Bankruptcy Intersection With Commercial Collections

By Johnathan C. Bolton[1]

I. Introduction

Many in the debt collection area view bankruptcy as a stumbling block that interferes with their debt collection efforts because the bankruptcy court is typically a debtor-friendly forum. However, bankruptcy court does not always have to be feared. The Bankruptcy Code contains a patchwork of debtor-friendly and creditor-friendly provisions that, in the right case, can be useful for creditors. This article will discuss some of the more important aspects of bankruptcy law for those in the debt collection area.

The most important areas in bankruptcy law intersecting with collection activities are: (1) the automatic stay under 11 U.S.C. § 362, which immediately halts all collection efforts upon a bankruptcy filing; (2) the discharge injunction under 11 U.S.C. § 524, which permanently bars collection of discharged debts; (3) proof of claim practice under 11 U.S.C. § 501 and Federal Rule of Bankruptcy Procedure 3001, governing how collection agencies may assert debts in bankruptcy proceedings; and (4) the Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. § 1692 et seq., which imposes independent obligations on collection agencies that may overlap with or be displaced by the Bankruptcy Code.

II. Bankruptcy Overview

Bankruptcy is a collective proceeding meant to level the playing field so that similarly-situated creditors are all treated in a similar fashion. However, each bankruptcy case must be analyzed in order to determine what a creditor can do to maximize its recovery or to limit its exposure to potential affirmative counterclaims by the estate in a particular case.

The Bankruptcy Code's protections are designed with the "honest but unfortunate debtor" in mind. Therefore, if a debtor fails to comply with the requirements of the Bankruptcy Code or Rules or otherwise commits wrongful acts during a bankruptcy case, such malfeasance can constitute "cause" for a creditor to obtain relief from the automatic stay, to seek the appointment of a trustee, or to seek conversion or dismissal of a case.

III. Keep the End Goal In Mind

For creditors, payment is the overall goal in a collections case. In bankruptcy, payment should remain the creditor's ultimate goal. The unsecured or secured nature of a claim, along with the number and amount of other similarly-situated claims in a particular class, can have a significant effect on an individual creditor's recovery. Because secured claims have the highest priority in bankruptcy, in most cases, unsecured claims generally receive less than full payment. Therefore, at the outset creditors should carefully weigh the time and expense of pursuing a claim against the possible percentage of recovery they can ultimately expect to receive in a given case.

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IV. Early Planning and Positioning Are Critical.

Creditors should not wait until a bankruptcy case is filed in order to start analyzing how they will react to a bankruptcy filing by a litigation target. Instead, creditors should *always* consider the potential effect of a possible bankruptcy filing on their collection case and consider what steps they can take *before* a filing to put them in a better position. Early planning and analysis will help, for example, if a collection target threatens bankruptcy in an attempt to extract concessions during litigation. Additionally, if a collection matter is settled before a potential bankruptcy is filed, provisions should be put into the settlement agreement dealing with a possible bankruptcy filing in the future.

V. Timing of the Bankruptcy Filing

Many times, a debtor will file a bankruptcy case in reaction to a ruling, a judgment or order of a court issued in litigation or arbitration. Sometimes, a bankruptcy case will be filed before a final judgment can be entered. This timing is to keep a creditor's claim "contingent," "unliquidated" and/or "disputed" in the bankruptcy case, requiring the creditor to timely file a proof of claim in order to preserve its claim.

Creditors and collection agencies, and their attorneys, should be aware that collection activities and even settlements reached in litigation can be affected by a later bankruptcy filing.

VI. Judgments and Garnishments

Creditors who have obtained judgments and/or garnishments pre-petition are at risk of having their judgments and/or garnishments undone if they were completed during the Preference Period (defined below) or if there were irregularities in the garnishment process.

VII. The 90-Day Preference Period

Under Section 547 of the Bankruptcy Code, a payment received by a creditor within 90 days of the bankruptcy filing (the "Preference Period") can be recovered by the estate for the benefit of all creditors if it is determined that, among other things, the debtor is insolvent at the time of the payment and the payment enables the creditor to receiver more than it would receive if the debtor was in a chapter 7 liquidation case. *See* 11 U.S.C. § 547.

For example, payments a creditor receives from a debtor pursuant to a settlement agreement may be challenged as a "preference" if the debtor files a bankruptcy case within the Preference Period after making the payment.

VIII. Fraudulent Transfers

Under Section 548 of the Bankruptcy Code, a transfer of money or property received by a creditor received within 2 years of the bankruptcy filing (or longer if there is a state law version of the Uniform Fraudulent Transfers Act or Uniform Fraudulent Conveyances Act enacted) can be recovered by the estate for the benefit of creditors if it is determined that, among other things, the debtor is insolvent at the time of the transfer and the consideration for the transfer is less than reasonably equivalent value.

The only real defense to a fraudulent transfer claim, assuming the debtor was insolvent at the time when made, is to establish that the consideration given for the transfer equals reasonably equivalent value.

IX. Applicable Law in a Bankruptcy Case

Although state or federal law governs a creditor's substantive claim in a bankruptcy case, bankruptcy law has procedural requirements that, if not followed, can affect the allowability of the claim.

