing them after very long days, and they're writing them very carefully. After all, if a lawyer is on the wrong side of a court-initiated sanctions opinion and decides to appeal, the lawyer gets to write a brief, designate the record, and argue the appeal. The judge who wrote the sua sponte sanctions opinion, however, only stands on the opinion—there is no advocate automatically arguing for the judge's view of what happened.[15] It's not

12. *See id.* (explaining that the simple son's questioning lacks sophistication but shows a sincere desire to learn and understand).

13. *See id.* (stating that the son who does not know how to ask lacks cleverness and therefore remains silent).

14. There are other analogies at play here. For example, as I was coming up with the title for this essay, I kept hearing, in the back of my mind, another theme in the Seder: "The Lord brought us out of Egypt with a mighty hand and outstretched arm, with great awe, miraculous signs and wonders." *See, e.g.*, Barry Dov Lerner, Jewish Family Education Passover Haggadah: A Complete Haggadah, Feb. 21, 2010, http://www.jewish freeware.org/downloads/folder.2006-01-07.0640323187/5770COMPLETEMASTERHaggadahPaginated3-8-10WITHOUT%20SONGS.pdf (alterations in original) (quoting Deuteronomy 26:8). Maybe a judge's gritted teeth and clenched jaw is not the Almighty's mighty hand and outstretched arm (OK, it's not even close), but I'm trying to convey a feeling of powerfulness here.

15. *See generally* Greenfield v. First City Bancorporation of Tex., Inc. (*In re* First City Bancorporation of Tex., Inc.), 270 B.R. 807 (N.D. Tex. 2001) (explaining the standard of review for a bankruptcy opinion), *aff'd*, 282 F.3d 864 (5th Cir. 2002).

an accident, then, that these opinions are among the most meticulously crafted that I've read: it's the judge's only shot at explaining the rationale for initiating the sanction. If the judge doesn't do a good job of explaining why the sanction was necessary (and assuming that the sanction *was* necessary), then the opinion will be reversed on appeal, and the misbehaving lawyer will learn nothing from the experience.[16]

Due to the serious nature of sanctions opinions, judges also tend to be careful in the problems that they're addressing. The significant ethics breaches that a court might describe in a sanctions opinion could trigger state bar disciplinary proceedings. Keeping this synergy in mind, the judge must provide a careful record of the lawyer's transgressions.[17] I have never found a judge who looked forward to writing a sanctions opinion. There are many parts of a judge's day that can be challenging and some that can be satisfying, but no judge enjoys having to sanction a bad lawyer.

II. "WICKED CHILD" OPINIONS (IGNORING THE RULES)

If a lawyer wants to set a judge's teeth on edge, the fastest way to do that is to flout the law—either bankruptcy law or the ethics rules. *In re Fahey*[18] is a great example of a court sanctioning a lawyer whose exploits were so bad that they were actually statistically significant.[19]

In *In re Fahey*, the Bankruptcy Court opened a miscellaneous matter to consider whether or not the sanctioned lawyer should be disciplined for:

> a clear and consistent pattern of (1) failure to file information required by

16. Worse yet, the misbehaving lawyer may well discover that whatever he did is worth more to him (e.g., charging clients for incompetent advice, representing multiple clients with clear conflicts of interest, or allowing a client's ire to run roughshod over a non-client) than any potential punishment his misbehavior might cost him. *Cf. id.* at 809–10 (detailing the actions that led the bankruptcy court to impose sanctions, and noting that lesser sanctions had failed to have an effect on the defendant's behavior).

17. *See* Susan M. Freeman, *Ethical Dilemmas—How to Avoid Them (Sorry Counsel, You Signed It: Ethics Rule 9011, and Inadequate Filings)*, 8TH ANN. ROCKY MTN. BANKR. CONF. § VI (2003) ("The bankruptcy court or appellate court may refer its sanctions determination to the state professional disciplinary authority, commencing a state disciplinary process."); *see also In re Fahey*, No. 09-00501, 2009 WL 2855728, at *1 (Bankr. S.D. Tex. Sept. 1, 2009) ("The [c]ourt will also forward this memorandum . . . to the State Bar of Texas for such disciplinary action as they might deem appropriate.").

18. *In re* Fahey, No. 09-00501, 2009 WL 2855728 (Bankr. S.D. Tex. Sept. 1, 2009).

19. *See id.* at *1–3 (reviewing defendant's case history before the bankruptcy court and providing statistical breakdowns of the percentage of dismissed cases that were the result of defendant's mistakes).

> Bankruptcy Code § 521 when he files petitions commencing cases under the Bankruptcy Code, (ii) inadequate representation of clients, (iii) lack of expertise in bankruptcy law, (iv) unreasonable delegation of authority and responsibility to a contract paralegal that resulted in substantial harm to bankruptcy debtors, (v) filing pleadings containing false statements, and (vi) failure to comply with the Bankruptcy Code, Federal Rules of Bankruptcy Procedure (FRBP), and local rules.[20]

In arriving at the reasonable conclusion that the lawyer's behavior was egregious, the court reviewed three years of Chapter 13 cases that the lawyer had filed and compared his results with those of other lawyers practicing in his region.[21]

	[that lawyer]	Other Attorneys
Number of Chapter 13 Cases Filed 1/1/2006 to 3/31/2009	62	226
% of cases that were dismissed	92%	28%
% of cases dismissed for failure to file § 521 information	47%	2%
% of cases dismissed within 90 days after petition was filed	61%	6%

[22]

The Chapter 13 trustee in Laredo, where the sanctioned lawyer's cases were based, conducted an independent analysis that confirmed the court's findings.[23] The United States Trustee also reviewed the sanctioned lawyer's results in the lawyer's Chapter 7 and Chapter 11 filings, with similar results.[24] As if the results were not reason enough to call for sanctions,[25] the sanctioned lawyer admitted to the court that none of his petitions actually had his clients' signatures.[26] Because the

20. *Id.* at *1.
21. *Id.* at *2–3.
22. *Id.* at *2.
23. *See In re Fahey*, 2009 WL 2855728, at *2–3 (summarizing the independent analysis conducted by the Chapter 13 trustee).
24. *See id.* at *3–4 (listing the findings of the United States Trustee in regard to defendant's Chapter 7 and Chapter 11 cases).
25. In keeping with my Passover theme, *Dayenu* (Hebrew for, in essence, "that would have been enough"). GreatJewishMusic.com, Learn to Sing Dayenu, http://www.greatjewishmusic.com/Midifiles/Passover/Dayenu.htm (last visited Mar. 3, 2010) (providing the translation of *Dayenu*).
26. *In re Fahey*, 2009 WL 2855728, at *5.

lawyer had ignored warnings about his behavior in prior cases, the court banned the lawyer from practicing bankruptcy law until the lawyer could demonstrate that he knew what he was doing in bankruptcy cases. In addition, the court referred the lawyer for further discipline by the district court and the State Bar of Texas.[27]

Willful ignorance of the practice of bankruptcy law is one thing. The failure to abide by the rules of common decency and the basics of professionalism is quite another. In *In re Martinez*,[28] the bankruptcy court sanctioned a creditor's lawyers—and the creditor itself—for insisting that a scrivener's error be enforced as filed.[29]

The debtors in the case had three houses, and Wells Fargo Bank had several liens on all of the houses.[30] The debtors agreed to stipulate to relief from stay on one of the houses—a house in which they weren't living.[31] Although both sides (the bank's lawyers and the debtors' lawyer) thought that the house, which was the subject of the stipulation, was one of two other houses that the debtors were voluntarily surrendering, the legal description of the house in the stay relief stipulation was actually the one house that the debtors did not want to surrender. Here's what happened next:

> When the mistake was pointed out to the lawyer from [Wells Fargo's outside law firm], he ultimately acknowledged it. When asked to sign a stipulation vacating the order on the mistaken stipulation, the lawyer refused. He claimed that his client, Wells Fargo, would not consent to vacating the mistaken stipulation. As a result, on March 17, the debtors sought an order shortening time for the court to hear a motion to vacate the stipulation. The reason shortened time was requested was simple: if Wells Fargo would not consent to vacating the mistaken stipulation, then Wells Fargo presumably intended to take advantage of the mistake and foreclose on the debtors' residence. The court agreed to hear the motion on March 24.
>
> [Wells Fargo's outside law firm] did not oppose the debtors' request for a hearing on shortened time. Despite being ordered to file a written response, it did not do so. A lawyer from [Wells Fargo's outside law firm] did, however, appear at the hearing. His appearance consisted primarily of his statement that his client, Wells Fargo, would not allow him to consent to vacate the stipulation.

27. *Id.* at *1.
28. *In re* Martinez, 393 B.R. 27 (Bankr. D. Nev. 2008).
29. *Id.* at 41–42.
30. *Id*. at 30.
31. *Id*. at 30–31.

