U.S. Department of Justice

Executive Office for United States Trustees

Office of the Director *Washington, DC 20530*

June 10, 2022

MEMORANDUM

TO: United States Trustees

FROM: Ramona D. Elliott
Acting Director

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

I. Introduction

In our role as the "watchdog" of the bankruptcy process, one of the USTP's core responsibilities is to protect and preserve the integrity of the bankruptcy system. In doing so we seek to promote fair access to the bankruptcy system while ensuring that no participant is treated improperly. Enhancing access to justice not only includes removing barriers to entry but also ensuring that all debtors who seek bankruptcy protection in good faith and comply with the Bankruptcy Code's requirements receive the relief the law affords them. This includes ensuring that debtors are properly and adequately represented by their attorneys, who in turn are negotiating the terms of their fee arrangements and representation in good faith.

The Bankruptcy Code's[1] statutory framework generally prohibits postpetition payment of attorney's fees arising from prepetition retention agreements in chapter 7 cases. The Supreme Court held in *Lamie v. United States Trustee*[2] that chapter 7 debtors' attorney's fees may not be paid out of the bankruptcy estate, and almost all courts that have considered the issue have held that attorney's fees owing under a prepetition retainer agreement are a dischargeable debt.[3] As a

[1] 11 U.S.C. §§ 101 *et seq.*
[2] 540 U.S. 526, 537 (2004). The Court's reasoning was that 11 U.S.C. § 330(a) only authorizes compensation to professionals employed under § 327, which does not include the debtor's attorney in a chapter 7 case unless employed by the trustee under § 327(e).
[3] *See, e.g., Rittenhouse v. Eisen*, 404 F.3d 395, 397 (6th Cir. 2005).

result, the traditional model for representation in chapter 7 cases is payment of the entire attorney's fee for the case[4] in full before the case is filed.

"Bifurcated" fee agreements—which split an attorney's fee between work performed prior to the filing of a bankruptcy petition and work performed postpetition—have become increasingly prevalent in chapter 7 consumer bankruptcy cases.[5] Bifurcated agreements are generally structured so that minimal services—limited to those essential to commencing the case—are performed under a prepetition agreement for a modest (or no) fee, while all other services are performed postpetition, under a separate postpetition retention agreement, arguably rendering those fees nondischargeable.

Courts and stakeholders in the bankruptcy community have expressed differing views on the propriety of bifurcated fee agreements.[6] Some courts have held that bifurcation by its nature violates certain local rules governing the professional responsibilities of counsel owed to their debtor clients.[7] Other courts have held that nothing is inherently improper about bifurcation, provided that certain guardrails are obeyed.[8]

Absent contrary local authority, it is the USTP's position that bifurcated fee agreements are permissible so long as the fees charged under the agreements are fair and reasonable, the agreements are entered into with the debtor's fully informed consent, and the agreements are adequately disclosed. Bifurcated agreements provide an alternative under the current statutory framework to the traditional attorney's fee model, which some have noted present a barrier to accessing the bankruptcy system for debtors who may need relief but are unable to pay in full before filing. The benefits these type of agreements provide—increasing access and relief to those in need—must be balanced against the risk that these fee arrangements, if not properly structured, could harm debtors and deprive them of the fresh start afforded under the Bankruptcy Code.

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[4] Typically, a flat fee for all services essential to the successful completion of the case.

[5] This Memorandum only addresses enforcement guidelines for bifurcated fee arrangements. The exclusion from these guidelines of other alternative fee arrangements—such as the practice of filing chapter 13 cases solely to pay attorney's fees over time—should not be construed as acceptance of the propriety of such arrangements. When any fee arrangement violates the Bankruptcy Code or Rules, the USTP will take enforcement actions as appropriate.

[6] *See, e.g.,* 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 (2020); Adam D. Herring, *Problematic Consumer Debtor Attorney's Fee Arrangements and the Illusion of "Access to Justice"*, ABI JOURNAL, Vol. XXXVII, No. 10, Oct. 2018; Daniel E. Garrison, *Liberating Debtors from "Sweatbox" and Getting Attorneys Paid*, ABI JOURNAL, June 2018, at 16. *See also* Adam D. Herring, "Great Debates" at the ABI Consumer Practice Extravaganza (Nov. 5, 2021).

[7] *See, e.g., In re Baldwin*, No. 20-10009, 2021 WL 4592265 (Bankr. W.D. Ky. Oct. 5, 2021); *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. 2021), *rev'd and remanded* No. 9:21-cv-01082-JMC, 2022 WL 766352 (D.S.C. Mar. 14, 2022).

[8] *See, e.g., In re Kolle*, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021); *In re Brown*, 631 B.R. 77, 101 (Bankr. S.D. Fla. 2021); *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020); *In re Hazlett*, No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019).

The USTP's enforcement approach to bifurcated agreements balances these concerns. The USTP will review bifurcated fee agreements to ensure that they harm neither the debtors who rely on the bankruptcy system to obtain relief nor the integrity of the system. When appropriate, we will bring enforcement actions to address these harms. This document sets forth general guidelines that United States Trustees and their staff should use to assist them in determining whether to take enforcement action with respect to bifurcated fee agreements.

II. Attorney's Fees Under Bifurcated Agreements Must Be Fair and Reasonable

When reviewing attorney fee agreements in consumer cases, our first consideration is to ensure that the agreements serve the best interests of clients, not their professionals. This tension is most evident—and the potential for the greatest harm to debtors exists—in the structuring of fees under bifurcated agreements. The three most common fee-related issues we see in cases involving bifurcated fee agreements relate to the allocation of fees and services, the reasonableness of the fees, and third-party financing.

First, it is important to ensure that there is a proper allocation of prepetition and postpetition fees and services. This issue commonly arises in no- or low-money down cases. It is the USTP's position that fees earned for prepetition services must be either paid prepetition or waived, because the debtor's obligation to pay those fees is dischargeable. This is particularly important to ensure—and to clearly document—that debtors receive appropriate prepetition consultation and legal advice, including with respect to exemptions and chapter selection.[9] Debtors who enter into bifurcated fee agreements should receive the same level of representation as debtors who enter into traditional fee agreements. Bifurcation must not foster cutting corners in properly preparing the case for filing by eliminating tasks that should be performed prepetition or postponing all or some of those services until after the petition is filed to ensure that the attorney can bill for those services postpetition. Additionally, fees for postpetition services must be rationally related to the services actually rendered postpetition,[10] so that a flat postpetition fee is not a disguised method to collect fees for prepetition services. Attorneys also should not advance filing fees and seek their reimbursement postpetition. Advanced filing fees are generally held to be dischargeable prepetition obligations.[11]

Second, attorney's fees charged to debtors in bifurcated cases—as in all cases—must be reasonable.[12] Bifurcated fee agreements should not be viewed as an opportunity to collect higher fees than those collected from clients who pay in full, before filing. 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.

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[9] The Bankruptcy Code requires attorneys to certify, by signing the petition, that they have performed a reasonable investigation into the facts and circumstances of the case and that the attorney, after performing an adequate inquiry, has no knowledge that the information in the schedules is incorrect. 11 U.S.C. §§ 707(b)(4)(C–D).

[10] *See Brown*, 631 B.R. at 93 (citing *Hazlett*, 2019 WL 1567751).

[11] *See, e.g., Matter of Riley*, 923 F.3d 433, 439-40 (5th Cir. 2019); *Brown*, 631 B.R. at 102-03.

[12] 11 U.S.C. § 329(b).

Third, arrangements that employ outside parties to finance bifurcated fee agreements, including (but not limited to) factoring, assignment of the attorney's accounts receivable, and direct lending to clients, warrant significant additional scrutiny. The particulars of arrangements under which a third party finances the debtor's postpetition attorney's fees must be fully disclosed under Bankruptcy Rule 2016(b), including the details of the attorney's relationship with the entity providing the financing. The nature of these arrangements may incentivize overcharging, because the attorney generally receives only a percentage of the total fee charged or otherwise incurs financing costs. It is improper for an attorney using third-party financing to pass along the cost of that financing to their clients. Third-party financing arrangements may also create unwaivable conflicts of interest between the attorney and their clients and may violate applicable state ethical rules.[13]

The USTP should bring enforcement actions where bifurcated fee agreements adversely affect the client's representation, seek recovery of unreasonable fees, improperly allocate fees or services, improperly burden debtors with financing costs, or otherwise result in conflicts of interest.

