

Norton Bankruptcy Law Adviser
July 2012

Fee Splitting: Between the Devil and a Boulder

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Between a Rock and a Hard Place [FN2] is Aron Ralston's autobiographical account of his experience being trapped in a slot canyon in the Utah desert that led him to amputate his right arm with a dull knife on a multi-tool in order to free himself after his arm became trapped by a dislodged boulder.

Consumer bankruptcy lawyers sometimes face a similar dilemma: trapped between the devil of 11 U.S.C. § 504's prohibition of fee-sharing--risking disgorgement of fees for engaging in fee-sharing--and a boulder where the lawyer should retain outside help to competently process the matter. The issue is not always clear. One court acknowledged that “[f]ee-sharing is a somewhat confusing area of law;” [FN3] another observed that the matter was the subject of a “confusing maze of rules and sections.” [FN4]

The prohibition against fee-sharing: 11 U.S.C. § 504

In a nutshell, the Bankruptcy Code prohibits fee-sharing or “fee splitting” in a case with persons not technically employed by the firm. [FN5] The Code and Bankruptcy Rules require, as well, full disclosure of any fee-sharing or any agreement to share fees by debtors' counsel. [FN6] The prohibition actually has two elements: 1) the prohibition against *fee-sharing per se*, and 2) duty to *disclose* any fee-sharing agreement in a particular case. [FN7]

The Code provides several so-called “safe-harbors” in this context. It is okay to share fees with a “member, partner, or regular associate” of the firm, which includes, a “professional association, corporation, or partnership,” [FN8] as long as it is timely disclosed. And, to the extent an attorney is retained as special counsel to represent the estate, shared compensation is probably acceptable. [FN9]

But, some attorneys who do predominantly consumer bankruptcy work never give § 504 a second thought. Others assume it doesn't apply in a particular case. And some are shocked to find that they should have thought about it a lot more, before losing an arm by disgorgement of fees.

The issue of fee-sharing may arise in several situations in the context of a consumer Chapter 7 or Chapter 13 case. [FN10] It also appears in Chapter 11 cases.

Typical situations in which fee-sharing may arise

1. Attorney needs outside expertise in a particular field to competently handle the bankruptcy case.
2. Attorney needs help processing a high volume of consumer bankruptcy cases, and seeks the services of a “temp” attorney or an independent petition preparer (paralegal).

3. Attorney pays or receives a referral or forwarding fee.
4. Prior to filing bankruptcy the debtor already has an attorney representing him or her with a law suit, such as a personal injury case (i.e. "special counsel") (variation: trustee retains special counsel on behalf of the estate).
5. To reduce travel costs or charges, the attorney retains another attorney to appear at § 341 meetings or court hearings.
6. Attorney needs to retain an attorney in another jurisdiction (i.e., "local counsel").
7. Attorney pays a separate marketing entity to generate "leads."
8. Attorney pays bonuses to law firm staff based on some formula linked to volume of cases.

Reasons for the prohibition

Courts have cited several purposes behind the fee-splitting prohibition, including:

- A tendency to increase the billable hours resulting in higher costs to the debtor (or the estate); [FN11]
- Lack of court or trustee control over an independent professional employed by the attorney; [FN12]
- "Trafficking"; [FN13]
- Encouraging the unauthorized practice of law. [FN14]

Behind these policies is the overarching policy to "preserve the integrity of the bankruptcy process to the end that, among others, lawyers attend to their duty as officers of the bankruptcy court ... rather than to treat their interest in bankruptcy matters as matters of traffic." [FN15]

The sanctions for violation of § 504 are typically monetary in the form of an order for disgorgement, and range from small (\$100 per *In re Peterson*) [FN16] to large (\$2.4 million per *In re ACandS*). [FN17]

Increasing attention to § 504

There is a history of rules addressing fee-sharing in bankruptcy cases. This history demonstrates that, like rules on compensation of debtor's attorneys in general, it was not consumer bankruptcy attorneys' abuses, but rather abuses by corporate legal entities that stimulated adoption of rules prohibiting fee-sharing, beginning as far back as a 1729 English Act of Parliament. [FN18]

Interpretation of § 504 has gained importance in recent years, for several reasons, including that consumer bankruptcy cases are more complicated than they used to be, and that the practice of "outsourcing" portions of cases to outside professionals--independent bankruptcy petition preparers hired by both debtors acting *pro se* and debtors' attorneys seeking help to process cases to keep the costs of full-time staffing to a minimum [FN19]--has increased. A thorough exploration of the needs of, and the trends in, employment of temporary outside professionals, with emphasis on bankruptcy firms, is the set forth in *In re Worldwide Direct, Inc.* [FN20]

'The past two decades have witnessed a remarkable transformation of the legal market A critical component of this transformed legal market is the incorporation of paralegals providing a wide range of legal services'

The most recent trend has corporations and law firms using attorneys and paralegals who are not even in this country to perform legal work that would otherwise be done by attorneys and paralegals in-house.

The use of such professionals has reduced the cost to firms, in training and in salaries. To the extent that these cost-savings are passed on to clients and debtors' estates, the use of temporary employees is laudable. [FN21]

Questions that arise in regard to fee-sharing

The issue whether an attorney has engaged in fee-splitting, or has failed to disclose it, may seem relatively simple--did he or didn't she share a fee with an outside professional? But given the many possible scenarios listed above in which fee-sharing may arise within the meaning of § 504, a number of questions may be involved.

1. Against what evil does the prohibition of fee-splitting guard against?
2. In a case of obvious fee-splitting, is it okay as long as in this particular case all of the “evils” have been avoided?
3. Is an attorney listed as “of counsel” equivalent to a “regular associate”?
4. May an attorney who “associates” on only one matter or case for the primary firm be deemed “of counsel” or a “regular associate”?
5. Can an attorney be “of counsel” or a “regular associate” of more than one law firm at the same time?
6. Can an attorney with a separate law practice be “of counsel” or a “regular associate” of another firm?
7. What does it take to be a “regular associate”? For example, is the primary firm responsible for withholding trust-fund taxes from the “associate's” paycheck?
8. Is it always wrong to associate an expert if by associating, the total of professional fees that the client must pay is necessarily larger than if the primary attorney had blundered on as a sole attorney on the matter?
9. Is paying the associated attorney as a “cost” (as opposed to a “fee”) passed on to the client, equivalent to fee-splitting?
10. Are funds deposited in an attorney's trust account, a portion of which is subsequently paid to an outside professional, deemed “fees” within the meaning of “fee-splitting”?
11. Is it prohibited fee-sharing if the attorneys who split fees are not representing the estate in any capacity?
12. Does the rule extend to fees paid by a third party (such as a family member, spouse, employer, etc.)?
13. Does the associated professional have an independent duty to disclose the arrangement in a case?
14. Are fees paid in a typical no-asset Chapter 7 case subject to § 504, or rather limited to fees paid as administrative expenses when the attorney represents the estate in some capacity?

15. If the debtor retains the other professional and pays her directly, is it still fee-sharing?
16. Is the obligation to pay the outside professional fee-sharing if it is an obligation which the debtor's bankruptcy attorney must pay regardless of whether she is paid or reimbursed by the debtor?
17. Does sharing an "advance payment for future services," when the debtor transfers her entire equitable and legal interest to the attorney upon payment of the retainer fee, violate the rule?
18. Are "bonuses" paid to office staff based on volume or on new signups deemed fee-sharing? [FN22]
19. Does the rule apply equally to postpetition receipt of fees and prepetition retainer fees?
20. Does the employment of so-called "limited-engagement" or "unbundling" retainer agreements avoid the problem of fee-sharing?
21. Does the § 504 prohibition apply equally to Chapter 7 and Chapter 13 cases?
22. Does the firm's employment of 'temp' lawyers and paralegals violate § 504?

Each of the above questions has arisen in various published opinions that address fee-splitting. Each could be included in a litany of traps for the unwary, and in many cases it is pretty clear from the opinion that the debtor's attorney, and the outside professional, have been blind-sided by a disgorgement order. Hence, clarification of the fee-splitting rule becomes increasingly important.

