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UNITED STATES DISTRICT COURT

DISTRICT OF OREGON

ERIC W. OLSEN, **CIV. NO. 05-6365-HO**
KEVIN D. SWARTZ,
JASON C. MCBRIDE,

Plaintiffs,

v.

ALBERTO GONZALES, in his official capacity as United States Attorney General, and **ILENE LASHINSKY**, in her official capacity as United States Trustee for Region 18,

Defendants.

DEFENDANTS' MEMO. IN SUPPORT OF MOTIONS FOR RECONSIDERATION AND FOR JUDGMENT ON THE PLEADINGS

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The parties spoke by telephone and attempted to resolve the issues raised in this motion, but were unable to reach an agreement.

INTRODUCTION

Defendants Alberto Gonzales and Ilene Lashinksy respectfully ask the Court to reconsider its conclusion that 11 U.S.C. § 526(a)(4) transgresses the First Amendment and to enter judgment on the pleadings in favor of defendants. Plaintiffs lack constitutional standing to challenge this provision, which, in any case, accords with the First Amendment – it is an ethical rule that is narrowly tailored to protect debtors and creditors from inappropriate legal advice.

On August 11, 2006, the Court granted defendant's motion to dismiss four of the five claims in plaintiffs' Complaint for Declaratory and Injunctive Relief ("Complaint"), December 1, 2005, all of which challenge the constitutionality of amendments to the Bankruptcy Code enacted in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The Court concluded that plaintiffs lack standing "for most of the[ir] challenges" and that defendants were entitled to judgment on the merits with respect to a number of plaintiffs' claims. Order, August 11, 2006, at 13-27. The Court, however, denied defendants' motion to dismiss the fifth claim, plaintiffs' First Amendment challenge to 11 U.S.C. § 526 (a)(4), concluding that, under the First Amendment, the provision is both under-inclusive and over-inclusive. Id. at 14-16.

As with "most of the[ir] challenges," plaintiffs lack standing to dispute the constitutionality of § 526(a)(4). Plaintiffs have not established standing because they have not alleged that they have been injured by § 526(a)(4). See Lujan v. Defenders of Wildlife, 504 U.S. 555, 561 (1992). As the Court pointed out in its Order, a plaintiff can establish standing in a First Amendment case, in certain

circumstances, if he or she alleges that a law has had a chilling effect on his or her speech. Order at 11. But plaintiffs here have not alleged that § 526(a)(4) has chilled their speech. See Complaint. And even if they had, their complaint would still fall short because they have not adequately alleged that § 526(a)(4) applies to their intended speech; such an allegation is a prerequisite to securing standing based on the chilling effect of a statutory provision. Califronia Pro-Life Council, Inc. v. Getman, 328 F.3d 1088, 1094-95 (9th Cir. 2003). Because plaintiffs have not demonstrated that they have standing under Article III to challenge § 526(a)(4), the Court should dismiss their complaint for lack of subject matter jurisdiction. See Steel Co. v. Citizens for a Better Environment, 523 U.S. 83, 102-110 (1998).

Since the Court lacks jurisdiction over plaintiffs' claim, it need not reach the merits. But if the Court does reach the merits, it should enter judgment in favor of defendants. See Fed. R. Civ. 12(c). Section 526(a)(4) is an ethical rule designed to protect debtors and creditors from inappropriate legal advice to debtors. Because it is an ethical rule, the Court should review it under a standard of intermediate, rather than strict, scrutiny. This standard's "narrow tailoring" requirement calls for a reasonable fit between § 526(a)(4) and its purposes, not a perfect one, Bd. of Trustees of the State University of N.Y. v. Fox, 492 U.S. 469, 480 (1989). Section 526 satisfies this test; it is not unconstitutionally overinclusive or underinclusive. In its Order, the Court lists a number of examples of advice that, in its view, would be improperly prohibited under this provision. Order at 14-15. In fact, many of the examples would not fall within § 526's ambit, because the advice does not encourage the client to incur debt solely to take advantage of discharge or to game the means test, which is used to determine whether to apply a presumption that a bankruptcy filing is abusive, see 11 U.S.C. § 707(b)(2)(A). What is more, the underinclusiveness about which the

