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Beware cut-rate bankruptcy advice

Bankruptcy has become little more than a few months in purgatory rather than the 7-year ache -- and lifelong disgrace -- it once was.

By [Liz Pulliam Weston](#)

Deborah and Victor Valle fell behind on their mortgage payments last year after Victor, a 43-year-old union truck driver, was idled by the Southern California grocery workers strike.

When their lender started foreclosure proceedings, the Valles hired a lawyer, David Baran, to file a Chapter 13 bankruptcy so they could keep their home and have time to make up the late payments.

Baran filed the bankruptcy papers on Oct. 3, 2003. Within a few weeks, Victor was back at work and the couple had enough cash to bring their mortgage current.

But the attorney failed to file the necessary paperwork to stop the foreclosure and didn't show up for a key hearing -- all the while, the Valles said, assuring them that everything was fine.

On Dec. 5, 2003, the couple learned that their home had been sold.

2 types of bankruptcy mills

"Somebody comes to your door and says you have four days to move out," said Deborah, 39, the mother of four. "That was a shock."

The Valles now live in a budget Orange County motel. The real estate company that bought their four-bedroom house in La Mirada, Calif., quickly sold it to another family. Deborah sadly watched the new owners move in recently as she was driving by her former home.

As bankruptcy filings have soared to new records, many consumers are turning to high-volume bankruptcy law practices and bankruptcy-petition preparers for help in reorganizing their finances, staving off foreclosure or wiping out debt. Dubbed "bankruptcy mills" by their critics, many advertise heavily on radio and television, while others deluge homeowners in foreclosure by direct mail -- which is how the Valles found their attorney.

Bankruptcy mills can come in two flavors:

High-volume practices run by attorneys, who may or may not ever meet their clients before appearing in court.

Storefront bankruptcy-petition preparers who advertise cut-rate services, usually without a lawyer's help.

Either way, critics say, the results can be disastrous. Some mills employ bait-and-switch tactics, advertising a low-cost bankruptcy and then jacking up the fees. Others insist they can help debtors avoid insolvency for a fat up-front charge, only to push clients into filing -- or filing the bankruptcy paperwork without the clients' knowledge.

Bad advice costs the consumer

Critics say the mills often give poor advice, causing their clients' cases to be dismissed, leaving them saddled with debts that could have been erased or encouraging them to file when they shouldn't.

Dawn Carr of Phoenix used a paralegal to file Chapter 7 liquidation to wipe out her student loan debt. It wasn't until two years later, when a collection agency started calling, that she learned student loans only rarely can be erased in bankruptcy. Hers wasn't.

"So now I have a bankruptcy on my credit report that is essentially an empty one," Carr fumed. "What makes me more upset about the whole thing is that they should have known and didn't say a word, but they sure didn't have a problem taking my money for all the fees."

Debtors also can lose property that should have been protected. Miguel Vasquez of Lancaster, Calif., lost his home because of a bankruptcy preparer's incompetence, according to his attorney, Oscar Parra.

The preparer talked Vasquez into using his girlfriend's Los Angeles address as his own because the preparer didn't want to drive to Lancaster, more than an hour away, to attend the bankruptcy hearing, Parra said. Vasquez, who speaks little English, didn't understand the repercussions of the decision -- and apparently, neither did the preparer.

Because the Lancaster property wasn't listed as his primary residence, the bankruptcy trustee could -- and did -- seize the home to pay Vasquez' creditors. Had the preparer listed the property correctly, Vasquez' equity in the property would have been protected under state law, Parra said.

An increasing problem

The U.S. Trustee Program, which supervises bankruptcy case administration, says bankruptcy mills are an increasing problem. The program filed 243 actions in fiscal year 2002 for attorney misconduct, up 62% from the year before. Actions against bankruptcy petition preparers rose 43%, to 1,150.

Among the cases:

A bankruptcy-petition preparer in Woodland Hills, Calif., advertised \$99 bankruptcies, only to use high-pressure sales tactics on low-income elderly and disabled clients to boost the fee to \$650.

A bankruptcy-petition preparer in Alexandria, Va., called himself a "foreclosure specialist" and charged up to \$3,500 for his services, which included trying to buy clients' homes at below-market prices and then renting the properties back to them.

An Oklahoma City attorney repeatedly failed to show up for bankruptcy hearings, in one case forcing a disabled client to make a 280-mile journey to attend a rescheduled meeting.

A Denver attorney in at least five cases redeemed his clients' property from foreclosure proceedings, reselling each time for profits of up to \$50,000.

In Los Angeles, the U.S. Trustee last year forced attorney Claudia Phillips to sell her practice as part of a settlement agreement after she repeatedly failed to meet with clients or represent them adequately in court. Court papers said Phillips allowed others to forge her signature and those of her clients on documents, adding that Phillips' husband, Kenneth, who was not a lawyer, actually ran the practice and offered legal advice.