Scope of this article

To address all of these questions would require a whole book; each question could be the subject of a separate article. For example, the increasing outsourcing of consumer bankruptcy work to independent paralegals deserves a thorough treatment. To simplify things, this article addresses only one of the scenarios described above, which is a debtor's attorney in a consumer Chapter 7 or Chapter 13 case who realizes she needs outside help to timely and competently handle a case. For example, this could be consulting or retaining another attorney with special expertise, or "outsourcing" the petition preparation to an independent paralegal or petition preparer. These scenarios are not uncommon, and embrace many of the questions that may arise.

Hypothetical

An attorney takes a consumer bankruptcy case and quickly finds himself in over his head due to massive delinquent taxes and a complicated financial history; he approaches another attorney, who has her own practice, for help on the tax-discharge issues in the case.

Duty to associate co-counsel

As a general rule an attorney in this situation has a duty to associate outside counsel when she needs help to competently handle the case. Some state rules of professional conduct impose such a duty. For example, Rule 3-110 of the California Rules of Professional Conduct provides:

- (C) If a member does not have sufficient learning and skill when the legal service is undertaken, the member may nonetheless perform such services competently by 1) associating with or, where appropriate,

professionally consulting another lawyer reasonably believed to be competent, or 2) by acquiring sufficient learning and skill before performance is required. [FN23]

However, at least one court has stated that “the prohibition on fee sharing applies even though such fee sharing (or fee-splitting) might otherwise be authorized under the state bar rules applicable to the professionals.” [FN24]

And a California attorney must balance the admonition of Rule 3-110 with Rule 2-200 Financial Arrangements Among Lawyers:

(A) A member shall not divide a fee for legal services with a lawyer who is not a partner of, associate of, or shareholder with the member unless:

(1) The client has consented in writing thereto after a full disclosure has been made in writing that a division of fees will be made and the terms of such division; and

(2) The total fee charged by all lawyers is not increased solely by reason of the provision for division of fees and is not unconscionable as that term is defined in rule 4-200. [FN25]

The California rule mirrors almost the exact wording of the ABA Model Rules of Professional Conduct. [FN26]

Some bankruptcy court opinions acknowledge the prudence of seeking outside help when appropriate noting “an attorney should not, without associating competent counsel, accept cases counsel is incompetent to handle.” [FN27]

From The American Bar Association, Center For Professional Responsibility, comments on fee-sharing:

As a new lawyer or solo practitioner it may be especially advantageous to ... affiliate with co-counsel on a case and agree to share fees.

Model Rule 1.5(e) allows lawyers to divide fees in two ways. First, fees may be divided on the basis of the proportion of services rendered. Alternatively, if the division of fees will not be based upon the allocation of services rendered by each attorney, fees may be divided if each lawyer assumes responsibility for the representation as a whole and the client agrees in writing to the participation of each lawyer, including the share of the fee each lawyer will receive. It should be noted, however, that state versions of Rule 1.5 vary, with many requiring that a division of fees be made in proportion to the services performed. [FN28]

In our hypothetical, the debtor's attorney has a choice: Retain or associate an outside attorney with expertise in the tax discharge issues, which may invite a charge of fee-sharing (i.e., sacrifice his right arm); or go it alone and possibly make a big mistake regarding the tax matters (for which he may be sued) (i.e., sacrifice his left arm). It would seem at first glance fairly simple; if he takes a fee from the debtor, and subsequently pays a portion of it to another professional who is not a “member, partner, or regular associate” of the firm, it is fee-sharing.

Does the § 504 prohibition of fee-sharing apply in Chapter 7?

Returning to the hypothetical, if challenged about the fees, a Chapter 7 debtor's attorney can attack the underlying assumption that § 504 applies in Chapter 7 cases.

Typically in Chapter 7 the outside or contract attorney represents only the debtor, and not the estate, and hence the prohibition against fee-sharing prescribed by § 504 does not apply to the primary attorney sharing a fee with outside counsel. In Chapter 7, such attorney does not represent the estate or expect to be compensated by the estate, because that section governs only fees awarded under § 503(b)(2) or 503(b)(4). Section 503(b)(2) refers to “compensation awarded under section 330(a)” which in turns refers to compensation awarded to “a professional person employed under section 327 and 1103[.]”

In turn, § 327 refers to professional persons employed by the trustee “to represent or assist the trustee in carrying out the trustee's duties”--in other words, the estate. But in our hypothetical, the typical Chapter 7 case, the attorney

ney or attorneys represent the debtor rather than the trustee or the estate. Section 503(b)(4) refers to professionals employed pursuant to § 503(b)(3), which refers to creditors or professionals in certain capacities who render services that benefit the estate, and do not include debtor's attorneys. [FN29] The inapplicability of § 504 to attorneys who represent only the debtor has been acknowledged by some courts:

Following the labyrinthine language of [the cited] ... code sections to their end reveals that the payment [the debtor's attorney] received from the debtor prior to the commencement of the case is not compensation or reimbursement under either § 503(b)(2) or § 503(b)(4), and thus the payment [debtor's attorney] later made to Collins [hired to represent debtor at the 341 meeting] ... does not fall under the prohibitions on fee sharing set forth in § 504(a). [FN30]

However, there aren't a lot of cases addressing exactly that issue, and a few deem § 504 applicable in Chapter 7, but the facts in those cases muddle the issue somewhat. For example, in one case, the debtor's attorney sought payment for an independent paralegal that helped in the case, the opinion addressed a fee application in the case. The case apparently went through both Chapter 11 (where § 504 clearly applies) and Chapter 7. And in that case the court ordered the Chapter 7 trustee to hold back some funds pending the court's adjudication of the § 504 issue. Ultimately the court disallowed compensation for the paralegal without prior court approval, on the basis that the paralegal could not fall into any of the categories for which fee sharing is allowed (specifically, the paralegal was not a "regular associate" of the firm.) So, just how much of Chapter 11 washed over into the Chapter 7 case on the issue of fee-sharing is obscure.

A trap for the unwary in Chapter 7 might be failure to consult applicable state rules of professional conduct. For example, one Chapter 7 case held that § 504 did not apply in Chapter 7, but the rules of professional conduct for the State of Texas prohibited fee sharing. [FN31]

Does Rule 2016(b) duty to disclose apply in Chapter 7?

While we have seen above that § 504's prohibition of fee-sharing itself does not apply in the ordinary Chapter 7 case, a reading of Rule 2016(b) appears to apply the duty to disclose even to professionals who do not seek compensation from the estate, but have provided some service to the debtor. That Rule provides that "every attorney for a debtor" must disclose how much, the source, and other key arrangements. Presumably that phrase includes not just the filing attorney, but all attorneys who provided some bankruptcy assistance. Arguably, as well, such attorney would file a separate Form B-203, Disclosure of Compensation of Attorney for Debtor. [FN32]

Does the duty to disclose apply to our contracted lawyer whose services are retained and paid for out of the Chapter 7 debtor's funds, prior to the case being filed? In the typical situation the tax expert has used up all of her retainer fee prior to the primary attorney proceeding to file the case. Hence, it cannot be said that she is seeking compensation from the estate, and so § 504 does not apply. Nevertheless that attorney may have a duty to disclose.

Does the § 504 prohibition apply in Chapter 13?

Unlike Chapter 7, in Chapter 13 the prohibition does apply because debtors' attorneys in Chapter 13 are allowed compensation per § 330(a)(1)(B) [FN33] (i.e., from the estate). However, there is room to argue the issue--to what extent are the fees property of the estate.

