By Elizabeth E. Stephens

Using Appearance Counsel in Court: Risky Business?

A bankruptcy judge sitting in New York recently considered one aspect of the continuing discussion regarding the balance among providing professional services to consumer debtors, running a business and charging an affordable fee for the services. In *In re D'Arata*,[1] the court ordered debtor's counsel to disgorge all fees charged to the debtor when debtor's counsel failed to appear personally for the first, as well as the continued, § 341 meeting of creditors. Instead, he employed uninformed "appearance counsels" and failed to amend inaccurate schedules. The court easily concluded that under § 329(b) and Rule 2017(a), debtor's counsel should return the fee to the debtor.[2]

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The debtor never met his attorney, as they communicated exclusively online and telephonically. Living on an income of $1,435 per month, it took Vincent D'Arata a year to save $900 to pay counsel's legal fee.[3] The debtor knew that an attorney would represent him at the meeting of creditors, but he did not know who it would be. He was not represented by the counsel he retained; rather, his attorney sent an "appearance counsel."[4]

The *D'Arata* court described "appearance counsel" as "attorneys who appear at proceedings at the request of the debtor's chosen attorney."[5] Other courts have noted that there really is no such thing as "appearance counsel": Once an attorney makes an appearance in a bankruptcy case, he/she has made an appearance for *all* matters and must appear unless excused by the court.[6]

In *In re Bradley*, the court cataloged the inherent problems in employing appearance attorneys. Appearance attorneys are typically not fully informed and might be faced with an unanticipated situation. Further, they lack accountability due to lack of authority to speak on the debtor's behalf, which in turn promotes poor lawyering. Some attorneys never even meet with their clients, and the use of appearance attorneys ultimately results in the improper representation of the client.[7]

Furthermore, as many courts have held, the appearance of debtor's counsel at a § 341 meeting is a core obligation,[8] since it is often the only time that the debtor must appear at the courthouse. It can be intimidating, and having an attorney knowledgeable about bankruptcy and the debtor's case can lead to less anxiety and provides necessary assistance.[9]

Disgorgement Under § 329(b) and Rule 2017

With the above case law and principles in mind, the judge in *D'Arata* had no problem finding that the debtor's counsel should disgorge his fee to the debtor under § 329 and Rule 2017. Debtor's counsel failed to appear at the § 341 hearings, and the document preparation was also inadequate. Under § 329(b),

> [if] such compensation exceeds the reasonable value of such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to ... (2) the entity that made such payment.[10]

Under Rule 2017(a), after notice and a hearing the court, on motion of a party or its own initiative,

> may determine whether any payment of money or any transfer of property by the debtor, made directly or indirectly and in contemplation of the filing of a petition under the Code by or against the debtor ... to an attorney for services rendered or to be rendered is excessive.[11]

The court has broad discretion under § 329(b). The *D'Arata* judge found that "the question is whether the [sum] he was paid was excessive for what he accomplished for [the] debtor in this case."[12] Further, the court found that the value of legal services is lessened when an attorney violates ethical standards.[13] The court then found that debtor's counsel violated ethical standards when

