**Navigating the Confluence of Access to Justice and the Business of Law**:
The History and Modern Practice of Bifurcating Consumer Chapter 7 Cases

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## INTRODUCTION

Consumer debtors are struggling longer than ever outside of bankruptcy, and when they do file find it more difficult than ever to pay for an attorney's assistance. Debtors should have affordable and immediate access to bankruptcy without compromising their attorney's ability to be paid. Unfortunately, however, many debtors simply can't prepay a chapter 7 attorney's fee. This reality leaves debtors without many workable options: they can delay filing and hire an attorney on a so-called "layaway plan" that prolongs their financial distress for months and sometimes years; they can file *pro se* and try to navigate the system on their own at a significantly higher risk of failing to achieve a discharge; or they can file a so-called "fee-only" chapter 13, typically at a much higher cost and with a vastly reduced chance of achieving a discharge.

This dilemma has led to the rise of "bifurcated" chapter 7 engagements. In a bifurcated engagement, the debtor signs a pre-petition engagement agreement with an attorney and pays little or no money down to get their case filed. The debtor then signs a post-petition engagement agreement to have the same attorney represent them for the balance of the case. By creating a separate, post-petition obligation between the attorney and client that is not subject to the stay or discharge, the attorney can offer post-petition payment terms, allowing the client the benefit of an immediate filing despite lacking sufficient money to prepay the attorney.

The practice of bifurcation is not new. There is a 25-year history of caselaw dealing with the mechanics and ethics of offering chapter 7 debtors post-petition payment terms. This caselaw provides a clear roadmap for offering debtors this option legally and ethically. The practice offers a practical solution to the increasing problem of low-income debtors affording legal representation in chapter 7.

## LEGAL ANALYSIS

### A. The Current Plight of Debtors and Inadequacies of the System

Debtors are languishing outside of bankruptcy longer than ever before and at great personal and societal costs. In a recently published article, the co-investigators of the Consumer Bankruptcy Project summarized these conclusions after a comprehensive review of the bankruptcy system. See "Life in the Sweatbox," Pamela Foohey, Robert M. Lawless, Katherine Porter & Deborah Thorne, 94 *Notre Dame L. Rev.* 219 (2018) (hereinafter, "*Sweatbox*"). Among their conclusions:

- debtors wait longer than ever before to file, despite crushing financial pressure, id. at 235;
- debtors and, in particular, "long strugglers" who languish two years or more in financial distress before filing, arrive in bankruptcy with less assets and higher debts, id. at 239-41;
- debtors (and, again, particularly "long strugglers") go without "medicine, food, utilities, car repairs, and paying the mortgage or rent" before filing, id. at 242-43;
- this "[f]inancial misery hurts families," id. at 255;
- "existing in a state of money scarcity damages people's ability to lead productive lives," id. at 257; and,

- entering bankruptcy with higher debts and fewer assets hampers people's ability to truly obtain a fresh start, regardless of the discharge, id. at 259-60.

**B. The Importance of Representation to a Debtor's Success in Chapter 7**

Once debtors make the difficult choice to file bankruptcy, the assistance of counsel becomes critical to their success. *Pro se* debtors have a far lower chance of achieving a discharge than those who have attorneys. Virtually all represented debtors obtain a discharge, but *pro se* debtors have a several times higher likelihood of failing to achieve this fresh start. See *Sweatbox* at 229 n. 55; see also Angela K. Littwin, "The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for Its Surprising Success," 52 W. & Mary L. Rev. 1933, 1974 tbl. 3b (2011) (summarizing study results that represented chapter 7 debtors were nine times more likely to get a discharge than unrepresented debtors). Moreover:

> [t]he burden that *pro se* debtors place on the court system has been widely recognized. Judges, trustees, and court staff have detailed the extra time and system resources eaten up by aiding *pro se* debtors who are attempting to navigate the complexities of the bankruptcy process. Moreover, these efforts and resource expenditure are often for naught. The chance a *pro se* debtor's case will be dismissed because of a failure to comply with the dictates of the Bankruptcy Code and Rules is considerably higher than if the debtor were [*sic*] represented.

