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**CLUE OR CLUELESS? -
THE CONTINUING MYSTERY OF ETHICS**

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I. RETENTION OF PROFESSIONALS

***In re Specialty Rest. Group, LLC*, No. 07-30779, 2007 WL 1231603 (Bankr. N.D. Tex. April 24, 2007).** The official committee of unsecured creditors (the “Committee”) objected to the debtor’s application to employ general bankruptcy counsel pursuant to sections 327 and 329 claiming that proposed counsel was not disinterested. The objection was premised upon the Committee’s claims that proposed counsel had failed to conduct a UCC search and to commence the debtor’s bankruptcy case within ninety (90) days of the perfection of a security interest by one of the debtor’s secured creditors (i.e. that proposed counsel had committed mal-practice and that the Committee therefore had a claim against it, thereby disqualifying proposed counsel). The bankruptcy court opined that under Texas law, a malpractice claim was personal to the debtor and as such the debtor was the only party that could assert such a claim. Given that client satisfaction is the main inquiry in Texas malpractice cases and that the debtor was satisfied with proposed counsel’s performance, the bankruptcy court approved proposed counsel’s retention over the Committee’s objection.

***In re Fortune Natural Resources Corp.*, 366 B.R. 558 (Bankr. E.D La. 2007).** Certain of the debtor’s former directors filed a claim pursuant to section 503(b)(1)(A) of the bankruptcy code to which the creditors’ committee objected. The bankruptcy court found that the directors had acted in both their capacities as directors and as “professional persons” as that term is used in section 330 of the Bankruptcy Code. Since the directors had not and could not be retained pursuant to section 327, due to their “failure to meet the disinterestedness requirement of Section 327(a)”, the Bankruptcy Court denied their claim. In doing so, the Bankruptcy Court opined that “a court should not circumvent the limitations placed on retention of professionals by compensating a disqualified professional under Section 503(b)(1)(A).”

***In re Modanlo*, 342 B.R. 230 (D. Md. 2006).** The debtor moved to disqualify counsel (“Counsel”) for one of its creditors alleging that the debtor was a “prospective client” of Counsel. The allegation was based upon the debtor’s telephone conversations with Counsel discussing potential representation of the debtor in the debtor’s yet to be filed bankruptcy case. (Maryland’s Rule 1.18 of Professional Conduct prohibits counsel from representing a client materially adverse to those of a prospective client in the same or substantially related matter.) More specifically, the debtor, though a third party, spoke with Counsel regarding the debtor’s history, formation, corporate structure, ongoing litigation, assets and liabilities, and possible legal strategies. Denying the motion, the court held that: 1) the debtor waived the issue by waiting five months before bringing the motion to disqualify; 2) allowing the debtor to delay the bankruptcy case would be to the tactical advantage of the debtor thereby prejudicing the creditor; and 3) that the debtor had not shared any significantly harmful information with Counsel.

***In re Meridian Auto. Systems-Composite Operations, Inc.*, 340 B.R. 740 (Bankr. D. Del. 2006).** A motion to disqualify counsel (“Counsel”) for an informal committee of first lien holders (“Committee”) was filed by a secured creditor (the “Secured Creditor”) alleging that Counsel had violated the Delaware Rules of Professional Conduct. Prior to the filing of the bankruptcy case, the Secured Creditor, who held both first and second lien debt, retained Counsel to analyze the debtor’s credit and intercreditor agreements. Some of the members of the Committee held both first and second lien debt. Counsel was retained to represent the

Committee with regard to the various intercreditor issues. The Secured Creditor alleged, *inter alia*, that Counsel was representing an adverse client on substantially related matters without its consent in violation of Model Rule of Professional Conduct 1.9. The court found that Counsel could not “advise each tranche of secured debt holders as to rights via-a-vis the other under the Credit Documents without ‘changing sides in the matter in question.’” Further, the court held that since the Committee was adverse to the Secured Creditor and Counsel had not obtained written consent from its former client, the Secured Creditor, to represent the Committee, that Counsel had violated Model Rule 1.9. Accordingly, the court granted the motion thereby disqualifying Counsel from further representation of the Committee in the case.

***In re Woodworkers Warehouse, Inc.*, 323 B.R. 403 (D. Del. 2005).** Despite the fact the bankruptcy court had previously denied the debtor’s attempt to retain a law firm as general counsel pursuant to section 327(a) due to a conflict of interest (*i.e.* representing official committee of unsecured creditors in prior bankruptcy case), the bankruptcy court approved the debtor’s employment of the law firm as special counsel for the purposes of: 1) obtaining court approval of use of cash collateral; 2) selling assets through a going out of business sale; and 3) preparing and negotiating a key employee retention program. On appeal, the United States Trustee argued that the law firm’s representation of the debtor was in direct conflict with section 327(e), which requires special counsel to only be retained for a special purpose other than general representation in conducting the case. The district court noted that the term “conducting the case” is not defined by the bankruptcy code and undertook an analysis of case law addressing the issue. Affirming the bankruptcy court, the district court determined that the services provided by special counsel did not amount to “conducting the case.”

