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U.S. SUPREME COURT UPDATE WITH WANDA BORGES & BRUCE NATHAN: SUPREME COURT CASES AND DECISIONS THAT COULD IMPACT TRADE CREDITORS

SUPPLEMENTAL MATERIALS

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Jevic: U.S. Supreme Court Strikes Down Nonconsensual "Structured Dismissals" That Violate Bankruptcy Priority Rules

By Bruce Nathan, Esq. and Philip Gross, Esq.

The United States Supreme Court in a 6-2 decision in *Czyzewski v. Jevic Holding Corp.* ("*Jevic*") put an end to the increasingly popular practice in the bankruptcy world known as "structured dismissals," at least on a nonconsensual basis. While bankruptcy practitioners were nervous that the Supreme Court's *Jevic* decision might put an end to all types of pre-Chapter 11 plan distributions that violate the priority scheme embodied in the Bankruptcy Code, trade creditors, employees and lenders can breathe a sigh of relief because *Jevic* acknowledged that certain types of payments that are often approved by the bankruptcy court at the outset of a Chapter 11 case are not prohibited under the appropriate circumstances. Moreover, fully consensual structured dismissals are still permitted. However, lacking a fully consensual structured dismissal, the *Jevic* decision will leave debtors (and lenders funding a Chapter 11 case) with the choice of having to fund and confirm a Chapter 11 plan, dismiss the Chapter 11 case (without a structured dismissal order), or convert the Chapter 11 case to a Chapter 7 bankruptcy.

In the *Jevic* case, the creditors' committee sued Sun Capital Partners and CIT Group, arguing that a pre-bankruptcy leveraged buyout hastened *Jevic*'s bankruptcy by saddling *Jevic* with debts that it could not service. The debtor, creditors' committee, Sun and CIT ultimately reached a "structured dismissal" settlement that failed to provide for any distributions to a class of former *Jevic* truck drivers (the "WARN Claimants") that held $8.3 million in priority wage claims for pre-bankruptcy state and federal WARN Act violations.

The Bankruptcy Court approved the structured dismissal—despite the inclusion of a provision whereby low-priority general unsecured creditors would receive a distribution while the WARN Claimants would not be getting anything—over the objections of the WARN Claimants and the United States Trustee. The Bankruptcy Court ruled that such dismissals are justified in exceptional circumstances where a better alternative is not available. The District Court and Third Circuit Court of Appeals affirmed with the Third Circuit cautioning that priority-skipping structured dismissals should be approved only in "rare" circumstances.

On appeal, the Supreme Court reversed, explaining that the "rare case" exception would open the floodgates and holding that a bankruptcy court cannot "approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent." The Supreme Court explained that while the Bankruptcy Code grants a court the power to dismiss a Chapter 11 case, it does not authorize the approval of *final* and *end-of-case* distributions that deviate from the Bankruptcy Code's priority scheme.

Critically for purposes of trade creditors, employees and lenders, the Supreme Court distinguished priority-violating structured dismissals—which are now disallowed—from other types of interim distributions in Chapter 11 cases and that "serv{e} significant Code-related objectives." Specifically, the Supreme Court noted (without expressly ruling) that the following types of orders, under the appropriate circumstances, can be approved:

- "Critical vendor" orders that allow payment of essential suppliers'/trade vendors' prepetition unsecured claims;
- "First-day" wage orders that allow payment of employees' prepetition wages;
- "Roll ups" that allow lenders that continue financing the debtor to be paid first on their prepetition claims; and
- Interim distributions of settlement proceeds to fund a litigation trust that would press claims on the estate's behalf, but in a situation where the Chapter 11 case remains pending.

Critically for purposes of trade creditors, employees and lenders, the Supreme Court distinguished priority-violating structured dismissals—which are now disallowed—from other types of interim distributions in Chapter 11 cases.

SELECTED TOPIC

Wanda Borges, Esq.

SCOTUS and Technology Will Rule Credit Card Surcharge Issues

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Fifteen years ago, commercial credit grantors never dreamed of passing through the cost of accepting credit cards from their customers. Many believed this to be illegal. As it turned out, it was perfectly legal, for the most part. The true crux of the problem was that most, if not all, contracts between the merchant and the credit card provider prohibited those costs from being passed on to the customer.

Credit Card Contract Issues Resolved

In 2005, several antitrust lawsuits were commenced against MasterCard, Visa and many of the providing banks on the basis that those parties were conspiring against the merchants and restraining their trades by prohibiting the pass-through of the surcharges which the banks required the merchants to pay for the ability to accept credit card payments. The litigation was granted class-action status and continued for many years, culminating in settlements in 2013 that were claimed to be the largest antitrust settlements ever. More than $7 billion was allocated to be shared with the class of plaintiffs in various forms.

Numerous appeals were subsequently filed and much confusion remains regarding whether surcharges to customers are really legal. The lawsuit may have been won, but that did not change the laws of the 10 states and Puerto Rico that maintained statutes prohibiting the passing through of surcharges to customers by merchants. This created even more confusion! There are two major issues with these statutes that continue to cause litigation and speculation.

It is unclear whether the existing statutes are intended for business-to-business transactions or only for business-to-consumer transactions.

