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## PROFESSIONAL RESPONSIBILITY AND ATTORNEYS AS DEBT RELIEF AGENCIES

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A CLE Presentation

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## INTRODUCTION

Sections 526, 527, and 528 of Title 11 of the bankruptcy code, which apply to debt relief agencies, were amended effective on October 17, 2005. Most practitioners have interpreted the definition of a debt relief agency to include bankruptcy attorneys. This article addresses the possible conflicts between these sections of BAPCPA<sup>1</sup> and the Indiana Rules of Professional Conduct<sup>2</sup> as they related to these amendments. This article will discuss several instances where BAPCPA may run afoul of the Indiana Rules of Professional Conduct.

### 1. Are Attorneys Debt Relief Agencies?

Section 101(12A) defines a **debt relief agency** is defined as:

...any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include –

- (A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;
- (B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986;
- (C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;
- (D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act), or any affiliate or subsidiary of such depository institution or credit union; or
- (E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

Section 101(4A) defines **bankruptcy assistance** is defined as:

[A]ny goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

Section 101(3) defines an **assisted person** is defined as:

...any person whose debts consist primarily of consumer debts and the value of whose non-exempt property is less than \$150,000.<sup>3</sup>

The definition of debt relief agency is broad enough that it appears to encompass bankruptcy attorneys, especially when read in conjunction with 101(4A). Therefore, a strict interpretation of the rule seems to indicate that a bankruptcy attorney is a debt relief agency and subject to Sections 526, 527, and 528.

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<sup>1</sup> Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

<sup>2</sup> Indiana adopted the ABA Model Rules of Professional Conduct in its entirety and therefore does not differ from the ABA Model Rules.

<sup>3</sup> This amount is adjusted every three years by section 104.

## 2. Debt Relief Agency Restrictions Versus the Attorney's Duty to Fully Inform the Client

Under section 526(a)(4), a debt relief agency shall not: advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or *to pay an attorney or bankruptcy preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.* (emphasis added)

A strict interpretation of the rule indicates that a bankruptcy attorney can no longer advise clients to incur debt in order to pay attorney fees related to the bankruptcy. While not allowing an attorney to advise a client regarding payment of attorney fees related to bankruptcy poses some problems in itself, other issues arise when examining an attorney's ethical duties under the Indiana Rules of Professional Conduct.

Rule 1.4(b) addresses communications with a client and states that: A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.<sup>4</sup>

Rule 1.5(b) addresses fees and states that:

[t]he scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate.<sup>5</sup>

Given these ethical obligations, how can an attorney follow his ethical obligations without violating 526(a)(4), when 526(a)(4) appears to prohibit full and complete disclosure when the ethical rules require it?

On a related note, since the provisions prohibit an attorney from advising a debtor from incurring additional debt, what is an attorney to do when incurring additional debt is in the best interest of the assisted person? See Rule 1.4(b) above. How does this square with the Rules of Professional Conduct?

## 3. Bankruptcy Contracts: Ethical Dilemma Between Attorney and Client

Under Section 528, debt relief agencies that render bankruptcy assistance must enter into a written contract, disclosing the extent of services provided, fees charged, and disclose in all advertising that their services contemplate bankruptcy. 11 U.S.C. 528(a). Section 527 enumerates the duties required of a debt relief agency. Finally, Section 526 references violations of Section 526, 527, or 528, which voids the contract and creates civil liability on the part of the attorney.

Section 526(c)(1) states: Any contract for bankruptcy assistance between a debt relief agency and an assisted person that does not comply with the material requirements of this section, section 527, or section 528 shall be void and may not be enforced by any Federal or State court or by any other person other than such assisted person.

Section 526(c)(2) states:

Any debt relief agency shall be liable to an assisted person in the amount of any fees or charges in connection with providing bankruptcy assistance to such person that such

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<sup>4</sup> Burns Ind. R.P.C. 1.4(b)

<sup>5</sup> Burns Ind. R.P.C. 1.5(b)

debt relief agency has received, for actual damages, and for reasonable attorneys' fees and costs if such agency is found, after notice and a hearing, to have—

(A) intentionally or negligently failed to comply with any provision of this section, section 527, or section 528 with respect to a case or proceeding under this title for such assisted person;

(B) Provided bankruptcy assistance to an assisted person in a case or proceeding under this title that is dismissed or converted to a case under another chapter of this title because of such agency's intentional or negligent failure to file any required document including those specified in section 521; or

(C) intentionally or negligently disregarded the material requirements of this title or the Federal Rules of Bankruptcy Procedure applicable to such agency.

So, only the debtor can enforce a contract voided due to violations of Sections 526, 527, or 528, and the debt relief agency is liable for open-ended damages. Therefore, the debtor can enforce the contract, but leave the bankruptcy attorney with no rights under the contract. In such a situation, the attorney's interests will become adverse to that of the client. This may conflict with the Indiana Rules of Professional Conduct.

