
CHAPTER 16

Criminal Liability for the Bankruptcy Practitioner

by Ronald R. Peterson

John Gellene was a bright, rising bankruptcy star in the firmament above Bankruptcy World. He was a partner in one of Wall Street's most prestigious firms. On December 2, 1994, the 37-year-old Gellene had persuaded the United States Bankruptcy Court for the Eastern District of Wisconsin to confirm his embattled plan of reorganization for Bucyrus-Erie in less than one year.¹ For John Gellene, it was the greatest accomplishment of his legal career. He led Bucyrus-Erie from the brink of financial extinction through the gauntlet of angry creditors to the promised land of prosperity and growth. Bucyrus-Erie's creditors celebrated a larger recovery than many thought possible. By any measure the case was an unqualified success.

Two years later, John Gellene's star began to sink. In December 1996, Jackson National Life (JNL), one of Bucyrus-Erie's largest creditors, filed a motion in the bankruptcy court to compel his firm to disgorge millions of dollars in fees that Gellene and his firm had earned in saving the company. On September 25, 1997, Bucyrus-Erie sued Gellene's firm for over \$35 million in damages arising from Gellene's representation.² Ultimately, his firm would return millions of dollars of fees that it had earned.

It got worse. On November 1, 1997, the law firm fired Gellene. Then, on December 9, 1997, a federal grand jury sitting in Milwaukee indicted Gellene on two counts of bankruptcy fraud and one count of perjury.³ On March 3, 1998, after three hours of deliberation, a jury found John Gellene guilty on all

1. *In re Bucyrus-Erie Co.*, Case No. 94-20787 (Bank. E.D. Wis.).

2. *Bucyrus Int'l Inc., et al. v. Milbank Tweed, et al.*, Case No. 97-01051 (E.D. Wis.).

The case was ultimately remanded to the Circuit Court of Milwaukee County.

3. *United States v. Gellene*, Case No. 97-00221 (E.D. Wis.).

three counts. On July 28, 1998, in the very courthouse where he had achieved his greatest success, John Gellene was sentenced to 15 months in prison at Fort Dix, New Jersey, a \$15,300 fine and two years of probation. Gellene's conviction was affirmed by the court of appeals in *United States v. Gellene*, 182 F.3d 578 (7th Cir. 1999). As a result, John Gellene was disbarred, and his career and life were totally ruined.

His rising star had become a fiery shooting star. How could something that seemed so right wind up so wrong? Gellene was the first lawyer in the United States convicted of executing a faulty Bankruptcy Rule 2014 affidavit.⁴ Cynics would say that he was a victim of geography. Only north of the Cheddar Curtain would somebody ever dream of charging a bankruptcy lawyer with such a crime. Or, as some suggest, was it the culmination of a perfect bankruptcy storm?

Despite Mr. Gellene's fall from grace, very few bankruptcy professionals are charged with bankruptcy crimes in the United States. Research indicates that John Gellene is the only lawyer ever charged, criminally, with making a materially false Bankruptcy Rule 2014 affidavit. This phenomenon reflects not only the general integrity of the bankruptcy bar, but the fact that bankruptcy crimes are very hard to prove. In addition, the civil remedies—which include disgorgement or denial of fees, disqualification from a particular case, or a general bar from representing any debtor in any case—are used instead by bankruptcy courts to police the system; in many instances they have a greater deterrent effect. Bankruptcy crime is also underreported because prosecutors prefer to indict and accept pleas from defendants for crimes that are easier to prove, such as tax evasion, ERISA fraud, or garden-variety *malum in se*⁵ offenses. Consequently, bankruptcy criminal prosecutions are show trials by an overworked Justice Department designed to keep the system honest by making examples out of some poor unfortunate. What evoked a civil penalty in one case, *Leslie Fay* (discussed below), became a criminal one in *Gellene*.

This chapter will first explore what constitutes a bankruptcy crime. Next, it will show how these statutes were applied in a precedent-breaking way to Mr. Gellene. The chapter will then review the areas where the professional may be skating on thin ice; finally, it will explore emerging areas of criminal exposure.

4. See FED. R. BANK. P. 2014, requiring a verified statement of the professional to be engaged by the debtor setting forth the professional's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the office of the United States Trustee.

5. *Malum in se* literally means “wrong in itself.” An offense is “malum in se” if it is inherently evil, such as murder or theft.

I. The Crime

The following charts show the traditional bankruptcy crimes and the ancillary offenses that most often attach to bankruptcy related indictments.

Chart 1

18 U.S.C. § 152	General prohibition against sin: concealment of assets; false oaths and claims; bribery
18 U.S.C. § 153	Embezzlement against estate
18 U.S.C. § 154	Adverse interest and conduct of officers: Trustees buying property from their own estates
18 U.S.C. § 155	Borah Act: fixing of professional fees
18 U.S.C. § 156	Knowing disregard of bankruptcy law or rule by a Bankruptcy Petition Preparer
18 U.S.C. § 157	Bankruptcy fraud
18 U.S.C. § 158	Designation of United States attorneys and agents of the F.B.I. to address abusive reaffirmations of debt and materially fraudulent statements in bankruptcy schedules.
18 U.S.C. § 3057	Bankruptcy investigations: Requirement that Judges, Trustees, and Receivers report to the U.S. Attorney any pre- or post-petition violations of bankruptcy or non-bankruptcy criminal statutes.

In addition to these crimes, most bankruptcy indictments include indictments for the offenses listed on Chart 2.

Chart 2

18 U.S.C. § 2	Aiding and abetting
18 U.S.C. § 3	Accessory after the fact
18 U.S.C. § 4	Misprision of felony
18 U.S.C. § 371	Conspiracy to commit bankruptcy fraud
18 U.S.C. § 1001	Fraud and false statements
18 U.S.C. §§ 1341, 1343 & 1344	Mail fraud, wire fraud and bank fraud
18 U.S.C. § 1503	Obstruction of justice
18 U.S.C. §§ 1621 through 1623	Perjury
26 U.S.C. § 7201 et seq.	Tax evasion and fraud and willful failure to file

II. The General Prohibition Against Sin

The starting point for a bankruptcy lawyer's criminal liability for a bankruptcy crime is 18 U.S.C. § 152, the general prohibition against sin (set out in the § 152 sidebar).

