

Straight & Narrow

BY CHRIS HAWKINS

Paper Chase: Court Approves Meticulously Disclosed Bifurcation of Chapter 7 Engagement

Those with the greatest need for the financial relief afforded by a successful bankruptcy case often lack the financial resources necessary to secure adequate legal representation, particularly in the context of individual chapter 7 cases. ABI has devoted substantial resources toward addressing this dilemma.

Without limitation, the ABI Commission on Consumer Bankruptcy — building on prior work by the ABI National Ethics Task Force¹ — provided a number of recommendations geared toward improving debtors' access to the bankruptcy process.² These recommendations include (1) system changes to make chapter 7 cases less expensive for debtors, including improvements to bankruptcy form software to reduce expenses³ and legal representation for low-income debtors similar to the federal public defender program;⁴ and (2) amendments to the Bankruptcy Code to make attorneys' fees nondischargeable — subject to procedural safeguards — or to delay the debtor's discharge to facilitate post-petition payments of reasonable fees set forth in pre-petition agreements.⁵

The ABI Commission also considered the potential benefits and risks associated with limited-scope representation, also known as “unbundling.”⁶ The Commission noted the ethical concerns related to obtaining meaningful consent when the debtor might not understand the limitations on the services to be provided.⁷ Because local and state bar requirements might lead to different conclusions on the appropriate level of unbundling, the Commission recommended that the issue be addressed through the promulgation of local rules.⁸

While not a product of local rules, a recent opinion from the U.S. Bankruptcy Court for the Eastern District of Kentucky⁹ provides the documentation road map for attorneys seeking to balance clients' access to bankruptcy relief with the

ethical limitations associated with unbundling. The court's approval of the attorney's bifurcation of engagements into pre- and post-petition components might evidence a trend toward ensuring that those most in need of legal assistance through the bankruptcy process can afford to pay for it.

Key Ethical Considerations

The Model Rules of Professional Conduct set the baseline ethical considerations that attorneys face when considering a limited-scope representation or bifurcation of services in a chapter 7 case. These rules expose the tensions associated with providing quality legal services to chapter 7 debtors who have limited means to pay.

First, Model Rule 1.1 provides that “[a] lawyer shall provide competent representation to a client” and explains that “[c]ompetent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.”¹⁰ In the context of unbundling, the tension arises from the level of preparation that is necessary to provide competent representation. While the attorney must meet the ethical obligation to thoroughly prepare a client's chapter 7 case, the attorney also must protect against the risk of nonpayment.

Second, Model Rule 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.”¹¹ Much of the skepticism surrounding unbundling and bifurcation relates to the concept of informed consent. The ABI Task Force opined that “any attempt to limit the scope of representation must be fully disclosed and clearly understood by the debtor before proceeding with the engagement.”¹² In other words, the attorney must disclose in detail the services to be performed, as well as the services that will not be performed and the consequences of excluding such services.

Third, Model Rule 1.3 requires that a lawyer act “with reasonable diligence and promptness



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1 See Final Report of the ABI National Ethics Task Force (2013) at pp. 49-73, available at abi-org-corp.s3.amazonaws.com/materials/Final_Report_ABI_Ethics_Task_Force.pdf.

2 See Final Report of the ABI Commission on Consumer Bankruptcy (2019) at pp. 89-102, available at commission.abi.org/full-report.

3 *Id.* at pp. 93-94.

4 *Id.* at p. 94.

5 *Id.* at pp. 94-99.

6 *Id.* at p. 99.

7 *Id.* at pp. 99-100.

8 *Id.* at p. 101.

9 *In re Chanda S. Carr*, 2020 WL 373507, Case No. 19-20873 (Bankr. E.D. Ky. Jan. 22, 2020).

10 Model Rule 1.1.

11 Model Rule 1.2.

12 ABI Task Force Report, *supra* n.1, at pp. 53-54.

in representing a client.”¹³ Again, the tension arises with respect to the diligence required of an attorney representing a debtor that has not paid in advance for all services required to navigate the chapter 7 process. With unbundling, the attorney limits financial exposure and could be acting with reasonable diligence in the context of the agreed-upon services. However, the question remains whether the limited scope of the representation itself can be considered an ethical breach with regard to diligence. If the attorney only files a petition and leaves the rest of the process to the debtor to navigate, the attorney arguably has not acted with reasonable diligence, regardless of the limited scope.

Fourth, Model Rule 1.5 provides that “[a] lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses”¹⁴ and that “[t]he scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation.”¹⁵ The questions with respect to unbundling and bifurcation relate to reasonableness. The attorney might run afoul of Model Rule 1.5 if the fees are not adequately disclosed, and the fees might not be considered reasonable if the attorney has not materially advanced the debtor’s efforts to successfully navigate the chapter 7 process.

