

**DUE DILIGENCE AND THE ATTORNEY LIABILITY
PROVISIONS OF BAPCPA**

**Prepared by Joel T. Marker
McKay, Burton & Thurman
170 South Main St., Suite 800
Salt Lake City, UT 84101
Telephone: (801) 521-4135
Email: joel@mbt-law.com**

Attorneys representing debtors in consumer bankruptcy cases practice under numerous ethical and statutory duties intended to enforce a standard of professionalism on the field. Most debtors' counsel represent their clients with diligence, competence and compassion, often under difficult circumstances and at risk that they will not be fully compensated if a case turns out to be more complicated than anticipated. However, when attorneys fail to live up to reasonable diligence expectations, they prejudice their clients and other parties in interest, impede the administration of justice and subject themselves to liability for their faults. This paper will review some of the diligence duties imposed on the consumer debtor counsel and provide specific suggestions to raise the performance bar to the benefit of both client and counsel.

Ethical Responsibilities

In Utah, an attorney's diligence obligations begin with his duties under the Utah Rules of Professional Conduct. Rule 1.1 requires a level of competence that is reasonable under the circumstances: "[a] lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Similarly, Rule 1.3 dictates that a lawyer "shall act with reasonable diligence and promptness in representing a client." With respect to communication with a client, Rule 1.4 requires that a lawyer explain the matter "to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." The standard of care set forth in the Rules of Professional Conduct is one of reasonable diligence under the circumstances.

Debt Relief Agency Provisions

The debt relief agency provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (11 U.S.C. §§ 526, 527 and 528) adopt the standard of reasonable care in imposing additional duties on attorneys representing debtors in consumer bankruptcy cases. Section 526(a)(2) of the Bankruptcy Code provides as follows:

(a) A debt relief agency shall not—

...

(2) 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 and misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading.

An attorney failing to exercise reasonable care in preventing a client from filing statements or schedules containing untrue or misleading statements “shall” be liable to the client in the amount of any fees and charges received by the attorney, for actual damages and for reasonable attorneys’ fees and costs, under Section 526(c)(2).

The role of counsel in ensuring the accuracy of the debtor’s schedules has been a matter of concern for the courts even prior to BAPCPA. One court criticized an attorney for failing to include accurate information in the statements and schedules, for having the debtors sign the documents before they were completed, and for the attorney’s belief that certain assets were exempt and therefore did not need to be disclosed in the schedules.¹

Another court sanctioned an attorney for failing to disclose his clients’ prior bankruptcy case (in which the same attorney had represented the debtors approximately six months earlier), failing to disclose the sale of the debtors’ home between the two cases, and

failing to disclose their possession of \$60,000 in sale proceeds on the petition date of the second case.²

Reasonable Inquiry Obligations in Chapter 7

BAPCPA also imposes new certification standards directed at attorneys who represent consumer debtors in Chapter 7 cases. These new standards, set forth in Section 707(b)(4)(C) and (D), provide:

- (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.

An American Bar Association task force has suggested that in interpreting and applying Section 707(b)(4)(C)'s "reasonable investigation" requirement, attorneys and the courts should use the "reasonable inquiry" standard articulated under Rule 9011 jurisprudence.³ Specifically, the task force accepted the following articulation of an attorney's reasonable pre-filing investigation:

The duty of reasonable inquiry imposed upon an attorney by Rule 11 and by virtue of the attorney's status as an officer of the court owing a duty to the integrity of the system requires that the attorney (1) explain the requirement of full, complete, accurate, and honest disclosure of all information required of a debtor; (2) ask probing and pertinent questions designed to elicit full, complete, accurate, and honest disclosure of all information required of a debtor; (3) check the debtor's responses in the petition and Schedules to assure they are internally and externally

consistent; (4) demand of the debtor full, complete, accurate, and honest disclosure of all information required before the attorney signs and files the petition; and (5) seek relief from the court in the event that the attorney learns that he or she may have been misled by a debtor.⁴

