

SCOTUS Grants Debt Collectors Limited Reprieve

Bankruptcy & Restructuring Alert

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The United States Supreme Court recently held that the submission of a proof of claim in a Chapter 13 bankruptcy case for payment of a time-barred claim did not violate the Fair Debt Collection Practices Act (the "Act"). Overturning the decision of the Eleventh Circuit Court of Appeals, the Court explained that the Bankruptcy Code includes certain safeguards which limit the potential for abuse, and thus, the assertion of a time-barred claim in bankruptcy proceedings did not constitute a practice prohibited under the Act. The dissent took a more pragmatic approach which expressed a need to protect consumers amidst what it perceived as increasingly aggressive debt collection practices.

In *Midland Funding, LLC*, the debtor ("Respondent") filed a petition for relief under Chapter 13 of the Bankruptcy Code. The creditor ("Petitioner") timely filed a proof of claim concerning credit card debt incurred by the Respondent a decade prior to her bankruptcy petition. During the bankruptcy case, the Respondent's counsel objected to the claim as barred by the applicable statute of limitations. The Petitioner did not respond, and the bankruptcy court disallowed the claim. Thereafter, the Respondent brought suit in federal district court for alleged violations of the Act arising out of the Petitioner's submission of the proof of claim. The district court found that the Act did not apply and dismissed the action. The circuit court of appeals reversed, and the Petitioner appealed to the Supreme Court of the United States.

Justice Breyer, writing on behalf of the five-member majority, concluded that the filing of a proof of claim for a time-barred claim did not constitute a false, deceptive, misleading, unfair or unconscionable practice under the Act. At the outset, the majority acknowledged that the Bankruptcy Code defines a "claim" as "a right to payment." The Court further held that a party's right to payment is determined as a matter of state law, and that Alabama law recognized the Petitioner's right to receive payment of its debt after the expiration of the statute of limitations. The Respondent sought to counter these expansive rights by arguing that "claims" under the Bankruptcy Code are limited to "enforceable claims." The majority rejected this argument based on Section 101(5) of the Bankruptcy Code, specifically the absence of the word "enforceability" from the Bankruptcy Code's definition of "claim," and Congress's express recognition of the right to payment "whether or not such right is ... contingent ... [or] disputed." Where the right to payment included unenforceable claims, the Court reasoned that the Bankruptcy Code provides a framework for reconciling claims, in which the bankruptcy trustee

plays a pivotal role in objecting to the allowance of the claim, and if the objection is sustained, in preventing the creditor from receiving compensation. Accordingly, the Petitioner's submission of the proof of claim did not violate the Act.

Justice Sotomayor, on behalf of the three dissenting justices, took the majority to task for its reliance on the "structural features" of the Bankruptcy Code in light of the efforts of what it perceived to be improper debt collection practices. Citing to data from the Federal Trade Commission and Consumer Financial Protection Bureau, the dissent highlighted the financial incentive of professional debt collectors to pursue a recovery. Given the monetary investment, some professional debt collectors commence lawsuits regardless of the passage of time, based on the hope that the consumer will not respond. This practice exploits the fact that the statute of limitations is an affirmative defense which must be asserted. Although the adversarial process is the foundation of the American legal system, the dissent complained that placing the onus on consumers to expend resources to assert a statute of limitations defense often results in the court entering default judgment against the consumer based on the latter's failure to take action. The bankruptcy process is no different, in which the minority criticized the majority's praise of certain safeguards as shortsighted, because a properly filed proof of claim, absent the filing of an objection, is deemed valid and allowed. Citing common sense, the dissent concluded that no party should be permitted "to profit on the inadvertent attention of others," and the filing of a claim that the debt collector knows to be time-barred constitutes "unfair" and "unconscionable" collection practices.

While the Court did not punish the Petitioner for its efforts to collect on the time-barred claim, creditors would be wise to exercise restraint. First, the Court's holding is limited in scope, and it should not be interpreted as undermining the purpose or intent of the Act. Second, the Court based its opinion on the broad rights afforded the Petitioner under Alabama law. State law governing another creditor's claim may be less broad, in which case a time-barred claim may not qualify under Section 101(5) of the Bankruptcy Code. Third, the majority noted that the Petitioner's acknowledgment of the passage of time in the proof of claim undercut the argument that its actions were false, deceptive or misleading. Fourth, the debtor and bankruptcy trustee possess adequate incentives to object to time-barred claims. While the submission of a proof of claim is rarely expensive or time-consuming, omnibus objections offer a cost-effective means of addressing objectionable claims. Finally, the person submitting the proof of claim must sign the submission under penalty of perjury, and regardless of the commentary from the Advisory Committee on the Federal Rules of Bankruptcy Procedure, attorneys should be aware of the consequences of violating Bankruptcy Rule 9011.

The above-referenced case is *Midland Funding, LLC v. Johnson*, 581 U.S. _____ (2017).