AMERICAN BANKRUPTCY INSTITUTE

2021 Consumer Practice Extravaganza

Be Prepared: Best Practices for Intake

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CONCURRENT SESSION

2021

2021 CONSUMER PRACTICE Extravaganza
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Bankruptcy Intake: The Good Practices

SullivanHill

Duties of the Debtor and Debtor's Counsel

Debtor's Duty to Disclose

Section 521(a)(1) requires the debtor to, *inter alia*, file a list of creditors, a schedule of assets and liabilities, current income and expenditures and a statement of financial affairs.

Duties of the Debtor and Debtor's Counsel

Code Provisions Mandating Investigation by Debtor's Counsel and Regulating Debt Relief Agencies

Several provisions were added to the Bankruptcy Code by the BAPCPA, which affected the relationship between the debtor and the debtor's counsel. Section 707(b)(4)(C) provides in relevant part that "[t]he signature of an attorney on a petition…shall constitute a certification that the attorney has…performed a reasonable investigation into the circumstances that gave rise to the petition…"

THE CONSULATION SHOULD BE CONDUCTED BY AN ATTORNEY

Learning the Hard Way

In re Finn, 2020 WL 6065755* (Bankr. C.D. III. 2020).

In re Tran, 427 B.R. 805 (Bankr. N.D. Cal. 2010).

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

The Follow-up: Pointers and Tips for Reasonable Inquiry into Some Common Issues in Disclosure of Assets and Debts*

*These practice pointers and tips are mostly attributable to the Task Force on Attorney Discipline Best Practices Working Group, Ad Hoc Committee on Bankruptcy Court Structure and Insolvency Processes, A.B.A. Section of Business Law, *Working Paper: Best Practices for Debtor's Attorneys*, Bus. Law., Nov., 2008, at 79-151. I strongly recommend reading the entire article for guidance on all aspects of due diligence regarding the representation of debtors and disclosure in the bankruptcy petition and schedules.

You Know the Assets – Now What?
Exemption Planning

1. Confirm the Client Goals

Do not assume you know what the goals of the representation are.

- Start with the expectation for the end of the process and work backward to develop a strategy to meet that expectation
- What specific assets do the client want to retain?
- What are the other goals?
- Redefine/refine the real issues

2. Investigate and Confirm the Facts

Never provide advice based solely on information given by client.

- Always confirm client-provided information by reviewing documents
- Confirm the type and source of claims
- Examine the title to real estate and titled personal property
- Ask what advice they've received at cocktail parties or from friends (or the internet)

3. Know the Law!

What law will apply?

- Is there a choice of law provision in agreements?
- Where is your client a resident and what exemptions apply?
- What statutes of limitation can a trustee or creditor use?
- 10 year lookback under BAPCPA

4. Provide a Written Plan

Apply the law to the facts and give the client a written BEP.

- "Do no harm."
  - Complete and accurate schedules and statements
  - No over the top advice and counsel
- Avoid "badges of fraud" transactions
- The BEP letter should address all or some of:
  - What property is exempt and can that exemption be attacked
  - Identify and discuss dischargeability and discharge issues
  - Identify fraudulent transfers and/or preferences
  - Whether the client is better off in or out of bankruptcy

5. Advice, Counsel, and Risk Warnings

Consider providing written advice.

- Available exemptions, categories, dollar limits, and other relevant information
- Appropriate disclaimers should be incorporated into retention agreements and identify:
  - Objections to and possibly total or partial loss of exemptions
  - Denial of discharge
  - Risk and monetary/non-monetary costs of litigation
  - Uncertainty of outcome due to application of law to fact or status of law
  - Cost/benefit analysis

6. Full Disclosure in the Schedules!

Disclose all transfers of property on the statements and schedules.

- Even inadvertent omissions can impair claimed exemptions or the right to receive a discharge.

Super Sleuthing: Tools of the Trustee

They will look. Make sure you look first.

Commonly used tools

- Petition and schedules (and previous petitions and schedules)
- Documents provided for the Meeting of Creditors
- State court dockets, land records
- Zillow and other realtor websites

Remember 11 U.S.C. § 521 – Debtor's duties

They may look. Make sure you look first.

Less Common Tools

- Unclaimed funds websites
- Probate dockets, town tax records
- State commercial recording websites
- Social media
- Additional requested documents

They can look. Make sure you look first.

When the trustee suspects fraud

- 2004 Exam
- Background check
- Log-in information for financial institutions
- Even more additional requested documents
- Beware the anonymous tip (and the ex-factor!)

They looked…and liked what they found. Now what?

Consequences for unscheduled income and assets

- Amendments
- Liquidation
- Loss of exemption
- Loss of discharge – 11 U.S.C. §§ 523 and 727
- Litigation
- Disgorgement of fees
- Malpractice and/or grievance
- Criminal referral
  - Trustee's duty – 18 U.S.C. § 3057(a)
  - Penalties – 18 U.S.C. §§ 152 and 157:
    - Fines – up to $250k
    - Imprisonment – up to 5 years

Bankruptcy Exemption Planning

Or

"What is the length of the Chancellor's Foot?"

I. Overview and Topic Summary

A. Bankruptcy Exemption Planning ("BEP") aka pre-bankruptcy planning refers to advice and counsel provided to clients designed to assist them in maximizing the amount of exempt property they can retain in a proceeding under Title 11 or under state law. It is very similar to advice and counsel that tax lawyers provide to clients to minimize tax liabilities: counseling clients to take maximum advantage of those provisions allowed under applicable law.

B. This presentation will be limited to classic "pre-bankruptcy planning" techniques of using existing assets or income to maximize the use of available exemptions and minimize the existence of non-dischargeable debts.

C. The presentation will exclude more sophisticate forms of Asset Protection Planning (trusts, interlocking LLCs, corporations, and offshore planning tools).

II. The Historical Background of Bankruptcy Exemption Planning

A. The case law prior to the 1978 Code

1. *Kangas v. Robie*, 264 F. 92 (8th Cir. 1920): the general rule is mere conversion alone, without extrinsic facts showing fraud, bad faith or corrupt design, will not defeat the exemption claim.

2. *In re Ellingson*, 63 B.R. 271, 278 (Bankr. N.D. Iowa 1986) observed:

> The courts have stated that the doing of that which is legal should not be penalized. Thus, the simple act of converting nonexempt property into exempt property on the eve of bankruptcy is not a fraud upon creditors. Such a conversion will not, in and of itself, deprive the debtor of his right to the exemptions or bar his discharge. An early Eighth Circuit opinion supporting this proposition is *Forsberg v. Security State Bank*, 15 F.2d 499 (8th Cir. 1926). In that case the debtor had sold a large part of his property, consisting of horses, cattle and hogs, and with the proceeds from that property purchased sheep and other personal property which was exempt under the applicable state law.

In the *Forsberg* case the court cited the case of *First National Bank v. Glass*, 79 F. 706 (8th Cir. 1897) where the court stated:

> An insolvent debtor may use with impunity any of his property that is free from the liens and the vested equitable interests of his creditors to purchase a homestead for himself and his family in his own name. If he takes property that is not exempt from judicial sale and applies it to this purpose, he merely avails himself of a plain provision of the Constitution or the statute enacted for the benefit of himself and his family. He takes nothing from his creditors by this action in which they have any vested right. The Constitution or statute exempting the homestead from the judgments of creditors is in force when they extend the credit to him, and they do so in the face of the fact that he has this right. Nor can the use of property that is not exempt from execution to procure a homestead be held to be a fraud upon the creditors of an insolvent debtor, because that which the law expressly sanctions and permits cannot be a legal fraud.

The court went on to state in ***Forsberg*** that the mere conversion of nonexempt assets into exempt assets is not a fraud upon creditors. The court stated that

there must be facts constituting fraud apart and distinct from the mere transfer of non-exempt property into exempt. ***In re Forsberg***, 15 F.2d at 502. This rule has been cited and followed in a number of other cases since that decision. ***See***, ***In re Reed***, 700 F.2d 986 (5th Cir. 1983); ***In re Adlman***, 541 F.2d 999 (2d Cir. 1976); ***Wudrick v. Clements***, 451 F.2d 988 (9th Cir. 1971).

B. The Emergence of "Bankruptcy Planning" as a separate and recognized area of practice. In his 1982 article entitled "A General Theory of the Dynamics of the State Remedies/Bankruptcy System," 1982 Wis. L. Rev. 311, Professor Lynn LoPucki mentioned BEP as "this somewhat dubious branch of practice," and observed, in footnote 99:

> The term 'bankruptcy planning' has been used for several years to describe the somewhat dubious process discussed here. It apparently entered the literature in 1978 when Professor Lawrence King of the New York University commented during the video seminar entitled 'How to Practice Under the New Bankruptcy Code,' jointly produced by Matthew Bender and the New York University School of Law, 'This is going to open up a whole new area of practice. It's going to be called 'bankruptcy planning.'
>
> Professor Frank Kennedy of the University of Michigan replied, 'We've had that. That's nothing new.'
>
> Professor Vern Countryman of the Harvard Law School agreed, adding, 'Every debtor's counsel in California, unless he's incompetent and ought to be sued for malpractice gets those building and loan association stocks before he puts him into bankruptcy.'

