Ethical Considerations in Chapter Choice

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I. Introduction

"Those who represent consumer debtors face many potential ethical issues, as varied as the clients who seek help."[1] Even the choice of which chapter under the Bankruptcy Code is best suited for achieving a client's objectives can give rise to ethical issues. An attorney owes duties of competency, candor, and professionalism to clients, the court, and opponents.[2] A bankruptcy attorney must not only comply with the Rules of Professional Conduct including those that establish standards for: (1) competency (Rule 1.1.), (2) diligence (Rule 1.3), (3) communication (Rule 1.4), (4) confidentiality (Rule 1.6), (5) conflicts of interest (Rules 1.7, 1.8, 1.9, and 1.10), (6) candor to the court (Rule 3.3), and (7) ex parte communications with the court (Rule 3.5), but must also comply with certain statutory and procedural requirements governing attorney conduct and performance.[3]

For example, when filing consumer bankruptcy petitions, attorneys must comply with the requirements of Bankruptcy Code section 707.[4] Under Code section 707(b)(4)(C), an attorney who signs a petition or other pleading certifies that the attorney has performed an investigation into the financial affairs of the debtor to ensure that the pleading is well grounded in fact and

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[1] Donald R. Lassman and Dr. Daniel A. Austin, *Ethical Ambiguities on the Front Lines of Consumer Representation*, 33 Am. Bankr. L.J. 26 (July 2013).

[2] Tennessee Supreme Court Rule 8 (adopting the ABA Model Rules for Professional Conduct) and the Memphis Bar Association Guidelines for Professional Courtesy and Conduct, made applicable to practice in the U.S. Bankruptcy Court for the Western District of Tennessee by Local Bankruptcy Rule 2091-1, adopting Local District Court Rule 83.4(c) and (g).

[3] Lois R. Luica and Nancy B. Rapoport, *Final Report of the American Bankruptcy Institute National Ethics Task Force* (April 21, 2013) (hereinafter "ABI Final Ethics Report"), available at materials.abi.org/FinalEthicsReport. See also, G. Thomas Curran, Jr., *How Much Diligence is Due? Defining an Attorney's Duty to Perform a Pre-Petition Inquiry*, 33 Am. Bankr. L.J. 25 (Nov. 2013).

[4] Curran, at 74.

warranted by existing law or a good faith argument for change to existing law. Additionally, an attorney who signs a petition certifies that he "has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect."[5] If a court finds that an attorney has violated section 707(b), it may assess civil penalties and award attorney fees and costs pursuant to section 707(b)(4)(A) and (B).

Code section 526(a)(2) requires that, as a "debt relief agency," a consumer debtor's attorney "exercise reasonable care in determining the accuracy of the information contained in a debtor's petition and schedules."[6] Section 527 specifies information and disclosures the attorney must make to his client, and section 528 directs the execution of a written contract of employment prior to filing a bankruptcy petition.[7] Failure to comply with any of these sections can subject the attorney to disgorgement of fees and civil penalties and/or payment of the attorney fees and costs of either the debtor, the state, or the U.S. Trustee.[8] In determining whether a debtor's attorney has satisfied the inquiry and investigation requirements of Code sections 707 and 526, the trend in the courts is to apply the "reasonable inquiry" standard of Rule 9011.[9] "The standard is an objective one: An attorney cannot defend himself or herself by claiming that he or she was subjectively ignorant to the murky facts of the debtor's case."[10]

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[5] 11 U.S.C. § 707(b)(4)(D).

[6] 11 U.S.C. § 526(a); *Milavetz, Gallop & Milavetz PC v. U.S.*, 559 U.S. 229, 235, 130 S. Ct. 1324 (2010).

[7] 9 William L. Norton, Jr. and William L. Norton, III, NORTON BANKR. L & PRAC. §172:25 (3rd ed. 2008).

[8] Curran, at 24, citing, 11 U.S.C. § 526(c).