***In re Cyrus II P’ship*, No. 05-39857, 2008 WL 3003824 (Bankr. S.D. Tex. July 31, 2008).** Chapter 7 trustee (the “Trustee”) filed a notice of the Trustee’s retention of various expert witnesses (the “Experts”) to be utilized in the adversary proceeding. Thereafter, a debtor and her husband filed a motion requesting that the bankruptcy court enter an order directing the Trustee to show cause as to why he should not be required to comply with section 327 and file applications to retain the Experts. The bankruptcy court undertook a detailed analysis regarding the retention of expert witnesses and determined that the central question was “the subject matter of the expert’s testimony and evaluating how closely such matter is related to core bankruptcy issues.” Accordingly, the more closely the testimony is related to core bankruptcy issues the more likely the expert witness is to fall within the section 327 requirements. The bankruptcy court ultimately determined that the Experts were not retained to testify regarding core bankruptcy issues and therefore the Trustee was not required to file applications to retain the Experts.

***In re Contractor Tech., Ltd.*, No. Civ.A. H-05-3212, 2006 WL 1492250 (S.D. Tex. May 30, 2006).** Chapter 7 trustee (the “Trustee”) filed application to employ special litigation counsel (“Counsel”) to prosecute certain avoidance actions. A creditor (the “Creditor”) objected to retention of Counsel because, *inter alia*, Counsel had a direct conflict of interest and was not disinterested due to its representation of certain of the debtor’s other creditors. The bankruptcy court approved Counsel’s retention subject to Counsel not providing any assistance to the Trustee with regard to those creditors represented by Counsel. The Creditor appealed the bankruptcy court’s ruling. On appeal, the district court affirmed the bankruptcy court and held that Counsel did not have a direct conflict of interest and the bankruptcy court’s finding of fact

that “[Counsel] does not possess ‘a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors’ should not be disturbed.”

***In re Marble*, No. 07-50099-RLJ-11, 2007 WL 1556836 (N.D. Tex. May 25, 2007).** The United States Trustee (the “UST”) objected to the retention of proposed counsel (“Counsel”) for chapter 11 debtors. The UST alleged that Counsel could not meet the requirements of section 327(a), which requires that Counsel not hold or represent an interest adverse to the estate and be disinterested. The UST’s basis for the objection was that Counsel served as trustee of a spendthrift trust under which one of the debtors was a beneficiary. Allowing Counsel’s retention, the bankruptcy court held that Counsel’s duties as trustee of the trust and in representing the debtors were closely aligned and approved Counsel’s retention.

***In re Cygnus Oil and Gas Corp.*, No. 07-32417, 2007 WL 1580111 (Bankr. S.D. Tex. May 29, 2007).** Chapter 11 debtor (the “Debtor”) filed application to retain general bankruptcy counsel (“Counsel”). The United States Trustee (the “UST”) filed an objection to Counsel’s retention asserting that Counsel was not a “disinterested person” as required by section 327(a) of the Bankruptcy Code. The UST’s objection was based upon Counsel’s disclosure that: 1) one of its partners (the “Partner”) held stock in the Debtor; 2) the Partner had at one time served as a director of the Debtor; and 3) as of the petition date the Debtor owed Counsel in excess of \$77,000.00. Allowing Counsel’s retention, the bankruptcy court (i) rejected the *per se* rule that a single person’s disinterestedness is imputed to his entire firm for purposes of disqualification under section 327(a) of the Bankruptcy Code and (ii) confirmed that the waiver of the pre-petition claim absolved Counsel of a claim of disinterestedness on that issue.

II. DISCLOSURE ISSUES

***In re Balco Equities Ltd., Inc.*, 345 B.R. 8 (Bankr. S.D.N.Y. 2006).** Chapter 7 trustee (the “Trustee”) filed adversary seeking an accounting and disgorgement of firm’s (the “Firm”) retainer for failure to disclose connections and for failure to file application with court for approval of its fees, as required by retention order and section 330. Denying all of the Firm’s requested professional fees and directing the Firm’s retainer be disgorged and turned over to the Trustee, the court found that the Firm had violated Bankruptcy Rules 2014(a) and 2016(b) in multiple untimely and incomplete disclosures. Moreover, the court found that the Firm lacked disinterestedness pursuant to sections 328(c), 327(a), and 101(14) of the Bankruptcy Code and that if the proper disclosures had been made the Firm’s retention would never have been approved. Upon reconsideration, the court upheld its ruling and noted that the Firm had failed to disclose multiple conflicts of interests and connections with several parties in interest and that the Firm had conceded that it was not disinterested as defined in section 101(14).

