UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

NANCY M. BROWN
CRAIG T. BROWN

CASE NO. 01-66480

Debtors

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Presently before this Court are two motions filed April 4, 2002 and June 11, 2002 ("Motions"), respectively, by the United States Trustee ("UST"), seeking the disgorgement of fees paid to American Bankruptcy Counselors ("ABC")/The Law Group, Ltd. (the "Law Group"), Chicago, Illinois, and Douglas P. Bates ("Bates"), Auburn, New York, attorneys who represented the Debtors, Nancy M. Brown and

Craig T. Brown, in connection with their chapter 7 bankruptcy. The Motions allege violations of §§ 110, 329 and 504 of the Bankruptcy Code ("11 U.S.C. §§ 101-1330) ("Code"), as well as the Disciplinary Rules of the Code of Professional Responsibility, as adopted in New York State and found as an Appendix to the New York Judiciary Law, more specifically DR 3-101 and DR 3-102.[1]

The motions were adjourned several times and were finally argued at the Court's regular motion term in Syracuse, New York, on October 1, 2002. Following the hearing, the Court reserved its decision and granted the parties the opportunity to file additional memoranda of law by November 5, 2002.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1) and (b)(2)(A).

FACTS

The Debtors, interested in resolving their debt problems, researched their options by conducting an Internet search. The Law Group, which is an Illinois professional corporation, advertises its expertise

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[1] UST's initial motion filed on April 4, 2002 ("April Motion"), made reference to a sharing of compensation in violation of Code § 504. The UST's second motion filed on June 22, 2002 ("June Motion"), makes no reference to Code § 504, but rather relies on Code §§ 110 and 329, as well as the Lawyer's Code of Professional Responsibility as adopted in New York State.

in bankruptcy through an Internet website. Upon visiting the Law Group website, the Debtors completed a questionnaire. Based on the Debtors' answers to the questions on this form, ABC, apparently an affiliate of the Law Group, determined the Debtors' suitability for bankruptcy. *See* Affidavit of Richard Grossman ("Grossman Affidavit"), sworn to on September 18, 2002, attached to Bates' Response to Trustee's Motion for Disgorgement of Fees ("Bates' Response"), filed September 26, 2002 as Exhibit B.

Thereafter, the Law Group contacted the Debtors and explained their method of doing business with regard to handling bankruptcies outside of their geographical practice area. The Law Group allegedly informed the Debtors that its attorneys would fill out the necessary paper work and contact a local attorney in the Debtors' area.[2] The local counsel, after registering with the Law Group,[3] would review the petition, possibly provide advice regarding "local issues," file the petition, and appear on behalf of the Debtors at the first meeting of creditors. For all of these services, a payment of $850 plus a filing fee of $200 was requested (a total of $1,050). Of this amount, local counsel would retain $250 for his services, $200 would be applied to filing fees and the remaining $600 would be awarded to the Law Group for its fees.[4]

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[2] The Law Group consists only of attorneys, none of whom are licensed to practice in either New York or in the federal courts of the Northern District of New York. Additionally, no evidence was provided to the Court to suggest that any of the Law Group's attorneys had attempted to appear in the Northern District of New York *pro hac vice*.

[3] The registration procedure requires that the local counsel complete a form, listing the number of years the attorney has practiced bankruptcy and the name of the attorney's malpractice insurer, among other things. *See* Grossman Affidavit. Additionally, and at the request of the Law Group, Bates completed a Bankruptcy Referral Registration Form for the purpose of having the Law Group refer future cases. *See* UST's April Motion at Exhibit A.

[4] According to the Debtors' Statement of Financial Affairs, the Debtors actually paid $850 to ABC in March 2001. The statement filed by Bates pur*sua*nt to Code § 329 and Rule 2016 of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P.") indicates that the Law Group paid him $850, not the Debtors.

The Law Group typically delegates preparation of a bankruptcy petition to one of its experienced bankruptcy attorneys. The completed petition, in its preliminary form, is then sent to a "local attorney" who meets personally with the client. The local attorney in this case, Bates, also reviews the bankruptcy petition for "completeness and accuracy" and may advise the client as to available exemptions. *See* Grossman Affidavit.[5] The Debtors' Chapter 7 petition was filed in this Court on November 1, 2001.