> After hearing the evidence, the court vacated the order on the stipulation. It then issued an order to show cause why the lawyer from [Wells Fargo's outside law firm], the [Wells Fargo's outside] law firm [itself], and Wells Fargo should not be sanctioned for their individual and collective conduct in refusing to aid the debtors in rectifying the admitted mistake.[32]

To borrow a phrase from the humorist Dave Barry,[33] I am not making this up: lawyers for Wells Fargo preferred to force a hearing to fix a scrivener's error rather than tell their client that its refusal to put the correct legal description of the house into an amended stipulation was outrageous.[34] In an opinion that spanned everything from contract law (why the lawyers could have reformed the stipulation) to bankruptcy rules (Rule 9011) to ethics rules, the court explained just how awful the lawyers' behavior had been:

> Clients may not demand unethical or unlawful conduct from their lawyers and expect compliance. As established above, [Wells Fargo's outside law firm] and its lawyers knew, or should have known, that Wells Fargo had no reasonable or nonfrivolous basis to oppose setting aside the stipulation. At a minimum, they had a duty to tell this to Wells Fargo, and to withdraw from the representation or take some other action if Wells Fargo insisted on opposing. They neither withdrew nor did they offer any evidence of compliance with Rule 1.4.
>
> The court understands that lawyers do not give away their services, and that good business and good lawyering each require that the lawyer serve the client's business needs. But law is a profession as well as a business. Because of this status, lawyers must not allow the interests or dictates of a client to control their professional judgment. . . .
>
> This court is concerned that [Wells Fargo's outside law firm] and its lawyers sacrificed their professional independence to the demands of a large institutional client. They should have counseled Wells Fargo to agree to vacate the mistaken stipulation, and informed them that any other course of conduct was unreasonable and one in which they could not participate. Instead, they followed Wells Fargo's instructions without apparent regard to their professional obligations. In short, rather than remain as independent professionals counseling Wells Fargo, [Wells

32. *Id*. at 31.

33. *See* Dave Barry—Biography, http://www.davebarry.com/about.html (last visited Mar. 3, 2010) ("Dave Barry is a humor columnist. For 25 years he was a syndicated columnist whose work appeared in more than 500 newspapers in the United States and abroad.").

34. *See In re Martinez*, 393 B.R. at 34 (explaining that Wells Fargo's outside law firm and its lawyers chose to follow Wells Fargo's orders, despite knowing they were without basis).

> Fargo's outside law firm] and its lawyers instead chose to become unthinking agents for Wells Fargo's ends.
>
> The smooth functioning of the courts and the interests of justice always trump a client's unreasonable demands.[35]

So far, the "wicked child" cases involve lawyers who are stubbornly incompetent in their practice of bankruptcy law and lawyers who persist in furthering their clients' unreasonable demands. Sometimes, though, the "wicked child" case will involve some wildly temperamental lawyer behavior. In *Greenfield v. First City Bancorporation of Texas, Inc. (In re First City Bancorporation of Texas, Inc.)*,[36] the sanctioned lawyer was accused, among other things, of:

- characterizing other attorneys, including an Assistant United States Attorney, as "stooges," "puppet," a "weak pussyfooting 'deadhead'" who "had been 'dead' mentally for ten years," "various incompetents," "inept," "clunks," "falling all over themselves, wasting endless hours," "a bunch of starving slobs," an "underling" who graduated from a 29th-tier law school, and "in mortal fear of taking a lie detector test";
- calling the chairman of First City a "hayseed" and "washed-up has been" and other directors "scoundrels";
- referring to attorneys as having been fired by their former firms; . . .
- referring to the work of other attorneys as "garbage," demonstrating "legal incompetence," and involving "ludicrous additional time and expenses"; . . .
- alleging fraud, cover-ups, payoffs, and bribes with (apparently) little if any evidence to support the characterizations; and
- referring to extraneous and prejudicial matters, such as a "scandal" at a Houston hospital that was another client of one of the opposing attorneys.[37]

Although the bankruptcy court had tried a variety of other sanctions to "curb . . . [the lawyer's] contumacious conduct,"[38] none of those sanctions seemed to work.[39] The lawyer eventually appealed the order of significant monetary sanctions, and the district court affirmed.[40]

35. *Id*. at 36–37 (citations and footnotes omitted).

36. Greenfield v. First City Bancorporation of Tex., Inc. (*In re* First City Bancorporation of Tex., Inc.), 270 B.R. 807 (N.D. Tex. 2001).

37. *Id.* at 810 (footnotes omitted).

38. *Id*.

39. *Id.* (noting that the bankruptcy court had imposed "lesser sanctions" such as "oral and written admonitions and warnings," to no avail).

40. *Id*. at 807–08.

The lawyer's arguments on appeal had chutzpah: his statements were true; he had seen worse behavior pass without sanction; his tactics were effective; the recipients of his remarks had, in essence, asked for it; and the judge had made plenty of other bad decisions.[41] Nice try, but no cigar. The district court observed that the Northern District of Texas had set forth certain standards of conduct for litigators, and that this lawyer's behavior fell well below those standards:

> If anything, Appellants' brief provides further evidence of Greenfield's inability to conform to the standards expected in this district. In the briefs, he emphasizes that an opposing attorney attended Brooklyn Law School (Greenfield graduated from Harvard Law School) and offers the two schools' respective rankings by *U.S. News & World Report*, apparently as evidence that the other attorney is inferior in support of Greenfield's statement that the lawyer had been fired by another law firm. He also brings up what he characterizes as errors by the bankruptcy judge in other rulings, apparently as evidence that the judge's conclusions as to evidence are untrustworthy. Both of these remarks are arguably additional violations of the *Dondi* standards.[42]

With an aside that the lawyer might want to consider an anger management course, the district court affirmed the bankruptcy court's sanctions order.[43]

My guess is that not all outbursts come from lawyers with anger issues. Some outbursts may well come from the fact that bankruptcy lawyers have ample opportunity to interact with bankruptcy judges at meetings, CLEs, and conferences—in addition to any cases in which they interact—and sometimes that familiarity can bring contempt.[44]

41. *See In re First City*, 270 B.R. at 812 (describing improper sanctions arguments).

42. *Id.* at 813–14. The court, citing to *Dondi Properties Corp. v. Commerce Sav. & Loan Ass'n*, 121 F.R.D. 284 (N.D. Tex. 1988) (en banc), listed some of the standards that lawyers are expected to follow. *In re First City*, 270 B.R. at 812.

43. *Id.* at 814.

44. Take the famous "few French fries short of a Happy Meal" comment that one bankruptcy lawyer made to a bankruptcy judge during a hearing. *See* Posting of Ronald V. Miller, Jr., to The Maryland Injury Lawyer Blog, A Few French Fries Short of a Happy Meal, http://www.marylandinjurylawyerblog.com/2007/05/a_few_french_fries_short_of_a_happy_meal.html (May 29, 2007) (noting a comment made by a lawyer to a judge in a bankruptcy court and its possible consequences). As this blog pointed out:

> "I suggest to you with respect, Your Honor, that you're a few French fries short of a Happy Meal *in terms of what's likely to take place*." This is probably directed to the way the details of the bankruptcy plan would unfold. Moreover, although she later *su[a] sponte* calls for a show cause hearing as to why the lawyer should be permitted to continue to practice before her, the judge did not stop the hearing to address the issue. She simply asked counsel to proceed. Obviously, tone is lost when you are reading a transcript. We have no idea how

Even a well-regarded lawyer can find himself facing an order to show cause for treating the judge with too much informality, although garden-variety informality likely will not trigger an order to show cause.

What can we learn from "wicked child" situations? We can conclude that, eventually, a lawyer's repeated misbehavior can be so clearly beyond the pale that even the most patient of judges will say "enough."

III. "UNMINDFUL CHILD" OPINIONS (UNAWARE OF THE RULES)

It's not just experienced lawyers who can anger a court to the point where the court takes the time to write a lengthy sanctions opinion. Bankruptcy novices—at least those who clearly have not taken the time to learn the fundamentals of bankruptcy practice and policy—can find themselves on the wrong end of a sanctions opinion as well.

In re Aston-Nevada[45] is a good example. Bankruptcy cases are supposed to be collective actions, designed to bring all of the debtor's creditors together in one forum to determine equitable treatment. Therefore, a bankruptcy case that is a one-creditor, one-debtor dispute is typically not an appropriate use of the Bankruptcy Code's collective treatment. Lawyers for debtor Aston-Nevada either didn't understand this fundamental point or chose to ignore it when they began their representation of a Chapter 11 debtor who had filed for bankruptcy protection on the eve of state court litigation.[46] The debtor had only one asset: a liened-up Porsche.[47] The debtor's lawyers managed to bollix up the case in a variety of ways. For example, they attempted to dismiss the case without notice and a hearing, and they sent someone to appear at a Rule 2004 examination who had no knowledge regarding the whereabouts of the debtor's Porsche.[48] Not willing to miss a step, the debtor's lawyers also filed a response to the court's separate order to show cause regarding sanctions against them.[49] That response

this really happened.

> The way to avoid this issue in the first place is for lawyers to bear in mind that there is [a] tran[s]cript being generated. It is also a good idea for lawyers, particularly in this kind of venue, to save [their] Jerry Seinfeldlike efforts [for another venue]. For every time you get a laugh or someone thinks you a[re] witty, someone else thinks you are silly or disrespectful. For the latter, this is certainly Exhibit A.

Id.