Do These Statutes Apply to Consumer or Commercial Transactions?

It is unclear whether the existing statutes are intended for business-to-business transactions or only for business-to-consumer transactions. Most of the 10 states contain statutory language similar to the following: "No seller…or any credit card issuer may impose a surcharge on a card holder who elects to use a credit card in lieu of payment by cash, check or similar means." Three states—Colorado, Kansas and Maine—have adopted the Uniform Consumer Credit Code. California's statute specifically uses the word "consumer." Massachusetts' statute is included under "Consumer Credit Cost Disclosure" rules. Oklahoma's statute is contained under the title "Consumer Credit Code." Texas' prohibitions are governed by the Consumer Credit Commission. Puerto Rico's statute specifically uses the word "consumer." One would believe, therefore, that the credit card surcharge pass-through prohibition in these seven states and Puerto Rico impacts consumer credit transactions and not commercial transactions. The remaining three states—Florida, Maine and New York—have statutes which do not contain even a hint that they are limited to consumer transactions. What is also interesting to note is that when the Supreme Court heard argument on the surcharge issue (*see below*), the focus was on consumers.

Are These Statutes Unconstitutional?

There have been lawsuits filed in California, Florida, New York and Texas challenging the constitutionality and legality of the surcharge prohibition.

In a lawsuit titled *Italian Colors Restaurant et al. v. Harris*, the U.S. District Court in California declared the statute prohibiting the passing through of surcharges to be unconstitutional. That case has been appealed to the 9th Circuit Court of Appeals. To date, the 2nd, 5th and 11th Circuit Courts have issued decisions on the prohibitive statutes. The Circuits are split. The 2nd Circuit Court of Appeals upheld New York's anti-surcharging law in *Expressions Hair Design v. Schneiderman*. The 5th Circuit Court of Appeals found Texas' statute to be lawful (*Lowell v. Pettijohn*). The 11th Circuit Court of Appeals in Dana's R.R. Supply found Florida's anti-surcharge law unlawful because it violated merchants' First Amendment free speech rights.

SCOTUS Oral Arguments

On Jan. 10, the U.S. Supreme Court heard oral argument on the *Expressions Hair Design v. Schneiderman* case. A decision in this case will also impact the 5th Circuit decision, which is on hold pending the ruling in *Expressions Hair Design*.

The focus was on whether or not the New York statute violates the First Amendment right of free speech with little focus on whether or not surcharge pass-through is or is not legal or whether it should be allowed. Counsel for the Petitioner (Hair Design) opened his argument by saying, "This case is about whether the state may criminalize truthful speech that merchants believe is their most effective way of communicating the hidden cost of credit cards to their customers." This is at issue because, while the New York statute and other state statutes prohibit charging a customer an additional surcharge when paying by credit card, those same statutes permit a merchant/vendor to give a discount to a customer who pays with cash. Counsel tried to persuade the justices that the merchant who wishes to truthfully tell customers that the same product will cost more if paid by credit card is punished for doing so while another merchant that tells its customers that the same product will cost less if paid by cash is rewarded. In either instance, the customer has the same pricing information. "[Y]ou can charge the two different prices, one for cash, one for credit, but what runs afoul of the law is *describing* the price difference one way as a surcharge versus a credit," the attorney said.

The justices seemed to understand the basic concept that: "Some consumers are going to pay more; some consumers are going to pay less." However, in trying to pin down counsel as to why the statute was a violation on free speech, Justice Samuel Alito said, "If it's okay to post the higher price and nothing more, and if the higher price is the credit card price, they are forcing the merchant to speak in a particular way." Justice Sonya Sotomayor also interjected, "I just don't see anything about speech in the statute…. To me, it's very simple: One price for everything." She continued by saying, "I'm hard pressed to see if that's the interpretation given to what I view as the plain meaning of the statute, that that would be unconstitutional."

The U. S. attorney suggested that the Supreme Court should send the case back down to New York to let its judges decide clearly what the statute intends.

Counsel for the respondents countered the petitioner by saying, "The plain text of New York's statute refers only to a pricing practice and not to any speech…the application of the statute is straightforward. The seller may not add to its listed prices and instead must adhere to those prices if a customer decides to pay by using a credit card." Justices similarly interrupted the attorney's prepared argument, peppering him with the same kinds of questions they had thrown at the petitioner's counsel.

The lightest moment during the arguments came when Justice Alito posited, "Suppose some kids have a lemonade stand or they're washing cars and they say a glass of lemonade is $1. Then somebody comes up to them and says, 'I'd like to buy that with a credit card.' It might happen today. That would be a violation if they put the $1 there on the assumption that everybody is going to pay cash for their lemonade. These are tech-savvy kids, so they could process a credit card purchase if they wanted to." All present laughed at the response that there was no exception for kids selling lemonade.

The decision by the Supreme Court will, I am sure, be a most interesting read. Will it solve the problem? That is the question which remains to be answered.

