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Supreme Court's Holding in *Taggart v. Lorenzen*, 2019 U.S. LEXIS 3890 (June 3, 2019)

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I. Summary of Holding and Lessons to Be Learned

In a 9–0 decision authored by Justice Breyer, the Supreme Court of the United States considers "the legal standard for holding a creditor in civil contempt when the creditor attempts to collect a debt in violation of a bankruptcy discharge order" and holds that contempt sanctions may be appropriate "when there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order." *Taggart v. Lorenzen*, 2019 U.S. LEXIS 3890, at *9-10 (June 3, 2019).

The *Taggart* decision aligns the contempt standard in the bankruptcy discharge context with the "no fair ground of doubt" standard historically used in the context of nonbankruptcy injunctions. In doing so, the Court provides greater certainty for debtors and creditors regarding the applicable legal rules and strikes a balance between protecting a debtor's discharge and not creating excessive risk of liability for creditors. The decision reflects a broad sense of judicial pragmatism and a desire to better calibrate bankruptcy and nonbankruptcy law when possible.

II. Legal Background

The Supreme Court long ago described "the two great objects" of the federal bankruptcy law as its operation "to grant a discharge to honest debtors who should conform to its provisions, and to distribute their property ratably among all their creditors." *Buckingham v. McLean*, 54 U.S. (13 How.) 151, 166 (1852). Indeed, effecting the discharge is in many ways the essence of federal bankruptcy law, particularly for consumer debtors, but also for municipal debtors or reorganizing business debtors. *See, e.g.*, *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1934) (grounding the operation of the bankruptcy discharge as a matter "in the nature of a personal liberty" and "of great public concern"). The discharge is what ultimately allows a debtor to break with the pre-bankruptcy past and enjoy a fresh start or streamlined business operations.

Bankruptcy Code section 524(a) provides that a discharge under any chapter of the Bankruptcy Code automatically "operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived." 11 U.S.C. § 524(a)(2).[1] Beyond creating this injunction, the statute does not specify possible remedies for violation of the injunction or provide a standard of misconduct correlating to particular remedies. This stands in contrast to the

1 The self-effectuating nature of the modern discharge is an important break with the Supreme Court's early bankruptcy jurisprudence, pursuant to which discharge in bankruptcy was an affirmative defense that could be waived if not raised by the debtor in subsequent litigation. *See, e.g.*, *Dimock v. Revere Copper Co.*, 117 U.S. 559, 565-66 (1886); *Lone Star Sec. & Video, Inc. v. Gurrola (In re Gurrola)*, 328 B.R. 158, 165-70 (B.A.P. 9th Cir. 2005) (detailing rejection of *Dimock* approach in 1970 legislation and through the subsequent enactment of section 524(a)); *Meadows v. Hagler (In re Meadows)*, 428 B.R. 894, 904-07 (Bankr. N.D. Ga. 2010) (similarly rejecting *Dimock* rule in modern bankruptcy context).

automatic stay operative during the pendency of a bankruptcy case, as to which section 362(k) generally provides that "an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." 11 U.S.C. § 362(k)(1).

Courts have adopted different standards and tests to fill the statutory gap. Some courts have concluded that a creditor can be found in contempt of the discharge injunction and sanctioned if it was aware of the discharge and intended the act violative of the discharge, all without regard to the creditor's subjective beliefs, intent, or general "good faith." *See, e.g.*, *IRS v. Murphy*, 892 F.3d 29, 38-40 (1st Cir. 2018); *Green Point Credit, LLC v. McLean (In re McLean)*, 794 F.3d 1313, 1323 (11th Cir. 2015); *Hardy v. United States (In re Hardy)*, 97 F.3d 1384, 1388-91 (11th Cir. 1996); *Roth v. Nationstar Mortg. LLC (In re Roth)*, 568 B.R. 139, 142 (M.D. Fla. 2017); *In re Ritchey*, 512 B.R. 847, 858-59 (Bankr. S.D. Tex. 2014); *Cherry v. Arendall (In re Cherry)*, 247 B.R. 176, 186-88 (Bankr. E.D. Va. 2000). Other courts, however, have considered whether the creditor had a good-faith basis to believe its acts were not violative of the discharge. *See, e.g., Missouri Dep't of Soc. Servs. v. Spencer (In re Spencer)*, 868 F.3d 748, 751-52 (8th Cir. 2017); *In re Walker*, 195 B.R. 187, 210 (Bankr. D.N.H. 1996).

