By Jeana K. Reinbold

Can Stale Debt Claims Be Paid in Bankruptcy?

Editor's Note: *The* Crawford *decision has been the subject of several recent* ABI Journal *articles; explore the* Journal *archive at abi.org/abisearch.*

The issue of the permissibility of the filing of a claim in a bankruptcy case based on an out-of-statute debt has been frequently discussed since the Eleventh Circuit Court of Appeals in *Crawford v. LVNV Funding LLC* created a split of authority by holding that the mere filing of such a claim in a bankruptcy case violates the Fair Debt Collection Practices Act (FDCPA).[1] Notwithstanding *Crawford*, creditors have maintained that the mere filing of an accurate proof of claim does not — and many courts have agreed. In most states, the debt remains valid, although remedies have been limited.[2]

On the other hand, many debtors' advocates have taken the position that the filing of a stale proof of claim in bankruptcy is virtually indistinguishable from seeking to collect on it and enforce it.[3] As the protections of the Bankruptcy Code and system are inadequate to protect vulnerable debtors, FDCPA liability should also strictly attach against debt collectors who file claims on account of stale debt in bankruptcy cases.[4]

As a trustee, I have recently struggled with the issue of how to properly address such claims. If state law provides that the underlying debt is not extinguished, should such claims automatically always be objected to in bankruptcy cases? Under what circumstances (if any) can or should such claims be paid? This article summarizes (1) a situation concerning stale debt from a recent case in which I served as chapter 7 trustee; (2) the apparent conflict between the permissibility and allowance of such claims; and (3) how I have decided to approach the treatment of claims for stale debt in bankruptcy, until our local courts or controlling precedent dictate otherwise.

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Recent Case of Out-of-Statute Debt

Recently, a debtor filed for chapter 7 in January 2015, and I was appointed trustee. Copies of filed federal and state tax returns for the tax year 2014 showed that the debtor expected to receive tax refunds totaling more than $7,500, only a partial amount of which could be claimed exempt under Illinois law. Following the § 341 meeting, I set a claim date with the bankruptcy court and sent a demand letter for turnover of the refunds to the debtor's attorney. The debtor promptly complied and turned over a little more than $6,400 to me as trustee.

> **As stale debt claims remain viable under most state laws and the Bankruptcy Code's definition of a "claim" clearly encompass them, it appears that such claims may be paid *pro rata* with other allowed general unsecured claims absent prejudice to the debtor.**

The debtor's original schedules listed no secured creditors and 13 different unsecured creditors with total debt exceeding $54,000. Following passage of the bar date, however, I made the curious discovery that only one creditor had filed a proof of claim in the case. The claim exceeded the amount that I had collected, but the attachment to the claim indicated that the date of the last transaction, payment and charge-off for the account occurred in 1996. If the attachment was correct, it appeared that the debt was well past the applicable statute of limitations for legal enforcement in Illinois.

The dilemma: Was I duty-bound to object to the only claim filed in the case based on its stale status? It was notable that such an objection would be at my own expense as it would eliminate my compensation for collection of the asset in the case.[5]

1 *Compare Crawford v. LVNV Funding LLC*, 758 F.3d 1254 (11th Cir. 2014), *with Simmons v. Roundup Funding LLC*, 622 F.3d 93, 96 (2d Cir. 2010), and *Walls v. Wells Fargo Bank NA*, 276 F.3d 502, 510 (9th Cir. 2002); *see also Broadrick v. LVNV Funding LLC and Resurgent Capital Servs. LP (In re Broadrick)*, 532 B.R. 60, 66-68 (Bankr. M.D. Tenn. 2015) (collecting and discussing cases).

2 Alane A. Becket and William A. McNeal, "A Claimant's Dilemma: The Statute of Limitations and Proofs of Claims," XXXIV *ABI Journal* 4, 50-51, 104, April 2015; *see also* Susan E. Trent, "*Crawford* Surprises: Stale Debt, FDCPA and Proofs of Claim," XXXIII *ABI Journal* 10, 14, 82-83, October 2014. Both of these articles are available at abi.org/abi-journal. *See Broadrick*, 532 B.R at 74 n.8; *see, e.g., Buchanan v. Northland Grp. Inc.*, 776 F.3d 393, 396-97 (6th Cir. 2015).

3 James J. Haller and Tara Twomey, "Debt Collectors Should Not Get a Free Pass in Bankruptcy," XXXIV *ABI Journal* 11, 30, 71, November 2015, *available at* abi.org/abi-journal.

4 *Id.*

5 Compensation for chapter 7 trustees is typically based on distributions to creditors, which does not include surplus funds returned to the debtor. *See* 11 U.S.C. § 326.