Reasonable Bifurcation Offers a Solution

Hon. Tracey N. Wise recently issued an opinion that might represent another step forward in providing low-income debtors with access to justice while minimizing attorneys’ risk of nonpayment and incentivizing ethical and effective representation. In *Carr*, a detailed engagement in which the chapter 7 debtor agreed to pay \$300 pre-petition and \$1,185 post-petition for legal services was approved.¹⁶

Judge Wise noticed that one of the law firms regularly practicing before her had disclosed a fee arrangement that included a \$300 pre-petition payment and an anticipated \$1,185 post-petition payment.¹⁷ While she had no concerns about the quality of the legal services performed by the firm, she nevertheless found it appropriate to further investigate the firm’s arrangements with its chapter 7 clients.¹⁸ Accordingly, Judge Wise entered orders requiring the firm to file its written engagement agreements, requiring the U.S. Trustee to examine such engagement agreements and setting a hearing to discuss the firm’s fee practices.¹⁹

Judge Wise found that the firm normally holds an initial meeting with prospective clients to discuss the bankruptcy process and obtain basic information sufficient to assess bankruptcy options.²⁰ If chapter 7 is an appropriate option, the firm presents two payment options via a detailed written disclosure that the firm and debtor review together in

person.²¹ The first option is a flat fee, paid completely pre-petition, for \$1,135²² that covers a \$335 filing fee and \$800 in attorneys’ fees.²³ If the debtor cannot afford to pay \$1,135 in advance, the firm offers an arrangement in which it accepts payments pre- and post-petition pursuant to two separate contracts.²⁴ The disclosure provides that under this bifurcated agreement option, the debtor pays \$300 pre-petition for initial limited services, including the filing of a petition and list of creditors, plus an application to pay the filing fee in installments.²⁵ The post-petition payments total \$1,135, which are paid in 12 monthly installments of \$98.75.²⁶ In essence, the debtor pays an extra \$350 if he/she chooses the bifurcated agreement option.

Judge Wise outlined the numerous and detailed disclaimers set forth in both the initial disclosure provided to the debtor and the engagement agreements themselves. Particularly notable is a detailed list of the legal services that are excluded in the absence of the post-petition engagement, such as attendance at the meeting of creditors, the filing of the balance of required documents, providing documents to the chapter 7 trustee and U.S. Trustee, and payment in installments of the filing fee.²⁷ The disclosure includes in bold print a warning that the debtor’s failure to complete these tasks could result in dismissal of the case.²⁸

The disclosure includes a statement that the debtor was not required to retain the firm post-petition and that the debtor could retain another attorney or proceed *pro se*.²⁹ The disclosure then describes the separate post-petition agreement with the post-petition fee of \$1,185, which includes the filing fee.³⁰ The disclosure includes a clear notice (in bold print) that the agreement to pay \$1,185 for post-petition services would not be dischargeable and that the debtor would remain personally liable for those fees.³¹

Next, Judge Wise considered the separate engagement agreements. The pre-petition engagement agreement itemizes the services to be provided (prepare and file the petition, creditor matrix and application to pay filing fee in installments) and the services to be excluded.³² The pre-petition engagement agreement discloses that the agreement be terminated immediately after the filing of the petition.³³ It also describes the services that the firm would provide under the post-petition agreement, but recommends that the debtor hire an attorney even if the debtor does not retain the firm.³⁴ The firm also discusses each term of the pre-petition agreement with the debtor in person and has the debtor initial each paragraph and sign the agreement.³⁵

The post-petition agreement contains similar details with respect to the scope of services, delineating the rou-

13 Model Rule 1.3.

14 Model Rule 1.5(a).

15 Model Rule 1.5(b).

16 *Carr*, 2020 WL 373507, at *12.

17 *Id.* at *1.

18 *Id.*

19 *Id.*

20 *Id.*

21 *Id.* at *2.

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.*

26 *Id.* at *2.

27 *Id.*

28 *Id.*

29 *Id.*

30 *Id.*

31 *Id.* at *2.

32 *Id.* at *3.

33 *Id.*

34 *Id.*

35 *Id.*

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tine services to be provided, including transmitting documents to the chapter 7 trustee and U.S. Trustee; filing documents required to complete the petition; attending the meeting of creditors; responding to not more than one motion for relief from stay; taking reasonable steps to retrieve garnished funds; reviewing and executing reaffirmation agreements; arranging for a financial-management course; and paying the filing fee.³⁶ This agreement also contains specific exclusions for dischargeability actions and motions to avoid judicial liens, and includes the terms of payment.³⁷

As a matter of first impression in her district, Judge Wise concluded that the bifurcated fee arrangement complies with applicable Bankruptcy Code provisions, Bankruptcy Rules and applicable ethics rules.³⁸ Without limitation, she found that the pre-petition engagement and agreement and post-petition engagement agreement, as executed by the debtor, constitute written contracts that complied with § 528(a)(1) and that the terms of the engagement and the fees to be charged are clearly and conspicuously disclosed.³⁹ Judge Wise also held that the firm did not advise the debtor to incur debt to pay for legal services.⁴⁰ She found that the prohibition in § 526(a)(4) did not prevent a debtor from paying legal fees directly over time.⁴¹

