AMERICAN BANKRUPTCY INSTITUTE

Winter Leadership Conference

"Hit Me with Your Best Shot": Sanctionable Shenanigans by Debtor's Counsel and Others

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Hon. Gregory R. Schaaf
U.S. Bankruptcy Court (E.D. Ky.); Lexington

Hon. Madeleine C. Wanslee
U.S. Bankruptcy Court (D. Ariz.); Phoenix

CONCURRENT SESSION

2023

Hit Me With Your Best Shot: Sanctionable Shenanigans by Debtor's Counsel and Others
A Panel of American Board Certified Judges Consider Attorneys' Ethical and Practice Concerns

December 2, 2023, 1 p.m. to 2 p.m. Eastern Daylight Time

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Judges on our panel

Hon. Rene Lastreto II
Judge, U.S. Bankruptcy Court (E. D. Cal.); Fresno

Hon. Gregory R. Schaaf
Chief Judge, U.S. Bankruptcy Court (E.D. Ky.); Lexington

Hon. Madeleine C. Wanslee
Judge, U.S. Bankruptcy Court (D. Ariz.); Phoenix

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Thank you to the law clerks who prepared briefs on some of the cases presented today

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Discussion: the role of legal specialization

The primary role of legal specialization is to help consumers, lawyers, and the media find competent lawyers in a given location and field of law. Another important role is to encourage lawyers to continue with their professional growth.

Certified specialists have demonstrated their ethics, experience, and capabilities. Congress recognized this in 11 U.S.C. §330(a)(3)(C) ("In determining the amount of reasonable compensation to be awarded to an examiner, trustee under chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including … with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field … ").

How has legal specialization helped our panelists in their careers? Thirty-six sitting judges are board certified by The American Board of Certification – about 10% of all authorized judgeships.

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COMPETENCE AND DILIGENCE IN REPRESENTATION
11 USC § 526(a)(1)

6

In re Baker, 2023 WL 4139541 (Bankr. N.D. Ga. 2023) (Hagenau, J.) [Page 1 of 3]

- The UST moved the Court to reduce the attorney's fees of debtor's counsel. Counsel failed to attend four out of five 341(a) meetings offering no explanation beyond he had other matters to attend to. Counsel also failed to file accurate pleadings on behalf of the debtor, failing to disclose a number of salient facts (whether the Debtor is married, whether the Debtor is employed, incomplete schedules and mailing matrix, etc). Further, counsel did not obtain the debtor's original signature on his petition and he did not produce any writing confirming his authority to file the petition on behalf of the debtor.

- Counsel failed to disclose his attorney fee and failed to file the Debtor's credit counseling certificate or tax returns. Lastly, this was a pattern of behavior with counsel, as he has acted similarly in other cases.

- 11 U.S.C. § 526 mandates that shall not fail to perform any service that agency informed the assisted person it would provide in connection with the case. Case law mandates that bankruptcy attorneys must be prepared to assist the debtor through the normal, ordinary, and fundamental aspects of the process. Filing correct statements/schedules and attending 341 meetings are fundamental and core obligations of a bankruptcy attorney. By not doing these things counsel is in violation of 11 U.S.C. § 526.

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In re Baker, 2023 WL 4139541 (Bankr. N.D. Ga. 2023) (Hagenau, J.) (cont'd) [Page 2 of 3]

- 11 U.S.C. § 707(b)(4)(C) mandates that an attorney's signature on papers constitutes a certification that counsel has performed a reasonable investigation into the circumstances that gave rise to the filing and has determined that the paper is well grounded in fact and law. 11 U.S.C. § 707(b)(4)(D) provides that the signature of an attorney shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules is incorrect. A cursory review of the petition and the schedules show that they were inaccurate. Accordingly, the counsel's filing of the petition and schedules were in violation of 11 U.S.C. § 707(b)(4)(C) & (D).

- 11 U.S.C. § 329 requires any attorney representing a debtor to file a statement of the compensation paid or agreed to be paid for services rendered or to be rendered in connection with a bankruptcy case. Further, Bankruptcy Rule 2016(b) requires an attorney to file the § 329 statement with the UST within 14 days after the order for relief. Fed. R. Bankr. P. 2016(b). Caselaw states that failure to comply with obligations under either § 329 or B.R. 2016(b) subject the attorney to forfeiture of any right to receive compensation or disgorgement. Lastly, the Court pointed out that fees are also assessed for their reasonableness and the facts of the case do not support any compensation being paid as the papers were inaccurate and counsel did not attend meetings of creditors or diligently review his filings for accuracy.

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In re Baker, 2023 WL 4139541 (Bankr. N.D. Ga. 2023) (Hagenau, J.) (cont'd) [Page 3 of 3]

Conclusion

- The Court determined that counsel's actions were violative of both 11 U.S.C. § 329 and FRBP 2016(b). Because of the lack of quality service provided by counsel, the Court determined that the full disgorgement of the fee is an appropriate sanction. Furthermore, the Court found that counsel violated 11 U.S.C. §§ 329, 526, and 707 and Bankruptcy Rule 2016(b), that his actions were beyond the pale and represent a pattern of behavior for him. As such, counsel was ordered not to filed anything with the Court for 6 months and was required to take ethics CLE's.

9

What is the minimum level of competence expected by the Court for a $1,000 retainer?

10

In re Bush, Case No. 22-10043, ECF # 149 (Bankr. W.D. Pa. 6 Oct 23) (Taddonio, J.) [Page 1 of 2]

- "Attorney left the bat and ball on the coffee table; and the Debtors chose to play indoors. But once he learned of the damage they caused, Attorney had a duty not to hide the broken lamp."
- When Debtors filed their petition, they were in the midst of pursuing a personal injury claim with Special Counsel. Debtors' Attorney valued the claim in Schedule A/B at $2,000 even though he knew, or should have known, that the claim had a much higher value.
- Several months later, in May 2022, Debtors' Attorney called Debtors to inform them that the Court confirmed their plan. During this conversation, Debtors notified Counsel of a further settlement yielding an additional $55,000 which Debtors had already spent on a new truck and home renovations.
- After learning this information, Counsel failed to: (i) amend Debtors' schedules or their plan, (ii) seek approval of the settlement, (iii) file an application to employ Special Counsel, or (iv) make any disclosure to the Court. Rather, counsel "admitted that he intentionally withheld the status of the settlements to avoid adversely affecting the Debtors' ability to obtain a modification of their residential mortgage loan." After withholding this information for approximately 6 months, counsel filed the necessary disclosures. By this time, however, Debtors had already totaled their new vehicle purchased with the settlement proceeds without having insurance.

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In re Bush, Case No. 22-10043, ECF # 149 (Bankr. W.D. Pa. 6 Oct 23) (Taddonio, J.) [Page 2 of 2]

- Special Counsel, though unaware of Debtors' Bankruptcy, offered to voluntarily disgorge $7,000 in fees and took responsibility for the delay in filing its employment application. Unlike Special Counsel, Debtors' Attorney "failed to fully grasp the gravity of his missteps and the importance of adhering to proper procedures." Debtors' Attorney, the Court held, had the greater culpability. Though not responsible for his clients' wrongdoing, he did have a duty to timely disclose their misconduct. Since he failed to do so, the Court found he violated Rule 9011(b)(3) and imposed $5,600 in sanctions.

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What duty of candor does a debtor's attorney have to the Court?

13

FAILURE TO DISCLOSE FEE INFORMATION

14

In re Dordevic, 62 F.4th 340, 342-343 (7th Cir. 2023) (Scudder, C.J.)

