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FEE ISSUES RELATED TO COUNSEL'S ACCEPTANCE OF POST-DATED PAYMENTS IN CHAPTER 7 PROCEEDINGS

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I. INTRODUCTION

Our law offices are business entities. Ideally, our offices operate with compatible goals of providing quality, affordable legal services to our communities while striving to be profitable. However, unlike many general business entities, a law office is a professional entity and its attorneys are subject to a higher set of ethical standards, known as the Rules of Professional Responsibility. Those of us who practice bankruptcy law, especially in the consumer debtor realm, are subject to an enhanced set of ethical obligations dictated by the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure. Failure to adhere to our ethical obligations, especially in our financial relationship with our clients, may lead to personal professional indignities. On a systematic level our failures work to lower the public's perception of our legal system and serves to erode the integrity of our courts.

II. ACCESS TO JUSTICE CONCERNS

"How can I afford to pay for bankruptcy, when I can't afford to pay to pay my bills?" We've all heard that line (more times than we can count) uttered by a frustrated potential client, usually at the end of the consultation, when we start to discuss our fees. Since 2005, we hear it even more often, as the impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on attorney fees was substantial.

BAPCPA implemented the Means Test and further requires attorney certification of the facts and information contained within the petition. Raising the bar on the work that goes into the preparation phase of a Chapter 7, raises the price commensurate with that work. These changes discouraged both attorneys who previously practiced bankruptcy from continuing to do so, as well as young or new practitioners from considering a practice in the bankruptcy field. Because of the increased costs of a Chapter 7 bankruptcy proceeding, consumers with low or fixed incomes are essentially barred from accessing affordable legal assistance in the bankruptcy realm.

Legal service agencies are limited in their ability (financially and otherwise) to assist all those who need their help. Consumers can file *pro se*, but suffer the consequences of their inability to prepare accurate documents and to understand the complex nuances of bankruptcy law. Faced with limited options, many consumers opt to forego bankruptcy and suffer the loss of property or the inability to participate in the future economy. Many others end up in the more complex Chapter 13 proceeding,

because it offers an ability to pay an attorney through a payment plan, over time. The Courts are keenly aware of the dilemma faced by debtors. Pro bono and pro se clinics are offered in many jurisdictions, but the need still outweighs the availability.

III. STATUTES AND RULES IMPLICATED BY THE ACCEPTANCE OF POST-DATED OR THRID PARTY CHECKS

Attorneys, by nature, are generally a creative bunch and over the years have adopted practices meant to increase the effectiveness of billing and receiving payment for their services, while at the same time, address the need of the debt laden consumer to obtain bankruptcy protection and relief quickly. One of the more creative methods adopted has been the acceptance of post-dated checks from the client or a third party (i.e. family member or friend). Under this scenario, the debtor provides their attorney with a series of post-dated checks. The attorney then cashes these checks, post-petition, usually on a monthly basis.

Most of the courts addressing these issues, have frowned upon this practice. Attorneys engaging in this practice have found themselves the recipients of an array of penalties and sanctions. A review of cases law across the nation indicates that the acceptance of post-dated checks triggers statutory and rule concerns, in abundance.

A. 11 U.S.C. §362 and 11 U.S.C. §524

A prominent concern of courts addressing the post-dated check issue is that the attorney initially violates the Debtor's automatic stay protections and eventually the discharge injunction. Courts have routinely determined that a post-dated check creates a claim on the part of the attorney:

> "Bankruptcy Code section 101(5) defines a 'claim' as 'any right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, disputed, undisputed, legal equitable, secured, or unsecured.' . . . 'Post-dated checks do give rise to a right to payment. . . A post-dated check is, in effect, the functional equivalent of a promissory note. . . A post-dated check – like a promissory note – really is nothing more than a promise to pay a certain sum of money at a specified time. For that reason, a post-dated check is a 'claim' under Bankruptcy Code Section 101(5)."

In re Walton, 454 B.R. 537, 542 (Bankr. M.D. Fl 2011).

Section 362 prohibits "any act to collect, assess, or recover a claim against a debtor that arose before the commencement of the case under this title." 11 U.S.C §362(a)(6). Once the discharge is entered, the automatic stay becomes a permanent injunction as to the personal liability of the debtor with respect to dischargeable debt. 11

U.S.C. §524(a)(1). Fees due owing to one's bankruptcy attorney are not among those exceptions to discharge enumerated under Section 523. See 11 U.S.C §523(a).

> "The majority view is that pre-petition agreements to pay a flat fee in post-petition installments are dischargeable debts."

In re Waldo, 417 B.R. 854, 880 (Bankr. E.D. Tn. 2009).

Arguments that post-dated checks are subject to the exception of Section 362(b)(11) (exemption for the presentation of a negotiable instrument), have not been successful:

> "Code Section 362(b)(11) was enacted to protect the integrity of the banking system, and it would be absurd to find the exception could be used to provide cover for an attorney who was attempting to avoid disclosing his clandestine arrangement for collecting fees post-petition."

In re Davis, 2014 WL 3497587 at *5 (Bankr. N.D. Al. 2014).

It follows that violations of the automatic stay, pursued post-discharge, become violations of the discharge injunctions:

> "[t]he injunction imposed by Code §524(a) was violated each time a check was deposited, whether or not it was paid by the debtor's bank."

In re Davis, 2014 WL 3497587 at *6 (Bankr. N.D. Al. 2014).

B. ABA MODEL RULES 1.7 AND 1.8

A second major concern over the acceptance of post-dated checks, as routinely expressed by the court, relates to the Model Rules of Professional Conduct's prohibitions against attorneys creating matters which conflict their interests to that of their client. While not all jurisdictions have adopted the ABA Model Rules, most jurisdictions have adopted a substantially similar version of a rule addressing conflicts of interest.

Model Rule 1.7(b) requires that "a lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interest."

Model Rule 1.8 requires that "a lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless: (1) the transaction and terms on which the lawyer acquires the interest are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client; (2) the client is advised and is given reasonable opportunity to seek the advice of independent counsel in the transactions; and (3) the client consents in writing thereto."

If it's accepted that post-petition payments on a pre-petition obligation to an attorney are subject to the automatic stay and discharge injunction, and a client was clearly apprised of these protections, why would they ever consent to a post-petition check scheme, or concern themselves with the validity of those check post-petition? Many clients are desperate for the relief bankruptcy can provide. Many are less sophisticated than their attorney. Without oversight, the bankruptcy attorney-client relationship provides the perfect opportunity for a client to be taken advantage of.

The Court in *In re Waldo*, in seven (7) separate Chapter 7 cases, addressed the conflicts that arise when an attorney accepts post-dated checks and in some of those cases, pursues collection of those returned for not sufficient funds:

> "As raised by many of the courts examining the issues of post-dated checks, there are **serious ethical implications in such a practice**, and the same is true here – that by accepting post-dated checks for dischargeable debts and not advising their clients that the debts were at least potentially dischargeable, Clark & Washington and Mr. Crawford created a conflict of interest."

In re Waldo, 417 B.R. 854, 886 (Bankr. E.D. Tn. 2009) (emphasis added).

> The issuance of the post-dated checks, transferred "an interest – possessory, security or otherwise pecuniary in nature – in property of the Debtors" to their attorneys.

In re Waldo, 417 B.R. 854, 886 (Bankr. E.D. Tn. 2009).

The Court in *In re Walton*, looked to *In re Waldo* for guidance in dealing with the same law firm, operating cross jurisdictionally, to find a conflict arose:

> "The agreement constitutes a business transaction between Clark & Washington and its clients. . . [t]he client is walking into bankruptcy with an adverse relationship with counsel that requires another lawyer's assistance to understand."

In re Walton, 454 B.R. 537, 546 (Bankr. M.D. Fl 2011).

Bankruptcy Judge Robinson elaborated on the conflict the Debtor's attorney created with his post-dated check scheme, in a footnote:

> "The post-dated check arrangement put Cobb's own interest in getting paid in direct conflict with his client's interest in obtaining a discharge from all pre-petition debts."

In re Davis, 2014 WL 3497587 at *FN 31 (Bankr. N.D. Al. 2014).

