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Client Alert

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U.S. Supreme Court Narrowly Holds that Filing of Time-Barred Proof of Claim Does Not Violate FDCPA, But Leaves Door Open to Application of the Act in Other Circumstances

The Supreme Court of the United States in *Midland v. Johnson* reversed the Eleventh Circuit Court of Appeals and held that a debt collector that files a proof of claim for debt that is barred by the applicable statute of limitations does not violate the Fair Debt Collection Practices Act (FDCPA) if the face of the proof of claim makes clear that the statute of limitations has run. The Supreme Court refused to accept the debtor's argument that Midland's proof of claim was "false, deceptive, or misleading" under the FDCPA. The Court focused on the broad definition of the term "claim" under the Bankruptcy Code and the structure of the claims process, which places the burden on debtors or trustees to object to claims. The Court also determined that the filing of Midland's claim was not "unfair" or "unconscionable." Unlike a collection lawsuit against an unwitting consumer, the Court noted the numerous safeguards attendant to the bankruptcy process, which is voluntarily commenced by a consumer. However, the Court stopped short of holding that the Bankruptcy Code supplants the FDCPA in bankruptcy proceedings, leaving the door open for courts to apply the FDCPA to different facts or to impose sanctions under Bankruptcy Rule 9011.

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The 5-3 decision[1] is a notable victory for the debt buying industry.[2] Hundreds of adversary proceedings across the country brought by debtors asserting similar violations against debt buyers and debt collectors had been stayed pending the determination of the issue by the U.S. Supreme Court. Most of these cases are likely to be dismissed now that the Court has ruled.

The primary question for the Court involved the statutory interpretation of "claim" as used in the Bankruptcy Code and the procedural rules for claims allowance. The Bankruptcy Code defines "claim" broadly as a "right to payment."[3] State law generally governs a creditor's right to payment. In this case, Alabama's law provides that a right to payment continued after the limitations period had expired.[4] Accordingly, Midland held a right to payment under applicable state law sufficient to file a proof of claim. The Court then considered the claims allowance process, noting that it is incumbent upon the debtor or trustee, who is a sophisticated party with a statutory obligation to review proofs of claim, to seek disallowance of a disputed claim.[5]

The Court next considered whether Midland's assertion of a time-barred claim is "unfair" or "unconscionable" under the FDCPA, which the Court admitted was a closer question.[6] Here, the Court distinguished a bankruptcy proceeding from a civil suit, where there is a risk that "a consumer might

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[1] Justice Gorsuch took no part in the decision.
[2] The decision is *Midland Funding, LLC v. Johnson*, 581 U.S. ___, 2017 U.S. LEXIS 2949 (May 15, 2017).
[3] *See* 11 U.S.C. § 101(5)(A).
[4] *Johnson*, 2017 U.S. LEXIS 2949 at *7-8.
[5] *Id.* at *9-10.
[6] *Id.* at *10-11.

unwittingly repay a time-barred debt."[7] In the eyes of the majority, the bankruptcy claims process is "generally a more streamlined and less unnerving prospect for a debtor than facing a collection lawsuit."[8] The Court also cited a legitimate benefit to debtors from including all claims (even stale ones) in a Chapter 13 bankruptcy proceeding. All filed claims are subject to the discharge and the Court noted the related potential benefit to debtors' credit reports.[9] For these reasons, the Court declined to find that Midland's filing of the time-barred claim was "unfair" or "unconscionable."

