

MAY 2017 ■ NO. 4

Consumer Finance Litigation

U.S. Supreme Court Holds Debt Collectors Are Not Liable under the FDCPA for Pursuing Time-Barred Claims in Bankruptcy Court

Action Item: The U.S. Supreme Court holds that filing a proof of claim on a time-barred debt is not a false or deceptive collection practice within the meaning of the Fair Debt Collection Practices Act.

In a 5-3 decision in *Midland Funding, LLC v. Johnson*, No. 16-348, 2017 WL 2039159 (U.S. May 15, 2017), the United States Supreme Court held that a debt collector's filing of a time-barred proof of claim in a Chapter 13 bankruptcy proceeding is not "false," "deceptive," "misleading," "unfair," or "unconscionable" within the meaning of the Fair Debt Collection Practices Act ("FDCPA").

In overturning the Eleventh Circuit Court of Appeals, the Supreme Court held that the protections and remedies afforded to consumers under the FDCPA with respect to time-barred claims, are unavailable in Chapter 13 bankruptcy proceedings. The Supreme Court's decision makes clear that debt collectors may pursue time-barred debts in a debtor's bankruptcy proceeding.

Background

In *Johnson*, Midland Funding LLC ("Midland") filed a proof of claim in the respondent Johnson's Chapter 13 bankruptcy case, seeking to collect \$1,879 in unpaid credit card charges, noting that the last time any charge appeared on Johnson's account was more than 10 years ago. The relevant statute of limitations under Alabama law is six years. Johnson subsequently sued Midland in the U.S. District Court for the Southern District of Alabama, claiming that Midland's proof of claim on an obviously time-barred debt was a false and deceptive collection practice in violation of the FDCPA, 15 U.S.C. § 1692k.

Midland filed a motion to dismiss Johnson's action, which was granted by the District Court. The trial court held that the Bankruptcy Code, which allows creditors to file a proof of claim for any "right to payment," even those which are time-barred, cannot be reconciled with the FDCPA, which prohibits the prosecution of time-barred claims.¹ The District Court applied the doctrine of implied repeal, holding that the later-enacted Bankruptcy Code implicitly repealed the earlier-enacted FDCPA, thus prohibiting debtors from seeking FDCPA remedies against claimants who had filed proofs of claim in their Chapter 13 bankruptcy cases.

1. The Supreme Court in *Johnson* noted that although "numerous lower courts have found that, in the context of an ordinary civil action to collect a debt, a debt collector's assertion of a claim known to be time barred is 'unfair,'" it has yet to decide this matter "and does not now decide." See *Johnson*, No. 16-348, 2017 WL 2039159, at *6.

Under the Bankruptcy Code, a “creditor...may file a proof of claim” in a debtor’s bankruptcy. 11 U.S.C. § 501(a). A “claim” is defined as any “right to payment” recognized under state law. *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450 (2007). As in many states, Alabama law provides that a creditor has the right to payment of a debt even after the limitations period has expired. *See e.g. Ex parte HealthSouth Corp.*, 974 So.2d 288, 296 (Ala.2007) (passage of time extinguishes remedy but the right remains).

On appeal, the Eleventh Circuit overturned the District Court’s decision, holding that the Bankruptcy Code and the FDCPA are not irreconcilable as the Bankruptcy Code “allows all ‘creditors’ to file proofs of claim, while the FDCPA dictates the behavior of only ‘debt collectors’ both within and outside of bankruptcy.” As such, the Court held that while a “creditor may file a [time-barred] proof of claim in a Chapter 13 bankruptcy proceeding... when that creditor is also a ‘debt collector’[,],...the creditor may be liable under the FDCPA for ‘misleading’ or ‘unfair’ practices” for filing such a claim. In other words, the Eleventh Circuit held that the FDCPA does not conflict with the Bankruptcy Code, it merely provides an extra layer of protection for consumers against claims brought by debt collectors in a Chapter 13 bankruptcy proceeding.

Supreme Court Decision

In overturning the Eleventh Circuit’s decision, the Supreme Court pointed to three factors leading to its holding that a debt collector’s filing of a time-barred proof of claim in a Chapter 13 bankruptcy proceeding does not violate the FDCPA.

First, a time-barred claim cannot be deemed “false,” “misleading,” or “deceptive,” as a creditor under Alabama law (and in most states), has the right to payment of a debt even after the limitations period has expired. The Supreme Court noted that the “law has long treated unenforceability of a claim (due to the expiration of the limitations period) as an affirmative defense...[a]nd we see nothing misleading or deceptive in the filing of a proof of claim that, in effect, follows the Code’s similar system.” Meaning, while a bankruptcy trustee may properly deny a time-barred claim, filing the time-barred claim is not “false” or “deceptive.”

Second, the Supreme Court distinguished civil actions with Chapter 13 bankruptcy proceedings. The Supreme Court noted that although lower courts have found that, in the context

of ordinary civil actions, a debt collector’s prosecution of a time-barred claim is “unfair” and may be in violation of the FDCPA, such findings are unavailing in the context of bankruptcy proceedings. Specifically, the Court ruled that while consumers in a civil collections action may unwittingly pay a stale claim, because bankruptcy proceedings are commenced by the consumer and overseen by a knowledgeable trustee, “these features...make it considerably more likely that an effort to collect upon a stale claim in bankruptcy will be met with resistance, objection, and disallowance.”

Third, the Supreme Court stated that allowing claims for violations of the FDCPA in the context of bankruptcy proceedings would upset the Bankruptcy Code’s “delicate balance of a debtor’s protections and obligations.” Specifically, the Court held that allowing an FDCPA claim in the context of a bankruptcy proceeding would “authorize a new significant bankruptcy-related remedy” that is not provided in the Bankruptcy Code. Additionally, “it would permit post-bankruptcy litigation in an ordinary civil court concerning a creditor’s state of mind—a matter often hard to determine.”

Conclusion

The Supreme Court’s holding that a creditor’s filing of a time-barred proof of claim in a Chapter 13 bankruptcy proceeding is not a false, deceptive, misleading, unfair, or unconscionable debt collection practice within the meaning of the FDCPA is a victory for all debt collectors, as it makes clear that debt collectors may pursue time-barred debts in bankruptcy proceedings. Debt collectors can now proceed with filing proofs of claim on time-barred debts in bankruptcy proceedings without the fear of debtors commencing civil suits for violations of the FDCPA.

For more information, please contact:

Jonathan M. Robbin
212.885.5196 | JRobbin@BlankRome.com

Edward W. Chang
215.569.5342 | EChang@BlankRome.com

Diana M. Eng
212.885.5572 | DEng@BlankRome.com

Sholom Wohlgelernter
212.885.5527 | SWohlgelernter@BlankRome.com