The Nassau Lawyer

July-August 2011

Investigating your Client's Bankruptcy Petition
How Much is Enough?

By Marcus Monteiro

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act")1 put bankruptcy practitioners on stern notice: Put up or pay up. The Act threatened attorneys with penalties for failing to properly investigate petitions for accuracy.2 Specifically, the Act provides that the signature of an attorney on a petition constitutes a certification that the attorney has performed a reasonable investigation into the circumstances that gave rise to the petition and determined that the petition is well grounded in fact, is warranted by existing law, and does not constitute an abuse.3 Regarding the schedules contained in the petition, the Act only requires that an attorney certify that she has no "knowledge after an inquiry that the information in the schedules filed with such petition is incorrect."4 Failing to adhere to the inquiry obligations under the Act is now sanctionable.

Attorneys were alarmed, some even predicting the end of consumer bankruptcy days, complaining: "Congress has sung and I do not like either the melody or the lyrics, so it is time to bring down the curtain on representing consumer debtors… the added burden and risks of the Act are simply more than I care to bear."5 Other scholars bellowed: "bad news for debtors, worse news for lawyers."6 But does the Act really impose any enhanced obligations from Federal Bankruptcy Rule 9011? More importantly, to what extent are attorneys obligated to investigate the underlying facts from their clients before filing bankruptcy petitions?

The Act's History

The new rules were created in response to a growing sense that bankruptcy laws moved from assisting "honest but unfortunate debtors" to a "financial management" tool for a "cunning" strategist.7 The new means test contained in the Act would serve as a bright line guide to separate honesty from abuse, by allowing only a specified range of expense to income ratio.8 To work properly, however, the means test is critically dependent on accurate schedules and petitions.9 This created a challenge because, with the rise in bankruptcy filings (250,000 in 1979 to 1.5 million by 2004), trustees and courts lacked the necessary funding and time to investigate all petitions, schedules, and statements to determine their underlying factual accuracy.10 Recognizing this need, the Act recruited more parties to the detective effort.11

Formerly, only the Court or U.S. Trustee could move to dismiss a Chapter 7 petition, which required a finding of "substantial abuse."12 Now, any "party in interest," including creditors and trustees, is permitted to move to dismiss abusive cases.13 More importantly, facing sanctions under the Act, attorneys were put on the hook for inaccurate submissions.14 As one legal commentator put it, "[b]y threatening sanctions, the provisions assign the duty of ferreting out abuse to the debtors' attorney in the first instance. The attorney lacks any substantial incentive to risk begin sanctioned, even if the chance of sanction is low." 15

Unchanged by the Act, however, is Rule 9011(a), which requires a signature for every "petition, pleading, written motion, and other paper, except a list, schedule, or statement, or amendments…" Also unchanged is Rule 9011(b), which states that "presenting to the court 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" that: (i) the submissions are not being presented for any improper purpose; (ii) the claims, defenses, and other legal contentions therein are warranted by existing law; (iii) the allegations and other factual contentions have evidentiary support or are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and (iv) the denials of factual contentions are warranted on the evidence. The

difference between the terms "inquiry reasonable" used in Rule 9011(b) and "reasonable investigation" used in the Act at Section 707(b)(4)(C) is of no consequence.16

Similar to the Act, Rule 9011 makes a distinction between the petition and its schedules. Accordingly, it is debatable whether the inquiry contained in Rule 9011(b) applies to schedules and statements. The First Circuit believes Rule 9011(b) is applicable to schedules, holding: "it is well established that Bankruptcy Rule 9011(b) applies to debtor's attorneys even with respect to a debtor's schedules, statement of affairs and other documents disclosing assets, which debtors, but not counsel, are required to sign."17

Legal commentators disagree: "[I]t is not clear whether Rule 9011 of the Federal Rules of Bankruptcy Procedure previously applied due to the exclusion of schedules and statements in Rule 9011(a)."18 The Michigan bankruptcy court adds: "whether Rule 9011 applies to statements of affairs and schedules is debatable."19 Because of this lingering uncertainty, it is dangerous to disregard the Rule 9011(b) inquiry regarding schedules and statements.

Accordingly, it is not clear if the Act imposes any meaningful heightened obligation from Rule 9011. The Massachusetts bankruptcy court believes not, holding "707(b)(4)(C) and (D) parallels Rule 9011. It created no new standard. It simply codified and put an exclamation point on Rule 9011 in the preparation of certain documents."20 Accordingly, while the case law may still be in its infancy, the alarm over additional investigation obligations under the Act appears over-hyped.

In any event, New York attorneys are prohibited from filing knowingly false documents, as similarly prohibited by the Act at Section 707(b)(4)(D), under the Code of Professional Responsibility.21

Penalties
If Section 707(b) is violated, the Act contains a statutory basis for sanctions, including reimbursing the trustee for reasonable cost in moving the court.22 The Act also provides for "a civil penalty against the attorney" payable to the trustee for Rule 9011 violations. 23 However, Rule 9011(c) already contained a provision providing for "an appropriate sanction upon the attorneys" who violate it, which can include a penalty to the court, payment to the moving party of a motion, attorney's fees or other expenses.

Thus, the Act may have merely crystallized sanction provisions that were already on the Rule 9011 books. Thus, commentators have pronounced that "[courts] will, at most, use [the Act] as additional ammunition to sanction bad conduct that would have been punishable in any event."24

Avoiding the Penalties
Under either the Act or Rule 9011, how much investigation does the practitioner have to conduct to avoid dismissal or sanctions?