Court expressed concern, namely, that a non-profit organization could offer advice that the statute bars others from providing, is unproblematic: "[A] regulation is not fatally underinclusive simply because an alternative regulation, which would restrict more speech or the speech of more people, could be more effective." Blount v. SEC, 61 F.3d 938, 946 (D.C. Cir. 1995) (emphasis in the original); see also Moser v. FCC, 46 F.3d 970, 974-75 (9th Cir. 1995). Accordingly, defendants ask the Court to reconsider its conclusion that § 526(a)(4) is unconstitutional and enter judgment in their favor.

STATUTORY BACKGROUND

The 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." H.R. Rep. No. 109-31, 109th Cong., 1st Sess. 5 (2005), reprinted at 2005 U.S.C.A.A.N. 88, 89. Congress found that there was "abuse by attorneys and other professionals." 2005 U.S.C.C.A.N. 88, 92. As proof of such abuse, a House report cited the results of a civil enforcement initiative undertaken by the United States Trustee Program, among which were the conclusion 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)).

To correct these problems, Congress included in the BAPCPA "provisions strengthening professional standards for attorneys and other who assist consumer debtors with their bankruptcy cases." 2005 U.S.C.A.A.N. at 103. These standards are known as the "debt relief agency provisions." 11 U.S.C. §§ 526-528. The standard at issue here is Section 526(a)(4), which 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). The term "assisted person" means "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150,000." 11 U.S.C. § 101(3). This portion of the statute thus prohibits an attorney from "advis[ing]" an assisted person (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).

It is important to note in relation to Section 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),[1] would increase the likelihood that a bankruptcy attorney would counsel his or her client to take on debt before filing for bankruptcy. In discussing the means test, the Honorable Randall Newsome, United States Bankruptcy Judge for the Northern District of California, issued the following warning:

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

> 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). The Honorable William Brown, United States Bankruptcy Judge for the Western District of Tennessee, also warned that "the fact that allowed expenses can be increased by incurring secured debts provides a strategy for avoiding the means test." Bankruptcy Reform Act of 1999 (Part II), Hearing before House Judiciary Comm., 106th Cong., 1st Sess. 30 (1999). Attorneys who opposed the means test before Congress also recognized this danger. For example, Judith Greenstone Miller, an attorney testifying on behalf of the Commercial Law League of America, stated that means test is "likely to be the subject of creative avoidance efforts by counsel for debtors." Bankruptcy Reform, Joint Hearing before House Judiciary Comm. and Senate Judiciary Comm., 106th Cong., 1st Sess. 157 (1999). As she explained,

> Because individuals with secured debt are allowed deductions for such obligations prior to calculating available disposable net income, a debtor with too much income could trade in an old car for a new one, or take a second loan on a house, deduct the payments from the means formula and thereby become eligible for chapter 7 relief.

Id. See id. at 96 (statement by Ms. Miller that means test "invites manipulation" by giving a debtor the incentive to increase his or her debts to avoid the presumption that his or her bankruptcy filing is abusive).

The BAPCPA establishes various remedies for violations of Section 526(a)(4). First, a debt relief agency shall be liable to an assisted person for (a) "any fees or charges" paid to him or her by the assisted person, (b) "actual damages," and (c) "reasonable attorneys' fees," if the debt relief

agency is found, after notice and a hearing, to have "intentionally" or "negligently" violated Section 526. 11 U.S.C. § 526(c)(2)(A). Second, in addition to such other remedies as are provided by State law, the BAPCPA authorizes state attorneys general to bring actions to enjoin violations of Section 526 and recover damages for debtors. 11 U.S.C. § 526(c)(3). Finally, "nothwithstanding any other provisions of Federal law and in addition to any other remedy provided by Federal or State law, the court, on its own motion or on the motion of the United States trustee or debtor" may enjoin violations or impose an appropriate civil penalty, if the court "finds that a person intentionally violated [Section 526] or engaged in a clear and consistent pattern or practice of violating this section." 11 U.S.C. § 526(c)(5).

