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Attorney Fee Bifurcation

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BIFURCATED CHAPTER 7 ATTORNEY FEE ARRANGEMENTS AND FACTORING OF ATTORNEY FEES: THE POTENTIAL PROBLEMS, PITFALLS, AND ALTERNATIVES[1]

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All debtors' attorneys likely share the experience of meeting someone new in a social setting, explaining the work they do, then immediately hearing the question, "If someone is broke, how do they pay you?" Without question, the bankruptcy code provides no easy roadmap for consumer attorneys to be compensated by their chapter 7 debtor clients who often do not have ready access to savings or other available funds to pay in advance for the legal work they need.[2] One of the most significant challenges facing potential clients seeking debt relief through chapter 7 bankruptcy is how to afford to pay for their legal representation. This is not a new challenge. The problem for both the clients and the consumer bar is that courts have rightly concluded that any obligation owed to debtors' counsel under a prepetition chapter 7 fee agreement is not only stayed upon the filing of the bankruptcy but is also fully dischargeable.[3]

[1] These materials are adapted from an article by H. David Cox as published in the ABI Journal, June 2021.
[2] As one court has observed, a prepetition attorney fee agreement requiring the debtor to make post-petition installment payments "runs afoul of the general rule that prepetition debts are dischargeable." *In re Abdel-Hak*, 2012 Bankr. LEXIS 5393 (Bankr. E.D. Mich. 2012).
[3] *See*, *Rittenhouse v. Eisen*, 404 F.3d 395 (6th Cir. 2005); *In re Fickling*, 361 F.3d 172 (2nd Cir. 2004); *Bethea v. Robert J. Adams & Assocs*., 352 F.3d 1125 (7th Cir. 2003).

The Challenge of Getting Paid as Debtors' Counsel

The ABI Consumer Commission recognized the conundrum that consumer lawyers face when offering their services to potential chapter 7 debtors. The Commission's Report identified four possible ways to be compensated, each with its own flaws and drawbacks.[4] In the most common and traditional method, lawyers simply delay the filing in order to collect the required fees for the representation prior to filing the case. While such a method assures compliance with the Code and ethical rules, the burden on the client is high as he or she must scrape together funds at a time when they are seeking relief from debt. A small subset of lawyers is willing to gamble more with their fees and file a case without full payment with the hope that the debtor will voluntarily pay the fees from non-estate assets thereafter. This might aptly be called the "file and pray" option. Still other lawyers look to chapter 13 as a means for getting the debtor the relief needed with little paid up front, but such a practice raises questions about the suitability and overall cost of bankruptcy for the client.

These materials focus on the final option referenced in the Commission's Report, the bifurcation of the chapter 7 legal services into prepetition and post-petition contracts for services. Few disagree that consumer debtors' counsel should be paid appropriately for their good work; however, it is the opinion of the authors that bifurcation schemes are not the answer, particularly when they involve the factoring or financing of attorney's fees with third party vendors. The Consumer Commission recognized the problems inherent in such arrangements and "expressly disapprove[d] of attorney fee factoring agreements between debtors' attorneys and third-party collectors."[5] As this article further explains, the manner in which bifurcated cases have developed in practice not only exposes debtors' counsel to undue risk, it also becomes yet another tax on those in the most financial need.[6]

The Bifurcation Model

In recent years, a small but growing number of attorneys have utilized an approach to attract clients that permits them to offer low or no-money-down chapter 7 representation by dividing the legal services necessary for the entire case into two primary bundles: one for services that are rendered prepetition and the second for services that are rendered post-petition. Separating the work required for a bankruptcy into two parts like this is often referred to as "bifurcation," particularly if the client is provided the option to be represented for the full case, albeit in two parts.[7] At its core, the purpose of the bifurcation is to turn the attorney fee

