

DEALING WITH DEBT

BY RON SATIJA

Every so often, a lawyer walks through my door asking for his or her options regarding debt. There are as many debt scenarios for lawyers as there are clients, so it's not possible to go through all of them, but there are issues that come up enough that they're worth knowing.

The first issue is bar discipline. Can an attorney be disciplined for filing bankruptcy? The answer is no, but it comes with a caveat. There is no disciplinary rule directly prohibiting a lawyer from filing bankruptcy, but bankruptcy does not alleviate the impact of any bar rule. Attorneys filing for bankruptcy must still follow the Texas Disciplinary Rules of Professional Conduct. An attorney planning on closing his or her law office must, upon withdrawal, ensure that client matters are completed or handed back to the client properly and must make sure that the client's rights are preserved, per Rules 1.15(b) and (d).

As with other unsecured debt, bankruptcy can discharge a malpractice claim, but no one else's liability is discharged. A law firm, general partner, or malpractice insurer may still be on the hook. Some jurisdictions have found that failure to report the potential claim to the insurer can result in a disciplinary claim, even though the failure was due to the debtor's good-faith belief that the debt was going to be discharged.

A second issue that comes up is partnership as an asset in the bankruptcy. Stephen Sather, a bankruptcy lawyer at Barron & Newburger, P.C. in Austin, says it is good practice for a partnership agreement to contain a buyout clause that allows the remaining

partners to buy out the insolvent partner. These clauses are typically keyed to some lower value than the insolvent lawyer's current share of the accounts receivable, and they permit the remaining partners to pay their partner a set amount rather than have to wage a fight against a bankruptcy trustee over valuation. The key, Sather says, is that the price paid must be fair. If a valid buyout clause exists, the lawyer should consider resigning from the partnership prior to filing bankruptcy so that the buyout can be accomplished prior to the filing. The money received in such a scenario may be used for the support of the lawyer. Spending it shouldn't pose a problem as long as it is used for ordinary and necessary expenses. On the other hand, transferring money to a relative to hold or buying a new asset, such as a ski boat, would be problematic. The important question to ask is whether the payment is one the attorney would make if he or she were not filing bankruptcy.

Pre-bankruptcy planning is the process of having a bankruptcy attorney review a

debtor's assets and determine which are at risk of loss in a Chapter 7 "liquidation" case (additional assets can be kept in Chapter 11 or Chapter 13 reorganization cases). In many cases, as detailed in the context of buyouts, a little planning can help a debtor get value from assets rather than have them liquidated for payment to creditors. The corporate form of the practice is one method. A sole proprietorship/practitioner form may leave all accounts receivable vulnerable, whereas a partnership, corporation, or L.L.C. is a separate entity, so creditors may not directly reach the assets. There may be contractual protections, such as buyout agreements and actual sale of assets. Also, lawyers may avail themselves of the typical exemptions available under Texas law, such as for homesteads, personal property, annuities, and retirement accounts. It should be stressed that the time to do asset planning is prior to getting into trouble. Bankruptcy law has several provisions that penalize a transfer made with intent to hinder, delay, or defraud creditors. Amounts invested in a homestead or personal property in contemplation of bankruptcy can be recovered by a trustee, and the debtor can lose his or her discharge as well.

The biggest issue confronting the insolvent attorney is stress. Debtors may be subject to dozens of phone calls a day from creditors. The home may be set for foreclosure. Wreckers may be circling for a vehicle on which payments are past due. When lawyers go under, they may hide their heads in the sand rather than address a huge problem. The first job of a

