Consumer Bankruptcy/Ethics & Professional Compensation

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Consumer Committee and Ethics & Professional Compensation Committee
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II. Trust but Verify: The Duty to Independently Verify Information Provided by Clients

TOPIC #1: DUTY TO VERIFY INFORMATION PROVIDED BY CLIENT:

What is the duty of counsel to independently verify information provided by a debtor? How far does the obligation to be sure extend under Rule 9011 and the Bankruptcy Code? Must counsel independently verify assets with public records, liens with public records, lawsuits and potential claims with public records, creditors with credit reports and so forth?

RESPONSES / DISCUSSION:

The starting point for the answers to these questions in consumer cases is § 707(b)(4), which provides:

(4) (C) The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has—

(i) performed a **reasonable investigation** into the circumstances that gave rise to the petition, pleading, or written motion; and

(ii) determined that the petition, pleading, or written motion—

(I) is well grounded in fact; and

(II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).

(D) The signature of an attorney on the petition shall constitute a certification that the attorney has **no knowledge after an inquiry** that the information in the schedules filed with such petition is incorrect.

To provide guidance on the broad new requirements in the statute, the *Ad Hoc Committee on Bankruptcy Court Structure and Insolvency Processes, Task Force on Attorney Discipline, ABA Section of Business Law* published an article entitled "**Attorney Liability Under Section 707(b)(4) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005"** *The Business Lawyer; Vol. 61, February 2006* (hereafter the "ABA 707(b)(4) article").

The ABA 707(b)(4) article provided specific guidance on what constitutes a "reasonable investigation" under the new provisions:

> "§ 3.1 "REASONABLE INVESTIGATION"
>
> **Recommendations**
>
> As a standard, "reasonable investigation" should be governed by the case law interpreting and applying the "reasonable inquiry" standard under Rule 9011. Attorneys should be able to rely on case law that allows time constraints to be taken into account.
>
> The reasonableness of the attorney's inquiry should not be analyzed with the benefit of hindsight; rather, the analysis should, as under Rule 9011, focus on the attorney's inquiry at the time that the inquiry was made.
>
> **Attorneys should verify information supplied by the debtor if such verification may be accomplished with a reasonable expenditure of time and expense and, in the attorney's professional judgment, the information provided by the client is inconsistent or contains other indications of inaccuracy**.
>
> Attorneys should be able to rely upon documents prepared by third parties in the scope of their employment, including tax returns, credit and title reports, child support enforcement agency statements, or information from the debtor's pre-petition credit counseling agency.
>
> Unless and until the courts articulate new standards for section 707(b)(3)'s good faith requirement,21 attorneys should be able to rely on case law developed under section 707(a),22 specifically those cases interpreting and applying the "bad faith" and "totality of the circumstances" tests. Case annotations relevant to these recommendations are attached as Appendix A and incorporated herein."

ABA 707(b)(4) report at p. 703. The same report also adopted a case law formulation of the duty:

> More specifically, the Task Force accepts the following articulation of an attorney's reasonable pre-filing investigation:
>
> The duty of reasonable inquiry imposed upon an attorney by Rule 11 and by virtue of the attorney's status as an officer of the court owing a duty to the integrity of the system requires that the attorney (1) explain the requirement of full, complete, accurate, and honest disclosure of all information required of a debtor; (2) ask probing and pertinent questions designed to elicit full, complete, accurate, and honest disclosure of all information required of a debtor; (3) check the debtor's responses in the petition and Schedules to assure they are internally and externally consistent; (4) demand of the debtor full, complete, accurate, and honest disclosure of all information required before the attorney signs and files the petition; and (5) seek relief from the court in the event that the attorney learns that he or she may have been misled by a debtor.

ABA 707(b)(4) report at p. 703 (citing *In re* Robinson, 198 B.R. 1017, 1024 (Bankr. N.D. Ga.1996); *In re* Armwood, 175 B.R. 779, 789 (Bankr. N.D. Ga. 1994); *In re* Matthews, 154 B.R. 673, 680 (Bankr. W.D. Tex. 1993). *See In re* Huerta, 137 B.R. 356, 379 n.8 (Bankr. C.D. Cal. 1992).

In addition, the ABA 707(b)(4) article provided specific guidance on what constitutes a "inquiry":

> **"§ 4. SECTION 707(B)(4)(D)**
>
> § 4.1 "INQUIRY"
>
> **Recommendation**
>
> Attorneys should conform their "inquiry" requirement under section 707(b)(4)(D) to the "reasonable inquiry" standard under Rule 9011.
>
> Attorneys should be able to rely on case law that allows time constraints to be taken into account.
>
> The reasonableness of the attorney's inquiry should be not be analyzed with the benefit of hindsight; rather, the analysis should, as under Rule 9011, focus on the attorney's inquiry at the time that the inquiry was made.
>
> **Attorneys should verify information supplied by the debtor if such verification may be accomplished with a reasonable expenditure of time and expense and, in the attorney's professional judgment, the information provided by the client is inconsistent or contains other indications of inaccuracy**.
>
> Attorneys should be able to rely upon documents prepared by third parties in the scope of their employment, including tax returns, credit and title reports, child support enforcement agency statements, or information from the debtor's pre-petition credit counseling agency.
>
> Case annotations relevant to these recommendations are attached as Appendix A and incorporated herein."

The ABA 707(b)(4) article concludes that the duty of "reasonable investigation" or "inquiry" can normally be fulfilled by reliance on information provided by the client, confirmed by information in documents prepare by 3rd parties as long as the information is consistent across the board. If the information lacks internal consistency or contains other indications of inaccuracy, then additional verification or investigation is warranted. The magnitude or scope of the effort and resources in the additional investigation will vary depending on the case, issues and amount of inconsistency. Prudent counsel will confirm in writing the inconsistent information, additional documents / effort needed and related matters in written record to the client. Counsel

will also document the professional judgments made at the time (problems, issues and additional investigation needed or not) in appropriate cases.

What is the scope of the duty to investigate or inquire in the absence of red flags or inconsistent information supplied by a client ?

That duty to investigate / inquire can be fulfilled by meeting the legal standard for disclosure in the bankruptcy schedules. In other words, the duty to inquire or investigate has been met when counsel's investigation has resulted in adequate information to comply with the applicable legal standard. In the **"Working Paper: Best Practices for Debtors' Attorneys"** *The Business Lawyer; Vol. 64, November 2008* (hereafter the "ABA Best Practices Paper") the standard was described as:

> **1.4.2. Judicial Standards on Disclosure**
>
> . . . . The Working Group believes that notice should be the guiding principle underlying the debtor's duty of complete and accurate disclosure. In other words, disclosure should be sufficient to put the trustee and creditors on notice of the possible existence of assets available for distribution and actions that may be taken against the debtor.
>
> There are a variety of reasons underlying our belief that notice is the appropriate standard. Foremost among them is the trustee's affirmative duty to investigate the financial affairs of the debtor.[1] Requiring the debtor and the debtor's attorney to undertake a comprehensive and detailed pre-filing investigation would render this duty superfluous, especially in light of the debtor's post-petition obligation to cooperate with the trustee.[2]

Thus, it is the author's opinion that counsel has met the minimum duty of "investigation / inquiry" when adequate information has acquired so as to allow counsel to prepare bankruptcy documents that put readers of those documents on inquiry notice of assets, transactions and related matters.

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[1] *See* 11 U.S.C. § 704(a)(4) (2006).

[2] *See* 11 U.S.C. § 521(a)(3) (2006).

TOPIC #2: CLIENT FRAUD, LAWYER USE OF FRAUDULENT INFORMATION PROVIDED BY CLIENT:

What is the duty of counsel when he or she finds that the client has given him or her false information and that false information is disseminated by counsel?

RESPONSES / DISCUSSION:

Step #1: RECONFIRM THE FACTS: a) what the original information was; b) what the source(s) of the original information was; c) the basis for the current belief it was both false and provided by the client; d) how it was missed in the quality control process; and e) where it was actually used or disseminated by counsel.

Step #2: IDENTIFY THE RELEVANT RULES AND LAW

Model Rule 1.2(d) provides as follows:

> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

What is knowledge? Model Rule 1.0(f) provides that knowledge can be "inferred from the circumstances." The vagueness of the definition should be a red flag to a lawyer who "smells a rat" in connection with what a client is telling the lawyer or other parties to a transaction.

Excerpts from the Comments to Model Rule 1.2 appear below.

Comment Criminal, Fraudulent and Prohibited Transactions

[9] Paragraph (d) prohibits a lawyer from knowingly counseling or assisting a client to commit a crime or fraud. This prohibition, however, does not preclude the lawyer from giving an honest opinion about the actual consequences that appear likely to result from a client's conduct. Nor does the fact that a client uses advice in a course of action that is criminal or fraudulent of itself make a lawyer a party to the course of action. **There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity.**

[10] When the client's course of action has already begun and is continuing, the lawyer's responsibility is especially delicate. **The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed. A lawyer may not continue assisting a client in conduct that the lawyer originally supposed was legally proper but then**

discovers is criminal or fraudulent. The lawyer must, therefore, withdraw from the representation of the client in the matter. See Rule 1.16(a). In some cases, withdrawal alone might be insufficient. It may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like. See Rule 4.1.

[11] Where the client is a fiduciary, the lawyer may be charged with special obligations in dealings with a beneficiary.

[12] Paragraph (d) applies whether or not the defrauded party is a party to the transaction. Hence, a lawyer must not participate in a transaction to effectuate criminal or fraudulent avoidance of tax liability. Paragraph (d) does not preclude undertaking a criminal defense incident to a general retainer for legal services to a lawful enterprise. The last clause of paragraph (d) recognizes that determining the validity or interpretation of a statute or regulation may require a course of action involving disobedience of the statute or regulation or of the interpretation placed upon it by governmental authorities.

[13] If a lawyer comes to know or reasonably should know that a client expects assistance not permitted by the Rules of Professional Conduct or other law or if the lawyer intends to act contrary to the client's instructions, the lawyer must consult with the client regarding the limitations on the lawyer's conduct. See Rule 1.4(a)(5).

Disclosure of client fraud to others. Rules 1.6(b)(2)&(3) provide as follows:

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

* * * *

> 2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;
>
> (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

Most states have an exception to confidentiality that is the same or nearly the same as the provisions quoted just above, see the state-by-state analysis at Thomas D. Morgan & Ronald D. Rotunda, 2008 Selected Standards on Professional Responsibility 149-164 (2008).

Most states' rules do not command the lawyer to reveal client fraud to others; they permit disclosure. One must, however, be wary of Model Rule 4.1(b), which provides:

> In the course of representing a client a lawyer shall not knowingly:
> * * *
> *

(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Step #3: APPLY THE RULES AND LAW TO THE FACTS

The ABA Standing Committee on Ethics and Professional Responsibility addressed this situation in **Formal Opinion 92-366 (1992)**. The opinion advises that a lawyer who finds that his or her services are being used to perpetrate a fraud **must first withdraw from any representation** that would directly or indirectly assist the continuation of the fraud. If continuing the representation would suggest to innocent third parties that all was well in the client's legal affairs, then the lawyer must withdraw to avoid giving a false impression. The committee suggested that a lawyer be allowed to withdraw any assistance unknowingly provided to a fraudulent project; this would be accomplished by means of a **"noisy withdrawal"--the lawyer's disavowal of previous work product, opinion letters, and the like**. [3]This, the opinion acknowledged, "may have the collateral effect of disclosing inferentially client confidences obtained during the representation." **A noisy withdrawal is not permitted if the client's fraud is complete rather than ongoing**. The ABA committee was not in agreement on the rectification issue, and three members issued a strong dissent. For an overview of these issues and a discussion of the rules pertaining to disclosure of client fraud, see Weinstein, Client Confidences and the Rules of Professional Responsibility: Too Little Consensus and Too Much Confusion, 35 S. Tex. L. Rev. 727 (1994).

It has been suggested that the provision in the Comment to Rule 1.6 allowing a lawyer to give notice of withdrawal and disaffirm and withdraw documents prepared by the lawyer reconciles perceived inconsistencies among Rules 1.2, 1.6, and 4.1(b). Rotunda, The Notice of Withdrawal and the New Model Rules of Professional Conduct: Blowing the Whistle and Waving the Red Flag, 63 Or. L. Rev. 455 (1984).

STATE OPINIONS ON CLIENT BANKRUPTCY FRAUD

Connecticut Opinion 96-5 (3/14/96) Confidentiality; Disclosure of fraud; Bankruptcy; Malpractice. A lawyer who discovers that his former client, who is now suing him for legal malpractice, committed fraud in the bankruptcy proceeding in which the lawyer's services were used may reveal the fraud to the extent necessary to rectify its consequences. One reasonable method of rectification would be to contact the U.S. Trustee or his attorney. Whether the lawyer may reveal the information to establish a claim or defense in the malpractice action depends on the facts, the law, and the circumstances. Rule 1.6.

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[3] See Susan Freeman, *Are DIP and Committee Counsel Fiduciaries for the Client's Constituents or the Bankruptcy Estate? What is a Fiduciary Anyway?,* 17 AM. BANKR. INST. L. REV. 291 (2009) (discussing standards for withdrawal of counsel).

