

Post-Taggart, Debtors May Face Higher Pleading Standard

By **Shane Ramsey and John Baxter** (August 23, 2019, 2:06 PM EDT)

The recent decision from the United States District Court for the Middle District of Alabama in Moore v. Automotive Finance Corp.^[1] demonstrates how the U.S. Supreme Court's decision this term in Taggart v. Lorenzen^[2] means that a complaint can be dismissed for failure to state a claim even if it plausibly alleges a violation of the discharge injunction.

Before turning to the case in question, a brief recap of the Supreme Court's decision in Taggart is warranted.

The Taggart Decision

In Taggart, the Supreme Court rejected a strict-liability standard for the imposition of contempt for violating the discharge injunction. Instead, the justices unanimously held that the bankruptcy court may "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."^[3]

The decision also rejected the U.S. Court of Appeals for the Ninth Circuit's idea that a subjective, good faith belief about the inapplicability of the discharge injunction is a defense to contempt.^[4]

In so holding, the court said the outcome was informed by Section 524(a)(2), the statutory discharge injunction, and by Section 105(a), the bankruptcy version of the All Writs Act. The court reasoned that its conclusion rested upon a long-standing interpretive principle: When a statutory term is "obviously transplanted from another legal source," it "brings the old soil with it."^[5]

The court explained that the Bankruptcy Code provides that a discharge order "operates as an injunction," under Title 11, Section 524(a)(2), and that a court may issue any "order" or "judgment" that is "necessary or appropriate" to "carry out" other bankruptcy provisions, 11 U.S.C.A. Section 105(a), and that these provisions, bring with them the "old soil" that has long governed how courts enforce injunctions.^[6]

The court added that in cases outside the bankruptcy context, the court has said that civil contempt should not be found "where there is [a] fair ground of doubt as to the wrongfulness of the defendant's conduct,"^[7] and for the notion that "principles of 'basic fairness requir[e] that those enjoined receive explicit notice' of 'what conduct is outlawed' before being held in civil contempt."^[8]

The court said that this standard is generally an objective one, and a party's subjective belief that she was complying with an order ordinarily will not insulate her from civil contempt if that belief was objectively unreasonable. But subjective intent is not always irrelevant, the court added. Civil contempt sanctions may be warranted when a party acts in bad faith, and a party's good faith may help to determine an appropriate sanction, the court



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explained.

These traditional civil contempt principles apply straightforwardly to the bankruptcy discharge context, the court reasoned, holding that under the fair ground of doubt standard, 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.

Given that the “typical discharge order entered by a bankruptcy court is not detailed,” the court held that civil contempt “therefore 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.”[9]

The Moore Case

In Moore, the debtor, an operator of a used-car dealership, filed a Chapter 7 petition in 2012. The debtor obtained a discharge, which, among other debts, discharged a \$70,000 personal liability to an auto finance company.[10]

After the bankruptcy case was closed, the debtor formed a new corporation to sell used cars. The new business required access to online and physical auctions of used cars. As described in the debtor’s complaint, a company known as AuctionAccess approved credentials allowing used car dealers to participate in auctions throughout the country. Allegedly, the finance company persuaded AuctionAccess to withhold credentials for the debtor’s new company.[11]

Having been barred by the finance company from receiving credentials from AuctionAccess to buy cars at auction, the debtor struck a deal to pay the finance company \$2,000. In return, the finance company withdrew its objection, thus allowing the debtor’s new company to obtain credentials for participating in auctions.[12]

The debtor then reopened his 2012 bankruptcy and filed a complaint alleging that the finance company violated the discharge injunction under Section 524(a). The bankruptcy court dismissed the complaint under Rule 12(b)(6) for failure to state a claim.[13]

On appeal, the district court upheld dismissal in an opinion issued on July 24, 2019. Applying the law to the facts, the court began with Taggart, noting that someone cannot be held in contempt of the discharge injunction if there was “an objectively reasonable basis for concluding that the creditor’s conduct might be lawful.”[14]

The court then set forth four pertinent rules regarding discharge: (1) discharge does not eliminate the underlying debt, only the debtor’s personal liability; (2) a creditor is not required to do business with someone who has received a bankruptcy discharge; (3) a creditor can require a debtor to repay a discharged debt as a condition to continuing a business relationship; and (4) a debtor can elect to pay a discharged debt.[15]

Implications of the Moore Opinion

In Moore, the court found that because there was a “reasonable basis” for believing that the creditor’s conduct did not violate the discharge injunction, the creditor could not be held in contempt under Taggart.

Prior to Taggart, however, the debtor might have stated a plausible claim for a discharge

violation, at least if the complaint included allegations that the finance company caused AuctionAccess to depart from its usual business practices.

In other words, in a post-Taggart world, it is no longer sufficient to state a plausible claim for violation of the discharge injunction. The debtor must assert an ironclad claim to survive a motion to dismiss. In effect, the Taggart decision has raised the bar for pleading a discharge injunction violation for debtors and their counsel. Debtors seeking to raise such claims must now plead with particularity that the actions alleged to be in violation of the discharge injunction have no “reasonable basis” for the creditor’s belief that the actions were not in violation of the discharge injunction.

While it is too early to tell how other courts will interpret the “reasonable basis” standard articulated in Taggart, the immediate impact appears to be a heightened pleading standard for alleging such violations. Both sides of the bankruptcy bar should take note, as discharge injunction violations and the sanctions associated therewith have traditionally been a powerful tool in a debtor’s arsenal with respect to preserving his or her fresh start. The imposition of a “reasonable basis” standard provides creditors with a new defense to these claims and could result in further dismissals of discharge injunction violations in the future.

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[1] No. 2:19-cv-223-ALB, 2019 WL 3323328 (M.D. Al. July 24, 2019).

[2] ___ U.S. ___, 139 S. Ct. 1795 (2019).

[3] Id. at 1801.

[4] Id. at 1802.

[5] Id. at 1801.

[6] Id.

[7] Id. at 1801-02 (citing California Artificial Stone Paving Co. v. Molitor, 113 U.S. 609, 618 (1885) (emphasis in original)).

[8] Id. at 1802 (citing Schmidt v. Lessard, 414 U.S. 473, 476 (1974) (per curiam)).

[9] Id.

[10] Moore v. Auto. Fin. Corp., 2019 WL 3323328, at *1.

[11] Id.

[12] Id.

[13] Id.

[14] Id. at *2.

[15] Id.