# *Taggart v. Lorenzen*

## Contempt Standards for Discharge Order Violations and (Maybe?) Beyond

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The United States Supreme Court decided *Taggart v. Lorenzen*[1] on June 3, 2019. In *Taggart*, the Court determined that courts may hold creditors in civil contempt for violating a bankruptcy discharge order if there is "no fair ground of doubt" as to whether the order barred the creditor's conduct. *Taggart* squarely concerned violation of a discharge order; however, the Supreme Court has left the legal community wondering whether a similar standard should apply to address violations of bankruptcy's automatic stay. Although Justice Breyer could not resist giving us a sneak peek into his thoughts on this issue, *Taggart* may ultimately have less relevance to automatic stay violations than many believe.

## I.
## A Tale of Too Much Litigation

The facts of *Taggart* are, to put it mildly, procedurally complex. The story begins in 1999 with Bradley Taggart, a general contractor who formed the aptly named Sherwood Park Business Center, LLC ("Sherwood") to develop and operate a business park in Sherwood, Oregon. Taggart and

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[1] 139 S. Ct. 1795 (2019) (hereinafter, "*Taggart*").

three others each owned a 25% member interest in Sherwood. Sherwood's operating agreement provided that each member had a right of first refusal before any other member could transfer their membership interest, and a majority of the other members had to approve any membership interest transfer.[2]

Things went reasonably well until 2004, when Taggart began experiencing financial difficulties. He stopped paying payroll taxes and began diverting business funds for his personal use.[3] A year later, the other members of Sherwood realized what Taggart had been up to. They initiated arbitration proceedings and ultimately won an award against him for conversion of funds and breach of fiduciary duty to Sherwood.[4]

Unsurprisingly, Taggart's financial condition continued to deteriorate. In 2007, Taggart sought to sell his membership interest in Sherwood but decided he did not want to comply with the terms of the operating agreement. As a workaround, Taggart transferred his membership interest to a newly created entity, BT of Sherwood, LLC ("BT"). He subsequently transferred his membership interest in BT (and, hence, his interest in Sherwood) to his attorney, John Berman, for $200,000.[5]

The other members of Sherwood did not sit idly by while Taggart flouted the LLC's rules. Instead, they filed a complaint against Taggart, BT, and Berman in Oregon state court, seeking to unwind the transfers among Taggart, BT, and Berman; expel Taggart due to breach of contract; and allow one of Sherwood's existing members to purchase Taggart's membership interest in Sherwood. Taggart filed a response raising affirmative defenses and counterclaiming for attorneys' fees.[6]

On November 4, 2009, about 14 months after the state court litigation began, Taggart filed for chapter 7 bankruptcy. The state court trial, which was supposed to begin that same day, was stayed. Taggart received a discharge of his debts on February 23, 2010, after the bankruptcy trustee determined that he had no assets available for distribution to his creditors.[7]

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[2] In re Taggart, 548 B.R. 275, 279 (9th Cir. B.A.P. 2016) (hereinafter "In re Taggart").

[3] *Id.*

[4] *Id.* at 280.

[5] *Id.*

[6] *Id.*

[7] *Id.*

After Taggart received his discharge, the state court lawsuit resumed. During the litigation, Taggart was deposed, and Berman, who represented Taggart in the litigation, filed a motion to dismiss the claims against Taggart.[8] Berman argued that dismissal was appropriate because the claims the other Sherwood parties had brought against Taggart all related only to his pre-bankruptcy conduct.[9] Because they dealt with pre-bankruptcy conduct, those claims were subject to discharge.[10] Berman's motion said nothing about Taggart's counterclaim for attorneys' fees. The state court denied the motion to dismiss and after a trial, found in favor of the Sherwood members and dismissed Taggart's counterclaims.[11] Although the court had previously ruled that it would not enter a money judgment against Taggart, the court did unwind the transfers of his Sherwood membership interest.[12] Taggart appealed the court's judgment.

