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Reaffirmation Agreements post BAPCPA[1]

A reaffirmation agreement is an agreement that provides the continuation of a debtor's personal liability on a debt that has been discharged. This is different from a lien that continues through bankruptcy unaffected. After a bankruptcy discharge, the personal obligation is gone. The lien, however, unless avoided or dealt with otherwise, remains.

A bankruptcy discharge operates as a permanent injunction, designed "to eliminate any doubt concerning the effect of the discharge as a total prohibition on debtor collection efforts, and 'to insure that once a debt is discharged, the debtor will not be pressured in any way to repay it.' *In re Melendez*, 235 B.R. 173, 186 (Bankr. Mass. 1999) (hereinafter *Melendez II*) (citing *In re Latonowich,* 207 B.R. 326, 334 (Bankr.Mass. 1997) (additional citations omitted). The right to discharge preserves the very purpose of bankruptcy, by which "Congress intended to afford the 'honest but unfortunate' debtor a 'fresh start.'" *In re Melendez ,* 224 B.R. 252, 254 (Bankr. D. Mass. 1998)(Hereinafter *Melendez I)*, (citing *Grogan v. Garner*, 498 U.S. 279, 286-87, 111 F.Ct. 654, 112 L.Ed. 2d 755 (1991)). Even though the personal liability of the debtor is discharged, the creditor may still pursue the collateral, *in rem*. That is, the lien may be foreclosed but the liability is limited to the value of the collateral and no deficiency against the debtor is possible.

Evolution of Reaffirmation Agreements and Bankruptcy Law[2]

The idea of formally "reaffirming" a dischargeable debt is a relatively recent

[1] Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) aka Bankruptcy Abuse Reform Fiasco (BARF)

[2] The history of reaffirmation agreements presented here is largely a reproduction of Cathy Vance's chapter on reaffirmations in *Attorney Liability in Bankruptcy* (ABA Press. 2006)

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phenomenon in bankruptcy law. Under the Bankruptcy Act of 1898, it was generally understood that a debtor could waive the discharge with respect to a particular debt, and the courts would enforce the promise to pay despite the lack of new consideration.[3] It was too easy for debtors to reaffirm debts without meaning to as some creditors took unfair advantage of debtors' voluntary attempts to repay discharged debts, undermining the "fresh start" that bankruptcy promises. In 1973, the Commission on the Bankruptcy Laws of the United States, in its recommendations to Congress, identified the problems with reaffirmation practices in bankruptcy:

> Substantial evidence of the use of reaffirmation to nullify discharges has come to the Commission's attention. To the extent reaffirmations are enforceable, the "fresh start" goal of the discharge provision is frustrated. Reaffirmations are often obtained by improper methods or result from the desire of the discharged debtor to obtain additional credit or continue to own property securing a discharged debt. [4]

The 1973 Commission recommended that Congress enact a statutory reaffirmation process, one limited to secured debt.[5] Congress obliged, but without the limitation. Instead, it required court approval of any reaffirmation agreement,[6] but did not require the involvement of

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[3] In In re Melendez I, 224 B.R. 252 (Bankr. D. Mass. 1998) (hereinafter "Melendez I")

[4] Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973) (Part I, Chapter 7, § C.3).

[5] This recommendation would resurface 25 years later in the National Bankruptcy Review Commission Report.

[6] As enacted in the 1978 Code, § 524(c) provided, in relevant part:

An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if –

(1) such agreement was made before the granting of the discharge…;

(2) the debtor has not rescinded such agreement within 30 days after such agreement becomes enforceable;

(3) the provisions of subsection (d) of this section have been complied with; and

(4) in a case concerning an individual, to the extent that such debt that is not secured by real property of the debtor, the court approves such agreement as –

(A)(i) not imposing an undue hardship on the debtor or a dependent of the debtor; and

(ii) in the best interest of the debtor; or

(B) (i) entered into in good faith; and

(ii) in settlement of litigation under section 523 of this title, or providing for

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Reaffirmation Agreements post BAPCPA1A reaffirmation agreement is.wpd

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the attorney for the debtor, except to advise the debtor and, perhaps, get them to the hearing, and, depending upon the sensibilities of the particular judge, attend the hearing.

This process did not work well because judges were spending substantial time explaining and generally not approving reaffirmation agreements. Courts were overwhelmed and calendars were back logged. All Debtors were required to attend two hearings (a discharge hearing was also mandatory at the time[7]), requiring two days of missed work. Everyone was frustrated and there was a move to get the judiciary out of the process. The reaffirmation approval process needed to be changed.

This change happened with the Bankruptcy Amendment and Federal Judgeship Act of 1984. Congress shifted the approval from the courts to debtors' counsel. The 1984 amendments were intended to make the process of reaffirmation less cumbersome by requiring court approval of a reaffirmation agreement only where the debtor was not represented by counsel. An amendment to § 524(c),[8] required the debtor's attorney to ensure that the agreement did not "impose an undue hardship on the debtor or a dependent of the debtor" and that the agreement "represented a fully informed and voluntary agreement by the debtor." Only pro se debtors [9] were required to attend a hearing.[10]

The 1984 amendment was the first of many that created substantial liabilities for debtors' attorneys in dealing with reaffirmations. In essence, debtor's counsel was stepping into the

redemption under section 722 of this title.
In re Melendez, 224 B.R. 252, n.4 (Bankr. D. Mass. 1998).

[7] The Bankruptcy Reform Act of 1978 required a discharge hearing before the discharge could be issued. The debtor was required to attend and the Bankruptcy Judge was required to read a lecture explaining what the discharge meant. In addition the § 341 hearing has always been mandatory.

[8] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 353 (1984).

[9] Bankruptcy Amendment and Federal Judgeship Act of 1984.

[10] In spite of the language of the section, courts have held that courts that the Judge has ultimate authority and (*Melendez I* and if there is a dispute, the matter should be noted for a judicial determination *In Re Vargas, infra.*

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shoes of the court. It became incumbent upon debtor's counsel to determine whether the reaffirmation agreement was appropriate for the debtor and, in essence, to "approve" the agreement. Thus began the laying of liability traps for debtor's attorneys in the reaffirmation process.

