

How to Use Adversary Proceedings Process in Chapter 7 and 13 Cases

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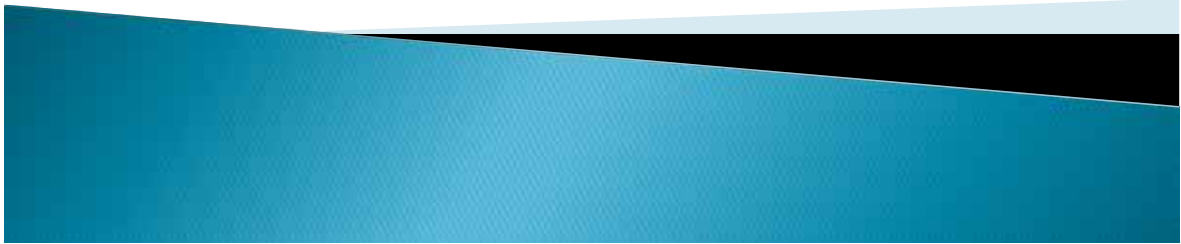
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Chapter 5 Avoidance Actions

- ▶ Preference and fraudulent conveyance lawsuits, also known as Chapter 5 avoidance actions, are some of the most common forms of litigation in bankruptcy courts
- ▶ The Bankruptcy Code contains broad powers to recover assets for the benefit of the entire bankruptcy estate that might not otherwise exist, or are limited to specific creditors under state law.
- ▶ Avoidance actions for the return of property of the debtor or its value from the non-debtor defendant (or subsequent transferee)



Chapter 5 Avoidance Actions

▶ 11 U.S.C. § 547– Preferences

- Allows recovery of pre-petition payments made on account of an antecedent debt
- The primary purpose of preference law is to promote the equality of the distribution of an insolvent debtor’s assets among its creditors. It is intended to half a debtor from “preferring” one creditor over another.
- Must prove each element of Section 547 by a preponderance of the evidence in order to avoid and recover a transfer
- Several defenses to 547 actions – contemporaneous exchange for new value; transfers made in the ordinary course of business; subsequent new value



Chapter 5 Avoidance Actions

▶ 11 U.S.C. § 548 – Fraudulent Transfers/ Conveyances

- 11 U.S.C. § 548(a)(1)(A)– Actually Fraudulent Transfer
 - Transfers made within 2 years before the date of the filing with the intent to hinder, delay, or defraud creditors may be avoided
- 11 U.S.C. § 548(a)(1)(B)– Constructive Fraudulent Transfer
- 548(c) – Good faith defense
- Section 548’s purpose is to prohibit debtors from placing their property beyond the reach of their creditors or transferring their property for less than reasonable consideration
- State law claims may exist and contain longer reach back periods



Chapter 5 Avoidance Actions

- ▶ 11 U.S.C. §§ 544, 545, and 549
 - Section 544 of the Bankruptcy Code allows the trustee to avoid transfers if they are avoidable under state law – 544 is the provision that allows the avoidance of unperfected liens
 - Section 545 of the Bankruptcy Code allows a trustee to avoid certain types of statutory liens which arise under state law – most importantly, landlord liens
 - Section 549 permits trustees or debtors in possession to avoid any post-petition transfer of estate property that was unauthorized by the code or the Bankruptcy Court



11 U.S.C. § 549– Post Petition Transfers

- ▶ Avoid any post-petition transfer of estate property that was not authorized by the Bankruptcy Code or the Bankruptcy Court
- ▶ Section 549 provides exceptions for certain good-faith transfers of real property and transfers made by the debtor after the filing of an involuntary case
- ▶ Section 549 allows a debtor to recover from a payday lender presenting a post-dated check after the filing; although the transaction is not a violation of the stay, the amount paid can still be recovered



Chapter 5 Avoidance Actions

▶ Statute of Limitation

- Section 546(a) provides a statute of limitation by which plaintiffs must file suit on avoidance actions
- Plaintiffs have the later of two years after the filing of the petition or one year after the appointment of a bankruptcy trustee to file suit
- If the action is not brought during this time period, the estate loses the right to assert the preference claim



11 U.S.C. § 550

- ▶ Although it is not an avoidance section, Section 550 governs the liability of the initial and subsequent transferees of avoidable transfers – in other words, it is the enforcement provision of Chapter 5
- ▶ If the trustee wants to recover property, or its value, or avoid a lien, the trustee must bring an action to avoid under 544, 545, 547, 548 or 549
- ▶ Section 550 allows the trustee to recapture the transferred property or its value and return it to the bankruptcy estate to be equitably distributed to all creditors*
- ▶ Avoided liens are preserved for the benefit of the estate



How Do You Bring an Avoidance Action?

