Educational Materials

Monday, October 9, 2017 | 10:45 – 11:45 AM

NCBJ 2017

LAS VEGAS

The Wolf (of Wall Street) at the Door: Lending to the Financial Underclass

Presented by:

NCBJ | National Conference of Bankruptcy Judges

NCBJmeeting.org

91st Annual
National Conference of Bankruptcy Judges

October 8–11, 2017
Las Vegas, Nevada

The Wolf (of Wall Street?) at the Door: Lending to the Financial Underclass

Honorable D. Sims Crawford, U.S. Bankruptcy Court (N.D. Ala.)
Theodore "Thad" O. Bartholow III, Kellett & Bartholow, PLLC
Professor Creola Johnson, The Ohio State University Moritz College of Law

The Wolf (of Wall Street?) at the Door: Lending to the Financial Underclass

Table of Contents

2017 NCBJ Annual Conference
The Wolf (of Wall Street?) at the Door:
Lending to the Financial Underclass

Theodore O. Bartholow, III ("Thad")
Attorney at Law
Kellett & Bartholow PLLC
Dallas, Texas

Financing the cost of bankruptcy:
For many years, attorneys representing consumer debtors have grappled with the problem presented by debtors who need to file bankruptcy *right now*, but they lack sufficient funds to pay for it prior to filing. Solutions that have emerged include "unbundling" or "bifurcation" of pre-petition and post-petition services, "attorney fee only" Chapter 13's, factoring agreements with third-parties that fund bankruptcies by "purchasing" the right to recover on debtors' post-petition fee obligations, and even directing debtors to work with certain third party lenders who pay a portion of attorneys' fees to attorneys when debtors referred by those attorneys enter into post-petition automobile financing agreements.
In addition to practical problems, ethical rules restrict an attorney's options in dealing with debtor clients concerning fees. The Bankruptcy Code and Rules can make it challenging for debtor's counsel to get paid. For example, if debtor and counsel agree pre-petition that debtor will pay counsel after the case is filed, but the debtor is later unwilling or unable to pay, the attorney may be prohibited from collecting during the case pursuant to the automatic stay § 362(a)(6), as well as after the case, pursuant to the discharge injunction § 524(a).

"Attorney fee only" Chapter 13's

The "attorney fee only" Chapter 13 model has been criticized as increasing the amount of attorneys' fees borne by the debtor, as well as adding to the duration of the bankruptcy and the risk that the debtor would not receive a bankruptcy discharge, particularly when the debtor would otherwise qualify for Chapter 7. One soon-to-be-published study estimates that 55% of "no money down" debtors exited bankruptcy still owing the same debts they did before spending time and money filing bankruptcy. See, Pamela Foohey, Robert M. Lawless, Katherine Porter, & Deborah Thorne, __ S. CAL. LAW REV. __, *"No Money Down" Bankruptcy* (forthcoming 2017). *See also*, Ronald J. Mann & Katherine Porter, *Saving Up for Bankruptcy*, 98 GEO. L. J. 289, 319-24 (2010) (investigating how tax refunds and paychecks influence bankruptcy filing patterns). *See also*, *Lamie v. U.S. Trustee*, 540 U.S. 526 (2004) (noting that chapter 7 debtor's attorney may not be compensated from bankruptcy estate funds unless the attorney is employed by the trustee under 11 U.S.C. § 327).

In re Moore, No. 15-12254, 2016 WL 4247041 (Bankr. D. Kan. August 5, 2016) (noting that although debtors were "eligible for and, perhaps, best suited to be in chapter 7," the fact that debtors could not afford the necessary advance payment of the chapter 7 fee was sufficient justification for filing the fee-only Chapter 13: "Expecting [debtors] to save $2,000 for a chapter 7 case over a period of months while navigating the dangerous waters of collection and repossession, is not reasonable. The fact that they are judgment-proof will not stop collection calls and letters or make them any less unpleasant." Thus, applying totality of circumstances analysis (debtors were both over 70 years old, with health issues and fixed income), court approved fee-only Chapter 13).

Berliner v. Pappalardo (In re Puffer), 674 F.3d 78, 82 (1st Cir. 2012) (reversing denial of confirmation of fee only plan on *per se* basis, remanding to bankruptcy court for determination of whether plan had been filed in good faith.).

Sikes v. Crager (In re Crager), 691 F.3d 671, 675–76 (5th Cir. 2012) (reversing district court ruling that bankruptcy court erred in confirming fee only plan, declining to impose *per se* rule against fee only plans, and deferring to bankruptcy court's findings regarding witness's demeanor and credibility).

In re Brown, 742 F.3d 1309, 1318 n. 7 (11th Cir. 2014) (affirming denial of confirmation of fee only plan, accepting court's conclusion that debtor would discontinue payments to creditors after attorneys' fees were paid, before creditors would receive distribution).

"Bifurcation" of services

What are the questions presented by the "bifurcation" model, in which a retainer agreement is entered into and a de minimis fee is paid by the debtor to debtor's counsel for pre-petition services limited to preparation and filing of the bankruptcy petition and basic analysis and counseling associated with that process, and then, after the filing the debtor and counsel enter into a separate "post-petition" retainer agreement that covers preparation of schedules and statements, representation of the debtor at the § 341 meeting and other basic services traditionally associated with "basic" chapter 7 representation?

- Does the debtor really sign one retainer document before the filing and another document afterwards? What kind of disclosures and documentation are necessary to prove this?

- Is it ethical for an attorney to commence a debtor's bankruptcy and then demand that the debtor enter into a separate post-petition agreement to secure that attorney's services for completing the rest of the bankruptcy?

- What about "bifurcation" agreements in which 60-70% of the debtor's attorneys' fees for post-petition services are paid by a factoring company that effectively finances the attorney's post-petition services in exchange for purchasing the right to recover the entire balance of the post-petition fees from the debtor?

    - *See generally*, downloadable document containing summaries of dozens of cases addressing issues related to bifurcation of fees, available at http://www.bkbilling.com/caselawsummary.
    - Is this just a sale by debtor's counsel of the post-petition fees, receivable?
    - Does timing of payment by third party matter, i.e. before work is performed vs. immediately upon debtor's entry into "post-petition" retainer agreement?

- To what extent is the client's "informed consent" required with respect to the attorney's assignment of fees to the third party funder, and how should that be established?

- Automatic stay implications?

- § 504 fee sharing and Rule 2016 disclosure concerns?

In re Grimmett, No. 16-01094-JDP, 2017 WL 2437231 (Bankr. D. Idaho June 5, 2017). The court in this case chronicles a Chapter 7 debtor's dealings with her bankruptcy counsel, in which the debtor entered into separate "pre-petition" and "post-petition" fee agreements, a/k/a "unbundled" representation agreements. The court documents the extremely limited scope of the "pre-petition" services included in the pre-petition representation agreement as compared with the supposedly "post-petition" services that were to be performed by debtor's counsel, conditioned upon the debtor continuing to make payment under the contract, which was entered into in its entirety pre-petition. The court in *Grimmett* was clearly disturbed by debtor's counsel's aggressive collection tactics, which included admittedly hollow threats to withdraw as counsel for the debtor as well as false "warnings" that debtor's discharge would be denied unless fees were paid. Ultimately, the court concluded that the "bifurcated" or "unbundled" fee agreement was improper and unenforceable and that the debtor's counsel's conduct was clearly unethical.
In re Fair, No. 15-33400-SGJ-13, 2016 WL 3027264 (Bankr. N.D. Tex. 2016)(Rejecting debtor's counsel's and third-party auto lender's scheme to use undisclosed post-petition and/or post-conversion automobile financing to fund bankruptcies in connection with filing of chapter 7 bankruptcies and conversions from chapter 13 to chapter 7.)

<u>*Is* quantum meruit *recovery available?*</u>

See *Gordon v. Hines (In re Hines)*, 147 F.3d 1185 (9th Cir. 1998).

> The issue in *Hines* was "whether the postpetition rendition of legal services bargained for pursuant to a prefiling fee agreement entitles Gordon to recover the fees for those later services, not from the bankruptcy estate . . . but directly from Hines herself." *Id*. at 1189. The Ninth Circuit decided that "claims for lawyers' compensation stemming from such postpetition services actually provided to the debtor really do not fall within the automatic stay provisions of Section 362(a)(6) or the discharge provisions of Section 727." *Id*. at 1191. The court took two distinct paths in reaching that conclusion.
>
> First, the court reasoned that because § 362(a)(6) prohibits actions "to recover a claim against the debtor that arose before the commencement of the case," the panel concluded that Gordon's actions fell outside the protections of the automatic stay. While the agreement between Gordon and Hines to perform certain services was entered into before the bankruptcy case was converted, the Ninth Circuit reasoned

> that Gordon would be entitled to collect fees only if and when he actually performed those services. As a result, the court observed that "it strains that statutory language a good deal to characterize the attorney as having violated the Section 362(a)(6) automatic stay by seeking payment once the postpetition services have thereafter been performed." *Id*. at 1191. In other words, because Gordon's "claim" could not exist until he actually provided the post-conversion services, § 362(a)(b) did not stay his efforts to collect those fees.
>
> The second basis for the court's decision was an equitable one. It held that, at the time Hines fired Gordon as her counsel, he had "an undischarged claim for any fees earned by him in excess of" the funds he had already collected via the cashing of postdated checks. *Id*. Gordon could not look to the pre-petition fee agreement to enforce payment because he had not provided all of the agreed services. But even if Hines' contractual obligation to pay him was discharged in the bankruptcy case, Gordon could nonetheless recover for the services he provided to Hines after conversion via the equitable remedy of quantum meruit. *Id.*15 (fn15: "The doctrine of quantum meruit permits recovery, on the basis of an implied promise to pay, of the reasonable value of the services rendered or the materials provided." *Bakker v. Thunder Spring-Wareham, LLC*, 108 P.3d 332, 338 (Idaho 2004).)

(Analysis of *In re Hines* quoted from *In re Grimmett*, No. 16-01094-JDP, 2017 WL 2437231 (Bankr. D. Idaho June 5, 2017).)

Addressing Post-Petition Emergencies in Chapter 13 cases, where debtor requires prompt access to credit or other financial resources:

Emergencies. Air conditioners go out in the summer, heaters fail in the winter, cars break down, storm damage, theft or vandalism, necessary tools of trade break or wear out, unanticipated medical issues arise, funeral and burial/cremation expenses for immediate family members, and the list goes on and on. Within the confines of the Code and Rules, how should Chapter 13 debtors go about addressing these emergencies?

- Speed – "need cash now" = incentive to disregard the Code – in practical terms, many Chapter 13 debtors "just do it" when they need to borrow money or obtain credit post-petition.
- Consequences – But is this a stay violation by the debtor (is that even possible)? By the post-petition lender staking claim to post-petition income?
- Are there policy reasons for allowing or encouraging debtors to access credit post-petition?
- Criteria – is the deal fair? How much court / trustee oversight on loan terms is appropriate?
- Is there a better way? Houston may have a . . . solution.

Post-petition car loans

"Can anyone offer a lead for a financing company who will finance a vehicle coming off lease during a ch. 13? The dealer my client leased the car from in the first place will not work with someone in [bankruptcy]."

- List serve email from a Chapter 13 debtor's attorney, 6/6/17.

Pre- v. Post-Confirmation in Ch13 – what's the difference? Property of the estate issues, implications for the automatic stay, practicalities, practicalities. . .

> Proceeding from the outlook of chapter 13 as a global settlement of claims against the debtor, a resolution of this disagreement over what constitutes property of the estate quickly becomes apparent. If all of the debtor's postconfirmation property remains property of the estate, the debtor is not free to alienate assets without court permission; a trip to the gas station must be preceded by a trip to the courthouse. On the other hand, if the estate ceases to exist at confirmation, it puts prepetition creditors' prospects of being paid in accordance with the plan in jeopardy. This also puts at risk the likelihood of the debtor eventually receiving a discharge.

Lawrence Ponoroff, *Rethinking Chapter 13*, 59 ARIZ. L. REV. 1, 20 (2017).

Ward "v." Fields: Is Court Approval Required for Post-Petition Auto Loans?

In re Ward, 546 B.R. 667 (Bankr. N.D. Tex. March 14, 2016) (Judge Jernigan) (considering whether court approval is required for a debtor to incur post-petition debt for car loan, evaluating interplay of § 364 with §§ 1304, 1305, 1322, 1329, and determining that debtor must obtain court approval prior to obtaining post-petition car loan)

In re Fields, 551 B.R. 424 (Bankr. D. Minn. May 27, 2016) (Judge Ridgway) (disagreeing with Judge Jernigan's opinion in *Ward*, holding that § 1304 did not apply to consumer debtor not "engaged in business" and therefore it was not necessary for debtor to obtain court approval prior to obtaining credit post-petition, finding that § 1329's interaction with § 1305's provision for allowance of post-petition claims for "property or services necessary for the debtor's performance under the plan" provided a vehicle for modification of plan to account for consumer debt incurred by the debtor post-petition, which did not require court intervention prior to obtaining the credit). But what happens if no claim is ever filed for the post-petition debt? Is the debt discharged? Does the creditor have to determine whether the debtor is in bankruptcy prior to extending the credit, or else risk violating the automatic stay?

Stay violation claims and issues regarding dischargeability of Payday loans:
In re Marquardt, 561 B.R. 715 (Bankr. C.D. Ill. Dec. 29, 2016) (Chief Judge Gorman) (Payday lender was denied recovery in non-dischargeability proceeding against debtor-defendant that defaulted in the non-dischargeability suit. Court held that payday loans are not open end credit plans under TILA and are not entitled to presumption of non-dischargeability. Creditor failed to establish prima facie case for fraudulent misrepresentation exception to discharge because there was no evidence that the Debtor obtained the loan with no intent to pay the debt, nor was there evidence sufficient to infer under the totality of the circumstances that debtor intended to deceive or cheat the payday lender. Court noted in particular that the nature of the payday lending business is "providing loans to the insolvent." As such, payday lenders "are almost never justified in relying on a debtor's assurances of repayment.").

Payday loan payments: do payday loan creditors violate the automatic stay by depositing post-dated checks after the bankruptcy is filed?

In re Meadows, 396 B.R. 485 (6th Cir. B.A.P. 2008). Payday lender that retained funds from pre-petition check cashed post-petition did not violate stay. § 362(b)(11) excepts from the automatic stay "presentment of a negotiable instrument and giving of notice of and protesting dishonor of such an instrument." Held that proper remedy was avoidance adversary proceeding under § 522(h), but noted the lack of any attorney fee-shifting remedy in the avoidance statute and therefore, based on the relatively small amount involved, that it would be unlikely that the debtor or the trustee would pursue turnover.

Materials and resources regarding issues related to payday lending, title loans, overdraft protection, and other short-term funding sources.

Proposed Rule, Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,864, 48,122 (July 22, 2016)

BUREAU OF CONSUMER FIN. PROT., DATA POINT: CHECKING ACCOUNT OVERDRAFT 5 (July 2014), *available at* http://www.consumerfinance.gov/f/201407_cfpb_report_data-point_overdrafts.pdf

BUREAU OF CONSUMER FIN. PROT., CFPB STUDY OF OVERDRAFT PROGRAMS 30-31 (June 2013), *available at* http://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf.

Gary Stein, *New Insights on Bank Overdraft Fees and 4 Ways to Avoid Them*, Bureau of Consumer Fin. Prot., http://www.consumerfinance.gov/about-us/blog/new-insights-on-bank-overdraft-fees-and-4-ways-to-avoid-them/ (Feb. 25, 2016).

Julia Merton, Payday Lending and Its Regulation, 36 Rev. of Banking & Fin'l Law 52 (2017).

American Bankers Association, Small Dollar Credit (Industry Whitepaper), April 2017. Accessed June 6, 2017 at http://www.aba.com/Advocacy/Documents/SmallDollarWhitePaper2017Apr.pdf (arguing that

"The proposed *Payday, Vehicle Title, and Certain High-Cost Installment Loans* rule is projected to reduce the availability of storefront payday lenders by up to 81%.28 Because payday lending and overdraft protection are close substitutes for many consumers, the elimination of small-dollar alternatives will likely cause many consumers to turn to overdraft protection. Further restrictions of overdrafts will leave millions of consumers without viable (legal) options or to bounce more checks with the accompanying fees and other consequences." At p. 27.

Should You Use Payday Loans or Overdraft Checks?, Making Money, http://money-things.communizine.net/should-you-use-payday-loans-or-overdraft-checks/. Bretton Woods calculated that at the $25.56 average effective overdraft cost per transaction, it is less expensive for a consumer to pay for an overdraft of $170 or more than to use a payday loan at a cost of $15 per $100 advanced. Also, the average payday loan advance of $350 would cost the consumer $52.50 versus $25.56 for an overdraft of the same amount.