For example, if a creditor fails to timely file a proof of claim when required, the creditor's claim by become time-barred by bankruptcy law, even though the underlying claim was asserted within the applicable statute of limitations.

Knowing bankruptcy procedures and keeping track of deadlines in a bankruptcy case are critical to a successful recovery.

a. Federal Preemption Issues

With respect to the interplay between federal and state law, the issue of federal preemption arises. When state law and federal law conflict, federal law displaces, or preempts, state law, due to the Supremacy Clause of the U.S. Constitution.

One of the most significant recent cases in the area of bankruptcy and collections law preemption is the Ninth Circuit's decision in *Brown v. Transworld Systems, Inc*., 73 F.4th 1030 (2023), which clarified the scope of the preemption doctrine and confirmed that claims under the Federal Debt Collection Practices Act ("FDCPA") that are premised on theories wholly independent of a bankruptcy discharge order remain viable.

The Ninth Circuit held that each alleged FDCPA violation triggers its own one-year statute of limitations and that certain litigation acts within a debt collection lawsuit, such as filing an affidavit purporting to establish a new basis for ownership of a debt, may constitute distinct FDCPA violations with their own limitations periods.

The *Brown* decision has significant implications for collection agencies that purchase and litigate on consumer debt portfolios, as it exposes them to FDCPA liability for litigation conduct that is not directly tied to a bankruptcy discharge.

X. Participating in the Bankruptcy Case

As an unsecured creditor, in order to receive payment of a claim against the Debtor, a creditor must usually participate in the bankruptcy case. Of course, the level of participation depends on many factors, including the amount of the claim at issue and whether the debt is disputed.

However, participation also has its costs. As discussed below, when a creditor participates in a bankruptcy case, particularly when it files a proof of claim, it makes itself subject to any counterclaims that the estate may have against it.

Although it is possible for a creditor not to participate in a bankruptcy case and still get paid (i.e., the debtor properly schedules the creditor's claim and pays it), it is not recommended.

As discussed in the *Ryniker* case below, when collection agencies are acting on behalf of a creditor in a bankruptcy case in filing a proof of claim, issues can arise that could affect both the collection agency and the underlying creditor because of their agency relationship.

a. Agency Issues

Agency issues can arise in bankruptcy cases when there is one entity acting as the agent of another. Of course, this is the case with collection agencies who act as agents of their creditor clients. Notice given to one can be deemed notice to the other by virtue of their agency relationship.

In a recent case, the Court found a violation of the discharge injunction (discussed below) against a collection agency when the original creditor, not the agency, received notice of the debtor's discharge. In *Faust v. Texaco Refining and Marketing Inc. (In re Faust)*, 270 B.R. 310 (Bankr.M.D.Ga.1998), the court held that a creditor's knowledge of a debtor's Chapter 7 discharge could not be imputed to the collection agency to which the creditor had referred the account for collection, absent evidence that the creditor had informed the agency of the bankruptcy. This principle places the burden on the original creditor to communicate bankruptcy status to its collection agents.

b. ***Ryniker v. Sumec Textile Co.*, 24-2090 (2d Cir. May 27, 2026).**

In the recent case of *Ryniker v. Sumec Textile Co.,* the Second Circuit considered whether service of an adversary complaint on a collection agency engaged by a foreign creditor, was valid service on the foreign creditor under Bankruptcy Rule 7004(b)(3). In finding that service was valid, the Second Circuit vacated the district court's order and the bankruptcy court's dismissal of the complaint and reinstated the default judgment against the foreign creditor, and remanded for further proceedings.

The Ryniker case involved the chapter 11 of Décor Holdings, Inc. and its affiliates, who listed a China-based textile manufacturer ("Sumec") as its second-largest unsecured claim. *Id.* at 6. Sumec had an export credit insurance policy with a state-owned insurance company ("Sinosure") and had executed a document entitled "Collection Trust Deed" authorizing Sinosure to collect "the full amount" of its $3,029,719.52 claim, with "full power" to exercise rights in Sumec's or Sinosure's name. *Id.* at 6-7.

Sinosure retained a U.S. collection agency and granted it "full power" to exercise rights and remedies in Sinosure's or its own name for amicable debt collection "for collection against [Décor]". *Id.* at 7-8. The collection agency filed a Proof of Claim for $3,029,719.52 on behalf of “Sumec” as the creditor and listed its own employee as the address for where notices to the creditor should be sent, including an email contact. *Id.* at 8.

The bankruptcy litigation administrator of the Debtors’ post-confirmation estates filed a “Complaint to Avoid and Recover Transfers Pursuant to 11 U.S. C. 547,548, and 550 And to Disallow Claims Pursuant to 11 U.S.C. 502,” seeking to recover from Sumec $693,048.84 within the preference period. *Id.* at 9.

The litigation administrator served the summons and complaint by mail to Sumec care of the Collection Agency at the address of the collection agency in the Proof of Claim and emailed courtesy copies to the listed email. The representative of the collection agency acknowledged receipt, forwarded the papers internally, and engaged in communications about defenses and extensions while referencing Sumec as “our client and the creditor.” *Id.* at 9-10. fter no response or appearance by Sumec, a default was entered. *Id.* at 11. A default judgment was then entered against Sumec for $693,048.84 plus interest. *Id.* at 12.

