Great Debates

Brian T. Fenimore, Moderator
Lathrop & Gage LLP; Kansas City

Consumer Debate

Resolved: An out-of-statute proof of claim violates the FDCPA.

Pro: Theodore O. Bartholow, III
Kellett & Bartholow PLLC; Dallas

Con: Alane A. Becket
Becket & Lee, LLP; Malvern, Pa.

Business Debate

Resolved: Assets can be sold free and clear of liens in state court receiverships.

Pro: Claire Ann Resop
Steinhilber Swanson, LLP; Madison, Wis.

Con: Hon. Arthur B. Federman
U.S. Bankruptcy Court (W.D. Mo.); Kansas City

Judges Debate

Resolved: Third-party releases should not be allowed in chapter 11 plans.

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

Con: Hon. Thomas L. Saladino
U.S. Bankruptcy Court (D. Neb.); Omaha

Great Debate - Resolved: An out-of-statute proof of claim violates the FDCPA

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In *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254 (11th Cir. 2014)[1] the 11th Circuit held that 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, for knowingly filing a proof of claim for a debt on which the statute of limitations had run. 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. The court added that the protections afforded by the automatic stay are not implicated because the stay prohibits debt collection outside the bankruptcy proceeding only. Its succinct, almost visceral test is if a creditor's conduct is violative in state court, it is also violative in bankruptcy court. In a footnote, the court characterized the trustee's lack of objection to the "stale" claim as a "fail[ure in its] statutory duty to object to improper claims."

The Statute of Limitations: A Definition

[1] Hull, Walter, and Goldberg, JJ. Op. by Goldberg, J., U.S. Court of International Trade; *cert. denied*, 135 S.Ct. 1844 (2015).

A statute of limitations is a legislatively proscribed period of time within which a lawsuit must be brought on a claim. In most cases, the running of the statute of limitations is an affirmative defense to suit that must be raised by a defendant.[2] The limitations period for a specific type of action under state law, *e.g.*, a personal injury claim, may vary from state to state.[3]

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. For instance, courts vary on whether revolving credit accounts are 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. Additionally, 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 if the statute of limitations applies also involves facts 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 surviving a motion to dismiss or not.

The Effect of the Running of the Statute of Limitations

[2] Fed. R. Civ. P. 8(c)(1). As is generally true elsewhere, in Alabama the statute of limitations is an affirmative defense, not an element of the plaintiff's claim. *E.g., Special Assets, L.L.C. v. Chase Home Finance, L.L.C., 991 So. 2d 668, 675 (Ala. 2007).*" *Johnson v. Midland Funding, LLC*, 528 B.R. 462, 467 n.8 (S.D. Ala. 2015).

[3] 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).

It is nearly uniformly held that the running of the statute of limitations does not extinguish the debt, but rather, only the remedy if raised properly and proven.[4] "The expiration of a statute of limitation 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."[5]

The Statute of Limitations and the FDCPA

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."[6]

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. Yet, nothing in the FDCPA prohibits the lawful collection of debts for which the statute of limitations has run.[7]

Likewise, filing suit on an out of statute debt is not a violation of the precise terms of the FDCPA. However, "Federal 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

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[4] *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.").
[5] *Gatewood v. CP Med. LLC*, Adv. No. 5:14-ap-7068, No. 5:13-bk-73363, at 2-3 n.2.
[6] 15 U.S.C. § 1692(a) (2014).
[7] *Johns v. Northland Group, 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").

that debt violates §§ 1692e and 1692f."[8] Section 1692e of Title 15 prohibits the false representation of -- the character, amount, or legal status of any debt.[9] Section 1692f prohibits using unfair or unconscionable means to collect or attempt to collect any debt.[10] Filing suit when the plaintiff knows the statute of limitations provides the defendant with a complete defense has been held to violate both provisions.

However, "…[C]ourts have recognized that a debt collector's mere request that a consumer pay an existing but time-barred debt does not itself run afoul of the FDCPA, insofar as some might consider repayment a moral obligation even if the debt is not legally enforceable." *Thompson v. Resurgent Capital Servs., L.P.*, No. 2:12-CV-01018-JEO, 2015 WL 1486974, at *18 (N.D. Ala. Mar. 31, 2015).

The Statute of Limitations and Bankruptcy Claims

The Bankruptcy Code defines "claim" broadly as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . . ".[11] The definition is intentionally expansive so that any party who may make a claim against the debtor is notified of the bankruptcy,[12] after which any disputes over the claim can be adjudicated.

Indeed, the fact that a claim may be subject to disallowance due to the running of an applicable statute of limitations, "does not defeat the *existence* of the claim in bankruptcy." *Roach vs. Edge* (*In re Edge*), 60 B.R. 690, 699 (Bankr. M.D. Tenn. 1986). "Quite the contrary: the existence of the claim must be determined independent of limitations

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[8] *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1259 (11th Cir. 2014).
[9] 15 U.S.C. § 1692e (2014).
[10] 15 U.S.C. § 1692f (2014).
[11] 11 U.S.C. § 101(5).
[12] *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.'").

questions else the process of *allowance* under § 502 becomes redundant if not circular." *Id.* By ruling that a proof of claim for an out of statute debt is a violation of the FDCPA, the 11th Circuit in *Crawford v. LVNV Funding LLC*[13], has effectively prohibited certain claimants from filing legitimate bankruptcy claims, eschewing the claim determination process for adjudicating the allowance of claims.

Around the Country

Since *Crawford*, several Circuits addressing the issue have rejected the position of the 11th Circuit. Most recently, on August 25, 2016, the 4th Circuit Court of Appeals joined the growing majority of Circuits rendering decisions at odds with *Crawford.* In *Dubois v. Atlas Acquisitions LLC*, a case originating in the Maryland courts, a debt collector filed proofs of claim in two separate bankruptcy cases. In both cases, the debts were beyond the statute of limitations. The debtors responded by filing adversary complaints against the debt collector in which they objected to the claims and alleged the filing of the claims violated the FDCPA. The debt collector conceded the underlying debts were time-barred and agreed to their disallowance. However, the Bankruptcy Court dismissed the FDCPA claims, finding that filing a proof of claim does not constitute debt collection activity under the FDCPA. The debtors were permitted to appeal directly to the 4th Circuit.

The 4th Circuit determined that, while the filing of a proof of claim is debt collection activity, filing a proof of claim on a stale debt does not violate the Act. In response to the debtors' argument that a stale debt does not constitute a valid "claim" as defined by the Bankruptcy Code, the court noted that the expiration of the statute of limitations does not extinguish the underlying debt, but merely eliminates the remedy of filing a lawsuit to collect it. Therefore, the debt still constitutes both a right to payment and a "claim" under the Bankruptcy

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[13] 758 F.3d 1254 (11th Cir. 2014).

Code. Next, the court rejected the debtors' argument that filing a time-barred claim is akin to filing a lawsuit on a stale debt, which has consistently been held to violate the FDCPA. The court distinguished the filing a proof of claim from the filing of a lawsuit, focusing primarily on the protections afforded a debtor by the bankruptcy process and the more burdensome aspects of a civil collections lawsuit.

Just fifteen days earlier, the 7th Circuit reached a similar conclusion in *Owens v. LVNV Funding, LLC*. In that case, the Bankruptcy Court disallowed claims filed in the cases of two debtors because they were time-barred. The debtors then sued the debt collectors in the District Court alleging a violation of the FDCPA through conduct that was false, deceptive, and misleading, as well as an unfair or unconscionable means of collecting a debt. More specifically, the debtors argued the filing of the claims was deceptive or unfair because the debt collectors' business models rely on debtors, their attorneys, and the bankruptcy trustee failing to object to the claims. Under the Bankruptcy Code, a claim is deemed allowed when no objection is filed and thus may provide the claimant with payments through the debtor's bankruptcy plan when the debt would otherwise be subject to a statute of limitations defense. The District Court, however, dismissed the lawsuit and the debtors appealed to the 7th Circuit.

On appeal, the 7th Circuit found that the Bankruptcy Code permitted debt collectors to file complete and accurate proofs of claim, even when the debt is time-barred and that filing such proofs of claim does not violate the FDCPA.[14] The court first disagreed with the debtors' assertion that a "claim" as defined by the Bankruptcy Code allows the filing of only "legally enforceable" obligations. The court reasoned that simply because a debt is no longer legally enforceable, that does not mean the debt has been extinguished, and that the broad definition of "claim" under the Bankruptcy Code encompasses even legally unenforceable claims. Therefore,

[14] The debtors have petitioned the U.S. Supreme Court for a writ of certiorari.

it found there was nothing inherently misleading or deceptive in filing such a claim. Like the court in *Dubois*, the 7th Circuit focused on the protections afforded by the bankruptcy process and the differences between a bankruptcy case and a civil lawsuit. Unlike a litigant in a lawsuit, a debtor in bankruptcy is afforded notice of the age and origin of the debt associated with a proof of claim, so the debtor can file an objection without even having memory of the debt or documentation evidencing it. Additionally, debtors are normally represented in bankruptcy by attorneys who are aware of statutes of limitations and, even when not represented, the trustee has the duty to object to improper claims.

The debt collection industry should be cautioned that although *Owens* is a favorable decision, it left open the possibility of liability in any case where conduct "misleads an unsophisticated consumer to believe a time-barred debt is legally enforceable," such as in cases where a debtor is unrepresented and lacking the sophistication to object, and where a trustee fails to review the claim and file an objection.

The case that kicked off the summer hot-streak of decisions on the issue of time-barred debt and led the way in rejecting *Crawford* was *Nelson v. Midland Credit Management, Inc*. in the 8th Circuit. As in *Owens*, the debtor filed suit in the District Court, citing violations of the FDCPA after a debt collector filed a stale proof of claim in his bankruptcy case. The debtor argued the debt collector engaged in conduct in which the natural consequence was to harass, oppress, or abuse him and also that it used false, deceptive, or misleading representations or unfair or unconscionable means to collect the debt. The 8th Circuit, like the Circuit Courts that would soon follow, rejected *Crawford* on the bases that the protections afforded by the Bankruptcy Court satisfy the concerns of the FDCPA and that accurate and complete time-barred proofs of claim are not false, deceptive, misleading, unfair, or unconscionable. The court noted that *Crawford* ignores the inherent protections against harassment and deception within the bankruptcy process and that a key difference between a bankruptcy claim and litigation is that "a bankruptcy debtor is aided by 'trustees who owe fiduciary duties to all parties and have a statutory obligation to object to unenforceable claims.'"

Finally, it is noteworthy that both the 9th and 2nd Circuits have weighed in on the side of debt collectors on the issue of whether the Bankruptcy Code precludes actions based on the FDCPA. The 9th Circuit has ruled broadly that no FDCPA action can be based on a violation of the Bankruptcy Code, finding that such violations are dealt with exclusively by the Code. The 2nd Circuit has not foreclosed the possibility of a Bankruptcy Code violation becoming the basis for a FDCPA action, but it has determined the filing of a proof of claim cannot form such basis. The issue of time-barred debts is currently pending in the 1st, 3rd, and 6th Circuits. Though a shift away from *Crawford* is evident, the issue remains unresolved. This uncertainty makes it critical for anyone involved in the bankruptcy collections process to be aware of the current status of the law on the issue, including any legal or factual nuances between the individual Circuit Court opinions.

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GREAT DEBATE
THE CONSUMER'S PERSPECTIVE: DEBT COLLECTORS VIOLATE THE FDCPA WHEN THEY FILE PROOFS OF CLAIMS FOR OUT OF STATUTE DEBTS

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I. INTRODUCTION

Debtors do not file Chapter 13 bankruptcy cases to address stale debts. The passage of time and the operation of law already effectively put those old debts to rest. Rather, virtually every debtor to file Chapter 13 bankruptcy does so to deal with his or her current creditors with a current right to collect on outstanding debts through the legal system.

