

Clients Behaving Badly: The Ethics of Addressing Client Misconduct

DEBTOR BREAKOUT SESSION

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I. What is Client Misconduct?

- Lying to you or your office staff.
- Lying to the Trustee.
- Failure to disclose income or bonus's on Form 22.
- Failure to accurately disclose number of dependents or household members on Form 22.
- Failure to disclose assets.
- Failure to disclose liabilities.
- Failure to supply the necessary tax returns and/or pay advices required by a Chapter 7 or Chapter 13 Trustee.
- Either leaving out certain creditors to meet eligibility requirements for Chapter 13 or intentionally lowering those amounts.

II. Effect of Client Misconduct

- Chapter 7 Trustee or the Office of the United States Trustee can file an Objection to Discharge pursuant to Section 727 of the Bankruptcy Code.
- Chapter 7 Trustee can also file a motion to dismiss for failure to provide tax returns or transcripts.
- Section 521(e)(2)(B) states that if the debtor fails to provide the tax returns or transcripts the court **shall** dismiss the case unless the debtor demonstrates the failure to comply is due to circumstances beyond the control of the debtor.
- U.S. Trustee can file motion to dismiss.
- Chapter 13 Trustee can file a motion to dismiss or objection to confirmation.

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- Chapter 7 Trustee, Chapter 13 Trustee or Office of the United States Trustee can make a criminal referral of the debtor and/or the attorney representing the debtor pursuant to “Title 18: Crimes And Criminal Procedure – Bankruptcy Crimes”.
- Debtor can have assets taken away and sold by a Chapter 7 Trustee.
- Debtors can lose their exemptions if a creditor or a Trustee discovers that there has been a concealment or undervaluation of an asset.

III. Discussion about Judicial Estoppel

- Judicial estoppel is an equitable doctrine designed “to protect the integrity of the judicial process” by preventing litigants from “deliberately changing positions according to the exigencies of the moment”. *New Hampshire v. Maine*, 532 U.S. 742, 749-50, 121 S. Ct. 1808, 149 L.Ed.2d 968 (2001).
- The doctrine is generally invoked to prevent a party from asserting positions in successive judicial proceedings that are so clearly inconsistent that accepting the latter position would create the perception that at least one of the Courts was misled.
- Typically the doctrine is applied when the debtor has concealed a pending or potential cause of action that would have been administered by a Trustee.
- The courts have consistently held that a debtor who conceals a legal claim and denies owning an asset on their bankruptcy schedules is judicially estopped from later pursuing that claim.
- The insurance companies defending these causes of action typically assert the proposition that the Trustee/debtor can only recover the amounts necessary to satisfy the creditor body. No surplus can be paid to the Debtor.
- The Debtor has also committed misconduct when the potential or pending case of action was not disclosed in a Chapter 13 proceeding.
- Clearly the value of any cause of action would affect the value of property to be distributed pursuant to the Chapter 13 plan since the amount being distributed cannot be less than the amounts the creditors would receive if the debtor was liquidated under Chapter 7.

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- It is very common that when a Chapter 7 Trustee uncovers a hidden cause of action this results in a 100% distribution to all claimants.
- Various cases that discuss the concept of judicial estoppel (Thanks to E. Philip Groben from my office for these cases).
 - i. *In Re Enyedi*, 371 B.R. 327 (Bkrcty.N.D.Ill., 2007)
 - ii. *Aikens v. Soul Circus, Inc.*, 2011 WL 2550828 (N.D.Ill.)
 - iii. *Brown v. Yellow Transp., Inc.*, 2010 WL 152000 (N.D.Ill.)
 - iv. *Kimbrell v. Brown*, 651 F.3d 752 (C.A.7 (Ill.), 2011)
 - v. *Cannon-Stokes v. Potter*, 453 F.3d 446 (C.A.7 (Ill.), 2006)