C. The Legislative History of the 1978 Code. Congress was clearly aware of BEP at the time the Code was adopted and the committee reports from both houses provided that Debtors may maximize their exemptions, even when they do so shortly before the filing of a bankruptcy petition. The legislative history supporting section 522 of the Bankruptcy Code is found in reports accompanying bills favorably reported out of the House and Senate Judiciary Committees.

1. The Senate Report, No. 989, dated July 14, 1978, provides, as follows:

   As under current law, the debtor will be permitted to convert non-exempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under

the law. S. Rep. No. 989, 95th Cong., 2d Sess. 76 (1978), U.S. Code Cong. & Admin. News 1978, p. 5787.

2. The House Report, No. 595, dated September 8, 1977, provides, as follows:

   As under current law, the debtor will be permitted to convert non-exempt property into exempt property before filing a bankruptcy petition. See Hearings, pt. 3, at 1355-58. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law. H.R. Rep. No. 595, 95th Cong., 1st Sess. 361 (1977), U.S. Code Cong. & Admin. News 1978, p. 5787.

D. Selected portions of the BAPCPA Amendments in 2005 & Legislative History

1. § 522(a)(3)(A): the 730-day rule for exemption eligibility designed to discourage forum shopping for jurisdictions with more favorable exemptions (Florida, Texas unlimited homestead exemptions)

2. § 522(o): residence interests acquired within 10 years prior to filing with the actual intent to hinder, delay, or defraud creditors

3. § 522(p): the 1,215 day (3.3 years) rule that limits a residence/homestead exemptions to $155,675

4. § 548(e): the 10-year self-settled trust claw back under the actual intent to defraud standard

5. House Report 109-31, Part 1, pp. 15-16, dated 4/8/2005, identified a fairly narrow concern the amendments above were intended to address:

"The bill also restricts the so-called 'mansion loophole.' Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all of the equity in their homes. In light of this, some debtors actually relocate to these states just to take advantage of their 'mansion loophole' laws. S. 256 closes this loophole for abuse by requiring a debtor to be a domiciliary in the state for at least two years before he or she can claim that state's homestead exemption; the current requirement can be as little as 91 days. The bill further reduces the opportunity for abuse by requiring a debtor to own the homestead for at least 40 months before he or she can use state exemption law; current law imposes no such requirement. . . . .

> To the extent a debtor's homestead exemption was obtained through the fraudulent conversion of nonexempt assets (e.g., cash) during the ten-year period preceding the filing of the bankruptcy case, S. 256 requires such exemption to be reduced by the amount attributable to the debtor's fraud. S. 256 also authorizes a trustee to avoid any transfer of property that a debtor made to a self-settled trust (of which the debtor is a beneficiary) within the ten-year period preceding the filing of the debtor's bankruptcy case if the debtor made the transfer with **actual intent to hinder, delay, or defraud a creditor** of the debtor."

E. The Current Majority View/Rule:

1. *Ford v. Poston*, 773 F.2d 52 (4th Cir. 1985) provides a good overview of the current majority rule in most, if not all, circuits:

"Mere conversion of property from non-exempt to exempt on the eve of bankruptcy—even though the purpose is to shield the asset from creditors—is not enough to show fraud. *First Texas Savings Association v. Reed*, 700 F.2d 986, 991 (5th Cir. 1983). In fact, it is clear from the legislative history of The 1978 Act that the debtor is to be allowed to make full use of his exemptions. The House and Senate Reports stated the following:

> As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 361 (1977), reprinted in 1978 U.S. Code Cong. & Ad. News 5963, 6317; S. Rep. No. 989, 95th Cong., 2d Session 76, reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 5862 (emphasis added)."

Significantly, however, both the House and Senate Reports used the phrase "[a]s under current law." Under existing law prior to passage of the 1978 Act, courts qualified this apparent blanket approval of conversion by denying the discharge if there was extrinsic evidence of actual intent to defraud creditors. *First Texas Savings Association v. Reed*, 700 F.2d 986, 990 (5th Cir. 1983). This qualification applies as well in cases arising under the 1978 Act. *Id.*; *Schmidt v. White (In re White)*, 28 B.R. 240 (Bankr. E. D. Va. 1983).

F. When do Pigs become Hogs? And how does the length of the Chancellor's foot help answer that question and provide guidance to debtors and counsel?

1. *Norwest Bank Nebraska NA v. Omar A. Tveten (In re Tveten)*, 848 F.2d 871 (8th Cir. 1988): Judge Richard Sheppard Arnold's dissent in Tveten sums up the problem with pigs v. hogs as a rule of law:

"If there ought to be a dollar limit, and I am inclined to think that there should be, and if practices such as those engaged in by the debtor here can become abusive, and I admit that they can, the problem is simply not one susceptible of a judicial solution according to manageable objective standards. A good statement of the kind of judicial reasoning that must underlie the result the Court reaches today appears in *In re Zouhar*, 10 B.R. 154 (Bankr. D.N.M. 1981), where the amount of assets converted was $130,000. The Bankruptcy Court denied discharge, stating, among other things, that 'there is a principle of too much; phrased colloquially, when a pig becomes a hog it is slaughtered.'" Id. at 157. If I were a member of the Minnesota Legislature, I might well vote in favor of a bill to place an over-all dollar maximum on any exemption.

But sitting as a judge, by what criteria do I determine when this pig becomes a hog? If $700,000 is too much, what about $70,000? Would it matter if the debtor were a farmer, as in *Forsberg*, rather than a physician? (I ask the question because the appellee creditor's brief mentions the debtor's profession, which ought to be legally irrelevant, several times.) **Debtors deserve more definite answers to these questions than the Court's opinion provides. In effect, the Court today leaves the distinction between permissible and impermissible claims of exemption to each bankruptcy judge's own sense of proportion. As a result, debtors will be unable to know in advance how far the federal courts will allow them to exercise their rights under state law.**

Where state law creates an unlimited exemption, the result may be that wealthy debtors like Tveten enjoy a windfall that appears unconscionable, and contrary to the policy of the bankruptcy law. I fully agree with Judge Kishel, however, that [this] result ... cannot be laid at [the] Debtor's feet; it must be laid at the feet of the state legislature. Debtor did nothing more than exercise a prerogative that was fully his under law. It cannot be said that his actions have so tainted him or his bankruptcy petition as to merit denial of discharge.

Johnson, *supra*, at 963 (footnote omitted). I submit that Tveten did nothing more fraudulent than seek to take advantage of a state law of which the federal courts disapprove.

I would reverse this judgment and hold that the debtor's actions in converting property into exempt form do not bar a discharge in bankruptcy."

2. *Hanson v. First National Bank in Brookings*, 848 F.2d 866 (8th Cir. 1988): In his concurring opinion in Hansen, issued on the same day as Tveten, Judge Arnold took issue with the disparate results reached in the *Hanson* and *Tveten* cases, stating that:

"[I]n *Tveten* the major indicium of fraudulent intent relied on by the Bankruptcy Court was Dr. Tveten's avowed purpose to place the assets in question out of the reach of his creditors, a purpose that, as a matter of law, cannot amount to fraudulent intent, as the court's opinion in Hanson explicitly states. The result, in practice, appears to be this: a debtor will be allowed to convert property into exempt form, or not, depending on findings of fact made in the court of first instance, the Bankruptcy Court, and these findings will turn on whether the Bankruptcy Court regards the amount of money involved as too much. With all deference, that is not a rule of law. **It is simply a license to make distinctions among debtors based on subjective considerations that will vary more widely than the length of the chancellor's foot."**

G. Summary of the status of BEP in 2016, the authors' views:

The general rule remains intact: mere conversion alone, even on the eve of bankruptcy, without extrinsic evidence of fraud, is acceptable conduct.

If you counsel clients on BEP, we suggest you advise the clients as to the unsettled nature of the law, the risk they are taking on, their capacity for risk tolerance and then let them decide how much or how little risk they want. Be careful to document this advice in writing and to **confirm that the client is the one making the informed choice** about how much and how aggressive the planning should be.

At the risk of oversimplification, the authors suggest that if the BEP in question is consistent with the general rule (mere conversion, no fraud), the following guidelines seem reasonable (or at least not unreasonable):

Under $50,000: Probably not going to get a second look from anyone.

Above $50,000 and less than $100,000: Will get more scrutiny, may or may not be enough money at issue to mount a litigation effort that will have a sound cost/benefit outcome for a bankruptcy estate.

Above $100,000: Will get more scrutiny, probably more than enough money at issue to mount a litigation effort that might result in a sound cost/benefit outcome for the bankruptcy estate.

