# Case Law 2016: At Least Some Courts Have Spoken

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2016

# CASE LAW UPDATE

## ABI
## Hon. Eugene R. Wedoff
## Seventh Circuit Consumer Bankruptcy Conference

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Seventh Circuit Cases and Resulting Rulings from Lower Courts

**Defalcation While Acting as a Fiduciary**

- ***In re Jahrling*, 816 F.3d 921 (7th Cir. 2016)**: A former client brought an adversary proceeding in the debtor-attorney's Chapter 7 case, seeking a finding that a state court malpractice judgment was nondischargeable pursuant to 11 U.S.C. § 523(a)(4). The Bankruptcy Court ruled that the legal malpractice debt was nondischargeable, because the debtor-attorney committed defalcation while acting as a fiduciary. In affirming the Bankruptcy Court and the District Court, the Seventh Circuit found that the debtor-attorney's conduct in representing his non-English speaking client – which included selling the client's home at a price that was far below market price, relying on the purchasers' counsel to communicate with the client in the language spoken by the client, and failing to draft the purchase agreement in accordance with the client's wishes – constituted a gross deviation from the standard of conduct that any Illinois attorney would observe in a debtor-attorney relationship and rose to the level of fiduciary defalcation for purposes of 11 U.S.C. § 523(a)(4).

- *In re Bastanipour*, -- B.R. ---, 2016 WL 3277269 (Bankr. N.D. Ill. June 7, 2016): Prior to filing, the chapter 7 debtor/defendant had worked as a licensed real estate agent. At one point, she convinced her client, the plaintiff, to buy an apartment in Chicago to use as an investment/rental property. Although the plaintiff expressed disinterest in purchasing the property, the defendant told him she could get it for him with no down payment and that he could rent it for enough to pay the mortgage. Despite these representations by the defendant, the plaintiff ended up owing $490,000 prior to closing. Further, at closing the plaintiff learned for the first time that he was purchasing the property from the defendant. When the defendant filed for bankruptcy, the plaintiff filed an adversary complaint asserting that he had a nondischargeable claim against the defendant pursuant to 11 U.S.C. § 523(a)(4) (fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny). The Court found that a fiduciary relationship existed and that the defendant had violated her fiduciary duty by failing to disclose to the plaintiff that she owned the apartment. Further, the defendant committed a defalcation by consciously disregarding the risk that selling the apartment to the plaintiff would violate that duty. However, because the plaintiff had failed to prove that the defendant' defalcation caused him to suffer a loss, the Court entered judgment for the defendant.

**Show Me the Money**

- ***Harris v. Viegelahn*, 135 S.Ct. 1829 (2015):** The debtor converted his case from Chapter 13 to Chapter 7 and filed a Motion to Compel the Chapter 13 Trustee to turn over the undistributed funds that the Trustee had collected pursuant to the confirmed Chapter 13 Plan. The Trustee argued that the funds should instead be distributed to creditors in accordance with the terms of the plan. The Bankruptcy Court granted the Trustee's Motion, and the Trustee appealed. The District Court affirmed, but the Fifth Circuit Court of Appeals reversed. The Supreme Court granted certiorari and held that undistributed plan payments made by a debtor and held by the Chapter 13 Trustee at the time of a

case's conversion to Chapter 7 must be returned to the debtor rather than distributed to creditors. The Supreme Court discussed the purpose behind a Chapter 7 case – providing the debtor with a fresh start. Thus, a Chapter 7 estate does not include the wages a debtor earns subsequent to the bankruptcy filing pursuant to 11 U.S.C. § 541(a)(1). Conversion from Chapter 13 to Chapter 7 does not commence a new bankruptcy case and does not effect a change in the filing date. *See* 11 U.S.C. § 348(a). Therefore, in a case converted from Chapter 13 to Chapter 7, a debtor's postpetition earnings do not become part of the new Chapter 7 estate. 11 U.S.C. 348(f)(1)(A), (f)(2). Accordingly, undistributed plan payments held by the Trustee when the case is converted to Chapter 7 must be returned to the debtor.

- *In re Gorniak*, 549 B.R. 721 (Bankr. W.D. Wisc. 2016): Chapter 11 debtors converted their case to Chapter 7. The Chapter 7 Trustee sought turnover of funds held in a debtor-in-possession account, which consisted only of post-petition earnings on the date of conversion. The Court cited 11 U.S.C. § 541(a)(6), which provides that "earnings from services performed by an individual debtor after the commencement of the case" are excluded from the bankruptcy estate. In a chapter 13 case, the estate includes "earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 . . . ." 11 U.S.C. § 1306(a)(2). Similarly, in a chapter 11 case, § 1115(a)(2) provides that "earnings from services performed by the debtor after commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 . . ." are included in the estate. The debtors argued that, pursuant to *Harris v. Viegelahn*, post-petition earnings are not property of a chapter 7 estate after a conversion. However, the Court stated that the *Harris* court did not discuss Chapter 11 cases or conversions from Chapter 11 to Chapter 7. Therefore, the debtors were required to turnover the funds in the DIP account to the Trustee.

- *In re Edwards*, 538 B.R. 536 (Bankr. S.D. Ill. 2015): Before *Harris v. Viegelahn*, both Chapter 13 trustees in the Southern District of Illinois distributed post-petition payments received prior to a case's conversion or dismissal in accordance with the terms of the confirmed Chapter 13 plan. *Harris* directly precluded trustees from continuing this policy in the event of a case's conversion. The question presented in this case was, in light of *Harris*, whether post-petition property and wages in the trustee's possession at the time of the dismissal of a Chapter 13 case must be distributed in accordance with the confirmed plan or returned to the debtor. The Court held that, irrespective of *Harris*, such property and wages must be returned to the debtor because, under § 349(b)(3) of the Bankruptcy Code, the debtor has a vested right in such post-petition property and wages.

- *In re Meier*, 550 B.R. 384 (N.D. Ill. 2016): Chapter 11 debtors converted their case to Chapter 7. While the case was proceeding under Chapter 11, the debtor continued working and deposited his post-petition earnings in a DIP account. After conversion, a creditor sought to compel the debtor to turnover the DIP account funds to the estate. The Court found held that the post-petition earnings remained part of the estate upon conversion to Chapter 7 and did not revert to the debtor.

**Collectible Bibles are Exempt**

- ***In re Robinson*, 811 F.3d 267 (7th Cir. 2016)**
  - *In re Robinson*, 498 B.R. 207 (Bankr.S.D.Ill. 2013) (Bankruptcy Court ruling): The debtor claimed a valuable copy of the Book of Mormon as an exempt bible pursuant to the Illinois exemption statute, 735 ILCS 5/12-1001(a). This section allows for the exemption of a debtor's necessary wearing apparel, bible, school books, and family photos. Debtor possessed other bibles as well. The Trustee argued that allowing the exemption for the valuable book would violate the purpose and intent of the statute. After examining the relevant case law, as well as the context of the statute's language, the Court sustained the Trustee's objection. The Illinois exemption statute was passed, at least in part, with the intent to protect the bare necessities of a debtor. A bible was included in the exemption statute to protect the debtor's daily devotional aid. The exemption of the collectible, rare, and valuable book failed to fulfill the intent of the legislature or the purpose of the statute. In its current condition, the bible was not usable. The debtor appealed, and the district court reversed. The Trustee then appealed.
  - *In re Robinson*, 811 F.3d 267 (7th Cir. 2016): The Court of Appeals held that a dollar-value limitation could not be read into the statute where one did not appear. The Court stated that, in ascertaining the legislature's intent, a court must first look to the statutory language itself. Where the language is clear, the court must give the language full effect and should not look to extrinsic aids for construction. Because the legislature had not included a monetary limit in the statute exempting "necessary wearing apparel, bible, school books, and family pictures," it did not intend that a debtor's exemptions be limited to items of negligible value. Therefore, the valuable Book of Mormon was exempt.

- No other Seventh Circuit cases citing this case

**Issues with Secured Creditors' Claims**

- ***In re Pajian*, 785 F.3d 1161 (7th Cir. 2015):** A secured mortgage lender filed a proof of claim three months after the expiration of the deadline for filing proofs of claim in the chapter 13 debtor's case. The debtor objected, as the creditor had missed the deadline for filing claims under Rule 3002(c). The creditor argued that it did not need to file a proof of claim to receive distributions from the chapter 13 plan. The Court held that Rule 3002(c) requires all creditors – secured and unsecured -- to file a proof of claim to receive distributions. The Court also noted that a secured creditor who fails to file a claim can still enforce its lien through a foreclosure action, even after the debtor receives a discharge.

- *In re Hrubec*, 544 B.R. 397 (Bankr. N.D. Ill. 2016): Per an agreement with a creditor who held a lien on the debtor's vehicle, the debtor sought to pay the debt owed to the creditor through his Chapter 13 plan. The creditor did not file a proof of claim before the claims bar date, but the debtor's plan included payment to the creditor for its secured debt. The Court stated that the statement from *Pajian* – "a creditor must file a proof of claim in

order to participate in chapter 13 plan distributions" – was dictum, its only significance being to emphasize that a creditor may choose between payment under a plan or reliance on enforcement of its rights outside of bankruptcy. Therefore, the Court held that "when a debtor voluntarily proposes a plan that includes payments to a secured creditor, and that creditor has no objection to its treatment under the proposed plan, there is no need for the creditor to file a proof of claim and the plan is not unconfirmable."

- *In re Johnson*, 2016 WL 106595 (Bankr. E.D. Wisc. Jan. 8, 2016): The Court did not allow a late filed student loan claim, even though the creditor had not been scheduled and did not have notice of the bankruptcy case. The Court noted that this did not violate the creditor's due process rights, because the creditor's claim would not be discharged. To avoid waiting to collect its claim until completion of the plan, the creditor could seek relief from the automatic stay.

Southern District of Illinois Cases

***In re Edwards*, 538 B.R. 536 (Bankr. S.D. Ill. 2015)**

See summary in Seventh Circuit section above.

***In re Forby*, 2015 WL 4124332 (Bankr. S.D. Ill., July 7, 2015)**

The creditor filed its proof of claim one day before the claims bar date. The claim was rendered deficient by the Clerk's office, because it did not substantially conform to Official Form 10 but, rather, was a one-page statement of account. The creditor received notice of the claim's deficiency five days after the claims bar date. Upon receiving notice, the creditor filed an amended claim using Official Form 10. The Trustee objected to the amended claim, arguing that under the Seventh Circuit's decision in *In re Greenig*, 152 F.3d 631 (7th Cir. 1998), the claim was barred as untimely, and that the Court was without authority to hold that the timely filed deficient claim was an "informal proof of claim" pursuant to the informal proof of claim doctrine, and thus that the late filed formal claim was an inadequate amendment to the deficient claim.

