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Consumer

How to Minimize Your Consumer Practice Malpractice Risk

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Best Practices in Consumer Bankruptcies[1]

Pre-Filing

1. Why should I care about best practices?

1.1. 11 U.S.C. § 727& § 523

The primary reason practitioners should care about best practices is to ensure that clients receive a fresh start. As all practitioners should know, sections 727 and 523 carry harsh consequences. Those sections don't just pose a problem for bad actors. Even unwary or negligent debtors may find themselves in the middle of an adversary proceeding to deny them a fresh start when a little preparation and planning could have avoided the problem.

1.2. Reducing Work and Administrative Hassles

Besides 727 and 523 actions, following a set of best practices will make your life easier. A set of best practices ensures that you have all the information and documentation you need when you need it. Having it all simplifies drafting schedules and providing documents to trustees and the US Trustee when they inevitably want something. Additionally, it allows you to streamline complying with various requirements and deadlines such as (1) reaffirmation agreements and lease assumptions; (2) providing documents to the chapter 7 trustee; and (3) filing the Debtor's financial management certificate. Missing the deadlines for all of those can result in enormous time and expense in the form of continued 341 meetings, motions to extend time, and paying to reopen a case to file the financial management certificate.

1.3. Ethical Duties and Malpractice Claims

As discussed further below, the Code and state bars impose duties on attorneys. Following best practices enables attorneys to adhere to those duties.

Most states' law on attorney malpractice is similar to Wisconsin:

> To prevail in an action for legal malpractice, a plaintiff must prove four elements: (1) a lawyer-client relationship existed; (2) the defendant committed acts or omissions constituting negligence; (3) the attorney's negligence caused the plaintiff injury; and (4) the nature and extent of injury. . . . The last two elements in a claim for legal malpractice arising out of civil representation most often require the plaintiff to prove a "suit within a suit" by showing that, "'but for the negligence

[1] A full list of the sources used in drafting this outline, as well as their authors is included at the end of this outline. The author, Nicholas Hahn of Steinhilber Swanson LLP, borrowed from many sources and tried to attribute as best he could in the footnotes.

of the attorney, the client would have been successful in the prosecution or defense"' of the underlying civil action.[2]

In other words, in order to prevail a client has to prove the attorney had a duty to act a certain way, the attorney did not act that way, and but for the attorney's failure to carry out his duty, the client would not have been harmed.

It is not hard to imagine how failing to ask a question or do a minimal amount of due diligence could lead to a 727 or 523 claim and the cost an expense of defending one.

2. Intake

2.1. Retainer

As the Supreme Court told us in *Milavetz, Gallop & Millavetz v. United States*,[3] bankruptcy attorneys are "debt relief agencies," and therefore section 528 applies to them.

11 U.S.C. § 528 – Within 5 days of providing any services, attorneys must provide "assisted persons" with a contract. An assisted person is anyone who has primarily consumer debts and whose non-exempt personal property is worth less than $192,450.00. 11 U.S.C. § 101(3). Section 58 requires:

- A written contract explaining clearly and conspicuously the services the attorney will provide, the fees, and the term of payment; and
- A copy of the contract for the client to keep.

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- Have your client sign an acknowledgement that he or she received the contract.
- Sign a consultation agreement, since 528 applies to "any bankruptcy assistance services . . .," and that could even mean telling an individual to wait for 6 months to avoid the means test.
- Consider using check boxes to delineate what services will be provided. Check boxes are clearer and more conspicuous choice than a block of text and legalese.

2.2. Scope of Representation[4]

[2] *Hicks v. Nunnery*, 253 Wis. 2d 721, 746-47 (Wis. Ct. App. 2002).

[3] 559 U.S. 229 (2010).

[4] For a terrific discussion of this topic, see Carrie A. Zuniga, *The Ethics of Unbundling Legal Services in Consumer Cases*, Am. Bankr. Inst. J., October 2013, at 14.

The model ABA model rules and about 41 states allow "unbundling," or allowing the attorney and client limit the scope of representation:

In general, unbundling raises serious questions. Bankruptcy potentially entails many proceedings, additional required disclosures, and consequences for the unwary. Those consequences could include, losing objections to exemptions, losing a discharge, or having case dismissed for simple clerical errors or minor oversights.

2.2.1. What is allowed under the state's ethical rules?

When in doubt, attorneys should always reference their state's ethics rules, call their ethics hotline, and any decisions or guidance published by the ABA or their local courts and regulatory bodies.

ABA Model Rules

Rule 1.1:

> A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Rule 1.2:

> A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

Rule 1.0(e)

> "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

2.2.2. What the Bankruptcy Court Expects

- **Check the local rules and public comments by judges**. While the Code and many courts' local rules don't explicitly disallow unbundling, many judges and much case law frown on the practice in some cases.

- **Unbundling the 341 Meeting**. Most Courts have held that unbundling meetings of creditors breaches the duty of competence and is unreasonable. *See, e.g.*, *In re Johnson*, 291 B.R. 462, 466 (Bankr. D. Minn. 2003) ("In this District, attendance and representation at the meeting of creditors is mandatory in most circumstances, and

may not be avoided by discounting compensation and modifying the Rule 2016(b) statement.").

- **Unbundling Reaffirmations**. *In re Collmar*, 417 B.R. 920, 924 (Bankr. N.D. Ind. 2009) ("The decision to reaffirm an otherwise dischargeable debt plays a critical role in the bankruptcy process - so critical, that assistance with the decision is part of the services that make up the competent representation of a chapter 7 debtor.").

- **Informed Consent**. Given the complexity and risks involved with bankruptcy, whether a client can give informed consent may be unlikely.