Lois R. Lupica & Nancy Rapoport, "Best Practices for Limited Services Representation in Consumer Bankruptcy Cases," Final Report of the ABI National Ethics Task Force at 50 (Amer. Bankr. Inst. April 21, 2013).

**C. The Options for a Debtor Unable to Prepay for Chapter 7 Legal Services**

To summarize, then: debtors are in a more desperate position than ever to file; and they are in a poorer position than ever to pay an attorney to handle their chapter 7 case, but would fare significantly better in chapter 7 with the assistance of counsel. What, then, are the options for debtors who cannot afford to fully pay an attorney in advance to represent them in a chapter 7 case? In the recently released Final Report of the American Bankruptcy Institute's three-year Commission on Consumer Bankruptcy,[1] four alternatives are discussed to the most preferable (but currently unavailable) option of having chapter 7 attorney's fees declared non-dischargeable by Congress: 1) "The attorney can delay filing a chapter 7 case until the debtor has paid up front all of the anticipated fees in the case," id. at 90; 2) "The attorney can file a chapter 7 case without receiving full payment of the anticipated fees, hoping that the debtor will voluntarily pay the fees from non-estate assets postpetition," id. at 91; 3) "The attorney can bifurcate the legal services to be provided, first entering into an agreement with a nominal fee covering only prepetition services and then entering into a postpetition agreement for the bulk of the fees to cover postpetition services" as to which, "[b]ecause it occurs postfiling and creates postfiling obligations, the automatic stay and the bankruptcy discharge do not apply," id.; or 4) "The debtor can file the case under chapter 13 instead of chapter 7," id. Each of these options is perfectly legal but, among them, bifurcation best balances a debtor's needs for immediate relief and the assistance of counsel, and the attorney's need to be paid.

So-called "layaway plans" are not a good solution. Delaying bankruptcy prolongs a debtor's financial distress and exposes them to all of the negative effects summarized by the CPB investigators.

[1] Final Report of the ABI Commission on Consumer Bankruptcy (American Bankruptcy Institute, 2019), https://www.nclc.org/images/pdf/bankruptcy/rpt-abi-commission-on-consumer-bankruptcy.pdf.

Moreover, it puts a debtor in the counter-intuitive position of having to muster the cash to pay an attorney while all of the debtor's creditors continue to clamor for payment.

Expecting counsel to file a chapter 7 case with the mere hope of a voluntary, post-petition payment is completely untenable. Presumably, an attorney in this situation would be ethically obligated to explain to the debtor that the unpaid fees would be discharged in bankruptcy, leaving the attorney without a realistic hope of payment. Ultimately, this option makes the practice of chapter 7 debtor law inherently unattractive, all to the ultimate detriment of debtors and a system that works best when debtors have capable representation.

And, finally, placing debtors in chapter 13 solely to provide a means for attorneys to be paid is an ethically dubious practice and clearly not in the best interest of debtors. "More than 95% of people who file under chapter 7 receive a discharge. In contrast, a mere one-third of chapter 13 cases end in a completed repayment plan such that debtors receive a discharge. Most chapter 13 bankruptcies end without debt forgiveness." Pamela Foohey, Robert M. Lawless, Kathering Porter & Deborah Thorne, "'No Money Down' Bankruptcy" 90 So. Calif. L. Rev. 1055, 1057 (2017) (footnotes omitted). Moreover, "[a]ttorneys charge an average of $1,229 to file and represent a debtor in a chapter 7 case and an average of $3,217 to file and represent a debtor in a chapter 13 case," id. at 1058 (footnotes omitted), meaning that this practice costs debtors significantly more than simply filing a chapter 7. Paying more for a lower chance of success, and all just to provide a way for attorneys to get paid, is a bad idea.

**D. The Legal Support for and Efficacy of Bifurcated Chapter 7 Engagements**

The history and legal support for the practice of bifurcation is extensive, and it is predicated on well-accepted principles of bankruptcy law. It has—quite literally—been accepted as "hornbook law" that a "debtor's attorney may be compensated for postpetition services from debtor's post-petition earnings." *Collier Consumer Bankruptcy Guide*, § 5.03[5][b].

