Consumer Bankruptcy Program
District of Delaware
January 30, 2018
Case Summaries

Supreme Court

Midland Funding, LLC v. Johnson, 137 S.Ct. 1407 (2017)(per Bryer, J.) Does the filing of a proof of claim on account of a debt for which the statute of limitations had clearly expired constitute a violation of the Fair Debt Collection Practices Act? The Supreme Court, in a 5-3 decision, determined that it did not.

The Court was faced with an issue that has been increasingly occurring in bankruptcy cases across the United States. As a result of debt buyers acquiring debts in various forms, buyers have proceeded to file proofs of claim in various debtor bankruptcy cases. In some instances, the debts acquired by the debt buyer arose well beyond the applicable statute of limitations and the debt buyer would be unable to commence a collection action on account of that debt in any other forum. However, as of a result of the debtor's bankruptcy filing, the debt buyer could file a proof of claim on account of that debt noting that the debt was beyond the applicable statute of limitations. The Court was tasked with determining whether filing such a proof of claim – where the debt buyer made clear that the applicable statute of limitations governing the collection had long since run – was nevertheless a "false, deceptive or misleading representation" or an "unfair or unconscionable" means of attempting to collect on the debt.

The Court held that the Fair Debt Collection Practices Act was not implicated simply because the proof of claim noted on its face that the statute of limitations had run. The Court began with the language of the Bankruptcy Code noting that the definition "claim" in the Bankruptcy Code is simply a right to payment. The Court went on to note that creditors have a right to payment of a debt even after the limitations period has expired. Although the debtor argued that a claim would be "false" because it was not enforceable, the Court concluded that the overall language of the Bankruptcy Code does not require "enforceability" to be a condition to the filing of a claim. In fact, the Court noted that §502(b)(1) of the Bankruptcy Code specifically states that that a claim will be disallowed if it is "unenforceable". The Court then reasoned that if the Bankruptcy Code specifically included a provision of disallowance due to "un-enforceability" then the mere filing of a claim which was unenforceable on its face could not be "false".

The Court then turned to whether the filing of a stale claim was nevertheless "unfair" or "unconscionable." The Court noted that the bankruptcy system treats untimeliness as an affirmative defense and the trustee bears the burden of investigating claims and pointing out when a claim is stale. The Court held that that preservation of the affirmative defense and the Trustee's investigatory obligations – together with applicable bankruptcy sanctions – meant that the filing of an obviously timed bar claim would not necessarily constitute unfair or unconscionable acts within the definition of the Fair Debt Collection Practices Act.

Justice Sotomayor, joined by Justices Ginsburg and Kagan, dissented concluding that the mere filing of a time barred claim should constitute an "unfair or unconscionable" means to collect on a debt. The dissent spent significant time outlining the business economics associated with the debt trading business. Debt buyers often acquire old debts for "pennies on the dollar" because the older debts are harder to collect. The dissent noted that it is a violation of the Fair Debt Collection Practices Act to knowingly file a lawsuit in court to collect on a time barred debt. Therefore, the dissent posited that debt buyer turned to bankruptcy forums to simply submit

proofs of claim in the "hope" that parties will not be incentivized to file objections on the statute of limitation bases. The dissent noted that statutes of limitations can be "revived" in the event of making payments on account of stale obligations. Therefore, it is all the more important to "police" the submission of these outdated proofs of claim so as to prevent the inadvertent "revival" of stale claims because claims are paid on a pro rata basis without specific confirmation of the specific claim. The dissent likened the filing of a claim in bankruptcy court to the filing of lawsuit in state court. Since the latter is clearly barred by the Fair Debt Collection Practices Act. The dissent reasons that the submission of a claim which is time barred in bankruptcy should be similarly barred.