Notwithstanding the foregoing, the U.S. Supreme Court case of *Law v. Siegel*, 134 S. Ct. 1188 (2014) is a game changer in the area of BEP. In *Siegel*, the U.S. Supreme Court

held that the bankruptcy court erred in "surcharging" a debtor's homestead exemption to recover attorney's fees and costs incurred by the trustee to uncover the debtor's fraudulent conduct during the bankruptcy proceedings. Both the bankruptcy court and the Ninth Circuit Court of Appeals held that the court could use its inherent equitable powers to surcharge the debtor's exemption. However, the Supreme Court reversed holding that "[i]t is hornbook law" that bankruptcy courts cannot "override explicit mandates of other section of the Bankruptcy Code." Id. at 1194 (quoting Collier on Bankruptcy, ¶ 105.01[2], p. 105-06 (16th ed. 2013)).

The relevant—and significant for BEP—dicta, stated:

> But even assuming the Bankruptcy Court could have revisited Law's entitlement to the exemption, §522 does not give courts discretion to grant or withhold exemptions based on whatever considerations they deem appropriate. Rather, the statute exhaustively specifies the criteria that will render property exempt. See §522(b), (d). Siegel insists that because §522(b) says that the debtor 'may exempt' certain property, rather than that he *'shall* be entitled' to do so, the court retains discretion to grant or deny exemptions even when the statutory criteria are met. But the subject of 'may exempt' in §522(b) is the debtor, not the court, so it is the debtor in whom the statute vests discretion. A debtor need not invoke an exemption to which the statute entitles him; but if he does, the court may not refuse to honor the exemption absent a valid statutory basis for doing so.
>
> Moreover, §522 sets forth a number of carefully calibrated exceptions and limitations, some of which relate to the debtor's misconduct. For example, §522(c) makes exempt property liable for certain kinds of prepetition debts, including debts arising from tax fraud, fraud in connection with student loans, and other specified types of wrongdoing. Section 522(o) prevents a debtor from claiming a homestead exemption to the extent he acquired the homestead with nonexempt property in the previous 10 years 'with the intent to hinder, delay, or defraud a creditor.' And §522(q) caps a debtor's homestead exemption at approximately $150,000 (but does not eliminate it entirely) where the debtor has been convicted of a felony that shows 'that the filing of the case was an abuse of the provisions of' the Code, or where the debtor owes a debt arising from specified wrongful acts—such as securities fraud, civil violations of the Racketeer Influenced and Corrupt Organizations Act, or 'any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years.' §522(q) and note following §522. The Code's meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions. See *Hillman* v. *Maretta,* 569 U. S. ____, ____ (2013) (slip op., at 12); *TRW Inc.* v. *Andrews*, 534 U. S. 19, 28–29 (2001).

...

> ***But federal law provides no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code***.
> (emphasis added)

The Sixth Circuit Court of Appeals has made the broad pronouncement that "Under *Siegel*, bankruptcy courts do not have authority to use their equitable powers to disallow exemptions or amendments to exemptions due to bad faith or misconduct." *Ellmann v. Baker (In re Baker)*, 791 F.3d 677, 683 (6th Cir. 2015).

Relying on *Ellmann*, the Bankruptcy Court for the Eastern District of Tennessee explained:

> this court may not deny a debtor an exemption for mere bad faith or even fraudulent concealment without a statutory basis for doing so. In light of clear language in *Ellmann* prohibiting disallowance on the basis of bad faith or misconduct, the court finds that there is no fraudulent transfer exception based on the bankruptcy court's equitable powers that would provide a basis for disallowance of an exemption. The court must find a statutory basis for any disallowance.

In re Hurt, __ B.R. __ , Case No: 1:15-bk-12294-SDR (Bankr. E.D. Tenn. 2015) (decision was issued December 31, 2015, only weeks before these materials were prepared).

Despite the BEP ramifications of *Siegel*, never underestimate the desire of some trustees, judges, and creditors to attack BEP efforts. Practitioners would would be wise to apply the principles in this outline and take a "belt and suspenders" approach to BEP to maximize the probability of success.

III. The Ethical and Professional Liability Landscape

A. Model Rule of Professional Conduct [1] 1.1, Competency: "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."

1. Once you define the scope and objectives of the engagement, make sure you are competent or that you associate with someone who is. If clients don't get the results they are looking for, they may turn on you. See Comment 2, Model Rule 1.1.

[1] All citations are to the ABA Model Rules of Professional Conduct located at:

http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct.html

2. Make sure the project is appropriately resourced so that you can prepare properly.

3. See American Bankruptcy Institute, Final Report of National Ethics Task Force, section on Competency for Debtor Counsel, available at:

http://materials.abi.org/sites/default/files/2013/Apr/Final_Report_ABI_Ethics_Task_Force.PDF

B. MRPC 1.2(d), No advice to commit fraud; Rule 1.2(a) Scope Of Representation And Allocation Of Authority Between Client And Lawyer

1. The Model Rule provides:

(a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter. . . .

(d) 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.

2. **Official Comments:**

Criminal, Fraudulent, and Prohibited Transactions

[9] Paragraph (d) prohibits a lawyer from knowingly counseling or assisting a client to commit a crime or fraud. **This prohibition, however, does not preclude the lawyer from giving an honest opinion about the actual consequences that appear likely to result from a client's conduct.** Nor does the fact that a client uses advice in a course of action that is criminal or fraudulent of itself make a lawyer a party to the course of action. **There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity**.

[10] When the client's course of action has already begun and is continuing, the lawyer's responsibility is especially delicate. The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed. A lawyer may not continue assisting a client in conduct that the lawyer originally supposed was legally proper but

then discovers is criminal or fraudulent. The lawyer must, therefore, withdraw from the representation of the client in the matter. See Rule 1.16(a). In some cases, withdrawal alone might be insufficient. It may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like. See Rule 4.1.

[11] Where the client is a fiduciary, the lawyer may be charged with special obligations in dealings with a beneficiary.

[12] Paragraph (d) applies whether or not the defrauded party is a party to the transaction. Hence, a lawyer must not participate in a transaction to effectuate criminal or fraudulent avoidance of tax liability. Paragraph (d) does not preclude undertaking a criminal defense incident to a general retainer for legal services to a lawful enterprise. The last clause of paragraph (d) recognizes that determining the validity or interpretation of a statute or regulation may require a course of action involving disobedience of the statute or regulation or of the interpretation placed upon it by governmental authorities.

[13] If a lawyer comes to know or reasonably should know that a client expects assistance not permitted by the Rules of Professional Conduct or other law or if the lawyer intends to act contrary to the client's instructions, the lawyer must consult with the client regarding the limitations on the lawyer's conduct. See Rule 1.4(a)(5).

C. MRPC Rule 1.4, Communication:

1. The Model Rule provides:

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), 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.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

2. This rule imposes numerous duties on counsel at various stages of the representation.

3. Communicate with the client regularly (preferably in writing) and retain all communications. Keep the client in the driver's seat.

D. MRPC 3.7, Reliance on counsel defense/lawyer as witness: If BEP advice gets challenged and the client desires to rely on the advice of counsel defense, the rule provides "a lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless:" certain limited exceptions that rarely apply.

E. Attorney Client Privilege, Reasonable Reliance on Counsel & Crime Fraud Exception

1. Reasonable Reliance on Counsel: *In re Ellingson*, 63 B.R. 271, 278 (Bankr. N.D. Iowa 1986) observed:

"While some of the omissions and mistakes made in these debtors' schedules, such as the failure to reveal the $20,400.00 transfer of machinery, were material omissions, Federal Land Bank has failed to sustain the burden of showing that the omissions were made knowingly and fraudulently. The debtors placed their trust and reliance for preparation of the schedules in their attorney. Unlike many debtors who take a cavalier and indifferent attitude toward their schedules, these debtors were extremely concerned and went to great lengths to make certain that the schedules were correctly and completely prepared. Unfortunately, through a combination of bad advice and poor communication, errors did arise in the schedules.

Generally, a debtor who acts in reliance on the advice of his attorney lacks the required intent to deny a discharge of his debts. See *In re Adeeb*, 787 F.2d 1339, 1343 (9th Cir. 1986). Such reliance on the advice of the attorney must be reasonable. In re Bateman, 646 F.2d 1220, 1224 (8th Cir. 1981).

The evidence in this case shows that not only did the debtors make frequent inquiries of their attorney concerning the accuracy of their schedules and statement of affairs, but the debtors' attorney telephoned the Trustee subsequent to the first meeting of creditors to advise him of the errors, and did amend the schedules accordingly. **Based upon all of the facts, it is the conclusion of this Court that the reliance upon the debtors' attorney was reasonable in this situation and should not bar the debtors' discharge for false oath."** (emphasis added)

2. A more detailed discussion of the reliance on counsel is at: Gregory E. Maggs, "Consumer Bankruptcy Fraud And The "Reliance on Advice of Counsel" Argument," 1995, Winter, 69 Am. Bankr. L.J. 1.

