

The Good, the Bad and the Ugly: Pre-Filing Ethics in Chapter 13 and Chapter 7

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**The Good, the Bad and the Ugly: Pre-Filing Ethics in Chapter 13
and Chapter 7**

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Introduction

This section presents a series of hypothetical scenarios designed to facilitate a discussion about what is appropriate when advising a client or a potential client about the best strategy for their bankruptcy case before and after the petition is filed. For the purposes of this discussion only, the Michigan Rules of Professional Conduct will be used.

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Hypothetical Scenario 1

- 11 U.S.C. §526(a): "A debt relief agency shall not . . . (4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title . . ."
- *Milavetz, Gallop & Milavetz, P.A., et al. v. U.S.*, 559 U.S. 229, 130 S.Ct. 1324, 1333 (2010)
 - "[W]e hold that attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies within the meaning of BAPCPA."
 - "[W]e conclude that § 526(a)(4) prohibits a debt relief agency only from advising a debtor to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose." *Id.* at 1336.
 - "Our construction of § 526(a)(4) to prevent only advice principally motivated by the prospect of bankruptcy further ensures that professionals cannot unknowingly run afoul of its proscription." *Id.* at 1338.
 - *Milavetz* Fn.6: The hypothetical questions *Milavetz* posits regarding the permissibility of advice to incur debt in certain circumstances, *see Brief for Milavetz 48–51*, are easily answered by reference to whether the expectation of filing for bankruptcy (and obtaining a discharge) impelled the advice. We emphasize that awareness of the possibility of bankruptcy is insufficient to trigger § 526(a)(4)'s prohibition. Instead, that provision proscribes only advice to incur more debt that is principally motivated by that likelihood. Thus, 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," § 523(a)(2)(C)(ii)(II), is similarly permissible.
- *Hersh v. U.S.*, 553 F.3d 743 (5th Cir. 2008): "[T]he language of section 526(a)(4) can and should be interpreted only to prohibit attorneys from advising clients to incur debt in contemplation of bankruptcy when doing so would be an abuse or improper manipulation of the bankruptcy system. Thus, section 526(a)(4) has no application to good faith advice to engage in conduct that is consistent with a debtor's interest and does not abuse or improperly manipulate the bankruptcy system."
- *In re Hornung*, 425 B.R. 242, 249 (Bankr. M.D. N.C. 2010): "The Court notes that by purchasing these vehicles, the Debtors reduced their monthly disposable income on the means test by \$130.84, raising the specter of impermissible manipulation. *See In re McLaughlin*, 305 B.R. 505, 509 (Bankr.W.D.Mo.2004) ('The Debtors actions, however, in purchasing two new and relatively expensive vehicles on the eve of bankruptcy indicates that the Debtors likely have engaged in some calculated manipulation of the Bankruptcy Code.');
- *see also Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 130 S.Ct. 1324, 1333–34, 176 L.Ed.2d 79 (2010) ('Section 526(a)(4) prohibits a debt relief agency from 'advis[ing] an assisted person' ... 'to incur more debt in contemplation of' filing for bankruptcy....')."

- *In re Spisak*, 361 B.R. 408, 414 (Bankr. D. Vt. 2007): noting, in the context of the fee waiver eligibility analysis, that the existence and value of a debtor's exempt property (against which a debtor might borrow funds for fees) must be considered in view of 526(a)(4)'s directive against incurring new debt in anticipation of filing.

Hypothetical Scenario 2

- 11 USC §547(c)(4): The trustee may not avoid under this section a transfer – to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor – (A) not secured by an otherwise unavoidable security interest and (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor. . . .
- *Hersh v. U.S.*, 553 F.3d 743 (5th Cir. 2008): “[T]he language of section 526(a)(4) can and should be interpreted only to prohibit attorneys from advising clients to incur debt in contemplation of bankruptcy when doing so would be an abuse or improper manipulation of the bankruptcy system. Thus, section 526(a)(4) has no application to good faith advice to engage in conduct that is consistent with a debtor’s interest and does not abuse or improperly manipulate the bankruptcy system.”
- 11 USC §526(a)(4): 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 a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

