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Credit Reporting and Bankruptcy: Is Your Post-Discharge Credit Reporting Inviting Trouble?

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In difficult economic times, debtors' attorneys closely review credit reports looking for potential legal claims against creditors. Long after a debtor has been discharged from bankruptcy, creditors can find themselves defending claims of improper credit reporting. A recent case from the Eastern District of North Carolina illustrates the trouble facing creditors who furnish incorrect reports of discharged debt. See *In re Adams* (Bankr. E.D.N.C. 2010).

The *Adams* debtors filed a chapter 13 petition in 2008 and received a discharge after completion of plan payments. A few days after the discharge, the debtors filed a motion seeking a declaration from the bankruptcy court that all payments due on their residential mortgage were current. The mortgage lender was served with this motion but filed no response. The bankruptcy court entered an order declaring the mortgage debt current. Thereafter, the debtors applied to refinance their mortgage. They were turned down when their existing lender provided the prospective lender with a payoff statement and loan history containing serious errors. The report stated that the debtors' residence was in foreclosure, which was not true. Despite repeated demands, the lender failed to correct the errors. The debtors then re-opened their bankruptcy case and filed a motion asking the court to find lender in violation of the discharge injunction and in contempt of court.

The bankruptcy court found the lender in contempt for willfully, knowingly and flagrantly violating the discharge injunction and the order finding the mortgage current, and awarded compensatory and punitive damages to the debtors. The debtors suffered actual harm because they were unable to refinance their home at market rates, incurred attorneys' and appraisal fees in their refinancing efforts and their credit was damaged by the false negative reporting. Factors significant to the damage award included: (1) it had been 21 months since the debtor filed the motion to show cause, during which time the lender took no action to correct its credit reporting; (2) even though the lender stated that it would update its credit reports, it still provided no proof of doing so at the show cause hearing in 2010; (3) from 2007 to well into 2009, the lender was still reporting the debtors' mortgage as being in foreclosure; (4) the lender had assessed foreclosure fees and costs and applied the debtors' payments to those costs instead of to the loan principal; and (5) the lender did not acknowledge the seriousness of the matter.

The court reduced the interest rate on the debtors' loan from 10.8% to 6%, thereby reducing the loan balance by $10,000. The court awarded punitive damages in the amount of $66,300, which represented a fine of $100 per day beginning when the lender was served with the debtors' motion and ending when the lender complied with the contempt order. The lender was ordered to prove to the court, debtors' counsel and the chapter 13 trustee that it had contacted all three major credit reporting companies and clarified that the debtors were in bankruptcy and the debt was current from date of discharge to the date of the corrected report. In addition, the lender was ordered to pay attorneys' fees for the chapter 13 trustee and debtors' counsel, including appraisal expenses incurred by the debtors. Finally, if the lender failed to comply within 14 days of the contempt order, the punitive damages were to be applied as a setoff against the amount owed on the mortgage debt, effectively eliminating the loan balance.

Do Bankruptcy Courts Impose Uniform Post-Discharge Credit Reporting Rules?

Bankruptcy courts have awarded damages due to incorrect and misleading credit reporting under numerous legal theories, including violation of the discharge injunction and automatic stay provisions of the Bankruptcy Code, as well as violation of the federal Fair Debt Collection Practices Act ("FDCPA") and Fair Credit Reporting Act ("FCRA"). However, application of these laws varies within the court system.

The bankruptcy discharge injunction "operates as an injunction against the commencement or continuation of an action, the employment of process of an act to collect, recover or offset any such debt as a personal liability of the debtor, whether or not such discharge is waived." One line of bankruptcy cases has held that in addition to the erroneous credit reporting, a creditor must perform some other overt act to collect the discharged debt in order to violate the discharge injunction. These courts reason that the Bankruptcy Code does not require a creditor to take an affirmative step to notify credit reporting agencies that a debt has been discharged. These courts do not view the mere carryover of the pre-discharge debt on the credit report as an attempt to collect the debt.

A contrary line of cases rejects the requirement of an additional overt act by the creditor, and holds that incorrect credit reporting alone can be a violation of the discharge injunction. Some courts have inferred an attempt to collect from a creditor's refusal to update its credit reporting post-discharge. Courts have held that the failure to report a debt as "discharged" or "individual in bankruptcy" with a "zero" balance on the account after a debtor has had his debt discharged may constitute a violation of FCRA, the discharge injunction or both.

Lessons for Creditors

In the face of inconsistent authority, creditors in all jurisdictions are best-served by taking a conservative approach to credit reporting to minimize the risk of compensatory and punitive damages claims by debtors. Particularly when a debtor requests such action, a creditor should consider updating the report of a discharged debtor to reflect the discharge and a zero balance due, or to reflect the status of the debt as otherwise ordered by the Bankruptcy Court. The debtor may be willing to sign a waiver of any potential claims of credit-reporting violations in exchange for such action by the creditor, resulting in a relatively quick, easy way for both sides to avoid costly litigation.

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