Section 524(c) was again revised under the Bankruptcy Reform Act of 1994 because the problem emerged of some attorneys regularly approving reaffirmation agreements seemingly without regard to the "undue hardship" and other requirements. Under the 1994 amendment, two new requirements were added to § 524(c). Subsection (c)(2)(B) provided that any reaffirmation agreement filed with the court must "contain … a clear and conspicuous statement that such agreement is not required under this title, under non-bankruptcy law, or under any agreement not in accordance with the provisions of this subsection." Subsection (c)(3)(C) reflected heightened accountability on the part of debtor's counsel, requiring that the affidavit of an attorney representing a debtor explicitly state that "the attorney fully advised the debtor of the legal effects and consequences of a reaffirmation and any default under such an agreement."

Problems remained, however. As Cathy Vance explains in *Attorney Liability in Bankruptcy*'s "Reaffirming Debt after Bankruptcy" chapter (hereafter "Vance"):

> A Massachusetts bankruptcy judge noticed some problems in Sears' handling of its reaffirmations with debtors. The court discovered a pattern of noncompliance on Sears' part that landed the retailer in serious hot water; it was on the receiving end of a class action and had to pay millions of dollars in damages and civil fines.
>
> But the judge discovered another problem: Many of the problems with the Sears agreements could and should have been discovered by the debtors' attorneys, who should never have filed the declarations or approved of the agreements because they were

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> burdensome, contained onerous terms, or were generally not in the debtors' best interests. The court began to issue show cause orders as to why these attorneys should not be sanctioned under Rule 9011. The result was … a heightened degree of scrutiny of the terms of reaffirmation agreements and attorney declarations.

Id. at 263-64.

BAPCPA once again amended the reaffirmation process, this time substantially. In addition to dictating the form and content of disclosures that must be made to debtors, the amendment added a new certification for debtors' attorneys. Where a presumption of undue hardship arises (measured by income less expenses), the attorney is required to certify that, in the opinion of the attorney, the debtor can make the payments under the reaffirmation agreement. However, if the creditor is a credit union, this extra certification is not necessary.

Decisions on Reaffirmation under BAPCPA

A body of case law is beginning to develop on reaffirmations under the amended procedures mandated by BAPCPA. Although much remains unclear regarding these new provisions, courts are defining some of the parameters of the new disclosure requirements and other aspects of the BAPCPA amendments, and at least one court has discussed the new attorney certification.

Attorney Certifications under BAPCPA

In *In re Mendoza*, 347 B.R. 34 (Bankr. W.D.Tex., 2006) Judge Leif M. Clark, was faced with a situation where a reaffirmation agreement signed by the attorney, but without the required financial information, was filed with the court. After finding that "according to the form and the statute" the court had an obligation to review any reaffirmation where an undue hardship was present. Judge Clark undertook an exhaustive analysis of the reaffirmation agreement and the

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disclosures and certifications required. A copy of the decision is attached as Appendix 1. Judge Clark found that the statute was obtuse and that the major reason that the "official form is a disaster is that it tracks the statute."

Judge Clark found that a determination of what the form means and what the attorney was certifying was important because of the potential liability to the attorney who signs a reaffirmation agreement. In footnote 6 he writes:

> Section 526(a)(2) prohibits the debtor's attorney (who is, in virtually all of these cases, a "debt relief agency") from making "... any statement in a document filed in a case or proceeding under this title that is untrue or misleading, or that upon the exercise of *reasonable care,* should have been known by such agency to be untrue or misleading." *See* 11 U.S.C. § 526(a)(2) (emphasis added). Thus, even negligently certifying a debtor's ability to make reaffirmation payments could subject the attorney to the range of penalties spelled out in section 526(c). Nor, presumably, would the attorney's exposure end there, as many non-bankruptcy remedies could also come into play, ranging from suits for malpractice, through grievance actions by state bars, and class action suits by aggrieved former clients.

BAPCPA does not establish new duties for a debtor's attorney except in cases where there is a presumed undue hardship. *Mendoza* made no holding on the liability that could arise under this new certification because the central issue in the case concerned was when a hearing was required where an attorney signs the agreement but does not provide the requisite certifications. Thus, although *Mendoza* gives us a hint at the new certification, it remains the subject of speculation.

<u>Mandatory Disclosures</u>

BAPCPA does not establish new duties for a debtor's attorney except in cases where there is a presumed undue hardship. So far as the mandatory disclosures are concerned, the

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statute is silent as to party that must provide them to the debtor. On the one hand, it can be argued that the new Section 524(k) makes it much more difficult for creditors because it provides for specific disclosures regarding the actual financial cost of a reaffirmation agreement to a debtor. Indeed, the cases that have addressed the required disclosures have held that the failure to make the required disclosures results in disapproval of the agreement. This happened in *In re Quintero*, 2006 WL 1351623 (Bankr. N.D. Cal. May 17, 2006), where the court refused to approve the reaffirmation agreement because the creditor had failed to make the required disclosures. The court parsed the statute and decided that the creditor could not foreclose where the debtor had entered into the agreement and the court has refused to approve it because it was not in the proper form and the required disclosures were not made.

> The question then presented is whether National may repossess the Car even if the Debtor is not in default on her payments based on the Court's failure to approve the Agreement. The Bankruptcy Code is ambiguous on this point. However, the only reasonable conclusion is that National may not do so. BAPCPA includes in its title the phrase "consumer protection." The addition to section 524(k) is probably the primary protection provided to chapter 7 debtors by BAPCPA. Congress cannot have intended to leave it within a secured creditor's power to thwart a chapter 7 debtor's attempt to retain her car and reaffirm her debt by failing to comply with the requirement that the creditor supply the debtor with the expanded disclosures at the appropriate time.
>
> This conclusion is not inconsistent with the express language of the statute. Section 521(a)(6) provides only that a debtor may not retain the collateral unless the debtor enters into a reaffirmation agreement. It does not require the reaffirmation agreement to be approved. This conclusion is also consistent with section 362(h)(1)(B) which provides that the automatic stay does not terminate and the collateral remains property of the estate if the debtor has offered to enter into an agreement to reaffirm the debt on the same terms provided by the contract and the creditor has refused. By failing to comply timely with section 524(k), National

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has in effect refused to enter into an enforceable reaffirmation agreement with the Debtor.