Hypothetical Scenario 3

- 11 U.S.C. § 109(e): Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$383,1751 and noncontingent, liquidated, secured debts of less than \$1,149,5251, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than \$383,1751 and noncontingent, liquidated, secured debts of less than \$1,149,5251 may be a debtor under chapter 13 of this title.
- 11 U.S.C. § 1325(a): “Except as provided in subsection (b), the court shall confirm a plan if . . . (3) the plan has been proposed in good faith and not by any means forbidden by law . . . (7) the action of the debtor in filing the petition was in good faith”
- *In re Okoreeh-Baah*, 836 F.3d 1030, 1033–34 (6th Cir. 1988): “[C]ourts should take into account the totality of the circumstances confronting a debtor, not simply his pre-plan conduct, when deciding whether or not to confirm a Chapter 13 plan.” (footnote omitted)
- *In re Thompson*, No. 11-20138-13, 2011 WL 5520963, at *1 (Bankr. D. Kan. Nov. 14, 2011): Citing Sixth, Seventh and Ninth Circuit authority, § 109(e) eligibility “is similar to the amount in controversy question in federal diversity jurisdiction cases, and should similarly be decided based on the debtor’s assertions in the schedules unless the assertions are not made in good faith.” Although schedules were in good faith, undersecured portion of debts were added to other unsecured debts and made debtors ineligible.²
 - *Cf. Cini v. Genesis Enters., Inc. (In re Cini)*, No. 11-00056, 2011 WL 6209610 (Bankr. D. Mont. Dec. 14, 2011): Looking to statements for eligibility purposes is not iron-clad

² Certain Citations used courtesy of Ch13online.com and Keith M. Lundin.

rule when it is readily ascertainable that unsecured debt on petition date exceeded statutory limits. Prior stipulation and related order admitted that principal creditor did not have perfected security interest and that its claim was wholly unsecured, in amount exceeding § 109(e) eligibility limit. Debtor given 14 days to convert, or case would be dismissed.

- *Liggett v. Schwartz (In re Schwartz)*, No. 11-13160, 2012 WL 1020011 (E.D. Mich. Mar. 26, 2012): Rejecting distinction between “claim” in § 506(a)(1) and “debt” used in § 109(e), unsecured portion of undersecured debt must be counted as unsecured debt for eligibility purposes. Confirmation order was vacated, with remand to dismiss for ineligibility.
 - *But see In re Holland*, 293 B.R. 425, 429 (Bankr. N.D. Ohio 2002): “[T]he Court believes that, if directly confronted with the issue, the Sixth Circuit would not, in determining a debtor’s Chapter 13 eligibility under § 109(e), divide an undersecured debt into its respective secured and unsecured parts.” (citing *In re Morton*, 43 B.R. 215 (Bankr. E.D. N.Y. 1984)).

Hypothetical Scenario 4

- 11 USC §330 (4)(A): Except as provided in subparagraph (B), the court shall not allow compensation for-- (i) unnecessary duplication of services; or (ii) services that were not (I) reasonably likely to benefit the debtor's estate; or (II) necessary to the administration of the case.
- 11 USC §330 (4)(B): In a chapter 12 or chapter 13 [11 USCS §§ 1201 et seq. or 1301 et seq.] case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

Hypothetical Scenario 5

- MRPC 1.3: Duty to act with reasonable diligence and promptness in representing a client
- MRPC 1.4(b): A lawyer must explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation
- MRPC 1.7(b): A lawyer can’t represent a client if representing them will materially limit the lawyer’s responsibilities to another client or a third person or is limited by the lawyer’s own interests UNLESS there is reasonable belief that the representation will not be adversely affected and the client consents after consultation
- MRPC 8.4(a): It is a violation of this rule to violate one of the other rules
- MRPC 8.4(c): A lawyer must not engage in conduct that is prejudicial to the administration of justice
- 11 USC § 329(a): Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation.
- 11 USC § 329(b): If such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to—(1) the estate, if the property transferred--(A) would have been property of the

estate; or (B) was to be paid by or on behalf of the debtor under a plan under chapter 11, 12, or 13 of this title [11 USCS §§ 1101 et seq., 1201 et seq., or 1301 et seq.]; or (2) the entity that made such payment.

