

IN THE UNITED STATES DISTRICT COURT  
 FOR THE NORTHERN DISTRICT OF TEXAS  
 DALLAS DIVISION

SUSAN B. HERSH,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civil Action No. 3-05-CV-2330-N
	)	
UNITED STATES OF AMERICA, et al.,	)	
<u>Defendants.</u>	)	

**REPLY IN SUPPORT OF FEDERAL DEFENDANT'S MOTION TO DISMISS**

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. Plaintiff challenges 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 requirement to provide consumer debtors with certain written disclosures, 11 U.S.C. § 527.<sup>1</sup> None of plaintiff's arguments supports her claims.

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<sup>1</sup> While plaintiff concedes that the term "debt relief agency" is broad enough to include attorneys, she argues that the Court should not read the term to include attorneys under the doctrine of constitutional avoidance. Memorandum of Law in Opposition to Federal Defendant's Motion to Dismiss ("Pl. Mem.") at 5-6. This argument, however, erroneously assumes that the provisions are unconstitutional if the term is read to include attorneys. As explained infra at 2-9, plaintiff's constitutional challenges have no merit. Moreover, reading the definition to exclude attorneys is inconsistent with the plain language and legislative history of the Act. Memorandum in Support of Federal Defendant's Motion to Dismiss ("Def. Mem.") at 4-6, 9-11.

**I. SECTION 526(a)(4) DOES NOT VIOLATE THE FIRST AMENDMENT.**

**A. Gentile Balancing Test Should Be Applied.** 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 Def. Mem. at 16-23. Plaintiff seeks to avoid the Gentile balancing test by arguing that the strict scrutiny test, which requires the government to prove that a restriction serves a compelling state interest and is the least restrictive means to achieve that interest, should be applied. Pl. Mem. at 6-14. Plaintiff bases this argument on two erroneous assumptions: (1) that § 526(a)(4) is not an ethical rule for purposes of the Gentile test unless there is "an independent rule" that prohibits "incurring more debt in contemplation of" filing a bankruptcy petition (id. at 7-8), and (2) that the Gentile test only applies to commercial and public speech by attorneys and not to advice. Id. at 8-9. 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 23 n. 14), this Court does not need to reach that issue because the Gentile test applies.

Plaintiff's argument that § 526(a)(4) cannot be an ethical rule unless incurring "more debt in contemplation" of filing for bankruptcy is itself illegal attempts to equate the Gentile test with the test applied to prohibitions on counseling another to engage in illegal conduct. Such prohibitions are not reviewed under the Gentile test. Such counseling is "unprotected speech" and is, therefore, reviewed under the even more lenient rational basis test. See United States v. Solomon, 825 F.2d 1292, 1297 (9th Cir. 1987); United States v. Buttorff, 572 F.2d 619, 624 (8th Cir. 1978). 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) does just

that by protecting the bankruptcy proceedings from abuse and debtors from advice that could result in the denial of relief.<sup>2</sup> Def. Mem. at 20-23.

Plaintiff's assumption that the Gentile test does not extend to restrictions on advice given to clients is also incorrect. The Supreme 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 plaintiff offers support for her 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 university 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'

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<sup>2</sup> Plaintiff's assertion that defendant's characterization of § 526(a)(4) as an ethical rule "only exists in the Federal Defendant's pleading" is simply incorrect. Congress itself described the "debt relief agency" provisions as establishing "professional standards." 2005 U.S.C.C.A.N. at 92.

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. Plaintiff apparently tries to find some support for her 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 attorneys are always subject to the strict scrutiny test. Indeed, the Supreme Court's subsequent decision in Gentile held that the balancing test applied in Ohralik v. Ohio State Bar Ass'n 436 U.S. 447 (1978), in the commercial speech context, 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 held that this restriction violated the First Amendment 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. In fact, the Court found that the LSC restriction 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 5-6.

**B. Section 526(a)(4) Satisfies the Gentile Test.** Section 526(a)(4) satisfies the Gentile

test because it protects the integrity of the judicial system without too strictly limiting speech. Def. Mem. at 20-23. Plaintiff does not directly 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 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.<sup>3</sup> Instead, plaintiff makes the claim that the government has no interest in preventing such abuse. Pl. Mem. at 9. This assertion is absurd and ignores the fact that the bankruptcy system was established by the federal government and the important role played by the U.S. Trustee in preventing abuse.

