

PROMARKET

Insights shaping the future of capitalism.

CHICAGO BOOTH

Stigler Center
for the Study of the Economy
and the State

BOOK REVIEWS REGULATION THE EQUITABLE ECONOMY

Is the US Bankruptcy System Morally Bankrupt?

BY ANAT ADMATI July 23, 2025



sorbetto/Getty Images

Anat R. Admati reviews *Unjust Debts: How Our Bankruptcy System Makes America More Unequal* (2024) by Melissa B. Jacoby.

My local utility, Pacific Gas and Electric (PG&E), filed for Chapter 11 bankruptcy in early 2019 to preempt lawsuits related to multiple wildfires involving its aged equipment. Shortly after it emerged from bankruptcy in July 2020, a victim of a 2017 fire who had previously sued PG&E for damages and became an “unsecured creditor” in the bankruptcy told me about the opaque court process and the outcomes it produced. I was flabbergasted. Tens of thousands of victims seeking to recover from the devastation of the fires ended up with claims against a trust that owned 25% of PG&E shares, inefficiently bearing non-diversifiable risks. Other creditors, including insurance companies, and all lawyers, were paid in cash. The hedge funds that controlled PG&E through bankruptcy and played key roles in the process dumped their shares quickly and moved on. The process and outcome seemed disturbingly flawed. They were part of a **troubled history**

for PG&E that includes criminal convictions for federal crimes, but with minimal consequences for PG&E as a corporation and with no PG&E employees or executives implicated.

“Unjust Debt” refers to injustices produced by United States bankruptcy law and to Melissa B. Jacoby’s suggestion in her book, *Unjust Debts: How Our Bankruptcy System Makes America More Unequal*, that bankruptcy should return to its original “just debt” intent to apply just to contractual (debt) promises. Prevailing narratives hold that bankruptcy can “reduce suffering and promote innovation” (p.4), but instead its application is uneven and often problematic. Powerful parties transformed bankruptcy into “a legal Swiss army knife” that undermines civil justice and can rob people of their legal rights without consent even when debtors’ obligations are due to bad behavior.

The first two chapters of *Unjust Debts* describe personal bankruptcy, explaining how Chapter 7 of the U.S. Bankruptcy Code, which provides immediate debt relief (with key exceptions such as student debt and fines), and Chapter 13, where relief is conditional on successful completion of a court-supervised repayment plan, work. An individual in bankruptcy has little control over the process, or privacy. About two thirds of Chapter 13 filers —disproportionately Black —never receive any relief. A 2005 law made personal bankruptcy **less debtor friendly**, causing delays in filing that further benefit lenders. Differential outcomes “pile on” existing inequality, including **racial wealth inequality** baked into **other laws**. Policies such as student loans that create “**debt traps**” for the poor can interact with bankruptcy law, as happened in the 2016 bankruptcy of for-profit college ITT, which left students without fraudulently promised education as well as with hard-to-discharge debt owed to both private lender and the government. The remaining chapters, drawing stark and thought-provoking contrasts, focus on what Jacoby refers to as “fake people,” also known as “legal persons,” entities like corporations, nonprofits and municipalities that are separate from all “real people” (humans) and created entirely by law. “The system perceives lawyers and their clients’ financial problems in profoundly different ways, depending on whether their clients are real or fake people” (p. 64). Unlike humans, “enterprises that can persuade a majority of their creditors and a court to support their Chapter 11 plans can cancel almost everything, even debts arising from willful or malicious injury or fraud” (p. 67).

Chapter 11 bankruptcy allows managers of bankrupt corporations to continue controlling information and decisions, does not require government-appointed trustees, and provides *final relief* from obligations, sometimes also releasing third parties not in bankruptcy from liability, upon the *approval* of a plan rather than after debtors fulfil promises they made in the plan. Those involved in the process, including judges, have no duty or true incentives to promote societal objectives like deterring corporate misconduct. Does it always make sense to allow companies that persistently engage in pollution, wage theft, reckless endangerment or fraud to get a fresh start (and possibly thrive later) and never pay fully for the harm they caused?

The book discusses in chapter four the history of municipal bankruptcies and key examples, particularly Detroit. Cities in bankruptcy may be able to reduce prior obligations to victims of civil rights violations such as police brutality, where remedies may not be only monetary.

Similar issues arose in the bankruptcy of gunmaker Remington in 2020, discussed in chapter five (“My Money, My Rules”). Families of Sandy Hook school shooting suing Remington wanted information about its marketing of deadly weapons to prevent future harm. This chapter explains the history of Chapter 11 bankruptcy and how it enables corporations to insulate themselves from obligations. One approach, used by Remington in 2020, is proposing a quick and “essential” sale of the company that requires certain liabilities be cancelled.

Chapters five and six cover more examples of the use of bankruptcy for non-contractual liabilities, starting with asbestos in the 1980s and including Bikram Yoga, Weinstein Company, and Purdue Pharma. In the Purdue case, after this book went to print the Supreme Court blocked the bankruptcy plan that provided permanent releases from all litigation to Sackler family owners, some bearing significant responsibility to the massive opioid crisis but only third parties in Purdue’s corporate bankruptcy.

Explaining accessibly the cynical use of bankruptcy as “litigation tool” to evade accountability and deprive people of legal rights (as in the PG&E case, not discussed in the book) is the most significant contribution of this important book. A common trick illustrated in the case of Boy Scouts of America, which filed for bankruptcy to deal with a pervasive sexual harassment scandal, is to include as many victims as possible in a bankruptcy “class,” each getting equal voting right. Victims with strong cases that would have succeeded in civil courts might be outvoted by others who would have been unable to get any compensation elsewhere. A broader problem (for all laws), seen in Purdue’s case, is the ability to remove money out of reach of legal jurisdictions.

Basic corporate finance textbooks calculate the tax “shield” corporations gain by borrowing. They do not ask why tax laws reward excessive use of debt funding by corporations that makes bankruptcies more likely, and the discussion entirely ignore the use of corporate bankruptcy as “shield” from non-debt liabilities. Law schools teach future lawyers how to use all tools and shape laws to benefit corporate clients.

Economists seem remarkably blind to the fact that firms are separate legal (“fake”) persons, and the significant impact this separateness can have on economic outcomes. In reviewing Steven Shavell’s *Foundations of Economic Analysis of Law*, Richard Posner (2006) **lamented** that “the ‘law’ that Shavell analyzes is an abstract or stylized—a simplified— version of actual law; it is law minus detail and texture, law trimmed to fit the economic model.” *Unjust Debts* explains the detail, texture and political economy of U.S. bankruptcy law in a highly readable form, and illustrates how they matter. It **also shows** that **the power to shape laws and**

enforcement, including through **deceptive narratives** that contribute to the loss of trust in institutions, matters greatly too.

This book offers new research directions for economists related to bankruptcy and much beyond. Studying the detail, texture, implementation and political economy of laws as they apply to real people and to “fake” people, also across jurisdictions, is important. Such explorations can help address distortions in the system and improve outcomes.

*This review was originally published by the American Economics Association as “**Review of Jacoby, Melissa B. Unjust Debts: How Our Bankruptcy System Makes America More Unequal.**” Minor stylistic changes have been made for the ProMarket version.*

Author Disclosure: The author reports no conflicts of interest. You can read our disclosure policy [here](#).

Articles represent the opinions of their writers, not necessarily those of the University of Chicago, the Booth School of Business, or its faculty.

Subscribe [here](#) for ProMarket’s weekly newsletter, Special Interest, to stay up to date on ProMarket’s coverage of the political economy and other content from the Stigler Center.

Related Posts:

1. **Why Stock Buybacks Increase Financial Stability in Banking**

The Unbundling of Chapter 11

[Melissa B Jacoby](#)

Aug 13, 2024 ⌚ 8 min read

Summary

- ❑ When Congress passed the Bankruptcy Code, drafters envisioned a multistep process to sell an operating company through Chapter 11, one that included creditor governance and voting. Today, the privileges of Chapter 11 are often separated from the checks and balances, overriding many other laws in the process.
- ❑ Lenders that offer new financing to financially distressed companies frequently use their leverage to unbundle the Chapter 11 package deal, notably by insisting that companies sell themselves quickly without voting or satisfying the requirements of a Chapter 11 plan. Appellate courts have tolerated these practices if the company can articulate a business reason.
- ❑ Purchasers in quick Chapter 11 sales benefit from a federal court order approving the sale and offering finality—a finality that has broader ramifications for creditors. Some appellate courts have adopted an expansive interpretation of section 363(f) of the Bankruptcy Code that overrides successor liability doctrine.
- ❑ Chapter 11 gives companies considerable discretion over what to do with pending contracts, to maximize the benefits to the bankruptcy estate, but in unbundled bankruptcy cases, there is a risk a non-bankrupt private party can co-opt this already controversial power for its own benefit.

We are making improvements to our user experience and offering more transparency and control over cookies. By clicking "Accept All Cookies," you agree to the storing of cookies on your device to enhance site navigation, analyze site usage, and assist in marketing efforts. Click on "Customize Settings" to learn more about individual cookies and choose settings by category. [Privacy policy](#).

[Cookies Settings](#)

Accept All Cookies



iStock.com/Manuta

This article is adapted from chapter 5 of [*Unjust Debts: How Our Bankruptcy System Makes America More Unequal*](#) by Melissa B. Jacoby (New Press, 2024).

Bankruptcy court is the busiest part of the federal judiciary. In theory, bankruptcy exists to cancel or restructure debts—a safety valve designed to provide a mechanism to restart lives and businesses that have experienced financial distress. *Unjust Debts* explores how an expansive interpretation of the national bankruptcy power falls short on its core functions while also unduly encroaching on other laws and policies, and calls for a more limited and effective bankruptcy system going forward.

* * *

On December 14, 2012, Adam Lanza killed twenty children and six adults at Sandy Hook Elementary School and then killed himself—all in a matter of minutes with a semiautomatic rifle made for military combat. Grieving families sued gun and ammunition

We are making improvements to our user experience and offering more transparency and control over cookies. By clicking "Accept All Cookies," you agree to the storing of cookies on your device to enhance site navigation, analyze site usage, and assist in marketing efforts. Click on "Customize Settings" to learn more about individual cookies and choose settings by category. [Privacy policy](#).

When Congress passed the Bankruptcy Code in 1978, drafters envisioned a multistep process to sell an operating company through Chapter 11. That process gave control and governance rights to claimants of many kinds to help chart the company's future and allocate its value. Remington, its lenders, and potential buyers preferred to follow a different script that has developed through practice, one that allows consequential decisions about the company to happen without creditor governance and voting or the raft of statutory requirements in the Bankruptcy Code. Buyers demand sale orders insulating them from responsibility for the seller's alleged wrongdoing, no matter how profitable the company becomes under new ownership.

Remington is not an outlier. Today, powerful parties regularly use Chapter 11 for games of chicken. Dismantling the statutory package of benefits and obligations allows powerful parties to extract and divert the benefits of Chapter 11 for themselves, overriding many other laws in the process.

In 1978, when Congress enacted the Bankruptcy Code, giving companies latitude to reorganize was said to foster competition and preserve jobs, as well as promote equal treatment of similarly situated creditors. Because the new Bankruptcy Code defined "debt" broadly, Chapter 11 would sweep in liabilities arising from diverse legal doctrines far beyond contract law, including tort and statutory, regulatory, and constitutional law, and it could change claimants' rights without their consent.

This power came with trade-offs. Creditors of all kinds would collaborate with the company on a restructuring plan. In addition to shared governance and creditor voting, the Chapter 11 package included responsibilities to investigate and potentially remedy wrongdoing. The threat and reality of these checks and balances, including the possibility of displacing management, were designed to make the system operate fairly for everyone.

Chapter 11 puts a thumb on the scale in favor of reorganization through provisions that boost the odds a troubled company will recover. Lenders that offer new financing to a financially distressed company can get legal protection unavailable in private transactions. The bankrupt company also gets to make decisions (subject to court review) about its ongoing contracts without counterparty consent.

We are making improvements to our user experience and offering more transparency and control over cookies. By clicking "Accept All Cookies," you agree to the storing of cookies on your device to enhance site navigation, analyze site usage, and assist in marketing efforts. Click on "Customize Settings" to learn more about individual cookies and choose settings by category. [Privacy policy](#).

If the Chapter 11 package is so important, why is that package unbundled on a regular basis? [Money](#).

Section 364 of the Bankruptcy Code provides incentives for lenders to extend credit to a troubled company. The lender gets more assets of the bankruptcy estate as collateral to secure the loan and higher priority repayment rights. Backed by an enforceable federal court order, these loans involve government intervention that private credit markets value greatly. Section 364 was meant to attract lenders to compete to fund distressed but viable companies. Studies consistently show that these loans are profitable and extremely low risk.

Unfortunately, these loans too often are also financially [extractive](#), reallocating value away from other creditors. What's more, however, lenders frequently use the leverage of their position to unbundle the Chapter 11 package deal meant to protect all stakeholders, [including refusing to fund investigations and other elements that promote the integrity of the process](#).

As noted earlier, Bankruptcy Code drafters envisioned sales of entire companies happening through a Chapter 11 plan approval process, with creditor voting. Yet, lenders commonly insist that the company sell itself quickly without voting or satisfying the requirements of a Chapter 11 plan. That dynamic is captured in a [Wall Street Journal quotation](#): "More companies that wind up in bankruptcy court are facing a stark demand from their banks: sell yourself now." Appellate courts have tolerated these practices if the company can articulate a good business reason. That approach invites sale advocates to recite a parade of horrors if their request is opposed or denied: value destroyed, jobs lost.

A purchaser in a quick Chapter 11 sale gets significant benefits because even the truncated process delivers what ordinary mergers and acquisitions do not: a federal court order blessing terms and offering finality. Under section 363(m) of the Bankruptcy Code, if the court has approved the sale and the transaction has closed, an appellate court cannot unwind the sale if it later finds it flawed.

We are making improvements to our user experience and offering more transparency and control over cookies. By clicking "Accept All Cookies," you agree to the storing of cookies on your device to enhance site navigation, analyze site usage, and assist in marketing efforts. Click on "Customize Settings" to learn more about individual cookies and choose settings by category. [Privacy policy](#).

[doctrine](#). The U.S. Court of Appeals for the [Fourth Circuit relieved the buyer of a coal company](#) from retired coal miners' pension and health care benefits mandated by the federal Coal Act because the sale happened in bankruptcy. In TWA's third bankruptcy, the airline aimed to sell itself quickly to American Airlines, which did not want to honor a settlement TWA had reached with flight attendants for pregnancy discrimination. In its objection, the federal government explained that the Bankruptcy Code did not authorize bankruptcy sales overriding federal antidiscrimination laws. The [U.S. Court of Appeals for the Third Circuit blessed the sale](#) and cited job saving and future employee benefits as rationales.

There are no guarantees that these sales save jobs, of course. Consider the Weinstein Company, the entertainment firm. It already was low on employees by the time it filed for Chapter 11 to sell itself quickly to a private equity firm. The company said the sale would save jobs, but the [buyer made no binding commitment](#) to keep the remaining employees. Indeed, seemingly at the buyer's request, the company laid off more employees before the sale was finalized. Although one of the buyers of Remington, the gun and ammunition company, promised to rehire two hundred workers, the *Wall Street Journal* reported that it fired them in the interim, such that the workers lost their health benefits during the COVID-19 pandemic. Unbundled bankruptcies, which deviate from the package deal Congress prescribed, are themselves a gamble.

Although insulation from successor liability should lead to higher sale prices in theory, many [scholars and commentators worry that this does not happen in reality](#), potentially undercompensating claimants for the protections they have lost in the process. Claimants may receive smaller recoveries from quick going-concern sales—either [because the sale did not maximize value](#), or because the privately negotiated sale procedures distorted the distribution of the sale proceeds, or both. [Lenders setting the timeline may not need or be seeking top dollar for the company](#) in order to be fully compensated.

The unbundling of Chapter 11 also greatly affects ongoing contract rights. Chapter 11 gives companies considerable discretion over what to do with pending contracts, to maximize the benefits to the bankruptcy estate. The company can even assign some contracts to a third party without counterparty consent. The catch is that doing so is

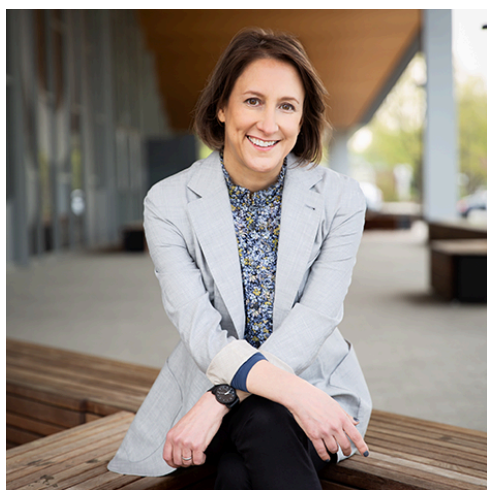
We are making improvements to our user experience and offering more transparency and control over cookies. By clicking "Accept All Cookies," you agree to the storing of cookies on your device to enhance site navigation, analyze site usage, and assist in marketing efforts. Click on "Customize Settings" to learn more about individual cookies and choose settings by category. [Privacy policy](#).

property from films and television. To have a qualifying bid to compete with the stalking horse bidder to buy the company, other bidders were required to identify on a short timeline which contracts they wanted and how they would cure defaults. The stalking horse bidder, a private equity firm, was given a long period of time to decide, after the sale to it had been approved, which contracts it wanted and how much it was willing to pay. This process not only reduced the ability of others to submit competitive bids, but it also made it impossible to determine whether the contract decisions were in the best interest of The Weinstein Company bankruptcy estate as the law requires.

* * *

Congress built Chapter 11 to enable an overindebted company to stay in business if a company could persuade enough creditors to support its vision, reflected through voting and plan confirmation. The rights and obligations in the integrated Chapter 11 package were not intended to be frictionless; they were gateways to significant legal privileges. Dismantling Chapter 11 to facilitate a quick sale turns this federal law into a platform for dealmaking among the most powerful parties, allowing them to extract the law's extraordinary perks without fulfilling federal law objectives.

Author



Melissa B Jacoby

We are making improvements to our user experience and offering more transparency and control over cookies. By clicking "Accept All Cookies," you agree to the storing of cookies on your device to enhance site navigation, analyze site usage, and assist in marketing efforts. Click on "Customize Settings" to learn more about individual cookies and choose settings by category. [Privacy policy.](#)

We are making improvements to our user experience and offering more transparency and control over cookies. By clicking "Accept All Cookies," you agree to the storing of cookies on your device to enhance site navigation, analyze site usage, and assist in marketing efforts. Click on "Customize Settings" to learn more about individual cookies and choose settings by category. [Privacy policy](#).

The Human Edge: How AI Is Revolutionizing Bankruptcy and the Ethical Considerations in Supporting Innovation

Panelists:

- **Natasha Labovitz** – Partner at Debevoise & Plimpton LLP
- **Chacey Malhouitre** – Member at Jackson Kelly PLLC
- **Isabel Arana de Uriarte** – Director at AlixPartners LLP

I. Introduction: Setting the Stage

Bankruptcy and restructuring are rapidly evolving as artificial intelligence becomes integral to critical workflows across professional firms and clients. This panel brings together leaders in law and financial advisory to discuss how AI is driving efficiency and shaping decision-making in the field, ensuring that technology complements, rather than replaces, human expertise.

II. Section 1: Foundations of AI in Professional Services

- A. We often hear of the horror stories about AI causing ethical concerns. AI, however, is becoming integrated in many aspects of our daily lives.
 - 1. Examples:
 - a. Google searches regularly show AI-generated answers to question-based searches with links to “source” material
 - b. Microsoft Co-Pilot is often integrated in Microsoft Office Suite products
 - c. Spotify playlists
 - d. Customer service for websites
 - e. AI capability is now integrated into Westlaw, much the same way Keycite was integrated many years ago
 - 2. Knowing how to use AI, and its limitations, is essential.
- B. Artificial intelligence in professional services encompasses both narrow applications, focused on specific tasks, and broader system-level integrations. With adoption soaring, AI’s role is expected to become fundamental to daily practice within the coming years, enabling firms to manage increasingly complex cases and deliver better, more efficient outcomes for clients.

1. Firms are embracing AI to boost efficiency and productivity, automating repetitive tasks so teams can deliver higher-quality work faster and devote more time to strategic client needs.
 - a. In many cases this embrace is driven by clients, who are demanding that firms use AI in this way
2. AI is driving cost savings in for professional services firms, allowing them to complete routine tasks, including non-billable and non-client facing tasks, with fewer person hours. The cost savings benefits both firms and clients, all while maintaining service quality
3. By leveraging AI solutions, firms aim to reduce human error and administrative burdens, enhance accuracy in analysis, and generate actionable business insights that drive better client outcomes and competitive advantage

III. **Section 2: Real-World Applications of AI in Bankruptcy**

See R. McWilliams, H. Pak, B. Porter, *AI In Bankruptcy: The Human Touch Still Delivers*, Journal of Corporate Renewal, October 2024, Appendix.

A. Transforming Legal Workflows for Lawyers

1. Legal Research
 - a. Different from Open Source AI, such as ChatGPT, Gemini, etc.
 - i. End to end encryption
 - ii. “Sandbox” or does not retain documents
 - iii. Does not learn from inputs
 - iv. Case law comes from database (cases, statutes, regulations, treatises, and other traditional secondary sources, etc.)
 - b. Examples of products:
 - i. Lexis+AI Protégé (including Lexis Create+)
 - ii. Westlaw CoCounsel
 - iii. vLex
 - iv. Harvey

2. Workflows:
 - a. These are drafting or reviewing aids—Lawyers now employ AI tools to automate labor-intensive tasks such as reviewing large volumes of contracts, identifying risks or missing provisions, and compiling court-ready documentation.
 - b. These advancements free up expert time for strategic analysis and advocacy, while ensuring greater accuracy and speed in case management.
 - c. In some cases, such as discovery applications where AI is used to review a vast amount of information in a time frame that would be impossible for humans, the use of AI could make the difference between completing a task (potentially with imperfections) or being unable to finish it at all.
 - d. *Real world examples or demonstrations*
3. Some firms are creating their own internal platforms

B. Streamlining Financial Advisory and Restructuring

1. Financial advisors use AI analytics to rapidly process financial statements, manage large datasets, quickly analyze large volumes of documents, automate workflows, and predict likely outcomes under various scenarios.
2. This technology enhances due diligence, automates reporting, and allows practitioners to deliver more timely, data-driven advice to clients throughout all stages of the bankruptcy process. We will discuss examples of AI applications in business forecasting, bankruptcy case management, claims estimation and reconciliation, and due diligence.
3. *Real world examples or demonstrations*

C. Maintaining the Human Edge in an AI-Driven Landscape

1. Even as AI delivers powerful insights and automation, human judgment remains the cornerstone of professional services in bankruptcy and restructuring.
2. Experts are needed to interpret complex findings, provide operational expertise, drive strategic alternatives and retain core skills in investigation, negotiation, and advisory work.

3. The effective blend of technology and professional expertise ensures that client outcomes are driven by both innovation and prudent stewardship.

IV. Section 3: Risks and Ethical Considerations

A. Professional Mistakes and Cautions

1. Use of AI, like any information source, implicates a number of ethical duties:
 - a. Competence
 - b. Candor
2. Poor application of AI, especially without adequate human oversight, can lead to severe professional missteps—such as in cases where unverified outputs resulted in court sanctions for submitting fabricated evidence. These incidents underscore the ongoing necessity for expert validation even as AI capabilities grow.
 - a. Use appropriate AI resources for the task—e.g., ChatGPT may be okay for non-client marketing information, but legal sources or internal secured platforms should be used for research and/or sensitive client information
 - b. Ensure your client does not have any prohibitions against using AI
 - c. Understand how AI works and how to prepare your prompts
 - d. Understand the limitations of AI, including the legal-based platforms, and review the work like you would with a new lawyer or summer associate
 - e. Consider attorney-client privilege and work-product privilege implications
3. *Real world examples/demonstrations of good and bad results from legal AI sources*

B. Regulatory Considerations

Data privacy and bias are paramount issues when leveraging AI in bankruptcy practice. Practitioners must ensure confidential information remains protected, actively monitor algorithms for fairness, and maintain transparency with clients while using these advanced systems.

C. Courts Addressing AI

1. Federal Rule of Bankruptcy Procedure 9011(b) provides:

By presenting to the court a petition, pleading, written motion, or other document—whether by signing, filing, submitting, or later advocating it—an attorney or unrepresented party certifies that, to the best of the person’s knowledge, information, and belief formed after an inquiry reasonable under the circumstances:

(2) the claims, defenses, and other legal contentions **are warranted by existing law** . . .

Federal Rule of Civil Procedure 11 is nearly identical.

2. Cases- See Appendix

- a. *In re Martin*, 670 B.R. 636, 638 (Bankr. N.D. Ill. 2025) (attorney sanctioned for using ChatGPT and submitting nonexistent legal authority).
- b. *Richburg v. Glyndon Square LLC (In re Richburg)*, Case No. 25-ap-80037 (Bankr. D. S. C. Aug. 27, 2025) (attorney sanctioned for using Co-Pilot and submitting fake citations).
- c. *Buckner v. Hilton Global*, Case No. 24-cv-00375 (E.D. Ky. June 20, 2025) (*pro se* litigant not excused from rule 11 obligations and likening AI generated filings to “ghostwriting”).
- d. *Versant Funding Ltd. Liab. Co. v. Teras Breakbulk Ocean Navigation Enters., Ltd. Liab. Co.*, Case No. 17-cv-81140 (S.D. Fla. May 20, 2025) (local counsel filing document without checking citations jointly and severally liable with attorney drafting pleading using AI and citing hallucinated cases)
- e. *Noland v. Land of the Free, L.P.*, 114 Cal. App. 5th 426, 426 (2025) (refusing to order sanctions payable to opposing counsel where counsel did not discover or alert the court of the hallucinated cases submitted by plaintiff’s counsel).

3. Standing Orders

- a. S.D. Ohio, Judge Newman, Standing Order Governing Civil Cases (Dec. 18, 2023, Amended Aug. 27, 2025 to add new AI provision)

- b. S.D. Ohio, Judge Hopkins, Standing Order Governing the Use of Generative AI (Aug. 20, 2025)
- 4. Proposed Federal Rule of Evidence 707:

See Excerpt from Report of Judicial Conference Committee on Rules of Practice and Procedure

When machine-generated evidence is offered without an expert witness and would be subject to Rule 702 if testified to by a witness, the court may admit the evidence only if it satisfies the requirements of Rule 702 (a)-(d). This rule does not apply to the output of simple scientific instruments.

 - a. At its meeting, the Judicial Conference Committee on Rules of Practice and Procedure, by a vote of 8-1, recommended the proposal to add a new Rule 707 for release for public comment. The Department of Justice voted against the proposal.
 - b. The Judicial Conference Committee on Rules of Practice and Procedure proceeded with seeking public comment, not necessarily to enact the rule, but to seek comment and input to assist with a new rule

V. Section 5: Panel Discussion and Audience Q&A

The panel will feature an active conversation among practicing professionals, drawing on real cases to illustrate both opportunity and challenge. Attendees are invited to engage with direct questions about how to best harness AI's potential in bankruptcy.

VI. Conclusion: Charting a Responsible Path Forward

See AI Governance Lab (AlixPartners and BTGroup), *Insights and Practical Steps for Managing Ris in the Age of Artificial Intelligence*.

Professionals must balance ambitious technology adoption with careful oversight and ethical stewardship. By embracing AI thoughtfully, restructuring experts can unlock transformative benefits for clients while charting a responsible course.

APPENDIX



AI IN BANKRUPTCY: THE HUMAN TOUCH STILL DELIVERS VALUE

October
2024

Journal of
Corporate
Renewal

28

BY ROBB MCWILLIAMS,
PARTNER AND MANAGING DIRECTOR,
HOYOUNG PAK, PARTNER AND MANAGING DIRECTOR
& BRYAN PORTER, DIRECTOR, ALIXPARTNERS

When it comes to artificial intelligence (AI), the progression from proof of concept to real-world application can feel like the biggest gap to bridge. Financial advisors at AlixPartners working on bankruptcies see the critical balance that must be struck between reliance on AI-driven results and the value of human judgment, played out through increasing use of AI through the lifecycle of a case.

The tangible benefits that the AlixPartners' turnaround and restructuring professionals are realizing for clients with developing technology must be understood alongside the continued need for human hands at the wheel.

First Day Motions

Preparing companies to file Chapter 11 is very similar to a large due diligence exercise. In many instances, turnaround professionals perform a thorough assessment and evaluation of the company to determine what relief is needed through the first day motions and in the preparation of the information needed to support the relief requested at this stage.

AI can provide welcome assistance in this process. As an example, the technology can monitor a virtual data room and notify the engagement team when clients have uploaded new files or have updated previously provided information. AI can also categorize the numerous documents from clients, based on defined parameters, such as organizational charts, debt agreements, contracts, etc. By using AI, machine learning, and natural

language processing to classify client-uploaded documents, engagement teams can receive the correct client documents more quickly and efficiently.

In addition, AI is able to assist in the extraction of key information from client documents, such as account numbers from invoices for the utility motion exhibit or bank account information from a bank statement for the cash management motion. Further, AI can generate structured reports based on the information it extracts from documents. AI can also help validate information to ensure its accuracy and prevent errors by checking work against the documents in the virtual data room. In addition, sanity checks can be applied, flagging any potential misalignments with the underlying data, which can accelerate double-checks.

As part of the process of identifying the amount of relief needed by clients through the first day motions, turnaround professionals typically run through a process with the client's procurement team to categorize vendors based on the goods or services they provide.

Identifying the purpose of the vendor is a monotonous and tedious manual task involving multiple client discussions. In this case, AI can be leveraged to search the web or scan third-party sources (when given permission) to understand the type of goods or services provided by a vendor. An additional level of categorization can be added to determine whether

continued on page 30



When it comes to claims and claims management in bankruptcy, AI helps streamline the process for increased efficiency. It can help connect filed proofs of claim to scheduled claims, ensuring that overall claim liabilities are not overstated.

continued from page 29

a vendor is identified as foreign, foreign with domestic operations, or domestic, with each category potentially facing different treatment in the vendor motion.

Once vendors have been categorized by AI, they are aligned to the various motions (insurance, employee wages/benefits, utility, etc.). Another historically manual effort assumed by AI at this stage is in streamlining the grouping of vendors with the same name—for example, ATT, AT&T, AT & T, or AT&T Corp is standardized as AT&T—ensuring an accurate view of the total vendor amount due. Accelerating this activity allows the data to be loaded into models to classify the vendor information required for the motions more quickly. Additionally, AI expedites the preparation of draft first day motions for client review and approval, enhancing overall efficiency and allowing clients to move forward with greater speed.

SOFAs & Schedules

The Statement of Financial Affairs (SOFAs) and Schedules of Assets and Liabilities (Schedules) are enormous reporting tasks for some companies, resulting in thousands or even tens of thousands of pages being filed with the court. It is important that a client's senior leaders understand what is publicly filed in those reports, but it is unrealistic to expect them to review the reports in detail. Here, AI can help prepare an executive summary of the information filed with the court, giving clients a high-level understanding of the publicly available information without the need to digest thousands of pages of documentation.

Claims Management

When it comes to claims and claims management in bankruptcy, AI helps streamline the process for increased efficiency. Similar to vendor categorization and grouping vendors with the same name, AI can help connect filed proofs of claim to scheduled claims, ensuring that overall claim liabilities are not overstated. AI can also help reconcile invoices asserted in a proof of claim against a company's accounts payable.

Further, in the right circumstance, AlixPartners understands AI and image recognition can help understand visual information. For example, for a claimant that submits before and after photos of their house that was damaged in a fire, AI is able to assist in evaluating the amount of damage done to the home. This ability remains an evolving string to AI's bow, because the technology is only as good as its past experiences and the data it receives, while complex or poor quality images can also pose challenges.

Contract Assessments

In relation to the assessment of contracts for assumption or rejection in the bankruptcy court, AI has already proven useful on multiple fronts. First and foremost, AI has the ability to help extract key elements from the contract—counterparty name, address, contract title, contract date, and contract expiration date, for example. These key elements are not only useful for the assessment of the contract but also assist in the reporting and noticing of contracts. As discussed above regarding connecting filed proofs of claims to schedules claims, AI can link contracts to claims to

deliver a complete view of a potential creditor to a client, alongside the ability to highlight indemnification clauses and guarantees in contracts.. All this information is helpful when evaluating the multitude of factors that will impact decisions around whether to assume or reject a contract.

Monthly Operating Reports & Post-Confirmation Reports

Regarding Monthly Operating Reports and Post-Confirmation Reports, AI can help automate the manual data entry process into the prescribed U.S. trustee forms. Further, the technology is able to eliminate the manual effort of extracting the different components of financial information from accounting systems, spreadsheets, and other such platforms or file types.

Conclusion

From a bankruptcy case management perspective, the promises of streamlined processes and efficiency realization—saving time and money for clients—is absolutely within AI's potential. Further, the data privacy and security component of AI cannot be overlooked, because it is feasible to host data and AI in the same secure systems.

However, as with many previous digital evolutions, the power of human instruction, direction, and judgment cannot be underestimated. Expert verification and validation remains critical, ultimately delivering a level of client value that AI has yet to harness. ■

The authors would like to recognize Rob Cerff, director at AlixPartners, and Mo Bhasin, SVP at AlixPartners, for their thoughtful contributions to this article.



Robb McWilliams is a partner and managing director on AlixPartners Turnaround and Restructuring practice. He brings over two decades of expertise in operational and financial restructurings across diverse industries including chemicals, mining, telecommunications, gaming and hospitality, retail, utilities, and industrial and consumer products. McWilliams' proven approach to crisis management and bankruptcy has consistently delivered successful turnarounds for distressed assets.



Hoyoung Pak is the co-leader of global AI and data at AlixPartners, leading AI-driven transformations across industries and services. With extensive experience in management consulting and executive roles, he leverages AI to enhance decision-making, optimize operations, and deliver impactful results in growth and cost reduction. Previously, as chief operating officer at a global design and packaging graphics firm, Pak led an enterprise-wide transformation that improved EBITDA by 20% through process improvement and AI innovations.



Bryan Porter is a director at AlixPartners and has more than 25 years of professional experience in accounting and business processes. He has been instrumental in leading clients through bankruptcy contingency planning, reporting, claims resolution, preference analysis, and plan voting. Porter applies his accounting experience and data skills to analyze large and complex data sets deliver results. He has also played a major role in the development of data models that AlixPartners uses across multiple engagements.

How do you get to the forefront of what's next?

Gain a strategic advantage with data-driven insights, the latest tools and industry-leading security. We're delivering the cutting edge of digital innovation to help drive your business.

What would you like the power to do?®

Start the conversation
Adam Moss, amoss5@bofa.com
business.bofa.com



"Bank of America" and "BoFA Securities" are the marketing names used by the Global Banking and Global Markets divisions of Bank of America Corporation. Lending, derivatives, other commercial banking activities, and trading in certain financial instruments are performed globally by banking affiliates of Bank of America Corporation, including Bank of America, N.A., Member FDIC. Trading in securities and financial instruments, and strategic advisory, and other investment banking activities, are performed globally by investment banking affiliates of Bank of America Corporation ("Investment Banking Affiliates"), including, in the United States, BoFA Securities, Inc., which is a registered broker-dealer and Member of SIPC, and, in other jurisdictions, by locally registered entities. BoFA Securities, Inc. is a registered futures commission merchant with the CFTC and a member of the NFA.

Investment products offered by Investment Banking Affiliates: **Are Not FDIC Insured** **Are Not Bank Guaranteed** **May Lose Value**

©2024 Bank of America Corporation. All rights reserved. GBGM-563-AD 6107252

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:	)	Chapter 13
	)	
Marla C. Martin,	)	Case No. 24 B 13368
	)	
Debtor.	)	Honorable Michael B. Slade
_____	)	

**MEMORANDUM OPINION FINDING VIOLATION OF
BANKRUPTCY RULE 9011 AND IMPOSING SANCTIONS**

On June 11, 2025, I issued an order directing the Semrad Law Firm, LLC (“Semrad”) and Thomas E. Nield to show cause why they should not be sanctioned for filing a brief containing fake quotations and nonexistent authority manufactured by artificial intelligence and why their compensation does not exceed the reasonable value of their services pursuant to 11 U.S.C. § 329. (Dkt. No. 56) Semrad then withdrew the offending brief (*see* Dkt. No. 58 (withdrawing Dkt. No. 51)), and it and Mr. Nield separately responded to my show cause order. (*See* Dkt. Nos. 67, 71) Semrad also withdrew its application for compensation in this case. (*See* Dkt. No. 68) The United States Trustee and Chapter 13 Trustee both argue that I should sanction Semrad and Mr. Nield (*see* Dkt. Nos. 66 and 70) and it is now my duty to address the Show Cause Order.

While I appreciate Mr. Nield’s and Semrad’s remorse and candor, I find that they both violated Federal Rule of Bankruptcy Procedure 9011. I further find that a modest, joint-and-several sanction of \$5,500, paid to the Clerk of the Bankruptcy Court, along with a requirement that Mr. Nield and another senior Semrad attorney attend an upcoming course on the dangers of AI scheduled for the National Conference of Bankruptcy Judges (NCBJ) annual meeting in September, is the least harsh sanction that will appropriately address counsel’s conduct and deter future, similar misconduct from them and others. My reasons follow.

I.

On September 11, 2024, the Debtor and Semrad entered into this Court's form Court Approved Retention Agreement (CARA). Semrad filed the CARA along with the Debtor's signed voluntary petition under chapter 13 of the Bankruptcy Code and related papers on her behalf the next day. (*See* Dkt. No. 1)

This is the Debtor's eighth bankruptcy case. (*See* Dkt. No. 6) Each of the prior seven cases was dismissed for one reason or another. (*Id.*) Three of the Debtor's prior cases (Case Nos. 18-10082, 16-36239, 07-18870) were dismissed after confirmation because the Debtor failed to make plan payments. The other four (Case Nos. 18-02822, 16-36239, 07-13303, 07-01898) were dismissed before confirmation

For its part, Semrad is a prolific filer of Chapter 13 cases; a material percentage of my docket consists of cases filed by that firm. And the Debtor and Semrad are very familiar with one another; Semrad had represented the Debtor in three prior bankruptcy cases before this one. Each time Semrad represented the Debtor before this case, the Debtor pursued and confirmed a chapter 13 plan, only to have her case dismissed when she was unable to comply with the plan's requirements. (*See* Case Nos. 18-10082, ECF Nos. 68 & 70; 12-28654, ECF Nos. 55, 56 & 65; 07-18870, ECF Nos. 74 & 75) And in each of those cases, Semrad petitioned for, and was awarded, attorneys' fees. In total, before this case, the Debtor had paid Semrad \$8,958.45 for its services, but she is yet to complete a bankruptcy case successfully to earn a discharge.¹

¹ According to the chapter 13 trustee's final report and account filed August 31, 2020, in Case No. 18-10082 (Dkt. No. 72), the trustee paid \$894.45 to Semrad through the plan, and the debtor advanced \$400 according to the fee application (Dkt. No. 16). According to the chapter 13 trustee's final report and account filed May 16, 2017, in Case No. 12-28654 (Dkt. No. 68), the trustee paid \$3,500 to Semrad through the plan, and the debtor advanced \$350 according to the fee application (Dkt. No. 14). And according to the chapter 13 trustee's final report and account filed February 24, 2009, in Case No. 07-18870 (Dkt. No. 77), the trustee paid \$2,314 to Semrad through the plan, and the debtor advanced \$1,500 according to the fee application (Dkt. No. 13).

This case has had its problems, too. The primary challenge posed by the Debtor's current situation is that she did not pay the real estate taxes owed on her Chicago home between 2012 and 2018. Creditor Corona Investments, LLC acquired rights to those payments and an associated tax lien secured by her home. The Debtor's initial chapter 13 plan proposed a \$1,600 monthly plan payment and would have paid Corona \$74,735, providing 0% interest. (Dkt. No. 10 §§ 2.1, 3.2) That was obviously wrong, and Corona (since even before my appointment to the bench) objected to the Debtors' initial plan long ago, pointing out the error. (*See* Dkt. No. 14 (*citing* 35 Ill. Comp. Stat. 200/21-75 and *In re Lamont*, 740 F.3d 397, 404 (7th Cir. 2014))

To give the Debtor a fair chance to confirm a plan that could save her home and the substantial equity she has in it, my predecessor and I continued the Debtor's confirmation hearing eight times to facilitate negotiations between her and Corona. (*See* Dkt. Nos. 16, 20, 25, 29, 32, 37, 40, 46)² Despite these efforts, after I entered a briefing schedule to consider Corona's objection (Dkt. No. 45), and briefs were filed (*see* Dkt. Nos. 49 & 51), I advised Semrad that I could not possibly confirm the then-latest proposed Plan because, even *if* I overruled Corona's objection, the Plan was clearly not feasible: it proposed to pay creditors \$2,400 per month (*see* Dkt. No. 43 § 2.1), while the schedules swore that the Debtor's disposable income was only \$1,600 per month (*see* Dkt. No. 1, Schedule J, Line 23(c)). When I pointed out that straightforward feasibility problem on June 10, Semrad advised the schedules on file were incorrect and the Debtor had more income than sworn. Which is its own problem. And while Debtor's counsel later filed amended schedules (Dkt. No. 72) and an amended Plan that matched them (Dkt. No. 73), the amended Plan did not comply with an order I had entered that required

² The Chapter 13 Trustee dutifully pointed out the problems with Debtor's counsel's work since the beginning and asked that the case be dismissed last fall. (*See* Dkt. No. 19) My predecessor and I collectively continued the Trustee's motion to dismiss seven times, for the same reason: to give the Debtor every reasonable opportunity to confirm a plan to save her home, if possible. (*See* Dkt. Nos. 21, 27, 31, 39, 42, 48, 54)

any amended plan to be signed by both the Debtor and her counsel. (*Compare* Dkt. No. 55 at 2 (order requiring Debtor’s signature) *with* (Dkt. No. 73) (amended plan lacking signature))

I required the Debtor’s signature on any proposed amended plan for a good reason. On March 6, 2025, Debtor’s counsel signed and filed on behalf of the Debtor a proposed Plan that (if confirmed) would have required the Debtor to make monthly plan payments of \$2,600 for 60 months and to provide 18% interest to Corona on its claim. (*See* Dkt. No. 35, §§ 2.1, 3.2) But on April 8, 2025, the Debtor personally appeared in Court (while Mr. Nield appeared via Zoom) and told me that she did not agree with the plan that her counsel had filed—suggesting the plan had been filed without her approval. Then, at the next hearing on June 10, 2025, when I asked Mr. Nield whether the Debtor was on board with a further-amended Plan (a question to which there are only two potential answers, yes or no), he equivocated, said that she “is, in some sense, in agreement with it” because she had made one monthly payment of \$2,400 (the revised monthly payment called for in the then-current proposed Plan), while also confirming she had not signed off on the filing of amended schedules that would make that Plan feasible. (*See* Dkt. No. 65 (6/10/25 Hr’g Tr.)) That is why my June 10 order required “that both the Debtor *and* the Debtor’s counsel sign any amended plan before it is filed.” (*See* Dkt. No. 55 at 2 (emphasis in original)) Unfortunately, neither directive was honored; Semrad filed an amended plan without the Debtor’s signature eight days after the deadline. (*See* Dkt. No. 73)

The Plan was finally confirmed earlier this week (*see* Dkt. No. 75), but suffice it to say that I have real concerns about the way that this case has been handled. I expect materially more care from Debtor’s counsel. And the Chapter 13 Trustee has expressed broader concerns about Debtor’s counsel generally, alleging (among other things) that Semrad often has clients sign blank signature forms, which leads to the filing of inaccurate sworn declarations, and often files

cases without possessing (or being able to procure on a timely basis) basic documents necessary to prosecute any Chapter 13 case. (*See* Dkt. No. 69 (Chapter 13 Trustee’s Response to Court’s Rule to Show Cause))

The Chapter 13 Trustee’s allegations are very serious. But I am not taking the allegations into account in this ruling because Semrad did not have an opportunity to respond to them, they relate primarily to the section 329 examination that is unnecessary given Semrad’s withdrawal of its fee petition, and the reason for the Order to Show Cause was limited to the fake citations in Semrad’s response brief. However, the allegations are consistent with my general observation that Semrad should be taking more care when filing and prosecuting Chapter 13 cases than has been shown here.

II.

I described in my Show Cause Order (Dkt. No. 56) the problem that led us here. To summarize: I entered a briefing schedule to help me resolve the dispute between the Debtor and Corona; it required Corona to file a written objection to the proposed plan while giving the Debtor a chance to respond. (Dkt. No. 45) Corona then filed a “kitchen sink” objection, disputing feasibility and challenging the plan treatment offered to it and other creditors. (Dkt. No. 49) The Debtor’s response—signed by Mr. Nield and Semrad on her behalf—argued that Corona lacked standing to make any arguments other than disputes over the treatment of Corona’s own claim. (*See* Dkt. No. 51)

While the argument that creditors lack standing to complain about the treatment of other creditors if it does not impact the objector directly rang true, the claim that Corona lacked standing to object to *feasibility* did not. So my staff and I began to examine the issue in depth to see if Semrad’s argument was supported by the caselaw. We found the following:

What Counsel's Brief Claimed	What Actually Exists
" <i>In re Montoya</i> , 341 B.R. 41 (Bankr. D. Utah 2006). The court held that '[a] secured creditor's standing to object to confirmation is limited to issues that affect its rights directly.' Secured creditors cannot object based on disposable income or plan feasibility because those issues do not impact their claims." (Dkt. No. 51, at 1-2)	<i>In re Montoya</i> , 341 B.R. 41 (Bankr. D. Utah 2006) exists, and the citation is correct. However, not only does the language quoted by counsel not appear anywhere in the court's opinion, but the opinion does not address issues of standing at all. The opinion certainly does not dispute a secured creditor's right to challenge the feasibility of a chapter 13 plan.
" <i>In re Jager</i> , 344 B.R. 349 (Bankr. D. Colo. 2006). The court found that secured creditors are 'not entitled to raise objections related to other creditors or the debtor's disposable income.' These objections fall within the purview of the Chapter 13 trustee." (Dkt. No. 51, at 2)	<i>In re Jager</i> , 344 B.R. 349 (Bankr. D. Colo. 2006) does not exist.
" <i>In re Coleman</i> , 373 B.R. 907 (Bankr. W.D. Wis. 2007). A secured creditor may only object to confirmation where 'the plan proposes to alter the treatment of its secured claim in violation of §1325(a)(5).' Here, there is a limited issue regarding Corona's rights as they pertain to § 1325(a)(5), none of which are brought up in lines 16-20." (Dkt. No. 51, at 2)	<i>In re Coleman</i> , 373 B.R. 907 exists, although the case is from the Bankruptcy Court in the Western District of Missouri, not Wisconsin. Again, not only does counsel's quotation not appear in the case at all, the opinion does not discuss the proposition for which it is cited, let alone support it.
" <i>In re Russell</i> , 458 B.R. 731 (Bankr. E.D. Wis. 2011). The Court said 'A secured creditor's standing is limited to objecting to the treatment of its claim. It lacks standing to object to confirmation based on issues like feasibility or disposable income that do not directly impact its rights.'" (Dkt. No. 51, at 2)	<i>In re Russell</i> , 458 B.R. 731, exists, although the case is from the Bankruptcy Court in the Eastern District of Virginia, not Wisconsin, and is from 2010, not 2011. Yet again, the quotation from counsel's brief does not appear anywhere in the court's opinion, and the opinion does not touch on the topic of standing at all.

In sum, what happened here is that Mr. Nield cited four cases for a proposition of law, but none of them exist as alleged in his brief. Worse still, none of the quotations relied upon in the Semrad brief are actual statements written by any court.

I raised the problems created by these apparently fake citations at the hearing on June 10. I asked Mr. Nield directly whether he used some sort of AI to come up with this portion of his brief, and he stated the following: "I think the citation element of these cases, I guess, was – I ran it through AI to some extent, but I didn't think that the citation was wrong." (Dkt. No. 65,

6/10/25 Hr’g Tr. at 20:10-13) I then issued my Show Cause Order (Dkt. No. 56), describing the problem in detail and directing both Mr. Nield and Semrad to respond.

To his credit, Mr. Nield appears to both understand what he did wrong and to be remorseful for it. He states that he “had never used AI to do any legal research prior to this specific instance,” and he “simply entered queries into the program which elicited problems.” (Dkt. No. 71 at 2) Mr. Nield then “did not review the relevant, underlying quotes from the opinions cited by the AI program” because he “assumed that an AI program would not fabricate quotes entirely.” (*Id.*) Mr. Nield promises that he will never again use an AI program to do legal research “without checking every element of the AI’s work product” and advises that he “has self-reported his behavior to the IARDC and is willing to take steps this Court deems necessary to ensure this happens again.” (*Id.* at 3)

For its part, Semrad states that, as a firm, it “strictly prohibits using AI for legal research or the generation of legal citations without manual verification” and that Mr. Nield’s use of ChatGPT for this purpose was “outside of the firm’s research protocol.” (Dkt. No. 67 at 1–2) Semrad does not identify how it communicated that restriction on AI use to its attorneys and staff or what the firm’s “research protocol” was prior to this case, but claims to have conducted an internal investigation (of unspecified breadth) which did not reveal other instances of improper AI usage prior to this one. (*Id.* at 2) That said, in recognition of the problem here, Semrad (1) withdrew its request for compensation in this case; (2) created a formal Artificial Intelligence Policy (which went into effect after, and as a result of, this incident); (3) required all attorneys at the firm to complete online CLE training in the “ethical and appropriate use of AI in legal practice”; and (4) offered to reimburse opposing counsel for time reviewing the offending brief. (*Id.* at 2-3)

III.

Federal Rule of Bankruptcy Procedure 9011(b)(2) provides that:

By presenting to the court a petition, pleading, written motion, or other document—whether by signing, filing, submitting, or later advocating it—an attorney or unrepresented party certifies that, to the best of the person’s knowledge, information, and belief formed after an inquiry reasonable under the circumstances . . . the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument to extend, modify, or reverse existing law, or to establish new law.