[4] ABI Commission on Consumer Bankruptcy, 2017-2019 Final Report and Recommendations, at pp. 89-92, available at https://consumercommission.abi.org/commission-report.
[5] Final Report of the ABI Commission on Consumer Bankruptcy § 3.01 at p. 91 (American Bankruptcy Institute 2017-2019 Report and Recommendations).
[6] Washington Post reporter, DeNeen L. Brown, opines that "[y]ou have to be rich to be poor…. Put it another way: The poorer you are, the more things cost." Ms. Brown's article explores the high cost of services for those in financial need. For example, "[p]ayday advance companies say they are providing an essential service to people who most need them. Their critics say they are preying on people who are the most 'economically vulnerable.'" The High Cost of Poverty: Why the Poor Pay More (washingtonpost.com) www.washingtonpost.com/wp-dyn/content/article/2009/05/17/AR2009051702053.html?sid=ST2009051801162. Monday, May 18, 2009.
[7] *In re Hazlett*, No. 16-30360, 2019 Bankr. LEXIS 1166, *17 (Bankr. D. Utah Apr. 10, 2019).

obligation into a post-petition, nondischargeable debt that can be collected from the client after the bankruptcy is filed.

Financing or Factoring Attorney Fees

Related to bifurcation is the emerging practice of some debtors' attorneys to contract with factoring companies or finance companies in order to assure some amount of up-front compensation to the attorney even when he or she offers low or no-money-down chapter 7 bankruptcies. In factoring situations, the debtor's attorney sells to a factor the post-petition accounts receivable for the bifurcated services contracted under the post-petition attorney fee agreement. The factor then collects directly from the debtor these post-petition fees without fear of violating the automatic stay or discharge injunction. Financing agreements work similarly, with the lender typically extending credit to the debtor's attorney secured by the receivables from the post-petition fee agreement and then providing the collections for those post-petition fees. The use of factoring companies and financing agreements like these, however, adds significant costs to the representation that are typically borne by the debtors in the form of higher attorney's fees and have come under scrutiny by certain courts and the Office of the U. S. Trustee, with complaints filed in various enforcement actions.[8]

Bifurcation is Based on a Flawed Premise

To be financially attractive as a low or no-money-down option, the bifurcated practice model relies on the premise that debtors' counsel may properly structure the case in such a way that the attorney completes the overwhelming majority of legal work required in the case *after* the filing of the petition. If true, then the attorney is able to maximize the fees for that work that may be collected as a post-petition obligation, undeterred by the automatic stay or the discharge injunction. Under such a scenario, a skeletal petition would be filed for little or no fees up-front from the debtor in order to initiate the case, and then the debtor would be offered the opportunity to contract post-petition for the remaining services of the attorney needed to complete the case.

The problem, however, is not in the theory of the business model but in its application. In practice, attorneys using bifurcated fee agreements may claim that the bulk of their work on a chapter 7 occurs *post-petition* but these attorneys have, in fact, inverted the distribution of work needed to represent properly chapter 7 debtors. The overwhelming majority of work needed to advise and represent a chapter 7 client competently is done *before* the case is filed, not after. By filing a case without having completed a thorough and reasonable investigation of the facts and circumstances of the client, counsel may unwittingly set in motion events out of the control of the debtor, with potential dire consequences and no path to exit other than pleading "cause"

[8] *See*, *e.g.*, Adversary Proceeding No. 17-01271, filed in the case of *In re Gilmore*, in the U.S. Bankruptcy Court for the Central District of California which resulted in a stipulated final judgment entered 8/16/19 providing for disgorgement, sanctions and injunctive relief. The enforcement action in *In re Neufville*, Case No. 17-24812, from the District of Maryland also resulted in a consent order entered 4/12/19 with certain sanctions against the debtor's counsel. A more recent and still pending case example may be found in the Western District of Washington in the Adversary Proceeding, *United States Trustee v. McAvity*, Case No. 20-00400.

under 11 U.S.C. § 707(a).[9] Following this method is akin to buckling your client into a dangerous rollercoaster at its highest point with the tracks beneath him or her yet unfinished.

The Court in *In re Wright* recognized this fallacy in the bifurcation model.[10] In that case, counsel sought to bifurcate the legal services into prepetition and post-petition work, with the debtor's counsel also factoring the fees due under the second contract. Under the attorney's arrangement with the factoring company, the attorney would be paid 60% of the post-petition fee upon execution of the contract, with an additional 15% of those fees paid if the accounts were sufficiently paid by the debtors.