Judge Wise concluded that the firm had not violated Bankruptcy Rule 1006(b)(3), which prohibits a debtor's attorney from being paid its legal fees before the filing fee is fully paid.⁴² The firm's post-petition engagement agreement specifically provides that the debtor's monthly payments would be applied first to the filing fee, then to interest and principal due for the attorneys' fees.⁴³ Judge Wise also determined that the firm was not a creditor of the debtor at the time of the petition.⁴⁴ Without limitation, the pre-petition engagement agreement, under which the debtor paid \$300 in advance, terminated upon the firm's filing of the chapter 7 petition.⁴⁵ The debtor owed the firm no money at the time of the petition.⁴⁶

Judge Wise held that the firm had disclosed a reasonable compensation arrangement with the debtor, as required by § 329(a) and Bankruptcy Rule 2016(b).⁴⁷ She found the firm's fees to be reasonable and commensurate with fees charged by other firms in her district.⁴⁸ She also concluded that the firm had not impermissibly withdrawn from representation in the debtor's case because the pre-petition engagement agreement clearly provided for termination of services upon the filing of the peti-

tion and the firm did not withdraw under the post-petition engagement agreement.⁴⁹ Judge Wise rejected the U.S. Trustee's argument that the firm did more work pre-petition than post-petition, such that the pricing under the agreements was unreasonable.⁵⁰ She concluded that the amount of work performed post-petition supported the higher flat fee.⁵¹

The firm in the Carr case “assiduously followed the best practices” drawn from prior cases. Notably, the firm’s disclosures followed many of the best practices also set forth by the ABI National Ethics Task Force.

Finally, Judge Wise found that the firm's bifurcated engagement with the debtor was in compliance with Kentucky's Rules of Professional Conduct.⁵² She opined that the firm had not impermissibly limited the scope of representation with respect to the services provided under the bifurcated engagements.⁵³ The limitation on the scope of the firm's work under the pre-petition engagement agreement was reasonable under the Kentucky version of Model Rule 1.2 because it clearly and conspicuously informed the debtor that additional steps were necessary to successfully complete the case.⁵⁴ Judge Wise walked through all of the steps the firm took to explain to the debtor — in writing and in person — the scope of the representation, the nature of the bifurcated engagements, and the debtor's option to proceed *pro se* or retain other counsel in lieu of executing the post-petition engagement agreement.⁵⁵ Judge Wise then determined that the firm took all necessary steps to provide competent representation under the Kentucky version of Model Rule 1.1, which ultimately led to the debtor receiving a chapter 7 discharge.⁵⁶ While noting that other courts have held that certain tasks in a bankruptcy case are so fundamental that they cannot be unbundled, Judge Wise concluded that the firm's bifurcated engagement in this case did not present ethical problems.⁵⁷

Detailed Disclosures Drive the Result

Judge Wise's opinion follows the lead of several cases in other jurisdictions where bifurcated engagements have

36 *Id.* at *4.

37 *Id.*

38 *Id.* at *6.

39 *Id.* at *6-*7.

40 *Id.* at *7.

41 *Id.*

42 *Id.* at *8.

43 *Id.*

44 *Id.*

45 *Id.*

46 *Id.* at *8-*9.

47 *Id.* at *9.

48 *Id.*

49 *Id.*

50 *Id.*

51 *Id.*

52 *Id.* at *10.

53 *Id.*

54 *Id.*

55 *Id.*

56 *Id.* at *11.

57 *Id.*

been approved, including *Hazlett*⁵⁸ and *Walton*.⁵⁹ These courts have recognized that the bifurcated agreements serve the important purpose of providing debtors access to the bankruptcy process — access that might not otherwise have existed.⁶⁰ However, the key takeaway is that bifurcated engagements will only work in the context of “informed consent,” which results from detailed disclosures.

58 *In re Hazlett*, Case No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah April 10, 2019).

59 *Walton v. Clark & Washington*, 469 B.R.383 (Bankr. M.D. Fla. 2012).

60 *Carr*, 2020 WL 373507, at *12.

The firm in the *Carr* case “assiduously followed the best practices” drawn from prior cases.⁶¹ Notably, the firm’s disclosures followed many of the best practices also set forth by the ABI National Ethics Task Force.⁶² Because of the detailed disclosures provided by the firm, the debtor had a clear understanding of the engagement and was able to proceed through chapter 7 with informed consent.⁶³ **abi**

61 *Id.*

62 ABI Task Force Report, *supra* n.1, at p. 55.

63 *Carr*, 2020 WL 373507, at *12.

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