

# Straight & Narrow

BY ALEXANDER M. LAUGHLIN

## Unbundling as a Means of Financing Bankruptcy Fees and Working Without a “Wet” Signature

Debtors are required to pay a filing fee in order to commence voluntary bankruptcy cases, and the U.S. Supreme Court has sustained the constitutionality of the filing fee as a predicate to the debtor receiving a discharge.<sup>1</sup> Cases are subject to dismissal if the filing fee is not paid.<sup>2</sup> The Bankruptcy Code<sup>3</sup> and Federal Rules of Bankruptcy Procedure<sup>4</sup> allow an individual debtor to commence a voluntary bankruptcy without paying the full filing fee and allow the debtor to, in essence, finance that fee.

In an effort to finance *debtor’s counsel’s fees*, attorneys have sought to restrict their roles as debtor’s counsel by “unbundling” certain legal services as post-petition offenses. Attempts to use pre-petition engagement agreements in this fashion have not withstood challenges by the Office of the U.S. Trustee and the courts, especially when the required disclosures are not made, or when the petition or other documents have not actually been signed before filing. This article examines the problems surrounding the unbundling of legal representation as way to finance debtor’s counsel’s fees and the misuse of the electronic case filing protocols in failing to obtain original, signed (“wet”) signatures prior to filing.

Individual debtors can unilaterally set forth the filing fee payment terms, but the last filing fee installment must be paid within 120 days of the filing date. Official Form B 3A provides, and Bankruptcy Rule 1006(b)(3) requires, that the debtor pay all of the filing fee installments prior to the debtor paying the debtor’s attorney “or any other person who renders services to the debtor in connection with the case.”<sup>5</sup> The “postponement of attorneys’ fees” while the debtor is paying the filing fee in installments illustrates one of the boundaries that prohibits a debtor from entering into pre-petition agreements to finance professional fees.

Section 329 of the Bankruptcy Code and Bankruptcy Rule 2016(b) mandate disclosures for payments made “in a case under this title, or in con-

nection with such a case,” and requires that all fees paid for bankruptcy-related services be reasonable. The Rule 2016 disclosures must be made whether or not the attorney is applying for compensation, because “[i]t is only by review of the [Rule] 2016(b) statement that the trustee, the court, or any interested party can be apprised of the debtor’s intentions to pay counsel before such payment occurs, and of any additional services that counsel intends to perform.”<sup>6</sup> Payments made to attorneys in a case under title 11 “or in connection with such a case” that are not disclosed are inherently not reasonable and are subject to disgorgement.

Attorneys and clients are allowed to limit the scope of the attorney’s representation of the client. The American Bar Association’s Model Rules of Professional Conduct Rule 1.1(a) requires that attorneys provide “competent representation to a client [requiring] the knowledge, skill, thoroughness and preparation reasonably necessary for the representation.” Model Rule 1.2(c) allows attorneys to limit the scope of their representations as long as the limitation is reasonable and the client gives informed consent after full disclosure. The extent of this disclosure and the client’s appreciation of the narrowed scope of the representation are of focused concern under the Model Rules.

Model Rule 1.4(b) requires that the lawyer “explain a matter to the extent [that is] reasonably necessary to permit the client to make informed decisions regarding the representation.” However, can someone in financial distress understand the gravity and scope of the imposed restricted representation and make an “informed consent,” especially when the informed consent is made in the context of obtaining a reduced fee? “Unless debtors truly understand what they bargain away [in the context of limited bankruptcy representation], the bargain is a sham.”<sup>7</sup>

The Affordable Bankruptcy Program and a promissory note in *In re Grimmert*<sup>8</sup> established the terms of the debtor’s chapter 7 engagement and were predicated on “the preparation and filing of a



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1 *United States v. Kras*, 409 U.S. 434, 457 (1973) (Stewart, J. dissenting) (finding that debtor who cannot afford filing fee is “too poor to even go bankrupt”).

2 See 11 U.S.C. §§ 707(a)(2), 1112(b)(4)(K), 1208(c)(2) and 1307(c)(2).

3 All references are to the U.S. Bankruptcy Code, 11 U.S.C. § 101, *et seq.*

4 All citations to Rules are references to the Federal Rules of Bankruptcy Procedure, unless otherwise noted.

5 See Fed. R. Bankr. P. 1006(b)(3).

6 *Goodbar v. Beskin*, 2013 WL 1249124 at \*6 (D. W.D. Va. March 26, 2013) (citing 9 *Collier on Bankruptcy* ¶ 2016.18, p. 2016-22, and *In re Fricker*, 131 B.R. 932, 940-41 (Bankr. E.D. Pa. 1991)).

7 *In re Castorena*, 270 B.R. 504, 529 (Bankr. D. Idaho 2001).

8 2017 WL 2437231 (Bankr. D. Idaho June 5, 2017).

bare-bones petition.” The filing of the schedules, statement of financial affairs and attendance at the § 341 meeting were contracted as post-petition services to be paid pursuant to the promissory note. *Grimmett* addressed what was determined to be an improper attempt to bifurcate the debtor’s legal representation between pre-petition and post-petition services.

