GOOD HELP IS HARD TO FUND: THE PROBLEM OF EARNED UPON RECEIPT RETAINERS AND PRE-FUNDED LITIGATION

1. Introduction

The “honest but unfortunate debtor” is not some mythical beast, nor is she particularly elusive. She is, in fact, so common that the American bankruptcy system was built largely to identify and protect her. We assume our debtors to be honest, and our laws generally require a trial and proof of fraudulent intent before we deny a discharge. It is an extension of the American ideal that one is “innocent until proven guilty.” However, unlike in the criminal justice system, a debtor in bankruptcy is not guaranteed assistance of counsel if she cannot afford an attorney, and the very act of filing a bankruptcy petition strips the debtor of assets she could otherwise have used to retain experienced counsel to represent her in a post-petition adversary such as a complaint to except a debt from, or to deny, discharge. She is often at an immediate disadvantage despite the presumption of honesty because she simply cannot afford to protect her discharge. Good help is not hard to find in bankruptcy—in the opinion of the authors, our bankruptcy bar is over-brimming with legal professionals of the first water: it is often, however, very difficult to fund.

At times, chapter 7 debtors and their counsel can see bankruptcy litigation coming. The creditor has been particularly tenacious in its enforcement efforts outside of bankruptcy, and there is no expectation that the litigation will stop at bankruptcy's door: or the creditor is an institutional or government entity, powerful and dispassionate, and has an endless ability to fund litigation in any venue. Understandably, when bankruptcy litigation is expected or a near certainty, savvy debtors with funds on hand--and their counsel-- sometimes seek to circumvent the United States Code provisions that enfold into the bankruptcy estate “all legal or equitable interests of the debtor in property.” They try to carve out what would otherwise become property of the estate to pay the debtor's post-petition attorneys' fees. There are several strategies to this end, and some are more effective than others. Trustees and their counsel also have at their disposal tools to limit those strategies and maximize property of the estate through disgorgement of pre-petition retainers.

In this article, we will explore some of the strategies employed by debtors to pay for bankruptcy litigation, including attendant limitations and pitfalls. Let us be clear that this article does not condemn these strategies per se, as they are often undertaken in desperation by genuinely honest debtors without the specific intent to harm the estate or creditors: nor does this imply approval, however, as these strategies necessarily deplete bankruptcy estates and tend to thwart the bankruptcy distribution scheme. Judgments aside, retainer strategies are a reality of the system in which bankruptcy professionals operate. This article therefore ultimately suggests methods for trustees or creditors to identify and deal with these strategies, as well as suggesting one possible legitimate retainer strategy that affords debtors some protection in qualifying circumstances while safeguarding the majority of assets in bankruptcy for the estate: the solution is not to pre-fund bankruptcy litigation, but to pre-package it to whatever extent reasonable. While it is a solution available to only the most well-heeled debtors, it is suited to the problem, as those are primarily the debtors who employ the retainer strategies that ostensibly circumvent existing laws regarding property of the estate.
II. The Relationship Between the Estate and Attorney Retainers

Debtor is being hounded by creditors, or is subject to pre-bankruptcy litigation, and upon the filing of her bankruptcy has reason to expect a complaint under 11 U.S.C. § 523 for nondischargeability of debt or under 11 U.S.C. § 727 for denial of discharge. She has a second problem: all of debtor's non-exempt property will become property of her bankruptcy estate, she can't use property of the estate to pay her post-petition attorneys' fees, and she won't have enough exempt property or post-petition income to fund expensive bankruptcy litigation. Her attorneys don't work for free, so the debtor starts looking for ways to pay them.

A. The Bankruptcy Estate

The filing of a voluntary petition commences a bankruptcy case, and a bankruptcy estate comprises “all legal or equitable interests of the debtor in property as of the commencement of the case.” With limited exceptions such as an inheritance within 180 days of the petition date, property of a chapter 7 bankruptcy estate cannot exceed whatever interests a debtor holds at the time she filed her petition. Property of the estate is interpreted broadly. The purpose of the creation of the estate, after all, is to corral the debtor's property to be ratably divided amongst her creditors and allow her a fresh start. To achieve this goal, almost everything that can be fairly said to belong to the debtor as of the commencement of the bankruptcy comes into the estate for the payment of creditors. This ensures that creditors receive as much as possible, such that the debtor's fresh start does not offend notions of fair play. The Supreme Court has mandated that property rights as of the commencement of the case are determined by relevant non-bankruptcy law, including state law. Therefore, although title 11 of the United States Code dictates what property comes into a bankruptcy estate, bankruptcy courts look to state law to determine what the debtor's interest in property actually is at the time of the filing of the petition.

Because § 541(a) defines the scope of estate property and such definition generally does not extend to exempt property or property that an individual chapter 7 debtor acquires after the filing of the petition, almost all such assets do not constitute estate property. Such assets, however, are often insufficient to cover the substantial attorneys' fees that accompany adversary proceedings. The question therefore becomes: in addition to the customary flat fee for filing a chapter 7 bankruptcy, can a debtor pay her attorney a large sum prior to bankruptcy to pre-fund anticipated bankruptcy litigation, or does the trustee have a claim to such a retainer?

B. Unearned Retainers are Property of the Estate

Funds paid to an attorney pre-petition become property of the bankruptcy estate on the petition date if “under applicable state law, the debtor had an interest in the funds at the time of the filing of the bankruptcy case.” In this case, the applicable law to determine the debtor's interest in funds is California law governing attorney-client relationships and retainers. California law distinguishes between security retainers, which the attorney holds in trust as security for payment on account of future services, and “true” retainers, which are forfeited to the attorney and are deemed completely and irrevocably earned upon payment. There is little question that security retainers remain the client's property: they are held in trust for the client, and the client can demand the return of the unearned portion at any time. Unused security retainers become property of the estate upon the filing of a bankruptcy petition. “True” retainers, however, are more abstruse and often form the basis of disagreement between debtors' counsel and chapter 7 bankruptcy trustees.