III. Facts and Proceedings Below

The *Taggart* case arises from a convoluted and long-pending set of litigation among Bradley Taggart ("Taggart") and several other investors in Sherwood Park Business Center, LLC ("SPBC"). The other investors had sued Taggart and an attorney in Oregon state court for breach of the applicable operating agreement. *Emmert v. Taggart (In re Taggart)*, 548 B.R. 275, 278 (B.A.P. 9th Cir. 2016). Shortly before trial in state court, Taggart filed a chapter 7 bankruptcy petition. *Id.*

Taggart completed his bankruptcy case and received his discharge. *Id.* Several of the other SPBC investors then sought to continue their state-court litigation. *Id.* The litigation continued on the condition that no monetary judgment could be awarded against Taggart and resulted in the state court finding that the SPBC operating agreement had been breached and Taggart had been expelled from SPBC. *Id.* The other investors then moved for an award of attorneys' fees against both Taggart's attorney and Taggart, although the request regarding Taggart was limited to fees incurred after his discharge on the theory that Taggart had "returned to the fray" by participating in the state-court action. *Id.*

Taggart responded by moving to reopen his bankruptcy case and seeking to hold the other parties in contempt for violating the discharge by seeking an award of attorneys' fees against him in state court. *Id.* After a series of intervening appeals and decisions in state and federal court regarding the plaintiffs' entitlement to attorneys' fees and the "return to the fray" doctrine, the bankruptcy court found that the other SPBC investors acted in contempt of the discharge injunction and were therefore liable for actual damages of $5,000 and Taggart's attorneys' fees. *See In re Taggart*, 2015 Bankr. LEXIS 864, at *14 (Bankr. D. Or. Mar. 17, 2015).

The other investors appealed the contempt ruling to the Bankruptcy Appellate Panel for the Ninth Circuit (the "BAP"). The BAP concluded that the bankruptcy court had applied the wrong legal standard by concluding that the SPBC investors' "subjective or good faith beliefs were irrelevant" and

thus ignoring whether they had actual knowledge that their actions were violating the discharge injunction. *See In re Taggart*, 548 B.R. at 290-91. The BAP accordingly reversed the bankruptcy court's finding of contempt and vacated its judgment sanctioning the SPBC investors. *See id.* at 291.

The parties then filed cross-appeals to the Ninth Circuit Court of Appeals, which implicated both the discharge injunction issue as well as earlier findings about the "return to the fray" doctrine. For his part, Taggart argued "that the BAP committed reversible error when it held that the [investors] could not be held in contempt because they did not *knowingly* violate the discharge injunction." *Lorenzen v. Taggart (In re Taggart)*, 888 F.3d 438, 442-43 (9th Cir. 2018). The circuit court explained that knowledge of the applicability of an injunction must be affirmatively proven and that "the 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***." *See id.* at 443-44 (emphasis added). The bankruptcy court accordingly erred when it refused to consider whether the SPBC investors had a good-faith belief that the discharge injunction was inapplicable based on the "return to the fray" doctrine. *See id.* at 444. To the contrary, such a "good faith belief, even if unreasonable, insulated them from a finding of contempt." *Id.* As such, the BAP appropriately reversed the bankruptcy court's contempt sanctions. *Id.* at 444-45. Having found that a subjective good-faith belief insulated the creditors from a contempt finding, the circuit court declined to reach the issue presented by their cross-appeal regarding whether the discharge injunction in fact applied in Taggart's case. *See id.* at 445.

After his petition for rehearing was denied by the Court of Appeals for the Ninth Circuit, Taggart petitioned for a writ of certiorari, seeking review of a basic question: "Whether, under the Bankruptcy Code, a creditor's good-faith belief that the discharge injunction does not apply precludes a finding of civil contempt." The Supreme Court granted Taggart's petition on January 4, 2019. *See Taggart v. Lorenzen*, 139 S. Ct. 782, 202 L. Ed. 2d 511 (2019). Several *amicus* briefs were filed on both sides, most notably a brief for the United States as *amicus curiae* supporting neither party, in which the Office of the Solicitor General argued that, contrary to the Ninth Circuit's analysis, a creditor's subjective good faith does not preclude a finding of civil contempt, but civil-contempt remedies are nevertheless unavailable if there is an "objectively fair ground of doubt" regarding whether the creditor's conduct violates the discharge. The case was argued on April 24, 2019 (as the last argued case of October Term 2018), with the Solicitor General participating in divided oral argument in support of neither party.