In *Grimmett*, the lack of the debtor/client’s informed consent as to the unbundling of legal services and financing of post-petition fees was exacerbated by the attorney’s post-petition collection efforts. The dunning emails indicated that if payment was not made, the bankruptcy case would be dismissed, default interest under the promissory note (originated at 36 percent) would be imposed, the debtor would be subject to “collections,” and counsel would withdraw as the debtor’s attorney. Counsel also failed to give proper Bankruptcy Rule 2016 disclosures, and the court found that the engagement agreement required the debtor to make payments to the attorney before all of the filing fee installment payments had been made in violation of Bankruptcy Rule 1006(b)(3).<sup>9</sup>

The stressed-out debtor wrote to the judge and forwarded copies of the Affordable Bankruptcy Program as embodied in a “Chapter 7 Retainer Agreement and Promissory Note,” along with the emails dunning her for payment under the retainer agreement. The U.S. Trustee then filed a motion to declare the agreements as unenforceable and requiring that all fees be subject to disgorgement.

In addition to addressing the unbundling of legal services in debtor representation for bankruptcy cases and the necessary informed consent by the lay client before entering into such limited representation, *Grimmett* also addressed conflicts of interest created by the chapter 7 retainer agreement and promissory note, counsel’s Bankruptcy Rule 2016(b) disclosures, the violation of the court’s installment fee payment order, and counsel’s post-petition collection actions.

Against the attorney’s arguments that the representation agreement rendered the claims for fees for legal services provided after the petition was filed as nondischargeable and not subject to the automatic stay, the *Grimmett* court, perhaps channeling former White House Press Secretary Sean Spicer at his first press conference, held that the pre-petition agreement “was discharged in bankruptcy, period.”<sup>10</sup>

In finding that “the Agreement was inconsistent with counsel’s obligation to represent a debtor/client as a matter of bankruptcy law,”<sup>11</sup> the *Grimmett* court, citing *In re Castorena* on the extent of the informed consent, found that “[i]f either [the] lawyer or client wishes to limit services in order to preserve a lower fee, that limitation must be carefully considered and narrowly crafted, and be a result of educated and informed consent.”<sup>12</sup> The *Grimmett* court continued its reference to *Castorena* “for clarity” in finding that “when accepting an engagement to represent a debtor in relation to a bankruptcy proceeding, an attorney must be prepared to assist that debtor through the normal, ordinary and fundamental aspects of the process.”<sup>13</sup> The court listed

those “normal, ordinary and fundamental aspects” to include attendance at the first meeting of creditors “and responding to issues that arise in the basic *milieu* of the bankruptcy case.”<sup>14</sup>

Attorneys representing individual debtors in bankruptcy proceedings seeking to contract away those “normal, ordinary and fundamental aspects” in the “basic *milieu*” of bankruptcy “will find it exceedingly difficult to show that he properly contracts away any of the fundamental and core responsibilities as such engagement necessarily imposes.”<sup>15</sup> Attorneys restricting their debtor representations to exclude appearances at the first meeting of creditors will encounter substantial resistance, with most courts concluding that not appearing at a § 341 meeting is a fundamental failure to represent the debtor, causing one bankruptcy judge to state that “[a]ny debtor’s counsel who does not understand the vital importance of attending a meeting of creditors with the debtor is in desperate need of further education.”<sup>16</sup>

In cancelling the Affordable Bankruptcy Program and the chapter 7 retainer agreement and promissory note, and ordering all fees returned to the debtor, the court found that the agreement created an irreconcilable conflict of interest because it permitted counsel to withhold representation until the attorneys’ fee payments had been made. The court also found that the attorney’s original and amended Bankruptcy Rule 2016 statements contained inaccurate information, resulting in an admonishment from the court referenced in a footnote that began with, “But it gets worse!”<sup>17</sup> The court continued, “The compensation to be paid to an attorney can be deemed excessive [under § 329] for a host of reasons, including but not limited to ... failure to comply with the disclosure requirements, the existence of conflicts of interest, and the like.”<sup>18</sup> After ruling that the obligations under the agreements executed pre-petition were subject to discharge “period,” the *Grimmett* court went on to address the issues surrounding the signing and filing of the petition and other documents in the bankruptcy case.

Cases involving attempts to unbundle legal services and the failure to make proper Bankruptcy Rule 2016 disclosures seem to carry other problems. While the U.S. Trustee and court were addressing the issues and problems arising from the limited nature of the representation and engagement in *Grimmett*, it was discovered that the electronically filed documents in the case had not been signed before they were filed.

Bankruptcy Rule 5005(a)(2) permits documents to be filed, signed or verified by electronic means. As a result, most original, signed documents are no longer filed at the courthouse. Both debtor and counsel must sign the original document prior to it being filed electronically, and once signed, the original must be maintained and preserved by counsel. In an electronic case filing world, attorneys (as officers of the court) are now the custodians of those pleadings, and play a critical role in the archiving and maintenance of

<sup>14</sup> *Id.*

<sup>15</sup> *In re Castorena*, 270 B.R. at 530 (Bankr. D. Idaho 2004).

