Consumer Ethics: The Multiple Roles of Consumer Debtor s Counsel Under BAPCPA: Can You Be a Watchdog, Counselor and Advocate at the Same Time?

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INTRODUCTION

All lawyers, including both debtor and creditor, are expected simultaneously to be **counselors** as well as **advocates**. The Model Rules of Professional Conduct (**MRPC**) have well-developed standards for assisting lawyers in balancing these roles. **MRPC 2.1** governing the lawyer s role as **counselor** requires a lawyer to exercise independent professional judgment and render candid advice. **MRPC 3.1** governing the lawyer s role as **advocate** requires that a lawyer have a good faith basis for the positions and defenses advocated on behalf of a client. But BAPCPA arguably imposed on debtor s counsel a new role: that of **watchdog**. The **watchdog** role is found in various provisions throughout BAPCPA, but is most apparent in the **Rule 11** requirements incorporated into **707(b)**,[1] the debt relief agency provisions in **526 - 528**, and in the issues involving mortgage claims and fees. There are real risks of sanctions, disgorgement, and ethical complaints for lawyers who fail to balance these simultaneous yet inherently contradictory roles.

It is difficult enough as a consumer debtor lawyer to balance zealous representation (**MRPC 3.1**) while still attempting to remain independent and objective (**MRPC 2.1**), particularly while trying to get paid! The role of **watchdog** injects new concerns into this mix; the concern that your self-interest in protecting yourself inhibits the development of the trust and confidence that is inherent in a good attorney-client relationship; the concern that this inhibition may detract from the independent, zealous representation that the ethics rules demand.

These materials will attempt to assist you in threading your way safely through these thorny ethical thickets.

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[1] All references are to 11 U.S.C., unless other noted.

I. RULE 11 BEHIND EVERY DOOR (or, chimera or shibboleth?)[2]

INTRODUCTION

Rule 11 as applicable to bankruptcy lawyers in the form of **Rule 9011** has never applied to schedules and statements. BAPCPA s legislative history, however, indicated a sense of Congress that debtors attorneys were assisting debtors in lying and concealing assets in their schedules and statements. Although **Rule 9011** has not been amended, Congress did incorporate **Rule 11**-like standards within **707(b)**, the means test section. The issues for debtor s attorneys are:

- How does **707(b)** change prior practice?
- Does **707(b)** impose new duties on debtors attorneys?
- If so, how do you satisfy these duties ethically yet economically?

For general guidance on this topic, every debtor s attorney should read the ABA s Task Force on Attorney Discipline Report, dated October 6, 2005.

RULES:

Rule 9011(a): Every petition, pleading, written motion, and other paper, **except a list, schedule, or statement, or amendments thereto**, shall be signed by at least one attorney of record ....

Rule 9011(b): By presenting to the court (whether by signing, filing, submitting or later advocating) a petition, pleading, written motion, or other paper, an attorney ... is certifying that to the best of the person s knowledge, information, and belief, formed after **an inquiry reasonable under the circumstances**[3]

(1) it is not being presented for any **improper purpose...**

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[2] These materials were originally prepared by Cynthia F. Grimes and were graciously updated where noted by Daniel J. Casamatta.

[3] For an example of an unreasonable inquiry pre BAPCPA, *see* **Briggs v. Labarge (In re Phillips)**, 433 F.3d 1068 (8th Cir. 2006). Attorney violated **Rule 9011** by a filing a bankruptcy petition without meeting with client or obtaining her signature; reliance on older signatures in file and general knowledge that debtor seemed to want action taken in light of pending home foreclosure was not a reasonable inquiry; Court affirmed bankruptcy and BAP court finding that **Rule 9011** was violated, but struck monetary sanctions as heavy handed... *Compare* **Henry v. Sikes,** 2006 U.S. Dist. LEXIS 29317 (D. LA April 19, 2006). Debtor s attorney relied on debtor s statement that car was not encumbered by lien without requesting copy of title or registration; bankruptcy court found in pre BAPCPA case that debtor s attorney failed to conduct reasonable inquiry and sanctioned attorney $3,000 plus $1,500 for trustee s fees in objecting to debtor s exemption in the car; Judge told attorney he needed to get with the program in light of the more stringent requirements under BAPCPA; on appeal, district court struck $3,000 sanction as excessive, noting that the old law did not impose such stringent investigatory requirements on debtors attorneys, but affirmed the award of attorney fees and expressed no opinion as to the requirements of BAPCPA for debtors attorneys.

(2) the claims, defenses, and other legal contentions therein are **warranted by existing law** or a nonfrivolous argument for an extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have **evidentiary support**[4] or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are **warranted on the evidence** or, if specifically identified, are reasonably based on a lack of information or belief.

Rule 9011(c): Sanctions: Key Points:

(1) **Due process still applies:** Sanctions motions by a party must be made separately from other motions; describe the specific conduct**;** served in accordance with **Rule 7004**; and comply with 21 day safe harbor rule. *See* **Hutchinson v. Pfeil,** 208 F.3d 1180 (10th Cir. 1997) (**Rule 11** motion untimely when filed after summary judgment). *See also* **AeroTech v. Estes**, 110 F.3d 1523, 1528-29 (10th Cir. 1997) (movant did not seek **Rule 11** sanctions until after plaintiff had moved to dismiss its claims against him and therefore **Rule 11's** cure provision prevented movant from seeking sanctions), *quoting* **Elliott v. Tilton,** 64 F.3d 213, 216 (5th Cir. 1995) ("The -safe harbor provision added to **Rule 11** contemplates such service to give the parties at whom the motion is directed an opportunity to withdraw or correct the offending contention. The plain language of the rule indicates that this notice and opportunity prior to filing is mandatory"). Rulings under **Rule 11** are authoritative in cases involving **Bankruptcy Rule 9011**. **In re Rex Montis Silver Co**., 87 F.3d 435 (10th Cir. 1996).

(2) **Court s Own Initiative**: court must issue show cause order.

(3) **Sanctions are discretionary**: If ... the court determines that [there is a violation] the court **may** ... impose an appropriate sanction...

(4) **Sanctions are limited**: Sanctions shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others in a similarly situation; sanctions may consist of directives of a nonmonetary nature, a order to

[4] Lest we forget that **Rule 9011** also applies to the lawyers of creditors, *see* **In re Rivera**, 2006 Bankr. LEXIS 946 (Bankr. D. N.J. May 25, 2006). Law firm fined $125,000 and individual lawyer fined $500 for using pre-signed forms in support of certifications for stay reliefs. The practice came to light when a particular certification used in connection with alleged postpetition mortgage defaults in 2005 bore a 2003 fax date, and the numbered paragraphs were inconsistent. The employee of the mortgage processor who had pre-signed blank certifications in bulk had not even worked for the mortgage processor in over a year. Besides the fact that this process violated the duty of inquiry into the factual contentions, the court also found this to be a violation of the improper purpose clause of **Rule 9011.**

pay a penalty to the court, or if warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys fees and expenses incurred as a direct result of the violation; no monetary sanction against represented party for violation of **Rule 9011(b)(2)** (no legal basis).

(5) **Sanctions on court s own initiative**: no monetary sanctions may be awarded unless the court issues its order to show cause before a voluntary dismissal or settlement of the claims made by or against the party which is or whose attorneys are to be sanctioned.

APPLICABLE STATUTES:

521(a) generally requires *all* debtors to file:

- a *list* of creditors
- a *schedule* of assets and liabilities
- a *schedule* of current income and current expenditures
- a *statement* of the debtor s financial affairs
- if **342(b)** applies (individual debtor with primarily consumer debts), a *certificate* of the attorney that the attorney delivered to the debtor the **342(b)** notice
- 60 days of payment advices
- a *statement* of the amount of monthly net income, itemized to show how the amount is calculated
- a *statement* disclosing any reasonably anticipated increase in income or expenditures over the 12-month period following the date of the filing of the petition

NOTE: **Rule 9011** in its current version post-BAPCPA still does not apply to lists, schedules and statements. But **QUERY:** By presenting schedules, were you subject to **Rule 11** pre-BAPCPA? *See* **In re Kelley**, 255 B.R. 783 (Bankr. N.D. Ala. 2000) (sanctions under **105**).

707(b)(4): 4 potential new attorney liability standards????

FIRST: Losing a 707(b) Motion

707(b)(4)(A): The court, on its own initiative or on the motion of a party in interest, in accordance with the procedures described in **Rule 9011** ... may order the attorney for the debtor to reimburse the trustee for all reasonable costs in prosecuting a motion filed under **707(b)**, including reasonable attorneys fees, if

1. a trustee files a motion for dismissal or conversion under this subsection; and
2. the court

   (a) grants such motion: and
   (b) finds that the action of an attorney for the debtor in filing a case under this chapter violated **Rule 9011** ...

OBSERVATIONS:

- This section is redundant; sanctions only available if the attorney violated **Rule 9011**; that was the case pre-BAPCPA!

- This section only applies to Chapter 7 debtor s attorneys representing an individual debtor with primarily consumer debts.[5]

- Why would any litigant want to prosecute a motion under this subsection?

- The 21 day safe harbor applies to litigants sanction motions.

- It is unlikely that a creditor would bring a sanctions motion under this section since only the trustee s attorney fees, and not the creditor s, would be reimbursed.

- Chapter 7 trustees typically have no incentive to expend the time and energy to dismiss or convert a case under **707(b)** and also must comply with the 21 day safe harbor.

- The United States Trustee who typically has filed **707(b)** motions in the past may not be a beneficiary of the attorneys fees reimbursement; in other sections, specifically **707(b)(4)(B)**, the Code distinguishes between a trustee and the United States trustee ; **Rule 9001** includes a definition of trustee as including a debtor in possession, but does not mention United States Trustee ; in fact, United States Trustee is separately defined from trustee.

- The debtor s attorney has time to avoid being sanctioned on the court s own initiative; this section requires the trustee to have filed and won the motion and that the debtor s attorney filed the case in violation of **Rule 9011** (improper purpose, no legal or factual basis); those allegations presumably would be in the motion to dismiss or convert and thus an attorney would have the opportunity to remedy the situation before the motion was granted.