Rule 1.16 lays out when an attorney must withdraw and when an attorney has the discretion to withdraw his representation of a client. Rule 1.16(c)(2) states that a lawyer shall withdraw from the representation of a client if:

The representation will result in a violation of the Rules of Professional Conduct or other law.<sup>6</sup>

While Rule 1.16 does not specifically require withdrawal when an attorney becomes adverse to his client, it is logical to conclude that an attorney cannot satisfy his ethical obligations to his client when his interests are adverse to that client. Would Rule 1.16 require the attorney to withdraw his representation of the debtor? How is an attorney to follow 526(c)(2) while not violating the Rules of Professional Conduct?

#### **4. Recent Events Out of the Southern District of Georgia**

An Order issued the day BAPCPA went into effect demonstrates how one jurisdiction will attempt to interpret these sections as applied to attorneys. The United States Bankruptcy Court for the Southern District of Georgia relied on section 526(c)(5) which authorizes the court, on its own motion, to enjoin against attorneys violations of the debt relief agency provisions or impose civil penalties. The Court reasoned that if it had the jurisdiction to initiate a disciplinary action and punish a violation, it must have jurisdiction on its own motion to conclude that certain types of persons or activity are not included. The Court concluded that bankruptcy attorneys are not included in the definition of "debt relief agency."<sup>7</sup>

The Court listed three reasons why Congress did not contemplate attorneys to be included in the definition of debt relief agency. First, the broad definition of "debt relief agency" does not include the word "attorney" or "lawyer" while it does specifically include "bankruptcy petition preparer." Also, there is no reference to debt relief agencies under the definition of "attorney"<sup>8</sup> The Court reasoned that since the definition of "debt relief agency" does not mention attorneys, but does include "bankruptcy petition preparers" (in which the definition expressly excludes attorneys) Congress must not have intended to include attorneys under "debt relief agencies."

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<sup>6</sup> Burns Ind. R.P.C. 1.16(c)(2)

<sup>7</sup> A copy of the Order can be viewed at [www.gasd.uscourts.gov](http://www.gasd.uscourts.gov)

<sup>8</sup> 11 U.S.C. 101(4) states that, "[t]he term "attorney" means attorney, professional law association, corporation, or partnership, authorized under applicable law to practice law."

Second, the Court relies on section 507(b) which states that debt relief agencies are required to inform assisted persons that they have a right to hire an attorney or to represent themselves, that only an attorney can give legal advice, and inform an assisted person on how to file their case *pro se*. The Court found it illogical that Congress intended to require an attorney “to tell an assisted person that he/she has the right to hire an attorney or how to prepare the documents *pro se* that the attorney is poised to prepare on that person’s behalf.” Since it doesn’t make sense for an attorney to advise an assisted person that they have the right to hire an attorney, the Court concluded that section 507 was meant to regulate attorneys.

Finally, the Court addresses 526(d)(2) which states that there is no effort to curtail the state’s role in enforcing “qualifications for the practice of law.” The Court viewed these provisions as the federal regulation of the practice of law, which the Court stated, “could possibly violate the Tenth Amendment.”<sup>9</sup> Since Congress could not have intended to create federal rules that “usurp” state regulation, the Court reasoned that Congress could not have intended sections 526, 527, and 528 to apply to attorneys.

Since October 17<sup>th</sup>, 2005, several other courts have filed similar Orders. However, on October 27, 2005, Felicia Turner, the United States Trustee for Region 21 filed a notice of appeal on the Order from the Southern District of Georgia. The issues to be presented on appeal are:

1. Did the Bankruptcy Court have jurisdiction to enter the Order from which the appeal is taken, notwithstanding the absence of any case or controversy before it presenting the issue addressed by the Order?
2. Did the Bankruptcy Court have the power to grant the relief set forth in the Order, i.e. to excuse attorneys practicing before it from complying with the provisions of the Bankruptcy Code regulating debt relief agencies, including without limitations 11 U.S.C. §§ 101(12A), 101(4A), 526, 527, and 528, so long as their activities fall within the scope of the practice of law and do not constitute a separate commercial enterprise?

It will be interesting to see how this plays out in the courts in the coming months. Will more jurisdictions follow the Southern District of Georgia and issue these Orders? If and when the U.S. Trustee fights these Orders, will attorneys in the end be required to follow sections 526, 527, and 528? If the court finds that the provisions apply to attorneys, how rigorous do you think the courts will hold the attorneys to the requirements of these provisions, given the provisions’ conflicts with the Rules of Professional Responsibility? If the courts find that the provisions do not apply to attorneys, whom did Congress mean by ‘debt relief agency’?

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<sup>9</sup> “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” U.S. Const. Amend. 10.