On appeal, the District Court vacated the default judgment, holding that the collection agency lacked actual or apparent authority to accept service on Sumec and finding notice not reasonably calculated. *Id.* at 21-23. On remand, the bankruptcy court dismissed the adversary proceeding with prejudice under Rule 12(b)(5). *Id.* at 25.

The Second Circuit accepted direct appeal, reviewed de novo, and reversed. The Second Circuit first discussed actual authority, and explained that actual authority includes implied authority necessary or incidental to achieve the principal’s objectives, and subagents’ actions and notice can bind the principal. *Id.* at 28-30.

The Court explained that the record documents showed that Sumec authorized Sinosure to collect the “full amount” and, through Sinosure,the collection agency acted as subagent for that collection, including filing the Proof of Claim and designating where creditor notices go. *Id.* at 35-36. The Court found that the collection agency had implicit actual authority to accept service in the bankruptcy adversary proceeding because resisting preference recovery and claim disallowance is part of collecting the “full amount.” *Id.* at 37.

The Second Circuit also held that service by mail on the collection agency satisfied Bankruptcy Rule 7004(b)(3)’s requirement for service on an “agent authorized by appointment,” given the established subagency and designated notice address in the Proof of Claim. *Id.* at 39.

The *Ryniker* case is a lesson for collection agencies participating in bankruptcy cases and listing themselves as authorized agents of the underlying creditor. This can lead to being authorized to accept service of complaints from the estate to recover pre-petition transfers. In particular, granting “full rights” and “full power” to an agent to collect the full amount of a claim can imply authority to accept service and defend against preference and claim-disallowance actions.

XI. The Automatic Stay

The automatic stay under 11 U.S.C. § 362 immediately halts most creditor actions upon the filing of a bankruptcy petition, providing debtors a reprieve from collection efforts and protecting the equitable distribution among creditors. Federal courts hold exclusive jurisdiction over the scope and modification of the stay, which broadly prohibits collection and enforcement of judgments against the debtor or estate property, barring specific exceptions.

Collection agencies fit squarely within the scope of this prohibition. Courts have consistently held that once a collection agency receives actual notice of a bankruptcy filing, it must not only cease new collection efforts but must also affirmatively act to halt any pending collection proceedings.

The Ninth Circuit addressed this affirmative duty in the case of *Eskanos & Adler, P.C. v. Leetien*, 309 F.3d 1210 (9th Cir. 2002), which held that the Bankruptcy Code imposes an affirmative obligation to discontinue post-petition collection actions in non-bankruptcy forums. In *Leetien*, a collection agency was promptly notified of a Chapter 7 filing of a debtor but delayed nearly three weeks before dismissing its state court collection action. The Bankruptcy Court affirmed sanctions of $1,000 jointly and severally against the creditor and the collection agent, finding a willful violation of the automatic stay. The court emphasized that a party violating the automatic stay by continuing a collection action in a non-bankruptcy forum must dismiss or stay such proceedings immediately or risk sanctions.

Courts have also held that collection agencies must have procedures in place to immediately halt all collection efforts upon learning of a bankruptcy, and failure to do so exposes the agency to sanctions. *See In re Riddick*, 231 B.R. 265 (Bankr. N.D. Ohio 1999).

a. Violations of the Automatic Stay

In the Ninth Circuit, actions taken in violation of the automatic stay are void and can subject creditors and their attorneys to liability for damages. *See, e.g., Schwartz v. United States (In re Schwartz)*, 954 F.2d 569 (9th Cir. 1992)(IRS tax assessment made in violation of the automatic stay was void, not voidable); *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000) (judicial proceedings in violation of the automatic stay are void ab initio; because such proceedings are void, a bankruptcy court is not obligated to extend full faith and credit to them.); *Burton v. Infinity Capital Management*, 862 F.3d 740 (9th Cir. 2017)(judicial proceedings taken in violation of the automatic stay are void; any state court modification of the automatic stay constitutes an unauthorized infringement on the bankruptcy court's jurisdiction); *see also In re Gasprom, Inc.*, 500 B.R. 598 (B.A.P. 9th Cir. 2013)(the scope of protection provided by the automatic stay is interpreted very broadly, and stay exceptions are interpreted narrowly; actions taken in violation of the stay are void ab initio).

It is important for collections agencies to have safeguards to prevent unintentional violations of the automatic stay by issuance of computer-generated demand letters. Any accounting/collection system should allow a “bankruptcy hold” to be placed on an account to prevent the inadvertent sending out of demand letters after a bankruptcy case is instituted to avoid stay violations.

b. Punitive Damages for Willful Violations of the Automatic Stay

Punitive Damages can be assessed against creditors if a violation of the automatic stay is determined to be willful. *See In re Bloom*, 875 F.2d 224 (9th Cir. 1989)(a creditor's multiple filings and representations after being warned by debtor's counsel constituted willful violations of the automatic stay warranting punitive damages under § 362(h) (now § 362(k)); *In re Snowden*, 769 F.3d 651 (9th Cir. 2014) (an award of punitive damages for a willful violation of the automatic stay requires some showing of reckless or callous disregard for the law or rights of others; affirmed award of emotional distress damages);

In the case of *In re Riddick*, 231 B.R. 265 (Bankr. N.D. Ohio 1999), a collection agency continued to telephone a Chapter 13 debtor weekly about her student loan debt despite being advised of her bankruptcy filing. The court found a willful violation and awarded $850 in attorney fees and $3,000 in punitive damages — $500 for each of the six contacts made after notification. Similarly, in the case of *In re Brockington*, 129 B.R. 68 (Bankr. D.S.C. 1991), a collection agency and its employee repossessed a debtor's automobile despite the debtor's statement that she had filed for bankruptcy. The court found a willful violation and awarded actual damages, punitive damages, attorney fees, and costs.