Ethan D. Trotz, *Using a Shotgun to Kill a Fly: Issues with the CFPB's Payday Lending Proposal and the Need to Incentivize Banks to Enter the Marketplace*, 21 N.C. Banking Inst. 327 (2017). *Available at*: http://scholarship.law.unc.edu/ncbi/vol21/iss1/17

Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,867 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041) ("This rulemaking is focused on . . . short-term loans. The largest category of short-term loans are "payday loans," . . . and short-term vehicle title loans . . . .").

Hurley, Mikella and Adebayo, Julius, "CREDIT SCORING IN THE ERA OF BIG DATA," *Yale Journal of Law and Technology*: Vol. 18: Iss. 1 , Article 5. Available at: http://digitalcommons.law.yale.edu/yjolt/vol18/iss1/5

***Forget "Fake News"!* How about "Fake Proofs of Claims" and "Fake Mortgage Modifications"?!**

<u>Fake Proofs of Claims</u>: A tale of the Brothers Tucker from Kansas City: driving exotic race cars down a road, paved with bogus payday loans, to perdition.

- Big brother Scott Tucker: the payday loan king-turned-professional race car driver, who now owes the Gov't $1.2B for his illegal and predatory lending tactics.

- Middle brother Joel Tucker: the computer guy: developed the database and software platform for farming out online loan applications to potential lenders. Used that database to fabricate millions of fake loan accounts for real people, which he then sold to debt buyers, including to Jeff Dunn on behalf of Porania LLC, a debt buyer specializing in purchasing debts owed by borrowers in bankruptcy. After buying at least one portfolio of Joel Tucker's fake loans supposedly owed by real Chapter 13 debtors, Porania proceeded to sell off a substantial piece of the portfolio to debt buyer Avi Schild's Atlas Acquisitions, Inc., and both Porania and Atlas proceeded to flood bankruptcy courts around the nation with proofs of claims based on fake payday loan debts, which were purportedly originated by non-existent and/or defunct payday lending operations "Castle Peak" and "United Debt Holdings." Unfortunately for Atlas and Porania (and for Joel), an alert Chapter 13 Trustee and the Bankruptcy Judges in the Southern District of Texas identified these claims as suspect, which were uniformly in the amount of either "$390" or "$300" and were never scheduled by the debtors as known pre-petition obligations. For much more (juicy) detail, see the documents filed in Misc. Proc. 16-302 in the Bankruptcy Court for the Southern District of Texas. Also, just Google Joel and Scott Tucker for the thoroughly-covered tabloid version of events.

<u>CFPB Enforcement Actions against Chase Bank, Portfolio Recovery Associates, and Encore Capital Group</u>:
Consent order Chase entered into with the CFPB states, "[Chase] sold to debt buyers certain accounts that were inaccurate, settled, discharged in bankruptcy, not owed by the consumer, or otherwise uncollectable. The debt buyers then sought to collect these inaccurate, settled, discharged, not owed, or otherwise uncollectable debts from consumers." *In re Chase Bank USA N.A. and Chase Bankcard Servs., Inc.*, 2015-CFPB-0013 Consent Order filed July 8, 2015, Doc. No. 1, at p. 2.

Consent Order, Portfolio Recovery Assocs., LLC, CFPB No. 2015-CFPB-0023 (Sept. 8, 2015), http://files.consumerfinance.gov/f/201509_cfpb_consent-order-portfoliorecovery-associates-llc.pdf;

Consent Order, Encore Capital Grp., CFPB No. 2015-CFPB-0022 (Sept. 3, 2015), http://files.consumerfinance.gov/f/201509_cfpb_consent-order-encore-capitalgroup.pdf.

<u>Fake mortgage modifications</u>:
In re Eyer, Case No. 12-70985, Memorandum Order Striking Notice of Payment Change, Docket No. 93 (Bankr. W.D. Penn. Dec. 30, 2015)(striking 3002.1 payment change notice filed by Wells Fargo that provided that payment was changing due to a 'trial modification' that the debtor had not sought or accepted).
In re Allen, Case No. 13-31034, Order Sustaining Objection to Notice of Mortgage Payment Change, Docket No. 29 (Bankr. W.D. N.C. Sept. 19, 2016)(same)
Bibliography/Summary of Additional Resources:

<u>*Articles and Governmental Agency Reports*</u>

Stifler, Lisa, 11 Harvard Law & Policy Rev. 91 *Debt in the Courts: The Scourge of Abusive Debt Collection Litigation and Possible Policy Solutions* (2017).
Article noting the "significant growth and evolution" of the debt collection industry, and evaluating the explosion of debt collection litigation that has occurred in recent times. Provides current demographics and statistics regarding composition of consumer debt in America, as well as the debt collection business itself. In particular, Stifler notes that the advent of debt buying has dramatically altered debt collection industry. 10-K filings from 2002 to 2015 for Encore Capital Group and Portfolio Recovery Associates (the two largest publicly traded debt collection companies in the U.S.) reflected annualized revenue increasing by more than twenty percent every year. Notes in particular that debt buyers are using litigation on an unprecedented scale as a collection tactic. In addition to having questionable support for their legal claims, debt buyers rely on scale of their operations to obtain default judgments on debts purchased for pennies on the dollar, which debt buyers proceed to use to garnish wages and bank accounts.

Chan, Sewin; Haughwout, Sewin; Hayashi, Andrew; van der Klaauw, Wilbert, *Determinants of mortgage default and consumer credit use: The effects of foreclosure laws and foreclosure delays,* STAFF REPORT, FEDERAL RESERVE BANK OF NEW YORK, No. 732 (2015). Examining how factors affecting mortgage default spill over to other credit markets. Noting that homeowners with negative equity default on mortgages and HELOCs at higher rates and prioritize repaying credit cards and auto loans over making mortgage payments and that larger unused credit card limits make preservation of credit cards take priority over housing debt. As a result, non-recourse mortgage statutes *reduce* credit card defaults despite increasing default on housing debt. However, delayed foreclosures increase default rates for both housing and non-housing debts.

Dallas Fed Economic Letter Vo. 11 No. 3 April 2016, *Increased Credit Availability, Rising Asset Prices Help Boost Consumer Spending*. Explaining that a combination of much less household debt, revived access to consumer credit and recovering asset prices have bolstered U.S. consumer spending and predicting that this trend will continue despite 50% reduction since the mid-2000s of the housing wealth effect, which was an important amplifier during the boom years.

Kyle Herkenhoff, Gordon Phillips, Ethan Cohen-Cole, *The Impact of Consumer Credit Access on Employment, Earnings and Entrepreneurshipt*, NBER Working Paper No. 22846, November 2016. Accessed at http://faculty.tuck.dartmouth.edu/images/uploads/faculty/gordon-phillips/entrepreneurship.pdf
Academic study addressing the question: How does consumer credit access impact job flows, earnings, and entrepreneurship? To answer this question, the authors build a dataset linking individual employment and entrepreneur tax records to TransUnion credit reports, focusing on the effect on consumer credit access following bankruptcy flag removal from the credit reports. Noting that removal of the bankruptcy flag permits individuals to more freely engage in self-employment. In addition, after removal of the bankruptcy flag from consumers' credit reports, unemployed and self-employed individuals are more likely to find unemployment-insured "formal" jobs at larger firms that pay greater wages. These estimates imply that firms believe previously bankrupt workers are 3.8% less productive than non-bankrupt workers, on average. These results suggest that consumer credit access matters for each stage of entrepreneurship and that credit-checks may be limiting formal sector employment opportunities.

Neil Bhutta, Jacob Goldin, and Tatiana Homonoff, "Consumer Borrowing after Payday Loan Bans," *The Journal of Law and Economics* 59, no. 1 (February 2016): 225-259. Noting that efforts to regulate high-interest payday loans have proliferated in recent years as the payday lending industry has expanded. Studies variations in payday-lending laws to evaluate the effect of payday loan restrictions on consumer borrowing, finding that payday lending regulations can be effective at reducing payday lending, in response to such restrictions, consumers resort to other forms of high-interest credit (for example, pawnshop loans) rather than traditional credit instruments (for example, credit cards). Such shifting is present, but less pronounced, for the lowest-income payday loan users. Our results suggest that policies that target payday lending in isolation may be ineffective at reducing consumers' reliance on high-interest credit.
FED. DEPOSIT INS. CORP., FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 2 (2015) (Table ES.1), *available at* https://www.fdic.gov/householdsurvey/2015/2015report.pdf.

Consumer Financial Protection Bureau May 2016 Report: *Single Payment Vehicle Title Lending*. Available at http://files.consumerfinance.gov/f/documents/201605_cfpb_single-payment-vehicle-title-lending.pdf

Finding that supposedly "single-payment" title loans frequently turn into long-term debt. APRs are frequently in the 300% range, and if loans are not repaid in full, borrowers must renew the loan and frequently pay a fee for the renewal. CFPB found that around 2/3 of the revenue supporting the title loan industry comes from borrowers whose title loans have continued for periods of seven or more months. Auto title lending has become more prevalent after payday loans have been subject to increasing regulations and enforcement actions.

Consumer Financial Protection Bureau March 2014 Data Point: Payday Lending. Available at http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf

Report based on data from 12-month period and in excess of 12 million storefront payday loans. Key findings include: (1) Payday loans frequently become revolving doors of debt; (2) Four of five payday loans are rolled-over or renewed; (3) Three of five payday loans' fee expenses exceed the amount borrowed because 60 percent of the loan "sequences" last seven or more loans in a row, and 50 percent last ten or more loans in a row; (4) One of five payday loans end up costing the borrower more than was borrowed; (5) Four of five payday borrowers either default or renew a payday loan over the course of a year; (6) Four of five who renew borrow the same amount or more.

https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2016Q2.pdf (reporting total of $12.29 trillion in outstanding household debt in the second quarter of 2016).

The FTC considers the advent and growth of debt buying to be the most significant change in the debt-collection industry. *See* FED. TRADE COMM'N, COLLECTING CONSUMER DEBTS: THE CHALLENGES OF CHANGE 13 (2009), https://www.ftc.gov/sites/default/files/documents/public_events/life-debt/dcwr.pdf

Income volatility has increased in the United States over time. *See* Anthony Hannagan & Jonathan Morduch, *Income Gains and Month-to-Month Income Volatility: Household Evidence from the US Financial Diaries*, Working Paper New York University US Financial Diaries Project (June 29, 2015), *available at* https://wagner.nyu.edu/files/faculty/publications/Income_Gains_and_Income_Volatility_-_US_Financial_Diaries_-_Hannagan_and_Morduch_-_June_2015.pdf.

SARAH WOLFF, CENTER FOR RESPONSIBLE LENDING, THE CUMULATIVE COST OF PREDATORY PRACTICES: THE STATE OF LENDING IN AMERICA & ITS IMPACT ON U.S. HOUSEHOLDS (2015), http://www.responsiblelending.org/sites/default/files/uploads/13-cumulativeimpact.pdf (discussing the cumulative impacts to U.S. households of predatory lending practices).

OFFICE OF THE COMPTROLLER OF CURRENCY, OCC Bulletin 2014-37, Consumer Debt Sales (Aug. 4, 2014), http://www.occ.treas.gov/news-issuances/bulletins/2014/bulletin-2014-37.html ("Certain types of debt are not appropriate for sale. Debt clearly not appropriate for sale, because it likely fails to meet the basic requirements to be an ongoing legal debt, includes . . . " debt that has been settled or is in the process of settlement, debt protected by bankruptcy protection, debt due to fraud, and debt lacking evidence of ownership).

Encore Capital Grp., Annual Report (Form 10-K) 14 (Feb. 24, 2016) ("We believe that this reduction in supply is also the result of certain financial institutions temporarily halting or curtailing their sales of charged-off accounts in response to increased regulatory pressure on financial institutions."); PRA Grp., Annual Report (Form 10-K) 19 (Feb. 26, 2016) ("Currently, a number of large banks that historically sold defaulted consumer debt in the United States are out of the debt sale market . . . . Should these conditions worsen, it could negatively impact our ability to replace our receivables with additional portfolios sufficient to operate profitably.").

Julia Fonseca, Katherine Strair, and Basit Zafar, *Access to Credit and Financial Health: Evaluating the Impact of Debt Collection,* FEDERAL RESERVE BANK OF NEW YORK STAFF REPORTS, no. 814, May 2017.

> "Despite the prevalence of debt collection and the intense regulatory activity surrounding this industry, little is known about how these practices impact consumers. This paper conducts an empirical analysis of the effect of debt collection on consumer credit and on indicators of financial health, employing individual credit record data and a difference-in-differences research design that compares outcomes for consumers in states that increased the restrictiveness of legislation with those for consumers in the remaining states. We find consistent evidence that restricting collection activities leads to a decrease in access to credit and a deterioration in indicators of financial health. Moreover, our estimated treatment varies considerably with the borrower's age and baseline credit score, with effects concentrated primarily among borrowers with the lowest credit scores."

David Lazarus, *Buried deep within GOP bill: a 'free pass' for payday and car-title lenders*, LOS ANGELES TIMES, May 30, 2017. *Accessed at* http://www.latimes.com/business/lazarus/la-fi-lazarus-choice-act-payday-loans-20170530-story.html. This column explores how the "Financial Choice Act" currently (as of June 2017) in the House of Representatives includes proposed changes to the authority of federal regulatory agencies (including the CFPB) to preclude such authorities from exercising "any rulemaking, enforcement or other authority with respect to payday loans, vehicle title loans or other similar loans."

2017 NCBJ Annual Conference
The Wolf (of Wall Street?) at the Door:
Lending to the Financial Underclass

Creola Johnson
President's Club Professor of Law
The Ohio State University
Columbus, Ohio

PAYDAY LOANS

I. <u>BANKRUPTCY CONTEXT</u>

A. Automatic stay violations

1. <u>Post-petition collection calls to collect debt</u>
   a. *In re Hodge*, 367 B.R. 843, 846 (Bankr. M.D. Ala., 2012) (awarding a debtor actual damages of $4,044.49 and punitive damages of $1,000 where payday lender made several calls to the debtor).
   b. *In re Snowden*, 422 B.R. 737, 740–41 (Bankr. W.D. Wash. 2009) (payday lender's collection department attempted **post-petition** to contact Snowden by telephone at least 16 times); *In re Snowden*, 769 F.3d 651, 657 (9th Cir. 2014) (upholding award of emotional distress damages and punitive damages where, among other things, payday lender called Snowden's job where she was a nurse and had to leave patients to answer the calls) (quoting a debtor as stating "I don't know if you've ever seen a nurse work.... Not only are you leaving that room to come answer the phone, you're putting a patient on hold.... That's a big thing.").
2. <u>Post-petition threats to have consumer prosecuted/arrested</u> –
   a. *In re Hodge*, 367 B.R. 843, 846 (Bankr. M.D. Ala., 2012). After the Money Shop received notice of the automatic stay, its employee called Ms. Hodge and stated the following:

      > "I have gotten your letter from Brock & Stout. I've also talked to the DA's office. With your check, it doesn't stop me from criminally prosecuting you and having you arrested. I want my money, so Brock & Stout's not going to clear you with a debt from me. … I can either fight it in court with Brock & Stout or I can have you arrested. Either way, you're gonna pay me."

Id. at 849 ("On hearing the recording and fearing that her imminent arrest would result in the loss of her children and her job, Ms. Hodge left the house and spent that night away from her home. . . . [W]hile at work, Ms. Hodge was apprehensive fearing arrest.").

b. *Nee v. Sterling Ross & Associates LLC et al. (In re Nee)*, A. P. No. 14-2244, 2015 WL 1727180 (Bankr. W.D. Pa. April 13, 2015) (imposing actual and nominal punitive damages on debt collection company for its post-petition email messages and telephone calls to the debtor that demanded payment from the debtor and threatened him with arrest).

3. Post-petition Electronic Funds Transfer (EFT) –

    a. *See In re Snowden*, 422 B.R. 737, 740–41 (Bankr. W.D. Wash. 2009) (holding by the bankruptcy court that a payday lender's post-petition EFT of money from the debtor's account was a willful violation of the automatic stay and was not the "presentment" of a check protected by § 362(b)(11). *See also Snowden v. Check Into Cash of Washington, Inc., (In re Snowden)*, 769 F.3d 651, 657 (9th Cir. 2014) (upholding the bankruptcy court's finding that Ms. Snowden suffered significant and substantial emotional distress as a result of the payday lender's EFT and finding that the EFT "upended both her finances and her efforts to manage her affairs. . . .").

    b. Tenn. Op. Att'y. Gen. No. 11-40 (Tenn. A.G.), *available at* 2011 WL 3013849 ("The term 'check' as defined in the Deferred Presentment Services Act does not include electronic fund transfers ('EFTs') in which funds are moved from one account to another through use of an electronic terminal without employing paper documents. The deferred presentment services governed by the Act contemplate the use of a conventional paper check.").

