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How Much Diligence Is Due?

Defining an Attorney's Duty to Perform a Pre-Petition Inquiry

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With the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), it is more important than ever for us, as debtors' attorneys, to acknowledge the duties that we owe to our clients before filing a petition for bankruptcy relief. An attorney's duties of full disclosure and candor to the court are essential to maintaining the integrity of the bankruptcy system. Moreover, with the addition of 11 U.S.C. § 526(a)(2) (along with other pre-existing Bankruptcy Code provisions), a debtor's attorney who fails to disclose information on a petition or pleading risks civil penalties, attorneys' fees and costs, attorney disciplinary measures[1] or even criminal charges.[2]

The Bankruptcy Code has always emphasized an attorney's duty to truthfully disclose all known assets, liabilities and financial affairs in the debtor's schedules and pleadings. At least as early as the Bankruptcy Reform Act of 1978,[3] a debtor's attorney who signed a petition or other pleading certified that the attorney performed a reasonable investigation into the financial affairs of his or her client to ensure that the pleading was well grounded in fact.[4]

However, BAPCPA extended this duty through the enactment of 11 U.S.C. § 526(a)(2) to apply to any person who qualifies as a "debt relief agency,"[5] which aims to prevent abusive practices by bankruptcy professionals, as well as to ensure that all of a debtor's financial information is taken into account in administering his or her estate.[6] Although most debtors' attorneys make it a habit to review online court records, official records, property appraiser's reports and other available information, provisions like 11 U.S.C. §§ 526(a)(2) and 707(b)(4)(D), as well as Federal Rule of Bankruptcy Procedure 9011, may require additional probing prior to filing a bankruptcy petition.

The "Reasonable Inquiry" Standard under 11 U.S.C. § 526(a)(2)

Section 526(a)(2) of the Bankruptcy Code provides the following:

> A debt relief agency shall not ... 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 or misleading, or that upon the exercise of reasonable care, should have been known by such agency to be untrue or misleading.

The requirement that an attorney exercise reasonable care in determining the accuracy of the information contained in a debtor's petition and schedules is often referred to as the "reasonable inquiry" standard. Section 526(a)(2) makes the attorney or debt-relief agency liable to the client for erroneously omitting critical information without investigating the truth or falsity of the alleged facts. An attorney who fails to perform a reasonable inquiry can be subject to disgorgement of fees to the debtor and civil penalties, and can be required to pay the attorneys' fees and costs of either the debtor, the state or U.S. Trustee.[7]

In re Gutierrez: Application of a Traditional Negligence Standard

Since 2005, several courts have explored the scope of a debt-relief agency's duty to perform a reasonable inquiry under § 526. In *In re Gutierrez*, a debtor sought the full return of all fees paid to his attorney after alleging that the attorney failed to exercise reasonable care before filing his petition.[8] The debtor first met with the attorney on March 13, 2006. The attorney prepared the debtor's petition, schedules and statements, which disclosed a home owned by the debtor. After their first meeting, but before filing the petition, the debtor quit-claimed his interest in the home to his nonfiling spouse and recorded the deed. The debtor met with the attorney to file the petition almost two months after their first meeting, but the attorney did not ask whether any information had changed or become inaccurate since their last meeting, so the transfer was not disclosed.

The U.S. Bankruptcy Court for the Northern District of California held that the attorney did not violate 11 U.S.C. § 526(a)(2) by failing to ask whether the debtor's circumstances had changed prior to the filing.[9] The court applied a negligence standard, reasoning that the debtor would not have

1 Most states' rules regulating attorney conduct require an attorney to be candid with the court. *See, e.g.*, Model Rules of Prof'l. Conduct R. 3.3.
2 *See* 18 U.S.C. §§ 151-158.
3 S. Rep. No. 95-989 (1978).
4 *See, e.g.*, 11 U.S.C. § 707(b)(4)(C).
5 A "debt relief agency" includes any person who provides bankruptcy assistance to a consumer debtor for a fee, which generally includes attorneys. For a more complete discussion on whether attorneys are considered "debt relief agencies," *see Milavetz, Gallop & Milavetz PC v. U.S.*, 559 U.S. 229, 235-39 (2010).
6 *Id.* at 236 n.3.
7 11 U.S.C. § 526(c).
8 *In re Gutierrez*, 356 B.R. 496, 500 (Bankr. N.D. Cal. 2006).

told the attorney about the transfer even if the attorney had asked.[10] The debtor had more than one opportunity to tell the attorney about the transfer and still failed to do so. As a result, the debtor was not able to prove causation, a crucial element to any negligence claim.[11]