> In order to make an informed decision, the client must understand what might be faced in the bankruptcy, and the risks associated with representing himself in handling those contingencies. Many lawyers find themselves surprised by what can arise in an otherwise "simple" bankruptcy case. The reported decisions of this and other bankruptcy courts make it clear that, even in garden variety consumer chapter 7 cases, counsel for debtors and those who might be characterized as their adversaries (creditors, or occasionally the trustee) sometimes have distinctly polar views of what is permissible and what is not. The ability to adequately explain the lay of the bankruptcy landscape, including all its variations, contingencies and permutations, in order to obtain a truly informed consent is suspect.[5]

- **What should attorneys not unbundle?** At least one court has articulated a list:

> > [S]ome matters that may arise—**objections to the exemptions** the debtors have claimed, **objections to discharge based on alleged errors or omissions in the Schedules or Statement of Financial Affairs**, and **motions to dismiss under § 707(b) for substantial abuse** -- are so closely related to the advice the attorney gave in the prepetition preparation for filing that the attorney would at least be morally bound, and might be legally bound, to defend the debtors' position against such attacks.[6]

Other services such as (1) reaffirmations, (2) lease assumptions, (3) meetings of creditors, and (4) follow-up with the trustee or US Trustee should also not be unbundled.

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[5] *In re Castorena*, 270 B.R. 504, 529 (Bankr. D. Idaho 2001).

[6] *Redmond v. Lentz & Clark (In re Wagers)*, 340 B.R. 391, 399 (Bankr. D. Kan. 2006).

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Determining the scope of representation will depend on the circumstances of each case and whether the attorney has complied with the rules. Clients must truly understand what they are losing.

The ABI has developed a list of best practices, including a model form engagement letter.[7]

1. The initial client interview and counseling should make clear the expected scope of representation and the expected limited fee.

2. Attorneys counseling unsophisticated consumer debtors must be mindful, when gathering initial information to assess a case, to avoid the formation of the debtor's perception that a full-scale attorney-client relationship is being formed.

3. An engagement letter and informed consent should be prepared in plain language and carefully reviewed with the debtor. This letter must clearly and conspicuously set forth the services being provided, the services *not* being provided, and the potential consequences of the limited services arrangement.

4. The engagement letter must also clearly describe the fee arrangement, including a statement of how fees for additional services will be charged.

5. All documents and disclosures filed with the bankruptcy court should be done with full candor consistent with the attorney's duty of confidentiality, disclosing the exact nature of the representation and the calculation of fees for services being provided.

6. In the event that withdrawal from the unbundled representation becomes warranted, attorneys must be mindful of protecting their client's interests to the fullest extent practical when exiting the case.

7. As is the case with all legal representation, if the attorney becomes aware of a legal remedy, problem, or alternative outside of the scope of his or her representation, the client must be promptly informed. The attorney has the further obligation to provide his or her client with a thorough explanation of the potential benefits and harms implicated, in order for the client to make an informed decision as to how to proceed.

2.3. Disclosures. In addition to a written contract, section 527 requires a host of disclosures.

[7] Lois R. Lupica and Nancy B. Rapoport, Final Report of the ABI National Ethics Task Force, April 21, 2013, at 53; 60-63.

- § 527(a)(1) – The attorney must inform consumer debtors of the differences between the different chapters of bankruptcy and the types of services available from credit counseling agencies. § 342(b)(1).

  Although section 527(a)(1) does not require informing clients of the penalties for hiding assets and lying as is required under § 342(b)(2), the attorney definitely should, because it coincides with his or her duties as an attorney under Model Rule 1.4 requiring lawyers to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."

- § 527(a)(2) – Within three days after offering to represent a consumer client, the attorney must provide the prospective client written notice advising the client:
  - What information she has to supply with the petition and during the case.
  - What assets and liabilities she has to disclose, as well as the *replacement* value of the assets where requested.
  - Currently monthly income for the means test.
  - Information a client provides may be audited and that failure to provide information can result in dismissal or criminal sanctions.

- § 527(b) – This section is a disclosure the attorney must give to clients.
- § 527(c) – Except to the extent the attorney performs a reasonably diligent inquiry, the attorney must provide information informing the client (1) how to value assets; (2) how to complete the list of creditors; and (3) how to determine what property is exempt and how to value exempt property at replacement value
- § 527(d) – The attorney has to keep a copy of the disclosures under 521(a)(1) for two years.

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- Create a packet with all the required disclosures It would not hurt to put some of them in an FAQ format.
- Add the written contract, consultation agreement, and acknowledgement to the packet. To make it extra easy, add in information on how to get credit counseling with your attorney code written in.
- Make a number of packets so if a client comes in, you have a packet ready to give them and fill out.
- Scan or copy the entire signed packet so that you have it for a potential audit.

2.4. Explaining the Consequences of Bankruptcy. Along with the required disclosures, should adequately explain the risks and benefits of bankruptcy under the circumstances. For instance, in a chapter 7 or chapter 11, the risks include involuntarily losing property.

Explaining common risks in written form to include with the Code's mandatory disclosures would be wise.

3. Choosing the Forum: (1) Bankruptcy; (2) State Law Insolvency Procedures; (3) Informal Workout; or (4) Nothing

In some cases, there are many options to deal with unmanageable debt burdens. Bankruptcy is normally only one possible tool at an attorney's disposal.

3.1. Bankruptcy

Bankruptcy is generally the quickest and most effective way to obtain a fresh start. However, the attorney should fully consider the pros and cons of each chapter.

3.1.1. Chapter 7. Generally chapter 7 is best for individuals with no non-exempt assets, below median income, or substantial business debts.

3.1.2. Chapter 13. For individuals who do not qualify for chapter 7 or who significant, non-exempt assets they do not want to lose risk losing, chapter 13 is the better option. It is also a good option for people intending to catch up on secured debt obligations and workout their mortgages.

Although Chapter 13 may be onerous for debtors, it comes with distinct advantages: (1) no 727 actions (although a chapter 13 discharge may be revoked under §1328(c) if obtained by fraud through circumstances unknown to the moving party prior to the time the discharge order was entered); (2) a unilateral right to dismiss the case; (3) the debtor cannot be forced to sell property; (4) a short timeline for creditors to file claims. Also, debtors tend to be less likely to be sued on 523 actions in chapter 13; and (5) an enhanced discharge that allows debtors to discharge some 523 claims.