III. Ensuring Adequate Attorney Disclosure and Fully Informed Debtor Consent to Bifurcated Agreements

In addition to ensuring that bifurcated agreements are fair and reasonable, courts examining and permitting bifurcated agreements have emphasized the importance of adequate disclosure and the client's fully informed consent. One court permitting the use of bifurcated agreements noted that "the propriety of using bifurcated fee agreements in consumer chapter 7 cases is directly proportional to the level of disclosure and information the attorney provides to the client and the existence of documentary evidence that the client made an informed and voluntary election to enter into a postpetition fee agreement."[14] Similarly, professional conduct standards governing fee sharing and limited scope representation[15] reinforce the need for disclosure and informed consent. The requirement of informed consent to bifurcated agreements is derived directly from the Bankruptcy Code's requirements that attorneys representing consumer debtors deal forthrightly and honestly with their clients, that they not make misrepresentations about the services they will provide or the benefits and risks of filing bankruptcy, and that they make certain disclosures and promptly enter into a clear and conspicuous written contract explaining the services the attorney will render and the terms of any fee agreement.[16]

The following disclosure and consent factors can assist your 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

[13] *Brown*, 631 B.R. at 99, n. 34.
[14] *In re Hazlett*, No. 16-30360, 2019 WL 1567751 at *8 (Bankr. D. Utah Apr. 10, 2019).
[15] *See, e.g.,* Model Rules of Prof. Conduct R. 1.2(c), 5.4(a) (AM. BAR ASS'N 1983).
[16] 11 U.S.C. §§ 526–528.

segment of the representation, including that 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 fee between the bifurcated fee agreement and a traditional fee agreement,[17] and the client's options with respect to the postpetition fee agreement.[18]

- 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 disclosure and consent considerations described above are not exhaustive and should not be mechanically applied, but instead qualitatively assessed to determine whether adequate disclosures were made and whether those disclosures permit a consumer debtor considering a bifurcated fee agreement to give informed consent. Additionally, when applying these criteria we must consider local authority and act accordingly where local rules or jurisprudence have imposed other clear standards for adequate client disclosures and conditions of informed consent—whether more or less stringent.[19]

IV. Ensuring Adequate Public Disclosure

The Bankruptcy Code and Rules also require public transparency in professionals' dealings with their clients, and the USTP regularly enforces these requirements. 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

[17] As discussed *supra*, it is the USTP's position that fees under bifurcated agreements should not be higher than those under traditional fee agreements for the same services.

[18] Generally, these options are for the client to sign the postpetition agreement for the attorney's continued representation; to hire other counsel; or to proceed in the case *pro se*.

[19] We are aware that some courts have found that bifurcation is impermissible under local rules governing representation of debtors. *See, e.g., Baldwin*, 2021 WL 4592265; *Prophet*, 628 B.R. 788. The existence and wording of such local rules varies, and bankruptcy courts within a district may interpret them differently. In determining whether to take an enforcement action with respect to a bifurcated fee arrangement, the USTP will consider and follow applicable local authority but also should be mindful to exercise discretion in accordance with these guidelines to focus on those cases where the debtor is harmed or the integrity of the bankruptcy process is jeopardized.

Rule 2016(b).[20] The nature of bifurcated agreements requires detailed disclosures in order to satisfy the Bankruptcy Code's standards. Failure to make adequate public disclosures required under the Bankruptcy Code and Rules may be a basis to bring an enforcement action.[21]

V. Conclusion and Important Notes

It is vital that the USTP acts consistently across jurisdictions in these and other legal matters. Please ensure that all staff who engage in civil enforcement in consumer cases are familiar with these guidelines. Each case will have unique facts that should be considered in a manner consistent with these guidelines.

Please consult the Office of the General Counsel if there are any questions regarding these guidelines or their application in specific cases. This memorandum is an internal directive to guide USTP personnel in carrying out their duties, but the final determination of whether a bifurcated fee agreement complies with the Bankruptcy Code and Rules resides solely with the court. Nothing in this memorandum has any force or effect of law or imposes on parties outside the USTP any obligations beyond those set forth in the Bankruptcy Code and Rules.[22]

Thank you for your continued cooperation and diligence in this important area of responsibility.

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[20] The default remedy for failure to make proper disclosures under section 329(a) is return of all fees. *See, e.g., SE Prop. Holdings, LLC v. Stewart*, 970 F.3d 1255, 1266 (10th Cir. 2020).

[21] Postpetition attorney's fee installment payments should be disclosed as monthly expenses on the debtor's Schedule J. This allows courts and the USTP to quickly evaluate whether the debtor can actually afford the attorney's fees charged under the postpetition contract, which is a factor in determining whether the bifurcated agreement is in the debtor's best interest. However, note that we do not take the position that Rule 2016(b) requires that attorneys using bifurcated agreements file a supplemental compensation disclosure each time they receive a postpetition payment, provided that the terms of the postpetition agreement have been previously disclosed and there have been no material changes.

[22] Additionally, nothing in this memorandum: (1) limits the USTP's discretion to request additional information, conduct examinations under Bankruptcy Rule 2004, or conduct discovery with respect to its review of a particular fee arrangement; (2) limits the USTP's discretion to take action with respect to any particular fee arrangement; or (3) creates any private right of action on the part of any person enforceable against the USTP, its personnel, or the United States.

By Adam Herring and Scott Bomkamp

Ensuring "Access" and "Justice"

USTP's Enforcement Guidelines for Bifurcated Fee Agreements

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The Bankruptcy Code generally prohibits the post-petition payment of a chapter 7 debtor's attorney's fees based on a pre-petition retainer agreement.[1] As a result, the debtor must traditionally pay the entire fee for the case in full before the case is filed, unless the debtor's attorney is willing to file the case with no recourse to compel post-petition payments.[2] Many have suggested that this statutory structure presents a barrier to accessing the bankruptcy system for those who may most need relief.[3]

The increasingly prevalent practice of "bifurcating" attorney fees has arisen as an alternative. However, stakeholders have expressed starkly varying views on the propriety of bifurcated fee arrangements.[4] Similarly, some courts have expressly prohibited bifurcation based on local rules and attorneys' professional duties,[5] while others have held that there is nothing inherently impermissible about bifurcated agreements if properly done.[6]

In jurisdictions that allow them, bifurcated arrangements may help debtors who are unable to quickly come up with the full fee for a chapter 7 case. However, they also present substantial risks for abuse. If bifurcation is permitted, the benefits must be balanced against those risks, and the arrangements must be properly disclosed, structured and implemented to prevent harm to debtors and the integrity of the system.

Bifurcated Fee Agreements in Practice

Under a bifurcated fee arrangement, the client first executes a pre-petition retainer agreement limited to the attorney preparing and filing a "skeletal" chapter 7 petition.[7] The fee for pre-petition services may be as little as $0.[8] Most pre-petition agreements in bifurcated models describe the debtor's post-petition options as (1) hiring the attorney under a post-petition agreement to provide full representation through the remainder of the case; (2) hiring other counsel to complete the case; or (3) completing the case *pro se*.

After the petition has been filed, the client executes the post-petition retainer agreement, under which the debtor agrees to pay post-petition fees in installments.[9] Next, the attorney prepares and files the remaining bankruptcy documents, including the schedules and statement of financial affairs, attends the § 341 meeting of the creditors with the client and otherwise represents the client in the bankruptcy case.[10] The fee charged under the post-petition agreement is the remainder of the fee for the case that was not paid pre-petition.