Technology Has Wreaked Havoc on the Antitrust Settlements

The class-action antitrust lawsuits are now under attack because of the wrongdoing of some attorneys. In December 2014, one of the attorneys representing MasterCard in the Antitrust Surcharge litigation was arrested and charged with conspiracy with an opposing attorney to defraud two law firms and a client of several million dollars. The former law firm discovered several confidential documents in counsel's possession relating to American Express. In February 2015, the firm notified the parties and the court that the elements of procedural and substantive fairness required in relation to approval of the proposed settlement may have been compromised. All federal courts permit and even mandate electronic filing of court documents. So it is no surprise that the same technology that permits one to save time and the expense of paper copies and mailing will also be the technology that nails you. Technology led to the downfall of the two attorneys and the American Express settlement. An email was discovered between the two containing attachments with the confidential documents and a statement at the end of the email which said "burn after reading." Both law firms have been thrown off the case. One of the attorneys was indicted in November 2015. The criminal prosecution against that counsel is ongoing as of this writing.

As a result, the American Express surcharge litigation is ongoing and there is risk that the MasterCard/Visa settlements could unravel.

There is no question that merchants are moving forward with ways to pass through their surcharges. The use of technology will enable those merchants to discern between states where they can do so and those where a prohibition still remains. As to the antitrust litigation, whatever the outcome in court, it will not likely change the way the credit card companies are doing business today. Thus, surcharging pass-through is here to stay in one way or another.

U.S. Supreme Court Questions Constitutionality of New York Credit Card Surcharge Ban as a Regulation of Commercial Speech

By Bruce Nathan Esq. and Andrew Behlmann, Esq.
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On March 29, 2017, in a potential, or at least temporary, victory for the plaintiffs in *Expressions Hair Design et al. v. Schneiderman*, the United States Supreme Court ruled that New York's credit card surcharge ban regulates speech, not pricing. The Supreme Court vacated the June 2016 decision of the Second Circuit Court of Appeals, which had upheld the statute as a constitutional regulation of pricing, and remanded the case to the Second Circuit with instructions to instead analyze the statute as a commercial speech regulation.

The statute at issue, New York General Business Law § 518, provides that "No seller in any sales transaction may impose a surcharge on a holder who elects to use a credit card in lieu of payment by cash, check, or similar means." Violations of § 518 carry misdemeanor criminal penalties of a fine of up to $500, imprisonment up to one year (!), or both.

Merchants accepting payments by credit card typically pay fees of approximately 1% to 5% of the amount of the transaction, depending on a number of factors, such as the brand and type of card, the nature of the merchant's business, and the amount of the transaction. The *Expressions* plaintiffs, a group of New York merchants, wanted to offset their cost of accepting credit cards by imposing a surcharge on customers who paid by credit card. Visa and MasterCard historically prohibited merchants from imposing surcharges for credit card payments, thus rendering state statutes such as § 518 redundant. However, a 2012 anti-trust settlement (currently being re-engineered after being overturned on appeal) led to modifications in the Visa and MasterCard network rules to permit merchants to pass the cost of card acceptance onto customers through a surcharge at the point of payment. This change promptly brought a handful of state statutes banning credit card surcharges, such as § 518, back into the news and the courts.

Although § 518 prohibits merchants from adding surcharges to credit card transactions, it does *not* preclude merchants from raising prices across the board and offering a discount for payment by cash or check. For instance, under § 518, charging $20.00 for a product and adding a $1.00 surcharge for credit card payments would be forbidden, but charging $21.00 for the same product and offering a $1.00 discount for cash or check payment would not. In either instance, however, the fundamental economic reality is *exactly the same*: a customer paying for the product in cash will pay $20.00, while a customer paying for the same product with a credit card will pay $21.00.

The *Expressions* plaintiffs filed a lawsuit against the New York Attorney General in June 2013 in the United States District Court for the Southern District of New York, seeking two forms of relief: first, a declaration that § 518 is unconstitutional and preempted by other federal laws, and second, an injunction preventing the state from enforcing the statute. The plaintiffs asserted, among other things, that § 518 unconstitutionally restricts the manner in which they can communicate their pricing to customers. In the hypothetical scenario above, customers would pay the exact same prices under either the (forbidden) surcharge arrangement or the (permissible) discount structure. The only difference is in the words used to define the two pricing schemes. That seemingly arbitrary distinction, the plaintiffs argued, infringed on their First Amendment rights. The merchants – for obvious reasons – wanted the ability to maintain and post their usual prices, but charge an additional fee for credit card payments to properly reflect the added costs imposed by the credit card networks.

The merchants prevailed in the District Court. That court adopted the merchants' view that, among other infirmities, § 518 is unconstitutional because it impermissibly regulates speech by drawing an arbitrary distinction between the words "discount" and "surcharge" even though there is no difference whatsoever between the economic realities of the two pricing structures.

The Second Circuit reversed the District Court, holding that § 518 is *not* unconstitutional. Rather, the Second Circuit ruled that § 518 is simply a pricing regulation and that it is "far from clear" that the statute prohibits a dual pricing scheme (i.e., posting separate prices for cash and credit, as opposed to a single price plus a surcharge for a particular mode of payment). The Supreme Court granted certiorari to review the Second Circuit's decision.

In the Supreme Court, the merchants waived a facial challenge to the overall constitutionality of § 518, and instead challenged the statute only as it has been or could be applied to them in one particular pricing scenario: posting a single cash price and an additional credit card surcharge (either as a percentage of the price or a fixed amount). The Supreme Court agreed with the Second Circuit's determination that § 518 would bar this type of pricing arrangement. However, the Supreme Court rejected the Second Circuit's holding that § 518 is simply a pricing regulation and instead held that § 518 regulates speech because it regulates "the ***communication*** of prices ***rather than prices themselves …***" (emphasis added).

