

## ETHICAL CONSIDERATIONS IN CHAPTER 13 PRACTICE

*Lou Jones Breakfast Club – December 8, 2009*

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- I. AMERICAN BAR ASSOCIATION (ABA) MODEL RULES OF PROFESSIONAL CONDUCT
  - A. Rules promulgated by the ABA to resolve ethical problems.
    1. Designed to provide guidance to lawyers and a structure for regulating conduct through disciplinary proceedings.
    2. Not designed to provide a basis for civil liability.
      - a. Courts, however, have looked to the Model Rules for guidance in their opinions (e.g., an indication that a lawyer violated an ethical duty might be a basis for finding that a lawyer is disqualified from representing a client because of a conflict of interest).
  - B. Rules are not themselves binding. Most states have adopted the ABA Model Rules in whole or in part.
  - C. Wisconsin has substantially adopted the ABA Model Rules in Supreme Court Rule (SCR) Chapters 20A and 20B.
    1. “Wisconsin Committee Comments” appear where there is a point of difference between a Model Rule and a Supreme Court Rule.
    2. “Wisconsin Comments” are added by the Wisconsin Supreme Court where the court considered additional comment appropriate.
  - D. Resources
    1. ABA Model Rules and Wisconsin Supreme Court Rules can be found on the ABA website and wisbar.org, respectively.
    2. Wisconsin State Bar Ethics Hotline
      - a. Available to State Bar Members to informally and confidentially discuss an ethics question with ethics counsel.
        - i. (608) 250-6168 or (800) 444-9404 x 6168
    3. Request a Professional Ethics Committee opinion about prospective behavior only (i.e., opinion requests must not relate to past or present conduct of a specific member of the Bar).
      - a. Send letter detailing your concern to the State Bar of Wisconsin, P.O. Box 7158, Madison, Wisconsin 53707.

## II. SPECIFIC RULES

### A. Competence – Rule 1.1

1. “A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonable necessary for the representation.”
  - a. Factors to consider:
    - i. Complexity and specialized natures of the matter;
    - ii. The lawyer’s general experience;
    - iii. The lawyer’s training and experience in the field in question;
    - iv. The preparation and study the lawyer is able to give the matter; and
    - v. Whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question.
  - b. Generally, the required proficiency is that of a general practitioner.
  - c. Also, “[t]o maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice....”
2. Application of Rule 1.1 to Chapter 13 Practice
  - a. Under what circumstances should a lawyer with no Chapter 13 experience represent a debtor or a creditor in Chapter 13 case?
  - b. It is extremely important for a lawyers practicing in this area to stay abreast of changes in the law.
    - i. Practitioners are still feeling the effects of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) more than four years later (*e.g.*, *Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269 (10<sup>th</sup> Cir. 2008), *cert. granted*, No. 08-998; *In re Johnson*, 400 B.R. 639 (Bankr. N.D. Ind. 2009), *appeal docketed*, No. 09-1212 (7<sup>th</sup> Cir. Jan. 29, 2009)).

### B. Diligence – Rule 1.3

1. “A lawyer shall act with reasonable diligence and promptness in representing a client.”
  - a. Even though a lawyer must act with zeal and dedication in representing a client, “reasonable diligence does not require the use of offensive tactics or preclude the treating of all persons involved in the legal process with courtesy and respect.”
  - b. Procrastination is specifically pointed out in the comments to this rule as the most widely resented professional shortcoming of a lawyer. Lawyers should not act with unreasonable delay and control their work load to that each matter may be handled competently.
2. Lawyers practicing in Chapter 13 are under constant, short deadlines.
  - a. Time period to object to confirmation of plans.

- b. Objection period in response to motions for relief from the automatic stay and to motions to dismiss.
- c. Deadlines for creditors to file proofs of claim.
- d. Time to file an appeal.

