



U.S. Department of Justice

Executive Office for United States Trustees

Office of the Director

Washington, DC 20530

June 10, 2022

MEMORANDUM

TO: United States Trustees

FROM: Ramona D. Elliott
Acting Director

SUBJECT: Guidelines for United States Trustee Program (USTP) Enforcement Related to
Bifurcated Chapter 7 Fee Agreements

I. Introduction

In our role as the “watchdog” of the bankruptcy process, one of the USTP’s core responsibilities is to protect and preserve the integrity of the bankruptcy system. In doing so we seek to promote fair access to the bankruptcy system while ensuring that no participant is treated improperly. Enhancing access to justice not only includes removing barriers to entry but also ensuring that all debtors who seek bankruptcy protection in good faith and comply with the Bankruptcy Code’s requirements receive the relief the law affords them. This includes ensuring that debtors are properly and adequately represented by their attorneys, who in turn are negotiating the terms of their fee arrangements and representation in good faith.

The Bankruptcy Code’s¹ statutory framework generally prohibits postpetition payment of attorney’s fees arising from prepetition retention agreements in chapter 7 cases. The Supreme Court held in *Lamie v. United States Trustee*² that chapter 7 debtors’ attorney’s fees may not be paid out of the bankruptcy estate, and almost all courts that have considered the issue have held that attorney’s fees owing under a prepetition retainer agreement are a dischargeable debt.³ As a

¹ 11 U.S.C. §§ 101 *et seq.*

² 540 U.S. 526, 537 (2004). The Court’s reasoning was that 11 U.S.C. § 330(a) only authorizes compensation to professionals employed under § 327, which does not include the debtor’s attorney in a chapter 7 case unless employed by the trustee under § 327(e).

³ See, e.g., *Rittenhouse v. Eisen*, 404 F.3d 395, 397 (6th Cir. 2005).

result, the traditional model for representation in chapter 7 cases is payment of the entire attorney’s fee for the case⁴ in full before the case is filed.

“Bifurcated” fee agreements—which split an attorney’s fee between work performed prior to the filing of a bankruptcy petition and work performed postpetition—have become increasingly prevalent in chapter 7 consumer bankruptcy cases.⁵ Bifurcated agreements are generally structured so that minimal services—limited to those essential to commencing the case—are performed under a prepetition agreement for a modest (or no) fee, while all other services are performed postpetition, under a separate postpetition retention agreement, arguably rendering those fees nondischargeable.

Courts and stakeholders in the bankruptcy community have expressed differing views on the propriety of bifurcated fee agreements.⁶ Some courts have held that bifurcation by its nature violates certain local rules governing the professional responsibilities of counsel owed to their debtor clients.⁷ Other courts have held that nothing is inherently improper about bifurcation, provided that certain guardrails are obeyed.⁸

Absent contrary local authority, it is the USTP’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. Bifurcated agreements provide an alternative under the current statutory framework to the traditional attorney’s fee model, which some have noted present a barrier to accessing the bankruptcy system for debtors who may need relief but are unable to pay in full before filing. The benefits these type 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.

⁴ Typically, a flat fee for all services essential to the successful completion of the case.

⁵ This Memorandum only addresses enforcement guidelines for bifurcated fee arrangements. The exclusion from these guidelines of other alternative fee arrangements—such as the practice of filing chapter 13 cases solely to pay attorney’s fees over time—should not be construed as acceptance of the propriety of such arrangements. When any fee arrangement violates the Bankruptcy Code or Rules, the USTP will take enforcement actions as appropriate.

⁶ See, 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); Adam D. Herring, *Problematic Consumer Debtor Attorney’s Fee Arrangements and the Illusion of “Access to Justice”*, ABI JOURNAL, Vol. XXXVII, No. 10, Oct. 2018; Daniel E. Garrison, *Liberating Debtors from “Sweatbox” and Getting Attorneys Paid*, ABI JOURNAL, June 2018, at 16. See also Adam D. Herring, “Great Debates” at the ABI Consumer Practice Extravaganza (Nov. 5, 2021).

⁷ See, e.g., *In re Baldwin*, No. 20-10009, 2021 WL 4592265 (Bankr. W.D. Ky. Oct. 5, 2021); *In re Prophet*, 628 B.R. 788 (Bankr. D.S.C. 2021), *rev’d and remanded* No. 9:21-cv-01082-JMC, 2022 WL 766352 (D.S.C. Mar. 14, 2022).

⁸ See, e.g., *In re Kolle*, No. 17-41701-CAN, 2021 WL 5872265 (Bankr. W.D. Mo. Dec. 10, 2021); *In re Brown*, 631 B.R. 77, 101 (Bankr. S.D. Fla. 2021); *In re Carr*, 613 B.R. 427 (Bankr. E.D. Ky. 2020); *In re Hazlett*, No. 16-30360, 2019 WL 1567751 (Bankr. D. Utah Apr. 10, 2019).

