Ethics in Representing the Consumer Debtor

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Disclosure of Attorney Compensation

A. Overview

1. The required statement disclosing the compensation of debtor's counsel must be filed within 14 days after the order for relief.

2. The written engagement agreement between the debtor and debtor's counsel must be filed with the disclosure of compensation.

3. The specific source of compensation must be accurately disclosed.

4. Debtor's counsel must file an amended disclosure of compensation for any amounts received post-petition within 14 days after any payment or agreement not previously disclosed; and

5. Amounts listed in the disclosure statement should be consistent with amounts disclosed in answer to Question No. 9 on the Statement of Financial Affairs.

B. Disclosure in More Detail

Compensation of debtors' attorneys is a matter critical to "the integrity of the bankruptcy process." *In re Nelson*, 424 B.R. 361, 363 (Bankr. N.D. Ill. 2009); *see also In re Kindhart*, 160 F.3d 1176, 1177 (7th Cir. 1998) (calling the question of attorney's fees "an important matter not only to attorneys, but also to the courts and the public"); *In re Andreas,* 373 B.R. 864, 872 (Bankr. N.D. Ill. 2007). Because of its importance, the subject is treated extensively in both the Bankruptcy Code and Rules.

Section 329(a) of the Code requires an attorney for a debtor in a case under any chapter to disclose the compensation the debtor has paid or agreed to pay for the attorney's services, if the payment or agreement was made within one year of the filing of the case. 11 U.S.C. § 329(a). Rule 2016(b) adds that "[e]very 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 shared or agreed to share the compensation with any other

entity ….” Fed. R. Bankr. P. 2016(b). The Rule also requires that “[a] supplemental statement shall be filed and transmitted to the United States trustee within 14 days after any payment or agreement not previously disclosed.”

Regardless of the source, all compensation paid to the debtor’s attorney during the applicable period must be disclosed. *In re Jackson*, 401 B.R. 333, 339 (Bankr. N.D. Ill. 2009). The legislative history of § 329 reflects the “Congressional concern that a debtor’s payments to his attorney present a ‘serious potential for evasion of creditor protection provisions of the bankruptcy law.’” *Id*.

C. Consequences of Failing to Disclose in a Timely and Accurate Fashion

Failing to disclose compensation in a timely and accurate fashion can have serious consequences. In *In re Varan*, No. 11 B 44072, 2014 WL 2881162 (Bankr. N.D. Ill. June 24, 2014), the debtor’s counsel did not file the Rule 2016(b) disclosure statement until more than a year after being retained. Even then, the statement was filed only after the U.S. Trustee sent counsel a draft motion for sanctions. The statement ultimately filed disclosed that compensation had been paid by a limited liability company, one that was an asset of the debtor not disclosed on either the debtor’s original or any amended Schedule B. *Id.* at *8-9.

The U.S. Trustee sought sanctions based on both the inaccurate Schedule B and the failure of counsel to file a timely and accurate Rule 2016(b) statement, and the court granted the motion. Concluding that counsel knowingly and willfully failed to comply with the requirements of § 329 and Rule 2016(b), the court ordered (1) disgorgement of all fees received in the bankruptcy case and a related adversary proceeding; (2) reimbursement to the U.S. Trustee for attorneys’ fees and costs incurred in bringing the sanctions motion; and (3) completion of a professional responsibility course at an ABA-approved law school. *Id.*

Not only must the disclosure statement be filed timely and disclose accurately the source of compensation, it must also describe accurately the payments counsel has received. In *Torres v. Chang*, No. 11-10862, 2014 WL 4929062 (Bankr. D. Md. Sept. 30, 2014), counsel filed a 2016(b) statement disclosing compensation of $4,500 and had confirmed a Chapter 13 plan that provided for payment of the same amount. It turned out that counsel had actually received an additional $1,500 directly from the debtor ($500 pre-petition and $1,000 thereafter), for a total of $6,000 in compensation. *Id.* at *5. Not only that, but the debtor testified that he believed the agreed fee was $3,500 and he had never seen counsel's version of the engagement letter. *Id.* In ordering the disgorgement of the fees the debtor had paid, the court commented that counsel's lack of candor throughout the debtor's bankruptcy case had violated her professional responsibilities to her client and to the court, *id.*, declaring: "Her conduct evidences a clear disregard for the code of professional conduct to which she is bound and is both offensive and undermines the legal profession." *Id.* at *6.

D. Sources of Judicial Authority to Impose Sanctions for Disclosure Violations

Section 329(b) of the Code authorizes a bankruptcy court to cancel any agreement for compensation and order the return of any payment made under that agreement to the extent the payment was "excessive." 11 U.S.C. § 329(b). Courts can impose sanctions under this section for failing to file a timely disclosure statement, for failing to file an accurate disclosure statement, or for failing to file any disclosure statement at all. *In re Jackson*, 410 B.R. 333, 340 (Bankr. N.D. Ill. 2009). Courts not only can order disgorgement of fees paid but can deny some or even all compensation to the offending attorney. *Id.* "Many courts, perhaps the majority, punish defective disclosure by denying all compensation." *Andreas*, 373 B.R. at 872.

