THE MIXED MESSAGE OF MIDLAND FUNDING

by ANNETTE JARVIS and THOMAS HWANG

On May 15, 2017, a divided Supreme Court entered its decision in *Midland Funding, LLC v. Johnson*, holding that a creditor's filing of a time-barred proof of claim in a chapter 13 bankruptcy case, does not constitute a violation of the Fair Debt Collection Practices Act (FDCPA). 137 S. Ct. 1407 (2017).

Background

The case emanated from the 2014 bankruptcy case of respondent Aleida Johnson when she filed a petition under chapter 13 of the bankruptcy code (the "Code"), commencing a bankruptcy case in an Alabama bankruptcy court. The petitioner, Midland Funding, LLC filed a proof of claim in the bankruptcy case asserting a claim in the amount of $1,879.71, based on credit-card debt Midland had purchased pre-petition, but also stating that the last charge on the account was from 2003. Because the applicable statute of limitations was six years, Johnson objected to the claim, and the bankruptcy court disallowed the claim. Subsequently, Johnson commenced an action in federal district court alleging that Midland Funding violated the FDCPA because filing the time-barred claim in the bankruptcy case constituted false, deceptive, "misleading," "unconscionable," or "unfair" conduct under the FDCPA. *Id.* at 1411. The district court found Midland Funding's conduct did not violate the FDCPA, but the Eleventh Circuit reversed. *Id.*

The Majority's Opinion

Writing for the 5-3 majority, Justice Breyer, joined by Justices Roberts, Kennedy, Thomas, and Alito, engaged a literal, statutory construction approach. *Id.* First, explaining why a time-barred claim is not false, deceptive, or misleading, the Court pointed to the Code's definition of "claim" as a "right of payment" and congressional intent to adopt the broadest definition of the term. *Id.* at 1409. In refuting Johnson's argument that "claim" under the Code means an enforceable claim, the Court referenced section 502(b)(1) of the Code, noting that it provides that if a claim is unenforceable, it will be disallowed, not that it is not a claim. *Id.* at 1412. The Court also looked to applicable Alabama law remarking that it, like the state law of many states, entitles a creditor to repayment on a debt even after the expiration of a statute of limitations, and untimeliness constitutes an affirmative defense that a bankruptcy debtor may assert. *Id.* at 1410. Thus, the majority determined that filing a time-barred claim *alone* is neither misleading nor deceptive. *Id.* at 1412. Finally, the majority stressed that determining whether a statement is misleading requires consideration of the "legal sophistication of its audience" and that the audience in chapter 13 bankruptcy cases includes a trustee knowledgeable with bankruptcy, affirmative defenses to claims, and the claims allowance process. *Id.* at 1413.

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Turning to the issue of whether Midland Funding's conduct was unfair or unconscionable, the Court acknowledged that while some lower courts have held in a civil context that collection of a time-barred claim is "unfair," there is a fundamental difference between civil suits and chapter 13 bankruptcy proceedings. *Id.* In the former, Justice Breyer observed, the lower courts have harbored concerns that "a consumer might unwittingly repay a time-barred debt" while in the latter, such con-

cerns are significantly diminished for several reasons: (1) because the consumer commences the proceeding, s/he is "not likely to pay a stale claim just to avoid going to court;" (2) procedural bankruptcy rules guide and streamline the claims resolution practice and provide protections to a consumer debtor, including appointment of a sophisticated trustee who will review and object to claims; and (3) the inclusion and disallowance of a claim in the bankruptcy could potentially benefit the debtor as it will lead to a discharge of the debt, which carries with it a prohibition of further pursuit of collection against the debtor, and will minimize harm to her/his credit. *Id.*