Subsequently, the Sherwood members filed a petition seeking attorneys' fees from Taggart. Not surprisingly, Taggart opposed the petition, arguing that he had "not sought to be involved" in the litigation after his bankruptcy filing and that his discharge in bankruptcy therefore protected him from liability for attorneys' fees.[13] For good measure, Taggart also reopened his bankruptcy case and filed a motion there seeking to hold the Sherwood members in contempt for violating the bankruptcy discharge injunction, which prohibits parties from trying to collect a debt that has been discharged in bankruptcy.[14] Taggart also sought sanctions consisting of his attorneys' fees and costs, as well as sums for emotional distress and punitive damages.[15]

The state court concluded that Taggart had never abandoned his counterclaim for attorneys' fees and that he had instead pursued his claim after his

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[8] *Id.* at 281.

[9] *Id.*

[10] *See* 11 U.S.C. § 727 (providing that a discharge is effective against prepetition claims).

[11] In re Taggart, *supra* note 2 at 281.

[12] *Id.*

[13] *Id.*; *see* In re Ybarra, 424 F.3d 1018 (9th Cir. 2005) (determining that post-petition attorneys' fees and costs are not discharged when the debtor voluntarily "returns to the fray" of the litigation after bankruptcy).

[14] In re Taggart, *supra* note 2 at 283.

[15] *Id.*

bankruptcy filing.[16] The state court thus awarded attorneys' fees in favor of the Sherwood members.

The bankruptcy court agreed with the state court and denied Taggart's contempt motion.[17] On appeal, the district court reversed, concluding that Taggart had not "returned to the fray" to pursue his counterclaim after bankruptcy and that the Sherwood members had violated the bankruptcy discharge order.[18] The district court then remanded the case to the bankruptcy court for a determination of whether Taggart had proven that the Sherwood members "knowingly" violated the discharge injunction.

The bankruptcy court subsequently held the Sherwood members in civil contempt.[19] In doing so, the court used a standard similar to strict liability, finding that it could not consider the members' subjective beliefs regarding whether the discharge applied.[20] Instead, because the Sherwood members had actual knowledge of the discharge injunction when they requested attorneys' fees in state court, the bankruptcy court found that they had, by virtue of that knowledge, intended the actions that violated the discharge injunction.[21]

On appeal, the Ninth Circuit Bankruptcy Appellate Panel vacated the sanctions,[22] and the Ninth Circuit affirmed.[23] The Ninth Circuit, however, applied a different, subjective standard, concluding that a creditor's good faith belief that the discharge order does not apply to its claim precludes a contempt finding, even if that belief is unreasonable.[24] The Supreme Court granted certiorari to consider the question of when a court can hold a creditor in civil contempt for attempting to collect a debt in violation of the discharge order.

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[16] *Id.* at 282-83.

[17] *Id.*

[18] *Id.* at 284.

[19] *Id.* at 285.

[20] *Id.* at 284-85.

[21] *Id.*

[22] *Id.* at 291.

[23] In re Taggart, 888 F.3d 438 (9th Cir. 2018).

[24] *Id.* at 444.

## II.
## THE COURT'S OPINION: FINDING A MIDDLE GROUND

Justice Breyer, writing for a unanimous Court, began his quest for the correct standard by looking at two Bankruptcy Code provisions: § 524, which discusses the effect of the bankruptcy discharge, and § 105, which addresses the powers bankruptcy courts have to, among other things, hold parties in contempt.[25] After reviewing these provisions, the Court determined that the Code does not grant bankruptcy courts unlimited authority to hold creditors in civil contempt. Instead, the relevant Bankruptcy Code provisions, which were derived from traditional standards in equity practice, brought the "old soil" of this practice with them. In other words, traditional equity standards for how courts enforce injunctions should inform when a bankruptcy court can hold a party in civil contempt for violating the discharge order.[26]

Outside of bankruptcy, courts cannot hold parties in civil contempt when there is a fair ground of doubt as to the wrongfulness of that party's conduct.[27] The Court characterized this as an objective standard, but noted that the party's subjective intent may also be relevant. Thus, the Court sought to forge a middle ground between the Ninth Circuit's and the bankruptcy court's standards, concluding that civil contempt is appropriate when a creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope.[28]

The Court next addressed why both the Ninth Circuit and the bankruptcy court had adopted the wrong standards. The Court first observed that the Ninth Circuit's more subjective standard was fraught with problems: it was inconsistent with traditional contempt principles, was too reliant on "difficult-to-prove states of mind," and would too often encourage creditors to try to collect discharged debts, even if they stood on "shaky legal ground."[29]

On the other hand, the bankruptcy court's "strict liability" standard was arguably too harsh. Taggart had urged the Court to adopt this standard,

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[25] *Taggart*, *supra* note 1 at 1801.

