Bankruptcy Practice: Keeping It Ethical

Presented by:
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The "rules" of ethics for bankruptcy attorneys are not found in title 11 of the U.S. Code, but in title 18 (the federal criminal code). This presentation will include an examination of ethical issues which may be encountered by attorneys in bankruptcy cases, including fraud, false statements made in connection with a bankruptcy case and concealment of assets.

This presentation will include an analysis of selected provisions of the federal criminal code as they relate to bankruptcy cases, including the following provisions: 18 U.S.C. § 152 (concealment of assets; false oaths and claims; bribery), § 155 (fee arrangements in cases under title 11 and receiverships), and § 157 (bankruptcy fraud). The presentation will also include a summary of recent federal convictions of debtors who filed bankruptcy in the Western District of Louisiana and were later convicted for committing violations of the federal criminal code.

Finally, the presentation will include an analysis of applicable rules of professional conduct. In the Fifth Circuit, courts initially look to the district's local rules when considering the standard of professional conduct for the lawyers appearing in federal court. *FDIC v. U.S. Fire Ins. Co.*, 50 F.3d 1304, 1312 (5th Cir.1995). In the Western District of Louisiana, Local Rule 83.2.4 provides that the Louisiana Rules of Professional Conduct shall apply. The Louisiana Rules, however, "are not the sole authority" governing professional conduct in federal cases. *FDIC*, 50 F.3d at 1312. "Motions to disqualify are substantive motions affecting the rights of the parties and are determined by applying standards developed under federal law." *In re Dresser Indus., Inc.*, 972 F.2d 540, 543 (5th Cir.1992). Because the Fifth Circuit recognizes the American Bar Association Model Rules of Professional Conduct as the national standard, a bankruptcy court in this circuit should apply both the ABA Model Rules and the Louisiana Rules in its analysis. *In re ProEducation Int'l, Inc*., 587 F.3d 296, 299 (5th Cir. 2009).

A federal court's inherent powers "include the power to control and discipline attorneys appearing before it," *Id.*, and to suspend attorneys who practice before it. *In re Snyder*, 472 U.S. 634, 643, 105 S.Ct. 2880 (1985). In addition to its inherent power, a bankruptcy court has the authority to examine the transactions between a debtor and his, her or its counsel pursuant to the provisions of 11 U.S.C. §§ 105(a) and 329 and Bankruptcy Rules 2016(b) and 2017 and to enter appropriate orders for relief regarding the attorney-client arrangement between a debtor and counsel.

18 U.S.C. § 152. Concealment of assets; false oaths and claims; bribery

A person who--

(1) knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor;

(2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11;

(3) knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, in or in relation to any case under title 11;

(4) knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney;

(5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11;

(6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11;

(7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation;

(8) after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor; or

(9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor,

shall be fined under this title, imprisoned not more than 5 years, or both.

Cases related to 18 U.S.C. § 152:

Attorney Grievance Com'n of Maryland v. Fraidin 91 A.3d 1078 (Md.,2014). Disbarment was warranted as a sanction for attorney's misconduct arising out of his intentional mishandling of his attorney trust account and his assisting of his wife in the preparation of her bankruptcy documents, which included misrepresentations of fact for the purpose of defrauding the bankruptcy court; attorney's motives were dishonest and selfish, attorney made false statements and misrepresentations during disciplinary proceedings, and attorney failed to take responsibility for his actions relating to the bankruptcy proceedings.

In re Disciplinary Proceeding Against McGrath, 178 Wash.2d 280, 308 P.3d 615 (Wash.,2013). Attorney who made false statements and claims against his wife's bankruptcy estate and bankruptcy estate of limited liability company (LLC), fraudulently transferred, received, and concealed bankruptcy assets committed felonies and, thus, violated Rules of Professional Conduct (RPC) that prohibited criminal conduct and conduct prejudicial to the administration of justice. 18 U.S.C.A. § 152; Rules of Professional Conduct 8.4(b, d).

In re Disciplinary Proceedings Against Schoenecker, 336 Wis.2d 253, 258-260, 804 N.W.2d 686, 688 - 689 (Wis.,2011). Three-year suspension of attorney's license to practice law was an appropriate level of discipline in light of his serious misconduct. The professional misconduct involved the attorney's own personal bankruptcy proceeding. During the course of litigation with a creditor, the attorney filed chapter 7 bankruptcy. In his bankruptcy schedules, the debtor claimed that he had become unemployed on June 30, 2009. He failed to disclose, however, that he had also been operating a separate solo law practice apart from his prior employment with the Clair law firm. He disclosed only the income he had earned from the Clair law firm. He did not disclose any of the income he had received from his "side" practice. In addition to filing these inaccurate schedules, the debtor-attorney also falsely testified under oath at a meeting of creditors on August 31, 2009, that his bankruptcy filing was true and correct and did not need to be amended, except to correct the names of some creditors. On January 12, 2010, the bankruptcy court granted the debtor-attorney a discharge in bankruptcy. After the U.S. Trustee learned of the debtor-attorney's practice of law on his own apart from the Clair law firm, the Trustee moved to revoke the discharge in bankruptcy on the ground that the bankruptcy had been gained through fraud. The debtor-attorney agreed to a stipulation to revoke his bankruptcy discharge in May 2010. In the stipulation, he acknowledged that he had testified falsely at the August 2009 meeting of creditors and in a subsequent deposition taken on October 20, 2009. He also admitted that his bankruptcy schedules had not been true because he had failed to disclose that he had received income from his private law practice during the six-

