***Unbundling Revisited – recent decisions regarding services***

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Both the 9th Circuit Court of Appeals and the 9th Circuit Bankruptcy Appellate Panel have authorized “unbundling” of services in certain circumstances.[[1]](#footnote-1) The Idaho Rules of Professional Conduct also allow unbundling in similar circumstances. Recent decisions from both courts, as well as the District of Idaho courts, have created a minefield for practitioners seeking to properly unbundle legal services. This article seeks to review the relevant and recent authority regarding unbundling – with a goal of providing background for group discussion at the 38th Annual Commercial Law & Bankruptcy Section Conference in 2020 held in McCall.

***In re Castorena***

*In re Castorena* is the essential cornerstone for any discussion of unbundling legal services in Idaho.[[2]](#footnote-2) In this 2001 case, the Debtor’s attorney sought to limit his representation largely to providing pre-petition assistance to the Debtor. The attorney did not sign the bankruptcy petition or appear at any post-petition hearings (unless paid extra). After several of these cases were filed, the Court required counsel to appear and justify his limited representation. In determining that counsel failed to perform the essential duties of a debtor’s attorney, Judge Myers took the opportunity to outline the basic duties of debtor’s attorneys:

The first, and most obvious, is the obligation to appear as debtor’s counsel of record and to represent the debtor … [Furthermore], an attorney must be prepared to assist that debtor through the normal, ordinary and fundamental aspects of the process. These include the proper filing of all required schedules, statements and disclosures; preparation and filing of necessary amendments to the same; attendance at the §341 meeting; turnover of assets to the trustee, and cooperation with the trustee; compliance with the tax turnover and other orders of the Court; performance of the duties imposed by §521(1), (3) and (4); counseling in regard to §521(2) and the reaffirmation, redemption, surrender or retention of consumer goods securing obligations to creditors, and assisting the debtor in accomplishing those aims; and responding to issues that arise in the basic milieu of the bankruptcy case, such as violations of stay and stay relief requests, objections to exemptions and avoidance of liens impairing exemptions, and the like.

270 B.R. at 530.

This summary has stood the test of time for Idaho bankruptcy attorneys and frames the discussion of what services those attorneys must provide. Other questions have arisen since *Castorena* was decided: how can attorneys be paid for these services (pre- vs. post-petition payments); are adversary proceedings included in the essential services; are there differences between flat fee or hourly fee arrangements; if adversary proceedings are included, how can attorneys be paid for those services?

***Gordon v. Hines (In re Hines)***

*Hines* dealt with a pre-filing agreement to pay certain portions of the debtor’s attorney fee post-filing, which the debtor in fact did.[[3]](#footnote-3) The debtor then terminated that attorney (Gordon), and reverted back to her original attorney. That attorney then sought stay-violation sanctions against Gordon. The Ninth Circuit recognized the quandary it faced:

[T]he very administration of the bankruptcy system requires that attorneys for Chapter 7 debtors must have a legally enforceable right for their postpetition services that were contracted for before filing of the petition. If the absence of such a right were to become the law, it does not require much thought to recognize that the entire system would suffer a massive breakdown. In our view the required recognition of such a right, essentially a doctrine of necessity, is best implemented by a holding that all claims for lawyers’ compensation stemming from such postpetition services actually provided to the debtor really do not fall within the automatic stay provisions of Section 362(a)(6) or the discharge provisions of Section 727.[[4]](#footnote-4)

Secondarily, the Ninth Circuit also recognized that the attorney’s post-petition claim may not even arise until services are provided post-petition, which takes it out of the pre-petition claim arena.[[5]](#footnote-5) In *Hines*, however, the Ninth Circuit recognized that the attorney had been terminated – consequently the pre-petition agreement no longer existed and could no longer form the basis for the attorney’s claim for fees. For that reason, the Ninth Circuit then turned to the quantum meruit argument and allowed fees pursuant to that argument. Notably, the Ninth Circuit did not deny Gordon’s claim for post-petition fees because the pre-petition agreement had been discharged – it was denied because the pre-petition agreement had been terminated by the debtor firing Gordon.

