Case Law & Rules Regarding the Sharing, Bifurcation, Factoring, Financing & Disclosure of Attorneys Fees in Individual Chapter 7 Cases
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Charging a surcharge to bifurcate fees is unreasonable. *In re Allen*, 628 B.R. 641 (B.A.P. 8th Cir. 2021)

The U.S. Trustee filed a motion challenging the fees charged by the attorney of two individual chapter 7 debtors. Both debtors had selected a "later pay" option, which allowed payments on a $2,000 fee to be made postpetition on a monthly basis for twelve months. Had they chosen a full, up-front payment, the fee would have been $1,500. The bankruptcy court entered orders approving attorney fees, but only in the lower amount of $1,500. The attorney appealed.

The bankruptcy court found that the attorney provided the same services he would have provided to both debtors under either the pre-pay or later-pay arrangements – namely, prepetition counseling, filing the petition and statement of financial affairs, filing all documents required by § 521 of the Bankruptcy Code, and attending § 341 hearings. The debtors each received a discharge in due course, and the trustee filed a report of no distribution in each case. Based on these findings, the court found that the extra $500 contemplated under the post-filing fee arrangement exceeded the value of the services provided by the attorney.

The attorney argued on appeal that the bankruptcy court was required to consider the reasonableness of his fees in these cases under a lodestar analysis, which is "the number of hours reasonably expended on the litigation [is] multiplied by a reasonable hourly rate." Rejecting that argument, the Eighth Circuit BAP held that courts are not bound to apply the lodestar calculation in every case where attorney fees are challenged, particularly when attorneys charge a no-look fee. Pointing out that the attorney bore the burden of proving reasonableness, the BAP held that the bankruptcy court did not abuse its discretion in reducing the fees.

Attorney who bifurcated and factored attorney fees in numerous cases referred for discipline for violation of numerous ethics rules. *In re Kolle*, __ B.R. ___, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021).

The United States Trustee ("UST") filed adversary complaints in four chapter 7 bankruptcy cases against an attorney and his law firm, seeking sanctions, disgorgement, and discipline, arising out of the attorney's and his law firm's practice of failing to disclose they had "factored" fees owed to them by some of their chapter 7 debtor clients. After a court-ordered mediation, the parties reached a settlement requiring the law firm to disgorge fees and to pay a civil penalty as to those cases. When the motion seeking the court's approval for the settlement was filed, however, it came to light that the factoring and nondisclosure had occurred – not just in the four cases – but in an additional 100 cases or more. In considering additional sanctions against the attorney based on the newly-revealed cases, the court reviewed ten of those cases at random.

As has been true in the Western District of Missouri for some time, bifurcated fee agreements are generally not prohibited by the Code or Rules, so long as the allocation between

pre- and postpetition services is reasonable, the court held. In this case, the court had no choice but to find that the attorney disclosures in these cases violated the Code, Rules, and local rules by (1) failing to disclose to the court what the attorney had agreed to charge for his legal fees; (2) failing to disclose to the court what payments he received; (3) failing to disclose to the court a "complete statement" of his fee agreements and arrangements for payment with a factor (BK Billing); (4) failing to seek approval of the agreements under this court's local rule; and (5) failing to show that his fees were reasonable. The attorney also violated the Rights and Responsibilities Agreement (which is required under local rule to invoke the presumption that a flat fee is reasonable) by failing to agree to provide pre- and postpetition services to these debtors for one fee.

The court laid out what the Bankruptcy Code, Bankruptcy Rules, local rules, and disciplinary rules require. Because the attorney had already agreed in the settlement with the UST to disgorge fees and pay a civil penalty, the court concluded that no additional monetary sanction was warranted, but made a disciplinary referral to the Office of Chief Disciplinary Counsel of the State of Missouri based on the findings in the case.

Attorneys violated multiple bankruptcy rules, code provisions, and ethics rules under its bifurcation, factoring, and fee-advancement agreements with debtors. *In re Rosema*, ___ B.R. ____, No. 19-30584-BTF7, 2022 WL 2662869 (Bankr. W.D. Mo. July 8, 2022).

