Consumer Case Law Updates

CONCURRENT SESSION

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CONSUMER CASE LAW UPDATE

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Introduction: Things are moving fast in consumer bankruptcy. The following materials cover some of the most significant issues of the year including the jurisdiction of the bankruptcy court, proofs of claim and old debt, and a series of issues regarding what is and is not property of the estate.

1. *Wellness International v. Sharif:* the Uncertain Fate of Bankruptcy Jurisdiction and the Effect of Consent.

By Cecilia Lee, Esq., Lee & High, Ltd.
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Since 2011, the Supreme Court has decided two cases relating to the constitutional authority of Bankruptcy Courts to enter final judgments in proceedings that are outside the resolution of the debtor-creditor relationship and that seek to augment the bankruptcy estate. *Stern v. Marshall*, 131 S. Ct. 2594 (2011) and *Executive Benefits v. Arkison*, 134 S. Ct. 2165 (2014). In January 2015, the Supreme Court heard arguments in its third bankruptcy jurisdiction case in four years. *Wellness International v. Sharif*, No. 13-935, places at issue both the constitutional authority of the bankruptcy court to enter final judgment that a chapter 7 debtor is the alter ego of a trust for which the debtor is the trustee but not a beneficiary, as well as the necessity and character of consent to enter such a final judgment.

Stern held that the Bankruptcy Court lacked constitutional authority to enter final judgment on a state law counterclaim despite statutory authority conferred by 28 U.S.C. § 157(b)(2)(C). In *Executive Benefits*, the Supreme Court assumed, without deciding, that a fraudulent conveyance action is a *Stern* claim, and held that no constitutional infirmity existed where the defendant received District Court *de novo* review of the Bankruptcy Court's findings and conclusions. In *Wellness*, the Supreme Court has squarely before it the extent of the Bankruptcy Court's jurisdiction over what has been broadly characterized as a "*Stern* claim," meaning one for which statutory authority exists for bankruptcy jurisdiction but which is unrelated to the resolution of the debtor-creditor relationship and seeks to augment the bankruptcy estate with property in which third parties have an interest.

Wellness places at issue diametrically opposed policies of bankruptcy jurisprudence; the exclusive jurisdiction not only over property of the estate, but of the authority to define that estate, versus the separation of powers ensured in Article III of the Constitution. For bankruptcy practitioners and jurists, the issue would be seemingly obvious and simple: of course, the bankruptcy court has jurisdiction to enter a final judgment on what is property of the estate. It is difficult to articulate a more bankruptcy-centric inquiry, one more inextricably rooted in the invocation of bankruptcy jurisdiction. But the issue in *Wellness* is not that simple, involving bankruptcy jurisdiction over a common law claim that the debtor is the alter ego of a family trust for which he serves as trustee but is not a beneficiary. In this light, the exercise of bankruptcy jurisdiction may be more *Stern*-like; one that involves the rights of third parties and that seeks to augment the estate. The Seventh Circuit sided with the Debtor in holding that alter ego claim is a *Stern* claim over which the entry of final judgment by the bankruptcy court is not constitutionally authorized.

In addition, after passing the opportunity to rule on consent in *Executive Benefits*, the Supreme Court now has another opportunity to address consent in *Wellness*. If the Court determines that the alter ego claim is a *Stern* claim, the issue is whether the Debtor's consent to the entry of final judgment may be implied or whether it must be express, as the Debtor advocates.

With these two pivotal issues poised for determination, a brief recitation of the source of bankruptcy jurisdiction and summaries of *Stern* and *Executive Benefits* is in order to set the stage to understand the issues in *Wellness*.

Source of Bankruptcy Court Jurisdiction

Federal district courts have "original and exclusive jurisdiction of all cases under title 11." 28 U.S.C. § 1334(a). By reference to this original and exclusive jurisdiction, bankruptcy courts may hear and enter final judgments in all "core" proceedings "arising under" title 11 and "arising in" a title 11 case. 28 U.S.C. § 157(b)(1); *Stern*, 131 S.Ct. at 2603. "A matter 'arises under' the Bankruptcy Code if its existence depends on a substantive provision of bankruptcy law." *In re Ray*, 624 F.3d 1124, 1131 (9th Cir. 2010). A matter "arises in" a title 11 case "if it is an administrative matter unique to the bankruptcy process that has no independent existence outside of bankruptcy and could not be brought in another forum, but whose cause of action is not expressly rooted" in the Code. *Id*. Congress has defined "core proceedings" to include sixteen nonexclusive categories listed in 28 U.S.C. § 157(b)(2).

Bankruptcy courts also have "related to" jurisdiction in non-core proceedings, over which they may preside but may only submit proposed findings of fact and conclusions of law to the District Court. 28 U.S.C. § 157(c)(1). However, if the parties consent to the jurisdiction of the Bankruptcy Judge to hear and determine "related to" proceedings, the Bankruptcy Court may enter a final order. 28 U.S.C. § 157(c)(2).

The Holding of *Stern*

The issue in *Stern* was whether a debtor's counterclaim against a claimant was within the bankruptcy court's "core" jurisdiction pursuant to 28 U.S.C. § 157(b)(2)(C). *Stern*, 131 S.Ct. at 2594. The Supreme Court held that although the Bankruptcy Court had statutory jurisdiction to enter judgment on the counterclaim, the Bankruptcy Court lacked "the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim." *Id*. at 2620. The Court reasoned that while § 157 purported to extend bankruptcy authority to enter final judgment on any counterclaim by the debtor, the bankruptcy court was not an Article III court such that it was subject to constitutional assurances of independence to allow adjudication of state common law claims. *Id*. at 2597. Moreover, the counterclaim was not necessary to resolve the creditor's claim and was otherwise unrelated to the claim allowance process. *Id*.

The Court characterized the question presented as a "'narrow' one." *Id*. at 2620. Despite this seeming caution, courts quickly grappled with the application of *Stern* to fraudulent conveyance actions. Thus, based in part on *Stern*, the Ninth Circuit held that while fraudulent conveyance actions, like the counterclaims brought by the estate against the creditor in *Stern*, are classified as "core" pursuant to 28 U.S.C. § 157(b)(2), "the Constitution prohibits bankruptcy judges from entering a final judgment in such core proceedings." *Executive Benefits Ins. Agency v. Arkison* (*In re Bellingham Ins. Agency, Inc.*), 702 F.3d 553, 561 (9th Cir. 2012), *aff'd*, 134 S. Ct. 2165 (2014).

In holding that the trustee's claims were "*Stern* claims,", i.e., claims designated for final adjudication in the bankruptcy court as a statutory matter but prohibited from proceeding in that way as a constitutional matter, the Ninth Circuit relied in part on *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989), in which the Supreme Court held that defendants to a fraudulent conveyance action have a Seventh Amendment right to trial by jury. In concluding that a non-Article III court may not enter final judgment in fraudulent conveyance claims, the Ninth Circuit found compelling the statement in *Granfinanciera* that fraudulent conveyance actions were "quintessentially suits at common law that more nearly resemble state-law contract claims." *Bellingham*, *supra* 702 F.3d at 562. Noting that the Supreme Court in *Stern* specifically compared the state law claim at issue there to "the fraudulent conveyance claim at issue in *Granfinanciera*," the Ninth Circuit concluded that the "common character" of the *Stern* claim and fraudulent conveyance claims means that "neither can be consigned to the bankruptcy courts without doing violence to the constitutional separation of powers." *Id*. at 562.

The Holding of *Executive Benefits*

In a unanimous decision, the Supreme Court affirmed the 9th Circuit's decision in *Bellingham, Exec. Bens. Ins. Agency v. Arkison*, 134 S. Ct. 2165 (U.S. 2014). The Court examined – again – the history of modern bankruptcy legislation that led to *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), a case that declared unconstitutional the grant of bankruptcy jurisdiction to decide a state-law contract claim against an entity that was not a party to the proceeding. As a result, Congress enacted the 1984 Act, which referred exclusive jurisdiction in the from the District Courts to the Bankruptcy Courts for "core" matters, over which the Bankruptcy Courts may enter final judgment reviewable by appeal by the District Courts. The referral included "non-core" matters that are related to a bankruptcy case and, absent consent for the entry of final judgment, over which the Bankruptcy Courts enter Supreme *Benefits* Court agreed with the Ninth Circuit that the fraudulent conveyance claims are *Stern* claims, namely, ones defined as core in § 157(b) but that may not be adjudicated to final judgment by the Bankruptcy Court absent consent. However, it is important to note that the *Executive Benefits* Court *assumed* this without directly ruling that the fraudulent conveyance claim is a *Stern* claim.