ARGUMENT

Plaintiffs Lack Standing to Challenge the Constitutionality of § 526(a)(4)

Plaintiffs lack standing to challenge § 526(a)(4) because they have not alleged an injury sufficient to support standing. Plaintiffs allege that § 526(a)(4) violates the First Amendment. But they do not allege that the provision will chill their speech, nor do they even properly allege that § 526(a)(4) applies to their intended speech. See Complaint. Without such allegations, plaintiffs lack constitutional standing, and this Court lacks subject matter jurisdiction over the claim. See Steel Co., 523 U.S. at 102-110. In its Order, the Court indicated that these shortcoming could be corrected simply by additional pleading. Order at 7, 11. These shortcomings in the complaint are something more: They are serious omissions that deprive the Court of subject matter jurisdiction over plaintiff's claim.[2] Lujan, 504 U.S. at 560-561; Steel Co., 523 U.S. at 102-110; Herman Family

[2] District Courts have the inherent power to reconsider interlocutory orders. City of Los Angeles Harbor Division v. Santa Monica Baykeeper, 254 F.3d 882, 885 (9th Cir. 2001).

Revocable Trust v. Teddy Bear, 254 F.3d 802, 807 (9th Cir. 2001) ("Once the district court reached the conclusion that it had no underlying original subject matter jurisdiction, there was nothing left to do but dismiss the case.")

Article III standing is "an irreducible constitutional" and a prerequisite to the exercise of subject matter jurisdiction. Lujan, 504 U.S. at 560; Steel Co., 523 U.S. at 102-04. For a plaintiff to have standing, it must demonstrate, "with the manner and degree of evidence required at successive stages of litigation," that it has suffered a concrete injury in fact. Id. at 561. At a minimum, though, a plaintiff must make "general factual allegations of [such an] injury resulting from defendant's conduct." Id. A plaintiff challenging the constitutionality of a law under the First Amendment can satisfy this pleading requirement if it alleges that it has forgone speech because of an actual and well-founded fear that the law will be enforced against it. California Pro-Life Council, Inc., 328 F.3d at 1094-95. A plaintiff's intended speech must arguably fall within the statute's reach for a fear of enforcement to be well founded. Id. at 1095.

Plaintiffs have not alleged that they have forgone speech for fear that § 526(a)(4) will be enforced against them, or even that § 526(a)(4) applies to their intended speech, and thus have not established standing. In the claim challenging this provision, plaintiffs allege that "[t]he code's prohibition on plaintiffs advising their clients to incur debt if the client is an 'assisted person' is a violation of the First Amendment of the United States Constitution." Complaint ¶ 23. Nowhere in this abstract (and erroneous) legal conclusion about the constitutionality of § 526(a)(4) do plaintiffs tie the provision to any injury that they have suffered. And while the Court correctly noted that plaintiffs hypothetically could allege that their speech has been chilled, Order at 11, they have not done so. Accordingly, plaintiffs have not established that their speech has been chilled. See

California Pro-Life Council, Inc., 328 F.3d at 1094-95. What is more, plaintiffs have not alleged that § 526(a)(4) even arguably encompasses their intended speech. This section governs speech by attorneys to individuals (namely, assisted persons) whose debts consist primarily of consumer debts, 11 U.S.C. § 526(a)(4), and plaintiffs have not alleged that they advise such debtors, see Complaint. Thus, plaintiff's intended speech does not arguably fall within the statute's reach and any fear of enforcement would not be well founded. California Pro-Life Council, Inc., 328 F.3d at 1095. For the above stated reasons, the Court lacks subject matter jurisdiction over plaintiffs' claim.

Plaintiffs' Claim Fails on the Merits

Section 526(a)(4) is narrowly tailored to achieve its purposes of protecting debtors and creditors from inappropriate legal advice to debtors. Section 526(a)(4) is an ethical rule of limited scope. As such, it is subject to a balancing test of intermediate scrutiny. See Gentile v. State Bar of Nevada, 501 U.S. 1030, 1073 (1991). Under this standard, to be constitutional, a law's scope must reasonably match its purpose; the fit need not be perfect. See Fox, 492 U.S. at 480. Section 526(a)(4) satisfies this standard: It is neither fatally overinclusive nor underinclusive, and thus it is constitutional.

