ABI/UMKC Midwestern Bankruptcy Institute

Consumer: The Sharing, Splitting, Unbundling, Factoring, Financing, Bifurcation and Disclosure of Debtors' Attorneys' Fees: Ethical Ramifications and What You Need to Know

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The Sharing, Splitting, Unbundling, Factoring, Financing, Bifurcation & Disclosure of Attorney Fees: Ethical Ramifications & What You Need to Know

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Why Do We Care?

Let's Dive Into The Basics

Applicable Code Sections

- 329 – Disclosure of all compensation paid or to be paid and disgorgement to the extent fees are unreasonable
- 504 – Prohibition against fee sharing
- 528 – Debt Relief Agency provisions
  - Written fee contract
  - Executed within 5 business days after first date of any bankruptcy assistance
  - Clear and conspicuous explanation of
    - The services to be provided; and
    - The fees or charges for such services and the terms of payment

Applicable Rules

- 2016(b) – Requirement to file statement of fees paid or promised to be paid plus duty to amend within 15 days
- 2017 – Examination of Debtor's transactions with Debtor's attorney
- 1007(b)(3) – Postponement of attorney fees until the court filing fee paid in full
- MO L.R. 2016-1 – Less than "no look" + execution of the RRA for all pre- and postpetition services = no need to apply for approval of fees
- If anything else, must file motion and hold fees in trust until court approval
- MO L.R. 2091-1 – no withdrawal except for good cause

The Kicker

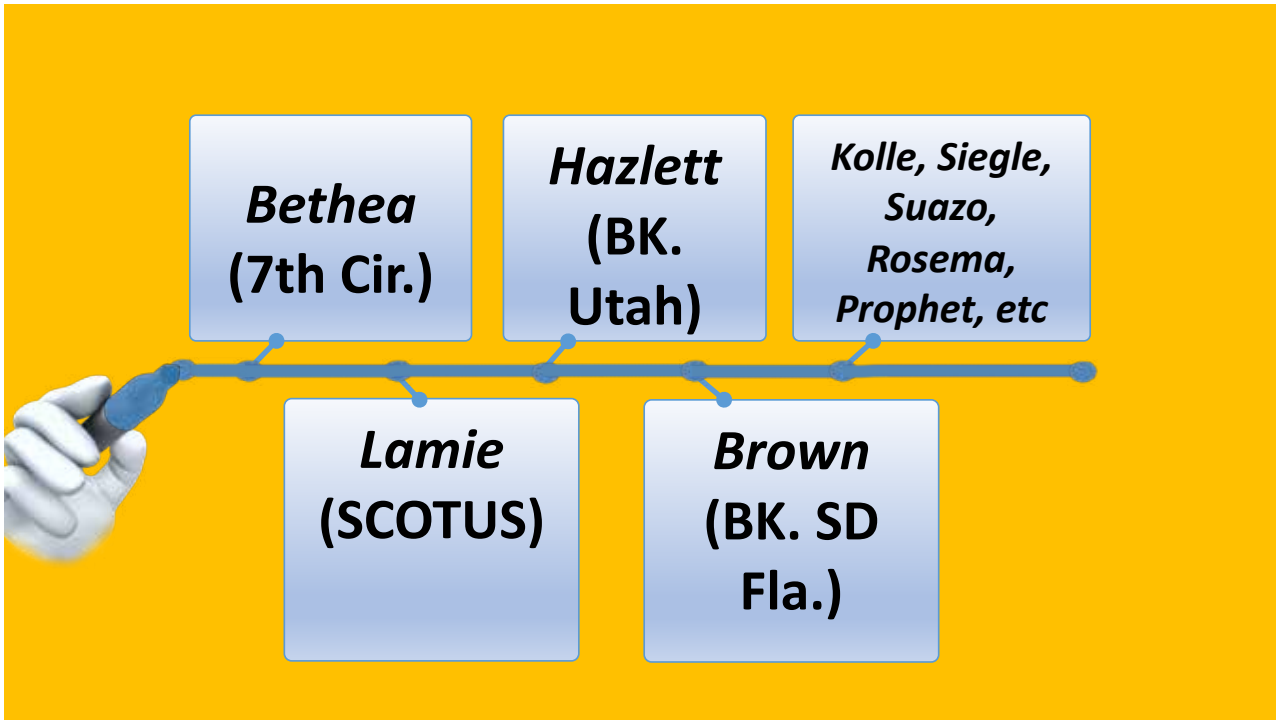
- § 362(a) – collection of prepetition debts stayed
- § 524 – prepetition debts discharged
- § 526(c)(1) – noncompliant fee agreements are void
- § 707(b)(4)(D) – Rule 11 standards before filing

What is Unbundling?

Is Unbundling Permitted? Ethical?

I Get Unbundling. But What is Bifurcation? Permitted? Ethical?


Is Factoring /Financing Permitted?
Ethical?


Bethea (7th Cir.)
Hazlett (BK. Utah)
Kolle, Siegle, Suazo, Rosema, Prophet, etc
Lamie (SCOTUS)
Brown (BK. SD Fla.)

A Panoply of Ethical Issues Raised

- 1.1 Competence
- 1.2 Scope of Representation
- 1.3 Diligence
- 1.4 Communication
- 1.5 Fees
- 1.6 Confidentiality
- 1.7 Conflict of Interest
- 1.8 Prohibited Conflicts of Interest
- 1.15 Trust Accounts
- 3.3 Candor Towards the Tribunal
- 5.4 Professional Independence
- 8.4 Misconduct

Fee Splitting? Fee Sharing?


Disclosure
Issues


Best Practices

Questions?


TROUBLE
DILEMMA
DOUBT
QUESTION
EXPRESS
UNCERTAINTY
QUESTION
PROBLEM

The Sharing, Splitting, Unbundling, Factoring, Financing, Bifurcation & Disclosure of Debtors' Attorneys Fees: Ethical Ramifications and What You Need to Know[1]

Case Law

Advising a client to incur debt to pay fee violates § 526. ***Cadwell v. Kaufman, Englett & Lynd, PLLC*****, 886 F.3d 1153 (11th Cir. 2018)**

Debtor entered to an agreement which obligated him to pay $1,700 in attorney fees to the law firm of Kaufman, Englett and Lynd ("KEL") for filing a chapter 7 petition. KEL instructed the debtor to pay the fees via credit card. Debtor later filed action against KEL under 11 U.S.C. § 526(a)(4), alleging that KEL wrongfully advised him to incur debt in contemplation of filing bankruptcy. The district court found for KEL. Debtor appealed. The court interpreted § 526(a)(4), which provides that a debt relief agency shall not:

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

Saying there were at least three ways to read this statute, the Eleventh Circuit read it as follows:

> A debt relief agency shall not . . . advise an assisted person of prospective assisted person to incur more debt [1] in contemplation of such person filing a case under this title or [2] to pay an attorney or bankruptcy petition preparer a fee or change for services performed as part of preparing for or representing a debtor in a case under this title.

The Eleventh Circuit held that unlike the first prohibition in § 526(a)(4) – regarding advice to incur additional debt "in contemplation of" a bankruptcy filing (which requires proof that the advice was given for an invalid purpose designed to manipulate the bankruptcy process) – the second prohibition (against advice to incur debt to pay for a lawyer's bankruptcy-related representation) does not entail an invalid-purpose requirement. To violate the second prohibition, the Court held, it is enough just that the debtor was "advised . . . to incur more debt . . . to pay an attorney" for bankruptcy-related legal services."