1 ____ B.R. ____; 2018 WL 3740680 (Bankr. S.D.N.Y.).
2 *Id.* at *6. *See also* 11 U.S.C. § 329; Fed. R. Bankr. P. 2017(a).
3 *Id.* at *2.
4 *Id.* at *3.
5 *Id.* at *6.
6 *See In re Carvajal*, 365 B.R. 631, 632 (Bankr. E.D. Va. 2007); *see also In re Olson*, 2016 WL 3453341*4 (Bankr. D. Idaho 2016) (counsel appearing at § 341 meeting is representing debtor; more appropriate term is "substitute" counsel).
7 495 B.R. 747, 804-05 (Bankr. S.D. Tex. 2013). *Accord In re Jacobson*, 402 B.R. 359, 365 (Bankr. W.D. Wash. 2009). *In re Johnson*, 411 B.R. 296, 302 (Bankr. E.D. La. 2008). *See generally* Hon. Jim D. Pappas, "Simple Solution = Big Problem," *The Advocate*, October 2013 at 31.
8 *In re Castorena*, 270 B.R. 504, 530 (Bankr. D. Idaho 2001); *accord In re Seare*, 493 B.R. 158, 193 (Bankr. D. Nev. 2013) (representation at § 341 meeting is mandatory to fulfill duty of competence); *In re Johnson*, 411 B.R. 2961, 302 (Bankr. E.D. La. 2008) (unbundling appearance at meeting of creditors is *per se* unreasonable).
9 *In re Harwell*, 439 B.R. 455, 458 (Bankr. W.D. Mich. 2010).
10 11 U.S.C. § 329(b).
11 Fed. R. Bankr. P. 2017(a).
12 *D'Arata*, 2018 WL 37406809 at *5 (citing *In re Nakhuda*, 544 B.R. 886, 903 (9th Cir. 2016)).
13 *Id.* (citing *In re Damon*, 40 B.R. 367, 376 (Bankr. S.D.N.Y. 1984)).

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Sanctions under Rule 9011(c) might be initiated by a third party by motion,[24] or on the court's own initiative.[25] For motions initiated by a third party, Rule 9011(c)(1)(A) provides a safe harbor requiring a movant to serve the motion or complaint 21 days prior to filing. Further, monetary sanctions might not be awarded on the court's initiative unless the court issues an order to show cause.[26] The safe harbor provision is afforded when a third party initiates sanctions, but there is no equivalence when the court issues an order to show cause. When the court initiates sanctions by an order to show cause, a heightened standard akin to contempt is required.[27] Sanctions imposed under Rule 9011(b) must be limited to what is sufficient for deterrence of further misconduct.[28]

In *In re Bonilla*,[29] debtor's counsel failed to comply with fee-disclosure requirements. At the time of the § 341 meeting, the debtor was represented by appearance counsel. The debtor testified that he paid his attorney in full, contrary to the disclosure statement, which listed zero. He sought to pay the filing fees in installments. The chapter 7 trustee brought a motion for sanctions under Rules 9011(b) and 2016(b), as well as § 329, on a number of grounds, including under Rule 1006(b)(3), because an attorney may not receive payment from the debtor when there is a filing fee balance.

Bonilla illustrates the risk in using appearance counsel for the first meeting of creditors. The significance of the case is that it correctly analyzed the various options for imposing sanctions. The court first considered sanctions under Rule 9011(b) and rejected that option because the trustee failed to comply with the safe-harbor provision.[30]

The court next considered sanctions under § 105(a),[31] which provides in relevant part that "the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[32] The court noted that § 105(a) gave the court broad authority to exercise its equitable powers, but it does not allow the court to override other Bankruptcy Code sections. Since the case before it was not based on a court order, the *Bonilla* court declined to impose sanctions under § 105(a).

The court eventually ordered the disgorgement of fees under § 329 and Rule 2016.[33] The *Bonilla* court took the same approach to the fee issues as the *D'Arata* court in grounding the disgorgement decision in a specific statute. As the *D'Arata* court demonstrated, the determination of the value of services might be mitigated or aggravated by adherence, or lack thereof, to ethical rules and the performance of professional duties.

Ethical Pitfalls

Employing appearance counsel is a form of unbundling services. Like unbundling services, it may not be unreasonable *per se*. Nevertheless, as Hon. **Meredith A. Jury** noted in her concurrence in the *Seare* appeal, "an attorney who wishes to limit her or his scope of bankruptcy representation should be mindful of the ethical minefield he or she must navigate."[34]

While numerous state ethical rules might be implicated in the context of appearance counsel, the major ethical pitfall is the failure to obtain the client's informed consent to representation by substitute counsel. Informed consent has two components: (1) providing sufficient information; and (2) obtaining valid consent.[35] At a minimum, the use of substitute counsel must be disclosed in advance of the hearing.[36] Clearly, failure to disclose attendance by appearance counsel deprives the debtor of the ability to consent.[37]