What happened here does not appear to have been addressed in a published Bankruptcy Court opinion before, but there is a body of District Court cases where counsel submitted briefs containing fake cases or quotations “hallucinated” by AI, and Federal Rule of Civil Procedure 11 is “essentially identical” to Bankruptcy Rule 9011. *Baermann v. Ryan (In re Ryan)*, 411 B.R. 609, 613 (Bankr. N.D. Ill. 2009). The holdings of those District Court cases are both uniform and highly persuasive: “At the very least, the duties imposed by Rule 11 require that attorneys read, *and thereby confirm the existence and validity of*, the legal authorities on which they rely.” *Benjamin v. Costco Wholesale Corp.*, No. 24-cv-7399, 2025 WL 1195925, at *5 (E.D.N.Y. Apr. 24, 2025) (quoting *Park v. Kim*, 91 F.4th 610, 615 (2d Cir. 2024) (emphasis added in *Benjamin*)).³ It is undisputed that Mr. Nield did not do so. Thus, he violated Federal Rule 9011.

The sanctions available for violations of Rule 9011 include a nonmonetary directive, an order to pay a penalty into court, or in some circumstances an order directing the violator to pay

³ See also, e.g., *Mid Central Operating Engineers Health & Welfare Fund v. HoosierVac LLC*, No. 24-cv-00326, 2025 WL 574234, at *3, 5 (S.D. Ind. Feb. 21, 2025) (recommending sanctions for citing authorities “hallucinate[d]” by artificial intelligence in court filings); *Gauthier v. Goodyear Tire & Rubber Co.*, No. 23-CV-281, 2024 WL 4882651, at *3 (E.D. Tex. Nov. 25, 2024) (imposing sanctions under Fed. R. Civ. Pro. 11(b) for filing a brief that included fake case law generated by artificial intelligence “without reading the cases cited, or even confirming the existence or validity of the cases included”); *Mata v. Avianca, Inc.*, 678 F. Supp. 3d 443, 465 (S.D.N.Y. 2023) (same); *Garner v. Kadince, Inc.*, No. 20250188-CA, 2025 WL 1481740, at *3 (Utah Ct. App. May 22, 2025) (same).

his or her opponent’s attorneys’ fees. *See* Fed. R. Bankr. P. 9011(c)(4). And where (as here) sanctions are to be imposed, “[a]bsent exceptional circumstances, a law firm must be held jointly responsible for a violation committed by its partner, associate, or employee.” Fed. R. Bankr. P. 9011(c)(1). But sanctions “must be limited to what suffices to deter repetition of the conduct or deter comparable conduct by others similarly situated.” Fed. R. Bankr. P. 9011(c)(4).

As I advised in my Show Cause Order, courts in similar cases have issued monetary sanctions of up to \$15,000, along with various non-monetary sanctions. (Dkt. No. 56 at 3)⁴

Below is a chart detailing the sanctions imposed in some of the recent similar cases:

Case	Facts	Sanctions
<i>Wadsworth v. Walmart Inc.</i> , 348 F.R.D. 489 (D. Wyo. 2025)	Plaintiff’s counsel filed Motions in Limine citing nine cases; eight did not exist. Following an Order to Show Cause, the attorneys admitted that the cases were hallucinated by an AI platform. The drafter stated that it was his first time using AI in this way and he didn’t learn the cases were questionable until the Court asked him to Show Cause. After the Order to Show Cause issued, counsel: (1) withdrew the Motions, (2) were forthcoming about the use of AI, (3) paid opposing counsel’s fees for defending the Motions, and (4) implemented policies and training to prevent another occurrence.	The Court revoked the drafter’s pro hac vice status and imposed a \$3,000 fine. The Court also imposed a sanction of \$1,000 on each of the two attorneys who signed, but did not draft, the motions (for a total of \$5,000 in fines).
<i>Mid Cent. Operating Eng’rs Health & Welfare Fund v. HoosierVac LLC</i> , No. 24-cv-00326, 2025 WL 574234 (S.D. Ind. Feb. 21, 2025)	Defendant’s counsel filed a brief that cited an alleged Seventh Circuit case the magistrate judge could not locate because it was fake. The magistrate judge reviewed counsel’s prior submissions and found similar issues in two other briefs. After the magistrate judge issued an Order to Show Cause, the lawyer admitted his error and took CLE courses on AI use.	The magistrate judge recommended that counsel be sanctioned \$15,000. The District Court adopted the recommendation but reduced the penalty to \$6,000. <i>Mid Cent. Operating Eng’rs Health & Welfare Fund v. HoosierVac LLC</i> , No. 24-cv-00326, 25 WL 1511211 (S.D. Ind. May 28, 2025).

⁴ *See also Attaway v. Illinois Dep’t of Corr.*, No. 23-cv-2091, 2025 WL 1101398, at *3 (S.D. Ill. Apr. 14, 2025) (“With the rise of incorrect citations and new emerging technologies, courts have assessed monetary sanctions anywhere from \$2,000 to \$15,000 for violations similar to Plaintiff’s conduct.”).

Case	Facts	Sanctions
<i>Mata v. Avianca, Inc.</i> , 678 F. Supp. 3d 443 (S.D.N.Y. 2023)	Plaintiff’s counsel filed an “Affirmation in Opposition” to Defendant’s motion, which cited and quoted purported judicial decisions that did not exist. After Defendant’s counsel pointed out the flaws with Plaintiff’s cited case law, Plaintiff’s counsel did not withdraw the offending brief or volunteer an explanation to the Court. At the hearing on the Court’s subsequent Order to Show Cause, authoring counsel revealed that he had used ChatGPT, claiming he had not known that ChatGPT was capable of making up cases, and signing counsel admitted that he reviewed the Affirmation for style but made no inquiry into the author’s research, even though the author had no familiarity with the law at issue.	The attorneys were required to send the sanctions opinion, the Affirmation, and the sanctions hearing transcript, with a cover letter, to their client and to each judge falsely identified as the author of a fabricated opinion (and to file copies of the letters sent on the case docket). In addition, the Court imposed a \$5,000 joint and several penalty on the attorneys.
<i>Coomer v. Lindell</i> , Case No. 22-cv-01129, 2025 WL 1865282 (D. Colo. July 7, 2025)	Defense counsel filed a brief that contained erroneous AI-generated citations. They claimed a prior draft had been mistakenly filed, rather than a corrected final version. However, the alleged final version they contended they meant to upload had many of the same erroneous citations, among other deficiencies. The Court also took judicial notice that Defense counsel took steps to correct similar issues in a brief filed before a different federal court just days after it had issued the order to show cause in this matter.	Two lawyers were each ordered to pay \$3,000 (for a total of \$6,000), and one of the penalties was jointly and severally ordered against the lawyer and his law firm.
<i>Benjamin v. Costco Wholesale Corp.</i> , No. 24-CV-7399, 2025 WL 1195925 (E.D.N.Y. Apr. 24, 2025)	The Court was unable to locate five out of seven cases cited by Plaintiff’s counsel in a reply brief and issued an Order to Show Cause. In her Response, Plaintiff’s counsel admitted that the five cases did not exist, said she used an AI platform called ChatOn, and claimed she failed to sufficiently review the reply before filing it because she was pressed for time. She stated she had never used AI for anything	The Court ordered counsel to identify (1) the two CLE classes that she already took and whether she was required to pay for them; and (2) the prospective CLE classes she intended to take. After receiving that information, the Court issued a monetary sanction of \$1,000.

Case	Facts	Sanctions
	law related before, and informed the Court that she took and intended to take CLE classes regarding the use of AI in federal court practice.	
<i>Ramirez v. Humala</i> , No. 24-CV-242, 2025 WL 1384161 (E.D.N.Y. May 13, 2025) ⁵	Four of eight cases cited by Plaintiff's counsel were hallucinated by AI, and the Court issued a Show Cause Order. In response, Plaintiff's counsel admitted the error, apologized, and conducted a full internal investigation.	The Court ordered a joint and several penalty of \$1,000 on the attorney and her law firm.

Mr. Nield and Semrad ask me not to sanction them at all given that they have already voluntarily: (1) admitted their misconduct and promised not to do it again; (2) withdrawn any application for compensation in this case; and (3) watched an online CLE video. But while I appreciate their candor and efforts, “[t]here must be consequences.” *Ferris v. Amazon.com Servs., LLC*, No. 24-cv-304, 2025 WL 1122235, at *2 (N.D. Miss. Apr. 16, 2025). While I believe this mistake was unintentional, a “citation to fake, AI-generated sources . . . shatters [] credibility” and “imposes many harms.” *Kohls v. Ellison*, No. 24-cv-3754, 2025 WL 66514, at *4–5 (D. Minn. Jan. 10, 2025). So the consequences “are steep.” *Id.* at *5.

⁵ I reviewed the unpublished opinions that Mr. Nield referred to in his brief (*see* Dkt. 71 at p. 4-5) and they do not change my thinking in this case. The Memorandum Opinion in *Iron Tax, Accounting & Fin. Sols., LLC v. Story Law Firm, P.L.L.C.*, No. 23-CV-5243 (W.D. Ark. April 8, 2025), ECF No. 49, attached as Exhibit B to Mr. Nield's brief, merely includes a footnote (at page 16, n.2) in resolving summary judgment and *Daubert* motions that flags (presumably for the first time) counsel misciting a few cases, commenting that “short of the use of AI, it is unclear how such errors would slip past a reasonably diligent attorney.” That the Court declined to pursue the matter further for reasons unknown does not weigh against imposing sanctions here. In *Araujo v. Wedelstadt*, No. 23-cv-1190 (E.D. Wis. Jan 22, 2025), the offending lawyer realized the errors in his response before the court's consideration and amended the pleading identifying the incorrect citations. *Id.*, ECF Nos. 35, 38. The court's decision (attached as Exhibit C to Mr. Nield's brief, *see* Dkt. 71, Ex. C) calls the use of AI “unacceptable,” but let counsel off with only a warning, presumably on account of his rectifying the error early. I also reviewed the transcript that Mr. Nield attached as Exhibit A to his brief, where a court declined to sanction counsel after finding, among other things, that the offending attorney had already experienced “adverse” publicity from his misconduct that “sent the necessary message” not to do it again. Hr'g Tr. at 18:1–4, *Iovino v. Michael Stapleton Associates, Ltd.*, No. 21-CV-64 (W.D. Va. Oct. 30, 2024), ECF No. 204. To me, these outcomes are at the lenient end of a spectrum of various responses a Court can have to this situation. For the reasons I give in this opinion, I believe a modest sanction is appropriate here.

The first reason I issue sanctions stems from Mr. Nield’s claim of ignorance—he asserts he didn’t know the use of AI in general and ChatGPT in particular could result in citations to fake cases. (Dkt. No. 71 at 3) Mr. Nield disputes the court’s statement in *Wadsworth* that it is “well-known in the legal community that AI resources generate fake cases.” 348 F.R.D. at 497. Indeed, Mr. Nield aggressively chides that assertion, positing that “in making that statement, the *Wadsworth* court cited no study, law school journal article, survey of attorneys, or *any* source to support this blanket conclusion.” (Dkt. No. 71 at 3–4, emphasis in Mr. Nield’s brief as filed)

I find Mr. Nield’s position troubling. At this point, to be blunt, any lawyer unaware that using generative AI platforms to do legal research is playing with fire is living in a cloud. This has been a hot topic in the legal profession since at least 2023, exemplified by the fact that Chief Justice John G. Roberts, Jr. devoted his 2023 annual Year-End Report on the Federal Judiciary (in which he “speak[s] to a major issue relevant to the whole federal court system,” Report at 2) to the risks of using AI in the legal profession, including hallucinated case citations.⁶ To put it mildly, “[t]he use of non-existent case citations and fake legal authority generated by artificial intelligence programs has been the topic of many published legal opinions and scholarly articles as of late.”⁷ At this point there are *many* published cases on the issue—while only a sampling are cited in this opinion, all but one were issued before June 2, 2025, when Mr. Nield filed the offending reply. *See, e.g.,* Jaclyn Diaz, *A Recent High-Profile Case of AI Hallucination Serves*

⁶ Available at <https://www.supremecourt.gov/publicinfo/year-end/2023year-endreport.pdf>.

⁷ *O’Brien v. Flick*, No. 24-61529-CIV, 2025 WL 242924, at *6 (S.D. Fla. Jan. 10, 2025); *see also Willis v. U.S. Bank Nat’l Ass’n*, No. 25-cv-516, 2025 WL 1408897, at *1 (N.D. Tex. May 15, 2025) (“It is no secret that generative AI programs are known to ‘hallucinate’ nonexistent cases, and with the advent of AI, courts have seen a rash of cases in which both counsel and *pro se* litigants have cited such fake, hallucinated cases in their briefs.”) (quoting *Sanders v. United States*, 176 Fed. Cl. 163, 169 (2025); *Evans v. Robertson*, No. 24-13435, 2025 WL 1483449, at *2 (E.D. Mich. May 21, 2025) (same, with same quote); *Benjamin*, 2025 WL 1195925, at *1 (citing the numerous judicial opinions in recent weeks and months that address the “epidemic” of lawyers citing fake cases after using AI to perform legal research)).

as a Stark Warning, NPR ILLINOIS (July 10, 2025, 12:49 PM), <https://www.nprillinois.org/2025-07-10/a-recent-high-profile-case-of-ai-hallucination-serves-as-a-stark-warning> (“There have been a host of high-profile cases where the use of generative AI has gone wrong for lawyers and others filing legal cases It has become a familiar trend in courtrooms across the U.S.”). The Sedona Conference wrote on the topic in 2023.⁸ Newspapers, magazines, and other well-known online sources have been publicizing the problem for at least two years.⁹ And on January 1, 2025, the Illinois Supreme Court issued a “Supreme Court Policy on Artificial Intelligence” requiring practitioners in this state to “thoroughly review” any content generated by AI.¹⁰

⁸ See, e.g., Hon. Xavier Rodriguez, *Artificial Intelligence (AI) and the Practice of Law*, 24 SEDONA CONF. J. 783, 784, 791 (2023) (“[T]here is a need for education in the legal community to understand errors or ‘hallucinations’ that may occur in the output of the [large language models] powering these platforms. Attorneys and courts need to be aware of both the benefits and limitations that these AI platforms present.”), cited in *Versant Funding LLC v. Teras Breakbulk Ocean Navigation Enters., LLC*, No. 17-CV-81140, 2025 WL 1440351, at *4 (S.D. Fla. May 20, 2025).

⁹ See Nicole Black, *Do NOT, I Repeat, Do NOT Use ChatGPT For Legal Research* (June 22, 2023, 1:47 PM), <https://abovethelaw.com/2023/06/do-not-i-repeat-do-not-use-chatgpt-for-legal-research/> (Generative AI tools “are bald-faced liars that pull facts out of thin air . . . , including legal cases”); see also, e.g., Benjamin Weiser, *Here’s What Happens When Your Lawyer Uses ChatGPT*, N.Y. TIMES (May 27, 2023), <https://www.nytimes.com/2023/05/27/nyregion/avianca-airline-lawsuit-chatgpt.html>; Larry Neumeister, *Lawyers Submitted Bogus Case Law Created by ChatGPT. A Judge Fined Them \$5,000*, ASSOCIATED PRESS (June 22, 2023), <https://apnews.com/article/artificial-intelligence-chatgpt-fake-case-lawyers-d6ae9fa79d0542db9e1455397aef381c>; Erin Mulvaney, *Judge Sanctions Lawyers Who Filed Fake ChatGPT Legal Research*, WALL ST. J. (June 22, 2023), <https://www.wsj.com/us-news/judge-sanctions-lawyers-who-filed-fake-chatgpt-legal-research-9ebad8f9>; and LegalEagle, *How to Use ChatGPT to Ruin Your Legal Career*, YOUTUBE.COM (June 10, 2023), <https://www.youtube.com/watch?v=oqSYljRYDEM> (cited in *Schoene v. Ore. Dep’t of Human Servs.*, No. 23-cv-742, 2025 WL 1755839, at *7 n.6 (D. Or. June 25, 2025)); and Lyle Moran, *Lawyer Cites Fake Cases Generated by ChatGPT in Legal Brief*, LegalDive (May 30, 2023), <https://www.legaldive.com/news/chatgpt-fake-legal-cases-generative-ai-hallucinations/651557/>; Sara Merken, *AI ‘Hallucinations’ in Court Papers Spell Trouble for Lawyers*, REUTERS (Feb. 18, 2025, 2:55 PM), <http://reuters.com/technology/artificial-intelligence/ai-hallucinations-court-papers-spell-trouble-lawyers-2025-02-18/> (both cited in *Powhatan Cnty. Sch. Bd. v. Skinger*, No. 24cv874, 2025 WL 1559593, at *9 n.7 (E.D. Va. June 2, 2025)).

¹⁰ Available at <https://ilcourtsaudio.blob.core.windows.net/antilles-resources/resources/e43964ab-8874-4b7a-be4e-63af019cb6f7/Illinois%20Supreme%20Court%20AI%20Policy.pdf> (Effective Jan. 1, 2025) (“Attorneys, judges, and self-represented litigants are accountable for their final work product. All users must thoroughly review AI-generated content before submitting it in any court proceeding to ensure accuracy and compliance with legal and ethical obligations. Prior to employing any technology, including generative AI applications, users must understand both general AI capabilities and the specific tools being utilized.”).

Counsel’s professed ignorance of the dangers of using ChatGPT for legal research without checking the results is in some sense irrelevant. Lawyers have ethical obligations not only to review whatever cases they cite (regardless of where they pulled them from), but to understand developments in technology germane to their practice.¹¹ And there are plenty of opportunities to learn—indeed, the Illinois State Bar Association chose “Generative Artificial Intelligence – Fact or Fiction” as the theme of its biennial two-day Allerton Conference earlier this year, calling the topic “one that every legal professional should have on their radar.”¹² Similar CLE opportunities have been offered across the nation for at least the past two years.

The bottom line is this: at this point, no lawyer should be using ChatGPT or any other generative AI product to perform research without verifying the results. Period. *See, e.g., Lacey v. State Farm Gen. Ins. Co.*, No. CV 24-5205, 2025 WL 1363069, at *3 (C.D. Cal. May 5, 2025) (“Even with recent advances, no reasonably competent attorney should out-source research and writing to this technology—particularly without any attempt to verify the accuracy of that material.”); *Mid Cent. Operating Eng’rs*, 2025 WL 574234, at *2 (“It is one thing to use AI to assist with initial research, and even non-legal AI programs may provide a helpful 30,000-foot view. It is an entirely different thing, however, to rely on the output of a generative AI program without verifying the current treatment or validity—or, indeed, the very existence—of the case presented.”). In fact, given the nature of generative AI tools, I seriously doubt their utility to assist in performing accurate research (for now). “Generative” AI, unlike the older “predictive”

¹¹ *See, e.g.,* ABA Model Rule 1.1, Comment 8, made applicable here by Local Bankruptcy Rule 9029-4A (and applicable to all Illinois lawyers following adoption by the Supreme Court of Illinois), requires lawyers to “keep abreast of changes in the law and its practice, including benefits and risks associated with relevant technology.”

¹² Mallory P. Sanzeri, *Allerton Conference 2025: Exploring the Future of Law with Artificial Intelligence*, ILLINOIS STATE BAR ASSOCIATION, <https://www.isba.org/sections/ai/newsletter/2025/03/allertonconference2025exploringthefutureoflawwitha> (last visited July 17, 2025).

AI, is “a machine-learning model that is trained to *create* new data, rather than making a prediction about a specific dataset. A generative AI system is one that learns to generate more objects that *look like* the data it was trained on.” Adam Zewe, *Explained: Generative AI*, MIT NEWS (Nov. 9, 2023), <https://news.mit.edu/2023/explained-generative-ai-1109> (emphasis added). Platforms like ChatGPT are powered by “large language models” that teach the platform to create realistic-*looking* output. They can write a story that reads like it was written by Stephen King (but wasn’t) or pen a song that sounds like it was written by Taylor Swift (but wasn’t). But they can’t do your legal research for you. ChatGPT does *not* access legal databases like Westlaw or Lexis, draft and input a query, review and analyze each of the results, determine which results are on point, and then compose an accurate, Bluebook-conforming citation to the right cases—all of which it would have to do to be a useful research assistant. Instead, these AI platforms look at legal briefs in their training model and then create output that *looks like* a legal brief by “placing one most-likely word after another” consistent with the prompt it received. Brian Barrett, “*You Can’t Lick a Badger Twice*”: Google Failures Highlight a Fundamental AI Flaw, WIRED (Apr. 23, 2025, 7:44 PM), <https://www.wired.com/story/google-ai-overviews-meaning/>.

If anything, Mr. Nield’s alleged lack of knowledge of ChatGPT’s shortcomings leads me to do what courts have been doing with increasing frequency: announce loudly and clearly (so that everyone hears and understands) that lawyers blindly relying on generative AI and citing fake cases are violating Bankruptcy Rule 9011 and will be sanctioned. Mr. Nield’s “professed ignorance of the propensity of the AI tools he was using to ‘hallucinate’ citations is evidence that [the] lesser sanctions [imposed in prior cases] have been insufficient to deter the conduct.” *Mid Cent. Operating Eng’rs*, 2025 WL 574234, at *3.

The second reason I issue sanctions is that, as described above, I also have concerns about the way this particular case was handled. I understand that Debtor’s counsel has a massive docket of cases. But every debtor deserves care and attention. Chapter 13 cases can be challenging to file and manage—especially when they involve complexities like those in this case. If a law firm does not have the resources to devote the time and energy necessary to shepherd hundreds of Chapter 13 cases at the same time, it should refer matters it cannot handle to other attorneys who can—lest a search for time-saving devices lead to these kinds of missteps. What I mean to convey here is that while everyone makes mistakes, I expect—as I think all judges do—attorneys to be more diligent and careful than has been shown here.¹³

IV.

The sanctions that I choose “must be limited to what suffices to deter repetition of the conduct or comparable conduct by others similarly situated.” Fed. R. Bankr. P. 9011(c)(4). And to be clear, I am *only* picking sanctions to redress the conduct described in the Order to Show Cause, *not* the further alleged misconduct described in the Chapter 13 Trustee’s brief. (See Dkt. No. 69 at 3) I agree with the U.S. Trustee that the sanctions within my discretion include an ARDC referral, a monetary sanction, a finding that the compensation to be paid to counsel exceeds the reasonable value of their services per 11 U.S.C. § 329, and/or a non-monetary sanction. Semrad has advised me that it will not seek compensation for this case, so a Section 329 finding is not necessary. And Semrad advises that Mr. Nield has already self-reported to the ARDC, mooted that option, too. What I believe is necessary here, and constitutes the least

¹³ Here’s another example of what I am talking about: Mr. Nield filed a reasonably compelling brief telling his side of the story (*see* Dkt. No. 71), but he did not sign it. Bankruptcy Rule 9011(a) requires all briefs to be signed and provides that “[t]he court must strike an unsigned document unless the omission is promptly corrected after being called to the attorney’s or party’s attention.” I note this not just to point out another error caused by inattention, but to alert counsel that I am required by the Bankruptcy Rules to strike his brief if he does not sign and re-file it promptly.

harsh sanctions appropriate to address the conduct and deter repetition by others similarly situated, has two parts—one monetary and one non-monetary.

First, I order Mr. Nield and Semrad, jointly and severally, to pay a penalty to the Clerk of the Bankruptcy Court of \$5,500.¹⁴ I seriously considered a larger fine, but after reading their briefs, I believe this sum is sufficient given the candor and remorse both Mr. Nield and Semrad have shown since the Order to Show Cause was issued, the seriousness with which they have addressed the Order already, and the attention they gave the Debtor to confirm the most recent Plan following the June 10 hearing. I view this as a modest sanction, and the next lawyer who does the same thing is warned that he or she will likely see a more significant penalty.

Second, more education (and in-person education) is always better, and I believe additional in-person education is necessary given the conduct here. Fortunately, this year's annual meeting of the National Conference of Bankruptcy Judges (NCBJ) is here in Chicago, making the meeting convenient and not burdensome for local attorneys to attend in person. Even more fortuitously, during the meeting, at 9:00 a.m. on Friday, September 19, 2025, NCBJ will hold a plenary session titled "*Smarter Than Ever: The Potential and Perils of Artificial Intelligence*" to which all registered attendees and their guests are invited.¹⁵ Mr. Nield, and at least one other senior attorney at the Semrad firm (chosen by Mr. Semrad), are ordered to register for and attend that session of the NCBJ annual meeting in person. Others reading this opinion are welcome, too.

¹⁴ Bankruptcy Rule 9011 requires that Semrad be equally responsible for Mr. Nield's conduct absent "exceptional circumstances." See Fed. R. Bankr. P. 9011(c)(1). I see no such "exceptional circumstances" here and thus a joint-and-several penalty is appropriate.

¹⁵ Annual Meeting Schedule, NCBJ, <https://ncbj.org/annual-meeting/schedule-events/complete-schedule/>.

V.

For the reasons stated here, I will issue a separate order,

1. Finding that Thomas E. Nield and The Semrad Law Firm, LLC, have violated Rule 9011 of the Federal Rules of Bankruptcy Procedure.
2. Imposing sanctions for the violation of Rule 9011:
 - a. directing Mr. Nield and Semrad, jointly and severally, to pay a penalty of \$5,500 to the Clerk of the Bankruptcy Court within 10 days,
 - b. directing Mr. Nield to register and attend in person the NCBJ plenary session on Artificial Intelligence, and
 - c. directing Semrad to have a second senior attorney register for and attend the NCBJ AI session in person; and
3. Concluding the section 329 examination as moot.

Signed: July 18, 2025

By: 

MICHAEL B. SLADE
UNITED STATES BANKRUPTCY JUDGE

In re Richburg

United States Bankruptcy Court for the District of South Carolina

August 27, 2025, Decided; August 27, 2025, Filed

C/A No. 25-01297-EG, Adv. Pro. No. 25-80037-EG, Chapter 13

Reporter

2025 Bankr. LEXIS 2115 *; 2025 LX 301809

In re, Rodney Richard Richburg, Sr. and Pamela M Tisdale-Richburg, Debtor(s). Rodney Richard Richburg Pamela M Tisdale-Richburg, Plaintiff(s), v. Glyndon Square LLC, Defendant(s).

Counsel: [*1] For Internal Revenue Service (IRS), Creditor (3:25bk01297): Lee E. Berlinsky, Charleston, SC; Austin McCullough, USAO, Charleston, SC.

For Navy Federal Credit Union, Creditor (3:25bk01297): Ashley Stanley, Hutchens Law Firm LLP, Columbia, SC.

For Rodney Richard Richburg, Sr., Debtor (3:25bk01297): Paul L. Held, Sumter, SC.

For Pamela M Tisdale-Richburg, Joint Debtor (3:25bk01297): Paul L. Held, Sumter, SC.

For Dawn M. Hardesty, Trustee (3:25bk01297): Dawn M. Hardesty, Columbia, SC.

For Rodney Richard Richburg, Sr., Debtor, Plaintiff (3:25ap80037): Paul L. Held, LEAD ATTORNEY, Sumter, SC.

For Pamela M Tisdale-Richburg, Joint Debtor, Plaintiff (3:25ap80037): Paul L. Held, LEAD ATTORNEY, Sumter, SC.

Judges: Elisabetta G. M. Gasparini, United States Bankruptcy Judge.

Opinion by: Elisabetta G. M. Gasparini

Opinion

ORDER IMPOSING NONMONETARY SANCTIONS

The legal profession has entered a brave new world of technological advances. Generative artificial intelligence ("AI") has become increasingly accessible in recent years, making it easier than ever to quickly distill information from a plethora of sources. Many lawyers have embraced this technology, seeing it as a valuable

tool to help them serve their clients in more efficient [*2] and cost-effective ways. As with other new development in the practice of law, there are growing pains. Attorneys must reconcile the integration of new technology in their work with their existing ethical duties and professional responsibilities. Without proper knowledge of how AI works, lawyers may unjustifiably rely on the content it generates in ways that violate rules of professional responsibility.

The matter before the Court presents that very issue—an attorney filing a pleading that cites fake caselaw "hallucinated" by AI.¹ The Court entered an Order and Rule to Show Cause (the "Show Cause Order")² after discovering that the cases cited in a motion filed in the above-captioned adversary proceeding (the "Adversary Proceeding") did not exist. Debtors' attorney ("Counsel"), a solo practitioner with approximately 40 years of experience, admitted that the fake citations were generated by AI, and out of haste and a naïve understanding of the technology, he did not independently verify the sources were real before including the citations in the motion filed with the Court seeking a preliminary injunction. Having heard the explanation and arguments Counsel provided and having considered [*3] the facts of this case, while considering the procedural context in which the issue

¹ As the Court understands the term, "hallucinations" are false answers or nonexistent content created by generative AI systems in response to user prompts. See Zach Warren, *GenAI Hallucinations Are Still Pervasive in Legal Filings, but Better Lawyering Is the Cure*, THOMSON REUTERS (Aug. 18, 2025), <https://www.thomsonreuters.com/en-us/posts/technology/genai-hallucinations/> ("These hallucinations are false 'facts' generated by GenAI systems and can occur due a number of issues, including incomplete or inaccurate data sets, confusing or misworded prompts, or answers that are irrelevant to a given question."); *Dehghani v. Castro*, No. 2:25-cv-0052 MIS-DLM, 2025 WL 988009, at *4 n.7 (D.N.M. Apr. 2, 2025) ("A hallucination occurs when an AI database generates fake sources of information.").

² ECF No. 11, entered July 30, 2025.

arises and the limitations imposed by Federal Rule of Bankruptcy Procedure 9001(c)(4)(B)(ii), the Court imposes non-monetary sanctions. Not to diminish the gravity of Counsel's actions in this case, the Court intends for this Order to also serve as a "lesson learned" for the bar in general of the potential consequences of uninformed reliance on generative AI in legal practice.

FINDINGS OF FACT

Counsel represents Rodney Richard Richburg and Pamela M. Tisdale-Richburg ("Debtors" or "Plaintiffs") in both their main Chapter 13 bankruptcy case and the Adversary Proceeding. On July 19, 2025, with the assistance of Counsel, Debtors filed an adversary complaint as well as a Motion for Preliminary Injunction (the "Motion") against Glyndon Square LLC ("Defendant") for the alleged violation of the automatic stay relating to Defendant's pursuit of an eviction action³ for leased commercial property which Debtors used to operate their limited liability company, UBI Southeastern Properties LLC ("UBI LLC"). In the Motion, Debtors argued that UBI LLC is property of their bankruptcy [*4] estate pursuant to [11 U.S.C. § 541](#) and any eviction concerning property leased for their business operations should be enjoined while Debtors are in bankruptcy. In support of Debtors' assertion that they would likely succeed on the merits of the Adversary Proceeding, the Motion cited *In re Parkdale, LLC* and *In re Ahn*—both citations for cases that do not exist. The hallucinated citations were used to support Debtors' position that it is settled law in this district that an LLC—and by implication its assets—are property of the bankruptcy estate in a case filed by the LLC's members in their personal capacity, meaning that such assets are protected by the automatic stay under [11 U.S.C. § 362](#).⁴

³ Debtors listed a lease with Defendant for "rental of a call center location" in Schedule G in their main bankruptcy case, C/A No. 25-01297-EG (filed April 6, 2025). They also listed their 100% ownership interest in their business, UBI Southeast Properties LLC, in Schedule A/B. From the record before the Court, it is not clear whether the lease at issue is between Defendant and UBI Southeast Properties LLC and/or Debtors.

⁴ The Court notes that while Debtors' membership interests in the LLC are clearly property of Debtors' bankruptcy estate under [11 U.S.C. § 541\(a\)](#) and are therefore covered by the automatic stay, the same cannot be said for the assets of the LLC. See [S.C. Code Ann. § 33-44-501\(a\)](#) ("A member is not a co-owner of, and has no transferable interest in, property of a limited liability company."); *In re Brittain*, 435 BR 318, 322

Debtors also cited [S.C. Code Ann. § 33-44-301\(1\)](#) for the proposition that "a membership interest [in an LLC] is personal property," but that section of the South Carolina Code deals with agency of members and managers of an LLC and does not appear to be relevant in the context for which it is cited.

The Court discovered the improper case citations upon reviewing the Motion and, in the Order and Notice of Emergency Hearing (the "Order Setting Hearing")⁵ scheduling a hearing on the relief sought for July 29, 2025, the Court noted that Counsel should be [*5] prepared to explain where he obtained the case citations and why the cited statute was referred to in support of a proposition for which the statute does not stand. On July 22, 2025, Counsel submitted correspondence to chambers apologizing for the erroneous citations.⁶ Based on the explanation provided, it is the Court's understanding that Counsel used Microsoft CoPilot, a generative AI platform, to draft at least some of the pleadings and to find case citations to ultimately include in the Motion without verifying the sources cited.⁷ Debtors also filed an Amended Motion for Temporary Injunction ("Amended Motion") the day

([Bankr. D.S.C. 2010](#)) (noting that a member's bankruptcy estate has no interest in property of an LLC, the estate's property interest is limited to the member's distributional interest, and a member's possessory interest alone is insufficient to constitute property of the estate); *In re Ollis*, No. 18-04549-HB, 2019 WL 244452, at *2 (Bankr. D.S.C. Jan. 16, 2019) (finding the automatic stay to be inapplicable to property of the debtor's LLC where the debtor failed to cite any applicable authority that would justify the property's inclusion in the debtor's bankruptcy estate). Though the Court questions the merits of Debtors' argument to the contrary, particularly given that the real cases cited in the Amended Motion (defined *infra*) still do not appear to support Debtors' position, the focus of this order is on the improper citation of cases fabricated by AI.

⁵ ECF No. 4, entered July 2, 2025.

⁶ ECF No. 5.

⁷ As stated in the correspondence filed with the Court:

The AI did a good job of drafting a complaint. I did check and revise it. It is based on facts and law included in the motion which was not drafted by AI. Unfortunately, I have learned the hard way that AI "scrapes" everything. It is accurate on the complaint because the motion was in close proximity, literally in time and context. . . .

I would have double-checked, but I really believed in the AI so much that I have paid a subscription and the AI confirmed well-settled case law that I know to be true. . . .

after the Court entered the Order Setting Hearing, replacing the erroneous citations with new citations in support of Debtors' argument that LLCs owned by an individual debtor are property of the debtor's bankruptcy estate. On July 28, 2025—the day prior to the scheduled hearing on the Motion seeking a preliminary injunction—Debtors filed a Notice of Voluntary Dismissal, dismissing the Adversary Proceeding pursuant to [Fed. R. Civ. P. 41\(a\)\(i\)](#) and rendering the Motion moot.⁸ The Court then issued the Show Cause Order to address whether any sanctions may be appropriate under [Fed. R. Bankr. P. 9011](#) in light of Counsel's [*6] use of citations that were clearly "hallucinated" by AI or whether disgorgement of fees was warranted pursuant to [11 U.S.C. § 329](#).

Counsel appeared at the show cause hearing and explained that prior to this case, he had never used AI for legal research and his experience with AI was limited to occasional use for hobbies. According to Counsel, he was drafting the Motion on a Saturday and was in a hurry to finish, so in his haste and desire to avoid a "tedious and drawn out" research process, he prompted CoPilot to find South Carolina caselaw supporting what he acknowledged was a "weak position." He admitted that he did not verify the authenticity of the cases cited prior to filing the document on [*7] CM/ECF, as he claimed CoPilot also provided short blurbs summarizing the cases, giving them the appearance of legitimacy. Counsel stated that he did not know the citations were made up until he read the Court's Order Setting Hearing. He was "shocked" to learn that AI can generate fake sources in its results, as he expected it to operate akin to a traditional Google search—providing existing material scraped from across the internet. Counsel stated that he does not intend to use AI for legal research going forward and will subscribe to Westlaw or Lexis. He also confirmed that he did not charge Debtors any fee for the Adversary Proceeding, nor will he seek compensation for services performed in connection therewith. Counsel indicated that he has received \$1,100 in compensation for Debtors' main bankruptcy case.⁹

⁸ ECF No. 9. The deadline for defendant to respond to the Motion was set for July 28, 2025 at 10:00 a.m. No response was filed by that time and the dismissal was then filed later that day. The Court was also informed that a settlement had been reached with Defendant.

⁹ According to Form B2030—Disclosure of Compensation of Attorney for Debtor—Counsel agreed to accept \$3,100 in the main case, but so far has been paid \$1,100, with the

CONCLUSIONS OF LAW

The Court issued the Show Cause Order *sua sponte* to address whether sanctions should be imposed on Counsel pursuant to Rule 9011 of the Federal Rules of Bankruptcy Procedure. Neither Defendant nor any other party filed a response to the Show Cause Order or sought any other relief. Rule 9011 provides, in pertinent part:

By presenting to the court a petition, pleading, written motion, or other document—whether by signing, filing, [*8] submitting, or later advocating it—an attorney or unrepresented party certifies that, to the best of the person's knowledge, information, and belief formed after an inquiry reasonable under the circumstances . . . the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law

[Fed. R. Bankr. P. 9011\(b\)](#); see also [Benjamin v. Costco Wholesale Corp.](#), 779 F.Supp.3d 341, 347 (E.D.N.Y. 2025) (noting that [Fed. R. Civ. P. 11](#) imposes a duty on attorneys to certify that they have conducted a reasonable inquiry and have determined that any papers they file with the court are well grounded in fact and legally tenable). Bankruptcy Rule 9011 mirrors Rule 11 of the Federal Rules of Civil Procedure, and the Fourth Circuit has instructed that courts may look to caselaw interpreting Rule 11 when determining whether there has been a violation of Rule 9011. [In re Weiss](#), 111 F.3d 1159, 1170 (4th Cir. 1997); see also [In re Defeo](#), 632 B.R. 44 (Bankr. D.S.C. 2021).

Under Rule 11, an attorney's conduct is evaluated based on a standard of objective reasonableness, meaning that a violation only occurs if "a reasonable attorney in like circumstances could not have believed [the] actions to be legally justified." [Hunter v. Earthgrains Co. Bakery](#), 281 F.3d 144, 153 (4th Cir. 2002) (quoting [In re Sargent](#), 136 F.3d 349, 352 (4th Cir. 1998)); see also [Dehghani v. Castro](#), No. 2:25-cv-0052 MIS-DLM, 2025 WL 988009, at *3 (D.N.M. Apr. 2, 2025) (quoting [Adamson v. Bowen](#), 855 F.2d 668, 673 (10th Cir. 1988)) (explaining that under the objective reasonableness standard, "[i]f after reasonable inquiry, a competent attorney could not form [*9] a reasonable belief that the pleading is well grounded in fact and is

remainder to be paid through the Chapter 13 plan.

warranted by existing law, then such conduct is sanctionable under Rule 11"). "If, after notice and a reasonable opportunity to respond, the court determines that [such provision] has been violated, the court may . . . impose an appropriate sanction on any attorney, law firm, or party that committed the violation or is responsible for it." [Fed. R. Bankr. P. 9011\(c\)\(1\)](#). Such sanctions, which may include "a nonmonetary directive," must be limited to only "what suffices to deter repetition of the conduct or deter comparable conduct by others similarly situated." [Fed. R. Bankr. P. 9011\(c\)\(4\)\(A\)](#). The Court may seek to impose sanctions *sua sponte* by entering an order that provides the offending party with notice as to the specific conduct at issue and an opportunity to show cause as to why the party has not violated Rule 9011(b). [Fed. R. Bankr. P. 9011\(c\)\(3\)](#). Rule 9001(c)(4)(B), however, sets forth some limitations on the imposition of monetary sanctions: "The court must not impose a monetary sanction, including when the Court *sua sponte* raises issues concerning a violation of Rule 9011: . . . "on its own, unless it issued the show-cause order under (c)(3) before voluntary dismissal or settlement of the claims made by or against the party that is, or whose **[*10]** attorneys are, to be sanctioned."

"Across the country, courts have issued a panoply of sanctions against attorneys who submitted fake cases." [Benjamin, 779 F.Supp.3d, at 347](#) (citing cases); see also [In re Martin, 670 B.R. 636 \(Bankr. N.D. Ill. 2025\)](#) (citing several district court opinions imposing sanctions for similar misconduct). Though there are many district court opinions addressing the issue, to date *In re Martin* appears to be the only published opinion in which a bankruptcy court has imposed sanctions under Rule 9011 for an attorney's submission of AI-generated citations to nonexistent authorities. In that case, the court sought to impose sanctions *sua sponte* after discovering fake quotations and citations to nonexistent authorities in a brief prepared and filed by the debtor's attorneys. After the court issued a show cause order, the attorneys withdrew the offending brief as well as their application for compensation in the case, filed a response to the order, and addressed the court's concerns at a hearing. The attorneys admitted that citations were unverified AI hallucinations, apologized for the misconduct, and represented that their firm was taking corrective steps to implement a formal AI policy, require the firm's attorneys to complete continuing legal education **[*11]** in the ethical use of AI in legal practice, and offer reimbursement to opposing counsel for time spent reviewing the offending brief. Though appreciative

of the attorneys' candor and efforts to remedy the situation, the court found that the attorneys violated Bankruptcy Rule 9011 and indicated that sanctions were a "steep" but necessary consequence because "citation to fake AI-generated sources . . . shatters [] credibility" and "imposes many harms." [In re Martin, 670 B.R. at 646](#) (quoting [Kohls v. Ellison, No. 24-cv-3754, 2025 WL 66514, at *4-5 \(D. Minn. Jan. 10, 2025\)](#)). Notably, that case had been plagued with issues from the beginning, including counsel's filing of a chapter 13 plan without Debtor's review or consent. [Id. at 640](#). While limiting the issue addressed in the opinion to the fake citations, the court noted that "the allegations are consistent with my general observation that [the attorneys] should be taking more care when filing and prosecuting Chapter 13 cases than has been shown here." [Id. at 641](#). Accordingly, the court ordered the attorneys to pay a penalty of \$5,500 and attend training on the use of AI in legal practice. [Id. at 649](#) (stating that "[t]he second reason I issue sanctions is that, as described above, I also have concerns about the way this particular case was handled.").

Although the facts of this case are not **[*12]** identical to the facts in [Martin](#) and Counsel's conduct in this case has not been as egregious as what was before the Bankruptcy Court in the Northern District of Illinois, this Court agrees with the [Martin](#) court that "[t]he bottom line is this: at this point, no lawyer should be using ChatGPT or any other generative AI product to perform research without verifying the results." [Id. at *21](#). Under Rule 9011, an attorney may be sanctioned for, among other things, misrepresenting facts or making frivolous legal arguments. At the very least, the duties imposed by Rule 9011—as well as [Fed. R. Civ. P. 11](#)—require that attorneys read and confirm not only that cases cited stand for the proposition asserted, but also that they exist. There does not appear to be any other way to meet the requirement that an attorney ensures that "legal contentions are warranted by existing law or by nonfrivolous argument". See [Fed. R. Bankr. P. 9011\(b\)\(2\)](#).

Blind reliance on work product or research generated by AI also raises issues with the rules of professional responsibility. Rule 1.1 of the South Carolina Rules of Professional Conduct addresses how the competence required of lawyers in representing their clients extends to the lawyers' use of technology. See Rule 1.1, RPC, Rule 407 SCACR ("A lawyer shall provide competent representation to a client. Competent representation requires **[*13]** the legal knowledge, skill, thoroughness and preparation reasonably necessary for the

representation."). Comment 8 to Rule 1.1 provides, in relevant part, that "[t]o maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, *including a reasonable understanding of the benefits and risks associated with technology the lawyer uses to provide services to clients*" *Id.* cmt. 8 (emphasis added). Though the South Carolina Bar has not issued any ethics opinions concerning the use of AI in legal practice, opinions and practical guidance from other state bars provide guidelines for AI use that are similar to what Comment 8 to South Carolina's Rule 1.1 advises with respect to an attorney's use of technology in general.¹⁰

Thus, it appears that while using AI is not in and of itself problematic, a lawyer's ethical duties require proper knowledge of the technology and careful review of any legal analyses and citations generated by AI. When used correctly and cautiously, generative AI can prove to be an efficient tool; however, attorneys should be aware of [*14] the inherent risk of hallucinations and remain diligent in verifying the accuracy of AI-generated material. Attorneys should also use caution in drafting pleadings with AI; hastily filing AI-generated documents

without ensuring that the caselaw or arguments asserted therein are correct can be a Rule 9011 and ethical pitfall.¹¹ Letting AI draft answers to legal questions without subsequent review by an attorney may also be akin to allowing non-attorney staff to practice law without supervision—a clear violation of the rules of professional responsibility.¹² It is, after all, the attorney's duty to ensure filings comply with all applicable legal and ethical obligations, and that duty cannot be delegated.

Counsel has acknowledged the mistakes and based on the correspondence filed and statements at the hearing, clearly expressed his remorse for his blind reliance on a technological tool which he did not seem to fully understand. Though the Court precluded the concerns with the fake cases originally cited in the Motion in the Order Setting Hearing, the Court did not issue the Show Cause Order until after the motion was amended and a voluntary dismissal [*15] of the Adversary Proceeding was filed. Thus, a strict reading of Rule 9011(c)(4)(B)(ii) would preclude the Court from seeking to impose monetary sanctions on Counsel *sua sponte*. Here, there is no indication that the voluntary dismissal was filed for the purpose of avoiding monetary sanctions. The arguments in Debtors' complaint were weak from the

¹⁰ See, e.g., Alaska Bar Assn. Ethics Comm., Ethics Op. 2025-1 (2025) (stating that it is ethically permissible for attorneys to use generative AI to assist clients "but before doing so, the lawyer should understand, to a reasonable degree, how the technology works, its limitations, and its ability (or not) to safeguard client confidences and secrets"); Pa. Bar Assn. Comm. on Legal Ethics & Pro. Resp., Informal Op. 2024-200 (2024) ("[G]enerative AI tools, like any tool in a lawyer's arsenal, must be used with knowledge of their potential and awareness of the risks and benefits the technology offers [and] are to be used cautiously and in conjunction with a lawyer's careful review of the 'work product' that those types of tools create" and further advising that "[b]ecause generative AI creates content . . . lawyers have an obligation to verify that the citations are correct and that they accurately summarize the cases or other information cited."); Cal. St. Bar Standing Comm. on Pro. Resp. & Conduct, *Practical Guidance for the Use of Generative Artificial Intelligence in the Practice of Law* (2023) ("It is possible that generative AI outputs could include information that is false, inaccurate, or biased. A lawyer must ensure competent use of the technology, including the associated benefits and risks, and apply diligence and prudence with respect to facts and law."). The Pennsylvania Bar Association's Committee on Legal Ethics and Professional Responsibility explains that results from generative AI in particular need careful review for accuracy and relevance because "unlike its predecessors . . . it creates content, and it is the creation of content that necessitates heightened awareness by lawyers.").

¹¹ Particularly in situations like Counsel described experiencing here, prompting generative AI to find caselaw or draft arguments taking a particular position that is not supported by existing law can backfire, as hallucinations may be more likely to occur when there are little to no existing authorities available that clearly satisfy the user's request. See Conor Murray, *Why AI "Hallucinations" Are Worse Than Ever*, FORBES (May 6, 2025, 1:12 PM), <https://www.forbes.com/sites/conormurray/2025/05/06/why-ai-hallucinations-are-worse-than-ever/> (noting that "[q]uestions asked outside of the data the AI model knows can lead to the bot responding with incorrect information," and reasoning models like ChatGPT and OpenAI are "designed to maximize the chance of giving an answer, meaning the bot will be more likely to give an incorrect response than admit it doesn't know something").

¹² See Rule 5.3, 5.5 & cmt. 2, RPC, Rule 407 SCACR ("This Rule does not prohibit a lawyer from employing the services of paraprofessionals and delegating functions to them, so long as the lawyer supervises the delegated work and retains responsibility for their work."); Fla. St. Bar Assn. Comm. on Pro. Ethics, Op. 21-1 (2024) (noting that while Florida's equivalent to Rule 5.3, RPC, Rule 407 SCACR defines a nonlawyer assistant as a "person," "many of the standards applicable to nonlawyer assistants provide useful guidance for a lawyer's use of generative AI").

outset, and Debtors appeared to have resolved the eviction issue with Defendant prior to the Notice of Voluntary Dismissal being filed. Regardless, the Court notes, for future reference, that voluntary dismissal is not the cure-all solution to avoid monetary sanctions for violations of [Fed. R. Bankr. P. 9011](#). Among other reasons, if a party has responded to the offensive pleading, court approval for the dismissal is necessary and may allow the Court to impose monetary sanctions. The Court also has the authority under [11 U.S.C. § 329](#) to order disgorgement of an attorney's compensation to the extent the compensation is unreasonable in light of the attorney's transgressions.

The Court finds that Counsel violated Rule 9011 and non-monetary sanctions are appropriate to deter future misconduct. The Court further notes that while, under difference circumstances, it may have issued monetary sanctions, the sanctions [*16] should also be limited to what is sufficient to deter repetition of the conduct or deter comparable conduct by others similarly situated. This should serve as a guide of what not to do when using AI in pleadings filed with this Court.

As indicated in the Show Cause Order, the Court may also review whether Counsel's compensation in representing Debtors exceeds the reasonable value of his services, in which case the Court may order such compensation be returned to Debtors pursuant to [11 U.S.C. § 329](#). Given Counsel's statements at the hearing averring that he has not and will not seek compensation from Debtors for services he provided in connection with the Adversary Proceeding, the Court has no need to review Counsel's fees under § 329.

CONCLUSION

For the reasons stated herein, the Court finds that Counsel has violated Federal Rule of Bankruptcy Procedure 9011 and a nonmonetary directive for Counsel to complete three (3) hours of continuing legal education in addition to any annual requirements that may be imposed on Counsel by the South Carolina Bar is an appropriate sanction.

IT IS, THEREFORE, ORDERED that Counsel is hereby directed to complete at total of three (3) hours of continuing legal education on ethics in addition to the requirements that [*17] he may be subject to by the South Carolina Bar, including at least two (2) hours related to the ethical use of artificial intelligence in legal

practice.¹³ Counsel shall file with the Court a certification of compliance with this Order, listing the courses and number of CLE credit hours completed for each, by no later than February 1, 2026.

AND IT IS SO ORDERED.

FILED BY THE COURT

08/27/2025

/s/ Elisabetta G. M. Gasparini

Elisabetta G. M. Gasparini

US Bankruptcy Judge

District of South Carolina

Entered: 08/27/2025

End of Document

¹³ To be clear, the three (3) hours are in addition to any CLE requirements imposed by the South Carolina Bar. If Counsel is exempt from CLE requirements under **Rule 408(a)(2)(B), SCACR**, he must nevertheless complete the continuing legal education ordered herein.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
LOUISVILLE DIVISION

MICHAEL J. BUCKNER, JR.

