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**STRUCTURED PAYMENT OF
CH. 7 LEGAL FEES**

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Fee Bifurcation in Chapter 7
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Background:

A chapter 7 debtor's prepetition agreement to pay attorneys' fees post-petition is an unenforceable dischargeable debt. *See Lamie v. U. S. Tr.*, 540 U.S. 526, 538 (2004). Thus, attorneys' prepetition fees owed under prepetition agreements are not excepted from a debtor's chapter 7 discharge. *See Rittenhouse v. Eisen*, 404 F.3d 395, 396 (6th Cir. 2005). Accordingly, an attorney who takes a post-petition action to collect on unpaid prepetition fees as a personal liability of the debtor violates either the automatic stay in § 362(a) or the discharge injunction in § 524. *In re Gourlay*, 483 B.R. 496, 500 (Bankr. E.D. Mich. 2012), *aff'd* 496 B.R. 857 (E.D. Mich. 2013). This leaves attorneys who represent consumer debtors in a difficult position, and often narrows the opportunities available to debtors who would benefit from filing a chapter 7 case.

A recent decision set out the options that consumer debtors and their attorneys face:

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

In re Brown, Nos. 20-23632, 20-23354, 20-18268, 2021 Bankr. LEXIS 1598, at *2–3 (Bankr. S.D. Fla. June 16, 2021).

As noted, some attorneys will enter into fee agreements with clients to file chapter 7 cases, accept some portion of the fee prepetition, and understand that the remaining amount due cannot be pursued without violating the automatic stay and the discharge injunction. Debtors may willingly pay discharged prepetition debts, and these attorneys rely on their relationships with these debtors, and their efforts on their behalf, to hopefully receive additional funds from them voluntarily in the future.

However, many attorneys will not take this path and, instead, require consumers who wish to file a chapter 7 case to pay their legal fees in full prior to filing. Yet, many debtors cannot afford these fees, leaving them with one less option.

In contrast to cases under chapter 7, the Bankruptcy Code allows chapter 13 debtors to pay their

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attorney's fees over time. As a result, a consumer debtor with regular income can file a chapter 13 bankruptcy case with the help of an attorney, with little or no money paid up front, and obtain the benefit of the automatic stay. As a result, many debtors that would be eligible for chapter 7 instead file cases under chapter 13, which can be far less advantageous for them. As explained in a 2017 article:

Chapter 7 results in a quick discharge, relieving people from their debts soon after filing, but people must give up any assets over certain limits. Chapter 13 requires debtors to complete a three-to-five year repayment plan before receiving a discharge, but people may keep all property, such as homes and cars, as they continue to pay. More than 95% of people who file under chapter 7 receive a discharge. In contrast, a mere one-third of chapter 13 cases end in a completed repayment plan such that debtors receive a discharge. Most chapter 13 bankruptcies end without debt forgiveness.

Pamela Foohey, Robert M. Lawless, Katherine Porter & Deborah Thorne, "*No Money Down*" *Bankruptcy*, 90 S. CAL. L. REV. 1055, 1057 (2017).

These authors further explained:

Our data analysis shows that chapter choice is powerfully shaped by when debtors must pay their attorneys and how attorneys can receive payments. These financial considerations have nothing to do with the substantive law that governs chapter 7 and chapter 13 bankruptcies, such as the different approaches to secured debts and eligibility to file.

Id. at 1058. The access to justice concerns associated with this finding are profound. Nevertheless, attorneys must operate within the framework of applicable guidelines, and courts must enforce the rules and laws as enacted.

Unbundling vs. fee bifurcation:

Against this background, lawyers have tried to provide chapter 7 services to debtors while still obtaining payment for those services post-petition without running afoul of the Bankruptcy Code. Two approaches are unbundling services and entering into bifurcated fee agreements. These two concepts are not the same.

Unbundling, generally

Unbundling is a process where an attorney, by agreement, provides a limited scope of services to a client, performing only specific tasks. To explain unbundling and what is considered its major practical drawback, one bankruptcy judge wrote:

With unbundling, the attorney is contractually limiting services to a discrete task, such as filing the bankruptcy petition. The primary concern with unbundling is that the attorney provides a limited service and then leaves the client to his or her own devices to complete the legal process. This is problematic, even though it is becoming more widely recognized that having at least some legal representation

in a consumer Chapter 7 case is better than none.