In reviewing counsel's fees upon the motion of the U.S. Trustee, the Court questioned the designation of services allegedly provided post-petition, finding that if the bulk of the work were truly completed post-petition, counsel would not be adequately analyzing the case.[11] The Court found that the actual time spent for prepetition services was not consistent with the fee charged to pre- versus post-petition services. The effect was to turn an otherwise dischargeable prepetition claim into a nondischargeable claim and that "such a scheme works a fraud on both the debtor and the Court."[12]

The Court also found that the attorney failed to disclose that he shared fees with any third party and that he conflated the total amount the debtor agreed to pay for his services with the amount that the attorney agreed to accept from the factoring company. The Court was troubled by the higher fees in the bifurcated cases, concluding that "BAPCA presents serious impediments to the legality of this kind of bifurcated services scheme…." Notwithstanding these stated concerns about the factoring and bifurcation arrangement, the Court limited its ruling to matters under § 329 and ordered the disgorgement of fees based on improper disclosures.

The apparent misrepresentation of counsel's work as being completed post-petition was also evident in another action to review attorney's fees initiated by the U.S. Trustee in a case filed in the Bankruptcy Court for the Eastern District of Missouri. In that case, *In re Allen*, the U.S. Trustee alleged that the debtor's attorney bifurcated his services and financed his attorney's fees with a third-party lender.[13] The petition and matrix were filed for $0.00 down, with a second fee agreement entered post-petition for $2,000.00 and to be paid $167.00 per month for 12 months.[14] The receivables under that second agreement were then pledged to the financing company in exchange for an advance of 75% of the value of the post-petition agreement.

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[9] In fairness to the debtor, would the "cause" be an admission that the debtor's counsel failed to complete the due diligence necessary to advise properly on whether the case should have been filed in the first place?
[10] *In re Wright*, 591 B.R. 68 (N.D. Ok., Sept. 4, 2018).
[11] *Id*., at 94.
[12] *Id*. Notwithstanding these concerns raised about the bifurcation arrangement and the factoring of fees, the Court limited its ruling to matters under § 329 and ordered the disgorgement of fees based on improper disclosures. *Id*., at 99.
[13] *See*, Docket No. 15, *United States Trustee's Motion for Examination of the Fees of Debtor's Attorney,* filed October 9, 2020, in the U.S. Bankruptcy Court for the Eastern District of Missouri case of *In re Allen*, Case No. 20-42663.
[14] *Id.*

Among the problems identified by the U.S. Trustee was the glaring and somewhat inconvenient truth that a mere 49 minutes after the initial petition was filed, the debtor's counsel filed the full balance of the debtor's schedules, statement of financial affairs, statement of intention, Official Form B22A, and Disclosure of Compensation of Attorney for Debtor.[15] As counsel for the U.S. Trustee noted in her brief to the Court, it is "nearly inconceivable" that counsel would be able to prepare all the schedules and statements for the case and then review them, along with a second fee agreement, with the client for signature and filing, as appropriate, with the court.[16]

The timing of events and accuracy of disclosures matter in bankruptcy and raise significant ethical concerns. If an attorney were to attempt to treat a case as bifurcated and have the client sign a post-petition fee agreement that purports to charge for work that was, in fact, completed prepetition, the attorney would not only be a party to an improper agreement requiring the payment a discharged debt but would also be violating the automatic stay and misrepresenting facts to the court. Ultimately, the Court in the *Allen* case did not directly address these issues but entered instead a limited, summary order reducing the attorney's fees based on the value of the work actually performed in the case without delving into the accuracy or merits of the bifurcation and financing arrangement.[17]

The appeal of the *Allen* case was heard by the Eighth Circuit BAP and affirmed.[18] In its decision, the BAP limited its review to the issue of whether the bankruptcy court abused its discretion in finding the attorney's fees were excessive under the bifurcated arrangement and ultimately the BAP agreed that the bankruptcy court acted well within its authority.[19] While the BAP specifically declined to express an opinion on the validity of bifurcation agreements or the unbundling of services, it took note of the fact that the attorney provided the same services to clients regardless of whether they bifurcated their fees or paid in full, yet the fees charged were different.[20] The BAP affirmed the decision reducing attorney's fees that was based, in part, on the bankruptcy court's findings that the additional fees charged to the bifurcated clients were unreasonable.