45. *In re* Aston-Nevada Ltd. P'ship, 391 B.R. 84 (Bankr. D. Nev. 2006).
46. *Id*. at 90.
47. *Id*.
48. *Id*. at 91.
49. *Id*.

managed to insult the judge on several different levels:

> Their joint response, filed April 29, 2005, described the language in the court's prior memorandum as "outlandish, improper, unfounded and boorish" as well as "false" and "reckless." The court's reasoning was based, [the law firm] asserted, "on flimsy threads of inference and guesswork," and it exceeded the "reason and decorum expected of a judicial officer." For good measure, [the law firm] stated that the prior memorandum was "offensive, distasteful, crude, untrue, and should never [have been] issued by any judiciary or judicial officer administering equity and justice . . ."[50]

Not satisfied with lobbing insults at the court, the debtor's lawyers also threatened to seek judicial discipline.[51] At the show-cause hearing, the court gave the lawyers a chance to retract some of their allegations.[52] They refused.[53] In doing so, they gave new meaning to the concept of cluelessness.

In explaining why the lawyers deserved to be sanctioned for their conduct, the court divided the ethics lapses into two categories: errors caused by a lawyer's inexperience in bankruptcy practice and errors caused by crossing the line from zealous advocacy to bad faith.[54] Most troubling about the lawyers' behavior was their failure to use their own legal judgment to dissuade their client from impermissible actions:

> [The law firm's] and [the individual lawyer's] prevarications and misstatements were deliberate and not careless. They were part of a concerted effort to delay the inevitable through pettifoggery and evasion. In short, their misrepresentations were designed to mislead the court. For the reasons set forth above, each of them independently constitutes a violation of Rule 9011.

50. *In re Aston-Nevada*, 391 B.R. at 95; *see also id.* at 95 n.18 (describing the "soft-footed[ness]" of the court's prior memorandum regarding sanctions). I have no idea what "soft-footed" means in this context, but it can't be good.

51. *Id*. at 95–96.

52. *Id*. at 96.

53. *Id*.

54. *In re* Aston-Nevada Ltd. P'ship, 391 B.R. 84, 96 (Bankr. D. Nev. 2006). On the latter point, the court observed:

> The court's refusal to characterize [the law firm's] and [the individual's] actions as merely hapless is further supported by their collective reaction to the order to show cause. The court considered separately sanctioning the response, since it clearly contains inappropriate and sanctionable language, but instead chooses to view it as a part of [the law firm's] and [the individual's] general approach to litigation, an approach that is unacceptable under any reasonable view of modern lawyering.

Id. at 97.

> Even if [the law firm] had not affirmatively misled the court, its conduct nonetheless violated Rule 9011. In particular, when [the law firm] learned of the meager facts related to Aston-Nevada and its filing, it should have declined to file an opposition. And these facts could have (and should have) either come out during the initial client consultation or soon thereafter by checking PACER for Aston-Nevada's docket information. Instead, [the individual lawyer] and [the law firm] took the passive approach to client representation, that of doing anything and everything the client requests, regardless of its questionable nature.
>
> This a lawyer may not do.[55]

In sanctioning the lawyers, the court pinpointed the essence of their misbehavior:

> To act on such frivolous claims, then, without independent investigation, was to succumb to the so-called "butler-style" of representation, under which the sequaciously servile lawyer does whatever the client wants and then cites that client's command as a shield to the improper actions. This style of lawyering, however, has no place in bankruptcy court or, for that matter, in any court.[56]

When I first read *Aston-Nevada*, I knew that the court was going to come up with some creative sanctions as soon as I saw "sequaciously servile."[57] Such a phrase, elegant in its alliteration, signals that the court has passed any point of tolerance for misbehavior. And I wasn't disappointed. The sanctions included, in addition to monetary sanctions:

- A public reprimand, by virtue of the opinion's publication;[58]
- A requirement that each of the law firm's attorneys must, before appearing before the court or filing any document with the court, first file a declaration with the following components:

> [T]hat, during the twenty-four months immediately preceding the desired filing or appearance, the person has: (A) taken eight hours of continuing legal education regarding the practice of bankruptcy; (B) taken at least four hours of continuing legal education regarding ethics or professional responsibility; *and* (ii) attaches to the declaration, for filing in the case in which the person desires to appear, (A) a copy of this opinion; and (B) a copy of the brochure or other similar writing indicating the scope of the

55. *Id*. at 102 (footnotes omitted).
56. *Id.* at 103.
57. *Id*. The court's use of "splenetic and threatening" wasn't bad either. *In re Aston-Nevada*, 391 B.R. at 109.
58. *Id*.

continuing legal education program attended.[59]

- Removing from the firm's website any indication that the firm has expertise in bankruptcy law "unless and until at least one partner of the firm meets the continuing education requirements set forth" in the sanctions order.[60]

Who can't appreciate a sanction that closely tied to the lawyers' misbehavior? I love this case for its reasoning regarding the sanctions:

> The notion that any action requested by a client should be taken so long as some argument, no matter how tenuous, can be made for it, has a corrosive effect. If unchecked, it spreads in the form of "tit-for-tat" reciprocity that lowers the level of practice, and multiplies litigation needlessly.[61]

In "unmindful child" types of cases, it isn't that the lawyers didn't know how to say no to their clients. Instead, they didn't know the underlying substantive law—in this context, bankruptcy law—or why knowing the law gave them a good legal footing for refusing to do their clients' inappropriate bidding.

IV. "WARNING SHOT" OPINIONS

In any taxonomy, there are some opinions that defy classification, and there are some that aren't, strictly speaking, sanctions opinions. There are even pre-opinion warnings, such as Judge Jaroslovsky's open letter to lawyers filing individual Chapter 11 cases:

> NOTICE TO BAR REGARDING INDIVIDUAL CHAPTER 11 CASES
>
> There has been a recent spate of individual Chapter 11 cases filed by attorneys who have neither the experience nor the education nor the competence to venture into Chapter 11. I believe that there are very few bankruptcy lawyers other than State Bar certified specialists who should be contemplating representation of Chapter 11 debtors in possession.
>
> I see rampant errors being made in issues relating to cash collateral, conflicts of interest, and compensation.
>
> . . . .
>
> A Chapter 11 is not just a big Chapter 13. If you represent a Chapter 11 debtor in possession, your client is the *estate*, not the

59. *Id*. at 110.
60. *Id*.
61. *Id*. at 109.

> debtor personally. Failure to understand this results in serious liability exposure.
>
> Forget about trying to fix your compensation. You will be paid what I allow, period. I suggest you not spend retainers until your fees are allowed to avoid having to return money you have already spent.
>
> I see frequent malpractice in individual Chapter 11 cases and I am quick to note it on the record. Your employment will not be approved unless you have substantial current malpractice insurance. If you are going "bare," don't even think about taking a Chapter 11 case.[62]

My guess is that Judge Jaroslovsky was tired of seeing incompetent lawyers make multiple missteps in cases that needed lawyers who were well-versed in Chapter 11 practice. The world of business bankruptcy is sufficiently different from the world of consumer bankruptcy that experts in one are not automatically experts in the other. There is no shame in being good in one world but not the other. Hubris shouldn't tempt a lawyer into reaching far beyond her competency level.

In terms of a case that doesn't involve sanctions but does involve unwise behavior by professionals, you can't beat my favorite "you're on thin ice" opinion. In *In re Energy Partners*,[63] the court warned two investment banking firms seeking employment under the more liberal 11 U.S.C. § 328 terms[64] that their requested compensation was over-the-top greedy.[65] In denying their application for an order approving their retention, the court began the opinion with an ode to the tone-deafness of the application:

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62. Alan Jaroslovsky, *Notice to Bar Regarding Individual Chapter 11 Cases*, Sept. 9, 2009, http://www.canb.uscourts.gov/files/notice%20re%20chapter%2011.pdf.

63. *In re* Energy Partners, Ltd., 409 B.R. 215 (Bankr. S.D. Tex. 2009).

64. § 328(a) provides:

> The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

11 U.S.C. § 328(a) (2006). Once a professional has been appointed under § 328, the bankruptcy court will find it extremely difficult to alter the terms of the professional's compensation because finding that the terms and conditions of compensation were unforeseeably improvident is nearly impossible.

65. *In re Energy Partners*, 409 B.R. at 227.

> Oblivious to recent congressional and public criticism over executives of publicly-held corporations who are paid monumental salaries and bonuses despite running their companies into the ground, two investment banking firms now come into this Court requesting that they be employed under similarly outrageous terms. They do so because two committees in this Chapter 11 case have filed applications to employ these investment banking firms to perform valuation services even though two other independent firms have already performed similar valuations. These investment bankers, who wish to have their fees and expenses paid out of the debtor's estate, have sworn under oath that they will render services only if they immediately receive a nonrefundable fee aggregating $1.0 million. This Court declines the opportunity to endorse such arrogance. The purse is too perverse.[66]

In a written opinion that reminded me of my favorite part of Monty Python's Argument Clinic,[67] the court reiterated its earlier oral ruling regarding an emergency motion to employ these two professional firms.[68] Apparently, neither of the professional firms was willing to take "no" for an answer.

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66. *Id*. at 215.

67. Argument Clinic:

> Man: Ah, Is this the right room for an argument?
> Mr Vibrating: I told you once.
> Man: No you haven't.
> Mr Vibrating: Yes I have.
> Man: When?
> Mr Vibrating: Just now.
> Man: No you didn't.
> Mr Vibrating: Yes I did.
> Man: You didn't
> Mr Vibrating: I did!
> Man: You didn't!
> Mr Vibrating: I'm telling you I did!
> Man: You did not!!
> Mr Vibrating: Oh, I'm sorry, just one moment. Is this a five minute argument or the full half hour?
> Man: Oh, just the five minutes.
> Mr Vibrating: Ah, thank you. Anyway, I did.