- In any event, the sanctions are not mandatory: the court *may* order the attorney... to reimburse the trustee... **707(b)(4)(A)**.

SECOND: Generally violating Rule 9011

707(b)(4)(B): If the court finds that the attorney for the debtor violated **Rule 9011**, the court, on its own initiative or on the motion of a party in interest, in accordance with such procedures, may order

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[5] **103(b)**: Subchapters I and II of chapter 7 apply only in a case under such chapter and this section deals only with motions for dismissal/conversion for abuse under **707(b)**, which is applicable only to a case filed by an individual debtor under this chapter whose debts are primarily consumer debts. **707(b)(1).**

1. the assessment of an **appropriate civil penalty** against the attorney for the debtor; and
2. the payment of such civil penalty to the trustee, United States trustee (or bankruptcy administrator, if any).

OBSERVATIONS:

- Who does this section apply to? Clearly it applies to chapter 7 debtor s attorneys by its express terms, but is it limited to conduct in connection with **707(b)**? Or does this subsection stand alone, possibly making it applicable to all chapter 7 debtor s attorneys, regardless of whether the debtor is an individual or not, or whether the debts are business or consumer? The ABA Task Force concludes that, based on statutory construction (this section is part of **707(b)**) and legislative history, this subsection does not apply broadly to all debtor s attorneys.

- This section does not impose any new liability standards for debtor s attorneys; it merely expands the court s remedies for violation of **Rule 9011.**

- **Rule 9011(c)(2)** already provided that the court could order the violator to pay a penalty into court.

- This section now also allows the court to order the penalty paid to the trustee or United States Trustee.

- Penalty and attorney fees are distinct terms. *See* **In re Fjeldstad**, 293 B.R. 12 (9th Cir. BAP 2003) (the **Rule 9011 (c)(2)** penalty parallels civil contempt and inherent sanctions and is limited to what is sufficient to deter repetition of the conduct).

- Perhaps this section was a way to reimburse the United States Trustee who otherwise is not incurring attorney fees?

THIRD: Reasonable Investigation Requirement

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

1. performed a **reasonable investigation** into the circumstances that gave rise to the petition, pleading, or written motion; and
2. determined that the petition, pleading, or written motion
   (a) is **well grounded in fact**; and
   (b) 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).

OBSERVATIONS:

- Again, there is an issue of to whom and to what actions does this section apply?

- The ABA Task Force concludes this subsection should only apply to debtor s attorneys where **707(b)** is applicable.

- Because the legislative history indicated Congressional intent to tighten judicial oversight in connection with consumer cases, the ABA Task force concludes that this section is limited to the **pre-filing conduct of attorneys** representing consumer debtors in Chapter 7 cases to ensure that the debtor s case is not an abuse under the means test and is not filed other than in good faith.

QUERY: Is that consistent with the plain language? Also **QUERY**: This section does not incorporate **Rule 9011**, as does other sections, and does not include any other remedy. What is the penalty for violation? (Of course, **MRPC 3.1** requires a lawyer s claims to be meritorious).

- This section does not include schedules!

- Since **707(b)(4)(C)** uses terms (reasonable investigation, well grounded in fact, warranted by existing law) different from **Rule 9011**, are these terms intended to impose a standard different or higher than **Rule 9011**?

- Was the term **reasonable investigation** intended to impose a standard different from the **reasonable inquiry** standard of **Rule 9011**?

- The ABA Task Force points out that courts commonly use these terms **interchangeably** and that the standard should be the same.

- The most widely accepted standard pre-BAPCPA for reasonable inquiry in connection with an attorney s pre-filing investigation was the **Five Step Plan** :

  1. **Explain** the requirement of full, complete, accurate and honest disclosure of all information to the Debtor;

  2. **Ask** probing and pertinent questions designed to elicit full, complete, accurate and honest disclosure;

  3. **Check** the Debtor's responses to be sure they are internally and externally consistent;

  4. **Demand** of the Debtor full, complete, accurate and honest disclosure of all information prior to placing your signature on the petition; and

  5. **Seek relief** from the Court by moving to withdraw in the event the attorney finds he was misled.

  See, e.g., **In re Matthews**, 154 B.R. 673 (Bankr. W.D. Tex. 1993).

- The ABA Task Force posits that if the debt relief agent gives the 527 disclosures and **342(b)** notice that the attorney has satisfied steps 1 and 4 of the duty of reasonable investigation.

- Because the application of the **707(b)** means test is unclear in many instances, the ABA Task Force recommends that the courts adopt the reasonable investigation standard, to allow courts to interpret **707(b)(4)(C)** in a manner consistent with Congressional intent but without subjecting attorneys to liability before attorneys have guidance on how **707(b)** will be interpreted.

- **Well grounded in fact** is the old **Rule 11** language prior to December 1997 when **Rule 11** was amended.

- The ABA Task Force says that there are two interpretative alternatives: (1) interpret **707(b)(4)(C) s well grounded in fact** as the same as **Rule 9011's having evidentiary support** or (2) interpret **707(b)(4)(C)** as resurrecting case law prior to th December 1997 amendment.

NOTE: This may not be an issue in the 10th Circuit. Two cases pre-**Rule 11** amendment use the terms **well grounded in fact** and **evidentiary support** interchangeably. *See*, **Adamson v. Bowen**, 855 F.2d 668 (10th Cir. 1988); **Crabtree by and through Crabtree**, 904 F.2d 1475 (10th Cir. 1990).

- **Warranted by existing law** is also old **Rule 11** language.

- The ABA Task Force points out that the 1997 **Rule 11** amendment replaced good faith with nonfrivolous in an effort to forestall pure heart, empty head types of arguments.

- The 10th Circuit s standard has always been an objective standard. E.g., **Adamson v. Bowen**, 855 F.2d 668 (10th Cir. 1988) (The standard by which courts evaluate the conduct of litigation is objective reasonableness whether a reasonable attorney admitted to practice before the district court would file such a document.)

- According to the ABA Task Force: If we assume **707(b)(4)(C)** is limited and will be interpreted incorporating existing **Rule 9011** standards, then the issue a debtor s attorney must really worry about is: that the attorney s signature on the petition constitutes a certification that the petition does not constitute an abuse (i.e., that debtor has failed the means test of **707(b)(2)** or that the debtor filed the petition in bad faith or the totality of the circumstances of the debtor s financial situation demonstrates abuse under **707(b)(3)**.

- The ABA Task Force likens this analysis to that of a plaintiff s attorney s pre-filing analysis of predetermining whether there are affirmative defenses to an anticipated claim.

- In other words, the debtor s attorney should not only perform the means test analysis to determine if a presumption of abuse arises, but should determine whether there are special circumstances that rebut the presumption.

- However, standards vary in different districts. *See, e.g*., **White v. General Motors Corp**., 908 F.2d 675, 682 (10th Cir. 1986) (part of a reasonable attorney s pre-filing investigation must include determining whether any obvious affirmative defenses bar the case.) . *But see* **Golden Eagle Distrib. Corp. v. Burroughs Corp**., 801 F.2d 1531, 1542 (9th Cir. 1986) (attorney need not step first into the shoes of opposing counsel to find all potentially contrary authority...).

- ABA Task Force Bottom Line: unless a debtor s bankruptcy case is plainly not permitted under the jurisdiction s interpretation of the bad faith and totality of the circumstances tests, an attorney should not be required to anticipate the various arguments parties might put forth in post-petition challenges to the debtor s motivation in filing bankruptcy.

FOURTH: Schedules Certification

707(b)(4)(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**.

OBSERVATIONS:

- This section conflicts with **Rule 9011**, but in conflicts between the Code and the Rules, the Code wins. *E.g*., **Rule 9029**; **In re Barnes**, 308 B.R. 77 (Bankr. D. Colo. 2004).

- The difficulty in interpreting this section is what do the terms **inquiry**, **knowledge**, and **incorrect** mean?

- There is no requirement in **707(b)(4)(D)** that the inquiry be reasonable as required in **707(b)(4)(C)** and **Rule 9011**.

- Does **inquiry** mean an exhaustive analysis or a bare inquiry or something in between (i.e., a reasonable inquiry)?

- The ABA Task force posits that **inquiry** should incorporate a reasonableness standard, based on analogy to **523(a)(2)(B)** and **Field v Mans,** 116 S.Ct. 437 (1995) (fraud exception to discharge requires justifiable reliance): the inclusion of reasonable in **523(a)(2)(B)** but not in **523(a)(2)(A)** means the latter requires something different, a more lenient standard of justifiable reliance.

- ABA Task Force Bottom Line: Ironically, one can argue based on plain language that the attorney s standard under **707(b)(4)(D)** is a bare inquiry; however, such is not in keeping with the legislative intent. Therefore, the standard should be above a bare inquiry

but more lenient than **Rule 9011**!

- Per the ABA Task Force: As with inquiry, the absence of qualifying language leaves room to argue that the **knowledge** requirement in **707(b)(4)(D)** requires the attorney have had *actual* knowledge the schedules were incorrect before sanctions may be imposed.

- The ABA Task Force recommends that knowledge be interpreted to include what the attorney knew or should have known.

- What is **incorrect** information?

- Per the ABA Task Force: Attorneys should be liable for **incorrect** information only where, after reasonable inquiry, the attorney knew or should have known of the incorrectness. Further, an attorney should not be liable for information not discoverable prior to the filing of the petition.

- In other words, an attorney should not be sanctioned because an attorney reveals that the schedules as originally filed, were incorrect.

***BAPCPA & SANCTIONS UPDATE*: 707( )(4) & R 11 P U BAPCPA**[6]

***I R*, 370 B.R. 804 (Bankr. D. Minn. 2007)**.

Judge Kishel includes a footnote on the provisions of **707(b)(4)** in his opinion denying the U.S. Trustee s motion to dismiss because of an issue with the 10 day statement of **707(b)(2)**. While *dicta* in the case, the Court defines the general drift of **707(b)(4)(C)** as:

> (D)ebtors counsel are to exercise significant care as to the completeness and accuracy of all recitations in their clients schedules, after they have made a factual investigation and legal evaluation that conforms to the standards applicable to any attorney filing a pleading, motion, or other document in a federal court. The content of a debtor s petition and schedules is relied on, and should have the quality to merit that reliance.