4. Post-petition presentment of a post-dated check given pre-petition to a lender by the debtor is NOT a violation of the stay, per § 362(b)(11).

    a. *In re Kearns*, 432 B.R. 276 (Bankr. D. Idaho 2010).

    b. *Buckeye Check Cashing, Inc. v. Meadows (In re Meadows)*, 396 B.R. 485 (B.A.P. 6th Cir. 2008).

B. Avoidable transfers

1. § 549 –Unauthorized post-petition transfers to payday lender

    a. Post-petition presentment of the check- *In re Kearns*, 432 B.R. 276 (Bankr. D. Idaho 2010); *In re Meadows*, 396 B.R. 485 (B.A.P. 6th Cir. 2008).

    b. Post-petition EFT is an unauthorized transfer.

C. Implications of SCOTUS's decision in *Midland Funding*

1. *Midland Funding LLC v. Johnson*, No. 16-348, 2017 WL 2039159 (U.S. May 15, 2017) (holding that creditor's filing of proof of claim based on a time-barred debt does not violate the FDPCA as this debt still meets the Bankruptcy Code's definition of a "claim") (Justice Stephen Breyer writing for a 5-3 majority).
2. Justice Sonia Sotomayor dissented and was joined by Justices Ruth Bader Ginsburg and Elena Kagan. "Professional debt collectors have built a business out of buying stale debt, filing claims in bankruptcy proceedings to collect it, and hoping that no one notices that the debt is too old to be enforced by the courts," Justice Sotomayor wrote. "This practice is both 'unfair' and 'unconscionable'."
3. *Dubois v. Atlas Acquisitions LLC (In re Dubois)*, 834 F.3d 522, 527 (4th Cir. 2016) (in a case involving a debt buyer that bought time-barred payday loan debts after the debtors filed bankruptcy, holding that the debt buyer's "filing of a proof of claim in a Chapter 13 bankruptcy based on a debt that is time-barred does not violate the FDCPA").
4. Contend for narrow reading of *Midland*. Example: *Conner v. Howe*, 344 F. Supp. 2d 1164 (S.D. Ind. 2004) (holding that (1) attorney was a "debt collector" when it filed a lawsuit to obtain a judgment in client's favor, (2) he violated the FDCPA by attempting to collect an illegal payday loan in violation of the state's loan sharking statute, and (3) attorney's lawsuit, filed post-petition, did not violate the automatic stay where he sought to obtain a judgment against the debtor, not to enforce such judgment).
5. Potential Problem with a Proof of Claim based on bogus payday loan debt – for an example of the pervasive problem of bogus payday loan debt, *see* Complaint at 9-10, 50 *F.T.C. v. CWB Services, LLC*, et al., No. 4:14-cv-00783-DW (W.D. Mo. Sept. 5, 2014), available at https://www.ftc.gov/system/files/documents/cases/140917cwbcmpt.pdf. The payday lenders make deposits and withdrawals from the consumer's bank accounts based on false representations that the consumer had previously authorized them to do so and based on "bogus applications, electronic transfer authorizations, or loan documents." *Id*. (alleging, "in numerous instances, consumers who never agreed to Defendants' payday loans in the first place are trapped in a cycle of indefinite finance charges, or are forced to close their bank accounts and be subjected to abuse and harassment from third-party debt collectors.").

II. NON-BANKRUPTCY CONTEXT

A. Payday lenders fill the void left by traditional banks

1. Industry Adept at Circumventing laws

a. *See* Timothy Goldsmith & Nathalie Martin, *Interest Rate Caps, State Legislation, and Public Opinion: Does The Law Reflect The Public's Desires?*, 89 Chi.-Kent L. Rev. 115, 116-118 (2014) (discussing ballot initiatives in several states and stating that interest-rate caps on payday loans were approved by voters in the red states of Arizona and Montana).

b. *See* Creola Johnson, *America's First Consumer Financial Watchdog Is on a Leash: Can the CFPB Use Its Authority to Declare Payday-Loan Practices Unfair, Abusive, and Deceptive?*, 61 CATH. U. L. REV. 381, 396-427 (2012) (describing how payday lenders in several states, including Ohio, circumvent key provisions of newly-enacted state laws and proposing that the Consumer Financial Protection Bureau (CFPB) ban certain payday-loan terms, including balloon payments and short maturity dates).

c. *James v. Nat'l Fin., LLC*, 132 A.3d 799, 837 (Del. Ch. 2016) (after a detailed examination of lender's arguments, finding that lender's extremely high cost loan—requiring payments totaling $1,820 on a $200 loan—was unconscionable and finding, among other things, "the purpose and effect of the [lender's] installment loan structure" was to circumvent Delaware's Payday Loan Law).

d. *Jackson v. Payday Fin., LLC* ,79 F. Supp. 3d 779, 788 (N.D. Ill. 2015) (allowing the plaintiffs' consumer protection claim to proceed "[i]n light of Illinois' enactment of several consumer protection statutes limiting the permissible interest charged to Illinois residents" and finding that "the alleged assessment of interest over 100% is unscrupulous and oppressive and sufficiently constitutes an unfair practice".).

B. Federal enforcement lawsuits

1. *ACE Cash Express, Inc.*, CFPB No. 2014-CFPB-0008 (July 8, 2014) – The CFPB's investigation uncovered an ACE training manual with a graphic circular diagram allegedly demonstrating how ACE employees were expected to create a "sense of urgency" in order to trap consumers into a cycle of indebtedness. *See* Press Release, Consumer Fin. Prot. Bureau, CFPB Takes Action Against ACE Case Express for Pushing Payday Borrowers Into a Cycle of Debt (July 10, 2014), http://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-ace-cash-express-for-pushing-payd ay-borrowers-into-cycle-of-debt [https://perma.cc/HA6K-E7LX] (In a lawsuit against ACE Cash Express, the second largest payday lender, the CFPB alleged that ACE's own in-

house employees as well as ACE's third-party debt collectors threatened consumers with criminal prosecution in order to get them to pay.).

2. Scott Tucker, Joel Tucker, and others for unlawful payday lending practices - *See FTC v. AMG, Services, Inc.*, No. 2:12-CV-00536, 2017 WL 1704411 (D. Nev. May 1, 2017) (granting the FTC's motion for summary judgment against Scott Tucker, his lending company and other related defendants and finding that "the Tucker Defendants are jointly and severally liable for restitution in the amount of $1,266,084,156," or nearly $1.3 billion); *FTC v. Joel Jerome Tucker*, 2:16-cv-02816 (D. Kan. Dec. 16, 2016) (Complaint) (alleging that Joel Tucker sold fake payday loan debt portfolios, resulting in consumers paying debts they did not owe); also Press Release, FTC Charges Defendants with Selling Fake Payday Loan Debt Portfolios (Jan. 9, 2017), available at https://www.ftc.gov/news-events/press-releases/2017/01/ftc-charges-defendants-selling-fake-payday-loan-debt-portfolios; Steve Vockrodt, *Judge orders KC law firm to turn over client records in Scott Tucker payday lending case*, Kansas City Star, June 7, 2017, at http://www.kansascity.com/news/business/article154935814.html#storylink=cpy (reporting that in the criminal trial of Scott Tucker, who is accused of running an unlawful payday loan operation, Tucker's law firm was ordered to turn over documents related to the operation; attorney-client privilege could not be used to conceal Tucker's alleged criminal or fraudulent conduct).

3. *Operation Collection Protection* – Beginning in 2015, the FTC initiated a coordinated federal-state-local enforcement program targeting illegal debt collection. The nationwide crackdown included over 165 actions involving the FTC, CFPB and more than 70 federal, state, and local law enforcement and regulatory authorities against collectors who used illegal tactics such as harassing phone calls and false threats of litigation or arrest. Many of these companies were charged with (1) collecting phantom payday loan debt, (2) collecting via unlawful text messages and emails, (3) making unlawful threats, including threats of arrest, in violation of the FDCPA and FTC Act, and (4) violating the Fair Credit Reporting Act violations. *See* CONSUMER FIN. PROT. BUREAU, *FAIR DEBT COLLECTION PRACTICES ACT: CFPB ANNUAL REPORT 2017* (2017), https://s3.amazonaws.com/files.consumer finance.gov/f/documents/201703_cfpb_Fair-Debt-Collection-Practices-Act-Annual-Report.pdf [https:// perma.cc/LA2M-AG4S]; *See*, Press Release, Fed. Trade Comm'n, FTC and Federal, State and Local Law Enforcement Partners Announce Nationwide Crackdown against Abusive

Debt Collectors (Nov. 4, 2015), https://www.ftc.gov/news-events/press-releases/2015/11/ftc-federal-state-local-law-enforcement-partners-announce [https://perma.cc/2D4F-LKBB].

4. *CFBP vs. Moneytree* – loans were payday loans but were called "title loans;" enforcement action alleges that Moneytree threatened to repossess consumers' vehicles even though the loans were unsecured. *See Moneytree, Inc.*, No. 2016-CFPB-0028, (Dec. 16, 2016), available at 2016 WL 8539275.

C. State enforcement actions and private lawsuits

1. *State of Arizona vs. Quik Cash* - Arizona's attorney general alleged payday lender Quik Cash engaged in deceptive practices, which included engaging in pattern of suing customers who default on their loans in county courts far away from where they lived or worked and far from where the loans were created in order to make it purposefully inconvenient for customers to appear. *See* Press Release, Attorney General Tom Horne Announces Settlement Agreement with Quik Cash Financial Services, Mar. 8, 2011, https://www.azag.gov/press-release/attorney-general-tom-horne-announces-settlement-agreement-quik-cash-financial-services (consent judgment against Quik Cash Financial Services, which agreed to pay up to $170,000 in restitution to eligible consumers); *State of Arizona, ex rel. Terry Goddard*, Attorney General vs. Quik Cash, et. al., Complaint, 2009 WL 4768130 (Ariz. Super. Dec. 4, 2009).
2. *State ex. rel King v. B&B Inv. Grp.*, 329 P.3d 658, 670-71, 676 (N.M. 2014) (in a lawsuit filed by the State of New Mexico, holding that $50 to $300 loans with interest rates at approximately 1,500% were substantively unconscionable, noting "these loans are objectively low-value products and are grossly disproportionate to their price").
3. State of Washington - *Cash Advance Group - Payday Loan Debt Collection Scam*, WA DEP'T FIN. INSTS. (Feb. 14, 2017), http://www.dfi.wa.gov/consumer/alerts/cash-advance-group-payday-loan-debt-collection-scam [https:// perma.cc/FB9G-ADR2] (warning from the Washington State Department of Financial Institutions about a group of entities operating a payday lending debt scam where some consumers fell prey to threats of arrests contained in fake arrest warrants attached to email messages sent to the consumers).
4. *Aurandt v. Brown, et al.*, No. 3:15-275, 2017 WL 1215451 (W.D. Pa. Mar. 31, 2017) (denying, in part, defendants' motion to dismiss, thereby allowing plaintiffs' go forward with RICO, FDCPA and invasion of privacy claims). *See also* Second Amended Complaint, *Aurandt vs.*

Brown, et al., 3:15CV00275 (W.D. Pa. Apr. 21, 2017) (alleging, inter alia, that defendants used spoofing technology to make it appear that collection calls were coming from the Altoona Police Department in order to unlawfully collect payday loan debt and that defendants made calls impersonating law enforcement and threatening to have consumers arrested if they did not pay).

D. **CFPB's proposed rules to regulate payday loans and other consumer loans -** In June of 2016, the Consumer Financial Protection Bureau (CFPB) proposed new rules to curb the abuses of payday loans, auto title loans, and other forms of short-term credit. *CFPB Proposal Looks to End Payday Loan Debt Trap*s, FED. BANKING L. REP. ¶ 154–379 (June 2, 2016); Payday, Vehicle Title, and Certain High-Cost Installment Loans (proposed June 2, 2016) (to be codified at 12 C.F.R. pt. 1041), http://files.consumerfinance.gov/f/documents/Rulemaking_Payday_Vehicle_Title_Certain_High-Cost_ Installment_Loans.pdf [https://perma.cc/76PH-4V5P] [hereinafter CFPB's Proposed Rules].

AUTO LOANS AND CAR TITLE LOANS

I. <u>BANKRUPTCY CONTEXT</u>

A. **Fraudulent Transfers**

1. *Jones v. Mayhall Enters., L.L.C.* (*In re Jones*), 304 B.R. 462, 475 (Bankr. N.D. Ala. 2003) (finding constructive fraud where debtor surrendered to the car title lender a vehicle worth $7,350 upon default on a loan of only $1,500).
2. *Bell v. Instant Car Title Loans* (*In re Bell*), 279 B.R. 890 (Bankr. N.D. Ga. 2002) (holding that a Chapter 13 debtor had made a sufficient showing of probable success on the merits to justify a preliminary injunction against any further sale or disposition by a car title lender of a pawned vehicle worth at least $10,000 that was forfeited to satisfy a $5,300 debt, and stating that "[a] vehicle worth $10,000 is not reasonably equivalent in value to an obligation of $5,300").

B. **Property of the Estate**

1. *In re White*, No. 17-00102-TOM-13, 2017 WL 2198953 (Bankr. N.D. Ala. May 18, 2017) (in a case involving a car dealership's argument that a debtor did not own a vehicle due to its "conditional delivery," holding that debtor had a sufficient ownership interest in the vehicle and it became estate property where she had signed, pre-petition, an agreement to buy and finance the purchase of the vehicle, the dealership had represented to

debtor that she had been approved for financing, the debtor had obtained auto insurance on the vehicle, and the debtor had made a $1,000 down payment.).

2. *In re Howard*, 507 B.R. 394 (Bankr. N.D. Ga. 2014) (holding that Chapter 13 debtor, whose vehicles were subject to a car title loan, no longer had rights in the vehicles as of commencement of his bankruptcy case where the debtor failed to redeem vehicles within the grace period provided by Georgia law; thus, vehicles were not included in "property of the estate.").
3. *Geddes v. Mayhall Enter., LLC* (*In re Jones*), 304 B.R. 462 (Bankr. N.D. Ala. 2003) (holding that a vehicle was not property of the estate because although the debtors were still in possession of the vehicle that was subject to a car title loan, the debtors lost their interest in the pawned vehicles where, as of the petition date, the title loan had matured and the debtors' statutory right of redemption had expired).

C. Automatic stay violations

1. *Weber v. SEFCY* (*In re Weber*), 719 F.3d 72, 73, 81 (2d Cir. 2013) (affirming district court's holding that a lender willfully violated the automatic stay by its post-petition possession of debtor's vehicle for more than 50 days "by declining to surrender the vehicle absent a turnover order [;]… the lender wrongfully 'exercised control' over the vehicle").
2. *In re Law*, 497 B.R. 843 (Bankr. N.D. Tex. 2013) (imposing actual and punitive damages on auto lender for a willful violation of the automatic stay where a lender sent a letter only to the Chapter 7 debtor (and not her attorney) demanding she pay, even though the debtor had already timely filed her Statement of Intention indicating her surrender of the vehicle and had already filed schedules conspicuously indicating that the vehicle was in the actual possession of her estranged husband). The court noted that although the lender's demand letter had subtle references to a possible discharge in bankruptcy, it screamed "(in all capital letters) 'AMOUNT NOW DUE' and 'LAST DAY FOR PAYMENT.'" *Id.* at 850.
3. *Loe v. Green Tree Servicing LLC (In re Loe)*, A.P. No. 12-04108, 2013 WL 6628960 (Bankr. N.D. Tex. Dec. 17, 2013) (finding that Green Tree, the servicer for a mobile home lender, violated the discharge injunction via several telephone calls made to collect on a promissory note from a debtor, who received a prior Chapter 7 discharge of all debts, including the note, and that it violated the stay in the debtor's current Chapter 13 case via its repeated collection calls regarding the note)
4. *In re Velichko*, 473 B.R. 64, 69–70 (Bankr. S.D.N.Y. 2012) (finding that a creditor violated the stay where the creditor, arguing that bankruptcy law did not apply to it, "withheld [debtor's] only means of transportation—

causing her to incur more debt by forcing her to rent a car.... Then as a condition for her to receive possession of the car … [creditor] extracted from her over $800 in arrears and a reaffirmation agreement”).