Monty Python's Flying Circus: Argument Clinic, *available at* http://orangecow.org/pythonet/sketches/argument.htm (last visited Mar. 8, 2010). In both of the *Energy Partners* opinions, the court clearly stated, not just once but several times, that the requested compensation terms were simply not going to fly. *In re Energy Partners*, 409 B.R. at 215; *In re* Energy Partners, Ltd., No. 09-32957-H4-11, 2009 WL 2970393, at *1 (Bankr. S.D. Tex. Sept. 15, 2009). The parties nonetheless went around and around, seeking approval anyway.

68. *In re Energy Partners*, 409 B.R. at 216.

Here's what the two firms wanted. Tudor Pickering wanted

> (a) a nonrefundable advisory fee of $500,000.00 payable pursuant to the Court's Procedure for Professionals Order; (b) a nonrefundable expert witness fee of $25,000.00 per day, payable each day that a Tudor Pickering Holt & Co. Securities, Inc. (Tudor Pickering) employee is requested, and made available, for the purpose of deposition or testimony; (c) a nonrefundable extended assignment fee of $100,000.00 per month, payable beginning September 1, 2009, and each month thereafter; and (d) any out-of-pocket expenses. According to the Tudor Pickering Application, the services Tudor Pickering will render to the Equity Holders' Committee include, but are not limited to, the following: (a) analyzing the Debtor's assets and liabilities, the valuation of the Debtor's businesses and objecting to the plan of reorganization; (b) attending meetings and negotiating with representatives of the Debtor and creditors; (c) assisting in the review, analysis, and negotiation of the plan of reorganization; (d) appearing before this Court and other courts and protecting the Equity Holders' Committee's interests; and (e) performing all other necessary valuation services in this case.[69]

Houlihan Lokey wanted roughly the same arrangement, minus the $25,000 per day witness fee, for assisting the Unsecured Noteholders' Committee.[70] In rejecting the two employment applications, the court noted that neither Tudor Pickering nor Houlihan Lokey could prove that it would provide valuation services that were superior in kind to other professionals, including other professionals who were already employed in the case at substantially lower fees.[71]

In finding that the testimony supporting the applications was conclusory and self-serving, the court also pointed out the inappropriateness of a $25,000 per day witness fee:

> [A]side from the unreasonableness of expecting to be paid an up-front, nonrefundable $500,000.00 fee, the Court is also extremely discouraged that Tudor Pickering has also requested a $25,000.00 per day witness fee. It is noteworthy that this fee is to be paid regardless of whether the witness testifies for one hour or eight hours, or somewhere in between. In these dire financial times, a request to be paid a $25,000.00 per day witness fee out of the coffers of a publicly traded company in bankruptcy is not only excessive, but unconscionable—particularly when the amount of this *daily* fee is compared to the *annual* compensation earned by certain Americans who provide arguably more essential services to

69. *Id*. at 218–19 (citations and footnotes omitted).
70. *See id*. at 219 (listing the proposed fees for Tudor Pickering and Houlihan Lokey).
71. *Id*. at 227.

society.[72]

Just in case the two professional firms missed the point of the opinion, the court concluded with some very clear language:

> At some point, this Court must draw the line between what is reasonable and what is not. To quote the Fifth Circuit: "'[W]hen a pig becomes a hog it is slaughtered.'" "As the finder of fact, the bankruptcy court has the primary duty to distinguish hogs from pigs." Although the Fifth Circuit expressed this sentiment under a different set of facts than those in the case at bar, this Court sees good reason why this maxim applies here with equal force. These two investment banking firms have become hogs. Indeed, the investment bankers in the case at bar appear to have embraced the outlook expressed by Michael Douglas's character, Gordon Gekko, in the film *Wall Street* that "Greed—for lack of a better word—is good. Greed is right. Greed works." That may be how Wall Street views the world, but it is not how this Court sees things. In this Court, Greed is not good; Greed is wrong; and Greed does not work. Rather, the Court refers the parties to the words of Frederick Douglass, a prominent and compelling figure in American history who knew something about hard work: "People might not get all they work for in this world, but they must certainly work for all they get."[73]

If you were on the losing end of this opinion, you would likely experience many emotions: anger, certainly; perhaps chagrin; maybe embarrassment. But would you move the court to reconsider the language of the opinion? Houlihan Lokey did,[74] and the court responded in the second round with this language:

> They are unhappy because, among other things, the Opinion referred to the investment bankers as greedy, arrogant hogs. Their motion to amend requests this Court to unsay what it said and to unwrite what it wrote. This, the Court will not do.
>
> . . . In this Court's eyes, Houlihan Lokey attempted to raid the debtor's coffers by suddenly swooping in and swiftly scooping out unseemly sums of cash from the estate. In other words, Houlihan Lokey was a greedy

72. *Id*. at 230–31 (footnotes omitted). Footnote 16 is classic, concluding with this line: "The per annum salaries of the military personnel, nursing-aides, and public school teachers [all of whom may make $25,000/year], compared with the requested daily fee of $25,000.00, speaks volumes about the level of hubris among some members of the investment banking community." *In re Energy Partners*, 409 B.R. at 231 n.16.

73. *In re* Energy Partners, Ltd., 409 B.R. 211, 237 (Bankr. S.D. Tex. 2009) (alteration in original) (footnotes and citations omitted).

74. *In re* Energy Partners, Ltd., No. 09-32957-H4-11, 2009 WL 2970393, at *1 (Bankr. S.D. Tex. Sept. 15, 2009).

hog. The Court declines to amend the Opinion.[75]

Oops. At least, "oops" from Houlihan Lokey's point of view. Perhaps the better part of valor would have been to decide not to file the motion for reconsideration.

Leaving *Energy Partners* aside as a warning shot about overreaching, there's a clear thread running through all of these court-initiated sanctions opinions: in these cases, the judge is so fed up that he or she sits down to write a detailed account of what the lawyer did wrong in order to provide the appellate court with a sufficient rationale for the opinion when the lawyer appeals.

Consider the workload of the average bankruptcy court today. It's insane.[76] In order to sit down and write a sanctions opinion, a bankruptcy judge must add hours and hours of documentation and explanation to that already overwhelming workload. So why do the judges even bother?

In part, they do it because they're trying to send a signal—to the lawyer whose conduct falls beyond the pale and to all of his colleagues who practice before that court—that certain behavior will cost the lawyer more than any perceived advantages that the lawyer might get from cutting those ethical corners. They do it because lesser means, such as sidebars and in-chambers conversations, haven't worked to curb the behavior. They do it because it's their job to enforce the law.

Suffice it to say that no bankruptcy judge issues a sanctions opinion without first thinking long and hard about all of the consequences. Not only is there extra work, but because there's no one designated to represent the bankruptcy court's rationale for the sanctions on appeal, any judge writing a sanctions opinion also knows that he or she is

75. *Id.* Just in case Houlihan Lokey missed the point, the court reiterated: "[B]ecause this Court finds Houlihan Lokey's proposed fees to be facially exorbitant, and the Movants provided woefully insufficient evidence to convince this Court otherwise, the Court made no manifest error of fact characterizing Houlihan Lokey as greedy hogs." *Id.* at *10.

76. S*ee, e.g.*, Posting of Bob Lawless to Credit Slips, http://www.creditslips.org/creditslips/2008/12/bankruptcy-filings-in-2009.html (Dec. 18, 2008, 15:11 PST) ("For 2009, I am expecting a little under 1,400,000 bankruptcy filings [up from about 1.1 million]."); *see also* Arnold M. Knightly, *Bankrupt in Nevada? Many Are: Court Records Reveal Filings Jump 58.6 Percent in 2009*, LAS VEGAS REV.-J., Jan. 15, 2010, at D1, *available at* http://www.lvrj.com/business/bankrupt-in-nevada-many-are-81666032.html (detailing the dramatic increase in bankruptcy filings in Nevada and other states); American Bankruptcy Institute, Annual Business and Non-Business Filings by State (2007–09), http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=60253&TEMPLATE=/CM/ContentDisplay.cfm (last visited Mar. 24, 2010) (showing an increase in total bankruptcy filings from 2007 to 2008 in every state).

helpless to designate the record going up on appeal or to argue that the sanctions order was correctly decided.[77]

I know that every judge faces these problems—extra work and no representation on appeal—when writing a court-initiated sanctions opinion. The problem isn't limited to bankruptcy judges. One factor, though, does make the bankruptcy judge's decision even more difficult: the fact that, on appeal, the reviewing court often doesn't understand the sanctioned lawyer's behavior in the context of normal bankruptcy law practice.[78]

V. "I DON'T UNDERSTAND BANKRUPTCY LAW" REVERSALS

Even when a case involves a party's motion for sanctions, rather than a *sua sponte* sanctions order by a bankruptcy court, a district court can wholly miss the severity of the sanctioned lawyer's behavior. It's clear in those situations that someone has dropped the ball in explaining the bankruptcy court's reasons for sanctions to the district court. Take *In re Cochener*.[79] After the debtor's first lawyer, Hawks, filed the debtor's Chapter 7 petition, the Chapter 7 trustee asked Hawks for additional information after it appeared that the debtor's initial schedules were incorrect and that the debtor may have concealed some of her assets.[80] Hawks, feeling out of his league, affiliated a second, board-certified bankruptcy lawyer, Barry, to help him with the case.[81] Barry moved to dismiss the case on June 18, 2001, alleging that "'[n]o creditor in this

77. *See generally* Greenfield v. First City Bancorporation of Tex., Inc. (*In re* First City Bancorporation of Tex., Inc.), 270 B.R. 807 (N.D. Tex. 2001) (explaining the standard of review for a bankruptcy opinion).

