UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
Civil No. 05-CV-2626JMR/FLN

MILAVETZ, GALLOP & MILAVETZ, et al., Plaintiffs, v. UNITED STATES of AMERICA Defendant.	**MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS**

INTRODUCTION

The focus of this action is on the "debt relief agency" provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), 11 U.S.C. §§ 101(12A), 526 -528. These provisions establish certain standards for professional conduct for attorneys and bankruptcy petition preparers who provide bankruptcy assistance to consumer debtors with limited assets. Plaintiffs – a law firm, two of its attorneys and two unnamed members of the public – raise three facial constitutional challenges to these provisions. First, plaintiffs assert that the provisions violate the First and Fifth Amendments because, they contend, the term "debt relief agency" is unconstitutionally vague. Second, they assert that 11 U.S.C. § 526(a)(4), which prohibits a debt relief agency from advising consumer debtors with limited assets to incur more debt in contemplation of filing a bankruptcy petition, violates the First Amendment. Third, plaintiffs allege that 11 U.S.C. §§ 528(a)(4) and (b)(2), which require a debt relief agency to insert a specified statement in its advertisements of bankruptcy assistance services or assistance with debts, violate the First

Amendment.

Plaintiffs' complaint should be dismissed. First, this Court lacks jurisdiction to consider the claims of plaintiffs proceeding under the pseudonyms of John Doe and Mary Roe. 1st Am. Compl. ¶ 10. Fed. R. Civ. P. 10(a) requires a complaint to state the names of the parties. While courts permit plaintiffs to proceed under pseudonyms in rare cases with permission, here plaintiffs have not sought permission. Nor have they offered any justification for using pseudonyms.

Second, none of plaintiffs' claims states a claim upon which relief can be granted. Plaintiffs' Fifth Amendment claim that the term "debt relief" agency is unconstitutionally vague has no merit. Contrary to plaintiffs' assertion (1st Am. Compl. ¶ 45), the term "debt relief agency" is defined by the BAPCPA. It defines "debt relief agency" as "any person" that, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C § 101(12A). "Bankruptcy assistance" includes "providing information, advice, counsel . . . or [ ] legal representation[.]" 11 U.S.C. § 101(4A). Therefore, the definition of the term "debt relief agency" is not vague. Attorneys who provide advice and legal representation to assisted persons fall squarely within the plain language of the BAPCPA.

Plaintiffs' First Amendment claims also have no merit. Section 526(a)(4) does not prohibit an attorney from advising an assisted person about what the bankruptcy law states. Nor is it a general prohibition against advising an assisted person to incur debt. Instead, it prohibits an attorney only from advising an assisted person "<u>to incur more debt in</u>

contemplation" of filing for bankruptcy. 11 U.S.C. § 526(c)(4) (emphasis added). In other words, it prohibits advice to incur more debt because the debtor intends to file for bankruptcy. This restriction is an ethical standard that protects debtors from receiving advice that could result in the denial of relief and that prevents abuse of the bankruptcy system. Thus, it should be upheld under the balancing test set forth in Gentile v. State Bar of Nevada, 501 U.S. 1030, 1075 (1991).

Sections 528(a)(4) and (b)(2) also do not violate the First Amendment. Contrary to plaintiffs' assertion, these provision do not "prohibit plaintiff Milavetz, Gallop and Milavetz, P.A., from engaging in certain marketing communications." 1st Am. Compl. ¶ 35. Rather Sections 528(a)(4) and (b)(2) simply obligate attorneys to include the following statement, or a substantially similar one, in their advertisements of bankruptcy assistance or assistance with debts directed to the general public: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528(a)(4), (b)(2). Courts review such disclosure requirements pursuant to a relaxed standard under which disclosure requirements, to pass constitutional muster, need only be "reasonably related" to the "State's interest in preventing deception of consumers" and not unjustified or unduly burdensome. Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 651 (1985). The disclosure statement requirement in §§ 528(a)(4) and (b)(2) easily meets this test. Congress enacted the disclosure requirements after hearing evidence about consumer deception by way of advertisements promising debt relief without mentioning that such relief may actually involve filing for bankruptcy. This requirement ameliorates that problem by ensuring that potential clients know that bankruptcy is an option that attorneys may recommend to them.

Accordingly, this Court should grant defendant's motion to dismiss because (1) it lacks jurisdiction of the claims of the unnamed plaintiffs, and (2) all of the claims fail to state a claim upon which relief can be granted.

STATUTORY BACKGROUND

After conducting a series of hearings, Congress found that over the past decade "the number of bankruptcy filings had *nearly doubled to more than 1.6 million cases filed in fiscal year 2004.*" H.R. Rep. No. 109-31, 109th Cong., 1st Sess. at 4, reprinted in 2005 U.S.C.C.A.N. at 91 (emphasis in original).[1] It concluded that this "increase in consumer bankruptcy filings has adverse financial consequences for our nation's economy." Id. For example, in 1997 alone, "it was estimated that *more than $44 billion* of debt was discharged by debtors who filed for bankruptcy relief, a figure when amortized on a yearly basis amounts to a loss of at least $110 million every day." Id. (footnotes omitted). According to one estimate, these losses "translate into a $400 annual 'tax' on every household in our nation." Id.