C. Communications – Rule 1.4

- 1. “A lawyer shall: (1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent . . . is required by these Rules; (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished; (3) keep the client reasonably informed about the status of the matter; (4) promptly comply with reasonable requests for information; and (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.”
  - a. Failure to return telephone calls seems to be a common complaint.
  - b. Informing client of settlement offers.
    - i. Comment to Rule 1.4 provides “a lawyer who receives from opposing counsel an offer of settlement in a civil controversy . . . must promptly inform the client of its substance *unless the client has previously indicated* that the proposal will be acceptable or unacceptable or has authorized the lawyer to accept or to reject the offer.” (Emphasis added).

D. Confidentiality of Information – Rule 1.6

- 1. “A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).” Subsection (b) describes information related to the representation of a client that a lawyer may reveal “to the extent the lawyer reasonably believes necessary: (1) to prevent reasonably certain death or substantial bodily harm; (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services; (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services; (4) to secure legal advice about the lawyer's compliance with these Rules; (5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or (6) to comply with other law or a court order.”

- a. Essentially, Rule 1.6 requires a lawyer to not reveal any information revealed to the lawyer by the client.
  - b. Requirement for client confidences serves the public interest since people are more likely to seek legal advice and be aware of their legal obligations if they know that their communications will be private.
2. Work Product Evidentiary Privilege Compared with Rule 1.6
- a. Ethical duty under Rule 1.6 is broader than evidentiary privilege under Federal Rule of Civil Procedure (FRCP) 26(b)(3) (e.g., certain confidential information not within the scope of the evidentiary privilege may be discoverable by the opposing party).
  - b. FRCP 26(b)(3) allows for discovery of documents and tangible things prepared in anticipation of litigation or for trial under certain circumstances, but an exception is carved out for “disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney . . . of a party concerning the litigation.”
  - c. The Seventh Circuit Court of Appeals has described the test to be used in determining whether something is work product as “whether the materials sought to be protected from disclosure were in fact prepared in anticipation of litigation.” *Binks Mfg. Co. v. Nat’l. Presto Indus.*, 709 F.2d 1109, 1118 (7<sup>th</sup> Cir. 1983). The mere fact that litigation does eventually arise does not cover materials prepared by an attorney by the work product privilege. *Id.*
    - i. Application of this test to bankruptcy cases:
      - i. Documents prepared by an attorney while drafting/planning to file a bankruptcy petition would not be covered by the privilege unless litigation was anticipated.
      - ii. Privilege would apply within the context of an adversary proceeding.
      - iii. Might also apply if an examination under Federal Rule of Bankruptcy Procedure (FRBP) 2004 is ordered.

#### E. Dealing With Unrepresented Person – Rule 4.3

- 1. “In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer’s role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.”
  - a. Key is to clarify that you do not represent the *pro se* person’s interests and not provide legal advice.

- b. Concern is that an unrepresented might assume that a lawyer is a disinterested authority on the law.
2. In Chapter 13 practice, interactions between attorneys and both *pro se* creditors and *pro se* debtors commonly arise.

