Virginia Beach Bar Association Vegas 2017 Seminar Itinerary at the Palazzo October 5-8, 2017

Thursday, October 5-

Arrival Cocktail Party 5:00-8:00pm (open bar with heavy hors d'oeuvres)

Friday, October 6-

8:30-9:00 a.m. Breakfast at Grand Lux Café on site at Palazzo.

9:00-11:00 a.m. October 6, 2017, at 9:00 a.m. Grand Lux Café, Palazzo Hotel Las Vegas (Presented by Christopher Jacobs, Kalfus & Nachman with Materials Credited to the Virginia State Bar and Reproduced with Permission of James McCauley, Bar Counsel).

1. Ethics Update
2. Sanctions Hypotheticals
3. Sanctions Written Materials
4. Top 10 Bar Complaints
5. Vignettes with a Twist
6. Aspirational timeline
7. Virginia Rules of Professional Conduct 2017

11:30 a.m. to 6:00 p.m. Cabana the Pool Club with Cocktails.

Saturday, September 24-

8:30-9:00 a.m. Breakfast at Grand Lux Café on site at Palazzo

9:00-11:00 a.m. October 7, 2017, at 9:00 a.m. Grand Lux Café, Palazzo Hotel Las Vegas (Presented and Composed by Jeffrey Marks, Kaufman & Canoles)

1. CREDITORS' RIGHTS AND BANKRUPTCY LAW FOR NORMAL LAWYERS (aka, The Basics For State Court Practitioners)See Attached detailed Outline.
   a. From Filing suit to Discharge- See attached materials

11:30 a.m. to ? Poolside relaxation and mingle with colleagues.

Sunday, September 25-

Departure (various times depending on flight times)

Ethics Update 2017: Hot Topics

1. Conflicts—Lobbying Firms that employ legislator—LEO 1884

This opinion addresses a situation where a lawyer who is a member of the Virginia General Assembly joins a consulting firm. The consulting firm is owned by a law firm composed of Virginia lawyers and it employs both lawyer and non-lawyer lobbyists and consultants. The lawyer asks whether the lawyers and nonlawyers in the consulting firm would be barred from lobbying the General Assembly if he joined the consulting firm, and further, whether that bar would extend to members of the law firm as well.

In this opinion, the Committee concluded that **both lawyers and nonlawyers in the consulting firm, as well as the lawyers in the law firm that own the consulting firm, would be barred from representing clients or otherwise lobbying before the General Assembly if a lawyer in the consulting firm were a member of the General Assembly.** This conclusion follows from prior legal ethics opinions that establish that a lawyer may not lobby a public body if another member of the lawyer's firm is a member of that public body. For purposes of Rules 1.11(a) and 8.4(d), there is no reason to distinguish between lawyers associated in a law firm and lawyers associated in a consulting firm. Because a lawyer may not circumvent the Rules of Professional Conduct by using others to engage in conduct that he could not personally engage in, a lawyer may not permit his non-lawyer colleagues to appear before the General Assembly under these circumstances.

The opinion further concludes that **the lawyers in the law firm that own the consulting firm are prohibited from appearing before the General Assembly while a member of the consulting firm is also a member of the General Assembly.** To conclude otherwise would be to place form over function and essentially allow the firms to use a screen to avoid the conflict created by the General Assembly member's employment by the consulting firm.

2. Lawyer Impairment—Duty of Supervising Lawyer—LEO 1886[1]

Substance abuse, mental health issues, and other causes of physical or mental impairment can be among the hardest issues for lawyers to acknowledge in themselves or in others, including their partners and colleagues. Lawyers are understandably reluctant to suggest that a colleague is suffering from an impairment, especially when the nature of the impairment is such that the colleague may not be aware of her own issues. However, partners and other lawyers who have

This topic was written by Emily F. Hedrick, Assistant Ethics Counsel, and used with permission.

managerial authority over other lawyers in a firm may not ignore the impairment of another lawyer in the firm.

Legal ethics opinion 1886, approved by the Supreme Court of Virginia on December 15, 2016, makes clear that **Rule of Professional Conduct 5.1 requires a partner or other lawyer with managerial authority in a firm to take precautionary measures before a lawyer's impairment results in serious misconduct or a material risk to client or the public. This means that partners and supervisory lawyers are required to take action when they reasonably believe that another lawyer in the firm may be suffering from a significant impairment. This duty is different from the duty to report another lawyer's misconduct under Rule 8.3(a); there is an independent duty to ensure that the impaired lawyer does not engage in misconduct even if she has not already done so.**

In practical terms, the first step for the firm (acting through its partners or other managing lawyers) when it believes that a lawyer in the firm is suffering from an impairment will be to confront the impaired lawyer and strongly encourage her to seek an appropriate evaluation and/or treatment for her impairment. Lawyers Helping Lawyers, an independent, non-disciplinary and non-profit organization that assists legal professionals and their families dealing with depression, addiction and cognitive impairment, may be able to help with figuring out how best to handle this confrontation and with finding resources to refer the lawyer to for assistance or treatment. LHL or other professionals may be able to assist the firm in determining how to manage an impaired lawyer and how to evaluate what level of involvement by the firm is necessary and appropriate.

Depending on the nature and extent of the impairment, and the nature of the firm's practice, the firm may be able to allow the lawyer to continue to practice with limitations and supervision — for example, a lawyer who has no problem drafting documents when there is no external pressure from short deadlines or other demands, but who cannot maintain composure in an adversarial situation, may be able to limit her practice to research and writing while being removed from any time-sensitive matters or matters involving contact with other parties. On the other hand, the lawyer may be so impaired that she cannot competently practice law at all, and the firm may need to forbid her from working at the firm and insist that she seek appropriate assistance, counseling, therapy, or other treatment as a condition of returning to work at the firm.

In addition to proactively addressing an impairment before clients are affected, the other lawyers in the firm need to evaluate whether the impaired lawyer has already committed misconduct that raises a substantial question as to her honesty, trustworthiness, or fitness to practice law. If so, Rule 8.3(a) requires them to report that misconduct, even if the firm has already taken steps to address the misconduct and prevent it from recurring in the future and even if the impairment has already been reported to Lawyers Helping Lawyers. As the LEO explains: "The report to the lawyer disciplinary agency is necessary to address the misconduct and protect the public. The report to the lawyer assistance program [LHL] is necessary to address the underlying illness that may have caused the misconduct." Note, though, that the duty to report is subject to the duty of confidentiality to the firm's clients, and a lawyer's misconduct cannot be reported if the client refuses to allow disclosure of confidential information necessary to make the complaint.

3. Lawyer Advertising Rule Amendments Adopted by the Supreme Court of Virginia Effective July 1, 2017.

The Standing Committee on Legal Ethics proposed significant revisions to Rules 7.1-7.5, governing lawyer advertising, including the **deletion of Rules 7.4 and 7.5 and the streamlining of Rule 7.1 to a single statement that communications about a lawyer's services may not be false or misleading.**[2] Claims of specialization and the content of firm names, previously addressed by Rules 7.4 and 7.5 respectively, are addressed now by comments to Rule 7.1, since they are just specific examples of the general obligation not to make false or misleading statements. The required disclaimer for statements of case results has been removed from Rule 7.1, again shifting to a general false or misleading standard rather than a mandatory technical requirement. Only minor changes were made to Rule 7.3, on solicitation of clients, to more clearly define the term "solicitation" and to expand the comments to more clearly explain how the Rules apply to paying for marketing services, including paying for lead generation.

The proposed changes to Rules 7.1, 7.4, and 7.5 largely derive from a report and recommendation issued by a committee of the Association of Professional Responsibility Lawyers (APRL) describing the need to simplify and modernize lawyer advertising rules in light of changes caused by the rise of Internet marketing and communications, and in light of increasing concern about the viability of constitutional or antitrust challenges to advertising regulations. Many advertising rules were developed in a time when print advertising was primary, and therefore are unwieldy or impractical when applied to now-common Internet communications. For example, the requirement that a disclaimer must precede each statement of case results makes it impossible to ever mention a case outcome on Twitter, because the disclaimer alone would exceed the character limit of a Twitter post. The cross-border nature of Internet communications also raises difficult issues, as advertising rules vary greatly from state to state and lawyers often find it impossible to comply with all the rules that could possibly apply to their communications.

Surveys conducted by APRL as part of its study of states' approaches to the advertising rules show that the majority of complaints about lawyer advertising come from competing lawyers and involve technical rule violations; consumer complaints about lawyer advertising are rare, and when they are made, generally involve communications or conduct that are clearly false and misleading. These findings suggest that technical requirements, like the specifically required

---

[2] Rule 7.2 was deleted in 2013 when parts of that rule were merged into Rules 7.1 and 7.3. If the Supreme Court of Virginia adopts the 2017 proposed amendments, Rules 7.1 and 7.3 will comprise all regulation of lawyer advertising and solicitation. This is a significant step toward deregulation and simplification of regulation.

text and placement of the case results disclaimer currently present in Rule 7.1(b), may not be justified by the need to protect clients or the public.

The Committee also considered the APRL committee's analysis of a number of case decisions in the last decade that have struck down lawyer advertising rules, and the fact that restrictions on speech are particularly vulnerable when there is a lack of empirical support for the necessity of the restriction. The recent United States Supreme Court decision in *North Carolina State Board of Dental Examiners v. F.T.C.,* 547 U.S. ___, 135 S. Ct. 1101 (2015), has also raised concerns for regulators about the possibility of increased antitrust scrutiny of regulatory actions, particularly if it appears that the regulation is being carried out by lawyers with a competitive interest in the market.

The Committee determined, based on all of these factors, that the best option is to adopt the APRL committee's recommendation to streamline the rules to focus on the core issue of preventing false or misleading speech, as well as the specific concerns raised by solicitation of clients, and to otherwise remove or relax technical regulations that have no demonstrated connection to public protection.

Comments on the proposed amendments were strongly positive. The only change that the Committee made to the proposed rules in light of the comments was to change "communication" to "solicitation" in Rule 7.3(c), as suggested by Brett Callahan's comment. In response to a comment from Cullen Seltzer that arrived after the Committee approved the proposed rules for submission to Council, the Committee Chair is proposing that Council further revise Rule 7.3(c)(4) so that the rule will read "is contacted pursuant to a court-ordered notification." A court might order a lawyer to send a communication to unrepresented persons in a context that is not a class action, and it should be clear that any such communication is not subject to the rule requiring solicitations to be labeled as "advertising material."

At the VSB Council Meeting on February 25, 2017, Council voted 65-1 to petition the Supreme Court of Virginia to adopt the proposed rule amendments. The Supreme Court of Virginia has adopted all the proposed changes effective July **1,** 2017.

4. Amendments to Rules 1.6 and 3.3—Client Perjury—Adopted by the Supreme Court of Virginia Effective December 16, 2016.

Effective December 16, 2016, these rule amendments adopted by the Supreme Court of Virginia clarify a lawyer's obligations when a client discloses her intent to commit perjury well in advance of trial, when the lawyer can withdraw from the representation before the client's intended perjury occurs. Under the prior version of Rule 1.6(c)(1), the lawyer was arguably required to report the client's intention to commit perjury once that intention is expressed, even if that occurs long before trial. This interpretation of the rule, however, is inconsistent with the comments to Rule 3.3 that specifically address the issue of client perjury, and indicate that withdrawal before trial is generally a sufficient remedy.

RULE 1.6

After consideration of the apparent conflict between Rule 1.6(c)(1), requiring immediate disclosure, and the comments to Rule 3.3 that provide that **withdrawal is the appropriate remedy when the client's intent is expressed in advance of trial, the Court accepted the Committee's position that Rule 3.3 expresses the correct approach to client perjury.** The Committee has revised Rule 1.6(c)(1) to resolve any doubt about its application and to clarify that Rule 3.3 sets out the lawyer's obligations if the client intends to commit perjury. Rule 1.6(c)(2) was deleted in its entirety, since the lawyer's obligation when a client commits fraud on a tribunal is already addressed by Rule 3.3.

Rule 1.6(c)(1) now requires a lawyer to report only future crimes that are "reasonably certain to result in death or substantial bodily harm to another or substantial injury to the financial interests or property of another," rather than requiring disclosure of a client's intent to commit *any* crime, no matter how minor. On its face, former Rule 1.6(c)(1) required the lawyer to report the client's intent to go fishing without a license or other misdemeanor offense. These revisions better balance the lawyer's duty of loyalty to her client with the lawyer's duty to society.

The amendments do not change the strict requirement in Rule 1.6(c)(1) that before reporting the client's stated intent to commit a future crime, the lawyer must first persuade the client, when feasible, to abandon his/her intent. In this regard, Comment [7c] observes:

> Third, the lawyer may learn that a client intends prospective criminal conduct. As stated in paragraph (c)(1), the lawyer is obligated to reveal such information if the crime is reasonably certain to result in death or substantial bodily harm to another or substantial injury to the financial interests or property of another. Caution is warranted as it is very difficult for a lawyer to "know" when proposed criminal conduct will actually be carried out, for the client may have a change of mind. If the client's intended crime is perjury, the lawyer must look to Rule 3.3(a)(4) rather than paragraph (c)(1).

A strict reading of Rule 1.6(c)(1) suggests that the only time a lawyer *is required* to report the client's intent to commit a crime is only if the client has stated an intent to do so. Suppose a lawyer has information that clearly establishes the client's intent to commit a crime reasonably certain to result in death or substantial bodily harm to another, but the client has not stated his intent to the lawyer? Under newly added paragraph (b)(7), it appears that the lawyer could *permissibly* make the disclosure he or she may not feel obligated to report under paragraph (c)(1).

The amended Rule 1.6 adds a seventh provision to paragraph (b), permitting disclosure when reasonably necessary to "prevent reasonably certain death or substantial bodily harm." This provision mirrors ABA Model Rule 1.6(b)(1), and permits the lawyer to disclose information about actions by the client or third parties that are reasonably certain to lead to death or substantial bodily harm, even if the harm is not the result of a crime. The amendments revised various comments to the Rule to reflect these changes.

RULE 3.3

Comments to Rule 3.3 were revised and added in order to more thoroughly address the lawyer's obligations in cases of false evidence or testimony, now that Rule 3.3 is clearly established as the sole source of the lawyer's obligations in these situations. Paragraph (d) clarifies that the lawyer only has a duty to reveal a third party's fraud upon a tribunal *when that fraud occurs in the course of a proceeding in which the lawyer is representing a client* — a lawyer does not have a general obligation to disclose fraud by third parties when the lawyer is not involved in the case at all.

The adopted rule amendments added paragraph (e) and accompanying comment [15], both from the ABA Model Rule, to establish and explain a definite time limit on the lawyer's duty to disclose and rectify false evidence or false statements made to the Court. The rules require, and will continue to require, that **if a lawyer knows that a client has committed perjury, the lawyer must report that fact to the court promptly. The duty to report client perjury will not apply if the client's perjury is revealed to the lawyer *after* a final order has been entered and the time for an appeal has expired.** This is a departure from the prior rule. The bar and Court concluded that a more sensible time limit on the duty to report is at the conclusion of the proceeding after a final order has been entered and the time for an appeal has run. This time limit strikes a better balance by requiring disclosure of the client's perjury when the matter is still before the Court and there is a greater likelihood that remedial action will be possible and effective, but protecting the client's confidences once the matter is final.

5. Rule 1.6(d)—Cybersecurity and Duty to Protect Client Data—Adopted by the Supreme Court of Virginia, Effective March 1, 2016.

Rule 1.6(d):

A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information protected under this Rule

<u>Acting Reasonable to Preserve Confidentiality</u>

[19] **Paragraph (d) requires a lawyer to act reasonably to safeguard information protected under this Rule against unauthorized access by third parties and against inadvertent or unauthorized disclosure by the lawyer or other persons who are participating in the representation of the client or who are subject to the lawyer's supervision.** See Rules 1.1, 5.1 and 5.3. The unauthorized access to, or the inadvertent or unauthorized disclosure of, confidential information does not constitute a violation of this Rule if the lawyer has made reasonable efforts to prevent the access or disclosure. Factors to be

considered in determining the reasonableness of the lawyer's efforts include, but are not limited to, the sensitivity of the information, the likelihood of disclosure if additional safeguards are not employed, the employment or engagement of persons competent with technology, the cost of employing additional safeguards, the difficulty of implementing the safeguards, and the extent to which the safeguards adversely affect the lawyer's ability to represent clients (e.g., by making a device or important piece of software excessively difficult to use).

[19a] Whether a lawyer may be required to take additional steps to safeguard a client's information in order to comply with other laws, such as state and federal laws that govern data privacy or that impose notification requirements upon the loss of, or unauthorized access to, electronic information, is beyond the scope of this Rule.

[20] Paragraph (d) makes clear **that a lawyer is not subject to discipline under this Rule if the lawyer has made reasonable efforts to protect electronic data, even if there is a data breach, cyber-attack or other incident resulting in the loss, destruction, misdelivery or theft of confidential client information.** Perfect online security and data protection is not attainable. Even large businesses and government organizations with sophisticated data security systems have suffered data breaches. Nevertheless, security and data breaches have become so prevalent that some security measures must be reasonably expected of all businesses, including lawyers and law firms. **Lawyers have an ethical obligation to implement reasonable information security practices to protect the confidentiality of client data.** What is "reasonable" will be determined in part by the size of the firm. See Rules 5.1(a)-(b) and 5.3(a)-(b). The sheer amount of personal, medical and financial information of clients kept by lawyers and law firms requires reasonable care in the communication and storage of such information. A lawyer or law firm complies with paragraph (d) if they have acted reasonably to safeguard client information by employing appropriate data protection measures for any devices used to communicate or store client confidential information.

To comply with this Rule, a lawyer does not need to have all the required technology competencies. The lawyer can and more likely must turn to the expertise of staff or an outside technology professional. Because threats and technology both change, lawyers should periodically review both and enhance their security as needed; steps that are reasonable measures when adopted may become outdated as well.

[1] Because of evolving technology, and associated evolving risks, law firms should keep abreast on an ongoing basis of reasonable methods for protecting client confidential information, addressing such practices as:

(a) Periodic staff security training and evaluation programs, including precautions and procedures regarding data security;

(b)Policies to address departing employee's future access to confidential firm data and return of electronically stored confidential data;

(a) Procedures addressing security measures for access of third parties to stored information;

(b)Procedures for both the backup and storage of firm data and steps to securely erase or wipe electronic data from computing devices before they are transferred, sold, or reused;

(c) The use of strong passwords or other authentication measures to log on to their network, and the security of password and authentication measures; and

(d)The use of hardware and/or software measures to prevent, detect and respond to malicious software and activity.

Cloud Computing and Virtual Law Offices

LEO 1872: Rule 1.6 requires the lawyer to act with reasonable care to protect information relating to the representation of a client. When a lawyer is using cloud computing or any other technology that involves the use of a third party for the storage or transmission of data, the lawyer must arrangements between the law firm and the third-party vendor to follow Rule 1.6(b)(6) and exercise care in the selection of the vendor, have a reasonable expectation that the vendor will keep the data confidential and inaccessible by others, and instruct the vendor to preserve the confidentiality of the information. The lawyer will have to examine the third-party provider's use of technology and terms of service in order to know whether it adequately safeguards client information, and if the lawyer is not able to make this assessment on her own, she will have to consult with someone qualified to make that determination.

Hacker Steals Lawsuit Settlement Funds

Bile v. RREMC, LLC and Denny's Corp, Civ. Action. No. 3:15cv051 (Eastern Dist. Va., J. Payne, Aug. 24. 2016)

Plaintiff and Defendant reached a settlement of an employment discrimination lawsuit. Each side filed motions to enforce the settlement after Defendant's counsel inadvertently delivered to a hacker the settlement proceeds. At a settlement conference, the parties agreed to settle the case for $63,000 and executed a settlement agreement. A hacker obtained access to Plaintiff's e-mail account, obtained knowledge of the pending settlement and sent an e-mail to defense counsel, posing as Plaintiffs counsel, with instructions to wire the settlement funds to an account purporting to be the Plaintiff's account in London. Defense counsel complied and wired the settlement funds to the account as instructed. Two days later Plaintiff's counsel called Defense counsel to inquire about the status of the funds at which point counsel realized that the e-mail with the wire transfer instructions did not originate from Plaintiff's counsel. Defendant's counsel unsuccessfully tried to claw back the wired funds. Plaintiff refused to discontinue the lawsuit and Defendant refused to pay another $63,000.

At issue was the fact that Plaintiff's counsel earlier received an email from an "aoi.com" account that was visually similar to Plaintiff's legitimate aol.com account, with instructions to wire the settlement funds to a particular account in Plaintiff's name at Barclay's in London. Shortly thereafter, Plaintiffs counsel verified that his client did not send that particular email. Plaintiffs counsel deleted the email without alerting Defendants' counsel or the Court to the fact that his client's email account was compromised and that he had received what he considered a fraudulent email. Judge Payne made a finding that Plaintiff and his counsel had actual knowledge a malicious third party was targeting the settlement for a fraudulent transfer to an overseas account that did not belong to Plaintiff.