- Disgorgement of all fees received by Chapter 7 debtor's counsel was warranted for brazen failure to file corrected financial disclosure form after being warned several times by the UST that his original filing underreported his compensation. While Debtor's Counsel initially disclosed that he was paid $5,000 for his services prepetition, he was actually paid $21,000.
- After warning debtor's counsel three times, the Chapter 7 Trustee filed a motion under § 329 requesting counsel forfeit all fees. Counsel explained that he had not updated his disclosure because he was unfamiliar with the disclosure requirements. The Court, however, found this explanation lacking given Counsel was involved in more than 350 cases in that district alone.
- The Code's fee disclosure requirements are "central to the integrity of the bankruptcy process." 3 Collier on Bankruptcy ¶ 329.01 (16th ed. 2022). And disclosure is mandatory for good reason: it protects both debtors from overreaching lawyers and creditors from losing their fair share of the estate.
- On appeal, the Seventh Circuit affirmed the bankruptcy court's decision. "Plain and simple, attorneys must inform the bankruptcy court of their compensation and promptly update the filing if their fees change." Id. at 342. Here, Debtor's Counsel failed to do so and, thus, was disgorged of all fees.

15

Are post-petition payments to debtor's counsel normally policed by the Court?

16

In re Reeves, 648 B.R. 289 (Bankr. D.S.C. 2023) (Duncan, J.)

- Retainer agreement providing that attorney would provide all services associated with bankruptcy matter for $3,700 paid by Chapter 13 debtor, which included a disclosure of 47 types of services that required debtor to pay an additional fee, but without providing a specific list of services covered by the $3,700, was not clear and conspicuous as to services to be provided to debtor and the fees related thereto as required by Bankruptcy Code provision governing requirements for debt relief agencies. 11 U.S.C.A. § 528(a).

- In addition to the $3,700 no-look fee, Debtor's Attorney filed a Supplemental-Fee Request seeking $1,289 in fees and costs which included $904 for fees and expenses related to a Motion for Moratorium and $385 for filing a change of address. The UST and Chapter 13 Trustee filed objections.

- Recognizing its responsibility to carefully scrutinize attorney compensation to prevent overreaching, the Court first held the Attorney failed to meet his disclosure obligations under 11 U.S.C. § 329 and under Fed. R. Bankr. P. 2016. The Court found: (1) inconsistencies regarding what services were excluded from the flat fee; and (2) concerns that Debtor failed to receive timely and full disclosure of any excluded services. Since "[a]ttorneys representing debtors in bankruptcy cases have an affirmative duty to fully and completely disclose all fee arrangements and all payments[,]" the attorney's failure to do so required the Court to deny the supplemental fee request.

17

How often do you hold hearings on chapter 13 supplemental fee requests?

18

FAILURE TO DISCLOSE CONNECTIONS

19

In re Fundamental Long Term Care, Inc., 81 F.4th 1264 (11th Cir. 2023) (Tjoflat, J.)

- Creditors, various probate estates, obtained judgments against debtor due to debtor's misconduct in operating nursing homes. The Court approved the Trustee's application to employ Special Counsel to assist in pursuing causes of action for the benefit of the Estate.
- Approximately five years later, Creditors discovered that Special Counsel had a longstanding representation of a real estate investment trust. This Trust leased property to Debtor. It was on this property that Debtor operated a nursing home where events transpired causing Debtor to become liable to Creditors. Because Special Counsel never disclosed its representation of the Trust which owned the property Debtor leased to operate a nursing home, Creditors moved to disqualify Special Counsel and for the disgorgement of fees.
- Law firm was not disqualified from representing trustee by virtue of its longstanding representation, as outside counsel, of real estate investment trust that had owned real property on which one of debtors' nursing homes was located, or trust's connections with nursing home operators or other entities.

20

Do you agree with this result?

21

In re Inmet Mining, LLC, 2023 WL 4534024 (Bankr. E.D. Ky. 2023) (Schaaf, J.) [Page 1 of 3]

- Debtor filed a chapter 11 petition and an application to employ Debtor's counsel pursuant to §§ 327(a) and 329. The application claimed Debtor's attorneys do not hold or represent any interest adverse to the Debtor, and that each of its attorneys is a "disinterested person" within the meaning of § 101(14), as modified by § 1107(b). The initial application also claimed the attorneys at the law firm have no connection with the Debtor, any of the Debtor's creditors, or any other party in interest in the chapter 11 case, or their respective attorneys, accountants, and advisors.

- Notwithstanding this representation in the body of the application, the declaration attached to the initial Application disclosed a familial relationship between an attorney in the Debtor's law firm ("Britt") and his brother ("Jerrod"), who was affiliated with the Debtor's primary secured creditor and proposed DIP lender, BMMS, and also the sole manager of the sole member of the Debtor.

- The Debtor's sole member was a limited liability company called IMG. BMMS exercised its rights under an equity pledge to appoint Jerrod as the sole manager of IMG immediately prior to the bankruptcy. Jerrod is affiliated with BMMS as principal of a merchant banking arm of BMMS's parent company.

- Britt performed legal work for the prepetition Debtor that included negotiations for the DIP financing provided by BMMS. His brother Jerrod simultaneously negotiated the DIP financing for BMMS. Britt also intended to actively work on the bankruptcy case.

22

In re Inmet Mining, LLC, 2023 WL 4534024 (Bankr. E.D. Ky. 2023) (Schaaf, J.) [Page 2 of 3]

- The initial application was denied on procedural grounds, but the Court raised concerns about disinterestedness at the first day hearing. The Court told the Debtor and its proposed counsel that it must address these concerns if another application was filed.

- The Debtor responded by filing another application to employ a different law firm that was subsequently approved. The Debtor's prior counsel filed a motion to withdraw, and also filed a limited application to employ the firm from the date of the petition through the termination of its relationship with the Debtor. The limited application disclosed the familial relationship in the body of the Application and in an amended declaration that also claimed that consent to the filing of the bankruptcy was based "solely upon recommendation by the Board of Managers of the Debtor" under which all authority for the Debtor is vested. The claim was inconsistent with the Debtor's corporate resolutions, and the limited application did not address the Bankruptcy Court's concerns about disinterestedness.

23

In re Inmet Mining, LLC, 2023 WL 4534024 (Bankr. E.D. Ky. 2023) (Schaaf, J.) [Page 3 of 3]

- The law firm argued that that Jerrod was not in control of the Debtor because the Debtor's Board of Managers had the authority to file the bankruptcy petition. The Court rejected this argument. It noted that BMMS orchestrated and controlled the ownership structure of the Debtor in the weeks prior to the petition date. BMMS appointed Jerrod as IMG's sole manager. Jerrod and BMMS created and signed the Operating Agreement that established the Board of Managers and appointed a new CRO as the only manager. The Operating Agreement also gave Jerrod, and hence BMMS, the right to replace the CRO or dilute the Board with other managers under their control. They were also free to amend the Operating Agreement, which could include restructuring management and ousting the CRO. The Court concluded that any independence of the CRO was illusory, as further illustrated by the corporate documents authorizing the bankruptcy that reflect Jerrod's approval as sole manager of IMG. Therefore, Jerrod is a person in control of the Debtor, and Britt is an insider as his brother, and cannot represent the Debtor.

- The Court ultimately granted the motion to withdraw and denied the law firm's limited application to represent the Debtor and/or receive compensation.

24

Do you look for hidden disclosures in employment application declarations not present in the application itself?

25

WHAT IS A BIFURCATED RETAINER AGREEMENT? DOES IT VIOLATE THE BANKRUPTCY CODE OR RULES? IN RE CIALELLA VS. IN RE SUAZO

26

Bifurcated fee agreements are allowed under the Code.
In re Cialella, 643 B.R. 789 (Bankr. W.D. Pa. 2022) (Agresti, J.) [Page 1 of 5]

- After Chapter 7 debtor received discharge and her case was closed, court *sua sponte* reopened case to determine whether bifurcated fee arrangement utilized by debtor's counsel should be permitted, and if so under what conditions. UST raised issue whether counsel should be sanctioned for admitted failure to properly disclose bifurcated fee arrangement.