Section 329 is the most commonly invoked source of judicial power to address disclosure violations. Another source, less well known and much less commonly used, is § 526(c). Section 526 addresses restrictions on "debt relief agencies" and regulates the interactions between those agencies and "assisted persons." A "debt relief agency" is any person, including attorneys, "who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration …." 11 U.S.C. § 101(12A); *see also Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 236-37 (2010). An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $186,825." 11 U.S.C. § 101(3).

Section 526(a) declares that a "debt relief agency"—for current purposes an attorney—"shall not," among other things, "(1) fail to perform any service that such agency informed an assisted person or prospective assisted person it would provide in connection with a case or proceeding under this title," and "(2) make any statement…that is untrue or misleading, or that upon the exercise of reasonable care, should have been known by such agency to be true or misleading." 11 U.S.C. § 526(a)(1), (2).

Section 526(c) puts teeth in these prohibitions. The provision is complex and extensive, but one court summarized the potential remedies this way: "Section 526(c) provides that refunds, actual damages to the debtor, civil penalties, sanctions, attorney's fees and costs, and injunctive relief shall be ordered if the debt relief agency acted intentionally or negligently in failing to comply with §§ 526, 527, and 528; intentionally or negligently disregarded material requirements of title 11; intentionally violated § 526; or engaged in a clear and consistent pattern or practice of violating § 526." *In re Peckham*, No. 9:13-bk-04690-FMD, 2013 WL 5984467, at *4 (Bankr. M.D. Fla. Nov. 12, 2013).

The Ethics of Withdrawing as Attorney: Candor and Confidentiality

A. Introduction

Representation of a debtor in bankruptcy is generally considered to be an appearance for the duration of the bankruptcy case, whether in a chapter 7 or chapter 13 case. Instances arise, however, when an attorney must withdraw his or her appearance. Sometimes the reason for withdrawal is a negative or difficult situation arising with the client. In those cases, to what extent may you disclose to the court your reasons for withdrawal, and what are your obligations, if any, to prevent or remediate fraud by amending filings or alerting the court? For answers to these questions, we look beyond the procedural requirements in the Federal Rules of Bankruptcy Procedure ("Rules") and the Bankruptcy Code ("Code") and examine the applicable rules of professional conduct. The Chicago rules relating to these issues will be used to illustrate the interplay of the bankruptcy rules and the rules of professional conduct, but attorneys should consult their respective rules governing their district and state.

In Chicago, as in the majority of the surrounding districts, attorneys practicing in the bankruptcy court must be admitted to practice before the district court, not before the bankruptcy court which does not have its own bar. As such, district court local rules relating to professional conduct apply. The bankruptcy court for the Northern District of Illinois local rule 9029-4A states "[t]he Rules of Professional Conduct for the Northern District of Illinois, as amended from time to time, shall apply in all proceedings and matters before this court." Accordingly, the district court's local rule 83.50 states in part:

> Applicable disciplinary rules are the Model Rules adopted by the American Bar Association. On any matter not addressed by the ABA Model Rules or for which the ABA Model Rules are inconsistent with the Rules of Professional Conduct, a lawyer admitted to practice in Illinois is governed by the Illinois Rules of Professional Conduct, as adopted by the Illinois Supreme Court, and a lawyer not

admitted to practice in Illinois is bound by the Rules of Professional Conduct for the state in which the lawyer's principal office is located. LR83.50

Because the ABA Model Rules ("Model Rules") are trumped by the Illinois Rules of Professional Conduct ("IRPC") when there is an inconsistency, an attorney must examine both to determine the appropriate course of conduct.

B. Withdrawal

The ABA Model Rule relating to withdrawing as attorney is as follows:

Rule 1.16 Declining Or Terminating Representation

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the rules of professional conduct or other law;

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or

(3) the lawyer is discharged.

(b) Except as stated in paragraph (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(3) the client has used the lawyer's services to perpetrate a crime or fraud;

(4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;

(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

> (6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or
>
> (7) other good cause for withdrawal exists.
>
> (c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.
>
> (d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled, and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

Comment 3 to Rule 1.16 recognizes the tension between obligations to the tribunal and to the client:

> Difficulty may be encountered if withdrawal is based on the client's demand that the lawyer engage in unprofessional conduct. The court may request an explanation for the withdrawal, while the lawyer may be bound to keep confidential the facts that would constitute such an explanation. The lawyer's statement that professional considerations require termination of the representation ordinarily should be accepted as sufficient. Lawyers should be mindful of their obligations to both clients and the court under Rules 1.6 and 3.3.