Judge Payne found that Defendants substantially performed under the settlement agreement and therefore were entitled to substantial performance by Plaintiff under the agreement. Citing UCC law regarding third-party fraud and depositing checks at a bank, the Court noted that a party whose failure to take ordinary care results in loss must be the party to bear that loss. The Court also noted that a blameless party [defendants] is entitled to rely on reasonable representations, even when those representations are made by fraudsters. The Court stated:

> The parties have cited no decision articulating that an attorney has an obligation to notify opposing counsel when the attorney has actual knowledge that a third party has gained access to information that should be confidential, such as the terms of a settlement agreement, or the attorney has knowledge that the funds to be paid pursuant to a settlement agreement have been the target of an attempted fraud. Nor has the Court located such authority. However, the principle is an eminently sensible one . . . that attorneys have an obligation to contact [opposing] counsel when and if they receive suspicious emails instructing [them] to wire settlement funds to a foreign country where such [a] request has never been made during the course of performance of the parties. . . . [Plaintiffs counsel] failed to act with the ordinary care that he, correctly, says should govern this case.
>
> Two days before the fraud was perpetrated on [defense counsel], both [plaintiff's counsel] and [plaintiff] were aware that an unidentified third party had targeted the settlement funds for diversion to a Barclay's account that had nothing to do with [Plaintiff]. Additionally, [both] knew that the email account [for Plaintiff's counsel] was being used in an effort to perpetrate a fraud. [Plaintiff's counsel] failed to pass this information along to Defendants, defense counsel or the Court. This failure substantially contributed to the loss of $63,000 within the meaning of U.C.C. §3-406.

Law Firms Continue to Be Hacked by Cybercriminals

Last year, Cravath, Swaine & Moore and Weil Gotshal & Manges, two of the largest firms in the United States, got caught in a major cybersecurity breach later linked to a $4 million-plus insider-trading scheme. Cybersecurity firm Mandiant estimated that 80 of the largest 100 firms in the country, by revenue, have been hacked since 2011. Other law firms are finding their information systems infected by malware simply because an employee opened a file attachment to an e-mail. The firm will typically have to take down their entire network, run applications to locate the virus and wipe clean the hard drive where the virus originated. Bottom line: If the source of the e-mail is unknown or even if it is known but it is not expected, the e-mail or file attachment should not be opened until the e-mail is quarantined and inspected. Firewalls should be used to block employees from accessing websites where malware can be inadvertently downloaded.

Clients are forcing law firms to buck up with cybersecurity. The 2016 ABA Legal Technology Survey Report reveals that 30.7% of all law firms and 62.8% of firms of 500 lawyers or more reported that current or potential clients provided them with IT security requirements.

Industry standards give law firms a framework. Some firms are using ISO/IEC 27001 certification. The National Institute of Standards and Technology (NIST) framework from the DOJ also provides guidance for law firms in cybersecurity. The second edition of *The ABA Cybersecurity Handbook:• A Resource for Attorneys, Law Firms and Business Professionals,* will be published before the ABA Annual Meeting in August 2017.

At the Solo & Small Firm Forum on April 11, 2016 on the Eastern Shore of Virginia, Sharon Nelson commented that there was a time when we may have been capable of preventing cyber-attacks. That time is gone. She acknowledged now that prevention of a cyber-attack is no longer a realistic goal. The best we can do now is have measures in place to "detect" and "react" when there has been a breach of security, and minimize the severity of its consequences, i.e., corruption, theft, destruction of confidential client information. Sharon Nelson reported that successful cyber-attacks on law firms have occurred including large law firms like Weil Gotschal.

A panel of experts made a similar pessimistic assessment at a program on cyber security in Richmond on October 1, 2015 for the Richmond Bar Association.[3] As ethics and technology expert, David G. Ries, author of "Safeguarding Confidential Information: Attorneys' Ethical and Legal Obligations" (January 2016) observes:

> These threats are a particular concern to attorneys because of their duty of confidentiality. Attorneys have ethical and common law duties to take competent and reasonable measures to safeguard information relating to clients. They also often have contractual and regulatory duties to protect client information and other types of confidential information.
>
> Effective information security requires an ongoing, comprehensive process that addresses people, policies and procedures, and technology, including training. It also requires an understanding that security is everyone's responsibility and constant security awareness by all users of technology.

[3] Cyber Security/Data Breach - Technology and Policy, October 1, 2015, presented by Greg Burkhart: Principal Director, Cyber 4Sight Services, Booz Allen Hamilton; Kevin Minsky: Associate General Counsel, Booz Allen Hamilton;Michael Woods: Vice President and Associate General Counsel, National Security and Public Safety, Verizon Communications

Here are some resources to learn more about IT security:

- Federal Trade Commission, "Start with Security" guidance to businesses (https://www.ftc.gov/system/files/documents/plain-language/pdf0205-startwithsecurity.pdf). This is generic guidance drawn from the FTC's recent enforcement cases. It's fairly simple and written in non-technical language, but it provides some insight into what one group of federal regulators are thinking is (or should be) the standard of care for a business.

- NIST Cybersecurity Framework (http://www.nist.gov/cyberframework/). This document was developed through a lengthy consultation process with industry; it is meant to provide a general approach to cybersecurity, and to point businesses toward the relevant existing standards. In many industry contexts, it is becoming the de facto "standard of care."

- NIST Recommendations (http://csrc.nist..gov/publications/PubsSPs.html). These documents are more detailed and technical recommendations developed through the NIST collaborative process with industry. The "800" series are particularly important in cybersecurity. The documents are designed for use by IT professionals responsible for implementing a company's cybersecurity program.

- Verizon Data Breach Report (DBIR) (http://www.verizonenterprise.com/DBIR/) is annual analysis of cyber threats as reflected in actual data breaches and security incidents. The report looks at anonymized data submitted by a broad range of law enforcement agencies, private companies, and cybersecurity providers.

- DHS Information Sharing resources: DHS supports a number of information sharing initiatives. You can find summary information here: http://www.dhs.gov/topic/cybersecuritv-information-sharing.

- Steptoe & Johnson Cyberlaw Podcast (http://www.dhs.gov/topic/cybersecurity-information-sharing). Weekly podcast put out by a group of lawyers at Steptoe. They provide a good summary of case law, policy developments, and legislation relating to cyber, data breach, privacy, national security, etc.

Personal Identifying Information (PH)

In addition to the ethical issues of confidentiality, injury can result by misuse or theft of client information, and new statutes in many jurisdictions regarding protecting and securing client information require security breaches to be reported. **To date 46 states have enacted breach notification statutes.** For a list of states and their corresponding notification statute, see the NCSL (National Conference of State Legislatures) website.

Virginia statute Va. Code § 18.2-186.6: In addition to § **32.1-127.1:05, Breach of medical information notification Va. Code § 18.2-186.6 Breach of personal information notification** requires businesses to report to the A.G.s office any disclosure of a client(s) PII. Virginia law requires a business or state agency to notify any Virginia resident whose unencrypted personal information, as defined, was acquired, or reasonably believed to have been acquired, by an unauthorized person.

> ...(B) If unencrypted or unredacted personal information was or is reasonably believed to have been accessed and acquired by an unauthorized person and causes, or the individual or entity reasonably believes has caused or will cause, identity theft or another fraud to any resident of the Commonwealth, an individual or entity that owns or licenses computerized data that includes personal information shall disclose any breach of the security of the system following discovery or notification of the breach of the security of the system to the Office of the Attorney General and any affected resident of the Commonwealth without unreasonable delay. Notice required by this section may be reasonably delayed to allow the individual or entity to determine the scope of the breach of the security of the system and restore the reasonable integrity of the system. Notice required by this section may be delayed if, after the individual or entity notifies a law-enforcement agency, the law-enforcement agency determines and advises the individual or entity that the notice will impede a criminal or civil investigation, or homeland or national security. Notice shall be made without unreasonable delay after the law-enforcement agency determines that the notification will no longer impede the investigation or jeopardize national or homeland security.

What Should We Be Doing to Exercise Reasonable Care to Protect Client Data from Cyberattack?

What should lawyers be considering as reasonable efforts to protect confidential client information from cyber-attacks? Here is a list of examples:

1. All security patches should be promptly installed.
2. Software which is no longer supported, and therefore not receiving security updates, cannot ethically be used.
3. Authentication — passwords which are used to gain access to law firm data should be a minimum of 14 characters, using capital and lower case letters, numbers as well as special characters.
4. Passwords should not be shared or used in multiple places.
5. Law firms should have a password policy including some of the advice above as well as mandating that passwords be changed regularly (the recommended time period is every 30 days).
6. Where two-factor authentication is available, it should be utilized.

7. All mobile devices should be encrypted and have the ability to be remotely wiped if they are lost or stolen. They should also be protected by security software.

7. We are rapidly reaching the point where e-mails containing confidential data should be encrypted. Several years ago, encryption was cumbersome. Today, it is inexpensive and simple. Lawyers may wish to have an IT professional install and configure their encryption solution.

8. There should be a checklist for departing employees to ensure that all law firm data is returned to the firm and that no further access to the law firm network is technically possible.

9. Law firms should consider annual security assessments.

10. All law firms should have anti-malware software — larger firms should have enterprise grade software. Today's software is not just antivirus software, but can also filter spam, recognize and prevent dangerous components in e-mails and attachments and remove them, and use heuristics to identify potentially dangerous communications.

11. Larger firms will want to explore intrusion detection systems and data loss prevention hardware/software.

12. All firms, of any size, should have an Incident Response Plan, in addition to other security related policies, including disaster recovery plans, BYOD (bring your own device), BYON (bring your own network), etc.

13. Identify all laws and regulations which may apply to your data. Do you hold data which is governed by HIPAA, HITECH or Sarbanes Oxley? Do you hold PII (personally identifiable information)?

14. All firms should have an updated network diagram so it is clear where all data resides and to assist digital forensics experts in the event of a security incident.

15. The security of all third party vendors which hold law firm confidential data (including data in the cloud) should be investigated — again, the standard of reasonableness applies. Lawyers certainly need to read the Terms of Service of anyone who holds their confidential data.

16. Law firms should conduct annual training about data security, including the dangers of phishing and social engineering.

17. As ransomware has evolved, it is now critical that backups be engineered to be impervious to ransomware. In a very small firm, with an external hard drive backup, it may suffice to simply unplug the drive. But more complex backup systems are needed by larger firms.

18. Backups need to be tested on a regular basis.

20. Wireless networks should protected by WPA2 encryption — the only encryption which has not yet been broken.

1. Logging should be enabled on servers whenever possible to aid in the investigation of security incidents.

2. Physical security is also important. Servers should be physically protected. Depending on the size of the law firm, lawyers may include keys, prox cards, alarm codes, video cameras, etc. as part of physical security.

3. If you permit access to your wireless network for guests, their access should be on a properly configured guest network so that they cannot access your confidential data.

4. Make sure there is access control to important data — as an example, there is no reason why a secretary needs to access the firm's financial data.

5. Change all default IDs and passwords — they are freely available on the Internet.

6. Consider a redundant Internet connection, in case your primary connection goes down.[4]

New standards on "cloud computing" have been promulgated the Legal Cloud Computing Association (LCCA), an organization whose purpose is to facilitate adoption of cloud computing technology within the legal profession, consistent with the highest standards of professionalism and ethical and legal obligations. These standards were released just recently in 2016:

— Must disclose where data is housed—physically and geographically

— Must meet certain industry certifications (SOC 2, or ISO 27001 or 27018

— Geographical redundancy—data centers in multiple locations

— Encryption for storage at and transmitting data to and from data center.

— Disclose practices and frequency of testing for hacking and vulnerability

— Disclose policies on limiting access by third parties and request/subpoenas by third parties to obtain customer date, including customer notification

— Data retention policy

— End user authentication (multi-factor, password strength, device authentication, cerficate protocols)

— Addition/Deletion of Authorized users

— Tracking, use of audit logs

— End User's ability to add or delete data

Source: Draft Report of VSB Future of Law Practice Study Committee, Technology Subcommittee Draft Report (April 2016).

— Ability to retrieve data in a non-proprietary format; restoration or back up of inadvertently deleted data

— Terms of Service understandable to end user.

— Privacy policy and restrictions on employee access

— Uptime guaranty or assurance

— Confidentiality of user's data

— Ownership of Data

— Data Breach Notification

— Disaster Recovery

6. Proposed LEO 1885: Avvo Legal Services and Other Online Lead Generation Companies and Rules 5.4(a) and 7.3(b)

The Virginia State Bar Ethics Committee has issued for public comment an advisory opinion on whether the Rules of Professional Conduct permit lawyers to participate in online lawyer-client matching services (ACMS). Some business models place lawyers in violation of the Rules of Professional Conduct while others do not. We have labeled Avvo as an ACMS. Avvo is not a lawyer referral service. Under the business model used by Avvo Legal Services the lawyer

a) accepts a client that has signed up for limited scope legal services[5] advertised to the public by the ACMS for a legal fee set by the ACMS;

b) allows the ACMS to collect the full, prepaid legal fee from the client, and to make no payment to the lawyer until the legal service has been completed;

c) authorizes the ACMS to electronically deposit the legal fee to the lawyer's operating account when she completes the legal service; and

d) authorizes the ACMS to electronically withdraw from the lawyer's bank account a "marketing fee" which, by prior agreement between the ACMS and the lawyer, is set by the ACMS and based upon the dollar amount of the legal fee paid by the client[6].

---

[5] A random sample of services and fees a lawyer agrees to provide through the firm operating this program might be, for example:

Document review: Residential purchase and sale agreement	$495
File for uncontested divorce	$995
Create a parenting plan	$595
Create a living trust bundle (couple)	$1,095

The prospective client selects the advertised legal service and chooses a lawyer identified on ACMS's website as willing to provide the selected service. The prospective client pays the full amount of the advertised legal fee to the ACMS. Thereafter, the ACMS notifies the selected lawyer of this action, and the lawyer must call the prospective client within a specified period. After speaking to the prospective client, and performing a conflicts check, the lawyer either accepts or declines the proposed representation.

A lawyer who participates in an ACMS using the Avvo Legal Services model identified herein risks violating the Virginia Rules of Professional Conduct because she

a. cedes control of her client's or prospective client's advanced legal fees to a lay entity;

b. undertakes representation which will result in a violation of a Rule of Professional Conduct;

c. relinquishes control of her obligation to refund any unearned fees to a client at the termination of representation;

d. shares legal fees with a nonlawyer; and

e. pays another for recommending the lawyer's services.

In Opinion 2016-3, the Supreme Court of Ohio Board of Professional Conduct sharply observes, with respect to a similar business model:

> ***the company, not the lawyer, controls nearly every aspect of the attorney-client relationship, from beginning to end. The company, not the lawyer, defines the type of services offered, the scope of the representation, and the fees charged. The model is antithetical to the core components of the client-lawyer relationship because the lawyer's exercise of independent professional judgment on behalf of the client is eviscerated. A lawyer who participates in an ACMS does not violate Rules of Professional Conduct governing limited scope representation, reasonableness of legal fees, and the exercise of independent professional judgment, if she adheres to the Rules governing those aspects of every representation. Avvo Legal Services offers fixed-fee limited scope legal service. A lawyer and client may agree to limit the goals and objectives of the representation. Rule 1.2(b). However, the limitation must not impair the lawyer's ability to provide competent representation and is otherwise consistent with the Rules of Professional Conduct. The client must consent "after consultation" to the limited scope representation. *See,* Rule 1.2(b).

A lawyer does not violate Rule 1.2(b) merely because her contact with a prospective client flows from a proposed limited scope legal representation advertised by a non-lawyer business firm. Indeed, there are several contexts in which a third-party nonlawyer defines the scope of a lawyer's representation of a client. In pertinent part, Comments [6] and [7] to Rule 1.2 state that

[6] For example, the "marketing fee" might range from $40 for a $149 legal service to $400 for a $2995 service.

> [6]The objectives or scope of services provided by a lawyer may be limited by agreement with the client or **by the terms under which the lawyer's services are made available to the client.** For example, a retainer may be for a specifically defined purpose. Representation provided through a legal aid agency may be subject to limitations on the types of cases the agency handles. When a lawyer has been retained by an insurer to represent an insured, the representation may be limited to matters related to the insurance coverage. ***.
>
> [1]An agreement concerning the scope of representation must accord with the Rules of Professional Conduct and other law. **Thus, the client may not be asked to agree to representation so limited in scope as to violate Rule 1.1 [Competence]***.** [Emphasis supplied throughout.]

In other words, there are circumstances in which a lawyer may agree to allow a nonlawyer to limit the scope of the representation where the lawyer's independent professional judgment is not impaired by the limitation.

The second issue is that the lawyer must assess independently whether the fixed fee for a particular limited scope service *as set by the non-lawyer business firm or ACMS is* a reasonable fee applying the eight factors listed in Rule 1.5. Normally, but not always, the lawyer sets the fee for a legal service.

The third issue arises out of the ACMS holding the fee paid by the client until the lawyer has completed the work. Under Rule 1.15, lawyers are required to place an advanced fee in their trust account and must keep it there until the fee is earned. If the fee is not earned and the client terminated the representation before the service is performed, the lawyer must refund the unearned fee to the client. Rule 1.16(d); LEO 1606. May a Virginia lawyer ethically "opt-out" of the obligations imposed by Rule 1.15 by consenting to a third-party lay ACMS's collection and retention of the client's advanced legal fees? Proponents of the Avvo model argue that the consumer/client is protected when he/she uses their credit card, which enables them to "charge back" or challenge the charge if they are dissatisfied with the service. Further, proponents argue that Rule 1.15 does not apply since the lawyer has not taken custody or control over any client funds until after they have been earned and cannot reasonably be expected to safeguard client funds or property that has yet to come into her possession.

<u>Ethically Impermissible Sharing of Legal Fees with a Nonlawyer</u>

The fourth issue is whether the lawyer is impermissibly sharing legal fees with a nonlawyer as prohibited by Rule 5.4(a).

The North Carolina State Bar has issued a legal ethics opinion which approves a lawyer's participation in an online for-profit service which has both the attributes of a lawyer referral service and a legal directory. The business model under review in that opinion is described, in pertinent part, as follows:

> A commercial Internet company (the company) operates a website that matches prospective clients with lawyers. A prospective client logs onto the website where he registers and is given an identification number to preserve anonymity. The prospective client posts an explanation of his legal problem on the website and consents to contact from participating lawyers. There is no charge to the prospective client for the standard service but, for more individualized and faster service, there is a fee.
>
> The company solicits lawyers to participate in its service. To participate, a lawyer must be licensed and in good standing with the regulatory agency of his state of licensure. A participating lawyer is charged a **one-time registration fee** that covers expenses for verifying credentials, technical system programming, and other set-up expenses. An **annual fee** is charged to each participating lawyer for ongoing administrative, system, and advertising expenses. The **amount of the annual fee varies by lawyer based on a number of components, including the lawyer's current rates, areas of practice, geographic location, and number of years in practice.** ***
>
> If a client-lawyer relationship is formed between a participating lawyer and a user of the service, it is done without the participation of the company. **The company does not get involved in the lawyer-client relationship or in related financial matters such as fees, retainers, invoicing, or payment.** [Emphasis supplied throughout.]
>
> In answer to the question of whether a lawyer may ethically participate in such a program, the opinion states:
>
> Yes, **provided there is no fee sharing with the company in violation of Rule 5.4(a),** and further provided the participating lawyer is responsible for the veracity of any representation made by the company about the lawyer or the lawyer's services or the process whereby lawyers' names are provided to a user. [Emphasis supplied.]

A Rhode Island legal ethics opinion[8] specifically approved lawyers' participation in a program run by an Internet company called "Legal Match.com". In addressing whether the arrangement violated the prohibition on fee sharing, the opinion draws the important distinction between ethically permissible advertising costs and impermissible fees charged to a lawyer based upon legal fees generated:

---

[7] North Carolina Ethics Op. 2004-1 (2004) **"Participation in On-Line Legal Matching Service"** http://www.ncbar.com/ethics/ethics.asp

[8] Rhode Island Supreme Court Ethics Advisory Panel Opinion No. 2005-01 https://www.courts.ri.gov/AttomeyResources/ethicsadvisorypanel/Opinions/2005-01.pdf

> The fee to LM. corn is a flat fee which buys advertising and access to requests for legal services posted by consumers. **Unlike the fees in [Rhode Island] Ethics Advisory Opinion No. 2000-04, the annual fee is not a percentage of, or otherwise linked to, a participating attorney's legal fees.** [Emphasis is supplied.]

Rhode Island Ethics Advisory Opinion No. 2000-4, referred to above, found linkage between a consulting company's fee and the attorney's fee to be unethical fee-sharing with a nonlawyer *and* ethically impermissible payment for recommending a lawyer's services:

> In the arrangement proposed by the inquiring attorney, **there is a direct relationship between the consulting fees paid to the consulting company and the attorney's fees earned through the website.** A participating attorney agrees to pay $15,000 to the consulting company for every $100,000 in gross fees he/she earns as a result of the site. In essence, the fee paid to the consulting company is a fifteen percent commission of the gross attorney's fees. As such, **the consulting fee is payment for recommending the lawyer's services** and is violative of Rule 7.2(c).
>
> The proposed arrangement is problematic in other respects. It runs afoul of Rule 5.4(a) **which prohibits attorneys from sharing fees with nonlawyers.***** [Emphasis supplied.]