In traditional English, a “retainer” was one in personal service who waited attentively upon their employer, such as a valet, a valet, a butler, or a footman. Later, the word came to mean a periodic payment made to keep a professional
“on call,” recalling that same concept of constant availability. Under modern California law, a “true” (also called a “classic” or an “earned upon receipt”) retainer resembles this latter meaning: it is strictly defined as a sum of money paid by a client to secure an attorney's availability over a given period of time. It is *425 not pre-payment for future services: “A true retainer is a specific amount of money paid by a client to a lawyer to guarantee the lawyer's services if they are needed at some point in the future. The client is buying the lawyer's commitment and the lawyer is promising to be available. The lawyer is not getting compensated for actual work--that would be separate. This is a hold on his time.” True retainer funds are the attorney's funds and are completely nonrefundable: a client has no legal or equitable interest in such funds after they are paid, and the funds are not subject to refund upon termination of the attorney-client relationship. This is because the thing for which the funds are paid, guaranteed attorney availability, is manifest immediately upon payment. Furthermore, true retainers cannot be held in an attorney's client trust account, because the funds are immediately property of the attorney and the California Rules of Professional Conduct prohibit commingling attorney funds and client funds: true retainers must be placed in the attorney's proprietary or operating account.  

“A true earned upon receipt retainer is one paid to a lawyer for which the only consideration exchanged is the promise to represent the client and no other party in the particular matter. The consideration cannot include logically the provision of future services if the retainer is truly earned upon receipt.” Moreover, if the client is entitled to return of any unearned portion of the “earned on receipt” retainer, then said retainer would be property of the estate. Under the California Rules of Professional Conduct, “when used to signify a pre paid fee, the term ‘non refundable retainer’ is misleading ... because an attorney's fee is never truly nonrefundable until earned.” As noted in Lais, if a fee agreement does not specify a period of time for which the attorney is to be available pursuant to Baranowski, nor does the attorney set aside a specific period of time, it is not a true retainer in spite of “unavailability” and non-refundability language: it is in fact an advanced fee “security” retainer. Retainers for specific legal services are not “true” retainers.  

Thus, where a debtor has paid her attorney a true “earned upon receipt” retainer prior to bankruptcy, she retains no legal or equitable interest in the funds, and the retainer does not become property of the estate upon the commencement of the case. Easier said than done, however: “true” retainers are extremely rare, in part because most clients do not want to pay attorneys' high fees unless they are receiving actual legal services. Unused retainers remaining in attorneys' accounts on the petition date constitute property of the estate unless debtor and attorney intended the funds to be a classic “retainer” in the sense of paying the attorney to be on call for a specified period, the attorney deposited the funds directly in their proprietary or operating account (as opposed to their attorney-client trust account), and the attorney did or intended to bill separately for any actual legal services rendered. Importantly, “true” retainers by definition do not serve the purpose of prefunding bankruptcy litigation, and therefore do not solve the problem under discussion, because they cannot be for future services. In an effort to protect their fee for post-petition services, bankruptcy counsel will sometimes designate funds as “earned upon receipt” and “non-refundable,” thinking that this prevents the funds from becoming property of the estate. But merely calling pre-paid attorneys' fees a “true” retainer, and even designating the payment as nonrefundable in the retainer agreement, will not control: the actual purpose of the payment and how it is treated control. If the attorney intends to “draw down” on the funds as earned, or even if the funds are intended as a flat fee for future legal services, the funds are in reality security retainers for future services, and California law would not enforce the “non-refundable” clause of the fee agreement, but would require return of the fee if the attorney failed to provide the agreed legal services. The client therefore retains an interest in all earnable funds until earned and any unearned portion of the fee is returnable to the client. Given the debtor's legal and equitable interest in the retainer, the funds become property of the estate upon the commencement of a case under title 11 of the United States Code. If it is a true retainer, it merely secures the attorney's availability, and the client would still have to pay for future legal services, which defeats the goal of paying for post-petition services with pre-petition funds.
C. Pre-Petition Retainers for Post-Petition Services are Subject to Disgorgement

The bankruptcy court has the authority to determine whether retainer funds paid to a debtor's attorney should be disgorged, and whether such funds are an asset of the bankruptcy estate. In the context of pre-petition retainers, the court looks to whether the amount paid pre-petition is commensurate with the work actually done pre-petition or in connection with the petition: any additional funds paid (for instance, those intended to secure services in connection with an anticipated adversary proceeding) would be surplus to the pre-petition work, and would be subject to disgorgement as excessive.

Section 329 of title 11 provides that if compensation paid to an attorney in connection with a bankruptcy proceeding exceeds the reasonable value of the services provided, “the court may cancel any such agreement, or order the return of any such payment, to the extent excessive, to--(1) the estate, if the property transferred--(A) would have been property of the estate.” 27 Rule 2017 of the Federal Rules of Bankruptcy Procedure provides that “On motion by any party in interest or on the court's own initiative, the court after notice and a hearing may determine whether any payment of money or any transfer of property by the debtor, made directly or indirectly and in contemplation of the filing of a petition under the Code by or against the debtor or before entry of the order for relief in an involuntary case, to an attorney for services rendered or to be rendered is excessive.” 28 As this relief may be obtained “on motion,” an adversary proceeding is not required. Any disgorged fees recovered by the trustee under § 329(b) constitute property of the bankruptcy estate. 29

D. No Time Bar to Motions for Disgorgement

Debtors, trustees, and their respective counsel also need to be aware that there is no time bar to a chapter 7 trustee's disgorgement motion. A bankruptcy court may review debtors' counsels' fees at any time. Nowhere in title 11 or in the Federal Rules of Bankruptcy Procedure is any deadline or limitation placed on disgorgement. 30 Indeed, § 329 specifically subjects all payments made after one year prior to the filing of the bankruptcy petition (i.e. including all payments made during the pendency of the case) to review for reasonable value of the services. 31 Federal Rule of Bankruptcy Procedure 2017 refers to the court's ability, including on its own initiative, to review “any payment of money or any transfer of property,” without reference to time limitations. 32 As noted below, rule 2016(b) also requires ongoing disclosures throughout the bankruptcy case, a provision often overlooked by debtors' counsel. 33 There is arguably no laches defense if a trustee does not bring the motion promptly after the petition date, nor does post-petition depletion of pre-petition retainers absolve counsel of their duty to turn over property of the estate should the court order disgorgement. Just as court-appointed professionals' fee applications are interim until fees are finally allowed (usually in connection with a trustee's final report or chapter 11 plan confirmation), chapter 7 debtors' counsels' fees are subject to review and disgorgement at any time.