Plaintiff

v.

Civil Action No. 3:24-cv-375-RGJ

HILTON GLOBAL, ET AL.

Defendants

* * * * *

MEMORANDUM OPINION & ORDER

Pro Se Plaintiff Michael Buckner (“Buckner”) moves “for judicial recusal due to appearance of impartiality, conflict of interest, and judicial discouragement of lawful access to relief” and requests the undersigned be recused from “all further proceedings in this matter.” [DE 38 at 318]. Several days after filing this motion, Buckner filed his Notice of Appeal [DE 39] as to this Court’s March 21, 2025 Memorandum Opinion and Order [DE 36] and judgment [DE 37] which dismissed the case.¹ No response has been filed by Defendants Hilton Worldwide Holdings Inc. (“Hilton”) or Brian Waller (“Waller”) and the time for doing so has passed. This matter is ripe. For the reasons below, Buckner’s Motion for Recusal [DE 38] is **DENIED**.

¹ Filing a notice of appeal with the district court divests the district court of jurisdiction to act in a case, except on remedial matters unrelated to the merits of the appeal. *Fort Gratiot Sanitary Landfill, Inc. v. Mich. Dep’t of Natural Res.*, 71 F.3d 1197, 1203 (6th Cir. 1995). After the filing of a notice of appeal, the district court retains jurisdiction only to enforce the judgment or to “proceed with matters that are in aid of the appeal.” *Taylor v. KeyCorp*, 680 F.3d 609, 616 n.8 (6th Cir. 2012) (citations omitted). To be sure, the category of actions a district court can take in aid of the appellate process is “narrowly defined.” *United States v. Sims*, 708 F.3d 832, 834 (6th Cir. 2013). It does not include “actions that *alter* the case on appeal.” *United States v. Carman*, 933 F.3d 614, 617 (6th Cir. 2019) (quoting *Inland Bulk Transfer Co. v. Cummins Engine Co.*, 332 F.3d 1007, 1013 (6th Cir. 2003)). But here, the district court ruling on the motion to recuse (made after the court’s dismissal of the case) does not alter the case on appeal. *Greer v. Strange Honey Farm, LLC*, 114 F.4th 605, 613 (6th Cir. 2024). While the Court might also choose to deny the motion as moot, *see Dixon v. Clem*, 492 F.3d 665, 680 (6th Cir. 2007) (“we find no abuse of discretion in its denying Dixon’s recusal motion as moot”), for purposes of completeness and transparency the Court addresses the merits.

I. FACTUAL BACKGROUND

Buckner was employed by Tata Consultancy Services Limited, Inc. (“TCS”). Buckner’s claims arise from an employment dispute which began with an email exchange between Buckner and Waller and included Hilton employees, third-party contractors, and third-party vendors, although all were using internal “Hilton” email addresses. [DE 12-1 at 66-75]. According to Buckner, on May 7, 2024, Waller was responsible “for applications under the Migration Program managed by [Buckner.]” [DE 31-1 at 218]. As part of the application review process, Monisha Bhatia wrote “[w]e have started analyzing and we will sync up for any outstanding questions.” [Id.]. Buckner replied to Monisha Bhatia’s email, saying “[w]e need a date for the sync up.” [Id.]. And in response, Waller, an employee of Hilton, sent an email, which said: “Hello all, Michael [Buckner]/ Vaibhav, just wanted to call out the tone in these emails is rather aggressive. Not the Hilton way.” [DE 31-1 at 218]. Buckner asserts that the statements “falsely accused [Buckner] of aggressive misconduct, company misconduct and violation of traditional professionalism.” [DE 31-1 at 218-19]. After receiving this email, Buckner filed suit on May 24, 2024. [DE 1-1 at 8-9].

On November 20, 2024, TCS, terminated Buckner’s employment. Buckner claims that prior to termination he had an exemplary performance record, “with no prior disciplinary actions or legitimate justification for termination.” [Id.].

Buckner sought to amend his complaint to ultimately assert six claims in total: Defamation against Waller, Respondeat Superior and Negligent Supervision against Hilton, Retaliation, Wrongful Termination in Violation of Public Policy, and Civil Conspiracy against Hilton and TCS. [Id.]. This Court found amendment to add claims of Libel-Defamation against Waller; Respondeat Superior and Negligent Supervision Against Hilton; and Retaliation and Wrongful Termination in Violation of Public Policy Against Hilton and TSC; and Civil Conspiracy futile. In addition, this

Court granted Hilton’s Motion to Dismiss, finding that for the same reasons that Buckner’s libel defamation claim was found to be futile regarding his Fourth Amended Complaint, his libel defamation claim in his original complaint failed to state a claim on which relief may be granted. *See* Fed. R. Civ. P. 12(b)(6). The Court also granted Waller’s Motion to Dismiss [DE 28]. The Case was then dismissed in its entirety with prejudice. Buckner timely appealed and the appeal pending. [DE 39].

II. DISCUSSION

Buckner now moves for recusal of the undersigned under 28 U.C.S. § 455(a) on grounds that

Judge Jennings’ spouse, Patrick Jennings, is a partner at Commonwealth Alliances, a lobbying firm with longstanding ties to corporate interests, including Microsoft – accompany known for exerting significant political and legal influence and the subject of multiple defamation claims, including *Battle v. Microsoft*, a high-profile defamation suit filed in Kentucky.

[DE 38 at 319]. Buckner then states that “[g]iven the similarity of the issues and the broad implications that such entities represent in the tech and consulting sectors, this raises not only the specter of conflict, but the outright stench of partiality. . .” [*Id.*]. He then asserts disqualification is required under 28 U.C.S. § 455(a). [*Id.*].

Buckner sets forth the “facts” in support of his motions as

- The judge’s spouse is a paid lobbyist with Commonwealth Alliances.
- Commonwealth Alliances represents or may represent interests aligned with global technology and consulting firms – Microsoft among them.
- Plaintiff’s claims involve defamation and retaliation by multinational corporations, including Hilton Worldwide Holdings and Tata Consultancy Services (TCS) – entities whose operations and legal positions may be directly or indirectly aligned with those of Microsoft and others with ties to the lobbying industry.

[DE 38 at 320]. Buckner then alleges these “connections” create the appearance of partiality that is legally intolerable. No reasonable person could read this arrangement and feel confident that the courtroom was free from the shadow of corporate lobbying and institutional favoritism.” [*Id.*].

Additionally, Buckner appears to compare his case to *Battle v. Microsoft*, stating that “[j]ust as Microsoft sought to obscure liability through legal gymnastics and reputational maneuvers, so too do Hilton and TSC attempt to minimize and mischaracterize Plaintiff’s very real claims of defamation, retaliation and conspiracy.” [DE 38 at 321]. He then concludes that this “convergence of interests between the Defendants in this matter and lobbying ecosystem that Judge’s Jennings spouse operates within in far too close for comfort – and far too close for constitutional fairness.” [*Id.*].

Finally, Buckner chastises the Court for noting that the Plaintiff, likely because of using artificial intelligence, cited to two nonexistent cases in support of his motion and cautioned the Plaintiff that such citations wasted the opposing party’s time and money, the Court’s time and resources, and caused “reputational harms to the legal system.” *Morgan v. Cmty. Against Violence*, No. 23-cv-353-WPJ/JMR, 2023 WL 6976510, at *8 (D.N.M. Oct. 23, 2023). Buckner asserts that because he is pro se, such warning have a chilling effect on those who seek access to the legal system without representation. [DE 28 at 320-21].

A. Standard

“A district judge is presumed to be impartial, and the party challenging such impartiality bears ‘the substantial burden of showing otherwise.’” *Pharmacy Records v. Nassar*, No. 05-cv72126, 2008 WL 4965337, at *3 (E.D. Mich. Nov.18, 2008) (quoting *United States v. Denton*, 434 F.3d 1104, 1111 (8th Cir. 2006) and in turn quoting *Fletcher v. Conoco Pipe Line Co.*, 323 F.3d 661, 664 (8th Cir. 2003)); *Scott v. Metro. Healthcare Corp.*, 234 F. App’x 341, 352 (6th Cir.

2007). “The burden is not on the judge to prove that he is impartial.” *Id.* “The standard is an objective one.” *United States v. Gallion*, No. 07-39(WOB), 2008 WL 1904669, at *2 (E.D. Ky. Apr. 29, 2008) (citing *Liteky v. United States*, 510 U.S. 540, 548 (1994)). “[T]he judge need not recuse himself based on the subjective view of a party no matter how strongly that view is held.” *Id.* (quoting *United States v. Sammons*, 918 F.2d 592, 599 (6th Cir. 1990), and citing *United States v. Burger*, 964 F.2d 1065, 1070 (10th Cir. 1992)). “Indeed, there ‘is as much obligation for a judge not to recuse when there is no occasion for him to do so as there is for him to do so when there is.’” *Id.*; *see also Laird v. Tatum*, 409 U.S. 824, 837 (1972) (noting “equal duty” principle”); *United States v. Angelus*, 258 F. App’x 840–42 (6th Cir. 2007) (“Although a judge is obliged to disqualify himself when there is a close question concerning his impartiality . . . he has an equally strong duty to sit where disqualification is not required) (inner quotations and citations omitted); *Hinman v. Rogers*, 831 F.2d 937, 939–40 (10th Cir. 1987) (collecting cases); *Pharmacy Records v. Nasser*, 572 F. Supp. 2d 869, 876 (E.D. Mich. 2008) (“[W]here the standards governing disqualification have not been met, disqualification is not optional; rather, it is prohibited.”) (citation omitted).

Section 455(a) of Title 28 provides that a United States judge “shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.” 28 U.S.C. § 455(a). Section 455(b) designates particularized situations in which recusal is mandated. *Union Planters Bank v. L & J Dev. Co.*, 115 F.3d 378, 382 (6th Cir. 1997). Under §455(c) a judge is under a statutory duty to “inform himself about his personal and fiduciary financial interests, and make a reasonable effort to inform himself about the personal financial interests of his spouse and minor children.” 28 U.S.C. § 455(c). “Scienter is not an element of a violation of § 455(a),” but knowledge is required under § 455(b). *Liljeberg v. Health Servs. Acquisition Corp.*, 486 U.S. 847, 859 (1988). A “financial interest” is defined as “ownership of a legal or equitable interest, however

small, or a relationship as director, adviser, or other active participant in the affairs of a party[.]” 28 U.S.C. § 455(d)(4). Courts have interpreted “financial interest” to refer to a direct interest, not a “remote or contingent” interest. *In re Virginia Elec. & Power Co.*, 539 F.2d 357, 366–67 (4th Cir. 1976); *see also Scott*, 234 F. App’x at 357 (“[W]e hold that ‘disqualification is not required on the basis of [such] remote, contingent, indirect or speculative interests.’” *United States v. Bayless*, 201 F.3d 116, 127 (2d Cir. 2000)).

Section 455 “does not require the judge to ‘accept as true the allegations made by the party seeking recusal.’” *Scott*, 234 F. App’x at 353–54 (quoting *In re Martinez–Catala*, 129 F.3d 213, 220 (1st Cir. 1997)). Rather, the district court may make the necessary factual findings and decide whether the facts warrant disqualification. When considering a § 455 recusal request, “the judge is free to make credibility determinations, assign to the evidence what he believes to be its proper weight, and to contradict the evidence with facts drawn from his personal knowledge.” *Id.* at 354. The standard under § 455 is objective. *Roberts*, 625 F.2d at 129. “[A] judge must recuse herself if a reasonable, objective person, knowing all of the circumstances, would have questioned the judge’s impartiality.” *Hughes v. United States*, 899 F.2d 1495, 1501 (6th Cir. 1990); *see also Burley v. Gagacki*, 834 F.3d 606, 615–16 (6th Cir. 2016); *United States v. Adams*, 722 F.3d 788, 837 (6th Cir. 2013). Because the standard is objective, the judge need not recuse herself based on the subjective view of a party. *See Sammons*, 918 F.2d at 599. As a practical matter, the only basis for establishing bias or prejudice is an “extrajudicial source.” *United States v. Howard*, 218 F.3d 556, 566 (6th Cir. 2000) (quoting *Liteky*, 510 U.S. 540).

B. Timeliness of Buckner’s Motion

The Court must first address the timeliness of Buckner’s motion. In assessing a motion to recuse, § 455 is subject to “a timeliness requirement.” *Layman v. United Parcel Serv., Inc.*, No.

3:17-CV-738-CRS, 2019 WL 3291567, at *1 (W.D. Ky. July 22, 2019) (citing Wright & Miller, 13D FEDERAL PRACTICE AND PROCEDURE § 3550 (3d ed. 2019) (collecting cases)). “This timeliness requirement applies to matters that are public knowledge, even if the movant does not in fact know them.” *Id.* at 2 (citing *Goward v. United States*, 569 F. App’x 408, 410–11 (6th Cir. 2014)); *United States v. Siegelman*, 640 F.3d 1159, 1188 (11th Cir. 2011) (“The rule has been applied when the facts upon which the motion relies are public knowledge, even if the movant does not know them.”) (citation omitted); *United States v. Sypher*, No. 3:09-CR-00085, 2010 WL 5393849, at *2 (W.D. Ky. Dec. 22, 2010), *aff’d*, 684 F.3d 622 (6th Cir. 2012). Courts have held that the purpose of this rule “is to ‘conserve judicial resources and prevent a litigant from waiting until an adverse decision has been handed down before moving to disqualify the judge.’” *Siegelman*, 640 F.3d at 1188 (citing *Summers v. Singletary*, 119 F.3d 917, 921 (11th Cir. 1997)).

Here, Buckner filed his case over a year ago in May 2024 and it was removed to this Court and the undersigned in June 2024. On March 21, 2025, this Court entered its final order in this matter and dismissed Buckner’s claims. [DE 36; DE 37]. The information set forth as the “facts” regarding Mr. Jennings and Commonwealth Alliances are publicly available on the internet. Information found from “searching the internet” is public information. *Layman*, 2019 WL 3291567, at *1. Moreover, much of the information cited is subject to state ethics reporting requirements and is summarized by news outlets routinely throughout the year. Accordingly, Buckner had an obligation to bring any legitimate motion to recuse many months ago when the case was assigned to the undersigned, and not now, after receiving an adverse decision. *See Layman*, 2019 WL 3291567, at *1; *Siegelman*, 640 F.3d at 1188.

The Court finds that Buckner’s many-month delay fails to meet the timeliness requirement. *See id.* Yet the Court will continue to examine the merits of Buckner’s claims under § 455 out of an abundance of caution and transparency.

C. Analysis

Under 28 U.S.C. § 455(a), a federal judge must disqualify herself from a proceeding where the judge’s “impartiality might reasonably be questioned.” 28 U.S.C. § 455(a), *Hughes*, 899 F.2d at 1501 (finding that Sections 144 and 455 are treated the same in the Sixth Circuit). Personal bias as used in these sections is “prejudice that emanates from some source other than participation in the proceedings or prior contact with related cases.” *Pharmacy Records*, 572 F. Supp. 2d at 875 (quoting *United States v. Nelson*, 922 F.2d 311, 319–20 (6th Cir. 1990)). It may be predicated on extrajudicial sources such as the judge’s background or associations. *Id.* Disqualification under § 455(a) and (b) must be predicated upon extrajudicial conduct rather than on judicial conduct.” *Krupansky*, 619 F.2d at 578; *Youn*, 324 F.3d at 423; *see generally, Liteky*, 510 U.S. 540. “Bias finding its source in the judge’s view of the law or the facts of the case itself is not sufficient to warrant disqualification.” *Pharmacy Records*, 572 F. Supp.2d at 875 (citing *Story*, 716 F.2d at 1090).

Here, the alleged extra judicial conduct which causes the appearance of partiality appears to be Mr. Jennings’ representation of either Microsoft, specifically, or multinational corporations, generally. Simply put, Mr. Jennings does not represent Hilton or Waller or even TSC, as such Mr. Jennings does not represent any party to the proceeding. Moreover, Buckner’s case was a defamation and employment matter, and while Buckner asserts that “Commonwealth Alliances represents or may represent interests aligned with global technology and consulting firms – Microsoft among them,” he fails to point to any specific issue or client related specifically to his

case or to the defamation or employment issues generally. Mr. Jennings does not represent Microsoft on any specific issues of defamation or wrongful termination liability that would have any implications here, nor does Buckner point to any. Moreover, neither the undersigned nor Mr. Jennings had any involvement in the Microsoft case cited by Buckner. He just generally appears to object to the fact that Mr. Jennings represents corporate interests. This relationship is far too tenuous and simply unrelated to create the appearance of partiality or require recusal.

But, even assuming a closer connection, “[a]s a general proposition, the fact that the spouse or the spouse’s business has a business relationship with an entity that appears in an unrelated proceeding before the judge usually does not require the judge’s recusal.” *Garrett v. Ohio State Univ.*, No. 2:18-CV-692, 2021 WL 7186381, at *5 (S.D. Ohio Sept. 22, 2021), *aff’d*, No. 21-3972, 2023 WL 2012158 (6th Cir. Feb. 15, 2023) (citing Guide to Judiciary Policy, Vol. 2, Ch. 2, Advisory Opinion No. 107). Even still,

When a judge knows that a client of the judge’s spouse or the spouse’s business appears before the judge, the Committee has advised that the judge should evaluate certain factors to determine whether recusal is warranted. These factors include: (1) the spouse’s personal role or lack of personal role in providing services to the client, (2) whether the services provided to the client are substantial and ongoing, (3) the nature of the client’s relationship to the spouse or the spouse’s business, and (4) the financial connection between the client, the business, and the judge’s spouse (including the percentage of business revenue the client provides and the amount of compensation the spouse earns from the client). Additionally, judges should consider recusal whenever they become aware of circumstances suggesting that the hiring of the spouse or the spouse’s business may have been influenced by the judge’s position.

Id.

Neither Microsoft nor any of Commonwealth Alliances clients are parties to this litigation. Not only are they not parties, but they are also not witnesses in this matter. *United States v. Turner*, No. CRIM. 05-02, 2005 WL 3234331, at *1 (E.D. Ky. Nov. 30, 2005). As a result, the policy guidance is not directly applicable because any connection to Mr. Jennings’ business is farther

removed, yet reviewing the factors further demonstrates that his representation is not grounds for recusal. (1) Mr. Jennings’ clients are not appearing before the undersigned in this case. (2) The work performed by Mr. Jennings for Microsoft’s and Commonwealth Alliances’ other clients is entirely unrelated to this case or even the subject matter of this litigation. (3) Microsoft and all other Commonwealth Alliances clients’ relationship to Mr. Jennings’ business is solely through an arm’s-length contract for specific services. (4) Microsoft is just one of approximately 75 clients serviced by Mr. Jennings and Commonwealth Alliances from which Mr. Jennings derives income. (5) While Microsoft is a long-time client of Mr. Jennings’ business, it has never been represented in relation to any defamation or other employment issues in Kentucky by Mr. Jennings. (6) There is no allegation, nor could there be any evidence, that Mr. Jennings was hired by Microsoft because of the undersigned’s position, in part due to the fact that the relationship began long before the undersigned took the bench. Mr. Jennings and these two clients have an arm’s-length business relationship and no personal relationship. Based on these factors, there are no grounds for an objective person with knowledge of the facts to question the impartiality of the undersigned or for the undersigned to recuse on this basis.

D. Use of Artificial Intelligence by Buckner

Buckner’s motion also chastises the Court for commenting on Buckner’s citation to nonexistent case law. He asserts this has a chilling effect on litigation. While a chilling effect on litigation is certainly not the intended effect, the Court cannot permit litigants to file false or misleading briefs with the Court regardless of whether these falsehoods are made using artificial intelligence (“AI”) or are simply made-up wholesale.

AI programs “are based on complex mathematical systems that learn their skills by analyzing enormous amounts of digital data. They do not — and cannot — decide what is true and

what is false. Indeed, at times, they just make stuff up—a phenomenon some A.I. researchers call hallucinations.” Cade Metz & Karen Weise, *A.I. Is Getting More Powerful, but Its Hallucinations Are Getting Worse*, N.Y. Times (May 6, 2025), <https://www.nytimes.com/2025/05/05/technology/ai-hallucinations-chatgpt-google.html>. As such, some courts have rejected the use of such AI programs in legal pleadings “out of hand”. *Hunt v. Morissette*, No. 2-24-CV-12947-TGB-APP, 2025 WL 1660358, at *1 (E.D. Mich. June 11, 2025) (citing *J.G. v. New York City Dep't of Educ.*, 719 F. Supp. 3d 293, 308 (S.D.N.Y. 2024)). And while this district has not dismissed AI “out of hand” or required disclosures regarding use of AI, this Court nonetheless has an obligation to prevent fraud on the court from misuse of this technology.

The Court accepts a *pro se* plaintiff’s allegations as true and “construe[s] filings by *pro se* litigants liberally.” *Owens v. Keeling*, 461 F.3d 763, 776 (6th Cir. 2006) (citing *Spotts v. United States*, 429 F.3d 248, 250 (6th Cir. 2005)). However, while *pro se* pleadings are “liberally construed” and “held to less stringent standards than formal pleadings drafted by lawyers,” *Erickson v. Pardus*, 551 U.S. 89, 94 (2007) (per curiam), *pro se* plaintiffs must still satisfy basic pleading requirements. *See Hill v. Lappin*, 630 F.3d 468, 470–71 (6th Cir. 2010); *Whaley v. Equifax Info., Servs., LLC*, No. 3:22-CV-357, 2023 WL 5899845, at *1, n.1 (S.D. Ohio Sept. 11, 2023). Moreover, the Federal Rules of Civil Procedure impose a continuing duty of candor on representations made to the court by attorneys and unrepresented parties and authorize sanctions for any violation of that duty. Fed. R. Civ. P. 11; *see also Ridder v. City of Springfield*, 109 F.3d 288, 293 (6th Cir. 1997) (discussing continuing duty of candor); *Metron Nutraceuticals, LLC v. Cook*, 550 F. Supp. 3d 484, 487 (N.D. Ohio 2021).

Additionally, the use of artificial intelligence can be likened in some ways to ghostwriting. Drafting legal documents for a *pro se* litigant is often called “ghostwriting”—a practice the federal courts almost universally condemn. *See, e.g., Evangelist v. Green Tree Servicing, LLC*, No. 12-15687, 2013 WL 2393142, at *3 n. 6, 2013 U.S. Dist. LEXIS 76875, at *11 n.6 (E.D. Mich. May 31, 2013) (collecting cases). Litigants may proceed *pro se*, but the right to undisclosed assistance in conducting their case is limited by ethical and procedural rules. *In re O'Connor*, No. 08-16434, 2009 WL 1616105, at *3 (N.D. Ohio Feb. 27, 2009); *see also Thigpen v. Banas*, No. 08 C 4820, 2010 WL 520189, at *1 (N.D. Ill. Feb. 11, 2010) (recognizing that ghostwriting “on behalf of a *pro se* plaintiff raises a serious matter of unprofessional conduct”). These limits exist whether the ghostwriter is a lawyer, *Kircher v. Township of Ypsilanti*, No. 07-13091, 2007 WL 4557714, at *4, 2007 U.S. Dist. LEXIS 93690, at *9 (E.D. Mich. Dec. 21, 2007), a non-lawyer, *O'Connor*, 2009 WL 1616105, at *4, or someone with some legal training, *Gordon v. Dadante*, No. 1:05-CV-2726, 2009 WL 1850309, at *27, 2009 U.S. Dist. LEXIS 54147, at *95 (N.D. Ohio June 26, 2009). Ghostwriting “evades the requirements” of Rule 11 which is in part why it is disfavored. *Metron Nutraceuticals, LLC*, 550 F. Supp. 3d at 487 (citing *Thigpen*, 2010 WL 520189, at *1; *see also Evangelist*, 2013 WL 2393142, at *3 n.6, 2013 U.S. Dist. LEXIS 76875, at *12 n.6 (noting ghostwriting violates “the spirit” of Rule 11)). In similar fashion, the use of artificial intelligence to effectively “ghostwrite” briefs, can allow for violation of the spirit of Rule 11 and creates serious concerns for maintaining candor to the Court. Such concerns were directly on display in Buckner’s brief, in the citation to nonexistent cases.

The citation to nonexistent case law in support of Buckner’s arguments directly violates his duty of candor to the Court. Further, “[q]uite obviously, many harms flow from such deception—including wasting the opposing party’s time and money, the Court’s time and

resources, and reputational harms to the legal system (to name a few).” *Morgan*, No. 23-cv-353-WPJ/JMR, 2023 WL 6976510, at *8).

As stated previously, while the Court recognizes that Buckner is *pro se*, his status will not be tolerated as an excuse for citing nonexistent case law or violating his duty of candor to the court. In addition, it is well established that “judicial rulings alone almost never constitute a valid basis for a bias or partiality motion.” *Liteky*, 510 U.S. at 555. Instead, they are proper “grounds for appeal, not for recusal.” *Id.* This Court’s opinion pointing out Buckner’s citation to nonexistent case law, along with its implications, is an issue for appeal and not a valid basis for recusal.

CONCLUSION

Accordingly, the Court, having considered the Buckner’s motion and related filings and being otherwise sufficiently advised, **IT IS ORDERED** that Buckner’s Motion for Recusal [DE 38] is **DENIED**.



Rebecca Grady Jennings, District Judge
United States District Court

June 18, 2025

cc: Plaintiff, pro se

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 17-cv-81140-DIMITROULEAS/MATTHEWMAN

VERSANT FUNDING LLC, a Delaware
Limited Liability Company,

Plaintiff,

vs.

TERAS BREAKBULK OCEAN
NAVIGATION ENTERPRISES, LLC f/k/a
TERAS BBC OCEAN NAVIGATION
ENTERPRISES HOUSTON, LLC; et al.,

Defendants,

and

TERAS AMERICA, LLC; PNG PROJECT
SERVICES, LTD.; TERAS QUEENSLAND
PTY LTD.; TRUENORTH ENERGY
SYSTEMS, LLC; CARGO RISK
CONSULTING, LLC; AND SJS
INVESTMENTS, LLC,

Third-Party Defendants.

**ORDER IMPOSING SANCTIONS DUE TO SUBMISSION OF “HALLUCINATED”
CASE BY COUNSEL FOR DEFENDANTS AND THIRD-PARTY DEFENDANTS**

THIS CAUSE is before the Court *sua sponte*. The issue before the Court is the Court’s consideration of the imposition of sanctions upon counsel for the Defendants and Third-Party Defendants in light of their admitted submission of a wholly fabricated “hallucinated” case citation

contained within a Response [DE 371] they filed on April 22, 2025. The submission of the hallucinated case citation resulted from the use of Artificial Intelligence (“AI”) without attorney verification of the accuracy of the case citation.

I. THE FACTS ARE UNDISPUTED

There is no mystery as to what happened here. On April 22, 2025, Timothy R. Lord, Esq., admitted pro hac vice, and Joel A. Bello, Esq., as local counsel, both signed and filed a Response [DE 371] on behalf of the Defendants and Third-Party Defendants¹ to Plaintiff Versant Funding LLC’s Motion for a Determination that the Teras Emails Are Not Privileged or That Any Applicable Privileges Have Been Waived [DE 368].² Mr. Lord is a member of State Bar of California and the Washington State Bar, as well as possibly other Bars, and Mr. Bello is a member of The Florida Bar and the Southern District of Florida Bar.

In their April 22, 2025 Response filed on the docket in this case, counsel Lord and Bello stated: “Plaintiff’s motion relies on generalized references to the sale of claims but ignores the strict legal requirement that assignments of privilege must be clear and unmistakable. *See Travelers Casualty & Surety Co. v. J.P. Morgan Securities LLC*, 73 A.3d 167, 174–75 (Del. 2013).” [DE 371 at 6]. This *Travelers Casualty* case and citation is a clear hallucination submitted by counsel Lord and Bello.

In Plaintiff’s Reply filed on April 24, 2025, Plaintiff’s counsel explained that Plaintiff

¹ While the Response states that it is being filed on behalf of “Defendants”, without defining that term, the Response is signed by two attorneys as “Attorneys for Defendants & Third Party Defendants.”

² The Court recently entered its Order Granting Versant Funding LLC’s Motion for a Determination that the Teras Emails Are Not Privileged or That Any Applicable Privileges Have Been Waived [DE 383], but did not address the submission of the hallucinated case in that order. The Court does so now.

“cannot respond to TrueNorth’s claim that under a purported case, *Travelers Casualty & Surety Co. v. J.P. Morgan Securities LLC*, 73 A.3d 167, 174–75 (Del. 2013), that the assignment of privilege rights from the Trustee to SAK is invalid (DE 371, p.6). Upon multiple counsel checking Westlaw and Lexis, Versant was unable to locate the opinion, suggesting it is an AI generated hallucination.” [DE 373 at 6]. The Court also conducted its own research and was unable to locate the cited case.

Thereafter, on May 8, 2025, approximately two weeks after Plaintiff pointed out the hallucinated case in its Reply [DE 373], Defendants filed a Notice of Withdrawal of Citation [DE 379], “withdrawing the following citation contained on page six (6) of its *Response to Plaintiff’s Motion Regarding Waiver of Attorney-Client Privilege* filed at Docket Entry 371: *See Travelers Casualty & Surety Co. v. J.P. Morgan Securities LLC*, 174–75 (Del. 2013).” No explanation was given at that time as to why that case citation was withdrawn.

On the same date, May 8, 2025, the Court entered a Paperless Order [DE 380] requiring counsel Lord and Bello to file a response explaining how and why the non-existent case and citation appeared in the Response. On May 8, 2025, Defendants filed a response [DE 381], as required, and stated that Mr. Lord attempted to use AI to help him with legal research for the Response, never having used it before. *Id.* at 2. Once Mr. Lord determined that the case cited at the end of the Response did not exist, he called Plaintiff’s counsel to apologize. *Id.* Mr. Lord is “willing to directly and personally reimburse Defendant’s counsel for the time spent attempting to verify the erroneous cite and understand[s] that the Court may levy justifiable sanctions.” *Id.* Counsel further stated, “Timothy R. Lord, Esq., and local counsel have also jointly initiated procedural safeguards to prevent this error from happening again by ensuring he, and local counsel,

undertake a comprehensive review of all citations and arguments filed with this and every court prior to submission to ensure their provenance can be traced to professional non-AI sources.” *Id.* at 2–3.

The Court held a motion hearing via Zoom VTC on May 9, 2025, addressing the pending motion and this hallucination issue. At that hearing, Mr. Lord again apologized to the Court and opposing counsel. He also admitted that he used AI and failed to check the case citation before submitting the Response. He emphasized that he had never previously used AI for legal work and was unfamiliar with the process. Mr. Lord took full responsibility for the hallucinated citation. Further, as local counsel, Mr. Bello also admitted to not having checked the case citation before he filed the Response which had been prepared by pro hac vice counsel Mr. Lord.

In sum, this is a case where it is clearly established and admitted that pro hac vice counsel Lord utilized AI to research and prepare a Response containing a hallucinated case citation, which was filed with this Court by Mr. Bello who did not check the case citations. Both attorneys signed the filed Response.

II. APPLICABLE RULES AND LAW

First, Federal Rule of Civil Procedure 11(b) states, in relevant part, that, in presenting to the Court a written and signed pleading, motion, or other paper, an attorney “certifies that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances: (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation” and also that “(2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law.” Fed. R. Civ. P.

11(b)(1)–(2).

Second, The Local Rules for the Southern District of Florida refer to the obligations of pro hac vice counsel and local counsel when appearing in a case in this district. Specifically, Southern District of Local Rule 4(b)(3) requires as follows:

A pro hac vice motion shall conform to the form provided for these purposes on the Court's website and designate at least one member of the bar of this Court who is authorized to file through the Court's electronic filing system, with whom the Court and opposing counsel may readily communicate regarding the conduct of the case, upon whom filings shall be served, and who shall be required to electronically file and serve all documents and things that may be filed and served electronically, and who shall be responsible for filing and serving documents in compliance with the CM/ECF Administrative Procedures. See Section 2B of the CM/ECF Administrative Procedures. The pro hac vice motion must be accompanied by a written statement consenting to the designation, and the address and telephone number of the named designee(s). Upon written motion and for good cause shown the Court may waive or modify the requirements of such designation.

S.D. Fla. L.R. 4(b)(3).

Third, “[e]very member of The Florida Bar and every lawyer of another state or foreign country who provides or offers to provide any legal services in this state is within the jurisdiction and subject to the disciplinary authority of this court and its agencies under this rule and is charged with notice and held to know the provisions of this rule and the standards of ethical and professional conduct prescribed by this court.” Fla. R. Reg. Fla. Bar 3-4.1. The Rules Regulating the Florida Bar state that “[a] lawyer must provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.” Fla. R. Reg. Fla. Bar 4-1.1. Further, “[t]o maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, engage in continuing study and education, including an understanding of the benefits and risks associated

with the use of technology, including generative artificial intelligence, and comply with all continuing legal education requirements to which the lawyer is subject.” *Id.*

Fourth, the Court has inherent authority to sanction the misuse of AI when it affects the Court’s docket, case disposition, and ruling. The Court’s inherent power is derived from the Court’s need “to manage [its] own affairs so as to achieve the orderly and expeditious disposition of cases.” *Chambers v. NASCO, Inc.*, 501 U.S. 32, 43, 111 S. Ct. 2123, 115 L. Ed. 2d 27 (1991) (internal citations and quotation marks omitted). Courts have long been recognized as having certain implied powers that are “necessary to the exercise of all others.” *Id.* at 43 (citing *United States v. Hudson*, 11 U.S. 32, 34, 3 L. Ed. 259 (1812); *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 764, 100 S. Ct. 2455, 65 L. Ed. 2d 488 (1980)). These powers are “governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the orderly and expeditious disposition of cases.” *Chambers*, 501 U.S. at 43 (quoting *Link v. Wabash R. Co.*, 370 U.S. 626, 630–31, 82 S. Ct. 1386, 8 L. Ed. 2d 734 (1962)). A court’s “inherent power extends to a full range of litigation abuses” and “must continue to exist to fill in the interstices.” *Id.* at 46. To exercise its inherent power to impose sanctions, a court must find that the party acted in bad faith. *McDonald v. Cooper Tire & Rubber Co.*, 186 F. App’x. 930, 931 (11th Cir. 2006).

Fifth, under 28 U.S.C. § 1927, attorneys can face sanctions for engaging in practices that unnecessarily delay or increase the complexity of the litigation. Section 1927 provides that “[a]ny attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorney’s fees

reasonably incurred because of such conduct.” 28 U.S.C. § 1927. To justify the grant of attorney’s fees under 28 U.S.C. § 1927, the Court must find that (1) the attorney engaged in unreasonable and vexatious conduct; (2) such conduct multiplied the proceedings; and (3) the amount of the award does not exceed the costs, expenses, and attorney’s fees reasonably incurred due to such conduct. *Goode v. Wild Wing Cafe*, 588 F. App’x 870, 874 (11th Cir. 2014) (citing *Peterson v. BMI Refractories*, 124 F.3d 1386, 1396 (11th Cir. 1997)). Based on the foregoing, sanctions can be imposed under this statute when an attorney’s actions, such as filing frivolous pleadings or pursuing claims without a reasonable basis, are deemed unreasonable and vexatious and multiplied the proceeding, as occurred in the instant case.

III. ANALYSIS

The legal system finds itself in a brave new world, driven by rapid advancements in technology which are materially changing how attorneys practice law and litigate. A relatively recent development for our legal system is the availability of Artificial Intelligence³, including some of its subsets such as “Machine Learning”⁴, “Natural Language Processing”⁵, and

³ “AI is not a single piece of hardware or software, but rather, a constellation of technologies that gives a computer system the ability to solve problems and to perform tasks that would otherwise require human intelligence.” NAT’L SEC. COMM’N ON A.I., FINAL REPORT 31 (2021), <https://www.dwt.com/-/media/files/blogs/artificial-intelligence-law-advisor/2021/03/nscai-final-report--2021.pdf>.

⁴ “Machine learning (ML) is the process by which a machine learns to perform tasks and improve on the performance of those tasks. How machines go about “learning” and with what degree of autonomy, change, and accuracy is the complicated part. Specifically, learning, as applied to machines, refers to the mathematical means by which they identify, aggregate, and derive meaning from data.” JAMES E. BAKER, LAURIE N. HOBART, MATTHEW MITTELSTEADT, AN INTRODUCTION TO ARTIFICIAL INTELLIGENCE FOR FEDERAL JUDGES 15 (Fed. Jud. Ctr. 2023), <https://www.fjc.gov/content/375968/introduction-artificial-intelligence-federal-judges>.

⁵ Natural Language Processing is also a subset of AI which enables computers to read text or hear speech and analyze large volumes of data which can be useful in document analysis, eDiscovery, contract review and legal research. *See AI for Lawyers: What Is AI and How Can Law Firms Use It?*, CLIO, <https://www.clio.com/resources/ai-for-lawyers/lawyer-ai/>.

“Generative AI.”⁶

In the Court’s view, there is nothing inherently wrong with an attorney properly and competently utilizing AI or any of its subsets to practice law or litigate cases. However, the evolving technology has many glitches (including hallucinations) and does not always work properly or as expected. It is not always accurate and is prone to provide hallucinated cases, law, or facts. This is why close and careful attorney supervision, fact-checking, and citation-checking are absolute necessities when utilizing AI or any of its subsets. A basic prerequisite to the filing of any pleading, motion, response, reply, or paper in court is for the drafting and filing attorney(s) to carefully check every case citation, fact, and argument to make sure that they are correct and proper. Attorneys cannot delegate that role to AI, computers, robots, or any other form of technology. Just as a competent attorney would very carefully check the veracity and accuracy of all case citations in any pleading, motion, response, reply, or other paper prepared by a law clerk, intern, or other attorney before it is filed, the same holds true when attorneys utilize AI or any other form of technology.

As noted by United States District Judge Xavier Rodriguez of the United States District Court for the Western District of Texas, a recognized expert in the area of AI and the legal system, “[a]ttorneys using AI tools without checking on the accuracy of their output are responsible for the consequences of incorporating inaccurate information into their work product.” Hon. Xavier

⁶ “Generative AI is a specific subset of AI used to create new content based on training on existing data taken from massive data sources in response to a user’s prompt, or to replicate a style used as input. The prompt and the new content may consist of text, images, audio or video.” Maura Grossman, Paul Grimm, Daniel Brown, & Molly Xu, *The GPT Judge: Justice in a Generative AI World*, 23 Duke L. & Tech Rev. 1, 8 (2023) (available at <https://scholarship.law.duke.edu/dltr/vol23/iss1/1/>). One example of Generative AI is ChatGPT. *Id.* at 11.

Rodriguez, *Artificial Intelligence (AI) and the Practice of Law*, 24 SEDONA CONF. J. 783, 784 (2023). In discussing the rapid pace of AI developments, Judge Rodriguez goes on to state, “[w]hile these developments have been impressive, there is a need for education in the legal community to understand errors or ‘hallucinations’ that may occur in the output of the LLMs powering these platforms. Attorneys and courts need to be aware of both the benefits and limitations that these AI platforms present.” *Id.* at 791. Unfortunately, not all attorneys have heeded Judge Rodriguez’s sage advice. That includes Mr. Lord and Mr. Bello in this case.

In the instant case, we have a situation where pro hac vice counsel Mr. Lord utilized AI to draft a response to a motion but then failed to check on the accuracy of the citations contained in the response. This is error number one. Mr. Lord then forwarded the draft response to local counsel Mr. Bello who also did not verify the accuracy of the case citations. This is error number two. Mr. Bello then filed the Response with the hallucinated case citation and principle of law which it allegedly supported on the docket. This is error number three. The filed Response was signed by both Mr. Lord and Mr. Bello, placing both of them under the ambit of Federal Rule of Civil Procedure 11 and other applicable rules and law. The filing by an attorney of a pleading, motion, response, reply, or other paper in court without checking the accuracy of the case citations and the proposition the case supports, resulting in a fake case citation being presented to the Court, violates an attorney’s legal and ethical duties and obligations. In light of this conduct, the Court deems that sanctions are appropriate against both counsel, and the Court must now consider what sanctions are appropriate to impose upon Mr. Lord and Mr. Bello.

To be clear, the Court finds that sanctions are appropriate under Rule 11(b) and 11(c) because both attorneys presented to the court a written response without conducting a reasonable

inquiry as specified and required by the Rule. They both violated Rule 11 in submitting a fake hallucinated case citation which allegedly supported a principle of law for which they were advocating. Further, sanctions are appropriate under the Court's inherent authority to manage its own affairs and achieve the orderly and expeditious disposition of cases. Here, counsel were at least reckless in their conduct, placing them under the ambit of the Court's inherent authority. Further, under 28 U.S.C. § 1927, both attorneys engaged in practices that unnecessarily increased the complexity of the litigation by filing a Response that was frivolous in part and contained misrepresentations. And finally, under our Local Rules, both counsel had an obligation to act competently, in accordance with applicable Florida Bar Rules, and not submit a Response containing false representations to the Court. Simply put, there are many bases in this case upon which to impose sanctions on counsel.

IV. APPROPRIATE SANCTIONS

A. Against the Parties

The Court shall impose sanctions upon Mr. Lord and Mr. Bello only, pursuant to Federal Rule of Civil Procedure 11(b)(2) and (c), 28 U.S.C. § 1927, our Local Rules, and the inherent authority of the Court. Although the Court could impose sanctions upon Defendants and Third Party Defendants themselves, the Court will not do so here. The Court finds that the imposition of sanctions on the parties themselves, that is, upon Defendants and Third Party Defendants, would not be appropriate under the particular facts of this case. The parties apparently had no role in drafting and filing the Response at issue. The fault here was clear attorney error, negligence, and recklessness which the Court will not impute to the parties at this juncture; however, if further similar issues arise, the Court will consider sanctions against the parties themselves as well as

offending counsel.

B. Against the Attorneys

As to counsel, pro hac vice counsel Mr. Lord stated at the hearing that he accepts full responsibility for the inclusion of the hallucinated case in the filed Response. Mr. Lord stated that local counsel Mr. Bello took no part in the drafting of the Response.

As relevant to the determination of sanctions, the Court finds that Mr. Lord did not purposely attempt to mislead the Court. Nor did he intentionally submit a fake case citation. Mr. Lord has been practicing law for a very long time and, according to him, this was his first attempt at using AI to assist him in drafting a response. He was, however, clearly quite careless, negligent, and reckless, in drafting, submitting, signing and causing the filing of a Response with this Court which contained a hallucinated case citation for a proposition of law he advocated. The Court will also give him some credit for eventually acknowledging his error, apologizing to the Court and opposing counsel, and filing along with his local counsel Mr. Bello a notice withdrawing the case citation. However, in this regard, counsel did not move to withdraw the citation until approximately two weeks after Plaintiff's counsel pointed out the hallucinated case in Plaintiff's Reply. This was an unnecessarily slow response to a serious misrepresentation. Also, the Notice of Withdrawal did not state why the case was being withdrawn.

As to Mr. Bello, a member of this Bar, he is certainly less culpable here. He did not draft the Response, and he improvidently relied upon pro hac vice counsel to draft and verify the Response. However, local counsel in federal cases have serious obligations to their clients and the court. Taking on the role of local counsel in a federal case is serious business. In this regard, Mr. Bello filed a Motion to Appear *Pro Hac Vice*, Consent to Designation, and Request to

Electronically Receive Notices of Electronic Filing on behalf of Mr. Lord on August 6, 2024. [DE 349]. In that motion, Mr. Bello consented to “be designated as a member of the Bar of this Court with whom the Court and opposing counsel may readily communicate regarding the conduct of the case, upon whom filings shall be served, who shall be required to electronically file and serve all documents and things that may be filed and served electronically, and who shall be responsible for filing and serving documents in compliance with the CM/ECF Administrative Procedures.” *Id.* at 2. That motion was later granted by the Court based upon Mr. Bello’s consent and representations to this Court. [DE 350]. Thus, under our Local Rules, Mr. Bello, as local counsel, had numerous obligations to fulfill. He did not fully comply with his obligations by engaging in certain conduct such as filing the Response which contained the fake hallucinated case citation and not checking on the accuracy of the Response before he filed it. Mr. Bello also signed the filed Response along with Mr. Lord. This subjects Mr. Bello (as well as Mr. Lord) to the dictates of Rule 11 and other applicable rules and law.

However, the Court finds that Mr. Bello did not engage in purposeful bad faith misconduct. As local counsel, he was careless, negligent, and reckless in filing a response without ensuring the accuracy of the case citation and principle of law. He improvidently relied on Mr. Lord entirely for the accuracy of the Response which he filed with the Court. As Local Counsel, he had an obligation to ensure that the Response he was signing and filing was accurate and did not contain any misrepresentations such as the hallucinated case at issue. This should be a warning to attorneys who take on the role of local counsel in our federal courts. It is a serious role, and it must be taken seriously by counsel.

This Court is not the first to encounter counsel who submit hallucinated, fake case citations.

Some other courts have also unfortunately encountered similar situations where counsel submitted an AI-generated pleading, motion or other paper which contained hallucinated case citations. In a recent case in the Southern District of Florida, a pro se litigant utilized generative AI and failed to admit it, instead making additional misrepresentations to the court. *O'Brien v. Flick*, No. 24-61529-CIV, 2025 WL 242924, at *6 (S.D. Fla. Jan. 10, 2025). The Court ultimately dismissed the case with prejudice as a sanction for such misconduct. *Id.* at *8; *see also Thomas v. Pangburn*, No. CV423-046, 2023 WL 9425765, at *7 (S.D. Ga. Oct. 6, 2023), *report and recommendation adopted*, No. 4:23-CV-46, 2024 WL 329947 (S.D. Ga. Jan. 29, 2024), *appeal dismissed*, No. 24-10368-C, 2024 WL 5389428 (11th Cir. Oct. 21, 2024) (dismissing the case partially as a sanction due to the plaintiff's citation of sham cases).

In the instant case, Mr. Lord and Mr. Bello did not engage in such misconduct as specified in *O'Brien v. Flick*, and they did not attempt to minimize their behavior. They did not attempt to cover up their error or obfuscate the issue. They accepted responsibility and apologized. Had they not done so, and had they attempted to cover up their conduct, the Court would be imposing much more serious sanctions in this case.

In other similar cases, courts have imposed lesser sanctions other than dismissal, striking of pleadings, or entry of a default judgment. For example, in *Mata v. Avianca, Inc.*, 678 F. Supp. 3d 443, 466 (S.D.N.Y. 2023), the attorneys were sanctioned for citing to fake cases in a brief which were hallucinated by ChatGPT. The court in that case issued sanctions which included a penalty of \$5,000 to be paid into the court registry. *Id.* at 466. In *Wadsworth v. Walmart Inc.*, 348 F.R.D. 489, 497 (D. Wyo. 2025), counsel submitted motions containing AI-generated fake cases, but honestly apologized for their mistake afterwards. The Court revoked pro hac vice counsel's

admission and fined each attorney in the amount of either \$1,000 or \$3,000 to be paid into the court registry. *Id.* at 499.

The Court does not view the revocation of Mr. Lord's pro hac vice status as appropriate at this time; however, if further similar issues arise, the Court will readdress this issue. Instead, the Court will impose an award of attorney's fees and costs against Mr. Lord and Mr. Bello, as well as fines against each counsel, and a CLE requirement, as further explained below.

V. CONCLUSION

The Court takes the submission of a hallucinated, fake case citation supposedly supporting a principle of law very seriously. It is a serious misrepresentation to the Court and to opposing counsel. Judges in our nation's courts are quite busy and need to be able to rely upon competent counsel to submit well-reasoned pleadings, motions, responses, replies, and other papers containing accurate and supported arguments, facts, and case law. That did not occur here when the offending Response was filed.

This case should be a warning to lawyers that your pleadings, motions, responses, replies, and other papers filed with any Court must be first checked and then double-checked. There is no room in our court system for the submission of fake, hallucinated case citations, facts, or law. And it is entirely preventable by competent counsel who do their jobs properly and competently.

In sum, counsel who decide to enter a case to litigate must ensure that they carefully evaluate, elucidate, and advocate—not hallucinate.

The Court has carefully considered the applicable rules, law, and case law. As found earlier in this Order, sanctions are appropriate against both offending counsel. Having considered the totality of the facts here, the conduct of counsel, and the applicable law and rules, it is hereby

ORDERED as follows:

1. First, the Court will award Plaintiff all reasonable attorney's fees and costs incurred by its counsel for the time they spent in researching and replying to the Response [DE 371]. Both Mr. Lord and Mr. Bello shall be jointly and individually liable for the payment of this award. The parties' counsel shall promptly confer and attempt in good faith to determine and agree upon the reasonable attorney's fees and costs that were incurred by Plaintiff's counsel in this regard. The parties shall then file a Joint Notice on or before **May 27, 2025**, stating whether they have been able to agree upon the fees and costs to be paid, and if so, the specific amount agreed upon, and the payment schedule. The Court will then issue any further Order as deemed necessary. If the parties and their counsel cannot agree on a reasonable amount of fees and costs, or a payment schedule, they shall file separate notices on or before **May 28, 2025**, stating the nature of the dispute over the fees and costs (whether it involves the time incurred, hourly rate, or other issues) and their respective positions. The Court will promptly determine the amount of the attorney's fees and costs to be paid to Plaintiff by Mr. Lord and Mr. Bello and issue any appropriate further orders.
2. Second, Mr. Lord and Mr. Bello are both required to attend and complete, within 30 days from the date of this order, an approved CLE on Artificial Intelligence which has an ethics component addressing the ethical and legal obligations of counsel and parties regarding the use of Artificial Intelligence. Attendance can be in person or remote, such as attending and completing an online CLE presented by The Florida Bar or other recognized entity. They shall each file notices with the Court on or before **June 20, 2025**, stating whether and how they have completed the requisite CLE and complied with this Order.

3. The Court further ORDERS Mr. Lord to forthwith pay a fine in the amount of one thousand dollars (\$1,000.00) to the Registry of the Clerk of this Court. The Court also further ORDERS Mr. Bello to forthwith pay a fine of five hundred dollars (\$500.00) to the Registry of the Clerk of this Court. Counsel shall determine the logistics of the payments by contacting the Clerk of Court. Each counsel shall file a notice with the Court stating they have paid their respective fines.
4. Finally, failure to fully comply with this Order may result in further, more serious sanctions.

