Proof of Claim as FDCPA Violation

The Fair Debt Collection Practices Act prohibits debt collection practices which are "false, deceptive, misleading, unfair, or unconscionable". In 2017, the United States Supreme Court ruled that filing a proof of claim in a bankruptcy case for a debt, which was subject to a statute of limitations defense, was not a violation of the FDCPA.

More recently, a bankruptcy court in Philadelphia explained that the Supreme Court's ruling did not categorically exclude bankruptcy proofs of claim from the requirements of the FDCPA. A creditor that files a "false, deceptive, misleading, unfair or unconscionable" proof of claim in a bankruptcy case remains subject to penalties for violation of the FDCPA. A creditor that files a proof of claim for debt which is legally uncollectible may be liable under the FDCPA.

Bernadin v. U.S. Bank (In re Bernadin), 610 B.R. 787 (Bankr. E.D. Pa. 2019).

Dispute Prevents Involuntary Case

Three creditors may commence a bankruptcy case against a debtor by filing an involuntary petition. However, in order to qualify as a petitioner, the creditor must hold a claim against the debtor that is "not the subject of a bona fide dispute as to liability or amount." Bankruptcy courts have been divided as to whether a dispute over a small part of a debt disqualifies a creditor, where there is no dispute over the major part of the debt.

A federal appeals court in San Francisco has ruled that a dispute over any amount bars the creditor from acting as a petitioner, even where there is a substantial undisputed part of the claim. This limits petitioning creditors to those without disputes over their invoices. It also incentivizes debtors to manufacture minor disputes over the invoices of petitioning creditors.

State Dep't of Revenue v. Blixseth, 942 F.3d 1179 (9th Cir. 2019).

Default Interest Not a Penalty

As a matter of general legal principles, a contract provision that provides for a penalty in the event of default is not enforced by the courts. However, courts generally enforce provisions of loan documents that provide for a higher interest rate in the event of a default by the borrower. These courts explain that the default interest rate reflects a risk allocation rather than a penalty.

Without going so far as to say that a default interest rate can never be a penalty, a New York bankruptcy judge found that a default interest rate seven percentage points higher than the non-default rate was not a penalty. In surveying the case law, the court noted that a default increase in the interest rate from 6.125% to 24% was found not to be a penalty, and a 38% default rate had been approved.

In re 1111 Myrtle Ave. Group, 598 B.R. 729 (Bankr. S.D.N.Y. 2019).

This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation. Congress has required bankruptcy attorneys to state: "I am a debt relief agency. I help people file for bankruptcy relief under the Bankruptcy Code." 11 U.S.C. § 528. If you wish to receive Notes on Debtor/Creditor Relations *by email, go to www.jamesolsonattorney.com/newsletter.html and click on the link at the word "here".*