Great Debates

Douglas E. Deutsch, Moderator
Chadbourne & Parke LLP; New York

Resolved: A chapter 11 plan can grant a third-party release.

Pro: Hon. Barbara J. Houser
U.S. Bankruptcy Court (N.D. Tex.); Dallas

Con: Hon. Dennis R. Dow
U.S. Bankruptcy Court (W.D. Mo.); Kansas City

Resolved: A bankruptcy judge can disband a creditors' committee.

Pro: Mark T. Power
Hahn & Hessen LLP; New York

Con: Kelly Beaudin Stapleton
Alvarez & Marsal; New York

Resolved: Filing a proof of claim on a time-barred debt violates the FDCPA.

Pro: Theodore O. Bartholow, III
Armstrong Kellett Bartholow P.C.; Dallas

Con: Joann Needleman
Clark Hill, PLC; Philadelphia

Last in Line

By Scott A. Wolfson

Plan's Release of Nondebtors Invalid under *Dow Corning*

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In *National Heritage Foundation Inc. v. Highbourne Foundation*,[1] the Fourth Circuit Court of Appeals recently held a chapter 11 plan's non-consensual, third-party release of nondebtors as invalid because the release lacked adequate factual support. The circuits remain split on whether the Bankruptcy Code permits a plan to release nondebtor parties.[2]

Those allowing such releases do so only in limited circumstances because the releases test "the outer reaches of a bankruptcy court's jurisdiction."[3] The Fourth Circuit applied *Dow Corning*'s six substantive factors test for nondebtor releases[4] and struck the release of the debtor's officers and directors in *National Heritage Foundation*. This article analyzes the Fourth Circuit's decision and provides practical suggestions for objecting to third-party releases in plans.

Return Trip to the Fourth Circuit

The *National Heritage Foundation* case has a long procedural history previously detailed in the *ABI Journal*.[5] The case was before the Fourth Circuit a second time, following its remand to the bankruptcy court to make specific factual findings and to explain why the findings support the plan's nondebtor releases.[6]

National Heritage Foundation (NHF) is a nonprofit public charity that administers and maintains donor-advised funds.[7] These are funds in which donors relinquish all rights and interests in the assets they donate.[8] NHF owns and controls all of the donated assets, but the donors can make nonbinding recommendations regarding the use of the assets.[9]

NHF filed a voluntary chapter 11 petition in 2009 after a state court entered a multimillion-dollar judgment against it.[10] The bankruptcy court approved NHF's fourth amended and restated reorganization plan.[11] The reorganization plan contained a provision releasing NHF, the unsecured creditors' committee and its members, any designated representatives of the committee, and any officers, directors or employees of NHF, the committee, or their successors and assigns (collectively, the "released parties") from all claims relating to the debtor's business.[12] The reorganization plan's release provision provided that the released parties

> shall not have or incur, and are hereby released from, any claim, obligation, cause of action, or liability to any party in interest who has filed a claim or who was given notice of the Debtor's Bankruptcy Case (the "Releasing Parties") for any act or omission before or after the Petition Date through and including the Effective Date in connection with, relating to, or arising out of the operation of the Debtor's business, except to the extent relating to the Debtor's failure to comply with its obligations under the Plan.[13]

Several NHF donors challenged the reorganization plan's confirmation on the grounds that the release provision was invalid.[14] The district court initially affirmed the bankruptcy court's confirmation of the reorganization plan.[15]

In the first appeal, the Fourth Circuit vacated that portion of the district court's judgment affirming the release provision, holding that the bankruptcy court failed to make sufficient factual findings to support its conclusion that the release provision was essential.[16] "Although we reiterated this circuit's longstanding rule that nondebtor releases may be enforced in appropriate circumstances, we cautioned that they should only be approved 'cautiously and

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1 2014 WL 2900933 (4th Cir. June 27, 2014).

2 Prohibiting nondebtor releases: *See, e.g., Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995) ("[Section] 524(e) precludes bankruptcy courts from discharging the liabilities of nondebtors."); *Landsing Diversified Properties II v. The First Nat'l Bank and Trust Co. of Tulsa (In re Western Real Estate Fund)*, 922 F.2d 592, 600-02 (10th Cir. 1990) (citing § 524(e) in refusing to enjoin creditor's suit against nondebtor post-confirmation because permanent injunction "effectively relieves the nondebtor from its own liability to the creditor"). Section 524(e) provides that "[e]xcept as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." No *per se* bar against nondebtor releases: *See, e.g., Deutsche Bank AG, London Branch v. Metromedia Fiber Network Inc. (In re Metromedia Fiber Network Inc.)*, 416 F.3d 136, 141 (2d Cir. 2005) ("[S]uch a release is proper only in rare cases."); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 217 (3d Cir. 2000) (holding that lower courts lacked sufficient evidentiary and legal basis to authorize nondebtor release); *Nat'l Heritage Found. v. Highbourne Found.*, 2014 U.S. App. LEXIS 12144 (4th Cir. June 27, 2014) (allowed in "exceptional circumstances"); *Class Five Nevada Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002) ("[E]njoining a nonconsenting creditor's claim is only appropriate in 'unusual circumstances.'").

3 *Johns-Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52, 55 (2d Cir. 2008), *rev'd sub nom.*, *Travelers Indemn. Co. v. Bailey*, 129 S. Ct. 2195 (2009).

4 *Dow Corning*, 280 F.3d at 658.

5 *See* Jason W. Harbour, "Fourth Circuit Declines to Adopt Blanket Rule against Nonconsensual Nondebtor Releases," *ABI Journal*, Vol. XXXI, No. 2 (March 2012).

6 *Nat'l Heritage Found.* at *2.

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.*

12 *Id.* at *2-*3.

13 *Id.* at *3.

14 *Id.*

15 *Id.*

16 *Id.* at *4.

infrequently.'"[17] To determine whether the appropriate circumstances existed in this case, the Fourth Circuit remanded the case with instructions to the bankruptcy court to consider the six substantive *Dow Corning* factors, specifically, whether:

(1) there is an identity of interests between the debtor and the third party;
(2) the nondebtor has contributed substantial assets to the reorganization;
(3) the injunction is essential to the reorganization;
(4) the impacted class, or classes overwhelmingly voted to accept the plan;
(5) the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; and
(6) the plan provides an opportunity for those claimants who choose not to settle to recover in full.[18]

A different bankruptcy judge considered the case on remand and gave the parties the option of reopening the record to present more evidence, but they declined to do so.[19] The bankruptcy court concluded that only one *Dow Corning* factor had been met and declared the release provision unenforceable.[20] The district court affirmed.[21]

The Fourth Circuit held that NHF failed to carry its burden of proving that the facts and circumstances of the case justified the release provision.[22] It found that only the first *Dow Corning* factor, an identity of interests between NHF and the released parties, existed.[23] The court concluded that an expansive indemnity obligation of NHF to the released parties under NHF's bylaws was sufficient to meet the identity-of-interests factor.[24]

The second *Dow Corning* factor required NHF to demonstrate that the released parties made a substantial contribution of assets to the reorganization.[25] The court found that none of the released parties made any financial contribution to the reorganization.[26] The court also dismissed NHF's assertion that this factor was satisfied by NHF's officers and directors promising to continue to serve, holding that the assertion lacked factual support and that, even if a promise to continue serving NHF had been made, it would not constitute a substantial contribution of assets,[27] nor did their prior service constitute a substantial contribution: "[O]fficers and directors, all of whom are insiders, performed their duties either because they were paid to do so (in the case of [the] officers), or because they had a fiduciary obligation to do so (in the case of the directors)."[28]

The third *Dow Corning* factor required NHF to demonstrate that the release was "essential" to its reorganization.[29] NHF contended that the risk of litigation from its thousands of donors rendered the release provision essential because NHF would likely have to indemnify its officers and directors for their legal expenses should such suits arise.[30] The court recognized the possibility of this indemnity obligation arising, but held that the evidence did not suggest that NHF's reorganization is doomed without the release.[31] "NHF has provided little to no evidence regarding the number of likely donor claims, the nature of such claims, or their potential merit."[32]

Nor did the court view the risk of officer and director flight as rendering the release essential to NHF's reorganization plan.[33] In discounting this risk, the court noted that most of NHF's insiders are members of a single family, and that the release itself provides little inducement for officers and directors to stay because the release would not shield them from liability for their continued service.[34] In addition, if the officers and directors did leave, NHF did not suggest that it would face difficulty recruiting new personnel.[35]

The court also pointed to the reorganization plan's severability clause as further support for its holding that the release was not shown to be essential to NHF's reorganization.[36] The severability clause provided that the reorganization plan would remain in effect "[s]hould any provision in this Plan be determined to be unenforceable," which suggested that the reorganization plan would remain viable absent the release.[37]

