Ethics
(Including §§ 526-528; Asset Disclosure and Valuation; Fee Apps)

Concurrent Session

Stuart A. Gold, Moderator
Gold Lange & Majoros, PC; Southfield, Mich.

Brian J. Small
Thav Gross PC; Bingham Farms, Mich.

Hon. Thomas J. Tucker
U.S. Bankruptcy Court (E.D. Mich.); Detroit

David W. Van Zyl
Chapter 13 Trustee Office; Kalamazoo, Mich.

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Materials prepared by: Judge Thomas J. Tucker,
with much assistance from Robin R. Mocabee, Law Clerk,
United States Bankruptcy Court, Eastern District of Michigan

I. Introduction

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) added Sections 526, 527 and 528 to the Bankruptcy Code. These Code sections relate to debt relief agencies. Sections 526 and 528 impose restrictions and requirements on debt relief agencies. Section 527 lists the disclosures debt relief agencies must make when they provide bankruptcy assistance to assisted persons. Section 526(c) also provides for sanctions and remedies against a debt relief agency in specific circumstances. The complete text of §§ 526-528 is included at the end of these written materials.

Questions have arisen about some of the language used in Sections 526 - 528. Some of the questions were answered last year by the U.S. Supreme Court's decision in *Milavetz, Gallop & Milavetz, PA. v. U.S.*, - - - U.S. - - -, 130 S.Ct. 1324, 176 L.Ed.2d 79 (March 8, 2010). Other questions remain.

II. Consumer Bankruptcy Attorneys Who Advise or Represent Assisted Persons and Receive Compensation are Debt Relief Agencies Subject to §§ 526-528.

One question that arose was whether attorneys are "debt relief agencies" as defined in § 101(12A) and, in turn, are subject to §§ 526-528. *In Milavetz*, the Supreme Court held that consumer bankruptcy attorneys are debt relief agencies.

- *Milavetz, Gallop & Milavetz, PA. v. U.S.*, - - - U.S. - - -, 130 S.Ct. 1324, 176 L.Ed.2d 79 (March 8, 2010)

Milavetz, Gallop & Milavetz, PA., a law firm engaged in bankruptcy practice, along with its firm's president, another bankruptcy attorney with the firm, and two of its clients, sought a pre-enforcement declaratory judgment in U.S. District Court that §§ 526-528 did not apply to them because none of them were "debt relief agenc[ies]" as defined in § 101(12A). In the alternative, the Plaintiffs argued that certain restrictions on attorney speech imposed under 11 U.S.C. § 526(a)(4) and § 528 were unconstitutional as violations of the First Amendment.

The Supreme Court held that "attorneys are debt relief agencies when they provide qualifying

services to assisted persons." *Milavetz*, 130 S.Ct. at 1332.

III. A couple of particular danger areas for debtor's attorneys

Among the many provisions in §§ 526-528, two that debtor's attorneys need to be especially mindful of are in § 526(c)(2). Such attorneys may be required to pay back to their client all fees and charges they received from the client, plus pay them any actual damages and reasonable attorney fees and costs, under either of these circumstances:

• if the attorney intentionally or negligently disregarded the material requirements of the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure. § 526(c)(2)(C). Question: how often does this happen?

or

• if the client's case is dismissed or converted because the attorney intentionally or negligently failed to file any required document. § 526(c)(2)(B). Question: how often does this happen?

IV. More about *Milevetz*

A. Constitutionality of § 528 advertising provisions

In *Milavetz*, after holding that attorneys are debt relief agencies, the Supreme Court held that the requirements relating to advertisements under §§ 528(a)(3), (a)(4), (b)(2)(A) and (b)(2)(B), are not unconstitutional. According to the Court, these provisions regulate commercial speech and are permissible under the less exacting "rational basis" standard of scrutiny articulated in *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 651, 105 S.Ct. 2265 (1985). The Court explained that the requirements in § 528 are reasonably related to the government's interest to prevent "inherently misleading commercial advertisements;" and to require an "accurate statement of the advertiser's legal status and the character of assistance to be provided;" and that these provisions "do not prevent debt relief agencies . . . from conveying additional information." *Milavetz*, 130 S.Ct. at 1340.

B. The meaning and constitutionality of § 526(a)(4)

The Supreme Court also upheld § 526(a)(4)'s prohibition that a debt relief agency cannot "advise an assisted person . . . to incur more debt in contemplation of" filing for bankruptcy. The Court narrowly read § 526(a)(4)'s prohibition only to preclude "advice to load up on more debt with the expectation of obtaining [a] discharge - *i.e.*, conduct that is abusive *per se*." *Id*. at 1336. After this initial statement of its holding, the Court went on to restate its holding in several slightly different ways. For example, it stated that the advice that is forbidden is advice to incur more debt "when the impelling reason for the advice is the anticipation of bankruptcy," *id*. at 1337; or when the advice to incur more debt is "principally motivated by [the] likelihood" of

bankruptcy, *id*. at 1338 n.6; or "when the impetus of the advice to incur more debt is the expectation of filing for bankruptcy and obtaining the attendant relief." *Id*. at 1339.

As explained by the Court, an attorney may counsel a client to incur more debt for a "valid purpose" without violating § 526(a)(4). *Id*. The Court gave some examples of what would be such a "valid purpose:"

> advice to refinance a mortgage or purchase a reliable car prior to filing because doing so will reduce the debtor's interest rates or improve his ability to repay is not prohibited, as the promise of enhanced financial prospects, rather than the anticipated filing, is the impelling cause. Advice to incur additional debt to buy groceries, pay medical bills, or make other purchases "reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor," is similarly permissible.

Milavetz, 130 S.Ct. at 1339 n.6 (quoting 11 U.S.C. § 523(a)(2)(C)(ii)(II)).

C. Appellate decisions after Milavetz

Of the federal appellate courts, so far only the Second Circuit has issued decisions applying *Milavetz*.

- *Adams v. Zelotes*, 606 F.3d 34 (2nd Cir. 2010)

In this case, the Second Circuit reiterated that § 526(a)(4) does not prohibit attorneys from advising clients to incur more debt in advance of bankruptcy when doing so serves legitimate purposes, nor does BAPCPA restrict "frank discussion" between attorney and client about incurring debt." *Id*. at 38 (citing *Milavetz* at 1337-38). The Second Circuit further explained that in *Milavetz* the "Supreme Court . . . determined that § 526(a)(4) "does not broadly prohibit bankruptcy professionals from providing reasonable financial advice to clients. . . ." *Id*. (quoting *Milavetz* at 1337).

- *Connecticut Bar Ass'n v. United States*, 620 F.3d 81 (2nd Cir. 2010)

The Connecticut Bar Association, the National Association of Consumer Bankruptcy Attorneys, the law firm of Brown & Welsch, P.C., several attorneys in their individual capacities, and a debtor sued the United States, the Attorney General, and the United States Trustee in U.S. District Court. The plaintiffs sought to enjoin the enforcement of § 526(a)(4); § 527(a) and (b); § 528(a)(1)-(2); and § 528(a)(3)-(4) and (b)(2) as unconstitutional under the First Amendment. In addition, the plaintiffs argued that the written contract requirements of § 528(a)(1)-(2) violated the Fifth Amendment's Due Process Clause.

Relying on *Milavetz*, the Second Circuit rejected all of the plaintiffs' constitutional challenges except one. The court remanded the case for additional proceedings on the

constitutionality of the attorney fee advice prohibition in § 526(a)(4), because this issue had not been fully developed by the parties or addressed by the district court. (*See* Open Question No. 2 below)

D. Some open questions

1. Under *Milavetz*, what specific types of advice "to incur more debt in contemplation" of bankruptcy would be for a "valid purpose," in addition to the examples given by the Supreme Court? At least one source has suggested that practitioners may find some guidance by reviewing the case law on pre-bankruptcy purchases by debtors deemed by courts to be abusive of the bankruptcy process under 11 U.S.C. § 707(b)(3). *See* Christopher Frost, Consumer Bankruptcy Practice is Just a Little Bit Harder: Milavetz Gallop and Milavetz, P.A., 30 No. 5 Bankruptcy Law Letter 1 (May 2010).