The Supreme Court's determination that § 518 regulates commercial speech is not the end of the story. While some commentators have predicted that the *Expressions* plaintiffs have a strong chance of prevailing on remand, the Supreme Court did not offer any insight on whether § 518 is a constitutional regulation of commercial speech. The commercial speech doctrine is not as well-developed as the Supreme Court's jurisprudence regarding individual speech, nor are the protections as robust. The Supreme Court first ruled in 1976 that commercial speech is entitled to some level of First Amendment protection, holding that commercial speech may not be banned in its entirety. In 1980, the Court announced a three-step test for ascertaining the constitutionality of regulations of commercial speech. Under that test, a statute that regulates commercial speech, such as § 518, is only constitutionally permissible if (1) a substantial governmental interest is at stake, (2) the speech regulation at issue directly advances that substantial governmental interest, and (3) the regulation is narrowly tailored – that is, no more extensive than necessary to advance that interest. In 1989, the Court refined the "narrowly tailored" prong of the test, providing that the regulation must bear a "reasonable fit" to the governmental interest it serves.

The Supreme Court remanded the case to the Second Circuit to consider the constitutionality of § 518 as a regulation of commercial speech, as applied to the "single price plus surcharge" arrangement described above. Under the commercial speech doctrine, the Second Circuit can only uphold § 518 if it first finds that prohibiting such a pricing regime serves a substantial governmental interest, and then finds that the prohibition in § 518 bears a reasonable fit in furtherance of that interest.

The Attorney General will likely assert on remand, consistent with prior arguments in the *Expressions* litigation, that § 518 serves a substantial governmental interest by protecting consumers from being misled by merchants' advertised prices, only to learn at the time of payment that they will be charged an added fee for paying by credit card. It is difficult to fathom consumers requiring "protection" from a modest surcharge, particularly where the applicable Visa and MasterCard rules require clear signage advising consumers of it at the point of sale – and where consumers have the option not to proceed with a purchase if they dislike the surcharge. Absent a threshold finding that § 518 serves a substantial governmental interest, such as consumer protection, the statute would not survive the plaintiffs' challenge. However, if the Second Circuit *does* find that § 518 serves the substantial governmental interest of consumer protection (or otherwise), it very likely would also find that the statute furthers and bears a "reasonable fit" to that interest, and thus satisfies the other two prongs of the constitutional standard.

In light of the Supreme Court's directive to consider § 518 as a speech regulation, it is entirely possible that the Second Circuit will reverse its prior holding on remand and will instead uphold the District Court's determination that § 518 is unconstitutional as applied to the "single price plus surcharge" pricing arrangement. It is also possible that the Second Circuit will follow the admonition in the concurring opinions that the Supreme Court should have remanded the case back to the Second Circuit with an instruction to certify to the New York Court of Appeals the question of how § 518 operates: that is, which pricing schemes, if any, § 518 would permit and which it would prohibit. However, as other commentators have noted, the Supreme Court's opinion contains so little guidance on the underlying First Amendment issues that there is no guarantee of what the Second Circuit will do on remand.

Two additional petitions for certiorari are pending in the Supreme Court with respect to conflicting decisions by the Fifth Circuit, which upheld the Texas surcharge ban as a constitutional pricing regulation, and the Eleventh Circuit, which struck down the Florida surcharge ban as an unconstitutional restriction on merchants' speech. In light of the Supreme Court's decision in *Expressions*, it is possible that the Court will summarily reverse the Fifth Circuit with similar instructions to consider the Texas statute as a speech regulation. Granting certiorari in the Eleventh Circuit case, which considered Florida's surcharge ban as a speech regulation, would provide the Supreme Court an opportunity to expand on the application of the commercial speech doctrine to such regulations.

In summary, if the Second Circuit strikes down § 518, at least as applied to the pricing scheme at issue in *Expressions*, the takeaway for merchants accepting credit cards from customers located in New York (debates regarding the applicability of § 518 to B2B transactions aside) will be that § 518 will no longer prohibit the posting of a single price and the imposition of a surcharge atop that price for payment by credit card. Time will tell whether that is the outcome here.

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He writes and speaks frequently about bankruptcy matters and financial issues. Before becoming a lawyer, he worked in senior financial management at a midsized, privately held company.

After Ruling in Expressions, Supreme Court Summarily Vacates Fifth Circuit Decision Upholding Texas Surcharge Prohibition and Denies Review of Eleventh Circuit Decision Striking Down Florida's Surcharge Ban

By Bruce Nathan, Esq. and Andrew Behlmann, Esq.
Lowenstein Sandler LLP

Editor's note: The companion article on this subject, published in the 1Q 2017 CRF News, may be accessed HERE.

On March 29, 2017, the United States Supreme Court issued its long-awaited decision in Expressions Hair Design, et al. v. Schneiderman, holding that New York's prohibition against surcharging credit card transactions is a regulation of commercial speech and remanding the case to the Second Circuit Court of Appeals for further consideration as such.