Henson v. Santander Consumer USA, Inc., 137 S.Ct. 810 (2017) (per Gorsuch, J.) In Justice Gorsuch's inaugural opinion, a unanimous Supreme Court held that a company that regularly attempts to collect debts it purchased after the debts had fallen into default is not a per se "debt collector" subject to the Fair Debt Collection Practices Act ("FDCPA"). This decision overrules Third Circuit precedent FTC v. Check Investors, Inc., 502 F.3d 159 (3rd Cir. 2007). Previously, it was thought that the FDCPA applied to all debt buyers who obtained accounts after they were in default. However, the Supreme Court now has limited that classification. The statute applies to debt collectors which are defined as entities which regularly seek to collect debt "owed… another." Therefore, the statute's plain language appear to focus on third party collection agents collecting for a debt owner, not a debt owner seeking to collect debts for itself. Having said that, the opinion is not as radical as one would think. The Court noted that this ruling does not exempt all debt buyers. The FDCPA also defines a "debt collector" as one that is engaged "in any business the principal purpose of which is the collection of debts" §1692a(16). In this case, Santander USA also originated and serviced it own loans. But there are plenty of debt buyers such as Portfolio Recovery Associates and Midland Funding etc. which do not and, accordingly would still be covered as "debt collectors" under the Act.

Third Circuit

Zoakites v. Lansaw (In re: Lansaw) 853 F.3d 657 (3rd Cir. 2017(per Melloy, J.) The Third Circuit allows damages for emotional distress arising from an “egregious” willful violation of automatic stay. 11 USC §362(k)(1).

Debtors were moving to a new business location but had not yet vacated their prior premises. With knowledge of the Chapter 7 bankruptcy the existing landlord locked Debtors out of a business (day care) premises, physically threatened Debtor-wife (including a police call) and threatened to sue a subsequent landlord unless the debtors agreed to return to landlord’s now locked premises, (including phone calls by counsel to the new landlord), all post-petition actions were described by the bankruptcy judge as “egregious”, who awarded Debtors $2,600 in

attorney fees and $7,500 for emotional distress and assessed $40,000 in punitive damages. The Landlord asserted “emotional distress” is not actual damages” as required by Section 362(k)(1).

This is a case of first impression in the Third Circuit. The First, Ninth, Eleventh Circuits allow such damages; the Seventh was officially “skeptical” but indicated it is possible

The landlord also claimed Debtors had failed to provide sufficient evidence of their emotional distress or causation; no medical evidence or testimony. The courts found the action so egregious, that claimant’s “credible testimony” was sufficient.

In re: Klaas, 858 F.3d 820 (3rd Cir. 2017)(per Krause, J.) The Third Circuit affirmed decisions of the Bankruptcy and District Courts allowing Chapter 13 debtors to “cure” a shortfall of Plan payments after the expiration of the 60 month Plan term. “[W]e conclude the Bankruptcy Code does permit a bankruptcy court to grant such a grace period” and did not abuse its discretion in this case. Debtors, having paid over $174,000 in plan payments, found themselves “short” $1,123, after the 60 months. The Trustee filed a Motion to Dismiss1 but agreed to withdraw the Motion upon payment which they did within 16 days of the Motion. However, a creditor joined in the Motion and pressed it forward, seeking dismissal of the case.

While Section 1322(d)(1) confirmation of a plan that exceeds 60 months, the issue is whether the Bankruptcy Court may deny a motion to dismiss and/or grant a completion discharge where there remains at the end of the Plan term a shortfall the debtor is ready, willing and able to cure.

The Court held that bankruptcy courts have discretion to deny dismissal and allow a grace period, so that if such payment is made within that grace period, the debtors will then have completed “all payments under the plan” and only then would be statutorily entitled to a discharge. 11 U.S.C. § 1328(a).

Delaware Cases

<u>In re Fayson</u>, No. 16-10013 (BLS), 573 B.R 531 (Bankr. D. Del. July 13, 2017) The Debtor purchased a used Mercedes Benz in 2014 and filed a chapter 13 petition in 2016. She proposed and had confirmed a plan proposing to retain the vehicle and pay the secured claim in full. Six months into the confirmed plan, however, the Debtor, claiming maintenance and warranty issues, returned the vehicle to the secured creditor and sought to modify her plan to surrender the vehicle and convert any deficiency claim into an unsecured claim. The secured creditor objected, contending that a "910 claim" may not be modified. A 910 Claim is the colloquial term for a claim secured by a motor vehicle purchased by the debtor within 2-1/2 years (910 days) of the petition date. If the debtor chooses to retain the vehicle, a 910 Claim must be treated as fully secured and paid in full under a chapter 13 plan.The creditor also contended that even if the Debtor could so modify the plan, the Debtor was not acting in good faith. Joining the majority view on this issue, the Court held that under section 1329(a), a debtor may modify a confirmed chapter 13 plan that originally sought to retain a motor vehicle as collateral securing a "910 Claim" to surrender the motor vehicle and reclassify the any deficiency as unsecured, so long as the modification is proposed in good faith as required by section 1325(a)(3). In holding that the vehicle could be surrendered, the Court noted that surrender is a form of payment and that numerous other provisions of the Bankruptcy Code supported this proposition. The Court also held that it would require a further evidentiary hearing to determine whether the Debtor had proceeded in good faith.

