

MEMORANDUM

TO: [REDACTED], Esq.
[REDACTED], and [REDACTED]

FROM: [REDACTED], Esq.

RE: Attorney Malpractice Issue Within the Context of Bankruptcy Law

DATE: November 5, 2005

This Memorandum is presented pursuant to your request of November 4, 2005.

FACTS

Plaintiffs retained defendant attorney to obtain their discharge from back taxes in bankruptcy. Defendant asked them whether they had filed their returns beyond three years, and they said they had. In fact, they had not, and defendant filed their bankruptcy petition four days early, causing \$25,000 not to be discharged. In a resulting malpractice action, plaintiffs' expert has testified that a bankruptcy attorney exercising due care would obtain confirmation from the IRS before filing.

ISSUE

Did defendant have a duty to investigate to determine whether plaintiffs' representations were false?

SUMMARY

Yes. Defendant, as an attorney, particularly an attorney holding himself out as being knowledgeable about bankruptcy proceedings, owed an affirmative duty of care to plaintiffs to properly and completely investigate all material facts potentially having a bearing on plaintiffs' obtaining of a bankruptcy discharge covering their outstanding tax obligations. This duty expressly extended to independently confirming the veracity of plaintiffs' conclusory statements regarding their filing of tax returns within a specified time frame.

DISCUSSION

A. Defendant Posed the Wrong Question to Plaintiffs in the First Place.

Defendant actually had, and breached, *two* separate duties toward plaintiffs. Before reaching the question of whether defendant had a duty to determine whether plaintiffs' representations were

false, defendant first had the threshold duty to pose his inquiry regarding plaintiffs' tax return situation so that it would properly cover the issues pertinent to plaintiffs' goal of achieving a full bankruptcy discharge of their tax debts.

Defendant posed the wrong question to plaintiffs when he asked "...whether they had filed their returns beyond three years..." This assumes that the rule requires that the tax return be filed more than three years before the bankruptcy, but this is incorrect. The rule is in fact that the due date of the return must be over three years old¹, and the actual filing date over two years old²; moreover, any actual assessment of tax must be older than the 240-day period preceding the filing of the bankruptcy petition³.

Defendant's failure to pose the correct question to plaintiffs while inquiring about the status of their tax return filing is indicative of the fact that defendant was apparently ignorant of the applicable law pertinent to the area in which he was practicing. An attorney is required to possess such a reasonable knowledge of the law as is ordinarily possessed by other attorneys. *Smith v. Woodall*, 270 P.2d 746 (Colo. 1954); *Ramp v. St. Paul Fire & Marine Ins. Co.*, 254 So.2d 79 (La. App. 4 Cir., 1971), amended on other grounds 269 So.2d 239, 263 La. 774; *Lapinsky's Estate v. Sparacino*, 132 S.E.2d 765, 148 W.Va. 38 (W.Va., 1963). He or she is also obliged to discover those additional rules of law which, although not commonly known, may be readily found by standard research techniques. *Boss-Harrison Hotel Co. v. Barnard*, 266 N.E.2d 810, 148 Ind.App. 406 (Ind. App., 1971). In the factual situation addressed by this Memorandum, defendant was apparently unaware of the correct statutory bankruptcy rules governing the discharge of tax obligations, and thereby breached his duty to plaintiffs by failing to even pose the correct inquiry which, had it been correctly posed, might well have led to a different outcome in plaintiffs' bankruptcy proceedings.

In the balance of this Memorandum, it is assumed that defendant's conduct caused plaintiffs to run afoul of the *correct* and *applicable* rule, and that their bankruptcy discharge, as a result, did not cover the \$25,000 obligation mentioned in "Facts" as stated above.

B. Case Law Analysis of Very Similar Facts.

1. The *Moore, et al. v. Tillis* Case and Its Factual Scenario.

The question of whether defendant had an affirmative duty to investigate and independently determine whether, and when, plaintiffs had actually filed their tax returns has been resolved unequivocally by at least one state trial court in an unreported, but nevertheless extremely persuasive, opinion. In *Moore, et al. v. Tillis*, Superior Court of California, County of Los Angeles, Civil No. BC210216 (September 21, 2000), the debtors/plaintiffs retained a bankruptcy attorney (the defendant) expressly for the purpose of discharging income tax liabilities.

¹ 11 U.S.C. §507(a)(8)(A)(i).

