

Round & Round Program: Leading Cases

Prof. Ralph Brubaker, Moderator

University of Illinois College of Law; Champaign, Ill.

Hon. Daniel P. Collins

U.S. Bankruptcy Court (D. Ariz.); Phoenix

Hon. Mary Grace Diehl

U.S. Bankruptcy Court (N.D. Ga.); Atlanta

Hon. Dennis R. Dow

U.S. Bankruptcy Court (W.D. Mo.); Kansas City

Hon. Robert D. Drain

U.S. Bankruptcy Court (S.D.N.Y.); New York

Hon. Michael A. Fagone

U.S. Bankruptcy Court (D. Maine); Bangor

Hon. Bruce A. Harwood

U.S. Bankruptcy Court (D. N.H.); Manchester

Hon. Pamela Pepper

U.S. District Court (E.D. Wis.); Milwaukee

Hon. Deborah L. Thorne

U.S. Bankruptcy Court (N.D. Ill.); Chicago

Hon. Eugene R. Wedoff (ret.)

Oak Park, Ill.

AMERICAN BANKRUPTCY INSTITUTE

**AMERICAN BANKRUPTCY INSTITUTE
2016 WINTER LEADERSHIP CONFERENCE
Round and Round with the Judges Program
Saturday, December 3, 2016**

Topics

- (1) *Dischargeability of Student Loan Debts: Recalibrating the Standards***
Honorable Daniel P. Collins, Chief Judge
United States Bankruptcy Court, District of Arizona

- (2) *Motors Liquidation and the Future of Free-and-Clear Sales***
Honorable Mary Grace Diehl
United States Bankruptcy Court, Northern District of Georgia

- (3) *Equitable Mootness: Alive or Dead?***
Honorable Dennis R. Dow
United States Bankruptcy Court, Western District of Missouri

- (4) *The Interplay of the Federal Arbitration Act and the Bankruptcy Code***
Honorable Robert D. Drain
United States Bankruptcy Court, Southern District of New York

- (5) *Are There Any Limits on the § 546(e) Safe Harbor?***
Honorable Michael A. Fagone
United States Bankruptcy Court, District of Maine

- (6) *The Implications of Husky for § 523(a)(2)(A) Litigation***
Honorable Bruce A. Harwood, Chief Judge
United States Bankruptcy Court, District of New Hampshire

- (7) *If You Snooze, Do You Lose? Stale Proofs of Claim and the FDCPA***
Honorable Pamela Pepper
United States District Court, Eastern District of Wisconsin

- (8) *Wandering Through the Bankruptcy Jurisdiction Maze: Entering Money Judgments on Nondischargeable Debts***
Honorable Deborah L. Thorne
United States Bankruptcy Court, Northern District of Illinois

- (9) *Jevic: When Is Absolute Priority Not So Absolute?***
Honorable Eugene R. Wedoff
United States Bankruptcy Court, Northern District of Illinois (retired)

Moderator: Ralph Brubaker
Carl L. Vacketta Professor of Law
University of Illinois College of Law

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Dischargeability of Student Loan Debts: Recalibrating the Standards
Honorable Daniel P. Collins, Chief Judge
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STUDENT LOAN DEBTS IN BANKRUPTCY

Presented By¹:

Magdalena Reyes Bordeaux, Esq.
Supervising Senior Staff Attorney
Consumer Law Project
Debtor Assistance Project
Public Counsel

610 S. Ardmore Ave.

Los Angeles, CA 90005

Telephone: (213) 385-2977/Facsimile (213) 385-9089

mbordeaux@publiccounsel.org

Steven Frederick Werth, Esq.

SulmeyerKupetz, A Professional Corporation

333 South Hope Street, 35th Floor

Los Angeles, CA 90071

Telephone: (213) 626-2311/Facsimile (213) 629-4520

swerth@sulmeyerlaw.com

¹ The views expressed in this presentation are for discussion purposes only and are not necessarily reflecting of the position of the authors, their firms, or any of their clients.

I. STUDENT LOAN DEBT

A. Student Loan Debt Tops \$1 Trillion

Traditionally, education has returned a great value for its cost, as well as served as a vehicle for social mobility for students graduating with undergraduate and post-graduate degrees. However, the recent weak job market, coupled with unprecedented high student loan debt, has made this outcome less promising for many recent graduates.

Today, 40 million people collectively owe \$1.2 trillion in student loan debt.² Unlike the modest dollar-amount loans made to students in the 1970's by local banks and colleges, present-day students face mammoth costs to pay for education. *Roth v. Educ. Credit Mgmt. Corp. (In re Roth)*, 490 B.R. 908, 922 (B.A.P. 9th Cir. 2013) (Pappas, J., concurring). The high cost of education has forced nearly all students to borrow heavily to finance their future. *Id.* at 922.

For the 2014-2015 academic year, the College Board reported that a moderate college budget for an in-state public college averaged \$23,410, while a moderate budget at a private college averaged \$46,272.³ The economic picture is not brighter for students seeking a post-graduate degree, such as a law degree. In 1985, the average private law school tuition was \$7,526. By 2013, it had ballooned to \$41,985.⁴

Given the high student loan debt and recent weaknesses in the job market, some wonder whether the bankruptcy courts should re-examine the ability of debtors with significant student

² Susan Dynarski, "New Data Gives Clearer Picture of Student Debt," *N.Y. Times*, Sept. 10, 2015, available at http://www.nytimes.com/2015/09/11/upshot/new-data-gives-clearer-picture-of-student-debt.html?_r=0 (last visited on November 9, 2015).

³ "What's the Price Tag for a College Education?" *College Data*, available at http://www.collegedata.com/cs/content/content_payarticle_tmpl.jhtml?articleId=10064 (last visited on November 9, 2015).

⁴ "Tuition Increases in Nominal Dollars," *Law School Transparency*, available at <http://www.lawschooltransparency.com/reform/projects/Tuition-Tracker/> (last visited on November 9, 2015).

loan debt to discharge that debt. Currently, student loans are extremely difficult to discharge in a bankruptcy case. This has not always been the case, and it may be that this will change in the future.

I. THE BACKGROUND OF STUDENT LOAN DEBT

A. Congress Takes Action Regarding Student Loans

The Constitution authorizes Congress to establish "uniform laws on the subject of bankruptcies throughout the United States." Article I, §("Section") 8, Cl. 4. It is a central tenet of U.S. bankruptcy law that the goal of bankruptcy is to provide the "honest but unfortunate debtor" with a fresh start.

Prior to 1976, student loans could be discharged in the same way credit card debt and other unsecured debt could be discharged in a bankruptcy case. However, in the early 1970's, proponents of a discharge exception pointed to alleged abuses of bankruptcy laws by debtors saddled with large amounts of educational debt but with well-paying jobs who would file bankruptcy shortly after graduation when their loans became due.⁵ To combat these perceived abuses, Congress passed the Education Amendments Act of 1976, and the first exception to a debtor's discharge for student loans became effective in 1977. Pub L. 940482. Congress codified this provision in the Bankruptcy Code the following year as 11 U.S.C. § 523(a)(8).⁶

For bankruptcy cases filed after September 30, 1977, student loan debts which were less than five years old did not discharge unless it was determined "that payment from future income or other wealth will impose an undue hardship on the debtor or his dependents." Pub. L. 940482,

⁵ Neil T. Phillips, "Note, How Poor Is Poor Enough? Tracking the Evolution of Student Loan Dischargeability from Judge Haight to Judge Easterbrook," *12 Geo. J.L. & Pub. Pol'y* 329, 333(2014) (citing H.R. REP. No. 93-137(1973); H.R. REP NO. 95-595(1977).

⁶ See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 523, 92 Stat. 2591.

Sec. 439. But, student loan debts more than five years old could be discharged as normal and did not require a showing of undue hardship.

In 1990, Congress extended the period of nondischargeability to 7 years. Pub L. 101-647. And until 1997, student loans which were sufficiently old (at that point, at least 7 years old) could be discharged without a showing of undue hardship. In 1998, however, Congress eliminated the time-based restriction altogether, and demonstrating undue hardship became the only way to discharge student loans when filing for bankruptcy relief. In 2005, Congress extended this exception to discharge private student loans.⁷

B. The Statute

11 U.S.C. § 523(a)(8) is the statute in the Bankruptcy Code which makes student loans nondischargeable unless there is a showing of undue hardship. That section states:

"A discharge under ... this title does not discharge an individual debtor from any debt— ... (8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—

(A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the International Revenue Code of 1986, incurred by a debtor who is an individual."

⁷ See Bankruptcy Abuse and Consumer Protection Act of 2005, Pub. L. 109-8, § 220, 119 Stat. 59 (codified at 11 U.S.C. § 523 (a)(8)(2012)).

While the syntax of this section is disjointed, its meaning is clear: for the types of debts identified in subparts (A) and (B), a general discharge of a debtor will not discharge those debts unless failure to do so "would impose an undue hardship on the debtor and the debtor's dependents."

C. The Meaning Of Undue Hardship

The Bankruptcy Code does not define the term "undue hardship" in Section 523(a)(8). In fact, when Congress added the term to Section 523(a)(8), that term did not exist anywhere else in the Bankruptcy Code. Since this date, the term has been added elsewhere to the Code, such as Section 524. Section 524(c) requires that reaffirmation agreements entered into by the debtor must be reviewed by the court to ensure that repayment of the obligation will not pose an undue hardship on the debtor or a dependent of the debtor. More recently, in 2005, Congress included language under Section 524 to guide the bankruptcy courts in examining what constituted undue hardship.

Under Section 524(m)(1), the statute specifically states:

“...it shall be presumed that such agreement is an *undue hardship* on the debtor if the debtor’s monthly income less the debtor’s monthly expenses as shown on the debtor’s completed and signed statement in support of such agreement as required under subsection (k)(6)(A) is less than the scheduled payments on the reaffirmed debt.”

11 U.S.C. §524(m)(1) (emphasis added).

Although the way in which undue hardship arises under Section 524 is different than dischargeability under Section 523(a)(8), Congress did use the same phrase in both statutes. As

the term “undue hardship” was not defined when the exception to discharge was first codified in 1978, however, this left courts to define the term on their own.

In 1985, the District Court for the Southern District of New York ruled on a case which was to have a major impact on how courts interpret the term *undue hardship* under Section 523(a)(8) – *In re Brunner*, 46 B.R. 752, 754 (S.D.N.Y. 1985), a case that was later upheld by the Second Circuit. There, a student just ten months out of her Master's program sought to discharge \$9,000 in student loan debt, immediately after the grace period before payments became due expired, and having made no efforts to pay anything on the loans.

The court recognized that undue hardship was undefined in the Bankruptcy Code and that the statute otherwise gives no hint of the phrase’s intended meaning. *Id.* at 753. The court first reviewed the history of how the term "undue hardship" came into existence:

That term was lifted verbatim from the draft bill proposed by the Commission on the Bankruptcy Laws of the United States ("the Commission"). The Commission's report provides some inkling of its intent in creating the exception, intent which in the absence of any contrary indication courts have imputed to Congress. The Commission noted the reason for the Code provision: a "rising incidence of consumer bankruptcies of former students motivated primarily to avoid payment of educational loan debts." Report of the Commission on the Bankruptcy Laws of the United States, House Doc. No. 93-137, Pt. I, 93d Cong., 1st Sess. (1973) at 140 n. 14, reprinted in Collier, *supra*, Appendix 2, at PI-i. This "rising incidence" contravened the general policy that "a loan . . . that enables a person to earn substantially greater income over his working life should not as a matter of policy be dischargeable before he has demonstrated that for any reason he is unable to earn sufficient income to maintain himself and his dependents and to repay the educational debt." *Id.* at 140, n. 15. The Commission implemented this policy by delaying dischargeability for five years, a time period which, it was anticipated, "gives the debtor an opportunity to try to meet his payment obligation." After five years, the exception is lifted in recognition of the fact that "in some circumstances the debtor, because of factors beyond his reasonable control, may be unable to earn an income adequate both to meet the living costs of himself and his dependents and to make the educational debt payments." *Id.* at 140, n. 16. As a calculation of "undue hardship," the Commission envisioned a determination of whether the amount and

reliability of income and other wealth which the debtor could reasonably be expected to receive in the future could maintain the debtor and his or her dependents at a minimal standard of living as well as pay off the student loans. *Id.* at 140-41, n. 17.

The *Brunner* District Court then analyzed the public policy behind making student loans difficult to discharge in the first place, essentially boiling down to the fact that the government must give loans to students who are poor credit risks at the time, and concluded that the test for undue hardship should be the following:

"In conclusion, obtaining a discharge of student loans in bankruptcy prior to five years after they first come due requires a three-part showing:

- 1) that the debtor cannot, based on current income and expenses, maintain a "minimal" standard of living for himself or herself and his or her dependents if forced to repay the loans,
- 2) that this state of affairs is likely to persist for a significant portion of the repayment period of the student loan, and
- 3) that the debtor has made good faith efforts to repay the loans."

Id. at 756. The District Court found that the debtor's situation could potentially improve, and so denied the debtor a discharge. On appeal, the Second Circuit upheld this ruling. *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. N.Y. 1987). Hereafter, this decision will be the one referred to as the "Brunner" decision, and the 3-part test identified above will be referred to as the "Brunner Test."

Most courts have adopted the Brunner Test as the test to use to determine whether or not a debtor has made a showing of undue hardship under Section 523(a)(8). *Brunner* has been adopted in the 9th Circuit. *United Student Aid Funds, Inc. v. Pena (In re Pena)*, 155 F.3d 1108, 1111-12 (9th Cir. 1998).

However, not all courts use the Brunner Test. The 8th Circuit uses a "totality of the circumstances" test. *Educ. Credit Mgmt. Corp. v. Jespersen*, 571 F.3d 775, 779, 782 (8th Cir. 2009). The "totality of the circumstances" test is as follows:

In evaluating the totality-of-the-circumstances, our bankruptcy reviewing courts should consider: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependents' reasonable necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case. [citations] Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt – while still allowing for a minimal standard of living – then the debt should not be discharged. Certainly, this determination will require a special consideration of the debtor's present employment and financial situation – including assets, expenses, and earnings – along with the prospect of future changes – positive or adverse – in the debtor's financial position.

Long v. Educ. Credit Mgmt. Corp. (In re Long), 322 F.3d 549, 554-555 (8th Cir. 2003). There, the court stated that it rejected the Brunner Test because the court felt it was an overly restrictive interpretation of undue hardship and would reduce the Court's inherent discretion contained in Section 523(a)(8). *Id.* at 554. The First Circuit also uses this test. *Abdinoor v. Navient Sol'ns, Inc. (In re Abdinoor)*, 2015 BNH 006 (Bankr. D.N.H. 2015).

II. WHAT KINDS OF LOANS ARE INCLUDED WITHIN SECTION 523(a)(8)?

Section 523(a)(8) does not make all student debt dischargeable; only that debt which fits within the language of the statute. For example, one court has ruled that a loan taken out to pay for flight school is dischargeable. See *Nunez v. Key Educ. Res./GLESI (In re Nunez)*, 527 B.R. 410 (Bankr. D. Or. 2015). Many debtors simply concede that their debts meet these requirements, however certain cases turn on this language and rule in favor of debtors. However, the scope of this section is not absolute, and debtors may prevail in an argument that the type of loan one has makes the statute inapplicable. Also, the lender has the burden of proof on proving

that the type of loan at issue is the type covered by Section 523(a)(8). *Brunell v. Citibank (South Dakota) N.A. (In re Brunell)*, 356 B.R. 567, 580 (Bankr. D. Mass. 2006).

In reading Section 523(a)(8)(A)(ii), one can see how a lender's burden could be easy to satisfy, as that subpart appears to state that the statute applies to "an obligation to repay funds received as an educational benefit, scholarship, or stipend" without limitation. However, in *Nunez* the court explained that this subparagraph cannot be read on its own. Prior to the 2005 amendments to the Bankruptcy Code, the language of what is now 523(a)(8)(A)(i) and (ii) was an integrated whole. Thus, (A)(ii) should be read in conjunction with (A)(i), and (A)(i) limits the types of loans to which the statute applies, specifically, loans either directly or indirectly from the government or nonprofit institutions. *Id.* at 415. Courts that follow *Nunez* will thus engage in a two-part analysis to determine whether an educational debt is even subject to nondischargeability. First, is there some kind of obligation to repay a benefit received from a governmental unit, or a program funded by the government or nonprofit? If so, it's included by Section 523(a)(8)(A). If not, is it a qualified education loan, as defined in section 221(d)(1) of the International Revenue Code of 1986? If so, it's included by Section 523(a)(8)(B).

How does a debtor determine if a loan is covered by 523(a)(8)(B)? 26 U.S.C. § 221(d) provides in relevant part:

1) Qualified education loan. – The term "qualified education loan" means any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses

(2) Qualified higher education expenses. – The term "qualified higher education expenses" means the cost of attendance . . . at an eligible educational institution For purposes of the preceding sentence, the term "eligible educational institution" has the same meaning given such term by [26 U.S.C.] section 25A(f)(2)

In turn, 26 U.S.C. § 25A(f)(2) provides as follows:

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(2) Eligible educational institution. – The term "eligible educational institution" means an institution –

- (A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of enactment of this section, and
- (B) which is eligible to participate in a program under title IV of such Act.

Thus, in order for this section to be met, a bankruptcy court must determine if the particular school is eligible for title IV funding. *See* 527 B.R. at 416. The document that provides that information is called the "Federal School Codes" list, and the list for 2014 and 2015 can be found at <http://ifap.ed.gov/fedschcodelist/attachments/1415FedSchoolCodeList.pdf>. Debtors should check the most updated version of that list and determine if the educational institution is on that list. If no, the Section 523(a)(8)(B) cannot be satisfied.

If a debtor owes an obligation that is covered either under (a)(8)(A) or (a)(8)(B), then the only way for a debtor to obtain discharge of that debt is by demonstrating that the debt, if not discharged, would "impose an undue hardship on the debtor and the debtor's dependents."

III. UNDUE HARDSHIP, REVISITED

Given the above, it is tempting to approach any analysis as to whether undue hardship under Section 523(a)(8) can be shown by simply determining whether one is in a district which applies the Brunner Test or the totality of the circumstances test, and applying that test. The problem with that approach is that if one too quickly adopts it, one is likely to miss an important part of the analysis and may be forced too quickly into a test which virtually ensures that a debtor will not receive a discharge. It is worth pausing, therefore, at this moment to note the issues that exist before one proceeds further.

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First, the term “undue hardship” is not defined in Section 523(a)(8). No Circuit has defined it, nor has the Supreme Court ruled on its definition. While a test is a way of approaching whether or not the facts fit within the meaning of the words "undue hardship," the test is not the words. The 8th Circuit noted this in *Long v. Educ. Credit Mgmt. Corp.* when it stated that it felt that the Brunner Test is too restrictive and limits a Court's discretion. 46 B.R. 752, 754. Courts can give that term meaning consistent with Congressional intent and court precedent, supported by the facts of each individual case, without necessarily applying any test at all.

Second, the Brunner Test may not be a useful test to apply any longer. The concurring opinion in *Roth v. Educ. Credit Mgmt. Corp. (In re Roth)*, 490 B.R. 908, 920 (B.A.P. 9th Cir. 2013) contains an extensive discussion as to why it should be rejected. *Id.* at 920 ("the Brunner test for determining undue hardship is truly a relic of times long gone"). Americans now collectively owe more than \$1 trillion in student loan debt. An Ivy League education can cost in excess of \$200,000, and that is simply for an undergraduate degree. American manufacturing jobs have declined significantly since 1987, and employees' real wages have stagnated.

Some now posit that the cost of obtaining a college degree might never be overcome by improved income prospects. Thus, while bankruptcy courts in the Ninth Circuit may treat the Brunner Test as binding law due to *In re Pena*, the Ninth Circuit decision which adopted that test, arguments can be made that the test, and the case law interpreting it, is no longer helpful or appropriate. The Brunner test and the totality of the circumstances test are just two of many tests.

As such, one should note before jumping into the Brunner Test or any other test that significant arguments can be made that the court's task is not to apply a test at all but to

determine "undue hardship," and that making that determination might require the court to divert from prior case law which unreasonably restricts its discretion.

IV. EXAMINING THE BRUNNER TEST

The debtor has the burden of proof to demonstrate that not discharging a student loan debt will result in undue hardship. To obtain such a ruling, the debtor will have to file a complaint to determine the debt to be nondischargeable, and the Court will have to enter a judgment either after a motion for summary judgment or a trial. A debtor cannot obtain a discharge of her student loan debts simply by filing a motion in her bankruptcy case. An adversary proceeding must be commenced. Fed. R. Bankr. P. 7001(6).

Currently, the Brunner Test continues to be the most common way for a court to determine if the debtor can meet the undue hardship test under Section 523(a)(8).

A. The Brunner Test

In *Brunner*, the Second Circuit adopted the District Court's standard for undue hardship. That required a three-part showing: (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans. *Brunner*, 831 F.2d at 396.

These questions are in the disjunctive, so the debtor must show all three in order to prevail. Courts typically review all three factors when making their decision due to the possibility of an appeal, but they are not required to do so. If a Court finds that a single factor cannot be met, it does not need to conduct any further analysis.

B. The First Factor

The first factor of the *Brunner* test is that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans. When analyzing whether a "minimal" standard of living can be maintained, "the debtor must demonstrate more than simply tight finances." *Rifino v. United States (In re Rifino)*, 245 F.3d 1083, 1088 (9th Cir. Wash. 2001).

The starting point for this analysis is going to be the debtor's Schedule I and Schedule J, which identifies the debtor's monthly income and expenses. The Court also looks at the monthly amount required to be paid to service the debtor's student loans. The Court will then reach the following conclusions, depending on the relationships between those numbers:

1. Option One: The Debtor Has Enough To Make Student Loan

Payments

If a debtor's schedules indicate that the debtor has a surplus of income and that that surplus is enough to make monthly payments on her student loan obligation, the Court likely will rule that this debt is nondischargeable and is unlikely to perform any further analysis. *See Freeland v. United States Dep't of Educ. (In re Freeland)*, 2015 Bankr. LEXIS 2991 (Bankr. D. Or. Sept. 2, 2015) (income minus expenses left a balance of \$442.00 per month, which was enough to pay \$300 per month student loan; therefore, debt was not dischargeable); *Brunell v. Citibank (South Dakota) N.A. (In re Brunell)*, 356 B.R. 567, 580 (Bankr. D. Mass. 2006).

2. Option Two: The Debtor Has Enough To Make Student Loan

Payments, But Only If Those Payments Are Zero Or Abnormally Low

There are certain programs that student loan borrowers can sign up for which reduce a borrower's monthly payment obligations.

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- The Income Contingent Repayment plan (ICRP) is available from the U.S. Government and contemplates that the debtor will repay the loans over a 25-year period, with payments pegged to income, with loan forgiveness to occur in the 25th year, with the forgiveness of that loan creating a taxable event.
- The Public Service Loan Forgiveness program discharges any remaining debt after 10 years of full-time employment in public service, but the borrower must have made 120 payments over that period to obtain the benefit.
- The Income Based Repayment plan (IBR) allows borrowers to cap their student loan payments on the major types of federal student loans at a small percent of current discretionary income, if the borrower makes payments on time.

The availability of these programs may be a relevant factor in many courts' analyses as to whether the *Brunner* test can be satisfied. *Lee v. Regions Bank Student Loans (In re Lee)*, 352 B.R. 91, 95 (B.A.P. 8th Cir. 2006).

However, courts have noted that the availability of income-based repayment options should not foreclose the ability to obtain a discharge of student loan debts. *Lee v. Regions Bank*, 352 B.R. 91, 96. See also *Roth v. Educ. Credit Mgmt. Corp. (In re Roth)*, 490 B.R. 908, 920 (B.A.P. 9th Cir. 2013) (noting "potentially disastrous" tax consequences of discharging debt through such program). In fact, courts have found that to the extent a judge thinks debtors ***always must*** agree to a payment plan and forgo a discharge, that this was an ***incorrect*** proposition of the law. *Krieger v. Educ. Credit Mgmt. Corp.*, 713 F. 3d 882 (7th Cir. Ill. 2013) (noting that the statutory language is that a discharge is possible when payment would cause an "undue hardship" and that it was important not to allow judicial glosses, such as the language in *Brunner*, to supersede the statute itself). It is important to note that even the *Brunner* court stated

that “it is not unreasonable to hold that committing the debtor to a life of poverty for the term of the loan – generally ten years – imposes ‘*undue hardship*.’” *In re Brunner*, 46 B.R. 752, 754. (emphasis added).

Moreover, courts have found that even where a debtor qualifies for loan payment reduction under ICRP and IBR, the Court is not relieved of its duty to determine whether the debtor's student loans impose an undue hardship. See *Limkemann v. U.S. Dep't of Educ. (In re Limkemann)*, 314 B.R. 190, 195 (Bankr. N.D. Iowa 2004); *Monroe v. U.S. Dep't of Educ. (In re Monroe)*, 2015 Bankr. LEXIS 3222 (Bankr. W.D. Ark. Sept. 22, 2015). Courts have also noted that requiring debtors to participate in these creditor programs as a condition to obtaining a bankruptcy discharge means the lender, not bankruptcy judges, will decide which loans can be forgiven, and this surely was not what Congress intended in enacting Section 523(a)(8). *In re Roth*, 490 B.R. 908, 923. That said, if the debtor has enough extra cash each month to make that minimal payment, the debtor may have a difficult time convincing the Court that she should prevail on this issue.

Nevertheless, there are several arguments that one can make that a bankruptcy court should not place undue weight on the existence of a repayment program.

First, these repayment programs often have requirements that may be difficult to satisfy. Some may state that the borrower does not receive the benefit unless all payments are made in full and on time – a difficult prediction for any borrower to make when looking 10 to 25 years into the future. Some may require the borrower to remain continually employed during that time.

Second, there is no guarantee that Federal student loan repayment programs will be around during the duration of the proposed repayment period. Congress can and does defund

federal projects to balance the Federal budget, and student loan forgiveness programs could become a drain on U.S. coffers – especially given that today there is already over \$1 trillion in outstanding student loan debt.

Third, the existence of repayment programs does not change the language of Section 523(a)(8). As such, bankruptcy courts should not determine that the existence of a potential repayment program bars debtors from relief under Section 523(a)(8).

3. Option Three: The Debtor's Stated Income Does Not Exceed Her Expenses

Typically, a debtor's stated income on Schedule I is going to be either equal to or only slightly greater than a Debtor's stated expenses on Schedule J. On its face, the debtor won't have any extra money to pay for student loan debt at all. The Court will then scrutinize each of the Debtor's expenses and determine whether they are reasonable. This is a totality of the circumstances test, and is going to change based on the debtor's age, number of dependents, and geographic location.

Typically, courts are going to find that some of the debtor's expenses can be reduced. Courts are not bound to accept the expense numbers that other courts have used for their debtors, but it is worth surveying the types of monthly expenses that some courts have found to be appropriate⁸:

Rent: \$1,000 for singles. \$1,550 for families.
Gas and normal maintenance on vehicle: \$50 for singles
Food: \$200 for groceries. For families, up to \$950
Restaurants. \$50 for singles. For families, up to \$110
Phone: \$50 for singles. For families, up to \$180

⁸ Many of these expenses are found in *Batdorf v. Mae (In re Batdorf)*, 2014 Bankr. LEXIS 4236 (Bankr. E.D. Cal. Sept. 26, 2014), *Shells v. United States Dep't of Educ. (In re Shells)*, 530 B.R. 758 (Bankr. E.D. Cal. 2015), *Murphy v. United States Dep't of Educ. (In re Murphy)*, 535 B.R. 97 (Bankr. W.D. Pa. 2015).

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Entertainment: \$25 for singles. \$125 to \$200 if you have dependents
Children's savings: \$50
Electricity: \$250 for families
Automobile Insurance: \$83 for families
Cable/Internet: \$142 for families
Clothing: \$100 for families
Water: \$55 for families
Household supplies: \$100 for singles, \$300 for families
"Home Maintenance" of \$500.00 for a single
Unforeseeable: \$100 for families
Car payments: \$345 for a single
Forced pension payments (if part of a union or such) – any amount
Elective pension payments – none allowed

After doing this expense reduction, the Court will revisit whether the debtor has enough income to make student loan payments. If the debtor has multiple loans at different monthly payment amounts, the court may then determine that some of them can be paid, mixing and matching the loans to get to the proper amount that can be paid with the surplus. See *Monroe v. U.S. Dep't of Educ.*, 2015 Bankr. LEXIS 3222 (ruling that 4 of debtor's 9 loans were nondischargeable, as the debtor could pay the aggregate of their monthly payment amount with her excess income over expenses).

The court may also do an overall "reality check" and determine whether the debtor's income puts her above the poverty line. If so, the court might be reluctant to find that the debtor's expenses cannot be reduced. See *Shells v. United States Dep't of Educ. (In re Shells)*, 530 B.R. 758, 765 (Bankr. E.D. Cal. 2015).

C. The Second Factor

The second factor is a debtor must prove that "that her present inability to pay will likely persist throughout a substantial portion of the loan's repayment period." *Educ. Credit Mgmt. Corp. v. Nys (In re Nys)*, 446 F.3d 938, 945. (9th Cir. 2006). The Ninth Circuit has explained that bankruptcy courts should endeavor to identify whether "additional circumstances" exist to

support this finding, but clarified that "the determinative question is whether the debtor's inability to pay will, given all we know about the salient features of her existence, persist throughout a substantial portion of the loan's repayment." *Id.* at 946. Importantly, the second prong does not require that the debtor "show exceptional circumstances beyond the inability to pay in the present and a likely inability to pay in the future." *Nys*, 446 F.3d at 947.14.

In *Nys*, the Ninth Circuit indicated that courts may refer to the following non-exhaustive list of possible "additional circumstances" which may prevent a debtor from having the ability to pay in the future:

1. Serious mental or physical disability of the debtor or the debtor's dependents which prevents employment or advancement;
2. The debtor's obligations to care for dependents;
3. Lack of, or severely limited, education;
4. Poor quality of education;
5. Lack of usable or marketable job skills;
6. Underemployment;
7. Maximized income potential in the chosen educational field, and no other more lucrative job skills;
8. Limited number of years remaining in the debtor's work life to allow payment of the loan;
9. Age or other factors that prevent retraining or relocation as a means for payment of the loan;
10. Lack of assets, whether or not exempt, which could be used to pay the loan;

11. Potentially increasing expenses that outweigh any potential appreciation in the value of the debtor's assets and/or likely increases in the debtor's income; and

12. Lack of better financial options elsewhere.

See *McCafferty v. United States Dep't of Educ. (In re McCafferty)*, 2015 Bankr. LEXIS 3600, 22-23 (Bankr. E.D. Wash. Oct. 23, 2015).

This prong has two purposes. It closes a loophole in the first factor, which requires that the analysis be of the debtor's "current income and expenses," as it prevents debtors from obtaining a discharge simply because the debtor is currently unemployed or for some reason cannot at that point in time meet financial obligations. Second, it makes it extremely difficult for debtors to obtain a discharge when they are young, or soon after they have finished their education. The reasoning is that younger persons have some hope of obtaining a job in the future in the field in which they obtained their degree, and therefore their finances are likely to improve in the future.

However, this prong is now being questioned by the courts as a growing number of students have student debt that is decades old. Courts have found that requiring a debtor to demonstrate that his or her financial prospects are forever hopeless is an unrealistic standard. *In re Roth*, 490 B.R. 908, 923 (finding that the court should craft an undue hardship standard that allows bankruptcy courts to consider all relevant facts and circumstances on a case-by-case basis to decide whether the debtor currently, or in the near-future, can afford to repay the student loan debt while maintaining an appropriate standard of living).

D. The Third Factor

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The third factor is that the debtor has made a good faith effort to repay the loan. This looks to a debtor's efforts to obtain employment, maximize income, minimize expenses, and make prior payments; looks at whether the debtor has previously sought to obtain an unreasonable number of deferments or forbearances; and looks at the timing of the debtor's attempt to obtain a discharge. See *Shells v. United States Dep't of Educ.*, 530 B.R. 758. This factor also takes into account whether a debtor is credible at trial. *Batdorf v. Mae (In re Batdorf)*, 2014 Bankr. LEXIS 4236 (Bankr. E.D. Cal. Sept. 26, 2014) (finding good faith standard met, where debtor juggled finances to prevent home from being foreclosed, made some student loan payments, and appeared credible on the stand).

If a debtor simply can't make payments because they don't have enough money, at least one court says that that has satisfied the good faith test. *England v. United States (In re England)*, 264 B.R. 38, 48 (Bankr. D. Idaho 2001); *Roth v. Educ. Credit Mgmt. Corp. (In re Roth)*, 490 B.R. 908, 917 (B.A.P. 9th Cir. 2013) (discharging student loan debt despite debtor never making a voluntary loan payment). Courts are likely to view a debtor's failure to make prior payments when she had the ability to do so as an indicator of bad faith. *McCafferty v. United States Dep't of Educ. (In re McCafferty)*, 2015 Bankr. LEXIS 3600 (Bankr. E.D. Wash. Oct. 23, 2015). Paying non-student loan debt while failing to pay student loan debt is not, on its own, an indicator of good faith. *Fuller v. United States Dep't of Educ. (In re Fuller)*, 296 B.R. 813, 819 (Bankr. N.D. Cal. 2003).

The availability of repayment plans also factors into this analysis. Some courts have held that a debtor probably has to either contact the lender to ask about negotiating a repayment plan or investigate the existence of other repayment programs to pass this test. *Educ. Credit Mgmt. Corp. v. DeGroot*, 339 B.R. 201, 339 B.R. 201 (D. Or. 2006) (finding failure on part of Chapter

7 debtor to even apply for income-contingent repayment program was failure to make "good faith" effort to repay her student loan debt); *Fulbright v. United States Dep't of Educ. (In re Fulbright)*, 319 B.R. 650, 663 (Bankr. D. Mont. 2005) (finding no discharge for debtor who declined repeated offers by student loan creditor to allow him to participate in income-contingent repayment program).

While case law in the Ninth Circuit states that even where a debtor makes no attempt to investigate or enroll in a repayment program, that does not necessarily tip the balance against a finding of good faith (*In re Roth*, supra); that is one of the elements the court weighs in its analysis, and in the absence of anything persuasive to the contrary, it could easily be persuasive.

V. THE TOTALITY OF THE CIRCUMSTANCES TEST

Courts in the 1st Circuit and 8th Circuit look to a number of facts and circumstances to assist them in determining undue hardship. Such factors include:

- (1) total present and future incapacity to pay debts for reasons not within the control of the debtor;
- (2) whether the debtor has made a good faith effort to negotiate a deferment or forbearance of payment;
- (3) whether the hardship will be long-term;
- (4) whether the debtor has made payments on the student loan;
- (5) whether there is permanent or long-term disability of the debtor;
- (6) the ability of the debtor to obtain gainful employment in the area of the study;
- (7) whether the debtor has made a good faith effort to maximize income and minimize expenses;
- (8) whether the dominant purpose of the bankruptcy petition was to discharge the student loan; and
- (9) the ratio of student loan debt to total indebtedness.

McLaughlin v. U.S. Funds (In re McLaughlin), 359 B.R. 746, 750 (Bankr. W.D. Mo. 2007).

This test is more open-ended than the Brunner test, though it looks to the same general issues. One recent decision in the 8th Circuit discharged a debtor's student loan debt despite the fact that under an income-contingent repayment program, he would pay zero. See *Abney v.*

United States Dep't of Educ. (In re Abney), 2015 Bankr. LEXIS 3849 (Bankr. W.D. Mo. Nov. 10, 2015) ("Undue hardship should not be interpreted so harshly as to prevent this debtor – who is acting in good faith to fulfill his obligations – from ever getting the fresh start that the Bankruptcy Code is intended to provide."). That decision further criticized income-based repayment plans as particularly burdensome to older debtors, who would be eligible for a discharge of that debt only after 25 years of payment, and that discharge would be a taxable event.

VI. CONCLUSION

An attempt to obtain a student loan discharge can be an uphill battle. While bankruptcy courts may or may not be satisfied with the old tests and methods for determining whether an undue hardship exists under Section 523(a)(8), no new test has yet emerged to supplant the Brunner Test.

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Round and Round with the Judges Program
Saturday, December 3, 2016

Motors Liquidation *and the Future of Free-and-Clear Sales*

Honorable Mary Grace Diehl

United States Bankruptcy Court, Northern District of Georgia

IN RE MOTORS LIQUIDATION COMPANY, 829 F. 3D 135 (2ND CIR. 2016)

SUMMARY OF CASE:

General Motors filed a Chapter 11 case in 2009 after an infusion of capital by the United States Government failed to solve the company's financial problems. Shortly after the case was filed, the Bankruptcy Court for the SDNY approved a sale of substantially all of GM's assets to a newly formed company, known as "New GM" and owned in large part by the US Government. The sale was pursuant to section 363(f) and was "free and clear of all liens, claims, interests and encumbrances."

Notice of the 363 sale was provided by direct mail to "all parties known to have asserted any lien, claim, encumbrance or interest" in the assets to be sold. Publication notice was published in the NYT and WSJ. The bankruptcy court heard over 850 objections to the proposed sale. New GM agreed to assume liability for accidents which occurred after the closing of the 363 sale and to honor express warranties issued in connection with the sale of GM cars. In addition, as a result of negotiations, new GM agreed to assume liability for any Lemon Law claims.

Old GM was to be liquidated and the proceeds of the liquidation were to be distributed from a Liquidation Trust. A bar date for claims was established.

In 2014, New GM issued a recall of vehicles with ignition switch defects. Over 25 million vehicles were recalled. New GM undertook an investigation of the ignition switch defect. It was determined that the faulty ignition switch first appeared in the 2002 models. Old GM took only minimal action about the switch prior to the bankruptcy, despite knowledge of the defect and its relationship to moving stalls and non-deployment of air bags.

Following the recalls, dozens of class actions were filed against New GM for economic losses and personal injuries caused by the ignition switch defect. New GM defended with the "free and clear" sale order. New GM would pay for post-sale personal injuries, make repairs and follow Lemon Law, but nothing else. Certain Plaintiffs filed an AP in bankruptcy court seeking relief against both old GM and new GM. After determining that it had jurisdiction, the BR Ct determined that claims against Old Gm were equitably moot. While the BR court found that notice to the plaintiffs lacked due process, there was no prejudice to the lack of notice since the court determined it would have approved the sale order even it notice had been proper.

The Second Circuit held that "successor liability" claims can be barred by a free and clear order where the claims flow from the debtor's ownership of the sold assets and arise from a right to payment that arose before the filing of the petition or resulted from pre-petition conduct fairly giving rise to the claims. There must be some contact or relationship such that the claimant is identifiable.

The 2nd Circuit then applied those principles to 4 types of claimants: (1) pre-closing accident claims; (2) economic loss claims from any defects; (3) claims related to the conduct of New GM and (4) used car purchaser claims. The Court held that pre-closing claims were encompassed within the sale order. The economic loss claims, while a closer question also fall within the sale order as "contingent claims." The contingency was Old GM's failure to advise claimants of the defect. The

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independent claims were not within the sale order nor were the used car purchaser's claims. These claims have no relationship to old GM.

The issue then becomes the role of procedural due process as to the first 2 types of claims. The Second Circuit agreed with the bankruptcy court that Old GM should have notified by direct mail the owners of its vehicles with defective ignition switches because they knew or should have known of the switch defect. The speed of the case did not eliminate the need for the basic constitutional right of due process. However, the 2nd circuit, while not deciding whether prejudice is a necessary element in the due process analysis for a 363 sale, concludes that the bankruptcy court erred in concluding that there was no prejudice. Essentially, the 2nd circuit noted that the bankruptcy sale process was a negotiation and notice to the plaintiffs at the sale stage might have resulted in a different negotiated settlement. The Circuit Court relied on the facts that the purpose of the sale was to restore consumer confidence and the role of the U.S. government in the sale process. These facts and the cataclysmic alternative of total liquidation suggested to the 2nd Circuit that the sale would have been approved on different terms.

With respect to claims against Old GM's liquidation, the 2nd Circuit did not reach the equitable mootness determination made by the Bankruptcy Court because Old GM was not a party to any of the litigation.

Discussion Questions:

1. Is the "prejudice test" adopted by the 2nd Circuit reasonable or will there always be prejudice since ability to negotiate will likely always be present?
2. Is this a unique case because of the uniqueness of GM (government presence and control) or will it have general applicability to all 363 sales involving products in the stream of commerce?
3. The parties before the court (plaintiffs and purchaser) were both innocent parties. The wrongdoer – old GM – gets off scot-free. How can this result be avoided?

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Saturday, December 3, 2016**

Equitable Mootness: Alive or Dead?

Honorable Dennis R. Dow

United States Bankruptcy Court, Western District of Missouri

Ullrich v. Welt (In re Nica Holdings, Inc.), 2015 WL 9241140 (11th Cir. 2015).

FACTS:

Debtor entered into an assignment for the benefit of creditors (an “ABC”) under Florida law with defendant Welt named assignee of its assets to dispose of in accordance with state law. After failure to liquidate the company, Plaintiff Ullrich (co-owner of Debtor) filed suit against Welt and Welt filed a malpractice suit against the law firm representing him as assignee. Welt also filed a Chapter 7 on behalf of Debtor and the state court lawsuits were removed to bankruptcy court. The trustee obtained bankruptcy court approval of the settlement of both actions, over Ullrich’s objections and motions to stay. The district court affirmed Ullrich appealed to the 11th Circuit.

Appellees argued that , among other things, the doctrine of equitable mootness applied to the appeal because the settlements had been effectuated in both of the suits which were the only assets of Debtor.

ISSUE:

Did the doctrine of equitable mootness apply to the appeal of the approval of the settlement agreements?

HOLDING:

The doctrine of equitable mootness did not apply to the appeal of the approval of the settlement agreements.

ANALYSIS:

Equitable mootness permits appellate courts to dismiss challenges when effective relief would be impossible.¹ The 11th Circuit determined that whether or not an appeal is equitably moot depends on the specific circumstances and issues of each individual case. The court stated that in order to find an appeal equitably moot, an appellate court must determine that it cannot grant effective relief. No single factor is determinative, but it identified several questions important to the inquiry:

- (1) Has a stay pending appeal been obtained?² If not, then why not?
- (2) Has the plan been substantially consummated?³ If so, what kind of transactions have been consummated?
- (3) What type of relief does the appellant seek?
- (4) What effect would granting relief have on the interest of third parties not before the court?
- (5) And, would relief affect the re-emergence of the debtor as a revitalized entity?

The Court found that appellant attempted several times to obtain a stay and was not granted a stay through no fault of his own. Also, it was not clear to the court that the settlement agreements had been substantially consummated. No creditors had been paid anything yet as a result of either settlement and the funds remained in the bankrupt estate. Further, the

¹ In a footnote, the court notes that the doctrine normally arises in connection with appeals of confirmation of Chapter 11 plans. Accordingly, some courts have questioned whether the doctrine is applicable in Chapter 7 cases. Because it determines that the appellees have not shown the appeal to be equitably moot, it assumes without deciding that mootness applies in a Chapter 7 context. *Ullrich*, 2015 WL 9241140 at *8, n. 4.

² The absence of the stay is a factor to consider and does not compel a finding of mootness. *Ullrich*, 2015 WL 9241140 at *8, n. 5.

³ The court observed that it had noted before that substantial consummation does not itself resolve the issue of equitable mootness. *Ullrich*, 2015 WL 9241140 at *8, n. 5.

transactions at issue were not complicated or irreversible and the settlements did not contemplate a revitalization of Debtor that would be thwarted by the appellate court's decision. The court concluded that effective relief would not be precluded in this case and equitable mootness did not dictate dismissal.

ADDITIONAL HOLDING:

Reversed and remanded. (Based on the court's decision that Welt, as assignee, did not have authority to file bankruptcy on behalf of Debtor).

In re Allied Nevada Gold Corp., et al., 2016 WL 4987081 (D. Delaware Sept. 15, 2016)

FACTS:

On their petition date, Debtors entered into a restructuring support agreement with the majority of its creditors. Following the filing of the plan of reorganization, Debtors' business was negatively affected by numerous factors, leading to an amended plan and amended restructuring agreement. Equity security holder objected to the amended plan on the grounds that it undervalued Debtors and should be increased to enable greater distributions to stockholders. Bankruptcy Court confirmed the plan. The consummation of the plan triggered several transactions, including formation of reorganized debtors, repayment of secured debt obligations, issuance of new debt, and distribution of substantial cash.

Shareholders/appellants appealed confirmation of plan and other bankruptcy court rulings. Appellees argued that appeal should be dismissed by reason of equitable mootness. Appellants responded that equitable mootness doctrine is unconstitutional and appeal is not equitably moot.¹ They argued that an order vacating confirmation would not affect the success of the plan because the plan was only a visionary scheme.

ISSUE:

Does the doctrine of equitable mootness apply to the issues raised on appeal by the shareholders?

HOLDING:

Yes. Appeals dismissed on the grounds of equitable mootness.

¹ The Court did not address the issue of constitutionality.

ANALYSIS:

Equitable mootness is a narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated reorganization plans. The Third Circuit first recognized the doctrine in the *Continental Airlines* case² in which it noted the factors to be considered in making the mootness determination: 1) whether the plan has been substantially consummated, 2) whether a stay has been obtained, 3) whether the relief requested would affect the rights of parties not before the court, 4) whether the relief requested would affect the success of the plan, and 5) the public policy of affording finality to bankruptcy court judgments. These factors were refined in subsequent Third Circuit opinions and identified as two analytical steps: 1) whether a confirmed plan has been substantially consummated, and 2) if so, whether granting the relief requested will fatally scramble the plan and/or significantly harm third parties who have justifiably relied on it. The question then becomes whether granting relief will require undoing the plan as opposed to modifying it so as not to cause its collapse.

Here, the court concluded that the plan had been substantially consummated as that term is defined in §1101(2). A number of transfers and distributions had occurred. In addition, no stay had been obtained, a critical factor in the equitable mootness determination. “Where no stay has been obtained, the reorganization plan goes forward, and it is difficult to undo the acts of third parties proceeding under the plan without prejudicing those third parties.” In this case, numerous

² *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996)(en banc).

third parties not before the court would be adversely affected, including exit funding lenders, recipients of distributions, and traders of the Debtors' new common stock.

The court also noted that appeals challenging plan valuations have been rejected under the equitable mootness doctrine because the proposed relief (revaluation of the company) would “likely topple the delicate balances and compromises struck by the plan.” This was particularly relevant here where the reorganization was complex and a large number of parties were involved in the negotiation of the terms of the reorganization.

Finally, the court reasoned that the public policy of affording finality to plan confirmation orders favors dismissal on equitable mootness grounds. “[T]he importance of allowing approved reorganizations to go forward in reliance on bankruptcy court confirmation orders may be the central animating force behind the equitable mootness doctrine.”

Ochadleus, et al. v. City of Detroit, Michigan (In re City of Detroit, Michigan),
2016 WL 5682704 (6th Cir. 2016).

FACTS:

The City of Detroit filed for Ch. 9 municipal bankruptcy on July 18, 2013. After extensive negotiations, the City crafted intricate settlements with creditors and stakeholders, participants in the City's pension benefits plan. Those claimants voted 73% in favor of accepting the Plan. On November 12, 2014, the Eighth Amended Plan was confirmed. The City proceeded to implement the extensive plan and issued \$287.5 million in bonds and \$720 million in notes; transferred assets and property; and implemented a 2 year budget, among other things.

In 2016, several pensioners appealed to the district court and challenged the reduction to their pensions and other agreed provisions. The City moved to dismiss as equitably moot and the district court agreed and dismissed the appeals. The pensioners appealed to the 6th Circuit and it affirmed.

ISSUE:

Is the equitable mootness doctrine applicable in this case; is the doctrine still a viable doctrine; and is it available in a Chapter 9 case?

HOLDING:

Yes, equitable mootness applies and the district court is affirmed.

ANALYSIS:

Equitable mootness protects the need for finality in bankruptcy proceedings and allows third parties to rely on finality by “preventing a court from unscrambling complex bankruptcy reorganizations when the appealing party should have acted before the plan became extremely difficult to retract.” [cites omitted].

Equitable mootness is analyzed with a three-part test: (1) whether a stay has been obtained; (2) whether the plan has been “substantially consummated”; and (3) whether the relief requested would significantly and irrevocably disrupt the implementation of the plan or disproportionately harm the reliance interests of other parties not before the court. Substantial consummation is measured by the Code definition, 11 U.S.C. §1101(2), which considers the extent of the debtor’s transfer of property, assumption of responsibilities, and distribution of assets as prescribed by the plan.

The most important factor is whether the relief requested would affect the rights of third parties or the overall success of the plan and requires a case-by-case assessment of the feasibility and effect of the relief requested.

In this case, the court determined that all three factors favored applying equitable mootness. Appellants did not obtain a stay; the plan had been substantially consummated; and the requested relief of omitting bargained for pension reductions would unravel the entire plan and adversely affect third parties, including the entire city population of Detroit.

Appellants also asserted that equitable mootness is not a viable doctrine under Supreme Court case law and cited several cases in which the Court emphasized the obligation of the federal courts to decide cases within their jurisdiction. The 6th Circuit found those were not

bankruptcy cases and the holdings did not expressly extend to equitable mootness and the Supreme Court has not abolished equitable mootness.

Additionally, appellants asserted that equitable mootness does not apply in Chapter 9 cases and relied on an Alabama district court case, *Bennett* (currently pending appeal in the 11th Cir.), that declared equitable mootness inapplicable in Chapter 9 cases. The 6th Circuit analyzed that case and determined that the reason that court found equitable mootness did not apply in that Chapter 9 context was because the third factor in the three-part test was not met. In the present case, appellants' class was given a vote and an opportunity in public hearings to present argument and evidence and approved the settlement. The 6th Cir. found that the fact debtor is a municipality in a Chapter 9 proceeding rather than a business enterprise makes no difference in applying equitable mootness. "Substantial consummation" applies in Chapter 9 circumstances just as in a Chapter 11.

DISSENT:

The Supreme Court has recognized that judges should not decline to exercise their judicial power in cases that are otherwise within their jurisdiction.

- A. Equitable mootness is not justified by the Bankruptcy Code. Congress' express inclusion of two bankruptcy-law exceptions to appellate review (un-stayed orders and post-confirmation plan modification) indicates an intent to preclude recognition of others. The doctrine contradicts relevant appellate-jurisdiction statutes and purports to authorize the making of federal common law despite lack of evidence that Congress intended this.

- B. Equitable mootness upsets the delicate constitutional balance on which Bankruptcy Court system is based. It cuts off entirely the right to appeal to an Article III court and effectively delegates the power to prevent that review to the very non-Article III tribunal whose decision is at issue because bankruptcy courts control nearly all the variables that are considered in assessing whether an appeal is equitably moot.

- C. No legal basis exists to extend equitable mootness to Chapter 9. The doctrine grows out of statutory provisions that do not apply to Chapter 9.

Bankruptcy Law Letter

NOVEMBER 2015 | VOLUME 35 | ISSUE 11

Equitable Cuteness: Of Mountains and Mice

By Bruce A. Markell

Introduction

Circuit courts are buzzing this year with a doctrine peculiar to bankruptcy: equitable mootness. This edition of the *Bankruptcy Law Letter* looks at three recent circuit level cases issued in the last six months which could reshape and perhaps redefine the doctrine. Each of these cases, *In re One2One Communications, LLC*,¹ *In re Tribune Media Company*,² and *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Properties Inc.*,³ involves efforts by plan proponents to dismiss potentially meritorious appeals on grounds that too much has occurred since confirmation to make any decision by an appellate court relevant. Before examining each of these cases, however, I take a quick survey of the development of the equitable mootness doctrine.

Evolution

As doctrines go, equitable mootness is relatively new, dating from 1981. Most trace its origins to *Trone v. Roberts Farms, Inc. (In re Roberts Farms, Inc.)*.⁴

Roberts Farms

In *Roberts Farms*, the debtor had filed a Chapter XI case under the 1898 Bankruptcy Act, and confirmed its plan of arrangement. Trone, a creditor, objected. Before lodging his appeal of the confirmation order, Trone sought a writ of mandamus from the district court seeking to bar the bankruptcy judge from implementing the plan. The request was denied.⁵ The appellees then moved to dismiss the appeal as moot, and the district court granted the motion. Trone appealed that order (and also foolishly tried again for a writ of mandamus, which again was denied).

On appeal to the Ninth Circuit, the only issue was the propriety of the mootness dismissal. The appellees again moved to dismiss the appeal on mootness grounds. After examining cases involving sales from bankruptcy estates, and the adoption of Rule 805 (a precursor to Section 363(m)), the court had the following to say:

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Here . . . many intricate and involved transactions . . . were contemplated by the plan of arrangement (even to and including liquidation and reorganization of the debtor corporation) and stand solely upon the order confirming the plan of arrangement for court approval and confirmation of the transactions. Were we to deny the motion to dismiss for mootness and on consideration of the merits reverse the order of the District Court, what would be the result? Are we not quite patently faced with a situation where the plan of arrangement has been so far implemented that it is impossible to fashion effective relief for all concerned? Certainly, reversal of the order confirming the plan of arrangement, which would knock the props out from under the authorization for every transaction that has taken place, would do nothing other than create an unmanageable, uncontrollable situation for the Bankruptcy Court.⁶

As authority, the court cited *Mills v. Green*,⁷ an 1895 Supreme Court case in which the Court

dismissed an appeal that sought to enjoin the selection of a committee to attend a constitutional convention that had already occurred by the time the Court heard the appeal.

Interestingly, the Ninth Circuit dealt with Trone's failure to seek a stay as a separate grounds for dismissing the appeal.⁸ On this aspect, the Ninth Circuit had the following to say:

it is obligatory upon appellant in a situation like the one with which we are faced to pursue with diligence all available remedies to obtain a stay of execution of the objectionable order (even to the extent of applying to the Circuit Justice for relief (Rule 51, Supreme Court Rules)) if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from.⁹

Thus, there were two grounds in *Roberts Farms* for dismissal: one of futility of remedy, and the other an equity-based analysis based on a lack of diligence and a change of circumstances.

Continental

Roberts Farms and the doctrine of equitable mootness had slow acceptance after 1981. In 1996, however, the equitable mootness doctrine received a major boost in *In re Continental Airlines*.¹⁰ There, the Third Circuit, sitting on *en banc* with a bare majority of 6-5, explicitly embraced equitable mootness without explicitly defining it. Instead, the majority opinion noted five factors to be considered:

Factors that have been considered by courts in determining whether it would be equitable or prudent to reach the merits of a bankruptcy appeal include (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.¹¹

Among other authorities, the majority used *Roberts Farms* to justify this set of factors. But as pointed out by then-Judge Alito in dissent, *Roberts Farms* was a narrow decision, apparently based on the theory that courts should refrain from deciding a case where "no relief was practicable as a result of the many post-confirmation transactions that were irreversible" due to former Bankruptcy Rule

EDITOR IN CHIEF: Ralph Brubaker, Carl L. Vacketta Professor, University of Illinois College of Law

CONTRIBUTING EDITORS: Christopher W. Frost, Thomas P. Lewis Professor, University of Kentucky College of Law
Bruce A. Markell, Professor of Bankruptcy Law and Practice, Northwestern University School of Law

PUBLISHER: Jean E. Maess, J.D.

MANAGING EDITOR: Clay Mattson, J.D.

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

805.¹² Judge Alito did not see the same statutory basis or the same facts in *Continental*. As he explained, “the holding of *Roberts Farms* was gradually extended well beyond anything that could be supported by the authority on which *Roberts Farms* rested.”¹³ And as there was no clear statutory basis precluding the court from hearing case, he dissented.

Charter

The Third Circuit wasn’t the only circuit embracing equitable mootness. The Second Circuit was developing its own jurisprudence on the subject, which it expressed in *R2 Investments, LDC v. Charter Communications, Inc.*¹⁴ In *Charter*, the nation’s fourth largest cable company sought Chapter 11 relief. Its confirmed plan contained many compromises and, to no surprise, many creditors believed those compromises were improper.

They appealed, and sought a stay. It was denied. The plan proponents then “immediately took actions under the Plan, including cancelling the equity issued by the prepetition Charter, issuing shares in the reorganized Charter, converting notes issued by the prepetition Charter entities into new notes, and issuing warrants to Charter’s prepetition noteholders.”¹⁵

At the Second Circuit, the objectors were met with equitable mootness arguments. The Second Circuit characterized its standard used to determine equitable mootness as follows:

In this circuit, an appeal is presumed equitably moot where the debtor’s plan of reorganization has been substantially consummated. . . . “Substantial consummation” is defined in the Bankruptcy Code to require that all or substantially all of the proposed transfers in a plan are consummated, that the successor company has assumed the business or management of the property dealt with by the plan, and that the distributions called for by the plan have commenced. See 11 U.S.C. § 1101(2).

The presumption of equitable mootness can be overcome, however, if . . . five . . . factors are met:

- (1) “the court can still order some effective relief”;
- (2) “such relief will not affect the re-emergence of the debtor as a revitalized corporate entity”;
- (3) “such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken

place and create an unmanageable, uncontrollable situation for the Bankruptcy Court”;

- (4) “the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings”; and
- (5) “the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from.”¹⁶

Charter left open some important questions. Just who had the burden of introducing evidence of factors that could “overcome” the presumption of mootness? What did it mean to “knock the props out from under” the plan provisions? What exactly was the role of a stay request?

Semcrude

Cases nonetheless progressed in the Second Circuit and elsewhere. *Continental* was often cited as a key precedent in deciding dismissal motions. In 2013, however, the Third Circuit had another look at *Continental*’s five factors in *Samson Energy Resources Company v. Semcrude, L.P. (In re Semcrude, L.P.)*.¹⁷

It was not satisfied with their content. Here’s why:

These factors . . . are interconnected and overlapping. . . . “The second factor principally duplicates the first in the sense that a plan cannot be substantially consummated if the appellant has successfully sought a stay.” In analyzing the first factor, courts have asked “whether allowing an appeal to go forward will undermine the plan, and not merely whether the plan has been substantially consummated under the Bankruptcy Code’s definition.” This collapses the first and fourth factors. The third factor adds an additional consideration—whether granting relief will undermine “the reliance of third parties, in particular investors, on the finality of [plan confirmation].” “Finally, the fifth factor supports the other four by encouraging investors and others to rely on confirmation orders, thereby facilitating successful reorganizations by fostering confidence in the finality of confirmed plans.”

In practice, it is useful to think of equitable mootness as proceeding in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.¹⁸

Against this background came the wave of equitable mootness decisions in 2015.

The Recent Cases

Semcrude did not end the debate. Although it called for a careful and nuanced analysis, many lawyers were deaf to its warnings. They pressed equitable mootness in all cases, even ones that were small and simple. Their actions could be characterized as proceeding “[w]ith the thrust and lack of craft of a berserk sword; All lion, none of the fox.”¹⁹ And this strategy nearly did them in—but not quite.

One2One

The first significant reaction in the Third Circuit was *In re One2One Communications, LLC*.²⁰ *One2One* is notable as much for its concurrence as for its main opinion. But both are worth studying.

The Majority Opinion

One2One was a billing services company concentrating on the cable industry. It had gotten into trouble over stealing clients, however, and because of those thefts it and its chief executive officer²¹ were on the wrong end of a \$9 million judgment.²² That judgment chased One2One into Chapter 11.

Other than the judgment, however, One2One’s case was fairly simple. It had but 17 unsecured creditors, not counting insiders. It had one secured creditor with a blanket lien on all of One2One’s assets, and that lender was owed less than \$100,000.²³ There were no structural changes in the debtor (only an option for a change of ownership), and no public equity or debt was floated as part of the plan. As noted by the Third Circuit, “the Plan did not provide for new financing, mergers or dissolutions of entities, issuance of stock or bonds, name change, change of business location, change in management or any other significant transactions.”²⁴ The plan did, however, release third parties; in particular, it released the former executive from the \$9 million judgment.

Quad/Graphics, Inc., the holder of the \$9 million judgment, appealed. Among other things, it believed that the plan violated the absolute priority rule, and improperly released the CEO from its judgment. It sought and was denied a stay by both the bankruptcy and the district courts. The debtor

then sought to dismiss the appeal on equitable mootness grounds.

The district court faithfully intoned the learning of *Continental*, and dismissed the appeal. Quad/Graphics appealed to the Third Circuit.

The circuit reversed. It also looked to *Continental*, but threw in citations to *Semcrude* as well.²⁵ Somewhat surprisingly, the appellate court found that the granting of the motion to dismiss was an abuse of discretion. It was surprising not because of the facts, but because the abuse of discretion standard which the court applied is quite a burden for an appellant to establish, especially in a fact intensive inquiry such as equitable mootness requires.

The Third Circuit found two instances of abuse of discretion. First, the district court “placed the burden on Appellant to demonstrate” that reversal would undermine the plan. Second, “it concluded that because granting Appellant’s requested relief would reverse the Plan, this factor necessarily favored the Debtor.”²⁶

As to the first point, the court found that, as with most civil matters, the person who seeks the requested relief has the burden to demonstrate entitlement to that relief. Appellees who wish to dismiss need to demonstrate that the appeal is equitably moot. Switching burdens is an error of law, and the Third Circuit thought it thus thought it an abuse of discretion.²⁷

The second error, however, is not so easily justified. Here, the debtor had argued that the expectations of the plan sponsor, the creditors and the employees would be at risk. The plan sponsor had invested \$200,000 in the company and had assumed managerial roles and taken managerial responsibility. The creditors had received two installments of payments. New employees had been hired.

These arguments did not move the Third Circuit. Labeling them “routine transactions,” the court indicated that such actions were “likely to transpired in almost every bankruptcy reorganization.”²⁸ Combined with a lack of publicly-issued debt or equity, “that would make it difficult to retract the

Plan,” the court found an abuse of discretion in applying the first and fourth *Continental* factors—whether the plan was substantially consummated²⁹ and whether the relief would affect the success of the plan. It thus reversed.

The Concurrence

That, however, was not the end of the story. Circuit Judge Krause appended a 15-page concurrence, nearly double the length of the majority opinion. And what a concurrence. It was nothing short of a full blown, no page limit, attack on equitable mootness.

She first questioned whether equitable mootness was being implemented in the fashion intended. As she saw it, equitable mootness was a limited doctrine that should be cautiously applied in complex cases.³⁰ Yet “district courts have continued to invoke the doctrine in modest, non-complex bankruptcies and where appellants have sought limited relief.”³¹ The fact that the “thoughtful and diligent” district judge in *One2One* “misconstrued” the case law behind equitable mootness “reflects a doctrine adrift and in need of reconsideration.”³²

She then searched for the analytical underpinnings of the doctrine, and found none. In light of this vacuum, she suggested as a theme of her concurrence that the duty of federal judges to hear cases properly before them trumped the “abdication” of jurisdiction she found inherent in equitable mootness.³³ In particular, she found Congress’ implementation of Section 363(m) and 364(e), sections which insulate certain sale and financing orders from appeal, created a negative inference that such insulation extends to appeals from confirmation orders.³⁴

Judge Krause then questioned the constitutionality of the doctrine in light of *Stern v. Marshall*. Her argument is compact, and compelling: how can a system that requires Article III supervision of bankruptcy judges as a condition of its existence tolerate a doctrine in which Article III judges are required to decline to review a certain, important, class of orders entered by the bankruptcy judges they are supposed to supervise?³⁵

Judge Krause’s final critique was of the doctrine’s

efficacy. In essence, she pointed to the fuss caused by whether an appeal is moot, and wondered whether the energy expended on equitable mootness dismissal motions would be better spent reviewing the merits—and posited that cases would end earlier or at the same time were there no fights about mootness.³⁶

In light of these criticisms, Judge Krause suggested en banc review to eliminate the doctrine was appropriate. She stated that other doctrines and approaches could fill the role served by equitable mootness. In particular, she suggested laches and sanctions against delay. She also suggested a more expansive view towards many things thought to be scrambled by consummation of a plan.³⁷ With respect to this last point, Judge Krause particular looked to the Seventh Circuit and its acceptance that even mergers and stock issuances can be unwound.³⁸

Even if en banc review were not to be granted, and the doctrine retained, Judge Krause offered a series of modifications to make the rule less objectionable. She first suggest that, with respect to diligence, dismissal should only occur if a stay is not sought, and not inquire into other aspects of diligence.³⁹

She then would seek clarification the “significant harm” and “justifiable reliance” factors of *Continental*, and not defer to those “who act opportunistically or advocate unlawful plan provisions.”⁴⁰

Judge Krause’s third suggestion is that a de novo, instead of an abuse of discretion, review would be appropriate.⁴¹

Finally, she suggested that courts should take “‘a quick look at the merits of [an] appellant’s challenger’ to determine if it is ‘legally meritorious or equitable compelling.’”⁴²

All good arguments. But the parties did not seek a rehearing in *One2One*, and another panel of the Third Circuit took up Judge Krause’s challenge not less than two months later in *In re Tribune Media Company*.⁴³

Tribune

Tribune is in part an appellate opinion, and in

part an answering brief to Judge Krause's concurrence in *One2One*. And, as we shall see, it is the winning brief. As with *One2One*, there is a majority opinion and a concurrence—with the author of the majority opinion also the author of the concurrence!

