By Stephen W. Sather

Courts Find Obstacles to Limited Representation in Consumer Cases

Stephen W. Sather
Barron & Newburger, PC
Austin, Texas

Stephen Sather is head of Barron & Newburger, PC's Bankruptcy Section in Austin, Texas, and is board certified in business bankruptcy law by the American Board of Certification and the Texas Board of Legal Specialization.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) added new responsibilities for consumer debtors. These include pre-petition credit counseling,[1] satisfying a means test for above-median debtors[2] and post-petition financial education.[3] BAPCPA also added new requirements for consumer bankruptcy lawyers, including that they provide required notifications,[4] as well as a written agreement.[5] These new requirements increased the cost for consumer debtors. According to ABI's Consumer Bankruptcy Fee Study, the average cost of filing a chapter 7 case increased by 30 percent while the cost for filing for chapter 13 increased by 24 percent.[6] As a result, there are some debtors who are just too poor to afford bankruptcy.

Consequently, many jurisdictions have seen an increase in *pro se* filings,[7] which are often associated with poorer results for the debtor.[8] What can be done to accommodate debtors who cannot afford a bankruptcy lawyer? *Pro bono* legal services by bar associations and firms are certainly part of the answer, but they can only accommodate a limited number of filers. Two other options that some firms have tried include bifurcation of fees and unbundling, or "*à la carte*," services, both of which provide some benefit for consumers while raising ethical concerns.[9]

Bifurcation of Fees

When a debtor cannot pay the full cost for a bankruptcy in advance, there is a risk that the unpaid portion of the fee agreement will be discharged as a pre-petition debt.[10] This can cause a conflict of interest between an attorney and client because the law firm becomes a creditor attempting to collect a discharged debt from its client or could be obligated to provide the balance of the services without compensation.

Bifurcation attempts to solve this problem by dividing the engagement into two parts. Bifurcated agreements are generally structured so that minimal services — limited to those essential to commencing the case — are performed under a pre-petition agreement for a modest (or no) fee, while all other services are performed post-petition, under a separate post-petition retention agreement, arguably rendering those fees nondischargeable. In other words, the consumer pays one fee for what can be referred to as the "basic package." If the debtor wishes to engage the firm to provide additional services, it can enter into a separate agreement post-petition. The ethical risk is that the services provided for the initial fee will most likely be insufficient to help the client make it to the point of discharge, and the client may be effectively forced to sign a new contract that would not be subject to the disclosure requirement of the Bankruptcy Code.

Recently, the U.S. Trustee Program has issued amended guidelines for bifurcated representation,[11] which state:

> Absent contrary local authority, it is the [U.S. Trustee Program]'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.[12]

These amended guidelines were issued because the benefits these types 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.

However, while these principles seem straightforward, application thereof is difficult in practice. Bankruptcy courts have concluded in the past that a zero-down fee agreement that requires the law firm to advance the filing fee violates the prohibition against advising an assisted person to incur debt in contemplation of a bankruptcy proceeding provided for in 11 U.S.C. § 526.[13]

1 11 U.S.C. § 109(h).
2 11 U.S.C. § 707(b)(2).
3 11 U.S.C. § 727(a)(11).
4 11 U.S.C. § 527(a).
5 11 U.S.C. § 528(a).
6 Prof. Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, (December 2011), p.6, *available at* ssrn.com/abstract=2132913 (unless otherwise specified, all links in this article were last visited on June 27, 2023).
7 Ed Flynn & Phil Crewson, "Data Show Trends in Post-BAPCPA Filings," XXVII *ABI Journal* 6, 14, 64-65, July/August 2008, *available at* abi.org/abi-journal (noting two locations in California and one in Arizona where *pro se* filings exceed 20 percent of cases filed).
8 Angela Littwin, "The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for Its Surprising Success," 52 *Wm. & Mary L. Rev.* 1933 (2011).
9 In addition to state ethical rules governing lawyers in general, consumer debtors' attorneys who qualify as debt-relief agencies are also subject to 11 U.S.C. §§ 526-528. Among other things, a debt-relief agency must present a client with a contract within five business days and may not misrepresent the services to be provided.
10 *Rittenhouse v. Eisen*, 404 F.3d 395, 397 (6th Cir. 2005).
11 Guidelines for U.S. Trustee Program Enforcement Related to Bifurcated Chapter 7 Fee Agreements (June 10, 2022) (hereinafter, "Guidelines"), *available at* justice.gov/ust/bifurcated-fee.
12 *Id.* at p. 2.
13 11 U.S.C. § 526(a)(4); *In re Brown*, 631 B.R. 77 (Bankr. S.D. Fla. 2021).

