

**LEO 1883:**

**ETHICAL OBLIGATIONS OF A LAWYER FOR A CHAPTER 7 BANKRUPTCY PETITIONER IN HANDLING FIXED FEES ADVANCED BY THE CLIENT**

This opinion provides guidance to attorneys who face the conflict between the ethical obligation to maintain unearned legal fees advanced by a client<sup>1</sup> in an attorney trust account and the application of bankruptcy law which would render fees in trust an asset of the petitioner's bankruptcy estate and unavailable to the attorney or the client at the time a Chapter 7 petition is filed.

**QUESTION PRESENTED:**

May a debtor's attorney withdraw from his trust account the balance of his client's advance of a fixed legal fee immediately before filing the client's Chapter 7 petition in bankruptcy when there remain post-petition legal services that are incomplete or have yet to be performed?

**APPLICABLE RULE OF PROFESSIONAL CONDUCT:**

Rules of Professional Conduct 1.15(a)(1) and 1.15(b)(4)<sup>2</sup> apply to the issue presented in this opinion.

**ISSUE PRESENTED:**

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<sup>1</sup> This opinion does not address, and is not intended to apply to, those instances when a bankruptcy petitioner's legal fees are paid by a third party, when legal fees are structured so as to be payable by a debtor from post-petition income, if permissible, or when substantial post-petition legal services are involved. The opinion is intended to address the ethical dilemma occasioned when the bankruptcy lawyer accepts his full fixed fee directly from the client in advance of his filing the client's Chapter 7 bankruptcy petition.

<sup>2</sup> **RULE 1.15 Safekeeping Property**

(a) Depositing Funds.

(1) All funds received or held by a lawyer or law firm on behalf of a client or a third party, or held by a lawyer as a fiduciary, other than reimbursement of advances for costs and expenses shall be deposited in one or more identifiable trust accounts; all other property held on behalf of a client should be placed in a safe deposit box or other place of safekeeping as soon as practicable.

(b) Specific Duties. A lawyer shall:

(4) promptly pay or deliver to the client or another as requested by such person the funds, securities, or other properties in the possession of the lawyer that such person is entitled to receive[.]

According to the National Association of Bankruptcy Trustees, “[i]n approximately 90% of the Chapter 7 bankruptcy cases filed, there are no assets available for liquidation, either because assets are exempt (protected) by debtors or liened by secured creditors.”<sup>3</sup> Lawyers who handle Chapter 7 bankruptcy cases for debtors normally charge fixed fees for their services. Those fees are intended to cover both pre-petition and post-petition legal services, which end when the client obtains his bankruptcy discharge.

Under current bankruptcy law, an estate is created when a voluntary bankruptcy petition is filed, and fees advanced to his attorney by a Chapter 7 debtor which remain in trust upon the filing of a petition become the property of the bankruptcy estate under 11 U.S.C. §541. Interpreting 11 U.S.C. §330(a)(1)<sup>4</sup>, the United States Supreme Court in *Lamie v. United States Trustee*, 540 U.S. 526, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004) held that unless the debtor’s attorney has been hired by the bankruptcy trustee in a Chapter 7 case, the debtor’s attorney cannot be paid from the assets of the bankruptcy estate.

This being so, the very purpose of the attorney’s fixed fee being secured by its collection before legal services are performed is undermined if the unearned portion of those fees, remaining in the attorney’s trust account, cannot be applied to the attorney’s credit once the client’s petition has been filed. Compounding this problem is the conflict of interest<sup>5</sup> that might arise between the

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<sup>3</sup> See website entry at <http://www.nabt.com/faq.cfm#Q1>

<sup>4</sup> **§330. Compensation of officers**

(a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, a consumer privacy ombudsman appointed under section 332, an examiner, an ombudsman appointed under section 333, or a professional person employed under section 327 or 1103—

(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, ombudsman, professional person, or attorney and by any paraprofessional person employed by any such person; and

(B) reimbursement for actual, necessary expenses.

