

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.)
_____)

**REPLY
IN SUPPORT OF
MOTION TO DISMISS**

INTRODUCTION

In enacting the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Congress found there was "abuse by attorneys and other professionals." H.R. Rep. No. 109-31, 109th Cong., 1st Sess. 5 (2005), reprinted at 2005 U.S.C.C.A.N. 88, 92. To correct this abuse, Congress included "provisions strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." Id. at 103. Plaintiffs challenge the constitutionality of two of those standards: the prohibition against advising a consumer debtor to "incur more debt in contemplation of filing" for bankruptcy, 11 U.S.C. § 526(a)(4), and the disclosure requirements in advertisements for bankruptcy assistance, 11 U.S.C. § 528(a)(4) and (b)(2). None of plaintiffs' arguments in their opposition supports their claims.

I. SECTION 526(a)(4) DOES NOT VIOLATE THE FIRST AMENDMENT BECAUSE IT IS AN ETHICAL RULE WHICH SATISFIES THE GENTILE STANDARD.

Section 526(a)(4) does not violate the First Amendment because it is an ethical

rule that satisfies the balancing test applied to such rules, Gentile v. Bar of the State of Nevada, 510 U.S. 1030, 1075 (1992). See Memorandum of Law in Support of Motion to Dismiss ("Def. Mem."), at 15-26.

In their opposition, plaintiffs do not dispute that § 526(a)(4) would be upheld as constitutional if the Gentile balancing test is applied. Instead, they argue that the strict scrutiny test, which requires the government to prove that the restriction serves a compelling state interest and is the least restrictive means to achieve that interest, should be applied. Memorandum of Law ("Pl. Mem.") at 3. Plaintiffs base this argument on two erroneous assumptions: (1) that the Gentile test only applies to commercial and public speech by attorneys and not to advice (id. at 3-5), and (2) that § 526(a)(4) is not an ethical rule for purposes of the Gentile test unless there is "an independent rule" which prohibits "incurring more debt in contemplation of" filing a bankruptcy petition. Id. at 5. Neither assumption is valid. Thus, while defendant does not concede that § 526(a)(4) could not be upheld under the strict scrutiny test (see Def. Mem. at 26 n. 12), this Court does not need to reach that issue because the Gentile test applies.

A. The Gentile Test Is Not Limited To Commercial and Public Speech.

Nothing in Gentile remotely suggests that the standard is limited to commercial or public speech by an attorney. To the contrary, the Court noted that leniency traditionally has permeated its review of ethical restrictions on lawyers "even in an area far from the courtroom and the pendency of a case." Gentile, 510 U.S. at 1073. Indeed, Gentile has

been described as providing the standard for reviewing restrictions on attorneys' speech "in general." United States v. Scarfo, 263 F.3d 80, 92-93 (3rd Cir. 2001). In fact, in Canatella v. Stovitz, 365 F. Supp. 2d 1064, 1071-1072, 1076 (N.D. Cal. 2005), the court specifically applied the Gentile's standard to § 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). Section 526(a)(4) resembles § 6068(c), of course, in that both restrict the advice that a lawyer can give to a client prior to the initiation of a legal proceeding.

None of the cases cited by plaintiffs offers support for their contention that a stricter test should be applied to ethical restrictions on advice. Board of Trustees of the State University of New York v. Fox, 492 U.S. 469 (1989), did not involve a challenge to an ethical rule for attorneys. Instead, it involved a challenge to a regulation prohibiting commercial entities from selling certain goods or services on State Universities campuses Id. at 472. Students and a company selling housewares challenged the rule as applied and alleged that it was overbroad because it prohibited non-commercial speech "such as tutoring, legal advice and medical consultation provided (for a fee) in students' dormitory rooms." Id. at 482. The Supreme Court remanded the case to the district court with instructions to consider plaintiffs' "as applied" challenge before it addressed the "overbreadth" claim. Id. at 486. Plaintiffs apparently try to find some support for their

contention that strict scrutiny should be applied from the Court's statement that "legal advice" was not commercial speech. Id. at 482. But nothing in the decision states or suggests that restrictions on "legal advice" or other non-commercial speech by an attorney are always subject to the strict scrutiny test. Indeed, the Supreme Court's subsequent decision in Gentile held that the balancing test applied by Ohralik v. Ohio State Bar Ass'n 436 U.S. 447 (1978), also applied to non-commercial speech by attorneys.

Legal Services Corp. v. Velazquez, 531 U.S. 533 (2001), is also inapposite. 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 violates 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 laws. Id. at 539. In that case, unlike here, the restriction was not an ethical restriction seeking to protect the integrity of the judicial system. The Court found the LSC restriction unconstitutional because it harmed clients and the judicial system by preventing a legal services attorney from bringing legitimate suits on behalf of clients. The restriction here, on the other hand, seeks to protect clients and the integrity of the judicial proceedings. See infra at 6-9.