Some attorneys use third-party financing to support their bifurcated fee business model. While the specific terms vary, outside financing generally pays the attorney an immediate lump sum and relieves the attorney of the burdens of collection. Typical financing models involve the attorney factoring, or granting a security interest in, their accounts receivable.[11] In exchange, the finance company charges a fee, which is often a substantial percentage of the total attorney's fee charged.[12]

Recent Case Law Developments

Decisions have generally either approved bifurcation subject to protective conditions, or disapproved it entirely. In two recent decisions, the U.S. Bankruptcy Court for the Western District of Missouri addressed bifurcation using third-party financing models.[13] The court held that bifurcation was not *per se* forbidden. However, in both cases, the debtors' attorneys failed to make adequate disclosures and charged unreasonable fees. The court put it succinctly: "All attorney fee agreements must be reasonable. And, in bankruptcy cases, all fee agreements, payments, terms, and sources must

1 *See Lamie v. United States Trustee*, 540 U.S. 526, 537 (2004) (chapter 7 debtors' attorneys generally may not be compensated by bankruptcy estate); *Rittenhouse v. Eisen*, 404 F.3d 395, 397 (6th Cir. 2005) (chapter 7 debtor's attorneys' fees owing under pre-petition retainer agreement are dischargeable debt).

2 Adam D. Herring, "Problematic Consumer Debtor Attorneys' Fee Arrangements and the Illusion of 'Access to Justice,'" XXXVII *ABI Journal* 10, 32, 58-59, October 2018, *available at* abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on July 26, 2022).

3 *See, e.g.*, § 3.01, ABI Comm'n on Consumer Bank. Final Report, *available at* consumercommission.abi.org; Daniel E. Garrison, "Liberating Debtors from 'Sweatbox' and Getting Attorneys Paid: Bifurcating Consumer Chapter 7 Engagements," XXXVII *ABI Journal* 6, 16, 66-68, June 2018, *available at* abi.org/abi-journal.

4 *See* Herring, *supra* n.2. *See also, e.g.*, 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 (2020); David Cox, "Why Chapter 7 Bifurcated Fee Agreements Are Problematic," XL *ABI Journal* 6, 30-31, 53-54, June 2021, *available at* abi.org/abi-journal; Garrison, *supra* n.3.

5 *See, e.g., In re Suazo*, No. 20-17836, 2022 WL 2197567 (Bankr. D. Colo. June 17, 2022); *In re Siegle*, 639 B.R. 755 (Bankr. D. Minn. 2022); *In re Baldwin*, 640 B.R. 104 (Bankr. W.D. Ky.); *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. 2021), *rev'd and remanded*, 639 B.R. 664 (D.S.C. 2022).

6 *See, e.g., In re Rosema*, No. 20-40366, 2022 WL 2662869 (Bankr. W.D. Mo. July 8, 2022); *In re Kolle*, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021); *In re Brown*, 631 B.R. 77, 101 (Bankr. S.D. Fla. 2021); *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020); *In re Hazlett*, No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah April 10, 2019).

7 *See, e.g., Walton v. Clark & Washington PC*, 469 B.R. 383, 385 (Bankr. M.D. Fla. 2012).

8 *Id.*; *see also Hazlett*, 2019 WL 1567751 at *1.

9 *Walton*, 469 B.R. at 385.

10 *Id.*

11 *See, e.g., In re Milner*, 612 B.R. 415, 422 (Bankr. W.D. Okla. 2019).

12 *Id.*

13 *Rosema*, 2022 WL 2662869; *Kolle*, 2021 WL 5872265.

be fully, completely, and accurately disclosed in addition to being reasonable. Period."[14]

The U.S. Bankruptcy Court for the Southern District of Florida has followed similar principles and provided guidance for proper bifurcation in the district.[15] It was particularly concerned with adequate client disclosures and informed consent, and set out detailed requirements.[16] The court also outlined the attorney's duties and services that must be performed pre- and post-petition.[17] As for attorneys' fees, the court concluded that it would assess the reasonableness of a post-petition fee on its own, and not in comparison to the pre-petition fee charged.[18] In other words, the court would not be concerned with a $0 pre-petition fee as long as the post-petition fee is reasonable in light of actual or potential post-petition services. The court noted that attorneys may not recoup filing fees advanced pre-petition, because such advances are dischargeable pre-petition loans.[19] In addition, although none of the firms at issue in the decision employed third-party financing, the court stated in a footnote that factoring post-petition fees is impermissible because it creates an inherent conflict of interest and violates the Florida Rules of Professional Conduct.[20]

Some courts have found bifurcation to be *per se* impermissible. These cases reason that bifurcation involves inherent violations of an attorney's duties and common local rules requiring that the attorney who files a case is responsible for performing all essential tasks in the case, unless the court permits withdrawal. In *Prophet*, the U.S. Bankruptcy Court for the District of South Carolina said:

> Separate representations and bifurcation are not permitted. Counsel cannot walk the debtor client to the courthouse door, file only a few of the required documents, and insist that the representation has been completed even if maintaining that additional (but in counsel's mind uncontracted) services will be provided until the Court acts on a motion to withdraw. This strains too much the bankruptcy attorney/client relationship, especially given the disparity between the contracting parties over issues that otherwise are the inherent subject of the attorney/client relationship — claims, debts, personal liability and the right to payment.[21]

On appeal, the district court reversed, concluding that the bankruptcy court had misapplied its own local rule, and remanded the case for consideration of the U.S. Trustee's arguments regarding the attorney's disclosures and fees.[22] Subsequent cases have adopted the *Prophet* court's reasoning, which remains good law in those districts.[23] Recently, the *Siegle* and *Suazo* bankruptcy courts held that the debtors' attorneys violated local rules and § 526 of the Bankruptcy Code because the bifurcated agreements misrepresented the attorneys' obligation to continue to represent the debtors post-petition under the applicable local rules.[24]

The USTP's Enforcement Guidelines

To balance the worthy goal of expanding access to the bankruptcy system with the risk of harm from abusive practices, the "Guidelines for U.S. Trustee Program (USTP) Enforcement Related to Bifurcated Chapter 7 Fee Agreements" were released in June 2022.[25] The Guidelines are an internal directive designed to guide USTP personnel and promote a consistent enforcement approach, and they have been made publicly available to inform the bankruptcy community about the USTP's enforcement positions.

As a starting point, the USTP's position is that absent contrary applicable authority, bifurcated fee agreements are permissible provided that three criteria have been met: (1) the fees charged under the agreement must be fair and reasonable; (2) the attorney must provide adequate disclosures to clients, and clients must provide fully informed consent; and (3) the attorney must make sufficient public disclosures related to the fee agreement. The USTP's guiding principle in determining whether to take an enforcement action is redressing harm — to debtors or the integrity of the bankruptcy system — resulting from noncompliant arrangements. Each of these criteria is discussed in greater detail herein.

Fair and Reasonable Fees

Bifurcated agreements present a potential for harm in the structuring of fees. The USTP's first consideration in reviewing any fee arrangement in a consumer case is ensuring that it serves the best interests of clients rather than professionals.

Attorneys' fees under a bifurcated agreement must be properly allocated between pre- and post-petition fees and services. The USTP's position is that fees earned for pre-petition services must either be paid pre-petition or waived, because they are a dischargeable pre-petition debt. This ensures that attorneys comply with their professional and statutory duty to provide appropriate pre-petition counseling, including regarding chapter selection and exemptions.[26] Concomitantly, post-petition fees must be rationally related to post-petition services, so that a flat post-petition fee is not a vehicle to collect fees for work that was performed or should have been performed prior to the filing of the case.[27] Finally, attorneys should not advance filing fees and seek post-petition reimbursement, as advanced filing fees are dischargeable pre-petition loans.[28]

Attorneys' fees must also be reasonable. Bifurcation is not an invitation — nor an entitlement — to collect higher fees than would be collected from similarly situated clients who pay in full before filing. In addition, bifurcated fee models that employ outside financing invite significant scrutiny. These arrangements may incentivize overcharging because the attorney incurs (often substantial) financing costs that they may attempt to pass along to their clients. For example, in *Baldwin*,

14 *Rosema*, 2022 WL 2662869 at *26.
15 *Brown*, 631 B.R. 77.
16 *Id.* at 98-100.
17 *Id.* at 96-98.
18 *Id.* at 94.
19 *Id.* at 102-03.
20 *Id.* at 97, n.30.
21 *Prophet*, 628 B.R. at 804.
22 *Prophet*, 639 B.R. at 676.
23 *Baldwin*, 640 B.R. at 118-19.
24 *Suazo*, 2022 WL 2197567 at *17 ("[T]he two-contract model ... was wholly illusory."); *Siegle*, 639 B.R. at 759.
25 Guidelines, *available at* justice.gov/ust/page/file/1511976/download.
26 *See* 11 U.S.C. § 707(b)(4). *See also U.S. Trustee v. Ashcraft, et al.*, No. 17-ap-01271-mw, ECF No. 45 (Bankr. C.D. Cal. Aug. 8, 2019) (attorneys using factoring model stipulated as part of settlement with USTP that they routinely filed initial inaccurate schedules that had to be later amended and that they did not conduct any meaningful analysis of whether their clients could afford post-petition payments).
27 *But see Brown*, 631 B.R. at 92-93 (rejecting U.S. Trustee's argument that court should compare charge for pre-petition services to fee for post-petition services given that majority of bankruptcy services in chapter 7 are rendered pre-petition).
28 *See, e.g., Matter of Riley*, 923 F.3d 433, 439-40 (5th Cir. 2019); *Brown*, 631 B.R. at 102-03.