I. The Scope of Section 526(a)(4) Is Limited.

Section 526(a)(4) does not establish a general prohibition against advising an assisted person to incur more debt prior to filing bankruptcy. Nor does it prohibit an attorney from advising an assisted person about what the law states or the risks that incurring certain debts may jeopardize the assisted person's ability to obtain relief under the Bankruptcy Code. Instead, it predominantly prohibits an attorney 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). Section 526(a)(4) is designed

to proscribe advice to take on debt solely because the assisted person 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)). This narrow interpretation of § 526(a)(4) is fully consistent with the purpose of the BAPCPA, which is "to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system." 2005 U.S.C.A.A.N. at 88-89.

This interpretation of the provision also accords with the Supreme Court's interpretation of similar language in an estate tax statute in United States v. Wells, 283 U.S. 102 (1931). In that case, the Court held that the phrase "in contemplation of death" meant "that thought of death is the impelling cause of the transfer." Id. at 118. The Court explained that "if it is the thought of death, as a controlling motive prompting the disposition of property, that affords the test, it follows that the statute does not embrace gifts inter vivos which spring from a different motive." Id. The same reasoning applies here. Just as the phrase "in contemplation of death" focuses on the motivation for making the gift, the phrase "to incur additional debt in contemplation" of filing for bankruptcy focuses on the reason for incurring the debt. It does not forbid an attorney from counseling a debtor to take on debt when the attorney would give the same advice for reasons other than evading the means test or gaming the bankruptcy system.

II. The Supreme Court Has Held That Ethical Restrictions on Attorney Speech Are Subject to the Balancing Test Rather Than Strict Scrutiny.

The Court suggests in footnote five of its Order that § 526(a)(4) should be reviewed under the strict scrutiny standard. Order at 14 n.5. But the Supreme Court has employed a more lenient

balancing test when reviewing regulations on attorney speech which are designed to prevent violations of professional duties of competency or loyalty to a client, or other abuses of the special trust that attorneys hold as agents of the justice system. See Gentile, 501 U.S. at 1073; Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 460-62 (1978); In re Sawyer, 360 U.S. 622, 646-47 (1959) (concurring opinion of Justice Stewart) ("[O]bedience to ethical precepts [by attorneys] 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. 436 U.S. at 453, 454 n.9. 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 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 "'self-employed businessmen,'" but also are "'trusted agents of their clients'" and "'assistants to the court in search of a just solution to dispute.'" Id. (quoting Cohen v. Hurley, 366 U.S. 117, 124 (1961)).

The Supreme Court again applied a 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, the Court 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. See id. at 1073-74. Instead, it held that the speech of

attorneys "may be regulated under a less demanding standard than that 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 concluded that "a constitutionally permissible balance" is achieved when 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. The Court added that "[e]ven if a fair trial can be ultimately ensured [without a gag order] through voir dire, change of venue, or some other device, these measures impose serious costs to the system," and "[t]he State has a substantial interest in preventing officers of the court, such as lawyers, from imposing such costs on the judicial system and on the litigants." Id. at 1075. Accord United States v. Scarfo, 263 F.3d 80, 92-93 (3d Cir. 2001); United States v. Brown, 218 F.3d 415, 426 (5th Cir. 2000).

Indeed, the Supreme Court has noted that leniency traditionally has permeated its review of ethical restrictions on lawyers "[e]ven in an area far from the courtroom and the pendency of a case." Gentile, 501 U.S. at 1073. In this vein, Gentile has been described as providing the standard for reviewing restrictions on attorneys' speech "in general." Scarfo, 263 F.3d at 92-93. And in fact, in Canatella v. Stovitz, 365 F. Supp. 2d 1064, 1071-1072, 1076 (N.D. Cal. 2005), the court specifically applied the Gentile standard to an ethical restriction on advice given by attorneys. The court rejected a Amendment challenge to 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 the

regulation . . . against [the] lawyer's First Amendment interest in the kind of speech that was 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." 365 F. Supp. 2d 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. See Gentile, 501 U.S. at 1075-76.