Looking for the source of this meteoric increase in bankruptcy filings, Congress determined that the bankruptcy system "ha[d] loopholes and incentives that allow and –

[1] The BAPCPA is the product of nearly eight years of proposals and hearings on reform of bankruptcy law and practices. See 2005 U.S.C.C.A.N. at 92-96.

sometimes – even encourage[d] opportunistic personal filings and abuse," 2005 U.S.C.C.A.N. at 91, and that attorneys sometimes played a role in exploiting these "opportunities." A civil enforcement initiative undertaken by the United States Trustee Program, and considered by Congress, found that "[a]buse of the system is more widespread than many would have estimated." Id. (quoting J. Christopher Marshall, Civil Enforcement: An Early Report, Journal of the Nat'l Ass'n of Bankr. Trustees 39 (Fall 2002)). The study "'consistently identified'" such problems as "'misconduct by attorneys and other professionals'" along with "'debtor misconduct and abuse . . . , problems associated with bankruptcy petition preparers, and instances where a debtor's discharge should be challenged.'" 2005 U.S.C.C.A.N. at 92 (quoting Antonia G. Darling and Mark A. Redmiles, Protecting the Integrity of the System: the Civil Enforcement Initiative, Am. Bankr. Institute J. 12 (Sept. 2002)).

Congress heard evidence regarding several specific problems with the bankruptcy bar. One was the use of deceptive advertisements by some bankruptcy practitioners. Dean Sheaffer, Chairman of the Pennsylvania Retailers' Association, testified that some lawyers run advertisements "promising to make individuals' debts disappear" without even mentioning bankruptcy. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, Hearing on H.R. 975 before House Judiciary Comm., 108th Cong., 1st Sess. 55 (2003)(Exhibit A). And the House Judiciary Committee took note of a consumer alert issued by the Federal Trade Commission which warned that some advertisers promising debt relief may actually use bankruptcy as the method for such relief. See, e.g., Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong., 2d Session 90-92 (1998)(Exhibit B). As Senator Sessions explained, "[i]n many instances, the deceptive and fraudulent advertising practices of bankruptcy mills lure consumers into bankruptcy unnecessarily." 151 Cong. Rec. S2472 (March 10, 2005)(Exhibit C).

The evidence before Congress also suggested that some bankruptcy attorneys were failing to provide clients with sufficient information regarding their options and the consequences of bankruptcy. The Honorable Edith Hollan Jones, United States Court of Appeals Judge for the Fifth Circuit and member of the National Bankruptcy Review Commission, testified as follows:

> Most debtors never see a judge. Many bankruptcy lawyers never talk to their clients. The first time they see their clients often is when they are in a herd of people in bankruptcy courts and the lawyer raises a hand, and says, "Anyone's who's my client needs to step forward right now."

Bankruptcy Reform Act of 1998: Part I, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong., 2d Sess. 15 (1998)(Exhibit D). Congressman James Moran testified that "there are some within the bankruptcy profession operating like a mill, steering many consumers into bankruptcy without adequately informing them of their choices . . . ." Id. at 13. In this same vein, a study conducted by Tahira K. Hira, a Professor at Iowa State University, revealed that the two most common complaints of people who had their debts discharged in a bankruptcy proceeding were a lack of information, and concern, about the practices of their lawyers. The Consumer Bankruptcy Reform Act: Seeking Fair and Practical Solutions to Consumer Bankruptcy Crisis, Hearing on S. 1301 before Senate Judiciary Comm., 105th Cong., 2d Sess. 29 (1998)(Exhibit E).

BAPCPA is "a comprehensive package of reform measures" designed "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors." 2005 U.S.C.C.A.N. 88, 89. As part of this package, Congress amended the Bankruptcy Code ("Code") to establish certain standards of professional conduct for "debt relief agencies," see 11 U.S.C. §§ 526-528, a category of individuals that includes attorneys or their law firms. See 11 U.S.C. §§ 101(12A), 101(4A).

Section 526 lays down a number of rules of professional conduct for lawyers when dealing with consumer debtors. Section 526(a)(4), for example, provides that:

> A debt relief agency shall not [] advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for representing a debtor in a case under this title.

11 U.S.C. § 526(a)(4). This portion of the statute thus prohibits an attorney from "advis[ing]" a consumer debtor (1) "to incur more debt in contemplation of" filing for bankruptcy; or (2) "to incur more debt . . . to pay" an attorney or bankruptcy petition preparer. 11 U.S.C. § 526(a)(4). If an attorney violates this provision, he or she may be obligated to return "any fees or charges" paid to him or her by the debtor-client along with

"actual damages" and "reasonable attorneys' fees." 11 U.S.C. § 526(c)(2)(A). Also, state attorneys general may bring actions to enjoin violations of § 526 and recover damages for debtors, and the courts, the United States Trustees, or debtors may bring actions seeking injunctive relief or civil penalties. 11 U.S.C. §§ 526(c)(3), (5).

It is important to note in relation to § 526(a)(4) that, in addition to the more general evidence about attorney misbehavior, Congress heard testimony to the effect that its addition of a means test that depends on debt levels, see 11 U.S.C. § 707(b)(2)(A),[2] would increase the likelihood that a bankruptcy attorney would counsel his/her client to take on debt before filing for bankruptcy. The Honorable Randall Newsome, United States Bankruptcy Judge for the Northern District of California, issued the following warning:

> The more debt that is incurred prior to filing, the more likely the debtor will qualify for Chapter 7. Perverse as it may seem, I can envision debtor's counsel advising their clients to buy the most expensive car that someone will sell them, and sign on to the biggest payment they can afford (at least until the bankruptcy is filed) as a way of increasing their deductions under § 109(h).

Bankruptcy Reform Act of 1998: Part I, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong., 2d Sess. 25 (1998)(Exhibit D).

