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Supreme Court Rules That State-law Non-judicial Foreclosure Proceedings Are Not Generally Subject to the Fair Debt Collection Practices Act

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Earlier this year the United States Supreme Court issued its unanimous decision in *Obduskey v. McCarthy & Holthus LLP*, 139 S. Ct. 1029 (2019), which held that the most significant provisions of the Fair Debt Collection Practices Act, 15 U.S.C. § 1692 *et seq.* ("FDCPA"), do not apply to persons engaged in state-law non-judicial foreclosure proceedings. This decision has already been applied to a foreclosure by advertisement under Michigan law, and is likely to be an ongoing source of litigation.

The Facts

Dennis Obduskey bought a home in Colorado with a $329,940 loan secured by the property; two years later he defaulted. In 2014, the mortgage holder hired a law firm, McCarthy & Holthus LLP ("McCarthy"), to act as its agent to carry out a non-judicial foreclosure under Colorado law. McCarthy first sent Obdusky a letter advising that it had been instructed to commence foreclosure against the property, disclosed the amount of the debt, and identified the creditor. The letter purported to provide notice pursuant to the FDCPA and Colorado law. Obdusky responded with a letter invoking § 1692g(b) of the FDCPA, which provides that if a consumer disputes the amount of a debt, then the "debt collector" must "cease collection" until it "obtains verification of the debt" and mails a copy to the debtor. *Obduskey*, 135 S. Ct. at 1035.

Instead, McCarthy initiated a non-judicial foreclosure action by filing a notice of election and demand with the county public trustee pursuant to Colorado law. The notice stated the amount due and advised that the public trustee would sell the property for the purpose of repaying the indebtedness. *Id.*

Obdusky then filed a lawsuit in federal court alleging that McCarthy had violated the FDCPA by, among other things, failing to comply with the verification procedure. The district court dismissed the lawsuit on the ground that McCarthy was not a "debt collector" within the meaning of the FDCPA so that the relevant provisions (*i.e.*, verification of debt requirement) did not apply. The Tenth Circuit affirmed, concluding that the "mere act of enforcing a security interest through a non-judicial foreclosure proceeding does not fall under" the FDCPA. The Supreme Court granted *certiorari* to resolve a circuit split. *Id.*

Relevant Language of the FDCPA

The Court began its analysis by quoting what it called the "primary definition" of the term "debt collector" which "means any person . . . in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or asserted to be owed or due another." *Id.* at 1035-6.

However, the Court noted that the third sentence of the definition of "debt collector" provided what the Court called the "limited-purpose" definition:

> For the purpose of section 1692f(6) [the] term [debt collector] also includes any person . . . in any business the principal purpose of which is the enforcement of security interests. [*Id.* at 1036 (emphasis added)]

The referenced § 1692f(6) prohibits a "debt collector" from "taking or threatening to take any non-judicial action to effect dispossession or disablement of property if – (A) there is no present right to possession of the property . . .; (B) there is no present intention to take possession of the property; or (C) the property is exempt by law from such dispossession or disablement." *Id.*

The Court noted that the rest of the FDCPA imposed "myriad other requirements on debt collectors" including that they may not use or threaten violence or make repetitive annoying

phone calls, or make false, deceptive, or misleading representations in connection with a debt, like misstating the debt's "character, amount, or legal status." *Id.* (citing §§ 1692d & 1692e).

The Court Rules That McCarthy Was Not Subject to Most of the FDCPA

The Court first noted that, if the definition of "debt collector" had consisted only of the "primary definition," then a person engaged in non-judicial foreclosure proceedings would easily qualify as a "debt collector" for all purposes under the FDCPA, since foreclosure is a means of collecting a debt. *Id.*

But the Court noted that the term "debt collector" also contains the "limited purpose" definition which the Court said posed "an insurmountable [] obstacle to subjecting McCarthy to the main coverage of the [FDCPA]." *Id.* The "limited purpose" definition states that "*[f]or the purpose of section 1692f(6)*" a "debt collector" "*also* includes" a business, like McCarthy, "the principal purpose of which is the enforcement of security interests." *Id.* at 1037 (quoting § 1692a(6) (emphasis added)). This phrasing, especially the word "also," was critical to the Court's analysis:

> This phrase, particularly the word "also," strongly suggests that one who does no more than enforce security interests does *not* fall within the scope of the general definition. Otherwise, why add this sentence at all?

Id.