3.1.3. Chapter 11 or 12? While not common, chapters 11 or 12 may be suitable for many individuals. For instance, in many areas, housing prices are so high that an individual may not qualify for a chapter 13, given the secured debt limits. And some individuals may qualify for chapter 12 relief, even their primary debts are consumer in nature. Chapter 12 provides options that chapter 13 doesn't, such as allowing the debtor to modify a home mortgage and modify other secured debts which would otherwise have to be paid in full within five years through a confirmed chapter 13 plan.

3.2. State Law Insolvency Options – Some individuals dislike the numerous disclosures in bankruptcy or may have very few debts that would make bankruptcy cost-ineffective. If an attorney's state has an insolvency process, attorneys should also consider the state process if it would be more suitable. **Example**: debtor has one payday loan for $10,000 and the state

has an inexpensive mechanism to stop interest and penalties and repay the balance over 3 years. Clearly, the state mechanism may be a better option over bankruptcy.

3.3. Workout with Creditors – An informal workout should be an option if an individual can resolve a few problematic debts without filing bankruptcy and all the risks and downsides that entails. While this situation is uncommon, and creditors' cooperation is often difficult to obtain, it is not impossible.

3.4. Do nothing – If an individual is "judgment-proof," bankruptcy may be a waste of time and money. If the individual lives in an exempt homestead, lives off of exempt sources of income (SSI/veteran's benefits/retirement annuity), and all other assets are exempt, bankruptcy may not offer any benefits beyond eliminating phone calls.

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Attorneys should fully inform their clients of all the options to deal with debt. Even if it is obvious to the attorney, ethical rules and the bankruptcy code require attorneys to fully inform their clients about their options and the risks and benefits of each choice.

4. Drafting Petition and Schedules

In addition to local rules, at least three provisions of the Code concern an attorney's duties to perform due diligence and ensure what they are telling the Court is actually true to the best of their knowledge. Violations entail possible sanctions including attorney's fees. Attorneys should keep these duties in mind when preparing petitions and schedules. A violation of 526 can result in disgorgement, and a violation of 707(b)(4) can result in dismissal.

§ 526(a)(2) – Imposes a "reasonable inquiry" standard.

> A debt relief agency shall not . . . "make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue or misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading . . . ."

Courts have generally held that 526(a)(2) imposes a negligence standard on consumer attorneys;

- *In re Casavalencia*, 389 BR 292 (Bankr. S.D. Fl. 2008) (imposing sanctions on attorney who failed to discover that debtor had flagrantly violated securities laws, appeared to be running a Ponzi scheme, and other pertinent facts) ("No reasonable or responsible lawyer could have filed a petition and schedules so replete with misstatements if that lawyer had done anything approaching the "reasonable inquiry" requirements of Federal Rule of Bankruptcy Procedure 9011.").

- *In re Guterrez*, 356 B.R. 496, 500 (Bankr. N.D. Cal. 2006) ("11 U.S.C. § 526(c)(2) makes an attorney who acted intentionally or negligently liable for fees already received, actual damages, and attorneys' fees if the attorney's conduct was negligent or intentional.").

§ 707(b)(4) – Imposes a "reasonable investigation" standard

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

(i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and

(ii) determined that the petition, pleading, or written motion--

(I) is well grounded in fact; and

(II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).

(D) The signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.

- *In re Withrow*, 391 B.R. 217 (Bankr. D. Mass. 2008) (employing five-factor test to determine whether an attorney violated Rule 9011 and 707(b)(4)(C) when he failed to list six bank accounts or claim any exemptions on Schedule C):

> "(1) did the attorney **impress upon the debtor the critical importance of accuracy in the preparation of documents** to be presented to the Court; (2) did the attorney **seek from the debtor, and then review, whatever documents were within the debtor's possession**, custody or control in order to verify the information provided by the debtor; (3) did the attorney **employ such external verification tools** as were available and not time or cost prohibitive (e.g., on-line real estate title compilations, on-line lien search, tax "scripts"); (4) was **any of the information provided by the debtor** and then set forth in the debtor's court filings **internally inconsistent** - that is, was there anything which should have obviously alerted the attorney that the information provided by the debtor could not be accurate; and (5) **did the attorney act promptly to correct any information presented to the Court** which turned out, notwithstanding the attorney's best efforts, to be inaccurate."

Fed. R. Bankr. P. 9011.

(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.

4.1. Drafting the Schedules and Gathering Information from Clients

As we learned above, attorneys have a duty to perform a reasonable investigation and inquiry before filing or signing a petition. Clients will always be the primary source of information, and under some circumstances, their word may suffice.

4.1.1. Aliases or Prior Bankruptcies – Whether a prior case was pending will have an impact on whether there is an automatic stay and whether they debtor may even obtain a discharge. See section below on public records searching and PACER.

4.1.2. Assets – Normally what assets debtors have is fairly straight-forward, as they are typically house-hold goods, ordinary automobiles, vanilla retirement or insurance accounts, or other common assets.

4.1.2.1. Ask about *all* categories of assets.

Even though most people are honest and have a good handle on their assets, Schedule A/B contains many forms of assets debtors ordinarily forget about such as LLCs that may not do any business, interests in trusts, family-owned hunting land, and valuable collectibles. Omitting assets may not torpedo a case. Even if it doesn't, they can entail lengthy follow-ups with trustees or the US Trustee.

The best practice is to read each category on Schedule A/B, even if it may seem tedious.

4.1.2.2. Valuation

The schedules require debtors to state the ***current value*** of the property they own. Current value is apparently identical to ***fair market value***.[8]

But remember that in some instances in chapters 7 and 13, the debtor has to know the ***replacement value*** of an item. *See* 11 U.S.C. § 506(a)(2) ("With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.").