D. Denial of Discharge -

1. *In re Rivas***,** 558 B.R. 690 (Bankr. D.N.J. 2016) (in response to BMW Financial Services’ motion to deny the debtor a discharge under § 727(a)(2), (3) and (5) due to the disappearance of a vehicle purchased by the debtor, holding that, while the debtor was negligent in failing to maintain insurance on the vehicle and the debtor’s brother was negligent in leaving the vehicle running while he ran a quick errand, such failures did not rise to the level of fraud or intentional wrongdoing).
2. *In re Frazier,* 551 B.R. 410 (Bankr. N.D. Ill. 2016) (in response to a creditor’s motion to deny a Chapter 7 debtor a discharge of auto loan debt under § 523(a)(6), holding that the debtor's conduct in failing to retrieve her vehicle, which was impounded by the city for unpaid parking fees, was not willful where the debtor was motivated solely by her inability to pay the fees and lacked an understanding or consideration of how her actions would affect the creditor as a result of the vehicle being sold or destroyed by the city).

E. Violation of the Discharge Injunction

1. *In re Maddox*, 530 B.R. 889 (Bankr. M.D. Ala. 2015) (holding that Chapter 13 debtors stated a plausible claim against Capital One for violating the discharge injunction by (1) its filing of a proof of claim in the debtors’ current case to recover auto loan debt that had been discharged in the debtors' prior Chapter 7 case and (2) its abandoning of an *in rem* claim due to its failure to repossess the vehicle despite having obtained stay relief).
2. *Pratt v. General Motors Acceptance Corp.* (*In re Pratt*), 462 F.3d 14 (1st Cir.2006) (holding that GMAC violated the discharge injunction by refusing to repossess its collateral - a worthless vehicle - and by refusing to release the lien on the vehicle unless the debtors paid the pre-petition auto loan debt in full).

F. Other Issues

1. **Unclean Hands & Kill Switches -** *In re Mabone*, 471 B.R. 534 (Bankr. E.D. Mich. 2012) (holding that an auto lender could not obtain sanctions against a debtor for filing a Chapter 13 petition in bad faith because the lender had unclean hands where it, upon learning that it would have to return the vehicle to the debtor, used a “kill switch” or starter interrupt device to remotely disable the vehicle's ignition system, so that the debtor could not start it.).

2. **Recoupment in Ch. 13 Plan -** *In re Schwalb,* 347 B.R. 726 (Bankr. D. Nev. 2006) (applying Nevada law) (holding that a car title lender had a security interest in a debtor's vehicles which were subject to title loans, finding that lender did not comply with provisions of UCC Art. 9, and allowing the debtor to recoup statutory damages from the lender due to its non-compliance, thereby allowing lender's secured claim in the debtor's Ch. 13 plan to be to be reduced accordingly).
3. **Confirmation of a Ch. 13 Plan -** *In re White,* No. 17-00102-TOM-13, 2017 WL 2198953 (Bankr. N.D. Ala. May 18, 2017) (in a case involving a car dealership's "conditional delivery" and argument that debtor did not own the vehicle, holding that the debtor had sufficient ownership interest in the vehicle and the debtor's plan would be confirmed in light of the fact that she had maintained insurance on the vehicle and set forth a feasible plan to pay the vehicle's full value).

II. NON- BANKRUPTCY CONTEXT

A. Auto Lending

1. **Large Settlement -** *Santander to Pay $25.9 Million to Resolve Subprime Auto Loan Probes,* Reuters, Mar. 29, 2017, https://www.reuters.com/article/us-banco-santander-settlement-idUSKBN1702EN (Massachusetts and Delaware Attorneys General (AGs) announced settlements with a national subprime lender to resolve allegations that the lender originated unfair and usurious auto loans in violation of Massachusetts and Delaware consumer protection laws. The AGs alleged that the lender originated subprime loans to more than 2,000 Massachusetts and Delaware consumers and then packaged them and sold them to investors, despite knowledge that the consumers' incomes reported on their loan applications were inflated or falsified by the dealerships.).
2. **Research -** Delvin Davis, Ctr. for Responsible Lending, *Auto Loans*: *The State of Lending in America and Its Impact on U.S. Households,* http://www.responsiblelending.org/state-of-lending/reports/4-Auto-Loans.pdf (discussing many subprime auto financing practices, including requiring terms that make it difficult for borrowers to pay and equipping vehicles with starter interrupt devices, aka kill switches, and GPS-tracking technologies); Brian Melzer & Aaron Schroeder, *Loan Contracting in the Presence of Usury Limits: Evidence from Automobile Lending*, Consumer Financial Protection Bureau, Office of Research, Working Paper No. 2017-02) (March 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2919070 (finding that

when auto lenders are bound by laws with APR caps or usury limits, lenders simple increase the sales price on vehicles and increase the loan amounts to get around these laws and providing as an example that "a $9,000 loan at 30% interest has the same required monthly payment as a $10,650 loan at 20% interest over a four-year term").

B. Car Title Lending

1. **Research -** Nathalie Martin & Ozymandias Adams, *Grand Theft Auto Loans: Repossession and Demographic Realities in Title Lending*, 77 MO. L. REV. 41, 62 (2012) (describing the results of a study of car title lenders in New Mexico and revealing that while consumers who obtain title loans own their vehicles, most consumers earn income at or near the poverty line); Pew Charitable Trusts, *Auto Title Loans: Market Practices and Borrowers' Experiences*, at 4 (2015), *available at* http://www.pewtrusts.org/~/media/Assets/2015/03/AutoTitleLoansReport.pdf?la=en (finding that the average car title loan is $1,000 and the average APR is 300%); Kathryn Fritzdixon, Jim Hawkins & Paige Marta Skiba, *Dude, Where's My Car Title?: The Law, Behavior, and Economics of Title Lending Markets*, 2014 U. ILL. L. REV. 1013, 1054 (2014) ("Instead of banning title lending, policymakers should foster a market with information that will help customers understand the true cost of title loans.").
2. **Recent Enforcement Action -** Press Release, Mich. Att'y Gen. Bill Schuette, Schuette Secures Victory Against Auto Title Loan Company Liquidation, LLC to Protect Michigan Residents from Illegal Title Loans (June 8, 2016), https://web.archive.org/web/20170424204834/http://www.michigan.gov/ag/0,4534,7-164-46849-386461--,00.html (announcing that Michigan's attorney general obtained a default judgment and permanent injunction against Liquidation, LLC, along with several related defendants, for numerous violations, including making illegal car title loans and engaging in unlawful collection practices, such as illegally repossessing consumers' vehicles and stealing the equity after selling the vehicles).
3. **Possible Violation of Military Lending Act** - *Cox v. Cmty. Loans of Am. Inc.*, 625 F. App'x 453, 455 (11th Cir. 2015) (finding that an implied private right of action exists under the Military Lending Act ("MLA") and thereby allowed active duty military servicemembers to proceed with their class action lawsuit alleging that several car title lenders violated the MLA by charging an annual interest rate that exceeded the MLA's statutory maximum.).

4. **Possible Violation of Privacy Law** - *Cantu v. TitleMax, Inc*., No. 5:14-CV-628- RP, 2015 WL 4526987, at *4 (W.D. Tex. July 23, 2015) (denying car title lenders' motion to dismiss, thereby allowing the plaintiffs' class-action lawsuit to proceed where the plaintiffs allege that the lender violated the Driver's Privacy Protection Act, 18 U.S.C. §§ 2721, et seq., by "engaging in a pattern of accessing state motor vehicle records to obtain information about consumers who had previously obtained car title loans from other companies for purposes of marketing its own title loan services to these potential customers".).
5. **Possible RICO violations** - *Gregoria v. Total Asset Recovery, Inc*., No. 12–4315, 2015 WL 115501, 2015 U.S. Dist. LEXIS 1818 (E.D. Pa. Jan. 8, 2015) (holding that a repossession agent for a car title lender could be liable under the Racketeer Influenced and Corrupt Organizations Act (RICO) (which prohibits the "collection of unlawful debt") for engaging in pattern of repossessing cars after borrowers have defaulted on car title loans charging interest rates of 150%, which was usurious and, therefore, unlawful under Pennsylvania law); *Goldenstein v. Repossessors, Inc*., 815 F.3d 142 (3d Cir. 2016) (holding that because "the prohibition on the 'collection of unlawful debt' under the statute encompasses efforts to collect on a usurious loan," a legitimate repossession company for the car title lender could be liable under RICO where the plaintiff-borrower pledged his car as collateral for a loan charging an interest rate of 250%).
6. **Arbitration -** *Kelly v. Credit Acceptance et al.*, Docket No. 1:16-cv-00223, 2017 WL 1051124, (N.D. Miss. Mar. 20, 2017) (granting auto lender's motion to compel a debtor to arbitrate where the debtor made several claims, including allegation that lender activated the starter interrupt device several times to disable the debtor's vehicle and alleging that the debtor was sometimes put in a dangerous situation due to the car not starting).

C. Concern over Kill Switches & GPS tracking

1. **Starter Interrupt Devices –** better known as "kill switches"—are devices that many car dealerships, auto financing companies, and car title lenders install on vehicles purchased or owned by consumers and are used to prevent the vehicles from starting when consumer-borrowers default on loans secured by the vehicles. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,867 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041) The Consumer Financial Protection Bureau ("CFPB") is proposing rules to regulate payday loans and car vehicle title loans and noting that it has received complaints from consumers about the kill switches. These devices also emit a very loud

beeping noise when the day approaches for the borrower's next payment. Use of the kill switches in combination with GPS tracking allows auto and car title lenders to prevent the vehicle from starting and ascertaining its location so it can be repossessed.

2. **Oklahoma Law -** The Vehicle Protection Product Act, which became effective in 2009, regulates "vehicle protection products" (or "VPPs"). *See* Okla. Stat. tit. 36, §§ 6650 et seq. The Act contains several prohibitions, including that "[a] vehicle protection product seller or warrantor may not require as a condition of financing that a retail purchaser of a motor vehicle purchase a vehicle protection product." *See* 36 Okla. Stat. tit. 36 §§ 6657(B).
3. **Proposed Federal Rules -** The CFPB has proposed rules that would regulate payday loans, car title loans, and other high-cost loans. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,867 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041) ("This rulemaking is focused on . . . short-term loans. The largest category of short-term loans are 'payday loans'. . . and short-term vehicle title loans . . . . ").
4. **State enforcement action –** *See*, *e.g.*, Michigan Settlement (see above) (alleging that car title lenders required consumers to permit the installation of a GPS tracking device on the consumers' vehicles before issuing loan proceeds).
5. **News Reports-** media outlets have reported on the potential harm to consumers. *See*, *e.g.*, Michael Corkery and Jessica Silver-Greenberg, *Miss a Payment? Good Luck Moving That Car, N.Y. Times* , Sept. 24, 2014, http://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/ (describing the experiences of several consumer-borrowers, including a woman who had fled from an abusive husband and whose car was repossessed after a large subprime lender used the device to track down the vehicle).

Honorable D. Sims Crawford[1]
United States Bankruptcy Judge
Northern District of Alabama
Southern Division

I. THE IMPACT OF BANKRUPTCY RULE 3002.1

Bankruptcy Rule 3002.1 was adopted in 2011 and it was amended December 1, 2016.

> Rule 3002.1 is a potent and multi-faceted tool for debtors, debtors' attorneys, chapter 13 trustees and bankruptcy courts. If used effectively, it ensures that chapter 13 debtors receive accurate post-petition mortgage statements, reduces the likelihood that chapter 13 debtors will be charged improper or unwarranted mortgage fees, and prevents conduct that could otherwise jeopardize the fresh starts earned by chapter 13 debtors.

Colleen A. Brown and Ha Young Chung, *The Not-So-New Rule 3002.1: It Only Works if We Use It*, XXXVI ABI Journal 1, 18, 56, Jan. 2017, *available at* abi.org/abi-journal.

The Rule reads as follows:

> **Rule 3002.1**. Notice Relating to Claims Secured by Security Interest in the Debtor's Principal Residence
>
> **(a) In general**
>
> This rule applies in a chapter 13 case to claims (1) that are secured by a security interest in the debtor's principal residence, and (2) for which the plan provides that either the trustee or the debtor will make contractual installment payments. Unless the court orders otherwise, the notice requirements of this rule cease to apply when an order terminating or annulling the automatic stay becomes effective with respect to the residence that secures the claim.
>
> **(b) Notice of payment changes**
>
> The holder of the claim shall file and serve on the debtor, debtor's counsel, and the trustee a notice of any change in the payment amount, including any change that results from an interest rate or escrow account adjustment, no later than 21 days before a payment in the new amount is due.
>
> **(c) Notice of fees, expenses, and charges**
>
> The holder of the claim shall file and serve on the debtor, debtor's counsel, and the trustee a notice itemizing all fees, expenses, or charges (1) that were incurred in connection with the claim after the

[1] Presentation materials prepared with the assistance of Janna Ifshin, career law clerk to the Honorable D. Sims Crawford.

bankruptcy case was filed, and (2) that the holder asserts are recoverable against the debtor or against the debtor's principal residence. The notice shall be served within 180 days after the date on which the fees, expenses, or charges are incurred.

(d) Form and content

A notice filed and served under subdivision (b) or (c) of this rule shall be prepared as prescribed by the appropriate Official Form, and filed as a supplement to the holder's proof of claim. The notice is not subject to **Rule** 3001(f).

(e) Determination of fees, expenses, or charges

On motion of the debtor or trustee filed within one year after service of a notice under subdivision (c) of this rule, the court shall, after notice and hearing, determine whether payment of any claimed fee, expense, or charge is required by the underlying agreement and applicable nonbankruptcy law to cure a default or maintain payments in accordance with § 1322(b)(5) of the Code.

(f) Notice of final cure payment

Within 30 days after the debtor completes all payments under the plan, the trustee shall file and serve on the holder of the claim, the debtor, and debtor's counsel a notice stating that the debtor has paid in full the amount required to cure any default on the claim. The notice shall also inform the holder of its obligation to file and serve a response under subdivision (g). If the debtor contends that final cure payment has been made and all plan payments have been completed, and the trustee does not timely file and serve the notice required by this subdivision, the debtor may file and serve the notice.

(g) Response to notice of final cure payment

Within 21 days after service of the notice under subdivision (f) of this rule, the holder shall file and serve on the debtor, debtor's counsel, and the trustee a statement indicating (1) whether it agrees that the debtor has paid in full the amount required to cure the default on the claim, and (2) whether the debtor is otherwise current on all payments consistent with § 1322(b)(5) of the Code. The statement shall itemize the required cure or postpetition amounts, if any, that the holder contends remain unpaid as of the date of the statement. The statement shall be filed as a supplement to the holder's proof of claim and is not subject to Rule 3001(f).

(h) Determination of final cure and payment

On motion of the debtor or trustee filed within 21 days after service of the statement under subdivision (g) of this rule, the court shall, after notice and hearing, determine whether the debtor has cured the default and paid all required postpetition amounts.

(i) Failure to notify

If the holder of a claim fails to provide any information as required by subdivision (b), (c), or (g) of this rule, the court may, after notice and hearing, take either or both of the following actions:

> **(1)** preclude the holder from presenting the omitted information, in any form, as evidence in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless; or
> **(2)** award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

Fed. R. Bankr. P. 3002.1

While the Rule was implemented to add transparency for the Debtor on residential mortgage loans, it has created other issues for the courts to address. Fortunately, amendments made in December 2016 clarified when the notices are required and when they can cease. The Advisory Committee Notes explain the 2016 Amendments as follows:

> Subdivision (a) is amended to clarify the applicability of the rule. Its provisions apply whenever a chapter 13 plan provides that contractual payments on the debtor's home mortgage will be maintained, whether they will be paid by the trustee or directly by the debtor. The reference to § 1322(b)(5) of the Code is deleted to make clear that the rule applies even if there is no prepetition arrearage to be cured. So long as a creditor has a claim that is secured by a security interest in the debtor's principal residence and the plan provides that contractual payments on the claim will be maintained, the rule applies.
> Subdivision (a) is further amended to provide that, unless the court orders otherwise, the notice obligations imposed by this rule cease on the effective date of an order granting relief from the automatic stay with regard to the debtor's principal residence. Debtors and trustees typically do not make payments on mortgages after the stay relief is granted, so there is generally no need for the holder of the claim to continue providing the notices required by this rule. Sometimes, however, there may be reasons for the debtor to continue receiving mortgage information after stay relief. For example, the debtor may intend to seek a mortgage modification or to cure the default. When the court determines that the debtor has a need for the information required by this rule, the court is authorized to order that the notice obligations remain in effect or be reinstated after the relief from the stay is granted.

