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Straight & Narrow

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Ethical Ambiguities on the Front Lines of Consumer Representation

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Those who represent consumer debtors face many potential ethical issues, as varied as the clients who seek help. This article will address several common scenarios.

Unbundling

One day, Lawyer Jones[1] is contacted by a potential client who is facing several potential civil suits alleging fraud. Like many practitioners, Lawyer Jones has ample bankruptcy expertise, but relatively little litigation experience. Moreover, he is not sure whether the client can afford to pay extra for dischargeability litigation, should it come to that. Lawyer Jones appears to have the following options: (1) represent the client in regards to his chapter 7 filing, but expressly exclude any discharge and/or dischargeability litigation in the letter of engagement and on the Rule 2016(b) statement; (2) help the client secure representation from another lawyer for such matters; (3) agree to handle whatever matters come up in the case and just hope for the best; or (4) decline to handle the entire bankruptcy case.

"Unbundling" is not *per se* prohibited, as long as any limitation on the scope of representation is consistent with the applicable rules of ethics and professional responsibility.[2] The client must give informed consent to any such limitation; therefore, the attorney must clearly explain the bankruptcy process and what results could occur in proceedings in which the debtor is not represented.[3] Local bankruptcy rules frequently specify aspects of the case that a lawyer must perform, such as preparing and filing all schedules, lists and other required documents, representing the debtor at the § 341 meeting, amending schedules and statements to comport with developments in the case, reaffirmation agreements and motions to redeem personal property.[4]

If allowed by local rules, an attorney can exclude discharge litigation in writing at the commencement of his/her representation. If local rules or standing orders include discharge litigation in the list of required services, the attorney may want to enter into an hourly fee agreement with the client. The fee agreement should specify that the representation is not a fixed-fee agreement and that an upfront retainer will be applied to expenses and services that are rendered during the course of representation so that the attorney may appropriately bill by the hour in the event of discharge/dischargeability litigation. The agreement should also state that the attorney may withdraw from representation if bills are not timely paid. Of course, any such withdrawal is done with the court's permission, and the attorney must anticipate that the court could refuse to allow withdrawal if litigation has commenced.[5]

Fee-Only Chapter 13 Cases

Assume that a prospective client is facing imminent home foreclosure or wage garnishment, and is looking for bankruptcy relief. Although the client readily qualifies for a chapter 7, she does not have the money to pay the attorneys' fees. On the other hand, as her monthly income exceeds the income guidelines to qualify for *pro bono* representation, she could afford to pay the fees in installments over time. In a situation like this, the client and attorney might consider a fee-only chapter 13, under which the sole payment made by the debtor is the attorneys' fee. Since it is a chapter 13

1 Lawyer Jones is a fictional example created by the authors.
2 *Dignity Heath v. Seare (In re Seare)*, 493 B.R. 158, 176 (Bankr. D. Nev. 2013).
3 *Id.* at 197-203 (determining counsel's obligations under the Nevada Rules of Professional Conduct).
4 *See, e.g., In re Ortiz*, 496 B.R. 144, 151 (Bankr. S.D.N.Y. 2013) (discussing examples of required services in New York federal courts).
5 *Danvers Savs. Bank v. Cuddy (In re Cuddy)*, 322 B.R. 12, 19 (Bankr. D. Mass. 2005) (failure to replenish fee retainer does not constitute "cause" allowing attorney to withdraw during chapter 7 case).

case, the legal fees will be significantly higher than if the case was filed under chapter 7.

Even if there is not a *per se* rule against such plans, a fee-only chapter 13 case will receive very high scrutiny, and there is a high probability that a bankruptcy court will refuse to confirm the plan. For example, the Eleventh Circuit recently affirmed a bankruptcy court's finding that the debtor's 36-month chapter 13 petition and plan were filed in bad faith where a chapter 7 case would clearly have been in the client's best interest; only the bankruptcy attorney benefited from the chapter 13 filing, and the debtor was likely to default in his chapter 13 case (after the attorneys' fee installments had been paid) and not end up with a discharge.[6]

The appeals court found it important that the bankruptcy court did not have a *per se* rule, noting that the same bankruptcy court had approved a 60-month "attorney-fee-centric" fee plan in another case where the creditors received a substantial distribution, even though the debtor in that case would likewise have qualified for discharge under chapter 7.[7] Other courts have reached similar results.[8]

Lien-Stripping in Chapter 7 Cases

In a hypothetical scenario, Ms. Smith requires relief from substantial credit card debt. She is current on the first mortgage on her principal residence but is at least 18 months behind on a second mortgage held by a private lender. The value of Ms. Smith's residence is at least $20,000 less than the balance of the first mortgage. She has no monthly disposable income on her B-22 or monthly net income on her Schedule I/J, so chapter 13 relief is not available.