4.1.2.2.1. Sources for Valuation – Debtors are normally competent to testify about the value of their own assets. *See Cunningham v. Masterwear Corp.*, 569 F.3d 673, (7th Cir. 2009) ("[T]he federal rules . . . have been interpreted to permit a property owner to testify about the value of his property."). As a result, for most ordinary assets that will not be the subject of lien avoidance, relying on the debtor's assertions will probably suffice.

However, many debtors over-value their assets. If a debtor appears to be outside of his exemptions, it may help to investigate what the property's fair market or replacement value really is. Similarly, many debtors may undervalue their assets, so if something doesn't seem right, look into it.

- **Zillow.com –** Good starting point, but likely not admissible evidence.
- **Real estate tax assessments** – Another good starting point, but may not be admissible or current.
- **Comparative Market Analysis –** These are usually performed by real estate brokers based on comparable sales.
- **Appraisals** – Appraisals are probably the best means of determining the value of real estate, but they are costly. The cost, however, may be justified if it enables a debtor to strip a large junior mortgage.

4.1.2.2.2. Collateral Estoppel. Consumer attorneys should be aware that judicial may apply to Schedule A/B.[9] In *Neidenbach v. Amica Mutual Insurance Co.*, the debtors scheduled household goods worth $7,000 and real estate worth $300,000. The Debtors had a fire and filed a claim for $262,500 in personal property and $375,000 for the real estate. The insurance company challenged the claim at the district court. The District Court, finding the discrepancy between the schedules and the claim incredible, voided the

[8] Hon. Cynthia A. Norton, *Ethical Implications of Valuing Assets in Bankruptcy*, Amer. Bankr. Inst. J., Feb. 2017, at 23 (citing Instructions to Schedule A/B Property (Official Form 106A/B) (12/15).

[9] Norton, *supra* (discussing *Neidenboch v. Amica Mutual Insurance Co.*, 96 F.Supp. 3d 925 (E.D. Mo. 2015)).

insurance contract as fraudulent and ordered the Debtors to repay over $58,000 in relocation expenses the insurance company paid. Although the court didn't mention judicial estoppel, the same logic would apply in other contexts.

4.1.3. Debts

Getting an accurate list of the debtors total liabilities is key. Unscheduled debts may not be discharged. 11 U.S.C. § 523(a)(3). Also, including everyone up-front will reduce the headache and cost of amending the schedules. And, in some cases, it will avoid the US Trustee filing a 727 action on the basis that the debtor falsified his schedules. Finally, by giving creditors notice, a consumer attorney can tee-up a good stay violation/discharge injunction violation/consumer law action if creditors refuse to stop collection efforts—those all have fee shifting provisions.

4.1.3.1. Sources of Information for common debts. Obtaining at least one credit report, but preferably all three, is the minimum. Clients can obtain all three for free from http://www.annualcreditreport.com. Never refer them to freecreditreport.com. Credit reports contain the vast majority of consumer debts and may even reflect whether a debt is being collected by a third-party. It can also provide a rough amount for outstanding balances on secured claims.

If the Debtor also ran or runs a business, obtain a list of all of the business's trade creditors, lenders, and lessors. The client most likely personally guaranteed many or all of the debts and those creditors may not report to credit rating agencies.

It is also good practice to have the client draw up a list of everyone he or she owes money and bring in all their bills for the past three months to obtain creditors' addresses to provide as proper notice as possible.

11 U.S.C. § 342(c)(2)

> (A) If, within the 90 days before the commencement of a voluntary case, **a creditor supplies the debtor in at least 2 communications sent to the debtor with the current account number of the debtor and the address at which such creditor requests to receive correspondence**, then any notice required by this title to be sent by the debtor to such creditor shall be sent to such address and shall include such account number.
>
> (B) **If a creditor would be in violation of applicable nonbankruptcy law by sending any such communication within such 90-day period and if such creditor supplies the debtor in the last 2 communications** with the current account number of the debtor and the address at which such creditor requests to receive correspondence, **then any notice required by this title to be sent by the**

> **debtor to such creditor shall be sent to such address and shall include such account number**.

11 U.S.C. § 342(g)

> Notice provided to a creditor by the debtor or the court other than in accordance with this section (excluding this subsection) shall not be effective notice until such notice is brought to the attention of such creditor. . . . **A monetary penalty may not be imposed on a creditor for a violation of a stay in effect under section 362(a) (including a monetary penalty imposed under section 362(k)) or for failure to comply with section 542 or 543 unless the conduct that is the basis of such violation or of such failure occurs after such creditor receives notice effective under this section of the order for relief.**

In other words, attorneys cannot obtain stay violation sanctions or consumer protection law sanctions unless notice was proper. In states with treble damages for unfair trade practices, that' s a lot of money left on the table for attorneys.

Also, if a debtor intends to object to a claim, a default judgement may be subject to collateral attack unless § 342's requirements are met. *See, e.g., In re President Casinos, Inc.*, 418 B.R. 332 (Bankr. E.D. Mo. 2009). One of the authors of this outline, Nicholas Hahn, Paul Swanson's associate, has witnessed a default judgment discharging student loans overturned, as well as a stay violation award totaling at least $30,000 and $100 per day in punitive sanctions challenged (and then settled) as a result of non-compliance with section 342.

4.1.3.2. Tax Debts. Determine whether tax debts are dischargeable or secured, and whether they are for trust fund taxes. Income taxes can be paid through a chapter 13 plan and discharged *without interest*. On the other hand, trust fund taxes, like worker's compensation and sales taxes aren't dischargeable. § 1328(a)(2); § 507(a)(8)(C).

- Request transcripts.
- Determine whether the taxes are dischargeable as general unsecured claims. If practitioners are unsure, http://www.taxdischargedeterminator.com has good reviews, as does Morgan King's book, "Discharging Taxes Under the Bankruptcy Reform Act of 2005."
- A guide to determining whether taxes are dischargeable is attached.

4.1.3.3. Section 523 Debts

These are the debts that aren't discharged in a chapter 7 and are fairly common. Two of them are below.