After the completion of the Debtors' bankruptcy proceeding and subsequent discharge, the UST filed the current motion for the disgorgement of fees.

ARGUMENTS

In her April motion, the UST argued that ABC/the Law Group and Bates violated Code § 504(a)(1), which prohibits fee sharing between attorneys in a bankruptcy case except under certain limited circumstances not present here. The UST relies on the decision of this Court in *In re Matis,* 73 B.R. 228 (Bankr. N.D.N.Y. 1987).

In her July motion, the UST argues that ABC/the Law Group engaged in the unauthorized practice of law, under certain sections of the N.Y.S. Lawyer's Code of Professional Responsibility by preparing the Debtors' petition. *See id*. The UST contends that the Law Group is comprised of attorneys who neither have a license to practice law in New York State nor are admitted to practice in the Northern District of New York. It is the UST's position that they are practicing law in New York State without a

[5] The Court notes that the record is devoid of any assertions by Bates as to what services he actually provided to the Debtors.

license by providing legal counseling and advice regarding the selection of specific New York State exemptions.

Additionally, the UST argues that the retention of Bates as local counsel serves as "merely a subterfuge for the unauthorized practice" because the Law Group maintained control over the case after the introduction of local counsel. *See* UST's June Motion at ¶¶ 9 and 10. The UST also asserts that the Law Group is not acting as counsel for the Debtor, but rather is "a clearinghouse for preparing bankruptcy petitions and retaining cooperative local attorneys to represent a particular debtor in the district where the petition is to be filed." *Id.* at ¶ 2. The UST argues that such an operation, combined with the fact that the fees charged by the Law Group exceed those allowed to be charged for the mere preparation of a bankruptcy petition in the Northern District of New York, violates Code. § 110 and/or § 329.

In opposition, Bates argues that the Law Group is not a bankruptcy petition preparation service, but a law firm comprised of attorneys who generate bankruptcy petitions and essentially arrange for a local attorney to file the petitions and represent the debtors in their respective jurisdiction. *See* Bates' Response at 2-3. Bates contends that the Law Group was not engaged in the unauthorized practice of law and asserts that there is nothing improper in allowing the Law Group to be paid for its work in marshaling the information needed for bankruptcy and working with the Debtors to prepare a preliminary draft of the bankruptcy petition. *Id.* at 6.[6] Furthermore, Bates asserts that "virtually every state that has examined the issue allows its attorneys to divide fees with out of state lawyers provided in-state ethical requirements are

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[6]Bates cites to *In re Desilets*, 291 F.3d 925 (6th Cir. 2002) as support for this position. *In re Desilets*, the Sixth Circuit found that an attorney who was licensed to practice law in Texas and lived in Wisconsin was allowed to practice law in the United Stated District Court for the Western District of Michigan on the basis of his Texas law license so long as he limited his practice to bankruptcy matters in federal court.

satisfied." *Id.* at 3 (citations to various state ethics opinions omitted).

Finally, Bates contends that the UST's reliance upon Code. § 504(a) is misplaced, because Code § 504 does not apply to Chapter 7 consumer bankruptcy, but "is limited to situations in which an attorney (or some other professional) is hired by a trustee, a creditor or a committee to perform services for the bankruptcy estate, and that person subsequently seeks compensation or reimbursement from the estate." *See* Bates' Additional Memorandum in Opposition to UST's Motion for Disgorgement of Fees, filed October 31, 2002 ("Bates Memorandum") at 1.

DISCUSSION

Violation of New York Code of Professional Responsibility

The UST seeks, in her June Motion, to recover fees paid to the Law Group alleging that it engaged in the "unauthorized practice of law" in contravention of the N.Y.S. Lawyer's Code of Professional Responsibility, DR 3-101 and 3-102. "The N.Y.S. Lawyer's Code of Professional Responsibility as adopted from time to time by the Appellate Divisions of the State of New York, and as interpreted and applied by the United States Court of Appeals for the Second Circuit shall be enforced by [the District Court for the Northern District of New York]." *See* Local Rule 83.4(j) of the Local Rules of Practice of the United States District Court for the Northern District of New York. Although not expressly set out in the Local Rules of this Court, attorneys practicing before this Court are expected to comply with the same code of professional conduct.