78. There are, of course, times when the reviewing court does understand the bankruptcy court's reason for issuing a court-initiated sanctions opinion and simply disagrees with the statutory underpinning used to justify the sanctions. For example, in *Price v. Lehtinen* (*In re Lehtinen*), the bankruptcy court had sanctioned a debtor's lawyer for, among other things, failing to show up at the debtor's Chapter 13 confirmation hearing, lying to the debtor about the status of her case, and pressuring the debtor to use the lawyer as a real-estate broker for the sale of her home. Price v. Lehtinen (*In re* Lehtinen), 332 B.R. 404 (B.A.P. 9th Cir. 2005), *aff'd*, 564 F.3d 1052 (9th Cir. 2009), *cert. denied*, 78 U.S.L.W. 3065 (U.S. 2009) (mem.). The Bankruptcy Appellate Panel of the Ninth Circuit agreed with the bankruptcy court's conclusion that the lawyer deserved sanctions and was accorded due process, but the BAP remanded the case because the bankruptcy court had not applied the ABA standards regarding sanctions, which the BAP had previously adopted. *Id.* at 411–17.

79. *In re* Cochener, 360 B.R. 542 (Bankr. S.D. Tex. 2007), *aff'd in part, rev'd in part sub nom.* Barry v. Summers (*In re* Cochener), 382 B.R. 311 (S.D. Tex. 2007), *rev'd per curiam*, 297 F. App'x 382 (5th Cir. 2008).

80. *Id*. at 549.

81. *Id.* at 550–51.

case would suffer any legal prejudice by its dismissal;' and '[t]he interests of the creditors and Debtor would be better served by the dismissal of this bankruptcy proceeding rather than its continuation and adjudication.'"[82] Given that Barry was aware that the debtor may have been concealing assets,[83] his motion to dismiss was outside the standard of care of a bankruptcy lawyer—and certainly outside the standard of care of a board-certified bankruptcy lawyer. To make matters worse, Barry instructed the debtor not to attend a Section 341 meeting of creditors, even though the debtor's case hadn't yet been dismissed.[84] Barry also instructed the debtor not to turn over certain documents that the Chapter 7 trustee had requested when Hawks was representing her.[85] Even worse, Barry opposed another document request from the trustee in connection with a Rule 2004 examination of the debtor on the grounds that the document request sought information about possible fraudulent conveyances that were more than a year old and thus outside the trustee's reach.[86] (Any decent bankruptcy lawyer—and certainly a board-certified bankruptcy lawyer—would have known that Barry's argument was spurious.) Finally, in a burst of chutzpah, Barry sought to withdraw from the debtor's case.[87] Although the bankruptcy court allowed the withdrawal, it was clear that the withdrawal was to be "'without prejudice to any claims, ethical or otherwise, held by the [Chapter] 7 trustee.'"[88] Eventually, the trustee was able to recover just over $90,000 from the debtor and her relatives because of the fraudulent transfers.[89] In a fit of pique, the debtor also ruined some real property that belonged to the estate.[90]

After a variety of other activities in the case not relevant to the sanctions issue, the trustee moved for sanctions against Barry,[91] and the

82. *Id.* at 552.

83. *Id*.

84. *In re Cochener*, 360 B.R. at 552.

85. *Id.* at 554.

86. *Id.* at 555.

87. *Id*. at 556.

88. *Id*. at 557.

89. *In re* Cochener, 360 B.R. 542, 560 (Bankr. S.D. Tex. 2007), *aff'd in part, rev'd in part sub nom.* Barry v. Summers (*In re* Cochener), 382 B.R. 311 (S.D. Tex. 2007), *rev'd per curiam*, 297 F. App'x 382 (5th Cir. 2008).

90. *See id*. at 563 (laying out the destruction of the trustee's real property after the debtor moved out).

91. *Id*. at 564–65. By this time, other bankruptcy judges in the Southern District of Texas had already sanctioned Barry for his misbehavior in other cases. *Id*. at 565–66. The court in *Cochener* took judicial notice of these other sanctions. *Id.*

court awarded sanctions under its inherent powers pursuant to 11 U.S.C. § 105 and under 28 U.S.C. § 1927 (vexatious litigation).[92] If one were to poll a random grouping of knowledgeable bankruptcy lawyers, my guess is that 100 percent of them would conclude that Barry's behavior in the case was shockingly bad.

The district court, however, would (and did) disagree, finding in part that:

> Although willful misrepresentation of the facts and/or the law in a submission to the court constitutes bad faith, the Bankruptcy Court failed to cite any law or evidence from which it could plausibly have found that the two statements it characterized as "blatantly false" misstated the law or the facts, or represented anything other than a good faith attempt to dismiss a case that even the trustee's attorney agreed should not have been filed.[93]

The district court just couldn't have been more wrong, on a variety of grounds, regarding Barry's behavior. The district court judge who wrote the opinion is extremely intelligent, so it's difficult to figure out the disconnect between what the bankruptcy court thought of the misconduct and what the district court thought of it. The denouement of the case? In a per curiam opinion, the Fifth Circuit reversed the district court and affirmed the bankruptcy court.[94] Lesson? If the briefing on appeal doesn't put the behavior of the sanctioned bankruptcy lawyer into context, a non-bankruptcy-trained judge may not understand why the behavior merited sanctions. That failure to understand, in turn, may allow serial misbehavior to go unchecked.

VI. "WHAT THE HEY?" REVERSALS

There is another category of reversals: those that defy understanding. I call these the "what the hey?" reversals. Where the reversing court's explanation of its reasoning is so lacking that it provides zero guidance as to the reversing court's reasoning, then those reversals have to fall within the "what the hey?" category.

92. *Id*. at 586.

93. Summers v. Barry (*In re* Cochener), 382 B.R. 311, 332 (S.D. Tex. 2007), *rev'g In re* Cochener, 360 B.R. 542 (Bankr. S.D. Tex. 2007), *rev'd per curiam*, *In re* Cochener, 297 F. App'x 382 (5th Cir. 2008).

94. Summers v. Barry (*In re* Cochener), 297 F. App'x 382, 384 (5th Cir. 2008) (per curiam). In its opinion, the Fifth Circuit emphasized the importance of "enforc[ing] the integrity of the process by policing the accuracy of debtors' schedules and representations to the court." *Id.*

Take the case of *Rossana v. Momot* (*In re Rossana*).[95] Beller, the attorney sanctioned in the case, originally represented one of the Rossanas in a civil lawsuit against a lawyer named Momot, involving ownership of a bar, as well as in the criminal action when Mr. Rossana was charged with assault on Mr. Momot after Mr. Momot had won the civil suit.[96] Beller eventually became the bankruptcy lawyer for Mr. and Mrs. Rossana.[97] As part of the Rossanas' bankruptcy case, Beller filed a complaint against Momot for having executed on too much of the Rossanas' property to satisfy the civil judgment.[98] Beller won the over-execution complaint, and in 2003, he garnished Momot's bank account to satisfy the judgment.[99] In 2007, without withdrawing from the Rossanas' representation,[100] Beller moved to set aside that same judgment on behalf of Momot.[101]

It's safe to say that Beller's actions were clearly wrong under either the rule involving conflicts of interest with current clients[102] or the rule involving conflicts with former clients.[103] It's even safe to say that law students, when faced with a similar fact pattern in their basic Professional Responsibility course, would understand how wrong Beller's actions were.[104] In sanctioning Beller with a public reprimand and a referral to Nevada's disciplinary counsel, the court reasoned:

> [T]hat this [was] an egregious violation of the Nevada Rules of Professional Conduct that [fell] outside all accepted norms of the legal profession. Indeed, Beller's conduct discredit[ed] the work of all

95. Rossana v. Momot (*In re* Rossana), 395 B.R. 697 (Bankr. D. Nev. 2008), *rev'd in an unpublished opinion*, Beller v. Momot, No. 2:08-CV-1139-RCJ-PAL (D. Nev. 2009) (on file with the *St. Mary's Law Journal*).

96. *Id.* at 699.

97. *Id.*

98. *Id.* at 699–700.

99. *Id.* at 700.

100. Not that withdrawal would have mattered. Beller could never have represented Momot on the Rossanas' judgment, absent the Rossanas' consent, under Nevada's version of Model Rule 1.9, which provides, "[a] lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing." NEV. RULES OF PROF'L CONDUCT R. 1.9(a) (2006).

101. *Rossana*, 395 B.R. at 700.

102. *See* NEV. RULES OF PROF'L CONDUCT R. 1.7 (2006) (defining a concurrent conflict of interest to exist when "(1) [t]he representation of one client will be directly adverse to another client; or (2) [t]here is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client[.]").