"To satisfy the fourth *Dow Corning* factor, NHF was required to prove that the class" affected by the release — the donors — overwhelmingly voted in favor of the plan.[38] The reorganization plan presumed the donor class's support for it without a formal vote because donor claims were eligible for full payment with interest under the plan.[39] NHF also asserted that the donor class's support for the reorganization plan, if not presumed, was irrelevant because the donors are not actually creditors of NHF, having relinquished their ownership and control over the donated assets and maintaining only the ability to make nonbinding recommendations regarding the use of the assets.[40]

The court did not resolve whether an unimpaired class's presumed support for the reorganization plan is sufficient to satisfy this *Dow Corning* factor.[41] The court viewed this factor as weighing "only marginally" in NHF's favor and held that the presumed support "does not make up for the fact that most of the other *Dow Corning* factors weigh against enforcing the Release Provision."[42] The court also noted that the equities weighed against NHF in meeting this factor because the donors, those most affected by the release, were not given the opportunity to accept or reject the plan.[43]

The fifth *Dow Corning* factor addresses whether the debtor's plan provides a mechanism to consider and pay all or substantially all of the class(es) that were affected by

17 *Id.* (quoting *Behrmann v. Nat'l Heritage Found. Inc.*, 663 F.3d 704, 712 (4th Cir. 2011) ("*NHF I*")).
18 *Id.* at *4-*5 (internal quotations omitted).
19 *Id.* at *5.
20 *Id.* at *5-*6.
21 *Id.*
22 *Id.* at *5.
23 *Id.* at *7-*8.
24 *Id.*
25 *Id.* at 8.
26 *Id.*
27 *Id.* at *8-*9.
28 *Id.* at *9 (quoting *NHF I* at 229).
29 *Id.* at *9-*10.
30 *Nat'l Heritage Found.* at *10.
31 *Id.* at *10-*11.
32 *Id.* at *10.
33 *Id.* at *11-*12.
34 *Id.* at *12.
35 *Id.*
36 *Id.* at *12-*13.
37 *Id.* at *13.
38 *Id.*
39 *Id.* at *13-14.
40 *Id.* at *14.
41 *Id.* at *15.
42 *Id.*
43 *Id.*

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the nondebtor release.[44] The court held that this factor was not met because NHF's reorganization plan did not include such a mechanism and NHF did not present any evidence, in the form of expert testimony or otherwise, that NHF made a bona fide effort to ensure the consideration of nearly all of the donor class's claims.[45]

The final *Dow Corning* factor is whether the plan provides an opportunity for those who chose not to settle to recover in full.[46] The court held that this factor, like the fifth factor, was not met, reiterating the import of NHF's failure to provide any mechanism to pay donor claims outside of the bankruptcy proceedings.[47] "[T]he very purpose of the Release Provision is to preclude any recovery from third-party sources outside of the Plan."[48]

Finding that only one *Dow Corning* factor — the identity of interests between NHF and the released parties due to an expansive indemnity provision — had been met, the Fourth Circuit held that NHF had not established "exceptional circumstances" justifying the nondebtor release.[49] The court advised that a debtor need not demonstrate that every *Dow Corning* factor weighs in its favor in order to obtain approval of a nondebtor release, but warned that adequate factual support must be shown to warrant such "exceptional relief."[50]

Objecting to Nonconsensual Nondebtor Releases

While objections will be specific to the nature, scope and context of each plan's proposed nonconsensual nondebtor release, the Fourth Circuit's opinion provides guidance for objecting to plan release provisions. The following are considerations to include.

Adequate Factual Findings

The primary lesson of *National Heritage Foundation* is that adequate factual findings must support the jurisdiction's criteria for allowing a plan's release provision. Objectors in bankruptcy court should proffer evidence opposing the release, and the lack of sufficient factual findings should be exploited at trial and in any appeal.[51]

Expert Testimony

Objectors should not hesitate to provide expert testimony in opposition to the proposed release. NHF's failure to provide any expert testimony, including in connection with the likely number, nature and potential merits of donor claims, and with respect to the plan's protection of donor's interests, was held against it.[52] Objectors should also consider having an expert testify about the alleged substantial contribution by those whom the plan proposes to release.

Plan Severability Clause

Plans routinely contain broad severability clauses, stating that the plan will remain in effect should any provision in it be determined to be unenforceable. A severability clause can be used to an objector's advantage. The Fourth Circuit cited the severability clause in NHF's reorganization plan in holding that the release of nondebtors was not essential to the reorganization plan.[53]

Equitable Mootness

Equitable mootness was not addressed in the *National Heritage Foundation* case, but it is an important consideration in litigating an objection to a plan's nonconsensual nondebtor releases. The Second Circuit in *Deutsche Bank AG, London Branch v. Metromedia Fiber Network Inc. (In re Metromedia Fiber Network Inc.)*,[54] citing *Dow Corning*, held that the bankruptcy court's findings were insufficient to support the validity of the plan's nonconsensual nondebtor release, but dismissed the appeal as "equitably moot."[55] "Equitable mootness is a prudential doctrine that is invoked to avoid disturbing a reorganization plan once [it has been] implemented."[56] The court explained that "an appeal should … be dismissed as moot when, even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable."[57]

The *Metromedia* court gave significance to the fact that the appellants did not seek a stay of the confirmation order, nor did they seek an expedited review of their appeal.[58] The court held that the debtor's plan had been substantially consummated and therefore refused to disturb the bargain that had been struck by the debtor and the released parties.[59] Consequently, those objecting to plan release provisions should diligently pursue a stay of the confirmation order and expedited consideration of any appeal.

Conclusion

A chapter 11 plan's nonconsensual release of nondebtors will typically face an uphill approval battle. The Fourth Circuit's decision in *National Heritage Foundation* outlines the typical areas of dispute and provides guidance for objecting parties.[60] abi

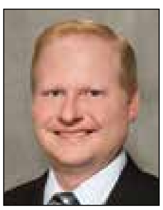
44 *Id.*
45 *Id.* at *17.
46 *Id.*
47 *Id.* at *17-*18.
48 *Id.* (citation and internal quotation omitted).
49 *Id.* at *18-*19.
50 *Id.* at *19.
51 *Id.* at *10.
52 *Id.* at *10 and *17.
53 *Id.* at *12-*13.
54 *Deutsche Bank AG, London Branch v. Metromedia Fiber Network Inc. (In re Metromedia Fiber Network Inc.)*, 416 F.3d 136 (2d Cir. 2005).
55 *Id.* at 139.
56 *Id.* at 144.
57 *Id.* at 143.
58 *Id.* at 144.
59 *Id.* at 145. The court did not indicate whether the debtor's plan contained a severability clause.
60 *Nat'l Heritage Found.* at *20.

Practice & Procedure I

By William L. Medford

Disbanding Committees upon Chapter 11 Trustee Appointment

Do Unsecured Creditors Lose Their Voice?



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The participation of official committees in chapter 11 proceedings is, for many unsecured creditors, the only effective means of active participation. Active participation can meaningfully impact the potential distribution to creditors, as well as the preservation of claims against insiders and/or secured creditors, and prevents small unsecured creditors from suffering a legal hijacking. While large unsecured creditors may have the motivation and financial means to protect their interests and pursue available rights and remedies, small unsecured creditors often lack such means.

Such is the purpose of forming an official committee of unsecured creditors, and this purpose differs from the role of the chapter 11 trustee. A chapter 11 trustee has the duty to represent the interests of the entire bankruptcy estate, not just unsecured creditors. Nonetheless, in a recent case from the U.S. Bankruptcy Court for the Western District of North Carolina, the court granted a chapter 11 trustee's motion to disband the previously formed official committee of unsecured creditors.[1] In granting said motion, the bankruptcy court held, *inter alia*, that the chapter 11 trustee adequately represented the interests of unsecured creditors, making a committee superfluous.[2]

The *Pacific Avenue* Ruling

In *Pacific Avenue*, after appointment, the chapter 11 trustee moved the bankruptcy court to disband the previously formed official committee of unsecured creditors. The court found cause to grant the motion based on (1) a purported lack of necessity to protect creditor interests, (2) the fact that the administrative expense was no longer justified and (3) the court's opinion that the committee had become counterproductive.[3]

The bankruptcy court found that a committee was no longer necessary due to the lack of a stake a committee (as a committee vs. committee members) has in a bankruptcy case, with it operating as "a representative voice for relatively small stakeholders."[4] While noting that a committee is the only such voice while the debtor in possession controls the process, the bankruptcy court found such representation to be adequate in a chapter 11 trustee.[5]

A chapter 11 trustee, the bankruptcy court reasoned, has a statutory duty to unsecured creditors,[6] and as such, the court found a committee to be "duplicative and unnecessary."[7] The court further noted that post-chapter 11 trustee appointment, such a case is typically a liquidation and, as in chapter 7 cases, official committees are not contemplated.[8]

The bankruptcy court predicated its decision on its inherent authority from 11 U.S.C. § 105(d), which provides, "unless inconsistent with another provision of this title or with applicable Federal Rules of Bankruptcy Procedure, [the court] may issue an order at any such conference prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically." The court relied on § 105 due to the lack of any provision regarding the disbanding of an official committee, whether in § 1102 or otherwise.