In contrast to the business models identified with approval in the North Carolina and first-cited Rhode Island legal ethics opinions, the Avvo model calls for legal fee sharing which some bar opinions hold is ethically impermissible under Rule 5.4(a). A legal fee is shared with a nonlawyer when a fixed portion of it is given by the lawyer to her Internet advertiser, whose entitlement to the fee occurs only when the lawyer has earned her legal fee, and when the amount of the advertiser's fee is based on the amount of that legal fee. Avvo Legal Services calls the fee paid by the lawyer a "marketing fee." Avvo's General Counsel, Josh King, also states that there is no fee-sharing because the lawyer collects the entire fee when the work is finished and pays Avvo the "marketing fee" out of their operating account, as opposed to the trust account, and therefore no fee division has occurred. Calling the online service's entitlement a "marketing fee" does not alter the fact that a lawyer is sharing her legal fee with a lay business. As stated, the amount of the "marketing fee" is itself linked directly to the amount of the lawyer's fee earned on each legal matter obtained by the lawyer through the intermediary ACMS. The larger the legal fee, the larger the "marketing fee" that Avvo collects. Critics argue that the fact that the ACMS executes a separate electronic debit from the lawyer's bank account for its "marketing fee" following the firm's electronic deposit of the full legal fee to the lawyer's bank account does not change the ethically impermissible fee-sharing character of the transaction. If the ACMS were to withhold its "marketing" fee from the legal fee due the lawyer, the "fee sharing" element might appear more pronounced. However, the firm's debiting the lawyer's account following transmission of the full legal fee is but a technical nicety which does not change the substance of the transaction. The form of the transaction cannot mask the substance of it: the legal fees are shared with a nonlawyer in direct violation of Rule 5.4(a).

The Pennsylvania Bar Association's Legal Ethics and Professional Responsibility Committee in Formal Opinion 2016-200 flatly declared that "[a] lawyer who participates in [a program such as is detailed here] in which the program operator collects 'marketing fees' from that lawyer that vary based upon the legal fees collected by the lawyer, violates RPC 5.4(a)'s prohibition against sharing legal fees with a nonlawyer."

The Opinion identifies other jurisdictions' like conclusions on the subject of ethically impermissible fee-sharing with a nonlawyer, stating:

> Ethics opinions that have considered similar compensation arrangements have concluded that marketing, advertising, or referral fees paid to for-profit enterprises that are based upon whether a lawyer received any matters, or how many matters were received, or how much revenue was generated by the matters, constitute impermissible fee sharing under RPC 5.4(a). For example, Ohio Opinion 2016-3, which addresses the same types of FFLS [acronym for "Flat Fee Limited Scope"] programs discussed in this Opinion, states that "a fee-splitting arrangement that is dependent upon the number of clients obtained or the legal fee earned does not comport with the Rules of Professional Conduct." S.C. Opinion 16-06, which also addressed a FFLS program, reached the same conclusion. Other ethics opinions which have, in various contexts, concluded that advertising, marketing, or referral fees calculated on the basis of matters received or legal fees generated violate Rule 5.4(a) include: Arizona Opinion 10-01; Alabama State Bar Ethics Opinion RO 2012-01 ("Alabama Opinion 2012-01"); Indiana State Bar Association Legal Ethics Committee Opinion 1 of 2012 ("Indiana Opinion 1 of 2012"); Kentucky Bar Association Ethics Opinion E-429 and South Carolina Ethics Advisory Opinion 93-09.

A fifth issue is whether the lawyer's payment of a "marketing fee" to Avvo Legal Services is a violation of Rule 7.3(b).

Ethical Restriction on Giving Anything of Value to One Who Recommends the Lawyer's Services

Subject to the exceptions set forth below, Rule 7.3(b) prohibits a lawyer from giving "anything of value" to a person who recommends the lawyer's services. Whether the referring person is a lawyer or nonlawyer is not relevant to an analysis of conduct covered by Rule 7.3(b)[9]. A lawyer may violate Rule 7.3(b) without at the same time violating the fee-sharing prohibition contained in Rule 5.4(a) because the source of the compensation given to the referring person need not be a legal fee.

9
There is one exception: Rule 1.5(e) permits a lawyer to share legal fees, under certain conditions, with *another lawyer* who has referred a case to her. A note to Virginia Legal Ethics Opinion 1130 states:

> **Legal Ethics Committee Notes. —** This LEO was overruled by Rule 1.5(e), which does not require that a lawyer sharing in fees also share responsibility, thus allowing "referral fees" if the client consents after full disclosure.

Rule 7.3(b) lists only four specific exceptions under which a lawyer may give something of value to another for recommending a lawyer's services (footnote 9), only two of which are applicable to a lawyer's participation in the for-profit business firm's operations here under review:

1. payment of "the reasonable costs of advertisements or communications"; and/or

2. payment of the "usual charges of a legal service plan or a not-for-profit qualified lawyer referral service".

A "marketing fee" based upon a lawyer's having been actually hired to perform legal services for which a fee has been earned, with the amount of the "marketing fee" based upon the amount of the lawyer's fee is not a reasonable cost of advertisement. It is in form and function the payment of a referral fee to a nonlawyer. Payment of the so-called "marketing fee" is not required unless and until the lawyer finishes a legal matter for a client the lawyer has obtained as a result of the ACMS's efforts. The ACMS which identifies available lawyers on its website is neither a "legal service plan" nor a "not-for-profit qualified lawyer referral service". It is a for-profit lay entity with a business model whose revenue is derived by sharing the lawyers' earnings derived specifically from clients and fees generated to the lawyers by the program.

In discussing a rule analogous to Virginia Rule 7.3(b), the South Carolina bar deemed it a violation of its rule to compensate an Internet service which advertises lawyers' services by paying the Internet service based on fees obtained from clients whom the lawyer receives via participation in the service:

> South Carolina Rule of Professional Conduct 7.2(c)[10] prohibits lawyers from giving "anything of value to a person for recommending the lawyer's services" but includes an exception for the "reasonable cost of advertisements." A lawyer may ethically make payments to an Internet service for advertising the lawyer's services based either on a set monthly or yearly fee or based on the number of hits or referrals from the service to the lawyer. **Lawyers could not ethically pay the service any portion of the fees received from clients obtained through the service.** See S.C. Rule Prof Cond. 5.4(a). This opinion deals only with services

---

[10] RULE 7.2: ADVERTISING

(c) A lawyer shall not give anything of value to a person for recommending the lawyer's services except that a lawyer may

(1) pay the reasonable costs of advertisements or communications permitted by this Rule;

(2) pay the usual charges of a legal service plan or a not-for-profit lawyer referral service, which is itself not acting in violation of any Rule of Professional Conduct; and

(3) pay for a law practice in accordance with Rule 1.17.

> that are open to attorneys generally. Services that restrict or screen attorney participation may violate Rule 7.2(c). [Emphasis is supplied.]

See, South Carolina Bar Ethics Advisory Opinion 01-03.

South Carolina Bar Ethics Advisory Opinion 16-06, issued in 2016, analyzed the ethical implications of a lawyer's participation in a service precisely as described here. It concluded that the marketing fees charged are not the ethically permissible reasonable costs of advertising:

The service, however, purports to charge the lawyer a fee based on the type of service the lawyer has performed rather than a fixed fee for the advertisement, or a fee per inquiry or "click." In essence, the service's charges amount to a contingency advertising fee arrangement rather than a cost that can be assessed for reasonableness by looking at market rate or comparable services.

Presumably, it does not cost the service any more to advertise online for a family law matter than for the preparation of corporate documents. There does not seem to be any rational basis for charging the attorney more for the advertising services of one type of case versus another. For example, a newspaper or radio ad would cost the same whether a lawyer was advertising his services as a criminal defense lawyer or a family law attorney. The cost of the ad may vary from publication to publication, but the ad cost would not be dependent on the type of legal service offered.

PA Formal Opinion 2016-200, cited above, addresses the "reasonable cost of advertisements" issue from the perspective of the differing marketing fees charged, as tethered to the legal fees themselves:

> *** The cost of advertising does not vary depending upon whether the advertising succeeded in bringing in business, or on the amount of revenue generated by a matter. One FFLS [Flat Fee Limited Scope] program charges participating lawyers "marketing fees" ranging from $10 for a $39 "Advice Session" to $400 for a "Green Card Application," which generates $2,995 in legal fees. Clearly, there cannot be a 4000% variance in the operator's advertising and administrative costs for these two services, particularly since the operator does not, and cannot, have any role in the actual delivery of legal services.***

There are a variety of forms in which lawyers may advertise, one being via Internet services which identify lawyers available to handle particular types of legal matters. Comment [4] to Rule 7.3 speaks approvingly of services available to lawyers:

[4] Lawyers are not permitted to pay others for channeling professional work. However, Paragraph (b)(1) allows a lawyer to pay for advertising and communications permitted by this Rule, including the **costs of print directory listings, on-line directory listings, newspaper ads, television and radio airtime, domain-name registrations, sponsorship fees, banner ads, and group advertising.** A lawyer may compensate employees, agents, and vendors who are engaged to provide marketing or client-development services, such as **publicists, public-relations personnel, business-development staff, and website designers.** *** [Emphasis supplied.]

CONCLUSION

A Virginia lawyer may certainly participate in a for-profit lay business firm's Internet advertising platform from which members of the public are matched with Virginia lawyers who are identified as willing and available to handle particular matters for fixed legal fees *if the cost of doing so* complies with Rule 7.3(b)(1) and if the lawyer complies with the other Rules of Professional Conduct discussed above. The "reasonable costs of advertising or communications" may be based on any number of factors which the advertising lawyer may assess for herself: quality of presentation, market exposure, demography, and measurable levels of interest evoked (through Internet "clicks" or "hits"). However, a Virginia lawyer violates Rule 7.3(b) when she pays another—including an Internet marketer—a sum tethered directly to her receipt, and the amount, of a legal fee paid by a client.

The proposed opinion may be found at the VSB web site at:
http://www.vsb.orgisite/regulation/leo_1885

Comments are due by May 5, 2017.

The VSB will submit proposed LEO 1885 to Council for review. If Council votes to approve the opinion, the bar will petition the Supreme Court of Virginia to adopt it.

7. Comments Sought on Proposed LEO 1887—Impaired Lawyer Over Whom No One Has Supervisory Authority.

In this proposed opinion, the Committee considered the differences between the situations presented in LEO 1886, involving supervisory lawyers' duties to take preemptive steps to ensure that other lawyers in the firm do not violate the Rules of Professional Conduct by representing clients while suffering from an impairment, and the situation presented by a sole partner in a firm or solo lawyer who is impaired. In the latter scenarios, no one has a duty under Rule 5.1 to act on the lawyer's impairment; the only ethical duty arises from Rule 8.3(a), requiring a lawyer to report another lawyer's misconduct when she has reliable information about a violation of the Rules that raises a substantial question as to the lawyer's honesty, trustworthiness, or fitness to practice law.

The Committee concludes in this proposed opinion that evidence of a lawyer's possible impairment, standing alone, does not necessarily trigger the duty to report misconduct under Rule 8.3(a), although in many cases the impairment will lead to violations of the Rules that do trigger that duty. The proposed opinion also encourages lawyers to contact Lawyers Helping Lawyers (LHL), or another lawyer assistance program, or to suggest that the possibly-impaired lawyer contact LHL, for guidance on how to address the underlying impairment regardless of whether a bar complaint is filed.

The proposed opinion may be found at the VSB web site at:
http://www.vsb.org/site/regulation/leo 1887

Comments are due by May 5, 2017.

Hypothetical One: Honest Mistake

Facts

Honest Mistake is a divorce attorney in Smalltown, Virginia. Ms. Mistake employs a single, part-time employee, Legal Assistant, and runs her law practice through a single Desktop Computer that sits in the reception area of her law office. All active client files are maintained electronically in folders labeled with the client's name on the computer's desktop. Older client files are kept on DVDs labeled and arranged alphabetically on a bookshelf next to the Desktop Computer. The Desktop Computer, which is not password-protected, is frequently left unattended. Moreover, the virus protection software expired years ago and the information has been backed up only twice in four years.

In June 2016, Ms. Mistake agrees to represent Divorce Client in regard to a divorce from Money Bags, a wealthy architect and the current mayor of Smalltown. Ms. Mistake represented Mayor Money Bags six years ago in his contentious divorce from his first wife. Ms. Mistake files the divorce and, after refreshing her memory of Mayor Money Bags' assets by reviewing her Mayor Money Bags client file on DVD, she issues subpoenas to four financial institutions.

As the financial information is produced, Legal Assistant stores the information on the Desktop Computer in a file labeled Divorce Client and shreds the paper copies. Ms. Mistake reviews the financial information and concludes that Mayor Money Bags is accepting kickbacks from municipal contractors. She seizes the opportunity, calls his attorney, and threatens to "have a conversation with the Commonwealth's Attorney" if Mayor Money Bags doesn't agree to pay $3,000 per month in spousal support.

To turn up the heat, Ms. Mistake gives an interview to Blogger in which she makes multiple references to Mayor Money Bags' "questionable" finances and "shady" dealings. She declines to give Blogger any supporting documentation. Nevertheless, on his way out of the office, Blogger copies the clearly labeled Divorce Client file from the unattended Desktop Computer onto a thumb drive. Blogger later posts on-line allegations that Mayor Money Bags could be facing criminal indictment. For good measure, Blogger also telephones Mayor Money Bags and offers to cease his on-line posting in return for a $100,000 payment.

A few days later, Divorce Client reconciles with Mayor Money Bags, fires Ms. Mistake, and demands the return of her file, including Mayor Money Bags' financial records. Ms. Mistake agrees – only to learn from Legal Assistant that, according to Computer Expert, the Desktop Computer has been attacked by a virus and Divorce Client's file has been corrupted. Upon receipt of this news, Divorce Client files a Bar Complaint and an investigation follows.

<u>Misconduct Phase</u>

Bar Counsel presents the case to the Disciplinary Board in July 2017. After a hearing, the Board finds the following violations in the case:

> RPC 1.6(d) for failing to take reasonable steps to prevent the unauthorized access of Divorce Client's file by Blogger.
>
> RPC 1.9(c) for a conflict of interest for using information gained in her prior representation of Mayor Money Bags to Mayor Money Bags' disadvantage.
>
> RPC 3.4(i) for threatening to present criminal charges against Mayor Money Bags for the sole purpose of gaining advantage in the pending divorce and spousal support proceeding.
>
> RPC 8.4(b) for engaging in deliberately wrongful conduct that reflects adversely on her fitness to practice law by using a former client's confidential information to his disadvantage and threatening a former client with criminal prosecution based on information obtained using that confidential information.

By a split vote, the Board declines to find that Ms. Mistake violated RPC 1.1 for failing to demonstrate reasonable competence in regard to the electronic storage and protection of client files.

Sanctions Phase

The Board now convenes to determine the appropriate sanction. The Bar presents evidence of Ms. Mistake's disciplinary history, which consists of one Private Admonition in 2008 for a lack of diligence and a failure to communicate with a client about a divorce matter. The Bar also offers court records establishing that Mayor Money Bags is now facing four felony charges in Smalltown Circuit Court for allegedly accepting kickbacks in exchange for facilitating the award of municipal contracts.

Ms. Mistake testifies that she did not know she had violated any ethical rules, that she never intended to threaten Mayor Money Bags with criminal prosecution, and that she would have discovered the existence of the bank accounts anyway. Since Divorce Client and Money Bags reconciled, she believes there was "no harm, no foul." It was an "honest mistake," she testifies. She also testifies that she has gone to the police about Blogger, who she asserts is the real villain, and is even considering pursuing a civil action against him herself.

Finally, she tells the Board that she has decided to improve her file security and, toward that end, has instructed Legal Assistant to purchase state-of-the-art virus protection software and establish routine back-up procedures for client files.

Deliberation: What is the appropriate sanction?

Six-Month Suspension

One-Year Suspension

Three-Year Suspension

Other

Hypothetical Two: Letter Writer

Facts

Letter Writer has a small law practice in College Town, Virginia. His long-time client, Slum Lord, wants to evict a group of college students from one of his rental properties. "They're two months behind on rent, they broke the dishwasher, and the place reeks of weed," Mr. Lord tells Mr. Writer. Mr. Writer files and serves a Summons for Unlawful Detainer the next day without providing the students with a pay-or-quit notice as required by the residential lease and the governing statute. One of the students, Law Student, notices the deficiency and succeeds in having the Unlawful Detainer dismissed without prejudice. Mr. Lord tells Mr. Writer that he is considering finding another attorney.

Embarrassed and enraged, Mr. Writer immediately sends the students a pay-or-quit notice. The letter also states: "If you do not vacate the premises within 30 days, I will report your drug use at the rental property to the police. I have two witnesses from your last party. I also play golf with the judge. She listens when I call."

Law Student sends the letter to the Virginia State Bar, which opens the matter for a preliminary investigation and sends a letter to Mr. Writer demanding a written response within 21 days. Mr. Writer ignores the Bar Complaint. After Bar Counsel refers the matter to the district committee for investigation, Mr. Writer fails to respond to four separate interview requests from the VSB Investigator.

VSB Investigator appears unannounced at Mr. Writer's law office. Mr. Writer tells VSB Investigator that he did not respond to the Bar Complaint because it was "utter nonsense" and a waste of everyone's time. He also tells VSB Investigator that a student intern drafted the letter and that he just signed it on the way out of the office one day. "Looks like he made another mistake," Mr. Writer adds.
When asked for the intern's name and address, Mr. Writer says that it was "Smith or Jones or something like that" and that, since he didn't pay the intern, he has no idea what his address is. When pressed further, he also says that he did not hire the intern through the College, that the intern has stopped coming in to the office, and that he thinks the intern has dropped out of school "probably because of drugs." He then cuts the interview off and says, "I can't believe the Bar doesn't have better things to do."

VSB Investigator contacts the registrar at the College but is unable to identify any student who worked as an intern for Mr. Writer. VSB Investigator also interviews Law Student, who expresses surprise at being contacted. "Mr. Writer told me he called his college roommate, Bar Counsel, and had the Bar Complaint dismissed." Law Student acknowledged that the students were behind in their rent and that they broke the dishwasher, but disavowed any knowledge of drug use at the residence. She also said the students were not evicted and were not contacted by any law enforcement officials. Bar Counsel tells VSB Investigator that he was not Mr. Writer's college roommate and that he has, in fact, never met Mr. Writer.

<u>Misconduct Phase</u>

Bar Counsel presents the case to a Subcommittee, which considers the Bar Complaint and the Report of Investigation prepared by VSB Investigator and concludes that the available evidence can reasonably be expected to establish that Mr. Free committed the following violations:

> RPC 3.4(i) for threatening to present criminal charges solely to gain an advantage in a civil matter;
>
> RPC 8.1(c) for failing to respond to the Bar's lawful demand for information during the course of a disciplinary matter when he failed to provide a written response to the Bar Complaint;
>
> RPC 8.1(d) for obstructing the Bar's investigation into a disciplinary matter by misinforming Law Student that the Bar Complaint had been dismissed;
>
> RPC 8.4(c) for engaging in conduct involving dishonesty, fraud, deceit or misrepresentation that reflects adversely on his fitness to practice law by misrepresenting to Law Student that the Bar Complaint had been dismissed and that he was Bar Counsel's college roommate; and
>
> RPC 8.4(d) for stating or implying that he could improperly influence a tribunal when he implied that, based on his personal relationship with the judge, he could have Law Student convicted of a drug crime.

Subcommittee expresses its opinion that Mr. Writer probably lied to the students about having any witnesses to drug crimes and to the Bar about who drafted the letter. Subcommittee is also skeptical that student intern exists, but concludes that there is insufficient evidence to prove any of these lies by the requisite clear and convincing standard.

Sanctions Phase

Subcommittee then considers the appropriate sanction, at which point Bar Counsel informs Subcommittee that Mr. Writer has no disciplinary record and that he has practiced law for more than 20 years. Subcommittee also considers a recent letter written by Mr. Writer to VSB Investigator in which Mr. Writer apologizes to VSB Investigator for his disrespectful behavior and impolite statement(s) during the interview. In the letter, Mr. Writer states that his poor behavior resulted from financial stress stemming from an ongoing divorce and states that he wrote a letter to the College complaining about the quality of its student interns and threatening to withhold his annual monetary contribution to the College if the College did not address his concerns promptly. In the future, he says, "you can be sure I will be writing all of my letters myself."

Deliberation: What is the appropriate sanction?

Private Admonition

Public Reprimand

Public Reprimand with Terms

Certification to the Disciplinary Board

Hypothetical Three: Pro Bono

Facts

Pro Bono is a lawyer who devotes much of his time to social causes and charities in Riverside. Mr. Bono received his law degree eight years ago, but has limited his law practice to a handful of court-appointed criminal cases each year.

When the president of the Riverside Food Bank, Happy Client, suffers minor injuries after being rear-ended at a stoplight, Mr. Bono volunteers to handle the personal injury claim for a 30% contingency fee. He promises Ms. Client a quick settlement.

Four years later, Mr. Bono sends Ms. Client a $6,500 check with "settlement" written on the memo line and a short letter saying he has waived his contingency fee since the case took longer than he anticipated. Ms. Client writes Mr. Bono, thanks him for his work, and asks him for a copy of the settlement agreement. Mr. Bono never responds. Ms. Client files a bar complaint against Mr. Bono.

The Virginia State Bar investigates and determines that Mr. Bono filed the personal injury lawsuit in 2012, non-suited it in 2014, and re-filed it in 2015. The court dismissed the lawsuit in 2016 after Mr. Bono failed to have it served within one year of filing. Mr. Bono confesses to VSB Investigator that he had never handled a personal injury case before, that he could not find an expert witness to testify, that he was embarrassed by his inability to move the case along, and that he paid the $6,500 to Ms. Client from his own personal funds.