Plaintiffs' reliance on New York State Bar Ass'n v. Reno, 999 F.Supp. 710 (N.D.N.Y. 1998), is likewise misplaced. In that case, plaintiff challenged a statute that made it a crime for an attorney to counsel or assist an individual to dispose of certain assets to qualify for Medicare. Unlike here, there was no contention that the prohibition was an ethical restriction to protect the client and the integrity of the judicial system.

Accordingly, there is no support for plaintiffs' contention the ethical restrictions on advice should not be evaluated under the Gentile test.

B. § 526 Is An Ethical Rule Because It Protects Client Debtors and the Integrity of the Judicial Proceedings.

Plaintiffs also assert that § 526(a)(4) cannot be an ethical rule unless incurring "more debt in contemplation" of filing for bankruptcy is itself illegal. This argument attempts to equate the Gentile test with the test applied to prohibitions on counseling another to engage in illegal conduct. Prohibitions on counseling another to engage in illegal conduct, however, are not reviewed under the Gentile standard. Instead, courts have held that such counseling is "unprotected speech" and, as such, is reviewed under the even more lenient rational basis test. See United States v. Solomon, 825 F.2d 1292, 1297 (9th Cir. 1987) (the First Amendment did not protect an attorney who advised and assisted in the creation of illegal tax shelters); United States v. Buttorff, 572 F.2d 619, 624 (8th Cir. 1978) (The First Amendment does not protect counseling others to violate the law.).

Thus, the determination of whether § 526(a)(4) is an ethical rule does not turn on

whether incurring more debt in contemplation of filing for bankruptcy is itself illegal. Instead, an ethical rule is a rule designed to protect "the integrity and fairness" of the judicial system, Gentile 501 U.S. at 1075. Section 526(a)(4) protects this interest by protecting debtors from receiving advice that could result in the denial of relief and by protecting the bankruptcy system from abuse and attempts to circumvent the means test by incurring additional secured or unsecured debt. Def. Mem. at 21-26.

Plaintiffs dismiss the need to protect these interests by asserting that § 526(a)(4) is overbroad and that "much debt incurred prior to filing is not fraudulent." Pl. Mem. at 12.¹ This argument is misguided. First, it ignores that the harm here is not limited to fraud. Aside from fraudulent debt, 11 U.S.C. § 523(a)(2), incurring additional debt prior to filing a bankruptcy petition can be impermissible under 11 U.S.C. § 707(b) and result in the dismissal of a petition.² Because BAPCPA amends the Code by lowering the threshold that must be met for a bankruptcy court to dismiss a debtor's petition from

¹ Plaintiffs' reliance on the court's use of the "badge of fraud" test in Whitney v. Whitney, 107 B.R. 645 (Bankr. D. Minn. 1989), is misplaced. Whitney did not address the issue of incurring additional debt in contemplation of bankruptcy. Instead, it addressed the issue of whether the debtor's purchase of a homestead with otherwise non-exempt assets was fraud. Id. at 652. The court found that it was not fraud based on the "strong" policy "in favor of protecting homestead." Id.

² Prior to the enactment of BAPCPA, determination of "substantial abuse" included 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." See, e.g., In re Price, 353 F.3d 1135, 1140 (9th Cir. 2003); U.S. Trustee v. Harris, 960 F.2d 74, 76-77 (8th Cir. 1992); In re Rathbun, 309 B.R. 901, 904 (Bankr. N. D. Tex 2004); In re Ailello, 284 B.R. 756, 761 (Bankr. E.D.N.Y 2002).

"substantial abuse" to "abuse" of Chapter 7, 11 U.S.C. § 707(b)(1), it is even more critical to deter attorneys from advising clients to intentionally incur debt in contemplation of filing for bankruptcy.

Moreover, accruing greater debt in contemplation of bankruptcy might be used to circumvent the means test. 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.) Under the means test, 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 the debtor's disposable 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 in some cases 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.

Second, while some remedies for such abuse existed prior to BAPCPA, § 526(a)(4) expands the available remedies. The remedy provided by the Code for fraudulent debts is to deny the debtor discharge of a particular debt, 11 U.S.C. § 723, and

the remedy for abusive filings is to dismiss the petition as abusive, 11 U.S.C. § 707.

Those remedies penalize a client who relied upon his attorney's advice and incurred such debt. Section 526(a)(4) seeks to avoid these injuries by allowing debtors to seek

compensation from their attorneys when they are injured by such advice. 11 U.S.C.

