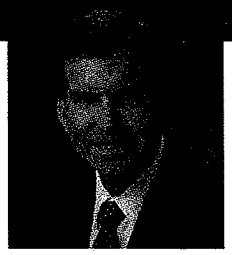

Bankruptcy Abuse and Lawyers

By Jeffrey P. Lewis

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Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to stop practices viewed as consumer abuse and abuse of the bankruptcy system. One of the abuses that Congress wished to address was the practice of debtors who load up on debt with the expectation of obtaining its discharge in bankruptcy.

The act contains several provisions that regulate the conduct of "debt relief agen[cies]," that is, "professionals who provide bankruptcy assistance to consumer debtors." Like other consumer protection legislation, such as the Unfair Trade Practices Act, a question raised upon its enactment was whether it was intended to apply to lawyers who represent consumer debtors. Stated differently, can a lawyer constitute a debt relief agency under the act when he or she — or his or her firm — provides services that qualify under the act? If so, this can have significant consequences. For example, under 11 U.S.C. §526(a)(4), a debt relief agency shall not "advise an assisted person ... to incur more debt in contemplation of such person filing a case under this title. ..." Under §101(3), an assisted person "is someone with limited nonexempt property whose debts consist primarily of consumer debts." Under §101(4A), " 'Bankruptcy assistance' refers to goods or services 'provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding' in bankruptcy." Moreover, under §528, a debt relief agency must make certain clear and conspicuous disclosures in its advertising of bankruptcy assistance services. As some examples, it must state in substance "that the services or benefits are with respect to bankruptcy relief under this title" and that "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." The act provides several remedies, such as a private cause of action by a debtor for actual damages and disgorgement of fees, provides for reasonable attorneys fees and costs, gives standing to state attorneys general to sue on behalf of a resident debtor for damages and allows for the imposition of a civil penalty.

If we conclude that the act can apply to lawyers, a question is raised as to the extent to which it restricts legal advice concerning the incursion of additional debt under circumstances where the debtor is contemplating filing for bankruptcy. One of the perceived abuses that prompted enactment of this legislation is the practice of debtors incurring substantial consumer debt immediately before filing for bankruptcy. There are instances, however, where the incursion of some debt qualifies as a legitimate strategy by the debtor for the benefit of the creditors. But, assuming its application to lawyers, does this act prohibit lawyers from recommending such a strategy?

Several legal challenges have been mounted against the act with respect to, among other things, its application to lawyers and its constitutionality. Recently, the U.S. Supreme Court weighed in on all these issues in *Milavetz, Gallop & Milavetz, P.A. v. United States,* 130 S.Ct. 1324, 176 L.Ed 2d 79 (2010).

A law firm, two of its bankruptcy lawyers and their clients brought a pre-enforcement suit in federal district court seeking declaratory relief relating to the act's debt-relief-agency provisions. The district court agreed with plaintiffs' argument that an attorney does not qualify as a debt relief agency under the act. To reach this conclusion, it finds the restriction under §526(a)(4) against advising a debtor to incur more debt in contemplation of filing for bankruptcy and the disclosure restrictions under §528 unconstitutional as applied to lawyers.

On appeal by the government, a three-judge panel of the 8th U.S. Circuit Court of Appeals affirmed in part and reversed in part. Applying the plain language of the act, the court unanimously held that an attorney can be a debt relief agency under the act and therefore subject to its requirements. It also unanimously held that the disclosure requirements under §528 are constitutional. But a majority of the panel found §526(a)(4) invalid because it "broadly prohibits a debt relief agency from advising an assisted person ... to incur *any* additional debt when the assisted person is contemplating bankruptcy," even when the advice constitutes prudent pre-bankruptcy planning not intended to abuse the bankruptcy laws. Therefore, in the majority's view, "§526(a)(4) could not withstand either strict or intermediate scrutiny." In the dissent's view, this provision should be read narrowly to prevent only advice to abuse the bankruptcy system, noting that this construction "would avoid most constitutional difficulties."

The Supreme Court holds that the act applies to lawyers and that the challenged provisions of §§526 and 528 are constitutional. Although all nine justices concurred in the result, two justices wrote separately: Justice Antonin Scalia because he objected to a footnote in the majority opinion written by Justice Sonia Sotomayor, and Justice Clarence Thomas because he disagreed with the majority's reasoning for finding §528's advertising disclosure requirements constitutional.

Utilizing a statutory construction analysis, the court finds that the act does not exclude attorneys in spite of several contrary arguments, including that it would unduly intrude upon the state regulation of attorneys. Therefore, the court holds that all attorneys who provide bankruptcy assistance to assisted persons are debt relief agencies.

In interpreting §526(a)(4) as a potential "broad, content-based restriction on attorney-client communications," the court rejects the majority view taken by the 8th Circuit panel, adopting a much narrower interpretation similar to the view expressed by the minority of that court. It concludes that "§526(a)(4) prohibits a debt relief agency only from advising a debtor to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose." It applies the following test to determine whether the advice is prohibited under the act: "whether the impelling reason for 'advis[ing] an assisted person ... to incur more debt' was the prospect of filing for bankruptcy." Based upon this narrow interpretation, the act "presents no impediment to 'full and frank' discussions" between lawyer and client with respect to this issue.

The court notes that §528's advertising disclosure requirements involve an accurate statement with respect to the advertiser's legal status and the character of the services being provided. Moreover, they do not prevent an attorney from conveying any other advice to a client. Therefore, the court found them constitutional as they apply to attorneys because they "are 'reasonably related to the [government's] interest in preventing deception of consumers. ...' "

The Supreme Court's holding in *Milavetz* establishes that attorneys can be subject to the act and will have to comply with its requirements.