Thereafter, on November 8, 2011, citing the *Allen* BAP opinion, the Bankruptcy Court for the District of Minnesota issued an *en banc* order requiring debtors' counsel practicing in its district to file a motion to review and seek approval of attorneys' fees in cases where any fees are unpaid or otherwise come due after the date of filing.[21] Failure to comply will result in a show cause being issued against the offending attorney.

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[15] *Id*.
[16] *Id*.
[17] *See*, Docket No. 25, *Order Granting United State Trustee's Motion Concerning Attorney's Fees,* entered November 23, 2020, in the U.S. Bankruptcy Court for the Eastern District of Missouri case of *In re Allen*, Case No. 20-42663.
[18] *In re: Allen*, 628 B.R. 641 (B.A.P. 8th Cir. 2021).
[19] *Id*., at 644.
[20] *Id*.
[21] *In re: Post-Petition Attorney's Fee Arrangements in Chapter 7 Case*, Case 21-00401, (Bankr. D. Mn., *en banc*, 11/08/21).

Higher Fees

Factoring and financing scenarios also typically result in the debtor paying a significantly higher amount in attorney's fees simply because the debtor is unable to pay the fees in full prior to filing the case. Increasing attorney's fees to compensate for the factoring or financing of fees runs afoul of the reasonableness of fees requirements of 11 USC § 329(b). The fact that the attorney is willing to accept an amount that is discounted from what he or she would otherwise be asking the debtor to pay due to factoring or financing arrangements supports the notion that the fees that the debtor is being charged are inflated. As at least one state bar ethics committee acknowledged the issue by asking, "[i]f the lawyer is willing to do the work with a thirty percent discount, we question (but do not resolve) whether the total fee is reasonable."[22]

As an example, the Court in *In re Milner*,[23] cancelled the debtor's counsel's post-petition fee agreement that required $2,700.00 in total payments on the basis that the fees charged were unreasonable.[24] In that case, the Court found that counsel offered debtors the option of paying $1,500.00 prior to the filing of the case if fees were paid up-front.[25] Counsel also offered a bifurcated fee agreement option whereby the debtors would pay just $300.00 down to get the case filed and then complete 12 payments of $200.00 per month post-petition. The debtor in the *In re Milner* case proceeded with the bifurcated fee option, notwithstanding the additional 80% cost over the up-front payment option of $1500.00 that the attorney offered to many of his clients.[26]

The bifurcated services in *In re Milner* also involved a financing arrangement.[27] The attorney, in order to facilitate the payment and collection of the debtor's post-petition payments, entered into a line of credit agreement with a third-party lender. Under the line of credit terms for that attorney's cases, the lender would advance to the attorney 60% of the $2,400.00 that the debtor would be paying post-petition and then the lender would proceed to collect the full cost of the bankruptcy from the debtor according to the set payment terms. If the debtor made all required payments, the attorney would receive another 15% that had been held back.[28] Under the financing agreement, the lender would retain $600.00 of the $2,400.00 paid by the debtor. In the event payments were not made by the debtor, the attorney remained liable for the total credit extended.[29]

Although the *Milner* Court found that bifurcated contracts are not prohibited under the Bankruptcy Code and that each case must be analyzed for appropriateness, the Court concluded that the debtor's attorney did not provide adequate disclosure of his fees and services as required under 11 U.S.C. §§ 526-528 and voided the prepetition and post-petition contracts.[30] The Court

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[22] Utah State Bar Ethics Committee Advisory Opinion No. 17-06 (Revised), at ¶ 19, August 16, 2018.
[23] 612 B.R. 415 (Bankr. W.D.Ok. 2019) (currently on appeal). At the time of the submission of this article, no decision on the appeal at the District Court has been issued.
[24] *Wright* at 443.
[25] *Id.,* at 421.
[26] *Id*., at 438.
[27] *Id*., at 422.
[28] *Id*.
[29] *Id*.
[30] *Id*., at 443.