- 11 USC § 330(a)(1): After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329 [11 USCS §§ 326, 328, and 329], the court may award to a trustee, a consumer privacy ombudsman appointed under section 332 [11 USCS § 332], an examiner, an ombudsman appointed under section 333 [11 USCS § 333], or a professional person employed under section 327 or 1103 [11 USCS § 327 or 1103]--(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, ombudsman, professional person, or attorney and by any paraprofessional person employed by any such person; and (B) reimbursement for actual, necessary expenses.
- 11 USC §330(a)(2): The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested
- Fed. Bank. R. Civ. Proc. 2016(b): Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required.
- Fed. Bank. R. Civ. Proc. 2017: On motion by any party in interest or on the court's own initiative, the court after notice and a hearing may determine whether any payment of money or any transfer of property by the debtor, made directly or indirectly and in contemplation of the filing of a petition under the Code by or against the debtor or before entry of the order for relief in an involuntary case, to an attorney for services rendered or to be rendered is excessive.
- *Matter of Prudhomme*, 43 F.3d 1000, 1002-3 (5th Cir. 1995): Rule 2016(b)'s one year time frame for reporting attorney's fees is not a statute of limitations but a rebuttable presumption that all attorney's fees incurred in the year prior to the petition date were paid in contemplation of filing that case.
- *In re Basham*, 208 B.R. 926 (B.A.P. 9th Cir. 1997): the fact that the attorney did not sign the petition or actually file the Debtors' papers with the court is irrelevant for the purposes of the application of the 11 USC 329 and hence the filing of the statement under 2016(b).
- *In re Downs*, 103 F.3d 472 (6th Cir. 1996): the failure to comply with the filing of 2016(b) statement may result in the application of sanctions in the form of disgorgement.

Hypothetical Scenario 9

- MRPC Rule 1.8(b): A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client consents after consultation, **except as permitted or required by Rule 1.6 or Rule 3.3.** (emphasis added)
- MRPC Rule 1.9(c): A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter: (1) use

information relating to the representation to the disadvantage of the former client **except as Rule 1.6 or Rule 3.3 would permit or require with respect to a client**, or when the information has become generally known; or (2) reveal information relating to the representation **except as Rule 1.6 or Rule 3.3 would permit or require** with respect to a client. (emphasis added)

- MRPC Rule 1.6(a): “Confidence” refers to information protected by the client-lawyer privilege under applicable law, and “secret” refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.
- MRPC Rule 1.6(b): **Except when permitted under paragraph (c), a lawyer shall not knowingly: (1) reveal a confidence or secret of a client; (2) use a confidence or secret of a client to the disadvantage of the client; or (3) use a confidence or secret of a client for the advantage of the lawyer or of a third person, unless the client consents after full disclosure.** (emphasis added)
- MRPC Rule 1.6(c): A lawyer may reveal: (1) confidences or secrets with the consent of the client or clients affected, but only after full disclosure to them; **(2) confidences or secrets when permitted or required by these rules, or when required by law or by court order; (3) confidences and secrets to the extent reasonably necessary to rectify the consequences of a client's illegal or fraudulent act in the furtherance of which the lawyer's services have been used; (4) the intention of a client to commit a crime and the information necessary to prevent the crime;** and (5) confidences or secrets necessary to establish or collect a fee, or to defend the lawyer or the lawyer's employees or associates against an accusation of wrongful conduct.
- MRPC Rule 3.3(a): A lawyer shall not knowingly: (1) make a false statement of material fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; (2) fail to disclose to a tribunal controlling legal authority known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or (3) offer evidence that the lawyer knows to be false. If a lawyer has offered material evidence and comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. (emphasis added)
- MRPC Rule 3.3(b): **If a lawyer knows that the lawyer's client or other person intends to engage, is engaging, or has engaged in criminal or fraudulent conduct related to an adjudicative proceeding involving the client, the lawyer shall take reasonable remedial measures,** including, if necessary, disclosure to the tribunal. (emphasis added)
- MRPC Rule 3.3(c): The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.
- MRPC Rule 3.3(d): In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts that are known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.
- MRPC Rule 3.3(e): When false evidence is offered, a conflict may arise between the lawyer's duty to keep the client's revelations confidential and the duty of candor to the court. **Upon ascertaining that material evidence is false, the lawyer should seek to persuade the client that the evidence should not be offered or, if it has been offered, that its false character should immediately be disclosed. If the persuasion is ineffective, the lawyer must take**

