

The 2005 Bankruptcy Reform Act Changes The Rules For Debt Relief Agencies, Assisted Persons, And Advertising

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A. Introduction

1. Sections 526, 527, and 528 are new with the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, §227(a)(2005) (“the 2005 Act”). The stated intent of Congress in enacting section 526 and related provisions was to strengthen “professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases.” H. R. Rep. No. 109-31, pt. 1, 109th Cong., 1st Sess. 17 (2005), *reprinted in* 2005 U.S.C.C.A.N. at 103. Section 526 places certain restrictions on the activities of “debt relief agencies.” Section 527 imposes several disclosure duties on debt relief agencies that provide bankruptcy assistance to assisted persons. Section 528 mandates certain duties with respect to retainer agreements and also requires debt relief agencies to include certain disclosures and other statements in advertisements.
 - a. Sections 526, 527, and 528 refer to three terms that are new with the 2005 Reform Act and that are defined in section 101 of the Bankruptcy Code: “assisted person,” “bankruptcy assistance,” and “debt relief agency.” Each of these definitions contains imprecise language that will likely create problems in application. A complete discussion of those issues is beyond the scope of these materials.

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A complete set of the course materials from which this outline was drawn may be purchased from ALI-ABA at www.ali-aba.org/aliaba/CM048.htm.

2. The purpose of these materials is to describe and explain some of the implications of these provisions for attorneys and others whose activities and practices will likely be affected by the provisions. These materials are not intended to cover all of the issues or to analyze all possibly relevant issues. The purpose is to provide an overview of selected issues and a general analysis thereof.

B. “Prospective Assisted Person”

1. *Section 526(a)—General Provisions*

- a. As stated above, section 526(a) places certain restrictions on the activities of debt relief agencies. 11 U.S.C. §526(a). Those restrictions include the following:
 - i. A debt relief agency shall not fail to perform any service that it informed an assisted person or prospective assisted person that it would provide in connection with a bankruptcy case or proceeding.
 - ii. A debt relief agency shall not make any statement or counsel or advise any assisted person or prospective assisted person to make any statement in a filed document in a bankruptcy case or proceeding that is untrue and misleading, or should have been known to be so upon the exercise of reasonable care by the agency.
 - iii. Section 526(a)(3) makes it unlawful for a debt relief agency to misrepresent to any assisted person or prospective assisted person the services the agency will provide or the benefits and risks of becoming a debtor under the Code. This section covers misrepresentations that are direct, indirect, affirmative, or by material omission.
 - iv. Section 526(a)(4) prohibits debt relief agencies from advising an assisted person or prospective assisted person to incur more debt in contemplation of filing a bankruptcy case or to pay an attorney or bankruptcy petition preparer for services performed as a part of preparing for a case under the Code.
- b. Section 526(a)(4) has been held facially unconstitutional by two courts. *See Hersh v. United States*, 2006 WL 2088270 (N.D. Tex. July 26, 2006) and *Olsen v. Gonzales*, 2006 U.S. Dist. Lexis 56197 (D.C. August 11, 2006). In both decisions, the respective courts found that section 526(a)(4) unconstitutionally restricts free speech because it prohibits lawyers from advising debtors to take on additional debt in contemplation of bankruptcy even though doing so may be advisable and legal.

2. *Problems Of Definition: Prospective Assisted Person*

- a. One problem with section 526(a) is the lack of a clear definition for the term “prospective assisted person.” The term “assisted person” is defined in section 101. (*See* Part C of these materials, *supra*.) However, the term “prospective assisted person” is not defined elsewhere in section 526 or elsewhere in the Code. It will presumably be left up to the courts to provide interpretive guidance.
- b. The lack of a precise definition for “prospective assisted person” is important because the remedial provisions of section 526 appear to apply only to assisted persons and not to prospective assisted persons. *See* §526(c)(1). It is thus important to be able to determine when an entity or individual

who was a prospective assisted person becomes an assisted person entitled to the remedial provisions of the statute. Analogies to other areas of law, such as the ABA Model Rules of Professional Conduct, may be helpful but are certainly not definitive.

i. For example, the ABA Model Rules of Professional Conduct contain a similar term, “prospective client.” Rule 1.18(a) of the ABA Model Rules of Professional Conduct (2004). Under Rule 1.18(a) of the Model Rules, a prospective client is described as “[a] person who discusses with a lawyer the possibility of forming a client-lawyer relationship with respect to a matter.” *Id.* Comments 1 and 2 to Rule 1.18 state:

[1] Prospective clients, like clients, may disclose information to a lawyer, place documents or other property in the lawyer’s custody, or rely on the lawyer’s advice. A lawyer’s discussions with a prospective client usually are limited in time and depth and leave both the prospective client and the lawyer free (and sometimes required) to proceed no further. Hence, prospective clients should receive some but not all of the protection afforded clients.

[2] Not all persons who communicate information to a lawyer are entitled to protection under this Rule. A person who communicates information unilaterally to a lawyer, without any reasonable expectation that the lawyer is willing to discuss the possibility of forming a client-lawyer relationship, is not a “prospective client” within the meaning of paragraph (a).

3. *Toward A Workable Definition*

- a. Analogizing from the Model Rules to sections 526 and 101, a workable definition of “prospective assisted person” might be as follows: “A person who discusses with the lawyer the possibility of becoming an assisted person with respect to a bankruptcy case or proceeding is a prospective assisted person.” Moreover, the observations in the commentary to Rule 1.18(a) also seem applicable to the bankruptcy context and might serve to place some reasonable constraints on those entitled to remedial protection under the Code. Prospective assisted persons might also engage a lawyer for purposes of disclosure or reliance. The lawyer’s discussions with the prospective assisted person will tend to be limited in duration and detail. Finally, unilateral communication without a reasonable expectation of a willingness to form a relationship should not be enough to make an individual or an entity an assisted person within the meaning of section 101.

C. Assisted Person

1. *The Definition And Potential Problems In Application*

- a. As noted earlier, the 2005 Act does provide a definition of “assisted person.” Section 101 defines “assisted person” as “any person whose debts consist primarily of consumer debts and the value of whose non-exempt property is less than \$150,000.” 11 U.S.C. §101(3). This term is new with the passage of the 2005 Act.
- b. Although the expressed intent of Congress in enacting section 526 and related provisions was to improve the conduct of professionals and others who assist consumer debtors with their bankruptcy cases, the definition of assisted persons might create problems in application. For example, the definition of “assisted persons” is so broad that it could be applied to most consumer debtors even though most consumer debtors do not actually use the services of traditional debt relief agencies. Additionally, the definition does not specify that the assisted person be a debtor *in bankruptcy* even