In re Hazlett, No. 16-30360, 2019 Bankr. LEXIS 1166, at *16–17 (Bankr. D. Utah Apr. 10, 2019).

Courts generally evaluate whether it’s acceptable to unbundle legal services in bankruptcy cases by reference to the jurisdiction’s rules of professional conduct. The current version of 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.” Courts in several different jurisdictions have considered whether unbundling services in bankruptcy runs afoul of their jurisdiction’s rule on limiting the scope of a debtor’s representation under this two-prong standard and have reached different results. *Compare In re Bowman*, No. 19-04789-JJG-7, 2020 Bankr. LEXIS 298, at *4–6 (Bankr. S.D. Ind. Jan. 30, 2020) (finding that state rules of professional conduct permit unbundling of services, but attorney’s proposed exclusion of “heavily litigated matters” from services provided was unreasonable and resulted in ambiguity, preventing the debtor from providing informed consent to the arrangement), *with In re Banks*, No. 17-10456, 2018 Bankr. LEXIS 315, at *10 n.6 (Bankr. W.D. La. Feb. 2, 2018) (“This Court permits ‘unbundling’ for legal services in Chapter 7 cases for adversary proceedings; however, it requires debtor’s counsel must represent the debtor, without exception, for all legal services from case filing to discharge, or the date a discharge order would have been entered if a complaint under 11 U.S.C. § 727 is filed in the main bankruptcy case.”).

Fee bifurcation, generally

Fee bifurcation, in contrast, happens when the attorney and client enter into more than one agreement for the provision of bankruptcy services. Under these arrangements, an attorney will contract to represent a debtor during the entire bankruptcy case. One contract will be signed pre-petition for a specific scope of work in exchange for a specific fee paid prepetition, and the second contract will be signed post-petition to provide services for the remainder of the case in exchange for another fee paid post-petition.

Within the last several years, many courts have analyzed differing versions of bifurcated fee arrangements.

In *In re Hazlett*, the attorney for the debtor offered an option under which the attorney would file a debtor’s petition even though the debtor, under a prepetition agreement, would not pay the lawyer any money prepetition, and instead would pay the full legal fee for the representation in monthly installments under a post-petition agreement. *In re Hazlett*, 2019 Bankr. LEXIS 1166, at *1. The debtor in this Utah case chose this option and signed a prepetition agreement accompanied by detailed disclosures. *Id.* at *4. After the lawyer filed the debtor’s petition, the debtor signed the post-petition agreement requiring monthly payment of legal fees with additional detailed disclosures. *Id.* at *6. The United States Trustee’s office investigated the fee agreements and moved for sanctions against the lawyer. *Id.* at *8. Judge Anderson found that the payment arrangement was permissible. *Id.* at *34–35.

In *In re Carr*, after noticing unusual and confusing fee disclosures from a law firm, I reviewed a bifurcated fee arrangement sua sponte and concluded that the firm’s arrangement with its client was permissible under the Bankruptcy Code, the applicable Local Rules, and Kentucky’s ethics

rules. *In re Carr*, 613 B.R. 427, 436–42 (Bankr. E.D. Ky. 2020). In that case, the United States Trustee’s Office also did not see any issues with the fee arrangement, although the chapter 7 Trustee raised concerns about the value of the services provided prepetition and post-petition and whether the attorneys improperly were being paid post-petition for prepetition work. *Id.* at 438–39. I concluded that they were not. *Id.* at 444.