reasonable remedial measures. The advocate should seek to withdraw if that will remedy the situation. **If withdrawal from the representation is not permitted or will not remedy the effect of the false evidence, the lawyer must make such disclosure to the tribunal as is reasonably necessary to remedy the situation, even if doing so requires the lawyer to reveal information that otherwise would be protected by Rule 1.6.** (emphasis added)

I. Hypothetical Scenario 1: To Borrow or Not to Borrow is that the Question?

A. Facts:

1. Debtors come in to see Counsel. They decide to file Chapter 13. Both cars are ancient. One has broken down. Counsel advises debtors that he cannot tell debtors to borrow funds, but they need a better car. He says he has sent people to Larry's Easy Car Lot down the street. Debtors purchase a vehicle for \$20,000 with 17 percent interest and payment of \$497 per month. Shortly thereafter, Debtor Counsel files the case. Car is valued at \$20,000 but interest rate and monthly payment are reduced. Creditor objects to reduction in interest rate and monthly payment and alleges bad faith. Debtor Counsel responds by amending plan to pay the car directly with higher interest rate and reduces percentage to unsecured creditors. Debtors testify at 341 that they thought Counsel told them to borrow the money for the car. Counsel says, "No - I most assuredly did not." Chapter 13 Trustee objects because of amended plan and refers 'borrowing issue' to the U.S. Trustee for review.

B. Discussion:

1. Was the advice to go see Larry's Easy Car Lot down the street in derogation of the statute?
2. If not - how should this be handled?

II. Hypothetical Scenario 2: Not Grandma!

A. Facts:

1. Debtor meets with Counsel for an initial consultation. Debtor tells Counsel that she paid her grandmother \$5,000 six months ago as full repayment for a loan. Counsel advises Debtor that this repayment constitutes a preferential transfer under 11 USC §547(b) and, as such, may be avoided by the Trustee. The Debtor states that she does not want the Trustee to take possession of the \$5,000 and distribute it for the benefit of other creditors.

B. Discussion:

1. Can Counsel advise the Debtor that she can have her grandmother re-loan the same \$5,000 before the petition is filed and, after the filing date, the Debtor (after properly exempting the \$5,000.00) can give that money back to her grandmother in full; thus avoiding a preference action by the Trustee? (*See* 11 USC §547(c)(4)).
2. Would this advice be “principally motivated” by the likelihood that the Debtor will file for bankruptcy? Even if it is principally motivated by the impending bankruptcy, should this advice be construed as advising “abuse and improper manipulation of the bankruptcy system”? *See Hersh v. U.S.*, 553 F.3d 743 (5th Cir. 2008).
3. How do the *Milavetz* decision, the *Hersh* decision, and 11 USC 526(a)(4) conflict, if at all, with Counsel’s duty to fully disclose to the Debtor all of the options available to her to avoid a preference action?

4. Would such advice be more acceptable if the Debtor, after receiving the advice from Counsel, waited several more months (but still less than a year) before filing a petition?

III. Hypothetical Scenario 3: Know Your Limit!

A. Facts:

1. Debtors come in to see Counsel. Debtor's debt is clearly over the Chapter 13 debt limits. He pays down credit debt of \$20,000 to be under the limit of §109(e). Plan asks Trustee to pursue the preference action. Debtor wife also files. Debtor Counsel asks Court to jointly administer the two cases.