On Monday, April 3, 2017, the Supreme Court ruled on petitions for certiorari in the two other surcharge-related cases that were pending before it.

In Rowell et al. v. Pettijohn, a group of merchants sought review of a decision by the Fifth Circuit Court of Appeals, which – like the Second Circuit in Expressions – held in early 2016 that the Texas surcharge ban is a constitutionally permissible regulation of pricing. On Monday, the Supreme Court granted the merchants' petition, summarily (i.e., immediately and with no further briefing or argument by the parties) vacated the Fifth Circuit's decision, and remanded the case back to the Fifth Circuit for further consideration in light of the Supreme Court's holding in Expressions.

In Bondi v. Dana's Railroad Supply, et al., the Florida Attorney General sought review of a decision by the Eleventh Circuit Court of Appeals, which held in late 2015 that Florida's surcharge ban is a facially unconstitutional regulation of merchants' speech. The Supreme Court denied the state's petition for a writ of certiorari, leaving the Eleventh Circuit's ruling intact. As a result, the Florida surcharge ban has effectively been overturned in its entirety.

Denial of certiorari in Dana's means the Supreme Court will not have an opportunity to provide further guidance on the application of the commercial speech doctrine to credit card surcharge bans unless and until another case – possibly even Expressions or Rowell, depending upon the outcome in those cases on remand – comes up from the Courts of Appeals. However, the Dana's decision at least suggests that the Supreme Court is receptive to the Eleventh Circuit's reasoning, and is a knockout punch for Florida merchants, whose surcharging fight is now over unless and until the Florida legislature decides to craft a new surcharge ban.

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SELECTED TOPIC

Wanda Borges, Esq.

Supreme Court Rulings on Credit Card Surcharge Issues Disappointing, at Best

The long-awaited decision by the Supreme Court of the United States (SCOTUS) is disappointing to merchants, credit grantors and credit card networks alike. It was hoped that a strong decision by SCOTUS would resolve the question as to whether individual state laws prohibiting the pass through of credit card surcharges are unconstitutional, and therefore, illegal.

With the settlement of the MasterCard/Visa antitrust litigation and the rule changes by MasterCard, Visa, Discover and American Express, merchants excitedly looked forward to passing through their credit card surcharges to their customers. A rapid examination into various state laws, however, left merchants frustrated as they realized that 10 states plus Puerto Rico had laws prohibiting those merchants from passing their surcharges on to their customers. The dust had barely settled on the rule changes by MasterCard and Visa when several lawsuits were commenced challenging the anti-surcharge laws of California, Florida, Texas and New York.

The first case to be filed was *Expressions Hair Design, et al v. Eric T. Schneiderman* in the United States District Court for the Southern District of New York. That case was commenced for a determination that New York State's General Business Law §518 is unconstitutional, vague and in violation of the First Amendment right to freedom of speech. New York's anti-surcharge law says "[n]o seller in any sales transaction may impose a surcharge on a holder who elects to use a credit card in lieu of payment by cash." The primary argument in the case was that a merchant could readily offer a discount for a cash payment but was prohibited from imposing a surcharge for a payment made by credit card. In determining that the New York anti-surcharge law is unconstitutional Judge Rakoff said that, "[I]n terms of their immediate economic consequences, surcharges and discounts are merely different labels for the same thing—a price difference between cash and credit." He said further that, "[T]his virtually incomprehensible distinction between what a vendor can and cannot tell its customers offends the First Amendment and renders Section 518 unconstitutional." On appeal, the 2nd Circuit Court of Appeals ruled that New York's law is neither unconstitutional nor does it violate a merchant's freedom of speech. The 2nd Circuit decided that this anti-surcharge issue addressed price regulations which govern conduct and that freedom of speech has nothing to do with this statute. The case then moved on to the Supreme Court of the United States. In reading the transcript from oral argument which was held on January 10, it was apparent to me that the Supreme Court Justices were struggling to understand the arguments before them. Counsel for the Petitioner seemed unable to frame the issues well enough to persuade the Justices that the case was about freedom of speech. He said that merchants who were truthful to their customers and announce that a different price will be charged for cash or credit were being punished for honestly giving those customers both prices. His statement "[Y]ou can charge the two different prices, one for cash, one for credit, but what runs afoul of the law is describing the price one way as a surcharge versus a credit." The Justices did not seem to agree and Justice Sotomayor even said that she did not "see anything about speech in the statute." In the opinion, however, delivered by Chief Justice John Roberts, he stated succinctly "The question presented is whether §518 regulates merchants' speech and—if so—whether the statute violates the First Amendment. We conclude that §518 does regulate speech and remand for the Court of Appeals to determine in the first instance whether that regulation is unconstitutional." In an earlier article, after initially reading the transcript, I

> A merchant could readily offer a discount for a cash payment but was prohibited from imposing a surcharge for a payment made by credit card.

suggested that SCOTUS was not going to solve the surcharge issue. Unfortunately, I was right!

This decision has prolonged the agony of merchants who are trying to obtain a clear ruling on whether or not the various states can prohibit surcharging.