explained that the compensation terms of the disclosure statement were difficult to understand, the disclosure of matters covered by both contracts was unclear, the disclaimer of representation was both confusing and inappropriate, and the fee options were also confusing.[31]

The court's concerns in *Milner* highlight many of concerns with bifurcated fee agreements in general. If a court is confused by the terms of a representation agreement, it is virtually certain that a consumer debtor will also be confused and uncertain as to the terms of representation. Does the debtor understand that the very person the debtor is trusting to help them eliminate all their debt could very well be the same person that is attempting to collect debt from the debtor post-petition? Does the debtor understand that in a factoring situation the attorney has agreed assign the right to collect the post-petition portion of the attorney fee to a non-attorney third-party that is unknown to the debtor, a third-party that is not governed by the same set of ethics guidelines that govern attorneys, a third-party that appears to simply play the role of collection agent?

Reasonable, Disclosed And Informed

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

The ABA's Model Rules of Professional Conduct 1.2(c) provides that "[a] lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent." Rule 1.0(e) then defines "informed consent," explaining that it "denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." Courts carefully consider the requirement of informed consent in the context of bifurcated fee arrangements, specifically questioning whether the debtor comprehends the risks associated with the withdrawal of the attorney should the post-petition payments not be completed.[32] It would be no easy task to explain to any layperson the risks of representing oneself at a meeting of creditors and the need to complete all tasks necessary for a discharge. Debtors should be advised of any options other than entering into a second fee agreement, including proceeding *pro se* or hiring another lawyer to complete his or her case.[33] Boilerplate agreements with legal disclosures may not be sufficient to meet the high burden of informed consent in these situations.

The U.S. Trustee initiated an enforcement action in a case in Maryland over the attorney's use of bifurcation along with the factoring of attorney's fees. The Trustee's allegations and the debtor's attorney in the *In re Neufville* matter included concerns related to the debtor's counsel's use of retainer documents, consent forms, and recurring payment forms

[31] *Id*., at 442.
[32] See e.g., *In re Grimmett*, 2017 Bankr. LEXIS 1492 (D. Idaho 2017) (affm'd on appeal).
[33] *See*, *Walton II*, at 386.

provided by the third-party factory company.[34] The U.S. Trustee alleged that the use of those forms of a third party by the debtor's attorney that had a financial arrangement with that third party impacted the attorney's independent professional judgment and created a conflict of interest.[35]

Local Rules Can Make Bifurcation Problematic

In a recent South Carolina case, a local attorney representing potential chapter 7 debtors offered the option to several clients to enter into bifurcated fee agreements.[36] The attorney also financed the attorney's fees with a third-party lender who would assist with the collection of accounts receivable. The U.S. Trustee filed motions in three such cases, challenging the use of bifurcated fee arrangements under §§ 329(a), 526, and 528, and the Court's local rules. The U.S. Trustee requested the Court order the attorney to return to the debtors all funds he received under the post-petition fee agreements.

The Court ordered return of all fees paid post-petition in the three cases and held that bifurcated agreements violated a Local Rule providing that, with the exception of 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."[37]

Cautious Approval of Some Bifurcation Arrangements

Notwithstanding these concerns, some bifurcation agreements have been approved by courts.[38] Judge Kevin Anderson's opinion in *In re Hazlett* has developed into one of the most influential and often cited analysis of bifurcated fee agreements and concludes that such arrangements are not per se prohibited.[39] The opinion, however, sets forth a strict test to consider when analyzing bifurcation cases that has proven influential to other courts in subsequent cases.[40] In addition, the opinion acknowledges the inherent problems with certain factoring mechanisms and discourages factoring generally unless the arrangement meets strict ethical requirements.[41]

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[34] Ultimately the *In re Neufville* matter was resolved by the entry of a consent order entered 4/12/19 cancelling the fee agreements between the debtor and the debtor's attorney and providing for the disgorgement of certain fees. *In re Neufville*, Case No. 17-24812, Docket Entry No. 104, April 12, 2019, U.S. Bankruptcy Court for the District of Maryland.