F. Conflict of Interest: Transactions With Client – Rule 1.8(a)

1. This Rule prohibits a lawyer from entering into a business transaction with a client or knowingly acquiring an adverse pecuniary interest to a client unless:
  - a. The transaction is fair and reasonable and the details are disclosed in understandable terms to the client;
  - b. The client is advised, in writing, to seek independent legal counsel about the transaction; and
  - c. The client consents, in writing, to the terms of the transaction and the lawyer’s role in it.
2. *In re Mallory*, 2009 Bankr. LEXIS 845 (Bankr. E.D. Va. Jan. 6, 2009).
  - a. Chapter 13 Debtors entered into a transaction with Debtors’ counsel’s son, who worked as a paralegal in counsel’s office, to sell their home to him for \$67,000. Debtors’ counsel filed a motion to sell the real estate but did not disclose his relationship with the buyer, either as his son or as an employee of his law firm. The U.S. Trustee objected and the court denied the motion to sell because of the conflict of interest. The case was subsequently converted to Chapter 7 and the Chapter 7 trustee ended up selling the real estate for \$114,000 and paying all creditors in full.
  - b. The U.S. Trustee then filed an adversary complaint against Debtors’ counsel to impose sanctions, for disgorgement of fees and for an account of all funds received by Debtors’ counsel during the course of Debtors’ bankruptcy case.
  - c. The court found that counsel’s filing of the motion to sell was a “clear and obvious” conflict of interest. Further, the court stated that, “[i]n short, a debtor’s bankruptcy attorney as an officer of the court simply cannot request the court to approve transactions with the attorney’s close relatives, at least without full disclosure of all circumstances that might obviate a conflict. Neither the court nor the trustee should have to spend time examining such transactions.”
    - i. This point also relates to Rule 3.3, requiring candor toward to the tribunal.
  - d. Lastly, the court found it troublesome that Debtors’ counsel made no effort to determine whether the \$67,000 that his son was going to pay for real estate, which the Chapter 7 trustee sold for \$114,000, was the fair market value.
  - e. As a sanction, the court ordered that Debtors’ counsel complete a total of ten hours of ethics courses approved by the Virginia bar within twelve months.

G. Candor Toward the Tribunal – Rule 3.3(a)

1. A lawyer may not knowingly:
  - a. Make a false statement to the court or fail to correct a false statement previously made;
  - b. Fail to disclose to the court legal authority in the controlling jurisdiction known to the lawyer to be adverse to the position of the client, even if not disclosed by opposing counsel; or
  - c. Offer evidence that the lawyer knows to be false. If anyone called by the lawyer offers material evidence that the lawyer later discovers is false, the lawyer must take remedial measures, which includes disclosure to the tribunal.
    - i. The duty to disclose adverse precedent is counterintuitive and therefore likely to be overlooked. In Chapter 13 practice, decisions interpreting the Code under BAPCPA seem to be issued daily. As such, it is that much more important to stay updated as to legal opinions so as to not run afoul of this Rule.
2. Under Rule 3.3(d), in an *ex parte* proceeding, a lawyer must inform the court of all material facts known to the lawyer that will enable the court to make an informed decision, even if the facts are adverse.
  - a. In Chapter 13, the filing of adversary actions to determine the liens of second mortgage holders seems to have increased lately. In many of these cases, no response from the mortgagee is filed and a prove-up hearing may be required. Under Rule 3.3(d), debtors' counsel is under an ethical duty to inform the court of any informal response was received by the mortgagee or of anything that is adverse to the debtor's position.
3. *In re Alexander*, 2003 Bankr. LEXIS 1297 (Bankr. N.D. Tex. Oct. 1, 2003).
  - a. Debtors' counsel failed to inform the bankruptcy court that his license to practice law was suspended. After hearing testimony from counsel (which, the court did not find credible), and considering his past license suspensions, the court found counsel's behavior egregious enough to (1) suspend his license to practice before that bankruptcy court for an indefinite period of time, but not less than one year; (2) refer the matter to the district court for the Northern District of Texas with a recommendation that counsel's license for the entire district be revoked; and (3) refer the matter to the Department of Justice for further investigation.

H. Meritorious Claims and Contentions -Rule 3.1

1. "A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law. A lawyer for the defendant in a criminal proceeding, or the respondent in a proceeding that could result in

incarceration, may nevertheless so defend the proceeding as to require that every element of the case be established.”

- a. The comments to this rule state: “What is required of lawyers . . . is that they inform themselves about the facts of their clients' cases and the applicable law and determine that they can make good faith arguments in support of their clients' positions.”
- b. Examples that might implicate this rule:
  - i. Motions for relief from stay where no cause to lift the stay exists.
  - ii. Objections to motions for relief or to dismiss that provide no basis for the objection other than that counsel cannot get a hold of client.
  - iii. Form objections that do not address the grounds for the relief requested in the motion.
  - iv. Objections stating that a debtor has made payments to a creditor or the trustee when payments really have not been made.