103. NEV. RULES OF PROF'L CONDUCT R. 1.9 (2006).

104. I know that it's safe to say that. I've asked them.

> attorneys before this court and in the state of Nevada by calling into question whether attorneys will faithfully and loyally serve the interests of their clients.[105]

Having read this opinion, I would have expected the district court to have affirmed the sanctions on appeal. I would have been wrong. In reversing the bankruptcy court's decision, the district court provided this explanation of where the bankruptcy court's reasoning ran aground:

> [This] Honorable Court ... finds and concludes as follows:
> 1. No act or omission on the part of Appellant Beller constitutes a violation of NEV. RULES OF PROF'L CONDUCT R 1.7;
> 2. No act or omission on the part of Appellant Beller constitutes a violation of NEV. RULES OF PROF'L CONDUCT R 1.9;
> 3. No act or omission on the part of Appellant Beller constitutes the representation, concurrent or otherwise, of parties having materially adverse interests;
> 4. No act or omission on the part of Appellant Beller constitutes a conflict of interest;
> 5. No act or omission on the part of Appellant Beller constitutes an egregious violation of the Nevada Rules of Professional Conduct that fall[s] outside all accepted norms of the legal profession;
> 6. No act or omission on the part of Appellant Beller breaches any duty, expressed or implied, of attorney loyalty or faithfulness; and
> 7. The conduct of Neil J. Beller at issue constitutes a mere professional courtesy and in no way, actual or potential, threatened harm to any represented party.[106]

Ah, the old "mere professional courtesy" exception to the ethics rules![107] Of course that would explain what the Bankruptcy Court had gotten wrong—if only there were such an exception, anywhere, in any state's ethics rules, let alone in Nevada's. If any opinion reversing an order for sanctions deserves the "what the hey?" moniker, this one does.

There are four basic positions that the reviewing court can take when the sanctioned lawyer takes his case up on appeal:[108] it can affirm the

105. *Rossana*, 395 B.R. at 707.

106. Beller v. Momot, No. 2:08-CV-1139-RCJ-PAL, at 3–4 (D. Nev. 2009) (unpublished opinion on file with the *St. Mary's Law Journal*).

107. If I were reading this paragraph aloud, I'd be impersonating Maxwell Smart's voice in the *Get Smart* series. If you're old enough to remember this series, you'll remember that Agent Smart would typically respond to a countermeasure by an agent of the archenemy CHAOS by saying, "Ah, the old [fill in the blank by describing the countermeasure] trick!" Catchphrases, The Get Smart Web Page, http://www.wouldyou believe.com/phrases.html (last visited Mar. 24,, 2010).

108. There are many good articles and treatises that discuss the powers of a bankruptcy

bankruptcy court's decision (which leaves open the possibility for the sanctioned lawyer to appeal up the chain of reviewing courts); it can reverse the bankruptcy court's decision on procedural grounds (right idea, wrong rule); it can so wholly misunderstand the wrongful behavior of the sanctioned bankruptcy lawyer (or just not care about it) that it reverses the bankruptcy court's decision for completely inappropriate reasons (depending on whether the court misunderstands the behavior or just does not care, we'd have either an "I have no idea" reversal or the "what the hey?" reversal); or it can, on a close call, just disagree with the bankruptcy court and give the benefit of the doubt to the sanctioned lawyer.[109]

All but the first position create a disincentive for bankruptcy judges even to bother initiating a sanctions order in the first place. Maybe that disincentive is good for lawyers generally, given how miserable sanctions opinions can make their lives, with the possible disciplinary proceedings, increased malpractice premiums, and general embarrassment that can follow from sanctions.

Given the egregious nature of the misbehavior that triggers court-initiated sanctions, however, disincentives that follow from a misunderstanding of why the bad behavior was, in fact, bad are worse. Especially when we talk about sanctioning lawyers in consumer bankruptcy cases—either debtor-side or creditor-side—we're talking about lawyers who have made real people's lives miserable enough to catch the attention of the bankruptcy court. We're talking about debtors' lawyers who botch up debtors' cases and deprive them of legitimate relief that the Bankruptcy Code can provide. We're also talking about creditors' lawyers who take advantage of mistakes to

court to sanction lawyers who practice before it. *See generally* 1 COLLIER ON BANKRUPTCY ¶ 8.07 (Alan N. Resnick & Henry J. Sommers eds., 16th ed. 2009); 2 COLLIER ON BANKRUPTCY ¶ 105.02(6)(b) (Alan N. Resnick & Henry J. Sommers eds., 16th ed. 2009); 10 COLLIER ON BANKRUPTCY ¶ 8020.05 (Alan N. Resnick & Henry J. Sommers eds., 15th ed. revised 2007). In addition, there are several useful articles that discuss how the appeals process works in bankruptcy cases. *See, e.g.*, Judith A. McKenna & Elizabeth C. Wiggins, *Alternative Structures for Bankruptcy Appeals,* 76 AM. BANKR. L.J. 625, 626–32 (2002) (providing an executive summary and findings of a Federal Judicial Center study of the bankruptcy appellate process and mentioning possible areas of reform under discussion since 1999); Bernard Trujillo, *Self-Organizing Legal Systems: Precedent and Variation in Bankruptcy*, 2004 UTAH L. REV. 483, 492–99 (2004) (describing the bankruptcy appellate structure and discussing its shortcomings). Therefore, I won't discuss those two issues here.

109. I have a sneaking suspicion that district court judges, who probably don't see a lot of lawyer misbehavior in their own courts, may have a hard time believing how awful some lawyers appearing in bankruptcy court can be.

bully people who, by definition, are virtually defenseless. My guess, then, is that we don't want to deter judges from ridding the system of bad lawyers.

VII. CONCLUSION

As with court-initiated sanctions opinions in non-bankruptcy cases, no party represents the court's reasoning on appeal. The lawyer appealing the sanction designates the record; the appellate court reviews the case and renders a decision. If, for example, a debtor's lawyer gets sanctioned and appeals the sanction, the debtor himself isn't likely to retain a lawyer to argue on appeal that what the debtor's lawyer did was very, very bad. Therefore, an order requiring the debtor's lawyer to refund all fees to the debtor can be reversed on appeal without the appellate court hearing from either the bankruptcy court or the injured debtor, leaving the debtor himself whipsawed: bad lawyer behavior; no one to argue on the debtor's behalf. There are two injured parties when a lawyer's behavior is egregiously bad: someone in the case has suffered actual damage, and the legal system has suffered from the sanctioned lawyer's failure to live up to some minimal professional standards. Perhaps the injured party will have a voice on appeal, but there's an empty chair in the appellate courtroom for the legal system's own representative.

The empty chair in the appellate courtroom happens in non-bankruptcy cases involving court-initiated sanctions, too. Perhaps what the legal system needs is an amicus curiae process to help reviewing courts understand the standard of care in all court-initiated sanctions cases. Maybe we should start with court-initiated sanctions appeals in bankruptcy cases, where the practice of bankruptcy law is so specialized that not every reviewing court can know when a lawyer's behavior is beyond the pale.

I like the idea of amicus briefs to help reviewing courts understand bankruptcy lawyer misbehavior. But unless a lawyer somehow finds out about the misbehavior, I'm not sure how to initiate the amicus's participation on appeal. We wouldn't need amicus briefs in every appeal. For appeals that go to a bankruptcy appellate panel—a three-judge panel composed of bankruptcy judges—the judges on the BAP will be all too familiar with the standard of care in bankruptcy cases. However, not all appeals go through a BAP; some go straight to a district court.[110] What we really need is a system for educating courts that have Article III judges (district courts and above). Most Article III judges don't see enough bankruptcy cases to know the difference between not-great behavior and downright scandalous behavior.

Another option might be to give the Office of the United States Trustee[111] more of a role in court-initiated sanctions appeals.[112] United States Trustees certainly have the right to appear in such hearings, but the U.S. Trustee system is overworked as it is, and I can't imagine that many U.S. Trustees or Assistant U.S. Trustees would want to add this duty on a regular basis.

A third option is for the court to appoint an expert to represent the court's position on appeal. Like the amicus option, the expert would likely have to do the work pro bono; there just isn't enough money to go around, especially in most consumer cases, to pay an expert to appear in a sanctions appeal. At least the court-appointed expert option has the advantage of being a systematic way for the bankruptcy court to make sure that the reviewing court understands the significance of the sanctioned lawyer's behavior.

Finally, speeding up the appeals process with some sort of a fast-track program for sanctions appeals would provide a better link between the lawyer's misbehavior and the review of that misbehavior. The longer the lag between the sanction and the finality of appeals, the more damage a bad lawyer can do to his clients. A fast-track option could work because, typically, the facts of a sanctions opinion aren't disputed—just the interpretation of those facts.

We could, of course, do nothing: leave the system as it is, knowing that the behavior of some execrable lawyers will ultimately be rewarded by persistent appeals and well-crafted briefs.[113] If we leave the system

110. *See* 1 COLLIER ON BANKRUPTCY ¶ 5.01(Alan N. Resnick & Henry J. Sommers eds., 16th ed. 2009) (giving a full description of the process). Here is the nutshell: appeals go to the U.S. District Court or, if a Bankruptcy Appellate Panel has been created and the parties haven't opted out, to the BAP. *See* 28 U.S.C. § 158 (2006) (establishing the appellate jurisdiction of the United States District Courts and providing that "the judicial council of a circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges . . . to hear and determine, with the consent of all the parties, appeals").

