Elder Law and Bankruptcy

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BANKRUPTCY AND THE ELDERLY CLIENT

I. Underlying Causes of the Increasing Bankruptcy Among Seniors

40 million Americans are over age 65 – 13% of the population. Ten thousand people turn 65 each day in the US and that number will remain consist through 2030. By 2039, that number is expected to increase to 88.5 million, 20% of the population. According to a recent study by the Mid-America Regional Council, the number of older adults (65 years of age and older) in the Greater Kansas City area is expected to increase by 233,000 between 2010 and 2030, and the older adult workforce will nearly double. Over the next two decades, the number of older adults will increase three times more than any other age group. In combination, this demographic shift implies more than half – 58% - of the regions' entire population growth between 2010 and 2030 will be because of increase in the older adult population (Mid-America Regional Council, 2015).

About 5.3 million Americans have Alzheimer's and that number is increasing. And 70% of people over the age of 65 will require long-term care according to the Department of Health and Human Resource. Thus, seniors will need more help accessing quality health care and advice. Couple that fact with the realities that our society is more mobile resulting in fewer children living close to their parents, more Baby Boomers (both male and female) are working into their late 60s resulting in fewer available caregivers to provide care for aging parents.

Our growing financial and personal care concerns in the Elder Care Continuum include health care costs, housing, financial exploitation, interest and fees on credit cards, mounting debt, outliving our resources and becoming dependent, losing control, job security, protecting current wealth, and our ability to gift or create family legacy. And these concerns are real and potentially devastating *unless* we take steps to avoid the Crisis.

The Rising Tide of Senior Bankruptcy Filings[1]

[1] Much appreciation is extended to Julie Pollock, then UCLA Rosenfield Fellow with the United States Bankruptcy Court for the Central District of California, and her article entitled *Seniors in Bankruptcy*, November 2013 from which portions of the research and this article have been cited,

Older Americans are filing for bankruptcy at alarming rates – a trend that may reflect the eroding financial security of old age in the United States today. Americans are living longer while retiree benefits are shrinking, the cost of health care is increasing, and the housing market remains unstable. While 90% of Americans aged 65 and older receive Social Security benefits, over half of this group has no pension income, and one-third has no retirement savings at all (Radwan & Morgan, 2010).

Within this context, the bankruptcy population in the United States is graying. While younger Americans are less likely to file for bankruptcy today than they were in the 1990's, there has been a marked increase in the filing rates of older adults over the past three decades (Pottow, 2012). Between 1991 and 2007, the rate of bankruptcy filings for those 55-64 years of age jumped 40%, 65-74 years of age jumped 125%, and those 75-84 years of age skyrocketed 433.3% (Throne, Warren & Sullivan, 2009)

In fact, while petitioners aged 65 and older comprised only 2.1% of consumer filers in 1991, they represented 7.0% of the consumer bankruptcy population by 2007, according to data collected by the Consumer Bankruptcy Project (CPB), a national study directed by Elizabeth Warren and Robert Lawless (Pottow, 2012).

Further data gathered by the Institute for Financial Literacy (IFL) shows that this trend has continued in recent years, with seniors constituting 9.1% of the consumer bankruptcy population in 2010 (Linfield, 2011).

The group of Americans aged 55 to 64 has also experienced a sharp increase in consumer filing rates since 1991. According to the CBP, adults 55 to 64 represented 6.1% of consumer filers in 1991, and 15.3% by 2007 (Pottow, 2012). The Institute for Financial Literacy reports that this percentage has continued to grow, reaching a staggering 18.1% by 2010 (Linfield, 2011).

Causes of Financial Distress

Why are so many older adults filing for bankruptcy? Through a survey disseminated by the Consumer Bankruptcy Project in 2007, debtors aged 65 and older listed five primary reasons for filing: (1) interest and fees on credit cards, (2) illness and injury, (3) income problems, (4) aggressive debt collection, and (5) housing problems (Thorne, 2010).

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- Debt, Interest and Fees on Credit Cards

Deregulation of the financial services industry over the past several decades has resulted in rising interest rates on credit cards across the nation, and an increased debt load for many Americans – particularly older adults (McGhee & Draut, 2004). Two Supreme Court decisions, *Marquette National Bank of Minneapolis v. First Omaha Service Corp., 439 U.S. 299 (1978)* and *Smiley v. Citibank, 517 U.S. 735 (1996)*, essentially eliminated state usury restrictions on interest rates, penalties, and late fees for nationally chartered banks (McGhee & Draut, 2004).

As a result, the credit card industry began to employ increasingly unscrupulous practices in the 1990's, including aggressive solicitation to financially vulnerable populations who now disproportionally bear the burden of high interest rates and fees. By 2004, over one-third of households with an income below $10,000 per year owned a credit card (Wheary & Draut, 2007).

These practices may have significantly impacted older adults, who currently carry more credit card debt than their younger counterparts – even though they are less likely to purchase non-essential items through credit (Traub, 2013). In fact, seniors aged 65 to 69 saw a 217% growth rate in credit card debt between 1992 and 2001 (Loonin & Renuart, 2006). Looking specifically at the bankruptcy population, consumer filers aged 65 and over held an average of $22,562 in credit card debt in 2007, as compared to $13,615 for younger debtors (Pottow, 2012).

- Illness and Injury

The average elderly American couple will spend $225,000 in out-of-pocket medical expenses between the ages of 65 and 80 (Thorne, 2010). Medicare does not fully cover the costs of healthcare, and the consequences of poor health can be devastating, even for those with insurance. The rate of bankruptcies caused by medical debt rose nationally from 2001 to 2007, from 46.2% to 62.1% (Thorne, 2010). On average, medical debtors are older than those who file for nonmedical reasons (Thorne, 2010).

Adding to a family's medical expenses is the cost of long-term care: the continuum of services, both medical and non-medical, that individuals often require as they age, including skilled nursing, toileting, bathing, or dressing. Two-thirds of Americans will need long-term care at some time in their lives, at a cost of about $30,000 per year for in-home services, and significantly higher for nursing home care (Radwan & Morgan, 2010).

- Housing

The 2007 Consumer Bankruptcy Project showed that 27% of petitioners aged 65 and older selected "Housing Problems" as a reason for filing (Thorne, 2010). Due to fixed incomes in retirement, older Americans spend a higher proportion of their annual incomes on housing costs than younger individuals (Lipman, Lubell & Salomon, 2012).

Moreover, the foreclosure crisis of 2007 significantly affected older Americans. The percentage of Americans aged 50 and over with serious mortgage delinquency increased by 456% between 2007 and 2011, compared to 361% for Americans under 50 (Trawinsky, 2012). Elders are also three times more likely than the general population to be targeted for sub-prime mortgage loans (McGhee & Draut, 2004).

Conclusion

The demographic shifts in consumer bankruptcy over the past several decades warn of an increasingly tenuous financial landscape for elder Americans today. Given the demographic transitions that will occur as the Baby Boom generation enters retirement, the financial insecurity of older Americans is expected to become increasingly significant in coming years.

The data highlights the economic strain on American families as they grow older, evidenced by a growing presence in the consumer bankruptcy system. According to Thorne (2010), "The increasing rate of bankruptcy filings among our oldest citizens is an ethical issue that we, as a country, must address and reverse. To ignore this social dilemma would be a national disgrace" (p. 203).

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II. Alternatives to Bankruptcy for Elderly and Disabled Persons: Medicaid assistance for long-term care expenses

Medicaid is a welfare program that has layers of sources of law including federal law,[2] regulation,[3] and policy,[4] state law,[5] regulation[6] and policy,[7] and both federal and state case law.[8] Applications for medical assistance with the cost of nursing facility care are submitted to the KanCare Clearinghouse.[9] Medicaid applicants for long-term care assistance must meet a four-part eligibility test.