3. Crime Fraud Exception: U.S. v. Zolin, 491 U.S. 554 (1989) outlined the process for asserting the crime/fraud exception to the privilege:

In appropriate circumstances, ***in camera*** review of allegedly privileged attorney-client communications may be used to determine whether the communications fall within the crime-fraud exception. 491 U. S. 562-575. Federal Rule of Evidence 104(a), which provides that a court is bound by the rules of evidence with respect to privileges when determining the existence of a privilege, does not prohibit the use of *in camera* review. 491 U. S. 565-570. However, before a district court may engage in *in camera* review at the request of the party opposing the privilege, that party must present evidence sufficient to support a reasonable belief that such review may reveal evidence that establishes the exception's applicability. Once this threshold showing is made, the decision whether to engage in in camera review rests in the sound discretion of the court. 491 U. S. 570-572. The party opposing the privilege may use any relevant nonprivileged evidence, lawfully obtained, to meet the threshold showing, even if its evidence is not "independent" of the contested communications as the Court of Appeals uses that term. 491 U. S. 573-574.

F. Liability to third parties: If the BEP transfers are challenged and the challenges are successful, there is the risk that, with the benefit of hindsight, the conduct of counsel will be scrutinized and counsel may be exposed to:

1. Criminal sanctions;

2. Disciplinary sanctions;

3. Civil liability under conspiracy, aiding and abetting or other theories

G. Liability to the client

1. In the 1980s, a John Deere dealer in Iowa Falls, IA ran into financial problems and retained a bankruptcy lawyer, David Nelsen, who assisted him in converting about $700-800,000 into the Iowa unlimited life insurance exemption. Benton filed a chapter 11 case and the unsecured creditors committee filed an objection to the exemption and later settled it for about 50/50.

2. Benton later sued his lawyer, David Nelsen and the case is reported as *Benton v. Nelsen*, 502 N.W.2d 288 (Iowa 1993).

IV. Practice Pointers/Traps for the Unwary

A. Structure the creation of the exemption to fit the underlying social policies

1. *In re Ellingson*, 63 B.R. 271, 277-278 (Bankr. ND Iowa 1986) observed:

"The Court starts with the often cited proposition that exemptions should further one or more of the following social policies:

(1) To provide the debtor with property necessary for his physical survival;

(2) To protect the dignity and the cultural and religious identity of the debtor;

(3) To enable the debtor to rehabilitate herself financially and earn income in the future;

(4) To protect the debtor's family from the adverse consequences of impoverishment;

(5) To shift the burden of providing the debtor and his family with minimal financial support from society to the debtor's creditors.

Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 Rutgers Law Review 615, 621. See also, *In re Hahn*, 5 B.R. 242 (Bankr. S.D. Iowa 1980).

Here, the debtors' acquisition and improvement of their homestead is consistent with several of these policies. The homestead certainly protects the family unit from impoverishment, relieves society from the burden from supplying subsidized housing, and provides to the debtors a means to survive during the period following their bankruptcy filing when they might have little or no outside income."

2. *Norwest Bank Nebraska NA v. Tveten*, 848 F.2d 871 (8th Cir. 1988):

In ***Forsberg***, ***supra***, for example, we stated that it is not fraudulent for an individual who knows he is insolvent to convert non-exempt property into exempt property, thereby placing the property out of the reach of creditors "because the statutes granting exemptions have made no such exceptions, and because the policy of such statutes is to favor the debtors, at the expense of the creditors, in the limited amounts allowed to them, by preventing the forced loss of the home and of the necessities of subsistence, and because such statutes are construed liberally in favor of the exemption." ***Forsberg***, ***supra***, 15 F.2d at 501 (emphasis added). Similarly, in ***In re Ellingson***, ***supra***, 63 B.R. 271, in holding that the debtors' conversion of non-exempt cash and farm machinery did not provide grounds for denial of a discharge, the court relied on the social policies behind the exemptions. The court found that the debtors' improvement of their

homestead was consistent with several of these policies, such as protecting the family unit from impoverishment, relieving society from the burden of supplying subsidized housing, and providing the debtors with a means to survive during the period following their bankruptcy filing when they might have little or no income.

B. Other Pointers/the basics:

1. CONFIRM THE CLIENT'S GOALS. Do not assume you know what the goals of the representation are.

    a. Often, it is productive to start with where the BEP client realistically expects to be at end of the process. Then, you can work backwards and develop a strategy that fulfills the BEP client's expectations.

    b. What specific assets does the BEP client want to retain (besides, "all of them")? Go through the balance sheet asset by asset and confirm the goals on each one. You may be surprised. What is a reasonable and realistic asset retention goal?

    c. What other goals does the client have? Take care of spouse, former spouse, paramour, kids, grandkids ? Stick it to former spouse, former business partner? Get them to talk, open up, and tell you what the goals are.

    d. After you interview the client and the spouse to find out what they think the problems are, then try to redefine or refine what the real problems are.

2. INVESTIGATE & CONFIRM THE FACTS

    a. Never provide advice and counsel based solely on information given by the client.

    b. Always confirm client provided information by reviewing documents: contracts, trusts, account statements, real estate title searches, tax returns, financial statements to lenders or filed in divorce cases.

    c. People don't usually lie to the IRS but frequently exaggerate to lenders on financial statements.

    d. Check declarations pages on insurance policies in select cases.

e. Confirm the source and types of claims. Are there fraud claims or other claims that might be non-dischargeable under § 523 issues?

f. Are there tax claims, other governmental claims, DSO or student loan claims which can be paid now if they are non-dischargeable?

g. Is the potential debtor about to inherit or receive life insurance proceeds?

h. Look at retirement accounts and sources of funds. Have formalities of pension funds been maintained?

i. Examine the title to real estate and titled personal property (vehicles, bank and investment accounts). Look at source documents such as deposit account agreements rather than what ownership designation may be on a statement.

j. Examine personal and real property insurance policies.

k. Do not involve others in the clients' problems--i.e. children or parents or friends.

l. Ask what advice they have gotten at cocktail parties or from friends.

3. KNOW THE LAW!

a. What law will apply?

b. Is there choice of law provisions in agreements which you must deal with?

c. Where is your client a resident and what exemptions apply? Understand the new residence requirements of BAPCPA. If you file bankruptcy, timing may be critical. Apply the Paul Masson principle: “We will sell no wine before its time.”

d. If residency is a problem, can you delay things to get a more favorable situation?

e. What statute of limitation or cause of action can a creditor or trustee use?

f. 10 year look back under BAPCPA.

4. PROVIDE A WRITTEN PLAN. Apply the law to the facts and give the client a written BEP.

a. Remember the first rule of the Hippocratic Oath: “First do no harm.” This is best accomplished by making sure that counsel ensures:

i. Complete and accurate schedules & statements

ii. No “over the top” advice and counsel

b. Avoid "badges of fraud" transactions: A BEP may be scrutinized and may be viewed with more suspicion if any of the "badges of fraud" identified by case law or the actual intent prong of the UFTA are present.

c. Advise against acquiring exempt assets with borrowed funds from encumbered property?

d. The BEP letter should address some or all of:

i. what property is exempt and if that exemption can be attacked

ii. Identify and discuss any dischargeability issues under § 523 and any discharge issues under § 727

iii. The existence of any fraudulent transfers or preferences or insider preferences

iv. Is the client better off in bankruptcy or out of bankruptcy?

5. ADVICE, COUNSEL & RISK WARNINGS. Consider providing written advice.

    a. available exemptions, categories, dollar limits, and other relevant information;

    b. risks: Appropriate disclaimers related to BEP should be incorporated into your retention agreements and identify all possible adverse consequences, primarily litigation risk:

        i. objection to and possibly total or partial loss of exemptions;

        ii. denial of a discharge;

        iii. monetary cost of litigation of the above;

        iv. non-monetary cost of litigation (stress, distraction from job or pleasure, marital disharmony, etc.) that arises when third parties get sued or involved as witnesses;

        v. uncertainty of outcome due to application of law to facts;

        vi. uncertain status of law: no "guarantee" of results in this area; this is a volatile and highly uncertain area of the law.

        vii. Provide a cost/benefit analysis and overall assessment of the BEP: Measure the adverse consequences of converting assets against the benefits of the acquisition of a particular piece of property. Only assets needed by the debtor for a "fresh start" are worth the risk of incurring possible adverse consequences. Let the client make the final decisions about the scope and extent of the BEP.

6. **FULL DISCLOSURE IN THE SCHEDULES**: Be sure to disclose all transfers of property on the debtor's bankruptcy statements and schedules. (Even inadvertent omissions can impair claimed exemptions or the right to receive a discharge.)

C. Charging for BEP

1. Hourly: undercompensates counsel for the value provided to the client.

2. Fixed Fee: maybe, but client might get sticker shock and go to the lawyer across town.

3. Flat Rate: charge the same % as the chapter 7 trustee does in § 326(a):

    a. 25 percent on the first $5,000 or less;
    b. 10 percent in excess of $5,000 but not in excess of $50,000
    c. 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000;
    d. 3 percent of such moneys in excess of $1,000,000

V. Selected Sources, Resources, And Other Helpful Hints And Links

ABI Best Practices: The Task Force on Attorney Discipline's Best Practices Working Group, Ad Hoc Committee on Bankruptcy Court Structure and Insolvency Process published the "Working Paper: Best Practices for Debtors' Attorneys", 64 Bus. Law 79 (2008), a working paper on the preparation and completion of a debtor's pleadings.