By contrast, courts have declined to impose damages where a collection agency lacked actual knowledge of the bankruptcy filing. In the case of *Greer v. Healthcare Financial Services, LLC (In re Greer)*, 498 B.R. 98 (Bankr. S.D. Miss. 2013), a collection agency filed a state-court collection action post-petition, but the bankruptcy court found no willful violation because the address listed in the debtor's bankruptcy schedules for the agency was incorrect, mail had been returned to the court, and the agency immediately ceased collection efforts upon receiving a copy of the adversary complaint. Similarly, in *In re Fowler*, 16 B.R. 596, 597 (S.D. Ohio 1981), the court found a technical violation of the automatic stay but declined to award damages where the violation was unintentional and the debtor suffered no actual harm.

c. Obtaining Relief From The Automatic Stay

Creditors can seek relief from the automatic stay to pursue their claims in a non-bankruptcy forum in which litigation has been pending.

Section 362(d)(1) of the Bankruptcy Code provides that the Court shall grant relief from stay "for cause, including the lack of adequate protection of an interest in property." 11 U.S.C. § 362(d); *see In re Kronemyer*, 405 B.R. 915, 921 (B.A.P. 9th Cir. 2009) ("What constitutes 'cause' for granting relief from the automatic stay is decided on a case-by-case basis."); *In re Conejo Enters., Inc.*, 96 F.3d 346, 351-52 (9th Cir. 1996) ("The decision to grant or deny relief from the automatic stay is committed to the sound discretion of the bankruptcy court… [u]pon a showing of cause, a bankruptcy court shall grant relief from the [automatic] stay. 'Cause' has no clear definition and is determined on a case-by-case basis.") (internal cites omitted); *In re Arnold*, 806 F.2d 937, 939 (9th Cir. 1986) ("debtor's lack of good faith in filing a bankruptcy petition has often been used as cause for removing the automatic stay... existence of good faith depends on an amalgam of factors... [t]he bankruptcy court should examine the debtor's financial status, motives, and the local economic environment."); *In re Merriman*, 616 B.R. 381, 387

(B.A.P. 9th Cir. 2020) ("In assessing whether relief from stay should be granted to allow state court proceedings to continue in that forum, the bankruptcy court should consider judicial economy, the expertise of the state court, prejudice to the parties, and whether exclusively bankruptcy issues are involved.").

The automatic stay is often vacated to allow non-bankruptcy litigation to proceed in a more appropriate non-bankruptcy forum for litigating the issues. *See In re Hakim*, 212 B.R. 632 (Bankr. N.D. Cal. 1997) (articulating a seven-factor test for granting relief from stay to allow pending litigation to proceed, including: (1) whether insurance coverage with a duty of defense is available; (2) whether judicial economy favors continuation in the original tribunal; (3) whether the litigation has progressed to trial-readiness; (4) whether issues are governed solely by state law; (5) whether the litigation involves other parties over whom the bankruptcy court lacks jurisdiction; (6) whether the creditor has a probability of success on the merits; and (7) whether threshold bankruptcy-law issues should be resolved first.)

In particular, "courts in the Ninth Circuit have granted relief from the stay under § 362(d)(1) when necessary to permit pending litigation to be concluded in another forum if the non-bankruptcy suit involves multiple parties or is ready for trial." *Truebro, Inc. v. Plumberex Specialty Products, Inc.* (*In re Plumberex Specialty Products, Inc*.), 311 B.R. 551, 556–57 (Bankr.C.D.Cal.2004)) (internal cites omitted); *In re Quintrall*, No. ADV. 06-90399, 2007 WL 7540996, at *4 (B.A.P. 9th Cir. July 5, 2007) (noting several factors favoring relief from the automatic stay: the state court litigation involved multiple nondebtor parties, similar causes of action and factual allegations, the case had been pending for over two years with discovery nearing completion, and trial could be set quickly).

d. When the Automatic Stay Ends

Unless otherwise ordered by the Bankruptcy Court, the automatic stay against property of the estate continues until the debtor's property is no longer property of the estate. The automatic stay of all other actions against the debtor continues until the time the case is closed, the case is dismissed, or a discharge is granted or denied, whichever is earlier.

XII. Schedules of Assets and Liabilities and Statements of Financial Affairs

The Bankruptcy Code requires that a debtor list all of its assets and debts on its Schedules of Assets and Liabilities (the "Schedules") under penalty of perjury. Furthermore, debtors must fill out a detailed Statement of Financial Affairs ("SOFA") that lists various historical information, including all pending lawsuits, all keepers of records and historical financial information under oath, and all potential preferential transfers.