Section 527 requires that debt relief agencies provide certain disclosures and notices to an assisted person, including (1) a description of the various types of bankruptcy

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[2] The means test is used to determine whether the presumption that a Chapter 7 filing is abusive should apply. See infra at 17 n. 5. If a filing is determined to be abusive, it is dismissed or converted to a Chapter 11 or 13 filing. 11 U.S.C. § 707(b)(1).

proceedings and the costs and benefits of proceeding under each chapter, (2) an explanation of the information that the debtor is to provide during the bankruptcy proceeding (e.g., an accurate accounting of assets and liabilities), and (3) a warning that the assisted person's failure to provide such information may result in the dismissal of the case or other sanction, including a criminal sanction. 11 U.S.C. § 527(a). A debt relief agency must also provide an assisted person with a separate specified notice explaining, *inter alia,* that the assisted person may proceed pro se or hire an attorney, or a bankruptcy petition preparer, and that the attorney or preparer must furnish the person with a "a written contract specifying what the attorney or bankruptcy petition preparer will do for you and how much it will cost." 11 U.S.C. § 527(b). In addition, except to the extent that it provides the information itself, a debt relief agency must provide an assisted person with reasonably sufficient information regarding valuation of assets and determining liabilities, income, and other information required to be provided in the proceeding. 11 U.S.C. § 527(c).

Section 528 provides that a debt relief agency shall execute a written contract with the assisted person explaining "clearly and conspicuously" the agency's services and fees. 11 U.S.C. § 528(a)(1). It also requires a debt relief agency to insert in any advertisements of bankruptcy assistance services or "assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure or inability to pay consumer debt" the following statement or a substantially similar one: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. §§

528(a)(4), (b). This disclosure requirement includes advertisements for "'federally supervised repayment plans' or 'Federal debt restructuring help' or other similar statements that could lead a reasonable consumer to believe that debt counseling was being offered when in fact the services were directed to providing bankruptcy assistance with a chapter 13 plan or other form of bankruptcy relief under this title." 11 U.S.C. § 528(b)(1)(B).

ARGUMENT

I. THE COURT LACKS JURISDICTION TO CONSIDER THE CLAIMS OF THE ANONYMOUS PLAINTIFFS.

Two of the plaintiffs have filed under fictitious names – John Doe and Mary Roe. They assert that they "are members of the public who wish to obtain legal advice from plaintiff attorneys . . . about possible bankruptcy and prebankruptcy planning, including their present and future assets, liabilities, income, income, and expenses." 1st Am. Compl. ¶ 10.

There is no legal basis for plaintiffs to file anonymously in this case. The Federal Rules of Civil Procedure require plaintiffs to disclose their names in the instrument that they file to commence a lawsuit. See Fed. R. Civ. P. 10(a) ("In the complaint the title of the action shall include the names of all the parties . . ."). "Public access to this information is more than a customary procedural formality." Doe v. Stegall, 653 F.2d 180, 185 (5th Cir. 1989). Instead, "[l]awsuits are public events," and the public has a legitimate interest in knowing all of the facts involved, including the identities of the parties. Doe v. Frank, 951 F.2d 320, 324 (11th Cir. 1992); accord Southern Methodist Univ. Assoc. of Women Law

Students v. Wynne & Jaffe, 599 F.2d 707, 712 (5th Cir. 1979) (recognizing the "general principle" that the "identity of the parties to a lawsuit should not be concealed"). Thus, the Federal Rules "make no provision for suits by persons using fictitious names or for anonymous plaintiffs." Nat'l Commodity & Barter Ass'n v. Gibbs, 886 F.2d 1240, 1245 (5th Cir. 1979); accord Southern Methodist Univ., 599 F.2d at 712.

As a general rule, the failure to identify a party by name in a Complaint constitutes a jurisdictional defect. A civil action "has not been commenced . . . unless and until it is filed in full compliance with Rule 10(a) of the Federal Rules of Civil Procedure which requires that the title of the action shall include the names of all parties." Doe v. United States Dept. of Justice, 93 F.R.D. 483, 484 (D. Colo. 1982). Thus, "absent permission by the district court to proceed anonymously . . . the federal courts lack jurisdiction over unnamed parties, as a case has not been commenced as to them." National Commodity and Barter Assoc., 886 F.2d at 1245.

Although, in certain limited circumstances, courts have recognized that parties may be permitted to proceed anonymously, "there is a strong presumption against allowing parties to use a psedudonym." Luckett v. Beaudet, 21 F. Supp. 2d 1029 (D. Minn. 1998). The "rare dispensation" of allowing parties to proceed anonymously is only justified in the "critical" case, James v. Jacobsen, 6 F.3d 233, 238 (4th Cir. 1993), or the "unusual case." Does I Thru XXIII v. Advanced Textile Corp., 214 F.3d 1058, 1067 (9th Cir. 2000). Thus, the "use of fictitious names is disfavored, and [the Court] has an independent duty to determine whether exceptional circumstances justify such a departure from the normal method of proceeding in federal courts." Doe v. City of Chicago, 360 F.3d 667, 669-70 (7th Cir. 2004) (citing Doe v. Blue Cross & Blue Shield United of Wisconsin, 112 F.3d 869, 872 (7th Cir. 1997)). Such exceptional circumstances have been found to exist where "the issues involved are of a sensitive and highly personal nature, such as birth control, abortion, homosexuality, or the welfare rights of illegitimate children or abandoned families." Southern Methodist Univ., 599 F.2d at 712-713 (alterations, footnotes, and quotations omitted).

In this case, plaintiffs have not not sought permission to proceed anonymously. Nor have they offered any basis for not disclosing their real names. Accordingly, this Court should dismiss the claims of the individual debtors for lack of jurisdiction.

II. THE BAPCPA DOES NOT VIOLATE THE FIRST AND FIFTH AMENDMENTS.

In Count IV, plaintiffs argue that the BAPCPA violates the First and Fifth Amendments, contending that it is unconstitutionally vague. As support for this claim, plaintiffs assert that the term "debt relief agency" is not defined in the Act. See 1st Am. Compl. ¶ 45. This is simply not true. As explained above, BAPCPA defines the term "debt relief agency," with certain exceptions not applicable here, as "any person" that, for a fee, "provides any bankruptcy assistance to an assisted person." 11 U.S.C. § 101(12A).[3] "Bankruptcy assistance" includes "providing information, advice, counsel . . . [and] legal

[3] A "person" is defined as an "individual, partnership or corporation." 11 U.S.C. § 101(41).

representation." 11 U.S.C. § 101(4A). Thus, while the definition of "debt relief agency" does not specifically mention attorneys, its plain language, when coupled with the definition of the term "bankruptcy assistance," clearly covers attorneys who provide "advice," "counsel," or "legal representation" with respect to a bankruptcy proceeding.