[9] Curran, at 25, citing, *In re Kayne*, 453 B.R. 372 (B.A.P. 9th Cir. 2011); *In re Garrard*, 2013 WL 4009324 (Bankr. N.D. Ala. 2013). See also *In re Bradley*, 495 B.R. 747 (Bankr. S.D. Tex. 2013).

[10] Curran, at 25.

A financially distressed debtor seeks bankruptcy relief in order to eliminate as much debt as possible and retain as much property as possible.[11] Crucial to achieving those objectives is determination of which chapter under the Bankruptcy Code is best suited to the debtor's financial circumstances. Giving appropriate advice about the appropriate chapter for relief is the duty of a competent and disinterested attorney.

II. Chapter Choices

Subject to certain eligibility requirements, an individual may file for bankruptcy relief under chapter 7, 11, 12, or 13. Chapter 12 relief is only available if the debtor is a family farmer or fisherman.[12] Because of the complexity and expense, chapter 11 is not a good choice for most individuals unless they are not eligible for relief under chapter 13.[13] For most individuals, the choice is between chapter 7 or chapter 13.

A. Chapter 7

Chapter 7 has these advantages: (1) debtor does not have to pay anything to unsecured creditors whose debts are dischargeable; (2) a chapter 7 case is typically concluded in a matter of months, allowing the debtor to obtain a discharge and the opportunity to begin rebuilding finances in a short period of time; and (3) attorney fees are lower in a chapter 7 than the reorganization chapters.[14] It is most beneficial for debtors who have no nonexempt property and can afford to make payments to retain any property subject to secured liens.[15]

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[11] W. Homer Drake Jr., Paul W. Bonapfel, Adam Goodman, CHAPTER 13: PRACTICE & PROCEDURE § 2:5 (2nd ed. 2014).

[12] 11 U.S.C. §109(f).

[13] 11 U.S.C. §109(e).

[14] W. Homer Drake Jr., Paul W. Bonapfel, Adam Goodman, CHAPTER 13: PRACTICE & PROCEDURE § 2:5 (2nd ed. 2014).

[15] *Id.*; *In re Brown*, 742 F.3d 1309 (11th Cir. 2014).

The determination of whether chapter 7 is best suited for achieving a client's objectives requires consideration of whether: (1) the petition may be subject to dismissal as a bad faith filing under Code section 707(a) or for substantial abuse under Code section 707(b); (2) whether or not the debtor is entitled to a discharge under Code section 727(a) and whether any of the debtor's debts may be excepted from discharge under Code §523; and (3) whether the debtor can afford to retain property by redeeming property or reaffirming obligations for property subject to security interests; paying the trustee the value of any non-exempt property; or avoiding liens on any exempt property.[16]

B. Chapter 13

Chapter 13 has these advantages: (1) it is not subject to dismissal for abuse under Code section 707(b) if the debtor's annualized current monthly income is above the median income in the debtor's state; (2) it permits a debtor to protect assets by developing a plan for repayment of creditors; (3) it permits a debtor to pay nondischargeable priority debts such as administrative expenses, taxes, and domestic support obligations through a plan; and (3) certain debts may be dischargeable in a chapter 13 that are not dischargeable in a chapter 7.[17]

C. Ethical Issues

Ethical issues arise when the chapter chosen for relief is not the chapter best suited for achieving the client's objectives. In particular, ethical issues arise when an attorney files a petition: (1) under a chapter for which the debtor is not eligible for relief; (2) for an improper purpose; or

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[16] W. Homer Drake Jr., Paul W. Bonapfel, Adam Goodman, CHAPTER 13: PRACTICE & PROCEDURE § 2:5 (2nd ed. 2014).

[17] *Id.*; *In re Brown*, 742 F.3d 1309 (11th Cir. 2014).

(3) under chapter 13 for debtors who would be better served by chapter 7 but who are unable to pay attorney fees pre-petition.