The listing of a claim on the Debtor's Schedules makes the claim "allowed" for bankruptcy purposes. *See In re Dynamic Brokers, Inc.*, 293 B.R. 489 (B.A.P. 9th Cir. 2003) (under § 1111(a), a scheduled, undisputed, noncontingent, liquidated claim is both deemed filed and deemed allowed; a creditor who fails to file a proof of claim in a Chapter 11 case when the claim is scheduled as undisputed, noncontingent, and liquidated does not lose its claim.); *In re Carolina Tobacco Co.*, 375 B.R. 602 (Bankr. D. Or. 2007) (where a claimant does not file a proof of claim but the claim is scheduled by the debtor as not disputed, contingent, or unliquidated, the claim is deemed filed and is accorded the same evidentiary effect as one actually filed by the creditor). This information can be extremely helpful to collections attorneys for, among other things, determining the collectability of the creditor's claim in a given case.

On the Schedules, the debtor is permitted to state their value of a claim. Therefore, many times debtors schedule disputed litigation claims at $0.00. As discussed above, if a creditor fails to timely file a proof of claim to controvert the scheduled amount of the claim, that creditor risks having its claim valued at $0.00 and will not receive distributions from the estate.

XIII. Filing a Proof of Claim

A creditor must file a proof of claim to participate in any distributions if its claim is not scheduled as an "allowed" claim.

A properly filed proof of claim constitutes prima facia evidence of the validity of the claim, unless objected to. *See Wright v. Holm (In re Holm)*, 931 F.2d 620 (9th Cir. 1991) (a properly filed proof of claim constitutes prima facie evidence of the validity and amount of the claim and is strong enough to carry over a mere formal objection without more); *Lundell v. Anchor Construction Specialists, Inc.*, 223 F.3d 1035 (9th Cir. 2000) (a proof of claim is prima facie evidence of validity and amount; upon objection, the objector must produce evidence which, if believed, would refute at least one allegation essential to the claim's legal sufficiency; if the objector produces sufficient evidence, the burden reverts to the claimant to prove validity by a preponderance of the evidence; the ultimate burden of persuasion remains at all times upon the claimant).

All required attachments and evidence should be attached to the proof of claim form. However, the failure to attach all documents is not typically fatal. *See In re Heath*, 331 B.R. 424 (B.A.P. 9th Cir. 2005) (a credit card issuer's alleged failure to attach sufficient documentation might deprive a proof of claim of its prima facie validity, but this was not a basis for disallowing the claim; the statute sets forth the sole grounds for objections, which do not include lack of compliance with Rule 3001(c)); *In re Lasky*, 364 B.R. 385 (Bankr. C.D. Cal. 2007)(debtors' scheduling of claims as liquidated, noncontingent, and undisputed was in the nature of an admission, which prevented the court from disallowing claims to the extent they did not exceed the amounts scheduled, regardless of whether proofs of claim had requisite supporting documentation).

XIV. The Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act (15 U.S.C. § 1692 et seq.) imposes liability on creditors and collection agencies for taking prohibited actions in attempting to collect a debt. Typically, FDCPA claims occur before a bankruptcy case, but can continue to impose liability post-bankruptcy and even post-discharge.

One of the most litigated questions in this area is whether a debtor may bring an FDCPA claim against a collection agency for conduct that also violates the Bankruptcy Code, or whether the Bankruptcy Code's remedial scheme preempts the application of the FDCPA. The circuits have reached different conclusions depending on the nature of the underlying conduct and the timing of the claim.

In *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502, 506-07 (9th Cir. 2002), the Ninth Circuit held that the Bankruptcy Code precludes a simultaneous FDCPA claim where the claim is premised on a violation of the discharge injunction, reasoning that allowing such a claim would enable the debtor to circumvent the Code's remedial scheme. The Ninth Circuit later clarified this rule in *Brown v. Transworld Systems, Inc.*, 73 F.4th 1030 (9th Cir. 2023), holding that FDCPA claims are not precluded when they are based on a theory wholly independent of the discharge order. In *Brown*, the court allowed an FDCPA claim premised on the allegation that the collection agency filed a knowingly meritless debt collection lawsuit because it could not prove ownership of the debts — a theory that did not depend on the existence of the discharge order.

The Second Circuit took a different approach in *Garfield v. Ocwen Loan Servicing, LLC*, 811 F.3d 86 (2d Cir. 2016), holding that the Bankruptcy Code does not broadly repeal the FDCPA for purposes of claims based on conduct that would also constitute violations of the discharge injunction. The Second Circuit reasoned that no irreconcilable conflict exists between the post-discharge remedies of the Code and the FDCPA, and that in the post-discharge context the former debtor no longer has the protection of the bankruptcy court.