As discussed above, in a Chapter 7 case § 504 probably doesn't prohibit fee sharing, but the rule is not so simple in Chapter 13. It seems clear that the primary attorney, that is, the one who prepares and files the papers and represents the debtor in the Chapter 13 case, receives compensation per 11 U.S.C. §§ 327, 329 and 330, and is therefore paid from the estate (at least for fees paid through the Chapter 13 plan). Accordingly, the § 504(a) prohibition of fee-sharing to someone not in the firm seems to apply at least to the extent the primary attorney shares fees (but the trustee can apply to appoint special counsel per 11 U.S.C. § 327(a)). [FN34] In one case, for example, when the debtor's

attorney proposed to pay an independent paralegal for preparation of the petition and the Chapter 13 plan, the court disallowed the fee application because it violated § 504, and also because the paralegal was found to have engaged in the unauthorized practice of law. [FN35]

But in our hypothetical let's assume that the contract attorney is being paid separately by the debtor; the tax expert attorney does not technically *represent* the debtor in the case *per se*, she is simply providing some ancillary service to the debtor, such as evaluating whether the taxes will be dischargeable in Chapter 13. So, does the prohibition apply?

Arguably, if the fee-sharing is done prepetition, and all fees are consumed prepetition, leaving nothing in the estate, § 504 does not apply, because none of the fees already paid and burned up in services performed at the time the petition is filed, is property of the estate. This would seem doubly true if the contract attorney is retained and paid separately by the debtor

But most Chapter 13 cases reserve some compensation to be paid through the plan. So, with reference to the hypothetical--debtor's attorney needs to somehow obtain the help of an outside tax expert - even an attorney who is separately retained by the Chapter 13 debtor may be in trouble with the fee-sharing rule. Keep in mind that § 504 prohibits fee-sharing in any case where the professional seeks compensation from the estate. Hence, if the outside attorney is paid or expects to be paid by the debtor during the pendency of the Chapter 13 case, the question is, are the fees property of the estate?

An argument can be made that if the plan includes the default "vesting" of property of the estate in the debtor, [FN36] the debtor is free to retain anyone she pleases. In such case, the question is, is the debtor's postpetition income property of the estate? The answer may vary, and is probably a matter of the district in which the case is filed.

If the plan departs from the Code's default clause that reverts property of the estate in the debtor consistent with 11 U.S.C. § 1327(c) and instead provides that property of the estate remains in the estate (which is permissible under the same Code section), the opposite argument may apply-- namely, that the debtor's postpetition income may be deemed property of the estate. In that event, the outside attorney may be prohibited from fee-sharing, and at the very least must be approved by the court. But keep an eye on what the outside counsel is doing. If outside counsel represents the debtor in a personal injury case, for example, the award or settlement may be deemed property of the estate, in which case the prohibition may apply, unless approved in advance by the court.

For example, the court in *In re Ferguson*, [FN37] a Chapter 13 case, disallowed a 33% contingency fee for special counsel who handled the debtor's personal injury case. The special counsel's retention had been approved by the court, but the retention order did not cover the terms of the retainer agreement. While the special counsel had been retained by the trustee (so we can presume the settlement was deemed property of the estate) another attorney working on the case as co-counsel with the special counsel was not disclosed or approved. The court ruled that notwithstanding the special and co-counsel attorneys shared office space and resources, and co-counsel frequently made bankruptcy court appearances for the special counsel, the special counsel's co-counsel was not a "regular associate" of the special counsel, and the compensation arrangement between them violated § 504. The court cited the fact that the co-counsel had his own separate law practice and his own clients.

Does the Rule 2016(b) duty to disclose apply in Chapter 13?

Debtor's attorney is clearly obligated by § 329 and Rule 2016 to disclose any fees paid from whatever source. [FN38] This would include the Rule 2016(b) duty on the debtor's attorney, as well as the debtor's duty to disclose all fees paid to all attorneys, including independent attorneys, who have provided bankruptcy related services, in question number nine on the Statement of Financial Affairs.

Hypothetical solutions

Whether § 504 does or doesn't apply to attorneys who represent only the debtor in Chapter 7 or Chapter 13 cases, our hypothetical lawyer may want to avoid the question altogether, that is, put as much distance between himself and § 504 as possible. Even in Chapter 7 he's nervous about whether the local judge will find some rationale to hold that § 504 applies. Hence, we examine several feasible retainer situations that may safely avoid the § 504 prohibition in Chapter 7. Arguably these same strategies apply equally in Chapter 13. We'll list them here, and expand in further remarks following.

Option A. Treat tax expert's fees as a cost

Debtor's attorney retains the attorney tax-expert as a "cost" item to be passed on to the debtor, without the debtor's attorney leveraging a premium on the costs (i.e., does not treat the payments to the outside attorney as a fee, but merely an expense).

Option B. Tax expert "associates" with debtor's attorney

Debtor's attorney takes steps to make the tax expert a "regular associate" or "of counsel."

Option C. Client retains tax expert separately

Debtor's attorney stays out of the fee loop altogether, and has the client retain and pay the tax expert directly.

Option D. A third party pays the fees

Grandpa or a friend (perhaps even a nonfiling spouse) pays the fee to the primary attorney, who then shares some of it with the contract attorney, or pays it directly to the contract attorney.

Discussion

Option A--Payments treated as case "costs"

This scheme seems to make sense for both Chapter 7 and Chapter 13 cases. The prohibition against sharing the fee typically would not extend to payments the Chapter 7 debtor's attorney makes for typical out-of-pocket expenses, such as court reporter's fees, photocopy costs, appraiser's fees, online public records searches, postage, and the like. [FN39] If the debtor's attorney hires a law student or an independent paralegal to do some legal research in the case, can't that be treated as a mere "cost" rather than a "fee"? If so, what's the difference between paying a student to research an issue, and paying an attorney to do the same? As pointed out above, § 504 prohibits sharing a fee with "any person," and the prohibition is not limited to attorneys.

Intuitively, for purpose of § 504, there is no meaningful difference between paying a non-lawyer to do research, and paying an attorney for the same service. [FN40] Several cases have applied the rule to payments made to an independent paralegal or attorney paid to do legal research. [FN41] But those were cases in which the debtor's attorney sought payment *out of the estate* (one was a Chapter 11, the other was a Chapter 11 converted to Chapter 7). In our hypothetical, the fees are to be paid to the primary attorney by the debtor prior to filing the case, and it is presumed as well that all such sums will be consumed by billable time as of the petition date (thus removing the funds from the estate).

Several courts have addressed the difference between treating the contracted attorney's fees as billable time generating a profit to the primary attorney by billing the client at a higher hourly rate than paid to the contract attorney,

and the arrangement whereby the fees paid are passed on to the debtor with no premium added on. The court in *In re Worldwide Direct, Inc.*, [FN42] was presented with a Chapter 11 case in which the debtor's attorneys sought compensation for attorneys hired from a "temp" agency at a rate higher than that charged to the estate (law firm paid temp fees of \$600,000 but billed them to the estate at \$900,000). The court rejected the firm's argument that the extra \$300,000 was justified by the additional overhead of adding staff, space and computers to accommodate the additional temp staff, but allowed the charges to be billed at the same amount as paid to the temp staff. [FN43]

A similar ruling was made in *In re Warner*:

Appellee Hastings argues that in the course of his representation of the debtor it was necessary to subpoena a material witness located in Kentucky. Since none of the debtor's counsel were licensed in Kentucky it became necessary to retain Mr. Smith to obtain the subpoena. This arrangement according to the appellee is not a proscribed fee-sharing arrangement, but rather is merely the payment of a reasonable expense for a necessary service. [FN44]

Another case concurred that "'[a]ctual costs ... are reimbursable ... but not in amounts which include any profit or markup factor to the applicants.'" [FN45] The court agreed with debtor's counsel and treated it as a mere cost to be reimbursed by the debtor.

In *In re Kewriga* [FN46], the bankruptcy court addressed whether, under § 504, a debtor's attorney can hire an attorney, who is not a member of the law firm, without court approval, in order to do research and writing. The court found that this fee arrangement did not fit any of the exceptions of § 504. Accordingly, § 504 mandated denial of fees for conducting legal research done by attorney who was not a member, partner or regular associate of debtor's counsel.