Treatises & Manuals:

West's Bankruptcy Exemption Manual, 2009 ed. Regarding duty to accurately disclose, properly schedule, and the consequences of not properly scheduling assets, specifically:

1. Sections 2.21 to 2.26 address property that is excluded from the estate.

2. Section 7.1 discusses the need for adequacy of descriptions.

3. Sections 8.4 and 8.5 discuss the impact of omission of assets & inaccurate valuations.

4. Section 8.22 is entitled "Ambiguity construed against debtor."

Fraudulent Transfers, Prebankruptcy Planning and Exemptions, 2015 ed. Peter Spero, Thompson West Publishing. "Covering both federal bankruptcy laws and applicable state laws, Fraudulent Transfers, Prebankruptcy Planning and Exemptions helps make sure you, your family, or your clients don't run afoul of fraudulent transaction requirements. This work has been cited in many published opinions. The author gives special attention to the liability and responsibility of lawyers who may be implicated in fraudulent transfers and explains how to minimize your exposure to liability. He also discusses collateral consequences such as criminal liability, denial of discharge in

bankruptcy, and nondischargeable debts, as well as prebankruptcy planning and a state-by-state analysis of exemptions."

http://legalsolutions.thomsonreuters.com/law-products/Treatises/Fraudulent-Transfers-Prebankruptcy-Planning-and-Exemptions-2015-ed/p/100949201

Law Review & other Articles:

Lynn LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 Wis. L. Rev. 311,.

Alan N. Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 Rutgers Law Review 615.

Boshkoff, Douglass, *Fresh Start, False Start, or Head Start?*, Indiana Law Journal: Vol. 70: Iss. 2, Article 4 (1995). Available at: http://www.repository.law.indiana.edu/ilj/vol70/iss2/4

Georgianne L. Huckfeldt, *Conversion of Nonexempt Assets to Exempt Assets Prior to Bankruptcy—A Question of Fraud*, 56 Mo. L. Rev. (1991). Available at: http://scholarship.law.missouri.edu/mlr/vol56/iss3/13

Business Law Today, ABA. Volume 12, Number 3 - January/February 2003, *Squirreling It Away: The business lawyer's role in pre-bankruptcy planning*. Nathan F. Coco and David C. Christian II http://www.americanbar.org/content/dam/aba/publications/blt/2003/01/squirreling-it-away-200301.authcheckdam.pdf

Kenrick Young, *Pre-Bankruptcy Planning from Debtor's Point of View in 2003,* 4 U.C. Davis Bus. L.J. 6 (2003)

http://blj.ucdavis.edu/archives/vol-4-no-1/pre-bankruptcy-planning.html#b6

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March 13, 2016

Via email only / and US mail to:

Kalispell MT 59991

RE: **Bankruptcy Exemption Planning and/or Pre Bankruptcy Planning**
Highly Confidential and Privileged / Do not share

Dear :

I want to thank you for the opportunity to represent you and clarify our agreement as to the extent of the legal services I will provide. You have retained me to represent you with respect to an analysis of your financial situation and recommendations for protection of your assets, maximizing your exempt property and related matters.

Bankruptcy Exemption Planning (BEP) which involves the sale, exchange or other transfers of assets may involve tax consequences which you should explore with a qualified tax adviser. One example of this is the "capital gain or loss" that may arise upon the sale, exchange, transfer or other disposition of an asset(s). Other tax matters associated with repositioning assets may have a significant impact before, during or after the proposed transaction. Unless agreed otherwise in writing, the services provided by me do not include advice regarding the potential tax consequences of this asset protection plan.

FACTUAL BACKGROUND

From our meeting(s) on I understand the following:

1. one of your creditors, , has filed a lawsuit against arising out of ;
2. what else ?
3. further ?

You indicated your personal balance sheet situation is as follows:

PERSONAL BALANCE SHEET

ASSETS		LIABILITIES		
Description	Value	Name	Amount	Comment / Disposition[1]
Parcel #1		Lien #1 Lien #2		

NET WORTH:

You indicated you are the sole / controlling shareholder of a corporation / LLC named which is organized under the laws of and that the balance sheet of is:

ASSETS		**LIABILITIES**	
Description	Value	Creditor name	Amount
	$		$
	$		$
	$		$
	$		$
	$		$
	$		$
	$		$
	$		$

1 What is the goal for each asset and what is the business or financial plan to make it happen ?

	$		$
	$		$

As you are aware, you are my only source of information about your situation and I have not undertaken any independent verification of the information you have provided. If the information you provided to me is not accurate for some reason it may undermine my analysis of your situation and the plan I have outlined.

DOCUMENTS & REPORTS PROVIDED: none

ADDITIONAL DOCUMENTS, REPORTS or OTHER INFORMATION NEEDED FOR COMPLETE DIAGNOSIS / ANALYSIS: Recorded / conformed real estate documents, title report, tax returns (personal & entity), paycheck stubs, UCC lien searches,

CLIENT FINANCIAL AND LEGAL GOALS

During our initial meeting you indicated your goals were to:

1. simplify your life and protect your own assets and income;
2. to provide you and your family with property necessary for his physical survival;
3. to protect your dignity and the cultural and religious identity;
4. to enable you and your family to bounce back from this setback, rehabilitate yourself financially and earn income in the future;
5. to protect yourself and your family from the adverse consequences of impoverishment;
6. to not become a burden to society or have to resort to public assistance
7. insulate your property holdings and income streams from liability associated with the lawsuit and any judgment that may be obtained;
8. to end the lawsuit and discharge any liability so you can get a fresh start in life; and

9. to maximize any property you may be able to retain post-bankruptcy;

10. to segregate your income and property holdings from those of your spouse;

11. next

If you eventually file a bankruptcy proceeding *in Montana* each of you would be entitled to claim the following types of property as exempt:

Property type	Single value	Joint value
homestead real estate[2] (including mobile home)	$250,000	$ask me
one motor vehicle	$2,500	$5,000
household goods, clothing, appliances, books, animals, crops (cannot exceed $600/item)	$4,500	$9,000
tools of the trade	$3,000	$6,000
cash value life insurance	all	all
medically prescribed health aids	all	all
your right to receive social security, unemployment, public assistance, veterans benefits, alimony, child support	all	all
certain retirement plans	check with me if you have any retirement plans	

Other states have different exemption laws than Montana and the scope of those exemptions varies widely. The exemptions in other states may have higher dollar limits in some categories and less generous in other exemptions than Montana. If you contemplate moving sometime prior to the filing of a bankruptcy you should consider the effect a move

2 Married persons need to discuss this with me. In addition, § 522(o) and (p) of the Code impose signifigant restrictions on the ability to create value in a homestead.

would have on your ability to acquire exempt property.

REASONABLE EXPECTATIONS FOR AN ASSET PROTECTION PLAN

Will this BEP work ? Will it successfully achieve my goals ? There are many definitions of success in the context of BEP but it must first be acknowledged that the word "work" is defined by reference to where a particular BEP client would have landed had he not earlier engaged in BEP. As has been my view for at least 3 decades, the ultimate goal of BEP is realized if the client weathers a legal storm at least moderately better than he otherwise would have in the absence of any planning. My success with clients over the last 30+ years have far surpassed this standard.

Many Variables Determine the Success of BEP

The many variables that exist under any given plan prevent one from making blanket statements or generalizations about BEP. These many variables applicable to any BEP, include:

1. The facts peculiar to a given client's situation.

2. The client's goals.

3. The manner and extent to which the client's goals are or can be incorporated into the design of the BEP.

4. The skill with which the BEP was crafted.

5. The nature of the asset or assets transferred as part of the BEP.

6. The skill with which the BEP is attacked.

7. The skill with which the BEP is defended.

8. The thoroughness and protectiveness of the BEP's applicable law.

9. Whether the opposing party is a governmental agency.

10. Whether any criminal sanctions are threatened.

11. The law of the forum court.

12. Any biases or the bent of the presiding judge

Even under the most unfortunate and difficult circumstances, the BEP still normally results in extra work, litigation, uncertainty and effort for a creditor or trustee, and frequently results in a settlement for less than the full amount owed on the debt(s) or the full value of the assets.

Bankruptcy Exemption Planning is best considered as another risk management tool in the toolbox: it erects one more hurdle or barrier that a creditor must overcome in seeking to seize assets using the involuntary legal process. That creditor(s) may still engage in litigation, prosecute it with vigor and presumably any settlement will reflect the additional protection provided by the BEP.

PLAN RECOMMENDATIONS and IMPLEMENTATION

It is very important that the plan be implemented properly by you with our ongoing assistance and advice.

You should begin to identify options to implement the plan that is outlined in this letter but check with me before you make a final selection or otherwise begin to actually implement the plan. Proper implementation is of critical importance at all stages:

1) when you sell or liquidate assets;

2) when you transfer assets (exchange or otherwise); or

3) the acquisition of new assets should be reviewed with me.