IV. What Can You Do To Counter Client Misconduct

- You can search the Cook County Recorders Office (or equivalent county) to determine if mortgages or liens are on property.
- For various counties you can access the Clerk of the Court website to see if there are any pending lawsuits or foreclosure actions.
- It is important to see if there are any Memorandums of Judgment that have been recorded so you can avoid the lien if possible.
- Many times there is a delay between obtaining the client information and filing of the Chapter 7 or 13 for various reasons.
- However a lot of things can change during that period of time.
- If there is a potential cause of action that arises and you do not identify it you may be guilty of potential malpractice. This would be especially true if the debtor is judicially estopped from pursuing that claim due to nondisclosure.
- Perhaps a staff member could contact the Debtor to see if anything has changed since the original intake of their information.
- In a more complicated case you can also run lien searches, tax searches and asset searches through various providers.
- A detailed review of a debtor's tax returns can also reveal information that should be disclosed on the Schedules, Statement of Financial Affairs or Form 22 (Means Test)

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- V. What governs my client's misconduct and who may report this misconduct?
- As mentioned above "Title 18: Crimes And Criminal Procedure – Bankruptcy Crimes" and Rule 9011 of the Bankruptcy Code govern Debtor and Attorney Conduct.
 - 18 U.S.C. 3057 gives Judges, Receivers, and Trustees a duty to report conduct that fits within the ambit of Title 18 as it relates to Bankruptcy.
 - Anyone can report misconduct to the Court by referring it to the Chief Judge, however, not every case is governed by Title 18, sanctions under Rule 9011 permit the court to find civil liability as well. Client conduct must be egregious enough to rise to the level of criminal conduct.
- VI. What types of misconduct fall within the scope of Title 18?
- 18 U.S.C. § 152 focuses on concealment of assets; false oaths and claims; bribery. Example *U.S. v O'Connor*, 158 F. Supp. 2d 697 (E.D. Va., 2001); *U.S. v. Bauer*, 551 F.3d 786 (C.A.8 (MN), 2008)
 - 18 U.S.C. § 153 deals with embezzlement against the estate.
 - 18 U.S.C. § 154 Adverse Interest and Conduct of Officers- requires that interested parties not purchase any property of the Bankruptcy Estate or prevent inspection of Bankruptcy Estate property.
 - 18 U.S.C. § 155 Fee agreements in cases under title 11 and receiverships
 - 18 U.S.C. § 156 Knowing disregard of bankruptcy law or rule- Applies to Bankruptcy Petition Preparers.
 - 18 U.S.C. § 157 Bankruptcy Fraud- A few examples
 - i. Concealing Assets- *In re Kalliana*, 202 B.R. 600 (Bankr. N.D. Ill., 1996)
 - ii. Multiple Case Filings – Unreported opinions make examples of clients who file multiple cases in a short time frame. Example of unreported opinion *In re Onkst* 2007 WL 1493874 (C.A.7(Ind.)).
 - iii. Developing a scheme to defraud creditors- *U.S. v Naegele*, 367 B.R. 1 (D.D.C., 2007)-

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- 18 U.S.C. § 158- Designates the U.S. Attorney and FBI as the parties to investigate conduct related to Title 18.

VII. Attorney liability

- 18 U.S.C. §§ 152, 153, 154, 155, and 157 all apply to Attorneys
- The Northern District of Illinois Bankruptcy Court's disciplinary power is derived through the aforementioned statutes and Local Rule 9029-4B titled Attorney Disciplinary Proceedings.
- Bankruptcy Rule 9011 through Federal Rule of Civil Procedure 11 governs civil liability for misconduct by an attorney.

VIII. Potential Client's and their misconduct

- Illinois Rules of Professional Conduct 1.18 govern attorney client privilege for a potential client.
- Potential clients are afforded attorney client privilege for initial consultations.

IX. What can happen to my client?

- Dismissed Bankruptcy Case
- A Bar from filing a Bankruptcy Case
- Vacating Discharge
- Under Title 18- the statement listed on the bottom of the Declaration Regarding Schedules and Statement of Financial Affairs delineates liability- Penalty for making a false statement or concealing property: Fine of up to \$500,000 or imprisonment for up to 5 years or both. 18 U.S.C. §§ 152 and 3571