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Heightened Standard for Imposition of Civil Contempt Sanctions Arising from Violation of Discharge Order Help Center



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On June 3, 2019, the U.S. Supreme Court released a unanimous decision in *Taggart v. Lorenzen* concluding that a court is authorized to “impose civil contempt sanctions when there is no objectively reasonable basis for concluding that the creditor’s conduct might be lawful under the discharge order.” [1] Put another way, “civil contempt ... 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.” [2] In doing so, the Supreme Court held that “the [Ninth] Court of Appeals erred in applying a subjective standard for civil contempt. Based on the traditional principles that govern civil contempt, the proper standard is an objective one.” [3]

Underlying Facts

The underlying litigation addressed by the Supreme Court involved an Oregon state court litigation brought by a company and two of its owners against Taggart, a former owner. Prior to trial, Taggart filed for chapter 7 bankruptcy protection in the U.S. Bankruptcy Court for the District of Oregon and obtained a discharge under § 727 of the Bankruptcy Code. Despite the discharge, the Oregon state court entered judgment against Taggart and awarded \$45,000 in legal fees, holding that they were not barred by the discharge order. Taggart returned to the bankruptcy court and obtained an order holding that the plaintiffs in civil contempt. [4] The bankruptcy court found the plaintiffs liable because (1) they were aware of the discharge order and (2) they intended the actions that violated that order, akin to a strict liability standard. Upon appeal, the Bankruptcy Appellate Panel vacated the sanctions, and the Ninth Circuit affirmed the panel’s decision. The Ninth Circuit held that civil contempt sanctions were not proper where the creditor had a good-faith belief that the discharge order did not apply to its claim.

Court’s Reasoning

The basis for the Supreme Court’s decision was “a longstanding interpretive principle: When a statutory term is ‘obviously transplanted from another legal source,’ it ‘brings the old soil with it.’” [5] Here, the Court held that ‘old soil’ “includes the ‘potent weapon’ of civil contempt,” where courts have 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.’” [6]

In overruling both the underlying bankruptcy court’s decision and the Ninth Circuit’s decision, the Supreme Court placed substantial weight on reducing litigation and litigation costs. The Supreme Court rejected the Ninth Circuit’s standard of not imposing sanctions “even if the creditor’s belief is unreasonable,” holding that such a standard would lead “creditors who stand on shaky legal ground to collect discharged debts, forcing debtors back into litigation (with its accompanying costs) to protect the discharge that it was the very purpose of the bankruptcy proceeding to provide.” [7] Similarly, in rejecting the bankruptcy court’s strict liability standard, the court held that such a standard would force creditors to seek “advance determinations ... [and] thereby risk additional federal litigation, additional costs, and additional delays.... These negative consequences, especially the costs associated with the added need to appear in federal proceedings, could work to the disadvantage of debtors as well as creditors.” [8]

Ramifications

While the decision is barely five months old, it has already led to reversals and remands throughout the U.S. [9] At least three courts have refused to sanction creditors despite their conduct violating discharge orders.

- The bankruptcy court for the Northern District of Alabama found that monies owed by the debtor to Jackson County for solid waste collection services were general unsecured debt dischargeable and not exempt, yet found that sanctions were not warranted for “post-discharge [collection] actions because the Court [found] that there was a fair ground of doubt under the circumstances of [the] case as to whether the actions of Jackson County by its enforcement officer were lawful under the discharge order.” [10]
- Similarly, the U.S. District Court for the Middle District of Alabama found that a creditor’s action in refusing to remove a credential block based on a discharged debt did not subject the creditor to sanctions because “[a]t the very least, there [was] ‘an objectively reasonable basis for concluding that the creditor’s conduct might be lawful.’” [11]
- Last, the U.S. Bankruptcy Court for the Western District of Michigan found that while a creditor’s demand letter was a discharge violation, the creditor would not be subject to sanctions because (a) the letter had a bankruptcy disclaimer, (b) the letter was sent to the debtor and her counsel, and (c) the creditor only sent one letter, and at the time the creditor sent the letter, there was “fair ground of doubt in [the] district as to whether sending the communication was lawful, given the disclaimer and context discussed above.” [12]

Conclusion

The Supreme Court has adopted a subjective standard for considering contempt sanctions that takes into account whether there was “no fair ground of doubt” as to whether a creditor’s conduct was barred by a discharge order. It will be interesting to see whether this decision and the heightened standard for sanctions embolden creditors whose debts have been discharged to test the waters and take collection efforts thereafter.

[1] *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1801 (2019).

[2] *Id.* at 1802.

[3] *Id.* at 1804.

[4] Initially, the bankruptcy court found for the plaintiffs, holding that Taggart had “returned to the fray,” thus the fees were not subject to one discharge order as they were incurred post-petition. *Id.* at 1800. The district court reversed that determination, found that the plaintiffs violated the discharge order and remanded the matter to the bankruptcy court.

[5] *Id.* at 1801, quoting *Hall v. Hall*, 138 S. Ct. 1118, 1128 (2018).

[6] *Id.* at 1801, quoting *California Artificial Stone Paving Co. v. Molitor*, 113 U.S. 609, 618 (1885).

[7] *Id.* at 1803.

[8] *Id.*

[9] See, e.g., *In re Dickerson*, Case No. C19-143 (W.D. Wa. Oct. 11, 2019). In *Dickerson*, the district court reversed and remanded in light of the “new standard for judging violations of 11 U.S.C. § 524” that was set forth in *Taggart*. The district court directed the bankruptcy court “to apply the correct legal standard to the facts of this case. In the event the Bankruptcy Court concludes sanctions are appropriate, it should determine the amount of sanctions appropriate under the circumstances.”

[10] *In re Jenkins*, Case No. 19-80930 (Bankr. N.D. Ala. Nov. 4, 2019). In *Jenkins*, the “fair ground” was Jackson County’s claim that its debt was exempt from discharge under § 523(a)(7) as a debt for a fine or penalty payable to a governmental unit.

[11] *Moore v. Automotive Finance Corp.*, Case No. 19-223 (M.D. Ala. July 24, 2019), citing *Taggart*.

[12] *In re DiStefano*, Case No. 18-05001 (Bankr. W.D. Mich. Oct. 30, 2019).