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CONSUMER BANKRUPTCY

Portion of New Bankruptcy Laws Declared Unconstitutional

Court of Appeals Strikes Down Provision which Prevented Attorneys from Advising Clients

by Craig D. Robins, Esq.

CRAIG D. ROBINS, ESQ.

In a question of first impression in the Circuits, the U.S. Court of Appeals for the Eighth Circuit in St. Louis just handed down, on September 4, 2008, the first Federal Appeals Court ruling that a portion of the new bankruptcy laws is unconstitutional. The Court struck a provision which had prevented attorneys from counseling clients about incurring new debt prior to filing.

The Court of Appeals, in a 2-1 ruling, said the provision was unconstitutional and limited attorneys' freedom of speech by "preventing attorneys from fulfilling their duty to clients to give them appropriate and beneficial advice."

The New Laws Contain Many Changes to Practice and Procedure. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), which became effective in October 2005, contains many new Bankruptcy Code provisions which had the effect of drastically altering the landscape of bankruptcy practice. Several sections contain directives mandating how bankruptcy practitioners can advertise and advise their clients. Many of these provisions have created substantial burdens on bankruptcy counsel to comply with.

The Concept of the Debt Relief Agency. From the outset, some of the most controversial provisions of BAPCPA were set forth in Bankruptcy Code provisions 526, 527 and 528 which required bankruptcy attorneys to be considered "Debt Relief Agencies." This is a totally new concept that did not exist prior to BAPCPA.

Under the new statute, bankruptcy attorneys, as Debt Relief Agencies, have new restrictions and requirements. For example, § 526(a)(4) bars a debt relief agency from advising a client "to incur more debt in contemplation" of a bankruptcy filing, while §§ 528(a)(4) and (b)(2) require debt relief agencies to include a disclosure notice in their bankruptcy-related advertisements stating that: "'We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code[,]'or a substantially similar statement." I previously addressed some of these issues in my January 2006 column in the *Suffolk Lawyer*.

The Constitutional Challenge. Milavetz, Gallop & Milavetz, a bankruptcy law firm in Minnesota, brought suit against the

United States seeking a declaratory judgment that certain provisions of BAPCPA — §§ 526(a)(4) and 528(a)(4) and (b)(2)—did not apply to attorneys and are unconstitutional as applied to attorneys. (*Milavetz v. U.S.A.,* 2008).

The United States District Court granted summary judgment to the attorneys and issued an order declaring that: (1) attorneys in the District of Minnesota were excluded from the definition of a "debt relief agency" as defined by BAPCPA; and (2) the challenged provisions were unconstitutional as applied to attorneys in the District of Minnesota.

The government appealed, resulting in the Court of Appeals decision which both affirmed and reversed parts of the District Court decision.

Prior Federal Court Decisions Reached Conflicting Conclusions. There have been several decisions interpreting the constitutionality of BAPCPA's "Debt Relief Agency" provisions. I previously reported on the very first such decision that was issued the very first day that BAPCPA went into effect. A Georgia Bankruptcy Court judge released a *sua sponte* decision that attorneys were not "Debt Relief Agencies," and were therefore excused from any compliance with those requirements.

Since that 2005 decision, two other bankruptcy courts relied upon it in issuing similar decisions including the earlier District Court in *Milavetz*. However, despite these rulings, a majority of courts have held that bankruptcy attorneys fall within the definition of "Debt Relief Agencies."

Connecticut Bankruptcy Court Reaches Renders Similar Decision. Meanwhile, the very next week, on September 9, 2008, the U.S. District Court for Connecticut reached a similar decision in the case of *Connecticut Bar Association v. U.S.A.*

District Court Judge Christopher Droney ruled that the BAPCPA statute that limited attorneys from advising clients to incur debt in contemplation of bankruptcy was so broad that it unconstitutionally restricted attorneys' First Amendment rights.

Judge Droney wrote, "A Lawyer who represents consumers contemplating bankruptcy bears the duty of zealous representation and the prohibition on giving legal advice unnecessarily interferes with this duty."

The judge continued, "If the government seeks to prevent manipulation of the bankruptcy system, a more narrowly tailored approach would be to penalize those who take on certain types of debts, rather than prohibiting legal advice about permissible courses of action."

This suit was brought in 2006 by the National Association of Consumer Bankruptcy Attorneys (which all regular bankruptcy practitioners should join) and the Connecticut Bar Association.

Practice Tip. Both the *Milavetz* and *Connecticut Bar Association* decisions are very important because they underscore the rights of attorneys to help debtor-clients put their affairs in order before filing bankruptcy. Although the *Milavetz* case technically applies only to the Eighth Circuit, it is the only decision on a federal appellate level addressing the issue. Accordingly, until this matter is addressed by other appellate courts or the Supreme Court, the *Milavetz* decision can offer some guidance as to how attorneys in our jurisdiction can advise and counsel our clients.

Typical Situations Where Counsel May Want to Suggest Incurring Debt. A frequent situation that I encounter is when a consumer client has a car lease that is about to end. Prior to BAPCPA, I would have advised the debtor to immediately surrender the existing car and obtain a new car lease, as getting a new car lease is easier to do before filing. However, under BAPCPA, such advice theoretically involves advising the client to incur new debt in contemplation of bankruptcy.

Another example is where a client who is contemplating bankruptcy might benefit from refinancing a mortgage, to lower monthly payments or even to take cash out to pay off other debts.

These two examples were actually cited by the Court in the *Milavetz* decision. The Court stated that "there are certain situations where it would likely be in the assisted person's, and even the creditors', best interest for the assisted person to incur additional debt in contemplation of bankruptcy."

Counsel who seek to aggressively represent their clients might now feel a greater level of comfort in being able to make such recommendations to their clients as there is appellate support for doing so. Nevertheless, the issue has not yet been addressed in our jurisdiction.

Editor's Note: Craig D. Robins, Esq., a regular columnist, is a bankruptcy attorney who has represented thousands of consumer and business clients during the past twenty years. He has offices in Medford, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com.
Please visit his Bankruptcy Website: CraigRobinsLaw.com.