Another aspect of such an arrangement is the difference between, on the one hand, the primary attorney paying the outside attorney out of funds deposited by the debtor, or out of a settlement of the debtor's civil case, [FN47] and, on the other hand, the primary firm being obligated to pay the fees wholly independent of any fees recovered from the debtor. The implication is that when a firm obligates itself to pay for outside help out of its own funds rather than the debtor's fees, the payments by definition do not fall within the meaning of fee-sharing because no actual fee paid by the debtor is the source of the payments to the contract attorney (i.e., the law firm pays from its operating account, which contains fees received from a multiplicity of clients, and hence no part of it is directly traceable to any particular client; even if the client never pays a fee, the firm is obligated to compensate the associated attorney). In this scheme the cost of the contracted attorney is not reimbursed by the debtor.

This distinction has been recognized by some courts. Although not a model of clarity, the opinion in *In re Age Refinig, Inc.* found that an agreement obligating the trustee to pay two law firms separately out of the trustee's contingency fees, rather than look to the debtor for payment, was not equivalent to fee-sharing. [FN48] In a Chapter 13 case the question arose whether fees paid by a mortgage company to its law firm, paid through the plan, constituted fee-sharing; in holding that they were not, the opinion explains the fact that the fees were an obligation of the mortgage company wholly separate from any funds coming from the Chapter 13 estate. [FN49]

Keep in mind that the outcome may be different in a Chapter 13 case because compensation, which is presumed to include both fees and costs, is authorized by § 330(a)(4)(B), making the costs subject to § 504.

So, whether or not associating a research attorney and treating the payments made to such attorney as a cost, or a fee, is a hair-splitting exercise for which there is scant discussion in the published opinions. Accordingly, in our hypothetical the respective attorneys may be better off looking at other possible ways to get the outside help needed without running into § 504.

Option B--Tax expert treated as a "regular associate"

Treating the associated attorney not as an independent contractual entity but rather as a “regular associate” has been discussed in more cases than Option A. The prohibition against fee-sharing may not apply in the typical Chapter 7, but clearly applies in Chapter 13; whether a Chapter 7 or a 13, the safe harbor of “regular associate” applies. Hence, this part of the discussion is relevant to Chapter 13 cases, as well. [FN50]

The problem, already mentioned, is that the Code provides no definition of the phrase *regular associate*, and case law seems to be all over the ballpark on the status of “of counsel” as well as “regular associate.”

The ultimate question presented by section 504 in the context of this case is whether the temporary attorneys and paralegals used by [the firm] to perform work for the debtors on behalf of [the firm] were ‘regular associates’ of the firm. [FN51]

Unfortunately the cases do not shed much light.

Bankruptcy Rule 9001(10) defines a regular associate as “any attorney regularly employed by, associated with, or counsel to an individual or firm.” That doesn't help us much.

Let's assume in our hypothetical that the attorneys agree to treat the tax expert as a regular associate, or something seemingly related, “of counsel.” What do the opinions say about such a notion within the realm of § 504?

Several opinions have found the contract attorney to be a “regular associate” in the context of fee-sharing.

Factors that cases have cited as evidence of a “regular associate” status:

- Primary law firm treats associated attorney as an employee for payroll deduction purposes [FN52] and is obligated to pay him or her, regardless of any fees received by the client;
- The associated attorneys “acted like associates of the firm;” [FN53]
- Associated attorney listed as “of counsel” on law firm letterhead and documents filed with the court; [FN54]
- Associated attorney performs actual services on the cases; [FN55]
- Associated attorney is supervised or controlled by the firm; [FN56]
- Associated attorney is held out to the public as “of counsel;” [FN57]
- Associated attorney is included on firm's malpractice policy; [FN58]
- Firm provides the attorney's desk, supplies, computers, etc.; [FN59]
- Associated attorney is paid on an hourly basis, not as a share of the client's fees. [FN60]

“Regular associate” status not found

However, several opinions have rejected the contract attorney as a “regular associate.” In *Peterson*, [FN61] the primary attorney regularly paid another attorney to attend 341 meetings. The court held that notwithstanding the regularity, the contract attorney was not a “regular associate” of the firm. In *Ferguson*, [FN62] when the attorneys merely shared office space and office resources, in rejecting the regular associate argument the court worked hard to

split hairs, on the ground that to be a regular associate one must be “in” the firm as provided by § 504(b)(1); the opinion blew off the definition of regular associate found in Rule 9001(10) as “any attorney regularly employed by, *associate with, or counsel to* an individual or firm.” Note that one uses “in” and the other uses “with” and “to.” Is there a meaningful difference, or is the distinction simply straining to justify a conclusion? What the opinion seems to be saying is that one cannot be a “regular associate” to a firm unless one is already a regular associate *in* the firm. Seems like circular reasoning.

In one of the oft-cited cases, *In re Matis*, [FN63] the court found the relationship was not an “association” within the meaning of § 504, notwithstanding that the two attorneys shared an office and a waiting room, and shared the office copy machine and supplies, parking space, and even some furniture.

Can an attorney be a regular associate of one firm, while she has her own separate law practice and separate clients? Assume in our hypothetical the tax expert attorney is in his own practice with his own office in a different city, and different clients. But to bypass the § 504 issue our primary attorney wants to make the tax guy a “regular associate” of his firm, identified as “of counsel” on letterhead, web site, etc. Several cases have addressed such relationships. [FN64]

Matis held no regular associate status when the contract attorney has her own private practice and own clients. [FN65] While *Peterson* held (perhaps in dicta) that an associate of one firm may also be an associate of another firm, thus not bound by the § 504 rule. [FN66]

On account of the lack of clarity in the opinions that tackle the question, if the associate attorney is a “regular associate” within the meaning of § 504, our hypothetical tax expert is probably on safer ground to avoid that relationship (unless of course, she has actually joined the firm and is a member in all respects). Accordingly, Option 3, discussed below, becomes more attractive.

Option C - Debtor's primary attorney stays out of the fee loop altogether, and the client retains and pays the tax expert out of debtor's funds.

This arrangement has rarely, if ever, been addressed by a bankruptcy court. It is the option that appears most likely to avoid the fee-sharing problem, because it is hard to argue that the two attorneys are sharing a fee when they are each retained by, and paid by, the debtor.

But even in the simpler situation of a contract attorney retained and paid directly by the debtor, there are several questions that must be mulled over, if not clearly answered.

For example, if the debtor has given funds to the primary attorney, who then deposits the funds into her client trust account, is a subsequent payment to the contract attorney out of that fund fee-sharing? It would appear not. Arguably, the funds on deposit in the trust fund continue to belong to the debtor, and become “fees” *per se* only when transferred to the attorney's operating account for payment of services rendered. This is the finding in several cases.

The court held in *In re Anderson*, “unearned retainers must be deposited into a client trust account, and upon a bankruptcy filing, the retainer is property of the bankruptcy estate.” [FN67] The court concluded similarly in *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*: “Retainers paid to counsel for the debtor are to be held in trust for the debtor, and the debtor's equitable interest in the trust is property of the estate.” [FN68]

Another question: What about a retainer agreement characterized as “advance payment for future services”? The weight of authority is that the debtor transfers all of her interest in the funds to the attorney, and hence the funds are no longer property of the estate. Arguably, in those states that recognize advance-payment retainer agreements, such funds are not subject to the fee-sharing prohibition. [FN69] However, the validity of advance-payment agreements

has been held to be subject to state law; when state law does not recognize their validity, they are not valid in bankruptcy. [FN70]

Based on the weight of authority, the safest way to avoid the § 504 issue in a typical consumer bankruptcy case is to have the client individually retain and pay the associated attorney's fees, and to have a retainer agreement that is explicit that the payment is an advance payment for future services. [FN71]

Whether the debtor pays cash upon retaining the associated lawyer, or permits primary bankruptcy counsel to transfer funds deposited in the trust account to such counsel, appears not to be outcome determinative of the fee-sharing question.