§ 152 provides:

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 claims 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 the 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 the 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.⁶

The statute contains the seven deadly sins of bankruptcy:

1. Concealment of estate property
2. False oaths and certifications
3. False claims
4. Improper receipt of estate property
5. Bribery
6. Destruction or falsification of records
7. Withholding information from the trustee

In addition, there is an implied requirement that the fraud relate to some material matter.⁷ While these acts are fairly well understood, the most critical portions of this statute are the adverbs: knowingly and fraudulently.

Knowingly

An act is done knowingly if it is done voluntarily and intentionally, and not because of accident, mistake or other innocent reason.⁸ The Seventh Circuit held that “[A]n action taken in good faith is on the other side of an action taken knowingly.”⁹ An action can also be taken knowingly if the defendant merely turned a blind eye to obvious facts.¹⁰

As one authority explained, “Examples of willful blindness might include signing the required statements and schedules without reviewing them, keep-

6. 18 U.S.C. § 3571(b)(3) provides that the fine for a felony is up to \$250,000 for individuals and \$500,000 for an organization. In addition, 18 U.S.C. § 3571(d)(3) increases the fine to twice the pecuniary gain or loss involved in a crime. *Also see* Sentencing Guidelines.

7. 1 E. DEVIIT & C. BLACKMAN, *FEDERAL JURY PRACTICE AND INSTRUCTIONS* §14.04 (1977); *see also* *United States v. Nichols*, 808 F.2d 660, 663 (8th Cir. 1987).

8. *United States v. Shaddock*, 112 F.3d 523 (1st Cir. 1997); *United States v. Zehbrach*, 47 F.3d 1252 (3d Cir. 1995); *United States v. Defazio*, 899 F.2d 626, 635 (7th Cir. 1990); *United States v. Lewis*, 718 F.2d 883 (8th Cir. 1983).

9. *United States v. Koster*, 163 F.3d 1008, 1012 (7th Cir. 1998).

10. *See United States v. Yasser*, 114 F.2d 558 (3d Cir. 1940).

ing sloppy books and records when circumstances would indicate that proper accounting would disclose adverse information or participating in a scheme in which there is ample reason to suspect skullduggery, but continuing to participate in the scheme despite these reasons.”¹¹

A debtor’s lawyer is also skating on thin ice when she files a case without ever meeting her client. What is important to remember is that, unlike Sgt. Schultz of “Hogan’s Heroes” fame, the “I know nothing” defense will not necessarily work in a criminal prosecution.

Fraudulently

A statement is fraudulent if it was made, or caused to be made, with the intent to deceive.¹² Fraud means that the perpetrator acts with the intent to deceive or to cheat parties affected by the bankruptcy case.¹³ Fraud includes both misstatements and actions. As the Seventh Circuit explained in *McClellan v. Cantrell*:¹⁴

Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth. No definite and invariable rule can be laid down as to a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated.¹⁵

In *McClellan*, no one accused the perpetrators of communicating anything. The case dealt with actions rather than words.

Gellene appealed his conviction for bankruptcy fraud, arguing that in addition to proving that he acted knowingly and fraudulently, the government had to prove materiality. Because creditors did not suffer any loss (and quite possibly obtained a premium), Gellene argued “no harm, no foul.” While that argument might work in basketball, the court of appeals in the *Gellene* case held that a statement is made fraudulently for purposes of § 152 if it is made with an “intent to deceive,” and rejected Gellene’s argument that § 152 is limited to false statements that deprive the debtor of his property or the bankruptcy estate of its assets.¹⁶ The materiality requirement is satisfied because Gellene’s conduct challenged the integrity of the bankruptcy system.

11. COLLIER ON BANKRUPTCY (15th rev. ed.), 97.02[1](a), 7-32.

12. BLACK’S LAW DICTIONARY 662 (6th ed. 1990).

13. *United States v. Sabeth*, 262 F.3d 207 (2d Cir. 2001).

14. 217 F.3d 890 (7th Cir. 2000).

15. *Id.* at 893, quoting *Stapleton v. Holt*, 207 Okla. 443, 250 P.2d 451, 453-54 (Okla. 1952).

16. *United States v. Gellene*, 182 F.3d 578, 586-87 (7th Cir. 1999).

In *United States v. Sabbeth*, the court of appeals adopted the *Gellene* rule.¹⁷ The court concluded: “We held long ago that section 152 is ‘essentially equivalent to a perjury statute’ and that ‘only the basic requirements of perjury need be proved.’”¹⁸

In addition to the general prohibition against sin, Congress recently enacted 18 U.S.C. § 157 as a companion to § 152.

18 U.S.C. § 157 provides:

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 bankruptcy petition under section 303 of such title*,¹⁹
- (2) files a document in a proceeding under title 11:
- (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.

In addition, the fines for a violation of § 157 can cumulate up to \$250,000. Section 157 has two fundamental requirements:

- There must be an artifice or scheme to defraud or an intent to devise a scheme or artifice to defraud; and
- That artifice or scheme must be made in contemplation of the filing of a bankruptcy case, the filing of a document in that case, or a representation made to the court in the case.

A fraudulent activity prior to bankruptcy, but not in contemplation that a bankruptcy would be filed, would probably not lead to a conviction under § 157.

Many wonder what this statute adds that is not already covered by § 152. Its most important contribution is that it follows very closely the language of the federal mail fraud statute.²⁰ There are over 133 years of judicial precedent

17. 262 F.3d 207 (2d Cir. 2001).

18. *Id.* at 217, quoting *In re Robinson*, 506 F.2d 1184, 1189 (2d Cir. 1974).

19. It is not clear from the amendment whether the italicized language added by the BRA is intended to be added only in subsection (1) or in subsections (2) and (3) as well. One version of the amended Code shows it in all three places; another only in subsection (1). Both note the confusion.

20. 18 U.S.C. § 1341.

behind the mail fraud statute that can be applied by analogy to bankruptcy fraud cases. Section 157 adds another arrow in the prosecutor's quiver. As a result, it is not unusual to see indictments for the same set of facts under both §§ 152 and 157.

III. In Search of Full Disclosure

The *Gellene* case gives an excellent example of how the prosecution established the elements of “knowingly” and “fraudulently.”