- ▶ Rule 7001
 - An adversary proceeding is the bankruptcy court's version of a civil complaint. Adversaries are governed by Rule 7001
 - Proceedings brought to avoid transfers by the debtor under §§ 544, 545, 547, 548 or 549 require an adversary proceeding
 - On the other hand, violations of the discharge injunction and other similar proceedings may be prosecuted by motion
 - Rule 7004 governs service of process in adversary proceedings
 - An adversary complaint and summons must be served and addressed "to the attention of" an appropriate individual or office – note 7004(h)



Preferences – Fraudulent Transfers

- ▶ **Who Has the Power to Prosecute? The Debtor or the Trustee?**
 - **Chapter 7**
 - The Chapter 7 bankruptcy trustee has certain "strong arm" or avoiding powers which allow the trustee to reach back and undo certain transactions that took place prior to a Chapter 7 filing. Included among these actions are "avoidable preferences"
- ▶ Practice Note – if the Chapter 7 trustee does not pursue an action, a Chapter 7 debtor or a creditor acting for a Trustee after Bankruptcy Court approval may have standing



Preferences – Fraudulent Transfers

▶ Who Has the Power to Prosecute? The Debtor or the Trustee?

◦ Chapter 7 Cont'd

- A Chapter 7 debtor may bring avoidance actions for his or her own benefit in limited circumstances. More specifically, the debtor must establish standing under section 522(h) of the Bankruptcy Code. Standing only arises if the debtor establishes:
 - (1) the transfer to be avoided cannot have been a voluntary transfer of property by the debtor;
 - (2) the debtor cannot have concealed the property;
 - (3) the trustee cannot have attempted to avoid the transfer;
 - (4) the debtor must exercise an avoidance power usually used by the trustee that is listed within section 522(h); and
 - (5) the transferred property must be of a kind that the debtor would have been able to exempt from the estate if the trustee (as opposed to the debtor) had avoided the transfer pursuant to one of the statutory provisions in section 522(g)



Preferences – Fraudulent Transfers

▶ Who Has the Power to Prosecute? The Debtor or the Trustee?

◦ Chapter 13

- A debtor in chapter 13 possesses some avoidance powers
- However, the Bankruptcy Courts throughout the country are split as to what extent a debtor in a Chapter 13 case can utilize such powers
- Some jurisdictions allow the debtor in a Chapter 13 case to exercise all avoidance powers as if the debtor was the trustee*
- This dispute may be resolved by Section 522(g) & (h) which specifically state the debtor may utilize the trustee's avoidance powers if:
 - the creation of the lien or transfer of the property was involuntary; and
 - the trustee does not attempt to avoid the transfer.



Preferences – Fraudulent Transfers

▶ Who Has the Power to Prosecute? The Debtor or the Trustee?

◦ Chapter 11

- In a Chapter 11 case, standing to pursue avoidance actions is usually limited to the debtor-in-possession, plan administrator, or liquidating trustee following the approval of a liquidating plan if avoidance actions remain property of the liquidating estate
- Whether a trustee or DIP has standing to pursue avoidance actions turns on whether the claim was retained in a Chapter 11 plan
- In Chapter 11, if the DIP fails to act, the court can grant derivative standing to a creditor or committee of creditors to bring the action



Preferences – Fraudulent Transfers

▶ Chapter 7 Alter Ego Claims

- Alter ego in insolvency – litigant claims that an opposing party is using the corporate form unjustly and in derogation of the litigant’s interests, and that the court should not maintain the “fiction” of a separate legal entity
- Trustee or creditors seek to pierce the veil between debtor and its shareholders, parent, or subsidiary in order to gain access to assets or claims for the benefit of the estate
- Alter Ego claims are claims of the estate in some jurisdictions, and claims of creditors in others
- Courts analyzing a trustee’s standing to assert alter ego claims generally focus on whether it is a cause of action held by the debtor entity under state law. When courts conclude it is a creditor claim, however, they generally find it is a cause of action belonging to all creditors. In those jurisdictions where common creditor claims may be asserted by the trustee, standing to pursue an alter ego cause of action was allowed



