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GUEST COMMENTARY

CORPORATIONS MAY BE PEOPLE, BUT THEY ARE NOT SERVICEMEMBERS

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The Servicemembers Civil Relief Act enables servicemembers “to devote their entire energy to the defense needs of the Nation” by deferring or suspending certain obligations during active duty and for certain periods after the end of active duty.¹ The SCRA's core protections include interest-rate reductions on certain credit obligations, and the prevention of foreclosure and repossession of certain property.

Both federal regulators and individual plaintiffs have pushed to expand the SCRA's protections to cover a broader range of obligations and liabilities. The business obligations of individual servicemembers is one area of increasing focus, as typified by a recent case, *Davis v. City of Philadelphia*.² A servicemember attempted to reduce the risk of personal liability by transferring property to a corporation that he owned. He did not realize, however, that the transfer would operate to remove the property from potential future SCRA protections.

The 3d U.S. Circuit Court of Appeals delivered the first appellate opinion on the issue, affirming a district court's order dismissing the case and holding that

SCRA protections do not attach to property owned by a corporation — and provided much-needed guidance on the limits of the SCRA's reach.

Michael Davis and his wife attempted to “insulate themselves from liability” by transferring full ownership of their rental property to Global Sales Call Center, a Pennsylvania corporation solely owned and managed by Davis.³ In 2009, after several periods of military service, Davis requested that the Philadelphia Department of Revenue reduce the interest accruing on Global's property tax debt under the SCRA because Davis was a servicemember.

The city department denied Davis's request on the basis that Global was a corporation and not a servicemember entitled to the SCRA's benefits and protections. Davis' ownership of Global did not change the analysis. Davis, at the direction of the revenue department, filed a tax abatement petition with the Philadelphia Tax Review Board in 2010, requesting a recalculation of the interest and penalties against his property. The Review Board agreed with the revenue department and denied Davis's petition.



Foreclosure prompts SCRA suit

The City of Philadelphia in 2011 initiated foreclosure proceedings against Global's property because of the company's failure to pay overdue property taxes. The City obtained a judgment from the Philadelphia Court of Common Pleas permitting foreclosure. Davis petitioned the court to reopen the judgment, arguing that the foreclosure violated his rights under the SCRA. The court again ruled in the City's favor and signed the foreclosure petition.⁴

Davis subsequently brought suit under 42 U.S.C. § 1983 in federal district court, arguing that the City had violated the SCRA. The district court granted the City's motion to dismiss, holding that Global lacked statutory standing to assert a SCRA claim because it was a corporate entity and not a servicemember eligible for the SCRA's protections.⁵

The district court also held that Davis lacked statutory and constitutional standing because he was not personally liable for Global's tax debt.⁶ Davis appealed the decision to the 3d Circuit.⁷

The appellate court affirmed the decision of the district court on three principal bases:⁸

- First, it emphasized that the SCRA defines a servicemember as “a member of the uniformed services.”⁹ The court noted that, “[a]lthough federal law treats corporations as ‘people’ in many respects, it does not deem them soldiers”¹⁰ for purposes of conferring statutory standing. Because only a “servicemember” may apply for relief under the SCRA, the statutory text prevented Global from asserting standing.¹¹
- Second, while the court disagreed with the court below that Davis lacked standing (as he was a servicemember),¹² it held that Davis could not state a claim for relief. Specifically, while Davis alleged that interest accrued on the debt exceeded the 6 percent statutory cap, he could not allege either that this excess interest was assessed against him personally or that a “servicemember” owned the property in question.¹³
- Finally, the appellate court also held that § 4026 of the SCRA did not prevent the City from foreclosing on the property. That section states that a creditor may not use a servicemember's personal assets to satisfy a business debt during a period of military service.¹⁴

The court recognized that the “necessary corollary to this rule is that business creditors *are* allowed to execute on the servicemember's *business assets* to satisfy business debt, even if the servicemember is personally liable for that business debt.”¹⁵ Because Global incurred the tax liability and owned the property, § 4026 did not apply.¹⁶

Decision emphasizes dividing line

The 3d Circuit's holding that the SCRA does not protect corporations extends a line of cases appropriately distinguishing between servicemembers and their business interests. In two unreported cases — *Cathey v. First Republic Bank*¹⁷ and *Newton v. Bank of McKenney*¹⁸— federal district courts held that the SCRA does not apply to obligations incurred by a corporation.¹⁹

In *Newton*, the court noted that, “had Congress meant to embrace corporations within the ambit of the SCRA, it certainly could have done so, just as it did with dependents.”²⁰ Importantly, the 3d Circuit maintained the distinction between corporation and servicemember for purposes of the SCRA notwithstanding that Davis owned and managed Global. Accordingly, the court ruled out the necessity for any balancing or majority ownership test.