Plaintiff also suggests the harm cited by defendant is limited to Chapter 7 petitions. Pl. Mem. at 8. Advice to incur more debt in contemplation of filing a Chapter 13 petition, however, presents the same concerns. The prohibition against discharging a debt obtained under false pretense or representation is not limited to petitions filed under Chapter 7. 11 U.S.C. § 523(a)(2). Advising a client to incur more debt in contemplation of bankruptcy can be detrimental to the client because in determining whether such debt is fraudulent, courts consider, among other reasons, "[w]hether or not an attorney has been consulted concerning the filing of bankruptcy before the charges were made." In re Mercer, 246 F.3d 391, 408 (5th Cir. 2001); In re Samani, 192 B.R. 877, 880 (S.D. Tex. 1986); In re Kramer, 38 B.R. 80 (W.D. La. 1984). Moreover, petitions filed under Chapter 13 can be

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<sup>3</sup> Defendant is unclear what plaintiff means when she states that providing advice to enable "clients to conform their income and expenses to established statutory guidelines" is permissible. Pl. Mem. at 2. Courts have dismissed petitions under § 707 when the debtor voluntarily decreases his income in order to qualify for Chapter 7. In re Helmick, 117 B.R. 187, 190 (Bankr. W.D. Pa. 1990); In re Manske, 315 B.R. 838 (Bankr. E.D. Pa. 2004). By the same token, increasing one's debts to meet the means test would constitute abuse.

dismissed or converted to Chapter 7 for various reasons, including "material default by the debtor with respect to a material term of the confirmed plan." 11 U.S.C. § 1307. Incurring additional debt may jeopardize the ability of a debtor to devise a realistic payment plan or increase the risk that the plan will be dismissed for failure to make timely payments. In addition, in order for a Chapter 13 plan to be confirmed, the debtor must show that his petition was filed in "good faith." 11 U.S.C. § 1325(a)(7).

Incurring additional debt in contemplation of filing a petition under Chapter 13 also impacts prior creditors because it dilutes the recovery available to them from the debtor's current earnings. It also harms the creditor who provided the new "eve-of-bankruptcy" loan. Indeed, plaintiff implicitly acknowledges this harm by admitting that a creditor who provided a car or a home equity loan on the eve-of-bankruptcy would not have provided the loan on the same terms had the creditor known that the debtor was planning to file for bankruptcy. Pl. Mem. at 7. Encouraging a client to take advantage of an unsuspecting creditor by incurring such debt clearly presents legitimate legal and ethical concerns. See 11 U.S.C. § 523(a)(2).

Moreover, contrary to plaintiff's assertion, the restriction on advice is a reasonable method to prevent such abuse.<sup>4</sup> While some remedies for such abuse existed prior to BAPCPA, § 526(a)(4) expands the available remedies. Denying the debtor discharge of a particular debt, 11 U.S.C. § 523, or dismissing his petition or converting it to a different chapter, 11 U.S.C. §§ 707 or 1307, penalizes a client who relied upon his attorney's advice and incurred such debt. Section 526(a)(4) seeks to

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<sup>4</sup> In Rubin v. Coors Brewing Co., 514 U.S. 476,485 (1995), the Court found that prohibiting the disclosure of alcohol content in beer labels was irrational because there was no prohibition against such disclosures in beer advertisements or on the labels for wine and spirits. In this case, the restriction on advice given by attorneys is consistent with and complements the existing prohibitions on abuse and fraud.

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.

Section 526(a)(4) is narrowly tailored to meet the government's interest in protecting the integrity of the bankruptcy system. As previously explained, § 526(a)(4) is not a general prohibition against incurring more debt prior to bankruptcy. Def. Mem. at 16-18. 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.

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

## **II. DISCLOSURE REQUIREMENTS IN SECTION 527 ARE CONSTITUTIONAL.**

The written disclosures in § 527 were designed to ensure that attorneys, at a minimum, provide assisted persons with certain basic information regarding bankruptcy. Plaintiff concedes that statutes compelling professionals, like attorneys, to provide accurate factual information do not violate the First Amendment. Planned Parenthood of Southeast Pennsylvania v. Casey, 505 U.S. 833, 884 (1992); Zauderer v. Office of Disiplinary Counsel, 471 U.S. 626, 650-51 (1985). Plaintiff, however, argues that the disclosures here require plaintiff to provide information which is false or misleading. Pl. Mem. at 15-16. This claim appears to rest on the notion that some of the statements in the disclosure may not be applicable in certain cases or may not provide a "complete" picture in specific cases.