Had Congress wanted to simply emphasize that "debt collector" includes those engaged in the enforcement of security interests, it would not have included the word "also." Moreover, if security-interest enforcers were covered by the primary definition, why would Congress have had to say anything about § 1692f(6)? *Id.*

Thus, the Court concluded that "giving effect to every word of the limited-purpose definition, narrows the primary definition, so that the debt-collector-related prohibitions of the

FDCPA [except for § 1692f(6)] do *not* apply to those who, like McCarthy, are engaged in no more than security-interest enforcement." *Id.* (emphasis in original).

Second, the Court stated its belief that Congress may have chosen to treat security-interest enforcement differently from ordinary debt collection in order to avoid conflicts with state non-judicial foreclosure schemes. Colorado's non-judicial foreclosure scheme provided certain protections designed to protect homeowners. Certain features of such state laws, such as advertising a foreclosure sale (an essential element of such laws), might conflict with the provision of the FDCPA which "broadly limits debt collectors from communicating with third parties 'in connection with the collection of any debt.' § 1692c(b)." *Id.*

Third, the Court relied on the legislative history of the FDCPA. Congress had considered a version of the statute that would have subjected security-interest enforcers to the full coverage of the FDCPA, as well as a version that would have totally excluded such persons. The final language enacted appeared to have the earmarks of a compromise: "The prohibitions contained in § 1692f(6) will cover security-interest enforcers, while the other 'debt collector' provisions of the [FDCPA] will not." *Id.* at 1037-8.

The Court cautioned that just because security-interest enforcers were not subject to the bulk of the FDCPA "is not to suggest that pursuing non-judicial foreclosure is a license to engage in abusive debt collection practices like repetitive nighttime phone calls; enforcing a security interest does not grant an actor blanket immunity from the [FDCPA]." *Id.* at 1039-40. However, since McCarthy had taken only the steps required by state law, the Court did not have to consider what other conduct might transform a security-interest enforcer into a debt collector subject to the main coverage of the FDCPA. *Id.* at 1039-40. Neither was the Court concerned that its decision would "open a loophole, permitting creditors and their agents to engage in a host

of abusive practices forbidden by the [FDCPA]." *Id.* at 1040. The Court seemed satisfied that states could guard against such practices or that Congress could expand the reach of the FDCPA. *Id.*

Applicability to Michigan's Foreclosure by Advertisement Process

Of course, Michigan law has its own non-judicial foreclosure process called "foreclosure by advertisement," MCL 600.3201 *et seq*. Like Colorado law, this law requires certain communications to and about the debtor, including notice of foreclosure being posted on the property as well as public notice of the foreclosure sale by publication in the local newspaper for four consecutive weeks.

At least one court has had occasion to apply *Obduskey* in the context of a Michigan foreclosure by advertisement. In *Thompson v. Five Brothers Mortgage Co. Services and Securing, Inc.*, 2019 WL 2051798 (W.D. Mich.), decided by Chief Judge Robert Jonker, the plaintiff (Thompson) had defaulted on a mortgage, causing the mortgagee to pursue non-judicial foreclosure by advertisement under Michigan law, at which it purchased the property at a sheriff's sale. After the redemption period had expired, the mortgagee's agent (defendant Five Brothers) secured the home by changing the locks, conducted maintenance and removed plaintiff's personal property that she had left behind. All of this was done without any state court order of eviction or order adjudicating rights to the home, although after the redemption period had run. *Thompson*, 2019 WL 2051798, *1. Ultimately, plaintiff learned that her personal property had been thrown out and sued Five Brothers alleging violation of the FDCPA and Michigan's anti-lockout statute. *Id.* at *2. When the case was first filed, the controlling law was *Glazer v. Chase Home Fin. LLC*, 704 F3d 453 (6th Cir. 2013), in which the Sixth Circuit had ruled that "mortgage foreclosure is debt collection under the" FDCPA. *Glazer*, 704 F3d at 464.

While Judge Jonker was attempting to schedule the trial, the Supreme Court issued *Obduskey*. Judge Jonker ordered the parties to address the impact of *Obduskey* which had abrogated the Sixth Circuit's decision in *Glazer*.

Judge Jonker first ruled that defendant was not a "debt collector" even under the "limited purpose" definition of that term. By the time defendant had entered the property, "the mortgagee had already recovered the property by exercising its foreclosure rights, buying the property at a sheriff's sale, and allowing Plaintiff's full redemption period to run In short, by the time [defendant] entered the property, the security interest had already been enforced by the mortgagee, and so [defendant] itself could no longer have been doing anything to enforce it. It could not, therefore, fall within the limited-purpose definition of a debt collector under the FDCPA." *Thompson* at *3 (emphasis added).

