AMERICAN BANKRUPTCY INSTITUTE

2023 Annual Spring Meeting

Danger Ahead! Avoiding and Addressing Ethical Landmines in Attorney Engagement and Compensation

Hosted by the Ethics and Professional Compensation & Young and New Members Committees

CONCURRENT SESSION

Hon. Hannah L. Blumenstiel, Moderator
U.S. Bankruptcy Court (N.D. Cal.); San Francisco

Timothy J. Anzenberger
Adams and Reese; Ridgeland, Miss.

Bodie B. Colwell
Preti Flaherty; Portland, Maine

Sarah Primrose
King & Spalding; Atlanta

2023

AMERICAN BANKRUPTY INSTITUTE
2023 ANNUAL SPRING MEETING

Danger Ahead! Avoiding and Addressing Ethical Landmines in Attorney Engagement and Compensation

Friday, April 21, 2023; 11:30 a.m. – 12:30 p.m.

PANELISTS

Timothy J. Anzenberger
Adams and Reese LLP
tim.anzenberger@arlaw.com
(601) 292-0715

300 Renaissance
1018 Highland Colony Parkway, Ste. 800
Ridgeland, MS 39157

3440 Toringdon Way, Ste. 205
Ste. 205
Charlotte, NC 28277

Hon. Hannah L. Blumenstiel
United States Bankruptcy Court (N.D. Cal.)

Bodie B. Colwell
Preti Flaherty
One City Center
Portland, ME 04101
bcolwell@preti.com
(207) 791-3000

Sarah Primrose
King & Spalding LLP
sprimrose@kslaw.com

1180 Peachtree Street NE, Ste. 1600
Atlanta, GA 30309
(404) 572-2734

Southeast Financial Center
200 S. Biscayne Blvd, 4700
Miami, FL 33131
(305) 462-6036

I. Standards Governing Employment of Estate-Retained Counsel

A. General BK Counsel

1. 11 U.S.C. § 327(a)

a. Must not "hold or represent an interest adverse to the estate"

i. Defined as either an economic interest that would tend to lessen the value of the estate or that would create either an actual or potential dispute in which the estate is a rival claimant *or* a predisposition under circumstances that render such a bias against the estate. In re Nilhan Developers LLC, 2021 WL 1539354, * 11 (Bankr. N.D. Ga. Apr. 19, 2021) (citing In re Prince, 40 F.3d 356, 361 (11th Cir. 1994)); In re Black and White Stripes LLC, 623 B.R. 34, 49 (Bankr. S.D.N.Y. 2020) (citing In re AroChem Corp., 176 F.3d 610, 623 (2d Cir. 1999)).

aa. Most common example of an economic interest adverse to the estate is holding a pre-petition claim for unpaid fees. In re Owens, 2014 WL 3867535, *4 (B.A.P. 9th Cir. Aug. 6, 2014) (holding that bankruptcy court correctly concluded that debtor's counsel was not disinterested for purposes of § 327(a) where they held a pre-petition claim for unpaid legal fees) (citations omitted).

- This prohibition is subject to an exception found in 11 U.S.C. § 1195, which applies only in cases under Subchapter V of Chapter 11. Under § 1195, Counsel is not disqualified for employment solely because they hold a pre-petition claim, so long as such claim is less than $10,000.

- This type of economic conflict can be rectified if Counsel expressly, irrevocably, and unconditionally waives its pre-petition claim. Owens, 2014 3867535 at *4 (citing, among other authority, In re Pillowtex, Inc., 304 F.3d 246, 253 (3d Cir. 2002)).

ii. Not a retrospective test; measured based on present interests. Black and White Stripes, 623 B.R. at 50.

iii. Objective standard, precluding employment where counsel holds an "interest or relationship, however, slight, that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules". Id.

iv. Evaluated on a case-by-case basis. Id.

b. Must be disinterested

i. 11 U.S.C. § 101(14) – "Disinterested Person" means a person that:

aa. is not a creditor, an equity security holder, or an insider;

bb. is not and was not, within 2 years before the Petition Date, a director, officer, or employee of the debtor; and

cc. 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, or for any other reason.