The Majority Opinion

Tribune involved a leveraged-buyout (LBO) gone bad. When the sponsor of the LBO, Sam Zell, structured the original buyout, he secured the debt necessary for the LBO financing with the assets of the target—the Tribune Company—and with guaranties from the Tribune Company's subsidiaries. When Tribune filed, the validity of this debt and the guaranties was placed squarely at issue.

Ultimately, the debtor, together with the Unsecured Creditors' Committee and with Tribune's lender, proposed a plan that settled the LBO-based claims for approximately \$369 million and a percentage of recoveries from other claims for relief.

Aurelius Capital Management, however, had bought \$2 billion of pre-LBO debt, and objected to the plan. It thought the settlement was way too cheap, and proposed its own plan. It lost; the bankruptcy court chose to believe the independent examiner's evaluation of the merits and of the value of the LBO claims, and approved the settlement and the plan on that basis.

Aurelius sought to stay the effectiveness of the plan. The bankruptcy court indicated it would enter a stay—if Aurelius would post a \$1.5 billion bond. Aurelius balked, and appealed seeking to eliminate the bond and expedite its appeal. It lost on both counts. Tribune then proceeded to implement its plan.

Tribune then filed the inevitable motion to dismiss on equitable mootness grounds. The district court granted the motion, and Aurelius again appealed.

The court, speaking through Judge Ambro, engaged in some consolidation and massaging of the equitable mootness doctrine. After citing *Continental's* five factors, Judge Ambro noted that "[t]his statement reveals that the doctrine was then, as

far as our Court was concerned, in its infancy."⁴⁴ Matters uttered in infancy are rarely binding, and so Judge Ambro noted that as the doctrine matured, experience brought about a more mature list of factors. As the court put it:

Over the years, our precedential opinions have refined the doctrine to its current, more determinate state. As we recently put it, equitable mootness . . . proceed[s] in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.⁴⁵

The formulation focuses on the effect a successful appeal (or the possibility that a successful appeal) would have on third parties. In particular, the court stated, this statement of the rule primarily focuses on investors, especially outside investors who contribute money as equity investments.⁴⁶

Favoring these investors' interests encourages socially valuable interests such as investing in viable reorganizations, and reducing disturbances of the free flow of commerce.⁴⁷ The court summarizes the rationale for its reformulation as follows:

The theme is that the third parties with interests protected by equitable mootness generally rely on the emergence of a reorganized entity from court supervision. When a successful appeal would not fatally scramble a confirmed and consummated plan, this specific reliance interest most often is not implicated, as the plan stays in place (with manageable modifications possible) and the reorganized entity remains a going concern.⁴⁸

Thus, if an appeal simply reallocates consideration from one class of creditors to another, it is less likely to be equitably moot than an appeal which seeks to attack a plan provision relied upon by an investor who has furnished hard money consideration.

Against this background, the court found Aurelius' appeal moot. Aurelius wanted nothing less than to scuttle the settlement with Zell, which formed the basis of the plan. If that were allowed, the result would "recall the entire Plan for a redo."⁴⁹

Judge Ambro then mused that "returning to the drawing board would at a minimum drastically diminish the value of new equity's investment. That

investment no doubt was in reliance on the Settlement”⁵⁰ Since Aurelius’ competing plan had done just that, and had been significantly out-voted, such a result would “give Aurelius by judicial fiat what it could not achieve by consensus within Chapter 11 proceedings”⁵¹

That may be a little too far. Appellate courts typically do not find facts, and it is unclear where Judge Ambro is getting facts such as the claim that a return to the drawing board would “drastically diminish” new equity’s value (after all, if Aurelius is right, it might actually increase its value). Similarly, it is not quite true that Aurelius sought victory by “judicial fiat”—that would discount the fact that all Aurelius sought was reversal of the order confirming the competing plan, not confirmation of its plan, something that would require additional factual findings at the bankruptcy court level.

And then there is an added insult. The court not only chastised Aurelius for trying to gain by appeal what it could not by negotiation, but also, as the court couldn’t “help but add,” what it could have obtained “if it had put up a bond.”⁵² This is sort of the ultimate gotcha. In most appeals, the amount of the appeal bond bears some resemblance to the liability of a party in the underlying action—a defendant who has a judgment entered against it posts a supersedeas bond keyed to the amount of its liability as found by the court. But in an appeal bond from a confirmation, the appellee is not bonding over a determination of its past liability; rather, it is bonding its future, contingent, liability to the debtor for simply taking an appeal. And it doesn’t even get a discount for the possibility it might prevail. In short, it gets taxed even if it wins for being cheeky enough to appeal.

This inequity is underscored by the amount of the required bond in *Tribune*—\$1.5 billion. A lot of money is required to post such a bond,⁵³ and curiously absent from the equitable mootness discussion is the fairness in requiring an appellant to be at risk for damage yet to occur to the estate for simply exercising its appeal rights.

Indeed, Judge Ambro re-emphasized the bond point when pointing out why it was fair to not hear

a meritorious challenge—the appellant had the opportunity to bond the consummation of the plan, and thus bears some responsibility for allowing it to consummate. Such inaction then gives justification to other parties to treat the confirmation as unassailable.⁵⁴

The court took some comfort that Aurelius never challenged the bond amount; it simply tried to eliminate the bond requirement entirely. That such an argument is not to be taken very seriously is underscored by noting that the court stated that the bankruptcy judge “carefully calculated the likely damage to the estate” and that “the valuation was well-considered and as convincing as the alchemy of valuation in bankruptcy can be.”⁵⁵

The court thus concluded that Aurelius’ appeal was moot—it would fatally scramble the reorganization while upsetting justifiable expectations of investors.

The Third Circuit did, however, allow another appeal in the same case. In addition to Aurelius, other creditors who had a prepetition subordination agreement had appealed claiming that the plan ignored that agreement. Here, the court had no trouble finding a lack of the destructive scrambling Aurelius sought. These creditors’ rights could be vindicated simply by ordering disgorgement against the class improperly receiving the distribution.

But the court tap dances around the reliance of the creditors in the subordinated class, stating that if the senior creditors were correct, the subordinated creditors “by definition cannot *justifiably* have relied on the payments.”⁵⁶ Moreover, noted the court, disgorgement was only one of many possible remedies; a change in future distributions to address the overpayment was another.⁵⁷

So Aurelius’ appeal is moot; the senior creditors’ is not. But that was not the end of the story.

The Concurrence

Judge Ambro, joined by another member of the panel, Judge Vanaskie, concurred in his own opinion. The purpose was plain: to respond to Judge Krause’s concurrence in *One2One* by laying “out briefly why this judge-made doctrine is abided by every Court of Appeals.”⁵⁸

Judge Ambro first addressed the constitutional issue: whether Article III supervision is eroded beyond recognition if Article III judges decline to hear appeals from confirmations entered by bankruptcy judges. He makes quick work of this argument. After noting that the constitutional concern is either a personal waivable right, or a structural right not capable of being waived, he disposes of the personal right argument by stating that “[a]s an equitable doctrine applied by Article III courts, equitable mootness does not implicate this right.”⁵⁹

This rings odd. Article III supervision and review presupposes the ability of an Article III court to review of the *merits* of a decision made by a non-Article III tribunal, not just the *consequences* of that decision. Undaunted by this mismatch of merits and consequences, Judge Ambro next addresses the structural concern, and also finds it absent. There is no congressional usurpation for the same reason as there is no personal right—the doctrine is one developed and applied by the judiciary, so that there is no congressional “aggrandizement” that the structural concern fears.⁶⁰

As to the statutory argument—that if Congress had wanted confirmation orders to have the same status as sale and financing orders, it would have so provided—Judge Ambro simply recounts that sometimes stuff happens, and stuff happening is not confined to bankruptcy. In this regard, he points out that bankruptcy courts are courts of equity, and in equity the merits of a position sometimes lose to the equities of the situation.⁶¹ In short, there is no bankruptcy exceptionalism here, just the unexceptional extension of traditional equitable concepts to the confirmation arena.

Judge Ambro concludes by putting forward a public policy argument that by favoring justifiable reliance by investors, costs of bankruptcy can be and often are reduced. The reduction of these costs “significantly mitigates the injustice to a wronged appellant whose cause may otherwise be deemed moot”⁶²

The stage was thus set for a battle on equitable mootness. On September 11, however, Judge Ambro, in accordance with Third Circuit rules, signed an order indicating that there would be no

rehearing, and stating that a majority of active judges had not supported a rehearing en banc.

Transwest

The final case in the cavalcade of equitable mootness decisions is *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Properties Inc.*⁶³ As with *One2One* and *Tribune*, there are two opinions, except the Ninth Circuit followed the tradition of a majority opinion and a dissent.

The Majority Opinion

In *Transwest*, lenders had claims approaching \$300 million against hotel properties worth \$92 million.⁶⁴ The lenders made the Section 1111(b) election, thereby forgoing their deficiency claim in return for a larger secured claim on the property. They made the election so that if the properties were ever sold after confirmation, their secured claim would be equal to their debt, and thus they might stand to collect more than the \$92 million.

The debtors, however, jiggered their plan so that if the hotels were sold between five and 15 years after confirmation, there would be no due on sale clause applicable. The lender believed that this gutted their Section 1111(b) clause and appealed.⁶⁵

The lender also requested a stay, and it was denied on the curious ground that the appeal was not likely to be moot if the stay were not granted, and thus there was no irreparable harm.⁶⁶

When the appeal was heard by the district court, however, that court thought the plan had been consummated and that third parties had relied on that consummation. It thus found upsetting the plan would be inequitable, and dismissed the appeal as moot.⁶⁷

When the Ninth Circuit got the appeal, it first set out the differences between equitable and constitutional mootness. “Unlike Article III mootness, which causes federal courts to lack jurisdiction and so to have an *inability* to provide relief, equitable mootness is a judge-created doctrine that reflects an *unwillingness* to provide relief.”⁶⁸

The Ninth Circuit then set out its own four elements of relief:

“We will look first at whether a stay was sought, for absent that a party has not fully pursued its rights. If a stay was sought and not gained, we then will look to whether substantial consummation of the plan has occurred. Next, we will look to the effect a remedy may have on third parties not before the court. Finally, we will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court.”⁶⁹

In undertaking this inquiry, the court indicated that factual findings made by the courts below were reviewed for clear error, but that legal conclusions were reviewed de novo.⁷⁰

In reviewing the appeal, the Ninth Circuit focused on the third consideration, that of whether it is possible to effect a remedy that is equitable. In this examination, however, the court stated that

[t]hird parties’ reliance on the consummation of the plan is not enough to find this prong satisfied. Rather, for this factor to weigh in favor of holding a party’s appeal to be equitably moot, the specific relief sought must bear unduly on innocent third parties.⁷¹

Here, the court noted that the outside investor had participated in the plan process and had even negotiated with the lenders over the final confirmation order. With such intimate knowledge of the plan process, the court thus held that such participation meant the outside investor was not an innocent third party, and that this difference in status affected the equities.⁷² This was the case even though the investor was not a party to the appeal, and thus could not be part of any court-ordered relief on the appeal.

The court thus found the appeal not equitably moot; the lenders’ claim to have their matter heard outweighed the other considerations put forward in favor of dismissal.

The Dissent

Judge Milan Smith dissented. The key point of disagreement was whether the investor’s participation in the plan process made a difference. Everyone acknowledged that the investor was not an insider, and was merely looking to protect its interests—as you would expect investors to do in order to ensure that their money was being invested wisely. By

categorizing the investor’s concerns as no different than insiders, Judge Milan indicated that the court had done much to erode confidence in the bankruptcy process, and to lower the amount that would be paid for future bankruptcy debtors (much to the detriment of creditors generally).

Conclusion

These decisions seem to indicate a trend that mindless extensions of equitable mootness will fail. There is some room left for the doctrine, but whether that room is a large or small space is still up for debate. Until more clarity exists, however, it is worthwhile to outline some of the differences and distinctions drawn.

On the difference side, the circuits disagree on whether the standard of review is de novo or abuse of discretion. The Third Circuit adopts abuse of discretion; the Ninth adopts de novo. Although the Ninth and the Third agree that it is the appellant’s burden to show an appeal is equitably moot, this is not consonant with the Second’s view in *Charter*; it is also belied somewhat by *Tribune*’s focus on Aurelius’s failure to challenge or supply evidence on the amount of a fair bond.

But the main point of contention is what constitutes justifiable reliance, and whose reliance counts. The Third Circuit undoubtedly would have ruled the opposite way had it been presented with the facts in *Transwest*. There was no doubt that the investors in *Tribune* were just as involved in the progress of that case as was the investor in *Transwest*.

At the end of this, however, the Third and the Ninth Circuits embrace the equitable mootness doctrine, with modification designed to rein in abuses. One change seems to be a move to confine the doctrine to large and complex cases that involve public debt or equity. Another is to allow, as in *Tribune*, appeals only if the appeal affects inter-class allocation of value, rather than presenting a challenge to the central core of the confirmation.

One2One, *Tribune* and *Transwest* spill much ink in trying to define or at least confine equitable mootness. In the end, however, the landscape has been left relatively unchanged, except for the dull

rumblings of discontent. To paraphrase an Aesop's Fable, the mountains have labored mightily, but produced a mouse.⁷³

ENDNOTES:

¹In re One2One Communications, LLC, 61 Bankr. Ct. Dec. (CRR) 94, 2015 WL 4430302 (3d Cir. 2015).

²In re Tribune Media Co., 799 F.3d 272, 61 Bankr. Ct. Dec. (CRR) 124 (3d Cir. 2015).

³In re Transwest Resort Properties, Inc., 801 F.3d 1161 (9th Cir. 2015).

⁴In re Roberts Farms, Inc., 652 F.2d 793, 7 Bankr. Ct. Dec. (CRR) 1248, Bankr. L. Rep. (CCH) P 68325 (9th Cir. 1981).

⁵The Ninth Circuit characterized the decision to seek a writ of mandamus instead of an appeal as "a procedural monstrosity." Roberts Farms, 652 F.2d at 795.

⁶Roberts Farms, 652 F.2d at 797.

⁷Mills v. Green, 159 U.S. 651, 653, 16 S. Ct. 132, 40 L. Ed. 293 (1895).

⁸Roberts Farms, 652 F.2d at 798 ("An entirely separate and independent ground for dismissal has also been established because Appellants have failed and neglected diligently to pursue their available remedies to obtain a stay of the objectionable orders of the Bankruptcy Court and have permitted such a comprehensive change of circumstances to occur as to render it inequitable for this court to consider the merits of the appeal.").

⁹Roberts Farms, 652 F.2d at 798.

¹⁰In re Continental Airlines, 91 F.3d 553, 29 Bankr. Ct. Dec. (CRR) 629, 36 Collier Bankr. Cas. 2d (MB) 785 (3d Cir. 1996) (en banc).

¹¹91 F.3d at 560 (citation omitted).

¹²In re Continental Airlines, 91 F.3d 553, 569, 29 Bankr. Ct. Dec. (CRR) 629, 36 Collier Bankr. Cas. 2d (MB) 785 (3d Cir. 1996) (Alito, J., dissenting). Rule 805 formerly provided that, unless stayed, "an order approving a sale of property . . . to a good faith purchaser . . . shall not be affected by the reversal or modification of such order on appeal."

¹³91 F.3d at 570 (Alito, J., dissenting).

¹⁴In re Charter Communications, Inc., 691 F.3d 476, 56 Bankr. Ct. Dec. (CRR) 254, 68 Collier Bankr. Cas. 2d (MB) 196, Bankr. L. Rep. (CCH) P 82339 (2d Cir. 2012), cert. denied, 133 S. Ct. 2021, 185 L. Ed. 2d 905 (2013).

¹⁵691 F.3d at 481.

¹⁶691 F.3d at 481 (quoting Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.), 10 F.3d 944,

952-53 (2d Cir. 1993)).

¹⁷In re Semcrude, L.P., 728 F.3d 314, 58 Bankr. Ct. Dec. (CRR) 100, Bankr. L. Rep. (CCH) P 82538, 179 O.G.R. 413 (3d Cir. 2013).

¹⁸Samson Energy Resources Co. v. Semcrude, L.P. (In re Semcrude, L.P.), 728 F.3d 314, 320-21 (3d Cir. 2013) (quoting In re Phila. Newspapers, LLC, 690 F.3d 161, 168 (3d Cir. 2012) (citing Nordhoff Invs., Inc. v. Zenith Elecs. Corp., 258 F.3d 180, 184 (3d Cir. 2001) (citations omitted)).

¹⁹Stephen Vincent Benét, Army of Northern Virginia (describing Confederate general John Bell Hood).

²⁰In re One2One Communications, LLC, 61 Bankr. Ct. Dec. (CRR) 94, 2015 WL 4430302 (3d Cir. 2015).

²¹These matters are never simple. The chief executive officer held no equity in the debtor, but was the husband of the owner of 75% of the equity interests in the holding company that held 100% of the membership interests in the debtor.

²²That judgment was affirmed during One2One's appeal. Quad/Graphics, Inc. v. One2One Communications, LLC, 529 Fed. Appx. 784 (7th Cir. 2013).

²³One2One, 2015 WL 4430302 at *5.

²⁴One2One, 2015 WL 4430302 at *5.

²⁵One2One, 2015 WL 4430302 at *3-4.

²⁶One2One, 2015 WL 4430302 at *5.

²⁷This itself is odd. Typically, courts of appeals review district courts' decisions to grant or deny equitable relief for abuse of discretion, underlying questions of law de novo, and findings of fact upon which the decision to grant equitable relief was made under the clearly erroneous standard. Preferred Sites, LLC v. Troup County, 296 F.3d 1210 (11th Cir. 2002); Grossbaum v. Indianapolis-Marion County Bldg. Authority, 100 F.3d 1287 (7th Cir. 1996).

²⁸One2One, 2015 WL 4430302 at *6.

²⁹The court played fast and loose with substantial consummation. While it agreed that the plan had been substantially consummated under the statutory definition contained in 11 U.S.C.A. § 1101(2), One2One, 2015 WL 4430302 at *5, the court found that the first Continental factor only required a determination "whether allowing an appeal to go forward will undermine the plan, and not merely whether the plan has been substantially consummated under the Bankruptcy Code's definition." One2One, 2015 WL 4430302 at *3 (quoting In re Philadelphia Newspapers, LLC, 690 F.3d 161, 168-69, 56 Bankr. Ct. Dec. (CRR) 222, 67 Collier Bankr. Cas. 2d (MB) 1770, Bankr. L. Rep. (CCH) P 82311 (3d Cir. 2012), as corrected, (Oct. 25, 2012) and cert. dismissed, 133 S. Ct. 1001, 184 L. Ed. 2d 777 (2013)).

³⁰One2One, 2015 WL 4430302, at 7 (Krause, J., concurring).

³¹One2One, 2015 WL 4430302, at 7 (Krause, J., concurring).

³²One2One, 2015 WL 4430302, at 8 (Krause, J., concurring).

³³One2One, 2015 WL 4430302, at 9 (Krause, J., concurring).

³⁴One2One, 2015 WL 4430302, at 11-12 (Krause, J., concurring).

³⁵One2One, 2015 WL 4430302, at 13-15 (Krause, J., concurring).

³⁶One2One, 2015 WL 4430302, at 15-16 (Krause, J., concurring).

³⁷One2One, 2015 WL 4430302, at 16-17. (Krause, J., concurring).

³⁸One2One, 2015 WL 4430302, at 18 (Krause, J., concurring).

³⁹One2One, 2015 WL 4430302, at 20 (Krause, J., concurring).

⁴⁰One2One, 2015 WL 4430302, at 20 (Krause, J., concurring).

⁴¹One2One, 2015 WL 4430302, at 21 (Krause, J., concurring).

⁴²One2One, 2015 WL 4430302, at 22 (Krause, J., concurring) (quoting *In re Paige*, 584 F.3d 1327, 1339, 52 Bankr. Ct. Dec. (CRR) 91 (10th Cir. 2009)).

⁴³*In re Tribune Media Co.*, 799 F.3d 272, 61 Bankr. Ct. Dec. (CRR) 124 (3d Cir. 2015).

⁴⁴Tribune, 799 F.3d at 278.

⁴⁵Tribune, 799 F.3d at 278 (quoting *Semcrude*, 728 F.3d at 321). Not surprisingly, Judge Ambro was *Semcrude*'s author.

⁴⁶Tribune, 799 F.3d at 279.

⁴⁷Tribune, 799 F.3d at 279.

⁴⁸Tribune, 799 F.3d at 280.

⁴⁹Tribune, 799 F.3d at 281.

⁵⁰Tribune, 799 F.3d at 281.

⁵¹Tribune, 799 F.3d at 281.

⁵²Tribune, 799 F.3d at 281.

⁵³For example, Exxon had to pay \$70 million to bond the \$5 billion punitive damages judgment in the *Exxon Valdez* case. See generally Jessica J. Berch, *The Costs of Litigation: A Proposal To Amend Federal Rule of Appellate Procedure*

39(a)(4), 83 Temple L. Rev. 103 (2010).

⁵⁴Tribune, 799 F.3d at 281.

⁵⁵Tribune, 799 F.3d at 282.

⁵⁶Tribune, 799 F.3d at 283 (emphasis in original).

⁵⁷Tribune, 799 F.3d at 283.

⁵⁸Tribune, 799 F.3d at 285 (Ambro, J., concurring).

⁵⁹Tribune, 799 F.3d at 285 (Ambro, J., concurring).

⁶⁰Tribune, 799 F.3d at 285-86 (Ambro, J., concurring).

⁶¹Tribune, 799 F.3d at 287-88 (Ambro, J., concurring).

⁶²Tribune, 799 F.3d at 289 (Ambro, J., concurring). Judge Ambro also takes a shot at Judge Krause's suggestion that courts take a quick view of the merits before finding equitable mootness, stating that "court have had unpleasant experiences with 'rigid order[s] of battle' like this before, and we do not see the wisdom of an ironclad requirement for all cases." Tribune, 799 F.3d at 289 n.2 (Ambro, J., concurring).

⁶³*In re Transwest Resort Properties, Inc.*, 801 F.3d 1161 (9th Cir. 2015).

⁶⁴Transwest, 2015 WL 5332447, at *1.

⁶⁵Transwest, 2015 WL 5332447, at *2. The lenders also objected that the bankruptcy court had applied § 1129(a)(10) on a per plan basis (since there was on consolidated plan) instead of a per debtor basis.

⁶⁶Transwest, 2015 WL 5332447, at *3.

⁶⁷Transwest, 2015 WL 5332447, at *3.

⁶⁸Transwest, 2015 WL 5332447, at *3 (emphasis in original).

⁶⁹Transwest, 2015 WL 5332447, at *4 (quoting *Motor Vehicle Cas. Co. v. Thorpe Insulation Co.* (In re Thorpe Insulation Co.), 677 F.3d 869, 881 (9th Cir. 2012)).

⁷⁰Transwest, 2015 WL 5332447, at *4.

⁷¹Transwest, 2015 WL 5332447, at *5.

⁷²Transwest, 2015 WL 5332447, at *6.

⁷³ <http://www.taleswithmorals.com/aesop-fable-the-mountains-in-labour.htm>.

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**Round and Round with the Judges Program
Saturday, December 3, 2016**

The Interplay of the Federal Arbitration Act and the Bankruptcy Code
Honorable Robert D. Drain
United States Bankruptcy Court, Southern District of New York

ABI Winter Leadership Conference: Round & Round with Judges

The Interplay of the Federal Arbitration Act and the Bankruptcy Code

Hon. Robert D. Drain

“Disputes that involve both the Bankruptcy Code and the [Federal] Arbitration Act often present conflicts of near polar extremes: bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach toward dispute resolution.”

MBNA America Bank, N.A. v. Hill, 436 F.3d 104, 108 (2d Cir. 2006). Courts’ enforcement in non-bankruptcy contexts of arbitration provisions, including waivers of class action rights within such provisions, has increased since that observation, in the light of relatively recent Supreme Court decisions including AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011); CompuCredit Corp. v. Greenwood, 132 S. Ct. 665 (2012); American Express Co. v. Italian Colors Rest., 133 S. Ct. 2304 (2013); and DirectTV v. Iburgia, 136 S. Ct. 463 (2015). This has led to an increasing number of attempts in bankruptcy cases to compel abstention, or obtain relief from the automatic stay in favor of arbitration.

- I. Preliminary Analysis: In re Bethlehem Steel Corp., 390 B.R. 784 (Bankr. S.D.N.Y. 2008)
 - A. Whether the parties agreed to arbitrate?
 - B. What is the scope of the arbitration agreement (broad vs. narrow), and does it apply to the dispute at issue?
 - i. When, if ever, does a debtor’s agreement to arbitrate bind the estate/trustee/debtor in possession? See id. at 793 (non-derivative statutory avoidance claims not covered by prepetition arbitration

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agreement). See also Hayes and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1155 (3d Cir. 1989) (debtor in possession generally bound by debtor's prepetition arbitration agreement but not as to avoidance power under 11 U.S.C. § 544(b)); In re Salander-O'Reilly Galleries, LLC, 425 B.R. 9, 31(S.D.N.Y. 2012) (“[A] trustee’s claims asserted as a lien creditor under Section 544, as well as assignee of a creditor’s liens, are not subject to a pre-petition agreement between the debtor and another party to arbitrate.”). Contrast In re Cardali, 2010 Bankr. LEXIS 4114, at *24 (Bankr. S.D.N.Y. Nov. 18, 2010) (fraudulent conveyance claims under sections 544, 548 and 550 of the Bankruptcy Code subject to arbitration because they are “quintessentially suits at common law that resemble state-law contract claims brought by a bankruptcy corporation to augment the bankruptcy estate”).

- II. Did Congress intend claims/rights under the Bankruptcy Code not to be arbitrable?
 - A. Express conflicts between the Bankruptcy Code and the FAA. See In re Hostess Brands, Inc., 2013 Bankr. LEXIS 79, at *9-10 (Bankr. S.D.N.Y. Jan. 7, 2013) (dispute over cash collateral use not arbitrable where section 363(e) of the Bankruptcy Code expressly provides for bankruptcy court’s determination of right to use cash collateral/decision affects multiple parties). See also In re White Mt. Mining Co., L.L.C., 403 F.3d 164, 169 (4th Cir. 2005) (by designating a matter as “core,” it may be argued that Congress expressed intent to choose bankruptcy courts over other deliberative bodies, including arbitrators, to decide the issue). An express conflict may

be found with another federal remedy, as well. See In re Fresh & Easy, LLC, 2016 Bankr. LEXIS 3690 (Bankr. D. Del. Oct. 11, 2016) (arbitration provision's waiver of class action remedy cannot be applied to preclude class action remedy under NLRA).

B. Inherent conflict between the Bankruptcy Code and the FAA.

- i. Is it enough to render a dispute non-arbitrable for the issue to be a core proceeding? Compare In re Lehman Bros. Hldgs. Inc. v. 344 Individuals, 2016 U.S. App. LEXIS 18288, at *3 (2d Cir. Oct. 6, 2016) (“If the proceeding is non-core, generally the bankruptcy court must stay the proceedings in favor of arbitration, as non-core proceedings *usually* do not warrant overriding the presumption in favor of arbitration. . . . [I]f the proceedings are core, a court must consider whether enforcing the arbitration provisions *would seriously jeopardize any underlying purpose of the Bankruptcy Code.*”) (emphasis added) with In re Brown, 354 B.R. 591, 603 (D. R.I. 2006) (“[A] bankruptcy court must maintain authority to exercise discretion concerning whether to enforce arbitration over core contract proceedings even where those contracts possess an arbitration agreement.”).
- ii. The foregoing distinction (i.e. “merely” core vs. “core and seriously jeopardizing the purposes of the Bankruptcy Code,” or “substantially core”)¹ affects the standard of review. See In re Lehman Bros. Hldgs. v. 344 Individuals, 2016 U.S. App. LEXIS 18288, at *3 (“If arbitration would severely conflict with the text, history, or purposes of the Bankruptcy

¹ One might ask why, in light of Stern v. Marshall, 131 S. Ct. 2594 (2011), and Wellness Int’l Network, Ltd. v. Sharif, 135 S. Ct. 1932 (2015), distinguishing between core and non-core still matters; however, the distinction is relevant where discerning Congress’ intent to provide the bankruptcy courts with decision-making power over particular issues that arise in bankruptcy cases, even if, in some instances, that intent was unconstitutional.

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Code, the bankruptcy court has discretion to compel or to stay the arbitration. We review its exercise of that choice for abuse of discretion.”); In re Anderson, 553 B.R. 221, 226 (S.D.N.Y. 2016) (*de novo* review of whether enforcement of discharge inherently conflicts with FAA).

- C. Inherent conflict analysis for core matters, which includes balancing policies underlying Bankruptcy Code and FAA
- i. Issues pertaining to claims allowance and priority (even under contract): may be non-arbitrable: In re Lehman Bros. Hldgs. v. 344 Individuals, 2016 U.S. App. LEXIS 18288, at *5-6 (not abuse of discretion to hold determination of claim priority dispute, under contractual subordination provision, non-arbitrable); Geron v. Cohen, 2013 U.S. Dist. LEXIS 188737 (S.D.N.Y. Mar. 21, 2013) (not abuse of discretion to hold trustee’s claim to enforce partnership agreement non-arbitrable, because trustee’s claim was inextricable from ex-partner’s claim against estate.).
 - ii. Denial of discharge (even where court is asked to fix liability and amount of non-dischargeable claim): may be non-arbitrable. Compare In re Koper, 516 B.R. 707, 722-23 (Bankr. E.D.N.Y. 2014) (court exercises its discretion not to stay adversary proceeding in favor of arbitration based on principles of judicial efficiency and economy under particular facts) with In re Hermoyian, 435 B.R. 465 (Bankr. E.D. Mich. 2010) (no asset case; no conflict with Bankruptcy Code to permit liquidation of debt in

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arbitration proceeding before determination of non-dischargeability in the bankruptcy court).

- iii. Affirmative claims by trustee or debtor in possession, where some claims are core and others are not: (may be non-arbitrable). See Salander-O'Reilly Galleries, 475 B.R. 9 (determination of whether an asset is property of the estate is core, as is section 544 claim: refusal to defer to arbitration not an abuse of discretion); In re Huffman, 486 B.R. 343, 362-64 (four core claims asserted by trustee, including claims created by the Bankruptcy Code, one non-core claim: court exercises discretion not to defer to arbitration); In re Harrelson, 537 B.R. 16 (Bankr. M.D. Ala. 2015) (similar analysis of similar claims by individual debtor).
- iv. Enforcement of automatic stay and discharge. (may be non-arbitrable where enforcement protects other parties/creditors; unclear whether court properly exercises discretion to preclude arbitration where enforcement is merely or primarily to provide affirmative recovery to debtor). Contrast In re Nat'l Gypsum Co., 118 F.3d 1056, 1064 (5th Cir. 1997) (enforcement of corporate discharge non-arbitrable) with MBNA Am. Bank, N.A. v. Hill, 436 F.3d at 108 (debtor's claim to enforce section 362(h) of the Bankruptcy Code was core but did not enhance the estate or debtor's fresh start: reversible error to have held non-arbitrable). Compare In re Belton, 2015 U.S. Dist. LEXIS 144371 (S.D.N.Y. Oct. 14, 2015) (reversible error to have held class action to enforce individuals'

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discharge non-arbitrable where defendants had corrected complained of conduct as to named plaintiffs and arbitration provision had class action waiver) with In re Anderson, 553 B.R. at 221 (proper exercise of discretion under similar facts not to compel arbitration: arbitration would severely jeopardize fresh start objective of Bankruptcy Code and lead to inconsistent applications of the section 524. Nothing more “fundamentally” core than a debtor’s discharge). See also In re Harrelson, 537 B.R. at 28 (noting favorably that debtor intended to pay to creditors non-exempt litigation proceeds from claim for violation of debt relief agency restrictions under section 526 of Bankruptcy Code, as well as noting that violations of such provision harm creditors as well as debtors). See generally Kara J. Bruce, “Vindicating Bankruptcy Rights,” 75 Md. L. Rev. 443 (2016).

October 21, 2016

**AMERICAN BANKRUPTCY INSTITUTE
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**Round and Round with the Judges Program
Saturday, December 3, 2016**

Are There Any Limits on the § 546(e) Safe Harbor?

Honorable Michael A. Fagone
United States Bankruptcy Court, District of Maine

An Overview of the “Safe Harbor” for Settlement Payments and Transfers in Connection with Securities Contracts

1. The Statute

Section 546(e) provides:

Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7) . . . that is made before the commencement of the case, except under section 548 (a)(1)(A) of this title.

11 U.S.C. § 546(e). Section 101 defines a “settlement payment” for purposes of the forward contract provisions of the Bankruptcy Code. *See* 11 U.S.C. § 101(51). Section 741(8) provides a similar definition of the term “settlement payment”:

a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade[.]

Section 741(7) provides a lengthy definition of the term “securities contract.”

2. The Statute’s History

Section 546(e) was first enacted in 1982.

It was amended several times, most recently in 2006. The 2006 amendment expanded the statute to cover transfers in connection with securities contracts made by, or to, or for the benefit of, one of the protected parties (*i.e.*, commodity brokers, forward contract merchants, stockbrokers, financial institutions, financial participants, and securities clearing agencies). It also added the phrase “(or on behalf of)” into the statute in connection with settlement payments.

3. The Legislative History

In enacting section 546(e), Congress intended “to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries.” H.R. Rep. No. 97-420, at 1 (1982).

4. Selected Circuit Court Decisions on Section 546

i. Kaiser Steel Corp. v. Charles Schwab & Co., Inc., 913 F.2d 846 (10th Cir. 1990) (holding that payments to broker in LBO transfer were settlement payments exempt from avoidance under section 546(e)). This case did not reach the question of whether the broker was a mere conduit and, thus, not a transferee of the challenged transfers.

ii. Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.), 952 F.2d 1230 (10th Cir. 1991) (holding that transfers made, through financial intermediaries, to selling shareholders in LBO constituted "settlement payments" that were shielded from avoidance by section 546(e)).

iii. Munford v. Valuation Research Corp. (In re: Munford), 98 F.3d 604 (11th Cir. 1996) (holding that section 546(e) does not apply to payments made by a debtor corporation to selling shareholders in a pre-petition LBO). In this case, the 11th Circuit found that the financial intermediary in the LBO was not a transferee, but rather was a mere conduit. Thus, the "settlement payments" in question were not made by or to one of the protected entities.

iv. Int'l Fin., Inc. v. Resorts Int'l, Inc. (In re: Resorts Int'l, Inc.), 181 F.3d 505 (3d Cir. 1999) (holding that transfers made by debtor to financial institutions in connection with LBO were settlement payments shielded from avoidance under section 546(e)).

v. Contemporary Indus. Corp. v. Frost, 564 F.3d 981 (8th Cir. 2009) (holding that payments made by debtor to a bank serving as escrow agent in connection with LBO involving privately-held securities were "settlement payments" to a "financial institution" protected from avoidance).

vi. QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.), 571 F.3d 545 (6th Cir. 2009) (holding that Section 546(e) is not limited to publicly traded securities but extends to transactions involving privately held securities).

vii. Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V., 651 F.3d 329 (2d Cir. 2011) (applying section 546(e) to payments to redeem unsecured and uncertificated commercial paper, prior to maturity, at par). Here, the Second Circuit examined the definition of "settlement payment" in section 11 U.S.C. § 741(8).

viii. Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. United Life Ins. Co. (In re Quebecor World (USA) Inc.), 719 F.3d 94 (2nd Cir. 2013) (holding that debtor's transfers to purchase private placement notes were transfers in connection with a securities contract that were shielded from avoidance).

ix. Picard v. Ida Fishman Rev. Trust (In re Bernard L. Madoff Inv. Sec. LLC), 773 F.3d 411 (2nd Cir. 2014) (applying section 546(e) to transfers in connection with a securities contract, even in the absence of any actual securities transaction)

x. In re Tribune Co. Fraudulent Conveyance Litig., 818 F.3d 98 (2nd Cir. 2016) (holding the state law constructive fraudulent transfer claims brought by creditors were preempted by the Bankruptcy Code, where an estate representative was challenging the same transfers under

section 548(a)(1)(A) and where the trustee was precluded, by section 546(e), from pursuing the constructive fraudulent transfer claims).

xi. FTI Consulting, Inc. v. Merit Mgmt. Grp., LP, 830 F.3d 690 (7th Cir. 2016) (holding that section 546(e) did not apply to payments made to a financial institution serving as a mere conduit; financial institution was not the transferee for purposes of chapter 5 of the Bankruptcy Code).

5. Other Noteworthy Cases

i. Kapila v. Espirito Santo Bank (In re Bankest Capital Corp.), 374 B.R. 333 (Bankr. S.D. Fla. 2007) (holding that even a broad interpretation of “settlement payment” requires focus on the context of the safe harbor to protect public markets).

ii. Kipperman v. Circle Trust (In re Grafton Partners, L.P.), 321 B.R. 527 (B.A.P. 9th Cir. 2005) (concluding that section 546(e) places a “line between public transactions that involve the clearance and settlement process and nonpublic transactions that do not involve that process”).

iii. Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. United Life Ins. Co. (In re Quebecor World (USA) Inc.), 480 B.R. 468 (S.D.N.Y. 2012) (holding that payments made to noteholders to redeem private placement notes were settlement payments protected by section 546(e) because they involved the transfer of cash made to complete a securities transaction), *aff’d on other grounds*, 719 F.3d 94 (2d Cir. 2013).

iv. Michaelson v. Farmer (In re Appleseed’s Intermediate Holdings, LLC), 470 B.R. 289 (D. Del. 2012) (holding that a dividend paid in connection with a LBO was not a settlement payment protected by section 546(e), even though the LBO was protected by section 546(e), because it was a one-way payment and not an exchange).

v. EPLG I, LLC v. Citibank, Nat’l Ass’n (In re Qimonda Richmond, LLC), 467 B.R. 318 (Bankr. D. Del. 2012) (holding that a payment on a letter of credit made in connection with a redemption of bonds was not a settlement payment protected by section 546(e) because it was independent of the obligation to repay the bonds and because letters of credit are clearly excluded from the definition of “security” in section 101(49)(B)(i)).

vi. AP Services LLP v. Silva, 483 B.R. 63 (S.D.N.Y. 2012) (concluding that payments made by wire transfer to defendant's bank accounts in the context of a securities transaction fell under the safe harbor, despite the fact that the financial institution was only an intermediary and took no beneficial interest in the transaction).

vii. Motors Liquidation Co. Avoidance Action Trust v. JPMorgan Chase Bank (In re Motors Liquidation Co.), 552 B.R. 253 (Bankr. S.D.N.Y. 2016) (holding that periodic payments of interest on promissory notes were not “settlement payments,” but declining to decide whether such payments were transfers made in connection with a securities contract).

viii. Weisfelner v. Fund 1 (In re Lyondell Chemical Co.), 503 B.R. 348 (Bankr. S.D.N.Y. 2014), *abrogated by*, In re Tribune Co. Fraudulent Conveyance Litigation, 818 F.3d 98 (2nd Cir. 2016)(holding, *inter alia*, that state law constructive fraudulent transfer claims brought by creditors were not preempted by Bankruptcy Code, even though section 546(e) prevented the trustee from avoiding the challenged transfers).

6. Discussion Questions

Should section 546(e) be applied only to transfers in connection with publicly-traded securities in connection with a “major bankruptcy”? Or should the statute be applied in connection with privately-held securities?

What is the extent to which the Bankruptcy Code preempts state law causes of action that a trustee could not pursue as a result of section 546(e)?

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Saturday, December 3, 2016**

The Implications of Husky for § 523(a)(2)(A) Litigation
Honorable Bruce A. Harwood, Chief Judge
United States Bankruptcy Court, District of New Hampshire

Bankruptcy Law Letter

JULY 2016 | VOLUME 36 | ISSUE 7

Is a Fraudulent Transfer Actually an “Actual Fraud”?

By Ralph Brubaker

That was the difficult and interesting question posed in the *Husky International Electronics, Inc. v. Ritz* case,¹ recently decided by the Supreme Court, with the “actual fraud” statutory language at issue being that of the discharge exception of Code § 523(a)(2)(A) for “actual fraud” debts. The debtor, though, and Justice Thomas, taking up the debtor’s cause in dissent, “concede[d] that fraudulent conveyances are a form of ‘actual fraud.’”² The majority, thus, was undoubtedly reassured in its ultimate conclusion, holding that “[t]he term ‘actual fraud’ in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.”³ The majority simply could “see no reason to craft an artificial definition of ‘actual fraud’”⁴ that would categorically exclude fraudulent conveyances from its ambit. Ironically, though (or perhaps fittingly), the meaning of “actual fraud” in this context is itself deceptively unclear, and the full implications of the *Husky* holding are also subject to uncertainty.

The circumstances in which the *Husky* holding will be implicated may well be rare and unusual (which was Justice Sotomayor’s implicit prediction in her opinion for the 7-1 majority)—applicable principally when the *transferee* of a fraudulent transfer files bankruptcy. The instincts driving the *Husky* holding are apparent, though, and the facts of *Husky* itself are illustrative. *Husky*, then, is a useful case for exploring how a fraudulent transfer can give rise to a nondischargeable debt for “actual fraud.”

Husky: Fraudulent Transfers, Alter Ego Liability, and Nondischargeable Debts for “Actual Fraud”

The facts, as found by the bankruptcy court, are as follows: Husky is a supplier of electronic device components, and between 2003 and 2007, Husky sold such components to Chrysalis Manufacturing Corp. At all relevant times, Daniel Lee Ritz, Jr. was a director and at least 30% owner of Chrysalis, and Ritz was in financial control of Chrysalis. Ritz also controlled a number of other corporations. Chrysalis was operational during this 2003-2007 period that it was purchasing product from Husky, but Chrysalis was not paying its

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debts as they became due, and Chrysalis ultimately owed Husky over \$160,000 for goods purchased but not paid for. Moreover, between November 2006 and May 2007, Ritz orchestrated a series of cash transfers, totaling nearly \$1.2 million, from Chrysalis to the other Ritz-controlled entities. “As a result of these transfers,” Chrysalis “was drained of all its cash and, therefore, could not pay its creditors” such as Husky.⁵ And with respect to all of these transfers, the bankruptcy court found that (1) Chrysalis was insolvent both before and after the transfer, and (2) Chrysalis did not receive reasonably equivalent value in exchange for any of the transfers.

EDITOR IN CHIEF: Ralph Brubaker, Carl L. Vacketta Professor, University of Illinois College of Law

CONTRIBUTING EDITORS: Bruce A. Markell, Professor of Bankruptcy Law and Practice, Northwestern University School of Law

Kara Bruce, Associate Professor, University of Toledo College of Law

Ben H. Logan, Lecturer in Law, University of California at Los Angeles School of Law, Affiliate Lecturer in Law, University of Washington School of Law

Eugene R. Wedoff, U.S. Bankruptcy Judge, Northern District of Illinois (retired)

PUBLISHER: Jean E. Maess, J.D.

MANAGING EDITOR: Clay Mattson, J.D.

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

In June 2007, Husky sued Chrysalis, Ritz, and several of the Ritz-controlled entities in Texas state court, seeking to collect the unpaid debt. A year later, though, Chrysalis filed a Chapter 7 petition, staying the pending Texas state-court suit as against Chrysalis. Thereafter, in May 2009, Husky sued Ritz in federal district court, asserting that Ritz was personally liable for Chrysalis’ debt to Husky under an alter-ego veil-piercing theory of liability. That suit was stayed in December 2009, however, when Ritz filed a Chapter 7 petition. Husky responded by reasserting its alter ego claim via an adversary proceeding in Ritz’s Chapter 7 case, alleging that (1) Ritz was personally liable for Chrysalis’ corporate debt to Husky, and (2) that debt was nondischargeable under, *inter alia*, Code § 523(a)(2)(A).

Code § 523(a)(2)(A), in relevant part, excepts from discharge “any debt for money, property, services, or . . . credit, to the extent obtained by false pretenses, a false representation, or actual fraud.” The sticking point in *Husky*, though, was that Ritz never made any false representations to Husky. Indeed, Ritz had no communication with Husky at all until *after* Husky had already sold its product to Chrysalis and Chrysalis thus had already incurred the unpaid debt to Husky. The question, therefore, was whether Ritz nonetheless could have incurred a debt to Husky for “actual fraud,” in the absence of any false representations by Ritz.

Alter Ego Liability for “Actual Fraud” Under Texas Corporate Law

Of course, an essential logical requisite to the nondischargeability of a debtor’s debt is that the debtor actually owes a debt to the creditor at issue under applicable nonbankruptcy law, and in the bankruptcy court, Ritz contested Husky’s assertion that Ritz was personally liable for Chrysalis’ corporate debt to Husky. By statute, under applicable Texas corporate law, a contract creditor such as Husky can pierce the corporate veil of a corporation and hold a controlling shareholder such as Ritz personally liable for a corporate contract debt only “if the obligee demonstrates that the . . . beneficial owner . . . caused the corporation to be used for the purpose of perpetrating and did perpetrate an *actual fraud* on the obligee primarily

for the direct personal benefit of the . . . beneficial owner.”⁶

The bankruptcy court held that “actual fraud” within the meaning of that Texas statute must be premised upon a misrepresentation, and since Ritz made no false representations to Husky, Ritz could not be personally liable for Chrysalis’ corporate debt to Husky. The district court on appeal, however, concluded (1) that the “actual fraud” required for veil piercing under Texas law need not involve a misrepresentation, and (2) that the requisite “actual fraud” could be established by fraudulent transfers made with “actual intent to hinder, delay, or defraud any creditor”⁷ of the corporation—the so-called “actual fraud” brand of fraudulent transfer under Texas’ codification of the Uniform Fraudulent Transfer Act (UFTA).⁸ Furthermore, the district court determined that the bankruptcy court’s findings established that the \$1.2 million of cash transfers from Chrysalis to other Ritz-controlled entities were accompanied by at least four of the “badges of fraud,” delineated in UFTA § 4(b) and that properly give rise to an inference of “actual intent to hinder, delay, or defraud” creditors via those transfers.⁹ Thus, it was conceivable that Husky could pierce the Chrysalis corporate veil and hold Ritz personally liable for Chrysalis’ debt to Husky under applicable state law.

Nondischargeability of “Actual Fraud” Debts Under Bankruptcy Code § 523(a)(2)(A)

Even if Ritz were personally liable for Chrysalis’ corporate debt to Husky under applicable Texas state law, nonetheless, the bankruptcy court and, on appeal, the district court and the Fifth Circuit, in turn, all held that Ritz’s debt to Husky could *not* be excepted from discharge under Code § 523(a)(2)(A) because a misrepresentation “is a necessary prerequisite for a showing of ‘actual fraud’ under” that nondischargeability provision.¹⁰ Ritz’s “actual intent to hinder, delay, or defraud” Chrysalis creditors, however—the basis for Ritz’s liability to Husky under Texas law—did *not* involve any misrepresentations by Ritz.

That interpretation of § 523(a)(2)(A) “actual fraud,” though, was at odds with that of the Seventh Circuit in the prominent case of *McClellan*

v. Cantrell,¹¹ and shortly after the Fifth Circuit’s *Ritz* decision, the First Circuit joined in the Seventh Circuit’s contrary interpretation.¹² The Supreme Court, therefore, granted certiorari in *Husky* to resolve the circuit split and, reversing the Fifth Circuit, held that “[t]he term ‘actual fraud’ in § 523(a)(2)(A) encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation.”¹³

There Is “Fraud,” and Then There Is “Fraud”

The term “fraud” is steeped in a certain amount of intractable vagueness and ambiguity, and as Professor Max Radin deftly demonstrated in a 1931 law review article, those difficulties can be traced to Roman law and its subsequent influence upon English law.¹⁴ While the term fraud is often associated with knowing, intentional acts of deceit, the root “term *fraus*, in Latin, does not really mean ‘fraud’ at all in the sense of ‘deceit’—at any rate, not deliberate” deceit.¹⁵

The [Latin] word for [deliberate deceit] is *dolus*. The word *fraus* means “prejudice” or disadvantage and it is used in that sense in a number of idiomatic expressions and formulas in legal as well as quite generally in non-legal writers. Unfortunately the word came to be applied both in legal as in non-legal writers to the quality of the act that caused the prejudice, as well as to the damage itself and so became almost—but not quite—interchangeable with *dolus*.¹⁶

Indeed, Roman law and usage itself seems to have initiated this indistinct amalgamation of *fraus* and *dolus*,¹⁷ and Anglo-American usage with respect to “fraud” has inherited this ambiguity, “which has compelled us to distinguish between ‘actual’ fraud and ‘constructive’ fraud, and forced other indirections upon us.”¹⁸

Who Put the Fraud in a Fraudulent Conveyance?

Fraudulent conveyance law is a prominent repository of the pervasive ambiguity surrounding “fraud” because “the terminology used to describe [the fraudulent debtor’s] offense is taken bodily from the Roman law, where *fraus creditorum* was an elaborately developed nominate tort.”¹⁹ While there were precursors in English medieval and feudal law,²⁰ the famous 1571 Statute of 13 Elizabeth contained the familiar formulation providing

“for the avoiding and abolishing of feigned, covinous and fraudulent . . . conveyances . . . which . . . are devised and contrived of malice, fraud, covin, collusion, or guile, to the end, purpose, and intent to delay, hinder or defraud creditors . . . of their just and lawful actions, suits, debts . . . and reliefs,” to the “hindrance of the due course and execution of law and justice.”²¹

That primordial cause of action—to avoid transfers made with actual “intent to hinder, delay, or defraud creditors”—has been a consistent feature of every modern codification of fraudulent conveyance law, from § 67e of the original Bankruptcy Act of 1898, to § 7 of the 1918 Uniform Fraudulent Conveyance Act (UFCA), to § 67d(2)(d) of the Bankruptcy Act as amended in 1938, to § 548(a)(1) of the 1978 Bankruptcy Code (now § 548(a)(1)(A)), to § 4(a)(1) of the 1984 UFTA), which was carried forward fully intact into the recently promulgated 2014 Uniform Voidable Transactions Act (UVTA).

Fraudulent Conveyance in Fraud of Creditors as Distinguished From Fraudulent Inducement by a Fraudulent Misrepresentation

Given the intrinsic ambiguities associated with the term “fraud,” it is often helpful to be more precise in specifying the “fraud” at issue. And as both the majority and the dissent in *Husky* fully recognized, there is a sharp and fundamental distinction between the “fraud” involved in (1) a transfer made with intent to defraud creditors that is the object of fraudulent conveyance law, and (2) the kind of fraudulent inducement with which the tort of fraudulent misrepresentation is concerned. Indeed, Justice Breyer adeptly illuminated that distinction nearly 30 years ago in a noteworthy scholarly opinion as a First Circuit judge.²²

The tort of fraudulent misrepresentation imposes liability on “[o]ne who makes a misrepresentation . . . for the purpose of inducing another to act or to refrain from action in reliance upon it.”²³ However, “[t]hat kind of fraud—dishonesty in the creation of the debt—is,” as Justice Breyer observed, “not the kind of fraud that the [fraudulent conveyance] Act addresses” through the “intent to hinder, delay, or defraud creditors” term of art.²⁴ And Justice Sotomayor echoed the same “basic point” in *Husky*,

that “fraudulent conveyances are *not* an inducement-based fraud.”²⁵

“Classic fraudulent conveyance law is concerned with a debtor who manipulates his assets so as to keep them from his creditors.”²⁶ A transfer made with intent to defraud creditors, therefore, within the meaning of fraudulent conveyance law, is one that by its design and purpose places assets beyond creditors’ reach and thus prejudices their efforts to collect on their claims by hiding or shielding assets from creditors. Fraudulent conveyance law is “concerned with transactions that shield [debtor] assets from creditors, not the manner in which specific debts were created.”²⁷ The fraud involved in a fraudulent conveyance is a logically *ex post* fraud that essentially assumes that debts will exist and, given that assumption, employs devices designed to frustrate those creditors’ access to the debtor’s assets.

As Justice Sotomayor properly recognized in *Husky*, then, “[i]n such cases, the fraudulent conduct is not in dishonestly inducing a creditor to extend a debt. It is in the acts of concealment and hindrance,” which may or (even more often) may not involve any misrepresentations by the fraudulent debtor.²⁸ Indeed, in formally changing the name of the officially recommended uniform act in 2014 from the Uniform Fraudulent Transfer Act to the Uniform Voidable Transactions Act, the Uniform Law Commission emphasized that the name change, while superficial rather than substantive,²⁹ nonetheless should help to make clear, inter alia, that “actual intent to hinder, delay, or defraud creditors” is directed at fraudulent conduct quite distinct from that of common-law fraudulent misrepresentation.³⁰

It is far from clear, however, how that cleavage cuts when set against the language of § 523(a)(2)(A)’s specification of debts for “false pretenses, a false representation, or actual fraud,” which explains the differing interpretations favored by majority and dissent in *Husky*.

Code § 523(a)(2)(A)’s Reference to “Actual Fraud”

The *Husky* majority chose to parse the wording

of § 523(a)(2)(A) very finely, first, by isolating the phrase “actual fraud” in order to consider its meaning, as distinguished from that of its nearest neighbors, “false pretenses” and “a false representation.” Then, within the phrase “actual fraud,” the Court further isolated the term “fraud” in order to determine whether that term includes within its meaning a fraudulent transfer.

Actual Fraud Is Not Coextensive With a False Representation

First, in considering the statutory series “false pretenses, a false representation, or actual fraud,” the *Husky* Court considered the “actual fraud” phrase to have meaning independent of “false pretenses” and “a false representation.” And there is support for that approach in the Bankruptcy Code’s legislative history, which indicates that “‘actual fraud’ [wa]s added as a ground for exception from discharge” in 1978,³¹ in addition to the pre-existing “false pretenses or false representations” grounds that were being carried forward from the 1898 Act.³² Thus, the *Husky* Court thought that “[i]t is therefore sensible to start with the presumption that Congress did not intend ‘actual fraud’ to mean the same thing as ‘a false representation,’ as the Fifth Circuit’s holding suggests.”³³

In fact, it is extremely odd to think that a § 523(a)(2)(A) debt must *always* be the product of a false representation, as the Fifth Circuit held, even if one accepted the view (which the Supreme Court obviously did not) that the scope of § 523(a)(2)(A) “actual fraud” is strictly confined to the common-law tort of fraudulent “misrepresentation.”³⁴ That common law, perhaps more properly characterized as the tort of fraudulent “deceit,”³⁵ imposes liability for fraud even in the *absence* of any misrepresentation by the defendant, under various circumstances, for mere *nondisclosure*.³⁶ And the same is true for “false pretenses” liability,³⁷ which appears to be a term-of-art reference to the traditional criminal theft offense of obtaining property by false pretenses.³⁸ That kind of fraud by omission can be forced into the lexicon of fraudulent “misrepresentation” only through the euphemistic device of treating the defendant’s *failure* to represent a particular fact “*as though* [the defendant] *had represented the nonexistence* of the matter that he has

failed to disclose.”³⁹ The *Husky* majority’s reading of the statute, therefore, that a debt for “actual fraud” need *not* be premised upon a false representation, is fully consistent with the most common forms of both criminal and civil fraud liability.⁴⁰

Fraud Includes Fraudulent Transfers

The *Husky* Court then made a further linguistic segmentation within the phrase “actual fraud,” in order to conclude that a fraudulent conveyance can be “actual fraud” within the meaning of § 523(a)(2)(A). “‘Actual fraud’ has two parts: actual and fraud,” with “actual” simply referring to the requisite wrongful intent for nondischargeability.⁴¹ Thus, according to the Court, “actual fraud” within the meaning of § 523(a)(2)(A) is anything “done with wrongful intent” (*actual* fraud) “that counts as ‘fraud.’”⁴² And, of course, as the Court reasoned in *Field v. Mans*, that determination must be made against the background of the accumulated common-law understanding of the term “fraud.”⁴³

Well, as the history of fraudulent conveyance law reveals, what Ken Kettering has referred to as the “primordial rule”⁴⁴ regarding transfers made with “actual intent to hinder, delay, or defraud” creditors, has for centuries been regarded as addressing wrongful “fraudulent” conduct. Indeed, the original 1571 Statute of 13 Elizabeth was also a penal statute, and the famous 1601 fraudulent conveyance decision in *Twyne’s Case* was a criminal case in the Star Chamber convicting the transferee, Twyne, of fraud.⁴⁵ Even today, there are state statutes that “criminalize a transfer made with the intent to hinder, delay, or defraud, adopting the original language of the Statute of Elizabeth,”⁴⁶ and the Model Penal Code includes similar offenses in its article dealing with “fraudulent practices.”⁴⁷ It is quite natural, therefore, to conclude that § 523(a)(2)(A)’s reference to “fraud,” if it means “anything that counts as ‘fraud,’”⁴⁸ includes fraudulent conveyances.

The § 523(a)(2)(A) “Obtained by” Limitation As an Implicit Reference to Fraudulent Inducement Debts

In dissent, Justice Thomas “agree[d] that, generally, we should give a common-law term of art its

established common-law meaning,” and he also seemed content with the conclusion that a misrepresentation is *not* an essential element of a nondischargeable “actual fraud” debt, stating that “[a]ctual fraud is broader than false pretenses or false representations, and ‘consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another.’”⁴⁹ Justice Thomas also did “not quibble with the majority’s conclusion that the *common-law* definition of ‘actual fraud,’” in general, “included fraudulent transfers.”⁵⁰ Nonetheless, he was convinced that a fraudulent conveyance is not the kind of “actual fraud” to which § 523(a)(2)(A) has reference, and he reached that conclusion by leaning upon the fundamental distinction (discussed above) between a *fraudulent conveyance* made in fraud of *creditors*, as contrasted with a *fraudulent inducement* debt.

Justice Thomas was of the opinion that the “actual fraud” reference, when considered in the context of the overarching grammatical structure of § 523(a)(2)(A), in particular its “obtained by” limitation, is referring specifically and exclusively to *fraudulent inducement* debts:

Section 523(a)(2) covers only situations in which “money, property, [or] services” are “obtained by . . . actual fraud,” and results in a debt. See *Cohen v. de la Cruz*, 523 U.S. 213, 218 (1998). The statutory phrase “obtained by” is an important limitation on the reach of the provision. Section 523(a)(2)(A) applies only when the fraudulent conduct occurs at the *inception of the debt*, *i.e.*, when the debtor commits a fraudulent act to induce the creditor to part with his money, property, services, or credit. The logical conclusion then is that “actual fraud”—as it is used in the statute—covers only those situations in which some sort of fraudulent conduct caused the creditor to enter into a transaction with the debtor. A fraudulent transfer generally does not fit that mold [T]he fraudulent transfer here, like all but the rarest fraudulent transfers, did not trick the creditor into selling his goods to the buyer, Chrysalis Manufacturing Corporation. It follows that the goods that resulted in the debt here were not “obtained by” actual fraud. § 523(a)(2)(A).⁵¹

If the “obtained by” limitation did, indeed, serve to limit § 523(a)(2)(A) to fraudulent inducement debts, then that would also necessitate interpreting the causation aspect of that phrase in a manner

that limited § 523(a)(2)(A) to fraudulent inducement debts. Thus, Justice Thomas also reasoned as follows:

[T]he plain meaning of the phrase “obtained by” . . . has an “inherent” “element of causation,” and refers to those debts “resulting from” or “traceable to” fraud. *Field v. Mans*, 516 U.S. 59, 61, 64, 66 (1995). As I have stated, “in order for a creditor to establish that a debt is not dischargeable, he must demonstrate that there is a causal nexus between the fraud and the debt.” *Archer v. Warner*, 538 U.S. 314, 325 (2003) (Thomas, J., dissenting). . . . The upshot of the phrase “obtained by” is that § 523(a)(2) covers only those debts that result from fraud at the inception of a credit transaction. Such a debt caused by fraud necessarily “follows a transfer of value or extension of credit induced by falsity or fraud.” [*Field v. Mans*, 516 U.S., at 66] (emphasis added).⁵²

That is not, however, the only possible way to interpret the “obtained by” phrase, and the *Husky* majority was not persuaded that the “obtained by” clause limits § 523(a)(2)(A) to fraudulent inducement debts.

A More Generous Construction of § 523(a)(2)(A)

If one were inclined to strictly and narrowly construe discharge exceptions in favor of the debtor, in furtherance of the fresh start policy, then Justice Thomas’ interpretation of § 523(a)(2)(A) would be particularly appealing. Indeed, the Fifth Circuit invoked that maxim in *Husky*.⁵³ The Supreme Court, though, over a very long run of decisions,⁵⁴ has not been at all inclined toward a narrow construction of the § 523(a)(2)(A) discharge exception for fraud debts. Indeed, the Court has repeatedly done just the opposite—broadly and generously construing § 523(a)(2)(A), because a narrow construction “would not square with the intent of the fraud exception”⁵⁵ to strictly “limit[] the opportunity for a completely unencumbered new beginning to the ‘honest but unfortunate debtor.’”⁵⁶ Thus, the Court has proceeded from the assumption “that ‘Congress intended the fullest possible inquiry’ to ensure that ‘all debts arising out of fraud are ‘excepted from discharge,’ no matter what their form,”⁵⁷ as “it is ‘unlikely that Congress . . . would have favored the interest in giving perpetrators of fraud a fresh start.’”⁵⁸

Resolving all possible ambiguities in favor of *not* discharging those debts incurred with the requisite fraudulent intent, then, it is easy to understand how the *Husky* Court could conclude that the language of § 523(a)(2)(A) can comfortably comprehend a fraudulent conveyance debt.

The Debtor's Debt Versus the Creditor's Claim

What is somewhat unique about the “debt” at issue in *Husky*, and that confounds the analysis somewhat, is that Ritz’s liability to Husky (whether cast as alter ego liability or fraudulent conveyance liability) did not arise from any direct dealings between Ritz and Husky. Rather, Ritz incurred secondary or derivative liability for a corporate debt that Chrysalis had previously incurred by purchasing product from Husky. The same, of course, is also true in more straightforward cases of a transferee’s fraudulent conveyance liability, as illustrated by the facts of *McClellan v. Cantrell*.

In *McClellan v. Cantrell*, Creditor sold machinery to Purchaser for \$200,000, on credit. Purchaser subsequently defaulted on its purchase debt to Creditor, and Creditor sued Purchaser to collect the debt and also to enjoin Purchaser from disposing of the machinery. During the pendency of Creditor’s suit, Purchaser colluded with his sister, Debtor, to thwart Creditor’s collection of the purchase debt via a “sale” of the machinery from Purchaser to Debtor for \$10, and then Debtor turned around and sold the machinery to someone else for \$160,000. When Creditor added Debtor as an additional defendant in his suit against Purchaser with a fraudulent conveyance claim, Debtor filed a Chapter 7 petition. And Creditor, of course, sought to except Debtor’s fraudulent conveyance liability from discharge as a § 523(a)(2)(A) debt for “actual fraud.”

As in *Husky*, then, Debtor’s fraudulent conveyance liability in *McClellan* is a kind of secondary or derivative liability for Purchaser’s purchase debt to Creditor. Indeed, for purposes of comparatively analyzing *Husky*, one could attach the corresponding Creditor, Purchaser, and Debtor labels to Husky, Chrysalis, and Ritz, respectively.

Notice that in order to construe § 523(a)(2)(A) as

limited to fraudulent inducement debts, Justice Thomas approached the relevant “debt” at issue from Creditor’s perspective: “[I]t would be nonsensical to say that a fraudulent transfer created the debt at issue,” because “the debt at issue did not originate from any transaction between [Debtor] and [Creditor].”⁵⁹ Thus, Justice Thomas read “debt for money, property, services, or . . . credit . . . obtained by . . . actual fraud” to mean “obtained from Creditor” “by actual fraud.” The only party with a debt for property obtained from Creditor in *Husky* and *McClellan*, though, is Purchaser, not Debtor. So § 523(a)(2)(A) can only have potential applicability to Purchaser’s debt, not Debtor’s, according to Justice Thomas.