111. For more about the powers of the Office of the United States Trustee, see DEPT. OF JUSTICE, U.S. TRUSTEE PROGRAM, ABOUT THE UNITED STATES TRUSTEE PROGRAM & BANKRUPTCY, http://www.justice.gov/ust/eo/ust_org/about_ustp.htm (last visited Mar. 8, 2010).

112. I know of at least one bankruptcy judge who, in some sanctions opinions, includes a request or requirement (depending on the case) that the Office of the U.S. Trustee appear in any appeal of the sanctions.

113. For example, see the long and storied disciplinary history of a lawyer named Smyth.

as it is, there will still be courts that initiate sanctions opinions in certain circumstances. But the system will stay tilted in favor of lawyers who shouldn't be practicing as they do. The unethical lawyers win twice: once by gaming the system in the first place, which gives them an advantage over the lawyers who play by the rules, and again by using their exploits to take clients away from lawyers who can promise to do only what the rules let them do.[114]

In keeping with my Passover theme, I'd describe the one-sidedness of appeals of court-initiated sanctions as akin to leaving the leverage all on Pharaoh's side. (Of course, the lawyers facing sanctions believe—with some justification—that all of the leverage is on the judge's side, but I'm more concerned with the system's one-sidedness at this point.) When Moses kept telling Pharaoh to "let my people go," Pharaoh kept coming up with all sorts of excuses. None of the excuses were particularly good (at least not from *my* people's point of view), but Pharaoh had all of the power, and he used that power in all sorts of bad ways: enslaving a people and generally acting the way that people can act when all of the incentives favor them (and when they are kings). It took divine intervention to level the playing field. Is it really so much to ask that we figure out a less-divine way to level the playing field when it comes to helping courts keep bad lawyers from contaminating

E.g., *In re* Brooks-Hamilton, 400 B.R. 238, 252 (B.A.P. 9th Cir. 2008) (stating that the bankruptcy court found, and the Ninth Circuit agreed, that Smyth's objections were frivolous, implausible, and filed for an improper purpose); Smyth v. City of Oakland (*In re* Brooks-Hamilton), 329 B.R. 270, 291 (B.A.P. 9th Cir. 2005) ("The bankruptcy court did not abuse its discretion in finding that Smyth had violated Rule 9011 in filing the objection to the city's claim, or in imposing a sanction of a six-month suspension from practice before the bankruptcy courts . . . ."), *aff'd in part, rev'd in part,* 271 F. App'x. 654 (9th Cir. 2008); *In re* Kellander, 10 F. App'x 585, 586 (9th Cir. 2001) ("The bankruptcy court sanctioned Smyth for filing a frivolous 11 U.S.C. § 522(f) motion to avoid a judgment lien and for filing the motion for an improper purpose.").

114. By making it so difficult to have sanctions "stick," what is happening to good lawyers is akin to what is happening to athletes who don't use steroids:

> Joe Morgan, a Hall of Famer and vice chairman of the National Baseball Hall of Fame, feels bad for players who didn't use performance-enhancers.
>
> "Those guys are being penalized twice," he said. "First, the guys who did steroids had all those great numbers, made all the money, and the guys who didn't do steroids and just had good years, didn't make as much money. So they get hurt there. Now at the end of their careers when you have to compare those numbers to the guys who did do steroids, they're going to get hurt again as far as the Hall of Fame is concerned. So I can't in my own mind excuse what happened, whatever the reason."

Ronald Blum, Gossage Wants Dopers Barred from Hall of Fame, YAHOO! SPORTS, Jan. 12, 2010, http://sports.yahoo.com/mlb/news?slug=ap-mcgwire-doping&prov=ap&type =lgns.

the system? *Dayenu.*[115]

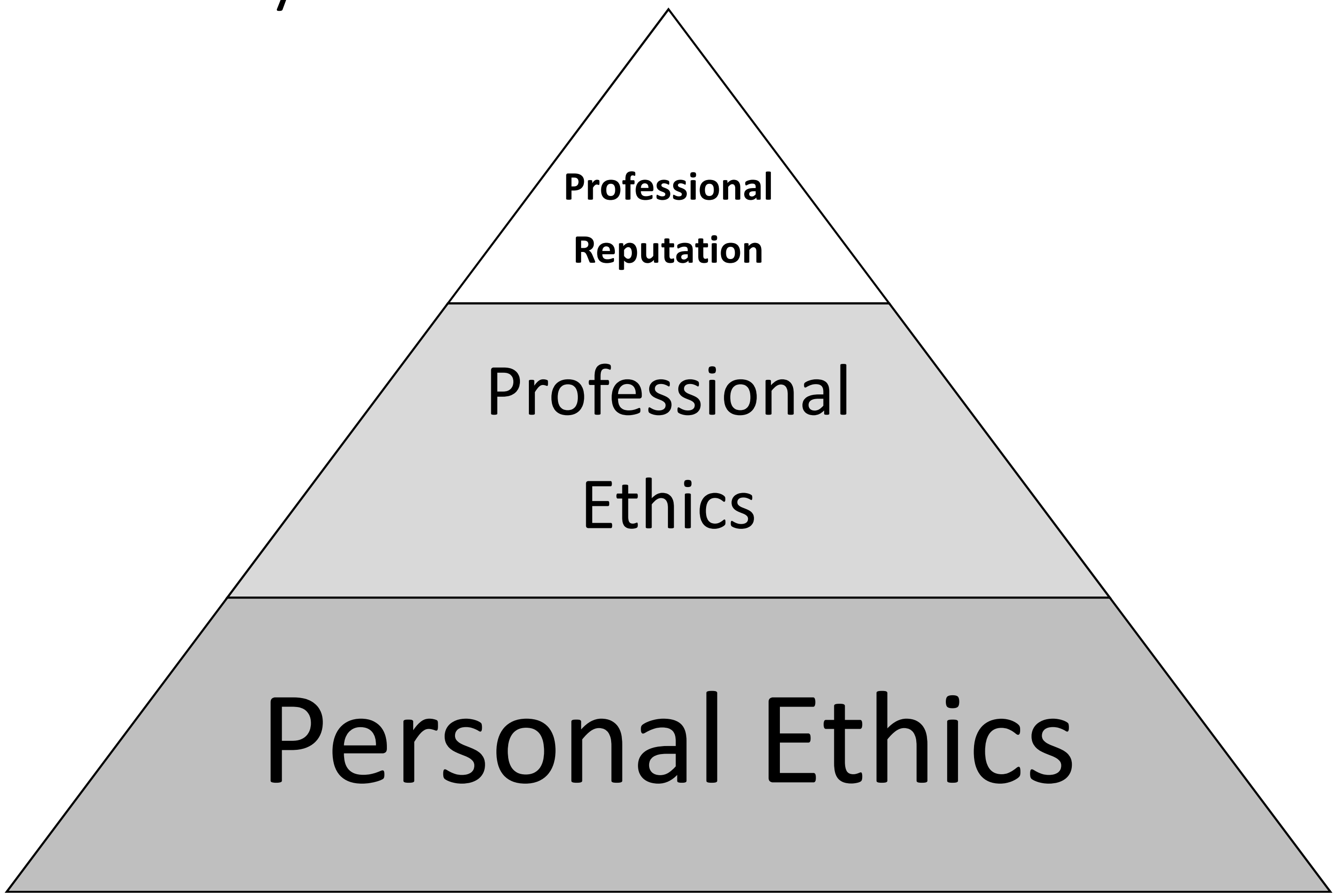
115. *See* n.25 *supra*.

Special Problems Presenting Financial Consultants as Expert Witnesses

and Other Ethics Hot Topics

These materials adapted from "Ethics Issues in Valuation" by Prof. Nancy B. Rapoport, Special Counsel to the President, University of Nevada, Las Vegas and Garman Turner Gordon Professor of Law, William S. Boyd School of Law.

The Ethics Pyramid



How Do Ethics Issues & Valuation Intersect?

- For lawyers:
  - Using an expert's opinion, *versus*
  - Using an expert to generate the opinion *<u>that you hope that the expert will write</u>*
  - Dealing with an option that is different from what you expected/wanted
  - Preparing the expert for giving testimony
  - Cross-examining an expert

How Do Ethics Issues & Valuation Intersect?

- For experts:
  - Methodology (and methodological ”flexibility”)
  - Opinion on issues outside of expert’s knowledge or “comfort zone”
  - Being used by lawyer as a tool to accomplish that which the lawyer can’t do himself
  - Refusing to admit the obvious

For lawyers acting as experts…

- Many ethics rules govern representation of clients
  - If you're a witness, you're not representing clients
- Some ethics rules apply to lawyers' conduct even when they're not representing clients
  - Rule 8.4 prohibits (among other things)
    - Violating other ethics rules
    - Committing a crime "that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects"; and
    - Lying, committing fraud or otherwise engaging in misrepresentation
    - Rule 8.4 is the "two for one rule" – violate any other state ethics rule, and you violate this one, too.