Florida's lawsuit concerning its anti-surcharge law has also been stymied by the Supreme Court. Yet, this lawsuit's current standing is favorable to merchants. The case of *Bondi v Dana's RR Supply* was commenced for a determination that Florida's nearly 30-year-old surcharge statute is a facially unconstitutional speech restriction. The federal trial court in Florida held that the Florida statute is constitutional and only governs conduct, a completely opposite position from Judge Rakoff in New York. However, the 11th Circuit Court of Appeals held that Florida's law is unconstitutional. This matter was also taken to the Supreme Court of the United States. In June 2016, Bondi, as the attorney general for the State of Florida petitioned the Supreme Court to hear this matter. The Supreme Court delayed deciding whether to hear the Florida case while it was considering the New York case as it perceived the issues to be virtually identical. It was well-known that the SCOTUS decision in *Hair Expressions* would impact the *Dana's RR Supply* case. Sure enough, the *Hair Expressions* case was decided on March 28, 2017 and on April 3, 2017, SCOTUS denied the petition to be heard filed by Bondi. What this means is that Florida's anti-surcharge law has been found to be unconstitutional and surcharge pass through is therefore permissible in the State of Florida.

SCOTUS did nothing to give credit grantors and merchants a clear directive as to how they can differentiate in price between cash and credit transactions.

The other lawsuits on this issue are less exciting. The case of *Italian Colors Restaurant et al. v. Harris* was commenced in California and the federal district court found the anti-surcharge statute to be unconstitutional and permanently enjoined its enforcement. That case has been appealed to the 9th Circuit Court of Appeals but has not yet been decided.

The case of *Lowell v. Pettijohn* was commenced in Texas. In this case, most like the *Hair Expressions* case, the 5th Circuit Court of Appeals ruled that Texas's no-surcharge law "regulates conduct, not speech, and, therefore, does not implicate the First Amendment." Like *Hair Expressions*, this case raised the constitutional question: "Do state no-surcharge laws—which allow merchants to offer "discounts" to those who pay in cash but prohibit them from imposing equivalent "surcharges" on those who pay by credit card—violate the First Amendment?" While SCOTUS was considering the *Hair Expressions* case, it held the petition to hear the *Lowell v. Pettijohn* case in abeyance. On April 3, 2017 SCOTUS denied the petition to be heard. Unlike the Florida case, however, which was simply denied by SCOTUS, the Texas case was "remanded for further consideration" in light of the SCOTUS decision in the *Hair Expressions* case.

What all of this means is that the litigation concerning the Texas, New York and California statutes will continue. The SCOTUS decision was so scant in terms of any actual discussion of the issues that no lower court can rely on the SCOTUS decision to shed any light on what the lower courts should or should not do relative to the anti-surcharge statutes. The merchant's battles against the anti-surcharge laws in Texas, California and New York are far from over. SCOTUS did nothing to give credit grantors and merchants a clear directive as to how they can differentiate in price between cash and credit transactions.

Nevertheless, more and more businesses are accepting credit card payments. It is incumbent on the credit grantor, therefore, to remain cognizant of the laws in the various states that currently prohibit the pass through of surcharges while watching for future news on litigation concerning these statutes.

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EXCERPTS FROM:

NOTEWORTHY DECISIONS ON THE FDCPA ARE IMPORTANT TO COMMERCIAL AND CONSUMER COLLECTION AGENCIES AND ATTORNEYS ALIKE:

Presented at the IACC/CLLA 2016 Mid-Year Conference

by: Stephen Sather, Esq. – Barron & Newburger, P.C.
Wanda Borges, Esq. – Borges & Associates, LLC

There are numerous decisions surrounding the FDCPA. The following material contains synopses of some recent cases that involve the FDCPA or may affect FDCPA cases. This material accompanies an oral presentation on these legal issues which can impact collection agencies and collection attorneys as a result of these decisions.

FILING PROOFS OF CLAIMS ON STALE DEBTS MAY OR MAY NOT VIOLATE THE FDCPA

Crawford v. LVNV Funding, LLC, 758 F.3d 1254 (11th Cir. 2014)

Stanley Crawford filed a Chapter 13 proceeding owing the Heilig-Mayers furniture company $2,037.99. Because of the 3 year Statute of Limitations, the debt became unenforceable in October, 2004. The Chapter 13 was filed in February, 2008. LVNV purchased the debt from Heilig-Mayers and filed a proof of claim in the Chapter 13 proceeding. Crawford commenced an adversary proceeding against LVNV alleging that filing the claim violated the FDCPA. Bankruptcy Judge Dwight Williams dismissed the adversary proceeding. United States District Court Judge Keith Watkins affirmed the Bankruptcy Court decision. The Eleventh Circuit reversed. It analyzed the FDCPA noting: 1) it was intended to stop "abusive, deceptive and unfair debt collection practices by many bill collectors, 2) a debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt [USC Section 1692f], 3) courts must use the "least sophisticated consumer" standard to evaluate whether a debt collector's behavior is 'unconscionable', 'deceptive', 'misleading' or 'unfair under the statute." LVNV admitted that an attempt to collect this time-barred claim would have been violative of the FDCPA but maintained a practice of filing such proofs of claims in bankruptcy cases because absent an objection the time-barred claim is automatically allowed. The court held that in bankruptcy "the limitations period provides a bright line for debt collectors of consumer debtors, signifying a time when the debtor's right to be free of stale claims comes to prevail over a creditor's right to legally enforce the debt." The filing of a proof of claim creates a misleading impression that the debt can be enforced. The automatic allowance provision in a chapter 13 would mean that the debt or a portion of it would be paid from future wages of the debtor and reduces cash available for other legitimate creditors. For these and other reasons the court heald "under the 'least-sophisticated consumer' standard" that the "filing of a time-barred proof of claim against Crawford in bankruptcy was 'unfair', 'unconscionable', 'deceptive', and 'misleading' within the broad scope of Sections 1692 e and f. Filing a proof of claim is the first step in collection a debt in bankruptcy and is, at the very least, an 'indirect' means of collecting a debt." Accordingly, the Eleventh Circuit held that LVNV's conduct violated the FDCPA's plain language.