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Addressing the convergence between the FDCPA and the Code, the majority stressed that in a chapter 13 proceeding, a trustee will typically hold the burden to review, object to and assert affirmative defenses against claims. *Id.* at 1414. Looking to the legislative foundations for each statute, Justice Breyer remarked that the FDCPA is intended to help consumers by minimizing abusive collection practices which could lead to bankruptcy while the Code is intended to establish a "delicate balance of a debtor's protections and obligations." *Id.* at 1415. According to the majority, this "delicate balance" could be upset by allowing Johnson's post-bankruptcy suit to proceed under the FDCPA because it would create a new bankruptcy related remedy not provided for in the Code. *Id.* Specifically, application of the FDCPA in this instance would shift the burden on creditors to investigate the merits of an affirmative defense, leading to "added complexity, changes in settlement incentives, and a shift from the debtor to the creditor [of] the obligation to investigate the staleness of a claim." *Id.*

The Minority's Dissent

Justice Sotomayor's dissent, followed by Justices Ginsberg and Kagan, focused more on policy considerations. Citing, *inter alia*, data from the Consumer Financial Protection Bureau and the Federal Trade Commission, Justice Sotomayor illustrated the enormous market for uncollected debt and the increasingly pervasive business practices of debt collectors who knowingly seek to collect on time-barred debts by filing claims and hoping that debtors do not respond or do not invoke the statute of limitations defense. *Id.* at 1417. It is noteworthy that her analysis of the data and corresponding condemnation was focused on the business conduct of debt collectors such as Midland Funding and not more typical, direct lending institutions, despite no distinction in the Code between differing holders of a claim. In the civil context, such conduct has been held to violate the FDCPA, and, according to the minority, the protections of the FDCPA should be extended to the bankruptcy context where the practice—essentially to entrap bankruptcy debtors—also is pervasive. *Id.* at 1419.

The dissent strongly questioned the majority's reliance on the protections afforded by procedural bankruptcy rules and the role of chapter 13 trustees, commenting that, in practice and actual experience, such protections are limited if not non-existent. *Id.* at 1420. Citing the amicus brief submitted by the National Association of Chapter Thirteen Trustees, the dissent observed that trustees are overworked. *Id.* It opined that debtors who fail to object to time-barred claims may resuscitate them, exacerbating the debtors' financial circumstances, and then remarked that debt collectors are not filing claims in good faith but instead are "hoping and expecting the bankruptcy system to fail." *Id.* at 1419. Because "one should not be able to profit on the inadvertent inattention of others," the dissent contended that the practices espoused by Midland Funding are both unfair and unconscionable, in violation of the FDCPA. *Id.* at 1421.

To conclude, Justice Sotomayor attempted to minimize the reach of the majority's decision, clarifying that the Court does not hold that the Code displaces the FDCPA nor does it take a position on whether or not a debt collector who files suit in a court outside of bankruptcy is in violation of the FDCPA. *Id.* at 1419-20. She left open the issue for further consideration and then invited Congress to amend the FDCPA to clarify what she believes is already implicit in the law. *Id.* at 1421.

The Court's Plain Language Approach

On its face, Justice Breyer's opinion tracks closely with the Court's policy of strict, textual statutory construction employed in cases under the Code that developed particularly after Justice Scalia joined the Court in 1986. This policy became apparent in the Court's decision in *United States v. Ron Pair Enterprises*, 489 U.S. 235 (1989). In that case, the Court held that postpetition interest was allowable on both consensual and nonconsensual oversecured claims, resolving a split between circuits as to whether section 506(b) of the Code adopted pre-Code practice of distinguishing between consensual and nonconsensual liens. The Court in *Ron Pair* noted that Congress did not distinguish consensual and nonconsensual liens in section 506(b); that the Code was a result of Congress' work to modernize substantive and procedural bankruptcy law; and, therefore, that there is no need to look beyond the plain language of a statute if it is "coherent and consistent" and a literal application does not lead to a result "demonstrably at odds with the intentions of its drafters." *Id.* at 240-42. While there has been historical variance from this steadfast policy in the jurisprudence of bankruptcy cases, Justices Scalia and Thomas largely leaned toward adhering to strict textualism up to Justice Scalia's passing. *See generally* Karen M. Gebbia-Pinetti, *Interpreting the Bankruptcy Code: An Empirical Study of the Supreme Court's*

Bankruptcy Decisions, 3 Chap. L. Rev. 173 (2000) (analyzing the Court's interpretive methods in majority and separate opinions related to the Code). *Midland* demonstrates that the Court continues to be guided by this policy of strict textualism under the Code. Indeed, even Justice Sotomayor calls for congressional statutory intervention to remedy what she perceives as an outcome contrary to what is already clearly implicit in non-bankruptcy law.