Aside from the statutory language used to define "debt relief agency" and "bankruptcy assistance," other provisions of the BAPCPA also indicate that Congress intended to include attorneys within the definition of "debt relief agency." For example, 11 U.S.C. § 526(d)(2) provides that no language in §§ 526, 527 or 528 shall be deemed to

> limit or curtail the authority or ability --
> (A) of a State or subdivision or instrumentality thereof to determine and enforce qualifications for the practice of law under the laws of the State, or
> (B) of a Federal Court to determine and enforce the qualifications for the practice of law before that court.

11 U.S.C. § 526(d)(2). If the debt relief agency restrictions did not apply to attorneys, this provision would be rendered meaningless.

In addition, § 527(b) specifically requires the written notice to also contain the following statements:

> IMPORTANT INFORMATION ABOUT BANKRUPTCY ASSISTANCE SERVICES FROM <u>AN ATTORNEY</u> OR BANKRUPTCY PETITION PREPARER. . . . THE LAW REQUIRES AN ATTORNEY OR BANKRUPTCY PETITION PREPARER TO GIVE YOU A WRITTEN CONTRACT SPECIFYING WHAT <u>THE ATTORNEY</u> OR BANKRUPTCY PETITION PREPARER WILL DO FOR YOU AND HOW MUCH IT WILL COST.

11 U.S.C. § 527(b) (emphasis in the form of underlining added). While this language does not explicitly state that an attorney is a debt relief agency, the reference to an attorney in connection with one of the specific obligations imposed on a debt relief agency (i.e., the provision of a written contract) strongly implies that an attorney falls within the definition of a debt relief agency. Indeed, the reference to the law requiring an attorney to provide a written contract to the debtor would make little sense unless an attorney were a debt relief agency.[4]

Thus, contrary to plaintiffs' allegation, the term "debt relief agency" is not vague. The term clearly encompasses an attorney who provides bankruptcy assistance to an assisted person.[5]

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[4] Even if the plain language of the statute left any room for doubt, the legislative history of the provision likewise demonstrates that Congress intended the term "debt relief agency" to encompass attorneys. In the Conference Report, Congress specifically found that there was "misconduct by attorneys and other professionals" in the bankruptcy system. 2005 U.S.C.C.A.N. at 92. See also supra at 5-6 (testimony in hearings regarding problems with practices by attorneys in bankruptcy proceedings). Moreover, in March 2005, while the BAPCPA was under consideration in the Senate, Senator Feingold offered an amendment to exclude attorneys from the definition of debt relief agency. 151 Cong. Rec. S2316 (March 9, 2005). That amendment was withdrawn by Senator Feingold in return for the adoption of other unrelated amendments. 151 Cong. Rec. S2453 (March 10, 2005).

[5] In their complaint, plaintiffs cite to an order issued by Judge Lamar W. Davis, the Chief Judge for the Bankruptcy Court in the Southern District of Georgia, which ruled that attorneys were not covered by the term "debt relief agency. 1st Am. Compl. ¶ 48. That order concedes that "the definition of debt relief agency is facially broad enough to cover bankruptcy preparers and attorneys" and "the inclusion of 'legal representation' in the scope of what a debt relief agency does certainly suggests a contrary result" to that which the court reached. Order at 5. The order, however, tries to avoid this clear reading of the statute by suggesting that "the inclusion of the term 'legal representation' in the definition of 'bankruptcy assistance' was Congress's effort to empower the Bankruptcy Courts presiding

II. SECTION 526(a)(4) DOES NOT VIOLATE THE FIRST AMENDMENT BECAUSE IT IS AN ETHICAL RULE WHICH SATISFIES THE GENTILE STANDARD APPLIED TO SUCH RULES.

In Counts I and III of their complaint, plaintiffs allege that Section 526(a)(4) violates the First Amendment because it is "vague, overbroad and creates a chilling effect upon lawyers whose duties include: discussing, receiving, and providing information to their clients." 1st Am. Comp. ¶ 41. See also id. ¶¶ 23-24. This challenge is based on misconceptions regarding both the scope of the restriction and the proper standard of review for such restrictions. As explained below, this restriction on advice is narrow and only prohibits an attorney from advising a debtor to take on additional debt because he or she intends to file for bankruptcy. Moreover, because this provision is an ethical rule, there is no basis for subjecting it to "strict scrutiny review." See Sable Communications of Cal, Inc. v. Sable, 492 U.S. 115, 126 (1988). Instead, it is subject to the more lenient test set forth in Gentile v. State Bar of Nevada, 510 U.S. at 1073.

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over a case with the authority to protect consumers" from "non-attorneys" who "often attempt to provide 'legal representation,' often to poorer, less educated, and more vulnerable citizens." Order at 5-6. This holding is misguided in at least two ways. First, as the order itself acknowledges, since the interpretation is not consistent with the plain language of this provision, there is no need to resort to legislative history. Exxon Mobil Corp. v. Allapattah Serv., Inc., 125 S.Ct. 2611, 2626 (2005). Second, as explained supra at 14 n.3, the legislative history demonstrates that Congress intended to include attorneys. In any event, the validity of the order is in serious question, inasmuch as it was issued by the bankruptcy judge sua sponte, in the absence of any pending case or controversy. The order has been appealed to the U.S. District Court of the Southern District of Georgia, Case No. 04:05cv00206(S.D. Ga.).