In this case, a close reading of the disciplinary rules cited by the UST reveals that the UST's

reliance upon them is misplaced. DR 3-101 is entitled "Aiding Unauthorized Practice of Law." It does not address the unauthorized practice of law such as is alleged by the UST herein, but rather, to the extent applicable here, prohibits the unlicensed practice of law. *See* DR 3-101(B). In addition, DR 3-102 is directed at fee sharing with a non-lawyer and is clearly inapplicable to the matter *sub judice*.

11 U.S.C. § 504

The UST also asserts that the arrangement between the Law Group and Bates violates Code § 504 which prohibits fee sharing under certain circumstances. This Court addressed this topic long ago in *In re Matis*, 73 B.R. 228. In that case, which was filed pursuant to Chapter 11 of the Bankruptcy Code, the debtor had paid two attorneys a total of $5,000 as a prepetition retainer. The two attorneys involved in the case occupied the same office suite but were found not to be "associates." The debtor had been referred by his regular non-bankruptcy attorney to an initial bankruptcy attorney, who in turn introduced him to a second bankruptcy attorney due to the latter attorney's familiarity with Chapter 11 bankruptcy. Upon filing, the debtor apparently had no further contact with his initial bankruptcy attorney. This Court allowed the initial attorney to retain $525 of the retainer for work he had performed prepetition. Further, it allowed the Chapter 11 attorney a fee of $5,250 for services rendered post-petition, which included his share of the initial retainer, namely $2,500, disallowing only 1 3/4 hours of service rendered before he was appointed by the Court to represent the Debtor pursuant to Code § 327.

In the contested matter *sub judice*, Bates does not dispute that he received $250 in attorney's fees and $200 in filing fees from the Law Group. If, as the disclosure of compensation indicated, the Debtors' paid $1,050, then the Law Group presumably retained $600 for initially preparing the petition. *See*

correspondence from the Law Group to Bates, dated September 24, 2001, attached to UST's Motions as Exhibit A.

Code § 504 provides that any person or entity receiving compensation under Code §§ 503(b)(2) or 503(b)(4) is precluded from sharing that compensation with anyone else, except if the person with whom the compensation is to be shared is "a member, partner, or regular associate in a professional association, corporation, or partnership." 11 U.S.C. § 504. Therefore, it is necessary to examine Code §§ 503(b)(2) and 503(b)(4) in order to determine whether or not Code § 504 applies to the facts here.

Code § 503(b)(2) provides that compensation awarded pursuant to Code § 330(a) is allowed as an administrative expenses. An examination of the statutory language of Code § 330(a) indicates that compensation may be awarded to parties who fall into one of four categories: (1) a trustee, (2) an examiner, (3) a professional hired under Code § 327, or (4) a professional hired under Code § 1103. This Court agrees with Bates that an attorney representing a debtor in a Chapter 7 bankruptcy case does not fall into any of these four categories. *See* Bates' Memorandum at 3.

Thus, the Court turns to the examination of Code § 503(b)(4) as a possible statutory bar to fee sharing. Code § 503(b)(4) allows administrative expenses for reasonable compensation to those who have represented, generally, a creditor, custodian or committee member whose expenses qualify for reimbursement under Code § 503(b)(3). This Court further agrees with Bates that an attorney representing debtors in a Chapter 7 bankruptcy case does not fall within the parameters of Code § 503(b)(4) and would not be compensated pursuant to that section. *See* Bates' Memorandum at 4.