- Bifurcated fee approach entails use of pre-filing agreement to provide solely for minimum amount of legal services needed to have a skeletal petition prepared and filed, thus initiating the bankruptcy, following which the parties enter into a post-filing agreement under which the bulk of the legal work is to be done; overall fee for bankruptcy filing is split between the two agreements, generally weighted heavily, or even entirely, to the post-filing agreement.

- The means of paying for consumer Chapter 7 cases presents something of a conundrum. Individuals who are contemplating a Chapter 7 filing are under considerable financial stress, yet to gain the protection of bankruptcy they are faced with the additional burden of coming up with an attorney fee. The average fee charged by local attorneys for a routine Chapter 7 case is approximately $1,500. Thus, together with the filing fee, an already financially-strapped individual may need to come up with at least $1,800 in order to file a Chapter 7 bankruptcy. 27

In re Cialella, 643 B.R. 789 (Bankr. W.D. Pa. 2022) (cont'd) [Page 2 of 5]

A number of different alternatives exist to address the no money to pay the Chapter 7 attorney fee "problem" discussed above.

(1) Pay the attorney fee in advance.

(2) File under chapter 13 instead of chapter 7.

(3) File the petition and other required documents and pray that the Debtor voluntarily pays the discharged portion of the attorney fee post-petition.

(4) Accept pre-petition a post-dated check that the attorney will cash post-petition.

(5) Use a "bifurcated" fee arrangement under which the attorney and the debtor enter into two separate fee agreements, one a "prefiling," or "prepetition" agreement signed before the petition is filed, and the other a "postfiling" or "postpetition" agreement signed thereafter.

We will now discuss these five alternatives in turn.

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In re Cialella, 643 B.R. 789 (Bankr. W.D. Pa. 2022) (cont'd) [Page 3 of 5]

(Alternative 1) Insist that the attorney fee must be paid in advance. If the debtor does not have the ability to pay the fee *in toto* then he must save up until the full fee can be paid, thereby delaying the filing. This approach often works if the debtor is not facing any immediate threat from creditors, but if there is an imminent foreclosure or repossession such a delay can be quite problematic.

(Alternative 2) File the case under Chapter 13, which allows for the postpetition payment of attorney fees as part of the plan, instead of under Chapter 7. While this can work, it ends up being much more expensive and burdensome for the debtor because Chapter 13 attorney fees are typically far larger than those in Chapter 7 and the debtor will be in bankruptcy for a longer period of time. Furthermore, using Chapter 13 primarily as a means to fund the payment of attorney fees is an abuse of the bankruptcy process. See e.g., In re Brown, 742 F.3d 1309 (11th Cir. 2014) (affirming finding by bankruptcy court that a Chapter 13 filing motivated not by a desire to adjust debts or preserve assets, but rather as a means to pay attorney fees, was not made in good faith; debtor would have been better off in Chapter 7); Foohey, et al., "No Money Down" Bankruptcy, 90 S. Cal. L. Rev. 1055 (2017) (discussing the empirical study showing that debtors who use Chapter 13 rather than Chapter 7 as a way to pay attorney fees pay $2,000 more have their cases dismissed at a rate of eighteen times higher than if they had filed under Chapter 7).

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In re Cialella, 643 B.R. 789 (Bankr. W.D. Pa. 2022) (cont'd) [Page 4 of 5]

(Alternative 3) Proceed with the Chapter 7 filing even though the debtor has only partially paid the agreed upon fee in the expectation that the debtor will voluntarily pay the remainder of the fee at some future time though not legally required to do so once a discharge has been entered.

(Alternative 4) Require a check from the debtor post-dated until after the filing date in the hope that the unpaid fee will then be treated as a post-petition obligation that is not discharged in the bankruptcy. This practice, however, has in general not fared well when brought to the attention of a court. See e.g., In re Davis, 2014 WL 3497587 (Bankr. N.D. Ala., July 11, 2014.)

(Alternative 5) Use a bifurcated fee agreement. In it's most basic form, the bifurcated fee approach entails the use of the prefiling agreement to provide solely for the minimum amount of legal services needed to have a skeletal petition prepared and filed, thus initiating the bankruptcy, following which the parties enter into a post-filing agreement under which the bulk of the legal work is to be done. The overall fee for the bankruptcy filing is split between the two agreements, generally weighted heavily (or even entirely) to the post-filing agreement. The theory behind this approach is that the debtor's obligation under the post-filing agreement will not be discharged in the bankruptcy and will thus remains a binding obligation of the debtor, providing some assurance to the attorney that the fee will be paid, even if over time.

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In re Cialella, 643 B.R. 789 (Bankr. W.D. Pa. 2022) (cont'd) [Page 5 of 5]

- In some instances the attorney also enters into a factoring or financing agreement with a third-party as part of the bifurcated fee arrangement, with the third party paying the attorney a discounted amount on the post-filing agreement fee "up front" in exchange for a security interest in the attorney's account receivable and a role in collecting subsequent installment fee payments due from the debtor under the post-filing agreement.

- A number of bankruptcy courts from around the country have considered whether the bifurcated fee approach is allowable under the relevant provisions of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, and the applicable rules of professional conduct. The results have been mixed, though a majority of the courts to have considered the matter have recognized that bifurcated fee arrangements are not inherently proscribed and thus may be used if certain conditions are met.

Holding: The Court adopted the majority view and found broadly that a bifurcated fee arrangement may be used in Chapter 7 cases provided certain strict conditions are met that are designed to assure that debtors are fully informed and treated fairly, and that proper disclosure to the Court is made by the attorney as part of the bankruptcy filing.

31

Is it equitable to reopen no asset chapter 7 cases to review fee agreements?

32

Bifurcated fee agreements are not allowed under the Code.
In re Suazo, 642 B.R. 838 (Bankr. D. Colo. 2022) (McNamara, J.) [Page 1 of 3]

- UST filed motion to examine the reasonableness of fees charged by counsel for Chapter 7 debtor, in particular, counsel's use of bifurcated pre- and post-filing fee agreements.

- Under the Code, Chapter 7 debtor's prepetition promise to pay attorney fees after the bankruptcy filing is discharged as part of the bankruptcy process. There is no exception to discharge of debts incurred by Chapter 7 debtor in conjunction with prepetition agreements to pay attorney fees.

- As such, attorneys who represent Chapter 7 debtors in bankruptcy generally require payment of their fees up front. The system creates a dilemma because many debtors have difficulty paying attorney fees in advance.

- Under the bifurcated fee agreement model, a debtor is asked to sign a pre-petition contract wherein an attorney agrees to provide only very limited legal services through the petition date. The attorney typically charges nothing or a small fee for performing the unbundled legal services, which consist of filing a "bare-bones" or "skeletal" case missing most of the documents required for a bankruptcy case to proceed to discharge.