***Barron v. Countryman*, 432 F.3d 590 (5th Cir. 2005).** The chapter 13 trustee (the “Trustee”) filed a series of motions (153) in the bankruptcy court complaining as to the methods under which a high volume consumer bankruptcy practitioner (the “Attorney”) collected his fees. Under the local rules in the Eastern District of Texas, an attorney was allowed to collect no more than \$2,000.00 for a chapter 13 cases without the filing of a detailed fee application. The Attorney would first require clients to pay approximately \$400.00 prior to the filing of their cases. These initial payments were considered “deposits” for pre-petition work and not retainers. As such, the Attorney took immediate possession of the payments rather than placing them in

trust or an IOLTA account. The Attorney also took additional payments in certain cases for contested matters in the debtors' bankruptcy cases. Bankruptcy court approval for these additional post-petition payments was never requested nor received. However, the remainder of the Attorney's \$2,000.00 fee was subject to bankruptcy court scrutiny pursuant to the chapter 13 confirmation process. The bankruptcy court held that the Attorney had violated the Bankruptcy Code, the Texas Disciplinary Rules of Professional Conduct (the "Texas Rules") (*i.e.* rule 1.14(a)), the Local Bankruptcy Rules (*i.e.* Rule 2016(b)), and the Local Rules for the United States District Court of Eastern District of Texas by failing to place pre-petition fees in escrow pending bankruptcy court approval and to file a fee application for the additional post-petition fees. Therefore, the bankruptcy court ordered the Attorney to disgorge all fees associated with one hundred and sixty-seven (167) cases. On appeal the district court affirmed the holdings of the bankruptcy court. On appeal to the Fifth Circuit, the court determined that: 1) the Trustee had standing to challenge the Attorney's payment system; 2) the bankruptcy court could require a fee application from the attorney for the "deposits" only if the amount remained within the debtors' estates; 3) the deposits were in the nature of "advanced payment retainers," which do not become property of a debtor's estate; 4) Texas Rules do not require "advanced payment retainers" to be placed in trust; 5) the Attorney violated Local Bankruptcy Rule 2016(e)(5) by accepting the post-petition payments without bankruptcy court approval. Accordingly, the Fifth Circuit vacated the portion of the order for disgorgement of the pre-petition fees and affirmed the disgorgement of the post-petition fees.

III. RULE 11 (9011) AND OTHER SANCTIONS

The Cadle Co. v. Pratt (In re Pratt), 524 F.3d 580 (5th Cir. 2008). In a case of first impression, the Fifth Circuit considered whether a creditor's utilization of informal notice complied with the safe harbor notice provisions of Rule 9011. The creditor filed a Rule 9011 motion (the "Motion") against the debtor's attorney. The bankruptcy court denied the Motion because the creditor had sent a warning letter to the debtor's attorney rather than a copy of the actual Motion. The bankruptcy court also awarded the debtor's attorney the fees associated with defending the Motion. On appeal the district court affirmed the denial of sanctions and remanded for further proceedings regarding the award of attorney's fees because the creditor had not been afforded the opportunity to "examine, question, or provide argument against the claimed fees and expenses." On appeal to the Fifth Circuit, the court decided *sua sponte* that it did not have jurisdiction to consider the remand with regard to the award of attorney's fees as the bankruptcy court had significant further proceedings to consider. However, the Fifth Circuit determined that it did have proper jurisdiction to consider the denial of sanctions. Affirming the lower courts' denial of sanctions, the Fifth Circuit held that: 1) it was undisputed that the creditor failed to serve a copy of the Motion prior to filing it with the bankruptcy court; 2) that informal notice (*i.e.* warning letters) does not meet the notice requirements of Rule 9011; and 3) strict compliance with the service requirements of Rule 9011 is required to prevail on a sanctions motion.

In re Yorkshire, No. 07-20644, 2008 WL 3306680 (5th Cir. Aug. 8, 2008). Members (the "Non-filing Members") of limited liability companies sought sanctions against other member (the "Member") who allegedly filed bankruptcy petitions on behalf of the companies without authority to do so. The bankruptcy court determined that: 1) the Member acted without authority when he filed the two bankruptcy petitions; 2) the Member filed the petitions to inflict injury on the Non-filing Members; 3) the Member's true motive for filing the petitions was his

dissatisfaction with his state law remedies as a minority investor; and 4) the “bankruptcy cases were filed with a bad motive and with no meaningful thought being given to the actual purposes of chapter 11 bankruptcy.” Accordingly, the bankruptcy court pursuant to its inherent authority and Rule 9011(c), issued sanctions against the Member and the filing attorney in the amounts of \$50,000.00 and \$40,000.00, respectively. On appeal, the district court affirmed the bankruptcy court. The Fifth Circuit opined that it is well-settled law that a federal court has the inherent authority to sanction litigants and attorneys that appear before it so long as it makes a specific finding of bad faith. The Fifth Circuit affirmed the bankruptcy court’s finding that the Member and his attorney filed the petitions with the requisite bad faith intent to harm the Non-Filing Members and found the sanctions to be appropriate.