III. Section 526(a)(4) Satisfies the Gentile Standard.

A. Section 526(a)(4) is an Ethical Standard Designed to Protect the Debtor and the Integrity of the Bankruptcy System.

Section 526(a)(4) is an ethical standard. Congress itself referred to the debt relief provisions as "provisions strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases." 2005 U.S.C.C.A.N. 103. Moreover, like the ethical restrictions at issue in Gentile and Ohralik, § 526(a)(4) seeks to prevent attorneys from abdicating their roles as "trusted agents of their clients" and "assistants to the courts in search of a just solution to a dispute." Ohralik, 436 U.S. at 460. As explained below, giving advice to incur debt to "game" the bankruptcy system compromises these roles because it undermines the two basic principles of the bankruptcy system, namely, that an honest debtor is entitled to a discharge to ensure a fresh start

and that a creditor should receive a proportional share of a debtor's assets according to the priorities set forth in the Bankruptcy Code. See United States v. Fox, 95 U.S. 670, 672 (1877).

First, Section 526(a)(4) seeks to protect the debtor's ability to obtain a discharge. As the court recognized in Hersh v. United States, 347 B.R. 19, 27 (N.D. Tex. 2006), "the consumer debtor is often at an informational disadvantage" vis-à-vis his or her attorney. Section 526(a)(4) recognizes this inequality and seeks to protect debtors from attorneys who would lead them to undertake abusive practices which would result in the debtor being injured because the bankruptcy court would order a particular debt non-dischargeable under 11 U.S.C. § 523, deny the discharge entirely under 11 U.S.C. § 727, or dismiss his or her petition or convert it into a different chapter, 11 U.S.C. §§ 707 and 1307. For example, courts consider debts incurred to take advantage of discharge to be fraudulent and, therefore, nondischargeable, see, e.g., 11 U.S.C. § 523(a)(2)(C), and one of the factors used to determine whether a debt fraudulent is "[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 (Bankr. S.D. Tex. 1986). What is more, while the prohibition on abuse is not new, it now has a broader scope as the BAPCPA has lowered 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). Section 526(a)(4)'s protections, then, are all the more important.

Similarly, if a debtor were to accrue greater debt to circumvent the means test, that would also constitute impermissible abuse.[3] Under the means test, abuse of the bankruptcy system is

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[3] 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); Bankruptcy

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. Courts have dismissed petitions under § 707 when the debtor voluntarily decreased 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 reasoning, increasing one's debt to meet the means test would constitute abuse.

The two previous paragraphs address Chapter 7 bankruptcy filings. But advice to incur more debt in contemplation of filing a Chapter 13 petition can also be detrimental to a debtor. In addition to the prohibition against fraudulent debt, 11 U.S.C. § 523(a)(2), in order for a Chapter 13 plan to be confirmed, the debtor must show that the petition was filed in "good faith." 11 U.S.C. § 1325(a)(7). The pre-BAPCPA standard was less demanding: The Bankruptcy Code required only that the debtor show that the plan itself "was proposed in good faith and not by any means forbidden

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Reform Act of 1999 (Part II), Hearing before House Judiciary Comm., 106th Cong., 1st Sess. 30 (testimony of The Honorable William Brown, United States Bankruptcy Judge for the Western District of Tenn.); Bankruptcy Reform, Joint Hearing before the House Judiciary Comm. and Senate Judiciary Comm., 106th Cong., 1st Sess. 96, 157 (1999) (testimony of Judith Greenstone Miller on behalf of the Commercial Law League of America).

by law." 11 U.S.C. § 1325(a)(3).[4] Given the BAPCPA's strengthening of the Code's anti-abuse measures (with respect to both Chapter 7 and Chapter 13 filings), it is more important than ever to deter attorneys from advising their clients to "incur debt in contemplation" of bankruptcy.