C. 11 U.S.C. §329(a) AND F.R.B.P 2016(b)

A reoccurring theme in the cases addressing the acceptance of post-dated or third party checks is the lack of disclosure by the law firm or attorney accepting these payment forms. Attorneys relying on the post-dated check practice, are rarely disclosing the terms of their unsavory dealings with the debtor. It is only upon investigation and discovery of these payments schemes that the Court has the opportunity to address the significant impediments to debtor's fresh start.

Section 329(a) requires: "Any attorney representing a debtor in a case under this title, or in connection with such a case, whether or not such attorney applies for compensation under this title, shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney, and the source of such compensation."

11 U.S.C. §329(a).

Section 329(a) is implemented through F.R.B.P. 2016(b):

"Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by §329 of the Code, including whether the attorney has agreed to share the compensation with any other entity. . .".

F.R.B.P. 2016(b)

Compliance with §329 and Rule 2016(b) is mandatory and failure to adhere may have serious consequences. Under circumstances where Debtor's counsel failed to disclose the true agreement (receipt of post-petition payments for pre-petition services) or even the actual amount of her compensation, the Court had this to say:

> "The Bankruptcy Code requires fee disclosure so that courts can 'prevent overreaching by debtor's attorneys and give interested parties the ability to evaluate the reasonableness of the fees paid' . . .[t]he heart of this framework is disclosure. . . In short, the Rule 2016(b) statement is an attorney's certification on which the Debtor, the Court, the Trustee, and the creditors rely. It is not a meaningless paper that attorneys can ignore or blithely treat as insignificant."

In re Bonilla, 573 B.R. 368, 378 (Bankr. D.P.R. 2017).

Judge Robinson was just as intolerant of Debtor's attorney's elaborate post-dated check scheme, falsely represented in the attorney's disclosures:

> "Compliance with Code §329(a) and Rule 2016(b) may be achieved only when attorneys *fully* and *accurately* complete a Disclosure of Compensation. . . To satisfy Code §329(a), Rule 2016 and Official Form B203, every material detail of a lawyer's fee arrangement with his client must be disclosed in simple language that leaves nothing to the imagination. . . Disclosures that are intentionally incomplete are tantamount to false disclosures, and in some instances, as here, even worse because they mislead the court and the parties in interest. . . To put it simply, post-dated checks are property, and receipt of any property by counsel for a debtor in payment of or as security for payment of fees must be disclosed. Anything less is a violation of the spirit and letter of §329 and Bankruptcy Rule [2016]."

In re Davis, 2014 WL 3497587 at *9-10 (Bankr. N.D. Al. 2014).

Revisiting the same law firm, the subject of *In re Waldo*, and their later attempts to end run the post-dated check issues, Judge Stair noted:

> "[t]he failure to comply with the disclosure rules is a sanctionable violation, even if proper disclosure would have shown the attorney had not actually violated any Bankruptcy Rules, and sanctions may also be imposed for negligent and inadvertent failures to disclose."

In re Lawson, 437 B.R. 609, 671 (Bankr. E.D. Tn. 2010).

D. DEBT RELIEF AGENCY PROVISIONS

BAPCPA imposed enhanced responsibilities on Debtor's attorney under several statutory provisions, known as the Debt Relief Agency provision. See *In re Milavetz*, 559 U.S. 229 (2010). Relevant to this discussion with respect to the acceptance of third party post-dated checks, is the prohibition of 11 U.S.C. §526(a):

"A debt relief agency shall not . . . (4) advise an 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 fee or charge for services as part of preparing for or representing a debtor in a case under this title."

11 U.C.C. §526(a)(4).

In *Lawson*, the law firm who had formerly been assessed sanctions for their post-dated check scheme in *In re Waldo*, created an alternate scheme to circumvent *Waldo's* rulings, whereby they encourage clients to "borrow" post-dated checks from relatives or friends. The debtors either: eventually had to pay back their relative or friend; or they paid their attorney later, monthly, in lieu of his cashing the post-dated check. The Court had this to say:

"Without finding conclusively that Clark & Washington has violated §526(a)(4), the court is nevertheless troubled by the acceptance of third-party post-dated checks."

In re Lawson, 437 B.R. 609, 669 (Bankr. E.D. Tn. 2010).

IV. THE COURTS' RESPONSES

The Courts' responses have been varied, but the majority of Courts have found the circumstances behind the acceptance of post-date checks to be suspect and subject to sanctions. Here's a sample of the sanctions assessed:

In re Bonilla – The attorney was required to disgorge all her fees in the case. Imposition of Section 105/Rule 9011 sanctions were denied.

In re Roman – The attorney was required to disgorge all her fees in the case. Imposition of Section 105/Rule 9011 sanctions were denied. This was a companion matter to *In re Bonilla*.

In re Davis – There was a separate opinion devoted to sanctions in this case. The attorneys were required to disgorge net fees in the amount of $127,971.66. They were further required to disgorge the filing fees for all their clients who would have otherwise qualified for IFP, in the amount of $48,654.00. The Court sanctions the attorneys $35.00 for NSF fees – 368 NSF x $35.00 = $12,880.00. The attorneys were ordered to attend a Practice Management class. The Court declined at the time to suspend filing privileges, but conditioned that declination on the attorney's compliance with all other sanctions.

In re Walton – The attorneys were ordered to disgorge all fees received in the seven (7) cases at issue. They were further ordered to return all post-dated checks in their possession and refund a $50.00 NSF fee to one client.

In re Lawson – The attorneys were required to disgorge fees in three (3) cases. They were further ordered to return all post-dated checks, including those of third parties. The Court ordered sanctions in the amount of $750.00 per cases (15 cases) to be paid the UST. The Court ordered the attorneys attach a certification to their 2016(b) Disclosures, that they'd had reviewed their fee arrangements with client in detail, for the next six (6) months. Lastly, they were ordered to pay the costs of prosecution.

V. OPTIONS (OR WARNINGS!)

The question remains, how do we, as bankruptcy attorneys, formulate Chapter 7 fee structures allow for those in dire need, but without immediately available resources, to file for bankruptcy protection? One thing is clear, the courts have universally cautioned that when a "flat or fixed fee pre-petition agreement is at issue the fee must be paid in full prior to the commencement of the debtor's case or the fee is discharged under §727(b). *In re Mansfield*, 394 B.R. 783, 791 (Bankr. E.D. Pa. 2008).

If you're practicing in the Ninth Circuit, the law is *Gordon v. Hines*, 147 F.3d 1185 (9th Cir. 1998). In *Hines*, the Court adopted the "doctrine of necessity" to deal with the dilemma of debtors to pay for attorney services. The Court considered the various options, but found that one way, or another, each of the options runs afoul of a Code provision. Barring a legislative solution, the Court held that "claims for attorney fees for post-petition legal services do not fall within the automatic stay provisions of Section 362(a)(6) or the discharge provisions of Section 727. *Hines* at 1191. The issue, as viewed by the Court, was not about pre-petition fees being paid post-petition, but post-petition fees bargained for pre-petition. The doctrine of necessity has not been widely accepted with respect to Chapter 7 attorney fee issues.

If you choose to tread beyond the clear directives of the courts (or you don't practice in the 9th Circuit), cases mention the following alternatives:

1. Flat fees – See *In re Bonilla* at 381, *In re Waldo* at 895

2. Fee Agreement Revision that properly segregate pre and post services, along with pre and post payments – See *In re Mansfield* at 793, *In re Bonilla* at 381, *In re Waldo* at 895

3. Post petition fees from non-estate assets – See *In re Bonilla* at 380

4. Acceptance of third party payments – See *In re Bonilla* at 381, *In re Waldo* at 895

5. Separate post-petition fee agreements – See *In re Slabbinck* at 596

6. Ideally, a legislative response that excepts attorney for debtor fees under §523.

Unbundling the Various Forms of Unbundling

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There is at least one thing that is certain in the world of Chapter 7 bankruptcy practice. Attorneys want to be paid for the services that they render to the debtor. There is a second thing that is almost as certain. Most debtors are willing to pay a reasonable fee for those services in order to receive a discharge of their personal debts. This paper will explore the various forms of unbundling utilized by consumer practitioners in order to reduce the need to charge full attorney's fees prior to the filing of a case and will also review issues related to the factoring of attorney's fees charged post-petition.