***Gwynn v. Walker (In re Walker)*, 532 F.3d 1304 (11th Cir. 2008).** In a matter of first impression, the Eleventh Circuit considered whether a party can seek sanctions pursuant to Rule 9011 after a court has ruled on the offending motion. On April 21, 2004, the creditor’s attorney filed a motion to disqualify the debtor’s attorney. On April 24, 2004, the debtor’s attorney gave notice to the creditor’s attorney that he would seek sanctions for the filing of the disqualification motion. On April 28, 2004, the bankruptcy court denied the motion to disqualify. On May 18, 2004, the creditor’s attorney filed a renewed motion to disqualify and the debtor’s attorney filed a motion for sanctions, which related to the first motion to disqualify. Thereafter, the bankruptcy court denied the motion to disqualify and granted the motion for sanctions. On appeal, the district court vacated the award of sanctions because the creditor’s attorney “had not been afforded twenty-one (21) days to withdraw her motion.” Thereafter, the creditor’s attorney filed a motion with the bankruptcy court to recover her costs associated with defending the sanctions motion. The bankruptcy court denied the creditor’s attorney’s fees, but granted limited costs in the amount of \$1,591.58. On appeal to the Eleventh Circuit, the court affirmed the denial of sanctions, holding “the service and filing of a motion for sanctions ‘must occur prior to the final judgment or judicial rejection of the offending’ motion.” The Eleventh Circuit also held that the bankruptcy court did not abuse its discretion when it denied the creditor’s attorney an award of fees, costs, and expenses, as the purpose of Rule 11 is to deter baseless filings and “[the creditor’s attorney’s] corresponding expenses could have been avoided if [she] had not filed her frivolous motion to disqualify [the debtor’s attorney] in the first place.”

***In re Stewart*, 391 B.R. 327 (Bankr. E.D. La. 2008).** The debtor filed an objection to the amended proof of claim filed by the servicing agent (the “Servicer”) of the holder of the debtor’s mortgage and demanded a payment history and support for the items included in the claim that were described as “Other Amounts for Inspection Fees, Appraisal Fees, NSF Check Charges and Other Charges”, “Pre-Petition Attorney [sic] Fees and Costs”, and “Escrow Advance.” The Servicer filed a response admitting that certain accounting discrepancies existed in the proof of claim. As of the first hearing on the objection, the Servicer had still not yet provided a loan history. Counsel for the Servicer represented to the court that based upon its review of various invoices it had become apparent that billing errors existed. The bankruptcy court continued the hearing and ordered the Servicer to produce a loan history prior to the continued hearing. At the continued hearing, the bankruptcy court found that: 1) the disclaimer language utilized on the proof of claim filed by the Servicer violated the administrative order issued by the court, which related to requests for post-petition fees or costs; 2) the Servicer failed to provide the debtor notice of all fees, costs or charges incurred, as required by prior orders of the court; 3) claimed inspection fees were neither noticed nor reasonable; 4) debtor was charged for unnecessary and

duplicative broker's price opinions; 5) Servicer's calculation of debtor's escrow balance was inaccurate; 6) Servicer charged debtor late fees that were not allowed under reasonable interpretation of contract terms; 7) Servicer provided adequate protection order to the bankruptcy court without disclosing the inclusion of various unapproved fees, which was a failure to be candid with the bankruptcy court and demonstrated Servicer's "willingness to take advantage of an elderly, *pro se*, widow." The bankruptcy court issued sanctions against the Servicer in excess of \$27,000.00 and ordered the Servicer to: 1) provide a loan history for every case pending in the district filed as of a certain date; 2) file the loan history on the claims register in each case; and 3) to amend each proof of claim as necessary to comply with the principals established in the case. The bankruptcy court also advised that it would enter an administrative order for the review of all of the accountings and proofs of claim and reserved the right to appoint experts, at the Servicer's expense, to review the filings and provide recommendations to the bankruptcy court.