Ms. Client is surprised by Mr. Bono's confession. She provides the VSB Investigator with a letter written to her by Mr. Bono in March 2016 – just two months after the lawsuit was dismissed – in which Mr. Bono states that he had driven to Norfolk the week before for a settlement conference on her case. He reported that the parties traded settlement proposals and that, as a result of his tenacious bargaining, he believes a settlement in the $5,000 to $7,500 range is achievable.

Misconduct Phase

Bar Counsel presents the case to the Disciplinary Board in July 2017. After a hearing, the Board finds the following violations in the case:

RPC 1.1 for failing to provide competent representation to Ms. Client.

RPC 1.3(a) for failing to exercise reasonable diligence in representing Ms. Client.

RPC 1.4(a) for failing to keep Ms. Client reasonably informed about the status of her lawsuit.

RPC 8.4(c) for engaging in dishonest and deceitful behavior that reflects adversely on his fitness to practice law by misrepresenting to Ms. Client that her personal injury lawsuit had resulted in a $6,500 settlement.

Sanctions Phase

The Board now convenes to determine the appropriate sanction. The Bar presents evidence of Mr. Bono's disciplinary history, which consists of no prior findings of misconduct. The Bar also calls Prosecuting Attorney, who testifies that Mr. Bono lied to her in 2016 when he told her that he needed a trial date continued to attend the funeral of his mother-in-law. Prosecuting Attorney also states that Mr. Bono later confessed the lie and apologized.

Mr. Bono testifies that he panicked when Ms. Client's personal injury lawsuit was dismissed and that, in order to avoid embarrassment, he told Ms. Client that he had settled her case. "I was going through a lot of issues at the time," he adds. "I was in and out of the hospital. I was having migraines and chest pains, but they could never tell me what was wrong. They put me on an anti-anxiety drug called Ativan. That seems to help. I'm just glad that I could fix the problem before anyone was harmed."

Mr. Bono also stated that, in addition to the $6,500 he paid to Ms. Client, he donated $1,000 to the Riverside Food Bank to help "set things straight." Finally, he testifies that he will probably stop taking clients soon. "The practice of law isn’t what I thought it would be, and I’ve learned I can’t handle the stress very well,” he tells the Board.

Ms. Client also testifies. She downplays her injuries from the car accident, states her belief that Mr. Bono is an asset to the Riverside Food Bank and the local community, and asks the Board to withhold imposing any discipline. “He made it right,” she tells the Board. “And that’s all that matters.”

When asked specifically about Mr. Bono’s $1,000 donation to the food bank, Ms. Client confirms the donation. “That was his idea too,” she states. “He asked me if I’d be nice if he made a big donation to the food bank.”

Three separate volunteers from local charities also testify that Mr. Bono has devoted hundreds of hours of his time to their charities over the past five years. None of the three, when asked, is aware of any particular health problem(s) Mr. Bono may have suffered recently.

<u>Deliberation: What is the appropriate sanction?</u>

Public Reprimand

One-Year Suspension

Three-Year Suspension

Other

WHAT'S IT WORTH? INTERACTIVE SANCTIONS PROGRAM

PURPOSES OF DISCIPLINE

The primary purpose of the bar's disciplinary system is to protect the public from unfit attorneys. The Supreme Court of Virginia has articulated the general principles to be considered in imposing a sanction as follows: "In arriving at the punishment to be imposed, precedents are of little aid, and each case must be largely governed by its particular facts, and the matter rests in the sound discretion of the court. The question is not what punishment may the offense warrant, but what does it require as a penalty to the offender, as a deterrent to others, and as an indication to laymen that the [bar] will maintain the ethics of the profession." *Maddy v. District Committee*, 205 Va. 652, 658 (1964), *quoting* 7 Corpus Juris Secundum, Attorney and Client, Section 38.

So the primary goals of discipline are:

- Penalizing the misconduct;
- Deterring other lawyers from committing misconduct; and
- Upholding the integrity of self-regulation

SANCTIONS OPTIONS AT EACH LEVEL

- Subcommittee Level:

<u>Without</u> the agreement of the Respondent, a Subcommittee may impose:

- A Dismissal *De Minimis* - defined as a finding the Respondent engaged in Misconduct that is clearly not of sufficient magnitude to warrant disciplinary action and the Respondent has taken reasonable precautions against a recurrence of same. (13-15.B.1.c)

- A Dismissal for Exceptional Circumstances - defined as a finding the Respondent engaged in Misconduct but there exist exceptional circumstances mitigating against further proceedings, which circumstances must be set forth in writing. (13-15.B.1.d)

- An Admonition Without Terms - Admonition generally defined as a private sanction imposed upon a finding that Misconduct occurred but no substantial harm to the Complainant or the public occurred and no further disciplinary action is necessary. (13-15.B.2)

A Subcommittee may also authorize an agreed disposition for:

- A Private or Public Admonition with or without Terms (13-15.B.4.a)

- A Private or Public Reprimand with or without Terms (13-15.B.4.b and c)

Generally, all Subcommittee decisions are by majority vote with the exception of approval of an agreed disposition which must be unanimous. (13-15.C).

In lieu of imposing discipline, a Subcommittee may:

- Set the complaint for a District Committee Hearing. (13-15.B.5) OR
- Certify the complaint to the Disciplinary Board for hearing based on a reasonable belief that Respondent engaged in Misconduct that, if proved, would justify a suspension or revocation. (13-15.B.3)

- District Committee Level:

A District Committee may impose any of the above except that any sanction must be public.

In lieu of imposing discipline, a District Committee may certify the complaint to the Disciplinary Board for hearing or initiate a proceeding before a three-judge panel.

District Committee decisions are by majority vote.

- Disciplinary Board/Three-Judge Panel Level:

A Disciplinary Board Panel and Three-Judge Panel may impose:

- A Public Admonition with or without Terms (13-18.M.1)
- A Public Reprimand with or without Terms (13-18.M.2)
- License Suspension for a stated period not exceeding five years (13-18.M.3.a)
- License Suspension for one year or less with Terms (13-18.M.3.b)

  OR

- License Revocation. (13-18.M.4)

A Disciplinary Board Panel and Three-Judge Panel may also authorize an agreed disposition for any of the above.

All Disciplinary Board and Three-Judge Panel decisions, including approval of agreed dispositions, are by majority vote.

Note that dismissal sanctions (*De Minimis*/Exceptional Circumstances) are not authorized at the Disciplinary Board/Three-Judge Panel Level. (13-18.M.)

FACTORS TO BE CONSIDERED

The ABA has published Standards for Imposing Lawyer Sanctions which set out the following factors a tribunal should consider in imposing a sanction:

- The nature of the duty violated (lawyers owe duties to clients, the public, the legal system, and as a professional);
- The lawyer's mental state (intentional, knowing or negligent);
- The potential or actual injury caused by the lawyer's misconduct; and

- The existence of aggravating or mitigating factors

- Aggravating Factors

The following may justify an increase in the degree of discipline:

- Prior disciplinary offenses;
- Dishonest or selfish motive;
- A pattern of misconduct;
- Multiple offenses;
- Bad faith obstruction of the disciplinary proceeding by intentionally failing to comply with rules or orders of the disciplinary agency;
- Submission of false evidence, false statements, or other deceptive practices during the disciplinary process;
- Refusal to acknowledge wrongful nature of conduct;
- Vulnerability of victim;
- Substantial experience in the practice of law;
- Indifference to making restitution;
- Illegal conduct, including that involving the use of controlled substances.

- Mitigating Factors

The following may justify a reduction in the degree of discipline:

- Absence of a prior disciplinary record;
- Absence of a dishonest or selfish motive;

- Personal or emotional problems;

- Timely good faith effort to make restitution or to rectify consequences of misconduct;

- Full and free disclosure to disciplinary board or cooperative attitude toward proceedings;

- Inexperience in the practice of law;

- Character or reputation;

- Physical disability;

- Mental disability or chemical dependency including alcoholism or drug abuse when:

    - There is medical evidence that the respondent is affected by a chemical dependency or mental disability;
    - The chemical dependency or mental disability caused the misconduct;
    - The respondent's recovery from the chemical dependency or mental disability is demonstrated by a meaningful and sustained period of successful rehabilitation; and
    - The recovery arrested the misconduct and recurrence of that misconduct is unlikely;

- Delay in disciplinary proceedings;

- Imposition of other penalties or sanctions;

- Remorse;

- Remoteness of prior offenses.

TOP 10 BAR COMPLAINTS

This presentation will address some of the most common types of complaints that the Bar receives. These written materials provide information regarding the Rules of Professional Conduct that apply to these types of complaints, as well as examples of disciplinary cases applying these Rules.

Competence. Diligence and Communication

Many bar complaints involve allegations that an attorney neglected a client's case. Specific allegations include that an attorney failed to return telephone calls, missed deadlines, or otherwise failed to take action as promptly as a client desired. The Rules of Professional Conduct most commonly implicated in neglect cases are Rules 1.1 (competence), 1.3 (diligence) and 1.4 (communication).

Mistakes are not necessarily misconduct. In *Pickus v. Virginia State Bar,* 232, Va. 5, 348 S.E.2d 202 (1986), the Supreme Court of Virginia stated that neglect that rises to the level of an ethical violation "involves indifference and a consistent failure to carry out the obligations which the lawyer has assumed to his client or a conscious disregard for the responsibility owed to the client . . . . Neglect cannot be found if the acts or omissions complained of were inadvertent or the result of an error of judgment made in good faith." *Id,* 232 Va. 5, 11, 348 S.E.2d 202 (1986), citing *ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1273* (1973).

Earlier this year the Fifth District Committee, Section II issued a public reprimand to an attorney for violations of Rules 1.3(a) and 1.4(a), among others. Respondent agreed to take on a personal injury case in July 2013. The insurance carrier denied his client's claim in October 2013. Respondent thought that he had terminated the representation at that point, but he provided no documentation of having done so. Rather, Respondent allowed the client to believe that he was still representing his interests for nearly two years, until after the statute of limitations had expired. *In Re: Patrick Richard Blasz,* VSB Docket Nos. 16-052-105221, 16-052-105641 (5-

11 Dist. Comm. Apr. 3, 2017). Respondent's actions rose to the level of ethical misconduct because (a) his conduct occurred over a lengthy period of time; and (b) his lack of clarity and inaction placed his client in a situation where the statute of limitations had expired.

Another attorney was disciplined for failing to perfect an appeal in two separate cases. In one instance, Respondent filed the notice of appeal several days late, and then did not tell his client that he had failed to timely appeal the case. In the other, Respondent never told his client that the appeal had been dismissed. *In re Michael Denis Kmetz,* VSB Docket No. 15-022103103 (2d Dist. Comm. Dec. 5, 2016). Although missing a single deadline is rarely considered ethical misconduct, Respondent's pattern of conduct, along with his failure to promptly inform his clients of his mistakes, resulted in discipline.

<u>Attorney's Obligation to Third Parties With Financial Interest in Litigation</u>

Sometimes the Bar receives complaints from third parties that they have not received payment from settlement proceeds. Rule of Professional Conduct 1.15(b)(4) requires an attorney to "promptly pay or deliver to the client or another as requested by such person the funds, securities, or other properties in the possession of the lawyer that such person is entitled to receive." A lawyer is also precluded from disbursing "funds . . . of a client or third party without their consent or conver(ing) funds . . . of a client or third party . ." *Id.*

Legal Ethics Opinion 1747 (2000) states that an attorney is required to honor (1) a valid lien on a case for medical bills; and (2) a contract signed by a client agreeing to pay a medical obligation out of settlement proceeds. *Id.* If a dispute exists, the attorney should escrow or interplead the funds. In *Virginia State Bar v. Timothy O'Connor Johnson,* Case No. CL09-2034 (Richmond Cir. Ct. Aug. 11. 2009), a three-judge panel found that Respondent violated the former Rule 1.15(c)(4) by refusing to honor a chiropractor's consensual lien with a client. Although Respondent was not a party to the assignment of benefits, he knew that his client had contracted with the chiropractor to pay the medical bill out of settlement. When the chiropractor refused to reduce his bill, Respondent attempted to arbitrate the dispute by disbursing to the chiropractor an amount less than what was owed. A three-judge panel found that Respondent owed a duty to either (1) pay the full amount owed to the chiropractor; (2) hold the amount in dispute in trust until the client and the chiropractor could resolve their dispute; or (3) interplead the disputed funds into the court. The court affirmed the District Committee's finding of misconduct.

Legal Ethics Opinion 1865 (Nov. 16, 2012) (copy attached) further explores an attorney's duties in the face of third party claims.

Trust Account Overdraft Notices

Rule 1.15(b) requires an attorney to set up a trust account at a financial institution specifically approved by the Virginia State Bar for that purpose. To be approved to maintain attorney trust accounts, the bank must agree to notify the Virginia State Bar every time an attorney trust account is overdrawn.

Frequently, a trust account overdraft notice is the result of a simple and isolated mistake that is quickly addressed and does not place client funds at substantial risk. Sometimes, however, it is an indicator of a larger problem. Examples of problems uncovered by trust account overdraft notices include:

- Leaving the attorney's money in the trust account for long after it has been earned, in violation of Rule 1.15(a)(3).
- Failure to maintain proper trust accounting procedures required by Rule 1.15(c).
- Failure to disburse "the funds, securities, or other properties in the possession of the lawyer that such person is entitled to receive," as required by Rule 1.15(b)(4).

In Re: H. Glenn Goodpasture, VSB Docket No. 17-060-108217 (6th Dist. Comm. Apr. 18, 2017) illustrates the terrifying consequences of failure to perform regular trust account reconciliations. The Bar received notification that Respondent had overdrawn his trust account by more than $100,000. An investigation revealed that Respondent's paralegal had been stealing money from the trust account for more than a year. The paralegal has since been indicted on 13 counts of embezzlement, totaling more than $200,000. Upon discovering the theft, Respondent fired the employee and took personal and financial responsibility for the loss. However, had Respondent been performing regular reconciliations as required by Rule 1.15, the losses should and would have been discovered much sooner. Accordingly, Respondent received both a public admonition and a substantial financial loss.

Commissioner of Accounts Complaints

Many attorneys serve as fiduciaries who are required to file accountings with the Commissioner of Accounts. Some attorneys perform this work as part of their regular profession, and others serve in this role only for family members and close friends. Regardless, when a fiduciary fails to make a complete and proper accounting by the deadline, the Commissioner is required to either issue a summons to the fiduciary pursuant to Va. Code § 64.2-1215 or to file a list of delinquent fiduciaries with the Circuit Court. When an attorney fails to respond to the Commissioner's summons or is reported to the Circuit Court, the Commissioner is required to notify the Bar. *See* Va. Code § 64.2-1216(C).

Missing a deadline, in and of itself, is not necessarily ethical misconduct. The difference between Commissioner of Accounts cases and other neglect cases is the requirement that the Commissioner of Accounts notify the Bar. As with other neglect cases, the Rules of Professional Conduct that are typically considered in Commissioner of Accounts cases are Rules 1.1 (Competence) and 1.3 (Diligence).

In Re: James Willis Hilidrup, VSB Docket No. 14-060-099391 (6th Dist. Comm. Nov. 16, 2015) is an example of a Commissioner of Accounts report that resulted in serious discipline. Respondent qualified as the Executor for his parents' estate. Respondent failed to submit inventories and accountings as required by law, and subsequently ignored both a warning letter and a summons from the Spotsylvania County Commissioner of Accounts. The Court ordered Respondent to file the inventory and accountings by a date certain, and Respondent failed to comply fully and on time. Respondent also failed to respond to the Bar's initial inquiry, thus violating Rule 8.1(c). Pursuant to an Agreed Disposition, the Disciplinary Board found that

Respondent violated Rules 1.3(a), 1.16(e) and 8.1(c) and suspended his license to practice law for 30 days.

Communications with Represented Persons

Rule 4.2 precludes a lawyer from communicating "about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so. Frequently, whether an attorney has violated Rule 4.2 depends on whether he or she knows that the person is represented at the time of the communication. The Rule does not say that the attorney "should know"; rather, it requires actual knowledge. Often, Rule 4.2 allegations are the result of a mistake or misunderstanding, in which case no violation can be found.

A well-known case involving an alleged Rule 4.2 violation is *Zaug v. Va. State Bar ex rel. Fifth Dist.-Section III Comm.* 285 Va. 457, 737 S.E.2d 914 (2013). Respondent was representing a doctor in a medical malpractice case. A plaintiff in that case called Respondent and told her about the stress that the lawsuit was causing her family. The plaintiff said that the forthcoming deposition of her husband would need to be canceled, and that she wanted to dismiss the lawsuit. Respondent told the plaintiff to contact her own counsel, and ended the call after about one minute. The Subcommittee issued a dismissal *de minimis* for violation of Rule 4.2, which Respondent appealed. The full district committee also imposed a dismissal *de minimis,* and a three-judge panel affirmed the district committee's decision.

Respondent appealed to the Supreme Court of Virginia, which reversed the decision. The Court held that the Bar failed to prove precisely when Respondent knew (a) that the plaintiff was represented; and (b) that the plaintiff was calling regarding the subject of her representation. Respondent's witness testified that Respondent terminated the telephone call within 30 seconds of learning these things, and the Court held that this was sufficient to comply with the Rule. The Court stated that terminating the call any sooner would have been discourteous and unprofessional, which is behavior that compliance with the Rules is intended to avoid.

Perceived Conflicts

Rule of Professional Conduct 1.7 is the general rule regarding conflicts of interest. Rules 1.8 through 1.11 address particular scenarios involving conflicts of interest.

Many members of the public, and even attorneys, have the misconception that if a person knows or knows of an attorney, that attorney cannot be adversarial to that person. These types of complaints frequently arise in the domestic relations context. A common complaint is that the complainant's current spouse's ex-spouse is represented by the complainant's former attorney in a custody dispute. This representation generally does not violate Rule 1.7 because the complainant, who had the prior relationship with the attorney, is not a party to the current custody dispute.

Another example of a common perceived conflict is an attorney who once represented a client in an unrelated matter and is now adverse to the client. For example, an attorney represented a complainant in a traffic matter more than 10 years ago. Now, the same attorney (who has since become an Assistant Commonwealth's Attorney) is prosecuting the complainant for grand larceny. Pursuant to Rule 1.9(a), the representation presents a conflict only if the two matters are "substantially related." In this situation, the alleged violations are probably too different and too remote in time to be substantially related.

That said, the Bar still addresses a number of very serious cases involving conflicts of interest. Once recent case was *In Re: Neil Kuchinsky,* Case No. CL-16-3242, VSB Docket No. 16-033-105536 (Chesterfield Cir. Ct. Mar. 14, 2017). There, Respondent represented a plaintiff in a civil lawsuit. Respondent set up a meeting with the defendant, who was unrepresented. During the meeting, Respondent told the defendant that he would settle the lawsuit if the defendant would engage in intimate contact with him. Pursuant to an Agreed Disposition, the three-judge panel found that Respondent violated Rule 1.7(a)(2), because there was a "significant risk that the representation of one . . . client . . . [would] be materially limited by . . . a personal interest of the lawyer." Respondent was suspended for five years.

Immigration Complaints/Matter *of Lozada*

In an immigration case, a party can attempt to overturn an adverse decision by alleging that his counsel was ineffective. In order to make such a claim, the party has to either (a) state that a Bar complaint has been filed; or (b) explain why a Bar complaint has not been filed. *Matter of Lozada,* 19 I&N 637 (BIA 1988). Understandably, many clients choose to file a Bar complaint. These complaints typically involve allegations of lack of diligence (Rule 1.3) and communication (Rule 1.4), and are subject to the same type of analysis as other cases involving neglect.

For example, *In Re: Alfred Lincoln Robertson, Jr.,* VSB Docket No. 15-042-102961 (4-11 Dist. Comm. May 31, 2016) involved a client who hired Respondent in September 2011. The client did not hear from Respondent for nearly four years. When the client followed up, he learned that Respondent had not filed the necessary forms to prevent the client's green card from expiring. Respondent accepted full responsibility for his mistake and refunded the client the full fee he had paid. Respondent signed an agreed disposition for a public reprimand with terms, in which he acknowledged that he had violated Rules of Professional Conduct 1.3 and 1.4.

Threats of Criminal or Disciolinary Charges

Pursuant to Rule of Professional Conduct 3.4(i), a lawyer may not "[p]resent or threaten to present criminal or disciplinary charges solely to obtain an advantage in a civil matter." Whether a threat has occurred is usually a straightforward determination. However, whether an attorney has committed a Rule 3.4(i) violation usually hinges on whether the threat was "solely" to obtain advantage in a civil matter. If the attorney had a separate, legitimate purpose for making the threat, a Rule 3.4(i) violation cannot have occurred under the plain language of the Rule.

In Re Vincent Mark Amberly, VSB Docket No. 16-053-105949 (5-III Dist. Comm. Feb. 21, 2017), was a recent matter involving a Rule 3.4(i) violation. There, the complainant had written a negative Yelp review of Respondent's client, and the complainant later testified as a fact witness in a civil matter, giving testimony adverse to Respondent's client. Respondent wrote the complainant a letter in which he contended that the complainant's testimony was false. He concluded the letter:

> My clients have requested that I proceed with a defamation case against you as well as seeking to press perjury charges against you. Before I proceed with litigation, I am writing you in an attempt to resolve and settle your defamation and perjury in an amicable and acceptable manner to all parties involved.

Respondent acknowledged that the purpose of raising the perjury threat was to persuade the complainant to negotiate with him. He also said that he had used similar language "on numerous other occasions with other potential adversaries," and, when asked, he provided the Bar with examples. Respondent received a public reprimand with terms.