IV. Analysis

Justice Breyer's opinion begins by framing the question before the Court as one about "the criteria for determining when a court may hold a creditor in civil contempt for attempting to collect a debt that a discharge order has immunized from collection." *Taggart*, 2019 U.S. LEXIS 3890, at *4. After a brief summary of the starkly different standards adopted by the lower courts, the Court recites its bottom-line conclusion that "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," which means "civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful." *Id.* at *5.

After briefly summarizing the facts and procedural history, *id.* at *5-9, the Court turns to the central question of the appropriate standard for civil contempt sanctions in the discharge context. In answering this question, the Court begins with "a longstanding interpretive principle: When a statutory term is obviously transplanted from another legal source, it brings the old soil with it." *Id.* at *10 (internal quotation marks omitted). Based on this principle, the provisions of the Bankruptcy Code creating a discharge injunction and providing bankruptcy courts with the power to issue orders enforcing the discharge "bring with them the 'old soil' that has long governed how courts enforce injunctions." *Id.* Part of the incorporated "old soil" is "the traditional standards in equity practice for determining when a party may be held in civil contempt for violating an injunction." *Id.* at *11.

Citing authorities dating back to the 1800s, the Court explains that the established civil contempt "standard is generally an *objective* one" under which the violator's conduct will be analyzed to determine whether there was a "fair ground of doubt" regarding the wrongfulness of the conduct. *See id.* at *11-12. Although a party's subjective intent may bear on how the ultimate burden is allocated and the appropriate sanction, the primary analysis should be about whether the violator's belief in the propriety of its actions was objectively reasonable. *See id.* at *12-13. These historic "civil contempt principles apply straightforwardly to the bankruptcy discharge context" and mean that "civil contempt therefore may be appropriate when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope." *Id.* at *13.

The Court rejects the two more-extreme standards adopted by some lower courts. The Ninth Circuit's standard (which no one defended on appeal) "is inconsistent with traditional civil contempt principles, under which parties cannot be insulated from a finding of civil contempt based on their subjective good faith," "relies too heavily on difficult-to-prove states of mind," and "may too often lead creditors who stand on shaky legal ground to collect discharged debts, forcing debtors back into litigation (with its accompanying costs) to protect the discharge that it was the very purpose of the bankruptcy proceeding to provide." *Id.* at *14. Conversely, Taggart's strict-liability-like standard "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," which "would alter who decides whether a debt has been discharged, moving litigation out of state courts, which have concurrent jurisdiction over such questions, and into federal courts." *See id.* at *15-16. This specter of "additional federal litigation, additional costs, and additional delays" would slow the administration of the bankruptcy system generally and create costs that "could work to the disadvantage of debtors as well as creditors." *See id.* at *16.

The Court notes that its standard creates a contrast with the standard applicable to actions for violation of the automatic stay, but concludes that the disjunct is appropriate given the textual language in Bankruptcy Code section 362(k) (for which there is no analog in the discharge context) and how "[t]he purposes of automatic stays and discharge orders also differ: A stay aims to prevent damaging disruptions to the administration of a bankruptcy case in the short run, whereas a discharge is entered at the end of the case and seeks to bind creditors over a much longer period." *See id.* at *17. In a lengthy parenthetical portion of the opinion (which perhaps would have been better drafted as a footnote), the Court pointedly notes that it is not deciding "whether the word 'willful' supports

a standard akin to strict liability" for purposes of actions under Bankruptcy Code section 362(k). *See id.* at *17-18.

The Court concludes by reiterating its holding that the proper standard for a contempt action in the discharge context "is an objective one" whereby "[a] court may hold a creditor in civil contempt for violating a discharge order where there is not a 'fair ground of doubt' as to whether the creditors conduct might be lawful under the discharge order." *Id.* at *18. This middle-ground "standard strikes the 'careful balance between the interests of creditors and debtors' that the Bankruptcy Code often seeks to achieve." *Id.* (quoting *Clark v. Rameker*, 573 U.S. 122, 129 (2014)). Because the Court of Appeals for the Ninth Circuit applied the wrong legal standard, the Court ultimately vacates the judgment below and remands for further analysis using the correct standard. *Taggart*, 2019 U.S. LEXIS 3890, at *18.