In re Nosek, 386 B.R. 374 (Bankr. D. Mass. 2008). Bankruptcy court issued show cause order as to why sanctions should not be imposed for apparent misrepresentations as to who was the holder of a certain note and mortgage. Local counsel ("Local Counsel") for mortgage servicer ("Servicer") filed various pleadings, some of which were prepared by the Servicer's national counsel ("National Counsel") asserting that the Servicer was the holder of the note and mortgage, when in fact a third party (the "Third Party") actually held both the note and mortgage. The bankruptcy court found held: 1) that Local Counsel and National Counsel had a duty to investigate facts before making representations to the court and not merely rely on the representations of their clients; 2) that the Servicer made multiple misrepresentations to the court; and 3) that the Third Party had a duty to oversee the activities of the Servicer and correct the misrepresentations made to the court. Accordingly, the bankruptcy court issued sanctions against the Servicer (\$200,000.00), Local Counsel (\$50,000.00 - \$25,000 against the law firm and \$25,000.00 against a partner of the firm), National Counsel (\$100,000.00), and the Third Party (\$250,000.00), pursuant to Rule 9011.

In re Commonwealth Sec. Corp., No. 06-30746-SGJ-7, 2007 WL 309942 (Bankr. N.D. Tex. Jan. 25, 2007). The alleged debtor, in an involuntary bankruptcy case, filed a Rule 9011 motion (the "Motion") for sanctions against the petitioning creditors. Prior to the filing of the Motion, the bankruptcy court entered a bond order (the "Order") thereby requiring each of the petitioning creditors to post their pro rata share of a \$50,000 bond pursuant to section 303(e), or alternatively opt out of the prosecution of the involuntary case. The Order also provided that if petitioning creditors opted out that the withdrawing petitioners (other than the "warring" 50% shareholder in the debtor, who was the principal of a substantial majority of the other petitioning entities) would not be subject to damage claims, pursuant to section 303(i). Thereafter, all of the creditors, including the shareholder-creditor, opted out of the prosecution of the involuntary bankruptcy case.

Unhappy with the safe harbor protections afforded to all but the shareholder-creditor, the alleged debtor filed an unsuccessful motion to modify or reconsider the Order. Considering the Motion, the bankruptcy court undertook an analysis of whether, in the context of an unsuccessful involuntary filing, damages pursuant to section 303(i) and Rule 9011 were mutually exclusive. The bankruptcy court ultimately determined that section 303(i) (designed to be a fee shifting statute even though allows for punitive damages in the event of bad faith) and Rule 9011 (not meant to shift fees but as a deterrent to bad acts) have distinct purposes. Accordingly, the

bankruptcy court determined that Rule 9011 would only be relevant in those instances in which section 303(i) was unavailable, such as when seeking sanctions against petitioning creditors' attorneys. Ultimately denying consideration of sanctions pursuant to Rule 9011, the bankruptcy court held that: 1) petitioning creditors had relied upon safe harbor afforded by the Order; and 2) by issuing the Order the bankruptcy court had exercised its discretion barring section 303(i) damages and did not intend to leave a loophole for the alleged debtor to seek sanctions against the creditors.

***Thomas v. United States of America (In re Thomas)*, Nos. 06-20115 06-2077, 2007 WL 654241 (5th Cir. Mar. 1, 2007).** Debtors' and their attorney appealed decision of district court affirming a bankruptcy court order allowing IRS's late filed proof of claim, vacating the debtors' confirmed chapter 13 plan, and issuing sanctions against the debtors' attorney pursuant to Rule 9011. Prior to the filing of the debtors' case, the tax court rendered its decision that debtors owed in excess of \$35,000.00 in back taxes and penalties. When debtors filed their chapter 13 plan they listed the IRS as a creditor with a priority claim in the amount of \$20,000.00. Two (2) months later, the debtors filed an amended chapter 13 plan summary, which showed the IRS with a priority claim in the amount \$5,000.00 and provided for its payment. The following month, the debtors chapter 13 plan was confirmed. Thereafter, the debtors filed a \$5,000.00 proof of claim on behalf of the IRS. Approximately ten (10) months later and well after the deadline for filing proofs of claim, the IRS filed both a priority and non-priority proof of claim. The debtors objected to the IRS's proofs of claim as being untimely. The bankruptcy court determined that "the debtors' proof of claim had intentionally made the tax claim ambiguous, despite debtors' knowledge of the source of the claim" and therefore allowed the IRS's newly filed claims and treated them as amendments to the claim filed by the debtors. The debtors' attorney admitted that "he intentionally had failed to list details about the claim so that it would appear ambiguous, intending to avoid disclosure of the tax period, time, and amount.