The Court held that the deficient claim was an informal claim and, therefore, that the late filed formal claim was a valid amendment thereto. The Court reasoned that the Seventh Circuit's *Greenig* decision affected a narrowing of the informal proof of claim doctrine, but that the creditor had complied with the doctrine's now limited contours. Accordingly, the Court overruled the Trustee's objection.

***Future Environmental, Inc. v. Vansyoc*, BK 15-60031; Adv. 15-6009 (Bankr. S.D Ill. April 12, 2016)**

Prior to the filing of the defendant's bankruptcy petition, plaintiff Future Environmental Inc. brought a complaint in the Will County, Illinois Circuit Court against its former employee, defendant Dale Vanscyoc, alleging civil conspiracy, willful conversion, fraud, and breach of

fiduciary duty. Although the defendant filed an answer, he failed to otherwise defend or participate in the state court litigation and ultimately, uncontested summary judgment was entered in favor of the plaintiff and against the defendant on the complaint.

Thereafter, the plaintiff brought a complaint to determine dischargeability of its judgment in the defendant's bankruptcy proceeding pursuant to 11 U.S.C. §§ 523(a)(2)(A), (4), and (6). It then moved for summary judgment on that complaint, alleging that the state court findings were determinative on the issues involved, and pursuant to the doctrine of collateral estoppel, should be given preclusive effect. The defendant objected, arguing that because the state court's order granting summary judgment failed to include any specific findings, it was insufficient to serve as a basis for granting summary judgment in the dischargeability proceeding. In addition, the defendant argued that because he had not contested the motion for summary judgment in state court, the matter had not been "actually litigated" for the purposes of collateral estoppel.

In granting the plaintiff's motion, the Court found that the plaintiff had satisfied all of the elements necessary to establish collateral estoppel as to the issue of fraud. The fact that the state court judgment did not contain specific findings was of no consequence, because the elements for establishing fraud under Illinois law are virtually identical to those necessary to support a complaint for fraud under 11 U.S.C. § 523(a)(2)(A).

***In re Alvion Properties, Inc.*, 538 B.R. 527 (Bankr. S.D. Ill. 2015)**

The Chapter 11 debtor owned two pieces of property: 1,294 acres of land owned fee simple, as well as the mineral rights to that land; and an additional 3,219 acres of mineral rights. The secured creditor with the mortgage on the property moved for a determination that the debtor was a single asset real estate under 11 U.S.C. § 101(51B). In response, the debtor argued that it was not a single asset real estate, because the property in question did not constitute a single property or project. The Court ruled in favor of the debtor, because the creditor failed to meet its burden of proving the existence of a single property or project.

***In re Downs*, BK 15-31561 (Bankr. S.D. Ill. Dec. 30, 2015)**

In 2010, five years prior to the debtor's bankruptcy filing, the mortgage holder filed a complaint in state court seeking to foreclose on its mortgage on debtor's real estate. The state court entered a Judgment of Foreclosure, and the creditor bought the property at a judicial sale. Following the foreclosure action, debtor filed for Chapter 13 bankruptcy three separate times, delaying the creditor from taking possession of the property. In the current bankruptcy, the creditor moved for relief from the automatic stay so that it could take possession of the property. The debtor sought to pay the mortgage through the Chapter 13 plan.

Section 1332(c)(1) of the Bankruptcy Code states that "a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured . . . until such residence is sold at a foreclosure sale. . ." In *Colon v. Option One Mortgage*, 319 F.3d 912 (7th Cir. 2003), the Seventh Circuit specified that, under Illinois law, a debtor's opportunity to cure a default on a principal residence ends after the foreclosure sale has been held. Here, the foreclosure sale had been held more than four years prior, and the debtor's opportunity to cure the default had expired

at that time. Therefore, the stay was lifted, and the creditor was allowed to take possession of the property.

**In re Grabowski, 2016 WL 3884817 (Bankr. S.D. Ill. May 16, 2016)**

Debtors/defendants Paul and Tonya Grabowski filed a Chapter 12 bankruptcy case on April 22, 2015. The Notice of Chapter 12 Case, Meeting of Creditors, & Deadlines fixed the deadline to file a complaint to determine dischargeability of certain debts as July 27, 2015. On January 8, 2016, the plaintiff filed a Complaint to Determine Dischargeability of Debt pursuant to 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(2)(B), alleging that the defendants had sold its collateral years before the bankruptcy filing. The defendants moved to dismiss the Complaint, arguing that it was time-barred pursuant to Federal Rules of Bankruptcy Procedure 4007(c) and 9006(b)(3), which require that a complaint to determine the dischargeability of a debt be filed "no later than 60 days after the first date set for the meeting of creditors," unless the party seeking to object to dischargeability files a motion for extension of time "before the time has expired." The plaintiff argued that its late-filed complaint should be allowed pursuant to the doctrine of equitable tolling.

The Court determined that the facts did not justify applying the doctrine and granted the defendant's motion to dismiss. The plaintiff became aware that its collateral had been sold on September 28, 2015, but did not file its complaint until almost four months later. Equitable tolling is only permitted "until the fraud or concealment is, or should have been, discovered." Therefore, the plaintiff's complaint was still filed too late.

Central District of Illinois Cases

***In re Currie*, 537 B.R. 884 (Bankr. C.D. Ill. 2015)**

An above-median income Chapter 13 debtor who owned a modest house outright proposed a Chapter 13 plan. The Chapter 13 Trustee objected, claiming that the debtor miscalculated her disposable income, because she took the Local Standard Housing and Utilities allowance when, in fact, she was not entitled to the deduction since she had no mortgage indebtedness related to her home. The debtor and the U.S. Trustee argued that the mortgage/rent deduction was properly taken by the debtor on Form B22C.

In overruling the Chapter 13 Trustee's objection, the Court noted that the Local Standard is divided into two separate line items. Inasmuch as some amount of the Local Standard is allocated specifically for utilities, maintenance, and the like, a debtor is assured of receiving a deduction for those expenses regardless of the amount of the mortgage payment. The historical record indicated that none of those involved in the creation of the two line items intended that any portion of the Local Standards for Housing and Utilities would be disallowed for any debtor with housing expenses. To the contrary, the intent was to make sure that the use of the Local Standard by debtors was properly coordinated with the additional allowed deduction for secured mortgage debt.

***In re Hart*, 540 B.R. 363 (Bankr. C.D. Ill. 2015)**

Counsel for a chapter 13 debtor's fee was cut drastically where the quality of the legal services provided was poor, and counsel failed to keep contemporaneous time records. Instead, he reconstructed the time records when required to provide an itemization. Counsel suggested that the practice was sanctioned by the American Bar Association. However, he was unable to provide authority for that proposition when asked.

***Ingram v. Henry (In re Henry)*, 2015 WL 7731429 (Nov. 30, 2015)**

The Chapter 7 Trustee demanded turnover from the debtor of tax refunds which were estate property. The Court entered a Turnover Order, but the parties verbally agreed to alter the Order to allow for installment payments rather than the lump sum by a date certain. The debtor made some payments, then stopped. The Trustee then filed a complaint to revoke the debtor's discharge. Two weeks later, the debtor paid the Trustee in full. The Trustee still asked that the discharge be revoked, because the debtor had failed to abide by the Turnover Order and had failed to cooperate with him in the turning over of estate property. The debtor argued that she paid the amounts due in full and denied that her conduct supported revocation of her discharge.

The Court found that the Trustee did not prove that the debtor's failure to surrender the property was done "knowingly and fraudulently." The Court further found that the Trustee could not rely upon the debtor's failure to comply with the Turnover Order, because he verbally consented to its modification, and there was no evidence presented that the violation of the installment agreement was willful.

***Richardson v. JPMorgan Chase Bank, N.A. (In re Jordan)*, 543 B.R. 878 (Jan. 7, 2016)**

The Chapter 7 Trustee filed a complaint to avoid a mortgage that was obtained from an unlicensed lender. The defendant – assignee of the original mortgage – moved to dismiss the complaint. The Court found that, because current Illinois law specifically provides that violations of the licensing statute do not result in mortgages obtained by unlicensed lenders being void, the motion to dismiss had to be granted. The Court further found that there is no private right of action under the Illinois Residential Mortgage License Act ("RMLA"), and that the Illinois legislature had, shortly after an Illinois appellate court had made a finding that a mortgage made by an unlicensed lender was void as against public policy, enacted an amendment to the RMLA explicitly stating that such a mortgage "shall not be held to be invalid solely on the basis of a violation under this existing law." 205 ILCS 635/1-3(e). Based upon this language, the Court found that no private right of action ever existed to remedy licensing violations, even before the amendment was enacted.

***Hardin v. Alewelt (In re Alewelt)*, 2016 WL 1313382 (Mar. 31, 2016)**

The debtor's former husband filed an adversary complaint, seeking a finding of nondischargeability as to a $43,000 debt owed to him by his former wife. The indebtedness arose as a result of a state court judgment finding that the debtor wrongfully obtained maintenance for an extended period of time during which she was engaged in conjugal

cohabitation with another man, and thereby was not entitled to receive maintenance care per the Judgment of Dissolution. The debtor essentially conceded that she had lied about where she lived, but argued that the misrepresentations were made to the IRS and several lending institutions, not to the plaintiff. Thus, the defendant argued, the plaintiff could not have relied on the misrepresentations.

The Court found that *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000) distinguishes between false pretenses, false representation, and actual fraud, and that reliance is only relevant when a fraud takes the form of a misrepresentation. Where, as here, actual fraud occurred, reliance is not required. Accordingly, the debt was nondischargeable.

***In re Thorpe*, 546 B.R. 172 (Bankr. C.D. Ill. 2016)**

The Chapter 7 Trustee brought a complaint, pursuant to his strong-arm powers, to avoid the debtor's ex-wife's interest in real property awarded to her by a divorce court. The Court held that the Trustee did not have a superior interest in real property and could not establish bona fide purchaser status. He could not override the divorce judgment awarding the marital residence to the non-debtor wife.

Summaries by:

Hon. Laura K. Grandy
Chief Judge
Bankruptcy Court for the Southern District of Illinois

## Fraudulent Transfer Issues

*Husky International Electronics Inc. v. Ritz*, 15-145 (Sup. Ct. May 16, 2016) – Daniel Ritz was the director and part-owner of Chysalis. Chrysalis incurred a debt to Husky for $164,000. Ritz drained Chrysalis of assets that could have been used to pay that debt by transferring $ to other entities Ritz controlled. Ritz filed a Chapter 7. Husky filed an adversary complaint under 523(a)(2) claiming Ritz's transfers of funds constituted "actual fraud". The District Court held that since the debt was not "obtained by…actual fraud" it was dischargeable. The Fifth Circuit affirmed, stating that there had to be a misrepresentation from a debtor to a creditor for there to be actual fraud, and there were no false representations made to Husky regarding the assets of Chrysalis. The Supreme Court reversed. It held that the plain language of §523(a)(2) refers to debts obtained by a false representation ***or*** actual fraud. Therefore, a fraudulent misrepresentation is not required. Furthermore, actual fraud would include any fraud done with wrongful intent. Going back to English bankruptcy practice, fraud has been used to describe a transfer of assets done to impair a creditor's ability to collect the debt. See attached article for more information.