Further confounding the status of the law, the Court side-stepped the issue of consent in *Executive Benefits*. Instead, it framed the outcome on whether the procedural protection of *de novo* review by the District Court passed constitutional muster. The Court held that *Stern* claims may proceed as non-core matters pursuant to § 157(c) over which the Bankruptcy Court may enter proposed findings of fact and conclusions of law to the District Court for *de novo* review and entry of a final judgment. Because those procedural protections were actually realized, the Supreme Court affirmed and never reached the issue of consent.

Enter *Wellness*, which raises both the scope of a *Stern* claim and the issue of consent.

The Unknown Reaches of *Stern* on Bankruptcy Jurisdiction and the Elusive Role of Consent.

The pivotal issue in *Wellness* is whether a state law alter ego claim against the chapter 7 debtor is a *Stern* claim. Depending on the Court's disposition of this issue, it may not reach the issue of consent.

Petitioner *Wellness International* had a long history of chasing Debtor Sharif, including obtaining a default judgment against him as in Texas, which led to discovery in aid of collection efforts. Sharif allegedly evaded answering discovery and ultimately filed a chapter 7 petition. Sharif failed to list assets that he contended were assets of a trust his mother created and for which Debtor was trustee and his sister the beneficiary. He testified about the assets, answered discovery relating to these assets but did not escape *Wellness's* complaint objecting to his discharge. *Wellness* included a claim for determination that the trust was the alter ego of the Debtor and that trust assets were property of the estate pursuant to § 541. The parties did not dispute that a debtor's legal title over trust assets does not render those assets property of the estate. 11 U.S.C. § 541(d).

Unsurprisingly, the manner in which the parties frame the dispute is markedly different. *Wellness* presented its position in terms of the jurisdiction of the Bankruptcy Court to decide what comprises property of the estate. It asserted that the Bankruptcy Court indisputably has exclusive jurisdiction over property of the estate, which only arises when the Debtor filed his bankruptcy petition. Thus, a dispute with the Debtor over what is and what is not property of the estate "stems from bankruptcy," coining a phrase from *Stern*, and could only arise post-petition because the estate is created solely by the filing of a petition. § 541(a). Thus, according to *Wellness*, the resolution of the alter ego theory derives entirely from § 541. That state law is determinative does not transform the Bankruptcy Code action into a state law action, *Wellness* argued, if for no other reason than long-standing bankruptcy jurisprudence holds that the debtor's interest in property in bankruptcy is defined by state law.

In contrast, Sharif characterized the claim solely as a common law alter ego claim that seeks to extinguish property interests of third parties (the trust and the sister) and to augment Debtor's estate by those trust assets, much like a fraudulent conveyance action. The Debtor argued that because he held bare legal title to the assets in trust, they never become part of the estate, and because *Wellness's* effort to augment the Debtor's estate does not derive from or depend on bankruptcy law, that pursuant to *Stern,* only Article III courts have constitutional authority claim, and not courts controlled by Congress or by the Executive. As such, the Bankruptcy Court did not have jurisdiction to enter final judgment.

The Seventh Circuit held in favor of the Debtor. Resolution in the Supreme Court may turn on whether the Court accepts *Wellness's* characterization of the claim as a core matter stemming from § 541 or the Debtor's characterization that the claim is at most non-core as a purely state law claim that seeks to augment the estate with property in which third parties have an interest.

The second issue, which *Wellness* contends only arises if the Supreme Court concludes that the claim is a *Stern* claim, is whether the Bankruptcy Court could properly exercise the judicial power of the United States by the litigants' consent and, if so, whether implied consent is sufficient to satisfy Article III. *Wellness* argued that the Debtor admitted that the entire adversary proceeding was core and that the Debtor never raised the *Stern* claim until well into briefing at the Seventh Circuit. *Wellness* also argued that Article III protects primarily "personal" rights as opposed to "structural" rights and that personal rights are subject to waiver. *Wellness* contends that Article III is not structurally at issue because the Bankruptcy Court was operating within the judicial branch and exercising jurisdiction over *Stern* claims upon referral and with the litigants' consent.

Not so, proclaimed the Debtor, who argued that the structural Article III issue may not be cured by consent, which may only be given expressly. F.R.B.P. 7012(b). The nature of the Article III violation is by definition structural, according to the Debtor, because of the separation of powers and the right of an individual to an independent judiciary in certain cases, not judges subject to legislative and executive manipulation. Accordingly, the violation of Article III could not be waived and was not waived.

The Court heard argument in January and is expected to render a decision before the end of the term.

2. Are Converted Chapter 13 Debtors Even Poorer than Before?

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Until 1994, three options existed for the disposition of plan contributions held by the Chapter 13 trustee upon conversion to chapter 7: the funds could be given to (1) the chapter 7 estate; (2) to the debtor; or (3) to creditors. Since the 1994 amendments to the Bankruptcy Code revised § 348(f), the first option for the disposition of funds from a converted chapter 13 case after confirmation of the plan was resolved: the chapter 7 estate is not a recipient of the funds unless conversion is in bad faith. However, the other competing parties to the funds have a chance to finally resolve their respective rights to such funds in the Supreme Court.

In December 2014, the Supreme Court granted certiorari in *Viegilahn v. Harris (In re Harris)*, 2014 U.S. App. LEXIS 12750 (5th Cir. July 7, 2014), which held that the Chapter 13 Trustee was obligated to disburse to creditors undisbursed funds upon conversion to chapter 7. In contrast, the Third Circuit in reached a different holding that such funds must be returned to the Debtor. *In re Michael*, 699 F.3d 3056 (3rd Cir. 2012).

In *Michael*, the Third Circuit relied on three legal bases for its conclusion. It held that, pursuant to § 1327(b), post-confirmation, property of the estate vests with the Debtor absent provision in the plan or a court order. The court also found persuasive § 348(e), which terminates the service of the chapter 13 trustee upon conversion. The court then turned to legislative history and its previous holding in *In re Bobroft*, 766 F.2d 802 (3rd 1985), which found that post-petition tort action was in a chapter 13 case was not property of the converted chapter 7 estate. In response to *Bobroft*, § 348(f) of the Code was amended in 1994 to provide that post-petition property in a chapter 13 case property is not part of the chapter 7 estate upon conversion. The *Michael* court was persuaded by this reasoning and found that the legislative history accorded with the policy of the Code in favor of repayment plans in chapter 13.

The Debtor in *Harris* echoed many of these arguments. The Debtor takes a position that may resonate well with this Supreme Court, finding in error *Harris'* reliance on policy and fairness considerations rather than the plain language of the Code. Specifically, the Debtor relies on the language of § 348(f) of the Code which provides:

> (1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title –
> (A) Property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or under the control of the debtor on the date of conversion; …

> (2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

The Debtor argued that this specific treatment of property in the case of bad faith is the sole instance in which Congress eliminated the Debtor's right property upon conversion. Thus, the Debtor's reliance on the language of § 348(f) forms the first of three statutory interpretations to conclude that the Debtor's post-petition wages still in the hands of the Trustee at conversion are excluded from property of the chapter 7 estate absent bad faith.

Next, the Debtor cites § 348(e), which provides that conversion under § 1307 "terminates the service of any trustee or examiner that is serving in the case before such conversion," thus depriving the chapter 13 trustee of authority to disburse funds. Finally, and similar to the reasoning in *Michael*, the Debtor relies on § 1327(b) for the proposition that property of the chapter 13 estate vests in the debtor upon confirmation, and that creditors do not acquire a vested right in the funds until distribution. On the policy side, the Debtor suggests that turning undistributed funds over to creditors upon conversion would discourage debtors from attempting chapter 13 at the outset. Unsecured creditors are not treated unfairly upon conversion, the Debtor argues, because the Debtor has already satisfied the requirement as a condition to confirmation of the plan that unsecured creditors will receive at least as much as they would in a chapter 7. Thus, having the funds paid over to the unsecured creditors at conversion would result in a windfall to them.

The disposition of this case may answer the immediate question of who receives the funds upon conversion - the Debtor or creditors of the chapter 13 estate - but undoubtedly there will be ancillary issues to be addressed. These include whether chapter 13 administrative expenses may be satisfied from the funds on a priority basis, including approved fees of debtor's counsel. The authority of the chapter 13 trustee to make more than final reporting is also in question, an issue raised in the circuit cases. Obviously, the trustee must make a disbursement to someone post-conversion although that requirement is not specifically stated in the code.