2. Other Parameters

a. Actual vs. Potential Conflicts of Interest

i. 11 U.S.C. § 327(c) – In a case under Chapter 7, 12, or 11 . . . Counsel is not disqualified from employment solely because they were employed by or represented a creditor, *unless* another creditor or the United States Trustee objects, in which case the court shall disapprove such employment if there is an actual conflict of interest.

ii. Actual Conflicts

aa. Require disqualification. 11 U.S.C. § 327(c); Nilhan, 2021 WL 1539354, *12.

iii. Potential Conflicts

aa. Where Counsel has only a potential conflict, and the possibility of the potential conflict morphing into an actual conflict is remote, Counsel may be employed in the Bankruptcy Court's discretion. Id.

bb. Fact intensive inquiry

AA. In re Boy Scouts of Am., 35 F.4th 149 (3d Cir. 2022) (citations omitted).

- Because the power to disqualify stems from a court's authority to supervise the attorneys appearing before it, a decision about whether to use that power is discretionary and never is automatic

- A court may conclude based on the facts before it that disqualification is not an appropriate remedy

- A court may consider the ability of litigants to retain loyal counsel of their choice, the ability of attorneys to practice without undue restriction, preventing the use of disqualification as a litigation strategy, preserving the integrity of legal proceedings, and preventing unfair prejudice

cc. Other Relevant Factors

AA. Length and scope of prior representation

- Even where prior engagement did not last long, it can still give rise to a disqualifying conflict, especially where it overlapped or directly impacted bankruptcy. Black & White Stripes, 623 B.R. at 51-52 (Counsel had disqualifying conflict that prevented its employment as general BK counsel for affiliated debtors where Counsel previously represented debtors and their principals in state court litigation involving creditors; BK estate had colorable claims against principals, which would mean Counsel would likely have to sue former clients).

- Counsel's prior representation of client directly adverse to debtor did not amount to an actual conflict where, during bankruptcy, Counsel

did not engage in any activity on behalf of adverse party and received no payments from adverse party. Nilhan, 2021 WL 1539354 at *12 (citing In re Vascular Access Centers L.P., 613 B.R. 613, 627 (Bankr. E.D. Pa. 2020)).

BB. Formalized Relationship

- Depending on the parties' expectations and understanding, a disqualifying conflict might exist even in the absence of a formalized attorney-client relationship. Nilhan, 2021 WL 1539354 at *12 (discussing In re New River Dry Dock, Inc., 497 Fed. App'x 882, 887 (11th Cir. 2012) (Counsel engaged in substantive discussions with potential buyers of debtor's assets and had a "strong expectation" that he would work for them, even though they had not executed an engagement agreement; this gave rise to a disqualifying conflict with respect to Counsel's employment by the debtors).

CC. Number of Lawyers Involved

- While most courts generally do not impute a single lawyer's disqualifying conflict to the entire law firm, where the disqualified attorney's conflict is significant, imputation of such conflict to the firm might be appropriate. Nilhan, 2021 WL 1539354 at *13 (discussing, among other cases, In re Essential

Therapeutics, Inc., 295 B.R. 203, 211 (Bankr. D. Del. 2003) and In re McDermott Int'l, Inc., 614 B.R. 244, 254 (Bankr. S.D. Tex. 2020)).

DD. Representation of Affiliated Debtors

- While it is possible for a single attorney or law firm to represent multiple debtors, where the debtors have or are likely to have claims against each other, a disqualifying conflict likely exists. Black and White Stripes, 623 B.R. at 50-51 (discussing, among other cases, In re Interwest Bus. Equip., Inc., 23 F.3d 311, 314 (10th Cir. 1994) and In re JMK Constr. Group Ltd., 441 B.R. 222-225 (Bankr. S.D.N.Y. 2010)).

EE. Dollar Value of Prior Representation

- In re Art Van Furniture LLC, 617 B.R. 509 (Bankr. D. Del. 2020) (where revenue from debtor's counsel's representation of another party to the bankruptcy case was de minimis, the court found no evidence upon which to conclude that counsel lacked zealousness in its representation of debtor).

3. Disclosures

a. FRBP 2014(a)

i. Requires the filing of an application requesting approval of Counsel's employment

aa. Application must explain:

AA. Why employment of counsel is necessary

BB. The reason(s) why counsel was selected

CC. The services to be rendered

DD. Any compensation arrangement

bb. Application must include a verified statement disclosing all of counsel's "connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the UST or any person employed in the OUST".