V. Practice Tips

The *Taggart* opinion provides important national clarity about the appropriate standard for bankruptcy courts to apply when considering whether to hold a creditor in contempt for violating the discharge. The largely objective standard articulated by the Court should be more easily administrable by trial courts and sensibly aligns bankruptcy and nonbankruptcy practice, thereby allowing bankruptcy courts to draw from nonbankruptcy precedent. As the opinion emphasizes, the standard selected by the Court is a balanced middle ground that splits the difference between two extremes before the Court (one of which no one actually defended on appeal). For cases pending in the Ninth Circuit, the decision is particularly important in correcting an appellate decision that threatened to remove almost all of the teeth from a cornerstone protection of federal bankruptcy law.[2]

There remains an asymmetry between actions for violation of the discharge and actions for violation of the automatic stay that courts and lawyers will need to carefully navigate. Although in many cases the standards should be clear based on the relevant time periods, it is possible that more difficult cases could arise, such as when a creditor's continuing course of conduct violates ***both*** the automatic stay and the discharge injunction. Regardless, practitioners should be mindful of the need to be precise in differentiating between what are, at least for now, two differing legal standards.

The *Taggart* opinion also includes some propositions of broader relevance. First, the "old soil" approach to harmonizing bankruptcy and nonbankruptcy law could help resolve the meaning of other concepts in the Bankruptcy Code that carry no special bankruptcy significance but have traditional content in the law more generally. *See also, e.g.*, *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 203 L. Ed. 2d 876, 2019 U.S. LEXIS 3544, at *15-17 (May 20, 2019) (adopting a very similar approach to give meaning to the concept of "breach" under Bankruptcy Code section 365). Second, the Court has

2 The implications of the now-vacated *Taggart* opinion in the Ninth Circuit were especially troubling given the presence of other circuit precedent that (wrongly, in the authors' view, and contrary to the rule in several other circuits) holds that the Bankruptcy Code displaces remedies that would be available under otherwise applicable nonbankruptcy law, such as a claim under the Fair Debt Collections Practices Act, as a result of a creditor's wrongful post-bankruptcy debt collection activities. *See Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502, 510-11 (9th Cir. 2002). This issue was raised but ultimately not decided in *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407 (2017), and thus a circuit split remains for potential resolution by the Supreme Court at some future date.

once again reiterated the "need for speed" in the bankruptcy context by emphasizing how one of the chief purposes of the law is to resolve cases promptly and efficiently. *See also, e.g.*, *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686, 1694, 191 L. Ed. 2d 621, 628 (2015) ("[E]xpedition is always an important consideration in bankruptcy."); Kenneth N. Klee & Whitman L. Holt, *Bankruptcy and the Supreme Court: 1801-2014* at 194 n.1394 & 341 (West Academic 2015) (citing and discussing authorities dating back to the 1800s in which the Supreme Court has highlighted the importance of speed in bankruptcy cases).

In sum, *Taggart* is a pragmatic opinion that adopts a balanced standard for when a party can be liable for contempt based on its violation of the discharge injunction. The *Taggart* standard creates a sensible symmetry between bankruptcy and nonbankruptcy law. Although of relevance to all bankruptcy lawyers, the *Taggart* opinion is particularly important for cases in the Ninth Circuit, which had previously been governed by the creditor-friendly standard erroneously adopted by the court of appeals.