<u>Civility</u>

A number of different Rules of Professional Conduct could apply to uncivil behavior by attorneys. Rule 3.4(j) states that an attorney shall not:

> File a suit, initiate criminal charges, assert a position, conduct a defense, delay a trial, or take other action on behalf of the client when the lawyer knows or when it is obvious that such action would serve merely to harass or maliciously injure another.

Along similar lines, Rule 4.4 states:

> In representing a client, a lawyer shall not use means that have no purpose other than to embarrass, delay, or burden a third person, or use methods of obtaining evidence that violate the legal rights of such a person.

In the most extreme cases, Rule 8.4(b) states that it is professional misconduct for a lawyer to "commit a criminal or deliberately wrongful act that reflects adversely on the lawyer's honesty, trustworthiness or fitness to practice law."

In Re John George Crandley, VSB Docket No. 14-021-099622 (2d Dist. Comm. Oct. 13, 2015), is a recent example of an attorney who was disciplined for uncivil behavior. As part of an agreed disposition, Respondent acknowledged that during a deposition, he repeatedly referred to the plaintiff's case as "crap." Respondent asked opposing counsel to move his file from view during the deposition, and when opposing counsel refused, Respondent said that the refusal was "nonsense" and "baloney." Respondent later said, condescendingly, that he was "sorry if I hurt your feelings" and asked if opposing counsel would like some water to help him feel better. While later impeaching the plaintiff, Respondent commented that he was "enjoying this." Respondent received a public reprimand without terms for violating Rules 3.4(j) and 4.4. Because this public reprimand was a violation of a prior probationary term, Respondent subsequently received a 90-day suspension. *In Re John George Crandley,* VSB Docket No. 16-021-105363 (Disc. Bd. May. 17, 2016).

VIGNETTES WITH A TWIST

Applicable LEOs and Rules of Professional Conduct ("RPCs"), with selected Comments, are attached for your ease of reference. Please note that not all RPCs apply, and some will have no application to any of the scenarios. This is intentional - your analysis should include elimination of RPCs as well as inclusion of them, based upon the evidence. Remember - the Virginia State Bar's burden of proof is clear and convincing evidence.

Focus on your jurisdiction's local rules, if any apply, and conventional methods of practice, again to the extent that they differ. Disagreement on issues is welcome. Each question assumes you are either Bar Counsel prosecuting the case, are a member of the subcommittee initially reviewing the case and voting whether or not to dismiss the matter or pursue some disciplinary sanction, or are a member of the ultimate adjudicatory panel, whether the Disciplinary Board, Three Judge Panel, or District Committee. Each set of problems will be discussed at the end of the 30 and 45 minute small group discussion period. The large group discussion will be conducted by the program moderators after you have analyzed the problems and answered the questions provided. Please move quickly to prepare your Team Leader to report to the group.

PROBLEM #1 (Amendments to RPC 1.6)

Ted Nology is an attorney practicing in a ten (10) person firm in an "eat what you kill" type of partnership. Mr. Nology handles criminal defense matters, divorce, and custody cases. Since the other members of his firm are engaged in practices entirely different and separate from his, Mr. Nology is the sole firm member handling these types of cases and his partners routinely send all criminal defense and matrimonial matters that come to the firm to him. Mr. Nology's firm hired a technology company to develop a "client portal" for the firm's use. At the time of the initial consultation with his clients, Mr. Nology advises his clients that they will be expected to upload all of their documents to their portal, to which they will have access 24/7. Mr. Nology, in turn, uploads everything that he generates over the course of the representation, including Intake Memoranda, which contain social security numbers, dates of birth and the like, correspondence with the client and others, pleadings, notes, billing records, etc.

After hiring the technology firm to create their client portal, Mr. Nology and his partners decided against retaining the firm on a semi-annual basis to conduct a security review because the cost was quite high, the law firm's margins are pretty tight, and this would have added a layer of difficulty to the firm's and its clients' use of the portal. Mr. Nology also believed that the portal was sufficiently secure as created, although one of his partners had a data breach recently that luckily did not result in any client harm. The firm also employs an IT person on a contract basis who is relatively familiar with the security and operation of the portal.

Because he is in court nearly all of the time, Mr. Nology created a "back door" entrance into the client portal through his personal smartphone. This allows him access to his clients' files regardless of where he is and allows him to communicate with his clients, keep them informed about what is happening in their cases, and answer any questions they might have quickly and efficiently. Mr. Nology can also pull down documents from the portal and email them to his clients directly from his smartphone.

The firm's portal was hacked and sensitive client information obtained, resulting in the theft of the identities of numerous firm clients. In addition, Mr. Nology lost his smart phone at the courthouse one day. Several clients have filed complaints with the Virginia State Bar. Based on the information you have:

A. If you were to prosecute the case, or were a member of the subcommittee reviewing these facts, what would be the Rules of Professional Conduct ("RPCs) implicated?
B. What would you consider in whether or not to prosecute, or vote to go forward with, this case?
C. Do you believe that the factual record is sufficient to support a finding by clear and convincing evidence of the rule violations you note?
D. If you were a member of the adjudicatory panel, would you vote in favor of finding that all of the rules charged were violated? What sanction would you impose? What ABA factors in aggravation and mitigation did you consider and how much weight did you give to each?
E. What are the differences, if any, on the above questions among your "team?"

PROBLEM #2 (Amendments to RPC 1.6)

During the course of his representation of Jimmy Tudor, who is charged with assault, battery, and malicious wounding, Mr. Nology interviewed one of the Commonwealth's witnesses, Fred See, who was present at the scene of the crime. Fred told Mr. Nology that he intended to testify that he watched as Mr. Tudor beat and kicked a man who was on the ground and barely conscious, something Mr. Tudor denies. Mr. Tudor, for his part, told Mr. Nology that it was Fred who beat the guy to a pulp, not him. The beaten man cannot recall since he was basically unconscious and suffered a severe concussion.

After his meeting with Fred, Mr. Nology had a meeting with Mr. Tudor, in which he relayed to him what Fred told him. Mr. Tudor became enraged and said, "I am going to kill that snitch! I know where he works and I will be waiting for him tonight when he gets off work!" Mr. Nology was troubled by these statements, but didn't think Mr. Tudor would actually harm Fred as he had known Mr. Tudor for years and, while he knew Mr. Tudor was a petty criminal, he had never been a violent one. Mr. Nology, therefore, did nothing. The next morning, the local newspaper reported that Fred had been accosted as he left his place of employment and was now in a coma. Based on the information you have:

A. If you were to prosecute the case, or were a member of the subcommittee reviewing these facts, what would be the Rules of Professional Conduct ("RPCs) implicated?
B. What would you consider in whether or not to prosecute, or vote to go forward with, this case?

C. Do you believe that the factual record is sufficient to support a finding by clear and convincing evidence of the rule violations you note?

D. If you were a member of the adjudicatory panel, would you vote in favor of finding that all of the rules charged were violated? What sanction would you impose? What ABA factors in aggravation and mitigation did you consider and how much weight did you give to each?

E. What are the differences, if any, on the above questions among your "team?"

PROBLEM #3 (Legal Ethics Opinion 1886)

One of Mr. Nology's partners, Ward Cleaver, has been an esteemed and well respected member of the bar for decades, dedicating his practice to estate work and appellate advocacy. He has a stellar reputation, has served on the Board of Bar Examiners, literally wrote the book on appellate advocacy in Virginia, and has received countless achievement awards during his career. One day, Mr. Nology received a phone call from one of Mr. Cleaver's clients, B. G. Shot, for whom Mr. Cleaver was set to argue an appeal of a criminal case before the Virginia Supreme Court. Mr. Shot, who is a drinking buddy of Mr. Nology, informed him that Mr. Cleaver failed to timely perfect that appeal, resulting in its dismissal. Mr. Shot was not too upset about the dismissal since he was not sure he intended to pursue the appeal all the way in any event.

Mr. Nology is fairly certain that there is a procedure by which the appeal can be resurrected, but he does nothing, telling Mr. Shot to give Mr. Cleaver a break given his stature in the legal community. The next morning, Mr. Nology ran into Mr. Cleaver in the firm lobby and noticed that he looked disheveled and confused. Since he was on his way out the door to court, Mr. Nology did not stop to chat and he soon forgot about this encounter.

After his encounter with Mr. Cleaver, Mr. Nology took on a complicated divorce and custody case for a very rich client, Lotsa M. Bags, III. Given the complexity of the case, Mr. Nology required an advance fee of $50,000.00. Mr. Bags gave him a check for that amount which Mr. Nology personally endorsed and gave to his long-time secretary, instructing her to deposit it into the firm's trust account. Mr. Nology began working on the case in earnest and by the end of the first month, had racked up nearly $30,000.00 in billables. He instructed his secretary to write him a check for that amount which he signed and then deposited into his personal account. The check bounced. An investigation revealed that the secretary had taken Mr. Bags' $50,000.00 check and cashed it, put the money in her pocket and, when Mr. Nology attempted to withdraw the $30,000.00, caught the next plane to Rio. The NSF automatically triggered a report to the Virginia State Bar.

Mr. Nology was having a very bad month. Imagine his joy when Jim Pain wheeled into his office. Mr. Pain had been severely injured in an automobile accident caused when a dump truck opened by accident on 1-95 South, dumping five tons of manure and causing a 10-car pile up. Mr. Pain was left with serious injuries and was wheel chair bound with multiple broken bones. Mr. Nology dutifully prepared the case, collecting Mr. Pain's medical records and communicating with the insurance adjuster. Mr. Pain began seeing a chiropractor, Dr. Alex Crack, as his condition improved in order to get his bones back in alignment. Dr. Crack submitted an Assignment and Authorization to Mr. Nology for his signature but Mr. Nology forgot to return it to him. The case settled, and Mr. Nology pulled his file to ensure that all Assignments were honored and those medical bills paid before he disbursed funds to his client and to himself. Dr. Crack's Assignment had been placed in the wrong file and so it was missed completely. Some months later, Dr. Crack called Mr. Nology for a status update. Mr. Nology realized what had happened, advised Dr. Crack of the oversight, and then appealed to his client,

Mr. Pain, to settle up with the good doctor. Mr. Pain refused to do so, and Dr. Crack filed a complaint with the Virginia State Bar. Based on the information you have:

A. If you were to prosecute the case, or were a member of the subcommittee reviewing these facts, what would be the Rules of Professional Conduct ("RPCs) implicated?
B. What would you consider in whether or not to prosecute, or vote to go forward with, this case?
C. Do you believe that the factual record is sufficient to support a finding by clear and convincing evidence of the rule violations you note?
D. If you were a member of the adjudicatory panel, would you vote in favor of finding that all of the rules charged were violated? What sanction would you impose? What ABA factors in aggravation and mitigation did you consider and how much weight did you give to each?
E. What are the differences, if any, on the above questions among your "team?"

PROBLEM #4

Some years later, Mr. Nology agreed to undertake the representation of a woman, Beatrice Focks, who claimed to have been sexually harassed at the television station where she worked. Ms. Focks explained to Mr. Nology that, when she brought the harassment to the attention of her superiors, following the internal protocols for reporting such events, she was summarily fired. Ms. Focks, who has a graduate degree in journalism and is quite bright and sophisticated, is nonetheless very distraught over how she was treated by people she trusted and had worked with for many years. She required a great deal of hand holding and reassurance. Mr. Nology told her she could email or call him anytime and she took him up on this offer. Although Mr. Nology never handled a sexual harassment suit, he has twenty (20) years of trial experience and is a good researcher. He did not charge Ms. Focks for the time he spent learning how to handle this type of case.

As the case proceeded, Mr. Nology filed the predicate EEOC Claim and obtained Ms. Focks' "Right to Sue" letter. He dutifully recorded and maintained all of the filing and other deadlines in the case on his smart phone. However, the day after he received Ms. Focks' "Right to Sue" letter, his phone dropped out of his pocket and he ran it over in his driveway. He had no backup calendaring system in place other than to upload the information from his phone to his personal computer at the office, which he did weekly. Unfortunately, he had not yet conducted his weekly back up of his phone data before crushing it in the driveway. As a result, he missed the deadline set forth in the "Right to Sue" letter to file Ms. Focks' suit. Horrified and embarrassed, Mr. Nology did not tell Ms. Focks what had happened and instead took steps to get an extension of the deadline from EEOC. Fortunately, he was able to do so and he thereafter filed suit on Ms. Focks' behalf.

Ms. Focks called and/or emailed Mr. Nology at least once, and sometimes multiple times, each day seeking status updates. Mr. Nology answered most of her calls and emails, but left the bulk of the updating responsibilities to his secretary, who could not report on substantive matters and mostly just held Ms. Focks' hand. The case proceeded toward trial with depositions and other matters coming fast and furious. Ms. Focks' need for information only increased as the case went on such that she was calling Mr. Nology several times a day. Eventually, she became disillusioned by Mr. Nology because of what she felt was a lack of care and attention to her case. She fired Mr. Nology and asked for her file back.

Terrified that Ms. Focks would discover the fact that he missed the first filing deadline, Mr. Nology delayed returning her file to her for several weeks despite receiving multiple demands from her new attorney. Mr. Nology knew that Ms. Focks had access to her portal, however, so he was not very pressed to return the file. When he finally did download the documents, copy them, and send the file to Ms. Focks' new lawyer, it did not contain the first "Right to Sue" letter. Ms. Focks and her new attorney obtained a copy of the first "Right to Sue" letter during discovery, and she promptly filed a complaint with the Virginia State Bar.
Based on the information you have:

A. If you were to prosecute the case, or were a member of the subcommittee reviewing these facts, what would be the Rules of Professional Conduct ("RPCs) implicated?
B. What would you consider in whether or not to prosecute, or vote to go forward with, this case?
C. Do you believe that the factual record is sufficient to support a finding by clear and convincing evidence of the rule violations you note?
D. If you were a member of the adjudicatory panel, would you vote in favor of finding that all of the rules charged were violated? What sanction would you impose? What ABA factors in aggravation and mitigation did you consider and how much weight did you give to each?
E. What are the differences, if any, on the above questions among your "team?"

CREDITORS' RIGHTS AND BANKRUPTCY LAW FOR NORMAL LAWYERS
(aka, The Basics For State Court Practitioners)

Virginia Beach Bar Association
Las Vegas, Nevada
October 7, 2017

PRE-LITIGATION

I. Confession of Judgment (Va. Code § 8.01-432).

1. Pre- or post-litigation

2. Written agreement in which the defendant admits liability and accepts the amount of agreed upon damages that must be paid to the plaintiff; minimizes the need for litigation to resolve a dispute.

3. § 8.01-433.1: Notice in boldface print not less than 8 point type:

   THIS INSTRUMENT CONTAINS A CONFESSION OF JUDGMENT PROVISION, WHICH CONSTITUTES A WAIVER OF IMPORTANT RIGHTS YOU MAY HAVE AS A DEBTOR AND ALLOWS THE CREDITOR TO OBTAIN A JUDGMENT AGAINST YOU WITHOUT ANY FURTHER NOTICE.

4. After confession, plaintiff serves the judgment on the defendant and defendant has 21 days under § 8.01-433.1 to attack.

5. Attorney-in-fact: you and/or your law firm.

6. Default provisions: interest, attorneys' fees, costs, etc.

7. Be careful because you are signing away rights to contest the claim.

II. Pre-Judgment Writ of Attachment (Va. Code §§ 8.01-533 through 576).

1. Seizing another's property in accordance with a writ or order for the purpose of securing satisfaction of a judgment yet to be rendered.

2. Standing - any entity that has a legal or equitable claim to:

   (a) any specific personal property;

   (b) any debt, including rent, whether it is due and payable or not;

   (c) damages for breach of contract, express or implied; or

   (d) damages for a wrong, or for a judgment for which no supersedeas or other appeal bond has been posted.

3. Va. Code Ann. § 8.01-534. Pretrial Attachment/Seizure:

   (a) File complaint pursuant to Va. Code Ann. § 8.01-537.

   (b) Section A of § 8.01-534 deals with the defendant. Pretrial attachment can be had if the defendant:

      (i) Is a nonresident or foreign corporation and has an estate or debts owing within the jurisdiction of the attachment;

      (ii) Is removing or is about to remove himself from the Commonwealth with intent to change domicile;

      (iii) Intends to remove or has removed the property from the Commonwealth;

      (iv) Is converting or about to convert property to hinder creditors;

      (v) Has assigned or disposed of property to hinder creditors;

      (vi) Has absconded, concealed or is about to conceal property to injure his creditors or is a fugitive from justice;

(c) Section B of § 8.01-534 deals with the property. Pretrial attachment can be had if the property:

(i) Will be sold, removed, or secreted or otherwise disposed of by the defendant in violation of an obligation to the plaintiff; or

(ii) Will be destroyed, or materially damaged or injured if permitted to remain in possession of defendant.

III. Lis Pendens (Va. Code § 8.01-268).

1. Notice of jurisdiction, power, or control which courts acquire over property in litigation pending action until final judgment, and is historically designed to protect a plaintiff from transfer or loss of real property which is the subject of a dispute.

2. A lis pendens does not create a lien, but rather binds third parties to the outcome of the pending litigation in the form of an encumbrance.

3. Potential uses of lis pendens:

(a) Domestic relations suits involving equitable distribution of spousal property;
(b) Partition actions by joint tenants;
(c) Quiet title;
(d) Purchases at executions, judicial sales, and tax sales;
(e) Avoidance actions involving fraudulent transfers, actual fraud, etc.;
(f) Complaints involving injunctions;
(g) Suit to enforce a lien;
(h) Mechanic's lien filing and its litigation;
(i) Adversary proceedings in bankruptcy;
(j) Intervention proceedings;
(k) Estate litigation;
(l) Arbitration (and possibly mediation);
(m) Landlord and tenant actions;
(n) Constructive trust litigation;
(o) Easements;
(p) Eminent domain and condemnation;

(q) Foreclosure;
(r) Specific performance;
(s) Forfeiture; and
(t) Adverse possession.

4. Virginia Code § 8.01-268(A) requires a very specific list of items which must be included in a memorandum of lis pendens:

(a) The title of the cause of the action or attachment;
(b) The general object of the action;
(c) The court where the action is pending;
(d) The amount of the claim;
(e) A description of the property; and
(f) Name of person whose estate is to be affected.

5. Analysis for a lis pendens action:

(a) Does the court have jurisdiction?

(i) The property must be located in the jurisdiction where the lis pendens action is filed; and

(ii) The court must have jurisdiction over the property.

(b) Filing of a lis pendens notice:

(i) Under Va. Code Ann. § 8.01-268, suits must be formally recorded in the recorder's office where the property is located; and

(ii) The instrument must also be properly indexed.

6. Defense of a lis pendens action:

(a) Lis pendens is an equitable action and, therefore, equitable defenses may work in the defense of a lis pendens action; and

(b) Slander of title is a defense of a lis pendens action if a lis pendens is improperly instituted. However, *see* 51 Am. Jur. 2d Lis Pendens § 44.

7. Difference between a pretrial attachment and a lis pendens?

(a) An attachment affects property and what the owner can do with the property, but a lis pendens does not. Also, please note the following:

(i) Rights of the plaintiff in a pretrial attachment are more significant than with a lis pendens; thus, there are more requirements for attachment;

(ii) A lis pendens action is important because of the effect on the property while litigation is pending;

(iii) Practitioners often confuse an attachment and lis pendens. A lis pendens is designed to put third persons on notice that there <u>may be</u> a claim which could affect the property. It is <u>prospective</u>. An attachment is much more serious and has immediate consequences on the property and what the defendant can do with the property pending litigation.

<u>IF NO RESPONSE, THEN GO AND GET A JUDGMENT</u>

I. File Suit.

1. General District Court:

(a) Jurisdiction < $25,000 exclusive of interest and attorneys' fees contracted for in instrument (§16.1-77):

(i) Exclusive less than $4,500; and
(ii) Concurrent with Circuit Court: $4,500 to $25,000.

(b) Exceptions to $25,000 threshold:

(i) § 55-230 (distress petition (i.e., prejudgment writ));
(ii) § 46.2-1135 (violations of vehicle weight);
(iii) § 19.2-143 (forfeiture of bond);
(iv) Certain interpleader suits; and

(v) Unlawful detainers (§ 16.1-77(3)) (commercial and residential).

2. Circuit Court:

(a) All claims for more than $25,000; and

(b) Certain jurisdictional specific claims.

II. Warrant in Detinue. File regarding specific property or obtain judgment for value.

III. Fair Debt Collection Practices Act (FDCPA)

1. The FDCPA is a set of bill collector rules that are designed to protect the consumer from abuse, harassment, false and misleading tricks and illegal debt collector tactics.

2. Federal law outlines what information debt collectors can gather on a consumer.

3. FDCPA applies to consumer debts.

4. FDCPA sets forth specific rules on how debt collectors collect.

5. 30 days

6. FDCPA specifies that communications are to be in writing.

7. Counsel needs to respond to debtor's written inquiries.

8. Offensively used by debtors and their attorneys to avoid debt.

9. "Trap for the unwary".

YOU NOW HAVE A JUDGMENT, WHAT'S NEXT?

I. **Debtor's Interrogatories** (Virginia Code § 8.01-506, *et al.*)

1. Determines the debtor's assets.

2. Requires the debtor to appear and answer questions about the type, amount, and location of all their assets:

   (a) Inquiries about personal and real property.
   (b) Transportation? How did they get there?
   (c) Keys?

3. Every six (6) months, affidavit.

4. General District Court v. Circuit Court:

   (a) Cost; and
   (b) Special Commissioner (court house v. office).

