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Ethical Ambiguities on the Front Lines of Consumer Representation

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ETHICAL AMBIGUITIES ON THE FRONT LINES OF CONSUMER REPRESENTATION


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ETHICAL AMBIGUITIES ON THE FRONT LINES OF CONSUMER REPRESENTATION

By

Donald R. Lassman and Daniel A. Austin

1. Unbundling Legal Services in Chapter 7 Cases

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

In most jurisdictions, “unbundling” is not per se prohibited, as long as any limitation on the scope of representation is consistent with the rules of ethics and professional responsibility binding on all attorneys. The client must give informed consent to any such limitation, therefore the attorney must clearly explain the bankruptcy process, and what results could occur in proceedings in which the debtor is not represented. Local bankruptcy rules frequently specify aspects of the case that the lawyer must perform, such as prepare and file all schedules, lists and other required documents, represent the debtor at the §341 meeting, amend schedules and statements to comport with developments in the case, reaffirmation agreements, and motions to redeem personal property.

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

1 Lawyer Jones is a fictional example created by the authors.
3 Id. at 197-203.
4 See, e.g., In re Ortiz, 496 B.R. 144, 151 (Bankr. S.D. N.Y.2013) (examples of required services in New York federal courts).
2. **Fee Only Chapter 13 cases**

Assume that a prospective client is facing imminent home foreclosure or wage garnishment, and is looking for bankruptcy relief. Although the client readily qualifies for a chapter 7, she does not have the money to pay the attorney’s fees. On the other hand, as her monthly income exceeds income guidelines to qualify for *pro bono* representation, she could afford to pay the fees in installments over time. In a situation like this, the client and attorney might consider a “fee only” chapter 13, under which the sole payment made by the debtor is the attorney’s fee. Of course, since it is a chapter 13 case, the legal fees will be significantly higher than if the case was filed under chapter 7.

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

The appeals court found it important that the bankruptcy court did not have a *per se* rule, noting that the same bankruptcy court had approved a 60-month “attorney-fee-centric” fee plan in another case where the creditors received a substantial distribution, even though the debtor in that case would likewise have qualified for discharge under chapter 7.7 Other courts have reached similar results.8

3. **Lien Stripping in Chapter 7 Cases**

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

Ms. Smith has a limited budget, but, as the attorney, you are thinking about the possibility of suggesting the client propose to strip off the second mortgage, even though you know that relevant case law is not favorable. You also know that strip-down by motion would be less expensive but may not permissible. You want to zealously represent Smith, but you must be mindful of cost, since you know (a) there is no case law in your jurisdiction on point, (2) the case

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7 *Id.*
8 *See, e.g., Berliner v. Pappalardo (In re Puffer)*, 674 F. 3d 78, 83 (1st Cir. 2012) (“While fee-only plans should not be used as a matter of course, there may be special circumstances, albeit relatively rare, in which this type of odd arrangement is justified”); *In re Pliler*, 487 B.R. 682,703 (Bankr. E.D.N.C. 2013) (although some fee-only plans have been approved, such cases are “highly indicative of bad faith…”); *In re Arlen*, 461 B.R. 550 (Bankr. W.D. Mo. 2011) (fee-only chapter 13 cases are “little more than disguised Chapter 7 proceedings”).
law from other jurisdictions is unsettled, and (3) from past experience that this private lender will vigorously oppose lien avoidance.

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

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

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

4. **Schedule Preparation**

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

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Bankruptcy schedules are signed under the penalties of perjury.\textsuperscript{14} False oaths may result in criminal prosecution\textsuperscript{15} or discharge denial,\textsuperscript{16} and omitted creditor claims may not be dischargeable.\textsuperscript{17} Omitting a creditor entirely would seem to be fraught with risk for Xu. As a backup plan, could Xu list the names of each business creditor on Schedule F, but exclude the corresponding addresses?

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

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

Courts generally recognize that the purpose of requiring debtors to provide the name and address of their creditors is to ensure due process notice of the bankruptcy filing so that creditors

\footnotesize{\textsuperscript{14} Fed. R. Bankr. P. 1008.  
\textsuperscript{15} 18 U.S.C. § 152 (2)  
\textsuperscript{16} See, 11 U.S.C. § 727(a)(4) which provides that a discharge may be denies if a debtor “knowingly and fraudulently” makes a false oath.  
\textsuperscript{17} See 11 U.S.C. § 523(a)(3); see, e.g., Judd vs. Wolfe, 78 F. 3d. 110 (3rd Cir 1996)(in no-asset chapter 7, debt is discharged whether listed or not so long as debt is not one described in §523(a)(2), (4) or (6)). \textit{But see In re Keenom}, 231 BR 116 (Bankr. M.D. GA. 1999) (in deciding whether unlisted debt should be discharged, Court must consider reasons for omission).  
\textsuperscript{18} 11 U.S.C. § 521(a)(1)(A) and (B)  
\textsuperscript{20} See, Gonsalves v. Belice (In re Belice), 2011 WL 4572003( B.A.P.,1st Cir. March 7, 2011) (when filing for relief, a debtor is required to file a list of creditors with their names and addresses).  
\textsuperscript{22} See, e.g., In re Clausen, 464 B.R. 827(Bankr. W.D. Wis, 2011).  
\textsuperscript{23} See Mass. Local Bankr. R. 1007-(a).}
may protect their rights,\textsuperscript{24} If the debtor is not seeking to discharge the business debt, and it is clear that (1) the case is a no-asset case such that timely claim filing is not important and (2) the debt is not of a kind specified in ¶¶ (2), (4), or (6) of § 523, listing the name of the creditor would seem to fulfill the debtor’s legal obligation under § 521 and achieve the debtor’s practical goal of preserving important future business relationships. If preservation of the business relationships becomes unnecessary post-filing, schedule amendment could be sought to eliminate any doubt as to dischargeability. Typically, schedule amendments are allowed as a matter of course,\textsuperscript{25} but amending to include information purposefully omitted could be problematic should an inquiry into the reason for the necessity of the amendment arise.

\textsuperscript{24} \textit{See In re} Sedlacek, 325 B.R. 202 (Bankr. E.D. TN., 2005).

\textsuperscript{25} Fed. R. Bank. P. 1009.