B. Discussion:

1. Is this ethical or good pre bankruptcy planning?
2. When can you rearrange debt limits for Chapter 13?

IV. Hypothetical Scenario 4: For Whose Benefit?

A. Facts:

1. Debtor retains Counsel to handle Chapter 13 case. After the Chapter 13 petition is filed, Debtor's former business partner (and Creditor in Chapter 13 case) files an adversary complaint against the Debtor to determine the non-dischargeability of a debt pursuant to 11 USC §523(a)(2). Debtor's counsel diligently represents the Debtor throughout the pre-trial and discovery periods at the end of which the Court has approved Debtor's counsel for the payment of \$10,000.00 to be paid from the estate. \$15,000.00 is the projected dividend to unsecured creditors under the confirmed plan. Debtor's counsel has moved to modify the Chapter 13

plan to reduce the dividend to unsecured creditors to \$5,000.00 thus making the plan once again feasible. Debtor's counsel, however, anticipates at least \$5,000.00 in attorney's fees going forward to trial.

B. Discussion:

1. To what extent should Debtor's counsel disclose the further anticipated cost of litigation in his modified plan?
2. To what extent can Counsel "bill the estate" for his anticipated fees going forward?
3. Should the impact to unsecured creditors have weight on how much Counsel can charge to the Chapter 13 Plan? If so, when must Counsel stop billing the estate and why?
4. Should Debtor's counsel attorney fees be dependent upon successfully defending the Debtor?

V. Hypothetical Scenario 5: The Troubled Referral

A. Facts:

1. Debtors met with Attorneys in January 2010 for advice on filing for bankruptcy relief. One of the Attorneys owns Firm A and one of Attorneys (Attorney B) is an attorney with a separate private practice. Attorneys advised the Debtors to file Chapter 11 bankruptcy. Both attorneys fail to provide the Debtors with a written contract within 5 days of providing the Debtors with bankruptcy assistance, in violation of 11 USC 528(a). Under the agreement signed by the Debtors 20 days after meeting with Attorneys, the Debtors paid a retainer of \$4,000.00 to Firm A. The retainer agreement

provided for an hourly rate of \$300.00 for Firm A's representation, and an hourly rate of \$250.00 for Attorney B's representation. Under the agreement, if the Debtors did file a Chapter 11 petition there would be a further retainer of \$6,000.00. Upon Firm B's recommendation, the Debtors entered into a separate fee agreement with Accountant, a forensic accountant residing in the same building as Attorney B. The Debtors paid the Accountant a separate retainer of \$2,000.00 to provide Attorneys with the financial information they needed to create a feasible "pre-packaged" Chapter 11 plan of repayment. The Debtors paid Firm A a total of \$13,000.00 in attorneys' fees over a period of two years, including \$4,000.00 on August 6, 2009, \$4,000.00 on October 29, 2010, and \$5,000.00 on September 9, 2011. Attorneys then referred the Debtors to another firm, Firm C, to discuss whether the Debtors should file a Chapter 13 case because neither Firm A nor Attorney B had any experience or familiarity with the Chapter 13 process. In an email between a partner and an associate at Firm C, the associate, Firm C's Chapter 13 specialist, stated that he considered the filing of a Chapter 11 case for the Debtors to be "a ridiculous idea and a waste of time and that they might avoid telling the Debtors so." This email was forwarded to Firm A and eventually came into the Debtors' possession. The Debtors were never told by Firm A that filing a Chapter 11 case was a "ridiculous idea or waste of time". Firm A continued to maintain that their "pre-packaged" Chapter 11 was the best option despite never filing a petition. Firm A will later state that

the inurrence of \$20,000.00 in Federal Tax debt by the Debtors in 2011 made the “pre-packaged” Chapter 11 less feasible. The preparation of the Chapter 11 case proceeds until the Debtors explicitly terminate Firm A’s services on February 11, 2012, after being referred to Attorney D by friends. On February 26, 2012, the Debtors met with Attorney D and signed an agreement for Attorney D to manage a Chapter 13 case on their behalf. Attorney D was able to file a Chapter 13 petition for the Debtors two days later, and the Chapter 13 plan was confirmed on July 25, 2012, five months after the petition was filed. Attorney D was awarded pre-confirmation attorney’s fees in the amount of \$3,500.00 for the successful and expeditious filing of a confirmed Chapter 13 plan. Firm A, Attorney B, and Accountant received notice of the Debtors’ filing of a bankruptcy petition when Attorney D mailed them a proposed Motion to Disgorge Professionals’ Fees on August 10, 2012.

