2023 Alexander L. Paskay Memorial Bankruptcy Seminar

Attorneys' Fees and Ethical Implications

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2023

Attorney's Fees and Ethical Implications
47th Annual Alexander L. Paskay Memorial Bankruptcy Seminar
February 21, 2023

Presented by:

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On Our Watch

BY ADAM HERRING AND SCOTT BOMKAMP

Ensuring "Access" and "Justice"

USTP's Enforcement Guidelines for Bifurcated Fee Agreements

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The Bankruptcy Code generally prohibits the post-petition payment of a chapter 7 debtor's attorney's fees based on a pre-petition retainer agreement.[1] As a result, the debtor must traditionally pay the entire fee for the case in full before the case is filed, unless the debtor's attorney is willing to file the case with no recourse to compel post-petition payments.[2] Many have suggested that this statutory structure presents a barrier to accessing the bankruptcy system for those who may most need relief.[3]

The increasingly prevalent practice of "bifurcating" attorney fees has arisen as an alternative. However, stakeholders have expressed starkly varying views on the propriety of bifurcated fee arrangements.[4] Similarly, some courts have expressly prohibited bifurcation based on local rules and attorneys' professional duties,[5] while others have held that there is nothing inherently impermissible about bifurcated agreements if properly done.[6]

In jurisdictions that allow them, bifurcated arrangements may help debtors who are unable to quickly come up with the full fee for a chapter 7 case. However, they also present substantial risks for abuse. If bifurcation is permitted, the benefits must be balanced against those risks, and the arrangements must be properly disclosed, structured and implemented to prevent harm to debtors and the integrity of the system.

Bifurcated Fee Agreements in Practice

Under a bifurcated fee arrangement, the client first executes a pre-petition retainer agreement limited to the attorney preparing and filing a "skeletal" chapter 7 petition.[7] The fee for pre-petition services may be as little as $0.[8] Most pre-petition agreements in bifurcated models describe the debtor's post-petition options as (1) hiring the attorney under a post-petition agreement to provide full representation through the remainder of the case; (2) hiring other counsel to complete the case; or (3) completing the case *pro se*.

After the petition has been filed, the client executes the post-petition retainer agreement, under which the debtor agrees to pay post-petition fees in installments.[9] Next, the attorney prepares and files the remaining bankruptcy documents, including the schedules and statement of financial affairs, attends the § 341 meeting of the creditors with the client and otherwise represents the client in the bankruptcy case.[10] The fee charged under the post-petition agreement is the remainder of the fee for the case that was not paid pre-petition.

Some attorneys use third-party financing to support their bifurcated fee business model. While the specific terms vary, outside financing generally pays

1 *See Lamie v. United States Trustee*, 540 U.S. 526, 537 (2004) (chapter 7 debtors' attorneys generally may not be compensated by bankruptcy estate); *Rittenhouse v. Eisen*, 404 F.3d 395, 397 (6th Cir. 2005) (chapter 7 debtor's attorneys' fees owing under pre-petition retainer agreement are dischargeable debt).

2 Adam D. Herring, "Problematic Consumer Debtor Attorneys' Fee Arrangements and the Illusion of 'Access to Justice,'" XXXVII *ABI Journal* 10, 32, 58-59, October 2018, *available at* abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on July 26, 2022).

3 *See, e.g.*, § 3.01, ABI Comm'n on Consumer Bank. Final Report, *available at* consumercommission.abi.org; Daniel E. Garrison, "Liberating Debtors from 'Sweatbox' and Getting Attorneys Paid: Bifurcating Consumer Chapter 7 Engagements," XXXVII *ABI Journal* 6, 16, 66-68, June 2018, *available at* abi.org/abi-journal.

4 *See* Herring, *supra* n.2. *See also, e.g.*, Terrence L. Michael, "There's a Storm a Brewin': The Ethics and Realities of Paying Debtors' Counsel in Consumer Chapter 7 Bankruptcy Cases and the Need for Reform," 94 *Am. Bankr. L.J.* 387 (2020); David Cox, "Why Chapter 7 Bifurcated Fee Agreements Are Problematic," XL *ABI Journal* 6, 30-31, 53-54, June 2021, *available at* abi.org/abi-journal; Garrison, *supra* n.3.

5 *See, e.g., In re Suazo*, No. 20-17836, 2022 WL 2197567 (Bankr. D. Colo. June 17, 2022); *In re Siegle*, 639 B.R. 755 (Bankr. D. Minn. 2022); *In re Baldwin*, 640 B.R. 104 (Bankr. W.D. Ky.); *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. 2021), *rev'd and remanded*, 639 B.R. 664 (D.S.C. 2022).

6 *See, e.g., In re Rosema*, No. 20-40366, 2022 WL 2662869 (Bankr. W.D. Mo. July 8, 2022); *In re Kolle*, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021); *In re Brown*, 631 B.R. 77, 101 (Bankr. S.D. Fla. 2021); *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020); *In re Hazlett*, No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah April 10, 2019).

7 *See, e.g., Walton v. Clark & Washington PC*, 469 B.R. 383, 385 (Bankr. M.D. Fla. 2012).

8 *Id.*; *see also Hazlett*, 2019 WL 1567751 at *1.

9 *Walton*, 469 B.R. at 385.

10 *Id.*

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the attorney an immediate lump sum and relieves the attorney of the burdens of collection. Typical financing models involve the attorney factoring, or granting a security interest in, their accounts receivable.[11] In exchange, the finance company charges a fee, which is often a substantial percentage of the total attorney's fee charged.[12]

Recent Case Law Developments

Decisions have generally either approved bifurcation subject to protective conditions, or disapproved it entirely. In two recent decisions, the U.S. Bankruptcy Court for the Western District of Missouri addressed bifurcation using third-party financing models.[13] The court held that bifurcation was not *per se* forbidden. However, in both cases, the debtors' attorneys failed to make adequate disclosures and charged unreasonable fees. The court put it succinctly: "All attorney fee agreements must be reasonable. And, in bankruptcy cases, all fee agreements, payments, terms, and sources must be fully, completely, and accurately disclosed in addition to being reasonable. Period."[14]

The U.S. Bankruptcy Court for the Southern District of Florida has followed similar principles and provided guidance for proper bifurcation in the district.[15] It was particularly concerned with adequate client disclosures and informed consent, and set out detailed requirements.[16] The court also outlined the attorney's duties and services that must be performed pre- and post-petition.[17] As for attorneys' fees, the court concluded that it would assess the reasonableness of a post-petition fee on its own, and not in comparison to the pre-petition fee charged.[18] In other words, the court would not be concerned with a $0 pre-petition fee as long as the post-petition fee is reasonable in light of actual or potential post-petition services. The court noted that attorneys may not recoup filing fees advanced pre-petition, because such advances are dischargeable pre-petition loans.[19] In addition, although none of the firms at issue in the decision employed third-party financing, the court stated in a footnote that factoring post-petition fees is impermissible because it creates an inherent conflict of interest and violates the Florida Rules of Professional Conduct.[20]

Some courts have found bifurcation to be *per se* impermissible. These cases reason that bifurcation involves inherent violations of an attorney's duties and common local rules requiring that the attorney who files a case is responsible for performing all essential tasks in the case, unless the court permits withdrawal. In *Prophet*, the U.S. Bankruptcy Court for the District of South Carolina said:

> Separate representations and bifurcation are not permitted. Counsel cannot walk the debtor client to the courthouse door, file only a few of the required documents, and insist that the representation has been completed even if maintaining that additional (but in counsel's mind uncontracted) services will be provided until the Court acts on a motion to withdraw. This strains too much the bankruptcy attorney/client relationship, especially given the disparity between the contracting parties over issues that otherwise are the inherent subject of the attorney/client relationship — claims, debts, personal liability and the right to payment.[21]

On appeal, the district court reversed, concluding that the bankruptcy court had misapplied its own local rule, and remanded the case for consideration of the U.S. Trustee's arguments regarding the attorney's disclosures and fees.[22] Subsequent cases have adopted the *Prophet* court's reasoning, which remains good law in those districts.[23] Recently, the *Siegle* and *Suazo* bankruptcy courts held that the debtors' attorneys violated local rules and § 526 of the Bankruptcy Code because the bifurcated agreements misrepresented the attorneys' obligation to continue to represent the debtors post-petition under the applicable local rules.[24]

The USTP's Enforcement Guidelines

To balance the worthy goal of expanding access to the bankruptcy system with the risk of harm from abusive practices, the "Guidelines for U.S. Trustee Program (USTP) Enforcement Related to Bifurcated Chapter 7 Fee Agreements" were released in June 2022.[25] The Guidelines are an internal directive designed to guide USTP personnel and promote a consistent enforcement approach, and they have been made publicly available to inform the bankruptcy community about the USTP's enforcement positions.

As a starting point, the USTP's position is that absent contrary applicable authority, bifurcated fee agreements are permissible provided that three criteria have been met: (1) the fees charged under the agreement must be fair and reasonable; (2) the attorney must provide adequate disclosures to clients, and clients must provide fully informed consent; and (3) the attorney must make sufficient public disclosures related to the fee agreement. The USTP's guiding principle in determining whether to take an enforcement action is redressing harm — to debtors or the integrity of the bankruptcy system — resulting from noncompliant arrangements. Each of these criteria is discussed in greater detail herein.

Fair and Reasonable Fees

Bifurcated agreements present a potential for harm in the structuring of fees. The USTP's first consideration in reviewing any fee arrangement in a consumer case is ensuring that it serves the best interests of clients rather than professionals.

Attorneys' fees under a bifurcated agreement must be properly allocated between pre- and post-petition fees and services. The USTP's position is that fees earned for pre-petition services must either be paid pre-petition or waived, because they are a dischargeable pre-petition debt. This ensures that attorneys comply with their professional and statutory duty to provide appropriate pre-petition counseling, including regarding chapter selection and exemp-

11 *See, e.g., In re Milner*, 612 B.R. 415, 422 (Bankr. W.D. Okla. 2019).
12 *Id.*
13 *Rosema*, 2022 WL 2662869; *Kolle*, 2021 WL 5872265.
14 *Rosema*, 2022 WL 2662869 at *26.
15 *Brown*, 631 B.R. 77.
16 *Id.* at 98-100.
17 *Id.* at 96-98.
18 *Id.* at 94.
19 *Id.* at 102-03.
20 *Id.* at 97, n.30.
21 *Prophet*, 628 B.R. at 804.
22 *Prophet*, 639 B.R. at 676.
23 *Baldwin*, 640 B.R. at 118-19.
24 *Suazo*, 2022 WL 2197567 at *17 ("[T]he two-contract model ... was wholly illusory."); *Siegle*, 639 B.R. at 759.
25 Guidelines, *available at* justice.gov/ust/page/file/1511976/download.

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tions.[26] Concomitantly, post-petition fees must be rationally related to post-petition services, so that a flat post-petition fee is not a vehicle to collect fees for work that was performed or should have been performed prior to the filing of the case.[27] Finally, attorneys should not advance filing fees and seek post-petition reimbursement, as advanced filing fees are dischargeable pre-petition loans.[28]

Attorneys' fees must also be reasonable. Bifurcation is not an invitation — nor an entitlement — to collect higher fees than would be collected from similarly situated clients who pay in full before filing. In addition, bifurcated fee models that employ outside financing invite significant scrutiny. These arrangements may incentivize overcharging because the attorney incurs (often substantial) financing costs that they may attempt to pass along to their clients. For example, in *Baldwin*, the court evaluated reasonableness by comparing the amount charged in cases in which the client paid the full fee up front to cases in which fees were bifurcated.[29] After finding that fees were $950 higher in the bifurcated fee cases because the attorney passed on a financing charge to his client, the court held that the convenience provided to the debtor was not worth such a hefty upcharge and that the increased fee was unreasonable and contrary to chapter 7's fresh start policy.[30]

Client Disclosures and Fully Informed Consent

Debtors must understand the fee agreements into which they are entering. The requirement that debtors provide fully informed consent to bifurcated agreements is derived from both the Bankruptcy Code and relevant rules of professional conduct. Sections 526-528 of the Code require, among other things, that attorneys representing "assisted persons" (most consumer debtors) deal honestly with their clients, not misrepresent the services they will provide or the benefits and risks of bankruptcy, make thorough required disclosures, and timely enter into a clear and conspicuous written agreement detailing services to be provided and the terms of any fee agreement. The court in *Hazlett*, an early decision permitting bifurcation, wrote that "the propriety of using bifurcated fee agreements in consumer chapter 7 cases is directly proportional to the level of disclosure and information the attorney provides to the client and the existence of documentary evidence that the client made an informed and voluntary election to enter into a post-petition fee agreement."[31]

In *Milner*, the bankruptcy court opined that pre- and post-petition contracts, which were prepared by a third-party finance company, were full of legalese and beyond the comprehension of the debtor or any average layperson seeking bankruptcy services.[32] Even debtor's counsel conceded that the debtor did not understand the distinction between the duties imposed by the pre- and post-petition contracts.[33] The court ordered disgorgement of the attorney's fees because §§ 329 and 528 of the Bankruptcy Code and Rule 2016 of the Federal Rules of Bankruptcy Procedure require thorough "plain English" disclosures to the client that are "simplistic, clear, and concise."[34] In addition, Rule 2016 requires disclosure of fee-sharing, and the court found that the debtor's attorney and the financing company were engaged in fee-sharing that was inadequately disclosed because both retained a portion of the debtor's payments.[35] Similarly, in *Baldwin*, the court was particularly concerned that the disclosures to the debtor did not explain the effect of default on the post-petition contract and did not fully explain the financial relationship between the financing company and the debtor's attorney.[36] In evaluating whether a debtor has given fully informed consent to a bifurcated fee agreement, the USTP will consider the following factors:

- whether the debtor's attorney has clearly disclosed both the services that will be rendered pre- and post-petition and the corresponding fees for each segment of the representation, including that certain listed services might not arise in a particular case;
- whether the attorney has disclosed their obligation to continue representing the debtor regardless of whether the debtor executes a post-petition agreement, unless the bankruptcy court permits the attorney's withdrawal;
- whether the attorney has clearly disclosed that the client is being provided the option to choose a bifurcated fee agreement, any difference in the total attorney's fee between the bifurcated fee agreement and a traditional fee agreement, and the client's options with respect to the post-petition fee agreement; and
- whether the agreement includes clear and conspicuous provisions explaining the options, costs and consequences of entering into a bifurcated fee agreement and providing the debtor with an option to rescind the agreement.

This should not be considered an exhaustive list, nor will the USTP apply these factors mechanically in determining whether a particular fee agreement is objectionable.[37] Instead, the USTP will qualitatively assess whether an attorney's disclosures were adequate to permit the debtor to give fully informed consent.

Public Disclosures

Full disclosure of professionals' dealings with their client is a hallmark of the Bankruptcy Code and Rules.[38] Attorneys employing bifurcated agreements must take particular care to fully and accurately make detailed disclosures of the particulars of their fee agreements and the amounts they have been paid and expect to be paid. Failure to make adequate disclosures is a basis for the USTP to take an enforcement action, and attorneys should be aware that the presumptive remedy under § 329(a) for inadequate disclosure of fees is full disgorgement.[39]

26 *See* 11 U.S.C. § 707(b)(4). *See also U.S. Trustee v. Ashcraft, et al.*, No. 17-ap-01271-mw, ECF No. 45 (Bankr. C.D. Cal. Aug. 8, 2019) (attorneys using factoring model stipulated as part of settlement with USTP that they routinely filed initial inaccurate schedules that had to be later amended and that they did not conduct any meaningful analysis of whether their clients could afford post-petition payments).
27 *But see Brown*, 631 B.R. at 92-93 (rejecting U.S. Trustee's argument that court should compare charge for pre-petition services to fee for post-petition services given that majority of bankruptcy services in chapter 7 are rendered pre-petition).
28 *See, e.g., Matter of Riley*, 923 F.3d 433, 439-40 (5th Cir. 2019); *Brown*, 631 B.R. at 102-03.
29 *Baldwin*, 640 B.R. at 125-26.
30 *Id.*
31 *Hazlett*, 2019 WL 1567751 at *8.
32 *Milner*, 612 B.R. at 428, 443.
33 *Id.* at 428.
34 *Id.*
35 *Id.*
36 *Baldwin*, 640 B.R. at 122.
37 The USTP will also take into account local rules or controlling authority that impose clear standards for adequate disclosures and conditions of informed consent, and act accordingly.
38 11 U.S.C. § 329(a); Fed. R. Bankr. P. 2016(b).
39 *See, e.g., SE Prop. Holdings LLC v. Stewart*, 970 F.3d 1255, 1266 (10th Cir. 2020).

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Conclusion

Enhancing access to justice must consist of both removing barriers to entry — "access" — and ensuring that debtors who act in good faith and comply with legal requirements receive the relief the law affords them: "justice." Absent amendments to the Bankruptcy Code,[40] where allowed, bifurcation on fair and reasonable terms presents a viable alternative to the traditional chapter 7 fee model and may enhance consumer debtors' ability to access the bankruptcy system. Consistent with its mission, the USTP will continue to enforce the Code in a uniform, balanced fashion to protect consumers and the integrity of the bankruptcy system. abi

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40 The ABI Commission on Consumer Bankruptcy made recommendations for Bankruptcy Code amendments that would permit post-petition payment of chapter 7 debtors' attorneys' fees. *See* Final Report, *supra* n.3.

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U.S. Department of Justice

Executive Office for United States Trustees

Office of the Director *Washington, DC 20530*

June 10, 2022

MEMORANDUM

TO: United States Trustees

FROM: Ramona D. Elliott
Acting Director

SUBJECT: Guidelines for United States Trustee Program (USTP) Enforcement Related to Bifurcated Chapter 7 Fee Agreements

I. Introduction

In our role as the "watchdog" of the bankruptcy process, one of the USTP's core responsibilities is to protect and preserve the integrity of the bankruptcy system. In doing so we seek to promote fair access to the bankruptcy system while ensuring that no participant is treated improperly. Enhancing access to justice not only includes removing barriers to entry but also ensuring that all debtors who seek bankruptcy protection in good faith and comply with the Bankruptcy Code's requirements receive the relief the law affords them. This includes ensuring that debtors are properly and adequately represented by their attorneys, who in turn are negotiating the terms of their fee arrangements and representation in good faith.

The Bankruptcy Code's[1] statutory framework generally prohibits postpetition payment of attorney's fees arising from prepetition retention agreements in chapter 7 cases. The Supreme Court held in *Lamie v. United States Trustee*[2] that chapter 7 debtors' attorney's fees may not be paid out of the bankruptcy estate, and almost all courts that have considered the issue have held that attorney's fees owing under a prepetition retainer agreement are a dischargeable debt.[3] As a

[1] 11 U.S.C. §§ 101 *et seq.*
[2] 540 U.S. 526, 537 (2004). The Court's reasoning was that 11 U.S.C. § 330(a) only authorizes compensation to professionals employed under § 327, which does not include the debtor's attorney in a chapter 7 case unless employed by the trustee under § 327(e).
[3] *See, e.g., Rittenhouse v. Eisen*, 404 F.3d 395, 397 (6th Cir. 2005).

result, the traditional model for representation in chapter 7 cases is payment of the entire attorney's fee for the case[4] in full before the case is filed.

"Bifurcated" fee agreements—which split an attorney's fee between work performed prior to the filing of a bankruptcy petition and work performed postpetition—have become increasingly prevalent in chapter 7 consumer bankruptcy cases.[5] Bifurcated agreements are generally structured so that minimal services—limited to those essential to commencing the case—are performed under a prepetition agreement for a modest (or no) fee, while all other services are performed postpetition, under a separate postpetition retention agreement, arguably rendering those fees nondischargeable.

Courts and stakeholders in the bankruptcy community have expressed differing views on the propriety of bifurcated fee agreements.[6] Some courts have held that bifurcation by its nature violates certain local rules governing the professional responsibilities of counsel owed to their debtor clients.[7] Other courts have held that nothing is inherently improper about bifurcation, provided that certain guardrails are obeyed.[8]

Absent contrary local authority, it is the USTP's position that bifurcated fee agreements are permissible so long as the fees charged under the agreements are fair and reasonable, the agreements are entered into with the debtor's fully informed consent, and the agreements are adequately disclosed. Bifurcated agreements provide an alternative under the current statutory framework to the traditional attorney's fee model, which some have noted present a barrier to accessing the bankruptcy system for debtors who may need relief but are unable to pay in full before filing. The benefits these type of agreements provide—increasing access and relief to those in need—must be balanced against the risk that these fee arrangements, if not properly structured, could harm debtors and deprive them of the fresh start afforded under the Bankruptcy Code.

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[4] Typically, a flat fee for all services essential to the successful completion of the case.

[5] This Memorandum only addresses enforcement guidelines for bifurcated fee arrangements. The exclusion from these guidelines of other alternative fee arrangements—such as the practice of filing chapter 13 cases solely to pay attorney's fees over time—should not be construed as acceptance of the propriety of such arrangements. When any fee arrangement violates the Bankruptcy Code or Rules, the USTP will take enforcement actions as appropriate.

[6] *See, e.g.,* Terrence L. Michael, *There's A Storm A Brewin: The Ethics and Realities of Paying Debtors' Counsel in Consumer Chapter 7 Bankruptcy Cases and the Need for Reform*, 94 AM. BANKR. L.J. 387 (2020); Adam D. Herring, *Problematic Consumer Debtor Attorney's Fee Arrangements and the Illusion of "Access to Justice"*, ABI JOURNAL, Vol. XXXVII, No. 10, Oct. 2018; Daniel E. Garrison, *Liberating Debtors from "Sweatbox" and Getting Attorneys Paid*, ABI JOURNAL, June 2018, at 16. *See also* Adam D. Herring, "Great Debates" at the ABI Consumer Practice Extravaganza (Nov. 5, 2021).

[7] *See, e.g., In re Baldwin*, No. 20-10009, 2021 WL 4592265 (Bankr. W.D. Ky. Oct. 5, 2021); *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. 2021), *rev'd and remanded* No. 9:21-cv-01082-JMC, 2022 WL 766352 (D.S.C. Mar. 14, 2022).

[8] *See, e.g., In re Kolle*, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021); *In re Brown*, 631 B.R. 77, 101 (Bankr. S.D. Fla. 2021); *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020); *In re Hazlett*, No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019).

The USTP's enforcement approach to bifurcated agreements balances these concerns. The USTP will review bifurcated fee agreements to ensure that they harm neither the debtors who rely on the bankruptcy system to obtain relief nor the integrity of the system. When appropriate, we will bring enforcement actions to address these harms. This document sets forth general guidelines that United States Trustees and their staff should use to assist them in determining whether to take enforcement action with respect to bifurcated fee agreements.

II. Attorney's Fees Under Bifurcated Agreements Must Be Fair and Reasonable

When reviewing attorney fee agreements in consumer cases, our first consideration is to ensure that the agreements serve the best interests of clients, not their professionals. This tension is most evident—and the potential for the greatest harm to debtors exists—in the structuring of fees under bifurcated agreements. The three most common fee-related issues we see in cases involving bifurcated fee agreements relate to the allocation of fees and services, the reasonableness of the fees, and third-party financing.

First, it is important to ensure that there is a proper allocation of prepetition and postpetition fees and services. This issue commonly arises in no- or low-money down cases. It is the USTP's position that fees earned for prepetition services must be either paid prepetition or waived, because the debtor's obligation to pay those fees is dischargeable. This is particularly important to ensure—and to clearly document—that debtors receive appropriate prepetition consultation and legal advice, including with respect to exemptions and chapter selection.[9] Debtors who enter into bifurcated fee agreements should receive the same level of representation as debtors who enter into traditional fee agreements. Bifurcation must not foster cutting corners in properly preparing the case for filing by eliminating tasks that should be performed prepetition or postponing all or some of those services until after the petition is filed to ensure that the attorney can bill for those services postpetition. Additionally, fees for postpetition services must be rationally related to the services actually rendered postpetition,[10] so that a flat postpetition fee is not a disguised method to collect fees for prepetition services. Attorneys also should not advance filing fees and seek their reimbursement postpetition. Advanced filing fees are generally held to be dischargeable prepetition obligations.[11]

Second, attorney's fees charged to debtors in bifurcated cases—as in all cases—must be reasonable.[12] Bifurcated fee agreements should not be viewed as an opportunity to collect higher fees than those collected from clients who pay in full, before filing. For example, it would be inappropriate for an attorney to offer a debtor a fee of $1,500 if they pay upfront, and $2,000 if they pay over time postpetition, particularly given that fees for prepetition work should have been paid or waived.

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[9] The Bankruptcy Code requires attorneys to certify, by signing the petition, that they have performed a reasonable investigation into the facts and circumstances of the case and that the attorney, after performing an adequate inquiry, has no knowledge that the information in the schedules is incorrect. 11 U.S.C. §§ 707(b)(4)(C–D).
[10] *See Brown*, 631 B.R. at 93 (citing *Hazlett*, 2019 WL 1567751).
[11] *See, e.g., Matter of Riley*, 923 F.3d 433, 439-40 (5th Cir. 2019); *Brown*, 631 B.R. at 102-03.
[12] 11 U.S.C. § 329(b).

Third, arrangements that employ outside parties to finance bifurcated fee agreements, including (but not limited to) factoring, assignment of the attorney's accounts receivable, and direct lending to clients, warrant significant additional scrutiny. The particulars of arrangements under which a third party finances the debtor's postpetition attorney's fees must be fully disclosed under Bankruptcy Rule 2016(b), including the details of the attorney's relationship with the entity providing the financing. The nature of these arrangements may incentivize overcharging, because the attorney generally receives only a percentage of the total fee charged or otherwise incurs financing costs. It is improper for an attorney using third-party financing to pass along the cost of that financing to their clients. Third-party financing arrangements may also create unwaivable conflicts of interest between the attorney and their clients and may violate applicable state ethical rules.[13]

The USTP should bring enforcement actions where bifurcated fee agreements adversely affect the client's representation, seek recovery of unreasonable fees, improperly allocate fees or services, improperly burden debtors with financing costs, or otherwise result in conflicts of interest.

III. Ensuring Adequate Attorney Disclosure and Fully Informed Debtor Consent to Bifurcated Agreements

In addition to ensuring that bifurcated agreements are fair and reasonable, courts examining and permitting bifurcated agreements have emphasized the importance of adequate disclosure and the client's fully informed consent. One court permitting the use of bifurcated agreements noted that "the propriety of using bifurcated fee agreements in consumer chapter 7 cases is directly proportional to the level of disclosure and information the attorney provides to the client and the existence of documentary evidence that the client made an informed and voluntary election to enter into a postpetition fee agreement."[14] Similarly, professional conduct standards governing fee sharing and limited scope representation[15] reinforce the need for disclosure and informed consent. The requirement of informed consent to bifurcated agreements is derived directly from the Bankruptcy Code's requirements that attorneys representing consumer debtors deal forthrightly and honestly with their clients, that they not make misrepresentations about the services they will provide or the benefits and risks of filing bankruptcy, and that they make certain disclosures and promptly enter into a clear and conspicuous written contract explaining the services the attorney will render and the terms of any fee agreement.[16]

The following disclosure and consent factors can assist your review of bifurcated fee agreements and determination whether an enforcement action is appropriate:

- Whether the attorney has clearly disclosed the services that will be rendered prepetition and postpetition, and the corresponding fees for each

[13] *Brown*, 631 B.R. at 99, n. 34.
[14] *In re Hazlett*, No. 16-30360, 2019 WL 1567751 at *8 (Bankr. D. Utah Apr. 10, 2019).
[15] *See, e.g.,* Model Rules of Prof. Conduct R. 1.2(c), 5.4(a) (AM. BAR ASS'N 1983).
[16] 11 U.S.C. §§ 526–528.

segment of the representation, including that certain listed services may not arise in a particular case.

- Whether the attorney has disclosed their obligation to continue representing the debtor regardless of whether the debtor executes a postpetition agreement, unless the bankruptcy court permits the attorney's withdrawal.

- Whether the attorney has clearly disclosed that the client is being provided the option to choose a bifurcated fee agreement, any difference in the total attorney's fee between the bifurcated fee agreement and a traditional fee agreement,[17] and the client's options with respect to the postpetition fee agreement.[18]

- Whether the agreement includes clear and conspicuous provisions explaining the options, costs, and consequences of entering into a bifurcated fee agreement and providing the debtor with an option to rescind the agreement.

The disclosure and consent considerations described above are not exhaustive and should not be mechanically applied, but instead qualitatively assessed to determine whether adequate disclosures were made and whether those disclosures permit a consumer debtor considering a bifurcated fee agreement to give informed consent. Additionally, when applying these criteria we must consider local authority and act accordingly where local rules or jurisprudence have imposed other clear standards for adequate client disclosures and conditions of informed consent—whether more or less stringent.[19]

IV. Ensuring Adequate Public Disclosure

The Bankruptcy Code and Rules also require public transparency in professionals' dealings with their clients, and the USTP regularly enforces these requirements. All attorneys representing debtors must promptly file disclosures of the particulars of their fee agreements and the amounts they have been paid under section 329(a) of the Bankruptcy Code and Bankruptcy

[17] As discussed *supra*, it is the USTP's position that fees under bifurcated agreements should not be higher than those under traditional fee agreements for the same services.

[18] Generally, these options are for the client to sign the postpetition agreement for the attorney's continued representation; to hire other counsel; or to proceed in the case *pro se*.

[19] We are aware that some courts have found that bifurcation is impermissible under local rules governing representation of debtors. *See, e.g., Baldwin*, 2021 WL 4592265; *Prophet*, 628 B.R. 788. The existence and wording of such local rules varies, and bankruptcy courts within a district may interpret them differently. In determining whether to take an enforcement action with respect to a bifurcated fee arrangement, the USTP will consider and follow applicable local authority but also should be mindful to exercise discretion in accordance with these guidelines to focus on those cases where the debtor is harmed or the integrity of the bankruptcy process is jeopardized.

Rule 2016(b).[20] The nature of bifurcated agreements requires detailed disclosures in order to satisfy the Bankruptcy Code's standards. Failure to make adequate public disclosures required under the Bankruptcy Code and Rules may be a basis to bring an enforcement action.[21]

V. Conclusion and Important Notes

It is vital that the USTP acts consistently across jurisdictions in these and other legal matters. Please ensure that all staff who engage in civil enforcement in consumer cases are familiar with these guidelines. Each case will have unique facts that should be considered in a manner consistent with these guidelines.

Please consult the Office of the General Counsel if there are any questions regarding these guidelines or their application in specific cases. This memorandum is an internal directive to guide USTP personnel in carrying out their duties, but the final determination of whether a bifurcated fee agreement complies with the Bankruptcy Code and Rules resides solely with the court. Nothing in this memorandum has any force or effect of law or imposes on parties outside the USTP any obligations beyond those set forth in the Bankruptcy Code and Rules.[22]

Thank you for your continued cooperation and diligence in this important area of responsibility.

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[20] The default remedy for failure to make proper disclosures under section 329(a) is return of all fees. *See, e.g., SE Prop. Holdings, LLC v. Stewart*, 970 F.3d 1255, 1266 (10th Cir. 2020).

[21] Postpetition attorney's fee installment payments should be disclosed as monthly expenses on the debtor's Schedule J. This allows courts and the USTP to quickly evaluate whether the debtor can actually afford the attorney's fees charged under the postpetition contract, which is a factor in determining whether the bifurcated agreement is in the debtor's best interest. However, note that we do not take the position that Rule 2016(b) requires that attorneys using bifurcated agreements file a supplemental compensation disclosure each time they receive a postpetition payment, provided that the terms of the postpetition agreement have been previously disclosed and there have been no material changes.

[22] Additionally, nothing in this memorandum: (1) limits the USTP's discretion to request additional information, conduct examinations under Bankruptcy Rule 2004, or conduct discovery with respect to its review of a particular fee arrangement; (2) limits the USTP's discretion to take action with respect to any particular fee arrangement; or (3) creates any private right of action on the part of any person enforceable against the USTP, its personnel, or the United States.

chapter 7 bankruptcy until the end of 2019. Chimney Cricket, however, was incorporated at the end of 2017 and began doing business in 2018. So Chimnee Cricket did not file for chapter 7 until nearly two years after passing its baton to Chimney Cricket. By that point, Chimney Cricket had done more than $5 million in business using a similar trade name and logo as Chimnee Cricket and using Chimnee Cricket's key employees and sources for customer leads. Chimney Cricket had taken the baton and was heading around the first corner on its leg of the relay before Chimnee Cricket filed for chapter 7 bankruptcy.

To its credit, Chimney Cricket acknowledges this flaw in its argument. Despite the timing, which Chimney Cricket concedes is "imperfect," Chimney Cricket contends "the effect is nonetheless the same." How so? Chimney Cricket never says. And it cites no authority in support of its position that a chapter 7 case filed after the baton has been passed somehow defeats a "mere continuation" claim. The Court therefore declines to insulate Chimney Cricket from liability based on a novel theory unsupported by case law.

III. Conclusion

At least when Cleo McDowell claimed in *Coming to America* that McDonald's and McDowell's were different, he could point to the fact that the companies had different officers, directors, and shareholders. Here, Jon Cerrito can make no such claim: Cerrito was the sole shareholder and president of both Chimnee Cricket and Chimney Cricket.

And, whereas McDowell may have believed the trivial differences between McDonald's and the fictional McDowell's were enough to defeat a trademark claim, the trivial differences between Chimnee Cricket and Chimney Cricket that Cerrito raises actually give the appearance that Chimney Cricket is simply a continuation of Chimnee Cricket.

Ultimately, it was up to Chimney Cricket to disprove that it was a mere continuation of Chimnee Cricket. It failed to do so. The evidence at trial was unmistakable that there was a relay-style passing of the baton from Chimnee Cricket to Chimney Cricket. Because there was a relay-style passing of the baton, Chimney Cricket is liable for the tax debts of Chimnee Cricket. By separate order, the Court will overrule Chimney Cricket's objection to the IRS's proof of claim.

Attorney Gregory L. Jones is directed to serve a copy of these Findings of Fact and Conclusions of Law on interested parties who do not receive service by CM/ECF and to file a proof of service within 3 days of its entry.

ORDERED.

IN RE: Cheryl BROWN, aka Cheryl Marie Brown, aka Cheryl Marie Brown-Grant, Debtor.

In re: Charmeen L. Mcfarland, Debtor.

In re: Lavonia Valerie McCoy, aka Lavonia Leggett McCoy, aka Lavonia McCoy, aka Lavonia Valerie Jackson McCoy, aka Lavonia V. Leggett McCoy, aka Lavonia V. McCoy, Debtor.

Case No. 20-23632-BKC-LMI, Case No. 20-23354-BKC-LMI, Case No. 20-18268-BKC-LMI

United States Bankruptcy Court, S.D. Florida.

Signed June 16, 2021

Background: In three separate "no money down" or "low money down" cases,

United States Trustee (UST) filed motions objecting to the business practices of two law firms with respect to the bifurcation of attorney fees in consumer Chapter 7 cases, seeking, inter alia, guidance from the court regarding bifurcation agreements and an injunction against prohibited conduct. Hearings were held.

Holdings: The Bankruptcy Court, Laurel M. Isicoff, Chief Judge, held that:

(1) for an attorney using a bifurcated fee arrangement to meet his or her obligation of competency with respect to prepetition services, the attorney must meet with a potential bankruptcy client and review sufficient information to competently advise the potential client whether to file bankruptcy and, if so, under what chapter;

(2) an attorney using a bifurcated fee arrangement must provide certain prepetition and postpetition "core services," as specified by the court;

(3) for disclosures to a potential client to be adequate, they must satisfy the requirements set forth by the court;

(4) an attorney using a bifurcated fee arrangement must make sure that any such arrangement is properly disclosed to the court and to parties in interest; and

(5) a law firm's payment of the filing fee with postpetition repayment by the debtor violates the Bankruptcy Code as well as the Florida Bar rules.

Ordered accordingly.

1. Bankruptcy ⚿3174

Although a Chapter 7 lawyer must be paid by the debtor, such lawyer cannot look to the estate or to the debtor postpetition for payment of fees for services rendered or to be rendered if the obligation to pay the fee arises prepetition. 11 U.S.C.A. § 330(a)(1).

2. Bankruptcy ⚿3030

There are four payment options available to potential Chapter 7 debtors who wish to retain counsel, each with its own set of problems and challenges: (1) delay filing the case until all the fees are paid up front, (2) the lawyer can file the Chapter 7 case without getting paid in full up front and hope that the debtor will voluntarily pay additional fees postpetition, (3) the attorney can bifurcate the legal services, or (4) the debtor can file a Chapter 13 case instead so that the fees may be paid postpetition.

3. Constitutional Law ⚿2488

Courts cannot rule based on what is good public policy; the judiciary's job is to enforce the law Congress enacted, not write a different one that judges think superior.

4. Bankruptcy ⚿3030

Phrase "bifurcation of fees" in bankruptcy refers to the practice of separating services provided to a client into services provided prepetition and postpetition; some services are provided prepetition for one fee, whether a flat fee or based on an hourly charge, which is paid before the bankruptcy petition is filed, and then any additional services that are provided postpetition are charged for, and paid for, postpetition.

See publication Words and Phrases for other judicial constructions and definitions.

5. Bankruptcy ⚿3030

Under local bankruptcy rules, any attorney of record for the debtor must assist the debtor with reaffirmation, redemption, or surrender decisions regardless of whether the debtor pays an additional fee. U.S.Bankr.Ct.Rules S.D.Fla., Rule 2090-1.

6. Bankruptcy ⚿3030

Use by debtors' attorneys of postpetition agreements to pay for prepetition services in Chapter 7 cases is not acceptable; such agreements merely seek to do indirectly what is prohibited directly. 11 U.S.C.A. § 330(a)(1).

7. Bankruptcy ⚿3193

Reasonableness of fees charged by counsel for Chapter 7 debtors is not gauged by a comparison between prepetition charges and postpetition charges. 11 U.S.C.A. § 330(a)(1).

8. Bankruptcy ⚿3192, 3200

Reasonableness of a flat fee arrangement for bankruptcy counsel is assessed differently than reasonableness evaluated through an hourly rate. 11 U.S.C.A. § 330(a)(1).

9. Bankruptcy ⚿3200

Because a flat fee encompasses all required services and the extent of required services is not fully predictable at the outset of a bankruptcy case, the reasonableness of a flat fee cannot necessarily be determined based on the amount of services required in the case; nevertheless, the amount of a proposed flat fee must bear some relationship to the work that will likely be required, which inevitably depends on the unique facts and circumstances of the case. 11 U.S.C.A. § 330(a)(1).

10. Bankruptcy ⚿3200

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, in assessing the reasonableness of postpetition flat fees charged by counsel, the bankruptcy court would take into account not only the work that was done, but also the services that might have been required in the case for which there would have been no additional charge; the court would not consider services that would not possibly arise in the case, such as dealing with student loan issues when a debtor did not have student loans. 11 U.S.C.A. § 330(a)(1).

11. Bankruptcy ⚿3196

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, the bankruptcy court would assess the reasonableness of any postpetition fees charged at an hourly rate for postpetition services under the traditional standards for determining the reasonableness of hourly fees not subject of the section of the Bankruptcy Code governing compensation of officers. 11 U.S.C.A. § 330.

12. Attorneys and Legal Services ⚿764, 793

Bankruptcy ⚿3200

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, in assessing the reasonableness of any postpetition flat fee charge and, in turn, in determining whether the services provided prepetition meet applicable standards of competency, bankruptcy courts must consider what services are required in any representation, whether required by applicable state professional bar rules, the Bankruptcy Code and bankruptcy rules, and that court's local rules. 11 U.S.C.A. §§ 330, 707(b)(4); Fed. R. Bankr. P. 9011(b).

13. Attorneys and Legal Services ⚿764, 767

Bankruptcy ⚿3030

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, for an attorney to meet his or her obligation of competency with respect to prepetition services, regardless of whether the debtor signs a postpetition retainer agreement, the attorney must meet with a potential bankruptcy client

and review sufficient information to competently advise the potential client whether to file bankruptcy and, if so, under what chapter. 11 U.S.C.A. §§ 330, 707(b)(4); Fed. R. Bankr. P. 9011(b); Fla. Bar Rule 4-1.1.

14. Attorneys and Legal Services ⚿765
Bankruptcy ⚿3030

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, to satisfy the requirements of a "reasonably prudent and competent" practitioner with respect to unbundling, there must be sufficient inquiry by attorney, not staff, when initially meeting with client to ascertain whether filing bankruptcy is appropriate relief and under what chapter, and to inform potential debtor of the consequences of that choice, attorney must assist debtor with his or her statutory duties unless permitted to withdraw, attorney must prepare and file all documents necessary to commence case, including, at minimum, petition, creditor's matrix, any motion to waive or pay filing fee in installments, statement of attorney compensation, and debtor credit counseling certificate, or, if applicable, motion to waive need to file certificate or file late, and attorney must attend the meeting of creditors unless permitted to withdraw prior to the meeting. 11 U.S.C.A. §§ 330, 521, 707(b)(4); U.S.Bankr.Ct.Rules S.D.Fla., Rule 2090-1(E); Fla. Bar Rule 4-1.2.

15. Bankruptcy ⚿2187, 3030

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, even if a debtor comes to the attorney on an emergency basis and the attorney must file a bare bones petition, the attorney and the debtor must be sufficiently informed prior to filing the petition to comply with Rule 9011, and certain documents must be prepared and filed. 11 U.S.C.A. §§ 330, 521, 707(b)(4); Fed. R. Bankr. P. 9011.

16. Bankruptcy ⚿3030

Propriety of using bifurcated fee agreements in consumer Chapter 7 cases is directly proportional to level of disclosure and information attorney provides to client and existence of documentary evidence that client made informed and voluntary election to enter into postpetition fee agreement. 11 U.S.C.A. § 330.

17. Bankruptcy ⚿3030

An attorney who represents a debtor in a consumer Chapter 7 case is counsel of record until allowed to withdraw.

18. Attorneys and Legal Services ⚿836
Bankruptcy ⚿3030

An attorney who represents a debtor in a consumer Chapter 7 case may not factor his or her legal fees; factoring creates an inherent conflict of interest between the attorney and the debtor, and violates the Florida Bar rules. 11 U.S.C.A. § 330; Fla. Bar Rules 4-1.7, 4-1.8, 4-5.4.

19. Attorneys and Legal Services ⚿765, 792
Bankruptcy ⚿3030, 3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, although there are times when what would normally be a prepetition service, such as preparation of the bankruptcy schedules and statement of financial affairs, may occur postpetition, especially when the filing is an emergency filing, in such a case the disclosure must make clear that the particular service will be performed postpetition only if not completed prepetition, and the agreement should also make clear whether amendments to documents are included in the fee and, if the amendment of certain documents is not included, what those docu-

ments are. 11 U.S.C.A. § 330; Fla. Bar Rule 4-1.2.

20. Bankruptcy ⚿3200

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, the issue of whether possible services were actually performed or could have ever been necessary is something the bankruptcy court may consider in determining the reasonableness of any postpetition flat fee. 11 U.S.C.A. § 330.

21. Attorneys and Legal Services ⚿765, 792

Bankruptcy ⚿3030, 3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, the postpetition agreement, if it is signed immediately following the petition, must include 14-day rescission period and describe the consequences if debtor rescinds the agreement, or, alternatively, debtor should be given 14-day window after petition is filed in which to sign postpetition agreement; prepetition agreement must disclose that regardless of whether postpetition agreement is signed, attorney must continue to represent debtor unless allowed to withdraw; if postpetition agreement has rescission clause, it must contain the same disclosure; and postpetition agreement must clearly state that obligation to pay fees under postpetition fee agreement is not an obligation that will be discharged when debtor receives his or her bankruptcy discharge. 11 U.S.C.A. § 330; Fla. Bar Rule 4-1.2.

22. Attorneys and Legal Services ⚿765, 792

Bankruptcy ⚿3030, 3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, debtor must be given a separate disclosure form that discloses he or she is being provided option to choose bifurcated fee arrangement, as well as whether bifurcated fee arrangement will have a different cost than a flat fee arrangement paid in advance of the filing, and the disclosure should also clearly describe debtor's options, including the consequences of choosing a particular option: (1) sign postpetition agreement and get services described in that agreement at the stated cost, that is, at flat fee or hourly rate, (2) do not sign agreement, and once attorney is permitted to withdraw, proceed with case without a lawyer, or (3) retain a new lawyer postpetition. 11 U.S.C.A. § 330; Fla. Bar Rule 4-1.2.

23. Attorneys and Legal Services ⚿765, 792

Bankruptcy ⚿3030, 3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, with respect to when proposed agreements and disclosures should be presented to debtor, in order for debtor to make a fully informed decision regarding his or her choices, debtor must be presented with the separate disclosure, the prepetition agreement, and the postpetition agreement when asked to sign the prepetition agreement, since a debtor cannot make an informed decision regarding a bifurcated arrangement without knowing what the "other side" agreement includes and requires; if debtor signs prepetition agreement, debtor must also sign separate disclosure. 11 U.S.C.A. § 330; Fla. Bar Rule 4-1.2.

24. Attorneys and Legal Services ⚿765, 792

Bankruptcy ⚿3030, 3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, disclosure to a potential client is adequate so long as (1) the potential debtor receives the separate disclosure form, (2) the prepetition agreement and

postpetition agreement are provided at the same time for the potential debtor's review, (3) the prepetition agreement clearly describes the services that must be performed prepetition as well as other services that may be provided, and (4) the postpetition agreement clearly describes the included services, delineated, where appropriate, as "if necessary," and specifically describes the excluded services, and any additional flat fee or hourly charge associated with those excluded services. 11 U.S.C.A. § 330; Fla. Bar Rule 4-1.2.

25. Bankruptcy ⚿3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, attorneys must make sure that any such arrangement is properly disclosed to the bankruptcy court and to parties in interest. 11 U.S.C.A. §§ 329, 330; Fed. R. Bankr. P. 2016.

26. Bankruptcy ⚿3030, 3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, the fee disclosure form need not be amended, and disclosure need not be made, each time the law firm receives payment; instead, this level of disclosure is not necessary so long as the form is amended when the postpetition agreement is signed, and the amended form discloses any payments that will be made monthly. 11 U.S.C.A. §§ 329, 330; Fed. R. Bankr. P. 2016.

27. Bankruptcy ⚿3179

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, if a debtor signs a postpetition agreement and it includes a monthly payment, there is no need for debtor's counsel to amend Schedule J to reflect the payment obligation, and then amend it again once the monthly payments are completed; because Schedule J reflects information as of the petition date, and as of the petition date, a Chapter 7 debtor does not have an obligation to pay an attorney a fee postpetition, there is no need to amend Schedule J but, instead, once debtor signs the postpetition fee agreement, debtor's counsel must file a fee disclosure form. 11 U.S.C.A. §§ 329, 330; Fed. R. Bankr. P. 2016.

28. Bankruptcy ⚿3030

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, a postpetition fee agreement cannot be signed prepetition; otherwise it is a contract subject to rescission. 11 U.S.C.A. § 330.

29. Attorneys and Legal Services ⚿237
Bankruptcy ⚿3030

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, it is necessary and appropriate for the debtor to have a rescission period; accordingly, any arrangement that gives the debtor a 14-day "cooling off" period, whether after the prepetition agreement is signed, or until the postpetition agreement must be signed, is acceptable. 11 U.S.C.A. § 330.

30. Attorneys and Legal Services ⚿849
Bankruptcy ⚿2128, 3030

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, as well as in cases filed under Chapter 13, a law firm's payment of the filing fee with the expectation of postpetition repayment by the debtor violates the Bankruptcy Code as well as the Florida Bar rules; the firm instead should be paid the funds in advance to cover the filing fee, or should hold a retainer in its trust account sufficient to reimburse the cost of the filing fee. 11 U.S.C.A. §§ 330, 362, 524, 526; Fed. R. Bankr. P. 1006; Fla. Bar Rule 4-1.8(e).

31. Bankruptcy ⚿3343.2

Because the filing fee is due upon the filing of the bankruptcy petition, if bankruptcy counsel advances the fee with the expectation of repayment postpetition, the debtor's obligation to repay the fee is a prepetition obligation that is dischargeable. 11 U.S.C.A. § 526.

32. Attorneys and Legal Services ⚿849

Florida Bar rule governing financial assistance to clients addresses the issue of access to justice by authorizing cost advances in contingency fee cases and allowing an attorney to advance costs on behalf of an indigent client; the rule does not mean that an attorney may always advance costs for a client regardless of whether the repayment is contingent on the outcome of the case. Fla. Bar Rule 4-1.8(e).

33. Attorneys and Legal Services ⚿237
Bankruptcy ⚿2190, 3030

In cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, a bifurcation agreement, like any other fee arrangement, should give the debtor the three choices allowed by federal law: pay the fee up front, complete the paperwork to pay the filing fee in installments, or, if applicable, seek waiver of the filing fee. 28 U.S.C.A. § 1930.

34. Attorneys and Legal Services ⚿237
Bankruptcy ⚿3030

In case involving bifurcated fee arrangement for basic consumer Chapter 7 legal services, law firm's prepetition agreement with debtor, which used the phrase "basic services," did not adequately describe what services the firm agreed to provide prepetition for the flat fee charged, nor did the agreement clearly outline debtor's three postpetition options, namely, sign a postpetition agreement, represent herself, or hire another lawyer to do the postpetition work. 11 U.S.C.A. § 330(a)(1).

35. Bankruptcy ⚿3200

In case involving bifurcated fee arrangement for basic consumer Chapter 7 legal services, $335.00 was a reasonable fee for the prepetition services that were provided by debtor's law firm where the services included the initial client interview and preparation of the bankruptcy schedules and the statement of financial affairs. 11 U.S.C.A. § 330(a)(1).

36. Bankruptcy ⚿3200

In case involving bifurcated fee arrangement for basic consumer Chapter 7 legal services, postpetition flat fee of $1,565.00 charged by debtor's law firm was reasonable for the actual services that the firm performed and the potential services the firm would have provided if necessary for debtor; postpetition, the firm attended the meeting of creditors and negotiated a settlement agreement with the bankruptcy trustee, the agreement also included, if necessary and at no additional charge, attendance at any Rule 2004 examination conducted by the trustee, review and attendance at hearings for motions for stay relief, preparation of objections to and defense of such motions, and review of redemption and reaffirmation agreements, and debtor ultimately succeeded in obtaining her discharge. 11 U.S.C.A. § 330(a)(1).

37. Bankruptcy ⚿3200

In two cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, prepetition flat fee of zero dollars charged by debtors' law firm for its prepetition representation, which included the initial client interviews and preparing the petitions, the schedules, and the statements of financial affairs, was reasonable. 11 U.S.C.A. § 330(a)(1).

38. Bankruptcy ⚿3200

In two cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, law firm's postpetition flat fee of $1,262.00 in first case and $1,362.00 in second case were reasonable and would be allowed; cases appeared to have been unremarkable postpetition other than a continued meeting of creditors, firm attended the meetings of creditors and took care of other matters generally incidental to getting a Chapter 7 case to discharge and closing, and the services that firm agreed to provide to debtors for the flat fee paid postpetition included negotiating with the trustee regarding any property or actions adverse to the clients, reviewing and negotiating reaffirmation agreements and motions to redeem, reviewing and responding to motions for stay relief, and preparing and serving any motions to avoid liens. 11 U.S.C.A. § 330(a)(1).

39. Bankruptcy ⚿2190, 3030

In future cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, law firm would not be allowed to advance the filing fee; instead, if a debtor were unable to pay the filing fee up front, then part of firm's prepetition services would have to include preparation of a motion seeking waiver of the filing fee or a motion seeking to pay the filing fee in installments. 11 U.S.C.A. §§ 330(a)(1), 526; Fed. R. Bankr. P. 1006; Fla. Bar Rule 4-1.8(e).

40. Bankruptcy ⚿3030

In two cases involving bifurcated fee arrangements for basic consumer Chapter 7 legal services, law firm's prepetition agreements with debtors were improper and/or misleading insofar as they stated that firm agreed to represent debtors "in all aspects of the case" but then conditioned that promise on debtors executing postpetition agreements, incorrectly described certain prepetition obligations, such as advising then-potential debtors of their responsibilities as debtors, including the need to attend debtor education courses and provide certificates of completion, as postpetition services, inaccurately described the filing fee as something the bankruptcy court required to be paid after bankruptcy petitions were filed, and listing among its postpetition services the sending of "*In re Mendiola*" letters, whose content was unknown to the court and, presumably, to potential debtors as well. 11 U.S.C.A. § 330(a)(1).

Chad T. Van Horn, Ft. Lauderdale, FL, for Debtor Lavonia Valerie McCoy.

Yevgeniy Feldman, Semrad Law Firm, LLC, Coral Gables, FL, for Debtor Charmeen L. Mcfarland, Cheryl Brown.

Haidan Huang, Fort Lauderdale, FL, for Debtor Cheryl Brown.

MEMORANDUM OPINION AND ORDER SETTING FORTH STANDARDS ON CHAPTER 7 BIFURCATED FEES AND DENYING REQUEST FOR INJUNCTIVE RELIEF

Laurel M. Isicoff, Chief United States Bankruptcy Judge

More and more the public is bombarded with advertising for "low money down" or "no money down" bankruptcies. The "legal" framework of these offers is the bifurcation of fees in chapter 7 bankruptcy cases. Are these arrangements a partial answer to the systemic challenge to access to justice? Are these arrangements a violation of the Bankruptcy Code? Are these arrangements a violation of the Rules Regulating the Florida Bar?

[1] In *Lamie v. U.S. Trustee*, 540 U.S. 526, 538, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004), the United States Supreme Court ruled that 11 U.S.C. § 330(a)(1) "does not authorize compensation awards to debtors' attorneys from estate funds." Several circuits, both before and after *Lamie*, have held that the unpaid balance of prepetition fees are dischargeable in bankruptcy. *See Rittenhouse v. Eisen*, 404 F.3d 395 (6th Cir. 2005); *In re Fickling*, 361 F.3d 172 (2d Cir. 2004); *Bethea v. Adams & Assoc.,* 352 F.3d 1125 (7th Cir. 2003); *In re Biggar*, 110 F.3d 685 (9th Cir. 1997). Thus, a chapter 7 lawyer must be paid by the debtor, but the chapter 7 lawyer cannot look to the estate or to the debtor postpetition for payment of fees for services rendered or to be rendered if the obligation to pay the fee arises prepetition.