1. Medical need

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[2] *See* 42 U.S.C. §§ 1396p and 1396r-5; 38 U.S.C. §1501 *et seq*.
[3] 20 C.F.R. §§ 416 *et seq*.; 39 C.F.R. 3.1 *et seq.*
[4] Social Security's Program Operations Manual System (POMS) can be found at: https://secure.ssa.gov/apps10/poms.nsf/aboutpoms
[5] *See* K.S.A. 39-709
[6] K.A.R 30-6-34 *et seq.*
[7] The latest version of DCF's operating policy, the Kansas Economic and Employment Services Manual – KEESM – can be found at: http://content.dcf.ks.gov/EES/KEESM/Keesm.htm
[8] See, for example, *Miller v. SRS,* 275 Kan. 349, 64 P.3d 395 (2003); *Brewer v. Schalansky,* 278 Kan. 734, 102 P.3d 1145 (2004); *White v. Kansas Health Policy Authority*, 198 P.3d 172 (2008); *Brown ex rel. Brown v. Day*, 555 F.3d 882 (10th Cir. 2009).
[9] An applicant can download most of the forms needed for a Medicaid application at http://content.dcf.ks.gov/EES/KEESM/Forms/Formstoc_10-13.html#EE

Nursing home care, whether skilled, intermediate, or custodial, must be the appropriate level of care for the medical assistance applicant. In Kansas, anyone seeking nursing facility care must be assessed to determine whether he or she needs a nursing home level of care – a CARE assessment, and the method for doing that is through the Kansas Dept of Aging and Disability Services.[10]

2. The Income Test

Kansas does not have a specific income limitation for eligibility. Rather, if the Medicaid applicant's countable income is less than the applicant's cost of care at the nursing facility, the applicant meets the income test.[11]

Once a Medicaid applicant becomes eligible for nursing facility assistance, almost all of his income will be used to meet his patient liability (a/k/a "client obligation") amount, among other things, and he will retain only $62 for his personal use.[12] For a single person without dependent minor children, therefore, all of the Medicaid recipient's income would normally be applied to nursing home expenses except the amount he pays in premiums for health insurance – Medicare supplemental insurance and, sometimes, dental[13] – for himself and his $62/month personal needs allowance.[14]

Short Digression . . . *Muir v. Kansas Health Policy Authority*, 334 P.3d 876 (Kan.App., Sept. 5, 2014). Medicaid recipient not permitted to deduct court-ordered child support and maintenance payments from available income.

3. The Resource Test

A Medicaid recipient cannot retain over $2000[15] in available,[16] non-exempt resources. Except for the special Medicaid rules permitting division of assets (married applicants), the resource rules are drawn from the law and regulations governing eligibility for Supplemental Security Income (SSI) which deal with the availability and exempt status of resources.[17] Practitioners can also rely upon the large body of case law in this area for guidance.[18]

a. **Exempt** resources include:

[10] KDADS www.kdads.ks.gov/SeniorServices/FAQ/faq_nf_care.html
[11] KEESM §8172.2
[12] KEESM §8160(2)
[13] But not Part D prescription drug coverage, because a Medicaid recipient is eligible for "zero premium" coverage of Part D.
[14] KEESM §8144.2 (institutional LTC).
[15] KEESM §5130
[16] KEESM §5200(3)
[17] 20 C.F.R. §§416 *et seq*.
[18] For a comprehensive treatment of Medicaid and SSI cases, law, and regulations, see Dayton, Garber, Mead, and Wood, ADVISING THE ELDERLY CLIENT (Thompson/West 2016).

- A home and contiguous acreage valued at less than $528,000.[19] At least for the first 6 months of institutionalization, an applicant is entitled to exempt the home even if there is no real expectation that he or she will be able to return home.[20]

- A car of any value.[21]

- Household goods, tools, personal effects, family keepsakes, memorabilia.[22]

- Life insurance with a face value of $1,500 (regardless of built-up cash value) or less and unlimited term insurance.[23]

- Contract Sales. A contract from the sale of real or personal property is exempt if the property is sold at fair market value, the proceeds are attributable as income, and the income is commercially reasonable.[24]

- Annuities, IF they are irrevocable, actuarially sound, and Kansas Estate Recovery is named as the primary contingent beneficiary (or the secondary contingent beneficiary, if the annuitant is married) if the Medicaid recipient dies before the annuity payments terminate.[25]

- Burial plans.[26] The recipient can have a revocable burial fund set aside up to $1,500 **or** an irrevocable plan up to $7,000, not including the burial plot or mausoleum, headstone or grave marker, or casket.[27]

- Real property, equipment or materials used in an income-producing trade or business.[28]

b. All other resources are **non-exempt**, including, but not limited to:

- Cash, stocks, CDs, mutual funds, savings bonds, etc.

- Fair market value of real estate other than the home and contiguous acreage.

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[19] KEESM §5331.1; the cap on the homestead exemption is not applicable when a spouse or dependent or disabled child resides there. §5331.1(1)(a), (b), and (c).

[20] KEESM §5331.3.

[21] KEESM §5520

[22] KEESM § 5430(12), (18), & (21)

[23] KEESM § 5430(15)

[24] KEESM § 5430(6)

[25] KEESM § 5630 *et seq.;* Section 6012 of the Deficit Reduction Act of 2005.

[26] KEESM § 5430(1)

[27] KEESM § 5430(2) & (9)

[28] KEESM § 5332 & KEESM § 5430(13); 42 U.S.C. §1382b

- Cash value of life insurance policies of which the applicant or the applicant's spouse is the owner (except if the total face value per person does not exceed $1,500).[29]

- Trust property – When owned by a trust, real property is countable, regardless of other potential exemptions.[30]

c. Proper spenddown techniques include:

- purchase of prepaid exempt burial plans for both marital partners;
- pay off or reduce the principal on any loans, including a mortgage;
- any and all improvements and repairs to the exempt home;
- any and all improvements to exempt income-producing property;
- upgrade of exempt family car;
- purchase of a "Medicaid compliant annuity;"
- payment of medical and other expenses for both marital partners; and
- payments to care providers under an appropriate personal services contract.[31]

4. Transfers

Transfers for less than adequate consideration – gifts – may incur eligibility penalties if the transfers took place within 5 years of application for Medicaid assistance. The penalty is calculated by taking the total amount of the gift and dividing that amount by $183.15[32] which produces the number of penalty days. The Medicaid applicant who is *otherwise eligible* is not eligible for Medicaid during a penalty period, which tends to get him or her in hot water with the nursing home.

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[29] KEESM 5430(15)(b)

[30] KEESM 5340 Nonexempt Real Property – [. . .] Trust Property - When placed in a trust, real property is considered.

[31] *See* K.S.A. 39-709(e)((4)

[32] KEESM § 5724.4. The penalty divisor is adjusted quarterly to reflect the average daily cost of nursing facility care in Kansas.

III. Alert! Weighty Impact of the Bankruptcy on Seniors: Too High a Price to Pay?

Older Americans have been swelling the ranks of the consumer bankruptcy system for decades. While in 1991, Americans aged 55 and older comprised only 8.2% of all bankruptcy petitioners, by 2010 this cohort accounted for 27.2% of filers, or nearly one-third of all Americans seeking bankruptcy relief (Linfield, 2011).

As the median age of bankruptcy filers in the United States continues to rise, it's important to consider not only how the older population fares through the bankruptcy process, but also how they recover after bankruptcy. One of the theoretical tenets behind the American consumer bankruptcy system is rehabilitation -- the idea that debtors should be afforded the opportunity to have a financial "fresh start" following discharge (Zargorsky & Lupica, 2008). By allowing individuals to financially re-situate themselves to spend, borrow, and repay money after a bankruptcy, the economy at large will benefit (Zargorsky & Lupica, 2008).

Unfortunately, the notion of a fresh start following bankruptcy remains elusive for many older debtors, who have fewer economically productive years ahead of them to rebuild financially. Researchers from 2001 Consumer Bankruptcy Project (CBP) surveyed Americans one year post-bankruptcy to assess improvement in financial circumstances. Overall, 65% of all debtors interviewed said that their financial circumstances improved following bankruptcy, while 27% said they stayed the same, and 8% said they worsened (Porter & Thorne, 2006). The most reliable indicator of improved financial circumstances post-bankruptcy was found to be -- unsurprisingly -- stability in income (Porter & Thorne, 2006).

Interestingly, as the age of debtors increased, the likelihood that they would see financial improvement after bankruptcy decreased (Porter & Thorne, 2006). In fact, out of all the demographic characteristics measured (including educational level, race, marital status, and dependent children) age was the only factor correlated to poorer financial outcomes post-bankruptcy (Porter & Thorne, 2006).

Older adults who experience job loss spend more time than younger cohorts looking for new employment (Porter & Thorne, 2006). Additionally, seniors are more likely than younger cohorts to experience medical problems,

and the consequences of poor health can be financially devastating, even with Medicare (Thorne, 2010).