According to the Court, the second prohibition is aimed at one specific kind of misconduct – namely, that "you should take on additional debt to pay me!" This is abuse, the Court held, because it puts the attorney's financial interest ahead of both the debtor's the creditors. Therefore,

[1] Materials prepared by Lindsey Gard, Summer 2022 Student Intern for Judge Cynthia A. Norton, U.S. Bankruptcy Judge for the Western District of Missouri, and Erica Garrett, law clerk to Judge Norton. These materials were prepared for the ABI Midwestern Bankruptcy Institute, October 2022. Note that these materials are not intended to be an exhaustive list of every bankruptcy case discussing these issues.

the attorney violated § 526(a)(4) when he instructed his client to pay his bankruptcy-related legal fees using a credit card. In so holding, the Eleventh Circuit rejected the firm's First Amendment arguments.

Famous first law of holes: When you're in one, stop digging; counsel ordered to disgorge fees for failing to promptly and accurately disclose fees. *In re 38-36 Greenville Ave LLC*, No. 21-2164, 2022 WL 1153123 (3d Cir. Apr. 19, 2022)

Debtor filed a chapter 11 petition with the aid of counsel. Pursuant to § 329(a) and Fed. R. Bankr. P. 2016(b), counsel disclosed the receipt of a $3,000 retainer. One year passed, and there was still no Chapter 11 disclosure statement filed in the case. After the debtor converted to chapter 7, counsel filed a fee application seeking fees totaling $31,819 of which $19,400 had already been received from debtor's sole shareholder as a "pre-payment for legal services."

At the fee hearing, the bankruptcy court learned that the payment was actually a loan from the shareholder to the debtor, which had not been pre-approved, and which was intentionally omitted from the debtor's Monthly Operation Reports in violation of §§ 704(a)(8) and 1106(a)(1). The bankruptcy court found that counsel intentionally withheld required information and misled the court in order to avoid either the conversion or the dismissal of the case, and to improperly pursue a state court appeal without having to post the required bond on appeal. Counsel's repeated violations of the Bankruptcy Rules and Code, along with counsel's lack of candor and disclosure, more than justified entry of an order requiring disgorgement of fees paid, denying counsel's request for further payment from the debtor's estate, and referring the firm's principal to the district court for possible disciplinary action, the court ruled. The Third Circuit affirmed, ruling such fee issues are core matters within the bankruptcy court's purview, and notably commenting: "This case highlights the famous first law of holes: when you're in one, stop digging. The appellant here, a law firm representing a small, limited liability company in a bankruptcy matter, ignored that law, and a few others, to its shame."

Note that the attorney has filed a petition for certiorari with the Supreme Court in this case.

Charging a surcharge to bifurcate fees is unreasonable. *In re Allen*, 628 B.R. 641 (B.A.P. 8th Cir. 2021)

The U.S. Trustee filed a motion challenging the fees charged by the attorney of two individual chapter 7 debtors. Both debtors had selected a "later pay" option, which allowed payments on a $2,000 fee to be made postpetition on a monthly basis for twelve months. Had they chosen a full, up-front payment, the fee would have been $1,500. The bankruptcy court entered orders approving attorney fees, but only in the lower amount of $1,500. The attorney appealed.

The bankruptcy court found that the attorney provided the same services he would have provided to both debtors under either the pre-pay or later-pay arrangements – namely, prepetition counseling, filing the petition and statement of financial affairs, filing all documents required by § 521 of the Bankruptcy Code, and attending § 341 hearings. The debtors each received a discharge

in due course, and the trustee filed a report of no distribution in each case. Based on these findings, the court found that the extra $500 contemplated under the post-filing fee arrangement exceeded the value of the services provided by the attorney.

The attorney argued on appeal that the bankruptcy court was required to consider the reasonableness of his fees in these cases under a lodestar analysis, which is "the number of hours reasonably expended on the litigation [is] multiplied by a reasonable hourly rate." Rejecting that argument, the Eighth Circuit BAP held that courts are not bound to apply the lodestar calculation in every case where attorney fees are challenged, particularly when attorneys charge a no-look fee. Pointing out that the attorney bore the burden of proving reasonableness, the BAP held that the bankruptcy court did not abuse its discretion in reducing the fees.

Entire fee disgorged for improper unbundling of services without fully informed consent. *In re Mawson*, No. BT 18-05012, 2021 WL 4073376 (Bankr. W.D. Mich. Sept. 7, 2021)

The debtor's attorney charged the debtor $2,165 plus the $335 filing fee for his services in a chapter 7 case, which excluded representation in "contested matters." This seems at first blush to be a reasonable fee for a fairly simple case, but case was not so simple: it involved several adversary proceedings, including a § 727 action by the U.S. Trustee for inaccurate disclosures, and an adversary that resulted in a nondischargeable judgment of $460,000 in favor of a bank. The U.S. Trustee filed a motion asking the court to order the attorney to return the $2,165 in fees he received from the debtor as being excessive because: (a) the schedules and statement of affairs were materially inaccurate despite the fact that the debtor had provided the relevant information to the attorney; (b) the attorney did not respond to the U.S. Trustee's complaint to deny the debtor's discharge; and (c) the attorney did not counsel the debtor concerning alternatives to chapter 7, which would have been appropriate under his circumstances.

The court found that, although this type of limited-scope representation is not *per se* inappropriate in bankruptcy cases, the evidence established that the debtor did not give informed consent to the limited scope of the attorney's representation, and the record was equally clear that the attorney did not competently represent the debtor in the course of this case. And, although some of the services may have been compensable, the attorney did not present any evidence. As a result, the court concluded that the compensation paid to the attorney exceeded the reasonable value of any services he rendered, and the court ordered that the attorney to disgorge the full $2,165 in attorney fees he was paid. The court also said it would enter a separate order requiring the attorney to show cause why he should not be subject to further discipline based on these findings, as well as the attorney's "conduct, outbursts, and antics during the evidentiary hearing."

Factoring of fees held to be fee-splitting and improper, and attorney cannot advance the debtor's filing fee. *In re Baldwin*, 640 B.R. 104 (Bankr. W.D. Ky. 2021)

This attorney filed eleven zero-down, skeletal chapter 7 petitions using bifurcated fee agreements. In ten of the cases, the debtors did not even pay the filing fee before their cases were filed. In every case, the debtors entered into a postpetition fee agreement to pay the attorney

$2,500. The attorney and Fresh Start Funding had entered into a Line of Credit and Accounts Receivable Management Agreement ("LOCARMA") under which Fresh Start provided the attorney with a $50,000 line of credit in exchange for a lien on, and right to collect, his accounts receivable. By signing bifurcated fee agreements, the debtors in each of these cases became an "approved account" with Fresh Start, which then advanced 60% of the respective fee to the attorney. The balance of each fee was retained by Fresh Start, with 15% of the fee applied to insurance against defaults and 25% of the fee being Fresh Start's fee. The bankruptcy court found that this type of agreement either placed the burden of the attorney's borrowing under the line of credit on his clients, or constituted improper fee splitting.

"On its face," the court said, the factoring agreement between the attorney and Fresh Start "is wholly beneficial for counsel and disturbingly expensive for his clients," creating a "serious conflict of interest" which was not appropriately disclosed to the debtor-clients. The court concluded that this practice violated the Bankruptcy Code, the court's local rules, and the applicable Rules of Professional Conduct. Further, the arrangement was "clearly designed to defeat existing Bankruptcy law and Rules enacted over at least a century ago to protect debtors, and all the machinations inherent in its processes will not save it from review and censure."