Section 1102 of Bankruptcy Code

Specifically, 11 U.S.C. § 1102(a) provides:

> (1) Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States [T]rustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States [T]rustee deems appropriate.
>
> (2) On request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States [T]rustee shall appoint any such committee;
>
> (4) On request of a party in interest and after notice and a hearing, the court may order the United States trustee to change the member-

1 *See In re Pacific Avenue LLC*, Case No. 10-32093, Docket No. 744 (Bankr. W.D.N.C. Jan. 26, 2012).
2 *Pacific Avenue* at 3-4.
3 This last factor seems to be a case-specific issue. The author notes that as this case is viewed from the outside, no comment is made regarding any parties' or professional's involvement therein. *Pacific Avenue* at 3-4.
4 *Pacific Avenue* at 3.
5 *Pacific Avenue* at 3.
6 *Pacific Avenue* at 3.
7 *Pacific Avenue* at 3.
8 While § 705 of the Code provides for the formation of an official committee in chapter 7 cases, the 1986 amendments to § 705 did not become effective in North Carolina or Alabama due to their opt-out of the U.S. Trustee Program. *Pacific Avenue* at 3.

ship of a committee appointed under this subsection, if the court determines that the change is necessary to ensure adequate representation of creditors or equity security holders. The court may order the United States trustee to increase the number of members of a committee to include a creditor that is a small business concern (as described in section 3(a)(1) of the Small Business Act), if the court determines that the creditor holds claims (of the kind represented by the committee) the aggregate amount of which, in comparison to the annual gross revenue of that creditor, is disproportionately large.

Section 1102 provides for the appointment of an official committee, as well as the court-ordered appointment of additional committees, if necessary, to ensure adequate representation of creditors.[9] Section 1102(a)(4) even provides authority for a court to change the size or membership of a committee, yet nothing provides authority for disbanding an official committee, nor is there much published precedence for disbanding an official committee. While a few opinions have addressed a court's authority to review a U.S. Trustee's formation of an official committee, none specifically address disbanding. One court has made passing reference, but only to say that the Bankruptcy Code does not specifically address disbanding.[10]

In *JNL Funding*, the court considered a secured creditor's motion to disband the official committee of unsecured creditors. Specifically, the movant asserted that none of the committee members held a note or guaranty executed by the debtor, and that each committee member's notes were executed by the debtor's principal, who was also a debtor-in-bankruptcy.

Although the court noted that § 1102 was silent as to disbanding a committee, the court stated that "the majority of courts [have held] that a bankruptcy court has the inherent power, as well as statutory authority under Section 105(a), to review acts of the [U.S. Trustee], under an 'arbitrary and capricious' or 'abuse of discretion' standard of review."[11] The court reasoned that the arbitrary and capricious standard was the appropriate standard, as compared to a *de novo* review, since the U.S. Trustee's formation and appointment of committees was an administrative act rather than a judicial act.[12] In fact, it is the administrative task aspect of committee formation and appointment that led Congress "to transfer authority to appoint the chapter 11 committee of unsecured creditors from the court to the United States [T]rustee."[13]

In holding that it had authority to review a U.S. Trustee's committee formation/appointment, the court analogized such a review to a review of an administrative agency carrying out its administrative functions.[14] Thus, "review of the [U.S. Trustee]'s action is similar to review of an agency exercising a power delegated by Congress to act, subject to review by a court. Judicial review of action by the [U.S. Trustee] in carrying out a power specifically delegated by Congress should be under the same arbitrary and capricious standard as is judicial review conducted by a court of an administrative agency's action under the [Administrative Procedures Act, 5 U.S.C. §§ 701, *et seq*.]."[15]

While determining that it had authority to review the U.S. Trustee's committee formation/appointment, the court ultimately determined that the U.S. Trustee had not acted arbitrarily and/or capriciously.[16] As such, the court did not address its authority if it had found arbitrary and capricious acts.[17] Accordingly, the court did not rule that it had authority to disband the committee as a whole, nor did the court address whether the appropriate remedy would have been to order the U.S. Trustee to appoint replacement committee members, authority that Congress removed from the courts and delegated to the U.S. Trustee in the 1986 Amendments.

The issue is that of congressional intent: Did Congress intend to relegate all authority to form and appoint official committees to the U.S. Trustee, or does the bankruptcy court have remaining authority to disband, appoint or form additional committees? While § 1102(a)(2) and (4) provides for a bankruptcy court to order the change of membership and even order the appointment of additional committees, § 1102(a) expressly states that the U.S. Trustee has the authority to form and appoint committees and their members. In fact, the express language of § 1102(a), "on request of party-in-interest," prohibits a court from *sua sponte* ordering the appointment of additional members and/or the formation of additional committees.

The *JNL Funding* court reviewed committee formation. *Pacific Avenue*, on the other hand, goes a step further in what appears to be a clash of judicial authority and the delegation of authority to the U.S. Trustee's office. *Pacific Avenue* is a case from an opt-out district, and as such, there was no U.S. Trustee to opine, object to or otherwise participate in the bankruptcy court's decision. Consequently, the *Pacific Avenue* holding may have limited precedence in most other districts.

Irrespective, the *Pacific Avenue* opinion is a case-specific result. The bankruptcy court did not state that disbanding a committee upon chapter 11 trustee appointment is appropriate in all cases, nor would it be correct in such a statement. Indeed, the dynamics of bankruptcy proceedings vary widely. A proceeding without a major secured creditor, for example, would have less of a need for a committee than a case where a major secured creditor was driving the case. Further, the divergent interests of unsecured creditors vs. equity interest-holders (in the rare circumstances of when equity could receive a return) creates a circumstance in which a chapter 11 trustee has differing constituents to consider and represent. In fact, such a circumstance might actually warrant an additional committee.

Committee Push-Back

For a committee threatened with a chapter 11 trustee's motion to disband, there is a little-known counter-offensive: § 1104(b). Indeed, while § 1104(a) of the Bankruptcy Code provides that the U.S. Trustee shall appoint a chapter 11 trustee, subsection (b) provides for the *election* of a chapter 11 trustee.[18] Election of a chapter 11 trustee follows the same procedure of elect-

9 *See* 11 U.S.C. § 1102(a).
10 *See In re JNL Funding Corp.*, 438 B.R. 356, 361 (Bankr. E.D.N.Y. 2010).
11 *JNL Funding*, 438 B.R. at 360 (citing *In re Mercury Fin. Co.*, 240 B.R. 270 (E.D. Ill. 1999); *In re Barney's Inc.*, 197 B.R. 431, 438 (Bankr. S.D.N.Y. 1996)).
12 *JNL Funding*, 438 B.R. at 360-62.
13 H.R. Rep. No. 99-764, 99th Cong., 2d Sess. 28 (1986), *reprinted in* U.S.C.C.A.N. at 5227, 5241.
14 *JNL Funding*, 438 B.R. at 362.
15 *Id.* at 363.
16 *Id.* at 363-64.
17 *Id.*
18 11 U.S.C. § 1104(b).

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ing a chapter 7 trustee under 11 U.S.C. § 702, though the timing varies slightly.

Specifically, § 1104(b) states that such an election must occur within 30 days of the appointment of a chapter 11 trustee. While such an election is time-sensitive, because the largest unsecured creditors typically make up the committee, authority exists under the Bankruptcy Code to alter the course of a bankruptcy proceeding via the election of a more "committee friendly" chapter 11 trustee.

Conclusion

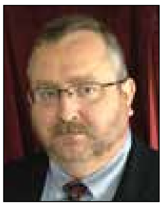
Pacific Avenue is one of those decisions that, upon first blush, alarms bankruptcy practitioners. Practitioners should be mindful that *Pacific Avenue* was a case-specific determination issued in an opt-out district. While those involved in the *Pacific Avenue* case certainly have their own opinions on the propriety of disbanding the official committee, others can only review from the outside and analyze how to apply such reasoning to future cases.