Paragraph (c) of Rule 1.16 states that the attorney must comply with applicable law regarding notice and procedures. The withdrawal procedure in local bankruptcy rule 2091-1(A) requires that each attorney seeking to withdraw must obtain leave of court by motion which motion must be served on the client and all parties of record. In Part (B) of this rule, withdrawal in chapter 7 cases is allowed under a specific circumstance, but does not enumerate other instances where withdrawal might be allowed:

> In a case under Chapter 7 of the Bankruptcy Code, including a case converted from Chapter 13, where (1) the debtor's attorney has agreed to represent the debtor conditioned on the debtor entering into an agreement after the filing of the case to pay the attorney for services rendered after the filing of the case, and (2)

> the debtor refuses to enter into such an agreement, the court may allow the attorney to withdraw from representation of the debtor on motion of the attorney.

This rule appears to address the problem presented in *Bethea v. Robert J. Adams & Associates*, 352 F.3d 1125 (7th Cir. 2003) where attorneys were not allowed to collect pre-petition fees post-petition because those fees are dischargeable. In addition to this specific allowance of withdrawal for failure to enter into a post-petition agreement, other reasons to withdraw commonly include retirement or illness of the attorney, new employment with a different firm, or a conflict of interest. Any of those reasons would likely be disclosed to the court and have the approval of the debtor.

Among the more difficult scenarios for a debtor's attorney to seek to withdraw is the debtor's failure to disclose information to the attorney or the court or failure to perform other duties of a debtor in bankruptcy. Attorneys often cite in their motion to withdraw that there has been an irretrievable breakdown of communication with the client. This phrase can be code for either non-payment of fees by the client or non-cooperation. In the bankruptcy context, the phrase can also mean that the debtor has refused to update schedules with newly-discovered information.

What may a debtor's attorney do with new information? What must the attorney do? The ideal course of action is immediately to disclose the information to the trustee and the court by filing amended schedules and turning over property of the estate, if applicable. But what course is appropriate if the client refuses to sign the required declaration to accompany the schedules and otherwise refuses to disclose the information? The attorney may be required to withdraw to avoid violating professional responsibility rules or may wish to withdraw even if not required in order to avoid further entanglement with an unscrupulous debtor. Whether the attorney withdraws or not, disclosure by the attorney of the debtor's omission may be required. There are

interrelated sections in the Model Rules which must be read together to determine what level of candor is allowed or required relating to client conduct.

C. Candor

The Model Rules relating to candor state that an attorney must correct false statements previously made to the court by the attorney and must take remedial measures to correct evidence that later proves to be false. These measures include disclosure to the court. An attorney must also take reasonable measures if the debtor has or is currently engaging in fraud, including disclosure to the tribunal.

Rule 3.3 Candor Toward The Tribunal:

(a) A lawyer *shall not* knowingly:

> (1) make a false statement of fact or law to a tribunal or *fail to correct* a false statement of material fact or law previously made to the tribunal by the lawyer;
>
> (2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or
>
> (3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, *the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal*. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging, or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

> (d) In an ex parte *proceeding*, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

Section (a) requires mandatory correction and remediation of false statements. If the case is a standard chapter 7 or chapter 13 case, the information to be corrected or disclosed usually appears in the debtor's schedules. Even though bankruptcy schedules are the debtor's statements, the attorney has some responsibility for the contents of the filing. Bankruptcy Rule 9011 states in part:

> By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney…is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,… 3) the allegations and other factual contentions have evidentiary support ….

Failure to follow Rule 9011 may result in sanctions for the attorneys. *See In re Varan*, No. 11-44072, 2014 Bankr. LEXIS 2807 (Bankr. N.D. Ill. June 24, 2014), examining what an attorney knew or should have known as it relates to subsequent disclosures and amended schedules.

D. Confidentiality

The remaining question is the extent to which an attorney can and must disclose information in the course of seeking to withdraw. The debtor has independent duties under the Code and Rules, but the attorney should not take cues from the debtor's conduct if the debtor is attempting to conceal assets or withhold information.

As set forth in section (c) of Rule 3.3 above, the duties of candor for the attorney continue even if compliance requires disclosure of information otherwise protected in the Rule 1.6. As set forth below, Rule 1.6 first states that an attorney shall not reveal information without consent, but goes on to state circumstances when an attorney may reveal information, including, under (b)(3) to mitigate or rectify injury to financial interests that will or has resulted from fraud.

Illinois Rules of Professional Conduct Rule 1.2(a) states that "a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued." Comment 10 to the rule shows how intertwined the rules relating to withdrawal can be and suggests that withdrawal alone may not be sufficient.

