Ensuring “Access” and “Justice”

USTP’s Enforcement Guidelines for Bifurcated Fee Agreements

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

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1 See Lamie v. United States Trustee, 540 U.S. 526, 537 (2004) (chapter 7 debtor’s 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 abai.org/abi-journal (unless otherwise specified, all links in this article were last visited on July 26, 2022).


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 abai.org/abi-journal; Garrison, supra n.3.


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

9 Walton, 469 B.R. at 385.

10 Id.
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. In exchange, the finance company charges a fee, which is often a substantial percentage of the total attorney’s fee charged.

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. 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 be fully, completely, and accurately disclosed in addition to being reasonable. Period.”

The U.S. Bankruptcy Court for the Southern District of Florida has followed similar principles and provided guidance for proper bifurcation in the district. It was particularly concerned with adequate client disclosures and informed consent, and set out detailed requirements. The court also outlined the attorney’s duties and services that must be performed pre- and post-petition. 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. 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. 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.

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 uncompromised) 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.

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. Subsequent cases have adopted the Prophet court’s reasoning, which remains good law in those districts. 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.

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. 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 exemp-

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12 Id.
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.
24 Suazo, 2022 WL 2197957 at *17 (“[T]he two-contract model ... was wholly illusory.”); Siegle, 639 B.R. at 759.
tions. 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. Finally, attorneys should not advance filing fees and seek post-petition reimbursement, as advanced filing fees are dischargeable pre-petition loans.

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, 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. 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.

**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.”

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. Even debtor’s counsel conceded that the debtor did not understand the distinction between the duties imposed by the pre- and post-petition

**Public Disclosures**

Full disclosure of professionals’ dealings with their client is a hallmark of the Bankruptcy Code and Rules. 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.

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26 See 11 U.S.C. § 707(b)(4). See also U.S. Trustee v. Ashcroft, 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 filled 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 102-93.
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.
39 See, e.g., SE Prop. Holdings LLC v. Stewart, 970 F.3d 1255, 1266 (10th Cir. 2020).
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, 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

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