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## To Be (Held in Contempt) or Not To Be? That Is the (Bankruptcy) Question

Recently, the United States Supreme Court in *Taggart v. Lorenzen*<sup>1</sup> set the legal standard that should be followed by bankruptcy courts when determining whether to hold a creditor in civil contempt for attempting to collect a debt in violation of a bankruptcy discharge order.<sup>2</sup> The unanimous decision of the Supreme Court reconciled a split which had developed in lower courts as to the nature of the proper standard for evaluating whether to hold a creditor in contempt for violating a discharge order.

The primary goal of every individual debtor who files for bankruptcy is to obtain a discharge order at the conclusion of his or her bankruptcy proceeding. The discharge order is what releases the debtor from liability for most pre-bankruptcy debts and bars creditors from attempting to collect on any such debts. Specifically, Section 524(a)(2) of the Bankruptcy Code provides that the discharge “operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor.”<sup>3</sup>

A creditor who attempts to collect on a debt that has been discharged pursuant to a discharge order runs the risk that it will be held in civil contempt by the bankruptcy court, and have money sanctions imposed upon it, pursuant to the court’s broad grant of authority under Section 105(a) of the Bankruptcy Code.

*Taggart* involved a dispute over interests in a limited liability company. Taggart, who owned an interest in the company, was sued by the company and the other owners for breach of contract. On the eve of the state court trial, Taggart filed for Chapter 7 bankruptcy protection in the U.S. Bankruptcy Court for the District of Oregon. The state court trial was stayed as a result of the bankruptcy filing, and at the conclusion of Taggart’s bankruptcy case the bankruptcy court entered a discharge order.<sup>4</sup>

After the discharge order was entered, the plaintiffs in the state court action tried to recover postpetition attorneys’ fees that they had incurred in the state court action after Mr.



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court agreed and held Mr. Taggart liable for the plaintiffs’ postpetition attorney’s fees. Mr. Taggart then moved to reopen his bankruptcy case to enforce the discharge order and hold the plaintiffs in contempt for violating the discharge order.<sup>5</sup>

The bankruptcy court found for the plaintiffs, finding that they had not violated the discharge order because Taggart had “returned to the fray” since Taggart had never abandoned his own counterclaim for attorney’s fees in the state court litigation. The bankruptcy court further held that Taggart had not met his burden of proof to establish by clear and convincing evidence that the plaintiffs had willfully violated the discharge injunction. The ruling was appealed the District Court and the case ultimately made its way to the Ninth Circuit Court of Appeals. The Court of Appeals held that creditors could not be held in contempt if they believed in good faith that the discharge injunction did not apply, even if the creditor’s belief was unreasonable.<sup>6</sup>

The Ninth Circuit’s decision caused a split in the courts as prior to its decision three

courts of appeals (First, Fourth and Eleventh),<sup>7</sup> two bankruptcy appellate panels and dozens of lower bankruptcy courts had held, on a standard akin to “strict liability,” that the Bankruptcy Code requires the imposition of sanctions for discharge violations, irrespective of a creditor’s good faith. Those cases held that “the focus of the court’s inquiry in civil contempt proceedings is not on the subjective beliefs or intent of the alleged contemnors in complying with the order, but whether in fact their conduct complied with the order at issue.”

The Supreme Court was therefore tasked with determining whether, under the Bankruptcy Code, a creditor’s good-faith belief that the discharge injunction does not apply precludes a finding of civil contempt. The Supreme Court determined that “a court may hold a creditor in civil contempt for violating a discharge order if there is *no fair ground of doubt* as to whether the order barred the creditor’s conduct. In other words, civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor’s conduct might be lawful.”<sup>8</sup>

In issuing its analysis, the Supreme Court reviewed traditional civil contempt principles that are used outside of the bankruptcy context. In those situations, the Supreme Court had previously held that civil contempt “should not be resorted to where there is [a] fair ground of doubt as to the wrongfulness of the defendant’s conduct.”<sup>9</sup> The standard, then, is generally an objective one although the Court did note that subjective intent “is not always irrelevant.”<sup>10</sup> For example, the subjective intent can be used to determine the appropriateness of the proposed sanctions. Under the fair ground of doubt standard, “civil contempt therefore may be appropriate when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope.”<sup>11</sup>

The Supreme Court further explained in its opinion that the “fair ground of doubt” standard strikes the balance between the interests of creditors and debtors in a bankruptcy proceeding. To hold otherwise, and only allow

for a subjective standard, would not only be inconsistent with traditional civil contempt principles, but it would also rely “too heavily on difficult-to-prove states of mind.”<sup>12</sup> On the other hand, supporting a purely objective standard “resembling strict liability may lead risk-averse creditors to seek an advance determination in bankruptcy court even where there is only slight doubt as to whether a debt has been discharge...risk[ing] additional federal litigation, additional costs and additional delays.”<sup>13</sup>

The Supreme Court’s ruling is its first decision on the application of contempt in a bankruptcy context and brings clarity to an issue that arises relatively frequently in bankruptcy courts. Following *Taggart*, cred-

itors should continue to exercise extreme extra caution before attempting to collect a debt that may have been discharged in a bankruptcy case. Creditors must investigate to determine whether there is a legitimate legal argument that collection can be pursued regardless of the discharge order. If challenged, creditors should also be prepared to pass the “no fair ground of doubt” test in the event that it is sued for civil contempt as a result of the attempted collection.

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1. 139 S.Ct. 1795 (2019).
2. 11 USC § 524(a)(2).

3. *Taggart*, 139 S.Ct. at 1799-1800.
4. *In re Ybarra*, 424 F.3d 1018, 1027 (9th Cir. 2005).
5. *Taggart*, 139 S.Ct. at 1799.
6. *Id.* at 1800-1801.
7. See *In re Pratt*, 462 F.3d 14, 19-21 (1st Cir. 2006) (holding that a creditor’s violation of a discharge order was actionable despite the lack of “bad faith”); *In re Fina*, 550 F. App’x 150, 154 (4th Cir. 2014) (holding a “good faith mistake is generally not a valid defense” to the violation of a discharge order); *In re Hardy*, 97 F.3d 1384, 1390 (11th Cir. 1996) (“the focus of the court’s inquiry in civil contempt proceedings is not on the subjective beliefs or intent of the alleged contemnors in complying with the order, but whether in fact their conduct complied with the order at issue.”)
8. *Taggart*, 139 S.Ct. at 1799.
9. *Id.* at 1801.
10. *Id.* at 1802.
11. *Id.*
12. *Id.* at 1803.
13. *Id.*