> When the client's course of action has already begun and is continuing, the lawyer's responsibility is especially delicate. The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed. A lawyer may not continue assisting a client in conduct that the lawyer originally supposed was legally proper but then discovers is criminal or fraudulent. The lawyer must, therefore, withdraw from the representation of the client in the matter. See Rule 1.16(a). In some cases, withdrawal alone might be insufficient. It may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like. See Rule 4.1. In such situations, the lawyer should also consider whether disclosure of information relating to the representation is appropriate. See Rule 1.6(b).

The general rule allowing the client to call the shots in the representation is balanced by Rule 1.6 relating to confidentiality. Rule 1.6 states in relevant part:

> **Rule 1.6 Confidentiality of Information**
>
> (a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).
>
> (b) A lawyer *may* reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:
>
> > *(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;*
> >
> > *(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;*

(6) to comply with other law or a court order…

It is important to note that under Rule 1.6, the attorney may disclose information about the representation of the client, but is not required to do so. Under Rule 3.3, on the other hand, the attorney must take remedial steps which may include disclosure. Comment 7 to Rule 3.3 elaborates on the balance of attorney and client interests:

> Paragraph (b)(2) is a limited exception to the rule of confidentiality that permits the lawyer to reveal information to the extent necessary to enable affected persons or appropriate authorities to prevent the client from committing fraud, as defined in Rule 1.0(d), that is reasonably certain to result in substantial injury to the financial or property interests of another and in furtherance of which the client has used or is using the lawyer's services. Such a serious abuse of the client-lawyer relationship by the client forfeits the protection of this Rule. The client can, of course, prevent such disclosure by refraining from the wrongful conduct.

E. Conclusion

Attorneys must use caution and care when withdrawing from representation of a debtor and must mitigate the harm that could be caused by debtor's potential or ongoing fraud or crime by correcting false information inadvertently or unknowingly presented to the court by the attorney.

Fee Agreements

A. The importance of a written fee agreement

A fee agreement is important for a number of reasons, not the least of which is that § 528 of the Bankruptcy Code requires every "debt relief agency"[1] to execute a written contract with an "assisted person"[2] not later than 5 days after providing "bankruptcy assistance".[3] The contract must specify clearly and conspicuously the services the agency will provide, the fees for such services, and the terms of payment. *See* 11 U.S.C. § 528(a).

Even if not required by statute, a written statement concerning fees is recommended for the simple reason that it reduces the possibility of misunderstanding.

But regardless of how detailed the § 528 written contract is, it will not protect your unpaid fees from being discharged. *See Bethea v. Robert J. Adams & Assocs*, 352 F.3d 1125 (7th Cir. 2003); *Rittenhouse v. Eisen*, 404 F.3d 395 (6th Cir. 2005). The Bankruptcy Code specifically identifies the types of pre-petition debts that survive discharge in § 523(a), and the debt for services rendered under a pre-petition fee agreement is not one of them.

B. Types of fee agreements

Before addressing the issue of how to get paid for services rendered post-petition, it is important to understand the types of retainers that apply to legal fees.

(1) A classic retainer, also referred to as a true or general retainer, is paid to secure the lawyer's availability, not to compensate the lawyer for services to be rendered. *In re McDonald*

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[1] Attorneys are "debt relief agencies." *See Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 236-37 (2010)

[2] An "assisted person" is "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $186,825." 11 U.S.C. § 101(3).

[3] "'Bankruptcy assistance' means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under [title 11]." 11 U.S.C. § 101(4A).

Bros. Constr., Inc., 114 B.R. 989, 998 (Bankr. N.D. Ill. 1990). The classic retainer is earned when paid and immediately becomes the lawyer's property. A classic retainer, paid pre-petition, is outside the estate and outside the purview of § 330, though it remains subject to disclosure and reasonableness review under § 329 of the Bankruptcy Code. *Barron v. Countryman*, 432 F.3d 590, 595-96 (5th Cir. Tex. 2005).

(2) A security retainer is paid for prospective services. This type of retainer remains the property of the client and must be deposited in a trust account and kept separate from the lawyer's own property until the lawyer applies it to services that are actually rendered. Because the debtor retains an interest in these funds, they become property of the estate at filing subject to §§ 329 and 330. *See McDonald Bros.*, 114 B.R. at 1000-02; *In re James Contracting Grp., Inc.*, 120 B.R. 868, 872 (Bankr. N.D. Ohio 1990).[4]

(3) An advance payment retainer, also known as a flat or fixed fee, is a payment to the lawyer in exchange for the commitment to provide legal services in the future. Whether ownership of these funds passes immediately to the lawyer upon payment or remains with the client depends on the jurisdiction. A number of courts follow the rule that an advanced payment retainer is earned upon receipt; thus it is the lawyer's property and does not flow through a trust account. *See McDonald Bros.*, 114 B.R. at 1000-02; *White v. Coyne, Schultz, Becker & Bauer, S.C. (In re Pawlak)*, 483 B.R. 169, 177 (Bankr. W.D. Wis. 2012); *Barron*, 432 F.3d at 596. Because it is the lawyer's property; the advance payment retainer does not become property of the estate when a case is filed. Although the trend seems to be moving toward allowing ownership of advance

