Bankruptcy Newsletter
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Creditors Attorney beware when filing a proof of claim

Two recent cases from the 11th Circuit point out the dangers of filing a proof of claim for an unenforceable claim or filing a proof of claim for a debt that has been discharged in a previous bankruptcy. *In re: Greenpoint Credit LLC vs. McLean,* 794 F. 3d 1313 (11 Cir. 2014) the Court determined that filing a proof of claim for a debt that had been previously discharged in a prior bankruptcy, was a violation of the discharge injunction. The court considered the sanctions for civil contempt and awarded the debtors compensatory sanctions for their emotional distress. It also entered a non-compensatory award at $50,000.00 as "coercive sanctions" to encourage Greenpoint to correct any defects in an automated computer system.

In re: Crawford LVNV Funding, the 11th Circuit Court also decided that the filing of a proof of claim by a debt collector for a debt that was stale i.e. beyond the statute of limitation and therefore unenforceable under state law constitutes a violation of the fair debt collection practices act entitling the debtor to damages.

See: *In re: Crawford* 158 F. 3d 1254 (11th Cir. 2014)

Legal Malpractice and Fiduciary Duties

In order to prevail on a complaint to except debt from discharge as one for debtor's fiduciary fraud or defalcation, a creditor must prove that (1) the debtor acted as fiduciary to creditor at the time the debt was created, and (2) the debt was caused by fraud or defalcation. 11 U.S.C.A. § 523(a)(4).

"Defalcation," within the meaning of the dischargeability exception, requires proof of a culpable state of mind involving knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior. 11 U.S.C.A. § 523(a)(4).

Recently, the Seventh Circuit upheld the ruling of a Northern District of Illinois judge who ruled that "legal malpractice debt could not be discharged because [the attorney] debtor committed a defalcation as a fiduciary to a client".

The cause of action arose when the debtor attorney allowed the home of his non-English speaking client to be sold far below its market value. What made this a case for defalcation was the fact that the debtor's attorney could not communicate with his client, relied solely on the purchasers' counsel to communicate with his client, and failed to include a life estate in the closing documents. As a result, the debtor's attorney's actions were found to be "a gross deviation from the standard of conduct that a law abiding person would observe in the debtor's situation". The $26,000 plus costs awarded to the creditor was upheld and found to be nondischargeable. *In re: Jahrling*, 816 F.3d 921.

Business Owner's Liability Was Not Extinguished by Criminal Acts of Employee

A convenience store owner in the state of Georgia authorized to sell lottery tickets in that state found herself in hot water after hiring an employee who stole from the Georgia Lottery Commission (GLC). The debtor convenience store owner failed to account for the sale of lottery tickets held in trust for the GLC, because she essentially handed the keys of the store to an allegedly larcenous employee for one month while she was pregnant. The Court held that the owner debtor was acting in a fiduciary capacity for the GLC, and allowing this employee to "run the store", was considered to be an act of "defalcation" under 11 U.S.C.A. § 523(a)(4). As a result, the debt of $30,000 owed to the GLC for proceeds purportedly misappropriated by the employee were precluded from discharge.

The reasons the Bankruptcy Court decided that "defalcation" occurred was because the debtor failed to perform due diligence when she hired the employee accused of theft. The employee was a regular customer of the store who inquired about a job at the store. The debtor owner did not perform a background check, nor did she require him to fill out an application. The only personal records she had on the employee was a phone number. The issue of "defalcation" was exacerbated by the fact that even after the owner was alerted to an unusually large number of tickets being activated, the debtor did not take immediate action.

The Court concluded, "[We] are sympathetic to the stress the debtor experienced in balancing a pregnancy and care of a newborn with the operation of a business, her conduct was such a gross deviation from the standard of conduct necessary to operate as a lottery retailer, the court cannot reach any other conclusion than the failure to account for the lottery proceeds constitutes a defalcation while acting in a fiduciary capacity." *In re Huynh,* 2016 WL 1403272 (Bkrtcy.N.D.Ga., Judge Bonapfel).

Unsuccessful Attempt to Assign Car Loan did not Violate ECOA

A car dealer that had provided financing for a borrower's car did not take "adverse action" within the meaning of the Equal Credit Opportunity Act (ECOA). The dealer unsuccessfully attempted to assign the car loan to a third-party lender. However, after the third party rejected the assignment, the dealer continued to honor the terms of the loan by allowing the borrower to keep the car as long as she made monthly payments. It was not until after the borrower failed to make the agreed payments that the dealer repossessed the car. Consequently, the dealer's actions did not constitute "adverse action" under the ECOA when the borrower failed to make the agreed payments.

Sincerely,

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