Unlike debtors' creditors holding unexpired, legally enforceable debts, *debt collectors* that file proofs of claims to collect old, out-of-statute, time-barred debts are engaged in a flagrant misuse of the bankruptcy process. They know they would face certain liability for violating the Fair Debt Collection Practices Act (FDCPA) if they were to file lawsuits in any other forum to collect these debts. They also know their proofs of claims would be rejected 100% of the time if the claims allowance process functioned as Congress intended. Yet, the debt collection industry also knows that the claims allowance process in Chapter 13 routinely breaks down and proofs of claims based on time-barred debts are routinely "accidentally" allowed and paid (in part or in whole). If the claim determination process in Chapter 13 bankruptcy never malfunctioned, *debt collectors* would stop filing these proofs of claims immediately.

Meanwhile, the debt collection industry cannot seriously claim that it has *any* good-faith basis for filing proofs of claims for out-of-statute debts (although it regularly recites a handful of transparently bogus "reasons" why these claims are "beneficial"). Moreover, debt collectors do not even attempt to defend their claims if anyone objects to them. This is because they do not and cannot deny that their claims are subject to an iron-clad dispositive defense (and would give rise to sanctions[1] and FDCPA liability if filed in any other court).

[1] *See, e.g., F.D.I.C. v. Calhoun*, 34 F.3d 1291, 1299 (5th Cir. 1994) (bringing a claim that, under the circumstances, is obviously subject to a bar or affirmative defense can result in sanctions under Rule 11).

By way of example, one case I have encountered first-hand perfectly demonstrates one of the major concerns created by debt collectors' filing of time-barred claims. In that case, the debtor's non-exempt assets were substantially greater (e.g. more than $30,000 in non-exempt value) than the filed proofs of claims for general unsecured debts in his bankruptcy case. If all of the filed general unsecured proofs of claims had been allowed, including the debt collectors' knowingly-filed proofs of claims for time-barred debts, the debtor would have had to pay more than $20,000 to his general unsecured creditors. After the debtor objected to the time-barred claims (his objections were totally unopposed by the debt collectors, which is always the case with these claims), the debtor ended up having to pay just $92.70 to his unsecured creditors.

Advocates for the debt collection industry might suggest that this result represents a windfall for the debtor since the statute of limitations does not "extinguish" the debt; it only eliminates the legal remedy. However, this is where the context and purpose of a bankruptcy case are most meaningful: people like this debtor do not file bankruptcy to deal with debts that are beyond the statute of limitations. Their old creditors holding "stale" claims, by and large, are not harassing them, and those debts have usually faded from memory. Rather, bankruptcy is a process for addressing the debtor's financial woes of the here-and-now. Bankruptcy is not intended to revive old debts, nor is it intended to offer a new bite at the apple to debtors' old creditors that failed to timely assert their legal remedies for collection when they had the opportunity granted to them by law.[2]

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[2] Incidentally, the effect of a discharge is strikingly similar to the effect of the statute of limitations, although it extends a bit further: "Bankruptcy does not erase debt; the discharge is only an injunction against attempts to collect the debt as a personal liability of the debtor. *See* 11 U.S.C. § 524(a)[.]" *In re Mahoney*, 368 B.R. 579, 584 (Bankr. W.D. Tex. 2007)(citing *In re Vogt,* 257 B.R. 65, 70 (Bankr. D. Co. 2000)); *see also In re Irby*, 337 B.R 293, 297 (Bankr. N.D. Ohio 2005). As the court in *Irby* explained:

Indeed, the debt collection industry is perfectly aware that they will only collect on their claims if the claims allowance process in Chapter 13 breaks down and fails. Yet they continue to file proofs of claims for time-barred debts in droves, defending their abusive scheme by arguing that their claims leave sufficient hints for others to spot their misconduct (after wasting others' time and resources), and because, they posit, the Bankruptcy Code (for indiscernible reasons) *invites* debt collectors to file meritless claims.

This abuse must end. There is no absolute right (in *any* functioning legal system) for any litigant to intentionally file frivolous claims. The debt collection industry's tactic in filing these proofs of claims is directly at odds with the Bankruptcy Code's plain text, clear structure, and statutory purpose. Their conduct needlessly burdens the bankruptcy process and harms innocent parties; it has no societal value or public benefit. The FDCPA forbids precisely this kind of misconduct in every other forum. The debt collection industry's attempt to create a "bankruptcy exception" that is absent from the text of both the Bankruptcy Code and the FDCPA and contrary to the intent and purposes of both laws must be stopped.

II. BACKGROUND CONTEXT OF THIS ISSUE

"The most significant change in the debt collection business in recent years has been the

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> [I]t is evident that the Plaintiffs' [sic] have based the success of their cause of action on a common misconception of bankruptcy law: that the bankruptcy discharge eliminates the very existence of a debt. But this is not the case. Nowhere in the Bankruptcy Code does it provide that a debt is extinguished. Instead, § 524, entitled "Effect of Discharge," limits its breadth to "operat[ing] as an injunction against the commencement or continuation of an action" to collect or recover a debt. The statute then goes on to limit the applicability of this "injunction" with this important proviso: "as a personal liability of the debtor [.]" In this way, upon discharge, it is only a debtor's personal obligation to pay the debt that is effectively extinguished; the debt itself remains.

Irby, 337 B.R. at 295. If the debt collection industry's rationale with respect to out-of-statute debts were to be extended to discharged debts, then we would see the absurd result of *discharged* debts being paid through debtors' Chapter 13 plans, a result that clearly is not contemplated by the Code.

advent and growth of debt buying."[3] The sale and resale of delinquent debt is now a multi-billion dollar industry.

Debt that is beyond the statute of limitations ("time-barred debt") and therefore legally unenforceable nevertheless has some value to a debt collector and is regularly sold in the distressed debt market. Meanwhile, most consumers do not know or understand their legal rights with respect to the collection of time-barred debt.[4]

A Federal Trade Commission ("FTC") study published in January 2013 found that six of the largest debt buyers in the nation paid an average of four cents for each dollar of delinquent consumer debt.[5] Older debt sells for a significantly lower price. During the three-year period of the FTC study, the nine largest debt buyers bought nearly $142 billion in debt. Importantly, of that amount, debt buyers bought over ***$38 billion dollars*** of bankruptcy debt. *Id.* at Table 2.

For example, in 2014, American Infosource reported that debt collector Resurgent/Sherman/LVNV filed 149,677 proofs of claim in 90,475 bankruptcy cases for consumer debts totaling $1,990,070,703.04.[6] In 2015, American Infosource reported that

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[3] Fed. Trade Comm'n, *Collecting Consumer Debts: The Challenges of Change – A workshop Report* (2009)[hereinafter *Challenges of Change]*, available at http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf
Although the Bankruptcy Code authorizes creditors to file proofs of claims, it does not require them to do so, nor does it create a right to file proofs of claims that seek to collect legally unenforceable obligations. Rather, as the Fifth Circuit recognized long ago, proofs of claims "should be filed only when some purpose would be served." *In re Simmons*, 765 F.2d 547, 551 (5th Cir. 1985) (citing 3 COLLIER ON BANKRUPTCY ¶ 501.01, at 501-3 (15th ed. 1985)).

[4] Fed. Trade Comm'n. *Repairing a Broken System: Protecting Consumers in Debt Collection Litigation and Arbitration* (2010) [hereinafter *Repairing a Broken System*], available at http://www.ftc.gov/os/2010/07/ debtcollectionreport.pdf

[5] Fed. Trade Comm'n, *The Structure and Practices of the Debt Buying Industry*, ii and 23 (January 2013) [hereinafter *Structure and Practices*] *available at* https://www.ftc.gov/sites/default/files/documents/reports/ structure-and-practices-debt-buyingindustry/debtbuyingreport.pdf.

[6] American Infosource, *AIS Insight 2014 Year in Review Edition* (2015), *available at* http://www.americaninfosource.com/

Resurgent/Sherman/LVNV was the third largest filer of proofs of claims in America, filing 107,608 claims in 69,064 bankruptcy cases for claims totaling $256,878,553.84.[7] In the first eight months of 2016, Resurgent/Sherman/LVNV has been the ***fifth*** largest filer of proofs claim in the country.[8]

Although we have found no statistics telling us the number and amount of the debts in these claims that are stale and unenforceable, obviously the large debt collection firms engaged in filing proofs of claims make millions of dollars on the proofs of claims they file based on out-of-statute debts in debtors' Chapter 13 bankruptcy cases, taking unfair advantage of a bankruptcy system that

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7 American Infosource, *AIS Insight 2015 Year in Review Edition* (2016), *available at* http://www.americaninfosource.com/

8 Summary of information contained in AIS Insight monthly reports, citations provided below.

Rank	Month	Cases	Claims	Total $ Amount of Claims	Average $ Amount per Claim
4	Jan-16	6,164	9,919	$22,162,535.10	$2,234.35
4	Feb-16	6,502	10,679	$22,349,931.69	$2,102.73
4	Mar-16	6,483	10.556	$22,051,814.82	$2,089.03
5	Apr-16	6,272	10,241	$22,104,767.03	$2,158.46
5	May-16	6,272	10,146	$22,102,490.29	$2,178.44
5	Jun-16	6,755	11,064	$23,229,423.50	$2,099.55
5	Jul-16	6,304	10,300	$21,562,740.75	$2,093.47
5	Aug-16	7,571	12,455	$29,851,240.08	$2,396.73
		52,323	**85,310**	**$185,414,943.26**	

American Infosource, *AIS Insight* (January 2016), *available at* http://www.americaninfosource.com/assets/AIS%20Insight_02-01-16.pdf
American Infosource, *AIS Insight* (February 2016), *available at* http://www.americaninfosource.com/assets/AIS%20Insight_03-02-16.pdf
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American Infosource, *AIS Insight* (July 2016), *available at* http://www.americaninfosource.com/assets/AIS%20Insight_08-02-16.pdf
American Infosource, *AIS Insight* (August 2016), *available at* http://www.americaninfosource.com/assets/AIS%20Insight_09-02-16.pdf

they know is not equipped to deal with tens of thousands of claims for millions of dollars of stale debt.

III. ARGUMENT

The debt collection industry argues (wrongly) that proofs of claims for time-barred debt cannot violate the FDCPA for two principal reasons: (1) the filing of a proof of claim does not "implicate" the FDCPA due to the procedural protections of the Bankruptcy Code, and (2) filing a proof of claim on a time-barred debt does not violate the FDCPA because the bankruptcy process offers sufficient protections to consumers. Both arguments are meritless and ultimately rely on the faulty premise that the overlap between the Code and the FDCPA effectively precludes application of the FDCPA to proofs of claims for stale debts.

A. There is no irreconcilable conflict between the Bankruptcy Code and the FDCPA with respect to proofs of claims that seek to collect time-barred debt.

Four circuit courts have held that the Bankruptcy Code does not outright preclude debtors' claims pursuant to the FDCPA. *See Johnson v. Midland Funding, LLC*, No. 15-11240, 2016 WL 2996372, at *3 (11th Cir. May 24, 2016); *Garfield v. Ocwen Loan Servicing, LLC*, 811 F.3d 86, 91 (2d Cir. 2016)(substantially abrogating and questioning 2nd Circuit's prior holding in *Simmons*; see next paragraph and footnote 10 below); *Simon v. FIA Card Servs., N.A.*, 732 F.3d 259, 274, 278 (3d Cir. 2013) (opinion by Southern District of Texas Judge Rosenthal, sitting with Third Circuit by designation); *Randolph v. IMBS, Inc.*, 368 F.3d at 732 (7th Cir. 2004).

