From the Top, in Brief:
2010 U.S. Supreme Court Bankruptcy Rulings

Mark G. Douglas

Thus far in 2010, the U.S. Supreme Court has handed down two decisions involving issues of bankruptcy law. In the first bankruptcy ruling, the court reversed a decision of the Eighth Circuit Court of Appeals, holding on March 8 in *Milavetz, Gallop & Milavetz, P.A. v. U.S.* that bankruptcy lawyers must advertise themselves as "debt-relief agencies." In doing so, the court upheld the constitutionality of provisions added to the Bankruptcy Code in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act. Among the new provisions are: (i) section 526(a)(4) of the Bankruptcy Code, which provides, among other things, 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"; and (ii) requirements in sections 527 and 528 that any debt-relief agency must specifically describe itself as such in advertising. The lawyers in *Milavetz* argued that these rules should not apply to bankruptcy lawyers, but if they do apply, they unconstitutionally prohibit bankruptcy lawyers from advising clients to take on more debt before bankruptcy, even when the advice would otherwise be legal and proper. The Eighth Circuit had ruled that section 526 violates the First Amendment by preventing "attorneys from fulfilling their duty to clients to give them appropriate and beneficial advice."

The Supreme Court, which agreed to hear the case to resolve a split in the circuits on the issue, readily concluded that bankruptcy lawyers are "debt-relief agencies" and therefore subject to the prescriptions and restrictions in sections 526 through 528. Writing for the court, Justice Sonia M. Sotomayor remarked that "the statutory text clearly indicates that attorneys are debt relief

agencies when they provide qualifying services to assisted persons." Nevertheless, because the case involved commercial speech, the court ruled that the disclosure provisions are subject to less exacting scrutiny. Justice Sotomayor explained that the provisions prohibit lawyers only from giving advice "designed to manipulate the protections of the bankruptcy system." Advice about new debt, she wrote, is prohibited "when the impelling reason for the advice is the anticipation of bankruptcy." In other words, the "incur more debt" prohibition applies only to advice that an attorney might give to a debtor to engage in the abusive practice of loading up on debt before filing for bankruptcy. In a footnote, Justice Sotomayor wrote that the law would not apply in situations when an attorney and his or her bankruptcy client were merely aware of the possibility of bankruptcy. Instead, she said, the law "proscribes only advice to incur more debt that is principally motivated by that likelihood" and thus is not overly broad.

Six other justices joined in Justice Sotomayor's opinion. Justices Antonin Scalia and Clarence Thomas concurred with the result but filed separate opinions detailing what they perceived to be flaws in the reasoning of the majority.

On March 23, a unanimous court ruled in *United Student Aid Funds Inc. v. Espinosa* that under Federal Rule of Civil Procedure 60(b)(4), a student loan provider was not entitled to relief from a bankruptcy-court order confirming a chapter 13 plan that discharged the debtor's student loan debt even though the bankruptcy court made no finding of "undue hardship" in an adversary proceeding, as required by section 523(a)(8) of the Bankruptcy Code and Federal Rule of Bankruptcy Procedure 7001(6). In affirming a ruling by the Ninth Circuit Court of Appeals, Justice Clarence Thomas, writing for the court, concluded that although the bankruptcy court's

failure to find undue hardship was a legal error, given the Bankruptcy Code's clear and self-executing requirement for an undue-hardship determination, the confirmation order is enforceable and binding on the lender because it had actual notice of the error and failed to object or timely appeal.

However, Justice Thomas wrote, the Ninth Circuit went too far when it overruled cases stating that bankruptcy courts must confirm a plan proposing the discharge of a student loan debt without a determination of undue hardship in an adversary proceeding unless the creditor timely raises a specific objection. To comply with section 523(a)(8), he explained, bankruptcy courts must make an "independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in an adversary proceeding." The court acknowledged the potential for "bad-faith litigation tactics" but observed that "expanding the availability of relief under Rule 60(b)(4) is not an appropriate prophylaxis." Penalties under various provisions governing attorney conduct, Justice Thomas remarked, should deter attempts to discharge student loan debt without the undue-hardship finding Congress required.

In certain other bankruptcy-related developments in the Supreme Court this year, the court denied certiorari on February 22 in *Ames Dept. Stores, Inc. v. ASM Capital, L.P.*, where it was asked to review a ruling by the Second Circuit Court of Appeals that section 502(d) of the Bankruptcy Code does not mandate disallowance of an administrative claim under section 503(b)(9) held by a creditor that had allegedly received a preferential transfer.

On April 19, the court granted certiorari in *Ransom v. MBNA*, where it will consider whether an above-median-income chapter 13 debtor may deduct from his projected disposable income, which would otherwise be available to unsecured creditors under a plan, an “ownership cost” for a vehicle the debtor owns free and clear. The Ninth Circuit ruled in August 2009 that, based upon its interpretation of section 707(b)(2)(A)(ii)(I), the deduction may not be taken when there is no debt on the auto. The federal courts of appeal are split on the issue, and the Supreme Court decided to take the case to resolve the circuit split. The case will be heard in the Supreme Court Term that begins in October.

Milavetz, Gallop & Milavetz, P.A. v. U.S., 130 S. Ct. 1324 (2010).

United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010).

In re Ames Dept. Stores, Inc., 582 F.3d 422 (2d Cir. 2009), *cert. denied sub nom. Ames Dept. Stores, Inc. v. ASM Capital, L.P.*, 130 S. Ct. 1527 (2010).

Ransom v. MBNA (In re Ransom), 577 F.3d 1026 (9th Cir. 2009), *cert. granted*, 2010 WL 333672 (Apr. 19, 2010).