I. Background

The bankruptcy code prevents attorneys and Chapter 7 debtors from entering into a contract that will allow them to reach both of these goals if the debtor does not pay the attorney at least some, if not all, of his or her fees before the attorney begins work. The problem arises from the practical fact that at least some of the attorney's services must be rendered pre-petition, thus giving rise to a pre-petition debt owed by the debtor to the attorney, and the legal fact that the bankruptcy code provides that any claim arising from a pre-petition debt is dischargeable.

As one court has observed:

> Chapter 7 attorney fees are not obligations that are compensable from the bankruptcy estate, thus a Chapter 7 lawyer must, in a perfect world, collect his fee in full from the debtor pre-petition. Because Chapter 7 debtors often do not have sufficient funds to pay attorney fees up front, lawyers often enter into pre-petition agreements allowing debtors to pay part of the fees pre-petition and the balance of the fees post-petition. This arrangement, however, runs afoul of the general rule that pre-petition debts are dischargeable.
> *In re Abdel-Hak*, 2012 Bankr. LEXIS 5393 (Bankr. E.D. Mich. 2012).

II. Unbundling Generally

Because debtors do not generally have the funds sufficient to pay Chapter 7 legal fees before the attorney begins rendering services, some Chapter 7 attorneys have devised a variety of methods to ensure payment. These methods are referred to collectively as "unbundling."

> Unbundling is the practice of limiting the scope of services that an attorney will provide—"dividing comprehensive legal

> representation into a series of discrete tasks, only some of which the client contracts with the lawyer to perform."
> *In re Seare*, 493 B.R. 158 (Bankr. D. Nev. 2013).
>
> Instead of traditional representation, where a lawyer handles a case from start to finish, limited scope representation, also known as "unbundling" or "discrete task representation," involves representation in which a lawyer performs some, but not all, of the work. *In re Ruiz*, 515 B.R. 362 (Bankr. M.D. Fla. 2014).

In Chapter 7, unbundling typically consists of dividing legal services into at least two bundles. The first concerns services that are rendered pre-petition and the second concerns services that are rendered post-petition.

III. Forms of Unbundling: How Many Contracts?

Attorneys utilize a number of variations on the unbundling theme in order to achieve the ultimate goal, that is, the payment of their fees. One way to analyze these different themes is to divide the variations into the number of fee contacts that the attorney enters into with the debtor. Attorneys use one, two, and even zero contracts (sometimes referred to as ghostwriting) to set forth the terms of the complete bankruptcy representation in an attempt to assure payment of their fees. Each method has its weaknesses.

A. One Contract.

Under the single contract method, the attorney and the debtor execute a single contract that covers services rendered both pre-petition and post-petition. In some cases, the contract designates what services will be rendered pre-petition and what services will be rendered post-petition. Some of these contracts will also designate what portion of the fees is for pre-petition services and what portion of the fees is for post-petition services. While all courts hold any unpaid debt based upon a claim for pre-petition services to be dischargeable in Chapter 7, the courts are in disagreement regarding whether an attorney can collect unpaid fees for post-petition services based on a pre-petition contract.

1. One Contract – Fees Earned Post-petition Not Dischargeable

Some courts have held that fees earned pre-petition are dischargeable if not paid at the time that the contract is executed and that the fees that are earned post-petition are not dischargeable. These courts tend to require evidence concerning the division of services into those that are rendered pre-petition and those that are rendered post-petition before any post-petition fees may be allowed. These courts also tend to award post-petition fees under a theory of *quantum meruit* if the attorney is discharged by the debtor before all services are rendered.

In *In re Hines*, 147 F.3d. 1185 (9th Cir. 1998), the debtor's first attorney filed a Chapter 13 petition on behalf of the debtor. A year later, the debtor consulted a second attorney who recommended that she convert the case to Chapter 7. The debtor signed a promissory note and

provided the second attorney with seven checks, the first to be cashed pre-conversion and the other six to be cashed post-conversion. The second attorney cashed the first checks prior to conversion. After the case was converted to Chapter 7, the second attorney cashed two more of the checks.

The debtor then returned to the first attorney who advised her that the she should not pay the remaining fees owed to the second attorney because they became dischargeable upon the conversion of the case. The Bankruptcy Court reduced the fees allowed to $375.00, the amount that had been paid to the second attorney by the debtor. The debtor appealed to the Bankruptcy Appellate Panel which reversed and remanded the case to the bankruptcy court for a determination of damages for violating the stay. The second attorney appealed to the Ninth Circuit Court of Appeals.

The Ninth Circuit held:

> In sum, we determine that as of the time that [the debtor] fired [the second attorney] to return to [the first attorney] as her attorney, [the second attorney] did have an undischarged claim for any fees earned by him in excess of the $375 that he had already collected via the first three $125 checks. To quantify that claim, [the second attorney] could not look to the entire remaining $500 that was originally contracted for, because [the debtor] (like any client) had the right to discharge him before he had completed his services.

The holdings of the Ninth Circuit were three-fold. First, the Court held that fees based on post-petition services are not dischargeable. It follows that any such debt arising from the rendering of such services are not subject to the automatic stay. Second, the Court held that an attorney cannot be compensated under the contract if all of the services are not provided. Third, the Ninth Circuit held that an attorney who has not performed all services due under the fee agreement does, nonetheless, have a right to payment under the doctrine of quantum meruit to the extent of the value of the services that have been rendered. The Court held that § 362 is not implicated and the attorney could recover the value of services actually rendered because the services in question were rendered post-petition.

Those courts that agree with the holding in *Hines* tend to require that the fee agreement clearly distinguish between services that are to be rendered pre-petition and those that rendered post-petition. In *In re Michel*, 506 B.R. 99 (E.D. Mi. 2014), the debtor and attorney signed a pre-petition "flat fee" agreement and debtor paid $450.00 of the $900.00 fee pre-petition. The contract did not designate what amounts were to be paid for pre-petition services and what amount was to be paid for post-petition services. After the § 341 meeting was concluded, the debtor paid the balance of $450.00. The U. S. trustee filed a motion to compel the attorney to disgorge the fees.

The *Michel* court held that attorney had to return the $450.00 paid post-petition to the debtor because the debtor's single pre-petition contract:

> … draws no distinction between pre-petition services and post-petition services to be rendered, and does not in any way apportion the $900.00 flat fee... into a fee amount for pre-petition services and a fee amount for post-petition services. The Court agrees with those cases holding that this kind of pre-petition flat fee agreement in a Chapter 7 case creates a debt that is entirely a pre-petition debt, which therefore is subject to the automatic stay and is dischargeable in the Chapter 7 case.
> *Michel* at 106.

The Court denied the attorney's motion for compensation under a theory of quantum meruit based on other acts of the attorney that the Court found objectionable.

2. One Contract – Fees For Post-petition Work Under Pre-petition Contract Fully Dischargeable

Other courts have held that the attorney's claim for unpaid fees against the debtor under a Chapter 7 fee agreement gives rise to a debt that is wholly dischargeable in bankruptcy regardless of the distinction between pre and post-petition services. In these cases, the Chapter 7 attorney may not collect any deficiency; the attorney must collect the entire amount of the fees at or before the time that the fee agreement is executed.

In *Bethea v. Robert J. Adams & Assocs.*, 352 F.3d 1125 (7th Cir.2003), *cert*. denied, 124 S.Ct. 2176, 158 L.Ed.2d 733 (2004), the Seventh Circuit Court of Appeals held that a pre-petition fee agreement gave rise to a debt that is subject to discharge. In *Bethea*, the debtors agreed to pay their Chapter 7 legal fees in installments, with some payments to be made pre-petition and some post-petition. The debtors received their discharges before paying all of the fees. They later hired a different attorney to contest the debt arising from the unpaid fees, claiming that it was discharged. The Seventh Circuit concluded that the retainer contract created a pre-petition, liquidated, dischargeable debt, and that § 329 does not create an unenumerated exception to the § 727(b) discharge. Accordingly, the bankruptcy attorneys were required to refund to the debtors any money collected after the discharge and any money collected while the automatic stay was in effect. *Id.*, at 1129.