Second, § 526(a)(4) also protects creditors (and the integrity of the bankruptcy system itself). Improperly enlarging the pool of pre-existing debt subverts the principle of proportional distribution, because it reduces the amount of money that would otherwise be payable to prior creditors. Section 526(a)(4) protects creditors from such a reduction by deterring advice that 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.

Accordingly, the government has important and legitimate interests in regulating the speech at issue. Just as the Supreme Court concluded in Gentile that certain statements made to the press during a trial present a serious risk of causing of unfair trial, advice to incur debt in contemplation of filing for bankruptcy presents a serious risk of causing prejudice to the outcome of the proceedings. Incurring such abusive debts could decrease the amount of money that each creditor would receive, and, 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

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[4] Chapter 13 petitions may also be 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 the debtor to devise a realistic payment plan or increase the risk that the plan will be dismissed for failure to make timely payments.

in turn prejudice an honest debtor who had relied on the bad advice of his attorney, and subsequently faces a raft of nondischargeable debts. Thus, whether viewed from the perspective of the debtor, the creditors, or the judicial system itself, a lawyer's advice to incur debt in contemplation of filing for bankruptcy would be substantially likely to prejudice the outcome of the bankruptcy proceeding and/or impose substantial costs on the judicial system to prevent such prejudice.[5] See Gentile, 501 U.S. at 1075 (explaining that the government has "a substantial interest in preventing officers of the court, such as lawyers, from imposing such costs on the judicial system").

B. Section 526(a)(4) is Narrowly Tailored.

Section 526(a)(4) is narrowly tailored; it is not unconstitutionally overinclusive or underinclusive. As an ethical rule, it is reviewed under the balancing test laid out above, not the strict scrutiny standard. When the standard of review is something less than strict scrutiny, narrow tailoring does not require a perfect fit. Fox, 492 U.S. at 480. Rather, the fit between a statute and

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[5] The other prong of the § 526(a)(4) restricts advice to incur debt "to pay an attorney or bankruptcy preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title," 11 U.S.C. § 526(a)(4). This restriction is also based on ethical considerations. The provision prohibits an attorney only from advising a consumer to incur debt to pay an attorney. In other words, it does not prohibit advice to incur debt to an attorney; it only prevents advice to obtain a loan from a third party to pay an attorney. The rationale for this distinction between incurring debt to an attorney and incurring debt to pay an attorney fees is clear. The data from the U.S. Trustee's Office in Lamie v. United States Trustee, 540 U.S. 526 (2004), which held that the Code generally does not allow attorneys for Chapter 7 debtors to be compensated from the estate, revealed that 96% of Chapter 7 cases have no assets in the estate to pay anything to creditors. Brief of the Solicitor General, 2003 WL 21839367, at 38-39. Accordingly, in the vast majority of the cases, when a debtor's attorney counsels a client to incur debt to pay him, he knows (or should know) that the creditor who provided the money to pay the attorney will recover nothing. Section 526(a)(4) protects the integrity and fairness of the bankruptcy system by discouraging attorneys from using their position as "trusted agents of their clients," Ohralik, 436 U.S. at 460 (quotations omitted), to secure preferential treatment for themselves by counseling clients to take out loans to pay them so that they (the lawyers) can avoid the sting of discharge at the expense of other unsuspecting creditors.

its purposes must only be reasonable. Id. Section 526(a)(4) satisfies this standard. Several of the examples of advice that the Court thought would be prohibited by the statute, would not in fact be prohibited. See below at pp. 19-20. Similarly, the underinclusiveness about which the Court was concerned is constitutionally unproblematic: Underinclusiveness is a problem when it represents an attempt to skew a public debate, Moser v. FCC, 46 F.3d 970, 974 (9th Cir. 1995), and that circumstance is not present here. Thus, § 526(a)(4) is narrowly tailored and passes constitutional muster.