The required disclosures are similar to Truth in Lending Disclosures. In fact, the new code requires some, but not all of the information that the courts in *Melendez I* and *II* (discussed below) required the attorney to obtain. Since institutional creditors provide this type of information routinely, the BAPCPA does not impose much of a hardship on this type of creditor. However, for the non-institutional creditor, it presents a hardship because of the necessity of providing all of the information. It does put the attorney for the debtor between a rock and a hard place.

<u>Other Decisions Applying BAPCPA Reaffirmation Amendments</u>

The reaffirmation provisions do not apply to real property. *In re Bennet* Slip Copy, 2006 WL 1540842 (Bkrtcy.M.D.N.C.), Bankr. L. Rep. P 80,635. Consequently, reaffirmation of real estate security agreements (mortgages, deeds of trust, etc.) is not necessary. In the vast majority of cases, the automobile is the item in question.

Section 521(a)(6) provides that if the individual debtor does not reaffirm, redeem, or return within 45 days, relief from stay is granted and the property is no longer property of the estate. It also provides that the debtor shall not remain in possession of personal property in which a creditor has an allowed secured claim. Thus, in *In re Steinhaus* --- B.R. ----, 2006 WL 2529631 (Bankr. D. Idaho 2006), the court held that even though the debtor had neither reaffirmed, redeemed nor returned, the creditor was entitled only to an order granting relief from stay. The court specifically found that it did not have authority to order the debtor turn the property over. The remedy, relief from stay, was mandated by the statute and granting any other

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relief would be beyond the court's jurisdiction, as Congress chose the remedy.

The Steinhaus court noted that because state law prohibited foreclosure until the debtor had a monetary default, the creditor still could not foreclose. This was the same result reached by the court in ; *In re Rowe,* 342 B.R. 341, 346-47 (Bankr.D.Kan.2006).

There are several cases (*In re Stillwell* --- B.R. ----, 2006 WL 2522190 (Bkrtcy.N.D.Okla.), *In re Laynas* 345 B.R. 505 (Bkrtcy.E.D.Pa.,2006). *In re Payton* 338 B.R. 899 Bkrtcy.D.N.M.,2006. where the court was faced with a situation where the court questioned the ability of the debtor to make the payments and refused to approve the reaffirmation, but refused to rule on the creditor's ability to foreclose. However, in *In re Quintero, supra.* denied reaffirmation and court refused to allow foreclosure.

> Section 521(a)(6) provides only that a debtor may not retain the collateral unless the debtor enters into a reaffirmation agreement. It does not require the reaffirmation agreement to be approved.

The proposed agreement must be on the same terms as the original. The creditor may not attempt to add additional terms. In *In re Hinson* --- B.R. ----, 2006 WL 2720886 (Bankr. E.D.N.C. 2006), the creditor attempted to add additional terms to the reaffirmation agreement and sought foreclosure when the debtor would not agree to the additional terms. The court concluded:

> Reaffirmation post-BAPCA, like pre-BAPCPA, remains a matter of contract, and Coastal may legitimately insist on terms additional to those in the original agreement. *See Schott v. WyHy Federal Credit Union (In re Schott),* 282 B.R. 1, 7-8 (B.A.P. 10th 2002)*; Jacobs v. Honda Fed. Credit Union (In re Jacobs),* 321 B.R. 451, 455 (Bankr.N.D.Ohio 2004)*; In re Graham,* 297 B.R. 695, 698 (Bankr.E.D.Tenn.2003). But having chosen to do so here in the case of a debtor who has always been current with her payments, Coastal must live with the consequences if the debtor declines to

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> reaffirm on Coastal's terms but desires to continue with the original agreement. As the debtor here timely agreed to reaffirm the debt on the original terms of the contract, the stay remains in place and the vehicle remains property of the estate, pursuant to § 362(h)(1)(B). The ipso facto clause of the contract remains ineffectual, as the provisions of § 521(d) that would give it effect have not been met.

Another problem is that the provision stating that the debtor may not remain in possession of the property applies only to property for which the secured creditor has an "allowed secured claim." In the normal no asset case, a proof of claim is never filed.[11] Consequently, in most cases, there is never an allowed secured claim." *In re Donald,* 343 B.R. 524, 536 (Bankr. E.D.N.C. 2006).

> Furthermore, no proof of claim was filed and Coastal does not have an "allowed claim" in any amount. Consequently, the redemption/reaffirmation requirement of § 521(a)(6) is not applicable in this case.

In re Donald, 343 B.R. 524, Bankr. L. Rep. P 80,682 Bkrtcy.E.D.N.C.,2006. The *Donald* court went on to find that "ride through" was not available but the meaning of that was unclear.

> It also is worth acknowledging that, ultimately, whether or not the "ride-through" option survives the new statutory hurdles may not make much of a difference to many debtors and creditors because in this circuit, and also in those that do not recognize the "fourth option," debtors continue to submit payments when due and creditors continue to accept them. Creditors frequently acquiesce in ride-through because chapter 7 debtors "usually become[ ] better able to afford paying secured debts, and this gain in creditworthiness may more than offset the creditor's loss of recourse against the debtor personally after discharge." Jean Braucher, *Rash and Ride-Through Redux: The Terms for Holding On to Cars, Homes and Other Collateral Under the 2005 Act,* 13 Am. Bankr.Inst. L.Rev. 457, 476 (Winter 2005).

[11] There is a rumor that GMAC is now filing a proof of claim in every case for just reason.

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In *In re Anderson* --- B.R. ----, 2006 WL 2536585 (Bkrtcy.D. Del.), the debtor brought a motion for contempt after the creditor repossessed on the debtor's failure to reaffirm. The court held that under the law of Delaware, the creditor could repossess when absence of a reaffirmation. The court found that Delaware's Retail Installment Sales Law did not apply to automobiles, however, sanctions were ordered in the sum of $500 because after repossession, the creditor tried to collect its costs.

One thing is clear: The failure to reaffirm puts the matter back in state court with state law remedies. *In re Steinhaus, supra; In re Row, supra.* This means that counsel must be familiar with local law and practice. The Uniform Consumer Credit Code (UCCC) apparently precludes foreclosure for a non-monetary default. *Steinhaus*. If the creditor continues to accept payments, it may be considered a waiver of the default. If the default (contained in the bankruptcy *ipso facto* clause) is waived, there is no basis for any foreclosure.