***In re Rodriguez*, Civil Action No. SA-06-CA-323-XR Bankr. Case No. 05-55166-LMC, 2007 WL 593582 (W.D. Tex. Feb. 20, 2007).** District court considered Rosario Divins' ("Divins") appeal of bankruptcy court order finding her in contempt and ordering Divins to pay \$15,000.00 to the clerk of the court and refund \$6,000.00 to the debtors. Divins, who was not a licensed attorney, had a long standing history of defying court orders related to: 1) her practice of taking money from individuals in exchange for her promise to prevent home foreclosures; 2) the unauthorized practice of law; 3) assisting with the preparation of forms in connection with the filing of bankruptcy cases; and 4) collecting referral fees from or sharing fees with attorneys. In the instant case, Divins took approximately \$6000.00 from the debtors and promised to prevent the foreclosure of their homestead. On appeal, the district court considered whether the bankruptcy court had the authority to issue such sanctions. The district court analyzed the differences between civil contempt actions which are meant to be "wholly remedial and serve to benefit the party who has suffered injury or loss at the hands of the contemnor" and criminal contempt actions which are meant to punish the contemnor. Discussing Fifth Circuit precedent, the district court found that bankruptcy court had authority to consider civil contempt actions, but that it did not have authority to consider criminal contempt actions. Accordingly, the district court reversed the \$15,000 fine finding that it was a punitive fine payable to the government and affirmed the \$6,000.00 award to the debtors finding that it was a compensatory payment to the injured party and thus a valid exercise of the bankruptcy court's civil contempt power.

***Friendly Fin. Service-Eastgate, Inc. v. Dorsey (In re Dorsey)*, 505 F.3d 395 (5th Cir. 2007).** Creditor filed a single adversary complaint against the debtors pursuant to sections 523 and 727 of the Bankruptcy Code. The bankruptcy court denied the requested relief under both 523 and 727 and enjoined the creditor from filing such complaints in either the Monroe or Alexandria Divisions unless it first obtained leave of court, citing a “chain of abusive” complaints filed by the creditor. The record reflected that: 1) the creditor had been repeatedly warned not to combine section 523 and 727 complaints; 2) the creditor’s former counsel had been sanctioned for the same offense; 3) the creditor continued to file frivolous complaints through its owner, who was also an attorney; and 4) the creditor had been repeatedly warned about its misuse of reaffirmation agreements. On appeal, the district court affirmed the ruling of the bankruptcy court holding that “[c]ourts have the power to enjoin a litigant from filing without leave of court where a party engages in a pattern of abusive conduct.” On further appeal, the Fifth Circuit affirmed in part (section 523 action), vacated in part (section 727 action and injunction), and remanded for further consideration. The Fifth Circuit determined that the creditor had standing and that since the injunction was based “primarily upon on [the bankruptcy court’s] conclusion that [the creditor] lacked standing to file the adversary proceeding” that the case should be remanded to the bankruptcy court “for reconsideration of the propriety of its injunction in the light of this opinion.”

Postorivo v. AG Paintball, Civil Action Nos. 2991-VCP, 3111-VCP, 2008 WL 3876199 (Del. Ch. Aug. 20, 2008). Plaintiffs moved to preclude violations of their attorney-client privilege and for sanctions against defendants and their attorneys (collectively, the “Targets”). The underlying suit was the result of a dispute regarding alleged misrepresentations as to the value of various property transferred in an asset purchase agreement between two businesses. In the sanctions motion, the plaintiffs: 1) sought confirmation that they retained the attorney-client privilege with regard to the negotiation of the asset purchase agreement and the assets and liabilities specifically excluded therein; 2) sought the court’s guidance as to the protection of said privilege, specifically in reference to its former employees that were at that time in the employ of the defendants; and 3) claimed that the Targets had “irreparably violated their privilege rights and sought an appropriate sanction, including disqualification of Defendants’ counsel or dismissal of [the] action.”

The court having previously determined that the plaintiffs had in fact retained their attorney-client privilege undertook an analysis of the actions of the Bad Actors to determine what if any violations had occurred. The court found that: 1) the Bad Actors were put on notice of the plaintiffs’ privilege claims; 2) the defendants’ attorneys failed to uphold their ethical duty to place the plaintiffs on notice that the Bad Actors had documents in their possession that were subject to the plaintiffs’ privilege claims and therefore committed litigation misconduct, if not violated the states Professional Rules of Conduct; and 3) the defendants’ attorneys failed to “provide the necessary cautionary instructions” to the plaintiffs’ former employees, who were now employees of the defendants, regarding the disclosure of privileged information prior to conducting interviews or requesting that they assist in the production of documents in support of the litigation. Ultimately, the court: 1) disqualified two (2) of the defendants’ attorneys from further participation in the case; 2) awarded the plaintiffs their attorneys’ fees associated with the prosecution of the sanctions motion; and 3) ordered that a copy of the opinion be forwarded to the Office of Disciplinary Counsel.