2. What does § 526(a)(4)'s fee advice prohibition mean? Section 526(a)(4) states, in full, the following. The fee advice prohibition language is in bold:

> A debt relief agency shall not — . . . **advise an assisted person or prospective assisted person** *to incur more debt* in contemplation of such person filing a case under this title or **to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.**

(bolding and italics added). There may be a question about the meaning of this prohibition. The question can be stated this way: is the italicized language above part of this advice prohibition, or not? In other words, is the prohibition not to advise an assisted person "to incur more debt . . . to pay an attorney . . . fee [etc.];" or, rather, is it not to advise an assisted person "to pay an attorney . . . fee [etc.]"?

This fee advice provision was not at issue in *Milavetz*. But in *Milavetz*, the Supreme Court described § 526(c)(4) in a way that may suggest the second of the above views of the fee advice prohibition:

> Section 526(a)(4) prohibits a debt relief agency from 'advis[ing] an assisted person' *either* 'to incur more debt in contemplation of' filing for bankruptcy '*or* to pay an attorney or bankruptcy petition preparer a fee or charge for services' performed in preparation for filing."

Milavetz, 130 S.Ct. at 1334 (emphasis added). The Second Circuit in *Connecticut Bar Ass'n v. United States*, 620 F.3d 81, 103 (2nd Cir. 2010), also seems to have read the fee advice prohibition this way, in describing § 526(c)(4), although the court in that case made no decision about the fee advice prohibition. Instead, it remanded that issue. The court stated that it was allowing plaintiffs, on remand, to pursue "a First Amendment challenge to the second prong of § 526(a)(4), which prohibits a debt relief agency from advising an assisted person 'to pay an

attorney or bankruptcy petition preparer a fee or charge for services performed' in connection with a bankruptcy proceeding."

The second view of the fee advice prohibition is perplexing and raises troubling issues. Under that view of the statute, for example, is it possible for an attorney to demand payment of his fee from the client, or insist on payment of the fee up front as a condition of doing work, but not thereby be deemed to have "advised" the client to pay that fee?

V. Consumer Bankruptcy Attorney Providing Pro Bono Representation is not a Debt Relief Agency

At least one court has held that a consumer bankruptcy attorney providing pro bono representation in a Chapter 7 case is not a debt relief agency.

- *In re Reyes*, 361 B.R. 276 (Bankr. S.D. Fla. 2007), aff'd in part, rev'd in part on other grounds 2007 WL 6082567 (S.D. Fla. 2007).

In *Reyes*, an attorney moved for a determination that her pro bono representation of a debtor meant that she was not a debt relief agency as defined in § 101(12A). The U.S. Trustee opposed the motion, arguing that a decision by the court was unnecessary based on the plain language of § 101(12A). The bankruptcy court overruled the objection due to pro bono counsel's argument that many law firms were reluctant to accept pro bono assignments, because of fear of being deemed debt relief agencies subject to §§ 526-528. The bankruptcy court held that pro bono counsel could not be deemed a debt relief agency, because she was not receiving any money or other valuable consideration from the debtor in exchange for any legal services rendered in the bankruptcy case. The fact that the attorney would receive credit from the state bar association toward fulfilling her annual pro bono obligation did not amount to "the payment of money or other valuable consideration."

The U.S. Trustee appealed. The district court affirmed the bankruptcy court's ruling that pro bono credits from the Florida State Bar association did not constitute "valuable consideration," and debtor's counsel was not a "debt relief agency."

VI. Constitutionality of Written Notices to be Provided by Attorneys to Assisted Persons

Sections 527(a) and (b) require debt relief agencies to give several written notices to assisted persons, beginning as early as three business days after offering to provide any bankruptcy assistance. The Second Circuit and the Fifth Circuit have held that § 527(a) and (b) are not unconstitutional under the First Amendment.

- *Connecticut Bar Ass'n v. United States*, 620 F.3d 81 (2nd Cir. 2010)

In *Connecticut Bar Ass'n*, the Second Circuit considered the constitutionality of the requirement § 527 (a) and (b) that a debt relief agency provide written disclosures to an assisted

person. First, the Court determined that § 527(a) and (b) regulate commercial speech. *Connecticut Bar Ass'n v. U.S.*., 620 F.3d at 95. Second, the Court held that the appropriate standard was the rational basis test articulated in *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 651, 105 S.Ct. 2265 (1985). The Second Circuit noted that § 527(a) and (b) are directed at misleading commercial speech, require the disclosure of specific information, and do not suppress speech. 620 F.3d at 96. The Court held that § 527(a) and (b) withstand rational basis scrutiny because they are supported by "documented confusion and deception in the bankruptcy process and a manifest need for more information." *Id*. at 97. The Court held that § 527(a) and (b) served a legitimate government interest to "avoid[] confusion and deception in the operation of" the nation's federal bankruptcy system and are rationally related to alleviate these concerns. *Id*. at 96-97.

- *Hersh v. U.S. ex rel Mukasey*, 553 F.3d 743 (5th Cir. 2008)

The Fifth Circuit in *Hersch v. U.S. ex rel Mukasey* only addressed First Amendment challenges to § 527(b), which requires a debt relief agency to provide certain basic, general information regarding bankruptcy cases. The Court concluded that § 527(b) does not violate an attorney's First Amendment rights because: (1) the government's interest furthered by § 527(b) was "substantially compelling" for First Amendment purposes; (2) it is narrowly tailored to promote the government's interest and (3) the burden on attorneys is reasonable. 553 F.2d at 766-68.

VII. Written Contracts between Attorneys and Assisted Persons

Section 528 requires a debt relief agency to execute a written contract with an assisted person. The written contract must be executed "not later than 5 business days after the first date on which such agency provides any bankruptcy assistance services to an assisted person, but prior to" the filing date of the assisted person's petition. 11 U.S.C. § 528(a)(1). The written contract must explain "clearly and conspicuously" the services to be provided by the agency, the fees for such services, and the terms of payment. 11 U.S.C. § 528(a)(1)(A) and (B).

Recently, the district court for the Eastern District of Michigan addressed the "5 business days" deadline of § 528(a) in two cases.

- *B.O.C. Law Group, P.C., v. Carroll*, (*In re Humphries*), 453 B.R. 261 (E.D. Mich. 2011) (Judge Lawson)

In *Humphries*, a law firm representing a chapter 13 debtor filed a fee application for pre-confirmation fees. The Chapter 13 Trustee objected. At the initial hearing, the bankruptcy court, *sua sponte*, raised the issue of whether the law firm had complied with 11 U.S.C. §§ 526-528. After further briefing by the parties, the bankruptcy court concluded that the law firm first provided bankruptcy assistance to its client almost one month before a written fee agreement was signed. The court then held that the five-business-days deadline was a material requirement of § 528, and as a result, under § 526(c)(1) the court was prohibited from enforcing the contract. So

fees were denied. The law firm appealed. The district court vacated the bankruptcy court's order and remanded the matter for further proceedings.

The district court concluded that the bankruptcy court disregarded the "precise language set out in [S]ection 526(c)(1) and the context in which the provision appears in the scheme of regulating debt service agencies." *In re Humphries*, 453 B.R. at 268. It explained that Section 526(c)(1) addresses "contract[s] for bankruptcy assistance" and Section 526(c)(2) "deals with the conduct of debt relief agencies (including law firms)." *Id*. The district court pointed out that "[t]hese two sanctions provisions are separate and distinct." *Id*. It further explained that

> The five-business-days requirement in section 528(a)(1) is directed at the conduct of a debt relief agency, not the contents of the agreement for services. In other words, that provision is a requirement of the agency, not a requirement of the contract. The requirements of the contract are described in sections 526, 527, and 528 that prescribe the mandatory and prohibited terms of the agreement for services. The five-business-days language does not set out what must be in such an agreement; it states *when* the agency must execute the agreement. . . . The remedy for a violation of that provision is set forth in subsection 526(c)(2), not subsection 526(c)(1).
> . . . .
>
> By applying a contract-violation remedy to an agency violation, the bankruptcy court rendered meaningless the distinction Congress made between faulty documents and nonconforming conduct in BAPCPA's remedial scheme.