#### I. FRBP 9011(b) – Representations to the Court

1. Overlaps with Model Rules 3.1 (Meritorious Claims and Contentions) and 3.3 (Candor Toward the Tribunal).
2. Provides that an attorney or unrepresented person who is presenting a document to the court, is thereby certifying that the document:
  - a. Is not being presented for an improper purpose, such as to harass or cause undue delay;
  - b. Contains claims, defenses or other legal contentions that are warranted by law or by a nonfrivolous argument for the extension, modification or reversal of existing law or for the establishment of new law;
  - c. Contains allegations that will have evidentiary support; and
  - d. If responsive, contains denials of factual allegations that are warranted on the evidence, or reasonably based on a lack of information and belief.
3. Sanctions for Violating FRBP 9011
  - a. Initiated by motion or on the court’s own initiative.
    - i. If initiated by motion, the complaining party must serve the other party pursuant to FRBP 7004 and file the motion with the court only if the challenged document is not withdrawn after 21 days of such service.
  - b. Sanctions may be a nonmonetary directive, an order to pay a penalty to the court or an order requiring payment of the movant’s attorney fees and/or costs.

#### J. Responsibilities Regarding Nonlawyer Assistants – Rule 5.3

1. A lawyer with managerial or supervisory authority in a law firm must make reasonable efforts to ensure that the firm has measures in effect

giving reasonable assurance that a nonlawyer assistant's conduct is compatible with the professional obligations of the lawyer.

- a. Means that a lawyer must give paralegals, secretaries and law clerks instructions about the ethical aspects of the law practice.
  - b. Further, this rule requires that lawyers with managerial authority make a reasonable effort to establish internal policies designed to make sure that all assistants comply with the Model Rules.
2. A lawyer is responsible for a nonlawyer assistant's conduct that would be a Rules violation if:
- a. The lawyer orders, or with knowledge of the conduct, ratifies the conduct at issue; or
  - b. The lawyer with managerial or supervisory authority knows of the conduct at a time when its consequences could be avoided or mitigated, but fails to take remedial action.

K. Scope of Representation - Rule 1.2(d)

1. "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law."
  - a. Under this rule, a lawyer may not advise a client to lie.
  - b. A lawyer may, however, provide an honest opinion about the consequences that are likely to result from a client's conduct. A lawyer may present an analysis of the legal aspects of questionable conduct but may not recommend the means by which to commit fraud or a crime and get away with it.
2. *In re Sadorus*, 2005 Bankr. LEXIS 2459 (Bankr. C.D. Ill. Dec. 8, 2005).
  - a. Here, Debtor, who resided in Illinois was referred to a bankruptcy law firm based out of California by a debt consolidation agency. None of the communications with the law firm prior to the filing of a Chapter 7 petition were in person; Debtor only spoke to several attorneys and a non-attorney assistant via telephone and e-mail. Debtor was concerned about \$8,000 he had in a bank account and did not want any of those funds going to his unsecured creditors. The non-attorney assistant that he spoke with told Debtor not to worry because those funds were exempt.
  - b. The California law firm hired local counsel out of Decatur, Illinois to appear at the § 341 meeting of creditors. Sometime prior to the meeting, local counsel met with Debtor and told him that he thought the \$8,000 would not be exempt. This news prompted Debtor to telephone the California law firm and the attorneys he spoke with agreed with local counsel's assessment that the funds would not be exempt. The California attorneys advised Debtor not to go the first § 341 meeting or the continued meeting and that the case would eventually be dismissed. They told him to state that he was sick for

the first meeting and that he forgot about the second one. Once the case was dismissed, the attorneys advised Debtor to spend the money and then to re-file after the money was spent.