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the court evaluated reasonableness by comparing the amount charged in cases in which the client paid the full fee up front to cases in which fees were bifurcated.[29] After finding that fees were $950 higher in the bifurcated fee cases because the attorney passed on a financing charge to his client, the court held that the convenience provided to the debtor was not worth such a hefty upcharge and that the increased fee was unreasonable and contrary to chapter 7's fresh start policy.[30]

Client Disclosures and Fully Informed Consent

Debtors must understand the fee agreements into which they are entering. The requirement that debtors provide fully informed consent to bifurcated agreements is derived from both the Bankruptcy Code and relevant rules of professional conduct. Sections 526-528 of the Code require, among other things, that attorneys representing "assisted persons" (most consumer debtors) deal honestly with their clients, not misrepresent the services they will provide or the benefits and risks of bankruptcy, make thorough required disclosures, and timely enter into a clear and conspicuous written agreement detailing services to be provided and the terms of any fee agreement. The court in *Hazlett*, an early decision permitting bifurcation, wrote that "the propriety of using bifurcated fee agreements in consumer chapter 7 cases is directly proportional to the level of disclosure and information the attorney provides to the client and the existence of documentary evidence that the client made an informed and voluntary election to enter into a post-petition fee agreement."[31]

In *Milner*, the bankruptcy court opined that pre- and post-petition contracts, which were prepared by a third-party finance company, were full of legalese and beyond the comprehension of the debtor or any average layperson seeking bankruptcy services.[32] Even debtor's counsel conceded that the debtor did not understand the distinction between the duties imposed by the pre- and post-petition contracts.[33] The court ordered disgorgement of the attorney's fees because §§ 329 and 528 of the Bankruptcy Code and Rule 2016 of the Federal Rules of Bankruptcy Procedure require thorough "plain English" disclosures to the client that are "simplistic, clear, and concise."[34] In addition, Rule 2016 requires disclosure of fee-sharing, and the court found that the debtor's attorney and the financing company were engaged in fee-sharing that was inadequately disclosed because both retained a portion of the debtor's payments.[35] Similarly, in *Baldwin*, the court was particularly concerned that the disclosures to the debtor did not explain the effect of default on the post-petition contract and did not fully explain the financial relationship between the financing company and the debtor's attorney.[36] In evaluating whether a debtor has given fully informed consent to a bifurcated fee agreement, the USTP will consider the following factors:

- whether the debtor's attorney has clearly disclosed both the services that will be rendered pre- and post-petition and the corresponding fees for each segment of the representation, including that certain listed services might 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 post-petition 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 fee between the bifurcated fee agreement and a traditional fee agreement, and the client's options with respect to the post-petition fee agreement; and
- 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.

This should not be considered an exhaustive list, nor will the USTP apply these factors mechanically in determining whether a particular fee agreement is objectionable.[37] Instead, the USTP will qualitatively assess whether an attorney's disclosures were adequate to permit the debtor to give fully informed consent.

Public Disclosures

Full disclosure of professionals' dealings with their client is a hallmark of the Bankruptcy Code and Rules.[38] Attorneys employing bifurcated agreements must take particular care to fully and accurately make detailed disclosures of the particulars of their fee agreements and the amounts they have been paid and expect to be paid. Failure to make adequate disclosures is a basis for the USTP to take an enforcement action, and attorneys should be aware that the presumptive remedy under § 329(a) for inadequate disclosure of fees is full disgorgement.[39]

Conclusion

Enhancing access to justice must consist of both removing barriers to entry — "access" — and ensuring that debtors who act in good faith and comply with legal requirements receive the relief the law affords them: "justice." Absent amendments to the Bankruptcy Code,[40] where allowed, bifurcation on fair and reasonable terms presents a viable alternative to the traditional chapter 7 fee model and may enhance consumer debtors' ability to access the bankruptcy system. Consistent with its mission, the USTP will continue to enforce the Code in a uniform, balanced fashion to protect consumers and the integrity of the bankruptcy system. abi

29 *Baldwin*, 640 B.R. at 125-26.
30 *Id.*
31 *Hazlett*, 2019 WL 1567751 at *8.
32 *Milner*, 612 B.R. at 428, 443.
33 *Id.* at 428.
34 *Id.*
35 *Id.*
36 *Baldwin*, 640 B.R. at 122.

37 The USTP will also take into account local rules or controlling authority that impose clear standards for adequate disclosures and conditions of informed consent, and act accordingly.
38 11 U.S.C. § 329(a); Fed. R. Bankr. P. 2016(b).
39 *See, e.g., SE Prop. Holdings LLC v. Stewart*, 970 F.3d 1255, 1266 (10th Cir. 2020).
40 The ABI Commission on Consumer Bankruptcy made recommendations for Bankruptcy Code amendments that would permit post-petition payment of chapter 7 debtors' attorneys' fees. *See* Final Report, *supra* n.3.

Case Law Summary – Bifurcated Fee Agreements

In an early opinion in the Eastern District of Michigan, Judge Shefferly ruled that an attorney may unbundle bankruptcy services by entering into separate contracts for pre-petition and post-petition services, with distinct fees associated for each. The Court held that such bifurcation is permissible if, consistent with the Michigan Rules of Professional Conduct, (1) the attorney's work is competent, (2) the client was adequately advised about any limitations of the services to be rendered, and (3) the client gave fully informed consent. ***In re Slabbinck, 482 B.R. 576 (Bankr. E.D. MI. 2012)***

A decision this year from Colorado identifies how a bifurcated fee agreement violated the Bankruptcy Code provisions that govern debt relief agencies. The retainer agreements in that case required no payment from the debtor to file the petition, or for any prepetition services. The Court ruled that the agreements violated 11 U.S.C. §526 because the pre and post-petition agreements were misleading. Specifically, the prepetition agreement, which provided for the filing of only a "bare bones" petition, did not adequately disclose the limitation of the legal services to be provided, in violation of 11 U.S.C. §526(a)(3), and that the retention agreement did not clearly and conspicuously explain the debt relief services to be provided, in violation of 11 U.S.C. §528(a)(1). The Court also found that the advancement by the lawyer of the bankruptcy filing fee violated 11 U.S.C. §526(a)(4). ***In re Suazo, 642 B.R. 838 (Bankr. D. Col. 2022).***

The District of Minnesota has entered an en banc administrative order that requires lawyers to file an application for approval of a bifurcated fee agreement. In another decision from earlier this year, one such application was denied because the agreements violated the debt relief agency provisions of the Bankruptcy Code. The Court ruled that the agreements gave misleading, or untrue, information about the lawyer's automatic withdrawal from the case if the post-petition agreement is not signed. The Court concluded "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)." ***In re Siegle, 639 B.R. 755 (Bankr. D. Minn. 2022)***