Option D--Have a friend or relative pay the fee

Another spin on the § 504 question is, what if a third-party pays the fees for the debtor? For example, is grandpa's generous payment of the fees on behalf of his grandson/daughter, deemed "fees" within the meaning of § 504? What if grandpa pays directly to the primary attorney who deposits the money to her operating account? It's certainly a fee, but does the prohibition apply? Again, a tedious tracking of §§ 504, 503, 330 and 327 brings us to the same destination--§ 504 applies only when the "person" seeks compensation *out of the estate*. Almost certainly the funds paid by grandpa are not included in the debtor's bankruptcy estate (unless given as a gift to the debtor, who then uses them to pay the retainer fee), and hence the prohibition would not apply.

The devil, or the boulder?

After all the dust settles, we still have an attorney who needs to get help from a tax expert. He needs to decide whether to risk his left arm (associate outside help) or his right arm (go it alone and hope for the best). He has to make a decision.

After looking at all the issues, our hypothetical associated lawyer is probably on the safest ground to avoid the § 504 issue, by being retained and paid *directly by the debtor*, rather than being paid as an expense, or as compensation as an associate of the primary firm. However, the question of who, exactly, is retaining the associated attorney is not the only potential problem.

Traps for the unwary

In a typical Chapter 7 or Chapter 13 case, whether the contracted attorney is retained by the primary attorney, or separately by the debtor - even assuming that § 504 does not prohibit fee-sharing in Chapter 7 cases - several issues remain to be addressed. Assuming that the attorneys involved have elected not to go the "regular member" or "regular associate" route, and instead treat the associated attorney as a separate entity retained directly by the client, below are several matters that both inform the debtor and provide C.Y.A. for the primary and associated attorneys.

Disclosure and consent of the debtor

Even when fee-sharing *per se* is not prohibited, several cases criticize the attorneys for failure to disclose the intent to pay a contract attorney either to the court or the debtor (or both). [FN72] The primary attorney for the debtor must include disclosure of the associated attorney's compensation, in question number nine of the Statement of Financial Affairs. The duty of full disclosure is made clear by 11 U.S.C. § 329 and Rule 2016. And, an argument can be made that the associated attorney, even if separately retained by the debtor, also has an affirmative duty to disclose the amount and terms of retention. Section 329(a) places such a duty on "[a]ny attorney representing the debtor ... or in connection with such a case" and Rule 2016(b) applies to "every attorney for the debtor" which arguably includes more than the debtor's primary attorney in the duty to disclose. This may require the filing of a separate 2016 Statement by the associated attorney. However, the phrases "represents" a debtor and "attorney for the debtor" suggest attorneys who actually sign the petition and appear on behalf of the debtor, rather than other attor-

neys merely provide research or consulting services.

So, what duties does the tax expert attorney have as far as disclosure is concerned? Certainly the debtor, and debtor's attorney, have a duty to disclose fees paid to all other lawyers within the preceding year before filing the petition, at least in the Statement of Financial Affairs.

Assuming that the duty to disclose under Rule 2016(b) applies to any attorney retained and paid by the client for bankruptcy related services, the parties should note that the duty to disclose any receipt of compensation must be satisfied within 14 days of any receipt of funds.

Disclosure to the Client

Whether fee-sharing is, or is not permissible, the cases and some “model” rules of professional conduct, suggest that all attorneys who provide any kind of bankruptcy-related services have a duty to assure that the debtor and the court are informed about who, exactly, is representing the debtor, who will perform bankruptcy-related services on behalf of the debtor, and what the compensation arrangement will be. [FN73] A simple single-page acknowledgment that the debtor has been informed of all attorneys in the case, signed by the debtor, is advisable. As additional C.Y.A., it is prudent to have the client sign a separate written retainer agreement with the outside attorney.

Several courts have denied fee applications for failure to file the disclosure notice prescribed by 11 U.S.C. § 329. For example, in a Chapter 13 case fees were denied to the extent generated by a paralegal when the attorney disclosed in his application for employment that part of his retainer was to be used to pay an outside paralegal to prepare bankruptcy schedules, but there was no filing representing that the paralegal was disinterested and did not hold an interest adverse to the estate. [FN74] A similar ruling was made in a case in which the primary attorney failed to disclose that he would pay an outside attorney to attend the 341 meeting. [FN75]

Again, the requirement to disclose appears to be a separate duty from the prohibition of sharing compensation, and appears to apply in Chapter 7 cases as well as Chapter 13. Remember that § 329 requires the attorney who provides services “in connection with the case” to file the 2016(b) statement.

And the duty to disclose probably extends to the client, as well:

Where the temporary lawyer is performing independent work for a client without the close supervision of a lawyer associated with the law firm, the client must be advised of the fact that the temporary lawyer will work on the client's matter and the consent of the client must be obtained. [FN76]

And it has been held that “the Debtors' knowledge or consent regarding representation at the 341 meetings does not validate an otherwise impermissible fee sharing arrangement.” [FN77]

Unused fees are property of the estate

Applicable to fees deposited with either the primary attorney or the associated attorney, in the typical case any portion of a fee not earned on account of billable time, at the time the petition is filed, becomes property of the estate. Hence, the associated attorney who is providing a related service must keep an eye on when the primary attorney intends to file, and make sure her services are completed and her fees fully earned pre-petition.

Proportional services

Another issue related to the unused balance of the retainer, is the general rule that courts will want to see that the amount of the fees paid, whether by a valid fee-splitting arrangement, or directly from the client, are reasonably proportional to the billable time incurred by each attorney. For example, in what appears to be some kind of marketing scheme where a central office takes calls from around the country and refers them out to local counsel, the court found that the division of fees was not proportional to the services provided respectively. [FN78]

Total aggregated fees

Keep in mind that many of the cases that address § 504 violations cite the danger that employing more than one attorney may cause the total fees to exceed what fees would be had there been only one attorney. [FN79] This does not necessarily prohibit any arrangement that increases the total cost to the debtor, but the attorneys should be prepared to justify dual representation to the trustee or the court. [FN80]

Conflicting state rules of professional conduct

The associated attorney should look to the State rules of professional conduct to determine whether they are consistent with the rules and bankruptcy case law of § 504. For example, one Chapter 7 Court held that § 504 did not apply in a Chapter 7 case, but the rules of professional conduct for the State of Texas prohibited fee-sharing. [FN81]

Avoid ghost writing

Resist the temptation to charge a client a fee to prepare his or her *pro per* bankruptcy, or assist an attorney in preparing the case, without full disclosure. Such practices have been the subject of sanctions. [FN82] A common feature of ghost writing is failure of the writer to sign the documents in violation of Rule 9011. Besides potential fee-sharing issues, ghost writing by definition violates the duty of disclosure of any person preparing documents filed in court. [FN83]

Get court approval when required

As explained above, situations arise in consumer bankruptcy cases when a contract or associate attorney is needed to represent the estate. It is not uncommon, for example, for the debtor to consult with a bankruptcy attorney and discloses he or she is the plaintiff in a personal injury suit and is represented by a P.I. attorney. Any award or settlement is property of the estate. Under the rules such attorney represents the estate and without court approval in advance may not be paid from an award or settlement.

Effect on policies behind § 504

Mentioned above, there are clear statements of the purposes behind the prohibition of fee-sharing. This needs to be brought up again, because the remedy this article has identified as most likely to safely satisfy the need for an attorney to associate with an outside professional - that is, to have the debtor retain such outside attorney directly, with a separate retainer agreement and pay the fees directly out of the debtor's funds - may conflict with some of those policies. For example, one reason to prohibit fee-sharing is that it tends to deprive the bankruptcy court of direct supervision and scrutiny of the contract attorney. [FN84]

“Moreover, fee sharing is prohibited in bankruptcy proceedings because fee sharing subjects the professional to outside influences over which the court has no control, which tends to transfer from the court some degree of power over expenditure and allowances.” [FN85] “In a case ... where a substitute attorney engages in questionable conduct, who is the client and [who is] the court supposed to look to as the responsible party?” [FN86]

If the contract attorney is a “regular associate” or member of the filing law firm, it's fairly clear that such attorney or firm is *held accountable* for the conduct of the associate or member. [FN87] But the primary attorney is probably not accountable for the conduct of an independently retained lawyer.