The court determined that advancing a client's filling fees on an expectation of repayment postpetition violates 11 U.S.C. § 526(a)(4). The court also found that the attorney's payment of the filing fee in ten of the cases was improper, noting that debtors who cannot afford to pay the entire fee up front may apply to pay the fee in installments or have the fee waived. And, advising a client to incur debt in order to pay for bankruptcy related legal services violates 11 U.S.C. §§ 362 and. § 524. The court also believed the practice violated certain rules of professional conduct. The court recommended that when debtors cannot afford to pay attorney fees in chapter 7 cases upfront, they should consider filing under chapter 13 and paying the attorney's fee through the plan.

It is interesting to note that the court had directed the attorney to seek an opinion from the Kentucky Bar Association on the ethical propriety of these specific fee agreements, and the association "declined to weigh-in on the matter." It also worth noting that the other bankruptcy judges in the Western District of Kentucky confirmed the authoring judge's legal conclusions as "represent[ing] the legal conclusions of all Judges of the Bankruptcy Court for the Western District of Kentucky." The court specifically ordered that no attorney representing chapter 7 debtors in that district shall enter bifurcated fee agreements such as those used by Fresh Start.

Finally, in denying the attorney's Rule 60(b) motion, the court held that the attorney had adequate due process, despite not receiving an evidentiary hearing on each of the individual contracts with the debtors.

Misleading bifurcated fee agreements held to be void. *In re Siegle*, 639 B.R. 755 (Bankr. D. Minn. 2022)

Counsel for this chapter 7 debtor filed an application to approve a bifurcated fee agreement. As is often the case in these little or zero-down bifurcated cases, the debtor was advised she had three options as to anything that occurred in her case postpetition: (1) sign the full fee agreement postpetition, (2) proceed *pro se*, or (3) hire another bankruptcy lawyer. The attorney filed the case, and the debtor signed the postpetition agreement.

The court found the advice about the available options to be untrue and misleading in violation of §§ 526(a)(2) and (3) since, *inter alia,* the attorney could not withdraw from the case after filing the petition under local rule. In the bankruptcy context, it "is well recognized that 'once counsel appears in a bankruptcy case for a debtor, withdrawal is not generally allowed unless replacement counsel is available, even if the reasons for withdrawal appear justified under the rules.'" Further, presence of both accurate and inaccurate statements in a fee agreement also implicate the requirement set forth in § 528(a)(1), which requires that the explanation of services be stated "clearly and conspicuously." The fact that the agreement appeared in lengthy, single-spaced documents compounded this problem.

The court held that this type of bifurcation not only violates the Minnesota local rule, but also that these bifurcated fee agreements failed to comply with the material requirements imposed on attorney-client relationships. For those reasons, court disapproved the fee application and declared the agreements to be void. In conclusion, the court gave helpful guidance to consumer practitioners:

> Upon filing a petition, counsel agrees to represent the debtor and provide all reasonably necessary bankruptcy services throughout the case, until and unless permitted to withdraw through substitution or court approval, and authorization to withdraw is neither automatic nor presumed. An agreement that purports to withhold such services, or to condition such services upon execution of an additional fee agreement, is fundamentally untrue and misleading, in violation of § 526(a)(2) and (3). Further, the presence of both true and untrue statements in a fee agreement does not comply with the requirement to "clearly and conspicuously" explain the services that will be provided, in violation of § 528(a)(1). These material defects render the Agreements statutorily void under § 526(c)(1).

Bifurcated fee agreements contained misrepresentations and were misleading. *In re Suazo*, No. BR 20-17836 TBM, 2022 WL 2197567 (Bankr. D. Colo. June 17, 2022)

This Colorado attorney became associated with a law firm known as Ovation Law, LLC, based out of Phoenix, Arizona. He entered into a "partnership agreement" with Ovation, although Ovation was an LLC in which the attorney had no membership interest, no equity, and no right to participate in the management of Ovation. In essence, Ovation referred its Colorado clients to the attorney, in n return for compensation from Ovation (referred to as the "partnership share," which was 33 1/3% of the agreed legal fees Ovation received from the debtor-clients. In conjunction with

the Ovation "partnership agreement," the attorney also entered into a Line of Credit and Accounts Receivable Management Agreement ("LOCARMA") with Fresh Start Funding, under which the attorney received a $50,000 line of credit secured by the attorney's accounts receivables, with a fee and holdback amount similar to what other cases have reported about attorneys' relationship with Fresh Start.

Two months later, the attorney filed a skeletal chapter 7 petition on behalf of the debtor, using a bifurcated fee agreement which was subject to the LOCARMA. Contemporaneously with the commencement of the bankruptcy case, the attorney submitted a "Disclosure of Compensation of Attorney for Debtor" wherein the attorney disclosed that the debtor had not paid anything before the petition date but agreed to pay him $2,998 later. The UST filed a "Motion to Examine the Reasonableness of Fees Charged by Debtor's Counsel Under 11 U.S.C. § 329 and Review of Attorney Conduct Under 11 U.S.C. §§ 526 and 105," through which the UST attacked the propriety of the bifurcated pre-petition agreement and post-petition agreement under a variety of legal theories.

After a thorough description of the arrangement and written agreements, and discussing several Code and Rule violations, the court concluded that the bifurcated pre- and postpetition agreements utilized in this bankruptcy case contained misrepresentations (indeed, outright false statements) and were misleading since, among other things, they did not accurately disclose the attorney's obligations under the Bankruptcy Code and local rules. And, the court said, there was no need for an emergency filing in the case, warranting the skeletal filing. Thus, the agreements were void under § 526(c)(1). The attorney and Ovation were ordered to disgorge all fees paid under the postpetition agreement, and were expressly enjoined from making any further such misrepresentations or misleading statements described in the opinion in the District of Colorado.

If done correctly, unbundling is not prohibited, but additional evidence was necessary to determine whether the attorney had provided the debtors with adequate advice about the scope of representation and reasonableness of fee arrangement. *In re Slabbinck*, 482 B.R. 576 (Bankr. E.D. Mich. 2012).

Debtor filed a chapter 7 case and entered into two separate agreements with counsel. The pre-petition agreement required $1,000 for prepetition services and $2,000 for the post-petition agreement to be paid at a rate of $166.67 per month. The UST, under § 329, filed motion seeking cancellation of fee agreement between chapter 7 debtors and counsel that had agreed to represent them and disgorgement of fees paid.

The court found that the applicable rules of professional conduct and their official comments allow an attorney and a client to take into consideration the client's ability to pay and to agree to limit the scope of representation. The court was persuaded that an agreement to limit an attorney's legal services in connection with an individual chapter 7 bankruptcy case by unbundling the pre-petition legal services from the post-petition legal services, is not *per se* prohibited by the rules of professional conduct and does not necessarily warrant any relief under § 329 of the Bankruptcy Code.

The court said: although § 329 of the Bankruptcy Code does not set forth specific criteria governing the unbundling of legal services in a chapter 7 case, it is clear that, minimally, the rules of professional conduct require that (1) the attorney competently represents the individual debtor despite any limitation on the scope of services; (2) the attorney provides adequate consultation to the individual debtor concerning any limitation on the scope of the attorney's representation and the legal matter in question; and (3) the individual debtor makes a fully informed and voluntary decision to consent to such limitation.

The court held that as long as a chapter 7 debtor's attorney competently performs those services that the debtor has hired the attorney to perform, provides an adequate consultation to the debtor concerning any limitations placed upon the services to be rendered in connection with the filing of a case, and obtains such individual's fully informed consent to such limitations, the attorney may unbundle the pre-petition services from the post-petition services by entering into a separate pre-petition agreement describing the services to be rendered and the fee to be paid prior to filing bankruptcy, and a separate post-petition agreement describing the services to be rendered and the fee to be paid post-petition. Stated another way, the court held that if the attorney's legal services for an individual debtor are unbundled between pre-petition services and post-petition services, in strict conformance with the rules of professional conduct, such unbundling of legal services does not by itself warrant any relief under § 329 of the Bankruptcy Code. According to the court, a contrary holding would fail to recognize the parties' freedom to contract and would shut Chapter 7 debtors who could not afford to prepay their attorneys' fees out of bankruptcy.