***I A*, 363 B.R. 484 (Bankr. E.D. Va. 2007).**

Chapter 7 Debtor s counsel had collected a filing fee from his client but failed to submit it to the court when filing the case. After the case was automatically dismissed by the court, counsel filed another chapter 7 case without consulting his client. The Court cited **707(b)(4)(C)** and **Rule 9011**, finding that counsel could not have made the reasonable inquiry necessary to satisfy the Code and Rules when filing the second case since he did not meet with his client. Counsel was suspended from practice for 90 days.

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[6] Prepared by Daniel J. Casamatta.

***In re   it ro* , 2008 WL 27505518 (Bankr. D. Mass. 2008).**

Judge Henry Boroff issued an order against debtor s counsel to show cause:

> [W]hy he should not, pursuant to **Fed. R. Bankr. P. 9011(c)(1)(B)**, be sanctioned on account of the alleged misrepresentations, omissions and errors in the debtor s bankruptcy schedules, statement of financial affairs and rebuttal of presumption of abuse.

It is important to note that no **707(b)** motion was pending against the debtor in this case. The case had been filed as chapter 13 and converted to chapter 7. The show cause order was issued after the trustee and the United States trustee objected to counsel s fee application. **QUERY:** Does this suggest that the provisions of **707(b)(4)(C)** and **(D)** are stand-alone provisions that apply outside of the **707(b)** or even outside of the chapter 7 context?

The Court analyzed the provisions of **707(b)(4)(C)** and **(D)** and found:

> (1) the certification in **707(b)(4)(D)** is a specific assurance that the statement had not been made lightly and is a product of an investigation insofar as practical under the circumstances, within the attorney s control and designed to discover the truth; and (2) an objective standard of whether the attorney s investigation is reasonable should be applied.

The Court formulated a five-prong objective test to determine if counsel s inquiry was reasonable:

(1) Did the attorney impress on the debtor the critical importance of accuracy in documents filed with the court?;

(2) Did the attorney seek and review whatever documents were in the debtor s possession, custody and control?;

(3) Did the attorney employ external verification tools that were available and not cost-prohibitive? The Court mentioned on-line real estate title compilations, on-line lien searches and tax scripts ;

(4) Was any information from the debtor inconsistent that should have alerted the attorney that information from the debtor could not be accurate?; and,

(5) Did the attorney correct any information submitted to the court when it turned out to be incorrect?

The Court s summary of this test was, Did the attorney do his or her level best to get it right? You should notice that Judge Boroff included *dicta* that he felt **Rule 9011** always was available to sanction counsel when schedules and statements were inaccurate. Presumably, he believes that this applies in all chapters of the Code. As such, he would assume that counsel should get it right in all cases.

Ultimately, Judge Boroff found that debtor s counsel did not get it right. He orders a monetary sanction of $3,585 payable to the chapter 7 trustee, which was three times the amount counsel intended to charge his client. Later, the Court also denied counsel s fees and ordered any fees he had been paid disgorged to the debtor.

Some interesting footnotes to ***Withrow*** :

Counsel in the case had been sanctioned in two prior cases and had a history of problems in case administration. *See* ***In re France***, 311 B.R. 1 (Bankr. D. Mass. 2004) and ***In re LaClair,*** 360 B.R. 388 (Bankr. D. Mass. 2006).

Counsel appealed the sanction and filed a motion to stay its imposition arguing among other things that: (1) **Rule 11** does not apply to schedules and statements since they are not signed by counsel; and (2) **707(b)(4)(C)** and **(D)** could not apply in the case since counsel filed the case and the schedules while the case had been in chapter 13.

Judge Boroff denied the stay finding that **Rule 11** applies to the preparation of schedules because **Rule 9011(B**) governs problems with a petition, pleading, written motion, or other paper either signed, filed, submitted or later advocated by counsel. Also, he finds that **707(b)(4)(C)** and **(D)** create no new standard. They simply codified and put an explanation point on **Rule 9011** in the preparation of certain documents. As such, **Rule 9011** would have applied in chapter 13 as well as in chapter 7 for the problems with debtor s schedules.

Ultimately, counsel did not properly perfect the appeal and it was dismissed.

II. DEBT RELIEF AGENTS *(or, doesn t look like an agent, smell like an agent, or act like an agent)*[7]

INTRODUCTION

BAPCPA contains provisions apparently intended to regulate debtors attorneys relationships with their debtor clients. It does so by establishing a definition of who may be a **debt relief agency** (**DRA**) and then proscribing and prescribing certain disclosures and actions that **DRAs** must follow. The requirements purport to govern what statements you may make to a client, how you can advertise, what advice you can give, and what your fee contract must say. Some of these disclosures appear to be contrary to a client s best interest and may be misleading and unethical under state law. A **DRA** who fails to comply with the requirements is subject to certain penalties.

The issues are:

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[7] Prepared by Cynthia F. Grimes.

- Do the **DRA** requirements apply to attorneys? If so, do they apply just to debtors attorneys or to all attorneys?
- How do the **DRA** requirements affect ethical obligations imposed by state law?
- What is the impact of various decisions holding the **DRA** requirements may be unconstitutional?
- In light of the uncertainty, what are the pitfalls to watch out for and what best practices may we implement to avoid any problems?

STATUTES:

101(12A) defines a **debt relief agency** as any person who provides **bankruptcy assistance** to an **assisted person** in return for the payment of money or other valuable consideration... with certain exclusions.

101(4A) defines **bankruptcy assistance** as any goods or services sold or otherwise provided to an **assisted person** with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

101(3) defines **assisted person** as [1] any person [2] whose debts consist primarily of consumer debts and [3] the value of whose nonexempt property is less than $150,000. **NOTE:** This does not say and who is a debtor or intends to seek relief under the bankruptcy code. **QUERY:** If in the course of a divorce proceeding, your client asks you about the possible effects if the other spouse files bankruptcy, do you then become a **DRA**? After all, you represent an individual with less than $150,000 in nonexempt assets and you are providing information about a proceeding in bankruptcy? The same could be true of individual creditors or personal injury plaintiffs, or many types of clients.

526, 527, 528: The DRA Provisions: The **DRA** provisions are encompassed in 3 new sections, **526** (Restrictions)**, 527** (Disclosures) and **528** (Requirements):

A. 526 RESTRICTIONS

526 is titled **Restrictions on Debt Relief Agencies**. It imposes four (4)restrictions on **DRAs:**

1. **526(a)(1): Failure to Perform A Promised Service:** The **DRA** shall not fail to perform any service that such agency informed an **assisted person** or **prospective assisted person** it would provide in connection with a case or proceeding under this title. **QUERY**: What if, in light of circumstances, something you advised clients to do you is no longer in your opinion a wise or prudent course? Must you perform the promised service even though it might be unethical?

2. **526(a)(2): Making of Untrue or Misleading Statements:** The **DRA** shall not make any statement, or counsel or advise any **assisted person** or **prospective assisted person** to make a statement in a document filed in a case or proceeding under this title, that is **untrue and misleading**, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading. **QUERY:** Is a different standard from **Rule 9011**? Is this a different standard from ethics requirements regarding meritorious claims and candor towards the tribunal?

3. **526(a)(3): Misrepresentation of Services/Benefits/Risks:** The **DRA** shall not misrepresent to any **assisted person** or **prospective person,** directly or indirectly, affirmatively or by material omission, with respect to

   (A) the services such agency will provide to such person;
   (B) the benefits and risks that may result if such person becomes a debtor in a case under this title.

QUERY: How do you ensure that you have appropriately represented the benefits and risks of filing bankruptcy? Do you have an obligation to discuss risks that may be beyond your legal competency or knowledge, such as the inscrutable calculation of how a consumer s credit rating will be affected by filing bankruptcy?

4. **526(a)(4): Advice to Incur More Debt:** The **DRA** shall not advise an **assisted person** or **prospective assisted person** to **incur more debt** in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title. **NOTE**: there are two constructions of **526(a)(4)**:

   O tion One*:* A **DRA** shall not advise an **assisted person** ... to incur more debt

   1. in contemplation of such person filing a case under this title, or
   2. to pay an attorney ... fee or charge for services performed

   O tion Two*:* A **DRA** shall not advise an **assisted person**

   1. to incur more debt in contemplation of such person filing a case under this title, or

   2. to pay an attorney ... fee or charge for services performed

QUERY: Does **526(a)(4)** prohibit you from advising a client to pay you at all? Or are you merely prohibiting from telling your client to borrow the fee from a family member or friend? What if it is in the client s best interest to borrow the fee or buy a car or refinance a mortgage or buy a car before filing bankruptcy? Note that you can apparently still advise a non assisted person (someone with more than $150,000 of nonexempt assets to incur more debt? Is that fair?

B. 527 DISCLOSURES

527 is entitled **Disclosures**. It requires the **DRA** to provide certain disclosures set forth in the text of the statute (including the helpful information that you can represent yourself) to the **assisted person** within three business days of first offering to provide **bankruptcy assistance** services to an **assisted person.** The **DRA** must also must retain copies of the **527(a)** disclosures for two years. **527(d)**. There are four (4) components to the **527** disclosures:

1. **527(a)(1): The 342(b)(1) Notice:** The **DRA** providing **bankruptcy assistance** to an **assisted person** shall provide: the written notice required under section **342(b)(1)**.

2. **527(a)(2): The Truthfulness Statements :** Not later than 3 business days after the first date on which the **DRA** first offers to provide any **bankruptcy assistance** services to an **assisted person**, a clear and conspicuous written notice advising the **assisted person** that

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

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

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

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

QUERY: There appears to be no time limit for providing the **342(b)** notice; since it is part of the official forms the client signs and files with the petition, won t the attorney always comply with this section? The **Truthfulness Statements,** by contrast, need to be given within 3 business days after offering to provide ~~b~~**ankruptcy assistance**. Is setting an appointment with a client an offer to provide **bankruptcy assistance**? Should you provide the **Truthfulness Statements** at the inception of the contact, even for someone you have just talked to on the phone?