Maryland Opinion 2004-19 (undated) Confidentiality; Misrepresentation; Disclosure of fraud; Former clients; Candor toward tribunals.
A lawyer who learns that a former client's bankruptcy petition contained a misrepresentation has no obligation under the ethics rules to reveal this to the court or the bankruptcy trustee. The facts indicate that due to a clerical error, the court issued the client a discharge even though the judge had denied him one, and that any fraud that the client committed has already occurred. At no point did the lawyer knowingly fail to make any disclosure necessary to avoid assisting in a fraud. Only under the "rectification" exception could the lawyer even be permitted to disclose, and then only if the lawyer were aware of additional facts leading him to reasonably conclude that his services had been used in furtherance of a fraud. Absent such facts, the lawyer should advise the former client that he will not be disclosing any confidential information. The lawyer should not try to induce the former client to make the disclosure by suggesting that the lawyer will do so if he does not do it himself. Opinion 2004-05; Rules 1.6, 3.3, 4.1.

Maryland Opinion 89-47 (6/12/89) Confidentiality; Disclosure; Bankruptcy. A lawyer who files a bankruptcy petition for a client may execute a declaration verifying that the lawyer has informed his client of debtor relief alternatives as required by law without breaching the attorney-client privilege or violating the rule on confidentiality. Once a client has authorized the lawyer to file the petition, he has impliedly authorized the disclosures necessary to carry out the representation. Rule 1.6.

North Carolina Opinion 99-15 (Revised) (10/20/00) Candor toward tribunals; Confidentiality; Disclosure of fraud; Disclosure of crimes; Bankruptcy; Former clients.
A client consulted a lawyer about filing a bankruptcy petition, at which time the lawyer advised him that there were several problems that either would preclude filing under Chapter 7 or result in a very large monthly payment if filed under Chapter 13. Several weeks later the lawyer learned that the client has retained another attorney and has filed a bankruptcy petition. The lawyer believes that the client intentionally failed to reveal the problematic information to the new attorney. Whether the lawyer is required to disclose the information is a matter to be determined under relevant law, including 18 U.S.C. §152, which imposes criminal penalties for fraudulent concealment of property belonging to the estate of a debtor. However, under Rule 1.6, the lawyer may disclose the information if the lawyer knows that the client is committing a fraud on the court and that the lawyer's services were used to commit the fraud; mere suspicion is not enough to trigger the exception to the duty to maintain confidentiality. If the exception applies and the lawyer decides to take action to rectify the fraud, the lawyer should disclose confidential information only to the extent necessary. The lawyer should first ask the client to rectify the fraud. If this is unsuccessful, the lawyer may disclose the information to the new attorney and state that he will notify the bankruptcy administrator if the fraud is not rectified or if no response is received from the attorney. If the attorney fails to respond or fails to address the lawyer's concerns, the lawyer may notify the bankruptcy administrator. Opinion 98-20; 18 U.S.C. §152; Rule 1.6(d)(3)(5).

North Carolina Opinion 98-20 (4/23/99) Candor toward tribunals; Bankruptcy practice; Confidentiality; Disclosure of fraud; Perjury. When a lawyer who represented a client in a bankruptcy proceeding learns from a third party that the client inherited a substantial sum of money, the lawyer is not required by Rule 3.3(a) to reveal this information to the court or bankruptcy administrator, even though the client is required to do so. Once a proceeding has concluded, Rule 3.3(a) ceases to govern a lawyer's conduct. However, Rule 1.6(d)(3) permits, but does not require, the lawyer to reveal such information if the

lawyer believes that he has a duty to do so under applicable law, unless it would substantially damage the interests of the client and there is a compelling legal interest of the client that may entitle the lawyer not to reveal the information. The lawyer should give the client the opportunity of being the one to inform the authorities by advising the client of his ongoing duty to report this information, that he is subject to the penalties of perjury if he fails to do so, and that the lawyer may reveal the information should the client fail to do so. Opinion 175; 11 U.S.C. §§521, 541, 18 U.S.C. §152, Bankruptcy Rules 1007(h), 1008; Rules 1.6, 3.3.

Pennsylvania Opinion 96-192 (1/3/97) Confidentiality; Misrepresentation; Disclosure of fraud; Candor to tribunal; Bankruptcy. A lawyer who learns that his clients committed fraud in their bankruptcy petition by concealing an unliquidated pre-petition asset may, and perhaps must, move to reopen the case to disclose the asset if the clients will not agree to. 18 U.S.C. 152(1); Rules 1.6, 3.3(a)(4); DR 4-101.

Pennsylvania Opinion 94-101 (6/27/94) Confidentiality; Disclosure of fraud; Bankruptcy. A lawyer for an individual in a Chapter 13 reorganization who learns that certain corporate assets of the client were sold and the proceeds disbursed to the client rather than to the trustee is not under a duty to disclose this fact but may reveal it if she chooses. It is recommended that the lawyer first attempt to persuade the client to rectify matters or to disclose the situation to the court himself. Withdrawal from the matter is inappropriate under these facts; the lawyer's duty to the court as well as the duties imposed by the bankruptcy statutes impose a fiduciary duty upon the lawyer to preserve and protect the assets of the estate. Rules 1.6, 3.3.

Pennsylvania Opinion 91-108 (7/22/91) Confidentiality; Candor to tribunal; Disclosure of fraud. A lawyer who represented two business entities in many real estate transactions and rendered several opinions dealing with the binding effect of certain contracts has the following responsibilities when one of the businesses is forced into bankruptcy and the lawyer learns that the contracts had been based on false information that enabled buyers to obtain financing based upon fraudulent costs: (1) The lawyer has no obligation to take remedial action to inform the financial institutions of the fraud because the lawyer was unaware of the fraud when the loans were made. The lawyer may disclose the fraud if he chooses to do so because his services were used in the fraudulent acts. (2) If the lawyer is called as a witness in the bankruptcy proceedings, he may disclose information necessary to avoid assisting in the client's fraud and must refrain from offering false evidence. If the court compels disclosure of other confidential information, the lawyer may disclose the minimum information necessary. (3) The lawyer may withdraw from representing clients in litigation involving the past fraudulent transactions. If he chooses to continue the representations, the clients may not use the fraudulent information and the lawyer must counsel them to be truthful. If the clients persist in the misrepresentations the lawyer must withdraw and must
advise the court of the fraudulent information presented. Rules 1.6(b)(c)(2), 1.16(b), 2.3, 3.3.

Pennsylvania—Philadelphia Opinion 2005-7 (5/05) Candor toward tribunals; Reporting misconduct; Disclosure of fraud; Disclosure of crimes. If a lawyer suspects, based on the opinion of a forensic accounting expert in the course of discovery, that the opposing party committed tax fraud and fraud on the bankruptcy court, the lawyer is not required by Rule 3.3(b) to inform the court or other agency of the party's putative fraud; the fact that a nonlawyer expert opines that fraud is “likely” does not create the level of “actual

knowledge" required by the rule, and the rule's requirement to take "reasonable remedial measures, including, if necessary, disclosure to the tribunal," is triggered only when the requisite degree of certainty is present. In addition the rule is unlikely to require disclosure where, as here, it appears that the conduct is the subject of the litigation and it is contemplated that the process will reveal that conduct. In any case, the rule would not impose a duty to disclose to any entity other than a tribunal. Similarly, if the lawyer believes that opposing counsel either aided in the fraud or knew of it and failed to reveal it, the lawyer is not required under Rule 8.3 to report it to disciplinary authorities because the lawyer lacks the requisite degree of "knowledge" required by the rule. Rules 3.3(b), 8.3.

Pennsylvania—Philadelphia Opinion 2004-12 (2/05) Candor toward tribunals; Confidentiality; Disclosure of crimes; Disclosure of fraud. A lawyer representing a client in a divorce and also in a bankruptcy filing discovered in the bankruptcy proceeding that the client had taken out a second mortgage on the marital home without the wife's knowledge, apparently forging her signature on the mortgage document, and falsely represented to the divorce court that there was only one mortgage on the home. Under Rule 3.3(a)(3), the lawyer is required to "take reasonable remedial measures, including, if necessary, disclosure to the tribunal." Disclosing the facts to counsel for the wife would be an appropriate reasonable remedial measure. It is not necessary for the lawyer to disclose the matter to any court; whether to do so is for opposing counsel to decide. Accordingly, the lawyer should consult with the client and advise him to make, or authorize the lawyer to make, the disclosure. If the client refuses, the lawyer must make the disclosures himself. Rule 3.3(a)(3).

Pennsylvania—Philadelphia Opinion 97-8 (8/97) Candor toward tribunals; Confidentiality; Disclosure of fraud; Bankruptcy of clients. A lawyer who learns that a personal injury suit filed on a client's behalf is based on a fraudulent claim and is later asked by the client to withdraw the suit is not required to disclose the reasons for withdrawing the complaint. However, the lawyer may disclose such information if doing so might reasonably lead to rectifying the consequences of the fraud. If the lawsuit is listed as an asset in a bankruptcy proceeding, bankruptcy court approval would be necessary before the suit can be voluntarily withdrawn and may require disclosure of the reasons for the withdrawal. Rules 1.6, 3.3.

Pennsylvania—Philadelphia Opinion 97-7 (7/97) Candor toward tribunals; Confidentiality; Disclosure of fraud; Bankruptcy of clients. A lawyer who possesses an unused portion of an advance payment retainer from a client who went through bankruptcy after hiring the lawyer is under no obligation to inform the bankruptcy court of the existence of the funds where the lawyer was not handling the bankruptcy, since the lawyer was not before a tribunal in a matter to which the information was relevant. Disclosure could be permitted if the lawyer discovers that the client intentionally placed her money with the lawyer in order to violate the bankruptcy code or other federal statutes; but if the retainer balance was disclosed in the bankruptcy filings, the lawyer may not disclose the existence of the retainer balance. Rules 1.6, 1.15(b), 3.3.

Pennsylvania—Philadelphia Opinion 94-2 (4/94) Confidentiality; Disclosure of fraud; Bankruptcy; Candor toward tribunal. A lawyer whose client in a bankruptcy matter forged the signature of her spouse on relevant documents and who misrepresented the spouse's participation in the case to the lawyer may release the file to the spouse's new counsel. Such disclosure may be necessary to rectify a fraudulent act wherein the

lawyer's services were used. Additionally, since the client contacted the lawyer purportedly to secure representation for both spouses, there is no expectation of confidentiality as between them. The lawyer may have an obligation to the court to disclose that a signature on the bankruptcy petition was fraudulent. Rules 1.6(a)(c)(2), 3.3(a)(2).

Texas Opinion 480 (6/20/91) Confidentiality; Disclosure of fraud; Candor toward tribunals; Bankruptcy. A lawyer who represented a corporation in involuntary bankruptcy proceedings and later learned from the client that certain settlement funds purportedly transferred to a third party creditor had been returned to the president of the corporation and placed in a trust to which the president had access, must make a good faith effort to persuade the client to authorize disclosure of this information to the court. If the client does not consent, the lawyer must himself disclose the information to the bankruptcy court to avoid assisting in perpetrating a fraud on the court. Rules 1.01(f), 1.05(c)(4)(6)(8), 3.03(a)(b)(c), 4.01(b).

Virginia Opinion 1777 (6/13/03) Confidentiality; Former clients; Disclosure of fraud; Candor toward tribunals; Bankruptcy. A lawyer who discovers that a former client for whom he had obtained a discharge in bankruptcy inherited real estate within the statutory 180-day notice period following the bankruptcy filing is neither required nor permitted to inform the bankruptcy court. Absent information clearly establishing fraud on the court, the lawyer must treat the former client's failure to disclose as a mistake. By the time the lawyer learned of the inheritance, the representation had concluded and the individual was no longer a client. Rules 1.6, 3.3.

Related Stories Lawyer Cannot Reveal Client's Omission In Reporting Assets to Bankruptcy Court, 19 Law. Man. Prof. Conduct 430 (07/30/2003).

Virginia Opinion 1140 (10/18/88) Confidentiality; Disclosure of fraud; Candor toward tribunals; Bankruptcy. A lawyer who learns that a bankrupt client, whom he represents in a breach of contract case, may have failed to report potential assets from the contract case to the bankruptcy trustee must determine whether such failure constitutes a fraud upon the court; if a fraud has been committed, the lawyer must advise the client to correct it and the lawyer himself must reveal information necessary to rectify the matter if the client fails to do so. Opinion 833; DR 4-101(D)(1)(2).

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Consumer Bankruptcy Fee Study

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With respect to the "core" issue of the Consumer Bankruptcy Fee Study—attorney fees and costs of access—the quantitative data enabled the answers to the "what" and "how much" questions. The qualitative data allows us to ask and answer the "why" and "how" questions about fees.

We asked debtors' lawyers to explain how a client typically pays them in Chapter 7 cases. While a majority of attorneys stated, that as a rule market forces determine legal fees, a few lawyers reported practicing in districts with codified "no look" fees in Chapter 7 cases.[1]

Many respondents also reported a high level of competition for Chapter 7 clients, and in some geographic areas, market saturation. The decline in legal business in other practice areas, such as real estate, has resulted in many new entrants into the consumer Chapter 7 market.[2] The issue raised by attorneys as well as by Panel Trustees and bankruptcy judges, is not simply the matter of increased competition, but the perception that there may be price undercutting, and sub-quality work being performed by lawyers less experienced in consumer bankruptcy practice.[3] Moreover, a U.S. Trustee noted that in some jurisdictions, "petition preparers . . . [put] a lot of downward pressure on the fees."[4]

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[1] *See In re* Williams, 357 B.R. 434, 439 (B.A.P. 6th Cir. 2006) ("A growing number of districts have established standardized attorney's fees for routine bankruptcy cases. These standardized fees are commonly referred to as 'presumptive,' 'fixed,' 'flat,' or 'no look' fees. These standard fees allow attorney's fees without requiring a detailed fee application in the absence of an objection. The Panel recognizes that this type of standardization, or uniform fee guideline, promotes efficiency by relieving the courts of the administrative burden of reviewing numerous attorney's fee applications; encourages predictability and efficiency for all involved in a chapter 7 or 13 case; and saves time for the court, trustees and the attorneys who represent debtors.") *See* Focus Group of Chapter 13 Trustees (July 15, 2010) (transcript on file with Principal Investigator); *infra* Appendix VI.