Debtors' Attorneys and Reaffirmations: Conflict and Liability

Conflict and potential liability for the debtor's attorney pervade the reaffirmation process because of the provisions of § 524 that are directed at attorneys. Section 524 requires the attorney to file a declaration stating that the attorney:

> "I hereby certify that (1) this agreement represents a fully informed and voluntary agreement by the debtor; (2) this agreement does not impose an undue hardship on the debtor or any dependent of the debtor; and (3) I have fully advised the debtor of the legal effect and consequences of this agreement and any default under this agreement
>
> "Signature of Debtor's Attorney: Date:".
>
> (B) If a presumption of undue hardship has been established with respect to such agreement, such certification shall state that in the

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> opinion of the attorney, the debtor is able to make the payment.
> [added by BAPCPA]

As this language makes clear, the conflict and potential liability for attorneys in the reaffirmation context existed prior to BAPCPA. The new law merely adds a layer of complexity.

Attorney Conflict

Conflict for debtors' attorneys takes two forms. As the court in *In re Vargas*, 257 B.R. 157, 158 (Bankr. N.J. 2001), explained, an attorney has a duty to the client AND to the court.

> In signing off on a reaffirmation agreement, the attorney assumes a dual role. It is not enough for an attorney to advise the clients of their rights and allow them to make a business decision. The attorney must exercise independent judgment. If the attorney cannot affirmatively state that the agreement does not impose an undue hardship on the debtor, the attorney must decline to sign a declaration attached to the agreement. By so doing, the attorney will assure judicial review and a hearing where the court will determine whether the agreement is in the best interest to the debtor.

It is the dual role of the attorney that presents the problem. All attorneys represent clients and they are also officers of the court and have a separate obligation to the court to assure the integrity of the process. Approving a reaffirmation agreement places an additional and different burden on the attorney. In addition to the requirement that the attorney follow the client's instructions, the attorney must pass independent judgment on whether the agreement is in the best interest of the client. This creates a conflict of interest. Even though the client/debtor wants to keep the Hummer and instructs the attorney to approve the agreement, the attorney should know from the preparation of the schedules and from common sense, that the monthly payment and costs of operation are much more than the client can afford. The attorney must then, as an

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officer of the court, decline to approve the agreement or risk sanctions from the court.

In order to approve a reaffirmation agreement under BAPCPA, an attorney must certify that a reaffirmation agreement will not impose an undue hardship upon his client and is in his client's best interest. It also requires, in cases where there is an undue hardship, that the attorney certify that the debtor has the ability to make the payments.

It is not enough to advise the debtor/client of their rights and allow them to make a business decision.

The first trap that an attorney encounters in the reaffirmation is "What is the role of the attorney?" What interest does the attorney represent? The attorney is the advocate for and must take direction from the client. However, the attorney is also an officer of the court and must serve a second master when approving a reaffirmation agreement.

The attorney's position as an Officer of the Court presents a completely different set of questions and duties for the lawyer. Instead of the requirement that the attorney provide legal advice, follow the client's direction and not participate in committing a fraud on the court, the attorney is called upon to exercise independent business judgment. Additionally, and more dangerous, if the attorney's business judgment differs from that of his client, the attorney is precluded from following his client's direction and must, as an Officer of the Court, refuse to approve the reaffirmation agreement.

There is no firm rule that tells the attorney what to do when faced with a situation in which the attorney is required to exercise independent professional judgment and that judgment conflicts with the client's instructions.

The *Vargas* court recognized the dilemma in which attorneys are placed when their independent professional judgment differs from what the client wants.

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> Debtors' attorneys have a choice to make when presented with their clients' reaffirmation agreements. They may remain strictly advocates and decline to sign the requisite declaration attached to the reaffirmation agreement. The court recognizes that attorneys' execution of these certifications may place some attorneys in a position of conflict. Culhane, Marianne and White, Michael, Debt After Discharge: an Empirical Study of Reaffirmation, 73 AM. BANKR.L.J. 709, 710 (1999). Specifically, attorneys may not wish to undertake the reaffirmation process because they would be taking on roles akin to *in loco parentis*. If this is the case, then attorneys are not obligated to take on the duties independently assessing their clients' financial status. If attorneys decline to sign the declarations, the corresponding reaffirmation agreements must be reviewed by the court. 11 U.S.C. § 524(c).

There are no reported cases detailing what happens to the attorney when (s)he declines to sign the agreement because he does not believe that it is in the client's best interest. The cases that have addressed the issue have not discussed the liability of the attorney, but have uniformly held that the clerk must set the matter for a hearing so that the judge can make a decision. *See, inter alia, In re Mendoza, supra.*

Rule 1.2 of the ABA Model Rules of Professional Conduct provides little guidance. It requires that a lawyer will abide a client's decisions concerning the objectives of representation. A lawyer shall abide by a client's decision whether to settle a matter.

The comment indicates that:

> Paragraph (a) confers upon the client the ultimate authority to determine the purposes to be served by the legal representation, within th limits imposed by law and the lawyer's professional obligations.

Similarly, the Restatement 3d of the Law Governing Lawyers addresses the issue in § 22.

> (1) As between client and lawyer, subject to Subsection (s) and § 23, the following and comparable decisions are reserved to the

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> client except when the client has validly authorized the lawyer to make the particular decision: whether and on what terms to settle . . . .
>
> (2) A client may not validly authorize a lawyer to make the decisions described in Subsection (1) when other law . . . requires the client's personal participation or approval.

A reaffirmation agreement of necessity requires the client's personal involvement. The client must pay the debt or, in the usual circumstances, return the collateral or take the chance of having the collateral repossessed. The decision to reaffirm must remain with the client. However, even though the decision to reaffirm is the most analogous to a settlement agreement in bankruptcy, it is fundamentally different because of the independent nature of the attorney's responsibility.

