2017 BURR Alert

Supreme Court Reverses Eleventh Circuit: Debt Collectors Can File Proofs of Claim On Stale Debt Without Violating FDCPA

By Kelly E. Waits May 2017

In a 5-3 decision written by Justice Stephen G. Breyer last week, the Supreme Court of the United States ruled that the Eleventh Circuit erred when it found that Midland Funding, one of the nation's largest purchasers of unpaid debt, was potentially liable under the FDCPA for filing proofs of claim in Bankruptcy Court relating to time-barred credit card debt.[1] Writing for the majority, Justice Breyer said that the filing of an accurate proof of claim that is obviously time-barred "is not a false, deceptive, misleading, unfair, or unconscionable debt collection practice within the meaning of the Fair Debt Collection Practices Act." Rather, Midland's proof of claim falls within the U.S. Bankruptcy Code's definition of the term, "claim," which means "right to payment," Justice Breyer said.

In analyzing whether the assertion of a time-barred claim was "unfair" or "unconscionable," the majority[2] focused on the differences between a state court action initiated by a debt-buyer to collect a debt after the statute of limitations for doing so had run, on the one hand, and the filing of a proof of claim in a bankruptcy case, on the other. Under the first scenario, lower courts have held that if a creditor files a lawsuit against an individual/consumer borrower on a claim that is time-barred, and does so knowingly, that action violates the FDCPA. For instance, an unrepresented and/or unsophisticated defendant who is intimidated by the lawsuit might respond by sending a check to pay the amount claimed rather than deal with the pending litigation, and thus the filing of the lawsuit is an unfair debt collection practice. Justice Breyer distinguished this from the consumer bankruptcy context, which provides additional protections to a consumer debtor, minimizing the risk to debtors as compared to defendants in civil lawsuits. First, a bankruptcy case is *voluntarily* initiated by the debtor who is invoking the court process. Second, a trustee is appointed and has a statutory duty to look at whether filed claims are valid. Lastly, because of the automatic stay halting collection action, a debtor would never consider responding to a filed proof of claim by sending a check to the claimant. "These features of a chapter 13 bankruptcy proceeding," concluded the Court, "make it considerably more likely that an effort to collect upon a stale claim in bankruptcy will be met with resistance, objection, and disallowance."

Another explanation offered by the majority as to why claims for stale debt are not the type of debt collection activities that violate the FDCPA is that these proofs of claim are accurate, truthful, and disclose all the information a debtor or trustee needs to know in order to make a determination of whether the claim is time-barred. Moreover, the Court noted that there is an important distinction between a creditor's *prima facie* case presented by its claim and any defense available to that claim, and ultimately, the majority explained, whether there is a valid defense to a claim does not negate the existence of a claim (or "right to payment") for outstanding debt owed. If a creditor believes it has a

[1] *Midland Funding, LLC v. Johnson*, U.S., No. 16-348 (May 15, 2017).

[2] Along with Justice Breyer, the majority included Chief Justice John G. Robert, Jr. and Justices Anthony M. Kennedy, Clarence Thomas, and Samuel A. Alito, Jr.

basis to make out *prima facie* case[3] and does so by filing a claim, the ball is in the trustee's court to object and prove the availability of an affirmative defense, such as untimeliness. Accordingly, there is nothing "false" or "misleading" about this practice. While this burden-shifting reasoning could be taken out of context, the Court made it clear it was not opining on state court actions filed by debt buyers to enforce stale debt.

Justice Sonia Sotomayor dissented[4], calling the decision a "trap for the unwary" and describing the multibillion dollar business of purchasing stale debt with the hope that no one notices its expiration in order to collect on it as "unfair" and "unconscionable," stating that "[i]t takes only the common sense to conclude that one should not be able to profit on the inadvertent inattention to others." Justice Sotomayor's comment refers to the unfortunate truth that the economics of consumer representation demand efficiency over thoroughness, and very few consumer debtor attorneys – or trustees – fully scrutinize every claim filed in every case. Thus, many stale claims go unchecked and receive a distribution from the debtor's assets, which may be paramount to a revival of the debt.

Notably, the majority opinion only answered one of the two questions presented – whether the filing of an accurate claim for an existing but time-barred debt violates the FDCPA, leaving unanswered the second question presented – whether the Bankruptcy Code precludes application of the FDCPA to the filing of a proof of claim for time-barred debt. This makes sense because the second question would only arise if the first question (whether the FDCPA applied to bar the practice of filing stale claims) was answered in the affirmative.

What are the ramifications of *Midland*? The decision may open the door for debt-buyers to use the bankruptcy process in a unique way, or it may simply retain the "status quo." Will bankruptcy trustees try to use Rule 9011 (the Bankruptcy Code's corollary to Rule 11 which provides for sanctions for improper conduct) to try to stop claims filed on stale debt? Certainly, trustees will be required to exercise more due diligence when reviewing claims to determine if affirmative defenses apply. This could put a burden on legitimate creditors (who would never knowingly file a claim for a debt that had been repaid, released, or was otherwise legally uncollectible) to respond to a trustee's inquiries. In addition, creditors may suffer reduced recoveries due to the trustee's increased legal expenses, or may experience a dilution of their claims when an invalid claim slips through the net and is paid. Another potential result is that debtor's and trustee's counsel could be exposed to malpractice claims if they fail to object to the type of claims at issue in *Midland*. In short, this decision could create a new burden on the bankruptcy system altogether.

If you would like more information, please contact:
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[3] A *prima facie* case is one that is "accepted as correct until proved otherwise."

[4] Justice Sotomayor was joined in her dissent by Justices Ruth Bader Ginsberg and Elena Kagan.