In attempting to avoid a motion to disband a committee post-chapter 11 trustee appointment, a committee must consider how and why it remains relevant to a case. For example, are there diverging party interests that prevents a chapter 11 trustee from fully representing unsecured creditors? Is there a major secured creditor aggressively driving a case? Is the chapter 11 trustee willing to waive claims against a secured creditor to obtain post-petition financing? Such factors, when and where they exist, weigh against disbanding a committee. abi

Feature

By James J. Haller and Tara Twomey

Debt Collectors Should Not Get a Free Pass in Bankruptcy



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This article supports the proposition that the Fair Debt Collection Practices Act (FDCPA)[1] applies to proofs of claim filed by debt collectors for debt obligations beyond the applicable statute of limitations. Dissenting opinions mistakenly preclude liability based on unrealistic "safeguards" against debt-collector abuse or a nonexistent conflict between the Bankruptcy Code and FDCPA. Instead of conflicting with the Code, the application of the FDCPA in the case of "stale" claims complements the bankruptcy-claims process and protects the integrity of a system that allocates a debtor's scarce resources among creditors with legally enforceable claims.[2]

Background

The concept that filing a proof of claim based on an unenforceable debt obligation violates the FDCPA rose to national prominence with the decision of the Eleventh Circuit Court of Appeals in *Crawford v. LVNV Funding LLC*.[3] The *Crawford* court began its analysis by correctly stating that debt collectors who attempt to collect stale debt through state court actions violate §§ 1692e and 1692f of the FDCPA.[4] Such collection actions are considered misleading, deceptive or unfair because unsophisticated consumers are generally unaware of a statute-of-limitations defense and do not have the memory or records to raise the defense.[5] Further, by filing a state court lawsuit, a debt collector falsely represents that the debt obligation is legally enforceable. By analogy, the *Crawford* court concluded that debt collectors filing stale claims in a bankruptcy case also violate the FDCPA.[6]

Since *Crawford*, many courts have chimed in on whether debt collectors violate the FDCPA by filing a stale claim in a bankruptcy case. Courts have reached different conclusions, and the issue is now on appeal in multiple circuits.[7] This issue has been written about numerous times, including a recent *ABI Journal* article by our colleagues **Alane A. Becket**, who serves as ABI's Vice President-Publications, and **William A. McNeal** of Pennsylvania-based Becket & Lee, LLP.[8]

The cases disagreeing with *Crawford* commonly find that either (1) an FDCPA violation is precluded by the Bankruptcy Code's claims process, or (2) filing an untimely claim is not deceptive, misleading or unfair to the least-sophisticated debtor and therefore does not violate the FDCPA. We believe, however, that the better reasoning is to the contrary: Preclusion of FDCPA claims is not supported by the text of the Bankruptcy Code or as a result of an irreconcilable conflict between the two statutes. Instead, the viability of FDCPA claims protects debtors and maintains the integrity of the bankruptcy-claims process. Other bankruptcy courts have held that the least-sophisticated-consumer standard does not apply in the bankruptcy context because debtors are protected by the safeguards embedded within the Bankruptcy Code and Rules.[9] However, these "safeguards" do not exist in the daily trenches of bankruptcy practice and they should not be used to shield debt collectors from liability.

FDCPA Crucial in Maintaining Integrity of the Bankruptcy-Claims Process

"[W]hen two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective."[10] The standard for establishing preclusion requires clear text or irreconcilable conflict between two statutes. There is no direct

1 *See* 11 U.S.C. § 1692, *et seq.*

2 Contrary to debt collectors' assertions, a debt obligation beyond the applicable statute of limitations is not a legally enforceable claim for which they have a right to payment under the Bankruptcy Code. *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559 (1990) ("The plain meaning of a 'right to payment' is nothing more nor less than an enforceable obligation...."); *McMahon v. LVNV Funding LLC*, 744 F.3d 1010, 1020 (7th Cir. 2014) (time-barred claims are not "legally enforceable"); *Huertas v. Galaxy Asset Mgmt.*, 641 F.3d 28, 32 (3d Cir. 2011) (statute of limitations "renders [the debt] unenforceable"); *see also* 11 U.S.C. § 101(5)(A) (defining "claim" as "right to payment").

3 758 F.3d 1254 (11th Cir. 2014), *cert. denied*, 135 S. Ct. 1844 (2015).

4 *Id.* at 1259-60 (collecting cases); *see also* 15 U.S.C. § 1692e (prohibiting false, misleading or deceptive representations); 15 U.S.C. § 1692f (prohibiting unfair or unconscionable conduct).

5 *See Phillips v. Asset Acceptance LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013) (citing *Kimber v. Federal Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987)). This rationale is supported by the underlying reason for statutes of limitations in general: They "represent a pervasive legislative judgment that it is unjust to fail to put the adversary on notice to defend within a specified period of time...." *United States v. Kubrick*, 444 U.S. 111, 117 (1979). Furthermore, "the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Id.* at 117 (citations omitted). Although a debtor may feel that he/she has a moral obligation to pay the debt, the debtor is no longer compelled to pay under the law.

6 *Crawford*, 758 F.3d at 1261; *see also In re Edwards*, -- B.R. --, 2015 WL 5830823, at *4-5 (Bankr. N.D. Ill. Oct. 6, 2015) (finding strong similarities between collection lawsuits outside of bankruptcy and proofs of claim in a bankruptcy case).

7 *See, e.g., Owens v. LVNV Funding LLC*, 2015 WL 1826005 (S.D. Ind. April 21, 2015), *appeal docketed*, No. 15-2044 (7th Cir. May 13, 2015); *Torres v. Asset Acceptance LLC*, ––– F. Supp. 3d ––––, 2015 WL 1529297 (E.D. Pa. 2015), *appeal docketed*, No. 15-2132 (3d Cir. May 13, 2015).

8 Alane A. Becket and William A. McNeal, "A Claimant's Dilemma: The Statute of Limitations and Proofs of Claim," XXXIV *ABI Journal* 4, 50-51, 104, April 2015. *See also* Kailey Grant, Katherine Yonover and Scott Zimmerman, "Cracking the *Crawford* Code: Treatment of Time-Barred Claims in Bankruptcy Proceedings," XXXIV *ABI Journal* 9, 34-35, 84, September 2015. Both articles are available at abi.org/abi-journal.

9 *See In re LaGrone*, 525 B.R. 419, 427 (Bankr. N.D. Ill. 2015); *Birtchman v. LVNV Funding LLC*, No. 1:14-CV-00713-JMS, 2015 WL 1825970, at *7-8 (S.D. Ind. April 22, 2015); *In re Perkins*, 533 B.R. 242, 261 (Bankr. W.D. Mich. 2015).

10 *J.E.M. Ag Supply Inc. v. Pioneer Hi-Bred Int'l Inc.*, 534 U.S. 124, 143-44 (2001); *Morton v. Mancari*, 417 U.S. 535, 550 (1974).

textual conflict between the Bankruptcy Code and FDCPA on this issue. Further, there is no implied preclusion because there is no irreconcilable conflict between the two statutes.[11]

Although the Bankruptcy Code contains a process for filing proofs of claim, nothing in that process compels a debt collector to file a claim for a *legally unenforceable debt*.[12] That is, the Bankruptcy Code's permissive language does not authorize conduct that is otherwise prohibited by the FDCPA. Furthermore, the fact that debt collectors are singled out for additional regulation does not create a conflict; it reflects Congress's considered judgment that this particular group imposes heightened risks of public harm and that their behavior must be restricted in ways that do not affect ordinary creditors.

The bankruptcy claims process is designed to run fairly and efficiently. It sets presumptions in favor of the validity of claims in order to expedite claims resolution. It is antithetical to the efficient operation of the system to allow debt collectors to engage in the pointless exercise of filing proofs of claim for debt obligations that are legally unenforceable with the expectation that debtor's counsel, the chapter 13 trustee or the U.S. Trustee Program (USTP) will spend valuable time and resources to object to that claim. Congress intended the FDCPA to fill the gaps of other laws, and it does exactly that: It prevents debt collectors from abusing the court system, including the bankruptcy courts, by filing knowingly invalid claims — all in the hopes of collecting when the process fails, not when it performs as intended.

Cases Distinguishing *Crawford* Rely on Illusory Safeguards

Those courts that hold that filing stale claims is not misleading, deceptive or unfair generally identify three illusory safeguards that protect debtors: (1) the Bankruptcy Rules that require disclosure of certain information related to the age of the debt; (2) the assumption that bankruptcy debtors are usually represented by an attorney; and (3) the assumption that the chapter 13 trustee or U.S. Trustee's Program will object to stale claims.[13]

False Safeguard No. 1

Debt collectors *must* disclose information in their proof of claim that identifies whether the statute of limitations has expired. Therefore, it is much easier to discover and object to stale claims.

Although debt collectors are supposed to disclose information that would identify a stale claim, there is no easy enforcement mechanism or motivating penalty that applies when that information is omitted. Fed. R. Bankr. P. 3001(c)(3), in relevant part, requires a debt collector to list the dates of the last transaction, the date of the last payment and the date the account was charged to profit or loss. The very purpose of the rule was to assist parties in identifying stale claims.[14] However, this rule is not easily enforceable because failure to include this information is not an independent basis to object to a proof of claim.[15] Instead, objections must fall into the categories listed in § 502(b). If the case proceeds to a final determination, the court *may* impose a penalty for failing to include this information.[16]

> **The bankruptcy safeguards relied upon to distinguish *Crawford* and deny debtors the protections of the FDCPA are, in actuality, ineffective.**

Debtors have limited tools to use in obtaining omitted information regarding a deficient claim, and the cost of employing such tools is extraordinary and often prohibitively expensive. Depending on the jurisdiction and inclination of the bankruptcy judge, the debtor may seek a court order for a Rule 2004 exam of the debt collector who filed the deficient proof of claim, file an adversary complaint to obtain an injunction or other equitable relief against the debt collector filing the proof of claim,[17] initiate the process for sanctions under Rule 9011 or refer the matter to the U.S. Trustee's Office for the filing of a false pleading, or ask the court to use its powers under § 105 to compel the debt collector to abide by Rule 3001. All of these options rely on the debtor's records and memory to establish a good-faith basis for filing the motion or adversary proceeding, and courts have expressed significant concern over just such reliance outside of the bankruptcy context.