Neither the Rule nor the Restatement specify what happens when the lawyer and client disagree. The comment to the rule indicates that:

> Because of the varied nature of the matters about which a lawyer and client might disagree and because the actions in question may implicate the interests of a tribunal or other persons, this Rule does not prescribe such disagreements are to be resolved. Other law, however, may be applicable and should be consulted by the lawyer. The lawyer should also consult with the client and seek a mutually acceptable resolution of the disagreement. If such efforts are unavailing and the lawyer has a fundamental disagreement with the client, the lawyer may withdraw from the representation.

Section 524 would seem to provide that if there is a disagreement, the lawyer may note the matter for a hearing and allow the court to decide. The plain reading of the statute does not seem to give this option. Section 524(j)(7) providing for a motion to the Court to approve a reaffirmation agreement applies only to unrepresented debtors. *Contra, In re Mendoza, supra.*

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While the new language has not been tested, it does not differ markedly from the pre-BAPCPA provisions. Although a minority of courts has interpreted the absence of statutory language explicitly authorizing the court to review attorney-negotiated reaffirmation agreement to mean the court has no such authority, the majority of courts have held that the absence of express language authorizing review does not preclude the bankruptcy court from scheduling a hearing when an attorney-negotiated reaffirmation agreement is filed. In the only reported decision under BAPCPA, Judge Clark in *In Re Mendoza, supra*. opted for a hearing.

In the late 1990's, several courts held that courts had not just the authority, but an obligation, to review attorney-negotiated reaffirmation agreements. In *In re Bruzzese*, Sears, the creditor whose reaffirmation agreements practices were being reviewed, objected that the Court had no authority to annul a reaffirmation agreement accompanied by an attorney's declaration. The Court disagreed, observing that, to the contrary, "It may be an abdication of duty for a judge to accept all declarations at face value." Although the Court noted that it was unclear exactly how a Court should police reaffirmation practices, it emphasized that such efforts were a part of the court's job.

Similarly, in *In re BankBoston*, the Court held that "Bankruptcy Courts possess an independent obligation to review reaffirmation agreements to ensure that the elements of Section 524(c) are satisfied." Other courts have also found that the court has an obligation to monitor attorney-negotiated reaffirmation agreement. *See Melendez*, 224 B.R. at 260; *In re Latonowitz*, 207 DR 326, 336 (Bankr D. Matt 1997), *In re. Hovestadt,* 193 B.R. 382, 386 (Bankr D. Mass 1996); *In re Izzo*, 197 B.R. 11, 12 N.2 (Bankr DRI 1996); *In re. Lindley*, 216 B.R. 81118 (Bankr ND Ill. 1998); *Hovestadt*, 193 B.R. at 386.

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As the *Bruzzese*[12] court aptly reasoned, "[i]f Sears were correct and bankruptcy courts lacked authority to annul attorney-negotiated reaffirmations, why would it be necessary for such agreements to be filed with the court?" *In re Bruzzese*, 214 B.R. at 450. Given the language of Rule 9011, it would be illogical to conclude that the court retains no authority to annual attorney-negotiated reaffirmation agreement.

In *Melendez* II, the Court stated that the purpose of Rule 9011 is "to control the practice of attorneys or those who act as their own attorneys, in the conduct of litigation in the Federal Court". *Melendez II*, 235 B.R.189 (citing *Melendez I*, 224 B.R. at 258 (additional citations omitted)). *Melendez I* explains that a court may initiate a Rule 9011 sanction inquiry *sua sponte*. Fed. R. Bankr. P. 9011(c)(1)(B). Rule 9011 thus provides the court with its authority to review attorney-negotiated reaffirmation agreement, because such review is the means by which the court can control and monitor the practices of attorneys.

The history of the Code also supports a conclusion that the court has the authority to annul reaffirmation agreements accompanied by a 524(c)(3) attorney declaration.

In order to approve a reaffirmation agreement, the attorney must perform a reasonable investigation.

In order to approve a reaffirmation agreement and comply with BR 9011, the attorney must first undertake an investigation as to the scope and nature of the obligation. The agreement must then be fully explained debtor. This requirement was first discussed by the court in *Melendez I supra.* The court held:

> Only if an attorney undertakes an appropriate investigation and considers the totality of the surrounding circumstances will the attorney have complied with Rule 9011 in making the § 524(c)(3)

[12] In re Bruzzese 214 B.R. 444 (E.D.N.Y. 1997)

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declaration.

In re Bruzzese, 214 B.R. 444 (E.D.N.Y. 1997), the court took an active role in policing its docket. The court issued Show Cause Orders in thirty (30) separate cases directing the debtors, their counsel, and Sears, the creditor obtaining a reaffirmation agreements, to appear and explain the reasons behind the reaffirmation agreement. The court explained the reason for issuing the orders as necessary to police the local bar.

> Through this sampling of cases, the Court sought to determine whether chapter 7 attorneys were effectively representing their clients, and if not, whether under section 329 of the Bankruptcy Code, their compensation should be reduced. Another way of articulating this judicial concern was to put the chapter 7 consumer debtors' bar on notice that the Court expects attorneys appearing before it to perform at an acceptable level of competency.

After testimony and many moves by Sears to stop the hearings on jurisdictional grounds, the court got to the economic basis of the agreement that the debtors' counsel had approved.

> What Sears did not disclose and what the debtor's attorney did not explain to his client is that, assuming no defaults in the timely payment of the reaffirmed amount, it would take 76 months to satisfy this amount. Over the 76 months, she would pay a stream of payments totaling $3,269.02, of which the aggregate interest would be $1,469.02. Query: even if the debtor could afford to service this debt, would she have as a rational decision-maker have agreed to carry this debt for seven years? For a wholly unsecured obligation, this would exceed the maximum payment term of 60 months permitted under a chapter 13 plan by 16 months. Other credit card issuers charge a far lower actual annual percentage rate for a $500 line of credit even to persons who have received a recent discharge in a chapter 7 bankruptcy case;

The court then discussed the conduct of counsel:

> 7. Counsel breached his fiduciary duty to represent his client effectively by his total lack of awareness of or disregard for the true economic costs of this transaction, and his resultant failure to

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> explain these costs and to point out other available sources of consumer credit at a much lower effective rate of interest;
>
> 8. By virtue of signing the declaration, counsel also misrepresented to this Court not only that he had fully advised the debtor of the legal and economic effect of entering into the reaffirmation agreement, but also that the debtor's performance under this reaffirmation agreement would not constitute an undue hardship on the debtor; and
>
> 9. In light of these facts, the fee charged to the debtors for legal services in this case was excessive. The value of these services with respect to this reaffirmation agreement was negative.