The bankruptcy courts in the Western District of Kentucky have ruled the use of certain bifurcated agreements impermissible in an opinion written by one judge, after consultation with the other judges in the district. The retainer agreements in that case involved a bifurcated arrangement, with no pre-petition payment required by the debtor, and the use of a finance company that provided the lawyer with a line of credit and assisted in the post-petition payment collections. The Court found the fee agreement objectionable for a number of reasons, including inadequate disclosures, and issues relating to fee splitting with the factoring company. ***In re Baldwin, 640 B.R. 104 (Bankr. W.D. Ky. 2021), reconsideration denied, 2022 WL 107376 (Bankr. W.D. Ky. January 11, 2022).***

Last year in Missouri, a bifurcated fee arrangement, with a factoring company component, was found to be violative of, or potentially violative of several rules of professional conduct, including attorney competence, limitation on the scope of representation, communication with clients, attorney fees, confidentiality, conflict of interest, trust accounts and property of others, professional independence of lawyers, candor towards the tribunal, and misconduct. ***In re Kolle, 641 B.R. 621 (Bankr. W.D. Mo. 2021).***

In the Western District of Pennsylvania, a recent opinion provides the consumer bankruptcy bar with set of guiding principles that should be followed when entering into bifurcated fee arrangements. In its opinion, the Court summarized several recent decisions from other districts, ultimately adopting the majority view that bifurcated fee agreements are not per se prohibited, so long as "certain strict conditions are met that are designed to assure that debtors are fully informed and treated fairly, and that proper disclosure to the Court is made by the attorney as part of the bankruptcy filing." ***In re Cialella, 2022 WL 4459962 (Bankr. W.D. Penn. 2022).***

THE UNITED STATES DEPARTMENT of JUSTICE
JUSTICE NEWS

Department of Justice

Office of Public Affairs

FOR IMMEDIATE RELEASE Wednesday, March 10, 2021

National Consumer Bankruptcy Law Firm Agrees to Pay More than $300,000 in Relief to Consumers and to a Six-Year Practice Ban in Settlement with U.S. Trustee Program

The Department of Justice's U.S. Trustee Program (USTP) has entered into a settlement with national consumer bankruptcy law firm Deighan Law LLC, previously known as Law Solutions Chicago and doing business as UpRight Law (UpRight). The settlement is set forth in a consent order entered by the Bankruptcy Court for the District of Montana on March 9 and resolves enforcement actions filed by the USTP over allegations of misconduct relating to UpRight's representation of Montana consumers as debtors or prospective debtors in bankruptcy cases. As stipulated in the settlement, UpRight has paid or will pay more than $300,000 in monetary relief and will be barred from representing bankruptcy clients in Montana for six years.

As a result of dozens of USTP actions filed since 2016, UpRight has paid or been ordered to pay almost $900,000 in monetary relief, including returning fees to over 500 impacted consumers and paying court-ordered sanctions, attorney's fees, and costs. Additionally, bankruptcy courts have imposed practice bans against UpRight in at least four jurisdictions.

"Lawyers who misrepresent their services to vulnerable clients and fail to perform as promised harm debtors, creditors, and the integrity of the bankruptcy system," said USTP Director Cliff White. "This settlement shows that the USTP will continue to hold accountable attorneys who fail to adequately and honestly represent their clients."

In the current matter, the USTP alleged that UpRight engaged in misconduct and misrepresentations impacting hundreds of Montana consumers, which came to light due to investigations by the USTP in two bankruptcy cases. In one case, UpRight substantially delayed filing its client's bankruptcy case for almost a year after it misrepresented that it had a local attorney who was licensed in Montana available to file the case. UpRight's delay resulted in a creditor garnishing more than $6,000 of the debtor's wages. In the other case, UpRight obtained payment of its attorney's fees by advising the debtors to participate in an improper scheme whereby they surrendered their vehicle to an out-of-state towing company. Another bankruptcy court previously sanctioned UpRight for implementing the towing program—which it used in more than 200 cases across the country—describing it as a "scam from the start," and the towing company's owners were indicted for their role in the scheme. UpRight's advice resulted in the debtors being sued by their automobile lender for conversion of its collateral.

In the settlement, UpRight does not contest the USTP's allegations that it engaged in misconduct in the course of its dealings with Montana consumers, including misrepresenting that it had a sufficient number of local Montana-licensed attorneys available to provide adequate bankruptcy representation, misrepresenting to clients the scope of legal services to be provided and the cost of those services, failing to timely provide its clients with written retainer agreements that clearly and conspicuously explained the legal services to be provided and the cost of those services, failing to discuss non-bankruptcy alternatives, failing to adequately supervise the firm's non-attorney staff (some of whom engaged in the unauthorized practice of law), providing erroneous legal advice, and failing to adequately supervise its Montana "partner" attorneys. This misconduct contributed to UpRight's substantial delay in filing

bankruptcy cases for Montana consumers. In addition, UpRight filed bankruptcy cases for only 109 of the 473 Montana clients from whom the firm collected at least a partial fee.

To resolve the USTP's allegations of misconduct, UpRight has refunded or will refund more than $300,000 in fees paid by Montana consumers for whom UpRight never filed a bankruptcy case. UpRight also agreed to pay a civil penalty of $10,309 and to return all fees, totaling $3,770, to the debtors in the two cases in which the USTP brought its enforcement actions. Additionally, UpRight will be barred from accepting bankruptcy clients or providing bankruptcy services to consumers in Montana, effective July 2, 2018, through July 2, 2024.

While the agreement resolves disputes with the USTP in the two underlying bankruptcy cases, it does not impact the rights of the debtors in those cases or any other parties or government agencies not participating in the settlement, including other Montana consumers, nor does it impact the USTP's rights to litigate enforcement actions against UpRight in other jurisdictions or to seek redress in other Montana cases. The two underlying cases are captioned *In re Dailey*, Case No. 15-61088-7 (Bankr. D. Mont.), and *In re Emerson*, Case No. 16-60056-7 (Bankr. D. Mont.).

The U.S. Trustee Program is the component of the Justice Department that protects the integrity of the bankruptcy system by overseeing case administration and litigating to enforce the bankruptcy laws. The Program has 21 regions and 90 field office locations. Learn more information on the Program at: https://www.justice.gov/ust.

Attachment(s):
Download Order Approving UpRight Settlement Agreement In re Dailey
Download Order Approving UpRight Settlement Agreement In re Emerson

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HAMMER AND NAILS – CONSTRUCTING THE USE OF APPEARANCE COUNSEL IN BANKRUPTCY CASES

Hon. Steven W. Rhodes Consumer Bankruptcy Conference
Consumer Bar Association
Eastern District of Michigan

November 11, 2022

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HAMMER AND NAILS – CONSTRUCTING THE USE OF APPEARANCE COUNSEL IN BANKRUPTCY CASES[1]

Hon. John T. Gregg
United States Bankruptcy Court
Western District of Michigan

For various reasons, lead counsel for a debtor in a bankruptcy case may be unable to participate in certain hearings, the meeting of creditors and/or other matters. In such instances, lead counsel may arrange for an attorney unaffiliated with his or her law firm to appear on behalf of the debtor. Such attorneys are often referred to as "appearance counsel," also known in some districts as *per diem* attorneys, substitute counsel, temporary attorneys, and associate counsel.[2] One court has described appearance counsel as follows:

> "Appearance attorneys" are attorneys who, at the request of the debtors' chosen attorney, appear and attempt to represent debtors at meetings of creditors and hearings on behalf of the debtors' attorney. An appearance attorney is neither a partner nor an associate at the law firm retained by the debtor. Rather, appearance attorneys are solo practitioners who generate income typically by contracting with multiple firms to represent their clients at proceedings at the courthouse. These lawyers are almost never disclosed to the court prior to their appearance, and debtors are often unaware that an appearance attorney will be representing them until they meet the attorney – usually mere minutes before a hearing or a meeting of creditors begins.

In re Bradley, 495 B.R. 747, 757 n.1 (Bankr. S.D. Tex. 2013).

Notwithstanding some valid concerns expressed by courts, the use of appearance counsel can, under the right circumstances, provide much needed flexibility to attorneys, and solo

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[1] These materials were previously prepared for use in connection with the Hon. Steven W. Rhodes Consumer Bankruptcy Conference sponsored by the American Bankruptcy Institute on November 12, 2018. They have been updated.