33

Bifurcated fee agreements are not allowed under the Code.
In re Suazo, 642 B.R. 838 (Bankr. D. Colo. 2022) (McNamara, J.) (cont'd) [Page 2 of 3]

- After the petition date, the debtor will be offered a new post-petition contract in which the debtor agrees to pay for the remaining deferred legal services (usually at a rate materially in excess of the standard up-front fee and payable in installments). The debtor is informed that if the debtor declines to sign a second fee agreement post-petition, counsel may withdraw, in which case the debtor will then need to proceed *pro se* or engage another lawyer.
- Through counsel the Debtor filed a petition under Chapter 7 on December 9, 2020. Contemporaneously with the commencement of the bankruptcy case, counsel submitted a "Disclosure of Compensation of Attorney for Debtor" (the "Initial Compensation Disclosure"), wherein he disclosed that the Debtor had not paid anything before the Petition Date but agreed to pay him $2,998.00 later.
- The initial filing was a "bare-bones" or "skeletal" submission which did not include many documents required by Section 521. Accordingly, on December 10, 2020, the Court issued a "Notice of Deficiency" requiring the debtor to file various documents by December 23, 2020. Thereafter, counsel drafted the missing "Statement of Financial Affairs," "Summary of Assets and Liabilities," "Schedules," "Chapter 7 Statement of Current Monthly Income," and "Chapter 7 Means Test Exemption." Debtor signed the foregoing documents on December 13, 2020. A few days later, on December 15, 2020, counsel filed all such documents with the Court. The Post-Filing Retainer Agreement was signed by the Debtor on December 16, 2020.

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In re Suazo, 642 B.R. 838 (Bankr. D. Colo. 2022) (cont'd) [Page 3 of 3]

Holding: debtor's attorney and law firm violated the sections of the Bankruptcy Code governing "debt relief agencies" because their pre-filing agreement was misleading and contained misrepresentations. See 11 USC § 526(c). The post-filing agreement was also misleading and contained misrepresentations.

Competent representation and timely filing of documents is clearly an obligation that an attorney owes a bankruptcy client. Section 526 provides that when a debt relief agency fails to comply with its provisions, the bankruptcy court may require refund of fees and [award] damages.

As a remedy for counsel's violations, the Court ruled that the pre- and post-filing agreements were void, all payments by debtor had to be refunded, and counsel would be enjoined from making similar misrepresentations or misleading statements in future fee agreements.

35

Do you allow bi-furcated retainer agreements?

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THIRD-PARTY FINANCING ARRANGEMENTS FOR RETAINER INSTALLMENT PLANS.

37

In re Lantz, 643 B.R. 614 (Bankr. D. Idaho 2022) (Hillen, J.)

- UST filed motion for sanctions against attorney who represented debtor in the present chapter 7 case as well as debtors in over 50 other cases, alleging that attorney engaged in sanctionable, fee-related misconduct and seeking both monetary and nonmonetary remedies.

- The Court first addressed the defective FRBP 2016 disclosure, which stated counsel reached bifurcated fee arrangements with the debtor and had a line of credit with an unidentified lender against his firm's receivables for this and other cases. The Court concluded the disclosure was "plainly misleading and inconsistent" regarding its description of what work would be done prepetition (and for what amount) and post-petition (and for what amount). The court ordered counsel, after the evidentiary hearing, to file an amended disclosure in the case and when he failed to do so, the Court found it to be sanctionable misconduct.

- The Court then explained that the financing arrangement for the bifurcated agreement was unlawful. The arrangement is essentially an installment payment plan, and when the payments are assigned to a third-party for collection, counsel then has access to a line of credit. The Debtor, however, could not afford to make the post-petition payments. Debtor's schedule J plainly shows that Debtor's expenses exceeded her income by $90.59 each month. The payment scheme put the Debtor at financial risk. Counsel advised the Debtor to enter into an arrangement that was financially harmful to Debtor but beneficial to counsel. This created a conflict of interest and violated the Rules of Professional Conduct.

38

Are you comfortable with retainer financing arrangements?

39

NO-LOOK FEE AGREEMENTS

40

In re Spurlock, 642 B.R. 269 (Bankr. S.D. Ohio 2022) (Humphrey, J.) [Page 1 of 2]

Counsel for Chapter 13 debtor filed application for allowance of fees.

The Debtor was below-median income. She scheduled one automobile and filed a chapter 13 Plan that paid the fully secured claim on a motor vehicle. The Plan provided for an estimated secured claim of $1,958.00 to be paid at the Till interest rate with minimum monthly payments of $100.00. The Plan did not provide for any of the other types of relief that are commonplace in many Chapter 13 cases.

The Plan accounted for the attorney fee of $4,350 and showed that the Debtor paid $625 up front. The remaining $3,725.00 was to be paid through the Plan in monthly payments of at least $125.00. The $3,725 balance would be paid in 30 months. The Plan provided a 3% dividend to non-priority unsecured creditors. The Bankruptcy Court entered an Order that questioned whether the maximum no-look fee of $4,350 was reasonable for the case.

"No-look fee" rule requires attorneys who opt-in to the flat fee structure to assess the facts and issues presented by each individual case to determine a reasonable flat fee, which may be equal to or lower than the maximum allowable flat fee; in the alternative, counsel may itemize their fees pursuant to local bankruptcy rule.

In re Spurlock, 642 B.R. 269 (Bankr. S.D. Ohio 2022) (Humphrey, J.) (cont'd) [Page 2 of 2]

No-look fee" rule does not entitle attorneys to receive an identical fee in every case or eliminate the requirement that a fee be reasonable and tied to actual and necessary work for the benefit of the estate or the debtor. "No-look fees," also called presumptive fees, are court-sanctioned flat fee ranges that are presumed to be reasonable attorney fees in Chapter 13 cases.

No-look fee structures allow attorneys to charge a flat fee up to a maximum amount for a set of basic services involved in Chapter 13 representation that are typically detailed in the local rule or general order adopting the structure.

Bankruptcy courts guard the public interest and the integrity of the bankruptcy system when carrying out the independent duty to review and determine the reasonableness of attorney fees in Chapter 13 cases; this duty exists even in the absence of an objection or when the debtor appears to support the fee application. 11 U.S.C § 330.

Holding: No-look fees subject to review and reduction by the Court. The Court found that in the case at bar the maximum "no-look fee" of $4,350 was not supported by actual and necessary work to represent debtor, and thus, award for reasonable compensation would be allowed in reduced amount.

How often do you review “no look” fees?

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OTHER MEANS OF PROTECTING/ENSURING PAYMENT: ATTORNEY LIENS ON EXEMPT PERSONALTY

44

Counsel may not take a lien in exempt personalty to secure his fees.
In re Turner, *2022 WL 17408088* (Bankr. D. Minn. 2022) (Tanabe, J.) [Page 1 of 2]

- Debtor and counsel entered into a "flat fee" agreement. As of the Petition Date, Debtor owed the Applicant $1,647 in prepetition legal fees. Under the Agreement, Debtor had an option to pay such fees after the commencement of her case.

- To secure her promise to pay, the agreement informed Debtor that counsel will take a statutory attorney's lien against all of her furniture, appliances, household goods, clothing, electronics, cell phone, televisions and computing devices owned on 09/16/2022 and the proceeds of these items. The agreement clearly explained the purpose of the attorney's lien in this case: "It is likely that you will receive your Chapter 7 Bankruptcy discharge before your flat fee is paid off. You[r] personal liability (responsibility) for the unpaid portion of our attorney's fees will also be discharged in Chapter 7. To protect our right to receive payment for the work we have done for you, we place an attorney's lien on some of your personal property."

- The Court invalidated the agreement for two reasons. First, the agreement did not accurately describe Minnesota law on attorney's liens as by statute attorney's may not take a security interest in exempted personalty to secure fees. Second, the Fee Agreement contained false and misleading statements about liens in violation of 11 U.S.C. § 526(a)(2).

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In re Turner, *2022 WL 17408088* (Bankr. D. Minn. 2022) (Tanabe, J.) (cont'd) [Page 2 of 2]

- Section 528(1)(b) requires bankruptcy attorneys to draft written fee agreements with clear and conspicuous payment terms. Further, 11 U.S.C. § 526(a)(2) prohibits bankruptcy attorney's from making untrue of misleading statements to consumer debtors when drafting fee agreements.