[4] The issue of whether a debtor's interest in a retainer is property of the estate is a question of federal law. *McCarthy, Johnson & Miller v. N. Bay Plumbing, Inc. (In re Pettit)*, 217 F.3d 1072, 1078 (9th Cir. 2000). However, bankruptcy courts must look to state law to determine whether and to what extent the debtor has any legal or equitable interests in property as of the commencement of the case. *See Butner v. United States*, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law.").

payment retainers to pass immediately to the lawyer, there are still cases that hold otherwise. *See, e.g., In re Doors & More, Inc.*, 127 B.R. 1001 (Bankr. E.D. Mich. 1991) [5]; *In re Printing Dimensions, Inc.*, 153 B.R. 715, 720-22 (Bankr. D. Md. 1993); *In re NBI, Inc.*, 129 B.R. 212, 221 (Bankr. D. Colo. 1991); *In re Hathaway Ranch P'ship,* 116 B.R. 208, 216-17 (Bankr.C.D. Cal. 1990).

One thing is clear: a lawyer who charges a soon-to-be debtor a security retainer must either deplete the retainer before filing the petition or turn over any balance remaining on the petition date to the Chapter 7 trustee.[6] Either way, the attorney may not collect for any post-petition services under the pre-petition retainer. The better option, in those jurisdictions recognizing earned-upon-receipt advance payment retainers, is to charge a flat fee that does not have to pass through a trust account. But even then, it is difficult to determine the appropriate fee to charge given the uncertainty of the amount of services that will be required post-petition, and the fees are still subject to review for reasonableness under § 329 and ethical guidelines.

C. Limited Scope Representation ("Unbundling")

Instead of handling a bankruptcy case in its entirety, some lawyers provide limited scope representation, limiting the parts of a case that the lawyer will handle. Limited scope services are also known as "unbundled" services. Filing only a bare-bones petition and schedules is an example of limited scope representation.

Whether a lawyer may provide limited scope representation in a bankruptcy case, and to what extent, depends on two bodies of rules. The first is the ethical rules of the particular

[5] However, in 2008, the Michigan Supreme Court issued a decision finding that a non-refundable, minimum-fee retainer was earned upon receipt. *See Griev. Adm'r v. Cooper*, 757 N.W. 2d 867 (Mich. 2008). *Contra In re O'Farrell*, 942 N.E.2d 799, 807 (Ind. 2011) (finding lawyer violated Rule 1.5(a) by charging and collecting flat fees that were wholly nonrefundable.)

[6] The retainer must be disclosed on Schedule B and, if possible, should be claimed as exempt on Schedule C.

jurisdiction in which the lawyer practices. Some ethical rules do not allow attorneys to provide limited scope representation; others allow it only under certain conditions. Most jurisdictions do require attorneys to outline clearly in their written retainer agreements what activities they will and won't provide for the fees charged.

The second is the rules of the particular bankruptcy court in which the attorney is practicing. Most bankruptcy courts have "local" rules dealing with issues not addressed by the Federal Rules of Bankruptcy Procedure. Some courts have rules that directly address limited scope representation.

The ABA Model Rules of Professional Conduct, largely adopted in some form in most states, permit Limited Scope Representation under certain, defined circumstances. The primary ABA Model Rules to be familiar with are Rule 1.1 (requiring competent representation), Rule 1.2(c) (permitting limited scope representation if reasonable and client gives informed consent), Rule 1.4(b) (requiring proper communication), Rule 1.5(a) (prohibiting a lawyer from charging or collecting an unreasonable fee), and Rule 1.5(b) (requiring an explanation of the scope of services covered by the fees charged).

1. Limitation of Representation by Task

Several district courts and bankruptcy courts have local rules addressing the obligations a lawyer takes on by appearing in a case. Some rules provide that attorneys who appear in a case must represent debtors in all related matters, including adversary proceedings. *See, e.g.,* Bankr. N.D. Ga., Local Rule 9010-4; Bankr. E.D.N.C., Local Rule 9011-1. Others exclude representation in adversary proceedings from those duties incurred merely by appearing in the case. *See, e.g.,* Bankr. N.D. Ill., Local Rule 2090-5(B); Bankr. W.D.N.C., Local Rule 2091-1.

Regardless of whether permissible by local rule, a lawyer seeking to limit the scope of representation must also fulfill ethical duties. It would seem almost impossible to fulfill those duties if the scope of representation is limited by task, particularly if the excluded task is routine or fundamental to the bankruptcy case.