The *Midland* case offered a situation where the Court could have strayed from its policy of literalism, which it has done on occasion, due to arguably competing policy interests embodied in two federal statutes. Even Justice Scalia, after the *Ron Pair* decision, has alluded to the need for expanded inquiry when the Code competes with important state or federal interests, explaining that in *Ron Pair*, "having found a 'natural interpretation of the statutory language [that] does not conflict with any significant state or federal interest, nor with any other aspect of the Code,' . . . we deemed the pre-Code practice to be irrelevant." *Dewsnup v. Timm*, 502 U.S. 410, 434-35 (1992) (Scalia, J., dissenting). Indeed, the fact that Justice Breyer authored the opinion breaking away from those with whom he typically aligns ideologically demonstrates the complexity of statutory construction, including how different levels and interpretations of textual construction and competing interests may lead to varying legal application and analysis.

In arriving at its decision in *Midland*, while focusing on a textual analysis, the majority did indeed look beyond the plain language of the federal statutes in question. This may be because two seemingly conflicting federal statutes were involved, or because of the importance of the policy issues, but it demonstrates the use of legislative history and intent, even in a textual analysis context. In doing so, the majority interpreted the legislative intent behind both statutes to deduce that the FDCPA is intended to protect consumers from suspect collection practices while the Code is intended to maintain a delicate balance between a bankruptcy debtor's obligations and protections. The majority focused on the need to not disrupt the "delicate balance" cultivated by the Code in concluding that Midland Funding's conduct was not unfair or unconscionable, therefore reinforcing the majority's textual analysis.

Significance for Bankruptcy Debtors

While the *Midland* decision will largely be seen as a loss for consumers and a victory for debt collectors, it is not entirely unexpected as the majority of courts have sanctioned the assertion of time-barred claims in the bankruptcy context, albeit in a defensive manner. For example, the Ninth Circuit in *El Paso v. America West Airlines, Inc. (In re America West Airlines, Inc.)* held that the assertion of a time-barred claim under section 502(d) of the Code which provides for disallowance of a claim of a transferee who does not return an avoidable transfer, is permissible even if the underlying avoidance action is time-barred. 217 F.3d 1161, 1167 (9th Cir. 2000). This may even be so where the party asserting the "defense" is an adversary proceeding plaintiff, as was the case in *Coxson v. Commonwealth Mortgage Company*, 43 F.3d 189 (5th Cir. 1995). There, joint chapter 13 debtors filed an adversary proceeding against a lender, alleging violations of state usury laws and the Truth in Lending Act (TILA) in response to the lender's foreclosure attempts during the bankruptcy case. The Fifth Circuit held that the claims, which had expired under the applicable TILA statute of limitations, did not bar the debtors' claims because they filed their action in response to the lender's proof of claim, akin to a permissible defensive recoupment action. *Id.* at 194.

Nor should this case necessarily be seen as unfriendly to bankruptcy debtors. As the minority endeavored to make clear, the majority's opinion in *Midland* is limited in reach, and further, there may be the potential for Congress to amend the FDCPA or the Code to clarify the intended interaction of these two federal laws with respect to the practice of filing stale claims. Moreover, while not an explicit focus of Justice Breyer's opinion, the majority emphasized the need to adopt the broadest available definition of "claim" under the Code, even including facially unenforceable claims.

Because claims may be discharged in a bankruptcy case, and because that discharge operates as an injunction against further actions to recover on the claim against the debtor or the debtor's property, capturing all such claims within the purview of a bankruptcy proceeding—including time-barred claims—provides a benefit to both consumer and business debtors alike. *Midland* therefore provides a silver lining in helping to maximize the certainty that all claims are addressed in a bankruptcy case, resulting in an enforceable fresh start for the debtor.

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