In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), a piece of legislation introducing a set of amendments to the U.S. Bankruptcy Code. Through BAPCPA, a means test was instituted to evaluate the incomes of debtors filing under Chapter 7. In Chapter 7 bankruptcy, a debtor's non-exempt assets are surrendered in exchange for a discharge of most debts.

Based on the means test, individuals with incomes above a certain threshold are no longer eligible to file under Chapter 7. In other words, the means test was adopted to shift wealthier debtors, who can afford to repay their creditors, towards Chapter 13 bankruptcy. In Chapter 13 bankruptcy, debtors develop a plan to repay their debts within 3 to 5 years.

Because the means test evaluates current income without taking into account future earning potential, it may put older Americans -- particularly those who are approaching retirement -- at a distinct disadvantage. Older Americans have fewer economically productive years ahead, and are more likely to have decreased future income and increased future expenditures. Those who are funneled towards Chapter 13 based solely on their current income will suffer an even greater reduction in economically productive years after completing the 3 to 5 year repayment plan.

Bankruptcy may not always be the best option for older Americans, as the promise of a fresh start remains highly elusive for many. Improved credit counseling and financial education enumerating the alternatives to bankruptcy would help older debtors make more informed decisions to file. Unless we take heed of the unique financial circumstances of older Americans, the notion of a fresh start in bankruptcy may remain out of reach for many.

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V. Client with Impaired Capacity

Representing older adults in bankruptcy presents ethical issues unlike those faced by many general practitioners. Issues of capacity and "who is the client" are daily circumstances of the bankruptcy law attorney representing the elderly. Given our modern medical advances, it is not uncommon and growing more common that we are faced with clients whose bodies have outlived their minds.

Resources are available to assist the attorney in making an initial assessment of the prospective client and the need for further evaluation of the prospective client's capacity:

"Folstein Mini Mental Status Exam"
https://www.uml.edu/docs/Mini%20Mental%20State%20Exam_tcm18-169319.pdf
Assessment of Older Adults with Diminished Capacity: A Handbook for Lawyers
American Bar Association Commission on Law and Aging
and American Psychological Association
https://www.apa.org/pi/aging/resources/guides/diminished-capacity.pdf

In Missouri, an attorney's ethical conduct is governed by the Missouri Supreme Court's Rules for Governing the Missouri Bar and the Judiciary. Rule 4 sets out the Rules of Professional Conduct applicable to all members of the Missouri Bar. Where Missouri's Rules of Professional Conduct address ethical issues encountered by the bankruptcy law attorney, those Rules, as well as related formal and informal ethics opinions expressed by the Advisory Committee, are required reading and understanding.

The practitioner owes specific duties to "the client" according to the Missouri Rules of Professional Conduct. However, the Rules do not expressly define "client." Thus, identifying who the attorney represents early in the process and communicating that clearly to others involved in assisting the client will help prevent potential ethical dilemmas. Commonly, the attorney will initially consult with a "prospective client" surrounded by the family and friends of the prospective client. Attorneys should be particularly careful when conducting the initial consultation with several family members that she does not receive information from the prospective client that may disqualify the attorney from representing the elderly person.

Typically, the attorney-client relationship is established between the bankruptcy attorney and the elderly person who has capacity. An attorney-in-fact may enter into the attorney-client relationship on the incapacitated person's behalf, if the older person lacks sufficient capacity to enter into the attorney-client relationship. When the attorney-in-fact retains the attorney, the attorney represents the principal and not the agent. Thus, all duties of the attorney are owned to the principal and not to the attorney-in-fact.

V.A.M.S. § 404.710.4 authorizes an attorney-in-fact to retain professionals, including an attorney, to act for the principal. For further analysis, *see*, Dayton, A., et.al., Ethical Issues Arising Under the Model Rules of Professional Conduct, 1 *Advising the Elderly Client* § 3:7 (2009) (attorney-client relationship is that of agent to principal, with the attorney acting in a fiduciary capacity for the principal), *Risbeck v. Bond*, 885 S.W.2d 749 (Mo.Ct.App.S.D. 1994), cert. denied, *Risbeck v. Bond*, 514 U.S. 1110, 115 S.Ct.1963, 63 USLW 3809, 3817 (U.S. Mo. May 15, 1995) (NO. 94-1575) (attorney-in-fact may represent the principal in litigation but may not act pro se on the principal's behalf).

Practitioners may consider draft provisions in durable powers of attorney which specifically provide for an attorney-in-fact filing a bankruptcy proceeding on behalf of the principal:

> **Section ___: Bankruptcy**
> My Attorney-in-Fact may act for me with respect to bankruptcy or insolvency, whether voluntary or involuntary, concerning me or some other person, or with respect to a reorganization, receivership, or application for the appointment of a receiver or trustee that affects an interest I have in any property or other thing of value.
>
> Specifically, and without limiting the preceding, my Attorney-in-Fact may act for me with respect to filing for bankruptcy, and in support of such filing may—
>
> (i) employ counsel to represent me;
> (ii) select any exemptions available to me;
> (iii) determine which debts to reaffirm;
> (iv) make any decisions regarding repayment and reorganization plans;
> (v) discuss my affairs with credit-counseling and debtor-education services;

(vi) discuss my affairs with and employ debt-restructuring services; and
(vii) take any other actions to further my interests.

Confidentiality rules should be discussed during the initial consultation. It is important that the attorney explains that disclosures to third parties waives the attorney-client privilege with respect to the disclosed information.

The duty of confidentiality is owed to the client. Frequently, the older adult may require the inclusion of family members in meetings with the attorney. The attorney should make sure to instruct all concerned that the attorney may communicate with family members only to the extent of the permission given by the client. Communications made in the presence of third parties will waive the attorney-client privilege *unless* the assistance of the third party is necessary to facilitate representation of a client with diminished capacity. Rule 4-1.14 of the Missouri Rules of Professional Conduct addressed the representation of clients with diminished capacity and Comment 3 to the Rule explains that the client may wish to have family members present during meetings with the attorney and that communications conducted in the third-party's presence will not necessarily waive the attorney-client privilege. *See*, Flowers, R., To Speck or Not to Speak: Effect of Third Party Presence on Attorney Client Privilege, 2 *NAELA J.* 153 (2006).

RULE 4-1.14: CLIENT WITH DIMINISHED CAPACITY

(a) When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment, or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.
(b) When the lawyer **reasonably believes** that the client **has diminished capacity**; **is at risk of substantial** physical, **financial** or other harm unless action is taken; and cannot adequately act in the client's own interest, the lawyer may take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a next friend, guardian ad litem, conservator or guardian.
(c) Information relating to the representation of a client with diminished capacity is protected by Rule 4-1.6. When taking protective action pursuant to Rule 4-1.14(b), the lawyer is impliedly authorized under Rule 4-1.6(a) to reveal information about the

> client, but only to the extent reasonably necessary to protect the client's interests.

(Adopted Aug. 7, 1985, eff. Jan. 1, 1986. Amended March 1, 2007, eff. July 1, 2007.) **(Emphasis added)**

Comment 1 to Rule 4-1.14 recognizes that the client's capabilities may be diminished in some but not all respects:

> [1] The normal client-lawyer relationship is based on the assumption that the client, when properly advised and assisted, is capable of making decisions about important matters. When the client is a minor or suffers from a diminished mental capacity, however, maintaining the ordinary client-lawyer relationship may not be possible in all respects. In particular, a severely incapacitated person may have no power to make legally binding decisions. Nevertheless, **a client with diminished capacity often has the ability to understand, deliberate upon, and reach conclusions about matters affecting the client's own well-being.** For example, children as young as five or six years of age, and certainly those of ten or twelve years of age, are regarded as having opinions that are entitled to weight in legal proceedings concerning their custody. It is also recognized that some persons of advanced age can be quite capable of handling routine financial matters while needing special legal protection concerning major transactions. **(Emphasis added)**

ATTACHED

"Training on Financial Elder Abuse, Dementia,
and Mental Competency Issues in Bankruptcy"
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CASE STUDY: IS PURCHASING AN ANNUITY THE ANSWER?

