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Consumer Track

Discharge and Dischargeability Issues

CONCURRENT SESSION

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CURRENT ISSUES IN DISCHARGE AND DISCHARGEABILITY PROCEDURE

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   (E. Philip Groben)

2. Arbitration in the Context of Discharge and Dischargeability Actions
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DISCHARGEABILITY EXCEPTIONS

1. The Expansion of § 523(a)(2)(a): *Husky Int'l Elecs., Inc. v. Ritz*
   (Claire Ann Resop)

Deadlines to Bring Objections to Discharge and Challenge Dischargeability

The procedures and deadlines by which a creditor or party in interest must bring an objection to discharge or to dischargeability of a certain debt is governed respectively by Rules of Bankruptcy Procedure (the "**Rules**") 4004(a) and 4007(c). Those Rules read, in part, as follows:

Rule 4004: Grant or Denial of Discharge

(a) Notice of Time Fixed. In a chapter 7 case, a complaint, or a motion under §727(a)(8) or (a)(9) of the Code, objecting to the debtor's discharge shall be filed no later than 60 days after the first date set for the meeting of creditors under §341(a). In a chapter 11 case, the complaint shall be filed no later than the first date set for the hearing on confirmation. In a chapter 13 case, a motion objecting to the debtor's discharge under §1328(f) shall be filed no later than 60 days after the first date set for the meeting of creditors under §341(a)…

(b) Extension of Time.

(1) On motion of any party in interest, after notice and hearing, the court may for cause extend the time to object to discharge. Except as provided in subdivision (b)(2), the motion shall be filed before the time has expired.

(2) A motion to extend the time to object to discharge may be filed after the time for objection has expired and before discharge is granted if (A) the objection is based on facts that, if learned after the discharge, would provide a basis for revocation under § 727(d) of the Code, and (B) the movant did not have knowledge of those facts in time to permit an objection. The motion shall be filed promptly after the movant discovers the facts on which the objection is based.

Rule 4007: Determination of Dischargeability of a Debt

(a) Persons Entitled To File Complaint. A debtor or any creditor may file a complaint to obtain a determination of the dischargeability of any debt.

(b) Time for Commencing Proceeding Other Than Under §523(c) of the Code. A complaint other than under §523(c) may be filed at any time. A case may be reopened without payment of an additional filing fee for the purpose of filing a complaint to obtain a determination under this rule.

(c) Except as otherwise provided in subdivision (d), a complaint to determine the dischargeability of a debt under §523(c) shall be filed no later than 60 days after the first date set for the meeting of creditors under §341(a). The court shall give all creditors no less than 30 days' notice of the time so fixed in the manner provided in Rule 2002. On motion of a party in interest, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be filed before the time has expired.

Both Rules allow the bankruptcy court to enlarge the time in which to bring objections, Rule 4004(b) allows for a party in interest to bring a motion upon which, after notice and a hearing, a court may, for cause, extend the deadline. A single motion to extend the discharge may be brought on behalf of multiple parties; however, the rules prevent a nonmoving party from 'joining' in an already filed motion. *In re Carlson*, 255 B.R. 22, 24 (Bankr. N.D.Ill. 2000); *See also* Rule 9014(c)(which does not incorporate joinder rules of civil procedure into contested bankruptcy matters).

1. What is cause sufficient to support an extension of the deadlines?

Black's Law Dictionary defines the term "cause" to mean a "grounds for legal action", and "good cause" as a "legally sufficient reason." What constitutes cause is a matter within the court's discretion. *Carlson*, 225 B.R. at 24. The Bankruptcy Code does not provide any definitions or assistance on what constitutes "good cause", but it does provide some examples of what constitutes cause in other contexts: Section 362(d) cause for relief from the automatic stay for lack of adequate protection of an interest in property, *See Baxter v. Sarmadi (In re Baxter)*, 602 Fed.Appx. 322, 324-25 (6th Cir. 2015)(discussing the cause in the context of the absence of a good faith filing); *In re Williams*, 144 F.3d 544, 546-47 (7th Cir. 1998)(analyzing whether an expired lease is cause to obtain relief from the automatic stay); Section 707(a) cause for dismissing a chapter 7 case for unreasonable delay which is prejudicial to creditors, nonpayment of fees, and failure to file information, *See In re Schwartz*, 799 F.3d 760, 763-64 (7th Cir. 2015)(debtor's lavish lifestyle provided cause for dismissal); *Merritt v. Franklin Bank, N.A. (In re Merritt)*, 211 F.3d 1269 (6th Cir. 2000)(debtor's assets and income was cause for dismissal); Section 1104 cause for appointment of a trustee or examiner upon fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, *See In re Bayou Group, LLC*, 564 F.3d 541, 546-48 (2d Cir 2009); Section 1112 dismissing a chapter 11 case or converting the case to chapter 7 for cause.