<sup>5</sup> See, Rule of Professional Conduct 1.7(a)(2):

**RULE 1.7 Conflict of Interest: General Rule.**

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(2) there is significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

bankruptcy attorney and his client were the balance of the unearned fee to be listed as a debt on the client's bankruptcy petition: It would be in the client's interest to have this debt to the attorney discharged, along with all other debts which the attorney is assisting the client in having discharged. Alternatively, were the attorney to be paid from a fee advance remaining in trust following the Chapter 7 bankruptcy filing available by resort to the debtor's Virginia homestead exemption, the sum so paid would reduce the debtor's exemption, to his detriment. An attorney who advises his client to use the client's homestead exemption to pay the lawyer's fee under these circumstances would have a conflict of interest.

Rule of Professional Conduct 1.15(a)(1) requires that fees collected in advance of the provision of legal services be placed in a trust account. An attorney may not apply to his credit any portion of a legal fee which has not been earned. Compendium Legal Ethics Opinion 1606, issued in 1994 when the Code of Professional Responsibility was in force, remains a vital resource for guidance on how legal fees are to be handled under the successor provisions of the Rules of Professional Conduct. The Opinion defines "advanced legal fees" and how they are to be handled as follows:

Advanced Legal Fees. Fees paid in advance for particular legal services not yet performed are advanced legal fees regardless of the terminology used in the employment contract. Advanced legal fees are not violative of the Disciplinary Rules as long as they are properly deposited and identified as belonging to the client until earned. The Committee has consistently opined that the element of payment for future legal services differentiates advanced legal fees from a retainer. LE Op. 1322, LE Op. 1178. The two terms are not synonymous.

Because advanced legal fees do not belong to the lawyer until the services are rendered, it is the opinion of the Committee that they must be deposited in an identifiable account (trust account) and remain the property of the client until they are earned by the attorney. The Committee notes that in some situations, the employment contract may provide that a portion of an advanced legal fee is considered to be earned at the time it is paid. In this case the earned portion becomes the property of the lawyer and may not be deposited in the lawyer's trust account.

Upon termination of the representation it is the duty of the attorney to refund any portion of an advanced legal fee which has not been earned. In addition, all fees charged against the account must be reasonable and must be adequately explained to the client. \*\*\*

The term "fixed fee" is defined in the Opinion :

Fixed Fee. The term fixed fee is used to designate a sum certain charged by a lawyer to complete a specific legal task. Because this type of fee arrangement provides the client with a degree of certainty as to the cost of legal services, it is to be encouraged.

**A fixed fee is an advanced legal fee. It remains the property of the client until it is actually earned and must be deposited in the attorney's trust account.** If the representation is ended by the client, even if such termination is without cause and constitutes a breach of the contract, the client is entitled to a refund of that portion of the fee that has not been earned by the lawyer at the time of the termination. LE Op. 681. In such circumstances, what portion of the fee has been earned requires a *quantum meruit* determination of the value of the lawyer's services in accordance with *Heinzman* and *County of Campbell v. Howard*, 133 Va. 19 (1922). [Emphasis supplied.]

#### **ANALYSIS:**

Given the dilemma presented by the tension between the lawyer's ethical obligation to retain unearned fees in trust and the legal effect of having those same fees revert to the bankruptcy estate under 11 U.S.C. §541 when a bankruptcy petition is filed, what is an attorney to do? One might also ask, how *have* attorneys been handling fees under these circumstances?

The Committee has learned from practitioners that three methods of handling advanced, fixed fees, for Chapter 7 bankruptcy cases are being employed. Lawyers are

1. treating advanced fees as "earned when paid" and are applying them upon receipt to the lawyer's credit;
2. withdrawing the balance of all fees remaining in their trust accounts at the time the client's Chapter 7 bankruptcy is concluded; or
3. withdrawing the balance of all fees remaining in their trust accounts immediately before the Chapter 7 petition is filed on behalf of the client.