DONE AND ORDERED in Chambers at West Palm Beach, Palm Beach County, in the Southern District of Florida, this 20th day of May 2025.


WILLIAM MATTHEWMAN
United States Magistrate Judge

Filed 9/12/25

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION THREE

SYLVIA NOLAND,

Plaintiff and Appellant,

v.

LAND OF THE FREE, L.P., et al.,

Defendants and Respondents.

B331918

(Los Angeles County
Super. Ct. No. BC716737)

APPEAL from a judgment of the Superior Court of
Los Angeles County, Stephen I. Goorvitch, Judge. Affirmed.

Mostafavi Law Group and Amir Mostafavi for Plaintiff and
Appellant.

Yadegari & Associates and Michael Yadegari for
Defendants and Respondents.

This appeal is, in most respects, unremarkable. Plaintiff filed a complaint alleging a variety of employment-related claims, and the trial court granted defendants’ motion for summary judgment, finding no triable issues as to any of those claims. Plaintiff challenges the grant of summary judgment on several grounds, none of which raises any novel questions of law or requires us to apply settled law in a unique factual context. In short, this is in most respects a straightforward appeal that, under normal circumstances, would not warrant publication.

What sets this appeal apart—and the reason we have elected to publish this opinion—is that nearly all of the legal quotations in plaintiff’s opening brief, and many of the quotations in plaintiff’s reply brief, are fabricated. That is, the quotes plaintiff attributes to published cases do not appear in those cases or anywhere else. Further, many of the cases plaintiff cites do not discuss the topics for which they are cited, and a few of the cases do not exist at all. These fabricated legal authorities were created by generative artificial intelligence (AI) tools that plaintiff’s counsel used to draft his appellate briefs. The AI tools created fake legal authority—sometimes referred to as AI “hallucinations”—that were undetected by plaintiff’s counsel because he did not read the cases the AI tools cited.

Although the generation of fake legal authority by AI sources has been widely commented on by federal and out-of-state courts and reported by many media sources, no California court has addressed this issue. We therefore publish this opinion as a warning. Simply stated, no brief, pleading, motion, or any other paper filed in any court should contain *any* citations—whether provided by generative AI or any other source—that the attorney responsible for submitting the pleading has not

personally read and verified. Because plaintiff's counsel's conduct in this case violated a basic duty counsel owed to his client and the court, we impose a monetary sanction on counsel, direct him to serve a copy of this opinion on his client, and direct the clerk of the court to serve a copy of this opinion on the State Bar.

FACTUAL AND PROCEDURAL BACKGROUND

I. Complaint.

Sylvia Noland (Noland) filed the present action in August 2018, and filed the operative second amended complaint (complaint) in August 2019. The complaint alleges as follows:

Defendants Jose Luis Nazar and Land of the Free, L.P. (collectively, defendants) own an office building located at 640 S. San Vicente Boulevard (the San Vicente property) and an event space located at 2400 Laurel Canyon Boulevard in Los Angeles (the Laurel Canyon property). In January 2018, defendants hired plaintiff to work as their leasing agent and sales representative. In that capacity, plaintiff showed the properties to potential lessees, prepared deal memos, and collected deposits and signatures on leases and contracts.

Defendants agreed to pay plaintiff for administrative work, plus a 6 percent commission for each event she booked at the Laurel Canyon property and a 2 percent commission for each tenant she secured for the San Vicente property. Defendants further agreed to pay plaintiff a \$3,500 monthly draw against her earnings and commissions. However, defendants never paid plaintiff \$1,000 per month for her administrative work, and in 2018 defendants told plaintiff they would no longer pay her a monthly draw. Further, defendants failed to pay plaintiff a

\$60,000 commission she was owed for securing a lease worth \$3.5 million over a 10-year term. Defendants also failed to pay plaintiff minimum wage or overtime, to maintain proper time records, and to provide plaintiff itemized wage statements.

In about June 2018, plaintiff learned that defendants did not have the necessary permits to lease office space at the San Vicente property to medical providers. Plaintiff “refused to work under intolerable working conditions that required [her to] secure lease agreements in blatant violation of the law and act unethically towards clients,” and she “was therefore left with no reasonable alternative but to resign and was constructively terminated.”

Plaintiff’s complaint asserted 25 causes of action, including violations of California’s wage and hour laws (1st–5th and 14th–22nd causes of action), retaliation (6th cause of action), constructive and wrongful termination (7th and 23rd causes of action), breach of contract (8th cause of action), quantum meruit (11th cause of action), violation of Business and Professions Code section 17200 (12th cause of action), penalties under the Private Attorneys General Act (PAGA; Lab. Code, § 1298) (13th cause of action), misclassification of employee as independent contractor (24th cause of action), and intentional infliction of emotional distress (25th cause of action).¹

¹ The trial court sustained demurrers to the ninth, tenth, and eighteenth causes of action, and thus we do not discuss them.

II. Defendants' first motion for summary judgment.

Defendants filed a motion for summary judgment in September 2022, noticing a hearing for December 1, 2022. Plaintiff moved to strike the motion as untimely. The trial court (Hon. David Sotelo) denied the summary judgment motion on the ground that it was not filed sufficiently in advance of the hearing date.

III. Defendants' request to continue trial and second motion for summary judgment.

A. Request to continue trial.

In January 2023, defendants filed an ex parte application to continue the trial from January to May 2023. Defendants' counsel stated that he had recently been in an automobile accident that limited his mobility and required multiple doctors' visits. Accordingly, "It would be very difficult for Defendant[s]' counsel to appear in trial at this time while he is in recovery."

Plaintiff responded that she was amenable to continuing the trial as long as the statutory five-year deadline for bringing the case to trial was tolled. At a January 2023 hearing, the parties stipulated to extending the five-year period through the end of December 2023, and the trial court continued the trial to May 2023. That date was later vacated, and trial was set for June 2023.

B. Second motion for summary judgment.

Defendants refiled their motion for summary judgment in January 2023. The motion was essentially identical to that filed in September 2022, urging that there were no triable issues of material fact as to any of plaintiff's causes of action.

Plaintiff responded by filing a motion for sanctions. Plaintiff asserted that sanctions were appropriate because (1) defendants had sought a trial continuance for the purpose of refileing their summary judgment motion, (2) defendants' second motion for summary judgment did not assert new or different facts or legal issues, and it therefore violated Code of Civil Procedure² section 437, subdivision (f)(2), and (3) the date on which the motion for summary judgment was set to be heard was fewer than 30 days prior to the date set for trial.

On May 25, 2023, the trial court denied the motion for sanctions and continued the hearing to allow plaintiff to file a substantive opposition to the summary judgment motion. The court's order explained as follows:

"This case originally was assigned to [Judge] David Sotelo Defendants previously filed a motion for summary judgment on September 29, 2022, and noticed the hearing for December 1, 2022, in advance of a trial date of January 17, 2023. Judge Sotelo denied the motion for lack of statutory notice without addressing the merits. Following Judge Sotelo's retirement, the case was reassigned

"Now, Defendants again move for summary judgment or, in the alternative, summary adjudication. Plaintiff did not file an opposition, but instead objected under . . . section 437c(f)(2), arguing that this is a successive motion for summary judgment. . . . The Court overrules the objection for three independent reasons.

² All subsequent undesignated statutory references are to the Code of Civil Procedure.

“First, the Court interprets section 437c(f)(2) as prohibiting successive motions for summary judgment only when there has been a prior ruling on the merits. As discussed, Judge Sotelo denied the motion on procedural grounds without resolving the merits. Therefore, section 437c(f)(2) does not prohibit Defendants from filing a second motion for summary judgment.

“Second, . . . [a] trial court may not refuse to hear a motion for summary judgment filed and served sufficiently in advance of trial. [Citation.] Defendants had a right to a decision on the merits, given that they filed their motion 110 days before trial.

“Finally, in the alternative, the Court exercises its discretion and elects to consider Defendants’ motion for summary judgment on the merits. Notwithstanding section 437c(f)(2), the Court has inherent authority to consider a second motion for summary judgment, provided there is good cause to do so. [Citation.] The Court does so for the reasons stated. Moreover, the issues raised in Defendants’ motion should be decided in advance of trial. It would not promote the interests of judicial economy to select the jury and permit Plaintiff to conduct her case-in-chief before ruling on these issues on a motion for non-suit.”

Plaintiff thereafter filed a substantive opposition to defendants’ motion for summary judgment, urging that there were triable issues of fact as to each cause of action. The court held a hearing on the motion and, after taking the motion under submission, granted summary judgment for defendants. Among other things, the court found the evidence was undisputed that (1) plaintiff was an independent contractor, not an employee, and thus the wage and hour laws did not apply to her, (2) defendants did not owe plaintiff a commission because the tenant plaintiff

said she secured ultimately did not execute a lease with defendants, (3) plaintiff had not demonstrated that she was subject to any adverse employment actions that could form the basis for a retaliation action, and (4) plaintiff did not demonstrate triable issues as to her intentional infliction of emotional distress claim.

On July 25, 2023, plaintiff filed a notice of appeal from the order granting summary judgment.³

³ An order granting summary judgment is not an appealable order. (E.g, *Champlin/GEI Wind Holdings, LLC v. Avery* (2023) 92 Cal.App.5th 218, 223; *Levy v. Skywalker Sound* (2003) 108 Cal.App.4th 753, 761, fn. 7.) Thus, in October 2023, this court directed plaintiff to provide the court with an appealable judgment or to explain why the appeal should not be dismissed. Plaintiff responded in a letter brief that no judgment had been entered, but the appeal should not be dismissed because the order granting summary judgment was a final order that resolved all pending issues between the parties. This court deferred the appealability question to the panel that would decide the appeal on the merits.

Although more than 18 months have passed since this court advised plaintiff of the need to obtain a judgment, plaintiff's counsel has not obtained one. Accordingly, we would be well within our discretion to dismiss the appeal. (See *Blauser v. Dubin* (2024) 106 Cal.App.5th 918, 920–923 [dismissing appeal from minute order granting motion for nonsuit].) Nonetheless, in the interests of justice and to avoid delay, we construe the order granting summary judgment as incorporating an appealable judgment, and the notice of appeal as appealing from such judgment. (See *Blauser*, at p. 922 & fn. 4; *Levy v. Skywalker Sound*, *supra*, 108 Cal.App.4th at p. 761, fn. 7.)

DISCUSSION

I. Plaintiff's counsel's reliance on fabricated legal authority.

We begin by noting that nearly all of the quotations in plaintiff's opening brief, and many of the quotations in plaintiff's reply brief, have been fabricated. That is, as noted above, although most of the cases to which the quotes are attributed exist, the quotes do not. Further, many of the cases plaintiff cites do not support the propositions for which they are cited or discuss other matters entirely, and a few of the cases do not exist at all. To give just a few examples:

Plaintiff asserts: "In *Schimmel v. Levin* (2011) 195 Cal.App.4th 81, the court discussed the legislative purpose behind Section 437c(f)(2), highlighting that it was enacted to prevent abuse of the summary judgment procedure by disallowing multiple motions on the same issues." In fact, *Schimmel* does not contain a single reference to either summary judgment or section 437c. Appellant's opening brief also purports to quote *Schimmel* as follows: "In *Schimmel v. Levin* (2011) 195 Cal.App.4th 81, 86–87, the court held: 'Section 437c(f)(2) embodies a legislative judgment that a party should not be allowed to bring multiple motions for summary judgment based on the same issues without demonstrating newly discovered facts or circumstances or a change in the law. This policy applies even when the prior motion was denied on procedural grounds.' " The quoted language does not appear in *Schimmel*—or in any other case of which we are aware.

Plaintiff also asserts: "In *Regency Health Services, Inc. v. Superior Court* (1998) 64 Cal.App.4th 1496, 1504, the court emphasized: 'A continuance should not be granted when it is

sought to facilitate procedural maneuvers rather than to promote justice.’ ” *Regency* does not address the granting of a continuance, and the quoted language does not appear anywhere in the opinion.

Plaintiff further asserts: “The court in *Peake v. Underwood*, 227 Cal.App.4th 428, 448 (2014), emphasized that filing a second dispositive motion without new facts or law is frivolous and subject to sanctions.” *Peake* does not address the filing of a second dispositive motion, and the only sanctions at issue in that case were for filing a frivolous pleading. (*Id.* at pp. 432–450.)

Plaintiff additionally asserts: “As in *Goldstine v. Liberty Mut. Ins. Co.*, 2020 WL 6216738 (W.D. Wash. 2020), where sanctions were imposed for similar baseless claims of personal hardship to delay proceedings, Mr. Yadegari’s actions warranted sanctions under California Code of Civil Procedure § 128.5 for making false statements to obtain an improper advantage.” *Goldstine* appears to be a fabricated case.

And, plaintiff asserts: “The California Court of Appeal in *Heckert v. MacDonald*, 208 Cal.App.3d 832, 837 (1989), emphasized that sanctions should be imposed where a party uses procedural rules to gain an unfair advantage by engaging in ‘frivolous litigation tactics.’ ” The words “frivolous,” “unfair,” and “tactics” do not appear in *Heckert*, which concerns the appellants’ claim that the trial court erred by refusing to order their real estate broker to pay their attorney fees as damages.

In total, appellant’s opening brief contains 23 case quotations, 21 of which are fabrications. Appellant’s reply brief contains many more fabricated quotations. And, both briefs are

peppered with inaccurate citations that do not support the propositions for which they are cited.

The extensive reliance on nonexistent legal authority would justify striking appellant’s opening brief or dismissing the appeal. (See, e.g., *In re Marriage of Deal* (2022) 80 Cal.App.5th 71, 77–81 [dismissing frivolous appeal]; *Huang v. Hanks* (2018) 23 Cal.App.5th 179, 182 [“ ‘appellate courts possess the . . . inherent power to summarily dismiss any action or appeal which . . . is based upon . . . frivolous grounds’ ”].) Nonetheless, because nothing indicates that plaintiff was aware that her counsel had fabricated legal authority, and defendants addressed plaintiff’s contentions on the merits, we will do the same. (See *People v. Wende* (1979) 25 Cal.3d 436, 443 [affirming on the merits rather than dismissing appeal as frivolous: “Once the record has been reviewed thoroughly, little appears to be gained by dismissing the appeal rather than deciding it on its merits”].)⁴

II. Plaintiff’s substantive arguments lack merit.

A. The trial court did not abuse its discretion by considering defendants’ second motion for summary judgment on the merits.

Section 437c, subdivision (f)(2), provides: “A party shall not move for summary judgment based on issues asserted in a prior motion for summary adjudication and denied by the court unless that party establishes, to the satisfaction of the court, newly discovered facts or circumstances or a change of law supporting the issues reasserted in the summary judgment motion.”

⁴ We will, however, impose sanctions on plaintiff’s counsel for filing a frivolous brief, as we discuss in part III of the Discussion.

Plaintiff contends that because defendants' second motion for summary judgment did not assert newly discovered facts or a change of law, the trial court lacked discretion under section 437c, subdivision (f)(2) to consider it. The trial court's authority to consider defendants' renewed motion for summary judgment is a question of law, which we review de novo. (*Marshall v. County of San Diego* (2015) 238 Cal.App.4th 1095, 1105 (*Marshall*); *People v. Lujan* (2012) 211 Cal.App.4th 1499, 1507 [whether a trial court has inherent authority to take an action is reviewed de novo].)

Plaintiff's contention is directly contrary to our Supreme Court's decision in *Le Francois v. Goel* (2005) 35 Cal.4th 1094 (*Le Francois*). There, the high court held that while section 437c, subdivision (f)(2) "prohibit[s] a party from making renewed motions not based on new facts or law," it does not restrict a trial court's inherent authority in any manner. (*Le Francois*, at pp. 1096–1097.) Indeed, the court said, an interpretation of section 437c, subdivision (f)(2) that limited the trial court's authority to reconsider its own rulings would raise "difficult constitutional questions"—namely, whether the statute "'emasculate[s] the judiciary's core power to decide controversies between parties.'" (*Le Francois*, at pp. 1104–1105.)

The *Le Francois* court explained that while a trial court is not required to rule on a second motion for summary judgment, courts "cannot prevent a party from communicating the view to a court that it should reconsider a prior ruling." (*Le Francois*, *supra*, 35 Cal.4th at p. 1108.) Further, "it should not matter whether the 'judge has an unprovoked flash of understanding in the middle of the night' [citation] or acts in response to a party's suggestion. If a court believes one of its prior interim orders was

erroneous, it should be able to correct that error no matter how it came to acquire that belief.” (*Ibid.*) Thus, the court said, section 437c does “not limit a *court’s* ability to reconsider its previous interim orders on its own motion, as long as it gives the parties notice that it may do so and a reasonable opportunity to litigate the question.”⁵ (*Le Francois*, at p. 1097; see also *id.* at pp. 1108–1109 [“To be fair to the parties, if the court is seriously concerned that one of its prior interim rulings might have been erroneous, and thus that it might want to reconsider that ruling on its own motion . . . it should inform the parties of this concern, solicit briefing, and hold a hearing”]; *Marshall, supra*, 238 Cal.App.4th at pp. 1104–1107 [trial court had inherent authority to entertain successive motions for summary judgment or summary adjudication]; *Minick v. City of Petaluma* (2016) 3 Cal.App.5th 15, 34 [“Trial courts always have discretion to revisit interim orders in service of the paramount goal of fair and accurate decisionmaking”].)

Le Francois is dispositive of plaintiff’s contention that the trial court lacked discretion to consider the renewed motion for summary judgment. While the trial court was not *required* to rule on defendants’ motion, it had discretion to exercise its inherent power to reconsider the prior order denying summary judgment and, having done so, to grant the motion. Plaintiff’s contention to the contrary is wholly without merit.

⁵ Because the trial court in *Le Francois* had not warned the parties it might change its previous ruling or allowed the parties to be heard on the issue, the Supreme Court remanded the matter “for the court and parties to follow proper procedure.” (*Le Francois, supra*, 35 Cal.4th at p. 1109 & fn. 6.)

B. The trial court did not abuse its discretion by denying plaintiff's motion for sanctions.

Below, plaintiff sought sanctions under sections 128.5 and 128.7 on the grounds that (1) defendants were prohibited under section 437c, subdivision (f)(2) from filing a second motion for summary judgment on the same grounds, and (2) defendants' counsel's claim that he had been in an automobile accident "was false, unsubstantiated, and was made in bad faith only to obtain [a] continuance to the trial date, so Defendants could file their second MSJ." In support, plaintiff asserted: "If [defendants' attorney] Mr. Yadegari's health condition resulting from the car accident indeed impaired his ability to prepare and appear for trial, it should also have prevented him [from preparing] for the [s]econd MSJ. . . . What is at issue here is whether Mr. Yadegari alleged his bodily injuries to continue the trial so he could re-use the [f]irst MSJ? The answer must be affirmative" The trial court rejected plaintiff's contention that sanctions were warranted, finding that there was good cause for defendants to renew their summary judgment motion, and the record did "not support Plaintiff's counsel's argument that Defendants' counsel misrepresented having been in an accident in order to obtain a continuance under false pretenses."

Plaintiff contends that the trial court erred by denying the motion for sanctions. We review a sanctions order for an abuse of discretion. (*McCluskey v. Henry* (2020) 56 Cal.App.5th 1197, 1205.) Under that standard, we "presume the trial court's order is correct and do not substitute our judgment for that of the trial court." (*Ibid.*) Further, we will uphold all orders based on express or implied findings supported by substantial evidence.

(*Hanna v. Mercedes-Benz USA, LLC* (2019) 36 Cal.App.5th 493, 513; *Frei v. Davey* (2004) 124 Cal.App.4th 1506, 1512.)

The trial court did not abuse its discretion by denying plaintiff's motion for sanctions. In support of defendants' application to continue trial, attorney Michael Yadegari declared under penalty of perjury that he "was recently in an accident where I was run over by a Sports Utility Vehicle ('SUV') while I was riding a scooter. This event has limited my mobility and I have to go to multiple doctors for my injury. It would be very difficult for me . . . to appear in trial at this time while I am in recovery." Plaintiff's sanctions motion provided no evidence that defendants' counsel had not been in an accident, but merely suggested the trial court should *infer* that was the case because counsel had been able to file a second motion for summary judgment. But the filing of the second motion for summary judgment did not require the inference plaintiff suggests. As plaintiff herself admits, the second summary judgment motion was "virtually identical" to the first, and thus the trial court was not required to infer from its filing that counsel's injuries were fabricated. Moreover, attending a trial in person requires a physical stamina that preparing a motion does not. And, in any event, the trial court was well within its discretion in crediting defendants' counsel's sworn testimony. (See, e.g., *Santa Clara County Correctional Peace Officers' Assn., Inc. v. County of Santa Clara* (2014) 224 Cal.App.4th 1016, 1027 [when reviewing a " 'judgment based on affidavits or declarations,' " a reviewing court " 'defer[s] to [the trial court's] determination of credibility of the witnesses' "].) The trial court thus did not err by denying the motion for sanctions.

C. Plaintiff has not demonstrated error with regard to her PAGA and employment claims.

Plaintiff contends the trial court erred by “fail[ing] to recognize disputed material facts in plaintiff’s PAGA and employment claims.” However, plaintiff does not identify any evidence in the record to support her claim. The contention, thus, is forfeited. (E.g., *Coziahr v. Otay Water Dist.* (2024) 103 Cal.App.5th 785, 799 (*Coziahr*) [“Points must be supported by reasoned argument, authority, and record citations, or may be deemed forfeited”]; *Badie v. Bank of America* (1998) 67 Cal.App.4th 779, 784–785 [“When an appellant fails to raise a point, or asserts it but fails to support it with reasoned argument and citations to authority, we treat the point as waived”].)

D. The trial court did not err by denying plaintiff’s request to reopen discovery.

At the May 25, 2023 hearing on defendants’ motion for summary judgment, plaintiff’s counsel asked the court to continue the hearing date and to reopen discovery. The court granted the motion to continue and allowed plaintiff to file an opposition on the merits, but it denied the request to reopen discovery. The court explained: “[T]he Court denies the request to reopen discovery for multiple independent reasons. Plaintiff’s counsel represented at the case management conference that discovery should remain closed. [Citation.] Plaintiff’s counsel’s request was not made in writing with proper notice to Defendants’ counsel. Plaintiff’s counsel does not articulate what ‘facts essential to justify opposition may exist but cannot, for reasons stated, be presented,’ as required by . . . section 437c(h). This case was filed four years and nine months ago, and

Plaintiff's counsel has had ample opportunity to conduct discovery. The record reflects no good cause for Plaintiff's counsel not having conducted the depositions of those who provided declarations in support of the motion. Indeed, their identities and significance to the case would have been clear at the outset, even assuming they were not identified in discovery. Finally, the schedule does not permit time to reopen discovery, given the age of the case, the impending five-year deadline, and the difficulty of setting trials later this year given congestion of the Court's calendar and the holidays."

Plaintiff contends the trial court erred by denying her request to reopen discovery in order to oppose defendants' motion for summary judgment. Plaintiff cites no legal authority in support of this contention, and thus she has forfeited it. (*Coziahr, supra*, 103 Cal.App.5th at p. 799.)

E. The trial court did not abuse its discretion by "fail[ing] to review plaintiff's opposition papers before issuing its tentative ruling."

Plaintiff asserts that the order granting summary judgment must be reversed because the trial court "failed to review" her opposition to the summary judgment motion. In support, plaintiff points to the trial court's statements at the May 25, 2023 hearing that plaintiff "did not oppose the motion on the merits," and at the June 26, 2023 hearing that it was "a bit confused why [an opposition] was not filed in the first place." Plaintiff suggests that these statements "strongly impl[y] the court overlooked or ignored the opposition papers filed by the plaintiff, a clear procedural error."

Plaintiff's contention is entirely without merit. "It is presumed that official duty has been regularly performed"

(Evid. Code, § 664),” and in the absence of contrary evidence, we must assume that the trial court followed the law. (*People v. Campo* (1987) 193 Cal.App.3d 1423, 1432.) No such evidence appears here. To the contrary, plaintiff’s counsel conceded in the trial court (and it is apparent from the record) that a substantive opposition to defendants’ motion for summary judgment had not been filed before the May 25, 2023 hearing. Indeed, it was *because* no opposition had been filed that the summary judgment hearing was continued a month, to June 26, 2023. And, at the June 26, 2023 hearing, the court stated that it allowed plaintiff to file an opposition on the merits, but “[t]he opposition was not persuasive to me.” The trial court could not have made that statement had it not reviewed plaintiff’s opposition. We perceive no abuse of discretion.

For all the foregoing reasons, the trial court did not err by granting summary judgment for defendants. We therefore will affirm the judgment.

III. Sanctions for pursuit of a frivolous appeal.

Prior to oral argument in this case, on our own motion we issued an order to show cause (OSC) why this court should not sanction plaintiff’s counsel, Amir Mostafavi, for filing appellate briefs replete with fabricated quotes and citations. The OSC noted that nearly all of the quotations in appellant’s opening brief, as well as many in the reply brief, were fabricated, and it warned that sanctions might include both an award of attorney fees and costs to defendants and an award of sanctions payable to the clerk of this court.

Attorney Mostafavi filed a written response. He acknowledged that he relied on AI “to support citation of legal issues” and that the fabricated quotes were AI-generated. He

further asserted that he had not been aware that generative AI frequently fabricates or hallucinates legal sources and, thus, he did not “manually verify [the quotations] against more reliable sources.” Mostafavi accepted responsibility for the fabrications and said he had since taken measures to educate himself so that he does not repeat such errors in the future. He asserted, however, that “[t]he majority of citations are accurate and support the propositions that were being advanced”; the appeal is not frivolous; and in spite of fabricated quotations, the brief “stands on meritorious arguments that are fully supported by the record.” Mostafavi therefore urges that “[s]hould the Court determine that some corrective action is warranted,” the appropriate remedy “is correction of the briefs rather than monetary sanctions” because counsel’s “citation irregularities,” although “regrettable,” “do not rise to the level requiring punitive measures given the isolated nature of the problems relative to the briefs’ overall representation of the reversible errors made by the trial court based on the cited record and not necessarily in complete reliance on the cited authorities.”

At oral argument, attorney Mostafavi explained that he wrote initial drafts of the briefs, “enhanced” the briefs with ChatGPT, and then ran the “enhanced” briefs through other AI platforms to check for errors. Counsel admitted that he did not read the “enhanced” briefs before he filed them.

For the reasons that follow, we decline to permit the filing of revised briefs and conclude that an award of sanctions against attorney Mostafavi is appropriate.

A. Legal principles.

The Code of Civil Procedure permits an appellate court to impose sanctions for filing a frivolous appeal. (§ 907 [“When it

appears to the reviewing court that the appeal was frivolous or taken solely for delay, it may add to the costs on appeal such damages as may be just”]; § 128.7 [attorney may be sanctioned for submitting pleading for which the attorney does not have a belief “formed after an inquiry reasonable under the circumstances” that the “legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law”].) The Rules of Court similarly permit the court to sanction a party or attorney for filing a frivolous appeal or motion, as well as for including in the record matters not reasonably material to the appeal or “[c]ommitting any other unreasonable violation of these rules.” (Cal. Rules of Court,⁶ rule 8.276(a)(4); see also *Huschke v. Slater* (2008) 168 Cal.App.4th 1153, 1155–1156.)

An appeal is frivolous if it is prosecuted for an improper motive or indisputably has no merit. “To determine whether an appeal is frivolous, we apply both a subjective standard, examining the motives of appellant and its counsel, and an objective standard, analyzing the merits of the appeal. (*In re Marriage of Flaherty* (1982) 31 Cal.3d 637, 649–650.) A finding of frivolousness may be based on either standard by itself, but the two tests are ordinarily used together, with one sometimes providing evidence relevant to the other.” (*Malek Media Group, LLC v. AXQG Corp.* (2020) 58 Cal.App.5th 817, 834 (*Malek*).) An appeal may be objectively frivolous if “appellant’s arguments rest on negligible legal foundation.” (*Id.* at pp. 834–835, quoting *Kurokawa v. Blum* (1988) 199 Cal.App.3d 976, 995–996); see also

⁶ All subsequent rule references are to the Rules of Court.

Estate of Kempton (2023) 91 Cal.App.5th 189, 206 [quoting *Malek*].)

Even if an appeal is not frivolous, this court has authority under rule 8.276 to sanction a party who unreasonably violates the Rules of Court. (See, e.g., *Bryan v. Bank of America* (2001) 86 Cal.App.4th 185, 194 [“[e]ven if an appeal is neither frivolous nor filed solely for delay, we have independent authority under rule 26(a) of the California Rules of Court [now, rule 8.276] to sanction a party who “has been guilty of any . . . unreasonable infraction of the rules . . . as the circumstances of the case and the discouragement of like conduct in the future may require” ’ ”]; *Jones v. Superior Court* (1994) 26 Cal.App.4th 92, 96 [same].) The Rules of Court require parties to support each point in a brief “if possible, by citation of authority.” (Rule 8.204(a)(1)(B).) Thus, courts have, in appropriate cases, sanctioned attorneys for including improper material in appellate briefs or failing to support assertions of law with legal authority. (See, e.g., *Evans v. Centerstone Development Co.* (2005) 134 Cal.App.4th 151, 166 [imposing sanctions for filing appellate briefs that “are cornucopias of” violations of rules of appellate procedure]; *Alicia T. v. County of Los Angeles* (1990) 222 Cal.App.3d 869, 884–885 [sanctioning attorney for citing unpublished opinion and asserting facts not supported by the record]; *Schulz v. Wulfin* (1967) 251 Cal.App.2d 776, 778–779 [sanctioning attorney for filing appellate brief containing “but two references to” the appellate record].) Such sanctions are appropriate to enforce court rules and “to discourage similar conduct in the future.” (*Evans*, at p. 168.)

B. Counsel’s reliance on fabricated legal authority renders this appeal frivolous and violative of the California Rules of Court.

Appellant’s counsel has acknowledged that his briefs are replete with fabricated legal authority, which he admits resulted from his reliance on generative AI sources such as ChatGPT, Claude, Gemini, and Grok. Counsel says that he was not previously aware of the problem of AI “hallucinations,” but he has educated himself about the issue since receiving the OSC.

In the last two years, many courts have confronted briefs populated with fraudulent legal citations resulting from attorneys’ reliance on generative AI. One court noted: “The issue of AI programs populating and citing to fake or nonexistent legal authority, what has become known as AI ‘hallucinations,’ is an issue for courts that is becoming far too common.” (*Powhatan County School Board v. Skinger* (E.D. Va., June 2, 2025, No. 3:24cv874) 2025 WL 1559593, at *9 (*Powhatan*).) Another court referenced a case citation that “has all the markings of a hallucinated case created by generative artificial intelligence (AI) tools such as ChatGPT and Google Bard that have been widely discussed by courts grappling with fictitious legal citations and reported by national news outlets.” (*United States v. Hayes* (E.D. Cal. 2025) 763 F.Supp.3d 1054, 1065 (*Hayes*).) And yet another noted a plaintiff’s “false citations” that “appear to be hallmarks of an artificial intelligence (‘AI’) tool,” observing that “[i]t is now well known that AI tools ‘hallucinate’ fake cases.” (*Schoene v. Oregon Dept. of Human Services* (D. Or., July 18, 2025, No. 3:23-cv-742-SI) 2025 WL 2021654 (*Schoene*), at *7; see also *Hall v. Academy Charter School* (E.D.N.Y. Aug. 7, 2025, No. 2:24-cv-08630-JMW) 2025 WL 2256653, at *4 [“The appearance of

hallucinated citations in briefs generated from AI is no longer in its nascent stage. Regrettably, the number and regularity with which courts have been faced with hallucinations in court filings continues to rise”].)

One recent article suggests that the problem of AI hallucinations is getting worse, not better, noting that OpenAI’s newest models hallucinated “30–50% of the time, according to company tests.” (Murray, *Why AI Hallucinations Are Worse Than Ever*, Forbes.com (May 6, 2025) <<https://www.forbes.com/sites/conormurray/2025/05/06/why-ai-halluncinations-are-worse-than-ever/>> [as of Sept. 12, 2025], archived at <<https://perma.cc/Q8NU-AEZ9>>.) The article explained that many AI models “are designed to maximize the chance of giving an answer, meaning the bot will be more likely to give an incorrect response than admit it doesn’t know something.” (*Ibid.*) A district court recently noted that this means AI hallucinations are “more likely to occur when there are little to no existing authorities available that clearly satisfy the user’s request” (*In re Richburg* (Bankr. D.S.C., Aug. 27, 2025, No. AP 25-80037-EG) 2025 WL 2470473, at *5, fn. 11)—such as, for example, when a lawyer asks a generative AI tool to supply a citation for an unsupported principle of law. And, because AI responses generally are “grammatically correct and . . . presented as fact” (Murray, *supra*), fabrications are not readily apparent. (See *Malone-Bey v. Lauderdale County School Board* (S.D. Miss., July 25, 2025, No. 3:25-cv-380-KHJ-MTP) 2025 WL 2098352, at *4 [“[H]allucinated cases look like real cases. They are identified by a case name, a citation to a reporter, the name of a district or appellate court, and the year of the decision. [Citation.] But, they are not real cases. These hallucinated cases are instead

inaccurate depictions of information from AI models that suffer from incomplete, biased, or otherwise flawed training data”].)

Many courts confronted with AI-generated authorities have concluded that filing briefs containing fabricated legal authority is sanctionable. (See, e.g., *Johnson v. Dunn* (N.D. Ala., July 23, 2025, No. 2:21-cv-1701-AMM) 2025 WL 2086116, at *1 [publicly reprimanding counsel for including fabricated citations in briefs, disqualifying counsel from further participation in the case, and referring counsel to the state bar]; *Powhatan, supra*, 2025 WL 1559593, at *10 [“The pervasive misrepresentations of the law in [defendant’s] filings cannot be tolerated. . . . It causes an enormous waste of judicial resources to try to find cited cases that do not exist”]; *Garner v. Kadince, Inc.* (Utah Ct. App. 2025) 571 P.3d 812, 816 [sanctioning counsel for filing appellate briefs containing fabricated legal authority]; *Versant Funding LLC v. Teras Breakbulk Ocean Navigation Enterprises, LLC* (S.D. Fla., May 20, 2025, No. 17-cv-81140) 2025 WL 1440351, at *3 (*Versant*) [noting court’s “inherent authority to sanction the misuse of AI when it affects the Court’s docket, case disposition, and ruling”]; *Lacey v. State Farm General Insurance Co.* (C.D. Cal., May 5, 2025, No. CV 24-5205 FMO (MAAx)) 2025 WL 1363069, at *1, fn. omitted [sanctioning counsel for “submitt[ing] briefs to the Special Master that contained bogus AI-generated research”]; *Benjamin v. Costco Wholesale Corporation* (E.D.N.Y. 2025) 779 F.Supp.3d 341, 347 [“Across the country, courts have issued a panoply of sanctions against attorneys who submitted fake cases”]; *Kruse v. Karlen* (Mo. Ct. App. 2024) 692 S.W.3d 43, 52 [“Filing an appellate brief with bogus citations in this Court for any reason cannot be countenanced and represents a flagrant violation of the duties of candor Appellant owes to this Court”];

Lee v. R&R Home Care, Inc. (E.D. La., Aug. 28, 2025, No. CV 24-836) 2025 WL 2481375, at *4 [sanctioning counsel for filing a brief containing a fabricated quotation; “The submission of any false authority undermines the Court’s confidence in counsel’s work and forces the Court to expend significant resources addressing the misconduct”]; *In re Richburg, supra*, 2025 WL 2470473, at *1 [sanctioning counsel for filing a pleading citing “fake caselaw ‘hallucinated’ by AI”].)

We agree with the cases cited above that relying on fabricated legal authority is sanctionable. As a district judge recently held when presented with nonexistent precedent generated by ChatGPT: “A fake opinion is not ‘existing law’ and citation to a fake opinion does not provide a non-frivolous ground for extending, modifying, or reversing existing law, or for establishing new law. An attempt to persuade a court or oppose an adversary by relying on fake opinions is an abuse of the adversary system.” (*Mata v. Avianca, Inc.* (S.D.N.Y. 2023) 678 F.Supp.3d 443, 461, fn. omitted; see also *Park v. Kim* (2d Cir. 2024) 91 F.4th 610, 615 [quoting *Mata*].)

To state the obvious, it is a fundamental duty of attorneys to *read* the legal authorities they cite in appellate briefs or any other court filings to determine that the authorities stand for the propositions for which they are cited. Plainly, counsel did not read the cases he cited before filing his appellate briefs: Had he read them, he would have discovered, as we did, that the cases did not contain the language he purported to quote, did not support the propositions for which they were cited, or did not exist. (See *Benjamin v. Costco Wholesale Corporation, supra*, 779 F.Supp.3d at p. 343 [“an attorney who submits fake cases clearly has not *read* those nonexistent cases, which is a violation

of [the federal equivalent of § 128.7]”]; *Willis v. U.S. Bank National Association as Trustee, Igloo Series Trust* (N.D. Tex., May 15, 2025, No. 3:25-cv-516-BN) 2025 WL 1408897, at *2 [same].) Counsel thus fundamentally abdicated his responsibility to the court and to his client. (See *Kleveland v. Siegel & Wolensky, LLP* (2013) 215 Cal.App.4th 534, 559 [“ ‘It is critical to both the bench and the bar that we be able to rely on the honesty of counsel. The term “officer of the court,” with all the assumptions of honor and integrity that append to it, must not be allowed to lose its significance’ ”].)

Counsel acknowledges that his reliance on generative AI to prepare appellate briefs was “inexcusable,” but he urges that he should not be sanctioned because he was not aware that AI can fabricate legal authority and did not intend to deceive the court. Although we take counsel at his word—and although there is nothing inherently wrong with an attorney appropriately using AI in a law practice—before filing any court document, an attorney must “carefully check every case citation, fact, and argument to make sure that they are correct and proper. Attorneys cannot delegate that role to AI, computers, robots, or any other form of technology. Just as a competent attorney would very carefully check the veracity and accuracy of all case citations in any pleading, motion, response, reply, or other paper prepared by a law clerk, intern, or other attorney before it is filed, the same holds true when attorneys utilize AI or any other form of technology.” (See *Versant, supra*, 2025 WL 1440351, at *4.)

We note, moreover, that the problem of AI hallucinations has been discussed extensively in cases and the popular press for several years. (See, e.g., Mulvaney, *Judge Sanctions Lawyers*

Who Filed Fake ChatGPT Legal Research, Wall. St. J. (June 22, 2023) <<https://www.tinyurl.com/mup8cn6d>> [as of Sept. 12, 2025], archived at <<https://perma.cc/H3HG-VAQ7>>; Weiser, *Here's What Happens When Your Lawyer Uses ChatGPT*, N.Y. Times (May 27, 2023) <<https://tinyurl.com/yxhza24w>> [as of Sept. 12, 2025], archived at <<https://perma.cc/H355-YHGC>>; *Schoene, supra*, 2025 WL 1755839, at *7 [“It is now well known that AI tools ‘hallucinate’ fake cases”]; *Powhatan, supra*, 2025 WL 1559593, at *9; *Hayes, supra*, 763 F.Supp.3d at p. 1065.) Thus, even a superficial review of the literature would have alerted counsel to this issue. Further, the State Bar of California released “Practical Guidance for the Use of Generative Artificial Intelligence in the Practice of Law” nearly two years ago, in November 2023. Citing specific California Rules of Professional Conduct, that guidance notes that generative AI outputs may “include information that is false, inaccurate, or biased,” and thus a lawyer who uses these outputs as a “starting point” must “critically review, validate, and correct both the input and the output of generative AI” to, among other things, “detect[] and eliminat[e] . . . false AI-generated results.” (<<https://tinyurl.com/4p59uyup>> [as of Sept. 12, 2025], archived at <<https://perma.cc/KG9Q-7YQD>>.)⁷

⁷ Additionally, the notes to Rule 1.1 of the California Rules of Professional Conduct expressly provide that “[t]he duties set forth in this rule include the duty to keep abreast of the changes in the law and its practice, including the benefits and risks associated with relevant technology.” (See Editors’ Note 1, Cal. Rules Prof. Conduct, foll. rule 1.1.) We therefore do not agree that counsel’s failure to educate himself about the limitations of

Counsel also asserts that sanctions are not appropriate because the brief's errors are "isolated" and "[t]he substantive legal authorities remain sound regardless of citation format irregularities." In other words, counsel suggests, his conduct is not sanctionable because *some* of his assertions are supported by accurate legal citations, and other assertions, although misattributed, find support in cases he did not cite. These contentions lack merit. Plainly, counsel's errors are not "isolated." As noted above, nearly *all* of the case quotations in appellant's opening brief and many more from appellant's reply brief are fabricated, and many of the cited cases do not stand for the propositions for which they are cited. These inaccuracies permeate plaintiff's opening and reply briefs. Moreover, "it is not this court's function to serve as [appellant's] backup appellate counsel." (*Mansell v. Board of Administration* (1994) 30 Cal.App.4th 539, 546.) It is counsel's job—*not* this court's—to identify legal authority to support appellant's contentions. The existence of (uncited) cases in support of plaintiff's legal contentions does not excuse the fraudulent case cites.⁸

In short, we conclude that this appeal is frivolous because it "rest[s] on negligible legal foundation" (*Malek, supra*, 58 Cal.App.5th at pp. 834–835) and is peppered with fabricated legal citations. The appeal also unreasonably violates the Rules

the legal tools he relied on makes the imposition of sanctions inappropriate.

⁸ Nor is it correct that plaintiff's "substantive legal arguments [are] sound" notwithstanding the fabricated citations. To the contrary, as we have discussed, plaintiff's appellate contentions are wholly without merit.

of Court because it does not support each point with citations to real (as opposed to fabricated) legal authority. (See Rule 8.204(a)(1)(B).)

C. An award of sanctions is appropriate in this case.

Sanctions may be awarded to the respondent to compensate for the costs of responding to a frivolous appeal, or to the clerk of the court for conduct that unnecessarily burdens the court and the taxpayers. As one court has explained, “ ‘Respondent[s] . . . are not the only parties damaged when an appellant pursues a frivolous claim. Other appellate parties, many of whom wait years for a resolution of bona fide disputes, are prejudiced by the useless diversion of this court’s attention. [Citation.] In the same vein, the appellate system and the taxpayers of this state are damaged by what amounts to a waste of this court’s time and resources. [Citations.] Accordingly, an appropriate measure of sanctions should also compensate the government for its expense in processing, reviewing and deciding a frivolous appeal.’ (*Finnie v. Town of Tiburon* (1988) 199 Cal.App.3d 1, 17.)” (*Kleveland v. Siegel & Wolensky, LLP, supra*, 215 Cal.App.4th at p. 559; see also *Huschke v. Slater, supra*, 168 Cal.App.4th at p. 1161 [quoting *Finnie*]; accord *Foust v. San Jose Construction Co., Inc.* (2011) 198 Cal.App.4th 181, 189–190; *In re Marriage of Gong & Kwong* (2008) 163 Cal.App.4th 510, 519–520.)

Attorney Mostafavi’s fabricated citations and erroneous statements of law have required this court to spend excessive time on this otherwise straightforward appeal to attempt to track down fabricated legal authority and then to research the issues presented without plaintiff’s assistance. We therefore conclude that an award of sanctions payable to the court is appropriate.

In 2013, another appellate court noted that appellate sanctions for frivolous appeals recently had ranged from \$6,000 to \$12,500, “generally, but not exclusively, based on the estimated cost to the court of processing a frivolous appeal.” (*Kleveland, supra*, 215 Cal.App.4th at p. 560, citing *Kim v. Westmoore Partners, Inc.* (2011) 201 Cal.App.4th 267, 294.) The costs of processing a frivolous appeal have undoubtedly increased in the intervening 12 years. Nonetheless, because counsel has represented that his conduct was unintentional, and because he has expressed remorse for his actions, we impose a conservative sanction of \$10,000. Such sanction shall be payable to the clerk of this court within 30 days of the filing of the remittitur. (See *Workman v. Colichman* (2019) 33 Cal.App.5th 1039, 1064–1065 [imposing sanctions of \$8,500]; *Kim*, at p. 294 [imposing sanction of \$10,000]; *DeRose v. Heurlin* (2002) 100 Cal.App.4th 158, 182 [imposing sanction of \$6,000].)⁹ We also direct counsel to serve a copy of this opinion on his client, and direct the clerk of the court to serve a copy of this opinion on the State Bar.

We decline to order sanctions payable to opposing counsel. While we have no doubt that such sanctions would be appropriate in some cases, in the present case respondents did not alert the court to the fabricated citations and appear to have become aware of the issue only when the court issued its order to show cause. Further, although respondents have requested that appellant be ordered to pay “all [respondents’] attorney’s fees and

⁹ This opinion constitutes a written statement of our reasons for imposing sanctions. (*Workman v. Colichman, supra*, 33 Cal.App.5th at p. 1065; *In re Marriage of Flaherty, supra*, 31 Cal.3d at p. 654.)

costs incurred in connection with this appeal,” they have not submitted a declaration attesting to what those fees and costs are.

We conclude by noting that “hallucination” is a particularly apt word to describe the darker consequences of AI. AI hallucinates facts and law to an attorney, who takes them as real and repeats them to a court. This court detected (and rejected) these particular hallucinations. But there are many instances—hopefully not in a judicial setting—where hallucinations are circulated, believed, and become “fact” and “law” in some minds. We all must guard against those instances. As a federal district court recently noted: “There is no room in our court system for the submission of fake, hallucinated case citations, facts, or law. And it is entirely preventable by competent counsel who do their jobs properly and competently.” (*Versant, supra*, 2025 WL 1440351, at *7.)

DISPOSITION

The judgment is affirmed. Attorney Amir Mostafavi is directed to pay \$10,000 in sanctions, payable to the clerk of this court, no later than 30 days after the remittitur is filed. The clerk is directed to deposit this sum into the court's general fund.

Pursuant to Business and Professions Code section 6086.7, subdivision (a)(3), the clerk of the court is ordered to forward a copy of this opinion to the State Bar upon return of the remittitur. Mostafavi is ordered, within 15 days of the issuance of the remittitur, to provide a copy of this opinion to his client and to file a certification in this court that he has done so.

Respondents are awarded their appellate costs.

CERTIFIED FOR PUBLICATION

EDMON, P. J.

We concur:

EGERTON, J.

KLATCHKO, J.*

* Judge of the Superior Court of Riverside County, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION, AT DAYTON

STANDING ORDER GOVERNING CIVIL CASES

Effective as of December 18, 2023

**Notice to counsel: New Requirement for Joint Proposed Final Pretrial
Conference Orders Effective as of December 18, 2023**

Notice to counsel: New AI Provision Effective as of August 27, 2025

Hon. Michael J. Newman
United States District Judge
Walter H. Rice Federal Building & U.S. Courthouse
200 West Second Street, Room 505
Dayton, Ohio 45402
newman_chambers@ohsd.uscourts.gov

Courtroom Deputy/Judicial Assistant:
Claire McDowell
(937) 512-1640
claire_mcdowell@ohsd.uscourts.gov

Court Reporter:
Julie Hohenstein
(937) 512-1639
julie_hohenstein@ohsd.uscourts.gov

TABLE OF CONTENTS

I.	GENERAL PROVISIONS	3
a.	Local Rules	3
b.	Conflicting General Orders	3
II.	PRETRIAL PROCEDURES	3
a.	Preliminary Pretrial Conference	3
b.	Rule 26(f) Conference and Report.....	4
c.	Scheduling Order	6
III.	MAGISTRATE JUDGE PRACTICE	6
a.	Assignment.....	6
b.	Reference	6
c.	Consent.....	7
IV.	DISCOVERY	7
a.	The Discovery Deadline.....	7
b.	Discovery Disputes and Associated Motion Practice	8
c.	Depositions in Lieu of Trial Testimony.....	8
d.	Protective Orders Governing Confidential Information in Discovery	8
e.	Inadvertent Disclosure.....	9
V.	MOTION PRACTICE	9
a.	Memoranda in Support	9
b.	Motion Filing Deadlines	9
c.	Evidence in Support.....	10
d.	Page Limitations and Formatting.....	12
e.	Impact on Court Discovery	12
f.	Hearings and Oral Argument.....	13
g.	Courtesy Copies	13
VI.	ARTIFICIAL INTELLIGENCE (“AI”) PROVISION.....	13
VII.	MEDIATION	14
VIII.	TRIAL, ASSOCIATED CONFERENCES AND DEADLINES	14
a.	Final Pretrial Conference.....	14

b.	Joint Proposed Final Pretrial Order	14
c.	Exhibits	16
d.	Jury Instructions.....	17
e.	Motions <i>in Limine</i>	18
f.	<i>Daubert</i> Motions	19
g.	Depositions.....	19
h.	Trial Briefs.....	20
i.	Courtroom Practice	20
IX.	APPENDICES.....	23

I. GENERAL PROVISIONS

a. Local Rules

The [Local Civil Rules of the United States District Court for the Southern District of Ohio](#), including the *Introductory Statement on Civility*, shall be strictly adhered to by all parties and counsel appearing before the undersigned and will be strictly enforced by the Court. The Court reserves the right to sanction counsel who violate the Local Rules or Civility Statement.

b. Conflicting General Orders

This Standing Order replaces Dayton General Order No. 12-01 for all civil cases assigned to the undersigned. On or after the effective date of this Standing Order, all counsel of record are charged with knowledge of the procedures and requirements contained herein.

II. PRETRIAL PROCEDURES

a. Preliminary Pretrial Conference

The assigned magistrate judge will generally set a pretrial scheduling conference to occur by telephone within 45 days after all parties have appeared in an action.

i. Participation

All *pro se* parties must participate in the preliminary pretrial conference. Parties represented by counsel need only appear at the preliminary pretrial conference through their “trial attorney” (defined in S.D. Ohio Civ. R.

83.4(a)).¹ Co-counsel for any party may also participate in the preliminary pretrial conference, but a party's "trial attorney" is required to participate.

ii. Subject Matter

During the preliminary pretrial conference, the assigned magistrate judge will discuss the contents of the Rule 26(f) report, including the dates and deadlines proposed by the parties; the parties' discovery plan; the need for issuance of a protective order governing the exchange of confidential information; the status of settlement negotiations; and whether the parties seek to engage in mediation or other alternative dispute resolution ("ADR") mechanism.

b. Rule 26(f) Conference and Report

Prior to the preliminary pretrial conference, the parties shall confer as required by Fed. R. Civ. P. 26(f) and jointly prepare a Rule 26(f) report for filing.

i. Trial Date

Trial in a civil case will generally not be set to commence any sooner than 5 months after the dispositive motion deadline.