- FRBP 5002(a)
    - Prohibits employment where Counsel is a relative of the presiding judge
    - Permits Counsel's employment where they are a relative of the UST in the region in which the case is pending, unless the court finds that such a relationship renders employment "improper under the circumstances of the case." Disqualification on this basis extends to Counsel's entire firm.
- In re SAS AB, 645 B.R. 37 (Bankr. S.D. N.Y. 2002).
    - No disqualifying conflict for bank to be employed by debtor-

in-possession where Chairman of bank's board had a family foundation that owned stock in the debtor and Chairman's cousin served on family foundation's board

- No disqualifying conflict by virtue of volume and significance of bank's pre-petition transactions with debtor

- Pre-petition payments and cash management fees paid to bank by debtor did not render bank a creditor and did not mean that bank was not disinterested for purposes of its employment

ii. Courts construe these disclosure requirements very broadly; an applicant must disclose *all* connections, regardless of whether they rise to the level of a disqualifying conflict. Nilhan, 2021 WL 1539354 at * 14 (citing, among other authority, I.G. Petroleum LLC v. Fenasci (In re West Delta Oil Co.), 432 F.3d 347, 355 (5th Cir. 2005)). "Professionals cannot pick and choose the connections they deem relevant or important." Nilhan, 2021 WL 1539354 at *15 (citing U.S. v. Gellene, 182 F.3d 578, 588 (7th Cir. 1999)).

aa. Nondisclosure or incomplete disclosure – whether willful or unintentional, and regardless of whether such failure proved harmless – renders Counsel subject to sanctions. Nilhan, 2021 WL 1539345 at *15 (citations omitted).

bb. What connections must be disclosed?

AA. Affiliates

- Generally, the United States Trustee takes the position that estate-retained professionals must disclose connections with all affiliates. See Memorandum from Clifford J. White III, Dir. of Exec. Office for United States Trustees (Dec. 4, 2019) (available at: https://www.justice.gov/ust/file/generalprinciplesdisclosureconflicts.pdf/download).

- "Affiliate" is defined in 11 U.S.C. § 101(2). To simplify: affiliation with the debtor exists where there is **(1)** ownership of 20% of more of debtor's voting securities; **(2)** control of 20% or more of debtor's voting securities; **or (3)** the holding of 20% or more of debtor's voting securities if the holder has the power to vote. In re Serendipity Labs, Inc., 620 B.R. 679, 686 (Bankr. N.D. Ga. 2020).

BB. Investments

- Investments held by the applicant, the applicant's affiliates, or applicant's individual professionals might need to be disclosed and can give rise to disqualifying conflicts

- Investments can be held directly (by the applicant, affiliate, or professional) or indirectly (through a third party)

- Investments that matter are those held in parties involved in the case or in the debtor's industry. See Memorandum from Clifford J. White III, Dir. of Exec. Office for United States Trustees (Dec. 4, 2019) (available at: https://www.justice.gov/ust/file/generalprinciplesdisclosureconflicts.pdf/download).

- United States Trustee will scrutinize investments carefully, focusing on:

    - Applicant's knowledge

    - Applicant's control

- If the applicant knew or should have known about the investment *OR* if the applicant controlled or could have controlled the selection of the investment, the United States Trustee will require disclosure

- Examples

    - Investment in a diversified mutual fund managed by an independent outside advisor need not be disclosed

    - Pooled investments sponsored by applicant in clients that might be parties to a case might need to be disclosed

b. 11 U.S.C. § 329/FRBP 2016(b)

i. § 329(a) requires every attorney representing a debtor in or in connection with a bankruptcy case to file a statement explaining the compensation paid or agreed to be paid, if such payment or agreement was made within 1 year prior to the Petition Date, for services rendered or to be rendered in contemplation of or in connection with the case, as well as the source of such compensation.

ii. FRBP 2016(b) requires that the statement mandated by § 329 be filed within 14 days after entry of the order for relief.

iii. Statement must be filed whether or not Counsel will be paid for work done.

iv. Per FRBP 2016(b), Statement also must disclose any agreement between Counsel and any third party to share compensation.

v. Under FRBP 2016(b), Counsel has a duty to supplement their Statement within 14 days after any payment or agreement not previously disclosed.

4. Purposes of Disclosures

a. Public Confidence

i. The retention and disclosure process is designed to ensure public confidence in the integrity and efficiency of the bankruptcy system by determining whether professionals can render undivided loyalty and untainted advice and by limiting the retention of professionals to those instances where the services are necessary.

ii. Absent complete, clear, and public disclosure of all connections, a court cannot determine whether a professional satisfies the rigorous statutory standard for employment.

b. Pursuant to 28 U.S.C. § 586(a)(3)(I), it is the United States Trustee Program's job to review applications in chapter 11 cases to employ law and other professional firms that will seek payment from the bankruptcy estate.