However, the above Bankruptcy Code sections which address cause do so in a manner more aligned with bad faith or a failure on the part of the debtor to effectively navigate a bankruptcy proceeding. In contrast to those negative cause examples, code sections which instead require a proactive cause are: Section 303(e) wherein the court may, for cause, require petitioning creditors to post bond in an involuntary case; Section 521(a)(2)(A) providing that the court may extend the time to file a statement of intentions for cause; or Section 1121(d)(1) a court may, for cause, modify the exclusivity period.

Cause in the context of 4004 and 4007 is of a proactive nature, and requires the movant to make an affirmative demonstration for a need relief apart from the actions of the debtor, although actions of the debtor may be considered by the court. A motion seeking an extension of these deadlines must identify the reason which is diving the movant to request relief, and the motion should identify said reason with some

degree of particularity. *See* Rule 9013. A court may rant additional time for further discovery, as long as the movant has not squandered opportunities to obtain discovery and other materials which may support an objection to discharge or dischargeability. *See In re Fithian*, 156 F.Supp 887 (D.Md. 1957). Cause for relief given by a movant must be related to the specific reasons why a debtor should not receive a discharge. *See* 11 U.S.C. §§ 727(a)(1)-(10). The administration of an estate by a trustee has no bearing on whether a debtor should receive a discharge, and therefore issues which effect the administration of an estate cannot be cause for an extension of the deadline by which to object to discharge. *In re Nevius*, 269 B.R. 209, 211 (Bankr. N.D.Ind. 2001); *see In re Leary*, 185 B.R. 405, 406 (Bankr.D.Mass.1995)(motion denied where no indication given to suspect grounds existed to object to discharge); s*ee also, In re James*, 187 B.R. 395, 397 (Bankr.N.D.Ga.1995)(granting motion to extend deadline to file dischargeability action where special circumstances were demonstrated); *In re Floyd*, 37 B.R. 890, 891 (Bankr.N.D.Tex.1984)(granting motion where debtor's affairs were complex and creditor needed additional time to undertake discovery, to be sure of its allegations, before filing an objection to discharge).

2. **Is this a jurisdictional deadline?**

Whether the deadlines of Rules 4004 and 4007 are jurisdictional or statutory is important because if said deadlines are jurisdiction in nature, once the deadline runs, the court loses the authority to hear matters related to the debtor's right to receive a discharge. By contrast, statutory deadlines are subject to waiver, estoppel, and equitable tolling. *United States v. Locke*, 471 U.S. 84, 94 n.10 (1985). The Supreme Court, when determining whether a particular deadline is a jurisdictional bar to a request for relief, looks to the statutory framework underlying the particular deadline, the congressional policy underlying the deadline, and prior Supreme Court opinions which may address that particular deadline. *Zipes v. Transworld Airlines, Inc.*, 455 U.S. 385 (1982).

The circuit courts have consistently held that the deadlines by which to bring objections to discharge or dischargeability are statutory and not jurisdictional bars. *See In re Benedict*, 90 F.3d 50 (2d Cir. 1996)("There is nothing in the Bankruptcy Code that persuades us to hold that Rule 4007(c) is any different from a statutory provisions that imposes a filing deadline."); *In re Kontrick*, 295 F.3d 724 (7th Cir. 2002)("[The furtherance of the prompt administration of bankruptcy estates and protection of the "fresh start" objective of the Code] are best fostered, not by a rigid jurisdictional approach, but by the exercise of equitable discretion in a manner consistent with the policies that animate the Bankruptcy Code."); *In re Maughan*, 340 F.3d 337 (6th Cir. 2003)(finding the Rule 4004 deadline to be statutory through a comparison of the jurisdictional deadline of Rule 4003 with need for court to exercise equitable powers in application of Rule 4004). The analysis given by the Seventh Circuit in its *Kontrick* decision was upheld on appeal to

the Supreme Court in *Kontrick v. Ryan*, 540 U.S. 443 (2004) ("*Kontrick II")*. In *Kontrick II*, the Court was asked to resolve whether a late filed complaint could be dismissed for want of subject matter after the bankruptcy court reaches the merits of the objection to discharge or, in other words, whether the defendant waived its rights to defend. *Id*. Only Congress may determine a lower federal court's subject-matter jurisdiction, and the Court looked to the language of 28 U.S.C. §§ 157(b)(1) and (b)(2)(I) and (J) to determine whether a bankruptcy court's jurisdiction in adjudicating objections to discharge or dischargeability is limited by a time constraint. *Id*. at 452-53. Section 157(c)(1), which addresses *de novo* district court review of bankruptcy court findings and conclusions in noncore proceedings is limited to "those matter to which any party has timely and specifically objected." The bankruptcy court's jurisdiction to hear and determine matters related to determinations as to the dischargeability of particular debts or objections to discharge include no such timeliness requirements. *Id.* at 453; 28 U.S.C. §§ 157(b)(2)(I) and (J).