Id. 268-69.

- *B.O.C. Law Group, P.C., v. Carroll*, (*In re Galloway*), No. 11-cv-10380, 2011 WL 2148603 (E.D. Mich. May 30, 2011) (Judge Murphy)

As in *Humphries*, the same law firm representing another chapter 13 debtor sought approval of its fee application. The Chapter 13 Trustee filed several objections, including that the law firm failed to execute a written contract with the Chapter 13 debtor within five business days of its initial consultation, in violation of 11 U.S.C. § 528(a)(1). The undisputed facts showed that (1) the debtor first met with the law firm on January 26, 2010; (2) nine days later on February 4, 2010, the debtor signed a retainer agreement for the firm to represent him in filing a Chapter 7 case; (3) on the same date, the debtor explained to the law firm that he wanted to keep his home; (4) the firm then provided the debtor with a written estimate of its fees to file a Chapter 13 case and instructed the debtor to obtain a market analysis on his home; and (5) on March 4, 2010, the debtor signed a second retainer agreement for the firm to represent the debtor in a Chapter 13 case. *Id*. As in *Humphries*, the bankruptcy court denied the firm's fee application. It found that the written fee agreement was not signed within five business days from the date the law firm first provided bankruptcy assistance to the debtor, as required by § 528(a)(1). *Id*. at *2. Therefore, the bankruptcy court held that the written contract was void under § 526(c)(1). *Id*.

The law firm appealed. The district court followed the analysis of *Humphries*, rejecting the Trustee's argument that the distinction between the contents of a contract and the conduct of a debt relief agency was not supported by the plain language of the statute. 2011 WL 2148603 at *5. The district court explained that:

> the Trustee correctly notes that § 526(a) and § 528(a) pertain to actions which debt relief agencies are authorized to engage in, § 526(c)(1) relates only to avoidance of a contract when the *contract* itself fails to comply with the material requirements of Sections 526 and 528. . . . The five-day requirement, however, is not a material requirement of the contract[.]

Id. (quoting *In re Humphries*, 453 B.R. 261, 268-69 (E.D. Mich. 2011) (emphasis in original). The district court concluded that the bankruptcy court "conflated § 526(c)(1) and § 526(c)(2) when it voided the written fee agreement for failure to comply with the five-day requirement." *Id*. The district court remanded the case to the bankruptcy court to further consider the fee application.

VIII. Undefined Terms in §§ 526-528

A. Vague, undefined phrases

Throughout §§ 526-528, there are several undefined and rather vague phrases, the presence of which make it hard for parties to predict how courts will rule in specific situations. These include:

- prospective assisted person (§ 526(a)(1)-(4));
- reasonable care (§ 526(a)(2));
- material requirements (§ 526(c)(1), (c)(2)(C))
- clear and conspicuous (§ 527(a)(2), § 527(b), § 527(c)); clearly and conspicuously (§ 528(a)(1), (a)(3), (a)(4); § 528(2)(A));
- clear and consistent pattern or practice (§ 526(c)(5));
- reasonable inquiry (§ 527(a)(2)(B)-(C));
- reasonably diligent inquiry (§ 527(c));
- reasonably accurately (§ 527(c));
- reasonably sufficient information (§ 527(c));

- substantially similar statement (§ 527(b), § 528(a)(4), and § 528(b)(2)(B)); and
- reasonable consumer (§ 528(b)(1)(B)).

B. Finding meaning from cases under Rule 9011(b); a recent Third Circuit case

The phrases "reasonable care," "reasonable inquiry," "reasonably diligent inquiry," or "reasonably sufficient information" might be given some meaning by the cases applying the reasonableness standard of Fed.R.Bankr.P. 9011(b), which says that an attorney filing a document makes several certifications to the court that "to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances."

In the Sixth Circuit, "[t]he test for imposing sanctions under Rule 9011(b) is whether the individual's conduct was reasonable under the circumstances." *B-Line*, *LLC*, *v*. *Wingerter* (*In re Wingerter*), 594 F.3d 931, 939 (6th Cir. 2010) (quoting *Corzin v*. *Fordu* (*In re Fordu*), 201 F.3d 693, 711 (6th Cir. 1999)). In applying this test, a "bankruptcy court is not to use the benefit of hindsight but should test the signer's conduct by inquiring what was reasonable to believe at the time the [filing] was submitted." *Id*. (quoting *Mapother & Mapother*, *P.S.C*. *v*. *Cooper* (*In re Downs*), 103 F.3d 472, 481 (6th Cir. 1996)).

- *In re Taylor*, - - - F.3d - - -, No. 10-2154, 2011 WL 3692440 (3rd Cir. August 24, 2011)

In *Taylor*, the Third Circuit recently discussed the reasonable inquiry standard of Rule 9011(b), to decide whether a bankruptcy court abused its discretion in imposing non-monetary deterrence sanctions against a law firm, the firm partner, a managing attorney, and its client (a mortgage lender,) for false and misleading statements. The statements were made in a motion for relief from stay and in a response to the debtors' objection to the mortgage lender's proof of claim.

The Third Circuit began its analysis by noting that several statements made by the attorneys were false and misleading representations to the bankruptcy court. It then explained that as required by Rule 9011, it had to determine the reasonableness of the inquiry the attorneys made before they made their representations to the court. In the Third Circuit,

> [r]easonableness has been defined as 'an objective knowledge or belief at the time of filing of a challenged paper that the claim was well-grounded in law and fact. . . . The requirement of reasonable inquiry protects not merely the court and adverse parties, but also the client. The client is not expected to know the technical details of the law and ought to be able to rely on his attorney to elicit from him the information necessary to handle his case in the most effective, yet legally appropriate manner.
>
> In determining reasonableness, [existing Third Circuit precedent] sometimes

> look[s] at several factors: 'the amount of time available to the signer for conducting the factual and legal investigation; the necessity for reliance on a client for the underlying factual information; the plausibility of the legal position advocated; . . . whether the case was referred to the signer by another member of the Bar . . . [and] the complexity of the legal and factual issues implicated. . . . However, it does not appear that the court must work mechanically through these factors when it considers whether to impose sanctions. Rather, it should consider the reasonableness of the inquiry under all the material circumstances. "[T]he applicable standard is one of reasonableness under the circumstances."

In re Taylor, 2011 WL 3692440 at *6-7 (internal citations omitted). As part of this analysis, the Court explained that the case before it involved

> the degree to which an attorney may reasonably rely on representations from their client. An attorney certainly 'is not foreclosed from relying on information from other persons.'. . . In making statements to the court, lawyers constantly and appropriately reply on information provided by their clients, especially when the facts are contained in a client's computerized records. It is difficult to imagine how attorneys might function were they required to conduct an independent investigation in every factual representation made by a client before it could be included in a court filing. While Rule 9011 "does not recognize a 'pure heart and empty head' defense" . . . , a lawyer need not routinely assume the duplicity or gross incompetence of her client in order to meet the requirements of Rule 9011. It is therefore usually reasonable for a lawyer to rely on information provided by a client, especially where that information is superficially plausible and the client provides its own records which appear to confirm the information.
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> . . . .[R]easonable reliance on a client's representations assumes a reasonable attempt at eliciting them by the attorney. That is, an attorney must, in her independent professional judgment, make a reasonable effort to determine what facts are likely to be relevant to a particular court filing and to seek those facts from the client. She cannot simply settle for the information her client determines in advance—by means of an automated system, no less—that she should be provided with.
> . . . .
>
> More generally, a reasonable attorney would not file a motion for relief from stay for cause without inquiring of the client whether it had any information relevant to the alleged cause, that is, the debtor's failure to make payments.

Taylor, 2011 WL 3692440 at *7-8 (internal citations omitted).

