By Stephen W. Sather

When (if Ever) Can an Attorney Advise a Client to Incur Debt?

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Attorneys advise their clients on a variety of matters. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) regulated one specific type of advice: When an attorney may advise a client intending to file for bankruptcy to incur debt.[1] So, when can an attorney recommend that a client contemplating bankruptcy incur new debt? While the U.S. Supreme Court has recognized that attorneys should be permitted to give their clients sound advice, a recent decision from the Eleventh Circuit illustrates that there is one type of advice to incur debt that is never permissible. The starting point is the text of § 526(a)(4), which states that a debt-relief agency should 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 a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

Supreme Court Allows Attorney Advice to Incur Debt for a Proper Purpose

After BAPCPA was passed, attorneys and professional groups challenged the constitutionality of § 526(a)(4) under the First Amendment. The attorneys argued that there could be many situations in which an attorney could ethically advise a client contemplating bankruptcy to incur new debt. The Supreme Court found that the statute was constitutional by taking a narrow view of its prohibitions.[2]

The Supreme Court focused on the first part of the statute, which refers to advising a client to "incur more debt in contemplation of such person filing a case under this title." The Court noted that the statute could be read broadly or narrowly. The broad view was that "an attorney is prohibited from providing all manner of "beneficial advice — even if the advice could help the assisted person avoid filing for bankruptcy altogether."[3] The narrow view was that "advice to incur more debt 'in contemplation of' bankruptcy is most naturally read to forbid only advice to undertake actions to abuse the bankruptcy system."[4]

The Court adopted the statute's narrow reading. One reason given was that inhibiting frank discussion between attorneys and clients would serve "no conceivable purpose within the statutory scheme."[5] Thus, one takeaway from *Milavetz* was that an attorney would not be prohibited from exercising his/her traditional role in counseling clients about possible courses of action.

Eleventh Circuit Applies *Per Se* Prohibition on Advice to Incur Debt to Pay Fees

A recent decision from the Eleventh Circuit[6] focused on the second part of the statute, which states that a debt-relief agency may not advise an assisted person to "incur more debt ... to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title."[7] In the case, a debtor agreed to pay a law firm $1,700 to file his chapter 7 petition. The fee was to be paid in six installments, and the agreement required that the payments be made on a credit card.[8]

After the debtor terminated his initial lawyer, he filed suit in district court for a violation of 11 U.S.C. § 526(a)(4). The court granted a motion to dismiss for failure to state a cause of action. Relying on *Milavetz*, the district court found that the mere advice to pay attorneys' fees using credit cards did not violate § 526(a)(4).

The Eleventh Circuit reversed and found that it was always a violation of § 526(a)(4) to advise a client to incur debt in order to pay attorneys' fees. It distinguished the general rule regarding advice to incur debt in contemplation of bankruptcy from the more specific admonition not to advise a client to incur debt to pay attorneys' fees.

The court of appeals posited three possible readings of the statute. Under the first reading, an attorney could never advise a client to pay attorneys' fees. Under the second reading, an attorney could never advise a client to incur debt to pay attorneys' fees for an improper purpose. Under the third reading, an attorney could not advise a client to incur

1 11 U.S.C. § 526(a)(4).
2 *Milavetz, Gallop & Milavetz PA v. United States*, 559 U.S. 229, 243 (2010).
3 *Id.* at 240.
4 *Id.*
5 *Id.* at 246.
6 *Cadwell v. Kaufman*, 2018 U.S. App. LEXIS (11th Cir. March 30, 2018).
7 11 U.S.C. § 526(a)(4).
8 *Cadwell* at *3.

more debt for the purpose of paying attorneys' fees. The court of appeals found the third option most persuasive:

> Properly interpreted, then ... *Section* 526(a)(4)'s second prohibition forbids lawyers from advising their clients "to incur more debt ... to pay an attorney ... a 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). Importantly, this second prohibition — unlike the first, which is modified by the "in contemplation of" phrase of art that drove the result in *Milavetz* — entails no invalid-purpose requirement. And that ... makes perfect sense, because the two prohibitions address different subjects. The first is framed in general terms: [I]t forbids advice "to incur more debt in contemplation of" a bankruptcy filing. That prohibition ... could cover both abusive advice (*e.g.*, advice to "load up" on debt just to get it discharged) and salutary advice that would likely inure to the benefit of both debtor and creditor (say, to refinance a mortgage to a better interest rate).
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> As the Supreme Court recognized in *Milavetz*, the "in contemplation of" clause acts as a divining rod of sorts to separate the abusive advice from the salutary. The second prohibition, by contrast, is aimed at one specific kind of misconduct — in essence, a bankruptcy lawyer saying to his client, "You should take on additional debt to pay me!" That sort of advice is inherently abusive in at least two respects. First, it puts the attorney's financial interest — getting paid in full — ahead of the debtor/client's. If a creditor discovers the timing and reason for the fee-related debt, it could challenge the debt's dischargeability, thereby compromising the debtor's fresh start.... Second, it puts the lawyer's own interests ahead of the creditors' in that, while ensuring the lawyer's full payment, it leaves a diminished estate on which creditors can draw.... Section 526(a)(4)'s second prohibition, then, has no need for any further invalid-purpose gloss, because the advice it targets is, in effect, suspect *per se*.[9]