That said, the evidence was not clear that the attorney had sufficiently informed the debtor about the unbundling in this case, so supplementation was required in order for the court to determine the propriety of the agreement in this case.

Bifurcation permitted if properly disclosed and reasonable. *In re Hazlett*, No. BR 16-30360, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019).

Debtor lacked the funds to pay a pre-petition retainer for an attorney to represent him in a chapter 7 case. Counsel offered the debtor a bifurcated fee arrangement that involved no retainer for filing the petition, and then a post-petition fee agreement to pay $ 2,400 in ten monthly installments. The parties agreed, counsel filed the case, and the debtor expeditiously received a discharge. Based on the issues raised by the attorney's use of the bifurcated fee agreements, the UST brought a motion for sanctions, and counsel filed a motion for summary judgment.

Addressing the legal and ethical issues that arise when a consumer client needs chapter 7 relief but lacks to funds to pay an up-front retainer, the court found that bifurcated fee agreements are not *per se* prohibited by the Bankruptcy Code or Utah's Rules of Professional Conduct. The court said it was neither encouraging nor prohibiting the use of bifurcated fee agreements in consumer chapter 7 cases but outlined essential practices when using a bifurcated fee agreement: Counsel may employ this option in situations where: (1) it is in the best interests of the client (e.g., the client could not otherwise afford to hire bankruptcy counsel); (2) the attorney provides appropriate disclosures, options, and explanations; (3) the client gives informed consent in writing; and (4) the attorney's fee and costs are reasonable and necessary.

Relying in large part on a Utah ethics opinion, the court found that, in this particular case, the attorney's fees were reasonable and that there was no basis for sanctions. The bifurcated agreement facilitated the debtor's ability to retain and pay for legal counsel. Counsel adequately explained and disclosed the debtor's options and debtor was fully informed of the use of factoring fees in order to consent.

Bifurcation permitted if debtor is fully informed and fees are reasonable, although the court cautioned that not all such arrangements will pass muster; court cautioned that fee statements must be specific about the existence and scope of dual contracts with debtors. *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020)

The fee statement in this case disclosed that attorneys for this chapter 7 debtor received $300 from debtor prepetition and were to be paid $1,185 postpetition. After reviewing the fee statement, the bankruptcy court, *sua sponte,* sought additional information from attorneys concerning their general engagement practices for chapter 7 cases and held a hearing.

The court found that no action was needed under § 329 to disrupt the fee agreement in this case. The attorneys' representation of debtors under the dual contract system satisfied the Code, the Bankruptcy Rules, and applicable ethical rules. In this case, the attorneys proceeded reasonably after having obtained the debtor's informed consent in writing. They accepted reasonable fees for prepetition work under their prepetition contract and agreed to a reasonable payment arrangement for their fees for post-petition work under their post-petition contract. Further, the court found that the dual contract system comported with persuasive law on separate fee agreements.

The court noted that not all multiple fee arrangements will pass muster. The court held that if done properly, an attorney may limit the scope of his or her bankruptcy services to a prepetition analysis of a debtor's bankruptcy options and filing the debtor's skeletal chapter 7 petition, and addressing a matter of first impression in the district, the "dual contract" arrangement by which attorneys used pre- and postpetition contracts to "bifurcate" the services provided to debtor was reasonable and so would not be disrupted by the court.

Notably, the court said: "In the future, the attorneys' fee statements must be more specific about the existence and scope of dual contracts in the same case." The court found that the attorneys in this case made great efforts to propose separate fee arrangements that comported with case law in which other attorneys had successfully formulated such arrangements. "Here, the attorneys assiduously followed the best practices drawn from these cases. They made full disclosures to Debtor so that Debtor could make an informed decision. Their efforts, reasonable fee arrangement, and willingness to provide access to the courts in this manner allowed Debtor to retain and pay for legal counsel and receive a Chapter 7 discharge," the court said, and allowed the fee arrangement to stand.

Bifurcation permitted if done properly and reasonably; court sets out standards for proper bifurcation; but, firm's payment of filing fee to be repaid postpetition violates the Bankruptcy Code as well as the Florida Bar rules. *In re Brown*, 631 B.R. 77 (Bankr. S.D. Fla. 2021)

In three separate "no money down" or "low money down" chapter 7 cases, the UST objected to the business practices of two law firms with respect to the bifurcation of attorney fees in consumer chapter 7 cases, specifically seeking guidance from the court regarding bifurcation agreements and an injunction against prohibited conduct. This court laid out standards for when such chapter 7 bifurcated fee agreements might be allowed.

The court first addressed reasonableness of fees. The court said there is no question that using the postpetition agreement to pay for prepetition services is unacceptable, since that is merely seeking to do indirectly what is prohibited directly. Reasonableness, the court said, is not gauged by a comparison between the prepetition charges and the postpetition charges. The court held that it would review reasonableness of the postpetition flat fee charged by taking into account not only the work that was done but also the services that might have been required in the case for whether there would have been no additional charge.

And, for an attorney using a bifurcated fee arrangement to meet his or her obligation of competency with respect to prepetition services, the attorney must meet with a potential bankruptcy client and review sufficient information to competently advise the potential client whether to file bankruptcy and, if so, under what chapter. Additionally, an attorney using a bifurcated fee arrangement must provide certain prepetition and postpetition "core services," including: sufficient inquiry by the attorney – not staff – a when initially meeting with a client to ascertain whether filing bankruptcy is the appropriate relief and determining under what chapter bankruptcy case could or should be filed. The attorney must also adequately inform a potential debtor of the consequences of that choice. Further, the attorney must assist the debtor with all of the debtor's obligations under § 521 unless permitted to withdraw. The attorney must also prepare and file all documentation necessary to commence the bankruptcy case. And, the attorney must attend the section 341 meetings unless permitted to withdraw.

And, attorney disclosure to a potential client is only adequate so long as:

(1) The potential debtor receives the separate disclosure form;
(2) The prepetition agreement and postpetition agreement are provided at the same time for the potential debtor's review;
(3) The prepetition agreement clearly describes the services that must be performed prepetition as well as other services that may be provided; and
(4) The postpetition agreement clearly describes the included services (delineated, where appropriate as "if necessary"); and specifically describes the excluded

services, and any additional flat fee or hourly charge associated with those excluded services.

Further, an attorney using a bifurcated fee arrangement must make sure that any such arrangement is properly disclosed to the court and to parties in interest, and additionally, the court suggested a 14-day rescission – or "cooling off" – period.

Lastly, the court concluded that the firm's financing the payment of the filing fee, subject to the debtor's postpetition obligation to reimburse, violated the Bankruptcy Code because, among other things, the attorney is advising the debtor to incur a debt to pay for bankruptcy related legal services in violation of §§ 362 and 524. Doing so also violated Florida's rules of professional conduct.

Attorney who bifurcated and factored attorney fees in numerous cases referred for discipline for violation of numerous ethics rules. *In re Kolle*, __ B.R. ___, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021).