The intent of Congress in limiting the instances where fee sharing is allowable is to "'preserve the integrity of the bankruptcy process . . . [so that professionals engaged in bankruptcy cases] attend to their

duty as officers of the bankruptcy court, . . . rather than treat their interest in bankruptcy cases as matters of traffic.'" *Matis*, 73 B.R. at 231-32, quoting 3 COLLIER ON BANKRUPTCY, ¶ 504.02[1] at 504-8 & 9 (15th ed. 1986). In the case at hand, the sharing of fees aided the Debtors in completing the Chapter 7 bankruptcy process. There has been no suggestion that the Debtors were inadequately represented notwithstanding the assertion of the UST that ABC/the Law Group is a "clearinghouse for preparing bankruptcy petitions." Therefore, following the Court's decision in *Matis*, the Law Group and Bates should be able to retain a portion of the total fee for their prepetition services for which there could be no administrative claim pursuant to Code §§ 503(b)(2) or 503(b)(4).[7]

11 U.S.C. § 110

> [C]ompetent representation requires the attorney to provide services that are necessary to achieve the basic, fundamental objectives of the representation. If the lawyer does nothing more than prepare the petition, statement, schedules and related documents and attend the § 341 meeting, the lawyer has done little more than a petition preparer [Footnote omitted]. At best, such representation will have provided the debtor with some preparation and advice . . . .

In re Egwim, 291 B.R. 559, 572 (Bankr. N.D. Ga. 2003).

In this case, the petition, statement of financial affairs and schedules were prepared by attorneys at the Law Group, which is comprised of attorneys who use "his or her own computer to generate a preliminary draft of a bankruptcy petition" and do not employ paralegals for these functions. *See* Bates'

[7] Arguably, a portion of the services rendered by Bates were actually rendered post-petition in that he appeared with the Debtors at the Code § 341 meeting of creditors, as well as appearing in defense of the Motions. Nevertheless, the portion of the compensation paid to Bates cannot be construed as having any relation to Code § 503(b)(2) or (b)(4).

Response at 2. Code § 110(a)(1) defines a "bankruptcy petition preparer" as "a person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing." Absent any further factual background, this Court views the Law Group not as petition preparers, but as attorneys, to whom Code § 110 does not apply.

11 U.S.C. § 329

The Agreement[8] signed by Bates, Grossman and Daniel M. Leibsker, an attorney with ABC, indicates that "[e]ach of the above mentioned parties [that have agreed to share the attorneys fees paid by the Debtors] will remain responsible for the completion of the legal work in this matter and responsible for the legal work of each." *See* Attachment to Disclosure of Compensation of Attorney for Debtor, included in the Debtors' petition pursuant to Code § 329(a) and Fed.R.Bankr.P. 2016(b). Having determined that Code § 110 is inapplicable to the case herein, the Court concludes that Bates and ABC/the Law Group must comply with Code § 329, which requires that "[a]ny attorney representing a debtor must file a statement of compensation paid or agreed to be paid 'whether or not such attorney applies for compensation.' 11 U.S.C. § 329. . . . The statement shall include the particulars of any such sharing or agreement to share by the attorney . . . ." *In re Greer*, 271 B.R. 426, 430 (Bankr. D. Mass. 2002).

Bankruptcy Rule 2016(b) applies to every attorney employed by the debtor, regardless of the purpose for which the attorney is retained. 11 U.S.C. § 329(a). The purpose for filing of a disclosure statement of compensation pursuant to Code § 329(a) and Fed.R.Bankr.P. 2016(b) is to provide a bankruptcy court with sufficient statutory authority to supervise the terms of any financial agreements

[8] The Agreement was also signed by the Debtors.

between a debtor and its counsel. *See Halbert v. Yousif*, 225 B.R. 336, 352 (E.D. Mich. 1998) (citation omitted); *see also In re Bell*, 212 B.R. 654, 657 (Bankr. E.D. Cal. 1997) (indicating in *dicta* that "[r]eview of the Rule 2016(b)/Section 329(a) statement enables the court or interested parties to determine if it is appropriate to set a hearing pursuant to 11 U.S.C. § 329(b) to consider cancelling the fee agreement or ordering disgorgement of the fees.").