In bankruptcy practice, these tools are scarcely used when claims are deficient because of the steep cost of obtaining debt-collector compliance. The bottom line is this: A debt collector who fails to include or inserts inaccurate information related to the statute of limitations is effectively insulated from an objection to the claim. This insulation prevents Rule 3001(c)(3) from acting as a full safeguard against abuse.

False Safeguard No. 2

The job of the debtor's attorney is to object to claims based upon time-barred debts. The economics of a standard debtor's chapter 13 case often diminishes the importance of objecting to claims if the plan proposes to pay back less than 100 percent of all claims. In most chapter 13 cases, a debtor does not propose to pay back his/her creditors in full. In those cases, the claims that are filed are paid *pro rata* with other claims; the parties who suffer from the allowance of time-barred claims are other creditors who have their *pro rata* claims diluted and are therefore paid less.[18] Even in cases for

11 *See In re Feggins*, -- B.R. --, 2015 WL 5011224 (Bankr. M.D. Ala. Aug. 25, 2015).

12 It is a violation of the FDCPA for debt collectors to represent that a debt is *legally enforceable* in a bankruptcy case. A claim on a time-barred debt is automatically "allowed" upon filing under 11 U.S.C. § 502(a) and is *per se* legally enforceable against a debtor's estate. The filing of a time-barred proof of claim is therefore legal enforcement of a legally unenforceable claim. It is certainly not an *invitation* to repay the time-barred debt as a moral obligation. *See McMahon*, 744 F.3d at 1020.

13 *See LaGrone*, 525 B.R. at 427; *Birtchman*, at *7-8; Perkins, 533 B.R. at 261.

14 *See LaGrone*, 525 B.R. at 427("As explained in the Advisory Committee Notes to the 2012 Amendments, these required disclosures were designed to 'provide a basis for assessing the timeliness of the claim.'").

15 *In re Reynolds*, 470 B.R. 138, 145 (Bankr. D. Colo. 2012) (since "claim disallowance falls outside of the remedies enumerated under Rule 3001(c)(2)(D), the rule precludes such a remedy"); *see also In re Critten*, 528 B.R. 835, 840-41 (Bankr. M.D. Ala. 2015) (collecting cases).

16 *See* Fed. R. Bankr. P. 3001(c)(2).

17 *See* Fed. R. Bankr. P. 7001(7) and 7001(9).

18 *See* 15 U.S.C. § 1692(e) (stating that FDCPA's purpose includes "eliminat[ing] abusive debt-collection practices by debt collectors" and ensuring "that those debt collectors who refrain from using abusive debt-collection practices are not competitively disadvantaged").

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Debt Collectors Should Not Get a Free Pass in Bankruptcy

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which 100 percent of claims are going to be paid, it remains time-consuming and expensive to object to claims, particularly when the proof of claim is deficient. Debtors cannot afford the cost of litigating small unsecured claims, and most debtors' attorneys do not have the time or resources to litigate the issue without compensation.

False Safeguard No. 3

The chapter 13 trustee or USTP will object to the claim. The Bankruptcy Code provides that a trustee can object to a claim "*if a purpose will be served*."[19] Most trustees will follow the same rationale as debtors' counsel that those harmed are only other unsecured creditors. In practice, trustees rarely, if ever, object to debt collectors' stale claims, nor do trustees expend resources to ensure compliance with Rule 3001(c)(3).[20]

The USTP is the only national enforcer of the Bankruptcy Rules,[21] but it only investigates a tiny fraction of filed claims and initiates even fewer enforcement actions. In July 2014, Executive Office for U.S. Trustees Executive Director **Clifford J. White, III** stated that in the previous 10-month period, the USTP reviewed more than 22,000 claims and found great variation in compliance among filers.[22] In almost that same period (between June 30, 2013, and June 30, 2014), there were 321,278 chapter 13 cases filed.[23] If one takes a conservative estimate of only five unsecured claims filed in each chapter 13 case, then approximately 1,606,390 claims were filed in chapter 13 cases in that period. Therefore, conservatively, the USTP reviewed only about 1.4 percent of claims for compliance with the rules and found levels of compliance varied even among that small sample, but did not take any public enforcement action against debt collectors. Simply put, none of these "safeguards" provide debtors any actual protection in the vast majority of bankruptcy cases.

Conclusion

The bankruptcy safeguards relied upon to distinguish *Crawford* and deny debtors the protections of the FDCPA are, in actuality, ineffective. Arguments that the Bankruptcy Code precludes application of the FDCPA to debt collectors filing stale claims in bankruptcy are similarly without support in the statutory text or case law. The proper application of the FDCPA to debt collectors filing stale claims in bankruptcy cases protects debtors and preserves the integrity of the bankruptcy-claims process. abi

19 *See* 11 U.S.C. § 1302(b)(1) (incorporating 11 U.S.C. § 704(a)(5)).
20 *See In re Edwards*, -- B.R. --, 2015 WL 5830823, at *5 (Bankr. N.D. Ill. Oct. 6, 2015).
21 Statement of Clifford J. White III before the Committee on the Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law, U.S. House of Representatives at a Hearing Entitled "Ongoing Oversight: Monitoring the Activities of the U.S. Trustee Program," May 19, 2015, p. 6, *available at* www.justice.gov/file/440401/download.
22 Remarks of Clifford J. White III before the 49th Annual National Association of Chapter 13 Trustees Seminar on July 17, 2014, p. 3, *available at* www.justice.gov/sites/default/files/ust/legacy/2014/07/17/NACTT_49th_Annual_Sem_07172014.pdf.
23 *See* Table F-2 — U.S. Bankruptcy Courts Statistical Tables for the Federal Judiciary (June 30, 2014), *available at* www.uscourts.gov/statistics/table/f-2/statistical-tables-federal-judiciary/2014/06/30.

Last in Line

By Kailey Grant, Katherine Yonover and Scott Zimmerman[1]

Cracking the *Crawford* Code

Treatment of Time-Barred Claims in Bankruptcy Proceedings

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Last year, the Eleventh Circuit in *Crawford v. LVNV Funding LLC* held that the filing of a proof of claim based on a debt for which the statute of limitations has passed is a violation of the Fair Debt Collection Practices Act (FDCPA).[2] In *Crawford*, the plaintiff owed more than $2,000 to a furniture company. The statute of limitations for the enforcement of that debt expired in 2004. Nevertheless, LVNV Funding LLC filed a proof of claim to collect the debt and was subsequently held to be in violation of the FDCPA.[3]

As previously noted in an *ABI Journal* article,[4] *Crawford* is noteworthy because it "created a split among the circuits by being the only one to rule that merely filing a proof of claim for a time-barred debt was an FDCPA violation,"[5] and in doing so confronted the "discreet subset of bankruptcy claimants ... defined by the FDCPA as 'debt collectors'"[6] with the potential for FDCPA liability.

Since *Crawford*, in the absence of guidance by other circuit courts or the U.S. Supreme Court, many district and bankruptcy courts have addressed the issue of whether the pursuit of time-barred debts in bankruptcy proceedings violates the FDCPA. This article examines the lower-court decisions addressing that issue, with particular attention given to the underlying policy reasons for the divergent outcomes.[7] The analysis will illuminate why the filing of a time-barred proof of claim should be treated as a violation of the FDCPA, even in the context of bankruptcy. In addition, this article provides guidance on how practitioners should operate in a post-*Crawford* world.

FDCPA Background

The FDCPA was enacted in 1996 "to eliminate abusive debt-collection practices by debt collectors, to [e]nsure that those debt collectors who refrain from using abusive debt-collection practices are not completely disadvantaged, and to promote consistent State action to protect consumers against debt-collection abuses."[8] The FDCPA prohibits debt collectors from using "any false, deceptive, or misleading representation or means in connection with the collection of any debt."[9] This includes making "false representation of the character, amount, or legal status of any debt," "threat[ening] to take any action that cannot be legally taken or that is not intended to be taken," and "fail[ing] to communicate that a disputed debt is disputed."[10]

Courts Adopting *Crawford* Position

One line of cases adopts the *Crawford* position that the filing of a time-barred proof of claim to collect debt after the statute of limitations period has expired is a violation of the FDCPA.[11] Courts following *Crawford* are primarily concerned with unsophisticated consumers being deceived by creditors. The risk of deception is particularly dire for *pro se* debtors who do not have access to legal counsel.