i. Due to the multiplicity of interests in a case-from large to small creditors, from employees to other stakeholders-the Bankruptcy Code and Rules mandate that professional firms disclose their connections to other parties in the case and satisfy conflict of interest standards.

ii. Although all parties in a case may object to the adequacy of a professional firm's disclosures and to a professional firm's retention because of potential or actual conflicts, it is usually only the USTP that makes inquiries or files objections. The Trustee's role as the "watchdog" of the bankruptcy system is to raise issues.

c. Fulsome disclosures can offer the applicant some protection from sanctions and/or disgorgement. It is better to get in front of any issues. Further, courts might treat a willful or intentional failure to disclose as an attempted fraud upon the court. This will often merit the harshest sanction. In fact, a professional might be sanctioned for incomplete disclosures even if proper disclosures would have shown that the professional was disinterested. See Nilhan, 2021 WL 1539354 at *15 (citations omitted).

5. Confidentiality?

a. United States Trustee typically argues that an applicant's disclosures must be part of the public record, unless the court grants a motion to seal or redact such material.

b. In bankruptcy cases/proceedings, sealing or redaction is governed by 11 U.S.C. § 107, which sharply restricts the universe of material that can be sealed or redacted.

6. Case Studies

a. KLG Gates LLP v. Brown, 506 B.R. 177 (E.D. N.Y. 2014).

i. Firm's boilerplate disclosure of connections with parties to BK case was insufficient

ii. Attorney was not required to disclose connections to other BK professionals

iii. Three-year delay in bringing motion to disqualify constituted a waiver of alleged disqualifying conflict

b. In re Chris Pettit & Assocs., P.C., 2022 WL 17723920 (W.D. Tex. Dec. 13, 2022).

i. Law firm represented debtor law firm and principal in state court actions filed by former clients

ii. Law firm that represented law firm debtor did not adequately disclose payments for work in contemplation of or in connection with the bankruptcy cases

iii. FRBP 2016(b) requires debtor's counsel to disclose source of funds paid for services

c. In re Easterday Ranches, Inc., 2022 WL 17184713 (Bankr. E.D. Wash. Nov. 23, 2022).

i. Affiliated debtors filed separate BK cases and proposed employment of common counsel

ii. Debtors were owned and managed by members of the same family

iii. One debtor operated a cattle ranching business; the other debtor was involving in farming

iv. President of cattle ranching business engaged in a scheme to defraud certain creditors by charging them for non-existent cattle

v. Farming debtor did not participate in fraud, but was liable with cattle ranching debtor for some of the debt owed to defrauded creditors

vi. UST objected to employment of common counsel; court overruled objection because "any intercompany disputes were theoretical at the time" and a creditors committee had been appointed for each debtor

vii. After debtors managed to confirm a plan, UST objected to fourth interim fee application filed by debtors' counsel, arguing that, during the negotiation of the plan, the farming debtor's stakeholders' interests were impermissibly subordinated to those of the cattle ranching debtor, giving rise to an actual conflict of interest on the part of debtors' counsel

vii. Court concluded that counsel did not inappropriately represent an interest adverse to either bankruptcy estate. Getting to consensual confirmation of the plan and resolution of the cases was "undoubtedly in the best interests of both

debtors and the collective interest of all their stakeholders." "The proposal of a joint plan advancing the common good for both Ranches and Farms is permissible" under the per plan framework of 11 U.S.C. § 1129(a)(10). The court also discussed the difference between affirmative litigation to determine the merits of a claim and negotiating the settlement or release of a claim for conflict purposes: "the acts of proposing and filing a chapter 11 plan are part of a negotiation process. This process differs both substantively and procedurally from affirmative litigation prosecuted via adversary complaint."

d. In re Nir West Coast, Inc., 638 B.R. 441 (Bankr. E.D. Cal. 2022).

i. Subchapter V debtor's sole shareholder was a co-debtor and guarantor of debtor, a recipient of preferential transfers, and a creditor of the estate, and a co-defendant with debtor in pre-petition state court wage and hour class action

ii. Proposed BK counsel had represented debtor and shareholder in the pre-petition litigation, which settled; Both debtor and shareholder were liable under settlement

iii. Proposed BK counsel did not disclose its connection to debtor's shareholder in employment application; disclosed only after a creditor and SubV trustee raised the issue

iv. Debtor's counsel then filed a fee application, which the BK court declined to approve

v. BK court concluded that counsel represented an interest adverse to the estate

e. In re Aearo Tech. LLC, 642 B.R. 891 (Bankr. S.D. Ind. 2022).