The cause of Gellene's demise was two sworn statements that he executed in order to represent the debtor. These are the same type of sworn statements that bankruptcy lawyers provide by the hundreds to federal courts every day. When a lawyer is retained to act as counsel for the Chapter 11 debtor, for a creditors' committee, or for a trustee, that application must comply with Bankruptcy Code § 327. Section 327(a) requires the lawyer to swear that he does not represent an interest adverse to the estate, and that he is a disinterested person. “Disinterestedness” is defined in Code § 101(14), as amended by the BRA, to mean a person who:

- (A) is not a creditor, an equity security holder, or an insider;
- (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
- (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.²¹

To aid the court in determining whether the adverse interest and disinterested tests are met, Bankruptcy Rule 2014 was promulgated to compel full disclosure. It provides that:

. . . The application [for retention] shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, or any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.²²

Rule 2014 is a minefield for even the most skilled and experienced professional. Most courts hold that the lawyer is not to act as an editor and may not decide that some connections are too trivial to be disclosed. That is for the

21. The BRA deleted all references to investment bankers as not disinterested. Otherwise, the new § 101(14) is the same definition confronted by Gellene prior to the BRA.

22. FED. R. BANKR. P. 2014(a).

United States Trustee to raise and the courts to decide. On the other hand, if a lawyer were to disclose every conceivable connection with a case, he might as well attach a copy of the U.S. census and an encyclopedia of business entities authorized to do business in the United States as an exhibit to the affidavit.

The compromise is a set of best practices that has evolved. Professionals are expected to make conflicts sweeps, with the use of a computer and an independent conflicts analyst, to determine which of the firm's clients are creditors and which clients are potential or existing targets of litigation by the debtor.²³ Lawyers are expected not only to look at their specific corporate clients, but also to run a corporate family search to replicate the same search for corporate siblings, children, and parents. Lawyers are also generally expected to determine whether any partner or associate was a director, shareholder or officer of the debtor. They should determine whether they, themselves, are a target of a wrathful debtor for voidable preferences or just good old-fashioned malpractice. The latter is particularly true if the firm advised the debtor in a leveraged buyout, stock redemption, spinoff, split-up, or a deal that just went south. Worse yet, lawyers must determine whether the firm or a member of the firm had a piece of a deal with the debtor. Lawyers should check to determine whether another firm client is a strident competitor in an oligopolistic market. Finally, lawyers should circulate a memo to all professionals in the firm asking for a subjective response as to whether the firm has adverse interests or connections that would lead to a finding of lack of disinterest.

On the other hand, probably no one would expect the firm to inquire as to whether the firm janitor owns a mutual fund that invests in stock in the debtor or whether the paralegal's girlfriend is an employee of the debtor. Nevertheless, the lawyer runs the risk that if he is too parsimonious in his disclosure, he will face the consequences, and that is exactly what John Gellene did.

Regardless, the attorney has a duty to supplement his affidavit when confronted with competing interests within his firm.

IV. The Gellene Case

Gellene and his firm represented Bucyrus-Erie, a Midwest rust-belt manufacturer of mining machinery headquartered in Milwaukee, Wisconsin.²⁴ In late 1985, Becor Western Corporation (Becor), Bucyrus-Erie's earlier name, faced a serious financial crisis. Becor retained Goldman Sachs and its rising star, Mikael Salovaara, to act as its investment banker and help Becor fund a lever-

23. See Chapter 7, which discusses bankruptcy conflicts in detail.

24. See MILTON C. REGAN, JR., *EAT WHAT YOU KILL* (2004), for a detailed history of not only Bucyrus-Erie, but of the trial of John Gellene.

aged buyout and exchange offer. Salovaara was to act as the debtor's advisor. When the dust settled, the management directors owned 100 percent of the common stock, while Goldman Sachs and its affiliates owned 100 percent of the preferred convertible stock. Unfortunately, Becor now was the obligor of \$177 million in high-interest debt. As a consolation prize, Becor had a new name, Bucyrus-Erie.

The lawyer who negotiated and documented this transaction was Lawrence Lederman of the leading firm of Wachtell, Lipton. Subsequently, Lederman migrated to Milbank Tweed, Hadley & McCloy, where Lederman met Gellene.

In the early 1990s, Bucyrus-Erie entered into additional financial transactions with Salovaara's new company, South Street Funds, including a sale/leaseback transaction, which allegedly impaired Bucyrus-Erie's unsecured creditors. JNL was Bucyrus-Erie's largest unsecured creditor and felt severely prejudiced by the deal. It was so angry that it demanded that Bucyrus-Erie sue Salovaara over the deal.²⁵

As Bucyrus-Erie's financial condition worsened, crippled by a declining world market for its products and high interest rates, Lederman turned to Gellene to serve as Bucyrus-Erie's restructuring counsel. Gellene would spend the next year negotiating a prepackaged bankruptcy plan of reorganization that was approved by almost every creditor constituency except JNL.

On February 18, 1994, Bucyrus-Erie and its parent, B-E Holdings, filed a voluntary petition under Chapter 11 in the bankruptcy court in Milwaukee. Filed along with the petition were a plan of reorganization, disclosure statement, and ballots supporting the plan from all but JNL.

Gellene wanted the court to approve his pre-petition disclosure statement and move rapidly to a hearing on confirmation of the plan, which provided for releases for Salovaara, South Street, and Goldman Sachs. However, JNL wanted a new disclosure statement that would reveal that Bucyrus-Erie had significant causes of action against Salovaara, South Street, and Goldman Sachs.

Gellene, like all bankruptcy lawyers, filed his application for retention with the court along with a Rule 2014 affidavit. This certificate disclosed that Gellene's firm had represented the original investment banker, Goldman Sachs, but did not disclose any relationships between Gellene's firm and Salovaara or South Street. (Strike One.) The affidavit, as many do, declared that neither Gellene nor anyone at his firm was aware of any other connection with Bucyrus-Erie companies, their creditors, or any other party in interest. As would come out much later in the case, Gellene was simultaneously representing South Street in another transaction. In addition, Gellene's firm was representing Salovaara in a dispute with his partner at South Street. The affidavit also failed to disclose that Lederman had social relationships with Salovaara.

25. *Id.* at 92.

