



Second Circuit Recognizes Bankruptcy Court's Inherent Authority to Impose Civil Contempt Sanctions

Recently, in an issue of first impression, the Second Circuit in *In re Larisa Ivanovna Markus*, 78 F.4th 554 (2d Cir. Aug. 30, 2023) considered the bankruptcy court's authority to impose non-nominal civil contempt sanctions, and upheld the bankruptcy court's order awarding substantial contempt sanctions against an attorney who failed to comply with a subpoena directed to his client and repeatedly ignored court orders.

Larisa Ivanova Markus (the "Debtor") is a Russian citizen who founded one of Russia's largest banks. The bank was declared insolvent, and the Debtor's creditors commenced proceedings against the Debtor in the Moscow Arbitration Court. The Moscow Arbitration Court appointed a representative to liquidate the Debtor's assets (the "Foreign Representative"). Ultimately, the Debtor was convicted of embezzling approximately \$2 billion from the bank she founded, and sentenced to more than eight years in prison.

The Foreign Representative initiated a Chapter 15 proceeding for the Debtor to discover the Debtor's assets located in the United States. The Foreign Representative served a subpoena upon Debtor's U.S. counsel, Viktor A. Worms. Mr. Worms unsuccessfully attempted to quash the subpoena, and subsequently made various excuses for noncompliance with the subpoena.

On July 30, 2019, Chief Judge Martin Glenn for the U.S. Bankruptcy Court for the Southern District of New York ordered Mr. Worms to "immediately communicate with [the Debtor] and her agents, including attorneys, to obtain and produce responsive documents ... to [the] extent the documents are in [the Debtor's] possession, custody, or control." Mr. Worms secured an extension of the July 30, 2019 Order, but the court warned Mr. Worms that sanctions could be imposed for non-compliance. Mr. Worms failed to produce any documents prior to the deadline, and the bankruptcy court directed the Foreign Representative to file a motion for contempt.

The Foreign Representative filed a motion for contempt seeking coercive sanctions, and provided the contact information of the Debtor's known agents to obtain responsive documents. The bankruptcy court granted the motion, and ordered Mr. Worms to pay attorneys' fees ("Fees Order") and \$1,000 per day as sanctions beginning on the date that compliance had been due ("Sanctions Order").

Mr. Worms' appealed to the district court arguing that the bankruptcy court lacked inherent authority to impose civil contempt sanctions and challenging the amounts set by the court. *See Markus v. Rozhkov*, 615 B.R. 679 (S.D.N.Y. 2020) ("*Rozhkov I*"). The district court, affirmed in part, and vacated in part, and remanded for limited reconsideration of both orders. *Id.* at 715, 717.

As to the Sanctions Order, the district court affirmed the bankruptcy court's factual findings that Worms failed to comply with its discovery orders "without justification," and held that the imposition of sanctions was proper pursuant to the bankruptcy court's inherent authority. *Id.* at 707, 710-11. The district court found that: (i) Worms was on notice that the bankruptcy court may impose sanctions pursuant to its inherent authority; (ii) Worms conceded that the bankruptcy court had such inherent authority; and (iii) the record supported imposition of civil contempt sanctions. While, the district court affirmed the imposition of prospective *per diem* sanctions for Mr. Worms' continued noncompliance from the date of the Sanctions Order, it vacated the \$34,000 in "lump-sum retroactive sanctions" as an improper criminal sanction and remanded for consideration of the appropriate amount. *Id.* at 714-15.

With respect to the Fees Order, the district court recognized that the bankruptcy court did not specify whether it imposed the award as an exercise of discretion pursuant to its inherent authority, or to comply with Rule 37. The district court held that because Rule 37 did not permit sanctions against Mr. Worms, reliance on Rule 37 would have been improper. Accordingly, the district court vacated the Fees Order and remanded to the bankruptcy court for clarification as to its source of authority. *Id.* at 717.

On remand, the bankruptcy court held that Worms was no longer in contempt as of November 27, 2019, when an agent of Markus (based in the United States) contacted Markus's agents and requested that they produce all documents, information, and communications responsive to the subpoena. *See In re Markus*, 619 B.R. 552, 571-72 (Bankr. S.D.N.Y. 2020) ("*In re Markus II*"), order vacated in part sub nom. *Worms v. Rozhkov*, 2021 WL 4124662 (S.D.N.Y. Sept. 9, 2021).

As to the Sanctions Order, the bankruptcy court calculated fifty-five days of contempt, representing the period from when the court determined that sanctions were warranted, through the date the documents were requested from Markus' agent, and ordered *per diem* sanctions in the amount of \$1,000 per day, for a total of \$55,000. *Id.* at 572.