i. Kirkland & Ellis sought employment as debtors' counsel. The non-debtor indirect parent of the debtors is 3M. 3M paid K&E's retainer on the debtors' behalf. K&E disclosed that connection to 3M in its employment application/declaration.

ii. K&E serves as lead counsel for 3M in litigation involving allegedly faulty earplugs.

iii. The UST objected to K&E's employment as debtors' bankruptcy counsel, arguing that the interests of 3M and the debtors were not aligned because they were co-defendants in the faulty earplug tort action, because 3M allegedly owed the debtors billions of dollars under a pre-petition funding agreement, and because 3M might have claims against the debtors arising from that funding agreement. According to the UST, K&E did not have undivided loyalty to the debtors.

iv. The court overruled the UST's objection, finding that K&E did not represent an interest adverse to the bankruptcy estate. The court concluded that the debtors and 3M did not have conflicting interests because they were working on a settlement that would resolve the faulty earplug litigation. The court noted, however, that a conflict could arise in the future, which might give rise to a basis for disqualification or disallowance of fees.

B. Special Counsel

1. 11 U.S.C. § 327(e)

a. A trustee or debtor-in-possession may employ Special Counsel even if Special Counsel previously represented the debtor, if employment is in the best interest of the estate, and so long as Special Counsel does not represent 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.

i. Courts widely recognize that a claim for pre-petition unpaid fees does not render Special Counsel not disinterested for purposes of § 327(e). In re Mallinckrodt PLC, 2022 WL 906462, *5-6 (D. Del. Mar. 28, 2022) (citations omitted).

2. 11 U.S.C. § 329/FRBP 2016(b)

a. Applies to Special Counsel. In re NNN 400 Capitol Center 16 LLC, 632 B.R. 243, 256 (D. Del. 2021).

3. FRBP 2014

a. Applies to Special Counsel. Id.

II. Unbundling of Services and Bifurcation of Fees

A. Unbundling

1. Meaning

a. Unbundled legal services (or limited scope representation) are an alternative to traditional, full-service representation.

b. Instead of handling every task in a matter from start to finish, the lawyer handles discrete, identified tasks.

c. Client remains responsible for any other tasks on a pro se basis

d. According to the American Bar Association, "it is like an à la carte menu for legal services, where: (1) clients get just the advice and services they need and therefore pay a more affordable overall fee; (2) lawyers expand their client base by reaching those who cannot afford full-service representation but have the means for some services; and (3) courts benefit from greater efficiency when otherwise self-represented litigants receive some counsel."

2. Historical Use and Evolving Perception

a. Historically, unbundled legal services—such as ghostwriting pleadings and briefs—were disfavored and, in fact, violated rules of professional conduct and local rules in certain jurisdictions. In re Futch, 2011 WL 1884187 (Bankr. S.D. Miss. May 18, 2011) (ghostwriting pleadings violates FRBP 9011).

b. More recently, the ABA and some states have recognized that permitted unbundled legal services may benefit low income litigants.

i. In 2000, the ABA amended Model Rule 1.2(c) to allow limited scope representation. The current version reads:

   aa. "A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."

ii. And Mississippi, for example, amended its Rule 1.2(c) in 2011 to expressly allow limited service representation.

   aa. Previously, Mississippi's rules contemplated "cradle to grave" representation, meaning that a lawyer who accepted a client's representation was obligated to provide representation until the matter was terminated or the lawyer was fired. The rule was amended to promote the representation of those with limited means.

      AA. "A lawyer may limit the objectives or scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."

      BB. Comment: "Limited scope representation is an important means of providing access to justice for all persons regardless of financial resources. Lawyers are encouraged to offer limited services when appropriate, particularly when a client's financial resources are insufficient to secure full scope of services. For example, lawyers may provide counsel and advice and may draft letters or pleadings. Lawyers

> may assist clients in preparation for litigation with or without appearing as counsel of record. Within litigation, lawyers may limit representation to attend a hearing on a discrete matter, such as a deposition or hearing, or to a specific issue in litigation."

c. By benefitting those with limited means, unbundled services appear particularly useful in consumer cases

3. Application in Bankruptcy Cases

a. In re Seare, 493 B.R. 158 (Bankr. D. Nev. 2013).

i. Addressed whether unbundled legal services in an adversary proceedings are appropriate.

ii. Begins with an overview of the legal profession, noting the historical rule of cradle to grave representation: "Lawyers are not plumbers. They cannot indiscriminately dismiss clients at their whim, or even if their clients don't pay on time. Lawyers are professionals that owe fiduciary duties to their individual clients, and must continue to represent them even if initially rosy predictions turn sour."