*In re Collazo*, 817 F.3d 1047 (7th Cir. April 5, 2016) – similar facts to *Husky* and *McClellan* (fraudulent conveyance scheme renders uncollectable the debtor's LLCs that borrowed money to rehab condos), with remand to bankruptcy court to decide in light of *Husky* decision (then pending). Also, discussion of options for bankruptcy judge when considering whether or how to enter money judgment in an adversary proceeding (consent or submission to district court). Includes discussion of IL statute of limitations for fraudulent transfer, and when a reasonably prudent person would have discovered the fraud.

*In re Wierzbicki*, 16-1334, 2016 WL 4011173 (7th Cir. July 27, 2016) – Analysis of fraudulent transfer under Sec. 548 and lack of reasonably equivalent value. (The debtor gave away the farm.) Wierzbicki owned a 40 acre farm in WI worth an estimated $300,000 where she lived with her 3 children and their father, Griswold. Griswold & Wierzbicki were involved in state court litigation where Griswold was attempting to gain an interest in the farm. After the trial court ruled against him, Griswold filed an appeal which was dismissed, but Wierzbicki wanted to end the litigation and agreed to quit claim the property to Griswold in exchange for dropping the rest of the litigation and assuming $149,000 in debt on the property, and it would remove her potential liability from a zoning dispute. The court observed that there was still $151,000 in equity in the property, after taking into consideration the assumption of debt and non-economic benefits such as "closure" and "security" are not valuable consideration: "As cold and unsentimental as that rule might seem, it is easier to understand from the perspective of creditors, most of whom would probably be unwilling to volunteer to provide a financial subsidy to enhance the insolvent debtor's family relationships by allowing the debtor to put valuable property beyond their reach."

*In re Smith,* 811 F.3d 228 (7th Cir. 2016) – IL tax lien sale is an avoidable fraudulent transfer, if the transfer was for less than reasonably equivalent value. The Court differentiated from the Supreme Court's holding in BFP v. Resolution Trust Corp, 511 U.S. 531 (1994) which held a mortgage foreclosure sale that complies with state law is a transfer for "reasonably equivalent value." However, since the bidding methods used in an Illinois tax sale are fundamentally different, the reason of BFP cannot be extended. Illinois tax sales do not award a tax lien to the highest bidder as other states do, or as is the case in a foreclosure sale. An Illinois tax lien is awarded to the lowest bid. In Illinois, the buyers bid based on the penalty interest rates that can be demanded from the delinquent taxpayer, starting at 18%, and going down to 0%, so there is no correlation between the sale price of a tax lien, and the value of the property. Therefore, a tax sale that took place within 2 years of the Debtor's Chapter 13, is considered a fraudulent transfer under §548.

*In re Blanchard*, 819 F.3d 981 (7th Cir. 2016) Acknowledging the "sometimes metaphysical difference between personal property and an interest in real property," court holds that mortgage recorded at register of deeds properly perfects lien in land contract vendor's interest in real estate and right to payment under the land contract, and thus Trustee could not use strong-arm powers to avoid the lien as an unperfected security interest.

## FDCPA and FCRA Claims

*Owens v. LVNV Funding LLC*, 15-2044 (7th Cir. Aug. 10, 2016) – FDCPA action dismissed where only alleged violation was the filing of a proof of claim on claim that was barred by the applicable state statute of limitations, and the statute of limitations extinguished only the remedy, but not the right to payment. See attached section on stale claims for more information.

There have been several decisions out of the Northern District of Illinois Court regarding post-discharge reporting by credit reporting agencies (CRA's). They all arise from the same fact pattern. Debtor is behind on his mortgage. Files a Chapter 13 bankruptcy and surrenders the home. Debtor receives a discharge of all debts, including the mortgage.

In *Ginnan v. Guaranteed Rate, Inc.,* (N.D.Ill. Jan 25, 2016), Ginnan's Equifax report listed Guaranteed Rate ("GR") showing a balance of $362,809, $50,000 past due and a monthly payment of over $2,000 per month. Ginnan sent two dispute letters and sued Equifax and GR for violations of the FCRA. GR filed a motion to dismiss, arguing there is no allegation that Equifax put GR on notice of the dispute or sent them any of the materials that Ginnan sent to Equifax with instructions to send to all creditors. The Court found this argument meritless and the motion was denied.

In *Smuk v. Bank of Am., N.A.* (N.D.Ill, Feb 2, 2016), The Smuks sent letters of dispute to Equifax and Experian but their Wells Fargo and Bank of America mortgage accounts were not corrected.

A second set of letters was sent and the accounts were still not corrected so the Smuks sued all 4 parties. Wells Fargo filed a motion to dismiss, arguing plaintiffs did not allege that Wells Fargo had written notice of the dispute. Again, the Court held that requesting the CRA notify the creditors is sufficient and no written notice was required. Again, the motion was denied

*Schlotfeldt v. Wells Fargo Home Mortg, Inc* (N.D.Ill. Feb 3, 2016) was the exact same case except the defendants were Wells Fargo and US Bank

*Jackson v. Experian Info. Solutions* (N.D.Ill. May 19, 2016) was similar. However, Residential Credit Solutions (RCS) did eventually update to show a $0 balance. However, Jackson alleged the language on the Experian report was confusing—it stated that the original amount owed was $536,000 and it was discharged in bankruptcy. It also stated that the debt had a balance of over $537,000 in June, July and August of 2015 and a scheduled payment of $3639 for each of those months. The Court denied RCS motion to dismiss, stating that the information RCS furnished tom Experian created the false impression that Jackson was continuing to make payments years after the debt was discharged.

*Hupfauer v. Citibank, N.A.* (N.D.Ill. Aug 19, 2016) has different facts. In this case, the credit report was corrected to show no balance owed or a monthly payment amount. Hupfauer alleged that there was an FCRA violation because the mortgage was Citibank was listed as in foreclosure rather than discharged in bankruptcy. In granting Experian's motion to dismiss, the Court held that since the credit report listed Plaintiff's discharge on the front page, it was not necessary to state that the mortgage was discharged on its individual trade line. Furthermore, listing the mortgage as having been foreclosed was not inaccurate, so there was no basis for a claim against Experian.

As an aside, it is also good to review *Dixon v. Green Tree Servicing, LLC* (N.D.Ind. May 11, 2015). In Dixon, a Chapter 7 was filed and there was no reaffirmation signed, but Mr. Dixon continued to make his monthly mortgage payments to Green Tree. Seven years after discharge, Mr. Dixon reviewed his credit report and saw that his account with Green Tree was listed as discharged in bankruptcy and never late, but that the last payment made was in May, 2006. Dixon filed a complaint under the FCRA saying the failure of Green Tree to report his current payments, would be considered inaccurate, misleading or incomplete under the FCRA. Green Tree filed a motion for summary judgment. The Court held that the FCRA does not state whether a creditor has a duty to report post-discharge payments. Green Tree stated that it was concerned that such reporting could be considered a violation of the automatic stay as they would appear to be collecting a discharged debt. Green Tree's motion was granted.

**Penalties Assessed to Debt Obtained via Fraud Fall Under §523(a)(2), not §523(a)(7)**

The Bankruptcy Court for the Southern District of Indiana addressed this in two recent cases. *In re Coulter*, (Bankr. S.D.Ind., April 8, 2016), Debtor filed a Chapter 13 and the Indiana Department of Workforce Development filed an adversary complaint against him under §523(a)(2) . Debtor conceded that the benefit overpayment and interest were non-dischargeable under §523(a)(2), but asserted that the penalties assessed to him would fall under §523(a)(7), which would be dischargeable in his Chapter 13. The Court held that 523(a)(2) covers all debt that a debtor incurs via fraud, including penalties as a result of the fraudulently incurred debt. *In re Burge* (Bankr. S.D.Ind., Dec 16, 2015), was slightly different. The Debtor filed a Chapter 7 and the Indiana Department of Workforce Development filed an adversary complaint against him under §523(a)(2) and §523(a)(7). After trial, the Court held that it was Debtor's former girlfriend who had made the false unemployment claims without Debtor's knowledge. So the debt was not excepted from discharge under §523(a)(2). However, the statutory penalties levied against the Debtor were not compensation for pecuniary loss and therefore would be nondischargeable under §523(a)(7).

**Judicial Estoppel**

*Metrou v. M.A. Mortenson Co.*, 781 F.3d 357 (7th Cir. March 23, 2015)—Debtor was injured at work in 2009 and listed his workers compensation claim on his Chapter 7 bankruptcy petition filed in 2010. A year after discharge, Debtor filed suit against two defendants he alleged contributed to his injury. Defendants asked the district court for summary judgment as the claim had not been listed on the Chapter 7 petition. In response to the motion for summary judgment, Debtor notified the Trustee who reopened the bankruptcy and moved to replace him as the plaintiff in the lawsuit. The district court allowed the substitution but ruled that the Trustee could not recover more than the value of the debts listed on the petition. Debtor indicated that he was unaware of any other potential cause of action until after the bankruptcy and there was no evidence to the contrary. In reversing, the Court held that a debtor who makes an innocent error and is willing to surrender the claim to the Trustee, would be entitled to receive any surplus after creditors have been paid, and the bankruptcy judge should determine if the Debtor would be entitled to the surplus.

*Seymour v. Collins* (IL., Sept 24, 2015)—Debtor was injured in an auto accident during his Chapter 13, and filed suit in state court. He did not amend his Chapter 13 petition or disclose the potential cause of action to the Trustee (the Trustee in an affidavit stated that she did not believe it was property of the Estate). The trial court found that the asset was never disclosed and therefore, judicial estoppel applied. The appellate court confirmed, although stating that even though there was no evidence that Debtors intended to deceive the bankruptcy court, the defendants were still able to establish that element of judicial estoppels. The Illinois Supreme

Court reversed, holding that there must be evidence of intent to deceive and that the determination of judicial estoppel cannot be by a rigid formula.