- Here, the agreement contained a number of untrue of misleading statements regarding attorney liens in Minnesota. These statements went beyond mere technical errors and crossed the line into misinformation designed to attempt to get a debtor to waive protections in favor of the attorney. For instance, the agreement insisted that the attorney had a valid statutory lien in the property under Minnesota law, which was not the case. Further, the agreement stated that the attorney would allow him to lawfully pursue the collection of unpaid prepetition legal fees, which was also not the case.

Holding. The Court held that the agreement was void pursuant to 11 U.S.C. § 526(c)(1). This section of the code voids fee agreements that do not comply with code requirements. The Court pointed out that it did not doubt the good intentions of consumer debtor attorneys who are trying to offer their services and get paid, but Congress has not excepted unpaid prepetition legal fees from a chapter 7 discharge and the Minnesota State Legislature has not created an exception to allow attorney's liens in personal goods under Minnesota's exemption statute.

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What is the most overreaching conduct you have witnessed by debtor's counsel in an attempt to collect attorney fees?

47

Federal Rule of Bankruptcy Procedure 9011

10-9011 Collier on Bankruptcy ¶ 9011.04

> Rule 9011 places an affirmative duty on attorneys and litigants to make a reasonable (under the circumstances) investigation of the facts and the law before signing and submitting any petition, pleading, motion or other paper.
>
> Attorneys and parties are required to "think first and file later"; to "look before leaping." They may not file suit hoping that discovery will later show that a claim was proper or "drop papers into the hopper and insist that the court or opposing counsel undertake bothersome factual and legal investigation." However, an attorney is entitled to make reasonable inferences from the available facts. The scope of reasonable inquiry in any given factual setting may be subject to dispute.

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Federal Rule of Bankruptcy Procedure 9011 (b)

(b) Representations to the Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances --

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

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

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

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

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Federal Rule of Bankruptcy Procedure 9011(c)

(c) Sanctions. If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

(1) **How Initiated**.

(A) **By Motion**. A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 7004. The motion for sanctions may not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected, except that this limitation shall not apply if the conduct alleged is the filing of a petition in violation of subdivision (b). If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

(B) **On Court's Initiative**. On its own initiative, the court may enter an order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto.

(2) **Nature of Sanction; Limitations**. A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated.[50]

Reasonable Inquiry Under FRBP 9011.
***Golden One Credit Union v. Fielder*, Case # 2023-2038 (Bankr. E.D. Cal. 11/2/23) (Lastreto, J.)** (Page 1 of 5)

Debtor filed a chapter 7 petition. Golden One Credit Union immediately filed a complaint alleging a debt owed to it to be non-dischargeable pursuant to 11 U.S.C. § 523(a)(2).

Golden One's complaint was boilerplate and alleged only two operative facts: (1) Golden One made an unsecured loan of $9,000 on November 3, 2022, to help the Debtor pay off a $12,500 Wells Fargo credit card debt; and (2) the Debtor did not make the first payment when due on December 20, 2022. Golden One filed the complaint without attending the first meeting of creditors, listening to the recording of the meeting, or posing any questions to Debtor or Debtor's counsel. The complaint was filed 7 days after the Meeting of Creditors and 63 days before the deadline for non-dischargeability actions.

The Debtor responded to the complaint by filing a document entitled "Defendant's Statement of Undisputed Facts in Support of Her Motion for Bankruptcy". The Debtor explained in her Statement that she sought help from Golden One regarding ways to address a $12,500 balance on a Wells Fargo credit card charging 24.3% interest. Golden One advised her against consolidating with another debt relief company or filing for bankruptcy and recommended a Golden One loan. The maximum Golden One was willing to lend was $9,000. The Debtor took Golden One's advice and accepted the $9,000 unsecured loan, which was disbursed on November 3, 2022. The next day she paid Wells Fargo $10,500 on its $12,500 credit card debt. The Debtor then incurred another $1,000 on the credit card between November 4, 2022, and December 20, 2022 [first loan payment due date] to avoid a default on other loans, including her Golden One loan. She realized Golden One's advice was poor and decided to file bankruptcy.

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Reasonable Inquiry Under FRBP 9011.
***Golden One Credit Union v. Fielder*, Case # 2023-2038 (Bankr. E.D. Cal. 11/2/23) (Lastreto, J.)** (cont'd) (Page 2 of 5)

- The Court deemed the "Defendant's Statement of Undisputed Facts" to be an Answer and ruled no discovery was necessary as no discovery was being requested by Golden One. A trial date was set for July 18, 2023, but seven days later, on July 5, 2023, Golden One requested dismissal of the adversary proceeding, which was granted on July 7, 2023. The Court then ordered Golden One to show cause for potential violations of § 523(d) and Bankruptcy Rule 9011.

- The show cause order noted that the timing of the filing of the Complaint long before the deadline and the prompt dismissal in the face of an imminent trial invited inferences that: (1) the complaint was not well-founded; (2) there was not a pre-filing "inquiry reasonable under the circumstances;" and (3) the complaint was filed for the improper purpose. The show cause order also noted that the boilerplate complaint alleged only two concrete facts and no other circumstances that might support an inference of actual intent to defraud.

Reasonable Inquiry.

- The Court started its analysis with the duty to make a reasonable inquiry pursuant to Rule 9011. Rule 9011(b) provides that the signature of an attorney filing a Complaint is a certification that there has been an "inquiry reasonable under the circumstances." The basic principle is to require litigants to "stop and think" before making legal or factual contentions.

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Reasonable Inquiry Under FRBP 9011.
***Golden One Credit Union v. Fielder*, Case # 2023-2038 (Bankr. E.D. Cal. 11/2/23) (Lastreto, J.)** (cont'd)(Page 3 of 5)

- The Court acknowledged that there is a correlation between "first payment" or "early payment" defaults and early payment defaults can indicate fraud. But it rejected the idea that the existence of an early payment default is by itself sufficient grounds for a lawsuit based on fraud. The Court criticized Golden One for not attempting to first obtain an explanation from the Debtor. There was no Rule 2004 examination. There was no inquiry directed to Debtor's counsel before filing the complaint. The Court then examined Golden One's counsel's review of the client file, petition and schedules, and found it insufficient.
- The Court concluded that Golden One and its counsel did not make a reasonable inquiry.

Improper Legal Contention.

The show cause order identified paragraph 14 of the complaint as a potentially unwarranted legal contention:

> "14. The Defendant's obligations to Plaintiff are not consumer debts as defined at 11 U.S.C. § 101(8) to the extent they were based upon fraud and willful, malicious, and tortious injury to Plaintiff."

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Reasonable Inquiry Under FRBP 9011.
***Golden One Credit Union v. Fielder*, Case # 2023-2038 (Bankr. E.D. Cal. 11/2/23) (Lastreto, J.)** (cont'd) (Page 4 of 5)

- The show cause order noted that the Court was unaware of any legal support for the allegation. It recognized that Rule 9011(b)(2) tolerates "argument for change to existing law," but only to the extent such argument is not frivolous. The Court concluded that the contention was frivolous because "consumer debt" does not lose its status as "consumer debt" if it is excepted from discharge. The Court concluded that paragraph 14 serves only two possible purposes: (1) to intimidate as part of an effort to extract an unjust settlement; and (2) to avoid exposure to attorneys' fees and costs under § 523(d) for unsuccessful § 523(a)(2) actions in which the creditor's position is not "substantially justified."

- The Court concluded that paragraph 14 is both baseless and was made without a reasonable and competent inquiry in violation of Rule 9011(b)(2). Rule 9011(b)(3) provides that the signature on the complaint constitutes a certification that the allegations and other factual contentions have evidentiary support. The Court concluded there is no evidentiary support for Golden One's allegations in the complaint.