B. Discussion:

1. Does it matter to what extent Firm A actually worked on preparing the Chapter 11 petition?
2. Is there a duty to report Firm A and Attorney B’s possible violations under MRPC by either Attorney D and/or the Trustee?
3. What are Firm A and Attorney B’s duties to report fees paid to them by the Debtors under Bankruptcy Rule 2016(b)?
4. What duty, if any, do either Attorney D and/or the Trustee have to compel compliance with Bankruptcy Rule 2016(b)?

5. What duty does either Attorney D and/or the Chapter 13 Trustee have to disclose and/or pursue possible malpractice and/or Consumer Protection Act cases against Firm A, Attorney B, or Accountant?
6. Does it matter whether the Debtors could exempt the potential recovery of either the retainers paid or the potential malpractice and/or Consumer Protection Act lawsuits?
7. Does 11 USC § 329 have any application in this matter?
8. What duty do either Attorney D and/or the Chapter 13 Trustee have to disclose and/or pursue a grievance with the Attorney Grievance Commission?
9. Can either Firm A or Attorney B negotiate a settlement which contains a provision that the Debtors' not file a grievance with the Attorney Grievance Commission?

VI. Hypothetical Scenario 6: Back to the Future!

A. Facts:

1. Debtor meets with Counsel for a consultation. Debtor informs Counsel that he has transferred a parcel of paid in full real estate via quit claim deed to a close friend, approximately 22 months prior to the present day. At the same time, Debtor also transferred title to a 2 year old vehicle to the same friend. Debtor had lost his job, and has remained unemployed until this time. Debtor wishes to file a Chapter 7.

B. Discussion:

1. Can this Debtor be advised to file a Chapter 7 now? Do these transfers need to be disclosed?
2. How about 6 months from now? Can the Debtor be advised to wait this (or any) time period before filing?
3. Suppose that Debtor's home and vehicle were only paid in full due to the application of non-exempt personal injury proceeds. How does that change the answer? What if the personal injury settlement resulting in the payoff occurred during the last 3 years?
4. What if the real property, instead of being quit claimed to a close friend, was transferred into tenancy by the entirety when the debtor married? Does it matter now that the home and vehicle were paid in full due to the application of non-exempt personal injury proceeds?
5. How about if it is the non-filing spouse who has the personal injury proceeds, and uses them to "buy in" to the property? Can you advise the Debtor this might be a prudent idea?

VII. Hypothetical Scenario 7: You Go Your Way. I will Go Mine.

A. Facts:

1. Joe and Jackie Debtor have been married for 25 years. Joe owns a house, subject to a small mortgage with a relatively substantial default, and Jackie is neither a joint owner nor a joint obligor on the mortgage. The house is worth well over double the relevant homestead exemption. The Debtors own a car jointly, subject to a bank's security interest. Joe's unsecured debts are minimal. Jackie's unsecured debts are substantial.

B. Discussion:

1. Is it proper, assuming the household income is under the median, to advise Joe and Jackie to file separate cases?
2. Suppose that in addition to her debts, Jackie has a savings account with approximately \$10,000 in it – can counsel advise Jackie to pay down the mortgage and file a chapter 7 by herself? What if she’s a joint obligor on the mortgage but not an owner of the property?
3. Suppose the state’s homestead exemption is unlimited. Can the couple use a \$250,000 personal injury settlement to add 5 bedrooms and 3 bathrooms to the house?

VIII. Hypothetical Scenario 8: Till Bankruptcy Do Us Part.

A. Facts:

1. Suppose instead that the house in Hypothetical Scenario 7 is worth less than the applicable homestead exemption, the house is owned jointly, and Joe and Jackie have been in a joint Chapter 13 case for approximately 18 months. Counsel was retained under a “flat fee” through case closing agreement, the majority of which was paid through the plan. The Debtors now intend to divorce, amicably. Jackie’s income comprises the vast majority of the household income; Joe’s is barely sufficient to cover the mortgage.