In this case, Bates filed a statement disclosing compensation of $850 received allegedly from the Law Group. The Debtors' Statement of Financial Affairs indicates that the $850 was actually paid to AMC by the Debtors in March 2001. Bates' Statement should have been more specific, reflecting the fact, as presented to this Court, that he received only $250. Furthermore, a separate statement should have been filed by ABC/the Law Group, specifying the fees received from the Debtors and the amount to be paid to Bates for his services pursuant to the Agreement.

Once a court determines that an attorney has violated § 329 and Bankruptcy Rule 2016, the Court has the authority to order the attorney to disgorge all of his fees. *See In re Basham*, 208 B.R. 926, 931 (B.A.P. 9th Cir.1997) (citation omitted). A "'court may exercise its discretion and deny or reduce fees for counsel's failure to disclose its fee arrangements, whether or not actual harm accrues to the estate.'" *In re Central Florida Metal Fabrication, Inc.*, 207 B.R. 742, 749 (Bankr.N.D.Fla.1997), quoting *In re Saturley*, 131 B.R. 509, 517 (Bankr. D. Me. 1991). Furthermore, noncompliance with Code § 329 and Fed.R.Bankr.P. 2016, even if negligent or inadvertent, serves as a basis for the Court to order disgorgement of fees. *Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.)*, 63 F.3d 877, 881 (9th Cir.1995), *cert. denied*, 516 U.S. 1049, 116 S.Ct. 712, 133 L.Ed.2d 667 (1996) (citation omitted).

In addition, the Court possesses the power to require disgorgement of fees paid pre-petition that exceed the reasonable value of similar services under Code § 329(b).[9] As noted above, Bates did file a statement disclosing the compensation he received for his services, which included reviewing the Debtors' petition for completeness and accuracy, advising them on the exemptions available to them under New York law and appearing on their behalf at the § 341 meeting of creditors. According to the statement, he received $850 for those services from the Law Group with whom he shared the monies, although there is nothing in the statement that specifies the allocation of the monies. A review of a cross-section of Chapter 7 petitions filed during the latter part of 2001 in the Northern District of New York indicates that the fees charged, on average, were approximately $600.[10] Thus, $850 exceeds the average fees charged in this district. However, based on the information provided to the Court which he failed to disclose in his statement, Bates actually received $250. The Court concludes that his fees were reasonable, and he need not disgorge them, having complied with the disclosure requirements of Code § 329 and Fed.R.Bankr.P. 2016. However, the Court finds that $600 paid to the Law Group for the preparation of the Debtors' petition does exceed the reasonable value for such services. In addition, as discussed above, the Law Group, as Debtors' attorneys, failed to file a statement with the Court disclosing the amount of fees it received. Based on the Court's finding that the attorneys employed by the Law Group do not constitute

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[9]In accordance with *In re Telford*, 36 B.R. 92 (BAP 9th Cir.1984), where the Court held that § 329 grants bankruptcy courts the right to review fees regardless of whether the person charging the fees is a licensed attorney, this Court has the jurisdiction to determine the reasonableness of fees paid prepetition.

[10] The Court examined the fees charged in twenty-four chapter 7 cases in 2001, without determining the complexity of the cases and the services rendered for those fees. It eliminated any fees in excess of $1,000, of which there were four, and calculated an average fee of $604 per case. This is somewhat higher than the estimate of the UST of approximately $500.

bankruptcy petition preparers, it must judge the fees paid by those typically charged by attorneys in Chapter 7 cases filed within the Northern District of New York, keeping in mind that a portion of the services were rendered by Bates, an attorney admitted to practice before this Court. The Court concludes that the Law Group has overcharged the Debtors in the amount of $250 and shall disgorge said amount by paying same to the Debtors[11] within fifteen (15) days of the date of this order, with proof of payment being provided to the UST within said period.

IT IS SO ORDERED.

Dated at Utica, New York

this 19th day of May 2003

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

[11] As the monies were paid by the Debtors in March 2001 and the case was not commenced until November 2001, it is unlikely that the monies would be property of the estate. Even if they were, the Debtors claimed a cash exemption of $975. Pursuant to § 283 of the New York Debtor and Creditor Law, they would have been entitled to a maximum of $2,500. Awarding them the $250 will still place them under that maximum.