*Hines* essential holding, that enforcement of a pre-petition agreement to pay post-petition fees was not a violation of the stay or discharge injunction, explicitly recognizes that the obligation is not discharged in a bankruptcy proceeding. This holding has been subsequently reaffirmed by the Ninth Circuit in a later decision.[[6]](#footnote-6)

***In re Grimmett[[7]](#footnote-7)***

*Grimmett* involved a Chapter 7 Debtor who, similar to many other Chapter 7 debtors, was unable to procure enough funds to pay her Chapter 7 attorney in full prior to the filing of the petition. Attorney and Grimmett agreed on a Chapter 7 Agreement and Promissory Note that split the services to be provided by the Attorney into both pre- and post-petition services. Under the Agreement, pre-petition services consisted of initial consultations, analysis of Grimmett’s financial situation and exemption planning, review of Grimmett’s questionnaire, and preparation and filing of the petition, SSN statement, Certificate of Credit Counseling and an application to pay the filing fee in installments. Everything else to be performed by the Attorney was considered either post-petition services, or additional services.

In conjunction with the Agreement, Grimmett agreed to pay the Attorney a flat fee of $2000. $500 of this amount was allocated to pre-petition services and had to be paid pre-petition, with regular monthly post-petition payments to begin within 21 days after the initial petition was filed, with the balance owed to be paid within 12 months of the petition date. The Agreement provided for automatic debit withdrawals for the post-petition payments, collection activity by the Attorney in the event of non-payment of the post-petition payments, and an acknowledgement that the Attorney may “factor” the post-petition payment stream with an outside company. After Grimmett made one post-petition payment, she was unable to continue making the required payments, and the Attorney began an increasingly-escalated attempt to collect the post-petition amounts owed. These attempts included threats to withdraw from the representation (which may have the effect of dismissing the bankruptcy case). After receiving several notices, Grimmett sent a letter to the Court describing the situation which the Court lodged in the docket. The United States Trustee then filed a motion to require the Attorney to disgorge all fees paid and for other sanctions.

After reciting the facts, the Court recognized the IRPC requirement of getting informed consent by the client prior to unbundling services. However, the Court declined to address the specific ethics-based issue, choosing instead to address unbundling under applicable bankruptcy rules and precedent. The Court first recited the *Castorena* list of “normal, ordinary and fundamental aspects” of a Chapter 7 case which attorneys should be prepared to perform. The Court characterized the Agreement as an attempt to unbundle the post-petition representation, in violation of both the spirit and letter of *Castorena*. The Court then turned to the US Trustee’s argument that, by attempting to collect the post-petition fees, the Attorney was violating either the bankruptcy stay or bankruptcy discharge (depending on the timing of the entry of discharge). Here, the Court had to grapple with Ninth Circuit precedent, *In re Hines*.[[8]](#footnote-8) In reviewing and applying the *Hines* decision, the bankruptcy court ruled that the pre-petition agreement to pay fees both pre- and post-petition was “discharged in bankruptcy, period, and [the Attorney] cannot enforce that contract obligation post-petition.” On appeal, the District Court reversed this part of the decision finding that the unbundling and bifurcation of fees was allowed – following the *Hines* precedent.[[9]](#footnote-9)

***In re Hazlett[[10]](#footnote-10)***

*Hazlett* involved a Debtor who could not afford a full retainer with a traditional firm and sought counsel willing to offer representation based mostly on the *Hines* model. The same firm as *Grimmett* above, offered representation in a model where no fee or partial fee were paid before filing the bankruptcy and after filing proceeding *pro se*, hiring another attorney to proceed, or hiring the same firm with a new post-petition fee agreement. Debtor continued with the same firm and successfully completed a no-asset case. Moving forward with the firm required a new agreement and included many disclosures, explanations, warnings, and consents. After the case closed, Hazlett complained about the repayment plan and procedure of the attorney to collect and another firm sought disgorging of fees, sanctions, restrictions on e-filing, and fees.

The *Hazlett* court noted the difference between bifurcating contracts and unbundling services. Unbundling is appropriate if the debtor will be properly represented and the ultimate purpose is to ensure the attorney is paid for post-petition representation. Such bifurcated agreements are not per se ethics violations, do not run afoul of the bankruptcy code, and are not unfair.

As similarly outlined in *Castorena*, Utah bankruptcy courts provided minimum standards of representation through their local rule 2091-1 which includes:

Scope of Representation. A debtor’s attorney must represent and advise the debtor in all aspects of the case, including the § 341 Meeting, motions filed aginst the debtor, reaffirmation agreements, agreed orders, and other stipulations with creditors or third parties, and post-confirmation matters. The debtor’s attorney must also represent the debtor in adversary proceedings filed against the debtor unless, pursuant to this rule, the Court has excused the attorney from this requirement. The scope of representation cannot be modified by agreement. The court may deny fees or otherwise discipline an attorney for violation of this rule.