Thereafter, in *In re Griffin,* 313 B.R. 757 (Bankr. N.D. Ill. 2004), the debtor executed a single pre-petition fee agreement providing for a payment of fees in the amount of $1,150.00. He made a $100.00 down payment before the petition was filed. The *Griffin* court held that the attorney's unpaid claim arising under the Chapter 7 pre-petition fee agreement gave rise to a pre-petition debt that was dischargeable in the Chapter 7 case and therefore subject to the automatic stay. *Id*., at 770.

3. One Contract – *Quantum Meruit* Considerations Regarding Dischargeability of Attorney Fees

Some courts have held that if the debt is not discharged, the attorney can recover under a theory of *quantum meruit* if the attorney is discharged by the debtor before completing all

obligations under the fee agreement. *Quantum meruit* determines the amount to be paid for services when no contract exists or when there is doubt as to the amount due for the work performed but done under circumstances when payment could be expected.

In *In re Grimmett*, 2017 Bankr. LEXIS 1492 (D. Idaho 2017) (affm'd on appeal), the attorney and debtor executed a fee agreement pre-petition that provided for fees of $500.00 to be paid pre-petition for pre-petition services and $1,500.00 to be paid for post-petition services according a set schedule. The debtor fell behind on the payments. The attorney attempted to collect the fees. The U.S. Trustee filed a motion to cancel the agreement and compel the attorney to disgorge the fees.

The bankruptcy court ordered the disgorgement of all fees, but then allowed the attorney to collect post-petition fees on a theory of quantum meruit:

> The Court disagrees [with the attorney's argument that a debt arising from post-petition services are non-dischargeable]. The Agreement was executed before Debtor's bankruptcy case was filed. As a result, Debtor's obligation to pay him under the Agreement was discharged in bankruptcy, period, and Counsel cannot enforce that contract obligation post-petition. To get paid for any post-bankruptcy services it provided, Counsel must invoke quantum meruit. While *Hines* is a case about the scope of the automatic stay, it also reinforced the holding in *Biggar* that a lawyer cannot collect for pre-petition legal services because that obligation is discharged. Here, Counsel likewise may not rely on his pre-petition fee agreement to collect for fees incurred post-petition. Counsel must instead seek payment for post-petition services based solely upon equity.
> *Grimmett*, at *27-28.

B. Two Contracts

Another approach to solving the fees problem in Chapter 7 attempted by some debtors' attorneys is to employ two contracts, one for pre-petition services and one for post-petition services.

In *Walton v. Clark & Washington, P.C.*, 454 B.R. 537 (Bankr. M.D. Fla.2011) ("*Walton I*"), the Chapter 7 attorney accepted postdated checks from the debtor as a pre-petition retainer. The Bankruptcy Court ruled that the Chapter 7 attorney was prohibited from accepting postdated checks as a pre-petition retainer for post-petition services that were to be provided to the debtor. The Court ruled that the postdated checks gave rise to pre-petition 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). The Court also ruled that the fee arrangement created a conflict of interest.

In response to the Court's opinion, the Chapter 7 attorney instituted a two-contract procedure under which the client executed one agreement for pre-petition services and a second agreement for post-petition services. After the debtor signed the pre-petition retainer agreement, the attorney prepared the petition and schedules. The attorney then filed the petition. Fourteen days after the attorney filed the petition, the debtor was given three options. The debtor could (1) proceed *pro se*; (2) retain the attorney to prosecute the Chapter 7 case; or (3) retain another attorney to prosecute the Chapter 7 case. If the debtor chose the second option, the parties entered into a post-petition retainer agreement. The client then made arrangements to pay the post-petition fees (generally in the form of automatic debits from the client's bank account) Thereafter, the attorney filed the balance of the schedules, statement of financial affairs, and other necessary documents.

The U.S. Trustee filed a motion to determine whether the attorney's new two-contract procedure violated the Court's prior ruling, resulting in a second opinion found at *Walton v. Clark 7 Washington, P.C.*, 469 B.R. 383 (Bankr. M.D. Fla. 2012) ("*Walton II*"). The Court cited two opinions for the proposition that a debtor may pay an attorney post-petition for post-petition legal services. As the Seventh Circuit recognized in *In re Bethea*, debtors "who cannot pay in full can tender a smaller retainer for pre-petition 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." *Bethea v. Robert J. Adams & Assocs*., 352 F.3d 1125, 1128 (7th Cir.2003). The Supreme Court has also recognized that a debtor is free to use post-petition funds to pay for post-petition legal services. *Lamie v. Trustee*, 540 U.S. 526, 535-36, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004). The *Walton II* court concluded that it must uphold the validity of the two-contract procedure absent some compelling reason not to do so.

The Court further concluded that the attorney had addressed other concerns regarding its prior procedure by (1) more fully setting out the costs and fees associated with filing the client's case; (2) specifying the client's three options for post-petition legal services; and (3) explicitly disclosing in the Rule 2016 disclosure statement that the pre-petition fee was $250 and that the contract between the client and the firm did not include post-petition services; and (4) setting out that the additional fee would be $1,000 in the event the debtor decided to retain the attorney for post-petition services. The attorney also agreed to represent the debtor during the two week period post-petition and to enhance its notice of two-contract procedure that it provided to the debtor. The Court concluded that there is no prohibition against a debtor making post-petition installment payments for post-petition services.

In *In re Slabbinck*, 482. B.R. 576 (Bankr. E.D.Mich. 2012), the Court allowed the attorney to enter into two contracts with the debtor, one contract for pre-petition services and one contract for post-petition services. The Court rejected the U. S. Trustee's argument that the two fee agreements were essentially a single agreement giving rise to a pre-petition debt and the U.S. Trustee's the argument that the attorney could not "legally" unbundle the legal services into pre-petition and post-petition services. If there is a problem with using two contracts, it is generally caused by the local rules.

In *Hines* the Court considered whether executing two fee agreements instead of one fee agreement would help a Chapter 7 attorney in the quest for payment. The Court, considering the

effect of the local rules on the two-contract approach, declined to agree with the *Walton II* holding:

> It has been suggested that a Chapter 7 debtor's attorney might avoid the compensation quandary by initially contracting only to provide pre-bankruptcy services and by initially accepting payment only for those pre-petition services. Then the attorney could later enter into a separate post-petition agreement to provide any necessary post-petition services. In addition to the patent artificiality of any such arrangement, it faces difficulties because of the ethical obligations that are typically imposed on any lawyer who files a bankruptcy (or any other) case on behalf of a client (see, e.g., Rules of the United States District Courts for the Northern District of California (Rule 11-5(a)), the Central District of California (Rule 2.8.2.1), the Eastern District of California (Rule 83-182(b)) and the Southern District of California (Rule 83.3(g)), all precluding an attorney who has filed an appearance from withdrawing from such representation without leave of court).
> *Hines*, 147 F.3d at 1190.

C. No Contract for Full Representation in the Case

In *In re Ruiz*, 515 B.R. 362 (Bankr. M.D. Fla. 2014), the attorney agreed to represent the debtor both before and after the Chapter 7 bankruptcy case was filed but did not sign the petition, attend the meeting of creditors with the Debtor, or perform the other minimal duties required of attorneys representing debtors. The debtor filed a signed petition indicating he was not represented by counsel. The attorney did not sign the petition, but did file a copy of a limited representation agreement with the Debtor. There was no agreement signed for the attorney to represent the debtor in the full bankruptcy case.

The Court framed the issue as follows: Can "an attorney provide services for consultation and preparation of the bankruptcy petition and related papers but then cause the debtor to file *pro se* without making an appearance or representing the debtor at the meeting of creditors?" *Ruiz* at 364. The Court first noted that Florida Rule of Professional Conduct 4-1.2(c) permits the unbundling of legal services if not prohibited by law or rule. The Court then inquired as whether the attorney violated Local Rule 2091-1 which provides that "[u]nless allowed to withdraw from a case ... by order of the Court ... counsel filing a petition on behalf of a debtor shall attend all hearings scheduled in the case or proceeding at which the debtor is required to attend...."