While the term "narrowly tailored" is not explicitly defined in Gentile, the Supreme Court has explained the application of this requirement in the context of cases applying the intermediate scrutiny test, which like the balancing test applicable to ethical rules, is less demanding than the strict scrutiny standard. In the realm of intermediate scrutiny, the Supreme Court has stressed that "narrow tailoring" does not require a perfect "fit." Fox, 492 U.S. at 480. For example, in reviewing a regulation of the time, place and manner of protected speech, the Supreme Court held that the requirement of narrow tailoring is satisfied "so long as the . . . regulation promotes a substantial government interest that would be achieved less effectively absent the regulation." United States v. Albertini, 472 U.S. 675, 689 (1985). Accord Ward v. Rock Against Racism, 491 U.S. 781, 797-98 (1989). Similarly, with respect to government regulation of commercial speech, the Supreme Court has found that the narrow tailoring requirement does not require that the "fit" be "necessarily perfect, but reasonable." Fox, 492 U.S. at 480.

Section 526(a)(4) is not unconstitutionally overinclusive because its scope reasonably matches its intended 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 or the risks of incurring certain

debts prior to bankruptcy. Nor does it prevent an attorney from advising a debtor to incur further debt in all cases. See above at 9-10. Instead, it predominantly 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. Id.

In its Order, this Court cited, from Hersh, 347 B.R. at 24-25, two examples of debts that, the Court thought, an attorney could not advise his or her client to incur: (1) a secured debt incurred to purchase a car that will allow the debtor to get to work on a regular basis so that he or she will have income with which to pay creditors, and (2) a loan that amounts to the "refinancing [of a debt] at a lower rate to reduce payments and forestall or even prevent entering bankruptcy," id. at 24. Order at 14-15. Neither of these situations, however, would fall within § 526(a)(4)'s ambit. In the circumstances described by the Court, the consumer takes on the debt either to facilitate his or her ability to earn money or to reduce his or her costs, not solely because he or she intends to file for bankruptcy. The debts make economic sense regardless of whether the person is filing for bankruptcy, and an attorney could not be punished for advising a client to incur them. This response applies as well to the Court's suggestion that § 526(a)(4) would prohibit an attorney from advising a client to incur debt by refinancing a loan when refinancing would allow the debtor to pay off more of his or her debts: The debt makes economic sense regardless of whether the person intends to file for bankruptcy.[6]

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[6] The Court points to several other examples of debts that, in the Court's view, an attorney could not advise her or her client to incur consistent with § 526(a)(4), among these are a debt incurred to pay a filing fee in a bankruptcy case and a debt incurred to convert a non-exempt to an exempt asset. Order at 15. Even if § 526(a)(4) prohibits advice to incur these forms of debt, the prohibitions are not as meaningful as they first appear. With regard to the filing fee, the Bankruptcy Code provides means to allow a debtor who does not have money to file without resorting to a loan. First, the debtor can make payment in installments. 28 U.S.C. §

Even if the Court were to conclude that § 526(a)(4) encompasses advice to incur debt in some instances in which the debt would not be abusive or fraudulent, that does not mean that § 526(a)(4) is unconstitutionally overinclusive and so not narrowly tailored: Section 526(a)(4) “promotes a substantial government interest that would be achieved less effectively absent the regulation." Albertini, 472 U.S. at 689. Incurring debt that is fraudulent or abusive (including attempts to evade the means test) is impermissible and subjects a debtor to dismissal or other adverse action. See above at 13-16. Prior to the BAPCPA, a court could deny the debtor discharge of a particular debt, 11 U.S.C. § 523, deny a discharge of all debts, 11 U.S.C. § 727, or dismiss his or her petition or convert it to a different chapter, 11 U.S.C. §§ 707 or 1307. But those remedies penalized 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. By doing so, it not only protects the debtor but also seeks to avoid the time and expense of dismissing such abusive filings incurred by the court, the creditors, and the U.S. Trustee. As the Supreme Court recognized in Gentile, 501 U.S. at 1075, the government has "a substantial interest in preventing officers of the court, such as lawyers, from imposing such costs on the judicial system." Thus, 526(a)(4) promotes a substantial government interest.