For example, plaintiff contends that the statement that debtors "will have to pay a filing fee to the bankruptcy court" is wrong because under F. R. Bankr. P. 1006(b), the payment may be made

in installments. It is not clear why plaintiff finds that this statement is misleading because whether payment is made in full or in installments, the fee must still be paid, except in the limited circumstances in which the fee may be waived by court. Plaintiff also questions the statements that a debtor may want to seek additional help in deciding whether to reaffirm his debts, preparing a Chapter 13 plan or filing under a chapter of the Code other than Chapters 7 and 13. She claims that these statements are misleading because they do not say that only an attorney can provide legal advice. This argument, however, ignores that last sentence of this disclosure which specifically states that "only attorneys, not bankruptcy preparers, can give you legal advice." 11 U.S.C. § 527(b). Similarly while the information provided regarding chapter 13 repayment plans is a brief description and does not fully set forth all permutations that may occur under the Code in any given chapter 13 case, the summary is not misleading. If additional information is needed to address a debtor's specific case, the attorney is free to provide it.

In short, the disclosures are simply intended to insure that the debtor has certain basic information regarding bankruptcy. They are not intended to be an exhaustive list of advice that a competent attorney should provide to a debtor-client about his or her particular case. Moreover, § 527 only requires an attorney to provide the information "to the extent applicable" and allows modification of the required statement so long as it is "substantially similar" to that offered by the statute. 11 U.S.C. § 527(b). Thus, to the extent that plaintiff believes that additional or clarifying information or advice is needed in particular cases, nothing in § 527 prevents her from providing it.

Contrary to plaintiff's claim, § 526(a)(4) is also not analogous to the law at issue in Riley v. National Federation of the Blind of N.C., 487 U.S. 781 (1988), requiring a fundraiser to disclose to potential donors the average percentage of gross receipts actually received by the charity from the

fundraiser. The Court applied strict scrutiny because the solicitations were inextricably tied to advocacy and the disclosure requirement "necessarily discriminates against small and unpopular causes." Id. at 2679. The disclosures at issue here, on the other hand, are more analogous to the disclosures required in Casey. They are made in a commercial context at the time in which the debtor is considering whether to retain an attorney to file for bankruptcy. 11 U.S.C. § 527(a) (notice must be given "not later than 3 business days after the first date on which a debt relief agency first offers to provide bankruptcy assistance to an assisted person.").<sup>5</sup>

#### IV. PLAINTIFF 'S FIFTH AMENDMENT CLAIM SHOULD BE DISMISSED.

Plaintiff alleges that BAPCPA violates "her clients' right under the Fifth Amendment to receive factually correct, truthful advice of counsel in a civil matter." 1st Am. Compl. ¶ 8. See also Id. ¶¶ 6-7, 14, 16. Plaintiff lacks standing to assert her client's constitutional rights. Def. Mem. at 23-25.

In her opposition, plaintiff does not refute this point. Instead, she reframes her claim to state that the provisions violate her purported "right to provide counsel." Pl. Mem. at 14. In her opposition, she cites no support for this alleged constitutional right to provide counsel. Instead, she relies upon cases which refer to her clients' right to counsel and claims that §§ 526(a)(4) and 527 "improperly impair Plaintiff's role in providing due process to her clients." Pl. Mem. at 14. In short,

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<sup>5</sup> Plaintiff also contends that § 527(b) "fails to limit its scope to clients contemplating bankruptcy themselves." Pl. Mem. at 17. This argument is apparently based on plaintiff's belief that the definition of "bankruptcy assistance," 11 U.S.C. § 101(4)(A), applies to individuals who provide services to creditors. This is an unnatural reading of that term. Congress passed the statute to address deficiencies in the conduct of attorneys representing consumer debtors. See, e.g., 2005 U.S.C.C.A.N. at 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).

despite her attempts to reframe her Fifth Amendment, the claim is still based on the purported due process rights of her clients.<sup>6</sup> Accordingly, this claim should be dismissed for lack of standing.

### CONCLUSION

For the foregoing reasons, the Court should dismiss plaintiff's complaint.

Respectfully submitted,

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<sup>6</sup> Even if she had standing to assert her clients' right, nothing in BAPCPA infringes on their purported Fifth Amendment right to counsel. Section 527 does not limit the advice that plaintiff may give to her clients. Instead, this provision requires plaintiff to provide assisted persons with certain written disclosures. While § 526(b)(4) does prohibit plaintiff from advising her clients to incur more debt in contemplation of bankruptcy, such advice would be encouraging her clients to engage in behavior which is abusive and would tend to adversely affect the client's ability to get bankruptcy relief, including being denied a discharge or having the client's case dismissed. *See supra* at 5-6. For that reason, such advice is not permissible. Thus, rather than infringing on a client's rights, this limitation protects clients from getting advice which could lead to the dismissal of the client's petition.