[2] Several "providers" arrange for appearance counsel in consumer and commercial bankruptcy cases on a national level. Based on a review of these providers' websites, appearance counsel is becoming "big business" in the legal profession.

practitioners in particular. It is extremely important, however, for lead counsel and appearance counsel to comply with the applicable provisions of the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, the local bankruptcy rules and the Michigan Rules of Professional Conduct. Absent careful adherence to these directives, lead counsel and appearance counsel put themselves at risk of fee disgorgement, sanctions, and possibly even disciplinary proceedings.

These materials are intended to briefly discuss some of the requirements that accompany the use of appearance counsel, including disclosure, advanced and informed consent from clients, and fee sharing restrictions.[3]

A. *Appearance Counsel in General*

A common misconception is that appearance counsel only appears for, and takes actions on behalf of, lead counsel. The role of appearance counsel is not, however, limited to simply appearing at a matter to request an adjournment, standing on a motion, or otherwise "covering" for lead counsel. Rather, even when serving in a limited capacity, appearance counsel has a duty to the client, not lead counsel. *See, e.g.*, *In re D'Arata*, 587 B.R. 819 (Bankr. S.D.N.Y. 2018); *In re Wright*, 290 B.R. 145 (Bankr. C.D. Cal. 2003); *In re Al Sammak*, 2016 WL 3912375 (Bankr. D. Idaho July 12, 2016); *In re Egwu*, 2012 WL 5193958 (Bankr. D. Md. Oct. 19, 2012); *In re Bernhardt*, 2012 WL 646150 (Bankr. D. Colo. Feb. 28, 2012).

Addressing the relationship among the lead attorney, appearance counsel and the debtor, one court emphasized the following:

> Despite [lead counsel's] characterization, [appearance counsel] were not simply agreeing to appear on [lead counsel's behalf]. They

[3] The materials are far from comprehensive. The author expresses no opinion regarding the decisions cited herein. Practitioners are encouraged to review the actual decisions in order to thoroughly understand their issues and holdings. For additional discussion regarding the use of appearance counsel in bankruptcy cases, *see* Hon. Alan Trust and Michael A. Pantzer, *Does Sending or Being an Appearance Attorney Have an 80 Percent Chance of Success?*, Am. Bankr. Inst. J. (July 2017); Neil M. Berman, *Judge, This Is Not My Case . . .*, Norton Bankr. L. Adviser 3 (May 2004); *see also* Darin Day, *New Limited Scope Rules Benefit Underemployed Attorneys and Overburdened Courts*, Mich. Bar. J. (June 2018).

> were appearing, as counsel, *for [the debtor]*. And, they were not just "appearing" – they were *representing* her at a § 341(a) hearing *as [the debtor's] attorney*. . . Even though this arrangement may be for a limited purpose or duration, [appearance counsel] is, for that time and purpose, *the* attorney who is representing [the debtor].

In re Olson, 2016 WL 343341, at *5 (Bankr. D. Idaho June 16, 2016) (emphasis included). Other than the limited scope of the representation, the role of appearance counsel is no different than that of co-counsel.

As discussed in more detail below, when acting as either lead counsel or appearance counsel, communication, disclosure and preparedness are of paramount importance.

B. *Disclosure Obligations Under the Bankruptcy Code and Fed. R. Bankr. P.*

The Bankruptcy Code and the Bankruptcy Rules, both of which require attorneys for debtors to make certain disclosures, do not distinguish between lead counsel and appearance counsel. Instead *all* attorneys must disclose the information required by section 329 and Bankruptcy Rule 2016(b).

1. 11 U.S.C. § 329 – Debtor's Transactions with Attorneys

Section 329(a) provides that:

> any attorney representing a debtor in or in connection with a case shall file a statement of the compensation paid or agreed to be paid for the services rendered or to be rendered by that attorney and the source of the compensation.

11 U.S.C. § 329(a). The language of section 329 is mandatory in all respects. It evinces Congress's intent that bankruptcy courts closely review and monitor compensation arrangements between a debtor and his or her attorney. *Henderson v. Kisseberth (In re Kisseberth)*, 273 F.3d 714, 720 (6th Cir. 2001). In the event that compensation is unreasonable, the court has the authority to cancel the agreement and/or order the attorney to disgorge amounts previously paid. 11 U.S.C. § 329(b).

By its express terms, section 329(a) requires an attorney for a debtor to file a statement of compensation. This requirement applies to any attorney representing the debtor *in* the actual case, including lead counsel and appearance counsel. It also applies to attorneys representing a debtor *in connection with a case*, an extremely broad phrase. *See, e.g.*, *In re Gorski*, 519 B.R. 67 (Bankr. S.D.N.Y. 2014) (debtor's divorce attorney subject to disclosure obligation in debtor's bankruptcy case).

In addition, section 329 requires an attorney to disclose the compensation paid or anticipated to be paid, as well as the source of any such compensation. *See Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996). This requirement is not limited to lead counsel and extends to appearance counsel. Lead counsel and appearance counsel therefore have independent obligations to disclose compensation arrangements. *See, e.g.*, *In re Egwu*, 2012 WL 5193958, at *4 (Bankr. D. Md. Oct. 19, 2012).

2. Fed. R. Bankr. P. 2016(b) – Compensation for Services Rendered and Reimbursement of Expenses

Section 329 is implemented by Bankruptcy Rule 2016(b), which provides that:

> Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code, including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be filed and transmitted to the United States trustee within 14 days after any payment or agreement not previously disclosed.

Fed. R. Bankr. P. 2016(b).

Bankruptcy Rule 2016(b) requires an attorney representing a debtor in any chapter and in any capacity related to the bankruptcy case to file a statement of compensation, even if the attorney is not being compensated for his or her services and regardless of the scope of the representation. *See, e.g.*, *In re Bradley*, 495 B.R. at 789-90; *In re Wright*, 290 B.R. 145, 155 (Bankr. C.D. Cal. 2003). This requirement is strictly enforced. *See Halbert v. Yousif*, 225 B.R. 336, 351 (E.D. Mich. 1998) (attorney must file statement of compensation and cannot rely on other documents filed with court in lieu of such statement); *see also In re Bernhardt*, 2012 WL 646150, at *6 (Bankr. D. Colo. Feb. 28, 2012) (disclosure under Bankruptcy Rule 2016(b) is not an "empty exercise" or one that may be satisfied by filing a form with the same information in every case).[4] Therefore, lead counsel and appearance counsel are each required to file a statement of compensation under Bankruptcy Rule 2016(b). *See, e.g.*, *In re Bradley*, 495 B.R. at 790 (citation omitted). If, for example, lead counsel for a debtor in a chapter 7 case agrees to pay or has paid appearance counsel $X, two statements of compensation should be filed with the court – one by lead counsel and another by appearance counsel, both of which disclose $X as compensation paid by lead counsel to appearance counsel.

The statement of compensation required by Bankruptcy Rule 2016(b) must specifically state whether the attorney filing the statement has shared or agreed to share compensation with any other entity (other than a member or associate of the disclosing attorney's firm). It must also explain the details of such arrangement. Neither section 329 nor Bankruptcy Rule 2016(b) provide further instruction as to the level of detail. As a matter of best practices, an attorney filing a

[4] Official Form 3020, which is entitled Disclosure of Compensation of Attorney for Debtor, has been prescribed for use by the Judicial Conference of the United States. *See* Fed. R. Bankr. P. 9009. Certain bankruptcy courts, including the Bankruptcy Court for the Eastern District of Michigan, have modified Official Form 3020. *See id*. (permitting modifications under appropriate circumstances). The form adopted by the Bankruptcy Court for the Eastern District of Michigan is available on its website at www.mieb.uscourts.gov/forms/all-forms.

statement of compensation should consider attaching his or her retention agreement with the debtor, as well as any fee sharing agreement with other attorneys. *See* 11 U.S.C. § 528(a) (requiring written contract between debtor and debt relief agency); *see also Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 235-39 (2010) (attorneys are debt relief agencies).[5]

The timing of such disclosures is also important. An attorney must file the statement within fourteen days of the order for relief (the petition date in most cases) or such other time as the court instructs. An attorney's disclosure obligations under Bankruptcy Rule 2016(b) do not end upon the filing of the initial disclosure though. An attorney is also required to file a supplemental statement within fourteen days of receiving payment or entering into an agreement for payment that was previously not disclosed. The obligation is continuing in nature, meaning an attorney must timely file a supplemental statement each time he receives payment or enters into a new agreement for compensation. *See In re D'Arata*, 587 B.R. at 822 n.5; *In re Hirsch*, 550 B.R. 126, 135 (Bankr. W.D. Mich. 2015) (citations omitted) (statement of compensation must be filed even after completion or dismissal of case); *In re Bradley*, 495 B.R. at 789 (lead counsel and appearance counsel required to file supplemental statements once lead counsel decides to use appearance counsel).