The bankruptcy court ordered two attorneys representing debtors in fifteen chapter 7 cases to show cause regarding the fees they charged their respective debtors. The attorneys and the UST, recognizing that they had no authority to "settle" the court's orders to show case, asked the court approve an agreement they had reached, believing the agreement addressed the court's concerns about the fees. In part, the settlement recognized that the attorneys had entered into pre- and postpetition agreements with their clients using forms drafted by Fresh Start Funding which had provided the attorneys with financing secured by the attorneys' accounts receivables. Under the agreement between Fresh Start and the attorneys, Fresh Start was to receive 25% of the "fees" paid by the debtors. The agreements between the debtors and the attorneys provided that the attorneys' fees would be paid through postpetition payments.

In some of the cases, the attorneys also advanced the filing fee, which was to be collected from the debtors postpetition. The attorneys acknowledged that in most of the cases the postpetition attorney fees charged were higher than the fees the attorneys normally charged for clients who paid in advance. They also acknowledged that the fee was unreasonable under § 329(b) to the extent the total fee exceeded the customary fee charged for chapter 7 cases and that their fee disclosures "were insufficient and misleading." Finally, the attorneys ultimately admitted that they had unbundled their services contrary to the local "rights and responsibility" agreements, which require attorneys to provide unbundled legal services for the pre- and postpetition obligations for a flat fee, and which they had signed with their clients.

In addition to disgorging fees in the cases and telling Fresh Start to stop collecting any unpaid balances from the debtors in these cases, the attorneys agreed that they would fully comply with the disclosure rules and no longer finance their fees using Fresh Start's program or any similar program. The attorneys also agreed that they would indemnify and make whole their clients to the

extent they suffered damages because of Fresh Start's credit reporting. And, the attorneys agreed to self-report the situation to the appropriate disciplinary authorities.

The court approved the settlement, stating that it was very similar to what the court would have ordered. But, in so ruling, the court said it was clear that the attorneys' disclosures were insufficient and misleading; that they charged unreasonable fees in most of the cases; they violated the local rules by executing the RRA but also bifurcating the fees and unbundling their fees; they had a conflict of interest with their clients; they had their clients agree to contracts that were void under § 528; and they allowed Fresh Start "to unreasonably interfere with their independent business judgment by requiring their use of fee agreements and modified disclosure forms; unreasonably allowed [Fresh Start] to obtain confidential client information without adequate informed consent; and unethically financed their attorney fees, among other potential ethical violations."

Misleading bifurcated fee agreements held to be void. *In re Siegle*, 639 B.R. 755 (Bankr. D. Minn. 2022)

Counsel for this chapter 7 debtor filed an application to approve a bifurcated fee agreement. As is often the case in these little or zero-down bifurcated cases, the debtor was advised she had three options as to anything that occurred in her case postpetition: (1) sign the full fee agreement postpetition, (2) proceed *pro se*, or (3) hire another bankruptcy lawyer. The attorney filed the case, and the debtor signed the postpetition agreement.

The court found the advice about the available options to be untrue and misleading in violation of §§ 526(a)(2) and (3) since, *inter alia,* the attorney could not withdraw from the case after filing the petition under local rule. In the bankruptcy context, it "is well recognized that 'once counsel appears in a bankruptcy case for a debtor, withdrawal is not generally allowed unless replacement counsel is available, even if the reasons for withdrawal appear justified under the rules.'" Further, presence of both accurate and inaccurate statements in a fee agreement also implicate the requirement set forth in § 528(a)(1), which requires that the explanation of services be stated "clearly and conspicuously." The fact that the agreement appeared in lengthy, single-spaced documents compounded this problem.

The court held that this type of bifurcation not only violates the Minnesota local rule, but also that these bifurcated fee agreements failed to comply with the material requirements imposed on attorney-client relationships. For those reasons, court disapproved the fee application and declared the agreements to be void. In conclusion, the court gave helpful guidance to consumer practitioners:

> 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). Further, the presence of both true and untrue statements in a fee

agreement does not comply with the requirement to "clearly and conspicuously" explain the services that will be provided, in violation of § 528(a)(1). These material defects render the Agreements statutorily void under § 526(c)(1).