***In re Porcheddu*, 338 B.R. 729 (Bankr. S.D. Tex. 2006).** Debtor challenged the accuracy of fees requested by creditor’s law firm (the “Firm”). Thereafter, the bankruptcy court issued a show cause order as to why firm and attorney should not be sanctioned for its conduct in attempting to shift costs from its clients to debtors. At the hearing on the fees, the attorney representing the Firm gave testimony attesting, *inter alia*, that the Firm’s fee statements offered in support of the request for fees were “contemporaneous business records maintained by [the Firm], that [the attorney] was a custodian of the records, and that the time entries were made on a contemporaneous basis.” Ultimately, the Firm and the attorney both admitted that all of the attorney’s testimony was incorrect. The bankruptcy court found that: 1) the fee statements were not business records; 2) the fee statements were created solely for litigation purposes and in order to avoid the hearsay rule; 3) the attorney was not the custodian of the records and in fact had no idea how they were created; 4) time entries were created after-the-fact based upon what the Firm believed was reasonable as opposed to the time actually spent on the task; 5) only the task records were kept contemporaneously; and 6) the Firm and the attorney had failed to comply with their duties under Rule 9011. Accordingly, in order to deter such conduct in the future, the bankruptcy court, pursuant to its inherent authority to regulate lawyers appearing before it, issued sanctions against the Firm and the attorney in the amounts of \$65,000.00 and \$1,000.00, respectively.

***McMillin v. Williams (In re Williams)*, No. 06-30557, 2007 WL 1029183 (5th Cir. April 4, 2007).** A creditor filed a “bare bones” adversary against a debtor approximately two (2) months after the bankruptcy court had dismissed the debtor-defendant, the husband in a joint case, from the case. (The wife-debtor remained a debtor in the case.) The bankruptcy court dismissed the adversary as moot and sanctioned the attorney for filing the complaint. The district court affirmed the bankruptcy court and the sanctioned attorney appealed. The Fifth Circuit determined that the bankruptcy court had not abused its discretion in sanctioning the attorney pursuant to Rule 9011 for filing a moot complaint, observing that the assertion by the attorney that his intent was to protect his client from the “non-debtor discharge” under section 524 was an after-the-fact attempt to justify the filing, in which the section 524 discharge had not been mentioned.

IV. MISCELLANEOUS ISSUES

***In re Parsley*, 384 B.R. 138 (Bankr. S.D. Tex. 2008).** The loan servicer (the “Servicer”) for the mortgagee attempted to withdraw a motion to lift stay (the “Motion”) on a chapter 13 debtor’s homestead, which, according to the debtor, contained inaccurate information with regard to his payment history. When the bankruptcy court asked local counsel (“Local Counsel”) for the loan servicer if the factual allegations in the Motion were inaccurate, counsel (“Counsel”) stated “[f]rom what I have read in our system this morning and what I could tell from this, *the answer is it was a good motion.*” The bankruptcy court informed Counsel “that it had concerns that the Motion contained factual inaccuracies. . .” and thereafter issued a show cause order (the “First Order”) as to why Local Counsel and Counsel should not be sanctioned for their actions related to the filing of the motion. Specifically, the bankruptcy court was concerned that the Servicer and/or its Local Counsel had caused the debtor to incur legal fees and expenses that could have been prevented had they not filed and withdrawn a motion containing factual inaccuracies, which should have been discovered had they given proper attention to the debtor’s payment history.

Prior to the hearing on the show cause order, the United States Trustee (the “UST”) filed a pleading encouraging the bankruptcy court to sanction both the Servicer and Local Counsel based upon a bad faith failure to investigate the factual basis for the Motion. Local Counsel filed a motion to strike the UST’s pleading asserting that it lacked standing to participate in the show cause hearing. The bankruptcy court issued a ruling that the UST did in fact have standing to participate. After hearing testimony from three (3) witnesses (the “Witnesses”) (an associate with Local Counsel; an associate with the Servicer’s national counsel (“National Counsel”); and the manager of the Servicer’s bankruptcy department) at the hearing, the Court issued a second show cause order (the “Second Order”).

In the Second Order, the bankruptcy court expressed its concerns regarding; 1) why Local Counsel’s attorney represented to the court that the Motion was “good” when the Witnesses all testified that the payment history attached to the Motion was inaccurate and one of the Witnesses actually testified that he learned as much from Local Counsel; 2) why National Counsel’s referral guidelines prohibit Local Counsel from communicating directly with the Servicer; 3) why National Counsel’s associate would testify that he was the attorney-in-charge when he had not filed a notice of appearance or signed the Motion; and 4) whether or not the Servicer in fact has a policy to ensure debtors are not charged for the drafting and filing of a lift stay motion when it is later withdrawn due to factual inaccuracies.