In the Final Report of the ABI Commission on Consumer Bankruptcy (the "ABI Commission Report"), the American Bankruptcy Institute's Commission on Consumer Bankruptcy (the "ABI Commission") wrote "the dischargeability of prepetition attorney's fees in chapter 7 hinders access to the bankruptcy system and access to justice." *Final Report of the ABI Commission on Consumer Bankruptcy*, § 3.01 Chapter 7 Attorney's Fees at 89 (American Bankruptcy Institute, 2017-2019).

[2] As the ABI Commission noted in the comments to section 3.01, currently there are four payment options available to potential chapter 7 debtors who wish to retain counsel, each with its own set of problems and challenges: (1) delay filing the case until all the fees are paid up front; (2) the lawyer can file the chapter 7 case without getting paid in full up front and hope that the debtor will voluntarily pay additional fees postpetition; (3) the attorney can bifurcate the legal services; or (4) the debtor can file a chapter 13 case instead so that the fees may be paid postpetition.

As the court wrote in *In re Hazlett*, 2019 WL 1567751 (Bankr. D. Utah 2019), without access to counsel, a consumer chapter 7 debtor must either file a case with no help or, perhaps even worse, file with the assistance of a bankruptcy petition preparer, many of whom charge more than lawyers, and who are prohibited from providing any legal assistance.

[3] The access to justice issues are troubling and compelling. However, the Court must rule within the framework of the law. As Judge Easterbrook observed in *Bethea*, 352 F.3d at 1127-28, the courts cannot rule based on what is good public policy. "[T]he judiciary's job is to enforce the law Congress enacted, not write a different one that judges think superior." *Id.*[1]

Practitioners have tried to develop ways, consistent with the legal restrictions just described, to provide a debtor who cannot pay all or part of the attorney fees up front, an option that would allow a small, or no, payment up front, with the opportunity to pay additional fees over time after the case is filed. Whether and to what extent these arrangements are allowable has been the subject of cases around the country.

These three cases present this Court with the opportunity to provide a framework for when and under what circumstances bifurcation of chapter 7 fees is allowable. As the Court made clear at the initial hearing on these matters, although these cases are assigned to the Chief Judge, the legal conclusions in this opinion

1. The Court joins many others in the bankruptcy community, urging Congress to address this issue through legislation.

represent the legal conclusions of all of the judges of the Bankruptcy Court of the Southern District of Florida.

FACTUAL BACKGROUND

This matter came before the Court upon three motions filed by the United States Trustee (the "UST") objecting to the business practices of the Semrad Law Firm, LLC (the "Semrad Law Firm") and Van Horn Law Group, P.A. (the "Van Horn Law Firm") (collectively the "Law Firms") with respect to the bifurcation of attorney fees in consumer chapter 7 cases. *United States Trustee's Motion for Examination of Fees of Chad T. Van Horn and Van Horn Law Group Under 11 U.S.C. Section 329(b); Federal Rules of Bankruptcy Procedure Rule 2016 and 2017; and for an Injunction Against Prohibited Conduct* (ECF #37, Case No. 20-18268-BKC-LMI (the "McCoy Case")) (the "McCoy Motion") addresses concerns raised by the practices of the Van Horn Law Firm. *United States Trustee's Amended Motion for Examination of Fees of Haidan Huang and the Semrad Law Firm a/k/a Debtstoppers Under 11 U.S.C. Section 329(b); Federal Rules of Bankruptcy Procedure Rule 2016 and 2017; and for an Injunction Against Prohibited Conduct* (ECF #20, Case No. 20-23632-BKC-LMI (the "Brown Case")) (the "Brown Motion") and *United States Trustee's Amended Motion for Examination of Fees of Yevgeniy Feldman and The Semrad Law Firm a/k/a Debtstoppers Under 11 U.S.C. Section 329(b); Federal Rules of Bankruptcy Procedure Rule 2016 and 2017; and For An Injunction Against Prohibited Conduct* (ECF #17, Case No. 20-23354-BKC-LMI (the "Mcfarland Case")) (the "Mcfarland Motion") address concerns raised by the practices of the Semrad Law Firm. The McCoy Motion, the Brown Motion and the Mcfarland Motion shall be referred to collectively as the "Motions". The Court held a hearing on the McCoy Motion and Mcfarland Motion on February 22, 2021 at 1:30 p.m. and on the Brown Motion on March 3, 2021 at 9:30 a.m. (collectively the "Hearings"), where the Court considered the Motions, the responses [2], and arguments of counsel.

The McCoy Case

Lavonia Valerie McCoy ("Ms. McCoy") filed her chapter 7 bankruptcy case on July 30, 2020 (the "McCoy Petition Date"). On June 30, 2020, Ms. McCoy executed a Contract for Prepetition Legal Services in a Chapter 7 Bankruptcy Case (the "McCoy Prepetition Agreement")[3] and on July 30, 2020, Ms. McCoy executed a Contract for Postpetition Legal Services in a Chapter 7 Bankruptcy Case (the "McCoy Postpetition Agreement").[4] The Disclosure of Compensation of Attorney for Debtor (ECF #5) (the "Form 2030 Fee Disclosure"), required to be filed by all attorneys representing debtors, states that the Van Horn Law Firm agreed to accept $2,235.00 for the described legal services, and that Ms. McCoy made a payment $335.00 prior to the McCoy Petition Date, leaving a "balance due" in the amount of $1,900.00. In the Form 2030 Fee Disclosure, in addition

2. *See Response to United States Trustee's Amended Motion for Examination of Fees* (ECF #22, Case No. 20-23354); *Response to United States Trustee's Amended Motion for Examination of Fees* (ECF #26, Case No. 20-23632); *Response to The United States Trustee's Motion for Examination of Fees of Chad T. Van Horn and Van Horn Law Group Under 11 U.S.C. Section 329(b); Federal Rules of Bankruptcy Procedure Rule 2016 and 2017; and for an Injunction Against Prohibited Conduct (DE 37)* (ECF #43, Case No. 20-18268).

3. The McCoy Prepetition Agreement is attached as Exhibit A to the McCoy Motion.

4. The McCoy Postpetition Agreement is attached as Exhibit B to the McCoy Motion.

to the pre-printed legal services described in the form, the Van Horn Law Firm added the following:

> Includes, $335 filing fee, $15 for Pre-Consumer Credit Counseling fees, $10 Post Credit Counseling Fee Courses, $75 Credit Report retrieval fee, and other estimated expenses of $150 as prescribed by the guidelines for compensation for professional services or reimbursement of expenses by Attorneys. Representation of the Debtor in Negotiation with the Trustee; Motions to Reopen Case; Review & Attendance, if necessary, to Motions for Relief from Stay; Review of Redemption Agreements; Post-Discharge review of Debtor's credit report. Preparation and prosecution of Motions to Reschedule 341 Meeting of Creditors; Attendance at Continued 341 Meeting of Creditors; Amendments to Statements or Schedules; Preparation of demand letters to garnishing creditors; Preparation and defense of an Objection to a Motion for Relief from Stay. Review of Student Loans.

The McCoy Prepetition Agreement provides:

> **Before the bankruptcy case is filed** I understand that the fee of **$335.00** is to be paid pursuant to the terms of this Contract as a flat fee ... in exchange for a commitment by VHLG to provide the legal services described above .... **After the bankruptcy case is filed**, I understand that I will be presented with a second retainer agreement to pay VHLG $1,900 for attorney's fees, which include any pre and post-petition costs to represent my interests, including: preparation and amendment, of schedules; preparation and attendance of the Section 341 Meeting of Creditors; review and attendance, to motions for stay relief; review of any redemption agreements; review of any reaffirmation agreements; case administration and monitoring; if necessary; as well as a post-discharge review of my credit report to ensure accurate reporting.

The McCoy Prepetition Agreement also provides:

> For the fee established in this agreement and the post-petition retainer, we agree to provide to you basic legal services in connection with your case. Basic services include, but are not limited to, advice to You before and during the case concerning the nature and effect of Chapter 7 bankruptcy; preparation and filing of statements and schedules; We will attend Your meeting of creditors; prepare any valid, supportable defense in the event of a motion to dismiss or motion for relief from stay; and We will prepare any request by You to add creditors, incur credit or suspend payments. Other basic services such as negotiating with creditors during the life of the plan, submitting requests for payment reports from the Trustee, and other regular and routine services not specifically stated are included without additional charge to you.

The McCoy Postpetition Agreement provides:

> As to the dischargeability of pre-filing fees, VHLG acknowledges that if any fees were owed prior to filing the bankruptcy, they are hereby uncollectable and will be discharged.
>
> In consideration of VHLG's post filing services, I agree to pay and VHLG agrees to accept $1,900 in attorney's fees'. The scopes [sic] of the services are outlined below. I further understand and agree that additional professional legal services will result in additional fees that are due. I understand that the fee is to be paid pursuant to the terms of this Contract as a flat fee, and this fee shall

immediately become property of VHLG in exchange for a commitment by VHLG to provide the legal services described above. Said funds will be deposited into the main bank account owned by VHLG and will be used for general expenses.

In the event you fail to timely pay the Post-Filing Fixed Fee, VHLG may file a motion with the Bankruptcy Court requesting permission to withdraw as your counsel. You have the right to terminate this Fee Agreement at any time, and in such event, VHLG is not obligated to return any portion of the fee paid.

I further understand that I have a fourteen (14) day right of' rescission of this agreement. In the case of rescission, I will notify VHLG within fourteen (14) days of executing this agreement and VHLG will no longer have any liability for representing me and I will not be liable for any fees herein.

The McCoy Postpetition Agreement identifies a detailed list of services to be provided postpetition.[5]

Ms. McCoy received her discharge on November 18, 2020 (ECF #35, Case No. 20-18268-BKC-LMI).

The Mcfarland Case

Charmeen Mcfarland ("Ms. Mcfarland") filed a chapter 7 bankruptcy case on December 7, 2020 (the "Mcfarland Petition Date"). Ms. Mcfarland signed an engagement agreement with the Semrad Law Firm on December 4, 2020 (the "Mcfarland

5. POST-FILING SERVICES/POST-FILING FEES

Preparation and filing the remainder of your required post filing bankruptcy documents, including (if necessary):

1. Statement of Financial Affairs (Official Form 7);
2. Schedules A through J and Perjury Statement of Schedules signed by debtors (Official Forms 6A-6J);
3. Summary of Schedules (Official Form 6 Summary);
4. Statistical Summary of Certain Liabilities (Official Form 6 Summary);
5. Disclosure of Compensation of Attorney for Debtor (Official Form B203);
6. Statement of Current Monthly Income and Means Test Calculation (Official Form 22 A);
7. Chapter 7 Individual Statement of Intention (Official Form 8);
8. Certification of Completion of Instructional course concerning personal financial management (Official Form 23) and certificate of course provider;
9. Providing the necessary documentation including tax returns and pay advices to the Trustee in advance of Your Meeting of Creditors;
10. Review and attendance, if necessary, to motions for stay relief; review of any redemption agreements;
11. Preparation and attendance of the Section 341 Meeting of Creditors;
12. Telephone conferences with You, the Trustee, Trustee's counsel, creditors and any other interested parties relating to the case; legal research and preparation of correspondence necessary to represent You in post filing matters;
13. Providing You the necessary information to enable You to complete the required post filing financial management class;
14. Preparation and amendment, if necessary, of schedules;
15. Review of any reaffirmation agreements;
16. Case administration and monitoring;
17. Motion to reopen, if necessary;
18. Attendance of 2004 Examination with Trustee;
19. Compliance with random US Trustee Audit;
20. A post discharge review of my credit report to endure accurate reporting;
21. Review of student loans;
22. Preparation and prosecution of a Motion Appear Telephonically at the 341 Meeting;
23. Preparation and prosecution of a Motion to Reschedule 341 Meeting;
24. Attendance at a continued 341 Meeting;
25. Preparation of amendments to Statement or Schedules;
26. Preparation of demand letter to a garnishing creditor;
27. Preparation and defense of an Objection to a Motion for Relief from Stay. . . .

Prepetition Agreement")[6], but did not pay the Semrad Law Firm any money prepetition. On January 13, 2021, after the 341 Meeting of Creditors[7], Ms. Mcfarland signed a second agreement for the postpetition services (the "Mcfarland Postpetition Agreement").[8]

The Mcfarland Prepetition Agreement identifies certain services that will be provided prepetition and the fee associated with those services.[9] The Mcfarland Prepetition Agreement also identifies certain services that will be provided postpetition and the fee associated with those services.[10]

6. A copy of the Mcfarland Prepetition Agreement is attached as Exhibit A to the Mcfarland Motion.

7. At oral argument, the Semrad Law Firm stated this delay was a mistake; normally the debtor signs a postpetition agreement as soon as the petition has been filed.

8. A copy of the Mcfarland Postpetition Agreement is attached as Exhibit B to the Mcfarland Motion.

9. a. **Before** the case is filed, the Firm agrees to:

i. Personally counsel you regarding the advisability of filing either a Chapter 13 or a Chapter 7 case, discuss both procedures as well as nonbankruptcy options, and answer your questions;
ii. Personally explain to you that the Firm is being engaged to represent you on all matters arising in the case, as required by Local Bankruptcy Rule, and explain how and when the attorney's fees are determined and paid;
iii. Personally review with you and sign the completed petition, statements, and schedules;
iv. Timely prepare and file your petition, statements, and schedules,
v. Advise you on which creditors you will need to continue to pay, such as housing or vehicle payments that you intend to retain.

b. The fee for services provide [sic] before the case is filed is $0

c. The Firm may also incur costs for such items as credit reports and tax transcripts for which it will not seek reimbursement.

10. a. **After** the case is filed, the Firm agrees to:

i. Advise you of the requirement to attend the meeting of creditors and notify you of the date, time, and place of the meeting;
ii. Advise you of the requirement to attend a debtor education course and provide a certificate of completion to the Firm;
iii. Send notice of your case filing to creditors;
iv. Correspond with creditors regarding any matters necessary for the administration of your case, including to cease payroll garnishments, unfreeze bank accounts, or recover property that was improperly seized by a creditor;
v. Timely submit to the Chapter 7 trustee properly documented proof of income, tax records as well as any other necessary documentation;
vi. Provide you with knowledgeable legal representation at the meeting of creditors as well as any continued or rescheduled meetings in time for check-in and examination;
vii. Timely prepare and file the notice of completion of the debtor education course;
viii. If the Firm will be employing another attorney to attend the meeting of creditors, personally explain to you, in advance, the role and identity of the other attorneys and provide that attorney with your file in sufficient time to review it and properly represent you at the meeting;
ix. Timely negotiate with the Trustee regarding any property or actions that the Trustee may pursue that could be adverse to your interests;
x. Timely prepare, file, and serve any necessary statements, amended statements, amended schedules and any change of address, in accordance with information provided by you;
xi. Monitor all incoming case information, including but not limited to, Reaffirmation agreements, notice of audits by the US Trustee, correspondence from you or any interested parties;
xii. Review and negotiate, if necessary, any reaffirmation agreements and personally explain the terms of said agreements to you;
xiii. Be available to respond to your questions throughout the term of the case;
xiv. Review and timely respond, if necessary, to Trustee motions to dismiss the case;

The Mcfarland Postpetition Agreement includes the same nineteen services for "postpetition fees" previously listed in the Mcfarland Prepetition Agreement and adds the following:

> xx. Provide post discharge services such as a review of Client(s)' credit report and advising Client(s) regarding possible discharge violations that may have occurred. b. The fee for services provided after the case is filed is $1,600.

The Mcfarland Postpetition Agreement provides that the fees owed postpetition are to be paid by the Debtor in monthly installments.

The Form 2030 Fee Disclosure (ECF #4) disclosed that the Semrad Law Firm had agreed to accept $1,262.00 [11] for legal services and that Ms. Mcfarland had made a payment of $0 prior to the Mcfarland Petition Date, leaving a balance due in the full amount of $1,262.00. Nowhere on the Form 2030 Fee Disclosure is there any indication that the fee will be paid monthly. Nor does the Form 2030 Fee Disclosure modify the undertakings identified in the pre-printed form.[12]

The Brown Case

The Brown Case is substantially similar to the Mcfarland Case. Cheryl Brown ("Ms. Brown") filed her chapter 7 bankruptcy case on December 15, 2020 (the "Brown Petition Date"). The Form 2030 Fee Disclosure (ECF #4) stated that the Semrad Law Firm agreed to accept $1,362.00 for legal services, and that Ms. Brown made a payment of $0 prior to the Brown Petition Date, leaving a "balance due" in the full amount of $1,362.00. On December 14, 2020, Ms. Brown executed an engagement agreement [13] with the Semrad Law Firm virtually identical to the one that had been signed by Ms. Mcfarland (the "Brown Prepetition Agreement").[14] On December 15, 2020, immediately after her bankruptcy petition was filed, Ms. Brown signed a second agreement for the postpetition services (the "Brown Postpetition Agreement"), which was virtually identical to the Mcfarland Postpetition Agreement.[15]

> xv. Review and timely respond, if necessary, to motions for relief from stay;
> xvi. Prepare, file, and serve all appropriate motions to avoid liens;
> xvii. Prepare, file, and serve all appropriate motion [sic] to redeem;
> xviii. Send *In Re Mendiola* letters to previously undisclosed creditors; and
> xix. Provide any other legal services necessary for the administration of the case.
> b. The fee for services provide [sic] after the case is filed is $1,262
> c. The firm will have no right to payment of the fee listed in section 4(b) unless you sign an agreement after the filing of your bankruptcy case to pay the Firm for services rendered after the filing of your case.
> d. After the case is filed, the Bankruptcy Court will require payment of filing fees in the amount of $335.00. In order to pay this, you have two (2) options (please circle one):
> i. Pay the costs directly to the bankruptcy court either all at once, or apply to pay these costs in installments; or
> ii. Request that the Firm pay the costs on your behalf for which it will seek reimbursement from you. . . .

11. The increase from $1,262.00 to $1,600.00 represents Ms. Mcfarland's obligation to repay the Semrad Law Firm the filing fee.

12. *See infra* note 18.

13. A copy of the engagement agreement is attached as Exhibit A to the Brown Motion.

14. Ms. Brown never ''circled'' her selection in paragraph ''d'' of the Brown Prepetition Agreement, which addresses the filing fee options. However, according to the UST, Ms. Brown ''testif[ied] at the continued Meeting of Creditors that the decision to borrow funds from [Semrad] was made prior to the [Brown Petition Date] and it was always included in the fee arrangement.'' (*See* Brown Motion at ¶15).

15. A copy of the Brown Postpetition Agreement is attached as Exhibit B to the Brown Motion.

Ms. Brown agreed to pay $1,700.00 [16] in monthly installments.

ANALYSIS

The UST has objected to the following business practices: "(1) the marketing of no or little money down Chapter 7 bankruptcy cases; (2) the bifurcation of bankruptcy services into pre-petition and post-petition components; (3) the performance of 'limited' pre-petition services for, purportedly, little or no charge; and (4) the post-petition collection of fees for purported postpetition services in an amount disproportionate to the services provided" in an "attempt to increase [their] client base and collect attorney fees for bankruptcy services through post-petition payments." (*See* McCoy Motion at 1; Mcfarland Motion at 1-2; Brown Motion at 1-2). In the Brown Motion, the UST also objects to the Semrad Law Firm paying the filing fee for the Debtor, which filing fee was later repaid post-petition by the Debtor through monthly payments. (*See* Brown Motion at 2).

The UST argues that the Law Firms' fees are not compensable under 11 U.S.C. § 329(b) or Local Rule 2090-1(E), and that the advancing of filing fees violates 11 U.S.C. § 526 and Rule 4-1.8(e) of the Rules Regulating the Florida Bar. The UST also argues that the Law Firms failed to comply with the filing and disclosure requirements of Fed. R. Bankr. P. 2016 and that the Debtors' Schedule Js were inaccurate because the postpetition fees were not listed as expenses. Most importantly however, the UST asks, as do the practitioners, for guidance from this Court on how to view bifurcation agreements in chapter 7 cases.

16. This amount includes the $338.00 filing fee. The filing fee increased from $335 to $338 on December 1, 2020.

The issues before the Court may be summarized as follows:

- Should bifurcation of fees be allowed at all?
- What is a reasonable prepetition fee versus a postpetition fee?
- What happens if the Debtor doesn't sign a postpetition fee agreement?
- What disclosures should be made to the debtor about a bifurcated fee arrangement?
- What disclosures must be made to the court about the bifurcated fee arrangement?
- Can the law firm advance filing fees on behalf of the debtor?

The Concept of Bifurcation

[4] The phrase "bifurcation of fees" in bankruptcy refers to the practice of separating services provided to a client into services provided prepetition and postpetition. Some services are provided prepetition for one fee (whether a flat fee or based on an hourly charge), which is paid before the bankruptcy petition is filed, and then any additional services that are provided postpetition are charged for, and paid for, postpetition.

[5] The UST specifically stated it is NOT, at this time, arguing that fee bifurcation in chapter 7 cases should be prohibited. And that makes sense because fee bifurcation occurs regularly in chapter 7 cases, as well as in other bankruptcy cases. Many law firms charge a flat fee that is paid in advance for filing a debtor's chapter 7 petition, preparing the schedules and statement of financial affairs, and attending the 341 meeting. These agreements typically exclude any postpetition representation such as attendance at 2004 exam-

inations, reviewing or defending motions for stay relief, or representation with respect to adversary proceedings, absent the debtor paying an additional fee for the separate retention.[17] While individual retainer agreements vary, for the most part the services to be provided in general chapter 7 consumer retainer agreements are the same as those listed in paragraph 5 of the Form 2030 Fee Disclosure.[18] After the bankruptcy case is filed, if the debtor requires additional services, counsel will seek additional fees. If the debtor cannot pay those fees, the attorney will usually move to withdraw.

What should be the allowable framework for the bifurcation of fees for basic chapter 7 consumer bankruptcy legal services? Can the "no money down" or "low money down" models ever satisfy the requirements of the Bankruptcy Code, the Bankruptcy Rules, the Rules Regulating the Florida Bar (the "Florida Bar Rules"), or this Court's Local Rules? In arguing against and in favor of these models, the UST and the Law Firms have referred to the guidelines set forth by Judge Williamson of the Middle District of Florida in *Walton v. Clark & Washington, P.C.*, 469 B.R. 383 (Bankr. M.D. Fla. 2012) ("*Walton*").

In *Walton*, Judge Williamson approved a bifurcated fee arrangement that met the following conditions:

> a. The "two-contract procedure" disclosure currently on pages 4–5 of the prepetition agreement and page 5 of the postpetition agreement must be set forth on a separate cover page.
>
> b. Firm clients must acknowledge that they have received and read the "two contract procedure" disclosure.
>
> c. The client must execute the prepetition agreement before the bankruptcy case is filed and the postpetition agreement after the bankruptcy case is filed.
>
> d. The postpetition agreement shall contain a provision notifying the client that (i) the client has the right to cancel the postpetition agreement—and all financial obligations arising under that agreement—at any time within 14 days after signing it; and (ii) the client may exercise his or her right to cancel the postpetition agreement by notifying [the law firm] in writing (at the address designated by the firm) within 14 days after signing the agreement of his or her intent to cancel the agreement.
>
> e. [The law firm] shall include language in its initial Rule 2016 disclosure stating that the firm will continue to represent the debtor in the case even where the debtor chooses not to retain the firm for postpetition services until the Court enters an order allowing the firm to withdraw from representation.

469 B.R. at 387-88.

The Reasonableness of Fees

Typically, in the bifurcated fee arrangements that have developed to address the chapter 7 fee challenge, only a small

17. Under this Court's Local Rules, however, any attorney of record for the debtor must assist the debtor with reaffirmation, redemption or surrender decisions regardless of whether the debtor pays an additional fee. *See* L.R. 2090-1.

18. In return for the above-disclosed fee, I have agreed to render legal service for all aspects of the bankruptcy case, including:

> a. Analysis of the debtor's financial situation, and rendering advice to the debtor in determining whether to file a petition in bankruptcy;
> b. Preparation and filing of any petition, schedules, statements of affairs and plan which may be required;
> c. Representation of the debtor at the meeting of creditors and confirmation hearing, and any adjourned hearings thereof.

amount or nothing is charged to the client prepetition.[19] In the cases before the Court, meaningful services were provided prepetition for little or no charge. Postpetition additional services were provided, but at a cost that the UST has argued is excessive and unreasonable, especially compared to the low or non-existent prepetition charge. Thus, the UST questions whether the postpetition fees are reasonable under section 329.

The UST argues that if a lawyer does what a lawyer is supposed to do prepetition – meet with the client to determine which chapter of bankruptcy, or bankruptcy at all, is in the client's best interest and complete the debtor's schedules and statement of financial affairs, as well as all other documents required to be filed with the petition - there won't be much to do postpetition that is not ministerial. Thus, the UST argues, bifurcation is just a disguised way to pay for prepetition services postpetition. Looking at the postpetition fees through the lens of section 329, the UST argues that the postpetition fees are clearly unreasonable. If, in fact, most of the services *were* provided postpetition, then, the UST argues, the Law Firms failed to competently represent their clients prepetition. Additionally, if the Law Firms failed to perform the appropriate diligence prepetition, the Law Firms may have violated Fed. R. Bankr. P. 9011 when filing the petitions.

In each of the cases before the Court, the Law Firms pointed out that all appropriate prepetition counseling and interviewing took place and all documents were completed prior to filing.[20] Debtors' counsel stated that there is nothing requiring them to charge a minimum amount for prepetition services. The Law Firms both argue that there are many services included in the description of postpetition services for which other law firms, using the traditional fee structure, charge, such as representing the client at a 2004 examination, amendments to the bankruptcy schedules, or defending motions for stay relief.

[6] There is no question that using the postpetition agreements to pay for prepetition services is not acceptable, since that is merely seeking to do indirectly what is prohibited directly. *See Hazlett*, 2019 WL 1567751, at *9 ("[F]ees for prepetition services should not be directly or surreptitiously slipped into the fee charged for postpetition services. If this happens, it could be cause for disgorgement under § 329 or other sanctions.")

[7] The UST's argument falls short because it measures the reasonableness of the postpetition fee solely by comparing the charge to the fee for the services and charges prepetition. However, that is not the appropriate test. In *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020), Judge Wise held that the reasonableness of the prepetition fees and the postpetition fees must be analyzed on the basis of the services provided with respect to each flat fee, not compared to each other. "[The Chapter 7 Trustee] assumes, in effect, that the Attorneys must charge Debtor a comparable hourly rate for prepetition and postpetition work. This is incorrect. The

19. When used in this portion of the opinion, the phrase "bifurcated fee arrangement" is intended to refer to the bifurcated fee arrangement for basic consumer chapter 7 legal services, where no money is paid in advance, or only a small amount of money is paid in advance.

20. The cases were unremarkable and each of Ms. Mcfarland, Ms. Brown and Ms. McCoy received their bankruptcy discharges.

Attorneys essentially agreed to perform prepetition services for one flat rate and postpetition services for a second flat rate. No party has argued that either flat rate was unreasonable." *In re Carr*, 613 B.R. at 439. The Court agrees; reasonableness is not gauged by a comparison between the prepetition charges and the postpetition charges.

The UST focuses on the services described in the Fee Agreements [21] that the Law Firms are to provide prepetition and postpetition. The UST argues that the description of services in the prepetition agreements and the postpetition agreements seem to be the same in some instances, creating confusion.[22] The UST also argues that the postpetition agreements should not include services that will *never* be provided to a particular debtor (e.g., defending a motion for stay relief if the debtor does not have any secured creditors). The UST also argues that, for purposes of determining the reasonableness of the postpetition fees, the services that *might* have been needed (2004 exam, schedule amendments, etc.) but were not, in fact, provided, should not be included. In sum, according to the UST, reasonableness can only be assessed by looking at the actual work performed, and the value of the actual services performed.

[8, 9] However, "reasonableness" of a flat fee arrangement is assessed differently than reasonableness evaluated through an hourly rate. *See, e.g., In re Dabney,* 417 B.R. 826, 831 (Bankr. N.D. Ga. 2009).

> Because a flat fee encompasses all required services and the extent of required services is not fully predictable at the outset of a case, the reasonableness of a flat fee cannot necessarily be determined based on the amount of services required in the case. Nevertheless, the amount of a proposed flat fee must bear some relationship to the work that will likely be required, which inevitably depends on the unique facts and circumstances of the case.

Id.

[10, 11] The Court holds that it will review the reasonableness of the postpetition flat fee charged by each of the Law Firms by taking into account not only the work that was done but also the services that might have been required in the case for which there would have been no additional charge.[23] The Court agrees that in determining the reasonableness of the flat fees charged by the Law Firms the Court should not consider services that would not possibly arise in the case, such as dealing with student loan issues when the debtor does not have student loans.[24]

The Obligation of Competency and the Issue of Unbundling

In addition to the need for clarity regarding what services are being provided for the prepetition flat fee and the postpetition flat fee, there is the issue of what

21. "Fee Agreements" refers collectively to all of the fee agreements that are the subject of this opinion.

22. In each of the three cases, there is some blurring of, and therefore ambiguity in, the description of what services are provided regardless of whether the Debtors agree to sign the postpetition agreement. The need for more clarity will be discussed below.

23. The reasonableness of any postpetition fees charged at an hourly rate for postpetition services will continue to be assessed under the traditional standards for determining the reasonableness of hourly fees not subject of 11 U.S.C. § 330. *See Johnson v. Ga. Highway Exp., Inc.*, 488 F.2d 714 (5th Cir. 1974).

24. This does not mean these types of services must be excluded from the list of services to be provided "if necessary." *See, e.g.,* the McCoy Postpetition Agreement.

services must be included as part of the prepetition services – the services an attorney *must* provide when retained by a consumer debtor, regardless of whether the debtor signs a postpetition retainer agreement.

[12] If there are certain services that must be provided prepetition, then any of those services promised postpetition cannot be considered in determining the reasonableness of the postpetition flat fee charge. That in turn leads to the question of whether the services provided prepetition meet the standards of competency required by the Florida Bar Rules and the requirements of Fed. R. Bankr. P. 9011(b) and 11 U.S.C. § 707(b)(4)[25].

In determining the answer to these questions, courts must consider what services are required in any representation, whether required by applicable state professional bar rules, the Bankruptcy Code and Bankruptcy Rules, and that court's local rules.

Competency

[13] Rule 4-1.1 of the Florida Bar Rules states that:

> A lawyer must provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.

The comment to Rule 4-1.1 notes that:

> Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners.

Thus, there is no question that an attorney must meet with a potential bankruptcy client and review sufficient information to competently advise the potential client whether to file bankruptcy and, if so, under what chapter.

Unbundling

Rule 4-1.2 of the Florida Bar Rules states that:

> **(c) Limitation of Objectives and Scope of Representation.** If not prohibited by law or rule, a lawyer and client may agree to limit the objectives or scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent in writing.

"Informed consent" and "reasonable" are both defined in the Florida Bar Rules. "Reasonable" is defined as "conduct of a reasonably prudent and competent lawyer." "Informed consent" is defined as follows:

> "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

25. Section 707(b)(4) provides:

> **(C)** The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has--
>
> **(i)** performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and
>
> **(ii)** determined that the petition, pleading, or written motion--
>
> **(I)** is well grounded in fact; and
>
> **(II)** is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1).
>
> **(D)** The signature of an attorney on the petition shall constitute a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.

What a "reasonably prudent and competent" chapter 7 consumer practitioner should do is framed by the Bankruptcy Code and this Court's Local Rules. This Court's Local Rule 2090-1(E) states that an attorney who makes an appearance in a case on behalf of a debtor is required, at a minimum, to assist the debtor with respect to all of his or her obligations under 11 U.S.C. § 521. Section 521 contains many requirements, some of which are prepetition requirements such as filing the list of creditors, some of which are postpetition requirements such as providing documents to the trustee, and some of which should take place prepetition but often do not, such as filing the bankruptcy schedules, the statement of financial affairs, and payment advices. Local Rule 2090-1(E) requires counsel of record to perform all section 521 responsibilities unless and until the Court permits the attorney to withdraw.

Both Law Firms acknowledge that, regardless of whether the debtor signs a postpetition agreement, the firm is attorney of record for the debtor until the firm is allowed to withdraw, meaning that the firm is responsible for representing the debtor [26] if withdrawal has not been approved by that date.

Several of the other bankruptcy courts that have looked at the issue of what core services must be provided if a lawyer accepts a consumer bankruptcy case have looked to both the courts' local rules and the state's bar rules. In *In re Slabbinck*, 482 B.R. 576 (Bankr. E.D. Mich. 2012), the court framed the analysis as what are the "services . . . necessary to achieve the basic, fundamental objectives of the representation." 482 B.R. at 584 (quoting *In re Egwim*, 291 B.R. 559 (Bankr. N.D. Ga. 2003)). The *Slabbinck* court agreed with the *Egwim* court that the fundamental objectives for a chapter 7 consumer debtor are to obtain his or her discharge and retain his or her exempt assets.[27] But, the *Slabbinck* court held, neither the Bankruptcy Code nor the applicable Michigan Rules of Professional Conduct "requires that the attorney represent the individual debtor in *all* matters necessary to pursue the client's ultimate objective." *Slabbinck*, 482 B.R. at 592. The court concluded:

> [C]ompetence of a Chapter 7 debtor's attorney is most appropriately evaluated by looking at the actual work that was agreed to be performed and then was performed by the attorney, not by looking at the remaining work that will have to be done to complete the case when the individual has not hired the attorney to perform those services and the attorney has not performed those services.

Id. at 593.[28]

In *Hazlett*, the court was required to consider this issue in the context of its court's Local Rule 2091-1, which rule requires that an attorney represent a debtor

26. Attending the 341 meeting is not listed in section 521. The Law Firms include attendance at the 341 meeting as a postpetition service, one that they do not need to provide if the debtor does not sign an agreement to provide postpetition services. However, both Law Firms acknowledge they must represent the debtors at the 341 meeting if they have not been permitted to withdraw.

27. The *Slabbinck* court disagreed with the *Egwim* court's ultimate holding that, except under very limited circumstances, a consumer chapter 7 lawyer is ''all in'' including representation of debtors for all adversary proceedings.

28. The court noted that chapter 13 practitioners frequently file ''bare bones'' petitions, filing the balance of the schedules and other documents postpetition. The court observed there is no ''principled basis to hold that an attorney who files a bare bones Chapter 7 petition for a prepetition fee . . . is automatically acting less competently.'' *Id.*

in all aspects of the case, including adversary proceedings.[29] The court held that the rule is not violated if the *debtor* chooses not to continue with the attorney postpetition.[30] The court did not provide concrete guidance on how those services must be bifurcated other than to note that the debtor and counsel both must be fully informed regarding the appropriateness of bankruptcy as an option, and, if so, under which chapter of the Bankruptcy Code the case should be filed.

In *Carr*, the court held the following prepetition services were adequate: preparing and filing the petition and the creditor matrix, the application to pay the filing fee in installments, and the statement of attorney compensation.[31] 613 B.R. 427 at 431-32.

But in *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. 2021), the court rejected the holdings of all of the above cases, determining that under section 707(b)(4) and that court's own local rule [32], an attorney who filed a bankruptcy case on behalf of a debtor was required to represent the debtor in all matters relating to the representation except for adversary proceedings and appeals. The *Prophet* court required the attorney to return to the debtors all fees that he had received postpetition in accordance with signed postpetition agreements. *Id.* at 803–04 .

[14] To address the issues of competency and unbundling, this Court holds that any lawyer choosing to represent a debtor must comply with the Bankruptcy Code, the Bankruptcy Rules, the Florida Bar Rules, and this Court's Local Rules. These statutes and rules collectively require sufficient inquiry by the attorney, not staff, when initially meeting with a

29. U.S. Bankruptcy Court, District of Utah Local Rule 2091-1 provides: ''Scope of Representation. A debtor's attorney must represent and advise the debtor in all aspects of the case, including the § 341 Meeting, motions filed against the debtor, reaffirmation agreements, agreed orders, and other stipulations with creditors or third parties, and post-confirmation matters. The debtor's attorney must also represent the debtor in adversary proceedings filed against the debtor unless, pursuant to this rule, the Court has excused the attorney from this requirement. *The scope of representation cannot be modified by agreement*.'' (emphasis added).

30. The Utah State Bar issued an ethics opinion on the use of ''zero down'' bankruptcy filings, bifurcated fee agreements, and the factoring of attorney's fees, including whether and when such arrangements involved impermissible unbundling. The court made clear that unbundling, while permitted by the Utah bar rules, was not permitted under Local Rule 2091-1, but that a bifurcated fee arrangement, where only the timing of services and the associated payment are separate, is not unbundling. *Hazlett*, 2019 WL 1567751, at *7-8.

31. Postpetition services in *Carr* were listed as: ''Scope of Post-Filing Routine Services: Attorney shall: (1) meet with client; (2) review available documentation and information; (3) transmit required documents to the UST and to the chapter 7 trustee: (4) file any documents, lists, statements, applications required to complete the petition after reviewing such with client; (5) appear at the meeting of creditors; (6) draft and file not more than one responsive pleading to a motion for relief from stay; (7) take reasonable measures to retrieve any and all monies garnished within 90 days of the bankruptcy filing; (8) review and execute any reaffirmation or assumption of lease agreements; (9) arrange for the required financial management course; and (10) pay filing fee of $335.00. (the 'post-filing routine services')." 613 B.R. 427 at 432. Certain other matters, such as adversary proceedings, would be provided at an hourly rate. *Id.* at 432-33.

32. The *Prophet* court acknowledged a South Carolina ethics rule allowing limited representation, similar to Rule 4-1.2 of the Florida Bar Rules, but rejected its applicability in light of the bankruptcy court's local rule regarding the required scope of representation.

client to ascertain whether filing bankruptcy is the appropriate relief, determining under what chapter a bankruptcy case could or should be filed, and additionally compel the attorney to adequately inform a potential debtor of the consequences of that choice. Further, the attorney must assist the debtor with all of the debtor's obligations under section 521 unless he or she is permitted to withdraw. The attorney must prepare and file all documents necessary to commence the bankruptcy case, which includes, at a minimum, the petition, the creditor's matrix, any motion to waive or pay the filing fee in installments, the statement of attorney compensation, and the Debtor Credit Counseling Certificate, or, if applicable, a motion to waive the need to file or file late, the certificate (collectively the "Minimum Required Documents"). And finally, the attorney must attend the section 341 meeting of creditors unless he or she is permitted to withdraw prior to the meeting.

[15] The Court recognizes that there are circumstances in which a debtor comes to the attorney on an emergency basis and the attorney must file a bare bones petition. But even in that circumstance the attorney and the debtor must be sufficiently informed prior to filing the petition to comply with Rule 9011, and certain documents must be prepared and filed.

Disclosure Issues – the Debtor

[16] A fundamental premise of all the fee bifurcation cases is disclosure. "The propriety of using bifurcated fee agreements in consumer chapter 7 cases is directly proportional to the level of disclosure and information the attorney provides to the client and the existence of documentary evidence that the client made an informed and voluntary election to enter into a postpetition fee agreement." *Hazlett*, 2019 WL 1567751 at *8.

The issues of disclosure to the debtor include timing and clarity. When should the disclosures be given and how clear should the disclosures be? Is the disclosure misleading if it includes services that could not possibly ever be needed in a particular case, such as listing motions to value or objecting to a student loan claim? What about services that may or may not be required, such as attending a 2004 examination, or opposing a motion for relief from stay?

Rule 4-1.2 of the Florida Bar Rules requires that the limitation on scope of representation must be reasonable and the client give "informed consent in writing."

[17] In *Carr*, the court found that the separate fee agreements it reviewed complied with the disclosure requirements by specifically describing what services were being provided prepetition and what services were being provided postpetition. The approved prepetition agreement also clearly described to the debtor what the debtor's options were if the debtor chose not to enter into a postpetition agreement with the attorney.[33] The agreement also disclosed that if the debtor did not pay the postpetition agreed-upon fees, the debtor could be sued for non-payment and the debt would not be discharged. The court in *Carr* also approved the postpetition description of excluded services, including adversary proceedings and motions for relief from stay, which, the agreement stated, would be charged at an hourly rate of $200.00.

33. Similar to the local rules discussed in all of the above cases as well as this Court's Local Rules, an attorney is counsel of record until allowed to withdraw. In *Carr,* the court stated it did not need to address that rule since the attorney did not seek to withdraw from any of the cases.

In *Walton*, Judge Williamson held that the "two contract" disclosure must be set forth on a separate cover page and must clearly explain the debtor's three options: continue with current counsel, proceed pro se, or retain new counsel.

[18] In *Hazlett*, the court found adequate a prepetition disclosure that clearly described the debtor's options before filing: (a) pay up front; (b) pay a small fee up front and, after the petition was filed, (i) sign a postpetition agreement with a certain fee, (ii) proceed pro se, or (iii) retain another firm; or (c) pay no money up front and (i) sign a postpetition agreement with a certain fee after the petition was filed, (ii) proceed pro se, or (iii) retain another law firm. In addition, the attorney provided the debtor with other extensive disclosures regarding bankruptcy filings, possible factoring of fees,33F [34] and the importance of providing true, complete, and accurate information in advance of filing the bankruptcy case.

[19] In the instant cases, the UST argues that the description of prepetition services and postpetition services in the Fee Agreements overlap and were, to some extent, duplications, or include services that were never performed or would never have arisen in the case due to the nature of the Debtor's assets and liabilities. The Court recognizes that there are times when what would normally be a prepetition service, such as preparation of the bankruptcy schedules and statement of financial affairs, may occur postpetition, especially when the filing is an emergency filing. But in such a case, the disclosure must make clear that the particular service will be performed postpetition only if not completed prepetition. The agreement should also make clear whether amendments to documents are included in the fee, and if the amendment of certain documents is not included, what those documents are.

[20] With respect to the adequacy of disclosure to the debtor, the Court holds that the disclosures may include services that may or may not be performed, and services that at the time of retention are clearly not required, so long as the agreement makes clear that some of the listed services will not arise in a particular case. The issue of whether possible services were actually performed or could have ever been necessary is something the Court may consider in determining the reasonableness of the postpetition flat fee.

[21] The postpetition agreement, if it is signed immediately following the petition, must include a 14-day rescission period and describe the consequences if the debtor rescinds the agreement. Alternatively, the debtor should be given a 14-day window after the petition is filed in which to sign a postpetition agreement. The prepetition agreement must disclose that regardless of whether the postpetition agreement is signed, the attorney must continue to represent the debtor unless allowed to withdraw.[35] If the postpetition agreement has a rescission clause, it must contain the same disclosure. And the postpetition

34. None of the Law Firms factored their fees so this opinion does not address the adequacy of any disclosures relating to factoring. However, the Court has determined that it will not allow any attorney to factor its legal fees. This creates an inherent conflict of interest between the attorney and the debtor, and violates R. Regulating Fla. Bar 4-5.4, 4-1.8, and 4-1.7.

35. Each of the Fee Agreements in this opinion disclosed that counsel would continue to represent the Debtor postpetition until allowed to withdraw even if the Debtor did not sign the postpetition agreement.

agreement must clearly state that the obligation to pay fees under the postpetition fee agreement is not an obligation that will be discharged when the debtor receives his or her bankruptcy discharge.

[22] The debtor must be given a separate disclosure form that discloses he or she is being provided the option to choose the bifurcated fee arrangement, and whether the bifurcated fee arrangement will have a different cost than a flat fee arrangement paid in advance of the filing. The disclosure should also clearly describe the debtor's options, including the consequences of choosing a particular option: (a) sign the postpetition agreement and get the services described in that agreement at the stated cost (flat fee or hourly rate); (b) do not sign the agreement, and once the attorney is permitted to withdraw, proceed with the case without a lawyer; or (c) retain a new lawyer postpetition.

[23] A final issue regarding disclosures is when the proposed agreements and disclosures should be presented to the debtor. In order for a debtor to make a fully informed decision regarding his or her choices, the debtor must be presented with the separate disclosure, the prepetition agreement and the postpetition agreement when asked to sign the prepetition agreement. A debtor cannot make an informed decision regarding a bifurcated arrangement without knowing what the "other side" agreement includes and requires. If the debtor signs the prepetition agreement the debtor must also sign the separate disclosure.

[24] Thus, the Court holds that disclosure to a potential client is adequate so long as

a) The potential debtor receives the separate disclosure form;

b) The prepetition agreement and postpetition agreement are provided at the same time for the potential debtor's review;

c) The prepetition agreement clearly describes the services that must be performed prepetition as well as other services that may be provided; and

d) The postpetition agreement clearly describes the included services (delineated, where appropriate as "if necessary"); and specifically describes the excluded services, and any additional flat fee or hourly charge associated with those excluded services.

Disclosure Issues – the Court

[25] In addition to the critical importance of disclosure to the client, attorneys also must make sure that any bifurcated fee arrangement is properly disclosed to the Court and to parties in interest.

Bankruptcy Rule 2016 requires that every attorney for a debtor (regardless of whether the attorney is applying for compensation) shall file the statement required by section 329. Section 329 requires a disclosure of the compensation paid or to be paid if the agreement was made within one year before the date of filing the petition for services rendered or to be rendered in contemplation of or in connection with the case, and the source of the compensation. While in each case before the Court the Form 2030 Fee Disclosure disclosed the fees paid and those agreed to be paid, none of the forms disclosed that the "to be paid" portions of the fees were contingent upon the debtor's execution of, or agreed to by virtue of, an agreement signed postpetition nor that the fees were to be paid on a monthly basis.

[26] Both Law Firms acknowledge that the Form 2030 Fee Disclosure needs to be amended when and if a debtor signs

a postpetition agreement, and, if the fees are being paid monthly, disclose the details of the monthly payment arrangement. The UST argues that the Form 2030 Fee Disclosure must be amended, and disclosure needs to be made, each time the law firm receives payment – meaning every month if payments are due monthly. The Court finds that this level of disclosure is not necessary so long as the form is amended when the postpetition agreement is signed, and that the amended form discloses the payments that will be made monthly.

[27] Schedule J requires that a debtor list all monthly expenses. The UST argues, and both Law Firms agree, that if a debtor signs the postpetition agreement and it includes a monthly payment, Schedule J must be amended to reflect the payment obligation, and then amended again, once the monthly payments are completed. The Court does not agree. Schedules I and J reflect information as of the petition date. As of the petition date, a chapter 7 debtor does not have an obligation to pay an attorney a fee postpetition. Once the debtor signs the postpetition fee agreement, the debtor's counsel must file the Form 2030 Fee Disclosure. There is no need to amend Schedule J.

Timing and Rescission

[28, 29] A postpetition fee agreement cannot be signed prepetition; otherwise it is a contract subject to rescission. However, a postpetition agreement signed immediately after the petition is filed does not provide the debtor with any meaningful opportunity to consider his or her options. Judge Williamson in *Walton* and other courts require some sort of "breathing room" for the debtor to sign or be obligated under the postpetition agreement. In *Walton*, Judge Williamson approved a 14-day rescission period. In *Carr*, the court approved a 14-day period between the petition date and the signing of the postpetition agreement. In each case, the law firm was required to continue representing the debtors until allowed to withdraw. The Court finds that it is necessary and appropriate for the debtor to have a rescission period. Therefore, any arrangement that gives the debtor a 14-day "cooling off" period, whether after the prepetition agreement is signed, or until the postpetition agreement must be signed, is acceptable to the Court.

Financing the Filing Fees

[30] Is the filing fee a prepetition or postpetition charge? Does a prepetition agreement by a debtor to reimburse the filing fee through a postpetition agreement violate 11 U.S.C. § 526 because the law firm is advising the debtor to incur debt in anticipation of bankruptcy or to pay for bankruptcy related legal services?

In the Brown Case and in the Mcfarland Case nothing was paid up front and the filing fees were paid by the Semrad Law Firm at the time the petitions were filed and then repaid through the monthly payment.[36] The Semrad Law Firm argues that the filing fee is due postpetition and therefore, appropriately included as a postpetition charge, because CM/ECF does not actually charge the fee until all of the documents to file the case have been up-

36. The Van Horn Law Firm charged Ms. McCoy $335.00 in advance; the balance of any fees was only due upon execution of an agreement for postpetition retention. In oral argument, counsel for the Van Horn Law Firm alternatively argued that the $335.00 was the filing fee, (the filing fee on the McCoy Petition Date was $335.00) or was attorney fees with the filing fee paid postpetition (and financed through the monthly payments). The McCoy Prepetition Agreement makes clear the $335.00 was an attorney fee, not the filing fee.

loaded. However, the Semrad Law Firm acknowledged in oral argument that, regardless of whether the debtor signs the postpetition fee agreement, if the Semrad Law Firm doesn't pay the filing fee immediately, its CM/ECF privileges will be suspended until the fee is paid. Moreover, Fed. R. Bankr. P. 1006 requires that the filing fee "accompany" the petition.

The Semrad Law Firm relies on *Carr*. In *Carr* the court held that the payment of the filing fee by the law firm [37], which was repaid postpetition over time, was acceptable so long as the payments were applied first to the filing fee, as required by 28 U.S.C. § 1930.[38],[39]

In addition to whether this type of fee repayment arrangement is prohibited by the Bankruptcy Code, the Court must consider whether the payment of the filing fee by a law firm with the expectation of repayment, either immediately or over time, violates R. Regulating Fla. Bar 4-1.8(e) which states that:

> A lawyer is prohibited from providing financial assistance to a client in connection with pending or contemplated litigation, except that:
>
> (1) a lawyer may advance court costs and expenses of litigation, the repayment of which **may** be contingent on the outcome of the matter; and
>
> (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(emphasis added).[40]

The Semrad Law Firm argues that because subsection (e)(1) states that the repayment "MAY be contingent on the outcome of the matter" repayment does NOT have to be contingent on the outcome of the matter. Moreover, the Semrad Law Firm argues, as reflected in the comment to Rule 4-1.8(e), the purpose of advancing the fee on behalf of a debtor is, like advancing costs in a contingency fee case, an access to justice issue. The Semrad Law Firm acknowledges it has not found any case that has allowed (or disallowed) cost advances in a non-contingency lawsuit.

[31] The Court finds that a law firm's payment of the filing fee with postpetition

37. The *Carr* court distinguished the Eleventh Circuit's holding in *Cadwell v. Kaufman,* 886 F.3d 1153, 1156 (11th Cir. 2018). In *Cadwell,* the Eleventh Circuit held that an attorney violates section 526 if the attorney advises the client to use a credit card to pay attorney fees. The *Carr* court observed that "this prohibition does not prevent a debtor from paying their [sic] counsel's legal fees directly over time." *In re Carr,* 613 B.R. at 437.

38. The court also held that because the outlay for the filing fee was repaid postpetition prior to paying any attorney fees, the arrangement did not violate Fed. R. Bankr. P. 1006(b)(3).

39. The UST argues that filing fees were really not an issue in *Carr* because the debtor paid the filing fee. The UST is not correct; the *Carr* court addressed the section 526 issue directly.

40. The Comment to R. Regulating Fla. Bar 4-1.8 provides:

> **Financial assistance**
> Lawyers may not subsidize lawsuits or administrative proceedings brought on behalf of their clients, including making or guaranteeing loans to their clients for living expenses, because to do so would encourage clients to pursue lawsuits that might not otherwise be brought and because financial assistance gives lawyers too great a financial stake in the litigation. These dangers do not warrant a prohibition on a lawyer advancing a client court costs and litigation expenses, including the expenses of diagnostic medical examination used for litigation purposes and the reasonable costs of obtaining and presenting evidence, because these advances are virtually indistinguishable from contingent fees and help ensure access to the courts. Similarly, an exception allowing lawyers representing indigent clients to pay court costs and litigation expenses regardless of whether these funds will be repaid is warranted.

repayment by the debtor violates the Bankruptcy Code as well as the Florida Bar Rules.[41] The filing fee is due upon the filing of the bankruptcy petition. Therefore, the debtor's obligation to repay the filing fee to the firm is a prepetition obligation that is dischargeable. A law firm that advances the fee with the expectation of repayment postpetition is violating section 526 by advising the debtor to incur a debt "to pay for bankruptcy related legal services", violating 11 U.S.C. § 362 and, assuming the debtor gets his or her discharge, violating 11 U.S.C. § 524.

[32, 33] Moreover, the payment of the filing fee is a violation of Rule 4-1.8(e).[42] The Court finds that the word "may" means that the attorney *may* advance costs the repayment of which is contingent on the outcome of the case, *not* that the attorney may always advance costs for a client regardless of whether the repayment is contingent on the outcome of the case. The interpretation advocated by the Semrad Law Firm renders Rule 4-1.8(e) meaningless.[43] The Rule addresses the access to justice issue [44] by authorizing cost advances in contingency fee cases and allowing an attorney to advance costs on behalf of an indigent client [45] A bifurcation agreement, like any other fee arrangement, should give the debtor the three choices allowed by federal law: pay the fee up front, complete the paperwork to pay the filing fee in installments, or, if applicable, seek waiver of the filing fee.[46]

APPLICATION TO THESE CASES AND THE REQUEST FOR INJUNCTIVE RELIEF

The Court will now examine the Fee Agreements.

In order to assess the reasonableness of the fees charged in each of the three cases at issue, the Court must consider the services provided or promised by each firm prepetition and postpetition. As the Court has already noted, this determination is not driven by a comparison of the prepetition and postpetition fees charged, nor, since in each instance a flat fee was charged, solely on the services *actually* performed postpetition.

[34, 35] The McCoy Prepetition Agreement did not adequately describe what services the Van Horn Law Firm agreed to provide prepetition for the flat fee charged but rather used the phrase "basic services." Despite the lack of clarity of promised services, the Court finds that $335.00 is a reasonable fee for the prepeti-

41. The Court is aware that law firms may be fronting the filing fees for debtors in cases filed under chapter 13. The rules discussed in this section apply to all chapters of the Bankruptcy Code. If a law firm is not paid the funds in advance to cover the filing fee or is not holding a retainer in its trust account sufficient to reimburse the cost of the filing fee, the law firm should re-examine this practice.

42. In *Carr,* the court held that the attorneys did not violate the Kentucky Rules of Professional Conduct by advancing the filing fee. The UST argues that the Kentucky Rules of Professional Conduct regarding financial assistance may be different than Florida's; they are not.

43. The Court acknowledges that Rule 4-1.8(e) could be written more clearly. Perhaps the Florida Bar will consider rewriting this particular sentence so there is no question whether attorneys may advance filing fees and other court costs for clients in all cases.

44. The comment to Rule 4-1.8(e) makes a distinction between paying a client's living expenses, which is never allowed, and advancing court costs and litigation expenses, which is permissible as provided in the Rule.

45. If a debtor is indigent perhaps the attorney should take the case pro bono.

46. *See* 28 U.S.C. § 1930.

tion services that were provided because the services included the initial client interview and the preparation of the bankruptcy schedules and the statement of financial affairs.