B. Discussion:

1. Can Counsel represent both parties if Jackie elects to split-convert her portion of the case? Can Counsel advise the two on their respective best courses of action?
2. If so, what is required?
3. What if they intend to leave the case as-is, despite the divorce? Keep in mind Jackie has been funding the plan.
4. Can Counsel charge Jackie fees post-conversion?
5. What if the majority of *all* the debt is Joe's, yet Jackie's income is still funding the plan. How (If at all?) should Counsel advise the Debtors?
6. Suppose the divorce is no longer amicable. What should Counsel do?

IX. Hypothetical Scenario 9: Now You See It. Now You Don't.

A. Facts:

1. Debtor consults with you about filing bankruptcy. Debtor discloses to you all of his assets, which include an extensive gun collection. The gun collection includes several guns given to the Debtor years ago by his late grandfather. The Debtor says that the gun collection is worth at least \$50,000, but that he would never sell the collection, because it has great sentimental and "political" value to him. He also says that he keeps his collection in his brother's basement in a neighboring town, "for safekeeping." After carefully assessing Debtor's financial situation, you advise Debtor that if he files bankruptcy, he will have to disclose the gun collection, and that he will not be able to exempt most of the collection. After you explain to Debtor the consequences of this in a Chapter 7 case

and in a Chapter 13 case, Debtor is very unhappy about the possibility of losing his gun collection if he files Chapter 7. He doesn't think he would have the means to purchase the non-exempt value of the gun collection from the Chapter 7 Trustee, and he doesn't want to file Chapter 13. And he says that he thinks his gun collection should be entirely exempt anyway, because it is protected by his right to bear arms under the Second Amendment, and this is the United States of America. Debtor says that he wants to "think about things," and that he will call you back in a few days to let you know whether he wants to file bankruptcy or not. A few weeks pass and you have not heard anything more from Debtor. Then you happen to learn that Debtor filed a Chapter 7 bankruptcy soon after talking to you, using a different bankruptcy attorney. Out of curiosity, you use PACER to review the Debtor's bankruptcy schedules and Statement of Financial Affairs. There is no disclosure of any kind about the Debtor's gun collection. Because you know the Debtor's current bankruptcy attorney to be a highly ethical and competent attorney, you believe that the Debtor must have purposely concealed his gun collection from his new attorney.

B. Discussion:

1. What, if anything, should you do, or may you do, about this apparent fraud on the Court and improper concealment of assets by the Debtor?
2. May you; should you; must you, do the following:

- a) Do nothing and say nothing; it's none of your business (you are not a creditor and do not represent a creditor in the Debtor's bankruptcy case; and you do not view the Debtor as being your current client in connection with his bankruptcy case.)
- b) Call the Debtor and tell him that he should disclose the gun collection to his current bankruptcy attorney immediately.
- c) Call the Debtor's current bankruptcy attorney and tell him about the Debtor's gun collection.
- d) Call the Chapter 7 Trustee and tell her about the Debtor's gun collection.
- e) Call the United States Trustee and tell them about the Debtor's gun collection.
- f) Write a letter to the bankruptcy judge assigned to the Debtor's case, reporting the gun collection, with a copy to Debtor, Debtor's attorney, the Chapter 7 Trustee, and the United States Trustee.

3. Specific Issues under Rule 1.6:

- a) Is the fact that the Debtor owns a valuable gun collection a "confidence" (*i.e.*, privileged) or a "secret" anymore, once the Debtor files bankruptcy? How can that fact be considered a confidence or secret any longer, since upon filing bankruptcy the Debtor has a legal duty to publicly disclose his ownership of the gun collection (e.g., in Schedule B)?

- b) But even if the above fact is no longer a confidence or secret, isn't the fact that the Debtor told you that he owned this gun collection still a confidence or secret (one or the other)?
- c) But if the answer to the above questions is "no" to part (a), but "yes" to part (b), there may be a practical problem. If you can and do reveal fact (a) (Debtor owns a valuable gun collection), the next question to you is likely to be: How do you know this? To this question, do you have to answer "I cannot answer that question"?
- d) Rule 1.6(c) states the situations when you "may" reveal a client's confidences and secrets; not when you must do so. If you "may" publicly reveal all about the Debtor's gun collection, and what the Debtor told you about it, *should* you do so, if Rule 3.3 (discussed below) does not require that you do so?
- e) Even if you conclude that you can tell no one else anything about the Debtor's gun collection and his intentional concealment of it, is there any reason you cannot call the Debtor himself, and urge him to come clean?
- f) Even if you conclude that you can tell no one else anything under Rule 1.6, may you tell Debtor's current bankruptcy attorney about the Debtor's gun collection and his intentional concealment of it?
- g) Would such a communication by you to Debtor's current attorney be protected, from that attorney's perspective, as a "confidence" or

“secret” of his client that he could not reveal publicly under Rule 1.6?