III. Pre-Petition Payments in Action 35

A. Beef Up Your Rule 2016 Forms: Even Reasonable Fees are Subject to Disgorgement if not Adequately Disclosed

Seeking a fresh start after a failed business venture and major medical expenses, Ms. Armine Goldman retained Agador Law to help her explore her legal options, counsel her regarding the wind-down of her business, and ultimately to file a chapter 7 bankruptcy petition. She paid Agador a $14,000 retainer, and Agador billed her hourly for legal work in connection with seeking bankruptcy alternatives and the business wind-down. When all alternatives were exhausted, Ms. Goldman requested that the remaining $5,000 of retainer be used as the firm's customary flat fee to prepare and file the bankruptcy petition, schedules, and statements, and accompany Ms. Goldman to her initial § 341(a) meeting of creditors. Ms. Goldman wrote a separate check directly to the court for the requisite filing fees. Agador did as Ms. Goldman requested, and on its
own account filled out the form required by Federal Rule of Bankruptcy Procedure 2016(b), indicating that the firm had received $5,000 from Ms. Goldman for services rendered in connection with bankruptcy. Ms. Goldman's chapter 7 trustee continued her § 341(a) meeting of creditors several times, and Agador sent an attorney to each § 341(a) meeting with Ms. Goldman, charging her hourly for all services provided after the first meeting. Ms. Goldman ultimately paid Agador Law a further $5,000 before the representation concluded. Agador never filed a supplemental rule 2016(b) statement. The trustee sought disgorgement of $9,000 to the estate and $5,000 to Ms. Goldman as a result of Agador's several failures of disclosure.

Section 329(b) and rule 2016(b) of the Federal Rules of Bankruptcy Procedure impose on chapter 7 debtors' counsel obligations of complete and ongoing disclosure of all funds received in connection with a bankruptcy case. Motions for disgorgement for inadequate disclosures are, perhaps happily, a tool under-utilized by chapter 7 trustees, and generally only occur when related issues have arisen in the case, such as discovery of a significant pre-petition retainer for services to be rendered in connection with a non-dischargeability action. Nevertheless, a particularly vigilant or tenacious chapter 7 trustee may choose to seek disgorgement in any case in which debtors' counsel have not made the requisite ongoing disclosures, even absent other retainer issues.

Section 329 of title 11 provides that an attorney representing a debtor “shall file with the court” a statement of any and all compensation received after one year before the filing of the debtor's bankruptcy. 36 Section 329(a) is implemented by rule 2016(b) of the Federal Rules of Bankruptcy Procedure, which provides that:

Every attorney for a debtor, whether or not the attorney applies for compensation, shall file and transmit to the United States trustee within 14 days after the order for relief, or at another time as the court may direct, the statement required by § 329 of the Code including whether the attorney has shared or agreed to share the compensation with any other entity. The statement shall include the particulars of any such sharing or agreement to share by the attorney, but the details of any agreement for the sharing of the compensation with a member or regular associate of the attorney's law firm shall not be required. A supplemental statement shall be *430 filed and transmitted to the United States trustee within 14 days after any payment or agreement not previously disclosed. 37

Rule 2016(b) imposes a continuing duty on debtors' counsel to supplement the original statement pursuant to § 329(a).

Section 329's disclosure requirements are “‘mandatory, not permissive’” and demand that an attorney be forthright in disclosing “the precise nature of the fee arrangement” with the debtor. “Counsel's fee revelations must be direct and comprehensive. Coy or incomplete disclosures which leave the court to ferret out pertinent information from other sources are not sufficient.” “The burden is on the applicant to make full, candid and complete disclosure--bankruptcy courts regularly order disqualification of counsel and deny or disgorge compensation as a sanction for improper disclosure.” Bankruptcy courts are empowered to examine all fees paid within the one year prior to bankruptcy, irrespective of the nature of the services rendered, in order to determine whether they were paid in connection with or in contemplation of bankruptcy and whether they are reasonable. Without full disclosure, the court cannot make an informed judgment regarding the nature and amount of compensation paid or promised by the debtor for legal services “in contemplation” of bankruptcy. Failure to satisfy the disclosure requirements of § 329(a) and rule 2016(b) can be grounds for disgorgement, “even if proper disclosure would have shown that the attorney had not actually violated any Bankruptcy Code provision or any Bankruptcy Rule.”

*431 As noted by Judge Peter H. Carroll, “[a]n attorney who violates § 329(a) and Rule 2016(b) forfeits any right to receive compensation for services rendered on behalf of the debtor and may be ordered to disgorge fees already
received.” The repercussions of inadequate disclosure are grave: “The consequences of an attorney's violation of the disclosure requirements regarding fees include denial of all fees requested.”

The test of whether attorneys' fee payments were made “in contemplation of” bankruptcy, and are therefore subject to §329, is a broad one. Whether the services provided were directly in preparation of bankruptcy petitions, schedules, and statements is irrelevant: research regarding the effects of bankruptcy, counseling in preparation for or for prevention of bankruptcy, and payments made immediately pre-petition to halt or conclude state-court litigation which will otherwise give rise to bankruptcy are all services “in contemplation of” bankruptcy. “Those cases in which a debtor's counsel has received undisclosed non-exempt asset shortly before bankruptcy as compensation primarily for future services have merited particularly close scrutiny by bankruptcy courts.” As set forth by Supreme Court in *Conrad, Rubin & Lesser*, the test for determining if a payment or transfer was made “in contemplation of” bankruptcy hinges upon the debtor's state of mind and “whether the thought of bankruptcy was the impelling cause of the transaction.”

In our example, Agador Law made two mistakes: it made inadequate disclosure of pre-petition retainers paid in connection with bankruptcy, and it failed to file a supplemental statement pursuant to rule 2016(b). Agador was paid $14,000 pre-petition, and only disclosed $5,000 of that fee. While the responsible attorney or paralegal may have considered the legal services regarding bankruptcy alternatives and business wind-down not to be “in connection with” the bankruptcy because Ms. Goldman was seeking primarily to *avoid* bankruptcy, the court disagreed. The amount of the undisclosed retainer, $9,000, was enough to induce the trustee to file the motion for disgorgement. The trustee in this case might not have sought disgorgement of the undisclosed *post-petition* payments, as such disgorgement would not benefit the estate but was instead payable to Ms. Goldman: but when the trustee requested that Agador supplement its rule 2016(b) disclosures to include post-petition amounts, Agador flatly refused. The attorney's apparent disdain for proper bankruptcy procedure motivated the trustee, in part, to pursue disgorgement so that Agador and the debtor bar would be clear in the future as to what the disclosure obligations are. In this case, the trustee did not seek nor did the court require disgorgement of the $5,000 that was disclosed: but those funds were also potentially subject to disgorgement due to Agador's other failures of disclosure.