Comparing § 526(a)(2) to Rule 9011

Other courts have compared the reasonable-inquiry standard under § 526(a)(2) to the one set forth in Bankruptcy Rule 9011.[12] Rule 9011 similarly requires an attorney to perform an "inquiry reasonable under the circumstances" before signing or filing any petition or pleading. A party that violates Rule 9011 is subject to a fairly broad range of sanctions, including monetary and non-monetary sanctions, as well as attorneys' fees and costs.[13]

For example, in *In re Garrard*, a slip opinion from the U.S. Bankruptcy Court for the Northern District of Alabama, the court applied the Rule 9011 definition of "reasonable inquiry" to a violation of 11 U.S.C. § 526(a)(2).[14] In this case, an attorney's duty to perform a reasonable inquiry requires five things:

> (1) to explain the requirement of full, complete, accurate, and honest disclosure of all information required of a debtor; (2) to ask probing and pertinent questions designed to elicit [such disclosure]; (3) to check the debtor's responses in the petition and Schedules to assure they are internally and externally consistent; (4) to demand of the debtor full, complete, accurate, and honest disclosure ... before the attorney signs the petition; and (5) to seek relief from the court in the event that the attorney learns that he or she may have been misled by a debtor.[15]

If an attorney fails to meet one of these requirements, he or she has breached the duty to perform a reasonable inquiry. In other words, an attorney cannot turn a blind eye to potential inconsistencies in the debtor's petition and absolve himself or herself from liability. He or she must take an active role in the debtor's case to ensure that the documents are complete, accurate and honest.

Courts in the First Circuit have implemented a similar five-factor test to evaluate violations of 11 U.S.C. § 707.[16] Like the test in *Garrard*, the First Circuit requires an attorney to advise the debtor of the importance of full disclosure; check for internal consistency throughout the petition, schedules, and statements; and promptly correct information that he or she discovers to be inaccurate. However, in *In re Withrow*, the court also required the attorney to employ "external verification tools," such as title records, court records, lien searches and tax transcripts, as long as the tools that were used were not overly costly or time-consuming for the attorney.[17]

The courts in *Gutierrez* and *Garrard* agreed that a negligence standard should apply to violations of § 526. *Gutierrez* applied the typical "but-for" test to address the issue of causation, which prompted the court to ask whether a more detailed inquiry by the attorney would have revealed the undisclosed information. *Garrard*, on the other hand, defined a "breach." Comparing an offending attorney's conduct to that of a reasonably competent attorney measures whether the attorney breached his duty of reasonable care. Based on the language of the statute and the prevailing case law, a court should only find that a violation of § 526 exists after it fully analyzes the claim under a traditional negligence standard. Although no court has explicitly stated this, it can be inferred from its application.

The "Reasonable Investigation" Standard under 11 U.S.C. § 707

The "reasonable inquiry" standard is often compared to the "reasonable investigation" standard under 11 U.S.C.

9 Even though the court absolved the attorney of violations under 11 U.S.C. § 526, it ultimately ordered the disgorgement of fees due to violations of 11 U.S.C. §§ 527 and 528 for failure to provide required notices and a fully executed copy of the fee agreement. *Id.* at 506.

10 *Id.* at 501-02.

11 *See also Conn. Bar Ass'n v. U.S.*, 620 F.3d 81, 103 n.22 (2d Cir. 2010) (stating that violation of 11 U.S.C. § 526 is not based on strict liability, but instead requires culpable state of mind by showing either negligence or intent).

12 *See In re Casavalencia*, 389 B.R. 496 (Bankr. S.D. Fla. 2008); *In re Garrard*, Nos. 13-40418-JJR13, 13-40419-JJR13, 2013 WL 4009324 (Bankr. N.D. Ala. 2013) (applying same five-factor "reasonable inquiry" test to violations of 11 U.S.C. §§ 526 and 707, and Rule 9011).

13 Fed. R. Bankr. P. 9011(c)(2).

14 *Garrard*, 2013 WL 4009324, at *4.

15 *Id.* (quoting *In re Thomas*, 337 B.R. 879, 892 (Bankr. S.D. Tex. 2006).

16 *In re Withrow*, 391 B.R. 217, 228 (Bankr. D. Mass. 2008) (holding that attorney who failed to list six bank accounts on Schedule B and claim any exemptions on Schedule C was subject to sanctions for failing to perform reasonable investigation under 11 U.S.C. § 707(b)(4)(C) and (D)).