As Justice Sotomayor pointed out, though, that is not what the actual language of § 523(a)(2)(A) says. “Nothing in the text of § 523(a)(2)(A) supports that additional requirement”⁶⁰ that the debt be one for money or property obtained from Creditor. Moreover, if our focus is upon identifying obligations Debtor incurred with the requisite fraudulent intent—consistent with the Court’s persistent view of the function of the § 523(a)(2)(A) discharge exception—then we will approach the relevant “debt” at issue from Debtor’s perspective rather than Creditor’s. Indeed, the “debt” to which § 523(a)(2)(A) expressly has reference is simply the “debt” Debtor seeks to discharge—Debtor’s debt, *not* Purchaser’s debt—and the only limitation that the phrase “obtained by” imposes is that Debtor’s “debt” be one “for money, property, services, or . . . credit . . . obtained by . . . actual fraud.” The actual text of § 523(a)(2)(A), therefore, easily comprehends Debtor’s debt in cases like *McClellan*. As Judge Posner put it in *McClellan*:

[Debtor] is alleged to have been a full and equal participant in her brother’s fraud, to have been in effect his accomplice. The debt that [Creditor] is seeking to collect from [Debtor] (and prevent her from discharging) arises by operation of law from her fraud. That debt [the one Debtor seeks to discharge] arose not when [Purchaser] borrowed money from [Creditor] but when [Debtor] prevented [Creditor] from collecting from [Purchaser] the money [Purchaser] owed [Creditor]. . . . [Purchaser’s] original debt to [Creditor] is not the debt at issue here. The debt at issue here is the debt that [Debtor] incurred to [Creditor] by committing a fraud against [Creditor].⁶¹

And if one focuses on the “debt” Debtor seeks to

discharge—Debtor’s fraudulent conveyance liability—the “obtained by” limitation of § 523(a)(2)(A) is easily satisfied in a case like *McClellan*, under the interpretation of that limitation announced by the Supreme Court in *Cohen v. de la Cruz*. In fact, Justice Thomas’ assumption that § 523(a)(2)(A) (via the “obtained by” limitation) could *only* be referring to Purchaser’s debt (and, thus, § 523(a)(2)(A) simply cannot except Debtor’s debt from discharge) is inconsistent with the Court’s very broad and inclusive interpretation of the “obtained by” clause in *Cohen v. de la Cruz*.

A Debt for Money or Property “Obtained by” a Fraudulent Transfer

Code § 523(a)(2)(A) excepts from discharge “any debt for money, property, services, or . . . credit, to the extent obtained by . . . actual fraud.” And in *Cohen v. de la Cruz*, the Court stated that “[t]he most straightforward reading of § 523(a)(2)(A) is that it prevents discharge of ‘any debt’ respecting ‘money, property, services, or . . . credit’ that the debtor has fraudulently obtained.”⁶² Thus, “[o]nce it is established that specific money or property has been obtained by fraud, . . . ‘any debt’ arising therefrom is excepted from discharge.”⁶³

As applied to a case like *McClellan*, therefore, Debtor obtained the machinery from her brother by participating in his fraud upon Creditor, and thus, her consequent fraudulent transfer liability to Creditor for the value thereof is excepted from discharge. Contrary to Justice Thomas’ assumption, then, that the “obtained by” phrase could *only* be referring to Purchaser’s debt (and not Debtor’s debt) in a case like *McClellan*, “the phrase ‘to the extent obtained by’ in § 523(a)(2)(A) . . . does *not* impose any limitation on the extent to which ‘any debt’ arising from fraud is excepted from discharge.”⁶⁴ Rather, “§ 523(a)(2)(A) prevents the discharge of all liability arising from fraud.”⁶⁵ The only “limitation” that the “obtained by” phrase imposes upon the scope of § 523(a)(2)(A) is that it must be “established that specific money or property has been obtained by fraud” and the debt at issue must be one “‘resulting from’ or ‘traceable to’ [that] fraud.”⁶⁶

That required causal connection is easily and

obviously present in cases like *McClellan*. As Justice Sotomayor stated in *Husky*:

[T]he recipient of the [fraudulent] transfer—who, with the requisite intent, also commits fraud—can “obtain[n]” assets “by” his or her participation in the fraud. If that recipient later files for bankruptcy, any debts “traceable to” the fraudulent conveyance will be nondischargeable under § 523(a)(2)(A). Thus, at least sometimes a debt “obtained by” a fraudulent conveyance scheme could be nondischargeable under § 523(a)(2)(A). Such circumstances . . . make clear that fraudulent conveyances are not wholly incompatible with the “obtained by” requirement.⁶⁷

Indeed, if one is inclined to construe the § 523(a)(2)(A) discharge exception generously, in order to “limit[] the opportunity for a completely unencumbered new beginning to the ‘honest but unfortunate debtor,’”⁶⁸ the intuition that a transferee’s fraudulent conveyance debt should *not* be categorically excluded from § 523(a)(2)(A) nondischargeability (as advocated by Justice Thomas) is quite compelling. As Judge Posner trenchantly observed in *McClellan*:

The two-step routine that [Creditor] alleges and that we must take as true—in which [Purchaser] transfers valuable property to [Debtor] for nothing in order to keep it out of the hands of [Purchaser]’s creditor and Debtor then sells the property and declares bankruptcy in an effort to shield herself from liability for having colluded with [Purchaser] to defeat the rights of [Purchaser]’s creditor—is as blatant an abuse of the Bankruptcy Code as we can imagine. It turns bankruptcy into an engine for fraud.⁶⁹

And note, that since the fraudulent transfer at issue in cases like *McClellan* and *Husky* is a transfer of Purchaser’s property (rather than Debtor’s property), the § 727(a)(2)(A) ground for discharge denial—that “the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . *property of the debtor*, within one year before the date of the filing of the petition”—has no applicability whatsoever to penalize Debtor’s fraud. Thus, the Supreme Court was entirely unmoved by the existence of the more specific discharge penalty directed at fraudulent conveyances in § 727(a)(2) and negative inference arguments therefrom, e.g., that the § 523(a)(2)(A) discharge penalty should *not*, therefore, be read to also address fraudulent conveyances via a more general “actual fraud” reference. Again, such arguments

might have some traction if the § 523(a)(2)(A) discharge exception should be strictly and narrowly construed in favor of the debtor. But the Court evidently does *not* indulge any such debtor-friendly pro-discharge presumption and is more inclined to construe § 523(a)(2)(A) as broadly as its language permits, in the interest of *not* “giving perpetrators of fraud a fresh start.”⁷⁰ And, of course, a more liberal and flexible interpretation of § 523(a)(2)(A) makes that provision much more responsive to the ever-evolving ingenious means by which fraudsters perpetrate their schemes.

The *Husky* Court, therefore, was unwilling to read the “obtained by” requirement in a manner that would categorically exclude fraudulent transfer debts from the scope of the § 523(a)(2)(A) discharge exception. The *Husky* case, though, presents another difficult issue regarding the “obtained by” requirement that the Court did not address.

Money or Property “Obtained by” Whom?

In *Cohen v. de la Cruz*, the Court stated that “[t]he most straightforward reading of § 523(a)(2)(A) is that it prevents discharge of ‘any debt’ respecting ‘money, property, services, or . . . credit’ that *the debtor has fraudulently obtained*.”⁷¹ In *Husky*, though, the alleged fraudulent transfers at issue were made to various Ritz-controlled entities rather than to the debtor, Ritz, personally, and the Supreme Court expressly refused to take a position on whether this particular aspect of the “obtained by” requirement was satisfied in *Husky*, leaving that for determination on remand.⁷²

Notwithstanding the above-quoted dicta from *Cohen v. de la Cruz*, the language of § 523(a)(2)(A) itself does *not* expressly dictate that *the debtor* must be the recipient of the money, property, services, or credit “obtained by” fraud. Thus, in the lower courts, “[t]hree views have emerged regarding the issue of whether a debtor must personally receive” the money, property, services or credit “obtained by” fraud before the § 523(a)(2)(A) discharge exception can apply.⁷³

As summarized by the Eleventh Circuit in its *Bilzerian* decision, “[t]he first view, which . . . is the narrowest, requires that the debtor personally

receive the fruits of the fraud.”⁷⁴ Indeed, the above quotation from *Cohen v. de la Cruz* (although dicta) suggests that the narrow view is a plausible construction of the language of § 523(a)(2)(A). At the other extreme, though, the broadest view is that the statute, by its terms, merely requires that the debtor engage in fraudulent conduct through which money or property was obtained, but the “debtor does not necessarily have to receive money [or property] personally or receive any benefit at all” from his/her fraudulent conduct, for any debt resulting therefrom or traceable thereto to be nondischargeable.⁷⁵

Most courts, however, including several circuit courts, have not followed either the narrow or broad view, but rather have adopted a middle course, which “is termed the ‘receipt of benefits’ theory. This theory requires that the debtor gain a *benefit* from the money [or property] that was obtained by fraudulent means.”⁷⁶ Cases invoking the receipt of benefits theory typically involve facts similar to *Husky*, where entities controlled by the debtor were the recipients of the money or property obtained by fraud. In *Husky*, then, this aspect of the “obtained by” requirement would seem to be met if either the broad view or the “receipt of benefits” theory prevails, both of which are more consistent with a liberal interpretation of the scope of § 523(a)(2)(A) that does not reward the fraudster who buries the fruits of that fraud in a thicket of controlled corporate entities.

How broadly this aspect of the “obtained by” requirement is interpreted will also affect the nondischargeability of the fraudulent conveyance liability of *other* nontransferees. For example, some states recognize a civil cause of action for conspiracy to commit a fraudulent transfer⁷⁷ or for aiding and abetting a fraudulent conveyance.⁷⁸ Assuming that such actors participate in a fraudulent transfer scheme with the requisite fraudulent intent, a desire “to ensure that ‘all debts arising out of’ fraud are ‘excepted from discharge,’ no matter what their form,”⁷⁹ again, would counsel in favor of a more liberal interpretation of this aspect of the “obtained by” requirement.

Actual Fraud Requires Wrongful Intent

The premise behind a more generous interpreta-

tion of the scope of § 523(a)(2)(A) is that the debtor's liability is, indeed, attributable to purposefully wrongful conduct, because § 523(a)(2)(A) belongs to "a set of statutory [discharge] exceptions that Congress normally confines to circumstances where . . . the presence of fault"—"of the kind that the criminal law" punishes—is what compels "preserving the debt."⁸⁰ Hence, in adding the "actual fraud" ground for nondischargeability in 1978, legislative history indicates that Congress "intended to codify current case law, e.g., *Neal v. Clark*, 95 U.S. 704 (1887), which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law."⁸¹

In that *Neal v. Clark* decision, the Court was interpreting the provision in the Bankruptcy Act of 1867 specifying "[t]hat no debt created by the fraud . . . of the bankrupt . . . shall be discharged,"⁸² and Justice Harlan elaborated "that the 'fraud' referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality."⁸³ And in the more recent *Bullock* case, the Court indicated⁸⁴ that "the term requires an intentional wrong," including "also reckless conduct of the kind that the criminal law often treats as the equivalent."⁸⁵ In *Husky*, the Court echoed that same "wrongful intent" standard, first articulated in *Neal v. Clark*, as providing "the requisite intent" to "commit[actual] fraud" within the meaning of § 523(a)(2)(A).⁸⁶ "Thus, anything that counts as 'fraud' and is done with wrongful intent is 'actual fraud'" falling within the discharge exception.⁸⁷

Nondischargeability of "Actual" Fraudulent Transfer Liability

In deciding "whether there must be actual fraud, or whether it is enough that there is implied or constructive fraud" to render a debt nondischargeable,⁸⁸ Justice Harlan in *Neal v. Clark* was wrestling with the ancient, intrinsic ambiguity surrounding "fraud" inherited from Roman law, "which has compelled us to distinguish between 'actual' fraud and 'constructive' fraud, and forced other indirections upon us."⁸⁹ And, of course, fraudulent conveyance law contains one of the most prominent

examples of the misleading nomenclature of "actual" and "constructive" fraud. So-called constructive "fraud" provides another instance of the beguiling nature of the legal terminology of "constructive" anything. Professor Markell has aptly described the term "constructive fraud" as "the ultimate misnomer in commercial law."⁹⁰ Constructive fraud is to actual fraud what constructive contract is to an actual contract—i.e., *not*.

Modern constructive fraud has its origins in two distinct lines of eighteenth and nineteenth-century case law—one involving gifts (then commonly known as "voluntary conveyances") and the other involving transfers for inadequate consideration (sometimes characterized as partial gifts or "partially voluntary" conveyances).⁹¹ Both lines of decision can be traced to early influential opinions by Chancellor Kent.⁹²

The significance of those decisions lay in the fact that in each, "Kent was unwilling to find actual fraud,"⁹³ yet provided a remedy nonetheless, despite the fact that the transfers at issue were not "fraudulent in fact," based simply upon "unequitable circumstances . . . which is only constructively fraudulent."⁹⁴ With respect to gifts, in particular, the absence of the requisite intent thereby to injure creditors, is widely acknowledged.⁹⁵ Kent, however, held that the fraudulent conveyance laws should reach them all the same:

If the question rests not upon an actual fraudulent intent (as is admitted in all the cases), it must be a case of fraud in law, arising from the act of a voluntary disposition [i.e., a gift], while indebted.⁹⁶ . . . I apprehend it is, upon the whole, better and safer not to allow a party to yield to . . . natural impulse by giving him the power of placing property . . . beyond the reach of existing creditors.⁹⁷ He must be taught by the doctrines of this Court, that the claims of justice are prior to those of affection. The inclination of my mind is strongly in favor of the policy and wisdom of the rule, which absolutely disables a man from preferring, by any arrangement whatever, and with whatever intention, by gifts of his property, his [objects of natural affection] to his creditors.⁹⁸

Such cases of constructive (i.e., *not*) "fraud" are fully "[d]ivorced from the mental states of the parties," and, therefore, are "avoidance actions of a different nature entirely" than the primordial actual fraudulent transfer, made with "actual intent to

hinder, delay, or defraud any creditor.”⁹⁹ “The impulse to which they respond is very different from that prohibiting transfers with actual fraudulent intent.”¹⁰⁰ The prohibition against gifts by an insolvent captures the instinct that “you must be just before you are generous.”¹⁰¹ More broadly, though, the prohibition against transfers for inadequate consideration by an insolvent (Kent’s allusive reference to “unequitable circumstances”) and the fact that “[m]any cases fall squarely within the scope of constructive fraud even though there is no hint of [transferor] misbehavior,” indicate “that some transfers by their very nature injure creditors of the” transferor: “Such transfers are inherently objectionable, and should be set aside. The focus of constructive fraud, then is on the *victims*—the creditors—rather than on the [transferor]. In short, constructive fraud is a form of strict liability to redress creditor injury.”¹⁰² As Baird and Jackson put it, “[a] birthday gift of cash by an insolvent . . . injures creditors just as much when his intentions are innocent as when they are not.”¹⁰³

Cases of merely constructive “fraud,” therefore, cannot give rise to a nondischargeable debt. Nondischargeability, therefore, can only come into play if the debt at issue arises from a so-called “actual” fraudulent transfer made with “actual intent to hinder, delay, or defraud any creditor” of the transferor. As Judge Posner stated in *McClellan*:

The distinction between actual and constructive fraud is the key [to nondischargeability]. To transfer property for less than adequate consideration may be desperate, foolish, or imprudent, and the receipt of such a transfer a pure windfall, but neither the transfer nor the receipt is in and of itself dishonest, and so neither is an appropriate ground for refusing to allow the debtor to discharge the debt arising from the transfer and thus to get on with his life without the debt hanging over his head. The situation is entirely different, and the debtor’s equities and argument for discharge much weaker, when the debtor is guilty of intent to defraud. The purpose of section 523(a)(2)(A) in confining nondischargeability to *actual* fraud is merely to recognize this difference and thus to exclude constructive fraud. See *Neal v. Clark*, 95 U.S. (5 Otto) 704, 709 (1877) [W]hen a conveyance is merely constructively fraudulent, in the sense that having transferred the property [at issue] without obtaining adequate consideration the [transferor] is now unable to pay his creditor, the transferee is not guilty of an actual fraud against

the creditor and so the creditor cannot use section 523(a)(2)(A) to prevent the transferee from discharging the debt in bankruptcy.¹⁰⁴

Likewise, in *Husky*, the Supreme Court indicated that the “wrongful intent” necessary to trigger nondischargeability under § 523(a)(2)(A) is “actual intent to hinder, delay, or defraud any creditor” of the transferor.¹⁰⁵ Even in cases of a so-called “actual” fraudulent transfer, though, a transferee’s liability will not necessarily, or even generally, be nondischargeable under § 523(a)(2)(A).

Transferee Liability for “Actual” Fraudulent Transfers

In the usual case, fraudulent transfer liability for an “actual” fraudulent transfer has an odd peculiarity regarding the wrongful intent necessary to impose liability on the transferee. “The only inquiry concerning actual intent that matters is that of the [transferor]: whether the [transferor] . . . intended to hinder, delay or defraud its creditor[s].”¹⁰⁶ While it is the transferor’s mens rea that ultimately determines whether a transfer is made with “actual intent to hinder, delay, or defraud any creditor” of the transferor, “the [transferor] is not the [] target. The remedy is against the transferee; the [transferor] is a mere bystander. It would make little sense to impose liability on the transferee based upon the mental state of a different person, the [transferor].”¹⁰⁷ Thus, modern fraudulent transfer statutes give the transferee of a fraudulent conveyance a good-faith for-value defense, such as the one contained in UFTA § 8(a), which provides that a transfer made “with actual intent to hinder, delay, or defraud any creditor of” the transferor “is not voidable . . . against any person who took in good faith and for a reasonably equivalent value.”¹⁰⁸

Juxtaposing an actual fraudulent transfer against a transferee’s good-faith for-value defense reveals that a transferee of an actual fraudulent transfer can have fraudulent conveyance liability even when the transferee does not share the transferor’s actual fraudulent intent. This is true with respect to both halves of the good-faith *and* for-value inquiry regarding a transferee’s liability. First, even a good-faith transferee is liable if the

transferee did not give reasonably equivalent value for the transfer (for the amount by which the value of the asset transferred exceeds the value given by the transferee in exchange). Thus, an actually fraudulent transfer made for no consideration (e.g., by way of a gift to a family member), is fully avoidable even if the transferee received the transfer in absolute good faith.

Second, a lack of good faith on the part of a transferee, that likewise renders an actual fraudulent transfer fully avoidable, is a mens rea threshold that falls well below the wrongful intent of the transferor (i) that makes the transfer a *prima facie* actual fraudulent transfer and (ii) that the transferee must share in order to trigger nondischargeability under Code § 523(a)(2)(A). Indeed, in this context, good faith is an objective, inquiry-notice standard. “[C]ourts look to what the transferee objectively ‘knew or should have known’ in questions of good faith, rather than examining what the transferee actually knew from a subjective standpoint.”¹⁰⁹ As the Supreme Court put it in an 1894 decision:

A statute that declares every transfer of property made with intent to delay or defraud any creditor of his demands void against all creditors of the debtor [is] subject to the rule that “whatever is notice enough to excite attention and put the party on his guard, and call for inquiry, is notice of everything to which such inquiry might have led.”¹¹⁰

* * * *

[W]hile the plaintiff was not bound to act upon mere suspicion as to the intent with which his brother made the sale in question, if he had knowledge or actual notice of circumstances sufficient to put him, as a prudent man, upon inquiry as to whether his brother intended to delay or defraud his creditors, and he omitted to make such inquiry with reasonable diligence, he should have been deemed to have notice of such fact, and therefore such notice as would invalidate the sale to him, if such sale was in fact made with the intent upon the part of the vendor to delay or defraud other creditors.¹¹¹

Thus, a transferee’s liability for an actual fraudulent transfer will often be premised upon a mens rea that does *not* rise to the level of “actual intent to hinder, delay, or defraud any creditor” of the transferor—the wrongful intent necessary to make a debt nondischargeable as one for “actual fraud”

under Code § 523(a)(2)(A). In the *Husky* case itself, the potential disconnect between the mens rea of the transferor and that of the transferee does not exist, “because Husky contends that Ritz was both the transferor and the transferee in his fraudulent conveyance scheme, having transferred Chrysalis assets to other companies he controlled.”¹¹² In other cases, though, the transferee may not share the transferor’s “actual intent to hinder, delay, or defraud” the transferor’s creditors.

Nondischargeability Requires Wrongful Intent by the Debtor-Transferee

A transferee’s liability for an actual fraudulent transfer, therefore, can be premised upon divergent *mentes reae* as between transferor and transferee: The transferor made the transfer “with actual intent to hinder, delay, or defraud” the transferor’s creditors, but the transferee was merely on inquiry notice of that fraud and did *not* have an “actual intent to hinder, delay, or defraud” the transferor’s creditors. Such a situation exposes yet another ambiguity in the language of § 523(a)(2)(A) that has perpetuated a longstanding controversy regarding so-called vicarious nondischargeability.¹¹³

The language of § 523(a)(2)(A) is ambiguous as to whether the debtor must have engaged in the fraud by which money or property was obtained. Indeed, “nothing in the text of § 523(a)(2)(A) restricts its effects solely to a debt [for money or property] ‘obtained by false pretenses, a false representation, or actual fraud’ of the debtor.”¹¹⁴ A literal reading of § 523(a)(2)(A), therefore, can lead to the conclusion “that debtors cannot discharge any debts that arise from fraud so long as they are liable to the creditor for the fraud.”¹¹⁵

The notion of vicarious nondischargeability originated in a curious 1885 opinion by Justice Harlan, in the case of *Strang v. Bradner*,¹¹⁶ which seems altogether inconsistent with his earlier opinion in *Neal v. Clark*. Reconciling those two decisions and, correlatively, deciding whether vicarious nondischargeability has any validity at all and, if so, determining its scope, requires a Herculean endeavor and, ultimately, is not entirely cogent or convincing.¹¹⁷ Even if *Strang v. Bradner* and vicarious nondischargeability retain some continuing

vitality, though,¹¹⁸ the principal liability context implicated by *Husky*—the fraudulent transfer liability of a transferee—nonetheless would seem to be controlled by the *Neil v. Clark* holding. Indeed, in *Husky* the Court indicated that the transferee of a fraudulent transfer must act “with the requisite [wrongful] intent” in order to “also commit[actual] fraud” that would render the transferee’s fraudulent conveyance liability nondischargeable. In fact, *Neil v. Clark* itself—the holding of which Congress “intended to codify” with the “actual fraud” discharge exception¹¹⁹—addressed precisely such transferee liability for a fraudulent transfer.

In *Neal v. Clark*, the debt at issue arose out of an executor’s administration of a decedent’s estate. In disposing of the decedent’s real property, the executor sold the land on credit, with the purchasers giving the executor secured promissory notes payable to the estate. The executor subsequently sold two of the notes to Neal, at a substantial discount from their face value, indicating to Neal that the proceeds would be used to pay the executor amounts the estate owed the executor. In fact, though, no amounts were owing from the estate to the executor, and the executor simply absconded with the proceeds. Neal subsequently received a discharge in bankruptcy, but was thereafter sued by the executor’s sureties in state court on behalf of the decedent’s estate, contending (1) that Neal was liable to the estate and its beneficiaries “on the ground of a fraudulent participation with the executor in the commission of a *devastavit* of his testator’s estate”¹²⁰ and (2) that Neal’s debt therefor was a nondischargeable fraud debt.

The *devastavit* action was closely analogous to the conventional fraudulent conveyance remedy, but was an action available to all claimants of the decedent’s estate (rather than just creditors) because “in courts of equity, the assets are treated as the debtor, or, in other words, as a trust fund, to be administered by the executor for the benefit of all persons who are interested in it, whether they are creditors or legatees, or distributees, or otherwise interested.”¹²¹ A *devastavit*, therefore, was a transfer made by an executor with intent to hinder, delay, or defraud creditors, beneficiaries, and other claimants on the decedent’s estate, and whenever there was a *devastavit* by the executor, “and the as-

sets or their proceeds can be traced into the hands of any persons affected with notice of such misapplication, there the trust will attach upon the property or proceeds in the hands of such person.”¹²²

In *Neal v. Clark*, the state court held, with respect to the notes sold to Neal, that “the executor commit[ted] a *devastavit* by making the sale for the purpose of converting the proceeds to his own use, and by actually so converting them.”¹²³ With respect to Neal, though, as transferee of the notes, the state court found that “[h]e was not guilty of actual fraud in making the purchase; but . . . he was guilty of constructive fraud, which was sufficient to implicate him as a participant in the *devastavit* certainly committed by the executor,”¹²⁴ because he was on inquiry notice of the executor’s *devastavit*.¹²⁵ The Virginia Supreme Court held that this was also sufficient to render Neal’s *devastavit* liability a nondischargeable debt for “fraud”:

The [bankruptcy] act does not say ‘actual’ fraud, or ‘moral’ fraud; or qualify the word by any other adjective. It uses only the generic word *fraud* Certainly if the purchaser had actually colluded with the executor to commit a *devastavit*, his fraud would have come within the meaning of the [bankruptcy] act. Why does it not come within the meaning . . . when he has so dealt with the executor . . . as to make him liable for [the executor’s fraud]?¹²⁶

The Supreme Court, though, via Justice Harlan’s opinion, answered that rhetorical question by rejecting any notion of vicarious nondischargeability “upon the ground of [Neal] having been guilty of an implied or constructive fraud.”¹²⁷

[T]he ‘fraud’ referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, . . . and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality.¹²⁸

* * * *

We concur in the view expressed by the State court, that Neal was not guilty of actual fraud. The evidence does not show that he entertained any purpose himself to commit a fraud, or to aid the executor in committing one.¹²⁹

* * * *

It results from what has been said that the debt or claim asserted against Neal was not ‘created by the fraud . . . of the bankrupt,’ within the meaning of the thirty-third section of the law of 1867. His dis-

charge in bankruptcy affords him complete protection.¹³⁰

In a previous issue of *Bankruptcy Law Letter*, I analyzed the implications of *Neal v. Clark*, in light of the subsequent *Strang v. Bradner* decision and Congress' codification of the *Neal v. Clark* "actual fraud" standard for nondischargeability in Code § 523(a)(2)(A), and that analysis clearly speaks to the dischargeability of a transferee's liability for an actual fraudulent transfer. Even if vicarious nondischargeability is a legitimate doctrine (of which I am highly skeptical),

extending the debtor's vicarious liability to vicarious nondischargeability of the liability, under the doctrine of *Strang v. Bradner*, simply buttresses the equitable compensation goals embodied in [a] nonbankruptcy [vicarious] liability scheme. The debtor's liability in *Neal v. Clark*, by contrast, was not based upon a purely vicarious/compensatory liability regime; applicable nonbankruptcy law imposed liability for the executor's fraudulent misconduct on Neal only upon a showing of some level of misconduct by Neal [inquiry notice of the fraud]. Neal's liability, therefore, was at least partially founded upon culpability, and the holding of *Neal v. Clark* is simply that the only level of culpability that gives rise to a nondischargeable debt is "positive fraud . . . involving . . . intentional wrong."

Together, then, *Neal v. Clark* and *Strang v. Bradner* illustrate that . . . when the debtor's liability under applicable nonbankruptcy law is premised upon a system of relative culpability, then the fraud exception's punitive objects are [paramount], reserving nondischargeability solely for those culpability-based debts that rise to the level of actual fraud.¹³¹

Because a transferee's liability for an actual fraudulent transfer—that the transferor made with actual intent to hinder, delay, or defraud the transferor's creditors—is also triggered by some level of culpability by the transferee, this is another context in which the only level of culpability that can render the transferee's liability nondischargeable is if the transferee "entertained any purpose himself to commit a fraud, or to aid the [transferor] in committing one."¹³² Indeed, that was the holding of the Supreme Court in the 1878 decision in *Wolf v. Stix*, in which the Court applied the *Neal v. Clark* decision (from its immediately preceding term) to a transferee's liability for an actual fraudulent transfer.¹³³

That insistence that a debt is nondischargeable only if the debtor's liability arises from "an intentional wrong" *by the debtor*, or "reckless conduct of the kind that the criminal law often treats as the equivalent," is "also consistent with a set of statutory [discharge] exceptions that Congress normally confines to circumstances where . . . the presence of fault" is what compels "preserving the debt."¹³⁴ The intuitive moral impulse embodied in § 523(a)(2)(A) is that we should *not* give "perpetrators of fraud a fresh start."¹³⁵ By the same token, then, if the debtor herself did not commit "actual fraud," her liability should be dischargeable. As Justice Harlan stated in *Neal v. Clark*, "[s]uch a construction of the statute is consonant with equity, and consistent with the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency."¹³⁶

ENDNOTES:

¹Husky Intern. Electronics, Inc. v. Ritz, 136 S. Ct. 1581, 62 Bankr. Ct. Dec. (CRR) 156 (2016).

²Husky, 136 S. Ct. at 1588. See also *id.* n.2 (quoting debtor's counsel at oral argument: "to be clear, we don't dispute that fraudulent conveyance is a form of actual fraud"); *id.* at 1590 (Thomas, J., dissenting) ("I do not quibble with the majority's conclusion that the *common-law* definition of 'actual fraud' included fraudulent transfers.").

³Husky, 136 S. Ct. at 1588.

⁴Husky, 136 S. Ct. at 1588.

⁵In re Ritz, 459 B.R. 623, 626 (Bankr. S.D. Tex. 2011), decision *aff'd*, 513 B.R. 510 (S.D. Tex. 2014), *aff'd*, 787 F.3d 312, 61 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 82829 (5th Cir. 2015), cert. granted, 136 S. Ct. 445, 193 L. Ed. 2d 346 (2015).

⁶Tex. Bus. Org. Code § 21.223(b) (emphasis added).

⁷Uniform Fraudulent Transfer Act (UFTA) § 4(a)(1).

⁸See In re Ritz, 513 B.R. 510, 535-38 (S.D. Tex. 2014) (relying upon *Spring Street Partners-IV, L.P. v. Lam*, 730 F.3d 427 (5th Cir. 2013)), *aff'd*, 787 F.3d 312, 61 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 82829 (5th Cir. 2015), cert. granted, 136 S. Ct. 445, 193 L. Ed. 2d 346 (2015).

⁹The bankruptcy court stated that "[a]s a result of" Ritz's "orchestration of the fund transfers out of Chrysalis's account," Chrysalis "was drained of all of its cash and, therefore, could not pay its credi-

tors.” 459 B.R. at 626, 628. Nonetheless, the bankruptcy court never made a specific finding that those transfers were made with “actual intent to hinder, delay, or defraud” Chrysalis’ creditors. At most, the bankruptcy court’s specific findings establish that the transfers were “constructively fraudulent” under UFTA § 5(a), in that they were made when Chrysalis was insolvent *and* Chrysalis did not receive reasonably equivalent value in exchange for any of those transfers.

¹⁰In *re Ritz*, 787 F.3d 312, 321, 61 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 82829 (5th Cir. 2015), cert. granted, 136 S. Ct. 445, 193 L. Ed. 2d 346 (2015).

¹¹*McClellan v. Cantrell*, 217 F.3d 890, 36 Bankr. Ct. Dec. (CRR) 92, 44 Collier Bankr. Cas. 2d (MB) 576, Bankr. L. Rep. (CCH) P 78219, 42 U.C.C. Rep. Serv. 2d 284 (7th Cir. 2000).

¹²In *re Lawson*, 791 F.3d 214, 61 Bankr. Ct. Dec. (CRR) 92, Bankr. L. Rep. (CCH) P 82845 (1st Cir. 2015).

¹³*Husky*, 136 S. Ct. at 1586.

¹⁴Max Radin, *Fraudulent Conveyances at Roman Law*, 18 Va. L. Rev. 109, 110-11 (1931). See also Kenneth C. Kettering, *The Uniform Voidable Transactions Act: or, the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 Bus. Law. 777, 807 (2015); Jay Adkisson, *The Uniform Voidable Transactions Act—What’s With the Name Change?*, *Forbes Personal Finance* (July 18, 2014), at <http://www.forbes.com/sites/jayadkisson/2014/07/18/the-uniform-voidable-transactions-act-whats-with-the-name-change/#e0d5e6b8f633>.

¹⁵Radin, 18 Va. L. Rev. at 111.

¹⁶*Id.* at 111.

¹⁷See Radin, 18 Va. L. Rev. at 129 (translating Digest of Justinian, Book 50, tit. 17, “A Collection of Ancient Legal Rules,” § 79, Papinian’s Questions, Book 32) (“In our law, in interpreting the word ‘fraud’ we always require an intentional element and do not merely apply it to acts which have a prejudicial result.”); Frank R. Kennedy, *Involuntary Fraudulent Transfers*, 9 Cardozo L. Rev. 531, 535 (1987) (“The Roman law, like so much of the Anglo-American law of fraudulent transfers, purported to be concerned only with dispositions that were intentionally fraudulent. Knowledge that creditors would suffer was considered sufficient, however.”).

¹⁸Radin, 18 Va. L. Rev. at 111.

¹⁹Max Radin, *Fraudulent Conveyances in California and the Uniform Fraudulent Conveyance Act*, 27 Cal. L. Rev. 1, 1 (1938).

²⁰As Professor Glenn noted, “[t]he very terms, ‘in fraud of creditors,’ and ‘with intent to defraud’ them, as appearing in Roman law, found their way, with monotonous regularity, into English statutes

long before the Act of Elizabeth was drafted.” 1 Garrard Glenn, *Fraudulent Conveyances and Preferences* § 60, at 83 (rev. ed. 1940) (footnote omitted). See also Kennedy, 9 Cardozo L. Rev. at 536 & n.16 (citing “English legislation directed at such transfers [that] had been enacted by Parliament during the preceding two centuries”); Radin, 27 Cal. L. Rev. at 1-2 (noting that the 1571 Statute of 13 Elizabeth “reenacted many of the provisions and repeated many of the words of statutes of Henry VIII and Edward III”).

Indeed, “[i]t has often been stated, the authorship being traceable to no less an authority than Lord Mansfield, that even if this statute had not been passed, creditors could have obtained the same relief at common law.” 1 Glenn, *Fraudulent Conveyances*, § 59, at 81 & n.8 (and discussing a 1477 chancery case nicely illustrating “that the equity courts could have worked out a doctrine in behalf of creditors”). See *Sumner v. Hicks*, 67 U.S. 532, 534, 17 L. Ed. 355, 1862 WL 6743 (1862) (“The Statute of Elizabeth was declaratory of the common law.”); *Cadogan v. Kennett*, 98 Eng. Rep. 1171, 1172 (K.B. 1776) (Mansfield, L.J.) (“The principles and rules of the common law, as now universally known and understood, are so strong against fraud in every shape, that the common law would have attained every end proposed by the statute[] 13 El. c.5.”). Moreover, from the very beginning, certain aspects of fraudulent conveyance law developed independently of the Statute of Elizabeth. Even after that codification, then, “the law of fraudulent conveyances was a mosaic of statutes and decisions, which had been developed around the Statute of Elizabeth.” 1 Glenn, *Fraudulent Conveyances*, § 58, at 80-81. That mosaic was replicated and propagated in the American colonies and states in their statutory enactments and common law, and it remained as such until the first uniform act, the Uniform Fraudulent Conveyance Act (UFCA) promulgated in 1918, was widely enacted by the states. See *id.* at 79-81; *Peters v. Bain*, 133 U.S. 670, 685, 10 S. Ct. 354, 33 L. Ed. 696 (1890) (noting that the English law “against fraudulent conveyances” developed under the Statute of Elizabeth “has been universally adopted in American law as the basis of our jurisprudence on that subject”).

²¹13 Eliz., ch.5, § I (1571), reprinted in 2 Glenn, *Fraudulent Conveyances*, at 1069.

²²See *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1507-11 (1st Cir. 1987) (Breyer, C.J.).

²³Restatement (Second) of Torts § 525 (1977).

²⁴*Boston Trading Group*, 835 F.3d at 1517 (some emphasis in original and some emphasis added).

²⁵*Husky*, 136 S. Ct. at 1587 (emphasis added).

²⁶Thomas Jackson, *Avoiding Powers in Bankruptcy*, 36 Stan. L. Rev. 725, 778 (1984).

²⁷In re Sharp Intern. Corp., 403 F.3d 43, 55-56, 44 Bankr. Ct. Dec. (CRR) 146 (2d Cir. 2005).

²⁸Husky, 136 S. Ct. at 1587.

²⁹The Official Comments explain that “[n]either the retitling of the Act, nor the consistent use of ‘voidable’ in its text [in lieu of ‘fraudulent’] effects any change in the meaning of the Act.” UVTA § 15, official comment 5. As of this writing, nine states have enacted the UVTA, and legislative bills proposing enactment of the UVTA have been introduced in an additional seven states.

³⁰“Such a transaction need not bear any resemblance to common-law fraud,” and “[t]he elements of a claim for relief [for ‘actual intent to hinder, delay, or defraud’ creditors] are very different from the elements of a claim of common-law fraud[ulent]” inducement by misrepresentation. UVTA § 4, official comments 8 & 10.

³¹S. Rep. No. 95-989, at 78 (1978) (emphasis added); H.R. Rep. No. 95-595, at 364 (1977) (emphasis added).

³²Bankruptcy Act of 1898, § 17a(2).

³³Husky, 136 S. Ct. at 1586.

³⁴In *Field v. Mans*, the Court stated that “[t]he operative terms in § 523(a)(2)(A), . . . ‘false pretenses, a false representation, or actual fraud,’ . . . imply the elements that the common law has defined them to include” and “look[ed] to the concept of ‘actual fraud’ as it was understood in 1978 when that language was added to § 523(a)(2)(A),” which the Court “construe[d] . . . to incorporate the general common law of torts.” 516 U.S. 59, 69-70 & n.9 (1995). “Then, as now, the most widely accepted distillation of the common law of torts was the Restatement (Second) of Torts (1976), published shortly before Congress passed the” Bankruptcy Reform Act of 1978. *Id.* at 70. Because that case involved an allegation of a non-dischargeable debt procured by misrepresentation, the Court looked to “[t]he [Restatement] section on point dealing with fraudulent misrepresentation.” *Id.* The *Husky* majority, though, took that reference to the common law of torts as precedential “only in setting forth the requirements of the form of fraud alleged in that case—namely, fraud perpetrated through a misrepresentation to a creditor.” *Husky*, 136 S. Ct. at 1589.

³⁵See Restatement (Second) of Torts ch. 22, topic 1 (titled “Fraudulent Misrepresentation (Deceit)”).

³⁶See Restatement (Second) of Torts §§ 550-551. Significantly, those circumstances go well *beyond* a fiduciary’s fraud liability for nondisclosure, which seems to be more specifically addressed via Code § 523(a)(4)’s discharge exception for “any debt for fraud . . . while acting in a fiduciary capacity.”

³⁷See 3 Wayne R. LaFave, Substantive Criminal Law § 19.7(b)(3), at 116-17 (2d ed. 2003); Model Penal Code § 223.3 (1980).

³⁸“[T]he modern crime of obtaining property by false pretenses (often called by the shorter term ‘false pretenses’) was created by Parliament in 1757,” and “[m]ost American states enacted a statute similar to the original English statute.” 3 LaFave, Substantive Criminal Law, § 19.7(a), at 114. See generally *id.* § 19.1(b), at 60-61; Model Penal Code § 223.1, comment 2(a), at 129-30.

³⁹Restatement (Second) of Torts § 551(1) (emphasis added). See also *id.* § 550. One is reminded of Abraham Lincoln’s famous story that he related to express his doubts regarding the linguistic gymnastics surrounding the Emancipation Proclamation: “In discussing the question, he used to liken the case to that of the boy who, when asked how many legs his calf would have if he called its tail a leg, replied, ‘Five,’ to which the prompt response was made that *calling* the tail a leg would not *make* it a leg.” Reminiscences of Abraham Lincoln by Distinguished Men of His Time 241 (Allen Thorndike Rice ed. 1909) (as told by George W. Julian).

⁴⁰See *Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754, 1760, 185 L. Ed. 2d 922, 57 Bankr. Ct. Dec. (CRR) 265, 69 Collier Bankr. Cas. 2d (MB) 456, Bankr. L. Rep. (CCH) P 82481 (2013) (stating that “[f]raud’ typically requires a false statement or omission,” including “fraud in the context of false pretenses” (emphasis added)).

⁴¹Husky, 136 S. Ct. at 1586.

⁴²Husky, 136 S. Ct. at 1586.

⁴³“The operative terms in § 523(a)(2)(A), . . . ‘false pretenses, a false representation, or actual fraud,’ carry the acquired meaning of terms of art” as “common-law terms,” and “there is no reason to doubt Congress’s intent to adopt a common-law understanding of the terms it used” in Code § 523(a)(2)(A). *Field v. Mans*, 516 U.S. at 69-70.

⁴⁴Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 *Cardozo L. Rev.* 1553, 1586 (2008). Kettering was the Reporter for the 2014 UVTA.

⁴⁵See *Twyne’s Case*, 3 *Coke Rep.* 80b, 76 *Eng. Rep.* 809, 823 (Star Chamber 1601) (reporting as “the judgment of the whole Court” that “Twyne was convicted of fraud”); 13 *Eliz.*, ch. 5, § III (providing that “all and every the parties to such feigned, covinous, or fraudulent . . . conveyance . . . before expressed, and being privy and knowing of the same . . . and also being thereof lawfully convicted, shall suffer imprisonment for one-half year without bail or mainprise”).

⁴⁶5 *Collier on Bankruptcy* ¶ 548.01[2][d], at 548-24.1 (16th ed. 2016) (citing state statutes).

⁴⁷See Model Penal Code art. 224; *id.* § 224.10 & comment 4; *id.* § 224.11(1).

⁴⁸Husky, 136 S. Ct. at 1586.

⁴⁹Husky, 136 S. Ct. at 1593 (Thomas, J., dis-

senting) (quoting 4 Collier (16th ed.) ¶ 523.08[1][e], at 523-46).

⁵⁰Husky, 136 S. Ct. at 1590 (Thomas, J., dissenting).

⁵¹Husky, 136 S. Ct. at 1591 (Thomas, J., dissenting).

⁵²Husky, 136 S. Ct. at 1591 (Thomas, J., dissenting).

⁵³Ritz, 787 F.3d at 321.

⁵⁴See *Archer v. Warner*, 538 U.S. 314, 123 S. Ct. 1462, 155 L. Ed. 2d 454, 41 Bankr. Ct. Dec. (CRR) 12, 49 Collier Bankr. Cas. 2d (MB) 1019, Bankr. L. Rep. (CCH) P 78821 (2003); *Cohen v. de la Cruz*, 523 U.S. 213, 118 S. Ct. 1212, 140 L. Ed. 2d 341, 32 Bankr. Ct. Dec. (CRR) 400, 38 Collier Bankr. Cas. 2d (MB) 1891, Bankr. L. Rep. (CCH) P 77644 (1998); *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755, 21 Bankr. Ct. Dec. (CRR) 342, 24 Collier Bankr. Cas. 2d (MB) 1, Bankr. L. Rep. (CCH) P 73746A, 70 A.F.T.R.2d 92-5639 (1991); *Brown v. Felsen*, 442 U.S. 127, 99 S. Ct. 2205, 60 L. Ed. 2d 767, 5 Bankr. Ct. Dec. (CRR) 226, 20 C.B.C. 273, 1 Collier Bankr. Cas. 2d (MB) 34, Bankr. L. Rep. (CCH) P 67122 (1979).

⁵⁵*Cohen v. de la Cruz*, 523 U.S. at 223.

⁵⁶*Grogan v. Garner*, 498 U.S. at 287.

⁵⁷*Archer v. Warner*, 538 U.S. at 321 (quoting *Brown v. Felsen*, 442 U.S. at 138).

⁵⁸*Cohen v. de la Cruz*, 523 U.S. at 223 (quoting *Grogan v. Garner*, 498 U.S. at 287).

⁵⁹Husky, 136 S. Ct. at 1591-92 (Thomas, J., dissenting).

⁶⁰Husky, 136 S. Ct. at 1589.

⁶¹McClellan, 217 F.3d at 894-95.

⁶²*Cohen v. de la Cruz*, 523 U.S. at 218.

⁶³*Cohen v. de la Cruz*, 523 U.S. at 218-19.

⁶⁴*Cohen v. de la Cruz*, 523 U.S. at 218 (emphasis added).

⁶⁵*Cohen v. de la Cruz*, 523 U.S. at 215.

⁶⁶*Cohen v. de la Cruz*, 523 U.S. at 218 (quoting *Field v. Mans*, 523 U.S. at 61, 64).

⁶⁷Husky, 136 S. Ct. at 1589 (citations omitted).

⁶⁸*Grogan v. Garner*, 498 U.S. at 287.

⁶⁹McClellan, 217 F.3d at 893.

⁷⁰*Grogan v. Garner*, 498 U.S. at 287.

⁷¹*Cohen v. de la Cruz*, 523 U.S. at 218 (emphasis added).

⁷²See Husky, 136 S. Ct. at 1589 n.3.

⁷³In re Bilzerian, 100 F.3d 886, 890, 30 Bankr. Ct. Dec. (CRR) 4, 37 Collier Bankr. Cas. 2d (MB) 234, Bankr. L. Rep. (CCH) P 77182 (11th Cir. 1996).

⁷⁴Bilzerian, 100 F.3d at 890.

⁷⁵Bilzerian, 100 F.3d at 890.

⁷⁶Bilzerian, 100 F.3d at 890. See In re Leonard, 2016 WL 1178649, at *7 (6th Cir. 2016); In re Brady, 101 F.3d 1165, 1171-72, 30 Bankr. Ct. Dec. (CRR) 15, 37 Collier Bankr. Cas. 2d (MB) 218, Bankr. L. Rep. (CCH) P 77202, 1996 FED App. 0379P (6th Cir. 1996); Bilzerian, 100 F.3d at 889-91; In re Arm, 87 F.3d 1046, 1049, 36 Collier Bankr. Cas. 2d (MB) 293 (9th Cir. 1996); In re Pryor, 992 F.2d 324, 1993 WL 152116, at *2 (5th Cir. 1993) (unpublished table decision); In re Ashley, 903 F.2d 599, 604, 20 Bankr. Ct. Dec. (CRR) 344, 23 Collier Bankr. Cas. 2d (MB) 176, Bankr. L. Rep. (CCH) P 73230 (9th Cir. 1990); In re Gerlach, 897 F.2d 1048, 1050 n.1, 22 Collier Bankr. Cas. 2d (MB) 1101, Bankr. L. Rep. (CCH) P 73280 (10th Cir. 1990).

⁷⁷See, e.g., *Chu v. Hong*, 249 S.W.3d 441, 444 (Tex. 2008); *Summers v. Hagen*, 852 P.2d 1165, 1169-70 (Alaska 1993) (en banc); *McElhanon v. Hing*, 151 Ariz. 403, 728 P.2d 273, 278 (1986) (en banc); *Croxson v. Croxson*, 130 Cal. App. 2d 50, 277 P.2d 864, 871 (2d Dist. 1954); In re Restaurant Development Group, Inc., 397 B.R. 891, 896-97, 50 Bankr. Ct. Dec. (CRR) 97 (Bankr. N.D. Ill. 2008) (Illinois law).

⁷⁸See, e.g., *Restaurant Dev. Group*, 397 B.R. at 897-98 (Illinois law); *Bondi v. Citigroup, Inc.*, 2005 WL 975856, at * 20 (N.J. Super. Ct. Law Div. 2005).

⁷⁹*Archer v. Warner*, 538 U.S. at 321 (quoting *Brown v. Felsen*, 442 U.S. at 138).

⁸⁰Bullock, 133 S. Ct. at 1761.

⁸¹124 Cong. Rec. 33,998 (1978) (statement of Sen. DeConcini); 124 Cong. Rec. 32,399 (1977) (statement of Rep. Edwards).

⁸²Bankruptcy Act of 1867, § 33.

⁸³*Neal v. Clark*, 95 U.S. 704, 709, 24 L. Ed. 586, 1877 WL 18562 (1877).

⁸⁴By stating “that the statutory term ‘defalcation’ [in Code § 523(a)(4)] should be treated similarly” to the term “fraud” as construed in *Neal v. Clark*. Bullock, 133 S. Ct. at 1759.

⁸⁵Bullock, 133 S. Ct. at 1759.

⁸⁶Husky, 136 S. Ct. at 1586, 1589.

⁸⁷Husky, 136 S. Ct. at 1586 (citing *Neal v. Clark*).

⁸⁸*Neal v. Clark*, 95 U.S. (5 Otto) at 707.

⁸⁹Radin, 18 Va. L. Rev. at 111.

⁹⁰Bruce A. Markell, *Following Zaretsky: Fraudulent Transfers and Unfair Risk*, 75 Am. Bankr. L.J. 317, 320 (2001). Markell is the author of the fraudulent transfer chapter of the current edition of *Collier on Bankruptcy*. See 5 Collier (16th ed.) ¶ 548.

⁹¹See generally John C. McCoid, *Constructively Fraudulent Conveyances: Transfers for Inadequate*

Consideration, 62 Tex. L. Rev. 639 (1983).

⁹²See *Reade v. Livingston*, 3 Johns. Ch. 481 (N.Y. 1818) (gift transfer); *Boyd & Suydam v. Dunlap*, 1 Johns. Ch. 478 (N.Y. 1815) (transfers for inadequate consideration). The case law regarding gift transfers originated in England around the middle of the eighteenth century. See 1 Glenn, *Fraudulent Conveyances*, § 268, at 446; Kennedy, 9 Cardozo L. Rev. at 538.

⁹³*McCoid*, 62 Tex. L. Rev. at 650.

⁹⁴*Boyd & Suydam v. Dunlap*, 1 Johns. Ch. at 482.

⁹⁵See, e.g., Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand. L. Rev. 829, 831 n.12 (1985) (“A person who wishes to be generous to a relative or friend does not necessarily have a bad state of mind toward creditors.”).

⁹⁶This aspect of *Reade v. Livingston*, allowing avoidance of any gift by a then-existing creditor who ultimately is not paid, eventually fell into disfavor as overly aggressive and gave way to the financial-vulnerability tests that now appear in Bankruptcy Code § 548(a)(1)(B)(i)-(III).

⁹⁷The Bankruptcy Code entirely abolishes the distinction between existing and future creditors in actions under § 548(a)(1), and pursuant to the doctrine of *Moore v. Bay*, 284 U.S. 4 (1931), partially abolishes the distinction in state-law fraudulent transfer actions under § 544(b)(1).

⁹⁸*Reade v. Livingston*, 3 Johns. Ch. at 505.

⁹⁹Markell, 75 Am. Bankr. L.J. at 321.

¹⁰⁰*McCoid*, 62 Tex. L. Rev. at 656.

¹⁰¹Robert Charles Clark, *The Duties of the Corporate Debtor to its Creditors*, 90 Harv. L. Rev. 505, 510 (1977).

¹⁰²Charles J. Tabb & Ralph Brubaker, *Bankruptcy Law: Principles, Policies, and Practice* 499 (4th ed. 2015).

¹⁰³Baird & Jackson, 38 Vand. L. Rev. at 832.

¹⁰⁴*McClellan*, 217 F.3d at 894.

¹⁰⁵See *Husky*, 136 S. Ct. at 1589 (citing *McClellan* and the *Husky* Court’s own discussion of “actual intent to hinder, delay, or defraud” in reference to “the requisite intent” for nondischargeability).

¹⁰⁶5 Collier (16th ed.) ¶ 548.04[2], at 548-63.

¹⁰⁷Kettering, 70 Bus. Law. at 809.

¹⁰⁸UFTA §§ 4(a)(1), 8(a). See also UVTA § 8(a); UFCA § 9; 11 U.S.C.A. § 548(c).

¹⁰⁹In re Agricultural Research and Technology Group, Inc., 916 F.2d 528, 535-36, 23 Collier Bankr. Cas. 2d (MB) 1517, Bankr. L. Rep. (CCH) P 73652 (9th Cir. 1990).

¹¹⁰*Shauer v. Alterton*, 151 U.S. 607, 621 (1894)

(quoting *Wood v. Carpenter*, 101 U.S. (11 Otto) 135, 141 (1879)).

¹¹¹*Shauer v. Alterton*, 151 U.S. at 621.

¹¹²*Husky*, 136 S. Ct. at 1589 n.3. Control of a corporation is sufficient to impute an actor’s fraudulent intent to the corporation. See 5 Collier (16th ed.) ¶ 548.04[1][a][iv], at 548-62.

¹¹³See generally Ralph Brubaker, *Fresh Start, Vicarious Liability, and the Fraud and Malice Discharge Exceptions: Punishment vs. Compensation—State Law vs. Federal Law*, 21 Bankr. L. Letter No. 5, at 1 (May 2001); Ralph Brubaker, *The Dischargeability of “Control Person” Liability for Federal Securities Fraud: Actual Fraud, Vicarious Nondischargeability, and the Vacillating Objects of the § 523(a)(2)(A) Discharge Exception*, 22 Bankr. L. Letter No. 5, at 5 (May 2002); Lawrence Ponoroff, *Vicarious Thrills: The Case for the Application of Agency Rules in Bankruptcy Dischargeability Litigation*, 70 Tulane L. Rev. 2515 (1996); Steven H. Resnicoff, *Is It Morally Wrong to Depend on the Honesty of Your Partner or Spouse?: Bankruptcy Dischargeability of Vicarious Debt*, 42 Case W. Res. L. Rev. 147 (1992).

¹¹⁴Brubaker, 22 Bankr. L. Letter No. 5, at 5 (emphasis added).

¹¹⁵In re M.M. Winkler & Associates, 239 F.3d 746, 749, 37 Bankr. Ct. Dec. (CRR) 95, Bankr. L. Rep. (CCH) P 78350 (5th Cir. 2001).

¹¹⁶*Strang v. Bradner*, 114 U.S. 555, 5 S. Ct. 1038, 29 L. Ed. 248 (1885).

¹¹⁷See Brubaker, 22 Bankr. L. Letter No. 5, at 8-10. To reconcile those decisions, one must accept the idea that “the fraud exception to discharge can and does vindicate *both* compensatory *and* punitive objects, and the means by which it determines the relevant objective in a particular case is through the federalism principle implicit in *both* opinions: deference to the policies embodied in applicable nonbankruptcy liability rules.” Id. at 10. Personally, though, I believe that the exclusive touchstone of the discharge exception for fraud debts “is serious debtor culpability and, thus, there is no [legitimate] reason to withhold discharge of the obligation of a wholly innocent (and only vicariously liable) debtor.” Heidi M. Hurd & Ralph Brubaker, *The Virtue of Bankruptcy* (Oxford Univ. Press forthcoming).

¹¹⁸The most plausible means by which to reconcile *Strang v. Bradner* with *Neal v. Clark*, see *supra* note 117, limits *Strang v. Bradner* to cases of purely vicarious liability that require no showing whatsoever of any fault by the vicariously liable debtor: “Where the debtor’s liability under applicable nonbankruptcy law is premised upon a purely vicarious/compensatory liability design, then the fraud exception (in deference to nonbankruptcy liability policy) is also purely compensatory, rendering a debtor’s purely vicarious fraud debt nondis-

chargeable.” Brubaker, 22 Bankr. L. Letter No. 5, at 10.

¹¹⁹124 Cong. Rec. 33,998 (1978) (statement of Sen. DeConcini); 124 Cong. Rec. 32,399 (1977) (statement of Rep. Edwards).

¹²⁰Neal v. Clark, 95 U.S. (5 Otto) at 706.

¹²¹Joseph Story, Commentaries on Equity Jurisprudence as Administered in England and America § 579, at 565 (Jairus W. Perry ed., 12th ed. 1877). See id. §§ 579-581; Everingham v. Vanderbilt, 51 How. Pr. 177, 182-83, 1876 WL 11155 (N.Y. Gen. Term 1876).

¹²²Story, Equity Jurisprudence, § 581, at 567.

¹²³Jones’ Ex’rs v. Clark, 66 Va. 642, 645, 25 Gratt. 642, 1875 WL 258 (1875), rev’d, 95 U.S. 704, 24 L. Ed. 586, 1877 WL 18562 (1877).

¹²⁴Jones v. Clark, 66 Va. at 662-63.

¹²⁵As explained by the Virginia Supreme Court: The [note] was payable to the executor in that character, which gave express notice to the purchaser that it belonged . . . to the testator’s estate; and he bought it from the executor at a discount of eighteen percent. . . . If he had made enquiry before he made the purchase, he could easily have ascertained that the sale would be . . . a *devastavit* by the executor. He ought to have made such enquiry, but he did not do it.

Jones v. Clark, 66 Va. at 663.

¹²⁶Jones v. Clark, 66 Va. at 666-67.

¹²⁷Jones v. Clark, 66 Va. at 667.

¹²⁸Neil v. Clark, 95 U.S. (5 Otto) at 709.

¹²⁹Neil v. Clark, 95 U.S. (5 Otto) at 707.

¹³⁰Neil v. Clark, 95 U.S. (5 Otto) at 709.

¹³¹Brubaker, 22 Bankr. L. Letter No. 5, at 9-10 (citation omitted)

¹³²Neal v. Clark, 95 U.S. (5 Otto) at 707.

¹³³In that case, the Court stated:

In *Neal v. Clark* (95 U. S. 704) it was decided that “fraud,” as used in this section of the bankrupt law, “means positive fraud or fraud in fact, involving moral turpitude or intentional wrong, . . . and not implied fraud or fraud in law, which may exist without imputation of bad faith or immorality.” With this definition we are content. It is founded both on reason and authority. Clearly it does not include such fraud as the law implies from the purchase of property from a debtor with the intent thereby to hinder and delay his creditors in the collection of their debts.

Wolf v. Stix, 99 U.S. 1, 7 (1878).

¹³⁴Bullock, 133 S. Ct. at 1759, 1761.

¹³⁵Grogan v. Garner, 498 U.S. at 287.

¹³⁶Neal v. Clark, 95 U.S. (5 Otto) at 709.

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Last in Line

BY HON. DEBORAH L. THORNE AND BRETT NEWMAN¹

What's Next After *Husky v. Ritz*: Has Pandora's Box Been Opened?



Hon. Deborah L. Thorne
U.S. Bankruptcy Court
(N.D. Ill.); Chicago



Brett Newman
University of Illinois
College of Law
Champaign, Ill.

Hon. Deborah Thorne is a bankruptcy judge in the Northern District of Illinois and serves as ABI's Vice President-Communication and Information Technology. Brett Newman is a recent graduate of the University of Illinois College of Law in Champaign, Ill.

The U.S. Supreme Court granted *certiorari* in *Husky International Electronics Inc. v. Ritz* to resolve a circuit split, but the decision left many more questions in its aftermath. The full scope of *Husky*'s impact is unknown, but several issues that are likely to follow the Supreme Court's decision stand out.

Background

The facts in *Husky* are unique but relatively straightforward.² For a number of years, Husky International Electronics sold electronic device components to Chrysalis Manufacturing Corp., a company controlled by Daniel Ritz (the debtor).³ Chrysalis did not pay for all of the goods it received, and Ritz transferred Chrysalis' assets to other entities controlled by him.⁴ Husky then sued Ritz, attempting to hold him personally liable for Chrysalis' debt. The suit eventually led to Ritz filing a chapter 7 petition. Husky responded with an adversary complaint, claiming Ritz was liable for Chrysalis' debt and that the debt owed to it was not dischargeable under § 523 of the Bankruptcy Code.⁵ The graphic illustrates the relationship among Husky, Ritz and Ritz's entities.

The bankruptcy court rejected these claims.⁶ The district court affirmed, holding that Ritz was personally liable but that Husky could still not prevail under § 523(a)(2)(A), which excepts debts from discharge "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by — false pretenses, a false representation, or actual fraud...."⁷ The Fifth Circuit also affirmed and held that a misrepresentation is needed to show actual fraud in § 523(a)(2)(A).⁸ In doing so, the Fifth Circuit rejected the Seventh Circuit's decision in *McClellan v. Cantrell*, in which Judge Richard Posner found that "actual fraud" in § 523(a)(2)(A) *does not* require a misrepresenta-

tion.⁹ After the Fifth Circuit decided *Husky*, the First Circuit sided with the Seventh Circuit,¹⁰ deepening the circuit split.

The Supreme Court granted *certiorari* in *Husky International Electronics Inc. v. Ritz* to resolve whether "actual fraud" in § 523(a)(2)(A) of the Bankruptcy Code requires a misrepresentation, and thus resolve the circuit split. On May 16, 2016, the Court ruled by a 7-1 vote¹¹ that fraudulent conveyances, like Ritz's alleged scheme, are within the scope of "actual fraud" in § 523(a)(2)(A).¹²

Justice Sonia Sotomayor delivered the opinion of the Court, which focused on two main points to justify its reversal of the Fifth Circuit's decision. First, the addition of "actual fraud" to § 523(a)(2)(A) in 1978 suggests that the phrase must include actions other than just false pretenses or false representations.¹³ Second, the Court reasoned that the common law understanding of fraud, going all the way back to the *Statute of 13 Elizabeth*, included fraudulent conveyances.¹⁴ The Court reversed the Fifth Circuit and remanded to decide, among other issues, "whether the debt to Husky was 'obtained by' Ritz'[s] asset-transfer scheme."¹⁵

Justice Clarence Thomas wrote a dissent that focused heavily on the "obtained by" issue, specifically that § 523(a)(2)(A) applies only at the *inception* of a debt, which was not the case in *Husky*.¹⁶ He followed that reliance on the debtor's misrepresentation was required to satisfy § 523(a)(2)(A).¹⁷ Because Ritz did not fraudulently induce Husky to sell goods to Chrysalis, Husky could not support a claim under § 523(a)(2)(A).¹⁸

Implications

While *Husky* answers the question of whether "actual fraud" requires a misrepresentation, several other questions are left in *Husky*'s wake.

¹ Disclaimer: None of the statements contained in this article constitute the official policy of any judge, court, agency or government official or quasi-governmental agency. The authors express their gratitude to Prof. Charles J. Tabb of the University of Illinois College of Law and Jasmine Reed, a law clerk to Hon. Pamela Pepper of the U.S. District Court for the Eastern District of Wisconsin, for their suggestions and insights.

² See *Husky Int'l Elecs. Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 314 (5th Cir. 2015).

³ *Id.*

⁴ *Id.* Ritz had varying degrees of ownership in the transferee entities.

⁵ *Id.* Husky's § 523 actions rest on a veil-piercing theory, where Husky attempted to hold Ritz liable for the companies that he controlled. This issue will need to be decided on remand for a § 523 claim to be successful.

⁶ *Husky Int'l Elecs. Inc. v. Ritz (In re Ritz)*, 459 B.R. 623 (Bankr. S.D. Tex. 2011).

⁷ *Husky Int'l Elecs. Inc. v. Ritz (In re Ritz)*, 513 B.R. 510 (S.D. Tex. 2014).

⁸ *Husky*, 787 F.3d at 321. The Fifth Circuit did not discuss, however, whether Ritz was personally liable.

⁹ *Id.*; see *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). In *McClellan*, the creditor sold assets to the debtor's brother, who subsequently transferred them to his sister (the debtor) for only \$10. *Id.* at 892. The debtor then sold the assets for \$160,000. *Id.* Then she filed a chapter 7 petition. *Id.* The Seventh Circuit found that a misrepresentation was not required to except a debt from discharge under § 523(a)(2)(A). *Id.* at 893. Judge Posner wrote that by participating in the fraudulent-transfer scheme, the debtor "obtained" assets by fraud and incurred a debt. *Id.* at 895.

¹⁰ *Sauer Inc. v. Lawson (In re Lawson)*, 791 F.3d 214 (1st Cir. 2015).

¹¹ Only eight justices participated in the decision due to Justice Antonin Scalia's death in February 2016.

¹² *Husky Int'l Elecs. Inc. v. Ritz*, 136 S. Ct. 1581 (2016).

¹³ *Id.* at 1586.

¹⁴ *Id.* at 1586-88.

¹⁵ *Id.* at 1589, n.3.

¹⁶ *Id.* at 1591 (Thomas, J., dissenting).

¹⁷ *Id.* (Thomas, J., dissenting).

¹⁸ *Id.* at 1592 (Thomas, J., dissenting).

Some of these issues may be particularly troublesome for bankruptcy courts. Most notably, the inclusion of fraudulent transfers under “actual fraud” significantly expands the scope of potential § 523(a)(2)(A) actions, leaving bankruptcy courts to deal with an influx of § 523(a)(2)(A) adversary proceedings. Given the peculiar factual situation in *Husky* and the unresolved “obtained-by” issue, the scope of *Husky*’s effects is unclear. Below are some of the issues that may follow from the increase in § 523(a)(2)(A) actions.