For further discussion regarding the application of section 329 and Bankruptcy Rule 2016(b) to the use of appearance counsel, see *In re Harwell*, 439 B.R. 455 (Bankr. W.D. Mich. 2010); *In re Al-Sammak*, 2016 WL 3912375 (Bankr. D. Idaho July 12, 2016); *In re Olson*, 2016 WL 3453341 (Bankr. D. Idaho June 16, 2016).

[5] For discussion regarding the unbundling of services in chapter 7, see *In re Slabbink*, 482 B.R. 576 (Bankr. E.D. Mich. 2012); *In re Gourlay*, 483 B.R. 496 (Bankr. E.D. Mich. 2012).

3. Fed. R. Bankr. P. 9010 – Representation and Appearance

An attorney appearing for any party (including the debtor) "in a case" is required to file a notice of appearance. Fed. R. Bankr. P. 9010(b). This requirement applies equally to lead counsel and appearance counsel. Although it is unclear whether Bankruptcy Rule 9010(b) technically requires an attorney to file a notice of appearance if he or she only attends the meeting of creditors, the Michigan Rules of Professional Conduct do. *See infra* at p. 9. Moreover, local rules may require appearance counsel to file a notice of limited appearance. *See infra* at p. 13. In order to ensure compliance with applicable authorities, appearance counsel should file some form of notice of appearance whenever he or she is representing a debtor (or any other party, for that matter).

For additional discussion regarding the need for appearance counsel to file notices of appearance, see *In re Jacobson*, 402 B.R. 359, 364-65 (Bankr. W.D. Wash. 2009).

4. 11 U.S.C. § 504 – Sharing of Compensation

Section 504(a) provides, in pertinent part, that "a person receiving compensation or reimbursement under section 503(b)(2) or 503(b)(4) . . . may not share or agree to share . . . any such compensation or reimbursement with another person; or any compensation or reimbursement received by another person under such sections." 11 U.S.C. § 504(a). Congress enacted section 504(a) to address at least three policy-driven concerns: (i) the potential that an attorney may inflate his or her fee to make up for the portion lost to sharing; (ii) the potential that the attorney may be subject to outside influences of which the court does not have knowledge or control; and (iii) the potential for the *de facto* transfer of judicial power over expenditures and allowances. *In re Egwu*, 2012 WL 5193958, at *4 (Bankr. D. Md. 2012).

Because section 504(a) only applies to attorneys who receive compensation allowed as an administrative expense, it generally does not apply to attorneys for chapter 7 debtors. *See Lamie*

v. United States Trustee, 540 U.S. 526 (2004). An attorney for a chapter 7 debtor may therefore agree to share compensation, whether pre or post-petition, so long as he or she complies with section 329, Bankruptcy Rule 2016(b) and any applicable rules of professional conduct.

The same cannot be said for an attorney, whether the lead attorney or appearance counsel, representing a debtor in a chapter 13 case. Even with the requisite disclosures under section 329 and Bankruptcy Rule 2016(b), section 504 seemingly precludes lead counsel and appearance counsel from sharing fees that are derived from an administrative expense allowed under section 503(b)(2) or (4).[6] At least one court has rejected an attempt to circumvent section 504 by concluding that it is inappropriate to include the fees of appearance counsel in a fee application filed by the lead counsel for a chapter 13 debtor. *In re Egwu*, 2012 WL 5193958, at *4 (Bankr. D. Md. Oct. 19, 2012); *but see also In re Wright*, 290 B.R. at 156 (discussing lead counsel applying for fees for services performed by contract attorney). Therefore, as a matter of best practices and to ensure technical compliance with section 504, appearance counsel in a chapter 13 case should consider filing his or her own *short* fee application or, if allowed by the local rules, a stipulation with the chapter 13 trustee. *See* Fed. R. Bankr. P. 2002(a)(6); LBR 2016-1(d) (Bankr. E.D. Mich.) (*ex parte* application for fees less than $1,000 in chapter 13 case with endorsed approval of debtor and trustee); LBR 2016-2(c), (d)(4) (Bankr. W.D. Mich.) (permitting stipulated final fee applications for $1,000 or less in chapter 13 cases).

[6] As the *Egwu* court noted, section 504 applies only to administrative expenses. *In re Egwu*, 2012 WL 5193958, at *4 n.15 (Bankr. D. Md. Oct. 19, 2012). Therefore, any fees paid prepetition are not subject to the prohibition on fee sharing. *Id*. Nonetheless, disclosure obligations remain under section 329, Bankruptcy Rule 2016(b) and the applicable rules of professional conduct.

C. *Michigan Rules of Professional Conduct*

The Michigan Rules of Professional Conduct are equally as important to the use of appearance counsel. They impose additional requirements to ensure that clients, including debtors in bankruptcy cases, have an opportunity to consent to the use of appearance counsel.

1. Mich. R. Prof. Cond. 1.2 – Scope of Representation

Rule 1.2(b) provides, in pertinent part that:

> [a] lawyer licensed to practice in the State of Michigan may limit the scope of a representation, file a limited appearance in a civil action, and act as counsel of record for the limited purpose identified in that appearance, if the limitation is reasonable under the circumstances and the client gives informed consent, preferably confirmed in writing.

Mich. R. Prof. Cond. 1.2(b).

Because Rule 1.2(b) specifically refers to a "limited appearance," it applies to appearance counsel in a bankruptcy case, which is a civil action. Moreover, the rule seems to contemplate that the notice of limited appearance will at least reference the role of appearance counsel and the services he or she is expected to provide.

Rule 1.2(b) clearly allows an attorney to limit the scope of a representation, subject to two conditions. First, any limitation must be pursuant to *an agreement with the client* and documented in writing whenever possible. *Accord* 11 U.S.C. § 528(a). It is not appropriate to attempt to limit the scope of the representation by presenting a client with a form agreement, by filing a notice of appearance, or by filing a statement of compensation without the terms of the engagement and the signature of the client.

Importantly, any agreement to limit the scope of the representation requires that the client give his or her "informed consent" to such limitation. "Informed consent" is defined as "an agreement to a proposed course of conduct after the lawyer has communicated adequate

information and explanation about the material risks of the proposed course of conduct, and reasonably available alternatives to the proposed course of conduct." Mich. R. Prof. Cond. 1.0. As such, an attorney may not limit the scope of his or her representation without first providing the client with sufficient information to understand the limitations of the engagement and the potential consequences thereof. Moreover, the client should be given sufficient time to understand the limitations, meaning that absent exigent circumstances, lead counsel should discuss use of appearance counsel well in advance of any hearing or the meeting of creditors that appearance counsel will attend.

Second, any limitation must be reasonable under the circumstances.[7] An attorney cannot limit the scope of the representation by disclaiming an obligation to represent a client with respect to a fundamental matter. In bankruptcy cases, courts have held that attorneys may not, among other things, limit the scope of their representation so as to exclude their obligation to appear with a debtor at the meeting of creditors. *See, e.g.*, *In re Castorena*, 270 B.R. 504, 524-28 (Bankr. D. Idaho 2001) (citations omitted); *In re Ortiz*, 496 B.R. 144, 150-51 (Bankr. S.D.N.Y. 2013); *see also In re D'Arata*, 587 B.R. at 828 (encouraging parties to report instances where counsel fails to meet obligations to debtor, including by failing to appear at meeting of creditors). In effect, because the meeting of creditors is such a critical event in a bankruptcy case, an attorney is expected to represent the debtor's interests at the meeting and cannot disclaim this obligation.[8]

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[7] As a threshold matter, lead counsel and appearance counsel must each conduct a conflicts search before agreeing to represent the client. *See* Mich. R. Prof. Cond. 1.7. An attorney must obtain the informed consent of the client to proceed with the representation if the conflict is not *per se* disqualifying. *Id*.