However, four other circuit courts have held, either explicitly or implicitly, that the Bankruptcy Code precludes or (incorrectly[9]) that it "preempts" the FDCPA: The Ninth Circuit's

[9] "Preemption" is the technical term from Supreme Court jurisprudence applicable to analyzing a potential conflict between federal and state law. As such, "preemption" is a misnomer with respect to analyzing whether the Bankruptcy Code and FDCPA conflict, since each is a federal law.

heavily criticized opinion in *Walls v. Wells Fargo Bank, N.A.,* 276 F.3d 502 (9th Cir. 2002), the Second Circuit's opinion in *Simmons v. Roundup Funding, LLC*, 622 F.3d 93 (2d Cir. 2010)[10] (following *Walls*), the Eighth Circuit's two-page decision in *Nelson v. Midland Credit Management, Inc.,* 2016 WL 3672073 (8th Cir. July 11, 2016)(adopting the rationale in *Simmons*), and the Fourth Circuit's recent split opinion in *DuBois v. Atlas Acquisitions*, No. 15-1945, (4th Cir. Aug. 25, 2016) (following *Simmons*, and despite claiming it was not deciding the preclusion issue, the majority expressly indicated that the FDCPA's remedies were "unnecessary" in the bankruptcy claims allowance context *because* of the presence of the Chapter 13 Trustee and suggesting that the proper solution for this issue would be for Congress to increase funding to the bankruptcy trustees.). None of these circuit courts applied the stringent federal statutory preclusion analysis required by the Supreme Court, and all four were therefore wrongly decided.

An FDCPA claim can be precluded by the Bankruptcy Code only if it is impossible to enforce both statutes. *Trevino v. HSBC Mortgage Services, Inc. (In re Trevino)*, 535 B.R. 110, 137-39 (Bankr. S.D. Tex. 2015). "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." *Randolph v. IMBS, Inc.,* 368 F.3d 726, 730 (7th Cir. 2004). "[W]hen two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *J.E.M. Ag. Supply, Inc. v. Pioneer Hi-Bred Intern, Inc.*, 534 U.S. 124, 143-44, 122 S.Ct. 593, 151 L.Ed.2d 508 (2001). In 2014, the Supreme Court addressed this issue squarely in *POM Wonderful LLC v. Coca-Cola Co.*, rejecting the notion

10 Notably, Judge Winter of the Second Circuit was on the panel for *Garfield* that substantially walked-back the holding in *Simmons* - *after* being on the panel that decided *Simmons*. *See Garfield,* 811 F.3d 86 (2d Cir. 2016); *Simmons,* 662 F. 3d 93.

that the FDCA (the Food, Drug, and Cosmetics Act) precluded enforcement of the Lanham Act because the FDCA supposedly offered protections that overlapped with the rights and remedies authorized by the Lanham Act. *POM Wonderful LLC v. Coca-Cola Co.*, 134 S. Ct. 2228 (2014).

The debt collectors that file these proofs of claims do not argue that the 95th Congress stated any "clear and manifest" intent to override the FDCPA when they enacted the Bankruptcy Code the year after they enacted the FDCPA. *See Johnson*, 2016 WL 2996372 (citing *POM Wonderful* 134 S. Ct. at 2236). "[R]epeals by implication are not favored and will not be presumed unless the intention of the legislature to repeal is clear and manifest." *Johnson*, 2016 WL 2996372 at *4 (citing *Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 127 S. Ct. 2518, 2532 (2007)).

In order to find that one federal law precludes application of another federal law, courts must find that there is a "positive repugnancy" between the competing statutes. *Johnson*, 2016 WL 2996372 at *4. This positive repugnancy test recognizes the Supreme Court's determination that federal statutes can typically coexist if they simply contain "different requirements and protections." *Id*. Federal courts are thus prohibited from inferring repeal by implication of a federal statute unless either the later statute expressly contradicts the prior statute or such a construction "is absolutely necessary" in order for the later statute to "have any meaning at all." *Nat'l Ass'n of Home Builders*, 551 U.S. at 662, 127 S. Ct. at 2532 (quotations omitted).

It follows that, as in *POM Wonderful*, Congress' failure to address this supposed conflict by amending either the Bankruptcy Code or the FDCPA in the 35+ years since they were first enacted constitutes "powerful evidence" that Congress did not intend for the Bankruptcy Code to be the only means of regulating debt collectors with respect to their conduct in bankruptcy cases. *POM*

Wonderful, 134 S. Ct. 2237. "[W]hen two statutes complement each other, it would show disregard for the congressional design to hold that Congress nonetheless intended one federal statute to preclude the operation of the other." *Id.* at 2238. The Bankruptcy Code and the FDCPA are complementary because each has its own purpose and imposes different requirements and protections. *See id*. The FDCPA establishes a private right of action in order to motivate injured consumers to hold debt collectors accountable for their abuses, a purpose (often described as a "private attorney general" function) that is distinct from the Bankruptcy Code's administrative claims allowance procedures, which seeks to efficiently distribute estate proceeds to legitimate creditors according to the debtor's Chapter 13 plan. *Id.* Thus, the Bankruptcy Code and the FDCPA coexist in a manner that "is quite consistent with the congressional design to enact two different statutes, each with its own mechanisms to enhance the protection of competitors and consumers." *Id.*

The Eleventh Circuit's recent *Johnson* opinion (with Fifth Circuit Judge Higginbotham on the panel) addresses this issue squarely and thoroughly, concluding that it is easy to enforce both the Bankruptcy Code and the FDCPA with respect to stale-debt proofs of claim filed by one particular type of creditor: *debt collectors*. *Johnson*, 2016 WL 2996372 at *5. *See Trevino*, 535 B.R. at 137-39 (after careful consideration of the preclusion factors, the court finds no "positive repugnancy" between the FDCPA and the Bankruptcy Code that would prevent enforcement of both statutes to remedy abusive debt collection conduct against consumers in bankruptcy, including with respect to unfair, deceptive, or harassing debt collection conduct in bankruptcy court). *See also Roth v. Nationstar Mortgage, LLC*, No. 215CV783FTM29MRM, 2016 WL

3570991, at *6 (M.D. Fla. July 1, 2016).[11] Although the debt collection industry misleadingly attempts to cast this issue as proposing a wholesale prohibition against any creditor filing a proof of claim for any out-of-statute debt, the reality is that the relevant prohibitions in the FDCPA pertain exclusively to *debt collectors*, and the vast majority of creditors who file proofs of claims in Chapter 13 cases are not subject to the FDCPA because they do not qualify as debt collectors. Further, the FDCPA and the Bankruptcy Code have co-existed for 35+ years and Congress has not seen fit to amend either law to limit the FDCPA's application in the bankruptcy context, despite having amended both laws several times.

If Congress wanted to exclude bankruptcy proofs of claims from the scope of the FDCPA, it certainly knew how. Indeed, Congress previously narrowly amended § 1692e(11) to exempt formal legal pleadings from the requirements of that section after the Supreme Court's opinion in *Heintz v. Jenkins*, 514 U.S. 291 (1995) (holding that the FDCPA applied to pleadings filed by an attorney that was regularly engaged in consumer debt collection activity). *See Marquez v. Weinstein, Pinson, & Riley, P.S.*, 15-3273, (7th Cir. Sept. 7, 2016) (discussing changes to FDCPA following Supreme Court's ruling in *Heintz*)

B. Even when a consumer is in bankruptcy, debt collectors' conduct, communications, and means of debt collection are still subject to the FDCPA's requirements, and debt collectors violate the FDCPA when they file time-barred proofs of claims.

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[11] In short, debt collectors are not *required* to file proofs of claims for out-of-statute debt. Thus, there is no positive repugnancy. If a debt collector chooses to file a claim for out-of-statute debt, it may be subject to a suit for violations of the FDCPA, just as if a debt collector chooses to file suit (or threaten suit) to collect an out-of-statute debt.[11] *See Johnson v. Midland Funding*, No. 15-11240, 2016 WL 2996372 at *3-6 (11th Cir. May 24, 2016) (explaining that the Bankruptcy Code neither prohibits creditors from filing claims nor shields creditors from the consequences of filing improper claims); *Trevino*, 535 B.R. at 136-39 (rejecting *Walls* and other decisions that have held that the Bankruptcy Code precludes the FDCPA). Proofs of claims "should be filed only when some purpose would be served." *In re Simmons*, 765 F.2d at 551 (5th Cir. 1985) (citing 3 COLLIER ON BANKRUPTCY ¶ 501.01, at 501-3 (15th ed. 1985)).

The FDCPA "imposes open-ended prohibitions on, *inter alia,* false, deceptive, or unfair" debt-collection practices. 15 U.S.C. §1692e." *Clomon v. Jackson*, 988 F.2d 1314, 1320 (2d Cir. 1993). Congress passed the FDCPA in 1977 "after it determined that '[e]xisting laws and procedures' were 'inadequate' to protect consumer debtors." *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1257-58 (11th Cir. 2014), *cert. denied*, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015) (citing 15 U.S.C. §1692b). *See Jeter v. Credit Bureau, Inc.,* 760 F.2d 1168, 1173 (11th Cir. 1985) (noting "that despite prior [Federal Trade Commission] enforcement in the area," Congress found "[e]xisting laws and procedures" inadequate).

Congress enacted the FDCPA "to eliminate abusive debt collection practices by debt collectors, to ensure 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 U.S.C. § 1692e; *Taylor v. Perrin, Landry, deLaunay & Durand*, 103 F.3d 1232, 1234 (5th Cir. 1997); 15 U.S.C. § 1692k. *See also Castro v. Collecto, Inc.*, 634 F.3d 779 (5th Cir. 2011). With respect to the second purpose, it is difficult to conceive of debt collection conduct that would be more directly unfair to a bankrupt consumer's legitimate creditors than debt collectors' use of the Bankruptcy Code's claims allowance process to siphon money away from creditors holding allowed claims for valid, legally enforceable debts.

1. Filing a proof of claim is a "communication" in connection with and "means" of debt collection.

Contrary to debt collectors' frequent argument that the filing of a proof of claim is not an attempt to collect a debt, it is well established that filing a proof of claim in connection with a consumer's Chapter 13 bankruptcy constitutes an attempt to collect a debt from a consumer for purposes of the FDCPA:

> [T]he broad prohibitions of § 1692e apply to a debt collector's "false, deceptive, or misleading *representation or means*" used "*in connection with the collection of any debt.*" 15 U.S.C. § 1692e (emphases added). The broad prohibitions of § 1692f apply to a debt collector's use of "unfair or unconscionable *means to collect or attempt to collect any debt.*" 15 U.S.C. § 1692f (emphasis added). The FDCPA does not define the terms "collection of debt" or "to collect a debt" in §§ 1692e or 1692f. However, in interpreting "to collect a debt" as used in § 1692(a)(6), the Supreme Court has turned to the dictionary's definition: "To collect a debt or claim is to obtain payment or liquidation of it, either by personal solicitation or legal proceedings." *Heintz v. Jenkins,* 514 U.S. 291, 294, 115 S.Ct. 1489, 1491, 131 L.Ed.2d 395 (1995) (quoting *Black's Law Dictionary* 263 (6th ed.1990)).

Crawford v. LVNV Funding, LLC, 758 F.3d at 1261 (concluding that debt collectors' filing of proofs of claim for time-barred debts violates §§ 1692e, 1692f). *See also Edwards v. LVNV Funding LLC* (*In re Edwards*), 539 B.R. 360, 364 (Bankr. E.D. Ill. 2015) (holding that filing a proof of claim is an action to collect a debt for purposes of the FDCPA). The cases the debt collection industry cites for the contrary position mistakenly assume that conduct has to be directed at the consumer in order to qualify as debt collection. However, it is well-established that communications and means of collection of consumer debt qualify as debt collection regardless of their intended target. What matters is whether the communication or means employed was intended to recover or assist in the recovery of consumer debt.