[36] Turning to the postpetition services promised or actually performed, the Court notes that postpetition the Van Horn Law Firm attended the 341 meeting and negotiated a settlement agreement with the chapter 7 trustee. And, of course, Ms. McCoy ultimately succeeded in obtaining her discharge. The McCoy Postpetition Agreement also included (if necessary) at no additional charge attendance at any 2004 examination conducted by the chapter 7 trustee, review and attendance at hearings for motions for relief from stay, preparation of objections to and defense of such motions, and review of redemption and reaffirmation agreements.

Law firms that have been paid in advance of filing charge debtors extra fees for all of the services just described. Thus, the Court finds that the postpetition flat fee of $1,565.00 was reasonable for the actual services that Van Horn Law Firm performed and the potential services the Van Horn Law Firm would have provided if necessary for Ms. McCoy.

[37] The Semrad Law Firm did a better job of describing its prepetition services. Prepetition the Semrad Law Firm performed an initial client interview and, in both cases also prepared the petition, the schedules, and the statement of financial affairs. Since the Semrad Law Firm charged Ms. Brown and Ms. Mcfarland a flat fee of zero dollars for its prepetition representation, the Court finds the prepetition flat fee was reasonable.

[38] The Brown Case and the Mcfarland Case appear to have been unremarkable postpetition other than a continued 341 meeting, and so it appears that, other than attending the 341 meeting, and taking care of other matters generally incidental to getting a chapter 7 case to discharge and closing, the Semrad Law Firm did not have to do much postpetition for either Ms. Brown or Ms. Mcfarland. The services that the Semrad Law Firm agreed to provide to Ms. Brown and Ms. Mcfarland for the flat fee paid postpetition included negotiating with the chapter 7 trustee regarding any property or actions adverse to the client, reviewing and negotiating reaffirmation agreements and motions to redeem, reviewing and responding to motions for stay relief, and preparing and serving any motions to avoid liens. All of these are services that other attorneys who get paid in advance would not provide without the payment of an additional fee postpetition. Thus, the Court finds that, based on the services performed and to be performed, if necessary, the Semrad Law Firm's postpetition flat fee of $1,262.00 in the Mcfarland Case and $1,362.00 in the Brown Case was reasonable and will be allowed.

[39] The Van Horn Law Firm and the Semrad Law Firm each advanced the filing fee and other costs for the Debtors. Although this Order holds that this practice is not permitted under the Florida Bar Rules, the Court will not require the filing fees to be disgorged. However, the Law Firms may not, in any new case filed after entry of this opinion, advance the filing fee. If the debtor cannot pay the filing fee up front then part of the Law Firm's prepetition services must include preparation of a motion seeking waiver of the filing fee or a motion seeking to pay the filing fee in installments.

Notwithstanding that the Court finds the Law Firms' fees were reasonable, the Court finds that each of the Law Firms disclosures were either inadequate, misleading, or both. The McCoy Prepetition

Agreement did not adequately describe what services are included as "Basic Services." The McCoy Prepetition Agreement also did not clearly outline the Debtor's three options postpetition: sign, represent yourself, or hire another lawyer to do the postpetition work.

[40] The Brown Prepetition Agreement and Mcfarland Prepetition Agreement (collectively the "Semrad Prepetition Agreements") state the law firm agreed to represent the Debtors "in all aspects of the case" but then conditioned that promise on the Debtor executing the postpetition agreement. There are other prepetition obligations described as postpetition services in the Semrad Prepetition Agreements such as advising the Debtor of her obligation to attend the 341 meeting. Advising a potential debtor of his or her responsibilities as a debtor is clearly a prepetition obligation and should be explained when the process of bankruptcy is described to a potential client. The Semrad Prepetition Agreements also describe the filing fee as something the Court requires to be paid after the petition is filed. That is not accurate. The Brown Postpetition Agreement and Mcfarland Postpetition Agreement (collectively the "Semrad Postpetition Agreements") included as a postpetition item services that must be provided prepetition including "advise Client(s) of the need to attend a debtor education course and provide a certificate of completion to the Firm." That is misleading and must be fixed. The Semrad Prepetition Agreements also list postpetition services, which list includes, if necessary, sending "*In re Mendiola*" letters. The Court has no idea what these letters are, and presumably neither does a potential chapter 7 consumer client.

All of this must be corrected, and presumably will be resolved when both Law Firms revise their agreements to comply with the requirements outlined in this opinion.

The Court will grant the UST's request for injunction insofar as, as of the date of this Order, all attorneys, including the Law Firms, must stop their current practices relating to bifurcated fee arrangements unless those arrangements comply with the requirements outlined by this Court. The balance of the UST's request is DENIED.

CONCLUSION

The parties asked the Court for guidance regarding bifurcated fee arrangements in chapter 7 cases. The Court holds that so long as attorneys offering a bifurcated fee arrangement comply with the terms of this Order, those arrangements do not violate the Bankruptcy Code or Bankruptcy Rules, this Court's Local Rules, or the Florida Bar Rules.

In re Donald F. WALTON, United States Trustee for Region 21, Plaintiff,

v.

CLARK & WASHINGTON, P.C., Defendant.

No. 8:09–mp–00010–MGW.

United States Bankruptcy Court, M.D. Florida, Tampa Division.

May 21, 2012.

Background: United States Trustee (UST) filed miscellaneous proceeding against law firm that represented individual debtors in consumer cases under Chapter 7 and Chapter 13, seeking declaration that firm's fee arrangement, which involved firm's receipt and deposit of postdated checks, violated automatic stay and discharge injunction, and also created conflict of interest between firm and its clients. The Bankruptcy Court, Michael G. Williamson, J., 454 B.R. 537, ruled that firm could not accept postdated checks as prepetition retainer for postpetition services in Chapter 7 cases. UST moved to determine whether firm's new practice, under which separate contracts for prepetition and postpetition services were executed, violated prior ruling.

Holding: The Bankruptcy Court, Michael G. Williamson, J., held that new procedure did not violate prior ruling or conflict with Bankruptcy Code or professional conduct rule, warranting its approval, with proposed modifications.

Modified new procedure approved.

1. Bankruptcy ⚿2588, 3170

There is no prohibition against a debtor making postpetition installment payments for postpetition legal services.

2. Attorney and Client ⚿143
Bankruptcy ⚿3200

New two-contract fee procedure employed by law firm in representing Chapter 7 and Chapter 13 debtors in consumer cases did not violate bankruptcy court's prior order barring previous arrangement under which firm had accepted postdated checks as prepetition retainer for postpetition services, and did not conflict with Bankruptcy Code or professional conduct rule, warranting court's approval of procedure, pursuant to which clients executed separate fee agreements for prepetition and postpetition services, prepetition agreement described procedure in detail and identified three options for postpetition legal services, clients received two-week cooling off period in which to select desired option, during which firm continued to provide representation, and firm continued to provide representation, if it was not selected as postpetition counsel, until allowed to withdraw by court order.

Denise E. Barnett, Tampa, FL, for Plaintiff.

Glenn E. Gallagher, Clark & Washington, LLC, Tampa, FL, Richard Thomson, Clark & Washington, P.C., Atlanta, GA, for Defendant.

AMENDED ORDER AND MEMORANDUM OPINION DETERMINING THAT CLARK & WASHINGTON'S TWO–CONTRACT PROCEDURE DOES NOT CONFLICT WITH THE COURT'S JULY 12, 2011 MEMORANDUM OPINION[1]

MICHAEL G. WILLIAMSON, Bankruptcy Judge.

This Court previously ruled in this miscellaneous proceeding that Clark & Wash-

ington was prohibited from accepting postdated checks as a prepetition retainer for postpetition services to be provided to their consumer clients.[2] Clark & Washington now has its clients execute two separate agreements: one for prepetition services and another for postpetition services. The agreement for prepetition services is executed before the petition is filed, and all services provided for under the agreement are completed with the filing of the chapter 7 petition. The relatively small payment for the prepetition services is also made before the petition is filed. The agreement for postpetition services is executed after the petition is filed. Payments under the postpetition retainer agreement are automatically debited from the debtor's bank account. The U.S. Trustee has moved to determine whether this new practice violates the Court's previous ruling.[3] For the reasons discussed below, the Court determines that, with certain modifications, this new practice is acceptable and does not conflict with the Court's previous ruling.

Background

The Defendant, Clark & Washington, P.C., is a law firm based in Atlanta, Georgia, with offices in various cities in the southeastern United States. Clark & Washington limits its practice to representing individual debtors in consumer cases filed under Chapters 7 and 13 of the Bankruptcy Code. The U.S. Trustee originally filed this miscellaneous proceeding seeking a declaration that the prepetition fee agreement Clark & Washington used at the time, which depended upon the use of postdated checks for payment, was impermissible. This Court agreed with the U.S. Trustee's position and entered an order prohibiting Clark & Washington from using postdated checks as part of its fee agreement with clients. The U.S. Trustee now seeks a determination as to whether a new two-contract procedure used by the firm is permissible. To understand whether the new two-contract procedure is permissible, it is helpful to understand how Clark & Washington's original prepetition fee agreement worked and the reason that fee agreement was impermissible.

The Postdated Check Fee Agreement

Before this miscellaneous proceeding was filed in 2009, Clark & Washington regularly entered into fee agreements with its consumer clients under which it would receive a relatively small payment for its prepetition work and postdated checks as a "retainer" for its postpetition work. Typically, the client provided Clark & Washington with four or five postdated checks in equal amounts to pay this retainer. Clark & Washington deposited the checks on the date specified on the checks.

1. This Amended Order and Memorandum Opinion supersedes the Court's April 20, 2012 Order and Memorandum Opinion Determining that Clark & Washington's Two–Contract Procedure Does Not Conflict with the Court's July 22, 2011 Memorandum Opinion (Doc. No. 66). Clark & Washington moved for reconsideration of decretal paragraph 1(d) of the Court's April 20, 2012 Order and Memorandum Opinion (Doc. No. 68). In light of that motion for reconsideration, the Court has amended decretal paragraph 1(d) to clarify the right of Clark & Washington's clients to cancel their postpetition contract. This Amended Order and Memorandum Opinion is otherwise identical in all respects to the April 20, 2012 Order and Memorandum Opinion.

2. *Walton v. Clark & Washington, P.C.,* 454 B.R. 537 (Bankr.M.D.Fla.2011).

3. Doc. No. 49 (the ''Motion'').

The dates specified were always after the petition date, and in some instances, they were after the discharge had been entered.

The U.S. Trustee files this miscellaneous proceeding

The U.S. Trustee objected to that fee arrangement. So he filed this miscellaneous proceeding seeking a declaration that Clark & Washington's fee arrangement: (i) violated Bankruptcy Code § 362's automatic stay (Count I); (ii) violated Bankruptcy Code § 524's discharge injunction (Count II); and (iii) created a conflict of interest between Clark & Washington and its clients (Count III).[4] Clark & Washington moved for entry of summary judgment in its favor on all three counts of the U.S. Trustee's Complaint.[5]

The Court invalidates the Postdated Check Fee Agreement

In its July 12, 2011 Memorandum Opinion, the Court ruled that the postdated checks gave rise to prepetition claims as a matter of law and that depositing the checks after the petition date violated the § 362 automatic stay or the § 524 discharge injunction (depending on when the check was deposited). This Court also ruled that the fee arrangement created a conflict of interest. Accordingly, the Court prohibited Clark & Washington from accepting postdated checks for deposit after the petition date as payment of its fees for chapter 7 cases.

Clark & Washington implements a new two-contract procedure

After the Court's Memorandum Opinion, Clark & Washington modified its fee agreement to remove the provisions that the Court had found to be impermissible. The result was a new two-contract procedure under which the client executes separate fee agreements for prepetition and postpetition services. Under this new procedure, the client first agrees to retain Clark & Washington to prepare and file the chapter 7 petition. After the prepetition retainer agreement is signed, the initial intake is done and the petition and schedules are prepared. The client then comes back for a second appointment to sign the petition and schedules. Clark & Washington files the petition and then immediately prepares a postpetition retainer agreement, which the client executes while at the firm's office. The client also makes arrangements to pay the postpetition fees (generally in the form of automatic debits from the client's bank account) while at the firm's office. Once that is done, the balance of the schedules, statement of financial affairs, and other papers are filed. The fee for the prepetition services is generally $250, while the fee for the postpetition services is generally $1,000.

The U.S. Trustee filed the Motion to determine whether Clark & Washington's new two-contract procedure violates this Court's prior ruling.[6] At the initial hearing on the Motion, the Court expressed two key concerns about the firm's new procedure. First, the transition from the prepetition contract to the postpetition contract appeared to be one continuous process with no time for the client to consciously choose whether to retain the firm for postpetition services. Second, the disclosures in the initial contract did not appear to be sufficient to fully explain the client's options for postpetition services.

Clark & Washington modifies the two-contract procedure

As a result of the Court's comments at the initial hearing, Clark & Washington

4. Doc. No. 1.

5. Doc. Nos. 32 & 33.

6. Doc. No. 49.

modified its two-contract procedure.[7] Under the modified procedure, the prepetition fee agreement describes the two-contract procedure in detail and sets forth the client's three options for postpetition legal services.[8] Those three options are: (i) the client can proceed pro se, (ii) the client can retain Clark & Washington, or (iii) the client can retain another firm.[9] Clark & Washington now gives its clients two weeks to exercise one of those three options; the debtor is no longer required to exercise one of those options on the same day the petition is filed.[10] In effect, Clark & Washington now provides a cooling off period. It is the validity of this modified two-contract procedure that is before the Court. The Court will next consider whether this modified procedure violates the Court's prior ruling or is otherwise legally impermissible.

Conclusions of Law[11]

As the Seventh Circuit recognized in *In re Bethea*, debtors "who cannot pay in full can tender a smaller retainer for prepetition work and later hire and pay counsel once the proceeding begins—for a lawyer's aid is helpful in prosecuting the case as well as in filing it." [12] The Supreme Court has also recognized that a debtor is free to use postpetition funds to pay for postpetition legal services.[13] Put another way, there is nothing inherently wrong with a lawyer giving terms to clients for the payment of legal services. As a consequence, the Court must uphold the validity of the modified two-contract procedure absent some compelling reason not to do so.

The Court, as set forth above, previously expressed two key concerns with the original two-contract procedure. Both of those concerns, however, have been substantially addressed by the modifications Clark & Washington made to its two-contract procedure. To begin with, under the modified two-contract procedure, the prepetition agreement now (i) more fully sets out the costs and fees associated with filing the client's case; and (ii) specifies the client's three options for postpetition legal services. Moreover, Clark & Washington's initial Rule 2016 disclosure statement explicitly specifies that the prepetition fee is $250 and that the contract between the client and the firm does not include postpetition services. Finally, the two-contract procedure contemplates the firm filing a supplemental disclosure that sets out the additional $1,000 fee in the event the client retains Clark & Washington for postpetition services.

That leaves the three concerns raised by the U.S. Trustee.[14] First, the U.S. Trustee contends that, under the modified two-contract procedure, debtors are forced to proceed pro se from the time their petitions are filed until they decide whether to retain Clark & Washington or another firm (or continue proceeding pro se). According to the U.S. Trustee, this could cause problems because the client has to provide information to the chapter 7 trustee and prepare for the meeting of credi-

7. Doc. No. 56.

8. *Id.*

9. *Id.*

10. *Id.*

11. The Court has jurisdiction over this miscellaneous proceeding under section 28 U.S.C. § 1334(b) and 11 U.S.C. §§ 544, 548, and 550. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (H), and (O).

12. *Bethea v. Robert J. Adams & Assocs.,* 352 F.3d 1125, 1128 (7th Cir.2003).

13. *Lamie v. Trustee,* 540 U.S. 526, 535–36, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004).

14. Doc. No. 57.

tors during this "gap" period, and the client will be left without representation. Making matters worse, creditors, other lawyers, and the chapter 7 trustee will not know the client is proceeding pro se during the gap period. Second, the U.S. Trustee contends that the disclosures contained in Clark & Washington's prepetition and postpetition contracts are insufficient. Third, the U.S. Trustee says the two-contract procedure is simply unnecessary as there are other alternatives.

The first two concerns are valid. But neither of them warrants precluding Clark & Washington from implementing its modified two-contract procedure. To begin with, Clark & Washington has already addressed the U.S. Trustee's concern that clients will be left unrepresented. Under the modified two-contract procedure, the firm agrees to continue representing the client during the two-week "cooling off" period. And if the client opts to retain another firm or continue pro se, Clark & Washington will continue to represent the client until the Court enters an order allowing the firm to withdraw. In order to leave no doubt, the Court will require Clark & Washington to include in its initial Rule 2016 statement that the firm will represent the client until the Court enters an order allowing the firm to withdraw from representation. So that adequately resolves the U.S. Trustee's first concern.

The second concern—inadequate disclosure—is admittedly more problematic. In fact, Clark & Washington concedes the disclosures in its modified two-contract procedure could be improved. For starters, it has agreed—and the Court will require—that the firm move the "Two—Contract Procedure" disclosure from the end of each contract to a separate cover page. In addition, the firm has agreed to have their clients sign and acknowledge that they have received and read the two-contract procedure disclosures. These modifications resolve the U.S. Trustee's second concern.

As for the U.S. Trustee's third concern, the Court is not persuaded that the two-contract procedure is objectionable simply because there may be other alternatives. In this regard, the U.S. Trustee contends that there are other approaches that would allow individuals with modest means to obtain legal representation. Yet the U.S. Trustee does not identify any of those other approaches. And in any event, that is not the standard. Clark & Washington is not precluded from using one fee arrangement simply because other arrangements may exist.

Conclusion

[1, 2] In the end, there is no prohibition against a debtor making postpetition installment payments for postpetition services. The Court concludes that Clark & Washington's two-contract procedure—with the modifications directed by the Court and agreed to by the firm—does not violate the Court's July 12, 2011 Memorandum Opinion. Nor does it conflict with any applicable Bankruptcy Code provision or rule of professional conduct. Accordingly, it is

ORDERED:

1. Clark & Washington's new two-contract procedure set forth in the exhibits attached to its November 28, 2011 Response to the Court [15] is approved with the following modifications:

a. The "two-contract procedure" disclosure currently on pages 4–5 of the prepetition agreement and page 5 of the postpetition agreement must be set forth on a separate cover page.

15. Doc. No. 56.

b. Firm clients must acknowledge that they have received and read the "two-contract procedure" disclosure.

c. The client must execute the prepetition agreement before the bankruptcy case is filed and the postpetition agreement after the bankruptcy case is filed.

d. The postpetition agreement shall contain a provision notifying the client that (i) the client has the right to cancel the postpetition agreement—and all financial obligations arising under that agreement—at any time within 14 days after signing it; and (ii) the client may exercise his or her right to cancel the postpetition agreement by notifying Clark & Washington in writing (at the address designated by the firm) within 14 days after signing the agreement of his or her intent to cancel the agreement.

e. Clark & Washington shall include language in its initial Rule 2016 disclosure stating that the firm will continue to represent the debtor in the case even where the debtor chooses not to retain the firm for postpetition services until the Court enters an order allowing the firm to withdraw from representation.

2. The Court reserves jurisdiction to enforce the terms of this Order.

DONE and **ORDERED.**

Craig PIAZZA, Appellant,

v.

NUETERRA HEALTHCARE PHYSICAL THERAPY, LLC, Appellee.

No. 0:11–cv–62569–KMM.

United States District Court, S.D. Florida.

April 26, 2012.

Background: Judgment creditor moved to dismiss debtor's Chapter 7 case as abuse of provisions of Chapter 7 and for bad faith under "for cause" dismissal provision. The Bankruptcy Court, John K. Olson, J., 451 B.R. 608, granted motion to dismiss, to extent brought under "for cause" provision, and debtor appealed.

Holdings: The District Court, K. Michael Moore, J., held that:

(1) debtor's bad faith in filing Chapter 7 petition can constitute "cause" for dismissal of case under "for cause" dismissal provision, and

(2) Chapter 7 case that was filed, not in response to any sudden financial disaster, but in attempt to frustrate creditor's attempts to collect on large judgment debt that accounted for roughly 55% of debtor's total liabilities, was properly dismissed as filed in "bad faith."

Affirmed.

1. Bankruptcy ⚿3782, 3786

On appeal, district court must accept bankruptcy court's factual findings unless they are clearly erroneous, but reviews bankruptcy court's legal conclusions de novo. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

2022 WL 1599973
Only the Westlaw citation is currently available.
United States Bankruptcy Court, M.D. Florida,
Tampa Division.

IN RE: Jeffrey SHATUSKY, Debtor.

Case No. 8:22-bk-00131-RCT
|
Filed 03/18/2022

Attorneys and Law Firms

Alan D. Borden, Debt Relief Legal Group, LLC, Erik Johanson, Erik Johanson PLLC, Tampa, FL, for Debtor.

Chapter 7

ORDER DENYING JOINT MOTION TO APPROVE POST-PETITION ATTORNEY FEE FINANCING ARRANGEMENT, WITHOUT PREJUDICE, AND ORDER ON UNITED STATES TRUSTEE'S MOTION TO REVIEW ATTORNEYS' TRANSACTIONS WITH THE DEBTOR

Roberta A. Colton, United States Bankruptcy Judge

***1** In *Lamie v. United States Trustee*, [1] the Supreme Court held that counsel for a Chapter 7 debtor cannot be paid from the bankruptcy estate and that any amounts due to counsel at the time the bankruptcy petition is filed are dischargeable. Since then, courts and consumer attorneys have struggled to find a way to help Chapter 7 debtors who cannot afford counsel on the front end of a bankruptcy case to avoid having to file their cases without the assistance of counsel.

To address the problem of unrepresented consumer debtors, courts have considered bifurcated contracts that separate pre-petition services from post-petition services. With a few exceptions, bifurcated contracts are a recognized tool to assist debtors who have insufficient cash upfront to hire an attorney to file a Chapter 7 bankruptcy case. [2] Of course, bifurcated contracts are permissible only if they meet stringent ethical and statutory requirements. Bankruptcy courts play an important role in policing bifurcated contracts to avoid abuse of vulnerable debtors and to ensure compliance with the Bankruptcy Code.

With a typical bifurcated contract, a debtor pays little or nothing up front for pre-petition services and then enters into a separate agreement with counsel for post-petition services. The burden falls on debtor's counsel to finance the fees for post-petition work by waiting for payments over time. To ease this burden, consumer attorneys first turned to factoring arrangements, where attorneys sell their receivables to third parties at a discount, with complex representations, warranties, and buy-back provisions. Factoring arrangements have faced mixed results in bankruptcy. [3]

This case represents the next chapter in the saga. Jeffrey Shatusky ("Debtor") did not have enough money to pay the lump sum attorney's fees for a Chapter 7 petition because his wages had been garnished. So, he signed a bifurcated fee agreement with his attorney's law firm, Debt Relief Legal Group, LLC ("DRLG"). Pre-bankruptcy he paid his own filing fee, and DRLG agreed to represent him *pro bono*. Post-filing, he signed a second agreement to pay a flat $2,000 fee either from his own resources or with a loan from Rebound Capital, LLC ("Rebound"). The lending arrangement was prearranged by DRLG. [4] Debtor elected to go with Rebound.

***2** With this brief background, and after a preliminary hearing on February 17, 2022, the Court considers two motions: (1) Debtor and Rebound's Expedited Joint Motion to Approve Post-Petition Financing Arrangement (Doc. 9) (the "Approval Motion"), the United States Trustee's Objection (Doc. 18), and Debtor and Rebound's Joint Reply (Doc. 22); and (2) the United States Trustee's Motion to Review Attorneys' Transactions with the Debtor and Grant Related Relief (Doc. 19) (the "UST Motion") and Debtor and Rebound's Joint Reply (Doc. 22).

In the Approval Motion, Debtor and Rebound seek approval of both the bifurcated fee arrangement (more specifically, the post-petition agreement between Debtor and DRLG), as well as the proposed financing agreement with Rebound. The UST Motion asks the Court (i) to review the pre- and post-petition agreements signed by Debtor; (ii) to cancel the post-petition bankruptcy agreement between Debtor and DRLG; (iii) to cancel the financing agreement between Debtor and Rebound; and (iv) to order DRLG to disgorge all of the attorney's fees received.

As explained below, the Court denies the Approval Motion without prejudice. The proposed bifurcated contract between Debtor and DRLG is permissible in principle, but it contains

deficiencies which preclude approval as filed. Likewise, the proposed arrangement with Rebound needs further refinement before it can be properly evaluated. With respect to the UST Motion, the Court grants the request to review both the pre- and post-petition contracts. Otherwise, the UST Motion is denied without prejudice. The Court will give Debtor and Rebound the opportunity to amend the existing agreements, consistent with this Order. The United States Trustee will then have an opportunity to weigh in on the amended documents.

I. Background

Debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code on January 12, 2022. Prior to that date, Debtor consulted with DRLG regarding his suitability for filing for bankruptcy. Debtor was having difficulties supporting his family due to a pending wage garnishment. DRLG determined that if Debtor could eliminate the wage garnishment and other liabilities, Debtor would be able to pay his debts as they came due post-discharge and rebuild his credit.

Bifurcated Fee Agreements [5]

DRLG offered Debtor two options to pay for DRLG's legal services. Under Option One, Debtor could pay a discounted flat fee of $1,800 before the filing of his bankruptcy petition, [6] and DRLG would represent Debtor through discharge. Under Option Two, Debtor could retain DRLG using the law firm's bifurcated retainer program (the "Two Contract Program"). Under the Two Contract Program, Debtor would sign a pre-petition contract, and DRLG would agree to represent Debtor *pro bono* to prepare the basic documents necessary to initiate his Chapter 7 case (the "First Contract"). Thereafter, Debtor would have the option of signing a post-petition agreement for DRLG to perform the remaining routine services necessary to represent Debtor through discharge for a flat fee of $2,000 (the "Second Contract").

Post-Petition Financing

***3** If Debtor elected Option Two, but lacked the ability to pay $2,000, DRLG informed Debtor that the fees could be paid through a financing arrangement offered by Rebound. Rebound would pay the $2,000 fee in full and, in exchange, Debtor would repay Rebound the $2,000 plus interest at a 17.99% interest rate. Debtor would repay Rebound in twelve monthly payments of $183.35, for a total amount due (including interest) of $2,200.20. (Doc. 9-1, p. 7).

If Debtor chose to finance his post-petition attorney's fees with Rebound, then Rebound would separately invoice DRLG for a processing fee of $120. Rebound would not deduct the $120 processing fee from the $2,000 fee Rebound paid to DRLG. Instead, DRLG would separately pay Rebound the $120 processing fee after being invoiced.

Debtor Chooses Option Two

Debtor chose Option Two. He signed the First Contract for *pro bono* services on January 11, 2022, which states in part:

> **Pre-petition Services.** Client understands that Firm is going to charge $ 0 for the following pre-petition bankruptcy services: (a) informing Client of Client's rights and responsibilities under the bankruptcy laws; (b) providing consultation to enable the Client to make an informed decision about filing Chapter 7; (c) advising Client of all available exemptions; (d) assisting the Client in complying with all of the requirements imposed by the bankruptcy laws and rules; (e) sending any pre-filing correspondence; (f) calculating current monthly income to determine if any presumption of abuse would arise under the Bankruptcy Code; (g) preparation and filing of the Chapter 7 Voluntary Petition, Statement of Social Security Number, Pre-filing Credit Counseling Certificate, and the List of Creditors.
>
> Client understands that once the bankruptcy is filed, Client will not be legally obligated to pay Firm any attorney fees for pre-petition services. ...
>
> **Fees and Costs NOT Covered.** The fee above does NOT include certain mandatory costs associated with the preparation for and the prosecution of this case including, but not limited to, the mandatory Court filing fee ($338.00) and fees for credit reports ($40.00 each).

(Doc. 19-1, p. 2). The First Contract also provides that Debtor must pay his bankruptcy filing fee of $338 in full or apply to the bankruptcy court to pay the filing fee in installments. (Doc. 19-1, p. 2). Debtor paid the filing fee, in full, with his petition.

The First Contract included a separate document entitled, "Two Contract Procedure Disclosure" (the "Disclosure") that explains DRLG's Two Contract Program and discusses Debtor's post-petition options:

> **Post-petition Options.** This Pre-Petition Agreement contemplates that Firm will provide all of the necessary services required for commencing a Chapter 7 bankruptcy case on Client's behalf. Client understands that there is remaining post-petition legal work which is necessary to finish the bankruptcy case in order to receive an Order of Discharge. Failure to timely file the balance of Client's bankruptcy pleadings, provide necessary documentation to interested parties, or attend mandatory meetings may result in dismissal of Client's case and prejudice Client's right to file subsequent bankruptcy cases. Firm's contractual responsibilities will end upon completion of the filing of the bankruptcy case. However, Firm will remain professionally obligated to serve as counsel of record for the Client until the Bankruptcy Court allows Firm to formally withdraw.
>
> ***4** After the bankruptcy case is filed, Client shall have three options regarding post-petition representation as set forth below.

(Doc. 19-1, p. 7).

The Disclosure then sets forth the three options: (1) Debtor can retain DRLG post-petition; (2) Debtor can retain other legal counsel post-petition; or (3) Debtor can proceed *pro se* post-petition. If Debtor chooses to retain DRLG post-petition, the Disclosure informs Debtor that he would sign the Second Contract for post-petition services. The Disclosure further informs Debtor that if he retains DRLG for post-petition services, he can pay the legal fees for those services from his own resources, or he can finance the legal fees through Rebound, if Rebound approves of him for the financing.

The Disclosure sets forth the timeline for selecting one of these three options and provides that DRLG will continue to represent him under options (2) and (3) until the bankruptcy court enters an order authorizing DRLG to withdraw:

> **Timeline to Retain Firm Post-Petition.** Client shall have **fifteen (15) days** from the date Client's bankruptcy case is filed to retain Firm for the post-petition services in this case. If Client does not formally retain Firm within that period, then Client agrees and consents to Firm's withdrawal as counsel in this case and Firm may file a motion to withdraw as Client's attorney but will continue to represent Client until such time when the Court enters an order authorizing Firm to withdraw as Client's attorney in the bankruptcy case.

(Doc. 19-2, p. 8). Debtor signed and acknowledged the Disclosure.

The Post-Petition Agreement with DRLG

On January 17, 2022, after his Chapter 7 petition was filed, Debtor signed the Second Contract retaining DRLG for post-petition services. (Doc. 9-1). The introduction to the Second Contract states:

> Client agrees to employ Firm to represent Client in Client's pending Chapter 7 bankruptcy case (Case No. 22-00131). **Client has been advised that Client is not obligated to sign this Post-Petition Agreement and that Client may consult with another attorney as to whether Client should do so. Client has further been advised that Client may choose to retain another attorney apart from Firm, or proceed without legal representation in which case Firm will continue to represent Client until such time as the Court enters an Order authorizing Firm to withdraw from Client's bankruptcy case, or Client's bankruptcy case is closed or dismissed.**

(Doc. 9-1, p. 1).

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The Second Contract describes the base legal services that are included and identifies certain services that are not included but that can be added for an additional fee:

2. Base Legal Services. The Base Legal Services included in this Post-Petition Agreement are the following:

• Preparing and filing Your Statement of Financial Affairs and Schedules of Assets and Liabilities and filing any necessary amendments to them (Required);

• Preparing and filing Your Means Test calculations and disclosures (Required);

• Meeting with You to review Your statements and schedules and have You sign them before we file them; (Required);

• Preparing for and attending Your Section 341 Meeting of Creditors, including any continuation of the Meeting (Required);

***5** • Administrating and monitoring Your case and communicating with You throughout the process (Required);

• Forwarding the Trustee Questionnaire and debtor documents to the Trustee (Required);

• Review and responding to Trustee requests (Required);

• Noticing Your employer to stop any garnishments;

• Reviewing and advising You about any turnover demands from the Trustee;

• Reviewing and advising You about any Rule 2004 examinations and attending such an examination;

• Reviewing and advising You about any audit of Your case by the United States Trustee;

• Drafting or responding to claims or objections to claims;

• Preparing and filing a motion to reinstate Your case if it is dismissed;

• Reviewing and advising You regarding any motions for stay relief;

• Reviewing, advising You about, negotiating and attending any hearing about a proposed reaffirmation agreement or redemption;

• Reviewing and advising You about any lien avoidance matters;

• Reviewing and advising You regarding any creditor violations;

• Any other legal service required by the local rules (Required); and

• Enrolling Client into a credit reporting and education program after You obtain Your bankruptcy discharge that will monitor and assist the Client with rebuilding Your credit.

* * *

3. Non-Base Legal Services. Legal services that exceed the scope of the Base Legal Services contemplated by the Retainer Fee may be provided by Firm post-petition for an additional fee, including but not limited to representing Client in: (a) converting the case to a Chapter 13 ($3,700-$4,200); (b) motion for mortgage modification ($1,800-$2,400); (c) Section 523 or 727 objections to discharge; (d) discharge proceedings, including those related to student loans, taxes or undue hardships; (e) motions for relief from, or continuation, defense or enforcement of the automatic stay (f) motions to redeem personal property($600.00); (g) rule 2004 examinations; (h) motions to avoid liens/judgments($500.00); (i) adversary proceedings; (j) contested matters regarding Client's claim of exempt property; (k) filing any amendments to the schedules; (l) motions to continue the 341 meeting of creditors and/or appearing for a continued 341 hearing ($150.00); (m) motions or adversary complaints to abandon/refinance/sell/purchase property; (m) assisting in carrying out the Debtor's Statement of Intentions; (n) monitoring an “asset case”; (o) reopening a bankruptcy case to submit post-filing proof of predischarge counseling; (p) representing You in any municipal, county, state or other local jurisdiction court matters; (q) representing You in any tax matters; (r) representing You in any efforts to discharge student loans; (s) pursuing creditors for violations of the automatic stay, discharge injunction or Fair Credit Reporting Act; and (t) issues that arise that are not specifically listed in the Bankruptcy Services section. For such Non-Base Legal Services, Client will be charged $395.00 per hour for attorney time and $175/hour for paraprofessional time billed in 6-minute minimum increments, unless a flat fee is indicated. Non-Base Legal Services will not be provided by Firm unless a separate

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retainer agreement is executed by Firm and Client upon mutually acceptable terms.

***6** (Doc. 9-1, p. 2-3).

The Second Contract contains the following termination provision:

> **18. Termination Policy. Client has the right to cancel this Post-Petition Agreement and all financial obligations arising under that Post-Petition Agreement at any time within fourteen (14) days after signing it. Client may exercise Client's right to cancel the Post-Petition Agreement by notifying Firm in writing of Client's intent to cancel at 901 W Hillsborough Ave., Tampa, FL 33603. Upon receipt of said notice, Client consents to Firm's withdrawal as attorney of record in Client's pending bankruptcy case. Firm shall continue to represent Client until the Court enters an Order allowing Firm to withdraw from representation.**

(Doc. 9-1, p. 6).

Finally, the Second Contract includes the essential terms of the financing offered by Rebound.

The Financing Agreement with Rebound

The final document signed by Debtor is a relatively simple financing agreement with Rebound (the "Financing Agreement"). (Doc. 19-2, p. 7-10). The terms in the Financing Agreement are the same as set forth in the Disclosure and the Second Contract with three notable additions: (i) a "Late Charge" of the greater of $20.00 or 5% of an installment if a monthly installment payment is more than 10 days late; (ii) an arbitration clause; and (iii) a statement that "[t]he Annual Percentage Rate may be negotiable with Rebound. Rebound may assign this Agreement and retain its right to receive a part of the Finance Charge." (Doc. 19-2, p. 7-9). The Financing Agreement also states that Debtor will not have to pay a prepayment penalty if he pays off the loan early.

II. Approval Motion and UST Motion

After signing the First Contract, the Second Contract, and the Financing Agreement, Debtor and Rebound, as well as the United States Trustee ("UST"), filed the instant motions seeking review of the agreements by this Court. The issues before the Court are: (1) whether the bifurcated contracts for Chapter 7 bankruptcy services between Debtor and DRLG should be approved because they meet the standards set forth in *Walton v. Clark & Washington, P.C. (In re Walton)*, 469 B.R. 383 (Bankr. M.D. Fla. 2012), and *In re Brown*, 631 B.R. 77 (Bankr. S.D. Fla. 2021); and (2) whether Rebound may finance the post-petition legal fees incurred by the Chapter 7 Debtor.

A. Bifurcated Contracts for Chapter 7 Bankruptcy Services

Walton and *Brown* both hold that bifurcated contracts for Chapter 7 services are permissible so long as they comply with ethical and statutory requirements.[7] This Court finds the analysis in both *Walton* and *Brown* to be thorough, comprehensive, and persuasive. And, in an effort to develop consistency, the Court will apply both *Walton* and *Brown* to Debtor's financial arrangements by focusing on the minimum requirements for an acceptable bifurcated contract.

However, this Court notes that in *Brown*, the UST specially represented to the Bankruptcy Court for the Southern District of Florida that it was "NOT, at this time, arguing that fee bifurcation in chapter 7 cases should be prohibited."[8] The UST now seems to take a more aggressive position. In opposition to the financing arrangement before the Court, the UST argues that bifurcated agreements are a "violation" of *Cadwell v. Kaufman, Englett & Lynd, PLLC*,[9] because the post-petition debt to be incurred by Debtor is intended to pay legal fees for a Chapter 7 case. So, the Court will address whether *Cadwell* prohibits bifurcated fee agreements in Chapter 7.[10]

***7** *Cadwell* did not involve a bifurcated fee agreement, but the Eleventh Circuit's analysis of 11 U.S.C. § 526(a)(4) is instructive. In *Cadwell*, a potential Chapter 7 debtor hired a law firm to help him file a Chapter 7 petition.[11] The client agreed to pay the law firm $1,700 in six installment payments

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before the bankruptcy petition would be filed. [12] According to the client, the law firm instructed him to make the six payments using a credit card. [13] After making four of the payments on two different credit cards, the client sued the law firm in federal district court for violating 11 U.S.C. § 526(a)(4). [14] Section 526(a)(4) prohibits law firms from advising a potential debtor "to incur more debt ... to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a [bankruptcy] case." [15]

Assuming the allegations of the client's complaint to be true, the district court nevertheless granted the law firm's motion to dismiss for failure to state a claim, concluding that the mere advice by the law firm to use a credit card to pay legal fees did not violate § 526(a)(4). [16] On appeal, the Eleventh Circuit reversed and stated that § 526(a)(4) "forbids lawyers from advising their clients 'to incur more debt ... to pay an attorney ... a fee or charge for services performed as part of preparing for or representing a debtor in a [bankruptcy] case.' " [17] The Eleventh Circuit explained:

> That sort of advice is inherently abusive in at least two respects. First, it puts the attorney's financial interest—getting paid in full—ahead of the debtor-client's. If a creditor discovers the timing and reason for the fee-related debt, it could challenge the debt's dischargeability, thereby compromising the debtor's fresh start. Second, it puts the lawyer's own interests ahead of the creditors' in that, while ensuring the lawyer's full payment, it leaves a diminished estate on which creditors can draw. [18]

Thus, an attorney may not advise his client to incur debt in order to pay the attorney for bankruptcy-related legal services. [19] This is not a startling conclusion in light of the language of § 526(a)(4). And, because the allegations of the client's complaint were presumed true—namely, that the attorney instructed him to incur the credit card debt to pay for legal fees—the conclusion that the client stated a claim for relief under § 526(a)(4) makes perfect sense.

However, *Cadwell* goes on to clarify that § 526(a)(4) does not prohibit attorneys "from discussing with debtors potential options and their legal consequences." [20] Instead, § 526(a)(4) "merely prohibits [attorneys] from giving their clients 'affirmative advice' to incur more debt in order to pay for bankruptcy-related representation." [21]

The facts of *Cadwell* are unique because, by suing his attorneys, the client effectively waived any attorney-client privilege, and the courts had to presume (for purposes of the motion to dismiss) that the client's description of the "advice" from the attorney was true. Here, where Debtor has not waived the attorney-client privilege, the Disclosure is the operative document, and it does not recommend or advise Debtor to incur debt to pay DRLG's fees. Rather, the Disclosure presents options for paying for legal services: prepay the fee pre-petition (at a discount), pay the fee post-petition directly to counsel, or finance the fee post-petition through Rebound, a third-party financing company. It also presents other options available to Debtor that do not relate to DRLG, such as hiring a new attorney or proceeding in Chapter 7 without representation.

***8** Furthermore, neither of the two concerns raised in *Cadwell* are implicated in this case. Unlike in *Cadwell* (where the credit card debt was ostensibly dischargeable), here, the post-petition debt is not dischargeable and the nature and extent of Debtor's discharge of pre-petition debt is not implicated. Indeed, the conduct in *Cadwell* was arguably a fraud on the credit card company, with the attorney allegedly complicit in the fraud. The pre-petition credit card debt allegedly advised by the attorney in *Cadwell* would have reduced distributions to other creditors by increasing the overall debt of the estate and would have left the potential debtor vulnerable to a discharge challenge on grounds that the credit card debt was fraudulently incurred. Here, Debtor's bankruptcy estate is not impacted by the Second Contract for post-petition fees, as no additional debt is added to the estate. If anything, the bankruptcy estate is potentially enhanced by the limited pre-petition *pro bono* services provided by Debtor's counsel.

The Court, therefore, rejects the argument that bifurcated agreements are *per se* prohibited under *Cadwell* or 11 U.S.C. § 526(a)(4). As such, the Court will evaluate Debtor's bifurcated agreements under the standards set forth in *Brown* and *Walton*.

1. Adequate Disclosure to the Client

First, and foremost, *Brown* and *Walton* require adequate disclosure to the client. This means that the pre-petition agreement should clearly set forth the limited services provided pre-petition and the cost for such services.[22] Likewise, the post-petition agreement should clearly set forth the services being provided post-petition and the cost for such services.[23] The post-petition agreement should also clearly list the excluded and additional, optional services that the client can separately request the attorney to provide, as well as the additional costs for those services.[24] Finally, the post-petition agreement must clearly state that the obligation to pay fees under the post-petition fee agreement is not an obligation that will be discharged when the debtor receives his or her bankruptcy discharge.[25]

The client must be able to review both the pre-petition agreement and the post-petition agreement before signing the pre-petition agreement.[26] Along with the pre-petition agreement, the client should also be given a separate disclosure statement regarding the bifurcated fee arrangement that must be explained to the client and which the client must sign.[27] The disclosure statement should inform the client that he or she has the following three options for proceeding post-petition: (1) retain the same attorney post-petition; (2) retain a new attorney post-petition; or (3) proceed *pro se* post-petition after the Court allows the attorney to withdraw.[28] Finally, the client must sign the pre-petition agreement before the attorney files the bankruptcy petition, and the client must sign the post-petition agreement after the filing of the bankruptcy petition.[29]

2. Provision of the Required Pre-Petition Services

Second, counsel must agree to provide the required pre-petition services. This means that the attorney must initially meet with the client to ascertain whether filing bankruptcy is appropriate, and if so, the attorney must determine under what chapter a bankruptcy case should be filed.[30] The attorney also must adequately inform the potential debtor of the consequences of that choice.[31] The attorney must assist the client with all of the debtor's obligations under 11 U.S.C. § 521, unless the attorney is permitted to withdraw.[32] If the court's local rules address the services that the attorney must provide when representing a client, those rules must be considered.[33]

***9** "The attorney must prepare and file all documents necessary to commence the bankruptcy case, which includes, at a minimum, the petition, the creditor's matrix, any motion to waive or pay the filing fee in installments, the statement of attorney compensation, and the Debtor Credit Counseling Certificate, or, if applicable, a motion to waive the need to file or file late, the certificate."[34] The attorney must also attend the section 341 meeting of creditors, unless the attorney is permitted to withdraw prior to the meeting.[35]

3. Cooling Off Period

Third, the client must be given at least a 14-day cooling off period. This means that the client must be given either: (1) 14 days after signing the post-petition agreement to cancel the agreement, or (2) a 14-day cooling off period between filing the petition and signing the post-petition agreement.[36] The attorney must continue to represent the client during the 14-day period, and if the client does not sign the post-petition agreement, the attorney must continue to represent the client until the court grants the attorney's motion to withdraw.[37]

4. Adequate Disclosure to the Court

Fourth, there must be adequate disclosure to the court. "Bankruptcy Rule 2016 requires that every attorney for a debtor (regardless of whether the attorney is applying for compensation) shall file the statement required by [Bankruptcy Code] section 329."[38] Furthermore, "[s]ection 329 requires a disclosure of the compensation paid or to be paid if the agreement was made within one year before the date of filing the petition ... and [the identification of] the source of the compensation."[39]

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For bifurcated fee agreements, adequate disclosure to the court means that the attorney must initially disclose to the Court the limited services to be provided under the pre-petition agreement and describe the payment for those services.[40] The attorney must also file a supplemental disclosure after the post-petition agreement is signed and describe the payment structure thereunder.[41]

5. Reasonable Fees

Fifth, the fees charged both pre-petition and post-petition must be reasonable. The reasonableness of the fees is analyzed on the basis of the services being provided, not compared to each other (*i.e.*, the amount of pre-petition fees is not simply compared to the amount of post-petition fees).[42] The amount of a " 'flat fee must bear some relationship to the work that will likely be required, which inevitably depends on the unique facts and circumstances of the case.' "[43] Thus, when reviewing the reasonableness of fees after-the-fact, courts will review the reasonableness of a post-petition flat fee charged "by taking into account not only the work that was done but also the services that might have been required in the case for which there would have been no additional charge."[44] In determining the reasonableness of a flat fee, courts "should not consider services that would not possibly arise in the case, such as dealing with student loan issues when the debtor does not have student loans."[45] Finally, when any of the required pre-petition services are promised post-petition, those required pre-petition services cannot be considered in determining the reasonableness of the post-petition flat fee charged.[46]

6. Filing Fee

***10** Sixth, the attorney's law firm cannot pay the filing fee for the client and then seek repayment post-petition.[47] The filing fee is due with the filing of the petition, and as such, that pre-petition obligation is dischargeable.[48]

7. Applying the *Brown/Walton* Requirements

Many of the requirements articulated in *Brown* and *Walton* are present here. The pre-petition contract signed by Debtor offers limited *pro bono* assistance. Under the local rules of this Court, unbundling or limiting services is permissible if the attorney is acting *pro bono*. Specifically, this Court's Local Rule 2091-1 provides that "an attorney who provides *pro bono* representation to a debtor may limit the representation to specified tasks in accordance with the Rules of Professional Conduct." This limited services exception for *pro bono* representation makes sense, and the UST does not seriously challenge the First Contract for *pro bono* services between Debtor and DRLG. Rather, the UST argues that DRLG is using the Two Contract Program to recoup its fees for pre-petition work, if the client signs the Second Contract. But the fact remains that DRLG provides limited *pro bono* services and assumes the risk that Debtor will not sign the post-petition Second Contract.

There is also no issue here with respect to the filing fee. Debtor is responsible for the fee whether paid in full pre-petition or paid in installments post-petition. Debtor chose to pay the fee in full pre-petition.

Finally, there is no suggestion that Debtor did not have an opportunity to review the Second Contract before signing the First Contract or that Debtor was given insufficient time to consider or rescind the Second Contract. Debtor was provided with a 15-day period to retain counsel after the bankruptcy petition was filed, as well as a 14-day cooling off period after Debtor signed the Second Contract.

a. Adequate Disclosures

All that said, the Court agrees with the UST that certain disclosure deficiencies in DRLG's Two Contract Program exist. First, setting aside the financing disclosures (which are discussed later), the Second Contract purports to distinguish "Base Legal Services" (which are included in the flat fee) from "Non-Base Legal Services" (which may be provided on an hourly basis or at an additional flat-fee basis post-petition). Unfortunately, there is overlap and ambiguity between the base and non-base services. As examples:

> **Base Legal Services Non-Base Legal Services** Preparing and filing schedules and any (k) filing amendments to the schedules amendments to them Attending the 341 meeting and any (l) appearing for a continued 341 meeting continuations

> Administrating and monitoring the case (n) monitoring an "asset case" Reviewing and advising about any Rule 2004 (g) Rule 2004 examinations examinations and attending such examinations Reviewing and advising regarding motions for (e) motions for relief from stay, or stay relief continuation, defense, or enforcement of the automatic stay Reviewing and advising regarding lien (h) motions to avoid liens avoidance matters
>
> You are not required to sign this Post-Petition Agreement, but Firm filed Your case hoping that You would sign it, and this creates a conflict of interest between You and the Firm since executing this Post-Petition Agreement obligates You to make payments that will not be discharged in Your bankruptcy.

At the preliminary hearing, DRLG acknowledged this overlap and ambiguity, but counsel argued that the ambiguity is necessary "just in case." Counsel's explanation/justification is not sufficient. There must be a clear delineation of the base legal services being provided and those that are not. Without such a delineation, it is impossible for the client (or the court) to determine the reasonableness of the flat fee charged. Reasonableness is evaluated based on the specific services that counsel has agreed to provide. With a flat fee, counsel will never know for certain what post-petition services will be necessary. As with any flat fee, the law firm hopes that most of the time it will make money, but it knows that sometimes it will not. In any event, the services that the law firm agrees to provide must be clearly disclosed, and such services must be provided if they are necessary.

***11** For example, in this case, the UST has moved to dismiss Debtor's case under 11 U.S.C. § 707(b)(3). (Doc. 24). In that motion, the UST argues that, although Debtor remains below medium income under the Means Test, Debtor's bankruptcy is abusive because, without the garnishment in place, Debtor can repay his creditors. Setting aside the merits of the UST's motion to dismiss, it is unclear whether DRLG's flat fee includes defense of the motion.

Second, DRLG also must conspicuously disclose that the obligation to pay post-petition fees will not be discharged. Although the Second Contract has some appropriate language, it is not clearly brought to Debtor's attention. Instead, it is hidden in Section 14, which is titled, "Important Information about Conflicts of Interest." (Doc. 9-1, p. 4). Paragraph C of Section 14 states, in relevant part:

(Doc. 9-1, p. 4). The fact that Debtor's obligation to pay fees under the Second Contract is not an obligation that will be discharged when Debtor receives his bankruptcy discharge needs to be more conspicuously set forth in the Second Contract.

Third, the Second Contract and proposed financing must be disclosed to the Court in the form of a supplemental disclosure statement filed within 14 days after the Second Contract is signed, as required by Bankruptcy Rule 2016(b). Rule 2016(b) plainly contemplates the filing of a supplement "within 14 days after any payment or agreement not previously disclosed." In this case, although the Second Contract is attached to the Approval Motion, Debtor's counsel has not yet filed a supplemental disclosure under Rule 2016(b).

b. Reasonable Fees

The UST challenges the reasonableness of the $2,000 flat fee charged by Debtor's counsel. By comparing the work that was supposed to be done pre-petition with the work to be done post-petition, the UST assumes the Second Contract necessarily compensates the attorney for pre-petition work. This comparison analysis has been rejected by at least two courts, including *Brown*, because the reasonableness of pre- and post-petition fees must be evaluated independently and "not compared to each other."[49] Nevertheless, until it is clear what services are and are not included in $2,000 flat fee, it is premature for the Court to determine if the $2,000 flat fee is reasonable or consistent with the Local Rules of this Court.[50]

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c. Other Considerations

Brown and *Walton* lay out the *minimum* requirements for an acceptable bifurcated contract for Chapter 7 bankruptcy services. There are other concerns as well. The UST has identified the following issues, which the Court agrees are not properly dealt with in the signed agreements before the Court: (1) DRLG may not share Debtor's financial information with Rebound; (2) DRLG may not reveal attorney-client privileged information to Rebound; (3) DRLG must continue to represent Debtor in the bankruptcy case, even if Debtor fails to make all of the required payments to Rebound and Rebound pursues collection activities against Debtor; (4) any services provided to Debtor, beyond what is included within the flat fee, must be under a separate and properly disclosed agreement; (5) the refund policy in the Second Contract, which states that fees that are paid are earned and non-refundable, must be modified to disclose that fees will be refunded if the Bankruptcy Court orders DRLG to do so; and (6) the Second Contract should provide that Debtor may opt-out from receiving communications from DRLG via automated dialers and prerecorded messages.

***12** The Court will not spend much time with these concerns because Debtor, DRLG, and Rebound have agreed to address them. Debtor and Rebound attached to their reply brief an amended draft version of the Second Contract, which has not been signed by Debtor or DRLG. (Doc. No. 22). However, the Court will not approve or review the draft document and give an advisory opinion. [51]

B. Financing Post-Petition Legal Fees

The next question is whether Rebound may finance Debtor's post-petition legal fees under the Financing Agreement. Specifically, Rebound offers to pay $2,000 to DRLG. In exchange, Debtor agrees to repay Rebound $2,000 plus interest at 17.99% in twelve monthly payments of $183.35, for a total amount due (including interest) of $2,200.20. (Doc. 9-1, p. 7).

There is also an agreement between Rebound and DRLG (a copy of which is not before the Court) that provides that Rebound will separately invoice DRLG a processing fee of $120 for this financing arrangement. Rebound will not deduct the $120 processing fee from the $2,000 Rebound pays to DRLG. Instead, DRLG will separately pay Rebound the $120 processing fee after Rebound invoices DRLG. This arrangement between Rebound and DRLG was not disclosed to Debtor.

Generally, a bankruptcy court does not get involved in a Chapter 7 debtor's post-petition financial affairs. [52] However, because the Financing Agreement is part of a larger agreement to bifurcate Chapter 7 attorney fees, review of the Financing Agreement is appropriate and necessary. [53]

A non-binding advisory opinion by the Florida Bar appears to condone an attorney offering clients options for financing attorney's fees with an independent, third-party lender. [54] Likewise, an opinion from the American Bar Association [55] emphasizes the need for counsel's independence from the lender to avoid the prospect of an attorney doing business with a client—conduct expressly prohibited by Florida Rule of Professional Conduct 4-1.8(a). Here, Rebound's counsel indicated during the preliminary hearing that an ethical opinion from the Florida Bar was being sought (and it may have since been obtained) to evaluate the proposed financing arrangement under the Florida Rules of Professional Conduct. Nevertheless, the propriety of the financing arrangement under the Bankruptcy Code is quite a different issue.

The parties have not cited to, and the Court has not been able to find, cases analyzing the issue of third-party financing arrangements like what is proposed here. [56] However, Debtor's financing arrangement again implicates § 526(a)(4). That statute states that a "debt relief agency," such as DRLG, shall not:

> ***13** advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title. [57]

As discussed above, the operative prohibition in § 526(a)(4) is to "advise." Presenting or discussing options, and their legal ramifications, is not advice withing the meaning

of this statute.[58] The Disclosure given to Debtor provides options and states that post-petition legal fees "may be paid in full from Client's own resources" or "may be financed, if approved, by a third-party finance company, Rebound Capital, LLC."[59] Simply presenting a financing option from an independent third-party does not, itself, violate § 526(a)(4).