The appellate panel noted that, in transferring their property to a corporation to protect themselves from personal liability, the Davises lost the personal protections of the SCRA in an “unfortunate twist of law and fate.”²¹ However, treating corporations as separate legal entities provides their owners with a number of advantages, including preferential tax treatment for corporate assets, limited liability for the individual owners, and the streamlined transfer of assets to a subsequent owner of the corporation.

As the appellate court noted, there are both benefits and limitations to incorporation, and Davis cannot “have his cake and eat it too.”²² The SCRA “must be

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read with an eye friendly to those who dropped their affairs to answer their country's call,"²³ but the 3d Circuit's decision affirms that the text of the statute appropriately limits the scope of its protections.

Notes

¹ 50 U.S.C. § 502(a).

² *Davis v. City of Philadelphia*, No. 15-2937, 2016 WL 2343042 (3d Cir. May 4, 2016).

³ *Id.* at 2, n.1.

⁴ Although the Third Circuit did not reach this issue because it held that Global was not entitled to the SCRA's protections, we note that — even if the SCRA had applied — by hearing Davis's SCRA argument and nevertheless issuing a court order permitting the foreclosure, the City appears to have complied with Section 3991(b)(1) of the SCRA: "Property described in subsection (a) may not be sold to enforce the collection of such tax or assessment except by court order and upon the determination by the court that military service does not materially affect the servicemember's ability to pay the unpaid tax or assessment."

⁵ *Davis*, No. 14-06979, 2015 WL 4461770, at *1 (E.D. Pa. July 21, 2015), *aff'd*, No. 15-2937, 2016 WL 2343042 (3d Cir. May 4, 2016).

⁶ *Id.*

⁷ The Third Circuit noted that Global itself did not file an appeal — this in itself is telling. Both Davis and Global filed suit in the District court as *pro se* co-plaintiffs. *Davis*, No. 14-06979, 2015 WL 4461770, at *1 (E.D. Pa. July 21, 2015), *aff'd*, No. 15-2937, 2016 WL 2343042 (3d Cir. May 4, 2016). The District Court required Global to obtain its own independent counsel, and Global did so. *Id.* This fact foreshadowed the District Court's, and later the Third Circuit's, decision to deny standing to Global as a corporation and to Davis as a separate party not obligated on the debt. *Davis*, No. 14-06979, 2015 WL 4461770, at *1 (E.D. Pa. July 21, 2015), *aff'd*, No. 15-2937, 2016 WL 2343042 (3d Cir. May 4, 2016).

⁸ *Davis* at 7.

⁹ *Id.* at 4 (quoting 50 U.S.C. § 3911(1)).

¹⁰ *Id.* at 5

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 6. The Third Circuit also declined to use equity to pierce the corporate veil, as to do so would require the court to hold that Davis's own corporation was "nothing but a sham" set up by Davis that Davis himself was attacking. *Id.* However, after the Third Circuit decided this case, Davis's lawyer all but admitted that Global was a sham corporation: "Davis was the sole proprietor for Global Sales, a mere shell business entity, and solely responsible for paying Global's taxes and overhead." Carrie Salls, *Army vet/business owner taking tax dispute with Philadelphia to U.S. Supreme Court*, PENN RECORD, June 22, 2016).

¹⁴ 50 U.S.C. § 4026(a).

¹⁵ *Davis* at 7 (quoting *Newton v. Bank of McKenney*, 2012 WL 1752407, at *6 (E.D. Va. May 16, 2012)).

¹⁶ This may not be the final word on the *Davis* case — counsel for Davis stated that he will ask the Supreme Court to review the Third Circuit's decision. Salls, *supra* note 14. As of the time this article was submitted for publication, a petition for a writ of certiorari has not been filed with the Supreme Court.

¹⁷ *Cathey v. First Republic Bank*, No. 00-CV-2001, 2001 WL 36260354 (W.D. July 6, 2001).

¹⁸ 2012 WL 1752407 (E.D. Va. May 16, 2012).

¹⁹ For a detailed discussion of *Cathey* see Jeffrey Naimon, Valerie Hletko, Sasha Leonhardt, & Kirk Jensen, *Citizen, Soldier, Small-Business Owner? Commercial Lending and the Servicemembers Civil Relief Act*, 21 WESTLAW BANK & LENDER LIABILITY (Dec. 14, 2015).

²⁰ *See, e.g. Newton v. Bank of McKenney*, No. 3:11CV493-JAG, 2012 WL 1752407, at *6 (E.D. Va. May 16, 2012) (citing *Keene Corp. v. U.S.*, 508 U.S. 200, 208 (1993)).

²¹ *Davis* at 7.

²² *Id.*

²³ *Le Maistre v. Leffers*, 333 U.S. 1, 6 (1948) (citing *Boone v. Lightner*, 319 U.S. 561, 575 (1943)).