One court has explained that the attorney's reasonable inquiry obligation requires that the attorney not simply accept the client's version of the facts on faith, but probe the client in that respect.⁵

While the reference in the statute and in case law to "attorney" does not preclude the use of paraprofessionals where appropriate and under proper supervision in the course of filing consumer bankruptcy cases, attorneys cannot evade their responsibilities by relying on those paraprofessionals. Rather, all attorneys must exercise not only supervision, but "professional judgment that derives only through personal involvement in the case and evaluation of the client's needs."⁶

Section 707(b)(4)(D) marks the first time that attorneys have been responsible, through the threat of sanctions, for the accuracy of their clients' schedules. The certification requirement set forth in Section 707(b)(4)(D) overrides the exception for statements and schedules under Bankruptcy Rule 9011(a) and, effective December 1, 2007, a notice in Official Form 1, the Voluntary Petition, advises the attorney that his signature on the petition constitutes a certification that the attorney has no knowledge after an inquiry that the information in the schedules is incorrect.

The ABA task force suggests that attorneys conform their "inquiry" requirement under Section 707(b)(4)(D) to the "reasonable inquiry" standard under Rule 9011.

- Attorneys should be able to rely on case law that allows time constraints to be taken into account.

- The reasonableness of the attorney’s inquiries should not be analyzed with the benefit of hindsight; rather, the analysis should, as under Rule 9011, focus on the attorney’s inquiry at the time the inquiry was made.
- Attorneys should verify information supplied by the debtor if such verification may be accomplished with a reasonable expenditure of time and expense, and in the attorney’s professional judgment, the information provided by the client is inconsistent or contains other indications of inaccuracy.
- Attorneys should be able to be rely upon documents prepared by third parties in the scope of their employment, including tax returns, credit and title reports, child support enforcement agency statements, or information from the debtor’s pre-petition credit counseling agency.

Specific Due Diligence Practice Pointers

1. Social Security Number.

Prior to filing, counsel must confirm the client’s social security number with appropriate third-party documentation, such as a social security card or correspondence from the Social Security Administration. Counsel should rarely rely on W-2 forms and never accept the client’s prior tax return or uncorroborated statement.

Case in point: Debtor listed incorrect social security number on his petition and creditor with otherwise dischargeable tax claim did not receive adequate notice of the debtor’s Chapter 13 case in order to file a timely proof of claim.⁷

Example of lack of reasonable inquiry: At 341 meeting, debtor presented petition, social security card and pay advices from two different jobs, comprising four different social security numbers.

2. Credit Counseling Certificate.

Three simple rules:

- 1) You must have the certificate in your hand before filing the case;
- 2) The certificate must be viable; and
- 3) You must file the certificate with Official Form 1, Exhibit D

(Individual Debtor's Statement of Compliance with Credit Counseling Requirement).

Case in point: Debtors' counsel did not thoroughly review the documents necessary to the filing of the case and delayed the actual filing of the petition until 189 days after the debtors obtained their credit counseling certificate. Lack of reasonable diligence on the part of debtors' counsel resulted in a motion to dismiss by the United States Trustee (denied by the court) and delayed administration of the case. Attorney's error warranted imposition of sanction in form of forfeiture of compensation and payment of \$200 fine under Section 105 of the Bankruptcy Code.⁸

Local Practice Note: Judge Boulden will dismiss an individual consumer debtor case, without notice, if the credit counseling certificate is not filed with Exhibit D.

3. Divorce Decree.

Always discuss your client's marital status prior to filing. If your client says that he is "single" probe further to learn if he is divorced or has never been married. If there has been a divorce within the last five years, the attorney must make a thorough review of the divorce decree to ascertain important bankruptcy issues such as the debtor's interest in a property settlement, or any obligation under a hold-harmless provision or

other form of domestic support obligation. Debtor's counsel may not rely on the client's memory or understanding of his rights or duties in these situations. Get the decree, read it, and advise your client appropriately.

