



## CRS Report for Congress

# Legal Challenges to the Client Communication Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

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### Summary

Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) in an effort to increase the level of integrity and fairness in the U.S. bankruptcy system. Some of the act's consumer protection provisions circumscribe the speech of attorneys who assist clients on bankruptcy matters. Several U.S. district courts have found that selected restrictions in these provisions violate the First Amendment right to freedom of speech. This report describes the relevant BAPCPA provisions and discusses the recent court decisions.<sup>1</sup>

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)<sup>2</sup> made significant changes to the United States Bankruptcy Code.<sup>3</sup> Many of its amendments were intended to remedy perceived abuses of the bankruptcy system. To this end, several of BAPCPA's provisions regulate communications of the newly created category of "debt relief agencies," both by mandating certain disclosures and restricting the content of certain forms of advice ("communication provisions").<sup>4</sup> The courts have generally interpreted these provisions to cover attorney-client communications,<sup>5</sup> resulting in controversy over the extent to which the Constitution permits the government to restrict attorneys' speech in order to further its goal of improving the American bankruptcy system. Critics challenge the communication provisions as unconstitutional, arguing that

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<sup>1</sup> This report was prepared under the general supervision of Robin Jeweler, Legislative Attorney.

<sup>2</sup> P.L. 109-8, 119 Stat. 23 (2005).

<sup>3</sup> 11 U.S.C. § 101 et seq.

<sup>4</sup> 11 U.S.C. §§ 526, 527, 528 (2005).

<sup>5</sup> See note 17 *infra*.

they have a chilling effect on attorney speech.<sup>6</sup> In addition, they claim that these provisions impede the ability of attorneys to best protect their clients and increase confusion among those receiving attorneys' advice.<sup>7</sup>

This controversy involves tensions that were evident during BAPCPA's enactment. During debate, supporters in Congress claimed that the communication provisions were necessary to prevent debtors from taking advantage of loopholes in the bankruptcy system and to reduce the number of unnecessary filings.<sup>8</sup> Banks and other lenders who supported the adoption of the communication provisions contended that these provisions were necessary to eliminate bankruptcy mills, which, they argued, allowed bankruptcy attorneys to handle their clients' cases without having sufficient attorney-client contact.<sup>9</sup> Some opponents of the provisions worried that their burdensome requirements singled out attorneys representing consumer debtors and would ultimately lead experienced bankruptcy attorneys to curtail their practice.<sup>10</sup>

Several U.S. district courts have now had occasion to rule on the communication provisions. A survey of these cases reveals that district courts have been increasingly willing to find that the communication provisions violate the First Amendment right to freedom of speech. Attorney plaintiffs have argued alternatively that attorneys are not covered by these provisions or that they violate the First Amendment right to freedom of speech. Initially, two U.S. district courts rejected constitutional challenges to the communication provisions, finding that the attorney plaintiffs failed to meet the standing requirements.<sup>11</sup> Subsequently, several U.S. district courts found that at least one of the communication provisions violates the First Amendment.

## Legal Issues

District courts have addressed four legal issues raised by the above provisions:

- whether attorney plaintiffs have suffered a sufficiently concrete injury to have standing to bring their claims;
- whether attorneys are included in the definition of a "debt relief agency";

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<sup>6</sup> Joyce E. Cutler, *BAPCPA Provisions Chill Lawyers' Speech, Create Conflicts, Experts Say at NCBJ Forum*, 18 BNA BANKRUPTCY LAW REPORTER 1019 (2006).

<sup>7</sup> Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act*, 79 AMERICAN BANKRUPTCY LAW JOURNAL 571, 578-580 (2005).

<sup>8</sup> H.Rept. 109-31 (I), at 3-5 (2005).

<sup>9</sup> Robert Wann Jr., Note, "*Debt Relief Agencies: Does the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 Violate Attorney's First Amendment Rights?*" 14 AMERICAN BANKRUPTCY INSTITUTE LAW REVIEW 273, 274 (Spring 2006), quoting Marcia Coyle, *Debtor's Attorneys See Red in Bankruptcy Bill; They See Malpractice Premium and Overhead Hikes; Judges' Workload Would Increase*, 179 N.J.L.J. 1126, March 21, 2005, at 12.