3. **527(b) Disclosures Regarding Attorney Fees and Other Items:** The **DRA**, at the same time as the **342(b)(1)** notices required in **527(a)(1)**, shall provide a clear and conspicuous statement, in a single document that is separate from other documents or notices, the following statement or a statement similar :

IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM AN ATTORNEY OR BANKRUPTCY PETITION PREPARER.

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

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

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

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

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

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

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

QUERY: Why would a lawyer advise someone to represent himself? Why would a lawyer want to give these disclosures which are not necessarily accurate and could be considered to be misleading (such as suggesting that the trustee is a court official, or suggesting that the case will involve litigation, when the vast majority of cases never involve a court appearance? Plus, it appears that this information, like the **342(b) notice**, does not have to be given within the 3 business days as the **Truthfulness Statements**; what good does it do to give debtors this information with the **342(b) notice** when the case is already prepared and being filed?

4. **527(c) Disclosures Regarding 521 Information.**

Except to the extent the **DRA** provides the required information itself after **reasonably diligent inquiry** of the **assisted person** or others so as to obtain such information **reasonably accurately** for inclusion on the petition, schedules or statements of financial affairs, a **DRA** providing **bankruptcy assistance** to an **assisted person,** to the extent permitted by nonbankruptcy law, shall provide each **assisted person** at the time required for the notice required under subsection (a)(1) **reasonably sufficient information** (which shall be provided in a clear and conspicuous

writing) to the **assisted person** on how to provide all the information the **assisted person** is required to provide under this title pursuant to **section 521**, including

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

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

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

QUERY: How can lawyers provide the information for the petition, schedules and statements by themselves ? What is the difference between **reasonably diligent inquiry**, **reasonably accurately**, and **reasonably sufficient**? Does this standard of **reasonably accurately** differ from **707(b)(5)(D)** (the attorney signature is a certification that the attorney has no knowledge **after inquiry** that the information is incorrect)? Is this requiring you to tell your clients in writing what information they need to prepare the petition, schedules and statements? If so, it is insufficient if you tell them on the phone what to bring to the office consultation? And, like the **Truthfulness Statements**, this disclosure is required to be given with the **342(b)** notice, presumably at the time of filing the timing of this disclosure would seem to be too late?

C. 528 REQUIREMENTS FOR DEBT RELIEF AGENCIES

528 is entitled **Requirements for Debt Relief Agencies**. There are five (5) components, two (2) of which relate to the fee contract, and three (3) to advertising.

1. **528(a)(1): Written Fee Contract:** The **DRA** shall, not later than 5 business days after the first date on which such agency provides any **bankruptcy assistance services** to an **assisted person**, but prior to such **assisted person s** petition under this title being filed, execute a written contract with such person that explains **clearly and conspicuously**

    (A) the services such agency will provide to such assisted person; and
    (B) the fees or charges for such services, and the terms of payment.

QUERY: Compare the timing in providing the **Truthfulness Statements** (not later than 3 business days after the first day on which a **DRA** first offers to provide any **bankruptcy assistance** services...) to the **Fee Contract** (not later than 5 business days after the first date on which such agency provides any **bankruptcy assistance** services...).

2. **528(a)(2)**: **Copy of Executed Contract to Client:** The **DRA** shall provide the **assisted person** with a copy of the fully executed and completed contract. **QUERY:** What is the difference between a fully executed and completed contract? There appears to be no deadline for providing a copy of the contract?

3. 528(a)(3): **Bankruptcy Advertising Must Relate to Bankruptcy Relief Under the Code:** The **DRA** shall clearly and conspicuously disclose in any **advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public** (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits **are with respect to bankruptcy relief** under this title.

   An **advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public** is defined in **528(b)(1)** to include descriptions of bankruptcy assistance in connection with a chapter 13 plan whether or not chapter 13 is specifically mentioned in such advertisement and any statements such as federally supervised repayment plan or federal debt restructuring help or other similar statements if that could lead a reasonable consumer to believe that debt counseling was being offered when in fact the services were directed to providing bankruptcy assistance with a chapter 13 plan or other form of bankruptcy relief under this title.

4. **528(a)(4): The Bankruptcy Miranda Warning:** The **DRA** shall clearly and conspicuously use the following statement in such advertisement: ―**We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.** or a substantially similar statement. **QUERY:** If you include the **Bankruptcy Miranda Warning** in your ad, doesn t it automatically comply with **523(a)(3)**? Doesn t this statement in an ad for a general practice firm make the ad misleading and perhaps unethical under state law?

5. **528(b)(2): Disguised Bankruptcy Advertising:** An advertisement, directed to the general public, indicating that the **DRA** provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall

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

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

D. PENALTIES/ENFORCEMENT

The **penalties and enforcement** sections are contained in **526(b) - (d)**. There are seven (7) components to these sections.

1. **526(b)**: **No Waiver of 526(a) Requirements**: Any **waiver** by an **assisted person** of any protection or right provided under this section **[526]** shall not be enforceable against the debtor by any Federal or State court of by any other person, other than an

assisted person. QUERY: By negative implication, does this mean that an **assisted person** *may* waive provisions of **527** and **528**?

2. **526(c)(1): Contracts Not in Material Compliance with 526, 527, 528 Void:** Any contract for **bankruptcy assistance** between a **DRA** and an **assisted person** that does not comply with the **material requirements** of this section [**526**], **527**, or **528** shall be **void** and may not be enforced by any Federal or State court or by any other person, other than such **assisted person**.

3. **526(c)(2): Liability to Assisted Person for Disgorgement, Damages and Attorney Fees:** Any **DRA** shall be liable to an **assisted person** in the amount of any fees or charges in connection with providing **bankruptcy assistance** to such person that such **DRA** has received, for actual damages, and for reasonable attorneys fees and costs if such agency is found, **after notice and a hearing**, to have

(A) **intentionally** or **negligently** failed to comply with any provision of this section [**526**], **527** or **528** with respect to a case or proceeding under this title for such **assisted person**;

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

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

QUERY: **526(c)(2)(B)** would seem to require mandatory disgorgement of the lawyers fees in the second case, even if the lawyer does nothing wrong in the second case? **526(c)(2)(C)** is even scarier if you blow a deadline, even if the result is no harm, no foul to your client, have you negligently disregarded the Rules?

4. **526(c)(3): State Attorney General Enforcement:** In addition to such other remedies as are provided under State law, whenever the chief law enforcement officer of a State, or an official or agency designated by a State, has reason to believe that any person has **violated** or **is violating** this section, the State

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

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

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

QUERY: Federal Courts have always regulated the attorneys fees of bankruptcy lawyers. What interest does a state attorney general have in pursuing **DRA** violations?

5. **526(c)(4): Concurrent Jurisdiction Between Federal and State Courts:** The district courts of the United States for districts located in the State shall have concurrent jurisdiction of any action under subparagraph (A) or (B) of paragraph (3) [**526(c)]**.
QUERY: This appears to attempt concurrent jurisdiction, but does it actually say that?

6. **526(c)(5): Enforcement by Court, U.S. Trustee & Debtor:** Notwithstanding any other provision of Federal law and in addition to any other remedy provided under Federal or State law, if the court, on its own motion or on the motion of the United States trustee or the debtor, finds that a person **intentionally violated** this section, or engaged in a **clear and consistent pattern** or practice of violating this section, the court may

   (A) **enjoin** the violation of such section; or

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

7. **526(d): State Law Preempted**? No provision of this section, **527** or **528** shall

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

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

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

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

APPLICABLE ETHICS RULES:

MRPC 1.5 governing **fees** requires fees to be reasonable. *Accord* **Mo.Sup.Ct. 4-1.5(a)**; **KRPC 1.5(a).**[8] Most noncontingent fee contracts are not required to be in writing. *See* **Mo. Sup. Ct. 4-**

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[8] There are many small differences between **Mo.Sup.Ct. 4-1.5** and **KRPC 1.5**, including that the Missouri Rule provides that a lawyer shall not make an agreement for, charge, or collect an unreasonable fee... ; the Kansas Rule by contrast states simply that a lawyer s fee shall be reasonable. **Mo.Sup.Ct. 4-1.5(a)**; **KRPC 1.5(a)**. Second, in Kansas, the Rule specifically states that a court determination that a fee is not reasonable shall not be presumptive evidence of a violation that requires discipline of an attorney (**KRPC 1.5(c)**); Missouri has no such statement. Third, although both states prohibit contingent fees in domestic and criminal cases, the Kansas rule in addition states that contingent fees are prohibited where precluded by statute. **KRPC 1.5(f)(3)**. Fourth, **KRPC 1.5** provides for, upon application of the client, that all fee contracts be subject to review and approval by the appropriate court having jurisdiction of the matter and the court shall have authority to determine whether the contract is reasonable. Missouri, by contrast, has no such provision. Finally, Kansas allows reasonable referral fees

1.5(b) (The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation). *Compare* **KRPC 1.5**: When the lawyer has not regularly represented the client, the basis or rate of the fee shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation.) **QUERY:** The reasonableness of attorney fees have always been the exclusive province of the court before which the lawyer appeared, which in bankruptcy cases meant the federal bankruptcy judge. Yet BAPCPA allows a *state* attorney general to enforce the fee contract and provides that applicable state law is preempted. Your fee contract could be enforceable and ethical under state law but void under BAPCPA?

MRPC 2.1 governing a lawyer s role as **advisor** provides that a lawyer shall exercise independent professional judgment and render candid advice.[9] **QUERY:** In many instances it is in a client s best interest to buy a new car before bankruptcy or to borrow the money to pay the fee. BAPCPA mandates that you not advise your client and if you do, the client may seek disgorgement of your fees, placing you in a no-win situation. Is this prohibition unconstitutional?