The *Crawford* court recognized the following arguments: (1) it is unlikely that unsophisticated consumers are aware of the option to file an objection to proofs of claim;[12] (2) unsophisticated consumers are more likely to comply with proofs of claim rather than expend the time and resources necessary to contest them;[13] and (3) the lapse of time makes it difficult for unsophisticated consumers to defend against time-barred claims.[14] Courts following *Crawford* generally invoke at least one of these policy arguments.[15]

For example, *Patrick v. Pyod* adopted the first argument from *Crawford*.[16] In this case, the court explained that while a chapter 13 debtor or trustee

1 Written with guidance from **Deborah L. Thorne**, a partner in the Finance, Insolvency and Restructuring Department of Barnes & Thornburg LLP. Ms. Thorne also serves as ABI's Vice President-Communication and Information Technology.

2 758 F.3d 1254 (11th Cir. 2014).

3 *Id.* at 1257.

4 Alane A. Becket and William A. McNeal, "A Claimant's Dilemma: The Statute of Limitations and Proofs of Claim," XXXIV *ABI Journal* 4, 50-51, 104, April 2015, *available at* abi.org/abi-journal.

5 *Id.* at 50.

6 *Id.* at 104.

7 Some courts have addressed this issue indirectly by ruling on whether the Bankruptcy Code pre-empts the FDCPA. *See, e.g., In re Broadrick*, 532 B.R. 60 (Bankr. M.D. Tenn. 2015) ("The only approach ... is to limit the circumstances when the FDCPA can be invoked in the bankruptcy proof of claim context."); *Johnson v. Midland Funding LLC*, 528 B.R. 462 (S.D. Ala. 2015) ("And because there is irreconcilable conflict, the [FDCPA] must give way to the [Bankruptcy] Code."); *Garfield v. Ocwen Loan Servs. LLC*, 526 B.R. 471 (W.D.N.Y. 2015) (finding borrower's FDCPA claims pre-empted by Bankruptcy Code when loan servicer attempted to collect debt that was previously discharged in prior bankruptcy proceeding). A full discussion of these cases is beyond the scope of this article.

8 15 U.S.C. § 1692e (2014).

9 *Id.*

10 *Id.*

11 *See, e.g., In re Brimmage*, 523 B.R. 134 (Bankr. N.D. Ill. 2015); *Patrick v. Worldwide Asset Purchasing II LLC*, No. 1:14-CV-00544-TWP, 2015 WL 627379, at *1 (S.D. Ind. Feb. 13, 2015); *Grandidier v. Quantum3 Grp. LLC*, No. 1:14-CV-00138-RLY, 2014 WL 6908482, at *1 (S.D. Ind. Dec. 8, 2014); *Patrick v. Pyod LLC*, 39 F. Supp. 3d 1032 (S.D. Ind. 2014); *Taylor v. Galaxy Asset Purchasing LLC*, No. 14 C 9276, 2015 WL 3645668 (N.D. Ill. June 11, 2015).

12 *Crawford*, 758 F.3d at 1254.

13 *Id.*

14 *Id.* at 1261 (finding that statutes of limitations are meant to "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").

15 *See infra*, n.11.

16 *Patrick v. Pyod LLC*, 39 F. Supp. 3d at 1032.

has the opportunity to object to a proof of claim, an unsophisticated debtor may not be aware of this option.[17] If an objection is not made, then the time-barred claim would be automatically allowed against the debtor as a result of the Bankruptcy Code's automatic allowance provision.[18] The court also recognized that the filing of a time-barred proof of claim in a bankruptcy proceeding could give a debtor the incorrect impression that the creditor has the ability to legally enforce repayment of the debt owed.[19] Therefore, the *Patrick* court agreed with *Crawford* and held that the filing of a time-barred proof of claim is "unfair," "unconscionable," "deceptive" and "misleading" within the scope of §§ 1692e and 1692f.[20] Another district court case, *Reed v. LVNV Funding LLC*, adopted *Crawford*'s second argument that even if the unsophisticated consumer is aware of the option to make an objection, filing any objection requires expending unnecessary time and resources.[21]

Courts Disagreeing with *Crawford*

In contrast, there is a long line of lower-court decisions that disagree with *Crawford* and find that filing a time-barred proof of claim in bankruptcy is not a violation of the FDCPA.[22] One bankruptcy case, *In re Murff*, disagreed with *Patrick*'s analysis.[23] *Murff* provided three separate rationales as to why the bankruptcy claims process does not raise the same concerns as collection actions and therefore does not implicate FDCPA liability.

First, the court asserts that debtors are not the only participants in bankruptcy proceedings and that they have the benefit of a trustee who has a fiduciary duty to examine proofs of claim and object to anything improper.[24] Furthermore, the court alleges that debtors in bankruptcy actions generally have less at stake than defendants in collection actions.[25] For example, if a time-barred claim is allowed in a bankruptcy proceeding, the creditors are the ones who are harmed in actuality rather than the debtor because the creditors will receive a lower *pro rata* distribution.[26] Finally, the court claims that debtors in bankruptcy proceedings are more likely to have the benefit of counsel than defendants in collection actions.[27] The court alleges that this is due to the fact that defendants in collection actions must retain counsel specifically to defend the action, whereas debtors have likely been represented from the inception of the proceedings.[28]

In addition, a recent bankruptcy opinion, *In re Perkins*, expressly declines to follow *Crawford*'s holding and emphasizes several policy reasons for doing so.[29] The *Perkins* court focused mainly on the differences that exist between collection actions and bankruptcy proceedings, and the protections that the Bankruptcy Code offers debtors, which the court asserted would dilute or eliminate the concerns raised by *Crawford*. First, the court highlighted the fact that the debtor was the defendant in a collection action and, therefore, had to assert the statute of limitations of defense.[30] Similar to *Murff*, the court emphasized the debtor's benefit of likely having access to counsel and a trustee in bankruptcy proceedings, which allows for oversight.[31] Second, debtors have the benefit of an automatic stay in bankruptcy, which the court maintains "provides a structured means by which to review and object to claims asserted by debt collectors."[32] Due to these alleged protections offered by the Bankruptcy Code, the *Perkins* court held that filing a stale proof of claim is not "unfair, unconscionable, misleading or deceptive conduct" as required to state a claim under the FDCPA.[33]

Special Problems of *Pro Se* Debtors

The policy arguments against *Crawford* are mostly predicated on the assumption that the debtor has access to counsel. However, this is not always the case, and these arguments are inapplicable to a growing population of debtors who are most vulnerable to the filing of these time-barred claims: *pro se* debtors. From 2005-11, the Administrative Office of U.S. Courts conducted a study of bankruptcy filings that highlighted a concerning trend.[34] During a five-year period, bankruptcy debtors with legal representation increased 98 percent, while *pro se* filings increased a dramatic 187 percent over the same time period.[35]

The alleged protections available in the Bankruptcy Code, as highlighted by *Perkins*, are insufficient to protect this growing population of *pro se* debtors. As explained in *Crawford*, unsophisticated *pro se* debtors are often unaware of the option to object to time-barred claims.[36] Even if a *pro se* debtor is aware of the opportunity to object, objecting to time-barred claims is costly and time-consuming, and can be difficult to defend.[37]

Even disregarding the vulnerability of *pro se* debtors, the *Crawford* approach is also preferable from a fundamental fairness standpoint. As noted in *Patrick*, the FDCPA claims are necessary to prevent creditors from using "the bankruptcy system to collect upon a debt, which it cannot use other legal means to collect."[38] Were it not for FDCPA actions, bankruptcy proceedings would provide creditors with a means to circumvent state statutes of limitations on

17 *Id.* at 1036.
18 11 U.S.C. § 502(a) and (b); *Grandidier*, 2014 WL 6908482, at *2 ("When a proof of claim is filed, it is deemed allowed unless a party in interest objects. If a party in interest objects, the bankruptcy court determines whether the proof of claim will ultimately be allowed and the amount of the claim allowed.").
19 *Patrick*, 39 F. Supp. 3d at 1036 (citing *Crawford*, 758 F.3d at 1259-60).
20 *Id.*
21 *Reed v. LVNV Funding LLC*, No. 14 C 8371, 2015 WL 1510375, at *3 (N.D. Ill. March 27, 2015).
22 *See, e.g., Torres v. Asset Acceptance LLC*, No. CIV.A.14-6542, 2015 WL 1529297 (E.D. Pa. April 7, 2015), *appeal docketed*, No. 15-2132 (3d Cir. May 13, 2015); *In re Dunaway*, 531 B.R. 267 (W.D. Mo. May 19, 2015); *In re Broadrick*, 532 B.R. 60 (Bankr. M.D. Tenn. 2015); *Birtchman v. LVNV Funding LLC*, No. 1:14-CV-00713-JMS, 2015 WL 1825970 (S.D. Ind. April 22, 2015); *Robinson v. eCast Settlement Corp.*, No. 14-CV-8297, 2015 WL 494626 (N.D. Ill. Feb. 3, 2015); *In re LaGrone*, 525 B.R. 419 (Bankr. N.D. Ill. 2015); *Donaldson v. LVNV Funding LLC*, No. 1:14-CV-01979-LJM, 2015 WL 1539607 (S.D. Ind. April 7, 2015); *Owens v. LVNV Funding LLC*, No. 1:14-CV-02083-JMS, 2015 WL 1826005 (S.D. Ind. April 21, 2015), *appeal docketed*, No. 15-2044 (7th Cir. May 13, 2015).
23 No. 13-B-44431, 2015 WL 3690994 (Bankr. N.D. Ill. June 15, 2015).
24 *Id.* at *5.
25 *Id.*
26 *Id.*
27 *Id.*
28 *Id.*