[2] Interview with Consumer Bankruptcy Attorney (Apr. 2, 2010) (notes on file with Principal Investigator); Focus Group with Consumer Bankruptcy Attorneys (Jan. 18, 2010) (transcript on file with Principal Investigator); Focus Group of Consumer Bankruptcy Attorneys (Apr. 2, 2010) (transcript on file with Principal Investigator); Focus Group of Consumer Bankruptcy Attorneys (Sept. 23, 2010) (transcript on file with Principal Investigator); Focus Group of U.S. Trustees (May 3, 2011) (transcript on file with Principal Investigator); Interview with Chapter 13 Trustee (Jan. 1, 2010) (notes on file with Principal Investigator); Consumer Bankruptcy Attorney Survey, questions 19, 30, 54, 64, & 69 (data on file with Principal Investigator).

[3] *See* notes 294–299 and accompanying text for a more complete discussion of the quality of consumer bankruptcy practice.

[4] Focus Group of U.S. Trustees (May 3, 2011) (transcript on file with Principal Investigator).

Respondents repeatedly observed a disconnect between the time it takes to responsibly represent a consumer debtor in a Chapter 7 case, and the legal fee the market will support. One attorney noted, "Doing a thorough job is time-consuming, and unfortunately most debtors can't afford to pay a fee sufficient to compensate for that time."[5] Others remarked that market fees are "depressed by attorneys . . . operating at a loss."[6] Still another remarked, "My fee does not cover my time for most of my Chapter 7 practice. I probably represent Chapter 7 debtors because I've always done so, and as a favor to referring attorneys who refer other bankruptcy matters to the office."[7]

Most counsel reported that clients typically pay their lawyers in full prior to filing a Chapter 7 case—the bankruptcy code does not allow a debtor's attorney to be paid from estate property.[8] Moreover, post-petition obligations that are incurred pre-petition are dischargeable, so any agreement to pay attorney fees after the filing is unenforceable.[9] Some respondents reported, however, that in order to enable cash-poor clients to file under Chapter 7, they enter into unenforceable agreements to be paid fees post-petition.[10] When asked if they end up receiving these fees, typically the response was, "sometimes I do, and sometimes I don't."[11]

Debtors' counsel is not the only professional in Chapter 7 cases for which compensation is an issue. Chapter 7 Panel Trustees uniformly expressed consternation about the Trustee fee structure currently in place. While Chapter 7 Trustees primary role is to liquidate and administer a debtor's non-exempt assets in asset cases,[12] in all cases—including cases in which there are no assets to liquidate and administer—the Chapter 7 Trustee is accountable for reviewing the debtor's petition and schedules, investigating the debtor's financial affairs, questioning him or her under oath, and submitting reports to the bankruptcy court, and the Office of the U.S. Trustee.[13] In addition, BAPCPA imposes a host of new responsibilities on Panel Trustees. They are now required to: collect, track, store, and safeguard case documents, such as tax returns; notify appropriate parties of domestic support obligations; review the accuracy of information in forms associated with the means test; and comply with the new requirements for uniform final reports.[14] They are also charged with the responsibility of investigating bankruptcy filings for abuse, criminal activity, and fraud, including mortgage fraud on the part of creditors.[15]

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[5] Consumer Bankruptcy Attorney Survey, question 69 (data on file with Principal Investigator).

[6] *Id.*

[7] *Id.*

[8] Lamie v. U.S. Trustee, 540 U.S. 526 (2004) ("§ 330(a)(1) does not authorize compensation awards to debtors' attorneys from estate funds, unless they are employed as authorized by § 327. If the attorney is to be paid from estate funds under § 330(a)(1) in a chapter 7 case, he must be employed by the trustee and approved by the court.")

[9] *Id.*

[10] Focus Group with Consumer Bankruptcy Attorneys (Jan. 18, 2010) (transcript on file with Principal Investigator); Focus Group of Consumer Bankruptcy Attorneys (Apr. 2, 2010) (transcript on file with Principal Investigator); Consumer Bankruptcy Attorney Survey, question 69 (data on file with Principal Investigator).

[11] Notes on file with Principal Investigator.

[12] 11 U.S.C. § 726.

[13] 11 U.S.C. § 341.

[14] *See e.g.* 11 U.S.C. §§ 704, 351.

[15] *See* 11 U.S.C. § 707.

For these services, Chapter 7 Panel Trustees are paid a portion ($60) of the filing fee paid by debtor. If the Trustee does liquidate assets, the Trustee will receive, in addition to the $60, a "trustee commission" based on the sliding scale formula set forth in § 326 of the Bankruptcy Code.[16] The commission is based on the value of the assets the Trustee brings into the bankruptcy estate. In cases where there are no assets for the Trustee to liquidate, the only compensation the Trustee receives is the $60 from the filing fee. The compensation scheme is justified by the theory that commissions received from asset cases will offset the nominal no-asset fee, such that the Trustee earns overall, reasonable compensation for his or her service.

According to the Study data, the system has failed Chapter 7 Panel Trustees. As observed by a Panel Trustee in testimony before the House Judiciary Committee,

> A major concern for trustees has been the lack of any compensation adjustment since 1994. Under the present law, trustees receive $60 for administering Chapter 7 cases in which "no assets" are liquidated. The last increase in this trustee compensation occurred in 1994, when the fee was raised from $45 to $60. Let me emphasize that this is a flat fee per case. A case could take an hour, a few hours, days, weeks, or in some unique circumstances, years, to bring to closure. Trustees essentially work on a "contingent" basis because if their efforts do not result in a dividend to creditors, they receive only the $60 no asset fee. Every trustee can tell about cases in which he or she devoted many hours and much money and did not recover any assets. In other cases, trustees are obligated by their statutory duties to spend the time and money to fulfill their duty without additional compensation. That happens on a daily basis in my practice.[17]

The matter of increasing the fee for Panel Trustees has been recurrently raised by bankruptcy stakeholders over the course of the past twenty years, and multiple Congressional hearings have been held on this subject, the most recent one in July 2011.[18] Provisions increasing the fee have been included in numerous bills, but to date, none have passed. When asked, if given the opportunity, what they would change about the Chapter 7 consumer bankruptcy system, the vast majority of Chapter 7 Trustee respondents said the fee level in no-asset cases should be increased to reflect the increased time spent meeting BAPCPA's mandates.[19] Eighty-six percent of respondents said that no-asset Chapter 7 cases take more Trustee time than they did prior to BAPCPA's enactment.[20] Sixty-four percent of Trustees said the same thing about Chapter 7 asset cases.[21]

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[16] According to the statutory bankruptcy commission formula, the Chapter 7 trustee will receive: (i) 25% of the first $5,000; (ii) 10% of the next $45,000; (iii) 5% of the next $950,000; and (iv) 3% of the balance. In addition, Chapter 7 Trustees are entitled to be paid for any legal services that he or she performs in order to collect and liquidate and administer assets. Some trustees will hire other lawyers or law firms to do this legal work, but other Chapter 7 Trustees will do the work themselves and bill the estate accordingly. Trustees must apply to the court and receive court approval for all commissions and legal fees. 11 U.S.C. § 326 (a).

[17] *Chapter 7 Bankruptcy Trustee Responsibilities and Remuneration: Hearing before the House Subcomm. on Courts, Commercial and Admin. Law, of the H. Comm. on the Judiciary*, 112th Cong. (2011) (statement of Robert C. Furr, on behalf of the National Association of Bankruptcy Trustees.)

[18] *Id. See also Bankruptcy Trustee Compensation: Hearing before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. (2008).

[19] Chapter 7 Trustee Survey, question 26 (data on file with Principal Investigator).

[20] Chapter 7 Trustee Survey, question 22 (data on file with Principal Investigator).

[21] *Id.*

Another strongly expressed concern was the impact of the *in forma pauperis* ("IFP") provision in BAPCPA.[22] The IFP provision allows for a filing fee waiver for debtors with income of less than 150% of the poverty level and an inability to pay the Chapter 7 fees in installments.[23] When a debtor's bankruptcy petition is granted *in forma pauperis* status, the filing fee is waived and, as a result, the Chapter 7 Trustee receives no fee at all.

When this provision was enacted as part of BAPCPA,[24] one of the more controversial issues was whether an IFP petition could be filed (and granted) if a paid attorney was representing the debtor in the bankruptcy case. Such an arrangement was ultimately sanctioned, although it was predicted that the issue would not frequently arise.[25]

Despite the prominence this issue took in the survey responses, the quantitative data revealed the incidence of IFP filings to be low: 1.9% of all Chapter 7 cases. Of all IFP petitions filed, 71.2% of them were approved. A number of Chapter 7 Panel Trustees observed, however, that the incidence of IFP filings have increased in the past two years as attorneys and debtors have become increasingly aware of their availability.[26] It was further observed that statistical data about the number of IFP cases and their impact on Chapter 7 Trustees does not reflect cases where motions are granted to pay filing fees in installments and the case ends in dismissal.[27] In such cases, the Panel Trustee may receive only fraction of the $60 fee. The quantitative and

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[22] A recent empirical study using the 2007 Consumer Bankruptcy Project IV data examined the frequency of IFP filings. The sample was supplemented by an oversample of cases in which debtors filed an *in forma pauperis* application. The study found that only 2.6% of income eligible debtors applied for fee waivers. Of all income qualified Chapter 7 debtors, (i) two-thirds of *pro se* filers, (ii) half of those with *pro bono* counsel, (iii) less than a third of debtors using a petition preparer, and (iv) 2.1% of those represented by an attorney, applied for a fee waiver. The study concluded that the "Chapter 7 filers who applied for a waiver do not appear to have been, on the whole, economically more needy than non-applicants." Philip Tedesco, *In Forma Pauperis in Bankruptcy*, 84 AM. BANKR. L.J. 79, 85 (2010).

[23] 28 U.S.C. § 1930(f). This is known as filing *in forma pauperis* which means, "in the character or manner of a pauper." BLACK'S LAW DICTIONARY 783 (7th ed. 1999). Eligibility for *in forma pauperis* filing is determined under the "poverty guidelines last published by the United States Department of Health and Human Services applicable to a family of the size involved." JUDICIAL CONFERENCE OF THE UNITED STATES, INTERIM PROCEDURES REGARDING CHAPTER 7 FEE WAIVER PROVISIONS OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 *available at* http://www.uscourts.gov/bankruptcycourts/jcusguidelines.html.

[24] *See* 28 U.S.C. § 1930(f). I am indebted to Judge James E. Massey of the United States Bankruptcy Court for the Northern District of Georgia for his counsel and observations.

[25] Philip Tedesco, *In Forma Pauperis in Bankruptcy*, 84 AM. BANKR. DEV. L.J. 79, 85 (2010).

[26] A Panel Trustee, who conducted an informal study of IFP waivers, noted, "As a matter of reference, during the period of July 1, 2010 to June 30, 2011 there were 1,105 cases filed in Vermont and 31 IFP's granted for a most recent percentage of 2.8% or an effective rate on the No-Asset fee of $58.32 currently . . . . During the period of October 1, 2011 to September 30, 2011 there were [according to] PACER 15,336 Chapter 7 cases filed, of which there were 1,023 IFP applications filed, for a 6.67%. This would result in an effect rate based on IFP cases of $56." Notes on file with Principal Investigator.

[27] As was observed by a Chapter 7 Trustee, another issue related to IFP waivers needs to be recognized: "the number of installment cases which are filed, and subsequently dismissed . . . . [O]ver 13% of the cases filed sought to pay the filing fee by installments, and of that, approximately 47% appear to actually complete the installments. Depending upon the amount paid under the installments, the resulting Trustee Compensation in failed cases is also reduced. This is a bit of a wildcard since verification of the data is difficult, but on the assumption that the installments are nominal the amount of cases not paid increases to over 14% making the effective rate in that District at $51.43." Notes on file with Principal Investigator.

qualitative data make clear that the frequency of use of *in forma pauperis* filings varies considerably from jurisdiction to jurisdiction.

As noted above, if a debtor does not pay a filing fee, the Chapter 7 Trustee receives no payment for administering the case. But in some instances, debtors' counsel is charging their indigent client a fee. We found that in all cases in which an IFP motion was filed and an attorney was paid, the mean debtor's attorney fee was $695. In cases where the IFP was granted, the mean attorney fee was $502.[28]

Table 1. *In Forma Pauperis* Cases

	Post-BAPCPA		
	% of cases	Attorney Fees	
		Current $	Inflation Adjusted 2005 dollars
All *in forma pauperis* cases	1.9%	$783	$695
in forma pauperis granted	71.2%	$563	$502
in forma pauperis no assets	100%	$783	$695

Bankruptcy judges also expressed consternation about the nominal fees paid to Panel Trustees in no-asset cases. As one judge observed, "we have primarily no-asset cases with minimal compensation to panel trustees, as well as numerous *pro se* filers who require additional time to be spent by the trustee."[29] Another judge noted,

> no commission for *in forma pauperis* cases [and] inadequate compensation for no-asset cases [are concerning]. These all take time. [There are] very few asset cases to earn the commissions. I am amazed that many of the trustees have not yet quit. In most cases they are the "face of the system"—it is important we have good trustees.[30]

It was further observed, "the $60 they get for a no-asset is grossly inadequate to compensate them for the amount of documents and information they must review. This low fee discourages people who would be great trustees from considering applying to be trustees. It is bad for the system."[31]

The concern about Panel Trustees leaving the system, and being discouraged from entering it appears to be real. As observed by one Chapter 7 Trustee who is giving up his trusteeship,

> The other portions of my firm's practice have been subsidizing my Chapter 7 consumer trustee practice for years. [There] are no financial rewards and [it has become] an

[28] *See infra* Appendix III, Table A – 11.