The *Melendez* court, *supra.* went through an exhaustive analysis of the items that an attorney must consider before approving a reaffirmation agreement.

> Debtor's counsel must also be familiar with and communicate to the debtor, in terms familiar to lay persons, the financial terms of the reaffirmation agreement. As guidance, debtor's counsel should consider the disclosures mandated by the Federal Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 and the Massachusetts Consumer Credit Cost Disclosure Act ("CCCDA"), Mass.Gen.Laws.Ann. ch. 140D, both of which seek to guarantee the accurate and meaningful disclosure of costs of consumer credit in order to enable the consumer to make an informed choice in the credit marketplace. *Desrosiers v. Transamerica Fin. Corp. (In re Desrosiers*), 212 B.R. 716, 722 (Bankr.D.Mass. 1997). To fulfill this statutory mandate, the Federal Reserve Board has promulgated Regulation Z, 12 C.F.R. § 226, detailing the disclosures that a lender must make in a consumer credit transaction. Both TILA and CCCDA are "remedial statutes designed to protect consumers, who are not on equal footing with creditors, either in bargaining for credit terms or in knowledge of credit provisions." Kathleen E. Keest, RECENT DEVELOPMENTS IN RESIDENTIAL MORTGAGE LITIGATION: TIL RECISSION AS A DEFENSE TO FORECLOSURE, 989 PLI/Corp 507, 531 (April, 1997); *see also Bizier v. Globe Fin. Servs., Inc.*, 654 F.2d 1, 3 (1st Cir. 1981); *Mechanics Nat'l Bank of Worcester v. Killeen*, 377 Mass. 100, 384 N.E.2d 1231 (1979).[fn20] Disclosures under TILA and CCCDA which are important in the context of reaffirmation agreements include the annual percentage rate, a statement on when payments are due, the

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> applicable grace period, the method for determining finance charges, and late payments or over-the-limit charges. In addition, debtor's counsel should verify with the creditor and disclose to the debtor the amount of the prepetition claim; the principal amount of the reaffirmed debt; the minimum monthly payment on the reaffirmed amount; and the amount, if any, of an extension or renewal of the debtor's credit line.
>
> To ensure that the debtor fully understands his or her obligations, debtor's counsel should insist that the creditor provide the debtor with the foregoing financial disclosures in writing and also provide the debtor with "a full and easily legible amortization schedule of the payments . . [which sets out] the number of months that it will take to satisfy the reaffirmed indebtedness." *Bruzzese*, 214 B.R. at 452. Debtors who seek to reaffirm a prepetition debt in exchange for a reinstatement of their credit line and/or an additional line of credit should also be given information about the amount of credit that will become available under the reopened credit line as the principal balance of that reaffirmed indebtedness is reduced, the amount of time it will take for the principal of the debt to be meaningfully reduced before the debtor can use the credit line, and the monthly minimum payment if that credit is used. [13]

The *Melendez* court then went on to discuss additional factors such as the likelihood of replevin and creditor coercion. Both of which must be discussed by the attorney with the client. It then went on to hold that: "Counsel for the debtor must also ensure that the debtor fully understands the agreement, the debtor's responsibilities thereunder, the consequences of any default and the right to rescind the agreement within the specified time period."

Only one Appellate decision has addressed the factors to be considered in approving a reaffirmation agreement. *In re Claflin*, 249 B.R. 840 (1st Cir. BAP 2000) addressed the factors in an appeal from the Bankruptcy Court's refusal to approve a reaffirmation agreement.

> Section 524(c)(6) provides the applicable legal standard regarding the approval of reaffirmation agreements subject to court review. To be enforceable, a court must find that a reaffirmation agreement

[13] Much but not all of this information is now required to be placed in the Reaffirmation Agreement by § 524(k).

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> is in the debtor's best interest and that it does not impose an undue hardship on the debtor or a dependent of the debtor. *See* §524(c)(6). In the context of § 524(c)(6), the term "undue hardship" has been defined as a reaffirmation that causes a "significant, but otherwise avoidable obstacle to the attainment or retention of necessaries by the debtor or the debtor's dependents." *In re Melendez, et al*., 224 B.R. 252, 261 (Bankr. D. Mass. 1998). When applying the best interest and undue hardship standards under § 524(c)(6), District Judge Gorton has suggested that the following factors be considered:
>
> 1. What alternatives, other than reaffirmation, are available to a debtor who wishes to retain estate property;
>
> 2. Whether the underlying debt is secured or unsecured;
>
> 3. If the debt is secured, the threat of repossession of, and the amount of equity, in the collateral;
>
> 4. The extent to which the collateral is a necessity; and
>
> 5. The debtor's payment history on the collateral.

To some degree, the investigation is made much easier by the increased disclosure requirements of revised §524(k) which requires that some of these disclosures be placed in the new form of Reaffirmation Agreement mandated by the statute.

Counsel who do not undertake all of these investigations prior to approving the reaffirmation agreement are subject to sanctions pursuant to BR 9011 if brought to the attention of the Bankruptcy Court.

Bankruptcy Rule 9011 imposes an additional burden on the debtor's attorney.

Bankruptcy Rule 901 makes Fed.R.Civ.P. 11 applicable to bankruptcy proceedings. It allows the court to impose sanctions against an attorney or other party who files a pleading that is frivolous, legally unreasonable or without factual foundation, or that is filed in bad faith or for

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an improper purpose. Fed.R.Bankr.P. 9011.

Subdivision (d) of Rule 9011 addresses an attorney's representations to the Court, and provides:

> Representation to the Court. By presenting to the Court (whether by signing, filing, or later advocating a petition, pleading, written motion or other paper, an attorney on underrepresented party is certifying that to the best of the person's knowledge, information and belief formed after an inquiry reasonable under the circumstances –
>
> 1. Is it not being presented for any improper purpose such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
>
> 2. The claims defense and other legal contentions therein are warranted by existing law or by a non-frivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> 3. The allegations and other factual contention have evidential support or the specifically so identified are likely to have evidentiary support after a reasonable opportunity for further investigation for discovery; and
>
> 4. The denials of factual contentions are warranted on the evidence or if specifically so identified are reasonably based on the lack of information or belief.