Unresolved Questions

The Supreme Court’s decision was a narrow one, limited to the finding that “actual fraud” under § 523(a)(2)(A) does not require a misrepresentation. The question of whether the debt owed to Husky was “obtained by” Ritz’s transfer scheme remains open.¹⁹

In its limited discussion on the issue, the Court stated that a transferor does not “obtai[n]” debt via a fraudulent conveyance, but a transferee can “obtai[n]” assets “by” participating in a fraud with the requisite intent.²⁰ If the transferee then files for bankruptcy, the debts that are “traceable to” the fraud are nondischargeable.²¹ Despite its commentary on the issue, the Court stopped short of determining whether Ritz’s debt was “obtained by” the transfer scheme. This might not stop creditors, however, from latching onto what appears to be the majority’s *dicta* when trying to satisfy the “obtained by” requirement.

This open issue is likely to spawn similar litigation, with lower courts left to decide whether a specific transferee “obtain[s]” a debt “by” receiving a fraudulent convey-

ance.²² On remand, the Fifth Circuit may very well deny Husky’s § 523(a)(2)(A) claim again — this time on the basis that Ritz’s alleged debt to Husky was not “obtained by” the fraudulent-transfer scheme.

Does this mean that bankruptcy courts can continue to deny § 523(a)(2)(A) claims similar to Husky’s if the debt was not “obtained by” actual fraud? Bankruptcy courts will need to examine whether the nexus between the debtor and the offended creditor is sufficient to support a § 523(a)(2)(A) action. Despite the Court answering the question that “actual fraud” in § 523(a)(2)(A) does not require a misrepresentation, the “obtained by” issue is likely to leave lower courts split on what to do with *Husky*-type cases.

Two Bites at the Apple

Section 727(a)(2)(A) of the Bankruptcy Code provides a remedy for all creditors when there are fraudulent transfers, but those actions are limited to transfers occurring within a year before filing the petition.²³ Section 523(a)(2)(A), which covers fraudulent transfers post-*Husky*, contains no such limitation. This gives creditors a possible second bite at the apple in preventing the discharge of debts owed to them. In addition, it could erode the protection of the one-year reach-back period in § 727(a)(2)(A).

Will this result in many more § 523(a)(2)(A) actions when § 727(a)(2)(A) is the more appropriate option? Section

19 *Id.* at 1589 n.3. Whether Husky could pierce the corporate veil and hold Ritz individually liable was also an open question that would need to be decided on remand.

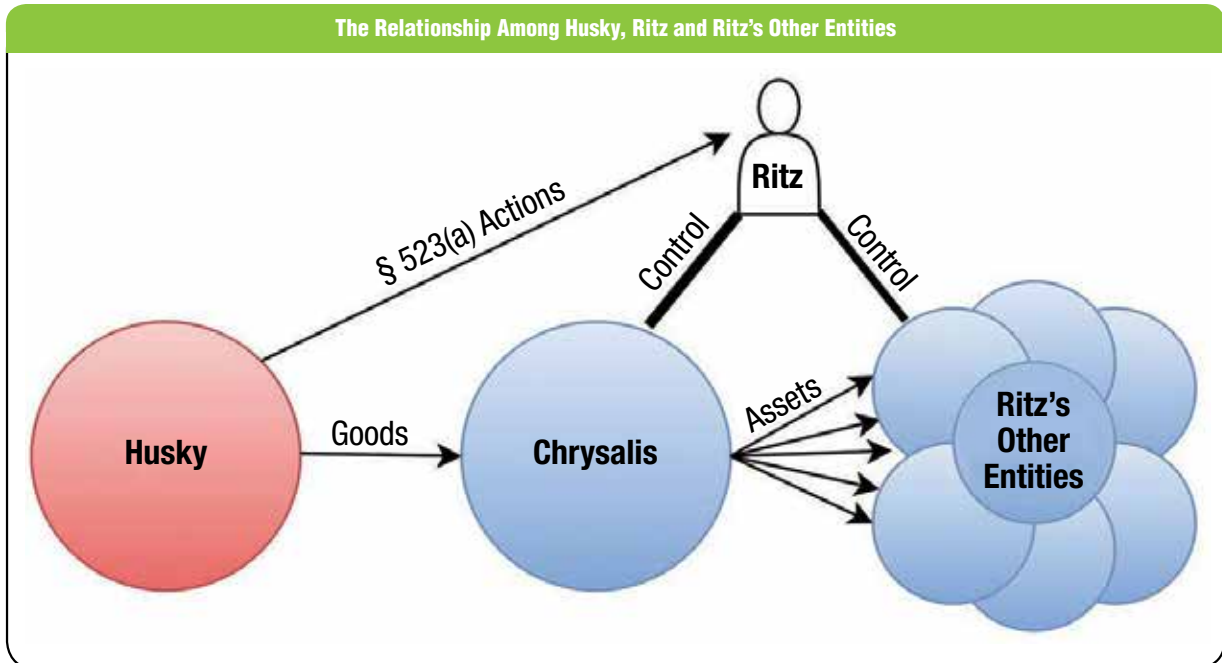
20 *Id.* at 1589.

21 *Id.*

22 For example, the Seventh Circuit has already addressed this question in *McClellan v. Cantrell*. In *McClellan*, the court acknowledged that a knowing recipient of a fraudulent transfer may obtain assets by fraud, and a debt “arises by operation of law” from the transferee’s fraud. 217 F.3d at 895. The court determined that this debt would not be dischargeable under § 523(a)(2)(A). *Id.*

23 “The court shall grant the debtor a discharge, unless ... the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition.”

continued on page 56



Last in Line: What's Next After Husky: Has Pandora's Box Been Opened?

from page 21

727(a)(2)(A) was clearly drafted to respond to fraudulent transfers,²⁴ but it is not so clear for § 523(a)(2)(A).

Organizing § 523(a)(2)(A) Actions

Section § 523(a)(2)(A) is meant to except specific debts owed to individual creditors from discharge. When the fraud at issue is related to the inception of the debt, it is not difficult to tie the debt to the fraud. The same cannot be said for subsequent fraudulent transfers that are far removed from the inception of a debt. Given the decision in *Husky*, however, there will likely be many § 523(a)(2)(A) actions that are not easily tied to a particular debt owed to one creditor. Some likely issues that will follow are best shown by a hypothetical.

For example, consider a situation similar to *Husky*.²⁵ An individual (the transferor) owes three creditors \$1,000 each. The transferor realizes that he is unable to pay his debts, and he transfers his last \$300 to his niece (the transferee). Assume, as will likely be the case in these types of actions, that the \$300 is not easily attributed to any one of the three individual creditors.²⁶ The transferee files a chapter 7 petition, and all of the transferor's creditors want to prevent the transferee from discharging her debt. Because the transferee received only \$300 in fraudulent transfers, does only the winner of the proverbial "race to the courthouse" get to except its debt from discharge? If not, which seems to be the only fair answer, how does a bankruptcy court organize competing § 523(a)(2)(A) actions? What happens if one of the creditors does not show up?²⁷ If the creditors are successful, how much of the debts owed to them can be excepted from discharge?²⁸ The questions do

not end here, and bankruptcy courts will be left to determine an equitable way to deal with these issues.

Changing the facts slightly, consider that there are now 100 creditors, most of which have considerable resources and are willing to file § 523 adversary complaints. Given that the fraudulent transfers cannot be specifically tied to the debt of any of the 100 creditors, all of them seek to file § 523(a)(2)(A) actions to prevent the transferee from discharging the debt that is owed to them. Surely it would not be economical or practical for 100 separate adversary proceedings to be initiated, seeking to except each separate debt from discharge. How will bankruptcy courts deal with this situation? Because the fraudulent transfers are not specifically tied to any of the 100 creditors, it would make sense for one action to be brought on behalf of all of the creditors.

The Bankruptcy Code incorporates provisions to allow one action to be brought on behalf of all the creditors, specifically §§ 548 and 727(a). In contrast, an action under § 523(a) benefits only the creditor that pursues it. The collective remedies in §§ 548 and 727(a) would surely be the more economical, equitable and practical approach for creditors to recover in the above example. These collective remedies provide a remedy for the benefit of all when the fraudulent transfers at issue are not directly attributable to any one single creditor. If the trustee does not pursue the above options, however, it leaves the door open for individual creditors to use § 523(a) for fraudulent transfers.

What Now?

Creditors will quickly respond to the Supreme Court's expansive reading of § 523(a)(2)(A), and it will be up to bankruptcy courts (absent further decisions from the courts of appeals) to respond to the increased use of the exception to discharge. The scope of the impact is unknown, but one thing is for sure: "Actual fraud" in § 523(a)(2)(A) includes receiving fraudulent transfers. Will this open Pandora's box, or is it much ado about nothing? **abi**

²⁴ *Id.*

²⁵ A similar hypothetical was posed by Hon. Eugene R. Wedoff (ret.), ABI's President-Elect, in a recent webinar. See "Experts Discuss Supreme Court's Ruling in *Husky International Electronics Inc. v. Ritz* and Its Impact on Fraudulent Conveyance Litigation," ABI Media Webinar (May 18, 2016), available at abi.org/educational-brief/experts-discuss-supreme-courts-ruling-in-husky-international-electronics-inc-v.

²⁶ This may not be the case if, for example, if the transferor conveyed one of the creditor's goods to the transferee. In that case, the affected creditor may be the only one with a viable § 523(a)(2)(A) action.

²⁷ See ABI Media Webinar, *supra* n.25. In his answer to Judge Wedoff's question, Prof. Anthony Casey of the University of Chicago Law School asked what would happen if only one creditor shows up.

²⁸ *Id.* In this type of hypothetical situation, Judge Wedoff asked how much of the debt owed to each creditor would be nondischargeable.

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Saturday, December 3, 2016

If You Snooze, Do You Lose? Stale Proofs of Claim and the FDCPA
Honorable Pamela Pepper
United States District Court, Eastern District of Wisconsin

Bankruptcy Law Letter

JUNE 2016 | VOLUME 36 | ISSUE 6

Debt Buyers Beware: Filing Proofs of Claim for Time-Barred Debt in the Eleventh Circuit and Beyond

Kara J. Bruce

In *Crawford v. LVNV Funding, LLC*, the United States Court of Appeals for the Eleventh Circuit remarked on a “deluge” sweeping through the U.S. bankruptcy courts: “Consumer debt buyers—armed with hundreds of delinquent accounts purchased from creditors—are filing proofs of claim on debts deemed unenforceable under state statutes of limitations.”¹ More recently, federal courts have faced a deluge of a different sort: lawsuits and adversary proceedings alleging that debt collectors violate the Fair Debt Collection Practices Act (FDCPA) by filing such time-barred proofs of claim.²

The flood of FDCPA cases can be attributed, at least in part, to *Crawford*, a 2014 case that held that filing time-barred claims is “unfair,” “unconscionable,” “deceptive,” and “misleading” under sections 1692e and 1629f of the FDCPA.³ Over the last two years, “copycat” *Crawford* cases have been winding their way through bankruptcy and district courts across the nation. In the absence of clear guidance from the Bankruptcy Code and Rules, a variety of approaches to address FDCPA liability for stale proofs of claim has emerged. At the time of this writing, appeals on some dimension of this topic are pending in the Courts of Appeals for the Third, Fourth, Sixth, Seventh, and Eighth Circuits.⁴

Just last month, the Eleventh Circuit resolved an issue that the *Crawford* opinion “dodged”: the extent to which bankruptcy’s claims allowance process precludes application of the FDCPA.⁵ In *Johnson v. Midland Funding, LLC*, the court held that filing a proof of claim in bankruptcy could form the basis of an FDCPA action.⁶ This holding lends greater weight to *Crawford* and deepens a circuit split on the intersection of the FDCPA and the Bankruptcy Code.

This issue of the Bankruptcy Law Letter examines the Eleventh Circuit’s recent case law on stale proofs of claim, with an eye toward the appeals pending in other circuits. It focuses on two key questions: First, to what extent does the Bankruptcy Code’s comprehensive statutory scheme impliedly repeal the FDCPA? Second, does filing an accurate but stale proof of claim offend the FDCPA?⁷

Mat #41844436

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On the first question, the Eleventh Circuit's recent decision in *Johnson* got it right. Well-settled principles of statutory interpretation instruct that federal statutes should be construed together whenever possible. Because the FDCPA and the Bankruptcy Code can operate simultaneously in the proof-of-claim context, courts should allow the FDCPA to augment the Code's remedies for filing wrongful proofs of claim.

As for the second question, *Crawford* reaches too far in holding that filing a time-barred claim, without more, violates the FDCPA. Still, there may yet be a role for the FDCPA in regulating the claims process. As long as the FDCPA is permitted

EDITOR IN CHIEF: Ralph Brubaker, Carl L. Vacketta Professor, University of Illinois College of Law

CONTRIBUTING EDITORS: Bruce A. Markell, Professor of Bankruptcy Law and Practice, Northwestern University School of Law

Kara Bruce, Associate Professor, University of Toledo College of Law

Ben H. Logan, Lecturer in Law, University of California at Los Angeles School of Law, Affiliate Lecturer in Law, University of Washington School of Law

Eugene R. Wedoff, U.S. Bankruptcy Judge, Northern District of Illinois (retired)

PUBLISHER: Jean E. Maess, J.D.

MANAGING EDITOR: Clay Mattson, J.D.

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

to apply in the bankruptcy context, the availability of money damages for clear violations of the statute (say, misrepresentations in a proof of claim) may provide bankruptcy participants a valuable incentive to monitor incoming claims more closely. In the process, perhaps they will detect a greater number of stale claims than they otherwise would.

The Fair Debt Collection Practices Act

Congress enacted the FDCPA to "eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses."⁸ The FDCPA prohibits debt collectors (a term defined to exclude the debtor's original creditor) from using "any false, deceptive, or misleading representation" or "unfair or unconscionable means" to collect or attempt to collect consumer debt.⁹ It likewise prohibits conduct "the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt."¹⁰ The FDCPA equips consumer debtors with a private right of action to recover actual damages, statutory damages, and reasonable attorney's fees and costs.¹¹ And, as the statute imposes strict liability, consumers need not prove intent or suffer actual damages in order to recover.¹²

Nothing in the FDCPA specifically bars the collection of time-barred debt, but courts have held that debt collectors violate the FDCPA if they sue or threaten to sue to collect stale debts.¹³ Courts have reasoned that this behavior creates the misleading impression that the debt is legally enforceable.¹⁴ Whether filing a stale proof of claim creates a similarly misleading impression is a question that has divided courts. Before discussing that issue, some background on the practice of filing stale claims might be helpful.

The Problem of Time-Barred Proofs of Claim

The Bankruptcy Code's definition of "claim" is broad.¹⁵ Really broad.¹⁶ It captures any and all liabilities a debtor might face, so that the debtor can resolve them in the bankruptcy case and emerge with a fresh start.¹⁷ In most jurisdictions, the

expiration of the statute of limitations does not extinguish the underlying debt.¹⁸ As such, a creditor owed a time-barred debt appears to have a “claim” in bankruptcy parlance.¹⁹

At the same time, the Code contemplates that these claims will not be paid from the debtor’s estate. The running of the statute of limitations is a basis for objection under § 502(b)(1), which provides that a claim shall be allowed “except to the extent that . . . such claim is unenforceable . . . under any agreement or applicable law.”²⁰ Nevertheless, despite the existence of a complete defense to payment, parties rarely object to stale claims. Without an objection, filed claims are “deemed allowed” and eventually receive a pro-rata share of any distribution from the debtor’s estate.²¹

The structure of the bankruptcy system helps to explain this pervasive failure to object to time-barred claims. The consumer bankruptcy process functions on economies of scale, with attorneys and trustees typically handling massive caseloads in a fairly routine manner.²² This process allows debtors to achieve relief from their debts at a very low out-of-pocket cost,²³ but it sacrifices some degree of individualized attention. In this context, stale claims often slip through the cracks, and debt buyers profit.

Debt buyers purchase consumer debt for pennies on the dollar.²⁴ Unlike state-law collection actions, collecting debt in bankruptcy costs next to nothing. There are no filing fees for proofs of claim. There is no need to obtain a default judgment or pursue post-judgment enforcement efforts. Instead, the debt collector need only file a proof of claim, or a few thousand proofs of claim, and wait for any distributions to arrive.

Bankruptcy Rule 3001(c)(3), enacted in 2012, seeks to improve the rate of claim objection by making it easier for debtors’ counsel and trustees to determine whether certain claims are time-barred. Rule 3001(c)(3) requires the holder of a claim based on an open-end or revolving consumer credit agreement to include in the proof of claim information that allows parties in interest to determine its timeliness.²⁵ But even if a greater number of claims are now detected, creditors face no penalty if a

party objects and the claim disallowed. Considering the low cost of pursuing stale claims, the practice may be profitable if the system fails even a small percentage of the time.²⁶

Some attorneys have attempted to combat this practice with FDCPA litigation. Debtors’ counsel have brought lawsuits in both district and bankruptcy courts²⁷ alleging that filing stale claims is “unfair,” “unconscionable,” “deceptive” and “misleading” in violation of the FDCPA.²⁸ These cases seek to increase the cost to debt collectors of filing time-barred claims, ideally deterring this behavior on a long-term basis. This trend has gained traction in the Eleventh Circuit in particular, based on two recent Eleventh Circuit Cases:

Crawford v. LVNV Funding, LLC

Stanley Crawford filed a petition for chapter 13 relief in the Middle District of Alabama in 2008.²⁹ Among his debts was an unsecured debt of \$2,037.99 owed to Heilig-Meyers Furniture Company.³⁰ The company had charged off the debt in 1999 and later sold it to an affiliate of LVNV Funding, LLC (LVNV).³¹ LVNV filed a proof of claim in the case, even though the statute of limitations on the underlying debt had expired three years earlier.³² Neither the trustee nor the debtor objected to the claim, and LVNV received a portion of Crawford’s wages committed to his chapter 13 plan.³³

Four years later, Crawford objected to the claim as unenforceable.³⁴ He commenced an adversary proceeding alleging that LVNV’s attempt to collect the time-barred debt violated the FDCPA.³⁵ The bankruptcy court dismissed the action, holding that “that the filing of a claim in the bankruptcy court, even one barred by the statute of limitations, does not constitute a violation of the Fair Debt Collection Practices Act.”³⁶ The district court affirmed, noting that “the elephantine body of persuasive authority” weighs against finding an FDCPA violation for filing a time-barred claim.³⁷

The Eleventh Circuit reversed.³⁸ It characterized LVNV’s conduct as an attempt to exploit the automatic allowance of claims in bankruptcy to obtain payment on an otherwise uncollectable

debt.³⁹ The Court likened this practice to filing suit on a time-barred debt, holding that filing a stale proof of claim likewise “creates the misleading impression” that the debt is enforceable.⁴⁰ Not only does this behavior affect the “least sophisticated” chapter 13 debtor who fails to object to the claim, the court explained, it also reduces funds available to other creditors with valid claims and “consumes energy and resources in the debtor’s bankruptcy case.”⁴¹ Because LVNV would have violated the FDCPA by filing a lawsuit on the debt in state court, the court held that LVNV violated the FDCPA by taking an analogous action in bankruptcy.⁴²

In reaching this holding, *Crawford* “dodged” the question whether the Bankruptcy Code precludes FDCPA liability for actions that occur in bankruptcy.⁴³ This issue—more properly framed as whether the Bankruptcy Code impliedly repeals the FDCPA—is subject to a circuit split. In late May of this year, the Eleventh Circuit weighed in on this issue, aligning with the now-majority approach of the Seventh and Third Circuits. In *Johnson v. Midland Funding, LLC*, the Eleventh Circuit held that filing a proof of claim could give rise to an FDCPA violation.⁴⁴ This case reversed two district court judgments that precluded application of the FDCPA in this context, *Johnson v. Midland Funding and Brock v. Resurgent Capital Services*.⁴⁵

Johnson v. Midland Funding

The facts of *Johnson v. Midland Funding* and *Brock v. Resurgent Capital Services* are similar to *Crawford*. In both cases, buyers of unpaid debts filed proofs of claim for stale debt in the plaintiffs’ chapter 13 cases.⁴⁶ In *Johnson*, the last transaction on the debtor’s account was over ten years before the debtor filed for bankruptcy.⁴⁷ In *Brock*, the debtor’s account had been inactive for over six years before bankruptcy.⁴⁸ The debtors sued their creditors in district court for violating 15 U.S.C.A. §§ 1692e and f.⁴⁹

In *Johnson*, the district court granted the creditor’s motion to dismiss.⁵⁰ It identified an “obvious tension” between the Bankruptcy Code and the FDCPA, based on the fact that the Bankruptcy Code permits filing a proof of claim for time-barred

debt, while the FDCPA, under *Crawford*, prohibits such behavior.⁵¹ The Court held that this tension created an “irreconcilable conflict” between the Bankruptcy Code and the FDCPA, and as such, “the [FDCPA] must give way to the [Bankruptcy] Code.”⁵² In *Brock*, the court granted the creditor’s motion for judgment on the pleadings based largely on the *Johnson* holding.⁵³ Both debtors appealed.

The Eleventh Circuit consolidated the appeals and reversed.⁵⁴ It underscored that “when two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.”⁵⁵ Under that standard, the two statutes could be read in a manner that allowed both to operate.⁵⁶ The court rejected the district court’s holding that applying the FDCPA to time-bared claims undermines creditors’ “right” to file claims, noting that the Bankruptcy Code’s authorization to file a claim “do[es] not shield debt collectors from the obligations that Congress imposed on them.”⁵⁷ The court also interpreted the Bankruptcy Code and FDCPA as “providing different tiers of sanctions for creditor misbehavior in bankruptcy” and underscored that it would “show disregard for the congressional design” to apply one statute to the exclusion of the other.⁵⁸

Beyond the Eleventh Circuit

In the two years since *Crawford* was decided, the FDCPA’s role in policing stale claims has experienced a great deal of development in courts across the nation. While some courts have found *Crawford* persuasive,⁵⁹ the weight of authority continues to hold that time-barred proofs of claim cannot give rise to FDCPA liability. Some of these courts find, in contrast to *Johnson*, that the FDCPA cannot apply in the proof-of-claim context.⁶⁰ Others hold that the mere filing of a time-barred proof of claim does not violate the FDCPA.⁶¹ Still others have disposed of cases on procedural grounds, holding the confirmation of a chapter 13 plan is *res judicata*.⁶²

At the time of this writing, appeals on some dimension of this topic are now pending in the Courts of Appeals for the Third, Fourth, Sixth, Seventh, and Eighth Circuits, at a minimum.⁶³ As such, we can expect the law to develop rapidly in

the weeks and months to come. The following sections take a closer look at the issues at play in these cases, beginning with the question presented in *Johnson*—whether the FDCPA has any application in the proof-of-claim process.

Repeal by Implication? Application of the FDCPA in Bankruptcy Cases

A threshold consideration in many stale-claim cases is whether the FDCPA can augment bankruptcy's comprehensive statutory scheme. When federal statutes purport to cover the same ground, the question is whether the more recently enacted statute—here, the Bankruptcy Code—works an implied repeal of the earlier—the FDCPA.⁶⁴ The Supreme Court instructs that courts must read federal statutes together whenever possible, as implied repeal is highly disfavored.⁶⁵ “In the absence of some affirmative showing of an intention to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable.”⁶⁶ Indeed, even in the bankruptcy context, there exists “a firm presumption that otherwise applicable nonbankruptcy statutes should continue in full force.”⁶⁷

Because nothing in the Bankruptcy Code or the FDCPA indicates Congress's intent that these statutes cannot overlap, implied repeal should only be found in the presence of an irreconcilable conflict.⁶⁸ Five circuits have considered whether the Bankruptcy Code and FDCPA irreconcilably conflict, and three distinct approaches have emerged. The Ninth Circuit finds the Code and FDCPA in complete conflict, precluding application of the FDCPA for all bankruptcy matters. The Second Circuit finds a conflict for matters that arise during a bankruptcy case, but permits the FDCPA to augment bankruptcy's remedies after discharge. The Third, Seventh and Eleventh Circuits follow a nuanced approach that considers implied repeal on an issue-by-issue basis. This section sketches the approaches adopted by each circuit, beginning with the most restrictive.

The Ninth Circuit's Sweeping Preclusion of the FDCPA

The Ninth Circuit has held that the Bankruptcy

Code completely precludes application of the FDCPA.⁶⁹ In *Walls v. Wells Fargo Bank*, the debtor sued a debt collector, alleging that its attempt to collect a debt discharged in bankruptcy violated section 1692f of the FDCPA.⁷⁰ The Ninth Circuit concluded that the FDCPA action was barred, as it was premised on a violation of § 524 of the Bankruptcy Code and “necessarily entail[ed] bankruptcy-laden determinations.”⁷¹ The court observed that the Bankruptcy Code features “complex, detailed, and comprehensive provisions” that “demonstrate[] Congress's intent to create a whole system . . . [to] adjust all of the rights and duties of creditors and embarrassed debtors alike.”⁷² The court found nothing in either the Bankruptcy Code or the FDCPA to indicate Congress's intent that the FDCPA should augment bankruptcy's comprehensive scheme.⁷³

In *B-Real, LLC v. Chaussee (In re Chaussee)*, the Ninth Circuit Bankruptcy Appellate Panel (BAP) applied *Walls* to the issue of time-barred claims.⁷⁴ The BAP echoed the *Walls* court's broad statement of conflict: “where the Code and Rules provide a remedy for acts taken in violation of their terms, debtors may not resort to other state and federal remedies to redress their claims lest the congressional scheme behind the bankruptcy laws and their enforcement be frustrated.”⁷⁵ The BAP also held that the FDCPA's debt-validation procedures required lenders to take actions that would violate the automatic stay.⁷⁶

The Ninth Circuit's sweeping approach to implied repeal is a poor model for other circuits to follow. By precluding the application of the FDCPA in bankruptcy because “nothing in either Act persuades [the court] Congress intended” that the FDCPA should apply, the Ninth Circuit turns the presumption against implied repeal on its head.⁷⁷ Rather than searching for an indication that the FDCPA should apply, the court should have applied the FDCPA unless it found Congressional direction to the contrary.

The Ninth Circuit's approach has other flaws. First, the court relied heavily on *MSR Exploration v. Meridian Oil, Inc.*, a decision involving the Bankruptcy Code's preemption of a state-law malicious-prosecution claim.⁷⁸ Yet the Supreme Court has

articulated an entirely different standard for the preemption of a state law than for the implied repeal of a federal statute.⁷⁹ Indeed, “the Supreme Court has shown a greater willingness to find that federal statutes and regulations preempt state-law causes of action.”⁸⁰

Second, plenty of circumstantial clues suggest that the FDCPA and the Bankruptcy Code can coexist. For example, the Supreme Court has allowed other federal statutes to apply to bankruptcy suits despite the existence of bankruptcy-specific rules governing the same issue.⁸¹ Moreover, the Bankruptcy Code and the FDCPA were passed a year apart and have remained in effect for nearly forty years.⁸² Yet, in all that time, Congress has taken no action to preclude the FDCPA’s operation in bankruptcy.⁸³

Finally, a recent Supreme Court case reversing the Ninth Circuit undermines the court’s implied-repeal framework. In *Pom Wonderful LLC v. Coca Cola Inc.*, the Ninth Circuit followed an analysis parallel to *Walls* and held that the “comprehensive” regulatory scheme of the Food, Drug, and Cosmetics Act (FDCA) precluded an unfair competition suit under the Lanham Act.⁸⁴ The Supreme Court overturned that decision, holding that “when two statutes complement each other, it would show disregard for the congressional design to hold that Congress nonetheless intended one federal statute to preclude the operation of the other.”⁸⁵ For all of these reasons, the Ninth Circuit’s approach is a poor one for other circuit courts to follow.

The Second Circuit’s Pre-Discharge Preclusion

The Second Circuit allows the FDCPA to supplement the Bankruptcy Code’s remedies for violations of the discharge injunction, but not for matters that arise during the bankruptcy case.⁸⁶ The court first considered the intersection of the FDCPA and the Bankruptcy Code in *Simmons v. Roundup Funding*, which involved an FDCPA action for filing an inflated proof of claim.⁸⁷ There, the court held the FDCPA cannot apply in the proof-of-claim context because “[t]here is no need to protect debtors who are already under the protection of the bankruptcy court, and there is no need to supplement the remedies afforded by bankruptcy itself.”⁸⁸

The court declined to address whether the sweeping preclusion adopted by the *Walls* case was appropriate.⁸⁹

Earlier this year, in *Garfield v. Ocwen Loan Servicing, LLC*, the court addressed FDCPA claims for the collection of debt discharged in bankruptcy.⁹⁰ In that case, the court “conclude[d] that the Bankruptcy Code does not broadly repeal the FDCPA.”⁹¹ It limited *Simmons* to matters that arise during the pendency of a bankruptcy case and held the FDCPA could augment the Code’s remedies for violating the discharge injunction.⁹²

Like the Ninth Circuit in *Walls*, the *Simmons* court focused entirely on the comprehensive nature of the proof-of-claim process.⁹³ This analysis ignores the standard repeatedly articulated by the Supreme Court and, like *Walls*, reverses the presumption against implied repeal. To be sure, *Simmons*’s emphasis on bankruptcy’s comprehensive protections has intuitive appeal. Yet these considerations are more properly geared toward whether a proof of claim is unfair, unconscionable, deceptive, or misleading.⁹⁴ The Second Circuit’s more recent decision in *Garfield* is more attentive to the presumption against implied repeal and, as such, limited *Simmons* to its facts.⁹⁵

A Better Approach

The Third and Seventh Circuits, joined now by the Eleventh Circuit, adopt the most permissive approach to FDCPA claims brought in bankruptcy. These courts give proper weight to the presumption against implied repeal, determining on an issue-by-issue basis whether applying the FDCPA would irreconcilably conflict with the Code.

The leading case in these circuits is *Randolph v. IMBS, Inc.*, which involved allegations that the debt collector violated various sections of the FDCPA by sending dunning letters during the debtors’ bankruptcy cases.⁹⁶ The Seventh Circuit emphasized that “repeal by implication is a rare bird indeed,” requiring either a clear statement from Congress or an irreconcilable conflict between the two statutes.⁹⁷ The court acknowledged that the Bankruptcy Code and the FDCPA overlapped, but held that “operational differences” did not

amount to an irreconcilable conflict.⁹⁸ Because “[i]t is easy to enforce both statutes, and any debt collector can comply with both simultaneously,” the court explained, the debt collector’s actions could violate the FDCPA.⁹⁹

The Third Circuit followed this approach in *Simon v. FIA Card Servs., N.A.*, which considered whether sending a letter requesting a Bankruptcy Rule 2004 examination and offering to settle a debt violated the FDCPA.¹⁰⁰ The court found that the Bankruptcy Code did not categorically preclude operation of the FDCPA.¹⁰¹ It noted that the proper inquiry is “whether the FDCPA claim raises a direct conflict between the Code or Rules and the FDCPA, or whether both can be enforced.”¹⁰²

The court then carefully examined the conduct underlying the FDCPA claim. For the debtor’s claims alleging that the correspondence was false and misleading under the FDCPA, the court found no conflict: a debt collector could comply with both statutes, so both could operate simultaneously.¹⁰³ The court reached a different result with respect to the debtor’s claim under § 1692(e)(11) of the FDCPA.¹⁰⁴ That section requires, *inter alia*, that debt collectors disclose in initial communications that “the debt collector is attempting to collect a debt and any information obtained will be used for that purpose.”¹⁰⁵ Meanwhile, the automatic stay prohibits “an act to collect, assess, or recover a [prepetition] claim against a debtor,” and courts have held that such a notice violates the automatic stay.¹⁰⁶ The *Simon* court held that if section 1692(e)(11) applied in bankruptcy, debt collectors could be found to violate the FDCPA by failing to provide the notice, yet violate the automatic stay by providing the notice.¹⁰⁷ Because these two provisions stood in irreconcilable conflict, the Bankruptcy Code precluded the debtor’s claim under § 1692(e)(11).¹⁰⁸

Evaluating Stale Claims Under the Third, Seventh, and Eleventh Circuits’ Approach

Randolph and *Simon* shed light on the high threshold for finding an “irreconcilable conflict” in the bankruptcy context. Mere overlap or “operational differences” are not enough.¹⁰⁹ Instead, courts should find implied repeal only where statutes can-

not operate together, such as in *Simon*, where one statute required what the other statute prohibited.¹¹⁰

The conflict at issue in the proof-of-claim process is, at most, between the FDCPA’s prohibition of misleading practices and the Bankruptcy Code’s authorization to file a proof of claim. Any conflict between an authorization and a prohibition is fully reconcilable if the party simply refrains from engaging in the prohibited conduct. In this case, a debt collector is not obligated to file a proof of claim and can easily comply with both statutes by electing not to file the claim.¹¹¹ If we assume that filing a time-barred claim does not violate the FDCPA, as courts outside of the Eleventh Circuit have held, the statutes are even more easily harmonized. Here, filing a stale claim does no offense to either statute, and both can operate simultaneously.¹¹²

In *Johnson*, the Eleventh Circuit rejected the district court’s contention that imposing FDCPA liability for filing time-barred claims undermines creditors’ rights to participate in the bankruptcy case.¹¹³ This contention, which some other courts have embraced,¹¹⁴ elevates the authorization to file a claim to an untenable position. While § 501 permits creditors to file a proof of claim, it does not establish the unqualified right to do so under any and all circumstances.¹¹⁵ On the contrary, creditors who file proofs of claim can be sanctioned under Bankruptcy Rule 9011¹¹⁶ or punished for violating the discharge injunction.¹¹⁷ Finding a debt collector liable under the FDCPA does no more harm to creditors’ “right” to file a proof of claim than these limitations. Accordingly, the Eleventh Circuit was correct to hold that “the Bankruptcy Code’s rules about who can file a claim do not shield debt collectors from the [FDCPA].”¹¹⁸

In addition, the FDCPA complements the Bankruptcy Code in both purpose and design. As the Eleventh Circuit highlighted in *Johnson*, the FDCPA “easily lies over the top of the Code’s regime” to provide an additional layer of protection against certain creditors.¹¹⁹ The FDCPA also diversifies the enforcement of the Bankruptcy Code and Rules. The FDCPA features litigation incentives, such as statutory damages and attorney’s fees, which encourage debtors’ counsel and perhaps

other parties to take on a greater supervisory function in the claims process.¹²⁰ FDCPA damages would increase the cost of creditors' misbehavior, potentially deterring this conduct on a long-term basis. In this way, application of the FDCPA can work to fill the gaps left open by consumer bankruptcy's high-volume structure.

In *Pom Wonderful*, the Supreme Court highlighted that such complementary enforcement regimes are often an integral part of a broader legislative scheme.¹²¹ In that case, the Court permitted competitors to bring claims under the Lanham Act despite the comprehensive regulation of juice labeling under the FDCA. In so holding, the Court explained that the Food and Drug Administration, which enforces the FDCA, "does not have the same perspective or expertise in assessing market dynamics that day-to-day competitors possess."¹²² As such, Lanham Act suits provide an additional check on manufacturers' conduct.¹²³ Allowing both the FDCA and the Lanham Act to regulate this area "takes advantage of synergies among multiple methods of regulation" and "is quite consistent with congressional design."¹²⁴ The Court's observations on legislative design apply with equal force to the overlapping coverage of the Bankruptcy Code and the FDCPA.

Thus, under the Third, Seventh, and Eleventh Circuits' approach to implied repeal, the FDCPA should be permitted to apply in the proof-of-claim context. As such, clear misstatements, such as an inflated proof of claim or an inaccurate statement regarding the secured status of a claim, would appear to violate the FDCPA.¹²⁵ Whether filing time-barred claims should likewise constitute a violation is a controversial question, discussed next.

Does Filing a Time-Barred Proof of Claim Violate the FDCPA?

The previous sections examined whether the FDCPA has any application in the bankruptcy arena. Assuming for present purposes that it does, this section considers whether filing a facially accurate but time-barred proof of claim violates the FDCPA. Again, the tension here is that filing a time-barred claim does not violate the Bankruptcy Code or Rules, but trades on the presumed validity

of bankruptcy claims to collect on otherwise uncollectable debt. Courts must decide whether this practice constitutes false, deceptive, misleading, unfair, or unconscionable conduct under the FDCPA.

Proofs of Claim Fall within the Scope of the FDCPA

Defendants have been quick to argue that filing a proof of claim does not constitute "debt collection," and thus is beyond the FDCPA's purview.¹²⁶ Courts have, by and large, disagreed. It is self-evident that creditors file proofs of claim with the intent to obtain some recovery on an underlying obligation, and as such, a proof of claim is "at the very least, an 'indirect' means of collecting a debt."¹²⁷ Although some litigants have argued that construing filing a proof of claim as collection activity would make filing proofs of claim violate the automatic stay,¹²⁸ this argument ignores the well-settled principle that the stay does not prohibit actions taken in the context of the bankruptcy case.¹²⁹

Defendants have argued, alternatively, that filing a proof of claim is an attempt to collect a debt from the bankruptcy estate rather than the debtor herself, and is thus not governed by the FDCPA.¹³⁰ But the FDCPA is not limited solely to debt collection actions taken against a consumer debtor.¹³¹ On the contrary, debt collectors can violate the FDCPA through both direct and indirect collection activities.¹³² In addition, the FDCPA makes debt collectors liable to "any person" who suffers a violation of the statute.¹³³ As such, filing a proof of claim is within the scope of the FDCPA.¹³⁴

Crawford's Strained Analogy to State-Court Litigation

In the typical case, a stale proof of claim is accurate on its face. *Crawford*, however, stands for the proposition that knowingly filing a time-barred claim nevertheless violates the FDCPA.¹³⁵ As noted above, the *Crawford* court reasoned that filing a time-barred claim gives the misleading impression that the debt is legally enforceable.¹³⁶ To reach that holding, *Crawford* relied almost entirely on the Seventh Circuit's decision in *Phillips v. Asset Acceptance, LLC*, which held that commencing a lawsuit to collect stale debt violated the FDCPA.¹³⁷

A closer look at *Phillips* reveals that this is a weak foundation for finding a violation of the FDCPA in this context.

Phillips emphasized that several asymmetries—those of information, sophistication, finances, and energy—tilt civil litigation’s playing field unfairly toward debt collectors:¹³⁸

As with any defendant sued on a stale claim, the passage of time not only dulls the consumer’s memory of the circumstances and validity of the debt, but heightens the probability that she will no longer have personal records detailing the status of the debt Because few unsophisticated consumers would be aware that a statute of limitations could be used to defend against lawsuits based on stale debts, such consumers would unwittingly acquiesce to such lawsuits. And, even if the consumer realizes that she can use time as a defense, she will more than likely still give in rather than fight the lawsuit because she must still expend energy and resources and subject herself to the embarrassment of going into court to present the defense; this is particularly true in light of the costs of attorneys today.¹³⁹

This holding removes the burden of raising a statute-of-limitations defense from the consumer in an effort to achieve a better balance between the parties.

In relying so heavily on *Phillips*, the *Crawford* court seems to have ignored that debtors in bankruptcy are in a fundamentally different position vis-à-vis their creditors than consumers sued in a state-court collection action. First, at the time the time-barred claim is filed, debtors are already under the protection of the bankruptcy court and, more often than not, represented by counsel.¹⁴⁰ Thus, the concern that debtors must “expend energy and resources” and suffer the embarrassment of litigation are muted.¹⁴¹ In addition, a private trustee is appointed in every consumer bankruptcy case, and bears a fiduciary duty to examine and object to claims “if a purpose would be served.”¹⁴²

Moreover, the bankruptcy system has responded to the problem of time-barred claims by enacting procedural rules that attempt to level bankruptcy’s playing field. As noted above, Bankruptcy Rule 3001(c)(3) requires the holder of a claim based on an open-end or revolving consumer credit agree-

ment to include in the proof of claim information that allows parties in interest to determine its timeliness.¹⁴³ Many courts have found this increased disclosure, together with bankruptcy’s overlapping protections, to distinguish a debtor in bankruptcy from a consumer sued in state court.¹⁴⁴

Some courts and commentators have challenged these distinctions, arguing that they do not provide debtors sufficient protection “in the daily trenches of bankruptcy practice.”¹⁴⁵ For example, while case trustees are charged with the duty to object to claims, the immense caseloads of many trustees and sheer number of claims filed makes it infeasible for them to actually do so in every case.¹⁴⁶ In addition, not all debtors are represented by counsel,¹⁴⁷ and there are good reasons to believe that *pro se* debtors would have an extraordinarily difficult time navigating the claims-objection process.¹⁴⁸

While these arguments paint an accurate picture of the realities of the claims process, they do not respond to a fundamental distinction between state-court litigation and filing stale proofs of claim. Filing a time-barred claim in bankruptcy takes advantage of vulnerabilities in the bankruptcy system, not vulnerabilities of individual consumers. Indeed, allowing a stale claim frequently has no effect on the debtor. Because the claimant shares in the total payments allocated to all of the debtor’s creditors, this may not translate to additional dollars out of a debtor’s pocket, but rather a smaller proportionate share for the other claimants of the debtor’s limited assets.¹⁴⁹

Considering the distinct nature of the bankruptcy process and the overlapping protections that the Bankruptcy Code and Rules provide, *Crawford*’s analogy to state-court litigation breaks down. Although the vulnerabilities of the consumer-defendant in state court litigation justify removing the burden of raising affirmative defenses, courts may find it difficult to justify a similar blanket rule in the bankruptcy context. As such, most courts will likely continue to hold that filing a time-barred claim, without more, should not amount to an FDCPA violation.

Is *Crawford* the End? Addressing Systematic Harms to the Bankruptcy Process

Some courts that have refused to hold debt collectors liable for filing stale claims have done so with disappointment.¹⁵⁰ It is one thing to say that no technical violation of the FDCPA has occurred in an individual case, but quite another to be sanguine about a practice that relies on the widespread failure of the bankruptcy system to function. In this section, I look beyond *Crawford v. LVNV* to review remedies that might be available to address the practice of flooding the bankruptcy system with stale claims.

Section 105 and Rule 9011

When courts are confronted with allegations that a litigant is systematically taking advantage of the court machinery, sanctions or contempt of court may seem like a more natural response than litigation under the FDCPA. Bankruptcy Rule 9011 requires that parties who submit proofs of claim certify that the claims are “not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.”¹⁵¹ It also requires parties to certify that “the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law.”¹⁵² Some courts have interpreted this duty to require litigants to consider “obvious affirmative defenses” before submitting a proof of claim.¹⁵³ Section 105 of the Code provides courts with statutory contempt powers, permitting courts to sanction parties for “abuse of process.”¹⁵⁴ This provision has been used to address “vexatious” litigation tactics in bankruptcy¹⁵⁵ and as a gap filler to address systematic overreaching by creditors in consumer cases.¹⁵⁶

At first blush, it would appear that these provisions could address the “deluge” of time-barred claims, particularly where a debt buyer allegedly files large numbers of claims with no meaningful review of their timeliness. But there are real limits on their effectiveness. First, proceeding under Rule 9011 in particular is more procedurally burdensome than filing a claim objection (although noth-

ing prevents the court from acting *sua sponte*).¹⁵⁷ Second, most courts have so far been reluctant to sanction the filing of time-barred claims, given the absence of a statutory prohibition and the conflicting precedent on whether this behavior is actionable.¹⁵⁸ Finally, section 105 must be exercised within the confines of the Bankruptcy Code.¹⁵⁹ Because the Code does not prohibit the filing of stale claims, it might not justify an independent cause of action to address the filing of stale claims.¹⁶⁰ These remedies would be more effective if the Code were amended to clarify that the mass filing of time-barred claims is inappropriate,¹⁶¹ but I am not holding my breath.

Novel Interpretations of the FDCPA

The fact that *Crawford* relies on a poor analogy to state-court litigation does not prevent courts from adopting a novel interpretation of the FDCPA to address the problem of time-barred claims. For example, some litigants have looked beyond *Crawford* to underscore the aggregate harm of this practice on the bankruptcy system itself. The contention is that the practice of filing time-barred claims is “predicated entirely on system failure,” which wastes resources and undermines the integrity of the bankruptcy process.¹⁶² Plaintiffs allege this conduct is an “unfair or unconscionable means to collect or attempt to collect any debt” under 15 U.S.C.A. § 1692f. It remains to be seen whether this theory or another will convince courts to allow FDCPA liability for stale claims. Perhaps some courts that are not persuaded by *Crawford*’s reasoning might be convinced to concur in the result.

Increased Vigilance with the Assistance of the FDCPA

If courts do not follow *Crawford* or embrace a novel reading of the FDCPA, the trustee and debtor’s counsel will continue to shoulder the burden of reviewing proofs of claim for statute-of-limitations defenses. But this task might be lightened in jurisdictions that follow *Johnson*’s lead, allowing the FDCPA to augment the Bankruptcy Code in the claims context.

In these jurisdictions, a misrepresentation in a proof of claim would no doubt violate the FDCPA.¹⁶³

Similarly, the omission of certain information, including information that would allow the debtor or trustee to assess the timeliness of the claim, could likewise amount to an FDCPA violation. The availability of damages for such errors and omissions might encourage debtor's counsel to review claims more thoroughly. In the process of this review, especially with the aid of the disclosure now required by Rule 3001(c)(3), perhaps they will discover and object to a greater number of stale claims than the system previously caught.

Conclusion

A flood of litigation challenging time-barred proofs of claim has swept through courts around the nation, generating conflicting decisions on nearly every aspect of this issue. As circuit courts weigh in on these cases, the role of the FDCPA in the proof-of-claim process will take on greater clarity. The Eleventh Circuit's liberal approach is not perfect, but it highlights that the FDCPA could play a role in regulating the proof-of-claim process.

ENDNOTES:

¹Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1256, 59 Bankr. Ct. Dec. (CRR) 205 (11th Cir. 2014), petition for certiorari filed, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015).

²15 U.S.C.A. §§ 1692-1692p (2015).

³Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 59 Bankr. Ct. Dec. (CRR) 205 (11th Cir. 2014), petition for certiorari filed, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015).

⁴See *infra* note 76.

⁵Johnson v. Midland Funding, — F.3d —, 2016 WL 2996372, at *4 (11th Cir. May 24, 2016). *Crawford* did not address this issue because the litigants had not raised it below. See *Crawford*, 758 F.3d at 1262 n.7.

⁶Johnson, — F.3d —, 2016 WL 2996372, at *6.

⁷This paper skips several other questions that have arisen in certain cases, such as whether FDCPA claims that arise after the confirmation of a debtor's plan are barred by *res judicata*. Compare *Covert v. LVNV Funding, LLC*, 779 F.3d 242, 247 (4th Cir. 2015) (plaintiffs' claims are barred by *res judicata*); with *In re Feggins*, 540 B.R. 895, 909 (Bankr. M.D. Ala. 2015) (*res judicata* does not apply).

⁸15 U.S.C.A. § 1692(e).

⁹15 U.S.C.A. §§ 1692e, 1692f.

¹⁰15 U.S.C.A. § 1692d.

¹¹15 U.S.C.A. § 1692k.

¹²See *Perkins v. LVNV Funding (In re Perkins)*, 533 B.R. 242, 255 (Bankr. W.D. Mich. 2015); but see 15 U.S.C.A. § 1692k(c) (providing for a "bona fide error" defense).

¹³See *Crawford*, 758 F.3d at 1259 (collecting authority).

¹⁴*Crawford*, 758 F.3d at 1261.

¹⁵11 U.S.C.A. § 101(5) (defining "claim" as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.").

¹⁶See H.R. REP. NO. 595, 95th Cong., 2d Sess. 309 (1979), reprinted at 1978 U.S. CODE CONG. & AD. NEWS 5963, 6266 (providing that the term "claim" should have "the broadest possible definition").

¹⁷See, e.g., *In re Buckley*, 404 B.R. 877, 891, 61 Collier Bankr. Cas. 2d (MB) 1470 (Bankr. S.D. Ohio 2009) ("The broad definitions of the terms 'claim' and 'debt' contained in the Code are central to the policy of a fresh start for a debtor and permit [] a debtor to receive the broadest possible relief in the bankruptcy court. . . .") (quoting *PBGC v. LTV Corp. (In re Chateaugay Corp.)*, 87 B.R. 779, 795, 17 Bankr. Ct. Dec. (CRR) 1089, 9 Employee Benefits Cas. (BNA) 2209 (S.D. N.Y. 1988), judgment aff'd, 875 F.2d 1008, 19 Bankr. Ct. Dec. (CRR) 913, 10 Employee Benefits Cas. (BNA) 2425, 111 Lab. Cas. (CCH) P 11200, 16 Fed. R. Serv. 3d 400 (2d Cir. 1989), judgment rev'd, 496 U.S. 633, 110 S. Ct. 2668, 110 L. Ed. 2d 579, 20 Bankr. Ct. Dec. (CRR) 1075, 22 Collier Bankr. Cas. 2d (MB) 1237, 12 Employee Benefits Cas. (BNA) 1593, Bankr. L. Rep. (CCH) P 73423 (1990) (internal quotation marks omitted)).

¹⁸Mississippi and Wisconsin are the only states that provide that the running of the statute of limitation extinguishes the debt. Miss. Code Ann. § 15-1-3; Wis. Stat. Ann. § 893.05.

¹⁹See, e.g., *In re Glenn*, 542 B.R. 833, 843 (Bankr. N.D. Ill. 2016) (collecting authority); c.f. Consolidated Opening Brief and Required Short Appendix for Plaintiffs-Appellants at 23, *Owens v. LVNV Funding, LLC*, Nos. 15-2044, 15-2082 and 15-2109 (7th Cir. Dec. 11, 2015) (arguing "claim" should be defined as an "enforceable" obligation).

²⁰11 U.S.C.A. § 502(b)(1).

²¹11 U.S.C.A. § 502(a); see also Fed. R. Bankr. P. 3001(f) ("A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the

claim.”).

²²See, e.g., Henry J. Sommer et al., *Consumer Bankruptcy Law and Practice*, 81 (John Rao ed., 8th ed. 2006) (“Once it has been decided that bankruptcy is appropriate in a particular case, most of the remaining work is relatively routine. A good deal of it involves preparation of the necessary papers for the initial filing. . . .”); but see Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*: 20 Am. Bankr. Inst. L. Rev. 17, 121-122 (2011) (noting that, especially after enactment of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), “there are ever fewer seemingly simple cases”).

²³William C. Whitford, *The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy*, 68 Am. Bankr. L. J. 397, 403 (1994) (“Routine, uncontested cases allow [consumer bankruptcy attorneys] to charge low fees, which in turn makes it easier to attract a sufficiently large clientele to justify investment in routinized procedures.”).

²⁴According to a Federal Trade Commission study, six of the largest debt buyers paid an average of four cents on the dollar for debt. Older debts typically sell for lower prices. Federal Trade Comm’n, *The Structure and Practices of the Debt Buying Industry*, ii and 23 (January 23); see also Dalié Jiménez, *Dirty Debts Sold Dirt Cheap*, 52 Harv. J. Leg. 41 (2015).

²⁵See Fed. R. Bankr. P. 3001(c)(3) (requiring creditors to disclose, among other things, the date of the last transaction, the date of the last payment, and the date the account was charged to profit or loss).

²⁶See generally Amicus Brief in Support of Plaintiffs-Appellants Arguing for Reversal in All Three Cases, *Owens v. LVNV Funding, LLC*, Nos. 15-2044, 15-2082 and 15-2109 (7th Cir. Dec. 11, 2015) (discussing the economic advantages of filing stale proofs of claim).

²⁷Compare *Torres v. Cavalry SPV I, LLC*, 530 B.R. 268, 270 (E.D. Pa. 2015); with *In re Perkins*, 533 B.R. 242, 249 (Bankr. W.D. Mich. 2015) (exercising “related-to” jurisdiction over the FDCPA claims and entering a final judgment with the consent of the parties).

²⁸15 U.S.C.A. §§ 1692e-1692f.

²⁹Crawford, 758 F.3d at 1257.

³⁰Crawford, 758 F.3d at 1257.

³¹Crawford, 758 F.3d at 1257.

³²Crawford, 758 F.3d at 1257.

³³Crawford, 758 F.3d at 1259.

³⁴Crawford, 758 F.3d at 1259.

³⁵Crawford, 758 F.3d at 1257.

³⁶Crawford v. LVNV Funding, LLC, No. 2:12-CV-701-WKW, 2013 WL 1947616, at *1 (M.D. Ala. May 9, 2013), vacated, 758 F.3d 1254 (11th Cir. 2014) (quoting the bankruptcy court).

³⁷Crawford, 2013 WL 1947616, at *1.

³⁸Crawford, 758 F.3d at 1262.

³⁹Crawford, 758 F.3d at 1259.

⁴⁰Crawford, 758 F.3d at 1262.

⁴¹Crawford, 758 F.3d at 1261.

⁴²See *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1261, 59 Bankr. Ct. Dec. (CRR) 205 (11th Cir. 2014), petition for certiorari filed, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015). LVNV’s petitions for panel and en banc rehearing before the Eleventh Circuit, and its petition for certiorari before the Supreme Court, were denied. *LVNV Funding, LLC v. Crawford*, 2015 WL 241892 (U.S.); *LVNV Funding, LLC v. Crawford*, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015).

⁴³See *Crawford*, 758 F.3d at 1262 n. 7.

⁴⁴Johnson, — F.3d —, 2016 WL 2996372, at *6.

⁴⁵Johnson, — F.3d —, 2016 WL 2996372, at *6.

⁴⁶Johnson, — F.3d —, 2016 WL 2996372, at *1.

⁴⁷Johnson, — F.3d —, 2016 WL 2996372, at *1.

⁴⁸Johnson, — F.3d —, 2016 WL 2996372, at *1.

⁴⁹Johnson v. Midland Funding, LLC, 528 B.R. 462 (S.D. Ala. 2015); *Brock v. Resurgent Capital Servs., LP*, No. CV 14-0324-WS-M, 2015 WL 4985700, at *1 (S.D. Ala. Aug. 20, 2015).

⁵⁰Johnson, 528 B.R. at 473.

⁵¹Johnson, 528 B.R. at 469.

⁵²Johnson, 528 B.R. at 473.

⁵³Brock, 2015 WL 4985700, at *3.

⁵⁴Johnson, — F.3d —, 2016 WL 2996372, at *6.

⁵⁵Johnson, — F.3d —, 2016 WL 2996372, at *4 (quoting *J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred Intern., Inc.*, 534 U.S. 124, 143-44, 122 S. Ct. 593, 605, 151 L. Ed. 2d 508, 60 U.S.P.Q.2d 1865 (2001) (quotation omitted)).

⁵⁶Johnson, — F.3d —, 2016 WL 2996372, at *5.

⁵⁷Johnson, — F.3d —, 2016 WL 2996372, at *5.

⁵⁸Johnson, — F.3d —, 2016 WL 2996372, at *5.

⁵⁹See, e.g., *In re Winik*, 39 F. Supp. 3 (D.N.J. 1941); *Taylor v. Midland Funding, LLC*, 94 F. Supp.

3d 941, 949 (N.D. Ill. 2015); *In re Brimmage*, 523 B.R. 134, 142 (Bankr. N.D. Ill. 2015); *Grandidier v. Quantum3 Grp., LLC*, No. 1:14-CV-00138-RLY, 2014 WL 6908482, at *3 (S.D. Ind. Dec. 8, 2014); *Reed v. LVNV Funding, LLC*, No. 14 C 8371, 2015 WL 1510375, at *3 (N.D. Ill. Mar. 27, 2015); *In re Avalos*, 531 B.R. 748 (Bankr. N.D. Ill. 2015); *In re Edwards*, 539 B.R. 360 (Bankr. N.D. Ill. 2015).

⁶⁰See, e.g., *Jenkins v. Credit Mgmt., Inc* (In re *Jenkins*), 538 B.R. 129, 133 (Bankr. N.D. Ala. 2015).

⁶¹*In re Gatewood*, 533 B.R. 905, 909 (B.A.P. 8th Cir. 2015); *Broadrick v. LVNV Funding, LLC* (In re *Broadrick*), 532 B.R. 60 (Bankr. M.D. Tenn. 2015); *Donaldson v. LVNV Funding, LLC*, 97 F. Supp. 3d 1033 (S.D. Ind. 2015); *LaGrone v. LVNV Funding LLC* (In re *LaGrone*), 525 B.R. 419, 427 (Bankr. N.D. Ill. 2015); *Torres v. Cavalry SPV I, LLC*, 530 B.R. 268 (E.D. Pa. 2015); *Jenkins v. Genesis Fin. Solutions* (In re *Jenkins*), 456 B.R. 236 (Bankr. E.D. N.C. 2011); *B-Real, LLC v. Rogers*, 405 B.R. 428 (M.D. La. 2009).

⁶²See *supra* note 6.

⁶³*Torres*, 530 B.R. at 268, appeal docketed No. 15-2131 (3d Cir. May 13, 2015); *Torres v. Asset Acceptance, LLC*, 96 F. Supp. 3d 541 (E.D. Pa. 2015); *DuBois v. Atlas Acquisitions, LLC* (In re *DuBois*), appeal docketed 15-1945 (4th Cir. 2015); *Perkins*, 533 B.R. at 242, appeal docketed 15-8050 (6th Cir. B.A.P. 2016); *In re Broadrick*, 532 B.R. at 60, appeal docketed No. 15-505 (6th Cir. Sept. 8, 2015); *Owens v. LVNV Funding, LLC*, 2015 WL 1826005 (S.D. Ind. 2015); *Scheible v. Quantum3 Group, LLC*, 2015 WL 6828753 (S.D. Ind. 2015) (briefing suspended); *Nelson v. Midland Credit Mgmt, Inc.*, appeal docketed, No. 15-2984 (8th Cir. 2016).

⁶⁴See *Randolph v. IMBS, Inc.*, 368 F.3d 726, 730, Bankr. L. Rep. (CCH) P 80100 (7th Cir. 2004).

⁶⁵See *National Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 662-63, 127 S. Ct. 2518, 168 L. Ed. 2d 467, 64 Env't. Rep. Cas. (BNA) 1513 (2007).

⁶⁶*Morton v. Mancari*, 417 U.S. 535, 550, 94 S. Ct. 2474, 41 L. Ed. 2d 290, 8 Fair Empl. Prac. Cas. (BNA) 105, 7 Empl. Prac. Dec. (CCH) P 9431 (1974).

⁶⁷G. Eric Brunstad, Jr., *Appeals of Remand Orders in Bankruptcy: Limiting Litigation over Where to Litigate and Some Lessons on Statutory Construction*, 5 J. Bankr. L. & Prac. 323, 342 (1996). For a discussion of interpretative presumptions in statutory analysis, see Elizabeth Y. McCuskey, *Body of Preemption*, 89 Temp. L. Rev. (forthcoming 2016).

⁶⁸See, e.g., *Randolph*, 368 F.3d at 730 (noting an absence of a “clearly expressed decision that the Bankruptcy Code displaces the FDCPA.”).

⁶⁹*Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502, 510, 38 Bankr. Ct. Dec. (CRR) 254, Bankr. L. Rep. (CCH) P 78563 (9th Cir. 2002).

⁷⁰*Walls*, 276 F.3d at 504.

⁷¹*Walls*, 276 F.3d at 510.

⁷²*Walls*, 276 F.3d at 510 (quoting *MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910, 914, 28 Bankr. Ct. Dec. (CRR) 608, 35 Collier Bankr. Cas. 2d (MB) 287, Bankr. L. Rep. (CCH) P 76761 (9th Cir. 1996)).

⁷³*Walls*, 276 F.3d at 510.

⁷⁴*B-Real, LLC v. Chaussee* (In re *Chaussee*), 399 B.R. 225 (B.A.P. 9th Cir. 2008).

⁷⁵*B-Real, LLC*, 399 B.R. at 236-37.

⁷⁶*B-Real, LLC*, 399 B.R. at 237.

⁷⁷*Walls*, 276 F.3d at 510.

⁷⁸See *Walls*, 276 F.3d at 510 (citing *MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910, 914, 28 Bankr. Ct. Dec. (CRR) 608, 35 Collier Bankr. Cas. 2d (MB) 287, Bankr. L. Rep. (CCH) P 76761 (9th Cir. 1996)).

⁷⁹See *Simon*, 732 F.3d at 271 (collecting cases).

⁸⁰*Simon*, 732 F.3d at 271.

⁸¹See, e.g., *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 254, 112 S. Ct. 1146, 117 L. Ed. 2d 391, 22 Bankr. Ct. Dec. (CRR) 1130, 26 Collier Bankr. Cas. 2d (MB) 175, Bankr. L. Rep. (CCH) P 74457A (1992) (giving effect to both 28 U.S.C.A. §§ 1291 and 1292, which govern general appellate jurisdiction, and 28 U.S.C.A. § 158, which governs jurisdiction over bankruptcy appeals); *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 116 S. Ct. 494, 133 L. Ed. 2d 461, 28 Bankr. Ct. Dec. (CRR) 243, 33 Collier Bankr. Cas. 2d (MB) 1338, Bankr. L. Rep. (CCH) P 76717 (1995) (holding “there is no reason [28 U.S.C.A. § 1447(d), the general removal statute, and 28 U.S.C.A. § 1452, the bankruptcy removal statute] cannot comfortably coexist in the bankruptcy context”).

⁸²See *Fair Debt Collection Practices Act*, Pub. L. No. 95-109, 91 Stat. 5874 (1977); *Bankruptcy Reform Act of 1978*, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

⁸³See, e.g., *POM Wonderful LLC v. Coca-Cola Co.*, 134 S. Ct. 2228, 2237, 189 L. Ed. 2d 141, 110 U.S.P.Q.2d 1877, 2014-1 Trade Cas. (CCH) ¶ 78800 (2014) (holding, in a case involving the Lanham Act and the Food, Drug, and Cosmetics Act, “[i]f Congress had concluded, in light of experience, [that the statutes conflicted], it might well have enacted a provision addressing the issue. . . .”).

⁸⁴*Pom Wonderful*, 679 F.3d at 1175 (9th Cir. 2012), rev'd, 134 S. Ct. 2228, 189 L. Ed. 2d 141 (2014).

⁸⁵*POM Wonderful LLC*, 134 S. Ct. at 2238.

⁸⁶*Garfield v. Ocwen Loan Servicing, LLC*, 811 F.3d 86, 91, 61 Bankr. Ct. Dec. (CRR) 260 (2d Cir. 2016); *Simmons*, 622 F.3d at 96.

