

Debtor's Attorney Sanctioned for 707(b) BAPCPA Abuse

By Craig Robins

A controversial decision just handed down by Central Islip Bankruptcy Judge Louis A. Scarcella, which sanctioned a debtor's attorney for failing to engage in due diligence prior to filing a typical Chapter 7 consumer petition, has already become a heated topic that the local bankruptcy bar is actively discussing. *In re Beinhauer* (Bankr E.D.N.Y. Case No. 14-74450-las, April 13, 2017).

The decision is interesting on several different levels, and several articles could easily be written about the various issues it addresses, including an attorney's obligation to engage in due diligence, what steps that entails, the propriety of various expenses consumer debtors often seek to take, and the impact of contributions from non-filing spouses.

Although BAPCPA, the 2005 Bankruptcy Abuse and Consumer Protection Act, which drastically overhauled the Bankruptcy Code, has been in place now for well over a decade, this decision is one of very few in our jurisdiction which has sanctioned an attorney for violating the "abuse" provisions of the act. Prior to passage of the act, consumer bankruptcy attorneys across the country expressed extreme concern over various BAPCPA provisions which imposed a much greater due diligence requirement on bankruptcy counsel to investigate the facts and information they place in a bankruptcy petition.

BAPCPA created the ability for any interested party, including trustees, to challenge a debtor's bankruptcy if it appeared to be "an abusive filing" as set forth in Bankruptcy Code section 707, and it also provided for awarding sanctions against debtor's attorneys for failing to properly do their job. This additional liability on counsel, combined with the complexity of the new means test eligibility requirement, was enough to send a great number of gen-

eral practitioners packing, after the act went into effect. They decided that bankruptcy had become too complicated, and the potential penalties for messing things up too great to continue to engage in a bankruptcy practice.

As it turned out, there have been relatively few cases across the country in which counsel have been sanctioned for failing to engage in BAPCPA due diligence. Almost all cases alleging abuse are brought by the Office of the United States Trustee and the UST very rarely seeks attorney's fees. This case is one of relatively few brought by someone else, in particular, the Chapter 7 trustee.

On September 30, 2014, Central Islip attorney Shawn Kassman filed a Chapter 7 petition. At the meeting of creditors a month later, Chapter 7 Trustee Marc Pergament examined the debtor and then adjourned it, requesting that the debtor provide additional information. The parties also stipulated to extend the trustee's time to file objections to discharge, which is often standard practice in such situations.

After the trustee reviewed everything, he filed a motion on April 24, 2015, seeking dismissal of the case as an abuse pursuant to Bankruptcy Code section 707(b)(1) and (3) based on "the totality of the circumstances." The trustee alleged, among other things, that the petition inaccurately reflected the debtor's monthly income. Rather than a deficit of \$239, as set forth in the debtor's budget schedules, the trustee calculated the debtor's monthly disposable income as \$1,636.

The trustee arrived at this higher amount by including monthly contributions the debtor made to her retirement plan, the amount the debtor repaid her retirement loan each month, contributions the debtor received each month



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from her non-filing husband, and payments the debtor made towards her son's college expenses.

Although the debtor was not married at the time of filing, the debtor later disclosed that she married just one month later. The trustee asserted that the debtor's disposable income, as he calculated, would be sufficient to pay the creditors' claims in full under a Chapter 13 plan over a period of 30 months. In the motion, the trustee also sought reimbursement of his fees and costs pursuant to section 707(b)(4)(A).

The debtor did not oppose the motion and Judge Scarcella dismissed the case. He then scheduled a further hearing on the trustee's request for attorney's fees to give Mr. Kassman time to file opposition papers. At a subsequent hearing, at which time the parties engaged in oral argument, the judge took the matter under advisement.

In seeking legal fees, the trustee contended that Mr. Kassman failed to make reasonable independent investigation into the debtor's income and expenses. The trustee asserted that a review of the debtor's pay stubs and bank statements prior to filing would have disclosed that the debtor's retirement fund contributions were not mandatory; the debtor paid her son's college tuition and expenses; and her husband contributed \$772 each month towards her expenses.

In his opposition, Mr. Kassman argued that the trustee is not entitled to legal fees because Mr. Kassman requested information from the debtor regarding the nature of her retirement plan contributions, but the debtor did not respond to his inquires; the debtor paid the college tuition through a joint account funded by her mother and as such it was properly excluded from the budget schedules; and the debtor did not notify Mr. Kassman about her engage-

ment and impending marriage, nor did she mention the husband's contributions toward her monthly expenses.