[29] Bankruptcy Judges Survey, question 23 (data on file with Principal Investigator).

[30] *Id.*

[31] Bankruptcy Judges Survey, question 23 (data on file with Principal Investigator)

> administrative hassle. Cases with assets to distribute mostly occur in urban areas. [Even when I have an asset case] there is more tension [than there used to be] about whether I will receive my maximum compensation on assets distributed.[32]

The no-asset Trustee fee and IFP issue and their impact on Chapter 7 Trustees implicates fundamental fairness. The collective effect of low or no fees paid to Chapter 7 Trustees for cases that require increasingly more work and resources resulted in 62% of respondents reporting a current lower net income from their Chapter 7 Trustee consumer practice than before BAPCPA's enactment.[33] Moreover, 92% of respondents "disagreed" or "strongly disagreed" with the statement, "I am fairly compensated by my work as a Chapter 7 Trustee in consumer cases."[34] Seventy-eight percent of respondents reported a "higher" or "much higher" stress level attributed to their Chapter 7 Trustee consumer practice.[35]

With respect to fees in Chapter 13 cases, there are significant distinctions in all fee-related practices, customs and policies at the state, district, court, and even individual levels. Over 50% of attorneys surveyed charge a flat fee to their Chapter 13 clients.[36] Fifteen percent of the lawyers reported charging by the hour, and ~15% used a combined hourly rate and flat fee.[37] Others reported charging a "sliding scale," depending upon what debtors can pay.[38] The median hourly rate reported by those responding attorneys who charge an hourly rate is $271.[39] Note however, that this is the rate charged, not necessarily the rate ultimately received.[40] In many instances, there is a significant divergence between the two.[41] Moreover, many lawyers reported that their effective hourly rate, when they charged the presumptively reasonable fee was considerably lower than their "usual" hourly rate.[42]

In many jurisdictions, the "flat fee" is a *de jure* or *de facto* "presumptively reasonable fee" arrangement ("PRF").[43] A PRF allows the lawyer to charge a flat, pre-approved fee for an array of services and avoid the necessity of filing a fee application with the court.[44] In some jurisdictions, the lawyer determines up front whether he or she will charge client the PRF. In at least one district, the attorney is afforded more flexibility in terms of the timing of the decision: "Attorneys make the decision within 30 days of the 341 completion to opt out of the base fee and this is due to complicated issues in the case."[45] In yet other jurisdictions, the amount of the PRF turns on the size of the plan payments: "In [my district] there is an 'official' no-look fee of

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[32] Interview with Chapter 7 Trustee (July 11, 2011) (Notes on file with Principal Investigator).

[33] Chapter 7 Trustee Survey, question 27 (data on file with Principal Investigator).

[34] Chapter 7 Trustee Survey, question 28 (data on file with Principal Investigator).

[35] Chapter 7 Trustee Survey, question 29 (data on file with Principal Investigator).

[36] Consumer Bankruptcy Attorney Survey, question 43 (data on file with Principal Investigator).

[37] Consumer Bankruptcy Attorney Survey, question 43 (data on file with Principal Investigator).

[38] Consumer Bankruptcy Attorney Survey, question 48 (data on file with Principal Investigator).

[39] Consumer Bankruptcy Attorney Survey, question 44 (data on file with Principal Investigator).

[40] *See supra* notes 284–289 and accompanying text.

[41] *Id*.

[42] Consumer Bankruptcy Attorney Survey, question 45 (data on file with Principal Investigator).

[43] *See infra* Appendix VI.

[44] As one Chapter 13 Trustee observed, "Per local rule, fee [applications] are an option if counsel does not want to be bound by the no-look fee. Some few always chose that option; most accept the no-look fee." Chapter 13 Trustee Survey, question 25 (data on file with Principal Investigator).

[45] Chapter 13 Trustee Survey, question 25 (data on file with Principal Investigator).

$3,000, but if the plan will pay less than a total of $5,000 (including attorney's fees and trustee's commission) the attorney fee is only $2,000."[46]

According to the Survey, in *almost all* jurisdictions with a PRF, the PRF array of services for Chapter 13 representation includes:

1. Initial meeting with debtors to explain the bankruptcy process;
2. Advice to debtors concerning their obligations and duties under the Bankruptcy Code and Rules, applicable court orders, and the provisions of their Chapter 13 plan;
3. Preparation and filing of the documents required by § 521 of the Bankruptcy Code;
4. Preparation and filing the plan;
5. Attending the 341 meeting;
6. Communication with client after the 341 meeting;
7. Attendance of confirmation hearing.[47]

In *some* jurisdictions, the PRF services also include:

1. Preparation and filing of all motions required to protect the debtor's interest;
2. Preparation and filing of responses to all motions filed against the debtor;
3. Preparation and filing any and all plan amendments;
4. Representing the debtor in connection with a motion for relief from stay;
5. Representing the debtor in connection with a motion for relief from stay which is resolved by agreement;
6. Representing the debtor in connection with a motion by the Chapter 13 Trustees seeking dismissal of the case;
7. Representing the debtor in connection with a motion by the Chapter 13 Trustee seeking dismissal of the case for which there is an agreement or no opposition;
8. Representing the debtor in connection with debtor's motion to modify the plan;
9. Representing the debtor in a contested matter.[48]

In *a few* jurisdictions, the PRF services also include:

1. Representing the debtor in an adversary proceeding as plaintiff;
2. Representing the debtor in an adversary proceeding as defendant;
3. Representing the debtor in any matter in which the court orders "fee shifting";
4. Representing the debtor in any matter in for which the first hearing is set more than 120 days following confirmation.[49]

In those jurisdictions where the PRF is a "cradle to grave" fee, there is no opportunity, even if the unforeseeable happens, for the lawyer to receive additional compensation.[50] Most often however, the debtor is charged the PRF in a standard case, but if a complication arises, such

[46] Notes on file with Principal Investigator.
[47] Consumer Bankruptcy Attorney Survey, question 51 (data on file with Principal Investigator).
[48] *Id.*
[49] *Id.*
[50] Focus Group of Consumer Bankruptcy Attorneys (Sept. 23, 2010) (transcript on file with Principal Investigator).

as the filing of an adversary proceeding, the attorney may be entitled to either a fixed amount of additional compensation, or payment of an hourly rate for time spent.[51]

The circumstances under which a lawyer would file either an abbreviated fee application and receive a fee amount in accordance with a local rule-based schedule, or file a more extensive fee application and receive an hourly rate, varies by district and by court. Illustrations include:

- "Motions for Relief from Stay generate a request for additional fees when multiple hearings are required."
- "All post-confirmation fees are by application with the exception to allowance of fees by stipulation with the debtor and Chapter 13 trustee if under $1,000."
- "We mostly see supplemental fee requests in connection with requests to modify confirmed plans."
- "Adversary proceedings almost always require fee applications."
- "There are basically two times I see fee applications: in failed cases that do not get confirmed (attorneys frequently file a fee application so that their unpaid fees are paid from the money in my possession . . . these are routinely granted by the Court); and exceedingly complicated cases (rarely see these filed . . . but when filed by my 'regular' debtors' bar, the fees are generally granted)."[52]

Not all lawyers exercise their right to augment the PRF by filing an application for additional fees. As one Chapter 13 Trustee noted,

> the most frequent participants in the system are "scared" to file the fee applications because they don't know what to expect and many comment that filing the application takes far longer than the fees incurred in many cases (and they can't seek payment for much of the time preparing the application) so they don't bother.[53]

At least one district builds an "administrative reserve" into every Chapter 13 plan as a way of ensuring the debtor will be able to pay additional legal fees if approved.[54] If the reserve fund is not used for attorney fees, it is distributed to unsecured creditors.[55] According to the data, the administrative reserve is not widely used.[56]

We further found in some Chapter 13 cases, fees charged by attorneys do not rise to the level of the PRF. A variety of reasons were cited for this, including: (i) filing a Chapter 13 to pay attorney fees, with the intention of converting to a Chapter 7 as soon as the fees were paid,[57] (ii)

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[51] Notes on file with Principal Investigator.

[52] Chapter 13 Trustee Survey, question 25 (data on file with Principal Investigator).

[53] *Id.*

[54] Notes on file with Principal Investigator.

[55] Notes on file with Principal Investigator.

[56] Notes on file with Principal Investigator.

[57] "Debtor can file [a Chapter] 7 but can't come up with the [fee] to file . . . . So the attorney has the debtor file [a Chapter] 13 to collect fees [through] the plan, but charges a fee between the normal [Chapter] 7 fee and the no-look [Chapter] 13 fee. If the debtor is having his pay garnished, this may be only way to get the case filed." Notes on file with Principal Investigator.

agreeing to a lesser fee for those in the military or other "sympathetic" clients,[58] (iii) determining that a debtor "can't afford" the no-look fee,[59] (iv) the case is a "disguised" Chapter 7,[60] (v) market pressures,[61] and (vi) the operational complexity of a case.[62]

A majority of lawyers reported, and the quantitative data confirmed, only the exceptional cases merited charging less than the PRF. One attorney observed that the client's ability to pay the PRF was used as a prognosticator of the success of the Chapter 13 plan: "if a debtor cannot afford the full legal fee, they are likely not able to complete a plan."[63]

The mean attorney fee values, however, revealed twenty-two jurisdictions where the PRF was higher than the mean fee received in a discharged case.

Table 2. Districts Where the Average Fee for Discharged Chapter 13 Cases Was Below the Presumptively Reasonable Fee Post-BAPCPA[64]

District	Average Fee Post-BAPCPA	Presumptive Fee Post-BAPCPA
ALNB	$1,685.06	$2,500
ALSB	$2,183.64	$3,000
AKB	$2,048.46	$2,500
CACB	$2,671.52	$3,000 to $4,000

[58] Fee discounts for service men and women, members of legal plans, and a few other "sympathetic" debtors were reported. "There aren't any hard and fast rules, but understand, I am a bankruptcy lawyer because I want to help people. If that means I decided to make less, that's a decision I make. And it's not a decision I make lightly." Interview with Consumer Bankruptcy Attorney (Sept. 25, 2011) (transcript on file with Principal Investigator).

[59] Chapter 13 Trustee Survey, question 25 (data on file with Principal Investigator) ("Many debtors' [attorneys] do not charge the full no-look fee if the debtor cannot afford it.") "Sometimes you might agree with the debtor to take less. This isn't that common since even a $1,000 price cut, only lowers a plan payment by $16 a month or so." Notes on File with Principal Investigator.

[60] "The [C]hapter 13 is a [C]hapter 7 in disguise. The most appropriate circumstance for this to occur is when the debtor does pass the means test in [Chapter] 7, but has a 0% payout to unsecured in a [Chapter] 13. This can occur when the debtor has child support income which is included in [Current Monthly Income] in [Chapter] 7 but excluded in [Chapter] 13, or has retirement account payroll deductions which are not an allowable expense in [Chapter] 7 but are in [Chapter] 13. The case is simpler than the normal [Chapter] 13 and the attorney charges less." Notes on file with Principal Investigator.

[61] "I would attribute below no-look median fees virtually entirely to market pressures . . . we have attorneys who take [Chapter] 13s for $2,000 or even less, while our no-look is $4,000/$4,500." Notes on file with Principal Investigator.

[62] "[It] depends on the complexity of the case, not just legal complexity but also (and probably more importantly) operational complexity, i.e., how can we rearrange the debtor's business/income *vis a vis* his overhead/expenses to make what appears to be a non-feasible plan feasible (one of the useful services a good attorney provides in the absence of an accountant who in a Chapter 11 would be doing that)." Notes on File with Principal Investigator.

[63] Notes on file with Principal Investigator.

[64] Presumptively reasonable fees values dating from 2006 to 2008 were considered post-BAPCPA. For the average fee numbers, the values from the quantitative analysis were used. Only those districts with a difference between the presumptively reasonable fee and the average fee of more than $200 were included. Districts where the presumptively reasonable fee was set by unwritten practice were not included in these tables. *See infra* Appendix VI, Table A – 24 and Appendix V, Table A – 18 for the complete data.

District	Average Fee Post-BAPCPA	Presumptive Fee Post-BAPCPA
CAEB	$3,265.09	$3,500
GASB	$2,260.53	$2,500
ILCB	$2,157.86	$2,500 to $3,000
ILSB	$3,156.43	$3,500
INSB	$3,195.96	$3,500
LAMB	$2,112.32	$2,500
MNB	$1,712.20	$2,000 to $2,500/$3,000
MOEB	$2,639.35	$3,000
NJB	$2,528.60	$3,500
NCEB	$2,614.70	$3,000
NCMB	$2,399.47	$2,500 to $3,000
NCWB	$2,299.51	$3,000
OHSB	$2,656.29	$3,000
OKEB	$1,942.42	$3,750
RIB	$2,832.21	$3,500
TNEB	$1,916.92	$3,000
TXSB	$2,435.13	$3,085
WYB	$1,798.04	$2,000

Not only is there variation in how much an attorney is paid, and the method by which the amount of the fee is determined, there are also material differences in Chapter 13 cases as to how the attorney fee is structured.[65] The extent to which an attorney receives his or her fees up front, in whole or in part, or over time as part of the plan payments, and over what period of time, turns on one of more of the following variables: (i) the lawyer's or the lawyer's firm's policies, predilections or business model, (ii) the presiding judge, (ii) the interpretation of the Bankruptcy Code in the jurisdiction, (iii) the Chapter 13 Trustee, (iv) the lawyer's predictions about the feasibility of the debtor's case, (v) the market for legal services, and (vi) local custom and practice.[66]

How fees are structured impacts not only how much is paid by a client, but also how much is received by the lawyer. The structure also affects chapter choice as well as the issue of how cases perform and their eventual disposition. An example of how this plays out was described by an attorney as follows:

> In [District A] attorneys get paid $200 a month, meaning that if nothing is taken in advance, the attorney [is] paid [over] . . . 15 months.[67] There is no judicial opinion on where these funds [should be] taken from, so frequently Debtors have "step" plans that provide $200 more a month for the first 15 months, then drop down.