In short, section 329(a) and rule 2016(b) require that all attorneys representing debtors disclose all fees received, and that those disclosures be transparent and comprehensive. Counsel who timely file a rule 2016(b) statement, but do not make full and clear disclosures, risk disgorgement. Indeed, debtors' counsel would be well advised to err on the side of caution and disclose all fees received within the one year prior to bankruptcy, regardless of whether the attorney believes the fees to have been paid “in connection with” or in contemplation of bankruptcy. Disclosing a lesser amount is manifestly risky, because an attorney who does not satisfy the disclosure requirements of § 329(a) and rule 2016(b), purposefully or accidentally, forfeits all right to receive compensation for services rendered on behalf of the debtor and may be ordered to return all fees already received. Counsel should also be mindful of their ongoing disclosure obligations and consider filing monthly rule 2016 forms, because payments by a debtor in bankruptcy must be disclosed within 14 days of receipt.

B. Don't Over-Egg the Pudding: Attorneys can Only Charge Reasonable Fees

Ms. Jacqueline Worthing personally guaranteed a $7 million loan from Shropshire Bank to her company, “Earnest Endeavor, LLC,” and ultimately suffered a judgment after Earnest failed and defaulted on the loan. Ms. Worthing's state court counsel referred her to Nikki Merriman, an experienced bankruptcy litigation attorney, who advised her to seek bankruptcy protection as soon as possible to preserve her homestead exemption and protect her future income. Ms. Merriman considered it possible, though not certain, that the Bank would file an adversary proceeding for determination that its judgment was nondischargeable. However, Ms. Worthing had gotten a new job, and her income was good: she could probably scrape up the money if a complaint was filed. Ms. Merriman was also willing to carry a receivable for post-petition work, if necessary.
since she believed Ms. Worthing would eventually pay the bill. Over muffins and tea-cake, they worked out a fee agreement: instead of the $6,000 flat fee Ms. Merriman usually charged to prepare and file a bankruptcy package and attend the first § 341(a) meeting of creditors, Ms. Merriman would charge Ms. Worthing a $20,000 flat fee. Ms. Worthing expressly requested a large retainer because she wanted Ms. Merriman to feel able to invest as much time as necessary to ensure that the bankruptcy schedules and statements were as close to perfect as possible. She also wanted to be certain to have counsel present if there were a second or third § 341(a) meeting of creditors. Ms. Worthing carefully gathered all her documents and necessary information, and meticulously filled out Ms. Merriman's standard bankruptcy questionnaire. Ms. Worthing's materials were so comprehensive that, in the end, there was little for Ms. Merriman to do to ready the schedules and statements for filing. Ms. Merriman disclosed all funds received on her rule 2016(b) form. Ms. Worthing's chapter 7 trustee unexpectedly concluded the § 341(a) meeting of creditors at the first meeting, Shropshire Bank missed its deadline to file an action for nondischargeability of debt, and Ms. Worthing received her discharge without incident. Ms. Worthing's trustee sought disgorgement from Ms. Merriman of $14,000.

Debtors and their counsel are not privileged to agree to any fee they like: in bankruptcy, all fees are subject to bankruptcy court review and oversight for reasonableness, and a fee that is deemed excessive is subject to disgorgement even if there was no fraudulent intent in setting the fee and even if the payment was not intended to secure extraordinary post-petition services.

*434 “The court has broad discretion under section 329(b) to disallow and require disgorgement of attorney compensation found to be excessive.”51 “The initial burden under section 329(b) is upon the attorney to justify the compensation charged in connection with a bankruptcy case.”52 The focus in determining whether pre-petition retainers are subject to disgorgement is whether the amount paid pre-petition is commensurate with the services provided prepetition, and whether the fee is “excessive” is an objective standard, not based on the parties' intent: “The standard applied under § 329(b) to determine the reasonable value of fees is set forth in § 330.”53 Section 330(a) provides that:

(3) In determining the amount of reasonable compensation to be awarded to an examiner, trustee under chapter 11, or professional person, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including:

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and
whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.\(^\text{54}\)

*435 In our example, Ms. Worthing and Ms. Merriman had the best of intentions. Ms. Worthing wanted exceptionally competent representation and did not want her counsel to feel shackled by a budget: Ms. Merriman had no intention of applying her flat fee retainer to impermissible post-petition services such as adversary proceedings. Nevertheless, they inadvertently agreed to an excessive retainer. In the end, because Ms. Worthing was intelligent, conscientious, and organized, the amount of time Ms. Merriman and her staff actually invested in preparing the necessary bankruptcy filing documents was minimal. And though Ms. Merriman reasonably anticipated that the Bank might assert itself in the bankruptcy, sending counsel to meetings of creditors and insisting on a more in-depth examination of the debtor, Shropshire was entirely absent from the bankruptcy proceeding, ultimately missing or letting pass its deadline to file an action for non-dischargeability of debt. The trustee asked the standard ten questions\(^\text{55}\) at the initial § 341(a) meeting of creditors, and there was nothing more for Ms. Merriman to do. Although the trustee in this case had the highest respect for Ms. Merriman and her ethics, she felt compelled to file the motion for disgorgement because the flat fee Ms. Worthing paid exceeded Ms. Merriman's standard rate more than twofold, in a case in which Ms. Merriman was called upon to invest less than usual time and effort.

Counsel's fees in bankruptcy are not left to the discretion of the attorneys and their clients. Although, as noted above, we find that motions for disgorgement are most common when there has been some other retainer malfeasance, any fee that exceeds the common rate by enough to be remarkable is going to be subject to scrutiny.