That said, the three-party (Debtor, DRLG, and Rebound) financing arrangement here requires far more disclosure than what was given to Debtor or the Court. On its face, certain provisions in the Second Contract (which DRLG and Rebound have agreed to remove) and the high interest rate in the Financing Agreement,[60] suggest a relationship between DRLG and Rebound that may not be entirely independent and which may have the potential for abuse. But it also suggests to the Court that the relationship is a work in progress.

At a minimum, a description of the relationship between DRLG and Rebound, as well as the fact that DRLG will pay Rebound a $120 processing fee, should be disclosed to Debtor before he signs the First Agreement. And, if any member of DRLG is or becomes involved with Rebound financially or managerially, this certainly must be disclosed to Debtor (and the Court) so that the arrangement can be properly evaluated under the Bankruptcy Code.[61]

III. Conclusion

The Court is sensitive to the problem of unrepresented debtors struggling with the intricacies of bankruptcy law. *Pro se* debtors also tend to consume more judicial time and resources than represented debtors, and the Middle District of Florida has one of highest number of *pro se* debtors in the country. The Court is also sensitive to the realities of practicing law and the burden on debtors' counsel of carrying the costs of representing consumer debtors. Some have suggested that consumers who cannot afford to file a Chapter 7 bankruptcy case should simply file under Chapter 13, where it is permissible to pay attorneys' fees post-petition. But the flat rate fee proposed for this Chapter 7 case is $2,000, while the flat rate for a Chapter 13 case in the Middle District of Florida is $4,500. That is not realistic or fair to prospective debtors.[62] The concept of a bifurcated fee agreement is not perfect, and it is, admittedly, a work around that must be very carefully drafted and implemented. But with adequate disclosure and attention to detail, it can be crafted in such a way as to satisfy the requirements of the Bankruptcy Code.

***14** Accordingly, this Court finds no *per se* violation of the Bankruptcy Code with an optional two-contract approach that bifurcates Chapter 7 legal fees, so long as the arrangement satisfies the *Brown/Walton* requirements and the Local Rules of the Court. Nor is it a violation § 526(a)(4) for an attorney to present a "third party" financing option to a client, so long as it is given as an option and not as affirmative advice to incur the debt. However, the signed Second Contract with DRLG and the signed Financing Agreement with Rebound cannot be approved or properly evaluated without further modification and disclosure.

For these reasons, it is **ORDERED**:

(1) The Court **GRANTS** the UST Motion (Doc. 19) to the extent the Trustee asks the Court to review the agreements before the Court; otherwise, the UST Motion is **DENIED** without prejudice.

(2) The Court **DENIES** without prejudice Debtor and Rebound's Approval Motion (Doc. 9).

(3) Debtor and Rebound shall have 30 days to file, consistent with this Order: (a) an amended bifurcated post-petition agreement between Debtor and DRLG (along with an amended disclosure document), (b) an appropriate Rule 2016 disclosure, and (c) an amended financing agreement between Rebound and Debtor.

(4) The United States Trustee thereafter will have 21 days to raise any further objections to the amended agreements.

(5) If an amended bifurcated post-petition agreement with an amended disclosure document, Rule 2016 disclosure, and/or an amended financing agreement is not timely filed by Debtor and Rebound, the request of the United States Trustee in the UST Motion to void the currently signed post-petition agreement between Debtor and Debtor's counsel, as well as the financing agreement between Debtor and Rebound, will be granted and those agreements will be cancelled.

Attorney Erik Johanson is directed to serve a copy of this order on interested parties who do not receive service by CM/ECF and file a proof of service within three days of its entry.

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All Citations

Slip Copy, 2022 WL 1599973

Footnotes

1 540 U.S. 526 (2004)

2 *Walton v. Clark & Washington, P.C. (In re Walton)*, 469 B.R. 383 (Bankr. M.D. Fla. 2012); *In re Brown*, 631 B.R. 77 (Bankr. S.D. Fla. 2021); *In re Hazlett*, No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019); *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020); *In re Milner*, 612 B.R. 415 (W.D. Ok. 2019). *But see In re Baldwin*, 2021 WL 4592265 (W.D. Ky. Oct. 5, 2021) (concluding that the bifurcated fee agreements before the court violated the Bankruptcy Code).

3 *See Baldwin*, 2021 WL 4592265 at *11 (holding that the factoring arrangement before the court failed to meet ethical and the statutory requirements); *Hazlett*, 2019 WL 1567751, at *12 (discouraging the use of the specific factoring arrangement before the court, as well as any similar arrangement, unless it strictly complied with the state's Rules of Professional Conduct and was fully disclosed, and even then, the court stated that such arrangement would be subject to court review).

4 At this stage of the proceedings, the relationship between DRLG and Rebound is not clear.

5 Bifurcated fee agreements are used to separate the Chapter 7 bankruptcy services counsel provides to a client pre-petition from those provided post-petition. *See Brown*, 631 B.R. at 91. The purpose of such bifurcation is that attorney's fees for pre-petition services are not collectible post-petition due to the automatic stay and then the Chapter 7 discharge, whereas the fees for post-petition services remain collectible after the Chapter 7 discharge. *See In re Griffin*, 313 B.R. 757, 761-62 (Bankr. N.D. Ill. 2004) (citations omitted).

6 DRLG maintains that it typically charges a $2,000 flat fee for a Chapter 7 case.

7 *See Walton*, 469 B.R. at 387; *Brown*, 631 B.R. at 105.

8 *See Brown*, 631 B.R. at 91.

9 886 F.3d 1153 (11th Cir. 2018).

10 *Cadwell* was decided after *Walton*.

11 *See Cadwell*, 886 F.3d at 1155.

12 *See id.*

13 *See id.*

14 *See id.*

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15 11 U.S.C. § 526(a)(4).

16 *See* *Cadwell*, 886 F.3d at 1155.

17 *Id.* at 1159 (quoting 11 U.S.C. § 526(a)(4)).

18 *Id.* (internal citation omitted).

19 *See id.* at 1160.

20 *Id.* at 1161.

21 *Id.*

22 *See* *Brown*, 631 B.R. at 100.

23 *See id.*

24 *See id.*

25 *See id.* at 99-100.

26 *See id.* at 100.

27 *See* *Walton*, 469 B.R. at 388; *Brown*, 631 B.R. at 100.

28 *See* *Brown*, 631 B.R. at 100.

29 *See* *Walton*, 469 B.R. at 388.

30 *See* *Brown*, 631 B.R. at 95, 97-98.

31 *See id.* at 98.

32 *See id.*

33 For example, under Local Rule 2091-1 for the Middle District of Florida, a bankruptcy attorney may limit the services to be provided if the attorney is acting *pro bono*. The Southern District of Florida, in which the *Brown* court sits, does not have a similar local rule. *But see* *In re Charles Pernell Prophet v. John P. Fitzgerald, III, United States Trustee*, No. 4:21-cv-01081-JMC, 2022 WL 766390 (D. S.C. Mar. 14, 2022) (reversing the bankruptcy court's ruling that its local rule, which imposed continuing duties on bankruptcy counsel who file a bankruptcy petition, prohibited bifurcated fee agreements in Chapter 7).

34 *See* *Brown*, 631 B.R. at 98.

35 *See id.*

36 *See* *Walton*, 469 B.R. at 388; *Brown*, 631 B.R. at 99, 101.

37 *See* *Walton*, 469 B.R. at 388; *Brown*, 631 B.R. at 99.

38 *See* *Brown*, 631 B.R. at 100.

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39 *See id*.

40 *See* *Walton*, 469 B.R. at 386.

41 *See id*.

42 *See Brown*, 631 B.R. at 93-94.

43 *See id*. at 94 (quoting *In re Dabney*, 417 B.R. 826, 831 (Bankr. N.D. Ga. 2009)).

44 *See Brown*, 631 B.R. at 94.

45 *See id*.

46 *See id*. at 95.

47 *See id*. at 102-03.

48 *See id*.

49 *Brown*, 631 B.R. at 93; *accord* *Carr*, 613 B.R. at 438-39.

50 An evaluation of reasonableness requires an individualized review of the specific services being provided and requires submission of evidence. For example, in *Hazlett*, the court evaluated the reasonableness of the fees charged—zero owed pre-petition and a retainer of $2,400 charged post-petition to cover attorneys' fees and costs, including the $350 filing fee—on a motion for summary judgment. *See* *Hazlett*, 2019 WL 1567751, at *11.

51 The UST also argues that Debtor cannot afford to enter into the Second Contract. Specifically, the UST points out that according to Debtor's schedules, Debtor only has $19.99 in net monthly income after paying his expected expenses—not nearly enough to cover the $183.35 monthly fee in this case. (Doc. 8, p. 21). And yet, as described above, the UST now moves to dismiss Debtor's Chapter 7 case because Debtor can repay his creditors now that he has filed bankruptcy and his wage garnishment is eliminated. (Doc. 24).

52 *See In re Green*, No. 20-10694, 2020 WL 7487785, at *1 (Bankr. N.D. Ind. Aug. 31, 2020) (stating that "[t]he bankruptcy court has no jurisdiction over a Chapter 7 debtor's post-petition financial affairs, except to the extent that they may involve issues associated with a discharge").

53 *See, generally*, 11 U.S.C § 329.

54 *See* FL Eth. Op. 16-2 (Fla. St. Bar Assn.), 2016 WL 8648795 (Oct. 21, 2016).

55 LAWYER'S FEE, ABA Formal Op. 18-484 (Nov. 27, 2018).

56 The Court notes that this is not a factoring arrangement, and thus, cases evaluating factoring arrangements are not on point.

57 11 U.S.C. § 526(a)(4).

58 *See* *Cadwell*, 886 F.3d at 1161.

59 Doc. 19-1, p. 7.

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60 The Court urges reconsideration of the 17.99% interest rate charged by Rebound. It is very near 18%, which is the highest rate permitted under Florida law under these circumstances. *See* Fla. Stat. § 687.03(1). Anything higher is usurious under Florida law. *See* Fla. Stat. § 687.02(1).

61 At the preliminary hearing, it was suggested that if the Court approved the financing arrangement in this case, an attorney with DRLG would join Rebound in some capacity. This is an important consideration in evaluating the arrangement, and this information was not shared with Debtor.

62 Indeed, attorneys have been routinely criticized for channeling prospective debtors (particularly minority debtors) into filing under Chapter 13 when a Chapter 7 bankruptcy would be more appropriate. *See, e.g., ABI Commission on Consumer Bankruptcy*, 2017–2019 Final Report and Recommendations, at pp. 159-66, available at https://www.nclc.org/images/pdf/bankruptcy/rpt-abi-commission-on-consumer-bankruptcy.pdf; Katherine M. Porter, Pamela Foohey, Robert M. Lawless and Deborah Thorne, " 'No Money Down' Bankruptcy," 90 S. Cal. L. Rev. 1055 (2017), available at https://www.repository.law.indiana.edu/facpub/2639.

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KeyCite Yellow Flag - Negative Treatment
Declined to Extend by In re Muma Services, Inc., Bankr.D.Del., November 27, 2002

182 B.R. 186
United States District Court,
S.D. Ohio,
Eastern Division.

In re NATIONAL LIQUIDATORS, INC., Debtor.

No. C–2–94–1066.
|
Bankruptcy No. 93–56266.
|
April 18, 1995.

Synopsis
Chapter 11 **trustee** objected to fee application by unsecured creditors' **committee's** law firm. The Bankruptcy Court, Charles M. Caldwell, J., 171 B.R. 819, denied fee application in toto, based on finding that law firm inadequately disclosed dual **representation** of individual **committee** member and that firm represented adverse interest. On appeal, the District Court, Kinneary, J., held that: (1) evidence did not establish adverse interest; (2) concurrent **representation** did not give rise to appearance of impropriety; (3) although law firm's disclosure was inadequate, denial of all compensation was inequitable and draconian; and (4) appropriate sanction for failure to timely disclose was to be determined on remand.

Affirmed in part, reversed in part, and remanded.

West Headnotes (27)

[1] **Bankruptcy** Discretion
District court's review of bankruptcy court's retention and compensation orders is limited to abuse of discretion. Bankr.Code, 11 U.S.C.A. § 1103(a).

[2] **Bankruptcy** Conclusions of law; de novo review
Bankruptcy Clear error
District court follows bankruptcy court's findings of fact unless clearly erroneous, but when reviewing for abuse of discretion on questions of law, court exercises plenary review using de novo standard.

[3] **Bankruptcy** Creditors' and equity security holders' **committees** and meetings
Unsecured creditors **committee** is appointed to ensure protection for unsecured creditors in Chapter 11 reorganization proceedings, and is intended to be partisan representative of the different interests and concerns of creditors. Bankr.Code, 11 U.S.C.A. § 1102(a)(1).
1 Case that cites this headnote

[4] **Bankruptcy** Creditors' and equity security holders' **committees** and meetings
Primary function of unsecured creditors **committee** appointed in Chapter 11 reorganization proceedings is to advise creditors of their rights and proper course of conduct in bankruptcy proceedings. Bankr.Code, 11 U.S.C.A. § 1102(a)(1).
2 Cases that cite this headnote

[5] **Attorneys and Legal Services** Bankruptcy and debt collection
Bankruptcy Code provision governing attorney's dual **representation** of creditors **committee** and other entities, including **representation** of one or more creditors of same class as represented by **committee**, is intended to prevent attorney conflicts of interest, and thus it prohibits concurrent **representation** if such **representation** would interfere with **counsel's** vigorous advocacy for either client, jeopardize **counsel's** undivided loyalty to either client, or endanger confidences and secrets of either client, and it prohibits dual **representation** where there exists even appearance of impropriety. Bankr.Code, 11 U.S.C.A. § 1103(b); Ohio Code of Jud.Conduct, Canons 4, 5, 9.

3 Cases that cite this headnote

[6] **Attorneys and Legal Services** Bankruptcy and debt collection

Amendment to Bankruptcy Code provision governing attorney's dual **representation** of creditors **committee** and other entities, to remove per se rule against **representation** of one or more creditors of same class as represented by **committee**, did not alter prohibition of **counsel** representing individual creditor and creditor's **committee** if individual creditor hired **counsel** to litigate issues potentially adverse to other **committee** members. Bankr.Code, 11 U.S.C.A. § 1103(b).

5 Cases that cite this headnote

[7] **Bankruptcy** Creditors' and equity security holders' **committees** and meetings

Creditors **committees**, with aid of their attorneys and independent examiners, investigate legitimacy of creditors' claims, and they investigate for existence of any recovery actions that estate should pursue against creditors, and thus inherent tension exists between **committee** and its members and constituents. Bankr.Code, 11 U.S.C.A. § 1103(b).

1 Case that cites this headnote

[8] **Attorneys and Legal Services** Bankruptcy and debt collection

Merely remote potential for dispute, strife, discord, or difference between **committee** and one of its creditors does not give rise to any conflict of interest or appearance of impropriety that would bar attorney from representing both parties. Bankr.Code, 11 U.S.C.A. § 1103(b).

1 Case that cites this headnote

[9] **Attorneys and Legal Services** Bankruptcy and debt collection

In case of attorney's dual **representation** of creditors **committee** and individual creditor, adverse interest will not be found to exist merely because **committee** member's or creditor's transactions with debtor will be investigated, or because remote, speculative, hypothetical possibility exists that, in future, estate or **committee** may dispute creditor's claim or bring cause of action against creditor. Bankr.Code, 11 U.S.C.A. § 1103(b).

3 Cases that cite this headnote

[10] **Attorneys and Legal Services** Bankruptcy and debt collection

Statutory bar to attorney **representation**, in cases where there is adverse interest posed by attorney's dual **representation** of creditors **committee** and individual creditor, includes requirement that there exist some allegation or evidence suggesting likelihood of some actual dispute, strife, discord, or difference between **committee** and its constituent or member, although this is not high threshold. Bankr.Code, 11 U.S.C.A. § 1103(b).

1 Case that cites this headnote

[11] **Attorneys and Legal Services** Bankruptcy and debt collection

Should any evidence suggest existence of possible challenges to creditor's claim, existence of possible recovery action against creditor, or existence of any possible dispute between **committee** and one of its constituents or members, then disqualifying adverse interest exists under Bankruptcy Code section governing dual **representation** by attorney; actual disputes or actual allegations of need for recovery action engender adverse interests, but speculation and hypothesizing are insufficient. Bankr.Code, 11 U.S.C.A. § 1103(b).

2 Cases that cite this headnote

[12] **Attorneys and Legal Services** Bankruptcy and debt collection

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Evidence that member of unsecured creditors committee was close friend of principal and founder of Chapter 11 debtor-corporation, that committee member was initial investor in debtor and served as group leader of investors, and that his wife served as employee for debtor did not establish that member held interest adverse to committee, as required to preclude law firm's dual representation of member and committee; neither member nor his wife was so closely related to debtor to be considered officer or other key decision-making employee, neither one was "insider," and debtor's founder acted alone when he defrauded creditors, including committee member. Bankr.Code, 11 U.S.C.A. § 1103(b).

[13] **Attorneys and Legal Services** Bankruptcy and debt collection

Absent evidence that estate actually possessed valid recovery claim against member of unsecured creditors committee, bankruptcy court's finding that member was potential preference defendant or fraudulent conveyance defendant did not support finding that member held interest adverse to committee, so as to preclude law firm's dual representation of member and committee; no party alleged existence of possible dispute concerning member's transactions or dealings with committee or estate, or that law firm failed to properly question member about his knowledge of and connection with Chapter 11 debtor and its founder, who was alleged to have raided corporate coffers, misused investor funds, and disappeared leaving debts owed to hundreds of creditors. Bankr.Code, 11 U.S.C.A. § 1103(b).

1 Case that cites this headnote

[14] **Bankruptcy** Particular cases and issues

Record did not support bankruptcy court's findings that there was lack of progress in case, that lack of progress was caused by representation of adverse interest by law firm representing unsecured creditors committee, and that dual representation of individual committee member had reduced law firm's efficacy as counsel to committee and contributed to overall suspicion of financial transactions in case; record, including 24–page itemized billing statement, gave clear impression that law firm, within four-month timeframe, worked diligently to expedite reorganization proceedings in interest of committee and capably represented committee. Bankr.Code, 11 U.S.C.A. § 1103(b).

[15] **Attorneys and Legal Services** Bankruptcy and debt collection

Issuance of subpoena to individual member of unsecured creditors committee did not establish that member held adverse interest precluding law firm's dual representation of member and committee; subpoena was issued to member and others for purposes of determining whether debtor was paying debts as they came due, as required for involuntary Chapter 11 petition, member was no longer needed to testify after conversion to voluntary proceeding, testimony with respect to debtor or its founder's debts would not have been inherently adverse to interests of committee, member did not refuse to comply with subpoenas, and law firm did not represent member with respect to subpoena. Bankr.Code, 11 U.S.C.A. § 1103(b).

[16] **Attorneys and Legal Services** Bankruptcy and debt collection

Creditor's stated intention to invoke Fifth Amendment in Securities and Exchange Commission's (SEC) suit against Chapter 11 debtor-corporation and its founder did not establish that creditor had adverse interest to unsecured creditors committee, so as to preclude law firm's dual representation of creditor in SEC action and of committee; no reasonable adverse inference could be drawn from creditor's stated intention to assert privilege because no independent evidence suggested that he held any interest adverse to, or that he ever engaged in any transaction, dealing, or behavior which was adverse to estate or committee. U.S.C.A.

Const.Amend. 5; Bankr.Code, 11 U.S.C.A. § 1103(b).

[17] **Self-Incrimination** Civil proceedings in general

Self-Incrimination Possibility or Danger of Prosecution

Self-Incrimination Adverse inferences

Fifth Amendment to United States Constitution does not always prohibit adverse inference in civil actions where person refuses to testify in response to probative evidence offered against him, but witness may have reasonable fear of prosecution and yet be innocent of any wrongdoing, and Fifth Amendment privilege serves to protect innocent who otherwise might be ensnared by ambiguous circumstances. U.S.C.A. Const.Amend. 5.

[18] **Self-Incrimination** Operation and Effect

Inference should not be drawn from invocation of Fifth Amendment privilege, or stated intention to invoke the privilege, unless other independent evidence demonstrates that inference is reasonable. U.S.C.A. Const.Amend. 5.

[19] **Bankruptcy** Conflict of interest

Chapter 11 **trustee's** after the fact, speculative assertion of possible conflict of interest was insufficient to create appearance of impropriety in law firm's concurrent **representation** of individual member of unsecured creditors **committee**, and law firm was thus not disqualified from recovering its fees as **counsel** to **committee**, where parties closest to proceedings knew of but did not object to dual **representation**, and **trustee** was only party who objected to **representation** and did so after **representation** had been completed. Bankr.Code, 11 U.S.C.A. § 1103(b).

[20] **Bankruptcy** Disclosure requirements

Disclosure requirements under bankruptcy rule governing application for appointment of **counsel** for creditors **committee** are mandatory, and duty of professionals is to disclose any and all connections with all creditors; attorneys cannot pick and choose which connections to disclose, and negligence is no excuse. Bankr.Code, 11 U.S.C.A. § 1103; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

3 Cases that cite this headnote

[21] **Bankruptcy** Disclosure requirements

When attorney in bankruptcy case fails to disclose adverse interest, court is required to deny fees *in toto*. Bankr.Code, 11 U.S.C.A. § 1103; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

1 Case that cites this headnote

[22] **Bankruptcy** Disclosure requirements

Where no adverse interest is discovered, court reviewing application for attorney's fees after **representation** has been completed is not required to deny fees *in toto* for attorney's failure to meet disclosure requirements, although court has discretion to alter conditions of employment, including compensation conditions, if such terms and conditions prove to have been improvident. Bankr.Code, 11 U.S.C.A. §§ 328(a), 1103; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

2 Cases that cite this headnote

[23] **Bankruptcy** Disclosure requirements

Absent actual disqualifying interest, justice requires that court retain discretion whether to deny fees to bankruptcy professional as sanction for failure to disclose. Bankr.Code, 11 U.S.C.A. § 1103; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

2 Cases that cite this headnote

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[24] **Bankruptcy** Disclosure requirements

Law firm for unsecured creditors **committee** failed to comply with disclosure requirements when it did not disclose its connection with individual **committee** member to bankruptcy court until six months after firm began representing member, and **representation** of member concerned matters germane to bankruptcy proceedings; firm represented member in Securities and Exchange Commission (SEC) action against Chapter 11 debtor-corporation and its founder. Bankr.Code, 11 U.S.C.A. § 1103; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

[25] **Bankruptcy** Disclosure requirements

Complete denial of fees was not warranted by failure of law firm for unsecured creditors **committee** to timely disclosure its dual **representation** of individual **committee** member in Securities and Exchange Commission (SEC) action against Chapter 11 debtor-corporation and its founder, where law firm performed abundance of valuable legal services, proposed value of such services was at least $55,000, and firm represented no adverse interest and caused no actual harm to bankruptcy estate. Bankr.Code, 11 U.S.C.A. § 1103; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

1 Case that cites this headnote

[26] **Bankruptcy** Disclosure requirements

As sanction for failure of law firm for unsecured creditors **committee** to adequately disclosure its dual **representation** of individual **committee** member, most equitable solution would be to deny law firm those fees for services performed after performing person, or person directing such performance, acquired actual knowledge of **representation** of individual member. Bankr.Code, 11 U.S.C.A. § 1103; Fed.Rules Bankr.Proc.Rule 2014(a), 11 U.S.C.A.

[27] **Bankruptcy** Decisions Reviewable

Bankruptcy court's statement that it would award attorney fees against unsecured creditors **committee's** law firm at separate hearing was not ripe for review on appeal from bankruptcy court's order denying law firm's fee application, where Chapter 11 **trustee** had not filed application for assessment of attorney fees, nor had court actually made fee award. Bankr.Code, 11 U.S.C.A. § 1103.

Attorneys and Law Firms

***190** Myron S. Terlecky, Columbus, OH, for National Liquidators, Inc.

OPINION AND ORDER

KINNEARY, District Judge.

This matter comes before the Court to consider the bankruptcy court's denial of Squire, Sanders, & Dempsey's application for attorneys' fees. The bankruptcy court denied the application because it found that Squire, Sanders, & Dempsey had represented an interest adverse to the **Committee** of Unsecured Creditors and had failed to timely disclose its **representation** of a creditor. For the reasons that follow, the Court **REVERSES IN PART, AFFIRMS IN PART,** and **REMANDS** for further proceedings.

I.

In October 1993, Vance Wolfe, principal and founder of National Liquidators, Incorporated ("National Liquidators"), disappeared leaving debts owed to hundreds of creditors. (R. 6 at 46.)[1] Mr. Wolfe had raided the corporate coffers for personal use, turned investor accounts into a classic "Ponzi Scheme," and bankrupted National Liquidators. (R. 6 at 29–44.)

As a result of Mr. Wolfe's actions, on October 13, 1993 three investors filed a petition pursuant to 11 U.S.C. § 303 for involuntary reorganization of National Liquidators. (R.D.)

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The Securities and Exchange Commission ("SEC") followed suit by filing a separate civil suit ("SEC action") against Mr. Wolfe and National Liquidators alleging securities law violations and seeking injunctive relief. *SEC v. Wolfe,* C2–93–1014.

On November 8, 1993, the **Committee** of Unsecured Creditors ("the **Committee**") elected Mr. Lucas, a creditor of National Liquidators, as co-chairman of the **Committee** and decided to retain Squire, Sanders, & Dempsey ("SS & D") as legal **counsel** in the bankruptcy proceeding. (R. 45 at 3; 47 at 2.) On November 9, the **Committee** filed an application with the bankruptcy court, signed by Mr. Lucas, seeking appointment of SS & D as **counsel** for the **Committee**. (R. 2.) The bankruptcy court granted the application and appointed SS & D on November 30, 1993. (R. 5.)

Less than five months later, the business of National Liquidators had deteriorated to such an extent that reorganization as a going concern was no longer feasible. (R. 29; 45 at 3; 46 at 29–30.) As a result, on March 18, 1994, the United States **Trustee** agreed to appoint a Chapter 11 **trustee** to proceed with the liquidation of National Liquidators. (R. 35; 36.)[2] Because of the agreed appointment of a Chapter 11 **trustee**, SS & D concluded ***191** its active **representation** of the **Committee**. (R. 46 at 30, 36, 44–55, 52–53.)

On May 6, 1994, SS & D filed its application for fees and expenses. (R. 39.) In that application, SS & D disclosed to the bankruptcy court, for the first time, that it had represented Mr. Lucas in the SEC action. (*Id.*) As it turns out, on October 27, 1993, Mr. Lucas had scheduled a meeting with the SEC to give testimony regarding his knowledge of and connection with National Liquidators. Prior to attending that meeting, Mr. Lucas retained SS & D attorney Phillip Lehmkuhl to discuss the upcoming meeting. (R. 45 at 3 ¶ 5; 46 at 27.) Mr. Lehmkuhl accompanied Mr. Lucas to the meeting and informed the SEC that Mr. Lucas's testimony would have to be postponed because of the retention of **counsel** just a few hours earlier. (*Id.*)

SS & D formally recognized this attorney-client relationship on November 5, 1993 when William Todd, an attorney for SS & D, "opened the file" for Mr. Lucas. (R. 47 at 2.) That **representation** continued until early March of 1994, (R. 43 at Ex. A; 43 at Exs. B, C.), and in the interim, Mr. Lucas informed the SEC that, if called to testify in the SEC action, he would invoke the Fifth Amendment privilege. (R. 43 at Exs. B, C.)

The Chapter 11 **Trustee** believed SS & D had untimely disclosed the **representation** of Mr. Lucas and that such **representation** created an interest disqualifying SS & D from representing the **Committee**. As a result, the Chapter 11 **Trustee** objected to the fee application. (R. 43 at 2–9.)

After a hearing on the application, the bankruptcy court concluded that SS & D had "failed to provide adequate disclosure and represented an adverse interest." (R. 49 at 19.) Based on that finding, the bankruptcy court denied the fee application *in toto* and ruled that it would award fees to the Chapter 11 **Trustee**. (*Id.* at 19–21.)

II.

[1] **[2]** This Court's review of the bankruptcy court's retention and compensation orders is limited to abuse of discretion. *In re Federated Dept. Stores, Inc.,* 44 F.3d 1310, 1315 (6th Cir.1995). The Court follows the bankruptcy court's findings of fact unless clearly erroneous, but when reviewing for abuse of discretion on questions of law, the Court exercises plenary review using a *de novo* standard. *Id.*

III.

[3] **[4]** To ensure protection for unsecured creditors in Chapter 11 reorganization proceedings, the United States **Trustee** normally will appoint a **committee** of creditors holding unsecured claims against the debtor. 11 U.S.C § 1102(a)(1). The **committee** is intended to be a partisan representative of the different interests and concerns of the creditors. *In re Daig Corp.,* 17 B.R. 41, 43 (Bankr.D.Minn.1981). The **committee's** primary function is to advise the creditors of their rights and proper course of conduct in the bankruptcy proceedings. *In re Subpoenas Duces Tecum,* 978 F.2d 1159, 1161 (9th Cir.1992). Ordinarily, it consists of those persons who hold the seven largest unsecured claims against the debtor. 11 U.S.C. § 1102(b)(1).

The Bankruptcy Code grants **committees** the power to employ professionals. 11 U.S.C. § 1103(a). Prior to 1984, however, it barred legal **counsel** for a creditor's **committee** from representing any other entity in connection with the case. *In re Combustion Equip. Assoc.,* 8 B.R. 566, 567–68 (Bankr.S.D.N.Y.1981). Consequently, where attorneys

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accepted invitations to represent a creditor's committee, those attorneys were required to cease all representation of their original creditor-clients. *In re Whitman,* 101 B.R. 37, 38 (Bankr.N.D.Ind.1989). Many attorneys were unwilling make that sacrifice, so often times the prohibition frustrated both the goal of ensuring competent representation for committees and the committee's right to choose counsel of its choice. *Id.*

[5] [6] Congress liberalized the restrictions on dual representation by amending 11 U.S.C. § 1103(b) in 1984. The amended provision now states, in part:

> An attorney ... employed to represent a committee ... may not, while employed by such committee, represent any other entity having an adverse interest in connection ***192** with the case. Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.

Id. The provision is intended to prevent attorney conflicts of interest. *In re Rusty Jones, Inc.,* 107 B.R. 161, 163 (Bankr.N.D.Ill.1989); *In re Oliver's Stores, Inc.,* 79 B.R. 588, 594 (Bankr.D.N.J.1987). Thus, it prohibits concurrent representation if such representation would interfere with counsel's vigorous advocacy for either client, jeopardize counsel's undivided loyalty to either client, or endanger the confidences and secrets of either client. *In re Oliver's Stores, Inc.,* 79 B.R. at 593–94; *see, e.g.,* Title 19 Ohio Rev.Code Ann. Cannons 4, 5 (Anderson 1994). It also prohibits dual representation where there exists even the appearance of impropriety. *In re Oliver's Stores,* 79 B.R. at 594; *see, e.g.,* Title 19 Ohio Rev.Code Ann. Cannon 9 (Anderson 1994). Therefore, the amendment did not alter the prohibition of counsel representing an individual creditor and a creditor's committee if the individual creditor hired counsel to litigate issues potentially adverse to the other committee members. *In re Grant Broadcasting of Philadelphia, Inc.,* 71 B.R. 655 (Bankr.E.D.Pa.1987).

The Bankruptcy Code does not define to "hold an adverse interest." Courts have defined it to mean: "to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant." *See, e.g., TWI Int'l v. Vanguard Oil & Serv. Co.,* 162 B.R. 672, 675 (S.D.N.Y.1994).

[7] Committees, with the aid of their attorneys and the independent examiners, investigate the legitimacy of creditors' claims. They also investigate for the existence of any recovery actions that the estate should pursue against creditors. Therefore, an inherent tension exists between the committee and its members and constituents. This inherent tension was well recognized prior to the 1984 amendments to section 1103(b). *See, e.g., In re Proof of the Pudding, Inc.,* 3 B.R. 645, 647 (Bankr.S.D.N.Y.1980).

[8] By eliminating the per se bar to dual representation in 1984, Congress implicitly determined that the inherent tension between a committee and one of its creditors, standing alone, was immaterial and any conflict too theoretical to warrant being classified as an adverse interest. That is, merely the remote potential for dispute, strife, discord, or difference between a committee and one of its creditors does not give rise to any conflict of interest or appearance of impropriety that would bar an attorney from representing both parties.

[9] It simply exceeds rational bounds to rule that an adverse interest exists merely because a committee member's or a creditor's transactions with the debtor will be investigated, or because a remote, speculative, hypothetical possibility exists that, in the future, the estate or the Committee may dispute the creditor's claim or bring a cause of action against the creditor. *See In re Poage,* 92 B.R. 659, 666 (Bankr.N.D.Tex.1988); *In re Peck,* 112 B.R. 485, 492 (Bankr.D.Conn.1990). If the Court were to adopt this definition, then qualified attorneys would be barred from representing any creditor and his committee unless the committee were a special committee divested both of any power or duty to investigate the transactions of its constituents and of any responsibility to advise the Committee on the legitimacy of creditors' dealings with the Debtor and the Committee.

Such a broad definition would create an injustice in cases, such as this one, where courts are called on to evaluate concurrent representation after completion of such representation. In such cases, attorneys would be punished simply because the committee routinely investigated the

creditor's transactions or because, at the beginning of the representation, it was hypothetically possible that the estate possessed a cause of action against the creditor or could dispute the creditor's claim.

[10] [11] Therefore, the Court believes that section 1103(b)'s bar to attorney representation includes a requirement that there exist some allegation or evidence suggesting the likelihood of some actual dispute, strife, *193 discord, or difference between the committee and its constituent or member. The Court is not establishing a high threshold. For example, should any evidence suggest the existence of possible challenges to a creditor's claim, the existence of a possible recovery action against the creditor, or the existence of any possible dispute between a committee and one of its constituents or members, then a disqualifying adverse interest exists under the Bankruptcy Code. Undoubtedly, actual disputes or actual allegations of the need for a recovery action engender adverse interests. *See, e.g., Badami v. K.E. Joy,* 175 B.R. 303 (Bankr.D.Neb.1994). Speculation and hypothesizing, however, will not carry the day.

IV.

The record fails to suggest even the remotest possibility of the existence of any actual dispute, strife, discord, or difference between Mr. Lucas and the Committee. There exists no reason to believe that SS & D had a meaningful incentive to act contrary to the Committee's interest. Furthermore, the facts fail to give rise to the appearance of impropriety.

A.

1.

[12] In finding that Mr. Lucas represented an adverse interest, the bankruptcy court stated:

> First, Mr. Lucas was a close personal acquaintance of Mr. Wolfe, was one of the initial investors, served as a group leader, and his wife served as an employee for the Debtor.

(R. 49 at 17.) The bankruptcy court erred in ruling that those facts demonstrate that Mr. Lucas held an interest adverse to the Committee.

The bankruptcy court cites no authority for the proposition, and this Court renounces the proposition, that a lawyer should not represent one client because that client is a personal friend with an adversary of another of the lawyer's clients. No evidence suggests that even those closest to this case during the period of the dual representation, i.e., Mr. Lucas's fellow creditors and the United States Trustee, were concerned about the friendship.

National Liquidators employed Mrs. Lucas, and Mr. Lucas was a group leader of investors and an initial investor in National Liquidators. The evidence, however, fails to indicate that either Lucas was so closely related to the Debtor to be considered an officer or other key decision-making employee. Thus, no evidence indicates that either Lucas was an "insider" for purposes of the Bankruptcy Code. In fact, Mrs. Lucas's position and relationship with National Liquidators was of such insignificance that the independent examiner chose not to include Mrs. Lucas in the group of employees which the examiner interviewed. (*See* R. 6 at 7–8.)

Vance Wolfe acted alone when he defrauded hundreds of creditors, including Mr. Lucas. No evidence establishes that anyone has disputed Mr. Lucas's claims. The evidence simply demonstrates that Mr. Lucas and his fellow creditors endeavored to protect the unsecured creditors' interests by determining whether National Liquidators should remain a going concern. If National Liquidators could remain a going concern, Mr. Lucas and the Committee shared the common goal of forming a reorganization plan that would maximize the chance for repayment to all unsecured creditors.

2.

[13] The bankruptcy court's finding of adverse interest was also premised on the following:

> Mr Lucas [was] a potential preference defendant or a potential fraudulent conveyance defendant. The very questions that the SEC intended to ask Mr. Lucas ... should have been foremost on the minds of Committee counsel. One of the key functions of committees is to, '... investigate the acts, conduct, assets, liabilities, and financial condition of the debtor [including possible causes of action against creditors].' ... The Court cannot fathom

how SSD could make the requisite inquiries and take action without violating the confidences and privileges associated with representing both of their clients.

***194** (R. 49 at 17–18) (alterations of original material omitted) (citations omitted.)

The record, however, lacks a suggestion that the estate actually possessed or possesses a valid recovery claim against Mr. Lucas. The record is devoid of any evidence that the Independent Examiner, any creditor, the **Committee**, the Debtor, or even the United States **Trustee** ever alleged the existence of a possible dispute concerning Mr. Lucas's transactions or dealings with the **Committee** or the estate. Moreover, the Chapter 11 **Trustee** has failed: to challenge Mr. Lucas's claims; to allege that the estate is entitled to recovery from Mr. Lucas; and to allege that Mr. Lucas breached any duty owed to the **Committee**.

No evidence suggests that SS & D failed to properly question Mr. Lucas about his knowledge of and connection with National Liquidators or Mr. Wolfe, and neither the United States **Trustee**, nor any creditor, nor the **Committee**, has ever alleged such a failure. In fact, the record establishes the converse. SS & D attorney John Dilenschneider stated: "Mr Lucas told us as much as he could about [the acquisition and disposition of National Liquidators investor funds and] ... his activities as an independent contractor." (R. 46 at 60.)

3.

[14] The bankruptcy court asserted the "lack of progress in this case" as evidence of SS & D's adverse interest. (R. 49 at 18.) The bankruptcy court speculated that **representation** of an "adverse interest" by SS & D was the reason "why there was not more cooperation and progress" with the SEC. (*Id.*) The court explained that it "[could] not help but believe that the administration of this case would have been enhanced" if SS & D had not represented Mr. Lucas. (*Id.* at 19.) The court then found that the dual **representation** had reduced SS & D's efficacy as **counsel** to the **Committee** and "had contributed to the overall suspicion of the financial transactions in this case." (*Id.* at 20.)

The record does not support the bankruptcy court's findings. No party to the bankruptcy proceedings has ever objected to SS & D's actions as they related to the pace of the bankruptcy proceedings. The bankruptcy court raised these points *sua sponte,* without any evidence being submitted by the parties. Furthermore, after it denied the fee application, the bankruptcy court was unsure as to whether it had even considered certain important evidentiary items. As a result, the court below feared that, had it considered those items, it might have altered its decision. (R. 55 at 28.)

The record sharply contradicts any finding that SS & D "reduced its efficacy as **counsel** to the **Committee**" or "contributed to the overall suspicion of the financial transactions in this case." The record gives the clear impression that SS & D worked diligently to expedite the reorganization proceedings in the interest of the **Committee** and capably represented the **Committee**. Attached to the fee application is a copy of the 24–page itemized billing statement that details the professional services provided to the **Committee** by SS & D. (R. 39 at Ex. B.) In addition to its day-to-day work on behalf of the **Committee**, SS & D:

(a) Provided names of additional investors/creditors to the United States **Trustee** prior to appointment of the **Committee** and prior even to its own appointment as **counsel**; (R. 45 at 1.)

(b) Cooperated with the independent examiner in the preparation of his First Interim Report and Second Interim Report and in his general investigation; (R. 11; R. 39.)

(c) Moved for authority to intervene in the SEC action in order to assure that "any funds recovered by the SEC should be disposed of by the Bankruptcy Court" because "[a]ny other disposition ... would likely jeopardize the feasibility of this Chapter 11 reorganization and substantially harm the interests of creditors of National Liquidators particularly those who were not involved in securities-related matters (i.e., trade creditors)"; (R. 7 at 3; 8; 10; 15; 16; 17; 18; 21; 24.)

(d) Moved to protect information in the Independent Examiner's reports from competitors of National Liquidators ***195** who might have been able to use it to the disadvantage of the Chapter 11 estate; (R. 9; 10; 12; 28.)

(e) Moved for authority to conduct Rule 2004 examinations of Vance Wolfe and other key witnesses; (R. 11; 14.)

(f) Made arrangements (with the Independent Examiner) for a meeting in Chicago with investors located there; (R. 20; 22; 23.) and

(g) Reached agreement and prepared an agreed order for appointment of a Chapter 11 Trustee. (R. 29; 30; 31; 35; 36; R. 37; 38.)

All these activities occurred within the space of barely four months. They are hardly a sign of "reduced efficacy" or "lack of progress"; they fail to suggest an adverse interest between the Committee members and Mr. Lucas; and they fail to suggest that SS & D has breached any ethical obligations owed to its clients.

4.

[15] The Trustee erroneously implies that a subpoena issued at the outset of the case demonstrates Mr. Lucas's adverse interest. Three creditors initiated this case as an involuntary reorganization proceeding on October 13, 1993. (R.D.) Under 11 U.S.C. § 303(h)(1), they bore the burden of promptly establishing that "the debtor is generally not paying such debtor's debts as such debts become due." The bankruptcy court scheduled a hearing for this purpose on October 19, 1993 pursuant to Rule 1013(a) of the Federal Rules of Bankruptcy Procedure. (R.E.) Although the record on appeal is unclear, it appears that the bankruptcy court issued the subpoena for Mr. Lucas, along with nine other individuals, for the purpose of aiding the bankruptcy court in its required determination of whether or not "the debtor was paying his debts as such debts [came] due." (*See* R. E; J at 3; 46 at 31–32.)

National Liquidators consented to adjudication under Chapter 11 on October 25, 1993. (R. 49 at 2; G.) The conversion to a voluntary proceeding dispensed with the need for the testimony of Mr. Lucas to establish the requirements of section 303(h)(1). In any event, testimony with respect to the status of National Liquidators or Mr. Wolfe's debts would not have been inherently adverse to the interests of the Committee. The record does not indicate that Miguel Lucas refused or would have refused to comply with the subpoena, nor did SS & D ever represent Mr. Lucas with respect to the subpoena.

5.

[16] [17] [18] Mr. Lucas's stated intention of invoking the Fifth Amendment in the SEC action does not take the possibility of a dispute, strife, discord, or difference, out of the realm of mere conjecture. The Fifth Amendment to the United States Constitution does not always prohibit an adverse inference in civil actions where a person refuses to testify in response to probative evidence offered against him. *Baxter v. Palmigiano,* 425 U.S. 308, 320, 96 S.Ct. 1551, 1559, 47 L.Ed.2d 810 (1976). However, " '[a] witness may have a reasonable fear of prosecution and yet be innocent of any wrongdoing. The [Fifth Amendment] privilege serves to protect the innocent who otherwise might be ensnared by ambiguous circumstances....' " *Lionti v. Lloyd's Ins. Co.,* 709 F.2d 237, 245 (3rd Cir.1983) (Stern, dissenting) (citations omitted). "Once a witness invokes privilege it is nigh to impossible to determine why he has done so.... [Triers of fact] are left with nothing but rank speculation in attempting to draw inferences from such an event." *Id.; see also, Farace v. Independent Fire Ins. Co.,* 699 F.2d 204, 210–211 (5th Cir.1983). Any inference is even more speculative when a person merely states, outside of legal proceedings, that if called to testify he will assert the Fifth Amendment privilege. Because of these ambiguities, an inference should not be drawn from an invocation of the Fifth Amendment privilege, or a stated intention to invoke the Fifth Amendment privilege, unless other independent evidence demonstrates that the inference is reasonable. *See State Farm Life Insurance, Co. v. Gutterman,* 896 F.2d 116, 119, n. 3 (5th Cir.1990); *National Acceptance Co. v. Bathalter,* 705 F.2d 924 (7th Cir.1983).

In the case *sub judice,* no reasonable adverse inference can be drawn from Mr. Lucas's stated intention to assert the Fifth ***196** Amendment privilege because no independent evidence suggests that Mr. Lucas holds any interest adverse to, or that he ever engaged in any transaction, dealing, or behavior which was adverse to the estate or the Committee. No evidence suggests that Mr. Lucas was the undeserving beneficiary of any estate properties, engaged in any fraud, or asserted a spurious claim, nor does any evidence suggest that Mr. Lucas breached any fiduciary duty owed to the Committee. No evidence suggests that he possesses information that he did not disclose to the Committee. No evidence suggests that Mr. Lucas was anything but candid and forthcoming during the investigation by those involved with the bankruptcy proceedings. (*See,* R. 6 at 7; 46 at 60; 46 at 48.)

B.

[19] The Court also finds that the concurrent representation did not give rise to the appearance of impropriety. As a result of the implicit Congressional approval of concurrent

representation absent an adverse interest, representation, cannot, in and of itself, create an appearance of impropriety. Furthermore, nothing in the record cited to by the bankruptcy court or the Chapter 11 Trustee, creates the appearance of impropriety.

The fact that those closest to the proceedings during the dual representation have never objected to SS & D's representation of either client is quite instructive. The United States Trustee learned of the dual representation two months before the hearing on fees, yet, as of the date of the hearing before this Court, he has never objected to such representation. Neither have the creditors even though their agents on the Committee knew of the representation. (*See,* R. 46 at 45–46.)

The Chapter 11 Trustee is the only party who objects to the representation, and he does so after the representation has been completed, with only a speculative assertion that an actual attorney's conflict of interest could have existed. The Chapter 11 Trustee's after the fact, speculative assertion is insufficient to create the appearance of impropriety. Neither a reasonable member of the bar nor members of the lay community would believe the dual representation to have been improper.

V.

A.

The bankruptcy court also denied the fee application *in toto* because the court concluded that SS & D's disclosure "was abysmal in terms of its initial lack of information and in terms of counsel's failure to supplement the record at the earliest opportunity." (R. 49 at 17.) This Court believes that the disclosure failed to comply with the requirements of the Bankruptcy Rules; however, the bankruptcy court abused its discretion when it denied fees *in toto.*

[20] Bankruptcy Rule 2014(a) requires that any application seeking appointment of counsel for a creditors committee pursuant to 11 U.S.C. § 1103:

> ... be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

These disclosure requirements are mandatory. *In re EWC, Inc.,* 138 B.R. 276, 280 (Bankr.W.D.Okla.1992). The duty of professionals is to disclose any and all connections with all creditors. Attorneys cannot pick and choose which connections to disclose, and negligence is no excuse.

[21] When an attorney fails to disclose an adverse interest, the Court is required to deny fees *in toto.* *In re Federated Dept. Stores, Inc.,* 44 F.3d 1310, 1320 (6th Cir.1995). Even where no adverse interest has been found, some court's find that denial of fees is mandatory where an attorney has failed to meet the disclosure requirements. *In re EWC, Inc.,* 138 B.R. at 280–281.

[22] **[23]** This Court finds, however, that where no adverse interest is discovered, a court, reviewing an application for attorney's fees after representation has been completed, is not required to deny fees *in toto* for an attorney's failure to meet the disclosure requirements. ***197** No bankruptcy section speaks directly to circumstances, such as these, where no disqualifying interest exists but an attorney knew of information he was required to disclose but failed to do so. The most analogous section is 11 U.S.C. § 328(a), which provides the Court with discretion to alter conditions of employment, including compensation conditions, "after the conclusion of employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing such terms and conditions." *See In re Begun,* 162 B.R. 168, 178–180 (Bankr.N.D.Ill.1993) In addition, the Court finds that, absent an actual disqualifying interest, justice requires that a court retain discretion whether to deny fees as a sanction for failure to disclose. *See In re Begun,* 162 B.R. at 178–180; *In re Love,* 163 B.R. 164 (Bankr.D.Mont.1993).

B.

[24] It is undisputed that SS & D failed to disclose its connection with Mr. Lucas to the bankruptcy court until May 6, 1994, six months after SS & D began representing Mr. Lucas. The representation of Mr. Lucas concerned matters

germane to this bankruptcy action. SS & D, therefore, failed to comply with the disclosure requirements.

[25] Under the facts of this case, however, the Court finds that the bankruptcy court abused its discretion by denying the application for fees *in toto*. It is undisputed that SS & D performed an abundance of valuable legal services. It is also undisputed that the proposed value of such services was at least $55,000, because no objection to the reasonableness of those fees was lodged in the bankruptcy court.

Because SS & D represented no adverse interest and caused no actual harm to the bankruptcy estate, the $55,000 sanction for failure to timely disclose was inequitable and draconian. Some sanction, however, is appropriate.

Failure to meet the disclosure requirements cannot be tolerated. Inadequate disclosures disable courts from properly determining the propriety of legal employment. This Court will not eviscerate the prophylactic protection against actual conflicts of interest by closing its eyes to violations of the disclosure requirements.

[26] The most equitable solution is to deny SS & D only those fees for services performed after the performing person, or the person directing such performance, acquired actual knowledge of the **representation** of Mr. Lucas.[3] Therefore, remand of this case is appropriate.

[27] The Court is unable to determine whether or not the bankruptcy court made any determination as to the reasonableness of SS & D's fee. Thus, unless it already has done so, on remand the bankruptcy court must first determine a reasonable fee for the services performed by SS & D. After the court determines a reasonable fee, the parties shall attempt to negotiate a reasonable sanction. Should the parties fail to come to an agreement on a reasonable sanction, the bankruptcy court shall impose the appropriate sanction for SS & D's failure to timely disclose. Such sanction should be determined by using the equitable solution discussed herein.[4]

VI.

Upon consideration and being duly advised, the Court **REVERSES** the bankruptcy ***198** court's finding of adverse interest, **AFFIRMS IN PART** and **REVERSES IN PART** the bankruptcy court's findings and rulings on SS & D's failure to meet the statutory requirements for disclosure, and **REMANDS** for further proceedings consistent with this **OPINION** and **ORDER.**[5]

IT IS SO ORDERED.

All Citations

182 B.R. 186

Footnotes

1 All citations to the "Records on Appeal" are indicated in this OPINION and ORDER through the abbreviation "R." with the accompanying record number or letter.

2 One of the Chapter 11 **Trustee's** principle duties was to aid in the prosecution of recovery actions. At the time of the hearing before this Court in February 1995, however, no recovery actions had been brought against any person.

3 This Court leaves to the parties and the bankruptcy court the duty to determine what services were performed, or directed to be performed, by persons after they actually learned of the dual **representation**. However, of the eleven members of SS & D who worked with the **Committee** between November and March 14, 1994, it appears that only Mr. Todd and Mr. Lehmkuhl had actual knowledge of the **representation** of Mr. Lucas. The other SS & D members appear to have acquired actual knowledge on or after March 15, 1994, a date after which SS & D only completed only a *de minimis* amount of work for the **Committee**.

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4 The bankruptcy court also stated that it would award attorney's fees against SS & D at a separate hearing. This decision is not ripe for review as there is nothing on the record demonstrating that the Chapter 11 **Trustee** has ever filed an application for the assessment of attorney's fees, nor is there any evidence on the record that the court has actually made such an award.

5 In ruling on SS & D's appeal, the Court did not consider the charts used at oral argument. Therefore the "Motion to Strike Charts Used at Oral Argument" is **MOOT.**

End of Document

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447 B.R. 786
United States Bankruptcy Court,
W.D. Texas, San Antonio Division.

In re AGE REFINING, INC., Debtor.

No. 10–50501–C
|
Feb. 22, 2011.

Synopsis

Background: Chapter 11 trustee, in effort to take advantage of knowledge already amassed by firm representing **creditors**' **committee** as result of its investigation, on **committee's** behalf, of avoidance claims against debtor's former officers, directors and shareholders, sought leave to employ this firm, along with is own general **counsel**, to prosecute these avoidance claims on behalf of estate.

Holdings: The Bankruptcy Court, Leif M. Clark, J., held that:

[1] fee arrangement between trustee and the two firms would not result in improper "fee splitting";

[2] law firm, as result of its employment as **counsel** to **creditors**' **committee**, did not hold any "adverse interest," such as might prevent Chapter 11 trustee from employing it;

[3] mere possibility that conflict of interest might arise at some point in future was not disqualifying; and

[4] law firm's **representation** of **creditors**' **committee**, inter alia, in investigating possible avoidance claims against Chapter 11 debtor's former officers, directors and shareholders, did not affect its "disinterestedness."

Application approved.

West Headnotes (20)

[1] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Professionals representing bankruptcy trustee are retained only pursuant to Bankruptcy Code provision governing employment of professional persons, without regard to whether they are retained on an hourly fee, on a contingent fee, or on some other basis. 11 U.S.C.A. §§ 327, 328.

1 Case that cites this headnote

[2] **Bankruptcy** Professional Persons in General

Bankruptcy Procedure

Bankruptcy Application; documentation and itemization

Bankruptcy statute governing compensation of professionals is single vehicle by which all professional persons employed by trustee are paid, regardless of nature of their fee arrangement with trustee, whether an hourly, contingent or some other fee agreement; while not all provisions of this statute are applicable when trustee has employed professional other than on hourly basis, only way for any professional to get paid, even professional who was retained under fixed fee, contingent fee, or bonus fee contract, is by court order, on application with notice and opportunity for hearing in accordance with statute. 11 U.S.C.A. §§ 328, 330.

2 Cases that cite this headnote

[3] **Bankruptcy** Professional services; attorney fees

Bankruptcy Professional Persons in General

Because all professionals retained by trustee, including those retained other than on hourly fee basis, are compensated pursuant to Bankruptcy Code provision governing compensation of professionals, their entitlement to payment arises under administrative expense provision, and they are subject to statutory prohibition against fee splitting. 11 U.S.C.A. §§ 330, 503(b)(2), 504(a).

1 Case that cites this headnote

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[4] **Bankruptcy** Professional Persons in General

Bankruptcy Code's prohibition against fee splitting applies even though such splitting of fees may otherwise be authorized under state bar rules applicable to the professionals. 11 U.S.C.A. § 504(a).

1 Case that cites this headnote

[5] **Bankruptcy** Persons entitled; members and associates

Chapter 11 trustee, in proposing to utilize, as **special** **counsel** to prosecute avoidance claims against debtor's former officers, directors and shareholders, both the law firm that served as general **counsel** to trustee and law firm which represented **creditors**' **committee** and which had extensively investigated such causes of action while representing **creditors**' **committee**, under arrangement by which firms would be compensated at 85% of their normal billing rates and share evenly in 6% success fee, did not violate statutory prohibition against fee splitting; no "fee splitting" would occur, where each firm was being retained independently by trustee on promise of receiving 3% of any recovery and would look to trustee, not to another firm, for payment. 11 U.S.C.A. § 504(a).