2. Courts evaluate whether a debt collector's conduct violates the FDCPA based on the "unsophisticated" or "least sophisticated" consumer standard.

In evaluating whether debt collection conduct violates the FDCPA, courts analyze the debt collector's conduct from the perspective of the "least sophisticated consumer" or "unsophisticated consumer." *Goswami v. Am. Collections Enter., Inc.,* 377 F.3d 488, 495 (5th Cir. 2004).[12] Under this analysis, it does not matter whether the consumer plaintiff was in fact

[12] *See also Watson v. Aurora Loan Servs. LLC*, No. 4:11-CV-301-BJ, 2012 WL 3594233, at *7 (N.D. Tex. Aug. 21, 2012); *Eilert v. Turner*, No. CIV.A. H-13-3758, 2015 WL 5178081, at *4 (S.D. Tex. Sept. 4, 2015), *adhered to on*

subjectively misled, deceived, or treated unfairly. *McCartney v. First City Bank,* 970 F.2d 45 (5th Cir. 1992). Rather, for purposes of evaluating liability for violations of §§ 1692d, 1692e, and 1692f of the FDCPA, courts consider only whether the unsophisticated or least sophisticated consumer was likely to have been misled, treated unfairly, or felt abused by the debt collector's conduct. *See McMurray v. ProCollect, Inc.*, 687 F.3d 665, 669 (5th Cir. 2012); *Taylor,* 103 F.3d at 1236. The availability of alternative remedies for debt collectors' conduct that violates the FDCPA does not factor into this analysis. *See Johnson*, 2016 WL 2996372 at *5.

The single most misunderstood aspect of the cases that consider whether a debt collector's filing of a time-barred proof of claim violates the FDCPA is the application of the least-sophisticated consumer standard. Many opinions properly articulate the least sophisticated consumer standard, but proceed to ignore it when evaluating the allegedly improper debt collection conduct. Although the court is not required to defer to the agencies' view, the FTC's and CFPB's "judgment is to be given great weight by reviewing courts," as these agencies are "often in a better position than are courts to determine when a practice is 'deceptive' within the meaning of the [FDCPA]." *FTC v. Colgate–Palmolive*, 380 U.S. 374, 384–385, 85 S.Ct. 1035, 13 L.Ed.2d 904 (1965). The factual findings of the FTC and CFPB are especially helpful when courts are asked, as in the case at bar, to determine how an unsophisticated consumer might construe a particular communication—a task for which empirical studies by agencies may well be more accurate than the "intuitions" of federal judges. *See McMahon*, 744 F.3d at 1020 ("Recognizing the distinction between what may confuse a federal judge and an unsophisticated consumer is important because the intended recipients of dunning letters span the entire range of abilities. We have therefore

reconsideration, No. CV H-13-3758, 2016 WL 1529914 (S.D. Tex. Apr. 14, 2016); *Fosen v. Weinstein & Riley, P.S.*, No. 4:12CV662, 2013 WL 4417526, at *1 (E.D. Tex. Aug. 14, 2013).

cautioned against reliance 'on our intuitions.'") (quoting *Evory v. RJM Acquisitions Funding L.L.C.*, 505 F.3d 769, 776 (7th Cir.2007)). With respect to the issues in this case, the FTC and CFPB have plainly embraced the concept that communications and means of collecting stale debts that fail to explicitly state that the debt in question is no longer enforceable due to the expiration of the statute of limitations violate the FDCPA. *See* Consent Order between the CFPB and Encore Capital Group, Inc., et al (Sept. 3, 2015), http://files.consumerfinance.gov/f/201509_cfpb_consent-order-encore-capital-group.pdf; Fed. Trade Comm'n, *The Structure and Practices of the Debt Buying Industry* (2013), *available at* https://www.ftc.gov/sites/default/files/documents/reports/structure-and-practices-debt-buyingindustry/debtbuyingreport.pdf.

3. Filing a lawsuit on stale debt is an FDCPA violation, and there is no material difference between a lawsuit on a stale debt and a proof of claim on a stale debt; both violate the FDCPA.

Federal circuit and district courts have uniformly held that a debt collector's threatening to sue on and/or filing a lawsuit to collect time-barred debt in state court violates the FDCPA. *Crawford*, 758 F.3d at 1259-60 (collecting cases); *Castro v. Collecto, Inc.*, 634 F.3d at 783, 787.

The similarities between filing a collection lawsuit outside of bankruptcy and filing a proof of claim in a bankruptcy are strong enough that the reasoning in the Fifth Circuit's *Castro* opinion and the Eleventh Circuit's *Johnson* opinion controls. In both forums, the creditor invokes the process of a court to seek payment on an unenforceable debt. *Edwards*, 539 B.R. at 364-65. In both, the debt collector files a formal document with the court that asserts a right to payment and enlists the process of the court to get paid. *Id.* at 365.[13] "The goal of the debt collector in both situations

[13] "In a collection lawsuit, the process includes filing a complaint asserting a right to payment, serving process, seeking a default judgment if there is no answer (as is typical) or otherwise obtaining a judgment, and collecting on the debt through post-judgment proceedings." *Id.* "In bankruptcy court, the creditor files a proof of claim asserting a

is to invoke the process of the court to be paid on a claim *when it is not entitled to payment*." *Id.* (emphasis added). Thus, the essential elements of the collection process are the same in both forums and there is no difference between the processes that justifies rejecting the reasoning or holdings of *Phillips*[14], *McMahon*[15], or *Castro* in the bankruptcy context.[16] *See id.*

4. Debt collectors violate the FDCPA by exploiting the claims allowance process to collect when the system malfunctions, not when it operates as Congress intended.

Debt collectors' use of the Chapter 13 claims allowance process as a means of collecting time-barred debt also violates the FDCPA's prohibition against the use of "unfair or unconscionable means to collect or attempt to collect" consumer debt. 15 U.S.C. § 1692f. By filing their proofs of claims for time-barred debts, debt collectors succeed only when the bankruptcy process breaks down and fails—as it routinely does. Their proofs of claims have no legitimate purpose: there are *zero* circumstances in which Congress intended time-barred claims to divert funds from the estate. The Debt collection industry's scheme is "'unfair,' 'unconscionable,' 'deceptive,' and 'misleading' within the broad scope of § 1692e and § 1692f." *Crawford*, 758 F.3d at 1260.

Debt collectors' proofs of claims are also unfair because they force the debtor to take the

right to payment." *Id.* "That proof of claim is allowed unless and until a debtor, a trustee, or another creditor objects to the claim." *Id.* (citing 11 U.S.C. § 502). "If no one objects, the claim will be paid from any assets available in the bankruptcy estate." *Id.*

14 *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076 (7th Cir.2013).

15 *McMahon v. LVNV Funding, LLC*, 744 F.3d 1010, 1020 (7th Cir. 2014).

16 Surprisingly, despite the clarity of the reasoning in *Phillips* and *McMahon*, the Seventh Circuit's recent split opinion in *Owens* (Chief Judge Woods dissenting) held otherwise. *Owens v. LVNV Funding, LLC*, 2016 WL 4207965 (7th Cir. Aug. 10, 2016). *Owens*, however, is distinguishable to the extent that it relies upon application of the "competent attorney" standard and not the least sophisticated consumer or unsophisticated consumer standard applicable in nearly every other Circuit.

unnecessary action of filing a claim objection when the debt collector knows its proof of claim is subject to an iron-clad affirmative defense. Claims in bankruptcy are automatically "allowed" unless someone objects. 11 U.S.C § 502(a). Under this automatic-allowance procedure, all unchallenged claims—even patently *invalid* claims—are included by default in Chapter 13 Trustee distributions pursuant to debtors' confirmed Chapter 13 plans. This creates opportunities for abuse: debt collectors that knowingly file defective claims can "unfairly game[] the system by taking advantage of the automatic claims allowance process . . . camouflaging [their claims] among the inundation of other claims filed," and hoping to "slip past the bankruptcy court's supervision unnoticed." *Feggins v. LVNV Funding LLC* (*In re Feggins*), 535 B.R. 862, 869 (Bankr. M.D. Ala. 2015). The sophisticated players within the professional debt collection industry know that if the process breaks down, they will illegitimately collect, despite having unenforceable claims, directly contrary to Congress's intent. *See* 15 U.S.C. § 1692f(1) (prohibiting "[t]he collection of any amount" not "permitted by law"). Indeed, if debt collectors could not profit from these claims, it is clear they would stop filing them.

Thus, rather than relying on the system's intended operation, the debt collection industry's business model depends on system failure.[17] These claims have no legal justification. *Avalos v. LVNV Funding LLC* (*In re Avalos*), 531 B.R. 748, 757 (Bankr. N.D. Ill. 2015). These debt collectors do not (and *cannot*) contend that they have any good-faith basis for their filings. Their only hope is that the system *malfunctions*. Debtors may unwittingly "fail to object," and the trustee may

[17] System failure is also all too predictable. Consumer debtors may review claims without an attorney, and many unrepresented debtors are unaware of limitations defenses. While trustees and attorneys are likely aware of limitation defenses generally, Chapter 13 Trustees in this district do not object to stale claims. Further, the mere presence of the last transaction date and/or charge-off date on the proof of claim is insufficient to inform the consumer or his counsel of the applicable statute of limitations. Where, as in the case at bar, the creditor fails to attach the contract (in violation of Rule 3001) there is no way to determine the applicable state law without further investigation. The debt collection industry, by design, takes improper advantage of these predictable deficiencies.

"fail[] to fulfill its statutory duty to object to improper claims." *Crawford*, 758 F.3d. at 1259 n. 5, 1261. When that happens, debt collectors can force Plaintiff to "pay the debt from [their] future wages as part of the Chapter 13 repayment plan, notwithstanding that the debt is time-barred and unenforceable in court." *Id*. at 1259.

This scheme is "an abuse of the claims allowance process and an affront to the integrity of the bankruptcy court." *Feggins*, 535 B.R. at 868. By filing their claims for legally unenforceable debts, debt collectors impose pointless costs on courts and innocent parties without any offsetting societal value or public benefit. In the best-case scenario, debtors, debtors' counsel, and/or the Chapter 13 Trustee are burdened with the hassle and expense of filing needless claim objections, and the court is forced to waste its time and resources rejecting the claims. In the worst-case scenario, the process breaks down and allows the invalid claims, diverting limited funds from vulnerable debtors and honest creditors. The basic administration of the Chapter 13 process is already sufficiently complex and labor-intensive without debt collectors' deliberate filing of baseless claims.

5. The Bankruptcy Code's claims allowance process does not authorize the filing of frivolous claims, and the knowing assertion of a claim subject to an iron-clad affirmative defense violates Rule 9011.

Debt collectors routinely claim that their filing of proofs of claims on out-of-statute debt is permitted by the Bankruptcy Code. However, the claims-process permits *genuinely disputed* claims; it does not tolerate (much less "permit") frivolous claims *indisputably* subject to an iron-clad defense. Nor does Rule 9011. *See, e.g., Calhoun*, 34 F.3d at 1299. The Code specifically authorizes a defense to time-barred claims only because otherwise there would be no mechanism for discarding untimely claims mistakenly filed in good faith. That hardly suggests that the

Bankruptcy Code permits parties to *knowingly* file defective claims—any more than Fed. R. Civ. P. 11 invites parties to file frivolous lawsuits or Title 18 of the U.S. Code invites parties to commit felonies. *See*, *e.g.*, *Trevino*, 535 B.R. 110.[18] Likewise, debt collectors' filing of proofs of claims for time barred debts when they already know their claims are time-barred at the time they were filed, violates Rule 11 as the Fifth Circuit plainly articulated in *Calhoun*. *See*, *Calhoun*, 34 F.3d at 1299.