Next, the objective of keeping the fees incurred to a minimum may be undermined. One suspects that the debtor will end up paying more for *two attorneys* than he would if he paid only one. On the other hand, it may as easily be argued that the debtor's failure to retain that reasonably necessary contract attorney could end up costing the debtor far more, as well as increasing the burden on all concerned to unravel a big mess.

Likewise, when the debtor retains some other “professional,” in addition to the bankruptcy attorney, there is the risk that the debtor will end up paying fees to someone who is essentially *practicing law without a license*, such as

an overly opinionated bankruptcy petition preparer or independent paralegal. As a practical matter, the prohibition against fee-sharing is unlikely to thwart such conduct, because neither the debtor nor the petition preparers are likely to be sensitive to the ramifications of § 504.

Summing it all up

Where do we wind up with our hypothetical debtor's attorney who retains an outside tax expert to assist in handling the case?

- The prohibition against fee-sharing with a person who is not a member, partner, or regular associate of the firm technically does not apply in consumer Chapter 7 cases (except when special counsel is retained to represent the estate, such as prosecuting a pre-petition personal injury claim);
- The duty to disclose applies in both Chapter 7 and Chapter 13 cases;
- The prohibition against fee-sharing under § 504 applies in consumer Chapter 13 cases, and certainly court appointment of special counsel (i.e., a contract attorney) to represent the estate is required. Although the cases do not make it very clear, special counsel in a Chapter 13 case may get around the prohibition in § 504 if the trustee applies to have such professional approved under § 327, or if counsel is found to be a “member, partner, or regular associate” per § 504(b)(1).

Assuring competency in consumer cases that are not routine

If it is reasonably necessary to bring outside help to timely, competently and, in the appropriate case, economically, protect the debtor's rights and interests shouldn't fee-sharing be permitted? The rules against fee-sharing exist ostensibly to protect the “integrity” of the bankruptcy system, which must include competent representation of debtors. And yet, those very rules just as often act to handcuff an attorney who needs, and should employ, outside expertise but is afraid to do so for fear the trustee will claim fee-sharing and seek disgorgement of the fees paid to the other attorney, as well as denial of compensation to the original attorney. [FN88]

All of the above discussion takes place in context of an over-riding truth: to “preserve the integrity of the Bankruptcy system,” debtors' attorneys, in whatever capacity, must be adequately compensated for their services. If they are not, their services to debtors will be compromised and the burden on trustees and the courts will increase. One of the ironies of the rules on compensation of debtors' attorneys is that trustees have filed a zillion objections to fees on the ground that they are too high, yet where are the reported cases addressing fees that are too low? Underpaid lawyers, some who become high-volume “mills,” with a corresponding drop in attention paid to each case, have done more harm to the integrity of the Bankruptcy system, than debtors' attorneys who charge too much. Likewise, attorneys who are afraid to seek outside help in a non-routine case and hence bungle through alone and pray for the best, do more damage than those who take common sense steps to retain the expertise needed for successful administration of a challenging case.

The integrity of the bankruptcy process should not be used to justify putting a debtor's attorney in the Blue John Canyon situation where he's likely to lose one arm, or the other.

[FN1]. The author thanks the attorneys on the NACBA and the **King** Bankruptcy Academy list serves, for their thoughtful remarks in connection with this topic.

[FN2]. Between a Rock and a Hard Place (Atria 2004).

[FN3]. In re Bass, 227 B.R. 103, 111 (Bankr. E.D. Mich. 1998).

[FN4]. Rodriguez Quesada v. United States Trustee, 222 B.R. 193 (D.P.R. 1998).

[FN5]. 11 U.S.C. § 504. At least one opinion goes so far as to cite a possible criminal prosecution for attempting to extort a firm into sharing a bankruptcy fee, pursuant to what is known as the Borah Act (18 U.S.C. § 152, 155). In re First Magnus Fin. Corp., No. 4:07-bk-01578-JMM, 2008 WL 576243, *6, n.1 (Bankr. D. Ariz. 2008).

[FN6]. Fed. R. Bankr. P. 2016(a) & (b); 11 U.S.C. § 329(a).

[FN7]. Fed. R. Bankr. P. 2016(b); In re Laberge, 380 B.R. 277, 283 (Bankr. D. Mass. 2008); In re Dennis, 164 B.R. 318 (Bankr. D. Ariz. 1994).

[FN8]. 11 U.S.C. § 504(b)(1); In re Laberge, 380 B.R. at 283 (“Attorney Curhan's failure to disclose his arrangement with Attorney Weiss [the contract attorney] precludes his receiving *any* compensation from this [Chapter 7] representation.”)

[FN9]. For example handling a personal injury case. See discussion below “Does the § 504 prohibition apply in Chapter 13). See §§ 330(a)(1)(B) and 327.

[FN10]. While this article addresses fee-sharing by debtor's counsel, the same issues may also arise with regard to a trustee's employment of outside counsel.

[FN11]. Goldberg v. Vilt (In re Smith), 397 B.R. 810 (Bankr. E.D. Tex. 2008); In re WorldWide Direct, Inc., 316 B.R. 639 (Bankr. D. Del. 2004); In re Peterson, No. 04-01469, 2004 WL 1895201, at *4 (Bankr. D. Idaho Aug. 25, 2004) (“Whenever fees or other compensation are shared among two or more professionals, there is incentive to adjust upward the compensation sought in order to offset any diminution to one's own share.”); In re van Dyke, 296 B.R. 591, 593 (Bankr.D. Mass. 2003); In re Greer, 271 B.R. 426 (Bankr. D. Mass. 2002).

[FN12]. In re Pittsburgh Corning Corp., 308 B.R. 716 (Bankr. W.D. Pa. 2004); In re Worldwide Direct, Inc., 316 B.R. 637; United States v. Miller, Cassidy, Larroca & Lewin (In re Warner), 141 B.R. 762, 765-66 (Bankr. M.D. Fla. 1992).

[FN13]. In re Matis, 73 B.R. 228 (Bankr. N.D.N.Y. 1987).

[FN14]. In re Zuniga, 332 B.R. 760 (Bankr. S.D. Tex. 2005) (attorney not admitted to practice in the jurisdiction); In re Bass, 227 B.R. 103 (Bankr. E.D. Mich. 1998) (“legal assistants” within the firm).

[FN15]. In re Matis, 73 B.R. at 231 (Chapter 11).

[FN16]. In re Peterson, 2004 WL 1895201, at *5.

[FN17]. In re ACandS, Inc., 297 B.R. 395 (Bankr. D. Del. 2003).

[FN18]. ABI Multidisciplinary Practices In The New Millennium, Central States Bankruptcy Workshop, June 2008-11 2000. See also **King, Morgan**, Compensation of Debtors' Attorneys in Consumer Bankruptcy - The Failure of Public Policy in Actual Practice and Suggestion for Reform, 1996-1997 Norton Annual Survey of Bankruptcy Law.

[FN19]. In re Worldwide Direct, 316 B.R. 647 (“The most recent trend has corporations and law firms using attor-

neys and paralegals who are not even in this country to perform legal work that would otherwise be done by attorneys and paralegals in-house.”). A recent article in the June 18, 2012 edition of *United State Courts: The Third Branch* states that the use of independent petition preparers by both debtors acting pro se and debtors' attorneys processing consumer bankruptcy cases is increasing. The article addresses primarily the use of petition preparers by debtors without attorney counsel, and asserts “U.S. Bankruptcy Courts increasingly are concerned with abuses committed by some non-lawyers in the business of helping prepare bankruptcy documents for a fee.” See also *In re Duran*, 347 B.R. 760 (Bankr. D. Colo. 2006) (“Neither he nor others associated with these scofflaw enterprises have been responsive to the various courts' efforts to address their undeniably overpriced poor quality services which they have marketed to an unsuspecting and vulnerable class of individuals.”); *In re Tarasiak*, 280 B.R. 791 (Bankr. D. Mass. 2002) (in a Chapter 11 case the attorney outsourced petition preparation to an independent paralegal and sought reimbursement; court denied fees for the paralegal as a violation of § 504); *In re Bush*, 275 B.R. 69 (Bankr. D. Idaho 2002) (independent petition preparer violates rules).