Judge Jonker then addressed, in the alternative, the outcome if defendant was found to be a "debt collector" under the limited-purpose definition, ruling that there would be no FDCPA violation under § 1692f(6), which prohibits non-judicial action to take possession of property subject to a security interest in only three situations: if there is no present right to possession, if there is no present intention to take possession, and if the property is exempt. *Id*. at *4-5.

Judge Jonker found that none of these applied. As to the last two situations, he found that there was obviously an intention to take possession (as shown by the completion of the foreclosure process) and that the property was not exempt. He ruled that the first situation also did not apply because the mortgagee, as the successful purchaser at the sheriff's sale, "had a right to possession under the terms of the mortgage and applicable law as long as entry would be achieved without breach of the peace, as happened here." *Id.* at *5 (citing *Bryan v. JPMorgan Chase Bank*, 304 Mich. App. 708, 713; 848 N.W.2d 482, 485 (2014), for the proposition that "If

a mortgagor fails to avail him or herself of the right of redemption, all the mortgagor's rights in and to the property are extinguished."). By the time defendant entered the property, it was doing so as a contractor of the party entitled to possession as a matter of law. Thus, defendant had committed no violation of the FDCPA. The court then dismissed plaintiff's sole remaining state law count.

Thompson is only the first of what is likely to be numerous cases testing the limits of the Supreme Court's decision in *Obduskey* in the context of Michigan's foreclosure by advertisement process. Among other things, courts will have to decide what "other conduct" beyond what is strictly needed to comply with Michigan law might transform a security-interest enforcer into a general-purpose "debt collector" subject to the fully panoply of the FDCPA.

NO FAIR GROUND OF DOUBT

Taggart v. Lorenzen

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The Supreme Court's June 3, 2019 ruling in *Taggart v. Lorenzen*, __ U.S. __, 139 S. Ct. 1795 (2019) established a new standard for determining whether a creditor can be held in civil contempt for violating the bankruptcy discharge injunction.

The Case Below

Taggart, as part owner of a company in Oregon, was sued in state court by his company and two of its other owners for breach of the company's operating agreement. Before trial, Taggart filed a Chapter 7 bankruptcy petition and subsequently received his discharge. After the discharge was entered, the Oregon state court entered judgment against Taggart in the prior proceeding. Subsequently the plaintiffs requested and received an additional judgment against Taggart in the state court for the attorney's fees they incurred in prosecuting the suit after Taggart filed bankruptcy.

The state court and later the bankruptcy court held that the judgment for postpetition attorney's fees was not discharged in Taggart's bankruptcy because Taggart had participated in the state court suit after filing bankruptcy. On appeal, the federal district court disagreed and held that plaintiffs had violated Taggart's discharge order by attempting to collect their attorney's fees.

On remand, the Bankruptcy Court was required to determine if plaintiffs should be held in civil contempt for violating the discharge order. To make this determination, the court held that civil contempt sanctions were permissible irrespective of the creditor's beliefs, so long as the creditor was "aware of the discharge" order and "intended the actions which violated" it. *Taggart* v Lorenzen 139 S. Ct. at 1799, quoting the opinion of the bankruptcy court below at *In re Taggart*, 522 B.R. 627, 632 (Bkrtcy. D.Ct. Ore. 2014). The Bankruptcy Court found that the creditor in this case was aware of the discharge and intended the actions which violated the discharge. As a result, the Bankruptcy Court held plaintiffs in civil contempt for violating the discharge order and awarded Taggart more than $100,000 in attorney's fees, $5,000 for emotional distress and $2,000 in punitive damages.

The Ninth Circuit Court of Appeals subsequently vacated the finding of contempt and the damage award. Using a subjective standard, the court of appeals held that a court cannot hold a creditor in civil contempt for violating a discharge order if the creditor had a good faith belief that the discharge order did not apply to the creditor's claim, even if the creditor's belief was unreasonable. *In re Taggart,* 888 F. 3d 438, 444 (9th Cir. 2018).

The Supreme Court's Holding

On appeal, the Supreme Court held that both of the courts below applied the improper standard for contempt, vacated the appeals court judgment and remanded the case to the appeals court for further proceedings.