Fed. R. Bankr. P. 3002.1, Advisory Committee Note (2016).

The issues are not limited to disputes about the notices. The issues range from the allowance of attorney fees for mortgage lenders who file the required notices, to deciding whether a discharge is appropriate when the Debtor is not current with his or her postpetition mortgage payments. We will address some of the frequent issues that have developed since the implementation of the Rule.

Fees for filing the Notices

The bankruptcy courts have differing opinions on whether the mortgage lenders' attorneys are entitled to fees for filing the notices:

- *In re Roife*, No. 10-34070, 2013 WL 6185025, at *3 (Bankr. S.D. Tex. Nov. 26, 2013): Debtor objected to the Notice of Post-Petition Mortgage Fees, Expenses and Charges for late charges in the amount of $142.26 and legal fees in the amount of $125.00. The $125.00 in legal fees included $50.00 for preparation of the Fee Notice and $75.00 for preparation of the Notice of Mortgage Payment Change. The court sustained the objection to the legal fees because the preparation was a ministerial task and the fact that sanctions may be imposed for incorrectly completing the task does not warrant the fees. *See also In re Boyd*, No. *12-80400*, 2013 WL 1844076 at *2 (Bankr. S.D. Tex. May 1, 2013), *In re Carr*, 468 B.R. 806, 807 (Bankr. E.D. Va. 2012), *In re Adams*, No. 12-00553-8-RDD, 2012 WL 1570054 (Bankr. E.D.N.C. May 3, 2012).

- *In re Lighty*, 513 B.R. 489, 494 (Bankr. D.S.C. 2014): Three cases were consolidated where each Debtor objected to the mortgage creditor's claim. The court construed each matter as a motion for a determination of fees, expenses or charges under Rule 3002.1. All three notices contained brief descriptions regarding the fees. All three mortgages contained the same underlying contractual language regarding attorneys' fees. The court took testimony in two out of three of the cases on the work performed by the mortgage lenders' attorney and found an attorney-client relationship existed in those two cases. The court determined where the attorney's fees were authorized by contract, there were six factors used by the state court in *Dedes v. Strickland*, 414 S.E. 2d 134, 137 (1992) to consider the reasonableness of the fees: "[1] the nature, extent and difficulty of the legal services rendered; [2] the time and labor necessarily devoted to the case; [3] the professional standing of counsel; [4] the contingency of compensation; [5] the fee customarily charged in the locality for similar legal services; and [6] the beneficial results obtained." Through the testimony of the attorneys in the two cases the court determined the fees were reasonable and were part of the "cure" amount pursuant to the underlying agreements.

- *In re Pittman*, C/A No. 14-03404-HB, 2015 WL 1262837, at *2-3 (Bankr. D.S.C. Mar. 16, 2015): The court heard the Debtor's Motion to Determine Post-Petition Fees, Expenses, and Charges under Rule 3002.1 and Creditor's Response. The Notice was for $650.00 for attorney's fees incurred post-petition - $225.00 for "Attorney fees" and $425.00 for "Bankruptcy/Proof of Claim fees." The court found that since the notice does not constitute *prima facie* evidence as to the validity

> of the amount of the claimed charges just stating "Attorney fees" or "Bankruptcy/proof of claim fees" does not support the charge made. The court could not determine from the documents if the fees were actually incurred or if they were necessary and reasonable. The court needed more adequate descriptions for the contractual charges as the court in *In re Lighty* had corrected with the evidence and testimony when the worked performed was not detailed in attached documents. The fees for the $650.00 were denied. *See also In re Susanek,* C/A No. 12-23545-GLT, 2014 WL 4960885, at *2 (Bankr.W.D. Pa. Sept 30, 2014), *In re Hale,* C/A No. 14-04337-HB, 2015 WL 1263255, at*3 (Bankr. D.S.C. Mar. 16, 2015).

The rule is most effective when the Debtor's counsel and the mortgage lender are proactive. Debtor's counsel has additional work to review all of the notices, and to ensure that the Debtor receives the benefits of the Rule. The mortgage lender has many deadlines to meet and notices to file to ensure that its appropriate fees or charges are not waived or disallowed.

Impact on Debtor and Debtor's counsel

> [D]ebtors' attorneys should make sure their clients comprehend the importance of reviewing their monthly mortgage statements and notifying their attorney (if paying their mortgage directly) or the chapter 13 trustee (if they are making CMPs to the trustee) if they see any fees, expenses or charges that they believe are erroneous. When an attorney hears of questionable post-petition mortgage charges, he/she should act promptly to rectify the error or file a motion to enforce Rule 3002.1(c).

See Brown and Jung, *supra*, at 56.

Debtor's counsel can:

- Request hearings pursuant to Rule 3002(h). Motions to Deem the Loan Current can ensure the Debtor obtain the fresh start envisioned by the filing of the bankruptcy. *Id.* at 56.
- File the notice required under Rule 3002.1(f) if the Trustee does not file the notice. *In re Fitch,* 540 B.R. 13, 15 (Bankr. D.Me. 2015).
- Modify the Chapter 13 plan to add correct post-petition fees and charges to be paid by the Trustee through the Chapter 13 plan or advise Debtor to pay these fees and charges directly to the mortgage lender.
- Remember to review remedies outside of bankruptcy court like those available under RESPA. "Congress intended for the bankruptcy court's role in supervising mortgage lenders to be limited in scope." *Ogden v. PNC, Bank, N.A. (In re Ogden),*

532 B.R. 329, 334 (Bankr. D. Colo. 2014). The Rule does not require the Debtor to file a Motion for Hearing after service of the cure response. *Bodrick v. Chase Home Finance, Inc. (In re Bodrick),* 498 B.R. 793, 805 (Bankr. N.D. Ohio Oct. 8, 2013).

Impact on Mortgage Lender

> In determining the burden of proof under Bankruptcy Rule 3002.1(h), the court must look to other subparts of Rule 3002.1 and read the statute as a whole. The mortgage holder is required to file and serve notices of payment changes no later than twenty-one days before the new payment is due and must itemize all postpetition fees, expenses or charges that the holder asserts are recoverable against the debtor or her residence. Fed.R.Bankr.P. 3002.1(b)-(c). Upon completion of the plan, if the mortgage holder contends there are outstanding amounts, it must file a response to Trustee's notice of final cure payment and "itemize the required cure or postpetition amounts, if any, that the holder contends remain unpaid as of the date of the statement." Fed.R.Bankr.P. 3002.1(g). The itemization must be sufficiently detailed for a debtor to contest the holder's response under Bankruptcy Rule 3002.1(g). *See In re Carr,* 468 B.R. 806, 808 (Bankr. E.D. Va. 2012) ("The creditor must respond to that notice [of final cure payment] by acknowledging that it is correct, or if it is not correct, stating *with particularity* the amounts that remain unpaid." (emphasis added)). Additionally, Bankruptcy Rule 3002.1(g) states that the mortgage holder's response to the notice of final cure payment does not enjoy the same prima facie presumption set forth in Bankruptcy Rule 3001(f). I conclude the mortgage holder has the burden to establish the prepetition cure amounts and outstanding postpetition obligations on the mortgage.

In re Howard, No. 10-52527 SLJ, 2016 WL 8222335, at *3 (Bankr. N.D. Cal. Aug.15, 2016).

The Mortgage lender:

- Has the burden to file the notices in a timely manner.

- Has the burden of proof that the notice is correct, since the notices have no presumption of validity. *In re Rodriguez,* No. 08-80025-G3-13, 2013 WL 3430872, at *4 (Bankr. S.D. Tex. July 8, 2013).

- May be sanctioned:
  > The importance of the obligations mandated by Rule 3002.1 is underscored by inclusion of a penalty for violations. When a party fails to comply with Rule 3002.1(c), Rule 3002.1(i) explicitly authorizes bankruptcy courts to impose sanctions. Such sanctions include precluding the mortgage creditor from presenting information that it failed to disclose in any contested matter or adversary proceeding in the case, and an "award [of] other appropriate relief, including reasonable expenses and attorney's fees caused by the failure." The corresponding Advisory Committee Note reinforces the bankruptcy courts'

authority to punish violations of Rule 3002.1, specifying that "sanctions [might] be imposed if the holder of a claim fails to provide any of the information required under subdivision (c)." *See* Brown and Jung, *supra*, at 18 (footnotes omitted).

In re Gravel, 556 B.R. 561 (Bankr. D.Vt. 2016): In three separate cases the Chapter 13 Trustee asked for sanctions based on repeated violations of Rule 3002.1

> [T]he Court concludes a sanction amount computed on the number of months this misconduct persisted after PHH assured the Court it had rectified the problem is warranted, reasonable, and well-founded. It will therefore impose a sanction in each of these three cases in the amount of $1,000 per month for the 25 months that have passed since approval of the settlement in Gravel, during which PHH improperly assessed post-petition fees and failed to file the required Rule 3002.1(c) notices. This sanctions amount reflects the serious nature of PHH's persistent and reckless violations of Rule 3002.1(c) and is intended to motivate PHH to comply with its Rule 3002.1 obligations going forward.

The court also found PHH in contempt. The total sanction imposed was $375,000.00 and was directed to be paid to the Legal Services Law Line of Vermont.

Discharge

The courts have issued differing opinions on whether the Debtor may receive a discharge when the mortgage lender's Response to Final Cure indicates that the Debtor is not current with his or her postpetition mortgage payments:

- *In re Gonzales*, 532 B.R. 828 (Bankr. D. Colo. 2015): Debtors did not dispute the Response to Notice of Final Cure which showed very substantial postpetition mortgage arrearages. The court held the Debtors were not entitled to a discharge because they had not made all payments under the plan. The entered discharge was revoked.

- Other courts allow the Debtor a discharge if the Debtor is otherwise eligible for a discharge and make no final determination as to the postpetition arrearages.

Conclusion

Rule 3002.1 has a great impact on Chapter 13 Debtors and mortgage lenders, and the Rule should not be overlooked by the parties.

> The level to which sanctions were imposed against PHH makes it clear that counsel representing mortgage servicers in chapter 13 cases must diligently advise clients on the importance of complying with Bankruptcy Rule 3002.1. Counsel must see to it that their clients have adequately adjusted their systems to ensure that notice of any post-petition fees is promptly served on the debtor and the trustee. Commercial lenders will likely be assumed to have knowledge of Rule 3002.1 and its requirements. As such, a court may find that the first two prongs of the *Gravel* test are already met. Protecting a client's interest requires counsel to be proactive, and the time for creditors and mortgage loan servicers to establish compliant business practices is now.
>
> Counsel representing mortgagees in chapter 13 cases must ensure that he/she is aware of any post-petition fees assessed on the mortgage loan and promptly make the required notice. Perhaps the best practice once a court issues a debtor-current order is to request that clients send debtors' statements to bankruptcy counsel to ensure that any additional charges or fees included comply with the requirements of Rule 3002.1 before delivering the statements to the debtor. When necessary, an unreported fee should be removed before issuing a statement.
>
> As *Gravel* illustrates, even a relatively small fee mistakenly left in a statement can have unintended and expensive consequences. Creditors do not simply risk having their claim to fees disallowed, they also risk being subject to significant sanctions, such as the $375,000 punishment that the Vermont Bankruptcy Court levied against PHH Mortgage Corp.

Anthony J. Manhart and Matthew J. Libby, *Rule 3002.1 Minefield: Mortgagees in Chapter 13 Face Substantial Sanctions for Noncompliance*, XXXVI ABI Journal 1, 20, 57, Jan. 2017, *available at* abi.org/abi-journal.

II. SUB-PRIME AUTO LENDING

"Subprime borrowers may have an extensive history of late or missed payments, default debt, excessive debt or no property assets that could be used as security. In the United States, subprime borrowers are often identified by having a FICO© credit score below 640." INVESTOPEDIA, http://www.investopedia.com/terms/s/subprime-borrower.asp (last visited May 26, 2017).

According to Michael Corkery and Jessica Silver-Greenberg's article *Miss a Payment? Good Luck Moving that Car,* N.Y. TIMES, Sept. 24, 2014, http://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/, lenders can profit from making loans to subprime borrowers because of the high interest rates charges. Interest rates on some subprime loans may exceed 29 percent.

"New car loans for subprime borrowers fell in the first quarter to 25.9 billion, the lowest in two years, according to the New York Fed's quarterly report on household debt and credit." Gabrielle Coppola, *Banks Tighten Auto Lending as More Borrowers Fall Into Default*, May 17, 2017, https://www.bloomberg.com/news/articles/2017-05-17/banks-tighten-auto-lending-ad-more-borrowers-fall-into-default-bloomberg. This reduction may be due to lenders tightening their practices so subprime auto lending does not reach the level of the subprime mortgage crisis.

GPS TRACKING AND DISABLING DEVICES

"The GPS allows a lender to monitor the location of a vehicle serving as its collateral and assists the creditor in physically repossessing the vehicle upon default by locating the vehicle without having to conduct a search as in a traditional repossession using a third-party company." PASSTIME, *How it Works,* http://www.passtimeusa.com/howitworks (last visited Sept. 27, 2014).

> Starter disabling devices although created by a variety of manufacturers, are generally designed to be installed in the vehicle of a subprime borrower. The device allows a lender (or the device manufacturer) to remotely disable the starter of the vehicle, rendering the car unusable until the borrower contacts the lender to negotiate a payment. The device is placed near the dashboard and is accompanied with a keycard that will often beep when the payment due date is approaching. The device will also indicate when the due date has passed, signaling the borrower to contact the lender to make a payment. Lenders purchase the device from a variety of manufacturers, so the precise design of the device itself often varies depending on the manufacturer (citations omitted).

Id. at 820.

Positives

- The devices allow loans to be made to subprime borrowers who would not otherwise be considered for a loan and thereby promote economic and financial stability. *See* PASSTIME, *supra.* The devices provide for timely payments and helps subprime borrowers rebuild impaired credit. Erica N. Sweeting, *Disabling Disabling Devices: Adopting Parameters for Addressing a Predatory Auto- Lending Technique on Subprime Borrowers,* 59 How.L.J. 817, 832 (2016) (citations omitted).

- The repossession costs are significantly lower for lender and for borrowers. Corkery and Silver, *supra,* at 2.

- The car may easily tracked if it is stolen. The devices can aid in apprehension of criminals and reduce criminal activity. Abby Ohleiser, *The Controversial GPS Device That Helped Police Catch Carlesha Freeland-Gaither's Alleged Abductor,* WASH. POST (Nov. 7, 2014). http://www.washingtonpost.com/news/post-nation/wp/2014/06/the-controversialgps-device-that-helped-officials-catch-an-alleged-philadelphia-abductor/.

Negatives

- Invasion of privacy. The borrowers feel they are constantly under surveillance. Corkery and Silver, *supra,* at 5.

- Safety concerns and dangers.

    - Although they are designed to only disable the vehicle when it is not in motion, there have been reported cases of the vehicle being disabled when idling or when in motion. Sweeting, *supra,* at 821.

    - Borrowers may be stranded or unable to use the vehicle when there is an emergency. Corkery and Silver, *supra,* at 1. There have been cases where the borrower is put in an extremely compromising position:

        For example, a woman in Austin, Texas fled to a shelter to escape her abusive husband.

> After failing to make her monthly payment, the lender shut off her starter and later sent a tow truck to take back the vehicle. The woman became terrified that her husband would be able to find out where she was from the tow truck company. Sweeting, *supra*, at 832 (citations omitted).

- The devices may be degrading and humiliating to customers who are constantly reminded of payments. Corkery and Silver, *supra*, at 3.