Consequently, it is completely non-controversial for a person who files their own petition *pro se* to realize after filing that they would be better off with counsel, and to hire and pay an attorney to assist them in completing the case. Likewise, if a debtor fires their prepetition counsel, or that attorney becomes incapacitated or dies, no one would prevent the debtor from hiring and paying another attorney to complete the case. Finally, even in traditional scenarios where a debtor pre-pays an attorney to represent them in their chapter 7 case, unforeseen events (like adversary proceedings, contested stay relief matters, etc.) sometimes arise and require the debtor to pay additional fees to their counsel from post-petition earnings. In each of these examples, the system recognizes two, key realities: 1) debtors are better off with counsel, and 2) attorneys need to be paid for their work. The only difference between each of these common situations and a bifurcated engagement is the timing of the client choosing the structure: bifurcation is a planned decision made with the client's informed consent at the outset of the engagement.

The earliest case law concerning post-petition payment terms for chapter 7 debtors arose 25 years ago. In each of these early bankruptcy court and district court cases (a few of which involved the same law firm operating in California and Arizona) the attorney's practice was to have a single, prepetition engagement agreement with a flat fee, but to allow the debtor to make post-petition installment payments. See In re Hessinger, 192 B.R. 211 (N.D. Calif. 1996); In re Voglio, 191 B.R. 420 (D. Ariz. 1996); In re Biggar, 185 B.R. 825 (N.D. Calif. 1995); In re Symes, 174 B.R. 114 (Bankr. D. Ariz. 1994); In re Mills, 170 B.R. 404 (Bankr. D. Ariz. 1994). The primary legal issue addressed in each case was the dischargeability of any portion of the fee that remained unpaid after the petition date, and all but one of the decisions concluded that the unpaid fee was discharged. See Hessinger, 192 B.R. at 217-18 (holding unpaid fees

discharged); Voglio, 191 B.R. at 422 (same); Biggar 185 BR. at 829 (same); In re Symes, 174 B.R. at 119 (same); but see Mills, 170 B.R. at 412 (finding unpaid fees nondischargeable).

And then, in 1999, the Ninth Circuit Court of Appeals issued its decision in Gordon v. Hines (In re Hines), 147 F.3d 1185 (9th Cir. 1998). In Hines, the Ninth Circuit Court of Appeals adjudicated whether an attorney who used a single, pre-petition engagement agreement had a viable claim to seek payment from the debtor for unpaid fees after the chapter 7 case had been filed. Id. at 1186. The Hines court concluded that although the prepetition engagement agreement was discharged in the bankruptcy, and the stay and discharge prevented the attorney from enforcing the contract, the attorney still had a viable claim under the equitable doctrine of *quantum meruit* for the reasonable value of the post-petition services that had been rendered, and the stay and discharge were not offended by pursuing payment of that value. Id. at 1191-92. While the *quantum meruit* approach in Hines has been criticized, the case spawned a number of other creative solutions to the problem of collecting post-petition attorney fees in chapter 7 cases.

Over the next several years, a number of cases dealt with situations where attorneys tried to structure engagements to offer chapter 7 debtors post-petition payment terms, with mixed success—and mixed viewpoints by the courts. But in each of these cases, the courts either intentionally or unintentionally clarified both how and how not to accomplish the goal.

For example, in Bethea v. Robert J. Adams & Associates, the Seventh Circuit Court of Appeals rejected the Hines approach and held that fees owed under a single, pre-petition engagement agreement do not survive discharge. 352 F.3d 1125, 1129 (7th. Cir. 2003). Along the way, though, the Bethea court rejected the idea that their holding necessarily meant that a debtor would have to forego representation if the entire fee could not be prepaid, observing that "[t]hose who cannot prepay in full can tender a smaller retainer for prepetition work and later hire and pay counsel once the proceeding begins—for a lawyer's aid is helpful in prosecuting the case as well as in filing it." Id. at 1128.

A year later, a bankruptcy court in Illinois prohibited an attorney from collecting unpaid fees under a prepetition engagement agreement for work in a redemption action, but laid out a road map for an enforceable, bifurcated engagement by referring to the Bethea decision:

> A second potential solution to the problem posed by *Bethea* would be for the debtor and the bankruptcy attorney to enter into a pre-petition retention contract requiring the attorney to perform either no post-petition services or very limited ones not including redemption work; then these parties could potentially enter into a post-petition contract for post-petition services the attorney has not already agreed to perform, creating a new post-petition claim.