6. Debt collectors violate the FDCPA by falsely representing that their time-barred proofs of claims are based on valid and legally enforceable debts despite knowing the opposite is true.

A debt collector's intentional filing of a proof of claim for a time-barred debt in bankruptcy violates the FDCPA's prohibitions against the use of deceptive or misleading communications and/or means of debt collection, unfair means of debt collection, and conduct the natural consequences of which is to harass and abuse consumers like the Plaintiff, and thus violates 15 U.S.C. §§ 1692d, 1692e, 1692f. The FDCPA "specifically prohibits the false representation of the character or legal status of any debt," which precisely describes this conduct. *McMahon*, 744 F. 3d at 1020. Their claims are indisputably time-barred and unenforceable. Yet, "[i]n the context of the Bankruptcy Code's automatic claims allowance process, the filing of a proof of claim amounts to an assertion that the underlying claim is enforceable and that the claimant is entitled to be paid out of the bankruptcy estate." *Feggins,* 535 B.R. at 869.

Particularly from the perspective of the least sophisticated consumer, proofs of claims convey the clear impression that they are based on valid and enforceable debts. These claims were

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[18] In any event, even if a creditor "may" file a proof of claim in a Chapter 13, if the creditor is also a "debt collector," as defined by the FDCPA, the creditor may be liable under the FDCPA for "misleading" and "unfair" practices when it files a claim on a debt it knows to be time-barred, and in doing so, creates the misleading impression to the debtor that the debt collector can legally enforce the debt. *Johnson*, 2016 WL 2996372 at *6 (citing *Crawford*, 758 F.3d at 1261).

filed on an official government form in a formal legal proceeding and are signed under criminal penalty by a corporate representative attesting to their validity. These claims do not affirmatively disclose that they are subject to a statute of limitations defense or otherwise invite an objection from the debtor. Rather, the simple fact that they are filed at all clearly implies that they are based on legally enforceable obligations of the debtor.

> As the Seventh Circuit has held, "[t]he proposition that a debt collector violates the FDCPA when it misleads an unsophisticated consumer to believe a time-barred debt is legally enforceable, regardless of whether litigation is threatened, is straightforward under the statute." *McMahon,* 744 F.3d at 1020; *see also Buchanan,* 776 F.3d at 399. The proposition is straightforward because § 1692e(2)(A) specifically prohibits "[t]he false representation of the character ... or legal status of any debt." And the issue of "[w]hether a debt is legally enforceable" is undoubtedly "a central fact about the character and legal status of that debt." *McMahon,* 744 F.3d at 1020. A misrepresentation about that fact thus constitutes a direct violation of § 1692e(2)(A). *Id.*

Carter v. First Nat. Collection Bureau, Inc., 135 F. Supp. 3d 565, 571 (S.D. Tex. 2015).

The Seventh Circuit's conclusion in *McMahon*, adopted by the District Court for the Southern District of Texas in *Carter*, is consistent with the findings of the federal agencies that regulate debt collectors through enforcement of the FDCPA (the Federal Trade Commission ("FTC") and the Consumer Financial Protection Bureau ("CFPB")): "consumers can be misled or deceived when debt collectors seek partial payments on stale debt," [and] "'most consumers do not know or understand their legal rights with respect to the collection of time-barred debt, so attempts to collect on stale debt in many circumstances may create a misleading impression that the consumer could be sued.'"[19]

[19] *Carter*, 135 F. Supp. 3d at 573 (internal citations omitted). *See Structure and Practices* at 47; *Repairing a Broken System* at 26; *McMahon*, 744 F.3d at 1015. *See also Crawford*, 758 F.3d at 1260 (noting that "limitations periods '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,'" (citing *United States v. Kubrick,* 444 U.S. 111, 117, 100 S.Ct. 352, 356–57, 62 L.Ed.2d 259

Moreover, courts have held far less consequential/far more innocuous forms of debt collection conduct aimed at recovering on time-barred debt to be deceptive and unfair in violation of the FDCPA. For example, dunning letters, which, unlike proofs of claims, result in no legal consequences if ignored, have easily been found to violate the FDCPA as unfair and misleading when they demand payment on time-barred debt without affirmatively disclosing to the consumer that the debt is legally unenforceable due to the expiration of the statute of limitations. *See Carter*, 135 F. Supp. 3d at 574. *Phillips*, 736 F.3d 1076; *Langley v. Northstar Location Servs., LLC,* No. CV H-16-1351, 2016 WL 4059355, at *3 (S.D. Tex. July 28, 2016) (it is appropriate to deny motions to dismiss when a § 1692e or f claim raises a fact issue as to how the unsophisticated consumer would perceive a debt collector's communication); *In re Murray*, 552 B.R. 1, 7 (Bankr. D. Mass. 2016) (under the least sophisticated consumer test, it makes no difference whether the consumer was actually misled as to the legal status of the debt); *Marquez*, 15-3273, (7th Cir. Sept. 7, 2016); *Heintz*, 514 U.S. 291; *Castro,* 634 F.3d 779. The technical correctness of the information on the face of a proof of claim that fails to disclose that it is based on a time-barred debt does not change the deceptive, misleading, unfair, harassing and abusive nature of this conduct: Whatever other information it may convey, filing a proof of claim is an assertion by the claimant that it has a legally enforceable right to payment.

C. The so-called "protections" that the Chapter 13 bankruptcy process provides to consumers do not work and are not a proper consideration when evaluating whether debt collectors' debt collection communication or means violates the FDCPA.

(1979)) ("the right to be free of stale claims in time comes to prevail over the right to prosecute them.") and that statutes of limitations "protect defendants and the courts from having to deal with cases in which the search for truth may be seriously impaired by the loss of evidence, whether by death or disappearance of witnesses, fading memories, disappearance of documents, or otherwise.").

Many published opinions have suggested that debt collectors that file proofs of claims for time-barred debt do not violate the FDCPA because consumers in bankruptcy supposedly have unique "protections" that consumers being sued in state court lack. However, in addition to being irrelevant to a proper FDCPA analysis under the Supreme Court's reasoning in *POM Wonderful*, the alleged "protections" of the Bankruptcy Code are illusory (otherwise this issue would not presently be so relevant). *See Edwards*, 539 B.R. at 365-67 (refuting all such arguments). First, debt collectors' proofs of claims in Chapter 13 for time-barred debts are actually more deceptive, unfair, and harmful for consumers than ordinary debt collection litigation because they are more likely to result in some payment, which has the dual impact on the consumer of potentially reviving the debt if the bankruptcy case is dismissed (as is frequently the case) and diminishing payment to other creditors holding claims based on valid, legally enforceable obligations. *See id.* at 366-67 (noting no need to pursue post-judgment discovery and collection in Chapter 13 because they system already provides a simple mechanism for payment – the Chapter 13 trustee). *Feggins*, 535 B.R. at 873-74 (potential for abuse by creditor even greater in bankruptcy than state court because the debtor has the burden not only to object to the claim but also proving the merits of the objection); c*f. In re Brunson*, 486 B.R. 759, 768 (Bankr. N.D. Tex. 2013) (debtor has no right to default judgment in context of objection to proof of claim).

Several courts have cited to the Trustee's duties to object to claims pursuant to 11 U.S.C. § 1302(b)(1), which allegedly obviates the need for the protections of the FDCPA.[20] However, the Chapter 13 Trustees around the country rarely, if ever, object to proofs of claim based on expiration

[20] Again, these arguments are refuted by the Supreme Court's reasoning in *POM Wonderful*, which requires enforcement of both the Bankruptcy Code and the FDCPA unless they irreconcilably conflict. *POM Wonderful*, 134 S. Ct. 2237.

of the applicable statute-of-limitations, even in cases where the debtor is not represented by counsel. Thus, unenforceable claims are in fact getting paid despite the supposed "statutory" duties of the Chapter 13 Trustee.[21] This is not, as the debt collection industry's argument suggests, because Chapter 13 Trustees are failing to do their job. Rather, without reviewing the underlying agreement and conferring with either or both the debtor and the creditor directly, Chapter 13 Trustees have no way of knowing what state's statute of limitations applies, much less whether the debts in question are indeed time-barred.

Moreover, and more importantly from an FDCPA perspective, as discussed above, the Fifth Circuit's precedent establishes that debt collectors' conduct is to be evaluated objectively from the perspective of the least sophisticated consumer, not the perspective of the Chapter 13 Trustee, debtors' counsel, or the court. Accordingly, how other more sophisticated participants in the bankruptcy process might understand these proofs of claim is not relevant to determine whether debt collectors' conduct violates the FDCPA.

Indeed, many debtors in bankruptcy are not represented, and thus do not have that supposed "protection" of counsel. *Edwards*, 539 B.R. at 366-67 (noting that no *pro se* debtor had successfully objected to a proof of claim in the court's 16 years on the bench). Many debtors' counsel do not object to stale proofs of claim (and should not have to, as explained elsewhere in this paper). Finally, whether or not a consumer has an attorney is irrelevant for the purposes of the FDCPA, which is a strict liability statute. Consistent with the Eleventh Circuit's holding in

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[21] In fact, if Chapter 13 Trustees did object to these claims, "the business of buying stale claims and filing proofs of claim in bankruptcy to collect on them would not be profitable," and debt buyers would stop doing it. *Edwards*, 539 B.R. at 365. "Instead, it appears to be a big and prosperous business." *Id.* (citing Jake Halpern, *Paper Boys: Inside the Dark, Labyrinthine and Extremely Lucrative World of Consumer Debt Collection*, N.Y. Times, August 17, 2014, Magazine). "[U]nenforceable claims are in fact getting paid despite the statutory duties of chapter 13 trustees." *Id.* at 366.

Johnson, the careful rationale of the 9th Circuit in *McCollough*, with Justice O'Connor sitting on the panel, unequivocally determined that the FDCPA applies even during litigation and even when the consumer is represented by counsel. *McCollough v. Johnson, Rodenburg & Lauinger, LLC,* 637 F.3d 939 (9th Cir. 2011) (debt collector's requests for admission in litigation that alleged facts the debt collector knew to be false violate the FDCPA §§ 1692e and 1692f). Indeed, in *Heintz v. Jenkins*, the Supreme Court held that the FDCPA applied to the litigation activities of lawyers in case where the consumer sued under the FDCPA with respect to a letter opposing counsel had sent to her lawyer. *Heintz v. Jenkins,* 514 U.S. at 299. All the concerns of *Phillips* and *Castro*, including the passage of time and the likelihood that the unsophisticated consumer would not know to assert a statute of limitations defense – are just as present in bankruptcy. *See Edwards,* 539 B.R. at 366-67.

The argument that the filing of a proof of claim has "less of an impact" on the debtor than the filing of a collection lawsuit also does not stand up to scrutiny, particularly under a strict liability FDCPA analysis. In a Chapter 13 bankruptcy, claims are almost always paid from a debtor's earnings. "Thus, real money from the debtor's post-petition income for a period of three to five years is used to pay creditors who file proofs of claim, including creditors like the defendants who routinely file claims that are unenforceable." *See id.* at 366. In many districts, the "unsecured creditors' pool" directly affects the total amount the debtor must pay to complete his plan, and in many cases, the best interest of creditors test in 11 U.S.C. § 1325(a)(4) and other provisions require debtors to pay a significant percentage, up to 100%, of all unsecured debt. "Thus, each allowed unsecured proof of claim can and often does have a real impact on the amount that a debtor must pay under his plan from his post-petition income." *Id.*

In short, Congress has never said that if a consumer has other protections, the FDCPA does not apply. Certainly, in enacting the Bankruptcy Code just one year after the FDCPA, Congress did not say, "Because this new Bankruptcy Code has so many protections for consumers, the FDCPA does not apply to actions taken by debt-collectors with respect to consumers in bankruptcy." The courts that have found otherwise have, basically, ruled incorrectly that the Bankruptcy Code implicitly repeals the FDCPA, without performing the proper analysis.