A. The Scope of the Advice Prohibited by Section 526(a)(4) Is Limited.

Contrary to plaintiffs' suggestion, this provision does not establish a general prohibition against advising an assisted person to incur more debt. Nor does it prohibit an attorney from advising an assisted person about what the law states. Instead, it prohibits a debt relief agency only from advising an assisted person "to incur more debt in contemplation" of filing a petition for bankruptcy. 11 U.S.C. § 526(a)(4)(emphasis added). The phrase "in contemplation of . . . filing a case under this title" is the key to understanding this provision, and as always, Congress's intention is the touchstone for interpretation, Chevron U.S.A. Inc. v. Natural Resources Defense Counsel, Inc., 467 U.S. 837, 842-43 (1984). Congress enacted the BAPCPA "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors;" it wanted to limit abuses of the bankruptcy system to mitigate the financial toll that bankruptcy filings were taking on creditors and the economy as a whole. See H.R. Rep. No. 109-31, 109th Cong., 1st Sess. at 1, reprinted in 2005 U.S.C.C.A.N. 88, 89, 91. In light of Congress's intention, the best interpretation of the "in contemplation" language is that it prevents an attorney from advising a debtor to take on debt because he or she intends to file for bankruptcy, as such advice is aimed at allowing the debtor to take unfair advantage of discharge (by running up debt primarily because it will not need to be repaid) or "game" the means test (by piling on enough debt to avoid a presumption of abuse, 11 U.S.C. § 707(b)(2)).[6] These opportunistic uses of bankruptcy are antithetical to the notions of "personal responsibility" and "integrity" that motivated Congress to pass the BAPCPA.

Section 526(a)(4) thus prohibits an attorney only from advising a debtor to take on debt because he or she intends to file for bankruptcy; it does not forbid an attorney from counseling a debtor to take on debt when the attorney would give the same advice even if the person were not contemplating filing for bankruptcy. See United States v. Wells, 283 U.S. 102, 110 (1931) (phase "in contemplation of death" in a tax statute governing gifts interpreted to mean "thought of death is the impelling cause of the transfer"). Thus, contrary to plaintiffs' assertion, it would not prohibit an attorney "to advise their clients [about] whether to refinance a home or obtain a mortgage with a lower rate of interest" (1st Am. Compl. ¶ 26) because an attorney would give that same advice to a person even if the person were not contemplating filing for bankruptcy. Likewise, § 526(a)(4) would not prohibit

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[6] Under the means test, an abuse of the bankruptcy system is presumed where the amount of the debtor's income, after deduction of certain expenses and other specified amounts, exceeds specified thresholds. See 11 U.S.C. § 707(b)(2)(A). Because the amount of secured and priority debt is one of the amounts deducted from income, increasing the amount of debt could reduce the amount of income under the means test, and thus allow an individual who would otherwise fall within the presumption of abuse to evade the presumption. Similarly, since the trigger for the presumption is based on the ratio of "available income" to the amount of "unsecured debt," increasing the amount of unsecured debt could also help an assisted person evade the presumption of abuse. See *Bankruptcy Reform Act of 1998: Part I*, Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong., 2d Sess. 25 (1998) (testimony of The Honorable Randall Newsome, United States Bankruptcy Judge for Northern District of California.) (Exhibit D).

advice to co-sign on a child's educational loan or to incur debt for emergency medical or dental care because such advice is not given because of the bankruptcy.[7]

Plaintiffs also misread the restriction in § 526(a)(4) regarding the payment of attorneys. Plaintiffs allege that this provision prohibits attorneys from advising their clients to pay for legal assistance in filing for bankruptcy. 1st Am. Compl. ¶ 29. This is incorrect. As the House Report explains, the second clause of § 526(a)(4) "prohibits [a debt relief] agency from . . . advising an assisted person or prospective assisted person <u>to incur additional debt</u> in contemplation of filing for bankruptcy relief or for the purpose of paying fees for services rendered by an attorney or petition preparer in connection with the bankruptcy case." H.R. Rep. No. 109-31(I), at 66 (2005) (emphasis added) . Indeed interpreting this provision as prohibiting advice to pay for legal assistance would be inconsistent with 11 U.S.C. § 528(a)(1)(B), which requires that a debt relief agency provide an assisted person with a

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[7] Since Section 526(a)(4) has a narrower meaning than suggested by plaintiffs, it is not clear that they have standing. <u>See</u> <u>Lujan v. Defenders of Wildlife</u>, 504 U.S. 555, 560 (1992); <u>National Council for Improved Health v. Shalala</u>, 122 F.3d 878, 882 (10th Cir. 1997) (plaintiff lacked standing to bring a First Amendment challenge to regulations governing labeling of dietary supplements with health claims where they did not "advance a single claim they wish to make, or receive, which could be prohibited under the health regulation."). In addition, because plaintiffs have not alleged that they intend to give the type of advice which is prohibited, there is a question whether their challenge to Section 526(a)(4) is ripe. The ripeness requirement insures that courts abstain from "entangling themselves in abstract disagreements." <u>Abbott Labs. v. Gardner</u>, 387 U.S. 136, 148 (1967). As this Court noted in <u>Minnesota School Board v. EEOC</u>, 184 F. Supp. 2d 899, 906 (D. Minn. 2001), "judicial resolution of a legal question fit for judicial review yet portending no immediate hardship would constitute little more than a law review article." <u>Id</u>. at 906 (quoting <u>Nebraska Public Power Dist. v. MidAmerican Energy</u>, 234 F.3d 1032, 1039 (8th Cir. 2000)).

written contract which sets forth "the fees or charges for such services."

In short, plaintiffs' challenge to Section 526(a)(4) is based on misreading of that provision.