MRPC 3.1 governing **meritorious claims and contentions** provides that a lawyer shall not bring or defend a proceeding or assert or controvert an issue unless there is a **basis** for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law.[10] **QUERY:** How does this interact with **526(a)(2)** (the **DRA** shall not make any statement, or counsel or advise any **assisted person** or **prospective assisted person** to make a statement in a document filed in a case or proceeding under this title, that is **untrue and misleading**, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading)?

MRPC 3.3 governing **candor towards the tribunal** states that a lawyer shall not **knowingly** make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer. [11] **NOTE:** The **DRA** provisions impose liability for even negligent failure to comply!

MRPC 7.1 governing **communications** bars a lawyer from making false or misleading

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where the client is advised and does not object (**KRPC 1.5(g)**); Missouri allows a division of fees only where the division is in proportion to the services performed and the each lawyer assumes joint responsibility for the representation, the client agrees and the agreement is in writing. **Mo.Sup.Ct. 4-1.5(e)**.

[9] **KRPC 2.1** and **Mo.Sup.Ct. 4-2.1** are identical.

[10] **KRPC 3.1** and **Mo.Sup.Ct. 4-3.1** are substantially identical; **Mo.Sup.Ct. 4-3.1** requires that the basis be both in law and fact.

[11] **KRPC 3.3** and **Mo.Sup.Ct. 4-3.3** are identical

communications about the lawyer or the lawyer s services.[12] **QUERY:** What if your firm is a general practice firm that advertises bankruptcy as well as divorce, or perhaps creditor representation, etc. BAPCPA s requirement that you state that you are a **DRA** could be a misleading statement in conflict with **MRPC 7.1.**

MRPC 7.2 governing **advertising**[13] permits advertising of legal services within the confines of the ethics rules.

MRPC 7.4 regarding communication of **fields of practice** and **specialization** prohibits generally lawyers from advertising that they are specialists, except with respect to patent and admiralty lawyers, and lawyers have been certified as specialists under certain conditions.[14] **QUERY:** Isn t the **Bankruptcy Miranda Warning** (that you help people file for relief under the Bankruptcy Code an implied representation that you specialize in bankruptcy?

CASE LAW UPDATE:

ISSUE # 1: Are Attorneys DRAs?

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[12] **KRPC 7.1** and **Mo.Sup.Ct. 4-7.1** are *not* identical and readers are directed to the read the rules themselves for the variances. **KRPC 7.1(a) - (c)** provides that a communication is false and misleading if it contains a material misrepresentation of fact or law or omits a fact necessary to make the statement considered as a whole not materially misleading, is likely to create an unjustified expectation about results the lawyer can achieve, or states or implies that the lawyer can achieve results by means that violate the ethics rules or the law or compares the lawyer s services with other lawyer s services, unless the comparison can be factually substantiated. **Mo.Sup.Ct. 4-7.1(a) - (k)** contains a much longer list of false and misleading communications, including, *inter alia*, if the advertisement is for a specific type of case concerning which the lawyer has neither experience nor competence, indicates an area of practice in which the lawyer routinely refers to other lawyers, without conspicuous identification of such fact.

[13] **KRPC 7.2** and **Mo.Sup.Ct. 4-7.2** are *not* identical and readers are directed to read the rules themselves for the variances. In brief, **KRPC 7.2** authorizes advertising through written, recorded or electronic means; requires a copy of the advertisement and the record of when and where it was used to be kept for 2 years; prohibits giving of value to a person recommending the lawyer s services, except that the lawyer may pay the reasonable cost of the advertising; and requires the advertisement to include the name of at least one lawyer responsible for the content. By contrast, **Mo.Sup.Ct. 4-7.2** requires that the advertisement and the name of the lawyer responsible for be kept for 2 years, but does not require the name of the lawyer in the advertisement itself. **Mo.Sup.Ct. 4-7.2(d)** also requires certain disclosures when another lawyer is financing the advertisement. **Mo.Sup. Ct. 4-7.2(e)** & **(f)** prohibit the advertisement of an existence of any office other than the principal office unless it is staffed by the lawyer at least 3 days a week and the advertisement includes the days and times the lawyer will be present or states that meetings will be by appointment only; and require the advertisement to contain the following conspicuous disclosure: *The choice of a la yer is an important decision and should not be based solely upon ad ertisem ents* ; provided, that the disclosures in subsections **(e)** & **(f)** need not be made if the advertisement is limited to the name of the law firm, the lawyers in the firm, the fields in which the lawyer and/or firm practice, the dates and places of admission to state and federal bars; and the address.

[14] **KRPC 7.4** and **Mo.Sup.Ct. 4-7.4** are *not* identical. **KRPC 7.4** allows a lawyer who is certified as a specialist in a particular field of law to so state, provided certifying organization has been approved by an appropriate state agency or accredited by the American Bar Association and the name of the certifying organization is clearly identified in the communication. by contrast, **Mo.Sup.Ct. 4-7.4** allows a lawyer to communicate the fact that he does or does not practice in particular fields; however, the lawyer may not state or imply he is a specialist unless the communication contains a disclaimer that neither the Supreme Court of Missouri nor The Missouri Bar reviews or approves certifying organizations or specialist designations.

Are Not: **In re Attorneys At Law and Debt Relief Agencies**, 332 B.R. 66 (Bankr. S.D. Ga. 2005) (holding attorneys are not **DRAs;** because the definition of **DRA** omits express reference to attorneys and includes a term bankruptcy petition preparer that excludes attorneys, it is difficult to conclude that Congress intended to include attorneys; reasoning that Congress intended to establish regulation of entities who interface with debtors in shadowy, gray areas not already covered by bankruptcy petition preparers regulations and to bolster existing bankruptcy petition preparer regulations), *appeal dismissed* 353 B.R. 318 (S.D. Ga. 2006) (U.S. Trustee appealed the bankruptcy court order, arguing that the bankruptcy court lacked jurisdiction to enter its order on the grounds there was no case or controversy; the District Court on appeal, noting that the U.S. Trustee had vaulted this Court into the BAPCPA s rat s nest... concludes the U.S. Trustee as a party not aggrieved had no standing to appeal).

Not Reached So Not Sure: **In re McCartney,** 336 B.R. 588 (Bankr. M.D. Ga. 2006) (Debtor s attorney filed a motion to determine status as a **DRA**, arguing that the **DRA** provisions violate the 1st Amendment and that Congress did not intend attorneys to be **DRAs** based on the statutory language and the lack of legislative history; since no party was attempting to enforce the **DRA** provisions against the attorney, the court found there was no case or controversy and dismissed the motion for lack of subject matter jurisdiction.)

Are Not (but hold the phone...!): **In re Hersh**, 347 B.R. 19 (N.D. Tex. 2006) (Debtor s attorney s declaratory judgment action seeking declaration that attorneys are not DRAs dismissed; plain language of **101(12A)** defining **bankruptcy assistance** includes legal representation; legislative history indicates Congress intended to include attorneys; **526(a)(4)** prohibiting advice regarding the incurring of more debt in contemplation of bankruptcy is a facially unconstitutional restriction on 1st Amendment speech, discussed below); **Olsen v. Gonzales**, 350 B.R. 906 (D. Ore. 2006) (following **Hersh**).

Are (probabl ... but battle not lost et): **Jackson v. McDow, Jr. (In re Jackson)**, 2006 U.S. Dist. LEXIS 68927 (D.S.C. 2006) (District Court reverses and remands bankruptcy court order denying Debtor s motion for declaration that **DRA** provisions invalid as applied to attorneys; debtor had argued to bankruptcy court that **DRA** provisions prevented her attorney from giving her advice; bankruptcy court erred in finding no case or controversy; debtor s attorney is restricted in ability to render legal advice; debtor s attorney thus faces significant impediments without a judicial decision because **DRA** provisions require debtors counsel to adjust their conduct immediately; district court directs that motion must be re-filed as an adversary complaint, however).

Are Not (and ... battle won?!) **Milavetz v. United States**, 355 B.R. 758 (D. Minn. 2006) (attorneys are not **DRAs** under doctrine of constitutional avoidance; statutory scheme is ambiguous if lawyers are included within **101(4A)** (definition of **bankruptcy assistance**) since **526(d)(2)(A)** also states that nothing in **526, 527** and **528** is intended to limit the authority of the states to determine and enforce qualifications for the practice of law; to avoid constitutional problem with DRA provisions impinging on states rights, court must opt for construction of statute that attorneys are not DRAs for purposes of these sections; **526(a)(4)** (prohibition against incurring debt) and **528** (advertising provisions) unconstitutional under 1st Amendment, discussed below.)

***Are Not (ditto as to pro bono lawyers)*: In re Reyes,** 361B.R. 276 (Bankr. S.D. Fla. 2007) (adopts **Milavetz;** attorneys are not **DRAs** and **526, 527, 528** unconstitutional; even if constitutional, DRA provisions do not apply to pro bono lawyers since bankruptcy assistance requires the giving of money or other valuable consideration; fact that pro bono attorney gets credit under bar program for pro bono representation does not constitute valuable consideration).

ISSUE # 2: Are Any or All of the DRA Provisions (526, 527, and 528 Unconstitutional?

***Su ested but Didn t Reach:* In re Attorneys At Law and Debt Relief Agencies**, 332 B.R. 66 (Bankr. S.D. Ga. 2005), *appeal dismissed* 353 B.R. 318 (S.D. Ga. 2006) (court order issued *sua sponte* first day of BAPCPA; in *dicta*; **DRA** provisions could constitute unconstitutional federal preemption of state law rights to regulate law practice under separation of powers and possibly 10th Amendment; constitutional issue not reached since it was determined attorneys are not **DRAs** under the language of the statute).

***Raised but Not Reached*: In re McCartney,** 336 B.R. 588 (Bankr. M.D. Ga. 2006) (debtor s attorney filed a motion to determine status as a **DRA**, arguing that the **DRA** provisions violate the 1st Amendment and that Congress did not intend attorneys to be **DRAs** based on the statutory language and the lack of legislative history; since no party was attempting to enforce the **DRA** provisions against the attorney, the court found there was no case or controversy and dismissed the motion for lack of subject matter jurisdiction.); **In re Geisenberger**, 346 B.R. 678 (E.D. Pa. 2006) (practicing bankruptcy attorney lacked standing)

***Not Reached but Reversed and Re anded:* Jackson v. McDow, Jr. (In re Jackson)**, 2006 U.S. Dist. LEXIS 68927 (D.S.C. 2006) (debtor s attorney brought motion; reversed and remanded with directions to file as adversary).