3. Claim Filer Beware! It's Not Just the Rules Committee Changing the Rules[1]

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Statutes seldom operate in isolation from other statutes and occasionally, the provisions of one federal statute are incompatible with those of another federal or state statute. Federal preemption resolves many conflicts arising with state laws. However, when one federal statute conflicts with another, few clear guidelines exist to determine which prevails. Under these circumstances, courts must look to statutory construction and interpretation principles, as well as the underlying statutory policies and congressional intentions because, fundamentally, each federal statute is born with equal effect under the law.[2]

One such potential conflict was recently addressed in *Crawford v. LVNV Funding, LLC*,[3] wherein the United States Court of Appeals for the Eleventh Circuit overruled the decisions of both the bankruptcy court and the district court, as well as a uniform body of federal law, and held that the filing of a proof of claim for a debt for which the statute of limitations had expired

[1] Excerpted with permission from Alane A. Becket, Gilbert B. Weisman & William A. McNeal, *Filer Beware! It's Not Just the Rules Committee Changing the Rules*, Norton Bankr. Law Adviser, Sept. 2014,

[2] *Baldwin v. McCalla, Raymer, Padrick, Cobb Nichols & Clark. L.L.C.*, No. 98 C 4280, 1999 U.S. Dist. LEXIS 6933, at *7 (N.D. Ill. Apr. 19, 1999)., *citing United States v. Palumbo Bros. Inc.,* 145 F.3d 850, 852 (7th Cir. 1998). Indeed, in *Randolph v. IMBS, Inc.*, 368 F.3d 726 (7th Cir. 2004) Judge Easterbrook notes, "When two federal statutes address the same subject in different ways, the right question is whether one implicitly repeals the other – and repeal by implication is a rare bird indeed. It takes either irreconcilable conflict between the statutes or a clearly expressed legislative decision that one replace the other." *Id.* at 730 (citing *Branch v. Smith*, 538 U.S. 354, 273 (2003)).

[3] No. 13-12389, 2014 U.S. App. LEXIS 13221 (11th Cir. July 10, 2014).

was a violation of the Fair Debt Collection Practices Act ("FDCPA" or "Act").[4] The decision sent shockwaves throughout the creditor community because, for the first time, some bankruptcy claimants could be penalized under the FDCPA for lawfully participating in a bankruptcy case, whereas other claimants filing similar claims would not.

The FDCPA vs. the Bankruptcy Code: The Statutory Scheme

Enacted in 1978, the FDCPA arose as a result of "abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors."[5] Premised on the concept that "[a]busive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of individual privacy,"[6] its drafters shared a concern that "[e]xisting laws and procedures for redressing these injuries are inadequate to protect consumers."[7] To that end, the FDCPA is purposed "to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses."[8]

The FDCPA does not apply to all types of debt nor does it apply to everyone who collects debts. Its prohibitions are limited to "debt collectors" collecting consumer "debts." The Act defines a debt as "any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment."[9] A "debt collector" is defined as:

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[4] *Id*. at **1-2.
[5] 15 U.S.C. § 1692(a).
[6] *Id*.
[7] 15 U.S.C. §1692(b).
[8] 15 U.S.C. § 1692(e).
[9] 15 U.S.C. § 1692a(5).

> [A]ny person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. . . . The term does not include—(A) any officer or employee of a creditor while, in the name of the creditor, collecting debts for such creditor.[10]

The FDCPA proscribes specific acts, for example, communicating with third parties about a debt or contacting debtors early in the morning or late at night. It also more generally prohibits debt collectors from engaging in harassing or abusive behavior, employing unfair practices in the collection of debts, and making false representations to collect debts.

Violations of the FDCPA incur strict liability and are punishable by actual damages, statutory damages of up to $1000, and attorney fees.[11] Class actions are not uncommon and can result in damages of up to $1000 for each named plaintiff and "such amount as the court may allow for all other class members, without regard to a minimum individual recovery, not to exceed the lesser of $500,000 or 1 per centum of the net worth of the debt collector," plus attorney fees.[12]

Bankruptcy, on the other hand, "gives to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."[13] The Bankruptcy Code places in the bankruptcy court the power of policing violations of bankruptcy statutes and rules.[14]

In most cases, the filing of a petition for bankruptcy relief invokes the automatic stay which, among other things, prohibits the commencement or continuation of any collection

[10] 15 U.S.C. § 1692a(6).
[11] 15 U.S.C. § 1692k(a).
[12] *Id*.
[13] *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).
[14] 11 U.S.C. § 105 ("Power of court (a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.").

efforts.[15] Thereafter, all creditors are invited to participate in the bankruptcy by filing a proof of claim. A "claim" in bankruptcy is a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . . ".[16] The definition is intentionally broad so that any party who may make a claim against the debtor is notified of the bankruptcy,[17] wherein any disputes over the claim can be adjudicated.

The FDCPA vs. the Bankruptcy Code: The Conflict

When a debtor files for bankruptcy protection, at least two troublesome conflicts between the Bankruptcy Code and the FDCPA may arise. First, a debt collector may, according to some, be held liable for damages, pursuant to the FDCPA, for actions taken during the pendency of the bankruptcy. Second, a debt collector who complies with the FDCPA may, again according to some, inescapably violate the Bankruptcy Code.

The *Crawford* Case

In February 2008, Debtor Crawford filed a Chapter 13 case. LVNV Funding, LLC ("LVNV"), a purchaser of the Debtor's delinquent Heilig-Meyers department store account, was listed as a creditor in the Debtor's schedule of unsecured debts, and filed a proof of claim. In 2012, the Debtor filed an adversary proceeding alleging that the filing of LVNV's claim was a violation of the FDCPA, because the state statute of limitations on the debt had run.[18] According

[15] Whether or not a creditor participates in the case, any discharge the debtor receives will relieve the debtor of personal liability for the obligation in most cases.
[16] 11 U.S.C. § 101(5).
[17] *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991) ("We have previously explained that Congress intended by this language to adopt the broadest available definition of 'claim.'").
[18] LVNV conceded that the debt was beyond the applicable statute of limitations. Interestingly, the Debtor's adversary proceeding was filed after the one year limitations period in the FDCPA. 15 U.S.C. § 1692(k).

to the Debtor, filing an out of statute claim is a violation of the FDCPA in the same way that suing or threatening to file suit on a time-barred debt is an FDCPA violation.[19]

In its motion to dismiss the adversary proceeding, LVNV argued that well-settled law from throughout the country holds that the filing of a proof of claim cannot be the basis for an FDCPA action. Importantly, it also explained that, even outside of bankruptcy, attempting to collect a debt that is out of statute, absent a suit or threat thereof, has uniformly been held not to be a violation of the FDCPA. Finally, the creditor maintained that filing a proof of claim in bankruptcy court cannot violate the FDCPA, which regulates actions against consumers. Rather, it is a request to participate in the bankruptcy case and receive distributions from the bankruptcy estate.

The bankruptcy court dismissed the Debtor's adversary proceeding, agreeing with LVNV that filing a proof of claim in bankruptcy court, even if barred by the statute of limitations, cannot premise a violation of the FDCPA.

The District Court

The Debtor appealed the dismissal of the adversary proceeding. In district court, the Debtor acknowledged that the position he was advocating would require a change in the law:

> But Appellants are fighting an uphill battle, and they candidly admit they cannot win their appeals without a change in the law. Indeed, the elephantine body of persuasive authority weighs against Appellants' position. . . . ('Federal courts have consistently ruled that filing a proof of claim in bankruptcy court (even one that is somehow invalid) cannot constitute the sort of abusive debt collection practice proscribed by the FDCPA, and that such a filing therefore cannot serve as the basis for an FDCPA action.').[20]

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[19] Threatening to file or filing suit on an out of statute debt has been held to violate 15 U.S.C. § 1692(e), which prohibits making any false, deceptive, or misleading representation or means in connection with the collection of any debt, including specifically, misrepresenting the legal status of a debt.

[20] *Crawford v. LVNV Funding, LLC*, No. 2:12-CV-701-WKW [WO], 2013 U.S. Dist. LEXIS 66169, at *4 (M.D. Ala. May 9, 2013).

In response to LVNV's argument that the change in the law suggested by the Debtor would unfairly prejudice a subset of creditors collecting only certain accounts in bankruptcy cases, the debtor dismissively remarked that such is the "yoke which debt collectors bear for the privilege of being debt collectors." He added, "[t]here is no reason to provide debt collectors with a playground full of vulnerable consumers in the Bankruptcy forum for debt collectors to bully with impunity from FDCPA liability."[21] The Debtor urged that "[t]his practice [of debt collectors' filing claims for out of statute debt] and this mistake of law must be stopped."[22]

The district court affirmed the dismissal of the Debtor's adversary proceeding, and expanded upon the rationale of the bankruptcy court, by considering the purpose of the FDCPA— to protect consumers from abusive, deceptive, and unfair treatment. The court reasoned that even if filing a proof of claim could somehow be considered an attempt to collect a debt under the FDCPA, doing so did not run afoul of the FDCPA. Observing that the Creditor never communicated with the Debtor, the district court said:

> Appellants were never threatened; they were never tricked; they were never lied to or deceived — they were never even spoken to. Appellees never asked Appellants for a dime; instead, they merely filed claims in the bankruptcy court. As a matter of law, that conduct does not amount to an effort to collect a debt. And even if it did, it is not the sort of abusive practice the FDCPA was enacted to prohibit.[23]

It noted that in the bankruptcy context, the parties operate under court supervision and there is little likelihood even the most unsophisticated consumer would be threatened or deceived in this environment.