[FN20]. *In re Worldwide Direct*, 316 B.R. 637.

[FN21]. *In re Worldwide Direct*, 316 B.R. at 647 (internals quotations and citations omitted).

[FN22]. *In re Bass*, 227 B.R. 103.

[FN23]. Cal. Rules of Prof. Conduct 3-110: Failing to Act Competently; *In re Zuniga*, 332 B.R. 760 (Bankr. S.D. Tex. 2005). “As a new lawyer or solo practitioner it may be especially advantageous to ... affiliate with co-counsel on a case and agree to share fees.” Thompson, Kathryn A., *Keeping Your Office Sharing Arrangements with Other Lawyers Squeaky Clean Under the Ethics Rules*, ABA Center for Professional Responsibility, May 2007.

[FN24]. *In re Age Refining, Inc.*, 447 B.R. 786, 798-99 (Bankr. W.D. Tex. 2011). See also *In re Smith*, 397 B.R. 810 (Bankr. E.D. Tex. 2008).

[FN25]. Cal. Rules of Prof. Conduct Rule 2-200 also prohibits referral or forwarding fees. Rule 2-200(B).

[FN26]. ABA Model Rules of Professional Conduct, Rule 1.5(e). “Model Rule 5.4 has been adopted by all states with the possible exception of the District of Columbia which adopted a slightly more expansive but still very restrictive version of the Rule.” ABI Central States Bankruptcy Workshop, *Multidisciplinary Practices In The New Millennium*, June 08 - 11, 2000.

[FN27]. *Younger v. Pennsylvania Res. Corp.* (*In re Younger*), 360 B.R. 89 (Bankr. W.D. Pa. 2006) (Chapter 13 case, debtor's attorney's competence called into question).

[FN28]. Thompson, Kathryn A., *Keeping Your Office Sharing Arrangements with Other Lawyers Squeaky Clean Under the Ethics Rules*, ABA Center for Professional Responsibility (May 2007).

[FN29]. There is a trap for the unwary here. An attorney retained prior to filing bankruptcy, to represent the debtor in a civil action such as a personal injury suit, is deemed to be representing the estate (because the P.I. cause of action becomes property of the estate). Hence, such attorney must seek court approval to continue representing the debtor in regard to that action, including approval of what is typically a contingent fee based on a percentage of the recovery, which equates with a fee-sharing arrangement. See *In re Smith*, 397 B.R. 819 (Bankr. E.D. Tex. 2008) (Chapter 7 trustee employed an attorney as “special counsel” to prosecute a contingency-fee case on behalf of the debtor, but failed to disclose the arrangement. The employed attorney subsequently settled the case for \$630,000 and took his “share” of the fee, then paid \$123,000 to another attorney as a “referral” fee, all without notifying or obtaining the consent of the trustee. In ordering the referring attorney to disgorge the entire amount paid to him, the court referred to such agreements as “reprehensible.”).

[FN30]. In re Johnson, 411 B.R. 296, 299 n.6 (Bankr. E.D. La. 2008) (“The power to review compensation arrangements for prior periods does not exist under section 504. To the contrary, by referencing subsections 503(b)(2) and (4), section 504 is explicitly limited to compensation paid from the estate.”).

[FN31]. In re Zuniga, 332 B.R. 760.

[FN32]. Typically referred to as the “2016(b) Statement.”

[FN33]. In contrast, debtor's attorney fees in Chapter 13 clearly fall within § 504, because such compensation is authorized by § 330(a)(4)(B). In re Ferguson, 445 B.R. 744 (Bankr. N.D. Tex. 2011); In re Younger, 360 B.R. 89 (Bankr. W.D. Pa. 2006); In re Peterson, 2004 WL 1895201; In re van Dyke, 296 B.R. 591.

[FN34]. However, one case has, perhaps in dicta, remarked that “[n]o such approval is required prior to a chapter 7 or chapter 13 debtor retaining professionals.” In re van Dyke, 296 B.R. at 593 n.4.

[FN35]. In re van Dyke, 296 B.R. 591.

[FN36]. 11 U.S.C. § 1327(b).

[FN37]. In re Ferguson, 445 B.R. 744 (the 1/3 contingency fee was disallowed based on inadequate notice to the debtor and debtor's counsel).

[FN38]. In re van Dyke, 296 B.R. 591.

[FN39]. However, even if § 504 does not apply, reimbursement for such costs out of the estate (as opposed to out of the Chapter 7 debtor's postpetition income) would have to be approved by the court.

[FN40]. Section 504 does not draw a distinction, as the prohibition applies to payments made “to another person.”

[FN41]. In re Tarasiak, 280 B.R. 791 (Bankr. D. Mass. 2002) (Chapter 7 converted to Chapter 11 where debtor's attorney paid an independent paralegal to prepare a Chapter 11 petition and related documents). The *Tarasiak* opinion cites the Chapter 11 opinion in *United States Trustee v. Grenoble Apartments, II (In re Grenoble Apartments, II)*, 152 B.R. 608, 611 (Bankr. D.S.D. 1993), holding that the retention of an attorney to conduct legal research on behalf of the debtor's attorney requires approval by the court pursuant to § 327(a). As Chapter 11 cases, they clearly fall within the § 504 ambit. In the *Tarasiak* case the debtor's attorney sought payment from the estate for \$500 he paid to an independent paralegal for preparation of the Chapter 11 petition. But his fee application was for compensation for those payments apparently made in the process of converting the case. The opinion does not address the distinction between applying § 504 in a Chapter 7 case as opposed to a Chapter 11 case, probably because, even though the services performed were in the Chapter 7 case, the compensation was sought to be paid by the Chapter 11 estate.

[FN42]. In re Worldwide Direct, 316 B.R. 637.

[FN43]. In re Worldwide Direct, 316 B.R. at 651-52.

[FN44]. In re Warner, 141 B.R. 762 (M.D. Fla. 1992).

[FN45]. In re Fincher, No. 13-08-11454 JA, 2012 WL 1155719, at *8 n.16 (Bankr. D.N.M. Apr. 5, 2012) (paren-

thetically quoting *In re CF&I Fabricators of Utah, Inc.*, 131 B.R. 474, 494 (Bankr. D. Utah 1991) (quoting *In re Prairie Cent. Ry. Co.*, 87 B.R. 952, 960 (Bankr. N.D. Ill. 1988)).

[FN46]. *In re Kewriga*, No. 01-44262, 2002 WL 484942 (Bankr. D. Mass. Mar. 28, 2002).

[FN47]. **King, Morgan, King's Fees & Ethics in Consumer Bankruptcy Cases**, ¶¶ 7.4(d) & 7.4(d)(3), available at www.BankruptcyBooks.com.

[FN48]. *In re Age Refining, Inc.*, 447 B.R. at 799-800 (“Neither firm is expected to look to the other firm for ‘it's cut’ of the fee. Each firm is sought to be separately retained for this engagement, on the terms and conditions set out in the agreement attached to the motion. Those terms do not entitle either firm to receive any more than 3% of any award in this case, and to receive that payment from the trustee, upon appropriate application to the court. The agreement does not authorize, or permit, or even contemplate, that either firm would be expected to pay the other firm out of whatever either firm received from the trustee. Thus, in both form and substance, the proposed arrangement is in fact *not* a fee sharing agreement and so does not violate section 504.”). This distinction appears to have been acknowledged by the court in *Worldwide Direct*.

[FN49]. *Barkley v. Prommis Solutions Holding Corp.* (In re Thorne), 471 B.R. 496 (Bankr. N.D. Miss. 2012).