17 *Id.*

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§ 707(b)(4)(D).[18] Under § 707(b)(4)(D), an attorney who signs a petition certifies that he or she has no knowledge that the information contained in the client's petition is incorrect after performing an inquiry. Unlike § 526(a)(2), violations of § 707 usually result in the dismissal of the debtor's case. However, similar to § 526(c), if a debtor's attorney violates § 707(b), the court may also assess civil penalties and award attorneys' fees and costs.[19]

The Ninth Circuit noted this comparison in *In re Kayne*.[20] In *Kayne*, a debtor told her attorney prior to filing that she had filed a lawsuit against a third party to recover money that was owed under a promissory note. To make matters worse, the debtor provided the attorney with a binder of documents that included a copy of a settlement agreement on the note and a list of payments received by the debtor, which the attorney did not review. As a result, the attorney did not disclose the note on the Schedule B and failed to list payments received as income on the Schedule I. The attorney believed that the payoff on the note was approximately $7,000 (an amount that would have been protected by the debtor's exemptions), and he explained this to the chapter 7 panel trustee at the meeting of creditors. After reviewing the settlement agreement, however, the trustee discovered that there was actually $61,250 owed on the note. The attorney admitted that he should have conducted a more thorough investigation before filing the petition.

The Ninth Circuit Bankruptcy Appellate Panel held that the debtor's attorney did not conduct a reasonable investigation into the facts of the case prior to filing the petition.[21] The court applied the same "reasonable inquiry" standard to both violations of Rule 9011 and § 707(b)(4)(D). It reasoned that the "reasonable inquiry" standard is an objective one wherein the attorney's conduct should be compared to that of "a competent attorney admitted to practice before the involved court."[22] Because the attorney did not ask pertinent and probing questions or otherwise gather adequate information, the court imposed $20,000 in sanctions.

Other courts in the Ninth Circuit have looked favorably on the analysis in *Kayne*. In *In re Seare*, the U.S. Bankruptcy Court for the District of Nevada applied *Kayne*'s reasoning in holding that an attorney violated § 707(b)(4)(D) when he failed to investigate the dischargeability of a debt that arose from a judgment for fraud.[23] Even though the debtor's attorney filed the debtor's petition on an "emergency" basis to stop a garnishment, the court did not excuse him from compliance with § 707(b)(4)(D).[24] The attorney quickly reviewed the documents that the debtor provided to him prior to filing and made the incorrect determination that the debt underlying the garnishment would be dischargeable. The debtor did not have a copy of the judgment on the debt and therefore did not provide it to the attorney.

The court reasoned that if the attorney had reviewed the records on the court's PACER website and read the judgment prior to filing, he would have discovered that the debt was incurred due to the debtor's fraud upon the court and that the debt would be nondischargeable. The court concluded that an attorney cannot rely on the information that his or her client provides if it is clear that the information is "incomplete or inconsistent, or raises a 'red flag.'"[25] The existence of a judgment against the debtor should have alerted the attorney to the fact that a further inquiry was necessary. After that discovery, the attorney had an obligation to take an active role in the debtor's case and thoroughly review the judgment.

If a debtor fails to provide certain requested documents or cannot explain inconsistencies in his schedules, the attorney can wait to file the case, refuse to file altogether, or refuse to represent the debtor.

Conclusion

Although various courts have different ways of defining "reasonable inquiry," they are generally aligned when determining what constitutes a violation. The standard is an objective one: An attorney cannot defend himself or herself by claiming that he or she was subjectively ignorant to the murky facts of the debtor's case. Allowing such a defense would promote purposeful ignorance and result in many unwelcome surprises for unsuspecting debtors. Although not every circuit has specifically defined "reasonable inquiry" as it applies to § 526, the current trend suggests that an attorney should apply the Rule 9011 standard in the absence of such a definition.

As debtors' attorneys, we should always review relevant court records, online title and lien searches, tax transcripts, and other readily available documents. We have a clearly defined duty to ask probing questions that elicit honest and accurate answers, resolve internal and external inconsistencies by conducting a cost-effective investigation, and verify information provided by clients by requesting pertinent documents. If a debtor fails to provide certain requested documents or cannot explain inconsistencies in his schedules, the attorney can wait to file the case, refuse to file altogether, or refuse to represent the debtor. A brief and effective investigation before filing a petition can help prevent the potential costs of a violation of § 526 or Rule 9011. Even more importantly, it can facilitate the successful administration of a debtor's case. abi

18 The "reasonable investigation" language actually derives from § 707(b)(4)(D)'s sister statute, 11 U.S.C. § 707(b)(4)(C), which provides that an attorney's signature certifies that he or she "performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion."

19 11 U.S.C. § 707(b)(4)(A) and (B).

20 453 B.R. 372 (B.A.P. 9th Cir. 2011).

21 *Id.* at 380.

22 *Id.* at 382 (quoting *Smyth v. City of Oakland (In re Brooks-Hamilton)*, 329 B.R. 270, 283 (B.A.P. 9th Cir. 2005)).

23 *In re Seare*, 493 B.R. 158 (Bankr. D. Nev. 2013).

24 *Id.* at 212.

25 *Id.*