The Eleventh Circuit

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[21] Rebuttal Brief To The Brief Of Asset Acceptance. p. 11.
[22] *Id.*
[23] *Crawford*, No. 2:12-CV-701-WKW [WO], 2013 U.S. Dist. LEXIS 66169, at *5.

The Debtor appealed to the United States Court of Appeals for the Eleventh Circuit. Conceding that it is only a suit or threat of suit that is actionable under the FDCPA, the Debtor changed his approach and analogized the filing of a proof of claim against a bankruptcy estate to the filing of a state court lawsuit against the Debtor:

> Crawford's position is simple. '….. the filing of a proof of claim is tantamount to the filing of a complaint in a civil action …..'. . . Since at least 1987 debt collectors have been on notice that filing suit on time-barred debt was a violation of the FDCPA. . . . Therefore, a ***debt collector*** who files a claim in the bankruptcy court to collect on a time-barred debt has filed a civil action to collect time-barred debt in violation of the FDCPA. [24]

The Debtor urged application of the FDCPA's "least sophisticated consumer" standard for adjudging whether the filing of a proof of claim for an out of statute debt is an abusive attempt to collect a debt. In doing so, he suggested that a debtor may be unaware that a time-barred claim may be objectionable, and that payment of the claim would reduce distributions to "legitimate creditors." Finally, the Debtor lamented the "energy and resources" required to object to the claim.

To prevail, the Debtor needed to convince the Eleventh Circuit of the validity of two novel arguments. First, as noted above, the court would have to find the filing of a proof of claim to be analogous to the filing of a state court suit on an unpaid debt by a debt collector, a violation of the FDCPA. Second, the court would have to agree that the remedy for filing a proof of claim on an out of statute debt could be found in the remedial provisions of the FDCPA, in addition to the Bankruptcy Code.

The Debtor correctly noted a split of circuit court authority on whether the FDCPA may be applied to redress putatively violative conduct occurring in the context of a bankruptcy case, citing *Randolph v. IMBS, Inc.* for the proposition that the FDCPA can be invoked even when a

[24] Brief of Plaintiff-Appellant, p. 4 (emphasis in original, internal citations omitted.)

debtor is in bankruptcy.[25] In *Randolph*, the debt collectors sent dunning letters to debtors in active bankruptcy cases. Rather than alleging a violation of the automatic stay, the debtors sued the debt collectors for violations of the FDCPA. The United States Court of Appeals for the Seventh Circuit ruled that the debtors' FDCPA suits based on the collection letters, were viable, even though the Bankruptcy Code contained separate remedies for violations of the automatic stay. The court specifically rejected the argument that the remedial provisions of the Bankruptcy Code impliedly repealed the FDCPA. Instead, the court found that when statutes can be interpreted in harmony, they should be, and that there was nothing improper about bringing an FDCPA action when debtors are dunned during bankruptcy. As to the basic differences between the FDCPA and the Bankruptcy Code, the Seventh Circuit found no inherent conflict justifying a restriction on the application of the FDCPA.[26]

LVNV conceded that the Bankruptcy Code and the FDCPA coexist. However, it argued that even if the FDCPA could be applied to the filing of a proof of claim, Debtor's adversary proceeding was properly dismissed "because he has not been the victim of false, fraudulent, harassing or oppressive collection efforts. In fact, he has not been subjected to any collection efforts at all."[27] It noted that the proof of claim was filed against the bankruptcy estate, neither a consumer nor a natural person and certainly not the Debtor himself, while the FDCPA is designed to protect debtors from abusive or unfair tactics.

LVNV pressed additional points. First, assuming that the FDCPA is applicable to proofs of claim, LVNV reiterated that the FDCPA is violated only by the filing or threatening of a lawsuit for an out of statute debt. The Act does not bar other lawful collection attempts, such as

[25] 368 F.3d 726 (7th Cir. 2004).
[26] *Id*., at 732 ("They are simply different rules, with different requirements of proof and different remedies.").
[27] Brief of Appellees, at p. 2.

dunning letters, and most relevantly, the filing of a proof of claim in a bankruptcy case. No court had ever found otherwise.

Next, LVNV observed that if the filing of a proof of claim were subject to the FDCPA, by definition, doing so is an "attempt to collect a debt." Under the Bankruptcy Code, attempting to collect a pre-petition debt is prohibited. As a result, under the Debtor's reasoning, every proof of claim would (nonsensically) violate the automatic stay.

LVNV further argued that even if a proof of claim were subject to the protections of the FDCPA, filing a claim for a debt on which the statute has run is not abusive, unfair, deceptive, false, or improper in any manner the FDCPA is designed to curtail. In fact, the proof of claim process is specifically how the Bankruptcy Code instructs creditors to apprise the court of their claims.

Finally, LVNV contended that while filing a proof of claim may superficially *appear* similar to a suit on a debt, it is in fact fundamentally different, because it is part of a process administered by a bankruptcy court pursuant to the Bankruptcy Code. The process includes an instruction to all creditors to file any "claim" against the bankruptcy estate—a claim being defined under the Code as any right to payment, including even disputed debts. If the debtor disputes the allowance of any claim, the Bankruptcy Code and Bankruptcy Rules include provisions for a debtor to challenge the claim.

The United States Court of Appeals for the Eleventh Circuit, in an opinion authored by Judge Richard W. Goldberg, United States Court of International Trade, sitting by designation, began by tipping its hand, "[a] deluge has swept through U.S. bankruptcy courts of late. Consumer debt buyers—armed with hundreds of delinquent accounts purchased from creditors—

are filing proofs of claim on debts deemed unenforceable under state statutes of limitations."[28] In reversing the bankruptcy and district courts, the circuit measured LVNV's conduct in filing a proof of claim for an out of statute debt against the "least sophisticated" consumer standard.[29] While noting that the least sophisticated consumer criterion "takes into account that consumer-protection laws are 'not made for the protection of experts, but for the public—that vast multitude which includes the ignorant, the unthinking, and the credulous',"[30] the court also acknowledged that the test has an objective component designed to "preserv[e] a quotient of reasonableness" into the determination.[31]

There was no dispute that had the Creditor filed a lawsuit against the Debtor in state court, it would have been a violation of the FDCPA. The court, carrying over that concern to the bankruptcy case, worried, "[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."[32] The court indicated that allowance of the claim would result in the payment of an "otherwise unenforceable time-barred debt" at the expense of "legitimate creditors with enforceable claims."[33]

In dismissing the creditor's argument that a proof of claim is not a "debt collection activity" regulated by FDCPA, the court persisted that filing of an out of statute proof of claim

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[28] No. 13-12389, 2014 U.S. App. LEXIS 13221, at *1 (11th Cir. July 10, 2014).

[29] Not all agree where, as in this case, any communication was with debtor's attorney only. *Champion v. Target Nat'l Bank, N.A.*, No. 1:12-CV-04196-RLV-WEJ, 2013 U.S. Dist. LEXIS 188123, at **24-25 (N.D. Ga. Mar. 22, 2013) ("The Ninth Circuit has concluded that a communication to a debtor's counsel is outside the scope of FDCPA. . . . Dicta from two other Circuits supports the same conclusion. . . . Finally, numerous district courts hold that the FDCPA does not apply to a communication to a debtor's attorney. . . . This Court agrees with the above-cited decisions and holds that the FDCPA does not apply to a communication to a debtor's attorney.").

[30] No. 13-12389, 2014 U.S. App. LEXIS 13221, at *7 (11th Cir. July 10, 2014).

[31] *Id.*at *7-8 (citation omitted).

[32] *Id.*at *11.

[33] *Id.*at *12.

was a false and fraudulent means to collect a debt and, therefore, a violation of the FDCPA.[34] In response to the Creditor's contention that it was not collecting a debt against a natural person, but rather against the bankruptcy estate, the court reasoned that the source of any payment, *i.e.*, the Debtor, was sufficient to satisfy this prerequisite.

Finally, the court also addressed the conflict, cited by LVNV, arising from application of the FDPCA to acts taken in a bankruptcy case, *viz.,* if filing a claim is an "act to collect" a debt, then every proof of claim would violate the automatic stay, a basic bankruptcy protection. The court found this concern unwarranted, employing somewhat circular reasoning.