month period prior to filing his bankruptcy petition. On the basis of the stipulation, the bankruptcy court did ultimately revoke the debtor-attorney's discharge in bankruptcy. Although there is no indication that he was ever criminally charged for violations of federal bankruptcy law, the attorney agreed that his conduct in the bankruptcy proceeding was a violation of 11 U.S.C. § 727(a)(4)(A), which, in turn, constituted a bankruptcy crime under 18 U.S.C. § 152 for making a false oath or account in a bankruptcy proceeding.

Attorney Grievance Com'n of Maryland v. Zodrow, 419 Md. 286, 19 A.3d 381 (Md.,2011). Attorney's conduct during his personal bankruptcy proceeding, failing to disclose his interest in property, failing to disclose monthly obligation under promissory note, giving false testimony as to his law firm's receipt of funds, failing to alert bankruptcy trustee that he had made an unsecured loan to a friend, violated rules prohibiting attorney from making a false statement to a tribunal, prohibiting attorney from knowingly disobeying an obligation under the rules of a tribunal, and prohibiting conduct involving dishonesty, fraud, deceit or misrepresentation. Disbarment was warranted. Md.Rule 16–812, Rules of Prof.Conduct, Rules 3.3, 3.4, 8.4(c).

18 U.S.C. § 155. Fee agreements in cases under title 11 and receiverships

Whoever, being a party in interest, whether as a debtor, creditor, receiver, trustee or representative of any of them, or attorney for any such party in interest, in any receivership or case under title 11 in any United States court or under its supervision, knowingly and fraudulently enters into any agreement, express or implied, with another such party in interest or attorney for another such party in interest, for the purpose of fixing the fees or other compensation to be paid to any party in interest or to any attorney for any party in interest for services rendered in connection therewith, from the assets of the estate, shall be fined under this title or imprisoned not more than one year, or both.

18 U.S.C. § 157. Bankruptcy fraud

A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so-

(1) files a petition under title 11, including a fraudulent involuntary petition under section 303 of such title;

(2) files a document in a proceeding under title 11; or

(3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title,

shall be fined under this title, imprisoned not more than 5 years, or both.

Cases related to 18 U.S.C. § 157

In re Yagman, 61 A.D.3d 30, 871 N.Y.S.2d 118 (N.Y.A.D. 1 Dept.,2009). Attorney's conviction for bankruptcy fraud under federal statute, for knowingly and intentionally filing bankruptcy petitions in which he fraudulently misrepresented and omitted material and substantial assets, was essentially similar to the New York felonies of offering a false instrument for filing in the first degree and perjury in the first degree, so as to provide a basis for automatic disbarment. 18 U.S.C.A. § 157.

In re Thomas, 223 Fed.Appx. 310, 2007 WL 654241 (5th Cir. 2007). Bankruptcy court did not abuse its discretion when it sanctioned Chapter 13 debtors' attorney, who signed documents containing intentional misrepresentations in an attempt to abuse the bankruptcy process by obtaining discharge of debts that his clients could not challenge in good faith, by imposing ethics instruction due to attorney's conduct in twice refusing, in open court, to recognize duty of candor, by forwarding its memorandum opinion to United States Attorney on grounds that making false representation in bankruptcy proceeding was federal crime, and by forwarding copy of its opinion to state bar pursuant to Code of Conduct for United States Judges. 18 U.S.C.A. § 157(3); Fed.Rules Bankr.Proc.Rule 9011.

U.S. v. Jackson, 363 B.R. 859 (N.D.Ill.,2007). Charges in count of indictment alleging that defendant, an attorney who had represented a debtor in bankruptcy, devised a scheme to defraud the bankruptcy court and the bankruptcy trustee by attempting to delay the court's order for him to disgorge attorneys fees, and that, as part of this scheme, defendant made a false representation to the court that he had placed $28,000.00 in attorneys fees in his firm's trust account, where it had always been escrowed, knowing that in fact the money was not in his trust account but had already been converted by him, were not for the same offenses for which defendant previously received a criminal contempt citation, which was based on defendant's failure to have returned the $28,000.00 prepetition fee to the trustee after the court, concerned over the safety of the funds, had ordered him to do so, and so charging defendant with that count did not violate the double jeopardy clause. U.S.C.A. Const.Amend. 5; 18 U.S.C.A. § 157(3).