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# UNITED STATES SUPREME COURT CLARIFIES STANDARD ON SANCTIONS FOR VIOLATING BANKRUPTCY DISCHARGE

On June 3, 2019, the United States Supreme Court in *Taggart v. Lorenzen* unanimously held that a bankruptcy court may impose contempt sanctions against a creditor for violating a discharge order where "there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful." The Court rejected the Ninth Circuit Court of Appeals' holding that a creditor's good faith belief that its collection actions did not violate the discharge order—even if unreasonable—shields the creditor from civil contempt sanctions.

A discharge order is a fundamental part of the bankruptcy system. It releases the debtor from personal responsibility for pre-bankruptcy debts, and enjoins creditors from attempting to collect a debt covered by the discharge order.

But not all debts are discharged. The Bankruptcy Code lists 19 categories of debt that are excepted from discharge. Discharge orders, however, do not specify which of the debtor's debts are discharged. As a result, it may be unclear whether a particular debt is covered by an order, leaving creditors to guess whether the debts owed to them were discharged.

In *Taggart*, the Court resolved when it is appropriate to sanction a creditor who guesses wrong and attempts to collect a debt in violation of a discharge order.

The facts of the case are unusual. Taggart transferred his interest in an Oregon limited liability company to his attorney. The company and the other owners sued Taggart in state court for transferring his interest in violation of the company's operating agreement. On the eve of trial, Taggart filed for Chapter 7 bankruptcy, which stayed the state-court litigation pending completion of the bankruptcy.

After Taggart received a bankruptcy discharge, the state-court action resumed. The state court unwound the transfer and ordered Taggart to pay the company's post-bankruptcy attorney's fees. While Taggart's discharge order would normally cover these fees, the state court concluded that Taggart "returned to the fray" of litigation after bankruptcy, thereby making him liable.

Meanwhile, Taggart returned to the bankruptcy court and asked that it hold the company and owners in contempt for violating the discharge order by seeking attorney's fees against him. The bankruptcy court denied Taggart's request, agreeing with the state court that Taggart had returned to the fray. The district court on appeal disagreed that Taggart had returned to the fray and, as a result, held that the company and owners had violated the discharge order.

On remand, the bankruptcy court imposed contempt sanctions against the company and owners for violating the discharge order. The company and owners appealed the sanctions award, and the Bankruptcy Appellate Panel reversed. Taggart appealed, and the Ninth Circuit affirmed the panel's decision. It held that a creditor's "good faith belief that the discharge injunction does not apply to the creditor's claim precludes a finding of contempt, even if the creditor's belief is unreasonable."

Justice Stephen Breyer's 11-page opinion unequivocally rejected the Ninth Circuit's "good faith belief" standard, holding that civil contempt sanctions are appropriate when there is no "fair ground of doubt" as to whether a creditor's actions violated a discharge order. The Court reasoned that the Ninth Circuit's subjective standard is contrary to traditional civil contempt principles and depends too much on "difficult-to-prove states of mind." The Court similarly rejected a near strict liability standard under which a creditor who violated a discharge order would be sanctioned, even if the creditor had an objectively reasonable basis for concluding that its conduct was lawful. Because the Ninth Circuit had applied an improper standard, the Court vacated the judgment and remanded for further proceedings consistent with the opinion.

As a practical matter, although the Court did not adopt the Ninth Circuit's subjective standard, *Taggart* is still a win for creditors because it provides some needed clarity on when creditors can be sanctioned for violating a discharge order. However, while this decision may provide peace of mind to many creditors collecting a debt after bankruptcy, it is important that creditors ensure they have an objectively reasonable argument that debts they are collecting were not discharged in bankruptcy. A failure to do so may result in civil contempt sanctions, including the debtor's attorney's fees and costs, damages for emotional distress, and punitive damages.

Creditors should also be aware that *Taggart's* standard on sanctions for violating a bankruptcy discharge order does not apply to violations of the automatic stay. Accordingly, creditors' objectively reasonable belief that their actions did not violate the automatic stay may not insulate them from sanctions.

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