[65] A number of lawyers observed that clients frequently shop for the lowest upfront fees and the willingness of lawyers to pay filing fees for clients (and receive later reimbursement through plan payments). This affects the market for consumer debtors' attorneys. Focus Group with Consumer Bankruptcy Attorneys (Jan. 18, 2010) (transcript on file with Principal Investigator); Focus Group of Consumer Bankruptcy Attorneys (Feb. 11, 2010) (transcript on file with Principal Investigator); Consumer Bankruptcy Attorney Survey, question 19 (data on file with Principal Investigator).

[66] Notes on file with Principal Investigator.

[67] If the plan payment is lower than $200/month, it takes longer for attorneys to receive their fee.

> In [District B], however, the Court [determined] that while [section] 1325 requires secured creditors to receive "equal monthly payments" it does not require that [those] . . . payments start at confirmation. Accordingly, these plans pay only "adequate protection payments" to secured creditors (usually cars) basically swiping some of their money to pay attorneys fees. Additionally, since the Code only requires pre-confirmation adequate protection payments for personal property collateral, the 2-4 months of pre-confirmation mortgage payments get diverted to pay attorneys fees, with that amount being added to the mortgage arrearage. With these . . . maneuvers, debtors' attorney fees usually get paid within 6-12 months of filing a case.
>
> Lastly, in [District C] the attorney fees are spread over the length of the Chapter 13 plan. This means that if nothing is taken in advance, the full amount is paid in 60 installments. Because of this, fees paid through the plan are incredibly devalued, both [because of the time value of money] and because of the [higher] risk of case dismissal. Accordingly, most attorneys [in District C] require $1500 or more "up-front."
>
> These three different schemes for paying attorney fees have real effects on chapter selection. [District C] has far fewer Chapter 13 cases . . . . [In many instances] potential clients either don't file or the attorney works with him or her to get them into a Chapter 7.
>
> Similarly, [District B] might have higher dismissal rates, since an attorney only needs a debtor to last 6-10 months to cover his or her costs, making it less risky [for the attorney] to take a more tenuous case.
>
> In [District A] with step-down plans, the first year, which is already often the hardest for a debtor, is even harder due to the heightened payment.[68]

On their face, these appear to be mere procedural decisions about the timing of fee distributions, but in practice, these decisions have a critical substantive effect on the debtor, the attorney as well as on the bankruptcy system as a whole.

The above discussion concerns fees charged in cases in which the debtor receives a discharge. The story with respect to attorney fees received in cases that end in a *dismissal* is very different. As the objective data reveals, attorney fees received in dismissed cases were 42% lower than those fees received in cases that end in discharge.[69] This, in part, accounts for the difference between the fee an attorney charges, and the fee the attorney receives.[70] When Chapter 13 Trustees were asked how much attorneys charged and how they are paid in dismissed cases, the answers varied greatly.[71] With respect to cases dismissed prior to confirmation, the range of answers included:

- "$800 paid pre-petition plus 25% of unpaid balance up to a max amount of $300; Any fees awarded in a dismissed or converted case must be by application (unless under $1,000)."

[68] Interview with Consumer Bankruptcy Attorney (Apr. 2, 2010) (notes on file with Principal Investigator).
[69] *See infra* Appendix II, Table A – 5.
[70] *Id.*
[71] The Chapter 13 Trustee responses included cases that were converted as well as dismissed.

- "In addition to the amount of the fee paid pre-petition, sometimes attorneys receive a portion of payments made prior to dismissal or conversion."
- "To the extent that pre-confirmation plan payments were made, the debtor's attorney will receive some pro rata portion distribution after, i) all required adequate protection payments are paid in full, and ii) the Trustee's 'new case set up fee.' Usually they receive nothing."
- "Generally, the dismissal orders provide for attorney fees to be paid up to $400."
- "Funds are refunded to the debtor in care of the attorney. The attorney may resolve with the debtor what if any are paid from the refund."
- "Pursuant to court order they get up to one-half of the no look fee if the case is dismissed."
- "We have a local rule that allows them up to $500 of the funds on hand toward their unpaid fee claim in a case that is dismissed or converted pre-confirmation. They also get to keep whatever they were paid pre-petition."
- "Debtors' attorneys will now receive up to $1,000, depending on balance on hand, in converted or dismissed cases."
- "My rule . . . is not to object to all but $100 or so of the requested fee (usually $2,500) if the dismissal/conversion is not the attorney's fault and the case was otherwise ready for confirmation. Often there is not enough money in our account to pay all that."
- "The attorney generally gets paid his retainer and some amount as an administrative fee based upon the Court's granting of a fee application."
- "If their client has made plan payments and there are funds in the case, the attorney will file a fee application for the 'no look' fee balance remaining less trustee's fees from the available funds."
- "It depends on the amount on hand after payment of the filing fee. Usually $300 to $900."
- "Cases crater in the first 9 months. The plan dictates how such fees are paid and in many cases, the fees have not been satisfied at the time of dismissal."
- "Attorneys who want to be paid need to file a motion for an administrative expense. These motions are typically allowed for the full amount of the no-look fee, though there is rarely enough money on hand to pay it."
- "We are a jurisdiction that pays pre-confirmation, so often times counsel is paid in full."
- "Depends on the amount of the plan payment—but 60-70% are likely getting the entire fee because such a small portion is going to adequate protection payments in most cases."
- "$300 per court order."
- "Presumptive fee of $900 if funds are on hand."
- "If attorney timely completed all tasks and dismissal was debtors fault, they can get the full presumptive fee (however, I usually only have one or two payments to

disburse on attorney fees). Other times, the court only allows the retainer, and in extreme cases, the [court] will require disgorgement."[72]

These answers show that the debtor's ability to complete a multi-year plan dictate whether an attorney will received their full fee, or nothing.[73] One attorney observed that a consequence of these varied policies is that lawyers take Chapter 13 cases essentially on a contingency basis. [74] This, in turn, has a profound effect upon the quality of legal services delivered.

3. Qualitative Analysis

Part III above describes the raw qualitative data that emerged from focus groups, interviews, and survey responses. Analysis of the data enables us to assess the operation of the consumer bankruptcy system generally, and evaluate the extent to which its objectives are being met. Two central themes became apparent:

1. The disunion between (i) complexity of the consumer bankruptcy system, (ii) the experience and resources needed to represent debtors through an often byzantine maze, and (iii) the dearth of resources available to pay for this representation; and

2. The irony presented by the ostensible goals of those who sought the 2005 Bankruptcy Code amendments and the unintended consequences of these changes in practice.

These themes cut across a preponderance of the data, and across all data sets. They also reveal causal linkages between the consumer bankruptcy process and outcomes.

a. Complexity, Experienced Professionals & Needed Resources

As the raw data details, the consumer bankruptcy system is exceptionally complex, and only more so since BAPCPA's enactment. Even a "seemingly simple" case may turn out to be "a minor quagmire."[75] And there are ever fewer "seemingly simple" cases. As observed, "the

[72] Chapter 13 Trustee Survey, question 37 (data on file with Principal Investigator).

[73] With respect to cases that were dismissed following confirmation, attorneys fared somewhat better. A majority of Chapter 13 Trustees reported that attorneys received what they had already been paid. In many jurisdictions, by that point, attorneys were paid all or most of their fee. Chapter 13 Trustee Survey, question 37 (data on file with Principal Investigator).

[74] Notes on file with Principal Investigator.

[75] The following was described in the blog post, *What Are We Worth as Bankruptcy Lawyers?* "I sat with a new client discussing his bankruptcy options, puzzling how to price a Chapter 7 that's fair to me and fair to the client. To the client, it no doubt looked like a 'simple' Chapter 7: a job, a couple of pieces of underwater property, no taxes, no spouse, no sweat, right?

To me, it looks like a minor quagmire:

- There's an income blip in the look back period;
- Client's parent lives on one property and pays "rent" only sporadically;
- We've got business expenses for investment properties, with any records scattered;
- Values of properties are undetermined;
- Credit card payments are made by automatic bank draft, the debtor hopes to stop;

paradigmatic Chapter 13 debtor" no longer exists: one in which a client has lost a well-paying job, incurs debt, gets another well-paying job, and then files for bankruptcy to discharge the debt incurred. It takes more skill and experience to responsibly and professionally represent consumer debtors—especially in this economic climate—than it used to. There is a greater need to have a nuanced understanding of the dissonance between how the system is designed to work in theory, and how it works in practice. Lawyers consistently report working harder than ever before, and experiencing higher stress levels that they directly attribute to practicing in the new consumer bankruptcy environment.

Moreover, the system is less tolerant of mistakes and yet there are so many more opportunities presented by BAPCPA for even seasoned attorneys to make errors.[76] Without a detailed understanding of how to make the system work, the temptation is there for lawyers to "cut corners" in order to minimize time spent on a client's case, or conversely, to spend so much time on a case that the legal fee exceeds what an insolvent client can reasonably afford. Efficiency coupled with a high level of skill, while important in every area of law practice, is crucial to the success of a consumer bankruptcy practice. "Best practices" for consumer bankruptcy lawyers requires finding a balance between comprehensively addressing a financially distressed client's interests, and doing so in a time sensitive and efficient manner.

"Best practices" however, are not consistently achieved by the whole of the consumer bankruptcy bar. Stakeholders noted "a lot of variation in the quality of practice," but this variation was not necessarily tied to the BAPCPA changes.[77] At least one trustee observed, "I [saw] crappy attorneys before, I [see] crappy attorneys now, I [saw] good attorneys before [and I see] good attorneys now."[78] It was also recognized that the cost of entry to the market is high, and "new entrants to the market disappear as fast as they appear," especially those lawyers who "occasionally" represent consumer debtors.[79] Attorneys, trustees, judges, and U.S. Trustee respondents all expressed concern about the system-wide negative effects of the expedient entry of less experienced and opportunistic lawyers into the consumer bankruptcy market.

Despite the observations about uneven quality of legal representation, one scholar recently asserted that compared to other government "redistributive programs," bankruptcy is a "relative success."[80] Recognizing that consumers are paying a high price for bankruptcy

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- There's recent purchase activity on several cards;
- The car loan is with a credit union that issued client a credit card: cross collateralization
- Future income both from job and properties will be different than look back; AND
- We expect to file a subsequent 13 to strip off/cram down underwater liens—so consistency is important."

Cathy Moran, *What Are We Worth As Bankruptcy Lawyers?,* BANKRUPTCY MASTERY http://www.bankruptcymastery.com/what-are-we-worth-as-bankruptcy-lawyers/.

[76] The consumer bankruptcy system was described as evidencing an "iceberg effect"—more beneath the surface than what meets the eye. Focus Group of Consumer Bankruptcy Attorneys (Apr. 2, 2010) (transcript on file with Principal Investigator).

[77] Focus Group of Consumer Bankruptcy Attorneys (Jan. 18, 2010) (transcript on file with Principal Investigator); Chapter 13 Trustee Survey, question 15 (data on file with Principal Investigator); Chapter 7 Trustee Survey, question 13 (data on file with Principal Investigator).

[78] Focus Group of Chapter 13 Trustees (July 15, 2010) (transcript on file with Principal Investigator).

[79] Focus Group of Consumer Bankruptcy Attorneys, (Apr. 2 2010) (transcript on file with Principal Investigator).

[80] Littwin *supra* note 39 at 1939 (defining success in terms of accessibility). Professor Littwin further noted, "Consumer bankruptcy attorneys contribute to the smooth running of the system, protect their clients

"benefits" and describing the phenomenon of the high cost of bankruptcy as the "affordability paradox," it was argued:

> when struggling bankruptcy consumers hand over much-needed funds to their lawyers, they are paying for more than representation in their individual cases. They are paying for the fact that much of the administrative work necessary to process their bankruptcies will be completed by people they have hired, rather than by government officials operating under the pressures of bureaucratic entitlement. They are paying for the continued development of a community of lawyers and judges that wants consumer bankruptcy to work.[81]

This community of lawyers is comprised of a mix of highly skilled and professional practitioners, and a cadre of less capable, experienced or committed counsel. The matter of encouraging and tangibly rewarding proficiency, dedication and best practices is a matter of serious concern. As with other professionals, attorneys are motivated by "objective symbols of recognition."[82] These symbols include reputational capital, professional honors, and high rates of remuneration.[83] Many respondents described a disconnect between the skill, time, and commitment it takes for attorneys to provide debtors with first-rate representation, and compensation that does not always reflect such excellence.