[FN50]. *Rodriguez Quesada v. United States Trustee*, 222 B.R. at 197-98 (Chapter 11 case) (“Therefore, the crucial inquiry remains whether or not these two associates can be considered ‘members’ or ‘regular associates’ of appellant's firm. Although such an inquiry may at first appear to be somewhat trite, it is in fact of the utmost importance. This is so because if the two lawyers are regular associates or partners in the appellant's firm, then pursuant to Fed. R. Bankr.P.2014(b), they may be ‘so employed without further leave of the court.’”).

[FN51]. *In re Worldwide Direct*, 316 B.R. at 647.

[FN52]. *In re Brown*, No. 09-44254, 2011 WL 477822 (Bankr. W.D. Mo. Feb. 7, 2011) (firm issued a Form 1099 instead of a W-2); *McDonald v. Southern Farm Bureau Life Ins.*, 291 F.3d 718 (11th Cir. 2002).

[FN53]. *In re Worldwide Direct*, 316 B.R. 637; but see *In re Ferguson*, 445 B.R. 744.

[FN54]. *In re Sheehan Mem'l Hosp.*, 380 B.R. 299 (Bankr. W.D.N.Y. 2007).

[FN55]. *In re Sheehan Mem'l Hosp.*, 380 B.R. 299.

[FN56]. *In re Worldwide Direct*, 316 B.R. at 648 (“In this case the temporary personnel worked in the HBD offices, under the direct supervision of HBD attorneys, performing tasks similar to the tasks that regular associates of HBD performed. Such direct supervision supports a finding that the temporary personnel must be considered ‘regular associates’ of HBD rather than outside lawyers.”); *Brown v. California* (In re Brown), 743 F.2d 664 (9th Cir. 1984).

[FN57]. *Lemonedes v. Balaber-Strauss* (In re Coin Phones, Inc.), 226 B.R. 131, 132 (S.D.N.Y. 1998); *In re Greer*, 271 B.R. 426 (Bankr. D. Mass. 2002).

[FN58]. *In re Coin Phones, Inc.*, 226 B.R. at 132.

[FN59]. *In re Coin Phones, Inc.*, 226 B.R. at 132.

[FN60]. *Rodriguez Quesada v. United States Trustee*, 222 B.R. 193.

[FN61]. In re Peterson, 2004 WL 1895201.

[FN62]. In re Ferguson, 445 B.R. at 751.

[FN63]. In re Matis, 73 B.R. 228.

[FN64]. In re Coin Phones, Inc., 226 B.R. 131 (That associated attorney maintained a separate practice did not negate a status as “of counsel” or “member” of a law firm: “A lawyer who is acting ‘of counsel’ for a law firm and is held out to the public will be regarded as a ‘member’ within 11 U.S.C. § 504, so as to be free from statutory limitations on fee sharing arrangements.”).

[FN65]. In re Peterson, 2004 WL 1895201.

[FN66]. In re Sheehan Mem'l Hosp., 380 B.R. 299 (Lawyers with an “of counsel” relationship are to be treated as members of a firm for purposes of 11 U.S.C. § 504. Although lawyers will usually affiliate with only one firm, they have on occasion maintained multiple “of counsel” relationships at the same time.).

[FN67]. In re Anderson, 253 B.R. 14, 23 (Bankr. E.D. Mich. 2000) (citing *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 478 (6th Cir. 1996) (“Retainers paid to counsel for the debtor are to be held in trust for the debtor, and the debtor's equitable interest in the trust is property of the estate.”)).

[FN68]. *Mapother & Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 478 (6th Cir. 1996).

[FN69]. In re Chatkhan, No. 09-51286-CEC, 2012 WL 714251 (Bankr. E.D.N.Y. Mar.5, 2012); In re King, 392 B.R. 62 (Bankr. S.D.N.Y. 2008).

[FN70]. The validity of advance-payment retainer agreements is addressed in many cases in the context of the three recognized forms of retainer agreements--advance-payment, security agreement, and “classic” retainer. “Advance fee retainers differ from security retainers in that ownership of the funds is intended to pass to the attorney at the time of the payment.” *Glassman v. Heimbach, Spitko & Heckman (In re Spitko)*, Adv. No. 05-0258, Case No. 04-18836bif, 2007 WL 1720242, at *7 (Bankr. E.D. Pa. June 11, 2007). Bankruptcy courts recognize advance-payment agreements if recognized by the respective State. In re *Dees Logging, Inc.*, 158 B.R. 302 (Bankr. S.D. Ga. 1993); In re *McDonald Bros. Constr. Inc.*, 114 B.R. 989, 997 & 1002 (Bankr. N.D. Ill. 1990) (“[T]he Bankruptcy Code does not render all prepetition retainers held by the debtor's counsel property of the estate. It is state law, rather than the Code, that defines the extent of a debtor's interest in such a retainer, and hence whether the retainer is property of the estate under Section 541.... Because the client retains no interest in an advance payment retainer, such a retainer does not become property of the estate and is subject only to disclosure under Section 329 of the Code, rather than to the fee application process of Sections 330 and 331.”).

[FN71]. However, the related issue, whether the portion of an advance-payment fee that is not expended in actual billable services at time of petition filing is property of the estate that must be paid over to the trustee, is not clear in the published opinions.

[FN72]. See *Tanzi v. Shulkin*, No. C05-5825 FDB, 2006 WL 2927660, at *7 (W.D. Wash. Oct. 12, 2006) (“The [Bankruptcy] Court disallowed these fees for failure of Shulkin to advise the Debtors of the hiring, billing rates, or methods of payment of contract attorneys, or to have the contract attorneys employment approved by the Court.”).

[FN73]. In re *Worldwide Direct*, 316 B.R. at 650 (Chapter 11) (“W]here the temporary lawyer is performing inde-

pendent work for a client without the close supervision of a lawyer associated with the law firm, the client must be advised of the fact that the temporary lawyer will work on the client's matter and the consent of the client must be obtained. This is so because the client, by retaining the firm, cannot reasonably be deemed to have consented to the involvement of an independent lawyer.”).

[FN74]. In re Tarasiak, 280 B.R. at 793 (Chapter 13).

[FN75]. In re Johnson, 411 B.R. 296 (Bankr. E.D. La. 2008) (Chapter 7).

[FN76]. In re Johnson, 411 B.R. 296; In re Worldwide Direct, 316 B.R. at 650-51.

[FN77]. In re Greer, 271 B.R. at 433.

[FN78]. In re Zuniga, 332 B.R. at 782.

[FN79]. A problem with a knee-jerk reaction to this policy is that in some cases the aggregated fees will certainly exceed the fees for a single attorney, but the nature of the case makes it necessary to obtain additional services.

[FN80]. In re Laberge, 380 B.R. 277 (“Attorney ... intended to retain attorney ...for his ‘expertise.’ But expertise in what?”).

[FN81]. In re Zuniga, 332 B.R. 760.

[FN82]. In re Brown, 371 B.R. 486 (Bankr. N.D. Okla. 2007) (Chapter 12) (Attorney after withdrawing as special counsel for the trustee, continued ghost writing pleadings for pro per debtor without signing them or otherwise disclosing); In re Thorne, 471 B.R. 496 (prohibition of fee sharing only applied where the professional seeks payment from the estate).

[FN83]. Lanier v. Futch (In re Futch), ADV. No. 09-00144-NPO, Case Nos. 09-01841-NPO & 09-51705-NPO, 2011 WL 1884187 (Bankr. S.D. Miss. May 18, 2011); In re Cash Media Sys., Inc., 326 B.R. 655 (Bankr. S.D. Tex. 2005).

[FN84]. In re Worldwide Direct, 316 B.R. at 647.

[FN85]. In re Winstar Commc'ns, Inc., 378 B.R. 756, 760 (Bankr. D. Del. 2007) (internal quotations omitted).

[FN86]. In re Johnson, 411 B.R. at 302.

[FN87]. In re Worldwide Direct, 316 B.R. at 649 (“HBD remains the party with a fiduciary duty to the Debtors and the estate for the proper performance of those duties”).

[FN88]. **King, Morgan, King's Fees & Ethics in Consumer Bankruptcy Cases**, ¶ 7.4(d), available at www.BankruptcyBooks.com.

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