- ⁸⁷Simmons, 622 F.3d at 97.
- ⁸⁸Simmons, 622 F.3d at 96.
- ⁸⁹Simmons, 622 F.3d at 96 n.2.
- ⁹⁰Garfield, 811 F.3d at 88.
- ⁹¹Garfield, 811 F.3d at 91.
- ⁹²Garfield, 811 F.3d at 91.
- ⁹³Simmons, 622 F.3d at 96.
- ⁹⁴See *infra* text accompanying notes 114-129 (considering the protections of the Bankruptcy Code when determining whether debt collectors' conduct violates the FDCPA).
- ⁹⁵See Garfield, 811 F.3d at 91.
- ⁹⁶Randolph v. IMBS, Inc., 368 F.3d at 727. Three debtors' actions were consolidated on appeal.
- ⁹⁷Randolph, 368 F.3d at 730.
- ⁹⁸Randolph, 368 F.3d at 730.
- ⁹⁹Randolph, 368 F.3d at 730.
- ¹⁰⁰Simon v. FIA Card Services, N.A., 732 F.3d 259, 262 (3d Cir. 2013).
- ¹⁰¹Simon, 732 F.3d at 274.
- ¹⁰²Simon, 732 F.3d at 274.
- ¹⁰³Simon, 732 F.3d at 279.
- ¹⁰⁴See Simon, 732 F.3d at 279-80.
- ¹⁰⁵15 U.S.C.A. § 1692(e).
- ¹⁰⁶11 U.S.C.A. § 362(a)(6); Simon, 732 F.3d at 280 (collecting authority).
- ¹⁰⁷Simon, 732 F.3d at 280.
- ¹⁰⁸Simon, 732 F.3d at 280.
- ¹⁰⁹See *supra* note 118-119, 123.
- ¹¹⁰See, e.g., *U.S. v. Borden Co.*, 308 U.S. 188, 198-99, 60 S. Ct. 182, 188, 84 L. Ed. 181 (1939) requiring a "positive repugnancy [between the old and the new laws]".
- ¹¹¹Johnson, — F.3d —, 2016 WL 2996372, at *6.
- ¹¹²See, e.g., *LaGrone*, 525 B.R. at 427.
- ¹¹³Johnson, — F.3d —, 2016 WL 2996372, at *6.
- ¹¹⁴See, e.g., *In re Jenkins*, 538 B.R. 129, 133 (Bankr. N.D. Ala. 2015); *In re Moses*, 542 B.R. 5, 12 (Bankr. N.D. Ala. 2015).
- ¹¹⁵*In re Feggins*, 540 B.R. at 907 ("Section 501(a) provides an open-ended right to file a proof of claim, not an impregnable right to file one.").
- ¹¹⁶See, e.g., *In re Sekema*, 523 B.R. 651, 654 (Bankr. N.D. Ind. 2015).
- ¹¹⁷*McLean v. Green Point Credit, LLC* (*In re McLean*), 794 F.3d 1313, 1322-23, 61 Bankr. Ct. Dec. (CRR) 95, Bankr. L. Rep. (CCH) P 82853 (11th Cir. 2015).
- ¹¹⁸Johnson, — F.3d —, 2016 WL 2996372, at *6.
- ¹¹⁹Johnson, — F.3d —, 2016 WL 2996372, at *5.
- ¹²⁰15 U.S.C.A. § 1692k.
- ¹²¹*POM Wonderful LLC v. Coca-Cola Co.*, 134 S. Ct. 2228, 2238, 189 L. Ed. 2d 141, 110 U.S.P.Q.2d 1877, 2014-1 Trade Cas. (CCH) ¶ 78800 (2014).
- ¹²²*Pom Wonderful*, 134 S. Ct. at 2234.
- ¹²³*Pom Wonderful*, 134 S. Ct. at 2234.
- ¹²⁴*Pom Wonderful*, 134 S. Ct. at 2239.
- ¹²⁵See, e.g., *Kline v. Mortgage Electronic Sec. Systems*, 659 F. Supp. 2d 940, 949-51 (S.D. Ohio 2009) (Denying motion to dismiss FDCPA action for filing proof of claim that claimed unlawful fees).
- ¹²⁶See, e.g., *In re Brimmage*, 523 B.R. 134, 139 (Bankr. N.D. Ill. 2015).
- ¹²⁷See, e.g., *Crawford* at 1262; *Gardner v. State of N.J.*, 329 U.S. 565, 573, 67 S. Ct. 467, 91 L. Ed. 504 (1947) (when a creditor "files a proof of claim . . . it is using a traditional method of collecting a debt.").
- ¹²⁸The automatic stay bars "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case" 11 U.S.C.A. § 362(a).
- ¹²⁹See *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348, 356, 60 Collier Bankr. Cas. 2d (MB) 659 (5th Cir. 2008) ("We find no precedents in which a court has held that asserting a right to payment in a Proof of Claim constitutes a violation of the automatic stay"); *Eger v. Eger* (*In re Eger*), 507 B.R. 1, 1 (Bankr. N.D. Ga. 2014) (collecting cases for the proposition that the automatic stay does not bar actions taken in the context of a bankruptcy case).
- ¹³⁰See, e.g., *Brimmage*, 523 B.R. at 140.
- ¹³¹15 U.S.C.A. § 1692(a) ("The term 'debt collector' means any person who . . . regularly collects or attempts to collect, directly or indirectly, debts owed"); *Brimmage*, 523 B.R. at 140 ("[T]o be a debt collector one need not collect directly from the debtor, but merely a debt that is owed to them.").
- ¹³²See 15 U.S.C.A. § 1692(a) (defining debt collector); 15 U.S.C.A. § 1692e (prohibiting false, deceptive, and misleading statements made in the collection of any debt).
- ¹³³See 15 U.S.C.A. § 1692k; *Todd v. Collecto, Inc.*, 731 F.3d 734, 739 (7th Cir. 2013) (holding that son of debtor had standing to sue for FDCPA violation).
- ¹³⁴*Brimmage*, 523 B.R. at 140.
- ¹³⁵*Crawford*, 758 F.3d at 1261.
- ¹³⁶*Crawford*, 758 F.3d at 1261.

¹³⁷Phillips v. Asset Acceptance, LLC, 736 F.3d 1076, 87 Fed. R. Serv. 3d 287, 82 U.C.C. Rep. Serv. 2d 183 (7th Cir. 2013).

¹³⁸See Phillips, 736 F.3d at 1079; In re Broadrick, 532 B.R. at 70 (Bankr. M.D. Tenn. 2015) (noting the decisions finding a FDCPA violation for filing sale lawsuits are “largely based on the nature of the proceedings and the inherent disparity between the power and positions of the parties.”).

¹³⁹Phillips, 736 F.3d at 1079 (quoting Kimber v. Federal Financial Corp., 668 F.Supp. 1480, 1487 (M.D. Ala.1987)).

¹⁴⁰Several of the distinctions highlighted in this section were thoughtfully articulated by my fellow BLL contributor, Judge Wedoff. See, LaGrone, 525 B.R. at 427.

¹⁴¹See LaGrone, 525 B.R. at 427.

¹⁴²See, e.g., Broadrick, 532 B.R. at 73.

¹⁴³See Fed. R. Bankr. P. 3001(c)(3).

¹⁴⁴See, e.g., Gatewood, 533 B.R. at 909; Broadrick, 532 B.R. 60; Donaldson, —F.Supp.3d —, 2015 WL 1539607; LaGrone, 525 B.R. at 427.

¹⁴⁵James J. Haller and Tara Twomey, Debt Collectors Should Not Get a Free Pass in Bankruptcy, XXXIV ABI Journal 11, 30-31, 71, November 2015; see also Edwards, 539 B.R. at 365.

¹⁴⁶Kara Bruce, The Debtor Class, 88 Tul. L. Rev. 21, 38 (2013) (discussing the limitations of case trustees); Edwards, 539 B.R. at 365 (“[E]xamin[ing] the details of virtually every unsecured proof of claim . . . is simply impracticable.”); see also Opening Brief of Appellant at 17-18, Adkins v. Atlas Acquisitions LLC (In re DuBois), No. 15-1945 (4th Cir. Oct. 20, 2015) (providing statistics on Maryland trustees’ workloads).

¹⁴⁷See Lupica, supra note 30, at 63-65 (discussing the rates of pro se bankruptcy filers).

¹⁴⁸See, e.g., Edwards, 539 B.R. at 366 (noting the judge “cannot recall a single pro se debtor who has managed [to object to a proof of claim] in 16 years on the bench.”); Amicus Brief in Support of Plaintiffs-Appellants Arguing for Reversal in All Three Cases, Owens v. LVNV Funding, LLC, Nos. 15-2044, 15-2082 and 15-2109 (7th Cir. Dec. 11, 2015) (explaining that pro se debtors likely do not even get notification that a time-barred claim is filed).

¹⁴⁹See LaGrone, 525 B.R. at 427; but see Edwards, 539 B.R. at 366 (describing cases in which debtors are directly affected by the filing of stale claims).

¹⁵⁰See, e.g., In re White, No. 14-03109-5-SWH, 2016 WL 1125640, at *5 (Bankr. E.D.N.C. Mar. 21, 2016), judgment entered, No. 14-03109-5-SWH, 2016 WL 1106610 (Bankr. E.D. N.C. Mar. 21, 2016) (“Having once again encountered the “stale claim problem,” the court is left in the unfortunate posi-

tion of understanding and empathizing with the debtor’s plight, while being unable to provide more of a remedy than disallowing the claim on the bases alleged and in light of the posture of this proceeding.”).

¹⁵¹Fed. R. Bankr. P. 9011(b)(1).

¹⁵²Fed. R. Bankr. P. 9011(b)(2).

¹⁵³Matter of Sekema, 523 B.R. 651, 654 (Bankr. N.D. Ind. 2015); see also Matter of Leeds Bldg. Products, Inc., 181 B.R. 1006, 1010, 27 Bankr. Ct. Dec. (CRR) 239 (Bankr. N.D. Ga. 1995) (collecting authority).

¹⁵⁴11 U.S.C.A. § 105(a) (Bankruptcy Courts have the power to issue “any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]” and may, “sua sponte, tak[e] any action or mak[e] any determination necessary or appropriate . . . to prevent an abuse of process.”). See also Simmons, 622 F.3d at 96 (noting that the possible remedies “include revocation of fraudulent proofs of claim and the court’s contempt power”); B-Real, LLC, 399 B.R. at 240-41.

¹⁵⁵In re Icenhower, 406 B.R. 42 (Bankr. S.D. Cal. 2009), aff’d in part, vacated in part, remanded, 474 B.R. 907 (S.D. Cal. 2012), aff’d, 567 Fed. Appx. 517 (9th Cir. 2014) (applying section 105 to address litigation tactics that multiply proceedings), aff’d in part, vacated in part on other grounds, remanded, 474 B.R. 907 (S.D. Cal. 2012).

¹⁵⁶In re Brannan, 485 B.R. 443, 454 (Bankr. S.D. Ala. 2013) (holding that section 105 powers could be used to address pervasive “robo-signing” practices); see also In re Parsley, 384 B.R. 138, 173 (Bankr. S.D. Tex. 2008) (discussing the use of section 105 to address pervasive mistakes in mortgage servicers’ filings, and noting that the fact that other parties to the case do not typically object “counsels in favor of this court . . . becoming more . . . involved.”).

¹⁵⁷See Fed. R. Bankr. P. 9011(c) (requiring requests for sanctions to be made by separate motion and to comply with the “safe harbor” procedure of Rule 9011(c)(1)(A)); In re Edwards, 539 B.R. at 367 (dismissing request for sanctions for failure to comply with these procedural requirements).

¹⁵⁸See, e.g., In re Edwards, 539 B.R. at 367 (“[G]iven the split of authority in this circuit and elsewhere discussed above, there is no basis for sanctioning the defendants for filing their proofs of claim in this case in any event.”); In re Freeman, 540 B.R. 129, 144 (Bankr. E.D. Pa. 2015) (“[G]iven the split in the case law, it is difficult to see how sanctions under Rule 9011(b)(2) can be imposed on claimants filing stale proofs of claim.”).

¹⁵⁹See, e.g., Keeler v. PRA Receivables Mgmt., LLC (In re Keeler), 440 B.R. 354, 366-67 (Bankr. E.D. Pa. 2009).

¹⁶⁰See, e.g., Keeler, 440 B.R. at 366-67.

¹⁶¹To avoid chilling the filing of valid claims for which a question on the statute of limitations is present, Section 501 could, for example, require creditors who submit proofs of claim have a good faith belief that claim is allowable.

¹⁶²See, e.g., Opening Brief for Patricia Ann Broadrick at 26-28, *Broadrick v. LVNV Funding, LLC*, No. 16-5042 (6th Cir. Apr. 15, 2016); Consoli-

dated Opening Brief and Required Short Appendix for Plaintiffs-Appellants at 30-34, *Owens v. LVNV Funding, LLC*, Nos. 15-2044, 15-2082 and 15-2109 (7th Cir. Dec. 11, 2015).

¹⁶³See supra note 112.

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Declined to Follow by [In re Robinson](#), Bankr.W.D.La., July 28, 2016

828 F.3d 749

United States Court of Appeals,
Eighth Circuit.

Domick Nelson, Plaintiff–Appellant

v.

Midland Credit Management,
Inc., Defendant–Appellee.

National Association of [Consumer Bankruptcy Attorneys](#), Amicus on Behalf of Appellant(s)
ACA International, Amicus on Behalf of Appellee(s)

No. 15-2984

|
Submitted: March 15, 2016

|
Filed: July 11, 2016

|
Rehearing and Rehearing En Banc Denied September 15, 2016

Synopsis

Background: After bankruptcy court disallowed as untimely the proof of claim filed by debt collector in debtor's Chapter 13 bankruptcy proceeding, debtor brought action against the debt collector, alleging the collector violated the Fair Debt Collection Practices Act (FDCPA) by filing the proof of claim on a time-barred debt. The United States District Court for the Eastern District of [Missouri](#), [E. Richard Webber, J.](#), 2015 WL 5093437, dismissed for failure to state a claim. Debtor appealed.

[Holding:] The Court of Appeals, [Benton](#), Circuit Judge, held that debt collector's filing of a time-barred proof of claim in debtor's Chapter 13 proceeding was not false, deceptive, misleading, unfair, or unconscionable under the FDCPA.

Affirmed.

West Headnotes (5)

[1] **Federal Courts**

[Pleading](#)

Court of Appeals reviews de novo a dismissal for failure to state a claim. [Fed. R. Civ. P. 12\(b\)\(6\)](#).

[Cases that cite this headnote](#)

[2] **Federal Courts**

[Dismissal for failure to state a claim](#)

In reviewing the grant of a motion to dismiss for failure to state a claim, the Court of Appeals assumes as true all factual allegations in the pleadings, interpreting them most favorably to the nonmoving party. [Fed. R. Civ. P. 12\(b\)\(6\)](#).

[Cases that cite this headnote](#)

[3] **Federal Civil Procedure**

[Insufficiency in general](#)

Federal Civil Procedure

[Matters deemed admitted; acceptance as true of allegations in complaint](#)

A complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face and, thereby, survive a motion to dismiss for failure to state a claim. [Fed. R. Civ. P. 12\(b\)\(6\)](#).

[Cases that cite this headnote](#)

[4] **Antitrust and Trade Regulation**

[Practices prohibited or required in general](#)

Antitrust and Trade Regulation

[Communications, representations, and notices; debtor's response](#)

Even if a debt collector does not make express misrepresentations, the Fair Debt Collection Practices Act (FDCPA) bars a debt collector

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from filing or threatening a lawsuit to collect a time-barred debt. Fair Debt Collection Practices Act, § 807, 15 U.S.C.A. § 1692e(2)(A), (5).

[2 Cases that cite this headnote](#)

[5] **Antitrust and Trade Regulation**

🔑 Practices prohibited or required in general

Bankruptcy

🔑 Time for Filing

Debt collector's filing of a time-barred proof of claim in debtor's Chapter 13 bankruptcy proceeding was not false, deceptive, misleading, unfair, or unconscionable under the Fair Debt Collection Practices Act (FDCPA); although FDCPA prohibited debt collector from filing or threatening a lawsuit to collect a time-barred debt, this rule did not extend to time-barred proofs of claim, because there was no need to protect debtors who were already under the protection of the bankruptcy court. Fair Debt Collection Practices Act, §§ 807, 808, 15 U.S.C.A. §§ 1692e, 1692f.

[3 Cases that cite this headnote](#)

*750 Appeal from United States District Court for the Eastern District of Missouri—St. Louis

Attorneys and Law Firms

Counsel who presented argument on behalf of the appellant and appeared on the brief was [Richard A. Voytas, Jr.](#), of Saint Louis, MO.

Counsel who presented argument on behalf of the appellee was Jason B. Tompkins, of Birmingham, AL. The following attorneys also appeared on the appellee brief; [Joshua C. Dickinson](#), of Omaha, NE., [Shilee T. Mullin](#), of Omaha, NE., [Chase T Espy](#), of Birmingham, AL.

Counsel who presented argument for amicus National Association of Consumer Bankruptcy Attorneys on behalf of appellant(s) was [Daniel Luke Geysler](#), of Los Angeles, CA. The following attorneys also appeared on the amicus brief; [Peter K. Stris](#), of Los Angeles, CA., [Tara A. Twomey](#), of San Jose, CA.

The following attorney appeared on the amicus brief of ACA International on behalf of appellee(s); [Brian Melendez](#), of Minneapolis, MN.

Before [WOLLMAN](#), [BENTON](#), and [SHEPHERD](#), Circuit Judges.

Opinion

[BENTON](#), Circuit Judge.

In November 2006, Domick R. Nelson defaulted on a consumer debt of \$751.87. On February 25, 2015, she filed a Chapter 13 petition in bankruptcy court. Midland Credit Management, Inc., as agent for the creditor, filed a proof of claim in bankruptcy court for the amount of the debt. According to the proof of claim, Nelson made no payment on the debt after November 2006. Nelson objected to the proof of claim, arguing it was time-barred. *See* § 516.120(1) RSMo 2000; *Discovery Grp. LLC v. Chapel Dev., LLC*, 574 F.3d 986, 990 (8th Cir. 2009) (recognizing that Missouri statutes of limitations are procedural, not substantive, and merely suspend the remedy without extinguishing the right). The bankruptcy court agreed, disallowing Midland's claim. *See* 11 U.S.C. § 558 (including statutes of limitation as a defense for a bankruptcy estate).

Nelson then sued Midland, alleging that, by filing the proof of claim on the time-barred debt, Midland violated the Fair Debt Collection Practices Act (FDCPA). *751 The district court¹ dismissed for failure to state a claim, holding that the FDCPA is not implicated by a debt collector filing an accurate and complete claim on a time-barred debt. Nelson appeals. Having jurisdiction under 28 U.S.C. § 1291, this court affirms.

¹ The Honorable E. Richard Webber, United States District Judge for the Eastern District of Missouri.

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[1] [2] [3] This court reviews de novo the Rule 12(b) (6) dismissal of Nelson's claims. *Cox v. Mortgage Elec. Registration Sys., Inc.*, 685 F.3d 663, 668 (8th Cir. 2012). This court assumes as true all factual allegations in the pleadings, interpreting them most favorably to Nelson, the nonmoving party. *Bell v. Pfizer, Inc.*, 716 F.3d 1087, 1091 (8th Cir. 2013). “[A] complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face.” *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009).

“Enacted to eliminate abusive debt collection practices, the FDCPA imposes civil liability on debt collector[s] for certain prohibited debt collection practices.” *Hemmingsen v. Messerli & Kramer, P.A.*, 674 F.3d 814, 817 (8th Cir. 2012) (alteration in original). Nelson alleges that Midland's claim violated three prohibitions in the FDCPA: “engag[ing] in any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt,” 15 U.S.C. § 1692d; “us[ing] any false, deceptive, or misleading representation or means in connection with the collection of any debt,” § 1692e; and “us[ing] unfair or unconscionable means to collect or attempt to collect any debt,” § 1692f. Because each of these allegations stem from the same conduct—the filing of the proof of claim—this court may consider the provisions together. See *Hemmingsen*, 674 F.3d at 817.

[4] More specifically, under the FDCPA, a debt collector may neither falsely represent “the character, amount, or legal status of any debt,” 15 U.S.C. § 1692e(2)(A), nor threaten “to take any action that cannot legally be taken or that is not intended to be taken,” *id.* § 1692e(5). Nelson argues that Midland, by submitting its claim, represented that the claim was valid and enforceable. See 11 U.S.C. § 502(a) (“A claim or interest ... is deemed allowed, unless a party in interest ... objects.”). Even if—as here—the debt collector does not make express misrepresentations, the FDCPA bars a debt collector from filing or threatening a lawsuit to collect a time-barred debt. See *Freyermuth v. Credit Bureau Servs., Inc.*, 248 F.3d 767, 771 (8th Cir. 2001) (“[I]n the absence of a threat of litigation or actual litigation, no violation of the FDCPA has occurred when a debt collector attempts to collect on a potentially time-barred debt that is otherwise valid.”).

[5] Nelson urges this court to follow the Eleventh Circuit and extend to bankruptcy claims the rule against actual or threatened litigation on time-barred debts. See *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254 (11th Cir. 2014); see also *Johnson v. Midland Funding, LLC*, 823 F.3d 1334, 1338–39, 2016 WL 2996372, at *3 (11th Cir. May 24, 2016) (clarifying *Crawford* by holding that the Bankruptcy Code does not preempt the FDCPA). In *Crawford*, the Eleventh Circuit held that knowingly filing a time-barred proof of claim violated the FDCPA's prohibitions against unfair, unconscionable, deceptive, or misleading conduct. 758 F.3d at 1261. The *Crawford* court reasoned that the same concerns underlying the rule against litigating *752 or threatening to litigate time-barred debts—the debtor's faded memory and lost records, possible ignorance of the statute of limitations, and expense to contest the stale debt—apply equally to a debt collector filing a claim on a stale debt. *Id.*

Crawford, however, ignores the differences between a bankruptcy claim and actual or threatened litigation. In *Freyermuth*, this court held that a defendant's FDCPA liability turns on “whether an unsophisticated consumer would be harassed, misled or deceived by” the debt collector's acts. *Freyermuth*, 248 F.3d at 771. The bankruptcy process protects against such harassment and deception. Unlike defendants facing a collection lawsuit, a bankruptcy debtor is aided by “trustees who owe fiduciary duties to all parties and have a statutory obligation to object to unenforceable claims.” *In re Gatewood*, 533 B.R. 905, 909 (8th Cir. BAP 2015); see 11 U.S.C. §§ 704(a)(5), 1302 (b)(1) (outlining trustees' duties, including objecting “to the allowance of any claim that is improper”).

Defending a lawsuit to recover a time-barred debt is more burdensome than objecting to a time-barred proof of claim. “[T]he Bankruptcy Code provides for a claims resolution process involving an objection and a hearing to assess the amount and validity of the claim ... [that] is generally a more streamlined and less unnerving prospect for a debtor than facing a collection lawsuit.” *In re Gatewood*, 533 B.R. at 909. Because a proof of claim does not expand the pool of available funds in bankruptcy, debtors have less at stake than a collection defendant. Rather, an unsecured creditor likely shares only “pro rata in the distribution of the pool of available funds and see[s] the unpaid portion of its claim discharged.” *Id.*

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These protections against harassment and deception satisfy the relevant concerns of the FDCPA. “There is no need to protect debtors who are already under the protection of the bankruptcy court, and there is no need to supplement the remedies afforded by bankruptcy itself.” *Simmons v. Roundup Funding, LLC*, 622 F.3d 93, 96 (2d Cir. 2010) (so stating while rejecting an FDCPA suit even where the proof of claim was inaccurate and inflated).

This court rejects extending the FDCPA to time-barred proofs of claim. An accurate and complete proof of claim

on a time-barred debt is not false, deceptive, misleading, unfair, or unconscionable under the FDCPA. The district court properly dismissed for failure to state a claim.

* * * * *

The judgment is affirmed.

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Owens v. LVNV Funding, LLC, 832 F.3d 726 (2016)

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Petition for Certiorari Docketed by [ALPHONSE D. OWENS, ET AL.](#)
v. [LVNV FUNDING, LLC, ET AL.](#), U.S., September 12, 2016
832 F.3d 726
United States Court of Appeals,
Seventh Circuit.

Alphonse D. Owens, Plaintiff–Appellant,
v.
[LVNV Funding, LLC](#), Defendant–Appellee.
Tia Robinson, Plaintiff–Appellant,
v.
eCast Settlement Corp., et
al., Defendants–Appellees.
Joshua Birtchman, Plaintiff–Appellant,
v.
[LVNV Funding, LLC](#), et al., Defendants–Appellees.

Nos. 15-2044, 15-2082, 15-2109
|
Argued June 1, 2016
|
Decided August 10, 2016

Synopsis

Background: In each of three separate cases, Chapter 13 debtors sued debt collectors in federal court for filing proofs of claim for “stale” or time-barred debts in alleged violation of the Fair Debt Collection Practices Act (FDCPA). In first case, the United States District Court for the Northern District of Illinois, [Manish S. Shah, J., 2015 WL 494626](#), granted debt collector's motion to dismiss. In second and third cases, the United States District Court for the Southern District of Indiana, Jane E. Magnus-Stinson, J., [2015 WL 1826005](#) and [2015 WL 1825970](#), also granted debt collector's motion to dismiss. Appeals were taken, and cases were consolidated.

Holdings: The Court of Appeals, [Flaum](#), Circuit Judge, held that:

[1] term “claim” as used in the Bankruptcy Code does not include only legally enforceable obligations, and so the act

of filing a proof of claim on a stale debt is not per se illegal under the FDCPA, and

[2] debt collectors' conduct in filing proofs of claim on stale debt in bankruptcy was not misleading, deceptive, unfair, or otherwise abusive under the FDCPA.

Affirmed.

[Wood](#), Chief Judge, filed dissenting opinion.

West Headnotes (13)

[1] **Federal Courts**

 [Pleading](#)

Federal Courts

 [Dismissal for failure to state a claim](#)


Court of Appeals reviews a dismissal for failure to state a claim de novo, accepting well-pleaded allegations in the complaint as true and drawing all reasonable inferences in the light most favorable to the plaintiffs. [Fed. R. Civ. P. 12\(b\)\(6\)](#).

[Cases that cite this headnote](#)

[2] **Antitrust and Trade Regulation**

 [Practices prohibited or required in general](#)

Bankruptcy

 [Claims allowable;what constitutes ‘claim.’](#)

Bankruptcy

 [Contingent or Unliquidated Claims](#)

Bankruptcy

 [Who May File](#)

Term “claim,” as used in the Bankruptcy Code, does not include only legally enforceable obligations, and so filing a proof of claim on a stale debt is not per se misleading or deceptive under the Fair Debt Collection Practices Act (FDCPA); two enumerated

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examples of “claims,” namely, contingent and unmatured claims, afford the creditor no collection right under state law when the claim is filed with the bankruptcy court, and the procedures established by the Code, including filing of proof of claim, opportunity to object, and required disclosure of status and origin of debt on proof of claim form, indicate that the Code contemplates that creditors will file proofs of claim for unenforceable debts, including stale debts, and that the bankruptcy court will disallow those claims upon the debtor’s objection. 11 U.S.C.A. §§ 101(5)(A), 502(b); Consumer Credit Protection Act § 802, 15 U.S.C.A. § 1692; Fed. R. Bankr. P. 3001(a), 3001(c)(3).

Cases that cite this headnote

[3] Limitation of Actions

➡ Operation as to rights or remedies in general

In most jurisdictions, including Illinois and Indiana, expiration of the statute of limitations period does not extinguish the underlying debt; in other words, a time-barred debt is still a debt, even if the creditor cannot file a collection suit.

1 Cases that cite this headnote

[4] Bankruptcy

➡ Claims allowable;what constitutes ‘claim.’

“Claim” in bankruptcy is more extensive than the existence of a cause of action that entitles an entity to bring suit. 11 U.S.C.A. § 101(5) (A).

Cases that cite this headnote

[5] Bankruptcy

➡ Limitations and time to sue; computation

Bankruptcy

➡ Claims allowable;what constitutes ‘claim.’

Bankruptcy Code specifically enumerates statutes of limitation as one means of proving the unenforceability of a claim. 11 U.S.C.A. § 558.

Cases that cite this headnote

[6] Bankruptcy

➡ Debts not scheduled or listed

Debts that are not brought to the bankruptcy court’s attention, either by the Chapter 13 debtor or by the creditor who files a proof of claim, will not be discharged. 11 U.S.C.A. § 1328(a).

Cases that cite this headnote

[7] Bankruptcy

➡ Effect of Discharge

Debt that is not discharged in bankruptcy remains collectible, although the avenues for collection are limited.

Cases that cite this headnote

[8] Limitation of Actions

➡ Renewal or revival of cause of action

Limitation of Actions

➡ Renewal or revival of cause of action

Under Illinois law, the statute of limitations period for a stale debt can be restarted by the debtor’s conduct, such as by making a payment on or promising to pay the debt. 735 Ill. Comp. Stat. Ann. § 5/13-206.

Cases that cite this headnote

[9] Bankruptcy

➡ Particular Debts or Liabilities

Bankruptcy

➡ Effect of Discharge

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Debtor who alerts the bankruptcy court to the existence of a time-barred debt or who objects to a proof of claim on a stale debt would secure a full discharge of the debt, without any fear of it returning on some future occasion.

Cases that cite this headnote

[10] **Bankruptcy**

☞ Summary allowance;necessity for objection

Bankruptcy

☞ Effect

When debtors fail to object to a proof of claim for a stale debt, the debt becomes part of the confirmed bankruptcy plan and the debtor is required to pay a portion of it.

Cases that cite this headnote

[11] **Antitrust and Trade Regulation**

☞ Practices prohibited or required in general

Bankruptcy

☞ Who May File

Debt collectors' conduct in filing proofs of claim on stale debt in Chapter 13 debtors' bankruptcy cases was not misleading, deceptive, unfair, or otherwise abusive under the Fair Debt Collection Practices Act (FDCPA); the proofs of claim were required to inform debtors about ages and origins of the debts, the proofs of claim set forth accurate and complete information about the status of the debts, debtors were represented by counsel at all stages of their bankruptcy proceedings, with the information contained in the proofs of claim a reasonably competent lawyer would have had no trouble evaluating whether the subject debts were timely, and debtors' attorneys were in fact able to secure complete discharge of the time-barred debts in debtors' bankruptcy proceedings without undue cost or burden. 11 U.S.C.A. § 101(5)

(A); Consumer Credit Protection Act § 802, 15 U.S.C.A. § 1692; Fed. R. Bankr. P. 3001.

Cases that cite this headnote

[12] **Antitrust and Trade Regulation**

☞ Communications, representations, and notices;debtor's response

“Unsophisticated consumer” standard is not appropriate when evaluating whether communications made to a debtor's lawyer violated the Fair Debt Collection Practices Act (FDCPA); rather, court should evaluate whether the communications would be likely to mislead a competent lawyer. Consumer Credit Protection Act § 802, 15 U.S.C.A. § 1692.

1 Cases that cite this headnote

[13] **Antitrust and Trade Regulation**

☞ Practices prohibited or required in general

Any debt collection practice that misleads an unsophisticated consumer to believe a time-barred debt is legally enforceable violates the Fair Debt Collection Practices Act (FDCPA). Consumer Credit Protection Act § 802, 15 U.S.C.A. § 1692.

1 Cases that cite this headnote

*728 Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division. No. 1:14-cv-02083—**Jane E. Magnus-Stinson**, *Judge*.
Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 1:14-cv-08277—**Manish S. Shah**, *Judge*.
Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division. No. 1:14-cv-00713—**Jane E. Magnus-Stinson**, *Judge*.

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Attorneys and Law Firms

David P. Leibowitz, Attorney, Allen Chern Law LLC, Chicago, IL, for Plaintiff–Appellant (Case No. 15–2044).

Jeanine Kerridge, Attorney, Barnes & Thornburg LLP, Indianapolis, IN, John P. Boyle, Esq., Attorney, Moss & Barnett, PA, Minneapolis, MN, for Defendant–Appellee (Case No. 15–2044).

David J. Philipps, Attorney, Philipps & Philipps, Palos Hills, IL, for Plaintiff–Appellant (Case No. 15–2082).

Rosa M. Tumialan, Attorney, Dykema Gossett PLLC, Joel D. Bertocchi, David M. Schultz, Corinne C. Heggie, Attorneys, Hinshaw & Culbertson LLP, Chicago, IL, for Defendants–Appellees (Case No. 15–2082).

Thomas Bradburn, Attorney, Bradburn Law Firm, Noblesville, IN, Daniel Luke Geyser, Esq., Peter K. Stris, Attorneys, Stris & Maher LLP, Los Angeles, CA, for Plaintiff–Appellant (Case No. 15–2109).

Joel D. Bertocchi, Nabil G. Foster, David M. Schultz, Attorneys, Hinshaw & Culbertson LLP, Chicago, IL, Jennifer J. Kalas, Attorney, Hinshaw & Culbertson LLP, Schererville, IN, for Defendants–Appellees (Case No. 15–2109).

*729 David S. Yen, Attorney, LAF, Chicago, IL, for Amicus Curiae Legal Assistance Foundation.

Donald S. Maurice, Jr., Attorney, Maurice Wutscher, LLP, Flemington, NJ, Daniel Nora, Attorney, Maurice Wutscher LLP, Chicago, IL, for Amicus Curiae National Creditors Bar Association.

Before Wood, Chief Judge, and Bauer and Flaum, Circuit Judges.

Opinion

Flaum, Circuit Judge.

In each of these consolidated cases, a debt collector filed a proof of claim, defined as “a written statement setting forth a creditor’s claim,” Fed. R. Bankr. P. 3001(a), for a time-barred debt in a Chapter 13 bankruptcy proceeding. After successfully objecting to the proof of claim, the

debtor sued the debt collector in federal court, alleging that the act of filing a proof of claim on a stale debt violates §§ 1692e and 1692f of the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692 *et seq.* (“FDCPA”). In each case, the district court granted the defendant debt collector’s motion to dismiss. For the reasons that follow, we affirm those decisions.

I. Background

The three consolidated cases currently before us are similar in material respects. In each case, a debtor filed for bankruptcy under Chapter 13 of the Bankruptcy Code.¹ The debtor was represented by counsel throughout the proceedings. In addition, a trustee was assigned to the case.

¹ The plaintiff-debtors are Alphonse D. Owens, Tia Robinson, and Joshua Birtchman.

During the bankruptcy proceedings, a debt collector submitted a proof of claim for a “stale” debt, or a debt for which the statute of limitations had expired.² The debt collector was not the original creditor, but instead a professional debt buyer who had purchased the stale obligation at a fraction of the debt’s face value. As required by Federal Rule of Bankruptcy Procedure 3001, the proof of claim filed by the debt collector accurately noted the origin of the debt, the date of the last payment on the debt, and the date of the last transaction.

² The defendant-debt collectors are LVNV Funding, LLC and eCast Settlement Corporation.

Realizing that the debt was time-barred and thus subject to an affirmative defense, the debtor objected to the claim, which was disallowed and eventually discharged. Shortly thereafter, the debtor brought a separate suit in federal court against the debt collector, alleging that the act of filing a proof of claim on a time-barred debt constituted a false, deceptive, misleading, unfair, or unconscionable means of collecting a debt in violation of §§ 1692e and 1692f of the FDCPA.

In each case, the district court granted defendant’s motion to dismiss under Federal Rule of Civil Procedure 12(b)(6).

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Two of the decisions—*Owens* and *Birtchman*—involved the same defendant and were decided on the same day by the same district court judge. In those decisions, the district court rejected the argument that the act of filing a proof of claim was deceptive or unfair, noting that the defendant was entitled to do so under the Bankruptcy Code. The district court also observed that defendant's proof of claim was complete, accurate, and provided the date of the final payment; as such, the court concluded that the proof of claim was not false or misleading.

In *Robinson*, the district court likewise dismissed the plaintiff's complaint under Rule 12(b)(6), holding that filing a proof of claim on a time-barred debt was not a deceptive, false, or misleading debt collection practice. The plaintiff then filed an *730 amended complaint in which she added additional allegations under the FDCPA. The district court dismissed the amended complaint as well, holding that the confirmation of plaintiff's bankruptcy plan barred her FDCPA claims under the doctrine of res judicata. The plaintiffs in all three cases appeal.

II. Discussion

Plaintiffs contend that the district courts erred by granting defendants' motions to dismiss. They maintain that filing a proof of claim on a stale debt misleads the debtor about the legal status of the debt and thus violates the FDCPA's prohibition against false, deceptive, misleading, unfair, and unconscionable debt collection practices.³ Their argument has two components. First, plaintiffs allege that the act of filing a proof of claim on a time-barred debt is inherently misleading because “claim” is defined to include only legally enforceable obligations. In other words, plaintiffs contend that because the claim process in bankruptcy is reserved for enforceable obligations, filing a proof of claim on a stale debt falsely cloaks the underlying obligation with an air of legitimacy. Second, plaintiffs contend that filing a stale proof of claim is deceptive because, in practice, the debtor and his attorney sometimes fail to object to the claim, allowing the debt collector to collect on an unenforceable obligation. Plaintiffs rely on our case law holding that the FDCPA prohibits creditors from filing lawsuits to collect on stale

debts. *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013). They allege that the rationale for this holding also applies in the bankruptcy context.

³ The FDCPA prohibits the use of “any false, deceptive, or misleading representation or means in connection with the collection of any debt.” § 1692e. The Act also prohibits the use of “unfair or unconscionable means to collect or attempt to collect any debt.” § 1692f.

[1] We review a dismissal under Rule 12(b)(6) de novo, accepting well-pleaded allegations in the complaint as true and drawing all reasonable inferences in the light most favorable to the plaintiffs. *Parish v. City of Elkhart*, 614 F.3d 677, 679 (7th Cir. 2010).

A. Definition of “Claim”

[2] As an initial matter, we disagree with plaintiffs' assertion that the term “claim” includes only legally enforceable obligations, and that filing a proof of claim on a stale debt is therefore per se illegal under the FDCPA. The Bankruptcy Code broadly defines a “claim” as a “right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured[.]” 11 U.S.C. § 101(5)(A). It would be strange to interpret “claim” as excluding legally unenforceable obligations when two of the enumerated examples—“contingent” and “unmatured” claims—afford the creditor no collection right under state law when the claim is filed with the bankruptcy court.⁴ See, e.g., *In re Chi., Milwaukee, St. Paul & Pac. R.R. Co.*, 6 F.3d 1184, 1192 (7th Cir. 1993) (noting that contingent *731 claims exist even before a cause of action has accrued).

⁴ The dissent disagrees with our reliance on this statutory language. Although the dissent is correct that the statutory definition of claim does not explicitly include time-barred debts, the list is not exhaustive, and instead sets forth examples of the types of debts that could constitute a claim. Our point is not that time-barred debts fit neatly into any of these categories (although they are in fact contingent, as certain actions by the debtor can restart the statute of limitations period even after it has run, see note

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6 *infra*). Instead, we observe that by including these examples, the broad statutory definition of claim undermines plaintiffs' argument that a claim includes only legally enforceable obligations.

[3] Moreover, a “claim” is defined as a right to payment. § 101(5)(A). In most jurisdictions, including Illinois and Indiana, the expiration of the statute of limitations period does not extinguish the underlying debt. See *Mascot Oil Co. v. United States*, 42 F.2d 309, 311 (Ct. Cl. 1930), *aff'd*, 282 U.S. 434, 51 S.Ct. 196, 75 L.Ed. 444 (1931) (“[T]he statute of limitations or other bar against a remedy for the collection of a debt does not extinguish the liability therefor.”); *Donaldson v. LVNV Funding, LLC*, 97 F.Supp.3d 1033, 1039 (S.D. Ind. 2015) (“It is true that [the creditor] cannot file a lawsuit, but it is the law in Indiana that the debt is still owed. The statute of limitations does not extinguish the debt, it merely limits avenues of collection.”); *Fleming v. Yeazel*, 379 Ill. 343, 40 N.E.2d 507, 508 (1942) (“[T]he statute of limitations controls the remedy for recovery of the debt, but the debt remains the same as before, excepting that the remedy for enforcement is gone.” (citation omitted)). In other words, a time-barred debt is still a debt, even if the creditor cannot file a collection suit. See *Pearl-Phil GMT (Far E.) Ltd. v. Caldor Corp.*, 266 B.R. 575, 581 (S.D.N.Y. 2001) (“Thus, under the Code, a right to payment need not be currently enforceable in order to constitute a claim.”). We have also held that the fact that the statute of limitations has run does not mean that all avenues of collection are prohibited. See *McMahon v. LVNV Funding*, 744 F.3d 1010, 1020 (7th Cir. 2014) (holding that it is not “automatically improper for a debt collector to seek re-payment of time-barred debts” so long as the debt collector does not use deceptive practices). Implicit in this holding is the understanding that a creditor with a stale debt retains some right to payment, even if recourse is only grounded in the debtor's moral obligation to pay. *Id.* (observing that “some people might consider full debt re-payment a moral obligation, even though the legal remedy for the debt has been extinguished”).

[4] [5] Therefore, a “claim” in bankruptcy is “more extensive than the existence of a cause of action that entitles an entity to bring suit.” *In re Keeler*, 440 B.R. 354, 362 (Bankr. E.D. Pa. 2009) (citing *In re Remington Rand Corp.*, 836 F.2d 825, 831–32 (3d Cir. 1988)); *In re Grossman's*, 607 F.3d 114, 121 (3d Cir. 2010) (holding

that a “claim” can exist in bankruptcy notwithstanding an inability to commence an action under state law at the time of filing). Further support for this interpretation comes from the claim allowance process set forth in the Bankruptcy Code, which has been described as a “sifting process.” *Gardner v. New Jersey*, 329 U.S. 565, 573, 67 S.Ct. 467, 91 L.Ed. 504 (1947); see also *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 449, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007) (describing the claim allowance process). Once a debtor files for bankruptcy, a bankruptcy estate is created that consists of “all legal or equitable interests of the debtor....” 11 U.S.C. §§ 541(a)(1); 1306(b). A creditor who wishes to collect on a debt may file a proof of claim, or “a written statement setting forth a creditor's claim.” *Fed. R. Bankr. P. 3001(a); Travelers*, 549 U.S. at 449, 127 S.Ct. 1199 (“When a debtor declares bankruptcy, each of its creditors is entitled to file a proof of claim....”). A proof of claim “constitute[s] prima facie evidence of the validity and the amount of the claim,”⁵ but not all claims are entitled *732 to payment. *Fed. R. Bankr. P. 3001(f)*. Importantly, the bankruptcy court must, upon an objection by a party in interest, disallow any claim that “is unenforceable against the debtor ... under any agreement or applicable law [.]” 11 U.S.C. § 502(b)(1). Furthermore, the Code specifically enumerates statutes of limitation as one means of proving the unenforceability of a claim. § 558; see also *In re Keeler*, 440 B.R. at 360 (“Therefore, if as of the date of the debtor's bankruptcy filing a creditor's claim was barred by the applicable statute of limitations, then the claim must be disallowed upon objection by a party in interest.”).

5 In addition, a creditor who files a proof of claim certifies that the claim is “not being presented for any improper purpose” and is “warranted by existing law....” *Fed. R. Bankr. P. 9011(b)(1), (2)*. Sanctions are available for violations of this rule. See *In re Volpert*, 110 F.3d 494, 501 n.11 (7th Cir. 1997); see also 11 U.S.C. § 105(a) (providing that a bankruptcy court has inherent power to impose sanctions). During oral argument, plaintiffs contended for the first time that defendants' conduct was eligible for sanctions and that the FDCPA applies to sanctionable conduct. Although at least one bankruptcy court has imposed sanctions on a debtor who filed a proof of claim on a time-barred debt, others have refused to do so, and this Court

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has not yet ruled on the propriety of sanctioning a debt collector who engages in the type of conduct at issue in these cases. Compare *In re Sekema*, 523 B.R. 651, 655 (Bankr. N.D. Ind. 2015) (imposing a \$1,000 sanction against a debt collector that filed time-barred proofs of claim), with *In re Keeler*, 440 B.R. at 366–67 (“Given that section 501(a) authorizes every creditor holding a claim to file a proof of claim, even if that claim is later disallowed under section 502(b), section 105(a) does not state a cause of action to sanction such a filing.”); *In re Simpson*, No. 08–00137, 2008 WL 4216317, at *3 (Bankr. N.D. Ala. Aug. 29, 2008) (holding that the creditor’s act of filing a proof claim on a time-barred debt was not sanctionable under § 105(a)); and *In re Varona*, 388 B.R. 705, 723–24 (Bankr. E.D. Va. 2008) (same); cf. *In re Fesco Plastics Corp.*, 996 F.2d 152, 154 (7th Cir. 1993) (“[W]hen a specific Code section addresses an issue, a court may not employ its equitable powers to achieve a result not contemplated by the Code.”).

[6] [7] [8] [9] Thus, the Bankruptcy Code contemplates that creditors will file proofs of claim for unenforceable debts—including stale debts—and that the bankruptcy court will disallow those claims upon the debtor’s objection. Indeed, filing a proof of claim allows the debt to be processed in the bankruptcy proceeding, which is intended to be all-encompassing. *In re Am. Reserve Corp.*, 840 F.2d 487, 489 (7th Cir. 1988) (“The principal function of bankruptcy law is to determine and implement in a single collective proceeding the entitlements of all concerned.”); *In re Glenn*, 542 B.R. 833, 841 (Bankr. N.D. Ill. 2016) (“Above all, bankruptcy is a collective process, designed to gather together the assets and debts of the debtor and to effect an equitable distribution of those assets on account of the debts. The more participation there is; the better this process works.” (citing *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186, 1194 (7th Cir. 1989))); 1 NORTON BANKR. L. & PRAC. 3d § 3:9 (2016) (“A fundamental principle of the bankruptcy process is the collective treatment of all of a debtor’s creditors at one time.”). In fact, sometimes even Chapter 13 debtors—such as plaintiff Owens—list stale debts in the schedule of unsecured debts that they file with the bankruptcy court. This is because debts that are not brought to the bankruptcy court’s attention (either by the debtor or by the creditor who files a proof of claim) will not be discharged, see 11 U.S.C. § 1328(a), and a debt that is not discharged remains collectible, although the

avenues for collection are limited. See *McMahon*, 744 F.3d at 1020.⁶

6 In fact, the statute of limitations period can be restarted by the debtor’s conduct, such as by making a payment on or promising to pay the debt. See, e.g., 735 Ill. Comp. Stat. 5/13-206. Of course, a debtor who alerts the bankruptcy court to the existence of the time-barred debt or who objects to a proof of claim on a stale debt would secure a full discharge of the debt, without any fear of it returning on some future occasion.

[10] *733 It is true that debtors may fail to object to a proof of claim for a stale debt. When that occurs, the debt becomes part of the confirmed bankruptcy plan and the debtor is required to pay a portion of it. To reduce the risk of this outcome, creditors are required to include details about the status and origin of the debt on the proof of claim form. Fed. R. Bankr. P. 3001(c)(3). The most recent revision to the Federal Rules of Bankruptcy Procedure explains:

Because a claim [based on consumer credit debts] may have been sold one or more times prior to the debtor’s bankruptcy, the debtor may not recognize the name of the person filing the proof of claim. Disclosure of the information required [under Rule 3001(c)(3)] will assist the debtor in associating the claim with a known account. *It will also provide a basis for assessing the timeliness of the claim.*

Fed. R. Bankr. P. 3001, Advisory Committee Notes (emphasis added).

These established procedures—the filing of the proof of claim, the opportunity to object, and the required disclosure on the proof of claim form—confirm that the Bankruptcy Code anticipates that creditors will file proofs of claim on stale debts. Nonetheless, plaintiffs maintain that we should rely on their limited interpretation of “claim.” The only support for their argument comes from a statement made in dicta by the U.S. Supreme Court in *Pennsylvania Department of Public Welfare v. Davenport*,

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495 U.S. 552, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990). In that case, the Court explained that a claim is a “right to payment,” and “a ‘right to payment’ is nothing more nor less than an enforceable obligation....” *Id.* at 559, 110 S.Ct. 2126.

Plaintiffs take this statement out of context. *Davenport* considered whether restitution obligations imposed in state criminal proceedings were “debts” as defined by 11 U.S.C. § 101(11). *Id.* at 558, 110 S.Ct. 2126. Because “debt” is defined as “liability on a claim,” the Court looked to the definition of “claim,” which is defined as a “right to payment.” *Id.* (quoting § 101(4) (A)). The petitioners argued that a restitution order could not represent a “right to payment” because the obligation could only be enforced by threatening to revoke probation, and not in civil proceedings. *Id.* at 558–59, 110 S.Ct. 2126. The Supreme Court rejected petitioners’ argument that the reason for an obligation or the way that it was enforced could take it outside of the statutory definition of “claim.” *Id.* at 560, 110 S.Ct. 2126. In so doing, the Court noted that a right to payment is “nothing more nor less than an enforceable obligation[.]” *Id.* at 559, 110 S.Ct. 2126.

Taken in context, it is apparent that this statement was not intended to address the issue of whether a “claim” includes only enforceable obligations. See *Johnson v. Midland Funding, LLC*, 528 B.R. 462, 466–67 (S.D. Ala. 2015), *rev’d on other grounds*, 823 F.3d 1334 (11th Cir. 2016) (noting that *Davenport* “cannot plausibly be read for the proposition that a ‘right to payment’ ... ceases to exist the moment the statute of limitations expires”). Moreover, the Supreme Court’s treatment of this subject in other cases conflicts with plaintiffs’ interpretation.

The Supreme Court has repeatedly recognized that Congress intended for the term “claim” to have “the broadest possible definition.” *Davenport*, 495 U.S. at 563–64, 110 S.Ct. 2126 (internal quotation marks omitted); see also *FCC v. NextWave Pers. Commc’ns Inc.*, 537 U.S. 293, 302, 123 S.Ct. 832, 154 L.Ed.2d 863 (2003); *Johnson v. Home State Bank*, 501 U.S. 78, 83, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991); *Ohio v. Kovacs*, 469 U.S. 274, 279, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985). In *Home State Bank*, the Supreme Court explored *734 the legislative background and history of the Code in evaluating whether

a mortgage interest could be characterized as a “claim.” *Id.* at 85–87, 111 S.Ct. 2150. The Court observed that unlike the modern Bankruptcy Code, the pre-1978 Code did not contain a single definition for claim, but defined a claim for purposes of corporate reorganizations as “includ[ing] all claims of whatever character against a debtor....” *Id.* at 85, 111 S.Ct. 2150 (alteration in original) (quoting 11 U.S.C. § 506(1) (1976)). The Court noted that in drafting a single definition of “claim” for the 1978 Code, Congress intended to “adop[t] an *even broader* definition of claim than [was] found in the [pre-1978 Act’s] debtor rehabilitation chapters.” *Id.* at 86, 111 S.Ct. 2150 (alterations in original) (quoting H.R. Rep. No. 95-595, at 309 (1977), *reprinted* in 1978 U.S.C.C.A.N. 5963, 6266). Congress also explained: “By this broadest possible definition ... the bill contemplates that all legal obligations of the debtor, *no matter how remote or contingent*, will be able to be dealt with in the bankruptcy case. *It permits the broadest possible relief in the bankruptcy case.*” H.R. Rep. No. 95-595, at 309 (emphasis added). Indeed, since *Davenport*, the Supreme Court has clarified that a “claim” merely *includes* a right to payment, which is nothing more nor less than an enforceable obligation. See *NextWave*, 537 U.S. at 302–03, 123 S.Ct. 832.

We therefore decline to adopt plaintiffs’ limited interpretation of “claim” and hold that a proof of claim on a time-barred debt does not purport to be anything other than a claim subject to dispute in the bankruptcy case. Filing such a proof of claim is not inherently misleading or deceptive.

B. The FDCPA

[11] The fact that the Bankruptcy Code permits creditors to file proofs of claim on stale debts does not conclusively answer the question presented in this case—whether defendants’ conduct violated the FDCPA. See *Randolph v. IMBS, Inc.*, 368 F.3d 726, 731 (7th Cir. 2004) (holding that the Bankruptcy Code did not implicitly repeal the FDCPA). Thus, we must determine whether defendants’ attempts to collect on plaintiffs’ time-barred debts in bankruptcy were false, deceptive, or misleading under the FDCPA.

Plaintiffs argue that defendants’ conduct was deceptive or unfair because their business model depends on the reality

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that the debtor, the trustee, and the debtor's attorney will sometimes fail to object to the stale claims. In other words, plaintiffs contend that creditors take advantage of the fact that the bankruptcy process will sometimes “break down and fail.” Plaintiffs rely on *Phillips v. Asset Acceptance, LLC*, in which we held that filing a state court lawsuit to collect on a time-barred debt violates the FDCPA. 736 F.3d at 1078. In *Phillips*, we explained that suing to collect on an old debt was misleading or deceptive because the consumer might not recall the debt or have evidence to mount a statute of limitations defense; in fact, an unsophisticated consumer might not even be aware of the statute of limitations defense. And “even if the consumer realizes that she can use time as a defense, she will more than likely still give in rather than fight the lawsuit because she must still expend energy and resources and subject herself to the embarrassment of going into court....” *Id.* at 1079 (quoting *Kimber v. Fed. Fin. Corp.*, 668 F.Supp. 1480, 1487 (M.D. Ala. 1987)). Plaintiffs contend that these concerns are likewise present in the bankruptcy context.

There is a circuit split on the issue of whether filing a proof of claim on a stale debt in bankruptcy is a misleading or deceptive act prohibited by the FDCPA. In *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1259–60 (11th Cir. 2014), cert. *735 denied, — U.S. —, 135 S.Ct. 1844, 191 L.Ed.2d 724 (2015), the Eleventh Circuit relied on *Phillips* to hold that it is. The Court reasoned that the act of filing the proof of claim “create[d] the misleading impression to the debtor that the debt collector can legally enforce the debt.” *Id.* at 1261. In so holding, the Eleventh Circuit relied on the “least sophisticated” consumer standard, which asks whether an unsophisticated consumer would be misled by the debt collector's conduct. *Id.*

The Second Circuit reached a different conclusion in *Simmons v. Roundup Funding, LLC*, 622 F.3d 93, 94 (2d Cir. 2010). In that case, the debtor objected to an inflated proof of claim and the bankruptcy court ultimately reduced the claim by more than half. *Id.* at 95. The debtor then sued the creditor in federal court, alleging that the creditor violated the FDCPA by misrepresenting the amount of the debt. *Id.* The district court dismissed the suit and the Second Circuit affirmed. *Id.* The Second Circuit noted that federal district courts across the country have held that the act of filing a proof of

claim in bankruptcy court is not an abusive debt collection practice proscribed by the FDCPA, even if the claim is invalid or unenforceable. *Id.* at 95–96. The Second Circuit reasoned that debtors who are under protection of the bankruptcy court do not need additional protection from debt collectors because the bankruptcy process affords sufficient remedies for abuse. *See id.* at 96.⁷ Recently, the Eighth Circuit relied on *Simmons* when rejecting a plaintiff-debtor's request to extend the FDCPA to time-barred proofs of claim in a case with nearly identical facts to the cases currently before us. *See Nelson v. Midland Credit Mgmt.*, No. 15–2984, 828 F.3d 749, 2016 WL 3672073 (8th Cir. July 11, 2016).

7 At oral argument, plaintiffs contended that the Second Circuit cast doubt on the continuing validity of *Simmons* in *Garfield v. Owen Loan Servicing, LLC*, 811 F.3d 86 (2d Cir. 2016). We disagree. The plaintiff in *Garfield* filed a suit in district court against a creditor who attempted to collect on a debt by threatening foreclosure and sending a delinquency notice, even though the debt had been discharged in the debtor's Chapter 13 bankruptcy. *Id.* at 88. In holding that the plaintiff-debtor had stated a claim for a FDCPA violation, the Second Circuit clarified that the Bankruptcy Code did not implicitly repeal the FDCPA. *Id.* at 91–92 (citing *Randolph*, 368 F.3d at 730). The Second Circuit did not abandon the rationale underlying *Simmons*—that there is less of a need to protect debtors who are protected by the bankruptcy court.

Like the Eighth Circuit, we decline to follow the Eleventh Circuit's approach. *See id.* at 751–52, 2016 WL 3672073 at *2. As an initial matter, we note that the concerns identified in *Phillips* regarding the misleading or deceptive nature of the conduct are less acute when a proof of claim is filed in bankruptcy, especially in a counseled case, as opposed to when a lawsuit is filed in state or federal court.⁸ First, because the proof of claim is required to inform the debtor about the age and origin of the debt, the consumer need not have a memory of it or records documenting it to file an objection—the affirmative defense is evident on the face of the claim. *See* *736 *In re LaGrone*, 525 B.R. 419, 427 (Bankr. N.D. Ill. 2015) (“Under Bankruptcy Rule 3001(c)(3), a claim for credit card debt ... must list the creditor who held the debt at the time of the account holder's last transaction, the

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date of the last transaction, the date of the last payment, and the date the account was charged to profit or loss.... [Therefore,] a debtor in bankruptcy should always have the information needed to determine whether the statute of limitations for a claim has expired.”). Second, as in the cases before us, debtors filing for bankruptcy are usually represented by attorneys who are familiar with the statutes of limitations for different types of debt. Even in other cases, when the debtor proceeds pro se, a bankruptcy trustee who is duty-bound to object to improper claims is appointed to oversee the proceedings. In addition, a debtor who has initiated bankruptcy proceedings and thus demonstrated a willingness to participate in them is unlikely to give in rather than fight the claim.⁹

⁸ The dissent reads *Phillips* and *McMahon* as precluding “any use of legal process” to collect on a stale debt. We do not read those cases as announcing a broad rule of this kind. *Phillips* outlawed lawsuits to collect stale debts, and for the reasons discussed above, we conclude that the rationale for that holding does not apply to the act of filing a proof of claim. The proper inquiry, set forth in *McMahon* and *Evory v. RJM Acquisitions Funding LLC*, for evaluating other types of collection activities employed by debt collectors is whether the collection effort would mislead the recipient of the communication (in the cases before us, the debtor’s lawyer or bankruptcy trustee) into believing that the debt is legally enforceable. See *McMahon*, 744 F.3d at 1020; *Evory v. RJM Acquisitions Funding LLC*, 505 F.3d 769, 774 (7th Cir. 2007).

⁹ Plaintiffs contend that filing objections to time-barred claims burdens the debtor and the bankruptcy court tasked with processing the objections. But the costs associated with objecting to a proof of claim are not substantial, as the objection process is simple. As the National Association of Consumer Bankruptcy Attorneys pointedly acknowledged in their amicus brief supporting plaintiffs’ position, “this sort of motion practice is among the simplest ... that [a consumer bankruptcy attorney] encounters.”

[12] Significantly, the Eleventh Circuit’s decision in *Crawford* is inapposite in light of our precedent. In *Evory v. RJM Acquisitions Funding LLC*, 505 F.3d 769 (7th Cir. 2007), we held that the “unsophisticated consumer” standard is not appropriate when evaluating whether

communications made to a *debtor’s lawyer* violated the FDCPA. *Id.* at 774. Rather, a court should evaluate whether the communications would be likely to mislead a competent lawyer. *Id.* at 775; see also *Bravo v. Midland Credit Mgmt., Inc.*, 812 F.3d 599, 603 (7th Cir. 2016) (reaffirming the “competent attorney” standard).

It is undisputed that plaintiffs were represented by counsel at all stages of their bankruptcy proceedings. Further, as discussed, the bankruptcy process afforded additional protections, including the appointment of trustees who were duty-bound to “examine proofs of claims and object to the allowance of any claim that is improper.” 11 U.S.C. §§ 704(a)(5); 1302(b)(1). Therefore, we must evaluate defendants’ actions under a “competent attorney” standard. *Bravo*, 812 F.3d at 603.

We conclude that, under this standard, defendants’ conduct was not deceptive or misleading. Plaintiffs do not allege that the information contained in the proof of claim was misleading; instead, they admit that the proofs of claim set forth accurate and complete information about the status of the debts. See *Donaldson*, 97 F.Supp.3d at 1038 (“A factual, true statement about the existence of a debt and the amount ... is neither false nor deceptive.”); cf. *Sheriff v. Gillie*, — U.S. —, 136 S.Ct. 1594, 1601, 194 L.Ed.2d 625 (2016) (noting that accurate statements are not false or misleading for purposes of the FDCPA). Therefore, to determine whether the statute of limitations had run, plaintiffs’ attorneys had to look no further than the proof of claim form, which included the date of the most recent payment. With that information, a reasonably competent lawyer would have had no trouble evaluating whether the debt was timely. See *Birtchman v. LVNV Funding, LLC*, No. 1:14-cv-00713, 2015 WL 1825970, at *8 (S.D. Ind. Apr. 22, 2015) (“A competent lawyer would undoubtedly be aware of the statute of limitations defense that is common in most areas of law and permitted by the Bankruptcy *737 Code.”). In sum, plaintiffs have failed to present any evidence that defendants engaged in deceptive, misleading, unfair, or otherwise abusive conduct prohibited by the FDCPA.

We are not unsympathetic to plaintiffs’ concern that in certain cases, debtors and their representatives fail to object to claims for unenforceable debts, which then become part of the bankruptcy plan. This outcome harms

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not only the debtor, who is forced to pay a portion of the stale debt out of limited means, but also creditors with legally enforceable debts whose share of the pie is reduced because an additional creditor is claiming a piece. See *Crawford*, 758 F.3d at 1261. But the risk of this outcome in such cases is not sufficient to support a FDCPA claim in the cases currently before us, where plaintiffs' attorneys successfully objected to proofs of claim that were neither false nor misleading.

[13] The dissent faults us for supposedly ignoring the realities of the bankruptcy process. To be sure, in certain cases, the debtor proceeds pro se and lacks the sophistication to understand that a claim for a stale debt is subject to disallowance, and the trustee does not abide by his statutory duty to review all claims filed in the debtor's case. Respectfully, the dissent attacks a straw man: this opinion does not foreclose relief under the FDCPA in cases involving such facts. We reiterate that any debt collection practice that “misleads an unsophisticated consumer to believe a time-barred debt is legally enforceable” violates the FDCPA. *McMahon*, 744 F.3d at 1020. The dissent decries a problem that is not present here—in these cases, the debtors were represented by attorneys and were able to secure complete discharge of the time-barred debts in their Chapter 13 bankruptcy proceedings without undue cost or burden.

Of course, if defendants had filed proofs of claim with inaccurate information, or had otherwise engaged in deceptive or misleading debt collection practices, plaintiffs would have a cause of action under the FDCPA. See *McMahon*, 744 F.3d at 1020; *Phillips*, 736 F.3d at 1079. But in these cases, the district courts did not err in concluding that plaintiffs had not stated claims for relief under the FDCPA.¹⁰

¹⁰ Because we affirm the district courts' conclusion that defendants' conduct did not violate the FDCPA, we do not address the district court's holding in *Robinson* that a confirmed Chapter 13 plan bars FDCPA claims that could have been filed in the bankruptcy proceeding under the doctrine of res judicata.

III. Conclusion

For the foregoing reasons, the judgments are AFFIRMED.

Wood, Chief Judge, dissenting.

This court held, in *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013), that the Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. §§ 1692 *et seq.*, prohibits a creditor from filing a lawsuit in state court to collect a debt for which the statute of limitations has expired. See also *McMahon v. LVNV Funding*, 744 F.3d 1010, 1020 (7th Cir. 2014). Today, the majority holds that the creditor may take comparable action within a bankruptcy proceeding, by filing a proof of claim on a debt that it knows to be stale—an action the creditor will take knowing that it will result in payment only if the staleness of the debt slips past the debtor, her lawyer (if she has one), and the trustee, and thus become collectible through the bankruptcy court (at the expense of other creditors). They rely on the broad scope of the types of claims that may or must be filed in bankruptcy, on the extra protections they believe bankruptcy affords, *738 and the fact that the type of limitations bar we are considering here cuts off only the right to sue, not the cause of action itself. None of those rationales holds up under close inspection, in my view, and so I dissent.

It is helpful to begin with a brief review of the holdings of *Phillips* and *McMahon*. In *Phillips*, the plaintiff sought to bring a class action against a debt collector that had sued her after the statute of limitations on the underlying creditor's claim had run. If that was true, we said, citing *Huertas v. Galaxy Asset Mgmt.*, 641 F.3d 28, 32–33 (3d Cir. 2011) (per curiam); *Harvey v. Great Seneca Financial Corp.*, 453 F.3d 324, 332–33 (6th Cir. 2006); and *Herkert v. MRC Receivables Corp.*, 655 F.Supp.2d 870, 875–76 (N.D. Ill. 2009), the debt collector's suit violated the FDCPA. We followed up on that statement in *McMahon*. Nothing in *McMahon* suggested that a lawsuit based on a time-barred debt, or even a demand for payment under color of legal right, is permissible, in the absence of an honest disclosure about the creditor's loss of the right to take legal action. Here is what we said:

We do not hold that it is automatically improper for a debt collector to seek re-payment of time-barred debts;

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some people might consider full debt re-payment a moral obligation, even though the legal remedy for the debt has been extinguished. But, as we held in *Phillips, supra*, if the debt collector uses language in its dunning letter that would mislead an unsophisticated consumer into believing that the debt is legally enforceable, regardless of whether the letter actually threatens litigation ..., the collector has violated the FDCPA. Because it is plausible that an unsophisticated consumer would believe a letter that offers to “settle” a debt implies that the debt is legally enforceable, it was correct in *Delgado* to decline to dismiss the action at this stage, and incorrect to dismiss the class allegations in *McMahon*.

The proposition that a debt collector violates the FDCPA when it misleads an unsophisticated consumer to believe a time-barred debt is legally enforceable, regardless of whether litigation is threatened, is straightforward under the statute [citing 15 U.S.C. § 1692e(2)(A), (5)].

744 F.3d at 1020. “Seeking” repayment is one thing: it could be accomplished by a polite, non-threatening letter advising the debtor of the debt's existence, and the fact that a lawsuit is time-barred. At most, the letter would represent an effort to persuade the debtor to pay, based on whatever advantage payment might confer (perhaps a moral advantage, perhaps a boost to one's credit rating). This is in stark contrast with the use of any type of legal process, whether a suit in state court, a suit in federal court, or the filing of a claim in bankruptcy. Those are all an entirely different matter, and nothing in *McMahon* condoned any use of any type of court to collect a concededly stale debt. I take it that my colleagues agree with me that proceedings in bankruptcy court “count” as a form of judicial proceeding, given the fact that the bankruptcy court (a unit of the federal district court, see 28 U.S.C. § 151) presides over the legal process of collecting all good-faith claims against the estate, amassing the assets of the estate, setting priorities, identifying what can and cannot be discharged, and then resolving who can be paid and how much. Unless there is something in the Bankruptcy Code to distinguish the proceedings in bankruptcy court from proceedings in the courts involved in *McMahon* and *Phillips*, that is enough for me to hold that the rule of those cases applies here as well.