It is not just attorney personal income that is at issue—significant gross receivables are required to support a law office. A law firm's income and cash flow must cover staffing an office with highly skilled and proficient support staff,[84] investments in expensive software, hardware and document storage systems,[85] as well as office rent, insurance, and other immutable operating costs.[86] Moreover, because consumer debtors are not likely to be repeat clients, at least in the short term,[87] lawyers must take affirmative steps to ensure a steady stream of new clients. This typically requires substantial investments in advertising.[88]

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from overreaching, and lobby against bankruptcy legislation that could potentially harm consumers." *Id.* at 1040.

[81] *Id.* at 1941.

[82] TALCOTT PARSONS, ESSAYS IN SOCIOLOGICAL THEORY, 43–46 (1964).

[83] *Id.*

[84] It was observed that practice under BAPCPA requires support staff to be "much smarter," and thus more expensive. Focus Group of Consumer Bankruptcy Attorneys, (Sept. 23, 2010) (transcript on file with Principal Investigator).

[85] The necessary software investments included Best Case Solutions, Chromata, Quickbooks, and Adobe Reader, among others. Notes on File with Principal Investigator.

[86] Because consumer debtor representation may be as long as a five-year commitment, once an attorney invests in the practice, the attorney has the incentive to maintain the practice.

[87] Jean M. Lown, *Serial Bankruptcy Filers No Problem*, 26-5 AM. BANKR. INST. J. 36 (2007) (finding in a limited district study few financial and demographic variables helpful in identifying serial filers).

[88] Advertisements commonly take the form of web pages, paid Google placements, yellow page ads, billboards, and less frequently, radio and television ads. In addition, a number of lawyers have established on-line blogs, to both educate their future clients, as well as to heighten their name recognition. Other lawyers with long-standing enough practices, however, reported largely relying on word of mouth and client referrals to develop and maintain their practices. We conducted a review of hundreds of consumer bankruptcy attorney websites in an effort to augment our survey sample size. We found many of these websites to have a great deal of substantive content, and for the most part, found them to be informative and consumer-centric. We also found that billboard advertising is more common in some areas of the country than others.

It was repeatedly observed by those attorneys struggling with these conflicting forces and by trustees and judges observing this struggle, that there a tension inherent in the indispensability of highly skilled consumer bankruptcy attorneys, and the resources reasonably available to sustain a quality bar. If the goal is for the consumer bankruptcy system to continue to operate with the integrity it does when "best practices" are adhered to, policies directed at reconciling this tension ought to be carefully considered.

b. BAPCPA's Unintended Consequences

Many of BAPCPA's unintended effects have turned the concept of relief for "poor but unfortunate debtors" on its head. It was consistently observed that BAPCPA's dictates resulted in "the poorest debtors [having] highest plan payments because their apparent disposable income cannot be taken out of the mix by high mortgage and car payments . . . ."[89] As numerous scholars have observed, "consumer bankruptcy suffer[s] from the irony that those who need it the most are often too poor to take advantage of its relief."[90] Moreover, "additional administrative costs in increased attorney fees [result in] reduced dividends to non-priority unsecured creditors."[91] As we found in our analysis of the quantitative data, overall distributions to unsecured creditors were uncharged—an irony that cannot be lost on the financial services industry lobbyists.[92]

Respondents consistently recounted the irony of how easy it was to "game" a system that facially appeared to leave little room for discretion and flexibility, but yet left the door wide open for manipulation.[93] Chapter 13 Trustees confirmed this observation. "The purpose of the means test was to create uniformity. In reality it created gamesmanship and absurdity. The real losers are the debtors and creditors [who] are paying more in fees for a process that has not improved."[94]

Moreover, it was observed that in an effort to achieve the goals of the bankruptcy system, judges are also working around the system's inflexible dictates. As one Chapter 13 Trustee observed, "the means test . . . uses totally made up numbers, and our judge uses special circumstances to get around it so we can go to the actual budget."[95] A Chapter 13 Trustee observed, "[based on] some comments that I get from the bench, [judges] felt that the law wasn't

[89] Chapter 13 Trustee Survey, question 39 (data on file with Principal Investigator).

[90] Littwin, *supra* note, 39 at 1935.

[91] Chapter 13 Trustee Survey, question 39 (data on file with Principal Investigator). "Debtors are now permitted to pay less to their unsecured creditors, and to propose from the outset of their case to pay less, even if, were the pre-BAPCPA Code requirements applied, they would be required to pay more and in many cases would be required to remain in plans longer." *Id.*

[92] *See supra* notes 139–144 and accompanying text.

[93] BAPCPA has removed much of the discretion that had been exercised by Trustees and judges pre-BAPCPA, and it has "turned trustees into collection agents and paper pushers rather than actively involved decision and judgment makers at the level and to the extent they were pre-BAPCPA." It was further noted, "Section 1325(b)(1) and related provisions such as 101(10)(A) [are] designed to eliminate judicial discretion and create a formula that often punishes the prudent but unfortunate [debtors] and rewards the more wealthy [imprudent] consumer with a sizeable house and car payment . . . ." Chapter 13 Trustee Survey, questions 29, 39 (data on file with Principal Investigator).

[94] Chapter 13 Trustee Survey, question 39 (data on file with Principal Investigator). *But see* Mann, *Sweat Box* supra note 9 (predicting that creditor benefits from BAPCPA would not come from greater bankruptcy case distributions but from the effect of slowing the time of debtors' inevitable filings).

[95] Chapter 13 Trustee Survey, question 39 (data on file with Principal Investigator).

in the best interest of the system as a whole. And so they kind of, through local rules, and through local practices, have refined it a little bit."[96]

The vast majority of respondents were adamant, however, that the variety of "strategic approaches" to working with the system were not taken for the purpose of corrupting or abusing the bankruptcy process but in an effort to enable needed relief for financially distressed debtors.[97] The strategies employed were an attempt to scale the "unproductive barriers to the success of a case."[98]

With all that said, the consumer bankruptcy system still leaves room for debtors, with the help of their attorneys, to achieve "success"—although definitions of success may differ depending upon the circumstances. Despite BAPCPA's procedural hurdles, debtors are continuing to file for bankruptcy protection and to receive, in many cases, needed discharge. Moreover, sometimes all a debtor needs is some time—to move, to refinance or modify a loan. As recounted by a Chapter 13 Trustee, "[to get] the debtor . . . 30 more days, . . . the debtor go[es] into [Chapter] 13, convert[s] to [Chapter] 7 just to get some more days. They don't complete either one of them, but it gives them time to move or try to finance or sell."[99] The "breathing room" afforded by bankruptcy may also bring stability to a household. "[A] parent or a family [may] . . . just want to keep their child in a school district until he gets out of high school, and that's a successful 13."[100]

[96] Focus Group of Chapter 13 Trustees (July 15, 2010) (transcript on file with Principal Investigator).

[97] "The system allows room for strategy." Notes on file with Principal Investigator.

[98] Bankruptcy Judges Survey, question 29 (data on file with Principal Investigator).

[99] Focus Group of Chapter 13 Trustees (July 15, 2010) (transcript on file with Principal Investigator). Another Chapter 13 Trustee observed, "Because to get a loan mod[ification] may be a success for them. That's all they needed was the time to figure it out. If they don't have a lien strip, they don't really need us after they get the loan mod[ification]." *Id.*

[100] Focus Group of Chapter 13 Trustees (July 15, 2010) (transcript on file with Principal Investigator).

Consumer Corner

By Peter C. Fessenden[1]

A Modest Proposal for the Care and Fee'ding of Debtor's Counsel

Peter C. Fessenden
Chapter 13 Trustee
Brunswick, Maine

Peter Fessenden has been the standing chapter 13 trustee in the District of Maine since 1981. He also serves as the case-by-case chapter 12 trustee and occasionally as a chapter 11 trustee in individual debtor cases.

I am a thrifty fellow, but when I had gallbladder surgery, I did not shop around for the cheapest surgeon. I looked for the person who was best qualified for my needs. The operation wasn't pleasant, but I had the reassurance of knowing I would receive excellent care from a skilled professional. The operation was successful and worth every penny of its substantial cost. And, of course, I can no longer process bile.

Like a lot of chapter 13 trustees, I am persnickety. I like it when my cases can be administered without fuss. I like it a lot, but like many of my chapter 13 colleagues, I know that not every debtor has simple problems, and that not every case is easy. Indeed, most chapter 13 cases are complex and difficult. I also know that even the most simple-appearing case is filled with traps and snares.

I look at the list of new cases filed in my district every day. When I first review a case, I do not look at the schedules of assets, the lists of creditors or even the budget and means test. I first look at the name of debtor's counsel. I have a good idea how the case will go just by knowing who is representing the debtor. Most of the time, I am happy with what I see. Sometimes, I wish I had my gallbladder back.

Just as nobody wants a cheap surgeon, nobody really wants a cheap bankruptcy lawyer—or a cheap any-kind-of-lawyer, for that matter. They want a good lawyer who works hard at learning the law and the rules. Good lawyers work hard at developing their skills, reassuring their clients and preparing their cases. They work hard fighting with me, the creditors and (carefully) with the judge. They are smart, efficient and effective. Good work deserves good money. The entire legal system benefits from excellent care provided by skilled professionals, and excellent work by excellent lawyers deserves excellent money.

Chapter 13 trustees, the U.S. Trustee and the bench occasionally make the grave mistake of castigating the high cost of debtor representation in simplistic terms. What deserves to be castigated is not a dollar figure. It is the high cost of ineffectiveness, ignorance, inattentiveness and sloth.

Most (but not all) districts employ some version of a "no-look" fee. The practice arose, in part, because of the peculiar nature of consumer debtors' bankruptcy practice. No one consumer case can bear the full cost of getting an aspiring debtor's attorney up to speed. Once a lawyer becomes skilled and experienced in consumer bankruptcy, improved efficiency may actually reduce compensation if representation is based on an hourly rate alone.

A no-look fee is a presumptively acceptable fee (*e.g.*, $2,500) that an attorney can customarily charge without filing an application for compensation. It includes fees and expenses paid by the debtor pre-petition and those paid by the trustee as part of a confirmed plan. It is a matter of administrative efficiency, and the no-look fee is commonly approved by the court as part of plan confirmation. For example, the debtors might have paid their lawyer $1,500 pre-petition, and so the plan might authorize the trustee to pay an additional $1,000 upon confirmation. If an attorney seeks additional compensation, he or she is expected to file a fee application itemizing all of the work and expenses for the entire case to date. If allowed by the court, such additional fees and expenses would typically be paid by the trustee from the plan to the extent of available funds.

"No-look" fees are comprised of two parts: whatever counsel can cajole from the debtors plus the balance to be received from the trustee through plan payments once the case is confirmed. Amounts vary from state to state and from district to district within states and for nonbusiness and business cases. In her epic study on consumer bankruptcy fees funded by the ABI Endowment, Prof. **Lois R. Lupica** (University of Maine School of Law; Portland, Maine) said the figures are between $1,500 and $4,500.[2]

In every case, debtor's counsel is required to enter into a fee agreement with his or her individual client under 11 U.S.C. § 528(a)(1). Section 329(a) of the Bankruptcy Code and Rule 2016(b) of the Federal Rules of Bankruptcy Procedure require disclosure on the docket of professional fees promised and paid. Although there is no official form, all of the commercial software companies have a standard boilerplate that is routinely used. Those forms describe the work covered by the compensation and provide a space for services that are not covered. A significant number of districts prescribe minimum services in order to receive the "no-look" amount.

The no-look amount may be set by local rule, standing order, judicial opinion or trustee guideline. In some districts, the fee is fixed as both a floor and

1 Edited by **Dianne C. Kerns**, chapter 13 trustee in Tucson, Ariz.

2 Lois R. Lupica, "The Consumer Bankruptcy Fee Study: Final Report," *ABI Law Review*, Spring 20.1 (2012): 17-161. Print.

ceiling, and all counsel must hew to the standard. In other districts, the no-look fee is a range. Counsel may keep their fees modest as a way of encouraging business in a competitive market; they approach the upper reaches at the peril of trustee/judicial review. Other districts still view the no-look amount as a guideline from which variation is frequent and challenges, if any, are on an *ad hoc* basis. A few districts have no presumptive compensation and require fee applications in every case.

A few jurisdictions hold counsel to the amount disclosed on the Rule 2016(b) statement, although most permit (with varying degrees of receptiveness) an application for additional compensation. In most districts, the no-look fee is the presumptive ceiling and floor for attorney compensation. Even the most generous presumptive fee in the current studies is surprisingly low when broken down. A $5,000 fee is $1,000 per year based on the commonplace post-Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) 60-month plan. While paralegals can perform much of the work, counsel has a professional obligation to provide supervision and guidance to paraprofessional staff. Assuming that counsel charges $250 per hour, that is four hours per year—*20 minutes per month*—to address the angst and turmoil of chapter 13 debtors who are trying to put their financial lives back in order, which brings the focus of this discussion: *Debtor's counsel deserves more money*.

Chapter 13 plans are crafted on the assumption (although not always the reality) that debtors are paying what they can fairly afford for the benefit of unsecured creditors. Counsel fees are already part of the plan calculus when they pay all or part of the remaining no-look amount. Assuming that the overwhelming majority of plans comport with the stated assumption, what happens if additional services—above and beyond the expectations of all parties in interest—are required for the continued viability of the case? Must the additional services be rendered *pro bono*? Will the debtor complete the plan, receive a discharge and then be faced with a bill (necessarily requiring counsel to wait months or years to be paid)? Will the necessary fees be carved out of the debtor's food budget, to be paid either directly or as part of additional plan contributions?

Chapter 13 is reorganization for real people. Chapter 11 is reorganization for corporations. (Of course, *Toibb v. Radloff*[3] said that chapter 11 is available to individuals, but the exception proves to be the rule.) Counsel fees in chapter 11 cases are not nickel-and-dimed. Chapter 13 counsel fees should be examined for the same balance between administrative cost and benefit that their bigger cousins enjoy.