JNL objected to Gellene's retention, arguing that his law firm was not disinterested and held an adverse interest. First, Gellene's partner, Lederman, had drafted and negotiated the financial documents related to transactions that allegedly torpedoed Bucyrus-Erie. If the leveraged buyout was avoidable as a fraudulent transfer, then the lawyers who put together the deal had to be concerned that they, too, would be sued as aiders and abettors, co-conspirators, or for malpractice. In addition, the plan contained releases for Gellene's other clients. How could he advise Bucyrus-Erie to walk away from allegedly valuable causes of action while representing other clients in the case?

After a rancorous hearing on his retention, Gellene filed a supplemental affidavit that was as deficient as the first one. While it gave more detail as to the Goldman Sachs engagements than the prior affidavit, it did not disclose any relationship with Salovaara or his companies. (Strike Two.)

In the meantime, Gellene was subject to a frontal assault by JNL, which challenged the adequacy of Gellene's disclosure statement. The debtors, the creditors' committee, and JNL spent over \$1 million in professional fees over whether Bucyrus-Erie had to disclose the possibility of these actions against Goldman Sachs, Salovaara, and South Street. In June 1994, the court conducted a trial and denied approval of Gellene's disclosure statement²⁶ for failure to address in detail the legal issues that arose from these pre-bankruptcy refinancing and potential defendants, including Salovaara and South Street.

Ultimately the combatants reached a deal in which the fraudulent conveyance claims that Bucyrus-Erie might have had against Salovaara and South Street were assigned to JNL. JNL and the other creditors (except Salovaara and South Street) received substantially all of the stock of the company. Subsequently, the plan was confirmed.

However, peace was short-lived. In the spring of 1995, Gellene applied for over \$1.96 million in compensation, as well as expense reimbursement for \$370,000. At trial on the fee application, Gellene testified that the Rule 2014 verifications that he had filed were truthful. (Strike Three.)

The prosecutors in the case had to establish that Gellene's oversight was not an innocent mistake. They had to prove that on three separate occasions, Gellene knowingly failed to make accurate disclosures and did so with fraudulent intent. The following facts show a pattern of knowing behavior and intent to deceive. These facts came to haunt Gellene at the trial:

26. A disclosure statement requires "adequate information," which, before it was amended by the BRA, was defined as: "information of a kind, and in sufficient detail, as far as reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records . . . that would enable . . . a hypothetical reasonable investor of the relevant class to make an informed judgment about the plan. . . ." Former Code § 1125(a)(1).

- At the fee hearing, Gellene was asked by Bankruptcy Judge Eisenberg about a certain disbursement to the Lotus Cab Company (Lotus). Judge Eisenberg asked Gellene if his firm owned Lotus, and Gellene answered no. Then Judge Eisenberg asked whether any of Gellene's partners owned Lotus and Gellene answered yes. The judge wondered why Gellene had not disclosed the relationship either in his fee application or in the motion for retention. Further, while Gellene's initial answer was technically correct, it was not totally candid.
- Gellene had practiced law in New York without a license for a number of years. He had passed the bar exam but failed to process the paperwork.
- In Gellene's application to be retained as counsel in Bucyrus-Erie, he lied about being a member of the bar of the U.S. District Court for the Southern District of New York. He was not.
- Gellene got caught lying about work he did for South Street. He misrepresented to the Colorado bankruptcy trustee his failure to respond timely to a claim objection.
- Gellene had disclosed in his verification that his firm had involvement with other clients that had a relationship with Bucyrus-Erie, proving he knew how to disclose when he wanted to. This established knowledge.
- Gellene failed to disclose the JNL fee objection to his own partners and then altered the pleadings when he did turn them over to his partners. This showed a pattern of prior fraudulent conduct.
- Gellene had published articles on bankruptcy ethics. Together with his substantial experience as a bankruptcy practitioner, this showed that he knew the rules of engagement.
- Gellene knew that his firm had represented both Salovaara and South Street in other matters, as he had worked on them himself.
- Gellene had forced the estate to expend substantial funds defending a disclosure statement that failed to disclose alleged causes of action against Salovaara and South Street.

These facts gave the prosecutors the ammunition to bring the indictment. They showed a course of conduct where Gellene lied and that Gellene knew what he was doing. John Gellene was charged with two counts of bankruptcy fraud under 18 U.S.C. § 152, and one count of a fraudulent declaration before a court under 18 U.S.C. § 1863.

*V. Foolish Consistency Is the Hobgoblin of Little Minds*²⁷

While John Gellene went to jail, similar cases with hauntingly similar facts have not resulted in any criminal charge. In fact, the conduct of the debtor's counsel in *Leslie Fay*²⁸ may have been more problematic than Gellene's. In that case, the debtor's counsel originally represented the debtor's audit committee. The audit committee issued a report exonerating the debtor's board of directors. However, the audit committee was composed of individuals who were themselves, or who worked for institutions that were, clients of the debtor's law firm. In addition, the accounting firm that was sued by angry shareholders of the company was also a client of the firm. The debtor's law firm did not disclose these connections when it was retained. Unlike the *Bucyrus-Erie* case, *Leslie Fay* was a financial scandal that did not have a successful reorganization. Nevertheless, the bankruptcy court permitted the debtor's counsel to continue and directed the parties to agree to a proper disgorgement of some of its fees to cover the costs suffered by the creditors' committee and an examiner in bringing this conduct to light. However, no one was indicted and nobody went to jail. One man's felony is—depending on the time and location—another man's civil penalty.

VI. What's Hot

While the *Gellene* case represents the high-water mark in what is criminal, most bankruptcy crime is far less extreme.

For example, Rule 2014 affidavits are not the only sworn statements that bankruptcy lawyers must make. Bankruptcy Rule 2106 provides:

Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States Trustee within 15 days after the order for relief or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States Trustee within 15 days after any payment or agreement not previously disclosed.

27. RALPH WALDO EMERSON, SELF-RELIANCE (1841).

28. 175 B.R. 525 (Bankr. S.D. N.Y. 1994)

There are few reported criminal cases dealing with fraudulent Rule 2016 statements, although the same standards as in the *Gellene* case would apply. The most notorious is *United States v. Martin*.²⁹ Erik Martin was a licensed consumer bankruptcy attorney who routinely filed Chapter 13 petitions for his clients. Consequently, he also routinely filed Bankruptcy Rule 2016 affidavits. In addition, in the Northern District of Illinois, Martin was required to file a Local Rule 39 affidavit stating that he did not improperly solicit his clients or receive an improper referral.