<sup>10</sup> Thomas Yerbich, *The Coming Exodus of Consumer Counsel*, 22 AMERICAN BANKRUPTCY INSTITUTE J. 10 (July/August 2003).

<sup>11</sup> A court finds that a plaintiff lacks standing if the plaintiff fails to prove a particularized injury that can be remedied by the courts.

- whether the prohibition against advising an assisted person<sup>12</sup> to incur additional debt in contemplation of filing for bankruptcy violates the First Amendment; and
- whether the mandate to make certain disclosures to assisted persons violates the First Amendment.

## Threshold Issue: The Standing Requirement

Standing has become a less significant obstacle to constitutional challenges of the communication provisions. This is due to the increased willingness of lower court judges to find the alleged suppression of speech to be a sufficient injury-in-fact. Initially, two courts declined to address the constitutional challenges raised by the attorney plaintiffs, finding that the plaintiffs did not have standing.<sup>13</sup> Noting that no party had enforced any of the communication provisions against them, both courts found that the plaintiffs failed to show they suffered a sufficient personalized injury that could be addressed by the courts. All other courts deciding this issue, however, have found that the attorney plaintiffs have standing. Notwithstanding the absence of any enforcement action taken against the plaintiffs, these courts concluded that the mere enactment of BAPCPA is a sufficient injury due to the resulting chilling effect on attorneys' speech.<sup>14</sup>

## The Communication Provisions: Judicial Interpretations

**11 U.S.C. § 101(12A): Definition of “Debt Relief Agency”.** BAPCPA defines the term “debt relief agency” as any person who provides bankruptcy assistance to an assisted person for payment or who is a bankruptcy petition preparer.<sup>15</sup> This definition contains certain exceptions, none of which expressly includes attorneys.<sup>16</sup>

Attorney plaintiffs have not been successful in arguing that the communication provisions do not apply to them, even though the definition of debt relief agency does not explicitly mention attorneys. With only one exception,<sup>17</sup> all U.S. district courts facing the matter have decided that attorneys are included in the definition of debt relief agency.<sup>18</sup>

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<sup>12</sup> Defined in 11 U.S.C. § 101 (3) as “any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than \$150,000.”

<sup>13</sup> *Geisenberger v. Gonzalez*, 346 B.R. 678, 681 (E.D.Pa. 2006); *In re McCartney*, 336 B.R. 588, 592 (Bankruptcy M.D.Ga. 2006).

<sup>14</sup> *Hersh v. U.S.*, 347 B.R. 19, 22 (N.D. Tex. 2006); *Olsen v. Gonzalez*, 350 B.R. 906, 912 (D.Or. 2006); *Zelotes v. Martini*, 352 B.R. 17, 21 (D. Conn. 2006); *Milavetz v. U.S.*, 355 B.R. 758, 762 (D.Minn. 2006).

<sup>15</sup> 11 U.S.C. § 101 (12A) (2005).

<sup>16</sup> 11 U.S.C. § 101 (12A) (A)-(E) (2005).

<sup>17</sup> The U.S. Bankruptcy Court for the Southern District of Georgia, in *In re Attorneys at Law and Debt Relief Agencies*, 332 B.R. 66 (Bkrcty.S.D.Ga. 2005), was the only court to hold that attorneys are not included in the definition of “debt relief agencies” in § 101(12A).

<sup>18</sup> *Hersh*, 347 B.R.at 22; *Olsen*, 350 B.R. at 912; *Zelotes*, 352 B.R. at 19.

**11 U.S.C. § 526(a)(4): Restrictions on Advice to Clients.** BAPCPA prohibits a debt relief agency from advising assisted persons either to incur additional debt in contemplation of filing for bankruptcy or to pay an attorney or bankruptcy petition preparer fees in exchange for bankruptcy services.<sup>19</sup>