In *Bacelli v. MFP, Inc.*, 729 F.Supp.2d 1328 (Bankr. M.D.Fla. 2010), the Middle District of Florida held that no irreconcilable conflict exists between the remedies available under the Bankruptcy Code for automatic stay violations and FDCPA claims based on collection letters that also violate the automatic stay. This means a debtor may, in appropriate circumstances, pursue both remedies simultaneously for pre-discharge collection conduct. Where a collection agency sends a collection letter regarding a debt that has been discharged in bankruptcy, courts have found FDCPA violations independent of the discharge injunction framework. For example, in *Eide v. Colltech, Inc.*, 987 F. Supp. 2d 951 (D. Minn. 2013), the court held that sending a collection letter when the debt has actually been discharged in bankruptcy violates the FDCPA, and that the FDCPA's debt-validation provision is not a prerequisite to filing such a claim.

a. Time-Barred Debts

The Supreme Court held that collection agencies violate the FDCPA by filing proofs of claim on time-barred debts in Chapter 13 bankruptcy proceedings in *Midland Funding, LLC v. Johnson*, 581 U.S. 224 (2017).

In *Midland Funding* , Midland Funding had filed a proof of claim in Johnson's Chapter 13 bankruptcy asserting a credit card debt where the last charge appeared more than ten years prior. The Court held that filing a proof of claim that is obviously time-barred is not a false, deceptive, misleading, unfair, or unconscionable debt collection practice within the meaning of the FDCPA. The Court's reasoning rested on several pillars: first, a time-barred debt remains a valid "claim" under the Bankruptcy Code's broad definition in 11 U.S.C. § 101(5)(A) because under Alabama law (and the law of many states) a creditor retains a right to payment even after the limitations period expires; second, the running of a limitations period constitutes an affirmative defense that the debtor must assert, and there is nothing misleading in a filing that follows this system; third, Chapter 13 proceedings involve knowledgeable trustees who understand that proofs of claim are subject to disallowance; and fourth, applying the FDCPA in this context would upset the “delicate balance” of the Bankruptcy Code's debtor protections and obligations. The Court also noted that filing and disallowing a stale claim can actually benefit debtors, because disallowance discharges the debt and prevents it from remaining on a credit report.

Courts continue to address FDCPA claims based on other alleged deficiencies in proofs of claim, such as mischaracterization of the components of a debt. In *Hill v. Resurgent Cap. Serv's, L.P.*, 461 F. Supp. 3d 1232, 1239 (S.D. Fla. 2020), the court held that a collection agency's mischaracterization of interest as principal in a proof of claim could constitute a material FDCPA violation, and that such a claim was not preempted by the Bankruptcy Code because it did not invoke a substantive right created by the Bankruptcy Code.

b. The FDCPA's Bona Fide Error Defense

The FDCPA's bona fide error defense is available to collection agencies that can demonstrate they maintained reasonable procedures to avoid sending collection letters to debtors in bankruptcy. In *Cross v. Risk Management Alternatives, Inc.*, 374 F.Supp.2d 649 (N.D. Ill. 2005), the court found that a collection agency's policies and practices to avoid sending collection letters to debtors in bankruptcy were reasonable, entitling the agency to invoke the bona fide error defense where it had conducted searches of computer databases for accounts most likely to be subject to bankruptcy petitions and had not received notice of the debtor's bankruptcy from the creditor or the debtor.

However, courts have held that a willful violation of the automatic stay cannot be excused by the bona fide error defense. *See In re Riddick*, 231 B.R. 265 (Bankr. N.D. Ohio 1999).

XV. The Discharge Injunction

In a chapter 11 case, once a chapter 11 plan is confirmed, the automatic stay is no longer in effect, but is replaced by a discharge injunction under sections 524(a)(2) and 1141(d)(1)(A) of the Bankruptcy Code.

Section 524 of the Code provides that an order discharging a debt in a bankruptcy case “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.” 11 U.S.C. § 524(a)(2). Even though section 524(a)(2) is a statutory provision, as it grants relief triggered by the discharge order, the injunction has been equated to an order of the court. 4 COLLIER ON BANKRUPTCY ¶ 524.02[2] (15th ed. rev.2009).

The discharge injunction is broad and prohibits any act taken to collect a discharged debt as a personal liability of the debtor. *Id.* Thus, the discharge injunction is a definite and specific court order that requires creditors to refrain from particular acts, i.e., any act to collect, recover, or offset any discharged debt as a personal liability of the debtor.

A violation of the discharge injunction is punishable as civil contempt, i.e. violation of a court order. In *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502 (9th Cir. 2002) the Court explained that contempt is the exclusive remedy for violation of the discharge injunction under § 524; there is no private right of action for damages; compensatory civil contempt allows an aggrieved debtor to obtain compensatory damages, attorney fees, and the offending creditor's compliance with the discharge injunction. *See also In re Taggart*, 980 F.3d 1340 (9th Cir. 2020) (civil contempt may be appropriate for violation of the discharge injunction if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful); *In re Gurrola*, 328 B.R. 158 (B.A.P. 9th Cir. 2005) (the discharge and the discharge injunction are effective against the world to the full extent of their statutory terms, regardless of notice; the word void in § 524(a) means void, not voidable; lack of notice may be a defense to contempt sanctions but does not otherwise vary the legal consequences of acts in violation of the discharge injunction.); *RS Air, LLC*, 651 B.R. 538 (B.A.P. 9th Cir. 2023) (§ 524(e) provides that the discharge of a debtor's debt does not affect the liability of any other entity on that debt; the Ninth Circuit employs an especially strict reading of § 524(e), repeatedly holding without exception that it precludes bankruptcy courts from discharging the liabilities of non-debtors); *In re Go*, 642 B.R. 50 (Bankr. D. Nev. 2022) (lender violated the discharge injunction by sending mortgage statements to debtors; civil contempt sanctions were appropriate where the lender had no objectively reasonable basis for concluding its conduct might be lawful; applied the fair ground of doubt standard.); *In re Culpepper*, 481 B.R. 650 (Bankr. D. Or. 2012) (Wells Fargo knowingly violated the discharge injunction by continuing to route calls to the debtor in an effort to reinstate a discharged debt after the debtor had clearly advised the bank she was not interested in a modification); *In re Pongco*, 614 B.R. 690 (Bankr. D. Alaska 2019)(that to recover contempt sanctions for violation of the discharge injunction, the movant must prove that the creditor (1) knew the discharge injunction was applicable and (2) intended the actions that violated the injunction; however, a creditor's good faith belief that the discharge injunction does not apply to its claim precludes a finding of contempt, even if that belief is unreasonable.).