¹ "Unless otherwise ordered, in all actions filed in, transferred to, or removed to this Court, all parties other than *pro se* parties must be represented at all times by a 'trial attorney' who is a permanent member in good standing of the bar of this Court. Each filing made on behalf of such parties shall identify and be signed by the trial attorney. The trial attorney shall attend all hearings, conferences, and the trial itself unless excused by the Court from doing so. Admission *pro hac vice* does not entitle an attorney to appear as a party's trial attorney, but the Court may, in its discretion and upon motion that shows good cause, permit an attorney who has been so admitted to act as a trial attorney." S.D. Ohio Civ. R. 83.4(a).

ii. Discovery Plan

In formulating a discovery plan, the parties shall consider the need for a protective order governing the exchange and use of confidential information during the discovery phase of the case.

iii. Filing

The Rule 26(f) report of the parties shall be filed at least 7 days prior to the date of the pretrial scheduling conference.

iv. Binding Nature of the Rule 26(f) report

In the absence of objection by any party, the Court will generally adopt in a Scheduling Order the following deadlines jointly proposed by the parties in the Rule 26(f) report: amending the pleadings; adding/joining additional parties; filing motions directed to the pleadings (*i.e.*, motions to dismiss or for judgment on the pleadings); disclosing lay and expert witnesses; completing discovery; and filing dispositive motions. Unless otherwise stated in the Court's Scheduling Order, the dates jointly proposed by the parties in the Rule 26(f) report shall govern the action and the parties are bound by the discovery plan and other agreements set forth in the Rule 26(f) report.

v. Form

A form Rule 26(f) report is attached in Appendix A to this Standing Order.

c. Scheduling Order

A Scheduling Order will promptly issue after the preliminary pretrial conference and shall, upon issuance, govern the case. No deadline set in the Scheduling Order shall be extended, amended, or continued in the absence of a Court Order issued upon good cause shown. In other words, even if all parties agree, a Court Order is nevertheless required to extend, amend, or continue any deadline set in the Scheduling Order. To seek amendment of deadlines, counsel or *pro se* litigants must file a motion to amend and comply with all provisions of the Local Rules. *See* S.D. Ohio Civ. R. 7.2 and 7.3.

III. MAGISTRATE JUDGE PRACTICE

a. Assignment

All civil cases, upon filing, are assigned by the Clerk to a district judge and a magistrate judge.

b. Reference

All civil cases assigned to the undersigned, upon filing, are hereby referred by this Standing Order to a magistrate judge pursuant to 28 U.S.C. §§ 636(b)(1)(A), (B), and (C) and § 636(b)(3). Unless otherwise ordered,² the magistrate judge is authorized to perform any and all functions authorized for full-time United States

² Certain categories of cases are referred to the United States magistrate judge to perform any and all functions authorized for full-time magistrate judges by statute. *See* **Dayton General Order, No. 22-01 (S.D. Ohio Jan. 28, 2022)**. These cases include, *inter alia*, IRS summonses, government loans, Miller Act cases, *pro se* cases, post-conviction relief matters, Social Security disability appeals, and all post-judgment proceedings in aid of execution. *Id.* In addition, other cases may be referred for full disposition upon the unanimous consent of the parties. *See* 28 U.S.C. § 636(c); *see also infra* § III(c).

magistrate judges by statute except that, unless specifically ordered, the following motions are not referred, regardless of when they may be filed: (1) motions for temporary restraining order or preliminary injunction; (2) motions to dismiss, for judgment on the pleadings, or for summary judgment; (3) motions for class certification; (4) motions *in limine*; and (5) motions for default judgment.

c. Consent

A United States magistrate judge of this court is available to conduct all proceedings in a civil action (including a jury or nonjury trial) and to order the entry of a final judgment (a judgment that may then be appealed directly to the United States Court of Appeals for the Sixth Circuit). A magistrate judge may exercise this authority only if all parties voluntarily consent. You may consent to have your case referred to a magistrate judge, or you may withhold your consent without adverse substantive consequences. *Pro se* litigants and counsel may consent at any time during the litigation so long as trial has not yet begun.

If all parties consent to the jurisdiction of the magistrate judge, they shall so advise the Clerk of Court by signing and jointly submitting to the Clerk [Form AO 85](#), which is attached to this Standing Order at Appendix B.

IV. DISCOVERY

a. The Discovery Deadline

No discovery from any source shall be requested or received, or any depositions occur, after the discovery deadline. All discovery must be completed, not just requested, by the discovery deadline. For such discovery to occur, the requesting

party must seek leave of court to amend the discovery deadline for that limited purpose. The Court may disregard -- on summary judgment, at trial, or otherwise -- any information or documents obtained, received, or produced after the discovery deadline.

b. Discovery Disputes and Associated Motion Practice

The parties may jointly request an informal discovery dispute conference with the assigned magistrate judge only after exhausting all extrajudicial means³ to resolve the dispute. *See* S.D. Ohio Civ. R. 37.1. In the absence of extraordinary circumstances, no discovery motion -- such as a motion to compel or a motion for a protective order (except for a joint motion for entry of a proposed protective order) -- shall be filed in a case assigned to the undersigned until the parties have participated in an informal discovery dispute conference as set forth in S.D. Ohio Civ. R. 37.1.

c. Depositions in Lieu of Trial Testimony

After the discovery deadline, a party may take a deposition for use at trial in lieu of live testimony only if leave of court is granted.

d. Protective Orders Governing Confidential Information in Discovery

Where the parties believe that a protective order is needed to govern the exchange and use of confidential information during the discovery phase of the case, the parties shall confer to negotiate the terms of such an order for the Court's approval.

³ The undersigned interprets the phrase "all extrajudicial means" to require both telephonic and written communication between the parties.

To obtain Court approval, the parties shall jointly file a motion for the entry a joint protective order and attach the joint proposed protective order thereto. In addition, the parties shall email the joint proposed protective order to the undersigned's chambers and the chambers of the assigned magistrate judge. In negotiating the terms of the protective order, the parties shall be familiar with Sixth Circuit case law, including *Shane Group, Inc. v. Blue Cross Blue Shield of Mich.*, 825 F.3d 299 (6th Cir. 2016). Form protective orders are available on the Court's [website](#).

e. Inadvertent Disclosure

Pursuant to Evidence Rule 502(d), an inadvertent disclosure of a communication or information covered by the attorney-client privilege or work-product protection made in connection with this litigation shall not constitute a waiver of that privilege or protection in this or any other federal or state proceeding.

V. MOTION PRACTICE

a. Memoranda in Support

Memoranda in support of a motion shall be appended directly to the motion and shall not be filed separately on the Court's CM/ECF docketing system.

b. Motion Filing Deadlines

Motions filed under Fed. R. Civ. P. 12 and 56 before the undersigned shall be briefed in the following manner: Plaintiff's memorandum in opposition is due within 21 days of the filing of the motion to dismiss; the movant's reply memorandum is due within 14 days of the filing of the opposition memorandum. All other motion, unless otherwise ordered, shall follow the same timeline.

c. Evidence in Support

The Court prefers that, to the extent practicable, all evidence used in support of a motion shall be filed on the Court's CM/ECF system before the motion is filed. Citations to evidence shall reference the case-specific document number and PageID number (*e.g.*, Doc. No. 50 at PageID 123) where the evidence cited is located within the record.

i. Depositions

Deposition transcripts referred to or relied upon in support of or in opposition to a motion shall be filed with the Court. When filing deposition transcripts, the parties shall file the full transcript in a condensed format. All deposition transcripts filed with the Clerk must include a signature page and statement of changes in form or substance made by the witness pursuant to Fed. R. Civ. P. 30(e) and the certificate described in Fed. R. Civ. P. 30(f).

ii. Confidential Information as Evidence

Except where impractical to do so, a party seeking to support a motion with information deemed "confidential" or otherwise protected by the terms of a protective order must, sufficiently in advance of date upon which the party seeks to file such information with the Court, confer with the party or parties designating the information confidential or otherwise protected by the terms of a protective order to determine whether it is appropriate to file a motion for leave to file that information under seal.

iii. Filing Evidence Under Seal

Leave of court is required before a party may file evidence on the Court's docket under seal. This includes information deemed "confidential" or otherwise protected by the terms of a protective order. When moving for leave to file information under seal, the moving party shall be familiar with the standards set by the Sixth Circuit, including *Shane Group*. The Court anticipates that motions for leave to file documents under seal will be accompanied by: (1) a memorandum explaining, with legal citations, why the proposed seal is no broader than necessary; and (2) an affidavit demonstrating compliance with *Shane Group* and its progeny.

Any Order denying a motion to seal or denying a motion for continued sealing will be stayed for a period of 14 days after entry of the Order during which an appropriate appeal from the Order may be filed or during which all or part of the material filed under seal may be withdrawn before it becomes a part of the public record. If an appeal is filed, the subject Order will remain stayed until the appeal is determined and, if the Order is affirmed, in whole or in part, the Order will remain stayed for an additional 14 days after the entry of the appellate ruling during which all or part of the material filed under seal may be withdrawn before it becomes a part of the public record.

iv. The Same Evidence Should be Filed Once

To the extent practicable, the parties should refrain from filing the same evidence multiple times on the Court's docket. For example, if the

transcript of a deposition is filed as Document #20 on the docket in support of a motion to compel, that same deposition should not be separately filed again to support a later-filed motion for summary judgment; instead, the party should simply cite Doc. 20 and the appropriate PageID in the motion for summary judgment. Similarly, if defendant cites a contract governing the relationship between the parties and files such contract as an exhibit in support of a motion for summary judgment, plaintiff should not again file the same contract as an exhibit to the memorandum in opposition; instead, plaintiff should simply cite to the contract filed by defendant.

d. Page Limitations and Formatting

While the Court prefers that memoranda not exceed the 20-page limitation set forth in S.D. Ohio Civ. R. 7.2(a)(4), leave of court is not required to file a memorandum exceeding that page limitation. However, parties filing memoranda exceeding 20 pages in length shall comply with all other requirements of S.D. Ohio Civ. R. 7.2(a)(4).

All briefs and memoranda shall comport with the following specifications: (1) one-inch margins on all sides; (2) main body of the text in 12-point, Times New Roman font; (3) footnote text in at least 10-point font in the same typeface as the main body of the text; and (4) citations in the main body of the text, not footnotes.

e. Impact on Court Discovery

Unless otherwise expressly ordered by the Court, discovery is not stayed, extended, continued, or tolled by the filing of any motion or while any dispositive motion

remains pending on the docket awaiting decision. For example: the filing of a motion for judgment on the pleadings or the pendency of a motion to dismiss does not stay or toll the discovery deadline pending a decision on the motion.

f. Hearings and Oral Argument

Unless required by law or otherwise ordered by the Court, all motions will be decided on the parties' written submissions filed in accordance with S.D. Ohio Civ. R. 7.2. The parties may request oral argument or a hearing on any motion by following the procedure set forth in S.D. Ohio Civ. R. 7.1(b).

g. Courtesy Copies

Unless requested by the Court, the parties need not provide the Court with courtesy copies of any motion or memorandum.

VI. ARTIFICIAL INTELLIGENCE (“AI”) PROVISION

No attorney for a party, or a *pro se* party, may use Artificial Intelligence (“AI”) in the preparation of any filing submitted to the Court. Parties and their counsel who violate this AI ban may face sanctions including, *inter alia*, striking the pleading from the record, the imposition of economic sanctions or contempt, and dismissal of the lawsuit. The Court does not intend this AI ban to apply to information gathered from legal search engines, such as Westlaw or LexisNexis, Internet search engines, such as Google or Bing, or Microsoft Suite products or the equivalent, such as Word. All parties and their counsel have a duty to immediately inform the Court if they discover the use of AI in any document filed in their case or an opponent's case. The purpose of this provision is not to prevent parties from using

AI tools, such as legal search engines or Microsoft Suite products but, rather, to prevent counsel and *pro se* parties from citing false, misleading and/or hallucinated cases and law.

VII. MEDIATION

Mediations are conducted by the Dayton magistrate judge not otherwise assigned to the case. To schedule a mediation, counsel should contact Judge Newman's Courtroom Deputy directly, not the magistrate judge's chambers.

VIII. TRIAL, ASSOCIATED CONFERENCES AND DEADLINES

a. Final Pretrial Conference

The date for the final pretrial conference will generally be set forth in the Scheduling Order issued at the outset of the case and will typically occur approximately 14 days or more prior to trial. The trial attorney and all co-counsel who intend to participate at trial shall attend the final pretrial conference. The Court reserves the right to bar from trial all counsel who fail to attend the final pretrial conference in person.

b. Joint Proposed Final Pretrial Order

No later than 7 days before the final pretrial conference, the parties shall file a joint proposed final pretrial order using the form attached hereto in Appendix C. A copy of the joint proposed final pretrial order shall also be emailed to the undersigned's chambers.

i. Procedures for Preparing the Joint Proposed Final Pretrial Order

During the parties' preparation of the joint proposed final pretrial order, counsel shall discuss and agree to the maximum number of trial days it will take to submit the case to the jury or, in bench trials, to the Court. In the event the Court has bifurcated any claims or issues, counsel shall discuss and agree to the maximum number of trial days it will take to submit each bifurcated stage of the case to the jury or, in bench trials, to the Court. Absent extraordinary circumstances or a showing of substantial prejudice, trial will not last longer than the maximum number of days agreed to by the parties in the Joint Final Pretrial Order.

Unless otherwise ordered by the Court or agreed to by the parties, the following procedure applies to the parties' preparation of the joint proposed final pretrial order:

1. Plaintiff shall prepare and deliver to each defendant a first draft of the joint proposed final pretrial order no later than 14 days prior to the filing deadline (without the information which is within the knowledge of defendants, such as lists of witnesses, exhibits, etc.);
2. Defendant must add all information necessary to complete a second draft of the joint proposed final pretrial order, clearly delineating the text which has been changed or added, and deliver the second draft to plaintiff(s) no later than 7 days prior to the filing deadline;
3. Following delivery of the second draft of the joint proposed final pretrial order, the parties shall confer and, thereafter, file and submit the joint proposed final pretrial order to the Court as set forth above.

ii. Sanctions

Failure to timely file the joint proposed final pretrial order as required may result in the continuance of the final pretrial conference and trial. Further,

the failure to timely file the joint proposed final pretrial order may result in the issuance of sanctions, including the dismissal of a case for failure to prosecute.

iii. Entry of the Final Pretrial Order

Following the final pretrial conference, the Court will promptly enter the final pretrial order with any changes thereto on the Court's docket.

c. Exhibits

Exhibits shall be marked with sequential numerals as follows: joint exhibits shall be designated by its sequential number, e.g., JX1, JX2. Plaintiff's exhibits shall be designated PX followed by its sequential number, e.g., PX1, PX2. Defendant's exhibits shall be designated DX followed by its alphabetically sequential letter e.g., DXA, DXB. In cases involving multiple plaintiffs and/or defendants, questions regarding how to properly mark exhibits will be discussed during the final pretrial conference

i. Exchange Between the Parties

Unless otherwise ordered, all exhibits shall be marked and copies of such delivered to all other parties no later than 3 business days before the final pretrial conference.

ii. Court Copies

A hard copy of all exhibits shall be provided to the undersigned's Courtroom Deputy at least 3 business days prior to trial. To the extent

possible, an electronic copy of all exhibits shall also be provided to the Court. If the parties are unable to provide the Court with electronic copies, 2 additional hard copies must be given to the undersigned's Courtroom Deputy at the time set forth above.

iii. Demonstratives

Sketches, models, diagrams, videos, PowerPoints, or any other demonstrative exhibit that will be used at trial for any purpose must be exhibited to all other parties no later than the final pretrial conference.

iv. Display of Exhibits at Trial

Unless admitted into evidence, no exhibit can be displayed to the jury without Court approval.

v. Admission into Evidence

The admissibility of all exhibits referred to during trial and offered by the parties, other than those examined by the jury, will be ruled upon by the Court, at the latest, prior to that party's resting. Either side may offer any marked exhibit, regardless of which party marked it. There is no requirement that counsel object to any exhibit at the final pretrial conference.

d. Jury Instructions

Proposed jury instructions and verdict forms must be filed 7 days or more before the final pretrial conference. In addition, a Word version of each parties' proposed jury instructions shall be emailed to chambers at

newman_chambers@ohsd.uscourts.gov. As filed, they shall be formatted so that each instruction can be printed on a separate 8.5" x 11" sheet of paper identified as "Plaintiff(s) (Defendant(s)) Requested Instruction No. ____." Each instruction must contain a citation of authority upon which counsel relies.

i. Citation to Authority

The Court uses as sources for its instructions O'Malley, Grenig, and Lee's FEDERAL JURY PRACTICE AND INSTRUCTIONS; OHIO JURY INSTRUCTIONS; the Sixth Circuit Pattern Jury Instructions; Pattern Instructions from other circuit courts; and instructions given in prior cases of a similar nature.

ii. Agreed Statement of the Case

The parties are required to confer and submit an agreed statement of the case to the undersigned's chambers via email (newman_chambers@ohsd.uscourts.gov) 7 days or more before trial.

e. Motions *in Limine*

Unless otherwise ordered, all motions *in limine*, directed to the presentation of evidence at trial, must be filed not later than 14 days prior to the final pretrial conference. Memoranda in opposition to motions *in limine* shall be filed no later than 7 days prior to the final pretrial conference. The failure to file a motion *in limine* does not waive any argument regarding the admissibility of evidence at trial.

f. *Daubert* Motions

The parties are encouraged to file *Daubert* motions simultaneously to their motions for summary judgment. If so filed, the opposing party will have 21 days to respond. No replies are permitted without leave of Court.

Any motion *in limine* addressed to the admissibility of expert testimony under *Daubert*, if not included in a previously filed motion for summary judgment, must be filed at least 30 days before the Final Pretrial Conference. Responses to such motions must be filed no later than 23 days before the Final Pretrial Conference. No replies are permitted without leave of Court.

g. Depositions

Counsel will specify in the joint proposed final pretrial order those portions of any deposition which will be read or played at trial in lieu of live testimony. The deposition itself must be filed with the Clerk not later than the date of the final pretrial conference. Opposing counsel will note objections to any portion of the deposition in advance of the trial, and the Court will rule on the objections either prior to the commencement of the trial or, at the latest, prior to the reading or playing of the deposition in open court.

Video presentations must include a method for cutting off either sound or the entire picture from the jury in situations where the Court must rule on objections to testimony. In addition to the video record itself, a typewritten transcript must be

provided to the Court and opposing counsel as an aid in following the videotape presentation and in ruling upon any objections.

Any deposition to be used solely for impeachment must be filed with the Clerk prior to the final pretrial conference.

h. Trial Briefs

Trial briefs, if desired by counsel or ordered by the Court, must be filed and served 7 days or more before trial. All briefs shall comply with S. D. Ohio Civ. R. 5.1, with citations and references conforming to S. D. Ohio Civ. R. 7.2(b) and the style requirements for memoranda set forth in this General Order. Counsel should use their trial briefs to instruct the Court in advance of trial in any area of law upon which counsel will rely at trial. Therefore, the briefs should contain arguments, with citations to legal authority, in support of any evidentiary or other legal questions which may reasonably be anticipated to arise at trial.

i. Courtroom Practice

Conduct of counsel during the trial of cases will be governed by the following:

i. Counsel Tables

The plaintiff in all civil cases, and the United States Government in criminal cases, will occupy the counsel table nearest the jury. Defendants in both civil and criminal cases will occupy the counsel table furthest from the jury.

ii. Court Sessions

Trials will usually start at 9:00 a.m. The morning session will continue until approximately noon. There will be a morning recess of approximately 15

minutes at an approximately 10:30 a.m. The afternoon session will start one hour after the end of the morning session unless otherwise announced. The afternoon session will usually end at approximately 4:30 p.m. A recess of 15 minutes will occur at approximately 3 p.m. It is expected that the parties and all counsel will be available at least 15-20 minutes prior to the beginning of the morning and afternoon sessions.

iii. *Voir Dire*

For *voir dire*, the Court will generally ask initial questions of the entire panel first and will then allow counsel for the parties to ask follow-up questions.⁴ Following questioning, the Court will entertain “for cause” challenges and peremptory challenges. The parties shall each have 3 peremptory challenges and may request additional peremptory challenges during the final pretrial conference.

iv. *Size of the Jury*

The Court will seat a jury of 8 in civil cases with a requirement of unanimity, unless otherwise ordered in the final pretrial order.

v. *Courtroom Demeanor*

Counsel should consult with Judge Newman at the final pretrial conference regarding the judge’s preference as to requesting permission to approach a witness.

⁴ For a list of sample questions, see *infra* Appendix D.

Presenting Exhibits to Witnesses. Since all evidence will have been previously deposited with the Courtroom Deputy, counsel should request the Courtroom Deputy to hand specific documents to the witness. Documents intended for impeachment purposes which are not admitted into evidence will be handed to the Courtroom Deputy for suitable marking and then handed to the witness.

Comments by Counsel. Counsel should address any comments to the Court and not to opposing counsel.

Objections. Counsel shall not make speaking objections and are not to argue objections in the hearing of the jury.

vi. Jury Charge Conference

The Court will hold a conference with counsel, in chambers and on the record, prior to the final argument in jury cases for the following purposes (1) counsel may be heard on proposed jury charges presented by either side and/or on the tentative charges submitted by the Court (counsel's attention is directed to Fed. R. Civ. P. 51); and (2) the Court will determine the length of the summations to the jury.

IT IS SO ORDERED.

December 14, 2023

s/Michael J. Newman
Hon. Michael J. Newman
United States District Judge

IX. APPENDICES

The following forms are available for the parties to use throughout the course of litigation:

1. Appendix A: Fed. R. Civ. P. 26(f) Order
2. Appendix B: Form AO85 for Unanimous Consent to Magistrate Judge Jurisdiction
3. Appendix C: Joint Proposed Final Pretrial Order
4. Appendix D: Sample Voir Dire Questions

Appendix A

Appendix B

UNITED STATES DISTRICT COURT

for the

_____)	
<i>Plaintiff</i>)	
v.)	Civil Action No. _____
_____)	
<i>Defendant</i>)	

NOTICE, CONSENT, AND REFERENCE OF A CIVIL ACTION TO A MAGISTRATE JUDGE

Notice of a magistrate judge's availability. A United States magistrate judge of this court is available to conduct all proceedings in this civil action (including a jury or nonjury trial) and to order the entry of a final judgment. The judgment may then be appealed directly to the United States court of appeals like any other judgment of this court. A magistrate judge may exercise this authority only if all parties voluntarily consent.

You may consent to have your case referred to a magistrate judge, or you may withhold your consent without adverse substantive consequences. The name of any party withholding consent will not be revealed to any judge who may otherwise be involved with your case.

Consent to a magistrate judge's authority. The following parties consent to have a United States magistrate judge conduct all proceedings in this case including trial, the entry of final judgment, and all post-trial proceedings.

<i>Printed names of parties and attorneys</i>	<i>Signatures of parties or attorneys</i>	<i>Dates</i>
_____	_____	_____
_____	_____	_____
_____	_____	_____

Reference Order

IT IS ORDERED: This case is referred to a United States magistrate judge to conduct all proceedings and order the entry of a final judgment in accordance with 28 U.S.C. § 636(c) and Fed. R. Civ. P. 73.

Date: _____

District Judge's signature

Printed name and title

Note: Return this form to the clerk of court only if you are consenting to the exercise of jurisdiction by a United States

magistrate judge. Do not return this form to a judge.

Print

Save As...

Appendix C

**j. IN THE UNITED STATES DISTRICT
COURT FOR THE SOUTHERN DISTRICT
OF OHIO WESTERN DIVISION AT
DAYTON**

Plaintiff(s)

vs.
District Judge Michael J. Newman

Case Number: _____

Defendant(s).

k. FINAL PRETRIAL ORDER

(A proposed final pretrial order following this form must be jointly prepared and filed not later than the date set forth in the Preliminary Pretrial Conference Order.)

This action came before the Court at a final pretrial conference held on _____
at _____ a.m./p.m., pursuant to Rule 16, Federal Rules of Civil Procedure.

I. APPEARANCES:

For Plaintiff(s):

For Defendant(s):

II. NATURE OF ACTION AND JURISDICTION:

A. This is an action for

B. The jurisdiction of the Court is invoked under Title _____ United States Code,
Section _____.

C. The subject matter jurisdiction of the Court (is) (is not) disputed. [If disputed,
state by which party and on what basis.]

III. TRIAL INFORMATION:

A. The parties' agree that the maximum number trial days is _____.

B. Trial to _____ has been set for _____.

IV. AGREED STATEMENTS AND LISTS:

A. General Nature of the Claims of the Parties:

(1) PLAINTIFF CLAIMS: (suggested type of simple language)

“Plaintiff asserts in Count 1 a right of recovery for defendants’ negligence as follows:

“Plaintiff asserts in Count 2 a right of recovery for defendants’ wanton and willful misconduct as follows:

“Plaintiff asserts in Count 3 a right to punitive damages and attorney fees for the following reasons:

(2) DEFENDANT CLAIMS: (suggested type of simple language)

Defendant denies liability as asserted in Counts _____ for the following reasons:

Defendant as an affirmative defense asserts:

(3) ALL OTHER PARTIES’ CLAIMS:

B. Uncontroverted Facts

Suggested Language:

“The following facts are established by admissions in the pleadings or by stipulations of counsel (set forth and number uncontroverted or uncontested facts.)

C. Issues of Fact and Law

Suggested Language:

(1) “CONTESTED ISSUES OF FACT: The contested issues of fact remaining for decision are: (list)”

(2) “CONTESTED ISSUES OF LAW: The contested issues of law in addition to those implicit in the foregoing issues of fact, are: (set forth)

OR: There are no special issues of law reserved other than those implicit in the foregoing issues of fact.”

If the parties are unable to agree on what the contested issues of fact or law are, their respective contentions as to what the issues are shall be set forth separately and clearly labeled.

D. Witnesses

Suggested Language:

(1) “Plaintiff will call or will have available for testimony at trial those witnesses listed in Appendix A hereof.”

(2) “Defendant will call or will have available for testimony at trial those Witnesses listed on Appendix B hereof.”

(3) _____ will call or will have available for testimony at trial those witnesses listed on Appendix C hereof.”

(4) “The parties reserve the right to call rebuttal witnesses whose testimony could not reasonably be anticipated without prior notice to opposing counsel.”

I. INSTRUCTIONS:

(1) A brief one or two sentence synopsis of the witnesses’ testimony must be given -- i.e., “Will testify to pain and suffering,” “Will testify to lost profits, *etc.*”

(2) Leave to call additional witnesses may be granted by the Court in unusual situations on motion with names, addresses, and an offer of proof of such witness’ testimony within twenty-four hours after the need to call such witness becomes known.

(3) The witnesses need not be called in the order listed, but the witnesses to be called on the succeeding day shall be disclosed to opposing counsel not later than the end of trial each day, unless otherwise ordered.

E. Expert Witnesses

Suggested Language:

“Parties are limited to the following number of expert witnesses, including treating physicians, whose names have been disclosed and reports furnished to the other side: Plaintiff (a) Defendant(s)

F. Exhibits

The parties will offer as exhibits those items listed herein and numbered with Arabic numerals as follows:

- (1) Joint Exhibits -- Appendix D (marked “JX_____”)
- (2) Plaintiff Exhibits Appendix E (marked “PX_____”)
- (3) Defendant Exhibits Appendix F (marked “DX_____”)
- (4) Third-Party Exhibits -- appendix G (use Arabic numerals prefixed by initial of party.

m. INSTRUCTIONS:

The above exhibits will be deposited with the Court’s Deputy Clerk not later than 4:00 p.m. on the third working day prior to trial.

G. Depositions

Suggested Language:

“Testimony of the following witnesses will be offered by deposition (read or videorecorded)”; OR “No testimony will be offered by deposition”

H. Discovery

Suggested Language:

“Discovery has been completed” OR

“The following provisions have been made for discovery.”

I. Pending Motions

Suggested Language:

“The following motions are pending at this time” OR “There are no pending motions at this time.”

J. Miscellaneous orders

INSTRUCTIONS: Set forth any orders not properly includable elsewhere.

V. MODIFICATION

Suggested Language:

“This final pretrial order may be modified at the trial of this action, or prior thereto, to prevent manifest injustice. Such modification may be made by application of counsel, or on motion of the Court.”

VI. SETTLEMENT EFFORTS

Suggested Language:

“The parties have made a good faith effort to negotiate a settlement,” or otherwise describe the status of settlement negotiations.

VII. TRIAL TO A JURY

PROPOSED INSTRUCTIONS ---

Suggested Language:

“The parties have submitted proposed jury instructions as required by Judge Michael J. Newman’s Standing Order Governing Civil Cases.”

Counsel for Plaintiff(s):

Counsel for Defendant(s):

Approved following Final Pretrial Conference:

Hon. Michael J. Newman United
States District Judge

Appendix D

VOIR DIRE QUESTIONS BY THE COURT

The Court will first conduct a preliminary examination, typically using questions such as the following. After the Court has finished its examination of the jury panel, counsel may elect to supplement the Court's examination with questions that do not repeat, in substance, any question the Court already has put to the panel.

1. I am now going to read the names of the parties and the witnesses that you may be hearing from in this case. Please listen to the list carefully as I will be asking you whether you know any of these people.

First, as I just told you, the Plaintiff is represented by _____. Seated at the counsel table with _____ is _____.

At the next table is the Defendant in this case _____. He [or she] is represented by _____ of _____.

The Plaintiff may call the following persons as witnesses:

The Defendant in this case may call the following persons as witnesses:

Is any panel member related by blood or marriage to any of the individuals that I have just named?

Are you personally acquainted with these persons, or do you have any knowledge of them, directly or indirectly, through your social, business, or professional lives?

2. Has any panel member ever heard of or been involved with any of the following entities or persons: [List any businesses or non-witness entities that will be important in this case.] Are any of these names familiar to any panel member?
3. **OUTLINE THE COUNTS IN THE COMPLAINT**

Does any panel member have prior knowledge or information about the allegation(s) made against the Defendant(s), which I have just explained to you? This includes knowledge gained from personal contacts or from the media.

Follow-up Questions for Any Affirmative Responses:

- i. From what source did you hear about this case (newspaper, TV, radio, conversation with others)?
 - ii. How many times did you hear or read about it?
 - iii. Do you remember specifically what you heard or read?
 - iv. Did what you heard or read cause you to have any feeling concerning the merits of the parties' claims?
 - v. Did what you heard or read cause you to have a favorable or an unfavorable impression concerning the parties?
 - vi. Do you today have any impression or even tentative opinion as to the probable outcome of this case?
4. Does any panel member have any personal interest of any kind in this case, or in the Defendant(s)?

5. If any panel member has served as a juror in the federal or state court -- either in a civil or criminal case -- and regardless of the outcome of such case(s), would your prior experience have any effect or influence on your ability to serve as a fair and impartial juror in this case?
6. Does any panel member have any feeling -- thought -- inclination -- premonition -- prejudice -- religious belief or persuasion -- or bias -- which might influence or interfere with your full and impartial consideration and which might influence you either in favor of or against either the Plaintiff or Defendant?
7. Is there any reason in your mind why you cannot hear and consider the evidence and render a fair and impartial verdict?
8. Can you take the law as the Court instructs you, without any reservation whatsoever, and apply the facts to the Court's instructions on the law? If you cannot do this, please hold up your hand.
9. Do you recognize and accept the proposition that jurors are the sole judge of the facts and the Court is the sole judge of the law? If you cannot do this, please hold up your hand.
10. Has any panel member formed or expressed any opinion as to the liability of the Defendant(s)?
11. Does any panel member have:
 - a. Any transportation problem? For example, does anyone have difficulty getting to or from the courthouse?
 - b. Any medical or disability problems, such as difficulty hearing, walking or seeing? Does any other medical problem exist which could affect your service on the jury?
12. The Court and counsel estimate this trial will last ____ days. Does any panel member have any immediate family or personal reason or situation which persuades you that you cannot serve as a juror during this period and give your undivided attention to this case?

Finally, can any of you think of any matter that you should call to the Court's attention that may have some bearing on your qualifications as a juror, or that -- even to the slightest degree -- may prevent your rendering a fair and impartial verdict based solely upon the evidence and my instructions as to the law?



STANDING ORDER GOVERNING THE USE OF GENERATIVE ARTIFICIAL INTELLIGENCE

With increasing frequency, litigants are relying on text-generation software powered by Artificial Intelligence ("AI") to prepare motions and other papers. This has prompted concern regarding the reliability and accuracy of filings in this Court. These generative AI platforms include, but are not limited to, ChatGPT, Google Gemini, and Harvey.ai.

Rule 11(b) of the Federal Rules of Civil Procedure provides that by submitting a motion, brief, pleading or other filing to the Court, an attorney or self-represented litigant certifies that their claims, defenses, and other legal contentions are warranted by existing law and that their factual contentions find evidentiary support. Notwithstanding this rule, litigants in this Court have submitted filings that include citations to non-existent cases or arguments and citations not warranted by existing law.

Thus, to guard against the use of generative AI in a manner that contravenes Rule 11, it is hereby **ORDERED** that any party, including any self-represented litigant, who uses generative AI to generate any portion of a motion, brief, pleading or other filing must attach to the filing a separate declaration disclosing the use of generative AI. In this declaration, the attorney or self-represented litigant must certify that he or she has reviewed the relevant source material and has verified that all submissions to the Court are accurate, and that the individual has otherwise complied with his or her Rule 11 obligations. This declaration should be captioned: "Disclosure and Verification of Use of Generative AI."

Any attorney or self-represented litigant who signs a motion, brief, pleading or other filing submitted to the Court will be held responsible for the contents of that filing under Rule 11, regardless of whether that individual used generative AI to generate any portion of that filing. Failure to comply with Rule 11(b) may result in sanctions. *See* Fed. R. Civ. P. 11(c).

IT IS SO ORDERED.

August 20, 2025


Jeffery P. Hopkins
United States District Judge

Excerpt from the May 15, 2025 Report of the Advisory Committee on Evidence Rules

**COMMITTEE ON RULES OF PRACTICE AND PROCEDURE
OF THE
JUDICIAL CONFERENCE OF THE UNITED STATES
WASHINGTON, D.C. 20544**

JOHN D. BATES
CHAIR

CAROLYN A. DUBAY
SECRETARY

CHAIRS OF ADVISORY COMMITTEES

ALLISON H. EID
APPELLATE RULES

REBECCA B. CONNELLY
BANKRUPTCY RULES

ROBIN L. ROSENBERG
CIVIL RULES

JAMES C. DEVER III
CRIMINAL RULES

JESSE M. FURMAN
EVIDENCE RULES

MEMORANDUM

TO: Hon. John D. Bates, Chair
Committee on Rules of Practice and Procedure

FROM: Hon. Jesse M. Furman, Chair
Advisory Committee on Evidence Rules

RE: Report of the Advisory Committee on Evidence Rules

DATE: May 15, 2025

I. Introduction

The Advisory Committee on Evidence Rules (the “Committee”) met on May 2, 2025, at the Administrative Office in Washington, D.C. * * * The Committee recommends * * * that two proposed amendments be released for public comment: an amendment to Rule 609 and a new Rule 707 to regulate machine-generated evidence.

* * * * *

II. Action Items

* * * * *

B. Proposed Amendments to Rule 609 for Release for Public Comment

The Committee recommended publication for public comment a modest proposed amendment to Rule 609(a)(1)(B), which currently allows for impeachment of criminal defendant witnesses with convictions not involving dishonesty or false statement if the probative value of the conviction in proving the witness's character for truthfulness outweighs the prejudicial effect. The proposed amendment approved by the Committee would result in the provision becoming somewhat more exclusionary. To be admitted, the probative value of the conviction would have to *substantially* outweigh its prejudicial effect. The amendment is narrower than other suggestions for change made to, and rejected by, the Committee in the last two years, namely a proposal to eliminate Rule 609 entirely and a proposal to delete Rule 609(a)(1), which would have meant that all convictions not involving falsity would be inadmissible to impeach a witness's character for truthfulness.

The Committee concluded that the amendment was warranted because a fair number of courts have misapplied the existing test to admit convictions that are either similar to the crime charged or otherwise inflammatory and because that error is not likely to be remedied through the normal appellate process. That is because the Supreme Court has held that a defendant may appeal an adverse Rule 609 ruling only if he or she takes the stand at trial, so appeals by defendants of adverse Rule 609 rulings are relatively rare.

The amendment, through its slightly more protective balancing test, would promote Congress's intent, which was to provide more protection to criminal defendants so that they would not be unduly deterred from exercising their rights to testify. The Committee believes that the tweak to the applicable balancing test would encourage courts to more carefully assess the probative value and prejudicial effect of convictions that are similar or identical to the crime charged, or that are otherwise inflammatory or less probative because they involve acts of violence. The proposal leaves intact Rule 609(a)(2), which governs admissibility of convictions involving dishonesty or false statement.

In addition, the Committee proposes a slight change to Rule 609(b), which covers older convictions. The rule is triggered when a conviction is over ten years old. That ten-year period begins running from the date of conviction or release from confinement, whichever is later. But the current rule does not specify the end date of the ten-year period. The absence of any guidance in the rule has led courts to apply varying dates, including the date of indictment for the trial at issue, the date that trial begins, and the date that the witness to be impeached actually testifies. The Committee approved a change to Rule 609(b) that would end the ten-year period on the date that the relevant trial begins. The Committee determined that the date of trial is the date that is most easily administered, the least amenable to manipulation, and that it is a proper date for determining the credibility of a witness who is going to testify at the trial.

At its meeting, the Committee, by a vote of 8-1, recommended the proposed amendments to Rule 609 for release for public comment. The Department of Justice voted in favor of the proposal.

The Committee recommends that the proposed amendments to Rule 609, and the accompanying Committee Note—which are attached to this Report—be released for public comment.

C. Proposed New Rule 707 to Regulate Machine-Generated Evidence for Release for Public Comment

For the past three years, the Committee has been researching and investigating whether the existing Evidence Rules are sufficient to assure that evidence created by artificial intelligence (“AI”) will be properly regulated for reliability and authenticity. The Committee has determined that there are two evidentiary challenges raised by AI: (1) evidence that is a product of machine learning, which would be subject to Rule 702 if propounded by witness; and (2) audiovisual evidence that is not authentic because it is a difficult-to-detect deepfake.

At its Fall meeting, the Committee considered proposals to amend the Evidence Rules to regulate machine learning and deepfakes. As to machine learning, the concern is that it might be unreliable, and yet the unreliability will be buried in the program and difficult to detect. The hearsay rule is likely to be inapplicable because the solution to hearsay is cross-examination, and a machine cannot be cross-examined. The Committee determined that the reliability issues attendant to machine output are akin to those raised by experts under Rule 702. Indeed, Rule 702 would be applicable to machine-learning if it was used by a testifying expert to reach her conclusion. But Rule 702 is not clearly applicable if the machine output is admitted without any expert testimony – either directly or by way of a lay witness.

After extensive discussion, the Committee has determined that a new rule of evidence may be appropriate to regulate the admissibility of machine evidence that is introduced without the testimony of any expert. The Committee concluded that amending Rule 702 itself would not be workable, for two reasons: (1) that Rule was just amended in 2023; (2) it is a rule of general applicability, and a separate subdivision dealing with machine evidence would be inappropriately specific and difficult to draft. The Committee’s solution was to draft a new Rule 707 providing that if machine-generated evidence is introduced without an expert witness, and it would be considered expert testimony if presented by a witness, then the standards of Rule 702(a)-(d) are applicable to that output. Examples of such possibilities include machine output analyzing stock trading patterns to establish causation; analysis of digital data to determine whether two works are substantially similar in copyright litigation; and machine learning that assesses the complexity of software programs to determine the likelihood that code was misappropriated. In all these examples, it is possible that the machine output may be offered through a lay witness, or directly with a certification of authenticity under Rule 902(13). The Committee is of the opinion that, in such instances, a showing of reliability must be made akin to that required under Rule 702.

The rule provides that it does not apply to the output of basic scientific instruments, and the Committee Note provides examples of such instruments, such as a mercury-based

Excerpt from the May 15, 2025 Report of the Advisory Committee on Evidence Rules

thermometer, an electronic scale, or a battery-operated digital thermometer. The Committee concluded that such an exception is warranted to avoid litigation over the output of instruments that can be presumed reliable but that, given the wide range of potential instruments and technological change, it is better to leave it to judges to determine whether a particular instrument falls within the exception than to try to be more specific in the rule. The Committee Note also provides that the rule not apply to output that can be judicially noticed as reliable.

The Committee agreed that disclosure issues relating to machine learning would be better addressed in the Civil and Criminal Rules, not the Evidence Rules. General language about the importance of advance notice before offering machine-generated evidence was added to the Committee Note.

At its meeting, the Committee, by a vote of 8-1, recommended the proposal to add a new Rule 707 for release for public comment. The Department of Justice voted against the proposal.

The Committee recommends that the proposed new Rule 707, and the accompanying Committee Note—which are attached to this Report—be released for public comment.

It is important to note that the Committee is not treating release for public comment as a presumption that the rule should be enacted. The Committee believes that it will receive critically important information during the public comment period about the need for this new rule and that it will get input from experts on the kinds of machine-generated information that should be subject to the rule or that should be exempt from the rule. Given the fast-developing field of AI, and the limits of the Committee's expertise on matters of technology, the Committee believes that the best way to obtain the necessary information to support or reject the rule is through public comment—which is sure to be extensive.

* * * * *

**PROPOSED AMENDMENTS TO THE
FEDERAL RULES OF EVIDENCE¹**

1 **Rule 609. Impeachment by Evidence of a Criminal**
2 **Conviction**

3 **(a) In General.** The following rules apply to attacking a
4 witness's character for truthfulness by evidence of a
5 criminal conviction:

6 **(1)** for a crime that, in the convicting jurisdiction,
7 was punishable by death or by imprisonment
8 for more than one year, the evidence:

9 **(A)** must be admitted, subject to Rule
10 403, in a civil case or in a criminal
11 case in which the witness is not a
12 defendant; and

13 **(B)** must be admitted in a criminal case in
14 which the witness is a defendant, if
15 the probative value of the evidence

¹ New material is underlined in red; matter to be omitted is
lined through.

16 substantially outweighs its prejudicial
17 effect to that defendant; and

18 (2) for any crime regardless of the punishment,
19 the evidence must be admitted if the court can
20 readily determine that establishing the
21 elements of the crime required proving—or
22 the witness’s admitting—a dishonest act or
23 false statement.

24 (b) **Limit on Using the Evidence After 10 Years.** This
25 subdivision (b) applies if more than 10 years have
26 passed—~~since~~ between the witness’s conviction or
27 release from confinement for it, ~~(whichever is later)~~
28 and the date that the trial begins. Evidence of the
29 conviction is admissible only if:

30 (1) the probative value, supported by specific
31 facts and circumstances, substantially
32 outweighs its prejudicial effect; and

33 (2) the proponent gives an adverse party
34 reasonable written notice of the intent to use
35 it so that the party has a fair opportunity to
36 contest its use.

37 * * * * *

38 **Committee Note**

39 Rule 609(a)(1)(B) has been amended to provide that
40 a non-falsity-based conviction should not be admissible to
41 impeach a criminal defendant unless its probative value
42 *substantially* outweighs the risk of unfair prejudice to the
43 defendant. Congress allowed such impeachment with non-
44 falsity-based convictions under Rule 609(a)(1), but imposed
45 a reverse balancing test when the witness was the accused.
46 That test is more protective so as not to infringe on the
47 accused's constitutional right to testify. The amendment
48 underscores the importance of applying a protective balance.
49 The amendment also makes the balancing test consistent
50 with that in Rule 703. Courts are familiar with the
51 formulation "substantially outweighs" as the same phrase is
52 used throughout the rules of evidence to describe various
53 balancing tests. Cf. Rule 403.

54 If a conviction is inadmissible under this rule, it is
55 inappropriate to allow a party, under Rule 608(b), to inquire
56 into the specific instances of conduct underlying that
57 conviction. Rule 608 permits impeachment only by specific
58 acts that have not resulted in a criminal conviction. Evidence

59 relating to impeachment by way of criminal conviction is
60 treated exclusively under Rule 609.

61 Nothing in this rule prohibits the use of convictions
62 to impeach by way of contradiction. Such impeachment is
63 governed by Rule 403. So for example, if the witness
64 affirmatively testifies that he has never had anything to do
65 with illegal drugs, a prior drug conviction may be admissible
66 for purposes of contradiction even if not admissible under
67 Rule 609. *See United States v. Castillo*, 181 F.3d 1129 (9th
68 Cir. 1999) (unequivocal denial of involvement with drugs on
69 direct examination warranted admission of the witness's
70 drug activity under Rule 403).

71 A number of courts have, in a kind of compromise,
72 admitted only the fact of a conviction to impeach a defendant
73 in a criminal case. Thus the jury hears only that the
74 defendant was convicted of a felony, not what the crime was.
75 Absent agreement by the parties, that solution is problematic
76 because convictions falling within Rule 609(a)(1) have
77 varying probative value, and admitting only the fact of
78 conviction deprives the jury of the opportunity to properly
79 weigh the conviction's effect on the witness's character for
80 truthfulness.

81 In addition, Rule 609(b) has been amended to set an
82 endpoint by which the rule's 10-year period is to be
83 measured. The lack of such an endpoint in the existing rule
84 has led courts to apply various endpoints, including the date
85 of the charged offense, the date of indictment, the date of
86 trial, and the date the witness testifies. The rule provides for

87 the date that trial begins as the endpoint, as that is a clear and
88 objective date and it is the time at which the factfinder begins
89 to analyze the truthfulness of witnesses.

**PROPOSED AMENDMENTS TO THE
FEDERAL RULES OF EVIDENCE¹**

- 1 **Rule 707. Machine-Generated Evidence**
- 2 When machine-generated evidence is offered without
- 3 an expert witness and would be subject to Rule 702 if
- 4 testified to by a witness, the court may admit the evidence
- 5 only if it satisfies the requirements of Rule 702(a)-(d). This
- 6 rule does not apply to the output of simple scientific
- 7 instruments.

Committee Note

Expert testimony in modern trials increasingly relies on software- or other machine-based conveyances of information. Machine-generated evidence can involve the use of a computer-based process or system to make predictions or draw inferences from existing data. When a machine draws inferences and makes predictions, there are concerns about the reliability of that process, akin to the reliability concerns about expert witnesses. Problems include using the process for purposes that were not intended (function creep); analytical error or incompleteness; inaccuracy or bias built into the underlying data or formulas; and lack of interpretability of the machine's process. Where a testifying expert relies on such a method, that method—and the expert's reliance on it—will be scrutinized under Rule 702. But if machine or software output is presented

¹ New material is underlined in red.

without the accompaniment of a human expert (for example through a witness who applied the program but knows little or nothing about its reliability), Rule 702 is not obviously applicable. Yet it cannot be that a proponent can evade the reliability requirements of Rule 702 by offering machine output directly, where the output would be subject to Rule 702 if rendered as an opinion by a human expert. Therefore, new Rule 707 provides that if machine output is offered without the accompaniment of an expert, and where the output would be treated as expert testimony if coming from a human expert, its admissibility is subject to the requirements of Rule 702(a)-(d).

The rule applies when machine-generated evidence is entered directly, but also when it is accompanied by lay testimony. For example, the technician who enters a question and prints out the answer might have no expertise on the validity of the output. Rule 707 would require the proponent to make the same kind of showing of reliability as would be required when an expert testifies on the basis of machine-generated information.

If the machine output is the equivalent of expert testimony, it is not enough that it is self-authenticated under Rule 902(13). That rule covers authenticity, but does not assure reliability under the preponderance of the evidence standard applicable to expert testimony.

This rule is not intended to encourage parties to opt for machine-generated evidence over live expert witnesses. Indeed the point of this rule is to provide reliability-based protections when a party chooses to proffer machine-generated evidence instead of a live expert.

It is anticipated that a Rule 707 analysis will usually involve the following, among other things:

- Considering whether the inputs into the process are sufficient for purposes of ensuring the validity of the resulting output. For example, the court should consider whether the training data for a machine learning process is sufficiently representative to render an accurate output for the population involved in the case at hand.
- Considering whether the process has been validated in circumstances sufficiently similar to the case at hand.

The final sentence of the rule is intended to give trial courts sufficient latitude to avoid unnecessary litigation over the output from simple scientific instruments that are relied upon in everyday life. Examples might include the results of a mercury-based thermometer, an electronic scale, or a battery-operated digital thermometer. Moreover, the rule does not apply when the court can take judicial notice that the machine output is reliable. *See* Rule 201.

The Rule 702(b) requirement of sufficient facts and data, as applied to machine-generated evidence, should focus on the information entered into the process or system that leads to the output offered into evidence.

Because Rule 707 applies the requirements of admitting expert testimony under Rule 702 to machine-generated output, the notice principles that would be applicable to expert opinions and reports of examinations and tests should be applied to output offered under this rule.



Insights and Practical Steps for Managing Risk in the Age of Artificial Intelligence

This paper has been drafted by practitioners, for practitioners. It outlines early risk management interventions to support successful deployment of Artificial Intelligence in enterprises and will be of interest to anyone seeking to accelerate AI value, safely. The aim of this paper is to take you from 'zero' to 'one' (i.e. from very little governance and risk management in place to a solid initial base).

AlixPartners

BT Group
The BT Group logo graphic, consisting of a series of horizontal bars in purple, yellow, green, and red.

Contents

Accelerating AI value, safely	2
AI risks	3
AI governance and risk management in practice	10
Conclusion	16
Annex 1	18

With special thanks to the AI Governance Lab Co-Chairs:

Janine McKelvey (BT Group) and Tim Roberts (AlixPartners)

The Writing Team

Myrna Macgregor (Ocado), Odvar Bjerkholt (BT Group), Lauren Webb (BT Group), Catherine Brien (AlixPartners) and Antonis Patrikios (Dentons)

Reviewing Team

Julia Bonder Le-Berre (Iron Mountain), Stefano Leucci (Stellantis) and Kirsten Mycroft (BNY)

Accelerating AI value, safely

Artificial Intelligence (AI) refers to machine-based systems that can, for a given set of human-defined objectives, make predictions, recommendations, or decisions influencing real or virtual environments. AI has enormous potential to solve business and societal challenges, for example dramatically improving the accuracy of diverse tasks – from medical diagnoses to fraud prevention. Generative AI's ability to create compelling new content (text, image, video etc.) can also fuel greater productivity, creativity and new user experiences.