Attorney plaintiffs have had success in challenging the constitutionality of this provision. Four U.S. district courts have held that the provision violates the First Amendment's guarantee of freedom of speech.<sup>20</sup> These courts all concluded that the provision is too broad in scope because it restricts more speech than is necessary to prevent debtors from being able to manipulate the system. Therefore, the courts reasoned, this restriction prevents attorneys from being able to best protect their clients. The U.S. District Court for the Northern District of Texas, for example, pointed out that a bankruptcy attorney may have a legitimate, non-abusive reason to counsel a client to incur additional debt. The court noted that a client might benefit from refinancing a mortgage at a lower rate in order to prevent bankruptcy or from taking out a loan on a car in order to be able to commute to a job and earn income.<sup>21</sup> Other legitimate reasons to incur additional debt, noted by the U.S. District Court for the District of Connecticut, include preventing wage garnishment or home foreclosure and borrowing money from family or friends in order to hire an attorney or pay a filing fee.<sup>22</sup>

Several courts have also found that the group of individuals covered by the provision is too narrowly defined. Highlighting the fact that the definition of debt relief agency excludes many other entities that advise debtors, such as nonprofit organizations, the U.S. District Court for Oregon observed that nothing in BAPCPA prevents nonprofits and other groups from advising debtors to incur additional debt.<sup>23</sup>

**11 U.S.C. § 527: Required Disclosures of Information on the Bankruptcy Process.** BAPCPA compels debt relief agencies to notify assisted persons of the following:

- the costs and benefits of proceeding under chapters 7, 11, 12, and 13 of the bankruptcy code;
- the types of services available from credit counseling agencies;
- the requirement that the assisted person provide only complete, accurate, and truthful information;
- the requirement that all assets and liabilities be disclosed;
- the requirement that an assisted person be able to choose to hire an attorney, hire a bankruptcy petition preparer, or represent himself or herself, but that only attorneys and not petition preparers can render legal advice;

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<sup>19</sup> 11 U.S.C. § 526(a)(4) (2005).

<sup>20</sup> *Hersh*, 347 B.R. at 2; *Olsen*, 350 B.R. at 916; *Zelotes*, 352 B.R. 1t 24-25; *Milavetz*, 355 B.R. at 765-66.

<sup>21</sup> *Hersh*, 347 B.R. at 24.

<sup>22</sup> *Zelotes*, 352 B.R. at 24.

<sup>23</sup> *Olsen*, 350 B.R. at 916.

- information on the process of filing for bankruptcy; and
- information on how to value assets, complete bankruptcy schedules, and determine what property is exempt.<sup>24</sup>

Each of the two courts to have considered the question have found that the disclosure requirements in Section 527 pass constitutional muster.<sup>25</sup> Both courts reasoned that subjecting attorneys to regulation of their professional activities is justified by the government's significant interest in ensuring that debtor clients are adequately informed.<sup>26</sup>

**11 U.S.C. § 528: Required Contract and Advertising Disclosures.** BAPCPA mandates that a debt relief agency do the following:

- within five days of first providing bankruptcy advice to an assisted person, execute a written contract with the person describing the services that will be provided and the corresponding fees;
- explain in its advertisements that its services are with respect to bankruptcy relief under the bankruptcy code;
- include the following, or a "substantially similar," statement in its advertisements: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code."<sup>27</sup>

The courts have been divided over whether this provision violates the Constitution. As of June 2007, the U.S. District Court for Minnesota is the only court to have found that any of the disclosures required by Section 528 violate the First Amendment.<sup>28</sup> In particular, the court found unconstitutional the requirement that debt relief agencies disclose in all public advertisements that they help people file for bankruptcy relief under the bankruptcy code. Rejecting the government's argument that the disclosure is necessary to prevent consumers from thinking that they can eliminate their debts without paying them or filing for bankruptcy, the court found that this disclosure will simply lead to customer confusion.<sup>29</sup> The court also concluded that this requirement is too broad in scope because it applies to accurate as well as deceptive advertising.<sup>30</sup> The other court considering the question has found the advertising requirements to be valid because the government has a strong interest in ensuring accurate advertising, and the provision has adequate safeguards to prevent customer confusion, such as giving attorneys discretion over how to make the disclosures and allowing them to make clarifications.<sup>31</sup>

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<sup>24</sup> 11 U.S.C. § 527 (2006).

<sup>25</sup> *Hersh*, 347 B.R. at 27; *Olsen*, 350 B.R. at 917-19.

<sup>26</sup> *Id.*

<sup>27</sup> 11 U.S.C. 527 (2005).

<sup>28</sup> *Milavetz*, 355 B.R. at 767.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Olsen*, 350 B.R. at 921.