Husband and Wife (age 60) own a business with substantial debt. Husband dies in December. Wife sells residence in February and clears $152,000. She immediately gives $13,000 each to four relatives. She makes the last voluntary payment on the business loans in April, closes the business, and uses the remaining $100,000 at the end of April to buy a single premium immediate annuity, choosing to have payments start 30 days later. The annuity pays monthly for 20 years guaranteed and she names a relative as beneficiary. Wife justifies the purchase based on the loss of Husband's income and reduced retirement benefits not leaving her with sufficient income to live, and asserts the annuity is just replacing lost income. Bank forecloses on business five months later and there is a $200,000 deficiency. Bank continues extended discussion with Wife over deficiency but ends up filing suit. This results in Wife filing bankruptcy not quite three years after purchase of annuity. Wife claims the annuity as exempt under Section 513.430.1(10)(e) RSMO which in relevant part provides:

> The following property shall be exempt from attachment and execution to the extent of any person's interest therein:
>
> (10) Such person's right to receive: (e) Any payment under a stock bonus plan, pension plan, disability or death benefit plan, profit-sharing plan, nonpublic retirement plan or any plan described, defined, or established pursuant to section 456.014, the person's right to a participant account in any deferred compensation program offered by the state of Missouri or any of its political subdivisions, or annuity or similar plan or contract on account of illness, disability, death, age or length of service, to the extent reasonably necessary for the support of such person and any dependent of such person unless:
>
> a. Such plan or contract was established by or under the auspices of an insider that employed such person at the time such person's rights under such plan or contract arose;
> b. Such payment is on account of age or length of service; and
> c. Such plan or contract does not qualify under Section 401(a), 403(a), 403(b), 408, 408A or 409 of the Internal Revenue Code of 1986, as amended, (26 U.S.C. Section 401(a), 403(a), 403(b), 408, 408A or 409);

In order to be exempt under this statute three conditions must be satisfied: (1) the payments must be received pursuant to a plan or contract of the kind

described; (2) payments must be made on account illness, disability, death, age or length of service; and (3) they must be reasonably necessary for the support of the debtor and the debtor's dependents. *In re Kurts*, 405 B.R. 333, 334 (Bkrtcy. W.D. Mo 2009). The third element was not disputed.

In re Eilbert, 162 F.3d 523 (8th Cir 1998). Reviewed a claim of exemption of an annuity under a similar Iowa statute. Husband died in a car wreck which seriously injured third parties. Wife, who is 74, receive substantial tenancy by entirety property which she liquidated and bought a $450,000 single premium variable annuity, requesting payments start in 60 days. Suit filed against Wife resulting from the automobile accident and judgment is entered. Wife filed bankruptcy 13 months after purchase of annuity. Court found that "annuity" is a generic term which refers to the method of payment, not the nature of the asset. The Court pointed to the fact that the payments were not "akin to future earnings", did not replace lost income and were not purchased by contributions over time. The Court held the annuity was not the type of contract covered by the statute. The Court also found that the payments were not on account of age. The debtor had chosen the date to start receiving payments, not linked to her age, and retained the right to make increased withdrawals. Thus the annuity was not exempt.

In re Andersen, 259 B.R.687 (8th Cir. BAP 2001). Reviewed a claim of exemption of an annuity under a similar Minnesota exemption statute. Debtor, at age 58, received an inheritance and purchased a $40,000 single premium, annuity. It was stipulated that she intended the annuity to be a retirement plan. Five years later she designated the age to start receiving payments, and those payments began the next year, when she was age 64. Seven years later she and her husband filed bankruptcy (13 years after the purchase of the annuity). The Court, relying on *Eilbert* but distinguishing the facts, found the annuity to be exempt. The Court established certain factors to review in determining whether the annuity is the type covered by the statute, as follows:

- Were the payments designed or intended to be wage substitutes?
- Were the contributions made over time?
- Do multiple contributors exist?
- What is the return on the investment?
- What control did the debtor exercise over the asset?
- Was the investment a pre-bankruptcy planning measure?

Using these factors, and in reliance on the stipulation that the annuity was purchased as a retirement plan, the Court found the annuity was of the type covered by the exemption statute.

In determining that the annuity was "on account of age" the Court stated that the date the benefits begin should be related to age. Further, the debtor should not have access to or control over the payments. The Court found that the debtor tied the payments to the date of her retirement and acknowledged the stipulation that the annuity was purchased in lieu of a retirement plan. Then the Court further found that once payments began, the debtor had no discretion as to the timing or amount of payments. Thus the Court found the payments were on account of age.

Rousey v. Jacoway, 544 U.S. 320, 125 S.Ct. 1561, 161L.Ed. 563 (2005). In interpreting Section 522(d)(10)(e)'s meaning, the phrase "on account of ... age" requires that the right to receive payment be "because of" age.

Huebner v. Farmers State Bank, 986 F. 2d 1222 (8th Cir. 1993). Debtors right to receive payment under an annuity was not triggered by any event identified in the statute such as age, illness, disability or death. Therefore, the payments fail to meet the "on account of"' requirement.

Training on Financial Elder Abuse, Dementia, and Mental Competency Issues in Bankruptcy

United States Bankruptcy Court
Central District of California
Roybal Room 1268
January 31, 2014
10:00 a.m. – 11:30 a.m

Table of Contents

Speaker Biographies

Molly Davies is the Vice President of Elder Abuse Prevention and Ombudsman Services at WISE & Healthy Aging, a non-profit social services organization in Santa Monica. In addition to overseeing the elder abuse prevention programs at WISE, she also directs the Los Angeles Financial Abuse Specialist Team (FAST) and is on the Steering Committee that founded the California Elder Justice Coalition.

Debra Deem is a Federal Bureau of Investigation (FBI) Victim Specialist who works with victims of financial and violent federal crimes under investigation by the FBI. Ms. Deem works extensively with victims of investment, mortgage, and Internet fraud; identity theft; and mass-marketing crimes, particularly those that target older adults. She also serves businesses and nonprofit organizations that have been victimized by fraud-related crimes. Ms. Deem has worked with federal and local crime victims for more than 25 years and previously served as a Victim Witness Coordinator for the U.S. Attorney's Offices in San Francisco and Los Angeles, California. She also has provided training and consultation at the federal level for more than 15 years. Ms. Deem has authored several articles related to victims of financial crime and recently coauthored a chapter on victims of financial crime in the third and fourth edition of *Victims of Crime.*

Dr. Stacey Wood is an Associate Professor of Psychology at Scripps College, in Claremont. She received her undergraduate degree from Middlebury College, her Ph.D. from the University of Houston in Neuropsychology and completed a postdoctoral fellowship in Neuropsychology at UCLA. Dr. Wood worked as a neuropsychologist and an expert witness on over 200 cases and testified around 30 times in federal, criminal, civil, probate, and arbitration courts. She is the Director of the Neuropsychology of Decision-Making laboratory at Scripps College and has published dozens of papers related to her work on the neuropsychology of decision-making across the lifespan. Her research is currently funded by the Department of Justice, and has been funded in the past by NIH, NSF, the Robert Wood Johnson Foundation and the Borchard Foundation for Law and Aging.

Mental Incompetency Issues in Bankruptcy Cases[1]

Bankruptcy Courts have experienced an increase in the number of bankruptcy filings by elder individuals.[2] Credit card debt has been cited as the number one cause. Debt related to medical issues is reported to be the second most common cause.[3] As the baby boomer population continues to age, courts are likely to face an increase in issues relating to mental incompetency. There is a lack of case law and guidance regarding how bankruptcy courts should resolve these issues. Below is a compilation of cases that address various issues related to mental incompetency in bankruptcy cases.

Legal Authority Vested in a Representative Prior to Bankruptcy

Ideally, a mentally incompetent individual will have a legal representative appointed before the individual files bankruptcy. A legal representative can be appointed via a: guardianship, conservatorship, guardian ad litem, or attorney-in-fact pursuant to a power of attorney. Federal Rule of Bankruptcy Procedure (FRBP) 1004.1 states:

> If an infant or incompetent person has a representative, including a general guardian, committee, conservator, or similar fiduciary, the representative may file a voluntary petition on behalf of the infant or incompetent person. An infant or incompetent person who does not have a duly appointed representative may file a voluntary petition by next friend or guardian ad litem. The court shall appoint a guardian ad litem for an infant or incompetent person who is a debtor and is not otherwise represented or shall make any other order to protect the infant or incompetent debtor.