Rule 9011, thus, "explicitly and unambiguously imposes an affirmative duty on each attorney to conduct a reasonable inquiry into the viability of a pleading before it assigns". *Id* (internal citations omitted). A § 524(c)(3) declaration therefore tracks 9011(B)(3) and (4).

Liability to the client.

Malpractice

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The second source of liability for debtor's counsel upon approving a reaffirmation agreement comes from the client. The attorney who approves a reaffirmation agreement without sufficient disclosure and investigation, is subject to a malpractice claim by the client.

The amount of damages to the debtor might include the full amount of the debt improperly reaffirmed, all payments and interest made and accrued, the attorneys' fees and costs incurred attempting to rescind the agreement. These damages can be substantial.

Does the court have the authority to annul a reaffirmation agreement accompanied by an attorney's 524(c)(3) declaration?

If the attorney is a Debt Relief Agency and the client an Assisted Person, there may be additional obligations and/or burdens depending upon the retainer agreement. *See, In re Mendoza, supra.*

Liability to the Creditor

New 524(k)(5)(A) requires that the attorney certify

> "I hereby certify that (1) this agreement represents a fully informed and voluntary agreement by the debtor; (2) this agreement does not impose an undue hardship on the debtor or any dependent of the debtor; and (3) I have fully advised the debtor of the legal effect and consequences of this agreement and any default under this agreement.
>
> "Signature of Debtor's Attorney: Date:"

There is a trap hidden in the statute, however. The next paragraph (B) provides that (B) If a presumption of undue hardship has been established with respect to such agreement, such certification shall state that in the opinion of the attorney, the debtor is able to make the payment.

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It is not necessary to make this certification if the secured creditor is a credit union.

Undue hardship is now a defined term.

> [I]t shall be presumed that such agreement is an undue hardship on the debtor if the debtor's monthly income less the debtor's monthly expenses as shown on the debtor's completed and signed statement in support of such agreement required under subsection (k)(6)(A) is less than the scheduled payments on the reaffirmed debt.[14]

The certification that "in the opinion of the attorney the debtor is able to make the payments," presents several questions. They are, *inter alia:* "Upon what basis is the attorney supposed to render this opinion?" "What factors should or must the attorney review before making this determination?" "Is the attorney entitled to rely upon the client's statement that he can make the payments or get the money to make the payments? None of these are answered in the statute. If the attorney guesses wrong, there may be liability. According to Judge Clark in *In Re Mendoza*, guessing wrong may invoke all of the panoply of liability arising out of the Debt Relief Agency provisions. Guessing yes may be problematic. In every reported case, courts faced with what might be considered an undue hardship have refused to approve the reaffirmation. [5]1

Courts interpreting pre-BAPCPA law did address the issue in the form of determining undue hardship and what would allow approval of the agreement anyway. This was before undue hardship was a defined term. Although if a debtor's Schedules I and J show no disposable income or a negative cash flow, there is a presumption that a reaffirmation agreement constitutes an undue hardship, there may be instances where that is not the case. For example, possibly the

[14]Much but not all of this information is now required to be placed in the Reaffirmation Agreement by § 524(k).
[15](*In re Stillwell* --- B.R. ----, 2006 WL 2522190 (Bkrtcy.N.D.Okla.), *In re Laynas* 345 B.R. 505 (Bkrtcy. E.D.Pa., 2006). *In re Payton* 338 B.R. 899 (Bkrtcy. D.N.M. 2006).

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debtor's income increased post-petition ; reaffirmation agreement therefore may not impose an undue hardship upon him.

Pursuant to § 524(k)(5)(A), if a presumption of hardship has been established, the debtor's attorney must sufficiently explain to the court that debtor is nonetheless able to make payments on the reaffirmed debt.

It is also important to note that an attorney cannot rely solely on a debtor's budget as reflected in Schedules I and J. In *Melendez* 235, the court found that an attorney's investigation was ongoing, not fixed at the point in time that the debtor completed Schedules I and J. Thus, an attorney must analyze the income and expenses of the debtor's household including an "update of the information contained in the debtor's Schedules I and J".

Whether a debtor's expenses exceed his or her post petition income, of course, is not the only question to consider when engaging in an undue hardship analysis. An attorney must also determine if reaffirmation of the debt is necessary to retain an item which the debtor or his or her dependents requires for their well-being. If the item is not necessary and a debtor's expenses exceeds his or her post-petition income, it is likely that payment of the reaffirmed debt would jeopardize the debtor's ability to pay for necessary living expenses and therefore impose an undue hardship on him or her. Conversely, if the item is necessary for the health and well-being of a debtor or his dependent, then it may be advisable for a debtor to reaffirm the debt notwithstanding his negative cash flow. Every court that has addressed the issue in a reported decision post BAPCPA, has refused to approve the reaffirmation.

The most troubling question is what is the effect if the attorney makes the certification and the debtor/client is unable to make the payments, for whatever reason.

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Aside from the potential liability to the client, if the required disclosures and explanations have not been given, does the client have a claim against the attorney for damages because the attorney followed the client's directions but failed to exercise the independent judgment that was discussed *supra.?* Possibly yes, but, what about the creditor?

If the reaffirmation agreement is not executed properly, or if the client is unable to make the payments in spite of the attorney's opinion that the payments are possible, there is potential liability to the creditor.

The attorney as guarantor.

The creditor can be expected to argue something like this: " You certified that the debtor could make the payments. I would not have entered into this agreement because I knew the debtor could not make the payments but your certification stated that (s)he could. I relied upon that certification. I now have this security interest in a car that has been mangled and is not worth nearly as much as I am owed. I have been damaged and you are the cause.

The attorney is now in a situation where the client is unhappy, the car is gone and there is a deficiency. The creditor is angry because there is now an uncollectible deficiency. They are all unhappy with the lawyer. Surely someone will file a law suit. The liability to the client is unclear but will probably be covered by the attorney's errors and omissions insurance. The liability to the creditor is another matter.