5. Bring a Court Reporter.

II. **Writ of *Fieri Facias*** (Virginia Code § 8.01-466, *et al.*)

1. Clerk issues and Sheriff serves writ of *fieri facias*.

2. Lien on the defendant's personal property (including business).

III. **Garnishment** (Virginia Code § 8.01-511, *et al.*)

1. Garnish the debtor's wages, bank accounts, or other assets.

   (a) Creditor files Suggestion For Summons in Garnishment.
   (b) Court issues and then serves Garnishment Summons.
   (c) Maximum wages: 25% of net disposable income.
   (d) Stacked up garnishments.

2. General District Court (90 days) v. Circuit Court (180 days).

3. Recover additional costs?

IV. **Levy** (Virginia Code § 8.01-487, *et al.*)

1. Request sheriff to seize and sell debtor's personal properties.
2. The sheriff will "levy on" the debtor's property and then conduct a sale.
3. But, bond requirements.
4. Garnish Contracts?

V. **Judgment Liens** (Virginia Code § 8.01-458, *et al.*).

1. Most cost-effective and efficient method to collect a judgment.
2. Judgment must be in same jurisdiction as real property.
3. Titled in name of judgment debtor?
4. Lien applies to after-acquired property.
5. 20 year life on judgments.

VI. **Divorce Decree and Support Liens** (**Virginia Code §** 8.01-460).

1. Lien upon real estate owned by the obligor's spouse.
2. Lien expires when the obligor satisfies the obligation in full.

VII. **Creditor's Bills (Virginia Code § 8.01-462).**

1. Complaint to enforce judgment lien.
2. "The rents and profits of all real estate subject to the lien will not satisfy the judgment in five years." Court may order commissioner to attest.
3. Real property may be sold in whole or in part.
4. Senior lienholders are paid first.
5. Attorneys' fees and costs recoverable (?)

<u>WHAT IF THERE IS A BANKRUPTCY FILING?</u>

I. Generally:

- Stop, drop, and roll:
  - (a) Stop what you are doing;
  - (b) Drop any collection efforts; and
  - (c) Roll over to your bankruptcy expert – every case is unique.
- Pending litigation- continue or dismiss?
- The Automatic Stay under 11 U.S.C. § 362(a)-a trap for the unwary.
  - (a) But, there are exceptions (i.e., frequent filers)
  - (b) Motion for Relief
- Chapter 7, 11, or 13?
- Are you a secured or unsecured creditor?
- ECF – electronic filing system

II. What to File and At What to Appear?

- Notice of Appearance
- §341 Meeting of Creditors
- Are you properly scheduled?
- Object to Chapter 13 Plan? Res Judicata as to status if Plan is confirmed.

III. Proof of Claim

- May not be needed or allowed in Chapter 7.
- Amounts owed as of the Petition Date.
- Do not need a liquidated and entered judgment at time of bankruptcy filing (if you learn nothing else…).
- Rule 3001 requirements- onerous.
- Write off and move on.

IV. Discharge

- Absolute defense to personal liability (but not *in rem*).
- Nondischargeable nature?
- No discharge for corporations

V. Miscellaneous Bankruptcy Cases of Some Relevance

Most individuals file cases under Chapters 7 or 13. In a Chapter 7 case, an individual discharges, or eliminates, personal liability for most unsecured debts such as credit card debt and medical bills, and keeps property that is within the amounts of the applicable exemptions. A Chapter 7 trustee liquidates a debtor's nonexempt assets and makes payments to the creditors according to certain statutory rules of priority. In a Chapter 13 case, a debtor proposes a repayment plan for all or of a percentage of the unsecured debts. At the end of a Chapter 13 plan, as in a Chapter 7, the debtor receives a discharge of personal liability for most unsecured debts. If the debtor's gross income is too high, he or she may not qualify for a Chapter 7.

A Chapter 13 case may allow the debtor to keep nonexempt property that would be at risk of being sold by a Chapter 7 trustee. Also, in a Chapter 13, a debtor may be able to cure an arrearage on a mortgage or a car loan by paying the arrearage through the Chapter 13 plan. A Chapter 13 plan also provides substantial opportunities to reduce car loan balances on loans for older vehicles, to eliminate second or third mortgages when the property's value is less than the balance owed on the first mortgage, and to pay income tax liabilities.

A. What Chapter should I file under? The Bankruptcy Means Test

The goal of bankruptcy is to provide a debtor with a "fresh start" if they have become overwhelmed by bills and creditors. Once someone decides to file for bankruptcy, the next decision they must make is what chapter of the Bankruptcy Code they should file under. For individuals, this means whether to file under Chapter 13 or Chapter 7 of the United States Bankruptcy Code. Chapter 7 allows debtors to rid themselves of secured debt and leases, while keeping most or all of their valuable goods and possessions. Chapter 13 allows debtors to repay their debts over a set plan, in order to get back on their feet and keep their homes and cars.

In order to file for Chapter 7 bankruptcy, a debtor must be able to pass the "means test." There are a couple ways for the debtor to do this. First, the debtor passes the means test if his or her current monthly income is less than the median income for a household of their size in their state.

If the debtor's median income is more than the state average, a debtor can also pass the means test if his or her monthly income, minus their monthly expenses, is less than a certain amount. If the individual does not pass the means test, then it will be presumed that the person is abusing the bankruptcy system. If so, then the case will be dismissed, and the debtor will not receive a discharge from his or her debt.

In order for a Chapter 13 plan to be approved, it must satisfy the "best interest of the creditors test." Under this test general unsecured creditors must receive at least as much money from the debtor as they would have received in Chapter 7.

In re Campbell
2016 Bankr. Lexis 2804 (Bankr. E.D. Va. 2016)

In this case, the Chapter 7 trustee filed a motion to dismiss the case, arguing that the debtor had abused his rights and obligations under the chapter. The trustee argued that the debtor deducted mortgage payments that he had no intention of paying when calculating his income for the means test. According to the trustee, this in turn led to a fake amount, which allowed the debtor to pass the means test. The court noted that the 4th Circuit had not addressed this issue in a Chapter 7 context. In looking at previous case law, the court did hold that, under Chapter 13, debtors may not make any deduction of secured debt payments on collateral they intend to surrender. Looking at similar Chapter 7 cases, the court found that there was a split in the case law on this issue. One case held that Chapter 7 debtors could deduct such payments they did not wish to continue. Another case held the opposite. The *Campbell* court agreed with the former, and found that presumption of abuse under 11 USC § 707(b)(2) did not arise.

The court then looked to see whether the debtor abused the bankruptcy system under 11 USC § 701(b)(1). The court noted that it looks at the following factors to see whether the debtor is abusing the bankruptcy system:

(1) Whether the bankruptcy petition was filed because of sudden illness, calamity, disability, or unemployment;

(2) Whether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay;

(3) Whether the debtor's proposed family budget is excessive or unreasonable;

(4) Whether the debtor's schedules and statement of current income and expenses reasonably and accurately reflect the true financial condition; and

(5) Whether the petition was filed in good faith.

In applying these factors, the court first found that the debtor's petition was not filed because of any sudden illness, loss of employment, or any other catastrophic event in the debtor's life. The court then found that the debtor failed to mention his regular quarterly bonuses, which he used to pay his former spouse, and that this weighed against the debtor as a purchase that exceeded his ability to repay. Third, the court found that the debtor did not live an extravagant lifestyle, and so his budget was not excessive.

Looking at the debtor's schedules and statement of income, the court found that there was no prospect of a meaningful distribution to unsecured creditors if his case converted to Chapter 11. Thus, the court held that the debtor did not abuse the bankruptcy system.

In re Cole
548 B.R. 132 (E.D. Va. 2016)

In this case, after the debtor had filed for Chapter 13 bankruptcy, the debtor's ex-wife objected to the confirmation of his proposed debt adjustment plan. In response, the debtor filed an objection to his ex-wife's proof of claim for attorney's fees because, according to him, she improperly asserted a different priority status for his obligation to pay his ex-wife's attorney's fees.

The court first addressed the debtor's ex-wife's objection. In applying the best interest of the creditors test, the court found that in a Chapter 13 case, only $41,800 would be distributed to unsecured creditors, whereas $178,485.75 would be distributed to creditors. The court thus found that the debtor failed to comply with the test, however, it allowed the debtor to amend his plan.

In regards to the debtor's objections to his wife's proof of claim, the court first looked at the divorce court's opinion, which found the debtor to be at fault for the divorce, and also mentioned the parties' unequal financial status, as well as the debtor's unwillingness to negotiate. The court thus found that attorneys' fees were a domestic support obligation, and the wife was entitled to receive them.

In re Wetdog Case #13
In re Rogers- Case #14-40219
U.S. Bankruptcy Court- S.D. Georgia (Savannah)

- Issue #1: 11 U.S.C. § 109(e): Debtors are not Eligible for Chapter 13

Section 109(e) of the Bankruptcy Code states, in pertinent part, as follows:

> Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $383,175 and noncontingent, liquidated, secured debts of less than $1,149,525, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $383,175 and noncontingent, liquidated, secured debts of less than $1,149,525 may be a debtor under chapter 13 of this title.

Here, the Debtors have scheduled $3,268,743.85 in unsecured claims of which $1,880,000.00 is attributed to Belle (Creditor) as being "a contingent, unliquidated, and disputed claim." As a result of the Belle Unsecured Claim having been filed in the amount of $2,058,945.19, Belle objects to the treatment of its claim by the Debtors as only being in the amount of $1,880,000.00.

The Debtors further state in the Amended Plan that they will pay nothing towards the Belle Unsecured Claim in the "approximate amount of $1,882,320.14" because it "is a contingent and unliquidated claim being paid in full outside of this plan by a third-party." Consequently, the Debtors' argument is ostensibly that they have noncontingent, liquidated, unsecured debts of $1,386,423.71 ($3,268,743.85 less $1,882,320.14) and, after consideration of the $1,365,762.09 SBA Claim, that they only have $20,661.77 in "noncontingent, liquidated, unsecured debts." The Debtors' theoretical and further premise ostensibly is that, given the argument that $20,661.77 is less than the $383,175.00 threshold under § 109 (e), the Debtors are thus eligible for Chapter 13 bankruptcy protection.

With respect to 11 U.S.C. § 109 (e), "debt" and "claim" are used interchangeably and the court must look to the "substance" of the obligation and not "the form." *In re Grenchik*, 386 B.R. 915, 918 (Bankr. S.D. Ga. 2007). Moreover, the Debtors have attempted to minimize their unsecured obligations by treating the Belle Unsecured Claim as being $-0- because the underlying loan is being paid through the Wetdog Bankruptcy Case.

However, the Debtors must continue to recognize both the Belle Unsecured Claim and the SBA Claim notwithstanding any treatment of these two obligations in the Wetdog Bankruptcy Case. *Ivanhoe Bldg. & Loan Ass'n of Newark, N.J. v. Orr*, 295

U.S. 243, 244 (1935); *Nuveen Mun. Trust ex rel. Nuveen High Yield Municipal Bond Fund v. Withumsmith Brown*, P.C., 692 F.3d 283, 295 (3rd Cir. 2012) ("*Ivanhoe* thus provides that a creditor may file a proof of claim for the total amount it is owed by a debtor even if it has recovered or may recover all or a portion of that amount from a non-debtor.").

Thus, as much as the Debtors may try to wish away the Belle Unsecured Claim (or even the SBA Claim), the legal and factual premise is that, even using the Debtors' claim that they only owe Belle $1,880,000.00 instead of $2,058,945.19 pursuant to the Proof of Claim, the Debtors still have at least $3,268,743.85 in unsecured debt.

The Debtors, therefore, are not eligible for Chapter 13 pursuant to § 109(e).

Therefore, the Bankruptcy Case must either be dismissed or converted to one under Chapter 7. *See In re Dillingham*, 104 B.R. 505, 511 (Bankr. N.D. Ga. 1989) ("This case cannot proceed under Chapter 13 since the unsecured debt in this case exceeds the quantitative limits of 11 U.S.C. § 109(e), making this debtor ineligible for Chapter 13 relief. Thus, ten days after the entry of this Order, this case will be converted to a case under Chapter 7.")

- Issue #2: 11 U.S.C. § 1325(a)(4): Amended Plan Fails the Best Interests Test

Section § 1325(a)(4) of the Bankruptcy Code, which is commonly referred to as the "best interests of creditors test" states, in pertinent part that:

> The court shall confirm a plan if the value, as of the effective date of the plan, of property to be distributed under the plan or account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the Debtor were liquidated under chapter 7 . . .

"In essence, this section requires that for a Chapter 13 case to be confirmed, unsecured creditors must receive as much in the Chapter 13 as they would in a hypothetical Chapter 7 liquidation case." *In re Locklear*, 386 B.R. 911, 913 (Bankr. S.D. Ga. 2007). In other words, the payouts in a Chapter 13 bankruptcy case must be as much as an unsecured creditor would receive in a Chapter 7 bankruptcy case.

The Amended Plan provides for no payments being made towards the total general unsecured debt, regardless as to whether the total amount is $3,268,743.85 as identified in the Debtors' schedules or the higher total amount which includes the amount of the Belle Unsecured Claim being included as alleged by Belle. Based on the February 12, 2014 correspondence and offer to purchase Wetdog, the Debtors' interest in Wetdog is worth at least $100,000. To the extent that the Debtors' interest in Wetdog was to be liquidated, there would be at least approximately $100,000 available to unsecured creditors. Even if priority debt is paid first out of the $100,000, there remains $50,000 in available funds.

Therefore, as the $100,000 being made available to unsecured creditors is more than the $-0- proposed payout, the Amended Plan fails the § 1325(a)(4) best interest test. In other words, were the Debtors in a Chapter 7 bankruptcy case, then the unsecured creditor would be receiving approximately $100,000 towards their claims, which is more than what they are to receive in the Amended Plan. Because the estate of the Bankruptcy Case has "assets that, if liquidated, could pay creditors", the Amended Plan is not confirmable pursuant to §1325(a)(4).

- Issue #3: All Projected Disposable Income Not Committed

Section § 1325(b)(1)(B) of the Bankruptcy Codes states, in pertinent part:

> If a trustee or allowed unsecured creditor objects to the confirmation of the modified plan, then this court may not approve the modified plan unless
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

"The express words of [1325(b)(1)(B)] gives Debtor two options if the [unsecured creditor] objects to a plan: (1) pay all of the creditors in full; or (2) provide [their] projected disposable income over a three-year period." *In re Thorne*, No. 05-41544, p. 5 (Bankr. S.D. Ga. 3/24/2008) (Bankr. S.D. Ga., 2008) (Davis, J.).

Moreover, under 11 U.S.C. § 1322(a)(1), the Debtors must tender to the Trustee "all or such portion of future earnings or other future income of the debtor … necessary for the execution of the plan." Accordingly, the Amended Plan is not confirmable under § 1325(b)(1)(B), and the Objection to Amended Plan should be sustained.

B. Filing for Bankruptcy and the Creation of the Automatic Stay

Once a debtor files for bankruptcy, all the defendant's assets and property is protected from collection by creditors. This is known as the automatic stay. Unless an exception applies, creditors will not be able to collect on the debt owed to them until it is approved by the bankruptcy court or distributed in the correct order under the bankruptcy code. While the stay is imposed, creditors can file motions asking the court for permission to lift the stay so to collect on the debt owed to them. These are known as motions for relief from automatic stay.

In Re Yankah
2015 Bankr. LEXIS 893 (Bankr. E.D. Va. 2015)

In this case, Ms. Yankah filed for Chapter 13 bankruptcy, which later converted to Chapter 7. Before filing her bankruptcy petition, Yankah entered into a lease with her landlord. Yankah was soon no longer able to pay her rent, and the landlord requested relief from automatic stay to enable him to enforce his lease agreement with Yankah, which was approved. The landlord took possession of the apartment, and Yankah was evicted. The landlord also took possession of other items in the apartment owned by Yankah, and sold these items to "set off" the debt Yankah owed to him.

Yankah filed a complaint, arguing that doing this violated his right to automatic stay. The court found that a "willful" violation of the automatic stay only required knowledge of the existence of the stay, and not an intentional act. Good faith mistakes as to the extent or application of the law do not matter.

The court found that the stay relief the court gave to the landlord did not entitle him to take possession of and use Yankah's personal property. The debtor's personal property remaining in the premises became property of the estate, and had to be distributed by the trustee. Thus, the landlord went beyond what the court allowed him to do when he requested relief from automatic stay.

In Re Manuel
212 B.R. 517 (Bankr. E.D. Va. 1997)

Chapter 13 debtor filed motion to show cause for violation of the automatic stay against the operator of a financing business, who had brought a prepetition garnishment proceeding against debtor and had failed to promptly dismiss it after debtor filed a bankruptcy petition. The Bankruptcy Court held that: (1) garnishor had an affirmative duty not to continue stay violation and, thus, acted willfully when he failed to promptly dismiss the garnishment, even though he did not believe himself to be in violation of the stay, and (2) garnishor would be required to reimburse debtor $250 toward attorneys' fees incurred in bringing present motion.

A creditor has a "responsibility to stop the downhill snowballing of a continuing garnishment." *Baum,* 15 B.R. at 541. In *Baum,* the judgment creditor was held in contempt for failing to release the garnishment. *See also, In re Mims,* 209 B.R. at 748–49; *In re Gray,* 97 B.R. 930, 934 (Bankr.N.D.Ill.1989); *Carlsen v. Internal Revenue Service (In re Carlsen),* 63 B.R. 706, 710–11 (Bankr.C.D.Cal.1986).

The creditor, having an affirmative obligation not to continue a violation of the automatic stay, **acted willfully when he failed to promptly dismiss the garnishment against debtor's wages**. He is thus subject to damages under § 362(h).

C. Exemptions

In re Benson
566 B.R. 800 (W.D. Va. 2017)

Upon the filing of a petition for bankruptcy, all of the debtor's legal and equitable interests in property become part of the bankruptcy estate. *See* 11 U.S.C. § 541. The debtor may, however, claim certain real and personal property as exempt from the estate. 11 U.S.C. § 522(b). If a state chooses to opt out of the federal exemption scheme detailed in 11 U.S.C. § 522(d), "any property that is exempt under ... State or local law" is excluded from the estate. 11 U.S.C. § 522(b)(3)(A); *see also Zimmerman v. Morgan*, 689 F.2d 471, 472 (4th Cir. 1982)(citing prior version of Code provision). **Because the Commonwealth of Virginia has opted out of the federal exemption scheme,** ***see*** **Va. Code Ann. § 34–3.1, the Debtor here had to claim her exemptions in compliance with Virginia law**. *See In re Nguyen*, 211 F.3d 105, 107 (4th Cir. 2000).

***In re Delima*,**
561 B.R. 647 (Bankr. E.D. 2016)

When a debtor files for bankruptcy, he or she is allowed to protect certain assets from a creditor by exempting them under federal or state law. In Virginia, assets ranging from livestock to family bibles may be exempted. One such exemption is found under Va. Code § 34-29, which limits the amount a creditor can garnish a debtor's income to 25%, thereby exempting 75% of the debtor's income.

In this case, the Delimas filed for Chapter 13 bankruptcy. On their bankruptcy schedules, they claimed $18,000 out of a $21,000 checking account as exempt under Virginia law. Because creditors under Virginia law are allowed to garnish up to 25% of a debtor's weekly disposable earnings, an issue arose as to whether otherwise exempt wages lost their exempt status when they were deposited into a checking account, and not directly paid to the debtors. The trustee objected to the exemption, arguing that Va. Code § 34-29 did not apply to any bankruptcy court order under Chapter 13.

The Court rejected this argument and found that the debtors were entitled to the exemption. According to the court, the plain language of the Virginia code clearly protected wages, regardless of whether they were deposited in a bank account or given directly to the individual. The court reasoned that "comingling" the debtor's income with money already in the checking account did not destroy the exempt status of the wages in the account. As long as the exempt income could be tracked, it would remain exempt.

Even if Virginia Code § 34-29 did not apply to Chapter 13, the U.S. Bankruptcy Code trumps Virginia state law, and under 11 U.S.C. § 1325, the court has the power to order any entity that paid the debtor's income to give part of that income to the trustee, thereby exempting the remaining income. Thus, the court overruled the trustee's objection.

In re Walley
525 B.R. 320 (E.D. Va. 2015)

Once the debtor files his or her petition, most of the property they own becomes "property of the estate" that the trustee will then distribute in order to pay off creditors. Not all of the debtor's property becomes property of the estate, however. Some property is exempted from creditors through state and federal exemption statutes. *Walley* concerned an issue of whether certain assets acquired by the debtors after filing for bankruptcy, were exempt under Virginia state law.

For Chapter 13 purposes, the 4th Circuit defines property of the estate as ‘the property described in 11 USC § 541, plus the property described in Chapter 13, acquired after the petition is filed and before the case is closed, dismissed, or converted. Under 11 USC § 522(b), a debtor could exempt property of the estate that is also exempt under state law.

In this case, the debtors filed for Chapter 13 bankruptcy. After their plan was approved, the debtors amended their plan to add a $4,500 money market account and $8,000 of equity in a car. They claimed that these newly-added assets were exempt, and were acquired after receiving an award for a personal injury action under Va. Code § 34-28.1.