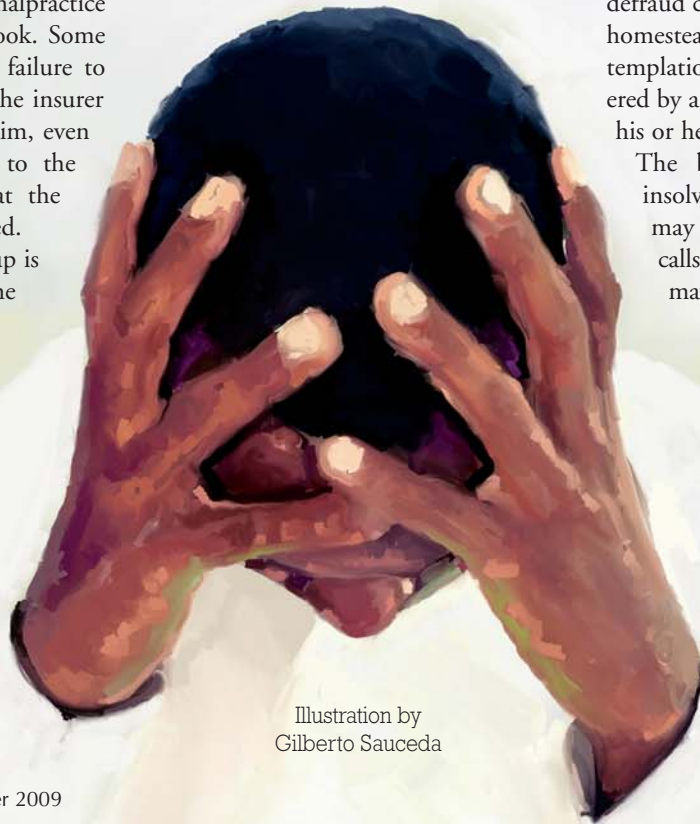


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Gilberto Saucedo

bankruptcy lawyer is to dispel that stress by assessing options. Home foreclosure is a long process in Texas, leaving time to assess options, and mortgage companies have been more willing to negotiate a forbearance or modification. With a vehicle, it may be necessary to ask if the vehicle is necessary or if others are available (e.g., a loaner from a friend). The repossession of a past-due vehicle creates an unsecured debt, but such debts are dischargeable in bankruptcy.

There are many options regarding unsecured debt short of filing bankruptcy. Attorneys negotiate for a living. It is almost always possible to negotiate a settlement with an unsecured creditor. However, it can also be very frustrating. The negotiating opponent is usually not another lawyer, but a low-paid, front-line employee with no authority or training. Settlements as low as 10 percent are not unheard of, though 25 to 75 percent are more common. It may depend on whether the attorney has resources to offer a lump sum payment or has to enter into a payment plan. In the case of credit cards, it is possible to outsource the negotiation to a credit-consolidation company. The caveat is that because interest continues to accrue, the monthly payment may be more than would be paid into a Chapter 13 plan without the benefits bankruptcy court oversight provides.

If credit card companies sue, that might provide a negotiating advantage the non-attorney debtor does not enjoy. Often just filing an answer will bring the creditor back to the negotiating table, with each additional use of the judicial forum — a motion to compel arbitration (all credit card agreements contain mandatory arbitration clauses), discovery, counterclaims (e.g., for debt collection violations), or attack on a defective affidavit — adding incentive for the creditor to settle. If nothing else, the attorney-debtor can buy time with litigation for some final, careful pre-bankruptcy planning, making sure not to disadvantage that creditor.

If, in the end, the attorney files bankruptcy, there are a couple of things to keep in mind. First, bankruptcy is not the end of the world. Credit tends to

recover a lot faster than expected (often in about two years if the discharged debtor makes timely payments on accounts that survive the bankruptcy or on new accounts). Second, the attorney-creditor may be able to take advantage of a special rule regarding business debt and may be eligible for a Chapter 7 case despite having income that is higher than average. Third, though it is not legal to discriminate in employment on the basis of having filed a bankruptcy, the bank-

ruptcy should be disclosed if it is asked about on the employment application.

No one wants to suffer under the stress that debt may bring, but, like anything else, it is a circumstance that can be managed and can provide an opportunity for growth.

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