Fees and Costs.

The Court noted that § 523(d) provides that, absent special circumstances, a creditor is liable for costs and a reasonable attorney's fees for the proceeding if the court finds that the position of the creditor was not substantially justified. The creditor has the burden to prove its position was substantially justified, which entails demonstrating a reasonable basis in law and fact and Golden One did not meet this burden.

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Reasonable Inquiry Under FRBP 9011.
***Golden One Credit Union v. Fielder*, Case # 2023-2038 (Bankr. E.D. Cal. 11/2/23) (Lastreto, J.)** (cont'd) (Page 5 of 5)

- Even so, the Court said that it was "Golden One's lucky day" because the debtor's bankruptcy counsel did not assist her in defending the adversary proceeding. The debtor did incur costs that were eligible for reimbursement and the record was sufficient for the Court to reasonably estimate her costs.

Sanctions.

The Court then assessed whether to award remedial sanctions pursuant to Rule 9011(c)(1)(B). The Court noted that it could not issue monetary sanctions where its order to show cause was issued after voluntary dismissal of the case under Rule 9011(c)(2)(B). But non-monetary sanctions are permitted.

The Court cited two areas of concern. First, Golden One's counsel failed to cite controlling Ninth Circuit authority regarding § 523(d). The consequence "is self-inflicted reputational damage." Second, Golden One's counsel violated Rule 9011(b)(2) by wrongly alleging that fraud disqualifies a debtor for "consumer debt" status in paragraph 14 of the complaint. The Court noted that Golden One's counsel had made this same allegation in six other complaints and this pattern supported sanctions. The Court therefore sanctioned counsel by imposing a requirement of prefiling review by the Court of every complaint alleging non-dischargeable debt before it is filed by that law firm for the next 18 months.

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Discussion: To comply with FRBP 9011, should a Section 523(a) plaintiff have to meet and confer with a debtor or her counsel before filing suit?

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If attorney for Chapter 7 debtor fails to undertake the required prepetition investigation, the Court may order attorney to reimburse trustee for all reasonable costs of filing any motion for dismissal if a violation of Rule 9011 is found.
***In re Prophet*, 651 B.R. 263 (Bankr. D.S.C. 2022) (Duncan, J.) aff'd sub nom. *In re Rosenschein*, 651 B.R. 677 (D.S.C. 2023)[Page 1 of 4]**

The matters before the Court were to consider the reasonableness of attorneys' fees, the propriety of using Fresh Start Funding ("FSF") to collect retainers from debtors post-petition, the adequacy of counsel's disclosures to the Debtors, and whether the record shows that the debtors were provided informed consent for the structure of the fee agreements.

The Bifurcated Fee Terms.
FSF provided counsel with financing to cover expenses associated with the bifurcation of fees. FSF also assisted counsel with collection of accounts receivable and extended a line of credit to attorneys for indemnification liability for shortfalls in collections.

Counsel gave his clients the option of choosing to pre-pay all fees or splitting the engagement into pre- and post-petition services. If a client chose the first option, then the client would enter into one agreement with counsel, covering both pre-filing and post-filing services for a fixed fee of $2,350 (including the filing fee) and providing for certain supplemental post-filing services charged at $300 per hour for attorney time and $150 per hour for paralegal time. Alternatively, counsel offered a bifurcated fee option where the client could either pay $500 pre-filing to cover the filing fee and other out-of-pocket costs, or pay zero dollars down. In this event the client was responsible for making monthly payments directly to FSF beginning shortly after the bankruptcy petition was filed.

***In re Prophet*, 651 B.R. 263 (Bankr. D.S.C. 2022) (Duncan, J.) (cont'd) [Page 2 of 4]**

- FSF provided counsel with forms for the pre- and post-filing agreements and counsel used those forms, with minor modifications. The Pre-Filing Agreement divided the work necessary for a chapter 7 case into three categories: (1) pre-filing services; (2) post-filing services; and (3) supplemental post-filing services.

- The Pre-Filing Agreement contained an "Unbundling or Limited-Scope Representation" paragraph that stated:
  By signing below, you acknowledge that the Law Firm has expressed that it is ready, willing and able to represent you for your entire chapter 7 case, even if you choose the File Now Pay Later option, which will require you to sign a Post-Filing Agreement. If you choose the File Now Pay Later option, you further represent that you are not doing this with the intention of having the Law Firm simply file your case and then withdraw, but instead to facilitate you making payments over time for your attorney fee so that you can have an attorney represent you through the entire chapter 7 process.

- The Post-Filing Agreement contained a disclaimer stating: "You must read, understand, and agree to the Post-Filing Agreement stated below before your Pre-Filing Agreement will be considered legally binding."

- The Court concluded that the attorneys' fees and costs are not reasonable and necessary because the fees under the "File Now Pay Later" option are significantly higher than normally charged to cover the costs counsel' arrangement with FSF

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***In re Prophet*, 651 B.R. 263 (Bankr. D.S.C. 2022) (Duncan, J.) (cont'd) [Page 3 of 4]**

Adequacy of Disclosures.
The Court concluded that counsel failed to comply with material requirements of §§ 526(a)(2)–(3) and 528(a)(1) and the Agreements were statutorily void under § 526(c)(1). The Court held that the disclosures were inadequate because the Pre-Petition and Post-Petition Contracts are not models of clarity, and fall short of the required clear and conspicuous explanation of services to be provided, fees to be charged, and terms of payment. Therefore, the Pre-Filing Agreement does not comply with the material provisions of § 528 and is void and unenforceable pursuant to § 526(c)(1).

Finally, the Court discussed the propriety of using FSF to collect from the Debtors. The Court emphasized that it does not take issue with the actual legal services provided to Debtors by counsel but rather the mechanism it selected for payment of his attorneys' fees. It observed that this mechanism results in a significant up-charge in the form of post-petition debt being incurred by financially challenged, distressed, and unsophisticated debtors. Further, the bifurcated fee structure conflicts with counsel' duty to adequately represent his clients and conflicts with the client's interests. The Court explained that the bifurcated fee structure has the logical and practical effect of discouraging attorneys from performing pre-petition services and limiting the time and effort spent on such services. Therefore, the bifurcated system either impairs the necessary pre-petition investigation and analysis, or it encourages the deceptive labeling of pre-filing services as post-filing services. This design prevents compensation for services from being discharged and facilitates the collection of such compensation.

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***In re Prophet*, 651 B.R. 263 (Bankr. D.S.C. 2022) (Duncan, J.) (cont'd) [Page 4 of 4]**

Informed Consent.
Finally, the Court explained that the Code requires that attorneys representing consumer debtors deal forthrightly and honestly with their clients, It concluded that the information in the Pre-Filing Agreement is not clear and conspicuous regarding the fees being paid, the services being provided, and the risks, and as such, negates informed consent.

Conclusion.
The Court ordered counsel to return all fees paid post-petition under the Agreements, less any filing fees or out of pocket costs, within 30 days. The Court did not impose sanctions.

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Discussion: do skeleton filings cause an additional burden upon the Court?

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Initiating bankruptcy cases for predeceased debtors: no safe harbor for filing petitions under FRBP 9011(c)(1)(A).
In re Bagsby, 40 F.4th 740 (6th Cir. 2022) (Donald, C.J.) (Page 1 of 3)

Counsel filed two skeletal Chapter 13 petitions on behalf of decedent debtor Gayle Bagsby in 2016 and 2018 at the request of the debtor's daughter Elizabeth Bagsby who was Administratrix of the probate estate. The cases were dismissed pursuant to 11 U.S.C. § 109(e) because a probate estate cannot be a debtor. Elizabeth Bagsby, proceeding *pro se*, filed three more Chapter 13 petitions on the Debtor's behalf thereafter. The Chapter 13 Trustee filed a motion to dismiss and a motion for sanctions against Elizabeth after she filed the fifth Chapter 13 petition. The Court then ordered counsel to appear and show cause as to why it should not impose sanctions for filing the two Chapter 13 petitions on behalf a deceased person.