Thus, *Cadwell* interpreted § 526(a)(4) as having two distinct parts: a general restriction on advising a client to incur debt in contemplation of bankruptcy, and a specific restriction on advising a client to incur debt to pay the attorneys' fees. As shown by *Milavetz*, the general prohibition is qualified by an improper-purpose requirement. However, the specific prohibition is, as the opinion states "suspect *per se*."[10]

What Advice to Incur Debt *Is* Permissible?

Milavetz and *Cadwell* provide two examples of when it is not permissible for an attorney to advise a client to incur debt. *Milavetz* gives the example of "loading up": incurring debt prior to bankruptcy with the intent of discharging it. *Cadwell* dealt with incurring debt to pay an attorney's fee. Beyond these examples, there is very little guidance on what is a permissible vs. impermissible reason for an attorney to give advice to incur debt.

Hypothetically, a debtor owns a car with 200,000 miles on it, which breaks down on a regular basis and requires the debtor to spend an average of $500 per month in repair costs. The debtor can purchase a car that gets good mileage with just 50,000 miles on it for a payment of $400 per month. In this case, replacing the current vehicle with a more reliable vehicle would make sense regardless of whether the person intended to file for bankruptcy. Thus, this advice is permissible.

However, what if a debtor wants to file for chapter 7 but is advised by his attorney that he has too much disposable income to satisfy the means test?[11] The attorney advises the debtor that if he were to increase his secured debts, he would meet the means test and be able to file for chapter 7. Based on the attorney's advice, the debtor replaces his reliable Nissan Sentra with a 2017 BMW convertible with a payment of $800 per month.

In this hypothetical, there is not a nonbankruptcy reason to buy the new vehicle. On the other hand, there is a bankruptcy-related reason to do so, namely to game the means test. There is at least one case that suggests that incurring debt to manipulate the means test is impermissible.[12] Since the advice in this hypothetical is purely designed to manipulate the means test, it is almost certainly impermissible.

It is a closer call when there are both bankruptcy- and nonbankruptcy-related reasons for incurring a debt. Combining the first two hypotheticals, assume that the debtor has a vehicle with no payment. However, the debtor drives a lot for work in a car that gets poor gas mileage. It also has repair expenses such that the cost of operating the vehicle exceeds the amount allowed by the means test. The debtor's proposed means test shows that there is $250 per month in disposable income. The debtor is concerned that once he files for chapter 13, he will not be able to purchase a new vehicle at a good interest rate. He has the ability to purchase a Toyota Prius for $300 per month, and when this is brought to the attorney's attention, the attorney advises him that not only is this a good business decision, it will allow him to pass the means test and file for chapter 7 as well.

The way this hypothetical is constructed, the means test is misleading because the debtor's operating expenses exceed the allowance. By purchasing a more reliable vehicle, the debtor can reduce operating expenses and pass the means test. In this case, even if the attorney advised the debtor to incur more debt for the express purpose of satisfying the means test, the attorney is still giving good counsel. The means test does not reflect the debtor's ability to pay because he has unusually high operating expenses. Reducing the operating expenses by purchasing a more reliable vehicle is good advice, even if it also has the effect of influencing the means test. Since there is a legitimate nonbankruptcy purpose for this advice, it would be permissible.

9 *Id.* at *13-14.
10 *Id.*

11 Under 11 U.S.C. § 707(b)(1), the court may dismiss a consumer debtor's case or require that the debtor convert his/her case to one under chapter 13 if granting relief would be "an abuse of the provisions" of chapter 7. The primary determinant of whether a case constitutes an abuse is what is known as the "means test," which is an elaborate formula that compares the debtor's income over the previous six months with a set of standard allowances as well as actual expenses. For more information, *see* David W. Allard and Katherine R. Catanese, "The Means Test, Part II: Deductions," XXVI *ABI Journal* 2, 14, 62-63, March 2007, *available at* abi.org/abi-journal.
12 *In re Hayes*, 2015 Bankr. LEXIS 161, n.4 (Bankr. S.D. Tex. 2015).

continued on page 64

Straight & Narrow: When Can an Attorney Advise a Client to Incur Debt?

from page 33

The general rule is that attorneys should give their clients sound advice with regard to incurring debt before bankruptcy. If a debtor can do something that makes financial sense and advantages him/her in the bankruptcy, it is advice that is both permissible and ethical. On the other hand, advising a debtor to incur debt for an improper purpose is never good advice.

Finally, advising a client to incur debt to pay the attorney's fee or filing fee is never permissible. When a debtor offers to pay with a credit card, the attorney should just say "no." abi