D. The debt collection industry's practice of systematically flooding bankruptcy courts with proofs of claims for debts they know to be time-barred is also an abuse of process.

The Fifth and Eleventh Circuits have specifically held that abuse of the proof-of-claim process can be remedied through the Court's § 105 powers. *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348, 356 n. 1(5th Cir. 2008); *see also Johnson* 2016 WL 2996372 at *5 (court can use § 105(a) to issue sanctions for creditor misbehavior in case where debt collector filed proofs of claims for out-of-statute debt, as well as provide remedies pursuant to FDCPA); *Rojas v. Citi Corp. Trust Bank FSB (In re Rojas),* 2009 WL 2496807 (Bankr. S.D. Tex. Aug. 12, 2009) (bankruptcy court can provide relief pursuant to §105 in nationwide class action alleging creditor filed false proofs of claims); *Trevino,* 535 B.R. at 126-127) (court refused to dismiss claims for abuse of process where creditor refused to withdraw claim for amounts that it knew the debtors did not owe and continued to litigate and argue that the debtors must pay the claim); *In re Dansereau*, 274 B.R. 686 (Bankr. S.D. Tex. 2002) (issuing sanctions pursuant to § 105 and/or Fed. R. Bankr. P. 9011 and an injunction to stop creditors from repeatedly filing proofs of claim marked as priority when they were not, thus causing trustees and debtors to file objections to them, resulting in added time and cost for the parties and the court.).

The debt collection industry's argument that filing a proof of claim in a Chapter 13 bankruptcy does not support a finding of bad faith is incorrect and relies on the misguided and unsupported rationale in *Robinson v. JH Portfolio Debt Equities, LLC*, 2016 WL 4069395 (Bankr. W.D. La. July 28, 2016). The *Robinson* opinion asserts that since there is "almost constant court oversight" in the claims allowance and objections process, it would be nearly impossible for a debt collector to consistently abuse the Chapter 13 claims process. *Id.* at *11. However, the *Robinson* court's reasoning fails to recognize that if its assumption was accurate, debt collectors would not be intentionally filing thousands of proofs of claims to collect on out of statute debts. In reality, the debt collection industry knowingly files thousands and thousands of frivolous proofs of claim on time-barred debts, knowing full-well that such claims will be disallowed anytime a debtor objects. Such actions are in bad faith and constitute a b razen abuse of the bankruptcy process.

Debate: Assets Can Be Sold Free & Clear of Liens in State Court Receiverships

I. State Receiverships

a. Purpose

i. An assignment for the benefit of creditors is a voluntary transfer of property, usually to a trustee or "general assignee," who administers the property, liquidates it, and distributes the proceeds equitably to all creditors. Hanna, *Contemporary Utility of General Assignments*, 35 VA. L. REV. 539, 539-40 (1949). The purpose of a receivership, or an assignment for the benefit of creditors, is to have a court-supervised, orderly liquidation of the assets of a business. *See*, Lucey, *The Liquidating "Chapter 11" in State Court,* ABI Journal (February 2001).

b. Powers of the Court and Receiver Under Recently-Enacted Missouri Statute

i. "[T]he court . . . shall have the power to appoint a receiver, whenever such appointment shall be deemed necessary . . . ." Mo. Rev. Stat. § 515.510.1. A receiver may be a limited receiver (appointed to take possession of only limited or specific property of the debtor) or a general receiver (appointed to take control of all or substantially all of the debtor's property).

ii. The appointment of a general receiver operates as a stay similar to the Bankruptcy Code's automatic stay for sixty days (or longer, if good cause shown). Mo. Rev. Stat. § 515.575.

iii. As of the time of appointment, "the receiver shall have the powers and priority as if it were a creditor that obtained a judicial lien at the time of appointment on all of the debtor's property that is subject to the receivership. . . ." Mo. Rev. Stat. § 515.535.

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iv. Except as otherwise provided, "the court in all cases has exclusive authority over the receiver, and the exclusive possession and right of control with respect to all real property and all tangible and intangible personal property with respect to which the receiver is appointed, wherever located . . . ." Mo Rev. Stat. § 515.540.

v. The receiver is authorized to operate the debtor's business: "If the appointment applies to all or substantially all of the property of an operating business or any revenue-producing property of the debtor, to do all the things in which the owner of the business or property may do in the exercise of ordinary business judgment, or in the ordinary course of the operation of the business as a going concern or use of the property including, but not limited to, the purchase and sale of goods or services in the ordinary course of such business, and the incurring and payment of expenses of the business or property in the ordinary course." Mo. Rev. Stat. § 525.545.1(2).

vi. If the receiver is authorized to operate the debtor's business or manage a debtor's property, the receiver may incur unsecured debt in the ordinary course of business as an administrative expense without court order; incur unsecured debt outside of the ordinary course with court order; and lien up the debtor's property, even if already secured. Mo. Rev. Stat. § 515.590.

vii. The receiver may assume, assign, and reject executory contracts. Mo. Rev. Stat. § 525.585.

viii. The receiver may sell assets free and clear of liens, claims, and of all rights of redemption. Mo. Rev. Stat. § 515.645 The receiver may abandon property. Mo. Rev. Stat. § 515.640.

ix. The receiver may assert claims and causes of actions, including fraudulent transfer claims. Mo. Rev. Stat. § 515.545.1.

x. The receiver may employ professionals with court approval. Mo. Rev. Stat. § 515.605.

xi. The receiver may demand turnover of estate property from any person in possession of such property, subject to court determination if a bona fide dispute exists. Failure to turn over property ordered by the court is punishable as a contempt of the court. Mo. Rev. Stat. § 515.550.1.

xii. The receiver may object to claims. Mo. Rev. Stat. § 515.620.1.

xiii. The statute sets out priorities of payment of unsecured claims. Mo. Rev. Stat. § 515.625.

xiv. The receiver has subpoena powers. Mo. Rev. Stat. § 515.545.1(9).

xv. The court may require a debtor to make business records available and submit to examination by the receiver. Mo. Rev. Stat. § 515.555.

xvi. The court may expand, modify or limit the receiver's statutory powers, authorities, and duties. Mo. Rev. Stat. § 515.545.3.

c. Common Powers of the Court

i. The circuit court has supervision of proceedings under Chapter 128, and may make all necessary orders and judgments, including the determination of lien rights. *Premke v. Pan American Motel, Inc.,* 35 Wis. 2d 258, 265 (1967).

ii. The court may provide for hearings and meetings of creditors or may remove a receiver or assignee under some circumstances and must remove a receiver or assignee under other circumstances. Wis. Stat. § 128.10(1)

iii. The court may implement "appropriate provisions remedies" and final relief is to be administered "to the equal distribution of all assets recovered among the creditors of the debtor." Wis. Stat. § 128.11.

iv. The court may make orders for payment of costs and expenses "as may be just," and can "enjoin proceedings" by other creditors against the insolvent. This is a discretionary and not a mandatory action by the court. Wis. Stat. § 128.14(1).

v. The court may order distribution of dividends, as well as payment of wage claims with priority. Wis. Stat. § 128.17(3) and (4).

vi. The court may condition the appointment of a receiver upon the giving of security by the person seeking the appointment of a receiver. Mo. Rev. Stat. § 515.510.5.

II. Constitutionality

a. Challenges to the constitutionality of receiverships have been generally unsuccessful, with the legislature making modifications where necessary to respond to constitutional failings.

i. *Pobreslo v. Joseph M. Boyd Co.,* 287 U.S. 518 (1933)

1. Supreme Court rejected appellant's contention that Wisconsin's receivership statute contravened the National Bankruptcy Act. Rather, the assignment did not have the effect of instituting proceedings contemplating discharge of the assignor from its debts, and the Court held that the statute was served to protect creditors against each other and assured equality of distribution unaffected by any requirement or condition in respect of discharge. The Court concluded that the statute was not inconsistent with the purposes of the Bankruptcy Act and was a valid and effective means to prevent garnishment of funds in the hands of the appellee.

A. "(T)he Wisconsin law merely governs the administration of trusts created by deeds like that in question, which do not differ substantially from those arising under common law assignments for the benefit of creditors. The substantive rights under such assignments depend upon contract; the legislation merely governs the execution of the trusts on which the property is conveyed. And as proceedings under any such assignment may be terminated upon petition of creditors filed within the time and in the manner prescribed by the federal [A]ct, it is apparent that Congress intended that such voluntary assignments, unless so put aside, should be regarded as not inconsistent with the purposes of the federal [A]ct." *Id*. at 526 (citations omitted).

ii. *In re Wisconsin Builders Supply Co*., 239 F.2d 649 (7th Cir. 1956)

1. Debtor executed a general assignment to a state receiver for the benefit of its creditors, then filed a voluntary bankruptcy petition. The trustee sought an order requiring the receiver to turn over the debtor's assets to the trustee. A referee found the appointment of the receiver void and that the state liquidation laws conflicted with the National Bankruptcy Act, so a turn over order was issued and the district court affirmed the order. On appeal, the state receiver argued that the assignment was valid because the voluntary provisions of the state liquidation laws were not preempted by the National Bankruptcy Act, and they were severable from the offensive involuntary state provisions. The appellate court reversed and remanded the order requiring surrender of debtor's assets to the trustee, finding that the voluntary provisions of the state law were not in conflict with the federal statutes.

A. "Section 128.01 provides that all assignments for the benefit of creditors shall be subject to the provisions of Chapter 128, and that the circuit courts shall have supervision of the proceedings under this chapter and may make all necessary orders and judgments therefor. The Supreme Court has expressly held that general assignments may be regulated by state statutes and supervised by state courts exercising powers specifically conferred by statute." *Id.* at 653.

B. "We fail to find any significant departures which would cause Chapter 128 to be legislation 'tantamount to bankruptcy.'" *Id.* at 655.

C. "The judgment is reversed and the cause remanded to the District Court with instructions to order the trustee in bankruptcy to return to the state court receiver all assets, if any, of the debtor, Wisconsin Builders Supply Co., in his possession or control." *Id.* at 657.

b. State receiverships have been found unconstitutional when they extend to persons or property outside the state's jurisdiction or conflict with the national bankruptcy laws.

i. When voluntary assignments contribute to bankruptcy's goal of equitable distribution, in harmony with the purposes of the Bankruptcy Code, state receiverships serve to protect creditors against each other and assure the equality of distribution unaffected by any requirement or condition in respect of discharge. However, when state laws provide for the full discharge of debts, they are preempted by federal bankruptcy law and are unconstitutional. Therefore, in general, discharge can be labeled as the limit of preemption or constitutionality, and preference statutes that supplement voluntary assignments generally survive constitutional challenges. *See,* Feld, *The Limits of Bankruptcy Code Preemption: Debt Discharge and Voidable Preference Reconsidered in Light of Sherwood Partners*, 28 Cardozo L. Rev. 1447 (2006).

ii. *International Shoe Co. v. Pinkus*, 278 U.S. 261, 49 S. Ct. 108 (1929)

1. On the day plaintiff in error obtained judgment against defendant in error debtor,

the debtor commenced a suit in chancery court praying to be adjudged insolvent and for the appointment of a receiver to take and distribute his property as directed by the Arkansas insolvency statute. Plaintiff in error brought suit asserting that the state insolvency statute had been superseded and suspended by passage of the Bankruptcy Act, and requested the judgment be paid out of the funds in the hands of the receiver. The chancery court overruled this contention, and dismissed the suit. The Arkansas Supreme Court affirmed. On writ of error, the court reversed, holding that the Arkansas statute was superseded by the Bankruptcy Act, and that plaintiff in error was entitled to have its judgment paid out of the fund in the hands of the receiver. The court found that enforcement of state insolvency systems would conflict with the national purpose to have uniform bankruptcy laws.