***526(a)(4) Facially iolates 1st A end ent; 527 Not Unconstitutional* :In re Hersh**, 347 B.R. 19 (N.D. Tex. 2006) (declaratory judgment action brought by debtor s attorney; although debtor s attorney s found not to be **DRAs**, **526(a)(4)** prohibiting advice to incur debt in contemplation of bankruptcy is a facially unconstitutional restriction on 1st Amendment speech, because it prevents lawyers from advising clients to take lawful actions and extends beyond considerations of abuse to prevent advice to take prudent actions; court need not decide whether strict or lenient scrutiny test[15] applies, since **526(a)(4)** does not pass even the lenient test; however, the **527** disclosures are not unconstitutionally compelled speech; **527** advances a sufficiently compelling government interest in attempting to ensure clients are given certain basic bankruptcy information, and the disclosures do not unduly burden either the attorney-client

[15] Traditionally, courts subject content-based restrictions on speech to strict scrutiny. Strict scrutiny requires the regulation of speech to be (1) narrowly tailored to promote (2) a compelling government interest. **In re Hersh**, 347 B.R. at 24. Ethical regulations are subject to a lesser standard, known as the **Gentile** balancing test, or more lenient standard. **Gentile v. State Bar of Nev.**, 501 U.S. 1030 (1991). This test involves balancing whether the regulation (1) serves the state s legitimate interest in regulating the activity in question and (2) imposed only narrow and necessary limitations on the lawyer s speech. **In re Hersh**, 347 B.R. at 24. In **Hersh**, the court rejected the U.S. Attorney s argument that the **DRA** provisions were only ethical regulations.

relationship or the ability of a client to seek bankruptcy.[16] The Court also rejected the Debtor s attorney s argument that these provisions violate the 5th Amendment right to counsel; the attorney has no standing to raise this issue on her client s behalf).

***526(a)(4) Facially Unconstitutional, Adopting Hersh; 526(a)(1), 527, 528 Not Unconstitutional*: Olsen v. Gonzales**, 350 B.R. 906 (D. Ore. 2006), motion for summary judgment granted 368 B.R. 906 (D. Ore. 2007) (declaratory judgment action brought by two bankruptcy attorneys and nonbankruptcy attorney on facial challenge to constitutional of **DRA** provisions; Court adopts **Hersh** analysis that **526(a)(4)** facially violates 1st Amendment; notes in addition that **526(a)(4)** is both over-inclusive, and under-inclusive; since the definition of **DRA** excludes non-profits, debtors can still obtain the advice that suggests the abuses the regulation was designed to prevent; court rejects argument that **526(a)(1)** unconstitutionally chills speech by subjecting attorneys to sanctions for failing to perform services that the **DRA** informed the assisted person it would provide; courts should interpret this section to not require attorneys to perform ill-advised or unethical services, and as as-applied challenge fails where the statute can be interpreted in a way that does not violate the constitution; **527** not unconstitutional for reasons specified in Hersh; **528** not unconstitutional facially under four-prong intermediate scrutiny commercial speech test[17]; it is not illegal or misleading for an attorney to advertise that he helps people file for bankruptcy relief under the bankruptcy code and that the attorney is a **DRA**; the forced inclusion of **DRA** gives consumers more accurate information to better determine what type of **DRA** they may require; court also rejects challenge that all **DRA** provisions are unconstitutionally vague; attorneys lack standing in facial challenge.

***524(a)(6), 528(a)(4) and 528(b)(2) Unconstitutional*: Milavetz v. United States**, 355 B.R. 758 (D. Minn. 2006) (action brought by bankruptcy attorneys, their law firm, and two unnamed members of the public; two unnamed members ordered to be named or would be dismissed; strict scrutiny test applies to **526(a)(4)**; **526(a)(4)** violates 1st Amendment as applied, and therefore declines to consider whether it is unconstitutionally vague and overbroad; **528(a)(4)** requirement that DRA include the We are a debt relief agency. We help people file for bankruptcy... fails the intermediate scrutiny test; it does not advance the government interest of clarifying bankruptcy service advertisements; it is a legislative contrivance which increases confusion; it is also not narrowly drawn since it broadly regulates absolutely truthful advertising throughout an entire field of legal practice.

***Adopts Milavet as to pro bono lawyers*: In re Reyes,** 361B.R. 276 (Bankr. S.D. Fla. 2007)

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[16] The **Hersh** court rejected the debtor s argument that some of the **527** disclosures are false or misleading, noting that in an area of law as intricate as bankruptcy, a generalized statement may often require further explanation, and nothing in **527** prohibits that. **In re Hersh**, 347 B.R. at 27.

[17] The four-prong intermediate scrutiny commercial speech test applies to professional services advertising cases. **Olsen v. Gonzales**, 350 B.R. at 919. The first prong requires the court to determine whether the expression is protected by the 1st Amendment right to commercial speech, which requires the expression at issue to propose a commercial transaction that is not unlawful or misleading. The second prong requires a court to ask whether the government has a substantial interest. If both inquiries are positive, then the third and fourth prongs look to whether the regulation directly advances the governmental interest asserted and whether the regulation is narrowly drawn. **Id**.

(adopts **Milavetz;** attorneys are not **DRAs** and 526, 527, 528 unconstitutional; even if constitutional, DRA provisions do not apply to pro bono lawyers since bankruptcy assistance requires the giving of money or other valuable consideration; fact that pro bono attorney gets credit under bar program for pro bono representation does not constitute valuable consideration).

526(a)(4) Unconstitutional; U.S. Trustee En oined From En orcing Against the Debtor Attorney-Plainti **: Zelotes v. Adams,** 352 B.R. 17 (D. Conn. 2006), motion to reconsider denied 363 B.R. 660 (D. Conn. 2007).

ISSUE # 3: Where the Rubber Hits the Road: How Are the DRA Penalty Sections Being Applied?

526(a)(2) Implicated in Undue Hardship Determination in Rea irmation Agreements**: In re Mendoza**, 347 B.R. 34 (Bankr. W.D. Tex. 2006) (in discussing the attorney s declaration in **524(k)(5)**[18] the Part C Certification by Debtor s Attorney that, inter alia, the agreement does not impose an undue hardship on the debtor**,** the court notes in *dicta* that **526(a)(2)** prohibits a **DRA** from making any statement in a document filed in a case or proceeding that is untrue or misleading, or that upon the exercise of reasonable care should have been known by the **DRA** to be untrue or misleading; the court states that an attorney who certifies a debtor s ability to make a reaffirmation payment when the debtor s monthly income less expenses leaves the debtor with not enough money to make the payment has been negligent or at the least, did not exercise reasonable care to assure that his certification was not untrue or misleading); *See also* **In re Wilson,** 363 B.R. 220 (Bankr. D. N. Mex. 2007) (court discusses standards for when to approve reaffirmation agreements and/or set hearings when debtor s counsel doesn t sign or the undue hardship box is checked; noting that creditors lawyers had appeared to be pressuring debtors counsel to certify something that was not true, which would violate **526(a)(2)**)

I DRA, Then No Attorney Client Privilege? **In re Norman**, 2006 Bankr. LEXIS 2925 (Bankr. E.D. Va. Oct. 24, 2006) (Chapter 13 trustee objected to confirmation on grounds that because debtor refused to turnover initial consultation and engagement letters from his attorney, the trustee couldn t determine feasibility; court rejects debtor s argument that trustee no standing to enforce the **DRA** provisions; by extrapolating the language and purpose of **527**, which states that any information the debtor provides during the bankruptcy process may be audited, it would follow that information regarding counsel s compensation can also be audited and verified; consequently, the debtor cannot have any reasonable expectation of privacy as to the contents of these documents when the disclosure of their contents if required under the Code ; investigating the letters falls within the trustee s power to investigate the debtor s finances.)

Fees Reduced or Debtor s Attorney s Failure to Provide Clear Fee Agreement to Debtor Under 528(a)**: In re Robinson**, 368 B.R. 492 (Bankr. E.D. Va. 2007) (Debtor s attorney filed fee application in Chapter 13 seeking $16,000+ in additional fees and stating that the award of

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18 **Section 524(k)(5)(A)** states that the attorney is to file a certification to the following effect: I hereby certify that (1) this agreement represents a fully informed and voluntary agreement by the debtor; (2) this agreement does not impose an undue hardship on the debtor or any dependent of the debtor; and (3) I have fully advised the debtor of the legal effect and consequences of this agreement.

the fees would not render the plan unfeasible and that fees would not prejudice other creditors; debtor and trustee objected; debtor argued she was never informed there would be additional fees and not provided a copy of the fee contract; trustee noted that the award would render plan unfeasible; court notes that attorney s statement that additional fees would not render plan unfeasible was a false statement prejudicial to creditors in violation of **526(a)(2)**; also, the single, visually dense, small-type, 902 word paragraph fee agreement was incomprehensible and internally inconsistent and did not constitute a clear fee agreement required under the spirit of **528(a)(1)** and **(2)**; court substantially reduces fees as penalty debtor had admitted she was ably represented and was not asking for complete disallowance).