In *Bernhardt*, the court found that under Colorado ethics rules, the client must be informed of the additional lawyer, and the fee arrangement must be fully disclosed and be accompanied by the written consent of both lawyers following the debtor's written consent. The court concluded that an attorney who requires the assistance of a non-employee must obtain (1) the filing of a Rule 2016 disclosure statement and (2) the consent of the client.[38] Further, the court in the *Olson* case noted that appearance counsel "*necessarily agreed to represent [the debtor] as her attorney, not just to appear*."[39] Any appearance by counsel necessarily triggers all the professional responsibilities due from an attorney to a client.[40]

Conclusion

The *Bradley* court summed it up admirably: "Attorneys are not fungible."[41] Debtors are entitled to representation by the counsel they retain unless they specifically consent to representation by substitute counsel. Consent must be written and informed.

Informed consent requires sufficient disclosure of information and valid consent. Counsel must meet with the client, determine the client's goals, and explain in detail the benefits or disadvantages of appearing with counsel other than the one retained. The client should also be fully informed as to the background and qualifications of the proposed substitute counsel and how he/she will be compensated. Clearly, contact information should be provided. The retainer agreement must be drafted based on the information actually conveyed to the client. Boilerplate provisions are unacceptable, and mere silence on the part of the client may not substitute for consent.

Both lead and substitute counsel are bound by the Bankruptcy Code and Rules to file disclosure statements,

24 Fed. R. Bankr. P. 9011(c)(1)(A).
25 Fed. R. Bankr. P. 9011(c)(1)(B).
26 Fed. R. Bankr. P. 9011(c)(2)(B).
27 *See Barber v. Miller*, 146 F.3d 707, 711 (9th Cir. 1988); *Nakhuda*, 544 B.R. at 899-900.
28 Fed. R. Bankr. P. 9011(c)(2).
29 573 B.R. 368 (Bankr. D.P.R. 2017).
30 *Id.* at 376-77.
31 11 U.S.C. § 105(a).
32 573 B.R. at 377.
33 *Id.* at 383-84.
34 *In re Seare*, 575 B.R. 599 (B.A.P. 9th Cir. 2014) ("*Seare II*") (Jury M., concurring).
35 *Seare*, 493 B.R. at 196-97.
36 *In re Bernhardt*, 2012 WL 646150 at *5 (Bankr. D. Colo. 2012).
37 *Id.*
38 *Id. Accord*, *In re Olson*, 2016 WL 3453341 at *6 (Bankr. D. Idaho 2016) (court found that both debtor's counsel and appearance counsel violated § 329(a) and Rule 2016(b)).
39 2016 WL 3453341 at *8 (emphasis in original).
40 *Id.*
41 495 B.R. at 808.

which describe in detail the fee agreements. While courts have generally focused on sanctioning debtor's retained counsel for statutory and ethical violations if the use of uninformed appearance counsel is indeed on the rise, courts will undoubtedly begin to focus more on the conduct of appearance counsel.[42]

Wise appearance counsel should review the petition and case notes 48 hours in advance of the hearing to ensure that there is enough time to identify possible issues, and should contact retained counsel and/or the client ahead of the § 341 meeting. Petitions might be freely amended, and a last-minute amendment might obviate a continuance.

Further, appearance counsel should be prepared to offer to amend and cooperate with the trustee if an issue arises during the meeting. Many of the cases imposing sanctions resulted from a trustee's motion for sanctions. Finally, and most obviously, appearance counsel must communicate back to retained counsel regarding the outcome of the § 341 meeting. **abi**

42 *See, e.g., In re Futreal*, 75 Collier Bankr. Cas. 2d 1085 (Bankr. W.D. Va 2016); Roy M. Terry, Jr. and Elizabeth L. Gunn, "*UpRight*: A Cautionary Tale of a National Consumer Law Firm," XXXVII *ABI Journal* 7, 32-33, 63-64, July 2018, *available at* abi.org/abi-journal.