§ 526(c)(2). It thus addresses the attorney's conduct directly. It further allows the Court to enjoin or impose civil penalties on an attorney who intentionally such advice or engaged in a consistent pattern of violating § 526(a)(4). 11 U.S.C. § 526(c)(5).³

Third, contrary to plaintiffs' claim, § 526(a)(4) is narrowly tailored to meet the government's interest. In their opposition, plaintiffs do not dispute that advice to incur more debt in the context of allowing the debtor to take unfair advantage of discharge (by running up debt primarily because it will not need to be repaid) or to "game" the means test (by piling on enough additional secured or unsecured debt to avoid the presumption of abuse), 11 U.S.C. § 707(b)(2), would be detrimental to clients as well as the integrity of bankruptcy system. Instead, plaintiffs argue that in certain instances advising a client to incur additional debt may be legitimate and not abusive. Pl. Mem. at 13. Plaintiffs cite to examples in which a client contemplating bankruptcy may need to seek medical

³ Plaintiffs also allege there is no need for § 526(a)(4) because Bankruptcy Rule 9011 already provides sanctions against attorneys for substantial abuse. The remedies provided by § 526(a)(4) are broader than those provided by Rule 9011 in that they allow a debtor to seek compensation, a State to bring an enforcement action, and the Court to impose civil penalties. 11 U.S.C. §§ 526(c)(2), (3), (5). Moreover, unlike Rule 9011, the conduct covered is not limited to filings in court.

treatment or surgery, to purchase a car because to his/her car becomes inoperable, or to co-sign a student loan for a child. Affidavit of Barbara Nevin, ¶¶ 10, 22; Pl. Mem. at 13.

While plaintiffs label these examples as examples of "pre-bankruptcy planning," the decisions to incur debt in those cases are not made because the debtor plans to file for bankruptcy. As previously explained, § 526(a)(4) is not a general prohibition against incurring more debt prior to bankruptcy. Def. Mem. at 16-19. Instead, it prohibits advice "to incur more debt in contemplation" of filing a petition for bankruptcy. The "in contemplation" language prevents an attorney 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) (phrase "in contemplation of death" in a tax statute governing gifts interpreted to mean "though of death is the impelling cause of the transfer.").

Accordingly, this Court should uphold § 526(a)(4) under the Gentile test.

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

Plaintiffs also challenge the requirement that attorneys include the following statement, or a substantially similar one, in their advertisements of bankruptcy assistance: "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). As previously explained, courts review such disclosure requirements under a relaxed standard. Def. Mem. at 26-29. To be

constitutional, the disclosure need only be "reasonably related" to the government's "interest in preventing deception of consumers" and not unduly burdensome. Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 651 (1985). Section 528's disclosure requirements for advertisements satisfy Zauderer's standard. 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. Def. Mem. at 5-6. The requirement ameliorates that problem by ensuring that potential clients know that bankruptcy is an option that attorneys may recommend.

Plaintiffs argue that § 528 does not meet the Zauderer test because requiring an attorney to insert this statement in advertisements can be misleading in certain instances. Specifically, plaintiffs assert that such a statement can be misleading when (1) the attorney does not regularly handle bankruptcy matters or (2) the attorney represents only creditors in bankruptcy proceedings. Pl. Mem. at 18-19.

This argument is based on a misreading of the statute. Contrary to plaintiffs' suggestions, § 528 requires only attorneys who are implicitly or explicitly touting "bankruptcy assistance services" or assistance with respect to relief from "credit defaults, eviction proceedings, excessive debt, debt collection pressures, or inability to pay any consumer debt" to include the disclosure statement in advertisements. 11 U.S.C. § 528(a)(4), (b)(2)(B). Thus, this section does not compel an attorney who has provided

bankruptcy assistance to a single client or who does not tout "bankruptcy assistance" in advertisements to insert any disclosures in advertisements.

Plaintiffs' assertion that attorneys who only represent creditors would need to insert the two-line text also incorrect. This argument is apparently based on plaintiffs' belief that the definition of "bankruptcy assistance," 11 U.S.C. § 101(4)(A), is broad enough to encompass advertisements by individuals who provide services to creditors. This is an unnatural reading of the term "bankruptcy assistance." Congress passed the statute to address deficiencies in the conduct of attorneys representing consumer debtors in bankruptcy, see, e.g., 2005 U.S.C.C.A.N. at 92 (mentioning misconduct by attorneys in the filing of cases); 103 (describing the standards as applying to "attorneys and others who assist consumer debtors with their bankruptcy cases"). The statute should be interpreted in light of this purpose. Chapman v. Houston Welfare Rights Org., 441 U.S. 600, 607-608 (1979).

Plaintiffs also assert that the disclosure may increase the cost of an advertisement by some unspecified amount. Any such increase in cost, however, is not unduly burdensome and is outweighed by the public benefit from insuring that consumers are given the specified notice.

Accordingly, the two-sentence disclosure statement is not misleading and the disclosure is reasonably related to preventing deception.