Although there is minimal case law addressing the issue, representatives appointed as guardians or conservators under state law are usually found to have sufficient authority to file a bankruptcy petition on behalf the person whom they represent.[4] The case law is divided, however, regarding whether an attorney-in-fact has sufficient authority under a power of attorney to file a petition on another person's behalf.[5] Courts have examined the specific language of the power of attorney to determine whether it vests the attorney-in-fact with the authority to file a bankruptcy petition. The Ninth Circuit has suggested that explicit

[1] Jennifer M. Leinbach, Judicial Law Clerk for the United States Bankruptcy Court for the Central District of California.
[2] Deborah Thorne et. al., *The Increasing Vulnerability of Older Americans: Evidence from the Bankruptcy Court*, 3 HARV. L. & POL'Y REV. 87 (2009).
[3] *Id.*
[4] *In re Kjellsen*, 53 F.3d 944 (8th. Cir. 1995); *In re Hall*, 188 B.R. 476 (Bankr. D. Mass. 1995); *In re Sapp*, No. 10-20580, 2011 WL 2971048 (Bankr. E.D. Mo. July 20, 2011).
[5] *In re Curtis*, 262 B.R. 619 (Bankr. D. Vt. 2001) (document lacking sufficient authority); *In re Hurt*, 234 B.R. 1 (Bankr. D. N.H. 1999) (document granting sufficient authority); *In re Smith*, 115 B.R. 84 (Bankr. E.D. Va. 1990) (document lacking sufficient authority).

authority to file a bankruptcy petition must be vested in a representative under the power of attorney.[6]

At least one bankruptcy court has remedied the issue of a joint debtor's insufficient authority to file a petition under a power of attorney on behalf of her mentally incompetent spouse by vesting the joint debtor with sufficient authority as a "next friend" *nunc pro tunc*.[7] Appointment of a "next friend" is discussed below. Power of attorney issues also affect whether an attorney-in-fact has sufficient authority to appear at the meeting of creditors on behalf of an incompetent debtor.[8]

"Next Friend" or Guardian ad Litem Petition to Commence Bankruptcy Case

If no legal representative is appointed for a debtor before a bankruptcy is filed, courts may be presented with a motion for appointment of "next friend" or guardian ad litem along with the bankruptcy petition. Therefore, the court must determine what is required for an individual to be appointed as either a "next friend" or guardian ad litem. As cited above, FRBP 1004.1 states that the court shall appoint a representative to protect an incompetent debtor.

Logically, the first issue is to determine whether the debtor is "incompetent" so that an appointment of a legal representative is necessary. If a guardian or conservator was previously appointed, the bankruptcy court will not have to make this determination. In the absence of such appointment, however, the bankruptcy court will be left in the unusual position of making a finding of incompetency. Neither the Bankruptcy Code nor Rules define incompetency. Therefore, bankruptcy courts have relied on state laws regarding incompetency procedures and the appointment of a guardian ad litem.[9]

If the debtor is domiciled in California, the bankruptcy court would utilize relevant California authority on incompetency, which is likely the California Probate Code provisions governing guardianships and conservatorships.[10] In California, guardianships govern minors and conservatorships govern adults.

Under the California Probate Code, the standards for determining whether to appoint a conservatorship of a person and the estate are as follows:

> (a) A conservator of the person may be appointed for a person who is unable to provide properly for his or her personal needs for physical health, food,

[6] *Wekell v. United States*, 14 F.3d 32, 33 (9th Cir. 1994) ("It is unclear whether the unnotarized power of attorney Mr. Allotta had extracted from his wife authorized him to file for bankruptcy on her behalf without obtaining her specific consent. We assume, without deciding, that the power of attorney was not adequate, and we accept, for purposes of our analysis, Ms. Wekell's protest that she did not otherwise consent." (citations omitted)).
[7] *In re Myers*, 350 B.R. 760 (Bankr. N.D. Ohio 2006).
[8] *In re Cherry*, No. 12-00803, 2013 WL 1352294 (Bankr. D. D.C. April 3, 2013); *see also In re Bergeron,* 235 B.R. 641 (N.D. Cal. 1999) (waiving the elderly debtor with dementia's appearance).
[9] *In re Moss*, 239 B.R. 537 (Bankr. W.D. Mo. 1999).
[10] CAL. PROB. CODE § 1400–3925 (West 2014).

> clothing, or shelter, except as provided for the person as described in subdivision (b) or (c) of Section 1828.5.
>
> (b) A conservator of the estate may be appointed for a person who is substantially unable to manage his or her own financial resources or resist fraud or undue influence, except as provided for that person as described in subdivision (b) or (c) of Section 1828.5. Substantial inability may not be proved solely by isolated incidents of negligence or improvidence.[11]

The movant has the burden of proving by clear and convincing evidence that conservatorship under either of these standards is warranted.[12]

Assuming that the requirements for appointment of a conservator are met, the court must determine whether to approve the "next friend" or guardian petition and motion. Case law is also sparse regarding what requirements must be met for the court to appoint a "next friend" or guardian in a bankruptcy case. In the context of a habeas corpus petition, the U.S. Supreme Court set forth a number of factors for a court to consider with respect to a next friend request:

> Most important for present purposes, "next friend" standing is by no means granted automatically to whomever seeks to pursue an action on behalf of another. Decisions applying the habeas corpus statute have adhered to at least two firmly rooted prerequisites for "next friend" standing. First, a "next friend" must provide an adequate explanation—such as inaccessibility, mental incompetence, or other disability—why the real party in interest cannot appear on his own behalf to prosecute the action. Second, the "next friend" must be truly dedicated to the best interests of the person on whose behalf he seeks to litigate, and it has been further suggested that a "next friend" must have some significant relationship with the real party in interest. The burden is on the "next friend" clearly to establish the propriety of his status and thereby justify the jurisdiction of the court.[13]

By analogy, these requirements may be applicable in a bankruptcy proceeding. Noting the absence of case law addressing "next friend" motions, one bankruptcy court set forth a laundry list of procedures for "next friend" motions and petitions:

> The court shares the concerns raised by the UST about the potential for abuse that exists with regard to motions to appoint a next friend under Fed. R. Bankr.P. 1004.1. Therefore, any future motion to appoint a next friend must comply with the following procedure and make a showing that the debtor(s) are financially incapable, and that the person seeking appointment

[11] CAL. PROB. CODE § 1801 (West 2014).
[12] *Id.*
[13] *Whitmore v. Arkansas*, 495 U.S. 149, 162-64, 110 S. Ct. 1717, 1726-28, 109 L. Ed. 2d 135 (1990).

knows the debtor(s)' financial situation and is dedicated to the debtor(s)' best interests.

First, any petition filed by a next friend must be accompanied by a motion to be appointed as next friend.

Second, the motion to be appointed as next friend must be accompanied by the following documents:

1. A copy of the power of attorney giving the movant authority to act for the debtor(s), if any.

2. A declaration from the person seeking to be appointed as "next friend" providing the following information:

A. the movant's name and relationship to the debtor(s);

B. whether the debtor(s) have a duly appointed representative under state law;

C. the reason why appointment of a next friend is necessary;

D. an explanation of why appointment of the movant as next friend would be in the debtor(s)' best interest;

E. the fee, if any, the next friend will charge the debtor;

F. the movant's criminal, financial, and professional history;

G. the movant's competence to handle the debtor(s)' financial affairs, including the movant's knowledge about the debtor(s)' financial affairs;

H. whether the movant has any interest, either current or potential, in the debtor(s)' financial affairs; and

I. whether any of the debtor(s)' debts were incurred for the benefit of the proposed next friend.

3. A letter from the debtor(s)' physician(s) regarding the debtor(s)' ability to conduct their own financial affairs.

4. A letter from the debtor(s)' care giver, if any, regarding the debtor(s)' ability to conduct their own financial affairs.