Despite the clear language of the United States Supreme Court in *Kontick II* that the deadlines provided by Rules 4004 and 4007 are statutory, and not jurisdictional, the Ninth Circuit decision *Anwar v. Johnson (in re Johnson)*, 720 F.3d 1183 (9th Cir. 2013) can be read as an erosion of the authority of the bankruptcy courts to adjudicate untimely objections to discharge. In *Johnson*, the objecting creditor's attorney experienced technical problems and was delayed in filing a nondischargeability complaint until 12:26 a.m. the morning after the deadline ran, or in other words, 27 minutes late. *Id*. at 1185-86. In deciding whether the objecting creditor was entitled to a retroactive extension of the objection deadline the Ninth Circuit used a strict reading of Rule 4007(c) and further held that the bankruptcy court lacked the equitable power under Section 105(a) to grant relief because such relief would be contrary to the language of Rule 4007(c). *Id.* at 1187, citing to *Zidell, Inc. v. Forsch (In re Coastal Alaska Airlines, Inc.)*, 920 F.2d 1428, 1432 (9th Cir. 1990). The Ninth Circuit, in effect, recognizes Rules 4004 and 4007 as statutory bars as decided by *Kontrick II*, but prevents the lower courts from entertaining defenses commonly associated with statutory bars.

3. **The deadline has passed, can I still object?**

Parties which have inadvertently allowed the 4004 or 4007 deadlines to run may receive a second wind if the court has granted another party an extension because the Rules do not explicitly limit an extension of time to only the specific creditor which files a motion for extension. *See Burger King Corp. v. B-K of Kansas, Inc*, 73 B.R. 671, 673 (D. Kan. 1987). In limited circumstances courts which have extended the bar date to the benefit of nonmoving creditors have found three elements were met: (1) the surrounding circumstances provided notice to the court and the debtor that a general extension was

warranted, (2) the surrounding circumstances demonstrated that cause existed for a general extension, and (3) the subsequent order indicated that a general extension was granted. *Wijewickrama v. Edgefield Holdings LLC (In re Wijewickrama)*, Case No. 1:16-cv-00347 (W.D.N.C. March 15, 2018 (Judge Martin Reindinger)); *In re Kneis*, 2009 WL 1750101 at *3 (Bankr. D.N.J. June 15, 2009)(citing *In re Watkins*, 365 B.R. 574, 577 (Bankr. W.D.Pa 2007); *In re Brady*, 101 F.3d 1165 (6th Cir. 1996); *In re Demos*, 57 F.3d 1037 (11th Cir. 1995).

Bankruptcy courts may equitably toll the deadline in extraordinary circumstances which has the effect of retroactively rendering an untimely filing timely, s*ee Maughan*, 340 F.3d 377, and courts will consider five factors: (1) lack of actual notice of the filing requirement; (2) lack of constructive knowledge of the filing requirements; (3) diligence in pursuing one's rights; (4) absence of prejudice to the defendant; and (5) the plaintiff's reasonableness in reminting ignorant of the notice requirement. *Id.* at 344. The primary focus of the court will be "on the diligence used by the plaintiff in pursuing its rights and the resulting prejudice, if any, to the defendant." *First Bank System v. Begue (In re Begue)*, 176 B.R. 801, 804 (Bankr.N.D.Ohio 1995). In *Maughan*, the Sixth Circuit found no error in the lower court's conclusion that the moving creditor was diligent in seeking to enforce its rights, despite notice of the deadline, due to the "dilemma" caused by recalcitrant debtors who refused to turn over documents and the obligation of a prospective adversarial plaintiff under 9011 to investigate fully before initiating an adversary complaint. *Id.* at 344. Furthermore, the lower court implicitly concluded that the movant's three-day delay in filing a motion to extend the time in which to object to discharge was due, at least in part, to the conduct of the debtors which are labeled as an attempt "to frustrate the ability of a litigant to comply with applicable law by failing or neglecting to adhere to lawful orders of the Court." *Id*.

Lastly, a party may ask the court to relate an untimely adversarial complaint back to a timely filed motion, or other such procedurally defective objection; however, the proponent of such relief will have to demonstrate that the original defective filing contains information sufficient to give the defendant fair notice of the claim and the grounds upon which the claim rests per *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007), and that two documents are similar enough so as to allow relation back.