C. Skunk Cabbage by any Other Name: “Bankruptcy Insurance” Doesn't Work

Ms. Algee Moncrieff worked hard to protect from creditors her considerable inherited fortune, including by multiple complex and probably fraudulent asset protection strategies. She also had $300,000 cash on hand when her creditors finally started to catch up to her. Believing her other assets to be safe, she decided to seek the perceived protections of bankruptcy. She consulted with several bankruptcy attorneys, but delayed hiring any. She did hire a man who introduced himself simply as “Lane,” and who discretely offered what he called “bankruptcy insurance.” Ms. Moncrieff paid Lane $240,000 in the six months prior to bankruptcy. In exchange, Lane promised that “if Ms. Moncrieff ever had \(^\text{436}\) to file for bankruptcy protection,” Lane would provide her with transportation, lodging, and a stipend of $8,000 a month, which she could use for any purpose including living expenses and attorneys' fees. He likened it to disability insurance, and she recognized a way to protect substantially all of the money for which she hadn't already found “safeguards.” Shortly thereafter, Ms. Moncrieff hired competent and well-regarded bankruptcy counsel and paid him a reasonable retainer, but when filling out her bankruptcy questionnaire she “forgot” to mention her offshore trusts, hidden assets, or the transfers to Lane. The bankruptcy petition was filed, and the trustee convened the first meeting of creditors. As a result of a tip received from one of the creditors, the trustee inquired what kind of car Ms. Moncrieff was driving that day. Ms. Moncrieff admitted that “Lane” had dropped off a Jaguar the night before for Ms. Moncrieff's use. She testified that she thought “Lane” was an attorney, because he told her their communications were privileged, but she didn't know for sure. A quick search of the California State Bar website turned up an attorney in the area by the name of “Seamus Lane” who had three state bar complaints against him. Ms. Moncrieff recognized the address listed on the State Bar website. The trustee promptly filed a motion for disgorgement of the $240,000 paid to Mr. Lane on the basis that the payment exceeded the value of the services rendered. The trustee argued that services whose sole intent is to hinder, delay, or defraud creditors are intrinsically without value.

The concept of “bankruptcy insurance” bears mentioning in any discussion of retainers subject to disgorgement, but to an ethical and experienced bankruptcy practitioner requires little explanation or analysis. As set forth in detail above,
an attorney representing a debtor “in connection with” a bankruptcy case is required to file disclosures of fees received within or after the one year prior to bankruptcy “for services rendered or to be rendered in contemplation of or in connection with the case by such attorney.” If the payment exceeds the reasonable value of the services, the attorney may be required to disgorge the funds.

As with funds designated as an “earned upon receipt” retainer that are actually intended as pre-payment for future services, the label placed on other prepetition payments to an attorney do not control: the nature of the payments control. Here, so-called “bankruptcy insurance” was actually assistance in the debtor's scheme to conceal assets. Because Mr. Lane was actually an attorney, and because his services were specifically provided in contemplation of bankruptcy, the “fee” he collected was subject to disgorgement on motion without the necessity of an adversary proceeding to avoid and recover a fraudulent transfer—though it seems likely that any adversary to avoid, recover, and preserve the transfer for the benefit of the estate would meet with success, given the debtor's other behaviors manifesting intent to hinder, delay, and defraud creditors. Quite aside from any post-petition outlay of cash, Mr. Lane's postpetition services (including provision of vehicles, cell phones, lodging, or other assistance during the pendency of the bankruptcy) were paid for pre-petition, which allows the trustee to analogize the payments to a pre-petition security retainer subject to bankruptcy court oversight and disgorgement.

D. Call a Spade a Spade: “Earned Upon Receipt” Retainers that are Treated Like Security Retainers are Subject to Disgorgement

Berta Wooster suffered a judgment in favor of the Federal Trade Commission for false advertising and misleading customers. She retained Reginald Jeeves, a highly-regarded and knowledgeable bankruptcy and business litigation attorney from a top national law firm, who advised her that she risked having the entire $23 million judgment deemed non-dischargeable. Ms. Wooster paid Jeeves a $120,000 retainer to assist her in connection with her anticipated bankruptcy. Jeeves undertook extensive factual research of Ms. Wooster's financial history, transactions, assets, and liabilities, as well as legal research regarding dischargeability of the FTC judgment and possible legal strategies for avoiding liens, preserving assets, and objecting to the FTC's claim while the judgment was on appeal. Two months later, Jeeves met with Ms. Wooster to present his conclusions and advice, and to work with her on preparing the necessary bankruptcy schedules and statements. He also presented Ms. Wooster with her bill to date, for $60,000. He explained to Ms. Wooster that assets of her bankruptcy estate would include legal and equitable interests, such as the unused portion of her security retainer, and offered a possible solution: his firm could convert the remaining security retainer to a non-refundable “earned upon receipt” retainer. This would ensure that Jeeves could provide Ms. Wooster legal services after bankruptcy, including representing her in any adversary proceeding. Ms. Wooster agreed, and the next day Jeeves filed Ms. Wooster's bankruptcy petition, schedules, and statements and a complete and correct rule 2016(b) statement. The FTC did file the expected adversary proceeding, and Jeeves represented Ms. Wooster in that case as well. He continued to bill her monthly for legal services and to draw down on the funds held in trust as the bills went out. Some months after the bankruptcy petition was filed, the trustee requested copies of all unredacted detailed billing statements for services Jeeves provided to Ms. Wooster, as well as all invoices. After conferring with his client, Jeeves entered into a stipulation for protective order with the trustee to preserve the attorney-client privilege, and turned over the requested statements and invoices. The trustee subsequently filed a motion for disgorgement of the $60,000 that had been “converted” to an earned upon receipt retainer just prior to bankruptcy.

The words “earned upon receipt” are not a magic spell. It is critical for attorneys and their clients to understand that there is a real and significant difference between security retainers and “true” retainers, and that labels will not control. Payment for actual services, irrespective of when they will be rendered, is never a “true” retainer, which is simply and only a payment to secure counsel's availability. Any payment that is intended as consideration for actual legal services is a security retainer and subject to refund, regardless of how it is labeled or whether the retainer agreement acknowledges that all unearned retainers are refundable pursuant to the California Rules of Professional Conduct. Once this distinction is made, and the retainer's actual nature is acknowledged, the court looks to the reasonableness of the fee in light of the services rendered as of the petition date to determine whether the retainer is subject to disgorgement.
“The clear weight of authority supports the proposition that reasonable compensation under § 330(a)(1) for actual, necessary services means services that benefit the debtor's estate, not the debtor.” 58 The services of chapter 7 debtors' counsel that benefit the estate are analyzing the debtor's financial condition, advising the debtor regarding whether to file a bankruptcy petition, preparation and filing of the petition, schedules, and statements, and representing the debtor at the § 341(a) meeting of creditors. 59 These services can be fairly said to benefit the estate because they ultimately result in the creation of the bankruptcy estate. "Courts have often applied the § 330(a) test in § 329(a) cases, usually because a retainer is involved and because the debtor's attorney intends the retainer to stand for services to be rendered to the debtor after the case is filed, e.g., for the defense of discharge and dischargeability litigation." 60 This is especially appropriate when considering the reasonable value of the legal services of chapter 7 debtor's counsel when they are being paid from assets of the estate--such as unearned retainers. Such payment is only reasonable if the services rendered were "necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title." 61

The Supreme Court has held that chapter 7 debtor's counsel cannot be paid from property of the estate. 62 Even prior to Lamie, this was the majority rule and the rule in the Ninth Circuit. 63 Under this authority, debtors' counsel cannot use a pre-petition retainer (in which, as discussed above, debtors retain an interest on the petition date) to pay for post-petition services because those funds became an asset of the estate upon the filing of the petition and the post-petition services do not benefit the estate.

