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Fla. Bankruptcy Ruling Is Cautionary Tale for Debt Collectors

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In the case of *In re: McIntosh*, a debt purchaser's assertion that it was entitled to enforce a debt not correctly listed on the debtor's bankruptcy schedules was met with significant pushback from the U.S. Bankruptcy Court for the Southern District of Florida.

In January, the court flatly rejected the debt purchaser's argument and imposed sanctions for violation of the discharge injunction totaling $64,686.93, including $10,000 for emotional distress and over $21,000 in punitive damages.

This case serves as a stark reminder of the importance of due diligence in debt collection practices and the potential consequences of failing to adhere to the Bankruptcy Code.

Background

In July 2002, the debtor and her then-spouse filed a "no asset" Chapter 7 bankruptcy petition, listing 35 unsecured creditors, including a $7,400 credit card debt. However, the entity listed as the holder of the debt, Direct Merchants Bank, was not the actual creditor but rather was a registered trademark owned by Metris Companies. Metris Companies was not listed in the debtor's schedules.

As this was a no-asset case, meaning there was no nonexempt property available for distribution to creditors, no deadline to file proofs of claim was set under Federal Rule of Bankruptcy Procedure 2002(e). In October 2022, the debtor received her discharge under Section 727 of the Bankruptcy Code.

At some point, Metris Companies apparently assigned the credit card debt to Florida Credit Research, a debt buyer. Five months post-discharge, the debt buyer sued the debtor in state court and received a judgment in its favor. In the subsequent action for sanctions in the bankruptcy court, the debt buyer asserted that it had had no knowledge of the debtor's bankruptcy case when it filed suit, that the debtor was personally served with the state court complaint, and that the debtor failed to defend or appear in the state court lawsuit.

Nineteen years later, the debt buyer filed a motion for proceedings supplementary to execution in state court to

collect on the judgment, which by then had grown to $24,839.19. The debt buyer did not conduct a search for bankruptcy filings prior to filing its motion to determine whether the decades-old debt had been discharged.

A few days after filing its motion for proceedings supplementary, the debt buyer obtained and served a writ of garnishment on the debtor's bank. The debtor's first inkling of the debt buyer's collection efforts came shortly thereafter, when she checked her bank balance on her phone and saw that she had a negative balance.

The debtor served an answer and motion to dissolve the writ of garnishment, attaching a copy of the docket and the creditor list from her 2002 bankruptcy case — which, as noted above, erroneously listed Direct Merchants Bank rather than Metris Companies. The creditor list apparently also used the wrong address for the creditor. The debtor asserted that the debt that Florida Credit Research sought to collect nonetheless had been discharged.

The Dispute

After being notified of the debtor's bankruptcy, the debt buyer filed a motion for final judgment in garnishment in state court, asserting that the debt was an unscheduled debt that was not discharged since neither it nor the entity from which it acquired the debt was listed as a creditor in the bankruptcy. The debtor moved to reopen her bankruptcy case and filed a motion for sanctions against the debt buyer.

Despite voluntarily dissolving its writ of garnishment, the debt buyer maintained at the sanctions hearing that it should not be subject to sanctions because, it claimed, it was unclear that the underlying debt had actually been discharged due to the omission of the correct name and address of the creditor.

The debt buyer argued that in the Eleventh Circuit, which includes Florida, an unscheduled claim is not discharged unless the debtor can show that the failure to list the claim was the result of an "honest mistake," and even then the debtor would have to move to reopen the case and properly schedule the debt in order to have it discharged.

The Court's Ruling

The court rejected the debt buyer's arguments based on the Bankruptcy Code's plain text. Contrary to the common misperception that unscheduled debts are not discharged in bankruptcy, the court held that that is true only in asset cases, where Bankruptcy Code Section 523(a)(3)(A) excepts unscheduled debts from discharge to allow creditors to timely file a proof of claim.

In a no-asset case, proofs of claim are not filed, so it is irrelevant whether a creditor's claim is scheduled or the creditor has notice or knowledge of the bankruptcy. Therefore, even though the debtor had not correctly listed the credit card debt on her bankruptcy schedules, it was still discharged as a matter of law. The court characterized the debt buyer's conduct as "egregious and reprehensible," showing "a reckless or callous disregard for the law or rights of others."

The court further demolished the debt buyer's reliance on Matter of Baitcher, a 1986 decision from the U.S. Court of Appeals for the Eleventh Circuit standing for the proposition that an unscheduled debt in a no-asset case may not be discharged if the omission of the debt was due to "fraud or intentional design." In addition to casting doubt on the nearly 40-year-old opinion, the court found it completely inapplicable as there was no allegation that the

debtor in this case had fraudulently or intentionally misidentified the holder of the credit card debt.

Takeaways

The court's ruling clarifies the common misconception about the dischargeability of unscheduled debts in no-asset bankruptcy cases. It emphasizes that in no-asset cases, the scheduling of a creditor's claim or the creditor's knowledge of the bankruptcy is irrelevant.

Importantly, the court's ruling explains that Baitcher does not stand for the proposition that a debtor has the burden to reopen her case to seek a determination of the dischargeability of unscheduled debt in order for that debt to be discharged — something that, until now, appeared to be a fair reading of the Eleventh Circuit's opinion. This clarification provides valuable guidance for debt collectors and creditors alike, indicating that unscheduled debts are discharged as a matter of law in no-asset cases.

The case also serves as a cautionary tale for debt collectors, demonstrating that a mere subjective belief that a debt has not been discharged will not shield them from significant sanctions. In addition to compensatory sanctions for attorney fees and expenses and emotional distress, the court also awarded significant punitive damages, finding that there was no "fair ground of doubt" as to whether collection of the debt violated the discharge injunction notwithstanding the debt collector's subjective belief to the contrary.

In conclusion, McIntosh underscores the importance of due diligence in debt collection practices. Entities seeking to collect a debt should first perform a PACER search for bankruptcy filings to determine whether the debtor has filed a bankruptcy since the incurrence of the debt.

They should also understand that a debt does not need to be scheduled correctly — or even scheduled at all — in a no-asset Chapter 7 bankruptcy case to be discharged. Thus, if a bankruptcy case has been filed, the debt collector is on notice that all debts — unless otherwise excepted from discharge — have most likely been discharged as a matter of law, and that any efforts to collect such debts may subject the collector to compensatory and punitive sanctions.

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