1 Case that cites this headnote

[6] **Bankruptcy** Trustee as representative of debtor or **creditors**

Bankruptcy Parties

Bankruptcy Attorneys

Chapter 11 trustee's retention, as **special** **counsel** to assist in prosecuting avoidance claims against debtor's former officers, directors and shareholders, the law firm which represented **creditors**' **committee** and which had extensively investigated such causes of action, on theory that it would be more efficient to simply "buy" the knowledge that firm already possessed rather than relying on firm to "educate" another lawyer, did not mean that **creditors**' **committee** was the real plaintiff in avoidance proceedings, and that **committee** should have sought court's permission to pursue avoidance claims on behalf of estate; while interests of Chapter 11 trustee and **creditors**' **committee** were closely aligned with respect to pursuit of these claims to maximize size of estate, law firm, in pursuing avoidance claims, would be acting solely on behalf of trustee and not pursuant to its duties as **counsel** to **creditors**' **committee**.

[7] **Bankruptcy** Attorneys

Language in proposed retention agreement between Chapter 11 trustee and firms that he sought to employ as **special** **counsel** to prosecute avoidance claims against debtor's former officers, directors and shareholders, requiring trustee to notify postpetition lender of any proposed settlement of these avoidance claims, did not mean that lender was some sort of secret "client"; lender, as party that was effectively funding everything that took place in case, and that was already on the hook for more money than any other **creditor**, was entitled to protect itself from not being kept in loop and to put that protection into writing.

[8] **Bankruptcy** Procedure

Bankruptcy Trustee as representative of debtor or **creditors**

Chapter 11 trustee, as party seeking to set aside certain transactions between debtor and its former officers, directors and shareholders, was free to exercise his business judgment as to whether such avoidance claims were best pursued in court or through mediation process, and bankruptcy court would not second-guess trustee's decision to institute adversary proceedings, especially where party asserting that trustee should first have resorted to mediation was one of the very officers, directors or shareholders named as defendant in trustee's complaint.

1 Case that cites this headnote

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[9] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Trustee may hire only those professionals who (1) do not hold or represent any interest adverse to estate, and (2) are disinterested. 11 U.S.C.A. § 327(a).

3 Cases that cite this headnote

[10] **Attorneys and Legal Services** Bankruptcy and debt collection

Relevant inquiry for court, in deciding whether law firm was disqualified, on adverse interest theory, from representing Chapter 11 trustee, was whether firm held or represented an interest adverse to that of estate with respect to specific causes of action for which trustee sought to retain firm. 11 U.S.C.A. § 327(a).

2 Cases that cite this headnote

[11] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

For professional to be disqualified from employment by trustee, as "representing or holding any interest adverse to the debtor or to the estate," professional must (1) possess or assert some economic interest that would tend to lessen value of bankruptcy estate, or that would create either an actual or potential dispute in which estate was rival claimant; or (2) possess a predisposition under circumstances that render such a bias against estate. 11 U.S.C.A. § 327(a).

2 Cases that cite this headnote

[12] **Attorneys and Legal Services** Bankruptcy and debt collection

Whether attorney possesses "adverse interest," such as will disqualify him from employment by trustee, depends on whether he has meaningful incentive to act contrary to best interests of estate and its sundry **creditors**. 11 U.S.C.A. § 327(a).

1 Case that cites this headnote

[13] **Attorneys and Legal Services** Bankruptcy and debt collection

Determination of whether attorney is suffering from "adverse interest," such as will disqualify him from employment by trustee, requires fact-specific inquiry and a case-by-case examination. 11 U.S.C.A. § 327(a).

[14] **Attorneys and Legal Services** Bankruptcy and debt collection

Law firm, as result of its employment as **counsel** to **creditors'** **committee**, did not hold any "adverse interest," such as might prevent Chapter 11 trustee from employing it as **special** **counsel** to assist trustee in pursuing avoidance claims against debtor's former officers, directors and shareholders, in order to gain advantage of knowledge that firm already possessed from investigating these avoidance claims on behalf of **committee**; trustee's and **committee's** interests were closely aligned with respect to pursuit of such claims in order to maximize size of estate. 11 U.S.C.A. § 327(a).

[15] **Attorneys and Legal Services** Bankruptcy and debt collection

Mere possibility that conflict of interest might arise at some point in future was insufficient grounds for disapproving, as **special** **counsel** to assist Chapter 11 trustee in pursuing avoidance claims against debtor's former officers, directors and shareholders, the law firm which represented **creditors'** **committee** and which had extensively investigated such causes of action while representing **creditors'** **committee**. 11 U.S.C.A. § 327(a).

[16] **Bankruptcy** **Representation** of debtor, estate, or **creditors**

Bankruptcy Disclosure requirements

Should actual conflict of interest arise in future, trustee and firm that he was retaining as **special** **counsel** were under continuing obligation to

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inform court of such an occurrence. 11 U.S.C.A. § 327(a).

[17] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Requirement that any professional seeking employment by trustee must be "disinterested" implicates only the personal interests of professional sought to be retained. 11 U.S.C.A. § 327(a).

[18] **Attorneys and Legal Services** Bankruptcy and debt collection

Law firm's **representation** of **creditors'** **committee**, inter alia, in investigating possible avoidance claims against Chapter 11 debtor's former officers, directors and shareholders, did not affect its "disinterestedness" and render it ineligible for employment by trustee to prosecute avoidance claims that it had previously investigated on behalf of estate. 11 U.S.C.A. § 327(a).

[19] **Bankruptcy** Privilege

Common interest doctrine provides that **counsel** for parties having a common interest in current or potential litigation may share information without waiving their respective privileges.

3 Cases that cite this headnote

[20] **Bankruptcy** Privilege

In Chapter 11 case in which trustee would be retaining both the law firm that was acting as general **counsel** to trustee and law firm representing **creditors'** **committee** as **special** **counsel** to pursue certain avoidance claims on behalf of estate, common interest doctrine would apply to protect privileged information shared in process of prosecuting estate claims.

1 Case that cites this headnote

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Harlin C. Womble, Jr., Jordan, Hyden, Womble & Culbreth, PC, Corpus Christi, TX, for Allen Ramirez, Mary Mercado.

Gary W. Wright, U.S. Attorney's Office, San Antonio, TX, for U.S.

Memorandum Decision on Trustee's Motion to Approve Contingent Fee Agreement

LEIF M. CLARK, Bankruptcy Judge.

Came on for hearing the foregoing matter. Eric J. Moeller, the chapter 11 trustee appointed in this case, seeks approval to retain two firms to prosecute certain causes of action owned by the bankruptcy estate against various entities that are or

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were related either to the debtor or to the debtor's former officers, directors and shareholders. An objection was filed by Glen Gonzalez, who is a shareholder, was an officer of the company until he was displaced by the chapter 11 trustee, continues to hold claims against the estate, and (along with a number of related companies) is the target of a suit by the chapter 11 trustee.

Background

This case involves a small oil refinery in San Antonio, Texas. It has two processing facilities at the refinery, a tank farm, a tank car loading facility and two transport loading systems. It also has storage tanks ***792** in nearby Elmendorf, Texas and subleases a terminal in Redfish Bay, Texas. It employs about 80 people. Despite its relative size, however, it is significant both to the local economy and to its customers, as it holds a contract to furnish jet fuel to the military, including an important contract to supply JP–8 fuels to three local Air Force bases, one of which, Randolph Air Force Base, is a key flight training base for the Air Force. The contract is not the refinery's only source of revenue, however, as it makes a variety of other products as well, including diesel products, solvents, and specialized fuels for commercial, industrial and government clients. At peak capacity, the refinery had a throughput in excess of 14,000 barrels per day. The company enjoyed strong profitability for a number of years, despite suffering under the impediment of having to rely on trucking to supply crude for feedstock. The oil industry suffered along with many others with the downturn in the economy. Refineries are especially vulnerable to fluctuations in the price of feedstock relative to the prices it can fetch for its product, and when that spread narrows, profitability can suffer. The refinery relies on regular suppliers as its source for feedstock, many of which require letters of credit as a condition to shipping.

The refinery had a lending relationship with JPMorgan Chase Bank, N.A., as agent for the Revolving Lenders and with Chase Capital Corporation, as agent for the Construction Lenders. The Revolving facility was for $50,000,000, and afforded both operating capital and letters of credit. It was secured by all of the debtor's inventory, accounts receivable, and cash. The Construction loan was in the original amount of $46,000,000, with $29,600,000 outstanding as of the petition date, virtually all representing outstanding (but undrawn) letters of credit. Chase Capital was also agent bank for Junior Lenders, for $10,000,000 in financing. Both the Construction loan and the Junior Lenders loan were secured by first and second liens, respectively, on all the debtor's real property, refining plants, expansion construction contracts, and most of the debtor's equipment.

As the refinery's cash flow began to suffer in 2009, losses began to accumulate, and the debtor sought to restructure its lending relationship with JPMorgan and Chase Capital. Unfortunately, those efforts foundered. When the lenders refused to issue further letters of credit, the debtor was no longer able to maintain its supply of crude (which cost an estimated $1.1 million per day). It thus filed this chapter 11 petition in early 2010, and quickly entered into a post-petition financing arrangement with its lenders, which enabled the debtor to once again obtain letters of credit to secure a continued supply of crude for the refinery.

Not long into the bankruptcy case, it became clear that the lenders were losing confidence in the management team at the refinery. Questions were raised about the refinery's use of a trucking company that was also owned by the Gonzalez family, and about various transactions that may have occurred between the refinery and a number of related companies. In an unfortunate confluence of events, one of the refinery's truck terminals caught on fire in May 2010, dramatically reducing the refinery's ability to receive sufficient crude to run at capacity. By June 2010, it was agreed by all parties, including the lenders, the Gonzalez entities, and the **Committee**, that a chapter 11 trustee should be appointed to displace management. Eric Moeller was appointed.

The **Creditors Committee**, through its **counsel**, commenced an investigation into suspected wrongful transactions. The ***793** trustee supported these efforts, but did not invest substantial resources of his own, preferring instead to focus his efforts on repairing the truck terminal, improving operations, and getting the refinery back up to full capacity, in preparation for the marketing and sale of the refinery. The lenders, who were financing all aspects of the bankruptcy by this time, including the legal fees associated with the investigation, favored this division of labor. By the fall of 2010, the **Committee** felt it had finally found enough to justify litigation. It approached the trustee, who agreed.

As the trustee was willing to initiate such litigation in his own right, there was no need for the **Committee** to seek authorization to bring an action in the trustee's stead. However, the trustee felt it appropriate to negotiate a **special** arrangement for the prosecution of this litigation. The plan

was to use both his attorneys, Langley & Banack, and the firm of Martin & Drought, which already represented the Official Committee of Unsecured Creditors in this case. These two firms were to be retained as special counsel under a special payment arrangement designed exclusively for the pursuit of this litigation. The arrangement consists of payment at an hourly rate charged at 85% of the respective firms' normal hourly rates, plus a 6% contingent fee, to be shared by the two firms. The retention agreement itself identifies the scope of retention as follows:

> ... the Firms will, subject to and conditioned upon court approval, represent the Trustee in prosecuting the causes of action owned by AGE Refining, Inc., ("AGE") and any of its assignees against AGE Transportation, Inc. ("ATI"), Tierra Pipeline, LP ("Tierra Pipeline"), Tierra Pipeline, GP, LLC ("Tierra GP"), Tierra G Squared Land and Properties, LP ("TGS"), Tierra G Squared Land and Properties, GP, LLC ("TGP"), Glen Gonzalez, Individually ("G. Gonzalez"), Glen Gonzalez Special Trust ("Gonzalez Trust"), and/or Al Gonzalez ("A. Gonzalez"), Sharon Gonzalez ("S. Gonzalez"), and collectively with ATI, Tierra Pipeline, Tierra GP, TGS, TGP, G. Gonzalez, Gonzalez Trust and A. Gonzalez ("the Gonzalez Parties") and/or any subsequent transferee or other individual or entity who may be found to have been involved with the Gonzalez Entities (together with the Gonzalez Parties, the "Gonzalez Entities") in the matters which are the subject of the actions (collectively, the "Litigation").

Agreement for Legal Services (attached as an exhibit to the Motion). The agreement adds that "[t]he services described herein are in addition to the roles that the Langley & Banack firm serves as general Chapter 11 counsel to the Trustee and MDPC firm [serves] for the Official Committee of Unsecured Creditors." *Id.* With respect to the contingent fee, the agreement states that it "shall be split between the Firms on a 50/50 basis with each Firm receiving 1/2 of the contingent fee ..." *Id.* The agreement adds that "[t]he Firms do not believe that the general representation of [the Trustee and the Committee] is a conflict with respect to the additional representation proposed herein." *Id.*

An objection to this arrangement was filed by Glen Gonzalez, one of the parties to be sued, but also a party in interest in the bankruptcy case, with claims against the estate. In the objection, Gonzalez asserted that the trustee's proposed retention of counsel for the Creditors' Committee "improperly blurs numerous distinctions." He points out that there is no basis for the Committee's direct prosecution of claims owned by the estate, but that retention of counsel for the Committee would appear to be a back-door effort to permit the Committee to do just that, without having to satisfy the ***794** standards set out by the Fifth Circuit in *Matter of Louisiana World Exposition v. Fed. Ins. Co.*, 858 F.2d 233 (5th Cir.1988). If this motion were construed as *de facto* authority for the Committee to pursue causes of action as co-plaintiff, then, he argues, it should be denied.

Gonzalez also asserts that there is no need for the trustee to retain any other firm than the counsel he has already retained in this case. He notes that the original retention order for Langley & Banack already authorizes that firm to pursue these very sorts of causes of action. Gonzalez says that there has been no showing that the firm is entitled to be retained on any basis different from the basis on which it was originally retained.

Next, Gonzalez says that, if both firms are to be retained, then the duties of the two firms should be divided. In essence, Gonzalez wants the firms to reveal who is doing what in their interim fee applications (though he does not expressly come out and say this). This sort of fee detail could, of course, reveal a good deal about the plaintiff's trial strategy to the defendants.

Gonzalez also raises a question about who is the true plaintiff in the case, as the retention agreement speaks of the need to consult JPMorgan Chase regarding any settlement proposal. Such an arrangement, it is suggested, intimates that JPMorgan Chase proposed and negotiated the fee arrangement. Says Gonzalez, "customarily counsel would consult with their client regarding a possible resolution of a dispute and file a motion to compromise controversies with the Bankruptcy Court with any party in interest having the right to object

and be heard. By Chase inserting itself into a role ordinarily occupied by a client it effectively has greater rights than are typically afforded under Bankruptcy Rule 9019. In addition, if the Fee Agreement has been proposed and negotiated by Chase, did Chase also agree to finance the litigation? If so, are there potentially two disclosed plaintiffs [sic] and a third undisclosed plaintiff?" Response, at ¶ 10.

A hearing on the motion was held, and all parties had a full opportunity to present relevant evidence and to make their arguments. This decision now resolves the questions presented.

Analysis

The retention of professionals by a trustee in a bankruptcy case is governed by sections 327 and 328. Section 327, in the parts relevant to the issue before the court, says that

> **(a)** Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys ... or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.
>
> ...
>
> **(c)** In a case under chapter ... 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or **representation** of a **creditor**, unless there is objection by another **creditor** or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.
>
> ...
>
> **(e)** The trustee, with the court's approval, may employ, for a specified **special** purpose, other than to represent the trustee in conducting the case, an attorney that has represented the debtor, if in the best interest of the estate, and if such attorney does not represent ***795** or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

11 U.S.C. § 327(a), (c), (e). This section thus tells us *who* the trustee may hire to represent him in a case.

[1] Section 328 provides, in relevant part, as follows:

> **(a)** The trustee ... with the court's approval, may employ or authorize the employment of a professional person under section 327 ... on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.
>
> ...
>
> **(c)** Except as provided in section 327(c), [or section] 327(e) ... of this title, the court may deny allowance of compensation for services and reimbursement of expenses of a professional person employed under section 327 ... if, at any time during such professional person's employment under section 327 ... such professional person is not a disinterested person, or represents or holds an interest adverse to the interest of the estate with respect to the matter on which such professional person is employed.

11 U.S.C. § 328(a), (c). This section thus tells us *on what terms* the trustee may hire professional persons to represent him in the case. [1]

***796** One other section has relevance to the issues presented in this case, though it is not one that was referenced by any of the parties in their moving papers. Section 504 states (in relevant part) that

> (a) ... a person receiving compensation or reimbursement under section 503(b)(2) ... of this title may not share or agree to share—
>
> **(1)** any such compensation or reimbursement with another person, or
>
> **(2)** any compensation or reimbursement received by another person under such sections.

11 U.S.C. § 504(a). The section applies to all persons who receive compensation "under section 503(b)(2)." *See id.* Section 503(b)(2), in turn, permits allowance (and payment) of "allowed administrative expenses ... including—... (2)

compensation and reimbursement awarded under section 330(a) of this title." 11 U.S.C. § 503(b)(2). Thus, section 504(a), and its prohibition on fee sharing, applies to any compensation awarded under section 330(a).

[2] Section 330(a) is the single vehicle by which *all* professional persons employed under section 327 are paid —regardless on what basis they are paid. Section 330 of course familiarly applies to (and regulates the allowed amount paid to) professionals who charge on an hourly rate basis. It also, however, applies to professionals who are paid on some other basis—contingent fee, flat fee, bonus arrangements, and such—though *some* of its provisions, such as subsection (a)(3), would not be applicable. [2]

***797** Thus, while section 328 governs the *terms and conditions* under which a professional might be hired, it is section 330 itself that actually governs whether the professional person will get *paid.* For any professional retained under section 327 (and that is all professionals retained by the trustee), the *only way* for any professional to get *paid*—even professionals who are retained under a fixed fee, contingent fee, or bonus fee contract—is by court order, on application with notice and an opportunity for a hearing given to other parties in interest in the case pursuant to section 330(a). Cases that hold that the court may not later alter the terms and conditions of a contingent fee contract, based on the language in section 328, do not stand for the proposition that such professionals are "retained" under section 328 (they are not). Nor do they stand for the proposition that such professionals are only "paid" under section 328 (they are not). *See Matter of Barron, supra.* It is only pursuant to section 330(a) that any professional retained by the trustee gets paid, regardless on what terms and conditions the professional was retained. *Barron* simply informs us that some of the *rules* regulating payment (to wit, section 330(a)(3)) will not apply to professionals whose retention agreement calls for payment on terms other than hourly rates. [3]

***798** [3] Because all professionals retained by the trustee —including those retained on a fee basis other than an hourly fee—are compensated "under section 330(a) of this title," their entitlement to payment arises under section 503(b)(2). *See* 11 U.S.C. § 503(b)(2). And because they receive their compensation, if any, "under section 503(b)(2) ... of this title," all such professionals are subject to the restriction on fee sharing in section 504(a)(1). *See* 11 U.S.C. § 504(a)(1). As the agreement in this case could be construed with respect to each of the firms sought to be retained to be one to "share or agree to share compensation with another person," the court must reach the question whether this agreement in fact does so. *See In re Futuronics Corp.,* 655 F.2d 463 (2nd Cir.1981) (disallowing fees for failure to disclose fee sharing arrangement); *Quesada v. United States Trustee,* 222 B.R. 193, 198 (D.P.R.1998) (finding Trustee's failure to disclose fee sharing arrangement violated Rule 2016 and denying compensation); *In re Cupboards, Inc.,* 190 B.R. 969, 971 (Bankr.M.D.Fla.1996) (requiring disgorgement of compensation of debtor's attorney who violated Rule 2016 by under-reporting and sharing fees with unauthorized advisor); *see also* Alan Resnick & Henry Sommer, 4 Collier on Bankruptcy, ¶ 504.02[7] (noting that "the Bankruptcy Code imposes upon the court a duty to scrutinize the actions of professionals who appear, file claims or provide services in the bankruptcy context").

[4] Section 504 imposes a prohibition against the practice of "fee-splitting," departing from Act practice that had permitted it "except in a case where one of the professionals simply referred or forwarded the bankruptcy case to another professional who thereafter rendered all the services." *In re Matis,* 73 B.R. 228, 230–31 (Bankr.N.D.N.Y.1987); *see also Goldberg v. Vilt (In re Smith),* 397 B.R. 810, 816 (Bankr.E.D.Tex.2008). *Collier* explains that

> Whenever fees or other compensation are shared among two or more professionals, there is incentive to adjust upward the compensation sought in order to offset any diminution to one's share. Consequently, sharing of compensation can inflate the cost of a bankruptcy case to the debtor, and therefore to the **creditors**. Fee splitting also subjects the professional to outside influences over which the court has no control, which tends

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> to transfer from the court some degree of power over expenditure and allowances.... The potential for harm makes such arrangements reprehensible as a matter of public policy as well as a violation of the attorney's ethical obligations.

ALAN RESNICK & HENRY SOMMER, 4 COLLIER ON BANKRUPTCY (15TH ED.), ¶ 504.01, at p. 504–3 (Matthew Bender 2009). Adds the treatise,

> While the legislative history of section 504 is sparse ... there can be no doubt that section 504(a) is intended to be mandatory and preemptory. The section illustrates a congressional intent to preserve the integrity of the bankruptcy process so that professionals, engaged in bankruptcy cases, attend to their duty as officers of the bankruptcy court, rather than treat their interest in bankruptcy cases as "matters of traffic."

Id., at ¶ 504.02, at p. 504–5. Importantly, the prohibition on fee sharing applies even though such fee sharing (or fee-splitting) ***799** might otherwise be authorized under state bar rules applicable to the professionals. *Id.,* at ¶ 504.02[3]; *see also In re Hepner,* 2007 WL 161003, at *2, 2007 Bankr.LEXIS 226, at *5 (Bankr.S.D.Tex. Jan. 16, 2007) (noting that the prohibition may be out of step with modern practice, but is nonetheless unambiguous).

But understanding just what constitutes fee sharing is not an easy task. *Collier* notes that, regardless whether attorneys could engage in fee splitting outside bankruptcy (and that practice is common in personal injury actions in Texas, and is specifically authorized under Texas rules of professional conduct),[4] in order for another attorney to obtain its part of the fee, "attorneys not in the same firm but who represent a single entity would thus be required to separately obtain court approval of their retention and fees." *Collier,* ¶ 504.02[3], at p. 504–8.

A decisive point seems to be whether the other firm in question is independently retained, as opposed to simply looking to the first firm for its payment. *See id.* For example, in *In re Anderson,* 936 F.2d 199 (5th Cir.1991), the debtor employed an attorney who in turn hired his son, who was not a member of his firm, and paid his son a retainer. The son's separate employment was not authorized by the court. The son could not be paid by the estate because he had not been retained by the estate, and he could not be paid by his father because that would violate the strictures of section 504(a). *Id.,* at 203. In *In re Soulisak,* 227 B.R. 77 (Bankr.E.D.Va.1998), a debt **counseling** firm offered financial and legal **counseling** to clients for a fixed fee, then contracted with an attorney to perform all the work prior to the first meeting of **creditors**. Among other violations, the court found this arrangement violated section 504 of the Code. *Id.,* at 82.

On the other hand, when an attorney retained an out of state attorney to subpoena a witness, the court found the arrangement to be merely a payment for a necessary service, and not fee sharing. *In re Warner,* 141 B.R. 762 (M.D.Fla.1992). In another case, an attorney's retention of a former officer of the debtor on an hourly basis to assist in collecting receivables for the trustee was found not to violate section 504. *In re Statewide Pools, Inc.,* 79 B.R. 312, 316 (Bankr.S.D.Ohio 1987).

[5] In this case, the trustee has affirmatively represented a desire to hire *two* law firms, each of which is to be separately compensated under a blended scheme consisting of hourly fees billed at 85% of the lawyers' ordinary billing rate, and a contingency fee totaling 6% of the award, one half to go to each firm. While the exact language of the agreement could be read as an agreement to "split" a 6% contingency fee, it functions more like a separate agreement to pay *each* firm a contingency fee of *3%* of any award. From the point of view of the trustee, the total contingency fee to be applied to any award will not exceed 6%, but the obligation to pay the contingency fee is one directly imposed on the trustee. Neither firm is expected to look to the other firm for "it's cut" of the fee. Each firm is sought to be separately retained for this engagement, on the terms and conditions set out in the agreement attached to the motion. Those terms do not entitle either firm to receive any more than *3%* of any award in this case, and to receive that payment from the trustee, upon appropriate application to the court. The agreement does not authorize, or permit, or even contemplate, that either

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firm would be expected to pay the other firm ***800** out of whatever either firm received from the trustee. Thus, in both form and substance, the proposed arrangement is in fact *not* a fee sharing agreement and so does not violate section 504.

[6] Next, the court turns to the objections urged by Glen Gonzalez.[5] A couple of them are easily disposed of. For example, it is broadly suggested that, if the trustee hires the law firm that represents the **Creditors' Committee** in this case, that means that the **Committee** is bringing this lawsuit, though it has not sought permission to do so. Yet it is clear from the motion that the client would be the trustee, and only the trustee, with respect to the scope of this retention. The trustee says he was motivated to retain the law firm because is has already invested substantial time and effort into ferreting out the facts to support the proposed litigation, and that it makes more sense to "buy" that knowledge by directly retaining the firm than it does to expect that firm to "educate" some other lawyer. What is more, because this particular firm is already a retained professional in the case, were it limited to simply "educating" some other firm, that work would in all likelihood still be billed to the estate, on the theory that the **committee's** constituency benefits from the trustee's pursuit of this litigation. It is more efficient to just hire the knowledge, maintains the trustee, and this court is inclined to agree with that economic argument (without here reaching other issues that this retention raises). It is clear that the law firm would not be representing the **Committee** in this retention, though the work would appear to be closely aligned with the interests of the **Committee** and its constituency in augmenting the estate by the pursuit of available causes of action. That the interests are aligned is unremarkable—it happens in bankruptcy cases all the time.

Nor is the court much concerned that the retention application for the firm of Langley & Banack stated that one of their expected duties might be the pursuit of chapter 5 actions. The trustee has determined that, based on the facts as they have developed in this case, he needs to put together a different kind of legal team to pursue what he now believes to be a significant piece of litigation held by the estate. Like any client, the trustee has the right to reconsider how he wishes to pursue that litigation, and who he wants to hire for the job. Nothing in the Bankruptcy Code strips the trustee of the same rights he would have as a client outside bankruptcy—to choose professionals as he deems fit to best represent him. The trustee is simply negotiating a new contract, and now seeks its approval. No rule of law prohibits that.

Gonzales also insists that duties should be divided to avoid overlap. The court can hardly disagree with the sentiment, but notes that, regardless whether the firms are attentive to a careful division of labor, the failure to do so carries with it a heavy price. Section 330(a)(4)(A)(i) expressly states that the court shall *not* allow compensation for unnecessary duplication of services.

[7] Gonzales also hauls out the canard that the retention agreement includes a proviso requiring the trustee to notify JPMorgan Chase of any proposed settlement, intimating that this provision shows that JPMorgan Chase is somehow an undisclosed "client" of the firms. Such a proviso does not, in fact, make Chase a "client." It is beyond dispute, however, that in this case, Chase has a strong vested ***801** interest in every aspect of the administration of the estate because Chase, through its post-petition financing agreements, is effectively *funding* everything taking place in this case. As the party footing the legal bill (at least on a cash flow basis), Chase it seems is entitled to a great deal of information about whether reasonable settlements are proposed, and whether it might be asked to provide further funding for continued litigation should a settlement proposal be spurned—especially if it were spurned without Chase's even knowing it had been made in the first place. The court is certainly not suggesting that any **counsel** in this case would (or would even have the desire to) run up fees in the case chasing windmills. Chase, however, as the party already on the hook for more money than any other **creditor**, certainly is entitled to protect itself from not being kept in the loop, and to put that protection in writing.

[8] Gonzalez also suggests that he would be willing to pursue alternate dispute resolution as an alternative to litigation, and that the estate might be better served by doing so as well. Perhaps. Then again, mediation is no panacea. Often, a certain amount of discovery in the context of formal litigation is necessary to make the mediation process more substantive. Otherwise, parties may be operating in the dark about both the potential upsides and the possible downsides in their respective positions. The court is not here suggesting that the parties delay pursuing mediation. However, the trustee as a party litigant is certainly free to exercise his business judgment that formally retaining **counsel** of his choice to pursue formal litigation best serves the interests of the estate. The court is reluctant to second-guess that business judgment based primarily on the arguments urged by one of the very parties the trustee has sued.

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There are more substantive objections to be addressed however, relating to whether this retention arrangement passes muster under the Bankruptcy Code's rules relating to disinterestedness and conflicts of interest. "The Fifth Circuit has long been 'sensitive to preventing conflicts of interest' and requires a 'painstaking analysis of the facts and precise application of precedent' when inquiring into alleged conflicts." *In re Contractor Tech., Ltd.*, 2006 WL 1492250, at *5, 2006 U.S. Dist. LEXIS 34466, at *16 (S.D.Tex. May 30, 2006) (quoting *In re West Delta Oil Co., Inc.*, 432 F.3d 347, 355 (5th Cir.2005)). There is no conflict of interest issue posed by the trustee's desire to employ its general **counsel** to aid in pursuing this litigation, on **special** compensation terms that differ from the terms under which the firm works in generally representing the trustee. As has been noted already, any issues regarding duplication of effort are already anticipated by section 330(a)(4)(A)(i), and it is unnecessary to add **special** language that simply repeats the directive of the statute.

[9] The trustee's request to employ Martin & Drought is a different matter. In order for the trustee to retain this firm, it must be established that doing so would not run afoul of the proscriptions contained in section 327(a), the section that regulates *who* a trustee may hire as a professional in a case. *See* discussion *supra.* As interpreted by the Fifth Circuit, section 327(a) sets forth a general two-part limiting test: the Trustee may hire only those professionals who 1) do "not hold or represent an interest adverse to the estate," and 2) are "disinterested." *In re Contractor Tech., Ltd.*, 2006 WL 1492250, at *4–5, 2006 U.S. Dist. LEXIS 34466, at *14 (S.D.Tex. May 30, 2006) (quoting section 327(a) and citing *In re West Delta Oil Co., Inc.*, 432 F.3d 347, 355 (5th Cir.2005)). Subsection (c) of section 327 further qualifies ***802** subsection (a) by providing that a person is "not disqualified for employment under this section solely because of such person's employment by or **representation** of a **creditor**, unless there is objection by another **creditor** or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest." *Id.* at *5, 2006 U.S. Dist. LEXIS 34466, at *15 (quoting § 327(c)). Thus, while subsection (c) does not permit disqualification of Martin & Drought solely because it also represents a **creditor** of the estate, "subsection (c) 'does not preempt the more basic requirements of subsection (a)' "—the professional must not have or represent an interest adverse to the estate, and must be disinterested. *Id.* (quoting *In re AroChem Corp.*, 176 F.3d 610, 621 (2d Cir.1999)). We thus turn first to whether Martin & Drought would be disqualified for employment under subsection (a). If so, then we look further at subsection (c) to see whether its safe harbor would apply.

[10] The first prong, whether the professional sought to be hired by the Trustee "has or represents an interest adverse to the estate," has been interpreted by analogizing to section 327(e), which uses the same language with respect to the retention of **special counsel** hired for a limited purpose. Several courts, including the District Court for the Southern District of Texas, have found that a proposed **counsel's** "adverse interest is relevant only if that interest relates to the matter on which the **special counsel** is employed." *In re Contractor Tech., Ltd., supra* at *4–5, 2006 U.S. Dist. LEXIS 34466, at *14; *see also* *Stoumbos v. Kilimnik,* 988 F.2d 949, 964 (9th Cir.1993) (requiring, under section 327(a), that there be only "no conflict between the trustee and **counsel's creditor** client with respect to the specific matter itself."); *In re AroChem Corp.,* 176 F.3d 610, 622 (2d Cir.1999) (stating that the Second Circuit " 'interpret[s] that part of § 327(a) which reads that attorneys for the trustee may "not hold or represent an interest adverse to the estate" to mean that the attorney must not represent an adverse interest relating to the services which are to be performed by that attorney' "). Thus, the relevant inquiry here is whether Martin & Drought holds or represents an interest adverse to that of the estate with respect to the specific causes of action for which the Trustee seeks to hire the firm. The source of conflict, if any in this case, would be Martin & Drought's prior and continuing **representation** as the **Creditor's Committee's** "general **counsel**" in the bankruptcy case.

[11] **[12]** **[13]** **[14]** The Fifth Circuit has adopted the following definition of "represent or hold any interest adverse to the debtor or to the estate":

> (1) to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant; or
>
> (2) to possess a predisposition under circumstances that render such a bias against the estate.

In re West Delta Oil Co., 432 F.3d 347, 356 (5th Cir.2005) (citing *In re Roberts,* 46 B.R. 815, 827 (Bankr.D.Utah 1985)). "The concept of 'adverse interest' has also been

articulated in terms of motivation: whether the attorney possesses 'a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors.' " *In re Contractor Tech., Ltd.,* 2006 WL 1492250, at *6, 2006 U.S. Dist. LEXIS 34466, at *19 (quoting *In re Martin,* 817 F.2d 175, 180 (1st Cir.1987)). The determination of whether an adverse interest exists is fact-specific, requiring a case-by-case examination. *Id.* Here, the objecting ***803** party has not identified any facts indicating that Martin & Drought "holds" any interest adverse to the estate. It is not a pre-petition creditor of Age. Nor does the firm personally possess any interests or claims against Age. If anything, Martin & Drought (as counsel for the Committee) has interests that are virtually identical to those of the trustee when it comes to prosecuting this litigation, as it involves maximizing (and monetizing) a cause of action available to the estate, the proceeds of which are likely to defray both the estate's administrative costs and perhaps afford a basis for distributions to unsecured creditors of the estate (assuming the litigation proves to be successful). Both parties seek to maximize the value of the estate for the benefit of creditors.

In *In re Stoumbos,* the trustee sought to employ, for the purpose of pursuing a preference action against the former president of the debtor, an attorney who had previously represented a creditor of the estate. *In re Stoumbos,* 988 F.2d at 964. The Ninth Circuit affirmed the bankruptcy court's approval of the attorney's retention, stating that "with respect to the [ ] preference action, the interests of [the creditor] and the trustee coincide: if money is recovered for the estate, [the creditor's] pro rata recovery will ultimately be greater." *Id.* Similarly, in *In re RPC Corp.,* the court approved the chapter 7 trustee's retention of counsel that also represented the debtor's former CEO and creditor of the estate for the purpose of pursuing a lender liability claim against a bank that had loaned money to the estate. 114 B.R. 116, 119 (M.D.N.C.1990). The court first noted that, while dual representation of the trustee and a creditor "seems at least suspect"...,

> the naked existence of a potential for conflict of interest does not render the appointment of counsel nugatory, but makes it voidable as the facts may warrant. It is for the court to decide whether the attorney's proposed interest carries with it a sufficient threat of material adversity to warrant prophylactic action.

Id. Ultimately, the court concluded that, inasmuch as the former CEO was also pursuing claims against the bank in connection with his personal guaranty of the loan at issue, "the estate's proposed suit was identical to [the former CEO's] suit, the firm had undertaken extensive litigation concerning [the former CEO's] claim against the bank and limited retention under the circumstances would 'save the estate the added expense that would be generated by retention of counsel unfamiliar with the facts and proceedings.' " *Id.* (internal quotations and citation omitted).[6] Here too, the trustee seeks to hire the Committee's counsel to pursue certain specific causes of action on behalf of the estate, ***804** and for the benefit of the estate and its creditors, including the Committee. Were the trustee intending to hire Martin & Drought as its *general* counsel, adverse interests might be presented, as it is often the case that the trustee and the committee will disagree over various administrative matters.[7] However, recalling that the focus must be placed on whether an adverse interest is created as a result of *this particular retention,* which is narrow in its scope, no adverse interest is presented "relating to the services which are to be performed by that attorney." *See* *In re AroChem Corp.,* 176 F.3d 610, 622 (2nd Cir.1999).

[15] Gonzalez expressed concern that even if no present conflict exists between the Trustee and Martin & Drought, one might arise in the future. The mere possibility of a conflict of interest arising at some point in the future, however, is not sufficient grounds for disapproving the proposed Retention Agreement. In *Contractor Technology*, the court found that "there is at best only a potential conflict of interest between" the trustee and the creditors' counsel (who the trustee sought to employ) "based on the conceivable existence of some claim against [counsel's] clients." 2006 WL 1492250, at *8–9, 2006 U.S. Dist. LEXIS 34466, at *27–28. The court concluded that the objector's concern was "fundamentally about the 'appearance of a conflict of interest,' " and that "[t]he concern about potential issue conflicts or the 'appearance of a conflict' [was] legally insufficient to warrant disqualification." *Id.* at *9, 2006 U.S. Dist. LEXIS 34466 at *29. The court relied, in part, on the Third Circuit's decision in *In re Marvel Entmt. Group., Inc.,* 140 F.3d 463, 476 (3d Cir.1998). In that case, the Third Circuit articulated a three-part inquiry posed by sections 327(a) and (c):

> [s]ection 327(a), as well as section 327(c), imposes a *per se* disqualification as trustee's **counsel** of any attorney who has an *actual* conflict of interest; (2) the district court *may* within its discretion—pursuant to § 327(a) and consistent with § 327(c)—disqualify an attorney who has a *potential* conflict of interest and (3) the district court may *not* disqualify an attorney on the *appearance* of conflict alone.

Id. (emphasis added). The court concluded that while the potential for a conflict of interest to arise existed in connection with the trustee's retention of a **creditor's** former **counsel**,[8] the possibility was remote and did not justify disapproving the Trustee's proposed Retention Agreement on those grounds. *Id.*

[16] The trustee here seeks to hire Martin & Drought solely for the purpose of prosecuting certain preference and fraudulent conveyance actions in which Martin & Drought's clients are not involved. The potential for conflict here is remote. By the same token, the practical business justifications for the firm's retention for this purpose are strong. The firm has already invested a substantial amount of time and effort into investigating possible causes of action, and in drafting a ***805** pleading. Retention of this firm is an efficient and cost-effective strategy for the trustee who wishes to pursue causes of action already developed by this firm. Of course, should an actual conflict of interest arise in the future, the parties are under a continuing obligation to inform the court of such an occurrence. *See* *In re Roberts,* 75 B.R. 402, 410 (Bankr.D.Utah 1987). Until then, mere speculation about the possibility of a conflict is insufficient grounds to justify disqualification of the firm's retention by the trustee.

The first prong of the inquiry is thus satisfied in this case.

[17] The second prong of section 327(a) provides that any person (or firm) retained by the trustee must also be "disinterested." Section 101(14)(E) of the Bankruptcy Code defines a "disinterested" person as one who "does not have an interest materially adverse to the interest of the estate or of any class of **creditors** or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor." 11 U.S.C. § 101(14)(E). Furthermore, courts have interpreted this definition to implicate only the personal interests of the professional sought to be retained. *In re Contractor Technology, Ltd.,* 2006 WL 1492250, at *7, 2006 U.S. Dist. 34466, at *22 (citing *AroChem,* 176 F.3d at 629). "Accordingly, to violate the requirements of § 101(14)(E), the professional personally must 'have' the prohibited interest; and the **representation** of an adverse interest cannot be imputed to the professional." *Id.; see also* *In re AFI Holding, Inc.,* 530 F.3d 832, 848 (9th Cir.2008) (concluding that the definition of disinterested "was intended to disqualify only **creditors** with personal claims and those 'holding' pre-petition adverse interests, not [persons] having claims in a representative capacity").

[18] Neither the trustee, Gonzalez nor the **committee** has pointed to any facts showing that Martin & Drought personally has any interest adverse to the estate, its **creditors** or equity holders. Just as Martin & Drought does not "hold" any interest adverse to the estate under the "adverse interest" prong of section 327(a), the firm does not "have" any such interest within the meaning of section 101(14)(E), and so "is not rendered 'interested' on that basis." *AroChem,* 176 F.3d at 629. In sum, Martin & Drought's continuing relationship with the **Committee** does not, in and of itself, preclude the Trustee's retention of the firm to prosecute certain specific causes of action on behalf of the estate under this prong.

While it is unnecessary to the analysis, given the court's conclusion that this retention arrangement passes muster under both prongs, it is nonetheless worth noting that, were one to construe section 327(c)'s reference to "a **creditor**" to include **representation** of a "a **creditor's committee**,"[9] the firm's **representation** of the **Committee** raises no actual conflict of interest with the firm's retention by the trustee for purposes of pursuing this litigation.

It is suggested that the retention arrangement is simply "too rich" for this estate, that the cost of two firms handling this litigation cannot be justified. However, it is only the objecting **creditor**—who is also a named defendant—who raises this concern. On its face, the objection lacks a certain sincerity. However, even taken at face value, the objection is not well

taken. As has previously been noted, the trustee desires to take advantage of the sunk costs ***806** represented by Martin & Drought's investigative work to date. By the same token, the trustee desires to retain his originally selected firm as well, an acknowledgment of the respect that he has for the skills and abilities of the team that he selected in this case as his general counsel. The trustee will no doubt be attentive to the costs associated with using two law firms, given that he will be using borrowed funds to pay for ongoing costs. The firms themselves are similarly motivated to be cost-effective in their division of labor, given the strictures of section 330(a)(4)(A)(i). The deal that the trustee has negotiated for the estate is a good one—a reduced hourly rate, in exchange for the opportunity to realize a reward in the form of a 3% contingent fee per firm. The economics of the proposal are frankly compelling.

[19] **[20]** One final issue merits brief discussion. In approving the Trustee's proposed Retention Agreement, Martin & Drought will find itself representing both the Trustee and the firm's current client—the Committee. This implicates the possibility of a potential waiver of the attorney-client privilege between the firm and the Committee. But this concern can be quickly dispatched. The common interest doctrine provides that counsel for parties having a common interest in current or potential litigation may share information without waiving their respective privileges. *In re Hardwood P–G, Inc.,* 403 B.R. 445, 460 (Bankr.W.D.Tex.2009). This court previously articulated the common interest doctrine as follows:

> In order to maintain the privilege, 'the common interest must relate to a litigation interest, not merely a common business interest.' Whether the common interest doctrine applies to a privileged document 'depends upon the reason for disclosure, and not when the document was created.' The common interest rule is not limited to parties who are perfectly aligned on the same side of a single litigation, rather the party asserting the privilege must simply demonstrate actual cooperation toward a common legal goal with respect to the documents they seek to withhold. However, this shared interest must be identical, not simply similar.

Id. In *Hardwood,* this court concluded that the common interest doctrine protected certain documents exchanged between the debtors, the Committee and the banks providing the DIP financing. *Id.* [10] The court found that "the parties were [ ] working in concert to recover, through litigation, causes of action of the estate for the benefit of the estate's creditors. The common legal goal of investigating and recovering the debtors' assets existed between the debtors, the Committee and the Banks." *Id.* Similarly, here, counsel for the Committee and counsel for the Trustee seek to jointly pursue litigation on behalf of the estate to their joint benefit. The common interest doctrine would apply to protect privileged information shared in the process of prosecuting estate claims.

Conclusion

For the reasons stated, the application of the trustee to retain both firms, on the terms specified in the application and the accompanying agreement, is approved. The objections are overruled.

All Citations

447 B.R. 786, 54 Bankr.Ct.Dec. 95

Footnotes

1 Practitioners seem to believe that section 328 is another section under which a professional can be retained, as an alternative to section 327, and argue that, if a person is "retained under section 328," their fees are thus virtually immune from later adjustment by the court. That is a misreading of the statute, however. They have apparently jumped to that conclusion from their reading of Fifth Circuit jurisprudence addressing the extreme limitations that are placed on revisiting some types of compensation arrangements—especially contingent fee agreements—by the language in section 328(a), which says that terms and conditions can only be revisited if they "prove to have been improvident in light of developments *not capable of being anticipated at the time of*

the fixing of such terms and conditions." *See* *Matter of Barron,* 325 F.3d 690, 694 (5th Cir.2003) (overruling a trial court's reduction of a contingent fee award, noting that settlement of a case without an actual trial was capable of being anticipated when the contingent fee agreement was made); *see also* *Gibbs & Bruns LLP v. Coho Energy Inc.* (*Matter of Coho Energy Inc.*), 395 F.3d 198, 205 (5th Cir.2004) (reducing fees awarded by an arbitration panel as being improvident in light of circumstances not capable of being anticipated, here, the arbitration panel's basing the award on a gross misunderstanding of the facts).

In fact, professionals representing the trustee are *only* retained under section 327. The language of section 328 discussed by the Fifth Circuit is actually language that applies to *all* terms and conditions under which **counsel** might have been retained. Thus, it is the *nature* of the terms and conditions, and their relationship to what is and is not capable of being anticipated, that is relevant. Some kinds of arrangements attempt to fix compensation in a way that cannot later be altered. *See* *Donaldson, Lufkin & Jenrette Sec. Corp. v. National Gypsum Co. (Matter of National Gypsum Co.),* 123 F.3d 861, 862 (5th Cir.1997). Fixed fee contracts, contingent fee contracts, and contracts with bonus features are all examples of agreements whose nature is such that, once approved at the retention stage, are difficult to revise later in the case, because it is so difficult to show that later developments were not capable of being anticipated. But it is the *nature of the agreement* and not the so-called "basis of retention" that affects a court's ability to revisit fee awards in a case. Hourly fee awards, paid on an interim basis pursuant to section 331, but not actually awarded until the entry of a final award pursuant to section 330, are by their nature capable of being adjusted, because they are not finally awarded until the conclusion of the services, and only then is the court obligated to make a one time determination whether the fee fits the standards set out in section 330(a)(3). All that *Matter of Barron* actually teaches is that some types of fee arrangements are, *by their nature,* immune from later adjustment under section 330(a)(3).

By way of example, a contingent fee agreement is one pursuant to which a professional agrees to be paid only on the condition that the professional prevails, but also agrees that, it if *does* prevail, its fee will be determined not by consulting a reasonable hourly rate times a reasonable amount of time expended, but rather by applying a fixed percentage to the award. Those "terms and conditions" expressly remove that professional from the application of section 330(a)(3). Only if the court were to determine that there were developments not capable of being anticipated that render the contingent fee *arrangement* itself improvident would a court be permitted to later substitute a fee award on some other basis. Thus, it is not the fee award as such but the *fee arrangement* that must later be found to have been improvident as a result of later unanticipated developments.

2 Section 330(a), in relevant part, provides:

> (a)(1) After notice to the parties in interest ... and a hearing, and subject to sections ... 328 ... the court may award to a ... professional person employed under section 327 ... reasonable compensation for actual, necessary services rendered by the ... professional person or attorney ...; and reimbursement for actual, necessary expenses.
>
> (a)(2) The court may, on its own motion, or on the motion of ... any other party in interest, award compensation that is less than the amount of compensation that is requested.
>
> (a)(3) In determining the amount of reasonable compensation to be awarded to ... a professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case ...

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and

(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

(a)(4)(A) ... the court shall not allow compensation for—

unnecessary duplication of services; or

services that were not—

reasonably likely to benefit the debtor's estate; or

necessary to the administration of the case

11 U.S.C. § 330(a).

3 Were a court to apply the section 330(a)(3) standards to a contingent fee contract, for example, the effect would be to "allow compensation different from the compensation provided under [the] terms and conditions" of the contract. *See* 11 U.S.C. § 328(a). As we have already noted, those retention terms and conditions may only be altered if later unanticipated developments arise. Other parts of section 330(a) *do* apply, however, to fixed fee agreements, contingent fee contracts, and the like. For example, section 330(a)(1) permits an award of "reasonable compensation," subject to section 328. *See* 11 U.S.C. § 330(a)(1)(A). If a professional retained on a contingent fee were to commit malpractice, then it would not be reasonable for that professional to receive an award. *See* *Matter of Intelogic Trace, Inc.,* 200 F.3d 382, 387 (5th Cir.2000) (citing *In re Temple Retirement Community,* 97 B.R. 333 (Bankr.W.D.Tex.1989) for the proposition that the court "has the independent authority and responsibility to determine the reasonableness of fees," in support of its conclusion that a final order authorizing a fee request is a de facto determination that there is no basis for challenging those fees, including a charge of malpractice or other wrongdoing that would undermine the finding of "reasonableness"). Thus, it is error to assert that section 330 *in toto* does not apply to contingent fee arrangements, as some might be tempted to say. It is only correct to say that some *portions* of section 330 (subsection (a)(3) in particular) can only apply to certain types of payment arrangements (primarily hourly rate arrangements). Other portions of section 330 (such as subsection (a)(1)) apply to regulate the payment of all professionals, regardless the terms and conditions of retention, because, by their nature, their application does not impermissibly alter the terms and conditions of retention. Of course, one could imagine a retention arrangement in which the trustee (or debtor-in-possession) agrees to pay a fee, regardless whether services are rendered, regardless whether the services are reasonable, regardless whether malpractice was

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committed, regardless whether the estate is damaged by the actions of the professional. Hopefully, however, most courts have the good sense not to approve such an arrangement in the first place.

4 *See* Texas Disciplinary Rules of Professional Conduct, Rule 1.04(f), (g), State Bar Rules, Art. X, § 9, *reprinted in* Texas Rules of Court—State (West pamphl. ed. 2010).

5 Gonzalez is listed as a **creditor** with a small trade claim in the original schedules filed in this case. *See* Doc. # 152, at p. 26. He thus has at least technical standing in this case.

6 *See also* *AroChem,* 176 F.3d at 627 (approving trustee's retention of **creditor's** former attorney because of the "identity of interests between the trustee and **special counsel's** former client with respect to the **special** matter for which **special counsel** was retained."); *In re Fondiller,* 15 B.R. 890, 892 (9th Cir. BAP 1981) (finding that chapter 7 trustee's employment of **creditor's counsel** was proper under section 327(a) because retention was "limited to the search for, and attempted recovery of, specific assets allegedly concealed, and the investigation of certain alleged fraudulent conveyances" in which the firm's **creditor** clients were not involved); *In re Contractor Tech., Ltd.,* 2006 WL 1492250, at *8, 9–10, 2006 U.S. Dist. LEXIS 34466, at *26, 32 (affirming bankruptcy court's approval of trustee's retention of law firm that represented 8 of the 400 **creditors** in the case to pursue certain claims identified by the trustee (not involving any of the firm's **creditor** clients) because "[t]he **creditors** and the Trustee [were] generally aligned in regard to the purposes of [the firm's] employment. All want[ed] [the firm] to recover substantial sums for the estate in order to pay **creditors**' claims in this bankruptcy case").

7 That has, unsurprisingly, been the case here, as the trustee sought authority to increase the borrowing base so that the trustee could increase throughput at the refinery, while the **committee** opposed that request because such additional borrowings would potentially place additional administrative costs ahead of the expected payout for unsecured **creditors**.

8 In *Marvel Entertainment*, the proposed **counsel** had previously been **counsel** for a secured **creditor** who was a **creditor** in the case, though it had not represented the **creditor** in the case *sub judice.* The court found that former **representation** to be insufficient to warrant a finding of either an actual or a potential conflict of interest. *Id.* at 477.

9 Because the facts of this case do not require the court to reach section 327(c), it is not necessary to here decide whether the subsection's reference to "a **creditor**" would also apply to "the **creditor's committee**."

10 It is an irony of bankruptcy that the party in *Hardwood P–G* asserting waiver of the attorney client privilege by virtue of this sharing of documents was represented by the very firm that now seeks to be retained by the trustee in this case—Martin & Drought.

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United States Bankruptcy Court, N.D. Florida, Tallahassee Division.

IN RE: GENERAL CAPACITOR, LLC, Debtor.

CASE NO.: 19-40279-KKS
|
Signed February 25, 2022

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ORDER DENYING *MOTION FOR RECONSIDERATION OF ORDER GRANTING, IN PART, MOTION TO PAY BROKER BLACKHAWK TECHNOLOGIES, LLC* (ECF NO. 350)

KAREN K. SPECIE, Chief United States Bankruptcy Judge

***1** THIS MATTER is before the Court upon the motion ("Motion")[1] filed by Kasper Holdings of Tallahassee, LLC ("Kasper") seeking "reconsideration" of this Court's order authorizing the Chapter 7 Trustee ("Trustee") to pay the Broker a commission of $75,840.00.[2] No party filed a response to the Motion. While the Court appreciates the clarity of Kasper's restated argument in the Motion, the Court still disagrees with Kasper's conclusion. For that reason, the Motion is due to be denied.

The issue at hand requires perusal of certain sections of the Bankruptcy Code pertaining to compensation of professionals. Relevant here is compensation of a brokerage firm, Blackhawk Technologies, LLC ("Blackhawk"). The Trustee retained Blackhawk, with Court approval, to assist in the marketing and sale of assets.

We begin by looking at the Trustee's application to employ Blackhawk ("Application").[3] That Application, which Kasper received and to which it did not file an objection, specifically requested employment of Blackhawk pursuant to Sections 327(a) and 328(a) of the Bankruptcy Code.[4] The Application also specified that Blackhawk's compensation was to be a percentage of the amount for which the assets were sold.[5] The approved Application specifically provided that Blackhawk's compensation "should not be subject to the standard of review under Section 330 ...."[6] The order approving the Application specified that Blackhawk was employed pursuant to Sections 327(a) and 328(a) and made no mention of Section 330.[7]

DISCUSSION

Case law is clear that compensation established under 328(a) of the Bankruptcy Code is not subject to later adjustment pursuant to Section 330(a).[8] Once the Court approved the Trustee's Application to employ Blackhawk, the amount of Blackhawk's compensation was firmly established, unless those terms were later proved to be "improvident in light of developments not capable of being anticipated at the time."[9]

Here, no party, including Kasper, claims that the amount of Blackhawk's compensation should be reduced or adjusted. Rather, Kasper quarrels with the Court's determination that the Trustee may pay Blackhawk now.