1930(a)(7) and Fed. R. Bank. P. 1006. Second, the bankruptcy court may waive the filing fee if the debtor has income less than 150 percent of the income for the poverty line and is unable to pay. 28 U.S.C. § 1930(f)(1). As for the conversion of non-exempt to exempt assets, a debtor can do this without incurring debt. Instead of borrowing against a non-exempt asset and using the loan to increase the debtor’s equity in an exempt asset, a debtor could sell a non-exempt asset and use the proceeds to increase his or her equity in an exempt asset.

Just as the concerns about overinclusivessness do not support the conclusion that § 526(a)(4) is unconstitutional, so the concerns about underinclusiveness do not undermine the constitutionality of § 526(a)(4). The Court concluded in its Order that § 526(a)(4) is underinclusive because the definition of "debt relief agency" excludes non-profit organizations and thus assisted persons "can still get advice that suggests the abuses the regulation was designed to prevent." Order at 16. This underinclusiveness does not render the provision unconstitutional. "The Supreme Court has repeatedly stated that 'underinclusiveness' may be the basis of a First Amendment violation only when a regulation represents an 'attempt to give one side of a debatable public question an advantage in expressing its views to the people.'" Moser v. FCC, 46 F.3d 970, 974 (9th Cir. 1995) (quoting City of Ladue v. Gilleo, 512 U.S. 43, 51 (1994)); see also R.A.V. v. City of St. Paul, 505 U.S. 377, 387 (1992) (explaining that "the First Amendment imposes not an 'underinclusiveness' limitation but a 'content discrimination' limitation"). Section 526(a)(4) does not give non-profit bankruptcy-advice providers an advantage in any public debate against for-profit bankruptcy-advice providers; the rule regulates a limited category of advice to certain clients, not the content of matters of public debate. In short, Congress chose to regulate less speech rather than more, and "a regulation is not fatally underinclusive simply because an alternative regulation, which would restrict more speech or the speech of more people, could be more effective." Blount v. SEC, 61 F.3d 938, 946 (D.C. Cir. 1995) (emphasis in the original). For the reasons stated above, § 526(a)(4) is both narrowly tailored and constitutional.[7]

[7] The Court's block quotation from the Hersh case includes citations to In Re RMJ, 455 U.S. 191, 203 (1982) and Conant v. Walters, 309 F.3d 629, 638-39 (9th Cir. 2002) as support for the proposition that § 526(a)(4) is not narrowly tailored. Order at 15. Those cases are distinguishable from this case. In re RMJ provides, "the States may not place an absolute prohibition on certain types of potentially misleading information, e.g., a listing, of areas of

CONCLUSION

For the above stated reasons, defendants respectfully ask the Court to reconsider its conclusion that § 526(a)(4) is unconstitutional and enter judgment in favor of defendants on plaintiffs' claim that § 526(a)(4) is unconstitutional.[8]

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practice, if the information also may be presented in a way that is not deceptive." In re R.M.J., 455 U.S. at 203. But this does not mean that states can regulate speech only if it is misleading; it simply outlines the government's ability to regulate information when the reason for the regulation is that the speech is said to be misleading. Indeed, the Supreme Court recognized that even when a communication is not misleading, "the State retains some authority to regulate" it if the State asserts "a substantial interest" and the interference with speech is "in proportion" to that interest. Id. at 203; see also id. at 207 (under the intermediate scrutiny test, a state may regulate in a manner that is "no more extensive than reasonably necessary to further substantial interests"). Therefore, nothing in In re R.M.J. suggests that the government must show a perfect fit under the narrow tailoring requirement. In Conant, the court found that the government's speech regulation, which related to a doctor's ability to recommend the medical use of marijuana, was not narrowly tailored. 309 F.3d at 639. But the Conant court applied strict scrutiny, see id. (citing NAACP v. Button, 309 F.3d 629, 637 (1963), a case applying strict scrutiny), and strict scrutiny does not apply here because, as detailed above, pp. 11-18, § 526(a)(4) is an ethical restriction on attorney speech.

[8] If the Court is not persuaded by defendants' motions for reconsideration and judgment on the pleadings on plaintiffs' § 526(a)(4) claim, given that the extant questions are purely legal, defendants ask that the Court enter final judgment on this claim, along with the claims on which the Court has ruled in defendants' favor.

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