4.1.3.3.1. DSOs v. Property Settlements. It's critical to review the divorce judgment, any settlement agreement with former spouses, and the transcript

of the hearings to determine the nature of a debt incurred in a divorce. Domestic support obligations aren't ever discharged. § 523(a).(5) However, property settlements can be under § 1328(a) and 523(a)(15). Whether an obligation is a DSO is often fact-intensive and may require a trial. There is a lot of case law on this issue, so research the particular issue and consult a good treatise like *Collier Family Law and the Bankruptcy Code*.

4.1.3.3.2. Theft by Contractor Debts. Look to see if your state has a theft by contractor or similar law. These impose fiduciary duties on contractors and create "technical trusts." If the general doesn't pay subcontractors or repay clients for unfinished work, the contractor may be civilly or criminally liable.

Did the Debtor's conduct arguably meet the standards for 523(a)(4) and your jurisdiction's and possible judge's case law. In some jurisdictions even the bankruptcy judges don't agree on whether there can be a per se violation of 523(a)(4). *Compare Baytherm Insulation, Inc. v. Carlson (In re Carlson)*, 456 B.R. 391 (Bankr. E.D. Wis. 2011) (holding that 523(a)(4) only requires a per se violation) *with In re Koch,* 197 B.R. 654, 658 (Bankr. W.D. Wis. 1996) (applying the defalcation standard under 7th Circuit case law at that time) *and Bldg. Trades United Pension Trust Fund v. Mueller (In re Mueller)*, 2011 Bankr. LEXIS 2290 (Bankr. E.D. 2011) (requiring creditors to prove a mental state above mere negligence for a 523(a)(4) claim).

If the Debtor has a rich uncle or a chance to obtain an advance on his inheritance, it may be a good idea to repay some of those debts to forestall a 523 action.

4.1.4. Leases. Read any of the Debtor's leases and determine whether the debtor will be able to or want to continue the lease. Whether a debtor can assume a lease depends on the chapter. In a chapter 7, only the trustee can assume a non-residential real estate lease, and the debtor's assumption of a residential real estate lease is essentially at the landlord's option. See §365(p)(2)(A). If a chapter 13 debtor wants to assume a personal property lease, put the assumption and any cure provisions in the plan. *See* § 365(p)(3). If a chapter 13 debtor seeks to assume a residential real estate lease, the provisions of § 365(b)(1)(A) permit a landlord to insist that pre-petition defaults be cured "promptly," as opposed to the ability to cure defaults in mortgages over the life of the plan.

4.2. Additional Investigation

4.2.1. "Доверяй, но проверяй." ("*Doveryai, no proveryai.*")—Russian proverb / "Trust, but verify."—Ronald Reagan

Some issues require much more due diligence, since your client will either lie, or just assume something that isn't true. And the consequences could be substantial.

4.2.2. Gifts. Make sure to ask about large gifts to insiders. Has the Debtor paid any family members' bills? Have they gotten engaged and bought a ring? While ordinarily not something the trustee will pursue, debtors must disclose this on the Statement of Financial Affairs.

4.2.3. Inheritances. Review any elderly and infirm family members' estate planning documentation and TOD/POD accounts. If it is possible to modify those instruments before bankruptcy, the family members may rather do so instead of paying their loved ones' creditors.

4.2.4. Credit Card "Blowouts". Counsel debtors to stop using credit cards before filing. And if they do, don't make large purchases. Some creditors—Cabella's Club Card, for instance—are extremely litigious and tend to file non-dischargeability actions at an abnormally high rate. The more time between the last credit card purchase and the bankruptcy the better.

4.2.5. Review Tax Returns (Schedule D). Review all the schedules of tax returns for at least two years prior, but preferably four. Schedule D will reflect sales that may be outside of the ordinary course of business and may reveal transactions with insiders that could be recoverable as constructively fraudulent.

4.2.6. Review insurance policies. While the insured value may differ from the replacement value or the fair market value, riders will indicate valuable assets debtors omitted from schedules.

4.2.7. Angry creditors/family members? Some of chapter 7 trustees' largest recoveries are a result of information provided by angry creditors and family members. Determine whether a creditor will likely talk with the trustee about questionable conduct. If so, waiting to file after any statutes of limitations have passed or filing a chapter 13 may be wise.

4.3. Additional Resources for Due Diligence

- **Public Records Search.** WestlawNext and Lexis Advance have great resources to simplify searching various databases all at once. If you have a subscription, a query

only takes a couple of minutes and will reveal a lot of information, such as insurance claims, real property ownership, prior addresses, and vehicle ownership.

- **PACER.** Useful for finding pending litigation and prior bankruptcies.

- **Title Report.** Ordering a title report may be cost effective for clients who do not want to obtain their own records from the recording office.

- **UCC/Vehicle Title Search.** Many states have a website to search vehicle titles by name and VIN. Similarly, searching for UCCs can determine any unscheduled creditors, as well as whether a security interest may be avoided as unperfected or preferential.

Minimum Documentation Attorneys Should Obtain[10]

1. Obtain recorded Deeds and Mortgages for all real property owned/previously owned for the last six (6) years by the Debtor.
2. Obtain a copy of the title to all vehicles.
3. Obtain three (3) to six (6) months bank statements for all bank accounts.
4. Perform a Westlaw/Lexis asset search.
5. Obtain tax transcripts for the prior four (4) years.
6. Obtain an Appraisal of the real property owned by the Debtor. This is extremely useful in a Chapter 13 case if you are intending to strip a lien. Providing this documentation to a Trustee may help you avoid an objection to confirmation.
7. Obtain the state equalized value and taxable value for all real property owned by the Debtor.
8. In homes where the Debtor(s) have high income/above medium income, it may be wise to obtain an Appraisal of all household assets.
9. If the Debtor pays child support, contact the applicable Friend of the Court and determine if any arrearage in child support exists.
10. Obtain Proof of Insurance for automobiles and for the home.
11. Obtain purchase dates of the vehicles/PMSI's to determine if the obligation can be crammed down in a Chapter 13. Remember one day can make the difference.
12. Obtain statements for credit cards to determine if non-dischargeability issues may exist.
13. Obtain a Credit Report, a Tri-Merge Report, if possible. This is a blended credit report from all three major credit reporting agencies. Otherwise, each individual can obtain their Credit Report at www.annualcreditreport.com. This Credit Report is available for free, annually.
14. Obtain proof of income for the six (6) months ending the last day of the month before the month that the case will be filed in.
15. Obtain a copy of all payment advices received by the Debtor within the last sixty (60) days and of the Debtor's spouse, significant other and obtain affidavits of support/rent from others providing income to the household.
16. Do a U.S. National Pacer search for any prior cases.
17. Obtain a copy of a Judgment of Divorce, if applicable.