After you have selected a proposed course of action, or asset acquisition, but prior to actually implementing it we should discuss the proposed course of action. You only get to do this once and it is important that it been done correctly to achieve your goals and to avoid the law of unintended consequences.

The FIRST OPTION, PREBANKRUPTCY PLANNING, is, in my judgment, . My opinion is based on a variety of factors: 1 ; 4) if you do too much protection, it may blow up in your face.

SPECIFIC TECHNIQUES INCLUDE

1. Sell nonexempt assets in arm's length sales to unrelated 3rd parties and keep good records of all transactions[3]

3 Under Montana law, it is clear that unless a creditor has obtained a judgment, issued an execution and actually levied on an asset, you are free to do with it as you wish. See MCA § **25-13-501. "What**

2. Use the sale proceeds to pay various bona fide non dischargeable debts[4]:

   a. reduce secured debt on exempt assets to build up exempt equity up to the dollar value of the exemption limit;

   b. pay non dischargeable tax debt;

   c. pay non dischargeable student loan debt;

   d. pay non dischargeable domestic support obligations (child support or alimony) or property settlement debts

3. Use the sale proceeds to acquire exempt assets (that have high purchase price, but rapidly depreciate or that have value unique to you) or for consumption:

   a. Fund IRA's, repay 401(k) loans;

   b. Obtain medical or dental treatment (hearing aids, dentures);

   c. Stock up the pantry, freezer, woodshed, propane tank or all;

4. Use the sale proceeds to make improvements to exempt assets (improvement cost is high, added value to asset is minimal)

   a. Home repair, upgrade, remodel or add:

---

property subject to execution. . . . . . Until a levy, property is not affected by the execution. " See also, MCA § **31-2-103. "Contracts of debtor are valid.** In the absence of fraud, every contract of a debtor is valid against all the debtor's creditors, existing or subsequent, who have not acquired a lien on the property affected by the contract." In addition, "The presumption that private transactions are fair and regular is conclusive unless controverted by other evidence. Lawrence v. Clepper (1993), 263 Mont. 45, 56, 865 P.2d 1150, 1158." Jones v. Arnold, 272 Mont. 317, 323 (Mont. 1995). The Court has also held that "While the transfer may well have been a strategic move to insure that . . . . was repaid, such a show of favoritism between legitimate, unprioritized creditors does not, by itself, constitute a fraudulent transfer." Larson Lumber v. Bilt Rite Construction, 2014 MT 61, 2014 Mont. Lexis 73.

4 MCA § **31-2-104. Payments in preference** provides: "A debtor may pay one creditor in preference to another or may give to one creditor security for the payment of the creditor's demand in preference to another. However, that general rule is limited by the insider preference provisions of the UFTA, at § **31-2-334. Transfers fraudulent as to present creditors** provide: "(2) A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent."

i. a home office;
ii. family room or basement;
iii. the roof;
iv. landscaping the yard / add a deck or patio
v. add a sprinkler system;
vi. replace old windows;
vii. paint, new carpet, vinyl, etc.
viii. remodel the kitchen, remodel or add a bathroom;

b. Repair, upgrade or tune up vehicles, ATV's snowmobiles, home electronics;

5. convert nondischargeable into dischargeable debt

6. use non exempt cash to get a secured credit card and run up the balance to within $500 of the amount of the CD before you file

7. create a Religious Corporation Sole, per Chapter 3, Title 35 of the MCA (see also County of San Luis Obispo v. Ashurst, 194 Cal. Rptr. 5. 146 Cal. BEP. 3d 380 (Cal. BEP. 2 Dist 1983)

The SECOND OPTION,

The THIRD OPTION, A CHAPTER 13 FILING is what I believe is your best choice. I have enclosed a handout on Nonbankruptcy and Bankruptcy Options which discusses Chapters 7 & 13 on pages 4-6

LEGAL RISKS OF PREBANKRUPTCY PLANNING

Asset protection planning and prebankruptcy planning are emerging areas of the law and, at best, areas of the law where the rules are uncertain. A leading treatise on the topic, "Asset Protection: Legal Planning and Strategies" has observed:

> Prebankrutpcy planning involves striking a balance between the rights of debtors to fully use available exemptions and the sense of equity that a court has that will prevent debtors from abusing exemptions to shield excessive assets from creditors. Unfortunately, there are no bright lines regarding this area and the application of the rules is often inconsistent. (Prebankruptcy Planning, ¶ 1.02[3]).

Outside of conduct at either extreme (clearly illegal or clearly permissible) there are no

clear rules that govern this area of the law. For instance, conversion of modest amounts of nonexempt property into exempt will not normally be challenged. However, conversion of significant amounts accompanied by fraud, such as lying to, misleading or being untruthful with creditors will pose significant risks.

The general rule is, and has been for many years, that the mere conversion of nonexempt assets into exempt assets, even on the eve of bankruptcy, is not fraudulent to creditors. However, the general rule is qualified by an exception: if extrinsic factors that suggest the presence of fraud exist in a given case, there may be problems. However, absent any of the factors noted below, this type of asset conversion and prebankruptcy planning is a legitimate, acceptable and prudent course of conduct for the financially distressed person contemplating bankruptcy.

The presence of any of the following factors may give rise to an inference of fraud in the transaction(s) or planning:

(1) a pattern of sharp dealing, material misrepresentation, concealment of facts, deception or other misleading behavior in communications with creditors and others;

(2) a *grossly excessive* amount of property converted into exempt form;

(3) abuse of the exemption, such as acquiring exempt property merely as a place to temporarily park funds until the financial distress passes by, at which time the asset will be reconverted to cash or otherwise for the benefit of the debtor;

(4) fraudulent intent or ill will towards a specific creditor (usually seen in the context of former spouses or business partners in the aftermath of an acrimonious divorce or business breakup);

(5) using loan proceeds, borrowed funds, cash advances or business assets or cash flow to acquire exempt property;

(6) inadequate consideration for property sold or transferred;

(7) whether they client retains possession, benefit or use of the property that was transferred or the transfer benefited the client's family.

The absence or presence of one or more of these factors does not automatically indicate the transaction is tainted or legitimate. The cases over the last 40 years demonstrate that different judges may view (and have viewed) the same identical factual situation and come to diametrically opposed conclusions.

In an article entitled "Converting Nonexempt Property to Exempt Property in Preparation for Bankruptcy" in the May/June 1996 issue of the Journal of Asset Protection (Vol I, No.5, page 25), after a review of many of the recent cases and judicial trends, one author observed:

> It is impossible to articulate any "bright line" rule or standard which can be used by debtors with confidence to determine whether to engage in, and the extent of any engagement in, bankruptcy estate planning. In the end, the court, will apply a kind of fact-specific judicial "smell test" to the subject transaction. Moreover, since judicial aptitudes, attitudes, sensitivities, and tolerance levels vary, so to do the reported decisions. What one judge may condone, another may penalize or undo.

I base my recommendations to you, and any other clients, on my knowledge of the law acquired from 30+ years of specialty experience in bankruptcy and debtor/creditor matters. In addition, I served as a bankruptcy trustee for 8 years and have challenged some of these transactions myself. I have carefully considered the information you have provided to me and applied the law and my experience to your facts and situation.

Although I believe the advice I am giving you is reasonable, appropriate, legal and ethical based on your situation this does not mean that it may not be challenged and that some judge may not see it differently. Given my experience in this area, I feel comfortable enough with my advice to rate the risk a client faces in a given case as low, moderate or high. Taking everything into consideration, in your case, I think the risk of this type of planning is . High, medium or low ?

Normally, the likelihood of challenges to these types of transactions is pretty rare and occur infrequently. The two most frequently used tools to challenge prebankruptcy planning are: (1) denial of a discharge for a fraudulent transfer; (2) denial of the claim of exemption; (3) lawsuits against the transferees of assets for recovery of the asset or the value. However, while the challenges occur infrequently, the consequences can be drastic.

If the BEP or any individual transfer I have outlined is challenged in legal proceedings by a bankruptcy trustee or your creditors, you are entitled to a defense that you relied on the good faith advice of counsel. If you choose to assert that defense I would no longer be able to represent you as counsel, as I would become a witness and cannot function in both capacities.

OTHER FACTORS

As a general matter, the more time that elapses between the prebankruptcy planning transactions and the actual filing of a bankruptcy case, the less likely the transactions will be scrutinized or successfully challenged. If it is possible for you to wait 2 or more years

after these contemplated transactions before you actually file a case that would be best.

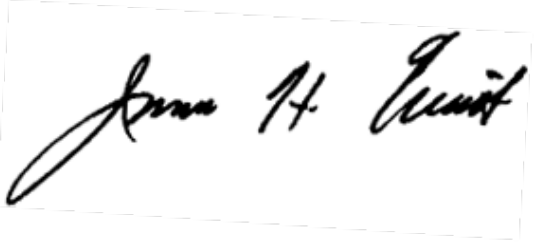
If creditors start filing lawsuits while you are engaged in this type of planning it will disrupt the planning, distract from implementation of the plan and generally make matters more difficult. The suits will need to be defended (and normally there are very few defenses to a garden variety creditor suit) and/or money will need to be paid to the creditor to maintain the status quo while you finish the planning process. I normally interpret the presence of creditor lawsuits as the end of the planning process and as clear indication of the need to move to the next step: filing the bankruptcy case.