In short, as Judge Scarcella summed up these defenses, "Kassman argues that any alleged errors in debtor's schedules and other documents were due to debtor's lack of response and uncooperativeness, rather than his own actions or inactions."

The court began its discussion by stating the legal framework. Bankruptcy Code section 707(b)(4)(A) essentially provides that the court may order the debtor's attorney to reimburse the trustee for all reasonable costs in prosecuting a 707(b) abuse motion, including reasonable attorney's fees, if the trustee files a motion for dismissal under that section which the court grants, and also finds the attorney violated Bankruptcy Rule 9011.

Bankruptcy Rule 9011 is substantially similar to FRCP Rule 11, which essentially requires any attorney who signs a filed court document to certify that to the best of the attorney's knowledge, information and belief, formed after an inquiry reasonable under the circumstances that the information is reasonably supported. The signature of an attorney on the petition constitutes a certification that the attorney has performed a reasonable investigation into the circumstances that gave rise to the petition. Bankruptcy Code section 707(b)(4)(D) provides that the signature of an attorney on the petition constitutes a certification that the attorney has no knowledge after an inquiry that the information in the schedules of the petition is incorrect.

The judge pointed out that, at a minimum, an attorney must make some affirmative investigation into the underlying facts. The attorney may not rely solely on information provided by the client nor accept all the client's assertions at face value. The attorney must independently verify publicly available

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facts to determine whether the client's representations are objectively reasonable and investigate further, if any inconsistencies are raised, by asking questions, obtaining additional documents, or by some other means.

The court then determined that there were two issues — whether Mr. Kassman failed to conduct a reasonable investigation into the circumstances that gave rise to the petition, and if so, whether the trustee's request for reimbursement of fees is appropriate. Judge Scarcella determined that Mr. Kassman failed to perform a reasonable investigation.

The schedules state that the debtor's retirement contributions were mandatory. However, Mr. Kassman made that statement now knowing if it was correct or not, and only sought further clarification after the trustee raised the issue. As such, Judge Scarcella concluded that Mr. Kassman failed to perform a reasonable inquiry.

Judge Scarcella found that the debtor used some of her disposable income to pay for her son's college tuition and expenses; yet this was not indicated in the original schedules. The

judge concluded that Mr. Kassman had sufficient information to make further inquiry about this, as one of the debts was a student loan, and the 20-year-old son lived with the debtor as a dependent. The court took issue that Mr. Kassman did not disclose a joint account from which the tuition payments were made. The judge also pointed out that college tuition may not be a reasonable budget expenditure.

With regard to the new marriage and contributions from the husband, the judge concluded that Mr. Kassman, who claimed he had no knowledge of the marriage, had a duty to inquire further, considering that the debtor scheduled an engagement ring as an asset. There was a joint bank account with the soon-to-be spouse and the judge questioned whether Mr. Kassman ever reviewed the statements from that account. "A reasonable attorney under the same circumstances then would have inquired into who the joint account owner was in relation to debtor, whether debtor lived with the joint account owner, and whether the joint account owner contributed to debtor's monthly expenses."

Judge Scarcella also found other apparent deficiencies and determined that the means test was not fully completed and some of the information provided was inaccurate.

In deciding to award attorney's fees to the trustee, the judge noted that Mr. Kassman performed some of his due diligence after the petition was filed, when it should have been done prior to filing. Mr. Kassman did not file the petition after a reasonable investigation. Apparently, Mr. Kassman only offered limited opposition to the trustee's motion and failed to provide sufficient evidence demonstrate otherwise.

It was ironic that Judge Scarcella frequently cited the *Parikh* decision (*Desiderio v. Parikh*), 807-72869-reg, AP 808-8062-reg Bankr. E.D.N.Y. 2014, in which the trustee, himself, was a party (debtor's attorney), and he was sanctioned by Judge Grossman for his own failure to engage in due diligence. This column discussed that case in the June 2014 issue of the *Suffolk Lawyer*.

Another interesting fact is that the trustee in this case brought a 707(b) proceeding against another debtor several years ago and was successful in

dismissing that case after neither the debtor nor the debtor's counsel opposed the motion. Like this case, the trustee also subsequently sought legal fees in a proceeding that was also before Judge Scarcella. However, in that case, the judge refused to award attorney's fees. Although the judge concluded that the debtor's attorney may have been lax in the preparation of the schedules, he determined that there was no evidence that the attorney had knowledge that the information in the schedules was incorrect at the time they were filed. *In re Hanson*, 2015 WL 891669 (Bankr EDNY Feb 27, 2015, Case No. 13-73855-las).

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