[35] The Trustee's pleading cited the Maryland Rules of Professional Conduct that correspond to the ABA Model Rules of Professional Conduct, including Rule 5.4(c) on maintaining the lawyer's professional independence, Rule 1.8(f) on receiving compensation from third parties, and Rule 1.7(a) on conflicts of interest.

[36] *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. Mar. 29, 2021) (appeal pending).

[37] *See*, SC LBR 9011-1(b).

[38] *See, e.g.*, *Hazlett* at *22; *Walton v. Clark & Washington, P.C.*, 469 B.R. 383 (Bankr. M.D. Fla. 2012); *In re Slabbinck*, 482 B.R. 576 (Bankr. E.D. Mich. 2012).

[39] *Hazlett* at *22.

[40] *Id*.

[41] Specifically, *In re Hazlett* references the Utah State Bar Ethics Committee Advisory Opinion No. 17-06 (Revised), August 16, 2018.

In *Hazlett*, the debtor's attorney offered the debtor three payment options: (1) pay the attorney $2,400.00 prepetition which included the attorney's fees and court filing fee; (2) pay the attorney $500 prepetition for the preparation and filing of the bankruptcy petition, statement of social security number, and application to pay the court filing fees in installments and then (a) proceed *pro se*, (b) hire another attorney to complete the case, or (c) enter into a post-petition fee agreement with the attorney to complete the bankruptcy case; and (3) pay nothing prepetition and enter into a prepetition retainer agreement for the preparation and filing of the initial bankruptcy papers for $0 down, with the option to either proceed *pro se*, hire another attorney, or enter into a post-petition fee agreement of $2,400 (which included fees and costs) in 10 equal monthly payments for the prosecution of the case through the entry of a discharge. The debtor selected the third option.

The *Hazlett* Court concluded that there are four essential requirements that must be satisfied when using bifurcated fee agreements: (1) the use of two contracts must be in the best interests of the client (*e.g*., the client could not otherwise afford to hire bankruptcy counsel); (2) the attorney must provide appropriate disclosures, options, and explanations; (3) the client must give his or her informed consent in writing; and (4) the attorney's fee and costs must be reasonable and necessary.[42] Applying this analytical framework to the facts of the case, the Court found that the attorney had met each of these requirements and did not strike down the bifurcated fee arrangement.[43]

Attorney fee financing lenders and other advocates may be quick to point to *Hazlett* as "approval" of their bifurcated arrangements with debtors' counsel. Such summary conclusion, however, oversimplifies the holding in the case. As noted by Northern District of Oklahoma Bankruptcy Judge Terrence Michael in his article reviewing the various methods chapter 7 attorneys are paid, *Hazlett* offers a very narrow opportunity or "window" for debtors' counsel to attempt to "squeeze through in order to provide legal services to debtors and be paid after the case is filed."[44] The *Hazlett* test may or may not be embraced by all courts, but where it is, the prongs of the test set a very high bar.

Hazlett is not alone in recent opinions approving bifurcated fee arrangements. In *In re Carr*, the Eastern District of Kentucky Bankruptcy Court analyzed the practices of a consumer practice that filed a number of chapter 7 cases receiving $300 from the debtors prepetition and then were paid $1,185 post-petition.[45] After the Court determined that debtor did not schedule any debt owed to the attorneys, the Court required the attorneys to file their written engagement agreement and related documents.

The Court made the following findings of fact. Under a single contract option, a Chapter 7 debtor could pay the attorneys $800.00 plus filing fees. Under a two-contract option, the debtor could pay the attorneys $300 prepetition for prepetition services rendered and $850.00 for

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[42] *Hazlett* at *22-23.
[43] *Hazlett*, though, is not alone in recent opinions approving bifurcated fee arrangements. *See, e.g., In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020). The *Carr* Court, however, did admonish the attorney to be clearer in his fee disclosure that the debtor was proceeding under dual fee agreements.
[44] Terrence L. Michael, *There's A Storm A Brewin': The Ethics and Realities of Paying Debtors' Counsel in Consumer Chapter 7 Bankruptcy Cases and the Need for Reform*, 94 AM. BANKR. L.J. 387, 400 (Fall, 2020).
[45] *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020).

post-petition services (plus $335.00 for the filing fee) to paid post-petition in 12 equal monthly payments of $98.75. The debtor had the option of continuing *pro se* or hiring another attorney for post-petition services. The Court noted that the payment scheme included a relatively modest internal interest rate of 7.55%, the attorney collected the payments from the debtor's bank account with consent, and no factoring agreements were involved.

