

Case Law Update on Chapter 7 Bifurcation and Offering Post- Petition Payment Terms to Clients



Agenda:

- Overview of Bifurcation
- History of the Practice
- Recent Cases & Outlook



Overview of Bifurcation

What is this and how does it work?

Why Bifurcation?

- “Sweatbox”—consumers languishing longer than ever
- Traditional prepaid option is a barrier to relief
- *Pro se* debtors burden the system and fail to achieve a discharge at high rates
- Lay-away programs extend suffering
- Fee-only chapter 13s are costly and ineffective

How Does Bifurcation Work?

- Services are split into clear pre-petition and post-petition engagement agreements
- Fee must also be *reasonably* allocated between the two engagements
- Any fees not collected pre-petition are discharged or waived

How Does the Process Flow Differ?

- Pre-petition engagement agreement signed at first consultation
- Intake questionnaire, document review, credit pull and thorough consultation accomplish diligence
- “Skeleton,” “rush,” “naked,” or “short” filing
- Client returns to sign post-petition engagement agreement, review schedules & statements, etc.
- Remainder of case proceeds as usual

Why Are Attorneys Interested?

- Allows them to help debtors who couldn't otherwise afford representation
- Helps attorneys to grow their practices
- Allows many attorneys to escape commoditization and price competition in the prepaid space

History of the Practice

How did we get here?

Mavericks Fish Around for a Solution

- Starting in the mid-90s, attorneys begin experimenting with how to offer post-petition payment terms
- 5 cases in Arizona and California involving single, prepetition agreement and post-petition payment terms
- 4 out of the 5 are invalidated

Hines Changes the Conversation

- 1999 9th Circuit Court of Appeals decision *In re Hines*
- Single, pre-petition engagement agreement
- Court concludes that contractual right is stayed and discharged
- Court nonetheless allows post-petition recovery of value of post-petition work under *quantum meruit*

7th Circuit First Recognizes Bifurcation

- 2003 7th Circuit Court of Appeals decision *In re Bethea*
- Invalidated post-petition collection of fees under a single, pre-petition engagement agreement
- Comment in dicta:

“[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.”

Pause: A Moment of Practical Consideration

- Debtors who file *pro se* or use petition preparers can hire counsel post-petition
- Debtors sometimes hire different counsel post-petition
- No one disputes debtor's right to hire and fire counsel as they see fit
- Certain post-petition work is expected to be subject to separate engagements—e.g., non-dischargeability

2004-2012: Continued Experimentation

- In re Griffin (N.D. Ill. 2004): court suggests 2-contract method
- In re Mansfield (E.D. Penn. 2008): “straddle” agreement
- In re Lawson, In re Waldo (E.D. Tenn. 2009, 2010): “straddle” agreements with hourly billing post-petition

2012: Modern Practice of Bifurcation Recognized

- In re Walton (M.D. Fla. 2012)
- Long saga of Clark & Washington
- “True” bifurcation approved without qualification

“[T]here is no prohibition against a debtor making postpetition installment payments for postpetition services.”

2012: Modern Practice of Bifurcation Recognized

- In re Slabbinck (E.D. Mich. 2012)
- 5 cases pending with different approaches
- “True” bifurcation approved without qualification

Slabbinck Quote

“[T]he Court understands that some individual debtors simply cannot afford to pay up front for all of the services required to both file and complete a Chapter 7 case prior to the time that they file their Chapter 7 bankruptcy case. The law does not prohibit such individuals from paying a smaller fee to an attorney to get their case filed and then, once the case is filed, either proceeding pro se or entering into a new agreement either with the same attorney or with another attorney to represent them in completion of their case, with the payment for any postpetition legal services to be paid out of such individual's future earnings.”

2012 to 2018: It's Not "Whether;" It's "How"

- In re Grimmer (Idaho 2017): single, pre-petition agreement, lack of disclosure, dunning debtor
- In re Wright (N.D. Okla. 2018): unreasonable fees and no disclosures
- UST actions and settlements across the country (California, Oklahoma, Missouri and Maryland)

Recent Case Law Developments

What's going on with this now?

In re Hazlett

- Utah bankruptcy decision in April 2019
- Attorney offered \$0-down
- Attorney used separate pre- and post-petition agreements
- Attorney's post-petition fee was nearly twice as high as a competitor's prepaid flat fee

In re Hazlett, cont'd

- Court distinguishes “unbundling” or limited scope representation
- Attorney was “ready and willing” to handle entire case
- Purpose of bifurcation was to facilitate representation, not to limit it

In re Hazlett, cont'd

- Court looks at reasonability of fees
- Employs lodestar analysis: reasonable hourly rate and reasonable amount of time creates presumptive amount
- Comparison to prepaid rate not relevant

In re Hazlett, cont'd

- Court emphasizes best interests of debtor and informed consent
- Disclosure to the court
- Reasonability of fees

United States Trustee Position

- Clifford White, Director of the USTP speaks to the National Association of Bankruptcy Trustees' annual meeting in Denver in August 2019
- Remarks published on the DOJ website
- “Commends” Hazlett decision

Cliff White Quote

“In the District of Utah, the bankruptcy court handed down a decision in In re Hazlett, 2019 WL 1567751 (Bankr. D. Utah April 10, 2019). I commend that opinion to your attention because the careful reasoning of the court actually highlights the factors we look for and which are almost always absent in the cases we bring.

.....

“[T]he court’s opinion provides an important four-part analysis in assessing bifurcation practices. It is instructive to the USTP and should be instructive to the bar as well.”

More Recent Developments

- Maryland and California cases settle
- *Sua sponte* inquiry in S.D. Texas approved practice
- Oklahoma decision approved bifurcation but found that attorney had done it incorrectly—decision on appeal
- Pending matter in Minnesota; evidentiary hearing in March

Fresh Start Funding & Protego Law

Who are we and what do we do?

Fresh Start Funding's Services

- Line of Credit Financing to Manage Cash Flow Stress of Offering Post-Petition Payment Terms
- Complete and Effective Payment Management Services
- Credit Reporting for Debtors to Rebuild Credit
- Best-Practices Forms, Support and News
- Defense Guaranty & \$50,000 Indemnity

Protego Law

- Handle inquiries and educate trustees
- All briefing
- In-person representation at hearings
- Settlement negotiation
- Appeal if needed

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Matt Hartley, Esq.
Managing Director
Matt@FreshStartFunding.com

Dan Garrison, Esq.
Managing Director
Dan@FreshStartFunding.com

(800) 915-6545
www.FreshStartFunding.com

