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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Creditors Risk Contempt By Pursuing Invalid Debt: Justices

By **Rick Archer**

Law360 (June 3, 2019, 11:27 AM EDT) -- The U.S. Supreme Court on Monday held that a creditor can be held in contempt for trying to collect on a debt that was wiped away in bankruptcy if there is no "fair ground of doubt" that a court order barred the creditor's conduct.

The high court unanimously rejected a Ninth Circuit ruling that sanctions were barred if the creditor acted in good faith belief the debt wasn't discharged as "inconsistent with traditional civil contempt principles," but found that petitioner Radley Taggart's argument that the creditor's understanding of the discharge order should not be considered would leave the courts clogged with requests to verify whether or not debts have been discharged.

"Rather, in our view, a court may hold a creditor in civil contempt for violating a discharge order if there is no fair ground of doubt as to whether the order barred the creditor's conduct," Justice Stephen Breyer, writing for the panel, said. "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."

The appeal arises from more than a decade of litigation over Taggart's decision in 2007 to sell his share of rights in real estate development Sherwood Park Business Center to his attorney, prompting his business partners to sue in Oregon state court claiming they had a right of first refusal, according to filings in the case.

Taggart's appeal challenges a Ninth Circuit decision from April to toss out contempt sanctions that had been imposed against Taggart's creditors. Affirming a bankruptcy appellate panel in Oregon, the Ninth Circuit found that the creditors could not be held in contempt for violating the discharge because they believed in "good faith" that the discharge injunction was inapplicable.

Taggart was on the eve of a state court trial in a suit brought by his former partners in a real estate development when he filed for Chapter 7 in 2007. He was discharged from damages stemming from the civil litigation in the bankruptcy, and when the bankruptcy stay was lifted and the state court case resumed, the parties agreed they would not pursue a monetary judgment against him.

But after winning at trial, the business associates sought attorney fees from Taggart, alleging that his post-bankruptcy participation in the case fell outside the discharge. After a round of rulings and appeals in state and bankruptcy courts, the business partners were found to have willfully violated the injunction and were ordered to pay more than $110,000 in compensation and punitive damages.

The contempt was subsequently overturned by a bankruptcy appellate panel and the Ninth Circuit affirmed that the sanctions should be vacated, saying the creditors acted in good faith belief the attorney fees fell outside the discharge.

In his appeal to the Supreme Court, Taggart contended the Ninth Circuit holding conflicted with rulings in three other circuits that have established grounds for contempt when a creditor violates a discharge, regardless of "subjective beliefs or intent."

After the Supreme Court took up the case in January, Taggart argued in his brief that the Bankruptcy Code demanded that sanctions be applied for attempts to collect discharged debts, regardless of whether the creditors believed the debts were discharged.

In their reply brief the creditors argued contempt sanctions are intended for "deliberate defiance" of court orders and said a reasonable good faith defense is appropriate.

In its opinion, the Supreme Court said the standard for contempt is "generally" objective and that the Ninth Circuit was wrong to conclude that even an "unreasonable" good faith belief the debts were not discharged was a defense.

However, it said that outside of bankruptcy cases it had found contempt should not be applied if there is a "fair ground of doubt" the defendant's behavior was wrong. The panel said fully applying the standards Taggart argued for would risk additional litigation and delays in bankruptcy, harming both debtors and creditors.

"A standard resembling strict liability may lead risk-averse creditors to seek an advance determination in bankruptcy court even where there is only slight doubt as to whether a debt has been discharged," Justice Breyer said.

In a phone interview Monday, Nicole Saharsky, one of the counsel for the creditors, said the decision had established a "very fair standard" for both creditors and debtors.

"Contempt is for when you know what the court wants you to do and you don't do it," she said.

She said she believes the creditors will likely prevail under the standard established in the ruling, saying they had reasonably relied on the state court's ruling that they could collect the fees.

"When the state court told us it's OK, it's a pretty good reason to think it's OK," she said.

In an email statement Monday, Taggart counsel Daniel Geyser said he was satisfied the court had decided against the Ninth Circuit's good faith standard, saying only in "unusual" cases can a creditor point to a legitimate reason to doubt a discharge.

"The court's new standard — 'objective reasonableness' — will thus protect debtors in the vast majority of cases, including this one," he said.

In a phone interview Monday, Shmuel Vasser, a restructuring partner at Dechert LLP, said the standard in the ruling is the standard most courts already apply when deciding on contempt sanctions.

“I don’t think this is going to make a big change in the practice, because my gut tells me most people were doing it this way anyway,” he said.

Taggart is represented by Daniel L. Geyser of Geyser PC and John W. Berman.

The creditors are represented by Nicole A. Saharsky, Andrew E. Tauber, Michael B. Kimberly, Matthew A. Waring, Minh Nguyen-Dang and Aaron Gavant of Mayer Brown LLP; Janet M. Schroer of Hart Wagner LLP; James Ray Streinz of Streinz Law Office LLC; and Hollis K. McMilan.

The case is Radley Weston Taggart v. Shelley A. Lorenzen et al., case number 18-489, in the U.S. Supreme Court.

--Additional reporting by Sean Forbes and Alex Wolf. Editing by Alyssa Miller.

Update: This story has been updated with more information and with comments from the parties' attorneys.