Even if the lawyer gets past the duties of communication and informed consent by explaining in terms understandable to the client the tasks the lawyer will perform, those the lawyer won't perform, the potential problems that may arise in any given case, and the difficulties of addressing those problems as a pro se debtor, the attorney still has to provide competent representation.[7] And any limitation on the scope of services to be performed must be reasonable.[8]

At least one court has interpreted the ethical duty of competence to mean that the lawyer is required "to provide services that are necessary to achieve the basic fundamental objectives of the representation." *In re Egwim*, 291 B.R. 559, 572 (Bankr. N.D. Ga. 2003). In most if not all bankruptcy cases, the objective is to obtain a discharge. Given this broad objective, the attorney is arguably required to represent the debtor on any matters that might stand in the way of that discharge.

Even if the duty of competence poses no obstacle, the limited representation still has to be reasonable. What is reasonable? Is it reasonable to exclude amending schedules if the debtor omitted an asset, whether by mistake or on purpose? Is it reasonable to exclude defending an objection to exemptions, particularly when the debtor relied on the attorney to assert proper

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[7] ABA Model Rule 1.1 provides: "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."

[8] ABA Model Rule 1.2 (c) provides: "A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."

exemptions? Picking and choosing between tasks that will be performed and those that won't is a problematic and uncertain exercise.

So how can an attorney strike that delicate balance between protecting their economic interests while providing competent representation to clients?

2. Limitation of representation based on pre- and post-petition services

There is some support for limiting services in a bankruptcy case by the time they are rendered—pre-petition versus post-petition. *In re Slabbinck*, 482 B.R. 576 (Bankr. E.D. Mich. 2012); *see also Bethea*, 352 F.3d 1125. In *Slabbinck,* the court found a limitation on services reasonable where separate contracts were entered into for pre-petition and post-petition services. *In re Slabbinck*, 482 B.R. 576. Such a limitation is only permissible, however, when a debtor has been fully advised of

> (1) the specific services debtor's counsel will perform as part of the pre-petition agreement to represent the debtor; (2) the specific services debtor's counsel will perform post-petition; (3) the necessity of a separate post-petition agreement regarding payment of those services; (4) the consequences to the debtor if the debtor chooses not to retain counsel post-petition; and (5) the consequences to the debtor if debtor retains counsel post-petition i.e. that fees for post-petition services survive discharge. *In re Abdel-Hak*, No. 12-46329-MBM, 2012 Bankr. LEXIS 5393, 18 (Bankr. E.D. Mich. Nov. 16, 2012) (citations omitted).

But, although it may be appropriate to distinguish between services rendered and charged for pre-petition and those rendered and charged for post-petition, carrying out that distinction may prove difficult. In *Slabbinck*, the debtors agreed to the pre-petition/post-petition division of services and fees. They signed the pre-petition agreement and signed the post-petition agreement. What happens if the debtor doesn't sign the post-petition agreement? Under the local rules of most courts, the attorney of record is still on the hook to represent the debtors in the case until an order is entered authorizing the lawyer to withdraw. Consequently, any legal services required between

the petition date and the date of an order authorizing the lawyer's withdrawal must be performed without compensation (assuming the debtor receives a discharge). If the debtor objects to the withdrawal and a hearing is required, there will be further delay and thus the possibility that more services will be required pending withdrawal. And then there is also the possibility that the court will not permit the withdrawal.

Under ABA Model Rule 1.16, in a matter that does not involve a crime, fraud, or a fundamental disagreement, a lawyer may withdraw from representation if:

> (1) withdrawal can be accomplished without material adverse effect on the interests of the client;
>
> * * *
>
> (5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;
>
> (6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or
>
> (7) other good cause for withdrawal exists.

Whether refusal to enter into a post-petition retainer agreement falls within one of the permissible reasons for withdrawal remains to be seen. But, since the alternative is to not get paid for post-petition work and there is no way of knowing how much post-petition work there may be, the best option is to divide the services and fees down the pre-petition/post-petition line.

D. Drafting the pre-petition fee agreement

Here are some recommendations for preparing your pre-petition fee agreement:

1. Clearly state that the fee is a flat fee and not a security retainer. (In Illinois, describe the fee as an "advance payment retainer", explain the special purpose for the advance payment

retainer and why it is advantageous to the client, inform the client of the option to employ a security retainer, and expressly say whether the lawyer is unwilling to accept anything but an advance payment retainer and give the reasons why.) [9]

2. Explain that the flat fee is earned upon receipt, and that it will not be held in trust but instead deposited into the lawyer's operating account as it is the lawyer's property (if permitted in your jurisdiction).

3. Describe the specific services the lawyer will perform as part of the pre-petition agreement to represent the debtor and how the fees/expenses will be applied.

4. Describe the specific services the lawyer will perform post-petition, if retained;

5. Explain that unless the debtor enters into a post-petition agreement after the case is filed, the lawyer will request permission from the court to withdraw from the case.

6. Explain what may happen if the debtor chooses not to retain the lawyer post-petition, including the technical aspects, legal ramifications, material risks, and available alternatives.