Unquestionably, the use of AI creates or amplifies risks and the potential for harm. These risks may be intimidating, but the biggest risk for many businesses is likely to be **missing out on the opportunities that AI creates.**

Each business should have a strategy to identify the most valuable opportunities for leveraging AI. This 'AI Strategy' should be centred within wider business strategy and values. It should also identify where AI can solve problems and deliver positive impact, prioritising what will be most valuable for the business (recognising that AI is not necessarily the right tool for every problem).

AI governance and risk management should be a core part of any AI strategy and will increase the chances of AI success through:

- **Building and/or deploying reliable AI systems:** interventions help build/deploy robust and sustainable AI systems that work as intended and mitigate risks. This avoids costly mistakes and reputational harm.
- **Driving confident adoption:** proactively addressing fairness, accountability and transparency is a core part of trustworthy AI which, in turn, supports adoption.
- **Ensuring regulatory preparedness:** governance anticipates current and imminent legal obligations (such as the EU AI Act) and related regulatory scrutiny.

There are numerous frameworks and resources available in this space; it can be challenging to figure out where and how to begin. This report provides **a blueprint of how to get started in a risk-based, proportionate, and practical way.**

Given AI's reliance on data, you should explore leveraging existing data governance initiatives to help shape AI governance. To learn more about data governance, please see PICCASO's Information Governance paper.

AI Risks

Some of the risks AI presents are new, others are not but evolve in the context of AI. They may result in loss of strategic business opportunities, legal liability, regulatory sanctions and significant reputational and brand damage for organisations. More alarmingly, they may result in hazards and harms to individuals and society as a whole. We have grouped risks in the section below, but in practice most span more than one category.

New Risks Created By AI

Operational risks

- **Safety:** including risks that can be physical, e.g. AI-powered autonomous vehicles may miscalculate and cause physical harm to drivers or other people.

Technical risks

- **Poor AI outcomes**
 - **'Data Quality':** the quality of the outputs of an AI system is directly linked to the quality of the training data used, poor quality in training data will impact the quality of outputs.
 - **'Hallucinations':** AI operates based on statistics and this can generate factually incorrect outputs which may still look realistic.
 - **Drift:** an AI model performance may decline over time, typically when there are changes in statistical properties (**model drift**). This may be the result of change in input data over time (**data drift**) or the rules that associate input variables to output variables may change (**concept drift**). As a result, the model degrades and it no longer produces reliable outputs.
- **Poor explainability/ interpretability of AI outcomes:** in some cases, there is a "black box" effect, meaning it is difficult for humans to understand (let alone explain to others) why or how the AI produced certain outputs.

Human risks

- **Encoding & propagating bias:** humans may unconsciously code their bias as they program, train and test AI models. There may also be existing bias in the training data, which the model then reflects. This may be **implicit bias** (which results in discrimination against a particular individual or group of individuals), **sampling bias** (data gets skewed towards a group of individuals) or **temporal bias** (the model functions properly after training but its performance degrades over time). These biases can then lead to discriminatory outcomes, causing harm and breaching anti-discrimination laws.
- **Ineffective oversight:** assessing at what phases to deploy human intervention (also referred to as 'human in the loop') is essential. Deploying human oversight at the wrong stage/s or not at all can result in negative outcomes.

Security risks

- **Malicious deepfakes:** Generative AI used to create synthetic images, video or audio to distort reality and deceive, e.g. mis/disinformation, fraud.
- **Model poisoning or malicious prompt injections:** deliberate input of harmful data into a model's training set, or into model prompts is designed to exploit or corrupt the system and perform unintended actions.
- **Model inversion:** an adversary with access to the AI system attempts to reconstruct or infer sensitive information about the training data. This could lead to a privacy, security or Intellectual Property (IP) breach.

Legal risks

- **Compliance risk under novel AI regulations:** legislation like the EU AI Act will introduce significant sanctions for compliance failures, establish new liability chains and make it easier for aggrieved persons to bring claims. Regulations in related areas such as product liability, data, security, IP and governance are likely to evolve or be amended to take account of AI.
- **Civil liability as a result of unintended AI outcomes or consequences:** whether as a result of bias, drift, hallucinations, intentional abuse or malicious compromise.

Existing Risks Compounded By AI

Operational risks

- **Missing out on the AI opportunity:** this is probably the biggest risk facing many commercial organisations. Effective AI governance can be an enabler or a hindrance; it is essential to get the balance right.
- **Supply chain risk:** the AI technology stack can be long and complicated, whether using a third-party AI system and/or downloading open-source AI models for internal development or use. Organisations face several challenges resulting from reliance on third parties, including lack of transparency concerning AI models design and/or training data, one-sided contract terms, and vendor lock-in. Using smaller AI vendors may entail additional risk, including immature data governance or compliance processes and risk of vendor failure.
- **Reputational risk:** over and above legal liability and regulatory exposure, an AI product or service that does not perform as expected may create reputational hazards and undermine user trust.
- **Climate impact:** AI is a data-hungry technology that requires significant amounts of computing power, data centre capacity and high-speed networks. This will increase greenhouse gas emissions, energy consumption, water consumption and use of natural resources.
- **Shadow AI:** unapproved use of AI systems or applications (e.g. by those disregarding or unaware of organisational safeguards) is likely to amplify many of the risks in this section, particularly privacy, security & regulatory risks.

Human risks

- **Lost or missing skills**
 - **Skills gap:** insufficient understanding of the different types of AI and their respective appropriate uses and limitations may result in inability to evaluate cost / benefit analysis and risks / rewards analysis properly. This risk may be compounded by inadequate AI training and awareness programmes in an organisation.
 - **Skills erosion:** as organisations rely increasingly on AI for certain tasks, the humans who used to perform them may lose skills and abilities. AI will also create new roles, requiring new skills not readily available within the existing workforce. Lack of planning around an 'AI enabled workforce' can lead to competitive disadvantage.
- **Job displacement:** AI may partly or wholly automate certain roles and tasks, leading to redundancies or redeployments. This must be handled with care, both in terms of employee consideration and applicable employment law and contractual requirements.

Governance and Legal Risks

- **Failure to update cybersecurity, privacy and IP risk approaches:** risk management and controls in these areas need to be built out to explicitly recognise and mitigate the risks outlined above, which AI has created or compounded. For example, new AI security risks materially increase the attack surface for cybersecurity teams to consider. And employees' use of generative AI applications will increase the risk of unintended privacy and IP leakage/ breach.
- **Liability under connected legal frameworks:** AI compounds legal risk in several areas of the law, including data privacy, intellectual property, cybersecurity, safety, product liability, employment, competition, and digital services regulation. Furthermore, achieving consistent approaches is politically challenging and time-consuming; complexity from a regulatory perspective increases the chances of non-compliance and liabilities.

Organisations should review these risks to identify which apply to them and to what extent. It is then important to establish your organisation's risk appetite. This exercise will help identify which governance interventions to put in place. The key objective should be to enable the roll-out of strong AI applications without undue friction, while controlling and managing key risks.

AI Governance Approach

There are **eight core building blocks for effective AI governance**, summarised in the diagram and explained in the table below. Although these components need to be present, in some form, in any sound AI governance programme, there is not a 'one size fits all' approach. Each element needs to be tailored to the business' AI strategy, context and risk appetite. You should start from the centre and build from there.



Fig 1. Core building blocks for effective AI governance

Building Blocks: Essentials and More Mature Capabilities

This is a toolkit organisations can use to help them move from an immature AI governance and risk management posture to a higher level of maturity.

Governance element		Essentials – required first	More mature capabilities – for stronger governance
A	Risk and compliance strategy	• Agree the organisation's business goals for AI • Make a list of all existing or planned AI use cases (i.e. an AI inventory). • Define the organisation's AI-related risks. Agree on posture & risk appetite.	• Identify the laws and regulations affecting the organisation relating to AI. • Identify the AI governance principles that the organisation will uphold.
B	Risk oversight	• Define clear roles and responsibilities to oversee and manage AI risks (could be an individual or a team)	• Ensure roles and responsibilities for risk oversight are spread across the organisation, in operational, compliance and audit functions. • Establish (or revamp) committees or working groups etc. to oversee AI risk management. • Ensure these teams are as diverse as possible.
C	Policies, procedures and standards	• Agree corporate approach to manage (or avoid) AI related risks. • Select guardrails or controls to stay within risk appetite. • Do a simple impact assessments to inform the above. • Agree escalation path for any high risk AI.	• Set policies to manage (or avoid) AI related risks . • Codify procedures for AI activities on a step-by-step basis. • Set standards to set the appropriate thresholds – e.g. encryption . • Design appropriate controls – preventive, detective, and corrective – tailored to the specific AI use cases envisaged and the risk appetite of the organisation.

Governance element		Essentials – required first	More mature capabilities – for stronger governance
D	Incident response and preparation	• Agree a shared definition of the types of AI incidents that need addressing. • Agree an approach to reporting and handling incidents (e.g. who is responsible for dealing with different kinds of incidents).	• Formally define an AI incident, including categories of severe event or incident (to determine appropriate response). • Establish a playbook (documented procedures and roles) for incidents. • Carry out periodic rehearsals of AI related incident procedures.
E	Monitoring and measurement	• Set up regular monitoring of the business for AI incidents and near misses throughout the AI development and deployment lifecycle, measuring the impact if they occur.	• Set up active monitoring of AI procedures, standards, controls – are they in place, are they working properly?
F	Reporting	• Set up process for reporting AI incidents to management (and other stakeholders when necessary).	• Create appropriate AI dashboards. • Report on risks, control performance, incidents, or breaches.
G	Testing	• Organise periodic testing or checking of AI related controls and procedures throughout the AI development and deployment lifecycle.	• Set up routine testing and checking regime for AI products and controls. • Stand up a team capable of ‘red teaming’ to understand weak spots in your controls.
H	Training and awareness	• Provide AI guidance or training for all staff, providing a base level of risk awareness. • Roll out targeted AI training for anyone using a higher risk AI application.	• Provide mandatory training for all staff, providing a basic level of AI risk awareness, some common AI protections and requirements. • Provide specialised AI training for different target audiences, depending on their roles and risk exposures (e.g. data scientists, product managers, procurement, compliance).

Controls to manage AI risk

Controls are the policies, procedures and mechanisms necessary to operationalise the organisation's AI governance and risk management principles.

As per the above, the starting point for managing AI risk is a robust inventory of use cases across an organisation.

Case study: one of the first AI governance actions for **Ocado Group**, a technology-led, global software and robotics platform business, was the creation of a comprehensive registry of AI use cases. The registry's fields include (i.a.) the area of AI application, purpose, success criteria and status (e.g. trial/under development/in production). It also identifies both a point of contact and a business owner for each AI application. Ocado now has 100+ use cases profiled within the registry, and uses this visibility to identify new opportunities and monitor for risk.

AI controls take different forms. Some apply to people, others apply to process, or technology. These controls have different flavours:

- Preventative controls deter issues from happening in the first place. For example, through access controls and encryption that prevent unauthorised access to AI data and systems.
- Detective controls involve identifying and responding to issues as they arise. For example, using anomaly detection systems to monitor for deviations from normal operational patterns, signalling potential issues in real time.
- Corrective controls mitigate damage after a risk has materialised, such as rollback mechanisms to restore system states in the event of a malfunction or breach, and robust post incident analysis routines to ensure learnings are fed back.

Case study - **AlixPartners** have worked with different organisations to identify the right mix of controls. Using a banking client versus a marketing firm by way of example: Banks using AI to support 'Know Your Customer' (KYC) responsibilities will have a very low tolerance for errors, and hence may prioritise preventative controls, whereas if AI is being used to suggest copy for marketing emails then a preventative control would disproportionately inhibit test and learn, and detective / corrective controls may be far more appropriate. (e.g. a human review/editing of the AI-suggested copy before it is released).

Often the most critical control is cultural, seeking to establish AI safety and trust by design. Training programs cannot only provide technical skills but also emphasise the importance of ethical decision making. Reward systems can recognise developers for ethical AI innovations. Additionally, clear communication and role modelling by senior leadership are essential, ensuring that AI governance principles are consistently applied and visible at all levels of the organisation.

Creating the control environment and what can you re-purpose

It is rarely necessary to start from scratch. Businesses should review: i) what level of governance and risk management is already in place; ii) how data and technology risk is currently managed; and iii) the overall investment in AI, and therefore what would be proportionate to invest in governance.

Based on this, there are two main options for securing the resources you need to get started:

- 1. Building on the current governance and risk management setup.** This would involve adding AI skills (through hiring or training) to whatever risk and governance teams the business has already – in finance, legal, data, procurement, risk and compliance, technology, privacy and security. And then ensuring there is good coordination and a clear definition of roles between them so that risks don't fall between the cracks and to guard against duplication of effort or overly complex/burdensome governance processes.
- 2. Creating new AI governance and risk management capabilities.** This would involve adding a new specialist role to an existing team or creating a new (likely small) team with specialist skills to review, monitor, test and report on AI use cases. The advantage of this approach is that it creates a centre of excellence, however small, with the skills required to really challenge any AI use case and advise on controls and incident handling.

AI governance and risk management in practice

We have separated AI governance and risk management activities into three stages: (1) development or procurement; (2) AI deployment; and (3) selling AI. This is because there are different controls to consider for each stage. We have also provided illustrative use cases to show how the controls can be deployed in practice.

When starting out, it is key to focus efforts on higher risk use cases, i.e. those with a more substantial impact on individuals or your organisation. That approach can be supplemented by

more general guidance and training for your employees to adopt when developing, procuring, deploying or selling AI that falls within lower risk use cases. AI-related regulation, such as the EU AI Act, can guide what these applications and requirements are, but for the purpose of this paper we have focussed on common controls when undertaking a full review of a high-risk use case rather than making these specific to country/industry legal requirements and regulatory expectations.

AI Development or Procurement

AI systems can be purchased, developed internally or a combination of the two. Most risks associated with these stages are often linked to data. The quality of the training data that goes into an AI model will materially impact its output. If the training data is inaccurate, unrepresentative, biased or infringes privacy or third-party intellectual property (IP), there is a risk that outputs will do the same. If sourcing an AI system, controls will also need to ensure that the system performs as expected at deployment.

Example Controls	Developing AI	Buying AI
Training Data	Identify, assess and document what data was used to train the model.	Undertake adequate due diligence to understand the training data used by the supplier.
Impact Assessment	Undertake and document an impact assessment, which includes data protection, fairness and ethical components.	- Undertake and document an impact assessment, which includes data protection, fairness and ethical components. - Understand whether the supplier intends to use your inputs and outputs from the AI system for any purpose (e.g. to train their AI model) and include contractual protections and technical measures to protect commercial, confidential or personal data.

Example Controls	Developing AI	Buying AI
Accuracy/ Performance	• Ensure the training is of sufficient quality and appropriate for the use-case. • Define clear testing criteria for new AI systems. • Undertake a trial with appropriate expertise to understand and analyse the outputs in line with the testing criteria.	• Where appropriate, seek contractual assurances from the supplier over the quality and fitness for purpose of the training data. • Undertake a trial with appropriate expertise to understand and analyse the outputs in line with the testing criteria. The supplier may need to provide expertise and access – this should be factored into contractual negotiations.
Bias	• Ensure training data is diverse and representative. • Ensure teams working on AI are interdisciplinary and diverse. • Test the system's performance for potential biases in outputs.	• Ensure supplier has implemented adequate controls to test for bias • Test and monitor the system in the deployment environment to identify any potential bias in outputs (e.g. as part of a trial)
Legal	• Ensure you have the right to use the training data and output data for the intended business purposes (consider privacy, IP, confidentiality and other contractual restrictions).	• Consider seeking contractual protection from the supplier on training data e.g. the supplier could warrant that it was permitted to use the training data from an IP or data protection perspective • Consider whether contractual controls are required to obtain assistance from the supplier to meet your transparency or training obligations at the deployment stage.

Case Study: **Iron Mountain**, a global information and asset management business, developed a proprietary digital platform to help customers bridge a gap between paper and digital records and enable in-depth data analytics on data contained in their records. AI functionality was then developed to enable customers to search and analyse their data at scale and with minimal human intervention. This required extensive training before deployment so a cross-functional team worked together to identify data that can be used to train the AI model which did not infringe upon privacy principles and customer contractual commitments. Conflicting interests had to be managed to ensure there was enough training data to ensure high performance of the functionality and accuracy of data outputs.

AI Deployment

Whether an AI system is procured or developed internally (or both), you will need to ensure there are controls in place to manage risks associated with deploying AI for use by your employees, clients and/or other users.

Example Controls	AI Deployment
Transparency	Prepare a notice to make clear individuals are dealing with an AI system or provide information on the impact of any decisions made by the AI. For example, customer support should make it clear whether a user is chatting to a human or a virtual agent.
Training & guidance	Ensure users of AI systems are trained on how to use the AI systems and informed of key risks and limitations. For example, users of a coding assistant tool should understand that due to the nature of generative AI system, code recommendations could be inaccurate; and depending on the training data used, recommendations might infringe third party IP.
Human Oversight	Where a human is receiving and using the outputs from AI, ensure they are instructed to check those outputs before using them, e.g. to ensure that they are not obviously inaccurate, do not contain personal or other sensitive data and don't point to material which infringes IP.

Example Controls	AI Deployment
In-life monitoring	Continually monitor AI use to check: ongoing performance (does the AI system continue to perform as intended against its stated purpose or is it subject to errors, bugs or model drift) and use case drift (whether it is used for purposes other than what was originally intended and, if so, how does that impact on individuals and the guardrails).
Input data	Consider whether there should be restrictions on input data. For example, when introducing an AI system to analyse contracts with your customers, consider whether there are any contractual restrictions in those contracts on where/ to whom data can be transferred.
Feedback and redress	Where AI use cases make decisions, ensure impacted individuals have clear routes of redress for affected individuals to question decisions made by AI (where relevant) and opportunities to give feedback.
Human-in-the-loop	Where an AI system engages in making automated decisions, include a human in the loop, especially when there are concerns that the system might be inaccurate or there is a high risk to individuals. For example, in the context of automated candidate assessment tools, consider how an individual can challenge decisions made by the AI system and the extent to which humans should be involved in approving or rejecting candidates.

Case Study: **BT Group** deployed Amazon Q (an AI powered coding assistant) to enhance the productivity of its workforce. Amazon Q provides real-time coding suggestions that reduces the time developers spend on time consuming and often repetitive tasks. To ensure the technology was safe, BT Group worked with Amazon to understand what code was used to train the system and how the inputs/outputs were used. Given the potential IP risks, technical controls were implemented to help identify code recommendations which might be subject to open source licence restrictions. In addition, BT Group developed a comprehensive set of guardrails and user training. As an added step, all users have to complete a simple quiz before getting access to the platform and users are asked to provide periodic feedback on the system's performance.

Selling AI

While most operational risk sits with the deployer of an AI solution, organisations selling AI solutions should implement adequate controls to mitigate any inherent risks arising from the AI solution they provide.

Example Controls	Selling AI
Documentation	Provide customers with clear usage instructions, performance information and known limitations of the technology. While the amount of information provided will vary by use-case, organisations should balance the need to disclose critical information against their commercial interests to keep proprietary data confidential.
Testing and post-deployment monitoring	Test and continue to monitor an AI solution's performance over time, notifying customers of any known vulnerabilities that are discovered (similar to how software providers issue security patches or updates).
Contractual terms	Implement adequate contractual arrangements to ensure responsibilities are clearly defined between the parties. This should include: usage restrictions, data ownership (i.e. can inputs/outputs be used to improve the product), liability, etc.
Customer vetting	Providers of high-risk AI solutions may want to consider vetting new customers to ensure their use of the technology is unlikely to result in harm or negative publicity.

Conclusion: How and Where to Start

The following four steps summarise the key recommendations of the paper and provide a blueprint of how and where to start:

1. Gather your stakeholders

Effective AI Governance is a multi-stakeholder effort involving many teams in your organisation. The success of your AI Governance programme will depend on your ability to bring key stakeholders together. As a starting point, you should consider:

- Who are the key teams that need to be engaged?
- Do your key stakeholders understand the importance of AI Governance? If not, start upskilling them (an easy way to start is by sharing this document).
- Who has final decision making if there are disagreements or risk-based decisions need to be made? i.e. who calls the shots?

2. Assess the impact of AI on your organisation, as well as potential risks

As outlined in the introduction of this paper, you should identify the most valuable use case opportunities for leveraging AI. With these use cases in mind, you can assess risk exposure. These two components will guide your governance approach. As a matter of priority, you should understand:

- How your organisation is using or will use AI (including: what tools, for what purposes, impact on organisation, etc.).
- What legal frameworks apply to your use of AI (e.g. EU AI Act, Sector specific rules, etc.) and what are the compliance requirements that should be met.
- The key risks your AI use-cases entail and your organisational risk appetite.

3. Identify controls & ownership

Now that you have your stakeholders identified and educated, your AI objectives and risks mapped and your AI governance principles identified, you should identify which of the various AI controls recommended in this paper are necessary. You should also agree who will take ownership of each control.

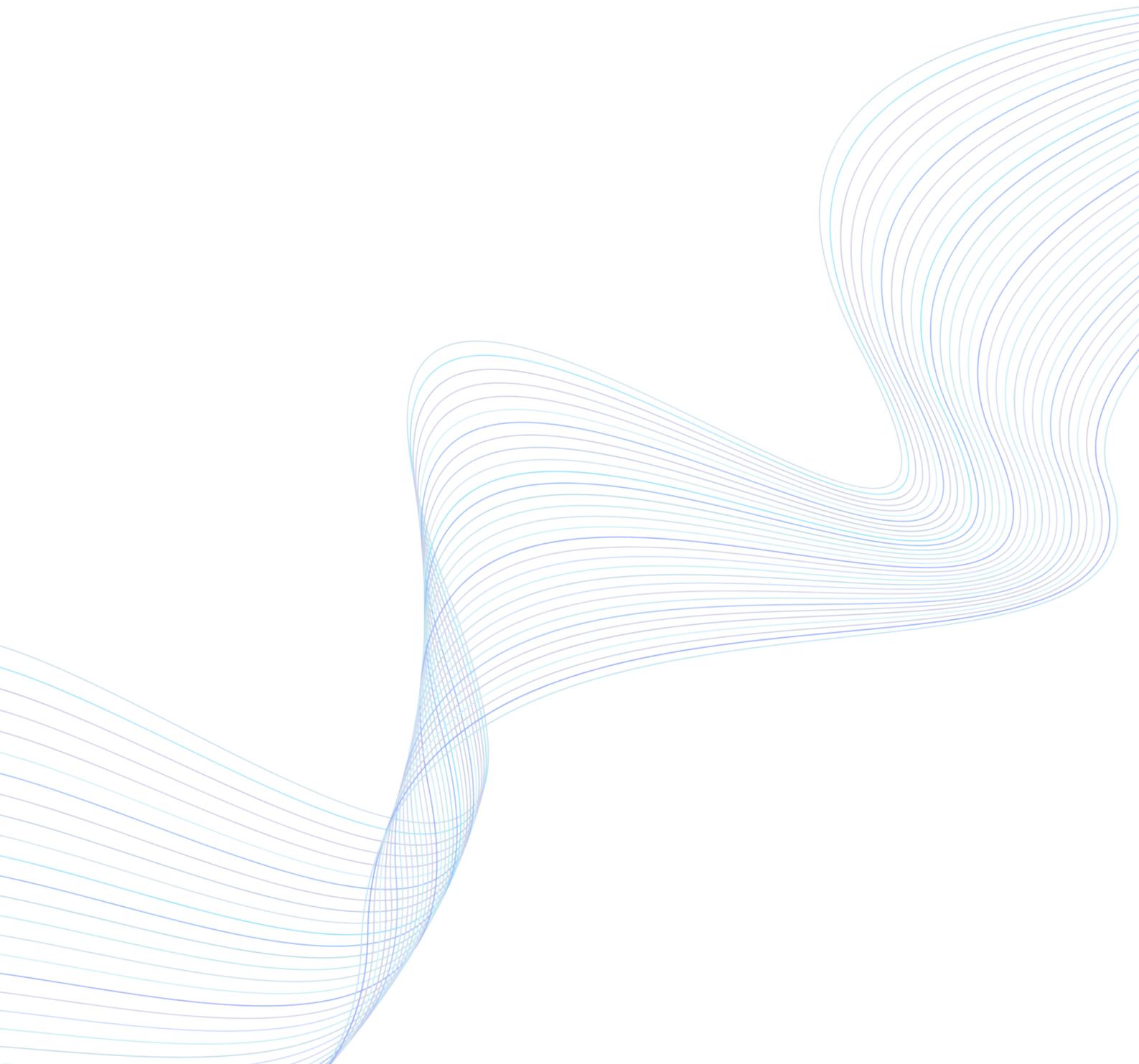
When agreeing ownership of the controls, it's essential to agree the objectives, outcomes and success criteria with all stakeholders.

4. Measure progress

You may want to consider ways in which you can demonstrate progress in your AI governance journey. For example, you could use an AI maturity framework to track how various AI governance components evolve over time.

By measuring your AI governance in an objective way, you can measure the effectiveness of your AI governance programme and any areas that might need improvement.

We hope this paper provides a strong foundation to help you start your AI governance journey. For further reading on this topic, see Annex II for some suggestions.



Annex 1: Further Reading

These links were compiled in September 2024, the reader should check if updated versions are available later as this topic is developing very quickly

From international institutions:

International Organisation for Standardisation (ISO) **ISO/IEC 42001:2023 standard** with requirements for establishing, implementing, maintaining, and continually improving an AI Management System (AIMS) within organisations

Link: <https://www.iso.org/standard/81230.html>

US 'National Institute of Standards and Technology' (NIST) **framework on AI risk management:**

Link: <https://www.nist.gov/itl/ai-risk-management-framework>

From other companies:

Microsoft's approach to **Responsible AI Impact Assessments**

Template: <https://query.prod.cms.rt.microsoft.com/cms/api/am/binary/RE5cmFk>

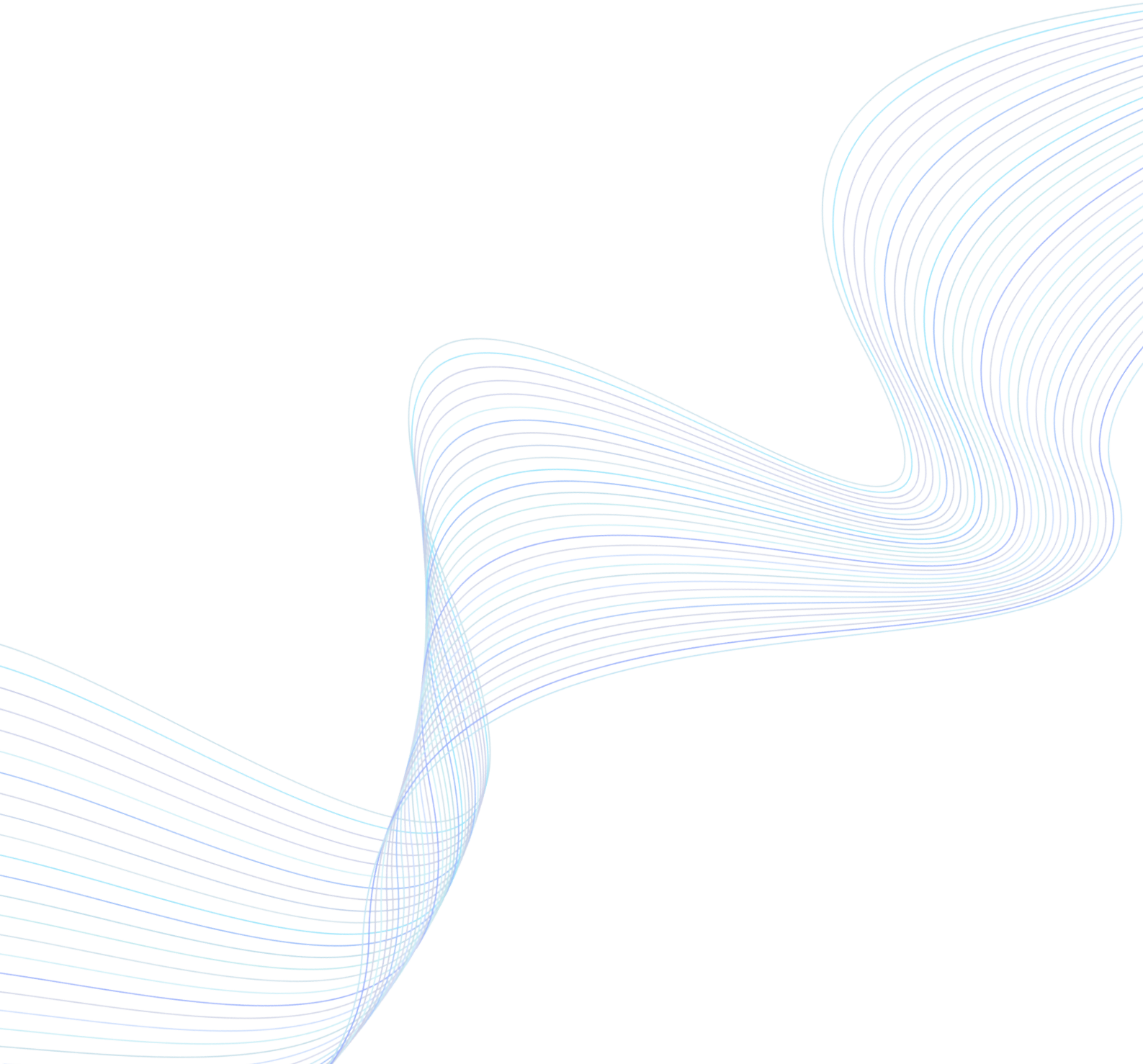
Guidance: <https://blogs.microsoft.com/wp-content/uploads/prod/sites/5/2022/06/Microsoft-RAI-Impact-Assessment-Guide.pdf>

Salesforce's suggested **AI Ethics maturity framework**

<https://www.salesforceairesearch.com/static/ethics/EthicalAIMaturityModel.pdf>



PICCASO
PRIVACY LABS



INTRODUCTION TO MERCHANT CASH ADVANCE AGREEMENTS IN BANKRUPTCY

By:
Anthony J. DeGirolamo, Esq.
3930 Fulton Dr., N.W., Suite 100B
Canton, Ohio 44718
(330) 305-9700
<http://www.trusteblogs.com/degirolamotruster.aspx>

Patricia B. Fugée, Esq.
Fisher Broyles
27100 Oakmead Drive, #306
Perrysburg, OH 43551
(419) 874-6859
patricia.fugee@fisherbroyles.com

M. Colette Gibbons Esq.
Attorney at Law
28841 Weybridge Dr
Westlake, Ohio 44145
(216) 798-6940
colette@mcgibbonslaw.com

Frederic P. Schwieg, Esq.
Attorney at Law
19885 Detroit Rd #239
Rocky River, Ohio 44116-1815
(440) 499-4506
fschwieg@schwieglaw.com

I. OVERVIEW OF MERCHANT CASH ADVANCE (MCA) AGREEMENTS

An MCA is a type of revenue-based funding that is incredibly quick and easy to obtain, very expensive, often containing onerous or even predatory terms, and requiring repayment via daily or weekly ACH/EFT out of the debtor's operating account typically in a very short timeframe. Too many MCA providers are unscrupulous, and some are even illegitimate altogether.

A. What is an MCA?

The key indicator that a funding agreement is an MCA agreement is the provision that in return for a specified sum paid to the debtor up front, the MCA funder purchases a specific amount, or specific percentage, of the Debtor's "future cash receipts" or future receivables, which is the amount that the debtor must pay to the MCA funder (which is usually much more than the sum paid to the debtor up front). Other hallmarks of an MCA agreement include:

- Charging significant upfront fees, which reduce the amount of the “purchase price” received by the debtor;
- Requiring daily or weekly payments by ACH, in an amount that is supposed to reflect the specified percentage or amount of future receipts acquired, rather than a definite repayment term;
- Providing that the parties intend that the transaction is not a loan;
- Requiring the debtor to waive defenses, including objections to prejudgment remedies; some even require execution of a confession of judgment or similar document from both debtor and its principal;
- Providing a “reconciliation” process by which the ACH payment amounts supposedly (in many instances) can be adjusted by increasing or decreasing the specified percentage, if actual receipts are not what was anticipated;
- Requiring the business owner to execute a personal guaranty;
- Requiring representations and warranties regarding the business’ financial condition;
- Prohibitions against the debtor obtaining additional MCA or other funding;
- Very high up-front costs, as well as large differences between the sum paid to the debtor up front versus the amount that the debtor must pay to the MCA funder; and
- The granting of a security interest either in the allegedly purchased future receipts or in all of the debtor’s assets, as security for the obligations. MCA funders often file UCC-1 financing statements, though rarely in their own names, so it is important to run a search and then verify the secured creditor represented in any UCC-1 filings made by an agent.

We will review these provisions in some detail later in these materials.

1. What is the Difference Between an MCA and a High Interest Loan?

Assuming for this purpose that an MCA funding agreement is not recharacterized as a loan itself, but is instead a sale of future receipts, there should be significant differences between MCA funding and a high interest loan. However, as will be discussed later, Courts are increasingly willing to recharacterize MCA funding agreements as loans when that is their true nature, which can alter their treatment in bankruptcy cases and potentially open them up to usury violations.

An MCA funding agreement that is not a disguised loan purports to provide for an actual sale of future receipts or receivables, which should mean that if there are insufficient, or no, such future receipts or receivables, then the MCA funder would have no recourse against the debtor-seller. In other words, if it is a true sale, then the MCA funder buys whatever may come into existence, and if the purchased receivables don’t exist, the MCA funder gets nothing. In contrast, the obligation to repay a high interest

loan exists irrespective of whether the borrower has continuing receipts or remains in business. The key difference is that in some jurisdictions, high interest loans are subject to usury restrictions, which if violated, can avoid the obligation to repay the loan. That is one of the reasons why there is so much litigation about whether particular MCA funding agreements should be recharacterized as a loan.

Another distinction concerns the use of cash collateral once a bankruptcy case is filed. The debtor will file a motion for authority to use cash collateral, and identify any traditional lenders with liens on cash, as well as any MCA funders who filed UCC-1s that include cash, receipts, receivables, etc. An MCA funder may oppose the use of cash collateral, arguing that there was a “true sale” of the sold future receipts, such that those funds are not property of the estate under 11 U.S.C. § 541, and thus, not cash collateral. If the transaction is truly a sale of future receipts, then there is potentially some validity to that argument, those as will be discussed below, there is little caselaw in support. In contrast, if the MCA transaction is a loan, then there is no argument that the cash receipts are not property of the estate.

Another distinction between an MCA funding that is a true sale, versus a high interest loan, concerns eligibility for Subchapter V. In the context of subchapter V eligibility – especially given the reduced statutory cap – claiming that an MCA funding transaction is a loan means that it is included in the debt unless it is contingent or unliquidated. 11 U.S.C. § 1182(1). And, while it may be disputed, a court could determine that the obligation is nonetheless neither contingent nor unliquidated, and thus it is included in the cap since disputing an obligation does not remove it from the analysis. See, e.g., *In re Heart Heating & Cooling, LLC*, Case No. 8:24-bk-01255-RCT, 2024 WL 1228370, at *14-30 (Bankr. D. Colo. Mar. 21, 2024) (where an MCA Agreement was considered a loan, Court counted towards statutory debt cap); compare, *In re McKenzie Contracting, LLC*, 2024 WL 3508375, at *6 (concluding that because the MCA funders’ proofs of claim, with attached agreements, appeared to be purchases, not loans under applicable law, their claims did not count towards the subchapter V eligibility determination).

The United States Bankruptcy Court for the Middle District of Florida, in *In re McKenzie Contractors, LLC*, overruled a creditor’s objection to the debtor’s designation as a subchapter V debtor. *In re McKenzie*, 2024 WL 3508375, at *3. The creditor contended that the debtor omitted from its schedules debts arising from merchant cash advances and thus understated its debt. The debtor maintained that its debts fell below the \$7,500,000 threshold, applicable at the time pursuant to 11 U.S.C. § 1181(1)(A), because the debts arising from merchant cash advance agreements were contingent, unliquidated debts. The court offered an overview of the mechanics of a merchant cash advance, observing “in exchange for an immediate advance of cash from the ‘buyer,’ the ‘seller’ sells its future accounts receivable.” *McKenzie*, 2024 WL 3508375, at *2. Further the court explained, in a merchant cash advance transaction, the buyer purchases a set percentage of “the seller’s underlying customer accounts receivable in exchange for an up-front purchase price that is less than the future amount to be collected by the buyer.” *Id.* Examination of a merchant cash advance transaction, the court noted, requires a court to determine whether the agreement is a sale of accounts receivable or disguised loan. In the context of subchapter V eligibility, if the merchant cash advance

transaction is a true sale, then it is excluded from the debt limit calculation. *Id.* Ultimately, the court found the agreements constituted true sales, and determined the transactions were contingent, unliquidated debts which did not count towards the debt limit. *McKenzie*, 2024 WL 3508375, at *4-6.

2. What is the Difference Between an MCA and Factoring?

Again, assuming for this purpose that an MCA funding agreement is not recharacterized as a loan, but is instead a sale of future receipts, it may seem like MCA funding is just like factoring. However, on closer examination, MCA agreements are quite different from factoring.

Unlike MCA funding transactions, factoring is the purchase of specific accounts receivable that actually exist at the time that the financing is provided to the debtor. A factor will typically engage in a detailed examination of the debtor's invoices and the credit worthiness of the debtor's customers as a part of its due diligence process. A factoring agreement is typically executed ahead of time, and then as the relationship proceeds, the factor is presented with specific receivables generated by the debtor, and it will decide to purchase some or all of them at the pre-agreed price, usually stated as a discounted percentage off of the face amount of the receivable. Factoring agreements will often have a maximum credit amount outstanding. Moreover, factors often collect receivables directly from the debtor's customers.

In contrast, MCA funding agreements purport to constitute a sale of a stated face amount, or percentage, of all future receipts and/or future receivables, neither of which even exist yet. Rather than collect directly from the debtor's customers, MCA funders collect the purchased receipts through periodic debits to the debtor's operating account. Another distinguishing characteristic is that, unlike factors, MCA funders typically perform less due diligence – often, none at all -- of the debtor's customers, focusing instead on the debtor's financial condition.

The difference can be most easily explained by an example. Debtor A and Debtor B are both in the interior design business of commercial lawn care. Debtor A has a factoring agreement with Factor, whereby the Factor may buy receivables at 85% of face value. Debtor A provides lawn care for customers X, Y and Z, generating specific invoices and corresponding accounts receivable for the work performed, with net 30-day payment terms. Once the work is performed and the specific accounts receivable exist, Debtor A can either wait the 30 days to be paid 100% by its customers, or it can sell these receivables to its Factor for 85% of the face value. If it sells the receivables, Debtor A gets 85% now and typically does not owe anything further to the Factor, and the risk is on the Factor as to whether the customer pays when the invoices are due.

In contrast, Debtor B enters into an MCA funding agreement and receives the sum of \$150,000, for which it owes the MCA funder \$225,000 from its future receipts from all sources, not from specific customer invoices and receivables. Debtor B must make the weekly payments to the MCA, whether or not its customers pay in full for work performed, subject of course to the right to employ the reconciliation process under the MCA agreement (assuming that the right is not illusory). These are admittedly oversimplified but help explain the different nature of the two kinds of transactions.

The distinction between factoring and MCA funding can be important because the Uniform Commercial Code (“UCC”) addresses factoring, both by defining an account receivable and providing mechanisms for factors to obtain and perfect security interests in accounts receivable. The UCC treats factoring, along with other kinds of transactions such as consignments, as if they were security interests under Article 9. But, as will be more fully discussed herein, the UCC at least arguably does not have any answers for dealing with MCA funding agreements.

B. History and Development of MCAs¹

As early as 1992 there were providers that began issuing loans on future credit card volume and called these advances “automated loan repayments.” There are articles attributing the practice to Barbara Johnson who, needing capital for her businesses, developed a system of obtaining upfront payment in exchange for a percentage of future credit card sales. According to this reporting, she and her husband patented the system for splitting credit card sales and founded Advance Me in 1998, which apparently became the first to use the MCA in the marketplace. Competition thrived, as apparently the patent was not upheld.

After the “great recession” of 2008 and following the collapse of the global financial system governmental entities took action and stricter financial regulations were imposed, including the Dodd-Frank Act and creation of Consumer Financial Protection Bureau. As a result, traditional banks restricted their lending and made traditional loans more difficult to obtain, especially for small businesses. Initially, some smaller institutions that are not subject to the supervision of the CFPC or regulation to the same extent as larger financial institutions got into the MCA businesses – especially when the Advance Me patent was avoided in 2008 -- thus opening the door to the MCA funding practices that are now seemingly everywhere. Further, beginning in the 2010s, larger institutions have begun to offer MCAs, thereby expanding their scope.

II. THE STRUCTURE OF THE MCA AGREEMENT AND LEGAL BASES

MCAs rely on a structure that seeks to evade UCC restrictions on taking interests in accounts perhaps subject to a prior security interest and limitations of usury by structuring the transaction as a sale of future deposits in the Debtor’s bank account.

A. Sale of “Receipt of Monies”

Cases sometimes miss the distinction between an MCA and factoring, referring to an MCA as receivable sales. Sample language from MCA agreements demonstrates why:

“Merchant hereby sells, assigns, transfers and delivers to Purchaser absolutely, without recourse, all of its right, title and interest in, to and under its future Receipts. ... ‘Receipt’ means any and all payments Merchant receives for the sale of goods or services in the ordinary course of business from, on account of or in connection with any and all invoices, accounts, contract rights and other payment obligations arising after the date of this Agreement with or by any customer or client of Merchant or

¹ This section of these materials was prepared in part by The Honorable Elisabetta G.M. Gasparini, U.S. Bankruptcy Judge for the District of South Carolina, and her law clerks, in connection with a recent presentation for the National Conference of Bankruptcy Judges in Chicago, in September 2025. This section is reproduced here with permission, and gratitude for the excellent work.

other third parties having a business relationship with Merchant, whether such payment is made in cash or by check, money order, wire transfer or any in other form.

“future accounts, receivables, contract rights and other entitlements arising from or relating to the payment of monies from Merchant’s customers, vendees and/or other third-party payors (including all payments made by cash, check, credit card, debit card, electronic payment application, electronic transfer or other form of monetary payment in the ordinary course of the Merchant’s business for the payments due to Merchant as a result of Merchant’s sale of goods and/or services (the ‘Receipts’)).”

Thus, the granting language in these agreements is sometimes (and perhaps deliberately) vague. A close read shows that the emphasis is on an assigned share of the actual *receipt* of payment rather than an assigned *right* to payment.

1. Is this Really an Account Under Article 9?

But does this technical drafting really create a meaningful distinction under Article 9? UCC § 9-109(A)(3) states that Article 9 applies to:

(A) ...

3) A sale of accounts, chattel paper, payment intangibles, or promissory notes;

Accounts are defined as:

(2)(a) "Account," except as used in "account for," means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, ...

c) "Account" does not include ... deposit accounts,

UCC § 9-102(a)(2)

The argument fails under this definition as the at the Debtor had at the time it entered into the MCA was a right to receive payment which is an “account” under the Uniform Commercial Code.

2. Can Such a Sale be Valid?

Query whether there is any difference between selling the right to payment in the future and selling the future receipt of that payment? An MCA agreement is attempting to create the immediate sale of something that did not exist at the time it was signed.

The sale of future actual receipt of payment is a legal impossibility. The law simply does not comprehend or countenance a present transfer of future property. It might recognize and even enforce a *promise* to

transfer property that the promisor hopes later to acquire, but that is something different. As one court put it, “[a]t law one cannot transfer by a present sale what he does not then own, although he expects to acquire it. But, while [such a] contract [is] without effect at law as a contract of sale, it operate[s] as an executory agreement to sell.”⁹ Indeed, it is a basic legal maxim that “one cannot give what one does not have” (or, in one of several phrasings in Latin, “*nemo dat qui non habet*”).

Hilson, J.F & Sepinuck, S.L., A "Sale" of Future Receivables: Disguising a Secured Loan as a Purchase of Hope, 9 Transactional Law. 14, 15 (2019)

3. Section 552 of The Bankruptcy Code

MCAs have argued that Section 552 does not cut off their right to take money from the Debtor’s bank accounts even after filing, because 11 USC §552(a) only applies to a security interest.

(a) Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

However, the definition of “security interest” in the Bankruptcy Code refutes this assertion. The Bankruptcy Code defines a security interest to be “a lien created by agreement.” 11 USC §101(51) “The term “lien” means charge against or interest in property to secure payment of a debt or performance of an obligation.” 11 U.S.C. § 101(37). “The term “debt” means liability on a claim.” 11 U.S.C. § 101(12). “The term “claim” means-(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured” 11 U.S.C. § 101(5).

An MCA is obviously claiming a right to payment which is a “claim” under the Bankruptcy Code and therefore a “debt.” The right to take the ACH debit from the Debtor’s deposit account is obviously a charge against or interest in the deposit account which is property of the Debtor. The most relevant definition of “secure” is to “free from risk of loss.” Merriam-Webster.com. As set forth above, the right to payment from the Debtor’s deposit account via ACH transfer was to secure payment free from risk of loss. Therefore, this is a lien under the Bankruptcy Code. This lien was obviously created by the agreements with the Debtor.

It is therefore a security interest under the Bankruptcy Code, and future right to take payments from the Debtor’s bank account is terminated upon filing.

B. ACH Rights and Payment Terms

The MCA agreement usually claims to purchase a specified percentage of the future deposit of the Debtor, usually from five to fifteen percent of the future deposits into a specified account. This number is determined by the MCA’s review of bank statements sent to it by the Debtor when applying for funding. The MCA receives an ACH on the Debtor’s bank account. The ACH is taken weekly and sometimes on a daily basis.

1. Interest in Bank Accounts Under Article 9

MCA's argue that they take free of the security interest of an account financier because they receive payment from a bank account pursuant to UCC §9-332. That section provides:

- (1) A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.
- (2) A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

The official comment to UCC §9-332 explicitly states "subsection (b) applies to transfers of funds from a deposit account; it does not apply to transfers of the deposit account itself or of an interest therein. For example, the section does not apply to the creation of a security interest in a deposit account." (Emphasis in original).

The MCA arguments are self-contradictory further demonstrating their invalidity. To the extent that the MCA is claiming that it holds a prior right to payment in the Debtor's deposit account, that is necessarily a transfer of an interest in that deposit account and therefore not subject to UCC §9-332(b). If the Claimant is claiming that it is receiving payment from the deposit account, then its argument that it has obtained the Debtor's right to future payment on its accounts is obviously false.

C. Reconciliation Provisions

Most MCA agreements have a reconciliation provision, which is a provision that provides that the debtor can apply to the MCA for an adjustment of the amount being taken out of its bank account on the grounds that it exceeds the agreed upon percentage. Typically however, these provisions are entirely at the discretion of the MCA and to the extent that they provide no meaningful relief, they can be an indicia that the MCA is really a disguised loan as will be discussed below. Nevertheless, when representing an MCA borrower, the first step is to try to use the reconciliation provision to reduce the payment.

D. Security Interests

Most MCA agreements provide for a blanket security interest in all assets of the debtor. Since the security interest covers far more collateral than the alleged purchase under the MCA, it is often a provision pointed to in establishing that the MCA lender is not assuming the risk of default. It is a ground for recharacterizing the MCA agreement as a disguised loan as will be discussed below.

E. Personal Guarantees

Most MCA agreements provide for a personal guarantee by the owner of the company of all amounts owed to the MCA. Like the security interest it is often a provision pointed to in establishing that the MCA lender is not assuming the risk of default, and is a ground for recharacterizing the MCA agreement as a disguised loan as will be discussed below.

F. Governing Law

Until recently, most MCA agreements have provided that they are governed by New York law. This may be changing as New York law is no longer so amenable to MCA funding.

1. Contractual Jurisdiction Provisions vs Forum State Law

Taking advantage of usury prohibitions can be a good reason to challenge the characterization of an MCA transaction as a purchase rather than a loan. Depending on the state law applicable to an MCA funding agreement, successfully recharacterizing the agreement as a loan rather than a sale could render it unenforceable if the actual cost of the funding, converted into annual interest, makes it usurious. For those with contracts governed by New York law, there is a robust statutory scheme for usury, providing that interest over 25% is criminally usurious and the obligation may be void. See, generally, *Adar Bays, LLC v. GeneSys ID, Inc.*, 37 NY 3d 320, 157 N.Y.S. 3d 800, 179 N.E. 3d 612 (2021) (addressing New York's usury laws and concluding that criminally usury obligations are void ab initio).

It may also be the case that even if the MCA funding agreement purports to be governed by the law of a state that does not have similar usury obligations, counsel may be able to persuade a Court to apply the law of the state in which the debtor has filed bankruptcy, for public policy reasons. Stated differently, a Court may be willing to apply local usury law notwithstanding application of different law according to the agreement, because most state's conflicts laws include a public policy exception for enforcement of choice of law provisions. See, e.g., *JLK Constr., LLC v. Alva Advance, LLC* (In re *JLK Constr., LLC*), 2024 Bankr. LEXIS 184 (Bankr.W.D. Mo. 2024) (evaluating enforceability of choice of law provisions); *Ideas v. 999 Restaurant Corp.*, 2007 WL 3234747 (N.Y. Sup. Ct. 2007) (declining to apply Illinois law, which had no usury limit, and instead allowing the debtor to assert the NY usury defense).

III. DEFENSES TO AND BANKRUPTCY TREATMENT OF MCAS

A. Recharacterization as Loan and Usury Defenses

Most litigation involving MCA lenders involves attempts to recharacterize the transaction as a loan rather than a purchase of a portion of accounts. In fact, pleading that the transaction is a loan rather than a sale is a necessary element for many other claims—usury and RICO for example. In bankruptcy, that is a precursor to the ability of a debtor to use its cash. Additionally, it leads to treating the MCA lender as a secured creditor in the plan. The case law below contains the elements to be proven to show an MCA transaction is a loan and not a purchase. Courts apply multiple factors listed here to determine who takes the risk of non-payment.