² 11 U.S.C. §507(a)(8)(A)(ii).

³ 11 U.S.C. §523(a)(1)(B).

Defendant was retained in August, 1995 to discharge income taxes incurred as a result of the payout of one plaintiff's pension plan, resulting in unexpected tax obligations for the tax years 1993, 1994, and 1995.

Defendant testified that she advised plaintiffs that their taxes would be discharged in the bankruptcy as long as they had filed their tax returns at least three years previous to the bankruptcy filing date; plaintiffs testified that they were told simply that the taxes would be discharged in the bankruptcy. In any event, defendant admitted that she never asked plaintiffs when they filed their 1993 tax return; that she assumed it was filed on April 15, 1994; and that she did not advise plaintiffs at length about the tax issues because she assumed they were intelligent people who would recognize the importance of the date of filing of the tax return. In fact, plaintiffs had filed for an extension for that particular taxable year.

Defendant filed the bankruptcy on May 16, 1997, and testified that she picked this date to assure that three years had elapsed from the date plaintiffs had filed their 1993 tax return. Plaintiffs' taxes for 1993 were ultimately determined not to have been successfully discharged in the bankruptcy proceeding because the petition was filed inside the relevant statutory period rather than beyond its expiration.

2. The Existence of an Affirmative Duty to Investigate.

The *Moore, et al., supra* court specifically addressed the question to which this Memorandum is directed, namely, an attorney's duty to investigate and inquire concerning the filing of tax returns when contemplated bankruptcy proceedings are anticipated to eliminate the debtor's tax obligations. The court first noted:

“One of the fundamental functions of any attorney is to advise and/or to investigate when necessary on behalf of the client. Liability can exist because the attorney failed to provide advice. Not only should an attorney furnish advice when requested, but he or she should also volunteer opinions when necessary to further the client's objectives. The attorney need not advise and caution about every possible alternative, but only of those that may result in adverse consequences if not considered.”

The court later went on to say:

“Based upon the foregoing, it seems clear that defendant owed plaintiffs a duty to advise them of the import of the statutory period to discharge tax liabilities, a duty to ask relevant questions pertaining thereto, *to investigate when the tax returns were filed*, and finally, to prepare and file a timely bankruptcy petition that would accomplish the aims of the client.” [Emphasis added]

The court ultimately imposed liability upon the defendant/attorney for legal malpractice, holding that:

“In failing to advise, question or investigate, defendant was unaware that plaintiffs did not file their 1993 taxes on April 15, 1994, but obtained an extension to file until August 15, 1994. As a result, the petition for bankruptcy was filed too early for the federal or state income taxes to be dischargeable. Defendant's argument that plaintiffs should have volunteered this information misses the point.”

In the often-cited holding in *Nichols v. Keller* (1993) 15 Cal.App.4th 1672⁴, the court explained an attorney's obligations this way:

“[I]t is reasonably foreseeable the [client] will offer a selective or incomplete recitation of the facts underlying the claim; request legal assistance by employing...everyday terms...and rely upon the consulting lawyer to describe the array of legal remedies available, alert the layperson to any apparent legal problems, and, if appropriate, indicate limitations on the retention of counsel and the need for other counsel. In the event the lawyer fails to so advise the layperson, it is also reasonably foreseeable the layperson will fail to ask relevant questions regarding the existence of other remedies and be deprived of relief through a combination of ignorance and lack or failure of understanding.”

Consistent with the analysis promulgated in *Nichols, supra* and its numerous progeny, the view of the *Moore, et al., supra* court is that there is no doubt that an attorney retained to conduct bankruptcy proceedings with the objective of achieving a full discharge of all of a debtor's tax liabilities owes an affirmative duty of care “...to investigate when the tax returns were filed...”, rather than simply relying on statements made by client laypersons concerning such critical facts.⁵

The standard of care prescribed by the trial court in *Moore, et al., supra*, is amply supported by numerous other holdings. In *Kirsch v. Duryea* (1978) 21 Cal.3d 303, 308, 578 P.2d 935, 146 Cal.Rptr. 218, 6 A.L.R.4th 334, for example, the California Supreme Court held that:

“The general rule with respect to the liability of an attorney for failure to properly perform his duties to his client is that the attorney, by accepting employment to give legal advice or to render other legal services, impliedly agrees to use such skill, prudence, and diligence as lawyers of ordinary skill and capacity

⁴ *Nichols, supra* involved a worker's compensation claim rather than a bankruptcy/tax issue, but its analysis applies across the board to every attorney's duties toward his or her clients.