B. The Supreme Court Has Held That Ethical Restrictions on Attorney Speech Are Subject to the Balancing Test.

The Supreme Court has recognized that the government may properly regulate some attorney speech, particularly when that speech breaches professional duties of competency or loyalty to a client, or otherwise abuses the special trust that attorneys hold as agents of the justice system. See Gentile v. State Bar of Nevada, 510 U.S. at 1073; Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 460-62 (1978). See also In re Sawyer, 360 U.S. 622, 646-47 (1959)(concurring opinion of Justice Stewart)("obedience to ethical precepts may require abstention from what in other circumstances might be constitutionally protected speech.").

In Ohralik, a state bar association had brought a disciplinary action against an attorney for soliciting accident victims in person for the purposes of representing them on a contingent fee basis. Applying a balancing test, the Supreme Court found that the disciplinary action did not violate the attorney's First Amendment rights because the government has a "special responsibility for maintaining standards among the members of the licensed professions." Ohralik, 436 U.S. at 460. The Court held that this interest "in regulating lawyers is especially great since lawyers are essential to the primary governmental function of administering justice, and have historically been 'officers of the court.'" Id. (quoting Goldfarb v. Virginia State Bar, 421 U.S. 773, 792 (1975)). As the Court stressed, lawyers are not only "selfemployed businessmen," but also are "trusted agents of their clients" and "assistants to the court in searching for a just solution to dispute." Id. (quoting Cohen v. Hurley, 366 U.S. 117, 124 (1961)).

The Supreme Court applied this same more lenient balancing test in evaluating the constitutionality of a gag order issued by a state court in a criminal case. Gentile v. State Bar of Nevada, 501 U.S. at 1073. In that case, Chief Justice Rehnquist found that lawyers are "subject to ethical restrictions on speech to which an ordinary citizen would not be." Id. at 1071. Thus, while the Court found that the order was void for vagueness, it did not apply strict scrutiny. Instead, Chief Justice Rehnquist held that the speech of attorneys "may be regulated under a less demanding standard than established for regulation of the press." Id. Under this more lenient test, courts balance the First Amendment rights of attorneys "against the government's 'legitimate interest in regulating the activity in question.'" Id. at 1075. The Court found that "a constitutionally permissible balance"was achieved because the ethical restrictions prohibit speech that would create a substantial likelihood of material prejudice to judicial proceedings and impose "only narrow and necessary limitations on lawyers' speech." Id. Accord United States v. Scarfo, 263 F.3d 80, 92-93 (3d Cir. 2001).

In Cantella v. Stovitz, 263 F. Supp.2d 1064, 1076 (N.D. Cal. 2005), a court recently applied this balancing test to an ethical restriction on advice given by attorneys. The court upheld Section 6068(c) of the California Business and Professions Code which provides that "it is the duty of an attorney . . . to counsel . . . those actions, proceedings, or defenses only as appear to him or her legal or just." Cal. Bus. & Prof. Code § 6068(c). The court held that the "task of the court" in reviewing such ethical standards was to "'weigh[] the State's interest in regulation . . . against [the] lawyer's First Amendment interest in the kind of speech at issue." Id. (quoting Gentile, 501 U.S. at 1073). The court upheld the restriction because it found that the state "had a strong interest in ensuring that its attorneys adhere to the highest standard of conduct" and that "[c]ounseling illegal or unjust actions or pleadings has a direct, adverse effect on the administration of the courts." Id. at 1076.

Therefore, in reviewing First Amendment challenges to ethical rules, courts balance the interests of the government in protecting judicial proceedings against the First Amendment rights of the attorneys. Applying this test, courts should uphold ethical rules restricting speech by an attorney when the regulated speech would create a substantial likelihood of material prejudice to a judicial proceeding and the rule is narrowly tailored to accomplish its purpose. Gentile, 501 U.S. at 1075-76.

C. Restricting Advice to Incur Further Debt in Contemplation of Bankruptcy Is An Ethical Rule Which Satisfies the Gentile Standard.

Section 526(a)(4) can be upheld under the Gentile test as such an ethical restriction. Just as the restrictions at issue in Gentile, Ohralik, and Cantella sought to protect the integrity of the legal system, § 526(a)(4) can be seen as a method for protecting the integrity and fairness of the bankruptcy system. More specifically, § 526(a)(4) seeks to protect two driving principles of the bankruptcy system, namely ratable distribution to creditors according to the priorities set forth in the Code, and a discharge to provide a fresh start for honest debtors. United States v. Fox, 95 U.S. 670, 672 (1877).

First, it protects creditors. Improperly enlarging the pool of pre-existing debt subverts the principle of ratable distribution, because it dilutes the dividend that would otherwise be payable to prior creditors. Section 526(a)(4) protects creditors from such dilution by deterring advice which would encourage debtors to accumulate debt simply to take advantage of the discharge or to "game" the new debt-triggered means test. Section 526(a)(4) also protects creditors by reducing the likelihood that a court will unwittingly discharge debts that Congress has determined, through the Code, see 11 U.S.C. § 707(a),(b), ought not be discharged.[8]

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[8] Ensuring that attorneys take their responsibilities to clients seriously and advocate only sensible courses of action is of particular importance in the bankruptcy context for an additional reason: Unlike most other areas of law, courts have permitted debtors to assert reasonable reliance on the advice of counsel as an excuse to avoid punishments for improper behavior under the Bankruptcy Code. See, e.g., Norwest Bank Neb., N.A. v. Tveten, 848 F.2d 871, 876 (8th Cir. 1988); In re Adeeb, 787 F.2d 1339, 1343 (9th Cir. 1986). (This defense has typically been invoked for denials of discharge due to fraudulent filings or transfers of assets.) Section 526(a)(4) helps to account for the fact that debtors may have less incentive to be careful about their bankruptcy-related actions (because they can avoid punishment by asserting reliance on their attorneys' advice) by enhancing attorneys' incentives not to give improper advice.