1. Chapter 13. For example, most courts addressing the issue have imposed sanctions on attorneys who filed chapter 13 petitions for debtors whose debts exceeded the limits of section 109(e) rendering them ineligible for relief under that chapter.[18] Likewise, a North Carolina bankruptcy court concluded that it was bad faith for an attorney to file a petition while aware that the debtor had not received the credit counseling required by section 109(h); to file a "hopeless" chapter 13 case; and to refile a "hopeless" Chapter 13 case when there had been no change in the debtor's circumstances.[19] These courts hold that Federal Rule of Bankruptcy Procedure 9011 imposes an obligation on debtors' attorneys to ensure that a debtor is eligible before pursuing relief.[20]

2. Chapter 7. A bankruptcy court determined that the filing of a chapter 7 case for a debtor who was not eligible for a discharge, for the sole purpose of delaying a garnishment creditor long enough for the debtor to file again upon becoming discharge eligible, was done for an improper purpose and imposed sanctions upon the attorney.[21] The court opined that, "[o]btaining a discharge is the only valid purpose . . . for filing a chapter 7 case for a consumer," but noted that there may be a valid purpose in filing a chapter 13 case when the debtor does not

[18] *In re Harwood*, 519 B.R. 535, 544 (Bankr. N.D. Cal. 2014) (collecting cases).

[19] *In re Burton*, 442 B.R. 421, 457-58 (Bankr. W.D. N.C. 2009).

[20] *Id.*; *In re Harwood*, 519 B.R. at 544; *In re Kersner*, 412 B.R. 733 (Bankr. D. Md. 2009).

[21] *In re Snyder*, 2011 WL 612254, *2 (Bankr. E.D. Wisc. 2011).

qualify for a discharge and "in that instance a debtor might not run afoul of bankruptcy policy of saving a home or other secured property or making payments to creditors to the extent of the debtor's ability. This is a valid use of the bankruptcy system."[22]

3. Unable to pay fees pre-petition. In the wake of *Lamie,*[23] one of the reoccurring issues in chapter choice being addressed by the courts is the practice of filing a chapter 13 petitions for debtors who would be better served by chapter 7 but who are unable to pay attorney fees pre-petition.[24] Chapter 13 petitions and plans must be filed in good faith.[25] The courts are evaluating such cases, dubbed "fee-only" or "fee-centric" plans, under the applicable good faith standards.[26] The only courts of appeal to address the good faith of filing "fee-centric" chapter 13 cases are the first, fifth, and eleventh circuits. These courts have declined to issue a rule that such cases are *per-se* filed in bad faith, concluding that the good faith of each case should be examined under a totality of the circumstances on a case by case approach.[27] The first circuit cautions, however, that fee-only plans may only be justified under relatively rare, special circumstances.[28] Many of the bankruptcy

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[22] *Id.*

[23] *Lamie v. U.S. Trustee,* 540 U.S. 526, 124 S. Ct. 1023 (2004).

[24] *In re Brown*, 742 F.3d 1309 (11th Cir. 2014); *In re Puffer*, 674 F.3d 78 (1st Cir. 2012); *In re Crager*, 691 F.3d 671 (5th Cir. 2012).

[25] 11 U.S.C. § 1325(a)(3) and (7).

[26] See, e.g., *In re Brown*, 742 F.3d at 1316-17.

[27] *Id.* at 1317; *In re Puffer*, 674 F.3d at 84; *In re Crager*, 691 F.3d at 675.

[28] *In re Puffer*, 674 F.3d at 84.

courts considering such plans find that they are highly indicative of bad faith.[29] These courts describe plans which propose to only pay administrative expenses as little more than "disguised chapter 7 proceedings" that violate the spirit and purpose of chapter 13.[30]

[29] *In re Hopper*, 474 B.R. 872, 887, n. 27 (Bankr. E.D. Ark. 2012).

[30] *In re Arlen*, 461 B.R. 550, 554 (Bankr. W.D. Mo. 2011).