The Third Circuit then concluded that the managing attorney's inquiry prior to making her representations to the court was unreasonable "both as to her general practice and in ways

specific to th[e] case." *Id*. at *7. The Court explained that the managing attorney failed to engage in any attempt to seek relevant facts from the bank. The managing attorney "had no relationship" with the bank and yet allowed the bank to "perilously narrowly" define the information that was relevant to the debtors' matter. And the Court reasoned that the inadequacy of the information provided by the bank about the debtors' account, through the automated NewTrak system, should have been immediately apparent to the managing attorney, because she was not provided with any information about the equity in the debtors' home even though she represented to the court that no equity existed. *Id*. The Court further noted that the managing attorney "ignored clear warning signs as to the accuracy of the data" she received from NewTrak. In their response to the stay relief motion and in their objection to the bank's proof of claim, the debtors explained the inaccurate information about the status of their mortgage payments, provided documentation that they had at least made partial payments, and explained the dispute with the bank over force-placed insurance. *Id*. at *8. All of these representations by the debtors were sufficient to put the managing attorney "on notice that the matter was not as simple as it might have appeared from the NewTrak file." *Id*. The Court reasoned that "[a]t that point, any reasonable attorney would have sought clarification and further documentation from her client, in order to correct any prior inadvertent misstatements to the court and to avoid any further errors." *Id*. The Court concluded that the managing attorney merely "mechanically affirmed facts . . . that *her own prior filing* with the court had already contradicted." *Id*. (emphasis in original).

The Third Circuit found no abuse of discretion by the bankruptcy court in imposing sanctions against the managing attorney or the law firm itself, but reversed the sanctions against the firm's only partner.

IX. Sanctions and Remedies for Violations of Sections 526-528

A. Remedies under §§ 526-528

Section 526(c)(1) voids any contract for bankruptcy assistance between an assisted person and a debt relief agency if the contract does not comply with the "material requirements" of §§ 526-528. Section 526(c)(1) further provides that a voided contract may not be enforced by a federal or state court or any other person, except an assisted person.

Section 526(c)(2) enables an assisted person to seek redress against a debt relief agency for its intentional or negligent (1) failure to comply with any provision of §§ 526-528 in an assisted person's case or proceeding under Title 11; (2) failure to file any required documents including those specified in § 521, which results in the dismissal or conversion of the assisted person's case; or (3) disregard of "the material requirements" of Title 11 or the Federal Rules of Bankruptcy Procedure applicable to such debt relief agency. A debt relief agency is liable to an assisted person for any amount of fees or charges the agency received from the assisted person, actual damages, and reasonable attorneys' fees and costs.

Section 526(c)(5) allows the U.S. Trustee, a debtor, or a court, on its own motion, to move for a determination that "a person intentionally violated this section or engaged in a clear and

consistent patter or practice of violating this section." Remedies include an injunction and "appropriate civil penalties."

B. Cases

There is not yet an abundance of decisions under § 526(c). A few of the cases are highlighted below.

- *Berry v. Maney*, (*In re Sustaita*, 438 B.R. 198 (B.A.P. 9th Cir. 2010)

The Bankruptcy Appellate Panel for the Ninth Circuit affirmed in part and reversed in part a bankruptcy court's enforcement of §§ 110, and 526-528 against a former licensed attorney deemed to be a bankruptcy petition preparer. The matter was brought before the bankruptcy court on motions filed by two Chapter 13 trustees and in which the U.S. Trustee subsequently joined. The panel upheld the bankruptcy court's order imposing statutory fines, the disgorgement of fees, a permanent injunction, and a referral to the U.S. Attorney's office for the filing of a criminal contempt proceeding. The panel, however, reversed the bankruptcy court's order imposing a $100,000 civil penalty under § 526(c)(5)(B) on due process grounds because the notice provided by the court did not provide "explicit notice" that the court was acting *sua sponte* under § 526(c)(5) or of its intent to impose a civil penalty as permitted under § 526(c)(5)(B)).

- *In re Bruckman*, 413 B.R. 46 (Bankr. E.D. N.Y. 2009)

Chapter 7 debtor moved to voluntarily dismiss his case for several reasons, including his attorney's failure (1) to provide him with the notice required under 11 U.S.C. § 342(b); and (2) to comply with §§ 526-528. The debtor's motion was opposed by the U.S. Trustee and creditor, American Express. The bankruptcy court rejected the debtor's arguments about the conduct of his attorney because there was no evidence in the record to support them. But even if there had been sufficient evidence, the bankruptcy court held, dismissal of the debtor's case for "cause" under § 707 was not an appropriate remedy for an attorney's noncompliance with §§ 526-528, because these Code sections expressly provide for other forms of relief.

- *McDow v. The American Debt Free Ass'c*, *Inc*., (In *re Spence)*, 411 B.R. 230 (Bankr. D. Md. 2009)

The U.S. Trustee filed 45 adversary proceedings against the same defendant — The American Debt Free Association, Inc. ("TADFA"). The U.S. Trustee alleged that TADFA's conduct violated § 110 and §§ 526-528 and requested civil penalties, injunctive and other relief. After a trial in the consolidated proceedings, the bankruptcy court found that TADFA, as a debt relief agency, violated § 526(a)(3) due to misrepresentations made by TADFA in its oral and written representations to debtors about the extent of its services and the benefits of filing a bankruptcy case; and TADFA violated the written contract and advertisement requirements under § 528(a)(1)-(a)(4) and § 528(b).

- *In re Casavalencia*, 389 B.R. 292 (Bankr. S.D. Fla. 2008)

Creditors moved to dismiss a Chapter 13 case on bad faith grounds. The bankruptcy court found that the debtor's Chapter 13 case was filed for an improper purpose and that his petition and schedules contained numerous falsehoods. The bankruptcy court dismissed the debtor's case and also sanctioned the debtor and his counsel for such bad faith. The court sanctioned the debtor's counsel under Fed.R.Bankr.P. 9011(b) due to his lack of a reasonable inquiry and for violation of § 526(a)(2). The court awarded $8,739.56 in sanctions against the debtor and his counsel, jointly and severally, with payment due to creditors' counsel.

- *In re Gutierrez*, 356 B.R. 496 (Bankr. N.D. Cal. 2006)

A Chapter 7 debtor filed a motion to compel his former attorney to disgorge all money he received in representing the debtor in his bankruptcy case. The debtor alleged that his attorney failed to comply with his duty not to make an untrue or misleading statement in the bankruptcy schedules; failed to provide the debtor with the "Bankruptcy Truthfulness Notice" as required under § 527(a)(2); and failed to comply with the written contract requirements of § 528(a)(1) and (a)(2). Under § 526(c)(2), the bankruptcy court found that debtor's former counsel acted negligently in failing to comply with § 527(a)(2) and § 528(a)(1) and (a)(2). The court awarded the debtor $700 as repayment of the fee he previously made and $675 as reasonable attorney fees.

Detroit 7th Annual ABI Consumer Bankruptcy Conference, November 11, 2011
MGM Grand, Detroit, Michigan

Concurrent Session: Ethics
(Including §§ 526-528; Asset Disclosure and Valuation; Fee Apps)

Relevant U.S. Bankruptcy Code Sections

Definitions

11 U.S.C. § 101(3) —

"The term "assisted person" means any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $175,750."

11 U.S.C. § 101(4A) —

The term "bankruptcy assistance" means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

11 U.S.C. § 101(12A) —

The term "debt relief agency" means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include —

(A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;

(B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;

11 U.S.C. § 101(12A) continued . . .

(C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;

(D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or

(E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

11 U.S.C. § 526: Restrictions on debt relief agencies

(a) A debt relief agency shall not —

(1) fail to perform any service that such agency informed an assisted person or prospective assistant person it would provide in connection with a case or proceeding under this title;

(2) make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue and misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading;

(3) misrepresent to any assisted person or prospective assisted person, directly or indirectly, affirmatively or by material omission, with respect to —

(A) the services that such agency will provide to such person; or

(B) the benefits and risks that may result if such person becomes a debtor in a case under this title; or

(4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

11 U.S.C. § 526: Restrictions on debt relief agencies continued . . .

(b) Any waiver by any assisted person of any protection or right provided under this section shall not be enforceable against the debtor by any Federal or State court or any other person, but may be enforced against a debt relief agency.

and(a) (1) Any contract for bankruptcy assistance between a debt relief agency assisted person that does not comply with the material requirements of this section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person, other than such assisted person.