A similar scenario is found in the tax context, where taxpayers are immune to penalty under 26 U.S.C. § 6662 if their action was prompted by reasonable good faith reliance on professional advice. See 26 C.F.R. § 1.6664-4. Accompanying this taxpayer exemption from penalty is a well-developed set of ethical rules for advice given by tax professionals, and corresponding penalties for violations of the rules in question. See 31 C.F.R. § 10.33-.37; id. § 10.50-.52. A similar system of ethical restrictions also exists in patent practice, where good-faith reliance on a patent counsel's opinion may constitute a defense to willful patent infringement or be germane to equitable intervening rights under 35 U.S.C. § 252. See, e.g., Ortho Pharmaceutical Corp. v. Smith, 959 F.2d 936, 943-45 (Fed. Cir. 1992); see also 37 C.F.R. §§ 10.23, 10.85, 10.89, and 10.130.

Second, § 526(a)(4) protects debtors from attorneys who would lead them to undertake abusive practices which would result in nondischargeability of a particular debt or denial of the dischargeability entirely. Certain consumer debts incurred on the eve of bankruptcy are presumed fraudulent and, therefore, nondischargeable under § 523(a)(2)(c). Additionally, even prior to the recent amendments, incurring additional debts prior to filing a bankruptcy petition could constitute impermissible abuse of the bankruptcy system, i.e., "substantial abuse," and result in the dismissal of a petition. See, e.g., In re Price, 353 F.3d 1135, 1139-1140 (9th Cir. 2004) (determination of "substantial abuse" would include a consideration of, among other things, whether the debtor has obtained "cash advancements and consumer goods on credit exceeding his or her ability to repay them" or "has engaged in eve-of-bankruptcy purchases"). As amended, the Code lowers the threshold that must be met for a bankruptcy court to dismiss a debtor's petition from "substantial abuse" to "abuse" of Chapter 7. See 11 U.S.C. § 707(b)(1). Under the revised Code, then, accruing greater debt in contemplation of bankruptcy, either to take advantage of discharge or "game" the means test, is more likely to lead to a dismissal of a petition. See § 707(b)(3)(B). Thus, it is more important than ever to deter unscrupulous attorneys from advising their clients to "incur debt in contemplation" of bankruptcy.[9]

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[9] Other provisions of Section 526(a) likewise plainly serve the purpose of protecting debtors from various forms of unprofessional or unethical conduct by bankruptcy practitioners including failing to perform agreed-upon services, 11 U.S.C. § 526(a)(1), making untrue or misleading statements, § 526(a)(2), or misrepresenting the lawyer's services or the risks and benefits of becoming a debtor, § 526(a)(3).

A lawyer's advice to incur debt in such cases would be substantially likely to prejudice the outcome of the bankruptcy proceeding. Incurring such abusive debts would dilute the ratable distribution to creditors or, in some cases, result in no recovery at all for creditors. To prevent such abuse in a particular case, creditors, the United States Trustee, and the court would have to expend substantial resources to dismiss the abusive filing. 11 U.S.C. § 707(a),(b). Such a dismissal may in turn prejudice an honest debtor who had relied on the advice of his attorney.

An attorney's advice to an assisted person to incur more debt to pay for his/her services with respect to the filing of a bankruptcy petition also presents a substantial likelihood of prejudice with respect to the outcome of the bankruptcy proceeding. The data submitted by the United States Trustee in Lamie v. United States Trustee, 540 U.S. 526 (2004), which held that the Code generally does not allow the attorney for Chapter 7 debtors to be compensated from the estate, reveal that 96% of chapter 7 cases closed during 2002 had no assets in the estate to pay anything to counsel or creditors.[10] Brief of the Solicitor General, 2003 WL 21839367, at 38-39. This helps explain why Congress adopted the restriction on debtors' attorneys not to advise their clients to incur more debt to pay them. In 96% of chapter 7 cases, debtors' attorneys will have counseled their clients and will know (or should know) that their clients' bankruptcy cases will be "no asset" cases, which means that a creditor who provided the money for the filing will recover nothing. Prohibiting

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[10] The Bankruptcy Code permits a debtor attorney to be paid from the estate if he is employed by the trustee with approval of the bankruptcy court. 11 U.S.C. § 327.

attorneys from advising clients to incur debts to pay them reduces the likelihood that a debtor will shift the cost of attorneys' fees to an unsuspecting creditor.

Section 526(a)(4) is narrowly tailored to prevent these harms to bankruptcy proceedings because it does not limit more speech than is necessary to accomplish this purpose. It does not prohibit an attorney from advising a client on what the law is or discussing the standards for determining when debt is abusive. Nor does it prevent an attorney from advising a debtor to incur further debt in all cases. Instead, it simply prohibits an attorney from advising a client to incur debt where the motivation for incurring such debt is that the debtor will be filing for bankruptcy. A prohibition against counseling debtors to incur debt in contemplation of seeking a bankruptcy discharge is thus a legitimate ethical restriction on attorneys, designed to safeguard the integrity of the system.[11]

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[11] In their complaint, plaintiffs cite Legal Services Corp. v. Velazquez, 531 U.S. 533 (2001). 1st Am. Compl. ¶ 30. The restriction at issue here is not analogous. In that case, the challenged provision prohibited a legal services organization funded by the Legal Service Corporation ("LSC") from representing clients in any effort to amend or otherwise challenge existing welfare laws. As interpreted by LSC, the restriction prevented an attorney from arguing to a court that a state statute conflicts with a federal statute or that a state or federal statute by its terms or application violated the United States Constitution. Id. at 537. The Supreme Court found that this restriction was unconstitutional because it prevented legal services attorneys from raising permissible challenges to the welfare law. Id. at 539. The Court found this restriction limited the ability of legal services attorney to represent their clients and impaired the judicial function itself by creating "lingering doubts whether the truncated representation had resulted in complete analysis of the case." Id. at 546. In sharp contrast, the restriction at issue here only prohibits advice to incur debts which would be abusive or seek to avoid the means test. Thus, it protects the client and the integrity of the judicial proceedings.