Another problem, bankruptcy attorneys say, is lawyers who push clients with few assets into Chapter 13 repayment plans rather than the Chapter 7 liquidation plans that make more sense. The reason? Chapter 13's increased complexity means higher fees -- and the repayment plan puts the attorney first among all the creditors who get repaid.

DIY bankruptcy on the rise

The problem of bad or incompetent advisers has grown so acute in recent years that two years ago the then-U.S. Trustee for the Southern California bankruptcy court, one of the busiest in the nation, took the extraordinary step of warning consumers about the perils of discount advice.

The trustee, Maureen Tighe, now a bankruptcy court judge, said debtors were "routinely" losing property in bankruptcy that should have been protected or were winding up stuck with debts that should have been erased.

The report, co-authored with the Los Angeles County Bar, focused on the rise of bankruptcy-petition preparers in the area. Nearly one in three bankruptcy filings in Southern California is "pro se" ("for self"), which means the filer has no attorney and has typically used a bankruptcy-petition preparer. The rate is nearly one in two in Santa Barbara, home of the largest bankruptcy-petition preparer chain, We the People.

Some firms cry 'foul'

Some of those dismissed as bankruptcy mills, however, say they're getting a bum rap.

"We do thousands and thousands of bankruptcy filings a year, and the vast, vast, vast majority have gone through just fine," said Jason Searns, general counsel for We the People, which has 150 offices in 28 states. "We are serving a huge, underserved market that can't afford lawyers."

We the People is the nation's largest legal self-help chain, advertising \$199 bankruptcies, \$349 divorces and low-priced business incorporation services. The company does not provide legal advice, Searns said, but helps consumers fill out the appropriate forms to represent themselves in court.

"Is it perfect for everyone? No. There are some people who really should go to lawyers," Searns said. "But people have the right to do it themselves if they want to, just as people have the right to go to Home Depot and do their own bathroom."

Petition preparers and discount attorneys say they're being lumped in with incompetents and scam artists as part of a legal turf war by higher-priced attorneys trying to protect their fees. The high-

volume operators say they offer consumers a low-cost alternative to regular bankruptcy attorneys, who typically charge \$800 to \$2,500 for a bankruptcy filing.

Advice that's simply wrong

But critics say too many consumers are being scammed, ending up with botched cases or filing for bankruptcy when they really shouldn't.

"'Bankruptcy-petition preparer' is a nice term for something that's evil," pronounces Leon Bayer, a Los Angeles bankruptcy attorney with 25 years' experience who now represents the Valles. "It's a street-corner paralegal who thinks that 'whatever a lawyer can do, I can do,' and their clients pay the price."

Then again, bankruptcy-mill attorneys may not be much better. In addition to representing clients whose attorneys have served them poorly, Bayer has collected some of the direct-mail appeals his clients receive when their lenders start foreclosure proceedings, a public process that tips off bankruptcy mills that someone might need their services. Some of the most deceptive letters were sent by attorneys soliciting business, Bayer said.

"Chapter 13 is NOT BANKRUPTCY," one attorney-sent letter proclaims, "but rather the 'Wage Earner Plan' designed to allow financially troubled persons to pay their bills, not wipe them out."

Of course, Chapter 13 *is* a bankruptcy filing. In return for paying some of their debts over three to five years, consumers can have the rest of their debts erased. In Chapter 7, most unsecured debts (other than student loans and recent taxes) are wiped out without a repayment plan.

Both types of filings put an automatic stop to any foreclosure or eviction proceedings, but Chapter 13s typically make it easier to protect the equity in a home. In a Chapter 7, the home's equity may be used to pay creditors.

For the Valles, justice is more bitter than sweet

Unlike some bankruptcy-mill victims, the Valles actually knew they were filing for Chapter 13. But the Valles say their attorney failed to act when their lender gave notice that it wanted to reinstitute foreclosure proceedings, a routine procedure known as "a motion for relief from the automatic stay."

After receiving a letter from the court about the motion, the Valles said they phoned their attorney and visited his office and were reassured the matter would be taken care of. A month after the lender filed its motion, the Valles got notice that the court had granted the lender's request. Court records show no opposition to the motion that was filed, and the Valles said the attorney failed to attend the hearing. Less than 10 days later, the home was sold. The Valles have received some justice. Bankruptcy court Judge Thomas Brown recommended that Baran be disbarred from bankruptcy practice, ruling that his "failure to perform services competently . . . directly caused the debtor, Victor R. Valle, to lose his home in a foreclosure sale."

The Valles are pursuing a malpractice case against Baran as well. But the most they can hope for is a return of the home equity they lost when their house was sold. They won't be able to get their house back or receive any compensation for the trauma they experienced.

"There's no such thing as 'pain and suffering'" in such cases, Deborah Valle said. "We lost our house, and that's it."

Liz Pulliam Weston's column appears every Monday and Thursday, exclusively on MSN Money. She also answers reader questions in the [Your Money message board](#).