A. "A state is without power to make or enforce any law governing bankruptcies that impairs the obligation of contracts or extends to persons or property outside its jurisdiction or conflicts with the national bankruptcy laws." *Id*. at 263-264.

B. "The power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount. Constitution, Art. I, § 8, cl. 4. The purpose to exclude state action for the discharge of insolvent debtors may be manifested without specific declaration to that end; that which is clearly implied is of equal force as that which is expressed. The general rule is that an intention wholly to exclude state action will not be implied unless, when fairly interpreted, an Act of Congress is plainly in conflict with state regulation of the same subject. In respect of bankruptcies, the intention of Congress is plain. The national purpose to establish uniformity necessarily excludes state regulation. It is apparent, without comparison in detail of the provisions of the Bankruptcy Act with those of the Arkansas statute, that intolerable inconsistencies and confusion would result if that insolvency law be given effect while the national Act is in force. Congress did not intend to give insolvent debtors seeking discharge, or their creditors seeking to collect claims, choice between the relief provided by the Bankruptcy Act and that specified in state insolvency laws. States may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations." *Id.* at 265.

III. The Supremacy Clause and Federal Preemption

a. "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const., amend. X.

b. Although only Congress, and not state legislatures, may enact discharge provisions to relieve debtors of their previously incurred debts, states are largely free to enact collective creditor regimes. *See* Feld, *supra*. Statutes that regulate receiverships or assignments for the benefit of creditors are thus permitted. In fact, the federal Bankruptcy Code specifically refers to their existence, making their creation within 120 days of a bankruptcy petition grounds for an adjudication in an involuntary bankruptcy case (11 U.S.C. § 303(h)(2)), and also requiring "custodians"—a term defined to include assignees for the benefit creditors (§ 101(11))—to turn over their estate to bankruptcy trustees when the bankruptcy petition has been filed within 120 days of the assignment. (11 U.S.C. § 543(b)(1)).

i. *Johnson v. Star*, 287 U.S. 527, 53 S. Ct. 265 (U.S. 1933)

1. Appellants challenged an order that reversed a judgment holding a state law was in conflict with federal bankruptcy law, and that the amount appellants sought to garnish was therefore subject to garnishment. Appellants had obtained a judgment against a debtor corporation which, being insolvent, assigned all its property to appellee for its creditor's benefit. Appellants refused to accept under the assignment and brought garnishment proceedings. Appellee argued he had converted the assigned property into cash, which was not subject to garnishment. The lower courts held appellee liable, but an appeals court reversed on the grounds that a state statute barred non-consenting creditors from seizing property covered by such assignments. The state's highest court affirmed. Appellant argued the state statute as construed was repugnant to federal bankruptcy statutes. The Supreme Court disagreed and affirmed, holding that an assignment that conveyed all debtor's property for the equal benefit of all his creditors who may accept under it was valid, even under the common law, except as against proceedings seasonably taken under the federal bankrupt act.

   A. "The statute in question is in no sense an insolvent law, providing for the discharge of a debtor by a compliance with its terms without the consent of the creditor; but is a statute which, for the better protection of creditors, prescribes a mode for the administration of the estates of insolvents under assignments made by the debtors themselves, which would be good at common law, unaided by the statute, and, like any other trust, could be enforced in a court of equity in the absence of a statute providing a mode of administration." *Id.* at 528-529.

B. "(I)n so far at least as an insolvent law of a State provides for a release by the creditors, it is suspended by a bankrupt law of the United States, but that if the assignment convey all the debtor's property subject to the payment of his debts for the equal benefit of all his creditors who may accept under it, it is otherwise valid, except as against proceedings seasonably taken under the bankrupt act." *Id.* at 529.

c. The two primary goals of bankruptcy are discharge and equitable distribution. State statutes granting a discharge are preempted whether or not the state discharge is identical to the federal discharge provision, and the Ninth Circuit extended this reasoning to state statutes implicating the goal of equitable distribution. According to the Ninth Circuit, if assignees can avoid preferences for the benefit of creditors under the state statute, the Bankruptcy Code's goal of equitable distribution would be frustrated. *See* Feld, *supra*.

i. *Sherwood Partners Inc. v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005)

1. Pursuant to a renegotiated agreement, the debtor paid the creditor $1 million but failed to deliver stock. About two months later, the debtor made a voluntary general assignment for the benefit of creditors to the assignee. The assignee shut down the debtor's business and sought to recover the $ 1 million payment to the creditor as a preferential transfer. The court determined that the Bankruptcy Code preempted the California statute, which gave the assignee the power to void preferential transfers that could not be voided by an unsecured creditor. The statute was preempted because: (1) 11 U.S.C. § 544(b) did not specifically incorporate the preference avoidance provisions of Cal. Code Civ. Proc. § 1800, since the trustee's powers under 11 U.S.C. § 544(b) were limited to those of unsecured creditors and the

assignee appointed pursuant to Cal. Code Civ. Proc. § 1800 was given new avoidance powers by virtue of his position, and (2) the exercise of the preference avoidance power by the assignee under the authority of § 1800 was inconsistent with the enactment and operation of the federal bankruptcy system.

A. "Congress has broad authority to preempt state laws, but whether Congress has done so in a particular instance is a matter of congressional intent. This intent is most easily detected where the statute expressly preempts other laws, but preemption may also be inferred where it is clear from the statute and surrounding circumstances that Congress intended to occupy the field, leaving no room for state regulation." *Sherwood Partners* at 1200.

B. The Supreme Court summarized the contours of the field preemption doctrine: "Absent explicit preemptive language, Congress' intent to supersede state law altogether may be found from a scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it, because the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject, or because the object sought to be obtained by the federal law and the character of obligations imposed by it may reveal the same purpose. Even where Congress has not entirely displaced state regulation in a specific area, state law is preempted where it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id.*, citing *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission*, 461 U.S. 190, 75 L. Ed. 2d 752, 103

S. Ct. 1713 (1983)

See also:

1. *In re Gokay*, 535 B.R. 758 (Bankr. S.D. Ohio 2015) (Ohio law providing that homestead exemption does not protect property from judgment liens for state taxes preempted by 11 U.S.C. § 522(f)).

2. *Viz Media LLC v. Steven M Spector PC*, 2007 WL 1068203 (N.D. Cal. Apr. 10, 2007) (despite *Sherwood Partners*, 11 U.S.C. § 547 does not preempt state law allowing assignment for benefit of creditors to avoid preference, provided avoidance powers are granted in equal measure to individual creditors).

3. *Carlson's for Music, Inc. v. Gould*, 176 Colo. 172, 489 P.2d 1038 (Colo. 1971) (portions of state statute providing for discharge are preempted, but those portions are severable).

4. *In re Newport Offshore*, 219 B.R. 341 (Bankr. D.R.I. 1998) (good discussion of purposes and workings of state receiverships).

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chapter 11 case or their recoveries under the plan. The Commissioners debated objective factors to determine whether a party sufficiently contributed to the process to be included in the exculpatory clause, but determined that a fact-intensive analysis would work best. They also emphasized that this limited immunity was not intended to protect bad actors, but rather to protect only those parties who act in good faith and who should be protected against claims relating to matters that should be resolved once the plan is confirmed and becomes effective.

The Commissioners discussed whether exculpatory clauses should protect the identified parties from simple negligence or something more. The Commission determined that immunity for conduct arguably constituting simple negligence should be subject to exculpation. It was not able to agree on the desirability of allowing exculpation for gross negligence or other standards of conduct, but believed that the parties and the court should make such decisions based on the facts of the case and public policy considerations. The Commission voted to recommend amendments to the Bankruptcy Code to clarify the permissibility of exculpatory clauses consistent with these principles and properly disclosed in the disclosure statement and plan.

3. Third-Party Releases

Recommended Principles:

- A debtor or plan proponent should be permitted to seek approval of third-party releases in connection with the solicitation and confirmation of the chapter 11 plan. Such third-party releases should be clearly and conspicuously highlighted and explained in the plan and the disclosure statement, identifying the proposed scope of, and parties to be covered by, the releases. The court should approve any such third-party releases based on evidence presented at the hearing and in accordance with the factors set forth below.

- In reviewing a proposed third-party release included in a chapter 11 plan, the court should consider and balance each of the following factors: (i) the identity of interests between the debtor and the third party, including any indemnity relationship, and the impact on the estate of allowing continued claims against the third party; (ii) any value (monetary or otherwise) contributed by the third party to the chapter 11 case or plan; (iii) the need for the proposed release in terms of facilitating the plan or the debtor's reorganization efforts; (iv) the level of creditor support for the plan; and (v) the payments and protections otherwise available to creditors affected by the release. In a case involving the application of third-party releases to creditors and interest-holders not voting in favor of the plan, the court should give significant weight to the last of these factors.

- A proposed release of a debtor's affiliates in the chapter 11 plan should be subject to the same review and approval process proposed above for general third-party releases in these principles.

Third-Party Releases: Background

A confirmed chapter 11 plan "discharges the debtor from any debt that arose before the date of such confirmation."[908] The discharge voids any judgments, and enjoins collection and similar actions, asserting personal liability against the debtor based on debts discharged under the plan.[909] Section 524(e) also provides that "[a] 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."[910] Courts and plan proponents often grapple with the scope and application of this limitation under section 524(e) in the context of third-party releases included in a chapter 11 plan. The Bankruptcy Code recognizes an exception to this limitation for debtors establishing trusts for asbestos claimants; in those cases, the court may enter an order enjoining actions against nondebtor parties.[911]

A release provision in a chapter 11 plan essentially relieves the identified nondebtor parties of any liability for any claims or causes of actions that third parties might hold against them. In a chapter 11 plan, a release may seek to cover the debtor's directors and officers, an unsecured creditors' committee and its members, a nondebtor plan proponent, a plan sponsor, the debtor's lenders and their agents, and other parties who may have been actively engaged in the chapter 11 case and perhaps made contributions to the process.[912] The release may encompass any and all claims or causes of action, or resulting liability, of these nondebtor parties. The release may be binding on only those third parties who consent to the release or who vote in favor of (or abstain from voting on) the plan and the release; it may also be binding on all third parties if the release is approved in connection with confirmation of the plan.[913]

Some commentators assert that section 524(e) prohibits all third-party releases, regardless of their scope or the parties purportedly bound by the provision. Two circuits, the Ninth and the Tenth, have adopted this strict view of third-party releases.[914] Specifically, the Ninth Circuit has stated: "The bankruptcy court lacks the power to confirm plans of reorganization which do not comply with the

908 11 U.S.C. § 1141(d)(1)(A).

909 *Id.* § 524(a). Specifically, section 524(a) provides that a discharge "voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, 1228, or 1328 of this title, whether or not discharge of such debt is waived." *Id.*

910 11 U.S.C. § 524(e).

911 11 U.S.C. § 524(g). *See generally Written Statement of Professor S. Todd Brown, SUNY Buffalo Law School Before the ABI Comm'n to Study the Reform of Chapter 11* (Nov. 7, 2013) (discussing issues related to resolution of asbestos claims), *available at* Commission website, *supra* note 55.