The majority finds such a distinction in the definition of the word “claim” in the *739 Bankruptcy Code, which provides that a claim is a “right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured[.]” 11 U.S.C. § 101(5)(A). My colleagues focus particularly on two of the items in this list—“contingent” and “unmatured” claims—as support for their view that a clearly time-barred claim may be submitted by a debt collector consistently with this statute.

Neither of those categories, however, covers a concededly stale debt. A claim based on such a debt is not contingent, because the expiration of the statute of limitations means that a lawsuit to collect it is no longer available. There is no event that could come to pass that could create an enforceable legal obligation for the debtor to pay up—at least no contingency that does not fall within the group of sharp or fraudulent practices that *Phillips* and *McMahon* hold are barred by the FDCPA. It is true that certain actions by the debtor can re-start the statute of limitations after it has run, but the debtor will not take those steps unless she is snookered into thinking that the debt is still legally enforceable. Cf. *Suez v. Med-I Solutions, LLC*, 757 F.3d 636, 639 (7th Cir. 2014) (en banc) (condemning collection tactic of suing in a court that is inconvenient to the debtor, hoping to obtain a default judgment “for a debt that the defendant doesn't actually owe”). We should not distort the meaning of the word “contingent” to include the possibility of the debt collector's successfully tricking the debtor into paying.

A stale debt is certainly not “unmatured.” If anything, it is overripe. Nor does the stale debt fit any other category in section 101(5)(A). I do not disagree with the notion, *ante* at n.4, that the list in section 101(5)(A) is illustrative. But it has not persuaded me that an effort to use legal process, hoping that the debtor (and others) will fail to spot a clear limitations defense, falls within either the enumerated possibilities or anything remotely related to them. Some things are simply too speculative, or too much against public policy, to include. A debtor could be induced to pay a fraudulent debt, too, but that does not mean that the Bankruptcy Code should be distorted into facilitating such a payment.

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It is important in this connection not to view the Code in isolation from the Rules of Bankruptcy Procedure. The filing of a proof of claim, like any other “petition, pleading, written motion, and other paper,” is subject to Bankruptcy Rule 9011, the counterpart to Federal Rule of Civil Procedure 11. By filing the proof of claim, the filer “is certifying that to the best of that person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, ... the claims ... are warranted by existing law[,] ... [and] the allegations and other factual contentions have evidentiary support....” Fed. R. Bkr. P. 9011(b). No one—not a debt collector, not any other kind of creditor—should be filing a proof of claim that fails to comply with this rule. Public policy, expressed in the Bankruptcy Rules, demands that we do not protect frivolous, bad-faith, or unfounded claims. And a proof of claim is no mere request on moral grounds to turn money over from the bankruptcy estate to the claimant: it is a legal mechanism through which the payment of that claim can be compelled, if the claim is not disallowed by the bankruptcy court. Put differently, the bankruptcy process is one of the avenues of collection that the expiration of the statute of limitations closes off for the creditor.

The concepts in Rule 9011 also supply a limitation on the rule that I would apply here. Where an old debt is subject to an *740 ironclad statute of limitations defense, such that any suit on that debt would amount to a violation of Federal Rule of Civil Procedure 11 (and its counterparts in state court and under Bankruptcy Rule 9011), the debt should not be eligible to be submitted in a proof of claim. If, on the other hand, there is a good-faith doubt about the applicability of a statute of limitations, then scheduling is compatible with both Civil Rule 11 and Bankruptcy Rule 9011, because it is possible to imagine a state of affairs in which a *legally* enforceable obligation exists. That leaves ample room for the operation of section 502(b)(1) of the Bankruptcy Code, which requires the bankruptcy court, upon objection from a party in interest, to disallow any claim that “is unenforceable against the debtor ... under any ... applicable law[.]” The statute of limitations is one such law, 11 U.S.C. § 558, and there will be cases in which its applicability is the subject of a fair dispute.

My colleagues imply that debtors may actually be better off if the stale claims are submitted to the bankruptcy court, because if the debtor, her lawyer, and the trustee (or one of them) is vigilant, the filing of the proof of the stale claim will be a meaningless act: the time-barred debt will be disallowed, and the debtor will have the protection of the discharge judgment. See *ante* at 732–33 & n.6. That is cold comfort to the debtor who knows that the debt collectors are banking on those cases where no one spots the stale claim—a claim on which an independent lawsuit is already barred by *McMahon* and *Phillips*—and it instead winds up as a recoverable item. Sometimes people like the “belt-and-suspenders” approach, giving them redundant protection of one kind or another, but there is no justification for forcing this on them. The statute of limitations itself is full protection against a lawsuit on a stale claim; it does not need to be supplemented by a bankruptcy discharge. That is why the majority's comment that “a debt that is not discharged remains collectible, although the avenues for collection are limited,” *ante* at 732, misses the boat. A time-barred debt *cannot be enforced in a legal proceeding*, even if in a theoretical or moral sense the debt remains.

The majority also tries to shoehorn these stale debts into the “remote or contingent” language used by Congress in H.R. Rep. No. 95-595. *Ante* at 734. But the stale debt is not “remote.” A debt owed by a third party to an entity owned by the debtor might be remote, or a debt Person A owes to Debtor, who then owes Creditor, might be remote. But the case before us now involves just a straightforward debt that could have been enforced until the statute of limitations expired. And I have already explained why these are not contingent debts—there are no contingencies, either anticipatory or after-the-fact, on which its legal collectability depends.

The reason this case is important is because the protections the majority believes exist in the bankruptcy courts are only as good as the human actors working in those courts. The majority notes, *ante* at 736, that “debtors filing for bankruptcy are usually represented by attorneys...” But “usually” does not mean always. In the Bankruptcy Court for the Northern District of Illinois, in the first five months of 2016 there were 19,291 bankruptcy filings; of that number, 1,748 (about 9%) were *pro se*. Over the course of a year, it is reasonable to conclude that

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thousands of *pro se* litigants seek the services of that one court. They tend to be unsophisticated (that is often why they fell into financial trouble in the first place), and they easily could be buffaloed into thinking that every proof of claim represented a legal obligation, when the proof makes no mention of the limitations bar. It is unrealistic to think that the *pro se* litigant or the busy *741 trustee will catch every scheduled stale claim—claims presented in filings that do not, in the only respect pertinent here, provide “accurate and complete information” about the matter, because they are mum about the unenforceability of the debt. (Indeed, I would be surprised if very many non-lawyers understand what a statute of limitations is, much less what the difference is between a bar on recovery and extinguishment of a claim.)

My colleagues, *ante* at 737, accuse me of attacking a straw man when I highlight the possibility of abuse, particularly for *pro se* litigants. I beg to differ. They concede that the bankruptcy court will disallow the stale debt as soon as it learns about the limitations defense. Thus, as I indicated at the outset, the scheduling of this debt represents only the hope that it will slip through the cracks and be reborn as an allowed claim in bankruptcy. To the extent they are leaving the door open for an FDCPA claim when a

bankruptcy petitioner (*pro se* or otherwise) is misled by the scheduling of the stale claim, I welcome that limitation, though its scope is unclear given the rationale the majority has adopted.

The majority stresses that there is an existing circuit split on this issue, and so we need only to line up on one side or the other. In keeping with our decisions in *Phillips* and *McMahon*, I would align this court with the Eleventh Circuit, see *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1259–60 (11th Cir. 2014), rather than the Second and Eighth, see *Simmons v. Roundup Funding, LLC*, 622 F.3d 93 (2d Cir. 2010); *Nelson v. Midland Credit Mgmt., Inc.*, No. 15–2984, 828 F.3d 749, 2016 WL 3672073 (8th Cir. July 11, 2016). I would hold that the scheduling of a proof of claim on a debt that undisputedly is no longer collectible through judicial proceedings because the statute of limitations has expired violates the FDCPA.

I respectfully dissent.

All Citations

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In re Dubois, --- F.3d ---- (2016)

2016 WL 4474156

2016 WL 4474156
United States Court of Appeals,
Fourth Circuit.

In re: [Eric Dubois](#), Debtor.
Chaille Dubois, f/k/a Chaille Gaines, f/k/
a Candace DuBois, f/k/a Candace Gaines,
f/k/a Candi Gaines, f/k/a Candi DuBois;
Kimberly Adkins, Plaintiffs–Appellants,

v.

[Atlas Acquisitions LLC](#), Defendant–Appellee,

and

Timothy P. Branigan; Nancy
Spencer Grisby, Trustees.

No. 15–1945

|

Argued: May 10, 2016

|

Decided: August 25, 2016

Synopsis

Background: Debtors brought adversary proceedings in separate Chapter 13 cases, asserting that debt collectors had violated the Fair Debt Collection Practices Act (FDCPA) by filing stale proofs of claim against their bankruptcy estates. The United States Bankruptcy Court for the District of Maryland, [Thomas J. Catliota](#), J., granted motions to dismiss FDCPA claims as failing to state cause of action, and debtors appealed directly to the Court of Appeals.

Holdings: The Court of Appeals, [Floyd](#), Circuit Judge, held that:

[1] filing of proof of claim in debtor's bankruptcy case is “debt collection activity” regulated by the FDCPA;

[2] time-barred debt falls within the Bankruptcy Code's broad definition of a “claim”; but

[3] filing of proof of claim in Chapter 13 case based on debt that is time-barred does not violate the FDCPA, at

least not where expiration of statute of limitations does not extinguish the debt under the applicable state law.

Affirmed.

[Diaz](#), Circuit Judge, filed dissenting opinion, joining in part in the majority opinion.

West Headnotes (18)

[1] Bankruptcy

👉 Proof; Filing

“Proof of claim” is form filed by creditor in bankruptcy proceeding that states the amount that debtor owes to creditor and reason for the debt.

[Cases that cite this headnote](#)

[2] Bankruptcy

👉 Conclusions of law; de novo review

On appeal directly from bankruptcy court, the Court of Appeals would review bankruptcy court's grant of motion to dismiss for failure to state claim de novo. [Fed. R. Civ. P. 12\(b\)\(6\)](#).

[Cases that cite this headnote](#)

[3] Bankruptcy

👉 Protection Against Discrimination or Collection Efforts in General; ‘Fresh Start.’

Principal purpose of the Bankruptcy Code is to grant fresh start to the honest but unfortunate debtor. [11 U.S.C.A. § 101 et seq.](#)

[Cases that cite this headnote](#)

[4] Bankruptcy

👉 Requisites in general

Being all-inclusive on bankruptcy schedules is consistent with the Bankruptcy Code's

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principle of honest and full disclosure. 11 U.S.C.A. § 101 et seq.

Cases that cite this headnote

for payment. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

Cases that cite this headnote

[5] **Antitrust and Trade Regulation**

🔑 Practices prohibited or required in general

Debt collector violates the Fair Debt Collection Practices Act (FDCPA) by filing lawsuit or threatening to file lawsuit to collect a time-barred debt. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

Cases that cite this headnote

[8] **Antitrust and Trade Regulation**

🔑 Practices prohibited or required in general

Bankruptcy

🔑 Proceedings, Acts, or Persons Affected

Interpreting “debt collection activity,” of kind regulated by the Fair Debt Collection Practices Act (FDCPA), to include the filing of proof of claim in debtor's bankruptcy case was not inconsistent with prohibition against postpetition debt collection activity by automatic stay, which applied only to debt collection activity outside of bankruptcy case. 11 U.S.C.A. § 362(a); Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

Cases that cite this headnote

[6] **Antitrust and Trade Regulation**

🔑 Practices prohibited or required in general

Bankruptcy

🔑 Proof; Filing

Filing of proof of claim in debtor's bankruptcy case is “debt collection activity” regulated by the Fair Debt Collection Practices Act (FDCPA), though proof of claim is filed with bankruptcy court for purposes of obtaining payment on debt, not from debtor, but from debtor's bankruptcy estate. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

Cases that cite this headnote

[9] **Bankruptcy**

🔑 Proceedings, Acts, or Persons Affected

Automatic stay simply bars actions to collect debt outside of, not within, bankruptcy proceeding. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[7] **Antitrust and Trade Regulation**

🔑 Communications, representations, and notices; debtor's response

Determining whether a communication constitutes an attempt to collect debt, of kind subject to the Fair Debt Collection Practices Act (FDCPA), is commonsense inquiry, that requires court to evaluate the nature of parties' relationship, the objective purpose and context of the communication, and whether the communication includes demand

[10] **Bankruptcy**

🔑 Automatic Stay

Automatic stay helps channel debt collection activity into the bankruptcy process. 11 U.S.C.A. § 362(a).

Cases that cite this headnote

[11] **Antitrust and Trade Regulation**

🔑 Persons and transactions covered

Debt collection activity directed toward someone other than debtor may still be actionable under the Fair Debt Collection

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Practices Act (FDCPA). Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

[Cases that cite this headnote](#)

Under Maryland law, time-barred debt still constitutes a right to payment and therefore a “claim” that the holder may file under the Bankruptcy Code. 11 U.S.C.A. § 101(5)(A).

[Cases that cite this headnote](#)

[12] **Bankruptcy**

👉 Claims allowable;what constitutes ‘claim.’

Time-barred debt falls within the Bankruptcy Code's broad definition of a “claim.” 11 U.S.C.A. § 101(5)(A).

[Cases that cite this headnote](#)

[17] **Bankruptcy**

👉 Claims allowable;what constitutes ‘claim.’

Debt need not be enforceable in court in order to be a “claim,” as that term is used in the Bankruptcy Code. 11 U.S.C.A. § 101(5)(A).

[Cases that cite this headnote](#)

[13] **Bankruptcy**

👉 Claims allowable;what constitutes ‘claim.’

Term “claim,” as used in the Bankruptcy Code, usually refers to a right to payment recognized under state law. 11 U.S.C.A. § 101(5)(A).

[Cases that cite this headnote](#)

[18] **Antitrust and Trade Regulation**

👉 Practices prohibited or required in general

Bankruptcy

👉 Time for Filing

Filing of proof of claim in Chapter 13 case based on debt that is time-barred does not violate the Fair Debt Collection Practices Act (FDCPA), where expiration of statute of limitations does not extinguish the debt under applicable state law. Consumer Credit Protection Act, § 802 et seq., 15 U.S.C.A. § 1692 et seq.

[Cases that cite this headnote](#)

[14] **Limitation of Actions**

👉 Operation as to rights or remedies in general

Under Maryland law, statute of limitations does not operate to extinguish a debt, but merely to bar the remedy.

[Cases that cite this headnote](#)

[15] **Limitation of Actions**

👉 Renewal or revival of cause of action

Under Maryland law, stale debt may be revived if debtor sufficiently acknowledges the debt's existence.

[Cases that cite this headnote](#)

Appeal from the United States Bankruptcy Court for the District of Maryland, at Greenbelt. Thomas J. Catliota, Bankruptcy Judge. (15-00110; 14-28589)

Attorneys and Law Firms

ARGUED: [Morgan William Fisher](#), LAW OFFICES OF MORGAN FISHER LLC, Annapolis, Maryland, for Appellants. [Donald S. Maurice, Jr.](#), MAURICE WUTSCHER, LLP, Flemington, New Jersey, for Appellee. ON BRIEF: [Courtney L. Weiner](#), LAW OFFICES OF MORGAN FISHER LLC, Washington,

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D.C., for Appellants. [Alan C. Hochheiser](#), BUCKLEY KING, LPA, Cleveland, Ohio, for Appellee.

Before [DIAZ](#), [FLOYD](#), and [THACKER](#), Circuit Judges.

Opinion

Affirmed by published opinion. Judge [Floyd](#) wrote the majority opinion, in which Judge [Thacker](#) joined. Judge [Diaz](#) wrote a dissenting opinion.

[FLOYD](#), Circuit Judge:

*1 [1] Appellants Kimberly Adkins and Chaille Dubois filed separate Chapter 13 bankruptcy petitions in the Bankruptcy Court for the District of Maryland. Appellee Atlas Acquisitions LLC (Atlas) filed proofs of claim in their bankruptcy cases based on debts that were barred by Maryland's statute of limitations.¹ The issue on appeal is whether Atlas violated the Fair Debt Collection Practices Act (FDCPA) by filing proofs of claim based on time-barred debts. We hold that Atlas's conduct does not violate the FDCPA, and affirm the bankruptcy court's dismissal of Appellants' FDCPA claims and related state law claim.

¹ “A proof of claim is a form filed by a creditor in a bankruptcy proceeding that states the amount the debtor owes to the creditor and the reason for the debt.” [Covert v. LVNV Funding, LLC](#), 779 F.3d 242, 244 n.1 (4th Cir. 2015).

I.

The facts of Appellants' cases are similar. Adkins filed for Chapter 13 bankruptcy on August 29, 2014. Atlas filed two proofs of claim in her case. The first proof of claim indicated that Adkins owed Atlas \$184.62 based on a loan that originated with payday lender Check N Go and that Atlas purchased from Elite Enterprise Services, LLC (Elite Enterprise) on September 15, 2014.² The proof of claim identified the last transaction date on the account as May 19, 2009. Atlas's second proof of claim was for \$390.00 based on a loan that originated with payday lender Impact Cash USA and that Atlas purchased from Elite Enterprise on November 18, 2014. The proof of

claim identified the last transaction date on that account as September 10, 2009. It is undisputed that both debts were beyond Maryland's three-year statute of limitations when Atlas purchased and attempted to assert the debts in Adkins's bankruptcy case. See [Md. Code Ann., Cts. & Jud. Proc. § 5–101](#). Adkins neither listed the debts on her bankruptcy schedules nor sent a notice of bankruptcy to Atlas.

² Atlas asks the Court to strike any allegation that the loans in this appeal originated with payday lenders. However, the proofs of claim attached to Appellants' complaints indicate that Atlas itself designated the debts “payday.” See [J.A.](#) 55, 140. Accordingly, we find this fact sufficiently alleged. See [Goines v. Valley Cmty. Servs. Bd.](#), 822 F.3d 159, 164–65 (4th Cir.2016) (explaining that on motion to dismiss, courts may consider documents attached to complaint as exhibits).

Dubois filed for Chapter 13 bankruptcy on December 6, 2014. Atlas filed a proof of claim for \$135.00 based on a loan that originated with payday lender Iadvance and that Atlas purchased from Elite Enterprise on January 5, 2015. The proof of claim identified the last transaction date on the account as October 18, 2008. It is undisputed that this debt was also beyond Maryland's statute of limitations when Atlas purchased and attempted to assert the debt in Dubois's bankruptcy case. Dubois did not list the debt on her bankruptcy schedules nor did she send a notice of bankruptcy to Atlas.

*2 Adkins and Dubois filed separate adversary complaints against Atlas. Both objected to Atlas's claims as being time-barred and further alleged that Atlas violated the FDCPA by filing proofs of claim on stale debts. Appellants sought disallowance of Atlas's claims as well as damages, attorney's fees, and costs under the FDCPA.³

³ Dubois additionally alleged that Atlas violated the Maryland Consumer Debt Collection Act (MCDCA). [Md. Code Ann., Com. Law § 14–201, et seq.](#) The parties do not analyze the MCDCA separately from the FDCPA. Accordingly, neither do we.

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[2] Atlas conceded that its claims were based on time-barred debts and stipulated to their disallowance. However, Atlas moved to dismiss Appellants' FDCPA claims under [Federal Rule of Civil Procedure 12\(b\)\(6\)](#) for failure to state a claim upon which relief could be granted. See [Fed. R. Bankr. P. 7012\(b\)](#) (incorporating [Rule 12\(b\)\(6\)](#) into adversary proceedings). After hearing consolidated oral arguments, the bankruptcy court concluded that filing a proof of claim does not constitute debt collection activity within the meaning of the FDCPA and granted Atlas's motion to dismiss. Pursuant [28 U.S.C. § 158\(d\)\(2\)](#), we permitted Appellants to appeal the bankruptcy court's decision directly to this Court. We review the bankruptcy court's dismissal of Appellants' claims under [Rule 12\(b\)\(6\)](#) de novo. See, e.g., [In re Mwangi](#), 764 F.3d 1168, 1173 (9th Cir. 2014); [In re McKenzie](#), 716 F.3d 404, 412 (6th Cir. 2013).

II.

Before addressing the substance of Appellants' claims, we provide a brief overview of the relevant statutes in this case: the Bankruptcy Code (the "Code") and the FDCPA.

A.

[3] [4] "The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.'" [Marrama v. Citizens Bank](#), 549 U.S. 365, 367, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (quoting [Grogan v. Garner](#), 498 U.S. 279, 286, 287, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991)). Through bankruptcy, the debtor's assets are collected for equitable distribution among creditors and his remaining debts are discharged. See [Covert v. LVNV Funding, LLC](#), 779 F.3d 242, 248 (4th Cir. 2015); [In re Jahrling](#), 816 F.3d 921, 924 (7th Cir. 2016). A bankruptcy debtor must file with the bankruptcy court a list of creditors, a schedule of assets and liabilities, and a statement of the debtor's financial affairs. [11 U.S.C. § 521\(a\)\(1\)](#). "[B]eing all-inclusive on the schedules is consistent with the Code's principle of honest and full disclosure." [In re Vaughn](#), 536 B.R. 670, 676 (Bankr. D.S.C. 2015). Scheduling a debt notifies the creditor of the bankruptcy and of the creditor's opportunity to file

a proof of claim asserting a right to payment against the debtor's estate. See [id.](#) at 679; [11 U.S.C. § 501\(a\)](#).

The bankruptcy court may "allow" or "disallow" claims from sharing in the distribution of the bankruptcy estate. [11 U.S.C. § 502](#). In Chapter 13 proceedings, allowed claims are typically paid, either in whole or in part, out of the debtor's future earnings pursuant to a repayment plan proposed by the debtor and confirmed by the bankruptcy court. See [id.](#) § 1322(a)(1); 4-501 [Collier on Bankruptcy](#) ¶ 501.01 (Collier). Upon completion of all payments under the plan, the bankruptcy court "grant[s] the debtor a discharge of all debts provided for by the plan or disallowed." [11 U.S.C. § 1328\(a\)](#). Thus, at the end of the process the debtor receives the "fresh start" contemplated by the Bankruptcy Code.

B.

*3 Congress enacted the FDCPA to eliminate abusive debt collection practices and to ensure that debt collectors who refrain from such practices are not competitively disadvantaged. [15 U.S.C. § 1692\(a\), \(e\)](#). The FDCPA regulates the conduct of "debt collectors," defined to include "any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another." [Id.](#) § 1692a(6). Among other things, the FDCPA prohibits debt collectors from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt," and from using "unfair or unconscionable means to collect or attempt to collect any debt." [Id.](#) §§ 1692e-1692f. The statute provides a non-exhaustive list of conduct that is deceptive or unfair (e.g., falsely implying that the debt collector is affiliated with the United States, [id.](#) § 1692e(1)). Debt collectors who violate the FDCPA are liable for actual damages, statutory damages of up to \$1,000, and attorney's fees and costs. See [id.](#) § 1692k(a).

C.

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[5] Federal courts have consistently held that a debt collector violates the FDCPA by filing a lawsuit or threatening to file a lawsuit to collect a time-barred debt. See [Crawford v. LVNV Funding, LLC](#), 758 F.3d 1254, 1259–60 (11th Cir. 2014) (collecting cases), cert. denied, — U.S. —, 135 S.Ct. 1844, 191 L.Ed.2d 724 (2015). Appellants contend that filing a proof of claim on a time-barred debt in a bankruptcy proceeding similarly violates the FDCPA. Atlas counters that filing a proof of claim is not debt collection activity and is therefore not subject to the FDCPA. Alas further argues that, even if the FDCPA applies, filing a proof of claim on a time-barred debt does not violate its provisions. These arguments are addressed in turn.

III.

[6] Atlas does not dispute that it is a debt collector but argues that filing a proof of claim does not constitute debt collection activity regulated by the FDCPA. See 15 U.S.C. § 1692e (prohibiting deceptive or misleading representations “in connection with the collection of any debt”); *id.* § 1692f (prohibiting unfair or unconscionable means “to collect or attempt to collect any debt”). Instead, Atlas contends that a proof of claim is merely a “request to participate in the bankruptcy process.” Appellee’s Br. 20.

[7] Determining whether a communication constitutes an attempt to collect a debt is a “commonsense inquiry” that evaluates the “nature of the parties’ relationship,” the “[objective] purpose and context of the communication [],” and whether the communication includes a demand for payment. [Gburek v. Litton Loan Servicing LP](#), 614 F.3d 380, 385 (7th Cir. 2010); see also [Olson v. Midland Funding, LLC](#), 578 Fed.Appx. 248, 251 (4th Cir. 2014) (citing [Gburek](#) factors approvingly). Here, the “only relationship between [the parties] [is] that of a debtor and debt collector.” [Olson](#), 578 Fed.Appx. at 251. Moreover, the “animating purpose” in filing a proof of claim is to obtain payment by sharing in the distribution of the debtor’s bankruptcy estate. See [Grden v. Leikin Ingber & Winters PC](#), 643 F.3d 169, 173 (6th Cir. 2011); 4–501 [Collier](#) ¶ 501.01. This fits squarely within the Supreme Court’s understanding of debt collection for purposes of the FDCPA. See [Heintz v. Jenkins](#), 514 U.S. 291, 294,

115 S.Ct. 1489, 131 L.Ed.2d 395 (1995) (explaining that in ordinary English, an attempt to “collect a debt” is an attempt “to obtain payment or liquidation of it, either by personal solicitation or legal proceedings” (quoting *Black’s Law Dictionary* 263 (6th ed. 1990))). Precedent and common sense dictate that filing a proof of claim is an attempt to collect a debt. The absence of an explicit demand for payment does not alter that conclusion, [Gburek](#), 614 F.3d at 382, nor does the fact that the bankruptcy court may ultimately disallow the claim.

[8] Atlas argues that treating a proof of claim as an attempt to collect a debt would conflict with the Bankruptcy Code’s automatic stay provision. The automatic stay provides that filing a bankruptcy petition “operates as a stay” of “any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case.” 11 U.S.C. § 362(a)(6). Atlas argues that if filing a proof of claim were an act to collect debt, then such filing would violate the automatic stay, “an absurd result.” Appellee’s Br. 21.

*4 [9] [10] Atlas’s quandary is easily resolved as the automatic stay simply bars actions to collect debt outside of the bankruptcy proceeding. See, e.g., [Cent. States, Se. & Sw. Areas Pension Fund v. Basic Am. Indus., Inc.](#), 252 F.3d 911, 918 (7th Cir. 2001) (“[D]emanding’ payment from a debtor in bankruptcy other than in the bankruptcy proceeding itself is normally a violation of the automatic stay”); [Campbell v. Countrywide Home Loans, Inc.](#), 545 F.3d 348, 354 (5th Cir. 2008) (explaining that the automatic stay “merely suspends an action to collect the claim outside the procedural mechanisms of the Bankruptcy Code”). The automatic stay helps channel debt collection activity into the bankruptcy process. It does not strip such activity of its debt collection nature for purposes of the FDCPA.

[11] Finally, Atlas argues that filing a proof of claim is not an attempt to collect debt because the proof of claim is directed to the bankruptcy court and trustee rather than to the debtor. However, collection activity directed toward someone other than the debtor may still be actionable under the FDCPA. See, e.g., [Sayyed v. Wolpoff & Abramson](#), 485 F.3d 226, 232–33 (4th Cir. 2007) (finding that FDCPA “plainly” applies to communications made by debt collector to debtor’s counsel rather than debtor);

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[Horkey v. J.V.D.B. & Assocs., Inc.](#), 333 F.3d 769, 774 (7th Cir. 2003) (finding that debt collector's phone call to debtor's co-worker was "in connection with the collection of a debt" where purpose of the call was to induce debtor to settle her debt). Although a proof of claim is filed with the bankruptcy court, it is done with the purpose of obtaining payment from the debtor's estate. That the claim is paid by the debtor's estate rather than the debtor personally is irrelevant for purposes of the FDCPA. See 15 U.S.C. §§ 1692e, 1692f (prohibiting the use of deceptive or unfair means to collect "any debt," without specifying a payor).

Accordingly, we find that filing a proof of claim is debt collection activity regulated by the FDCPA.

IV.

We next consider whether filing a proof of claim based on a debt that is beyond the applicable statute of limitations violates the FDCPA. Deciding this issue requires closer examination of the claims process in bankruptcy.

The Federal Rules of Bankruptcy Procedure specify the form, content, and filing requirements for a valid proof of claim. See, e.g., Fed. R. Bankr. P. 3001. A properly filed proof of claim is prima facie evidence of the claim's validity, and the claim is "deemed allowed" unless "a party in interest" objects. 11 U.S.C. § 502. The bankruptcy trustee and debtor are parties in interest who may object.⁴ Indeed, the trustee has a statutory duty to "examine proofs of claims and object to the allowance of any claim that is improper." *Id.* § 704(a)(5).

⁴ While the parties do not address the issue, it appears that creditors are also parties in interest who may object to a claim filed by another creditor. See, e.g., [Adair v. Sherman](#), 230 F.3d 890, 894 n.3 (7th Cir. 2000) ("Parties in interest include not only the debtor, but anyone who has a legally protected interest that could be affected by a bankruptcy proceeding. Therefore, if one creditor files a potentially fraudulent proof of claim, other creditors have standing to object to the proof of claim." (citation omitted)); [In re Varat](#)

[Enters., Inc.](#), 81 F.3d 1310, 1317 n.8 (4th Cir. 1996) ("All creditors of a debtor are parties in interest.").

If objected to, the Code disallows claims based on time-barred debts. See *id.* § 502(b)(1) (stating that a claim shall be disallowed if it is "unenforceable against the debtor ... under any agreement or applicable law"); *id.* § 558 (stating that the bankruptcy estate has "the benefit of any defense available to the debtor ... including statutes of limitation"). As previously noted, debts that are "provided for by the plan or disallowed under section 502" may be discharged. *Id.* § 1328 (emphasis added).

*5 Appellants contend that the FDCPA should be applied to prohibit debt collectors from filing proofs of claim on time-barred debts. Appellants argue that a time-barred debt is not a "claim" within the meaning of the Bankruptcy Code and that filing claims on time-barred debts is an abusive practice because such claims are seldom objected to and therefore receive payment from the bankruptcy estate to the detriment of the debtor and other creditors. Atlas, meanwhile, argues that a time-barred debt is a valid "claim" and that filing such a claim should not be prohibited because only debts that are treated in the bankruptcy system may be discharged.

A.

[12] The Bankruptcy Code defines the term "claim" broadly to mean a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A). By using the "broadest possible definition," the Code "contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case," thereby providing the debtor the "broadest possible relief." H.R. Rep. No. 95-595, p. 309 (1977); S. Rep. No. 95-989, p. 22 (1978).

[13] [14] [15] [16] "[W]hen the Bankruptcy Code uses the word claim ... it is usually referring to a right to payment recognized under state law." [Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.](#), 549 U.S. 443, 451, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007)

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(quotation omitted). Under Maryland law, the statute of limitations “does not operate to extinguish [a] debt, but to bar the remedy.” [Potterton v. Ryland Grp., Inc.](#), 289 Md. 371, 424 A.2d 761, 764 (1981) (quotation omitted); see also [Higginbotham v. Pub. Serv. Comm'n of Md.](#), 412 Md. 112, 985 A.2d 1183, 1191 (2009) (“[W]e have regarded limitations as not denying the plaintiff’s right of action, but only the exercise of the right.” (quotation omitted)). Indeed, a stale debt may be revived if the debtor sufficiently acknowledges the debt’s existence. [Potterton](#), 424 A.2d at 764; see also FTC, [Time-Barred Debts](#) (July 2013), <https://www.consumer.ftc.gov/articles/0117-time-barred-debts> (“Although the [debt] collector may not sue you to collect [a time-barred] debt, you still owe it. The collector can continue to contact you to try to collect.... [and] [i]n some states, if you pay any amount on a time-barred debt or even promise to pay, the debt is ‘revived.’”) (saved as ECF opinion attachment). Thus, under Maryland law, a time-barred debt still constitutes a “right to payment” and therefore a “claim” that the holder may file under the Bankruptcy Code.⁵

⁵ Appellants suggest that “by filing proofs of claim on time-barred debt, Atlas is trying to trick debtors into unwittingly reviving the statute [of limitations].” Appellants’ Reply Br. 4. Regardless of whether this is Atlas’s intent, it is difficult to see how a creditor’s filing a proof of claim would constitute acknowledgement of the debt by the debtor, particularly when there is persuasive authority that a debtor does not revive a time-barred debt by listing it in his bankruptcy schedules. See, e.g., [Biggs v. Mays](#), 125 F.2d 693, 697–98 (8th Cir. 1942); [In re Povill](#), 105 F.2d 157, 160 (2d Cir. 1939).

[17] Appellants note that a debt must be enforceable to constitute a claim, citing the Supreme Court’s statement that “[t]he plain meaning of a ‘right to payment’ is nothing more nor less than an enforceable obligation.” [Pa. Dep’t of Pub. Welfare v. Davenport](#), 495 U.S. 552, 559, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990). However, we do not read the Supreme Court’s statement to mean that a debt must be enforceable in court to be a claim. Indeed, the Bankruptcy Code treats debts that are “contingent” or “unmatured” as claims notwithstanding that such debts are not presently enforceable in court. 11 U.S.C. § 101(5) (A). Furthermore, in [Davenport](#), the Supreme Court found restitution orders to be claims even though “neither

the Probation Department nor the victim can enforce restitution obligations in civil proceedings.” 495 U.S. at 558, 110 S.Ct. 2126. Instead, such obligations are enforced by the “substantial threat of revocation of probation and incarceration.” [Id.](#)

*6 It is also notable that while the Bankruptcy Code provides that time-barred debts are to be disallowed, see, e.g., 11 U.S.C. § 558, the Code nowhere suggests that such debts are not to be filed in the first place. Indeed, the Bankruptcy Rules were recently amended to facilitate the assessment of a claim’s timeliness by requiring that claims such as the ones at issue in this appeal be filed with a statement setting forth the last transaction date, last payment date, and charge-off date on the account. [Fed. R. Bankr. P. 3001](#), advisory committee notes to 2012 Amendments (discussing filing requirements for claims based on open-end or revolving consumer credit agreements). This Rule suggests the Code contemplates that untimely debts will be filed as claims but ultimately disallowed. Lastly, excluding time-barred debts from the scope of bankruptcy “claims,” and thus excluding them from the bankruptcy process, would frustrate the Code’s “intended effect to define the scope of the term ‘claim’ as broadly as possible,” 2–101 [Collier](#) ¶ 101.05, and thereby provide the debtor the broadest possible relief. Accordingly, we conclude that when the statute of limitations does not extinguish debts, a time-barred debt falls within the Bankruptcy Code’s broad definition of a claim.

B.

[18] Next, we consider whether filing a proof of claim on a time-barred debt violates the FDCPA notwithstanding that the Bankruptcy Code permits such filing. As noted above, the FDCPA has been interpreted to prohibit filing a lawsuit on a time-barred debt. The rationale has been explained as follows:

As with any defendant sued on a stale claim, the passage of time not only dulls the consumer’s memory of the circumstances and validity of the debt, but heightens the probability that she will no longer

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have personal records detailing the status of the debt. Indeed, the unfairness of such conduct is particularly clear in the consumer context where courts have imposed a heightened standard of care—that sufficient to protect the least sophisticated consumer. Because few unsophisticated consumers would be aware that a statute of limitations could be used to defend against lawsuits based on stale debts, such consumers would unwittingly acquiesce to such lawsuits. And, even if the consumer realizes that she can use time as a defense, she will more than likely still give in rather than fight the lawsuit because she must still expend energy and resources and subject herself to the embarrassment of going into court to present the defense; this is particularly true in light of the costs of attorneys today.

[Kimber v. Fed. Fin. Corp.](#), 668 F.Supp. 1480, 1487 (M.D. Ala. 1987); see also [Crawford](#), 758 F.3d at 1260; [Phillips v. Asset Acceptance, LLC](#), 736 F.3d 1076, 1079 (7th Cir. 2013).⁶

⁶ The Eleventh Circuit in [Crawford](#) is the only court of appeals to hold that filing a proof of claim on a time-barred debt in a Chapter 13 proceeding violates the FDCPA. 758 F.3d at 1256–57. The Eighth Circuit has “reject[ed] extending the FDCPA to time-barred proofs of claim,” [Nelson v. Midland Credit Mgmt., Inc.](#), No. 15–2984, — F.3d —, —, 2016 WL 3672073, at *2 (8th Cir. July 11, 2016), and the Second Circuit has broadly held that “filing a proof of claim in bankruptcy court (even one that is somehow invalid) cannot constitute the sort of abusive debt collection practice proscribed by the FDCPA.” [Simmons v. Roundup Funding, LLC](#), 622 F.3d 93, 95 (2d Cir. 2010). Other circuits are presently considering the issue. See, e.g., [Owens v. LVNV Funding, LLC](#), No. 14–cv–02083, 2015 WL 1826005 (S.D. Ind. Apr. 21, 2015), appeal docketed, No. 15–2044 (7th Cir. May 13, 2015); [Torres v. Asset](#)

[Acceptance, LLC](#), 96 F.Supp.3d 541 (E.D. Pa. 2015), appeal docketed, No. 15–2132 (3d Cir. May 13, 2015).

We note at the outset a unique consideration in the bankruptcy context: if a bankruptcy proceeds as contemplated by the Code, a claim based on a time-barred debt will be objected to by the trustee, disallowed, and ultimately discharged, thereby stopping the creditor from engaging in any further collection activity.⁷ If the debt is unsecured and no proof of claim is filed, the debt continues to exist and the debt collector may lawfully pursue collection activity apart from filing a lawsuit. This is detrimental to the debtor and undermines the bankruptcy system's interest in “the collective treatment of all of a debtor's creditors at one time.” 1 [Norton Bankr. L. & Prac. 3d § 3:9](#). Clearly, then, when a time-barred debt is not scheduled the optimal scenario is for a claim to be filed and for the Bankruptcy Code to operate as written.

⁷ By contrast, raising a statute of limitations defense may defeat a lawsuit to collect a time-barred debt but would not extinguish the debt or necessarily prevent collection activity.

*7 Appellants complain, however, that trustees often lack the time and resources to examine each proof of claim and object to those that are based on time-barred debts. See Appellants' Br. 17–18 (explaining that Maryland has only three Chapter 13 trustees to manage approximately 5,000 cases per year, with approximately 10 proofs of claim filed in each case). Debt collectors like Atlas purportedly take advantage of this by filing claims on stale debts in hopes that the claims will go unnoticed and receive some payment from the bankruptcy estate. When successful, these debt collectors reduce the amount of money available to legitimate creditors and may sometimes cause debtors to pay more into their Chapter 13 plans.

We appreciate the harm that can be wrought if time-barred claims go unnoticed. However the solution, in our view, is not to impose liability under the FDCPA that would categorically bar the filing of such claims, but to improve the Code's administration such that it operates as written.⁸ This may be accomplished, for example, by allocating additional resources to trustees or through action of the United States Trustee, who appoints and supervises all Chapter 13 trustees. 28 U.S.C. § 586.

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8 Indeed, if Appellants are correct that trustees are failing to fulfill their statutory duty to examine and object to improper claims, this is surely producing adverse consequences beyond the context of time-barred debts.

Another consideration that counsels against finding FDCPA liability is that, for most Chapter 13 debtors, the amount they pay into their bankruptcy plans is unaffected by the number of unsecured claims that are filed. Chapter 13 debtors typically do not enter into 100 percent repayment plans; thus, their unsecured creditors receive only partial payment of their claims, with the remainder being discharged. See 8-1328 *Collier* ¶ 1328.02 (“Congress clearly contemplated chapter 13 plans paying little or nothing on unsecured debts....”). As additional claims are filed, unsecured creditors receive a smaller share of available funds but the total amount paid by the debtor remains unchanged. Thus, from the perspective of most Chapter 13 debtors, it may in fact be preferable for a time-barred claim to be filed even if it is not objected to, as the debtor will likely pay the same total amount to creditors and the debt can be discharged. See *In re Gatewood*, 533 B.R. 905, 909 (8th Cir. BAP 2015) (explaining that “debtors have less at stake in claims allowance than they would when facing enforcement of an adverse judgment in a collection action” because the allowance of additional claims would not affect the total amount the debtor would pay).⁹

9 As noted above, the FDCPA was enacted in part to protect scrupulous debt collectors from unfair competition. However, bankruptcy creditors are sophisticated entities that may object to improper claims. Thus, we will not invoke the FDCPA solely on their behalf when, as discussed above, there are reasons not to do so on behalf of bankruptcy debtors.

Various other considerations also differentiate filing a proof of claim on a time-barred debt from filing a lawsuit to collect such debt. First, the Bankruptcy Rules require claims like the ones filed by Atlas to accurately state the last transaction and charge-off date on the account, making untimely claims easier to detect and relieving debtors from the burden of producing evidence to show that the claim is time-barred.¹⁰ Second, a bankruptcy debtor is protected by a trustee and often by counsel

who are responsible for objecting to improper claims even if, as Appellants argue, they currently do not always do so. Third, unlike a debtor who is unwillingly sued, a Chapter 13 debtor voluntarily initiates the bankruptcy case, diminishing concerns about the embarrassment the debtor may feel in objecting to a stale claim. In sum, the reasons why it is “unfair” and “misleading” to sue on a time-barred debt are considerably diminished in the bankruptcy context, where the debtor has additional protections and potentially benefits from having the debt treated in the bankruptcy process.

10 There is no allegation that Atlas filed inaccurate proofs of claim. A debt collector who supplies false dates to obscure a claim's staleness may well violate the FDCPA. However, we have no occasion to consider that issue today.

*8 Lastly, Appellants concede that a debt collector would not violate the FDCPA by filing a proof of claim on a time-barred debt that the debtor had scheduled and did not designate as “disputed.” Appellants explain that scheduling a debt as undisputed is an “invitation to participate” because it provides “ ‘notice to a creditor that its debt will be paid ... in accordance with the filed proof of claim, claims objection process, and other bankruptcy provisions.’ ” Appellants' Br. 28 n.14 (quoting *Vaughn*, 536 B.R. at 678). However, such notice is sent whether a scheduled debt is disputed or not. Moreover, a time-barred debt that is disputed is less likely to be inadvertently allowed. Thus, we see no reason to attach FDCPA liability to a claim filed on a time-barred debt that is scheduled as disputed. Finally, the interests in discharge and collective treatment of claims discussed above convince us that FDCPA liability should not attach where a debtor fails to schedule a time-barred debt.

We conclude that filing a proof of claim in a Chapter 13 bankruptcy based on a debt that is time-barred does not violate the FDCPA when the statute of limitations does not extinguish the debt.¹¹

11 In light of this decision, we do not reach Atlas's argument that the Bankruptcy Code precludes the FDCPA and preempts the MCDCA from applying to the filing of a proof of claim.

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V.

For the foregoing reasons, we affirm the district court's dismissal of Appellants' FDCPA and MCDCA claims.

AFFIRMED

DIAZ, Circuit Judge, dissenting:

I join Part III of the majority opinion, which concludes that filing a proof of claim is debt-collection activity regulated by the Fair Debt Collection Practices Act (FDCPA), [15 U.S.C. § 1692 et seq.](#)

And while I agree that Atlas's time-barred claim is a “claim” under the Bankruptcy Code (as the majority concludes in Part IV.A), I cannot agree that Atlas's alleged conduct is consistent with the FDCPA (or the Maryland Consumer Debt Collection Act (MCDCA), [Md. Code Ann., Com. Law § 14–201 et seq.](#)).¹ Atlas buys the time-barred debt of people in bankruptcy and tries to collect by filing proofs of claim in their bankruptcy proceedings. As Atlas concedes, these claims should fail—the debt is unenforceable in court. But, absent objection, the Bankruptcy Code automatically allows all properly filed claims. [11 U.S.C. § 502](#). So Atlas plays the odds, representing itself as entitled to part of the debtors' estates. If someone notices the claims and objects, as happened here, Atlas grins sheepishly—“You caught me!”—and admits that the claim is meritless. But if the claim slips through, Atlas uses the bankruptcy court to garner a payoff on unenforceable debts. In my view, this sharp practice is misleading and unfair to debtors and other creditors, and it gives rise to a cause of action under the FDCPA.

¹ I join the majority in analyzing the FDCPA and MCDCA claims together, as the parties do.

Moreover, I would hold that the Bankruptcy Code does not impliedly repeal the FDCPA or preempt the MCDCA. Accordingly, I would vacate the opinion of the district court and remand for further proceedings.

I.

The FDCPA aims to “protect[] consumers from abusive and deceptive practices by debt collectors, and ... non-abusive debt collectors from competitive disadvantage.” [United States v. Nat'l Fin. Servs., Inc.](#), 98 F.3d 131, 135 (4th Cir. 1996). The statute prohibits a wide variety of collection tactics, including the use of “any false, deceptive, or misleading representation or means” of debt collection, [15 U.S.C. § 1692e](#), and “unfair or unconscionable means to collect or attempt to collect any debt,” [§ 1692f](#).

Although the FDCPA enumerates specific examples of these broad prohibitions, it does so “[w]ithout limiting [their] general application.” *Id.* For example, “[t]he false representation of ... the character, amount, or legal status of any debt” is a specific violation of the general ban on false, deceptive, or misleading representations. [§ 1692e\(2\)\(A\)](#). But Congress chose not to limit the general prohibitions, to “enable the courts, where appropriate, to proscribe other improper conduct which is not specifically addressed.” [Stratton v. Portfolio Recovery Assocs., LLC](#), 770 F.3d 443, 450 (6th Cir. 2014) (quoting [S. Rep. No. 95-382 at 4](#) (1977), *as reprinted in* 1977 U.S.C.C.A.N. 1695, 1698).

*9 One such court-imposed proscription applies to lawsuits to collect time-barred debt. [Crawford v. LVNV Funding, LLC](#), 758 F.3d 1254, 1259–60 & n.6 (11th Cir. 2014) (citing cases). Such lawsuits raise two major concerns in the consumer context. First, the “least sophisticated consumer”—from whose vantage point we view FDCPA communications, see [Russell v. Absolute Collection Servs., Inc.](#), 763 F.3d 385, 394 (4th Cir. 2014)—may be unaware of the existence of a statute-of-limitations defense and may therefore “unwittingly acquiesce to such lawsuits,” [Kimber v. Fed. Fin. Corp.](#), 668 F.Supp. 1480, 1487 (M.D. Ala. 1987). Second, “the passage of time not only dulls the consumer's memory of the circumstances and validity of the debt, but heightens the probability that [the consumer] will no longer have personal records detailing the status of the debt.” [Phillips v. Asset Acceptance, LLC](#), 736 F.3d 1076, 1079 (7th Cir. 2013) (quoting [Kimber](#), 668 F.Supp. at 1487).

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These same considerations support recognizing FDCPA liability for filing time-barred claims on unscheduled debts in bankruptcy.² [Crawford](#), 758 F.3d at 1260-61. But see [Nelson v. Midland Credit Mgmt., Inc., No. 15-2984](#), ___ F.3d ___, ___, 2016 WL 3672073, at *2 (8th Cir. July 11, 2016) (published opinion) (refusing to “extend[] the FDCPA to time-barred proofs of claim” because the Bankruptcy Code’s “protections against harassment and deception satisfy the relevant concerns of the FDCPA”). Here, where the proofs of claim provide enough information to determine the debt is time barred, the first consideration is of particular importance. An unsophisticated debtor reviewing a proof of claim may be unaware of the statute-of-limitations defense and—perhaps not appreciating the legal significance of even accurately listed last-transaction and charge-off dates—may nevertheless “acquiesce” to the claims.

² As the debtors concede, their case might be different had they scheduled these debts with the bankruptcy court, an action that might be seen as an invitation to a creditor to file a claim.

While some courts have found the role of the bankruptcy trustee in weeding out time-barred claims critical in distinguishing the bankruptcy context from civil lawsuits, see, e.g., [Nelson](#), ___ F.3d at ___, 2016 WL 3672073, at *2, I am not persuaded. At best, a debt collector who files such a claim wastes the trustee's time. At worst, the debt collector catches the trustee asleep at the switch and collects on an invalid claim to the detriment of other creditors and, in many cases, the debtor. In either case, the debt collector misleadingly represents to the debtor that it is entitled to collect through bankruptcy when it is not.

Moreover, there is reason to doubt the efficacy of the trustee as a vigilant steward of the debtor's estate. See, e.g., [In re Edwards](#), 539 B.R. 360, 365 (Bankr. N.D. Ill. 2015) (“Chapter 13 trustees in this district do not object to proofs of claim based on statute of limitations defenses. This is not surprising because objecting to claims based on affirmative defenses would require trustees to examine the details of virtually every unsecured proof of claim, which is simply impracticable.”). Indeed, if trustees performed their duties flawlessly, Atlas would have little incentive to engage in its scheme.

Like filing a lawsuit on time-barred debt, Atlas's alleged debt-collection activity in this case is precisely the sort of unfair and misleading practice that Congress intended the courts to recognize as a violation. After the debtors entered bankruptcy, Atlas bought their debts, or rather, as the bill of sales said, “charged-off receivables.” J.A. 58, 132, 143. All of these charged-off debts were more than five-years old, well outside Maryland's three-year statute of limitations. Nevertheless, Atlas filed proofs of claim to recover the unenforceable debts in the bankruptcy court. The relevance of the statute of limitations was not lost on Atlas, which included the following notice on two of the three proof-of-claim forms it filed: “This proof of claim is being filed pursuant to 11 USC Secs. 101(5), 501(a) and 502(b) as said claim may be outside of the statute of limitations.” J.A. 55, 140. [Section 502\(b\)](#) explains that if a claim is objected to, the court will allow the claim “except to the extent that ... such claim is unenforceable against the debtor and the property of the debtor, under any agreement or applicable law.” § 502(b)(1). In short, Atlas knew exactly what it was doing—exploiting a weakness in the bankruptcy system and preying on potential error to collect on debts where it should not. The practice subverts a core purpose of bankruptcy by diverting estate assets from the creditors entitled to receive them.

*10 Atlas rather stunningly argues that it is doing a public service: “[B]ut for Atlas' filing of its proofs of claim, those debts would not be subject to discharge and at the conclusion of Appellants' chapter 13 cases, Atlas could restart collection activity with respect thereto so long as it does not otherwise violate the FDCPA.” Appellee's Br. at 40. Really? While the statement is literally true, the (unintended) possibility that the time-barred debts will be disallowed and discharged hardly justifies Atlas's tactics. Moreover, that the debtors did not schedule the debts is some evidence that collection efforts have stopped. And it would not be surprising if they had; the time for enforcement has passed, and the combination of the statute of limitations and the FDCPA seriously limits what a debt collector can do to recover old debts. Ideally, debtors would remember all their old debts, realize they were time barred, schedule them as disputed, and see that they were disallowed. But the FDCPA asks what the least sophisticated consumer would do, not the ideal one.

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Atlas's conduct games the bankruptcy process; it does not ensure its integrity.

Accordingly, I would hold that Atlas's conduct constitutes a violation of the FDCPA. Such a holding would not impose a great burden on debt collectors. “[A] debt collector is not liable in an action brought under the [FDCPA] if [it] can show ‘the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.’ ” [Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich LPA](#), 559 U.S. 573, 576, 130 S.Ct. 1605, 176 L.Ed.2d 519 (2010) (quoting 15 U.S.C. § 1692k(c)). Atlas and other debt collectors can avoid FDCPA liability by putting in place a reasonable procedure to screen unscheduled, time-barred claims—if Atlas already has such a procedure, it can prove it in the district court.

II.

Because the majority determines that the FDCPA does not reach Atlas's conduct, it does not address the question whether—if the FDCPA on its own terms would apply to the filing of time-barred claims—the Bankruptcy Code nevertheless precludes such an action. To determine whether two federal statutes are compatible, we employ ordinary statutory interpretation principles. See [POM Wonderful LLC v. Coca-Cola Co.](#), — U.S. —, 134 S.Ct. 2228, 2236, 189 L.Ed.2d 141 (2014). Because the circuits are split on this issue and the arguments have been made extensively on both sides, I explain briefly my position that the two statutes do not conflict in this instance.

The Second and Ninth Circuits have concluded that the Bankruptcy Code precludes certain FDCPA suits. [Simmons v. Roundup Funding, LLC](#), 622 F.3d 93, 95–96 (2d Cir. 2010) (rejecting an FDCPA claim brought during the pendency of bankruptcy proceedings for the filing of an inflated proof of claim); [Walls v. Wells Fargo Bank, N.A.](#), 276 F.3d 502, 510–11 (9th Cir. 2002) (barring an FDCPA claim for post-bankruptcy debt collection in violation of the discharge order). Both rely on the comprehensive provisions and protections of the Bankruptcy Code to hold that it leaves no room for

FDCPA claims. [Simmons](#), 622 F.3d at 96; [Walls](#), 276 F.3d at 510.

The Third, Seventh, and Eleventh Circuits have rejected the notion that FDCPA actions may not be brought in the context of bankruptcy. [Johnson v. Midland Funding LLC](#), 823 F.3d 1334, 1341–42 (11th Cir.2016) (published opinion) (holding that the Bankruptcy Code does not impliedly repeal FDCPA actions for filing proofs of claim on time-barred debt); [Simon v. FIA Card Servs., N.A.](#), 732 F.3d 259, 274 (3d Cir. 2013) (permitting an FDCPA claim for the violation of the Bankruptcy Code's subpoena requirements); [Randolph v. IMBS, Inc.](#), 368 F.3d 726, 730–31 (7th Cir. 2004) (comparing the FDCPA and Bankruptcy Code and concluding they are compatible). In the view of these courts, the statutes do not expressly contradict one another, nor are they in “irreconcilable conflict” because “any debt collector can comply with both simultaneously.” [Randolph](#), 368 F.3d at 730; accord [Johnson](#), 823 F.3d at 1340–42; [Simon](#), 732 F.3d at 273–74; see also [Nat'l Ass'n of Home Builders v. Defs. of Wildlife](#), 551 U.S. 644, 662, 127 S.Ct. 2518, 168 L.Ed.2d 467 (2007) (“While a later enacted statute ... can sometimes operate to amend or even repeal an earlier statutory provision ..., ‘repeals by implication are not favored’ and will not be presumed unless the ‘intention of the legislature to repeal [is] clear and manifest.’ ” (third alteration in original) (quoting [Watt v. Alaska](#), 451 U.S. 259, 267, 101 S.Ct. 1673, 68 L.Ed.2d 80 (1981))).

*11 I would side with the view of the Third, Seventh, and Eleventh Circuits, at least on the facts of this case. Atlas does not argue that the Bankruptcy Code expressly bars FDCPA remedies. Instead, it contends the statutes are irreconcilable: “[W]hat [the debtors] allege is prohibited by the FDCPA (the filing of a proof of claim with respect to a ‘stale’ debt) is expressly permitted by the Bankruptcy Code.” Appellee's Br. at 34. But this argument is easily answered: Because the Bankruptcy Code does not obligate a creditor to file a proof of claim, a debt collector such as Atlas can comply with both statutes by not filing unscheduled, time-barred proofs of claim. See [Johnson](#), 823 F.3d at 1341–42; [Randolph](#), 368 F.3d at 730.³

³ For similar reasons, I would hold that the Bankruptcy Code does not preempt the MCDCA.

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This conclusion is buttressed by our holding, in a somewhat different posture, that an FDCPA claim may be brought during bankruptcy proceedings. [Covert v. LVNV Funding, LLC](#), 779 F.3d 242, 246–48 (4th Cir. 2015). In [Covert](#), debtors filed suit under the FDCPA and MCDCA after the completion of their bankruptcies, alleging that a creditor had unlawfully filed proofs of claim without a debt-collection license. [Id.](#) at 245. We found the claims barred by res judicata because the debtors failed to raise them during the bankruptcy. [Id.](#) at 247–48. Because res judicata applies to unraised claims only if they “could have been adjudicated in an earlier action,” [id.](#) at 246, we necessarily determined that the debtors “could ... have brought their affirmative claims for damages [under the FDCPA and MCDCA] during the bankruptcy process under [Federal Rule of Bankruptcy Procedure 7001\(1\)](#),

which provides that ‘a proceeding to recover money or property’ may be brought as an adversary action,” [id.](#) at 248. Similarly, I would hold that the Bankruptcy Code does not preclude or preempt the filing of the FDCPA and MCDCA claims in this case.

III.

Because I believe the debtors state a claim under the FDCPA (and MCDCA), I would reverse and remand for further proceedings.

All Citations

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**Round and Round with the Judges Program
Saturday, December 3, 2016**

*Wandering Through the Bankruptcy Jurisdiction Maze:
Entering Money Judgments on Nondischargeable Debts*

Honorable Deborah L. Thorne

United States Bankruptcy Court, Northern District of Illinois

Bankruptcy Law Letter

Vol. 29, No. 4

April 2009

Bankruptcy Court Jurisdiction to Enter a Money Judgment on a Nondischargeable Debt: Exposing *Pacor's* Deficiencies and the True Supplemental Nature of Third-Party "Related To" Bankruptcy Jurisdiction

By Ralph Brubaker

With the Fifth Circuit's recent decision in *Morrison v. Western Builders of Amarillo, Inc. (In re Morrison)*,¹ all circuit courts of appeals to address the issue have uniformly concluded that a bankruptcy court hearing a creditor's nondischargeability action against an individual debtor not only has jurisdiction to (i) declare the debt nondischargeable pursuant to Code § 523 but also has jurisdiction to (ii) liquidate and enter a money judgment against the debtor on the underlying debt.

Given the courts of appeals' unanimity, it might seem that the *Morrison* decision hardly warrants note, let alone an extended discussion occupying an entire issue of *Bankruptcy Law Letter*. Resolution of this jurisdictional issue, though, has not proved to be such a straightforward matter for the lower courts. Moreover, the significance of these decisions lies beyond their bare holdings in what those holdings reveal for a host of other jurisdictional quandaries for which there is rampant confusion and disagreement.

As the Fifth Circuit openly acknowledged in *Morrison*, a bankruptcy court's jurisdiction to enter a money judgment on a nondischargeable debt cannot be reconciled with any of the prevailing "tests" for the existence of federal bankruptcy jurisdiction. Most notably, because the outcome of the creditor's action against the debtor on the underlying nondischargeable debt can have no conceivable effect on the debtor's bankruptcy estate, it should not be considered "related to" the debtor's bankruptcy case under the (seemingly) accepted *Pacor* test. Indeed, since bankruptcy courts' jurisdiction to enter a money judgment on a nondischargeable debt can only be explained by principles of supplemental jurisdiction, the circuit courts' uniform approval of this jurisdiction

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EDITOR IN CHIEF: Ralph Brubaker, Professor of Law and Guy Raymond Jones Faculty Scholar, University of Illinois College of Law

CONTRIBUTING EDITORS: Christopher W. Frost, Frost, Brown, Todd Professor of Law, University of Kentucky College of Law; Robert M. Lawless, Professor of Law and Galowich-Huizenga Faculty Scholar, University of Illinois College of Law

PUBLISHER: Jean E. Maess, J.D.

MANAGING EDITOR: Mary A. Raha

Editor's Note: Cases reviewed in this issue have been reported through March 2009. The Bankruptcy Reform Act of 1978 is referred to herein as the Code; the former Bankruptcy Act is referred to as the Act; the Bankruptcy and Federal Judgeship Act of 1984, Public Law No. 98-353, is referred to as the 1984 Amendments; the Bankruptcy Reform Act of 1994 is referred to as the 1994 Amendments; the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 is referred to herein as the 2005 Amendments.

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is both a sub rosa repudiation of *Pacor* and an implicit (if grudging) acceptance of the notion that third-party “related to” bankruptcy jurisdiction is simply a codification of conventional principles of supplemental jurisdiction.

In re Morrison: A \$550,000 Nondischargeable Fraud Debt

Morrison involved a dischargeability action under Code § 523(a)(2)(B) for a debt incurred through a fraudulent financial statement. David Wilson Morrison was the President and principal shareholder of Morrison Excavation, Inc. In February 2002, Morrison’s accountant and financial advisor informed Morrison that his company was in serious financial trouble. Shortly thereafter, Morrison Excavation submitted a bid for an excavation subcontract to Western Builders. Contemporaneous with this subcontract bid, the Morrison Excavation bookkeeper discovered an accounting error that had overstated the company’s accounts receivable by approximately \$875,000, and after the appropriate downward adjustment, Morrison Excavation’s own financial statements would indicate that the company was insolvent. In response to the Morrison Excavation subcontract bid, Western Builders requested a copy of Morrison Excavation’s financial statements, and Morrison sent Western Builders a copy that still reflected the erroneously inflated value of accounts receivable, knowing that the stated accounts receivable figure was incorrect.

In early March 2002, Morrison Excavation and Western Builders entered into a contract for Morrison Excavation to do the specified excavation work. In late March, Western Builders began making advance payments under the contract, at the request of Morrison, to permit payment of Morrison Excavation’s subcontractors and suppliers. Morrison, though, did not fully pay all of those accounts, resulting in mechanics’ liens against the construction site. At this same time, Morrison used corporate funds of Morrison Excavation to pay off his personal home equity loan, and he also gave himself a substantial pay raise. By August, Morrison Excavation had abandoned the Western Builders job, leaving Western Builders to pay all amounts necessary to extinguish the mechanics’ liens attributable to Morrison Excavation’s work. Western Builders was also forced to hire a new

contractor to finish the excavation work at a contract price in excess of half a million dollars more than the Morrison Excavation contract price.

Morrison filed an individual Chapter 7 petition in 2004. In that Chapter 7 case, Western Builders commenced an adversary proceeding against Morrison, contending that Morrison was personally liable to Western Builders for fraud and seeking to have Morrison’s fraud debt to Western Builders declared nondischargeable under Code § 523(a)(2)(B). After trial, the bankruptcy court concluded that Morrison was, indeed, personally liable to Western Builders for his own fraudulent conduct, regardless of the fact that his actions were those of an agent being taken on behalf of his corporate principal, Morrison Excavation.² The bankruptcy court also concluded that Morrison’s knowing submission to Western Builders of a materially false financial statement rendered his fraud debt to Western Builders nondischargeable pursuant to Code § 523(a)(2)(B). Thus the bankruptcy court entered a money judgment for Western Builders against Morrison in the amount of Western’s established damages, \$549,773.63.³

Both the district court and the Fifth Circuit affirmed, but the Fifth Circuit, sua sponte, raised and asked for supplemental briefing on the issue of the bankruptcy court’s jurisdiction to do anything more than simply declare Morrison’s fraud debt to Western Builders nondischargeable (i.e., the bankruptcy court’s jurisdiction to liquidate and enter a money judgment against Morrison on the underlying debt). While ultimately affirming the bankruptcy court’s jurisdiction to liquidate and enter a money judgment on the nondischargeable debt, Judge Edith Jones’s opinion for the Fifth Circuit panel thoughtfully raises (but without resolving) all of the contradictions that this holding exposes in extant bankruptcy jurisdiction jurisprudence.⁴

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BANKRUPTCY LAW LETTER (USPS 0674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published and copyrighted by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526 St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing offices.

Subscription Price: USA, US Possessions, and Canada—\$464.50 annually. For subscription information: call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, PO Box 64833, St. Paul, MN 55164-9753

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526 St. Paul, MN 55164-0526.

Statutory Bankruptcy Jurisdiction

“Arising Under,” “Arising In,” and “Related To” Proceedings

Judge Jones began by noting that bankruptcy jurisdiction, like all other federal jurisdiction, is limited and must be affirmatively granted in a congressional statute. Congress’s grant of bankruptcy jurisdiction to the federal courts is contained in the following provision of the Judicial Code:

(b) ...notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 [the Bankruptcy Code], or arising in or related to [bankruptcy] cases under title 11.⁵

Thus the statute’s three jurisdictional nexuses—“arising under,” “arising in,” and “related to” proceedings—collectively constitute the full measure of federal bankruptcy jurisdiction.