Applicable Bankruptcy Code and Rules

Fed. R. Bankr. P. 2014
- requires counsel to disclose “any proposed arrangement for compensation”

11 U.S.C. § 329(a)
- requires disclosure of compensation paid or to be paid in connection with representing a debtor in a bankruptcy case

Fed. R. Bankr. P. 2016(b)
- requires that compensation be disclosed within 14 days after the order for relief

11 U.S.C. § 329(b)
- authorizes the court to cancel the agreement or order the return of a payment to the extent the payment is excessive

Fed. R. Bankr. P. 2017(a), (b)
- allows the court, after notice and a hearing, to determine whether payments made to an attorney either before or after the filing of a petition are excessive

11 U.S.C § 504
- with certain exceptions, sharing of compensation is prohibited

11 U.S.C §§ 523 and 727
- a chapter 7 discharge discharges pre-petition debt, except for certain enumerated nondischargeable debts in § 523

11 U.S.C § 524
- because any prepetition obligation that is not paid prior to a chapter 7 filing is subject to discharge under § 524, bifurcated agreements are sometimes designed to change the attorney’s prepetition fees into a postpetition, nondischargable debt11 U.S.C § 526(a)(4)

11 U.S.C § 526(a)(2), (a)(2), (a)(4); (c)(1)
- making an misleading statements, misrepresenting the services to be provided or benefits and risks of the representation and advising an assisted person or prospective assisted person to incur more debt in contemplation of filing a bankruptcy case are all prohibited; any contract that does not comply is void

11 U.S.C § 528
- lists the requirements for debt relief agencies providing bankruptcy assistance for debtors

28 U.S.C § 1930 & Fed. R. Bankr. P. 1006
- 28 U.S.C. § 1930 sets out bankruptcy filing fees
- Rule 1006, which incorporates 28 U.S.C. § 1930, requires bankruptcy filing fee installments to be paid within 120 days after a debtor files a bankruptcy petition
- The Rule specifically prohibits a debtor’s attorney from receiving any fee payments before the filing fee is fully paid

Applicable Model Rules of Professional Conduct

Rule 1.1 Competence

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Rule 1.2: Scope of Representation & Allocation of Authority Between Client & Lawyer

(a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter. . . .

* * *

(c) A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent. . . .

Rule 1.3: Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

Rule 1.4: Communications

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;
(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
(3) keep the client reasonably informed about the status of the matter;
(4) promptly comply with reasonable requests for information; and
(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Rule 1.5: Fees

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
(3) the fee customarily charged in the locality for similar legal services;
(4) the amount involved and the results obtained;
(5) the time limitations imposed by the client or by the circumstances;
(6) the nature and length of the professional relationship with the client;
(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
(8) whether the fee is fixed or contingent.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

* * *

(e) A division of a fee between lawyers who are not in the same firm may be made only if:

(1) the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation;
(2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
(3) the total fee is reasonable.

Rule 1.6: Confidentiality of Information

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

* * *

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

Rule 1.7: Conflict of Interest: Current Clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or
(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
(2) the representation is not prohibited by law;
(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
(4) each affected client gives informed consent, confirmed in writing.

Rule 1.8: Conflict of Interest: Current Clients: Specific Rules

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

* * *

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

> (1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter;
> (2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client; and
> (3) a lawyer representing an indigent client pro bono, a lawyer representing an indigent client pro bono through a nonprofit legal services or public interest organization and a lawyer representing an indigent client pro bono through a law school clinical or pro bono program may provide modest gifts to the client for food, rent, transportation, medicine and other basic living expenses. The lawyer:
>
> > (i) may not promise, assure or imply the availability of such gifts prior to retention or as an inducement to continue the client-lawyer relationship after retention;
> > (ii) may not seek or accept reimbursement from the client, a relative of the client or anyone affiliated with the client; and
> > (iii) may not publicize or advertise a willingness to provide such gifts to prospective clients.
> > Financial assistance under this Rule may be provided even if the representation is eligible for fees under a fee-shifting statute.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

> (1) the client gives informed consent;
> (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
> (3) information relating to representation of a client is protected as required by Rule 1.6.