912 Nondebtor releases for insiders such as officers and directors may be subject to more rigorous scrutiny, in part because "[t]hose who benefit from this type of release are most likely the ones asserting that the debtor will be irreparably harmed without it." Elizabeth Gamble, *Nondebtor Releases in Chapter 11 Reorganizations: A Limited Power*, 38 Fordham Urb. L.J. 821, 840 (2011) (analogizing to *Spach v. Bryant*, 309 F.2d 886 (5th Cir. 1962) and noting that bankruptcy court must apply "careful attention and special scrutiny when the claimants are officers, directors or stockholders of the corporate bankrupt"). *See also* Hopper v. Am. Nat'l Bank of Cheyenne, Wyo. (*In re* Smith-Chadderdon Buick, Inc.), 309 F.2d 244, 247 (10th Cir. 1962) ("A claim presented by an officer or director of the bankrupt is subjected to rigorous scrutiny and the claimant must prove good faith and fairness in the transaction").

913 "[T]he provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan." 11 U.S.C. § 1141(a). *See also* Sharon L. Levin et al., *The* WaMu *Lesson: Craft Your Release Carefully*, Law360, Jan. 28, 2011 (discussing rejection of releases in chapter 11 cases of *Washington Mutual Inc.* and *WMI Investment Corp.*).

914 *See* Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1402 (9th Cir. 1995), *cert. denied*, 517 U.S. 1243 (1996) (holding that section 524(e) precludes bankruptcy courts from discharging the liabilities of nondebtors); Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 625 (9th Cir. 1989) (same); Underhill v. Royal, 769 F.2d 1426, 1432 (9th Cir. 1985) ("Section 524(e) precludes discharging the liabilities of nondebtors."). *See also* Landsing Diversified Props.-II v. First Nat'l Bank & Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 601 (10th Cir. 1990) (holding that nondebtor release "improperly insulate[s] nondebtors in violation of section 524(e)"), *modified*, Abel v. West, 932 F.2d 898 (10th Cir. 1991).

applicable provisions of the Bankruptcy Code. . . . This court has repeatedly held, without exception, that § 524(e) precludes bankruptcy courts from discharging the liabilities of nondebtors."[915] The Ninth Circuit has, however, recognized that nondebtor releases may be permitted in asbestos claims cases pursuant to specific statutory authority.[916] The Fifth Circuit also appears to be more restrictive than permissive with respect to third-party releases.[917]

The other circuits that have considered the issue focus instead on section 105(a) of the Bankruptcy Code, which gives the court authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."[918] These courts are willing to consider and approve third-party releases under appropriate circumstances. To make this determination, these courts undertake a fact-intensive inquiry analyzing factors such as any contractual or consensual basis for the releases, the role and contributions of the nondebtor parties in the chapter 11 case, the protections afforded by the plan for third parties bound by the releases, and whether the releases are necessary for the debtor's effective reorganization. [919]

Courts adopting a permissive approach to third-party releases do not find section 524(e) as impermeable barrier.[920] They generally point out that section 524(e) does not contain "language of prohibition" and thus should not be interpreted to limit the court's power under section 105(a).[921] They also may distinguish the releases based on the facts of the given case, such as when the third

915 Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1402 (9th Cir. 1995), *cert. denied*, 517 U.S. 1243 (1996).

916 *Id.* at 1402, n. 6 ("The Bankruptcy Reform Act of 1994 added § 524(g) to the [Bankruptcy] Code. That section provides that in asbestos cases, if a series of limited conditions are met, an injunction issued in connection with a reorganization plan may preclude litigation against third parties.").

917 The Fifth Circuit view on nondebtor third-party releases and exculpation clauses is less clear. In several cases, the court has rejected such third-party releases, particularly when such releases are nonconsensual. *See, e.g.,* Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 253 (5th Cir. 2009); Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995). However, some Fifth Circuit cases suggest that the court does not categorically disprove of such releases and may approve them in certain limited circumstances. Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 253 (5th Cir. 2009) (suggesting that nondebtor releases are "most appropriate as a method to channel mass claims toward a specific pool of assets"); Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995) (suggesting that a release may be approved where the third party nondebtor liability is not extinguished but instead channeled to a settlement fund). *But see* Ad Hoc Group of Vitro Noteholders v. Vitro S.A.B. de C.V. (*In re* Vitro S.A.B. de C.V.), 701 F.3d 1031, 1062 (5th Cir. 2012) (stating that "[the Fifth Circuit] has firmly pronounced opposition to [nonconsensual nondebtor] releases"). The Fifth Circuit's decision in *Vitro* contains very strong language suggesting a complete prohibition on nonconsensual third-party releases. Nevertheless, even in *Vitro*, the Fifth Circuit acknowledges that specific, rather than general, third-party releases may be permissible under certain limited circumstances: "We have distinguished other cases for including general, as opposed to specific, releases. As a result, *Republic Supply Co.* provides no guidance where, as here, we are confronted not by a specific release, but by a general release of all the non-debtor subsidiaries." *Id.* at 1068–69 (citations omitted). Accordingly, the Fifth Circuit appears to lean more toward the restrictive approach of the Ninth and Tenth Circuits but may not be as all-inclusive in its prohibition. In addition, the Fifth Circuit has actually approved of releases in some limited circumstances, although the court has utilized different statutory authorization to do so. *See, e.g.,* Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229 (5th Cir. 2009) (using section 1103(c) to approve exculpation provisions for members of the creditors' committee but rejecting other release provisions).

918 *See, e.g.,* MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89 (2d Cir. 1988), *cert. denied*, 488 U.S. 868 (1988) (noting that section 105(a) "has been construed liberally to enjoin suits that might impede the reorganization process").

919 Deutsche Bank AG v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 142 (2d Cir. 2005) ("Courts have approved nondebtor releases when: the estate received substantial consideration; the enjoined claims were 'channeled' to a settlement fund rather than extinguished; the enjoined claims would indirectly impact the debtor's reorganization 'by way of indemnity or contribution'; and the plan otherwise provided for the full payment of the enjoined claims. Nondebtor releases may also be tolerated if the affected creditors consent.") (citations omitted). "But this is not a matter of factors and prongs. No case has tolerated nondebtor releases absent the finding of circumstances that may be characterized as unique." *Id. See also* Gillman v. Cont'l Airlines (*In re* Cont'l Airlines), 203 F.3d 203, 212 (3d Cir. 2000) (indicating that nondebtor releases may be appropriate in extraordinary cases); Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 761–62 (5th Cir. 1995) (holding that nondebtor releases could be issued because case satisfied "unusual circumstances" requirement; released parties provided substantial consideration to the estate and the release was a key provision of the plan).

920 *See generally* Ryan M. Murphy, *Shelter from the Storm: Examining Chapter 11 Plan Releases for Directors, Officers, Committee Members, and Estate Professionals*, 20 J. Bankr. L. & Prac. 4 Art. 7, Sept. 2011 (general review of case law addressing third-party releases).

921 Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 979 (1st Cir. 1995) (citations omitted).

party claims subject to the release are not extinguished, but channeled to allow recovery from separate assets, which commonly means the nondebtor did not receive a complete discharge.[922] Notably, some courts have held that the court's power under section 105(a) in the nondebtor release context should be exercised only when there are unique circumstances. The U.S. Supreme Court also has, in *dicta*, provided an additional factor to consider: whether the claims against the nondebtor third party are derivative of the debtor's wrongdoing.[923]

Third-Party Releases: Recommendations and Findings

The Commission considered this basic question: Should the Bankruptcy Code prohibit third-party releases in chapter 11 plans? The Commission agreed that a blanket prohibition on third-party releases was inadvisable. The Commissioners discussed case examples and particular fact patterns in which third-party releases facilitated a confirmable plan and ultimately benefited all stakeholders. They recognized, however, that third-party releases might not be appropriate in every chapter 11 case. For example, a release provision could be overly broad or not really necessary, particularly in cases where the benefits of the release to the estate are nominal, but the harm to creditors is significant. Accordingly, the Commission rejected carte blanche approval of third-party releases, as well as a presumption in favor of such releases.

The Commissioners discussed the competing considerations underlying the third-party release debate. A debtor may need the assistance of nondebtor parties to effect its reorganization. This assistance may be in the form of service, collaboration, funding, business commitments, or other means that allow the debtor to achieve its objectives in the chapter 11 case or in its postconfirmation operations. Nondebtor parties may be reluctant to contribute to the plan or the debtor's reorganization efforts if the nondebtor party might be exposed to liability or will have ongoing liability despite confirmation of the chapter 11 plan. On the other hand, limiting creditors' recoveries to those provided under the plan may substantially change the nature of their rights against nondebtor parties, and in turn further reduce their overall recoveries. In these instances, from the creditors' perspective, nondebtor parties may be receiving a windfall at the creditors' expense.

In light of these considerations, the Commission methodically worked through the various issues that arise in the context of third-party releases. The Commissioners started from the premise that consensual third-party releases — those releases binding only on creditors who expressly consent to the release through a vote on the plan that includes consent to the third-party release, a separate indication on the ballot that the creditor consents to the third-party release, or a separate agreement from the creditor in which it consents to the release — should be enforceable. The Commission disagreed with the Ninth and Tenth Circuits' position that contractual agreements between the affected parties regarding a third-party release should not be enforced. The Commissioners found these kinds of contractual agreements outside the scope of section 524(e) and consistent with the underlying policies of the Bankruptcy Code.

922 Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760–61 (5th Cir. 1995).
923 Travelers Indemnity Co. v. Bailey, 557 U.S. 137, 155 (2009) ("Our holding is narrow. We do not resolve whether a bankruptcy court . . . could properly enjoin claims against nondebtor insurers that are not derivative of the debtor's wrongdoing.").

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The Commissioners then reviewed the different kinds of nonconsensual third-party releases commonly included in chapter 11 plans. The Commissioners observed the challenges in crafting a bright-line test or general approval standard for such nonconsensual releases. They then considered the different tests used by courts to evaluate nonconsensual third-party releases. Specifically, the Commissioners analyzed the multi-factor tests used by the courts in the *Dow Corning* and the *Master Mortgage* cases, respectively. For example, the court in *Dow Corning* stated:

> We hold that when the following seven factors are present, the bankruptcy court may enjoin a nonconsenting creditor's claims against a nondebtor: (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The nondebtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has 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; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions.[924]

The court in *Master Mortgage* articulated a five-factor test that considers: (1) the identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) whether the nondebtor has contributed substantial assets to the reorganization; (3) whether the injunction is essential to reorganization; (4) whether a substantial majority of the creditors agree to such injunction — specifically, whether the impacted class or classes have "overwhelmingly" voted to accept the proposed plan treatment; and (5) whether the plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.[925]

The Commission considered the application of each factor to different scenarios, including the relationship of the factors to nonconsensual releases. It agreed that in the context of nonconsenting creditors or classes of claims, the factors focusing on the contributions of nondebtor parties, percentage recoveries by the affected creditors, and mechanisms established to facilitate recoveries to those creditors were of particular importance, with specific emphasis on the last of these factors. On balance, the Commission recommended a standard based on the *Master Mortgage* factors and rejected application of the *Dow Corning* factors. It further determined that the *Master Mortgage* factors adequately captured the careful review required in these cases and declined to incorporate separate identification of unique or unusual circumstances.

924 *In re* Dow Corning Corp., 280 F.3d 648 (6th Cir. 2002), *cert. denied*, 537 U.S. 816 (2002).
925 *In re* Master Mortg. Inv. Fund Inc., 168 B.R. 930 (Bankr. W.D. Mo. 1994).