Earlier this year, Judge Duncan held an evidentiary hearing to consider an attorney’s bifurcated fee arrangements at the request of the United States Trustee’s Office and concluded that the attorney’s fee agreements were impermissible in the District of South Carolina. *In re Prophet*, Nos. 20-03131-dd, 20-03171-dd, 20-03293-dd, 2021 Bankr. LEXIS 820, at *37 (Bankr. D.S.C. Mar. 29, 2021). The court concluded that a local rule prohibiting the unbundling of services in bankruptcy cases barred bifurcated fee agreements in that district. *Id.*

In the 9th Circuit, the Court of Appeals recognized compensation of chapter 7 debtors’ attorneys for postpetition services as an area of congressional oversight, with a substantial chilling effect on competent representation only prevented by the rarity of litigated disputes in this area. *Gordon v. Hines (In re Hines)*, 147 F.3d 1185, 1190 (9th Cir. 1998). The court ultimately approved a bifurcated fee arrangement, holding that “all claims for lawyers’ compensation stemming from . . . postpetition services . . . do not fall within the automatic stay provisions of Section 362(a)(6) or the discharge provisions of Section 727.” *Id.* at 1191. The court reasoned that the attorney did not violate § 362(a)(6) by attempting to collect fees for postpetition services rendered because the right to payment did not arise until the attorney actually rendered the postpetition legal services. *Id.*

More recently, in *Ridings v. Casamatta (In re Allen)*, the 8th Circuit BAP similarly approved a bifurcated fee arrangement; however, the BAP further ruled that the Bankruptcy Court for the Eastern District of Missouri did not abuse its discretion when it reduced postpetition attorneys’ fees. *Ridings v. Casamatta (In re Allen)*, No. 20-6023, 2021 Bankr. LEXIS 1650, at *10 (B. A. P. 8th Cir. 2021). The debtor was offered two alternatives: pay \$1,500 up front, or pay \$2,000 postpetition over the course of a year. *Id.* at *2–3. Because the same services would have been provided under either payment arrangement, and since there was otherwise nothing remarkable about the case, the court held that the extra \$500 under the postpetition arrangement exceeded the value of the services provided. *Id.* at *7–8.

Finally, Judge Isicoff recently issued a detailed opinion providing guidance regarding bifurcated fee arrangements in chapter 7 cases in the Southern District of Florida, concluding that bifurcated prepetition and post-petition fee arrangements between lawyers and their clients are permissible if they are reasonable. *In re Brown*, 2021 Bankr. LEXIS 1598, at *52. She held “that so long as attorneys offering a bifurcated fee arrangement comply with the terms of this Order, those arrangements do not violate the Bankruptcy Code or Bankruptcy Rules, this Court’s Local Rules, or the Florida Bar Rules.” *Id.*

Common considerations concerning bifurcated fee arrangements:

Courts that have recently reviewed bifurcated fee arrangements have focused on specific issues to determine whether to approve them. Interestingly, courts usually have reached similar interpretations of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure in the

context of bifurcated fee arrangements but have arrived at different outcomes based on state rules of professional conduct and their own local rules.

First, bankruptcy courts typically will consider the Bankruptcy Code's requirements and the applicable Federal Rules of Bankruptcy Procedure. For example:

As stated above, prepetition debts for legal fees are not excepted from a debtor's discharge under 11 U.S.C. § 523. When were the bifurcated fee agreements executed? On the same day? On the day the petition was filed?

The Code requires a chapter 7 debtor's attorney to disclose compensation "paid or agreed to be paid . . . for services rendered or to be rendered in contemplation of or in connection with" a bankruptcy case. 11 U.S.C. § 329(a). In turn, Fed. R. Bankr. P. 2016(b) requires that an attorney file a disclosure statement within 14 days of the order for relief. The Code also requires a bankruptcy court to consider whether fees are reasonable. 11 U.S.C. § 329(b).

The analysis of whether a bifurcated fee arrangement can pass muster is therefore guided by this overall requirement of reasonableness. Is it "reasonable" for a lawyer to enter into an agreement to meet with a debtor to assess their situation, and then file a petition and a few related items, for "no money down," and then enter into a second agreement for a flat fee of \$2,000, paid over time, to do post-petition work? Courts have not reached a uniform conclusion on this.

The questions raised about reasonableness are varied. Are debtors presented with options other than a bifurcated fee arrangement? If not, then did the debtor have a reasonable set of options to choose from? If a bifurcated fee arrangement is offered, is the debtor provided with both the prepetition and the post-petition contract for review at the same time so they understand what is accomplished under each contract? If the lawyer charges more for a bifurcated chapter 7 fee arrangement than for an up-front chapter 7 fee arrangement, is the reason for doing so reasonable? Finally, what does the written disclosure filed with the court say? Is it clear what the arrangements are between the debtor and attorney so that the court can evaluate the reasonableness of the fees being charged in accordance with § 329(b)?