The Court next considered *In re Merriam*, 250 B.R. 724 (Bankr.D.Colo.2000) which ruled that the attorney was required to sign the petition under Bankruptcy Rule 9011:

> "When an attorney has the client sign a pleading that the attorney prepared, the attorney creates the impression that the client drafted the pleading. This violates both Rule 11 and the duty of honesty and candor to the court. . . . [t]he failure of an attorney to sign a petition

> he or she prepares potentially misleads the Court, the trustee and creditors, and distorts the bankruptcy process."
> *Merriam*, 250 B.R. at 733.

The *Merriam* court did, however, allow the fees to stand because the attorney had adequately disclosed the limits of his representation, the debtor had chosen the more limited option, the fees were not unreasonable and there was no harm done to the debtor by the limited representation.

Ultimately, the *Ruiz* court also cited *In re Castorena*, 270 B.R. 504 (Bankr.D.Idaho 2001), in which the Court stated:

> This Court agrees that there is no excuse for a lawyer, who counsels a debtor regarding a bankruptcy and prepares that debtor's petition, schedules and related documents, to fail to sign the petition. The attorney is responsible for what appears in such pleadings, and his signature is a required certification under Rule 9011(b)."
> *Castorena*, 270 B.R. at 515.

Finally, the Court distinguished the facts in *Torrens v. Hood (In re Hood*), 727 F.3d 1360 (11th Cir.2013) from those in *Ruiz*. In *Hood*, a secretary in the law firm filled out the blanks on the form petition and the debtor filed it without an attorney signature. The Eleventh Circuit held, in a very limited holding that the attorney did not violate the Florida Rules of Professional Conduct.

The *Ruiz* court held that the attorney could not evade his responsibilities under Local Rule 9011-1 by doing all the work and then giving the debtor the papers to file falsely pretending he is acting *pro se*, and, further, that the attorney was obligated to sign, and is deemed to have filed, the petition. The *Ruiz* court ordered the attorney to disgorge all fees and concluded by stating that "The Law Firm inconsistently agreed, on one hand, to provide full representation to the Debtor, but, on the other hand, refused to formally appear in the case, sign the petition, attend the meeting of creditors with the Debtor, or provide the normal legal services required of attorneys representing debtors in Chapter 7 bankruptcy cases." *Ruiz* at 364.

IV. The Practice of Factoring Attorney Fees in Unbundled Cases

Related to unbundling is the emerging debtors' attorneys' practice of contracting with factoring companies to ensure the payment of attorney's fees in order to offer low or no money down Chapter 7 bankruptcies. Under the practice of factoring, the holder of accounts receivable sells them to the factor for a discounted amount, that is, an amount that is less than the face amount of the receivables. The factor then earns a profit by collecting the receivables.

In the context of consumer bankruptcy cases, the debtor's attorney might sell the post-petition accounts receivables for the unbundled or bifurcated services typically contracted under a post-petition attorney fee agreement. The use of factoring companies, however, has come

under scrutiny by the Office of the U. S. Trustee, and complaints filed in various enforcement actions highlight some of the potential issues.[1]

A. Typical Factoring Contract Terms to Consider

As with any contract, a factoring contract can take many different forms. The terms of a factoring contract between a Chapter 7 attorney and a factor will, like any contract, be determined by the parties. Certain terms are necessary, though. First, the parties must agree to a discount percentage that will be used to calculate the amount that the attorney will be paid once the amount of the receivable is determined. Second, the parties must agree to the terms of recourse that will be available to the factor in the event that the debtor fails to make the payments. In most instances, the agreement would provide the factor the right to prosecute an action for collection against the debtor. The parties might also address whether the factor would have recourse against the attorney if the debtor fails to make payments.

B. Potential Issues Raised by Factoring

The practice of factoring in the consumer debtor context raises a number of issues including: (1) whether the fees arising from post-petition Chapter 7 services are dischargeable, subject to the automatic stay, and may conceal the improper collection of attorney's fees for pre-petition services; (2) whether factoring causes the debtor to pay higher attorney's fees than the attorney otherwise would charge or than what may be deemed reasonable; and (3) whether the financial arrangement is properly disclosed in the schedules and statements filed with the petition.[2]

1. Dischargeability, Stay Implications and the Bifurcation of Services

The first issue that must be considered when a Chapter 7 attorney factors receivables owed by a debtor is whether the debtor's debt to the attorney, and hence the debtor's debt to the factor is dischargeable and subject to the stay imposed in 11 U.S.C. § 362. While all courts hold any unpaid debt based on a claim for pre-petition services to be dischargeable in Chapter 7, the courts are in in some disagreement, as described previously in this paper, regarding whether an attorney can collect unpaid fees for post-petition services based on a pre-petition contract. *Compare*, e.g., *Hines*, 147 F.3d. 1185 (9th Cir. 1998), with *Bethea*, 352 F.3d 1125 (7th Cir.2003). If the unpaid fees are dischargeable, then the factoring of the receivable arising from

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[1] *See*, *e.g.*, Bloomberg Law, *Firm Sued by U.S. Trustee Over Billing Practices in Chapter 7s*, December 19, 2017, https://biglawbusiness.com/firm-sued-by-u-s-trustee-over-billing-practices-in-chapter-7s/, (referencing Adversary Proceeding No. 17-01271, filed in the case of *In re Gilmore*, pending in the U.S. Bankruptcy Court for the Central District of California), and Bloomberg Law, *U.S. Trustee Files Motion Against Lawyer's Fees in Chapter 7 Case*, February 27, 2018, https://biglawbusiness.com/us-trustee-files-motion-against-lawyers-fees-in-chapter-7-case/, (referencing the Motion to Examine Fees filed in the case of *In re Neufville*, Case No. 17-24812, pending in the U.S. Bankruptcy Court for the District of Maryland).

[2] A further issue that is top of mind at least to most debtors is whether the factor will report payment delinquencies to the credit services. One factoring provider, BK Billing, states on its website, www.bkbilling.com that it reports on time payments positively to the credit bureaus, but it is not as clear from the website whether it also reports payment delinquencies to the credit agencies.

the debt does not change the analysis. The factored receivables would be discharged and subject to the automatic stay.

To minimize the risk of the discharge of fees, factoring companies suggest to debtors' counsel a two contract practice model.[3] The skeletal petition would be filed for low or no money down, and then the debtor would be offered the opportunity to contract, post-petition, for the services of the attorney needed to complete the case. Attorneys endorsing such a practice would note that it is not dissimilar from a *pro se* debtor that seeks out and hires competent counsel for the completion of the case and schedules after the debtor files his or her own basic petition. Under such a scenario, the fees due under the post-petition contract would not be dischargeable. *See*, Garrison, Daniel, *Liberating Debtors from "Sweatbox" and Getting Attorneys Paid, ABI Journal*, Vol. XXXVII, No. 6, June 2018, at p. 66. However, is a different analysis required when the same attorney is involved pre and post-petition in the planning of two legal services separate contracts?

Critics might argue that the planned division of services with the only substantial fees charged post-petition is a fiction because significant legal work is required before a petition may properly be filed. Competent representation requires review of assets, income and liabilities prior to filing even a skeletal petition. Thus, is the bifurcation of the work and ultimate factoring of the fees arguably concealing the improper collection of attorney's fees for pre-petition services?

Of course, if any issue as to the dischargeability of the fees remains an open question in a particular jurisdiction, the attorney would need to properly inform the client. In some actions, the Office of the United States Trustee has, in fact, asserted that the attorney in these scenarios has not properly advised the debtor regarding the automatic stay or the discharge.