(2) Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such debt relief agency has received, for actual damages, and for reasonable attorneys' fees and costs if such agency is found, after notice and hearing, to have —

(A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;

(B) provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency's intentional or negligent failure to file any required document including those specified in section 521; or

(C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

(3) In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has violated or is violating this section, the State —

(A) may bring an action to enjoin such violation;

(B) may bring an action on behalf of its residents to recover the actual damages of assisted person arising from such violation, including any liability under paragraph (2); and

11 U.S.C. § 526: Restrictions on debt relief agencies continued . . .

(C) in the case of any successful action under subparagraph (A) or (B), shall be awarded the costs of the action and reasonable attorneys' fees as determined by the court.

(4) The district courts of the United States for districts located in the State shall have concurrent jurisdiction of any action under subparagraph (A) or (B) of paragraph (3).

(5) Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person intentionally violated this section, or engaged in a clear and consistent pattern or practice of violating this section, the court may —

(A) enjoin the violation of such section; or

(B) impose an appropriate civil penalty against such person.

(d) No provision of this section, section 527, or section 528 shall —

(1) annul, alter, affect, or exempt any person subject to such sections from complying with any law of any State except to the extent that such law is inconsistent with those sections, and then only to the extent of the inconsistency; or

(2) be deemed to limit or curtail the authority or ability —

(A) of a State or subdivision or instrumentality thereof, to determine and enforce qualifications for the practice of law under the laws of that State; or

(B) of a Federal court to determine and enforce the qualifications for the practice of law before that court.

11 U.S.C. § 527: Disclosures

(a) A debtor relief agency providing bankruptcy assistance to an assisted person shall provide —

(1) the written notice required under section 342(b)(1); and

(2) to the extent not covered in the written notice described in paragraph (1), and not later than 3 business days after the first date on which a debt relief agency first offers to provide any bankruptcy assistance services to an assisted person, a clear and conspicuous written notice advising assisted persons that —

(A) all information that the assisted person is required to provide with a petition and thereafter during a cause under this title is required to be complete, accurate, and truthful;

(B) all assets and all liabilities are required to be completely and accurately disclosed in the documents filed to commence the case, and the replacement value of each asset as defined in section 506 must be stated in those documents where requested after reasonably inquiry to establish such value;

(C) current monthly income, the amounts specified in section 707(b)(2), and, in a case under chapter 13 of this title, disposable income (determined in accordance with section 707(b)(2), are required to be stated after reasonably inquiry; and

(D) information that an assisted person provides during their case may be audited pursuant to this title, and that failure to provide such information may result in dismissal of the case under this title or other sanction, including a criminal sanction.

(b) A debt relief agency providing bankruptcy assistance to an assisted person shall provide each assisted person at the same time as the notices required under subsection (a)(1) the following statement, to the extent applicable, or one substantially similar. The statement shall be clear and conspicuous and shall be in a single document separate from other documents or notices provided to the assisted person: "IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM AN ATTORNEY OR BANKRUPTCY PETITION PREPARER.

11 U.S.C. § 527: Disclosures continued . . .

"If you decide to seek bankruptcy relief, you can represent yourself, you can hire an attorney to represent you, or you can get help in some localities from a bankruptcy petition preparer who is not an attorney. THE LAW REQUIRES AN ATTORNEY OR BANKRUPTCY PETITION PREPARER TO GIVE YOU A WRITTEN CONTRACT SPECIFYING WHAT THE ATTORNEY OR BANKRUPTCY PETITION PREPARER WILL DO FOR YOU AND HOW MUCH IT WILL COST. Ask to see the contract before you hire anyone.

"The following information helps you understand what must be done in a routine bankruptcy case to help you evaluate how much service you need. Although bankruptcy can be complex, many cases are routine.

"Before filing a bankruptcy case, either you or your attorney should analyze your eligibility for different forms of debt relief available under the Bankruptcy Code and which form of relief is most likely to be beneficial for you. Be sure you understand the relief you can obtain and its limitations. To file a bankruptcy case, documents called a Petition, Schedules and Statement of Financial Affairs, as well as in some cases a Statement of Intention need to be prepared correctly and filed with the bankruptcy court. You will have to pay a filing fee to the bankruptcy court. Once your case starts, you will have to attend the required first meeting of creditors where you may be questioned by a court official called a 'trustee' and by creditors.

"If you choose to file a chapter 7 case, you may be asked by a creditor to reaffirm a debt. You may want help deciding whether to do so. A creditor is not permitted to coerce you in reaffirming your debts.

"If you choose to file a chapter 13 case in which you repay creditors what you can afford over 3 to 5 years, you may also want help with preparing your chapter 13 plan and with the confirmation hearing on your plan which will be before a bankruptcy judge.

"If you select another type of relief under the Bankruptcy Code other than chapter 7 or chapter 13, you will want to find out what should be done by someone familiar with that type of relief.

"Your bankruptcy case may also involve litigation. You are generally permitted to represent yourself in bankruptcy court, but only attorneys, not bankruptcy petition preparers, can give you legal advice."

11 U.S.C. § 527: Disclosures continued . . .

(c) Except to the extent the debt relief agency provides the required information itself after reasonably diligent inquiry of the assisted person or others so as to obtain such information reasonably accurately for inclusion on the petition, schedules or statement of financial affairs, a debt relief agency providing bankruptcy assistance to an assisted person, to the extent permitted by nonbankruptcy law, shall provide each assisted person at the time required for the notice required under subsection (a)(1) reasonably sufficient information (which shall be provided in a clear and conspicuous writing) to the assisted person on how to provide all the information the assisted person is required to provide under this title pursuant to section 521, including —

(1) how to value assets at replacement value, determine current monthly income, the amounts specified in section 707(b)(2) and, in a chapter 13 case, how to determine disposable income in accordance with section 707(b)(2) and related calculations;

(2) how to complete the list of creditors, including how to determine what amount is owed and what address for the creditor should be shown; and

(3) how to determine what property is exempt and how to value exempt property at replacement value as defined in section 506.

(d) A debt relief agency shall maintain a copy of the notices required under subsection (a) of this section for 2 years after the date on which the notice is given the assisted person.

11 U.S.C. § 528: Requirements of debt relief agencies

(a) A debt relief agency shall —

(1) not later than 5 business days after the first date on which such agency provides any bankruptcy assistance services to an assisted person, but prior to such assisted person's petition under this title being filed, execute a written contract with such assisted person that explains clearly and conspicuously —

11 U.S.C. § 528: Requirements of debt relief agencies continued . . .

(A) the services such agency will provide such assisted person; and

(B) the fees or charges for such services, and the terms of payment;

(2) provide the assisted person with a copy of the fully executed and completed contract;

(3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and

(4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

(b) (1) An advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public includes —

(A) descriptions of bankruptcy assistance in connection with a chapter 13 plan whether or not chapter 13 is specifically mentioned in such advertisement; and

(B) statements such as "federally supervised repayment plan" or "Federal debt restructuring help" or other similar statements that could lead a reasonable consumer to believe that debt counseling was being offered when in fact the services were directed to providing bankruptcy assistance with a chapter 13 plan or other form of bankruptcy relief under this title.

(2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall —

(A) disclose clearly and conspicuously in such advertisement that the assistance may involve bankruptcy relief under this title; and

11 U.S.C. § 528: Requirements of debt relief agencies continued . . .

(B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

FAILURE TO DISCLOSE ASSETS IN A BANKRUPTCY CASE

Materials by Brian J Small- Partner
And by Garik Osipyants- Associate
THAV GROSS PC.
30150 Telegraph Road, Suite 444
Bingham Farms, Michigan 48025
248 645 1700
WWW.THAVGROSS.COM

I. Introduction

As bankruptcy attorneys we are often asked by our clients, "**Do I have to disclose that?**" The question arises when potential debtors are trying to come up with a plausible way to conceal an asset whose value cannot be exempted. Of course, the proper answer is that you must always disclose all of your assets to the Trustee in bankruptcy, no matter what Chapter you have filed.