- h) Would Rule 3.3 (discussed more below) require Debtor’s *current* attorney, who innocently filed the Debtor’s false Schedule B, but who now would learn of the falsity, to reveal the false statement to the bankruptcy court or otherwise rectify the false statement? If the answer to this is yes, and Rule 3.3 did not require you to reveal the false statement, does that form a reason why you cannot tell Debtor’s current attorney about the false statement?
- i) You may believe that the Debtor’s failure to disclose his gun collection in his bankruptcy schedules or Statement of Financial Affairs is an “illegal or fraudulent act” within the meaning of Rule 1.6(c)(3), but Rule 1.6(c)(3) still might not apply here, for two possible reasons:
 - a. Because the Debtor, arguably, is not a “client” of yours when he commits the illegal and fraudulent act; and/or
 - b. Because *your* services have not been used “in the furtherance of” the Debtor’s illegal or fraudulent act. The mere fact that you correctly (and innocently) explained to the Debtor that he had a duty to disclose his gun collection if he filed bankruptcy; that he could not fully exempt it; and what the consequences would be, does not mean that the Debtor used your services “in the furtherance of” the

Debtor's later illegal and fraudulent failure to disclose the gun collection in his bankruptcy case. For example, the Comment to Rule 1.6 cites the Comment to Rule 1.2, which states in part the following:

- i. A lawyer is required to give an honest opinion about the actual consequences that appear likely to result from a client's conduct. **The fact that a client uses advice in a course of action that is illegal or fraudulent does not, of itself, make a lawyer a party to the course of action.** However, a lawyer may not knowingly assist a client in illegal or fraudulent conduct. There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which an illegal act or fraud might be committed with impunity (emphasis added).
- j) You may also believe that the Debtor's failure to disclose his gun collection is a "crime" within the meaning of Rule 1.6(c)(4), but Rule 1.6(c)(4) still might not apply here, for two possible reasons:
 - a. Because the Debtor, arguably, was no longer a "client" of yours when he formed his intention to commit such crime; and/or

- b. Because by the time you learn of Debtor's "crime" and his intention to commit such crime, the "crime" has already been committed. Arguably, you can no longer provide "the information necessary to prevent the crime" within the meaning of Rule 1.6(c)(4). (But if the Debtor's nondisclosure is a crime, is it a continuing crime, as long as such non-disclosure continues, for purposes of this rule?

4. Specific Issues under Rule 3.3:

- a) Is the discussion of Rule 1.6 above just needlessly complicating this problem? Do Rule 3.3(b) and 3.3(e) make the answer simple? If either of those rules requires that you disclose the Debtor's fraudulent concealment of assets, then that is the end of the matter.
- b) But do these provisions in Rule 3.3 apply in this situation? Do these provisions apply only when the fraudulent conduct has been done by your *current* client? And is the Debtor in this case only your *former* client, at most? Look at the words of Rule 3.3(b), for example. That rule requires disclosure by a lawyer only when that lawyer "knows that the lawyer's client or other person intends to engage, is engaging, or has engaged in criminal or fraudulent conduct related to an adjudicative proceeding involving the client." The reference in this phrase "or other person" is interesting, but isn't it necessary that the "criminal or fraudulent conduct" be "related to an adjudicative proceeding involving the client"? And

doesn't this mean an adjudicative proceeding involving your *current* client, not your *former* client? (And note that the Rules do distinguish expressly, in the conflict-of-interest context of Rule 1.9, at least, between a current client and a former client.) *See also* the reference to "the client's" and "the client" in the first two sentences of Rule 3.3(e).