You must keep and maintain very complete records of these transactions. If these transfers are questioned at some point in the future it will be very important to have accurate and complete records readily available to substantiate these transactions. Failure to keep good records of these matters may cause you significant problems in a future bankruptcy proceeding and is a separate ground for denial of your discharge.

If you file bankruptcy within 2 years of these transactions the bankruptcy law requires the details of the transactions to be disclosed on the papers filed in the case. This is not a problem in and of itself as you have nothing to hide and I have advised you as to what I believe are legitimate and sound transactions. However, if you wait a 2 years or more after the date of these matters, they will not need to be disclosed on the bankruptcy papers.

If you have any questions please give me a call. Thank you for your assistance in this matter. I will look forward to hearing back from you and helping you move onto the next step: implementation of this plan.

Very truly yours,



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Bankruptcy Intake–The Good Practices

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Bankruptcy intake is not so much an event as a process. It can be as simple as asking the potential client questions and discussing the answers, or as complex as seeking expert advice to value an asset. It is driven by the needs of the debtor, but also by the duties imposed by the Bankruptcy Code on debtor and counsel and must be grounded in the ethics of the legal profession. Intake practice is profoundly practical, but also key to the attorney-client relationship. What could go wrong?

I. Duties of the Debtor and Debtor's Counsel

A. Debtor's Duty to Disclose

Section 521(a)(1) requires the debtor to, *inter alia,* file a list of creditors, a schedule of assets and liabilities, current income and expenditures and a statement of financial affairs. A bankruptcy is considered a give and take process, a tradeoff, whereby debtors may receive the benefits of the Bankruptcy Code by making complete financial disclosure to creditors and the trustee. *In re Leongas*, 628 B.R. 71, 98 (Bankr. N.D. Ill. 2021). The debtor may not pick and choose what information to include or omit. *Matter of Skibicki*, 2021 WL 1396743*8 (Bankr. D. Neb. 2021). Moreover, the duty to disclose is ongoing. *In re Adamcik*, 2021 WL 3868251*5(Bankr. N.D. Tex. 2021)

B. Code Provisions Mandating Investigation by Debtor's Counsel and Regulating Debt Relief Agencies

Several provisions were added to the Bankruptcy Code by the BAPCPA, which affected the relationship between the debtor and the debtor's counsel. Section 707(b)(4)(C) provides in relevant part that "[t]he signature of an attorney on a petition . . . shall constitute a certification that the attorney has . . . performed a reasonable

investigation into the circumstances that gave rise to the petition . . . ." It has been widely held that section 707(b)(4)(C) is "coterminous" with the "reasonable inquiry" required under Rule 9011. *In re Seare*, 493 B.R. 158, 209-10 (Bankr. D. Nev. 2013). Not only does it suggest that Rule 9011 case law may be used to evaluate the reasonableness, but the standard for disclosure is that it must be sufficient to put the trustee on notice of possible assets.

Sections 526-528 govern the relationship between "debt relief agencies," which includes consumer bankruptcy attorneys, and "assisted persons." Section 526 requires debt relief agencies to perform as represented in connection with a bankruptcy proceeding. Section 527 mandates disclosures to debtors describing the purpose, benefits and costs of the relevant Code chapters; informs them that they must make truthful and accurate disclosures of income and assets and explain the possibility that litigation could be an outcome of filing for bankruptcy relief. Section 528 requires that any contract between the agency and assisted person must be in writing and explain the scope of services and the charges for them.

Of course, debtor's counsel is also subject to the Rules of Professional Conduct of the jurisdiction of the Bankruptcy Court. Of particular relevance is the duty of competence, which corresponds to ABA Model Rule 1.1 and the duty of communication with clients, which corresponds to ABA Model Rule 1.4.

II. The Initial Intake Consultation

A. The initial consultation should be preceded by the potential client completing a questionnaire providing information regarding assets, debts, prepetition transfers and other information required to completes the bankruptcy petition. The questionnaire may be made available on the attorney's website, along with other basic bankruptcy information and even submitted online.

B. THE CONSULTATION SHOULD BE CONDUCTED BY AN ATTORNEY

The duty of reasonable inquiry requires that an 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.

See, Task Force on Attorney Discipline Best Practices Working Group, Ad Hoc Committee on Bankruptcy Court Structure and Insolvency Processes, A.B.A. Section of Business, *Working Paper: Best Practices for Debtors' Attorneys*, Bus. Law., Nov., 2008, at 86 ("Working Paper"). Fulfilling these tasks requires, at minimum, an initial consultation with the client and a second, prefiling consultation with the client to review the completed petition and schedules. Although it seems unnecessary to say, the attorney must actually listen to the potential client and recommend action based upon the client's needs.

Learning the Hard Way

In re Finn, 2020 WL 6065755* (Bankr. C.D. Ill. 2020). Two cases filed by the same attorney came to the attention of the U.S. Trustee due to undisclosed sales, transfers and assets. The attorney failed to attend the 341 hearings. The U.S. Trustee also learned that the attorney did not meet with the debtors, by video or otherwise, but

only communicated by telephone and email. The U.S. Trustee filed a motion for sanctions against counsel.
Debtor's attorney must thoroughly interview the client, require the production of relevant information, review financial documents and resolve inconsistencies before filing a petition. Counsel failed to do so. The court ordered the attorney's fees disgorged and publication of its opinion as a public reprimand.

In re Tran, 427 B.R. 805 (Bankr. N.D. Cal. 2010). This case came to light when the bank sent a notification to the trustee. The trustee found that the schedules contained "horrific" omissions including an undisclosed $13,000 bank account, a 2008 Mercedes and a parcel of real property. It revealed a pattern of shoddy practices by the attorney. He advertised in a Vietnamese newspaper. The attorney's wife was Vietnamese. She, a nonlawyer, conducted the initial interviews and decided what chapter the client debtor would file. Moreover, the attorney's staff made their own decisions, in this case, staff deleted the Mercedes from the schedules at the request of the client.

The court ordered fees disgorged and sanctions imposed under section 329(b) and Rule 9011. The attorney was suspended from bankruptcy practice for 30 days. A permanent injunction was entered providing that a licensed attorney must conduct the initial client interview in all cases; a licensed attorney must spend at least one hour counseling the debtor and making sure all assets and debts were found and scheduled; and neither the attorney's wife, nor staff would be allowed to give legal advice.

In re Seare, 493 B.R. 158 (Bankr. D. Nev.2013). Debtor's chief concern when he and his wife appeared for an appointment with the lawyer was a garnishment. It arose from a judgment against him on an employment claim he litigated against his former employer, a hospital. He and his co-debtor spouse only met with his bankruptcy counsel once, at the initial consultation. Debtor brought the

judgment documents along to the consultation. Counsel briefly flipped through the documents and apparently assumed it was for medical debts, which were dischargeable under Nevada law. The retainer agreement provided for the unbundling of services, among others, representation in adversary proceedings. The hospital filed a nondischargeability action. The debtors' counsel refused to defend.

Upon learning of the circumstances at the first scheduling conference the court issued an OSC asking why the attorney should not be sanctioned for failure to defend the action.

In a lengthy opinion, the court considered the entire course of the attorney-client interaction. The court found that the attorney failed in his duties to investigate and competence and to communicate under Nev. Rules of Prof'l Conduct 1.1, 1.2(c), 1.5 and 1.4. Next the court considered section 707(b)(4)(c) and determined that he had not made reasonable inquiry into the nature of the debt to the hospital. He also violated sections 526 and 528 relating to the duties of debt relief agencies.

The court ordered disgorgement of fees under section 329(b). The court also ordered publication of the decision and ordered counsel to provide every client with a copy of the decision for the next two years. The judge also ordered the attorney to obtain five hours of CLE credit relating to debt collection and 10 hours of CLE credit regarding ethical responsibilities to clients.

III. The Follow-up: Pointers and Tips for Reasonable Inquiry into Some Common Issues in Disclosure of Assets and Debts*

Petition

Identity

Because the trustee may request identity verification, copy the debtor's driver license, passport or other ID and save to the file.

Prior names–Ask about past names including DBA or FDBA for the last eight years. Confirm that they are consistent with SOFA 18; compare with information on tax returns.
Social security, EIN or other tax ID–Confirm with tax returns W-2s, 1099s etc. Be sure to redact the number.

Address
Is the current physical address the same as the mailing address? Confirm accuracy of address for each spouse, especially if they are contemplating separation or divorce. Confirm again prior to filing.

Under Which Chapter will Case Proceed?
Chapter selection requires a professional determination after consideration of:

- the client's goals and financial circumstance;
- the purpose and requirements of the various chapters and explanation to the client;
- application of statutory and judicial eligibility rules.