⁵ Incredibly, referring to the \$700 fee that she had collected from plaintiffs in return for her services, defendant testified at trial that plaintiffs “Got what they paid for.” Needless to say, this did not pan out well as a meritorious defense to the claim for legal malpractice.

commonly possess and exercise in the performance of the tasks which they undertake. [Citations.]”

In very similar language, other courts have held that an attorney, by accepting employment to give legal advice or render legal services, impliedly agrees to use ordinary judgment, care, skill, and diligence in the performance of the tasks he or she undertakes. See, e.g., *Budd v. Nixen* (1971) 6 Cal.3d 195, 200; *Blain v. Doctors Co.* (1990) 222 Cal.App.3d 1048, 1062-1063; *Banerian v. O'Malley* (1974) 42 Cal.App.3d 604, 611-613, 116 Cal.Rptr. 919.

Bankruptcy proceedings can involve a very narrow, technical area of the law posing its own special hazards to the legal practitioner. “A significant area of exposure for the bankruptcy attorney concerns that attorney’s responsibility of counseling regarding the dischargeability of a particular debt and the issues that may develop as a result.” *Moore, et al., supra*, Amended Statement of Decision, at p. 4.

One of the fundamental functions of any attorney is to advise and/or to investigate when necessary on behalf of the client. *Moore, et al., supra*, Amended Statement of Decision, at p. 4. In the words of the California Court of Appeals:

“Liability can exist because the attorney failed to provide advice. Not only should an attorney furnish advice when requested, but he or she should also volunteer opinions when necessary to further the client’s objectives. The attorney need not advise and caution of every possible alternative, but only of those that may result in adverse consequences if not considered.”

Nichols, supra, 15 Cal.App.4th at pp. 1683-1684.

More particularly, a trained attorney is more qualified to recognize and analyze legal needs than a lay client, and, at least in part, this is the reason a party seeks out and retains an attorney to represent and advise him or her in legal matters. 2 *Mallen & Smith, Legal Malpractice*, §§ 19.5, 19.28, pp. 159-162, 229-233.

The *Moore, et al., supra* court continued to address the exact question to which this Memorandum is devoted when it held:

“Based upon the foregoing, it seems clear that defendant owed plaintiffs a duty to advise them of the impact of the statutory period to discharge tax liabilities, a duty to ask relevant questions pertaining thereto, *to investigate when the tax returns were filed*, and finally, to prepare and file a timely bankruptcy petition that would accomplish the aims of the client. Although aware of the applicable law, defendant breached these various duties. Plaintiffs’ expert testified in support of this conclusion when he opined that defendant’s omissions fell below the standard of care. It is without dispute that the subject taxes were dischargeable under the

Bankruptcy Code as long as they were ‘for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;’ (11 U.S.C. sec. 507(8)(A)(i), see also 11 U.S.C. sec. 523(a)(1).) In failing to advise, question, or investigate, defendant was unaware that plaintiffs did not file their 1973 [*sic*] taxes on April 15, 1994, but obtained an extension to file until August 15, 1994. As a result, the petition for bankruptcy was filed too early for the federal or state income taxes to be dischargeable. (See fn. 1, *supra*.) Defendant’s argument that plaintiffs should have volunteered this information misses the point.” [Emphasis added]

Learned bankruptcy commentators have repeatedly cautioned practitioners in the field against relying exclusively upon client or third-party oral representations, particularly in situations involving complicated taxation effects. See, e.g., Richard F. Armknecht III, “Discharging Tax Debts in Bankruptcy,” *The Compleat Lawyer*, Summer 1996, Vol. 13, No. 3, in which the author offered this note of warning regarding the 240-day rule of 11 U.S.C. §507(a)(8)(A)(ii):

“Caution should be exercised in determining whether an assessment has been made. Do not rely on the verbal statements of an IRS representative. If the debtor has any doubts as to when an assessment was made, debtor's counsel should request a Certificate of Assessments (Form 23-C) from the IRS.”