a. Attempts to Collect Discharged Debts

Collections agencies that attempt to collect discharged debts face contempt proceedings under Sections 105(a) and 524 of the Bankruptcy Code. In the case of *In re Blanco*, 649 B.R. 571 (Bankr. E.D. Wash. 2023), a collection agency commenced a state court collection suit against a Chapter 7 debtor, mischaracterizing discharged pre-petition debts as post-petition obligations. The bankruptcy court sanctioned the agency by ordering dismissal of the pending state court suit, directing the agency to refrain from any further collection on the discharged debts, awarding the debtor reasonable attorney fees and costs, and imposing a $100 fine to encourage future compliance.

A critical question in discharge injunction cases is whether a collection agency can be held liable when the original creditor, not the agency, received notice of the discharge. *See Faust v. Texaco Refining and Marketing Inc. (In re Faust)*, 270 B.R. 310 (Bankr.M.D.Ga.1998).

XVI. Bankruptcy Discovery and Tools

Some of the useful tools available to creditors in a bankruptcy case include the Bankruptcy Code’s requirement that a debtor attend a meeting of creditors where the debtor must testify under oath about the assets and debts set forth on its schedules. Creditors and their attorneys are allowed to attend and ask questions.

a. Rule 2004 Examinations

Rule 2004 of the Federal Rules of Bankruptcy Procedure allows a creditor to examine a debtor (or any other party in interest) under oath regarding the acts, conduct, property and financial condition of the debtor or any matter affecting the administration of the estate or the debtor's right to a discharge. Rule 2004 examinations are permissible "fishing expeditions" that are broader than the discovery permitted under state or federal procedural rules. *See In re N. Plaza, LLC*, 395 B.R. 113 (S.D. Cal. 2008) (the scope of a Rule 2004 examination is exceptionally broad and provides few of the procedural safeguards found in the Federal Rules of Civil Procedure; examinations are allowed for the purpose of discovering assets and unearthing frauds and have been compared to a fishing expedition); *In re Mastro*, 585 B.R. 587 (B.A.P. 9th Cir. 2018)(a Rule 2004 examination is the basic discovery device in bankruptcy cases, allowing broad examinations on any matters that may affect administration of the estate or the debtor's right to discharge; the examination may extend to third parties who have had dealings with the debtor; however, the examination is not without limits and should not be used to abuse or harass, or to stray into matters not relevant to the basic inquiry.); *In re Subpoena Duces Tecum*, 461 B.R. 823 (Bankr. C.D. Cal. 2011) (good cause for a Rule 2004 examination is generally shown if the examination is necessary to establish the claim of the party seeking it; once good cause is established, the burden shifts to the objecting party to show that the examination would be oppressive or burdensome; the U.S. Trustee had standing to seek Rule 2004 examinations of a mortgage servicer's representatives).