The Bankruptcy Code requires the debtor to make a full and complete disclosure of all assets and all liabilities in the bankruptcy schedules. (Property of the estate is defined in 11 U.S.C. § 541.) Coupled with this disclosure requirement is the requirement to disclose all preference payments made within the 90 days prior to filing to an ordinary creditor or within one year to an insider… (See 11 U.S.C § 547). You must also disclose all transfers of property in the last two years, (See 11 U.S.C § 548). One of the roles of the bankruptcy trustee is to ensure that debtors disclose all of their assets. The purpose of the bankruptcy system is to provide for an orderly and fair distribution of assets to the unsecured creditors.

It is very important that a debtor completely, truthfully and accurately discloses all of his/her assets. The bankruptcy laws afford the "honest debtor" a "fresh start". The bankruptcy laws provide rigid penalties for hiding or failing to disclose, including fine and jail for up to 5 years for bankruptcy fraud. (18 U.S.C. § 157.)

Despite repeated admonitions to disclose all assets some people try to trick the system. Failure to disclose assets in a bankruptcy case can potentially have significant consequences to the Debtor. "Debtors have an absolute duty to report whatever interest they hold in property, even if they believe their assets are worthless or are unavailable to the bankruptcy estate." *Wood v. Premier Capital, Inc.,* 291 B.R. 219,226 (1st Cir. BAP 2003).

Property or property rights may be lost to the bankruptcy trustee if not properly disclosed. The Bankruptcy Code defines "property" very broadly. It includes much more than obvious things like real estate, cars, jewelry, and bank accounts. It also includes intangible assets like tax refunds, potential lawsuits, and claims for personal injury, workers compensation, social security, or child support. So the simple reason you should disclose such claims is to be honest and to comply with the law, and to achieve the desired result, a discharge of debt!

A number of people forget that they have dormant savings accounts or accounts with credit unions, however, this also is property that needs to be disclosed. The same is true with tax refunds, bank accounts that you are on but do not use, (usually parent's accounts), accrued vacation pay, salary or pension rights, insurance interests, particularly if there is cash value. This is where a proper investigation is needed to be done by debtor's counsel. Counsel for the debtor is charged with the accuracy of the schedules and may be held personally responsible for

omissions in a Chapter 7 case pursuant to 11 U.S.C. § 526(c). A proper "due diligence" investigation can and will save you and your client from some very difficult problems.

Another common issue is when a client fails to disclose all of their property to the attorney and it turns out that there is no ability to amend the schedules and exempt the property after filing the case. Had the debtor disclosed all the property he/she had an interest in to the attorney he/she was working with, the attorney (armed with all the necessary information) may have advised the person not to file for bankruptcy or to delay the filing of the bankruptcy in order to keep the property. An additional significant risk in not disclosing all of the assets owned by the debtor is that the discharge can be denied or revoked.

II. Bankruptcy Code

When an individual or entity files a petition for bankruptcy protection under chapters 7, 11, or 13 of the Bankruptcy Code, a bankruptcy estate is created. Pursuant to Section 541(a)(1) of the Code, the bankruptcy estate is composed of "all legal or equitable interests of the debtor in property as of the commencement of the case." The scope of section 541(a)(1) is broad, encompassing both tangible and intangible property.

Included within the wide array of "intangible property" under section 541(a)(1) are prepetition causes of action held by the debtor. The Bankruptcy Code affords debtors the right to exempt certain property from the bankruptcy estate. Section 522 of the Bankruptcy Code directs what property a debtor may exempt. In chapter 7 proceedings, nonexempt property in a debtor's bankruptcy estate is subject to administration by the trustee for the benefit of creditors.
A specific example of property that may be partially or completely not exempt includes pending lawsuits and the benefits of same.

The Bankruptcy Code states that each debtor must file a list of property to properly exempt it. 11 USC 522(l). In other words, a debtor may lose the ability to exempt an asset if the debtor fails to disclose the asset even if the asset would otherwise be exempt under the appropriate statute.

Subject to the specific exemption rules, the Bankruptcy Code seeks to ensure that all property of the debtor is included in the debtor's bankruptcy estate for administration by the bankruptcy trustee. To accomplish that purpose, the following Bankruptcy Code sections address the disclosure requirements;

A. ". . . a person who knowingly and fraudulently conceals assets . . . in connection with a case under this title shall be subject to fine, imprisonment, or both . . ." § 342(b)(2)(A)
B. Section 527(a)(2)(A) ". . . all information that the assisted person is required to provide with a petition and thereafter during a case under this title is required to be complete accurate and truthful. . ."
C. Section 527(a)(2)(B) ". . . all assets . . . are required to be completely and accurately disclosed in the documents filed to commence the case . . ."
D. Section 527(a)(2)(D) ". . . information that an assisted person provides during their case may be audited pursuant to this title, and that failure to provide such information may result in dismissal of the case under this title or other sanction, including a criminal sanction."
E. Section 342(b)(2)(A) ". . . a person who knowingly and fraudulently conceals assets . . . in connection with a case under this title shall be subject to fine, imprisonment or both"

III. Cases

- *In re McDermitt*:•"Regardless of the financial or personal difficulties a debtor may be facing, the Bankruptcy Code requires a debtor and his or her attorney to guarantee the schedules that are filed are complete and accurate to the best of the debtor's knowledge."

- *In re Bellows-Fairchild,* 322 B.R. 675 (Bankr. D. Or. 2005):•"Neither a debtor nor his attorney is entitled to omit information or provide partial information simply because, in their view, the information provided is sufficient to the trustee to determine the value
- *In re Unruh*, 2008 WL 341465 (5th Cir. 2008): For purposes of denying an amended exemption, bad faith may be shown by a gross and deliberate understatement of the value of an asset, made in an attempt to deceive creditors or the bankruptcy court. *See also, In re Hannigan*, 409 F.3d 480, 484 (1st Cir.2005) (affirming a finding of bad faith where debtor had intentionally undervalued property by listing value for only one of two parcels); *In re Bauer*, 298 B.R. 353, 356 (8th Cir.BAP2003) (affirming a finding of bad faith where debtors substantially undervalued their home in schedules).
- Those who file bankruptcy petitions and schedules for debtors are reminded of their duty to ensure that accurate, complete, and reliable information is contained in those documents and is promptly provided to the case trustee if changes occur after filing. *In re McKain*, 325 B.R. 842, 851 (Bankr. D. Neb. 2005):

- *In re Robertson*, 370 B.R. 804, 809 n.8 (Bankr. D. Minn. 2007): [D]ebtors' counsel are to exercise significant care as to the completeness and accuracy of all recitations on their clients' schedules, after they have made a factual investigation and legal evaluation that conforms to the standards applicable to any attorney filing a pleading, motion, or other document in a federal court. The content of a debtor's petition and schedules is relied on, and should have the quality to merit that reliance.

IV. Exemptions

The general rule allows liberal amendment of exemption claims. "[T]he general rule is to allow liberal amendment of exemption claims, absent bad faith, concealment of property, or prejudice to creditors." *In re Williamson*, 804 F.2d 1355, 1358 (5th Cir. 1986).

Intentionally undervaluing asset may deprive debtor of an exemption. In the case of *Bauer v. Iannacone,* Chapter 7 case was reopened, after trustee uncovered information suggesting that debtors' residence may have been significantly undervalued on their schedules. 298 B.R. 353 (B.A.P. 8th Cir 2003). The debtors responded by amending their exemptions and to increase the amount of their homestead exemption. On trustee's objection to amended exemptions, the Bankruptcy Court entered an order disallowing the amended exemptions, and debtors appealed. The Bankruptcy Appellate Panel held that the debtors acted in "bad faith," so as to preclude them from amending their exemptions in order to assert the homestead exemption to which they would otherwise have been entitled to had they properly valued their property in first place.

Fraudulent concealment may result in the forfeiture of debtor's right to exempt an asset. In *In re Yonikus*, the debtor failed to list his work-related personal injury as an asset or claim it as

exempt. 996 F.2d 866, 868 (7th Cir. 1993). He failed to tell the Trustee about the settlement money he received and the court revoked his discharge for concealing an asset, yet he still attempted to amend his schedule of exemptions to claim the property as exempt. The Seventh Circuit affirmed the bankruptcy court's denial of the exemption based on debtor's fraudulent concealment of the asset.