Fair Credit Reporting Act (FCRA)

- ▶ The FCRA is a part of a group of acts contained in the Federal Consumer Credit Protection Act which includes
 - the Truth in Lending Act; and
 - the Fair Debt Collection Practices Act
- ▶ The Federal Trade Commission and the Consumer Financial Protection Bureau share enforcement authority under the FCRA, yet private consumer lawsuits seeking to recover actual or statutory damages for violations of the FCRA far outnumber agency actions
- ▶ When alleging FCRA violations, consumers also often bring claims under various similar state laws in the same action, such as automatic stay and discharge violations



Fair Credit Reporting Act (FCRA)

- ▶ **Statute of Limitations**
 - A plaintiff must bring an FCRA claim within the earlier of:
 - 2 years after the plaintiff discovers the violation
 - 5 years after the violation occurred
- ▶ **Jurisdiction**
 - As previously noted, consumers often bring state laws claims in the same action as their FCRA claims. The FCRA preempts certain state statutes and common law
 - The FCRA federal causes of action arise under Title 15, not Title 11 of the U.S. Code, therefore some bankruptcy courts hold that they do not “arise under,” nor are they “related to” bankruptcy cases, and thus should be dismissed from the bankruptcy court for lack of competent jurisdiction*



Fair Credit Reporting Act (FCRA)

▶ Damages

- For negligent violations of the FCRA, the claimant may recover actual damages and attorneys' fees and costs
- For willful noncompliance, a claimant may recover the greater of either actual damages or a statutory minimum of \$100 to a maximum of \$1,000, plus punitive damages, and attorneys' fees and costs – per violation

▶ Public Policy

- Congress enacted the FCRA in 1970 to promote the accuracy, fairness, and privacy of information in the files of consumer reporting agencies while also satisfying the important commercial need for consumer reports



Fair Debt Collection Practices Act (FDCPA)

- ▶ Regulates how a debt collector must conduct itself when it is attempting to collect debt
- ▶ Insolvent clients may have received numerous collection letters and phone calls that violate the FDCPA
- ▶ Schedule and Exempt FDCPA claims or lose it! (List “unknown” value for actual damage claims plus attorney fees)



Fair Debt Collection Practices Act (FDCPA)

▶ Statute of Limitations

- One year from each violation
 - Practice tip: If the SOL will run while the debtor is in BK, file a Motion with the Court to abandon the FDCPA claim so you may file it

▶ Jurisdiction

- Generally, a client may choose to:
 - (1) File the FDCPA case in Federal District Court if the discharge was issued and the case is complete; or
 - (2) File for Bankruptcy relief and bring Adversary Proceeding in Bankruptcy Court

▶ Note – many states have statutes that make any violation of FDCPA a violation of state law as well*



Fair Debt Collection Practices Act (FDCPA)

▶ Breach of the discharge – sending collection notices

- Collection attempts after bankruptcy's automatic stay may be FDCPA violations as well as Stay and Discharge violations

▶ Statutory damages

- \$1,000 per improper collection action, per defendant

Fair Debt Collection Practices Act (FDCPA)

▶ **Public Policy**

- FDCPA was approved in 1977 as Title VIII of the Consumer Credit Protection Act to:
 - eliminate abusive debt collection practices by debt collectors;
 - insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged; and
 - promote consistent State action to protect consumers against debt collection abuses



Truth In Lending Act (TILA)

- ▶ **Passed in 1968, TILA is a federal law that regulates the credit market and sets minimum standards for the information that a creditor must provide in an installment credit contract**
 - Under certain circumstances TILA may afford Debtors the right to rescind a loan



Truth In Lending Act (TILA)

- ▶ **What is the Procedure to Bring a Claim?**
 - Section 1640 of TILA enables consumers to institute actions for damages based upon a lender's TILA violations.
 - Section 1635 of TILA cover rescission

- ▶ **Debtors wishing to assert TILA claims must file an adversary proceeding in Bankruptcy Court in order to have their TILA claims heard***