The trustee objected, arguing that under 11 USC § 522, only property owned at the time the bankruptcy petition was filed could be exempt. The court disagreed. Looking at state and federal exemption law, the court found that in a Chapter 13 case, property of the estate included property acquired both before and after the commencement of the bankruptcy case. The court rejected the trustee’s reading of 11 USC § 522, because that provision only reflected jointly-held property, and not the type of property the couple in this case claimed as exempt. Thus, the court overruled the trustee’s exemptions.

In addition to these exemptions under state law, federal law defines property of the estate under 11 USC § 541. In a Chapter 13 case, property of the estate is further defined under § 1306. Under state and federal law, certain property of the estate may be exempted from creditors. Issues often arise in bankruptcy cases over which assets owned by the defendants are exempt, and which are creditors allowed to collect from.

Kocher v. Campbell
282 Va. 113 (2011)

- Plaintiff’s attorneys need to know it, live it, love it.

- Facts:
    - (a) April 6, 2004: Plaintiff injured in car accident
    - (b) October 1, 2005: Plaintiff files for Chapter 7
        - (i) Does not schedule the lawsuit

(ii) No mention of it at 341 meeting of creditors

(c) January 6, 2006: § 727 discharge granted

(d) February 3, 2006: Plaintiff files state court law suit

(e) April 1, 2006: after nonsuiting first case, re-files.

(f) January 4, 2008: Plaintiff nonsuits second case.

(g) February 14, 2008: Bankruptcy case re-opened.

(i) Plaintiff now schedules the lawsuit as an asset

(ii) Listed as exempt on Schedules B and C

(h) May 27, 2008: Plaintiff files third action (sits on service)

(i) May 29, 2009: bankruptcy court ordered it "exempt"

(j) December 10, 2009: trial court denies Defendant's motion for summary judgment for lack of standing.

- Virginia Supreme Court- "Reverse and Dismissed"

(a) Once bankruptcy petition, all assets are property of estate (§ 541), except for:

(i) Assets abandoned by Trustee after "notice and hearing" pursuant to § 544.

(ii) Exception under §522, etc.

(b) Plaintiff's cause of action became "property of the estate" on October 1, 2005 and remained so until May 29, 2009.

(i) "as a result of the plaintiff's filing a petition in bankruptcy, his inchoate personal injury claim passed to the bankruptcy estate on October 1, 2005."

(ii) Therefore, "all three complaints … filed in the circuit court … were filed during the period when the plaintiff lacked standing … because … only enforceable by the trustee."

(c) "Action filed by party who lacks standing is a legal nullity."

(d) "No tolling effect on the statute of limitation."

(e) "Standing acquired after the statute of limitations has run cannot be retroactively applied to cure the lack of standing that existed when the action was filed."

- "Because action was a nullity at the time of its filing and the statute of limitation had run before it was filed, trial court was wrong."

- Case dismissed.

- Editor's note: Exemption and value (is it really worth $1?)

D. Avoidance Powers

In re Circuit City
479 B.R. 703 (Bankr. E.D. Va. 2012)

Section 547(b) of the Bankruptcy Code permits a trustee to avoid certain payments made by a debtor to a creditor within the ninety-day period immediately preceding the Petition Date. *707 11 U.S.C. § 547(b). **The avoidance of such preferential transfers "promotes the 'prime bankruptcy policy of equality of distribution among creditors' by ensuring that all creditors of the same class will receive the same pro rata share of the debtor's estate ... [as well as] discourages creditors from attempting to outmaneuver each other in an effort to carve up a financially unstable debtor and offers a concurrent opportunity for the debtor to work out its financial difficulties in an atmosphere conducive to cooperation.**" *Morrison v. Champion Credit Corp. (In re Barefoot),* 952 F.2d 795, 797–98 (4th Cir.1991) (citation omitted).

A trustee may not, however, avoid a transfer "to the extent that the transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was (A) made in the ordinary course of business or financial affairs of the debtor and the transferee or (B) made according to ordinary business terms." 11 U.S.C. § 547(c)(2). The trustee has the burden of proving the avoidability of a transfer under § 547(b), and the creditor against whom recovery is sought has the burden of proving the nonavoidability of the transfer under § 547(c). 11 U.S.C. § 547(g).

In re CHN Construction
531 B.R. 126 (Bankr. E.D. Va. 2015)

The bankruptcy trustee has the power to recover certain property transferred to others, subject to the court's approval. This is known as the trustee's "avoidance powers." The trustee can avoid property transferred both before and after the debtor files for bankruptcy.

In this case, SunTrust Bank, one of the creditors to CHN industries, sought to avoid several transfers CHN made while it was in Chapter 11 bankruptcy. Looking at the plain language of the Bankruptcy Code, the court found that only the trustee could pursue avoidance actions. The court noted that other circuits outside of the Fourth have made two limited exceptions to this rule. First, some circuits have held that a creditor may initiate an avoidance action when a trustee unreasonably refuses to bring suit. Second, some courts permitted actions when the trustee granted consent.

The court found that, even if it did accept these exceptions, SunTrust failed to satisfy both. The court found that the trustee's refusal to bring suit was not unreasonable, and determined that the trustee gave proper consideration to CHN's transfers, and did not give SunTrust permission to pursue the avoidance actions.

E. Proof of Claims

In re Maddux
No. 15-33574-KRH (Bankr. E.D. Va. 2016)

A proof of claim is a form used by a creditor to indicate the amount of a debt owed by the debtor on the date of the bankruptcy filing. Bankruptcy Rule 3001 provides guidelines defining what a proof of claim is, and whether any supporting documentation is needed to be provided along with a creditor's proof of claim.

Maddux was a consolidated case composing of three separate bankruptcy cases. Midland Credit Management had filed a total of sixteen proof of claim forms in these cases.

The debtors filed objections to the proof of claims, arguing that: (i) they owed nothing to Midland, (ii) the writing on which Midland based their claim on was not attached to the proof of claim, and (iii) any evidence of interest and fees incurred by the debtors had not been properly disclosed under Bankruptcy Rule 3001(c)(2)(A). After the debtors filed their objections, Midland then filed amended proofs of claims, attaching a bill of sale, an affidavit of sale, the purchase price, copies of the account statement, and the seller's data sheet. The debtor then motioned for summary judgment, and the court held a hearing. The court ultimately found that Midland failed to properly itemize their interest, and this violated Bankruptcy Rule 3001(c)(2)(A). The court then held a hearing to determine whether Midland's violation of 3001(c)(2)(A) was willful, and thus sanction should be imposed. The court held Midland's violation was not willful, and that it would not disallow Midland's claim. However, it awarded attorneys' fees to the debtors for the cost they incurred as a result of Midland's noncompliance with Bankruptcy Rule 3001(c)(2)(a).

In re Holland
562 BR 305 (Bankr. E.D. Va. 2016)

A proof of claim is a written statement that notifies all interested parties in the bankruptcy case of the amount of debt owed by the debtor to the creditor on the date of filing the bankruptcy petition. In order to show a proof of claim, the creditor must send the proof of claim to the clerk of the same bankruptcy court where it was filed. The creditor must file the proof of claim within ninety days after the first meeting of the bankruptcy creditors.

In this case, the debtor's spouse filed a motion for relief from stay to conclude a pending divorce case. The debtor did not oppose most of the relief, however objected to the relief that would allow the divorce court to make a monetary damages award based on the allocation of marital debts between the parties.

The court stated that they consider three factors in deciding whether to grant relief from automatic stay: 1) the extent to which state law was applicable, 2) judicial economy and the efficient administration of the bankruptcy case, and 3) the protection of the bankruptcy estate. Balancing these three factors, the court ultimately concluded that the bar date to file proofs of claim expired without the non-debtor's spouse to file a proof of claim.

Without filing a timely proof of claim, the wife was unable to receive a distribution from the Chapter 13 trustee. The court reasoned that even if relief was granted, and the state court made a monetary award, the money award would be dischargeable debt anyway. The court responded that no purpose would be served by allowing the state court to make a monetary equitable distribution award, and the claim would thus be discharged at the conclusion of the bankruptcy case. Thus, the court denied the non-debtor spouse's motion.

F. Trustee's Powers in Managing the Estate

In re Champagne Serv. Inc.
560 B.R. 196 (2016)

Once a debtor files for bankruptcy, his or her property becomes "property of the estate" to be managed by a trustee. The trustee's job is to oversee the debtor's estate, and ensure that the property is distributed in accordance with the Bankruptcy Code. In Chapter 11 the trustee is empowered to retain or replace the debtor's attorney. The trustee can object to an attorney's employment for several reasons, such as when the attorney's representation of the debtor creates a conflict of interest with another party. Should the trustee object, the debtor has the burden of proving that hiring the attorney did not create a "conflict of interest."

In this case, a business, Champagne Services LLC, filed for Chapter 11 bankruptcy. After finding an attorney to represent them, Champagne Services made a retainer agreement with the attorney, which stated that all the fees owed to the attorney would be personally guaranteed by Champagne Service's sole owner. The trustee filed an objection to the retainer agreement. He argued that having the sole owner of Champagne Services personally guarantee the debt owed to an attorney created a conflict of interest, because the owner may have interests in opposition to those of the estate.

The court found that although there was nothing wrong with having the attorney's fees of debtor guaranteed by a third party, the attorney's employment application in this case failed to provide enough facts for the trustee or creditors to determine whether a conflict of interest existed. For example, the employment application failed to disclose whether the attorney previously represented Champagne Service's owner. The court also took issue with the fact that, in the retainer agreement, neither Champagne Services or its owner would list the attorney as a creditor and that any fee incurred would be reaffirmed after the bankruptcy discharge. In the words of the court, "counsel knew better." For these reasons, the court upheld the trustee's objections and denied the attorney's application of employment.

In re Evans
527 B.R. 228 (Bankr. E.D. Va. 2015)

Under 11 USC § 363, a trustee has the right to "use, sell, or lease" property of the estate in order to raise cash to pay off creditors. *Evans* involved an issue as to whether a trustee could sell a former co-tenancy, even though the co-tenant debtor had transferred his interest to the other cotenant (his ex-wife). A trustee may sell a co-tenancy under four conditions: 1) when partitioning the property between the estate and the co-owner is impractical, 2) when selling the estate's interest in the property would yield significantly less money than selling the property decree of he co-owner's interest, 3) the benefit to selling the property free of any co-owner's interest outweighs the negatives, and 4) the property was not used in the production of energy use.

In this case, the debtor filed for Chapter 7 bankruptcy in November of 2013. In June of 2014, the Chapter 7 trustee filed a complaint against the debtor and his ex-wife, seeking authority under 11 USC § 363 to sell their former marital residence, which the debtor and his wife owned as joint tenants in common at the time of the divorce, and the debtor later transferred his interest to his ex-wife before filing for bankruptcy. The trustee argued that the estate owned ½ of the property.

Based on the plain reading of the divorce decree, the court agreed. It found that "whatever legal and equitable rights the debtor had to the property under the divorce decree and property settlement agreement vested in the bankruptcy estates at the commencement of this bankruptcy case." Even though the debtor had issued a deed of transfer, giving his share of the property to his wife, the court found that the final divorce decree was of a "higher order than the property transfer deed" and thus remained enforceable. Thus, the court allowed the trustee to sell the residence.

In re Copely
547 B.R. 176 (Bankr. E.D. Va. 2016)

Under 11 USC § 542, once the property of the estate is created, any entity that is in custody of the property that the trustee could use, sell, or lease, must give that property to the trustee so the trustee can sell it to the courts.

In addition, creditors are often frustrated by the creation of the automatic stay and their inability to collect on their debt. However, if a creditor owes money to a debtor in a mutual debt situation before the bankruptcy case was filed, that creditor will be allowed to offset his debt against the money the debtor owes to him. This is what is known as a "set off." In order to set off the creditor's debt against the debtors, a creditor must file a motion for relief from stay. In addition, courts must decide whether the set-off right conflicts with any creditor's rights. Such was the issue in the 2016 case *In re Copely*.

In this case, a couple filed for Chapter 7 bankruptcy, and commenced an adversary proceeding by filing a complaint to seek the federal government to turn over a $3,000 tax refund. In response, the federal government argued that it used the money to set off the debt owed to it, and for that reason, the debtors had no claim upon which relief could be given. The court, in reading the relevant provisions of the Bankruptcy Code and case law, found that the federal government did not violate the automatic stay by setting off the tax overpayment to previous year's tax liability. Because of this, the court next had to address whether this right to a set off was trumped by the debtor's right to exempt property.

The court looked at the Western District of Virginia's case law regarding similar issues, and held that the debtor's right to an exception superseded the federal government's right to a set off, and therefore, ordered the government to release the overpaid tax burden.

G. Distribution of the Property of the Estate

In re Jervic Holding
580 U.S. ___ (2017)

A debtor's assets are distributed to creditors in a certain order as provided by the bankruptcy code. The rules that guide this order are known as the "priority rules." In *In re Jervic Holding*, the Supreme Court considered whether a bankruptcy court may authorize distribution of settlement proceeds in a manner that violates the Bankruptcy Code's priority rules scheme.

In this case, Jervic Transportation filed a Chapter 11 bankruptcy. Two lawsuits eventually emerged from this bankruptcy. In one suit, Jervic's truck drivers sued Jervic for violating the federal and state Worker Adjustment and Retraining Notification Acts. The other case involved a fraudulent conveyance action on behalf of Jervic's unsecured creditors. The parties to the fraudulent conveyance action negotiated a settlement that left out the truck drivers in the other suit. The truck drivers then filed a complaint, arguing that, as Jervic employees, Jervic's assets were supposed to be distributed to the truck drivers first, before Jervic's unsecured creditors.

The Supreme Court held 6-2 that, while the Bankruptcy Code does not state that the priority rules explicitly apply to structured dismissal settlements, the priority system was so important to the Bankruptcy Code that it should be presumed to apply, unless Congress expressed an intent to do otherwise. The Court also found that, although the dismissal sections of the Bankruptcy Code give judges some flexibility in determining the distribution of the debtor's assets, judges should limit their flexibility within the confines of the overall bankruptcy statutory scheme. The Court thus held that bankruptcy courts could not authorize distributions of settlement proceeds that do not follow the priority rules scheme established in the Bankruptcy Code without the consent of the affected creditors.

H. Dischargeability of Debts (i.e., is the debt still owed?)

Section 523 of the Bankruptcy Code contains exceptions to a debtor's discharge of personal liability (most intentional torts, restitution, etc.)

In re Evans
543 B.R. 213 (Bankr. E.D. Va. 2016)

For the debtor, the goal of undergoing bankruptcy is receiving a discharge. Discharge releases the debtor from personal liability for certain debts once the debtor completes the bankruptcy process. In other words, the debtor is no longer legally required to pay any debts that are discharged.

Under Chapter 13 of the bankruptcy code, debtors do not receive a discharge until they complete all payments under their bankruptcy plan. Once this occurs, the bankruptcy court will issue the discharge order. Once the trustee distributes all remaining funds to the creditors and files a final report with the court, the court will then close the case.

In this case, the debtor undergoing Chapter 13 bankruptcy was about to receive a discharge. The trustee objected, arguing that the debtor should not receive a discharge. The court looked at the plain language of the Bankruptcy Code and found that, generally speaking, once a Chapter 13 debtor completes all of the payments under his or her plan, the court must grant a discharge.

The court found that the debtor was unable to receive a discharge because she failed to make direct payments to her lender. The court reasoned that the case law supported the position that a Chapter 13 debtor was not entitled to receive discharge when she is late making payments under the plan. The court reasoned that this conclusion was neither absurd nor contrary to congressional intent, nor produced a harsh result. Thus, the court rejected the debtor's argument that a reading of the Bankruptcy Code permitted discharge even if the debtor only paid the trustee, and did not grant the discharge.

In re McCoy
2016 Bankr. LEXIS 2952 (2016)

Other types of debt exempted from discharge are debts for money, property, services, or credit obtained by false pretenses or actual fraud. Issues sometimes arise as to what types of debt are fraudulent and therefore not dischargeable. As is all dischargeability cases under 523(a), the plaintiff has the burden of proving that the debt was nondischargeable.

McCoy concerned a promise to repay a debt incurred by the debtor's mother-in-law, so to repay a lien and prevent foreclosure on the debtor's house. The court held that "for an unfulfilled contract to serve as a basis for a nondischargeability claim, a debtor must have the intention not to perform the promised acts at the moment the contract is formed." Therefore, creditors have the burden of proving that any written agreement to repay debts mas made with the intention to defraud.

In this case, a widow, Mrs. McCoy, deeded the house she lived in to her son and daughter-in-law, who proceeded to use the house as collateral to secure a loan in order to repay another debt. The son later died, and the daughter-in-law defaulted on the loan. The creditor obtained a judgment lien on the house Mrs. McCoy gave to the debtor. The debtor then conveyed the property back to Mrs. McCoy. At the same time, the debtor ran the risk of losing her own home.

The creditor filed a complaint against Mrs. McCoy, seeking satisfaction of the judgment obtained against the debtor. In order to pay off the liens on the house, Mrs. McCoy had to take out a reverse mortgage. As a condition of taking out a reverse mortgage, Mrs. McCoy made and executed a confessed judgment note, with the debtor in which the debtor agreed that she would repay her for satisfying the lien. According to the plaintiff, the debtor asserted to Mrs. McCoy that she had no intention of discharging the debtor, and promised to satisfy her debt fully.

By the end of 2013, the debtor had failed to make a single payment to Mrs. McCoy, and defaulted on her promise to pay Mrs. McCoy. Mrs. McCoy obtained a default judgment against the debtor, and enforced the judgment by garnishing some of the debtor's wages. However Mrs. McCoy soon died. The debtor later filed for bankruptcy and tried to have the remaining debt she owed to Mrs. McCoy discharged.

In considering whether this unfulfilled agreement was nondischargeable, the court first looked at whether the debtor made a misrepresentation. The court found that the debtor intended to fulfill the terms of the contract with Mrs. McCoy because she promised to "do the right thing," and also obtained a job after making the agreement. Thus, the court found that no misrepresentation was made. The court also found that there was not enough evidence that showed the debtor possessing a devious intent, because at best, her activity demonstrated "poor judgment regarding money matters and a failure to recognize her economic limitations." Third, the court found that the debtor's financial troubles and prolonged history of unemployment should have been warning signs to Mrs. McCoy of the debtor's inability to fulfill her obligation to repay her.

Thus, Mrs. McCoy was not justified in relying on the debtor. Because the court found that the plaintiff failed to show that the debtor did not intend to repay the widow, or failed to have requisite intent to deceive the widow, it concluded that there was no need for damages. Nor did the court find any evidence that the debtor waived the dischargeability of the debt. The court thus found that the debtor's agreement with Ms. McCoy was dischargeable.

In re Ward
2017 WL 2110781 (Bankruptcy E.D. Va. 2017)

Another type of fraudulent debt that is not dischargeable is debt incurred by "fraud or defalcation while acting in a fiduciary capacity." In the 4th Circuit, in order to prove that the debt was obtained by fraud, the creditor has the burden of proving that 1) the debtor was acting in a fiduciary capacity when the debt arose, and 2) the debt arose from the debtor's "defalcation," which is defined by the U.S. Supreme Court as "an intentional wrong."

In this case, creditor Liberty Mutual filed a nondischargeability claim against the debtor, arguing that the type of debt owed to them was acquired by "fraud or defalcation." The debtor, an attorney, was an administrator of several estates, and posted bond worth more than $1.2 million in connection with the administration of these estates. Liberty provided surety on these bonds. In exchange, the debtor executed an indemnity agreement with Liberty against any liability Liberty would incur.

The debtor later filed for Chapter 7 bankruptcy, and failed to file accountings for two of his estates, causing these estates to incur penalties. The debtor was removed as the administrator to one estate, and a bond was forfeited based on malfeasance for another estate. A judgment was instated against the debtor regarding two of the estates he managed. These judgments were entered in favor of Liberty. Liberty then sought an action to bar the discharge of the debtor's debt stemming from the two indemnity judgments. Because of the indemnity provisions, Liberty alleged that these debts were nondischargeable because the debts resulted from "fraud or defalcation while acting in a fiduciary capacity."

The court found that because the debtor served as a fiduciary administrator of several estates, the first element was satisfied. The court then looked at the relevant evidence, and found that a dispute existed as to whether the debtor had the sufficient culpable state of mind necessary to support a definition of “defalcation” because, as the court reasoned, even though the debtor shirked his responsibilities, his actions may not be so bad as to rise to the level of a fraud of defalcation. Thus, the court concluded that a trial should be held to determine whether the debt arose from fraud.

Husky Electronics v. Ritz
136 S. Ct. 1581

Sometimes debtors facing bankruptcy will try to prevent creditors from seizing their assets by transferring their money or property to another entity. This is called a “fraudulent transfer.” The trustee has the power to avoid these transfers under 11 USC § 548. Under this statute, any transfer made with the intent to “hinder, delay, or defraud” someone the debtor owes money to, or any transfer made while receiving less than a reasonably equivalent value that is either 1) made to an insider when he or she was involved, 2) engaged in a business transaction, or 3) believed that he or she would incur debts beyond their ability to pay them, is also a fraudulent transfer.

An important recent case regarding fraudulent transfers was *Husky Electronics v. Ritz*. In *Husky*, the Supreme Court considered whether a fraudulent transfer is a non-dischargeable debt under § 523 (a)(2)(A), even though the debtor did not make a false representation to a creditor.