b. Conversion or Dismissal of Cases

Creditors can seek to convert a case to Chapter 7 or dismiss a bankruptcy case for a "bad faith" filing. *See Marsch v. Marsch (In re Marsch*), 36 F.3d 825 (9th Cir. 1994)(although § 1112(b) does not explicitly require good faith, courts have overwhelmingly held that a lack of good faith in filing a Chapter 11 petition establishes cause for dismissal; the existence of good faith depends on an amalgam of factors and not upon a specific fact; the test is whether a debtor is attempting to unreasonably deter and harass creditors or attempting to effect a speedy, efficient reorganization on a feasible basis; a petition filed solely to delay collection of a judgment and avoid posting an appeal bond was filed in bad faith); *In re Leavitt*, 171 F.3d 1219 (9th Cir. 1999) (bad faith is cause for dismissal of a Chapter 13 case with prejudice under §§ 349(a) and 1307(c); the totality of the circumstances test applies, considering: (1) whether the debtor misrepresented facts or unfairly manipulated the Code; (2) the debtor's history of filings and dismissals; (3) whether the debtor only intended to defeat state court litigation; and (4) whether egregious behavior is present; a finding of bad faith does not require fraudulent intent); *In re Bowers Inv. Co., LLC*, 553 B.R. 762 (Bankr. D. Alaska 2016)(a debtor's bad faith in filing for Chapter 11 relief can constitute cause for conversion or dismissal; the debtor's unauthorized use of cash collateral resulted in substantial harm to the creditor and constituted cause to convert or dismiss; conversion to Chapter 7, rather than dismissal, was in the best interests of creditors and the estate.); *In re Little*, 657 B.R. 873 (Bankr. D. Idaho 2024)(filing bankruptcy to delay state court proceedings may be indicative of bad faith, allowing for dismissal or conversion from Chapter 11; once bad faith is put at issue, the debtor bears the burden of establishing that the petition was filed in good faith); *In re Premier Golf Props., LP*, 564 B.R. 710 (Bankr. S.D. Cal. 2016)(if there is cause to dismiss or convert a Chapter 11 case, the court must decide whether dismissal, conversion, or appointment of a trustee is in the best interests of creditors and the estate, and identify whether unusual circumstances establish that dismissal or conversion is not in the best interests of creditors; a finding of lack of good faith depends on the totality of the facts and circumstances); *In re Gress*, 257 B.R. 563 (Bankr. D. Mont. 2000)(bad faith as cause for dismissal of a Chapter 13 petition with prejudice involves application of the totality of the circumstances test; although not specifically listed, bad faith is a cause for dismissal under § 1307(c)).

c. Objections to Dischargeability/Discharge

Creditors can challenge a debtor's right to a discharge or can object to the dischargeability of certain debts. This can put tremendous pressure on a debtor who is seeking a discharge.

d. Appointment of a Chapter 11 Trustee

If there is sufficient "cause" present (*i.e.*, fraud, dishonesty, gross mismanagement), a creditor can seek the appointment of a trustee or an examiner (in a chapter 11 case) to oust the debtor's current management or seek dismissal of a case (in any chapter), particularly if it was filed in "bad faith" or solely for use as a litigation tactic.

Any creditor or party-in-interest can seek the appointment of a trustee or the Court can do so *sua sponte*. *See Fukutomi v. U.S. Trustee (In re Bibo, Inc.)*, 76 F.3d 256 (9th Cir. 1996)(bankruptcy court may appoint a Chapter 11 trustee sua sponte; the court's findings established fraud, dishonesty, gross mismanagement, and that appointment was in the interests of the estate; the court need not wait for a motion by a party in interest); *In re Corona Care Convalescent Corp.*, 527 B.R. 379 (Bankr. C.D. Cal. 2015)(cause and best interests of creditors and other parties are separate and independent bases for granting a motion for appointment of a Chapter 11 trustee under § 1104(a); the parties seeking appointment bear the burden of proving appropriate grounds by a preponderance of the evidence); *In re Am. Res., Ltd.*, 54 B.R. 245 (Bankr. D. Haw. 1985)(cause existed for appointment of a trustee for a Chapter 11 debtor where the debtor's manager was under indictment for engaging in illegal loans and uncontradicted findings of the state bank examiner raised serious questions as to the financial and managerial credibility of the debtor's present management); *In re Rosenblum*, 608 B.R. 529 (Bankr. D. Nev. 2019)(burden was on the party moving for appointment of a Chapter 11 trustee to show cause under § 1104(a)(1) or that appointment was warranted on a best interests theory under § 1104(a)(2); denied appointment where the movant failed to show any scenario where appointment would benefit any creditor other than herself); *In re Prods. Int'l Co.*, 395 B.R. 101 (Bankr. D. Ariz. 2008)(gross mismanagement of the estate constituted cause for dismissal, conversion, or appointment of a trustee under § 1112(b)(4)(B); appointment of a Chapter 11 trustee was in the best interests of creditors and the estate where the debtor's president had improperly transferred nearly $700,000 to his other companies).

XVII. Conclusion

Creditors and collection agencies operating in the debt-purchasing and collection space must maintain reliable compliance systems to identify debtors who have filed for bankruptcy. Upon receiving notice of a bankruptcy filing, a creditor or agency must immediately halt all collection activity and affirmatively dismiss or stay any pending collection proceedings in non-bankruptcy forums. Failure to do so risks willful violation findings under § 362(k), which carry mandatory actual damages, attorney fees, and potential punitive damages.

Creditors or collections agencies that purchase and collect on consumer debt portfolios face particular exposure in the proof of claim context. Proofs of claim accurately characterize the components of the debt. Assignees and collection agencies must also be prepared to establish chain of title for purchased debts, as filing a proof of claim without the ability to prove ownership of the debt may constitute a knowingly meritless collection action under the FDCPA.

Post-discharge, creditors and collection agencies must ensure that their systems accurately reflect the discharge status of debts before initiating any collection activity. The knowledge of the original creditor regarding a debtor's discharge is not automatically imputed to the collection agency, but agencies that receive accounts from creditors who knew of the discharge may face contempt sanctions if they proceed with collection.

As long as creditors are educated about the bankruptcy process, the bankruptcy court does not have to be feared for collection matters. In fact, as discussed above, in some instances a bankruptcy filing by a debtor can actually be *helpful* to creditors because it gives them the ability to use powerful bankruptcy tools to aid them in their collection efforts.

Best of luck with your collections efforts!