In our example, the $60,000 retainer funds that Jeeves and Ms. Wooster purported to convert to an “earned upon receipt” retainer were not a true retainer, in spite of the language of the modified retainer agreement. Just over two months pre-petition, Jeeves entered into a security retainer agreement with Ms. Wooster, which as one would expect specified certain services that were to be performed--bankruptcy planning and analysis and defense of an anticipated nondischargeability action--and did not designate a specific time period for the representation. Two months later, after Jeeves expended $60,000 of prebankruptcy attorney time on those issues, Jeeves and Ms. Wooster executed a new retainer agreement. There was no new payment in connection with second retainer agreement: merely a co-opting of funds already paid. The scope of services to be provided pursuant to the new retainer was substantially identical to the services set forth in the initial retainer agreement, and the new agreement specifically provided that Ms. Wooster would continue to be billed at an hourly rate after completion of the legal services contemplated by the new agreement. Finally, Jeeves maintained the retainer funds in his attorney client trust account. None of these facts are consistent with a “true” retainer. The retainer funds were therefore a security retainer on the petition date, and Ms. Wooster had a legal and equitable interest in the remaining $60,000, which constituted property of the bankruptcy estate.

Importantly, the retainer payments to Jeeves were not to “guarantee availability” if Ms. Wooster needed Jeeves' services: they were pre-payment for services that Jeeves and Ms. Wooster knew with substantial certainty were going to be needed. And while Jeeves tried to argue in his opposition to the trustee's motion for disgorgement that the retainer was for “a specific period of time,” namely “post-petition representation,” Jeeves kept track of his services to Ms. Wooster on an hourly basis, billed her for services rendered, and only drew down on the retainer as he earned it. As evidenced by Jeeves' billing statements, the $60,000 “earned upon receipt” retainer did not even cover the entire post-petition period of Ms. Wooster's bankruptcy. He continued to bill Ms. Wooster hourly after the $60,000 retainer was exhausted. The “period of time” for which the $60,000 was allegedly to secure Jeeves' availability was therefore illusory: the retainer was intended and used to pay for specific post-petition legal services. In this case, while the trustee had no reason to believe that Jeeves or his firm were attempting a deception--they may have misunderstood the nature of earned upon receipt retainers, as many attorneys do--the trustee nevertheless had a duty to seek disgorgement of the funds remaining as of the petition date.
Taken together, the authorities regarding earned upon receipt retainers and reasonableness of fees restrict debtors’ pre-petition retainer payments to those for the reasonable value of: services actually and necessarily rendered pre-petition; and customary post-petition services that directly benefit the administration of the bankruptcy estate, such as appearance at the § 341(a) meeting of creditors. As the debtor retains an interest in all other pre-petition retainer funds (except for that rare beast, the “true” retainer, which as described above is not in payment for specific legal services), debtors’ counsel can be required on motion to disgorge any other funds received prior to the filing of a bankruptcy petition. These authorities appear to allow for only a very narrow alleyway through which prepetition retainers for bankruptcy litigation services may pass, as discussed infra.

*441 E. Pre-Packaged Litigation: a Potential “Solution,” But Neither Easy nor Foolproof

After its successful lawsuit against Berta Wooster, the FTC also brought suit against Samantha Vimes, Ms. Wooster's business partner, seeking another $23 million judgment. Ms. Vimes had no other significant creditors, her home had less than $50,000 of equity in it, and although she had invested wisely for retirement, most of her $3 million of assets were liquid and not protected from creditors. Ms. Vimes hoped to find a way to avoid bankruptcy altogether: but because that seemed unlikely, she needed to be able to anticipate with fair certainty the outcome of any adversary that might be filed in her bankruptcy, in order to decide whether to file a bankruptcy petition immediately, wait it out, or seek a settlement with the FTC. Therefore, four months before judgment was entered against her, Ms. Vimes paid Willikins, Carrot, and Angua LLP, a small firm of certified bankruptcy specialists, $250,000 as a retainer for legal services. The retainer agreement provided that the money was a flat fee for comprehensive pre-petition bankruptcy litigation analysis and, if necessary, the preparation and filing of bankruptcy petition, schedules, and statements. The agreement provided that the retainer was not subject to refund unless WCA substantially failed to provide the agreed services, and that while Ms. Vimes would receive regular monthly statements describing in detail the legal services that had been rendered on her behalf, she would receive no bill and would not be charged an hourly rate. The retainer further provided that after the enumerated services had been provided, including, if necessary, appearance at Ms. Vimes' first § 341(a) meeting of creditors, the firm would require a new retainer agreement and Ms. Vimes would pay a standard hourly rate for further legal services. Willikins began intensive bankruptcy planning, including running through an entire mock adversary proceeding: he and a mid-level associate conducted all the research and to a large extent drafted all the documents that they expected to arise in any FTC adversary proceeding. They drafted a mock-up of a complaint for non-dischargeability, Ms. Vimes' answer, and a complete discovery cycle including deposition outlines, which allowed them to also draft a mock motion for summary judgment. This in-depth analysis was necessary to determine whether Ms. Vimes was likely to prevail in the anticipated adversary proceeding. In the three months prior to filing Ms. Vimes' bankruptcy petition, the firm invested more than 600 hours on her case, which if billed at usual hourly rates would have been more than $267,000 in fees. Based on the outcome of WCA's analysis and adversary mock-up, the firm advised Ms. Vimes to file a voluntary chapter 7 petition before judgment could be entered against her. They prepared the necessary filing documents, including a complete disclosure of the $250,000 flat fee retainer. Ms. Vimes was assigned the same trustee as Ms. Wooster: he requested complete *442 billing statements and invoices, which WCA turned over after execution of a stipulation for protective order. In the end, the trustee decided not to seek disgorgement from WCA, as there appeared to be no basis to do so.