Probably the most eloquent expression of an attorney’s obligation to clients under circumstances such as those which are the subject of this Memorandum was made by Justice Brandeis back in 1893, when he said:

"The duty of a lawyer today is not that of a solver of legal conundrums: he is indeed a counsellor at law. Knowledge of the law is of course essential to his efficiency, but the law bears to his profession a relation very similar to that which medicine does to that of the physicians. The apothecary can prepare the dose, the more intelligent one even knows the specific for most common diseases. It requires but a mediocre physician to administer the proper drug for the patient who correctly and fully describes his ailment. The great physicians are those who in addition to that knowledge of therapeutics which is open to all, know not merely the human body but the human mind and emotions, so as to make themselves the proper diagnosis-to know the truth which their patients fail to disclose' "

Mason, *Brandeis: A Free Man's Life* (1946), at p. 80.

C. An Independent Statutory Basis for the Duty to Investigate.

An argument can also be made that an attorney's duty to investigate his or her own clients' claims is, within a bankruptcy context, prescribed by law. *Bankruptcy Rule* 9011(b)(3)⁶ provides:

“(b) Representations to the Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, *formed after an inquiry reasonable under the circumstances...*[that] (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery...” [Emphasis added]

A private right of action using a standard of care imposed by a statute or rule generally only arises if the claimant belongs to the class for whose benefit the provision was enacted, a civil remedy is consistent with the underlying purpose of the enactment, and the statutes establish a standard of care that could apply to a civil action. See, e.g., *Cort v. Ash*, 422 U.S. 66, 78, 95 S.Ct. 2080, 2088, 45 L.Ed.2d 26 (1975) (describing factors to consider when implying a private right of action). In the fact situation addressed by this Memorandum, plaintiffs could argue that *Bankruptcy Rule* 9011(b)(3) was adopted for the benefit of people just like them: Namely, debtors forced to rely upon an attorney whose duties, under the Rule, include the conducting of “...an inquiry reasonable under the circumstances...” while preparing the bankruptcy petition and supporting schedules.⁷

The duty of inquiry prescribed by *Bankruptcy Rule* 9011(b)(3), *supra*, and the penalties against attorneys who abrogate that duty, have recently been substantially enhanced by the adoption of *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*. See, in general, “Some Upcoming Changes to Bankruptcy Law Are Making Attorneys Nervous: A Roundtable Discussion,” *Texas Lawyer*, July 27, 2005.

⁶ The *Bankruptcy Rules*, as promulgated and approved by the Supreme Court pursuant to statutory authorization from Congress, have the effect of being substantive law within the context of all bankruptcy proceedings. See *In re Parr*, 3 B.R. 692 (Bankr. E.D.N.Y., 1980).

⁷ *Bankruptcy Rule* 9011 is the statutory equivalent of Fed. R.Civ.P. 11, both of which authorize courts to impose monetary sanctions against parties (including attorneys) who make improper representations, submit improper filings, or otherwise conduct themselves unprofessionally before the court. By its own terms, Rule 9011 permits a court to impose sanctions on its own initiative or upon the motion of a party, such as the “opposing litigant injured by the violation.” *In re Palumbo Family Ltd. P'ship*, 182 B.R. 447, 473 (Bankr.E.D.Va.1995).

D. The Fact That Plaintiffs Affirmatively Represented to Defendant That They Had “Filed Their Returns Beyond Three Years” Did Not Extinguish Defendant’s Obligation to Independently Investigate Plaintiffs’ True Tax Situation.

As previously noted, the question put to plaintiffs by defendant should not have been “Have you filed your returns beyond three years?” Rather, it should have been “Is the due date of each of the returns for which you are seeking a bankruptcy discharge over three years old, and is the actual filing date over two years old, and has the IRS made any assessments against you during the last 240 days?” Assuming that plaintiffs’ answer to the proper questions had been “yes” to the first two parts of the inquiry and “no” to the third part, the issue arises as to whether or not these answers would have relieved defendant of a duty to inquire further in order to ascertain the correct facts regarding plaintiffs’ filing status rather than merely relying upon their oral representations.