Recently, the United States Supreme Court ruled in *Schwab v. Reilly,* that a Chapter 7 Trustee is not required to object to the exemptions made by the debtor in order to preserve the estate's right to retain any value in the asset beyond the value of the exempt interest. --- U.S. ----, 130 S.Ct. 2652, 177 L.Ed. 2d 234 (2010). The question in the case was, what happens when a debtor both reports an asset with an estimated market value and claims an exemption for the asset equal to the market value, the trustee does not object because the claimed exemption falls within the applicable-dollar value limit, and it later becomes apparent that the asset's true market value exceeds the claimed value and the applicable dollar-value limit?

The Court ruled that that pursuant to § 522 the debtor is only entitled to the dollar amount she claimed, not the full value of the asset. Further the court concluded that because the Code defines such property as an interest, not to exceed a certain dollar amount, in a particular asset, not as the asset itself, the value of the property claimed exempt should be judged on the dollar value the debtor assigns the interest, not on the value the debtor assigns the asset.

According to the Court's ruling, the trustee need not have objected to the exemption to preserve the estate's ability to recover value in the asset beyond the value the debtor declared exempt. The rationale for this conclusion was that the trustee had no basis for objecting in the first place–on its face, the exemption appeared to comply with the limit imposed by the rules,

and there was no way of knowing beforehand that the asset would appreciate in value beyond the limit.

V. Causes of Action

When an individual files for bankruptcy protection but fails to disclose an existing cause of action in his or her bankruptcy filings, such as is required both on the Schedule B and the in the Statement of Financial Affairs, and later receives a discharge, courts have held that the debtor possesses no standing to pursue the civil claim, because it was--and would have been the property of the trustee prior to discharge.

More specifically, the commencement of Chapter 7 bankruptcy extinguishes a debtor's legal rights and interests in any pending litigation, and transfers those rights to the trustee, acting on behalf of the bankruptcy estate. Thus, generally speaking, a pre-petition cause of action is the property of the Chapter 7 bankruptcy estate, and only the trustee in bankruptcy has standing to pursue it. If the Debtor has any kind of claim that could produce money or property for him/her, it's vital that it is disclosed in the petition. Under the doctrine of judicial estoppel, failure to disclose a potential claim in the bankruptcy proceeding can wipe out a claim.

Judicial estoppel is based on every court's desire to maintain its own integrity. Judges believe people should not be able to assert one set of facts in one court and completely opposite facts in another. Due to the fact the debtors who file bankruptcy swear that their schedules accurately disclose all of their assets, the failure to list a claim in effect states to the bankruptcy court that a debtor does not have a claim. Then, when the same debtor tries to prosecute the

claim in another court, or before an administrative agency, he or she is saying that there is a claim– the exact opposite.

If a party fails to adequately disclose a cause of action in bankruptcy the doctrine of judicial estoppels may bar later prosecution of those claims. For judicial estoppel to bar these subsequent claims, a defendant must establish three factors (1) that the party to be estopped has "taken two positions that are irreconcilably inconsistent"; (2) that the party has changed his or her position "in bad faith"; and (3) that dismissal is "'tailored to address the harm identified' and no lesser sanction would adequately remedy the damage done by the litigant's misconduct." *Montrose Medical Group Participating Savings Plan v. Bulger*, 243 F.3d 773, 779-80 (3rd Cir. 2001).

"The bankruptcy system cannot function fairly and effectively unless the debtor scrupulously complies with requirement of filing a schedule of assets and liabilities, so a debtor cannot omit a cause of action from his schedule of assets, leaving his creditors in the dark as to a potential source of payment for their claims, then bring the cause of action on his own once those claims have been compromised or released in the bankruptcy, keeping any recovery for himself." *Locapo v. Colsia,* 609 F.Supp.2d 156 (D.N.H.,2009).

VI. Denial of Discharge

The bankruptcy process processes a fundamental policy of granting a discharge to the honest but unfortunate debtor. Nevertheless, debtors who seek the protections permitted under the Bankruptcy Code have a duty to fully disclose the nature of their assets when preparing their statements and schedules. The denial of discharge serves to assure that " 'those who seek the

shelter of the bankruptcy code do not play fast and loose with their assets or with the reality of their affairs.'" *Palmacci v. Umpierrez,* 121 F.3d 781, 786 (1st Cir.1997), (quoting *Boroff v. Tully (In re Tully),* 818 F.2d 106, 110 (1st Cir.1987)).

A Chapter 7 debtor's attempt to avoid paying a judgment creditor by hiding and/or misrepresenting the value of his assets, including his manipulation of a substantial account receivable which was owed to him on the petition date by his closely-held corporation and in belatedly attempting to reclassify debt as equity, while passing along nearly all financial questions to his accountant and failing to explain any of the many serious questions about his financial dealings, were all sufficient reasons for denial of debtor's discharge based on his fraudulent post-petition transfer, concealment or other disposition of property of the estate. 11 U.S.C.A. § 727(a)(2)(B). *In re Pearlman,* 413 B.R. 27 (Bkrtcy.D.R.I.,2009).

VII. Title 18- Criminal Sanctions

U.S. bankruptcy laws provide a process and procedures that allows a debtor, who is unable to pay his creditors, to resolve his debts through the division of his assets among his creditors. Bankruptcy fraud is committed when individuals and corporations conceal and misstate assets, mislead creditors, and illegally pressure bankruptcy petitioners during a bankruptcy proceeding.

Criminal statutes that apply to bankruptcy fraud are 18 U.S. C. Section 152 that specifically prohibits knowingly and fraudulently (1) concealing property of the estate; (2) making a false oath or account; (3) making a false declaration, verification or statement under penalty of perjury; (4) presenting or using a false proof of claim against a debtor estate; (5)

receiving, post-petition, a material amount of property from a debtor with intent to defeat the provisions of the Bankruptcy Code; (6) offering, receiving, or attempting to obtain consideration for acting or refraining from acting in a case under the Bankruptcy Code; (7) transferring or concealing property in contemplation of a bankruptcy case or with intent to defeat the provisions of the Bankruptcy Code; (8) post-petition concealment or alteration of records; and (9) post-petition withholding of a debtor's records.

The statute applies to anyone who commits any of the above including debtors, creditors, fiduciaries and anyone else.

Section 153 of Title 18 makes it a crime for anyone to appropriate to their own use, embezzle, spend, or transfer any property belonging to a debtor's estate, and any actions of the same "persons" if they secret or destroy any document belonging to a debtor's estate.

Section 155 of title 18 prohibits knowing and fraudulent agreements that are aimed at fixing compensation in bankruptcy cases.

Section 157 of Title 18 is actually entitled "Bankruptcy Fraud" prohibits a person from (1) filing a bankruptcy petition; (2) filing a document in a bankruptcy case or proceeding; or (3) making a false or fraudulent representation, claim, or promise concerning or in relation to a repetition or pending bankruptcy case or proceeding (or a proceeding falsely asserted to be pending) if these acts are done as part of the scheme to defraud.

Other bankruptcy fraud criminal charges may include tampering with or falsifying records (18 U.S. C. Section 1519).

Those convicted of bankruptcy fraud face fines, imprisonment of no more than five years, or both.

Conclusion

Explaining to clients who knowingly want to hide assets from the Trustee that it is not a good idea is fairly simple; just tell them that they shouldn't lose sight of the true goal, a bankruptcy discharge. Bankruptcy is a privilege really, and many clients/potential debtors lose sight of this. Bankruptcy is an opportunity to eliminate most, if not all, debt and get a start fresh. It is NOT an opportunity to make a windfall profit, therefore the client MUST make all of the required disclosures.