Counsel for debtors can certainly bifurcate, whether necessary or needed under *Hines*, but limiting of services or unbundling is still prohibited.

Consequently, after *Hines*, *Grimmett*, and *Hazlett* it appears separating services into pre- and post-petition categories, with related pre- and post- petition payments is allowed[[11]](#footnote-11). However, several other cases continue to raise issues related to the post-petition services related to adversary proceedings, which are outside the scope of *Castorena’s* basic requirements, but contained in Utah’s local rule 2091-1.

***Tedocco v. DeLuca (In re Seare)***

*Seare* dealt with a debtor’s attorney’s attempts to unbundle *representation* of the debtor in a post-petition adversary case. Prior to filing his petition, the debtor was involved in litigation in the federal district court in Nevada. That litigation resulted in a judgment against the debtor, based on the debtor’s “fraud upon the court”, by falsifying certain records and allowing his attorney to file amended pleadings based on the falsified records. That judgment was what led the debtor to contemplate a bankruptcy filing. Prior to filing the petition, the debtor had one in-person contact with the attorney (“DeLuca”). The attorney was provided a copy of the judgment and order from the District Court, but told the debtor that it would be discharged. The attorney also used a form retainer agreement with certain disclaimers regarding nondischargeability, and which excepted representation for (among other things): “addressing allegations of fraud and nondischargeability” and “Adversary Proceedings”.

Shortly after the bankruptcy case was filed, the judgment creditor’s attorney informed the debtor and DeLuca that an adversary proceeding would be filed, asserting nondischargeability. As soon as that proceeding was filed, DeLuca forwarded copies to the debtor, with an instruction to contact a different attorney for representation, since DeLuca’s representation was completed. After a pro se answer was filed, the bankruptcy court issued an “Order to Show Cause Why This Court Should Not Sanction Anthony J. DeLuca for Failing to Representation Debtor in the Adversary Proceeding.” DeLuca responded. Ultimately, the bankruptcy court (and later, the Bankruptcy Appellate Panel) found that DeLuca had violated his ethical duties (and duties under the Bankruptcy Code) by improperly unbundling the adversary proceeding. Specifically, the courts found that DeLuca had not reasonably limited his services, and had also failed to get the clients’ informed consent to that limitation. The BAP confirmed, however, that an attorney may properly unbundle representation in adversary proceedings, provided the limited representation is reasonable and informed consent is obtained.

As recognized by Judge Jury in her concurrence: “Without the ability to unbundle adversaries, the flat fee which a consumer attorney would need to charge for basic bankruptcy representation might become prohibitive and exacerbate the already existing problem of pro se filings.”[[12]](#footnote-12)

Judge Jury’s concurrence provides an excellent roadmap for attorneys faced with potential adversary proceedings, in determining the limits and extent of fees to be charged:

1. At the initial intake interview with the debtor, identify fully and completely the debtor's goals. Almost by definition, the attorney therefore cannot have a predetermined business practice that excepts representation in adversary proceedings from the services the attorney will render unless the attorney and debtor identify that exception before deciding to commence representation. As noted by the bankruptcy judge, the decision to unbundle must be driven by the debtor's needs, not the attorneys.
2. The attorney may not rely solely on the debtor's input to help him or her ascertain the debtor's goal. Both the ethical rules and the Code require the attorney to conduct a reasonable investigation of the debtor's assets and liabilities. If the attorney learns that a judgment has been taken against the debtor, the attorney must make reasonable inquiry into the nature of the judgment in order to determine whether it might be subject to nondischargeability.
3. If, after ascertaining the debtor's goals, the attorney believes that limited scope representation is consistent with those goals, the attorney must then fully explain to the debtor the consequences and inherent risks which might arise if an adversary is filed against the debtor and the attorney has not included representation in that proceeding in the unbundled services. Informed consent is just that: informed. The debtor must understand the "legal jargon" and the practical effect on him or her of the limited scope representation before the consent is informed.
4. The attorney must customize the retainer agreement to the goals of debtor. That is not to say that much of the agreement cannot be boilerplate, but boilerplate without the attorney's active role in its preparation will be insufficient for limited scope representation. Just having the debtor read and initial the agreement does not assure the debtor is giving informed consent.
5. After describing to the debtor the risks of limited scope representation, the attorney must give the debtor the opportunity to "shop elsewhere" for an attorney who will provide full representation before entering into the contractual relationship with the debtor for the limited scope.
6. The attorney should document as fully as possible all the steps taken to comply with these requirements.