Martin became associated with Christopher Claxton, the host of a religious radio program broadcast in the Chicago area. Claxton was also the president and owner of Equinox Financial, Inc., a real property financing and brokerage house. Beginning in 1995, Claxton offered assistance to debtors concerning the management of their debts during the “business ministry” portion of the radio program. Claxton promised, among other things, to assist debtors through a debt-consolidation program. As a result of Claxton’s debt-consolidation program, he referred over 900 cases to Martin. In exchange for these referrals, Martin wrote checks to Claxton for almost \$200,000. Martin’s Rule 2016 affidavits neglected to disclose the referral payments to Claxton. As a result of the fraudulent Rule 2016 affidavits and the Local Rule 39 affidavits, Martin was indicted for violating 18 U.S.C. § 157(3). The U.S. attorney was not impressed, and Martin ultimately pled guilty and was sentenced to five years’ probation and a \$5,000 fine. Despite the *Martin* prosecution, the remedy of choice for most violations of Bankruptcy Rule 2016 is civil and not criminal.³⁰

VII. You Scratch My Back, I’ll Scratch Yours

When it comes to fee applications, it is a red-letter day when parties object to one another’s applications. That phenomenon occurred in the case of former Senator Borah of Idaho. As a result, in 1937, he drafted 18 U.S.C. § 155, known today as the Borah Act. This section provides:

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.

29. 1 CR 470 (N.D. Ill).

30. See *Law Offices of Nicholas A. Franke v. Tiffany*, 113 F.3d 1040 (9th Cir. 1997); *Neben & Starrett, Inc. v. Chartwell Financial Corp.*, 63 F.3d 877 (9th Cir. 1995).

Violation of this statute is a Class A misdemeanor, or fine of \$200,000, or both. The elements of this offense include:

1. the existence of an agreement, which can be written or a handshake
2. between the attorneys for parties or, in rare cases, the parties themselves
3. in a bankruptcy
4. for the purpose of fixing compensation paid to any professional;³¹
5. the compensation must come from assets of the estate, and
6. the agreements must have been made fraudulently and knowingly.

A review of case law and secondary sources does not reveal any criminal prosecutions for a violation of the Borah Act. The absence of criminal prosecutions may be because many fee applications are granted without objection. Could all these applications be perfect? What happens when the U.S. Trustee directs the parties to meet and confer and agree to a percentage haircut?

The only protection for the practitioner is to make sure that any agreement is exposed to the healing light of day, with full disclosure to the Bankruptcy Court. There can be no deceit if the court is properly advised.

VIII. Sales

Some commentators have remarked that the Bankruptcy Code has become a “National Foreclosure” statute. If that is true, the high point of a foreclosure action is the sale. The sale is the primary mechanism by which creditors receive any money. If the sale is public, fair, and open, the theory is that the market will provide the highest prices for creditors.

What happens when the process is not fair, and the parties collude to prevent the highest bid?

Jules Bagdan was a respected trustee in South Florida. He was chosen to be the Chapter 7 Trustee for Southeast Bank Corp., one of the largest Chapter 7 cases ever filed in Florida. In December 1991, he asked the bankruptcy court for authority to sell a corporate jet at a public sale. One bidder, Maxfly Aviation, Inc. of Naples (Maxfly), raised its offer to \$1.9 million. The other bidder, Gestiones y Transportes de Burgos S.A. from Spain (Gestiones), topped the bid by \$50,000. Maxfly asked for a five-minute recess. During that time, Gestiones purportedly gave Maxfly \$20,000 and Maxfly stopped bidding. The payment of the \$20,000 was not disclosed to the bankruptcy court until March 1992. Both bidders were clients of the trustee’s accounting firm. According to newspaper reports, at least one of the trustee’s employees helped with the translation. At some point, the trustee obtained knowledge of what had happened but did not report it to the court in a timely fashion.

31. Including designated haircuts.

The U.S. attorney opened an investigation to determine whether Bagdan should be indicted. There were further fears that the U.S. attorney might indict his entire Big Eight accounting firm, although that would not become fashionable until Enron. Since 18 U.S.C. § 152(6) makes it illegal to knowingly give or receive money for acting or forbearing to act in a bankruptcy case, the U.S. attorney ultimately indicted the two bidders, but spared the trustee. Later, a court examiner recommended against prosecution of the trustee. However, the trustee's accounting firm fired him, he was removed from what would have been the most profitable case of his career, he was forced to resign from the panel of trustees, and his career was ruined.

The first lesson from this case is that knowledge of someone *else's* bankruptcy crime may implicate the trustee, even though he was not a participant in the scheme. The second lesson is that the bankruptcy professional does not have to be indicted to feel the deadly sting of a bankruptcy crime.

Where the Action Is

The following cases involve attorneys and accountants who have recently been indicted or convicted of bankruptcy crimes. These cases are generally of the *malum in se* variety. This list should provide a good clue as to what types of conduct make attractive prosecutions for the U.S. attorney.

- Shannon Clark, a bankruptcy attorney, was indicted in the Eastern District of Tennessee on seven counts of mail fraud, money laundering, bankruptcy fraud, and false statements arising from her own Chapter 7 case, her representation of debtors, and a scheme with her husband involving credit card applications. She subsequently pled guilty. *United States v. Clark*, 04 CR 00057 (E.D. Tenn.).
- Patricia Anne O'Kane, a consumer bankruptcy lawyer, was charged with four counts each of wire fraud and bankruptcy fraud in the Southern District of Texas. O'Kane allegedly made unauthorized charges on clients' credit card accounts and used collateral intended by her clients to be surrendered to secured creditors. She subsequently pled guilty and was sentenced to 30 months in prison and five years' probation based upon her guilty plea to wire fraud and bankruptcy fraud. *United States v. O'Kane*, 03 CR 00364 (S.D. Tex.).
- Timothy Naegele, a lawyer and Chapter 7 debtor, was indicted on April 28, 2005, in the District of Columbia on 11 counts of bankruptcy fraud (18 U.S.C. §§ 152 and 157). The defendant allegedly failed to list several assets, including a case in which he represented

a party with a potentially lucrative contingency-fee agreement. *United States v. Naegele*, 05 CR 00151 (D. C.).