Third, the movant must give notice of the motion to be appointed as next friend to:

1. all creditors;

> 2. the United States Trustee;
>
> 3. any governmental entity from which the debtor is receiving any funds; and
>
> 4. the debtor(s)' closest relative, if known.
>
> Fourth, the court will hold a hearing on the motion to be appointed as next friend, which shall occur before the 341(a) meeting, if possible. The person requesting to be appointed as next friend shall appear and testify at the hearing, either in person or telephonically.[14]

As noted above, courts may also appoint a guardian ad litem to represent a debtor pursuant to FRBP 1004.1. According to Black's Law Dictionary, the distinction between the appointment of a "next friend" and the appointment of a guardian ad litem is guardianship. A "next friend" is "[a] person who appears in a lawsuit to act for the benefit of an incompetent or minor plaintiff, but who is not a party to the lawsuit and is not appointed as a guardian," and a guardian ad litem is "[a] guardian, usually a lawyer, appointed by the court to appear in a lawsuit on behalf of an incompetent or minor party."[15]

There may be situations, however, when no individual petitions the court for "next friend" appointment, but it is clear that the debtor is mentally incompetent. FRBP 1004.1 states that the court shall appoint a representative to protect an incompetent debtor. This rule needs to be considered in conjunction with FRBP 1016, which states:

> Death or incompetency of the debtor shall not abate a liquidation case under chapter 7 of the Code. In such event the estate shall be administered and the case concluded in the same manner, so far as possible, as though the death or incompetency had not occurred. If a reorganization, family farmer's debt adjustment, or individual's debt adjustment case is pending under chapter 11, chapter 12, or chapter 13, the case may be dismissed; or if further administration is possible and in the best interest of the parties, the case may proceed and be concluded in the same manner, so far as possible, as though the death or incompetency had not occurred.

Thus, if the debtor's incompetency is discovered during the pendency of a bankruptcy case, a liquidation will nevertheless continue, but the court may need to dismiss or convert a reorganization case. In certain instances, it may be appropriate for the court to *sua sponte* appoint a "next friend" under § 105.[16] Presumably, a "next friend" should be appointed if the representation will facilitate further administration of the bankruptcy case. Without such appointment, the debtor may not be able to adequately complete the credit

[14] *In re Lane*, No. 12-36873, 2012 WL 5296122, at *1-2 (Bankr. D. Or. Oct. 25, 2012).
[15] BLACK'S LAW DICTIONARY 774-75, 1142 (9th ed. 2009).
[16] *In re Moss*, 239 B.R. 537 (Bankr. W.D. Mo. 1999); In re Myers, 350 B.R. 760 (Bankr. N.D. Ohio 2006).

counseling or financial management course or seek a waiver of these requirements.[17] The request for the appointment of a representative for an incompetent debtor may come from the trustee, who will likely be the first to encounter the incompetency issue at the meeting of creditors or during the administration of the case.[18] In these situations, bankruptcy courts may be able to turn to the Public Guardian for the respective county where the debtor resides.[19] The Public Guardian can serve as a conservator for the debtor if the legal requirements for conservatorship are met, the debtor has no one else to serve as conservator, and it is in the best interest of the person.

Adversary Proceeding Application

Courts may also be faced with representation issues in adversary proceedings, especially those relating to nondischargeability actions. According to FRBP 7017, "Rule 17 F.R.Civ.P. applies in adversary proceedings, except as provided in Rule 2010(b)." Federal Rule of Civil Procedure (FRCP) 17 provides:

> (c) Minor or Incompetent Person.
>
> > (1) With a Representative. The following representatives may sue or defend on behalf of a minor or an incompetent person:
> >
> > > (A) a general guardian;
> > >
> > > (B) a committee;
> > >
> > > (C) a conservator; or
> > >
> > > (D) a like fiduciary.
> >
> > (2) Without a Representative. A minor or an incompetent person who does not have a duly appointed representative may sue by a next friend or by a guardian ad litem. The court must appoint a guardian ad litem—or issue another appropriate order—to protect a minor or incompetent person who is unrepresented in an action.

The issues in the context of an adversary proceeding may be related to whether an attorney-in-fact has sufficient authority to represent the incompetent individual. The Ninth Circuit Bankruptcy Appellate Panel (BAP) has held that an attorney-in-fact lacks adequate

[17] *In re Hammer*, No. 08-61505, 2008 WL 6177312 (Bankr. N.D. Ohio Nov. 10, 2008) (waiving financial course requirements).
[18] *In re Whitehead*, No. 05-50136, 2005 WL 1819399 (Bankr. N.D. N.C. July 22, 2005).
[19] For information on the Los Angeles Public Guardian see: http://dmh.lacounty.gov/wps/portal/dmh/our_services/public_guardian.
The Public Guardian is described as follows: "The Public Guardian provides a vital service to persons unable to properly care for themselves or who are unable to manage their finances. The service is provided through a legal process known as conservatorship. Persons in need of conservatorship are physically or mentally disabled to the point where they cannot utilize community services and resources. They usually have no family or friends able or willing to help."

authority to sign an adversary complaint and commence an adversary proceeding on behalf of an incompetent individual.[20] The BAP left unanswered whether an attorney-in-fact can sign a proof of claim on behalf of an incompetent individual.[21] Presumably, the claim would stand unless the debtor, or other party-in-interest, objected.

Issues may also arise if an adversary proceeding is filed against an unrepresented incompetent debtor. This may be a situation in which the court must exercise its authority under §105 to appoint a next friend *sua sponte*.[22] FRCP 17 states the Court must appoint a guardian ad litem to represent an unrepresented incompetent adversary party. Courts should also be wary that FRCP 55 prevents the court from entering default against an incompetent person.[23] Appointment of a representative may therefore be necessary for adequate prosecution of an adversary proceeding.

Conclusion

Mental incompetency issues in the context of bankruptcy cases are a relatively undeveloped area of law. Bankruptcy courts are nevertheless likely to see an increase in these issues as the American population ages and the percentage of the elderly population filing bankruptcy increases. Perhaps as the prevalence of these issues increases, courts will adopt local rules and forms to standardize the "next friend" petition and motion process, *e.g.* like the court in *Lane*, clearly laying out a laundry list of requirements. Development of a set of rules and procedures relating to representation of mentally incompetent debtors will not only streamline the process in the bankruptcy court, but also provide guidance for representatives and the bar in an area of law lacking such direction.

[20] *In re Foster*, No. 11-1252, 2012 WL 6554718 (Dec. 14, 2012, BAP 9th Cir. 2012).
[21] *Id.*
[22] *See, e.g., In re Moss*, 239 B.R. 537 (Bankr. W.D. Mo. 1999).
[23] *In re Ford,* No. 08-4069, 2009 WL 6499337 (Bankr. N.D. Ga. March 3, 2009).

Relevant Federal Rules of Bankruptcy Procedure and

Federal Rules of Civil Procedure

Rule 1004.1 Petition for an Infant or Incompetent Person

If an infant or incompetent person has a representative, including a general guardian, committee, conservator, or similar fiduciary, the representative may file a voluntary petition on behalf of the infant or incompetent person. An infant or incompetent person who does not have a duly appointed representative may file a voluntary petition by next friend or guardian ad litem. The court shall appoint a guardian ad litem for an infant or incompetent person who is a debtor and is not otherwise represented or shall make any other order to protect the infant or incompetent debtor.

Rule 1016. Death or Incompetency of Debtor

Death or incompetency of the debtor shall not abate a liquidation case under chapter 7 of the Code. In such event the estate shall be administered and the case concluded in the same manner, so far as possible, as though the death or incompetency had not occurred. If a reorganization, family farmer's debt adjustment, or individual's debt adjustment case is pending under chapter 11, chapter 12, or chapter 13, the case may be dismissed; or if further administration is possible and in the best interest of the parties, the case may proceed and be concluded in the same manner, so far as possible, as though the death or incompetency had not occurred.

Rule 7017. Parties Plaintiff and Defendant; Capacity

Rule 17 F.R.Civ.P. applies in adversary proceedings, except as provided in Rule 2010(b).

Rule 17. Plaintiff and Defendant; Capacity; Public Officers

(a) Real Party in Interest.

(1) Designation in General. An action must be prosecuted in the name of the real party in interest. The following may sue in their own names without joining the person for whose benefit the action is brought:

(A) an executor;

(B) an administrator;

(C) a guardian;

(D) a bailee;

(E) a trustee of an express trust

(F) a party with whom or in whose name a contract has been made for another's benefit; and

(G) a party authorized by statute.

. . .

(b) Capacity to Sue or Be Sued. Capacity to sue or be sued is determined as follows:

(1) for an individual who is not acting in a representative capacity, by the law of the individual's domicile;

(2) for a corporation, by the law under which it was organized; and

(3) for all other parties, by the law of the state where the court is located, except that:

(A) a partnership or other unincorporated association with no such capacity under that state's law may sue or be sued in its common name to enforce a substantive right existing under the United States Constitution or laws; and

(B) 28 U.S.C. §§754 and 959(a) govern the capacity of a receiver appointed by a United States court to sue or be sued in a United States court.