Attorneys representing debtors are considered "debt relief agencies" under the Code. 11 U.S.C. § 101(12A). Therefore, a chapter 7 debtor's attorney must satisfy the requirements of 11 U.S.C. § 528(a) regarding written contracts that "clearly and conspicuously" identify the scope of services to be provided and the fees charged for those services. In addition, as a "debt relief agency," the chapter 7 debtor's attorney also must comply with 11 U.S.C. § 526(a)(4), which prohibits advising a debtor to incur more debt in contemplation of bankruptcy, including debt to that attorney. So, what do the bifurcated fee agreements say? Are they accompanied by additional disclosures? How are these contracts presented to the debtor for consideration? How does the attorney confirm that the debtor understands the arrangement and the significance of executing a post-petition contract?

Debtors must pay their bankruptcy filing fee, including any installment payments, before their counsel can be paid under Fed. R. Bankr. P. 1006(b)(3), and so any bifurcated fee agreement must take this into account.

Next, courts consider the rules of professional conduct that apply in their jurisdiction and pertinent opinions that interpret those rules from the licensing authority and other courts. The applicable ethical rules courts will typically consult will include:

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

ABA Model Rule 1.2(a) and (c): “... 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” and “A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.”

ABA Model Rule 1.3: “A lawyer shall act with reasonable diligence and promptness in representing a client.”

ABA Model Rule 1.4(b): “A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.”

ABA Model Rule 1.5(a) and (b): “A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses” and “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”

Although many jurisdictions have adopted the ABA Model Rules or have substantially similar rules in place, attorneys must consult their jurisdiction’s ethics rules and pertinent opinions to evaluate the legal landscape they face when considering a bifurcated fee arrangement. For example, some jurisdictions prohibit an attorney from entering into a “factoring” relationship with a third party, whereby the attorney will sell or assign a debtor’s post-petition debt to a third party in exchange for a discounted lump-sum payment.

Finally, courts will consider the impact their local rules have on the analysis. In *Carr*, I determined that the local rules in the Eastern District of Kentucky applied insofar as they prohibited a bankruptcy attorney from withdrawing from a representation absent the court’s approval. *In re Carr*, 613 B.R. 427, at 438. In Utah, although a local rule requires that an attorney represent a debtor in all aspects of the case, including adversary proceedings, Judge Anderson found that this rule is not violated under a bifurcated fee arrangement whereby the debtor’s attorney is committed to provide all appropriate post-petition services pursuant to a post-petition agreement. *In re Hazlett*, 2019 Bankr. LEXIS 1166, at *19. In the District of South Carolina, a specific local rule “imposes a continuing duty on a debtor’s attorney to represent a debtor throughout a bankruptcy case (with the exception of adversary proceedings and appeals).” *In re Prophet*, 2021 Bankr. LEXIS 820, at *31. In the Southern District of Florida, one of the court’s local rules “states that an attorney who makes an appearance in a case on behalf of a debtor is required, at a minimum, to assist the debtor with respect to all of his or her obligations under 11 U.S.C. § 521,” which includes both prepetition and post-petition requirements, and “requires counsel of record to perform all section 521 responsibilities unless and until the Court

permits the attorney to withdraw.” *In re Brown*, 2021 Bankr. LEXIS 1598, at *29–30. And, in the Eastern District of California, a local rule offers a “transparent procedure for an attorney and an individual debtor agreeing to a bifurcated Chapter 7 fee agreement” that includes express requirements, disclosure obligations, and other guidelines. E.D. Cal. LBR 2016-3.

Conclusion:

As the varying opinions handed down by courts across the country have made clear, there is a large “gray area” associated with bifurcated fee agreements. Much of the analysis depends on the debtor’s circumstances and the nature and extent of an attorney’s disclosures. While it would be preferable for Congress to consider legislative solutions to this problem, several enterprising attorneys have managed to thread the needle in fashioning bifurcated fee agreements that pass muster in their jurisdictions.