2. Increased Attorney's Fees and Review of Reasonableness

Another issue that arises in the factoring scenario is whether the debtor is forced to pay a higher amount in attorney's fees. If the attorney would accept the reduced amount from the factor, he or she should also accept the same reduced amount from the debtor according to the Utah State Bar Ethics Committee. *See*, Advisory Opinion No. 17-06, at ¶ 2.c., September 27, 2017. In addition to implicating ethical responsibilities, increasing attorney's fees to compensate for the factoring of fees may run afoul of the reasonableness of fees requirements of 11 USC § 329(b). The fact that the attorney is willing to accept an amount that is discounted from what he is asking the debtor to pay might support the notion that the fees that the debtor is being charged are high. "If the lawyer is willing to do the work with a thirty percent discount, we question (but do not resolve) whether the total fee is reasonable." *Id.*, at ¶ 17. Of course, the other side of this coin is that the debtor could possibly pay less in a post-petition fee arrangement than he or she would pay through garnishment, which in many cases may in some jurisdictions be as much as 25% of a debtor's gross wages. *See*, *Liberating Debtors from "Sweatbox" and Getting Attorneys Paid,* at p.67.

[3] The complaint of the U.S. Trustee in the *In re Gilmore* case includes as an attachment a "welcome memo" from the factoring company which describes the suggested two contract approach. *See*, p. 29 of 147 of the Complaint at Docket Entry No. 1, December 12, 2017, Adversary Proceeding No. 17-01271.

3. Disclosure of the Financial Arrangement and Informed Consent

Clear disclosure of the bifurcation of the legal services and the factoring of the attorney's fees must be made both to the debtor and the Court. The American Bar Association's Model Rules of Professional Conduct Rule 1.2 (c) allows attorneys to limit the scope of their representations as long as the limitation is reasonable and the client gives informed consent after full disclosure. Further, Bankruptcy Rule 2016(b) mandates disclosures for payments made "in a case under this title, or in connection with such a case."

In addition, bifurcating legal services under a two contract system requires particular timing. The post-petition contract must in fact be executed after the date of the Chapter 7 filing and requires the informed consent of the debtor to the arrangement. This would likely need to include the clear disclosure to the debtor of the other options that he or she may have, including proceeding *pro se* or hiring another lawyer to complete his or her case. *See*, *Walton II*, at 386.

As with many thorny issues in the practice of bankruptcy, different approaches are developing that seek to accomplish the same goal: the payment of reasonable attorney's fees by debtors in an affordable and appropriate manner so that debtors may have access to the relief they need and also the benefit of competent legal advices during their cases. Case law is rapidly developing in this area that provides some guidance to practitioners, and the topic continues to be an active one in academic and professional publications. From these sources and others, counsel must be mindful of the relevant issues and ethical considerations as they establish procedures in their own firms for handling consumer debtor cases.

UPRIGHT ETHICAL OR DOWNRIGHT DANGEROUS?: ISSUES WITH LOCAL LAWYERS PRACTICING LAW ON A NATIONAL SCALE

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"This case involves yet another collision between traditional methods of providing—and policing—legal services to consumers for bankruptcy matters and attempts by attorneys and creative online marketers to tap into that market on a high-volume, multi-jurisdictional basis." *Robbins v. Delafield et al. (In re Williams)*, No. 15-71767, 2018 WL 832894, at *1 (Bankr. W.D. Va. Feb. 12, 2018).[1]

I. Introduction

The Upright Law saga involves the clash of attorneys seeking to fill a gap in legal services in the United States by utilizing technology to match available attorneys with untapped clients seeking consumer bankruptcy protection. While important, this niche as executed by Upright was harshly criticized by the United States Trustee's office ("UST") for the practices and procedures employed by Upright in meeting its objectives. Specifically, "[t]he UST attempt[ed] to paint Upright and by association its local 'partners' as money hungry 'bankruptcy boiler room' operators that have stepped over—and will continue to step over—legal and ethical lines without hesitation in their inexorable quest for the next dollar." *Id.* at *1. In contrast, the Upright Defendants "attempt[ed] to portray themselves as cutting-edge advocates for the financially distressed consumer. They contend[ed] they have identified a void in the legal market for consumers that they are uniquely able to fill by using technology and the internet to match underserved areas of clients with attorneys who have the capacity and ability to fill their needs on a national basis, all while staying within the bounds of the law." *Id.* The United States Bankruptcy Court for the Western District of Virginia had the opportunity to opine on a myriad of ethical issues associated with the practice of law conducted by Law Solutions Chicago, LLC ("LSC"), which did business as Upright Law, LLC ("Upright"), and concluded that "[l]ocal attorneys joining multi-jurisdictional law firms as local or limited partners cannot be both tall and short. An attorney cannot claim to be a partner in the firm and file cases with the Court as lead counsel, but yet claim no responsibility for what happens in the main office on the files the attorney decides to take. Attorneys considering joining firms with this business model should understand that, in this Court, while an injury might be initiated elsewhere—there is a real possibility the pain is going to be felt at home." *Id.* at *33.

[1] Hereinafter, *Robbins v. Delafield et al. (In re Williams)* will be short cited as *In re Williams*.

II. Background

a. Upright Law, LLC

Kevin Chern ("Chern"), Jason Royce Allen ("Allen"), and David Leibowitz ("Leibowitz") were the members of Upright. Each was a member of the Illinois bar. Chern was the managing partner of Upright and handled daily decisions of Upright in connection with that role. Besides the members, another key player was Edmund Scanlan ("Scanlan") who is a non-attorney who served as the "executive director" of Upright. His expertise was internet marketing, and he was paid $200,000 per year as an independent contractor. Scanlan had no ownership interest in Upright.

Upright had few actual employees. Instead, it "leased" most of its employees from Mighty Legal, LLC ("Mighty Legal"). Mighty Legal was indirectly owned, in part, by Scanlan, Chern, and Allen. Upright paid Mighty Legal 1.1 times its actual cost for payroll for its leased employees.

b. The "Onboarding" Process

In general, the "onboarding" process was a remote process by which Upright salespersons "closed" on sales of bankruptcy services to prospective (and unsuspecting) consumers. Upright began this onboarding process after it conducted research and determined that prospective clients overwhelmingly preferred to receive legal services without the burden of traveling to a brick and mortar location. Once prospective clients found Upright on the internet, they contacted Upright by phone or filled out an online request form.

An Upright client consultant would respond to a prospective client contact by holding an initial call with the potential client. Client consultants were junior, non-attorney employees. The client consultants were tasked with gathering basic information and determining whether the prospect was genuinely interested in filing for bankruptcy, whether the prospective client had the ability to pay for bankruptcy services, and whether the prospective client was the decision-maker for the family. If a prospective client passed the client consultant's initial screening, he or she was directed to a "senior client consultant."

Senior client consultants at Upright were expected to "sell" bankruptcy to the prospective client. Senior client consultants were also non-attorneys; they were instructed that they could not provide legal advice, although in several instances, those instructions were ignored. The prospect's filing chapter was pre-selected before the prospect ever spoke to an attorney. In addition, "[i]n at least one instance in this case, a debtor was told she could leave a debt off her bankruptcy schedules to protect an ex-spouse. UST Ex. 4–1, Tr. pp. 30–31. [Another] prospect was given the advice to hide a vehicle from the lender [. . .]" *In re Williams*, 2018 WL 832894, at *4. Yet another prospect asked about whether certain debts would be included in her case, and was advised that it would be up to the trustee to make that determination.

Upright senior client consultants were paid a base salary plus commission tied to the number of "closed" sales of bankruptcy services each achieved. Senior client consultants had a

specific number of sales to make or amount of fees to collect in order to remain employed. One senior client consultant testified that he was hired to "sell" bankruptcy to people. *Id.*

Senior client consultants were provided with a "Sales Play Book," which contained various methods to "close" sales of bankruptcy services. Chapter 1 was entitled "Sales Rules & Theory-Close or be Closed." This chapter included the following topics: 1) "Pitch Outline," 2) "Pitch Script," 3) "Moving to the Close," and 4) "Objection Handling." The Sales Play Book includes explanations on how to employ high pressure sales tactics in response to prospect concerns, such as the following:

Prospective Client Concern	Senior Client Consultant Response
"I need to pray about it."	"I appreciate that. I pray about every decision I make myself. How are you most comfortable praying? Let's pray together. I trust God won't mislead either of us. I am willing to accept God's will for the both of us."
"I need to talk to my Wife/Husband."	"I agree, and you should, but if your husband/wife is anything like mine, he/she never tells me no when I really need or love something, and I never tell him/her no." Or, "[b]etter to ask for forgiveness than ask for permission, so let's get you going right away[.]"
Already represented by counsel.	"[t]ell the client to fire their local attorney, they can send an email, then they can hire us."
Need time to think about it.	"This is the offer I am making you for right this moment in time, and it is a now or never offer as I will not be able to make this available tonight, tomorrow, or event [sic] later today. Because we have an incentive available to us right now, I am able to offer this to you now but it expires when we get off the phone. Let's take advantage of the incentive."