Looking at 707(b)(4), the First Circuit has held that debtor's counsel are to exercise significant care as to the completeness and accuracy of all recitations on their clients schedules after they have made a factual investigation.25 The attorney's certification must be based upon the "attorney's best knowledge, information and belief, formed after an inquiry reasonable under the circumstances.... Courts, therefore, must inquiry as to whether a reasonable attorney in like circumstances could believe his actions to be factually and legally justified."26

The Southern District of New York Bankruptcy Court in In re Alessandro recently added: "When an attorney conducts a reasonable investigation, she may rely on objectively reasonable representations of her client. All available documents that are relevant to the case should be examined."27 The court was also persuaded by the trustee's arguments that "[r]easonable investigation required counsel both to ask the Debtor probing and pertinent questions and to check the Debtor's responses in the Petition."28 The Alessandro court disgorged funds paid to the debtor's counsel when counsel failed to conduct a pacer search, which would have revealed the debtor's "frequent filer status."29 The court was unmoved by debtor's counsel's argument that he was under great time pressure or that his client failed to reveal prior non-Chapter 7 filings.30

Other courts have further held that an attorney investigation should include the following:

o impressing upon the debtor "the critical importance of accuracy in the preparation of documents to be presented to the Court;"31

o seeking and reviewing "whatever documents were within the debtor's possession, custody or control in order to verify the information provided by the debtor"32 (but does not appear to require an attorney to obtain documents that are not easily accessible);33

o employing "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');"34

o determining if there is anything which should have "obviously alerted the attorney that the information provided by the debtor could not be accurate;"35 and

o promptly correcting any inaccurate information.36

Note that many of these investigation criteria pertain to information contained in the schedules. Finally, an attorney should follow her common sense when probing clients and analyzing their responses and documents. A wise bankruptcy practitioner recognizes that if something is rattling at them, it may be a rattlesnake.37

Marcus Monteiro is a partner at Monteiro & Fishman LLP, 91 N. Franklin Street, Suite 108, Hempstead, New York 11550, (516) 280-4600 and can be contacted at mmonteiro @mflawny.com.

1. 11 U.S.C. § 707(b).
2. See 11 U.S.C. § 707(b)(4)(C)-(D); see also Bankruptcy Rule 9011.
3. 11 U.S.C. § 707(b)(4)(C).
4. 11 U.S.C. § 707(b)(4)(D); see also Henry J. Sommer, Trying to Make Sense Out of Nonsense: Representing Consumers Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bankr. L.J. 191, 206 (2005).
5. See Thomas J. Yerbich, The Coming Exodus of Consumer Counsel, ABI JNL. 10, at 10 (2003).
6. See Benjamin F. Davis, IV, Before the Law Sits A Gatekeeper: Finding Brilliance in the Attorney Liability Provisions of the Bankruptcy Abuse Prevention and Consumer Act, 23 Emory Bankr. Dev. J. 285, at 286 (2006)(quoting Geoff Gills, The New Bankruptcy Law: Bad News for Debtors, Worse News for Lawyers, 13-Sep Nev. Law 8 (2005)).
7. See Davis, supra note 6, at 293, 295 (2006)(citing Susan Jensen, A Legislative History of the Bankruptcy Abuse Prevention and Consumer Act of 2005, 79 Am. Bankr. L.J. 485 (2005)).
8. See generally id.
9. Id.
10. See id. at 293, 302-304.
11. Id.
12. 11 U.S.C. § 707(b)(2000).
13. 11 U.S.C. § 707(b)(1).
14. 11 U.S.C. § 707(b)(1).
15. Davis, supra note 6, at 314.
16. See Collier on Bankruptcy 707.05(1).
17. Lafayette v. Collins (In re Withrow), 405 B.R. 505, 512 (B.A.P. 1st Cir. 2009); see also In re Withrow, 391 B.R. 217, 226 (Bankr. D. Mass, 2008)("This Court has long believed that debtor's counsel have Rule 9011 obligations, even with respect to debtor's schedules, statement of affairs and other documents disclosing assets…").
18. Collier Bankruptcy Manual 707.06(2).
19. In re Trudell, 424 B.R. 786, 791 (Bankr. W.D. Mich. 2010).
20. In re Withrow, 2008 Bankr. LEXIS 2125, at 5 (Bankr. D. Mass. 2008).
21. See D.R. 7-102(A)(3)(concealing or failing to disclose something required by law); D.R. 7-102(A)(4) (knowingly use perjured testimony or false evidence); D.R. 7-102(5) (knowingly make a false statement of

fact; D.R.7-102(6)(participate in the creation of knowingly false evidence); D.R. 7-102(A)(7)(assist the client in knowingly fraudulent or illegal conduct); and D.R. 7-101(B)(aiding in unlawful conduct).
22. 11 U.S.C. § 707(b)(4)(A)(i)-(ii).
23. 11 U.S.C. § 707(b)(4)(B)(i)-(ii).
24. Collier on Bankruptcy 707.05(1).
25. Lafayette, 405 B.R. at 512 (citing In re Robertson, 370 B.R. 804, 809 n.8 (Bankr. D. Minn. 2007)).
26. Id. (citations and quotations omitted).
27. In re Alessandro, 2010 Bankr. LEXIS 3116, 9-10 (Bankr. S.D.N.Y. 2010).
28. Id.
29. Id.
30. Id.
31. In re Withrow, 391 B.R. at 228; see also In re Dean, 401 B.R. 917 (Bankr. D. Idaho 2008).
32. Id.
33. Collier Bankruptcy Manual § 707.06.
34. In re Withrow, 391 B.R. at 228; see also In re Dean, 401 B.R. at 917.
35. In re Withrow, 391 B.R. at 228.
36. Id.
37. Symposium: The Ethical Quandary and Financial Disincentives Imposed on Attorneys by the New Act, 22 Emory Bankr. Dev. J. 583, 596 (2006).