Prior to the June 10, 2022, bifurcated fee agreements USTP amended guidelines, law firms struggled with providing workable solutions. For example, in 2021 an attorney in the Middle District of Florida charged his client a fully earned fee of $388, which he deposited into his operating account, which covered the filing fee and credit-counseling fee.[14] The agreement stated that the firm would advance the filing fee after the case had been filed and seek reimbursement from the client.[15] The bankruptcy court voided this agreement for two reasons: (1) It violated the rule that the filing fee accompany the petition;[16] and (2) the attorney did not hold the filing fee in its trust account. While this case was decided before the amended U.S. Trustee guidelines were adopted, the governing statutes remain the same and would likely not be affected by the guidelines.

The difficulty of drafting a bifurcated fee agreement continues to be challenging, as illustrated by two South Carolina district court opinions.[17] In the first case, the attorneys offered their clients two different options. Under the "pay before you file" option, the client paid the entire attorneys' fee before filing for bankruptcy.[18] In contrast, the "file now, pay later" option allowed a client to pay a lesser fee that would cover services through the first meeting of creditors and a few other services.[19] The client would then enter into a post-petition fee agreement with the attorneys, hire another law firm or proceed *pro se*.[20]

The bankruptcy court ruled that bifurcated fee agreements were *per se* impermissible. The district court reversed, finding that bifurcated fee agreements were not categorically prohibited and remanded the case to the bankruptcy court for additional proceedings. On remand, the bankruptcy court found that the fees charged were excessive and that the clients did not give informed consent due to lack of sufficient notice and therefore disallowed all post-petition fees mandating refunds, less filing fees or out-of-pocket expenses incurred.[21]

The bankruptcy court found fault with multiple aspects of the agreements. First, it found that the two agreements created a unitary agreement such that the agreement to provide post-petition fees was discharged. Next, it found that the disclosure given to clients was inadequate, as the agreements left a blank for the amount to be paid for pre-petition fees. The bankruptcy court found that because the pre-petition charge was negotiated rather than fixed, that "may leave clients confused as to how much they can or have to pay."[22] The bankruptcy court also found that the firm charged excessive fees for the bifurcated fee because it charged $2,800 for the two-part fee and only $2,350 for the up-front fee.[23] On appeal, the district court affirmed, finding that the bankruptcy court's findings were not clearly erroneous.

The second district court opinion illustrates the difficulty in drafting an enforceable bifurcated fee agreement. The majority of the work that a consumer debtor's attorney undertakes would fall within the period of the pre-petition fee agreement. However, if the amount to be paid up front is not fixed, then it appears that the division of the fee between pre- and post-petition services is designed to be a financing device rather than a true estimation of the services to be rendered under each agreement. In addition, the fact that a bankruptcy case is a court proceeding where counsel may only withdraw with court permission means that, as a practical matter, the attorney would be obligated to perform the post-petition services regardless of whether the second contract was entered into.[24]

A group of attorneys dedicated to helping *pro se* parties navigate the bankruptcy system could develop sufficient expertise to fill the gap left by paid attorneys while avoiding the distortions created by charging clients with limited resources.

The problem of bifurcated fee arrangements can also arise where the attorney's standard fee agreement excludes representation in fraud-based nondischargeability adversary proceedings when the primary purpose for the representation is to discharge a debt that would have likely resulted in an adversary proceeding. When the attorney refused to represent the debtor in the adversary proceeding, the court found that the attorney had failed to obtain the debtor's informed consent for the exclusion and imposed sanctions.[25]

The paradox of the bifurcated fee agreements is that they attempt to increase access to bankruptcy relief by solving the problem of affordability by placing counsel in an adverse position to a client, which in and of itself is improper in a bankruptcy context. Congress could solve this problem by deeming attorney fee agreements nondischargeable the same as it provided that loans against certain retirement plans are nondischargeable.[26] However, without congressional action, drafting bifurcated fee agreements may prove impossible.