Any attorney who attempts to pre-package legal services that could not otherwise be paid for from property of the estate does so at her own peril: there is no guarantee that a court would accept the legitimacy of this strategy if there is any indication that the reason for the pre-packaging is to circumvent the law regarding property of the estate. Any intent to hinder, delay, or defraud creditors or the estate by removing assets from the trustee's grasp is not a legitimate retainer strategy. If, however, the services were actually provided in full pre-petition, and if the fee charged for those services was reasonable, then the fee paid for those services may not be subject to disgorgement. It was fully earned pre-petition, and is not refundable to the client under the California Rules of Professional Conduct: debtor therefore has no interest in the funds as of the commencement of the case.
There are circumstances in which this strategy is warranted, though they are limited. In Ms. Vimes' case, whether she filed bankruptcy at all, and when, hinged entirely on the unknown outcome of an almost-guaranteed adversary proceeding. WCA was truly not in a position to advise her as to the risks and benefits of bankruptcy until it had assessed to a high degree of certainty whether she would be likely to recover most of her assets in surplus, assuming her appeal of the FTC judgment was successful or its claim was disallowed, and whether she was likely to get her “fresh start” via discharge of the FTC judgment. If she was likely to remain liable for the FTC judgment, bankruptcy would have served no purpose. Researching and drafting a complaint, answer, complete discovery cycle, and motion for summary judgment prior to even filing the bankruptcy petition may have been reasonable pre-bankruptcy analysis in this case. It had the collateral benefit of minimizing Ms. Vimes' fees in the adversary proceeding, so that she was able from her income to keep current on WCA's bill for post-petition services, but it was also necessary and reasonable in light of the circumstances.

*443 There are several aspects of this pre-packaged bankruptcy litigation strategy that contributed to its success. First and most importantly, the need for bankruptcy planning on this scale was legitimate and not motivated by any intent to hoard property of the estate. Second, WCA made no attempt to manipulate or obfuscate the nature of the retainer funds. Third, WCA acknowledged its obligation pursuant to the California Rules of Professional Conduct to return the retainer if the firm did not perform the contracted services. Fourth, WCA made a full and complete disclosure on its rule 2016(b) form, and there is no question that the trustee and the court knew from the outset the precise measure of what WCA was paid and the terms of its agreement with Ms. Vimes. And finally, WCA did not attempt to withhold from the trustee any documentation relating to its representation of Ms. Vimes, including (after entry of an appropriate order protecting the attorney-client privilege) unredacted copies of the retainer agreement, detailed billing statements, and all invoices.

Pre-packaged bankruptcy litigation in chapter 7 is not easy. Counsel must carefully assess the situations in which it is warranted and be diligent that the justification for pre-packaging is legitimate and not a mere façade. It also requires the commitment of significant legal resources, because it concentrates into a few months the litigation steps that are usually stretched out over a year or more. But if the client has the money, the attorney has the time, and the strategy is justified, it may be a viable option for provision of legal services that incidentally also minimizes the risk that a debtor will be unable to afford to defend her discharge.

IV. Conclusion

In bankruptcy, honest debtors pledge their non-exempt assets in exchange for a discharge of debts. The creditors then receive ratable distributions from estate property. That ideal of a discharge fairly obtained is sometimes thwarted because debtors in bankruptcy are the people least able to afford representation of competent counsel to help them defend their discharge. Debtors have been known to burn through exempt assets and deplete their retirement funds paying attorneys for post-petition representation, only to lose their attorneys before trial due to inability to pay. This conundrum has led some debtors and their counsel to seek retainer strategies designed to sidestep the provisions of the Code enfolding all of a debtor's non-exempt assets into the estate. These retainer strategies are largely ineffective. Over-paying for services, parking debtor's money with an undisclosed attorney, and designating retainers for future services as nonrefundable and “earned upon receipt” do not impede the trustee and do not confound the bankruptcy court, which has broad powers to review transfers made to debtors' counsel and order disgorgement of any payments that do not comport with bankruptcy protocol. Strict and continuing disclosure requirements assist the court in its oversight of payments to attorneys, and the trustee's ability to seek disgorgement by motion streamlines the process.

In the end, only honest strategies prevail. If there is a legitimate purpose to be served by pre-packaging bankruptcy litigation, and if the attorney has the time and the gusto to compact 18 months' worth of research and drafting into a scant three or four months pre-petition, a debtor may be able to reap the collateral benefit of being able to pay with pre-petition dollars for what are customarily post-petition services. Outside this narrow realm of justifiable significant prepetition retainers, trustees have potent tools at their disposal to discover, investigate, and seek disgorgement of excessive pre- and post-petition payments to debtors' counsel.
Footnotes

1 Ed Hays is a founding partner of Marshack Hays LLP, a bankruptcy litigation firm in Irvine, California. Sarah Cate Hays is a senior associate of the firm. Ms. Hays has previously published articles in the California Bankruptcy Journal under the name Sarah C. Boone. The authors would like to thank Richard A. Marshack, who has served as a Chapter 7 panel trustee since 1985, for his contributions to these materials.

2 Ostrander v. Williams (In re Williams), Bankr. No. 11-42792-DML-7, Adv. No. 11-04190-DML, 2013 WL 1724606, at *2 (Bankr. N.D. Tex. Apr. 18, 2013) (Civil litigants are not automatically entitled to appointment of counsel if they cannot afford an attorney: “The decision to appoint counsel [in a civil case] is not automatic; rather, it is committed to the court's discretion.”).


6 11 U.S.C. § 541(a)(5): property of the estate includes “Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—(A) by bequest, devise, or inheritance; (B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or (C) as a beneficiary of a life insurance policy or of a death benefit plan.”

7 Foothill Capital Corp. v. Clare's Food Market, Inc. (In re Coupon Clearing Serv., Inc.), 113 F.3d 1091, 1099 (9th Cir. 1997) (“the estate [has] no greater rights in property than those held by the debtor prior to bankruptcy”).