29 533 B.R. 242, 2015 WL 4312313 (Bankr. W.D. Mich. 2015).
30 *Id.* at *14.
31 *Id.; see also Murff*, 2015 WL 3690994, at *5.
32 *Perkins*, 2015 WL 4312313, at *15.
33 *Id.*
34 Joseph Callanan, "*Pro Se* Bankruptcy Filings Growing Faster than Other Debtor Relief," *ABA Litigation News* (Dec. 29, 2011), *available at* apps.americanbar.org/litigation/litigationnews/top_stories/010312-pro-se-bankruptcy-growing.html (last visited July 27, 2015).
35 *Id.*
36 *Crawford*, 758 F.3d at 1261.
37 *Id.*
38 39 F. Supp. 3d at 1036.

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debt collection. Furthermore, the *Crawford* position favors creditors who file proofs of claim for which the statute of limitations has not run. Unless FDCPA actions are allowed, additional creditors would be able to file proofs of claim, thereby reducing the *pro rata* share of the bankruptcy estate to which creditors who have complied with the applicable statute of limitations would otherwise be entitled. Whereas the *Murff* court seemed to suggest that this adverse effect to creditors was a reason not to allow FDCPA actions,[39] it is logical that the more timely creditors be treated preferentially in bankruptcy proceedings.

Takeaway: Tap Brakes Before Filing PoC

The law surrounding time-barred proofs of claim is far from settled and likely to change. Several cases within the same circuits — and even the same districts — have come out on opposite sides of this issue.[40] Thus, it is ripe for appellate review and in fact, appeals are currently pending in the Third and Seventh Circuits.[41]

In light of the discord surrounding this issue, legal practitioners should err on the side of caution and operate as if the filing of a time-barred proof of claim would constitute a violation of the FDCPA. The risk of being subject to FDCPA liability is significant enough that practitioners should proceed as if *Crawford*'s holding applies regardless of jurisdiction. Although the U.S. Supreme Court denied the petition for *certiorari* in *Crawford*,[42] the unfolding legal landscape characterized by conflicting opinions across and within jurisdictions signifies that this issue warrants Supreme Court guidance. abi

39 2015 WL 3690994, at *5.

40 *See, e.g., Birtchman*, 2015 WL 1825970; *Robinson*, 2015 WL 494626; *In re LaGrone*, 525 B.R. 419; *Donaldson*, 2015 WL 1539607; *Patrick*, 2015 WL 627379; *Grandidier*, 2014 WL 6908482; *Patrick*, 39 F. Supp. 3d 1032; *Taylor*, 2015 WL 3645668; *In re Brimmage*, 523 B.R. 134.

41 *Owens*, 2015 WL 1826005; *Torres*, 2015 WL 1529297.

42 *Crawford*, 758 F.3d 1254, *cert. denied*, *LVNV Funding LLC v. Crawford*, 135 S. Ct. 1844 (April 20, 2015).

Feature

By Alane A. Becket and William A. McNeal

A Claimant's Dilemma: The Statute of Limitations and Proofs of Claim

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In recent months, especially after the Eleventh Circuit's opinion in *Crawford v. LVNV Funding LLC*,[1] the issue of a proof of claim based on a debt for which the statute of limitations had passed has generated significant interest. In *Crawford*, the court overruled the decisions of both the bankruptcy and district courts, as well as a previously 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 was a violation of the Fair Debt Collection Practices Act (FDCPA).[2] *Crawford* is especially troubling because the FDCPA only applies to certain entities and certain types of debt, specifically "debt collectors" collecting on "consumer debt," both as defined by the FDCPA.[3] Thus, the practical effect of *Crawford* is the imposition of liability under the FDCPA upon only certain claimants filing certain types of claims in a bankruptcy case, such claims as are filed without penalty by any other claimant. The court below, in affirming the dismissal of the adversary proceedings, noted:

> But Appellants are fighting an uphill battle, and they candidly admit [that] 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.").[4]

Despite this, the *Crawford* panel found an FDCPA violation and created a split among the circuits by being the only one to rule that merely filing a proof of claim for a time-barred debt was an FDCPA violation. Predictably, since the decision, bankruptcy creditors-claimants, who may coincidentally be debt collectors under the FDCPA, have been faced with an onslaught of litigation seeking damages and attorneys' fees pursuant to the FDCPA's strict liability and fee-shifting provisions.[5] Even more punitive is the retroactive application of *Crawford* to claims filed before the *Crawford* decision was issued.

Statute of Limitations: A Definition

A statute of limitations is a legislatively proscribed period of time "establishing a time limit for suing in a civil case, based on the date when the claim accrued."[6] In most cases, the running of the statute of limitations is an affirmative defense to a suit that must be raised by a defendant.[7] The limitations period for a specific type of action under state law (*e.g.*, a personal-injury claim) may vary from state to state.[8]

It is often unclear which statute of limitations applies to a particular claim. For example, contractual choice-of-law terms may discord with local conflict of laws statutes or precedent. There may be a dispute over which cause of action, and its applicable statute of limitations, applies to a claim. Are revolving credit accounts written contracts, accounts stated or, in the absence of a signed credit agreement, an unwritten account? The statute of limitations in many states differs as to actions on similar claims.

In addition, the beginning of the limitations period for an open or revolving consumer account is generally the date of the last transaction on the account. However, that date is also subject to interpretation. Is it the date of the last payment, the date of the creditor's last non-suit collection attempt, or the date of any creditor transaction on the account, such as final delinquency or interest charges?

Finally, determining whether the statute of limitations applies also involves facts that are uniquely within the defendant's knowledge, such as where the debtor lived during the life of the account and after delinquency. All of these factors make determining which statute of limitations applies and whether it has run more complicated, and the answer can mean the difference between a suit's surviving a motion to dismiss or not.

1 758 F.3d 1254 (11th Cir. 2014).

2 *Id.* at 1256; *see also* Susan E. Trent, "*Crawford* Surprises: Stale Debt, FDCPA and Proofs of Claim," XXXIII *ABI Journal* 10, 14, 82-83, October 2014.

3 A debt collector is defined as:

> [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.

15 U.S.C. § 1692a(6) (2014). 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 [that] are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment." 15 U.S.C. § 1692a(5) (2014).

4 *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).

5 *Crawford*, 758 F.3d at 1259 n.4; 15 U.S.C. § 1692k(a)(3).

6 *Black's Law Dictionary* 1422 (7th ed. 1999).

7 Fed. R. Civ. P. 8(c)(1).

8 For example, in Virginia, the statute of limitations for personal-injury claims is two years, Va. Code Ann. § 8.01-243A (2014). However, in Tennessee, it is one year, Tenn. Code Ann. § 28-3-104(a)(1) (2014).

In sum, the statute of limitations is an affirmative defense that must be raised and proven by a defendant. It is axiomatic that if the burden of determining the applicable statute of limitations falls on a plaintiff, a defendant's case may be compromised. When disputed, the ultimate determination of whether a statute of limitations has passed on a claim is the province of the court.[9]

Effect of the Running of the Statute of Limitations

The running of the statute of limitations does not extinguish the debt, but rather only the remedy if a defense of statute of limitations is properly raised and proven.[10] "The expiration of a statute of limitation[s] does not extinguish the substantive right itself, just the right to enforce a remedy.... A statute of repose or duration, on the other hand, provides a date upon which the substantive right itself no longer exists."[11]

The FDCPA and the Statute of Limitations

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."[12] 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,"[13] its drafters shared a concern that "[e]xisting laws and procedures for redressing these injuries are inadequate to protect consumers."[14] To that end, the FDCPA is purposed "to eliminate abusive debt-collection practices by debt collectors, to [e]nsure 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."[15]

The FDCPA proscribes specific acts (*e.g.*, 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. However, nothing in the FDCPA prohibits the lawful collection of debts for which the statute of limitations for a suit has run.[16]

Likewise, filing suit on an out-of-statute debt is not a violation of the precise terms of the FDCPA. However, "[f]ederal circuit and district courts have uniformly held that a debt collector's threatening to sue on a time-barred debt and/or filing a time-barred suit in state court to recover that debt violates §§ 1692e and 1692f."[17] Section 1692e of title 15 prohibits the false representation of the character, amount or legal status of any debt.[18] Section 1692f prohibits using unfair or unconscionable means to collect or attempt to collect any debt.[19] As stated by the *Phillips v. Asset Acceptance LLC* court:

> 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.*[20]

Statute of Limitations and Bankruptcy Claims

A "claim" in bankruptcy is not the same as a claim eligible for suit. The Bankruptcy Code broadly defines "claim" as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[21] The definition is intentionally expansive so that any party who may make a claim against a debtor is notified of the bankruptcy,[22] after which any disputes over the claim can be adjudicated.