The United States Trustee ("UST") filed adversary complaints in four chapter 7 bankruptcy cases against an attorney and his law firm, seeking sanctions, disgorgement, and discipline, arising out of the attorney's and his law firm's practice of failing to disclose they had "factored" fees owed to them by some of their chapter 7 debtor clients. After a court-ordered mediation, the parties reached a settlement requiring the law firm to disgorge fees and to pay a civil penalty as to those cases. When the motion seeking the court's approval for the settlement was filed, however, it came to light that the factoring and nondisclosure had occurred – not just in the four cases – but in an additional 100 cases or more. In considering additional sanctions against the attorney based on the newly-revealed cases, the court reviewed ten of those cases at random.

As has been true in the Western District of Missouri for some time, bifurcated fee agreements are generally not prohibited by the Code or Rules, so long as the allocation between pre- and postpetition services is reasonable, the court held. In this case, the court had no choice but to find that the attorney disclosures in these cases violated the Code, Rules, and local rules by (1) failing to disclose to the court what the attorney had agreed to charge for his legal fees; (2) failing to disclose to the court what payments he received; (3) failing to disclose to the court a "complete statement" of his fee agreements and arrangements for payment with a factor (BK Billing); (4) failing to seek approval of the agreements under this court's local rule; and (5) failing to show that his fees were reasonable. The attorney also violated the Rights and Responsibilities Agreement (which is required under local rule to invoke the presumption that a flat fee is reasonable) by failing to agree to provide pre- and postpetition services to these debtors for one fee.

The court laid out what the Bankruptcy Code, Bankruptcy Rules, local rules, and disciplinary rules require. Because the attorney had already agreed in the settlement with the UST to disgorge fees and pay a civil penalty, the court concluded that no additional monetary sanction was warranted, but made a disciplinary referral to the Office of Chief Disciplinary Counsel of the

State of Missouri based on the findings in the case. ***See addendum for a list of ten requirements the court set out for fee agreements in the Western District of Missouri.***

Proper bifurcation is permissible; but district court determined that remand to the bankruptcy court was necessary to determine whether bifurcation and factoring in this case were improper. *In re Prophet*, No. 4:21-CV-01081-JMC, 2022 WL 766390 (D. S.C. Mar. 14, 2022).

This case involved an appeal from the bankruptcy court's holding that a chapter 7 attorney's bifurcated fee agreements and factoring with Fresh Start Funding were impermissible under that court's local rules.

Due to financial struggles caused by the COVID-19 pandemic, the appellant-attorney began offering his clients two payment options: The first option allowed clients to enter into traditional fee arrangements in which the client prepaid all the fees for the case prior to filing. The second option allowed clients to bifurcate the fees, in a "file now pay later" arrangement. The bifurcated agreements were a popular option among the attorney's clients, and he filed more than one hundred such bifurcated cases.

The bankruptcy court held that the bifurcated fee agreements were impermissible under its local rules, specifically, local rule 9011-1(b), which provides:

> Except as may be provided in a written agreement with the debtor concerning appeals and adversary proceedings, the law firm/attorney which files the bankruptcy petition for the debtor shall be deemed the responsible attorney of record for all purposes including the representation of the debtor at all hearings and in all matters arising in conjunction with the case, including service, notice and communication via CM/ECF and the Federal Rules of Bankruptcy Procedure.

On appeal by the attorney, the district court reversed and remanded, concluding that purpose of the local rule 9011-1(b) is to maintain the integrity and efficient handling of matters before the bankruptcy court. The rule allows courts and other interested parties "to determine and rely on the appearance of counsel in order to encourage the efficient administration of cases, to include coordinating the service of pleadings and objections and the noticing of hearings." The goals of the rule are frustrated when an attorney fails to completely satisfy its provisions because "[c]lients who proceed through a case without an attorney to shepherd them through the complexities of the bankruptcy process tax the resources of the court[.]" Bifurcated agreements, when utilized properly and with sufficient safeguards, enable debtors who otherwise could not afford counsel to obtain legal services of an attorney to aid them in navigating the complex bankruptcy process, the court said. Reading the local rule as a total bar to bifurcated agreements, therefore, "would undermine the very purpose of the Rule," the district court held.

However, the district court said it was "mindful of the concern that attempts by counsel 'to limit or exclude certain types of representation, or to condition continued representation on the prepayment of additional fees, can leave debtors vulnerable and without representation during a

crucial part of their case.'" However, the attorney involved had acknowledged that, regardless of whether the debtor signs a post-petition agreement, he is the attorney of record for the debtor until the court allows him to withdraw, which was consistent with the Rules of Professional Conduct and local rule. And, importantly, the attorney did not in fact seek withdrawal and was successful in representing the debtors. The court said it could not read the local rule to bind debtors and their attorneys together for the duration of a case with no possible exit strategy for either party, particularly where the local rules specifically provide a means for withdrawal.

The district court expressly declined to make a determination as to the reasonableness of the attorney's fees, the propriety of using Fresh Start to collect from the debtors, the adequacy of the attorney's disclosures to the debtors, or whether the record showed that the debtors provided informed consent for the structure of the fee agreements. Rather, because the bankruptcy court had only ruled that the attorney violated the local rule, it remanded for further proceedings on those other issues.

Court lays out six requirements for proper bifurcation. *In re: Shatusky*, No. 8:22-BK-00131-RCT, 2022 WL 1599973 (Bankr. M.D. Fla. Mar. 18, 2022).

Debtor did not have enough money to pay the lump sum attorney fees for a chapter 7 petition because his wages had been garnished. So, he signed a bifurcated fee agreement with his attorney's law firm, Debt Relief Legal Group, LLC ("DRLG"). He paid his own filing fee pre-filing, and DRLG agreed to represent him "*pro bono*." Post-filing, however, he signed a second agreement to pay a flat $2,000 fee either from his own resources or with a loan from Rebound Capital, LLC ("Rebound"), which financing had been prearranged by DRLG. Debtor elected to go with the Rebound option. In this case, the court considered two motions: (1) the Debtor and Rebound's Expedited Joint Motion to Approve Post-Petition Financing Agreement and (2) the UST's Motion to Review Attorneys' Transactions with the Debtor.

The bankruptcy court held that, with a few exceptions, bifurcated contracts are a recognized tool to assist debtors who have insufficient cash upfront to hire an attorney to file a Chapter 7 bankruptcy case. But, bifurcated contracts are permissible only if they meet stringent ethical and statutory requirements. This court found no *per se* violation of the Bankruptcy Code with an optional two-contract approach that bifurcates chapter 7 legal fees, so long as the arrangement satisfies what this court referred to as "the *Brown/Walton* requirements" (citing *In re Walton*, 469 B.R. 383 (Bankr. M.D. Fla. 2012); *In re Brown*, 631 B.R. 77 (Bankr. S.D. Fla. 2021)), and the local rules of the court. The court expressed its sensitivity to the problem of unrepresented debtors struggling with the intricacies of bankruptcy law and the realities of attorneys practicing consumer bankruptcy law, but recognized that "the concept of a bifurcated fee agreement is not perfect, and it is, admittedly, a work around that must be very carefully drafted and implemented" in order to satisfy the requirements of the Bankruptcy Code.

This court laid out six requirements for a bifurcated contract: First, there must be adequate disclosure to the client. Second, counsel must agree to provide the required pre-petition service. Third, the client must be given a 14-day "cooling off period" between filing the petition and signing the post-petition agreement. Fourth, there must be adequate disclosure to the court. Fifth,

the fees charged both pre-petition and post-petition must be reasonable. And, sixth, the attorney or law firm cannot pay the filing fee for the client and then seek repayment post-petition.