*Lorenz v. Anonymous Physician # 1* (Ind. App., Feb 19, 2016)—Debtor was treated at Anonymous Hospital by several Anonymous medical providers in March and April, 2012. He was eventually admitted to Bloomington Hospital with renal failure, and had incurred over $190,000 in medical debt. Debtor filed a Chapter 7 in August, 2012 and did not list any potential claims. A no asset report was filed and the case was discharged in November, 2012. In March, 2014, Debtor filed a proposed malpractice complaint with the Indiana Dept. of Insurance. In July, 2014, the defendants filed to have the proposed complaint dismissed for judicial estoppel and lack of standing. On July 28, 2014, Lorenz, the Chapter 7 Trustee, file a motion to reopen the bankruptcy case. The case was reopened and Lorenz was reappointed the Trustee. Subsequently, Debtor amended Schedule B to list the potential cause of action. An Amended Proposed Complaint for Damages was then filed, listing the Trustee as the plaintiff, and the Debtor filed a motion in the trial court to have the Trustee substituted as the real party in interest. The trial court did not rule on the motion to substitute and dismissed the proposed complaint. The appellate court reversed, holding that although Debtor was not the real party in interest, he still had standing to sue, and Indiana Trial Rule 17(a)(2) states that an action shall not be dismissed without giving the real party in interest an opportunity to join in. Furthermore, the Court held that judicial estoppel only applies to an intentional misrepresentation. Finally, the Court held that since bankruptcy law is federal, it preempts state law and Indiana courts have only limited jurisdiction over bankruptcy matters. When a bankruptcy court addresses an issue bearing on a state law claim, the bankruptcy court's finding should be applied unless doing so would compromise Indiana laws. Since the bankruptcy court granted the motion to reopen, they clearly expressed the desire for the trustee to proceed in administering the asset, and the state court should not rule that judicial estoppel prevents the case from proceeding.

*Robinson v. Aurora St. Lukes* (Wis. App., July 14, 2015)—Debtor filed a Chapter 7 in May, 2013 and was discharged on August 19, 2013. On August 22, 2013, Debtor filed suit against Aurora for malpractice during treatment in August, 2010. The circuit court held that Debtor's failure to disclose the potential malpractice suit in his bankruptcy estopped him from pursuing the claim, and the case was dismissed. On appeal, the Court noted the efforts that Debtor went through in determining whether he had a malpractice claim (met with nine different attorneys) and that he alleged he was unaware he could file a malpractice complaint pro se until after his case was discharged. However, the Court also noted that the elements of judicial estoppel were present and the circuit court relied on the Seventh Circuit case of *Cannon-Stokes v. Potter*, 453 F.3d 446 (7th Cir 2006). Interestingly, and possibly because Debtor was proceeding pro se, there was no mention of the *Metrou* case, mentioned *supra*, which limited the *Cannon-Stokes* holding. Also interesting is that the circuit court did not take the Debtor's actual intent into consideration. One wonders if the Debtor had advised the Trustee of the possible case and had his bankruptcy reopened would the results have been the same.

## Chapter 13 Plan Modification

*Germeraad v. Powers*, No. 15-3237, 2016 WL 3443342 (7th Cir. June 23, 2016) – denial of trustee's motion to modify is final for purposes of appeal (distinguishing *Bullard*, which dealt with denial of confirmation). Chapter 13 plans cannot extend beyond 5 years, but bankruptcy court can permit debtors to cure default of plan payments beyond the five-year term. Additionally, although a modification cannot be requested after the five-year term, it can be approved. The requested modified plan becomes the plan as of the date it was filed.

## Grounds for Dismissal Under §707

*In re Schwartz,* 799 F.3d 760 (7th Cir. Aug. 24, 2015)—When Debtor was hired by Barclays, he was given a loan for $400,000, which would be forgiven in equal installments through the seventh anniversary of his hiring. He was fired before his second anniversary and in disputing the debt, was ordered by an arbitrator to repay Barclays $568,568. Debtor and his wife filed for Chapter 7, but between the arbitration award and the bankruptcy, Debtors spent thousands of dollars on "inessential consumer goods" and Barclays filed a motion to dismiss under §§ 707(a) and 707(b). The bankruptcy judge dismissed the case solely under 707(a) "for cause" rather than dealing with 707(b). Although Debtors still had household income of $114,000 they chose not to pay anything on their debts, even though they could have afforded to do so. Although the bankruptcy court specifically found no "bad faith" she found that the unjustified refusal to pay one's debts is valid grounds for dismissal under §707(a).

## Jurisdiction and Standing

*In re Ferguson*, 15-3093, 2016 WL 4440508 (7th Cir. August 23, 2016) – an opinion that began with a promising discussion of the retro-active application of the equitable doctrine of marshalling with respect to the sale of farm assets in a Chapter 12 case turns into an opinion about the lack of appellate jurisdiction. *Bullard* requires dismissal because, while the *issue* of marshalling was resolved by the district court, the case was remanded to the bankruptcy court to resolve the *dispute* as to how much money each party should get from the sale proceeds. Because finality depends on resolution of disputes, not issues, appellate jurisdiction was lacking.

*In re Jepson*, 816 F.3d 942 (7th Cir. 2016) – debtor lacks standing under applicable New York law to challenge mortgage assignment due to failure to conform to pooling and servicing agreement,.

*Stevens v. Sharif*, 15-1405 (N.D. Ill. Aug. 4, 2016) – Sharif's attorney Stevens sues the client for unpaid fees, and Sharif counterclaims against Stevens for malpractice, because Stevens did not raise a *Stern v. Marshall* argument until his reply brief in the first (2013) 7th Circuit appeal.

*In re Sobczak-Slomczewski*, 826 F.3d 429 (7th Cir. Jun. 13, 2016) – Court dismissed as untimely an appeal filed 15 days after order, holding that 14-day deadline in Rule 8002(a)(1) is jurisdictional, not procedural, because the deadline to appeal is rooted in the jurisdiction-granting statute, 28 U.S.C. § 158, which requires appeals to be filed in the time provided in Rule 8002.

## Statutory Interpretation

*Wittman v. Koenig*, No. 15-2798, 2016 WL 3997251 (7th Cir. July 26, 2016) – Requirement that annuity "complies with the provisions of the internal revenue code" to be exempt under Wisconsin law means compliance with the tax-deferral provisions of IRC Section 72, not that annuity must qualify for special tax treatment under Sections 401 to 409.

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# Last in Line

By Hon. Deborah L. Thorne and Brett Newman[1]

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

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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 misrepresentation.[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 vote[11] 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 conveyance.[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).

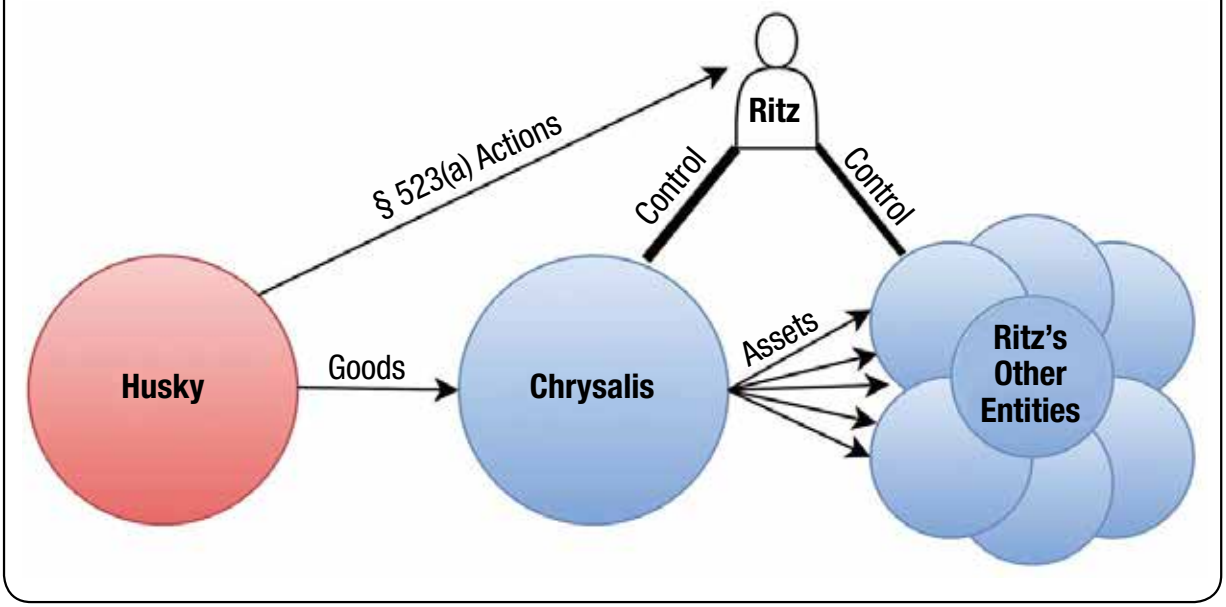
Will this result in many more § 523(a)(2)(A) actions when § 727(a)(2)(A) is the more appropriate option? Section

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*

**The Relationship Among Husky, Ritz and Ritz's Other Entities**



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

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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.

# TREATMENT OF TIME-BARRED CLAIMS IN BANKRUPTCY PROCEEDINGS

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## I. Introduction

A pattern has emerged, primarily in Chapter 13 cases, of adversary proceedings under the FDCPA against creditors for filing so-called "stale" claims—claims against a debtor that, as of the petition date, are time-barred by the applicable statute of limitations.[1] The process begins with a bankruptcy case in which assets are to be distributed (usually a Chapter 13 case), and a notice is mailed to creditors of the date by which claims must be filed. A creditor holding a "stale" claim responds by filing a proof of claim, including the statement Rule 3001(c)(3) requires for claims based on certain consumer credit agreements. From the Rule 3001(c)(3) statement, the debtor's counsel learns that the claim is time-barred and objects under section 502(b)(1). The objection is sustained, and the claim is disallowed (or the claim is withdrawn before the objection is heard).

After the claim is disallowed or withdrawn, or sometimes in conjunction with the claim objection, the debtor files an adversary proceeding against the creditor for alleging that the creditor's act of filing the "stale" claim violated provisions of the Fair Debt Collection Practices Act (FDCPA). The FDCPA provisions in question prohibit debt collectors from using "any false, deceptive, or misleading representations or means" to collect a debt, including misleading representations about the "legal status" of a debt, 15 U.S.C. § 1692e(2), and threatening or taking "any action that cannot legally be taken or that is not intended to be taken," or using "any false

[1] As one judge noted: "It isn't clear how the practice of bringing FDCPA claims in this context began, but there is no question that has caught on. On April 16, 2015, for example, the Chicago Bar Association held a seminar for the express purpose of training attorneys on how to bring FDCPA claims in bankruptcy entitled "Statute of Limitations on Debt Collection & More." Calendar of Events, Chicago Bar Assoc. This judge alone heard five other complaints and motions to dismiss predicated on the same arguments [in a single day]. *In re Glenn*, 542 B.R. 833, 834, FN.2 (Bankr. N.D. Ill. 2016) (internal citation omitted).

representation or deceptive means to collect or attempt" to collect a debt, 15 U.S.C. §§ 1692e(5), (10). Debt collectors who violate the FDCPA are liable for actual damages, "such additional damages as the court may allow, but not exceeding $1,000," and costs, including reasonable attorneys' fees. 15 U.S.C. § 1692k(a).