Prior Bankruptcy Cases
Check PACER for prior cases and related cases. If dismissed for lack of credit counseling determine whether it was dismissed or never actually filed. If there are several prior cases check for an injunction against future filings.

Exhibit D: Statement regarding consumer credit counseling
Advise clients to obtain and provide a certificate late in the process; confirm certificate has not expired at time of filing.

Venue
Determine residence 180 days prior to filing; check client's responses to SOFA Item 15.

Statement of debtor who is tenant of residential property
Is client a tenant? Does the landlord have a judgment against tenant for possession of the residence. Review the judgment. Determine whether debtor can cure under the terms of section 362(l).A

Schedules

Schedule A: Real Property
Determine debtor's understanding of any real estate interests possessed by debtor. Check public records such as recorders, secretary of state, mortgages, deeds of trust, tax notices, title reports, tax notices, divorce judgments.

Schedule B: Personal Property
Property rights are defined expansively under section 541, determined under state law and, thus, vary widely among jurisdictions. When in doubt, DISCLOSE. Avoid valuing as "unknown."

B.1: Cash on hand
Examine bank records for large withdrawals and missing deposits such as payroll.

B.2: *Financial account statements*
Obtain and review bank and other records. Amounts written on checks and not yet cleared as of petition date are likely property of the estate. Outstanding checks would be postpetition transfers and should be noted separately. But old school issues are so only part of the problem.

In re Ledesma, 2021 WL 4514678 (Bankr. E.D. Wis. 2021). The debtor was a young man with more money than common sense. After he was sued in state court by the guardian ad litem (GAL) for a child who was severely injured by debtor's dog, he filed for chapter 7 protection. The GAL filed an adversary proceeding seeking denial of debtor's discharge under section 727(a)(3)(failure to maintain

sufficient records) and (a)(4)(false oaths and omissions). The court found that the debtor's Venmo and Cash App transaction histories were insufficient records because they failed to show the reasons for deposits or expenditures. In particular, it was impossible to reconstruct debtor's true financial situation. He was a food server making $21,000 a year, but there were Venmo and Cash App receipts showing transfers of funds amounting to $34,500. For this and other reasons, the court denied discharge as requested.

B.4: *Household Goods*
Inquire about items purchased recently, antiques and electronics. Review insurance riders. Emphasize the consequences of trying to hide property. Consider a walk through if the circumstances warrant.

B.5: *Books, pictures, antiques, collections and collectibles*
Ask client: "Do you collect anything?" "Do you have a lot of books, artwork, coins, stamps, toys, etc." Explain the distinction between ordinary items and those that may have value. For individual items obtain receipts, appraisals, research on eBay. Consider a walk through.

B.7: *Furs and Jewelry*
In general treat like collectibles. Many people have items that should be disclosed in this category. To enter "None" may raise a red flag. On the other hand, most people vastly overestimate the value. Suggest the debtor obtain an appraisal.

B.8: Firearms and sports, photographic and other hobby equipment
Treat like collectibles. Clients may be less than candid regarding these items, which may have sentimental value, are family heirlooms, or that the client uses extensively for recreation.

B.9: *Insurance Policies*
Each insurance company and the surrender or refund value of each policy must be listed. The response is important because exemptions

may depend on it. Review declaration sheet and statement of current cash surrender value. Life insurance policies are scheduled in B. 20.

B.11: *Educational IRA or qualified state tuition plan*
Exemptions depend on the disclosure. At minimum review the declaration sheet and statement of cash surrender value. Recent statements, or even a consultation with a plan administrator may be necessary. If the IRA is for a child it must still be included. Do not include the names of minor children, however.

B.12: *Pension or profit sharing plans*
Exemptions depend on a thorough response. Review statements, plan documents, declaration sheet and statement of cash surrender value. Inquire about loans taken from a plan. If the personal liability is discharged through the bankruptcy, there could be tax consequences.

B.13: *Stock and interests in businesses*
Review tax returns and account statements for publicly traded stocks. Closely held interests may call for review of financial statements or accounts, buy-sell agreements, bankruptcy clauses in governing documents and/or consultation with the entity's accountant.

B.17: *Alimony, maintenance, support and property settlements*
Review judgments and orders. If divorce or custody hearings are pending confer with client's family law attorney. Inquire whether obligor is in arrears. If so, the full amount should be disclosed and factors should be discussed, which discount the full amount. Pending matters should also be disclosed in SOFA 4.a.

B.18: *Other liquidated debts owed to debtor including tax refunds*
Review the prior year tax refund and disclose an estimated amount. There is an election available under the IRC § 1398 whereby the

debtor can elect to split the tax year into two parts with the first part ending prior to filing and the second period starting on the filing date and going through the end of the year. Professional retainers should be disclosed under this item.

B.19: *Equitable or future interests, life estates and rights or powers exercisable for the benefit of the debtor other than real property interests*

This is a very confusing category. Ask your client whether any relatives have died and left a surviving spouse and whether there are any family trusts.

B.20*: Contingent and noncontingent interest in estate of decedent, life insurance policy or trust*

Again, inquire as to whether any relatives have died and left a spouse and whether there are family trusts. Life insurance policies to which a debtor is the beneficiary are listed here.

B.25: *Motor vehicles, trailers and accessories*

Review title or other evidence of liens. Perform online search if documents available there. Confirm value with Kelly Blue Book, or another online source. Have vehicle appraised if the debtor intends to redeem it. Courts increasingly insist that the duty of reasonable inquiry includes searching accessible free access databases.

In re Tatro, 2020 WL 534715*(Bankr. C.D. Ill. 2020). Debtor's counsel failed to discover, prepetition, that debtor owned a riding lawnmower, which had a lien on it as it was collateral for a personal loan. Post discharge, debtor's counsel brought a motion to reopen the case and to avoid the lien. Counsel charged $700 to reopen the case and do so. The UST brought a motion to disgorge the fee, arguing that the lien was easily ascertainable by searching a free database maintained by the secretary of state. The court agreed and ordered the fee disgorged.

B.31: *Animals*
Be sure clients understand that family pets, even if of no apparent value should be included here and that their expense information may be included in Schedule J.

B.35: *Other personal property not already listed*
Ask about sports club memberships, frequent flier miles, season tickets and lottery tickets.

Statement of Financial Affairs (SOFA)

SOFA 3: Payments to Creditors

Obtain and review checking account registers and statements for the last 12 months. 3(a)(primarily consumer debts) – look for aggregate payments in excess of $600. 3(c) Ask client if any relatives are creditors and if the client has repaid loans from any relatives. If so, request proof of payments. The issue of who is an insider can be very complex. Err on the side of caution. Ordinary course payments, such mortgage payments, can be summarily disclosed.

SOFA 4: Suits and administrative proceedings

Obtain and review lawsuit documents to determine status. Include all actions in which the client is named. If judgment is entered and the client owns real estate, confirm whether the judgment is a lien for lien avoidance purposes.

SOFA 6: Repossessions, foreclosures and returns

Ask client about any in the past year. Obtain a copy of deficiency or notice of disposition. Make sure creditor is listed on Schedules D,E, or F. Consider whether any turnover issues are implicated.

SOFA 7: Gifts

Ask if client made any gifts of over $200 in value to a single person or over $100 to a charitable organization. Review records of cash gifts and tax returns.

SOFA 10: Transfers

Explain the scope of "transfer" under section 101(54) in plain language. Ask about items transferred outright, gifted, sold, traded, sold, junked, pledged and disposed of in any fashion. Review documents evidencing the transaction. Obtain documentation from the transferee, if necessary. In addition to the transaction, inquire about the disposition of proceeds of the transaction. A 10 year look back period may be required for purposes of section 522(o), section 548.

SOFA 14: Property held for another

Ask client about property client holds, controls or physically possesses, but is owned by another. In particular financial accounts in clients name held for children or elderly relatives and vehicles titled in clients name, but belonging to someone else, often a child. Review a title for titled property. Consider making minimal disclosure of non-titled property located with client, but not owned by client.

Final Notes: First, although these materials have focused on the consequences to counsel of failing to adequately investigate a debtor's assets, debts and financial situation, it is the client who usually bears the consequences in the form of objections to discharge and nondischargeability litigation. It is no favor to them to be derelict in your duty. Second, we have not taken up the issue of fee arrangements, which is surely a program unto itself, but if your fee agreement includes "unbundling" services or "bifurcating" fees, an attorney must go over the agreement with the client and obtain informed consent to the arrangement.

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*These practice pointers and tips are mostly attributable to the Task Force on Attorney Discipline Best Practices Working Group, Ad Hoc Committee on Bankruptcy Court Structure and Insolvency Processes, A.B.A. Section of Business Law, *Working Paper: Best Practices for Debtors' Attorneys*, Bus. Law., Nov., 2008, at 79-151. I strongly recommend reading the entire article for guidance on all aspects of due diligence regarding the representation of debtors and disclosure in the bankruptcy petition and schedules.

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Faculty

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