- On May 11, 2005, Brian J. Almengual and his wife, Suzanne C. Warner-Almengual, both of whom are lawyers, were indicted in the Middle District of Florida on charges arising from their joint bankruptcy filing. The couple allegedly concealed property and gave false sworn testimony during their bankruptcy case. *United States v. Almengual, et al.*, 05 CR 00196 (M.D. Fla.).
- William Grabscheid pled guilty on April 11, 2005, to one count each of bankruptcy fraud and willful failure to file a tax return, admitting to diverting fiduciary-held funds totaling approximately \$35,000, including \$7,466 from accounts in cases where he served as bankruptcy trustee. *United States v. Grabscheid*, 05 CR 00035 (N.D. Ill.).
- Attorney Robert Suzenski pled guilty to one count of embezzlement of public money in the District of Arizona. Suzenski received debtors' funds into his trust account for payment of creditors and U.S. Trustee quarterly fees. He embezzled \$74,500 in funds intended for quarterly fee payments. He was sentenced to 21 months in prison and three years' supervised release, and ordered to pay more than \$76,000 in restitution, based on his guilty plea to one count of bankruptcy fraud. *United States v. Suzenski*, 03 CR 00502 (D. Ariz.).
- Disbarred attorney Bridgette Harris pleaded guilty to four counts of bankruptcy fraud in the District of Maryland. Harris solicited clients offering "foreclosure assistance" and filed bankruptcy petitions on their behalf using her home address and listing her employer, an attorney, as counsel of record without the attorney's knowledge or consent; and she filed bankruptcy in the Eastern District of New York, misrepresenting numerous facts and transferring her real property to relatives with the intent to hinder delay and defraud her creditors. She was sentenced to 18 months in prison and ordered to pay \$8,785 in restitution. *United States v. Harris*, 03 CR 00047 (D. Md.).
- Steven A. Dayton pled guilty to making false statements and creating false bankruptcy court documents, including a forged bankruptcy court order purporting to discharge the debts of two former clients. Dayton made the statements and created the false documents to conceal a scheme to defraud the former clients, from whom he had accepted a fee to file a bankruptcy case he never filed. He was sentenced to three years' probation and fined \$1,000 in the Central District of California based on his plea of guilty to one count of bankruptcy fraud (18 U.S.C. § 157(3)). *United States v. Dayton*, 03 CR 00057 (C.D. Cal.).

- Dean Bozzano was sentenced on October 24, 2003, in the District of Massachusetts to five years in prison and three years' supervised release, and ordered to pay \$1.06 million in restitution, after pleading guilty to bankruptcy fraud and embezzlement. Bozzano embezzled \$1.06 million from the estate of Chapter 11 debtor Maurice Corp. after the bankruptcy court appointed him as plan administrator, pursuant to a liquidating plan of reorganization, to oversee distribution of the estate assets. *United States v. Bozzano*, 02 CR 40007 (D. Mass.).
- Tax attorney Jeffrey A. Sherman was sentenced to 32 months in prison and ordered to pay \$598,381 in restitution for conspiring to commit bankruptcy fraud and aiding and abetting tax evasion. Sherman, a pre-bankruptcy tax-planning specialist who formerly worked for the IRS, participated in a scheme with lawyer Robert V. Beaudry to help clients hide their wealth and then discharge federal and state tax liabilities in bankruptcy. Clients John and Letantia Bussell made false statements and concealed assets to discharge more than \$4 million in liabilities, including a tax debt to the IRS of more than \$1 million, and client Robert Grant fraudulently discharged an \$11 million tax debt to the IRS. Beaudry, Grant, and the Bussells were also prosecuted. *United States v. Bussell*, 00 CR 00485, 01 CR 00056.
- Former panel trustee Robert Dennis Pryce pled guilty in the Central District of California to 17 counts relating to public corruption and 32 counts arising from a separate indictment alleging abuse of his role as a bankruptcy trustee. Pryce pleaded guilty to conspiracy, mail fraud, extortion, bribery, and money laundering in connection with his role in brokering a deal to bribe public officials for approving a waste-hauling contract in Carson County, California. The bankruptcy counts alleged that Pryce took kickbacks from a real estate agent and contractor in exchange for hiring them in his Chapter 7 trustee cases. He also made false entries on official trustee records and court submissions and laundered the kickback proceeds through bank accounts in his daughter's name. *United States v. Pryce*, 02 CR 1206, 02 CR 1207 (C.D. Cal.).
- Daniel Gates was indicted in the Western District of Pennsylvania on charges of mail fraud, bank fraud, money laundering, and bankruptcy fraud for embezzling at least \$3.6 million from clients, including non-bankruptcy clients. *United States v. Gates*, 03 CR 00200 (W.D. Penn.).
- Los Angeles bankruptcy attorney Lloyd Segal was sentenced to 18 months in prison and three years' supervised release and ordered to

pay \$118,825 in restitution. Segal previously pleaded guilty in the Central District of California to providing false Social Security numbers, a false name, and other false information in his own bankruptcy filings. *United States v. Segal*, 03 CR 00159 (C.D. Cal.).

- Suspended attorney Allen Robert Thayer was sentenced in the Northern District of Indiana to 27 months in prison following his conviction for bankruptcy fraud and perjury. Before filing a Chapter 7 bankruptcy, Thayer transferred his stock in a family farm corporation into an irrevocable trust and backdated the trust document, as well as certain mortgages, to keep the property from creditors. On his bankruptcy documents, he stated the false date and falsely listed his son as trust beneficiary. *United States v. Thayer*, 01 CR 00182 (N.D. Ind.).
- Robert Burrick was sentenced in the District of New Jersey to 18 months' incarceration and ordered to pay \$48,000 in restitution, based on his guilty plea to mail fraud and interstate transportation of securities and money obtained by fraud under 18 U.S.C. §§ 1341 and 2314. Burrick was charged with the embezzlement of more than \$100,000 from clients' trust accounts and the diversion of \$17,000 in funds from the Milburn Youth Soccer Club. One trust account held funds to be disbursed to creditors of Chapter 11 debtor Syntrex, Inc., for which Burrick served as post-confirmation distribution agent. *United States v. Burrick*, 002 CR 0081 (D.N.J.).
- On February 10, former consumer bankruptcy attorney Delbert Edwin Bartell of Ft. Worth, Texas, was sentenced in the Northern District of Texas to six months in federal prison based on his November 2002 guilty plea to making a false declaration in his bankruptcy case. In almost 10 years, Bartell filed six bankruptcy petitions to forestall Internal Revenue Service collection activities. *United States v. Bartell*, 02 CR 00168 (N.D. Tex.).
- Richmond City Councilman Sa'ad El-Amin and his wife, Beverly D. Crawford, both disbarred lawyers, were indicted in the Eastern District of Virginia on charges of bankruptcy fraud, tax fraud, mail fraud, wire fraud, bank fraud, and embezzlement. The indictment alleged that El-Amin, Crawford, and their former law firms owed the IRS more than \$700,000 in delinquent taxes, penalties, and interest for assessments and liens dating back to 1986; money from the couple's law firm trust account was used to pay \$114,000 in personal expenses; and the couple filed bankruptcy six times to impair IRS collection efforts. *United States v. El-Amin, et al.*, 03 CR 00055 (E.D. Va.).