The Court held a show cause hearing at which counsel, an attorney practicing for almost 40 years, testified that the 2 skeletal petitions he filed in the debtor's name were the only times he had ever filed a bankruptcy case for a deceased person. He further explained that he learned that a deceased person could not file for bankruptcy only after speaking with the UST. His conversation with United States Trustee led him to voluntarily dismiss the 2018 Chapter 13 petition. Counsel admitted that he did not research whether a decedent's estate could file for bankruptcy.

The petition was electronically signed by the decedent. Counsel testified that his law firm's software prevented him from uploading Elizabeth's "wet signature" which would have indicated that she signed the petition in a representative capacity for her mother.

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In re Bagsby, 40 F.4th 740 (6th Cir. 2022) (Donald, C.J.) (cont'd) (Page 2 of 3)

- Counsel did not disclose the $1500 he received for filing the 2016 petition, nor the $690 he received for filing the 2018 petition. Counsel testified that he usually filed the Rule 2016(b) fee disclosures with the schedules. But Elizabeth did not provide him with the information necessary to file the schedules.

- After the show cause hearing, the Court reopened the first two cases and issued sanctions *sua sponte* against Counsel and Elizabeth. The Court determined that: (1) Counsel failed to conduct any inquiries or legal research; (2) there was no basis in existing law to support a reasonable possibility of success, and (3) the cases were filed for the express purpose of delaying foreclosure actions. The Court found that Counsel violated Rule 9011 by signing and filing the accompanying statement of the Debtor's social security number. The Court also found that Counsel failed to make the required disclosures of the fees he received for filing the two Chapter 13 petitions, in violation of § 329 and Rule 2016(b). Finally, the Court held that Counsel violated ethics regulations and local bankruptcy rules pertaining to competence and candor. The Court imposed sanctions *sua sponte*, including: (1) a 90-day suspension from filing new bankruptcy petitions; (2) completing ten hours of continuing legal education courses in ethics; and (3) self-reporting to the Tennessee Board of Professional Responsibility.

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In re Bagsby, 40 F.4th 740 (6th Cir. 2022) (Donald, C.J.) (cont'd) (Page 3 of 3)

- On appeal, the Sixth Circuit explained that the test for imposing sanctions under Rule 9011(b) is whether the individual's conduct was reasonable under the circumstances. Under this test, the Court should not use the benefit of hindsight but should test the signer's conduct by inquiring what was reasonable to believe at the time the filing was submitted.

- The Sixth Circuit criticized counsel's reliance on a specific Rule 11 holding as ignoring a critical difference between the safe harbor provisions in Rule 11 and Rule 9011, or that Counsel's argument is expressly precluded under Rule 9011(c)(1)(A). The Sixth Circuit explained that, even assuming that the safe harbor provision in Rule 9011(c)(1)(A) applies to Rule 9011(c)(1)(B), the safe harbor provision has an exception for when "the conduct alleged is the filing of a petition." FED. R. BANKR. P. 9011(c)(1)(A). This is because filing "a [bankruptcy] petition has immediate serious consequences, including the imposition of the automatic stay under § 362 of the Code, which may not be avoided by the subsequent withdrawal of the petition." *Id.*

- The Sixth Circuit concluded that the Court correctly followed Bankruptcy Rule 9011(b) regarding an attorney's representations to the court in signing and filing a petition or other papers, and correctly determined that Counsel's conduct was unreasonable under the circumstances

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Discussion: how much harm do unmeritorious petitions cause?

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"National law firm" practice issues

Ease of finding clients through the Internet.

Client comfort with communicating with professionals on the Internet.

Disclosure of compensation split and bifurcated retainers.

Supervision of non-attorney staff.

Misrepresentation to clients.

66

In re Deighan Law LLC dba Upright Law, 637 B.R. 888 (Bankr. M.D. Ala. 2022) (Sawyer, C.J.) [Page 1 of 4]

- The Bankruptcy Administrator and the Chapter 13 Trustee filed several motions and complaints in the Middle District of Alabama Bankruptcy Court alleging a myriad a practice violations by Upright Law while representing debtors. The Court consolidated the various motions/complaints into a single order to show cause, which came before the court for argument in October 2019. The OSC distilled the arguments into two distinct issues. First, whether Upright's business model is compliant with the Code. Second, whether Upright's practices were below an acceptable standard.

- Upright Law is a limited liability company based in Chicago. It holds itself out as engaging in a professional business of representing debtors in consumer bankruptcy cases. Upright employs 105 people in Chicago, none of which are Alabama lawyers. Instead, it relies on attorneys licensed in each state to file the cases.

- Upright solicits individuals who are considering bankruptcy. This interaction necessarily involved legal advice by staff, the majority of whom are not licensed attorneys. Upright seeks to onboard the client, take their information, and populate a bankruptcy form. A retention agreement is generated and payments are made by the debtor to Upright in both a chapter 7 and 13 case. The decision to file a bankruptcy case and the selection of the chapter are considered to be the practice of law in Alabama. Upright then hired a lawyer to file the petition and attend the 341 meeting. Upright contends that the Alabama lawyers it hires are partners in Upright law; however, these attorneys have their own law practices and file for Upright using separate CM/ECF accounts. The local attorneys sign a limited partnership agreement that provides that they have no right to participate in the management of Upright and have no ownership or voting interest in the firm. Upright also retained the right to unilaterally modify the partnership agreement.

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In re Deighan Law LLC, 637 B.R. 888 (Bankr. M.D. Ala. 2022) (Sawyer, C.J.) (cont'd) [Page 2 of 4]

- Three Alabama Attorneys named in the show cause order hold themselves to be out as local partners of Upright Law, but all three have separate practices in Alabama. Alabama law does not define what a law firm or practice is, but Rule 9001(6) provides that a firm includes a partnership or professional corporation of attorneys or accountants. The Court determined that because the local attorneys have no right to engage in the management or control of the actions of the lawyers or non-lawyers in Chicago, the local lawyers are not partners and Upright is not a law firm authorized to practice law in Alabama pursuant to Rule 9001(6).

- The Court also noted that the fee agreement themselves contemplate non-lawyers or lawyers based in Chicago will be practicing law in Alabama. While a number of the duties that are required can be performed in Alabama by non-lawyers, they must be supervised by an Alabama lawyer. Because the local counsel explicitly do not have the ability to meaningfully supervise by virtue of their partnership agreements, Upright is using local counsel to paper over the unauthorized practice of law in Alabama. The Court cites a litany of examples of services by Upright that courts have held constitute the unauthorized practice of law in a bankruptcy case. Upright specifically breached a number of the stated instances, usually along the lines of improper communications by a non-attorney to clients in various forms.

- The Court concluded by pointing out that attorneys are bound by rules of professional conduct, which specifically outlaws assisting a non-lawyer practice law. The Court determined that the local attorneys were doing just that and engaging in the unauthorized practice of law along with Upright.