Furthermore, explain to them that while this will most likely be the only bankruptcy case they will ever file, the trustee has literally reviewed thousands of bankruptcy cases, and he or she is no dummy. The trustee assumes every debtor is lying about something and will attempt to unearth the truth. When it comes to asset investigation, the trustee is always smarter than the client who thinks he/she can get away with something. Complete and proper disclosure protects a client's rights in bankruptcy court. When in doubt, disclose. The client will never be wrong by disclosing too much. The key to a successful bankruptcy case is full disclosure and having complete supporting documentation. Thus, outside of exigent circumstances that require careful consideration, the best practice is to complete the required due diligence before filing the case. Obtain all supporting documents such as deeds, recorded mortgages, tax returns, pay stubs, and valuations before the filing of the case to put the client in the best possible position to fully comply with the disclosure requirement.

Ethics and Social Media: What Does It Mean For The Bankruptcy Practice?

Prepared by: David W. Van Zyl

Social Networking is a big part of most of our lives and now we are examining what it means for the practice of law. I attended the NACTT Seminar this summer in Anaheim and there was a really wonderful section on Ethics and Social Networking. That is why I thought it would be interesting to cover it here at this seminar for you. Peter Fessenden, the Standing Chapter 13 Trustee in the District of Maine prepared very helpful materials which I am excerpting here in quotations throughout my materials with his permission:

"Social media" is an evolving concept and not a fully defined term. It is most often described by examples: Facebook, MySpace, Twitter, LinkedIn, Flickr and YouTube. (Others will surely follow.) "

"The distinguishing characteristics of social media include "web-based services that allow individuals to (1) construct a public or semi-public profile within a bounded system, (2) articulate a list of other users with whom they share a connection, and (3) view and traverse their list of connections and those made by others within the system." Dahan M. Boyd & Nicole B. Ellison, *Social Networking Sites: Definition, History and Scholarship*, 13 Journal of Computer-Mediated Communication 11 (2007)."

"Although inherent in any computer-accessed system, it bears emphasizing for the purpose of this discussion that individuals use it in physical isolation. Each person is alone in his or her home, office, cubicle, table or park bench. She or he has the sensation of privacy, despite actual knowledge of public interaction."

The practice of bankruptcy requires that each of the Debtors need to fully disclose all their financial affairs. The Debtors prepare Schedules and statements which are filed with the court. As a Debtor's attorney I reviewed those Schedules and statements with the Debtors to make sure they were true and accurate to the best of their knowledge. Now, as a Trustee's attorney I review these Schedules and statements to determine if I need further information or documentation to verify their veracity. 11 U.S.C. §521(a)(3) requires the Debtor to "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title".

"Debtors are sometimes less than forthcoming. Despite the requirements for voluntary discovery under Fed.R.Civ.P. 26(a)(1) and 26(e), applicable to adversary proceedings by Fed.R.Bankr.P. 7026, defendants and respondents in adversary proceedings and contested matters are occasionally reluctant to spill the beans. Trustees, plaintiffs and movants should be prepared to dig below the surface. In the appropriate case, full-bore discovery may be

necessary. Traditional sources of information remain viable. Social media offer new vistas that have not been fully explored."

We can all google a name or look for someone's Facebook page in an informal manner. The difference is when we actively reach out to the other person and seek to make contact with them. If as counsel we try to interact with an opposing party, it changes everything.

"Rule 4.2 of the Model Rules of Professional Conduct proscribes unauthorized communication with a person known to be represented without his or her attorney's consent. It is improper for counsel to ask a represented party to be social media 'friends' without permission from that person's lawyer. Model Rule 8.4(a), as well as paragraph [4] of the commentary on Rule 4.2, make it clear that it is similarly improper for counsel to ask an employee or even a stranger to do so."

"Do things change if counsel seeks to be 'friended' be an unrepresented party? If counsel asks directly, stating accurately her or his own name and profile but without disclosing the underlying reason for the request, it depends on one's local bar standards. The New York City Bar Association Committee on Professional and Judicial Ethics saw no impediment in Opinion 2010-2. The Philadelphia Bar Association in Opinion 2009-02 required counsel to disclose his or her motive for the request. *See*, generally, Steven Seidenberg's article, "Seduced" in the February 2011 ABA JOURNAL. "

Following are some court decisions regarding social media in non-bankruptcy cases:

"In *Pietrylo v. Hillston Restaurant Group*, 2008 WL 6085437 (D.N.J. July 25, 2008), while rejecting the common law tort claim, the jury found a violation of the federal Stored Communications Act, 18 U.S.C. § 2071, et seq., where an employer gained access to an employee's less-than-complimentary Facebook page by bullying a co-worker to turn over her password. The overall conduct of the employer was deemed to be malicious, resulting in punitive damages four times the amount of the compensatory award."

"In *EEOC v. Simply Storage Management*, 2010 U.S.Dist. LEXIS 52766 (S.D.Ind. May 1, 2010), the defendant sought to undercut the claimants' charges of sexual harassment by searching their Facebook and MySpace pages. The court overruled the agency's blanket objections that the subpoenas for Facebook and MySpace access were overbroad and embarrassing harassment that infringed on the claimants' privacy. The court did, however, limit production to relevant information and photographs on the claimants' sites."

"McMillen v. Hummingbird Speedway, 2010 Pa. D.&C. LEXIS 270 (Pa. D.&C. Sept.9, 2010), was a humdrum personal injury action where the defendant sought access to Facebook and MySpace to demonstrate that the plaintiff engaged in activities incompatible with his claims

of severe injury. In light of his apparent vigor in some of the public Facebook postings, the court rejected the plaintiff's opposition to discovery."

As other areas of the law begin to use social media like Facebook for discovery, the question becomes how will those who practice bankruptcy law utilize social media? Will a trustee request a Debtor's password to his Facebook page so that it can be reviewed at the 341 hearing? Will creditor's attorney request to view a Facebook page to possible find out some information about their collateral? Should Debtor's attorneys be reviewing their client's Facebook and other social media pages to determine the accuracy of certain information provided? What is the obligation of the Debtor's attorney to make sure his client does not delete anything from his Facebook page? Should your office have a social networking policy? There is no question that the impact of social media may soon change the way we practice.

"Assuming that access to social media sites becomes commonplace, debtor's counsel will face additional ethical issues: What advice or information should be given to clients – or potential clients – about the likelihood of the trustee's investigation of social media sites? What are counsel's obligations to minimize the deletion of postings and photographs by clients or potential clients before the sites can be viewed by the trustee? Bank records can be retrieved by a trustee from the bank if a debtor has "lost" them. Social media postings and information are within the exclusive control of the debtor. Once deleted, they are extremely difficult to recover. (Of course, a computer hard drive can be torn down to retrieve anything that ever existed on it. In a consumer case, the cost would be prohibitive.) A debtor risks denial of discharge in Chapter 7 under § 727(a)(3) for destruction of or failure to preserve records or other information from which his or her financial condition might be ascertained. Dismissal "for cause" under § 1307(c) could be ordered for similar reasons."

"The debtor and debtor's counsel are usually the only ones who are aware of an impending bankruptcy filing. The eventual trustee cannot send a preservation letter before a case is filed. Debtor's counsel certainly has an obligation to inform the client, or potential client, of all likely events in the bankruptcy case. Is there a duty to prevent spoliation of information on a social media site?"

Social media and the practice of bankruptcy law raises all kinds of questions for all of us. Should Trustee's attorneys be social media "Friends" with Debtor's attorneys? I have several Debtor's attorneys who are Facebook friends but most of them have been friends for many years starting back when I was a Debtor's attorney.

Professor Nancy Rapoport, a professor at William S. Boyd School of Law, University of Nevada (Las Vegas, NV), who was also a panelist on this subject at the NACTT, included in her presentation what she called "Stupid lawyer tricks"

***Asking for a continuance to attend a funeral, and then posting pictures of your week's vacation on Facebook.**

***Applying for admission to a state bar and posting pictures of your excessive drinking (or having friends tag you in their pictures).**

***Tweeting about your client, your strategy, or the other side. (ever heard of re-tweeting?)**

I think we all have to be conscious of what we post on our social media sites or personal blogs. I am careful never to post anything specific about my job or any case I might be working on at the time. We all need to remember that what we say on the internet becomes permanent. I believe there is a heightened responsibility for each of us to be more responsible in our own personal social networking. As social media continues to explode, we will have to use the ethical standards we adhere to as attorneys in dealing with our personal as well as our client's social media sites.