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Chapman Client Alert

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Victory for Debt Collectors in First of Two Landmark Supreme Court Cases

The Supreme Court continues to redefine the scope of the Fair Debt Collection Practices Act (*"FDCPA"*), with one highly anticipated ruling issued this week in the case of *Midland Funding, LLC v. Johnson*, and another expected in *Henson v. Santander Consumer, USA, Inc.* before the Court adjourns for the summer in late June.

Supreme Court Resolves Circuit Split and Confirms Filing Bankruptcy Proof of Claim on Time-Barred Debt Is Not an FDCPA Violation

On May 15, 2017, the United States Supreme Court in *Midland Funding, LLC v. Johnson*, No. 16-348, 2017 WL 2039159 (U.S. May 15, 2017), held that a debt collector who files a bankruptcy proof of claim on a time-barred debt does not violate the FDCPA.

The dispute in *Midland* arose after debt collector Midland Funding, LLC (*"Midland"*) filed a proof of claim in a debtor's Chapter 13 proceeding. The debt upon which Midland based its claim was outside the applicable state statute of limitations. Following an objection by Johnson, the bankruptcy court denied Midland's claim, and the debtor later brought suit for an FDCPA violation. The district court dismissed the debtor's case after holding that the FDCPA did not apply in bankruptcy; however, the U.S. Court of Appeals for the 11th Circuit later reversed the decision and determined that Midland's conduct in filing the proof of claim on clearly time-barred debt was in fact an FDCPA violation. *See Johnson v. Midland Funding, LLC,* 823 F.3d 1334 (11th Cir. 2016)*, cert. granted,* 137 S. Ct. 326, 196 L. Ed. 2d 212 (2016).

In its holding this week, the Supreme Court found that Midland's conduct was neither unfair nor deceptive under the FDCPA. Specifically, the Court explained that pursuant to the plain language of the Bankruptcy Code, a proof of claim does not have to be enforceable at time of its filing. Thus, the Court reasoned, filing a proof of claim on a time-barred debt was contemplated by the Bankruptcy Code, and would therefore not be considered deceptive.

Further, the Court also found that filing a proof of claim on a time-barred debt did not rise to the level of unfair or unconscionable conduct prohibited under the FDCPA. Relying on holdings from a number of federal appellate courts that previously determined that filing a collection lawsuit on time-barred debt violated the FDCPA, the debtor argued that the filing a proof of claim is the equivalent of filing a collection lawsuit, and as such should be considered a violation. The Court disagreed, and pointed to the following key factors which distinguish a collection action from filing a proof of claim in a bankruptcy: (1) the customer initiates the bankruptcy and would therefore not be at risk of paying a time-barred debt to avoid a collection lawsuit; (2) the trustee's supervision and the procedural rules in place in a bankruptcy would prevent a bankruptcy estate from paying out on time-barred or otherwise unenforceable claims; and (3) there is the possibility that the filing of the claim will actually benefit the debtor because the debt would be discharged if the debtor is able to successfully complete his/her bankruptcy plan.

The Supreme Court's holding in *Midland* also reaffirms the Seventh Circuit's position in *Owens v. LVNV Funding, LLC*, 832 F.3d 726 (7th Cir., 2016), whereby the Seventh Circuit Court of Appeals held that a "claim" under the Bankruptcy Code encompassed more than legally enforceable obligations under the relevant state law, and therefore the act of filing a proof of claim on stale debt was not an automatic FDCPA violation.[1]

Supreme Court Hears Argument to Decide Whether Debt Buyers Are Debt Collectors Under the FDCPA

The United States Supreme Court heard oral arguments April 18th in *Henson v. Santander Consumer, USA, Inc.*, 817 F.3d 131, 136 (4th Cir. 2016), *cert. granted*, 137 S. Ct. 810, 196 L. Ed. 2d 595 (2017), on the issue of whether a company that collects on debts purchased after default should be considered a debt collector under the FDCPA.

In *Henson*, Santander purchased the plaintiffs' defaulted debt from the loan originator after acting as the loan servicer. After Santander began its collection efforts, Henson and the accompanying class of plaintiffs brought suit, claiming that Santander's debt collection practices violated the FDCPA. Santander moved to dismiss on the basis that it was exempted from the FDCPA because it was not acting as a third party debt collector, but was instead seeking repayment on its own debt. The District Court agreed with Santander, with the Fourth Circuit Court of Appeals also affirming the District Court's decision. Henson appealed to the United States Supreme Court, which elected to hear the appeal on January 13, 2017.

The Supreme Court's review comes in the face of a circuit split on this issue, with the Fourth, Ninth and Eleventh circuits holding that collectors of debt purchased after default are not debt collectors subject to the FDCPA, while the Third, Fifth, Sixth and Seventh circuits, and the District of Columbia Court of Appeals have taken the contrary position.

Not surprisingly, April's oral arguments focused primarily on the definition of "debt collector" under the FDCPA. The Act defines a "debt collector" as "any person…who regularly collects…debts owed or due…another." Henson took the position that debts were "owed" to the originator of the loan, but "due" to the debt buyer. Thus, under such reasoning, a debt purchaser could be considered a "debt collector" under the FDCPA because it was collecting on a debt "owed" to the originator of the loan (notwithstanding the fact that it was also collecting on a loan now "due" to the debt purchaser).

Conversely, Santander took the position that as the current holder of the debt, it was merely collecting on its own debt (the same as any creditor would) and was therefore not subject to the purview of the FDCPA.

With little guidance from past precedent as to the definition of "debt collector" under the Act, both sides also argued steadfastly for consideration of the policy implications or their respective positions. Henson and the consumer plaintiffs argued that debt collectors could circumvent the requirements of the FDCPA by simply purchasing debt they intended to collect on. Conversely, Santander argued that a purchaser of debt has very different motives than that of a debt collector, and it was for this reason that debt purchasers were intentionally excluded from the FDCPA.

In addition to resolving the current circuit court split, the Supreme Court's decision is also expected to drastically impact state collection agency and debt collection laws that mirror the FDCPA's provisions.

For More Information

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1 *Owens* dealt specifically with Illinois and Indiana claims, where the applicable state law holds that the running of the statute of limitations bars an action to collect, but does not extinguish a creditors' claim as to the debt. Application of the minority view held by Wisconsin, whereby the expiration of the statute of limitations extinguishes both the remedy and the right to payment, may have resulted in a different analysis. *See e.g.* Wis. Stat. §893.05; *Midland* at *4.

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