4. Real Property Issues.

Real property issues often pose substantial challenges to the average debtor. A competent and experienced attorney can advise his client on the proper disclosure of facts relating to ownership of real property, the value of the property, the nature and extent of liens, and the existence and character of prepetition transfers. Counsel should require reliable third-party documentation to assist in the preparation of statements and schedules relating to real property issues. A preliminary title report will provide information on ownership, existing liens and transfers within the last two years. County tax notices will provide information on ownership and assessed value. Online services, such as the website for the Salt Lake County Recorder's Office (slcorecorder.siredocs.com) provide both free and subscription information. Information such as current and historical assessed value is available free online; information and copies of documents affecting title are available for a subscription fee of \$25.00 per month and a charge of \$.01 per page.

a. Judgment lien avoidance.

It is common to see motions to reopen Chapter 7 cases--sometimes years after the case was closed--to avoid a judgment lien that is causing problems with a sale or refinance of the debtor's property. Attorneys who fail to assist their clients in identifying liens that may be avoided under Section 522(f) of the Bankruptcy Code cause unnecessary delay and cost and subject their clients to the risk of an adverse outcome. In

any case where the debtor owns real property (especially in cases where the debtor has been sued prepetition) counsel should obtain a preliminary title report or search information online to disclose ownership and lien information necessary to file an effective lien avoidance motion.

b. Ownership information.

A current county tax assessment notice or online search will assist counsel in determining whether the debtor has a present interest in real property. In a recent case in the District of Utah, an attorney was required to disgorge all fees in an individual consumer case where the debtor failed to claim an interest in his personal residence. The debtor was disabled, had been married for 25 years and had resided in the same residence with his wife for over 20 years. Despite these facts, the attorney did not probe the debtor's inconsistent statements and failed to take reasonable steps to determine the state of title to the residence. In fact, the debtor was a joint owner with his wife. If the attorney had been reasonably diligent, the case would never have been filed. Instead, the attorney's negligence cost the client an additional \$10,000 in fees and costs.

c. Transfers within two years.

A debtor who has sold real property within two years of the petition date must report detailed information on the transfer in response to question 10 of the statement of financial affairs. In order to assist the client in providing the who, what, where and when of the transaction, counsel must insist on a copy of the settlement statement from the sale closing. The settlement statement will also indicate the amount, if any, received by the debtor at closing and will lead to further questions concerning disposition of the sale proceeds.

Case in point: Recently a debtor filed for Chapter 7 relief two weeks after selling his residence and receiving approximately \$15,000 at closing. The attorney did not request a copy of the settlement statement (complaining that requesting such information would make his file “too thick”) and simply told his client that the proceeds were exempt as homestead proceeds. Without further input or suggestion from the attorney, the debtor made voluntary transfers of all of the sale proceeds to family members and creditors, which transfers were not reported in his statements and schedules. The attorney failed to understand that the debtor could not exempt homestead proceeds once voluntarily transferred (pursuant to Section 522(g) of the Bankruptcy Code) and the trustee’s subsequent investigation forced the client to convert his case to one under Chapter 13 of the Bankruptcy Code in order to avoid the trustee’s recovery of the transfers.

¹ *United States Trustee v. Lynn (In re Bellows—Fairchild)*, 322 B.R. 675 (Bankr. D. Or. 2005).

² *In re Hill*, 377 B.R. 8 (Bankr. D. Conn. 2007).

³ Catherine E. Vance & Jimmy F. Dahu, Am. Bar. Assoc., Report: Attorney Liability Under § 707(B)(4) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, at 12 (2005), http://www.abanet.org/legalservices/probono/businesslaw/bankruptcy/ncbj-06_task_force_report_on_attorney_liability.pdf.

⁴ *In re Robinson*, 198 B.R. 1017, 1024 (Bankr. N.D. Ga. 1996).

⁵ *Fleming Sales Co., Inc. v. Bailey*, 611 F. Supp 507, 519 (N.D. Ill. 1985).

⁶ Vance & Dahu, *supra* note 3, at 13.

⁷ *In re Ellett*, 506 F.3d 774 (9th Cir. 2007).

⁸ *In re Enloe*, 373 B.R. 123 (Bankr. D. Colo. 2007).