NEWS

Debtor's Attorneys See Red in Senate Bill

Bankruptcy judges more burdened also

Marcia Coyle
The National Law Journal
03-16-2005

Image: PhotoAlto

Printer-friendly version | Comment on this article | Reprints & Permissions

Sweeping bankruptcy legislation passed by the Senate last week would impose new requirements and new liability on debtor's attorneys, many of whom will decide that handling consumer bankruptcies is no longer worth the risk, said practitioners and legal scholars.

Key provisions, they added, would interfere with the attorney-client relationship, will increase malpractice premiums and overhead costs, and ultimately will leave many low-income clients without bankruptcy representation.

The bill's harsh treatment of debtor's attorneys, said unhappy practitioners and others, is just part of its primary goal of making Chapter 7 bankruptcies -- in which debtors seek discharge of their debts -- as difficult as possible.

"This is not a bankruptcy bill; this is a gift to a special interest group -- the credit card industry. There is not a credible bankruptcy organization in the country that supports this bill," said David P. Goch of Washington's Webster, Chamberlain & Bean, representing the Commercial Law League of America. (The league is the oldest and largest organization of attorneys and other professionals who represent the credit industry.)

The bill is expected to sail through the House of Representatives and be signed by President Bush quickly.

Bankruptcy judges too may soon re-evaluate their own jobs as the legislation increases their workload, fails to provide the necessary number of additional judges and draws them into the sometimes tedious application of a new means test for filers, said bankruptcy scholars.

"It wouldn't surprise me if in a few years we see a wave of bankruptcy judges stepping down to pursue other things," said bankruptcy scholar Robert Lawless of the William S. Boyd School of Law at the University of Nevada, Las Vegas.

But to the bill's proponents, chief among them Sens. Charles Grassley, R-Iowa, and Orrin Hatch, R-Utah, the attorney provisions are needed to reduce fraud and abuse within the bankruptcy system. "It is simply too easy for some mostly high-income debtors to simply wipe away their debts by filing for bankruptcy," Hatch said during last week's Senate debate.

But opponents and proponents would agree that S. 256, sought by banks and credit card issuers for the last eight years, will change the landscape of bankruptcy law for all involved.

The proposed new law has at its core a "means test" to separate those bankruptcy filers who can pay back a portion of their debts from those who cannot. Under the test, Chapter 7 filers earning more than the state median income would be presumed to have made an abusive filing. Those filers earning less than the median income would face extensive disclosure requirements to prove lack of income.

Last week the American Bar Association and 16 state bars from around the country lobbied intensely, and unsuccessfully, to amend three provisions in S. 256 that they felt would be particularly damaging to lawyers and their representation of financially strapped consumers.

Sens. Jeff Bingaman, D-N.M., and Russell Feingold, D-Wis., offered amendments to the three provisions, but as was the case with virtually every Democratic amendment offered, their changes were defeated or withdrawn.

The unamended provisions would:

Require the debtor's attorney to certify the accuracy of all factual allegations in the debtor's bankruptcy petitions and schedules. Attorneys would be subject to sanctions if any factual inaccuracies resulted in the dismissal of the client's Chapter 7 petition or in its conversion to a Chapter 13 petition, which requires some repayment of debt. The attorney could also be responsible for lawyer fees of the trustee or bankruptcy administrator who contested the Chapter 7 discharge.

Under Bankruptcy Rule 9011, bankruptcy attorneys, like all lawyers in federal court, must certify that pleadings and other items filed are supported by the facts. But the rule does not apply to bankruptcy schedules listing a debtor's financial information because those are prepared almost entirely from information supplied by the debtor, according to bankruptcy attorneys. The debtor bears responsibility for such schedules. S. 256 does not have a parallel requirement on creditor attorneys.

The bankruptcy bill also would require debtor's attorneys to certify the debtor's ability to make payments under a reaffirmation agreement. Debtors now do not have to discharge all outstanding debts. They can choose to "reaffirm" -- maintain liability for -- certain debts. Before a reaffirmation agreement can be approved, the debtor's attorney currently must only certify that the reaffirmation is voluntary and will not impose an undue hardship on the debtor.

And, finally, the bill contains provisions labeling any "person" who assists debtors with their bankruptcies in return for compensation a "debt relief agency." This section of the bill would impose a number of disclosure requirements on those assisting debtors and would require attorneys to include in their advertising and official communications a statement that "We are a debt relief agency."

ANTI-LAWYER?