***2** Kasper argues that Blackhawk's compensation is an administrative claim under 11 U.S.C. § 503(b)(2) that must be paid along with all administrative claims of equal priority. But this argument misses the mark. Section 503(b)(2) specifically includes "compensation ... awarded under section 330(a)" but makes no mention of compensation awarded under Section 328(a).[10]

Kasper attempts to bootstrap Section 328(a) compensation into Section 503(b)(2), by relying on the language in Section 330(a) that provides that after notice and a hearing, and *subject to section 328*, the court may award reasonable compensation to a professional employed under Section 327.[11] But courts have interpreted the

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"subject to" language in Section 330(a) to mean that once compensation to a professional is awarded under section 328(a), that compensation cannot be revisited or revised after the fact because of the prohibition of such adjustments that is a vital part of Section 328(a).[12]

Courts, including this one, do not read the "subject to" language in 330(a) as language of inclusion; rather, this language is considered limiting.[13] Nowhere does the Bankruptcy Code or do the courts interpret the "subject to" language in section 330(a) in such a way as to make compensation awarded under Section 328(a) equate to an award under section 330(a), which then would be subject to Section 503(b)(2). Kasper fails to connect these dots.

The legislative history of Section 328(a) is clear: by enacting this section, Congress' goal was to facilitate trustees' ability to hire professionals to assist in liquidating estate assets.[14] "Congress enacted § 328(a) to eliminate the previous uncertainty associated with professional compensation in bankruptcy proceedings, even at the risk of potentially underpaying, or, conversely, providing a windfall to, professionals retained by the estate under § 328(a)."[15] Courts generally view professional fee approval under Section 328(a) as "pre-approved fees."[16] "[P]rofessionals employed by the estate have the option of being compensated under either § 328(a) or § 330(a)."[17]

> The differences between §§ 328 and 330 affect the timing and process of the court's review of fees. For instance, under § 328, the bankruptcy court reviews the fee at the time of the agreement and departs from the agreed fee only if some unanticipated circumstance makes the terms of that agreement unfair. Under § 330, the court reviews the fees after the work has been completed and looks specifically at what was earned, not necessarily at what was bargained for at the time of the agreement. Bankruptcy professionals are aware that the amount of any professional's fees will be less certain if the bankruptcy court awards fees under § 330. Such uncertainty prompted Congress to enact § 328 to allow professionals to have greater certainty as to their eventual payment.[18]

***3** Here, the Trustee's retention of Blackhawk pursuant to Section 328(a) to sell tangible and intangible assets was no different than if the Trustee had retained Blackhawk to sell real property. In such a situation, the real estate broker would be paid a percentage commission at closing if he or she procured a sale that actually closed. If that broker did not obtain a willing and able buyer, and no sale closed, the broker would be entitled to no compensation. That is precisely the way the Trustee retained and proposed to pay Blackhawk here.

The district court in *In re Hannah Baby, LLC v. Chaffe Securities, Inc.,* affirmed the bankruptcy court's order allowing payment of professional fees to the debtor's restructuring advisor and investment banker that were pre-approved under Section 328(a).[19] Similarly in *In re John Q. Hammons Fall 2006, LLC,* over objection of a creditor, the bankruptcy court awarded and approved payment of a professional's pre-approved "Restructuring Transaction" fee of $7,000,000.00 because the agreement provided that the fee would be paid upon consummation of the transaction, which did, in fact, occur.[20]

Addressing fee applications and objections to professional fees approved under Section 328(a), Bankruptcy Judge Robert Drain stated:

> Section 328(a) reflects the view that professionals are entitled to know what they are likely to be paid for their work. If you agree to hire someone on a flat fee or percentage-fee basis, there should be some comfort that the compensation will be paid and that a court will not simply impose a new and different deal after all the work has been done.[21]

Judge Drain concluded his well-reasoned and exhaustive discussion of section 328(a) and how it affects professional fee applications by approving the fee application before him on the basis that the professional "had satisfied the terms of its engagement letter, and ... is entitled to the fee that it negotiated...."[22]

In *In re Wolf,* the Chapter 7 trustee retained an attorney to represent him on a contingency fee basis.[23] The bankruptcy court in *Wolf* approved that fee agreement under Section 328(a), but later disallowed the contingency fee and instead awarded an hourly rate.[24] The district court reversed and awarded the 1/3 contingency fee; the Ninth Circuit affirmed.[25]

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***4** Kasper urges that Blackhawk's compensation, which it maintains is governed by 503(b)(2), must be treated, and paid, with the priority of other administrative claims under Section 726(b).[26] But that is not what the Bankruptcy Code says. This argument would only be correct if Blackhawk's claim were one covered by Section 503(b), which it is not. Only claims described in Section 503(b)(2) are covered by Section 507(a)(2), and then governed to be paid *pro rata* under Section 726(b). Once again, Kasper fails to connect the dots between these sections of the Bankruptcy Code. Kasper cites no authority in support of this argument, and the Court has located none.

All parties, including Kasper, agree that Blackhawk has performed everything the Trustee retained it to do. No party objects to, or even questions that Blackhawk has earned the compensation it contracted for and that this Court approved under section 328(a). Rather, Kasper's argument—that Blackhawk's compensation should be paid *pro rata* with other administrative claims because this estate may be administratively insolvent—essentially seeks to reduce Blackhawk's compensation outside of the purview of Section 328(a). This argument contradicts the plain language of Section 328(a) and other sections of the Bankruptcy Code. If the Court were to rule as Kasper requests, such a ruling would be contrary to the purpose and legislative history of Section 328(a).

In light of the history of this case and the Chapter 11 debtor's prior unsuccessful attempt to sell the same assets, the possibility that this estate might become administratively insolvent was capable of being anticipated when the Trustee retained Blackhawk. Because Blackhawk's retention was specifically conditioned on Sections 327 and 328(a) of the Bankruptcy Code after notice to all creditors, including Kasper, and because Blackhawk performed what it was retained to do, it is appropriate to allow the Trustee to pay Blackhawk its commission now.

For the reasons stated, it is

ORDERED: the *Motion for Reconsideration of Order Granting, in Part, Motion to Pay Broker Blackhawk Technologies, LLC (Doc. 336),* ECF No. 350, is DENIED.

DONE and ORDERED on February 25, 2022.

All Citations

Slip Copy, 2022 WL 3010439

Footnotes

1 *Motion for Reconsideration of Order Granting, in part, Motion to Pay Broker Blackhawk Technologies, LLC (ECF No. 336)*, ECF No. 350.

2 *Order Granting, In Part, Motion to Pay Broker, Blackhawk Technologies, LLC (ECF No. 283)*, ECF No. 336.

3 *Trustee's Expedited Application for Employment of Blackhawk Technologies*, LLC, ECF No. 168.

4 *Id.* at pp. 8–9.

5 *Id.* at ¶ 6.

6 *Id.* at ¶ 21.

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7 *Order Approving Trustee's Application for Employment of Professional (Doc. 168)*, ECF No. 172, ¶ 2.

8 *See, e.g.*, *In re ASARCO, LLC,* 702 F.3d 250, 257–58 (5th Cir. 2012); *In re Fundamental Long Term Care, Inc.*, 626 B.R. 51, 57 (Bankr. M.D. Fla. 2021); *In re Hungry Horse, LLC,* 574 B.R. 740, 746 (Bankr. D. N. Mex. 2017); *In re Clark*, Case No. 12-30716-KKS, 2014 WL 10250672, at *2 (Bankr. N.D. Fla. July 28, 2014); *In re Chewing & Frey Sec., Inc.*, 328 B.R. 899, 911 (Bankr. N.D. Ga. 2005).

9 11 U.S.C. § 328(a).

10 11 U.S.C. § 503(b)(2)

11 11 U.S.C. § 330(a)(1).

12 *See, e.g.,* *In re Nat'l Gypsum Co.,* 123 F.3d 861, 862–63 (5th Cir. 1997); *Fundamental Long Term Care,* 626 B.R. at 57 (citing *Hungry Horse,* 574 B.R. at 746); *In re Clark*, 2014 WL 10250672, at *2; *Chewing & Frey Sec.,* 328 B.R. at 911.

13 Cases cited *supra* note 12; *see generally, A Guide to Reading, Interpreting and Applying Statutes*, Georgetown University Law Center, 12 https://www.law.georgetown.edu/wpcontent/uploads/2018/12/A-Guide-to-Reading-Interpreting-and-Applying-Statutes-1.pdf (Last visited Feb. 25, 2022) (noting that the "subject to ... may limit the scope of the statute, or may indicate that a certain part of the statute is controlled or limited by another section or statute").

14 *In re Coho Energy,* 395 F.3d 198, 204 (5th Cir. 2004).

15 *ASARCO,* 702 F.3d at 258.

16 *See, e.g., In re Nestor,* 628 B.R. 707, 720 (Bankr. S.D. Fla. 2019) (Section 328(a) "is the Bankruptcy Code section under which contingency fee arrangements are authorized...."); *In re Clark*, 2014 WL 10250672, at *2 ("Section 328 applies when the bankruptcy court approves a particular rate or means of payment, and § 330 applies when the court does not do so.").

17 *ASARCO,* 702 F.3d at 260 (citing *In re Texas Sec., Inc.,* 218 F.3d 443, 445 (5th Cir. 2000); *Nat'l Gypsum,* 123 F.3d at 862).

18 *Miller Buckfire & Co. v. Citation Corp. (In re Citation Corp.),* 493 F.3d 1313, 1318–19 (11th Cir. 2007).

19 *In re Hannah Baby, LLC v. Chaffe Secs., Inc.,* Case No. 1:19-cv-160-LG-RHW, Case No. 1:19-cv-173-LG-RHW, 2020 WL 1249905 (S.D. Miss. Mar. 16, 2020).

20 *In re John Q. Hammons Fall 2006, LLC,* 600 B.R. 436, 441, 447 (Bankr. D. Kansas) ("Because the Agreement provides that UBS is entitled to a Restructuring Transaction Fee of $7,000,000 upon consummation of a Restructuring Transaction, UBS will be awarded $7,000.000 as a Restructuring Transaction Fee.") The order approving employment of the professional specifically authorized the debtors to pay "all fees and expenses of [the professional] on the terms and conditions of [the Agreement]...." *Id.* at 441. The objecting creditor became obligated to pay all fees and expenses under the confirmed joint plans of reorganization, to the extent the fees were awarded by the bankruptcy court. *Id.* at 439. Had the parties here included such language in the order approving the Trustee's employment of Blackhawk, perhaps Kasper's objection and this ruling could have been avoided. But even with such language in the order, the creditor in *John Q. Hammons* opposed the award and obligation to pay the professional.

21 *In re Relativity Fashion, LLC,* Case No. 15-11989(MEW), 2016 WL 8607005, at *3 (Bankr. S.D.N.Y. Dec. 16, 2016).

22 *Id.* at. *12.

23 *In re Wolf,* 862 F.2d 319, 1998 WL 124779, at *2 (9th Cir. 1988) ("[T]he bankruptcy court and the trustee faithfully complied with section 328 in employing" the professional.)

24 *Id.* at *1.

25 *Id.* at *5.

26 Tellingly, this *pro rata* distribution would include Kasper's allowed administrative claim.

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IN RE: RELATIVITY FASHION, LLC, et al., Debtors.

Case No. 15-11989 (MEW) (Jointly Administered)
|
Signed December 16, 2016

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BENCH DECISION REGARDING OBJECTIONS TO FINAL FEE APPLICATIONS OF PJT PARTNERS L.P. AND HOULIHAN LOKEY CAPITAL INC.

Hon. Michael E. Wiles, United States Bankruptcy Judge

***1** We are here so that I can announce my decision on the final fee applications of PJT Partners LP (formerly Blackstone Advisory Partners L.P.) and Houlihan Lokey Capital, Inc. I will refer to them today as "PJT" and as "Houlihan."

This will constitute my bench ruling on the applications. I will instruct the attorneys for Relativity to prepare and submit a transcript of what I say. We will use that transcript as the basis for a written opinion that will clean

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up the citations and fix any other mistakes that I might make in the course of explaining my rulings today. It will be that final written opinion that will constitute my opinion on the applications, rather than the transcript of what I say today.

PJT and Houlihan are investment banking firms that were retained in these cases. Their retention agreements provided for compensation using a structure that is common to most investment banker retentions, both within and outside bankruptcy. More specifically, PJT and Houlihan were to be paid monthly fees plus a transaction fee. The monthly fees were to be paid on an ongoing basis. The transaction fee was to be paid if and when a transaction was consummated, so long as any other conditions in the agreement were met. Each agreement also provided for expense reimbursement.

In its final application, PJT seeks approval of compensation that includes a transaction fee of $4.5 million. This amount represents an agreed-upon reduction from the $5 million transaction fee that was set forth in the retention agreement. Objections to the PJT application have been filed by Robert Keach, who is the fee examiner, and by Relativity Secured Lender, LLC. I will refer to those objectors as "the fee examiner" and as "RSL." The fee examiner and RSL object to the transaction fee sought by PJT, but all issues as to other parts of the applications have been resolved by agreement between the parties.

Houlihan seeks compensation that includes a transaction fee of $5 million. The fee examiner and RSL, joined in this instance by Relativity Fashion, LLC, which is a debtor in these cases, have objected to the transaction fee. All other issues about the Houlihan final fee application have been resolved.

By way of summary and introduction: the fee examiner and RSL (and in the case of Houlihan, Relativity Fashion) contend:

- That PJT did not fulfill the contractual conditions to the payment of the transaction fee that it seeks;
- That the Court should review the PJT and Houlihan applications for reasonableness using the standards set forth in Section 330 of the Bankruptcy Code and not using the standard of review that would apply under Section 328(a) of the Bankruptcy Code;
- That the applications do not satisfy the Section 330 criteria and requirements with respect to the proposed transaction fees; and
- That the transaction fees should be denied in their entirety.

The Court reconfirmed at the outset of the hearing yesterday that no other party objects to the applications. That included confirmation that neither the United States Trustee nor the Official Committee of Unsecured Creditors has objections to the fee requests.

***2** In considering the objections, I have reviewed all of the briefs and other materials that the parties submitted and cited. I have also reviewed, and taken judicial notice of, my own prior orders in this case. I have also considered the testimony offered on December 8, 2016 in open court by Mr. Van Durrer and the declarations that the parties agreed to submit in evidence. As is appropriate in connection with my review of any fee application, I also bring to these matters my own sense of the results that were achieved and the role of the professionals in achieving these results, having supervised these cases since they were filed in 2015.

Before getting to the specifics of the applications and the objections, some general comments on a few points are in order to put my rulings in context.

First, it is appropriate to make some comments about the terms of Section 328(a) of the Bankruptcy Code and how the standards under Section 328(a) differ from those under Section 330 of the Bankruptcy Code. Section 328(a) says that a trustee, with the court's approval, may approve the retention of a professional "on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis." 11 U.S.C. § 328(a). In a Chapter 11 case, the debtor-in-possession has that same power, pursuant to 11 U.S.C. § 1107(a).

Different standards apply to the review of fee applications depending on whether or not the terms of employment have been approved under Section 328(a). Now, no matter whether Section 328 or Section 330 applies, a professional does not earn compensation if the terms and conditions of the retention agreement do not call for it. Some allegations to that effect were made in the objections to the PJT application, and I will deal with those later.

Apart from that, though, Section 328(a) states that once approved, fees are payable unless the approved terms and conditions "prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." 11 U.S.C. § 328(a). Essentially, under Section 328(a), reasonableness

is judged in advance, and the issue is not revisited except in the very narrow circumstances permitted by the statute.

Without a Section 328(a) approval, however, Section 330 calls for a review of reasonableness that, to some extent, is made after-the-fact, although the case law makes clear that the judgment is not supposed to be done completely with 20/20 hindsight. Under Section 330, a court reviews all "relevant" factors, including time spent, rates charged, whether services were necessary or beneficial at the time such services were rendered, whether the services were performed in a reasonable amount of time, and whether the compensation is reasonable based on customary compensation charged by comparably skilled practitioners in nonbankruptcy cases. 11 U.S.C. § 330(a)(3)(A-F). In addition, under Section 330 compensation is not supposed to be provided if there is an unnecessary duplication of services or if services were not reasonably likely to benefit the estate or necessary to the administration of the case. 11 U.S.C. § 330(a)(4)(A).

The reason for the different approach set forth in Section 328(a) was explained by the Fifth Circuit Court of Appeals in its decision in *Donaldson Lufkin & Jenrette Securities Corp. v. National Gypsum Co.* (*In re National Gypsum Co.*), 123 F.3d 861 (5th Cir. 1997). In that case the court held:

> Prior to 1978 the most able professionals were often unwilling to work for bankruptcy estates where their compensation would be subject to the uncertainties of what a judge thought the work was worth after it had been done. That uncertainty continues under the present § 330 of the Bankruptcy Code, which provides that the court award to professional consultants 'reasonable compensation' based on relevant factors of time and comparable costs, etc. Under present § 328 the professional may avoid that uncertainty by obtaining court approval of compensation agreed to with the trustee (or debtor or committee).

***3** *Id.* at 862. The Court in *National Gypsum* went on to say:

> If the most competent professionals are to be available for complicated capital restructuring and the development of successful corporate reorganization, they must know what they will receive for their expertise and commitment. Courts must protect those agreements and expectations, once found to be acceptable.

Id. at 862-63.

In other words, Section 328(a) reflects the view that professionals are entitled to know what they are likely to be paid for their work. If you agree to hire someone on a flat fee or percentage-fee basis, there should be some comfort that the compensation will be paid and that a court will not simply impose a new and different deal after all the work has been done.

Second, it is appropriate to make some comments about investment banker compensation in general, and in particular about so-called transaction fees, because there is often a lot of confusion about just what they represent.

As I explained above, it is common that an investment banker retention includes a provision for payment of monthly fees as well as transaction fees. Investment bankers' main compensation is through transaction fees. Those fees usually are contingent on the consummation of a transaction so that they are not paid if a transaction does not occur. But apart from that condition, they often have no other requirements. They often merely require that the transaction occur with no other conditions whatsoever.

Usually, but not always, the transaction fees are independent of the amount of time it takes to complete the transaction, the involvement of other people, et cetera. They are just tied to the fact that a transaction occurred, although the parties are free to add other conditions and qualifications if they think it is appropriate and if they negotiate such terms.

Transaction fees are not unique to bankruptcy. It has long been the practice of investment bankers to charge for their services in this exact same way outside of bankruptcy. There is also a long line of cases in which New York

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courts in particular have reviewed and upheld and enforced this transaction fee structure. *See*, for example, *Oppenheimer & Co. Inc. v. Metal Management, Inc.*, 2011 U.S. Dist. LEXIS 67762, at *24-30 (S.D.N.Y. 2011); *Deutsche Bank Securities, Inc. v. Rhodes*, 578 F.Supp.2d 652, 668 (S.D.N.Y. 2008); *CIBC World Markets Corp. v. TechTrader, Inc.*, 183 F.Supp.2d 605, 611-12 (S.D.N.Y. 2001); *Chase Manhattan Bank, N.A. v. Remington Products, Inc.*, 865 F.Supp. 194, 198-99 (S.D.N.Y. 1994); *PaineWebber Inc. v. Campeau Corp.*, 670 F.Supp. 100, 105 (S.D.N.Y. 1987); *see also FleetBoston Robertson Stephens Inc. v. Innovex Inc.*, 172 F.Supp.2d 1190, 1197 (D. Minn. 2001) (upholding such fee structures and terms of employment after applying New York law). These cases make clear that the transaction fee structure is common in the investment banking industry. Each of these decisions also confirmed that the banker only needed to comply with the terms of its retention agreement in order to be paid. Each case rejected efforts by parties to import other terms in the agreement; they rejected claims, for example, that a banker had not played a pivotal role in a transaction, or had not identified the party with whom the final transaction actually was completed, unless those requirements explicitly appeared in the bankers' retention agreement.

***4** In bankruptcy cases, some decisions and many submissions by parties reflect a misunderstanding about the transaction fees that are charged by investment bankers. Sometimes this is a problem of labels that are loosely applied. For example, in some cases the parties' submissions treat transaction fees as though they are requests for bonuses—what some courts refer to as "fee enhancements." Other parties and courts refer to transaction fees as "success fees" and, having applied that label, then treat the transaction fees as though they implicitly require a special kind of success in order to be earned.

There are, in fact, instances in bankruptcy in which a professional reserves the right to seek (or without having reserved such a right, seeks) a discretionary fee enhancement or success fee which is equivalent to a bonus. It is very important, however, to distinguish those cases from cases in which ordinary transaction fees are sought. Transaction fees are part of the standard, negotiated, base compensation for the investment banker, as confirmed in the New York cases I cited. They are not requests for bonuses above and beyond the approved compensation. Cases that address requests for extra compensation, beyond what is provided for in the retention agreement, really deal with entirely different matters.

For example, the objectors have cited the decision by Judge Glenn in *In re Residential Capital, LLC*, 504 B.R. 358 (Bankr. S.D.N.Y. 2014). That case involved a request for compensation by a court-approved chief restructuring officer. The retention agreement for that professional provided for compensation at an hourly rate. However, the retention agreement said that the professional could ask for an extra "success fee" at the end of the case, but only if the debtor and the unsecured creditors' committee, in their sole discretion, thought it was warranted.

In *Residential Capital*, the proposed extra fee emphatically was not part of the negotiated base compensation for the professional's work. It was understood that it might never be paid and that it effectively was a potential bonus that was entirely under the control of, and at the discretion of, the debtor, the committee, and the court.

It is entirely appropriate, if a bonus is being sought, as in the *Residential Capital* case, to look closely at the quality of the work done, the results achieved, and especially the role of the professional in achieving those results, in order to see whether they are such as to warrant a bonus above and beyond the previously agreed compensation. It is utterly wrong, however, to cite the *Residential Capital* case as though it sets forth a standard that must be met when an investment banker applies for final approval of its transaction fee. The transaction fee is not a bonus, and there is no reason why allowance of the transaction fee should be subject to the same standards as a request for payment of a bonus.

The objectors have also cited to the decision by Judge Morris in *In re Northwest Airlines Corp.*, 400 B.R. 393 (Bankr. S.D.N.Y. 2009). However, that case also involved a request for extra compensation above and beyond the prior agreed terms and conditions of employment. In *Northwest Airlines*, Lazard sought a fee that it called a completion fee, but its retention agreement and order did not provide for the payment of such a fee. Instead, the retention agreement merely said that Lazard would receive monthly fees. The only reference to a completion fee was a statement that the committee and Lazard agreed to defer consideration of the possibility of such a fee until the end of the case. When Lazard sought such a fee, the United States Trustee objected that Lazard's request amounted to a request for a fee enhancement or bonus, and Judge Morris denied the request.

***5** As with the *Residential Capital* case, I think it is wrong to treat the *Northwest Airlines* case as though it involves the same things as the transaction fees that ordinarily are sought by investment bankers. And it is wrong to suggest that an investment banker cannot receive its transaction fee unless it makes the same showing that a professional would have to make in order to receive a discretionary extra-contractual bonus. There is a big difference between a discretionary bonus and a percentage-based or flat fee that is the base compensation for the professional's work. Courts that consider applications for the payment of transaction fees should not be confused by the labels that people apply and should instead look at exactly what compensation is sought and the terms under which it is being sought.

I should also note that this same misunderstanding appears in some cases in which courts have attempted to calculate an investment banker's compensation based on inferred hourly rates. These are cases that have also been cited to me by the objectors, and they represent an approach that the objectors have urged me to take here. More particularly, some decisions have calculated an implied hourly rate for investment bankers, and they have done so so using only the monthly fees, which then are divided by the number of hours actually worked. But that mathematical approach presumes that the monthly fees, standing by themselves, are expected to constitute full compensation for the underlying work and that the transaction fee, somehow, is just an extra bonus form of compensation. For the reasons I have already said, I believe that is a false understanding of what the fees represent. If one really wanted to know what an investment banker's implicit hourly rate or expected hourly rate was, one would need to calculate the total expected fee, *including* the transaction fee, and divide that by the expected time required to accomplish the transaction. Looking only at the monthly fees results in a mathematically incorrect calculation.

In fact, if one were to calculate implicit "hourly" rates using only the monthly fees as a starting point (as the objectors urge me to do in this case), then by definition the calculation would always show that the monthly fees have already covered the reasonable hourly rates. They would do so because the calculation would have started with the false assumption that the monthly fees represent the full expected compensation for all of the work that was done.

Third, the parties in this case have referred to the so-called Blackstone Protocol, and some history and commentary on this is appropriate.

Effectively, the so-called Blackstone Protocol represents a negotiated truce between investment banks and the Office of the United States Trustee for the Southern District of New York. Historically, the United States Trustee has been a much larger opponent of Section 328(a) approvals than other parties have been. To some extent, this is based on a philosophical view that retentions and fees should always be reviewed after-the-fact. Other parties, including creditors' committees, sometimes object on similar grounds. But more often, they do not; and more often than not, those objections fade away. Sometimes committees object and then withdraw their objections when the committee reaches the point of hiring its own advisors who typically want Section 328(a) approval of their own fees.

The Blackstone Protocol was an arrangement that started in the Southern District of New York, I believe. It says, in effect, that parties are bound by the Section 328(a) standards, except for the United States Trustee, which has the right to object on Section 330 grounds. The United States Trustee confirmed during the hearing on December 8 that it has very rarely invoked this right.

***6** A similar approach is now reflected in orders entered in Delaware, although historically there was more litigation over the issue in Delaware. Some bankers sought modified versions of the New York Blackstone Protocol when they were retained in Delaware. The primary focus of the limitation was an effort to obtain an agreement that the United States Trustee could object on Section 330 grounds, but that the reasonableness of fees would not be based on hourly rate criteria. As just one example of such an order, I cite to the order entered in *In re GWLS Holdings, Inc.*, case number 08-12430 (Bankr. D. Del. December 5, 2008), docket number 263. I will not provide a further detailed history of the Delaware developments, because I do not have time to reconstruct it, and because it is not really necessary here.

For a time, in Delaware, the issue was the source of heated negotiations between the United States Trustee and the bankers, that often were resolved and that less often produced actual litigation. But eventually the parties stopped fighting over the issue. I think one reason was that some bankers did not want to fight over it, and it was hard for bankers to ask for limitations on the United States Trustee's objection rights if other bankers in similar positions did not think those limits were needed. So eventually the same Southern District of New York language began to become common in the Delaware retention orders as well.

The language, as agreed, says that the United States

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Trustee may object on all grounds set forth in Section 330 of the Bankruptcy Code, but it typically bars other parties from doing so. In effect, the Blackstone Protocol creates a hybrid situation in which the court must apply or may apply the Section 330 standards to an objection made by the U.S. Trustee, but otherwise must apply Section 328(a).

Frankly, it is not at all clear that Congress contemplated this kind of hybrid approach when it enacted Section 328(a). *See, e.g.,* *Riker, Danzig, Scherer, Hyland & Perretti v. Official Committee of Unsecured Creditors* (*In re Smart World Technologies, LLC*), 552 F.3d 228 (2d Cir. 2009). In *In re Smart World Technologies*, the court referred to Sections 328 and 330 as being "mutually exclusive," and held that a court may not conduct a Section 330 inquiry if there has been a Section 328(a) approval. *Id.* at 233.

The *Smart World* case did not involve an agreement of the kind we have here, so it did not rule on whether the hybrid approach reflected in the Blackstone Protocol is permitted under Sections 328 and 330. The best justification for the Blackstone Protocol that I have been able to theorize is that the hybrid standard of review to which the parties have agreed is, in effect, one of the approved terms of employment that is approved under Section 328(a), so that one of the approved terms is that the United States Trustee may object on Section 330 grounds while no other party is permitted to do so. The United States Trustee's objection rights, in other words, are made part of the agreed terms of retention that are protected by Section 328(a).

The fact that such rights are reserved for the United States Trustee does not mean that anyone else can assert objections under Section 330. The whole idea of the approved terms and of the Protocol is that only the United States Trustee can assert Section 330 objections. If, as described above, this limitation is one of the approved terms and conditions of employment under Section 328(a), then that approved term cannot be changed unless it is found to have been "improvident in light of developments not capable of being anticipated at the time." 11 U.S.C. § 328(a). A court cannot after-the-fact change the standards that apply to objections filed by other parties, or change the terms on which other parties may object to fee applications, any more than the court could elect to apply a Section 330 standard in the *Smart World* case.

***7** It would completely undermine Section 328(a) if all a court needed to do after approving a section 328(a) retention was to appoint a new party with standing to object and to give that new party the right to make objections on grounds other than Section 328(a). Under *Smart World*, a court is forbidden from doing that. Once the arrangement is approved and becomes part of the approved terms of employment, it is locked in. If those approved terms of employment say that only the United States Trustee has a right to assert Section 330 objections, then that is also a term that is locked in.

Exactly what it means for the United States Trustee to reserve rights to object under Section 330 is, frankly, not clear. There is some suggestion in the papers in this case, for example, that I should treat this reserved right as though it means that no pre-approval of the transaction fees had been given at all, and as though there had been no prior determination as to the reasonableness of the fees or as to whether the fees were consistent with market standards. But I approved the fees under Section 328(a) as to every party other than the United States Trustee. I could not do that without finding that the fees were reasonable and consistent with market standards.

I suppose one possibility is that the reservation of rights in the Blackstone Protocol means that the United States Trustee is not collaterally estopped on the question of whether the fee is market-based and can raise that issue later. But I am not at all sure that makes sense. Why should the United States Trustee retain a right to object after the fact on points that could have been raised and resolved at the outset? Fairness to all parties, it seems to me, means that issues that can be raised at the time of retention should be raised then, so the terms are resolved as far in advance as possible before the work is done.

The real aim of the arrangement, as I understand it, is not to postpone the litigation of issues that could and should be litigated at the outset, but instead to have greater flexibility after the fact than the literal terms of Section 328(a) would provide. In other words, it is an effort to have flexibility to deal with changed circumstances that the parties think may be relevant but that might not be capable of being considered under the literal terms of Section 328(a). Exactly what rights are conferred to the United Sates Trustee and what the proper scope of such rights should be is something I do not need to address further here for reasons I will explain.

Turning to the applications before me: as to PJT, the retention order (the "PJT Retention Order") is docket number 550 and was entered on September 21, 2015. Paragraphs 2 and 6 of the PJT Retention Order make clear

that the retention is approved under Section 328(a) of the Bankruptcy Code. However, the PJT Retention Order also said that the United States Trustee retained all rights to respond or object to interim and final applications on all grounds, including reasonableness pursuant to Section 330 of the Bankruptcy Code, and that the Court retained jurisdiction to consider any such objections by the United States Trustee on Section 330 grounds.

The Houlihan retention order (the "Houlihan Retention Order") similarly provides for retention under Section 328(a), and it has the same Blackstone Protocol language. In that case, however, the Section 330 rights were reserved not only for the United States Trustee, but also for the Official Committee of Unsecured Creditors.

***8** In these cases, the United States Trustee and the Official Committee of Unsecured Creditors have not objected to the PJT or Houlihan applications. The only objections filed were by the fee examiner and by RSL and, in the case of Houlihan, by Relativity Fashion. So, the first question presented to the Court is, what arguments do the objectors have the right to assert?

In the case of RSL and Relativity Fashion, no suggestion has been made to me of any reason why they, on their own behalf, should have rights to object pursuant to Section 330 standards as opposed to being confined to the standard of review under Section 328(a).

As to the fee examiner, the issue requires a little more discussion. The idea of hiring a fee examiner came up late in these cases. It was presented to me in the form of a stipulation among the debtors, the committee, and the United States Trustee. Paragraph 1 of the stipulation, found at docket number 1633 and entered on March 10, 2016, says that to the extent that the United States Trustee retained the rights under a Section 328(a) retention order to object on Section 330 grounds, "the fee examiner shall also be authorized (and shall have standing) to object to the allowance of such fees and expenses, consistent with this stipulation and order." *Id.* at 3.

The fee examiner contends that I approved the stipulation and therefore that the fee examiner has the right to make objections under Section 330 and is not constrained by the standards set forth in Section 328(a) of the Bankruptcy Code.

I think this argument is incorrect for two reasons.

First, I did not approve the stipulation as it was presented, and I specifically did not approve the rights that paragraph 1 purported to grant to the fee examiner. I expressed some skepticism about the concept of having a fee examiner in general, and I asked the parties to the stipulation to discuss it at the next scheduled hearing before the Court. At that hearing I told the parties that I did not intend, through the appointment of a fee examiner, to change the standards that would govern the review and approval of any of the professionals' fees. Consistent with that direction, I did not "so order" the stipulation itself. I entered a separate order which appears at docket number 1742, entered on April 5, 2016. That Order says that the stipulation is approved "except as set forth herein." *Id.* at 1. I also added a paragraph to the proposed order, which is paragraph 4 of the Order as entered. Paragraph 4 of my Order says that "[n]othing in the Stipulation or in this Order shall effect any modification to the standard of review that is applicable to the consideration of a fee application or to the standards under which any professional was retained." *Id.* at 2.

In my mind, if a professional had been retained under Section 328(a), and if under my prior orders only the United States Trustee or the Committee could challenge those professionals' fees based on other standards, I was not altering that arrangement. I was not purporting to grant similar rights to additional parties, because in my mind, that would change the standard of review applicable to the engagements I had approved. I thought the language that I added in paragraph 4 was clear on that point.

Second, in addition to the fact that I did not give the fee examiner the rights that were sought under paragraph 1 of the stipulation, I believe that under Section 328(a) I could not have done so.

***9** PJT and Houlihan were not parties to the stipulation. It was just a stipulation among the United States Trustee, the debtors, and the committee. The parties to the stipulation told me when we had our hearing that the retained professionals were not parties to it and had not reviewed or approved the terms of the stipulation. *See* Transcript of Hearing on March 31, 2016, Docket No. 1743, at 22.

The United States Trustee represented at the hearing that the idea for the fee examiner originated with Mr. Kavanaugh's counsel, that it was not a substitute for United States Trustee's review; that the United States Trustee might make suggestions to the fee examiner; but that the United States Trustee would continue its separate role and would make its own separate objections if it thought it appropriate to do so. *Id.* at 27.

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As a result, I do not understand how this stipulation could be treated as though it, in effect, changed the terms after-the-fact of the prior retention orders entered for Houlihan and PJT. The original arrangement was that the retentions were under Section 328(a). The only reservation in the case of PJT was in favor of the United States Trustee, and the only reservations in the case of Houlihan were in favor of the United States Trustee and the Official Committee of Unsecured Creditors.

Under the terms of Section 328(a) and under the *Smart World* decision, I had no power to give anyone else the right to assert objections based on Section 330 standards. Doing so, in effect, would have changed the retention from a Section 328(a) standard to a Section 330 standard, which *Smart World* says I could not do.

I have been urged to find that PJT and Houlihan consented to this, because they did not object to the application for approval of the stipulation. I do not believe that silence and a failure to object in that regard is consent or should be interpreted as having accomplished a change to the prior retention orders. Notably, nobody served papers suggesting that the terms of the prior retention orders were being changed by the stipulation or calling to the attention of Houlihan or PJT that their rights were potentially being affected by the stipulation. It asks far too much to say that a party consents to relief when it is not even formally notified that relief is being sought against it.

Now, the fee examiner did have the authority to make recommendations. I suppose that leaves open the possibility that the fee examiner might have made suggestions to the United States Trustee about objections that the United States Trustee might wish to make under Section 330. But that is not what we have here. The United States Trustee said at the fee examiner hearing, as noted above, that it would object on its own behalf if it had objections. The United States Trustee has made no such objection here, and it confirmed that at the outset of this hearing. The fee examiner has filed this objection in his own name and on his own behalf. For the reasons I have stated, I do not believe the fee examiner has the right to do so, except pursuant to the standards of Section 328(a). I did not grant that right, and I could not have done so even if I had wanted to.

I should note that I also have a lot of doubts and questions about some of the arguments that were made about the standards that I should have applied in the event that I had agreed that the fee examiner and other objecting parties could make objections under Section 330, but I do not need to reach those points.

***10** The parties have agreed that if the Section 328(a) standard applies, there is no issue as to the Houlihan application. In the case of PJT, if Section 328 applies, the only remaining issue is whether PJT is entitled to a transaction fee under the terms of its approved retention agreement.

The PJT retention agreement [Docket No. 284] defines a "Restructuring" on page 1 as collectively, "any restructuring, reorganization ... and/or recapitalization of the Company substantially affecting existing or potential debt obligations or other claims, including, without limitation, senior debt ... and/or any sale or other disposition of all or substantially all of the assets of or equity interests in the Company." *Id.* at 18. However, there is also a qualifier in the definition. A matter counts as a Restructuring under the agreement only if PJT "shall have provided material support and services with respect to such transaction." *Id.*

These cases began with an initial proposal to sell all of the assets, with the secured creditors acting as the stalking-horse bidder. An auction was scheduled and was conducted. There was no competing bid to buy all the assets, but there was a competing proposal that took a different form. More specifically, there was a suggestion that only some assets (while I will loosely refer to as the "Television Business") would be sold, and there would be a reorganization around the rest.

At the scheduled auction, at the offices of PJT on October 1 and 2, 2015, there were lengthy, intense negotiations that resulted in a tentative agreement on a new integrated proposal. Thereafter, the parties all collectively represented to me that a deal had been reached that provided that the Television Business would be sold and that one or more term sheets had been signed with regard to a restructuring of the rest of the obligations, and that the rest of the case would be focused on implementing, filling out, and effecting a reorganization along the lines that the parties had put into the term sheets. It was explicitly represented to me at the time and characterized to me consistently throughout these cases that the sale of the Television Business and the term sheets were related to each other and were part of a single package deal.

The fee examiner and RLS contend that PJT did not provide material support or services for the restructuring that was achieved. They contend that PJT worked only on the sale of the Television Business and did not work on the rest of the deal; that its work ended in October when Mr. Kavanaugh asked PJT to stop work; that many

components of the restructuring were negotiated after October without any involvement from PJT; and that many other parties did things—such as negotiate terms, draft documents, or undertake other important restructuring-related activity—without PJT's presence.

The first and main problem with these contentions is that they imply that the sale was separate from the restructuring term sheets, and unrelated to the overall restructuring. This is not the case. The sale of the Television Business was not separate from the rest of the restructuring transaction. It was an integral part of it. It was always described that way to me. The only witness at the hearing before me, Van Durrer, also described it that way during his testimony. RSL, in fact, in its own papers, described the sale transaction as being integrally related and part of a single package with the rest of the restructuring. Treating the sale of the Television Business as though it was separate and not part of the rest of what happened is not a reasonable way to view what happened in this particular case.

***11** It is also clear that the restructuring term sheets were direct outgrowths of the auction process. Furthermore, it is clear that those restructuring term sheets ultimately led directly to the plan that was confirmed. Mr. Durrer described the October events as critical steps to the reorganization. Of course, some things still had to be done, but the terms agreed to in October were the guiding terms that eventually found their way into the confirmed plan of reorganization.

Mr. Durrer also confirmed during his testimony that PJT provided material support and services in conjunction with the sale. The objectors did not really dispute that. In essence, their objection is that the sale part of the transaction should be viewed separately. But the evidence and my own recollection do not support that contention.

The only evidence before me is that PJT did everything one would expect the investment banker to do through the time in October when Mr. Kavanaugh asked PJT to stop work, mostly as a result of a conflict that had developed between Mr. Kavanaugh and the person from FTI who had previously directed PJT's work. The evidence is also that the October deals were a package and that PJT provided material support and services in producing that package. Finally, the evidence is that this package led directly to the confirmed plan.

There was some hint in the objections and arguments made at the hearing that the contractual requirement of material support and services required, in effect, that PJT have an actual and ongoing central role in every aspect of the ultimate restructuring. The contractual terms, and common sense, do not support that view.

First, that is not what the word "material" usually means. My old edition of Ballantine's Law Dictionary defines the word "material" as meaning "important." *See Ballentine's Law Dictionary* (3d ed. 1969). It did not require that PJT's services infuse every corner of the deal, or that PJT be the sole or even the primary driving force in achieving what happened, or even that PJT's work be the most important factor in what happened. It merely required that PJT's services be important. Clearly, PJT was important and material to the auction and sale that produced the term sheets. In that respect, its services were material to the restructuring that happened. In fact, PJT's services were more than just important: they were an essential part of the October agreements. The restructuring in this case was built on the foundation established in October, and PJT played a material role in building that foundation.

As to the suggestions that other parties drafted documents and negotiated other terms: every reorganization, especially in companies with capital structures as complicated as the one these companies had, requires a host of negotiations and documents. Lawyers typically do some negotiations. Business people typically do some others. Bankers typically do some. Other terms often are hammered out by the stakeholders themselves without any direct involvement by the debtors or their professionals. Of course other people played a part here in negotiating the terms that became part of the ultimate restructuring, as they do in all cases. But that hardly means that PJT did not provide "material support and services." If I were to interpret the requirement for the provision of material support and services as requiring that PJT had to be the dominant moving force in everything that happened, to the exclusion of the work done by other professionals, such an interpretation would be contrary to the way that everyone understands that a typical restructuring is conducted. In fact, if I were to interpret it that way, it is hard to see how any fee could ever have been earned.

***12** It is noteworthy that everyone who negotiated the retention agreement and who was a party to the case at the time of its approval supports PJT's application. The witness who testified yesterday said that he, too, supports the application. Moreover, finding that PJT is entitled to the compensation is consistent with my own understanding of what I was approving as well. The evidence, therefore, clearly showed that PJT has satisfied the terms of its engagement letter, and that it is entitled to the fee that it negotiated, subject to the reduction to which it has already agreed.

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There was a separate issue raised in the papers and discussed yesterday as to whether a sale occurred, as defined in the agreement. A determination of that issue would have required consideration of whether the Television Business constituted a sale of all or substantially all of the assets or whether the October agreements provided for a disposition of all or substantially all of the assets or equity. I would have needed a factual hearing before I could have decided such issues, but I do not need to reach them, and therefore I decline to do so.

For the foregoing reasons, the objections are denied and the parties are directed to submit orders that reflect allowance of the fees and expenses of PJT and Houlihan in accordance with their applications, subject to the modification of those amounts that were previously agreed to.

All Citations

Not Reported in B.R. Rptr., 2016 WL 8607005

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588 B.R. 678
United States Bankruptcy Court, S.D. New York.

IN RE: NINE WEST HOLDINGS, INC., et al.,[1]
Debtors.

Case No. 18-10947 (SCC) (Jointly Administered)
|
Signed 07/02/2018

Synopsis

Background: Debtor and its affiliates in jointly administered Chapter 11 cases filed application to retain distressed management consultant, which had overseen their daily operations prepetition, to provide them with an interim chief executive officer (CEO) and certain additional personnel, and to designate particular individual employed by consultant, who had served as officer and director of certain debtors, as interim CEO nunc pro tunc to the petition date. United States Trustee (UST) objected.

Holdings: The Bankruptcy Court, Shelley C. Chapman, J., held that:

[1] in seeking authorization for retention of distressed management consultants or turnaround consulting firms, debtors need not rely on the section of the Bankruptcy Code governing employment of professional persons, but may rely on the section of the Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason;

[2] debtors' consultant complied in all material respects with the requirements of the UST's so-called Jay Alix Protocol, even though individual in question had served as a director of a lone debtor entity within two years prior to the petition date;

[3] debtors' retention of consultant and of individual as interim CEO constituted a sound exercise of their business judgment; and

[4] consultant and individual were not "professional persons" within the meaning of the Code.

Objection overruled and application granted.

Procedural Posture(s): Application to Employ Attorney or Other Professional.

West Headnotes (12)

[1] **Bankruptcy** Possession, Use, Sale, or Lease of Assets

After notice and hearing, a debtor has broad discretion to use, sell, or lease, other than in the ordinary course of business, property of the estate, so long as such use is supported by a good business reason. 11 U.S.C.A. § 363(b).

[2] **Bankruptcy** Employment of Professional Persons or Debtor's Officers
Bankruptcy Possession, Use, Sale, or Lease of Assets

In seeking authorization for retention of distressed management consultants or turnaround consulting firms, debtors need not rely on the section of the Bankruptcy Code governing employment of professional persons, but may rely on the section of the Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason. 11 U.S.C.A. §§ 327, 363(b).

[3] **Bankruptcy** Employment of Professional Persons or Debtor's Officers
Bankruptcy Possession, Use, Sale, or Lease of Assets

"Jay Alix Protocol" is a national policy adopted by the United States Trustee (UST) whose purpose is to prevent conflicts of interest, that is, to prevent a distressed management consultant from using its position in one capacity to benefit itself in another capacity, whereby the UST assents to the retention of such consultants by a

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debtor pursuant to the section of the Bankruptcy Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason, as long as the firm complies with certain requirements set forth in the Protocol; it is not a provision of the Code or other law, nor is it binding on any court. 11 U.S.C.A. § 363.

2 Cases that cite this headnote

[4] **Bankruptcy** Employment of Professional Persons or Debtor's Officers
Bankruptcy Possession, Use, Sale, or Lease of Assets

Distressed management consultant retained by Chapter 11 debtor and its affiliates, which had overseen debtors' daily operations prepetition, complied in all material respects with core requirements of United States Trustee's (UST) "Jay Alix Protocol," even though particular individual employed by consultant had served as director of lone debtor entity within two years prior to petition date; consultant did not violate purpose of Protocol to prevent a consultant from using its position in one capacity to benefit itself in another capacity, neither individual nor any other of consultant's employees ever served on a parent board responsible for approving the prepetition or postpetition retention or compensation of consultant, and individual's de minimis service on subsidiary boards did not overlap with timing of consideration of either of consultant's engagement letters, but was done at discretion and under direction of parent boards, and primarily involved ministerial duties. 11 U.S.C.A. § 363(b).

[5] **Bankruptcy** Power and Authority

Bankruptcy courts are tasked with ensuring compliance with the Bankruptcy Code and ensuring that the Code is applied with common sense and in a predictable manner.

[6] **Bankruptcy** Employment of Professional Persons or Debtor's Officers
Bankruptcy Possession, Use, Sale, or Lease of Assets

United States Trustee (UST) could not, without notice, arbitrarily revoke its "Jay Alix Protocol," a national policy adopted by the UST in order to prevent conflicts of interest in connection with debtors' retention of distressed management consultants, given debtors' and advisory firms' reliance on over 14 years of precedent in which the Protocol was followed and firms were employed pursuant to the section of the Bankruptcy Code authorizing the use of estate property other than in the ordinary course of business if such use is supported by a good business reason, as opposed to the section of the Code governing employment of professional persons. 11 U.S.C.A. §§ 327, 363(b).

1 Case that cites this headnote

[7] **Bankruptcy** Possession, Use, Sale, or Lease of Assets

When considering whether to approve a debtor's use of estate property outside the ordinary course of business, courts review the business judgment of the debtor. 11 U.S.C.A. § 363(b).

1 Case that cites this headnote

[8] **Bankruptcy** Possession, Use, Sale, or Lease of Assets

Business judgment standard applied by courts when considering whether to approve a corporate debtor's use of estate property outside the ordinary course of business presumes that the court will not second guess the business judgment of a debtor's board in making a business decision, provided that the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. 11 U.S.C.A. § 363(b).

[9] **Bankruptcy** Employment of Professional Persons or Debtor's Officers
Bankruptcy Possession, Use, Sale, or Lease of Assets

Chapter 11 debtors' retention of distressed management consultant and of individual who was consultant's employee as interim chief executive officer (CEO) constituted a sound exercise of their business judgment; during the four years preceding the petition date and continuing postpetition, consultant's personnel had occupied key management positions and supported existing in-house functions, helping to oversee debtors' daily operations, find and pursue corporate opportunities, create and carry out business plans, and otherwise manage the company, individual and his team had overseen all aspects of company's affairs and had developed strong relationships with debtors' customers, vendors, and employees, creditors believed that retention of individual was key to debtors' success, and removing consultant and individual from their management roles at this critical time could put success of entire organization at risk. 11 U.S.C.A. § 363(b).

[10] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

"Professional person," within meaning of the section of the Bankruptcy Code governing the employment of professional persons, is one who plays an intimate or central role in the administration of the debtor's bankruptcy proceeding. 11 U.S.C.A. § 327(a).

1 Case that cites this headnote

[11] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

"Professional persons," within meaning of the section of the Bankruptcy Code governing the employment of professional persons, are defined to include firms or individuals who have been hired for the purpose of reorganizing the corporation or otherwise assisting it through the Chapter 11 bankruptcy process. 11 U.S.C.A. § 327(a).

[12] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Distressed management consultant retained prepetition by Chapter 11 debtors and individual who, as consultant's employee, had served as officer and director of certain of debtors were not "professional persons" within meaning of the section of the Bankruptcy Code governing employment of professional persons; although consultant and individual, inter alia, prepared debtors' schedules and statement of financial affairs (SOFAs), assisted in claims work, reviewed contracts for assumption or rejection purposes, and obtained debtor-in-possession (DIP) financing, and were intimately involved in postpetition sale of substantial portion of debtors' business, they were not hired for the sole purpose of reorganizing, as consultant was hired four years before petition date and, since then, individual and other of consultant's personnel had managed the company, running its daily operations and providing services that would have been needed independent of any bankruptcy filing. 11 U.S.C.A. § 327(a).

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MODIFIED BENCH DECISION ON DEBTORS' APPLICATION PURSUANT TO 11 U.S.C. §§ 105(a) AND 363(b) TO (A) RETAIN ALVAREZ & MARSAL NORTH AMERICA, LLC TO PROVIDE THE DEBTORS AN INTERIM CHIEF EXECUTIVE OFFICER AND CERTAIN ADDITIONAL PERSONNEL AND (B) DESIGNATE RALPH SCHIPANI AS INTERIM CHIEF EXECUTIVE OFFICER FOR NINE WEST HOLDINGS, INC. AND ITS DEBTOR AFFILIATES, *NUNC PRO TUNC* TO THE PETITION DATE

SHELLEY C. CHAPMAN, UNITED STATES BANKRUPTCY JUDGE

***682** Before the Court is the application (the "Application") of the Debtors to (a) retain Alvarez & Marsal North America, LLC ("A & M") to provide the Debtors an interim Chief Executive Officer and certain additional personnel and (b) designate Mr. Ralph Schipani as interim Chief Executive Officer for Nine West Holdings, Inc. and its debtor affiliates *nunc pro tunc* to April 6, 2018 (the "Petition Date").[2] In support of the Application, the Debtors filed the Declaration of Mr. Ralph Schipani [Dkt. No. 207] and the Supplemental Declaration of Mr. Schipani [Dkt. No. 419] ("Schipani Suppl. Decl.").

The sole objection to the relief sought by the Application (the "Objection") was filed by the Office of the United States Trustee (the "U.S. Trustee") on June 21, 2018, together with the Declaration of Andrea Schwartz in support of the Objection [Dkt. Nos. 408 and 409]. Six statements in support of the Application were filed by creditors and/or creditor groups representing virtually all levels of the Debtors' capital structure: (i) Wells Fargo Bank, National Association, in its capacity as ABL/FILO DIP Agent and Prepetition ABL/FILO Agent; (ii) an ad hoc group formed by certain lenders (the "Ad Hoc Secured Lender Group") that collectively beneficially own or manage (or are investment advisors or managers for funds that beneficially own or manage) approximately (a) $227.5 million in aggregate principal amount of the loans under that certain Term Loan Credit Agreement, dated as of April 8, 2014 (as amended, restated, supplemented, waived, or otherwise modified from time to time prior to the Petition Date, the "Prepetition Secured Term Loan Credit Agreement"), (b) $17.5 million in aggregate principal amount of the loans under that certain Secured Superpriority Debtor-in-Possession Term Loan Credit Agreement, dated as of April 11, 2018 (as amended, restated, supplemented, waived, or otherwise modified from time to time, the "DIP Term Loan Credit Agreement"), and (c) $17.5 million in commitments for future fundings under the DIP Term Loan Credit Agreement; (iii) the so-called Ad Hoc Group of Crossover Lenders, a group of holders of loans under the Prepetition Secured Term Loan Credit Agreement and loans under that certain Unsecured Term Loan Credit Agreement, dated as of April 8, 2014 (the "Prepetition Unsecured Term Loan Credit Agreement"); (iv) GLAS Trust Company, LLC, in its capacity as Administrative Agent

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under the Prepetition Unsecured Term Loan Credit ***683** Agreement; (v) Brigade Capital Management, LP, one of the Debtors' largest economic stakeholders, serving as (a) a lender under the DIP Term Loan Credit Agreement, (b) a holder of loans under the Prepetition Secured Term Loan Credit Agreement, (c) a holder of loans under the Prepetition Unsecured Term Loan Credit Agreement, and (d) a holder of 8.25% Senior Notes Due 2019; and (vi) the Official Committee of Unsecured Creditors. Replies to the Objection were filed by the Debtors [Dkt. No. 420] ("Debtors' Reply") and by A & M [Dkt. No. 426] ("A & M Reply").

The legal issue presented is a narrow, technical one: should the Debtors be permitted to retain A & M under section 363(b) of title 11 of the United States Code (the "Bankruptcy Code"), as requested by the Application, or must the retention of A & M be considered solely under section 327(a) of the Code, as the U.S. Trustee asserts? The U.S. Trustee argues that A & M and Mr. Schipani are professional persons within the meaning of section 327 of the Code and that employment of professional persons must be accomplished solely and exclusively under section 327; the U.S. Trustee submits that a debtor cannot use section 363(b) to employ a professional person. Taking its argument a step further, the U.S. Trustee posits that A & M cannot meet the disinterestedness requirement of section 327(a) and that, therefore, the Application must be denied.

The Debtors and A & M vehemently disagree with the arguments of the U.S. Trustee, pointing out that retention of distressed management consultants has been authorized pursuant to section 363(b) in dozens of other bankruptcy cases where the engagement satisfies the business judgment standard, and that the Objection directly contradicts the U.S. Trustee's national policy over the last 14 years of explicitly assenting to retention applications for management consultants pursuant to section 363(b) in similar circumstances, some involving A & M and others involving other turnaround consulting firms and personnel. Moreover, the Debtors and A & M argue that, in the context of these cases, A & M is not functioning as a "professional person" as such term is used in section 327(a), and that section 363(b) provides the appropriate basis for granting the Application.

A hearing on the Application was held today, June 28, 2018 (the "Hearing"). At the Hearing, the Court heard live testimony from Mr. Ralph Schipani.

The Court assumes familiarity with the general background facts of the Debtors' cases; its findings in this Bench Decision pertain solely to the facts surrounding the role of A & M and Mr. Schipani in these cases. The facts described herein are contained in the record and shall constitute the Court's findings of fact.

Background

For over four years, A & M has been providing vital management services to the Debtors and their non-debtor affiliates. Pursuant to A & M's prepetition engagement letter, which is attached to the Debtors' Reply as Exhibit A ("A & M 2014 Engagement Letter"), A & M was hired in April 2014 to assist two separate companies—Jones Holdings LLC and Nine West Holdings Inc.—in achieving strategic and operational goals, namely an internal restructuring of operational functions across the companies' business units following their acquisition by Sycamore Partners, L.P. (Schipani Supp. Decl. ¶ 3; Ex. A to Debtors' Reply (A & M 2014 Engagement Letter)). Following the acquisition, the new board of directors sought the assistance of A & M to implement the new business plan, which focused on organizing and developing the company's various ***684** brands and lines as separate business units. (Schipani Suppl. Decl. ¶ 2).