Id. at *3. Once the prospective client had been sold on engaging Upright and his or her payment had been received or scheduled, an "oral retention" agreement was entered into without first running a conflict check. The oral retention agreement provided that the "firm does not represent you until you talk to you [sic] local attorney and they accept you as a client," and that until fees are paid in full, the firm will not take action to file the case. Once the oral retention agreement had been entered into, the senior client consultant would transfer the prospective client to a local partner of Upright.

The local partners were attorneys who partnered with the Chicago-based Upright attorney members. Local partners signed a limited partnership agreement with Upright. It provided that they had no rights in the management of Upright and only a marginal, non-voting interest in Upright. Upright, however, held the local attorneys out to the public as "partners," including on the firm's website, letterhead, business cards, and in some cases, office signage.

The local partner had forty-eight hours to contact the client for a 10-15 minute compliance call. If the partner approved the representation and did not have any modifications to the fees to be paid or the relief to be sought, the local partner confirmed the representation to

Upright. The local partners would file pleadings and make in-person appearances. These partners generally had their own separate practices for which they would use separate CM/ECF accounts.

Prior to 2015, once a client paid Upright in full, Upright staff in Chicago prepared an initial draft of the petition and conducted a Skype interview with the client. A second interview was supposed to be held with the local partner, who would review the petition and make any final changes. After 2015, Upright required the local partners to prepare the petition and other documents; in exchange, the local partners received a larger share of the profits. As compensation for their services, the local partners received a share of the revenue generated from his or her clients and from a bonus pool from revenue earned in the local partner's jurisdiction. At all times, however, Upright prepared the Rule 2016 disclosures for the local partners. The UST described the local partnership structure as:

> [N]othing more than a "bankruptcy boiler room" and "telemarketing referral business," with the Chicago office as a "referral hub," and the partnership agreements just another way "to secure another person to attend 341 meetings and whitewash LSC's unauthorized practice of law, while [the local partner's] purpose was to receive additional revenue with minimum input." UST Initial Closing Argument ("UST Brief") at 3, 8, 15.

In re Williams, 2018 WL 832894, at *6.

c. The "New Car Custody Program"

In 2015, Upright began to offer its clients a unique way to "pay" for its legal services – cars for legal fees. The program was known as the "New Car Custody Program" or the "Sperro Program" and the program was offered to prospective clients before they ever spoke to an attorney. Chern, on behalf of Upright, learned about the program through Brian Fenner ("Fenner") who "pitched th[e] program as a service to consumer debtors who wanted to surrender their [overencumbered] car in bankruptcy" and explained that the "service facilitated the return of collateral to the auto finance company by having the debtor turn the car over to Fenner [by way of his company Sperro, LLC ("Sperro")], and Fenner [] notify[ing] the finance company that he has the car, and if desired, he would return the car to the finance company." *Id.* at *9. As it turned out, the Sperro Program was simply a way to defraud auto finance companies.

Chern's interest in the Sperro Program stemmed from Fenner's offer to pay Upright's legal fees on behalf of customers who participated in the Sperro Program. This arrangement would allow prospective clients to file for bankruptcy even if they could not afford to pay their own legal fees as long as those clients wanted to surrender their vehicles. Chern benefitted from this as it eliminated the delay caused by the installment payment plan and caused more debtors to be able to "pay" the full fee overall. Additionally, Fenner paid $150 per referral to a marketing company associated with Upright.

Once a client surrendered his or her vehicle to Sperro, the scam process began. First,

Sperro would tow the vehicle to Nevada, Mississippi or Indiana because these were the only three states that allowed for mechanic's liens to trump a vehicle lender's lien. In order to allow enough time for the mechanic's lien to properly attach to the client's vehicle and to generate additional fees, Fenner requested that Upright send out notices to the lender in a delayed fashion. Specifically, Fenner said:

> We have to hold the vehicle so many days before we can perfect our lien by state law. We also need some time to generate a profit margin. I would prefer not to send notification to the lien holder from the existing attorney up front. The Lien [sic] holder would already be notified in the petition. Any attempts to speed the process would eliminate our perfection of the lien as well as cutting our profit.

Id. at *10.

Once the lenders were contacted, they would be informed that they had choices regarding how to proceed. The lender could either pick up the vehicle and pay the towing and storage fees that Sperro had incurred (towing charges of $1.50 per mile, a $75 loading fee, and $45/day for storage fees), or abandon the vehicle so that Sperro could sell it. Chern, in describing the Sperro Program, stated that in sixty percent of cases, the lender would pick up the car and satisfy the charges. In the remaining forty percent of cases, the lender would abandon the vehicle. Chern also acknowledged that " 'Sperro really makes its money when the finance company abandons and Sperro auctions it off.' " *Id.* at *11.

Regardless of how the lender decided to proceed, a portion of the funds generated would be paid from Sperro to Upright for payment of the entire legal fee plus the filing fee on the client's behalf. In a seeming attempt to disguise this fact, Fenner suggested that Upright state that the entity paying the legal fees should be disclosed as Fenner & Associates. Nonetheless, in several cases, the Rule 2016 disclosures that Upright drafted reflected that attorneys' fees were paid by "Sperro." Nationally, Upright generated approximately $333,545 in fees from the Sperro Program, exclusive of filing fees.

In sum, as early as June of 2015, Upright management knew that Sperro was towing cars from as far away as Florida and Virginia to its storage units in Nevada, Mississippi, or Indiana with the goal of priming the secured lenders or keeping their collateral hostage unless they paid the excessive fees Sperro had "incurred." The local partners were generally not apprised of the details of the Sperro Program, although some did know about it.

III. *In re Williams*

In *Robbins v. Delafield et al. (In re Williams)*, No. 15-71767, 2018 WL 832894, at *1 (Bankr. W.D. Va. Feb. 12, 2018), the U.S. Bankruptcy Court for the Western District of Virginia considered the above-described ethical issues associated with the practice of Upright. The matter came before the Court by way of complaints initiating two separate adversary proceedings filed on May 31, 2016 and June 30, 2016 by the United States Trustee for Region Four, Judy A. Robbins, against Darren T. Delafield, John C. Morgan, Jr., John C. Morgan, Jr., PLLC, Upright

Law, LLC, Law Solutions Chicago, LLC, Jason Royce Allen, Kevin W. Chern, Edmund Scanlan, and Sperro, LLC. Other than Sperro, LLC, against which default was entered for failure to respond, the defendants were collectively referred to as the "Upright Defendants." The adversary proceedings were filed in the bankruptcy cases of Timothy and Andrian Williams, represented by Darren T. Delafield ("Delafield"), and Jessica Dawn Scott, represented by John C. Morgan ("Morgan"). Delafield and Morgan were both Upright partners.

a. The Williams Chapter 7 Case

Timothy and Andrian Williams were Upright clients in Virginia who sought bankruptcy protection under Chapter 7 of the United States Bankruptcy Code. After discovering Upright and proceeding through the onboarding process described above, a senior client consultant introduced the Williamses to the Sperro Program. The consultant informed the Williamses that, through the Sperro Program, they could surrender their Ford Taurus and have their legal fees and costs paid. Pending repossession, Mr. Williams advised that he had been contacted by the auto lender, which sought to pick up the Taurus if a payment was not made. In response, the consultant advised, " 'in this situation, if I were you, I would keep it hidden and we come get it, and at least pay off some of your bankruptcy [. . .].' " *Id.* at 12. Mr. Williams questioned the legality of the Sperro Program. He spoke directly to two Upright attorneys who told him that the Sperro Program was legal and that "it's totally fine [. . .]." *Id.* at *12. The Williamses ultimately decided to participate in the Sperro Program. The Taurus was towed to Indiana and sold at auction.