[10] This list was taken verbatim from Brian Joel Small, *How to Avoid Problems with the Trustee-Consumer Best Practices*, presented at the 2009 Central States Bankruptcy Workshop.

5. Pre-Bankruptcy Planning

5.1. Exemption Planning.

5.1.1. State or Federal? Available exemptions will vary based on your jurisdiction and the complicated timing structure under § 522(b)(3). A good resource is www.exemptionsexpress.com.

5.1.2. Converting Non-Exempt to Exempt Assets.

- Depending on the jurisdiction and the circumstances, large conversions of non-exempt assets may expose debtors to 727 actions or even losses of exemptions. The majority approach, however, appears to require some other facts besides conversion of assets.[11]

- Possible exempt assets include 529s, IRAs, homesteads, and life insurance.

5.2. Secured Debt Purchases.

- If a debtor needs a new car or a house, filing a bankruptcy will ruin a good credit rating. It will also likely disqualify him or her for a mortgage for at least two years. So purchasing a car would be advisable.

- A debtor may consider purchasing a car prior to a chapter 13. First, debtors can modify an otherwise usurious interest rate. Debtors cannot strip-down 910-car loans. *See* § 1325 hanging paragraph. The secured debt payments may also help on the means test, by adding a secured debt payment and by allowing the debtor to claim the ownership expense.

- Be aware of perfection issues. If a lien is avoided, the debtor will (1) lose the secured debt payment on the means test and (2) may have equity in excess of exemptions, thereby requiring more payments to unsecured creditors.

5.3. Tax Planning.[12]

5.3.1. Keep the clients' tax returns. Chapter 7 trustees may be able to claim tax refunds on the theory that they are rooted in the pre-petition period. *See In re Meyers,* 616 F.3d 626 (7th Cir 2010) (trustee entitled to a pro rata share of tax refunds when case filed mid-tax year). Changing withholdings or adjusting 401(k) saving may be a valuable way

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[11] *See In re Jackson*, 472 F.2d 589, 590 (9th Cir. 1973), *Murphey v. Crater (In re Crater)*, 286 B.R. 756, 761 (Bankr. D. Ariz. 2002); *see also* 4-522 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy, ¶ 52.08[5] (16th ed. 2015); *Addison v. Seaver (In re Addison)*, 540 F.3d 805 (8th Cir. 2008); *In re Smiley*, 864 F.2d 562, 567 (7th Cir. 1989); *In re Bower*, 932 F.2d 1100, 1102 (5th Cir. 1991); *but see Wolkovitz v. Beverly (In re Beverly)*, 374 B.R. 221 (B.A.P. 9th Cir. 2007).

[12] The author borrowed heavily from Tara Gascher and Stephen Berken's outline, Consumer Workshop I: Best Practices – Avoiding § 523, 727 and Malpractice Claims, available on the ABI Website.

to avoid paying anything to the trustee or into a chapter 13 plan. Also, if a debtor is eligible for the earned income tax credit, make sure to exempt the potential refund using the wildcard exemption, or any available state law exemptions.

Make sure your client fills out the IRS Form 2848 and equivalent state forms for the last 4 years in case you need access to their tax transcripts. Confirming a chapter 13 plan requires filing the last 4 years' tax returns. § 1325. And the last two years' returns are required for chapter 7 cases.

5.3.2. Preparing for a Chapter 13 Case

- Refer to the IRS's withholding calculator: https://apps.irs.gov/app/withholdingcalculator/ to determine how much your client should be withholding. Over-withholding may result in an objection by the trustee, or it may result in the debtor turning over too much to the trustee, depending on local practice. Similarly, under-withholding could lead to tax liabilities.

- Ensure that schedules I and J and Form 22C reflect the correct withholding amounts.

6. Emergency Filings

The best practice is to abstain from emergency filings. There isn't enough time for planning, due diligence, and weighing options. Unfortunately, there is often no other choice to prevent (1) evictions; (2) garnishments that would be under the preference limits; (3) property repossession; or (4) loss of a license.

If the client cannot pay the attorney before filing, the attorney should enter into two separate fee agreements. One that covers the pre-petition filing and another that covers work performed post-petition. An attorney would not want to violate the discharge injunction in his own case.

6.1. The same best practices still apply. At a minimum, attorneys must give the required disclosures, obtain a signed fee agreement, and get their clients' wet-ink signatures on everything required to be filed.

6.2. Minimum filings. A voluntary case is commenced when the Debtor files a petition. 11 U.S.C. § 301(a). Rule 1007 governs what must be included with the petition.

Under Rule 1007(c) and (f), the Debtor has 14 days to file any required states or schedules, but this time limit may be extended. Rule 1007(a)(5).

It's best to at least get all the creditors listed in schedules D/E/F for a few reasons. First, the creditors will receive timely notice. Second, amending D/E/F costs money and is a headache. Third, it is one less item to fix later.

6.3. Follow-up. In addition to providing clients with the normal disclosures, **immediately schedule an appointment for the client return to finish the deficiency schedules and statements within 14 or fewer days.** The sooner, the better. If the case is a chapter 13 case, make sure the plan is also filed within 14 days. Rule 3015(b).