Initially the Court considered but rejected the subjective standard applied by the ninth circuit. The Court observed that the subjective standard was "inconsistent with traditional civil contempt principles, under which parties cannot be insulated from a finding of civil contempt based upon their subjective good faith." 139 S. Ct. at 1802-03

In rejecting the subjective standard the Court also noted that it "relies too heavily on difficult - to - prove states of mind. And it may too often lead creditors who stand on shaky 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." *Id. at 1803.*

The Court then considered, but rejected, the standard used by the Bankruptcy Court which permitted a finding of civil contempt if the creditor was aware of the discharge order and intended the actions that violated the order.[1] The Court noted that this standard was akin to a strict liability standard "because most creditors are aware of discharge orders and intend the actions they take to collect a debt". *Id*. Therefore, it concluded that such a standard "would authorize civil contempt sanctions for a violation of a discharge order regardless of the creditor's subjective beliefs about the scope of the discharge order, and regardless of whether there was a reasonable basis for concluding that the creditors conduct did not violate the order". *Id.*

After dismissing the standards used by the lower courts, the Supreme Court held that "a court may hold a creditor in civil contempt for violating a discharge order if there is no fair

[1] This is the standard generally used by Bankruptcy Courts in the Sixth Circuit. See McCool v. Beneficial (In re: McCool), 446 B.R. 819, 823 (Bankr. N.D. OH 2010); In re: Waldo 417 B.R. 854, 891 (Bankr. E.D. Tenn 2009) and Gunter v. O'Brien & Assoc. 389 B.R. 67, 72 (Bankr. S.D. OH 2008)

ground of doubt as to whether the order barred the creditor's conduct. In other words civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful." *Id. at 1799.* The Court concluded, "Under the fair ground of doubt standard, 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" *Id. at 1802*

Old Soil

In reaching its conclusion the Court found that general principles governing injunctions apply in the context of a bankruptcy discharge violation. The Court stated "the statutes specifying that a discharge order 'operates as an injunction,' § 524(a)(2), and that a court may issues any 'order' or 'judgment' that is 'necessary or appropriate' to 'carry out' other bankruptcy provisions, § 105(a), brings with it the 'old soil' that has long governed how courts enforce injunctions. That 'old soil' includes the 'potent weapon' of civil contempt. *Id. At 1801 (citations omitted).*

The Court cautioned however that "the bankruptcy statutes … do not grant courts unlimited authority to hold creditors in civil contempt. Instead as part of the 'old soil' they bring with them, the bankruptcy statutes incorporate the traditional standards in equity practice for determining when a party may be held in civil contempt for violating an injunction." *Id.* As stated by the Court this includes principles of basic fairness which "require that those enjoined receive explicit notice of what conduct is outlawed before being held in civil contempt." *Id. at 1802 (citations omitted).*

The Court then emphasized that the 'no fair ground of doubt' standard is an objective standard. "We have explained before that a party's subjective belief that she was complying with an order ordinarily will not insulate her from civil contempt if that belief is obviously unreasonable. … 'the absence of willfulness does not relieve from civil contempt.'" Id. (citations omitted). The Court also stated, however, that subjective intent is not always irrelevant and that civil contempt sanctions may be warranted when a party acts in bad faith. *Id*.

It is important to note that the standard set forth by the Supreme Court in *Taggart* applies only in the case of a violation of the discharge injunction. It does not apply to a violation of the automatic stay. *Id. At 1803-04*.

Conclusion

Upon review of the Supreme Court's opinion in Taggart, it does not appear the fair ground of doubt standard set forth by the Court will replace the standard currently used by courts in the 6th circuit (and other circuits). Instead, it appears the standard will add an important element to the test used to determine if civil contempt sanctions are appropriate in the event someone is found to have violated the discharge injunction. It appears that from here forward a creditor may be held in contempt for violating the discharge injunction if:

1. The creditor was aware of the bankruptcy discharge;
2. The creditor intended the actions they took to collect the debt; and
3. There was no fair ground of doubt as to whether the discharge order banned the creditor's conduct.

Only time will tell how this new standard is ultimately applied by the courts.[2]

[2] On August 14, 2019 Judge Boyd issued his opinion in In re: Cantrell U.S. Bankruptcy Court W. D. MI Case no. 10-0324 which briefly addressed the standard set out in the Taggart decision. Importantly Judge Boyd noted that Taggart "did not abandon the requirement that the creditor must have knowledge of the bankruptcy case and/or the discharge order as prerequisites to a finding of contempt" *Id at p. 16, fn 5. (citations omitted).*