About the Author(s). Kenneth N. Klee is a nationally recognized expert on bankruptcy law. He became a Professor of Law Emeritus at the UCLA School of Law in 2014 and is a founding partner of Klee, Tuchin, Bogdanoff & Stern LLP, specializing in corporate reorganization, insolvency, and bankruptcy law. From 1974 to 1977, Professor Klee served as associate counsel to the Committee on the Judiciary, U.S. House of Representatives, where he was one of the principal drafters of the 1978 Bankruptcy Code. He served as a consultant on bankruptcy legislation to the U.S. Department of Justice in 1983–1984. From 1992 to 2000, he served as a member of the Advisory Committee on Bankruptcy Rules to the Judicial Conference of the United States. From 2000 to 2003, and previously from 1988 to 1990, Professor Klee has served since 2017 as a board member of the Ninth Judicial Circuit Historical Society and served as a member of the Advisory Board for several years before that. He has served three times as a lawyer delegate to the Ninth Circuit Judicial Conference. Professor Klee served as member of the executive committee of the National Bankruptcy Conference from 1985 to 1988, 1992 to 1999, 2005 to 2008, and 2011 to 2014, and in 2017–2018 served as Chair of its Membership Committee. He served from 2011 to 2014 as Chair of the NBC's Committee to Rethink Chapter 11 and also served as chair of its legislation committee from 1992 to 2000. Professor Klee is a past president and member of the board of governors of the Financial Lawyers Conference. Professor Klee was included in "The Best Lawyers in America" 2018 edition and has been included for at least 25 years. He has been named by *Who's Who Legal*, since 2012, as one of the top ten insolvency & restructuring attorneys in the world and was named by *The Legal 500* as one of the top nine leading attorneys in the municipal bankruptcy field for 2014. From 2003 to 2011 and periodically thereafter he was named by the *Daily Journal* as one of California's Top 100 Lawyers. Professor Klee is an author or co-author of four books: *Bankruptcy and the Supreme Court: 1801*–2014 (with Whitman L. Holt) (West Academic 2015); *Bankruptcy and the Supreme Court* (LexisNexis 2008); *BusinessReorganization in Bankruptcy* (West 1996; 2d ed. 2001; 3d ed. 2006; 4th ed. 2012); and *Fundamentals of Bankruptcy Law* (ALI-ABA 4th ed. 1996). He has authored or co-authored 32 law review articles on bankruptcy law. Recently, and within the past few years, Professor Klee has served as cocounsel for Bettina Whyte as COFINA agent in the Puerto Rico PROMESA restructuring cases; cocounsel for defendants Anadarko Petroleum Corp. and Kerr McGee in *Tronox v. Anadarko* (Bankr. S.D.N.Y.). and the Blavatnik defendants in *Weisfelner v. Blavatnik (In re Lyondell Chemical Co.)* (Bankr. S.D.N.Y.). During the summer of 2010, Professor Klee served as the appointed Examiner in the Tribune

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Whitman L. Holt is a partner of Klee, Tuchin, Bogdanoff & Stern LLP in Los Angeles. Mr. Holt has represented clients across the bankruptcy spectrum, including borrowers in and out of court, debtors subject to involuntary bankruptcy petitions, municipal debtors, secured creditors in and out of bankruptcy, hedge and distressed debt funds, equity sponsors, plaintiffs and defendants in bankruptcy-related litigation, and purchasers of assets via chapter 11 plans and section 363 sales. Mr. Holt also has significant experience regarding various alternative insolvency regimes, including bank and thrift receiverships under title 12 of the U.S. Code and proceedings for troubled insurers under state law. Mr. Holt's active bankruptcy-related appellate practice includes briefing multiple matters before the Supreme Court of the United States, including the prevailing merits brief in the landmark *Stern v. Marshall* case. Mr. Holt is the co-author (with Kenneth N. Klee) of *Bankruptcy and the Supreme Court: 1801–2014* (West Academic 2015), which is a comprehensive desk reference for lawyers, judges, law students, and scholars examining the Supreme Court's bankruptcy decisions from 1801 through 2014 from six different perspectives. Mr. Holt has consistently been recognized as one of the top corporate bankruptcy and restructuring attorneys in California by *Super Lawyers Magazine* and by *Chambers & Partners*. In 2015, Mr. Holt was elected as a Conferee of the National Bankruptcy Conference, which is an invitation-only organization dedicated to advising Congress about the operation of bankruptcy and related laws and which is widely regarded as the most prestigious professional organization in the bankruptcy field. In 2017, Mr. Holt was included in the American Bankruptcy Institute's inaugural list of "40 Under 40" bankruptcy, insolvency, and restructuring professionals from around the world. Mr. Holt is a graduate of Bates College (B.A., 2002, *magna cum laude* and Phi Beta Kappa) and Harvard Law School (J.D., 2005, *cum laude*).

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