A Dischargeability Declaration Is an “Arising Under” Proceeding

The most elementary aspect of federal bankruptcy jurisdiction is the power to entertain all civil proceedings “arising under” the Bankruptcy Code. This “arising under” bankruptcy jurisdiction was designed to replicate general federal question jurisdiction where the source of federal law under which a claim is made is the federal Bankruptcy Code.⁶

When a particular creditor objects to discharge of its debt, asserting that the debt is one excepted from the discharge pursuant to Code § 523, the parties to that action are the creditor and the individual debtor; the bankruptcy estate is not a party.⁷ Nonetheless, since the bankruptcy discharge is solely a creature of the federal Bankruptcy Code, the nondischargeability action is within both statutory and constitutional “arising under” jurisdiction. As Judge Jones noted in *Morrison*, then, the “arising under” statutory nexus clearly provides bankruptcy jurisdiction over a creditor’s request to have a debt declared nondischargeable:

Western Builders’ claim for a declaration of nondischargeability... “is, without question, a constitutional and statutory federal question claim ‘arising under’ the Bankruptcy Code, because the bankruptcy discharge is relief established by federal bankruptcy law and section 523 expressly authorizes such a declaration regarding the effect of the federal bankruptcy discharge.”⁸

Once a particular debt is declared nondischargeable, finding an appropriate basis for federal bankruptcy jurisdiction to then liquidate and enter a money judgment on that debt, though, proves much more elusive using the dominant judicial interpretations of the scope of the statutory jurisdictional nexuses. Moreover, the need to find an express statutory jurisdictional basis for such a federal-court money judgment is nicely illustrated by the historical evolution of dischargeability determinations in federal court.

A World Without Dischargeability Determinations in Federal Bankruptcy Court

Although a good deal, if not the bulk, of litigation to determine whether a particular debt is subject to a statutory discharge exception now occurs in federal bankruptcy court, historically, such dischargeability litigation did not and could not occur in the federal bankruptcy court granting the debtor a discharge. “The rule was that the bankruptcy court which granted a discharge had no residuary power to adjudge its effect upon any particular claim which might later be asserted against the debtor.”⁹ Rather, the discharge merely provided the debtor with an affirmative defense to be pled in any creditor’s subsequent action to enforce a discharged debt in a nonbankruptcy court, typically a state court.

It was only in that collateral litigation, then, that the debtor or a creditor could obtain a judicial determination as to whether the debt was subject to a statutory discharge exception. The established practice with respect to such dischargeability issues was that “this question was for the determination of the court,” typically a state court, “where an action upon the debt is brought.”¹⁰ “The lower federal courts were clear that... once the discharge was granted its effect on any particular creditor’s claim was to be determined by the non-bankruptcy court in which the creditor attempted to enforce the claim.”¹¹ Thus neither the debtor nor a creditor could “pray, in the bankruptcy, for a determination of the question of whether [a] particular debt will be barred by the discharge.”¹²

The Origins of Dischargeability Determinations in Federal Bankruptcy Court: From *Local Loan Co. v. Hunt* to the 1970 Discharge Amendments

After Local Loan Co. v. Hunt: No Jurisdiction to Enter a Money Judgment on a Nondischargeable Debt

Federal bankruptcy courts’ authority to make individualized dischargeability determinations was ushered in (indirectly) by the Supreme Court’s 1934 decision in

Local Loan Co. v. Hunt.¹³ *Local Loan* authorized federal bankruptcy courts, in “unusual circumstances,” to affirmatively enjoin creditors’ collection actions in violation of a debtor’s discharge decree. Moreover, and as an incident thereto, many federal courts found in the doctrine of *Local Loan* the authority to issue declarations as to the dischargeability of particular debts as a necessary prerequisite to such an injunction.¹⁴ These same courts, though, refused to liquidate nondischargeable debts and enter money judgments against debtors for lack of federal jurisdiction.¹⁵

Thus the federal courts have always considered the dischargeability issue to be an independent jurisdictional “claim” distinct from the creditor’s claim on the underlying debt. Therefore, a federal bankruptcy court’s entry of a money judgment on the underlying debt can only be premised upon an affirmative grant of jurisdiction therefor and cannot be considered part and parcel of federal jurisdiction over the dischargeability determination. Such a jurisdictional grant was forthcoming in the 1970 discharge amendments to the Bankruptcy Act of 1898.

After the 1970 Discharge Amendments: Specific Express Jurisdiction to Enter a Money Judgment on a Nondischargeable Debt

In 1970, Congress amended the Bankruptcy Act of 1898 to expressly codify not only a statutory discharge injunction but also the authority of federal bankruptcy courts to “determine the dischargeability of debts.”¹⁶ Moreover, in order to address concerns about multiplicity of suits in state and federal court,¹⁷ those amendments further provided that “if any debt is determined to be nondischargeable, [the court] shall determine the remaining issues, render judgment, and make all orders necessary for the enforcement thereof.”¹⁸

After the 1978 Reform Act: ??

The jurisdictional grant of the Bankruptcy Reform Act of 1978 providing for federal bankruptcy jurisdiction over all “arising under,” “arising in,” and “related to” proceedings was variously characterized as: “pervasive,”¹⁹ “complete,”²⁰ “comprehensive,”²¹ “as broad [a] jurisdiction as possible,”²² and “as broad as can be conceived.”²³ While not expressly providing authority for federal bankruptcy courts to render money judgments on nondischargeable debts, Congress clearly intended such authority to continue under the aegis of the Reform Act’s pervasive federal bankruptcy jurisdiction.

The 1973 Commission’s proposed bill would have explicitly provided for federal bankruptcy jurisdiction over “complaints requesting determination of the effect of a discharge, and seeking judgment on a debt excepted

from discharge.”²⁴ The Reform Act’s simplified pervasive jurisdiction was designed to subsume “all items listed by the Bankruptcy Commission in its proposed bill... as well as all items that the bankruptcy courts are now able to bear [sic] under [1898] Act § 2a,” including “determination of dischargeability of debts [and] liquidation of non-dischargeable debts.”²⁵

Judge Jones found this history persuasive as to congressional intent: “It is not unreasonable to conclude that Congress, which intended bankruptcy courts to exercise far more expansive jurisdiction under the Code than under previous law, could not have intended to cut back on their ability to enter money judgments in the... proceedings encompassed by non-dischargeability complaints.”²⁶

Entering a Judgment on a Nondischargeable Debt Is Not an “Arising Under” or “Arising In” Proceeding

Notwithstanding Congress’s desire that the federal courts should have bankruptcy jurisdiction under the current statute, if we apply the prevailing jurisdictional tests to a creditor’s request for a money judgment on a nondischargeable debt, we come to the inescapable conclusion that there is no federal bankruptcy jurisdiction. A nonbankruptcy/state-law claim on which a creditor seeks a money judgment obviously does not “arise under” the Bankruptcy Code. Furthermore, it does not “arise in” the bankruptcy case under the standard test for “arising in” proceedings.

An “arising in” proceeding has come to be considered one “that, by its nature, could arise only in the context of a bankruptcy case” or that “would have no existence outside of bankruptcy.”²⁷ A creditor’s claim on a nondischargeable debt cannot be an “arising in” proceeding under this test because the creditor’s underlying claim against the debtor would exist in exactly the same form even in the absence of the debtor’s bankruptcy filing. “Indeed, that is precisely the upshot of the determination of nondischargeability.”²⁸ Thus if the claim on the underlying debt is within federal bankruptcy jurisdiction at all, it is because it is “related to” the debtor’s bankruptcy case.

Entering a Judgment on a Nondischargeable Debt Is Not a “Related To” Proceeding Under the Pacor Test

“Related to” proceedings are of two types: (1) *Marathon*-like state-law actions by the bankruptcy estate against a third party are “related to” a debtor’s bankruptcy case;²⁹ (2) third-party nonbankruptcy/state-law actions to which the bankruptcy estate is not party are

also “related to” a debtor’s bankruptcy case in certain circumstances.³⁰

A creditor’s request that the bankruptcy court, in addition to declaring a debt nondischargeable, also liquidate the debt and enter a money judgment on the debt against the individual debtor personally is “related to” the debtor’s bankruptcy case only if it falls within the second category of “related to” proceedings. Although less obvious than other third-party disputes, a state-law claim by or against an individual debtor personally is analytically identical to any other third-party state-law claim to which the federal bankruptcy estate is not a party. Any such third-party state-law dispute falls within federal bankruptcy jurisdiction only if it is “related to” the debtor’s bankruptcy case in the necessary sense.³¹

The dominant test for the existence of third-party “related to” bankruptcy jurisdiction comes from the Third Circuit’s (in)famous *Pacor* opinion: “The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether *the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.*”³² Utilizing this *Pacor* test, we would have to conclude that a creditor’s request for a money judgment on a nondischargeable debt is not “related to” the debtor’s bankruptcy case.

Because the estate is not a party to the dischargeability proceeding, *Pacor* “teaches” us that the estate has no interest in the outcome of the creditor’s claim against the debtor, as the estate would not be bound by any money judgment against the debtor³³ and could fully relitigate the creditor’s claim against the estate in claims objection proceedings.³⁴ The only conceivable outcome-oriented effect on the estate from the creditor’s claim against the debtor would be if the creditor is able to collect from the debtor personally before any bankruptcy distribution. This would reduce the creditor’s claim against the estate to the benefit of all other creditors.³⁵ Yet, even this *Pacor*-like rationale for jurisdiction will usually be unavailable, as the vast majority of individual Chapter 7 filings are “no-asset” cases in which the filing and adjudication of creditors’ claims against the estate is futile.³⁶ Moreover, even in asset cases, the remote contingency of collecting from a co-liable entity, thereby reducing a creditor’s claim against the bankruptcy estate, does not perforce establish “related to” bankruptcy jurisdiction over the creditor’s action against the co-debtor under *Pacor*.³⁷

Thus the only demonstrable effect of any money judgment against the individual debtor would be to enhance the creditor’s future ability to collect the nondischargeable debt from the debtor’s postbankruptcy income and

assets, with no evident effect at all on property of the bankruptcy estate or creditors’ claims against the estate. Judge Jones in *Morrison* agreed:

[T]he rendition of a monetary judgment in favor of the creditor on that debt... is not clearly related to the bankruptcy case or administration of the debtor’s estate. Indeed, that portion of the judgment has, in the usual case, no bearing on the bankruptcy case because it requires the debtor to pay a single debt outside of, apart from, and even after the completion of bankruptcy, and it frees the creditor thereafter from limiting its collection efforts to those afforded by the bankruptcy system.³⁸

Viewed through the lens of the *Pacor* test, then, a creditor’s request to liquidate and enter a money judgment on a nondischargeable debt cannot be considered “related to” the debtor’s bankruptcy case. Indeed, the courts that actually have confronted the jurisdictional issue with the announced standards have come to the same conclusion—there is no federal bankruptcy jurisdiction to enter a money judgment against an individual debtor on a nondischargeable debt.³⁹ Yet, the vast majority of bankruptcy courts routinely entertain creditor requests for money judgments on nondischargeable debts.⁴⁰ Moreover, every circuit to address the issue, including the Fifth Circuit in *Morrison*, has held that there is federal bankruptcy jurisdiction to liquidate and enter a judgment on a nondischargeable debt.⁴¹ How could that be?

Entering a Judgment on a Nondischargeable Debt Is a Proper Exercise of Supplemental Jurisdiction

The courts of appeals have, to date, uniformly concluded that there is federal bankruptcy jurisdiction to liquidate and enter a money judgment on a nondischargeable debt—not because of any effect on the bankruptcy estate à la *Pacor* but because of the close factual and logical relationship between the dischargeability proceeding and any proceeding on the underlying debt. Judge Jones’s reasoning in *Morrison* is illustrative:

The pragmatic reasoning adopted by most circuit courts is hard to contradict. Logically, the litigation to prove nondischargeability also proves the basis for and amount of the debt. There would be no judicial efficiency in requiring the beneficiary of a nondischargeability judgment to pursue a separate lawsuit in state or federal court in order to secure a money judgment against the debtor... [E]ntry of judgment for the debt is proper because the court actually determined “the existence and validity of the debt” in [the nondischargeability] proceeding.⁴²

This is, of course, quite unmistakably a conventional supplemental jurisdiction rationale which premises federal jurisdiction over a claim for which there is no independent, freestanding basis for federal jurisdiction (i.e., the creditor's underlying state-law claim against the debtor personally) upon a "common nucleus of operative fact"⁴³ shared with another claim before the court for which there is an independent, freestanding basis for federal jurisdiction (i.e., the creditor's nondischargeability claim). In fact, the circuit courts' opinions contain many veiled references to principles of supplemental jurisdiction,⁴⁴ including reliance on one of the earliest progenitors of modern supplemental jurisdiction principles, *Alexander v. Hillman*,⁴⁵ and the accompanying equitable maxim in which principles of supplemental jurisdiction are rooted: complete disposition of an entire controversy.⁴⁶ As one bankruptcy court decision, heavily relied upon in circuit court opinions, noted, "the well-known maxim that once equitable jurisdiction has been properly invoked it will proceed to render a full and complete disposition of the controversy," like supplemental jurisdiction, is grounded in notions of judicial economy and procedural convenience, "prevent[ing] a duplication of effort and a multiplicity of suits."⁴⁷

In other words, the rationale for federal jurisdiction is the same as that precipitating the 1970 discharge amendments. It would be inconvenient and inefficient to require a separate action in state court to obtain a money judgment on a debt declared nondischargeable, so the federal bankruptcy court has supplemental jurisdiction to entertain the action on the underlying debt as an incident to its independent federal question jurisdiction over the dischargeability action.⁴⁸ The action on the underlying debt is not "related to" the debtor's bankruptcy case because of any effect on the debtor's bankruptcy estate; the action on the debt is "related to" the dischargeability proceeding, through a conventional supplemental nexus. Indeed, the Ninth Circuit is now quite explicit in attributing bankruptcy jurisdiction to enter judgment on a nondischargeable debt to "related to" jurisdiction and its fundamental character as a grant of supplemental jurisdiction: "the bankruptcy court's 'related to' jurisdiction also includes the district court's supplemental jurisdiction."⁴⁹

The immense judicial economy from adjudication of the creditor's underlying claim by the court hearing the nondischargeability action is, of course, meaningless according to *Pacor*. Indeed, *Pacor* was quite emphatic that third-party "related to" bankruptcy jurisdiction is not a form of supplemental jurisdiction: "[T]he mere fact that there may be common issues of fact between a civil proceeding and a controversy involving the bankruptcy estate does not bring the matter within the scope

of [third-party "related to" bankruptcy jurisdiction]. Judicial economy itself does not justify federal jurisdiction."⁵⁰ The dischargeability decisions, therefore, are a tremendous embarrassment not only for the *Pacor* test but also for *Pacor*'s disavowal of any role for supplemental jurisdiction principles in construing the reach of "related to" bankruptcy jurisdiction. Both of these revealed *Pacor* flaws, of course, have implications well beyond the dischargeability decisions themselves.

Recognizing the latter incongruity implicit in the Fifth Circuit's holding in *Morrison*, Judge Jones noted:

This court has... rejected supplemental jurisdiction for bankruptcy courts, see *Walker v. Cadle Co. (In re Walker)*, 51 F.3d 562, 569 (5th Cir. 1995)... *Walker*, however, involved the question of supplemental jurisdiction over a third-party claim, rather than what is considered here, the jurisdiction to enter complete relief between two parties on a claim.⁵¹

If "related to" bankruptcy jurisdiction is a grant of supplemental jurisdiction, though, which the dischargeability decisions clearly suggest, this attempt to distinguish *Walker* fails because "related to" jurisdiction unquestionably encompasses third-party claims, as the Supreme Court has acknowledged.⁵²

As this Contributing Editor argued in the March 2007 issue of *Bankruptcy Law Letter*,⁵³ the only reconciliation consistent with the terms of the jurisdictional statute and the legislative history regarding its purposes is to simply recognize that *Pacor* was wrong; third-party "related to" bankruptcy jurisdiction is supplemental jurisdiction, and there is "related to" bankruptcy jurisdiction over any third-party dispute sharing a conventional supplemental relationship with a claim before the court (1) "arising under" the Bankruptcy Code or (2) to which the federal bankruptcy estate is a party. Indeed, the Eleventh Circuit has now accepted this supplemental-jurisdiction interpretation of third-party "related to" bankruptcy jurisdiction, even outside the context of the dischargeability decisions, by affirming⁵⁴ Bankruptcy Judge Bonapfel's jurisdictional analysis in the *Hospitality Ventures/La Vista* case,⁵⁵ discussed in the March 2007 Bankruptcy Law Letter.

Entering a Judgment on a Nondischargeable Debt Is a Proper Exercise of Core Jurisdiction

The circuit cases on nondischargeable money judgments also reveal another odd anomaly in extant bankruptcy jurisdiction jurisprudence, distinct from the jurisdictional scope issue discussed above. There is also embedded in the statute's jurisdictional nexuses a separate, wholly unrelated issue growing out of the Supreme

Court's famous *Marathon* decision⁵⁶ and the subsequent Bankruptcy Amendments and Federal Judgeship Act (BAFJA) of 1984, enacted to cure the constitutional deficiency identified in *Marathon*, through the present core/noncore division of federal bankruptcy jurisdiction. Because the jurisdictional statutes now employ the same jurisdictional nexuses to simultaneously determine both (wholly unrelated) issues—both jurisdictional scope and core/noncore—it turns out (not surprisingly) that crafting useful “tests” that rationally define the content of each jurisdictional nexus (for both purposes simultaneously) is actually impossible, and the nondischargeable money judgment cases illustrate this nicely.

Marathon and the 1984 BAFJA amendments were concerned with an issue of separation of powers, and *Marathon*'s proscription, at its most basic level, was that the entirety of the 1978 Reform Act's pervasive federal bankruptcy jurisdiction cannot be assigned to non-Article III bankruptcy courts.⁵⁷ That separation-of-powers holding speaks solely to the proper allocation of federal bankruptcy jurisdiction as between Article III and non-Article III federal tribunals. *Marathon* and BAFJA, however, say nothing about the issue analyzed above, which is the issue of the scope of federal bankruptcy jurisdiction.⁵⁸ Irrespective of the type of federal judicial officer that will exercise it (Article III or non-Article III), what is the full extent of federal bankruptcy jurisdiction?

The scope of federal bankruptcy jurisdiction is, of course, a judicial federalism issue going to the allocation of judicial power as between the federal courts and the state courts. What disputes can we essentially take from the state courts and place before the federal courts through our pervasive federal bankruptcy jurisdiction? The principal bone of contention in the nondischargeable money judgment cases concerns judicial federalism and the scope of federal bankruptcy jurisdiction—is there any federal bankruptcy jurisdiction to enter a money judgment on a nondischargeable debt in federal court, or must we relegate the creditor to state court for entry of a money judgment?

Once we decide, though, that there is federal bankruptcy jurisdiction to liquidate and enter a money judgment on a nondischargeable debt (as all circuits, to date, have), the immediate follow-up inquiry is the separation-of-powers inquiry necessitated by *Marathon* and BAFJA. After *Marathon* and the ensuing 1984 BAFJA amendments, we are left with federal bankruptcy jurisdiction that is divided between the non-Article III bank-

ruptcy courts and the federal district courts. Bankruptcy judges have unrestricted jurisdiction over “core” bankruptcy proceedings “arising under” the Bankruptcy Code and “arising in” a bankruptcy case.⁵⁹ In noncore proceedings “related to” a bankruptcy case, however, unless the parties consent to adjudication in the bankruptcy court, any final order must be entered by a federal district court judge.⁶⁰

The statute's jurisdictional nexuses thus have evolved into catachrestic compartments that mark the boundaries between the limited jurisdiction of non-Article III bankruptcy judges and the residual authority of the Article III district courts. They could not have been designed for such purpose, however, since their original function was to vest the entirety of this federal jurisdiction in non-Article III bankruptcy judges. As Bankruptcy Judge Leif Clark correctly noted: “Obviously, then, Congress did not select these terms in 1978 to assure that it would be able to allocate the exercise of jurisdiction the way it did six years later in the 1984 amendments.”⁶¹

As the analysis above revealed, federal bankruptcy jurisdiction to liquidate and enter a money judgment on a nondischargeable debt is not properly considered either an “arising under” or “arising in” proceeding. This is true whether one interprets the content of the “arising in” nexus in accordance with its most plausible original meaning (considering only jurisdictional scope before *Marathon*)⁶² or using the prevailing “arising in” test formulated under the separation-of-powers influence of *Marathon*.⁶³ Thus if there is federal bankruptcy jurisdiction to liquidate and enter a money judgment on a nondischargeable debt, it can only be “related to” bankruptcy jurisdiction. If we mechanically transferred this result into the core/noncore dichotomy, we would then conclude that jurisdiction to liquidate and enter judgment on a nondischargeable debt is noncore “related to” jurisdiction.

The circuit cases on nondischargeable money judgments, though, have all held that bankruptcy courts have “core” jurisdiction to entertain an action on the underlying debt and enter a final judgment against the debtor. Like the inexplicable finding of “related to” jurisdiction using the *Pacor* test, this result also defies the beguiling formula for core “arising in” proceedings.⁶⁴ As Judge Jones noted in *Morrison*, “[c]ircuit courts that have approved the entry of money judgments by bankruptcy courts in nondischargeability cases have paid little attention to the jurisdictional dichotomy of core and related-to jurisdiction.”⁶⁵ How, then, can we justify core jurisdiction in the non-Article III bankruptcy courts to enter a money judgment on a nondischargeable debt?

The Case Against Core Jurisdiction: Traditional State-Law Action Not Involving Adjustment of the Debtor-Creditor Relation

The adjunct bankruptcy courts created by the 1978 Reform Act exercised all of the expanded, pervasive federal bankruptcy jurisdiction, yet the Reform Act bankruptcy judges were not given Article III status, with its protections of lifetime tenure and undiminished compensation. In *Marathon*, the Court held that jurisdictional design violated Article III as applied to the case before it, a suit by a Chapter 11 debtor to recover damages from a third party for breach of contract. Under the predecessor 1898 Act, such a suit would have been a plenary action against an adverse party, outside the summary jurisdiction of a non-Article III bankruptcy referee, requiring a plenary suit in state court or a federal district court. Under the Reform Act, however, this suit fell within the broad jurisdiction of the new bankruptcy courts.

A plurality of the *Marathon* Court concluded that this grant of jurisdiction to bankruptcy judges had “impermissibly removed most, if not all, of ‘the essential attributes of the judicial power’ from the Art. III district court, and ha[d] vested those attributes in a non-Art. III adjunct.”⁶⁶ The concurring justices agreed that jurisdiction to adjudicate the debtor’s action, which would exist in essentially the same form even if the debtor had not filed bankruptcy, could only be vested in an Article III judge.⁶⁷ Perhaps the broadest proposition on which both the plurality and concurrence agreed was this: “It is clear that, at the least, the new bankruptcy judges cannot constitutionally be vested with jurisdiction to decide this state-law contract claim against [defendant] *Marathon*.”⁶⁸ The Court subsequently characterized the *Marathon* holding as “establish[ing] only that Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review.”⁶⁹

Restricting the adjudicatory jurisdiction of bankruptcy courts to “core” proceedings through 1984 BAFJA amendments was obviously an attempt to cure the constitutional infirmities of the Reform Act. The terminology of “core” bankruptcy proceedings has no statutory ancestors and is apparently taken from Justice Brennan’s plurality opinion in *Marathon*, wherein he said that “the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case.”⁷⁰ Nowhere does the statute define a “core” proceeding. The closest thing to a definition comes through a nonexclusive list of matters

included within core proceedings, including the catch-all categories of “matters concerning the administration of the estate” and “other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship.”⁷¹ The second catch-all core category, like the “core” terminology itself, also apparently has its origins in the just-quoted passage from Justice Brennan’s *Marathon* opinion.

Nearly all of these cues would lead one to believe that liquidation and entry of a money judgment on a nondischargeable debt cannot be considered a core proceeding, as indicated by the prevailing post-*Marathon* test for core “arising in” proceedings. The action on the underlying debt, like the action at issue in the *Marathon* case itself, is a traditional state-law action that would exist in precisely the same form even if the debtor had not filed bankruptcy. While the dischargeability claim does involve the potential for adjustment of the debtor-creditor relation, the action on the underlying debt, should it be declared nondischargeable, does not involve any adjustment of the debtor-creditor relationship; it simply confirms and adjudicates the rights that prevail between the creditor and the debtor outside of bankruptcy. Likewise, the action on the underlying debt is totally unrelated to administration of the debtor’s bankruptcy estate and liquidation of the assets of that estate.

The Case for Core Jurisdiction: Summary Jurisdiction Under the 1898 Act

There is one significant difference between a nondischargeable money judgment and the action at issue in the *Marathon* case that legitimizes the circuit courts’ conclusion that there is core bankruptcy jurisdiction over the former. Under the jurisdictional provisions of the 1898 Act, the contract action at issue in *Marathon* would have been outside the summary jurisdiction of non-Article III referees to enter a final order in a summary proceeding, absent consent of the litigants. Under the 1970 discharge amendments, though, bankruptcy referees were specifically given summary jurisdiction to “determine the dischargeability of debts, and render judgments thereon.”⁷²

Notwithstanding much of the language of the *Marathon* plurality and concurring opinions, it seems that the most objectionable aspect of the 1978 Reform Act, in the eyes of the Court, was that it simply went beyond the 1898 Act in the jurisdictional authority entrusted to a non-Article III adjunct—a point made by Justice White in his dissent.⁷³ Thus the Court essentially constitutionalized the 1898 Act’s divide between summary and plenary proceedings, not only in *Marathon*

but also in subsequent decisions regarding the right to a jury trial in bankruptcy proceedings.⁷⁴

If this is an appropriate interpretation of the essence of the *Marathon* holding, and if the statutory content of core proceedings under the 1984 BAFJA amendments simply codifies the constitutional line between that which is and that which is not appropriate for final adjudication by a non-Article III adjunct—both of which appear to be the case—then the circuit courts' uniform conclusion that there is core jurisdiction in the bankruptcy courts to liquidate and enter a money judgment on a nondischargeable debt seems entirely appropriate. Core jurisdiction to enter a money judgment on a nondischargeable debt is best explained as consistent with the historical summary jurisdiction of bankruptcy referees under the 1898 Act. Judge Jones's opinion for the Fifth Circuit in *Morrison*, with her principal reliance on "tradition" and the reach of summary referee jurisdiction under the 1898 Act, confirms this.

- In re *Morrison*, 555 F.3d 473, 51 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 81399 (5th Cir. 2009).
- A corporate agent who engages in wrongful conduct, such as fraud, is directly responsible as a tortfeasor and is not shielded from liability by virtue of the fact that the agent's fraudulent conduct was taken on behalf of a corporate principal. See Restatement (Second) of Agency § 343 (1958) ("[a]n agent who does an act otherwise a tort is not relieved from liability by the fact that he acted at the command of the principal or on account of the principal"). Because a corporation (a fictional person) cannot "do" anything except through the actions of its corporate agents (real people), the corporation's fraud liability is purely a vicarious liability through which the corporation (i.e., the corporate property) is also subjected to liability for the corporate agent's fraudulent conduct. See Restatement (Second) of Agency § 257.
- In re *Morrison*, 361 B.R. 107 (Bankr. W.D. Tex. 2007), subsequently aff'd, 555 F.3d 473, 51 Bankr. Ct. Dec. (CRR) 23, Bankr. L. Rep. (CCH) P 81399 (5th Cir. 2009).
- See also Ralph Brubaker, On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory, 41 Wm. & Mary L. Rev. 743, 910-21 (2000); Hon. Randolph J. Haines, Old Rules Reveal *Pacor's* Shortcomings, Norton Bankr. L. Adviser Jan. 2003, at 1; In re *Lockridge*, 303 B.R. 449, 453-56 (Bankr. D. Ariz. 2003).
- 28 U.S.C.A. § 1334(b).
- See H.R. Rep. No. 95-595, at 445 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6401.
- See In re *Brady*, 101 F.3d 1165, 1170, 30 Bankr. Ct. Dec. (CRR) 15, 37 Collier Bankr. Cas. 2d (MB) 218, Bankr. L. Rep. (CCH) P 77202, 1996 FED App. 0379P (6th Cir. 1996) (noting that "a trustee may not file a nondischargeability complaint"); *Matter of Farmer*, 786 F.2d 618, 620-21, 14 Collier Bankr. Cas. 2d (MB) 467, Bankr. L. Rep. (CCH) P 71047 (4th Cir. 1986) (rejected by, In re *Brady*, 101 F.3d 1165, 30 Bankr. Ct. Dec. (CRR) 15, 37 Collier Bankr. Cas. 2d (MB) 218, Bankr. L. Rep. (CCH) P 77202, 1996 FED App. 0379P (6th Cir. 1996)) (same); 1 Thomas J. Salerno et al., *Bankruptcy Litigation and Practice* § 8.55, at 472, 474 (2d ed. 1995).
- Morrison*, 555 F.3d at 478 (quoting Brubaker, 41 Wm. & Mary L. Rev. at 911). Either the creditor or the debtor may request a declaration as to the dischargeability of any debt. See Fed. R. Bankr. P. 4007(a). Code § 523(c)(1), in effect, gives the bankruptcy court exclusive jurisdiction to determine the applicability of certain discharge exceptions, including the 523(a)(2) exception, whereas other discharge exceptions can be litigated collaterally. See 11 U.S.C.A. § 523(c)(1); Fed. R. Bankr. P. 4007 advisory committee note. See generally Ralph Brubaker, The Impact of the Discharge Injunction on State-Court Dischargeability Determinations, 22 Bankr. L. Letter, No. 8, Aug. 2002, at 7; Ralph Brubaker, Criminal Prosecutions, Statutory Bankruptcy Injunctions, and the Preclusive Effect of State-Court Determinations, 20 Bankr. L. Letter, No. 5, May 2000, at 1. As the Bankruptcy Code itself contemplates dischargeability declarations in federal court, the problems surrounding anticipation of a federal defense that plague the general federal question statute are avoided. See generally *Matter of National Gypsum Co.*, 118 F.3d 1056, 1062-64, 31 Bankr. Ct. Dec. (CRR) 237, 38 Collier Bankr. Cas. 2d (MB) 722 (5th Cir. 1997) (rejecting an argument that a federal declaratory action regarding the collateral effects of the discharge was an improper attempt to premise federal question jurisdiction upon anticipation of a federal defense). Moreover, as discussed below, the bankruptcy discharge has itself become more than a mere affirmative defense to a creditor's state-law claim.
- Garrard Glenn, *Effect of Discharge in Bankruptcy: Ancillary Jurisdiction of Federal Court*, 30 Va. L. Rev. 531, 532 (1944).
- Glenn, 30 Va. L. Rev. at 532, 533.
- Vern C. Countryman, The New Dischargeability Law, 45 Am. Bankr. L.J. 1, 2-3 (1971).
- Glenn, 30 Va. L. Rev. at 537.
- Local Loan Co. v. Hunt*, 292 U.S. 234, 54 S. Ct. 695, 78 L. Ed. 1230, 93 A.L.R. 195 (1934).
- See Countryman, 45 Am. Bankr. L.J. at 2-10.
- See, e.g., In re *Borek*, 180 F. Supp. 567, 571 (D.N.J. 1960) (finding no independent federal jurisdiction over a nondiverse state-law claim and noting that "entering judgment against the individual bankrupt in no way aids the administration of the bankrupt's estate... but only aids the individual creditor in pursuing his individual rights against the bankrupt"); In re *Anthony*, 42 F. Supp. 312, 316 (E.D. Ill. 1941) (even in cases where *Local Loan* permits a federal bankruptcy court to determine dischargeability of a debt, the court "cannot carry through and render a judgment upon a creditor's unreleased claim upon which execution may issue against the bankrupt's after-acquired assets").
- Bankruptcy Act of 1898 § 2a(12).
- See 1A *Collier on Bankruptcy* ¶ 17.28A[4], at 1742.4 (James Wm. Moore et al. eds., 14th ed. 1978); Countryman, 45 Am. Bankr. L.J. at 19, 21-22, 31-32 (tracing and summarizing the legislative history of the 1970 discharge amendments).
- Bankruptcy Act of 1898 § 17c(3); see also Bankruptcy Act of 1898 § 2a(12) (providing for jurisdiction to "determine the dischargeability of debts, and render judgments thereon").
- 124 Cong. Rec. 34,010 (1978) (statement of Sen. DeConcini); 124 Cong. Rec. at 32,419 (statement of Rep. Butler); 124 Cong. Rec. at 32,410 (statement of Rep. Edwards); 124 Cong. Rec. at 28,258 (statement of Sen. Wallop).
- H.R. Rep. No. 95-595, at 14 n.84, 48 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 5976 n.84, 6010.
- H.R. Rep. No. 95-595, at 46, reprinted in 1978 U.S.C.C.A.N. at 6007.
- Bankruptcy Reform Act of 1978: Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, 95th Cong. 544 (1977) (statement of Griffin Bell, Attorney General).
- Bankruptcy Court Revision: Hearings on H.R. 8200 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary, 95th Cong. 217 (1977) (statement of Griffin Bell, Attorney General).
- Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. II, § 2-201(a)(4), at 30 (1973); see also H.R. Doc. No. 93-137 § 4-506(d), at 137 ("If the court determines a debt to be nondischargeable in a proceeding commenced under this section, it shall determine any remaining issues concerning liability on the debt unless, for cause shown and in the interest of justice, the court suspends or declines the exercise of its jurisdiction"). Recognition of "the appropriateness of suspension or declination of jurisdiction" would permit "litigation

- in another court [that] has proceeded to a point where it would be wasteful of judicial resources and inequitable to one or more of the parties to require reintroduction of evidence and reargument of issues in the bankruptcy court.” H.R. Doc. No. 93-137 § 4-506(d), at 142.
25. H.R. Rep. No., 95-595, at 446, 49 (1977) (footnote referencing 1898 Act § 17c omitted), reprinted in 1978 U.S.C.C.A.N. 5963, 6401, 6010; see also H.R. Rep. No., 95-595, at 363 (noting that “the comprehensive grant of jurisdiction prescribed in the proposed [statute]... is adequate to cover the full jurisdiction that the bankruptcy courts have today over dischargeability and related issues under Bankruptcy Act § 17c”), reprinted in 1978 U.S.C.C.A.N. at 6319; S. Rep. No. 95-989, at 77 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5863.
 26. Morrison, 555 F.3d at 479.
 27. Matter of Wood, 825 F.2d 90, 97, 17 Collier Bankr. Cas. 2d (MB) 743, Bankr. L. Rep. (CCH) P 71955 (5th Cir. 1987).
 28. In re Cambio, 353 B.R. 30, 34, 52 Collier Bankr. Cas. 2d (MB) 1711, Bankr. L. Rep. (CCH) P 80162 (B.A.P. 1st Cir. 2004) (quoting Brubaker, 41 Wm. & Mary L. Rev. at 914-15).
 29. See Northern Pipeline Const. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598, 6 Collier Bankr. Cas. 2d (MB) 785, Bankr. L. Rep. (CCH) P 68698 (1982).
 30. See Celotex Corp. v. Edwards, 514 U.S. 300, 307-08 n.5, 115 S. Ct. 1493, 131 L. Ed. 2d 403, 27 Bankr. Ct. Dec. (CRR) 93, 32 Collier Bankr. Cas. 2d (MB) 685, Bankr. L. Rep. (CCH) P 76456, 31 Fed. R. Serv. 3d 355 (1995).
 31. See generally Brubaker, 41 Wm. & Mary L. Rev. at 910-21.
 32. Pacor, Inc. v. Higgins, 743 F.2d 984, 994, 12 Bankr. Ct. Dec. (CRR) 285, Bankr. L. Rep. (CCH) P 70002 (3d Cir. 1984). For an exhaustive critique of *Pacor* and its multiple manifest missteps, see Brubaker, 41 Wm. & Mary L. Rev. at 869-940.
 33. In finding no “related to” bankruptcy jurisdiction over the third-party claim before it, the *Pacor* court emphasized that “the outcome of that [third-party] action would in no way bind [the debtor’s bankruptcy estate]... [s]ince [the estate] is not a party” and “could not be bound by res judicata or collateral estoppel.” *Pacor*, 743 F.2d at 995.
 34. See generally James N. Duca & Cori Ann C. Yokota, The Role of *Res Judicata* in Bankruptcy Claim Allowance Proceedings, 17 U. Haw. L. Rev. 1 (1995); Jeffrey T. Ferriell, The Preclusive Effect of State Court Decisions in Bankruptcy (pt. 2), 59 Am. Bankr. L.J. 55, 80-86 (1985); James Wm. Moore, Res Judicata and Collateral Estoppel in Bankruptcy, 68 Yale L.J. 1, 28-29, 39-50 (1958).
 35. See Bass v. Denney, 1998 WL 59486, at *2 & n.4 (N.D. Tex. 1998), judgment rev’d, 171 F.3d 1016 (5th Cir. 1999).
 36. See Matter of Kubly, 818 F.2d 643, 644-45, Bankr. L. Rep. (CCH) P 71803 (7th Cir. 1987) (finding no “related to” jurisdiction over a third-party dispute in a no-asset case, even if it could affect the amount of a creditor’s unsecured claim).
 37. Compare Quattrone Accountants, Inc. v. I.R.S., 895 F.2d 921, 926-27 & n.4, 20 Bankr. Ct. Dec. (CRR) 168, 22 Collier Bankr. Cas. 2d (MB) 427, Bankr. L. Rep. (CCH) P 73256, 90-1 U.S. Tax Cas. (CCH) P 50103, 65 A.F.T.R.2d 90-580 (3d Cir. 1990) (the possibility of collection from a third party reducing a creditor’s claim against the bankruptcy estate was insufficient to establish “related to” jurisdiction over the creditor’s claim against the third party), with Halper v. Halper, 164 F.3d 830, 837-38, 33 Bankr. Ct. Dec. (CRR) 906, Bankr. L. Rep. (CCH) P 77909 (3d Cir. 1999) (reaching precisely the opposite conclusion); In re Celotex Corp., 124 F.3d 619, 626-27 (4th Cir. 1997) (same).
 38. Morrison, 555 F.3d at 479.
 39. See, e.g., Cambio, 353 B.R. at 33-35; In re Losanno, 291 B.R. 1 (Bankr. D. Mass. 2003); In re Hamilton, 282 B.R. 22, 39 Bankr. Ct. Dec. (CRR) 265, 48 Collier Bankr. Cas. 2d (MB) 1419 (Bankr. W.D. Okla. 2002); In re Thrall, 196 B.R. 959, 968-69, 36 Collier Bankr. Cas. 2d (MB) 521 (Bankr. D. Colo. 1996); In re Barrows, 182 B.R. 640, 653, 100 Ed. Law Rep. 1075 (Bankr. D. N.H. 1994); In re Marlur, 142 B.R. 304, 307, Bankr. L. Rep. (CCH) P 74735 (Bankr. E.D. Ark. 1992); cf. In re Bass, 171 F.3d 1016, 1019-23 (5th Cir. 1999) (finding no bankruptcy jurisdiction to entertain a garnishment action to collect on a bankruptcy court’s money judgment on a nondischargeable debt); In re McAllister, 216 B.R. 957, 964-69 (Bankr. N.D. Ala. 1998) (same); In re Sieger, 200 B.R. 636, 637-40 (Bankr. N.D. Ind. 1996) (same). Likewise, Professor Block-Lieb, without citation of authority, concluded that a creditor’s request for a money judgment on a nondischargeable debt has no effect on the estate and thus cannot be within third-party “related to” bankruptcy jurisdiction. See Susan Block-Lieb, The Case Against Supplemental Bankruptcy Jurisdiction: A Constitutional, Statutory, and Policy Analysis, 62 Fordham L. Rev. 721, 749 n.173 (1994).
 40. Thus, for example, the Supreme Court’s decision in *Cohen v. De La Cruz* addressing only a dischargeability issue nonetheless affirmed a bankruptcy court’s entry of a money judgment against an individual debtor on debts determined to be nondischargeable. See In re Cohen, 185 B.R. 171 (Bankr. D. N.J. 1994) (holding the debts nondischargeable), and In re Cohen, 185 B.R. 180 (Bankr. D. N.J. 1995), aff’d, 191 B.R. 599 (D.N.J. 1996), aff’d, 106 F.3d 52, 30 Bankr. Ct. Dec. (CRR) 389, 37 Collier Bankr. Cas. 2d (MB) 666, Bankr. L. Rep. (CCH) P 77265 (3d Cir. 1997), judgment aff’d, 523 U.S. 213, 118 S. Ct. 1212, 140 L. Ed. 2d 341, 32 Bankr. Ct. Dec. (CRR) 400, 38 Collier Bankr. Cas. 2d (MB) 1891, Bankr. L. Rep. (CCH) P 77644 (1998) (affirming liquidation and entry of a money judgment on the nondischargeable debts).
 41. See In re Sasson, 424 F.3d 864, 867-70 (9th Cir. 2005); In re Kennedy, 108 F.3d 1015, 1017-18, 30 Bankr. Ct. Dec. (CRR) 635, 37 Collier Bankr. Cas. 2d (MB) 980, Bankr. L. Rep. (CCH) P 77316 (9th Cir. 1997), as amended, (Mar. 21, 1997); Hall v. Davenport, 76 F.3d 372 (4th Cir. 1996) (unpublished table decision); In re McLaren, 3 F.3d 958, 965-66, 29 Collier Bankr. Cas. 2d (MB) 969, Bankr. L. Rep. (CCH) P 75430, 39 Fed. R. Evid. Serv. 495 (6th Cir. 1993); Abramowitz v. Palmer, 999 F.2d 1274, 1275-77, Bankr. L. Rep. (CCH) P 75364 (8th Cir. 1993); In re McLaren, 990 F.2d 850, 853-54, 24 Bankr. Ct. Dec. (CRR) 205 (6th Cir. 1993); Samuel v. Edd, 961 F.2d 220 (10th Cir. 1992) (unpublished table decision); Matter of Hallahan, 936 F.2d 1496, 1508, Bankr. L. Rep. (CCH) P 74066 (7th Cir. 1991); cf. In re Porges, 44 F.3d 159, 163-65 & n.7, 32 Collier Bankr. Cas. 2d (MB) 1354, Bankr. L. Rep. (CCH) P 76342 (2d Cir. 1995) (holding that in adjudicating a creditor’s claim against a Chapter 13 bankruptcy estate, there is bankruptcy jurisdiction to enter a money judgment against the debtor personally after dismissal of the debtor’s bankruptcy case, analogizing to the aforesaid cases); In re Thomas, 765 F.2d 926, 927-30 & n.3 (9th Cir. 1985) (finding an action to collect on the bankruptcy court’s money judgment on a nondischargeable debt from the California Real Estate Recovery Fund was “related to” the debtor’s bankruptcy case).
 42. Morrison, 555 F.3d at 479.
 43. See United Mine Workers of America v. Gibbs, 383 U.S. 715, 725, 86 S. Ct. 1130, 16 L. Ed. 2d 218, 61 L.R.R.M. (BNA) 2561, 53 Lab. Cas. (CCH) P 11135, 10 Fed. R. Serv. 2d 361 (1966).
 44. “[E]quitable jurisdiction attaches to the entire cause of action.” Kennedy, 108 F.3d at 1018; see also McLaren, 3 F.3d at 966 (same). The “cause of action” once marked the apparent limits of the pendent-claim variety of supplemental jurisdiction, after the Supreme Court’s opinion in *Hurn v. Oursler*, 289 U.S. 238, 245-48, 53 S. Ct. 586, 77 L. Ed. 1148, 17 U.S.P.Q. 195 (1933). In *Gibbs*, though, the Court repudiated *Hurn*’s cause-of-action test as unduly confusing in its application and “unnecessarily grudging” with respect to the scope of federal jurisdiction. See *Gibbs*, 383 U.S. at 722-24, 725.
 45. *Alexander v. Hillman*, 296 U.S. 222, 56 S. Ct. 204, 80 L. Ed. 192 (1935). See generally Brubaker, 41 Wm. & Mary L. Rev. at 784-88, 844-52.
 46. See Porges, 44 F.3d at 164-65; McLaren, 3 F.3d at 966; Hallahan, 936 F.2d at 1508.
 47. In re Devitt, 126 B.R. 212, 215, Bankr. L. Rep. (CCH) P 73912 (Bankr. D. Md. 1991).
 48. See In re Lang, 293 B.R. 501, 516-17 & nn. 18-19 (B.A.P. 10th Cir. 2003); Matter of Kinney, 114 B.R. 670, 671-72, 671, 60 Ed. Law Rep. 824 (Bankr. D. Neb. 1990) (holding that federal “courts have jurisdiction over cases and controversies in their entirety,” and “the court has jurisdiction to decide [the dischargeability] controversy and as an incident thereto has jurisdiction to enter judgment in favor of [the creditor] on the underlying debt”); In re Aerni, 86 B.R. 203, 205-06, 207-08, 47 Ed. Law

- Rep. 203, 11 Fed. R. Serv. 3d 623 (Bankr. D. Neb. 1988) (opining that the bankruptcy jurisdiction statute contains a grant of ancillary and pendent jurisdiction, thus permitting a federal judgment on a nondischargeable debt as part of the dischargeability proceedings); William T. Plumb, *The Tax Recommendations of the Commission on the Bankruptcy Laws—Tax Procedure*, 88 Harv. L. Rev. 1360, 1397 & n.203 (1975) (noting that “jurisdiction to render personal judgment on the claim is only ancillary to the issue of discharge” and is not an “independent power to render personal judgments on debts apart from the issue of nondischargeability”).
49. Sasson, 424 F.3d at 869.
 50. Pacor, 743 F.2d at 994.
 51. Morrison, 555 F.3d at 480 n.4.
 52. See *Celotex*, 514 U.S. at 307-08 n.5.
 53. Ralph Brubaker, *Supplemental Bankruptcy Jurisdiction*, 27 Bankr. L. Letter, No. 3, Mar. 2007, at 1.
 54. See *In re Hospitality Ventures/Lavista*, 265 Fed. Appx. 779 (11th Cir. 2008).
 55. *In re Hospitality Ventures/LaVista*, 358 B.R. 462 (Bankr. N.D. Ga. 2007).
 56. *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S. Ct. 2858, 73 L. Ed. 2d 598, 6 Collier Bankr. Cas. 2d (MB) 785, Bankr. L. Rep. (CCH) P 68698 (1982).
 57. See *Marathon*, 458 U.S. at 87 n.40 (Brennan, J., plurality opinion) (“It is clear that, at the least, the new bankruptcy judges cannot constitutionally be vested with jurisdiction to decide this state-law contract claim against [defendant] *Marathon*”).
 58. Indeed, all of the opinions in the *Marathon* case unceremoniously assumed that there would be no statutory or constitutional bar to an Article III federal court entertaining the Chapter 11 debtor’s state-law breach of contract action. See *Marathon*, 458 U.S. at 72 n.26, 84 n.36 (Brennan, J., plurality opinion) (stating that the debtor’s state-law contract action “may be adjudicated in federal court on the basis of its relationship to the petition for reorganization,” even though “Congress has not purported to prescribe a rule of decision for the resolution of [debtor’s] contractual claims”); *Marathon*, 458 U.S. at 89 (Rehnquist, J., concurring opinion) (stating that if the lawsuit “is to be resolved by an agency of the United States, it may be resolved only by an agency which exercises ‘[t]he judicial power of the United States’ described by Art. III of the Constitution”); *Marathon*, 458 U.S. at 92 (Burger, C.J., dissenting) (opining that with respect to “a ‘traditional’ state common-law action, not made subject to a federal rule of decision and related only peripherally to an adjudication of bankruptcy under federal law,” all of the “problems arising from today’s judgment can be resolved simply by providing that ancillary common-law actions, such as the one involved in these cases, be routed to the United States district court”); *Marathon*, 458 U.S. at 95 (White, J., dissenting) (reasoning that “if the Court is correct that such a state-law claim cannot be heard by a bankruptcy judge,” then “cases such as these would have to be heard by Art.III judges”).
 59. See 28 U.S.C.A. § 157(b).
 60. See 28 U.S.C.A. § 157(c).
 61. *In re Simmons*, 205 B.R. 834, 844 n.22 (Bankr. W.D. Tex. 1997).
 62. “[I]f we remove the separation of powers influence from the bankruptcy jurisdiction statute, ‘arising under’ and ‘arising in’ bankruptcy jurisdiction can be seen as grants of federal jurisdiction over all constitutional federal questions that arise in a bankruptcy case—those involving bankruptcy causes of action and those involving the bankruptcy estate.” Brubaker, 41 Wm. & Mary L. Rev. at 861.
 63. See *supra* notes 27-28 and accompanying text.
 64. See *In re Narciso*, 146 B.R. 792, 793 (Bankr. E.D. Ark. 1992) (holding that liquidation and entry of money judgment on nondischargeable debt is noncore “related to” proceeding).
 65. Morrison, 555 F.3d at 479.
 66. *Marathon*, 458 U.S. at 87 (Brennan, J., plurality opinion).
 67. See *Marathon*, 458 U.S. at 89-92 (Rehnquist, J., concurring opinion).
 68. *Marathon*, 458 U.S. at 87 n.40 (Brennan, J., plurality opinion); see also *Marathon*, 458 U.S. at 92 (Burger, J., dissenting) (describing narrow basis of concurrence as holding of the Court).
 69. *Thomas v. Union Carbide Agr. Products Co.*, 473 U.S. 568, 584, 105 S. Ct. 3325, 87 L. Ed. 2d 409, 22 Env’t. Rep. Cas. (BNA) 2033, 15 Env’t. L. Rep. 20698 (1985); see also *Commodity Futures Trading Com’n v. Schor*, 478 U.S. 833, 838-39, 106 S. Ct. 3245, 92 L. Ed. 2d 675 (1986) (quoting *Thomas v. Union Carbide*, 473 U.S. at 584).
 70. *Marathon*, 458 U.S. at 71 (Brennan, J., plurality opinion).
 71. 28 U.S.C.A. § 157(b)(2)(A) & (O).
 72. Bankruptcy Act of 1898 § 38(4).
 73. See *Marathon*, 458 U.S. at 99 (White, J., dissenting) (“I take it that the Court does not condemn as inconsistent with Art. III the assignment of these functions—i.e., those within the summary jurisdiction of the old bankruptcy courts—to a non-Art. III judge, since as the plurality says, they lie at the core of the federal bankruptcy power”).
 74. See Douglas G. Baird, *Bankruptcy Procedure and State-Created Rights: The Lessons of Gibbons and Marathon*, 1982 S. Ct. Rev. 25, 42-47; Ralph Brubaker, *Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten Callaway v. Benton Case*, 72 Am. Bankr. L.J. 1, 42 & n.184 (1998); Brubaker, 41 Wm. & Mary L. Rev. at 776-77 & n.111; S. Elizabeth Gibson, *Jury Trials and Core Proceedings: The Bankruptcy Judge’s Uncertain Authority*, 65 Am. Bankr. L.J. 143, 170 (1991) (“It appears that the Court might have in mind the bankruptcy court’s old summary jurisdiction when it considers what Congress could permissibly commit to bankruptcy court jurisdiction”); Thomas S. Marrion, *Core Proceedings and the “New” Bankruptcy Jurisdiction*, 35 Depaul L. Rev. 675, 683 (1986) (“The scope of summary jurisdiction under the Act of 1898 serves as a helpful guideline to determine what matters can be considered at the ‘core’ of bankruptcy administration, making possible an exercise of full judicial power by a non-Article III officer”).

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**A “SUMMARY” STATUTORY AND CONSTITUTIONAL THEORY
OF BANKRUPTCY JUDGES’ CORE JURISDICTION
AFTER *STERN* v. *MARSHALL***

*Ralph Brubaker**

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CONCLUSION

*Professor of Law, University of Illinois College of Law.

A “Summary” Statutory and Constitutional Theory of Bankruptcy Judges’ Core Jurisdiction After *Stern v. Marshall*

by

*Ralph Brubaker**

Perhaps fittingly, perhaps ironically, we are commemorating the 30th anniversary of the Supreme Court’s epochally disruptive decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,¹ while still reeling from another serious dislocation, delivered in the form of the Court’s recent opinion in *Stern v. Marshall*.² In that decision, the Supreme Court relied heavily upon *Marathon* to hold that the provision of title 28 (the “Judicial Code”) granting our non-Article III bankruptcy judges core jurisdiction to enter final orders and judgments on “counterclaims by the estate against persons filing claims against the estate”³ is unconstitutionally over-broad, at least as applied to the counterclaim at issue in the case, even though that counterclaim was compulsory and not permissive.

Few have been willing to accept at face value Justice Roberts’ assurance that the “decision does not change all that much.”⁴ Only time will tell, of course, but the majority’s reasoning has planted many potential landmines throughout the current statutory provisions governing bankruptcy judges’ adjudicatory authority, and in this article, I will attempt to discern where those perils (do or do not) lie.

Before reaching the constitutional issue, the Court grappled with a difficult interpretive issue regarding the statutory provision at issue, which itself

*Professor of Law, University of Illinois College of Law. I am grateful to Professor Rafael Pardo and Judge Rich Leonard for their invitation to contribute to this symposium and to Judge Bruce Markell for helpful comments on an earlier draft of this article.

This article is based upon an earlier version published as *Article III’s Bleak House (Part I): The Statutory Limits of Bankruptcy Judges’ Core Jurisdiction*, 31 BANKR. L. LETTER, Aug. 2011, at 1, and *Article III’s Bleak House (Part II): The Constitutional Limits of Bankruptcy Judges’ Core Jurisdiction*, 31 BANKR. L. LETTER, Sept. 2011, at 1.

¹458 U.S. 50 (1982).

²131 S. Ct. 2594 (2011).

³28 U.S.C. § 157(b)(2)(C) (2006).

⁴*Stern*, 131 S. Ct. at 2620.

established on the face of the pleadings (as is typically the rule for subject-matter jurisdiction). The bankruptcy judge should be able to let the actual evidence presented and the ultimate decisional needs of the particular case at issue dictate the full extent of his/her adjudicatory authority over state-law counterclaims. According to the *Stern v. Marshall* Court's own statement of the holding of the case, a bankruptcy judge only "lack[s] the constitutional authority to enter a final judgment on a state law counterclaim" to the extent that a particular issue of fact or law "is not resolved in the process of ruling on a creditor's proof of claim."²⁴⁹ This may well leave the parties with a great deal of uncertainty through the course of the litigation and may greatly complicate the litigation process—a danger of which Justice Breyer warned in his dissent.²⁵⁰ In the majority's view, though, such practical concerns simply do not rise to the level of constitutional significance that can overcome the mandates of Article III.

3. General Supplemental Core Jurisdiction

If general supplemental jurisdiction principles were properly applicable to expand the jurisdiction of non-Article III tribunals, those principles would obviously have application in many bankruptcy contexts other than simply "counterclaims by the estate against persons filing claims against the estate,"²⁵¹ and statutory authorization for such supplemental core jurisdiction could easily be found in the catch-all core categories.²⁵² Indeed, some courts have relied upon general supplemental (ancillary or pendent) jurisdiction principles as a basis for bankruptcy courts to exercise core jurisdiction over claims for which they would not have core jurisdiction as stand-alone claims, on the basis that these claims nonetheless are transactionally related to and joined with core claims pending before the bankruptcy court.²⁵³ Moreover, in the 1970 discharge amendments to the 1898 Act, Congress expressly gave referees final jurisdiction over just such an instance of supplemental summary jurisdiction in the case of referees' summary jurisdiction to enter final judgment against the debtor personally on a claim declared nondischargeable.²⁵⁴

However, the *Stern v. Marshall* Court's implicit repudiation of the

²⁴⁹*Id.* at 2620 (emphasis added).

²⁵⁰*See id.* at 2630 (Breyer, J., dissenting) (predicting "a constitutionally required game of jurisdictional ping-pong between" the bankruptcy court and the district court that will "lead to inefficiency, increased cost, delay, and needless additional suffering among those faced with bankruptcy").

²⁵¹28 U.S.C. § 157(b)(2)(C) (2006).

²⁵²*See id.* § 157(b)(2)(A) & (O).

²⁵³*See, e.g., In re Lionel Corp.*, 29 F.3d 88, 90, 92 (2d Cir. 1994).

²⁵⁴*See* Brubaker, *Bankruptcy Jurisdiction Theory*, *supra* note 19, at 911–21 & n.603; Ralph Brubaker, *Bankruptcy Court Jurisdiction to Enter a Money Judgment on a Nondischargeable Debt: Exposing Pacor's Deficiencies and the True Supplemental Nature of Third-Party "Related To" Bankruptcy Jurisdiction*, 29 BANKR. L. LETTER, Apr. 2009, at 1, 8 [hereinafter Brubaker, *Money Judgments on Nondischargeable Debts*].

broader supplemental summary jurisdiction implications of *Katchen v. Landy* as unconstitutional under Article III²⁵⁵ clearly indicates that any broad, general notion of supplemental core jurisdiction is also unconstitutional. Bankruptcy judges' general supplemental jurisdiction is at best noncore "related to" jurisdiction.²⁵⁶

The *Stern v. Marshall* decision in this regard also calls into doubt the constitutionality of the almost universal consensus to date (relying upon practice after the 1970 amendments to the 1898 Act) that bankruptcy judges have core jurisdiction to adjudicate and enter final judgment against the debtor personally on claims declared nondischargeable.²⁵⁷ As Douglas Baird rightly points out, that conclusion will now have to be reconsidered in light of *Stern v. Marshall*.²⁵⁸

As discussed above, the most that *Stern v. Marshall* implicitly admits is the possibility of supplemental core jurisdiction over common factual and legal issues that are "necessary" to adjudicate those matters historically considered "summary." Dischargeability determinations were within the 1898 Act summary jurisdiction of bankruptcy referees both before and after the 1970 amendments,²⁵⁹ and thus, the constitutionality of core jurisdiction in the bankruptcy courts to make "determinations as to the dischargeability of particular debts"²⁶⁰ seems secure. Before the 1970 amendments, though, the federal courts "refused to liquidate nondischargeable debts and enter money judgments against debtors for lack of federal jurisdiction," thus relegating the creditor to an additional plenary suit against the debtor in a nonbankruptcy state or federal court with jurisdiction over an action on the underlying debt.²⁶¹

The current grant of subject-matter jurisdiction to federal district courts to hear and render final judgment on debts declared nondischargeable is clearly constitutional (as a matter of Article III judicial federalism), as an appropriate instance of supplemental jurisdiction incident to the federal-question claim of dischargeability.²⁶² Supplemental *core* jurisdiction in the non-Article III bankruptcy courts to adjudicate and enter judgment on a debt

²⁵⁵See *supra* notes 205–24 and accompanying text.

²⁵⁶See Brubaker, *Bankruptcy Jurisdiction Theory*, *supra* note 19, at 921–33; see also *Townsquare Media, Inc. v. Brill*, 652 F.3d 767, 771–72 (7th Cir. 2011).

²⁵⁷See Brubaker, *Money Judgments on Nondischargeable Debts*, *supra* note 254, at 6–9.

²⁵⁸See Baird, *supra* note 99.

²⁵⁹See *In re Johnson*, 211 F. Supp. 337, 343 (D.N.J. 1962), *vacated and remanded on other grounds*, 323 F.2d 574 (3d Cir. 1963) (reinstating referee's dischargeability determination); Vern C. Countryman, *The New Dischargeability Law*, 45 AM. BANKR. L.J. 1, 9, 25 (1971).

²⁶⁰28 U.S.C. § 157(b)(2)(I) (2006).

²⁶¹Brubaker, *Bankruptcy Jurisdiction Theory*, *supra* note 19, at 913.

²⁶²See *id.* at 911–21; Brubaker, *Money Judgments on Nondischargeable Debts*, *supra* note 254, at 5–6.

declared nondischargeable, though, is much more questionable.²⁶³ Consistent with the rationale of *Stern v. Marshall*, bankruptcy courts' core jurisdiction over debts declared nondischargeable would seem to be limited to only those factual and legal issues necessary to dispose of the core nondischargeability action,²⁶⁴ and bankruptcy courts would seem to be limited to submitting proposed findings and conclusions to the district court on all other issues, including the amount of the creditor's nondischargeable claim.

4. Core "Arising Under" Jurisdiction Over Traditional "Plenary" Suits

One potential constitutional justification for bankruptcy judges' core jurisdiction that the Court surveyed in *Stern v. Marshall* is inconsistent with other premises embraced (and flatly contradicts direct statements) in the majority opinion and thus can no longer be safely indulged. Recognition of this reality means that bankruptcy judges' core jurisdiction under § 157(b)(2)(F) & (H) of the Judicial Code over proceedings to avoid and recover preferential transfers and fraudulent conveyances is unconstitutional, and statutory core jurisdiction over other bankruptcy causes of action may also be unconstitutional.

Both Justice Brennan's plurality *Marathon* opinion and Justice Rehnquist's concurrence emphasized the state common-law nature of the action at issue in that case.²⁶⁵ Justice Brennan further stated:

[W]hen Congress creates a statutory right, it clearly has the discretion, in defining that right to . . . provide that persons seeking to vindicate that right must do so before particularized tribunals created to perform the specialized adjudicative tasks related to that right. Such provisions do, in a sense, affect the exercise of judicial power, but they are also incidental to Congress' power to define the right that it has created. No comparable justification exists, however, when the right being adjudicated is not of congressional creation. In such a situation, substantial inroads into functions that have

²⁶³See Brubaker, *Money Judgments on Nondischargeable Debts*, *supra* note 254, at 6-9.

²⁶⁴In the rarer case where the trustee is also a party to the action because the creditor's claim against the debtor's bankruptcy estate is also being adjudicated by the bankruptcy court, final adjudication of all factual and legal issues necessary to fully dispose of the core claim allowance proceeding may fully and finally dispose of all issues necessary for the bankruptcy court to also enter a money judgment against the debtor personally if the debt is declared nondischargeable.

²⁶⁵See *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 84 (1982) (Brennan, J., plurality opinion) (emphasizing that "Northern's claim[s] for damages for breach of contract and misrepresentation[] involve a right created by state law"); *id.* at 90 (Rehnquist, J., concurring) ("There is apparently no federal rule of decision provided for any of the issues in the lawsuit; the claims of Northern arise entirely under state law.").

Wilke’s intended residuary beneficiary Galloni, inheriting the entire estate.³

[5] Lastly, Judge Baer also held the judgment debt to be nondischargeable under Subsection 523(a)(6), which excludes from discharge any debt ‘for willful and malicious injury by the debtor to another entity or to the property of another entity.’ Despite what has been said in the last sentence of n.3, this opinion will go on to discuss that second alternative briefly, for it provides another independent ground for the rejection of Barry’s appeal.

[6, 7] On that score the opinion in First Weber Group, Inc. v. Horsfall, 738 F.3d 767, 774 (7th Cir.2013) teaches that the wrong perpetrated by Barry—the injury that he caused to Galloni—was both ‘willful’ and ‘malicious,’ for that case confirms that ‘willfulness’ can be found if ‘the debtor’s act was substantially certain to result in injury’ (unquestionably the case here) and reconfirms that ‘maliciousness’ exists where ‘the debtor acted in conscious disregard of his duties or without just cause or excuse’ (internal quotation marks and brackets excluded) (also unquestionably the case here). In short, this Court certainly concurs with Judge Baer’s rejection of Barry’s weak contention of his mere negligence and embarrassment on his part, given his deliberate affirmative misconduct in concealing what he had done.

Conclusion

Analysis has demonstrated the emptiness of Barry’s legal position. This Court affirms the judgment of the Bankruptcy Court, and it too holds that Barry’s judgment indebtedness to Galloni is nondischargeable in his Chapter 7 proceedings

3. Although Judge Baer alternatively focused on the ‘defalcation’ branch of Section 523(a)(4) at pages 15-16 of her Opinion, this Court does not find that term—which is much like embezzlement in calling for the wrong-

under both 11 U.S.C. §§ 523(a)(4) and 523(a)(6).



ROBERT J. SIRAGUSA M.D. EMPLOYEE TRUST (formerly known as Dermatology Association of Bay County, PA, Defined Benefit Plan), Robert J. Siragusa, Individually, Dana Siragusa, and Robert Joseph Siragusa, Plaintiffs–Appellants and Cross–Appellees,

v.

Arturo COLLAZO, Defendant–Appellee and Cross–Appellant.

No. 14 C 5008

United States District Court,
N.D. Illinois, Eastern Division.

Signed May 19, 2015

Background: Investors who had agreed to provide short-term financing for condominium conversion projects in both Illinois and subsequently Arizona brought adversary proceeding to except debts from discharge on “false pretenses, false representation, or actual fraud” theory. The Bankruptcy Court entered judgment in favor of some of these investors, found for debtor on other claims, and declined to enter money judgment monetizing amount of nondischargeable debt, and both sides appealed.

Holdings: The District Court, Jorge L. Alonso, J., held that:

doer to profit financially—fits the facts of this case comfortably. But there is no need to explore that subject here, for the alternative of ‘fraud’ was unquestionably present, and it is necessary to kill a snake only once.