The USTP’s enforcement approach to bifurcated agreements balances these concerns. The USTP will review bifurcated fee agreements to ensure that they harm neither the debtors who rely on the bankruptcy system to obtain relief nor the integrity of the system. When appropriate, we will bring enforcement actions to address these harms. This document sets forth general guidelines that United States Trustees and their staff should use to assist them in determining whether to take enforcement action with respect to bifurcated fee agreements.

II. Attorney’s Fees Under Bifurcated Agreements Must Be Fair and Reasonable

When reviewing attorney fee agreements in consumer cases, our first consideration is to ensure that the agreements serve the best interests of clients, not their professionals. This tension is most evident—and the potential for the greatest harm to debtors exists—in the structuring of fees under bifurcated agreements. The three most common fee-related issues we see in cases involving bifurcated fee agreements relate to the allocation of fees and services, the reasonableness of the fees, and third-party financing.

First, it is important to ensure that there is a proper allocation of prepetition and postpetition fees and services. This issue commonly arises in no- or low-money down cases. It is the USTP’s position that fees earned for prepetition services must be either paid prepetition or waived, because the debtor’s obligation to pay those fees is dischargeable. This is particularly important to ensure—and to clearly document—that debtors receive appropriate prepetition consultation and legal advice, including with respect to exemptions and chapter selection.⁹ Debtors who enter into bifurcated fee agreements should receive the same level of representation as debtors who enter into traditional fee agreements. Bifurcation must not foster cutting corners in properly preparing the case for filing by eliminating tasks that should be performed prepetition or postponing all or some of those services until after the petition is filed to ensure that the attorney can bill for those services postpetition. Additionally, fees for postpetition services must be rationally related to the services actually rendered postpetition,¹⁰ so that a flat postpetition fee is not a disguised method to collect fees for prepetition services. Attorneys also should not advance filing fees and seek their reimbursement postpetition. Advanced filing fees are generally held to be dischargeable prepetition obligations.¹¹

Second, attorney’s fees charged to debtors in bifurcated cases—as in all cases—must be reasonable.¹² Bifurcated fee agreements should not be viewed as an opportunity to collect higher fees than those collected from clients who pay in full, before filing. For example, it would be inappropriate for an attorney to offer a debtor a fee of \$1,500 if they pay upfront, and \$2,000 if they pay over time postpetition, particularly given that fees for prepetition work should have been paid or waived.

⁹ The Bankruptcy Code requires attorneys to certify, by signing the petition, that they have performed a reasonable investigation into the facts and circumstances of the case and that the attorney, after performing an adequate inquiry, has no knowledge that the information in the schedules is incorrect. 11 U.S.C. §§ 707(b)(4)(C–D).

¹⁰ See *Brown*, 631 B.R. at 93 (citing *Hazlett*, 2019 WL 1567751).

¹¹ See, e.g., *Matter of Riley*, 923 F.3d 433, 439–40 (5th Cir. 2019); *Brown*, 631 B.R. at 102–03.

¹² 11 U.S.C. § 329(b).

Third, arrangements that employ outside parties to finance bifurcated fee agreements, including (but not limited to) factoring, assignment of the attorney's accounts receivable, and direct lending to clients, warrant significant additional scrutiny. The particulars of arrangements under which a third party finances the debtor's postpetition attorney's fees must be fully disclosed under Bankruptcy Rule 2016(b), including the details of the attorney's relationship with the entity providing the financing. The nature of these arrangements may incentivize overcharging, because the attorney generally receives only a percentage of the total fee charged or otherwise incurs financing costs. It is improper for an attorney using third-party financing to pass along the cost of that financing to their clients. Third-party financing arrangements may also create unwaivable conflicts of interest between the attorney and their clients and may violate applicable state ethical rules.¹³

The USTP should bring enforcement actions where bifurcated fee agreements adversely affect the client's representation, seek recovery of unreasonable fees, improperly allocate fees or services, improperly burden debtors with financing costs, or otherwise result in conflicts of interest.

III. Ensuring Adequate Attorney Disclosure and Fully Informed Debtor Consent to Bifurcated Agreements

In addition to ensuring that bifurcated agreements are fair and reasonable, courts examining and permitting bifurcated agreements have emphasized the importance of adequate disclosure and the client's fully informed consent. One court permitting the use of bifurcated agreements noted 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 postpetition fee agreement."¹⁴ Similarly, professional conduct standards governing fee sharing and limited scope representation¹⁵ reinforce the need for disclosure and informed consent. The requirement of informed consent to bifurcated agreements is derived directly from the Bankruptcy Code's requirements that attorneys representing consumer debtors deal forthrightly and honestly with their clients, that they not make misrepresentations about the services they will provide or the benefits and risks of filing bankruptcy, and that they make certain disclosures and promptly enter into a clear and conspicuous written contract explaining the services the attorney will render and the terms of any fee agreement.¹⁶

The following disclosure and consent factors can assist your review of bifurcated fee agreements and determination whether an enforcement action is appropriate:

- Whether the attorney has clearly disclosed the services that will be rendered prepetition and postpetition, and the corresponding fees for each

¹³ *Brown*, 631 B.R. at 99, n. 34.