BANKRUPTCY

The bankruptcy courts have differing opinions on whether GPS and disabling devices violate the automatic stay. One court in Ohio found:

> In this case, Creditor's continued use of the PassTime device violated the provisions of both § 362(a)(3) and (6). To avoid violating § 362(a), a creditor is not only required to refrain from certain activity, but may be required to take affirmative action. *See In re O'Neal*, 165 B.R. 859, 862 (Bankr.M.D.Tenn.1994) (holding that § 362(a)(3) requires a bank to take steps to discontinue an automatic loan payment from a debtor's checking account); *Sharon*, 234 B.R. at 688 (finding that the creditor violated the automatic stay by failing to return the Chapter 13 debtor's car that it had repossessed prepetition); *Thompson v. Gen'l Motors Acceptance Corp.*, 566 F.3d 699, 703 (7th Cir.2009)(same). As discussed above, on a biweekly basis, the PassTime device emitted warning sounds that Debtors' payment is coming due, which, as one court addressing a similar device observed, "serves no purpose other than to pressure [the debtor] to remit payment" in violation of § 362(a)(6) and "is not unlike that of sending a debtor a monthly statement with a payment coupon." *In re Garner,* No. 09–81998, 2010 WL 890406, *4, 2010 Bankr.LEXIS 721, *11 (Bankr.M.D.N.C. March 9, 2010) (citing *Cousins v. CitiFinancial Mortg. Co, (In re Cousins)*, 404 B.R. 281, 288–89 (Bankr.S.D.Ohio 2009)). By continuing the postpetition use of the device, Creditor also exercises control over property of the estate in violation of § 362(a)(3). *Id.* at *3; *Hampton v. Yam's Choice Plus Autos, Inc. (In re Hampton)*, 319 B.R. 163, 171 (Bankr.E.D.Ark.2005) (finding the existence of a similar device on the debtor's car "an overt exercise of control over estate property"). This was particularly evident on the several occasions when Debtors' Vehicle was rendered inoperable. 5 The court also finds that Creditor's violations of the stay were willful. There is no dispute that it received actual notice of Debtors' bankruptcy case in January 2014. There is also no dispute that Creditor could have, but did not, take steps to terminate the use of the PassTime device in Debtors' Vehicle after receiving such notice.

> The court further finds that Debtor Annie Horace was injured by the operation of Creditor's Pass Time collection device every time it beeped post-petition and every time it rendered the vehicle inoperable when she was using it and it should not have. (No testimony as to any injury Stephen Horace suffered was presented.) (footnote omitted).

In re Horace, Case No. 14-30103, WL 5145576, at *4-5 (N.D. Ohio Aug. 28, 2015). Another court in North Carolina found that "RSY's refusal to remove the Payment Protection System constitutes an intentional, and therefore willful, violation of the automatic stay pursuant to § 362(k) of the Bankruptcy Code. As a result, the Debtors are entitled to be compensated for actual damages." *In re Garner,* No. 09-81998, 2010 WL 890406, at *4 (Bankr. M.D.N.C. Mar. 9, 2010).

Other courts have found the devices do not violate the stay. A court in South Carolina followed this reasoning:

> The Court finds that Debtor has failed to prove by clear and convincing evidence that Auto Credit violated the automatic stay. Debtor argues that Auto Credit willfully exercised control over the Vehicle, in violation of § 362(a)(3), through its postpetition use of the Passtime System. However, the mere postpetition operation of the Passtime System does not constitute a violation of the automatic stay. *See In re Hampton*, 319 B.R. 163, 174 (Bankr.E.D.Ark.2005) (stating that the mere existence of a system that was similar to the Passtime System does not violate the automatic stay). Rather, Auto Credit was obligated under § 362(a)(3) to avoid exercising control over the vehicle. Thus, Auto Credit had to take appropriate measures to prevent the vehicle from being disabled if it wished to continue its use of the Passtime System. *See In re Dawson*, 2006 WL 2372821, No. 05–1463, slip op. at 8 (Bankr.N.D.Ohio Aug. 15, 2006) (finding that a creditor must either remove the disabling device or ensure that the debtor is provided with the correct codes to avoid violating the stay). In this case, Auto Credit avoided violating the stay by *445 providing the proper monthly and emergency codes to Debtor to ensure that the Passtime System would not disable the Vehicle. When the Vehicle was disabled on July 4, 2006, Debtor possessed an emergency code to render the Vehicle operational for twenty-four hours. On July 5, 2006, Auto Credit provided Debtor with a code that was set to expire at the end of August 2006. Upon request of Debtor's attorney, Auto Credit provided Debtor's attorney with a new extended code on July 10, 2006, which would have prevented the Vehicle from being disabled on September 1, 2006; however, Debtor failed to timely or properly enter the code. In both instances, Auto Credit had provided Debtor or Debtor's attorney with the correct codes. It was Debtor's responsibility to properly input the codes. Thus, Auto Credit was not in violation of automatic stay under § 362(a)(3) when the Passtime System disabled the Vehicle on July 4 and September 1, 2006. Accordingly, the

> Court need not address whether the alleged violations were “willful” for the purposes of § 362(k). *In re Lennan,* No. 96–1911, 1997 WL 657118, at *5 (4th Cir. Oct.9, 1997)(holding that because there was no violation of the stay, debtor was not entitled to attorney's fees for a *willful* violation of stay).

Grisard-Van Roey v. Auto Credit Center, Inc. (In re Grissard-Van Roey), 373 B.R. 441, 444-45 (Bankr. D.S.C. 2007).

CONCLUSION

Subprime auto lending accounted for roughly 25 percent of the auto loans in 2013 and approximately two million vehicles were installed with GPS technology and disabling devices at that time. Corkery and Silver, *supra,* at 2. The lenders are beginning to tighten standards to prevent a crisis like the mortgage crisis. If the loans continue more legislation and further scrutiny should ensue regarding the GPS tacking devices, the disabling devices and the predatory lending habits of the lenders. If the lending is tightened the automakers will suffer because they relied on the looser standards to boost sales. Coppola, *supra, 2.*

National Conference of Bankruptcy Judges
The Wolf (of Wall Street?) at the Door: Lending to the Financial Underclass

Las Vegas, Nevada
October 2017

Federal Rule of Bankruptcy Procedure 3001(c)(3)

Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Laura F. Atack, Law Clerk

Rule 3001(c)(3) of the Federal Rules of Bankruptcy Procedure (the "Rule(s)") sets forth the information required for a proof of claim "based on an open-end or revolving consumer credit agreement"[2] to be entitled to prima facie validity. Fed. R. Bankr. P. 3001(c)(3)(A); Fed. R. Bankr. P. 3001(f) ("A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim."). Such proofs of claim must include a statement containing:

> **(i)** the name of the entity from whom the creditor purchased the account;
> **(ii)** the name of the entity to whom the debt was owed at the time of an account holder's last transaction on the account;
> **(iii)** the date of an account holder's last transaction;
> **(iv)** the date of the last payment on the account; and
> **(v)** the date on which the account was charged to profit and loss.

Fed. R. Bankr. P. 3001(c)(3)(A)(i)–(v). Unlike other claims based on writings, a claim subject to Rule 3001(c)(3) does not have to be accompanied by a copy of the writing, but the holder must provide one within 30 days, if requested. Fed. R. Bankr. P. 3001(c)(1) (requiring that a proof of claim based on a writing include a copy of the writing, "[e]xcept for a claim governed by paragraph (3) of this subdivision"); Fed. R. Bankr. P. 3001(c)(3)(B) ("On written request by a party in interest, the holder of a claim based on an open-end or revolving consumer credit agreement shall, within 30 days after the request is sent, provide the requesting party a copy of the writing specified in paragraph (1) of this subdivision.").[3]

---

[2] Proofs of claim "for which a security interest is claimed in the debtor's real property" are, however, excluded. Fed. R. Bankr. P. 3001(c)(3)(A).

[3] *See also In re Umstead*, 490 B.R. 186, 195 (Bankr. E.D. Pa. 2013) ("The general requirement that a writing be attached has been *replaced* with two (2) other requirements: (1) the disclosure of specified information regarding the status of the account and the assignee's purchase of the account (as set forth in (3)(A)(i)–(iv)); and (2) the obligation to provide the documents on which the claim is based to a party in interest, *but only upon request.*").

Paragraph (3) was added to Rule 3001(c) in 2012, in part to assist the debtor or trustee in identifying and assessing the validity of the claim. As the Advisory Committee on Rules of Bankruptcy Procedure (the "Advisory Committee") stated:

> Because a claim of this type may have been sold one or more times prior to the debtor's bankruptcy, the debtor may not recognize the name of the person filing the proof of claim. Disclosure of the information required by paragraph (3) will assist the debtor in associating the claim with a known account.

Advisory Committee note accompanying the 2012 amendment to Fed. R. Bankr. P. 3001; *see also In re Crutchfield*, 492 B.R. 60, 67 (Bankr. M.D. Ga. 2013) ("Under the current version of the Rule, the same assignees merely need to provide a summary of specific data that is calculated to provide the debtor with enough information to match the claim with a debt."). Importantly, such information "will also provide a basis for assessing the timeliness of the claim." Advisory Committee note accompanying the 2012 amendment to Fed. R. Bankr. P. 3001; *In re Umstead*, 490 B.R. 186, 198 (Bankr. E.D. Pa. 2013) ("Rule 3001(c)(3)'s requirement that the last transaction date be disclosed appears to be designed to assist the debtor in evaluating: (1) the timeliness of the claim, (2) whether the amount of the claim is consistent with the debtor's recollection of his or her use of the credit card and, perhaps also even (3) identification of the particular credit card account.").

But what if a creditor does not include this information?

Noncompliance with Rule 3001(c) Is Not Grounds for Disallowance.

Several courts have held that mere noncompliance with Rule 3001(c) is not itself a basis for disallowance of a proof of claim. *See, e.g.*, *Perron v. eCast Settlement Corp. (In re Perron)*, No. 05-8075, 2006 WL 2933827, at *4 (B.A.P. 6th Cir. Oct. 13, 2006) ("Compliance is certainly important. However, the mere failure to comply with rules concerning the form and content of a proof of claim is not justification under the Bankruptcy Code to judicially invalidate a creditor's otherwise lawful claim." (quoting *In re Shaffner*, 320 B.R. 870, 876 (Bankr. W.D. Mich. 2005))); *Heath v. Am. Express Travel Related Servs. Co. (In re Heath)*, 331 B.R. 424, 435 (B.A.P. 9th Cir. 2005) ("Noncompliance with Rule 3001(c) is not one of the statutory grounds for disallowance.").

This is because § 502(b) sets forth the exclusive grounds for disallowance, and noncompliance with Rule 3001 is not one of them. 11 U.S.C. § 502(b) (providing that a claim shall be allowed "except to the extent that" any one of paragraphs (1)–(9) applies); *In re Norris*, — B.R. —, No. 16-44297-BDL, 2017 WL 1476120, at *2 (Bankr. W.D. Wash. Apr. 19, 2017) ("Failure to comply with Rule 3001(c) is not included as a ground for disallowance in 11 U.S.C. § 502(b)."). And Rule 3001(c)(2)(D) supports this conclusion, by providing consequences of noncompliance:

> If the holder of a claim fails to provide any information required by this subdivision (c), the court may, after notice and hearing, take either or both of the following actions:
>
> (i) preclude the holder from presenting the omitted information, in any form, as evidence in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless; or
> (ii) award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure.

Fed. R. Bankr. P. 3001(c)(2)(D).

Courts that have adopted the so-called exclusive approach to § 502(b), holding that noncompliance with Rule 3001(c) does not result in disallowance of the claim, include:

- *Perron v. eCast Settlement Corp. (In re Perron)*, No. 05-8075, 2006 WL 2933827 (B.A.P. 6th Cir. Oct. 13, 2006); *see also B-Line, LLC v. Wingerter (In re Wingerter)*, 594 F.3d 931, 941 (6th Cir. 2010) (noting that "[t]he ramifications for [violating Rule 3001(c)] are well-established" and citing *Heath* for the proposition that "failure to comply with Rule 3001 results in the creditor's proof of claim not being prima facie evidence of the claim's validity and amount");

- *Heath v. Am. Express Travel Related Servs. Co. (In re Heath)*, 331 B.R. 424 (B.A.P. 9th Cir. 2005);

- *Campbell v. Verizon Wireless S-CA (In re Campbell)*, 336 B.R. 430 (B.A.P. 9th Cir. 2005);

- *Dove-Nation v. eCast Settlement Corp. (In re Dove-Nation)*, 318 B.R. 147 (B.A.P. 8th Cir. 2004);

- *Maddux v. Midland Credit Mgmt., Inc.*, 567 B.R. 489, 499 (Bankr. E.D. Va. 2016) ("Mere non-compliance with the informational requirements of Rule 3001 such as attachment of documentation or providing specific information should not be, in and of itself, grounds to disallow the claim." (quoting *In re Goeller*, No. 12-17123-RGM, 2013 WL 3064594, at *3 (Bankr. E.D. Va. June 19, 2013)); and

- *In re Gilbreath*, 395 B.R. 356, 364 (Bankr. S.D. Tex. 2008) ("Although incomplete or insufficient proofs of claim are not prima facie valid, they are not automatically disallowed. The debtor, however, 'has no evidentiary burden to overcome' in objecting to a claim that is not prima facie valid. Once the debtor objects to a proof of claim, the claim's validity becomes a 'contested matter' and the burden shifts back to the creditor to prove the claim is valid by a preponderance of the evidence." (citations omitted)).

See also:

- *In re Melillo*, 392 B.R. 1, 4 (B.A.P. 1st Cir. 2008) (briefly discussing the split between exclusive and nonexclusive approaches, but failing to adopt one view or the other because assignee's failure to provide "sufficient evidence" that it owned the debt rendered claim unenforceable under state law and therefore subject to disallowance under § 502(b)(1)); *accord In re Doherty*, 400 B.R. 382, 383 (Bankr. W.D.N.Y. 2009) ("This Court fully agrees with the analysis and conclusions of the Bankruptcy Appellate Panel in *Melillo*. In the absence of sufficient proof of the ownership of a claim, whether it be by a purchaser, transferee or successor-in-interest, that proof of claim can and must be disallowed.");

- *In re Rodriguez*, 555 B.R. 871, 874 (Bankr. S.D. Fla. 2016) (citing *In re Moreno*, 341 B.R. 813, 817 (Bankr. S.D. Fla. 2006), and "criticiz[ing] the tactic of filing an objection to an undisputed scheduled claim[,] [noting that] 'if a debt is scheduled . . . for an amount equal to or exceeding the amount in the proof of claim, this Court will not tolerate attempts to obtain orders disallowing these claims if the only basis for the objection is lack of documentation'");

- *Critten v. Quantum3 Grp., LLC (In re Critten)*, 528 B.R. 835, 842 (Bankr. M.D. Ala. 2015) ("The consequence resulting from the failure to comply with Rule 3001 is to strip the claim of its prima facie validity but not necessar[ily] disallow the claim, and certainly not provide a private right of action for damages."); and

- *In re Shank*, 315 B.R. 799, 815 (Bankr. N.D. Ga. 2004) ("If the debtor thinks that every one of the challenged claims is overstated, that every claimant has included illegal or unauthorized charges, or that for any reason she has no liability to any of them, she may investigate fully her theories and raise every viable claim or defense that she has. If the debtor requires documentation to make a good faith inquiry into the existence or amount of any liability and a claimant refuses a legitimate request to produce it, an objection that asserts her good faith challenge and requests disallowance of the claim due to inadequate documentation would be appropriate and could well result in entry of an order disallowing the claim or requiring its amendment. . . . But if the debtor thinks, for example, in accordance with her [schedules], that she owes [a creditor] only $1,776.00 on the proof of claim filed by its assignee for $12,992.72, the proper objection is that the claimant has not established anything in excess of the amount the debtor admits is owed, not a request for complete disallowance of the claim merely because of inadequate documentation.").[4]

Rule 3007(d)(6) May Provide a Basis for Disallowance.

At least one court has assessed Rule 3007's impact on the disallowance of a claim for failure to comply with Rule 3001. Rule 3007(d) provides, in part, that:

> [O]bjections to more than one claim may be joined in an omnibus objection if all the claims were filed by the same entity, or the objections are based solely on the grounds that the claims should be disallowed, in whole or in part, because:
>
> . . .
>
> (6) they were presented in a form that does not comply with applicable rules, and the objection states that the objector is unable to determine the validity of the claim because of the noncompliance[.]

Fed. R. Bankr. P. 3007(d)(6).

[4] *But see Caplan v. B-Line, LLC (In re Kirkland)*, 572 F.3d 838 (10th Cir. 2009) (reversing BAP decision that had adopted exclusive approach and affirming bankruptcy court's disallowance of proof of claim because creditor failed to attach supporting documentation or provide explanation of its failure to do so as required by Rule 3001); *In re Henry*, 311 B.R. 813, 817–18 (Bankr. W.D. Wash. 2004). Courts have called the Tenth Circuit's decision in *Kirkland* into question following the 2012 amendments to Rule 3001. *See In re Reynolds*, 470 B.R. 138, 143 (Bankr. D. Colo. 2012) (declining to follow *Kirkland* and instead adopting the majority "exclusive approach," noting that the 2012 amendments to Rule 3001 providing for sanctions for noncompliance required *Kirkland* to be called into question).