***Attorney Ignorance of BAPCPA Re uirements is Negligence Punishable Under DRA Provisions*: In re Gutierrez**, 356 B.R. 496 (Bankr. N.D. Cal. 2006) (Debtor retained bankruptcy attorney under legal services plan; debtor lied to attorney about marital home having no value; transferred home to nonfiling spouse the day after the consultation and didn t advise attorney; after trustee discovered asset, avoided transfer and administered asset, debtor s attorney moved to withdraw; debtor objected that attorney had violated the **DRA** provisions and as a condition of withdrawal, requested disgorgement; although court rejects debtor s arguments that the nondisclosure was the attorney s fault or that attorney made misleading statements, court finds that finds that attorney negligently failed to provide the **Truthfulness Statements** and a written fee contract, and thus violated **527(a)(2)** and **528(a)(1) & (2)**; debtor s attorney fee disgorged plus required to pay debtor s new attorney s fees in prosecuting the motion). **NOTE:** The court noted there was no evidence that attorney s failure to comply was intentional; this was also the attorney s first case under BAPCPA; however, it appeared to court that attorney made little or no attempt to determine what new obligations were imposed by BAPCPA; if attorney was unaware despite publicity or not paying sufficient attention to the fundamental changes, he should not have been representing a debtor, and therefore the court concluded he was negligent.

***Attorney Incompetence Punishable Under DRA Provisions*: In re Irons**, 379 B.R. 680 (Bankr. S.D. Tex. 2007) (debtor s case was automatically dismissed for failure to timely file schedules, statements and pay advices; debtor argued it was his counsel s fault. Court notes that schedules and statements were chock full of inaccuracies and inconsistencies; the Form B22C lists no income although pay advices were filed and Schedule I projects income; plan proposes to pay the mortgage through the plan yet it is listed on Schedule J; court finds it is apparent that documents were not filed with the diligence required of a chapter 13 debtor or his counsel ; court sets further hearing to determine what relief to award in the case, including an injunction against debtor s attorney.)

***Attorney Participation in Bad Faith Filing Punishable Under DRA Provisions*: In re Casavalencia**, 389 B.R. 292 (Bankr. S.D. Fla. 2008) (court finds that debtor s chapter 13 bankruptcy filing was a deliberate abuse of the bankruptcy system and filed for improper purposes; debtor defrauded four individuals in investment scheme; failed to list a property being foreclosed and a BMW being repossessed in his schedules; listed himself as single even though he was married; court finds that no reasonable or responsible lawyer could have filed a petition and schedules so replete with misstatements (these 3?) if that lawyer had done anything approaching the reasonable inquiry requirements; sanctions and attorney fees awarded against debtor s attorney under **526(a)(2)** and attorney enjoined. **NOTE:** It is not clear from the

opinion why the judge believed the lawyer should have known about the 3 misstatements in the schedules and statements; the real issue seems to be that the debtor was a bad actor and didn t deserve to file chapter 13; the lawyer was punished because the petition was filed. This case is a warning to attorneys who represent bad actors.

ISSUE # 4: Are There Are Silver Linings to this Cloud?

The DRA Provisions Help our Argument For Increased Attorney Fees: **In re Chapter 13 Fee Applications**, 2006 Bankr. LEXIS 2710 (Bankr. S.D. Tex. Oct. 3, 2006) (mentioned as one of reasons to increase Chapter 13 fees); **In re McNally**, 2006 Bankr. LEXIS 1712 (Bankr. D. Colo. Aug. 10, 2006) (same).

The DRA Hammer Used Against Ban ruptcy Petition Preparers**: In re Langford**, 2005 Bankr. LEXIS 3201 (Bankr. M.D. N.C. Nov. 9, 2005) (bankruptcy petition preparers argue they are not engaged in the unauthorized practice of law due to new legal-type duties imposed on them under the **DRA** provisions; court rejects argument); **In re Barcelo**, 2005 Bankr. LEXIS 2148 (Bankr. E.D.N.Y. Oct. 24, 2005) (stipulation reached with We The People to set the parameters of their bankruptcy petition preparer practice in compliance with the **DRA** provisions).

III. THE MORTGAGE MELT-DOWN AND ETHICAL ISSUES[19]

Introduction

The exuberant and irrational mortgage lending during the last several years, which is largely blamed for much of the current credit crisis is also the source of a number of interesting and difficult dilemmas faced by debtor and creditor counsel. Recently, a number of cases have dealt with the issues stemming from the mortgage meltdown. One of the bigger problems is mortgage/deeds of trust being prepared and recorded with the wrong address or no address, being recorded late, or not being recorded at all. Other situations involve trying to identifying the mortgage holder after mortgage loans are packaged, sold, resold, and sent to a mortgage servicer, who may or may not also own the mortgage.

1. As counsel for a creditor --
   a. What can you take on faith from your client?
   b. How much back-up documentation must your client provide to prove to you or prove to the Court that it is the mortgage holder?
   c. What possible sanctions do you face if your representations to the Court are wrong?

2. As debtor's counsel --
   a. How much can you rely on what your client tells you?
   b. Should you run a title report on every piece of real estate that your client

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[19] Prepared by Howard S. Smotkin, with additional sources, noted below.

owns?

c. Should you examine the recorded deed of trust on every piece of real estate your client owns?
d. How much due diligence can your client afford?
e. How much due diligence can you afford not to do?
f. Is your client better off with a mortgage or without a mortgage when they file bankruptcy?
g. How aggressive should you be in pursuing a creditor's wrongful conduct?

The cases discussed below provide a summary of recent cases where courts have wrestled with these issues and provides insight into how to perhaps deal with these troubling situations. Conversely, some cases are instructive on how not to deal with these conundrums. It is interesting to note that in a number of the cases it is difficult to determine whether there were outright efforts to deceive the Court. More often than not, it appears that the problems resulted from the massive volume of mortgages, laziness, sloppy record keeping, and a general lack of diligence on the part of counsel. In other case however, it is relatively clear that the motives were far more sinister.

Case Review[20]

Mortgage Avoided Due to Erroneous Legal Description

***In re Stradtmann - Ameriquest Mortgage Company vs. Stradtmann et al.*, 391 B.R. 14, 2008 Bankr. LEXIS 1913 (B.A.P. 8th Cir. 2008).**

Debtors obtained a mortgage from Ameriquest. The mortgage correctly recited the address of the property, but the legal description related to an entirely different property. Subsequently, the IRS filed liens against the real estate. After the debtors filed bankruptcy, Ameriquest requested and obtained relief to pursue a state court action to reform the mortgage. As part of its motion for relief, Ameriquest acknowledged that it could not foreclose due to the problem with the legal description.

After Ameriquest filed the state court action, the Chapter 7 Trustee successfully removed the action back to the bankruptcy court to avoid Ameriquest s lien. The IRS also sought a ruling that its lien primed Ameriquest's mortgage. The Chapter 7 Trustee and IRS prevailed over Ameriquest, with the IRS being granted a first lien position. On appeal the 8th Circuit BAP affirmed finding that the defective legal description did not provide adequate notice of Ameriquest's interest in the property.

Mortgage Avoided Due to Delinquent Perfection During Preference Period

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[20] A substantial portion of the case review material in this section was originally prepared by Catherine V. Eastwood, Esquire, Partridge Snow & Hahn LLP, 2364 Post Road, Warwick, RI 02886 (401) 681-1900/(401) 681-1910 FAX, cve@psh.com, for a presentation at the ABI Northeast Bankruptcy Conference on May 2, 2008, titled, Messing With Mortgages: Continuing Consumer And Creditor Confusion. We gratefully acknowledge Ms. Eastwood's consent to use her material as part of this program.

***In re Marlene H. Schwartz -- Randall L. Seaver, Trustee vs. Mortgage Electronic Registration Systems, Inc. et al.,* 383 B.R. 119, 2008 Bankr. LEXIS 502 (B.A.P. 8th Cir. 2008).**

Debtor obtained a first and second mortgage on January 13, 2005, but neither mortgage was recorded until February 24, 2005. Less than 90 days after recording, the debtor filed bankruptcy. The Trustee successfully filed an action to avoid the first and second mortgages and an award of the value of the property transferred to each lender.

The interesting aspect of this case was that it was at the height of the mortgage frenzy. By the time the Trustee filed his action to avoid the preferences the debtor had already refinanced the property post-petition. Consequently the bankruptcy court and the BAP had to determine whether the post-petition financing had any impact on the Trustee's avoidance action or right to recover the value of the preferences; it did not.

Sanctions for Failing to Identify the Real Party In Interest

***In re Jacalyn S. Nosek - Nosek v. Ameriquest Mortgage Company et al.*, 386 B.R. 374, 2008 Bankr. LEXIS 1251 (Bankr. D. Mass. 2008)**

On April 25, 2008, Judge Rosenthal issued an memorandum of decision regarding an order to show cause why sanctions should not be imposed in the ***Nosek*** case. Ameriquest maintained throughout a prior adversary proceeding and bankruptcy case that it was the holder of the note and mortgage. When the debtor tried to attach funds held by two Chapter 13 Trustees to effect payment on the judgment issued in the prior case, Ameriquest argued it was merely the servicer of the loans and that it was not the owner of the funds sought to be collected. **The Court noted that Ameriquest and its attorneys had made misrepresentations to the court throughout the prior proceedings regarding its status as note holder.** Wells Fargo, NA as Trustee for Amresco Residential Securities Corp. Mortgage Loan Trust, Series 1998-2 was the real holder of the note. The Court issued a show cause why sanctions should not be imposed in light of the misrepresentations and to determine if the misrepresentations were indicative of very sloppy practice at best or an intentionally deceptive practice at worst.

After hearing the matter, the Court dismissed Ameriquest s arguments that the Debtor had knowledge of the real note holder as the assignment of mortgage was recorded with the Registry of Deeds, that it was industry practice for an original note holder to take back a note when a borrower defaulted and that it, as servicer, was allowed to proceed in its name pursuant to the Pooling and Servicing Agreement. Ameriquest was sanctioned **$250,000** for its misrepresentations. The local law firm and one of its partners was each sanctioned **$25,000** because the firm had institutional knowledge of the actual identity of the holder of the note. Ameriquest s national counsel was sanctioned **$100,000** for its failure to probe the information given to it by the lender. Finally, Wells Fargo was sanctioned **$250,000**. The Court stated that a note holder cannot hide behind the Pooling and Servicing Agreement and try to bifurcate the benefits of the note, namely its right to receive repayment of the loan, from all responsibilities associated with servicing and collecting payments. Total sanctions in this case aggregated a whopping **$650,000.**

Sanctions for Inaccurate Financial Information

***In re Parsley*, 384 B.R. 138, 2008 Bankr. LEXIS 593 (Bankr. S.D. Texas 2008)**

Along with the drastic increase in foreclosures and bankruptcy filings came an influx of motions for relief from the automatic stay. In ***Parsley***, Judge Bohm asked counsel why a motion from relief from stay was being withdrawn. The lawyer s answer resulted in two show cause orders. The real answer should have been that the motion for relief was filed in error due to an erroneous payment history. Unfortunately, counsel incorrectly represented to the Court that it was a good motion, which set off an explosion, leading to evidence of other misrepresentations.