<sup>16</sup> Chief Judge Alan Jaroslovsky’s 2004 letter to the attorneys appearing before him in the U.S. Bankruptcy Court for the Northern District of California as presented in “Ethics: Representation Issues: Don’t Gamble With Your Reputation or Getting Paid,” ABI Western Consumer Bankruptcy Conference, Jan. 21, 2013, available at [abi.org/education-events/sessions](http://abi.org/education-events/sessions).

<sup>17</sup> *In re Grimmett*, 2017 WL 2437231, at \*10 (Bankr. D. Idaho 2017), fn.17.

<sup>18</sup> *Id.* at \*9 (citations omitted).

<sup>9</sup> Apparently, counsel intended to pay the remaining filing fee from the debtor’s promissory note payments to the attorney.

<sup>10</sup> *In re Grimmett*, 2017 WL 2437231 (Bankr. D. Idaho 2017), at \*9.

<sup>11</sup> *Id.* at \*5.

<sup>12</sup> *Id.* at \*6 (citing *In re Castorena*, 270 B.R. at 531).

<sup>13</sup> *Id.*

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those originals. A pleading filed without first obtaining an original executed signature breaks one of the key principles underlying electronic case filing: The attorneys are now the repositories of original pleadings filed in the bankruptcy case — not the court.

In *Grimmett*, the voluntary petition, installment filing fee application, declarations concerning the schedules, statement of financial affairs and the verification of the creditor matrix all bore electronic “Adobe Echosign” signatures, even though the debtor never actually signed these documents before they were filed with the court. The court found that “the use of the software-generated signatures ... fell short of compliance with the Local Rules.”<sup>19</sup> The court continued, “[W]hen an attorney submits an electronically signed document to the Court, ‘he is certifying to the court that he has the [document] in his physical possession bearing the original signature of the [party]. If the certification is false, the attorney is subject to sanctions pursuant to Rule 9011.’”<sup>20</sup> Stating this unacceptable practice and professional trespass more forcefully, the U.S. Bankruptcy Court for the Eastern District of Virginia has held, “In sum, an attorney’s electronic submission of a document to the Court inaccurately ‘purporting to have [a party’s] signature is no different than [the attorney] physically forging [the party’s] signature and handing the [document] over the counter to the clerk.’”<sup>21</sup>

When Rule 9011<sup>22</sup> is added to this troubling visual, the responsibilities of attorneys filing electronic docu-

ments to only do so after the original signatures have been obtained should not have to be emphasized further. However, further emphasis is warranted nonetheless, and the standard of “obsessive attentiveness” when filing documents is articulated in *U.S. v. Carelock*,<sup>23</sup> and, as reported in an *ABI Journal* article,<sup>24</sup> so that bankruptcy practitioners are not viewed as armed tequila-addled inebriates with law licenses.<sup>25</sup>

While the Bankruptcy Code and Rules allow individual debtors to pay their required filing fees in installments, debtor’s attorneys are not permitted to act as lenders to their clients. A debtor/bankruptcy engagement structured in a manner that seeks to declare fundamental core bankruptcy services as post-petition, and to have those fees paid post-petition as an independent obligation not subject to discharge, is fraught with ethical pitfalls and serious sanctions. Attorneys have “an obligation to either handle the case from beginning to end and perform the services for whatever amounts the clients can afford, or refer the cases to another attorney.”<sup>26</sup>

The ethical issues are exponentially expanded when conflicts of interest and inadequate or nonexistent disclosures concerning the fees are made. Those disclosures have a resemblance to firearms and alcohol, with the embedded capacity for mistakes and poor judgment when the original documents filed electronically with the court are not first signed as required under the Bankruptcy Rules. **abi**

19 *Id.* at \*11.

20 *Id.* (citations omitted).

21 *In re Hurd*, 2010 WL 3190752 \*3 (Bankr. D. Idaho 2010) (citing *In re Wenk*, 296 B.R. 719, 725 (Bankr. E.D. Va. 2002)).

22 Bankruptcy Rule 5005(a)(2) permits “filing by electronic means” and provides that a “document filed by electronic means in compliance with a local rule constitutes a written paper for the purpose of applying these rules, the Federal Rules of Civil Procedure made applicable by these rules, and § 107 of the Code.”

23 459 F.3d 437, 443 (3d Cir. 2006) (“[The] ease of use [of computers] ... should not assuage the almost-obsessive attentiveness that is required when filing any document with a court.”).

24 Hon. Mary P. Gorman and Khadija V. Thomas, “Of Handguns, Tequila and Electronic Case Filing,” XXX *ABI Journal* 7, 16, 74-75, September 2011, available at [abi.org/abi-journal](http://abi.org/abi-journal).

25 *U.S. v. Carelock*, 459 F.3d at 443 (“A computer lets you make more mistakes faster than any invention in human history — with the possible exceptions of handguns and tequila.”).

26 *In re Basham*, 208 B.R. 926, 932-33 (B.A.P. 9th Cir. 1997).

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