7. Credit Counseling. This is a pre-requisite to filing bankruptcy. There are lots of providers, so attorneys should find the lowest-priced service that emails the certificates to attorneys and files the financial management certificate (the second course) for the debtors.

Section 109(h) requires individuals to obtain credit counseling "during the 180-day period ending on the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) . . . ." Most cases, sensibly, say that completing credit counseling on the same day, but pre-petition, is timely under 109(h). *See, e.g.*, *In re Spears*, 355 B.R. 116; *In re Swanson*, Case No. 06-00968, 2006 Bankr. LEXIS 3639 (Bankr. D. Idaho. Dec. 21, 2006). But other courts require a one-day waiting period. *See In re Gossett,* 369 B.R. 361 (Bankr. N.D. Ill. 2007).

Best Practices

Have the client complete the credit counseling at least a day before the filing, even though most courts do not impose a one-day waiting period.

Credit counseling, in most cases, tends to be a commodity product. So offering the cheapest option that also automates filing and sending the certificate is the best option.

Also, don't hesitate to ask for *pro bono* credit counseling if representing low-income individuals. In our experience, the agencies will usually require a copy of the client's Schedules I and J.

8. Chapter 13 Issues

8.1. Means Test

The best practice is to hand-calculate the debtor's last 6 months of income as well as any expenses reflected in pay checks. This will let you know exactly how much the debtor spends on insurance, retirement, and other expenses that can be deducted on the means test. This is especially important for clients whose pay can be sporadic, work multiple jobs, and may experience seasonal fluctuations. If the attorney can identify a large, anomalous spike, that may lead the attorney to suggest waiting to file or taking a *Lanning* adjustment.

8.2. Plan Issues

8.3. Math. Most of the chapter 13 math can be accomplished very quickly using Excel spreadsheets. Spending some time setting them up will save you lots of time.

8.3.1. Step 1: Categorize Debts and Determine Minimum Funding

8.3.1.1. Administrative. These typically comprise attorney's fees and the chapter 13 trustee's anticipated compensation. Trustees get up to 10% of funds disbursed, but it is normally much lower. 28 U.S.C. § 586(e). The best place to find what fees the trustee is currently receiving is your local trustee's website to review payments. Pending cases will have the most up-to-date fees charged on cases.

This category needs to be paid in full to confirm the plan, and it would be wise to include the full amount of anticipated fees. In many districts, the "no-look" fee may suffice for the whole case, but complicated cases may require more fees.

8.3.1.2. Priority. These normally include priority taxes (i.e., those younger than three years) and DSO arrears. These must also be paid in full. 11 U.S.C. § 1322(a)(2); § 507. If all of the Debtor's disposable income is being paid into the plan, DSO arrears assigned to a governmental agency can receive less than 100%.

8.3.1.3. Secured. This class comprises any claim secured by property. These normally include (1) common purchase money loans and (2) secured tax debt. Except for debts that mature outside of five years, these generally must be paid in full with interest within five years. Besides homesteads and 910-day car loans, debtors can reduce claims to replacement value under 506. If a lien is totally unsecured on a homestead, lien stripping is permissible. If possible, always reduce the interest rate to the lowest permissible rate under the *Till* methodology: prime rate + 1%.

Once you have determined the value of the collateral and the interest rate, put the numbers through an amortization calculator to get to the amount needed to fund this portion of the plan. Ordinarily, a straight-line amortization will suffice. However, balloon payments or stepped-up payments may suffice if the secured creditors accept the plan.

8.3.1.4. Cure Amounts. Section 1322(b)(5) allows debtors to cure defaults within a "reasonable" time. Check the agreement to determine the amount needed to cure if unknown and no POC is filed. § 1322(e).

8.3.1.5. General Unsecured. Everything else. These only have to be paid what they would receive in a chapter 7 liquidation. 11 U.S.C. § 1325(a)(4).

8.3.2. Step 2: Liquidation Analysis. A liquidation analysis is necessary to determine how much unsecured creditors must be paid. In other words, it determines the minimum amount the debtor has to pay in addition to all mandatory payments. This ordinarily comes into play if debtors have non-exempt equity in asses.

To determine what the liquidation analysis requires

1. Determine the liquidation value of all non-exempt property.
2. Subtract the debtor's exemption in the property.
3. Determine the chapter 7 trustee's compensation from the liquidation value less exemptions. For the formula, refer to section 326(a).
4. Next, deduct a reasonable percentage for costs of sale. Ten-percent is common.
5. Finally, deduct the amount of any secured claims on the property.
6. Deduct any capital gains or depreciation recapture income tax that may result from the sale.

Example:

Liquidation Value of House:	$100,000
Exemptions:	($50,000)
Ch. 7 Trustee Fees:	($5,750)
Cost of Sale (8%):	($8,000)
Mortgage:	($10,000)
Tax:	($0.00)
Best Interest Test Payments:	**$26,250.00**

Always hand-calculate the liquidation analysis if there is any non-exempt equity, since software, such as Best Case, may not include tax consequences to the estate or properly calculate the trustee's fee.

8.3.3. Step 3: Determine Funding: In above-median income cases, attorneys will be constrained, as the Procrustean bed of the means test determines how much needs to be funded. Regardless, attorneys still have room to ensure the best outcome for their clientss. For instance, chapter 13 can be used to pay down secured debt at a reduced interest rate, and proper planning may allow debtors to increase 401(k) contributions instead of paying unsecured creditors.

In the case of below-median debtors, the funding will largely depend on the purpose of filing the chapter 13. This will often depend on stripping down or cramming down a

car loan, catching up on arrears, or utilizing a court-sponsored mortgage mediation program. In other words, the Debtor will need to fund enough to pay attorney's fees, chapter 13 trustee fees, and pay for the secured collateral or priority payments. Normally, Chapter 13 trustees will want to ensure that the monthly payments in the plan match the net income listed in Schedule J.

8.4. **Fee Apps Are Like Voting: Early and Often.** Even in districts with "no-look" fees, attorneys should remember to file fee applications. If there is money that does not have to be paid to unsecured creditors and the attorney does work in excess of the no-look fee, he or she should be paid for it. Consult the local rules and local practice on how fee apps should be formatted and filed.