Conflict Between Claim Validity and Claim Allowability?

As is familiar to bankruptcy practitioners, § 502(a) of the Bankruptcy Code provides that a claim or interest is deemed allowed unless a party-in-interest objects.[6] It is also indisputable that the concept of a claim is defined broadly in the Code.[7] Section 101(5) further specifies that a claim is a "right to payment," even if such right is "disputed."[8]

Significantly, for a stale debt, most state laws provide that the statute of limitations limits the remedies, but does not extinguish the underlying debt.[9] Courts have noted that "[a] debt remains a debt even after the statute of limitations has run on enforcing it in court."[10] Creditors are generally permitted, with limitations, to pursue collection of even a stale debt.[11]

Based on these principles, it seems difficult to escape the conclusion that even a stale debt is still a valid debt for which a claim can be filed. However, it also seems equally clear that such a claim should not be allowed, at least where allowance of the claim would adversely affect the debtor.

Section 502(b) of the Bankruptcy Code enumerates grounds on which an objection to a claim might be made. One of these grounds is where a claim is unenforceable *against the debtor and property of the debtor*.[12] Where the statute of limitations for enforcement on a debt has run, a claims objection made on such grounds should also be sustained.

Overlapping the tension between a valid claim and an allowable claim is the principle that the case trustee has a duty to examine the proofs of claims and object to the allowance of any claim that is improper, if a purpose would be served.[13] I thought carefully about the question of what purpose would be served by an objection to a claim for stale debt in light of the forgoing principles.

6 11 U.S.C. § 502(a).
7 11 U.S.C. § 101(5); *see also Johnson v. Home State Bank*, 501 U.S. 78, 83-84 (U.S. 1991) (adopting broadest available definition of "claim" and determining that mortgage interest is a claim even after debtor's personal obligations have been extinguished).
8 11 U.S.C. § 101(5).
9 *See Broadrick*, 532 B.R at 74 n.8.
10 *See, e.g., Buchanan v. Northland Grp. Inc.*, 776 F.3d 393, 396-97 (6th Cir. 2015).
11 *See McMahon v. LVNV Funding LLC*, 744 F.3d 1010, 1020 (7th Cir. 2014) (noting that FDCPA is violated if debtor was misled into believing that debt was legally enforceable when it was not, but that it was not automatically improper for debt collector to seek repayment of stale debt as some debtors may feel moral obligation to pay).
12 11 U.S.C. § 502(b)(1) (emphasis added).
13 11 U.S.C. § 704(a)(5).

Determining "Purpose to Be Served"

In this case, I ultimately concluded that the claim based on stale debt was not proper and should be objected to[14] because the stale debt claim was not enforceable against the debtor, yet if it were disallowed, a surplus would go back to the debtor. Since a debtor would have an interest in a surplus case and the claim impeded the debtor's access to any surplus, objection seemed warranted.

Extending this reasoning, I have determined that in general I will object to a claim based on stale debt where it makes a difference to the debtor. Aside from creating a surplus to the debtor, the more frequent situation I have seen is where the successful disallowance of a claim will increase the funds available for distribution to other nondischargeable claims, such as student loans.

In most other cases, however, there appears to be no purpose to be served in objecting to such claims, at least from a distribution standpoint.[15] In a nonsurplus case in which other nondischargeable claims have not been filed, the distribution makes no difference to the debtor who is already obtaining a discharge for eligible debt.

Only other unsecured creditors are harmed by the diluted distribution, but they are the ones filing the claims.[16] In nonsurplus cases, absent a change in the law, it seems claims for stale debt, which are valid in amount, can simply be allowed and paid *pro rata* with other allowed claims.

Conclusion

As stale debt claims remain viable under most state laws and the Bankruptcy Code's definition of a "claim" clearly encompasses them, it appears that such claims may be paid *pro rata* with other allowed general unsecured claims absent prejudice to the debtor. It appears that the only reason to object to such claims would be if allowance of the claim would adversely affect the debtor or debtor's property. abi

14 One additional unsecured creditor did file a tardy claim in the case, in a much lesser amount, but provided at least one claim to pay.
15 This is not to say there might not be an occasional unusual case where it prejudices an atypical unsecured creditor, and the effect of the allowance of the claim on the distribution would be reviewed at that time.
16 A party without a pecuniary interest in the outcome of bankruptcy proceedings would not have standing to object to a distribution. *See In Cult Awareness Network Inc.*, 151 F.3d 605, 607-08 (7th Cir. 1998); *see also In re Ulz*, 401 B.R. 321, 328 (Bankr. N.D. Ill. 2009).