Method 1 is as ethically impermissible in connection with a Chapter 7 bankruptcy case as it would be in any other legal matter. Such money handling by the lawyer violates Rule 1.15(a)(1) and the precepts of LEO 1606. No client funds should be applied to the lawyer's credit, when tendered, for legal services which have yet to be performed. In the event the lawyer becomes disabled, dies, is discharged by the client, terminates representation of the client, or has his license to practice suspended or revoked, any unearned legal fees, which remain the property of the client, must be in a trust account, and thus on hand for return to the client.

Method 2 is unacceptable because the lawyer would be applying an asset of the bankruptcy estate created by 11 U.S.C. §541 to his own credit in contravention of 11 U.S.C. §330(a)(1), as interpreted by the United States Supreme Court in *Lamie v. United States Trustee, supra*.

Method 3 is an ethically permissible practice available to attorneys handling Chapter 7 bankruptcies for debtors at this time for the reasons stated below.

The Chapter 7 debtor’s attorney has no discretion to treat unearned fees on hand in his trust account as either potentially his or the client’s once the bankruptcy petition has been filed. The only proper “trustee” of such funds would be the Chapter 7 bankruptcy trustee, who superintends the disposition of the bankruptcy estate. Once the Chapter 7 bankruptcy petition is filed, funds on hand in an attorney’s trust account under Rule 1.15(a)(1) are no longer either the property of the client or potentially the property of the lawyer. Bankruptcy law pre-empts the lawyer’s authority to dispose of the funds in any manner other than to surrender them to the trustee upon request pursuant to Rule 1.15(b)(4). Therefore, once the Chapter 7 petition has been filed, the lawyer cannot dispose of that portion of the bankruptcy estate in his possession by applying funds in trust to his own credit or by remitting those funds to the client. The bankruptcy attorney has become, in a sense, the bankruptcy trustee’s trustee.

The debtor’s attorney’s fee disclosure form used in Chapter 7 bankruptcy cases does not require an accounting of and how and when fees paid before a petition was filed were or are to be applied to the attorney’s credit. The form merely requires an identification of the total fees charged, the sum already paid (with no reference to “earned”), and the balance due.<sup>6</sup>

It is thus the case that the court, the creditors, and the bankruptcy trustee are not systematically informed of the manner in which the attorney has disposed of, or intends to dispose of, the advanced fee paid to him, and whether any portion thereof remains in a trust account as of the time the bankruptcy petition was filed. The Committee is advised that as long as the fee listed on the disclosure form is reasonable, it typically remains unchallenged by creditors and the

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<sup>6</sup> In pertinent part, the form reads as follows:

**DISCLOSURE OF COMPENSATION OF ATTORNEY FOR DEBTOR**

1. Pursuant to 11 U.S.C. § 329(a) and Fed. Bankr. P. 2016(b), I certify that I am the attorney for the above-named debtor(s) and that compensation paid to me within one year before the filing of the petition in bankruptcy, or agreed to be paid to me, for services rendered or to be rendered on behalf of the debtor(s) in contemplation of or in connection with the bankruptcy case is as follows:

For legal services, I have agreed to accept ..... \$ \_\_\_\_\_  
Prior to the filing of this statement I have received ..... \$ \_\_\_\_\_  
Balance Due ..... \$ \_\_\_\_\_

bankruptcy trustee. The ethical question of how an advanced, fixed fee must be handled is not, however, addressed either by substantive bankruptcy law or by the bankruptcy rules of procedure.

For these reasons, the Committee believes that a lawyer who received advanced, fixed fees tendered by a client for a Chapter 7 case may ethically withdraw the balance of all fees remaining in his trust account immediately before the Chapter 7 petition is filed on behalf of the client.

Representing a client in a Chapter 7 bankruptcy typically consists of these basic tasks (described, in part, in the disclosure form referred to above):

1. Analyzing the debtor's financial situation, and rendering advice to the debtor as to whether a bankruptcy petition should be filed;
2. Preparing the petition (including schedules, and a statement of affairs);
3. Filing the petition; and
4. Representing the debtor at the meeting of creditors.