Judge Jury concludes: “Following these suggestions should go a long way to allowing consumer bankruptcy attorneys to unbundle adversary proceeding representation without violating ethical rules.”[[13]](#footnote-13)

***Ulrich v. Schian Walker, P.L.C. (In re Boates)[[14]](#footnote-14)***

*Boates* dealt with a pre-petition agreement to represent a debtor in a post-petition nondischargeability proceeding. Prior to filing, Boates (an attorney) was the defendant in negligent misrepresentation and fraud claims. When he informed the Plaintiff that he intended to file bankruptcy, the Plaintiff informed him it intended to pursue a nondischargeability proceeding. Prior to filing, Boates engaged Schian Walker to represent him in the bankruptcy case (flat fee $5000), as well as the adversary proceeding (flat fee $60,000). All fees were treated in the agreements as “earned on receipt” fees, and were fully paid prior to filing.

About six months after the bankruptcy and adversary cases were filed, Ulrich (the Chapter 7 Trustee) pursued recovery of the $60,000 fee from Schian Walker, arguing that the representation agreement was an executory contract that had been deemed rejected when it was not assumed, and therefore the Chapter 7 Trustee was entitled to the unearned portion of the fee. On summary judgment motions, the bankruptcy court ruled in favor of Schian Walker, finding that the agreement was not an executory contract.

The first question on appeal was whether the retention agreement was an executory contract for purposes of § 365. The BAP relied on the *Countryman* test and concluded that Boates still owed Schian Walker an express, material, contractual obligation to reimburse Schian Walker’s litigation costs, a breach of which would have excused Schian Walker from continuing its legal representation. Therefore, the retention agreement was an executory contract the trustee could assume or reject under § 365.[[15]](#footnote-15)

The second question was the effect of rejection under § 365(d)(1). The BAP concluded that the $60,000 itself was not property of the estate, as the retention agreement expressly provided that the fee was earned in full upon receipt and Schian Walker deposited the funds immediately into its general bank account. Relying, in part on *Hines*, the BAP noted that the estate still held an interest in the post-petition legal services. Rejection constituted a breach of that agreement, but not a termination, rescission, or relinquishment of the estate’s rights under the contract. The BAP concluded that under Arizona law (including the applicable rules of ethics), Boates necessarily had the right to terminate Schian Walker and seek a refund of those prepaid fees minus the value of any services provided before termination. Because those rights were held by the Trustee on behalf of the bankruptcy estate, the termination of the representation led to a right to fund of the unearned prepaid fees. The matter was remanded to determine the exact time notice of termination was provided to Schian Walker.[[16]](#footnote-16)

***In re Rodenbough[[17]](#footnote-17)***

*Rodenbough* involved counsel for chapter 7 debtors who after multiple consultations realized a complex and extensive bankruptcy case and ultimately requested $11,000 flat fee to retain and do all work in the case and anticipated adversary proceeding. Trustee sought turnover of amounts he viewed as beyond the work done on the date of petition. Debtors’ case and related adversary proceeding were ultimately successfully completed.

As outlined in this case, three basic types of retainers exist: 1) classic or true retainers, 2) security retainers, and 3) advance payment retainers. The details of the agreement give the nature and attributes of the retainer, not a name. (Classic retainers were not discussed in the case but secure availability over a period of time).

Security agreements are funds paid for future services and are applied as charged by the attorney. Funds not earned are returned to the client. Unearned portions of security retainers are property of the estate and require turnover.[[18]](#footnote-18) Further, counsel may not recover compensation from these funds unless employed by the estate. [[19]](#footnote-19)

Advance payment retainers, or flat fee retainers, are where an attorney receives payment in exchange for certain agreed-upon, enumerated services to be performed for a debtor in the future. Services agreed to be rendered can be the entire scope of services or may be limited to specific tasks. Advance payment retainers are not property of the estate.[[20]](#footnote-20) Attorneys are still obligated to refund unearned portions of the retainer when representation ends.

The court permitted parol evidence due to ambiguity in the contract. Ultimately, as a one-time flat fee payment, the retainer qualified as advance payment retainer and therefore not property of the estate.

**Conclusion**

Undoubtedly, debtors counsel should be aware of, and ensure they comply with, the decisions and guidance in the above cases. Indeed, the reasonableness and informed consent required by *Seare* may lead more debtors’ attorneys to the same problems encountered in *Boates* and *Rodenbough*. In any case, counsel need to be aware of the issues raised in these cases and approach your representation accordingly.