In re Griffin, 313 B.R. 757, 769 (Bankr. N.D. Ill. 2004).

A bankruptcy court in Pennsylvania suggested a somewhat different approach to the problem a few years later. See In re Mansfield, 394 B.R. 783 (Bankr. E.D. Penn. 2008). In Mansfield, an attorney used a single, prepetition engagement agreement and charged a flat fee for both pre- and post-petition work. Id. at 786. The court prohibited the attorney collecting unpaid fees after the case had been filed, but observed that a single, prepetition agreement could be modified to allow collection of fees for post-petition work: "The key to recovery for post-petition services . . . lies in the terms of the attorney's fee agreement . . . . [which] must segregate the fee(s) for prepetition work from the fee(s) for post-petition work . . . . [which] constitutes a postpetition debt of, or claim against, the debtor which is nondischargeable." Id. at 793. This practice came to be known as a "straddle" agreement.

In 2010, a Tennessee bankruptcy court rejected an approach that involved a single, pre-petition engagement agreement and a single, flat-fee structure, with the debtor giving the attorney a series of

post-dated checks to pay the fee. See In re Lawson, 437 B.R. 609, 674 (Bankr. E.D. Tenn 2010); see also In re Waldo, 417 B.R. 854 (Bankr. E.D. Tenn. 2009) (same). In the course of rejecting this approach, the Lawson court found it advisable "in order to avoid any further litigation as to what is and what is not allowed concerning fee arrangements in Chapter 7 cases . . . [to] summarize" what it found to be an acceptable structure for allowing post-petition payment for post-petition services. Id. The court then described a process for using a single, pre-petition "straddle" agreement that separately called out pre-petition and post-petition services, and provided for hourly billing for post-petition services rendered. Id. at 674-75.

By 2012, the thinking around bifurcation began to coalesce into the modern practice of separate pre- and post-petition engagement agreements with separate fees for each. That year, two decisions laid out the road map for this modern practice.

The first, Walton v. Clark & Washington, P.C., 469 B.R. 383 (Bankr. M.D. Fla. 2012), involved the same multi-state law firm that ran afoul of the decision in Lawson. Having also employed the post-dated check structure in a prior proceeding in Florida and receiving the same prohibition there, the firm pivoted to a new structure involving separate pre- and post-petition agreements that allowed them to offer installment payment terms for the post-petition flat fee. Id. at 384. The United States Trustee also objected to this new approach, and concerns expressed by the court at an initial hearing prompted the firm to modify the process before the final hearing that generated the court's published opinion. Id. Quoting Bethea, the Walton court concluded that "there is nothing inherently wrong with a lawyer giving terms to clients for the payment of legal services," and that "[a]s a consequence, the Court must uphold the validity of the modified two-contract procedure absent some compelling reason not to do so." Id. at 386. After fielding concerns from the UST about attention by the attorney during the gap in time between the filing of the petition and the debtor signing the post-petition engagement agreement, and about adequate disclosure to the client about the engagement structure, the Walton court concluded that "[i]n the end, there is no prohibition against a debtor making postpetition installment payments for postpetition services," and held that Clark & Washington's two-contract procedure was acceptable. Id. at 386-87.

The second case, In re Slabbinck, 482 B.R. 576 (Bankr. E.D. Mich. 2012), contains perhaps the most thorough explication to date about how a bifurcated chapter 7 engagement can be accomplished within both the bankruptcy code and the rules of professional responsibility. The Slabbinck court began its analysis by referring to a prior decision, In re Gourlay, 2012 WL 4791034 (Bankr. E.D. Mich. Oct. 9, 2012), wherein it blocked an attorney's effort to collect post-petition fees under a straddle agreement. Slabbinck, 482 B.R. at 581. The court went on to distinguish the situation in the prior case from the one at bar, noting that "[u]nlike *Gourlay*, this case involves two separate agreements, one of which the Debtors signed before their bankruptcy case was filed, and the other of which the Debtors signed after their bankruptcy case was filed." Id. The court explicitly rejected an argument by the UST that the two agreements "constitute a single, prepetition agreement creating an entirely pre-petition debt." Id. at 583.