Ultimately, the Court concluded that the attorneys' representation of debtors under dual contracts satisfied the requirements in the Code, the Bankruptcy Rules, and applicable ethical rules. The Court did offer one admonition, though. The attorneys should have been more clear in their fee disclosure regarding the fact that they were proceeding under a dual contract scheme of representation.

In re Brown, Judge Isicoff, also found that bifurcated fee arrangement that did not involve factoring may be permissible, but specifically stated in dicta that the Court would "not allow any attorney to factor its legal fees." [46] In determining whether a fee arrangement is permissible the Court looked at whether the arrangement was reasonable and whether counsel provided adequate disclosure of any limitation on the scope of representation as to the pre- and post-petition services to be rendered.

More recently, however, the Western District of Kentucky rejected bifurcated fee arrangements where factoring was involved.[47] In *In re Baldwin,* Judge Lloyd reviewed the fee arrangement of a single attorney in 11 cases. In each case, the attorney offered the Debtors a bifurcated fee arrangement, whereby he filed a skeletal Chapter 7 Petition and paid the filing fee. Seven to fourteen days after the skeletal Petition was filed the remaining schedules and statements were filed, including Form 2030, the attorney fee disclosure. In the disclosure, counsel indicated in response to Question 1, that the Debtor had agreed to pay $0.00 for legal services, that counsel had prior to the filing of the statement received $0.00, and that the balance due was $0.00.[48] In response to Question 4, counsel stated, "I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm." The disclosure went on to refer to the bifurcated fee agreement and explain the fee structure including counsel's line a credit from a third-party lender that was secured by the attorney fees due in connection with the cases. In each case, counsel was paid $0.00 in connection with the preparation and filing of the petition and he was to be paid $2,500.00 for work done after the petition was filed, including representation at the first meeting of creditors. The Debtors were allowed to pay the post-petition fees and costs in installments for up to 12 months.

The opinion contains an extensive overview of the fee agreement, filing process, and factoring arrangement, whereby the factoring company advanced 60% of the $2,500.00 attorney fee to the attorney soon after the second fee agreement was entered into, obtained a lien on the

[46] *In re Brown*, 2021 WL 2460973 at *27.
[47] *In re Baldwin,* 2021 Bankr. LEXIS 2753 (Bankr. W.D. Ky. Oct. 5, 2021).
[48] In ten of the eleven cases at issue in *Baldwin*, the attorney advanced the filing fee and then collected the advanced fee amount post-petition through the monthly installments. The Court specifically found that advancement of the filing fee by an attorney, with the expectation of repayment post-petition, violates 11 U.S.C. §526(a)(4). The court further found that advising a client to incur debt in order to pay for bankruptcy related legal services violates 11 U.S.C. § 362 and upon discharge violates 11 U.S.C. § 524. *25.

account receivable along with the right to collect, and ultimately retained 25% of the attorney fees as compensation for its services. The court found that the "essential problem presented [by the factoring arrangement] is that [counsel] is using the post-petition contract to get the debtor/client to pay fees they could not pay quite literally the moment before the petition is filed, adding a complex nondischargeable contract and exorbitant expenses to a debtor/client instead of the promised 'fresh start.'"[49]

The court ultimately found that the bifurcated fee contracts and arrangements at issue lacked adequate disclosure to the debtors and the court and that the fees were not reasonable. It concluded "after exhaustive analysis…that the fee arrangements offered by [counsel] and accepted by his clients…violate the United States Bankruptcy Code, the Federal Rules of Bankruptcy Procedure and the Kentucky Rules of Professional Conduct." In reaching his conclusion, Judge Lloyd consulted with all of the Judges in the Western District of Kentucky, each agreed with the Judge Lloyd's conclusions and the opinion specifically states that "the legal conclusions set forth in this Memorandum-Opinion represent the legal conclusions of all Judges of the Bankruptcy Court for the Western District of Kentucky."[50]

Alternatives

All courts addressing the issue of bifurcation and factoring have recognized the inherent dilemma facing debtors and debtors' counsel: how to be paid appropriately under the Code. However, short of Congress acting, solutions are few and most present their own risks.

