Of Paul Blart, Arbitration Agreements and Bankruptcy Discharges

A "huge controversy" in the industry

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By: Scott Brown

For several years I have been following five interesting New York lawsuits in bankruptcy court alleging a violation of the discharge injunction based on how the discharge was (or was not) reported to credit bureaus. Basically, debtors who received a discharge were disappointed to find that some of their creditors were not reporting their bankruptcy discharges to the credit bureaus, but instead were continuing to report the debt as "charged off" or "past due" in the tradelines. Why does this matter? Because, allegedly, the creditors would sell their bad debt accounts to debt collectors who, not realizing the debt was discharged in bankruptcy, continued to collect on the debt (sometimes successfully) and return a percentage of the collection to the original creditor.

(On a separate note, a lot of creditors who were allegedly engaged in this practice have since cleaned up their credit reporting to be more accurate -- and went the extra mile of deleting all tradelines of any accounts sold to debt collectors. But many lawsuits, including class actions, persist across the country.)

The creditors, not wanting to face an angry bankruptcy judge, tried to force the disputes to mandatory arbitration (a common provision in pretty much any consumer contract) while the debtors tried to keep the issue before the bankruptcy court. The bankruptcy judge said the issue was not subject to mandatory arbitration because the discharge is the fundamental right of the debtor obtained in bankruptcy and that right should not be jeopardized through decentralized resolution of claims through arbitration. This ruling was surprising because the arbitration lobbyist in this country have been stronger than the NRA; arbitration agreements, even if one-sided and buried deep in a contract, are almost always enforceable. Some of the creditors appealed.

Pausing for a minute, this legal issue reminds me a little of one of my favorite dumb movies – *Paul Blart: Mall Cop*. Early in the movie he's flirting with a woman who is working at a mall kiosk and she innocently calls him a "security guard". Paul quickly corrects her description. When she apologies, he explains: "It's just that there's a huge, huge controversy brewing in the industry right now, whether the title should be Security Guard or Officer. I'm sure you heard about it." Feigning interest, she responds: "I didn't." And he reassures her: "You will. You're gonna."

Well, the arbitration "controversy" is "huge" right now. Plaintiffs want to band together and stay in front of judges who are more sympathetic and award larger damages. Defendants want to go to arbitration and avoid the courts because it breaks up the "class action" and typically results in much lower damage awards.

Unpause again. The creditors (in separate but similar cases) appealed to the Southern District of New York. They were assigned different District Court judges. Wouldn't you know it, but one

judge said the mandatory arbitration provision applied to discharge violation litigation and the other said the arbitration provision was not enforceable. Well, the creditor who lost, appealed its case to the Second Circuit – just one court away from the U.S. Supreme Court. Surprisingly, the creditor lost again. The Second Circuit published its opinion a few days ago:

"Following the logic of [other Second Circuit cases], we find that arbitration of a claim based on an alleged violation of Section 542(a)(2) would 'seriously jeopardize a particular core bankruptcy proceeding.' *In re U.S. Lines, Inc.*, 197 F.3d at 641. We come to this conclusion because 1) the discharge injunction is integral to the bankruptcy court's ability to provide debtors with the fresh start that is the very purpose of the Code; 2) the claim regards an ongoing bankruptcy matter that requires continuing court supervision; and 3) the equitable powers of the bankruptcy court to enforce its own injunctions are central to the structure of the Code. The fact that Anderson's claim comes in the form of a putative class action does not undermine this conclusion." *In re Anderson*, 2018 WL 1177227 (8th Cir., March 7, 2018)

This is big news and a big victory for plaintiffs and their lawyers. If you haven't heard of it (other than humoring me by reading this), you're "gonna".

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Soctt Brown
Partner
602-262-5321 direct
sbrown@lrrc.com

Mr. Brown represents commercial, agricultural and private lenders, healthcare companies and other businesses in a broad array of transactions and litigation. His experience includes both in-house and outside counsel roles in loan origination and documentation, regulatory compliance, litigation in state and federal court, receiverships and bankruptcies.