Typically, in Chapter 7 bankruptcies, the time consumed by the legal services is predominantly devoted to the attorney's accomplishing tasks 1 and 2 above. Attending a meeting of creditors is typically routine in nature and not time consuming—especially when an attorney is able to make a single appearance on behalf of multiple clients such that the attorney's travel and waiting time devoted to each matter can be prorated.

It is thus the case that the fixed fee paid to the attorney at the inception of the representation in a Chapter 7 bankruptcy matter has been largely earned as of the time that the petition is filed. The Committee believes that under these circumstances, an attorney's fee agreement with the client may identify the filing of the bankruptcy petition as a reasonable "benchmark"<sup>7</sup> for distribution

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<sup>7</sup> See, "Frequently Asked Question" No. 22 contained on the Virginia State Bar's website:

## **22. Flat Fees**

**When is a flat/fixed fee considered earned? What happens if the attorney's representation is terminated before the representation is complete?**

Unless the fee agreement specifies otherwise, the entire flat fee is unearned and must remain in the trust account until the entire representation is complete. If the representation is terminated before the matter is complete, the attorney is entitled to a fee based on quantum meruit for the work done prior to termination.

**The fee agreement may provide for certain portions of the flat fee to be earned upon the completion of certain benchmarks, which would allow the attorney to draw down the flat fee in stages throughout the representation rather than earning the full fee at the conclusion of the matter. The**

to the attorney of the balance of the advanced, fixed fee, which remains in the attorney's trust account at that time. The disbursement made by the attorney from his trust account would eliminate both the problem of having that small portion of the advanced fee intended to cover the creditors' meeting become a part of the bankruptcy estate and the need to have the attorney himself listed in the bankruptcy petition as a creditor of his client.

Such a benchmark is entirely reasonable and consistent with the protection of client assets envisioned in Rule 1.15(a)(1) and LEO 1606 because bankruptcy courts, once a petition has been filed, have the authority to examine a debtor's transactions with his attorney and to order disgorgement of excessive fees under 11 U.S.C. § 329(a) and (b).<sup>8</sup> This is a remedy available to the debtor (and others) in a bankruptcy matter different than, and independent from, the traditional civil procedure in a state or federal court which would require proof by the client that he is entitled to a judgment against his attorney for having charged excessive fees. Thus, a bankruptcy court which determines that a debtor's attorney has failed to perform the services for which he was engaged may be ordered to "disgorge" fees from the attorney's own assets—and not from the bankruptcy estate—for refund to the disadvantaged debtor/client. This remedy provides ample protection to a client whose advanced fees, if there remained any in his attorney's trust account, would not then be the property of the attorney or the client, in any event.

#### **CONCLUSION:**

An attorney may ethically disburse from his trust account, to his own credit, the entirety of the advanced fixed fees tendered by the client and remaining in his attorney trust account immediately before he files the client's Chapter 7 bankruptcy petition. Disbursement at that time avoids the sum in trust becoming a part of the bankruptcy estate, and eliminates the conflict of interest which would apply in the face of a need to have an outstanding indebtedness to the attorney listed on the client's bankruptcy petition. The attorney has already performed most of the work associated with the client's matter as of the time a petition is filed, and it is a reasonable benchmark in a fixed-fee agreement to have the balance of fees disburseable immediately before the petition is filed. The client is assured protection in the event his lawyer fails to perform post-petition legal services fully and competently because the bankruptcy court is authorized to order the attorney to disgorge excessive fees and refund them to the client.

This opinion is advisory only and not binding on any court or tribunal.

Committee Opinion  
July 23, 2015

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**fee earned at each benchmark must be reasonable considering the amount of work completed.**  
[Emphasis is supplied.]

<sup>8</sup> For an excellent discussion and exercise of this authority in a Chapter 7 bankruptcy matter, see *In re Harwell*, 439 B.R. 455 (Bankr. W.D. Mich., 2010).