A & M's Role

Since April 2014, A & M has provided vital management services to the Debtors and their non-debtor affiliates and has overseen virtually all aspects of their day-to-day operations. The duties of A & M personnel and Mr. Schipani have included, among other things, (a) supervising and assisting in operations, finance, accounting, and treasury functions; (b) assisting in the identification of cost reductions and other operational improvements; and (c) assisting in the evaluation and development of budgets and business plans. (Ex. A to Debtors' Reply (A & M 2014 Engagement Letter) ¶ 1(b)). A & M was engaged to manage the day-to-day operations of the business and supplement traditional in-house functions.

As stated by Mr. Schipani in his Supplemental Declaration, A & M was not hired to restructure the obligations of the company, and nothing in A & M's prepetition engagement related to bankruptcy planning; rather, it was not until approximately three years after the engagement began, during the summer of 2017, that the company, in consultation with advisors and independent of A & M's activities and responsibilities, began considering the possibility of a bankruptcy filing. (Schipani Suppl. Decl. ¶ 6).

Since the Petition Date, A & M has continued in its role of managing the daily operations of the Debtors' business; any services it has performed relating to the Debtors' chapter 11 process have been services that could have been performed by existing company personnel, rather than A & M personnel, had the necessary resources been available within the company. (Schipani Suppl. Decl. ¶ 7). For example, A & M personnel assisted in the company's preparation of bankruptcy schedules and disclosures, which bolstered the function of the finance department and was, as Mr. Schipani states, "a necessary extension and continuation of the A & M team's existing role in managing operations." (*Id.*). A & M has continued to provide the type of services it has provided to the company for years, and such work supports the professionals hired by the Debtors specifically for bankruptcy purposes, in Mr. Schipani's words, "in the same way that in-house employees and officers of any company going through a restructuring typically would in my experience." (Schipani Suppl. Decl. ¶ 8). Significantly, Mr. Schipani and his team played an instrumental role in achieving significant success in the recent sale of certain of the Debtors' assets for a winning bid well over 50% higher than the stalking horse bid, which secured over $140 million of additional value for the Debtors' estates.

Mr. Schipani's Role as Officer

At the outset of the A & M engagement in 2014, Mr. Schipani served initially as Interim Vice President of Operations; his principal focus then was assisting the company with an internal restructuring of operational functions across various business units. (Schipani Suppl. Decl. ¶ 3). Subsequently, during A & M's prepetition engagement, Mr. Schipani also served in each of the following roles: (i) commencing after the acquisition, as Interim President of Shared Services, where he was tasked with determining which shared services would be distributed to each of the business units, assigning employees to the different units, and managing the team that ran the non-redistributed services functions; (ii) commencing in May 2015, as Interim President of Nine West Holdings, Inc., where Mr. Schipani was responsible for public financial reporting, conducting earnings calls, and overseeing cash flow management, overall capital management, and the creation of annual business plans; and (iii) commencing in June 2016, as Interim ***685** CEO of Nine West Holdings, Inc., where he "assumed responsibility for all aspects of the Company, including ensuring that the business plans of the individual business unit heads were coordinated and executed in a consistent manner" and where he became involved with the sale of the *Easy Spirit* brand and the acquisition of Kasper Topco Limited in January 2017. (Schipani Suppl. Decl. ¶¶ 3-5, 11).

Mr. Schipani's Role as Member of Subsidiary Boards

At the time of A & M's engagement, Mr. Schipani served as an officer but not as a director of certain of the Debtors. When the Interim Chief Operating Officer, Mr. Andrew Hede (another A & M Managing Director who had been appointed in connection with A & M's engagement) ceased working on the A & M engagement, Mr. Hede resigned from his positions on the boards of certain of the Debtors' subsidiaries or affiliates. (Schipani Suppl. Decl. ¶¶ 10-11). At that time, in May 2015, Mr. Schipani was appointed to replace Mr. Hede on the boards of Dongguan Jones Commerce and Trading Co. Ltd. and Kasper Global Limited. In September 2015, when Mr. Christopher Cade, Chief Financial Officer, resigned from his positions on certain subsidiary boards, Mr. Schipani was appointed to replace Mr. Cade on the subsidiary boards from which he was departing. Around this time, Mr. Schipani was appointed to the boards of two other subsidiaries (Nine West Group International Limited and GRI Group Ltd.) to replace a company employee who had resigned from her positions. Mr. Schipani was also appointed to the board of Kasper Topco Limited when the company acquired the entity in January 2017.

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All of Mr. Schipani's board appointments were made pursuant to the request of and under the supervision of the Debtors' parent level boards, on which he did not serve. (Schipani Suppl. Decl. ¶ 12).

The only legal entity that is a Debtor in these cases on whose board Mr. Schipani has served within the past two years is One Jeanswear Group Inc. Mr. Schipani and Mr. Joseph Donnalley (another officer of the company) served as the two members of this entity's board following Mr. Cade's resignation in September 2015. After Mr. Donnalley left the company in October 2016, Mr. Schipani served as the sole board member of One Jeanswear Group Inc. from October 2016 until August 2017, when Mr. Alan Miller and Mr. Harvey Tepner were appointed as additional board members. (Schipani Suppl. Decl. ¶ 13). Mr. Schipani resigned from each of his board positions on November 22, 2017. (Schipani Suppl. Decl. ¶ 14).

Mr. Schipani's role on each subsidiary board on which he served was "strictly administrative and did not entail substantive decision making as a director." (Schipani Suppl. Decl. ¶ 15). The boards on which he sat did not hold any meetings. His actions as a director were limited to signing written consents to enact decisions that were directed by the parent board, and he did so fewer than twenty times over the two-year period during which he served on the boards. (*Id.*). Prior to approving a transaction as a director, Mr. Schipani had already conducted a "substantive review and deliberation" in his capacity as an officer, and it was incidental that he would sign a written consent in his role as a director in order to formalize the approval. (Schipani Suppl. Decl. ¶¶ 15-16). At the Hearing, Mr. Schipani provided an example of this by referring to his vetting of the amendment of the ABL Credit Agreement in his role as an officer, after which he signed a written consent to the amendment in his role as a director. At no time did Mr. Schipani serve on the board of either (i) Debtor parent Jasper Parent LLC or (ii) lead Debtor Nine West Holdings Inc.; these two boards made all decisions ***686** with respect to the prepetition and postpetition retention and compensation of officers of the company and of professional firms such as A & M. (Schipani Suppl. Decl. ¶ 18).

As set forth in his Supplemental Declaration, of the approximately 9,857 hours Mr. Schipani billed between April 2014 and the Petition Date in connection with A & M's engagement by the company, he estimates that he spent less than one half of one hour, in total, on all matters relating to his service on the subsidiary boards. (Schipani Suppl. Decl. ¶ 17).

Discussion

I. Section 363(b) of the Bankruptcy Code

[1] Pursuant to section 363(b) of the Bankruptcy Code, after notice and hearing, a debtor has broad discretion to "use, sell, or lease, other than in the ordinary course of business, property of the estate," so long as such use is supported by a good business reason. 11 U.S.C. § 363(b)(1); *see, e.g.*, *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983) ("The rule we adopt requires that a judge determining a § 363(b) application expressly find from the evidence presented before him [or her] at the hearing a good business reason to grant such an application.").

[2] The Debtors and A & M submit that, pursuant to section 363(b), the Court may authorize the Debtors' retention of A & M and of Mr. Schipani as Interim CEO. They cite to numerous decisions and orders from this District and other districts in which courts have relied on section 363(b) to authorize debtors to retain management consultancy firms, including where a firm's personnel were expected to fill key officer roles and manage the debtor's day-to-day business. *See e.g.*, *In re Enron Corp.*, No. 01-16034, 2006 WL 1030421, at *2 (Bankr. S.D.N.Y. Apr. 12, 2006) (noting that court authorized the debtors, under section 363(b), to retain a management consulting firm to provide a chief executive and chief restructuring officer and additional individuals to serve as additional personnel during the chapter 11 cases); *In re Ajubeo LLC*, No. 17-17924, 2017 WL 5466655, at *4 (Bankr. D. Col. Sept. 27, 2017) (approving retention of management consulting firm to provide a chief restructuring officer under section 363(b)); *In re Copenhaver, Inc.*, 506 B.R. 757, 764-65 (Bankr. C.D. Ill. 2014) (holding that the retention of a current director as consultant and chief restructuring officer under section 363(b) would be appropriate given the "unique and

compelling circumstances" of the case, subject to modification of the court's oversight of the officers' fees); *In re Toisa Limited*, No. 17-10184 (Bankr. S.D.N.Y. Jan. 22, 2018) [Dkt. No. 458] (approving employment of a chief restructuring officer pursuant to section 363(b)); *see also* Debtors' Reply n.5 (citing orders entered by this Court authorizing retention pursuant to section 363(b) in sixteen cases); A & M Reply ¶ 22 (citing additional orders entered by this Court). In addition, with respect to A & M specifically, Exhibit A to the A & M Reply lists thirty-seven bankruptcy cases in which A & M itself has been retained as a management consultant pursuant to section 363 of the Bankruptcy Code. Notably, except in the case of *In re Toisa Limited*, the U.S. Trustee did not object in any of the cited cases to the debtor(s)' request to employ the advisors, consultants, and/or chief restructuring officers pursuant to section 363(b) of the Code nor press the position taken here today that such retentions could only proceed under section 327.

Seemingly ignoring this mountain of precedent, the U.S. Trustee argues that there is "a limited body of case law under which courts have approved the retention of restructuring professionals under ***687** section 363 and section 105(a)." (Objection, 22). With respect to cases referenced in which A & M was retained pursuant to section 363(b), the U.S. Trustee attempts to distinguish this case from those, asserting that "[n]one involved the retention of A & M to provide an interim CEO and certain additional personnel, and nearly all involved the retention of A & M to provide a Chief Restructuring Officer and other additional personnel or financial advisory services." (Objection, 5).

The Court is not persuaded by any of the U.S. Trustee's arguments with respect to section 363(b) and the Debtors' alleged inability to utilize this section of the Code to provide the basis for retention of A & M and Mr. Schipani in this case. First, with respect to the plethora of cases cited in which section 363(b) has been relied on for the retention of A & M (without objection by the U.S. Trustee), the Court observes that the U.S. Trustee's narrow, factual distinction between the retention of Mr. Schipani as *CEO* here and the retention of an A & M professional as *CRO* in the previous engagements is nonsensical. Is the U.S. Trustee's position that retention of a CRO can be authorized under section 363 but retention of a CEO cannot? While it is true that the Debtors seek to retain Mr. Schipani as CEO and not as CRO, the U.S. Trustee's position here is that A & M and Mr. Schipani cannot be retained under section 363 and must be retained under section 327 because they are playing an intimate, significant, and central role in the Debtors' reorganization and are thus "professional persons" as such term is used in section 327(a) of the Code. (Objection, 18). Had the Debtors sought to retain Mr. Schipani as CRO, however, it appears likely that the U.S. Trustee's position with respect to section 327 would remain unchanged; he would argue that the principal duties of a CRO are to provide support in a bankruptcy case and thus retention under section 327 is required.

The distinction that that U.S. Trustee attempts to make in his Objection is simply illogical. Moreover, a close examination of the thirty-seven cases listed on Exhibit A to the A & M Reply reveals that A & M was not in fact retained to provide solely a CRO and other additional personnel to the debtors in each and every one of such cases. Instead, here, as in many of the cited cases, A & M employees were retained pursuant to section 363(b) to serve as additional officers of the debtors, including in roles such as Interim Chief Executive Officer, Interim Chief Financial Officer, Interim Chief Operating Officer, and Interim Vice President of Finance, and to provide additional A & M personnel to assist such officers. *See, e.g., In re Angelica Corp., et al.*, No. 17-10870 (Bankr. S.D.N.Y. May 4, 2017) [Dkt. No. 149]; *In re Ignite Restaurant Group, Inc., et al.*, No. 17-33550 (Bankr. S.D. Tex. Jun. 28, 2017) [Dkt. No. 255]; *In re Local Insight Media Holdings, Inc., et al.*, No. 10-13677 (Bankr. D. Del. Dec. 17, 2010; Feb. 11, 2011) [Dkt. Nos. 162, 333].

a. The Jay Alix Protocol

[3] The U.S. Trustee's position that section 363(b) cannot provide the basis for retention of distressed management consultants such as A & M here lacks intellectual honesty and consistency, particularly when considered in light of the so-called Jay Alix Protocol adopted by the U.S. Trustee fourteen years ago. The full text of the Jay Alix Protocol (the "Protocol") can be found on the website of the U.S. Trustee.[3] The Protocol is not a provision of the Bankruptcy Code. It is not law, and it ***688** is not binding on this Court or any other court. As Joe Guzinski, then acting general counsel for the

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Executive Office for U.S. Trustee, stated on November 13, 2001,

> We have seen any number of situations where turnaround or other advisory services seek to be retained as professionals under Section 327 and also have a role in management .... In our view, that renders them an insider and, therefore, not disinterested. This protocol makes clear how advisory firms will work with the debtor in the future, at least in a way that's acceptable to the UST. We have some cases pending against certain firms at this point—there are some agreements pending that we're trying to bring in under the protocol. The protocol right now only applies to cases in Region 3. But we anticipate making it a policy nationwide after discussion with the USTs.

(*See* "EOUST SAYS JAY ALIX PROTOCOL WILL BE NATIONAL POLICY," Bankruptcy Court Decisions Weekly News & Comments, 38 No. 14 Bankr. Ct. Dec. News 1 (November 13, 2001)).

The Protocol began as a settlement agreement executed in 2004 between the U.S. Trustee and Jay Alix & Associates, a management consultancy firm, in a bankruptcy case unrelated to this one; it has developed into a national policy adopted by the U.S. Trustee whereby the U.S. Trustee assents to—indeed, directs—the retention of distressed management consultants by a debtor pursuant to section 363 of the Code as long as the firm complies with certain requirements contained in the Protocol. (*See* Protocol §§ I.A-C (defining crisis management engagements to include any engagement where the firm "furnishes interim executive officers" either prepetition or postpetition and stating that crisis management firm "shall seek retention under section 363 of the Bankruptcy Code")).

As correctly summarized by the Debtors in their Reply, the core requirements of the Protocol include the following:

> (a) the firm sought to be retained must serve in only one capacity (*i.e.*, as either a financial advisor, crisis manager, claims agent, or investor);
>
> (b) the firm's retention application must be filed under section 363 of the Bankruptcy Code and the application must disclose the firm's relationships with interested parties and make other disclosures showing the firm is otherwise disinterested;
>
> (c) the firm must file monthly staffing reports, which must be subject to Court review; and
>
> (d) retention of persons furnished by the firm must be approved by and act under the direction of an independent board of directors.

Requiring parties to comply with the Protocol has served as a way to avoid conflicts of interest. More specifically, the Protocol's "one hat" rule (which requires that the firm sought to be retained serve the debtor in only one capacity) is designed to avoid the "inherent conflict" between an advisor's duty to a debtor and its own business interests where the advisory firm serves both as a financial advisor retained pursuant to section 327 of the Bankruptcy Code and as a crisis manager with firm staff serving as officers of the debtor corporation. *See In re Saint Vincent's Catholic Med. Centers of New York*, No. 05-14945, 2007 WL 2492787, at *3 n.3 (Bankr. S.D.N.Y. Aug. 29, 2007). Put simply, the Protocol was designed to prevent a party from using its position in one capacity to benefit itself in another capacity. Footnote three to the Protocol states that a financial advisor "shall not seek to be retained in any capacity in a bankruptcy proceeding for an entity where any principal, employee or independent contractor of ***689** [the advisor] serves or has served as a director of the entity or an affiliate thereof within two years prior to the petition date." (Protocol, n.3). Compliance with the Protocol prevents a director of a debtor who is also an employee of the advisory firm sought to be retained from wielding undue influence over the hiring and compensation of such director's firm. The U.S. Trustee has not objected to the section 363 retention of distressed management consultants in scores, if not hundreds, of cases over the past fourteen years where such consultants have purportedly followed the Protocol.[4]

[4] Significantly, here, the U.S. Trustee's Objection fails to mention the Protocol at all, let alone A & M's compliance in all material respects with each of its requirements. Instead, the Objection on its face ignores the U.S. Trustee's prior position with respect to section 363 retentions and argues

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that retention of A & M can only be authorized pursuant to section 327(a) of the Code, implying that there was clear error in every case in which a bankruptcy court has in the past approved an A & M retention pursuant to section 363(b). Both the Debtors and A & M speculate in their respective Replies (and counsel for the U.S. Trustee confirmed at the Hearing) that the true origin of the Objection is A & M's alleged non-compliance with footnote three of the Protocol, given Mr. Schipani's service as a director of a lone Debtor entity within two years prior to the Petition Date.

Returning to first principles, the Court finds that the purpose of the Protocol—preventing a consultant from using its position in one capacity to benefit itself in another capacity—has not been violated by A & M here. As emphasized by the Debtors in their Reply, while Mr. Schipani did in fact serve as a director on a single subsidiary board within two years of the Petition Date, neither he nor any other A & M employee has ever served on the parent boards responsible for approving the prepetition or postpetition retention or compensation of A & M. (Debtors' Reply ¶ 20; Schipani Supp. Decl. ¶ 18). Nor did Mr. Schipani's service on certain subsidiary boards overlap with the timing of the consideration of either A & M's 2014 or 2018 engagement letters. Moreover, as the Court has found, Mr. Schipani's service on certain subsidiary boards was done at the discretion and under the direction of the parent boards and primarily involved what can fairly be characterized as ministerial duties and approvals of transactions he had previously vetted in his role as an officer. Accordingly, the circumstances surrounding the concerns which led to the development of the Protocol—avoiding undue influence by a director in the hiring of professionals—are simply not present here, and the Court finds that A & M has ***690** complied with the core requirements of the Protocol in all material respects.

For fourteen years, the crisis and interim management industry has relied on the implicit consent of the U.S. Trustee that such firms can be retained in a bankruptcy case pursuant to section 363 rather than section 327 if they meet the requirements of the Protocol, and the industry has developed its business model based on the understanding that the U.S. Trustee would enforce this policy consistently and fairly. To permit the U.S. Trustee to now reverse course in this case would be, in the words of A & M, "starkly inequitable." (A & M Reply ¶ 29). The only explanation the U.S. Trustee has provided for this stunning reversal of policy is that "all bets are off" because of Mr. Schipani's *de minimis* board service; the economic disruption that his departure would cause is of no concern to the U.S. Trustee. The U.S. Trustee has chosen to take a position that would unquestionably visit damage on this case, this company, and its creditors; he chooses compliance with a footnote over the interests of every creditor in this case.

[5] Courts are tasked with ensuring compliance with the Code and ensuring that the Code is applied with common sense and in a predictable manner. The U.S. Trustee cites to the Supreme Court's decision in *Jevic* for the proposition that deviating from strict interpretation of the Bankruptcy Code and creating a "rare case" exception to retain professionals pursuant to section 363 who might be ineligible under section 327 should not be permitted, as it may "threaten[ ] to turn a 'rare case' exception into a more general rule." (*See Czyzewski v. Jevic Holding Corp.*, —— U.S. ——, 137 S.Ct. 973, 986, 197 L.Ed.2d 398 (2017)). But the U.S. Trustee ignores the Supreme Court's additional statements regarding judicially-created exceptions not specifically found in the Code but which advance significant Code-related objectives. *Jevic* strictly interpreted the absolute priority rule; however, with respect to other instances "in which a court has approved interim distributions that violate ordinary priority rules," including " 'first-day' wage orders that allow payment of employees' prepetition wages, 'critical vendor' orders that allow payment of essential suppliers' prepetition invoices, and 'roll-ups' that allow lenders who continue financing the debtor to be paid first on their prepetition claims," the Supreme Court stated that "one can generally find significant Code-related objectives that the priority-violating distributions serve." *Id.* at 985. So too here.

[6] At the Hearing, counsel for the U.S. Trustee characterized the Application's use of section 363 as a "backdoor" way to avoid the limitations of section 327(a) of the Code, including the disinterestedness requirement. When questioned by the Court, counsel for the U.S. Trustee indicated that, if a turnaround consulting firm complies with the Jay Alix Protocol, however, the U.S. Trustee would "exercise his prosecutorial discretion" and not object to the debtor's seeking retention of the firm under section 363(b)

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instead of under section 327(a). Counsel's explanation in this regard appears to indicate the U.S. Trustee's belief that only the U.S. Trustee, and not the Court, has discretion to create an "exception" to the Code's requirement that professional persons be retained pursuant to section 327 rather than pursuant to section 363; *i.e.*, that it is only permissible for the Court to approve a section 363 retention if the U.S. Trustee approves. This cannot be. If the U.S. Trustee believes he can, through the Protocol, green-light an "exception" to section 327(a)—which the Protocol clearly does—then he cannot arbitrarily revoke such protocol without notice and inflict substantial harm ***691** on professionals and debtors who have acted in reliance on over fourteen years of precedent with respect to A & M and other similar advisory firms.

As described by counsel to A & M at the Hearing, companies approaching financial distress have been able to meet their needs for operational resources by engaging management consultancy firms to run the day-to-day management of such companies and, at times, to serve as their interim officers. Engagement of management consultancy firms prior to a bankruptcy filing and their continuing retention postpetition has enabled companies to achieve business continuity during their darkest hour. As aptly pointed out by the Debtors, if, however, section 327 is the only path available for a chapter 11 debtor to retain a restructuring advisory firm and officers supplied by such firm, firms that previously provided firm personnel to fill necessary management roles at the company must be jettisoned when the company files for chapter 11 by virtue of the fact that, having served as officers of the debtor, the firm and its personnel are arguably not disinterested within the meaning of section 101(14) and thus cannot be retained under section 327(a).

This practice would disrupt company management at the precise time when management services are most needed—an absurd result, to say the least. The U.S. Trustee's position in this regard appears to be that the more vital a role an advisory firm played at a company prepetition, the more likely it is that such firm and its personnel will be unable to serve as retained professionals in the company's bankruptcy case pursuant to section 327(a) of the Code. And to what end? Notably and inexplicably, the U.S. Trustee makes the unequivocable statement in its Objection that "[a] debtor cannot use section 363(b) to employ a professional person." (Objection, 21) (citing *In re Bicoastal Corp.*, 149 B.R. 216, 218 (Bankr. M.D. Fla. 1993)). It is quite difficult for this Court to reconcile this statement with the statement in the Protocol that the professional "*shall* seek retention under section 363 of the Bankruptcy Code." (*See* Protocol § I.C. (emphasis added)).

The Court declines to elevate form over substance in the manner sought by the U.S. Trustee, Instead, it concludes that rehabilitating a debtor and preserving the value of the debtor's business—significant Code-related objectives—can be best accomplished here by permitting the Debtors to utilize their estate assets under section 363 of the Code to hire the advisory services firm and its personnel who played key management roles at the company prepetition, thus ensuring the continuity of such services. The Court agrees with the observation made by counsel to the Ad Hoc Secured Lender Group at the Hearing that section 363 is "not a backdoor but, rather, an equally appropriate door" on which the Court can consider the retention of A & M and Mr. Schipani.

Even assuming that the U.S. Trustee was not estopped from arguing that the retention cannot be considered under section 363, an argument on which the Court declines to rule at this time, after considering the extensive case law and precedent cited by the parties providing authority for the retention of A & M and Mr. Schipani pursuant to section 363(b) and the Code-related objectives of rehabilitating a debtor and preserving its economic value for stakeholders, the Court finds that the U.S. Trustee's section 363 argument is without merit. For these reasons, the Court finds that nothing precludes the Debtors from relying on section 363(b) to seek authorization for the retention of A & M and Mr. Schipani.

***692 b. The Debtors' Business Decision to Retain A & M and Mr. Schipani is a Sound Exercise of Their Business Judgment**

[7] [8] When considering whether to approve a debtor's use of estate property outside the ordinary course of business pursuant to section 363(b), courts review the business

judgment of the debtor. The business judgment standard applied by courts presumes that the court will not second guess the business judgment of a debtor's board in making a business decision, provided that the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. *See* *In re Lionel Corp.*, 722 F.2d at 1071; *Off. Comm. of Subordinated Bondholders v. Integrated Resources Inc. (In re Integrated Resources Inc.)*, 147 B.R. 650, 656 (S.D.N.Y. 1992); *In re Global Crossing Ltd.*, 295 B.R. 726, 742-43 (Bankr. S.D.N.Y. 2003).

As is evident from the plethora of case law cited by the Debtors and A & M, courts in this District and elsewhere have entered orders permitting management consultant firms to be retained under section 363(b) based upon a finding that the engagement satisfies the business-judgment standard, without requiring applicants to meet a separate burden of proof under section 327(a).

[9] Mr. Schipani's testimony at the Hearing demonstrated that retention of A & M and of Mr. Schipani as Interim CEO are necessary to preserve and maximize the value of the Debtors' businesses and are of critical importance in these cases. During the four years preceding the Petition Date and continuing postpetition, A & M personnel have occupied key management positions and supported existing in-house functions, helping to oversee day-to-day operations, find and pursue corporate opportunities, create and carry out business plans, and otherwise manage the Company at the direction of the board of directors of parent Nine West Holdings, Inc. Mr. Schipani and his team have overseen all aspects of the company's affairs and have developed strong relationships with the Debtors' customers, vendors, and employees, particularly since Mr. Schipani has served as Interim CEO since June 2016. At the Hearing, Mr. Schipani testified in a measured, detailed, and passionate way concerning his responsibilities and role as CEO and acknowledged that he is viewed as the "face of the stability" of the company by creditors, vendors, and the company's 1350 employees, all of whom are counting on him.

As evidenced by the statements in support of the Application filed by six distinct creditor groups representing virtually all major stakeholders across the Debtors' capital structure, the Debtors' creditors believe that the retention of A & M and Mr. Schipani is critical to the Debtors' success. Mr. Schipani recently played a key role in obtaining dramatically increased value for the Debtors in an auction of certain of their businesses (*see* Dkt. No. 404), and he is expected to be a key participant in discussions regarding chapter 11 resolutions and to play a crucial role in further refining the Debtors' go-forward business plan. (*See* Debtors' Reply ¶¶ 24-25). In fact, were the Debtors *not* to seek to retain the continuing services of Mr. Schipani and A & M, it would be a manifestly *unreasonable* exercise of their business judgment.

Abruptly removing Mr. Schipani and A & M from their management roles at this time, more than four years into A & M's engagement and just as the Debtors are entering the most critical phase in their history as they seek to restructure their obligations in bankruptcy, could, as the Debtors assert, put the success of the entire ***693** reorganization at risk. As counsel for the Debtor emphasized at the Hearing, were Mr. Schipani and A & M to be ousted from the roles at this time, there would likely be insurmountable disruption to the Debtors' business. Their experience in managing the company would be impossible to replicate, and any new executive and supporting personnel would have a significant learning curve that the Debtors cannot afford at this time. In addition, as pointed out in a footnote to the Debtors' Reply, the importance of the continued retention of Mr. Schipani and A & M was recently made even more stark due to the resignation of the Debtors' chief financial officer. (*See* Debtors' Reply ¶ 24, n. 8).

The Debtors have demonstrated that retention of A & M and Mr. Schipani is clearly in the best interests of the Debtors, their estates, and their creditors, and, for all of these reasons, the Court declines to second-guess the business judgment of the parent board with respect to this decision.

II. Section 327 of the Bankruptcy Code

Section 327(a) of the Bankruptcy Code provides that a trustee or debtor in possession "with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in

carrying out the trustee's duties under this title." 11 U.S.C. § 327(a).

[10] [11] "[A] professional person is one who plays an intimate or central role in the administration of the debtor's bankruptcy proceeding." (Objection, 19 (citing *Comm. Of Asbestos-Related Litigants v. Johns-Manville Corp., et al. (In re Johns-Manville Corp.)*, 60 B.R. 612, 619 (Bankr. S.D.N.Y. 1986) (stating that a professional within the meaning of section 327 is one intimately involved in the administration of the reorganization process, for example, one who played a part in negotiating a plan, who is involved with disposing of or acquiring assets, or who interacts with creditors))). In this Circuit, "professional persons" are defined to include firms or individuals who have been "hired for the purpose of reorganizing the corporation or otherwise assisting it through the Chapter 11 bankruptcy process." *In re SageCrest II, LLC*, Nos. 3:10CV978, 3:10CV979, 2011 WL 134893, at *7 (D. Conn. Jan. 14, 2011).

In *SageCrest II*, the Court explained that "[o]fficers responsible for the day-to-day business of the debtor ... stand in contrast to professionals hired for the *sole purpose* of reorganizing the debtor organization." *Id.* (emphasis added); *see also In re Phoenix Steel Corp.*, 110 B.R. 141, 142 (Bankr. D. Del. 1989) (finding that workout managers hired as officers to evaluate company's financial condition and oversee day-to-day operations were not "professional persons" within the meaning of section 327(a)); *In re Dairy Dozen-Milnor, LLP*, 441 B.R. 918, 920 (Bankr. D.N.D. 2010) (stating that a "professional person" under section 327(a) is one who "takes a central role in the administration of the debtor's bankruptcy estate and bankruptcy proceedings as opposed to one who provides services to the debtor that are necessary regardless of whether a bankruptcy petition was filed"); *In re Seatrain Lines, Inc.*, 13 B.R. 980, 981 (Bankr. S.D.N.Y. 1981) (concluding that maritime engineers hired by the debtor were not "professional persons" because they did not play a central role in the administration of the bankruptcy case and the need for their employment did not arise from the bankruptcy itself).

[12] The U.S. Trustee argues that A & M and Mr. Schipani, are "professional persons" within the scope of section 327, as ***694** they "specialize in financial and operational restructuring" and, "[d]espite the label of Interim CEO, they are intimately involved in the restructuring of the Debtors' businesses and are central to the reorganization." (Objection, 18). In support of his assertion, the U.S. Trustee points to the fact that Mr. Schipani and A & M personnel, among other things, have prepared each of the Debtors' schedules and SOFAs; have assisted in claims work and in reviewing various contracts for the Debtors to determine which contracts to assume or reject; are preparing the Debtors' 13-week cash flow forecast; have been assisting with the debtor-in-possession financing; and were intimately involved in the postpetition sale of a substantial portion of the Debtors' business where they evaluated bids, qualified certain bids, and participated in the auction which ultimately led to a very significant sale for the Debtors. (*See* Objection, 18-19).

After listing these tasks (and others) in the Objection, the U.S. Trustee concludes that Mr. Schipani and A & M have been assisting the Debtors on "nearly every major element" of a large chapter 11 case and, thus, unquestionably are professional persons within the meaning of section 327(a) who must be retained under such Code section. (Objection, 18-19).

In contrast, A & M contends that Mr. Schipani and A & M, who were engaged over four years ago to manage the day-to-day operations of the company's businesses and not for the express purpose of administering the then-nonexistent bankruptcy estates, are not "professional persons" within the meaning of section 327(a). The Court agrees. Here, there can be no doubt that the *SageCrest* "hired for the purpose of reorganizing" formulation is inapplicable to A & M.

A & M was hired four years before the Petition Date, and, since that time, Mr. Schipani and other A & M personnel have managed the company, providing services that would be needed independent of any bankruptcy filing. The evidence supports this conclusion. As stated by Mr. Schipani in his Supplemental Declaration and at the Hearing, A & M was not hired to restructure the obligations of the company, and nothing in A & M's 2014 engagement related to bankruptcy planning; rather, it was not until approximately three years after the engagement began, during the summer of 2017, that the company, in consultation with advisors and independent of A & M's activities and responsibilities, began considering the possibility of a bankruptcy filing. (Schipani Suppl. Decl. ¶ 6).

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Since the Petition Date, A & M has continued in its role of managing the daily operations of the Debtors' businesses; any services it has performed relating to the Debtors' chapter 11 processes have been services that could have been performed by existing company personnel, rather than A & M personnel, had the necessary resources been available within the company. (*See* Schipani Suppl. Decl. ¶ 7). During the chapter 11 cases, A & M has continued to provide the types of services it has provided to the company for years, and such work supports the professionals hired by the Debtors specifically for bankruptcy purposes, in Mr. Schipani's words, "in the same way that in-house employees and officers of any company going through a restructuring typically would in my experience." (Schipani Suppl. Decl. ¶ 8). As A & M correctly asserts, "because the firm is not tasked with actually administering the bankruptcy estate," it does not fall within the definition of a "professional person" under section 327(a). (A & M Reply ¶ 6).

At the Hearing, counsel for A & M elicited testimony from Mr. Schipani which illustrated that the services he provides to the company postpetition have remained largely unchanged, albeit augmented by ***695** certain bankruptcy-related responsibilities such as attending section 341 meetings and preparing monthly operating reports. He compared his prepetition and postpetition responsibilities as CEO, testifying that, during both periods, he has been responsible for, among other things, monthly reporting; managing cash flows; controlling inventory; sales of assets; and negotiating the company's financing. For instance, Mr. Schipani testified that, in 2016, he coordinated the sale of the *Easy Spirit* brand and, during the chapter 11 cases, he worked on the sale of the *Nine West* brand; he was also responsible for negotiating amendments to the prepetition credit agreement much as he did in connection with the DIP credit agreement. Mr. Schipani's testimony was supported by a comparison of the scope of services set forth in the A & M 2014 Engagement Letter and in A & M's 2018 postpetition engagement letter. Mr. Schipani likened his role as Interim CEO to the role of other CEOs at distressed companies such as that of the CEO of Chemtura, with whom he worked closely.

The Court declines to find here that Mr. Schipani and A & M are "professional persons" as such term is utilized in section 327(a) of the Code. Their roles—both prepetition and postpetition—are focused on running the business. As Mr. Schipani's testimony made clear, the services that they have provided to support the Debtors' bankruptcy-specific professionals are largely work that the officers and managers of any bankrupt entity would have to do in the ordinary course. It would be an absurd result if their work in such roles was sufficient to render them "professional persons;" if this were the case, virtually every senior executive of every chapter 11 debtor would have to be retained under section 327(a). This simply cannot be.

As the Court has determined that section 327(a) does not apply to the retention of A & M and Mr. Schipani in these cases, it need not reach the U.S. Trustee's additional argument that they are not "disinterested" under section 101(14) of the Code and thus fail to meet the requirements of section 327(a).

For all of the foregoing reasons, the Objection is overruled, the Application is granted, and the Debtors are authorized to retain A & M to provide the Debtors with an interim CEO and certain additional personnel and to designate Mr. Schipani as Interim CEO pursuant to section 363(b) of the Bankruptcy Code. The Debtors are directed to submit an order consistent with this Bench Decision.

All Citations

588 B.R. 678, 65 Bankr.Ct.Dec. 240

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Footnotes

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Nine West Holdings, Inc. (7645); Jasper Parent LLC (4157); Nine West Management Service LLC (4508); Kasper Group LLC (7906); Kasper U.S. Blocker LLC (2390); Nine West Apparel Holdings LLC (3348); Nine West Development LLC (2089); Nine West Distribution LLC (3029); Nine West Jeanswear Holding LLC (7263); One Jeanswear Group Inc. (0179); and US KIC Top Hat LLC (3076). The location of the Debtors' service address is: 1411 Broadway, New York, New York 10018.

[2] This decision was dictated on the record of the hearing held on June 28, 2018. It has been modified to include full citations and defined terms, and reflects minor additional non-substantive modifications. The findings of fact and conclusions of law herein shall constitute the Court's findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052, made applicable to this proceeding pursuant to Bankruptcy Rule 9014. To the extent any finding of fact later shall be determined to be a conclusion of law, it shall be so deemed, and to the extent any conclusion of law later shall be determined to be a finding of fact, it shall be so deemed.

[3] *See* https://www.justice.gov/sites/default/files/ust/legacy/2014/08/11/J_Alix_Protocol_Engagement.pdf.

[4] Notably, courts in this District and others have approved the retention of restructuring advisors pursuant to section 363(b) well before the U.S. Trustee first implemented the Protocol. *See, e.g., In re Adelphia Commc'ns. Corp.*, No. 02-41729 (Bankr. S.D.N.Y. July 31, 2002) [Dkt. 253] (authorizing the retention of a restructuring advisory firm to provide personnel, including a CRO, pursuant to section 363(b)); *In re Enron Corp.*, No. 01-16034, 2002 WL 32150520 (Bankr. S.D.N.Y. Apr. 4, 2002) [Dkt. 2725] (authorizing the debtors to enter into an agreement with a consulting firm which then provided an individual as Acting CEO and CRO, and certain additional personnel pursuant to section 363(b)); *In re Iridium Operating, LLC*, No. 99-45005 (Bankr. S.D.N.Y. Oct. 12, 1999) [Dkt. 86] (authorizing and approving the terms of retention for restructuring officers pursuant to sections 105(a) and 363(b)); *In re Bill's Dollar Stores, Inc.*, No. 01-0435 (Bankr. D. Del. Mar. 14, 2001) [Dkt. 141] (authorizing the continued retention of an advisory firm to provide the debtors with interim management through their Interim CEO and CRO pursuant to section 363(b)).

End of Document

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614 B.R. 244
United States Bankruptcy Court, S.D. Texas, Houston Division.

IN RE: MCDERMOTT INTERNATIONAL, INC., et al., Debtors.

CASE NO: 20-30336 (Jointly Administered)
|
Signed: May 20, 2020

Synopsis

Background: Chapter 11 debtors filed applications to employ financial restructuring firm to provide a chief transformation officer and other support personnel, and to employ affiliated firm, whose employee had provided prepetition consulting services as debtors' "chief transformation officer," as debtors' financial advisor. No party objected, but United States Trustee (UST), seeking to implement so-called J. Alix Protocol, filed statement supporting both applications solely under section of the Bankruptcy Code authorizing the use of estate property other than in the ordinary course of business, and not under the Code section governing employment of professional persons in a bankruptcy case.

Holdings: The Bankruptcy Court, David R. Jones, Chief Judge, held that:

[1] as matters of apparent first impression for the court, prepetition consulting services provided by affiliated firm's employee neither rendered him an "insider" of debtors nor prevented firms from being "disinterested" within meaning of the Code, and so firms could be employed by debtors under the Code section governing employment of professional persons, and

[2] in the future, a debtor seeking to employ a financial advisor should file a single application for employment under the Code section governing employment of professional persons, and not, pursuant to the J. Alix Protocol, under the Code section authorizing the use of estate property other than in the ordinary course of business, even if proposed advisor provided prepetition financial advisory consulting services to debtor.

Applications granted.

Procedural Posture(s): Application to Employ Attorney or Other Professional.

West Headnotes (12)

[1] **Bankruptcy** Debtor in possession, in general

In a Chapter 11 case, a debtor-in-possession is vested with the rights and powers of a trustee. 11 U.S.C.A. § 1107(a).

[2] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

To be eligible for employment under the section of the Bankruptcy Code governing employment of professional persons in a bankruptcy case, a professional person must show that it (1) is disinterested, and (2) does not hold or represent an interest adverse to the bankruptcy estate. 11 U.S.C.A. § 327(a).

2 Cases that cite this headnote

[3] **Bankruptcy** Possession, Use, Sale, or Lease of Assets

Section of the Bankruptcy Code governing use, sale, or lease of property expressly provides authorization for the use of estate property outside the ordinary course of business. 11 U.S.C.A. §§ 363, 363(b).

[4] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Although the section of the Bankruptcy Code governing employment of professional persons in a bankruptcy case has been utilized to authorize the retention of professional persons, the language itself deals only with the use of estate property, not the conditions under which a professional person may be employed. 11

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U.S.C.A. § 363(b).

[5] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Bankruptcy Sale or Assignment of Property

Underlying premise of the "J. Alix Protocol," a national settlement protocol to resolve United States Trustee (UST) Program's objections to debtors' applications to retain chief restructuring officers (CRO) and their firms where the CRO had served in the role prior to the bankruptcy filing, is that while the section of the Bankruptcy Code governing employment of professional persons in a bankruptcy case would prohibit the employment of the financial advisory firm due to a lack of disinterestedness, the section of the Code authorizing the use of estate property other than in the ordinary course of business contains no such restriction; the protocol necessarily assumes that the alleged lack of disinterestedness of the individual serving as the CRO is per se imputed to the CRO's firm. 11 U.S.C.A. §§ 327(a), 363(b).

2 Cases that cite this headnote

[6] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Application process for a debtor's employment of a chief restructuring officer (CRO) demands complete transparency. 11 U.S.C.A. § 327(a).

[7] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Individual who provided prepetition consulting services as Chapter 11 debtors' "chief transformation officer" was not an "insider" due to his prepetition status, nor did that status prevent either a financial restructuring firm or that firm's affiliated firm, which actually employed him, from being "disinterested," and so, under the section of the Bankruptcy Code governing employment of professional persons, restructuring firm could be employed by debtors to provide a chief transformation officer and other support personnel, and affiliated firm could be employed as debtors' financial advisor; individual was never employed by debtors, debtors' prepetition employment of firms did not prevent their postpetition employment, and assuming arguendo that providing financial advisory services with title of chief transformation officer rendered individual "not disinterested," that lack of disinterestedness was not per se imputed to firms, nor were they otherwise alleged to be not disinterested. 11 U.S.C.A. §§ 101(14)(B), 327, 1107(b).

1 Case that cites this headnote

[8] **Bankruptcy** Construction and Operation

In construing the Bankruptcy Code, the court must presume that Congress meant what it said and will not infer that which clearly does not exist.

[9] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

The two primary goals of the section of the Bankruptcy Code governing employment of professional persons in a bankruptcy case are to ensure the impartiality of the professional and to provide court oversight in the determination of the reasonableness of the professional's compensation. 11 U.S.C.A. § 327(a).

[10] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Impartiality and court-oversight goals of the section of the Bankruptcy Code governing employment of professional persons in a bankruptcy case are best achieved through a transparent process that governs the employment of all professional persons employed by a debtor. 11 U.S.C.A. § 327(a).

[11] **Bankruptcy** Employment of Professional Persons or Debtor's Officers

Case-by-case approach should be used in determining whether an alleged lack of disinterestedness on the part of a consultant who provided prepetition services to a Chapter 11

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debtor should be imputed to the firm that employed the consultant. 11 U.S.C.A. §§ 101(14)(B), 327(a).

[12] **Bankruptcy** Employment of Professional Persons or Debtor's Officers
Bankruptcy Sale or Assignment of Property

When a Chapter 11 debtor seeks to employ a financial advisor, a single application for employment, seeking to employ the best financial advisory professionals to render the best financial advisory services for the benefit of debtors who so need their talents, should be filed under the section of the Bankruptcy Code governing employment of professional persons, and not, pursuant to the United States Trustee's (UST) so-called J. Alix Protocol, under the section of the Code authorizing the use of estate property other than in the ordinary course of business, even if the proposed advisor provided prepetition financial advisory consulting services to the debtor. 11 U.S.C.A. §§ 327(a), 363(b).

Attorneys and Law Firms

***246** Matthew D. Cavenaugh, Kristhy M. Peguero, Veronica Ann Polnick, Jackson Walker, LLP, Jeffrey L. Diamond, Houston, TX, Ciara Foster, Christopher T. Greco, Joshua A. Sussberg, Kirkland & Ellis LLP, New York, NY, Anthony R. Grossi, Kirkland & Ellis LLP, Washington, DC, John R. Luze, Kirkland & Ellis LLP, Chicago, IL, for Debtor.

MEMORANDUM OPINION

(Docket Nos. 434, 636 and 637)

DAVID R. JONES, UNITED STATES BANKRUPTCY JUDGE

***247** Before the Court are the Debtors' applications to employ (i) AlixPartners, LLP as the Debtors' financial advisor under 11 U.S.C. § 327(a) [Docket No. 636]; and (ii) AP Services, LLC to provide a chief transformation officer and other support personnel under 11 U.S.C. §§ 105 and 363(b)[1] [Docket No. 63]. The U.S. Trustee supports both applications solely under § 363(b). The Court approves both applications under 11 U.S.C. § 327(a). The Court issues this memorandum opinion to explain its analysis and to provide guidance for future applications filed in this district. A separate order approving the applications will issue consistent with this memorandum opinion.

Relevant Procedural History

1. By letter agreement dated October 22, 2019, McDermott International, Inc. and certain affiliates (collectively, "McDermott") and AP Services, LLC ("AP Services") entered into an agreement under which AP Services agreed to provide temporary personnel to McDermott to assist in a contemplated financial restructuring [Docket No. 434-1]. The October 22, 2019 engagement letter replaced a prior agreement dated September 17, 2019 between McDermott and AlixPartners, LLP ("AlixPartners"), an affiliate of AP Services. *Id.* Under the specific terms of the October 22 agreement, AP Services agreed to provide John Castellano on an hourly fee basis to provide professional services in the role of McDermott's chief transformation officer along with eight other identified professionals and various unidentified support personnel. *Id.* The October 22 agreement also provided for the payment of a $5 million success fee that was earned upon a successful restructuring. *Id.* The engagement agreement was amended on November 14, 2019 and again on January 20, 2020. *Id.* Interestingly, the January 20, 2020 amendment identifies AP Services as the "vendor," yet it is executed by AlixPartners as the "vendor." The November 14, 2019 amendment was not attached to the applications presented to the Court.

2. McDermott entered chapter 11 on January 21, 2020 [Docket No. 1]. On February 19, 2020, McDermott filed its application to employ AP Services and to designate Mr. Castellano as McDermott's chief transformation officer pursuant to the October 22, 2019 pre-petition agreement under 11 U.S.C. §§ 105 and 363 [Docket No. 434] (the

"Original Application"). The Court did not schedule a hearing or otherwise issue a ruling on the Original Application. Instead, the Court indicated during a hearing on February 24, 2020 that it had concerns about the application but would schedule a hearing if requested. [Transcript, pgs. 71-73, Docket No. 507]. Alternatively, the Court invited McDermott to take a different approach and amend its pleading. *Id.* On March 2, 2020, McDermott filed a notice indicating that modified pleadings would be filed [Docket No. 525].

3. On March 11, 2020, McDermott filed (i) an application to employ AlixPartners as the Debtors' financial advisor under section 11 U.S.C. § 327(a) [Docket No. 636]; and (ii) an amended application to employ AP Services under 11 U.S.C. §§ 105 and 363(b) [Docket No. 637].

***248** 4. The Court confirmed McDermott's proposed second amended plan by order entered March 12, 2020 [Docket No. 665 as amended at Docket No. 684]. At the confirmation hearing, the Court noted that the success experienced by McDermott in the case was due, in no small part, to the extraordinary talent and skill of Mr. Castellano and his team [Transcript, pgs. 176-77, Docket No. 690].

5. No party filed a formal objection to either of the two applications. On April 8, 2020, the U.S. Trustee filed a statement regarding the applications [Docket No. 835]. In the statement, the U.S. Trustee argued that both applications should be granted only under § 363(b) and not § 327(a) based on its assertion that both AP Services and AlixPartners were statutorily ineligible to be employed under § 327(a). *Id.* In so doing, the U.S. Trustee sought to implement what has become widely known as the J. Alix Protocol. *See, e.g., In re Nine West Holdings, Inc.*, 588 B.R. 678, 691 (Bankr. S.D.N.Y. 2018). Concerned about the status of their employment, AlixPartners and AP Services also filed a joint statement in support of the applications on April 18, 2020 [Docket No. 848].

6. Pursuant to the Court's *Protocol for Emergency Public Health or Safety Conditions* [General Order 2020-4], the Court conducted a video hearing on the two applications on April 28, 2020. During the hearing, the Court heard the testimony of Mr. Castellano. Mr. Castellano testified that AlixPartners and AP Services were engaged by McDermott to provide advice and services in connection with its restructuring and that he was not personally employed by McDermott at any time. [Transcript at 25-26, Docket No. 870]. Mr. Castellano further testified that his title as "chief transformation officer" was not magical and could have easily been "chief transformation person" or "head minion" [Transcript at 26, Docket No. 870].

7. At the conclusion of the hearing, the Court announced that it would grant the applications but not on the legal basis requested by McDermott or the U.S. Trustee. [Transcript at 26, Docket No. 870]. The Court issues this memorandum opinion to explain its reasoning.

Analysis

8. The Court has jurisdiction over this contested matter pursuant to 28 U.S.C. § 1334. This contested matter is a core proceeding arising under title 11 pursuant to 28 U.S.C. §§ 157(b)(2)(A) and (M). The Court has constitutional authority to enter a final order in this contested matter. *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). To the extent necessary, the parties have consented to the entry of a final order by the Court. *Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015).

Employment under 11 U.S.C. § 327(a)

[1] 9. The employment of professional persons in a bankruptcy case is governed by 11 U.S.C. § 327. Section 327(a) provides:

> **§ 327. Employment of professional persons**
>
> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a). In a chapter 11 case, a debtor-in-possession is vested with the rights and powers of a trustee.

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11 U.S.C. § 1107(a). *See also* ***249** *ASARCO v. Americas Mining Corp.*, 396 B.R. 278, 435 fns. 21, 32 and 35 (S.D. Tex. 2008) (the terms "debtor in possession" and "trustee" used interchangeably). Bankruptcy Rule 2014 further requires that an application to employ a professional person must set forth "specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee." Fed. R. Bankr. P. 2014.

[2] 10. To be eligible for employment under § 327(a), a professional person[2] must show that it (i) is disinterested; and (ii) does not hold or represent an interest adverse to the bankruptcy estate. *In re American Int'l Refinery, Inc.*, 676 F.3d 455, 461 (5th Cir. 2012); *In re W.F. Development Corp.*, 905 F.2d 883, 884 (5th Cir. 1990). A disinterested person is a person that (i) is not a creditor, an equity security holder or an insider; (ii) is not and was not, within two years prior to the petition date, a director, officer or employee of the debtor; and (iii) does not hold a material adverse interest to the bankruptcy estate or any class of creditors or interest holders by way of its relationship to the debtor or for any other reason. 11 U.S.C. § 101(14).

11. In addition to the requirements of § 327, § 1107(b) provides additional guidance on the employment of professional persons in chapter 11 cases:

> Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case.

11 U.S.C. § 1107(b).

Section 363(b)

[3] [4] 12. Section 363(b) does not specifically address the employment of professional persons. Rather, § 363(b) provides, in relevant part:

> **§ 363. Use, sale, or lease of property.**
>
> ...
>
> **(b)(1)** The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate....

This section expressly provides authorization for the use of estate property outside the ordinary course of business. *In re Asarco, L.L.C.*, 650 F.3d 593, 601 (5th Cir. 2011) (providing that section 363 of the Bankruptcy Code authorizes the use, sale, or lease of estate property subject to a business judgment standard). Although the above-cited language has been utilized as set forth below to authorize the retention of professional persons, the language itself deals only with the use of estate property not the conditions under which a professional person may be employed.

The Development of the J. Alix Protocol

[5] 13. As early as 2001, the United States Trustee Program began the implementation of a national settlement protocol to resolve its objections to debtors' applications to retain chief restructuring officers ("CROs") and their firms where the CRO had served in the role prior to the bankruptcy filing. *See* ***250** *In re Safety-Kleen Corp.*, Case No. 00-2303, Docket Nos. 2825, 2920 (Bankr. D. Del. 2000). The underlying premise of the protocol is that while § 327(a) would prohibit the employment of the financial advisory firm due to a lack of disinterestedness, § 363(b) contains no such restriction. The protocol necessarily assumes that the alleged lack of disinterestedness of the individual serving as the CRO is *per se* imputed to the CRO's firm. This approach has been become commonly known as the J. Alix Protocol (the "Alix Protocol"). The Alix Protocol has been both endorsed and criticized by various courts. *See In re Blue Stone Real Estate, Const. & Dev. Corp.*, 392 B.R. 897, 907 n.14 (Bankr. M.D. Fla. 2008) (noting the failure of the "Jay Alix" Protocol in that it does not provide the Court with the ability to meet the goals of section 327); *In re Saint Vincents Catholic Medical Ctrs. of New York*, Case No. 05-B-14945,

2007 WL 2492787 *14, 16 (Bankr. S.D.N.Y. August 29, 2007) (providing that the Jay Alix Protocol contains comprehensive disclosure requirements); *In re Adelphia Communications Corp.*, 336 B.R. 610, 667-668, 667 n.151 (Bankr. S.D.N.Y. 2006). The Alix Protocol is even now embodied within Volume 3 of the official United States Trustee Program Policy and Practices Manual. *See* https://www.justice.gov/ust/file/volume_3_chapter_11_case_administration.pdf/download.

14. In its original form, the J. Alix Protocol provided:

Protocol for Engagement of Jay Alix & Associates and Affiliates

I. Retention Guidelines

A. Jay Alix & Associates ("JA & A") is a firm that provides turnaround and crisis management services, financial advisory services, management consulting services, information systems services and claims management services. In some cases the firm provides these services as advisors to management, in other cases one or more of its staff serve as corporate officers and other of its staff fill positions as full time or part time temporary employees ("crisis manager"), and in still other cases the firm may serve as a claims administrator as an agent of the Bankruptcy Court. JA & A and its affiliates will not act in more than one of the following capacities in any single bankruptcy case: (i) crisis manager retained under Sec. 363, (ii) financial advisor retained under Sec. 327, (iii) claims agent/claims administrator appointed pursuant to 28 U.S.C. § 156(c) and any applicable local rules or (iv) investor/acquirer; and upon confirmation of a Plan may only continue to serve in a similar capacity. Further, once JA & A or one of its affiliates is retained under one of the foregoing categories it may not switch to a different retention capacity in the same case. However, with respect to subsequent investments by Questor this prohibition is subject to the time limitations set forth in IV.B below.

B. Engagements involving the furnishing of interim executive officers whether prepetition or postpetition (hereinafter "crisis management" engagements) shall be provided through JA & A Services LLC ("JAS").

C. JAS shall seek retention under section 363 of the Bankruptcy Code. The application of JAS shall disclose the individuals identified for executive officer positions as well as the names and proposed functions of any additional staff to be furnished by JAS. In the event the Debtor or ***251** JAS seeks to assume additional or different executive officer positions, or to modify materially the functions of the persons engaged, a motion to modify the retention shall be filed. It is often not possible for JAS to know the extent to which full time or part time temporary employees will be required when beginning an engagement. In part this is because the extent of the tasks that need to be accomplished is not fully known and in part it is because JAS is not yet knowledgeable about the capability and depth of the client's existing staff. Accordingly, JAS shall file with the Court with copies to the UST and all official committees a report of staffing on the engagement for the previous month. Such report shall include the names and functions filled of individuals assigned. All staffing shall be subject to review by the Court in the event an objection is filed.