The Slabbinck court next considered a UST argument that the bifurcated engagement constituted impermissible "unbundling" of services in violation of the Michigan rules of professional conduct, concluding (after an exhaustive review of case law and the Michigan ethical rules) that a debtor could agree to split the engagement between two agreements with adequate disclosure. Id. at 583-89. The court went on to conclude that the debtor in the case at bar had exercised informed consent after adequate disclosure by counsel, and that counsel's competence was not hampered by the bifurcation. See id. at 589-97. Summarizing its conclusion, the Slabbinck court noted:

> a pre-petition agreement to pay an attorney gives rise to a dischargeable debt. A post-petition agreement does not. For the Court to insist on an all or nothing approach, in the name of promoting attorneys' competence, will have the perverse effect of depriving needy individual debtors who cannot afford to pay in advance for *all* of the legal services they may need in an a Chapter 7 case, from hiring an attorney to provide them with *any* of the legal services that they may need in a Chapter 7 case.

Id. at 597. Ultimately, the court insisted that for a bifurcated engagement to be allowed, the attorney must "competently perform[] those services that the debtor has hired the attorney to perform, provide[] an adequate consultation to the debtor concerning any limitations placed upon the services to be rendered in connection with the filing of a case, and obtain[] such individual's fully informed consent to such limitations," but determined that the attorney in question had complied with these requirements in every respect. Id.

In the time since the Walton and Slabbinck decisions, there have not been any fundamental changes in the best-practice approach for providing post-petition payment terms to chapter 7 debtors, but a number of attorneys have been taken to task for failing to meet the technical and ethical requirements that have been enunciated to bifurcate effectively. See, e.g., In re Grimmett, 2017 Bankr. LEXIS 1492 (Bankr. D. Id. 2017) (used single, pre-petition agreement; failed to properly disclose; used threats of withdrawal to force payment); In re Ashby, No. 13-34537 (Bankr. W. D. Ken. July 10, 2015) (failed to structure "straddle" agreement properly; inadequately disclosed to client; inadequately disclosed to court under Rule 2016; charged an unreasonable fee; accepted attorney fee payments before filing fee fully paid); In re Davis, 2014 WL 3497587 (Bankr. N.D. Ala. July 11, 2014) (used single pre-petition engagement agreement and took post-dated checks); In re Wright, 598 B.R. 68 (Bankr. N.D. Okla. 2018) (charged unreasonable fee and failed to properly disclose to the court). In each of these cases, the courts have either not been asked to opine on the fundamental question of bifurcation, or have chosen not to do so in view of the other legal and ethical issues upon which the decisions were predicated.

In contrast to these decisions (and very recently), a bankruptcy judge in Utah approved a bifurcated chapter 7 engagement where the attorney effectively satisfied all of the technical and ethical requirements that have been established over the years. See In re Hazlett, No. 16-30360 (Bankr. D. Utah April 10, 2019). In Hazlett, "the Debtor lacked the funds to pay a pre-petition retainer for an attorney to represent him in a Chapter 7 case," and the attorney "offered the Debtor a bifurcated fee arrangement that involved no retainer for filing the petition, and then a post-petition fee agreement to pay $2,000 in ten monthly installments." Id. at 1. Noting, first, that "debtors who cannot pay an up-front retainer are left with three ineffectual options," the Hazlett court discussed the challenges of filing completely *pro se*, using a petition preparer to file and then prosecuting the case *pro se*, and filing a fee-only chapter 13. Id. at 9-12. The court then detailed the various ways in which attorneys had unsuccessfully dealt with this conundrum in the past, by "issuing post-dated checks, paying legal fees with a credit card, withdrawing funds from a retirement plan, or taking out a home equity loan." Id. at 12 (internal citations omitted).