The court held that the proposed bifurcated contract between this debtor and DRLG was permissible in principle, but it contained deficiencies which precluded approval as it was filed. The court denied the Approval Motion without prejudice, keeping in mind that the debtor's financing arrangement implicates § 526(a)(4), the operative prohibition of which is to "advise." It is not a violation § 526(a)(4) for an attorney to present a third party financing option to a client, so long as it is given as an option and not as affirmative advice to incur the debt. The proposed arrangement with Rebound, in this case, needed further refinement before it could be properly evaluated by the court. With respect to the UST's Motion, the court granted the request to review both the pre- and post-petition contracts, giving the debtor and Rebound the opportunity to amend the existing agreements, consistent with the court's order.

Attorneys violated multiple bankruptcy rules, code provisions, and ethics rules under its bifurcation, factoring, and fee-advancement agreements with debtors. *In re Rosema*, ___ B.R. ____, No. 19-30584-BTF7, 2022 WL 2662869 (Bankr. W.D. Mo. July 8, 2022).

The bankruptcy court ordered two attorneys representing debtors in fifteen chapter 7 cases to show cause regarding the fees they charged their respective debtors. The attorneys and the UST, recognizing that they had no authority to "settle" the court's orders to show case, asked the court approve an agreement they had reached, believing the agreement addressed the court's concerns about the fees. In part, the settlement recognized that the attorneys had entered into pre- and postpetition agreements with their clients using forms drafted by Fresh Start Funding which had provided the attorneys with financing secured by the attorneys' accounts receivables. Under the agreement between Fresh Start and the attorneys, Fresh Start was to receive 25% of the "fees" paid by the debtors. The agreements between the debtors and the attorneys provided that the attorneys' fees would be paid through postpetition payments.

In some of the cases, the attorneys also advanced the filing fee, which was to be collected from the debtors postpetition. The attorneys acknowledged that in most of the cases the postpetition attorney fees charged were higher than the fees the attorneys normally charged for clients who paid in advance. They also acknowledged that the fee was unreasonable under § 329(b) to the extent the total fee exceeded the customary fee charged for chapter 7 cases and that their fee disclosures "were insufficient and misleading." Finally, the attorneys ultimately admitted that they had unbundled their services contrary to the local "rights and responsibility" agreements, which require attorneys to provide unbundled legal services for the pre- and postpetition obligations for a flat fee, and which they had signed with their clients.

In addition to disgorging fees in the cases and telling Fresh Start to stop collecting any unpaid balances from the debtors in these cases, the attorneys agreed that they would fully comply with the disclosure rules and no longer finance their fees using Fresh Start's program or any similar program. The attorneys also agreed that they would indemnify and make whole their clients to the extent they suffered damages because of Fresh Start's credit reporting. And, the attorneys agreed to self-report the situation to the appropriate disciplinary authorities.

The court approved the settlement, stating that it was very similar to what the court would have ordered. But, in so ruling, the court said it was clear that the attorneys' disclosures were insufficient and misleading; that they charged unreasonable fees in most of the cases; they violated the local rules by executing the RRA but also bifurcating the fees and unbundling their fees; they had a conflict of interest with their clients; they had their clients agree to contracts that were void under § 528; and they allowed Fresh Start "to unreasonably interfere with their independent business judgment by requiring their use of fee agreements and modified disclosure forms; unreasonably allowed [Fresh Start] to obtain confidential client information without adequate informed consent; and unethically financed their attorney fees, among other potential ethical violations."

"Premium" charged for bifurcation ruled impermissible. *In re Gartei*, No. 22-11355 ELF (Bankr. E.D. Pa. Aug. 11, 2022)

In a very succinct opinion, the court held that the bifurcated agreements used by the attorney in this case did not violate the Code or Rules and was valid, *except* the court did not approve the "premium" added by the attorney for bifurcation. Notably, the court stated, in a footnote:

> I reach this conclusion largely for the reasons expressed in *In re Hazlet*t, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019); *see also* Guidelines for United States Trustee Program (USTP) Enforcement Related to Bifurcated Chapter 7 Fee Agreements (https://www.justice.gov/ust/bifurcated-fee).
>
> I agree with the analysis in *Hazlett*, subject to two (2) qualifications.
>
> First, while I agree that a complete and fulsome disclosure, (including, inter alia, the risks and benefits of incurring a post-petition obligation in order to retain an attorney's services, designed to permit a debtor to make an informed decision regarding entry into a bifurcated fee agreement with bankruptcy counsel), is essential to a valid bifurcated fee arrangement, I am not as sanguine about the real world impact of those disclosures. Many (but not all) debtors lacking the funds to pay the up front legal expenses for a chapter 7 filing are facing what can be characterized as an emergency (or "exigent circumstances" as stated in 11 U.S.C. §109(h). Such debtors may not be capable of critically evaluating what will often be the lengthy (multi-page), detailed disclosures that need to be made in support of a bifurcated fee agreement. I say this not to suggest that the disclosures should not be made, but only to point out that we should be realistic about the potentially limited benefit of the disclosures in facilitating an informed decision by the debtor.
>
> Second, the *Hazlett* decision does not deeply explore the issue of the allocation of the legal fee between the prepetition and postpetition periods. If bankruptcy courts are going to allow the bifurcation fee agreements, the amounts charged in the two (2) periods (i.e., prepetition and postpetition) must bear some

> reasonable relationship to the services during the time period covered by each contract.
>
> When a prospective debtor has very limited funds, both the debtor and counsel may be tempted to "backload" the fees into the postpetition contract. To the extent that courts permit this, in the interest of facilitating access to the courts, they may be engaging in a legal fiction. Even though the actual preparation and filing of the bankruptcy schedules and statement may occur postpetition, perhaps the most critical work performed by debtor's counsel in a chapter 7 case is the gathering and evaluation of sufficient information to ensure the propriety of the filing, both from a good faith and tactical perspective. This requires a review of a debtor's assets, debts and financial history, sufficient for counsel to form make an informed judgment call regarding the possible existence of non-exempt property, nondischargeable debts, potentially avoidable transfers and income levels that may render the filing in bad faith within the meaning of 11 U.S.C. §707(b). There may be some cases in which this legal work can be completed quickly, making it appropriate for the bulk of the legal work to be performed postpetition. But there also may be many cases where that is not possible and, in such cases, a strict allocation of time and fees between the prepetition and postpetition time periods may compel counsel to perform some uncompensated prepetition work or to decline to represent the debtor.

Note that in ***In re Mansfield*, 394 B.R. 783 (Bankr. E.D. Pa. 2008),** the court ruled that when a chapter 7 debtor enters into a prepetiton fee agreement with an attorney to render pre- and postpetition services in exchange for payment of a flat fee, the fee must be paid in full prior to filing, or the fee obligation will be discharged. Further, an attorney who continues to send bills on such an unpaid fee violates the automatic stay, and creates a conflict of interest. That said, since there were conflicting views among courts, and no previous caselaw from that district on point (at that time) the attorney would not be required to disgorge the fees. The court cautioned the attorney to not engage in similar transactions in the future.