> The automatic stay prohibits debt-collection activity outside the bankruptcy proceeding, such as lawsuits in state court. . . . It does not prohibit the filing of a proof of claim to collect a debt within the bankruptcy process. Filing a proof of claim is the first step in collecting a debt in bankruptcy and is, at the very least, an 'indirect' means of collecting a debt.[35]

The court's rationale was simple: "Just as LVNV would have violated the FDCPA by filing a lawsuit on stale claims in state court, LVNV violated the FDCPA by filing a stale claim in bankruptcy court."[36] It not only overturned the dismissal of the Debtor's adversary proceeding, it arguably went beyond the issue before it and ruled on the merits of the underlying action by holding LVNV's claim violated the FDCPA. The case was remanded for further proceedings.

What *Crawford* Means:

For the first time, a circuit court of appeals has found that a debt collector faces liability under the FDCPA for filing a proof of claim in a bankruptcy case; a claim which a non-debt collector could file with impunity. The decision has implications far beyond the windfall debtors

[34] *Id.* at *13.
[35] *Id.* at *17.
[36] *Id.* at *17-18. Likewise, the Chapter 13 Trustee was not immune from criticism by the panel. "Here, however, it appears the trustee failed to fulfill its statutory duty to object to improper claims, specifically LVNV's stale claim." *Id.* at *11.

and their attorneys will receive by litigating a strict liability statute that includes attorney fees in its damages provisions. In the wake of *Crawford,* it is no surprise that bankruptcy creditors are in the midst of defending themselves against "*Crawford"* suits in throughout the country. Retroactive application of the decision in *Crawford* has jeopardized any claim filed by a "debt collector" going back, ironically, to the limitations period for FDCPA suits.

A petition for certiorari has been filed and is awaiting a decision from the Supreme Court.

4. Sections 1306(a)(1) and 541(a)(5) and Post-Petition Inheritances – The Majority View Garners Two Additional Followers

By: Elizabeth L. Gunn, Sands Anderson PC
Richmond, VA

Section 541(a)(5) establishes that any inheritance, bequest, devise or proceeds of a life insurance policy where the debtor is the beneficiary, acquired within 180 days of the petition date, is property of the debtor's bankruptcy estate as if it was property of the debtor on the petition date. In chapter 13, § 1306(a)(1) extends the § 541 definition of property of the estate to include all property of the types defined in § 541 that the debtor acquires after commencement of the case but before the case is closed, dismissed, or converted. The question of which time period – the limited 180 days of § 541(a)(5) or the extended period of § 1306(a)(1) – controls for post-petition inheritances has been unsettled, with a majority view gaining traction. The majority view that § 1306 controls § 541 has recently been adopted by two more courts; however, in the Southern District of Georgia and the Middle District of Florida, the minority view that § 541 controls § 1306 remains valid.

In re Zisumbo, 519 B.R. 851 (Bankr. D. Utah 2014).

A combined decision in two separate chapter 13 cases. In the first case, filed in November 2010, the Debtor's plan provided for a 34.39% distribution to unsecured creditors over 60 months. In 2012, both the Debtor's parents died, and the Debtor received their residence through probate in July 2013. The Debtor filed a motion seeking approval to sell the inherited property, to use a portion of the proceeds to pay off the remaining balance of her plan, and to allow her to retain the balance. The chapter 13 trustee objected on the basis that the Debtor should be required to pay unsecured claimants in full using the proceeds of the post-petition inheritance. The Debtor responded that the proceeds of the sale were not property of the estate. The sale was authorized, but the proceeds were placed into escrow pending resolution of the trustee's objection. The Court treated the Debtor's motion to pay off the plan as a motion to modify the confirmed plan.

In the second case, filed in April 2011, the Debtors' plan provided for a distribution of 35% to unsecured creditors over 36 months, whose total allowed claims were approximately $32,750. In December 2012, one of the Debtor’s mothers passed away leaving the Debtors over $143,000 in cash and a vehicle valued at $6,000, both of which the Debtors received in December 2013. In January 2014, one of the Debtors passed away and his wife (the remaining Debtor) received $300,000 as the beneficiary of term life insurance policies. In March 2014, the remaining Debtor filed amended schedules to disclose the personal property received and claimed the life insurance policies as exempt. Prior to filing her amended schedules, counsel for the Debtor contacted the chapter 13 trustee and discussed the inheritance. The Debtor completed her plan payments in April 2014. In June 2014, prior to filing a Notice of Completed Plan Payments, the chapter 13 trustee filed a motion to modify the Debtor's plan to require a 100% return to unsecured creditors (requiring payment of another $23,445).

Following the recent majority trend of cases applying statutory construction to the interplay between §§ 541(a)(5) and 1306(a)(1), the Court held that the specific language of § 1306 governs the general provision of § 541(a)(5). As a result, any property specified in § 541 and received after the commencement of a chapter 13 but before the case is closed, dismissed or converted is property of the estate and the 180-day language of § 541(a)(5) does not apply.

Applying the majority view, the Court ruled the Debtor in the first case must modify her plan to apply the sale proceeds of inherited property to pay unsecured creditors 100%. However, because the trustee's motion in the second case was filed after completion of plan payments, based upon § 1329(a) the plan could not be modified, and under the unique circumstances of the case, the trustee's motion must be denied.

In re Roberts, 514 B.R. 358 (Bankr. E.D.N.Y. 2014).

The Debtors filed a joint chapter 13 petition in December 2011 and their 60-month plan, confirmed in April 2012, provided for a distribution of not less than 10% to unsecured creditors. The plan provided that property of the estate would revest in the Debtors on confirmation of the plan. In October 2013, the Mr. Roberts inherited a half interest property resulting in approximately $122,000 of proceeds. Around that same time, Mrs. Roberts employment terminated, decreasing the Debtors' monthly income. In January 2014, the Debtors filed a motion seeking to declare the proceeds not property of the estate and to modify the plan to allow for a lump sum payment to pay the remaining balance due. In the alternative, the Debtors asked the court to modify the plan to cease regular monthly payments and to surrender the proceeds in full satisfaction of their obligations.

The Court, after review of the majority and minority views, adopted the majority view that § 1306(a)(1) creates an exception to the general rule of § 541(a)(5). The Court reasoned that otherwise the phrase "in addition to" in § 1306(a) would be superfluous and meaningless. In considering the Debtors' proposed modification, the Court determined that effective date for the best interests of creditors test is the date of modification of the plan, thereby taking into account post-confirmation inheritances. The Court continued the hearing on the modification to allow the parties to determine the amount by which the Debtors' plan payments should be modified to account for the inclusion of the inherited funds and the decrease in the Debtors' income.

5. Administrative Holds – Violations of the Automatic Stay?

By: Elizabeth L. Gunn, Sands Anderson PC
Richmond, VA

As most debtor attorneys are aware, Wells Fargo Bank, N.A. has a policy of automatically instituting an administrative freeze on the accounts of any chapter 7 (and individual chapter 11) debtor upon determination of a bankruptcy the filing. Upon placement of the freeze, Wells Fargo sends a notice to debtor's counsel and a notice and request for direction from the chapter 7 trustee, as to what should be done with the frozen funds – turnover to the trustee or return to the debtor. The question is whether an administrative freeze and refusal to release funds for a period of time is a violation of the automatic stay. Two recent cases come to opposite conclusions.

Not a Violation – Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi), 764 F.3d 1168 (9th Cir. 2014).

The Debtors filed their case on August 3, 2009. Wells Fargo placed an administrative hold on their deposit accounts on August 6, 2009 and sent notification to Debtors' counsel and a request for instruction to the chapter 7 trustee. On August 29, 2009, the Debtors filed a motion for sanctions under § 362(k). It is clear from the opinion that the chapter 7 trustee never responded to Wells Fargo, but is unclear when Wells Fargo released the funds in question back to the Debtors. The Debtors were able to, and did timely, claim an exemption in the majority of the funds in question.

The Ninth Circuit found that the funds in the Debtors' account became estate property upon the filing of the Debtors' chapter 7 petition. During the period from the petition date until the expiration of the 30 day period after the 341 meeting to object to exemptions, or abandonment by the trustee, whatever is first, the Debtors may only "claim property as exempt." Therefore, the funds in question did not revest in the Debtor until the expiration of that period. During the period the funds were estate property, the Debtors had no right to control or possess the account funds. Wells Fargo requested instruction from the Trustee (in compliance with § 542(b)), but did not receive any guidance, therefore it did not violate the automatic stay as to the Trustee.

Further, the Ninth Circuit reasoned, once the objection period ended and the funds revested in the Debtors, they were no longer property of the estate or subject to § 362(a). In this case, there was no evidence that Wells Fargo did not provide immediate access and control to the funds after the expiration of the "property of the estate" period. Therefore, the placement and operation of the administrative pledge/freeze was not a violation of the automatic stay and the Debtors did not suffer any injury as a result thereof.

Violation of Stay – *In re Weidenbenner*, 521 B.R. 74 (Bankr. S.D.N.Y. 2014).