iii. Notes that unbundling has become more common in bankruptcy and may have its benefits: "The practice can benefit clients by giving them access to legal services that would otherwise be too expensive, and clients may feel a greater sense of satisfaction "flowing from the collaborative effort of achieving the client's desired goals."

iv. Recognizes unbundling's importance in promoting pro bono work: "Pro bono attorneys may be more willing to volunteer their time and effort if the representation has clear boundaries."

v. But there are concerns: "There is a particular concern in consumer bankruptcy practice that attorneys will unbundle services that are essential or fundamental to bankruptcy cases and clients' objectives."

vi. Some bankruptcy courts have found unbundling acceptable *if* all other ethical rules are followed.

vii. Ultimately, the bankruptcy court found that unbundled services were permissible, even in adversary proceedings, so long as the following rules were followed:

AA. Duty of competence

BB. Duty to communicate

CC. The arrangement must be reasonable under the circumstances

DD. Client must give informed consent

EE. Fees charged for limited services are communicated to the client

FF. Counsel complies with 11 U.S.C. § 707(b)(4)(C) and undertakes a reasonable investigation

B. Fee Bifurcation

1. Meaning

a. Most commonly occurs in cases filed under Chapter 7, in which debtor's counsel is not entitled to payment from the bankruptcy estate.

b. Where a debtor cannot afford to pay counsel's entire fee up front, in addition to the filing fee, debtor and counsel

will enter into a pre-petition agreement and a post-petition agreement.

i. Pre-petition agreement covers the work needed to prepare and file the petition, schedules, and other required documents.

ii. Post-petition (non-dischargeable) agreement covers the rest of the work needed to finish the case.

2. Courts' Varying Approaches

a. Majority – Bifurcation is permitted under certain circumstances, which includes full, transparent disclosure.

i. In re Brown, 631 B.R. 77 (Bankr. S.D. Fla. 2021).

aa. This case came before the court after the UST filed three separate motions (in 3 separate individual Chapter 7 cases) objecting to the business practices of two law firms with respect to bifurcated fee arrangements.

bb. Specifically, the UST objected to:

AA. The marketing of "no money down" or "little money down" Chapter 7 bankruptcy cases

BB. The bifurcation of bankruptcy services into pre- and post-petition components

CC. The performance of limited pre-petition services for little or no charge

DD. The post-petition collection of fees for purported post-petition services in an amount disproportionate to the services provided

EE. The law firm's payment of the filing fee, which the debtor reimbursed post-petition via monthly payments

cc. Ultimately, the UST asked to fundamental question f whether bifurcation of fees should be allowed at all and, if so, under what circumstances?

dd. The court held that bifurcation of fees should be permitted, subject to the following requirements:

AA. First, the pre- and post-petition fees must be reasonable. To determine the reasonableness of pre- vs. post-petition flat fees, courts must take into account not only the work that was done but also the services that might have been required and for which there would have been no additional charge. Courts should not consider services that would not possibly be necessary in the case, such as dealing with student loans when the debtor has no such loans, or defending a motion for relief from stay in a case in which the debtor has no secured creditors.

BB. Second, lawyers have an obligation of competency under applicable professional rules (such as ABA Model Rule 1.1, FRBP 9011(b), and 11 U.S.C. § 707(b)(4). This

obligation mandates that certain services be required pre-petition and therefore included in the pre-petition agreement and pre-petition fees regardless of whether the debtor ultimately signs a post-petition retainer agreement. For example, this requires counsel to prepare and file the petition for relief, creditor matrix, application to pay filing fee in installments, and the statement of attorney compensation.

CC. Third, because bifurcated fee arrangements contemplate limited services pre-petition, with a separate scope of services post-petition, the limitation of services must be reasonable under the circumstances. This is required under applicable professional rules (such as ABA Model Rule 1.2). Exactly what is "reasonable" under the circumstances is governed by the Bankruptcy Code, applicable local rules, and applicable rules of professional conduct.

DD. Fourth, the arrangement must be fully disclosed to the client and the client must provide informed, written consent. This is required by applicable professional rules (such as ABA Model Rule 1.2). Disclosure is appropriate so long as:

- The potential debtor receives a separate disclosure form;
- The pre-petition agreement and the post-petition agreement are

provided to the potential debtor for review at the same time;

- The pre-petition agreement clearly describes the services that must be performed pre-petition, as well as other services that might be provided; and

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

ee. Applying those requirements to the 3 cases before it, the court held that the arrangements mostly complied with the above, including that the fees charged were reasonable. Nonetheless, the court found the following violations:

AA. First, the law firms impermissibly advanced filing fees, which were to be repaid post-petition. The court did not, however, require disgorgement. Instead, the court prohibited this practice in the future.