<u>Welsh v. Bank of America et al. (In re Welsh)</u>, Adv. No. 15-51335 (BLS), 2017 Bankr. LEXIS 2365 (Bankr. D. Del. Aug. 23, 2017) Prior to the Debtor's bankruptcy, Bank of America mistakenly recorded a satisfaction of mortgage on the Debtor's residence, removing its lien from the property. Bank of America filed a complaint in the Delaware Superior Court to set aside the satisfaction, but prior to disposition, the Debtor filed a chapter 13 petition staying the Superior Court proceeding. Bank of America then filed a proof of claim in the bankruptcy case and an adversary complaint to determine the validity, priority or extent of its lien. Pending the Court's decision in the adversary proceeding, Bank of America filed a transfer of claim reflecting an assignment of the mortgage and satisfaction to LSF9, both of which LSF9 had recorded. The Debtor prevailed in the adversary proceeding and the lien was avoided. The Debtor then filed a complaint against Bank of America and other defendants, seeking damages and attorneys' fees and punitive damages for violations of the automatic stay and the defendants moved to dismiss. The Court denied a Rule 12(b)(6) motion to dismiss finding adequate the Debtor's allegations that the defendants had assigned and recorded a mortgage post-petition in violation of the stay. The Court noted however that in light of its ruling in the first adversary proceeding, in which it awarded the Debtor property unencumbered by a mortgage, the Court was unlikely to award damages for a stay violation beyond the free house the Debtor had already obtained, noting: "The Plaintiff will benefit mightily due to [Defendant's] honest mistake."

<u>Bounds v. Mullins (In re Mullins)</u>, Adv. No. 16-51034 (BLS), 2017 Bankr. LEXIS 2381 (Bankr. D. Del. Aug. 24, 2017) Howard Mullins was criminally convicted for assaulting Jerome Bounds, a former employee. Bounds thereafter sued Mullins for intentional torts and the parties entered into a settlement whereby Mullins agreed to pay Bounds $20,000. Thereafter, Mullins filed Chapter 7. Bounds filed an objection to discharge pursuant to 11 U.S.C. § 523(a)(6), alleging "willful and malicious act". Bounds successfully obtained summary judgement. In reaching its decision, the Court relied on Archer v. Warner, 538 U.S. 314 (2003) and looked beyond the terms of the settlement agreement to establish the underlying facts that led to the debt. The Court determined that Mr. Bounds' civil battery claim was born out of willful and malicious actions, especially because it had the full preclusive effect of a criminal conviction behind it: "Third Circuit law mandates that those liabilities arising from assault and battery are generally considered as founded upon a willful and malicious injury and re, therefore, within the exception to discharge." [Citing to *In re Granfoff*, 250 Fed. App'x. 494 (3d Cir. 2007).

Vara v. Martin (In re Womack), Adv. No. 17-50200 (BLS), 2017 Bankr. LEXIS 3698 (Bankr. D. Del. Oct. 25, 2017) The UST filed a complaint for injunctive relief, fines, disgorgement and civil contempt, alleging that the Defendant, Robert Martin, provided petition preparer services to chapter 13 debtors in violation of 11 U.S.C. § 110. The Defendant had entered into two prior Consent Orders agreeing to comply with Section 110. The UST alleged that the Defendant repeatedly solicited and encouraged individuals whose homes were imminently scheduled for short sale to file for chapter 13 relief , but did not adequately inform them of the potential consequences of a bankruptcy filing. The Defendant would instruct a Debtor how to fill out the forms and then claimed he did not prepare them. The Court agreed that the Defendant's conduct posed a serious risk of harm to desperate and vulnerable individuals who were facing the loss of their homes and found that the Defendant's "business model" was based upon practices that violated federal law and prior orders of the Court. Accordingly, the Court entered judgment against the Defendant in favor of the UST on all counts, requiring disgorgement of all fees in each of the relevant cases and imposing injunctive relief, treble fines, and civil sanctions in the amount of $25,000.