The defendant-creditor typically files a motion (under Fed. R. Bankr. P. 7012, incorporating Rule 12(b)(6) of the Federal Rules of Civil Procedure) to dismiss the adversary proceeding for failure to state a claim on the ground that the mere filing of a "stale" proof of claim in the debtor's bankruptcy does not violate the FDCPA. Most of the jurisprudence on this issue arises out of resolution of these motions.

## II. Bankruptcy Code Provisions and Rules Related to Filing Claims

For its claim to be allowed, a creditor must file a proof of claim. Fed. R. Bankr. P. 3002(a). Section 501 permits a creditor to file its claim, and a filed claim is automatically allowed under section 502(a) unless there is an objection. Under section 502(b) a claim will be disallowed to the extent that "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. § 502(b)(1).

Rule 3001 prescribes the form and content of a proof of claim. In addition to the requirement that claims be filed on the official form, Rule 3001(c) requires the filer of a claim to include certain information with the claim. If the claim is based on an open-end or revolving consumer credit agreement, an statement must be filed with the form that includes the following information:

> (i) the name of the entity from whom the creditor purchased the account;
>
> (ii) the name of the entity to whom the debt was owed at the time of an account holder's last transaction on the account;

(iii) the date of an account holder's last transaction;

(iv) the date of the last payment on the account; and

(v) the date on which the account was charged to profit and loss.

Fed. R. Bankr. P. 3001(c)(3). The advisory committee note indicates that, among other things, the required additional information will "provide a basis for assessing the timeliness of the claim." Fed. R. Bankr.P. 3001(c) advisory committee's note (2012).

## III. FDCPA and Stale Claims in Bankruptcy.

It is well-settled that threatening to file or filing a lawsuit to collect on a time-barred claim violates the FDCPA. What is not clear is whether it is a violation of the FDCPA to file a proof of claim for a time-barred debt in a bankruptcy case.

Federal courts have uniformly held that a debt collector's threatening to file or filing a time-barred suit in state court to recover a debt violates §§ 1692e and 1692f of the FDCPA. *Crawford v. LVNV Funding, LLC,* 758 F.3d 1254, 1259 (11th Cir. 2014) (collecting cases). The Seventh Circuit has concluded that the filing of a lawsuit on a time-barred debt is a violation of the FDCPA. *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1083 (7th Cir. 2013) ("[T]he debt collection suits against the class members were time-barred and hence violated the Fair Debt Collection Practices Act."). As the Third Circuit explained, "the majority of courts have held that when the expiration of the statute of limitations does not invalidate a debt, but merely renders it unenforceable, the FDCPA permits a debt collector to seek voluntary repayment of the time-barred debt *so long as the debt collector does not initiate or threaten legal action in connection with its debt collection efforts.*" *Huertas v. Galaxy Asset Mgmt.,* 641 F.3d 28, 32–33 (3d Cir.2011) (emphasis added.); see also *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" (emphasis added)). Thus, while a creditor may attempt to collect a time-barred debt, it becomes a FDCPA violation to initiate or threaten legal action to recover the debt. *But see McMahon v. LVNV Funding, LLC,* 744 F.3d 1010, 1020 (7th Cir. 2014) (a debtor states a claim for a FDCPA violation when it misleads an unsophisticated consumer to believe a time-barred debt is legally enforceable, regardless of whether litigation is threatened).

**A. Is Filing a Stale Proof of Claim is Like Commencing a Collection Action?**

Equating a proof of claim with a civil complaint is not a new concept. "The analogy between a proof of claim and a complaint finds further support in the application of Rule 7(a), Fed.R.Civ.P., to the former: the creditor need not reply to objections, and indeed is not permitted to do so, unless a counterclaim denominated as such is set forth, or the Court orders the creditor to make such reply to the objections. Application of Rule 7(a) would be contraindicated unless a proof of claim had the force of a complaint." *In re Am. Anthracite & Bituminous Coal Corp.*, 22 F.R.D. 504, 507 (S.D.N.Y. 1958) (internal citations omitted). As another court reasoned: "[t]he filing by [the creditor] of its proof of claim is analogous to the commencement of an action within the bankruptcy proceeding. The trustee's [objection] is in the nature of an answer incorporating an affirmative request for relief ... The claimant is deemed to consent to the jurisdiction of the court upon filing its proof of claim." *Nortex Trading Corp. v. Newfield*, 311 F.2d 163, 164 (2d Cir. 1962).

One circuit court recently held that "[s]imilar to the filing of a stale lawsuit, a debt collector's filing of a time-barred proof of claim creates the misleading impression to the debtor that the debt collector can legally enforce the debt." *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1261 (11th Cir. 2014), cert. denied, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015). As the

*Crawford* court explains, the fundamental policy which underpins statutes of limitations in civil actions should also apply to bankruptcy claims:

> Statutes of limitations protect defendants and the courts from having to deal with cases in which the search for truth may be seriously impaired by the loss of evidence, whether by death or disappearance of witnesses, fading memories, disappearance of documents, or otherwise.
>
> The same is true in the bankruptcy context. In bankruptcy, the limitations period provides a bright line for debt collectors and consumer debtors, signifying a time when the debtor's right to be free of stale claims comes to prevail over a creditor's right to legally enforce the debt. A Chapter 13 debtor's memory of a stale debt may have faded and personal records documenting the debt may have vanished, making it difficult for a consumer debtor to defend against the time-barred claim.

*Crawford*, 758 F.3d at 1261.

Several district and bankruptcy courts have followed *Crawford*, and denied a creditor's motion to dismiss an FDCPA claim against the creditor for filing time-barred proof of claim. *See, e.g.*, *Reed v. LVNV Funding, LLC*, No. 14 C 8371, 2015 WL 1510375 (N.D. Ill. Mar. 27, 2015); *Patrick v. Quantum3 Group, LLC*, No. 1:14–cv–00545–TWP–TAB, 2015 WL 627216 (S.D. Ind. Feb. 13) adopted, 2015 WL 1166055 (S.D. Ind. Mar. 12, 2015); *In re Seak*, No. 3:13–bk–5446–PMG, Adv. No. 3:14–ap–330–PMG, 2015 WL 631578 (Bankr. M.D. Fla. Jan. 22, 2015); *see also, Taylor v. Galaxy Asset Purchasing, LLC*, 108 F.Supp.3d. 628 (N.D. Ill. 2015); *Grandidier v. Quantum3 Group, LLC*, No. 1:14–CV–00138–RLY–TAB, 2014 WL 6908482 (S.D. Ind. Dec. 8, 2014); *In re Feggins*, 535 B.R. 862 (Bankr. M.D. Ala. 2015) (collecting case); *In re Holloway*, 538 B.R. 137 (Bankr. M.D. Ala. 2015); *In re Avalos*, 531 B.R. 748 (Bankr. N.D. Ill. 2015); *In re Brimmage*, 523 B.R. 134 (Bankr. N.D. Ill. 2015).

But most courts to address the issue have held that filing a proof of claim for a time-barred debt is not a violation of the FDCPA, including the majority of circuits to rule on the issue. On August 10, 2016, ruling on three cases consolidated for appeal, the Seventh Circuit

Court of Appeals held that debt collectors' filing proofs of claim for time-barred debts in bankruptcy was not a violation of the FDCPA debt collectors' conduct in filing proofs of claim on stale debt in bankruptcy was not misleading, deceptive, unfair, or otherwise abusive under the FDCPA. *Owens v. LVNV Funding, LLC*, No. 15-2044, 2016 WL 4207965 (7th Cir. Aug. 10, 2016). Just a month prior, the Eighth Circuit Court of Appeals reached a similar conclusion in *Nelson v. Midland Credit Mgmt., Inc.*, No. 15-2984, 2016 WL 3672073 (8th Cir. July 11, 2016).

The Seventh and Eighth Circuits have now joined the Second Circuit (*Simmons v. Roundup Funding, LLC*, 622 F.3d 93, 94 (2d Cir. 2010), and the majority of bankruptcy and district courts, in holding that a proof of claim filed on a stale claim does not violate the FDCPA. *See In re Glenn*, 542 B.R. 833 (Bankr. N.D. Ill. 2016) (no FDCPA liability for stale proof of claim); *LaGrone v. LVNV Funding LLC and Resurgent Capital Services* (*In re LaGrone* ), 525 B.R. 419 (Bankr. N.D. Ill. 2015) (same); *Owens v. LVNV Funding, LLC,* No. 1:14–cv–02083–JMS–TAB, 2015 WL 1826005 (S.D. Ind. Apr. 21, 2015) (same), *appeal docketed,* No. 15–2044 (7th Cir. May 13, 2015); *Torres v. Asset Acceptance, LLC,* 96 F.Supp.3d 541 (E.D. Pa. 2015) (same), *appeal docketed,* No. 15–2132 (3rd Cir. May 13, 2015); *Robinson v. eCast Settlement Corp.,* No. 14 CV 8277, 2015 WL 494626 (N.D. Ill. Feb. 3, 2015) (same); *Covert v. LVNV Funding, LLC,* No. DKC 13–0698, 2013 WL 6490318 (D. Md. Dec. 3, 2013) (filing proof of claim is not an attempt to collect debt under FDCPA), *aff'd on other grounds,* 779 F.3d 242; *Crawford v. LVNV Funding, LLC,* 2013 WL 1947616 (M.D. Ala. May 9, 2013) (no FDCPA liability for stale proof of claim), *rev'd,* 758 F.3d 1254 (11th Cir.2014); *Gatewood v. CP Medical, LLC (In re Gatewood),* 533 B.R. 905 (8th Cir. BAP 2015) (same); *Perkins v. LVNV Funding, LLC (In re Perkins),* 533 B.R. 242 (Bankr. W.D. Mich. 2015) (same); *Broadrick v. LVNV Funding, LLC (In re Broadrick),* 532 B.R. 60 (Bankr. M.D. Tenn. 2015) (no FDCPA

liability for stale proof of claim if information is accurate and applicable statute of limitations extinguishes only the remedy and not the right to collect debt); *Murff v. LVNV Funding, LLC (In re Murff),* No. 13 B 44431, No. 14 A 790, 2015 WL 3690994 (Bankr. N.D. Ill. Jun. 15, 2015) (no FDCPA violation for stale proof of claim); *Marcinowski v. Ecast Settlement Corp. (In re Marcinowski),* Case No. 13 B 33571, Adv. No. 14 A 00678, 2015 WL 3524977 (Bankr. N.D. Ill. Jun. 3, 2015) (same) (adopting *LaGrone*); *Dunaway v. LVNV Funding, LLC (In re Dunaway),* 531 B.R. 267 (Bankr. W.D. Mo. 2015) (same), *appeal docketed,* No. 15–8007 (8th Cir. Jun. 29, 2015); *LaGrone v. LVNV Funding, LLC (In re LaGrone),* 525 B.R. 419 (Bankr. N.D. Ill. 2015) (same); *Claudio v. LVNV Funding, LLC (In re Claudio),* 463 B.R. 190 (Bankr. D. Mass. 2012) (same); *Carter v. B–Line, LLC (In re Carter),* No. 10–10459–8–RDD, Adv. No. 11–00069–8–RDD, 2012 WL 627769 (Bankr. E.D. N.C. Feb. 24, 2012) (filing proof of claim is not an attempt to collect a debt under the FDCPA); *Jenkins v. Genesis Fin. Solutions (In re Jenkins),* 456 B.R. 236 (Bankr. E.D. N.C. 2011) (no FDCPA liability for stale proof of claim); *Keeler v. PRA Receivables Mgmt., LLC (In re Keeler),* 440 B.R. 354 (Bankr. E.D. Pa. 2009) (same); *Jacques v. U.S. Bank, N.A. (In re Jacques),* 416 B.R. 63 (Bankr. E.D. N.Y. 2009) (same); *Simpson v. PRA Receivables Mgmt., LLC (In re Simpson),* No. 08–00344–TOM–13, Adv. No. 08–00137, 2008 WL 4216317 (Bankr. S.D. Ala. Aug. 29, 2008) (same).