Addressing this issue is pertinent because defendant might attempt to argue that plaintiffs were *comparatively negligent* when they made their representation to defendant regarding their filing status, and that this comparative negligence relieved defendant of any duty to further investigate. If so asserted, this attempted defense will not be successful. It is well established that regardless of whether a particular state’s courts follow the rule of contributory negligence, or whether the law of the land is comparative negligence, neither gives rise to a defense against a claim of legal malpractice. A Florida decision citing both California as well as Oregon law is illustrative. In *Tarleton v. Arnstein & Lehr*, 719 So.2d 325, 331, 23 Fla. L. Weekly D1920 (4th DCA 1998), the court opined:

"A client cannot be found to be comparatively negligent for relying on an attorney's erroneous legal advice or for failing to correct errors of the attorney which involve the exercise of professional expertise. See *Becker v. Port Dock Four, Inc.*, 752 P.2d 1235, 1239 (Or. App. Ct. 1988); *Theobald v. Byers*, 13 Cal.Rptr. 864, 866-67 (Cal. 1st DCA 1961). Here, Former Wife relied on the Firm's representation that she could still bring her claims on the promissory notes even if she signed the settlement agreement. Simply because she was somewhat sophisticated in business matters does not impose upon her the burden to second guess her attorney's advice or to hire a second attorney to see if such advice was proper. The reason the Firm was hired was for their legal expertise and superior knowledge of the legal implications that the signing of the marital settlement agreement would entail. Thus, we find that the trial court erred in failing to direct a verdict in favor of Former Wife on the issue of comparative negligence. See *Becker*, 752 P.2d at 1239; *Theobald*, 13 Cal. Rptr. at 866-67."

The distinction between problems in a legal proceeding caused by the client, versus those caused by an attorney, is succinctly explained in 7A C.J.S., “Attorney & Client,” §255:

“Liability on the ground of negligence toward a client may not be imposed on an attorney for a client’s loss which results from his own free and voluntary act as to a matter wherein the attorney is deprived of control, where a matter is outside his scope of duty, but within the knowledge of the client, or where whatever loss has been suffered is due solely to the client’s own individual default. *However, where it is the duty of the attorney to investigate certain facts applicable to his client’s cause and report the results to the client, and if the attorney should have inquired but did not, the client cannot be said to have been negligent in failing to disclose matters within his own knowledge.*” [Citations omitted] [Emphasis added]

E. Whether or Not Defendant Had an Affirmative Duty to Investigate Plaintiffs’ Statements Concerning Their Filing Status May Now be a Moot Question.

At the risk of briefly departing from the specific issue posed for purposes of this Memorandum, the “Facts” do indicate that “In a resulting malpractice action, plaintiffs’ expert has testified that a bankruptcy attorney exercising due care would obtain confirmation from the IRS before filing.” Some courts have held that later state court actions for legal malpractice alleged to have occurred during the course of a federal bankruptcy proceeding are barred under the doctrine of *res judicata*. In *Grausz v. Linowes & Blocher, LLP*, 2003 U.S. App. LEXIS 3945 (4th Cir., March 6, 2003), for example, the Court of Appeals for the Fourth Circuit determined that the district court had subject matter jurisdiction over a bankruptcy debtor’s professional malpractice claim against the law firm that represented him in his bankruptcy case because the malpractice claim arose in the bankruptcy case. Further, the Fourth Circuit concluded that the bankruptcy court’s final fee order barred the debtor’s malpractice claim under principles of *res judicata* as the “core of operative facts” in the two actions were the same.

The same result under nearly identical operative facts was reached by the Court of Appeals for the Sixth Circuit in *Browning, etc., et al. v. Levy, etc., et al.* (2002) Electronic Citation: 2002 FED App. 0088P (6th Cir.) (recommended for full-text publication pursuant to Sixth Circuit Rule 206).

Here, in plaintiffs’ “...resulting malpractice action...”, presumably predicated upon defendant attorney’s breach of his duty to make further inquiry into plaintiffs’ income tax filing status, plaintiffs may well encounter – depending on what specifically happened during the course of their bankruptcy proceedings -- a similar claim preclusion issue that could effectively bar their cause of action.

CONCLUSION

It is inescapable that defendant, as an attorney, owed a duty of care to plaintiffs to completely and independently investigate all material facts potentially having a bearing on plaintiffs’ obtaining of a bankruptcy discharge, including whether their conclusory statements regarding their filing of tax returns within a specified time frame were accurate. Virtually nothing that

defendant might allege by way of a defense, short of a claim based on expiration of the applicable Statute of Limitations, would be likely to succeed. The duty in general, and within a bankruptcy context in particular, is well established in the law.

Prepared and submitted by:

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