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In re Deighan Law LLC, 637 B.R. 888 (Bankr. M.D. Ala. 2022) (Sawyer, C.J.) [Page 3 of 4]

The Court then turned to the instances of misconduct by the three Alabama attorneys:

*Failure to confirm the debtor's identity, having only spoken to the client by phone or email prior to meeting him at the 341 meeting.
*Filing unredacted paystubs which displayed the full social security number of a debtor in violation of Fed. R. Bankr. P. 9037(a).
*Failure to obtain the debtor's signature prior to filing the bankruptcy petition in violation of Fed R. Bankr. P. 5005(a)(2)(C).
*One case was closed without a discharge because a debtor failed to complete a financial management course, but counsel nevertheless falsely informed a debtor that he had received a discharge.
*Failure to retain a copy of a debtor's case file.
*Failure to provide copies of the Debtor's tax returns pursuant to 11 U.S.C. § 521(e)(2)(A). This is important because failure to do so mandates dismissal of the case.
*Preparing and filing deficient schedules.
*Filing a certificate of credit counseling that was over 180 days old in violation of 11 U.S.C. § 109(h)(1).
*Instructing client to sign a Declaration re: Electronic Filing before the debtor had reviewed her schedules.
*One debtor did not disclose that he had a ½ interest in his mother's house. It was revealed at the § 341 meeting. To prevent liquidation of the home, counsel moved to convert to chapter 13, which was granted. Counsel was then late filing the chapter 13 plan and other documents forcing a motion to reconvert to chapter 7, which was ultimately defeated, but it wasted a lot of time.

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In re Deighan Law LLC, 637 B.R. 888 (Bankr. M.D. Ala. 2022) (Sawyer, C.J.) [Page 4 of 4]

Holding:

*Upright Law and the Local Attorneys were ordered to disgorge all fees paid.

*The Court fined Upright $500,000 as a civil penalty for violation of § 526. The Court found this power inherent under § 105.

*Upright Law was enjoined from the practice of law in the Court.

*The three Alabama lawyers were required to complete 15 hours of CLE in bankruptcy law.

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Final thoughts from our Judges

Faculty

Mary Beth Ausbrooks is the sole owner in the consumer debtor firm of Rothschild & Ausbrooks, PLLC, in Nashville, Tenn. She is a Fellow of the American College of Bankruptcy and is Board Certified in Consumer Bankruptcy Law by the American Board of Certification, for which she presently serves as president. Ms. Ausbrooks has served as the Tennessee State chair for the National Association of Consumer Bankruptcy Attorneys and is a member of its board of directors. She has served as president, vice president and secretary for the Middle Tennessee Association of Consumer Bankruptcy Attorneys. Ms. Ausbrooks has been recognized in *Super Lawyers* for many years. She has presented on best practices for consumer debtor attorneys and on other aspects of the consumer debtor practice, and she is admitted to practice in the state of Tennessee, the District Court for the Middle District of Tennessee, the Sixth Circuit Court of Appeals and the U.S. Supreme Court. Ms. Ausbrooks received her J.D. in 1996 from the University of Memphis.

Wesley H. Avery is a bankruptcy practitioner with The Bankruptcy Law Center in Pasadena, Calif., and a member of the California State Bar. He is also a chapter 7 panel trustee and a chapter 12 trustee for the Central District of California. Mr. Avery is certified as a specialist in Bankruptcy Law by the State Bar of California and the American Board of Certification. He is AV-rated by Martindale Hubbell and 10.0 by Avvo, and has been a *Super Lawyer* since 2006. Mr. Avery is admitted to the U.S. Supreme Court, the Ninth Circuit Court of Appeals, all Federal District Courts of California, other federal courts and the California Supreme Court. He previously served as a major in the U.S. Army from 1996-97, at which time he was awarded the Meritorious Service Medal. He is a member of the ABA Subcommittee on Legal Specialization, was chairman of the California State Bar Bankruptcy Law Advisory Commission (2004-05) and was chairman of the State Board of Legal Specialization (2010-11). Mr. Avery is an adjunct professor at California State University at Northridge and a real estate broker. He received his B.A. with highest honors in economics and in political science from the University of California at Davis in 1980 (where he was elected to Phi Beta Kappa), his M.B.A. from Harvard Business School in 1984 and his J.D. from the University of California at Los Angeles in 1991.

Hon. René Lastreto II is a U.S. Bankruptcy Judge for the Eastern District of California in Fresno, sworn in on Sept. 14, 2015. Prior to his appointment, he was the managing partner with Lang, Richert & Patch in Fresno and, before that, the CFO of the firm. While in private practice for 34 years, Judge Lastreto emphasized litigation matters involving creditor rights in all courts in California. He also represented all constituencies in bankruptcy matters, including creditors (both secured and unsecured), creditors' committees, trustees, asset-purchasers, lessees, lessors, debtors and estate professionals. Before joining Lang, Richert & Patch in 1999, he was a partner at Dowling, Aaron & Keeler in Fresno, and prior to that, a partner at Crossland, Crossland, Chambers, Lastreto & Knudson. Judge Lastreto was trial counsel in many types of cases in both state and federal courts, and primary trial counsel in numerous contested matters representing various interests on agricultural and commercial code issues. He is a frequent faculty member in many continuing education programs, both teaching and writing on various creditor-related and agricultural issues. Prior to his appointment as a judge, he was on the commercial panel of the American Arbitration Association and arbitrated numerous commercial disputes, including construction and contract disputes. Judge Lastreto is Board Certified

in Creditors' Rights Law by the American Board of Certification. He received his undergraduate degree *cum laude* in 1978 from the University of Utah and his J.D. from the University of San Francisco in 1981.

Hon. Gregory R. Schaaf is Chief U.S. Bankruptcy Judge for the Eastern District of Kentucky in Lexington, initially appointed on Oct. 1, 2012, and named Chief Judge on Oct. 1, 2019. Prior to his appointment, he practiced in the areas of commercial reorganizations, including bankruptcies and workouts, and commercial transactions, including energy-related matters. He represented debtors, creditors' committees, trustees and individual creditors. Judge Schaaf is a CPA and worked as a solicitor in London from 1997-99, handling corporate matters and real estate transactions for English, Russian and American clients. He is a Fellow of the American College of Bankruptcy and is Board Certified in Business and Consumer Bankruptcy Law by the American Board of Certification. Judge Schaaf received his B.B. in accounting and his B.S. in law enforcement administration from Western Illinois University in 1984 with high honors, and his J.D. in 1991 from the University of Kentucky College of Law, where he was a member of the Order of the Coif and participated in its national moot court team and on its moot court board, as well as on the school's *Journal of Mineral Law and Policy*.

Hon. Madeleine C. Wanslee is a U.S. Bankruptcy Judge for the District of Arizona in Phoenix, sworn in on March 17, 2014. Previously, she was an associate and then partner at Gust Rosenfeld, PLC, where she was active in the firm's management committee and co-chaired the firm's Bankruptcy Practice Group. Her practice focused on bankruptcy and creditors' rights, and she represented small businesses, financial institutions, corporations and state agencies. While in private practice, Judge Wanslee was a certified bankruptcy specialist. She also argued a number of appeals, including *United Student Aid Funds Inc. v. Espinosa* before the U.S. Supreme Court. Judge Wanslee serves on the Ninth Circuit Conference Executive Committee (currently as program chair) and on various committees of the National Conference of Bankruptcy Judges. She is a frequent presenter and helps to train new judges through the Federal Judicial Center. Judge Wanslee is a former chair of the Ninth Circuit Bankruptcy Judges Education Committee, the Ninth Circuit Lawyer Representatives Coordinating Committee and the Arizona State Bar's Bankruptcy Section. She helped to charter and is past president of the Arizona Bankruptcy American Inn of Court. Judge Wanslee began her legal career as a law clerk for Hon. Robert Clive Jones of the Ninth Circuit Bankruptcy Appellate Panel. She received her B.F.A. and B.A. from the University of Arizona and her J.D. from Gonzaga University School of Law, where she served as a writer and executive editor of the *Gonzaga Law Review*. Following law school, she clerked for Chief Bankruptcy Judge Robert C. Jones of the District of Nevada.