My modest proposal for restructuring compensation in chapter 13 is that each plan should be designed with a contingent administrative reserve—not pledged to unsecured creditors but not guaranteed to counsel—which recognizes the likelihood that the debtor will require additional services above and beyond the no-look amount. The plan can provide for as large or as small an administrative reserve as may be justified under the circumstances of the case because any amounts not eventually approved and paid for as an administrative (legal or accounting or appraisal) expense will be distributed to general unsecured creditors near the end of the case.

3 *Toibb v. Radloff*, 501 U.S. 157; 111 S.Ct. 2197; 115 L.Ed.2d 145 (1991).

The size of the administrative reserve will always be in play during the confirmation process. Negotiations are generally between the trustee and the debtor (or the debtor's counsel) because the reserve amount remains contingent and is not funded unless and until additional fees are approved by the court upon application.

> **Ethical lawyers will serve their chapter 13 clients faithfully, whether they are paid or not.**

By way of example, consider an above-median case where $600 per month from the debtor is available for the plan, for a total of $36,000 over five years. Assume a 10 percent trustee fee, with all claims paid concurrently. Unpaid no-look fees are $3,000. (Local practice varies on how counsel fees are paid *vis-à-vis* other creditors. The bottom line is the same.) Secured claims are $20,000 plus required interest of $1,750. Domestic-support obligations (DSOs)[4] and priority tax claims are $4,200. The remaining amount usually available for unsecured creditors would be $3,460 or $57.50/month. Rather than distribute that amount to unsecured creditors, some amount—say $2,700—is allocated to the administrative reserve and only $750 is pledged and $12.50 is paid monthly to general unsecured creditors. The balance of $45 per month is not set aside during the travel of the case, however. It is used to increase the amount going to priority DSO and tax claims, paying them down faster. Once all allocated amounts are paid in full, $45 per month then accumulates unless an earlier fee application is approved, in which case those funds are paid to counsel. At the end of the plan, any remaining sums not approved for fees (plus any slippage in the trustee's fee below 10 percent) are disbursed to general unsecured creditors. (The slippage plus any amounts recovered from excess income tax refunds is available either for general unsecured creditors or for counsel fees, as local practice provides.)

In districts where a contingent administrative reserve has not been used, there could be an understandable reluctance among some counsel especially if zero percent plans are the norm: "My debtors just can't afford an additional $58 per month!" If true, amen. But it still begs the question of how to provide fair compensation for additional necessary services. The work will either be performed *gratis* or counsel will gladly wait for months or years because the debtor will be happy to pay the lawyer once the case is finished. And pigs will fly. As a practical matter, however, a modest monthly addition for the contingent administrative reserve is well within most debtors' ability.

A modest monthly addition is also well within most debtors' desire. Ethical lawyers will serve their chapter 13 clients faithfully, whether they are paid or not. However, the lawyer who is reasonably assured of fair recompense for that work will do so more quickly and with a joyful heart. Debtors know that. By and large, they also prefer to provide for some return to their unsecured creditors, even

4 11 U.S.C. § 101(14A).

continued on page 89

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if the actual amount is symbolic. And not having to make an unexpected additional payment during the case or after it ends to cover additional legal fees for necessary services is part of the comfort of predictability that the contingent administrative reserve offers.

We have used this approach in Maine for nearly 15 years, and the debtors' bar loves it. Debtors accept it as part of the program and feel more comfortable seeking assistance of counsel during the travel of their cases. I like it, but it isn't perfect. Just as work expands to fill the available time, so fees expand to consume the available reserve. Fees in Maine are higher than in other parts of the country. Fee fights are also more frequent, which lead to tension between the trustee and debtor's counsel, but then what's a little bile among friends?

Our judges see fee applications regularly and are willing to approve fair—even large—fees for excellent work by chapter 13 counsel when the funds are not only deserved but are available—hence, our perch atop the fee pyramid. The collateral result has been that fees overall in Maine have risen. Perhaps I have not been as diligent as I should have been in objecting; perhaps our bar has been self-congratulatory in its applications. Some have been embarrassed as Maine was revealed as Rainbow's End for legal fees. Our judges may have sensed their colleagues looking askance; recently they have exercised more frequent *sua sponte* review to deny fees for less-than-excellent effort and/or less-than-excellent results. Nonetheless, fees continue to be higher in Maine than in most other parts of the country. I am unapologetic.

There is a Japanese proverb: "The nail that sticks up is hammered down." Legal fees in Maine are sticking up higher than in the rest of the country. They don't guarantee good legal work, but they encourage it, which is a far better model than one based on fear and sanction. If consumer debtors' counsel fees are higher in Maine than anywhere else, the solution is not to reduce compensation, but to pay excellent fees for the excellent work done by excellent consumer attorneys everywhere. abi

Feature

By C.R. "Chip" Bowles, Jr.

Absolut[1] Ethical Bankruptcy

Recent Ethical Issues in Individual Chapter 11 Cases

Editor's Note: *For another article discussing the nonethical aspects of the absolute-priority rule, read the feature on page 34.*

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As readers of the *Journal* know, the challenges of representing an individual chapter 11 debtor are many, especially after the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[2] Among the issues that have been recently addressed by courts are (1) the split of authority on the issue of what impact the changes made by BAPCPA has had concerning the definition of what constitutes property of an individual chapter 11 debtor's bankruptcy estate and the requirements for confirmation of an individual's chapter 11 plan in a cramdown;[3] (2) whether involuntary bankruptcy cases can be filed against individuals; and (3) whether counsel who advise individual debtors prebankruptcy, but not during a bankruptcy, are subject to 11 U.S.C. § 329.

Distilling the Absolute-Priority Rule in Individual Chapter 11 Cases

The absolute-priority rule of the Bankruptcy Code is codified in 11 U.S.C. § 1129(b)(2)(B) and, as noted by the U.S. Supreme Court, it "provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan."[4] This rule applied in individual[5] chapter 11 cases prior to BAPCPA.[6]

As has been discussed at length previously in the *Journal*, two of the most important changes made to BAPCPA were the addition of 11 U.S.C. § 1115 and the modifications made to 11 U.S.C. §§ 1123 and 1129. Section 1115 designates as property of the estate all of the debtor's income earned from a job or "services performed" after a chapter 11 is commenced.[7] Sections 1123 and 1129 establish conditions to confirmation of individual chapter 11 plans, including a requirement that all projected dispensable income received by the debtor must be paid out under the plan.

The critical question raised by these modifications to the Code was whether they eliminated or modified the absolute-priority rule for property in individual chapter 11 cases, and there are two lines of cases addressing this issues. One—termed the "broad view"[8]—holds that the modifications to 11 U.S.C. §§ 1123 and 1129 abrogate the absolute-priority rule, although in a convoluted way.[9] A line of cases,[10] termed the "narrow view," holds that the absolute-priority rule survived the BAPCPA changes intact and still applies to individual chapter 11 debtor plans. As this split of authority is well discussed in the feature on page 34, this article only addresses ethical issues confronting individual chapter 11 debtor's counsel concerning the absolute-priority rule.

Good Faith

The initial and overriding issue is whether an attorney[11] can, in good faith, propose a plan for an individual chapter 11 debtor that does not propose to pay all creditors in full but nevertheless proposes that the debtor retains ownership interests in his or her property. In the Ninth Circuit, at least, the answer may be "no."

In the pre-BAPCPA case of *In re Perez*,[12] the Ninth Circuit, based on the absolute-priority rule, refused to affirm the confirmation of an individual debtor's chapter 11 plan that proposed to pay all creditors in full over a 67-month period, but without interest, even though the sole creditor who voted against

1 No, this is not an advertisement for a famous adult beverage, just another failed attempt at humor.

2 David S. Jennis and Kathleen L. DiSanto, "How Disposable Is Your Individual Chapter 11 Debtor's Income," 30 *Am. Bankr. Inst. J.* 1 (October 2011); ("Disposable Income"); Jennis and DiSanto, "Application of Absolute-Priority Rule and New Value Exception in Individual Chapter 11s," 30 *Am. Bankr. Inst. J.* 56 (July/August 2011) ("New Value Exception"); Jennis and DiSanto, "Make Yourself 'Necessary': How to Get Paid as Debtor's Counsel in Individual Chapter 11s," 30 *Am. Bankr. Inst. J.* 24 (June 2011) ("Necessary"). See C.R. "Chip" Bowles, Jr., "Ghosts of Individual Chapter 11 Debtors (Part 1)," 25 ABIJ 46 (December/January 2007) ("Ghosts Part I"), and Gregory R. Schaaf, Andrew D. Stosberg and Bowles, "Ghosts of Individual Chapter 11 Debtors (Part 2)," 26 *ABIJ* 36 (February 2007) ("Ghosts Part II").

3 Cramdown is used to refer to nonconsensual confirmation of a chapter 11 plan. *See In re Shat*, 424 B.R. 854, 858 n. 7 (Bankr. D. Nev. 2010).

4 *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) (internal citations omitted).

5 See the section in this article entitled, "Is a Debtor's Exempt Property Subject to the Absolute-Priority Rule?," for a discussion whether the absolute-priority rule prevented an individual chapter 11 debtor from retaining exempt property.

6 *See In re Walsh*, 447 B.R. 45, 47 n. 9 (Bankr. D. Mass. 2011); *In re Shat*, 424 B.R. 854, 858 (Bankr. S.D. Ohio 2010).

7 *See* "Ghosts I" at 98-99, which addresses issues arising from this broad definition.

8 *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010); *In re Bullard*, 358 B.R. 541 (Bankr. D. Conn. 2007).

9 *Id.*

10 *See, e.g., In re Kamell*, 451 B.R. 505, 508 (Bankr. C.D. Cal. 2011); *In re Stephens*, 445 B.R. 816, 820-21 (Bankr. S.D. Tex. 2011) (finding that broad reading of 11 U.S.C. § 1115 would make 11 U.S.C. § 541 mere surplusage); *In re Gelin*, 437 B.R. 435, 442 (Bankr. M.D. Fla. 2010). The trend of courts adopting the narrow view will likely continue in light of a recent court of appeals decision, *In re Lett*, 632 F.3d 1216 (11th Cir. 2011), concerning a pre-BAPCPA individual chapter 11 case in which the court of appeals ruled that the absolute-priority rule applied in individual chapter 11 cases, even though this issue was not preserved on appeal.

11 The author understands that there is a great deal of controversy regarding the debtor's duty and the duty of counsel for the debtor but thankfully, that issue is beyond the scope of this article. We will therefore assume for purposes of this article that the debtor has a fiduciary duty to the debtor's bankruptcy estate.

12 30 F.3d 1209 (9th Cir. 1994).

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Recent Ethical Issues in Individual Chapter 11 Cases

from page 30

the plan (and caused a class to vote against the plan), never filed an objection.[13] The *Perez* court further stated in *dicta*:

> [W]e are most disappointed in the estate's counsel, who is responsible for proposing and seeking confirmation of these failed plans....
>
> He has defended Plan 111 on appeal before the BAP and before us despite what appears to have been his clear understanding that the [absolute-priority rule] was not satisfied.[14]

Therefore, if the narrow view of 11 U.S.C. § 1115 prevails and there is no exception to the absolute-priority rule,[15] counsel will have to carefully consider the impact of *Perez*.[16]

Is There a Future Income Problem under Ahlers?

Although not addressed directly by most courts considering the narrow or broad views on the absolute-priority rule, an interesting question arises as to whether the *Norwest Bank Worthington v. Ahlers*[17] prohibition against "sweat-equity plans" has been (or could be) overruled by 11 U.S.C. §§ 1123(a)(8) and 1129(a)(15), which require that five years of an individual debtor's projected disposable income be distributed under a plan. *Ahlers*, in part, found that new value, in the form of future services, could not be new value on constitutional grounds as well as an interpretation of the absolute-priority rule of the Bankruptcy Code. As Congress now requires future income be paid under a plan, could an individual chapter 11 debtor propose a confirmable plan under the new value exception to the absolute-priority rule?

In *In re Shat*, the court noted in passing that BAPCPA "effectively overruled *Ahlers*"[18] on the issue of whether the future labor could constitute value under the absolute-priority rule, but only used this observation to support its determination that the broad view of 11 U.S.C. § 1115 was correct. However, the "narrow view" case of *In re Lindsey*[19] rejects the finding that there was no attempt to overrule *Ahlers* by BAPCPA. This issue will likely continue to be litigated in the future.

Is a Debtor's Exempt Property Subject to the Absolute-Priority Rule?

An interesting issue that presents numerous problems to debtor's counsel is whether a debtor can keep exempt property under a cramdown chapter 11 plan. The case of *In re Gosman*[20] held that even though exempted from the claims of creditors, exempt property was estate property and therefore covered by the absolute-priority rule. This meant, among other things, that a debtor could not attempt to use a contribution of exempt property as new value.

However, a majority line of case law seems to be developing that holds that exempt property is not subject to the absolute-priority rule requirement that the individual debtor cannot keep any interest in property unless all senior creditors are paid in full. This position is best set forth by the narrow view court of *In re Steedley*,[21] in which the court held:

> An individual debtor's ability to claim exemptions under § 522 exists for individual chapter 11 debtors. *In re Henderson*, 321 B.R. [550, 558 (Bankr. M.D. Fla. 2005)] (citing 11 U.S.C. § 1123(c)). "Once [a debtor's] exemptions are allowed the [property is] no longer part of the [d]ebtor's estate, and the [d]ebtor does not retain property on account of such interest because he retains it as a matter of right by virtue of recognition of his right to exemptions." *Id*. at 559. A debtor's interest in exempt property can therefore never be junior to the interest of an unsecured creditor because unsecured creditors cannot reach exempt property. *Id*. at 560. A debtor may thus retain exempt property without violating § 1129(b)(2)(B)(ii). *Id*. at 561; *In re Ballard*, 358 B.R. 541, 544-45 (Bankr. D. Conn. 2007).