Among the majority of courts dismissing FDCPA actions against creditors for filing stale claims, several have found that filing a stale claim is not sufficiently similar to commencement of a time-barred suit to be actionable under the FDCPA, highlighting the differences between filing a claim in a debtor-initiated bankruptcy and summoning a debtor into court. One court explained these differences this way:

> First, in collection lawsuits, the debtors themselves must assert the statute of limitations in an answer. Debtors in bankruptcy cases, on the other hand, have the benefit of a trustee

> with a fiduciary duty to all parties to examine proofs of claims and object to the allowance of any claim that is improper....
>
> Second, a debtor in bankruptcy has much less at stake in the allowance of a proof of claim than a defendant facing the prospect of an adverse judgment in a collection lawsuit. A proof of claim does not result in collection from the debtor personally but seeks only a share in the total payments available to all of the debtor's creditors....[Thus, often] the debtor will pay the same total amount to creditors, regardless of whether particular proofs of claim are disallowed....
>
> Third, in a collection lawsuit a consumer debtor would have to retain and likely pay for the services of a lawyer. Debtors in bankruptcy, by contrast, are likely from the outset of the case to be represented by an attorney who can both advise them about the existence of a statute of limitations defense and file an objection if the trustee does not....
>
> Finally, even if the trustee fails to file a claim objection based on the statute of limitations, even if filing a claim objection would have a significant benefit for the debtor, and even if the debtor did not have legal assistance, it would be easier—and less embarrassing—for the individual debtor to file a claim objection pro se than to deal with an untimely collection lawsuit.

*In re LaGrone*, 525 B.R. 419, 426-27 (Bankr. N.D. Ill. 2015).

Discussing the differences between commencement of a suit and filing a claim in bankruptcy, another court explains:

> [T]his is not the case of the debtor being dragged into a process by the creditor. The debtor was not forced from the comfort of his home to respond to egregious tactics by the creditor. Nor was the debtor hounded into bankruptcy, only to be met with a claim by the very party who forced the case to be filed. No evidence of any such actions exists here. In fact there is no allegation other than those set forth above, and those make clear that when the Debtor commenced a bankruptcy case, [the creditor] did nothing other than respond…
>
> Further, unlike in *Phillips*, the debtor picked this particular fight. Even if the debtor is pro se, to grant the debtor the breadth of protection that drove the *Phillips* decision would be manifestly unfair. The debtor must certainly be charged with greater responsibility in prosecuting the bankruptcy case which it commenced, and the creditor should be afforded its day in court in response to the debtor's actions. While it would be unfair to allow the creditor to do whatever it pleases as a result of the debtor's actions, it would be more unfair to say that the creditor may do nothing at all in response.

*In re Glenn*, 542 B.R. 833, 841-42 (Bankr. N.D. Ill. 2016)

The reasoning of *LaGrone*, *Glenn,* and similar decisions does not create a per se bar on FDCPA actions based on the filing of claims in bankruptcy cases. But these decisions make clear that FDCPA relief is not always appropriate. As a Tennessee bankruptcy court explained:

> The FDCPA should not be implicated with regard to stale debts when a creditor merely (a) files an accurate proof of claim in a bankruptcy case, (b) when the proof of claim includes all the required information including the timing of the debt, (c) the applicable statute of limitations is one that does not extinguish the right to collect the debt but merely limits the remedies, and (d) no legal impediment to collection or factual circumstances exist that would invoke the FDCPA other than merely the applicability of a statute of limitations.

*In re Broadrick,* 532 B.R. 60, 75 (Bankr. M.D. Tenn. 2015).

**B. Statutes of Limitations and the Status of Claims**

At the heart of the debtor's FDCPA actions concerning stale claims are the applicable state statutes of limitations. But not all statutes of limitations are created equally. Most state statutes of limitations do not extinguish a debt altogether; they merely bar use of the court system to seek collection of the time-barred debt. The attached chart summarizes the statutes of limitations for the states in the Sixth and Seventh Circuits, as well as the State of Minnesota. The statutes of limitations in all of these states except Wisconsin bar only the remedy, not the right[2].

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[2] It is debatable whether "rights" and "remedies" may be distinguished this way. One theory is that a right without a remedy is merely a "weaker" form of right:

> The weakest right is the one for which no legal remedy is available in case of its breach. Section 32(a) of the Israeli Contracts (General Part) Law 1973 offers an example of this type of legal right. It provides that "A gambling, lottery or betting contract ... does not provide ground for enforcement or damages." The Contracts Law thus envisages a type of contract that is valid and binding and confers legal rights and yet no legal remedy is available to protect it. In this respect it is a very weak right. Yet, there is no denying that at least in the eyes of the legislator it is a valid and legally binding right. In this respect it is similar to a legal right that cannot be enforced by virtue of a statute of limitation. Enforceable rights are in this respect "stronger" than non-enforceable rights.

Another theory is that, without a remedy, there can be no right:

> The right derives from the remedy and as a matter of sequence the remedy precedes the right. Consequently the absence of a remedy points to the non-existence of a legal right. This model is in line with the traditional approach of the common law under which "where there is a remedy there is a right" (ubi remedium ibi ius), and the granting of a remedy via an action in court remains to date a

Unique among the states surveyed, Wisconsin's statute codifies prior case law holding that its statute of limitations not only bars a remedy at law but extinguishes any underlying right as well. Thus, a time-barred claim in Wisconsin would likely fail to meet even the bankruptcy code's expansive definition of a "claim."

The broad definition of "claim" found in the Bankruptcy Code would seem to encompass time-barred claims in the majority of states where only the remedy, not the right, is extinguished. A "claim" is defined as "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). As the *Glenn* court observed, that definition is broad enough to include a right to payment held by a creditor, even if that right is unenforceable in court: "What further is necessary to establish a creditor's right to payment, than, well, a right to payment? The law [in Illinois] is clear that, even on a time-barred debt, the creditor has a right to keep a payment made after the bar." *Glenn*, 542 B.R. at 844. Another Illinois bankruptcy court disagreed: "By definition, stale debt is debt that is no longer owed. Debt collectors may get paid by a Chapter 13 debtor despite having no right to payment." *In re Avalos*, 531 B.R. 748, 756 (Bankr. N.D. Ill. 2015).[3] At least insofar as the Illinois statute of limitations is concerned, this appears to be an incorrect statement of the law, but as noted above,

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> major vehicle for the development of new legal entitlements and the expansion of established legal rights… This model, in its extreme form, was adopted by Holmes in whose view "[t]he primary rights and duties with which jurisprudence busies itself ... are nothing but prophesies." A legal right (and a legal duty) "is nothing but a prediction that if a man does or omits certain things he will be made to suffer in this or that way by judgment of the court."

Daniel Friedmann, *Rights and Remedies in* COMPARATIVE REMEDIES FOR BREACH OF CONTRACT (Oxford, Hart Publishing, 2004): 3-17.

[3] The *Avalos* court derides as "nonsense" the "claimant's argument that it has a right to payment but is shut out of ... its state court remedies," *Avalos*, 531 B.R. at 757 n.1, although many (perhaps a majority of) courts reach this precise conclusion regarding the status of time-barred claims.

this reasoning could apply in Wisconsin, where the expiration of the statute of limitations extinguishes both the remedy and the right.

But even if the debt is not literally extinguished under many state statutes of limitations, the protection of the FDCPA is not limited to literal misstatements or outright falsehoods. The FDCPA also prohibits statements that are deceptive or misleading, and "even a true statement may be banned if it creates a misleading impression." *Buchanan v. Northland Grp., Inc.*, 776 F.3d 393, 396 (6th Cir. 2015). To the extent a proof of claim is a "statement" about the validity of the claim, while technically true, it could be misleading, and thus potentially actionable under the FDCPA.

## IV. Sanctions for Filing Stale Claims

As an alternative to attacking stale claims under the FDCPA, some debtors have elected to challenge a creditor's proof of claim as a frivolous pleading under Bankruptcy Rule 9011. Rule 9011 is the bankruptcy equivalent of Rule 11 of the Federal Rules of Civil Procedure, and mandates that anyone who presents ("whether by signing, filing, submitting or later advocating") a particular position to the court ("a petition, pleading, written motion, or other paper") has an affirmative obligation to conduct a reasonable investigation into both the law and the facts before doing so, and that inquiry must lead to the conclusion that the presenter's position is warranted by existing law or a non-frivolous argument.

This approach is highlighted in the Judge Wood's dissent in *Owens*, wherein she states:

> Where an old debt is subject to an 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.

*Owens v. LVNV Funding, LLC,* No. 15-2044, 2016 WL 4207965, at *9 (7th Cir. Aug. 10, 2016)

Prior to the dissent in *Owens*, this approach was adopted by at least one other another court in the Seventh Circuit. See *In re Sekema*, 523 B.R. 651, 653 (Bankr. N.D. Ind. 2015), (citing Fed. R. Bankr.P. Rule 9011(b)(2)). In *Sekema*, the debtor objected successfully to a stale proof of claim, and the court then *sua sponte* scheduled a show-cause hearing to consider sanctions against the creditor under Rule 9011(b)(2). When the creditor failed to respond or appear at the hearing, the court imposed sanctions of $1,000 against the creditor, noting:

> Debtors' statute of limitations defense to both claims was blindingly obvious. It does not take a rocket scientist to figure out that [the creditor's claims are time barred]. A third grader could do the math. Moreover, coming to the conclusion that the claims might be time-barred did not require either claimant to look beyond the information it already possessed.