BB. Second, the pre-petition and post-petition agreements did not adequately disclose the services to be rendered. For example, one agreement imposed a flat fee for pre-

petition services that were simply described as "basic services."

CC. Ultimately, the court did not impose sanctions, but enjoined the law firms from entering into bifurcated agreements that did not comply with the requirements outlined by the court.

ii. UST Guidelines issued June 10, 2022 permit bifurcation of fees, so long as:

AA. Fees charged are fair and reasonable

BB. Debtor gives informed consent

CC. Agreements are disclosed to court and creditors

iii. Some courts have amended their local rules or issued General Orders that set forth these requirements. E.g., Standing Order MISC 22-3006 (Bankr. E.D. Pa.).

b. Minority – Bifurcated fee arrangements are void and impermissible.

i. In re Siegle, 639 B.R. 755 (Bankr. D. Minn. 2022).

aa. Debtor's counsel filed an application to approve a post-petition fee agreement, which was part of a bifurcated fee arrangement between debtor and debtor's counsel.

bb. The court denied the application, holding that both the pre- and post-petition agreements were void.

cc. The court began by noting that the general rule in its jurisdiction was that debtors sign a single agreement with counsel and pay *all* fees pre-petition. Under the court's local rules, the scope of services could be limited only by valid substitution of counsel or entry of a final order granting a motion to withdraw.

dd. The court then found that the bifurcated fee agreements in question violated these general rules, as well as 11 U.S.C. §§ 526 and 528.

ee. 11 U.S.C. § 528(a)(1)(A) requires bankruptcy attorneys to execute a written contract with consumer debtors within 5 business days "explaining clearly and conspicuously" the attorney's services. 11 U.S.C. § 526(a)(2) in turn prohibits bankruptcy counsel from making "untrue or misleading" statements to a consumer debtor. 11 U.S.C. § 526(a)(3)(A) prohibits counsel from misrepresenting services to consumer debtors.

ff. The court found that the agreements at issue were untrue and misleading, and therefore violated 11 U.S.C. §§ 526 and 528. Specifically, the agreements advised that (a) the lawyer's services would terminate immediately after the petition date; (b) the debtor would have to hire new counsel or proceed without counsel if they failed to execute the post-petition agreement; and (c) if the debtor failed to execute the post-petition agreement, they would be solely responsible for completing their bankruptcy case. Applicable law, however, prohibited counsel from withdrawing without prior

court approval, and withdrawal is not generally permitted unless replacement counsel is available.

gg. The court also held that the agreements were void under 11 U.S.C. § 526(c)(1), which provides that "[a]ny contract for bankruptcy assistance" in violation of 11 U.S.C. §§ 526 and 528 "shall be void and may not be enforced . . . ." While the court did not impose sanctions, the court held that the agreements could not be enforced against the debtor.

Faculty

Timothy J. Anzenberger is a partner with Adams and Reese LLP in Ridgeland, Miss., and is a commercial and bankruptcy litigator, pursuing the interests of financial institutions and other creditors in bankruptcy cases and litigating on their behalf in state and federal courts. He also is an experienced appellate litigator in financial-services cases, handling all stages of an appeal — from post-trial motions through oral argument. Mr. Anzenberger's experience includes representing lenders in commercial restructuring and bankruptcy cases, defending preference actions, defending lender-liability claims, prosecuting objections to discharge, pursuing fraudulent transfers and defending creditors in adversary proceedings. He is an active ABI member and frequently writes for the *ABI Journal* and its committee newsletters. He also currently co-chairs ABI's Ethics and Professional Compensation Committee and sits on the advisory board for the ABI's Southeast Bankruptcy Workshop. As part of his appellate practice, Mr. Anzenberger is a member of the Pro Bono Appellate Programs for the U.S. Courts of Appeals for the Fifth and Ninth Circuits. Prior to entering private practice, he clerked for Presiding Justice Jess H. Dickinson of the Mississippi Supreme Court and served as a legal extern in the Staff Attorney's Office of the U.S. Court of Appeals for the Fifth Circuit. Mr. Anzenberger received his B.A. in 2007 in political science from Noth Carolina State University and his J.D. summa cum laude in 2011 from Mississippi College School of Law, where he served as an executive editor of the *Mississippi College Law Review* and was active on the Moot Court Board, for which he was a National Champion and won Best Brief at the 2011 Andrews Kurth Moot Court National Championship. He also won Best Oral Advocate at the Ruby R. Vale Corporate Moot Court Competition and was a finalist at the Elliot Cup Bankruptcy Competition, and he received Best Paper Awards in Antitrust Law, Law and Economics, Criminal Law, Secured Transactions, Legal Writing and Capital Punishment Law.