As individual chapter 11 cases now include all post-petition earnings of debtors, there is a question of whether an individual can be placed into an involuntary chapter 11 case.

Enjoying the Product, Involuntarily

As individual chapter 11 cases now include all post-petition earnings of debtors, there is a question of whether an individual can be placed into an involuntary chapter 11 case.[22] This issue arose in the context of a very nasty chapter 11 case, *In re Marciano*.[23]

In *Marciano*, an involuntary chapter 11 petition was filed against an individual by a group of creditors that had obtained unstayed state court judgments against the debtor. The judgments were entered as sanctions for the debtor's discovery abuse. One of the debtor's objections to the involuntary petition was a constitutional challenge against 11 U.S.C. § 1115 as it would be applied in an involuntary chapter 11 case.

The basis of the debtor's constitutional challenge to the involuntary chapter 11 was that application of 11 U.S.C. § 1115(a)(2) in an involuntary individual chapter 11 case would violate the Thirteenth Amendment to the

13 *Id.* at 1214. *See also In re Lett*, 632 F.3d at 1216 (allowing absolute-priority objection to be first raised on appeal).

14 *In re Perez*, 30 F.3d at 1218-19.

15 Indeed, the *Shat* court discusses whether it is possible to propose or confirm a nonconsensual plan that pays creditors less than the present value of their allowed claims. *In re Shat*, 424 B.R. at 858.

16 In light of the problems creditors faced in *Perez* and *Lett*, it is better practice for creditors to both vote against and object to plans to have the absolute-priority issue considered.

17 485 U.S. 197 (1988).

18 424 B.R. at 867.

19 453 B.R. 886, 901 (Bankr. E.D. Tenn. 2011).

20 282 B.R. 45 (Bankr. S.D. Fla. 2002).

21 2010 WL 3528599 (S.D. Ga. 2010).

22 *See* Margaret Howard, "Bankruptcy Bondage," 2009 *U. Ill. L. Rev.* 199 (2009); Chemerinsky, "Constitutional Issues Posed in the Bankruptcy Abuse and Consumer Protection Act of 2005," 79 *Am. Bankr. L. J.* 571, 586-88 (2005).

23 459 B.R. 27 (9th Cir. B.A.P. 2011). *See also In re Marciano*, 446 B.R. 407 (Bankr. C.D. Cal. 2010) (retailing facts of underlying litigation, which led to $260+ million against to debtor).

Constitution.[24] This challenge, however, was weakened by the debtor's declaration that he did not have any earnings from post-petition income.[25]

However, neither the bankruptcy court nor the Bankruptcy Appellate Panel reached this constitutional issue, determining that the issue was not ripe. Both courts ruled that until the debtor was placed into an involuntary bankruptcy by the entry of an order of relief against the debtor, the constitutionality of 11 U.S.C. § 1115 could not be challenged.[26] In this case, the debtor raised this argument as part of his motion to dismiss the involuntary petition, and therefore, the issue could not be reached.[27] To date, this issue has not been raised again by the debtor. While this issue was not ripe in this case, it will arise again.

Disclosing the Bill: I Have to Do What?

Finally, a recent district court case, *In re Garcia*,[28] addresses which attorneys are subject to the provisions of 11 U.S.C. § 329 in an individual chapter 11 case. The facts of *Garcia* are fairly simple.

Prior to his individual chapter 11 filing, the debtor retained an attorney[29] to represent him in several foreclosure actions and short sales. The attorney later advised the debtor to file for bankruptcy, helped him find bankruptcy counsel and provided his counsel a list of foreclosure lawsuits for use in the debtor's schedules and statement of financial affairs.

After filing for bankruptcy, the debtor filed a motion against the attorney under 11 U.S.C. § 329 seeking disgorgement of fees, asserting that the value of fees the debtor paid to the attorney exceeded the reasonable value of these services. The bankruptcy court dismissed the motion, finding that the attorney was not subject to 11 U.S.C. § 329 because the attorney was not the debtor's bankruptcy counsel.

The district court reversed, stating that representing the debtor is not the test for determining whether attorneys are subject to 11 U.S.C. § 329. Rather, the court held that the subjective state of mind of the debtor was the key issue in determining whether an attorney is subject to 11 U.S.C. § 329.[30] The district court remanded for further proceedings to determine whether the debtor's dealing with the attorneys were for purposes of avoiding bankruptcy or were motivated by the possibility of bankruptcy. This opinion, especially in light of the current economy, should be reviewed by all attorneys representing parties who may be debtors.

Final Shot: The Conclusion

Representing an individual chapter 11 debtor has always been a daunting task. The recent decisions construing the absolute-priority rule, plus the *dicta* of *Perez*, may, however, move these challenges to the realm of near impossibility. As always, only time will tell. abi

24 459 B.R. at 39.
25 *Id.*
26 *Id.* at 40.
27 Even the bankruptcy appellate panel's dissent found that this constitutional issue was not ripe.
28 456 B.R. 361 (N.D. Ill. 2011).
29 There is a dispute as to whether the debtor paid the attorney $7,000 or $24,000 for her work.
30 As the court noted: "[a] fee payment is made 'in contemplation of' a bankruptcy if 'the underlying professional services were rendered at a time when the debtor was contemplating bankruptcy.'" *In re Gage*, 394 B.R. 184, 194 (Bankr. N.D. Ill. 2008). Thus, a subjective test of the debtor's state of mind is used in determining whether a transaction is subject to § 329. *See Zepecki*, 277 F.3d at 1045; *In re Dixon*, 143 B.R. 671, 676 n. 3 (Bankr. N.D. Tex. 1992) (articulating the test as "whether, in making the transfer, the debtor is influenced by the possibility or imminence of a bankruptcy proceeding"); *In re GIC Gov't Sec. Inc.*, 92 B.R. 525, 531 (Bankr. M.D. Fla. 1988) (asserting that fees paid for the purpose of avoiding bankruptcy are "clearly 'in contemplation of bankruptcy'").

Edge of the Black Chest:
An Individual Chapter 11 Fact Pattern

Hector B. Rossa ("Hector") is a financial consultant, artist (d/b/a Black Chest Creations and Dead Women's Pearls) and the 100% owner of Calipso Enterprises PSC ("PSC"), a financial advising service that employs five people. Unfortunately, an investment by Hector in Isle De Mortra Spa Inc. ("Isle") went bad due to the apparent fraud by the island's owner, Charlie "Lord" Beckett ("Beckett"). Hector financed his investment with a personal guarantee of Isle's mortgage and the pledge of a $2,000,000 CD, owned by PSC, to Isle's secured lender, Aztec Ltd. Bank ("Aztec").

Due to a mix up by PSC's non-bankruptcy counsel, Rageatti and Pintel ("R&P"), Hector does not have any form of employment contract with PSC, although he thought he had a contract and has been paid $75,000 per month for his services.

At the present time Hector and PSC's balance sheets look as follows:

Assets

	Hector Assets	PSC Assets
Cash	$50,000	$25,000
Accounts Receivable		$675,000 (all collectible)
Real Estate	$1,000,000 (Home) Vacation home in Aspen $500,000 $1,500,000 (Total)	
Total Service Contracts		4 deals (?): each with $100,000 per month base compensation
Personal Property	$2,250,000 Total PSC Stock $500,000 (Est.) $250,000 Household & personal items 1,000,000 art work $500,000 investment in other companies	$25,000 $2,000,000 CD (Pledged on the Aztec debt)
Intellectual and Other Property	(?) Lawsuit against Beckett for fraud	(?) Value of Good Will

Total Assets	$3,800,000+	$2,725,000+

Liabilities

	Hector Liabilities	PSC Liabilities
Taxes Due	$475,000 (2006 Income Tax)	None Current on tax liabilities
Secured Debt	Residence $1,500,000 (ABC Bank) Vacation Home $100,000 (Gibbs Nat'l Bank $1,600,000 (Total)	$1,100,000 ABC Bank All assets
Unsecured Business Debt		$500,000
Attorney Fees	(all current debts – R&P	$100,000
Unsecured Consumer Debt	$400,000 ($300,000 unsecured line with Gibbs' 100,000 credit card)	
Guaranteed Debts	$4,000,000 (Isle debt w/Aztec)	$4,000,000 (Isle debt w/Aztec)
Total Liabilities	$6,475,000	$5,700,000
Total Assets	$3,800,000 (+)	$2,725,000 (+)
Total Debts	$6,075,000	$5,700,000

As you note, $1.1 million of the ABC Bank debt and all of the guaranteed Isle debt are owed both by Hector and PSC. Isle is totally under water and it has no assets to satisfy the Guaranteed Debt. PSC also has a 10-year lease on its offices with Norington Properties.

Hector and PSC have the following monthly income and expenses (averaged for past 12 months). Hector is married to Mary Clung and has two sons, Jocard and James.

	Hector Monthly Income	PSC Monthly Income
("Base Salary")	$75,000	
Bonus	$10,000	
Business Income		$225,000
Other Income	$10,000 (art sales)	$200,000 ("Success fees")
Total Income	$95,000	$425,000

	Hector Expenses Family Living Expense
Food	$8,000
Auto	$3,000
Country Club Dues	$2,000
Mortgages	$12,000
Credit Cards	$18,000
Misc. Household Expenses	$5,000
Private Schools	$8,000
Insurance	$8,000
Taxes	$27,000
Total	$91,000

	PSC Expenses Business Expenses
Office Rent	$80,000
Furniture and Equipment Rent	$60,000
Salaries Bonus Benefits & Withholding	
Hector	$85,000
Other Employees	$110,000
Interest Expense Other Business Expenses	$25,000 $60,000
Total	$420,000

Hector and PSC just lost the Aztec lawsuit two days ago and were denied a stay of execution pending appeal. Both Hector and PSC need to file bankruptcy to protect against aggressive garnishments by Aztec's law firm Turner & Swan (T&S).

Hector's business is highly variable with earnings dependent on the market and Hector's referral network. Hector's art business, gold jewelry, is very stable and could expand if Hector did more work on it.

QUESTIONS

1. The PSC's business is almost exclusively due to Hector's reputation. Hector wants your firm to represent both himself individually and PSC in their prospective Chapter 11s. While Hector believes there is an identity of interests between him and PSC, there is the contract issue between PSC and Hector. Can you represent both Hector

and PSC in their Chapter 11s? Can you represent both prior to Bankruptcy and then get separate counsel for one of them when they file?

2. Hector asks you if there is any exemption planning you can do for him. He notes that he lives in Florida and he knows there are several exemptions available. Specifically he would like to sell his vacation home and use the equity to pay down the debt on his residence. Can you advise him on these issues and be his counsel in an individual Chapter 11 case?

3. Hector does not want to reduce any of his living expenses. On the second day of his bankruptcy, Aztec files a motion to limit Hector's living expenses to the $12,000 in mortgage payments, his taxes of $27,000 and $10,000 for all other expenses.

(a) Can you represent hector on this motion assuming you are bankruptcy counsel in Hector's individual Chapter 11?

(b) Assuming you can represent Hector, what should you advise Hector to do in his Chapter 11 concerning his expense situation?

4. Swallow Enterprises ("Swallow") approaches Hector and PSC and offers to purchase all of PSC assets through a plan, which will pay all of Hectors and PSC's unsecured debts under two conditions:

- Hector agrees to work for $500,000 per year (plus some bonuses, for five years for Swallow under a detailed employment contract with Swallow Enterprises;
- Hector agrees to a 5-year non-compete as part of his employment contract; and
- At least three of the four PSC contracts agree to continue their contracts with Swallow.

(a) Assuming the best plan Hector and PSC can propose in their Chapter 11s is a 75% payment over 5 years to unsecured creditors, can you recommend that Hector oppose the offer? Assuming Hector is against the offer, can you oppose the offer in his bankruptcy case?

(b) Hector tells you that all four PSC contracts have agreed to hire Hector individually and purchase his secured debt if he agrees to convert his Chapter 11 case and the PSC Chapter 11 case to Chapter 7s and discharge their unsecured debts. Hector thinks this will save him a lot of $$. What can, or do, you do on this matter?

(c) Assume that Hector in fact has a valid employment with a non-compete with his PSC and Swallow offers to purchase the PSC and pay off all of Hector's and the PSC's unsecured creditors. Does Hector have to agree to that transaction to meet his fiduciary duty to his creditors? If he refuses to agree to the assumption of his contract, would that be grounds for conversion?

5. Hector wants to sue Beckett for fraud, seeking $10,000,000 in damages. After six months of discovery, Beckett offers $2,000,000 to settle the law suit, payable to Aztec.

Aztec has agreed to forgive the rest of its debt with Hector and PSC for the $2,000,000 payment from Beckett.

(a) Assuming the offer is reasonable from a litigation stand point, what do you have to advise Hector concerning this offer?

(b) Assuming the offer is properly rejected, what are Hector's obligations to Aztec as a fiduciary during the appeal of their judgment?

6. Hector takes eight weeks of vacation each year. If he worked on his jewelry business four more weeks per year instead of traveling, his monthly expenses would go down $5,000 per month on average and his monthly income would go up $10,000 on average. What advice should you give Hector concerning this duties to maximize earnings for the estate?

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