- (1) even if bankruptcy court had constitutional authority, as non-Article-III court, to enter a money judgment liquidating amount of Chapter 7 debtor's nondischargeable debt to creditors, it was not required to do so;
- (2) district court would not exercise supplemental jurisdiction to monetize amount of nondischargeable debts;
- (3) bankruptcy court did not clearly err, in fraud-based nondischargeability proceeding, in finding that debtor's transfer of unsold condominiums securing investors' claims to different limited liability companies (LLCs) so that they could be mortgaged again was not evidence of any fraudulent scheme to defraud investors;
- (4) statute of limitations on fraud claims that creditors had against debtor, for inducing them to extend loans to LLC for condominium conversion project by falsely representing that these loans would promptly be repaid, began to run, at very latest, when creditors learned of sale of units for which they provided financing; and
- (5) bankruptcy court did not have to find that creditor was acting as his children's agent in order to find that debtor should have foreseen that his misstatements to creditor would be communicated to children, so that debtor's misstatements provided basis for nondischargeability claims by creditor's children as well.

Affirmed.

Judgment on appeal, 817 F.3d 1047.

1. Bankruptcy \S 3409

Even if bankruptcy court had constitutional authority, as non-Article-III court, to enter a money judgment liquidating amount of Chapter 7 debtor's nondischargeable debt to creditors, it was not

required to do so and acted well within its discretion in opting simply to determine that debt was nondischargeable without entering money judgment in light of the *Stern* question raised by creditors' request for entry of money judgment in their favor. 11 U.S.C.A. § 523(a).

2. Bankruptcy \S 2056, 3779

On appeal from bankruptcy court's determination that Chapter 7 debtor's debts to some of the complaining creditors were nondischargeable in bankruptcy, district court would not exercise supplemental jurisdiction to monetize amount of these nondischargeable debts, after debtor's no-asset Chapter 7 case had been administered and monetization of amount of nondischargeable debts could have no conceivable effect on estate, where record was not sufficiently developed to allow district court to determine amount of any nondischargeable debt, and any such determination would require additional fact finding. 11 U.S.C.A. § 523(a); 28 U.S.C.A. § 1334(b).

3. Bankruptcy \S 2056

District courts can exercise supplemental jurisdiction in bankruptcy cases.

4. Fraud \S 59(3)

Under Illinois law, damages for fraud are limited to out-of-pocket loss to plaintiff.

5. Fraud \S 59(3)

Under Illinois law, while damages for fraud are limited to out-of-pocket loss to plaintiff, such out-of-pocket loss, in case in which plaintiff was fraudulently induced to make a loan, may include amount of interest that plaintiff may have been able to earn from alternative use of his money.

6. Bankruptcy \S 3372.8

Bankruptcy court did not clearly err, in fraud-based nondischargeability pro-

units. (*Id.* at 19–20.) By that time, the properties had been encumbered with vast mortgage debt, and Collazo knew or should have known that the sales of the remaining units would not generate proceeds sufficient to pay the Siragusas in addition to the mortgage lenders, who had superior rights to repayment. (*Id.* at 20.) Further, an Eddy unit had already sold by that time, and Collazo had made no payment on the Eddy notes. (*Id.*) It was clear he had no intention of doing so, and all the elements of fraud were met. (*Id.* at 21–22.)

Nevertheless, the court found that Collazo had a defense to the Arizona fraud claims because the statute of limitations began to run as to Julie and Dr. Siragusa not in 2009, as the Siragusas argued, but in July 2007, when Julie called Dr. Siragusa to tell him she had sold another Eddy unit. (*Id.* at 16.) By that time, according to the court, Dr. Siragusa and Julie had information that would motivate a reasonable person to investigate more deeply. (*Id.*) The statute of limitations, which is five years under Illinois law, 735 Ill. Comp. Stat. 5/13–205, had run by the time Collazo filed for bankruptcy in November 2012. (*Id.* at 18.) The court held that the claim based on the \$800,000 debt to the Plan was dischargeable, but Dana and Robert Joseph’s claims based on the \$200,000 note were non-dischargeable because the statute of limitations did not begin to run as to them until 2009. (*Id.* at 22.)

The parties filed post-trial cross-motions to amend the judgment. The Siragusas contended that (1) a money judgment should have been entered on the portion of the debt that was determined to be non-dischargeable, (2) there was sufficient proof that the Chicago loans were based on a misrepresentation, (3) the statute of limitations should not have been applied to the Arizona loan, regardless of when it

began to run, because Collazo never argued that the claims based on the Arizona loan were time-barred, and (4) the statute of limitations was misapplied because the July 2007 conversation with Julie did not give Dr. Siragusa reasonable notice of wrongdoing that would trigger the statute. Collazo contended that Dana and Robert’s claims should also have been time-barred because Dr. Siragusa’s knowledge should have been imputed to them. The court denied the post-trial motions. (Bankruptcy No. 12 B 44342, Adversary Proceeding 13 A 000216, Dkt. 105, Order Denying Motions to Amend Order (“Supplemental Order”).) These cross-appeals followed.

I. THE SIRAGUSAS’ APPEAL

A. Whether Money Damages Should Have Been Awarded

The Siragusas claim that the bankruptcy court should have entered a money judgment in favor of Dana and Robert Joseph. In their post-trial motion, Dana and Robert Joseph sought a money judgment of \$1,076,032.36, the amount due on the November 22, 2005 Arizona note, which represents the \$200,000 principal amount of the note plus accumulated interest, calculated according to the terms of the note (Plaintiff’s Trial Exhibit 52). In the Siragusas’ view, by denying Dana and Robert Joseph’s motion for entry of a money judgment, the bankruptcy court forced Dana and Robert Joseph to litigate a new action in state court in order to obtain damages on their fraud claim, and this duplication of effort offends notions of fairness and judicial economy.

Collazo claims that the court properly declined to enter a money judgment because (1) it had no jurisdiction to do so under *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), which held that state law claims, even if related to bankruptcy matters, must be adjudicat-

ed by an Article III court, and (2) even if there was jurisdiction, it was not an abuse of discretion to decline to award money damages.

1. Whether the bankruptcy court erred by declining to enter a money judgment

[1] It is uncertain in this circuit, in the wake of *Stern*, whether a bankruptcy court has jurisdiction to enter a money judgment on a state-law claim, such as the Siragusas' fraud claims, in a dischargeability proceeding. The Seventh Circuit stated in an unpublished decision that "it is unclear whether *Stern* . . . restricts a bankruptcy court's power to resolve a creditor's state-law claim when the court decides whether that claim is nondischargeable." *Lee v. Christenson*, 558 Fed.Appx. 674, 676 (7th Cir.2014). Some lower courts have concluded that *Stern* imposes no such restriction, see *In re Boricich*, 464 B.R. 335, 337 (Bankr.N.D.Ill.2011), but others have concluded that it does, see *In re Wood*, 503 B.R. 705, 709–10 (Bankr.W.D.Wis.2013); *In re Strauss*, 523 B.R. 614, 624 (Bankr. N.D.Ill.2014).

In light of this uncertainty, the bankruptcy court decided, in the exercise of its discretion, not to enter a money judgment that might later be found to have been entered without jurisdiction. (Supplemental Order at 2–3.) This Court finds nothing improper in this decision. Even if the bankruptcy court had jurisdiction to enter a money judgment, it was not required to do so; it was well within the court's discretion to opt simply to determine that the debt is non-dischargeable without entering a money judgment. See *Nat'l Bank v. Buckley (In re Buckley)*, Bankruptcy No. 08–80409, Adversary Proceeding 08–8063, 2009 WL 400628, at *3 (Bankr.C.D.Ill. Feb. 17, 2009); see also *In re Sasson*, 424 F.3d 864, 874–75 (9th Cir.2005). The

bankruptcy court did not err in this respect.

2. Whether this Court should enter a money judgment itself

[2,3] The Siragusas further argue, however, citing *Executive Benefits Insurance Agency v. Arkison*, — U.S. —, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014), that even if this Court declines to reverse and remand the case to the bankruptcy court for entry of a money judgment, this Court can and should enter a money judgment itself. The bankruptcy court declined to enter a money judgment because it doubted whether it could constitutionally enter a money judgment on a state-law fraud claim under *Stern*, as explained above, and it doubted whether it had statutory subject matter jurisdiction to enter a money judgment under the Bankruptcy Code:

[Under 28 U.S.C. § 1334, a] district court has jurisdiction over all proceedings arising under title 11, or arising in or related to cases under title 11. Nothing in 11 U.S.C. § 523(a)—which limits the scope of a debtor's discharge—gives the bankruptcy court the authority to enter money judgments against the debtor, payable from the debtor's non-estate assets. Furthermore, because the entry of monetary judgment against a post-discharge debtor has no effect on distribution of the bankruptcy estate, it is not related to a case under title 11. Bankruptcy jurisdiction, the Seventh Circuit has said, "extends no farther than its purpose," which is "to provide a single forum for dealing with all claims to the bankrupt's assets." *Elscint, Inc. v. First Wis. Fin. Corp. (In re Xonics, Inc.)*, 813 F.2d 127, 131 (7th Cir.1987). (Supplemental Order at 2.) The Siragusas contend that the bankruptcy court's *Stern* concerns, even if valid, are not applicable in this Article III court. Further, unlike the bankruptcy court, this Court can exer-

cise supplemental jurisdiction over claims factually related to the non-dischargeability claim and enter a money judgment on them, even if such claims are not “related to” the bankruptcy case in the sense that they might have some effect on the distribution of the bankruptcy estate. *See Rahl v. Bande*, 316 B.R. 127, 132 (S.D.N.Y. 2004); *In re Ha-Lo Indus., Inc.*, 330 B.R. 663, 672–73 (Bankr.N.D.Ill.2005); *In re Conseco, Inc.*, 305 B.R. 281, 286 (Bankr. N.D.Ill.2004) (citing *Wieboldt Stores, Inc. ex. rel. Raleigh v. Schottenstein*, 111 B.R. 162, 166–67 (N.D.Ill.1990)).²

Collazo contends in response that the bankruptcy court did not make sufficient findings to liquidate Dana and Robert Joseph’s claims:

The debt owed to Dana and Robert Joseph is evidenced by a promissory note dated November 22, 2005 made . . . to Dana, Julie, and Robert Joseph Siragusa in the amount of \$200,000. The Bankruptcy Court found that the debt owed to Julie was barred by the applicable statute of limitations and Julie has not appealed that ruling. Accordingly, [a] court will have to determine the actual dollar amount of loans made by Dana and Robert Joseph which are evidenced

by this \$200,000 note. The Plaintiffs neither introduced evidence at trial as to the amounts which were purportedly loaned by Dana and Robert Joseph nor did the Bankruptcy Court make a determination as to what portion of the \$200,000 was actually loaned by these individuals.

(Br. and Arg. of Appellee and Cross-Appellant at 6.) It is true that the record was not developed to support a money judgment,³ and this Court agrees with Collazo that the record is presently inadequate to liquidate Dana and Robert Joseph’s state-law fraud claims. It is unclear what amounts Dana, Julie and Robert Joseph each contributed to the \$200,000 loan,⁴ and it is therefore impossible, on the present record, to determine how to calculate damages.

[4] If, in the present action, the Siragusas were suing to enforce the note itself, perhaps the \$1,076,032.36 figure that they submit, based on the amounts due on the note in principal and interest, would be the proper measure of damages. However, the claims presently at issue are Dana and Robert Joseph’s claims that Collazo committed *fraud* by making false representa-

2. These cases notwithstanding, one commentator has argued, in a seminal article, that district courts have no supplemental jurisdiction in bankruptcy cases, *see Susan Block-Lieb, The Case Against Supplemental Bankruptcy Jurisdiction: A Constitutional, Statutory and Policy Analysis*, 62 Fordham L.Rev. 721 (1994), and some courts, all citing Block-Lieb’s article, have recognized the uncertainty surrounding the issue, *see Chapman v. Currie Motors, Inc.*, 65 F.3d 78 (7th Cir.1995); *In re Walker*, 51 F.3d 562, 572–73 (5th Cir.1995); *Conseco*, 305 B.R. at 28. Most courts, however, have held that district courts can exercise supplemental jurisdiction in bankruptcy cases, *see Rhiel v. Cent. Mortg. Co. (In re Kebe)*, 444 B.R. 871, 879–80 (Bankr.S.D. Ohio 2011) (citing cases), and this Court will follow these decisions.
3. The bankruptcy court stated explicitly in its Opinion that “[t]his adversary proceeding is limited to the determination of dischargeability. It does not implicate *Stern v. Marshall*.” (Opinion at 13.) In other words, the bankruptcy court tried the case under the impression that no state-law claims were directly at issue because this case was purely an adversary proceeding to determine whether certain debts were non-dischargeable under § 523(a)(2)(A).
4. Julie may have been a lender in name only. She testified at trial that, at least originally, her brother and sister made her contribution for her, at their father’s direction, but counsel interrupted her before she finished her answer, and it remains unclear whether she ever paid them back. (Trial Tr. at 362.)

tions that induced them to make a loan, evidenced by the note, to Collazo's business entity. In Illinois, damages for fraud are limited to the out-of-pocket loss to the plaintiff, based on the rationale that the plaintiff is entitled to be placed in the same financial position he would have been if he had not been defrauded. *Martin v. Allstate Ins. Co.*, 92 Ill.App.3d 829, 48 Ill.Dec. 316, 416 N.E.2d 347, 352 (1981). Before the Court can enter a money judgment in favor of Dana and Robert Joseph, it must determine what amounts they actually paid; if Julie contributed some portion of the loan, and the Court enters a money judgment on the entire \$200,000, plus interest, without making any adjustment to account for the fact that Julie's share is not recoverable because her claim is barred by the statute of limitations, Dana and Robert Joseph will receive a windfall.

[5] Further, in a case in which the plaintiff was fraudulently induced to make a loan, damages for the out-of-pocket loss may be increased by the amount of interest that the plaintiff may have been able to earn from an "alternative use" of the money. *Fed. Deposit Ins. Corp. v. W.R. Grace & Co.*, 877 F.2d 614, 623 (7th Cir.1989); see also *Commercial Nat. Bank of Peoria v. Fed. Deposit Ins. Corp.*, 131 Ill.App.3d 977, 87 Ill.Dec. 107, 476 N.E.2d 809, 815 (1985). The \$1,076,032.36 figure the Siragas have proposed, based on a principal amount of only \$200,000, has apparently been calculated based on the exorbitant 20% and, after default, 25% rates of interest dictated by the terms of the note, which allowed enormous amounts of interest to accumulate over years of default. Other investments may have yielded lesser, more reasonable rates of return, so Dana and Robert Joseph's proposed damages, even assuming that they actually paid the whole \$200,000 principal amount themselves, may not put Dana and Robert

Joseph in the position they would be in if they had made an "alternative use" of the money.

In short, to enter a correct and proper money judgment on Dana and Robert Joseph's claims, this Court would have to hold further proceedings to receive new evidence and argument, or remand to the bankruptcy court so that it might hold further proceedings and submit proposed findings of fact and conclusions of law to this Court.

But Collazo's bankruptcy proceedings are otherwise completely and entirely concluded, and, as the bankruptcy court stated in its Supplemental Order, there is no pending claim with independent federal jurisdiction. The bankruptcy court had jurisdiction of this case under 28 U.S.C. § 1334, which gives district courts (and by reference, bankruptcy courts) jurisdiction over all proceedings arising under title 11, or arising in or related to cases under title 11. (Supplemental Order at 2.) A district court has jurisdiction over core bankruptcy proceedings, such as this adversary proceeding to determine non-dischargeability under 523(a), because it "arises under" title 11, and it may have jurisdiction over state-law claims, such as a state-law fraud claim, that are "related to" the bankruptcy case, but "because the entry of monetary judgment against a post-discharge debtor has no effect on distribution of the bankruptcy estate, it is not related to a case under title 11." (Supplemental Order at 2 (citing *Elscint, Inc.*, 813 F.2d at 131). Thus, this Court has jurisdiction to enter a money judgment only if it exercises its supplemental jurisdiction under 28 U.S.C. § 1367.

However, a case in which "the federal claim is resolved one way or another while the supplemental state-law claims are pending, unresolved," is "an attractive case for the court, in the exercise of discretion

conferred by section 1367, to relinquish its jurisdiction over them to the state courts, especially if the federal claim has . . . been resolved without a trial.” See *Townsquare Media, Inc. v. Brill*, 652 F.3d 767, 772 (7th Cir.2011). In this case, the federal claim was not resolved “without a trial,” but, because the Court needs to receive additional evidence and perhaps briefing to proceed, this case is the functional equivalent of a case in which the federal claims were dismissed or resolved prior to trial, not a case that has “proceeded through one court system and is almost finished with there.” *Chapman v. Currie Motors, Inc.*, 65 F.3d 78, 81 (7th Cir.1995).

In *Shapiro v. United States (In re Shapiro)*, 188 B.R. 140, 148–49 (Bankr.E.D.Pa. 1995), the court made a similar analogy and reached a similar conclusion when, in a post-discharge adversary proceeding stemming from a no-asset Chapter 7 bankruptcy, like this proceeding, it declined to liquidate the debtor’s non-dischargeable tax debt and opted instead to relinquish jurisdiction because only non-bankruptcy law issues remained in the case. *Shapiro* cited *Chapman v. Currie Motors, Inc.*, 65 F.3d 78, 82 (7th Cir.1995), in which the Court held that, “the bankruptcy proceeding having ended, the adversary proceeding became a dispute of no interest to anyone except the two adversaries, and their dispute revolved entirely around [an issue of state law]. There was not even a remote federal interest.”

As in *Chapman* and *Shapiro*, the interests of bankruptcy law are not served by the exercise of supplemental jurisdiction over the state-law fraud claim because the outcome of the proceeding will not affect the distribution of property in the bankruptcy estate. (Supplemental Order at 2.) Collazo’s bankruptcy was a no-asset Chapter 7 case; *i.e.*, the trustee reported that he made no distributions to creditors on

behalf of the estate because he found no non-exempt property to distribute. (*In re Collazo*, Bankruptcy No. 12 B 44342, Ch. 7 Trustee’s Report of No Distribution, Dkt. No. 59 (Bankr.N.D.Ill.Dec. 20, 2013).) Under such circumstances, any post-discharge liquidation of a non-dischargeable debt can affect only assets of Collazo that were exempt from the bankruptcy estate by law or were acquired post-bankruptcy. There is simply no federal interest dictating that this Court should exercise jurisdiction over Collazo’s disposition of these assets, and that makes this “an attractive case for the court to relinquish its jurisdiction to the state courts.” *Townsquare Media*, 652 F.3d at 772; see *Shapiro*, 188 B.R. at 148; *Buckley*, 2009 WL 400628, at *3–4.

To be sure, the parties’ interests in judicial economy and fairness deserve consideration. However, considering that further proceedings will be necessary to liquidate Dana and Robert Joseph’s fraud claims whether this Court takes on that task or leaves it to a state court, any time that may be saved by holding further proceedings here rather than in state court is slight, and in the circumstances of this case, the interest of judicial economy does not outweigh the interest in leaving questions of state law to the state courts. Like the bankruptcy court, this Court declines to enter a money judgment in favor of Dana and Robert Joseph.

B. Whether The Chicago Loans Were Based On Fraudulent Representations

[6] The Siragusas next contend that the bankruptcy court erred by finding that the Chicago loans were not based on a fraudulent representation because Collazo’s alleged misrepresentation—that he would pay the notes with the proceeds from the sale of the condo units after he had repaid the construction lender, without mention of the fact that the remaining

In re Arturo COLLAZO, Debtor.

**Dana Siragusa, et al., Plaintiffs–
Appellants,**

v.

Arturo Collazo, Defendant–Appellee.

No. 15–2324.

United States Court of Appeals,
Seventh Circuit.

Argued Jan. 21, 2016.

Decided April 5, 2016.

Background: Creditors who had lent money to entities formed by Chapter 7 debtor to develop realty brought adversary proceeding to except debts from discharge on “false pretenses, false representation, or actual fraud” theory. The United States Bankruptcy Court for the Northern District of Illinois, Eugene R. Wedoff, J., 2014 WL 866075, entered judgment in favor of creditors on nondischargeability claims, but only in part, finding that some creditors no longer had enforceable debts to except from discharge. Appeal was taken. The District Court, Jorge L. Alonso, J., 549 B.R. 693, 2015 WL 2415641, affirmed.

Holdings: The Court of Appeals, Posner, Circuit Judge, held that:

- (1) statute of limitations on fraud claims that creditors had against principal of limited liability company (LLC), for inducing them to extend loans to LLC for condominium conversion project by falsely representing that these loans would promptly be repaid, began to run, at very latest, when creditors learned of sale of units for which they provided financing;
- (2) fraud claims asserted by other creditors unaware of condominium sales were timely; and

(3) regardless of whether bankruptcy court, as non-Article-III court, had constitutional authority to enter final judgment establishing amount of debtor’s nondischargeable obligation to creditors for money that he fraudulently induced them to lend to entity formed by debtor to develop certain realty, bankruptcy court could establish amount of fraud liability with consent of parties.

Affirmed in part, and reversed and remanded in part.

1. Limitation of Actions ⇌100(1)

Illinois five-year statute of limitations on fraud claims begins to run when claimant discovers, or should have discovered, that he was injured by wrongful act. S.H.A. 735 ILCS 5/13–205.

2. Limitation of Actions ⇌95(2)

Applicable Illinois statute of limitations begins to run, not when the injured person discovers that he is the likely victim of wrongful act, but when reasonable person in his shoes would have discovered it.

3. Bankruptcy ⇌2826, 3342, 3408

There are two distinct issues in nondischargeability proceeding: (1) the establishment of debt itself, which is governed by state statute of limitations; and (2) question of dischargeability of any debt so established under the Bankruptcy Code, a distinct issue governed solely by limitations periods established by bankruptcy law. 11 U.S.C.A. §§ 523(a), 546.

4. Bankruptcy ⇌2825

Limitation of Actions ⇌100(12)

Statute of limitations on fraud claims that creditors had against principal of limited liability company (LLC), for inducing them to extend loans to LLC for condominium conversion project by falsely rep-

only when the condo units hadn't sold by the time the construction project was completed. The bankruptcy judge was entitled to find that no fraudulent representation had been made earlier, when the debt was incurred.

The bankruptcy judge also rejected Dana's claim that Collazo had committed fraud when he transferred the Chicago condo units to new LLCs. (Dana was the only one of the Siragusa offspring who had invested in those units.) The judges assumed that to constitute fraud under 11 U.S.C. § 523(a)(2)(A) a debtor's false representation must induce the creditor to part with money or property. Dana contends that Collazo committed fraud when he transferred condo units to new LLCs, since the fraud exception to a discharge in bankruptcy encompasses a debtor's transferring valuable property in order to keep it out of the hands of the creditors entitled to it. *McClellan v. Cantrell*, 217 F.3d 890, 894–95 (7th Cir.2000). That may have happened in this case; Collazo may have “rendered the debt uncollectible by making an actually fraudulent conveyance of the property that secured it,” and if so “his actual fraud [gave] rise to a new debt, nondischargeable because created by fraud.” *Id.* at 895; see also *In re Lawson*, 791 F.3d 214, 218–22 (1st Cir.2015). The question whether, as we held in the *McClellan* case, there can be a fraud without a fraudulent statement (for the fraud we're discussing is a silent transfer of property rather than a lie) is now before the Supreme Court in *Husky International Electronics, Inc. v. Ritz*, No. 15–145, argued on March 1 of this year. Should the Court agree with our analysis in the *McClellan* case, Dana will be entitled on remand to resuscitate her fraud claim.

[8] One issue remains to be discussed. The bankruptcy court, again seconded by the district court, refused to enter a money

judgment against Collazo even though both courts had concluded that his debts to Dana and Robert Joseph with respect to the Arizona project were nondischargeable, hence still enforceable, because they'd been obtained by fraud. If a claim is not discharged in bankruptcy but there are no assets in the estate to distribute to the creditor and therefore the debt is still owing, the claimant is free to seek damages against the debtor under the applicable state law defining a creditor's rights. Presumably the aim would be to obtain the damages from the future earnings of the bankrupt debtor, earnings not included in the estate in bankruptcy. The bankruptcy judge was uncertain, however, whether *he* had constitutional and statutory authority to enter a money judgment in a case governed by state law. *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), had held that a bankruptcy judge had no authority to enter final judgment on the debtor's state law counterclaim against a creditor. Uncertain about the application of *Stern* to the present case (which of course does not involve a counterclaim), the bankruptcy judge thought the counsel of prudence was to decline to proceed to judgment. He could have declined to award damages and instead remitted the creditors (Dana and Robert Joseph) to their state-court remedies, see *In re Sasson*, 424 F.3d 864, 874 (9th Cir.2005), since “nothing in [28 U.S.C. § 1334(c)(1)] prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.”

But the judge had, and on remand should consider, two other alternatives, because the entry of a monetary judgment after a finding of nondischargeability is “related to [a] case[] under title 11.” 28 U.S.C. § 1334(b). One is to determine

whether the parties would consent to his adjudicating the claim. See *Wellness Int'l Network, Ltd. v. Sharif*, — U.S. —, 135 S.Ct. 1932, 1939, 191 L.Ed.2d 911 (2015). The other is to submit his proposed findings of fact and conclusions of law to the district judge to accept or reject. See *Executive Benefits Insurance Agency v. Arkison*, — U.S. —, 134 S.Ct. 2165, 2170–72, 189 L.Ed.2d 83 (2014). As an Article III judge, the district judge is empowered to decide a case governed by state law, in this case the state law that authorizes a suit to collect a debt induced by fraud. He doesn't need the parties' consent.

Dana's claim that the transfer of unsold Chicago units to new LLCs was fraudulent, and Dana's and Robert Joseph's claim for a money judgment, are therefore remanded to the bankruptcy court, with the consequence that the judgment of the district court is

AFFIRMED IN PART, AND REVERSED AND REMANDED IN PART.



UNITED STATES of America,
Plaintiff–Appellee,

v.

Kenneth W. LEWIS, Defendant–
Appellant.

Nos. 14–2442, 14–2597.

United States Court of Appeals,
Seventh Circuit.

Argued April 11, 2016.

Decided April 20, 2016.

Background: Pro se defendant was convicted in the United States District Court

for the Central District of Illinois, James E. Shadid, Chief Judge, of wire fraud and money laundering. Defendant appealed.

Holding: The Court of Appeals, Bauer, Circuit Judge, held that defendant's vexatiousness in litigation tactics could not serve as a basis for lengthening sentence.

Affirmed in part, vacated in part, and remanded.

Sentencing and Punishment ◀117

Pro se defendant's vexatiousness in litigation tactics could not serve as basis for lengthening sentence in wire fraud prosecution.

Appeals from the United States District Court for the Central District of Illinois. No. 1:12-cr-10082-JES-JEH—James E. Shadid, Chief Judge.

Darilynn J. Knauss, Gregory R. Walters, Office of the United States Attorney, Peoria, IL, for Plaintiff–Appellee.

Ellen E. Boshkoff, Donald Eugene Morgan, Brian James Paul, Faegre Baker Daniels LLP, Indianapolis, IN, for Defendant–Appellant.

Before BAUER and WILLIAMS,
Circuit Judges, and ADELMAN,* District
Judge.

BAUER, Circuit Judge.

Defendant-appellant, Kenneth Lewis, appeals his conviction and sentence for wire fraud and money laundering. The district court sentenced him to 151 months' imprisonment for the four-count wire fraud

nation.

* Of the United States District Court for the Eastern District of Wisconsin, sitting by design.

**AMERICAN BANKRUPTCY INSTITUTE
2016 WINTER LEADERSHIP CONFERENCE**

**Round and Round with the Judges Program
Saturday, December 3, 2016**

Jevic: *When Is Absolute Priority Not So Absolute?*

Honorable Eugene R. Wedoff

United States Bankruptcy Court, Northern District of Illinois (retired)

Discussion Issues

- The difference between estate liquidation and estate distribution; when is a “sub rosa plan” a problem?
- The origin and importance of absolute priority
- The relevance of a purchaser’s assumption of debt
- The relevance of practical necessity; what circumstances are “rare”?
- What is the best outcome for the bankruptcy system?

Bankruptcy Law Letter

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Structured Dismissals: Smooth Off-Ramp or Artful Dodge?

Christopher W. Frost

Expediency is an attractive quality in Chapter 11 practice, and our attraction to that quality has led to significant changes in the ways in which financial distress is resolved. Going concern sales and global settlements have become regular features of Chapter 11 cases. Traditional negotiated plans of reorganization that focus on a reordering of creditor and shareholder interests still exist but, increasingly, practitioners of Chapter 11 have introduced new methods to short circuit the often cumbersome procedural and substantive requirements of the Code.

Going concern sales certainly respond to the need for expediency. The quick liquidation of the business assets is an attractive alternative to forcing creditors to negotiate against the backdrop of an uncertain judicial valuation. If one can reduce the assets to cash, the parties will find substantially less to argue about. Less is not nothing, however. Even following a quick sale in which everyone is satisfied that the estate received as much as possible, there are claims allowance, distributional questions, and avoidance actions to resolve and releases to be negotiated. So, the quest for expediency continues.

Structured dismissals are the latest innovation Chapter 11 practice. Rather than follow a going concern sale with a liquidating plan or a conversion to a Chapter 7 case that will address postsale issues, the parties negotiate a settlement that contemplates a dismissal order coupled with judicial orders resolving all of these issues. As one court described it:

Unlike the old-fashioned one sentence dismissal orders—“this case is hereby dismissed”—structured dismissal orders often include some or all of the following additional provisions, “releases (some more limited than others), protocols for reconciling and paying claims, ‘gifting’ of funds to unsecured creditors [etc.]”¹

Recently in *In re Jevic*,² the Third Circuit became the first court of appeals to consider the permissibility of such a structured dismissal holding that, in rare cases, a Chapter 11 can be resolved by a structured dismissal that deviates from the absolute priority rule. The case raises two issues that have been explored at some length in the Bankruptcy Law Letter—the sub rosa plan doctrine and the

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Mat #41675051



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application of the absolute priority rule to settlements and other nonplan distribution schemes. Unfortunately, the case pushes the law substantially farther away from enforcing the traditional goals of Chapter 11.

The Litigation, Settlement and Dismissal in *Jevic*

The debtor in *Jevic* was a trucking company that had been purchased in a leveraged buy-out by Sun Capital Partners in a transaction financed by CIT Group. Following the LBO, the debtor encountered financial difficulties and entered into a forbearance agreement under which Sun provided guarantees to CIT. In 2008, the debtor filed a Chapter 11 petition ceasing all business and terminating its employees. The case involved two significant pieces

of litigation. First, the unsecured creditors' committee filed a fraudulent transfer action against CIT and Sun. Second, a group of the debtor's truck drivers filed a suit under the state and federal Worker Adjustment and Retraining Notification ("WARN") Acts. During the three years in which these actions were pending, most of the debtor's assets were liquidated to repay CIT's secured claims. In March 2012, all that remained was \$1.7 million in cash secured by Sun's liens and the avoiding action.³

At that point, the debtor, Sun, CIT, the committee and the drivers met to negotiate a settlement of the fraudulent transfer suit. The resulting settlement provided a \$2 million payment by CIT for the debtor's and committee's legal expenses and other costs of administration. Sun, for its part, assigned its lien to a trust that would pay some administrative costs and return a 4% payment to general unsecured creditors. The WARN Act claimants—who had a claim they estimated to be \$12.4 million, of which \$8.3 million was a priority wage claim under Sec. 507(a)(4)—received nothing under the settlement. All of this was rolled into a structured dismissal, in which the bankruptcy court approved the settlement and dismissed the case.⁴

The WARN Act claimants and United States Trustee raised two basic challenges to the structured dismissal in the bankruptcy court and later on appeal. First, the focus of the UST in the bankruptcy case was on the basic authority of the court to issue a structured dismissal. The Code, the argument goes, only provides three ways to conclude a Chapter 11 case: 1) confirmation of a plan of reorganization; 2) conversion to a Chapter 7; and 3) simple dismissal under which the parties are restored to the status quo. Structured dismissals that have the effect of short circuiting the substantive and procedural creditor protections found in the other alternatives are not expressly permitted by the Code.

The second challenge, raised by the truck drivers, was focused more on the substance of the proposal. First, they argued that the payment to the unsecured creditors violated the Code's priority structure because it bypassed the priority WARN Act claims. Second, the employees challenged the settlement and its lack of any payment to them as

EDITOR IN CHIEF: Ralph Brubaker, Carl L. Vacketta Professor, University of Illinois College of Law

CONTRIBUTING EDITORS: Christopher W. Frost, Thomas P. Lewis Professor, University of Kentucky College of Law

Bruce A. Markell, Professor of Bankruptcy Law and Practice, Northwestern University School of Law

PUBLISHER: Jean E. Maess, J.D.

MANAGING EDITOR: Clay Mattson, J.D.

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BANKRUPTCY LAW LETTER (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

Subscription Price: For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

POSTMASTER: Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

a breach of fiduciary duty by the unsecured creditor's committee, which was pursuing the fraudulent transfer litigation as a representative of the estate as a whole, rather than a representative of the general unsecured creditors.

The bankruptcy court and district court rejected these challenges. A divided panel of the Third Circuit also rejected the challenges in what the majority described as a close decision.⁵ The court recognized the importance of Code priorities, which would have had to have been respected in a liquidating plan or a subsequent Chapter 11, but found that because neither course of action presented a viable alternative to the structured dismissal, the bankruptcy court's reluctant approval of the settlement was appropriate.⁶

Structured Dismissals: Viable Off-Ramp or Sub-Rosa Plan?

Apart from the priority issues specific to the structured dismissal in *Jevic*, the authority of courts to dismiss cases under orders that include forward looking commands and substantive outcomes is a matter of some controversy. The Code does not specifically provide for dismissals that include orders that conclude a case. Instead courts have found support for such orders in sections 1112(b) and 305(a)(1) which permit dismissal, and section 349, which governs the effect of a dismissal. Section 1112(b) provides the most general basis for dismissal requiring only a finding of cause, a finding that the interests of the creditors and estate would be better served by a dismissal and a determination that the appointment of a Chapter 11 trustee or examiner would not be in the best interests of the creditors or the estate. While "cause" is further delineated under section 1112(b)(4) the first of those examples is substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation—a common basis for the entry of a structured dismissal. Section 305, the abstention provision, is seen as providing a more limited basis for a structured dismissal. That provision requires a finding that dismissal is in the best interests of the creditors and the debtor. Given that abstention is nonreviewable under section 305(c), the courts

typically treat the section as applicable only in extraordinary cases.

Those sections only govern the dismissal aspect of a structured dismissal, however. The effect of the dismissal is determined under section 349(b). That section provides that "unless the court, for cause, orders otherwise," a dismissal reinstates avoided transfers, vacates turnover orders and section 550 or 553 judgments and reverts property of the estate in whatever entity was the property was vested immediately before the entry of the order for relief.⁷ The legislative history of the section indicates that Congress intended section 349 to "undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case."⁸ This legislative history and, more importantly the statutory language itself, also makes clear, however, that the court may alter that result for cause. Although the United States Trustee has questioned the statutory basis of structured dismissals, courts, including now the Third Circuit, have had little difficulty finding the authority to order a structured dismissal in appropriate cases. The question remains, however, what type of cases are appropriate.

The appellant's brief in *Jevic* provides a particularly vivid account of the argument against structured dismissals:

Rather than adhering to one of the three congressionally authorized egresses from chapter 11, structured dismissals blaze a new path without statutory authority: a "cafeteria style" dismissal where the parties pick some parts of the chapter 11 plan process (e.g., a liquidating trust), even though a chapter 11 plan cannot be confirmed; and then pick some parts of the chapter 7 process (e.g., appointment of a trustee), even though the parties do not seek conversion. The structured dismissal adds features that are not provided in either chapter 7 or chapter 11, e.g., adjudication of creditor claims by someone other than the Court. This a la carte approach violates the comprehensive chapter 11 and chapter 7 constructs established by Congress, and would, if adopted, establish a troubling precedent whereby parties feel emboldened to choose favored portions of the Code to cobble together new kinds of bankruptcy relief never contemplated by Congress.⁹

In addition, and more troubling, these new forms

of a la carte bankruptcy relief typically are accompanied by few of the procedural protections found in the more traditional resolutions—disclosure, creditor voting, claim resolution standards, the oversight of a trustee (in a Chapter 7). These concerns have led United States Trustees to object to structured dismissals in several cases and in at least one article.¹⁰

Courts, however, have found that structured dismissals provide an efficient and justifiable means of concluding a case—at least where the case is fully liquidated and the economically interested parties are in agreement. *In re Buffet Partners, L.P.*, provides an example of such a case.¹¹ There substantially all of the debtor's assets had been sold to the debtor's secured creditor in at a public auction leaving only a fixed sum of money to be distributed. The parties forged a settlement under which the debtor promised not to pursue remaining Chapter 5 avoiding actions, the buyer assumed unpaid administrative expenses and a capped amount of professional fees, \$500,000 was set aside into a trust for the benefit of unsecured creditors, the secured creditor waived its deficiency claim, and the principals (debtor, secured creditor and committee) executed releases of one another.¹²

The United States Trustee was the only party to object to the structured dismissal and the order garnered the affirmative support the debtor, the lender and the secured creditor. Although the court recognized that the U.S. Trustee was well within its right to object, it nevertheless approved the settlement, largely because “not one party with an economic stake in the case objected to dismissal in this manner.”¹³ The trustee's objection also included a motion to convert the case to Chapter 7 or to move forward with the plan process, options which the court believed would add significantly to the costs of the case. In addition, while the court agreed that the structured dismissal did have some plan aspects, it provided for full priority of senior interests over junior interests and all of the parties in the case had an opportunity to voice objections.¹⁴ In short, the court saw no reason to require the time and expense of a conversion or plan where no additional creditor protections would be achieved by those routes.

In re Naartjie Custom Kids, Inc. concerned a sim-

ilar set of circumstances.¹⁵ In that case, the debtor's assets had been sold in court-approved sales and the proposed structured dismissal simply distributed the remaining assets and tied up the loose ends in the case.¹⁶ Again the U.S. Trustee was the sole dissenting party and the order provided an additional 14 days for parties in interest to object to the proposed distribution.¹⁷ The court entered the order stating, “The Trustee's arguments against the structured dismissal appear to be better suited to those cases where there are a myriad of loose ends, lack of unanimity of support from creditors, and a failure to address the needs of creditors.”¹⁸

In re Biolitic Inc., provides an example of such a case.¹⁹ There the debtor's bankruptcy revolved around substantial litigation between it and AngioDynamics, one of its major distributors. In addition, the case featured substantial fraudulent transfer and related avoiding power litigation between the Chapter 11 trustee and a number of the debtor's nonfiling affiliates. The debtor and AngioDynamics forged a deal under which the court would enter a structured dismissal order that would create a liquidating trust funded by the debtor and AngioDynamics through contributions of estate assets including the actions against the nondebtor affiliates. A liquidating trustee was appointed, however, AngioDynamics would serve as advisor with power to consent to “all significant actions” of the trust. Finally, the claims of the nondebtor affiliates were subordinated to other allowed claims.²⁰

The court agreed that the motion satisfied the “practicality” test, presumably meaning that it presented a cheaper, quicker option for resolution than would a Chapter 11 plan or conversion. Still, the court refused to confirm the plan because it “alter[ed] parties' rights without their consent and lack[ed] many of the Code's most important safeguards.”²¹ The court set out the following requirements for approval for structured dismissals:

Even if a structured dismissal would result in more assets being made available to the creditor body, such relief may not be approved without assurances that creditor protections provided by confirmation or liquidation pursuant to § 1129 or dismissal or conver-

sion pursuant to § 1112(b) are either present or waived by all parties. If a chapter 11 case could be dismissed solely to avoid additional expenses associated with liquidating the estate, parties would rarely, if ever, convert to chapter 7 and the conversion option in section 1112(b) would essentially be rendered superfluous.²²

Unlike *Buffet Partners* and *Naartjie*, the court in *Biolitec* found that the objection to the structured dismissal raised real, as opposed to theoretical, concerns. One of these was the proposal to replace a chapter 7 trustee with a liquidating trustee that not only was outside the supervision of the court but was also under the control of a major creditor.²³ The subordination of the nondebtor affiliates was also a source of concern.²⁴ These substantive effects, the court held, were impermissible in the absence of disclosure and an opportunity for all of the creditors to negotiate and vote on the terms. Ultimately, the court concluded, the structured dismissal had the effect of a sub rosa plan and thus could not be approved.²⁵

Structured Dismissals and Absolute Priority

As the cases above illustrate, structured dismissals in cases in which priority rules are respected and everyone consents to the terms of the orders seem to provide a sensible and low cost means of wrapping up cases. Where all of the parties are not in agreement, however, the case for structured dismissals is far from convincing. Congress has set out a detailed framework of dispute resolution in bankruptcy, coupled with substantive rules—principally the absolute priority rule and the best interest test—that govern decision making in cases in which consent cannot be obtained. Unfortunately, the *Jevic* decision provides yet one more way to circumvent the Code's priority structure, upon justifications that do not stand under close scrutiny.

Several articles in the Bankruptcy Law Letter have noted and decried, the increasing willingness of courts to dilute the traditional strict adherence to absolute priority. Of course, absolute priority is a default rule, applicable only in the absence of creditor consent. Even in nonconsensual cases, however, parties and courts have found ways to avoid the strict application of the rule.

Jevic and the “Gifting Doctrine”

Jevic provides a discussion of both the availability of structured dismissals to serve as an off-ramp for Chapter 11 and the need to violate absolute priority in extreme circumstances. It is not, strictly speaking, a case about the so called “gifting doctrine.” In most gifting cases, a purportedly undersecured creditor agrees to share some of the proceeds of its collateral with a junior class in a way that by-passes an intervening class. The justification for permitting gifting is that an undersecured secured creditor is entitled to all of the proceeds of its collateral and therefore the secured creditor's decision to share its proceeds does not distribute estate property in a way that violates absolute priority.

The seminal case permitting gifting is *In re SPM Manuf. Corp.*²⁶ There, during the Chapter 11 case, the secured creditor and the unsecured creditors' committee entered into an agreement under which the committee agreed to help replace the debtor's management and to cooperate in the liquidation of the debtor, and the secured creditor agreed to share the proceeds of the liquidation with the unsecured creditors.²⁷ Following the liquidation and conversion to a chapter 7, the bankruptcy court refused to permit the secured creditor to pay the promised cut of the proceeds to the unsecured creditors, noting that the payment would bypass priority tax claims, and therefore would violate the Code's priority scheme.²⁸ Instead, the bankruptcy court required payment of the unsecured creditor's portion over to the estate for distribution according to Code's priorities.²⁹

The First Circuit reversed, reasoning that the funds promised by the secured creditor to the committee were not subject to distribution under the Code's priority rules, but instead were property that belonged to the secured creditor. As such, the transfer did not violate the Code.

The Code does not govern the rights of creditors to transfer or receive nonstate property. While the debtor and the trustee are not allowed to pay nonpriority creditors ahead of priority creditors, creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors.³⁰

Essentially, the gifting doctrine rests on the principle of “no-harm, no-foul.” Until the secured creditor is satisfied, priority claimants have no right to expect that the Code’s priority structure will provide them any payment. The agreement by the secured creditor to pay proceeds to a lower class, therefore, does not violate the rights of the members of the higher class.³¹

Although a number of lower courts have embraced the logic of SPM in both Chapter 7 and when analyzing a Chapter 11 plan,³² some circuit courts have been more skeptical. In *In re DBSD North America, Inc.*, the Second Circuit firmly rejected the notion that the gifting doctrine provided an exception to the absolute priority rule that would permit a secured class to gift stock and warrants to equity—bypassing unsecured creditors.³³ In *In re Armstrong World*, both the Delaware District Court and the Third Circuit concluded that an intra-class gift from unsecured creditors to equity violated the absolute priority rule.³⁴

Notwithstanding the *Armstrong World* opinion, the Third Circuit joined the First in approving the gifting doctrine based in *In re ICL Holding Co., Inc.*, a decision rendered just a few weeks ago. In that case, the secured lender group successfully used a credit bid to acquire all of the assets of the debtor. The unsecured creditors and the United States, which held a \$24 million capital gain tax claim on the sale, objected to the sale. The secured lenders entered into a settlement agreement with the unsecured creditors under which the lenders paid \$3.5 million to the unsecured creditors. The agreement also included an escrow arrangement, in which \$1.8 million was set aside to pay administrative claims (other than the government’s tax claim, of course).³⁵

The United States claimed that the sale agreement violated the absolute priority rule in two respects. First, that the payment to the administrative claimants violated the prohibition on unfair discrimination and that the payment to the unsecured creditors violated the rule against priority skipping—payment of lower priority claims without payment in full of higher priority claims.³⁶ Although the Third Circuit did not invoke the gifting doctrine by name, its rejection of the governments

arguments followed the same line of reasoning—that the payments were not made from estate property, but instead from the secured creditor’s own assets.³⁷ Although the court attempted to distinguish DBSD,³⁸ the only real basis to distinguish the cases is that DBSD involved gifting through a plan of reorganization, while the ICL Holding gift was made under a sale order—a distinction that was also important in *Jevic*.

Professor Brubaker has thoroughly analyzed these gifting cases and his thoughtful analysis provides ample support for rejection of the gifting doctrine as fundamentally inconsistent with the origins of the absolute priority rule as a “fixed principle” of bankruptcy distributions.³⁹ The absolute priority rule, as he pointed out, governs the division of the reorganization surplus and recognizes that the secured creditor does not have an unfettered right to all of that surplus.⁴⁰ Thus the notion that the distribution of that surplus is not a distribution of property of the estate is not accurate. In addition, permitting the secured creditor to control the distribution of the bankruptcy estate raises the possibility of collusion—a concern that likely motivated the Supreme Court to reject such distribution in its early equity receivership cases.⁴¹ Still the gifting doctrine continues to present a viable route around the priority rules, particularly where the distribution is accomplished outside of a reorganization plan.

Jevic was a very different type of case with very distinct, and more troubling, reasoning. As the dissent recognized, the money paid by the secured creditors, CIT and Sun, was paid in settlement of a cause of action against them—a cause of action that was indisputably property of the estate.⁴² Thus the rationale that the payment to the unsecured creditors and other administrative claimants did not distribute money that would otherwise have been unavailable to the truckers was not available. Neither the panel majority nor the appellees tried to shoe-horn the case into a gifting doctrine analysis.

Instead the Third Circuit characterized the bankruptcy court’s decision as an effort to make the best out of a bad situation. The court noted the bankruptcy court’s findings that “the traditional routes out of a Chapter 11 bankruptcy were impracti-

cable,” because there was no prospect of a viable plan of liquidation or reorganization in Chapter 11 and because there were insufficient assets in the estate to fund a Chapter 7 trustee. In addition, CIT and Sun stated that they would not enter into a settlement in a Chapter 7 case.⁴³ The court stated:

[T]he Bankruptcy Court had to choose between approving a settlement that deviated from the priority scheme of § 507 or rejecting it so a lawsuit could proceed to deplete the estate. Although we are troubled by the fact that the exclusion of the Drivers certainly lends an element of unfairness to the first option, the second option would have served the interests of neither the creditors nor the estate. The Bankruptcy Court, in Solomonian fashion, reluctantly approved the only course that resulted in some payment to creditors other than CIT and Sun.⁴⁴

Thus, the court approved the settlement as the “least bad alternative.”⁴⁵

Structured Dismissals as Sub Rosa Plans

The *Biolitec* court directly invoked the sub rosa plan doctrine in its disapproval of a structured dismissal that subordinated claims of a nonconsenting creditor and replaced a court supervised claim resolution process with a liquidating trustee. Similarly, Judge Scirica relied on the principles underlying the doctrine in his dissenting opinion in *Jevic*.⁴⁶ The majority simply did not address the question, instead reasoning that the settlement was not a plan and the absolute priority rule does not apply outside of the plan process. The lack of any analysis of the doctrine in the majority opinion likely reflects a fundamental misunderstanding of the doctrine and its purposes and led to an unfortunate outcome in *Jevic* that ignored the importance of the absolute priority as a central organizing rule in bankruptcy.

As Professor Brubaker has observed, “The sub rosa plan issue is easily (and thus frequently) collapsed into (and thus confused with the more general preliminary question of whether and when a § 363 sale of substantially all of the debtors assets is permissible in a Chapter 11 case.”⁴⁷ In the asset sale context, the question of whether a sale can be conducted is distinct from the question of how the proceeds of that sale should be distributed. The first question requires only a business justification

that a sale of assets will likely maximize asset value over the alternative of a traditional reorganization. The second question, distribution, is where the sub rosa doctrine has its bite. The same is true of settlements. Although settlements, such as the one in *Jevic* have the effect of fixing entitlements and liquidating the cause of action, the distribution of any value achieved by the settlement according to those established entitlements implicates absolute priority and therefore the sub rosa plan doctrine.

Professor Brubaker went on to note:

Unfortunately, much of the case law on sub rosa plans fails to make clear exactly what constitutes a sub rosa plan and what it is that is objectionable about a sub rosa plan. For example, it is common to simply state (unhelpfully) that “[t]he reason sub rosa plans are prohibited is based on a fear that a debtor-in-possession will enter into transactions that will, in effect, ‘short circuit the requirements of [C]hapter 11 for confirmation of a reorganization plan.’” Recognizing, though, that what we are seeking to preserve intact are the plan confirmation protections regarding distribution of the value of the debtor’s estate sharpens the analytical edge of sub rosa plan doctrine.⁴⁸

A view that the sub rosa plan doctrine is solely concerned with avoiding transactions that dictate the terms of a plan is likely to lead a court badly astray where it seems clear, as it did in *Jevic*, that a plan will not be confirmed. Even the dissent in *Jevic*, was reluctant to directly apply the sub rosa doctrine and instead relying on the “broader concerns” underlying the doctrine.⁴⁹

But the fact that a plan will or will not be confirmed is beside the point. The question is whether the asset sale, settlement or structured dismissal does what a plan would do—most importantly distribute assets of the estate. Alternatively, the same analysis should probably lead to a sub rosa Chapter 7 doctrine. Where a conversion to Chapter 7 is a possible outcome as it was in *Jevic*, the question is whether a structured dismissal does what section 726 would do—again distribute estate assets.

Forget the Sub Rosa Doctrine—Settlements Are Not Plans and Do Not Have to Comply with Absolute Priority!

The Third Circuit did not see it this way, instead relying on the Second Circuit's decision in *In re Iridium Operating LLC*.⁵⁰ That case, discussed at some length in an earlier issue of the Bankruptcy Law Letter,⁵¹ involved the settlement of a dispute over the validity of secured creditor's liens. The settlement of the case required a cash payment by the secured creditors to a litigation fund that would pay for the estate's pursuit of claims against Motorola, which also held administrative claims for business conducted with the debtor postbankruptcy. While the settlement provided that any proceeds from the Motorola action would be distributed according to Code priorities (with Motorola receiving its administrative priority), any leftover funds would be paid to the unsecured creditors—skipping Motorola's administrative claims.⁵² Motorola objected.

The case, like *Jevic*, did not involve the gifting doctrine.⁵³ Instead, the Second Circuit directly rejected the strict application of the absolute priority rule to settlements. Although the court noted that compliance with the absolute priority rule is the most important factor for a court to consider in approving a settlement, noncompliance can be overlooked where there are “specific and credible grounds to justify that deviation.”⁵⁴ In so holding, the court rejected the strict approach of the Fifth Circuit in *Matter of AWECO, Inc.*,⁵⁵ finding that the requirement of compliance with absolute priority in settlements “cannot accommodate the dynamic status of some pre-plan bankruptcy settlements.”⁵⁶

In *Jevic*, the Third Circuit followed right along—rejecting *AWECO* and analyzing the structured dismissal under the flexible approach of *Iridium*. The court found the settlement's provisions denying the WARN act claimants any recovery on their priority and nonpriority claims “regrettable” and stated that the exclusion of those claimants, “certainly lends an element of unfairness” to the settlement; but the deadlock in negotiations over the claims meant that something had to give. The *Jevic* court chose to place all of that “give” squarely on the Warn Act claimants.

Taking Priorities and Procedures Seriously: A Closer Look at the Hollow Justification of *Jevic*

Even if one assumes that there is some “give” in the priority structure of the Code, *Jevic* seems to be the worst type of case to employ such a justification. *Jevic* is a decision that plays to expediency over principle and thereby provides a somewhat ad hoc choice of winners and losers. The offered justification—the fact that the deal was the only one available that would result in a distribution to any creditor—seems insufficient to justify the court's disregard for the priority rights of the WARN Act claimants.

Consider carefully the nature of the dispute in *Jevic*. Two creditors, one of which was the debtor's shareholder were attempting to maintain the validity of their liens and avoid further damage claims in a suit brought by the creditors' committee on behalf of the estate. Allied against those creditors were the general unsecured creditors and a group of truckers holding substantial priority claims. It is only natural that the secured creditors would choose the committee as a negotiating partner under these facts—the committee was the group in control of the suit and its acquiescence would certainly be necessary for any deal to be successful. That necessity hardly justifies excluding the interests of the truckers in any deal, however.

For that justification, we need to explore further. The situation was somewhat complicated by the fact that the WARN Act claims were, at the time of the settlement, disputed. Again, however, the case could have been settled with the proceeds held pending the outcome of the WARN Act litigation. In any event the WARN Act litigation was substantially concluded by the time of the appeal, with the truckers winning a summary judgment on their state law WARN Act claims, but losing on the other claims.⁵⁷ The only other reason for excluding the WARN Act claimants was that Sun Capital (the debtor's sole shareholder) was also the subject of WARN Act claims brought by the truckers. Sun Capital, therefore, was unwilling to enter into a settlement that included the truckers unless they dismissed their case against it.⁵⁸ Certainly that position was an understandable one, but, then again,

so was the unwillingness of the truckers to give up their separate claim against Sun Capital in return for their share of the *Jevic* estate.

Thus, while it may have been true that the deadlock in negotiations threatened to mire the estate in litigation that might consume the entirety of the estate, there is little justification for forcing a result that effectively concluded the case by simply excluding the WARN Act claimants. The observation that the settlement was the only way anyone would have received any recovery simply restates the problem. Yes, we could often save the time and expense of litigating questions simply by ignoring substantive rights and picking a winner, but that is not the way we generally decide disputes. Indeed the claims of the various parties may not have been worth litigating, but that is no reason to pick a winner without bothering to litigate.

There is a more troubling aspect of the settlement and structured dismissal in *Jevic*, one that was raised by the WARN Act claimants but not addressed by the Third Circuit. The settlement and accompanying structured dismissal were negotiated and presented for approval by the creditors' committee. This is a natural allocation of negotiating authority given the fact that the committee had brought the action. But, as the WARN Act claimants pointed out, the committee's authority to bring the action through derivative standing was as an estate representative.⁵⁹ As estate representative, the committee had a fiduciary duty to the estate and all of the creditors. The settlement concluded, however, left out an important group of these creditors in favor of the committee's own constituents. Thus, while the settlement may well have been the only route to preserve estate value, the possibility that it may have been the product of collusion, or at least a lack of concern with the rights of the WARN Act claimants should not be easily dismissed. As I stated in my previous discussion of settlements and the absolute priority rule:

To the extent that the class receiving the give-up has some control over the conduct of the litigation and the settlement negotiations, that class certainly has an incentive to end the litigation in return for the side payment. Although bankruptcy courts in general are particularly good at rooting out the col-

lusion that necessarily results from a process with so many claimants with so many conflicting incentives, the basic rules that govern the process should be crafted to reduce that possibility.⁶⁰

In commenting on departures from absolute priority in the gifting context, Professor Brubaker observed:

It is virtually impossible to penetrate the real reasons for the "gift" to old equity: Is it really because they will provide substantial value to the reorganized entity, or is it simply because they have substantial control over the reorganization process, and a "gift" to them is necessary to grease the reorganization skids.⁶¹

The same observation might be applicable here. It is impossible to tell the settlement negotiated by the unsecured creditors' committee was the best available or whether it was simply easier for the committee to exclude the WARN Act claims.

The Next Non-Plan (Sub Rosa?) "Reorganization"

In a similarly sub-titled discussion of plan support agreements and absolute priority, Professor Brubaker noted that the importance of a firm understanding of the applicability of the absolute priority rule outside of the plan context is an issue that involves "nothing less than preserving (or abandoning) the very core and essence of bankruptcy reorganization law."⁶² Indeed, if we are to take distribution rules seriously courts will have to confront new devices that effect plan-like distributions and determine whether the "plan substitute" truly follows Chapter 11's ground rules. Settlements and plan support agreements tempt us to disregard these core principles in favor of expediency and regard for nonplan rights. Structured dismissals like the one in *Jevic* take us one step further away from the supposed "fixed principle" of absolute priority. The end result may be to encourage parties to force a deadlock, settle with the strongest of the contenders, and claim "well, your Honor, it is not perfect but it's the best we could do." "Best we can do" might be a distributional standard, but it is not a particularly appealing one.

ENDNOTES:

¹In re Strategic Labor, Inc., 467 B.R. 11, 17 n.10

(Bankr. D. Mass. 2012) (citations omitted), quoted in *In re Jevic Holding Corp.*, 787 F.3d 173, 177 (3d Cir. 2015).

²In *re Jevic Holding Corp.*, 787 F.3d 173, 61 Bankr. Ct. Dec. (CRR) 21, Bankr. L. Rep. (CCH) P 82826, 165 Lab. Cas. (CCH) P 10774 (3d Cir. 2015).

³Jevic, 787 F.3d at 175-76.

⁴Jevic, 787 F.3d at 176-77.

⁵Jevic, 787 F.3d at 184.

⁶Jevic, 787 F.3d at 185.

⁷11 U.S.C.A. § 349(b).

⁸HR Rept. No. 95-595 at 338 (1977).

⁹In *re Jevic Holding Co., Inc.*, Brief of Appellants, 2014 WL 3572018, *45-46 (3d Cir. July 8, 2014).

¹⁰See *In re Biolitec, Inc.*, 528 B.R. 261 (Bankr. D. N.J. 2014) (U.S. Trustee objection to structured dismissal); *In re Buffet Partners, L.P.*, 59 Bankr. Ct. Dec. (CRR) 232, 2014 WL 3735804 (Bankr. N.D. Tex. 2014) (same); *In re Naartjie Custom Kids, Inc.*, 534 B.R. 416, 61 Bankr. Ct. Dec. (CRR) 80 (Bankr. D. Utah 2015) (same); see also, Nan Roberts Eitel, T. Patrick Tinker, Lisa L Lambert, Structured Dismissals, or Cases Dismissed Outside of the Code's Structure, 30 Am. Bankr. Inst. J. 20 (March 2011) (Article critical of structured dismissals authored by Associate General Counsel For Chapter 11 Practice at the Executive Office for U.S. Trustee and two attorneys in U.S. Trustee's offices).

¹¹In *re Buffet Partners, L.P.*, 59 Bankr. Ct. Dec. (CRR) 232, 2014 WL 3735804 (Bankr. N.D. Tex. 2014).

¹²Buffet Partners, 2014 WL 3735804 at *1.

¹³Buffet Partners, 2014 WL 3735804 at *4.

¹⁴Buffet Partners, 2014 WL 3735804 at *3.

¹⁵In *re Naartjie Custom Kids, Inc.*, 534 B.R. 416, 61 Bankr. Ct. Dec. (CRR) 80 (Bankr. D. Utah 2015).

¹⁶Naatrjie Custom, 2015 WL 4244645 at *2.

¹⁷Naatrjie Custom, 2015 WL 4244645 at *8.

¹⁸Naatrjie Custom, 2015 WL 4244645 at *8.

¹⁹In *re Biolitec, Inc.*, 528 B.R. 261 (Bankr. D. N.J. 2014).

²⁰Biolitic, 528 B.R. at 265-66.

²¹Biolitic, 528 B.R. at 269.

²²Biolitic, 528 B.R. at 269.

²³Biolitic, 528 B.R. at 271.

²⁴Biolitic, 528 B.R. at 270.

²⁵Biolitic, 528 B.R. at 272.

²⁶In *re SPM Mfg. Corp.*, 984 F.2d 1305, 23 Bankr. Ct. Dec. (CRR) 1529, 28 Collier Bankr. Cas. 2d (MB) 451, Bankr. L. Rep. (CCH) P 75090 (1st Cir. 1993).

²⁷SPM, 984 F.2d at 1308.

²⁸SPM, 984 F.2d at 1309.

²⁹SPM, 984 F.2d at 1310.

³⁰SPM, 984 F.2d at 1313, citations omitted.

³¹SPM, 984 F.2d at 1312 (“[T]he distribution scheme of section 726 (and, by implication, the priorities of section 507) does not come into play until all valid liens on the property are satisfied.”).

³²See Brubaker, Taking Chapter 11's Distribution Rules Seriously: Inter-Class Gifting is Dead! Long Live Inter-Class Gifting, 31 Bankr. L. Letter No. 4, 2 (April 2011).

³³In *re DBSD North America, Inc.*, 634 F.3d 79, 100, 65 Collier Bankr. Cas. 2d (MB) 201, Bankr. L. Rep. (CCH) P 81933 (2d Cir. 2011).

³⁴In *re Armstrong World Industries, Inc.*, 432 F.3d 507, 514, 45 Bankr. Ct. Dec. (CRR) 222, 55 Collier Bankr. Cas. 2d (MB) 789, Bankr. L. Rep. (CCH) P 80434 (3d Cir. 2005) (“We adopt the District Court's reading of these cases, and agree that they do not stand for the unconditional proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive. Creditors must also be guided by the statutory prohibitions of the absolute priority rule, as codified in 11 U.S.C.A. § 1129(b)(2)(B).”).

³⁵In *re ICL Holding Co., Inc.*, 2015 WL 5315604, *2 (3d Cir. 2015).

³⁶ICL Holding, 2015 WL 5315604 at *6.

³⁷ICL Holding, 2015 WL 5315604 at *7-9.

³⁸ICL Holding, 2015 WL 5315604 at *9, n. 6.

³⁹See Ralph Brubaker, Inter-Class Give-Ups in a Chapter 11 Plan of Reorganization: Remembering the Origins of the Absolute Priority Rule, 25 Bankr. L. Letter No. 6 (June 2005); Brubaker, Taking Chapter 11 Distribution Rules Seriously, 31 Bankr. L. Letter No. 4.

⁴⁰Brubaker, Taking Chapter 11 Distribution Rules Seriously, 31 Bankr. L. Letter No. 4 at 11.

⁴¹Brubaker, Taking Chapter 11 Distribution Rules Seriously, 31 Bankr. L. Letter No. 4 at 11-12.

⁴²Jevic, 787 F.3d at 188 (Scirica, J. concurring in part and dissenting in part).

⁴³Jevic, 787 F.3d at 178.

⁴⁴Jevic, 787 F.3d at 185.

⁴⁵Jevic, 787 F.3d at 185.

⁴⁶Jevic, 787 F.3d at 187.

⁴⁷Brubaker, The Chrysler and GM Sales: § 363 Plans of Reorganization? 29 Bankr. L. Letter No. 9, 4 (Sept. 2009).

⁴⁸Brubaker, The Chrysler and GM Sales, 29 Bankr. L. Letter No 9 at 7, quoting *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007).

⁴⁹Jevic, 787 F.3d at 188 (Scirica, J. concurring in part and dissenting in part).

⁵⁰In re Iridium Operating LLC, 478 F.3d 452, 466, 47 Bankr. Ct. Dec. (CRR) 243, Bankr. L. Rep. (CCH) P 80874 (2d Cir. 2007).

⁵¹Frost, Settlements, Absolute Priority and Another Look at Inter-Class Give-Ups, 27 Bankr. L. Letter No.1 (June 2007).

⁵²Iridium, 478 F.3d at 457-60.

⁵³Iridium, 478 F.3d at 461.

⁵⁴Iridium, 478 F.3d at 466.

⁵⁵Matter of AWECO, Inc., 725 F.2d 293, 11 Bankr. Ct. Dec. (CRR) 953, Bankr. L. Rep. (CCH) P 69722 (5th Cir. 1984).

⁵⁶Iridium, 478 F.3d at 464.

⁵⁷Jevic, 787 F.3d at 190, n. 6 (Scirica, J. concur-

ring in part and dissenting in part).

⁵⁸Jevic, 787 F.3d at 186 (Scirica, J. concurring in part and dissenting in part).

⁵⁹Brief of Appellants, In re Jevic Holding Corp., 2014 W.L. 3572018, *39-40.

⁶⁰Frost, Settlements, Absolute Priority and Another Look at Inter-Class Give Ups, 27 Bankr. L. Letter No. 6 at 7.

⁶¹Brubaker, Taking Chapter 11's Distribution Rules Seriously, 31 Bankr. L. Letter No. 4 at 12.

⁶²Brubaker, Taking Chapter 11's Distribution Rules Seriously, 31 Bankr. L. Letter No. 4 at 13.

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