After multiple days of hearings on the Second Order, the bankruptcy court issued its lengthy (approximately 43 pages) opinion. The bankruptcy court made the following findings: 1) the UST was within its authority to investigate activities of Local Counsel, National Counsel, and the Servicer; 2) the bankruptcy court has the power to issue the show cause orders *sua sponte*; 3) the show cause orders were not moot despite Local Counsel’s reimbursement of the debtor’s legal fees because debtor had never been a party (*i.e.* the court issue the show cause orders *sua sponte*); 4) the Counsel acted in bad faith when it told the bankruptcy court that the Motion was “good”; 5) that Counsel’s bad faith was imputed to Counsel’s firm; 6) show cause orders were issued pursuant to the bankruptcy court’s inherent powers and were not in the nature of civil or criminal contempt; 7) it is well settled law that bankruptcy courts do not have criminal contempt power; 8) in order to issue sanctions under inherent power court must find clear and convincing evidence of conduct that is bad faith, vexatious, wanton, or undertaken for oppressive reasons; and 9) no evidence of bad faith on the part of National Counsel or Servicer. Ultimately, the bankruptcy court declined to issue sanctions against any of the parties, even those found to have acted in bad faith. The bankruptcy court reasoned that since the lead attorney for Local Counsel had been terminated by his firm and was still unemployed that he had been adequately punished and that Local Counsel had undertaken significant steps to prevent such events from occurring in the future.

***In re Advanced Telecomm. Network, Inc.*, 326 B.R. 191 (Bankr. M.D. Fla. 2005).** Defendant moved to disqualify plaintiff’s counsel (“Counsel”) because of a colloquy between the judge and Counsel. The defendant’s disregard of two prior contempt orders prompted Counsel to file an emergency motion to appoint a receiver *pendente lite* over corporations either controlled or owned by the defendant. Counsel attempted to file the emergency motion under seal, but Counsel’s confusion of the newly implemented rules for filing motions under seal via the ECF system ultimately resulted in the emergency motion being disclosed to the defendant’s counsel. At the *ex parte* hearing on the emergency motion, the judge and Counsel discussed possible

courses of action to prevent the defendant's removal or dissipation of assets, their general frustration with the defendant's actions, and the possibility of filing a similar motion on the first day of the upcoming trial. After both the adversary and bankruptcy case were transferred, the newly assigned bankruptcy court considered the motion to disqualify and opined that while *ex parte* hearings are generally disfavored the facts of the case warranted such a hearing. Denying the defendant's motion, the bankruptcy court held that the defendant suffered no harm as a result of the *ex parte* hearing given that: 1) the *ex parte* hearing was conducted on the record and the transcript was made available to the defendant; 2) the adversary was reassigned shortly after the *ex parte* hearing; 3) nothing in the conversation between the judge and Counsel rose to the level of a "specifically identifiable impropriety," which is required to disqualify Counsel.

***In re Layer*, No. 06-306, 2007 WL 2229624 (Bankr. N.D. Tex. July 31, 2007).** Bankruptcy court issued a second show cause order against attorney (the "Attorney") after learning that he had failed to comply with terms of order (the "Order") issued pursuant to the results of court's first show cause order. The Attorney had a pattern of failing to file the appropriate paper work in his client's chapter 13 cases. Pursuant to the terms of the Order, the Attorney was to refund fees associated with six (6) current chapter 13 cases, transition the clients to new bankruptcy counsel, and cease practicing before the United States Bankruptcy Court for the Northern District of Texas for a period of one (1) year. At the hearing on the second show cause order, the bankruptcy court determined that the Attorney had failed to comply with the terms of the Order and held the Attorney in civil contempt. Accordingly, the bankruptcy court, *inter alia*: 1) sanctioned the Attorney \$500.00 payable to the clerk of the court; 2) ordered the Attorney to execute promissory notes for all attorney's fees he had failed to refund; 3) ordered the Attorney to make monthly payments of to each of the clients until such time as the attorney's fees were refunded; 4) extended the Attorney's bar from practice in front of the United States Bankruptcy Court for the Northern District of Texas by an additional six (6) months; and 5) ordered that a copy of the order and transcript of the hearing be forwarded to the Office of the Chief Disciplinary Counsel of the State Bar of Texas.

***In re Plaza*, 363 B.R. 517 (Bankr. S.D. Tex. 2007).** A chapter 7 trustee (the "Trustee") moved to assume a contingency fee contract, which the debtor had enter into prior to the filing of his bankruptcy case, and to pay contingency fees as provided in the contract. At the hearing on the Trustee's motion, the bankruptcy court expressed concern over language in the contract that required the client to obtain the attorney's consent prior to entering into any settlement. The bankruptcy court believed the clause to possibly be unconscionable and asked the attorney to provide briefing on the issue. The bankruptcy court ultimately determined: 1) that the language in the contract was " directly at odds with the well accepted principal that it is the client who has exclusive control over whether to settle, compromise or adjust the cause of action" and therefore was unconscionable; 2) that the Trustee could not assume the contract even if the clause was stricken; 3) that the attorney was not entitled to his contingency fees under the common fund doctrine; and 4) that the attorney was entitled to two (2) unique *quantum meruit* claims for work performed both pre-petition (*i.e.* unsecured) and post-petition, which were to be treated the same as any other claim.