12 In re Dick Cepek, 339 B.R. 730 (B.A.P. 9th Cir. 2006).

13 CAL. R. PROF. CONDUCT 3-700(D)(2).


15 OXFORD ENGLISH DICTIONARY ONLINE, “retainer, n.2” (Feb. 9, 2016).

16 OXFORD ENGLISH DICTIONARY ONLINE, “retainer, n.1” (Feb. 9, 2016).


19 CAL. R. PROF. CONDUCT 3-700(D)(2).

20 Id. at 4-100.


**CAL. PRAC. GUIDE PROF. RESP. Ch. 5-B ¶5:260** (citing CAL. R. PROF. CONDUCT 3-700(D)(2), which requires prompt payment of unearned advance fee).


FED. R. BANKR. P. 2017(a) (emphasis added).


See generally 11 U.S.C. § 101 et seq. and the FEDERAL RULES OF BANKRUPTCY PROCEDURE.


Id. at 2016(b).

11 U.S.C. §§ 330(a)(5) and 331.

Each of the hypotheticals set forth in this article is based on actual cases in which the authors represented trustees in chapter 7 bankruptcy cases. The names and identifying facts have been fictionalized. The scenarios are real.


FED. R. BANKR. P. 2016(b).


*In re Laxague*, 981 F.2d 1258 (9th Cir. 1992).

See Keller Fin. Servs., 248 B.R. at 878 (§ 329 allows the court to review fees paid for services “performed at a time when the debtor was contemplating bankruptcy,” regardless of the nature of the services (internal quotations omitted)); Wooton v. Dixon (*In re Dixon*), 143 B.R. 671, 678 (Bankr. N.D. Tex. 1992) (§ 329 “imposes no restriction on the nature of the services rendered ...”); *In re Rheuban*, 121 B.R. 368, 378 (Bankr. C.D. Cal. 1991) (§ 329 does not limit the nature of the legal services that are subject to reexamination).

*Park-Helena Corp.*, 63 F.3d at 880; Consumer Seven Corp. v. U.S. Trustee (*In re Fraga*), 210 B.R. 812, 822 (B.A.P. 9th Cir. 1997) (emphasis added).
In re Perrine, 369 B.R. 571, 580 (Bankr. C.D. Cal. 2007) (citing Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis), 113 F.3d 1040, 1045 (9th Cir. 1997) (“an attorney's failure to obey the disclosure and reporting requirements of the Bankruptcy Code and Rules gives the bankruptcy court the discretion to order disgorgement of attorney's fees”); see also Park-Helena Corp., 63 F.3d at 882 (“Even a negligent or inadvertent failure to disclose fully relevant information [in a rule 2016 statement] may result in a denial of all requested fees.”); Jensen v. U.S. Trustee (In re Smitty's Truck Stop, Inc.), 210 B.R. 844, 849 (B.A.P. 10th Cir. 1997) (an attorney's failure to disclose a retainer in his Rule 2016(b) statement is sufficient to deny all fees, even if the nondisclosure was negligent or inadvertent).

See, e.g., In re Greco, 246 B.R. 226, 231 (Bankr. E.D. Pa. 2000) (a $2,200 payment to an attorney two months before bankruptcy for legal research concerning the effect of bankruptcy on the debtor's student loans was “in contemplation of” bankruptcy); Rheuban, 121 B.R. at 378 (“subjective review [is] embodied in the ‘in contemplation of’ language of § 329 and its predecessors, § 60(d) and Bankruptcy Rule 220”).

See, e.g., In re Jastrem, 253 F.3d 438, 443 (9th Cir. 2001); In re Basham, 208 B.R. 926, 931-32 (B.A.P. 9th Cir. 1997).

Basham, 208 B.R. at 931.


Stewart v. Law Offices of Dennis Olson, 93 B.R. 91, 95 (N.D. Tex. 1988) (citing In re Ryan, 82 B.R. 929, 931-32 (N.D. Ill. 1987) (all decisions interpreting § 330 of Bankruptcy Code carry over near-unanimous view that, as a matter of law, attorneys may recover from the estate only if their labors actually benefit the estate)); In re Taylor, 66 B.R. 390, 395 (Bankr. W.D. Pa. 1986); In re Moore, 57 B.R. 270, 271 (Bankr. W.D. Okla. 1986); In re Zweig, 35 B.R. 37, 38 (Bankr. N.D. Ga. 1983); In re Rosen, 25 B.R. 81, 86 (Bankr. D.S.C. 1982) (see also In re Jones, 665 F.2d 60 (5th Cir. 1982) (per curiam) (fees related to defending against objections to discharge not payable from estate); In re Cleveland, 80 B.R. 204, 205 (Bankr. S.D. Cal. 1987) (case law is well-settled that an attorney for a debtor in a chapter 7 case is not entitled to compensation out of the estate for services beneficial only to debtor; defense of non-dischargeability action not compensable out of estate); but see In re Deihl, 80 B.R. 1, 2 (Bankr. D. Me. 1987) (debtor's attorney entitled to compensation under § 330 for defense of dischargeability complaint).

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63 See, e.g., Alcala v. Towers (In re Alcala), 918 F.2d 99, 103 (9th Cir. 1990) (because the chapter 7 debtor's efforts in support of the debtor's motion to abandon property were not necessary to the administration of the estate and did not benefit the estate, the debtor's attorney was not entitled to attorney's fees pursuant to 11 U.S.C. § 330(a)); In re Weingarden, 84 B.R. 691, 692 (Bankr. S.D. Cal. 1988); In re Cleveland, 80 B.R. at 205 (case law is well-settled that an attorney for a debtor in a chapter 7 case is not entitled to compensation out of the estate for services beneficial only to debtor; defense of non-dischargeability action not compensable out of estate); In re Hanson, 172 B.R. 67 (B.A.P. 9th Cir. 1994).

64 Arguably, the payments may be subject to avoidance as fraudulent transfers. The Ninth Circuit recently concluded in Gladstone v. U.S. Bancorp (In re Green), No. 13-55773, 2016 WL 142469, at *10-11 (9th Cir. Jan. 8, 2016) that the phrase “an interest of the debtor in property” that appears in § 548 means “property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings.” If a court were to conclude that such prebankruptcy services were done with actual intent to hinder, delay, or defraud creditors and the Supreme Court's holding in Lamie that chapter 7 debtor's counsel cannot be paid from estate property, such payments may be avoided as fraudulent transfers.

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