D. Persons furnished by JAS for executive officer positions shall be retained in such positions upon the express approval thereof by an independent Board of Directors whose members are performing their duties and obligations as required under applicable law ("Board"), and will act under the direction, control and guidance of the Board and shall serve at the Board's pleasure (*i.e.* may be removed by majority vote of the Board).

E. The application to retain JAS shall make all appropriate disclosures of any and all facts that may have a bearing on whether JAS, its affiliates, and/or the individuals working on the engagement have any conflict of interest or material adverse interest, including but not necessarily limited to the following:

1. Connection, relationship or affiliation with secured creditors, postpetition lenders, significant unsecured lenders, equity holders, current or former officers and directors, prospective buyers, or investors.

2. Involvement as a creditor, service provider or professional of any entity with which JA & A or any

affiliate has an alliance agreement, marketing agreement, joint venture, referral arrangement or similar agreement.

3. Any prepetition role as officer, director, employee or consultant, but service as a pre-petition officer will not *per se* cause disqualification.

4. Any prepetition involvement in voting on the decision to engage JA & A or JAS in the bankruptcy case, and/or any prepetition role carrying the authority to decide unilaterally to engage JA & A or JAS.

5. Information regarding the size, membership and structure of the Board so as to enable the UST and other interested parties to determine that the Board is independent.

6. Whether the executive officers and other staff for the engagement are expected to be engaged on a full time or part time basis, and if part-time whether any simultaneous or prospective engagement exists that may be pertinent to the question of conflict or adverse interest.

7. The existence of any unpaid balances for prepetition services.

***252** 8. The existence of any asserted or threatened claims against JA & A, JAS or any person furnished by JA & A/JAS arising from any act or omission in the course of a prepetition engagement.

F. Disclosures shall be supplemented on a timely basis as needed throughout the engagement.

G. Where JA & A does not act as a crisis manager its retention will be sought as a financial advisor under section 327 of the Code or as a Court appointed claims representative.

II. Compensation

A. Compensation in crisis management engagements shall be paid to JAS.

B. The application to retain JAS shall disclose the compensation terms including hourly rates and the terms under which any success fee or back-end fee may be requested.

C. JAS shall file with the Court, and provide notice to the UST and all official committees, reports of compensation earned and expenses incurred on at least a quarterly basis. Such reports shall summarize the services provided, identify the compensation earned by each executive officer and staff employee provided, and itemize the expenses incurred. The notice shall provide a time period for objections. All compensation shall be subject to review by the Court in the event an objection is filed (*i.e.*, a "negative notice" procedure).

D. Success fees or other back-end fees shall be approved by the Court at the conclusion of the case on a reasonableness standard and shall not be pre-approved under section 328(a). No success fee or back-end fee shall be sought upon conversion of the case, dismissal of the case for cause or appointment of a trustee.

III. Indemnification

A. Debtor is permitted to indemnify those persons serving as executive officers on the same terms as provided to the debtor's other officers and directors under the corporate bylaws and applicable state law, along with insurance coverage under the debtor's D & O policy.

B. There shall be no other indemnification of JA & A, JAS or affiliates.

IV. Subsequent Engagements

A. Pursuant to the "one hat" policy as stated above, after accepting an engagement in one capacity, JA & A and affiliates shall not accept another engagement for the same or affiliated debtors in another capacity.

B. For a period of three years after the conclusion of the engagement, Questor shall not make any investments in the debtor or reorganized debtor where JA & A, JAS or another affiliate has been engaged.

Certain footnotes omitted.

[2] "Executive officers" shall include but is not necessarily limited to Chief Executive Officer, President, Chief Operating Officer, Treasurer, Chief Financial Officer,

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Chief Restructuring Officer, Chief Information Officer, and any other officers having similar roles, power or authority, as well as any other officers provided for in the company's bylaws.

https://www.justice.gov/sites/default/files/ust/legacy/2014/08/11/J_Alix_Protocol_Engagement.pdf.

[6] 15. While innovative at its inception, the Alix Protocol has become a tool to avoid transparency and create inequity. Based on the Court's observations, applicants selectively comply with the protocol's requirements in a majority of cases. The ***253** protocol's suggestion that separate entities be utilized as artificial barriers creates confusion. Applicants routinely push more and more services under the auspices of § 363(b) to avoid court oversight through the fee application process and the accompanying public transparency. Invoices are provided to limited parties in lumped fashion and kept from public scrutiny. Financial advisory services are inappropriately categorized as "back office" support services. Success fees are mentioned only in a back-page disclosure. Even the U.S. Trustee has not been above the fray. Contrary to its published position, the U.S. Trustee asserted in *In re Nine West Holdings, Inc.*, that the protocol was not applicable to an application where the financial advisory firm seeking retention was providing a temporary chief executive officer as opposed to a chief reorganization officer. 588 B.R. 678 (Bankr. S.D.N.Y. 2018). These examples are but a sampling and tarnish the sanctity of a process that demands complete transparency. Moreover, the protocol is completely unnecessary.

The AlixPartners/AP Services Applications

16. The applications in this case serve as an illustrative example of why a re-examination of the process is required. In its original application, McDermott sought only to employ AP Services on an hourly fee basis under § 363(b) to provide a range of financial advisory services [Docket No. 434]. Mr. Castellano was designated to serve as the chief transformation officer in the engagement with support provided by other AP Services personnel [Docket No. 434]. No mention is made of services to be provided by AlixPartners. As the employment was under § 363(b), no fee applications would be required. It is unclear whether the $5 million success fee would be the subject of a future pleading as court approval was described as needed only "as applicable" [Docket No. 434]. The cases cited for authority of the employment under § 363(b) have little to do with the employment of professional persons [Docket No. 434, para. 34]. Notably, no objections were filed to the original application.

17. After the Court indicated concern with the application, the Debtors filed two applications. The first application sought the employment of AlixPartners as a financial advisor on an hourly fee basis under § 327(a) [Docket No. 636]. The application is supported by an affidavit pursuant to Bankruptcy Rule 2014 and makes clear that all compensation, including the $5 million success fee, is subject to the fee application process under 11 U.S.C. § 330 [Docket No. 636]. The second application sought the retention of AP Services under § 363(b) and to designate Mr. Castello as chief transformation officer under the engagement [Docket No. 637]. The unbundling of the triangular relationship between the parties added a much appreciated level of transparency to the process.

[7] 18. In response to the two applications, the U.S. Trustee filed a statement asserting that while AlixPartners was ineligible to be employed under § 327, it had no objection to its employment under § 363(b) [Docket No. 835]. The U.S. Trustee continued to have no objection to AP Services' employment under § 363(b) [Docket No. 835]. At the core of the U.S. Trustee's position is the notion that Mr. Castellano's pre-petition consulting services as McDermott's "chief transformation officer" prevent both AP Services and AlixPartners from being disinterested under 11 U.S.C. § 101(14)(B) [Docket No. 835]. The U.S. Trustee further asserts that Mr. Castellano is an insider due to his pre-petition status. To complete the circle, the U.S. Trustee asserts that Mr. Castellano's status is *per se* imputed to both AP Services ***254** and AlixPartners. The Court disagrees.

19. First, the Court notes that Mr. Castellano has never been employed by McDermott. Both the pre-petition and post-petition relationships involved McDermott on one hand and AP Services/AlixPartners on the other. The prepetition employment by McDermott of AP Services/AlixPartners does not prevent their employment during the bankruptcy case. *See* 11 U.S.C. § 1107(b). Second, and assuming *arguendo*, that providing financial advisory services with a

title of chief transformation officer rendered Mr. Castellano not disinterested[3] under § 101(14), the Court questions whether that lack of disinterestedness is *per se* imputed to AP Services and AlixPartners.

20. In *In re: Cygnus Oil and Gas Corp*., the Court examined whether a *per se* rule imputing a single member's disinterestedness to the member's firm is appropriate. No. 07-32417, 2007 WL 1580111 (Bankr. S.D. Tex. May 29, 2007). Noting that the operative sections of the Bankruptcy Code were silent on the issue, Judge Isgur applied the plain reading of §§ 101(14) and (41) and determined that no *per se* rule existed. *Id.* at *3. A majority of courts agree with this determination. *See* *U.S. Trustee v. S.S. Retail Stores Corp. (In re S.S. Retail Stores Corp.),* 211 B.R. 699, 703 (9th Cir. BAP 1997); *Vergos v. Timber Creek, Inc.,* 200 B.R. 624, 627 (W.D. Tenn. 1996); *Capen Wholesale, Inc. v. Michel (In re Capen Wholesale, Inc.),* 184 B.R. 547, 551 (N.D. Ill. 1995); *In re Young Mens Christian Assoc.*, 570 B.R. 64, 68 (Bankr. W.D. Mich. 2017); *In re Sea Island Co.*, No. 10-21034, 2010 WL 4386855, *2 (Bankr. S.D. Ga. Oct. 20, 2010); *In re Creative Rest. Mgmt., Inc.,* 139 B.R. 902, 913 (Bankr. W.D. Mo. 1992).

[8] 21. The Court agrees with Judge Isgur's analysis. The Court must presume that Congress meant what it said and will not infer that which clearly does not exist. *See* *Conn. Nat'l Bank v. Germain,* 503 U.S. 249, 253–54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992) ("We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says [ ]."). In so doing, the Court notes that Congress has not been reluctant to impute one person's status to such person's firm when it determined it was appropriate to do so. *See, e.g.* Fed. R. Bankr. P. 5002 (prohibiting the employment of a professional person related to the bankruptcy judge as well as any members of such person's firm). The above analysis is equally applicable to the U.S. Trustee's argument that Mr. Castellano's alleged insider status must be imputed to AP Services/AlixPartners.

22. The Court has reviewed the decision in *In re Essential Therapeutics, Inc.* cited by the U.S. Trustee in support of a *per se* rule. 295 B.R. 203 (Bankr. D. Del. 2003). The "current climate of distrust of officers and directors" cited by the court as the basis for imposing a *per se* rule is simply insufficient to legislate an otherwise nonexistent condition into the Bankruptcy Code. Moreover, it leads one to consider whether such a rule would be required in a different "climate." If such a consideration is appropriate, then the *Essential Therapeutics* rule is not really a *per se* rule.

23. At the hearing on the applications, no party offered any evidence that AP Services or AlixPartners is a creditor, an equity security holder or an insider of McDermott. Likewise, no evidence was offered to suggest that AP Services or AlixPartners ***255** was an officer, director or employee of McDermott within two years of the petition date. No evidence was offered to suggest that Mr. Castellano's alleged disinterestedness should be imputed to AP Service or AlixPartners. Under § 101(14)(C), the Court is further required to ensure that AP Services and AlixPartners do not hold a material interest adverse to McDermott or any class of creditors or interest holders. No party alleges and the Court has no evidence of any such adverse interest. Based on the record presented, the Court finds that AP Services and AlixPartners are disinterested persons as the term is defined under § 101(14).

Conclusion

[9] [10] [11] 24. The two primary goals of § 327(a) are to ensure the impartiality of the professional and to provide court oversight in the determination of the reasonableness of the professional's compensation. *In re Ajubeo*, No. 17-17924-JGR, 2017 WL 5466655, at *3 (D. Col. Sept. 27, 2017); *In re Blue Stone Real Estate, Const. & Dev. Corp.,* 392 B.R. 897, 907 n.14 (Bankr. M.D. Fla. 2008). These goals are best achieved through the transparent process of § 327(a) that governs the employment of all professional persons employed by a debtor. The case-by-case approach to the imputation of a lack of disinterestedness harmonizes the expressed concerns all parties. The Court maintains the necessary discretion to address the inevitable unusual case. Both the Court's analysis and the professional's performance are publicly available for all to see. All relevant code sections work in harmony to promote efficiency without the need for artificial constructs to achieve a specific result.

[12] 25. In this case, the U.S. Trustee acknowledges the skill and contribution made by the applicants. Likewise, the Court previously noted that the case would not have been a success without their guidance. Their contributions deserve more than an obfuscated process designed to skirt the bankruptcy process implemented by Congress. In the future, the Court expects to see a single application for employment under § 327(a) seeking to employ the best financial advisory professionals to render the best financial advisory services for the benefit of debtors who so need their talents. The applications of AP Services and AlixPartners are approved pursuant to 11 U.S.C. § 327(a). Mr. Castellano is designated as McDermott's chief restructuring officer.

All Citations

614 B.R. 244

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Footnotes

1 Contrary to the pleadings and the arguments of the parties, McDermott does not seek to employ John Castellano. Mr. Castellano is the person designated to lead the engagement by AP Services/AlixPartners and has remained employed by AlixPartners at all relevant times.

2 The term "person" includes an individual, a partnership or a corporation. 11 U.S.C. § 101(41).

3 The Court expresses no opinion whether an outside chief transformation officer not employed by the debtor constitutes an officer under § 101(14)(B).

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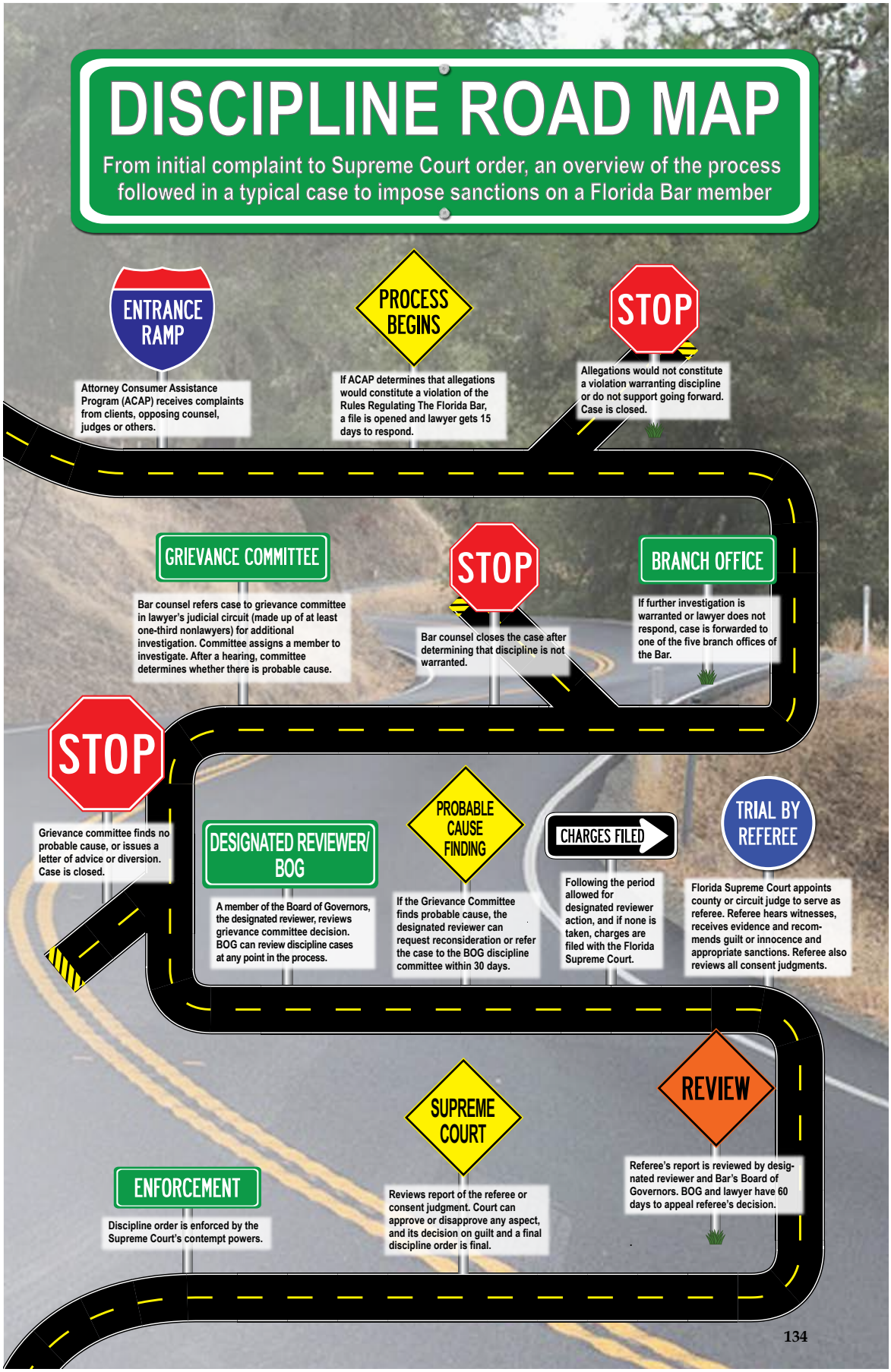
DISCIPLINE ROAD MAP
From initial complaint to Supreme Court order, an overview of the process followed in a typical case to impose sanctions on a Florida Bar member
ENTRANCE RAMP
Attorney Consumer Assistance Program (ACAP) receives complaints from clients, opposing counsel, judges or others.
PROCESS BEGINS
If ACAP determines that allegations would constitute a violation of the Rules Regulating The Florida Bar, a file is opened and lawyer gets 15 days to respond.
STOP
Allegations would not constitute a violation warranting discipline or do not support going forward. Case is closed.
GRIEVANCE COMMITTEE
Bar counsel refers case to grievance committee in lawyer's judicial circuit (made up of at least one-third nonlawyers) for additional investigation. Committee assigns a member to investigate. After a hearing, committee determines whether there is probable cause.
STOP
Bar counsel closes the case after determining that discipline is not warranted.
BRANCH OFFICE
If further investigation is warranted or lawyer does not respond, case is forwarded to one of the five branch offices of the Bar.
STOP
Grievance committee finds no probable cause, or issues a letter of advice or diversion. Case is closed.
DESIGNATED REVIEWER/ BOG
A member of the Board of Governors, the designated reviewer, reviews grievance committee decision. BOG can review discipline cases at any point in the process.
PROBABLE CAUSE FINDING
If the Grievance Committee finds probable cause, the designated reviewer can request reconsideration or refer the case to the BOG discipline committee within 30 days.
CHARGES FILED
Following the period allowed for designated reviewer action, and if none is taken, charges are filed with the Florida Supreme Court.
TRIAL BY REFEREE
Florida Supreme Court appoints county or circuit judge to serve as referee. Referee hears witnesses, receives evidence and recommends guilt or innocence and appropriate sanctions. Referee also reviews all consent judgments.
REVIEW
Referee's report is reviewed by designated reviewer and Bar's Board of Governors. BOG and lawyer have 60 days to appeal referee's decision.
SUPREME COURT
Reviews report of the referee or consent judgment. Court can approve or disapprove any aspect, and its decision on guilt and a final discipline order is final.
ENFORCEMENT
Discipline order is enforced by the Supreme Court's contempt powers.
134

Former client

The duty of confidentiality continues after the client-lawyer relationship has terminated. See rule 4-1.9 for the prohibition against using such information to the disadvantage of the former client.

Amended July 23, 1992, effective January 1, 1993 (605 So.2d 252); amended Oct. 20, 1994 (644 So.2d 282); March 23, 2006, effective May 22, 2006 (933 So.2d 417); amended July 7, 2011, effective October 1, 2011 (67 So. 3d 1037); amended May 29, 2014, effective June 1, 2014 (140 So. 3d 541); amended June 11, 2015, effective October 1, 2015 (167 So.3d 412).

RULE 4-1.7 CONFLICT OF INTEREST; CURRENT CLIENTS

(a) Representing Adverse Interests. Except as provided in subdivision (b), a lawyer must not represent a client if:

(1) the representation of 1 client will be directly adverse to another client; or

(2) there is a substantial risk that the representation of 1 or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Informed Consent. Notwithstanding the existence of a conflict of interest under subdivision (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a position adverse to another client when the lawyer represents both clients in the same proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing or clearly stated on the record at a hearing.

(c) Explanation to Clients. When representation of multiple clients in a single matter is undertaken, the consultation must include an explanation

though the person is unable to establish a client-lawyer relationship or make or express considered judgments about the matter when the person or another acting in good faith on that person's behalf has consulted with the lawyer. Even in an emergency, however, the lawyer should not act unless the lawyer reasonably believes the person has no alternative available. The lawyer should take legal action on behalf of the person only to the extent reasonably necessary to maintain the status quo or otherwise avoid imminent and irreparable harm. A lawyer who undertakes to represent a person in an exigent situation has the same duties under these rules as the lawyer would with respect to a client.

A lawyer who acts on behalf of a person with diminished capacity in an emergency should keep the confidences of the person as if dealing with a client, disclosing them only to the extent necessary to accomplish the intended protective action. The lawyer may disclose to any tribunal involved and to any other counsel involved the nature of his or her relationship with the person while maintaining the person's confidential information.

Amended July 23, 1992, effective January 1, 1993 (605 So.2d 252); amended March 3, 2022, effective May 2, 2022 (SC20-1467).

RULE 4-1.15 SAFEKEEPING PROPERTY

Compliance With Trust Accounting Rules. A lawyer shall comply with The Florida Bar Rules Regulating Trust Accounts.

Amended July 23, 1992, effective Jan. 1, 1993 (605 So.2d 252);, April 25, 2002 (820 So.2d 210).

RULE 4-1.16 DECLINING OR TERMINATING REPRESENTATION

(a) When Lawyer Must Decline or Terminate Representation. Except as stated in subdivision (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the Rules of Professional Conduct or law;

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client;

(3) the lawyer is discharged;

(4) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent, unless the client agrees to disclose and rectify the crime or fraud; or

(5) the client has used the lawyer's services to perpetrate a crime or fraud, unless the client agrees to disclose and rectify the crime or fraud.

(b) When Withdrawal Is Allowed. Except as stated in subdivision (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;

(2) the client insists upon taking action that the lawyer considers repugnant, imprudent, or with which the lawyer has a fundamental disagreement;

(3) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

(4) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or

(5) other good cause for withdrawal exists.

(c) Compliance With Order of Tribunal. A lawyer must comply with applicable law requiring notice or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) Protection of Client's Interest. Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interest, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled, and refunding any

482 So.2d 1354
Supreme Court of Florida.

THE FLORIDA BAR, Complainant,
v.
Alan B. FIELDS, Jr., Respondent.

No. 65650.
|
Jan. 23, 1986.
|
Rehearing Denied March 6, 1986.

Synopsis

Disciplinary proceedings were brought against attorney. The Supreme Court held that dereliction in failing to reach fee agreements with clients before representing them, in failing to communicate with clients concerning their legitimate concerns and questions on fees, and in failing to properly supervise nonlawyer employees warrants public reprimand.

Discipline ordered.

Ehrlich, J., concurred in part and dissented in part, with opinion in which Boyd, C.J., and Adkins, J., concurred.

West Headnotes (4)

[1] **Attorneys and Legal Services** Evidence, verdict, and findings

Attorneys and Legal Services Disposition and punishment; sanctions

Findings and recommendations of referee in attorney disciplinary proceeding will be upheld unless clearly erroneous or without support in evidence.

3 Cases that cite this headnote

[2] **Attorneys and Legal Services** Parties; standing

Under West's F.S.A. Code of Prof.Resp., EC2–23, attorney is responsible for making individual determination on client-by-client basis as to whether to institute suit for collection of bad debts, and cannot transfer this responsibility to an accountant.

[3] **Attorneys and Legal Services** Nature and Form

Attorney's constitutional right to sue clients to collect bad debts was not violated in connection with requirement that attorney make individual determination on client-by-client basis as to whether to institute suit. West's F.S.A. Code of Prof.Resp., EC2–23.

[4] **Attorneys and Legal Services** Public Reprimand, Censure, or Admonition

Dereliction in failing to reach fee agreements with clients before representing them, in failing to communicate with clients concerning their legitimate concerns and questions on fees, and in failing to properly supervise nonlawyer employees warrants public reprimand.

1 Case that cites this headnote

Attorneys and Law Firms

***1355** John F. Harkness, Jr., Executive Director and John T. Berry, Staff Counsel, Tallahassee, and David G. McGunegle, Bar Counsel and Diane J. O'Malley, Sp. Asst. Bar Counsel, Orlando, for complainant.

Alan B. Fields, Jr., of Dowda and Fields, Palatka, in pro per.

Frank M. Gafford, Lake City, for respondent.

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Opinion

PER CURIAM.

This disciplinary proceeding by The Florida Bar against Alan B. Fields, Jr., a member of the Bar, is before us on a four-count complaint of the Bar and report of the referee. The referee's report and record have been filed with this Court pursuant to Florida Bar Integration Rule, article XI, Rule 11.06(9)(b). Respondent has petitioned for review of the referee's findings of fact as to Counts I, III, and IV and recommendations of guilt and discipline which are as follows: *

As to Count I

(07B84C04—Vicky Lindley)

I find specifically that:
"1. Around May, 1980, Vicky Lindley (now Weaver) hired the respondent to file a paternity suit relating to her youngest daughter and to provide other relief with respect to title to her property....

"2. At that time, respondent did not discuss a fee arrangement with Ms. Lindley nor was any fee agreement signed by her. Finance or interest charges on unpaid principal amount of the fee also was not discussed. Ms. Lindley was advised that typically the court would order the ex-husband to pay the attorney's fees. She paid respondent $100.00 as a deposit....

"3. In October, 1980, Ms. Lindley became impatient with the case progress. Someone in respondent's office advised her the other attorney was dragging his feet which proved not to be the case since some delay apparently was caused by the respondent. Ms. Lindley then informed the respondent she no longer wished his services and subsequently hired James W. Sibrey in November.

"4. In November, 1980, respondent sent letters to Ms. Lindley through Mr. Sibrey enclosing a motion and consent for leave to withdraw and later a bill for $672.36. The bill, dated November 25, 1980 gave notice of a one-and-a-half percent per month finance charge on the outstanding balance which notice also was on prior September and October bills....

"5. By letter from Mr. Sibrey dated January 20, 1981, Ms. Lindley requested an itemization of respondent's charges. Respondent replied by letter dated January 25, 1981 indicating he would itemize his charges in court and thereafter refused further accounting. In fact, Ms. Lindley stated she never has received more than the monthly billing statements from respondent and only saw a copy of the account at the referee hearing....

"6. In July, 1983, almost two-and-one-half years after his January 22, 1981 letter, respondent's firm brought suit in Putnam County Court against Ms. Lindley alleging a debt owed of $995.95 which included the principal plus a finance charge or interest for the period. Ms. Lindley had been billed sporadically if at all during this period. She stated she did not receive any statements for a long period of time.... In fact, respondent's records show a finance charge of $259.75 was posted on March 29, 1983 for the February, 1981 through March, 1983 period, and that she was sent ***1356** a bill for the amount claimed in late June, 1983. Respondent's bookkeeper testified the posting and billing had been done preparatory to suit and probably nothing had been done in the interim.... The referee notes that in computing the finance charge, respondent's bookkeeper was adding the monthly charge to both the unpaid principal amount and the unpaid previous finance charges thereby making the annual percentage rate in excess of the maximum allowed by statute of 18% per year....

"7. Judgment was subsequently entered against Ms. Lindley in the total amount of $1,045.59 which included the $995.95 sued for plus costs. The judgment remains unsatisfied. Ms. Lindley did not sign a written contract authorizing the one-and-one-half percent per month finance charge on the outstanding principal balance of her bill or agree to same. Moreover, the fee arrangements were not clearly discussed with her. Respondent included in his lawsuit for the fees the finance charge for approximately two-and-one-half years for which he and his staff had done little to service during that period of time according to his own records. This referee notes that the charge should properly have been denominated as interest at the

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statutorily allowable rate of 6% prior to June 30, 1982, and 12% thereafter for matters without contracts."

....

As to Count III

(07B84C13—Dede Sharples)

I find specifically that:

"13. Respondent was retained by Ms. Sharples in December, 1978 to arrange for an increase in her child support. At that time, she was receiving approximately $120.00 per month for both children, one of whom was approaching the age of eighteen. The order setting forth the child support had occurred some ten years previously. She made respondent aware the husband was amenable at the time of the divorce to voluntary increases in the future if warranted.... Ms. Sharples also stated she made respondent aware her former husband was a man of means.... At the end of the case in September, 1979, the court increased the monthly child support to $200.00 for the one child....

"14. During the initial meeting, respondent advised her the court normally would make her ex-husband pay her attorney's fees although he claims he made her aware that she would be primarily liable. Ms. Sharples also testified the bookkeeper advised her the desired work would probably take approximately very few hours and she paid a partial retainer of $50.00. She advised both respondent and the bookkeeper her resources were quite limited.... Ms. Sharples was furnished with a fee agreement by his bookkeeper a few days later. The agreement provided for an hourly rate of $85.00 per hour and a finance charge of one-and-one-half percent per month or 18% per year on the unpaid balance of the bill. After reading it, she determined not to sign it and left the office.... This was not brought to respondent's attention until his representation ceased.

"15. Beginning the month after the initial visit, Ms. Sharples received monthly bills from the respondent. The first statement had a balance of $178.00. This statement noted a one-and-one-half percent per month finance charge. Thereafter, Ms. Sharples attempted on many occasions to contact the respondent about the growing bills and finance charges without success. She testified in her discussions with respondent's bookkeeper she was continually told the statements were routine and not to worry about it because they expected the ex-husband to have to pay the fee....

"16. In October, 1979, Ms. Sharples received a final bill for legal services and expenses from respondent stating a balance due of $2,052.46. On or about January 14, 1980, Ms. Sharples met with respondent after the court ordered her ex-husband to pay $131.00 in costs. She advised respondent she could not pay his bill and he agreed to reduce same but never did.... In July, 1980, respondent's firm brought suit against Ms. Sharples in Putnam County Court in the amount of $2,352.00 including ***1357** additional interest or finance charges of 18% per year from October 25, 1979. In 1983, respondent was awarded judgment in excess of $3,800.00 including interest of $1,429.26. After an appeal, the judgment was set aside and remanded to the county court where the amount was lowered to approximately $3,300.00 in 1984 reflecting allowance only of interest at the statutory rate for matters without contract as opposed to the finance charge of one-and-one-half percent per month for the period subsequent to the filing of suit.

"17. In this case, respondent's bookkeeper also computed the monthly finance charge not only on the unpaid balance but included the unpaid charges so that they were charging interest on interest resulting in a usurious amount in excess of the maximum 18% per year for interest and/or finance charges permitted by law. In fact, she used this method of posting for all unpaid bills which procedure respondent did not properly supervise....

"18. Respondent was successful in securing an increase in the child support from approximately $120.00 to $200.00 from the out-of-state ex-husband. For his services, the respondent charged over $2,000.00 which included finance charges in excess of 18% per year for the approximately ten months prior to October, 1979 when he sent Ms. Sharples a final bill. Three attorneys were questioned as to the reasonableness of respondent's fee. Two indicated that respondent had done considerable work in the file and obviously had incurred the time spent. However, both indicated that much of what respondent had done was not warranted by the case. The two also

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stated a reasonable fee would be between $500.00 and $750.00. The third attorney, who represented respondent in his fee suits, had provided an affidavit in the child custody proceeding and had pegged a reasonable amount at $1,350.00.

"19. I find that respondent's fee of $2,000.00 is clearly excessive under the circumstances given the criteria of Disciplinary Rule 2–106. I note the length of time between the previous order and this case of some ten years, the apparent willingness to increase child support if the circumstances have changed on the part of the husband, the inflationary impact over the past ten years and testimony of the other attorneys as to respondent's handling of the case. I further take judicial notice that respondent, acting as co-counsel in this instant case, filed lengthy and considerable motions and discovery, most of which were of little value in narrowing the issues and readying this case for final hearing.

"20. Respondent also filed suit against his former client and included in that suit improperly computed finance charges which were never agreed to either orally or in writing by Ms. Sharples."

As to Count IV

I find specifically that:
"21. Respondent's law firm has filed suit in at least twenty-eight cases in Putnam County Court during 1982 and 1983 in an effort to collect fees from clients and ex-clients.... Respondent's firm of Dowda and Fields, P.A. is, in effect, solely the respondent since Mr. Dowda has been retired for several years and no longer receives a salary from the firm.... Only seven fee suits were filed by approximately thirty-two other practicing Palatka attorneys during the same period...

"22. These suits were filed purportedly at the recommendation of respondent's accountant and for amounts from less than $100.00 to an excess [of a] few thousand dollars. At least three were for under $200.00. In fact, they ran the gamut....

"23. Opinions of the Professional Ethics Committee of The Florida Bar are only advisory. However, in this case the respondent attached a copy of a staff opinion enclosing Ethics Opinion 73–14 to paragraph 5 of his affirmative defenses to the amended complaint. That opinion discusses the criteria to be utilized to define whether a client is perpetrating fraud or a gross imposition on the attorney which is the criteria set forth in Ethical Consideration 2–23 for suing clients for fees which ***1358** states a lawyer "... should not sue a client for a fee unless necessary to prevent fraud or gross imposition by the client." The criteria in this opinion are that the client should owe the attorney a substantial fee, have the ability to pay and refuse to pay it. It appears many of the fees sued for by the respondent were not substantial in nature. He further testified that a third of those proved to be totally uncollectible and services of process could not be made on another third.... Finally, it is doubtful whether the clients had firmly refused to pay prior to the imposition of suit. For example, Ms. Lindley merely requested an accounting which was never furnished to her and Ms. Sharples had little luck in communicating about the fee or reaching an understanding with the respondent. Mr. Hodges had paid much of his $300.00 fee and was sued for about $100.00 plus costs after he discussed payment problems with the bookkeeper...

"24. Although the number of fee suits is not inordinate considering respondent's general pending caseload of in excess of 400, it appears he does not follow any set criteria in determining whether to file suit for fees thereby adding additional costs and/or interest.... It also matters not that respondent has written off several unpaid fees every year—a problem common to many attorneys. Although Ethical Consideration 2–23 is not a mandatory Disciplinary Rule, respondent's conduct in this regard clearly is not within its parameters."

III. *Recommendations as to Whether or Not the Respondent Should be found Guilty:* As to each count of the complaint I make the following recommendations as to guilt or innocence:

As to Count I

"I recommend the respondent be found guilty and specifically that he be found guilty of violating Disciplinary Rule 1–102(A)(6) of The Florida Bar's Code of Professional Responsibility for conduct adversely reflecting on his fitness to practice law

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by improperly charging finance charges or interest without agreement of the client and/or proper disclosure and for permitting the charge to be calculated both on the unpaid principle balance and the unpaid accumulated finance/interest charges rendering a usurious rate in excess of the statutorily permitted 18% per year. I recommend the respondent be found not guilty of violating Rule 11.02(3)(a) of Article XI of The Florida Bar's Integration Rule for action contrary to honesty, justice and good morals since it appears the improper finance/interest charge calculation was a result of lax office procedure and not intentional wrongdoing."

....

As to Count III

"I recommend respondent be found guilty and specifically he be found guilty of violating the following Disciplinary rules of The Florida Bar's Code of Professional Responsibility: 1–102(A)(6) for engaging in conduct adversely reflecting on his fitness to practice law for charging a finance/interest charge without any authorization from the client and/or proper disclosure and thereafter suing on same and permitting improper calculation of the rate resulting in one in excess of the statutory maximum; 2–106(A) and 2–106(B) for charging a clearly excessive fee; 3–104 for failure to properly supervise and exercise a high standard of care to insure compliance by nonlawyer personnel with The Florida Bar's Code of Professional Responsibility resulting in unclear fee arrangements with the client, failure to convey information from the client to the attorney and improper computation of the finance/interest charges resulting in a usurious rate in excess of the statutory maximum. Although respondent was responsible, he did not properly supervise the billing procedure. I recommend the respondent be found not guilty of violating Rule 11.02(3)(a) of Article XI of The Florida Bar's Integration Rule for conduct contrary to honesty, justice or good morals in that I do not find respondent's actions were done willfully with intent to harm the client or that the ***1359** imposition of the excess finance/interest charge was an intentional policy."

As to Count IV

"I recommend the respondent be found guilty of violating Disciplinary Rule 1–102(A)(6) of The Florida Bar's Code of Professional Responsibility for conduct adversely reflecting on his fitness to practice law by instituting fee suits against clients and former clients without having determined whether the client had the ability to pay same, that the fee in question was substantial in nature, or that the client had steadfastly refused to pay respondent's fee. I note careful consideration of those criteria is necessary to determine whether the client is committing fraud or a gross imposition on the attorney, thus warranting suit."

....

V. *Recommendation as to Disciplinary Measures to be Applied:* I recommend the respondent receive a public reprimand as provided in Rule 11.10(3) and that the reprimand be administered by personal appearance before the Board of Governors of The Florida Bar.

[1] **[2]** **[3]** Respondent challenges the referee's findings of fact and recommendations of guilt. We note that such findings and recommendations will be upheld unless clearly erroneous or without support in the evidence. *The Florida Bar v. Hoffer,* 383 So.2d 639 (Fla.1980); *The Florida Bar v. Hirsch,* 359 So.2d 856 (Fla.1978). The referee's findings and recommendations are amply supported by the record before us. Respondent himself professed to the referee that his contentious and unresponsive answer to Lindley's request for an itemized bill was a result of animus he felt toward her new attorney and that the numerous fee suits filed during the period in question were instituted as a result of his accountant's advice to clear his books by showing an effort to collect bad debts. Under Ethical Consideration 2–23, the attorney is responsible for making an individual determination on a client-by-client basis as to whether to institute suit. This responsibility cannot be transferred to an accountant. Respondent's argument that his constitutional right to sue clients is violated is unpersuasive under these circumstances.

[4] Respondent argues that a public reprimand is excessive and that he should receive at most a private

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reprimand. We do not agree. It is clear from the record that respondent has been derelict in failing to reach fee agreements with his clients before representing them, in failing to communicate with his clients concerning their legitimate concerns and questions on fees, and in failing to properly supervise non-lawyer employees.

Finally, respondent argues that the costs assessed against him are excessive. We disagree. The referee noted, and the record confirms, that respondent in the instant action, as co-counsel, filed "lengthy and considerable motions and discovery, most of which were of little value in narrowing the issues and readying this case for final hearing."

Having carefully reviewed the record, we approve the findings and recommendations of the referee. Accordingly, Alan B. Fields, Jr. is hereby publicly reprimanded, and the publication of this order and judgment shall constitute the public reprimand.

Judgment for costs in the amount of $2,064.49 is hereby entered against respondent, for which sum let execution issue. Interest at the statutory rate is to accrue on all costs not paid within thirty (30) days of entry of this Court's final order of discipline, unless the time for payment is extended by the Board of Governors.

It is so ordered.

OVERTON, McDONALD, SHAW and BARKETT, JJ., concur.

EHRLICH, J., concurs in part and dissents in part with an opinion, in which BOYD, C.J., and ADKINS, J., concur.

EHRLICH, Justice, concurring in part and dissenting in part.
I do not take issue with the findings of the referee with respect to guilt. The matters ***1360** at issue reflect poor business judgment and inadequate supervision over the business aspect of respondent's practice. In my opinion, a private reprimand is the proper punishment.

BOYD, C.J., and ADKINS, J., concur.

All Citations

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Footnotes

* The referee recommended a finding of not guilty on Count II. Respondent also seeks review of the assessed costs.

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CHAPTER 5. RULES REGULATING TRUST ACCOUNTS
5-1. GENERALLY
RULE 5-1.1 TRUST ACCOUNTS

(a) Nature of Money or Property Entrusted to Attorney.

(1) *Trust Account Required; Location of Trust Account; Commingling Prohibited*. A lawyer must hold in trust, separate from the lawyer's own property, funds and property of clients or third persons that are in a lawyer's possession in connection with a representation. All funds, including advances for fees, costs, and expenses, must be kept in a separate federally insured bank, credit union, or savings and loan association account maintained in the state where the lawyer's office is situated or elsewhere with the consent of the client or third person and clearly labeled and designated as a trust account except:

(A) A lawyer may maintain funds belonging to the lawyer in the lawyer's trust account in an amount no more than is reasonably sufficient to pay bank charges relating to the trust account; and

(B) A lawyer may deposit the lawyer's own funds into trust to replenish a shortage in the lawyer's trust account. Any deposits by the lawyer to cover trust account shortages must be no more than the amount of the trust account shortage, but may be less than the amount of the shortage. The lawyer must notify the bar's lawyer regulation department immediately of the shortage in the lawyer's trust account, the cause of the shortage, and the amount of the replenishment of the trust account by the lawyer.

(2) *Compliance with Client Directives*. Trust funds may be separately held and maintained other than in a bank, credit union, or savings and loan association account if the lawyer receives written permission from the client to do so and provided that written permission is received before maintaining the funds other than in a separate account.

(3) *Safe Deposit Boxes*. If a lawyer uses a safe deposit box to store trust funds or property, the lawyer must advise the institution in which the deposit box is located that it may include property of clients or third persons.

(b) Application of Trust Funds or Property to Specific Purpose. Money or other property entrusted to a lawyer for a specific purpose, including advances for fees, costs, and expenses, is held in trust and must be applied only to that purpose. Money and other property of clients coming into the hands of a lawyer are not subject to counterclaim or setoff for attorney's fees, and a refusal to account for and deliver over the property on demand is conversion.

(c) Liens Permitted. This subchapter does not preclude the retention of money or other property on which the lawyer has a valid lien for services nor does it preclude the payment of agreed fees from the proceeds of transactions or collection.

(d) Controversies as to Amount of Fees. Controversies as to the amount of fees are not grounds for disciplinary proceedings unless the amount demanded is clearly excessive, extortionate, or fraudulent. In a controversy alleging a clearly excessive, extortionate, or fraudulent fee, announced willingness of an attorney to submit a dispute as to the amount of a fee to a competent tribunal for determination may be considered in any determination as to intent or in mitigation of discipline; provided, such willingness shall not preclude admission of any other relevant admissible evidence relating to such controversy, including evidence as to the withholding of funds or property of the client, or to other injury to the client occasioned by such controversy.

(e) Notice of Receipt of Trust Funds; Delivery; Accounting. On receiving funds or other property in which a client or third person has an interest, a lawyer must promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer must promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, on request by the client or third person, must promptly render a full accounting regarding the property.

(f) Disputed Ownership of Trust Funds. When in the course of representation a lawyer is in possession of property in which 2 or more persons (1 of whom may be the lawyer) claim interests, the property must be treated by the lawyer as trust property, but the portion belonging to the lawyer or law firm must be withdrawn within a reasonable time after it becomes due unless the right of the lawyer or law firm to receive it is disputed, in which event the portion in dispute must be kept separate by the

lawyer until the dispute is resolved. The lawyer must promptly distribute all portions of the property as to which the interests are not in dispute.

(g) Interest on Trust Accounts (IOTA) Program.

(1) *Definitions*. As used in this rule, the term:

(A) "Nominal or short term" describes funds of a client or third person that the lawyer has determined cannot earn income for the client or third person in excess of the costs to secure the income.

(B) "Foundation" means The Florida Bar Foundation, Inc. which serves as the designated IOTA fund administrator and monitors and receives IOTA funds from eligible institutions and distributes IOTA funds consistent with the obligations and directives in this rule.

(C) "IOTA account" means an interest or dividend-bearing trust account benefiting The Florida Bar Foundation established in an eligible institution for the deposit of nominal or short-term funds of clients or third persons.

(D) "Eligible institution" means any bank or savings and loan association authorized by federal or state laws to do business in Florida and insured by the Federal Deposit Insurance Corporation, any state or federal credit union authorized by federal or state laws to do business in Florida and insured by the National Credit Union Share Insurance Fund, or any successor insurance corporation(s) established by federal or state laws, or any open-end investment company registered with the Securities and Exchange Commission and authorized by federal or state laws to do business in Florida, all of which must meet the requirements set out in subdivision (5), below.

(E) "Interest or dividend-bearing trust account" means a federally insured checking account or investment product, including a daily financial institution repurchase agreement or a money market fund. A daily financial institution repurchase agreement must be fully collateralized by, and an open-end money market fund must consist solely of, United States Government Securities. A daily financial institution repurchase agreement may be established only with an eligible institution that is deemed to be "well capitalized" or "adequately capitalized" as defined by applicable federal statutes

and regulations. An open-end money market fund must hold itself out as a money market fund as defined by applicable federal statutes and regulations under the Investment Company Act of 1940 and have total assets of at least $250 million. The funds covered by this rule are subject to withdrawal on request and without delay.

(F) A "qualified grantee organization" is a charitable or other nonprofit organization that facilitates or directly provides qualified legal services by qualified legal services providers and that has experience in successfully doing so.

(G) "Qualified legal services" are free legal services provided directly to low-income clients for their civil legal needs in Florida, and includes post-conviction representation, programs that assist low-income clients in navigating legal processes, and the publication of legal forms or other legal resources for use by pro se litigants.

(H) A "qualified legal services provider" is a member of The Florida Bar or other individual authorized by the Rules Regulating The Florida Bar or other law to provide qualified legal services.

(I) "Direct expenses required to administer the IOTA funds" means those actual costs directly incurred by the foundation in performing the obligations imposed by this rule. Direct expenses required to administer the IOTA funds must not exceed 15% of collected IOTA funds in any fiscal year without the court's prior approval. These costs include preparation of the foundation's annual audit on IOTA funds, compensation of staff who exclusively perform the required collection, distribution, and reporting obligations imposed by this rule and overhead expenses of the foundation directly related to fulfilling its obligations under this rule. Direct expenses required to administer the IOTA funds also include:

(i) actual costs and expenses incurred by the foundation to increase the amount of IOTA funds available for distribution;

(ii) funding of reserves deemed by the foundation to be reasonably prudent to promote stability in distribution of IOTA funds to qualified grantee organizations;

(iii) direct costs related to providing training and technology to qualified grantee organizations, as specified below; and

(iv) direct costs to administer the Loan Repayment Assistance Program and to distribute funds in connection with the program (but not the program funds themselves).

(J) "The court" means the Florida Supreme Court.

(2) *Required Participation*. All nominal or short-term funds belonging to clients or third persons that are placed in trust with any member of The Florida Bar practicing law from an office or other business location within the state of Florida must be deposited into one or more IOTA accounts, unless the funds may earn income for the client or third person in excess of the costs incurred to secure the income, except as provided elsewhere in this chapter. Only trust funds that are nominal or short term must be deposited into an IOTA account. The Florida bar member must certify annually, in writing, that the bar member is in compliance with, or is exempt from, the provisions of this rule.

(3) *Determination of Nominal or Short-Term Funds*. The lawyer must exercise good faith judgment in determining on receipt whether the funds of a client or third person are nominal or short term. In the exercise of this good faith judgment, the lawyer must consider such factors as the:

(A) amount of a client's or third person's funds to be held by the lawyer or law firm;

(B) period of time the funds are expected to be held;

(C) likelihood of delay in the relevant transaction(s) or proceeding(s);

(D) lawyer or law firm's cost of establishing and maintaining an interest-bearing account or other appropriate investment for the benefit of the client or third person; and

(E) minimum balance requirements and/or service charges or fees imposed by the eligible institution.

The determination of whether a client's or third person's funds are nominal or short term rests in the sound judgment of the lawyer or law firm. No lawyer will be charged with ethical impropriety or

other breach of professional conduct based on the exercise of the lawyer's good faith judgment.

(4) *Notice to Foundation*. Lawyers or law firms must advise the foundation, at its current location posted on The Florida Bar's website, of the establishment of an IOTA account for funds covered by this rule. The notice must include: the IOTA account number as assigned by the eligible institution; the name of the lawyer or law firm on the IOTA account; the eligible institution name; the eligible institution address; and the name and Florida Bar number of the lawyer, or of each member of The Florida Bar in a law firm, practicing from an office or other business location within the state of Florida that has established the IOTA account.

(5) *Eligible Institution Participation in IOTA*. Participation in the IOTA program is voluntary for banks, credit unions, savings and loan associations, and investment companies. Institutions that choose to offer and maintain IOTA accounts must meet the following requirements:

(A) Interest Rates and Dividends. Eligible institutions must maintain IOTA accounts which pay the highest interest rate or dividend generally available from the institution to its non-IOTA account customers when IOTA accounts meet or exceed the same minimum balance or other account eligibility qualifications, if any.

(B) Determination of Interest Rates and Dividends. In determining the highest interest rate or dividend generally available from the institution to its non-IOTA accounts in compliance with subdivision (5)(A), above, eligible institutions may consider factors, in addition to the IOTA account balance, customarily considered by the institution when setting interest rates or dividends for its customers, provided that these factors do not discriminate between IOTA accounts and accounts of non-IOTA customers, and that these factors do not include that the account is an IOTA account.

(C) Remittance and Reporting Instructions. Eligible institutions must:

(i) calculate and remit interest or dividends on the balance of the deposited funds, in accordance with the institution's standard

practice for non-IOTA account customers, less reasonable service charges or fees, if any, in connection with the deposited funds, at least quarterly, to the foundation;

(ii) transmit with each remittance to the foundation a statement showing the name of the lawyer or law firm from whose IOTA account the remittance is sent, the lawyer's or law firm's IOTA account number as assigned by the institution, the rate of interest applied, the period for which the remittance is made, the total interest or dividend earned during the remittance period, the amount and description of any service charges or fees assessed during the remittance period, and the net amount of interest or dividend remitted for the period; and

(iii) transmit to the depositing lawyer or law firm, for each remittance, a statement showing the amount of interest or dividend paid to the foundation, the rate of interest applied, and the period for which the statement is made.

(6) *Small Fund Amounts*. The foundation may establish procedures for a lawyer or law firm to maintain an interest-free trust account for client and third-person funds that are nominal or short term when their nominal or short-term trust funds cannot reasonably be expected to produce or have not produced interest income net of reasonable eligible institution service charges or fees.

(7) *Confidentiality and Disclosure*. The foundation must protect the confidentiality of information regarding a lawyer's or law firm's trust account obtained by virtue of this rule. However, the foundation must, on an official written inquiry of The Florida Bar made in the course of an investigation conducted under these Rules Regulating The Florida Bar, disclose requested relevant information about the location and account numbers of lawyer or law firm trust accounts.

(8) *Distribution of IOTA Funds by the Foundation.* No later than 6 months after the fiscal year, the foundation must distribute to 1 or more qualified grantee organizations all IOTA funds collected that fiscal year except for direct expenses required to administer the IOTA funds, funds required to fund the Loan Repayment Assistance Program, and an additional reserve amount if requested by the foundation and approved by the court. Prior to distribution, the foundation must maintain IOTA

funds separate from other foundation funds. The foundation may not condition distribution of IOTA funds to a qualified grantee organization on payment to the foundation for any purpose, including training or technology. The foundation must select qualified grantee organizations based on objective standards it develops. When adopted, the foundation must provide those standards to both The Florida Bar and the court and also prominently publish those standards on the foundation's website. The standards must require that IOTA funds be used to facilitate or directly provide qualified legal services by qualified legal services providers and, to ensure fair distribution of IOTA funds across Florida, must consider relevant data, including:

(A) demographic data provided by an appropriate governmental agency, such as the U.S. Bureau of Labor Statistics; and

(B) data provided by the qualified grantee organization on the use of any IOTA funds previously received.

(9) *Use of IOTA Funds by Qualified Grantee Organizations.* A qualified grantee organization must expend at least 85% of the IOTA funds received to facilitate qualified legal service providers providing or facilitating the provision of qualified legal services or, if such expenditures in any given year constitute less than 85% of the IOTA funds received, provide to the foundation a written justification. A qualified grantee organization must expend no more than 15% of the IOTA funds received for general administrative expenses not directly supporting the provision of qualified legal services and establishing reserves or, if such expenditures in any given year constitute more than 15% of the IOTA funds received, provide to the foundation a written justification. Except as provided below, general administrative expenses include rent, training, and technology. Expenditures to facilitate qualified legal service providers providing or facilitating the provision of qualified legal services are limited to:

(A) compensation paid to qualified legal service providers;

(B) compensation paid to support staff who are directly assisting qualified legal services providers, such as paralegals;

(C) compensation paid to staff necessary for coordinating volunteer qualified legal service providers; or

(D) expenses that otherwise directly facilitate providing qualified legal services, including training, legal research, and technology necessary to the provision of qualified legal services.

Compensation includes benefits such as health insurance and bar membership fees.

(10) *Reporting by the Foundation.* In addition to providing the court with a copy of the annual audit of IOTA funds, the foundation must annually certify to the court its compliance with this rule's requirements on the use of IOTA funds. This certification must include, but not be limited to:

(A) the amount of IOTA funds received;

(B) a detailed breakdown of direct expenses required to administer the IOTA funds;

(C) the name of each qualified grantee organization to which distributions were made;

(D) the amount of distribution received by each qualified grantee organization;

(E) a description of the process for determining eligibility and selection of each qualified grantee organization, including the objective standards developed for that purpose;

(F) the total amount received from sources other than IOTA funds;

(G) a detailed summary of the information provided to the foundation from qualified grantee organizations as required by subdivision (11) of this rule;

(H) the total amount distributed under the Loan Repayment Assistance Program and the number of qualified legal services providers to whom distributions were made; and

(I) any other information the court determines is relevant.

(11) *Reporting by Qualified Grantee Organizations.* Qualified grantee organizations must annually certify to the foundation their

compliance with this rule's requirements on the use of IOTA funds. This certification must include, but not be limited to:

(A) the number of qualified legal services providers compensated or facilitated by the use of IOTA funds;

(B) the number of clients receiving qualified legal services paid for or facilitated by the use of IOTA funds;

(C) the number of low-income Floridians who, while not directly represented, are nevertheless assisted by qualified legal services paid for or facilitated by the use of IOTA funds;

(D) the number of hours expended delivering qualified legal services paid for or facilitated by the use of IOTA funds;

(E) the types of matters for which clients received qualified legal services paid for or facilitated by the use of IOTA funds;

(F) an accounting of the use of IOTA funds, including the amount used to establish reserves and pay for overhead and other general administrative expenses;

(G) the total amount received from sources other than IOTA funds by the qualified grantee organization; and

(H) any other information the court determines is relevant.

(12) *Required Review.* The court will cause a review of the amendments to rule 5-1.1(g) finally adopted by the court on June 18, 2021, to be conducted to advise the court regarding their overall efficacy 2 years after their effective date. The scope of this review may also include any other matters related to the IOTA program.

(h) Interest on Funds That Are Not Nominal or Short-Term. A lawyer who holds funds for a client or third person and who determines that the funds are not nominal or short-term as defined in this subchapter may not receive benefit from any interest on funds held in trust.

(i) Unidentifiable Trust Fund Accumulations and Trust Funds Held for Missing Owners. When a lawyer's trust account contains an unidentifiable accumulation of trust funds or property, or trust funds or property held for missing owners, the funds or property must be designated