III. THE TERM "DEBT RELIEF AGENCY" INCLUDES ATTORNEYS WHO PROVIDE BANKRUPTCY ASSISTANCE TO ASSISTED PERSONS.

Plaintiffs' statutory claim that an attorney who provides bankruptcy assistance is not a "debt relief" agency is inconsistent with the plain language of the statute and its legislative history. Def. Mem. at 12-14. The BAPCPA 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). Since "bankruptcy assistance" is defined to include "providing information, advice, counsel . . . or [] legal representation[,]" 11 U.S.C. § 101(4A), attorneys who represent consumer debtors in bankruptcy proceedings are clearly included.

Despite this plain language, plaintiffs assign significance to the fact that the definition specifically mentions bankruptcy petition preparers but not attorneys.⁴ They suggest that this creates a negative inference that attorneys are not included in the definition. Pl. Mem. at 15-16. The statutory language and legislative history described above rebut any alleged negative inference. Moreover, where, as here, the plain language of an Act is broad enough to encompass attorneys, the courts have refused to imply an exclusion. For example, in Heintz v. Jenkins, 514 U.S. 291, 298 (1995), the Court held that lawyers who regularly engaged in litigation to collect consumer debts fell within the definition of "debt-collector" under the Fair Debt Collection Practices Act even though

⁴ They also argue that the Court should not read the term to include attorneys under the doctrine of constitutional avoidance. Pl. Mem. at 15. This argument, however, erroneously assumes that the provisions are unconstitutional if the term is read to include attorneys. As explained supra at 1-11, plaintiffs' constitutional challenges have no merit.

the definition did not mention "lawyers" or the "practice of law." Similarly, in Goldfarb v. Virginia State Bar, 421 U.S. 773, 786 (1975), the Supreme Court refused to imply an exemption for attorneys in the Sherman Act, which prohibits those engaged in a "trade or commerce" from price fixing. As the Supreme Court emphasized, "our cases have repeatedly established that there is a heavy presumption against implicit exemptions." Id. at 787. That presumption applies with particular force here because BAPCPA expressly excepted from the definition of "debt relief agencies" certain other types of persons or organizations (i.e. nonprofit organizations). See 11 U.S.C. § 101(12A). That Congress provided for such exceptions and did not exempt attorneys shows that attorneys who provide bankruptcy assistance to assisted persons are not exempt from the notice requirements and restrictions on "debt relief agencies." Detweiler v. Pena, 38 F.3d 591, 594 (D.C. Cir. 1994) ("Where a statute contains explicit exceptions, the courts are reluctant to find other implicit exceptions.").

Thus, the term "debt relief agency" encompasses an attorney who provides bankruptcy assistance to an assisted person.

IV. THE CLAIMS OF THE ANONYMOUS PLAINTIFFS SHOULD BE DISMISSED.

Two plaintiffs filed under fictitious names and simply asserted 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. While

plaintiffs concede that Fed. R. Civ. P. 10(a) requires a complaint to state the names of the parties, they argue that an exception exists "when the issues involved are of a sensitive and highly personal nature." Pl. Mem. at 21. Plaintiffs' attempt to fit within this exception is unsuccessful.

The proper procedure for filing under a fictitious name is to seek permission from the Court. National Commodity and Barter Assoc. v. Gibbs, 886 F.2d 1240, 1245 (5th Cir. 1979). By filing a motion seeking permission, the plaintiffs give the court and defendant an opportunity to verify that a real individual exists behind the fictitious name and to evaluate whether the particular facts presented by that individual warrant allowing the person to proceed under a fictitious name. Here, plaintiffs' counsel only makes broad allegations that the "financial situations of private citizens [are] clearly a matter of utmost the intimacy, especially when they feel the need to seek advice about bankruptcy" and plaintiffs "potentially risk injury to their credit and reputations." Pl. Mem. at 23.

Plaintiffs cite no support for their claims that seeking advice on bankruptcy is the kind of intimate personal information that has been protected by the court. Indeed, since bankruptcy proceedings are matter of public record, it is difficult to understand how plaintiffs can claim that such information is intimate personal information. Moreover, even if they fear injury from creditors, there is no justification for not providing the defendant their names under a protective order.

CONCLUSION

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

Respectfully submitted,
PETER D. KEISLER
Assistant Attorney General

THOMAS B. HEFFELFINGER
United States Attorney

BY: ROYLENE CHAMPEAUX
Assistant U.S. Attorney
Attorney ID No. 154805
600 U.S. Courthouse
300 South Fourth Street
Minneapolis, MN 55415
Tel: (612) 664-5600

s/ Marcia K. Sowles
THEODORE C. HIRT
MARCIA K. SOWLES, DC No. 369455
JUSTIN M. SANDBERG
U.S. Department of Justice
20 Massachusetts Ave., NW - Rm. 7108
Washington, D.C. 20530
Tel: (202) 514-4960
Fax: (202) 616-8470

Attorneys for Defendant