- (1) whether the buyer has a right of recourse against the seller;
- (2) whether the seller continues to service the accounts and commingles receipts with its operating funds; (3) whether there was an independent investigation by the buyer of the account
- (3) whether there was an independent investigation by the buyer of the account debtor;

- (4) whether the seller has a right to excess collections;
- (5) whether the seller retains an option to repurchase accounts;
- (6) whether the buyer can unilaterally alter the pricing terms;
- (7) whether the seller has the absolute power to alter or compromise the terms of the underlying asset; and
- (8) the language of the agreement and the conduct of the parties.

If the risk of loss is on the borrower, then the transaction is more likely to be found to be a loan, if it is the MCA lender, then it is likely to be found to be a purchase.

1. Calculation of the “Interest Rate”

It is relatively straightforward to calculate what the interest rate is for an MCA funding obligation, using various tools available. A few common methodologies and examples are set forth below.

Lender A

First, calculate the factor rate:

$$\begin{aligned} &\text{purchase amount divided by advance (actually received, after costs)} = \text{factor rate} \\ &\$239,250.00 \text{ divided by } \$150,000 = 1.595 \end{aligned}$$

Second, convert the factor rate to APR:

$$\begin{aligned} &\text{Total cost less the amount received} = \text{actual cost} \\ &\$239,230.00 - \$150,000 = \$89,230.00 \end{aligned}$$

Third, calculate the percentage cost of the advance

$$\begin{aligned} &\text{Actual cost divided by the amount received} = \text{percentage cost} \\ &\$89,230.00 \text{ divided by } \$150,000 = .5948 \end{aligned}$$

Fourth, calculate the annualized interest rate:

$$\begin{aligned} &\text{Percentage cost times 365 days} \\ &.5948 \times 365 = 217.102 \\ &\text{Then divide by the number of days in the repayment period to get} \\ &\text{the annualized interest rate:} \\ &217.102 \text{ divided by } 140 \text{ days} = 1.55 \text{ or } 155\% \end{aligned}$$

Lender B:

First, calculate the factor rate:

$$\begin{aligned} &\text{purchase amount divided by advance (actually received, after costs)} = \text{factor rate} \\ &\$374,750.00 \text{ divided by } \$225,000 = 1.6655 \end{aligned}$$

Second, convert the factor rate to APR:

$$\text{Total cost less the amount received} = \text{actual cost}$$

$$\$374,750.00 - \$225,000 = \$149,750.00$$

Third, calculate the percentage cost of the advance

Actual cost divided by the amount received = percentage cost

$$\$149,750.00 \text{ divided by } \$225,000 = .6655$$

Fourth, calculate the annualized interest rate:

Percentage costs times 365 days

$$.6655 \times 365 = 242.90$$

Then divide by the number of days in the repayment period to get the annualized interest rate:

$$242.90 \text{ divided by } 105 \text{ days} = 2.311 \text{ or } 231\%$$

As if this calculation was not striking enough, counsel can enter MCA transaction figures into a different MCA cost calculator on a website called nerdwallet.com, and it came up with the following effective interest rates: Lender A, 208.96% and Lender B, 389.03%.

2. Criminal Usury and Effect

Most case law involving MCA lenders are cases involving NY usury law commonly relying on choice of law provisions in the MCA agreements. Courts routinely find that NY Usury law can only be used defensively and not as an affirmative claim. At least one court noted below permitted a debtor to use usury law to obtain an injunction against an MCA lender to prevent the lender from collecting its accounts until an adjudication of the transaction could be done.

B. Fraudulent Transfers

Some debtors and trustees have attempted to recover payments to an MCA lender via fraudulent transfer claims. One of the challenges in this course of action is whether or not the MCA lender was paid more than was loaned. That was one of the findings in a decision summarized below. If the plaintiff is able to get past that obstacle, the plaintiff has to get past whether or not the MCA agreement is usurious. Query: how do counsel prove that the MCA lender did not give reasonable value in exchange for the payments it took if the debtor paid more than was loaned? Interest rate and fees are too high? Compare the MCA lender's price and fees to conventional lending the debtor did not qualify for?

C. Preference Recoveries

Preferential transfer claims against MCA lenders are subject to all the defenses other preferential transfer defendants may assert, most commonly, ordinary course of business defense. Typically, each MCA lender's deal will be the first deal with a particular debtor so there will be no history to the relationship but that is not an obstacle, in part, because of the most recent revisions to section 547 of the Bankruptcy Code which provide as follows:

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

Even though one may question whether any MCA transaction is truly “ordinary”, because the test is whether the payments were ordinary between the debtor and the MCA lender, **or** ordinary in the industry, preferential transfer recoveries are problematic.

However, with respect to the singular transaction, the OCOB defense may be overcome if the MCA lender alters payment terms unfavorably to the debtor leading up to a bankruptcy filing. In the Guttman case outlined below, the bankruptcy trustee’s complaint survived a motion to dismiss the fraudulent transfer and preferential transfer claims because it plausibly alleged those claims. The court said nothing about the MCA lender’s defenses.

D. Civil RICO

Often, MCA borrowers or bankruptcy trustees assert civil RICO claims under 18 U.S.C. § 1961 et seq., specifically 18 U.S.C. § 1964, against MCA lenders. The JLK case outlined below lists the several elements that must be plead to assert a RICO claim against an MCA lender. In JLK the court instructed that the plaintiff must plead: (i) the transaction was as loan; (ii) charged an illegal interest rate (2x the legal rate in NY); (iii) the MCA lender made multiple illegal loans to other borrowers (a pattern); (iv) defendants distinct from the enterprise as culpable persons (not employees, agents, officers, or directors of the enterprise).

In recent years, there have been some successful challenges to the propriety of MCA funding agreements under RICO. Essentially, the argument is that if the transaction is a sufficiently usurious loan, it is itself a violation of RICO. While this is somewhat outside the scope of this discussion, a few of those cases are noted below. RICO litigation is complicated, time consuming and expensive, but it is possible that in the right case, citing RICO and surviving a motion to dismiss may be useful in ultimately getting to a consensual resolution that the parties can live with, and that allows the debtor to survive. A few examples of RICO cases brought against MCA funders include: Lateral Recovery, LLC v. Cap. Merch. Servs., LLC, 632 F. Supp. 3d 402, 451-467 (denying motions to dismiss targeting various RICO claims against MCA funder); Haymount Urgent Care PC v. GoFund Advance, LLC, 609 F. Supp. 3d 237, 251 (same); Lateral Recovery LLC v. Queen Funding, LLC, No. 21 CIV. 9607, 2022 WL 2829913, at *8 (S.D.N.Y. July 20, 2022) (same).

E. Plan Treatment

1. General Unsecured Claim

MCA lenders are usually subordinate to the debtor’s existing traditional asset-based lenders. Generally, the senior lenders are under secured, therefore, there is no equity in the collateral remaining for the MCA lender(s). Plan treatment of such MCA

lenders, employing Bankruptcy Code section 506, results in the MCA lenders being treated as nonpriority unsecured creditors. Debtor's counsel may not even have to file an adversary proceeding to achieve that result. Even if the MCA lender files a secured proof of claim, so long as they do not object to the plan, no adversary proceeding will be needed. An example of this is In re For Paws Blue Cross Animal Hospital, LLC, Case No. 23-60829. The debtor had seven MCA lenders, all but one of which were treated as completely unsecured in the plan.

Assuming counsel are able to achieve a confirmed plan treating MCA lenders as nonpriority unsecured creditors, are counsel required to object to their claims? The answer to that depends on the dividend. If professional fees, both pre and post-confirmation, are a reduction in the debtor's disposable income or projected disposable income, it may be better not to object. You have to analyze the cost of litigation, probability of success, and affect on the dividend.

F. MCA Responses to Bankruptcy Filing

While it may be a function of the size of the case, the response of MCA lenders is typically very mild. The initial push-back comes at the use of cash collateral phase. debtor's counsel can preserve the debtor's rights to contest the MCA debt by providing a replacement lien in the same validity and priority as on the petition date without conceding the validity and priority of their liens. If and when the court overrules any objections filed, most MCA lenders simply ignore the case with the exception of filing their proof of claim—which gives away the argument that the transaction is a loan versus a purchase. It is best practice to schedule all MCA lenders as disputed, unliquidated—maybe contingent—why not, to force them to file a proof of claim.

IV. CASE LAW AND STATE AND FEDERAL RESPONSES TO MCAS

A. State Case Law

1. Collins v. MCA Receivables, LLC, 2024 LEXIS 11505 (S.D.N.Y Jan. 23, 2024).

Borrowers sued MCA and its principals for declaratory relief, fraud, breach of contract, and RICO. The MCA moved to dismiss the complaint. The NY usury claim was dismissed because under NY law, usury can only be used defensively. Fraud in the inducement claims were not dismissed because borrowers were not sophisticated business people and relied on MCA lender's agent's representations. Claim for fraudulent fees dismissed because the fees were disclosed in the MCA agreement.

2. Div. 5, LLC v. For a Fin. Advance, LLC, 2024 U.S. Dist. LEXIS 200191 (S.D.NY Nov. 4, 2024).

Borrowers sought preliminary injunction against MCA lender from collecting its debt. Borrower sought to use NY usury law to prevent the MCA from sweeping the borrower's bank accounts in which it claimed a security interest. The court noted that it had never seen NY usury law used in such a way, but noted that the borrower raised a substantial question regarding using NY usury law in that way. The court indicated that the borrower was not seeking to invalidate the MCA agreement or recover fees paid, it is seeking to protect itself from future efforts to collect an illegal debt. The court noted the issue of loan vs. sale but did not decide that issue in granting the preliminary injunction.

3. S & T Bank, Inc. v. Advance Merch. Servs., LLC, 255 N.E. 3rd 164 (Ohio Ct. App. 1st Dist. 2024).

S & T Bank filed suit against multiple MCA lenders totaling over \$48,000,000. The defendant MCAs moved to dismiss the bank's civil conspiracy and fraud claims related to large overdrafts caused by the borrower's check kiting scheme. The court denied the motion to dismiss as to the MCAs who lent money to the borrower after the check kiting scheme was underway and granted it to the MCAs who lent money beforehand. The court stated that because the MCAs continued to lend money to the borrower, only with shorter terms and higher daily withdrawals, a reasonable inference could be drawn that the MCAs advanced money with the knowledge and understanding that they would be repaid with fraudulently obtained funds.

4. First Fin. Bank v. Tailored Fund Cap., LLC, 256 N.E. 3rd 744 (Ohio Ct. App. 1st Dist. Oct. 16, 2024).

The bank in this case sought recovery of funds withdrawn from borrower's bank accounts by an MCA. The bank was granted summary judgment on its claims that the MCA converted funds on deposit which were subject to the bank's security interest. The appeals court reversed based upon O.R.C. §1309.332. That section provides that a transferee who takes money from a deposit account takes the money free of a security interest absent collusion. The bank did not allege collusion and as a result, its judgement was reversed.

5. Glob. Merch. Cash Inc. v. Stellar Beach Realty & Rentals, LLC, 2025 LEXIS Dist. 43038 (E.D.N.Y March 10, 2025).

Defendant borrowers counterclaimed against the MCA for declaratory relief, breach of contract and RICO. The borrower withdrew its claim for declaratory relief but opposed the motion to dismiss the claims for breach of contract and RICO. The court found that the borrower failed to adequately plead breach of contract because it failed to plead its own adequate performance under the contract (that it made its payments). The court indicated that to support a RICO claim, the borrowers must allege and prove the existence of 2 entities: a person and an enterprise that are not the same person. The borrowers alleged that the MCA's owner is a person and that the enterprise was the MCA's owner with other principals, investors, and the MCA itself. The court dismissed the RICO claim because the borrower failed to allege and identify any of the MCA's investors. The court cited several decisions indicating that identifying the enterprise and its owners, employees, and agents, is not sufficient to sustain a RICO claim. Borrower was given 30 days to amend its claims.

6. Guttman v. EBF Holdings, LLC (In re Global Energy Servs), 2025 LEXIS 774 (Bankr. MD Mar. 31, 2025).

The trustee in Guttman sought recovery of \$145,000 that the debtor paid the MCA alleging, among other things, fraudulent transfer, preferential transfer, and turnover claims. The MCA moved to dismiss the trustee's claims. The court was squarely confronted with whether or not the transaction was a loan or a sale. Applying New York law, the court found that New York uses a 3 part test: (i) is there a reconciliation provision; (ii) does the agreement have a finite term; and (iii) whether there is any

recourse should the borrower declare bankruptcy and indicated that the test is to determine who bears the ultimate risk of loss. Looking first at the reconciliation provision, the court indicated that if reconciliation is not mandatory, or if the MCA has discretion to reject a reconciliation request, that factor favors the transaction being a loan. Next, the court considered whether there was an implicit or explicit finite term in the agreement. The court noted that this factor ties to the reconciliation because if payments are flexible, then the term is as well. Finally, the court considered whether there was recourse. In this instance, the court noted that bankruptcy was not an event of default, the MCA's security interest was limited to receivables, and the owner's guaranty was not a guaranty of payment. The court found that the transaction was a sale.

7. In re Williams Land Clearing, Grading, & Timber Logging, LLC, 2025 Bankr. LEXIS 1201 (Bankr. E.D.N.C. May 15, 2025).

The court in Williams Land was addressing multiple motions for summary judgment filed by several MCA defendants. The reorganized debtor in a confirmed liquidating plan filed fraudulent transfer claims against several MCAs. Citing Cap Call, LLC v. Foster (In re Shoot the Moon, LLC), 635 B.R. 797, 820 (Bankr. D. Mont. 2021), the court listed the following factors to determine if a transaction is a sale or loan.

- (1) whether the buyer has a right of recourse against the seller;
- (2) whether the seller continues to service the accounts and commingles receipts with its operating funds; (3) whether there was an independent investigation by the buyer of the account
- (3) whether there was an independent investigation by the buyer of the account debtor;
- (4) whether the seller has a right to excess collections;
- (5) whether the seller retains an option to repurchase accounts;
- (6) whether the buyer can unilaterally alter the pricing terms;
- (7) whether the seller has the absolute power to alter or compromise the terms of the underlying asset; and
- (8) the language of the agreement and the conduct of the parties.

Similarly to Guttman, the court indicated that the test is focused on determining who bears the risk of nonpayment.

The court analyzed the reconciliation process and finite term factors together and found that because there were no facts presented to the court establishing true opportunity to adjust payments, a finite term could easily be found by adding up the weekly payments until the total debt was paid. The court next considered recourse in bankruptcy. The court dismissed the issue of whether or not bankruptcy was as default and instead, focused on the MCA's rights in bankruptcy. The fact that the MCA filed a secured proof of claim, and had an all assets security interest, indicate that the MCA had recourse. Remedies available to the MCA such as acceleration, assignment of leases, power of attorney, and additional costs of collection and attorneys' fees pointed to a loan rather than a sale. Lastly, the court considered that the MCA purchased of all accounts until the

balance is repaid. That indicated that the MCA is purchasing whichever accounts pay first, thereby minimizing the risk of loss to the MCA.

The court ultimately found the agreement to be void as a usurious loan under New York law and void *ab initio*. Turning to the debtor's claims, the court granted summary judgment to the MCA on the fraudulent transfer claims because the MCA advanced \$245,000 and the debtor did not pay back more than \$245,000. The court granted summary judgment on the debtor's preferential transfer claims but, only as to payments not made in the ordinary course of business.

Lastly, a senior lender to the debtor filed conversion claims against the MCA. The court deemed the MCA to have constructive knowledge of the senior lender's lien via the UCC filing. The court further found that the lender had no present right to its collateral because there was no default, it had not made a demand to the MCA for a return of its collateral, and because the property was money, it must have been designated for a specific purpose and used for an unauthorized purpose to support a conversion claim. The court granted the MCA's motion for summary judgment on the conversion claim.

8. JLK Construction, LLC v. Alva Advance, LLC, 2025 Bankr. LEXIS 1573 (Bankr. W.D. MO June 30, 2025)—second amended complaint filed & motion to dismiss pending.

This is an interesting case on how not to plead a complaint against an MCA. The debtor filed its complaint alleging the following counts: (i) declaratory relief that the transaction was loan and not a purchase; (ii) usury; (iii) fraud; (iv) racketeering; (v) preferential & fraudulent transfers; and (vi) objection to claims and to determine validity and priority of liens. The court dismissed all counts with 21 days leave to amend. The court initially pointed out that simple recitations of the elements of a claim, conclusory statements, or legal conclusions described as "shotgun pleading" is not acceptable. The decision is a good road map (at least under Florida law applied by the court in this instance) of how not to plead a complaint against an MCA.

B. Regulatory Efforts.

Several states, including California, Connecticut, Florida, Georgia, Kansas, Louisiana, Maryland, New Jersey, New York, North Carolina, Virginia and Texas have begun enacting, or have already enacted, some regulations with respect to MCA funding, and several federal statutes may be applicable as well.. *See, e.g.*, <https://onyxiq.com/commercial-financing-disclosure-laws/>, <https://www.sofi.com/learn/content/merchant-cash-advance-regulations/>, <https://www.mayerbrown.com/en/insights/publications/2022/04/virginia-enacts-merchant-cash-advance-registration-and-disclosure-law>, <https://www.gtlaw.com/en/insights/2024/9/new-commercial-financing-laws-take-effect-in-connecticut-kansas>. Accordingly, depending on the applicable law under the particular MCA agreement, or where the MCA recipient is located, it is worth looking at any such regulations to see if there are provisions that may help with businesses in over their heads.

Beyond this handful of states, however, most efforts to deal with MCA funding have been left to civil cases and in some instances, criminal prosecutions.

C. Criminal Prosecutions²

As noted, there are bad actors within the MCA funding industry. Criminal authorities have taken note, including the attorneys general in several states, including New York and New Jersey; the Federal Trade Commission; and certain Securities Regulators. There have been successful efforts to close some funders and to criminally prosecute the worst offenders.

1. *People of the State of New York v. Yellowstone Capital LLC, et al.*, No. 450760/2024 (Supreme Court of the State of New York) (Complaint filed on March 7, 2024)

Following a five-year investigation into the defendants' practices, Letitia James, Attorney General of the State of New York, brought an action against Yellowstone Capital (aka Fundry LLC), various of its subsidiaries, and some of its executives.

a) Complaint and Allegations

The Complaint, spanning over 280 pages of allegations and relief sought, requested that the Supreme Court of the State of New York issue an order and judgment, among other things:

- i. Permanently enjoining defendant and their related entities and agents from engaging in the fraudulent and illegal practices alleged in the complaint, including (a) misrepresenting the nature of the products and services they provided; (b) issuing, selling, or servicing loans under the guise that they are Merchant Cash Advances or non-loan transactions; (c) violating New York Banking Law §§ 340 and 356 ; (d) misrepresenting the amounts of funds that defendants would provide to merchants, fees that defendants would charge and the basis for such fees, as well as the amounts of payments that defendants would collect.
- ii. Permanently enjoining David Glass (Yellowstone's de facto officer part owner and co-founder who, according to the Complaint, was previously convicted of securities fraud) from participating in the business of advertising, marketing, soliciting, brokering, underwriting, offering, or collecting on merchant cash advances, factoring loans, or any other type of business financing.
- iii. Enjoining defendants from involvement in the Merchant Cash Advance business for an appropriate length of time of no less than ten (10) years.
- iv. Ordering defendants to cease all collection of payments or other moneys related to the Merchant Cash Advances.

² Sections IV.C., D., and E. of these materials were prepared by The Honorable Elisabetta G.M. Gasparini, U.S. Bankruptcy Judge for the District of South Carolina, and her law clerks, in connection with a recent presentation for the National Conference of Bankruptcy Judges in Chicago, in September 2025. This section is reproduced here with permission, and gratitude for the excellent work.

- v. Ordering the rescission of each agreement entered between defendants and any merchant in connection with the issuance of a Merchant Cash Advance.
- vi. Ordering defendants to file papers in court sufficient to obtain vacatur of all court judgments issued in their favor and against merchants and/or their guarantors concerning purported defaults or breaches of Merchant Cash Advance transactions by merchants, or settlement agreements with merchants, including judgments issued based on the filing of a confession of judgment.
- vii. Staying all marshals, sheriffs, and collections agents who hold executions under such judgments from executing or collecting upon them.
- viii. Ordering defendants to apply for dismissal of all pending court proceedings filed on their behalf against merchants and/or their guarantors concerning purported defaults or breaches of MCA transactions.
- ix. Ordering defendants to provide an accounting to defendants of their collections concerning MCAs including but not limited to: a list of names and addresses of each merchant from whom defendants collected or received monies since 2013; a complete history of all monies collected by defendants from all such merchants, including an accounting of monies provided to such merchants, fees collected; and copies of all MCA agreements.
- x. Ordering defendants to pay full restitution and damages as to all merchants that had entered into agreements with defendants for MCAs, including those not identified at the time of the order, with such an award providing for (a) the refund of all interest collected by defendants, (b) the refund of all monies collected by defendants pursuant to their fraudulently obtained court judgments, (c) the refund of all monies collected by defendants as fraudulent fees, (d) the refund of all monies over collected by defendants beyond the total collection amounts represented, and (e) damages for losses caused by defendants' conduct.
- xi. Ordering defendants to pay a civil penalty of \$5,000 for each fraudulent MCA transaction.
- xii. Ordering defendants to disgorge all profits from the fraudulent and illegal practices alleged in the complaint.

According to the complaint, the evidence showed that Yellowstone and related entities—leaders in the merchant cash advance industry since 2009—had for years conducted a scheme to fraudulently and illegally take money from small businesses across the United States through usurious, unconscionable loans. In their agreements, defendants misrepresented that each transaction was a purchase of a “specified percentage” of the merchant’s future receivables and that the “daily amount” to be repaid was a good faith approximation of the Specified Percentage. Moreover, to create the illusion that payment amounts and terms were variable, respondents stated in each agreement that merchants could request a “reconciliation” of past payment amounts to

ensure that they did not exceed the “specified percentage” of revenue. While promising to reconcile merchants’ payment amounts and provide refunds if the payments exceed those percentages, defendants manipulated their specified percentages such that it was virtually impossible for merchants to obtain reconciliation refunds. Thus, as the complaint alleges, in reality the transactions were usurious loans, repayable at fixed amounts over finite terms, subject to sky-high interest rates, and collectable by defendants even when the merchants declare bankruptcy.

The complaint includes the following example, which depicts a clearer picture of typical MCA transactions and provides support for the allegations in the complaint. In 2022, one of Yellowstone’s related entities, Delta Bridge, issued an MCA to Cookies Restaurant Group LLC (“Cookies”) in Catskill, New York. The MCA set a “daily amount” of \$208 and a “specified percentage” of 49% and further stated that the “daily amount” was a “good faith approximately of the Specified Percentage of Cookies’ Future Receipts.” But a review of Cookies’ bank statements submitted to Yellowstone’s company during the underwriting phase reflected that \$208 was actually between 13-18% of Cookies’ average daily revenue—not 49% as stated in the agreement. By doing so, Delta Bridge raised the bar impossibly high for Cookies to obtain a reconciliation of its past payments. When Cookies experienced a 50% decline in revenues, Delta Bridge refused Cookies’ request for a reconciliation refund because the amount Delta Bridge had collected (\$6,953) was still less than 40% of the merchant’s \$37,041 in revenues. Thus, the reconciliation clauses were mere “window dressing.”

In further pleadings filed with the state court, the NY Attorney General argued that the agreements were unconscionable not only because of their excessive interest rates and onerous, one-sided provisions, but also because defendants in essence preyed upon financially desperate merchants while defrauding them with misrepresentations, effectively ensuring that they will eventually default on the agreements. The NY Attorney General further alleged that defendants had committed repeated and persistent illegal acts in the form of criminal usury and civil usury and, in so doing, posited that the MCAs were disguised loans.

In its pleadings, the Attorney General offered other examples of how Yellowstone and its related companies were imposing arbitrary rules to prevent merchants from receiving reconciliation refunds:

- Yellowstone’s agreements stated that reconciliation was not available to a merchant in default of its MCA, while ensuring that the merchants were in essence in default on Day One by requiring that their receipts be free and clear of other encumbrances, when in fact Yellowstone knew that merchants had often already pledged their receipts to other MCA companies.
- Yellowstone ensured that merchants would default by defining “Default” in the MCAs to include any instance when a merchant’s bank rejected four (or fewer) debit attempts by Yellowstone. By doing so, Yellowstone ensured that merchants with insufficient funds to cover Yellowstone’s daily debits would be in essence ineligible to receive reconciliation.

- Yellowstone prevented reconciliation by counting merchant's non-revenue income as revenue to make it appear that merchant's sales had not decreased. They did this by counting as revenue funds that merchants received from other MCA companies.
- Yellowstone restricted reconciliation in additional ways, including by allowing merchants to request relief only during a narrow, five-day window each month. Thus, a "mid-month decline in revenues" could trigger a default under the contract and entitle the funder to immediately seek the whole uncollected amount.

b) Settlement

On January 22, 2025, the NY Attorney General announced a settlement with the network of 25 predatory lending companies controlled by Yellowstone Capital and its officers. The settlement includes a \$1,065 billion judgment against Yellowstone, with over \$534 million of that paid by canceling all outstanding debts owed by small businesses, including over 1,100 across New York state and over 18,000 nationwide. The settlement would also deliver \$16M in restitution to small businesses that Yellowstone targeted with illegal high-interest loans.

As explained in the press release, while the funders promised to "reconcile" or refund small businesses' daily payments to ensure they never rose above an agreed-upon percentage of their revenue, they used numerous fraudulent measures to ensure borrowers almost never qualified for these payment refunds. As a result, the transactions actually functioned as short-term loans with ultra-high interest rates of up to 820 percent per year – more than 50 times the legal interest rate. The press release regarding the settlement, which can be found at <https://ag.ny.gov/press-release/2025/attorney-general-james-announces-1-billion-settlement-predatory-lender>, further stated:

Under the settlement announced today, the Yellowstone entities are canceling all amounts owed by merchants, totaling \$534,552,724, and together with Stern and Reece, have made an immediate \$16.1 million payment toward the remaining \$514 million judgment that will be distributed to impacted small businesses. This cash payment will be increased to \$30 million if they fail to comply with the terms of the settlement. The Yellowstone entities are required to cease all attempts to collect on balances owed by businesses they lent to, discontinue pending actions to enforce them, vacate unsatisfied court judgments, and terminate some liens on small businesses' property. The companies and the officers will also be permanently banned from the merchant cash advance industry. The \$1.065 billion total judgment is the largest consumer settlement obtained by OAG, excluding multistate settlements.

If you have clients with MCA obligations, look into this case to see if the MCA funders your clients dealt with are included in the Yellowstone settlement. It is not too late to file claims, and it is not too late to obtain release of UCC-1s, dismissal of collection suits, vacation of judgments, etc. To check: <https://ag.ny.gov/resources/individuals/credit-debt-lending/yellowstone-settlement>.

2. People of the State of New York v. Richmond Capital Group LLC, et al., No. 4513680/2020 (Supreme Court of the State of New York) (Complaint filed in June of 2020)

On February 6, 2024, the New York Attorney General announced a judgment against three merchant cash advance companies—Richmond Capital Group, Ram Capital Funding, and Viceroy Capital Funding (the “Richmond Companies”)—and their principals for over \$77 million.

In June 2020, NY Attorney General Letitia James sued the companies for hurting small businesses in New York and throughout the nation. According to the press release found at <https://ag.ny.gov/press-release/2024/attorney-general-james-announces-historic-judgment-against-predatory-lender>, the OAG investigation uncovered that the Richmond Companies were loaning money to small business owners at astronomically high interest rates and over short terms, illegally charging undisclosed fees, debiting excess amounts from merchants’ bank accounts, and fraudulently obtaining judgments against merchants by filing false affidavits in New York state courts. One example presented to the court showed that the Richmond Companies loaned \$10,000 to a small business and required its owner to pay back \$19,900 within 10 days, through daily payments of \$1,999. As a result of the large daily payments and the short, 10-day repayment term, the annual interest rate for the merchant cash advance, including fees, came close to 4,000 percent — almost 250 times the legal interest rate.

In September 2023, the state court had required the Richmond Companies to stop collecting their outstanding debt and to repay thousands of small businesses the unfair interest they had to pay. The judgment followed the Richmond Companies’ refusal to provide an accounting and full history of monies collected as part of the September 2023 court decision.

3. New Jersey Attorney General Settlement with Yellowstone Capital

On December 27, 2022, the New Jersey Division of Consumer Affairs entered a consent order with Yellowstone Capital LLC and several related companies to resolve allegations that, in violation of the New Jersey Consumer Fraud Act, the company engaged in abusive lending practices in connection with merchant cash advances to small business owners. Pursuant to the settlement, Yellowstone had to forgive all outstanding balances for customers who entered into MCAs, estimated to be approximately \$21.7 million, and pay more than \$5.6 million to the Division for purposes that may include restitution, attorneys’ fees, costs of investigation, litigation, and of administering restitution, and penalties up to \$250,000. The order also imposed additional requirements regarding Yellowstone’s agreements and collections activity discussed above.

The press release dated January 3, 2023, announcing the settlement can be found at <https://www.njoag.gov/ag-platkin-announces-27-375-million-settlement-with-yellowstone-capital-llc-and-related-entities-over-allegations-of-unlawful-lending-servicing-and-collection-practices/>.

D. FTC Actions

1. *Federal Trade Commission v. RCG Advances, et al.*, Case No. 20-CV-4432 (S.D.N.Y.).

The FTC filed a complaint against RCG Advances, LLC—formerly known as Richmond Capital Group, LLC—and their related entities and individuals. The complaint alleged that, since at least 2015, the defendants had deceived small businesses and other organizations by misrepresenting the terms of merchant cash advances they provided, and then used unfair collection practices, including threatening physical violence, to compel consumers to pay. The FTC also alleges that defendants had made unauthorized withdrawals from consumers’ accounts. The press release from January 5, 2022, can be found at <https://www.ftc.gov/news-events/news/press-releases/2022/01/merchant-cash-advance-providers-banned-industry-ordered-redress-small-businesses>.

Two of the defendants, RAM Capital Funding, LLC and its owner Tzvi Reich, were permanently banned from the merchant cash advance and debt collection industries and were required to pay \$675,000 to settle the FTC charges. As part of the settlement, the defendants were ordered to vacate any judgments against their former customers and to release any liens against their customers’ property. The proposed order would also ban these defendants from making these and similar misrepresentations, and from further violations of the Gramm-Leach-Bliley Act. The FTC’s case against the other defendants—RCG Advances, LLC, Robert Giardina, and Jonathan Braun—continued and resulted in the judgments set forth below. The press release from June 6, 2022 can be found at <https://www.ftc.gov/news-events/news/press-releases/2022/06/ftc-action-results-ban-richmond-capital-owner-merchant-cash-advance-debt-collection-industries>.

The FTC’s continued lawsuit against RCG Advances, LLC and Robert Giardina led to a court order that permanently banned the company and owner from the merchant cash advance industry. The FTC alleged that the scheme’s operators lied to small business owners about terms and fees for their financing, and threatened them with violence when they were unable to pay. In addition, the court ordered RCG Advances and Giardina to make an upfront payment of \$1.5 million and subsequent payment of more than \$1.2 million to refund to consumers. The press release from October 30, 2023 is available at <https://www.ftc.gov/news-events/news/press-releases/2023/10/ftc-case-leads-permanent-ban-against-merchant-cash-advance-owner-deceiving-small-businesses-seizing>.

With respect to Jonathan Braun, who controlled small-business funding company RCG Advances, he faced a permanent ban from the merchant cash advance and debt collection industries. A federal court issued summary judgment in favor of the FTC along with a permanent injunction against Braun. The court’s opinion granting summary judgment in favor of the FTC found that Braun engaged in “extensive misconduct” that violated both the FTC Act and the Gramm-Leach-Bliley Act, and that Braun was liable for the damages caused by his and the company’s unlawful conduct. The press release from February 14, 2024 is available at <https://www.ftc.gov/news-events/news/press-releases/2024/02/court-enters-203-million-judgment-ftc-case-against-merchant-cash-advance-operator-jonathan-braun>.

The District Court for the Southern District of New York subsequently entered a judgment requiring Jonathan Braun to pay \$20.3 million in monetary relief and civil penalties. It was the first trial by jury that the FTC had ever conducted. The judgment followed a trial in which a jury found that Braun, in his role with RCG Advances, which formerly did business as Richmond Capital Group, knowingly violated the Gramm-Leach-Bliley Act by deceiving small businesses about the amount of funding that Defendants would provide to and collect from them. The court entered a judgment of \$3,421,067 to redress the harm that Braun's misconduct caused to small businesses. In addition, noting the utter disregard and contempt that Braun showed to consumers, including spewing vile threats and profanities to small business owners, the court imposed \$16,956,000 in civil penalties for Braun's violations of law.

As an example of the "threats" that Mr. Braun made, the judgment provides as follows:

Sixth and finally, Mr. Reich recorded a video of Mr. Braun making grossly threatening comments to a borrower over the phone in order to intimidate the borrower from gaining information. Among other things, Mr. Braun threatened to send the consumer to jail and said he would spit on the consumer's "[***]ing face on visiting day" in prison. Mr. Braun told the consumer to drive his Honda "off a cliff" and that he hoped the consumer's wife would leave him. Throughout the call, Mr. Braun also called the consumer a "[***]ing lowlife," a "loser," a "degenerate," and "a piece of s[***]t."

2. Federal Trade Commission, Plaintiff v. Yellowstone Capital, et al., Case No. 20-cv-06023 (S.D.N.Y.).

Yellowstone and its related companies were also named defendants in a lawsuit filed by the FTC for alleged unfair and deceptive acts or practices in violation of the FTC Act in connection with the same activities. That lawsuit resulted in a settlement requiring the defendants to pay \$9,837,000 to the FTC to be used in providing refunds to the impacted businesses. The Press Release from April 22, 2021 is available at <https://www.ftc.gov/news-events/news/press-releases/2021/04/cash-advance-firm-pay-98m-settle-ftc-complaint-it-overcharged-small-businesses>.

E. Securities Regulators

MCAs can also lead to securities violations when used to finance business operations. The issue can arise when the funding structures used by MCA originators to attract investors, such as participations in MCA transactions, could be classified as unregistered securities under federal law. A good example is the case *Securities and Exchange Commission v. Complete Business Solutions Group, Inc.* et al., No. 9:20-Cv-81205 (S.D. Fla.). In the summer of 2020, the Securities and Exchange Commission filed an action and obtained a TRO to stop a fraudulent scheme that had raised nearly half a billion dollars from approximately 1,200 investors nationwide.

According to the SEC's complaint, spouses Lisa McElhone and Joseph W. LaForte orchestrated a scheme to raise investor funds through unregistered securities offerings for the cash advance company they controlled, Complete Business Solutions Group Inc., doing business as Par Funding. The Complaint further alleged that

McElhone and LaForte made opportunistic loans, some of which charged more than 400% interest, to small businesses across America. To fund the loans, McElhone and LaForte, with the assistance of other Par Funding personnel, used a network of unregistered sales agents and affiliated entities to sell promissory notes to the public while lying to or misleading investors about Par Funding's business, how investor funds would be used, and LaForte's role and criminal history.

The SEC's complaint, filed on July 24, 2020, charged the defendants with violating the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and the securities registration provisions of Sections 5(a) and 5(c) of the Securities Act. The SEC sought disgorgement of ill-gotten gains, prejudgment interest, and civil penalties. For additional information see Press Release from July 31, 2020 and available at <https://www.sec.gov/enforcement-litigation/litigation-releases/lr-24860>. The principals were also under indictment for various crimes, including securities fraud, extortionate collection of credit, tax crimes, perjury, obstruction of justice, witness relationship and witness tampering. Eventually some of them pled guilty and were sentenced to over 10 years in prison.

American College of Bankruptcy

Sixth Circuit Educational Program in Memory of G.

Christopher Meyer

November 18, 2025

Independent Directors & Corporate Governance

Panelists:

Evan R. Fleck, Partner, Milbank

Andrew Medvedev, Dean, Weatherhead School of Management,
Case Western Reserve University

Glenn C. Pollack, Managing Director, Candlewood Partners

Adrienne K. Walker, Partner, Foley

Moderator:

Daniel A. DeMarco, Partner, Hahn Loeser & Parks LLP

This panel will explore the evolving role of independent directors in corporate restructurings and bankruptcies. The discussion will address governance challenges that arise when boards confront financial distress, including potential conflicts of interest and fiduciary duties.

Panelists will also examine recent case law and best practices for ensuring transparency and accountability in the decision-making process. *

* The panelists and moderator wish to acknowledge and thank Katie L. Steiner, Associate, Hahn Loeser & Parks LLP, for her substantial contributions and assistance in developing, researching and preparing the topics outlined herein and in researching and preparing the accompanying annotated bibliography.

Independent Directors and Corporate Governance

I. Introduction

- A. How, if at all, do directors' duties evolve as a company's financial situation deteriorates? Do those duties extend to creditors in addition to shareholders and, if so, when? (*See, e.g., N. Am. Catholic Educ. Programming Found. v. Gheewalla*, 930 A.2d 92 (Del. 2007).)
- B. Directors' responsibility to maximize value for shareholders is often in tension with creditor interests. How is the role of the independent director designed to mitigate this tension?

II. Fiduciary Duties & the Rise of Independent Directors

- A. Fiduciary duties of directors (Delaware law; generally).
 - i. Loyalty & care—what do they mean?
 - ii. Standards of review for breach of fiduciary duty (business judgment rule; enhanced scrutiny; entire fairness).
- B. Rise in popularity of independent directors.
 - i. Trends in recent history with respect to manager, lender, and sponsor control.
 - ii. What is the purpose of independent directors, and how do they function—at least in theory—to insulate decisionmakers from conflicts?
 - iii. How does this theory break down in practice, in light of structural biases and issues created by serial repeaters, among other factors?

III. Independent Directors—Facilitators or Adversaries?

- A. Utility of independent directors as facilitators.
 - i. How, in practice, do independent directors promote trust? How do they create decision-making processes and restore confidence in the organization? How do they function (unofficially) as “informants,” and to whom?
 - ii. What “expertise” do independent directors typically lend? Does the existence of an independent director supplant the need for a Chief

Restructuring Officer (CRO)? How are independent directors different from a receiver?

- iii. How does the independent director come into contact with the Bankruptcy Judge, the Office of the U.S. Trustee, and/or Official Committees (whether bond holders, tort claimants, or general unsecured creditors)?
- iv. How does the role of the independent director change when the distressed organization is a nonprofit?

B. How to attack—or defend—the independent director?

- i. “Divide and Conquer” strategies.
- ii. Are there instances in which independent directors have been trapped in litigation or by threats of litigation?

IV. Mega-Case Perspective

A. “Independent” directors in practice.

- i. When and why are they typically used? (*E.g.*, seeking sponsor releases, etc.)
- ii. How are independent directors used in distressed situations as a pro-active defensive measure?
- iii. How do independent-director fee structures complicate their role?

B. Outlier or Wave of the Future? The *Exactech* chapter 11 case.

- i. Case overview.
- ii. What were Judge Silverstein’s critiques of the independent director in this case?
- iii. What value, if any, did the independent director add, especially in relation to the additional time and costs involved? Could the role have been performed by a CRO instead?
- iv. Were there other, and perhaps better, alternatives to the independent director and why?

V. Middle-Market Perspective

- A. Utility of independent directors in middle-market companies and cases.
 - i. Examples of success stories (*e.g.*, how the appointment of independent directors has permitted a foreclosure to move forward, etc.).
 - ii. When are CROs used in lieu of (or in conjunction with) independent directors and why?
 - iii. What do compensation structures typically look like?
 - iv. What trends are emerging in the middle market ?
- B. How does the middle-market experience compare with that of enterprises in the mega tier?
 - i. What accounts for the differences?
 - ii. Will some of the trends in the mega tier begin to appear in the middle market? What will it take for that to happen?

VI. Concluding Thoughts & Questions

- A. Predictions for the future in terms of the role and usage of the independent director.
- B. How can the utility of the independent director be improved?
- C. Best practices as they pertain to independent directors.
 - i. When should independent directors be installed?
 - ii. How can the structural biases be mitigated?
 - iii. What practices give courts pause versus those that instill greater trust?
- D. Audience questions.

Annotated Bibliography

The following articles, several of which date to recent months, address current issues involving independent directors in Chapter 11 cases. This selection of articles is not intended to be comprehensive, but rather to provide a contextual framework for the panel discussion.

I. Academic Articles, Blog Posts, and Conference Materials

Jared A. Elias, Ehud Kamar & Kobi Kastiel, *The Rise of Bankruptcy Directors*, 95 S. CAL. L. REV. 1083 (2022), https://southerncalifornialawreview.com/wp-content/uploads/2023/02/Elias_Final.pdf.

This frequently cited article criticizes independent directors, highlighting the presence of structural biases and correlation between the appointment of independent directors and lower recoveries for unsecured creditors. For a convenient distillation of an early version of this paper, see *New Working Paper Raises Significant Concerns Regarding “Bankruptcy Directors” in Chapter 11 Cases*, Schwartz Law (Sept. 15, 2021), <https://nvfirm.com/new-working-paper-raises-significant-concerns-regarding-bankruptcy-directors-in-chapter-11-cases/#:~:text=Overall%2C%20the%20findings%20showed%20that,of%20private%20Dequity%20funds.%E2%80%9D>.

Hon. Thomas M. Horan, *et al.*, *That’s What Boards Are For: Corporate Governance Issues in Chapter 11*, 97th Annual National Conference of Bankruptcy Judges (Oct. 11–14, 2023, Austin, TX), https://ncbj.org/wp-content/uploads/2024/01/Thats-What-Boards-Are-For_Corporate-Governance-Issues-in-Chapter-11.pdf.

These conference materials address a recent case in which debtors sought court approval for the pre-petition appointment of two independent directors, and wherein such approval was granted over the objections of the U.S. Trustee. These materials also provide an overview of frequent academic criticisms of independent directors.

Adam Levitin, *The Academics Speak Up: Levitin on Independent Directors*, Creditor Rights Coalition (June 7, 2025), <https://creditorcoalition.org/the-academics-speak-up-independence-is-a-misnomer/>.

In this blog post, Prof. Levitin (Georgetown Law) criticizes the lack of independence of “independent” directors.

Robert W. Miller, *Everyone Is Talking About Bankruptcy Directors*, 23 FLA. ST. U. BUS. REV. 61 (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4723620.

This article outlines the rise in popularity of independent directors and proposes a solution for insulating independent directors from bias.

II. Law-Firm White Papers

Appointing Independent Directors for Distressed Companies: An Alternative to Bankruptcy, Choate (Sept. 10, 2025), <https://www.choate.com/insights/appointing-independent-directors-for-distressed-companies-an-alternative-to-bankruptcy/>.

This article provides a list of considerations and proposes best practices pertaining to the appointment of independent directors.

Chapter 11 Filing Without Consent of Independent Director Dismissed as Unauthorized, Jones Day (May 22, 2025), <https://www.jonesday.com/en/insights/2025/05/chapter-11-filing-without-consent-of-independent-director-dismissed-as-unauthorized>.

This article considers bankruptcy blocking rights apropos of a recent decision (*In re 301 W N. Ave., LLC*, 666 B.R. 538 (Bankr. N.D. Ill. 2025)), wherein the court granted lender's motion to dismiss a chapter 11 filing because the independent director did not consent to it, as required by the loan agreement and debtor's LLC agreement.

Facilitator or Foe? Addressing Contributions and Critiques of the Chapter 11 Independent Director, Weil, Gotshal & Manges LLP (2022), <https://www.sbli-inc.org/archive/2022/documents/Examining-the-Expanding-Role-of-Independent-Directors-in-Modern-Chapter-11-Bankruptcies.pdf>.

This article rebuts common academic criticisms of independent directors, especially concerning their encroachment on unsecured creditors' committees and lack of disinterestedness, as well as the alleged correlation between their appointment and lower recoveries for unsecured creditors.

Independent Directors Properly Exculpated as Debtors' Disinterested Fiduciaries Under Chapter 11 Plan, Southern District of Texas Bankruptcy Court Rules, Paul Weiss (March 10, 2025),

https://www.paulweiss.com/media/b2in101x/independent_directors_properly_exculpated_as_debtors_disinterested_fiduciaries_under_chapter_11_plan_southern_district_of_texas_bankruptcy_court_rules.pdf.

This article outlines a recent decision by the U.S. Bankruptcy Court for the Southern District of Texas finding that debtor's chapter 11 plan exculpated debtor's independent directors for conduct performed in the scope of their duties during the administration of the chapter 11 case, absent gross negligence or intentional misconduct, even though the independent directors were appointed post-petition.

Special Committees Gain Traction in Chapter 11 Investigations, Morris James LLP (Aug. 28, 2025), <https://www.morrisjames.com/p/10213e8/special-committees-gain-traction-in-chapter-11-investigations/>.

This article outlines bankruptcy judges' expectations for special committees of independent directors and best practices for forming and advising special committees.



SIXTH CIRCUIT EDUCATIONAL PROGRAM IN
MEMORY OF

G. CHRISTOPHER MEYER

CONSUMER MASHUP

Robert Barr

Julie Rabin, Moderator

Toni Freeburg



Presentation Outline

CONSUMER MASHUP

Consumer Bankruptcy:
Issues frequently encountered in
current consumer cases

*Wohleber v. Skurko (In re
Wohleber)*, 596 B.R. 554
(6th Cir. BAP 2019):

The intersection of consumer
bankruptcy and divorce



PRO SE BANKRUPTCY CASES

- Approx. 10% of consumer chapter 7 filings.
- Bankruptcy petition preparers (BPPs) are becoming more prevalent.
- BPPs may not practice law; their fees are limited to \$125.00; and they may do nothing more than type the petition and schedules.
- *See* 11 U.S.C. § 110; *Gould v. Clippard*, 340 B.R. 861 (Bankr. M.D. Tenn. 2006) (sanctioning BPP for violations of § 110 & unauthorized practice of law).



Debt Relief Companies

- Sell packages of services including debt relief and settlement with creditors “to avoid bankruptcy.”
- From a chapter 7 trustee perspective: the services are rarely effective.
- If a consumer bankruptcy case is subsequently filed, may result in claims against the debt relief company for fraudulent conveyance (11 U.S.C. § 548), violations of the Ohio Consumer Sales Practices Act (O.R.C. § 1345.01), and violations of the Ohio Debt Adjustment Companies Act (O.R.C. § 4710.01).

Should a Consumer Bankruptcy Case be Filed (perhaps no)?



- Retiree with no assets, on social security or pension.
- Foreclosure, when the only/primary debt is a mortgage deficiency. *See* O.R.C. § 2329.08 (statute of limitations = 2 years from confirmation of judicial sale).
- The debts cannot be discharged (tax debts, student loans). *See* 11 U.S.C. § 523(a)(8).
- In the midst of a contested divorce (support, property & debt disputes).
- A personal bankruptcy may effectively terminate an operating business



COMMON OHIO EXEMPTIONS

(EFFECTIVE APRIL 2025, SEE O.R.C. § 2329.66(A))

- Residence – \$182,625
- Vehicle - \$5,025
- Furniture/Appliances/Clothing - \$16,850 aggregate
- “Wildcard” - \$1,675
- Personal injury claim - \$31,650
- 100%: social security, pension, IRA, 401k, earned income credit, child tax credit, 529 college savings



HOMESTEAD EXEMPTION ISSUES:

- Residence in Ohio: \$182,625 for a single debtor. O.R.C. § 2329.66(A)(1).
- “Residence” means occupancy of the premises by the debtor as a principal place of dwelling. This is determined as of the petition date.
- “Mere intention to occupy premises as a home at some future time without residence or occupancy is insufficient to establish a homestead.” *Mutual Bldg. & Inv. Co. v. Afros*, 152 Ohio St. 369, 373 (1949).
- To claim a homestead exemption for each of two co-debtor spouses, they both must have a legal interest in the property.



HOMESTEAD EXEMPTION ISSUES:

(PART II)

- A homestead exemption may not be claimed in a parcel of vacant land not used as the residence, even if adjacent to or contiguous with the home/dwelling. *In re Caperton*, Case No. 10-31775, 2011 Bankr. LEXIS 5761 (Bankr. N.D. Ohio 2011).
- To claim a homestead exemption for each of two co-debtor spouses, they both must have a legal interest in the property.
- A fraudulent or preferential transfer undermines a claim of exemption. Under 11 U.S.C. § 522(g), an exemption cannot be claimed in property voluntarily transferred by a debtor pre-bankruptcy.



HOMESTEAD EXEMPTION ISSUES:

(PART III)

- IRS liens are senior in priority to homestead exemption. 11 U.S.C. § 522(c)(2)(B). United States v. Estes, 450 F.2d 62, 65 (5th Cir. 1971).
- A bankruptcy trustee may preserve the penalty portions of IRS liens for the benefit of the bankruptcy estate. 11 U.S.C. § 724(a) states: “The Trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title.” 11 U.S.C. § 726(a)(4) includes claims, “whether secured or unsecured, for any fine, penalty, forfeiture, or for multiple, exemplary, or punitive damages...”
- Under § 724(a), penalties may be avoided and preserved for unsecured creditors pursuant to § 551. IRS v. Baldiga, 619 B.R. 524, 534 (D. Mass. 2020).



CO-OWNER SALES IN BANKRUPTCY

Under § 363(h), a bankruptcy trustee may sell both the debtor's interest and a co-owner's interest in real property if:

- Partition is impracticable
- A sale of the bankruptcy estate's undivided partial interest would realize significantly less for the estate than a sale of the entire property free and clear of the co-owner's interest
- The benefit to the estate outweighs the detriment to the co-owner
- The property is not used in the production of electricity, gas, etc.

Note that under § 363(i), a debtor's spouse or co-owner has the right to match the sale offer.

UNIQUE ASSETS IN BANKRUPTCY

Real Estate

TIME SHARES	MINERAL RIGHTS	PARTIAL INTERESTS	CARVE-OUTS
• Most are not saleable • Disney timeshares • Sale methods • Internet auctioneers	• Buyer entities • Title issues • Sell “subject to” • Liabilities to government entities	• Inherited real estate • Buyer entities • Sell “subject to” • Internet auctioneers	• Not encouraged in consumer cases • Must benefit general unsecured creditors • Consent of all secured parties



WHO QUALIFIES FOR CHAPTER 7?