1. *See, e.g., Gordon v. Hines (In re Hines)*, 157 F.3d 1185 (9th Cir. 1998); *Tedocco v. DeLuca (In re Seare),* 515 B.R. 599 (9th Cir. BAP 2014). [↑](#footnote-ref-1)
2. *In re Castorena*, 270 B.R. 504 (Bankr. D. Idaho 2001). [↑](#footnote-ref-2)
3. *See* *Gordon v. Hines (In re Hines)*, 157 F.3d 1185 (9th Cir. 1998). While the agreement in *Hines* was created during the Chapter 13 portion of the case, and therefore might be considered a post-petition agreement, it is treated as a pre-petition agreement under the provisions of 11 U.S.C. § 348(d). [↑](#footnote-ref-3)
4. *Hines*, 147 F.3d at 1191. [↑](#footnote-ref-4)
5. As the Court recognized, *Hines* reaffirmed a previous Ninth Circuit case which had determined that claims for unpaid pre-petition services were discharged in the Chapter 7 bankruptcy. *See, e.g., Hessinger & Assocs. v. U.S. Trustee (In re Biggar)*, 110 F.3d 685 (9th Cir. 1997). However, *Hines* dealt with claims for post-petition services rendered, and therefore did not reach the issues dealt with in, or otherwise extend, *Biggar*. [↑](#footnote-ref-5)
6. *See, e.g., Sanchez v. Gordon (In re Sanchez)*, 241 F.3d 1148 (9th Cir. 2001). [↑](#footnote-ref-6)
7. *In re Grimmett*, [2017 Bankr. LEXIS 1492](https://advance.lexis.com/document/midlinetitle/?pdmfid=1000516&crid=9df73d75-7afa-4e75-8775-c23b76484798&pddocfullpath=%2Fshared%2Fdocument%2Fcases%2Furn%3AcontentItem%3A5NPX-CB51-F049-500M-00000-00&pdcomponentid=6406&ecomp=-7xfk&earg=sr11&prid=f1b2c252-494f-499f-b9fe-6d0bd543dd62) (Bankr. D. Idaho 2017). *Grimmett* also dealt with some other deficiencies by the Attorney, including confusion regarding the required Rule 2016(b) statements regarding the Attorney’s fees, as well as whether the Attorney had obtained “wet signatures” from Grimmett prior to filing the petition, statements and schedules. [↑](#footnote-ref-7)
8. *Gordon v. Hines (In re Hines),* 147 F.3d 1185 (9th Cir. 1998). [↑](#footnote-ref-8)
9. *See In re Grimmett*, Case No. 1:17-CV-00266-EJL, Docket 16 (D. Idaho 2018). The requirement to disgorge fees was upheld, however, on other grounds. [↑](#footnote-ref-9)
10. *In re Hazlett*, 2019 WL 1567751 (Bankr. D. Utah 2019). *Hazlett* also dealt with the use of a factoring company for collections, disclosures of third parties, reasonableness of fees, whether “wet signatures” were obtained, and other argued deficiencies of the attorney. [↑](#footnote-ref-10)
11. Practitioners must continue to take care that pre- and post-petition contracts still comply with the debt-relief agency provisions of § 526 and §528, otherwise additional grounds exist for avoidance of the contract and related fees. *In re Milner*, 2019 Bankr. LEXIS 3976 (Bankr. W.D. Okla. 2019) [↑](#footnote-ref-11)
12. 515 B.R. at 622. [↑](#footnote-ref-12)
13. *Tedocco v. Deluca (In re Seare)*, 515 B.R. at 624. [↑](#footnote-ref-13)
14. *Ulrich v. Schian Walker, P.L.C. (In re Boates)*, 551 B.R. 428 (9th Cir. BAP 2016) [↑](#footnote-ref-14)
15. 551 B.R. at 435. [↑](#footnote-ref-15)
16. 551 B.R. at 437-38. [↑](#footnote-ref-16)
17. *In re Rodenbough*, 2018 Bankr. LEXIS 3192 (Bankr. D. Idaho 2018). [↑](#footnote-ref-17)
18. *In re Dearborn Constr., Inc.*, 03.1 IBCR 17, 20 (Bankr. D. Idaho 2003). [↑](#footnote-ref-18)
19. *In re Blackburn*, 448 BR 28, 35 (Bankr. D. Idaho 2011). [↑](#footnote-ref-19)
20. *Id.* at 38. [↑](#footnote-ref-20)