The Court considered whether a debt could still be nondischargeable as “actual fraud” because no misrepresentation was made. In this case, Chrysalis Manufacturing Corporation owed a debt to Husky International Electronics (“Husky”). Husky sued Daniel Ritz, the board member in charge of Chrysalis’s finances, to recover their debt. Mr. Ritz had Chrysalis divert their money to other entities that Ritz owned, and withheld payment to Husky. Husky argued that these transfers were “actual fraud” under 11 USC § 523(a)(2)(A), and was thus not dischargeable after Ritz’s bankruptcy.

The district court held that because the debt was not obtained by actual fraud, it could be discharged in bankruptcy. The Fifth Circuit Court of Appeals affirmed, holding that a necessary element of “actual fraud,” is misrepresentation from a debtor to a creditor. The court found that misrepresentation was lacking in this case.

In reviewing this case on appeal, the Supreme Court first looked at the history of fraudulent conveyances and the definition of fraud under the common law. It found that the common law definition of a “fraud” did not require misrepresentation from a debtor to a creditor. Such conveyances historically involved "a transfer… without transfer of possession, or grossly inadequate consideration."

The Court concluded that even though the transferee of the conveyance made no misrepresentation to the debtor's creditors, the transferor did not obtain any debt as part of a fraudulent conveyance. The court concluded that the transferee thus committed fraud. The court reasoned that any overlap between fraudulent conveyances and the nondischargeability of the debt incurred by fraud did not warrant a different interpretation of "actual fraud." Thus, a transferee who later filed for bankruptcy could be subject to a dischargeability action under § 523(a)(2)(A) for a debt obtained by fraudulent conveyance.

I. Domestic Support Obligations

The Bankruptcy Code contains exceptions to a debtor's discharge of personal liability in divorce related cases:

(i) Domestic Support Obligation ("DSO") in Bankruptcy Code § 523(a)(5):

- A bankruptcy discharge does not discharge an individual debtor from a debt for a domestic support obligation under any chapter of the Bankruptcy Code.
- In a Chapter 13 case, a debtor is required to propose a plan that pays a DSO in full.

(ii) Property Settlement Debt found in Bankruptcy Code § 523(a)(15):

- Chapter 7 case: a property settlement debt is not discharged
- Chapter 13 case: a property settlement obligation is discharged.

Therefore, particularly as it relates to a Chapter 13 case, the starting point in determining any issue of dischargeability of a divorce debt is to answer the question: is the debt a domestic support obligation? Again, if the answer is "yes," the debt will not be discharged if the debtor files a bankruptcy case under any chapter.

The 2005 BAPCPA added the term "domestic support obligation" to the Bankruptcy Code. The amendments instituted by BAPCPA relative to the definition of a DSO have increased the ability of creditors owed a DSO to collect that debt. In order for a particular debt to be considered a DSO, the debt must meet the four elements contained in the statutory definition. If the debt is not a DSO, but is a property settlement debt, a different dischargeability provision applies in Chapter 7 cases. The term DSO created by BAPCPA appears in several provisions of the Bankruptcy Code.

Domestic Support Obligation is defined in § 101(14A) of the Bankruptcy Code:

> (14A) The term "domestic support obligation" means a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is—
>
> (A) owed to or recoverable by—
>
> (i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
>
> (ii) a governmental unit;
>
> (B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;
>
> (C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of—
>
> (i) a separation agreement, divorce decree, or property settlement agreement;
>
> (ii) an order of a court of record; or
>
> (iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and

(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

A state court's designation or language in an agreement stating that a debt is support or property settlement is not binding on the bankruptcy court in determining dischargeability, and a court can look behind such language to determine the real nature of the debt. Even if a decree or marital settlement agreement contains language stating that there is no alimony or that a debt cannot be discharged in bankruptcy, a bankruptcy court can hold that the obligation is not a DSO and is not excepted from discharge under 523(a)(5). A payment of support, maintenance, or alimony need not be payable directly to the spouse or one of the payees listed in the first element of the definition in order to be nondischargeable.

In re Combs
543 B.R. 780 (Bankr. E.D. Va. 2016)

While debts representing domestic support obligations are nondischargeable in a Chapter 13 bankruptcy proceeding, debts within the scope of § 523(a)(15) are not excepted from discharge under § 1328(a). In contrast to § 523(a)(5), debt under § 523(a)(15) is owed to a spouse, former spouse, or child of the debtor and not of the kind described in [§ 523(a)(5)] that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit[.] *Id.* § 523(a)(15).

Thus, debts arising from, among other things, equitable distribution orders and property settlement agreements upon the dissolution of a marriage may be dischargeable if such debts do not constitute domestic support obligations. *See id.; see also id.* § 523(a)(5); 793 *Pagels v. Pagels (In re Pagels),* Adv. Proc. No. 10–07070–SCS, 2011 WL 577337, at *6 (Bankr.E.D.Va. Feb. 9, 2011).

The characterization of marital debt is critical to the determination of discharge: "If the subject debt is a § 523(a)(15) debt, the debt is dischargeable in the Defendant's Chapter 13 bankruptcy proceeding under § 1328(a). If the subject debt is a §523(a)(5) debt, the debt is nondischargeable in the Defendant's Chapter 13 bankruptcy proceeding pursuant to §§ 523(a)(5) and 1328(a)." *In re Pagels,* 2011

WL 577337, at *6. The non-debtor spouse (in this case, Lawrence) has the burden to demonstrate, by a preponderance of the evidence, that her claims are in the nature of alimony, maintenance, or support. *Grogan v. Garner,* 498 U.S. 279, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991); *Tilley v. Jessee,* 789 F.2d 1074, 1077 (4th Cir.1986); *Beaton v. Zerbe* (*In re Zerbe),* 161 B.R. 939, 940 (E.D.Va.1994).

The analysis for determining whether an obligation is in the nature of alimony, maintenance, or support is fact-specific and dependent on federal bankruptcy law, not state law. *In re Johnson,* 397 B.R. 289, 296 (Bankr.M.D.N.C.2008) (citing *Strickland v. Shannon* (*In re Strickland),* 90 F.3d 444, 446 (11th Cir.1996); *Yeates v. Yeates* (*In re Yeates),* 807 F.2d 874 (10th Cir.1986); *Long v. West* (*In re Long),* 794 F.2d 928 (4th Cir.1986); *Adams v. Council, Baradel, Kosmerl & Nolan, P.A.* (*In re Adams),* 254 B.R. 857, 861 (D.Md.2000); *Catron v. Catron* (*In re Catron),* 164 B.R. 912, 918–19 (E.D.Va.1994), *aff'd,* 43 F.3d 1465 (4th Cir.1994); *794 *Nelson, Keys & Keys, P.C. v. Hudson* (*In re Hudson),* Adv. No. 07–8011, 2007 WL 4219421, at *1 (Bankr.C.D.Ill. Nov. 27, 2007); *Brunson v. Austin* (*In re Austin),* 271 B.R. 97, 106 (Bankr.E.D.Va.2001); *Baker v. Baker* (*In re Baker),* 274 B.R. 176, 188 (Bankr.D.S.C.2000)).

When analyzing whether an obligation serves as alimony, maintenance, or support under bankruptcy law, Judge Waldrep points out that **the bankruptcy court "must not rely on the label used by the parties or the state court, but must look beyond the label to examine whether the debt actually is in the nature of support or alimony."** *Id.* (citing *Cummings v. Cummings,* 244 F.3d 1263, 1265 (11th Cir.2001); *Brody v. Brody* (*In re Brody),* 3 F.3d 35, 38 (2d Cir.1993)).

In the Fourth Circuit, courts first look at the mutual or shared intent of the parties to create a support obligation. *Tilley,* 789 F.2d at 1078 (stating that intent is the threshold that must be crossed before any other concerns become relevant); *see In re Yeates,* 807 F.2d 874, 878 (10th Cir.1986); *Long v. Calhoun* (*In re Calhoun),* 715 F.2d 1103, 1109–10 (6th Cir.1983) (showing that the initial inquiry is to determine whether there was intent to create support). The court should look at the parties' intent at the time of the divorce or separation. *E.g., Brody,* 3 F.3d at 38; *Tilley,* 789 F.2d at 1077; *Shaver v. Shaver,* 736 F.2d 1314, 1316 (9th Cir.1984). The labels attached to certain provisions in a separation agreement are not dispositive of their "nature," but the labels are persuasive evidence of the parties' intent. *Tilley,* 789 F.2d at 1077–78 (a label in the agreement erects a "substantial obstacle" for the party seeking to overcome it); *Catron,* 43 F.3d at *2.

Courts of the Fourth Circuit have articulated an "unofficial" test for the intent inquiry, which provides for the court to look at: (1) the actual substance and language of the agreement, (2) the financial situation of the parties at the time of the agreement, (3) the function served by the obligation at the time of the agreement (*i.e.* daily necessities), and (4) whether there is any evidence of overbearing at the time of the agreement that should cause the court to question the intent of a spouse. *Catron,* 164 B.R. at 919 (citing *Kettner v. Kettner,* No. 91–587–N, 1991 WL 549386 (E.D.Va. Nov. 19, 1991)) (the Fourth Circuit noted that approval of the use of these factors did not preclude the use of other formulae). Furthermore, because this list is non-exclusive and the inquiry is fact intensive, courts should consider all relevant evidence. *Lepley,* No. 07–20344, 2007 WL 2669128, at *3. Ultimately, courts may look beyond the four corners of a divorce decree or the agreement of the parties to determine the nature of the payments constituting the debts sought to be discharged. *In re Cribb,* 34 B.R. 862, 864 (Bankr.D.S.C.1983); *see also In re Bristow,* No. 04–50235, 2005 WL 1321996, *1–2 (Bankr.M.D.N.C. April 22, 2005).

To determine the parties' intent, the Court will consider the four factors established in *In re Catron,* discussed in *In re Johnson,* and utilized by this Court in numerous other cases, including *In re Pagels* and *In re Austin*: (i) whether there is any evidence of overbearing at the time the Divorce Decree and Order were entered; (ii) the actual language and substance of the Divorce Decree and Order; (iii) the financial situation of the parties at the time the Divorce Decree and Order were entered; and (iv) the function served by the obligations set forth in the Divorce Decree and Order. *See Catron v. Catron* (*In re Catron),* 164 B.R. 912, 919 (E.D.Va.1994), *aff'd,* 43 F.3d 1465 (4th Cir.1994) (unpublished table decision); *In re Pagels,* 2011 WL 577337, at *10; *In re Austin,* 271 B.R. at 106 (citing *In re Crosby,* 229 B.R. 679, 681 (Bankr.E.D.Va.1998)).

As to each factor, the Court must undertake a number of considerations. In *Kettner v. Kettner,* Civ. A. No. 91–587–N, 1991 WL 549386 (E.D.Va. Nov. 19, 1991), Judge Clarke wrote that if a spouse has suffered overreaching as a result of the other spouse's actions, the court should question the actions and intent of the overreaching spouse. Judge Clarke provided wisdom as to undertaking such a determination: In determining whether a spouse's will has been overborne, the court should consider whether both parties were represented by an attorney, whether the terms of the agreement grossly favor one spouse over the other or leave one spouse with virtually no income, the statements of the spouses in court, the age, health, intelligence and experience of the spouses, the bargaining positions of the parties, whether there were any misrepresentations, and whether the creditor spouse had knowledge of the debtor spouse's weakness or inability to fulfill the terms of the agreement. *Kettner v. Kettner,* Civ. A. No. 91–587–N, 1991 WL 549386, at *2 (E.D.Va. Nov. 19, 1991).

When examining the actual language and substance of the agreement, "the Court should be cognizant of the context in which the obligation arises under the agreement." *In re Austin,* 271 B.R. at 106 (citing *In re Catron,* 164 B.R. at 919; *Grasmann v. Grasmann* (*In re Grasmann*), 156 B.R. 903, 908 (Bankr.E.D.N.Y.1992)). While the Court should consider the label given to an obligation, the Court is not bound by such designation, as any such label may not indicate the true nature of the obligation. *Tilley v. Jessee,* 789 F.2d 1074, 1077–78 (4th Cir.1986); *Kettner,* 1991 WL 549386, at *1; *see also In re Austin,* 271 B.R. at 106–07 (quoting *Garza v. Garza* (*In re Garza),* 217 B.R. 197, 201 (Bankr.N.D.Tex.1998); *In re Grasmann,* 156 B.R. at 908). The Court should take into account how the obligation is to be paid (whether in a lump sum or over a period of time) and whether the payment is to be made directly to the spouse or to a third party. *In re Catron,* 164 B.R. at 919; *Kettner,* 1991 WL 549386, at *1. The Court may also consider any tax ramifications resulting from the obligation and any termination provisions regarding the obligation. *In re Catron,* 164 B.R. at 919; *Kettner,* 1991 WL 549386, at *1; *In re Pagels,* 2011 WL 577337, at *10 (quoting *In re Austin,* 271 B.R. at 106–07).

When considering the parties' financial situation, the Court should compare each party's work history, experience, and ability; income stability, potential, and opportunities; physical health; and future income needs. *In re Austin,* 271 B.R. at 107–08 (citing *In re Catron,* 164 B.R. at 919; *Bedingfield v. Bedingfield* (*In re Bedingfield),* 42 B.R. 641, 647 (S.D.Ga.1983); *796 *In re Grasmann,* 156 B.R. at 908; *Zaera v. Raff* (*In re Raff),* 93 B.R. 41, 47 (Bankr.S.D.N.Y.1988)). In the present case, because the parties have a minor child, the Court will also consider the fact that Lawrence has primary custody of the child. *In re Catron,* 164 B.R. at 919; *Kettner,* 1991 WL 549386, at *2.

Evaluating the role the obligation was intended to perform involves examination of numerous factors concerning both the parties' past and future circumstances, including how long the parties were married; whether either party was at fault in the marriage; whether the parties had any children; and the parties' standard of living during the marriage. *See In re Catron,* 164 B.R. at 919; *Kettner,* 1991 WL 549386, at *2 (citing *Stone v. Stone* (*In re Stone),* 79 B.R. 633 (Bankr.D.Md.1987); *In re Austin,* 271 B.R. at 108 (citing *Peterson v. Peterson* (*In re Peterson),* 133 B.R. 508, 512 (Bankr.W.D.Mo.1991); *In re Raff,* 93 B.R. at 47). The Court will also consider if the obligation arises from a past or future commitment and whether it represents an allocation of debt or a division of property. *In re Austin,* 271 B.R. at 108 (citing *In re Peterson,* 133 B.R. at 512–13). Finally, the Court will assess if the obligation was intended to provide daily necessities, "whether the award was intended to balance a disparity in incomes, and whether, without the debt at issue, the support award would have been sufficient...." *Id.* (citing *Baker v. Baker* (*In re Baker),* 146 B.R. 862, 866 (Bankr.M.D.Fla.1992); *In re Grasmann,* 156 B.R. at 908; *In re Peterson,* 133 B.R. at 512; *In re Raff,* 93 B.R. at 47).

Attorney fees awarded in connection with divorce proceedings can be determined to be nondischargeable under § 523(a)(5). *See Silansky v. Brodsky, Greenblatt & Renehan* (*In re Silansky*), 897 F.2d 743, 745 (4th Cir.1990) (concluding that attorney fees owed by the debtor to the former spouse's attorney arising from their divorce proceeding was nondischargeable). Courts reach such a conclusion where the obligation underlying the award of attorney fees is also nondischargeable. *Beaton v. Zerbe* (*In re Zerbe),* 161 B.R. 939, 940–41 (E.D.Va.1994); *see also Ewing v. Ewing* (*In re Ewing),* 180 B.R. 443, 446 (Bankr.E.D.Va.1994) ("The majority rule among Bankruptcy Courts is that an obligation to pay attorneys' fees is 'so tied in with the obligation of support as to be in the nature of support or alimony and excepted from discharge.' ") (quoting *Romano v. Romano* (*In re Romano),* 27 B.R. 36, 38 (Bankr.M.D.Fla.1983)); *Crooks v. Crooks* (*In re Crooks),* Adv. No. 94–3053–S, 1994 WL 16191547, at *2 (Bankr.E.D.Va. Oct. 13, 1994).

In re Hardesty
553 BR 86 (Bankr. E.D. Va. 2016)

Not all debt is exempted from a discharge. Some debt liability lasts even after the debtor receives his or her discharge. One of these debts are "domestic support obligations" under 11 USC § 523(a)(5). In bankruptcy court, issues often arise as to what amount, if any, of a post-divorce judgement constitutes a "domestic support obligation."

In 2008, the plaintiff and the defendant entered into a trial separation, whereby both parties amended and executed a property settlement agreement. After, both parties entered into a final decree of divorce. The final decree affirmed and incorporated but did not merge the property settlement agreement into the final decree. This property settlement agreement addressed the disposition of the marital property. It required the debtor to refinance a mortgage on the property, or remove the plaintiff's name form liability.

Three years later, the debtor filed for Chapter 13 bankruptcy. Afterwards, the debtor stopped making payments on the mortgages. The plaintiff sued, alleging that the debtor breached the property settlement agreement because he failed to remover her name on the mortgage. This resulted in a lowering of her credit score. The plaintiff argued that on an indemnity provision in the agreement allowed her to recover damages. She refused, arguing that these damages were nondischargeable debt under 11 U.S.C. § 523(a)(5) of the bankruptcy code.

In looking to see whether there was "mutual intent' to create an obligation or alimony, maintenance, or support, the court used a four-fact test, considering:

1) the actual substance and language of the agreement

2) financial situation of the parties at the time of the agreement

3) functions served by obligation at the time of the agreement, and

4) whether there as any overbearing pressure at the time of the agreement

First, in looking at the divorce settlement agreement, the court found that the couple unambiguously waived any right for either party to assert a claim for support or maintenance. In addition, the agreement also did not provide the appropriate tax treatment characterized in the indemnity agreement as an obligation in the nature of "alimony, maintenance, or support." Second, the court looked at the financial situation of the parties and found that the debtor was in a weaker financial situation than his ex-wife. Third, the court found that, since the non-debtor spouse was able to purchase a new home despite the debtor defaulting on his obligation to her, that her living condition appeared unaffected by the debtor's default. Finally, the court found no evidence of any overreaching pressure by either party.

For these reasons, the court found that the non-debtor spouse failed to prove that the post-divorce financial obligation was "alimony, maintenance, and support," and thus found the debtor's post-divorce obligation to be dischargeable.

In re Lopez
No. 16-10258-BFK (Bankr. E.D. Va. 2016)

Lopez concerned whether an award for post-divorce attorney's fees was a "domestic support obligation." In this case, the debtor had filed for Chapter 13 bankruptcy. His ex-wife filed a proof of claim seeking a priority recovery in $ 36,000 in attorney's fees, which were awarded to her at the conclusion of her and the debtor's divorce action. The debtor filed an objection to her proof of claim. At the hearing, the attorneys for both parties during the divorce testified regarding their billing practices, the authenticity of their bills, and how much of the case could be attributed, and in their opinion, how much of their fees were "custody, alimony, maintenance, and support," and how much were property distribution. The court found the final divorce decree to be vague, and concluded that slightly less than $10,000 was the amount to classify as a priority claim. The remainder of the claim was classified as unsecured debt.

In re Davis
No. 15-11174 (Bankr. E.D. Va. 2016)

In order to prove that a certain type of debt was not dischargeable, the creditor has the burden of proving it satisfies one of the types of nondischargeable debt. The creditor must do so by a preponderance of the evidence that the type of debt owed to him or her is not dischargeable.

In *Davis*, an issue arise as to whether $35,000 in legal fees awarded in a divorce case was a "domestic support obligation," and therefore non dischargeable debt. The debtor filed for Chapter 13 bankruptcy. During the debtor's divorce proceeding, the debtor's ex-spouse incurred $108,000 in attorney's fees. To help offset the cost, the Circuit Court awarded $ 35,000 in the legal fees to the wife, however did not allocate the money in any way, basing it instead on the "totality of the circumstances."

During the adversary proceedings, invoices for the legal fees were not entered into evidence, and the bankruptcy court thus found it impossible to sort out which of the $35,000 was a nondischargeable domestic support obligation, and which were disposable property. Thus, the court found that the debtor's spouse failed to meet her burden of proving that the $35,000 award was a domestic support obligation and entered a judgement in favor of the debtor.

Jeff is a partner in Virginia Beach office of Kaufman & Canoles where his practice focuses on commercial litigation, general litigation, family law, and complex commercial disputes with a particular experience in creditors' rights and bankruptcy matters. He represents all types of lenders, vendors and other creditors in bankruptcy, commercial litigation and creditors' rights matters. In addition to appearing on behalf of the firm's clients at all levels of the state and federal courts, he provides representation to creditors, debtors, and trustees in Chapter 7, 11, and 13 bankruptcy cases. Prior to graduating from the William & Mary School of Law, Jeff was a Certified Public Accountant with an international accounting firm.

Virginia Beach Bar Association's 2017 Seminar on Ethics and Creditors' Rights and Bankruptcy Law For Normal Lawyers (aka, The Basics For State Court Practitioners)

October 6, 2017, at 9:00 a.m. Grand Lux Café, Palazzo Hotel Las Vegas.

1. Ethics Update
2. Sanctions Hypotheticals
3. Sanctions Written Materials
4. Top 10 Bar Complaints
5. Vignettes with a Twist
6. Aspirational timeline
7. Virginia Rules of Professional Conduct 2017

October 7, 2017, at 9:00 a.m. Grand Lux Café, Palazzo Hotel Las Vegas.

1. CREDITORS' RIGHTS AND BANKRUPTCY LAW FOR NORMAL LAWYERS (aka, The Basics For State Court Practitioners)See Attached detailed Outline.
    a. From Filing suit to Discharge- See attached materials