Two Types of Rules to Consider

- Rules that apply to lawyers when ***<u>using</u>*** an expert
- Rules that apply to lawyers when ***<u>they are experts</u>***

- *Pro tip:* Even when ethics rules don't apply directly to your potential expert (who is not representing a client), make sure you do a conflicts check on matters in which your expert has been employed.
  - Rule 1.7 (Current Clients)
  - Rule 1.9 (Former Clients)

Expert Nightmares, Part I

- The expert whom you've hired to prove "X" has already testified in other matters that "X" is not correct.
  - Ethics rules implicating competence and diligence
  - It's counsel's job to make sure the choice of expert is appropriate.

- Rule 3.3 (Candor to the Tribunal)
  - Don't offer false evidence – including a hinky expert report – and don't make false statements of fact or law (and don't let the expert do that either)
  - Lying to the court is a career-limiting decision
    - Letting an expert do it isn't any better

Expert Nightmares, Part I

- Rule 3.1 (Meritorious Claims & Contentions)
  - Don't "bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous"
  - Putting on an expert that isn't credible hurts counsel's credibility
- Rule 3.4 (Fairness to Opposing Party or Counsel)
  - Subsection (b) prohibits counsel from falsifying evidence, counseling or assisting a witness to testify falsely, or offering an inducement to a witness that is prohibited by law
  - Doesn't do much for your reputation with the court or opposing counsel

Competence & Diligence

- Finding a good expert
    - Referrals from people you trust
    - Referrals from experts you have used before
    - Due diligence
    - Personal observation (for example, an opposing expert in unrelated matter)
    - Try to find someone who isn't always testifying for the same side

Consulting vs. Testifying Experts

- Varying degrees of discoverability of discussions, work product

"Where an expert is a consultant with no potential to be a testifying expert, counsel can act with minimal care (e.g., don't leave expert correspondence on the table in the Food Court at the local mall while standing in line at the Sbarro). But where the consultant holds any real potential to be presented as an expert witness at trial, counsel should treat the witness as a testifying expert from the outset for purposes of planning communication and attempting to deny opposing counsel to sensitive materials. For example, if otherwise privileged documents are used to refresh an expert's recollection or prepare for testimony, most courts will find any privilege waived and will require production of the documents."

DAVID F. HERR, ROGER S. HAYDOCK, & JEFFREY W. STEMPEL, FUNDAMENTALS OF LITIGATION PRACTICE § 3:7 (2011 ed.).

Experts – Red Flags

- Unusual social network participation*
- Hard to contact – slow to respond
- Uses a referral service (not his own business) to get expert engagements
- Doesn't ask to check for conflicts of interest
- Sounds like a stuffed shirt, even during first contact
- Uses word "we" incorrectly ("We argued X in the last four cases)," which implies that they view themselves as advocates and not an independent neutrals
- No mastery of facts of the case
- Clings to theories even in light of different facts
- Argues with opposing parties (or the Court)
- Has been found not credible by a Court on the same issue

** Ballroom dancing pictures, OK. Pictures of keg-stands, not OK.*

Experts – Red Flags

- Expert deviates from established conventions on developing his opinion (e.g. calculating value) w/o being able to explain reasons for doing so
- Expert can't explain the opinion in a step-by-step, logical, clear manner.
- Expert can't or doesn't list all sources on which he or she relied to develop the report
- Expert is being paid by contingency fee (or gets an incentive if a particular result is achieved)
- Expert answers questions without stopping to think about what the questioner is really asking

The Six ”C”s of Ethics Considerations

In performing valuations for any bankruptcy-related purpose, the expert should consider:

1. **Compliance** with promulgated professional standards
2. **Competency** to perform the subject analysis
3. **Completeness** of the subject analysis
4. **Correctness** of the analysis and the conclusion
5. **Confusion** caused by the analyst in the analysis
6. **Consistency** with previous positions

Robert F. Reilly, *Analyst Ethics Considerations in Bankruptcy Business/Stock Valuations,* 29-AUG AM. BANKR. INST. J. 56 (2010):

Expert Nightmares, Part II

- TOUSA
  - Bad compensation structure: “If you say “X”, you get $$$$$”

  - First, the firm was compensated on a contingency-fee basis: The firm could earn a $2 million ‘premium’ *only* upon the issuance of an opinion finding solvency, which dwarfed the amounts payable to the firm on a time and expense basis if it were unable to give an opinion of solvency;
  - Second, the firm relied entirely on projections provided by TOUSA's management and never examined individual divisions or community-level projects;
  - Third, TOUSA failed to revise these projections to account for the collapse in the housing market, of which TOUSA management was well aware, as demonstrated by numerous internal discussions and memoranda. . . .

Expert Nightmares, Part II

- TOUSA…
  - Fourth, the projections were far more optimistic than those that TOUSA was utilizing internally, with the ‘base case’ provided to the firm allowing for far higher growth in TOUSA's business than the ‘best case’ presented to the board of directors in a presentation occurring just four days after the July 31 transaction closed;
  - Fifth, the firm based its valuation on EBITDA multiples, which experts for both the plaintiffs and the defendants agreed was inappropriate and unreliable given TOUSA's business.”

* John C. “Kit” Weitnauer, *Valuation Questions Raised By* TOUSA*,* 29-MAR AM. BANKR. INST. J. 38, 76 (2010).

For Court to Admit Expert Testimony

- The Court must decide:
  - "whether expert testimony could assist the trier of fact in understanding the evidence or determining a fact in issue" (which will include questions of reliability and relevance) and
  - whether the expert is qualified to give the opinion.

BANKR. EVID. MANUAL § 702:1 Testimony by Experts—Overview, Bankr. Evid. Manual § 702:1 (2010 ed.) (JUDGE BARRY RUSSELL)

Be Precise

- Is your expert qualified to give an opinion with respect to the particular question at issue (not just generally, but specifically)?
  - Related question: does your expert believe that he or she is an expert in more areas than he or she actually is?
- Do your expert's qualifications match what he or she will be asked about?
  - Related question: if none of your experts have the "perfect background"…
    - Do you need more than one expert?
    - What are the risks that their opinions or methodology might conflict with each other?
- Have you given your expert everything that he or she needs to be able to form an opinion?
  - Related question - and potentially dangerous practice: Are you preventing the expert from accessing relevant information?

Be Precise

- Are you "suggesting" in which direction your expert's opinion should go?
  - Related question: do you really want an expert whose opinions can bend that easily?
- Have you prepped the witness for your questions, opposing counsel's questions, and questions from the judge?
  - Related question: have you checked the expert's previous opinions or testimony to make sure that your expert can't be impeached by their past testimony or, if there's a problem, have you dealt with it before your expert testifies?
- IS YOUR EXPERT DOING THE WORK HIMSELF?
  - Is your expert double-checking the work of their subordinates?

Expert Nightmares, Part III

Occulto v. Adamar of New Jersey, Inc., 125 F.R.D. 611 (1989) (production of attorney-prepared expert report not protected work product).

- "The videotaped deposition of Dr. Demko went forward on January 12, 1989, and Mr. Goldenziel concluded the direct examination and Mr. Riordan, on behalf of defendant, had almost completed cross-examination when something quite remarkable occurred. . . .
- Mr. Riordan discovered that Dr. Demko did not write his own Report. Instead, Dr. Demko's file contained a draft letter, not on Demko's letterhead, also dated December 20, 1988 [hereinafter "Draft Report"] which was verbatim the same as the Demko Report with one important exception. . . .

Expert Nightmares, Part III

The Draft Report bore the typewritten legend across the top:

PLEASE HAVE RE–TYPED ON YOUR OWN STATIONERY.

THANK YOU."

- **Q**: What's the only thing worse than drafting your expert's report and then asking him to retype it and submit it as his own?
- **A**: Lying about it after you get caught
- **Q**: What's the second worst thing about this?
- **A**: Hiring an expert who would agree to that.

Expert Nightmares, Part IV

- Single dumbest and most avoidable expert mistake:
  - When a judge askes the expert a question that really is straightforward (and will hurt the expert's side's case) and the expert ducks the question and hems and haws, the expert has lost the judge.
  - Always be honest and concede bad facts – a good witness will be able to put them into context as to why they don't change the expert's opinion or, better yet, why the expert considered those very facts and why they are already factored into the opinion

What an Expert Isn't: The Lawyer's Alter-Ego

Occulto v. Adamar of New Jersey, Inc., 125 F.R.D. 611, 616 (1989):

- "Experts participate in a case because, ultimately, the trier of fact will be assisted by their opinions, pursuant to Rule 702, Fed.R.Ev. They do not participate as the alter-ego of the attorney who will be trying the case."

Care & Feeding of Experts

- Be clear about the scope of the assignment
- If you want to cut costs, there are some things your office can prepare, such as a list of all documents transmitted to the expert
- Give the expert enough time to analyze the data and form an opinion. (An "expert emergency" is a failure on the part of counsel)
- Give your expert some reminders:
    - Update and proofread resume
    - Update list of materials reviewed for the opinion
    - Re-read opinion and relevant supporting materials before testimony

Care & Feeding of Experts

- Prepare the expert for deposition questions such as:
  1. Have you reached any opinions or conclusions not contained in your report?
  2. Have you been asked to form any other opinions?
  3. Do you plan to offer any other opinions?
  4. What additional work, if any, do you plan to perform related to this case?

  * Robert F. Reilly, *Valuation Analyst Guidelines Related to Bankruptcy Expert Reports and Testimony,* 29-OCT 60 AM. BANKR. INST. J. 60 (2010).