8.5. **Tax Season.** In many districts, debtors have to pay a portion of their tax refunds and provide copies of their tax returns. Attorneys should keep a spreadsheet or list of pending chapter 13 cases. They can use Word's mail merge function to quickly create form letters reminding clients about their duties. Nothing wastes time more than responding to motions to dismiss because the debtor did not provide a copy of his or her tax return.

Best Practices

- Manually calculate disposable income and any expenses.
- Manually calculate plan payments.
- Manually calculate the liquidation analysis payments.
- Automate calculation by creating spreadsheets containing formulae, such as amortization schedules and the chapter 7 trustee's fee.
- File fee applications whenever possible to avoid going uncompensated and letting unsecured creditors be paid.
- Be proactive during tax season. Doing so will head off any motions to dismiss for failure to file a return or pay tax refunds.

Post-Filing

9. Communication with Clients

Send the client a letter telling him or her when to appear at the meeting of creditors and what to bring: their social security card and picture ID. It is also good practice to send a copy of the schedules and a checklist of next tasks they have to perform. In most cases, the checklist will include finishing the course on financial management and reaffirming debts or assuming leases.

10. Calendaring. As soon as a case is filed, calendar all deadlines, including (1) the meeting of creditors, (2) dates to upload/email documents to the trustee or court, (3) reaffirmation agreements to be filing dates, (4) lease assumption dates, and (5) dates to file claims on behalf of creditors you want to be paid through a chapter 13 plan. That will ensure deadlines are not

missed, and it will ensure that if a client needs more time to file deficiency schedules or a plan, the attorney can file a motion before the deadline passes.

11. **341 Meeting of Creditors:** Attorneys should attend the meeting of creditors. That's a basic requirement of being an attorney, as trustees will often have questions or follow-up requests. Always follow-up with the trustee's requests.

12. **Recovering Preferences.** Debtors can recover transfers using the trustee's strong-arm power. § 522(h). Normally, this arises in garnishments. However, in consumer cases, the recovery is limited to transfers in excess of $600. § 547(8). However, many consumers may encounter issues with judgment liens, which may also be preferential. However, 522(g) limits whether the debtor can exempt avoided transfers. If the transfer was voluntary, the debtor cannot avoid it.

    Always try to avoid these transfers and ensure that you file case within the applicable time limits. Usually, a letter or a phone call suffices in lieu of proceedings in bankruptcy court. Disclose any recovery you receive to the trustee and hold the recovered money until the case closes, or the trustee abandons the property.

13. **522(f)(1) Lien Avoidance.** Avoiding nonpossesory, non-PMSI liens may be a source of value for debtors when lenders may have cross-collateralized security interests. Similarly, judgment liens may be avoidable to the extent of security interest. Always determine whether there are any liens to be avoided and do so.

14. **Reaffirmations and Leases**

    14.9. Reaffirm/Surrender/Ride-Through. Attorneys should inform clients about the consequences of reaffirming, surrendering and riding through.

    The benefits of reaffirming are that the debtors will likely not encounter problems if they want to refinance their mortgages. If they do not reaffirm, they may encounter problems refinancing.[13] The clients will continue receiving positive credit reporting on a secured debt. On the other hand, reaffirming a secured debt may interfere with the debtor's fresh start.

    14.10. Requirements

    524(c)(1) - The agreement must be made before the case closes. There is some case law suggesting Debtors may *file* agreements after the case is closed, as long as the agreement was made before then.

    524(c)(2) – The debtor must receive the required disclosures in 524(k).

[13] For a great article on the topic, see Natalie Bush-Lents, *Reaffirm to Refinance? Mortgage and Bankruptcy Policies Collide*, XXXIII ABI Journal 6, 38-39, 89, June 2014.

524(c)(3) – Attorney must certify that (1) debtor was fully informed and the agreement is voluntary; (2) the agreement does not impose an undue hardship; (3) the attorney fully advised the debtor of the consequences; and (4) Debtor has not rescinded the agreement.

The attorney should attend the reaffirmation hearing if one is required.

14.11. Leases. Section 365(p) concerns lease assumptions of personal property by debtors, although there is a strong argument that it applies to residential real estate in chapter 7 cases, too. The debtor has the option of notifying the lessor, in writing, that he or she wishes to assume the lease. The lessor may require debtors to cure any arrears.

Make sure that any assumption and cure issues are provided for in a chapter 13 plan.

The same issues risks and benefits present in reaffirmations are present in lease assumptions, except that there is no mechanism to rescind a lease assumption.

15. **Revising Creditor Matrix.** It should be common sense, but the attorney should proactively amend the creditor matrix. Providing notice of a bankruptcy case is critical to due process and obtaining a discharge.

The case of *In re Moragne*, Case No. 12-00324, 2013 Bankr. LEXIS 2680 (Bankr. D. Haw. July 2, 2016) is instructive. In 48 of the 96 emergency petitions a law firm filed between January 1, 2011 and June 30, 2012, the law firm failed to amend the mailing matrix. The US T brought a motion to force the firm to disgorge the firm's fees, which it won.

Besides ordering disgorgement, the court opened a new proceeding (13-70004, Bankr. D. Haw.) and ordered the law firm notify all of its clients (with some exceptions) between June 2008 and presumably the date of the order about the firm's failure to amend creditor matrixes as well as requiring the firm to pay $300 per client for the client to seek independent legal advice. In addition, the firm was ordered to amend any of the matrixes as necessary and make monthly status reports.

Case Closing

16. **Closing Letter with Copy of Discharge.** Even though the debtor will receive a copy of the discharge injunction, best practices require that the attorney also send a copy with a letter and final bill for all services. Consult your ethics rules on billing.

Also make sure to let them know about the discharge injunction. If a creditor continues to harass them, do not be afraid to file a discharge injunction violation proceeding.

Sources

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