MEDIAN INCOME – OHIO

SEE 11 U.S.C. §§ 101(39A), 707

- **\$62,952 – one earner**
- **\$79,491 – two people in household**
- **\$96,951 – three people**
- **\$119,897 – four people**
- **Add \$11,100 for each additional individual**

CHAPTER 7 AND 13 - INCOME ISSUES

- Full household income, including income of non-filing spouse (if not separated), must be disclosed.
- 11 U.S.C. § 521 requires a schedule of all income. In a chapter 13 case, 11 U.S.C. § 1325 mandates that all disposable income be utilized.
- *In re Kuhns*, Case No. 11-31518, 2011 Bankr. LEXIS 3900 (Bankr. N.D. Ohio 2011) (chapter 7 dismissed for failure to disclose spouse's income).
- *In re Skiles*, 504 B.R. 871 (Bankr. N.D. Ohio 2014) (utilizing an “economic unit” approach - income from non-filing family members in household must be included to confirm chapter 13 plan).

Exceptions to Discharge



FRAUD

- 11 U.S.C. § 523(a)(2)(A)
- False Financial Statement – 11 U.S.C. § 523(a)(2)(B)
- Must prove: debtor obtained money/services through material misrepresentation; debtor knew was false or made with gross recklessness as to truth; debtor intended to deceive; creditor justifiably relied; and the reliance was the proximate cause of loss. *In re Rembert*, 141 F.3d 277, 280-81 (6th Cir. 1988).
- A creditor must plead specific facts to support each element.

BREACH OF FIDUCIARY DUTY

- 11 U.S.C. § 523(a)(4) - Defalcation while acting in a fiduciary capacity, embezzlement, larceny
- “Fiduciary capacity” is interpreted narrowly. The Debtor must hold funds in trust for the benefit of the aggrieved party. *In re Garver*, 116 F.3d 176, 179 (6th Cir. 1997). The mere failure to meet an obligation while acting in a fiduciary capacity does not rise to the level of defalcation.

WILLFULL & MALICIOUS INJURY

- 11 U.S.C. § 523(a)(6)
- A creditor must prove that the injury from which the debt arises was both willful and malicious. *In re Markowitz*, 190 F.3d 455, 463 (6th Cir. 1999). This is a stringent standard.
- An intentional breach of contract is not enough to support a claim under § 523(a)(6).



PRECLUSION ISSUES IN BANKRUPTCY

- *Res Judicata* (claim preclusion) is not applicable in dischargeability proceedings
- *Collateral estoppel* (issue preclusion) can be applicable in dischargeability proceedings. Grogan v. Garner, 498 U.S. 279, 284 (1991).
- A non-bankruptcy court's determination of fraud may be preclusive in a subsequent bankruptcy case.



JULIE RABIN
jrabin@rabinandrabin.com
216.771.8084

CONTACT INFORMATION

For Any Questions

ROBERT BARR
rbarr@koehler.law
216.744.2739

TONI FREEBURG
rbarr@koehler.law
440.536.8039

American College of Bankruptcy

Judges Potpourri: Judges From Our Sixth Circuit States Consider Issues on Their Minds (And Your Minds If You Ask) That Will Help Local Practitioners In and Out of Court

Hon. Gregory R. Schaaf, U.S.B.C., E.D. Ky. - Moderator

Hon. Paul Hage, U.S.B.C., E.D. Mich.

Hon. John E. Hoffman, Jr., U.S.B.C., S.D. Ohio

Hon. Nancy B. King, U.S.B.C., M.D. Tenn

Hon. Jessica E. Price Smith, U.S.B.C., N.D. Ohio

**Judges Potpourri: Judges From Our Sixth
Circuit States Consider Issues on Their
Minds (And Your Minds If You Ask) That
Will Help Local Practitioners
In and Out of Court¹**

A. Sanctions

- (1) Statutory authority – 11 U.S.C. § 105(a); 28 U.S.C. § 157(b)(2)(A) (administration) & (E) (turnover of property of the estate).
- (2) Inherent authority
 - (i) “The inherent sanction authority allows a bankruptcy court to deter and provide compensation for a broad range of improper litigation tactics.” *Knupfer v. Lindblade (In re Dyer)*, 322 F.3d 1178, 1196 (9th Cir. 2003).
 - (ii) When imposing a sanction under its inherent power, the court must make a finding of bad faith. *In re Pastran*, 462 B.R. 201, 210 (Bankr. N.D. Tex. 2011).
- (3) Bankruptcy Rule 9011
 - (i) Obligations Imposed by Bankruptcy Rule 9011
 - (a) Bankruptcy Rule 9011(b) provides that, by filing a pleading or motion, the filer implicitly certifies that the pleading or motion meet certain requirements.
 - (b) Bankruptcy Rule 9011(b) imposes on attorneys and unrepresented parties the obligation to ensure that all submissions are truthful and submitted for proper litigation purposes.
 - (ii) Frivolousness or Improper Purpose
 - (a) A frivolous paper is neither well-grounded in fact and warranted by existing law nor a good faith argument for the extension, modification, or reversal of existing law.
 - (b) A pleading has an improper purpose if filed to harass, cause unnecessary delay or needlessly increase litigation costs.
 - (iii) Sanctions Under Bankruptcy Rule 9011
 - (a) Sanctions for violations of Bankruptcy Rule 9011(b) are authorized by Bankruptcy Rule 9011(c).
 - (b) Courts may act *sua sponte*, afford notice and reasonable opportunity to

¹These materials were originally prepared for the National Conference of Bankruptcy Judges Annual Meeting, September 17-20, 2025, and are reprinted herein with permission.

respond and are limited to “what is sufficient to deter repetition of conduct or comparable conduct by others similarly situated”.

- (c) May include nonmonetary directive, monetary penalty paid to the court, payment of attorneys’ fees and other costs.
- (d) A court may not impose monetary sanctions for arguments made in good faith, or on its own unless it issues the show cause order before voluntary dismissal or settlement of the claims made by or against the party that might be sanctioned.
- (e) Any order imposing sanctions must describe the sanctioned conduct and explain the basis for the sanctions.
- (f) “Akin to contempt”.
- (g) Court may, but has no requirement to, consider the sanctioned party’s financial situation.

B. Disinterestedness, Disclosures and Retaining Professionals

- (1) Bankruptcy Rule 2014(a) - “The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person'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. The application shall be accompanied by a verified statement of the person to be employed setting forth the person'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.”
- (2) Bankruptcy Rule 2014(a) requires a professional seeking authorization of the court to be employed, to disclose its connections to the debtor, its creditors and any party in interests. 11 U.S.C. § 327(a) is considered “the gatekeeper” which, on its face, authorizes retention of professionals that do not hold or represent an interest adverse to the estate and are not disinterested. Courts used Bankruptcy Rule 2014(a) disclosures to gauge whether the person to be employed is not disinterested or hold an adverse interest. *See In re Renaissance Residential of Countryside, LLC*, 423 B.R. 848, 857 (Bankr. N.D. Ill. 2010).
- (3) Adverse interest is generally recognized where the attorney either: “possess[es] or assert[s] any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant” or “possess[es] a predisposition under circumstances that render such a bias against the estate.” *Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610, 623 (2d Cir. 1999).

- (4) Aside from disinterestedness, there is a disclosure requirement for fee arrangements. Section 329(a) and Bankruptcy Rule 2016(b) together govern the disclosure requirements for any fee arrangements. These regulations present a “check” on debtors’ attorneys to disclose fee arrangements and payments. The two together require disclosure within 14 days of the order for relief of all fee arrangements and payments within one year of filing, and disclosure of all payments made within 14 days. A violation of these requirements can lead to disgorgement of fees and courts treat these violations as seriously as a breach of fiduciary duties. *See Futuronics Corp. v. Arutt, Nachamie & Benjamin (In re Futuronics Corp.)*, 655 F.2d 463, 470 (2d Cir. 1981); *SE Property Holdings, LCC v. Stewart (In re Stewart)*, No. 15-12215-JDL, 2022 WL 3209467 (Bankr. W.D. Okla. Aug. 3, 2022).
- (5) 11 U.S.C. § 328(c) of the bankruptcy code specifically authorizes courts to deny fees and reimbursement of expenses if at any time the court finds the attorney is not disinterested or may hold an interest adverse to the estate. *See Gray v. Eng.*, 30 F.3d 1319 (10th Cir. 1994). It is common that the disallowance can be ordered even when there has been no harm to the estate. *See In re Peoples Savings Corp.*, 114 B.R. 151 (Bankr. N.D. Ill. 1990). The Ninth Circuit has acknowledged that the issue of whether the disclosure requirement was violated and whether the professional was disinterested are distinct questions and separately sanctionable. *Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 880 (9th Cir. 1995).
- (6) Bankruptcy Rule 2017(a) implements § 329 by providing that the court on its own initiative or any party in interest can motion the court to review the debtor’s attorney fees for excessiveness. Congress enacted these sections in recognition of the fact that “[p]ayments to a debtor’s attorney provide serious potential for evasion of creditor protection provisions of the bankruptcy laws, and serious potential for overreaching by the debtor’s attorney, and should be subject to careful scrutiny”. S.Rep. No. 989, 95th Cong., 2d Sess. 39 (1978).
- (7) Once the court on its own initiative or party interest raises the question of the reasonableness of the attorney fees under § 329, the debtor’s attorney bears the burden of proving his/her fee is reasonable. The factors used to evaluate the reasonableness of the compensation are set forth in §330(a)(3) of the Bankruptcy Code and require a court to “consider the nature, extent, and value of such services, taking into account all relevant factors”, including the time spent on the services, rates charged; whether the services were necessary to the administration of or were beneficial to a case; whether the services were performed in a reasonable amount of time; and the customary compensation of comparably skilled attorneys in other cases. An attorney’s failure to justify the reasonableness of their fee can result in sanctions and disgorgement of their fees. Often the fees are returned to the debtor or bankruptcy estate, if the property transferred would have been property of the bankruptcy estate. Most often if the fee is paid pre-petition it will be considered property of the bankruptcy estate.
- (8) **Post-Petition Retainer in SubV:** *In re Kearney*, No. 24-61035-6-PGR, 2025 WL 1949468, at *2 (Bankr. N.D.N.Y. July 15, 2025).

Facts: In *In re Kearney* the United States Bankruptcy Court for the Northern District

of New York denied the U.S. Trustee's objection to the debtor's post-petition application to employ a law firm that had received a retainer post-petition without prior approval of the Bankruptcy Court. The UST argued that the debtor failed to get approval of the retainer as a transaction out of the ordinary course of business under 11 U.S.C. § 363(b).

Analysis: Section 328 (a) of the Code allows a debtor-in-possession to “employ ... a professional person ... on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis.” 11 U.S.C. § 328 (a)(emphasis added). Section 363(b) allows a debtor in possession to use estate property outside the ordinary course of business upon notice and hearing. Although the Second Circuit has not addressed the interplay between § 328(a) and § 363(b), courts across the country have generally concluded that post-petition retainers are governed by, and permitted under, § 328 (a).

C. Attorney-Client/Work Product Privilege in Bankruptcy Cases

- (1) Chapter 11 entity cases
- (2) Chapter 11 individual cases
- (3) 11 U.S.C. § 542(e) turnover of files. *See e.g., McKinstry v. Genser (In re Black Diamond Mining)*, 507 B.R. 209 (E.D. Ky. 2014) (all files must be turned over by attorney to client's trustee. No files can be withheld on attorney-client or work-product privilege grounds).
- (4) Consumer cases
 - (i) Is information given to debtor's counsel for inclusion in the bankruptcy schedules and employment applications subject to attorney-client privilege?
 - (a) Yes, at least for criminal purposes. *See, e.g., U.S. v. Bauer*, 132 F.3d 504, 509 (9th Cir. 1997) (minority position).
 - (b) No. *See, e.g., U.S. v. White*, 950 F.2d 426, 430-31 (7th Cir. 1991) (explaining there is no intent for information to be kept in confidence when it is disclosed on publicly-filed bankruptcy petition and schedules); *In re Myers*, 382 B.R. 304, 309 (Bankr. S.D. Miss. 2008) (indicating attorney-client privilege is narrowed in bankruptcy context and debtor has no expectation information will be kept confidential); *In re Wilkerson*, 393 B.R. 734, 742-43 (Bankr. D. Colo. 2007) (explaining information is not privileged when provided to complete bankruptcy schedules because there is no reasonable expectation of confidentiality; holding debtor waived privilege with respect to handwritten comments and questions on draft schedules which otherwise would have been privileged); *In re Eddy*, 304 B.R. 591, 596, 600 (Bankr. D. Mass. 2004) (concluding “the attorney-client privilege is inapplicable to communications

between the Debtor and her attorneys with respect to their retention or compensation for services rendered during the pendency of [the] bankruptcy case”). *See also U.S. v. Hubbard*, 16 F.3d 694, 697 n. 3 (6th Cir. 1994), *rev’d in part*, 514 U.S. 695, 115 S. Ct. 1754, 131 L. Ed. 2d 779 (1995) (“what [debtor] communicated to his attorney was to be conveyed to the bankruptcy trustee and the court via written pleading and thus was not protected by the privilege; the privilege only extends to confidential communicates, not communications.”).

(ii) When are communications expected from the attorney-client privilege by the crime/fraud exception to the privilege?

(a) The exception applies to communications or advice related to the commission of a fraud or crime. *See U.S. v. Ballard*, 779 F.2d 287, 292 (5th Cir. 1986).

(b) However, some courts have held that the purpose of the communications must be to further a future fraud or crime, not merely the communication provides evidence of a crime or fraud. *See In re Fortune Nat. Res., Corp.*, 350 B.R. 270 (Bankr. E.D. La. 2005).

(c) Matters involving the secret payment of legal fees and “lawyer shopping” often fall under the crime/fraud exception to the attorney-client privilege. *See U.S. v. Ballard*, 779 F.2d 287, 293 (5th Cir. 1986) (testimony of first attorney that he informed debtor he had to disclose in any bankruptcy filing transfers he made to his first attorney, father and wife was admissible under crime fraud exception).

(5) Do attorneys have duties to disclose fraud/crimes or breaches of fiduciary duty to the court?

(i) Yes. *See In re Saturley*, 131 B.R. 509 (Bankr. D. Me. 1991) (attorney has duty to disclose fraud or court); *Eisenberg v. White (In re White)*, 42 B.R. 494 (Bankr. E.D.N.Y. 1984) (same); *see also In re Himmel*, 533 N.E.2d 790 (Ill. 1988) (It is an ethical violation for an attorney not to disclose unethical conduct to the state bar association).

D. Competency, Zealousness, Candor and Civility – Rules of Professional Conduct

(1) The Preamble to the Rules of Professional Conduct state that “**every** lawyer is responsible to observe the law and the Rules of Professional Conduct” Preamble at 1 (emphasis added).

(2) The Rules require all lawyers to provide competent and diligent representation, and that we advocate with commitment and zeal. Rule 1.1(a) provides “A lawyer shall provide **competent** representation to a client. Competent representation requires the

legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.” (emphasis added). So, stay within your area of competence, especially in specialized areas such as bankruptcy law, because the comments to the Rule also make clear that “[e]xpertise in a particular field of law may be required in some circumstances.” Rule 1.1, cmt. 1.

- (3) Rule 1.3 provides that lawyers “shall act with reasonably diligence and promptness in representing a client.” Additionally, the comments to Rule 1.3 state that the “lawyer must act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client’s behalf [although the] lawyer’s duty to act with reasonable diligence does not require the use of offensive tactics or preclude the treating of all persons involved in the legal process with courtesy and respect.” Rule 1.3, cmt. 1. The Preamble to the Rules contemplate that as an advocate, “a lawyer zealously asserts the client’s position under the rules of the adversary system.” Preamble at 2.
- (4) Candor with the Court is also expected. Rule 3.3 provides that a lawyer shall not “knowingly or recklessly” make false statements of fact or law to the court, or “fail to disclose to the tribunal legal authority in the controlling jurisdiction directly adverse to the position of the client and not disclosed by opposing counsel.” The comments further provide that attorneys must be mindful of candor in legal argument as well: “[I]legal argument based on a knowingly or recklessly false representation of law constitutes dishonesty toward the tribunal. A lawyer is not required to make a disinterested exposition of the law but must recognize the existence of pertinent legal authorities. Furthermore, as stated in [Rule 3.3], an advocate has a duty to disclose directly adverse authority in the controlling jurisdiction that has not been disclosed by the opposing party. The underlying concept is that legal argument is a discussion seeking to determine the legal premises properly applicable to the case.” Rule 3.3, cmt. 4; *see also Meira v. Dairyland Ins. Co.*, 143 F.3d 1337 (10th Cir. 1998) (failure to cite controlling law in motion was unreasonable and demonstrated a reckless disregard of duty of candor to the court). So, any temptation to play “fast and loose” with facts or the law when making a presentation to the court, with the supposed justification that you are just making “legal argument,” will not suffice for compliance with your duty of candor.
- (5) Rule 3.4 of the Rules of Professional Conduct requires lawyers to be fair to the opposing party and opposing counsel. For example, comment 1 to the rule states: “The procedure of the adversary system contemplates that the evidence in a case is to be marshaled competitively by the contending parties. Fair competition in the adversary system is secured by prohibitions against destruction or concealment of evidence, improperly influencing witnesses, obstructive tactics in discovery procedure, and the like.” The requirement of a lawyer to be fair to opposing parties and their counsel is a basis for professionalism in our practice. Do not get so caught up in your case or the pressure you are under to affect your duty to be professional. Your reputation is at stake and one mistake can have significant negative effects on your client, you and your career.

E. Representation of Creditors and Committees

- (1) Conflicts of interest with bankruptcy estates.

- (i) The bankruptcy court has authority to disqualify counsel appearing before it for ethical violations. Counsel who previously represented a DIP (as DIP or as pre-filing debtor) may be asked to advise the people with whom she dealt, the company's insiders, after a trustee takes control. If the estate through the trustee sues the insiders, counsel may be disqualified from representing them if there is a substantial relationship between the litigation and the former estate representation. *See Kohut v. Lenaway (In re Lennys Copy Ctr. & More LLC)*, 515 B.R. 562 (Bankr. E.D. Mich. 2014).
 - (ii) Because DIP counsel represented the bankruptcy estate, a successor Chapter 7 trustee or plan liquidating trustee may raise a conflict and seek to disqualify the attorney from any substantially related representation in the case, such as representation of preference defendants. *See Galardi v. Galardi (Matter of Galardi)*, 644 B.R. 65 (Bankr. M.D. Ga. 2022).
 - (iii) Prepetition communications with a debtor may result in a disqualifying conflict precluding representation of a creditor, even if there is no actual engagement to represent the debtor. *See In re Muscle Improvement, Inc.*, 437 B.R. 389 (Bankr. C.D. Cal. 2010) (debtor's motion to disqualify counsel for creditor due to previous communications as prospective counsel for debtor).
- (2) Representation of Multiple Creditors
- (i) A single lawyer or firm may not represent one client if that representation will be directly adverse to another client, or may be materially limited by the lawyer's responsibilities to another client, unless the lawyer reasonably believes the representation will not adversely affect the relationship with each client and each consents after consultation. Model Rule 1.7.
 - (ii) Bankruptcy courts have the power and responsibility to enforce professional responsibility requirements over all attorneys appearing before them, whether or not their employment is court-approved. *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Committee*, 321 B.R. 147 (D.N.J. 2005). Thus, one creditor can object to its current or former counsel's appearance for another creditor and obtain an order of disqualification if there is an unwaived conflict of interest. *In re Meridian Auto. Sys.-Composite Operations, Inc.*, 340 B.R. 740 (Bankr. D. Del. 2006).
 - (iii) Bankruptcy Rule 2019 requires that counsel representing more than one creditor or equity security holder file a verified statement identifying them and disclosing specified information about them and their "disclosable economic interests." FED. R. BANKR. P. 2019(a) & (c). Failure to comply may result in inability to be heard in the case, invalidity of reorganization plan ballots or other documents filed on behalf of the creditors by the attorney, or other appropriate relief. *Id.* at 2019(e).
- (3) Fiduciary Duties of Creditors' Committee Members
- (i) Committees have fiduciary duties to the creditors or equity they represent, with

obligations of fidelity, undivided loyalty, and impartial service in the interests of all their constituents. *Woods v. City Nat. Bank & Tr. Co. of Chicago*, 312 U.S. 262, 61 S.Ct. 493, 85 L. Ed. 820 (1941); *Official Committee of Unsecured Creditors of Apex Global Information Servs., Inc. v. Qwest Commc'ns Corp.*, 405 B.R. 234 (E.D. Mich. 2009), *aff'd sub nom. In re A.P. Liquidating Co.*, 421 F. App'x 583 (6th Cir. 2011). They are not fiduciaries for the debtor or the bankruptcy estate in general. *Listecki v. Official Committee of Unsecured Creditors*, 780 F.3d 731 (7th Cir. 2015). Committees do not owe duties to particular creditors and may take action adverse to certain creditors. However, a committee should not prefer a subgroup of constituent creditors over another. *In re Nutritional Sourcing Corp.*, 398 B.R. 816 (Bankr. D. Del. 2008).

- (ii) Committee members must be able to comply with their fiduciary duties, or they will be disqualified. The committee may be reconstituted if the members cannot meet their obligations to their constituents as the case develops. *In re Pierce*, 237 B.R. 748 (Bankr. E.D. Cal. 1999).

(4) Committee Counsel's Fiduciary Duties

- (i) Professionals for a committee are bound by the same fiduciary responsibilities as committee members.

F. Artificial Intelligence and Ethics Issues

- (1) Florida Bar Ethics Opinion 24-1 (January 19, 2024) - Lawyers may use generative artificial intelligence ("AI") in the practice of law but must protect the confidentiality of client information, provide accurate and competent services, avoid improper billing practices, and comply with applicable restrictions on lawyer advertising. Lawyers must ensure that the confidentiality of client information is protected when using generative AI by researching the program's policies on data retention, data sharing, and self-learning. Lawyers remain responsible for their work product and professional judgment and must develop policies and practices to verify that the use of generative AI is consistent with the lawyer's ethical obligations. Use of generative AI does not permit a lawyer to engage in improper billing practices such as double-billing. Generative AI chatbots that communicate with clients or third parties must comply with restrictions on lawyer advertising and must include a disclaimer indicating that the chatbot is an AI program and not a lawyer or employee of the law firm. Lawyers should be mindful of the duty to maintain technological competence and educate themselves regarding the risks and benefits of new technology.
- (2) State Bar of California Standing Committee on Professional Responsibility and Conduct – Practical Guidance for the Use of Generative Artificial Intelligence in the Practice of Law.

G. Ethical Pitfalls for Attorneys When Using Social Media

- (1) Social media profiles may constitute legal advertising.

- (2) Avoid making false or misleading statements on social media sites.
- (3) Avoid making solicitations through social media.
- (4) Be careful not to disclose privileged or confidential information.
- (5) Be careful when “friending” judges and/or commenting on judges.
- (6) Avoid communicating with represented parties via social media.
- (7) Be careful when communicating on social media with unrepresented parties.
- (8) Be careful not to inadvertently create an attorney-client relationship through social media.
- (9) Be careful not to engage in the unauthorized practice of law on social media.
- (10) Think twice before posting testimonials, endorsements or ratings.

H. Ethics of Ghostwriting and Limited Representation

- (1) Ghostwriting occurs when an attorney drafts a pleading or other legal document for filing by a party who would otherwise appear to be proceeding *pro se*. The “*pro se* party” signs the document—not the attorney. Federal Courts have traditionally held that lawyers violate their duty of candor to the court when they ghostwrite for *pro se* litigants. See *In re Dreamplay*, 534 B.R. 106 (Bankr. D. Md. 2015); *Snyder v. Daugherty*, 899 F. Supp. 2d 391 (W.D. Pa. 2012).
- (2) Model Code of Professional Conduct 1.2(c): “A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.”
- (3) Comment 6 - The scope of services to be provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer’s services are made available to the client. When a lawyer has been retained by an insurer to represent an insured, for example, the representation may be limited to matters related to the insurance coverage. A limited representation may be appropriate because the client has limited objectives for the representation. In addition, the terms upon which representation is undertaken may exclude specific means that might otherwise be used to accomplish the client’s objectives. Such limitations may exclude actions that the client thinks are too costly or that the lawyer regards as repugnant or imprudent.
- (4) Comment 7 - Although this Rule affords the lawyer and client substantial latitude to limit the representation, the limitation must be reasonable under the circumstances. If, for example, a client’s objective is limited to securing general information about the law the client needs in order to handle a common and typically uncomplicated legal problem, the lawyer and client may agree that the lawyer’s services will be limited to a brief telephone consultation. Such a limitation, however, would not be reasonable if

the time allotted was not sufficient to yield advice upon which the client could rely. Although an agreement for a limited representation does not exempt a lawyer from the duty to provide competent representation, the limitation is a factor to be considered when determining the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation. *See* Rule 1.1.

- (5) As opposed to drafting a complaint or a motion, an attorney who simply completes a form bankruptcy petition for a debtor, without signing or indicating that the petition was prepared with the assistance of counsel, does not necessarily violate ethical rules against “ghostwriting.” *See Torrens v. Hood (In re Hood)*, 727 F.3d 1360 (11th Cir. 2013) (The bankruptcy court initially barred a law firm from practicing before the Bankruptcy Court for the Southern District of Florida for six months and referred the matter to the United States Attorney for potential violation of 18 U.S.C. § 157(3), after finding that completing a bankruptcy petition for the debtor constituted ghostwriting and fraud. The Eleventh Circuit reversed, finding that the firm’s action was not “ghostwriting” within the meaning of Florida’s Rules of Professional Conduct. Simply filling out a form did not rise to the level of undisclosed, prohibited attorney drafting. Also, the firm’s conduct was not fraudulent because no showing was made that any information included in the petition was false.
- (6) Ghostwriting issues can arise when attorneys try to limit their representation of a debtor to certain tasks. In a limited representation agreement, debtor’s counsel may agree to provide basic bankruptcy services while excluding representation of the debtor in other (usually contested) matters, such as adversary proceedings. Ethical pitfalls can arise when this type of “unbundling” is attempted. If the attorney attempts to “help” the debtor in matters outside the scope of agreed representation without observing proper protocols, anti-ghostwriting rules may be implicated. Similar issues may arise when a limited representation agreement attempts to exclude basic bankruptcy services, such as representation at the meeting of creditors. *See In re Ruiz*, 515 B.R. 362 (Bankr. M.D. Fla. 2014) (court ordered attorney to turn over its fee, finding that the limited representation agreement was prohibited by the Rules of Professional Conduct).
- (7) Ghostwriting from out-of-state is particularly risky. In *Dreamplay*, an attorney not licensed in the forum state of the bankruptcy court assisted the debtor in preparing bankruptcy motions throughout the case. *In re Dreamplay, Inc.*, 534 B.R. 106, 118–20 (Bankr. D. Md. 2015). The attorney did not sign the papers but did include footnotes indicating that he was assisting the debtor. The court imposed severe disciplinary sanctions on the attorney for (a) violating Bankruptcy Rule 9011 by not signing papers, (b) practicing law before the court without seeking *pro hac vice* admission, and (c) “ghostwriting,” though the presence of footnotes disclosing the attorney’s assistance was found to be a mitigating factor.

I. Other Interesting Issues and Topics:

- (1) ***Use of Deposition When Deponent Dies before Cross: Insight Terminal Solutions, LLC v. Cecelia Fin. Mgt. (In re Insight Terminal Solutions, LLC)***, 148 F. 4th 869 (6th Cir. 2025).

Facts: The bankruptcy court refused to recharacterize a loan as an equity contribution where the decedent arranged for one of his family-owned companies to transfer money to another. The decedent died before the trial over whether to recharacterize the loan or an equity contribution. The court excluded his deposition testimony from that trial because the opposing side lacked the opportunity to cross-examine him.

Analysis. The bankruptcy court erred by reading Fed. R. Civ. R. 32(a) as absolutely barring the use of a deposition if the opposing party lacked an opportunity to cross-examine the declarant. Nothing in the text of Rule 32(a) adopts a categorical cross-examination requirement. To the contrary, the text provides that a deposition “may be used” by a party if the party satisfies the three conditions listed in the rule. Fed. R. Civ. P. 32(a)(1) says:

(a) Using Depositions.

(1) In General. At a hearing or trial, all or part of a deposition may be used against a party on these conditions:

(A) the party was present or represented at the taking of the deposition or had reasonable notice of it;

(B) it is used to the extent it would be admissible under the Federal Rules of Evidence if the deponent were present and testifying; and

(C) the use is allowed by Rule 32(a)(2) through (8).

The rule thus suggests that the party has a “right” to use the deposition once the party proves those conditions. 8A Charles A. Wright et al., *Federal Practice and Procedure* § 2146, at 645 (3d ed. 2010) (quoting *Wright Root Beer Co. v. Dr. Pepper Co.*, 414 F.2d 887, 890 (5th Cir. 1969)).

(2) ***Committees In SubV:*** *In re Cinemex Holdings USA, Inc.*, No. 25-17559-BKC-LMI, 2025 WL 2489585, at *5–6 (Bankr. S.D. Fla. Aug. 28, 2025).

Analysis. Considering the enhanced role of a Subchapter V trustee, a court should consider the following non-exclusive list of factors when determining whether there is “cause” to appoint a creditors’ committee in a Subchapter V case pursuant to sections 1102(a)(3) and 1181(b):

(a) the size and complexity of the case (whether the case is one which more closely resembles a traditional chapter 11 case);

(b) the number of creditors involved in the case and the nature of their debt;

(c) the nature of the debtor's assets;

(d) the nature of the debtor's business and how it is regulated;

(e) the amount of secured debt, the number of secured creditors, and the nature of the collateral in which such creditors assert a lien;

(f) whether and to what extent any other creditor or other party in interest supports the relief requested;

(g) whether there are any other factors present in the case which, notwithstanding section 1183(b)(2), would interfere with the ability of the Subchapter V trustee to perform his or her normal statutory duties effectively.

(3) **Sovereign Immunity Waived or Not:** *United States v. Miller*, 604 U.S. – (2025).

Facts. On March 26, 2025, the United States Supreme Court decided *United States v. Miller*, resolving a circuit split and holding that in an action brought under § 544(b) of the bankruptcy code, § 106(a)’s sovereign immunity waiver applies only to the § 544(b) claim itself and not to any state-law claims nested within the federal bankruptcy claim. In *Miller*, the bankruptcy trustee of a Utah-based business whose shareholders misappropriated and transferred to the IRS approximately \$145,000 in company funds to satisfy personal federal tax liabilities filed an “avoidance” suit under 11 U.S.C. § 544(b) against the United States, seeking to claw back the misappropriated funds. The trustee cited Utah’s fraudulent transfer statute.

Analysis. Under §544(b), a trustee may avoid certain transfers that would be “voidable under applicable law”—that is, voidable outside of bankruptcy proceedings. 11 U.S.C. §544(b)(1). Section 544(b) requires a trustee to identify an actual creditor capable of voiding the transfer at issue under “applicable law.” That actual-creditor requirement—which restricts the universe of transactions a trustee can invalidate—is unique to §544(b).

Ordinarily, the Federal Government’s sovereign immunity would bar any suit against it under Utah law. But the Bankruptcy Code contains a sovereign-immunity waiver, §106(a), that abrogates the Government’s sovereign immunity “with respect to” §544. But the *Miller* Court held that §106(a)’s sovereign-immunity waiver applies only to the §544(b) claim itself and not to any state-law claims nested within that federal claim. “Section 106(a) is properly understood as a jurisdictional provision that empowers courts to hear §544(b) claims against the Government to the extent such claims are otherwise available under state law; it does not alter the substantive meaning of §544(b)’s ‘applicable law’ clause.”

(4) **Nondischargeability Action Deadline:** *In re Dowdall*, No. 24-42950, 2025 WL 1823666, at *1 (Bankr. E.D. Tex. July 2, 2025).

Facts: The bankruptcy court granted the debtor’s motion to dismiss a dischargeability complaint filed by the creditor because it was untimely under Bankruptcy Rules 4004(a) and 4007(c). The complaint was filed one day after the § 727 discharge objection deadline. The creditor failed to secure an extension before the deadline and later sought equitable relief, which the court denied. The court held that neither equitable grounds nor procedural exceptions justified the late filing.

Analysis: The court emphasized that deadlines under Bankruptcy Rules 4004(a) (objections to discharge under § 727) and 4007(c) (dischargeability objections under § 523) are strictly construed. Although the Chapter 7 trustee had successfully moved

to extend the § 727 deadline, the creditor had not joined or moved for its own extension before the deadline expired. The creditor's later motion to extend under Rule 4004(b)(2) was denied because it failed to meet the required criteria, and the court rejected arguments for equitable relief under § 105(a).

The court followed the reasoning in *In re McCain*, 652 B.R. 678 (Bankr. E.D. Tex. 2023) and *Yaquinto v. Ward (In re Ward)*, 978 F.3d 298 (5th Cir. 2020). In those cases, the courts emphasized that equitable exceptions to Rule 4004 are not permitted unless a court error occurred, which was not alleged here. Rule 9006(b)(3) limits extensions to those specifically authorized by Rule 4004. In short, because the complaint was untimely and amendment would be futile, dismissal with prejudice under Rule 12(b)(6) was appropriate.

- (5) **Reopening Chapter 7 After Stay Relief:** *In re Lenzie*, 2025 WL 1748240 (Bankr. N.D. Ala 2025) (Judge Mitchell).

Facts: The debtor filed for Chapter 7 bankruptcy, listing a home secured by a loan from Central State Bank. The bank obtained stay relief during the bankruptcy, foreclosed on the property, and filed an ejectment action in state court after the debtor's discharge but before the case was closed. The debtor filed counterclaims in the state court. The bank later sought to reopen the bankruptcy case, requesting surrender of the property and cessation of state litigation.

Analysis: The court noted that reopening a closed bankruptcy case under § 350(b) is discretionary and requires a showing of cause, considering factors such as the benefit to creditors or the debtor, prejudice to affected parties, alternative forums for relief, and the time elapsed since the case was closed. Central State Bank had already chosen to pursue state court remedies after obtaining relief from the stay and foreclosure. In *Renasant Bank v. Sanchez*, Case No.: 5:24-cv-01746-RDP, 2025 U.S. Dist. LEXIS 56280, 2025 WL 923470 (N.D. Ala. March 26, 2025), a nearly identical case involving the same creditor's attorney, both the bankruptcy and district courts rejected efforts to reopen a case that was already the subject of ongoing and appropriate state court proceedings. The bankruptcy court reasoned that Central State Bank had not only failed to present new evidence or compelling circumstances but also tried to withdraw its motion without explanation after an adverse ruling in the state court. The court found no meaningful distinction between this case and *Sanchez* and concluded that equitable considerations favored allowing the state court to resolve the remaining issues. Because the relief sought could be obtained in state court, and the bank had essentially abandoned its motion, the bankruptcy court denied the motion to reopen.

Tips for Debtors:

Warn Clients About Post-Discharge Litigation Risks: Even after discharge, creditors may pursue foreclosure or eviction in state court if they've obtained stay relief. Prepare clients for the possibility of defending such actions and emphasize the limited protection bankruptcy provides once the case is closed.

Push Back Against Improper Motions to Reopen: If a creditor seeks to reopen the

bankruptcy case after pursuing stay relief and initiating state court proceedings, argue that they've already elected their forum. Bankruptcy courts are unlikely to intervene just because the creditor is unhappy with the state court outcome.

Re-Examining In Pari **Delicto**

Does Daddy Need a New Pair of Shoes?

Moderator: Alan R. Lepene, Thompson Hine LLP

Panelists: Professor Ralph Brubaker, University of
Illinois College of Law
Michael W. Ott, Ice Miller LLP
Ian Rubenstrunk, Spencer Fane LLP

ACB Sixth Circuit Educational Program
In Memory of G. Christopher Meyer
November 18, 2025

Trustee Steps Into the Shoes of the Debtor and is Subject to All Defenses Enforceable Against the Debtor?

- Basis for the Concept
 - Section 70a of the Bankruptcy Act of 1898 provided that a bankruptcy trustee was vested “by operation of law,” as of the petition date, with the title of the bankrupt in specific property, “including rights of action.” §70a(5)
 - Courts interpreted Section 70a as providing that the trustee “stepped into the shoes” of the bankrupt and was “subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition.” *Bank of Marin v. England*, 385 U.S. 99,101 (1966) (Emphasis supplied).

- The Bankruptcy Code eliminated the concept of transferring the debtor's title in property to the trustee
 - Section 541(a) creates an estate upon the commencement of bankruptcy and provides in Section 541(a)(1) that property of the estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case.” (Emphasis supplied).
 - Section 323 provides that the trustee (a) “is the representative of the estate” and (b) “has capacity to sue and be sued.”

Does the Supreme Court's Holding in *Bank of Marin* Beg the Question Whether Claims and Defenses Asserted Against the Trustee are Enforceable?

- What role does state law play in determining whether a defense asserted against a trustee is enforceable?
 - *Butner v. United States*, 440 U.S. 48,55 (1979)
 - (“Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.”)
- Are there federal interests embodied in the Bankruptcy Code requiring a bankruptcy court to analyze the enforceability of the *in pari delicto* defense in an action brought by a bankruptcy trustee differently than the analysis to be made under state law?

What Are the Elements of the *In Pari Delicto* Defense and Its Purposes?

- The defense of *in pari delicto* is an equitable doctrine that derives from the Latin phrase, *in pari delicto potior est conditio defendentis*: “in a case of equal or mutual fault, the position of the defending party is the better one.”
- The defense is based upon two principles:
 - Courts should not mediate disputes between two wrongdoers; and
 - Denying relief to a wrongdoer is an effective means of deterring illegality.

See Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299,306 (1985)

- The defense is based upon the defendant's ability to impute to the plaintiff the misconduct of the plaintiff's agents.
- Exceptions and permutations
 - Adverse Interest Exception: *In pari delicto* does not apply where the bad actors are acting in their own interest adverse to that of the plaintiff.
 - Sole Actor Rule: There is an exception to the Adverse Interest Exception where the bad actor essentially was the plaintiff's sole decision-maker.
 - Innocent Insider Corollary: Sole Actor Rule does not apply if there was at least one decision-maker in a management role or among the shareholders who was innocent and could have stopped the fraud.
 - Public Policy: The defense may be rejected if allowing it would contravene public policy. See *Pinter v. Dahl*, 486 U.S. 622,633 (1988) (recognizing the “[*in pari delicto*]” doctrine’s traditional requirement that public policy implications be carefully considered before the defense is allowed.”)

Does §541(a)(1) Preempt State Law and Establish a Federal Rule that all Defenses Enforceable Against the Debtor, Including the *In Pari Delicto* Defense, Are Enforceable Against the Trustee?

- Federal preemption requires either an “explicit federal statutory provision,” or “comprehensive and detailed” federal statutory regulation of a matter, intended to displace state law. *O’Melveny & Myers v. FDIC*, 512 U.S. 79,85 (1994).
- Section 541(a)(1) provides that property of the estate includes “all legal or equitable interests of the debtor in property as of the commencement of the case.” (Emphasis supplied).
 - Is that an explicit Congressional command that, irrespective of the application of state law, all defenses enforceable against the debtor, including the *in pari delicto* defense, are enforceable against the trustee?

- *Sender v. Buchanan (In re Hedged – Investments Assocs)*, 84 F.3d 1281, 1285-86 (10th Cir. 1996) (*In pari delicto* defense enforceable against the trustee because “§541(a)(1) limits estate property to the debtor’s interests ‘as of the commencement of the case’. ... Neither the text of the Code nor its legislative history suggests any exceptions to the principle that the strength of an estate’s cause of action is measured by how it stood ‘as of the commencement of the case.’”) (Emphasis supplied).
- *Official Comm. of Unsecured Creditors v. R.F. Lafferty*, 267 F.3d 340,356 (3d Cir. 2001) (“[T]he explicit language of section 541 directs courts to evaluate defenses as they existed at the commencement of the bankruptcy.”)

Appellate Decisions Adopting a Federal Rule that all Defenses Enforceable Against the Debtor, Including the *In Pari Delicto* Defense, Are Enforceable Against the Trustee

- Eight Circuit Courts have adopted the federal rule on the basis of the language in §541(a)(1)
 - *Baena v. KPMG LLP*, 453 F.3d 1 (1st Cir. 2006)
 - *Official Comm. of Unsecured Creditors of Color Tile v. Coopers & Lybrand, LLP*, 322 F.3d 147 (2d Cir. 2003)
 - *Official Comm. Of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340 (3d Cir. 2001)
 - *Grayson Consulting, Inc. v. Wachovia Sec., LLC (In re Derivium Cap. LLC)*, 716 F.3d 355 (4th Cir. 2013)
 - *Terlecky v. Hurd (In re Dublin Sec. Inc.)*, 133 F.3d 377 (6th Cir. 1997)

- *Grassmueck v. Am. Shorthorn Ass’n*, 402 F.3d 833 (8th Cir. 2005)
- *Sender v. Buchanan (In re Hedged-Investments Assocs)*, 84 F.3d 1281 (10th Cir. 1996)
- *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145 (11th Cir. 2006)
- Although believing themselves to be constrained by the language in § 541(a)(1), a few of the courts appear apologetic for their holdings:
 - “Though the Seventh Circuit’s reasoning in [*Scholes v. Lehman*, 56 F.3d 750 (7th Cir. 1995)] enjoys a certain appeal, both from doctrinal and public policy perspectives, we cannot adopt it in this case. Put most simply, Mr. Sender is a bankruptcy trustee acting under 11 U.S.C. § 541, and bankruptcy law, apparently unlike the law of receivership, expressly prohibits the result Mr. Sender urges.” *In re Hedged-Investments*, 84 F.3d at 1285
 - “There is no limiting language in § 548 similar to that in § 541, and without that language there is no reason not to follow the better rule [in an action under § 548], under which Kesselring’s conduct would not be imputed to the Trustee because it would lead to an inequitable result in this case.” *McNamara v. PFS (In re Personal & Bus. Ins. Agency)*, 334 F.3d 239, 246-47 (3d Cir. 2003).

**Is it Appropriate to Consider Legislative History in
Determining Whether State Law Addressing the
Enforceability of the *In Pari Delicto* Defense Has
Been Preempted by Section 541(a)(1)**

- *Connecticut Nat. Bank v. Germain*, 503 U.S. 249,254 (1992)
("When the words of a statute are unambiguous, then this first canon is also the last: 'judicial inquiry is complete,'" *citing Rubin v. United States*, 449 U.S. 424,430 (1981))

- Assuming the language in § 541(a)(1) can be viewed, at best, as ambiguous, can the underlying legislative history be reconciled?
 - Senate Report No. 95-989 (1978) at 82:

“[§ 541] is not intended to expand the debtor’s rights against others more than they exist at the commencement of the case. For example, if the debtor has a claim that is barred at the time of the commencement of the case by the statute of limitations, then the trustee would not be able to pursue that claim, because he too would be barred. He could take no greater rights than the debtor himself had.” (Emphasis supplied).
 - House Conf. Report on HR 8200:

“Thus, as section 541(a)(1) clearly states, the estate is comprised of all legal or equitable interests of the debtor in property as of the commencement of the case. To the extent such an interest is limited in the hands of the debtor, it is equally limited in the hands of the estate except to the extent that defenses which are personal against the debtor are not effective against the estate.” Congressional Record, September 28, 1978 at 32399 (Emphasis supplied).

Can the Federal Rule Adopted in Cases such as *Hedged-Investments* and *Lafferty* be Reconciled with Principles of Statutory Construction?

- “*Expresso unius est exclusio alterius*”: “The expression of one thing is the exclusion of the other.”
- Section 541(e), as codified by the Bankruptcy Reform Act of 1978, which was recodified as §558 pursuant to technical amendments to the Code in the Bankruptcy Amendments and Federal Judgeship Act of 1984, provided that:

“The estate shall have the benefit of any defense available to the debtor as against an entity other than the estate, including statutes of limitation, statutes of frauds, usury and other personal defenses.”

- No similar language was included in §541 addressing the enforceability of defenses to claims asserted on behalf of the estate against third parties
- *Keene Corp. v. United States*, 508 U.S. 200,208 (1993) (“This fact only underscores our duty to refrain from reading a phrase into the statute when Congress has left it out. ‘Where Congress includes particular language in one section of a statute but omits it in another . . . , it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.’” *Russello v. United States*, 464 U.S. 16,23 (1983))
- Have the courts read into §541, language that Congress purposely excluded?

How Does the Application of State Law Affect the Availability of the *In Pari Delicto* Defense?

- In some states, the *in pari delicto* defense is not available if the wrongdoer has been removed and will not benefit from recovery.
 - *Bonhiver v. Graff*, 248 N.W.2d 291, 296 (Minn. 1976) (“Whether or not the company would be precluded from bringing this suit . . . [t]he receiver represents the rights of creditors and is not bound by the fraudulent acts of a former officer of the corporation.”)
 - *Scholes v. Lehman*, 56 F.3d 750, 754 (7th Cir. 1995) (“ . . . the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated.”)
 - *Federal Deposit Ins. Corp. v. O’Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (Applying California law in a federal equity receivership and holding that “[w]hile a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on the trustee, receiver or similar innocent entity that steps into the party’s shoes pursuant to a court order or operation of law.”)

- How would state courts address the issue if a bankruptcy trustee filed his/her complaint in state court rather than in the bankruptcy court?
 - *Waslow v. Grant Thornton LLP (In re Jack Greenberg, Inc.)*, 240 B.R. 486,507 (Bankr. E.D. Pa. 1999) (“Therefore, I conclude that Pennsylvania’s Supreme Court would reject the notion that equitable defenses can never be raised against a trustee plaintiff but rather would allow a court applying Pennsylvania law discretion to bar use of the defense when under the circumstances presented, it concludes that its invocation would produce an inequitable result.”)
- Several federal courts have held that a bankruptcy trustee is not subject to the *in pari delicto* defense if the wrongdoer was replaced by a receiver, or otherwise removed, prior to bankruptcy.
 - *In re LeNature’s*, 2009 U.S. Dist. LEXIS 85073 (W.D. Pa. Sept. 16, 2009) and 2009 U.S. Dist. LEXIS 98700 (W.D. Pa. Oct. 23, 2009) (*in pari delicto* defense not enforceable against bankruptcy trustee where custodian was appointed by state court five days prior to bankruptcy).
 - *Mukamal v. BDO Seidman, LLP (In re E.S. Bankest, L.C.)*, 2010 Bankr. LEXIS 2425 (Bankr. S.D. Fla. July 23, 2010) (*in pari delicto* defense was not a bar to trustee’s claims because receiver was appointed prior to bankruptcy).

- *In re NJ Affordable Homes Corp.*, 2013 Bankr. LEXIS 4798 (Bankr. D. N.J. 2013) (same)
- *Global Money Management LP v. McDonald*, 2008 U.S. Dist. LEXIS 12873 (S.D. Cal. 2008) (Debtor-in-possession under control of pre-petition receiver not subject to *in pari delicto* defense)
- This view has been rejected by other courts.
 - *Nisselson v. Lernout*, 469 F.3d 143,156 (1st Cir. 2006) (“[T]he fraud that underpins the trustee’s claims was complete at the moment the companies merged. Therefore, any post-merger changes in [debtor’s] corporate governance or management are beside the point. Simply put, bankruptcy trustees do not have access to an ‘innocent successor’ exception as a way of shielding themselves from the operation of an *in pari delicto* defense.”)

The Most Recent High Profile Case Involving the *In Pari Delicto* Defense: *Kelly v. BMO Harris Bank*, 115 F.4th 901 (8th Cir. 2024), *cert. denied* U.S. (2025)

- The Eighth Circuit reversed a \$500 million judgment against BMO Harris Bank entered after a jury found that the bank had aided and abetted breaches of fiduciary duties by the debtor's officers.
 - The court of appeals held that the appointment of a receiver prior to bankruptcy – even if it would have precluded the assertion of the *in pari delicto* defense against the receiver under Minnesota law – did not cleanse the debtor of its knowledge and participation in the fraud, and such knowledge and participation could be imputed to the debtor, and bar claims asserted by the receiver following the commencement of bankruptcy and his appointment as the bankruptcy trustee.
- The trustee filed a petition for a writ of certiorari which was denied.

- The question presented to the Supreme Court was whether the Eighth Circuit should have certified to the Minnesota Supreme Court whether, under Minnesota law, the commencement of a pre-bankruptcy receivership bars a defendant from thereafter asserting the *in pari delicto* defense.
- Did the trustee miss an opportunity to seek review of the question whether, in the absence of explicit language displacing state law, §541(a)(1) preempts state law and establishes a federal rule that all defenses enforceable against the debtor but for bankruptcy, including the *in pari delicto* defense, are enforceable against the trustee?

Can a Trustee Avoid Application of the *In Pari Delicto* Defense by Pursuing Rights of a Hypothetical Creditor Under §544(a)(1) and (2)?

- *PM Denver, Inc. v. Porter (In re Porter McLeod, Inc.)*, 231 B.R. 786 (D. Colo. 1999)
 - Court held under Colorado law that judgment lien creditors have the right to pursue all claims available to the debtor pre-bankruptcy.
 - Exercising the rights of a creditor under §544(a), the trustee has the right to bring a “creditors bill” to pursue claims belonging to the debtor.
 - *In pari delicto* defense not available because the trustee is acting in his §544(a) “creditor status.” *Id.* At 793-94
- This approach was rejected in *Anderson v. Morgan Keegan & Co. (In re Infinity Bus. Grp., Inc.)*, 31 F.4th 294 (4th Cir. 2022 (creditor stands in debtor’s shoes and would be subject to *in pari delicto* defense).

Are There *In Pari Delicto* Workarounds?

- Assignment of victims' claims
 - *Williams v. California 1st Bank*, 859 F.2d 664 (9th Cir. 1988) (Chapter 7 trustee cannot pursue claims assigned by investors where investors would recover proceeds, net of administrative costs and priority claims).
 - *In re Bogdan*, 414 F.3d 507 (4th Cir. 2005) (chapter 7 trustee could pursue, free of *in pari delicto*, claims assigned unconditionally by mortgage lenders).

- *Grede v. Bank of New York Mellon*, 598 F.3d 899 (7th Cir. 2010) (claims belonging to individual creditors assigned to a liquidating trust pursuant to chapter 11 plan could be pursued by the liquidation trustee free of *in pari delicto*.)
- Assignment of claims under chapter 11 plan can be accomplished through a plan settlement pursuant to which victims could be provided right to either opt in or opt out
 - Plan should provide that all potential litigation targets receive notice, and that objections to the contribution of claims be brought as plan objections.

Thank you!