[26] *Id.*

[27] *Id.*

[28] *Id.* at 1802.

[29] *Id.* at 1802-03.

saying that creditors unsure about whether a debt has been discharged can always seek an advance determination from the bankruptcy court before trying to collect the debt.[30] The Court was not convinced. It noted that advance determinations were only meant to be used in a small class of cases and that Taggart's proposal would have the effect of moving lots of litigation out of state courts and into the federal court system.[31] The costs and delays of this move, the Court pointed out, would disadvantage both debtors and creditors.

Having selected a standard, the Court could have concluded the opinion. However, because Taggart had also noted that lower courts use something akin to a strict liability standard for automatic stay violations, the Court proceeded to discuss whether the standard it was adopting for discharge violations should also apply to remedy violations of the automatic stay. The Court proved somewhat more elusive with this issue, hinting that a strict liability standard was perhaps inappropriate but also noting that the Bankruptcy Code provision concerning stay violations was differently worded from the provisions addressing discharge violations and observing that automatic stays serve very different purposes than discharge orders.[32]

Ultimately, the Court vacated the judgment below and remanded the case.

## III.
## Implications (or not) for the Automatic Stay

The Court's decision in *Taggart* has led some commentators to speculate as to whether it will lead lower courts to adopt a standard for automatic stay violations that is more akin to the one the Court chose for discharge order violations.[33] Yet, as the Court itself pointed out, there is reason to treat these violations differently. The automatic stay "aims to prevent damaging disruptions to the administration of a bankruptcy case in the short run."[34]

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[30] *Id.* at 1803.

[31] *Id.*

[32] *Id.* at 1803-04.

[33] *See, e.g.*, Bill Rochelle, *A Michigan Stay Opinion Raises Contempt Issues from the Supreme Court*, Rochelle's Daily Wire, Aug. 19, 2019.

[34] *Taggart*, *supra* note 1 at 1804.

In contrast, a discharge "is entered at the end of the case and seeks to bind creditors over a much longer period."[35]

In another recent Supreme Court bankruptcy case, *Czyzewski v. Jevic Holding Corp.*,[36] the Court drew a line between interim orders issued during the pendency of a bankruptcy case and final orders occurring at the end of a case.[37] The Court's discussion in *Taggart* about the different purposes served by the automatic stay and the bankruptcy discharge echoes its line-drawing in *Jevic*, suggesting that stay violations that occur during a bankruptcy case may be treated differently than discharge violations that occur after a case has ended. Thus, although *Taggart* toys with taking a position on addressing stay violations, the Court's holding may not have much influence in this area at all.

## CONCLUSION

The Court's decision in *Taggart v. Lorenzen* has set off concerns about the proper standard to be used when holding parties in contempt for other bankruptcy-related missteps, namely violations of the automatic stay. Although it is tempting to apply the same standard across the board in a bankruptcy case, there are good reasons for differentiating *Taggart*'s standard from the one used to remedy stay violations, as the Court's own opinion – and a prior Court decision – suggest. On the other hand, the Court did discuss the contempt standard for automatic stay violations in *Taggart* when it did not really have to, leaving the legal community to take up one of its favorite tasks: trying to guess what the Justices are thinking.

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[35] *Id.*

[36] 137 S. Ct. 973 (2017).

[37] *See* Daniel Bussel, *Opinion Analysis: Bankruptcy Priority Rules May Not Be Evaded in Chapter 11 Structured Dismissals*, SCOTUSblog, Mar. 23, 2017 (highlighting this point).