Truth In Lending Act (TILA)

- ▶ **Statute of Limitations**
 - For original loans – claims for damages under 1640 may be brought within one year from the date of violation
 - For refinances – Section 1635(f) allows consumers three years after the date of the transaction or upon the sale of the property, whichever occurs first, to rescind
 - Claims for recoupment can be brought at any time
- ▶ **Jurisdiction**
 - Some Bankruptcy Courts often decline to interpose themselves in “purely noncore” TILA matters




Truth In Lending Act (TILA)

▶ Statutory damages

- Creditors who violate any requirement imposed by TILA are liable to the consumer for statutory damages
 - The measure of statutory damages is twice the amount of the consumer's finance charge, subject to minimum and maximum recoveries
 - For consumer leases and open or closed-end loans not secured by residential real estate, the minimum and maximum amounts of statutory damages are \$100 and \$1,000, respectively
 - For closed-end loans secured by a consumer's real property or dwelling, the minimum and maximum amounts are \$200 and \$2,000, respectively
 - For a lender's failure to disclose credit terms, consumers are entitled to statutory damages of twice the lender's finance charges, between \$100 and \$5,000, depending on the type of credit
- 

Truth In Lending Act (TILA)

▶ Public Policy

- TILA was designed to promote the informed use of consumer credit, by requiring disclosures about its terms and cost to standardize the manner in which costs associated with borrowing are calculated and disclosed
 - As part of the Consumer Protection Act, the purpose behind the Truth in Lending Act is to provide uniform disclosures to make it easier for the consumer to shop for credit, as well as to help ensure the consumer understands the financial risks associated with a loan
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Injunction Violation Actions

- ▶ **Breach of the discharge – sending collection notices**
 - Section 524(a) bars any attempt to collect a prepetition debt as a personal liability of the debtor. This operates as an injunction, the violation of which can be sanctioned under the courts contempt power. Collection notices violate the discharge injunction
- ▶ **Jurisdiction**
 - An action by an individual debtor seeking relief from a violation of the discharge injunction is within the “Core” jurisdiction of the Bankruptcy Court
- ▶ **Statutory damages**
 - Section 524(a) does not include a specific provision setting forth available remedies for a violation of the discharge injunction. Courts impose sanctions, however, for civil contempt under § 105 of the Bankruptcy Code upon a showing of willfulness. Sanctions for a violation of the discharge injunction may include actual damages, attorney's fees, and in some circumstances, punitive damages



Wrongful Foreclosure

- ▶ **State or Federal Elements of the Claim**
 - The specific elements of a wrongful foreclosure claim will depend on whether the plaintiff is asserting their claim under federal or state law, the latter of which will inevitably vary by jurisdiction*
 - But note – Judicial foreclosure states do not have "wrongful foreclosure" causes of action because the foreclosure took place by court order
- ▶ **Damages**
 - When a foreclosure occurs, the mortgagor generally has two remedies: (1) it can let the sale stand and sue at law for damages, or (2) it can bring an equitable action to have the sale or foreclosure rescinded
 - Borrowers may also be able to obtain damages for emotional distress in a wrongful foreclosure action, if the borrower can prove by clear and convincing evidence that the servicer/trustee was guilty of fraud, or willful misconduct



Wrongful Foreclosure

▶ Jurisdiction – Stern?

- Wrongful foreclosure actions are generally a product of state law, giving rise to a question of whether the claims are core matters
- After *Stern*,* Bankruptcy Judges may be constitutionally prohibited from entering final judgments on certain matters, including state law tort claims that do not “stem from the bankruptcy itself” or “necessarily” resolve a creditor’s proof of claim. Rather, some courts hold that such matters are reserved solely for Article III judges
- While *Stern* dealt with only one narrow class of core matters, the ruling called into question Bankruptcy Judges’ authority to enter final judgments in a string of matters



Judicial Estoppel

- ▶ **Failure to schedule claims may result in their being lost to the debtor**
- ▶ **Elements**
 - Elements vary from jurisdiction to jurisdiction but in general, judicial estoppel applies when two positions taken by a party are clearly contradictory and when the first position has already been accepted by a court
- ▶ **Purpose**
 - The purpose of judicial estoppel is to prevent re-litigating issues that have already come before the court, saving court resources, and protecting the integrity of the courts