With respect to the Fees Order, the bankruptcy court held that the award was based on its inherent authority, but reduced the amount from \$60,000 to \$36,600 to discount for the unsuccessful arguments that the Foreign Representative proffered in his sanctions motion. *Id.* at 574, 578-79. The bankruptcy court also awarded the Foreign Representative, as he had requested, an additional \$63,500 for legal fees incurred defending the contempt sanctions on appeal before the district court. *Id.* at 579.

Mr. Worms appealed a second time to the district court, arguing that the bankruptcy court abused its discretion in awarding the additional \$63,500 in attorneys' fees. The district court affirmed that the bankruptcy court had the inherent authority to award attorneys' fees as sanctions to enforce compliance with its orders, but vacated the fees award as beyond the scope of this authority. *See Worms v. Rozhkov*, 2021 WL 4124662, at *5 (S.D.N.Y. Sept. 9, 2021) ("*Rozhkov II*").

Mr. Worms then appealed to the Second Circuit, challenging the imposition of \$55,000 in contempt sanctions and \$36,600 in fees. Mr. Worms argued that the court lacked inherent authority to impose civil contempt sanctions and that he had not received due process. *In re Larisa Ivanovna Markus*, 78 F.4th at 563.

Typically, a court will impose contempt related sanctions pursuant to Section 105(a) to enforce title 11 violations and Fed. R. Civ. P. 37 to enforce party discovery violations. However, in this case, the matter involved the enforcement of a subpoena, making Section 105(a) and Fed. R. Civ. P. 37 inapplicable, and the court looked to its inherent authority to impose sanctions on Mr. Worm. See *In re Larisa Ivanovna Markus*, 78 F.4th at 566-67. While the Second Circuit had previously upheld the inherent power of bankruptcy courts to “impose relatively minor non-compensatory sanctions on attorneys appearing before the court in appropriate circumstances,” it had not opined on “the outermost boundaries” of that power, “including the power to impose more substantial punitive sanctions.” *Id.* at 564

The Second Circuit concluded that a bankruptcy court’s inherent authority extends beyond non-compensatory sanctions on attorneys, but is by no means unlimited as the exercise should be a “last resort,” and cannot contravene valid statutory directives and prohibitions. The Second Circuit held that a bankruptcy court must specifically invoke its inherent authority as the basis for the sanctions, and comply with the mandates of due process before imposing contempt sanctions. *Id.* at 565-66.

The Second Circuit distinguished between actions by counsel on behalf of a client, and counsel’s own misconduct. Where an attorney is punished for actions undertaken for a client’s benefit, the imposition of sanctions under a bankruptcy court’s inherent powers may require a finding that the attorney acted in bad faith, supported by clear evidence that the attorney’s conduct is entirely without color and motivated by improper purposes. *Id.* However, if an attorney is sanctioned based upon their own misconduct, such as violation of a court order, then the bankruptcy court need not find bad faith before imposing sanctions under its inherent power. Last, any civil contempt sanction awarded against an attorney must be either compensatory or coercive as opposed to punitive. *Id.*

Applying these principles, the Second Circuit held that the bankruptcy court did not abuse its discretion in imposing sanctions against Mr. Worms pursuant to its inherent authority. The Court found that resorting to the bankruptcy court’s inherent authority was proper, because there was not another mechanism for compelling compliance with an order to enforce a subpoena, such as Section 105(a) and Fed. R. Civ. P. 37. The Second Circuit also affirmed the bankruptcy court’s finding that Mr. Worms the attorney had acted in bad faith, that he had “brazenly” disregarded the court’s discovery orders, including disregarding two court-imposed deadlines for compliance. The Court also found it significant that he did not make any effort to purge himself of contempt, but rather waited for a third party to comply with the order. Finally, the Second Circuit found that there was no basis to doubt Mr. Worms’ deliberate and repeated failure to comply with the bankruptcy court’s orders, and that the bankruptcy court did not abuse its discretion in determining that civil contempt sanctions were appropriate. *Id.* at 567-68.

The Second Circuit also rejected Mr. Worms’ due process argument, finding that he had sufficient notice of the conduct for which sanctions would be considered, as the bankruptcy court repeatedly had warned Mr. Worms that he was at risk of being sanctioned for his continued failure to comply with the court’s discovery orders. *Id.* at 568-69.

The Second Circuit's decision of first impression in *In re Larisa Ivanovna Markus* confirms that bankruptcy courts in this Circuit possess a potent tool to ensure that parties, and their counsel, comply with discovery and court orders. Counsel is permitted to make good faith arguments and objections to discovery requests, but can't "stonewall" discovery, and must advise their clients of their continuing obligation to comply with demands and court orders, or consider whether it is necessary to immediately inform the court of counsel's inability to obtain cooperation from their client, and seek to be relieved as counsel.

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