In this case, Countrywide Home Loans referred a motion for relief from stay to its national counsel who in turn referred the matter to local counsel. Testimony of associates employed by the national counsel revealed confusion over who the actual client was and who the attorney in charge was. Further investigation revealed that only national counsel was permitted to speak to Countrywide but that national counsel was not required to monitor post-petition payments. **The Court expressed concern that local counsel could not comply with Fed. R. Bankr. P. 9011 with respect to checking the financial information contained in the motion under this arrangement.**

The Court also inquired about charging legal fees to the borrower in situations where the motion for relief was improperly filed. Countrywide testified that a review of fees would be done at the time of the bankruptcy discharge to classify whether the fees were recoverable or non-recoverable. The judge expressed disdain for this procedure and had high doubts that the classification would ever take place. Testimony also revealed that the payment histories were prepared by paralegals and were not reviewed by any attorneys. Countrywide did not review the loan histories either. No one was catching the errors under this system. Judge Bohm wrote **what kind of culture condones its lawyers lying to the court and then retreating to the office hoping that the Court will forget about the whole matter**. Ultimately, no sanctions were imposed by the Court as the firms and Countrywide vowed to mend their broken practices.

***In re Allen*, 2007 Bankr. LEXIS 2063 (Bankr. S.D. Texas 2007)**

In an earlier matter, also in the Southern District of Texas, the Court sanctioned a law firm **$75,000** for filing an objection to a plan and a subsequent withdrawal of the objection that was deemed to be gibberish. It was clear to the Court that the pleadings were not being reviewed by an attorney after being generated by a computer because the objection listed reasons that were completely unrelated or blatantly opposite the contents of the Chapter 13 plan filed by the debtor. The Court s decision recited a string of prior violations of Fed. R. Bankr. P. 9011 involving the law firm. Moreover, the Court previously sanctioned the firm **$65,000**. The **$75,000** sanction was reduced from **$150,000** due to significant measures undertaken by the law firm to prevent the mistakes from reoccurring.

***In re Schuessler*, 386 B.R. 458, 2008 Bankr. LEXIS 1000 (Bankr. S.D. NY. 2008)**

Last April, in the Southern District of New York, Judge Morris issued a decision regarding an order to show cause why Chase Home Finance, LLC should not be sanctioned for submitting pleadings that were misleading and had no factual support. Chase filed a motion citing minimal payment defaults with no recitation of the large equity cushion in the real estate. The motion also left out pertinent facts regarding Chase s refusal to accept a payment at a branch office. **The Court stated that the decision was intended to serve as a warning to all creditors that the conduct of the mortgage servicer constituted an abuse of process and that a creditor s inattentiveness can be just as abusive as an intentional act of misconduct.** ***Schuessler***, at 464. The order did not impose monetary sanctions on Chase, other than payment of the debtor s legal fees and the disallowance of any charges to the debtor s account resulting from the motion to lift stay. The Court also denied the motion to lift stay. The Court intended the case to be a warning to all creditors. ***Schuessler,*** at 465.

Mortgage Fees

***Countrywide Homes Loans, Inc. f/k/a Countrywide Funding Corp.*, 384 B.R. 373, 2008 Bankr. LEXIS 1023 (Bankr. W.D. PA. 2008)**

In an unprecedented move, Judge Agresti, in April 2008, approved the Justice Department s further investigation of Countrywide due to widespread allegations that the lender is filing false or inaccurate claims, misapplying funds, assessing unreasonable fees to borrowers accounts or ignoring the discharge injunction and other court orders.

This matter was precipitated by a Standing Chapter 13 Trustee in Pennsylvania originally filing for sanctions against Countrywide due to her experience with the lender not cashing disbursement checks exceeding $500,000 that her office had sent to Countrywide for application to various borrowers accounts. She surmised that the lender would have assessed late charges and legal fees to the borrowers account since the accounts would appear to be delinquent.

During the investigation by the Standing Chapter 13 Trustee in the matter of ***In re Hill***, Docket #01-22574, Chapter 13 (Bankr. W.D. PA 2007), Countrywide produced letters indicating an escrow change in the debtor s payments, which led to the debtor owing money to the lender at the conclusion of her Chapter 13 plan. Unfortunately for Countrywide, the dated letter listed a mailing address for debtor s counsel, which counsel did not occupy until a year later. Countrywide ultimately conceded that it recreated the letters to show the amount of the mortgage payment that would have been due at various times during the Chapter 13 case and was not admitting the letters as evidence that the letters were actually sent. The ***Hill*** case was one of hundreds in Pennsylvania demonstrating that the Chapter 13 Trustee had legitimate concerns regarding Countrywide s practices.

The Pennsylvania matters led the United States Trustee s Office to file similar suits in Georgia[21]

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[21] The United States Trustee s Office filed a complaint on February 28, 2008 styled as ***Walton v. Countrywide Home Loans, Inc***., 08-06092-mhm in the Northern District of Georgia. The related bankruptcy case is ***In re Atchley***, 05-79232-mhm. In ***Atchley***, the homeowners eventually sold their home to avoid foreclosure but believe the payoff amount cited by Countrywide contained excessive fees and that Countrywide continued to accept

and Ohio[22] seeking to investigate the servicing practices of Countrywide. Various subpoenas have also been served by the United States Trustee s office upon Countrywide in Florida regarding the assessment of fees on borrower s accounts.

***In re Dorothy Stewart Chase*, Docket 07-11113, Chapter 13 (Bankr. E.D. LA 2008)**

Other lenders are also assessing fees to borrowers account without telling the borrowers. In reaction to the assessment of unwarranted fees and charges to an elderly debtor s loan, Judge Magner issued a 49 page decision on April 10, 2008 **ordering Wells Fargo to audit every proof of claim it filed in the district since April 13, 2007 and to provide a complete loan history on every account.** If the audits reveal additional concerns, the judge reserved the right to appoint experts to do forensic accountings at the expense of Wells Fargo. She also ruled that Wells Fargo was negligent in the loan servicing of Ms. Chase s loan and assessed damages of **$10,000,** legal fees of **$12,350** and sanctioned Wells Fargo **$5,000** for filing a consent order that did not reflect the agreement of the parties and for filing erroneous proofs of claim.

***In re Jones*, 2007 Bankr. LEXIS 2984 (Bankr. E.D. LA. 2007), Affirmed in part and reversed in part by, Remanded by: Wells Fargo Bank, N.A. v. Jones, 2008 U.S. Dist. LEXIS 63160 (E.D. La. July 1, 2008)**

In ***Jones***, Judge Magner sanctioned Wells Fargo **$67,202.45** for violating the order of confirmation and the automatic stay by improperly assessing the debtor s loan with fees of $16,852.01 and diverting payments made by the Chapter 13 Trustee and the Debtor to satisfy fees that had not been authorized by the Court. The judge stated that the ***Jones*** case would provide guidance in the post-petition administration of home mortgage loans to a degree that, until this decision issued, had been lacking in the industry. To avoid additional monetary sanctions, Wells Fargo agreed to revise its post-petition practice in all loans administered in the Eastern District of Louisiana and was ordered to implement and use accounting procedures set forth in the decision.

However, surprisingly, on appeal to the District Court, Wells Fargo, in its 146 page brief, disputed that it consented to the accounting procedures despite this exchange between Wells Fargo and the Bankruptcy Judge:

> MR. RUMAGE: [Wells Fargo] really want[s] to try and make sure that this does not happen again in the future. They really -- and Ms. Miller [corporate representative] is here to testify if the Court wants her testimony. **They are prepared to implement these accounting procedures,** to audit every account before the discharge, to make sure that they are doing everything that they possibly can to make sure that they are in compliance with the Court's order.

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trustee payments after the loan was paid off.

[22] The United States Trustee s Office filed a complaint on February 28, 2008 styled as ***Fokkena v. Countrywide Homes Loans, Inc.***, 08-05031-mss in the Northern District of Ohio. The related bankruptcy case is ***In re O Neal***, 07-51027. In ***O Neal***, Countrywide filed a proof of claim and objection to plan when it had already accepted a short sale on the property prior to the bankruptcy filing.

> THE COURT: Are they willing to enter into a **consent order** on those terms?
>
> MS. MILLER: Yes.
>
> MR. RUMAGE: Yes, Your Honor.
>
> MS. MILLER: Yes, Your Honor.
>
> THE COURT: Okay. Because that would at least give me something to enforce in the future if there was a problem in the future. Okay.

Jones at 2008 U.S. Dist. LEXIS 63189.

The District Court, clearly unhappy with Wells Fargo, disregarded most of its points on appeal and noted that some were borderline frivolous. The District Court noted that **the Bankruptcy Court clearly had authority to impose punitive damages** because it found Wells Fargo's behavior to be egregious. ***Jones*** at 2008 U.S. Dist. LEXIS 63184. Consequently, it remanded with respect to the issue of the accounting procedures and whether the Bankruptcy Court could impose such procedures based on the record on appeal.

One is left with the distinct impression that Wells Fargo may have been better off to live with the Consent Order. On remand it would not be surprising to see a SIZABLE punitive damage award in lieu of the accounting procedures.

Conclusion

Excess frequently breeds sloppy and reckless behavior. The overheated mortgage and real estate market of the last several years is a case in point. Mortgage lenders making loans at breakneck speed now find themselves victims of their own overzealous lending practices and inability to manage their own affairs. The result is that once reputable companies now must tread lightly where they ruled before. The 1000 pound gorillas are on the endangered species list.