The Debtors filed for chapter 7 and on March 7, 2014 and Wells Fargo placed an administrative hold on their accounts and sent a request for instruction to the chapter 7 trustee on March 12, 2014. On March 17, 2014, the chapter 7 trustee directed Wells Fargo to release the funds to the Debtors and the funds were released the same day. In the intervening 10 days, the Debtors had checks bounce and at least one vendor charge the Debtors a fee for an insufficient funds payment. On March 23, 2014, the Debtors filed a motion alleging the 10 day administrative freeze was a violation of the automatic stay. At the evidentiary hearing on the motion, the Court required a "high ranking policy person from Wells Fargo" to be present to give testimonial evidence regarding how and why Wells Fargo implemented its administrative pledge policy. (Interestingly, the witness testified that the administrative hold is only placed on accounts where the Debtor has accounts totaling an aggregate of $5,000 or more (i.e. $4,999.99 or less and the Debtor continues to have access to their funds)).

Focusing on the 1984 amendment of § 362(a) which added "to exercise control" over property of the estate, the Court found that unilaterally deciding to place a freeze on property of the estate was a perfect example of "control over property of the estate." Further, the Court determined that Wells Fargo's reliance on § 542(b) as mandating the hold was misplaced and did not override the stay violation. In support, the Court pointed to the "completely arbitrary" $5,000 threshold established by Wells Fargo for the freeze. As a result, if Wells Fargo's position as to § 542(b) was correct, every time it failed to place an administrative freeze on a balance below $5,000, it would be in violation of the Code. The Court further reasoned that § 542(b) is not one of sections enumerated in § 362(b) to which the automatic stay does not apply. In other words, Congress knew how to create an exception to the automatic stay and did not do so in the case of § 542(b).

The Court also took a practical view of the situation. It reasoned that if policies such as Wells Fargo's were lawful, it would make it more likely for debtors to "squirrel away secret stashes of cash" prior to filing to allow for them to continue to pay for food, gas and daycare. By eliminating the unlawful policies, it encourages debtors to continue to use bank accounts post-petition and provide a more accurate record of their financial situation from bank records.

With respect to damages under § 362(k), the Debtors were able to establish an injury due to the insufficient funds penalty charged by a creditor as a result of the administrative pledge which provided the Debtors standing to purse the violation. The Debtors' duty to surrender (as opposed to turnover) property was a duty merely to relinquish rights in the property to the trustee and cooperate in a trustee's efforts to take possession if the trustee chose to do so. By scheduling the accounts and cooperating with the trustee, the Debtors "surrendered" their property. Therefore, the Court awarded the Debtors the $25.00 NSF fee incurred plus attorneys' fees and costs for pursuing the action.

6. The *Law v. Siegel* Progeny – Is the "Bad Faith" Objection to Claimed Exemptions Truly Dead?

By: Elizabeth L. Gunn, Sands Anderson PC
Richmond, VA

Law v. Siegel, 134 S. Ct. 1188 (2014) represents a landmark opinion by the Supreme Court for consumer attorneys. Its holding that "[t]he [bankruptcy] Code's meticulous . . . enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exemptions" had the effect of eliminating the long-recognized equitable denial of exemptions based upon the fraud or bad acts of a debtor. Although in the underlying case the period for objecting to exemptions had passed without objection, and the movant trustee was seeking to surcharge the Debtor's homestead exemption to pay for administrative costs incurred as a result of his bad faith, dicta the Supreme Court's opinion went further. The court stated clearly, “[a] debtor need not invoke an exemption to which the statute entitles him; but if he does, the court may not refuse to honor the exemption absent a valid statutory basis for doing so." The bad faith/fraud denial of exemptions was not a statutorily based exemption, but one founded in bankruptcy court's equitable powers. Recognizing the opinion would provide a serious disadvantage for trustees (and an admitted disincentive for debtors to act in good faith), the Supreme Court stated that chapter 7 trustees and the courts have other, Code established, alternative remedies including denial of discharge, Rule 9011 sanctions, other sanctioning authority under section 105 or inherent powers, and criminal referrals.

Since *Law v. Siegel*, lower courts have nearly uniformly applied its ruling (and dicta) to the widest bounds and extent of its application, consistently holding that despite a debtor's worst actions or fraud on the court, the courts cannot deny a claimed exemption on the basis of bad faith or fraud. The Ninth Circuit BAP in *Gray v. Warfield*, 523 B.R. 170 (9th BAP 2014), held that *Siegel's* reasoning applies in evaluating an opposition to a motion to amend exemptions for bad faith. In *Gray* the court found that there is no practical difference in denying the amendment of an exemption for bad faith and denying the amended exemption itself.

As of the date of preparation of these materials, the lone outlier in the interpretation of *Siegel* is the unreported December decision of *In re Woolner*, 2014 Bankr. LEXIS 5048 (Bankr. E.D. Mich. 2014). In *Woolner*, Judge Shapero relied upon the language of Federal Rule of Bankruptcy Procedure 4003(b)(2), which was not applicable to Siegel because it was implemented after *Siegel* was filed. FRBP 4003(b)(2) provides:

> The trustee may file an objection to a claim of exemption at any time prior to one year after the closing of the case if the debtor fraudulently asserted the claim of exemption. The trustee shall deliver or mail the objection to the debtor and the debtor's attorney, and to any person filing the list of exempt property and that person's attorney.

FRBP 4003(b)(2) went into effect on December 1, 2008, and upon its issuance the Advisory Committee Notes stated:

> Subdivision (b)(2) is added to the rule to permit the trustee to object to an exemption at any time up to one year after the closing of the case if the debtor fraudulently claimed the exemption. Extending the deadline for trustees to object to an exemption when

> the exemption claim has been fraudulently made will permit the court to review and, in proper circumstances, deny improperly claimed exemptions, thereby protecting the legitimate interests of creditors and the bankruptcy estate. However, similar to the deadline set in § 727(e) of the Code for revoking a discharge which was fraudulently obtained, an objection to an exemption that was fraudulently claimed must be filed within one year after the closing of the case. Subdivision (b)(2) extends the objection deadline only for trustees.

Thus, as Judge Shapero questions – "Why would there have been proposed and the Supreme Court have adopted such a Rule that covers a situation with respect to which the Bankruptcy Court has no authority to adjudicate?" There is no purpose in adopting or having a rule which governs the time and manner by which a trustee may file an objection to an exemption based upon fraud, if as a matter of law, such objection does not exist.

As a result, the *Woolner* court (i) declined to follow the dictum in *Siegel*, (ii) found that the denial of a surcharge of an exemption is not analogous to denying a claimed exemption upon a timely objection for fraud or bad faith, and (iii) found that the inherent powers of the Bankruptcy Court to adjudicate matters of fraud in claiming exemptions should be eliminated only by clear statutory authority or specific binding decisional authority in a substantively analogous case, and denied the claimed exemption.

Consumer Case Law Update
ABI Annual Spring Meeting
April 18, 2015

Hon. Ray C. Mullins
U.S. Bankruptcy Court
N.D. Georgia, Atlanta, GA

Elizabeth Gunn
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Alane A. Becket, Moderator
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Agenda

- The state of bankruptcy jurisdiction after *Stern, EBIA* and *Wellness*
- New filings and old debts
- Bad Faith and Exemptions after *Law v. Seigel*
- The fate of undistributed plan payments upon conversion
- Administrative holds and the automatic stay
- Post-petition inheritance and property of the estate
- Credit reporting and bankruptcy

Wellness International v. Sharif: The Uncertain Fate Of Bankruptcy Jurisdiction And The Effect Of Consent

Wellness International v. Sharif: Questions Presented

- Whether bankruptcy court had statutory but not constitutional jurisdiction to enter final declaratory judgment that trust assets Debtor held title to as trustee are property of the estate on an alter ego theory, where the third parties with an interest in the trust property did not consent to such jurisdiction? E.g., is this a *Stern* claim or one that "stems from" the bankruptcy?
- Whether the Debtor consented to the entry of final judgment by filing a voluntary chapter 7; and
- Whether the Debtor's consent may be implied?

A Bit of History

- *Stern v. Marshall*, 131 S. Ct. 2594 (2011) : Bankruptcy Court lacked constitutional authority to enter final judgment on a state law counterclaim despite statutory authority conferred by 28 U.S.C. §157(b)(2)(C).

- *Executive Benefits v. Arkison*, 134 S. Ct. 2165 (2014): affirmed *In re Bellingham Ins. Agency, Inc.*, 702 F.3d 553, 561 (9th Cir. 2012), cert. granted, 133 S. Ct. 2880 (2013).

Outcome of *Executive Benefits*

Executive Benefits Court assumed without directly ruling that the fraudulent conveyance claim is a *Stern* claim.