[8] In a strongly worded letter regarding problems associated with use of appearance counsel, one trustee commented as follows with respect to the significance of the meeting of creditors for debtors:

> [Individual debtors] have most often never hired a lawyer. They are overwhelmed by debt. They are in need of help. They nearly all are honest debtors. They are not proud to be filing for bankruptcy. The day they appear for examination by the

2. Mich. R. Prof. Cond. 1.5 – Disclosure of Fee Division

Rule 1.5 of the Michigan Rules of Professional Conduct allows a division of a fee between lawyers who are not in the same firm to divide a fee if (i) the client is advised of, and does not object to, the participation of all the lawyers involved, and (ii) the total fee is reasonable. Mich. R. Prof. Cond. 1.5(e). In other words, the client must be given an opportunity to consider and approve of any fee sharing arrangement between lead counsel and appearance counsel. Although Rule 1.5(e) does not require that the client agree to the fee sharing arrangement in writing, appearance counsel and lead counsel should include such a disclosure in their respective retention agreements as a matter of best practices. *See* Mich. R. Prof. Cond. 1.2(b). The agreements should state the identity of all attorneys sharing in the fee and the amount to be paid to each attorney.

For additional discussion regarding fee disclosure requirements, see *In re Olson*, 2016 WL 3453341, at *7 (Bankr. D. Idaho June 16, 2016); *In re Bernhardt*, 2012 WL 646150, at *5 (Bankr. D. Colo. Feb. 28, 2012).

3. Mich. R. Prof. Cond. 1.1 – Competent Representation

Rule 1.1 of the Michigan Rules of Professional Conduct establishes the standard for competence of a lawyer with respect to a particular engagement by providing that a lawyer shall not:

> (a) handle a legal matter which the lawyer knows or should know that the lawyer is not competent to handle, without associating with a lawyer who is competent to handle it;
>
> (b) handle a legal matter without preparation adequate in the circumstances; or
>
> (c) neglect a legal matter entrusted to the lawyer.

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trustee is the lowest day of their lives. If ever there was a day when they need the help of their lawyer, it is the day of their § 341 examination.

In re D'Arata, 587 B.R. at 827.

Mich. R. Prof. Cond. 1.1. While the rule is fairly self-explanatory, it should be noted that it applies equally to lead counsel and appearance counsel. Lead counsel and appearance counsel must be fully prepared and possess the requisite skill and knowledge to provide the services expected by the client.

Importantly, Rule 1.1 provides that an attorney may not neglect a matter entrusted to the attorney. Obviously, Rule 1.1 imposes an obligation on appearance counsel with respect to the limited services he or she is providing. However, an additional burden is placed on lead counsel. Lead counsel must ensure that appearance counsel has been fully briefed, provided with all necessary information, and has coordinated with the client well in advance of any hearing, the meeting of creditors or any other matter. *See* Mich. R. Prof. Cond. 1.4 (requiring attorney to keep client reasonably informed and provide sufficient explanation to permit client to make informed decisions); *see also In re Bradley*, 495 B.R. at 787-88; *In re Olson*, 2016 WL 3453341, at *9 (Bankr. D. Idaho June 16, 2016). As a matter of best practices, lead counsel should participate in a meeting with appearance counsel and the client at least one week before a hearing or the meeting of creditors.

D. ***LBR 9010-1 (Bankr. E.D. Mich.) – Appearances***

The Bankruptcy Court for the Eastern District of Michigan has promulgated a local rule that addresses the use of appearance counsel at hearings and the meeting of creditors.[9] LBR 9010-1 (Bankr. E.D. Mich.). Although the Bankruptcy Court for the Western District of Michigan does not have a similar local rule, attorneys practicing in the Western District of Michigan may wish to refer to the Eastern District of Michigan's rule for guidance.

[9] Other bankruptcy courts have similar local rules. *See, e.g.*, LBR 2090-1(a)(2)-(3) (Bankr. C.D. Cal.); LBR 9010-6 (Bankr. S.D. Cal.); LBR 2017-1(a)-(b) (Bankr. E.D. Cal.); LBR 2090-1(D) (Bankr. S.D. Fla.); LBR 2090-2(a), (e) (Bankr. E.D.N.Y.).

Consistent with Mich. R. Prof. Cond. 1.1, LBR 9010-1 provides that all attorneys appearing before the court are expected to "be fully prepared and knowledgeable of the issues and matters to be addressed." LBR 9010-1(a)(2)(G) (Bankr. E.D. Mich.); *see* Mich. R. Prof. Cond. 1.1(b). Relatedly, any attorney appearing at a hearing or the meeting of creditors "must have sufficient familiarity and knowledge of the case and its prior proceedings as to permit informed discussion and argument." LBR 9010-1(b) (Bankr. E.D. Mich.). Appearance counsel is therefore expected to represent the interests of the debtor as if he or she was acting as lead counsel. Moreover, it is generally expected that the debtor's attorney "will attend and represent the debtor at the meeting of creditors, any hearing on reaffirmation agreements, and all other hearings within the scope of the representation." *Id*.

Subject to certain requirements, the local rules for the Eastern District of Michigan expressly allow for the use of appearance counsel, including at the meeting of creditors. LBR 9010-1(c) (Bankr. E.D. Mich.). According to the local rules, appearance counsel must file, prior to his or her appearance, a written notice of special appearance and a statement of compensation. *Id*. The statement of compensation filed by appearance counsel for a debtor must be countersigned by the debtor. *See* LBR 9010-1(d) (Bankr. E.D. Mich.). In addition, appearance counsel must provide a copy of a filed notice of special appearance upon request. LBR 9010-1(c) (Bankr. E.D. Mich.).

Finally, consistent with LBR 9010-1(b), appearance counsel "will be accountable for adequately representing the interests of the person or entity on whose behalf the appearance is made." *Id*. In other words, the role of appearance counsel is not to simply appear; it is to represent the interests of the client pursuant to all requirements imposed by the Bankruptcy Code, the

Bankruptcy Rules, the local rules, the Michigan Rules of Professional Conduct and other applicable authorities.

E. ***Practice Pointers***

The use of appearance counsel can be perilous to both lead counsel and appearance counsel if the relationship is not properly structured. As a matter of best practices, attorneys are encouraged to consider the following non-exhaustive actions when implementing an appearance counsel relationship:

- Lead counsel should perform a conflicts search prior to meeting with the client. Appearance counsel, whenever identified, should likewise conduct a conflicts search.

- If the client wishes to retain lead counsel, the parties should enter into a retention agreement.

- If lead counsel anticipates using appearance counsel, the client should be informed of the potential relationship, the identity of appearance counsel, if known, and the fee to be shared. Lead counsel should explain the relationship among lead counsel, appearance counsel and the client. The agreement should be set forth in writing, ideally as part of the retention agreement.

- Appearance counsel and the client should enter into a separate agreement reflecting the services to be performed, the fees for such services, and the person responsible for payment of such fees.

- Lead counsel and appearance counsel should file notices of appearance in the appropriate form.

- Lead counsel and, when identified, appearance counsel, should each file statements of compensation on the prescribed form in a particular district, and supplemented as necessary, under Bankruptcy Rule 2016(b). Any written agreements should be attached to the statements.

- Lead counsel, appearance counsel and the client should meet at least seven days before a hearing or the meeting of creditors. Lead counsel should provide appearance counsel with the file prior to the meeting with the client.

- After the hearing or meeting of creditors, appearance counsel should inform lead counsel of the results (ideally in a meeting with the client) and not rely on the client to do so.

- Lead counsel and appearance counsel should separately request fees in chapter 13 cases.