Turning to the legality of bifurcation, the Hazlett court first distinguished bifurcation from "unbundling" or using a limited services agreement. Id. at 14. Observing that the "primary concern with unbundling is that the attorney provides a limited service and then leaves the client to his or her own devices to complete the legal process," the court noted in contrast that "the purpose of the bifurcated agreement is decidedly not to abandon the debtor, but to enable the attorney to be paid for the post-petition services." Id. (internal citations omitted). So, while under a bifurcated arrangement "debtors are given the option to proceed *pro se*," the "decision is solely up to the debtor, as the attorney is ready and willing to complete the representation upon the signing of the post-petition fee agreement." Id. "Thus,"

the court concluded, "the bifurcated fee agreement is not for unbundling" and "only increases the affordability of the attorney's services and thereby increases a debtor's access to legal representation." Id. at 14-15.

As to disclosure, the Hazlett court noted that "[t]he 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 the post-petition fee agreement." Id. at 15. The court concluded that the attorney had met this requirement.

Turning, last, to the question of fees, the Hazlett court noted that "fees for pre-petition services should not be directly or surreptitiously slipped into the fee charged for post-petition services." Id. at 16. The court found that the post-petition fees were solely for post-petition work, and also found them objectively reasonable, using a modified lodestar analysis. Id. at 16, 20-21. This last point was of particular interest for two reasons: first, the attorney charged a higher fee for a bifurcated engagement than a prepaid one; and, second, the attorney's fee for a bifurcated engagement was nearly twice as a high as the fee for a prepaid engagement that was offered by a competitor with whom the debtor had consulted before hiring the attorney who filed the case. Id. at 2-4.

**CONCLUSION**

What this extensive history illustrates is a fairly simply road map for legally and ethically offering post-petition payment terms to chapter 7 debtors:

- Counsel should bifurcate their engagement by the debtor into clear pre- and post-petition engagement agreements (with the post-petition agreement *actually signed after the case is filed*), spelling out precisely what work and fee will be associated with the pre- and post-petition engagements;
- Counsel must provide robust disclosure to the debtor about the options available to them to structure the engagement (e.g., prepayment in a traditional structure versus a low-down or $0-down bifurcated option);
- Counsel must provide robust disclosure to the debtor who is inclined to choose a bifurcated structure of the further options following filing: proceeding *pro se*, hiring different counsel, or retaining the first attorney's further services under a separate post-petition engagement agreement;
- Counsel must provide robust disclosure to the court through the Form B2030/Rule 2016(b) disclosure of the structure and finances of the bifurcated engagement;
- Counsel must honor any local rules concerning withdrawal of counsel in the event the debtor does not execute the post-petition engagement agreement;
- Counsel must provide competent representation; and
- Counsel's pre- and post-petition fees must be reasonable under Section 329.

So long as this roadmap is followed, the case law overwhelmingly supports the proposition that bifurcating chapter 7 engagement agreements and offering post-petition payment terms to debtors strikes an appropriate legal and ethical balance between a debtor's need to have affordable access to the bankruptcy system, and counsel's need to be paid.

## *About the Author*

**Dan Garrison** Dan Garrison is the co-founder and managing director of Fresh Start Funding, which provides financing and payment management services to consumer chapter 7 attorneys across the United States. Prior to founding Fresh Start Funding, Dan had a nearly 25-year career as a nationally recognized corporate restructuring and business bankruptcy attorney. He holds an AV-Preeminent Rating from Martindale Hubbell, and has been listed in Southwest Superlawyers for bankruptcy and Best Lawyers in America for commercial litigation. In 2017, his work with two troubled hospitals was recognized as the national "Turnaround of the Year" in the middle-market category by the Turnaround Management Association and as the "Healthcare Transaction of the Year" by M&A Advisor.

Dan graduated from the University of Utah College of Law, where he was inducted into the Order of the Coif and served on the Utah Law Review. Following graduation, he clerked for the Hon. Dee V. Benson of the United States District Court for the District of Utah. For over 20 years, Dan has been a regular speaker and teacher for various state and local bar and professional associations and the American Bankruptcy Institute, and recently published articles on bifurcating chapter 7 cases, entitled "Liberating Debtors from the Sweatbox: Bifurcation in Consumer Chapter 7 Cases" in the June 2018 issue of the ABI Journal, and "There's No Such Thing as Too Much Information: Disclosure of Bifurcation and Financing in Chapter 7 Cases" in the July 2019 issue of that same publication.