7. Explain that the debtor has the option of hiring any lawyer post-petition, and if the debtor exercises that option, the post-petition fees will not be discharged in the bankruptcy case.

8. At least one author cautions lawyers never to describe any retainer or flat fee as "non-refundable," even if it is to be earned upon receipt. *See* Douglas R. Richmond, *Understanding Retainers and Flat Fees*, 34 J. Legal Prof. 113, 142 (2009). He explains that any fee may be reduced or ordered to be refunded if it is unreasonable; thus, branding any retainer or flat fee non-refundable is misleading.

> Describing a retainer or flat fee as non-refundable potentially violates Model Rule 1.5(a), which requires that all fees be reasonable; Model Rule 1.15(d), which controls lawyers' duty to

[9] For Illinois references, *see* Ill. Rule of Prof. Conduct 1.15(c).

> return to clients any funds to which they are entitled and to account for such funds when requested to do so; Model Rule 1.16(d), which governs lawyers' duties upon termination of a representation; Model Rule 8.4(c), which prohibits 'dishonesty, fraud, deceit, or misrepresentation;' and even Model Rule 8.4(d), which forbids conduct that is 'prejudicial to the administration of justice'. *Id.*

In Michigan, however, the word "non-refundable" controls whether the fee becomes property of the attorney that is not subject to deposit into a trust account. *Griev. Adm'r v. Cooper*, 757 N.W. 2d 867 (holding that a non-refundable retainer is permissible so long as the fee agreement memorializing the retainer is unambiguous); *Devolder v. Lee*, No. 14-10624, 2014 U.S. Dist. LEXIS 116212 (E.D. Mich. Aug. 21, 2014) (following *Cooper*, but noting criticism of non-refundable retainers). In Illinois, the lawyer must state that any portion of the retainer that is not earned or required for expenses will be refunded to the client.

9. Finally, even when charging flat fees, an attorney should keep contemporaneous time records and document expenses. Such records are essential if the attorney is called upon to demonstrate the reasonableness of their fees.

Pre-Petition Bankruptcy Agreement—Chapter 7

This agreement explains the terms of your retention of _____, ("the Firm") as your attorney in your Chapter 7 bankruptcy case.

The Firm specializes in bankruptcy, but it cannot guarantee the outcome of your bankruptcy case. We will explain the process to you and describe what is likely to happen in your case. Please ask us any questions you have. Because bankruptcy cases are complex and may involve a number of hearings and negotiations, this letter may not adequately cover all aspects of the case.

1. Flat Fee. A flat fee of $_____ must be paid to engage the services of the Firm. The fee is not a security retainer, but a fee earned upon receipt that will be deposited into the Firm's operating account. The flat fee is property of the Firm and will not be held in trust. An additional $_____ is required for the court filing fee.

2. Services. The Firm will provide the following limited services:

   a. analyze your financial situation, and render legal advice to determine whether to file a Chapter 7 petition in bankruptcy;

   b. prepare and file a Chapter 7 bankruptcy Petition, Bankruptcy Petition Cover Sheet, Notice to Individual Consumer Debtor, Form 21 Statement of Social Security Number, and a Creditor Matrix;

   c. prepare and file bankruptcy Schedules A-J, Statement of Financial Affairs, Statement of Intent, and Form 22A (Means Test);

   d. file your certificate of credit counseling after you have completed the required course;

   e. advise you of your duties as a debtor in bankruptcy;

   f. represent you with respect to any reaffirmation agreements (service required by Admin Order No 09-32, Eastern District of Michigan); and

   g. attend your first meeting of creditors (section 341 hearing) where you will be questioned under oath about your property interests and financial affairs.

   The following services are <u>not</u> part of this fee agreement:

   a. attendance at any Bankruptcy Rule 2004 examinations (similar to a deposition);

   b. attendance at any court hearings, except for hearings on reaffirmation agreements;

   c. preparation and filing of amended schedules or other bankruptcy forms, including the pre-discharge financial education certificate;

d. representation regarding reaffirmation agreements (if not a required performance);

e. representation in any objection to claim of exemptions;

f. representation in defending any motions for relief from stay, including motions for relief from the stay filed by secured creditor to foreclose on real property or repossess collateral;

g. representation in pursuing or defending any motions, including motions to compel abandonment of assets, motions to dismiss, or motions to avoid judicial liens on property;

h. representation for any type of tax advice, opinion, negotiation, or any other matters pertaining to the discharge of any tax under any state or federal law;

i. representation in any adversary proceedings

3. Post-Petition Representation. Many of the above services are necessary to obtaining a discharge and retaining exempt property. You must attend to them whether you do so on your own or with the representation of an attorney. If you desire to retain the Firm to represent you post-petition, the Firm requires that you enter into a post-petition fee agreement in the form attached as Exhibit "A". If the post-petition fee agreement is not signed, the Firm will ask the bankruptcy court for permission to withdraw from your case.