The least fraught, and perhaps most obvious alternative involves the debtor recruiting help from family or friends to pay the legal fees prior to filing. Care must be taken to identify whether the advance by others is a loan or a gift. If it is a loan, it must be scheduled as such. The risk of non-payment is thereby shifted to those near and dear to the debtor. If it is a gift, it should be disclosed on the Statement of Affairs and the Rule 2016 disclosure.

"File and pray" encapsulates the practice of accepting partial payment of the fee before filing with the debtor's promise to pay the balance voluntarily after filing. The Code is explicit that nothing prevents the debtor from voluntarily repaying a debt for the balance of her attorney's fees following entry of the discharge. §524(f). The utility of this approach is utterly dependent on the client's ability and willingness to make payment post-filing. Any obligation to pay the balance of the fees is discharged and thus collection options in the case of nonpayment are limited and the attorney must be explicit in communication with the client that the client has no legal obligation to pay. This author's experience with "file and pray" over decades of practice is 100% negative.

A low payment Chapter 13 utilizes the statutory provisions for payment of attorneys in 13 to get the debtor relief from his debts despite the lack of prepetition cash. Courts have divided over whether a Chapter 13 that functionally pays no creditor other than the debtor's lawyer is proposed in good faith. In *Crager*[51], the 5th Circuit affirmed confirmation of a fee-only Chapter

[49] *Id.* at *18.
[50] *Id*., at * 4.
[51] 691 F.3d 671(5th Cir. 2012).

13 and cited the trial court for the proposition that, given the debtor's age and health, it would "border on malpractice" to suggest selecting Chapter 7. On similar facts, the 11th Circuit opined in *Brown* [52]that an elderly debtor merely had to stop paying creditors for seven months or so, and he'd be able to pay for a Chapter 7.

Since the issue of how the profoundly cash-strapped individual is to exercise his rights to seek bankruptcy relief is well-known to the bench, this author wonders if the provisions of 524 could be utilized to seek approval of the court for debtor's reaffirmation of a bifurcated fee arrangement. The most obvious issue is the conflict presented by the attorney's role as debtor's advocate while being the very creditor whose interest is being carved out of the discharge. Query whether the need for disclosure associated with prepetition bifurcation agreements is meaningfully different from the disclosures required by Section 524.

Whatever counsel's approach to the payment conundrum, compliance with FRBP 2016(b) remains essential. The Rule implements Bankruptcy Code S. 329(a) requires disclosure of compensation paid or agreed to be paid in connection with the bankruptcy case and the source of that compensation. Failure to timely comply with the required disclosures can result in reduction in allowed fees or disgorgement of those fees.

Conclusion

Although this paper argues that bifurcation arrangements are not the answer to the compensation conundrum that debtors and their attorneys face, the law continues to develop. Before treading into the waters of bifurcating fees, debtors counsel should be sure to carefully study the opinions across the country addressing this area of the law to understand the risks. The inquiry should not stop there as bifurcation arrangements have been attacked under state ethical rules and local rules as well. Of course, attorneys should also carefully consider the local practices and decisions relevant to their own districts and review the enforcement actions of the Assistant U.S. Trustees in their area.

The tension created by the requirement of the prepayment of chapter 7 attorney's fee in the face of the overwhelming need for relief of individuals burdened with collections has resulted in attorneys employing several different approaches to being paid for their work. At the end of the day, consumer attorneys simply want to be compensated in a fair manner without risk to their licenses or livelihood, and it is likely from this simple desire that all of the creative arrangements for the payment of fees have sprung. In fairness to those practitioners that have tried new approaches, Congress did not design the Bankruptcy Code with a clear and easy mechanism for a chapter 7 attorneys to be paid. Until that changes, though, debtors' attorneys should be mindful of the risks of deviating from the prepayment of their fees.

[52] 742 F.3d 1309 (11th Cir. 2014).

Faculty

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