*Sekema*, 523 B.R. at 654. Another court reached a similar conclusion:

> A facially time-barred proof of claim is not well-founded. It follows that a creditor's only possible purpose in filing a facially time-barred proof of claim is to take advantage of the automatic claims allowance process of § 502(a) and hope that the debtor and the bankruptcy court do not notice the defect. Such conduct is an abuse of the claims allowance process and an affront to the integrity of the bankruptcy court...
>
> The Bankruptcy Code and Rules provide remedy for such conduct... Bankruptcy Rule 9011 authorizes the bankruptcy court to impose sanctions on creditors who file proofs of claim for any improper purpose or who make claims or legal contentions that are not warranted by existing law.

*In re Feggins*, 535 B.R. 862, 868–69 (Bankr. M.D. Ala. 2015).

Another court, however, declined to follow *Sekema* and *Feggins*, and refused to sanction a creditor for similar conduct:

> Indeed, given 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, even if, in the future,

> a substantial number of courts (including, perhaps, several courts of appeal) adopt the *Sekema*/*Feggins* position that it is improper to file proofs of claim without investigating and developing plausible responses to obvious affirmative defenses to a proof of claim. Unless and until the Supreme Court resolves the issue, a rational argument exists for the practice of filing stale proofs claims and compelling debtors and trustees to object to their allowance.

*In re Freeman*, 540 B.R. 129, 144 (Bankr. E.D. Pa. 2015)

At least one other court considered but denied a debtor's request for sanctions under section 105 against a creditor that filed a state claim:

> As discussed above, however, the claim at issue does not appear to be false or fraudulent. Although the debtor stated that she does not recall this debt, no evidence was offered to characterize this claim as representative of an invalid debt. Instead, the debtor's primary position is that the debt is time-barred. The claim represents a valid debt that the statute of limitations does not extinguish; rather, it bars enforcement of the debt. Thus, based on the unavailability of § 105 sanctions for the filing of a stale claim, the portions of the complaint that seek § 105 sanctions must be dismissed as the plaintiff has not stated a claim upon which relief can be granted.

*In re White*, No. 14-03109-5-SWH, 2016 WL 1125640 (Bankr. E.D. N.C. Mar. 21, 2016).

## V. Conclusion

In the coming year, other circuit courts will have an opportunity to weigh in on these issues, including *Martel* v. *LVNV Funding, LLC*, No. 15-2489 (1st Cir.) (appellant's brief submitted August 30, 2016); *Dubois* v. *Atlas Acquisitions LLC (In re Dubois)*, No. 15-1945 (4th Cir.); and *Broadrick* v. *LVNV Funding, LLC (In re Broadrick)*, No. 16-5042 (6th Cir.) (briefing completed as of August 11, 2016). An emerging majority of circuits (7th, 8th and 2nd) have upheld dismissals of debtor's FDCPA claims, while the Eleventh Circuit adopted the minority view in *Crawford*. If any of the other circuits side with the Eleventh, it may be up to the Supreme Court to ultimately decide this issue.

| State | Statute(s) | Extinguishes Remedy Only or Extinguishes Right & Remedy |
|---|---|---|
| **Michigan** | **6 Years** – **§ 600.5807(8)**: "No person may bring or maintain any action to recover damages or sums due for breach of contract, or to enforce the specific performance of any contract unless, after the claim first accrued to himself or to someone through whom he claims, he commences the action within the periods of time prescribed by this section… (8) The period of limitations is six years for all other actions to recover damages or sums due for breach of contract." | **Remedy Only:** "Under Michigan law, as under the law of most states, a debt remains a debt even after the statute of limitations has run on enforcing it in court. As a result, when the six-year limitations period ran on Buchanan's debt, that meant only that the creditor—LVNV today—could not enforce the debt in court without facing a complete legal defense to it." Buchanan v. Northland Group, Inc., 776 F.3d 393, 396-97, 2015 WL 149528 (6th Cir. 2015). |
| **Ohio** | **4 Years** = Sale of Goods – **§ 1302.98(A)**: "An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued."<br><br>**6 Years** = Promissory Notes –**§ 1303.16(A)**: "[A]n action to enforce the obligation of a party to pay a note payable at a definite time shall be brought within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the accelerated due date."<br><br>**6 Years** = Oral Contracts, Accounts – **§ 2305.07**: "[A]n action upon a contract not in writing, express or implied, or upon a liability created by statute other than a forfeiture or penalty, shall be brought within six years after the cause thereof accrued."<br><br>**8 Years** = Written Contracts – **§ 2305.06**: "[A]n action upon a specialty or an agreement, contract, or promise in writing shall be brought within eight years after the cause of action accrued." | **Remedy Only:** "The statutes of Ohio do not so provide but it has long been the law of Ohio that the debtor may defeat recovery by asserting the running of the statute of limitations. This right of the debtor to defeat recovery by pleading the statute of limitations must be kept in mind when the courts assert, as is said in Taylor v. Thorn, Admr., 29 Ohio St. 569, 573: 'They do not extinguish the debt nor affect its validity. They merely withhold from the owner thereof the right to employ remedial process for its collection.'" Summers v. Connolly, 159 Ohio St. 396, 402, 112 N.E.2d 391, 394, 39 A.L.R.2d 661, 50 O.O. 352 (1953). |
| **Kentucky** | **4 Years – § 355.2-725(1)**: "An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued."<br><br>**5 Years** – **§ 413.120**: "The following actions shall be commenced within five years after the cause of action accrued…(1) an action upon a contract not in writing, express or implied; (7) an action upon a bill of exchange, check, draft or order, or any endorsement thereof, or upon a promissory note, placed upon the footing of a bill of exchange; (9) an action upon a merchant's account for goods sold and delivered, or any article charged in such store account." | **Remedy Only:** "In Kentucky, 'a statute of limitations does not extinguish a legal right but merely affects the remedy.' *Wethington v. Griggs,* 392 S.W.2d 56, 57 (Ky.1964). Therefore, the statute of limitations affects the debt collector's remedy, but it does not eliminate the debt." Brewer v. Portfolio Recovery Associates, CIV.A. 1:07CV-113-M, 2007 WL 3025077, at *2 (W.D. Ky. Oct. 15, 2007) |
| **Tennessee** | **6 Years** – **§ 28-3-109(a)(3)**: "The following actions shall be commenced within six years after the cause of action accrued…Actions on contracts not otherwise expressly provided for." | **Remedy Only:** "The Tennessee statute of limitations on collection of a debt does not extinguish a creditor's rights in the debt, only the remedy." In re Broadrick, 532 B.R. 60, *74, 2015 WL 3855251 (Bankr. M.D. Tenn. 2015). |
| **Wisconsin** | **6 Years** – **§ 893.43(1)**: "[A]n action upon any | **Right & Remedy: § 893.05**: Relation of Statute of |

| | | |
|---|---|---|
| | contract, obligation, or liability, express or implied . . . shall be commenced within six years after the cause of action accrues or be barred." | Limitations to Right and Remedy – When the period within which an action may be commenced on a Wisconsin cause of action has expired, the right is extinguished as well as the remedy.<br><br>Wisconsin's statute of limitations effectively extinguishes a debt and renders it nil. Klewer v. Cavalry Investments, LLC, No. 01-CV-541-S, 2002 WL 2018830, at *3 (W.D. Wis. Jan. 30, 2002)<br><br>In Wisconsin the expiration of the statute of limitations does more than merely close the door of the courthouse. "The expiration of the limitations period extinguishes the cause of action of the potential plaintiff and it also creates a right enjoyed by the would-be defendant to insist on that statutory bar." Wojtas v. Capital Guardian Trust Co., 477 F. 3d 924 (7th Cir. 2007), citing Colby v. Columbia County, 202 Wis.2d 342, 350, 550 N.W.2d 124, 128 (1996). |
| **Illinois** | **10 Years – 735 ILCS 5/13-206**: "[A]ctions on bonds, promissory notes, bills of exchange, written leases, written contracts, or other evidences of indebtedness in writing and actions brought under the Illinois Wage Payment and Collection Act shall be commenced within ten years next after the cause of action accrued[.]"<br><br>*Case law says that the statute of limitations on a credit card debt without a written contract is 5 years since state law doesn't specify limits on open accounts. | **Remedy Only:** The running of the statute of limitations would bar defendant from collecting through the courts, but it does not extinguish plaintiff's debt. *See Walker v. Cash Flow Consultants, Inc.,* 200 F.R.D. 613, 616 (N.D.Ill.2001). That defendant cannot sue to recover the debt does not prevent it from seeking to recover the debt via an alternate route. Merely attempting to collect a time-barred debt does not violate the FDCPA. Murray v. CCB Credit Services, Inc., 04 C 7456, 2004 WL 2943656, at *2 (N.D. Ill. Dec. 15, 2004). |
| **Indiana** | **6 Years – § 34-11-2-9**: "An action upon promissory notes, bills of exchange, or other written contracts for the payment of money executed after August 31, 1982, must be commenced within six years after the cause of action accrues." | **Remedy Only:** "'We do not hold that it is automatically improper for a debt collector to seek repayment of time-barred debts; some people might consider full debt repayment a moral obligation, even though the legal remedy for the debt has been extinguished.' Thus, sending a dunning letter in an attempt to collect a stale debt does not, in and of itself, violate the FDCPA. However, *suing* to collect a time-barred debt is unquestionably an FDCPA violation." Holt v. LVNV Funding, LLC, 115CV00851RLYDKL, 2015 WL 7721222, at *3 (S.D. Ind. Nov. 30, 2015). |
| **Minnesota** | **6 Years – § 541.05(1)(1)**: "[T]he following actions shall be commenced within six years . . . upon a contract or other obligation, express or implied, as to which no other limitation is expressly prescribed[.]" | **Remedy Only:** "[T]he running of a statute of limitations on a debt does not extinguish the debt but merely bars the remedy for the recovery of the debt." Marriage of Chaignot v. Chapin, A05-1966, 2006 WL 2348119, at *13 (Minn. App. Aug. 15, 2006). |

## STUDENT DEBT DISCHARGE ISSUES

***Tetzlaff v. Educational Credit Management Corp.,*** 794 F.3d 756 (7th Cir. 2015).

Mark Tetzlaff owed approximately $260,000 in student loan debt guaranteed by Educational Credit Management Corporation. Tetzlaff filed a chapter 7 petition in 2012 and sought to discharge the student loan debt claiming that repayment constituted an "undue hardship" under 11 U.S.C. § 523(a)(8)[1] through the filing of an adversary proceeding. The bankruptcy court held after a trial that the debtor could not be discharged. The district court and the Seventh Circuit affirmed the bankruptcy court.