Ms. Smith has a limited budget, but as the attorney, you are thinking about the possibility of suggesting that the client propose to strip off the second mortgage, even though you know that the majority of relevant case law is not favorable. You also know that strip-down by motion would be less expensive but might not be permissible. You want to zealously represent her, but you must be mindful of cost, since you know (1) there is no case law in your jurisdiction on point, (2) the case law from other jurisdictions is not favorable, and (3) from past experience, this private lender will vigorously oppose lien avoidance.

The seminal case on lien avoidance is *Dewsnup v. Timm*,[9] which ruled that the strip-down of an undersecured claim (reducing the amount of the lien to the value of the property that the lien encumbers) in a chapter 7 proceeding is impermissible. Although *Dewsnup* did not address strip-off, which is the removal of a wholly unsecured lien, the logic behind *Dewsnup* would appear to apply equally to partially unsecured claims and wholly unsecured claims because the only difference between the two is the degree of undersecurity.

The only court of appeals decision that has allowed a strip-off in chapter 7 is the Eleventh Circuit in *In re McNeal*.[10] Assuming that your jurisdiction has not ruled on the issue, you will need to advise your client that the weight of authority is against her, and litigation may be protracted and expensive. If the client instructs you to proceed but cannot pay, must you seek to withdraw? If so, will a court permit you to do so if lien-stripping is considered a fundamental part of chapter 7 practice in your jurisdiction?

Schedule amendments are typically allowed ... but amending to include information purposefully omitted could be problematic should an inquiry into the reason for the necessity of the amendment arise.

In addition, courts disagree on the proper method — motion[11] or adversary proceeding[12] — to achieve a strip-off in a chapter 7 case. Adversary proceedings are typically more costly and time-consuming than motion practice, and given a limited budget, a motion would clearly be preferable. However, you know that the case law is unsettled on this issue, and if you adopt the wrong procedure, the lien-strip could be invalid.[13] A key touchstone of these decisions is due process for the creditor, so you must employ the procedure that will most likely ensure sufficient notice and opportunity to be heard by the lienholder.

Schedule Preparation

Clients frequently ask which creditors must be listed and which ones may be omitted. Hypothetical client Mr. Xu has debt related to a failed business that has since been closed. He is currently employed in the same field by a business competitor and hopes to be back in business soon, but will have to reestablish credit with his old vendors. Mr. Xu wants to preserve his future business opportunities and requests that you prepare the bankruptcy papers in a way that his business vendors are not notified of the bankruptcy filing. You want to help Mr. Xu achieve all of his goals, so your first thought is to simply omit the creditors entirely since he does not care if the business debt is discharged. However, you are mindful of the importance of preparing schedules correctly. Moreover, what if his business aspirations fail and the discharge of the business creditors becomes important? Will Mr. Xu be permitted to amend the schedules to add the omitted creditors at a later date?

Bankruptcy schedules are signed under the penalties of perjury.[14] False oaths may result in criminal prosecution[15] or discharge denial,[16] and omitted creditor claims may not be dischargeable.[17] Omitting a creditor entirely would seem to

6 *Brown v. Gore (In re Brown)*, 742. F.3d 1309, 1319 (11th Cir. 2014).

7 *Id.* at 1318.

8 *See, e.g., Berliner v. Pappalardo (In re Puffer)*, 674 F.3d 78, 83 (1st Cir. 2012) ("While fee-only plans should not be used as a matter of course, there may be special circumstances, albeit relatively rare, in which this type of odd arrangement is justified."); *In re Pliler*, 487 B.R. 682,703 (Bankr. E.D.N.C. 2013) (although some fee-only plans have been approved, such cases are "highly indicative of bad faith, if not per se bad faith"); *In re Arlen*, 461 B.R. 550, 554 (Bankr. W.D. Mo. 2011) (fee-only chapter 13 cases are "little more than disguised Chapter 7 proceedings").

9 502 U.S. 410, 417 (1992).

10 477 Fed. App'x. 562, 564-65 (11th Cir. 2012).

11 *See* 11 U.S.C. § 506 and Fed. R. Bankr. P. 3012.

12 *See* Fed. R. Bankr. P. 7001(2).

13 *Compare In re Giannasca*, No. 11-19499, 2014 WL 250352, at *1 (Bankr. D. Mass. Jan. 22, 2014) (strip-off requires adversary proceeding), *with Xu v. U.S. Trustee (In re Arebalo)*, No. 10 CV 2025, 2011 WL 133676, at *3 (Bankr. E.D.N.Y. March 31, 2011) (strip-off in chapter 13 might be accomplished by motion).

14 Fed. R. Bankr. P. 1008.

15 18 U.S.C. § 152(2).