Clearly, there are enough waffle words in the statute that a clever attorney (one hired by the E&O carrier probably) can construct a defense. "It was his opinion; there were facts not disclosed; or there was a change in circumstances that he could not reasonably foresee," are some that come to mind. A win for the creditor is not assured.

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What is assured is that the attorney loses under any circumstance. First, the action or demand must be reported to the attorney's insurance carrier raising premiums in future years. Second, the attorney must defend the claim. This will take time, money, and effort. It produces substantial stress.

There is little or no upside and there are many potential downsides.

CONCLUSION

With the enactment of the BAPCPA, the consensus is that Congress attempted to end what is known as Ride Through, the 4th option. Under prior law, in some circuits, if the debtor was current on the obligation on filing, there was no need to reaffirm and, the creditor could not foreclose or obtain an order directing the debtor to turn the property. Whether Congress was successful remains to be seen, however, it does not appear from the majority of cases so far that if this was the intent, that intent was realized even though all of the courts that have decided the issue have opined that it was eliminated. Nevertheless, the ultimate rulings do not support the opinion. *See, In Re: Steinhaus, supra.*

What is clear is that if you, as the attorney, decide to approve a reaffirmation agreement, you must use your independent judgment, make full disclosure, and be absolutely, brutally honest. You must use your independent business judgment concerning the debtor's abilities. To do anything else can subject to you to liability from three different directions, the debtor, the court, and, finally, the creditor.

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SOME SHORT QUESTIONS, AND MUCH SHORTER ANSWERS

If a debtor is insistent upon signing a reaffirmation agreement, but my opinion is that it would be an undue hardship upon the debtor or his dependents, does my duty to my client require that I comply with their wishes and certify the reaffirmation agreement?

No, but you need to have a provision in your retainer agreement that addresses this issue.

Does a debtor's attorney have an obligation to consider each individual creditor's reaffirmation agreement practices in determining whether reaffirmation agreement is appropriate for his client?

Yes.

Is there ever a reason to reaffirm an unsecured debt?

Yes, if it is in settlement of a dischargeability action that has actually been filed and which you believe the client will lose, or if the reaffirmation agreement is LESS than the cost of defense.

Are there reasons to approve reaffirmation of a secured debt?

Yes, if the creditor is offering a benefit, i.e. a reduced interest rate or if the item is vital to the client and you honestly believe that the debtor can make the payments. Perhaps if the collateral is necessary to the debtor and reaffirmation is not an undue hardship. Depending upon your district, if "ride through" is available, question may have a different answer.

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Points to Consider In Determining Whether YOU should approve a Reaffirmation Agreement

1. Your mantra should be: Is it in the debtor's best interest to reaffirm this obligation? Remember, your first duty is to your client. It is a fiduciary duty.

2. If the debt is unsecured there is very little, if any, reason to reaffirm the debt.

3. Is there a way to avoid the creditor claims under Bankruptcy Code § 522?

4. It is incumbent upon the creditor to show that the debt is secured.

5. Has the creditor properly acquired a security interest in the goods at issue in accordance with state law?

6. Can the creditor provide documents signed by the client at the time the account was established in which the client agrees to create a purchase money security interest as defined by U.C.C. 9-107 or other state law?

7. Do the documents show the dates and amounts of all charges including interest and late fees and payments made on the client's account?

8. Can the creditor provide a detailed description of the collateral, the current balance on the account, the present market value and the description of the method used to obtain the valuation?

> In *In re Kamps 217* B.R. 836 (Bkrtcy. C.D.Cal., 1998). the court stated "the sufficiency of a description of collateral turns on whether the description adequately describes the types of assets or the individual items." *Kamps,* at 852. Does the description of the collateral enable a third party to distinguish the collateral from other property?

9. Is the item an indisputable necessity to the debtor? Will the debtor's failure to reaffirm likely result in foreclosure or repossession?

10. What is the value of the collateral? What is condition of the collateral? Is it worn out, broken, or old?

> "A bank's security interest in such goods extends only to the present market value of the goods at issue. You should independently valuate the collateral; relying exclusively on the creditor's valuation is like asking the fox to guard the henhouse.

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11. Informed the debtor of his available options: Does the debtor know he may elect to redeem the property by paying the present fair market value in a lump sum; surrender the property and convert any remaining debt into a fully unsecured debt; take advantage of state laws concerning foreclosure by continuing to make payments without reaffirming? *(assuming this is available in your state.)

12. What is the likelihood that the creditor will repossess the property if the debt is not reaffirmed? If the creditor has no intention of repossessing the collateral then it is not in the debtor's best interest to reaffirm.

13. What are the economic consequences to the debtor of reaffirmation? Will reaffirmation pose undue hardship upon him? How necessary is the collateral to the well-being of the debtor and his dependents?

14. If it may be in your client's best interests to reaffirm, have you negotiated with the creditor to get the lowest possible value of the item, the lowest possible interest rate and other favorable terms for the debtor?

15. What is the actual cost of the reaffirmation to the debtor? What is the amount of interest on the debt and on any line of credit offered by the creditor? Does the interest exceed the interest rate a debtor might likely obtain from another source? Is the interest rate disclosed on the agreement? Does the language disclosing the financial details of the reaffirmation comply with § 524(k)?

16. Have the debtor's circumstances changed since the filing of Schedules I and J? Counsel's analysis of whether reaffirmation is a suitable option must be ongoing, taking into account any change in the debtor's circumstances.

17. How many debts is the debtor reaffirming? Is the debtor truly able to reaffirm multiple debts?

18. Is there any indication that the debtor's circumstances might change? If not, and the debtor currently cannot afford the reaffirmed debt, it is unlikely he will be able to afford it at a later point in time.

19. How long will it take the debtor to pay off the reaffirmed debt at the minimum payment?

20. Does the debtor understand how long it will take to pay off the reaffirmed debt if he makes the minimum payments each month?

21. Does the client understand that by law he may rescind the reaffirmation agreement during the time prescribed by § 524(c)(3)?

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22. Have you reviewed with your client the options available to the creditor in the event the debtor defaults on the reaffirmed agreement?
3

23. If the client cannot make the payments and the obligation is a presumed undue Hardship, can you?

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