* * *

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

Rule 1.15: Safekeeping Property

(a) A lawyer shall hold property of clients or third persons that is in a lawyer’s possession in connection with a representation separate from the lawyer’s own property. Funds shall be kept in a separate account maintained in the state where the lawyer’s office is situated, or elsewhere with the consent of the client or third person. Other property shall be identified

as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of [five years] after termination of the representation.

(b) A lawyer may deposit the lawyer's own funds in a client trust account for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose.

(c) A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

(d) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(e) When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

Rule 5.4: Professional Independence of a Lawyer

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

(1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;
(2) a lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price;
(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and
(4) a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.

(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;
(2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation ; or
(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

Rule 3.3: Candor Towards the Tribunal

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;
(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or
(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

Rule 8.4: Misconduct

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law;

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law; or

(g) engage in conduct that the lawyer knows or reasonably should know is harassment or discrimination on the basis of race, sex, religion, national origin, ethnicity, disability, age, sexual orientation, gender identity, marital status or socioeconomic status in conduct related to the practice of law. This paragraph does not limit the ability of a lawyer to accept, decline or withdraw from a representation in accordance with Rule 1.16. This paragraph does not preclude legitimate advice or advocacy consistent with these Rules.

ADDENDUM
Guidelines for Attorney Fee Approval in the Western District of Missouri

The Bankruptcy Code, Bankruptcy Rules, and local rules require, with respect to fee agreements between individual debtors and their attorneys in the Western District of Missouri, is that:

1. All agreements made after one year before the filing of the case for services rendered or to be rendered related to representation of a debtor in a case under title 11 or in connection with a case must be disclosed pursuant to § 329(a), Rule 2016(b), Official Form B2030, and L.R. 2016-1.A;

2. All payments paid or agreed to be paid related to representation of a debtor in a case under title 11 or in connection with a case must be disclosed pursuant to § 329(a), Rule 2016, Official Form B2030, and L.R. 2016-1.A;

3. The source of the payments made or to be made must be disclosed pursuant to Official Form B2030 and the payments shared only as permitted by the Code, rules and applicable ethics rules;

4. The attorney's signature on the disclosure constitutes a certification that the disclosure is a complete statement of any agreement or arrangement for payment to the attorney pursuant to Official Form B2030;

5. All agreements and all payments must be reasonable pursuant to § 329(b);

6. Any change to agreements and any additional payments received by the attorney must be disclosed with the timely filing of a supplemental disclosure until the case is closed pursuant to Official Form B2030, Rule 2016(b), and L.R. 2016-1.D;

7. Attorneys must execute the RRA unless excused by court order pursuant to L.R. 2016-1.A;

8. If the attorney executes the RRA and charges a total fee of less than the applicable no look amount, the fee will be deemed presumptively reasonable, but the attorney must represent the debtor for the disclosed fee for both the pre- and postpetition services set forth in the RRA pursuant to L.R. 2016-1.A and the RRA;

9. If the attorney does not execute the RRA agreeing to represent the debtor for pre- and postpetition services or charges a total fee in excess of the no look, or otherwise agrees to a nonstandard fee agreement, the attorney must disclose whatever the agreement is, disclose whatever the payments have been or will be, file a motion to approve the agreement and payments, and hold any payments in trust, pending court approval pursuant to L.R. 2016-1.C; and

10. A failure to comply with any of these requirements is subject to sanctions, disgorgement, or discipline pursuant to § 329(b), Rule 2017, and the court's inherent and equitable powers.

***In re Kolle*, ___ B.R. ____, 2021 WL 5872265, at *31 (Bankr. W.D. Mo. Dec. 10, 2021).**