Justice Sotomayor issued a strongly worded dissent that took issue with the fundamental business model of the debt buying industry. The dissent noted its belief that there is no business justification for filing time-barred proofs of claim other than "hoping and expecting that the bankruptcy system will fail," which should constitute an "unfair" and "unconscionable" practice in violation of the FDCPA.[10] The dissent notes that the Court does not hold that the Bankruptcy Code entirely displaces the FDCPA.[11] The dissent also takes issue with the majority's contention that the bankruptcy process is designed to "guide the evaluation of claims" by noting that the bankruptcy process facilitates the allowance, not disallowance, of claims and that debtors arguably are more vulnerable inside of bankruptcy than outside.[12] Justice Sotomayor closes the dissenting opinion by noting that the Court may not have the last word on the matter were Congress to amend the FDCPA to make it explicitly applicable to bankruptcy proceedings.[13]

While Congress could amend the FDCPA, there is another potential hurdle for debt buyers to jump. The Court in *Johnson* likely could have reached the same result by concluding that the FDCPA does not apply to debt collection in judicial proceedings. Courts are well equipped to address conduct that is "unfair" or "unconscionable" through the powers granted under Rule 11 of the Federal Rules of Civil Procedure or similar rules. In fact, the Office the United States Trustee has taken the position that knowingly filing time-barred proofs of claim violates the Bankruptcy Code's counterpart in Rule 9011 of the Federal Rules of Bankruptcy Procedure.[14] The dissenting opinion in *Johnson* references one such enforcement action against another debt buyer, Resurgent Capital Services, L.P. ("Resurgent").[15] In that case, the U.S. Trustee filed an adversary proceeding seeking injunctive relief and a monetary penalty against Resurgent for, among other things, its alleged routine filing of thousands of time-barred proofs of claim.

It is unclear what impact the decision in *Johnson* will have on future U.S. Trustee enforcement actions related to the filing of time-barred claims or on individual debtors bringing motions for Bankruptcy Rule 9011 sanctions rather than FDCPA violations. On the one hand, the Supreme Court suggests that its view of Bankruptcy Rule 9011's application to the issue differs from the U.S. Trustee's. The Court specifically notes in *Johnson* that, in considering amendments to the Bankruptcy Rules in 2009, the Advisory Committee on Rules of Bankruptcy Procedure declined to impose an affirmative obligation on a creditor to "make a prefiling investigation of a potential time-bar defense."[16] On the other hand, the Court did not specifically address the application of Rule 9011 to the facts of the case. Until the Executive Office of the U.S. Trustee provides additional guidance on its position after *Johnson*, all creditors should exercise prudence in filing claims for time-barred debt notwithstanding the Supreme Court's recent favorable decision.

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[7] *Id.* at *11.

[8] *Id.* at *12 (quoting *In re Gatewood*, 533 B.R. 905, 909 (B.A.P. 8th Cir. 2015)).

[9] *Johnson*, 2017 U.S. LEXIS 2949 at *13-14. The Court cited to 16 C.F.R. pt. 600, App. § 607, ¶6 (1991) for the proposition that a credit report may include discharged debt only if "the debt [is reported] as having a zero balance due to reflect the fact that the consumer is no longer liable for the discharged debt."

[10] *Johnson*, 2017 U.S. LEXIS 2949 at *26-27. The dissenting opinion did not address the issue of whether filing time-barred claims in bankruptcy is false, deceptive, or misleading" under the FDCPA.

[11] *Id.* at *27.

[12] *Id.* at *30.

[13] *Id.* at *31.

[14] Bankruptcy Rule 9011 closely mirrors Rule 11 of the Federal Rules of Civil Procedure.

[15] *Johnson*, 2017 U.S. LEXIS 2949 at *24 (citing *Casamatta v. Resurgent Capital Servs., L.P.*, Adv. Proc. No. 16-4102 (Bankr. W.D. Mo. Aug. 22, 2016)). The United States argued in *Johnson* that conduct that is sanctionable under Rule 9011 is unfair conduct in violation of the FDCPA. *Johnson*, 2017 U.S. LEXIS 2949 at*13.

[16] *Id.* at *16-17.

Contacts

Bankruptcy, Restructuring and Creditors' Rights

Tyler P. Brown
tpbrown@hunton.com

Justin F. Paget
jpaget@hunton.com

Consumer Financial Compliance and Litigation

Jarrett L. Hale
jhale@hunton.com

Greg G. Hesse
ghesse@hunton.com

Tara L. Elgie
telgie@hunton.com