16 *See* 11 U.S.C. § 727(a)(4)(A) (providing that discharge might be denied if debtor "knowingly and fraudulently" made false oath).

be fraught with risk for Mr. Xu. As a backup plan, could Mr. Xu list the names of each business creditor on his Schedule F, but exclude the corresponding addresses?

Section 521 of the Bankruptcy Code lists the debtor's duties in a bankruptcy case, including preparation of "a list of creditors" and "a schedule of liabilities."[18] The Code provides no further guidance regarding the contents of the "list" or the "schedules." However, several courts, while acknowledging that § 521 is silent on the point, have nevertheless concluded that § 521 requires a proper deliverable address where the creditor is destined to receive appropriate notice.[19] Bankruptcy Rule 1007(a)(1) and (2) provide that in voluntary or involuntary cases, the debtor "shall file with the petition a list containing the name[s] and address[es] of each entity included or to be included on Schedules D, E, F, G and H as prescribed by the Official Forms."[20] The Rules do not modify substantive rights and are merely procedural in nature.[21] The Official Forms include creditor schedules (*i.e.*, Schedules E, F, G and H), and the schedules expressly provide for inclusion of the name *and* address of the creditor.

While the Official Forms do not have the force of law, most courts conclude that the forms should be used and/or that the forms being filed should be in substantial compliance with the Official Forms.[22] In addition, many bankruptcy courts have adopted local rules addressing lists and schedules, typically providing that debtors must include lists of all creditors "and their last known complete addresses."[23] However, § 523 of the Bankruptcy Code provides for nondischargeability of a debt that is "neither listed nor scheduled, *with the name*, if known to the debtor, of the creditor to whom such debt is owed." Section 523 does not seem to require the debtor to list the creditor's addresses, suggesting that if the name of the creditor is listed, that alone may be sufficient to overcome nondischargeability on the basis of failure to "list or schedule" a creditor. However, does this mean that providing a creditor's name alone may suffice for purposes of schedule preparation?

Courts generally recognize that the purpose of requiring debtors to provide the names and addresses of their creditors is to ensure a due-process notice of the bankruptcy filing so that creditors may protect their rights.[24] If the debtor is not seeking to discharge the business debt, and it is clear that the case is a no-asset case such that timely claim filing is not important and the debt is not of a kind specified in sub-paragraph (2), (4) or (6) of § 523(a), listing the name of the creditor would seem to fulfill the debtor's legal obligation under § 521 and achieve the debtor's practical goal of preserving important future business relationships. If preservation of the business relationships becomes unnecessary post-filing, schedule amendments could be sought to ensure dischargeablity. Schedule amendments are typically allowed as a matter of course,[25] but amending to include information purposefully omitted could be problematic should an inquiry into the reason for the necessity of the amendment arise. abi

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17 *See* 11 U.S.C. § 523(a)(3); *see, e.g., Judd v. Wolfe (In re Judd)*, 78 F.3d. 110, 115 (3d Cir. 1996) (in no-asset chapter 7 case, debt is discharged whether listed or not as long as debt is not one described in § 523(a)(2), (4) or (6)). *But see In re Keenom*, 231 B.R. 116, 122 (Bankr. M.D. Ga. 1999) (in deciding whether unlisted debt should be discharged, court must consider reasons for omission).

18 11 U.S.C. §§ 521(a)(1)(A) and 521(B)(i).

19 *Anderson v. Richards (In re Anderson)*, No. 07-1328, 2009 WL 4840871, at *8 (Bankr. D. Mass. Dec. 10, 2009); *U.S. v. Sepell (In re Sepell)*, No. 05-30211, 2007 WL 853842, at *4 (Bankr. S.D. Iowa March 12, 2007).

20 *See Gonsalves v. Belice (In re Belice)*, No. 08-01241, 2011 WL 4572003, at *4 (B.A.P. 1st Cir. March 7, 2011) (when filing for relief, debtor is required to file list of creditors with their names and addresses).

21 28 U.S.C. § 2075 (providing that Rules shall not "abridge, enlarge, or modify any substantive right"); *In re Ryan*, 160 B.R. 494, 496 (Bankr. N.D.N.Y. 1993) ("There is a presumption that the Bankruptcy Rules do not affect substantive rights. This is supported by the language found in 28 U.S.C. § 2075, which provides that 'Such rules shall not abridge, enlarge or modify any substantive right.'").

22 *See, e.g., In re Clausen*, 464 B.R. 827, 830 (Bankr. W.D. Wis. 2011).

23 *See, e.g.*, Mass. Local Bankr. R. 1007-1(a).

24 *See WebMD Practice Sevs. Inc. v. Sedlacek (In re Sedlacek)*, 325 B.R. 202, 212-13 (Bankr. E.D. Tenn. 2005).

25 *See* Fed. R. Bank. P. 1009(a).