(c) Minor or Incompetent Person.

(1) With a Representative. The following representatives may sue or defend on behalf of a minor or an incompetent person:

(A) a general guardian;

(B) a committee;

(C) a conservator; or

(D) a like fiduciary.

(2) Without a Representative. A minor or an incompetent person who does not have a duly appointed representative may sue by a next friend or by a guardian ad litem. The court must appoint a guardian ad litem—or issue another appropriate order—to protect a minor or incompetent person who is unrepresented in an action.

. . .

Hypothetical Bankruptcy Situations

This is a non-exhaustive list of hypothetical situations in which elder abuse, dementia, and mental competency issues can arise in bankruptcy cases. The purpose of these hypotheticals is to promote discussion regarding how the court can prepare for and address these situations.

- In some scenarios there is an individual who is willing to assist the debtor with the bankruptcy process. In the event that these individuals have not sought legal representation on behalf of the estate, the court can at least advise the representative to seek legal counsel if it is needed for the administration of the case. The more challenging situations for the court will be if an incompetent person is not already represented by a guardian/conservator and no individual is petitioning to be a representative or "next friend," i.e. the incompetent debtor is *pro se*. How can the court handle these cases?

- When a petition or adversary complaint is filed by a debtor's guardian, conservator or attorney-in-fact, bankruptcy courts may encounter debtors with dementia or mental incompetency or who have been victims of elder abuse. The case law is divided regarding whether explicit authority is required for a guardian or conservator to file a bankruptcy petition. Neither the Ninth Circuit, nor the BAP, has ruled on this issue as it relates to FRBP 1004.1.

- If there is no legally appointed representative, a proposed representative may file a motion to be appointed as such along with the petition. The court will have to consider whether the individual qualifies to be a representative of the estate or a "next friend" under the relevant authority. The court may need to be wary of whether the proposed representative is filing the petition in good faith and in the best interests of the debtor.

- A proposed representative may also petition the court to appear on behalf of the debtor at the § 341(a) meeting of creditors conducted by the case trustee or United States trustee (UST) or request that appearance at the § 341(a) meeting be waived. Assuming that the representative is authorized to appear at the § 341(a) meeting, the representative would need to have sufficient knowledge of the debtor's estate and finances to appear in the debtor's place. Issues may arise regarding whether the representative has adequate legal authority, i.e. power of attorney, to undertake such representation.

- The Bankruptcy Code has a number of requirements, including a certification that the debtor has taken a credit counseling course and financial management course. If the debtor is suffering from dementia or incompetency, a representative may need to seek a waiver of these requirements. On occasion, courts have been presented with

such issues after the fact, such as when a family member forged an incompetent debtor's signature on a certificate of completion of these courses.

- An individual appears at intake and is clearly mentally incapacitated. The individual may appear with a bankruptcy petition preparer or "friend," but clearly shows signs of confusion or failure to understand the purpose of his/her presence at the Bankruptcy Court. If the individual is not represented by a guardian or conservator, FRBP 1004.1 mandates that the court shall appoint a guardian to represent an incompetent debtor that is not otherwise represented. The court may be able to refer the debtor to the Public Guardian for the county where the debtor resides that can be appointed conservator. Are there other sources for the court to contact in this situation, such that this individual may be properly represented? Is there any duty placed on the court to report this incident? If so, to what authority?

- What are the signs an individual is suffering from dementia, if any? What factors can the court examine to determine Debtor's competency and varying capacity?

- If the debtor's mental incapacity is not clear during the intake process or the incompetent person files the petition electronically, it is likely that the UST or case trustee will be the first to encounter the incompetency issue. The trustee may not be able to conduct a § 341(a) meeting without the individual being properly represented. Does the trustee have any duty to report the incompetency to any state authority, such as the county department of mental health or California Department of Public Health? Are there any other state or federal agency that would handle this matter?

- FRBP 1016 governs situations where the debtor's incapacity is discovered during the pendency of a bankruptcy case. In a chapter 7 case, the UST and case trustee must continue to liquidate the debtor's assets, as incompetency does not abate the process. The appointment of a representative may nevertheless be important in this instance. If the debtor's incompetency is discovered in a chapter 11, 12, or 13 case, the case could be dismissed unless further administration is possible. Some courts have determined that further administration would be possible if a representative is appointed. When the debtor's incompetency is discovered during the pendency of a case, it is usually brought to the court's attention by way of a petition to appoint a representative filed by the trustee.

- In a *pro se* chapter 7 asset case, the case trustee determines there is equity in Debtor's residence. Does the chapter 7 trustee or the UST have a duty to ensure that the mentally incapacitated individual is properly represented before any motion to sell the property is filed with the court (under § 363)? In a related vein, this could be an issue in a hearing on motion for relief from the automatic stay related to a debtor's real property. It may be difficult to explain the implications of such a motion

to an individual suffering from dementia. This could become a serious issue if the residence is equipped with assistance items and the mentally incapacitated individual needs assistance finding alternative housing after the property is sold. Are there resources that could assist in this situation?

- During the administration of a case, the trustee and UST suspect that elder abuse is occurring. What are the warning signs of elder abuse, if any? This issue could be present in a situation where the debtor has a representative but the representative is the suspected abuser. The trustee or UST may feel it is proper to refer the debtor to the appropriate resources but do not want to appear partial to the debtor. The California Courts website has an elder abuse self-help page that contains information regarding reporting elder abuse. Can the trustee, UST or court utilize the information available on that website without appearing partial?

- In a *pro se* case the trustee discovers that the estate may hold claims for elder abuse, financial or otherwise. How would those be prosecuted? The trustee would likely have a duty to pursue those claims, but would need to do so in a way that does not appear partial to the debtor. This would be an issue in a no asset case, in which the trustee has no resources to employ special counsel to prosecute the claims. Are there attorneys or organizations that provide low cost *or pro bono* services for prosecuting elder abuse claims?

- FRCP 17 applies in adversary proceedings. This rule permits a representative, guardian, or conservator to prosecute or defend an action in an adversary proceeding on behalf of the incompetent person. If an adversary proceeding is initiated against a *pro se* incompetent individual the court may need to appoint a representative to ensure that the debtor understands the nature of the suit against him or her.

- FRCP 55 prevents the clerk from entering default against an incompetent person. If a debtor/defendant is suffering from dementia, prosecution of an adversary proceeding may be impossible, because default cannot be entered against such a debtor.

- The Bankruptcy Court may encounter elder financial abuse issues in the context of an adversary proceeding to determine whether an elder abuse judgment may be deemed nondischargeable. Whether the debtor may discharge an elder abuse judgment will often depend on what sovereign prosecuted the crime and/or under what statute the action was prosecuted. The Bankruptcy Code contains certain limited exceptions to discharge in 11 U.S.C. § 523. If the judgment is entitled to preclusive effect, the elements of the previously adjudicated action must match those contained in § 523. For example, if the debtor is liable for a judgment under

California Penal Code § 368, crimes against elder or dependent adults, and if the judgment is payable to a governmental entity, it may be excepted from discharge under § 523(a)(7). If the debtor is subject to an elder abuse judgment for restitution under federal law, the judgment may be excepted from discharge under § 523(a)(13). If the elder abuse was litigated in civil court, however, excepting the judgment from discharge may be more difficult. A creditor may need to seek to have the judgment deemed nondischargeable under § 523(a)(6), which excepts willful and malicious injuries from discharge, § 523(a)(2)(A), which governs actual fraud, or § 523(a)(4), which excepts fraud committed while the debtor was acting in a fiduciary capacity. There is no specific exception to discharge for elder abuse. Navigating the exceptions to discharge may be difficult for an elderly individual or an incompetent adult and/or the estate representative without experienced counsel.