Johnson v. Midland Funding, LLC, 2016 U.S. App. LEXIS 9478 (11th Cir. 2016)

Johnson filed for chapter 13 bankruptcy. Midland Funding filed a proof of claim in the amount of $1,879.71. The last transaction on the debt was more than ten years before bankruptcy, which was longer than the six year statute of limitations under Alabama law. The District Court dismissed the case

notwithstanding the *Crawford* decision. The District Court found that the Bankruptcy Code, which affirmatively allows a creditor to file a proof of claim was in conflict with the FDCPA. As a result, it found that the FDCPA was impliedly repealed in this area. The Eleventh Circuit reversed. Although it had not addressed the issue of implied repeal in *Crawford*, it found that the Bankruptcy Code and the FDCPA could be "read together in a coherent way" and that "when a particular type of creditor—a designated 'debt collector' under the FDCPA—files a knowingly time-barred proof of claim in a debtor's Chapter 13 bankruptcy, that debt collector will be vulnerable to a claim under the FDCPA." **NOTE: SCOTUS DECISION MAY 15, 2017 – no violation.**

Birtchman v. LVNV Funding, LLC, 2015 U.S. Dist. LEXIS 52669 (S.D. Ind. 2015), on appeal at No. 15-2044, *Owens v. LVNV Funding, LLC* (7th Cir.).

Birtchman filed for chapter 13 bankruptcy. LVNV filed a proof of claim on a debt that was barred by the statute of limitations. Birtchman then filed suit against LVNV under the FDCPA. LVNV moved to dismiss, arguing that the debtor/plaintiff lacked standing to sue and that the complaint did not allege a violation of the FDCPA. The District Court ruled that the plaintiff had standing because the FDCPA did not require that there be actual injury. However, the District Court ruled that filing a truthful proof of claim, even one that was beyond the statute of limitations did not violate the FDCPA. The Court ruled that the claim was not "false, deceptive or misleading." There was no allegation that the proof of claim contained false information and the fact that the claim was time-barred could be determined from the information in the claim itself. The creditor's statement that the debtor was indebted to it was not false because the debt still existed even if it was unenforceable. The Court distinguished prior Seventh Circuit precedent holding that it was a violation of the FDCPA to file suit on a time-barred debt. The Court found that "the holding in *Phillips* was driven by concerns about debt collectors filing state court collection actions against unrepresented debtors that simply do not apply in the Chapter 13 context." The case was appealed to the Seventh Circuit Court of Appeals where it was joined with two other similar cases. Oral argument was heard on June 1, 2016. **NOTE – DECISION AUGUST 10, 2016. No violation**

Gatewood v. CP Medical, LLC, 533 B.R. 905 (8th Cir. BAP 2015)

Debtors filed for chapter 13 bankruptcy. CP Medical filed a proof of claim. Debtors' plan was confirmed. While the case was pending, the Debtors filed suit against CP Medical for violation of the FDCPA alleging that the medical debt was barred by the statute of limitations. The Bankruptcy Court granted summary judgment for the creditor, holding that filing a proof of claim did not constitute actual litigation or the threat of litigation. Rather, it was simply a request to share in the distribution to be made to creditors in the case. On appeal, the Bankruptcy Appellate Panel disagreed with the Bankruptcy Court's rationale but affirmed on different grounds. The BAP ruled that filing a claim "arguably invokes the litigation machinery." However, the court found that filing an accurate though time-barred claim was not a false, misleading, deceptive, unfair or unconscionable debt collection practice. "Mr. and Mrs. Gatewood are seeking to a discharge of their indebtedness, which including the debt owed to CP Medical. In fact, they did not object to CP Medical's claim. To then sue CP Medical under the FDCPA for doing that which it was invited to do—file an accurate proof of claim—offends the senses."

Dubois v. Atlas Acquisitions, LLC, No. 15-1945 (4th Cir.).