In *In re Today's Destiny*, the Bankruptcy Court for the Southern District of Texas adopted the exclusive approach,[5] but noted that, nonetheless, Rule 3007 may provide an additional reason for disallowance:

> [T]he claim must contain sufficient information for parties to discern the general basis of the claim. The Rules contemplate an objection based on the inability to determine the validity of a claim because of the claimant's failure to comply with Rule 3001. Rule 3007(d) states how omnibus objections shall be made. Subsection (6) specifically provides that objecting parties may object to a proof of claim if the validity of the claim cannot be determined because of the claimant's failure to comply with the Bankruptcy Rules. Fed. R. Bankr. P. 3007(d)(6). Accordingly, if an objecting party cannot discern whether there is a § 502(b) objection to the claim because the claimant failed to comply with the Bankruptcy Rules, the Court does not read the Code and Rules as requiring allowance. Due process requires no less.

In re Today's Destiny, Inc., No. 05-90080, 2008 WL 5479109, at *3 (Bankr. S.D. Tex. Nov. 26, 2008); *see also* Doron P. Kenter, *Can You Object to a Claim Just Because It Doesn't Include Supporting Documentation? The Answer May Not Be as Simple as You Think*, WEIL BANKRUPTCY BLOG (June 23, 2015), https://business-finance-restructuring.weil.com/claims/can-you-object-to-claim-just-because-it-doesnt-include-supporting-documentation-the-answer-may-not-be-as-simple-as-you-think/ ("[P]ursuant to Bankruptcy Rule 3007, a simple statement (i.e., that the debtor does not believe the claim is valid) is sufficient to serve as support for an otherwise purely procedural and formalistic objection."). There is, however, little to no other case law on the question of whether Rule 3007(d)(6) provides a basis for disallowance under these circumstances.

[5] The court in *Today's Destiny* followed the Tenth Circuit BAP decision in *B-Line, LLC v. Kirkland (In re Kirkland)*, 379 B.R. 341 (B.A.P. 10th Cir. 2007), a decision that was later reversed by the Tenth Circuit in *Caplan v. B-Line, LLC (In re Kirkland)*, 572 F.3d 838 (10th Cir. 2009).

National Conference of Bankruptcy Judges
The Wolf (of Wall Street?) at the Door: Lending to the Financial Underclass

Las Vegas, Nevada
October 2017

Midland Funding, LLC v. Johnson, 137 S. Ct. 1407 (2017)

Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Laura F. Atack, Law Clerk

I. Background

The Fair Debt Collection Practices Act (the "FDCPA")[6] was enacted in 1977 with the specific purpose of "eliminat[ing] abusive debt collection practices by debt collectors" while "insur[ing] that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged." 15 U.S.C. § 1692(e). In particular, the FDPCA prohibits debt collectors[7] from using "any false, deceptive, or misleading representation or means" or "unfair or unconscionable means to collect or attempt to collect any debt." 15 U.S.C. §§ 1692e & 1692f.

The FDCPA's place in the bankruptcy system became the subject of much debate as "[a] deluge . . . swept through U.S. bankruptcy courts . . . [of] [c]onsumer debt buyers . . . filing proofs of claim on debts deemed unenforceable under state statutes of limitations." *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1256 (11th Cir. 2014). The issue of whether filing a proof of claim on time-barred debt can be "unfair," "deceptive," or "misleading" under the FDCPA caused disagreement not just among circuits, but also within districts.[8] Before the question reached the Supreme Court, four appellate courts—the Fourth, Seventh, Eighth and Eleventh Circuits—had

---

[6] 15 U.S.C. §§ 1692–1692p.

[7] With certain exceptions, "'debt collector' means any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. . . [or] any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is collecting or attempting to collect such debts." 15 U.S.C. § 1692a(6). The Supreme Court in *Henson v. Santander Consumer USA Inc.* recently limited the scope of this definition as applied to debt buyers, holding that an entity collecting a debt it acquired from an originating lender (or that lender's transferee) does not fall under the FDCPA definition of "debt collector" as an entity who "regularly collects or attempts to collect . . . debts owed or due . . . another." 137 S. Ct. 1718 (2017). The Supreme Court's decision was limited, however, and a debt buyer may yet fall under the first definition of "debt collector"—one "in any business the principal purpose of which is the collection of any debts." *Id.* at 1721.

[8] *Compare Taylor v. Galaxy Asset Purchasing, LLC*, 108 F. Supp. 3d 628 (N.D. Ill. 2015) (denying motion to dismiss FDCPA claim based on filing time-barred proof of claim), *Taylor v. Midland Funding, LLC*, 94 F. Supp. 3d 941 (N.D. Ill. 2015) (same), *and Avalos v. LVNV Funding LLC (In re Avalos)*, 531 B.R. 748 (Bankr. N.D. Ill. 2015) (same), *with Robinson v. eCast Settlement Corp.*, No. 14 CV 8277, 2015 WL 494626 (N.D. Ill. Feb. 3, 2015) (granting motion to dismiss FDCPA claim based on filing time-barred proof of claim), *and LaGrone v. LVNV Funding LLC (In re LaGrone)*, 525 B.R. 419, 421 (Bankr. N.D. Ill. 2015) (same).

weighed in. The Eleventh Circuit held, in two separate opinions, that a debt collector violates the FDCPA when it files a proof of claim on a time-barred debt. *Johnson v. Midland Funding, LLC*, 823 F.3d 1334 (11th Cir. 2016);[9] *Crawford*, 758 F.3d 1254. The Fourth, Seventh and Eighth Circuits came to the contrary conclusion, holding that the filing of a time-barred proof of claim does not violate the FDCPA. *See Dubois v. Atlas Acquisitions LLC (In re Dubois)*, 834 F.3d 522 (4th Cir. 2016), *cert. denied*, No. 16-707, 2017 WL 2216948 (U.S. May 22, 2017); *Owens v. LVNV Funding, LLC*, 832 F.3d 726 (7th Cir. 2016), *cert. denied,* No. 16-315, 2017 WL 2216946 (U.S. May 22, 2017); *Nelson v. Midland Credit Mgmt., Inc.*, 828 F.3d 749 (8th Cir. 2016), *cert. denied,* No. 16-757, 2017 WL 2216949 (U.S. May 22, 2017).[10]

Midland Funding petitioned for review of the Eleventh Circuit's *Johnson* decision, and the Supreme Court granted certiorari to answer two questions:

> 1. Whether the filing of an accurate proof of claim for an unextinguished time-barred debt in a bankruptcy proceeding violates the Fair Debt Collection Practices Act.
>
> 2. Whether the Bankruptcy Code, which governs the filing of proofs of claim in bankruptcy, precludes the application of the Fair Debt Collection Practices Act to the filing of an accurate proof of claim for an unextinguished time-barred debt.

Midland Funding, LLC v. Johnson, No. 16-348, Pet. for Cert. at I, http://www.scotusblog.com/wp-content/uploads/2016/09/16-348-cert-petition.pdf.

---

[9] The Eleventh Circuit had already held in *Crawford* that filing a proof of claim on a stale debt violated the FDCPA. The main focus of its decision in *Midland Funding*, therefore, was whether or not the Bankruptcy Code impliedly repealed or precluded the FDCPA. The Eleventh Circuit held that it did not.

[10] Further appeals were pending in the First, Third and Sixth Circuits, but each has now been voluntarily dismissed. *See Martel v. LVNV Funding, LLC (In re Martel)*, 539 B.R. 192 (Bankr. D. Me. 2015), *appeal docketed*, No. 16-1653 (1st Cir. May 25, 2016); *Torres v. Asset Acceptance, LLC*, 96 F. Supp. 3d 541 (E.D. Pa. 2015), *appeal docketed*, No. 15-2132 (3d Cir. May 13, 2015); *Broadrick v. LVNV Funding LLC (In re Broadrick)*, 532 B.R. 60 (Bankr. M.D. Tenn. 2015), *appeal docketed*, No. 16-5042 (6th Cir. Jan. 14, 2016).

II. Decision

In a 5-3 decision,[11] the Supreme Court answered only the first question, holding that filing a proof of claim on a debt barred by the statute of limitations does not violate the FDCPA. *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407 (2017). Justice Breyer, writing for the majority, first held that it is "reasonably clear that [a time-barred] proof of claim [is] not 'false, deceptive, or misleading.'" *Id.* at 1411. The majority based its decision on the fact that a stale claim—at least in jurisdictions in which the statute of limitations merely extinguishes the remedy rather than the claim itself[12]—nonetheless "falls within the Bankruptcy Code's definition of the term 'claim,'" even if it is subject to disallowance. *Id.* at 1411–12. The Court rejected Johnson's argument that the Supreme Court had previously made clear in *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 559 (1990), that a "claim" means an "enforceable obligation." Justice Breyer explained:

> [T]he word "enforceable" does not appear in the Code's definition of "claim." See 11 U.S.C. § 101(5). The Court in *Davenport* likely used the word "enforceable" descriptively, for that case involved an enforceable debt. And it is difficult to square Johnson's interpretation with our later statement that "Congress intended . . . to adopt the broadest available definition of 'claim.'"
>
> It is still more difficult to square Johnson's interpretation with other provisions of the Bankruptcy Code. Section 502(b)(1) of the Code, for example, says that, if a "claim" is "unenforceable," it will be disallowed. It does not say that an "unenforceable" claim is not a "claim." Similarly, § 101(5)(A) says that a "claim" is a "right to payment," "whether or not such right is . . . fixed, contingent, . . . [or] disputed." If a contingency does not arise, or if a claimant loses a dispute, then the claim is unenforceable. Yet this section makes

[11] Justice Gorsuch did not participate in the decision.

[12] "Alabama's law, like the law of many States, provides that a creditor has the right to payment of a debt even after the limitations period has expired." *Midland Funding*, 137 S. Ct. at 1411–12 (citing numerous state court decisions holding that their states' statutes of limitations do not extinguish the creditor's right to payment, only its remedy).

> clear that the unenforceable claim is nonetheless a "right to payment," hence a "claim," as the Code uses those terms.

Midland Funding, 137 S. Ct. at 1412 (citations omitted). Thus, according to the majority, a proof of claim is merely "a statement by the creditor that he or she has a right to payment subject to disallowance." *Id.* at 1413. And because the creditor still has a right to payment under state law, its act of filing a proof of claim on a stale debt cannot be false, deceptive, or misleading. *Id.* at 1415.

Next, the Court addressed whether filing a proof of claim on a time-barred debt was "unfair" or "unconscionable" within the meaning of the FDCPA, which the Court characterized as a "closer" question. *Id.* at 1413. While it acknowledged that a number of lower courts have held or suggested that filing a lawsuit on a time-barred debt in "ordinary civil litigation" is "unfair" under the FDCPA,[13] the *Henson* Court was "not convinced . . . by this precedent."[14] *Id.* It found these authorities unpersuasive given the differences the Court saw between civil suits and bankruptcy proceedings. *Id.* According to the Court, there are "protections available in a Chapter 13 bankruptcy proceeding [that] minimize the risk to the debtor." *Id.* at 1414. For instance:

---

[13] *See, e.g.*, *Crawford*, 758 F.3d at 1259 ("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 that debt violates §§ 1692e and 1692f."); *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir. 2013) ("[The consumer's lawsuit] charges that Asset Acceptance sued her after the statute of limitations on the creditor's claim had run. If this is true, Asset Acceptance's suit violated the [FDCPA]."); *Dudek v. Thomas & Thomas Attys. & Counselors at Law, LLC*, 702 F. Supp. 2d 826, 833 (N.D. Ohio 2010) ("Filing a lawsuit to collect upon a time-barred debt, 'without first determining after a reasonable inquiry that the limitations period is due to be tolled, constitutes an unfair and unconscionable practice offensive to § 1692f.'" (quoting *Kimber v. Fed. Fin. Corp.*, 668 F. Supp. 1480, 1487 (M.D. Ala. 1987))); *Goins v. JBC & Assocs., P.C.*, 352 F. Supp. 2d 262, 272 (D. Conn. 2005) ("As the statute of limitations would be a complete defense to any suit, however, the threat to bring suit under such circumstances can at best be described as a 'misleading' representation, in violation of § 1692e.").

[14] The Court merely "assume[d], for argument's sake, that the precedent is correct" but emphasized that it "has not decided and does not now decide" the issue in the context of "ordinary civil litigation." *Midland Funding*, 137 S. Ct. at 1413. Accordingly, whether filing a lawsuit on a time-barred claim violates the FDCPA is still an open question. *See Kaiser v. Cascade Capital LLC*, No. 3:16-CV-00744-AC, 2017 WL 2332856, at *9 (D. Or. May 25, 2017) ("The Supreme Court's recent decision in [*Midland Funding*] . . . does not alter the persuasive weight of the cases [holding that a debt collector violates the FDCPA when it sues on a clearly time-barred debt].").

- “The consumer initiates such a proceeding and consequently the consumer is not likely to pay a stale claim just to avoid going to court.” *Id.* at 1413.

- “Procedural bankruptcy rules more directly guide the evaluation of claims.” *Id.*

- “[T]he claims resolution process is ‘generally a more streamlined and less unnerving prospect for a debtor than facing a collection lawsuit.’” *Id.* (quoting *Gatewood v. CP Med., LLC (In re Gatewood)*, 533 B.R. 905, 909 (2015)).

- “A knowledgeable trustee is available” and “[t]he trustee normally bears the burden of investigating claims and pointing out that a claim is stale.” *Id.* at 1413–14.

- “[A]t least on occasion, the assertion of even a stale claim can benefit a debtor [because] [i]ts filing and disallowance ‘discharge[s]’ the debt. And that discharge means that the debt (even if unenforceable) will not remain on a credit report potentially affecting an individual’s ability to borrow money, buy a home, and perhaps secure employment.” *Id.* at 1414.

Justice Breyer closed his majority opinion by expressing concern about the ramifications of applying the FDCPA in this context. In particular, Justice Breyer suggested that it would “authorize a new significant bankruptcy-related remedy” not provided for in the Code and “permit postbankruptcy litigation in an ordinary civil court concerning a creditor’s state of mind.” *Id.* at 1415. These considerations led the Court to conclude that filing a proof of claim on a time-barred debt is not false, deceptive, misleading, unfair, or unconscionable within the meaning of the FDCPA. *Id.*

III. Dissent

Justice Sotomayor, joined by Justices Ginsburg and Kagan, dissented, arguing that the practice of “buying stale debt, filing claims in bankruptcy proceedings to collect it, and hoping that no one notices that the debt is too old to be enforced by the courts . . . is both ‘unfair’ and ‘unconscionable’” under the FDCPA. *Id.* at 1416. Echoing the dissenting opinions of Judges Wood and Diaz in *Owens* and *Dubois*, respectively, Justice Sotomayor disagreed with the notion that the bankruptcy system is markedly different from “ordinary civil litigation.” *Id.* at 1419–20;

Dubois, 834 F.3d at 534 (Diaz, J., dissenting); *Owens*, 832 F.3d at 740–41 (Wood, J., dissenting).

And in challenging this premise, she made the following points:

- Just as in non-bankruptcy litigation, the statute of limitations is an affirmative defense, and the systematic filing of proofs of claim on obviously time-barred debt forces the debtors and the trustees to bear the cost of objecting. *Midland Funding*, 137 S. Ct. at 1418 (noting that the practice "'manipulates the bankruptcy process by systematically shifting the burden' to trustees and debtors to object even to 'frivolous claims'—especially given that filing an objection is costly, time consuming, and easy to overlook" (quoting the United States' amicus brief)); *id.* at 1420 (noting that the National Association of Chapter Thirteen Trustees, appearing as amici curiae, "describ[ed] the practice as 'wasteful' and 'exploit[ative]'").

    - *See also Owens*, 832 F.3d at 737 (Wood, J., dissenting) (describing the filing of a proof of claim on a stale debt as "an action the creditor will take knowing that it will result in payment only if the staleness of the debt slips past the debtor, her lawyer (if she has one), and the trustee"); *Dubois*, 834 F.3d at 533 (Diaz, J., dissenting) ("If someone notices the [stale] claims and objects, as happened here, [the creditor] grins sheepishly—'You caught me!'—and admits that the claim is meritless. But if the claim slips through, [the creditor] uses the bankruptcy court to garner a payoff on unenforceable debts.").

- The presence of a trustee does not have the protective effect the majority seems to think. *Midland Funding*, 137 S. Ct. at 1420 ("The problem with the majority's *ipse dixit* is that everyone with actual experience in the matter insists that it is false. The Government, which oversees bankruptcy trustees, tells us that trustees 'cannot realistically be expected to identify every time-barred . . . claim filed in every bankruptcy.'"); *Dubois*, 834 F.3d at 534 ("[I]f trustees performed their duties flawlessly, [debt collectors] would have little incentive to engage in [this] scheme.").