List of Helpful Websites

1. Los Angeles Superior Court probate forms, including conservatorship/guardianship forms: http://www.lasuperiorcourt.org/forms/ui/main.aspx?CT=PR

2. California Courts webpage with information on conservatorships and elder abuse and contact information and phone numbers for reporting elder abuse: http://www.courts.ca.gov/selfhelp-seniors.htm

3. Information on Conservatorships in California: http://www.canhr.org/factsheets/legal_fs/html/fs_ProbateConservatorship.htm

4. Los Angeles Public Guardian website: http://dmh.lacounty.gov/wps/portal/dmh/our_services/public_guardian

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ELDER BANKRUPTCY FILINGS; CAPACITY ISSUES

By Peter C. Anderson and Abram S. Feuerstein[1]

Older Americans are filing for bankruptcy at increasing rates.[2] And as the age of the average bankruptcy debtor increases, it appears that there is an increase in the number of debtors filing bankruptcy who have chronic and disabling medical conditions. Some of these individuals may lack physical capacity to undertake those actions necessary to complete a bankruptcy filing successfully and obtain a bankruptcy discharge of their debts. Others may lack mental capacity or competency to make financial decisions. Inevitably, there has been a rise in situations involving family members seeking to file bankruptcy cases for incapacitated relatives.

Unfortunately, some aspects of the law in this area are unsettled and not well developed. All too frequently, well-meaning relatives attempt to file bankruptcy cases for incapacitated, financially-distressed family members in a haphazard, improper fashion. Often, they run to the bankruptcy court armed only with a doctor's note attesting to the poor physical health or mental condition of their family member. Other individuals run to a local stationery store or look on the internet for a fill-in-the-blanks power of attorney form to support a bankruptcy filing. At times, family members risk committing bankruptcy crimes by forging documents and making false statements as they attempt to commence a bankruptcy case for a disabled or incompetent relative. Even experienced bankruptcy lawyers lack familiarity with the rules.

INCAPACITATED DEBTORS

The first question is whether incapacitated individuals can file bankruptcy. The short answer is, "yes." The Bankruptcy Code contemplates that incapacitated individuals may be bankruptcy debtors, and courts agree.[3]

Under Section 301 of the Bankruptcy Code, a voluntary bankruptcy case may only be commenced when an individual who may be a debtor files a bankruptcy petition. In turn, Bankruptcy Code Section 109 states who may be a debtor.[4] And that section contains no restrictions against incapacitated or disabled debtors.[5]

FILING THROUGH A REPRESENTATIVE OR NEXT FRIEND

Given that disabled and incapacitated debtors may file bankruptcy, the next question that arises is who, if anyone, has the authority to file a bankruptcy petition on behalf of a debtor who lacks capacity. In answering this question, the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure ("FRBP") provide only limited guidance.

Under FRBP1004.1, "(i)f an infant or incompetent person has a representative, including a general guardian, committee, conservator, or similar fiduciary, the representative may file a bankruptcy petition on behalf of the infant or incompetent person."

Rule 1004.1 also provides that if an infant or incompetent person does not have a duly appointed representative, the person "may file a voluntary petition by next friend or guardian ad litem. The court shall appoint a guardian ad litem for an infant or incompetent person who is a debtor and is not otherwise represented or who shall make any other order to protect the infant or incompetent debtor."

Hence, to the extent that a bankruptcy petition is filed on behalf of an infant or an incompetent person, sound practice dictates that counsel should ensure that to the extent there is a representative, appropriate documentation is filed with the petition establishing the representative's authority to file the petition. However, if no representative exists, the parties should follow Rule 1004.1 and seek an immediate court order appointing a guardian or a next friend.[6]

POWERS OF ATTORNEY

Other than the procedures outlined in Rule 1004.1 pertaining to "infants" and "incompetent persons," the Bankruptcy Code is silent as to whether someone can file a bankruptcy case on behalf of another person, typically by way of a power of attorney. Thus, at least one court has taken a very restrictive view and held that except as allowed by Rule 1004.1, another person may never file a voluntary case on behalf of another individual.[7]

By contrast, there are a range of bankruptcy decisions that authorize bankruptcy filings through the use of powers of attorney. Some of these decisions permit a petition to be filed pursuant to a broad, generic grant of authority contained in a power of attorney.[8] Other cases prohibit a bankruptcy filing absent a specific, express provision that enumerates a bankruptcy filing as part of the authority conveyed under the power of

ELDER BANKRUPTCY FILINGS; CAPACITY ISSUES (continued)

attorney.[9] A third group of cases takes a middle approach as to the necessary language in the power of attorney.[10]

Regardless of how a specific court will rule, practitioners must understand that bankruptcy courts are reluctant to permit a party other than the debtor to sign and file a petition under a power of attorney. As one court note d, "(t)he filing of a bankruptcy petition is a serious act which necessarily involves exposing the financial and legal affairs of the petitioner to all interested parties in a public forum."[11] Given its profound legal consequences, another court has observed that filing bankruptcy "should not be undertaken without careful deliberation."[12]

Moreover, the bankruptcy process contemplates complete and accurate disclosure about a debtor's financial condition – both in written bankruptcy schedules and statements, and in oral testimony at a meeting of creditors.[13] Typically, this information is only available from the debtor personally. And absent extraordinary circumstances, creditors have the right to demand the personal participation of the debtor in bankruptcy proceedings as a condition of the debtor obtaining a discharge.

In sum, filing a bankruptcy case is among the most important financial decisions a person will make during his or her lifetime. In light of the lack of clarity concerning the use of powers of attorney; the heightened importance of financial disclosure in bankruptcy cases; and the legal consequences of filing bankruptcy, attorneys should proceed very cautiously before advising clients to sign a bankruptcy petition for another person using a power of attorney. And in those extremely rare cases when a power of attorney is used, attorneys should check the language of the instrument to ensure that it authorizes a bankruptcy filing.

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[2] See generally, J. Golmant and J. Woods, "Aging and Bankruptcy Revisited," American Bankruptcy Institute Journal, September 2010; and J. Pottow, The Rise in Elder Bankruptcy Filings and Failure of U.S. Bankruptcy Law, 19 Elder L.J. 119 (2011).

[3] *In re Myers*, 350 B.R. 760, 762-3 (Bankr.N.D.Ohio 2006) (collecting cases).

[4] Unless otherwise noted, all statutory references are to the Bankruptcy Code, Title 11, United States Code, and rule references are to the Federal Rules of Bankruptcy Procedure.

[5] In fact, Section 109 supports the filing of bankruptcy by incapacitated and/or disabled persons. Most non-bankruptcy lawyers generally are aware that in 2005 Congress enacted substantial measures to reform the nation's bankruptcy laws. As part of the wide-ranging amendments, Congress enacted educational requirements for bankruptcy debtors. These mandate that debtors take a *pre*-bankruptcy credit counseling class; and, as a condition of receiving a bankruptcy discharge, debtors are required to take a financial management course *after* they file bankruptcy.

Under Section 109(h)(4), incapacitated or disabled debtors specifically are exempted from meeting the pre-bankruptcy educational requirement. Similarly, the discharge provisions of the Bankruptcy Code exempt incapacitated debtors from the requirement of completing a post-filing course. These provisions manifest a Congressional awareness that incapacitated debtors indeed could be bankruptcy debtors, and Congress went the extra step of excluding such debtors from the newly enacted educational requirements.

[6] The representative and/or would-be representative face another hurdle involving the 2005 education requirements added to the Code. The Code's educational requirements may be a non-delegable duty. *See, e.g., In re Hammer*, 2008 WL 6177812 (Bankr.N.D.Ohio 2008). Instead of a representative taking the class on behalf of a debtor or, worse, pretending that the incompetent debtor took the class and is capable of certifying that the requirement has been completed, the representative may want to consider filing a motion excusing compliance with the pre- and post-bankruptcy filing educational requirements.

[7] *In re Vitagliano*, 303 B.R. 292, 293 (Bankr.W.D.N.Y. 2003); *see also, In re Smith*, 115 B.R. 84 (Bankr.E.D.Va. 1990) (authorizing filing through a court-appointed guardian having specific authorization to file bankruptcy, but not a power of attorney).

[8] *See, e.g., In re Hurt*, 234 B.R. 1, 3-4 (Bankr.D.N.H. 1999).

[9] *See, e.g., In re Eicholz*, 310 B.R. 203, 207 (Bankr.W.D.Wash. 2004).

[10] *See, e.g., In re Curtis*, 262 B.R. 619, 622 (Bankr.D.Vt. 2001).

[11] *In re Brown*, 163 B.R. 596, 597 (Bankr.N.D.Fla. 1993).

[12] *Curtis*, 262 B.R. at 624.

[13] Section 343 of the Bankruptcy Code requires a bankruptcy debtor to appear and submit to an examination under oath at a meeting of creditors.