Hon. Hannah L. Blumenstiel is a U.S. Bankruptcy Judge for the Northern District of California in San Francisco. Prior to her appointment on Feb. 11, 2013, Judge Blumenstiel was an associate (2003-08) and then a partner (2008-12) with Winston & Strawn LLP, where she focused her practice on creditors' rights litigation in state and federal court, including bankruptcy court. From 2001 to 2003, Judge Blumenstiel was an associate with Murphy Sheneman Julian & Rogers LLP, where she represented debtors, creditors and trustees in bankruptcy cases and adversary proceedings. She served as a law clerk to Hon. Charles M. Caldwell of the U.S. Bankruptcy Court for the Southern District of Ohio (Eastern Division) from 1998 to 2001, and from 1997-98, she represented the State of Ohio's interests in bankruptcy cases as an assistant attorney general with the Revenue Recovery Section of the Ohio Attorney General's Office. Judge Blumenstiel sits on ABI's Board of Directors and serves as an Executive Editor of the *ABI Journal*. She received her J.D. from Capital University Law School in 1997 while working full-time for the Columbus Bar Association as director of its *pro bono* initiative, "Lawyers for Justice," and her B.A. from Ohio State University in 1992.

Bodie B. Colwell is Of Counsel with Preti, Flaherty, Beliveau & Pachios, Chtd., LLP in Portland, Maine, and represents businesses in financial distress both in and out of court. She also helps banks and businesses recover money owed to them. Ms. Colwell represents chapter 7 trustees of corporate and consumer debtors in the liquidation of assets and litigation matters, buyers of assets in bankruptcy, and distressed health care businesses in out-of-court workouts and liquidations. She also repre-

sents lenders in commercial and consumer matters and creditors in matters involving preference and fraudulent transfer avoidance claims. Ms. Colwell is an emerging leader in bankruptcy and restructuring. She has authored articles for the *ABI Journal* and is actively engaged in ABI committees, serving as Education Director for its Young and New Members Committee. In addition, she is a member of the International Women's Insolvency & Restructuring Confederation (IWIRC) and is the first New England-area attorney to be named as a semi-finalist for the IWIRC Rising Star Award. Ms. Colwell received her B.A. in 2004 from the University of Southern Maine and her J.D. *cum laude* from the University of Maine School of Law.

Sarah Primrose is a senior associate with King & Spalding LLP in Atlanta and represents debtors, lenders, investors, secured and unsecured creditors, and other parties in interest in a broad range of restructuring and special-situations matters, including high-profile chapter 11 cases, out-of-court restructurings and bankruptcy-related acquisitions. In addition, she represents litigants in contested matters, adversary proceedings, federal court appeals, and other complex bankruptcy and insolvency litigation. Ms. Primrose's practice spans a number of industries, including energy, health care, technology, manufacturing, retail, real estate, restaurant and hospitality. Prior to joining King & Spalding, she clerked for Hon. James E. Graves, Jr. of the U.S. Court of Appeals for the Fifth Circuit and Chief Judge Paul G. Hyman, Jr. of the U.S. Bankruptcy Court for the Southern District of Florida. Ms. Primrose is a longtime member of the International Women's Insolvency & Restructuring Confederation's Georgia Network (for which serves as a director at large), the Turnaround Management Association's Atlanta Chapter and ABI, for which she co-chairs its Ethics and Professional Compensation Committee. A regular speaker and prolific author, her work has been published in numerous industry journals, law reviews and other publications, and she is the edited of *Best of ABI 2022: The Year in Business Bankruptcy*. Ms. Primrose is an ABI 2022 "40 Under 40" honoree, and in 2020, 2021 and 2022, she was named as one of Yahoo! Finance's HERoes — 100 Future Leaders. She was also named a Rising Star by *Private Debt Investor* in 2022 and was named to *Georgia Trend Magazine*'s "40 Under 40" list in 2020. Ms. Primrose received her B.A. with honors and Phi Beta Kappa from Pennsylvania State University, and her J.D. *summa cum laude* from Michigan State University.