- Gregory Wayne Ginn and Waylon E. McCullen were indicted on August 24, 2004, in the Northern District of Texas on charges including concealment and transfer of assets, aiding and abetting, false statement, and conspiracy to commit bankruptcy fraud. Ginn, a certified public accountant, was appointed to carry out the reorganization plan of a company in Chapter 11 bankruptcy. The indictment alleged that Ginn transferred \$300,000 of the company's assets to his friend and local lawyer McCullen to cover a check unrelated to the bankruptcy, and then concealed that transfer. Ginn and McCullen returned the money to the bankruptcy estate but allegedly tried to cover up the true purpose of the transaction. *United States v. Ginn & McCullen*, 04 CR 00282 (N.D. Tex.).
- Michael Roberts was indicted in the Northern District of Illinois in 2002 for bankruptcy fraud, wire fraud, and mail fraud. He pleaded guilty on March 24, 2005, to the bankruptcy fraud charge. Roberts admitted that he defrauded 35 clients he filed bankruptcy cases for by creating bogus garnishment orders and forging the signatures of eight bankruptcy judges on those orders. Roberts admitted he submitted those orders to his clients' employers to collect additional fees. He was sentenced in August 2005. *United States v. Roberts*, 02 CR 00675 (N.D. Ill.).
- Ronald A. Arthur and his wife, Mary K. Arthur, were convicted of bankruptcy fraud and money laundering on November 7, 2005. Mr. Arthur was a real estate lawyer and consultant, and Mrs. Arthur was a nursing home administrator and former district attorney. The indictment charged the defendants with conspiring to conceal assets and engaging in money-laundering financial transactions with the concealed property. Mr. Arthur was also charged with making false statements under oath by failing to disclose more than \$237,000 in assets. They each face a maximum penalty of 20 years in prison, \$500,000 in fines, and three years of supervised release. *United States v. Arthur, et al.*, 04 CR 00122 (E.D. Wis.).
- A former attorney and Chapter 7 trustee, Greg Hamilton, pled guilty to one count of embezzlement in the District of Rhode Island. Hamilton took \$7,500 from a bankruptcy estate and paid his home mortgage with some of the proceeds. *United States v. Hamilton*, 04 CR 00041 (D.R.I.).
- William DeJesus Gutierrez pled guilty in the Eastern District of Pennsylvania to one count of making a false statement (18 U.S.C. § 1001). The indictment alleged Gutierrez used a fraudulent Social Security number on his Chapter 7 petition filed in the Eastern

District of Pennsylvania. *United States v. Gutierrez*, 03 CR 00821 (E.D. Penn.).

- Chapter 11 debtor's counsel Laurence Y. Solarsh was indicted in the Southern District of New York on February 27, 2004, on one count of embezzlement (18 U.S.C. § 153(a)) of approximately \$101,048 from the debtor's estate. *United States v. Solarsh*, 04 CR 00404 (S.D.N.Y.).
- Attorney Leland Jones III of Greenwood, Mississippi, was sentenced in the Northern District of Mississippi to five years' probation and ordered to pay a \$10,000 fine and \$8,681 in restitution to the estate, based on his guilty plea to concealing assets in a client's bankruptcy case (18 U.S.C. § 152(1)). *United States v. Jones*, 03 CR 00139 (N.D. Miss.).
- William S. Boyd III of Gulfport, Mississippi, pled guilty in the Southern District of Mississippi to embezzlement in connection with his representation of debtors. Boyd embezzled approximately \$163,500 in at least two bankruptcy cases. He was sentenced to 26 months in prison followed by three years' supervised release, and ordered to pay \$395,000 in restitution. *United States v. Boyd*, 03 CR 00005 (S.D. Miss.).
- Attorney John Eleazarian was indicted on October 27, 2005, for allegedly forging a bankruptcy judge's order. If Eleazarian is found guilty, the charge carries a maximum of five years in prison and/or a \$250,000 fine. *United States v. Eleazarian*, 05 CR 00428 (E.D. Cal.).

IX. Where's the Next Gellene Case?

There are two areas where criminal liability may increase under the BRA:

1. the attorney's responsibility to attest to the debtor's schedules and statement of affairs and
2. reaffirmation agreements.

In an address to the Central States Regional Meeting of the American Bankruptcy Institute, Bankruptcy Judge Stephen Rhodes of the U.S. Bankruptcy Court for the Eastern District of Michigan revealed that he had conducted a survey of schedules and statements of affairs being filed in his courthouse.³² He discovered that 198 out of 200 schedules and statements of affairs in the sampling contained errors, some significant.³³ Judge Rhodes opined that:

32. Hon. Steven W. Rhodes, *An Empirical Study of Consumer Bankruptcy Papers*, 73 AM. BANKR. L.J. 653 (1999).

33. *Id.* at 678.

1. there is a general lack of care and understanding by debtors and their attorneys in fulfilling the disclosure requirements;
2. the official forms do not adequately communicate the disclosure requirements; and
3. in some ways, the disclosure requirements are unrealistic and unnecessary, and serve only to make knaves of otherwise honest debtors and their attorneys.³⁴

Partly in light of Judge Rhodes's findings, Congress enacted § 319 of the BRA, which states that it is the "sense of Congress that Federal Rule of Bankruptcy Procedure 9011 be amended to provide that all documents, including schedules, submitted to the court or to a trustee by pro se debtors and represented debtors be submitted only after reasonable inquiry to verify that the information in the documents is well grounded in fact and warranted by existing law or a good faith argument for the extension or reversal of existing law."