4. Credit Counseling. You must attend pre-petition credit counseling before the bankruptcy petition is filed. You must also attend post-petition counseling after the bankruptcy petition is filed and within the time frame allowed by statute. Your debts will not be discharged if a post-bankruptcy credit counseling certificate is not filed with the court within the statutory time frame.

5. Meeting of Creditors. Shortly after your bankruptcy is filed with the court, you will receive a notice of the time and place that your Meeting of Creditors will be held. You must appear at this meeting or your bankruptcy case will be dismissed. The purpose of this Meeting is to give the creditors and the trustee an opportunity to question you under oath about your assets and the information contained in your bankruptcy schedules. This meeting lasts about ten minutes but because several other meetings may be scheduled before yours, you can assume that the entire proceeding will last about an hour.

6. Full disclosure. You are required to completely disclose all of your assets and all liabilities, and to provide all documents and information requested by the Firm before the bankruptcy petition and schedules can be prepared and filed with the court. If you fail to schedule a debt, it may not be discharged in your bankruptcy.

7. Non-Dischargeable Debts. Certain debts cannot be discharged in bankruptcy. You will be liable to repay any debt not discharged by your bankruptcy. The debts listed below are common

examples of the types of debts that cannot be discharged in bankruptcy. The list of non-dischargeable debts may be expanded by legislation or court decisions, and the Firm has no control over the type of debts that may be or become non-dischargeable.

a. Certain types of taxes, custom duties, or debts to pay taxes or custom duties.
b. Student loans.
c. Debts owed for spousal or child support.
d. Debts owed to the spouse, former spouse, or child in a domestic relations proceeding.
e. Debts arising from a previous bankruptcy wherein discharge of that particular debt was waived.
f. Debts owed for money, property, services, extension-or-removal, or refinancing of credit, if obtained by false pretenses, or false representations, or actual fraud.
g. Consumer debts for luxury goods obtained within 90 days of the date of filing of the bankruptcy petition.
h. Cash advances obtained within 70 days of the date of the filing of the bankruptcy petition.
i. Debts owed for fraud or defalcation while acting in a fiduciary capacity, or embezzlement or larceny.
j. Debts owed for fines, penalties, or forfeitures payable to and for the benefit of governmental entity.
k. Debts owed for death or personal injury arising from the operation of a motor vehicle, boat, or aircraft while intoxicated by drugs or alcohol.

8. Liens. Filing bankruptcy does not automatically discharge or remove liens from any real estate. The Firm will not take any action to avoid (remove) any lien on real estate unless you enter into a written agreement to retain the Firm to do so.

9. Audits. You may be subject to an audit by the U.S. Trustee.

10. Delay. The Firm may charge additional fees if you wait longer than 90 days from the first date the Firm is retained to finalize the bankruptcy petition and schedules due to additional due diligence and other update work required to finalize the bankruptcy.

I have read this fee agreement, understand its contents and agree to its terms and conditions.

Dated: _____

_____ _____
Attorney Signature Client Signature

_____
Client Signature

Post-Petition Bankruptcy Agreement—Chapter 7

The agreement explains the terms of your retention of _____ ("the Firm") as post-petition counsel in your Chapter 7 bankruptcy case

The Firm cannot guarantee the outcome of your bankruptcy case. Since bankruptcy proceedings are complex and may involve numerous kinds of hearings and negotiations, this letter may not cover all aspects of the case.

You have agreed to pay hourly for the Firm's services at the Firm's current hourly rates ranging from $___ to $___ depending on the attorney working on your case. Costs will be billed separately and may include court costs, courier services, postage, photocopies, facsimile, and telephone call charges. You will receive monthly statements showing the time expended and costs incurred on your case. All billing statements must be paid in full within 15 days after the statement date. Overdue balances will accrue interest at 12% per year, and you will be responsible for all costs of collection, including attorney fees, for any action necessary to collect the costs and fees incurred in the course of the Firm's representation. There will be a $30 charge for all checks returns for insufficient funds.

In return for the above fees, the Firm will represent you in all matters arising in your Chapter 7 bankruptcy case, including:

1. Attending any Bankruptcy Rule 2004 examinations;
2. Filing motions or responses to motions;
3. Attending court hearings after the initial Meeting of Creditors;
4. Recovering garnishments from creditors;
5. Assisting with reaffirmation agreements; and
6. Negotiating with your Trustee regarding your case.

This agreement does not include representation in any adversary proceedings. An adversary proceeding is a formal lawsuit which is litigated in the bankruptcy court. If an adversary proceeding is filed, we may discuss the possibility of the Firm representing you at that time, however, a retainer will be required in an amount to be established based upon the nature of the litigation and is payable in advance.

I have read this fee agreement, understand its contents and agree to its terms and conditions.

Dated: _____

_____ _____
Attorney Signature Client Signature

_____
Client Signature