Accordingly, Section 526(a)(4) should be upheld under the Gentile test.[12]

III. SECTION 528's DISCLOSURE REQUIREMENTS ARE CONSTITUTIONAL UNDER ZAUDERER.

In Count II of their complaint, plaintiffs contend that § 528 violates the First Amendment because it "prohibit such groups as such as Milavetz, Gallop and Milavetz, P.A. from engaging in certain marketing communications." 1st Am. Compl. ¶ 34. This claim has no merit. The First Amendment does not prohibit all regulation of advertisements, and the disclosure requirements imposed by §§ 528(a)(4) and (b)(2) satisfy the standard announced in Zauderer, 471 U.S. at 651.

In Zauderer, the Supreme Court upheld the Ohio Supreme Court's decision to punish a lawyer for failing to make a disclosure in an advertisement. 471 U.S. at 650. The lawyer placed an advertisement in a paper which read, "if there is no recovery, no legal fees are owed by our clients." Id. at 652. The Ohio Supreme Court punished the lawyer, pursuant to the Ohio disciplinary rules for lawyers, for failing to disclose in the advertisement that clients

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[12] Even if this Court were to find that strict scrutiny should be applied, 11 U.S.C. § 526(a)(4) should be upheld. Under the strict scrutiny test, the government "may regulate the content of speech in order to promote a compelling interest if it chooses the least restrictive means to further that interest." Sable, 492 U.S. at 126. There can be no dispute that prevention of abuse of the bankruptcy proceeding is a compelling government interest. Congress found that the increase in bankruptcy had "an adverse financial consequence on our nation's economy" and that abuse of the bankruptcy system was more widespread than many would have estimated. 2005 U.S.C.C.A.N. at 91. It further found that bankruptcy system had "loopholes and incentives that allowed and – sometimes – even encouraged opportunistic personal filings and abuse" and that misconduct by attorneys was part of the problem. Id. at 92. In placing a restriction on advice to incur further debt, Congress chose the least restrictive means. It only prohibited advice to incur debt in contemplation of bankruptcy. See supra at 16-17.

might owe costs if there were no recovery, even if they would not owe legal fees. Id. at 632, 635-636. The lawyer challenged the punishment, arguing that the disclosure requirement violated the First Amendment. Id. at 636. The Supreme Court sided with the state.

The Supreme Court recognized that there were "material differences between disclosure requirements and outright prohibitions on speech." Id. at 650. It explained that "[b]ecause the extension of First Amendment protection to commercial speech is justified principally by the value to consumers of information such speech provides, appellant's constitutionally protected interest in *not* providing any particular factual information in his advertising is minimal." Id. at 651 (emphasis in the original) (internal citation omitted). The Court then set out the governing standard, deciding that "an advertiser's rights are adequately protected as long as disclosure requirements are reasonably related to the State's interest in preventing the deception of consumers" and are not "unjustified or unduly burdensome." Id. Finally, the Court concluded that the state's disclosure requirement "easily passe[d] muster" under this reasonableness standard given the "self-evident" possibility of deception. Id. at 652.[13]

Section 528's disclosure requirements satisfy Zauderer's standard. They do not impose

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[13] See also In re R.M.J., 455 U.S. 191, 201 (1982) ("[A] warning or disclaimer might be appropriately required, even in the context of advertising as to price, in order to dissipate the possibility of consumer confusion or deception."); Bates v. State Bar of Arizona, 433 U.S. 350, 384 (1977) (noting that an attorney's advertisement may require "a warning or disclaimer . . . so as to assure that the consumer is not misled"); Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, 433 U.S. 350, 384 (1977) (noting that "information, warnings, and disclaimers" on advertisements may be necessary to prevent deception).

an outright ban on any particular advertising by debt relief agencies. Instead, they merely obligate debt relief agencies to place the following statement in advertisements that are actually, if not explicitly, touting bankruptcy assistance services: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. §§ 528(a)(4), (b)(2).[14] This required disclosure is reasonably related to the government's interest in preventing deception and is not unduly burdensome. Evidence before Congress indicated that some bankruptcy lawyers did not mention in their advertisements that their ability to make "debts disappear" derived from the use of the bankruptcy process. See, e.g., Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, Hearing on H.R. 975 before House Judiciary Comm., 108th Cong., 1st Sess. 55 (2003); (Exhibit A); Bankruptcy Reform Act of 1998 (Part III), Hearing on H.R. 3150 before House Judiciary Comm., 105th Cong., 2d Session 90-92 (1998) (Exhibit B). Such advertisements easily could have misled laypeople into thinking that debts could be erased without payment or bankruptcy. The potential for deception is apparent, then, and the sort of advertisements targeted by this amendment resemble the advertisement at issue in Zauderer, where an omission from a lawyer's advertisement created the "self-evident" possibility of deception. Zauderer, 471 U.S. 652. The disclosure requirement reasonably relates to the government's interest in forestalling deception by alerting people that a lawyer may use bankruptcy as a means to help them, even

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[14] In their complaint, plaintiffs complain that they want to continue to identify themselves as bankruptcy attorneys in such advertisements. 1st Am. Compl. ¶ 11. As long as plaintiffs include the required statement, nothing in Section 528 prevents plaintiffs from also describing themselves as attorneys or stating that they can provide legal advice.

though his or her advertisement does not say so. Also, it is not unduly burdensome: It consists simply in inserting a two-line admonition into certain advertisements.

Because the disclosure requirements in § 528 meet the Zauderer test, the Court should dismiss this claim pursuant to Rule 12(b)(6).

CONCLUSION

For the foregoing reasons, the Court should dismiss plaintiffs' complaint.

Respectfully submitted,

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