Applicable Bankruptcy Code and Rules

Fed. R. Bankr. P. 2014
- requires counsel to disclose "any proposed arrangement for compensation"

11 U.S.C. § 329(a)
- requires disclosure of compensation paid or to be paid in connection with representing a debtor in a bankruptcy case

Fed. R. Bankr. P. 2016(b)
- requires that compensation be disclosed within 14 days after the order for relief

11 U.S.C. § 329(b)
- authorizes the court to cancel the agreement or order the return of a payment to the extent the payment is excessive

Fed. R. Bankr. P. 2017(a), (b)
- allows the court, after notice and a hearing, to determine whether payments made to an attorney either before or after the filing of a petition are excessive

11 U.S.C § 504
- with certain exceptions, sharing of compensation is prohibited

11 U.S.C §§ 523 and 727
- a chapter 7 discharge discharges pre-petition debt, except for certain enumerated nondischargeable debts in § 523

11 U.S.C § 524
- because any prepetition obligation that is not paid prior to a chapter 7 filing is subject to discharge under § 524, bifurcated agreements are sometimes designed to change the attorney's prepetition fees into a postpetition, nondischargable debt

11 U.S.C § 526(a)(4)
- advising an assisted person or prospective assisted person to incur more debt in contemplation of filing a bankruptcy case is prohibited

11 U.S.C § 528
- lists the requirements for debt relief agencies providing bankruptcy assistance for debtors

28 U.S.C § 1930 & Fed. R. Bankr. P. 1006
- 28 U.S.C. § 1930 sets out bankruptcy filing fees
- Rule 1006, which incorporates 28 U.S.C. § 1930, requires bankruptcy filing fee installments to be paid within 120 days after a debtor files a bankruptcy petition
- The Rule specifically prohibits a debtor's attorney from receiving any fee payments before the filing fee is fully paid

Applicable Model Rules of Professional Conduct

Rule 1.1 Competence

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

Rule 1.2: Scope of Representation & Allocation of Authority Between Client & Lawyer

(a) Subject to paragraphs (c) and (d), 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. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter. . . .

* * *

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

Rule 1.3: Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

Rule 1.4: Communications

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;
(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
(3) keep the client reasonably informed about the status of the matter;
(4) promptly comply with reasonable requests for information; and
(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Rule 1.5: Fees

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
(3) the fee customarily charged in the locality for similar legal services;
(4) the amount involved and the results obtained;
(5) the time limitations imposed by the client or by the circumstances;
(6) the nature and length of the professional relationship with the client;
(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
(8) whether the fee is fixed or contingent.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

* * *

(e) A division of a fee between lawyers who are not in the same firm may be made only if:

(1) the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation;
(2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
(3) the total fee is reasonable.

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).

* * *

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

Rule 1.7: Conflict of Interest: Current Clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or
(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
(2) the representation is not prohibited by law;
(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
(4) each affected client gives informed consent, confirmed in writing.

Rule 1.8: Conflict of Interest: Current Clients: Specific Rules

(a) 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 fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

* * *

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;
(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client; and
(3) a lawyer representing an indigent client pro bono, a lawyer representing an indigent client pro bono through a nonprofit legal services or public interest organization and a lawyer representing an indigent client pro bono through a law school clinical or pro bono program may provide modest gifts to the client for food, rent, transportation, medicine and other basic living expenses. The lawyer:

(i) may not promise, assure or imply the availability of such gifts prior to retention or as an inducement to continue the client-lawyer relationship after retention;
(ii) may not seek or accept reimbursement from the client, a relative of the client or anyone affiliated with the client; and
(iii) may not publicize or advertise a willingness to provide such gifts to prospective clients.
Financial assistance under this Rule may be provided even if the representation is eligible for fees under a fee-shifting statute.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;
(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
(3) information relating to representation of a client is protected as required by Rule 1.6.

* * *

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

Rule 1.15: Safekeeping Property

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other property shall be identified

as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of [five years] after termination of the representation.

(b) A lawyer may deposit the lawyer's own funds in a client trust account for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose.

(c) A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

(d) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(e) When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

Rule 5.4: Professional Independence of a Lawyer

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

> (1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;
> (2) a lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price;
> (3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and
> (4) a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.

(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;
(2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation ; or
(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

Rule 3.3: Candor Towards 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.

Rule 8.4: Misconduct

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law;

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law; or

(g) engage in conduct that the lawyer knows or reasonably should know is harassment or discrimination on the basis of race, sex, religion, national origin, ethnicity, disability, age, sexual orientation, gender identity, marital status or socioeconomic status in conduct related to the practice of law. This paragraph does not limit the ability of a lawyer to accept, decline or withdraw from a representation in accordance with Rule 1.16. This paragraph does not preclude legitimate advice or advocacy consistent with these Rules.

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

Summary of MEMORANDUM from Ramona D. Elliott, Acting Director to United States Trustees, dated June 10, 2022 (attached)

The USTP takes the position that: bifurcated fee agreements are permissible so long as the fees charged under the agreement are fair and reasonable, the agreements are entered into with the debtor's fully informed consent, and the agreements are adequately disclosed. The benefits of these agreements are increases access relief to those in need.

In order to be fair and reasonable, bifurcated agreements must, first, have proper allocation between prepetition and postpetition fees and services. Fees earned for prepetition services must be either paid prepetition or waived because the debtor's obligation to pay those fees is dischargeable. Bifurcated fee agreements should receive the same level of representation as debtors in traditional fee agreements. Fees for postpetition services must be rationally related to services actually rendered postpetition. Attorneys should not advance filing fees and seek their reimbursement postpetition.

Second, the attorney's fees must be reasonable. Bifurcated fee agreements should not be viewed as an opportunity to collect higher fees. "For example, it would be inappropriate for an attorney to offer a debtor a fee of $1,500 if they pay upfront, and $2,000 if they pay over time postpetition, particularly given that fees for prepetition work should have been paid or waived."

Third, arrangements that employ outside parties to finance warrant significant additional scrutiny. The arrangements must be fully disclosed under Bankr. Rule 2016(b), including the details of the attorney's relationship with the entity providing the financing. It is improper for an attorney using third-party financing to pass along the cost of that financing their clients. And third-party financing may also create unwaivable conflicts of interest.

Debtors must be fully informed to consent to bifurcated fees. According to the Memo, the following disclosure and consent factors can assist a UST's review of bifurcated fee agreements and determination whether an enforcement action is appropriate:

- Whether the attorney has clearly disclosed the services that will be rendered prepetition and postpetition, and the corresponding fees for each segment of the representation, including those certain listed services may not arise in a particular case
- Whether the attorney has disclosed their obligation to continue representing the debtor regardless of whether the debtor executes a postpetition agreement, unless the bankruptcy court permits the attorney's withdrawal
- Whether the attorney has clearly disclosed that the client is being provided the option to choose a bifurcated fee agreement, any difference in the total attorney's fees between the bifurcated fee agreement and a traditional fee agreement, and the client's options with respect to the postpetition fee agreement

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

The UST notes that this is not an exhaustive list and should not be mechanically applied.

Lastly, according to the Memo, there must be adequate public disclosure in order to have a permissible bifurcated fee agreement. "All attorneys representing debtors must promptly file disclosures of the particulars of their fee agreements and the amounts they have been paid under section 329(a) of the Bankruptcy Code and Bankruptcy Rule 2016(b)."

Ethics Opinions

Utah Ethics Advisory Opinion, Number 17-06 (Revised), issued August 16, 2018, which may be found at https://www.utahbar.org/wp-content/uploads/2018/09/17-06-Revised-002.pdf.

Supreme Court of Arizona Attorney Ethics and Advisory Committee, Ethics Opinion File No. EO-20-003.

Articles

David Cox, *Chapter 7 Debtors And Their Counsel Deserve Better: Instead of Contouring the Attorney Client Relationship Though Bifurcated Fee Agreements, It Is Time To Find A Legislative Fix,* 31 No. 3 J. Bankr. L. & Prac. NL Art. 2 (Norton Journal of Bankruptcy Law and Practice Volume 31, Issue 3) (June 2022).