- c. A second Chapter 7 case was eventually filed and, at the meeting of creditors, some information from what happened in the previous case came to light and the bankruptcy court started asking some questions.
- d. The court ended up finding that the level of service provided by the California law firm was far below the minimum standard expected for attorneys that practiced in that court. The work was not only sloppy, but the law firm gave Debtor bad legal advice. The court noted that the fact that the bad legal advice came from a non-attorney employee was irrelevant.
- e. Most significantly, the court found that the actions of the California law firm were unethical. Advising Debtor to skip the creditors' meetings and to spend the money in the bank account "clearly violated the spirit and intent of the Bankruptcy Code."
- f. As sanctions, the court:
  - i. Ordered a disgorgement of all fees paid to the California law firm by Debtor;
  - ii. Ordered that the California law firm be responsible for payment of the trustee's fees and associated costs; and
  - iii. Suspended one of the California attorneys from the practice of bankruptcy law in the Central District of Illinois until he showed that he completed a certain number of continuing legal education classes.

L. Fees; Reasonableness - Rule 1.5(a)

1. In this district, we have a Court Policy to supplement FRBP 2016 and 2017.
  - a. Debtor's Attorney Fees
    - i. For all cases filed after October 1, 2007, as long as there is no objection to the fee, a formal fee application will not be required unless fees exceed \$3,000 at any time during a case.
    - ii. If any party in interest, including the court on its own motion, asks the court to determine the reasonableness of the fee charged, the debtor's attorney must submit a detailed fee application in accordance with Local Rule 2016.
  - b. Creditor's Attorney Fee for Motion for Relief
    - i. For all initial motions for relief from the automatic stay, the presumed reasonable fee is \$700, plus filing fee. If a party in interest objects, the court will then take a closer look.
2. *In re Clark*, 2009 Bankr. LEXIS 747 (Bankr. D. Or. Mar. 26, 2009).
  - a. This case involved the failure of Debtors' counsel, in several Chapter 13 cases, to accurately disclose to the court the total amount of his attorney fees. Further, counsel failed to promptly provide

documents pursuant to a case audit, thereby causing unnecessary work by the auditor and the United States Trustee.

- b. The court ended up ordering a disgorgement of fees and suspending Debtors' counsel from filing any bankruptcy cases in the District of Oregon for 90 days.

M. Terminating Representation – Rule 1.16(b)

1. Withdrawing from representation of a Chapter 13 debtor.
2. Is a motion to withdraw required?

N. Conflict of Interest, Imputation of Conflicts and Duties to Former Clients – Rules 1.7 -1.10

1. *In re Kennedy*, 2008 Bankr. LEXIS 1108 (Bankr. D. Neb. Apr. 8, 2008).
  - a. In this case, Debtor and her former spouse were involved in a divorce proceeding prior to the filing of her Chapter 7 petition. Her ex-husband, through counsel, filed a dischargeability adversary, a motion for relief from stay and motion to dismiss her case. A lawyer who now works as an associate in the ex-husband's counsel's law office was previously employed as an associate in a law office that represented the wife in her divorce.
  - b. Debtor's bankruptcy counsel filed motion to disqualify the ex-husband's attorney and his firm from representing the ex-husband in the bankruptcy case because of the involvement of the associate in the dissolution of marriage case.
  - c. The court looked not only to relevant case law, but also cited Model Rules (that were adopted by the Nebraska Supreme Court) in coming to its decision.
  - d. The court found that the divorce action was substantially related to Debtor's bankruptcy case and that litigation in the bankruptcy court concerned matters that arose from the divorce decree. The court stated that "the standards governing attorney conduct require disqualification" of the ex-husband's firm from representing him in the bankruptcy case.

O. Reporting Professional Misconduct – Rule 8.3(a)

1. "A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority."
  - a. This does not apply if information is given in confidence under Rule 1.6 or if information is given to a lawyer while participating in an approved lawyers' assistance program.