N O T E S O N

DEBTOR/CREDITOR

R E L A T I O N S

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Sanctions for Violating Chapter 11 Plan

In 2019, the United States Supreme Court clarified the standard for awarding sanctions against a creditor that tried to collect a debt discharged in a Chapter 7 bankruptcy case. The bankruptcy court had sanctioned a creditor for continuing a lawsuit against the debtor after the debtor had been granted a discharge in bankruptcy. The bankruptcy judge reasoned that sanctions were permissible because the creditor satisfied two conditions: (1) the creditor was aware of the discharge and (2) the creditor intentionally performed the action which violated the statutory injunction against continuing lawsuits post-discharge. On appeal, the federal appellate court reversed that decision, applying a different legal standard. The appellate court decided that a creditor cannot be sanctioned for a violation of the discharge injunction if the creditor has a good faith belief that the discharge order does not apply to the creditor's action.

On further appeal, the Supreme Court rejected both of these standards and adopted a middle position for determining when sanctions may be imposed on a creditor who violates the discharge injunction. The Court held that a creditor may be sanctioned for violation of the discharge injunction "if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful." This standard protects a creditor who proceeds on the basis of a credible legal position with which a judge subsequently disagrees. However, it does not protect a creditor who proceeds in good faith on an unreasonable interpretation of the discharge order.

Taggart v. Lorenzen, 139 S.Ct. 1795 (2019).

In 2022, a federal appellate court in Richmond, applied the standard from *Taggart* to a case involving a creditor's violation of provisions in a confirmed Chapter 11 plan of reorganization. The Chapter 11 plan had modified the terms of a mortgage on the debtor's real property. However, the mortgage holder failed to adjust the loan in its own records so that it would comply with the modified terms contained in the Chapter 11 plan. The debtor sought to sanction the mortgage holder for its failure to comply. As neither the bankruptcy judge nor the district judge had applied the *Taggart* standard, the appellate court sent the case back to the bankruptcy court to consider the motion for sanctions under the correct legal standard. The appellate court cautioned that the creditor's reliance on the advice of an attorney did not automatically create an "objectively reasonable basis" for failing to adjust the loan. However, "a party's reliance on guidance from outside counsel may be instructive, at least in part, when determining whether that party's belief that [it] was complying with the order was objectively unreasonable."

At the end of the day, a creditor seeking to take steps against a Chapter 11 debtor post-bankruptcy should seek legal advice before determining what a Chapter 11 plan permits. However, that advice does not completely protect the creditor from potential sanctions if the court later determines that the attorney's advice was unreasonable.

Beckhart v. Newrez LLC, 31 F.4th 274 (4th Cir. 2022).

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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".*

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