- A bankruptcy debtor is no more sophisticated than his or her civil litigation counterpart. *Id.* at 1420 ("[A] person who has filed for bankruptcy will rarely be in such a superior position; he has, after all, just declared that he is unable to meet his financial obligations and in need of the assistance of the courts."). Further, given that the Bankruptcy Rules "in fact facilitate the *allowance* of claims," a "debtor is arguably more vulnerable in bankruptcy—not less—to the oversights that the debt buyers know will occur." *Id.* at 1420–21.

- It is a stretch to justify the filing of time-barred proofs of claim by saying that the consumers actually "benefit" from the practice. *Id.* at 1421 ("A debtor whose trustee does not spot and object to a stale debt will find no comfort in the knowledge that *other* consumers with more attentive trustees may have their debts disallowed and discharged."); *Owens*, 832 F.3d at 740 ("My colleagues imply that debtors may actually be better off if the stale claims are submitted to the bankruptcy court, because if the debtor, her lawyer, and the trustee (or one of them) is vigilant, the filing of the proof of the stale claim will be a meaningless act: the time-barred debt will be disallowed, and

> the debtor will have the protection of the discharge judgment. . . . [But] [t]he statute of limitations itself is full protection against a lawsuit on a stale claim; it does not need to be supplemented by a bankruptcy discharge. . . . A time-barred debt *cannot be enforced in a legal proceeding*, even if in a theoretical or moral sense the debt remains.").[15]

Justice Sotomayor also challenged the majority's concern that allowing FDCPA lawsuits in response to stale proofs of claim would spur presumably inappropriate "postbankruptcy litigation in an ordinary civil court concerning a creditor's state of mind." *Id.* at 1419 n.5. The dissent noted that, in the first place, "nothing requires a debtor to engage in satellite litigation in order to sue a debt collector under the FDCPA; a debtor can easily file an adversary proceeding asserting an FDCPA claim with the bankruptcy court itself." *Id.* Nor is it a particularly difficult undertaking for a court—whether bankruptcy or not—to inquire into a "creditor's state of mind." *Id.* (noting that a court may conduct the same inquiry under Rule 11 or Bankruptcy Rule 9011).[16]

Finally, whether realistic or not, Justice Sotomayor concluded the dissent with a glimmer of hope that the majority opinion will not be the final word on the illegality of this practice: "I take comfort only in the knowledge that the Court's decision today need not be the last word on the matter. If Congress wants to amend the FDCPA to make explicit what in my view is already implicit in the law, it need only say so." *Id.* at 1421.

---

[15] Justice Sotomayor also pointed out that, "given the high rate at which debtors are unable to fully pay off their debts in Chapter 13 proceedings, most debtors who fail to object to a stale claim will end up worse off than had they never entered bankruptcy at all: They will make payments on stale debts, thereby resuscitating them and may thus walk out of bankruptcy court owing more to their creditors than they did when they entered it." *Midland Funding*, 137 S. Ct. at 1421. Multiple courts have declined to find that a debt paid partially through a Chapter 13 plan is revived. *See In re Washington*, No. CV 16-02667-JW, 2017 WL 1130144, at *8 (Bankr. D.S.C. Mar. 24, 2017); *Hope v. Quantum3 Grp. LLC (In re Seltzer)*, 529 B.R. 385, 389 (Bankr. M.D. Ga. 2015). Nonetheless, it is certainly a possibility that debtors—even if ultimately successful—may have to defend against such revival claims.

[16] And, although the dissent does not mention this, any court assessing an alleged FDCPA violation may have to inquire into the defendant's state of mind. In support of its suggestion that ordinary civil courts will have to take on the burdensome task of determining a party's intent, the majority cited the FDCPA's "safe harbor" provision, which protects a debt collector from liability if it "shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." *Midland Funding*, 137 S. Ct. at 1415 (quoting 15 U.S.C. § 1692k(c)). It is difficult to see how applying the FDCPA specifically to the filing of a proof of claim would alter this inquiry or make it any more onerous. Indeed, in any context in which the FDCPA is applicable, litigation concerning a creditor's state of mind may come into play as that is what the statute calls for.

National Conference of Bankruptcy Judges
The Wolf (of Wall Street?) at the Door: Lending to the Financial Underclass

Las Vegas, Nevada
October 2017

Henson v. Santander Consumer USA Inc., 137 S. Ct. 1718 (2017)

Hon. John E. Hoffman, Jr.
United States Bankruptcy Judge
Southern District of Ohio

Laura F. Atack, Law Clerk

The Fair Debt Collection Practices Act (the "FDCPA")[17] regulates the relationship between consumers and debt collectors by, among other things, prohibiting debt collectors from engaging in abusive debt collection practices and authorizing consumers to recover sanctions and attorneys' fees from those that do. The statute defines a "debt collector" (in part) as:

> any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. Notwithstanding the exclusion provided by clause (F) of the last sentence of this paragraph, the term includes any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is collecting or attempting to collect such debts. For the purpose of section 1692f(6) of this title, such term also includes any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the enforcement of security interests.[[18]]

15 U.S.C. § 1692a(6). "Stated more simply, this provision defines a debt collector as (1) a person whose principal purpose is to collect debts; (2) a person who regularly collects debts owed to another; or (3) a person who collects its own debts, using a name other than its own as if it were a debt collector." *Henson v. Santander Consumer USA, Inc.*, 817 F.3d 131, 136 (4th Cir. 2016), *aff'd*, 137 S. Ct. 1718 (U.S. 2017).

---

[17] 15 U.S.C. §§ 1692–1692p.

[18] The statute lists certain exceptions to the definition of "debt collector," including:

> (A) any officer or employee of a creditor while, in the name of the creditor, collecting debts for such creditor;
>
> . . . .
>
> (F) any person collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity (i) is incidental to a bona fide fiduciary obligation or a bona fide escrow arrangement; (ii) concerns a debt which was originated by such person; (iii) concerns a debt which was not in default at the time it was obtained by such person; or (iv) concerns a debt obtained by such person as a secured party in a commercial credit transaction involving the creditor.

15 U.S.C. § 1692a(6)(A), (F).

On June 12, 2017, the Supreme Court issued its opinion in *Henson v. Santander Consumer USA Inc.* The issue in *Henson* was whether Santander, which had purchased defaulted debts the consumers owed to a third party, fell within the ambit of this second definition of "debt collector" under the FDCPA—i.e., an entity who "regularly collects or attempts to collect . . . debts owed or due . . . another." 15 U.S.C. § 1692a(6). In a unanimous decision authored by Justice Gorsuch,[19] the Supreme Court found that "individuals and entities who regularly purchase debts originated by someone else and then seek to collect those debts for their own account" do not fall within this statutory definition. *Henson*, 137 S. Ct. at 1721. [20]

The Court began—and ended[21]—its analysis with the plain language of the statute:

> [T]he [FDPCA] defines debt collectors to include those who regularly seek to collect debts "owed . . . another." And by its plain terms this language seems to focus our attention on third party collection agents working for a debt owner—not on a debt owner seeking to collect debts for itself. Neither does this language appear to suggest that we should care how a debt owner came to be a debt owner—whether the owner originated the debt or came by it only through a later purchase. All that matters is whether the target of the lawsuit regularly seeks to collect debts for its own account or does so for "another." And given that, it would seem a debt purchaser like Santander may indeed collect debts for its own account without triggering the statutory definition in dispute[.]

Id. at 1721–22.

The Court rejected the consumers' textual and policy arguments. It first took on the petitioners' contention that because the FDCPA's definition of "debt collector" refers to debts

[19] *Henson* is the first opinion authored by Justice Gorsuch.

[20] *Henson* is the Court's second case dealing with the FDCPA's definition of "debt collector." In *Heintz v. Jenkins*, the Supreme Court held that the FDCPA "applies to attorneys who 'regularly' engage in consumer-debt-collection activity, even when that activity consists of litigation." 514 U.S. 291, 299 (1995).

[21] "As in any case of statutory construction, [the Court's] analysis begins with 'the language of the statute.' And where the statutory language provides a clear answer, it ends there as well." *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999) (citation omitted).

"owed"—using the past tense—the definition encompasses debts that were *previously* owed to another. The Court found no support for this argument in "good grammar, let alone ordinary meaning." *Id.* at 1722. Beginning with the word itself, the Court noted that "[p]ast participles like 'owed' are routinely used as adjectives to describe the present state of a thing . . . . [I]f you told a friend that you were seeking to 'collect a debt owed to Steve' . . . it seem[s] likely your friend would understand you as speaking about a debt *currently* owed to Steve, not a debt Steve *used* to own[.]" *Id.* The Court also looked to other provisions of the FDCPA in which "owed" was used clearly to "refer to present (not past) relationships" and in which distinctions were made between "original" and "current" creditors—distinctions that were not present in this definition of debt collector. *Id.* at 1722–23.

The Court next addressed the consumers' argument that the FDCPA's definition of "debt collector" includes those who regularly collect even their own debts if those debts were acquired after default. *Id.* at 1724. This argument, which the courts in the decisions listed below found to be persuasive, relies on the view that the FDCPA divides debt holders into two mutually exclusive categories: debt collectors and creditors. *Id.* The FDCPA's definition of "debt collector" specifically *excludes* "any person collecting or attempting to collect any debt owed . . . another to the extent such activity . . . concerns a debt which was *not in default* at the time it was obtained by such person." 15 U.S.C. § 1692a(6)(F)(iii) (emphasis added). And "'creditor' means any person . . . to whom a debt is owed, . . . [except] to the extent that he receives an assignment or transfer of a debt *in default*. . . ." 15 U.S.C. § 1692a(4) (emphasis added). Because a purchaser of a debt in default is not a creditor, and because a person who obtains a debt *not* in default is not a debt collector, one who purchases and collects on a debt post-default must be a debt collector. *Henson*, 137 S. Ct. at 1724.

Courts that have adopted this rationale include:

- *Bridge v. Ocwen Fed. Bank, FSB*, 681 F.3d 355, 362 (6th Cir. 2012) ("[T]he definition of debt collector pursuant to § 1692a(6)(F)(iii) includes any non-originating debt holder that either acquired a debt in default or has treated the debt as if it were in default at the time of acquisition.");

- *McKinney v. Cadleway Props., Inc.*, 548 F.3d 496, 501 (7th Cir. 2008) ("[T]he purchaser of a debt in default is a debt collector for purposes of the FDCPA even though it owns the debt and is collecting for itself."); *see also Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534, 536 (7th Cir. 2003) ("The Act treats assignees as debt collectors if the debt sought to be collected was in default when acquired by the assignee, and as creditors if it was not.");

- *F.T.C. v. Check Inv'rs, Inc.*, 502 F.3d 159, 173 (3d Cir. 2007) ("[Section] 1692a means that an entity is a creditor if the debt it is attempting to collect was not in default when it was acquired."); and

- *Perry v. Stewart Title Co.*, 756 F.2d 1197, 1208 (5th Cir. 1985) (holding that defendant was not a debt collector because "a debt collector does not include . . . an assignee of a debt, as long as the debt was not in default at the time it was assigned" and the defendant bought the loan *before* the plaintiffs were in default).

But the *Henson* Court rejected this argument—and explicitly abrogated *McKinney* and *F.T.C. v. Check Investors*—stating:

> [W]hile the statute surely excludes from the debt collector definition certain persons who acquire a debt before default, it doesn't necessarily follow that the definition must include anyone who regularly collects debts acquired after default. After all and again, under the definition at issue before us you have to attempt to collect debts owed *another* before you can ever qualify as a debt collector. And petitioners' argument simply does not fully confront this plain and implacable textual prerequisite. Likewise, even spotting (without granting) the premise that a person cannot be both a creditor and a debt collector with respect to a particular debt, we don't see why a defaulted debt purchaser like Santander couldn't qualify as a creditor. For while the creditor definition excludes persons who "receive an assignment or transfer of a debt in default," it does so only (and yet again) when the debt is assigned or transferred "solely for the purpose of facilitating collection of such debt *for another*." So a company collecting purchased defaulted debt for its own account—like Santander—would hardly seem to be barred from qualifying as a creditor under the statute's plain terms.

Henson, 137 S. Ct. at 1724 (citation omitted); *see also Davidson v. Capital One Bank (USA), N.A.*, 797 F.3d 1309, 1314–16 (11th Cir. 2015) (conducting in-depth statutory analysis to reject proposition that "a non-originating debt holder is a 'debt collector' for purposes of the FDCPA solely because the debt was in default at the time it was acquired").

Finally, the Court declined to allow any policy considerations to override the text of the statute:

> [W]e will not presume . . . that any result consistent with their account of the statute's overarching goal must be the law but will presume more modestly instead 'that [the] legislature says . . . what it means and means . . . what it says.'
>
> . . . [Instead,] these are matters for Congress, not this Court, to resolve.
>
> . . . [R]easonable people can disagree with how Congress balanced the various social costs and benefits in this area. We have no difficulty imagining, for example, a statute that applies the [FDCPA]'s demands to anyone collecting any debts, anyone collecting debts originated by another, or to some other class of persons still. Neither do we doubt that the evolution of the debt collection business might invite reasonable disagreements on whether Congress should reenter the field and alter the judgments it made in the past. After all, it's hardly unknown for new business models to emerge in response to regulation, and for regulation in turn to address new business models. Constant competition between constable and quarry, regulator and regulated, can come as no surprise in our changing world.

Henson, 137 S. Ct. at 1725–26 (citation omitted). It will remain to be seen whether Congress chooses to "reenter the field" in reaction to the ever-changing debt collection industry.

A Debt Buyer May Still Be Subject to the FDCPA

It is important to note what the Supreme Court explicitly did not decide: whether Santander (or other entities that regularly purchase debt) might fall under § 1692a(6)'s first definition of "debt collector"—those "in any business the principal purpose of which is the collection of any debts." *Id.* at 1721 ("[T]he parties briefly allude to another statutory definition of the term 'debt collector'—one that encompasses those engaged 'in any business the principal purpose of which is the collection of any debts.' § 1692a(6). But the parties haven't much litigated that alternative definition and in granting certiorari we didn't agree to address it either.").

It seems likely that the petitioners did not ask the Supreme Court to address this definition since both the district court and the Fourth Circuit had explicitly found that Santander's "principal purpose" was *not* the collection of debts. *Henson*, 817 F.3d at 137 ("[I]t is apparent that Santander does not fall within the first . . . definition[] of debt collector. The complaint does not allege, nor do the plaintiffs argue, that Santander's principal business was to collect debt, alleging instead that Santander was a consumer finance company."); *Henson v. Santander Consumer USA, Inc.*, No. CIV.A. RDB-12-3519, 2014 WL 1806915, at *4 (D. Md. May 6, 2014) ("There is no plausible allegation that Santander's primary business purpose is the collection of debts.").

So while the Court's holding in *Henson* may shrink the pool of debt buyers subject to the FDCPA, this does not mean that all debt buyers would be exempt from liability. But, as the cases cited below make clear, it will be especially important for a plaintiff claiming that the defendant qualifies as a debt collector under this alternative definition to clearly set forth the factual basis for this allegation:

- *Schlegel v. Wells Fargo Bank, NA*, 720 F.3d 1204, 1208–09 (9th Cir. 2013) ("The Schlegels concede that the complaint does not expressly state that the 'principal purpose' of Wells Fargo's business is debt collection . . . . The complaint fails to provide any factual basis from which we could plausibly infer that the principal purpose of Wells Fargo's business is debt collection. Rather, the complaint's factual matter, viewed in the light most favorable to the Schlegels, establishes only that debt collection is some part of Wells Fargo's business, which is insufficient to state a claim under the FDCPA.").

- *Hunte v. Safeguard Props. Mgmt., LLC*, — F. Supp. 3d. —, No. 16 C 11198, 2017 WL 2445137, at *3 (N.D. Ill. June 6, 2017) (holding that plaintiff did not adequately plead that defendant was a "debt collector" when the complaint alleged only that defendant's principal purpose was "managing and preserving at-risk and foreclosed properties" rather than "collecting debts" or "enforcing security interests").

- *Vitale v. First Fid. Leasing Grp.*, 35 F. Supp. 2d 78, 81 (D. Conn.) (finding that plaintiff had failed to state a claim for a violation of § 1692f(6) when plaintiff failed to allege that the "principal purpose" of repossession company's business was to enforce security interests), *aff'd*, 166 F.3d 1202 (2d Cir. 1998).

See also:

- *Pollice v. Nat'l Tax Funding, L.P.*, 225 F.3d 379, 404 (3d Cir. 2000) (finding that "there is no question that the 'principal purpose' of [the defendant]'s business is the 'collection of any debts,' namely, defaulted obligations which it purchases from municipalities" when by the defendant's own admission, it "'exists solely for the purpose of holding claims for delinquent taxes and municipal obligations'").