Unbundling

Unbundling is a more extreme form of limited representation than bifurcation, but it has its own possibilities and challenges. Unbundling is a form of limited representation where a client hires an attorney for certain limited purposes. The American Bar Association (ABA) Model Rules of Professional Conduct recognize that an attorney can "limit the

14 *In re Digregorio*, 645 B.R. 262, 263-65 (Bankr. M.D. Fla. 2022).
15 *Id.*
16 Fed. R. Bankr. P. 1006.
17 *Benjamin R. Matthews & Assocs. v. Fitzgerald (In re Prophet)*, 639 B.R. 664, 667 (D.S.C. 2022); *Prophet v. Fitzgerald (In re Rosenschein)*, 2023 U.S. Dist. LEXIS 80981 (D.S.C. 2023).
18 *In re Prophet*, *supra.*
19 *Id.*
20 *Id.*
21 *In re Rosenschein*, *supra.*
22 *Id.* at *20.
23 *Id.* at *21; *see also In re Siegle*, 639 B.R. 755 (Bankr. D. Minn. 2022) (stating that attorney's "unbundling" of legal services to exclude representation in adversary proceedings when, had he conducted adequate initial consultation, he would have known that filing of fraud-based nondischargeability was near certainty, was "unreasonable" and violative of state Rules of Professional Conduct).
24 Other recent cases where attorneys have encountered problems with bifurcated fee agreements include *United States Trustee v. Cialella (In re Anthony)*, 643 B.R. 789 (Bankr. W.D. Pa. 2022); *In re Andrus*, 2022 Bankr. LEXIS 1244 (Bankr. D. Id. 2022); *In re Descoteau*, 2022 Bankr. LEXIS 1295 (Bankr. D. Idaho 2022); *In re Rosema*, 641 B.R. 896 (Bankr. W.D. Mo. 2022).
25 *Dignity Health v. Seare (In re Seare)*, 493 B.R. 158 (Bankr. D. Nev. 2013), *aff'd*, 2014 Bankr. LEXIS 3584 (B.A.P. 9th Cir. 2014).
26 11 U.S.C. § 523(a)(18).

continued on page 60

from page 33

scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent."[27] The ABA has compared unbundling to an *à la carte* menu:

> Unbundling, or limited-scope representation, is an alternative to traditional, full-service representation. Instead of handling every task in a matter from start to finish, the lawyer handles only certain parts and the client remains responsible for the others. It is like an *à la carte* menu for legal services, where: (1) clients get just the advice and services they need and therefore pay a more affordable overall fee; (2) lawyers expand their client base by reaching those who cannot afford full-service representation but have the means for some services; and (3) courts benefit from greater efficiency when otherwise self-represented litigants receive some counsel.[28]

Imagine a situation where a debtor wishes to proceed *pro se* but wants an attorney to advise him on his choice of exemptions. Can the attorney charge the client $100 to review the exemptions without taking on any other obligations in the case? What if a *pro se* debtor wishes to have representation at the first meeting of creditors but does not want the attorney involved in preparing the bankruptcy petition?

The main difficulties with unbundling are that first, the attorney providing the limited representation must charge not just for the services provided but for the administrative cost of establishing the representation. Thus, a debtor who receives multiple forms of *à la carte* assistance may pay more than if he simply hired a full-cost attorney. The second is that an attorney providing *à la carte* assistance might not have sufficient information to provide the services. Exemptions may only be claimed on property that is properly scheduled. Therefore, exemption counseling will either be incomplete or require analysis of the completeness of the debtor's schedules.

As a result, there is a risk that *à la carte* representation will not provide a good value for the debtor. Finally, if the attorney enters an appearance in the case, she may not be permitted to withdraw.[29] If she does not enter an appearance, she may be subject to regulation as a petition-preparer[30] and must ensure that the debtor accurately discloses the fees paid to her and make 11 U.S.C § 110 disclosures.[31]

A Possible Solution

If full-price fees continue to increase and courts continue to find obstacles to limited representation, one option may be to create an Office of *Pro Se* Assistance within the U.S. Trustee's Office. A group of attorneys dedicated to helping *pro se* parties navigate the bankruptcy system could develop sufficient expertise to fill the gap left by paid attorneys while avoiding the distortions created by charging clients with limited resources.

This would be a dramatic shift in the mission of the U.S. Trustee's Office, which is currently dedicated to enforcement rather than assistance and could create conflicts within the office. However, it could be analogized to the Taxpayer Advocate Service within the Internal Revenue Service.[32] While a debtor assistance program (or one offered *pro bono* by local bar associations) would be novel, it could help bridge the *pro se* knowledge and accessibility gap. abi

27 ABA Model Rules of Prof'l Conduct 1.2(c).
28 Unbundling Resource Center, Am. Bar Ass'n, *available at* americanbar.org/groups/delivery_legal_services/resources.
29 *See* n.22.
30 11 U.S.C. § 110.
31 11 U.S.C. § 329(a); Fed. R. Bankr. P. 2016(b).
32 "IRS Taxpayer Assistance Centers," Taxpayer Advocate Serv., *available at* taxpayeradvocate.irs.gov/tax-terms/irs-taxpayer-assistance-centers-tacs.