Grassley and the bill's proponents say the certification requirements are necessary to improve the accuracy of bankruptcy petitions and schedules and to crack down on lawyers who abuse the system by filing frivolous and false petitions.

The "debt relief agency" provisions, proponents say, are aimed at so-called bankruptcy mills, where large volumes of cases are handled and where lawyers allegedly don't see their clients until a court hearing. There have been problems with inaccurate petitions and schedules, said bankruptcy scholar Lawless.

But he added, "You could say that for a lot of areas of law. We probably could improve the accuracy of criminal defendants at trials if we had a lawyer vouch for them. That's not the system we have," he said.

A number of debtor and creditor attorneys said that the proposed certification requirements would force them to hire private investigators, appraisers and auditors to verify the value of client assets.

The certification requirements will hit particularly hard those attorneys who do pro bono bankruptcies -- a substantial group, according to the ABA. They will be unwilling to bear the increased costs, debtor attorneys warned.

Sen. Bingaman noted during last week's debate that the University of New Mexico School of Law informed him that it would no longer be able to handle bankruptcy cases in its clinics if the certification requirements become law.

Marc Stern, a Seattle debtor's attorney, warned that the certification requirements will drive up the cost of filing a bankruptcy with a lawyer. And reaffirmation agreements will become a thing of the past, he added. "No lawyer is going to certify the client has the ability to make payments," he said. "How do you know? I won't do them."

Stern added, "I can't wait for the first case where there is certification and the debtor doesn't make the payments. You have a creditor saying, 'I relied upon that certification and wouldn't have agreed otherwise. Guess what, Mr. Lawyer -- you guaranteed and I detrimentally relied on your certification. Therefore I want you to make the payments.' "

Another Seattle attorney, Chuck Helm of Helm, Helm & Lovejoy, who does only unsecured collections work, agreed, saying, "I wouldn't represent a debtor if I had to sign a declaration. These cases don't generate enough fees to justify putting my butt on the line.

"The downside is too high and I'm sure my malpractice carrier would agree and I'm sure my rates would reflect that," he added.

Bingaman also noted on the Senate floor that one malpractice insurer -- Attorneys Liability Protection Society Inc., which insures 15,000 lawyers in 27 jurisdictions -- had estimated the certification requirements could result in immediate premium increases of 10 percent to 20 percent.

Some scholars indicated the "debt relief agency" requirements could violate the First Amendment because they compel speech. But the more immediate problem, said many lawyers, is the sweep of the provisions. Any lawyer -- tax, divorce, estate, real estate -- who provides "even a kernel" of bankruptcy advice in the course of representing a client would come under the debt relief agency requirements, they said. That could even include creditor lawyers.

The combination of all three requirements will reduce representation for low-income people, said John Rao, staff attorney for the National Consumer Law Center.

"What we fear will happen is there will be a real cottage industry of bankruptcy petition preparers," he said.

"There already are too many out there and there've been so many abuses by these companies. It may be the only affordable way to file bankruptcy after the bill or at least for some consumers."

The bankruptcy bill would provide some relief for bankruptcy courts by authorizing and funding 28 new judgeships. Those courts have not had new judgeships since 1992, and yet bankruptcy filings have skyrocketed in the intervening years.

But even these new judgeships, say bankruptcy scholars and others close to those courts, are too few. The Judicial Conference of the United States has requested 47. However, its own statistics would justify 100 new bankruptcy judgeships, it said.

If the bill becomes law, each bankruptcy case will take more time because of the means test, said Lawless and others. Judges will spend more time in Chapter 7 than they currently do and will be more heavily involved in minor consumer household budgeting issues, they added.

"I think there's going to be countervailing pressure," said Lawless. "The bill is going to make it impossible for a lot of people to get effective relief. There will be fewer bankruptcy petitions," he said.

"The first effect is going to swallow the second," he added. "Spending more time on cases is going to swamp any effect the bill will have on deterring filings."

There's "no question" there will be more work for the courts, agreed Rao, adding that this will come at a time when the courts already have reduced staffing because of budget problems.

All of these effects will make it "less attractive" to be a bankruptcy judge, said Lawless, adding, "Not because of the amount of work but the nature of the work is going to change. Judges are going to spend a lot more time on whether someone's expense fits into one category or another.

"The intellectual challenge and satisfaction of being a bankruptcy judge is going to diminish," he predicted. "Many bankruptcy judges could earn a lot more in the private sector. Part of the reason they give it up is public service, but also it's the intellectual rewards the job brings."

• About ALM • About law.com • Privacy Policy • Terms & Conditions