In two separate cases, debtors filed chapter 13 and creditors filed claims on debts that were past the statute of limitations. The debtors objected to the claims and alleged that filing the proofs of claim violated the FDCPA. The Bankruptcy Court for the District of Maryland dismissed the FDCPA actions and granted the objections to claim by consent. The Bankruptcy Court relied upon the District Court opinion in *Covert v. LVNV Funding, LLC*, 2013 Dist. LEXIS 175651 (D. Md. 2013), which had held that filing a proof of claim did not constitute an act to collect a debt. The case has been appealed to the

Fourth Circuit Court of Appeals. Oral argument was heard on May 11, 2016. **NOTE – DECISION AUGUST 25, 2016. No violation**

In re Joseph Shannon Mazyck and Anita Flippen Mazyck, 521 BR 726 (Bankr. D. S.C. 2014)

The Mazycks filed chapter 13 petitions in March 2014. No debts were scheduled for Cavalry SPV I, LLC ("Cavalry"). Cavalry filed 5 unsecured claims with no documentation other than a Statement of Account itemizing principal and interest asserted to be due on debts which had been written off between November 2004 and March 2005, approximately 9 years prior to the Mazycks' chapter 13 proceedings. The Debtors filed objections to the Cavalry claims totaling $71,890.39 asserting that the South Carolina 3 year Statute of Limitations should be applied to disallow the claims. Including the Cavalry claim in the chapter 13 payments would pay general unsecured creditors 10%. Disallowing those claims would increase payment to the other unsecured creditors to 16%. The Court determined that the Statute of Limitations ran on March 28, 2008. Two pertinent issues for the court were: 1) whether the affirmative defense of the 3 year Statute of Limitations for commencement of an action may serve as grounds to disallow a creditor's claim, and 2) whether the filing of a proof of claim constitutes a violation of the automatic stay. The FDCPA was not raised in this case although the court noted the *Crawford* decision and found its reasoning "persuasive" for the public policy issues that it raised. Although the court found that the filing of a proof of claim did not violate the automatic stay, the Cavalry claim was disallowed on evidence by the Debtors that the Statute of Limitation had run.

LaGrone v. LVNV Funding LLC and Resurgent Capital Services, 525 B.R. 419 (Bankr. N.D. Ill. 2015).

Similar to the Mazyck case, this case involved a chapter 13 debtor against whom a proof of claim had been filed on a debt where the Statute of Limitations had already run. This court discussed the earlier *Crawford* case. What is of importance in this case is that the Court found: 1) FDCPA actions are permissible in bankruptcy proceedings, 2) filing a proof of claim in a bankruptcy proceeding is an action to collect a debt, and 3) the filing of the proof of claim could be violative of the FDCPA if it indeed violated any sections of that Act. The court found that filing a proof of claim subject to a statute of limitations defense is not violative of the FDCPA.

Nelson v. Midland Credit Management, Inc., No. 15-2984 (8th Cir. 2016)

Domick Nelson filed a chapter 13 bankruptcy in February, 2015, owing a consumer debt to Midland. No payment had been made on that debt after November, 2006. Nelson objected to the proof of claim claiming it was time-barred. The claim was disallowed. Debtor filed suit for violation of the FDCPA. District Court dismissed on the basis that filing an accurate and complete claim on a time-barred debt did not violate the FDCPA. The Eighth Circuit affirmed on July 11, 2016. The Court held that the bankruptcy process provides sufficient protection from harassment to distinguish it from filing a state court collection suit. The court also held that filing a claim was not a collection action but was instead a request to participate in a common fund. Therefore, the FDCPA did not apply.

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Wanda Borges, the principal member of Borges & Associates, LLC, has specialized in commercial insolvency practice and commercial litigation representing corporate clients throughout the United States for over thirty years.

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Bruce S. Nathan, Partner in Lowenstein Sandler's Bankruptcy, Financial Reorganization & Creditors' Rights Group, has more than 35 years' experience in the bankruptcy and insolvency field, and is a recognized national expert on trade creditor rights and the representation of trade creditors in bankruptcy and other legal matters. Bruce has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed. Bruce also negotiates and prepares letters of credit, guarantees, security, consignment, bailment, tolling, and other agreements for the credit departments of institutional clients.

Bruce is co-chair of the Avoiding Powers Committee that is working with the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 and also participated in ABI's Great Debates at their 2010 Annual Spring Meeting, arguing against repeal of the special BAPCPA protections for goods providers and commercial lessors, and was a panelist for a session sponsored by the American Bankruptcy Institute ("ABI") and co-sponsored by Georgetown University Law Center. Bruce also regularly speaks at conferences held by the National Association of Credit Management, its international affiliate, An Association of Executives in Finance, Credit and International Business ("FCIB"), Credit Research Foundation ("CRF"), and many credit groups on bankruptcy, insolvency, and creditor's rights issues; is a member of NACM's Government Affairs Committee, a regular contributor to NACM's *Business Credit,* a contributing editor of NACM's *Manual of Credit and Commercial Laws*, and co-author of *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: An Overhaul of U.S. Bankruptcy Law*, published by NACM; and has contributed to CRF's Journal, *The Credit and Financial Management Review*.

Bruce is recognized in the Bankruptcy & Creditor/Debtor Rights section of *Super Lawyers* (2012-2017) and in March 2011, he received the Top Hat Award, a prestigious annual award honoring extraordinary professionals in the credit industry.

Bruce is also a co-author of "Trade Creditor Remedies Manual: Trade Creditors' Rights under the UCC and the U.S Bankruptcy Code" published by the American Bankruptcy Institute ("ABI") at the end of 2011, has contributed to the *ABI Journal*, and is a former member of ABI's Board of Directors and former Co-Chair of ABI's Unsecured Trade Creditors Committee.