- But *Bellingham* relied in part on *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989), in which the Supreme Court held that defendants to a fraudulent conveyance action have a Seventh Amendment right to trial by jury.
- In concluding that a non-Article III court may not enter final judgment in fraudulent conveyance claims, the Ninth Circuit found compelling the statement in *Granfinanciera* that fraudulent conveyance actions were "quintessentially suits at common law that more nearly resemble state-law contract claims." *In re Bellingham*, 702 F.3d at 562.

Unfinished Business

- *Executive Benefits* held that *Stern* claims may proceed as non-core matters pursuant to §157(c) over which the Bankruptcy Court may enter proposed findings of fact and conclusions of law to the District Court for de novo review and entry of a final judgment.

- SCOTUS did not rule on the issues of consent.

Wellness International Issues

- Undisputed: bankruptcy court has jurisdiction over property of the estate and to rule on what is property of the estate;
- Does lawsuit to declare that assets of trust over which the Debtor is trustee but not a beneficiary may be declared property of the estate by a theory of alter ego constitute a *Stern* claim?
- Is the alter ego claim one over which the Bankruptcy Court has statutory authority but lacks constitutional authority as a common law claim against third parties seeking to augment the estate?

Bankruptcy and Out of Statute Consumer Debts

Statute of Limitations: The Basics

- When a lawsuit is filed, SOL may be a defense
- Debtor's burden to assert and prove the SOL has run as a defense to a suit
- SOL as a defense is waived if not raised and judgment may be entered against Debtor
- State law is not generally violated when suit is filed on an out of statute debt
- Date the "clock begins to run" can vary from state to state
- The applicable SOL is not clearly defined
  - The state whose laws govern the contract?
  - The state in which the debtor lives?
  - Which SOL applies: contract, open account, account stated?

Has the SOL run?

The application of a statute of limitations is a legal determination, which we review for correctness. *Ottens v. McNeil*, 2010 UT App 237, ¶ 20, 239 P.3d 308. However, "[t]o the extent that the statute of limitations analysis involves 'subsidiary factual determination[s],' we review those factual determinations using 'a clearly erroneous standard.'" Id. (second alteration in original) (quoting *Spears v. Warr*, 2002 UT 24, ¶ 32, 44 P.3d 742).

Filing Suit on an Out of Statute Debt and the FDCPA

- Filing suit on an out of statute debt is not a violation of the precise terms of the FDCPA
- The FDCPA prohibits:
  - The false representation of -- the character, amount, or legal status of any debt. [15 USC 1692e]
  - A debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt. [15 USC 1692f]
- Filing suit on an out of statute debt has been held to violate both provisions

OOS Debts and the FDCPA

- *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1083 (7th Cir. 2013) (finding an FDCPA violation for suing on a debt on which applicable statute of limitations had run):

  Indeed, the unfairness of such conduct is particularly clear in the consumer context where courts have imposed a heightened standard of care—that sufficient to protect the least sophisticated consumer. Because few unsophisticated consumers would be aware that a statute of limitations could be used to defend against lawsuits based on stale debts, such consumers would unwittingly acquiesce to such lawsuits.

OOS Debts and the FDCPA

- *Grant-Hall v. Cavalry Portfolio Servs., LLC*, 856 F. Supp. 2d 929, 944 (N.D. Ill. 2012)

  The filing of a legally defective debt collection suit can violate § 1692e where the filing falsely implies that the debt collector has legal recourse to collect the debt.

OOS Debts and the FDCPA

- *Kimber v. Fed. Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987)

  The court agrees with Kimber that a debt collector's filing of a lawsuit on a debt that appears to be time-barred, without the debt collector [sic] having first determined after a reasonable inquiry that that limitations period has been or should be tolled, is an unfair and unconscionable means of collecting the debt.

Crawford v. LVNV, 758 F.3d 1254 (11th Cir. 2014)

The FDCPA affords a private right of action against a debt collector for, inter alia, unfair and deceptive practices, as tested by the least sophisticated consumer standard. Because, according to the court, the filing of a proof of claim is a debt collection activity, or at least an indirect means to collect, it falls within the ambit of the FDCPA. The court found that the filing of a proof of claim against an estate in bankruptcy for a debt that is knowingly legally unenforceable pursuant to apposite statute of limitations is unfair, unconscionable, deceiving, or misleading to such a consumer.

- rehearing denied
- stay of the mandate denied
- petition for certerori, amici & response filed

Background

- Debtors filed Chapter 13
- Creditors filed POCs for out of statute debts
- Debtors filed adversary proceedings against creditors for filing stale claims arguing, inter alia, FDCPA violations
- Creditors moved to dismiss arguing, inter alia, that filing a POC is not an FDCPA violation

Background (cont.)

- Debtors' AP dismissed by Bankruptcy Court
- Debtors appealed
- District Court affirmed dismissal of Debtors' AP
- Debtors appealed
- 11th Circuit vacated the District Court's dismissal of the Debtor's AP and remanded FDCPA case
    - (But, determined the FDCPA was violated)

Debtors' Principal Arguments

- Acknowledges that debtor's successful outcome would change the result of virtually every other judicial opinion on the subject
- Argues that despite the uniform nature of the bankruptcy laws, a "debt collector's" rights in bankruptcy are limited by the FDCPA:

  "… Sims (sic) position on the law will have no effect on Creditors because they will never be subject to the FDCPA. … The FDCPA is the yoke which debt collectors bear for the privilege of being debt collectors. There is no reason to provide debt collectors with a playground full of vulnerable consumers in the Bankruptcy forum for debt collectors to bully with impunity from FDCPA liability."

Creditors' Principal Arguments

The FDCPA is not "pre-empted" by the Bankruptcy Code, but:

- Overwhelming weight of authority: Filing an out of statute POC is not subject to the FDCPA
- The filing of a POC is not an "attempt" to collect a debt against a consumer
- A POC for an out of statute debt is not false or fraudulent
- A POC is not "tantamount" to a civil action/complaint
- The FDCPA historically applied to acts taken outside of the bankruptcy to collect a debt involved in a bankruptcy

The *Crawford* District Court (cont.)

Setting the weight of authority aside, Appellants have not alleged any conduct that amounts to an FDCPA violation. Appellants were never threatened, never tricked, never lied to or deceived; they were never even spoken to. Appellees never asked Appellants for a dime; instead, they merely filed claims in the bankruptcy court. As a matter of law, that conduct does not amount to an effort to collect a debt. Even if it did, it is not the sort of abusive practice the FDCPA was enacted to prohibit.

The *Crawford* 11th Circuit Opinion

A deluge has swept through U.S. bankruptcy courts of late. Consumer debt buyers--armed with hundreds of delinquent accounts purchased from creditors--are filing proofs of claim on debts deemed unenforceable under state statutes of limitations. This appeal considers whether a proof of claim to collect a stale debt in Chapter 13 bankruptcy violates the Fair Debt Collection Practices Act…

The *Crawford* 11th Circuit Opinion (cont.)

The 'least-sophisticated consumer' standard takes into account that consumer-protection laws are 'not made for the protection of experts, but for the public--that vast multitude which includes the ignorant, the unthinking, and the credulous.' … 'However, the test has an objective component in that while protecting naive consumers, the standard also prevents liability for bizarre or idiosyncratic interpretations of collection notices by preserving a quotient of reasonableness.' (internal citations omitted).

The *Crawford* 11th Circuit Opinion (cont.)

The automatic stay prohibits debt-collection activity outside the bankruptcy proceeding, such as lawsuits in state court. … It does not prohibit the filing of a proof of claim to collect a debt within the bankruptcy process. Filing a proof of claim is the first step in collecting a debt in bankruptcy and is, at the very least, an 'indirect' means of collecting a debt.

3/2/15

The *Crawford* 11th Circuit Opinion (cont.)

- 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.
- Similar 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.
- The "least sophisticated" Chapter 13 debtor may be unaware that a claim is time-barred and unenforceable, and thus fail to object to such a claim.

The "least sophisticated" Chapter 13 debtor may be unaware that a claim is time-barred and unenforceable and thus fail to object to such a claim.

- The Proof of Claim Form requires (all claims):
  - Documentation supporting the claim
  - Statement of the basis for the claim
  - Last 4 digits of account number
  - Name by which the debtor may know the creditor
  - Itemization of interest charges
- The Proof of Claim Form requires (secured claim):
  - Identification of security
  - Basis for perfection
  - Value of property
  - Interest rate
  - Amount of secured claim vs. amount of unsecured claim

13

The "least sophisticated" Chapter 13 debtor may be unaware that a claim is time-barred and unenforceable and thus fail to object to such a claim.

- The Bankruptcy Rules require (for claims based on revolving or open accounts):
  - (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.

The "least sophisticated" Chapter 13 debtor may be unaware that a claim is time-barred and unenforceable and thus fail to object to such a claim.