### *Facts*

Tetzlaff was 56 at the time of his filing. He lived with his 85-year-old mother and together they lived off her Social Security payments. Tetzlaff was divorced, had no children and was unemployed. During the mid-1990s through 2005 he pursued an MBA degree at Marquette University as well as a law degree from Florida Coastal School of Law. To finance these educational endeavors, he took out various federally guaranteed student loans. He later consolidated all of the loans with Educational Credit Management Corporation and is now the guarantor for the outstanding loan amount.

Although Tetzlaff was unsuccessful in passing the bar exam, prior to attending graduate school, he worked as a financial advisor, an employee-benefits consultant, an insurance salesman and a stock broker. Over the years, he had struggled with depression and alcohol abuse and had been involved in domestic disputes. He had several misdemeanor convictions. In testimony, he claimed that all of these factors combined made it very difficult to secure employment.

### *Discussion*

Under 11 U.S.C. § 523(a)(8) student loans are generally not dischargeable unless the debtor proves that excluding the loans from discharge "would impose an undue hardship on the debtor." The majority of the appellate courts, including the Seventh Circuit Court of Appeals have

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[1] Section 523(a)(8) states that a discharge under the Bankruptcy Code is not provided from any debt . . . . 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 Internal Revenue Code of 1986, incurred by a debtor who is an individual;

adopted the *Brunner* test for student loan discharge proceedings.[2] Under the *Brunner* test, the debtor must show:

1) [he] cannot maintain, based on current income and expenses, a "minimal" standard of living for himself and his dependents if forced to repay [his] loans;

2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period; **and**

3) [he] made good faith efforts to repay the loans.

The bankruptcy court found that Tetzlaff had met the first prong but not the last two. In examining the second prong, the appellate court noted that the debtor must show that his inability to pay is likely to persist for a significant portion of time. Tetzlaff had an "MBA, was a good writer, [was] intelligent, and family issues [were] largely over." The court also concluded that "Tetzlaff [was] not mentally ill and [was] able to earn a living." The court noted that Tetzlaff had shown his capabilities through the admirable job he had done in representing himself *pro se.* It summed up the second prong by stating that "undue hardship encompasses a notion that the debtor may not willfully or negligently cause his own default, but rather his condition must result from factors beyond his reasonable control."[3]

Similarly, the court found that the good faith requirement had not been met. Good faith is measured by the ability to "obtain employment, maximize income and minimize expenses all in an effort to repay the student loans. Past efforts to repay are taken into account. Many courts note that if the debtor attempted to pay down one loan but did not do so with the loan he is seeking to discharge good faith cannot be demonstrated. Tetzlaff had paid down one loan where he needed that school's cooperation in releasing his diploma and transcript but was not motivated by to repay other loans. Thus, the Court affirmed the lower courts' findings that Tetzlaff had not made a good faith effort to pay down his loans.

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[2] *See Brunner v. New York Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987); *In re Roberson*, 999 F.2d 1132, 1135 (7th Cir. 1993); *Pa. Higher Educ. Assistance Agency v. Faish* (*In re Faish*), 72 F.3d 298 (3d Cir. 1995); *United Student Aid Funds v. Pena* (*In re Pena*), 155 F.3d 1108 (9th Cir. 1998); *Hemar Ins. Corp. of Am. v. Cox* (*In re Cox*), 338 F.3d 1238 (11th Cir. 2003); *United States Dept. of Educ. v. Gerhardt* (*In re Gerhardt*), 348 F.3d 89 (5th Cir. 2003); *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302 (10th Cir. 2004); *Oyler v. Educ. Credit Mgmt. Corp.* (*In re Oyler*), 397 F.3d 382 (6th Cir. 2005); *Educ. Credit Mgmt. Corp. v. Frushour* (*In re Frushour*), 433 F.3d 393(4th Cir. 2005).

[3] Quoting, *In re Roberson,* 999 F.2d 1132, 1136, (7th Cir. 1993)

***Petition for Certiorari***

Tetzlaff filed a petition for certiorari with the Supreme Court. He cited the split between the circuits[4] and argued that the Brunner test is too rigid and creates a trap that is insurmountable for debtors to overcome. Certiorari was denied.

***Other Student Debt Issues***

***Partial Discharge of Education Debt***

Some arguments have been made that because the Code does not expressly allow partial discharge of education debt, that it may be allowed by using section 105(a) of the Code. As a result some courts have granted partial discharge of student loan debt by discharging part of the principal, accrued interest or attorney's fees, instituting a repayment schedule, deferring repayment or even by allowing a debtor to reopen bankruptcy proceedings to revisit the question of undue hardship.[5]

*Tenn. Student Assistance v. Hornsby (In re Hornsby),* 144 F.3d 433, 440 (6th Cir. 1998); *Miller v. Pa. Higher Assistance Agency (In re Miller)*, 377 F.3d 616, 620 (6th Cir. 2004) (When a debtor does not make a showing of undue hardship with respect to the entirety of her student loans, a bankruptcy court may – pursuant to its §105(a) powers – contemplate granting . . . a partial discharge of the debtor's student loans.")

Similarly, courts in the Tenth, Eleventh and Ninth Circuits have also approved partial discharges. See, *Alderete v. Educational Credit Management Corp. (In re Alderete),* 412 F.3d 1200 (10th Cir. 2005); *Hemar Ins. Corp. v. Cox (In re Cox),* 338 F. 3d 1238 (11th Cir. 2003), cert denied, 541 U.S. 991 (2004); *Saxman v. Educ.Mgmt.Corp. (In re Saxman),* 325 F.3d 1168, 1173 (9th Cir. 2003) ("bankruptcy courts may exercise their equitable authority under § 105(a) to partially discharge student loans").

Other courts have held that there is no provision for partial discharge. See, *In re Faish,* 72 F.3d 298, 306 (3d Cir. 1995) (Debtor was employed by the Commonwealth of Pennsylvania, Department as a budget analyst at the time of trial. She earned a gross yearly salary of $27,000.00 in 1993. The court found that Faish's current employment and income were good, and that while a payment to the educational loan creditor of nearly $300.00 per month impacts

[4] The Eighth Circuit uses a "totality of the circumstances test" under which the court considers "(1) the debtor's past, present and reasonably reliable future financial resources; (2) a calculation of the debtor's and dependants' reasonable necessary living expenses; and (3) any other relevant facts and circumstances" that are unique to that case. *Walker v. Sallie Mae Serv. Corp. (In re Walker)* 650 F.3d 1227, 1230 (8th Cir. 2011). The courts in the First Circuit also apply a "totality of the circumstances test." Although the First Circuit has not spoken on the issue, the First Circuit BAP has and use the totality of the circumstances test.

[5] See, *Committee Educational Session: Pomp and Circumstances, Part I: Education Loans,* June 11, 2013 American Bankruptcy Institute 487.

significantly upon Faish's disposable income, it does not place her or her son below the subsistence level, and therefore failed to meet that she was unable to maintain a minimal standard of living.); *In re Pincus,* 280 B.R. 303, 311 (Bankr.S.D.N.Y.2002) (Holding that there is no authority that suggests that a bankruptcy court has the authority to grant partial discharge of a single loan and to do so would be a gross departure from plain meaning rule of statutory construction.)

We have not been able to find any reported cases in the Seventh Circuit which supported partial discharge.

***Separate Classification of Student Loan Debt***

If the debtor does not seek a hardship discharge in a chapter 13 case, the debtor is obligated to pay the remainder of the debt that has not been paid during the plan after the case has been terminated, including any interest on the debt that has accrued during the plan. With this in mind, debtors have an incentive to pay as much of the nondischargeable debt in the plan as possible. One way to achieve this is through proposing a plan that provides for separate classification of the student debt within the plan. Reported cases discussing separate classification are divided as to whether this is permissible.[6]

Several reported decisions within the Seventh Circuit have allowed separate classification where there was not unfair discrimination of other creditors.

*In re Johnson*, 446 B.R. 921 (Bankr. E.D. Wis. 2011) Due to the long-term nature of the chapter 13, the debtor, without unfairly discriminating against her other unsecured creditors, was allowed to place her student loan debt into a separate class from other general unsecured claims. She was continued to make her regular payments on student loans while paying less than 100% dividend on her other unsecured debt. The court held that in a chapter 13 case, where the debtor is living frugally, and she has already amended her plan once to increase dividend to unsecured creditors, she could separately classify her student loan debt. If her student loan debt was lumped together with other unsecured debts and paid *pro rata*, the balance on her student loans obligations would actually increase at the end of her 5-year plan.

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[6] See, *Committee Educational Session: Pomp and Circumstances, Part I: Education Loans,* June 11, 2013 American Bankruptcy Institute 487. *See also*, *In re Stull,* 2013 WL 1279069 (Bankr. D.Kan. Mar. 27, 2013) (an above-median debtor's chapter 13 plan separately classifying and paying a non-dischargeable obligation from income earned in excess of the projected disposable income committed to pay unsecured debt does not unfairly discriminate – but the plan was ultimately rejected because it proposed paying interest on the student loan); *In re Pracht,* 464 B.R. 486 (Bankr. M.D. Ga. 2012)(separate classification and higher payment rate for student loan debt did not unfairly discriminate because it allowed debtor to participate in the Public Loan Forgiveness program and gave her the chance to write off $50,000 of student loan debt and advanced the goal of a fresh start).

*In re Truss*, 404 B.R. 329 (Bankr. E.D. Wis. 2009) The debtors were unlikely to be able to complete their chapter 13 plan without the challenged classification (separate classification for student loans), and creditors would be worse off than they would be with the separate classification. Judge McGarity explained that the Seventh Circuit, in determining whether a proposed plan discriminates unfairly instructed that the bankruptcy judge is to seek a result that is reasonable in light of the purposes of the relevant law and that it had not been able to come up with a good test. *In re Crawford,* 324 F.3d 539, 542 (7th Cir.2003). The court did however provide the following guidance: "if without classification the debtor is unlikely to be able to fulfill the Chapter 13 plan and the result will be to make his creditors as a whole worse off than they would be with classification, then classification will be a win-win outcome." *Id.* at 543. One example given by the court of such a "win-win outcome" included a debtor truck driver whose creditor was the state licensing bureau which unless paid in full would yank his license, with the consequence that the debtor would not have earnings out of which to make the payments called for in his plan. *Id.* Another example given in *Crawford* was a creditor who supplied the tools of the debtor's trade, and unless paid in full would cut him off and thereby prevent him from plying his trade, again with the result of depriving him of the earnings needed to fund the plan. *Id.* In those scenarios, the classification was permitted because the creditors as a whole would be better off and so would the debtor. *Id.* Separate classification was not found to be "unfairly discriminatory." In the *Truss* case, it was not unfair discrimination for the student loan creditor, to receive dividend of 60% to 79% over life of plan against other general unsecured creditors receiving a projected dividend of 2.44%. This was held to be the case even though the debtors, if they made pro rata payments on all of their general unsecured debt, could provide unsecured creditors with dividend of roughly 23.5%.