Attorney Delafield represented the Williamses in their Chapter 7 case in the Western District of Virginia as a local partner of Upright. Over time, Delafield had filed over thirty cases in the Western District of Virginia as an Upright local partner. For Delafield and Upright's representation of the Williamses, Fenner & Associates paid the legal fee to Upright through the Sperro Program. However, the Rule 2016 disclosure stated that the legal fees were paid by Sperro, a fact that ended up being critical in the case when it was examined at the Williamses section 341 meeting. At the meeting, Delafield denied knowing why Sperro had paid the Williamses fee. Instead, Delafield attempted to deflect questions about Sperro to another unidentified Upright attorney. Delafield claimed to be ignorant about the relationship between Sperro and Upright.

b. The Scott Chapter 7 Case

Jessica Dawn Scott ("Scott") also filed a Chapter 7 case with the assistance of Upright. Like the Williamses, Scott filed her case in the Western District of Virginia although she was represented by local partner Morgan. In total, Morgan filed at least nine cases for Upright. Prior to speaking with Morgan, Scott spoke with a senior client consultant about one of her debts as follows:

> Scott: ... like my ex and I have a loan together. Like what happens with that?

> Fox: Okay. So if you're both on a loan, you'll be taken off of all responsibility of the loan and he'll be fully responsible.
>
> Scott: Oh, God, that sucks.
>
> Fox: Now if you want to keep that loan though, we can keep it off and you can continue to pay on it ....
>
> Scott: But I still don't want to screw him over.
>
> Fox: Okay. Well I mean, we can leave that off, that's not a problem.

Id. at *14. Scott participated in the Sperro Program and had her legal fees paid by Sperro through Fenner & Associates.

Morgan never met Scott in person during her entire bankruptcy case. He had his non-attorney wife meet with Scott to review her petition and schedules.[2] The filings with the Court contained numerous errors, including that the Rule 2016 disclosure reflected an incorrect amount of fees paid to Upright and failed to state that Sperro or Fenner & Associates had paid the fees. Additionally, although Scott had participated in the Sperro Program, her disclosures indicated that her vehicle had been "attached, seized, or levied" and also indicated that she had not transferred property to anyone within two years of her bankruptcy filing. Morgan's former associate attended Scott's section 341 meeting with her even though he had no relationship with Upright. Despite this, Morgan's time records show that *he* personally attended Scott's section 341 meeting. In actuality, Morgan never met Scott in person until she was deposed in the case against, among others, Upright and Morgan.

The Sperro Program came to light at Scott's section 341 meeting when Scott was questioned about what had happened to her vehicle and who had paid her attorneys' fees. Two months later, Morgan attempted to correct Scott's disclosures. Morgan amended the Rule 2016 disclosure. He also amended Scott's Statement of Financial Affairs that purported to bear Scott's signature under oath, however, the Court later learned that Scott had not signed it nor did she know about it until her deposition in connection with the UST's case.

c. Conclusions of Law

The UST asserted six counts for relief against the Upright Defendants and Sperro. The UST argued that the Upright Defendants were obligated to file accurate statements pursuant to Rule 2016(b) of the Federal Rules of Bankruptcy Procedure describing the sharing of compensation between the entities involved, Morgan/Delafield's firms and Upright, because

[2] "When questioned by the Court why Morgan and his associate attorney allow his wife to go over petitions and schedules with consumer debtors, and also obtain their signatures, Morgan testified: 'Between the three of us, I would say that my wife has a superior knowledge of the law and the conduct of the signing and the elements of the bankruptcy petition. We often ask for her advice.' Morgan, Tr. 66, Day 4." *Robbins v. Delafield et al. (In re Williams)*, No. 15-71767, 2018 WL 832894, at *14 n.40 (Bankr. W.D. Va. Feb. 12, 2018).

they were not part of the same firm. Rule 2016(b) requires a debtor's attorney to disclose "whether the attorney has agreed to share the compensation with any other entity." Fed. R. Bankr. P. 2016(b). In reviewing the facts in connection with these provisions, the Court considered the Virginia Rules of Professional Conduct, which state: a "firm," or "law firm" "is a professional entity, public or private, organized to deliver legal services, or a legal department of a corporation or other organization," and that when individuals "present themselves to the public in a way suggesting that they are a firm or conduct themselves as a firm, they should be regarded as a firm for the purposes of the Rules." Va. R. Prof'l Conduct, Preamble, Terminology; 1.10 Cmt. [1]. The Court determined that Upright satisfied the standard of existing as a "law firm" such that Delafield and Morgan were permitted to share compensation with Upright and their Rule 2016 disclosures were not deficient for that reason.

Despite the Court's ruling regarding Rule 2016, it found against the Upright Defendants on several other grounds. Specifically, the Court declared the Williamses' contract with Upright void pursuant to section 528(a) of the Bankruptcy Code. Section 528(a) places requirements on debt relief agencies, which requirements Upright violated when the Williamses' vehicle was towed in connection with the Sperro Program long before the Williamses saw a written contract that complied with section 528(a).

The Court also declared that the fees Upright collected on behalf of the Williamses and Scott were unreasonable pursuant to section 329(b) of the Bankruptcy Code simply because the clients had been placed in the Sperro Program. The Court granted the UST's requests that the fees received by Upright be delivered to the respective bankruptcy estates. The Court added that although Upright had "jumped the gun and paid funds to the Williamses and Scott voluntarily after litigation commenced" in an apparent attempt to end-run the Court's proceedings, that would be "a loss Upright [would] have to bear." *Id.* at *26.

The Court also considered whether to grant the UST's request for an injunction against Upright, LSC, Morgan, and Delafield from violating section 526 of the Bankruptcy Code. The Court determined that "an injunction simply to order the defendants to obey the law and not violate Section 526 would be difficult to police and run afoul of Rule 65." *Id.* at *26.

Finally, the Court addressed the UST's request "to control admission to its bar and to discipline attorneys who appear before it." *Chambers v. NASCO, Inc.,* 501 U.S. 32, 43 (1991). The Court considered the above-described acts committed by the Upright Defendants, with particular attention to the Sperro Program and the fact that Upright presented the Sperro Program as an option before clients could speak with counsel. The Court determined that Upright had acted in bad faith based on the Sperro Program, the sales tactics employed by Upright consultants, and the provision of legal advice by non-lawyers and decided that "the privileges of LSC, Upright Law, Chern, and Allen to file or conduct cases, directly or indirectly, in the Western District of Virginia shall be revoked for a period of five (5) years." *Id.* at *30. The Court also fined Upright, LSC, Chern, Allen, Scanlan, and Sperro in the collective amount of $250,000.00. In addition, it fined Chern, separately and personally, in the amount of "$50,000.00 for his participation in and leadership of the Sperro scheme." *Id.* at *30.

Regarding Delafield, the Court found that he was equally responsible for the Upright

client consultants' actions such as the unauthorized practice of law and offering the Sperro Program to clients. The Court revoked Delafield's privileges to practice before the Court for one year and also sanctioned him $5,000 to be paid to the Williamses.

Regarding Morgan, the Court stated, "As a witness, the Court found Morgan to be defiant, unremorseful and wholly lacking in credibility." *Id.* at *14 n.40. The Court was particularly concerned with Morgan's attempts to impede the UST's investigation to the detriment of his former client and Morgan's reliance on staff to meet with clients in person and review their documents with them. The Court decided to revoke Morgan's privileges to appear before the Court for eighteen months. In addition, it sanctioned Morgan $5,000 to be paid to Scott.

Finally, the Court required Sperro to disgorge all funds it had received from: "(1) the sale or disposition of any property for which it remitted funds to LSC/Upright in connection with a case filed in this Court, and (2) any funds paid to it by or on behalf of a lender to recover that lender's collateral in connection with a case before this Court." *Id.* at *33.