ADDENDUM

Guidelines for Attorney Fee Approval in the Western District of Missouri

The Bankruptcy Code, Bankruptcy Rules, and local rules require, with respect to fee agreements between individual debtors and their attorneys in the Western District of Missouri, is that:

1. All agreements made after one year before the filing of the case for services rendered or to be rendered related to representation of a debtor in a case under title 11 or in connection with a case must be disclosed pursuant to § 329(a), Rule 2016(b), Official Form B2030, and L.R. 2016-1.A;

2. All payments paid or agreed to be paid related to representation of a debtor in a case under title 11 or in connection with a case must be disclosed pursuant to § 329(a), Rule 2016, Official Form B2030, and L.R. 2016-1.A;

3. The source of the payments made or to be made must be disclosed pursuant to Official Form B2030 and the payments shared only as permitted by the Code, rules and applicable ethics rules;

4. The attorney's signature on the disclosure constitutes a certification that the disclosure is a complete statement of any agreement or arrangement for payment to the attorney pursuant to Official Form B2030;

5. All agreements and all payments must be reasonable pursuant to § 329(b);

6. Any change to agreements and any additional payments received by the attorney must be disclosed with the timely filing of a supplemental disclosure until the case is closed pursuant to Official Form B2030, Rule 2016(b), and L.R. 2016-1.D;

7. Attorneys must execute the RRA unless excused by court order pursuant to L.R. 2016-1.A;

8. If the attorney executes the RRA and charges a total fee of less than the applicable no look amount, the fee will be deemed presumptively reasonable, but the attorney must represent the debtor for the disclosed fee for both the pre- and postpetition services set forth in the RRA pursuant to L.R. 2016-1.A and the RRA;

9. If the attorney does not execute the RRA agreeing to represent the debtor for pre- and postpetition services or charges a total fee in excess of the no look, or otherwise agrees to a nonstandard fee agreement, the attorney must disclose whatever the agreement is, disclose whatever the payments have been or will be, file a motion to approve the agreement and payments, and hold any payments in trust, pending court approval pursuant to L.R. 2016-1.C; and

10. A failure to comply with any of these requirements is subject to sanctions, disgorgement, or discipline pursuant to § 329(b), Rule 2017, and the court's inherent and equitable powers.

***In re Kolle*, ___ B.R. ____, 2021 WL 5872265, at *31 (Bankr. W.D. Mo. Dec. 10, 2021).**

SECOND ADDENDUM[2]

***Bethea v. Robert J. Adams & Assocs.*, 352 F.3d 1125 (7th Cir. 2003) (Easterbrook, J.), *cert. denied*, 541 U.S. 1043 (2004)**

***Lamie v. U.S. Trustee*, 124 S.Ct. 1023 (2004) (Kennedy, J.)**

***In re Kolle*, 641 B.R. 621, 629-30 (Bankr. W.D. Mo. 2021) (Norton, J.)**

In *Bethea v. Robert J. Adams Associates*, the bankruptcy court below had held that reasonable attorney fees are not discharged in a chapter 7 bankruptcy case. As such, the court dismissed the debtors' adversary complaint against their former bankruptcy attorneys for violating the automatic stay and discharge injunction by attempting (post-petition and post-discharge) to collect the unpaid installments owed under the parties prepetition retainer agreements.

The Seventh Circuit vacated the lower court decisions, holding that prepetition debts for chapter 7 legal fees are subject to discharge. In so holding, the Seventh Circuit addressed the public policy argument that such a reading forces the most destitute of debtors to forego legal assistance due to inability to pay in advance, noting in *dicta* that one option for such debtors was to "tender a smaller retainer for prepetition work and later hire and pay counsel once the proceeding begins. . . ." The court further observed that such legal fees incurred after filing could receive administrative priority.

The following year, in 2004, the United States Supreme Court held in *Lamie v. U.S. Trustee*, 124 S.Ct. 1023 (2004) – noting what might have been a typographical error in the statute – that § 330 of the Bankruptcy Code does not allow a chapter 7 debtor's attorney to be compensated from estate property unless attorney is employed with approval of the bankruptcy court.

As other attorneys have recently done, the debtors' attorney in *Kolle* (summarized in these materials) relied on *Bethea* in support of bifurcated fee agreements. The court in *Kolle* rejected that argument, pointing out that *Bethea* did not involve a factored fee agreement, and further holding:

> The problem with relying on *Bethea* was several-fold, however. First, *Bethea*'s holding reaffirmed that unpaid attorney fees agreed to prepetition are discharged in chapter 7. Second, the *dicta* the Motion quoted was actually a rejection of the debtor lawyer's policy argument that enforcing the discharge injunction would preclude debtors from finding lawyers . . . . And, most importantly, the *Bethea dicta* was overruled by the Supreme Court the very next year in the *Lamie* case.

In re Kolle, 641 B.R. 621, 629-30 (Bankr. W.D. Mo. 2021).

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[2] Second Addendum to *The Sharing, Splitting, Unbundling, Factoring, Financing, Bifurcation & Disclosure of Debtors' Attorney Fees: Ethical Ramifications and What You Need to Know*, prepared for the ABI Midwestern Bankruptcy Institute, October 2022.

Faculty

Adam E. Miller has been a trial attorney with the U.S. Trustee's office in Kansas City, Mo., since 2007. In 2010, he served on a detail in the Consumer Unit of the Office of General Counsel for the Executive Office of U.S. Trustees in Washington, D.C., where he assisted in providing policy and litigation guidance on all aspects of consumer cases to the 95 field offices of the U.S. Trustee Program. Before joining the U.S. Trustee Program, Mr. Miller was in private practice with the consumer bankruptcy firm of Morgan, Allen and King in Oklahoma City, Okla., and clerked for Hon. Yvonne Kauger on the Oklahoma Supreme Court. Mr. Miller received his B.A. from Oklahoma State University, his J.D. *summa cum laude* from Oklahoma City University, where he served as the acting managing editor of the *Oklahoma City University Law Review*, and his LL.M. from the Morin Center for Banking and Financial Law at the Boston University School of Law, where he served as the graduate editor of the *Review of Banking and Financial Law*.

Hon. Cynthia A. Norton is a U.S. Bankruptcy Judge for the Western District of Missouri in Kansas City. Prior to her appointment on Feb. 1, 2013, she was a founding partner of Grimes & Rebein, LC in Lenexa, Kan., where she focused on consumer and business bankruptcy, creditors' rights, commercial workouts and related fields. She also clerked for Hon. John E. Rees of the Kansas Court of Appeals and Hon. James A. Pusateri of the U.S. Bankruptcy Court in Topeka, Kan., and was previously an associate with Stinson, Mag & Fizzell, an associate and then partner with Lewis, Rice & Fingers, and Of Counsel with Levy & Craig, and established her own law firm in 1995. She has published an annual column reviewing Eighth Circuit bankruptcy cases of interest for *Norton's Bankruptcy Law Advisor* and has authored numerous articles, book chapters and seminar papers on bankruptcy-related topics, is a Fellow in the American College of Bankruptcy and a member of various bankruptcy organizations. She also is the recipient of the Michael R. Roser Excellence in Bankruptcy Award and the Robert L. Gernon Award for Outstanding Contribution to CLE, as well as the NCBJ Excellence in Education Award. Judge Norton received her B.A. in French and art history Phi Beta Kappa and *summa cum laude* from Kansas University in 1981, and her J.D. from the Kansas University Law School in 1984, where she was associate editor of its law review.

Samuel J. Turco, Jr. is a sole practitioner with Sam Turco Law Offices PC in Omaha, Neb. He has practiced law for since 1992 in Nebraska and Iowa, representing clients in chapter 7, 11, 12 and 13 bankruptcy cases. Mr. Turco frequently writes on the topic of bankruptcy law. He received his undergraduate degree from Creighton University in 1989 and his J.D. from the Nebraska College of Law in 1992.