¹⁴ *In re Hazlett*, No. 16-30360, 2019 WL 1567751 at *8 (Bankr. D. Utah Apr. 10, 2019).

¹⁵ *See, e.g.*, Model Rules of Prof. Conduct R. 1.2(c), 5.4(a) (AM. BAR ASS'N 1983).

¹⁶ 11 U.S.C. §§ 526–528.

segment of the representation, including that certain listed services may not arise in a particular case.

- Whether the attorney has disclosed their obligation to continue representing the debtor regardless of whether the debtor executes a postpetition agreement, unless the bankruptcy court permits the attorney's withdrawal.
- Whether the attorney has clearly disclosed that the client is being provided the option to choose a bifurcated fee agreement, any difference in the total attorney's fee between the bifurcated fee agreement and a traditional fee agreement,¹⁷ and the client's options with respect to the postpetition fee agreement.¹⁸
- Whether the agreement includes clear and conspicuous provisions explaining the options, costs, and consequences of entering into a bifurcated fee agreement and providing the debtor with an option to rescind the agreement.

The disclosure and consent considerations described above are not exhaustive and should not be mechanically applied, but instead qualitatively assessed to determine whether adequate disclosures were made and whether those disclosures permit a consumer debtor considering a bifurcated fee agreement to give informed consent. Additionally, when applying these criteria we must consider local authority and act accordingly where local rules or jurisprudence have imposed other clear standards for adequate client disclosures and conditions of informed consent—whether more or less stringent.¹⁹

IV. Ensuring Adequate Public Disclosure

The Bankruptcy Code and Rules also require public transparency in professionals' dealings with their clients, and the USTP regularly enforces these requirements. All attorneys representing debtors must promptly file disclosures of the particulars of their fee agreements and the amounts they have been paid under section 329(a) of the Bankruptcy Code and Bankruptcy

¹⁷ As discussed *supra*, it is the USTP's position that fees under bifurcated agreements should not be higher than those under traditional fee agreements for the same services.

¹⁸ Generally, these options are for the client to sign the postpetition agreement for the attorney's continued representation; to hire other counsel; or to proceed in the case *pro se*.

¹⁹ We are aware that some courts have found that bifurcation is impermissible under local rules governing representation of debtors. *See, e.g., Baldwin*, 2021 WL 4592265; *Prophet*, 628 B.R. 788. The existence and wording of such local rules varies, and bankruptcy courts within a district may interpret them differently. In determining whether to take an enforcement action with respect to a bifurcated fee arrangement, the USTP will consider and follow applicable local authority but also should be mindful to exercise discretion in accordance with these guidelines to focus on those cases where the debtor is harmed or the integrity of the bankruptcy process is jeopardized.

Rule 2016(b).²⁰ The nature of bifurcated agreements requires detailed disclosures in order to satisfy the Bankruptcy Code's standards. Failure to make adequate public disclosures required under the Bankruptcy Code and Rules may be a basis to bring an enforcement action.²¹

V. Conclusion and Important Notes

It is vital that the USTP acts consistently across jurisdictions in these and other legal matters. Please ensure that all staff who engage in civil enforcement in consumer cases are familiar with these guidelines. Each case will have unique facts that should be considered in a manner consistent with these guidelines.

Please consult the Office of the General Counsel if there are any questions regarding these guidelines or their application in specific cases. This memorandum is an internal directive to guide USTP personnel in carrying out their duties, but the final determination of whether a bifurcated fee agreement complies with the Bankruptcy Code and Rules resides solely with the court. Nothing in this memorandum has any force or effect of law or imposes on parties outside the USTP any obligations beyond those set forth in the Bankruptcy Code and Rules.²²

Thank you for your continued cooperation and diligence in this important area of responsibility.

²⁰ The default remedy for failure to make proper disclosures under section 329(a) is return of all fees. *See, e.g., SE Prop. Holdings, LLC v. Stewart*, 970 F.3d 1255, 1266 (10th Cir. 2020).

²¹ Postpetition attorney's fee installment payments should be disclosed as monthly expenses on the debtor's Schedule J. This allows courts and the USTP to quickly evaluate whether the debtor can actually afford the attorney's fees charged under the postpetition contract, which is a factor in determining whether the bifurcated agreement is in the debtor's best interest. However, note that we do not take the position that Rule 2016(b) requires that attorneys using bifurcated agreements file a supplemental compensation disclosure each time they receive a postpetition payment, provided that the terms of the postpetition agreement have been previously disclosed and there have been no material changes.

²² Additionally, nothing in this memorandum: (1) limits the USTP's discretion to request additional information, conduct examinations under Bankruptcy Rule 2004, or conduct discovery with respect to its review of a particular fee arrangement; (2) limits the USTP's discretion to take action with respect to any particular fee arrangement; or (3) creates any private right of action on the part of any person enforceable against the USTP, its personnel, or the United States.