It may take several years under the rule-making process before Rule 9011 is amended.

With respect to the reaffirmation abuse problem, the BRA also amended Code § 524(k) to require the attorney to execute a certificate in cases where there is a presumption of undue hardship. This is discussed in detail in Chapter 14. Just how an attorney is even supposed to know some of the facts to which he or she is certifying remains a mystery.

What is not a mystery is what Congress intends to do about the problem of reaffirmation abuse. Congress has enacted 18 U.S.C. § 1958. This section provides:

In General—The Attorney General of the United States shall designate the individuals described in subsection (b) to have primary responsibility in carrying out enforcement activities in addressing violations of section 152 or 157 relating to abusive reaffirmations of debt. In addition to addressing the violations referred to in the preceding sentence, the individuals described under subsection (b) shall address violations of section 152 and 157 relating to materially fraudulent statements in bankruptcy schedules that are intentionally false or intentionally misleading.

The statute goes on to require the U.S. attorney and the FBI to delegate one individual from each agency to be primarily responsible for investigating and prosecuting violations of §§ 152 and 157 related to schedules, statements of affairs, and reaffirmations.

34. *Id.* at 653.

*X. The New Bankruptcy Crime*³⁵

The BRA also creates a new bankruptcy crime: fraudulent involuntary petitions. In most jurisdictions, attorneys have always been on the hook for participating in improper involuntary bankruptcies through the sanctions provided for in § 303. The BRA does not affect these sanctions provisions, but it significantly increases the punishment: participating in an involuntary petition that is found to be fraudulent is now a crime. As amended, § 157 provides:

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 bankruptcy petition under section 303 of such title*;
- (2) files a document in a proceeding under title 11, *including a fraudulent bankruptcy petition under section 303 of such title*; or
- (3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, *including a fraudulent involuntary bankruptcy petition under section 303 of such title*, 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.

The BRA's tendency toward bad drafting creates some interpretive problems, most notably the lack of definition for "a fraudulent involuntary bankruptcy petition under" § 303 in either that section or amended 18 U.S.C. § 157. The logical interpretation is "an involuntary bankruptcy petition under § 303 that is fraudulent."

However, another BRA section amended § 303 in a way that raises questions about the correctness of this suggested interpretation. New § 303(l)(1) provides that if:

- the petition under § 303 is false or contains any false, fictitious, or fraudulent statement;
- the debtor is an individual; and
- the court dismisses the petition,

then "the court, upon the motion of the debtor, shall seal all the records of the court relating to such petition, and all references to such petition."

35. Thanks to Catherine E. Vance for providing this discussion.

Both this amendment and the inclusion of involuntary petitions in the criminal statute concern fraud, but the § 303 amendment is clearly directed only at cases commenced against individuals. So, it is possible that the new criminal statute applies only to individual cases as well.

It is beyond the scope of this discussion to resolve the question whether the new criminal provisions apply only in individual cases or to any involuntary petition, including in business cases, that is fraudulent. Therefore, the prudent approach for attorneys is to assume that, despite the possible limitation arising from the amendments to § 303, criminal liability attaches in both individual and business cases.

The more important question for our purposes is whether the new criminal provisions will apply to attorneys. We think the answer is “yes” for two reasons.

- Courts commonly mete out sanctions between the offending parties and their attorneys under § 303(i) and other provisions of the Code and rules as the circumstances warrant.
- Attorneys may not actively participate with their clients in perpetuating a fraud in any event.

Moreover, as discussed in this chapter, prosecutors have gone after attorneys under § 157 successfully and with devastating consequences to the offending lawyer.

My recommendation to the bar is that, in addition to reading Chapter 13, which thoroughly explores the new attorney certifications, consumer bankruptcy practitioners adopt a best-practice guide to ensure that a reasonable inquiry into the client’s assets and liabilities is conducted by the lawyer prior to filing. These tests may include a Choice Point or Lexis review on the Internet and ordering up a title search, car title search, a *Kelley Blue Book* review, or requiring the client to fill out a detailed questionnaire.

This procedure imposes two new burdens on an attorney. First, if the attorney fails to conduct any inquiry at all and the schedules or statement of affairs are materially false and the falsity could have easily been detected, will the U.S. attorney take the position that the attorney acted knowingly by burying his head in the sand? Will the Sgt. Schultz defense have any further vitality?

Second, if the attorney, through her new best business practices, discovers inaccuracies in the schedules or statement of affairs but files them anyway, she may be dead meat in a future criminal prosecution. Will the prosecutor wait for a set of egregious facts and bring an indictment against a bankruptcy lawyer, just to make her an example?

With respect to reaffirmations, the standards for making the certification that an attorney must follow are undefined. With luck, the bankruptcy courts

will establish standards in a civil context before some prosecutor defines them in a criminal one.

Lastly, the BRA also places all kinds of additional responsibilities on the debtor's lawyer, who may now find himself to be a debt relief agency (DRA), and places enormous burdens on the consumer bankruptcy lawyer, including disclaimers and disclosures both in public advertising and in private dealings with the client. These provisions are discussed in detail in Chapters ____.

In addition, § 707(b) creates a means test (discussed in Chapter ____). An attorney may be tempted to cut corners in her responsibility as a DRA or to game the system with respect to the means test. While there is no shortage of civil penalties for the errant consumer bankruptcy attorney, nothing in these sections makes civil penalties the exclusive remedy. Violations of the DRA provisions or aggressive gaming of the system could constitute criminal violations as well.

WARNING!!

Bankruptcy professionals cannot bury their heads in the sand, or divorce themselves from their client's conduct, and sail blissfully through bankruptcy. They must observe the new responsibilities under the BRA scrupulously, and not assume that any penalty will be a civil one.

While bankruptcy criminal liability seldom rises to the level of an indictment or conviction, even a criminal investigation—as the *Bagdan* case reveals—can be devastating. Bankruptcy professionals cannot bury their heads in the sand, or divorce themselves from their client's conduct, and sail blissfully through bankruptcy. They must observe the new responsibilities under the BRA scrupulously, and not assume that any penalty will be a civil one. Failure to pay close attention to the issues of bankruptcy crimes may result in too many additional shooting stars.