The fact that a claim might be subject to disallowance due to the running of an applicable statute of limitations "does not defeat the existence of the claim in bankruptcy."[23] "Quite the contrary: the existence of the claim must be determined independent of limitations questions else the process of *allowance* under § 502 becomes redundant, if not circular."[24] By ruling that a proof of claim for an out-of-statute debt is a violation of the FDCPA, the Eleventh Circuit has effectively prohibited certain claimants from filing legitimate bankruptcy claims, eschewing the claim-determination process for adjudicating the allowance of claims.

However, the most recent revision to Fed. R. Bankr. P. 3001 ("Proof of Claim") requires an open-end or revolving consumer credit claim to include the following information: The date of an account holder's last transaction, the date of the last payment on the account, and the date on which the account was charged to profit and loss.[25] The Advisory Committee Notes to the Rule state:

> 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.*[26]

Clearly, the drafters of the Federal Bankruptcy Rules were aware that out-of-statute claims are routinely filed, and crafted provisions to add transparency to those claims.

9 *Ottens v. McNeil*, 239 P.3d 308, 316 (Utah Ct. App. 2010) ("The application of a statute of limitations is a legal determination, which we review for correctness.").

10 *Gatewood v. CP Med. LLC*, Adv. No. 5:14-ap-7068, No. 5:13-bk-73363, at 2-3 n.2 (Bankr. W.D. Ark. Feb. 6, 2015) (order granting summary judgment to defendant and dismissing complaint) (citation omitted); *but see* Miss. Code Ann. § 15-1-3(1) (2014) ("The completion of the period of limitation prescribed to bar any action, shall defeat and extinguish the right as well as the remedy."); *Heritage Mut. Ins. Co. v. Picha*, 397 N.W.2d 156 (Wis. Ct. App. 1986) ("Wisconsin may be unique in holding that the running of a statute of limitations not only extinguishes the remedy to enforce a right but also destroys the right itself.").

11 *Gatewood v. CP Med. LLC*, Adv. No. 5:14-ap-7068, No. 5:13-bk-73363, at 2-3 n.2.

12 15 U.S.C. § 1692(a) (2014).

13 *Id.*

14 15 U.S.C. § 1692(b) (2014).

15 15 U.S.C. § 1692(e) (2014).

16 *Johns v. Northland Grp. Inc.*, No. 14-2947, 2015 U.S. Dist. LEXIS 93, at *10 (E.D. Pa. Jan. 5, 2015) (holding that "[p]ursuant to the FDCPA, a debt collector may seek voluntary repayment of the time-barred debt, so long as the debt collector does not initiate or threaten legal action in connection with the collection efforts").

17 *Crawford v. LVNV Funding LLC*, 758 F.3d 1254, 1259 (11th Cir. 2014).

18 15 U.S.C. § 1692e (2014).

19 15 U.S.C. § 1692f (2014).

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

21 11 U.S.C. § 101(5).

22 *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.'").

23 *Roach v. Edge (In re Edge)*, 60 B.R. 690, 699 (Bankr. M.D. Tenn. 1986).

24 *Id.*

25 Fed. R. Bankr. P. 3001(c)(3)(A).

26 Fed. R. Bankr. P. 3001, Advisory Committee Notes, 2012 Amendments (emphasis added).

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A Claimant's Dilemma: The Statute of Limitations and Proofs of Claim

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The *Crawford* Effect

In the months since *Crawford*, several courts outside of the Eleventh Circuit have adopted its reasoning, allowing FDCPA suits premised on the filing of out-of-statute claims to proceed.[27] One court resorted, *sua sponte*, to sanctions pursuant to Fed. R. Bankr. P. 9011.[28] Disconcertingly shifting the burden of affirmative defense away from a defendant to a claimant, the court castigated the claimant for apparently failing to investigate whether its claim was susceptible to a statute-of-limitations defense.[29]

In contrast, other courts faced with this issue have understood that a proof of claim filed in a bankruptcy case differs from a lawsuit based on an out-of-statute debt and have further held that even if a debt collector filing a proof of claim in a bankruptcy is subject to the FDCPA, there is nothing inherently false or fraudulent about filing a proof of claim.[30]

The potential for FDCPA liability imposes additional procedural obligations on a discreet subset of bankruptcy claimants: those defined by the FDCPA as "debt collectors." Such claimants would be required to attempt to reconcile not only the Bankruptcy Code and the FDCPA, but also conflicting limitation periods among jurisdictions. A ban would also entrap those, such as attorneys, who assist non-debt-collector creditors in the administration of their bankrupt accounts, particularly by filing their proofs of claims. It is unlikely that such outside parties would agree to file claims that subject them to FDCPA liability.

In recent years, collection of out-of-statute consumer debts has garnered significant interest at both the state and federal level. The National Consumer Law Center recently issued a report calling for the Consumer Financial Protection Bureau (CFPB) to ban all collection of out-of-statute debt.[31] Such a move would inevitably raise many questions. For example, does the CFPB retain the authority to make such a regulation? Even if the CFPB could regulate debt collection in this manner, do its powers extend to actions in bankruptcy that are permitted by its Code and Rules?[32] Perhaps legislative action must precede regulation banning all collection of out-of-statute debt. If so, what are its prospects? In any event, it seems certain that if the U.S. Supreme Court grants the writ of *certiorari* and reviews *Crawford*, it will dictate how bankruptcy treats claims on out-of-statute debt and possibly substantially affect the collection of such debt, outside of bankruptcy. abi

27 *See, e.g., Patrick v. PYOD LLC*, 1:14-cv539-RLY-TAB, 2014 U.S. Dist. LEXIS 116092 (S.D. Ind. Aug. 20, 2014) (denying motion to dismiss and holding that filing proof of claim in bankruptcy for out-of-statute debt is attempt to collect debt in violation of FDCPA because it creates misleading impression in least-sophisticated consumer that debt is legally enforceable); *accord, Grandidier v. Quantum3 Grp. LLC*, No. 1:14-cv-00138-RLY-TAB, 2014 U.S. Dist. LEXIS 169279 (S.D. Ind. Dec. 8, 2014) (same).

28 *In re Sekema*, No. 14-40145, 2015 Bankr. LEXIS 239, at *7-*8 (Bankr. N.D. Ind. Jan. 7, 2015).

29 *Id.* at *4-*5.

30 *LaGrone v. LVNV Funding LLC (In re LaGrone)*, Adv. No. 14 A 00578, No. 13 B 21423, 2015 Bankr. LEXIS 212 (Bankr. N.D. Ill. Jan. 21, 2015) (holding that filing proof of claim in bankruptcy for out-of-statute debt, alone, is no violation of FDCPA because it is not improper collection activity proscribed by FDCPA such as false representations, threats of illegal action, deceptive means of collection, or unfair or unconscionable collection methods); *Marcinowski v. eCAST Settlement Corp. (In re Marcinowski)*, Adv. No. 14 A 00678, No. 13 B 33571 (Bankr. N.D. Ill. Jan. 30, 2015) (order dismissing adversary proceeding for reasons set forth in *LaGrone v. LVNV Funding LLC (In re LaGrone)*, Adv. No. 14 A 00578, No. 13 B 21423, 2015 Bankr. LEXIS 212 (Bankr. N.D. Ill. Jan. 21, 2015)); *Gatewood v. CP Med. LLC*, Adv. No. 5:14-ap-7068, No. 5:13-bk-73363 (Bankr. W.D. Ark. Feb. 6, 2015) (order granting summary judgment to defendant and dismissing complaint; opining that while FDCPA and Bankruptcy Code can be read together, and while filing proof of claim may be attempt to collect debt, and while creditor and agent were debt collectors under FDCPA, nevertheless, time-barred proof of claim was not false, deceptive or misleading, and debtor's remedy to such claim lay in Code and Rules because FDCPA and Code, while overlapping, serve different purposes and FDCPA is not controlling after debtor files voluntary petition).

31 April Kuehnhoff and Margot Saunders, "Zombie Debt: What the CFPB Should Do About Attempts to Collect Old Debt," National Consumer Law Center, January 2015, *available at* www.nclc.org/images/pdf/debt_collection/report-zombie-debt-2015.pdf (last visited March 3, 2015).

32 *LaGrone*, Adv. No. 14 A 00578, No. 13 B 21423, 2015 Bankr. LEXIS 212, at *14. For its part, the Bankruptcy Code merely makes a proof of claim disallowed if it falls to a statute of limitations affirmative defense. 11 U.S.C. § 502(b).