Penalty for filing a false claim:

- Form B-10: Fine of up to $500,000 or imprisonment for up to 5 years, or both
- Fed. R. Bankr. P. 3001(c)(2)(D): If the holder of a claim fails to provide any information required by this subdivision (c), the court may, after notice and hearing, take either or both of the following actions:
  - (i) preclude the holder from presenting the omitted information, in any form, as evidence in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless; or
  - (ii) award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

Advisory Committee Note
Fed. Rule Bankr. P. 3001

Subdivision (c) is further amended to add paragraph (3). [P]aragraph (3) specifies information that must be provided in support of a claim based on an open-end or revolving consumer credit agreement (such as an agreement underlying the issuance of a credit card). Because a claim of this type may have been sold one or more times prior to the debtor's bankruptcy, the debtor may not recognize the name of the person filing the proof of claim. Disclosure of the information required by paragraph (3) will assist the debtor in associating the claim with a known account. It will also provide a basis for assessing the timeliness of the claim.

Circuit Authority

- Prior to *Crawford*, the 2nd, 3rd, 7th and 9th previously ruled on the alleged conflict between the Bankruptcy Code and the FDCPA

The *Law v. Siegel* Progeny – Is the "Bad Faith" Objection to Claimed Exemptions Truly Dead?

After *Law v. Siegel*

Gray v. Warfield, 523 B.R. 170 (9th BAP 2014)

- Denying motion for leave to amend exemptions for bad faith is essentially the same as denying the exemption for bad faith

But See In re Woolner
2014 Bankr. LEXIS 5048 (Bankr. E.D. Mich. 2014)

- FRBP 4003(b)(2) (effective 12/1/2008):
  - The trustee may file an objection to a claim of exemption at any time prior to one year after the closing of the case if the debtor fraudulently asserted the claim of exemption. The trustee shall deliver or mail the objection to the debtor and the debtor's attorney, and to any person filing the list of exempt property and that person's attorney.
- Advisory Committee Notes
  - Subdivision (b)(2) is added to the rule to permit the trustee to object to an exemption at any time up to one year after the closing of the case if the debtor fraudulently claimed the exemption. Extending the deadline for trustees to object to an exemption when the exemption claim has been fraudulently made will permit the court to review and, in proper circumstances, deny improperly claimed exemptions, thereby protecting the legitimate interests of creditors and the bankruptcy estate. However, similar to the deadline set in § 727(e) of the Code for revoking a discharge which was fraudulently obtained, an objection to an exemption that was fraudulently claimed must be filed within one year after the closing of the case. Subdivision (b)(2) extends the objection deadline only for trustees.

But See In re Woolner, 2014 Bankr. LEXIS 5048 (Bankr. E.D. Mich. 2014)

- Why would there have been proposed and the Supreme Court have adopted such a Rule that covers a situation with respect to which the Bankruptcy Court has no authority to adjudicate?" There is no purpose in adopting or having a rule which governs the time and manner by which a trustee may file an objection to an exemption based upon fraud, if as a matter of law, such objection does not exist.

- (i) declined to follow the dictum in Siegel, (ii) found that the denial of a surcharge of an exemption is not analogous to denying a claimed exemption upon a timely objection for fraud or bad faith, and (iii) found that the inherent powers of the Bankruptcy Court to adjudicate matters of fraud in claiming exemptions should be eliminated only by clear statutory authority or specific binding decisional authority in a substantively analogous case.

Are Converted Chapter 13 Debtors Even Poorer than Before?

IN RE HARRIS

- *Vigelahn v. Harris* (*In re Harris*), 2014 U.S. App. LEXIS 12750 (5th Cir. July 7, 2014). Supreme Court Case No. 14-400

- Exception to §1327(b) applied where confirmed plan required plan payments be made to trustee; debtor could not have vested interest as a result;
- Plan binds debtor and creditors, therefore trustee must distribute to creditors per plan;
- Trustee retains authority to disburse even after conversion

In re Michael, 699 F.3d 3056 (3rd Cir. 2012)

- Vesting of property upon confirmation is in the Debtor, absent court order or plan contents, section 1327(b);
- 1994 Amendments to section 348(f) make it clear that Debtor loses post-confirmation property of the estate only if the conversion is in bad faith;
- Section 348(e) terminates chapter 13 trustee upon conversion.

Administrative Holds: Violations of the Automatic Stay?

Mwangi v. Wells Fargo Bank, N.A.
764 F.3d 1168 (9th Cir. 2014)

- Case filed 8/3/2009
- Administrative pledge/freeze/hold placed 8/6/2009 – total funds frozen approximately $15,000
- Trustee and counsel notified 8/6/2009
- Debtors demand turnover of funds, WF refuses
- Debtors file § 362(k) motion on 8/29/2009
- Debtors claimed exemption in approximately 75% of funds as wages under Nevada law

Mwangi v. Wells Fargo Bank, N.A.
764 F.3d 1168 (9th Cir. 2014)

- **Not a Violation**
  - On the Petition Date, funds become property of the estate, not the debtors
  - WF solicited the Trustee for instructions as to treatment (as they claim is required under § 542(b). Therefore, no violation of § 362 as to the Trustee
  - Debtors may only "claim property as exempt" until the objection period for objections expires (or property abandoned). Upon expiration of that time, the property again becomes property of the debtors
  - Once exempt property returned to the debtors, no longer property of the estate and subject to § 362(a)
  - Therefore, no violation of the stay

In re Weidenbenner
521 B.R. 74 (Bankr. S.D.N.Y. 2014)

- Case filed 3/7/2014
- Administrative pledge/freeze/hold placed 3/12/2014
- Trustee and counsel notified 3/12/2014
- Trustee orders funds returned to debtors on 3/17/2014
- During period 3/12-3/17, debtors incur a $25 NSF fee for a bounced check as a result of the pledge/freeze/hold
- Debtors file § 362(k) motion on 3/23/2014
- Court requires a "high ranking policy person from Wells Fargo" to be present to give testimonial evidence regarding how and why Wells Fargo implemented its administrative pledge policy
- Evidentiary hearing held in October 2014

In re Weidenbenner
521 B.R. 74 (Bankr. S.D.N.Y. 2014)

Violation
  - 1984 amendment of § 362(a) added "to exercise control" over property of the estate
  - Unilaterally deciding to place a freeze on property of the estate was a perfect example of "control over property of the estate“
  - § 542(b) does not mandate the hold and did not override the violation of the § 362(a) stay
  - § 542(b) is not one of sections enumerated in § 362(b) to which the automatic stay does not apply
  - Practical reasons: no squirrelling away cash
  - $25.00 NSF was harm to support standing to pursue § 362(k)

Sections 1306(a)(1) and 541(a)(5) and Post-Petition Inheritances – The Majority View Garners Two Additional Followers

In re Zisumbo, 519 B.R. 851 (Bankr. Utah 2014)

Case 1

- Filed 11/2010
- 34.39% 60 month plan
- July 2013 inherited real estate
- Motion to sell property and payoff plan balance with proceeds

Case 2

- Filed 4/2011
- W's parent passes in 2012, inherit cash and vehicle in 12/2013
- H dies in 1/2014, wife obtains insurance proceeds
- W completes plan payments in 4/2014
- Trustee files motion to compel plan amendment in 6/2014

In re Zisumbo:

Property of the estate includes

- § 541(a)(5): Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the peition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—
  - (A) by bequest, devise, or inheritance; . . . or
  - (C) as a beneficiary of a life insurance policy or of a death benefit plan
- § 1306(a): Property of the estate includes, in addition to the property specified in section 541 of this title—
  - (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever comes first.

In re Roberts, 514 B.R. 358 (Bankr. E.D.N.Y. 2014)

- Joint petition filed 12/2011
- 60 month plan with 10% payment to unsecured creditors
- October 2013, H inherits interest in property worth $122,000 and W is laid off
- January 2014 debtors file motion to determine proceeds not property of the estate and modify plan to allow for lump sum payment to payoff plan, or, in the alternative, modify plan to cease regular monthly payments and surrender proceeds in full satisfaction of plan

Credit Reporting and Bankruptcy

Haynes v. Citibank, Bankr. S.D.N.Y (July 22, 2014)

- Original Creditor sold consumer accounts
- Creditor notifies CRAs that debt was charged-off and sold listing balance
- Debtor later files Chapter 7 and receives discharge
- Debtor writes original creditor requesting reporting be changed to "Discharged in Bankruptcy"
- Original Creditor refuses to change prior reporting
- Debtor alleges refusal violates §§ 524(a)(2) and 727
- Debtor seeks class certification

Haynes v. Citibank, Bankr. S.D.N.Y (July 22, 2014)

- Court denies Rule 12(b)(6) motion
- Accepting as true the allegation:

> *Chase has chosen not to advise the credit reporting agencies to the fact that the class members' debts have been discharged because Chase continues to receive payment either directly or indirectly on discharged debts.*

Questions?