Under Rule 7008, documents and filings may constitute a "complaint" even though they may not be labeled or captioned as such if the contain the following: (1) "a short and plain statement of the grounds for the court's jurisdiction[;]" (2) "a short and plan statement of the claim showing the pleader is entitled to relief;" and (3) "a demand for the relief sought". Fed. R. Civ. P. 8(a). *See, e.g., In re Dominguez*, 51 F.3d 1502, 1509 (9th Cir. 1995)(holding that a creditor's "discharge memorandum" was a sufficient "complaint" under Bankruptcy Rule 7008 to commence non-dischargeability proceeding); *In re Thompson*,

572 B.R. 638, 656 (Bankr. S.D. Tex. 2017); *In re Rand*, 144 B.R. 253, 255–56 (Bankr. S.D.N.Y. 1992); *In re Levine*, 132 B.R. 464, 467 (Bankr. M.D. Fla. 1991).

Federal Rule of Civil Procedure 15(c), incorporated through Rule 7015, allows for the relation back of an amended pleading to the date of the original when "the amendment asserts a claim or defense that arose out of the conduct, transaction, or occurrence set out – or attempted to be set out – in the original pleading." Fed. R. Civ. P. 15(c)(1)(B). Specifically, the original pleading must provide adequate grounds and information to be considered a complaint regarding nondischargeability. *See In re Markus*, 313 F.3d 1146, 1150 (9th Cir. 2002)(motion stating "object debtors discharge," without setting forth legal criteria for non-dischargeability or "any facts having to do with the nature of the conduct that caused the debt, or a claim for relief based on non-dischargeability," held insufficient); *In re Bozeman*, 226 B.R. 627, 632 (8th Cir. B.A.P. 1998)(cover sheet describing "Nature of Suit" as "To determine the dischargeability of a debt" and motions to extend time to file complaint held insufficient because "they are insufficient to satisfy the notice requirements of the Federal Rules"); *In re Hunter*, 552 B.R. 864, 870 (Bankr. D. Kan. 2016) (initial filings insufficient because they were "so bare that, even if construed as an original pleading [they] did not sufficiently describe [ ] the 'conduct, transaction, or occurrence'").

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THE COLLISION BETWEEN THE BANKRUPTCY CODE AND THE FEDERAL ARBITRATION ACT IN DISCHARGEABILITY AND DISCHARGE PROCEEDINGS

Many contracts underpinning disputes between individual bankruptcy debtors and their creditors contain arbitration provisions: credit card agreements, auto loan agreements, sales contracts and leases, employment contracts, shareholder agreements, student loan notes. The Federal Arbitration Act, 9 U.S.C. § 1, et seq. ("FAA") and the Bankruptcy Code, 11 U.S.C. § 101, et seq., are both powerful federal statutes albeit with sometimes conflicting purposes. The FAA and Supreme Court decisions implementing it aggressively enforce agreements to remove disputes from state and federal courts in favor of decentralized, private decision-making. The Bankruptcy Code acts to centralize debtor-creditor disputes in one centralized federal forum in support of a debtor's fresh start and equitable distribution of property of the estate. *United States Lines, Inc v. American Steamship Owners Mutual Protection and Indemnity Ass'n, Inc. (In re U.S. Lines, Inc.)*, 197 F.3d 631, 640 (2d Cir. 1999), *cert. denied* 529 U.S. 1038 (2000). These differing goals sometimes come into conflict in disputes involving discharge and dischargeability. While the analytical framework for resolving the conflict between the FAA and the Bankruptcy Code is now well-developed, the results of applying it in the context of discharge and dischargeability actions are not uniform or necessarily predictable.

1. General Principles Governing Enforceablity of Arbitration Provisions in Bankruptcy Matters

The FAA establishes a strong federal policy favoring arbitration. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (citing *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)). The FAA requires federal courts to vigorously enforce arbitration agreements, a principle that is not automatically diminished when a claim is based on a statutory right. *Id. (citing Dean Witter Reynolds Inc. v. Byrd***,** 470 U.S. 213 (1985)). However, "[l]ike any statutory directive, the mandate may be overridden by a contrary congressional command." *Id*. The FAA permits motions to compel arbitration. The party opposing arbitration of a statutory claim has the burden of showing that Congress intended to prohibit arbitration of a particular statutory claim. In *Shearson*, the Supreme Court established a three- factor test to determine whether there is contrary congressional intent. Courts are directed to look to: (1) the other statute's text; (2) the other statute's legislative history; or (3) an inherent conflict between arbitration and the other statute's underlying purpose. *Id*. at 227.

If the statute's text or legislative history indicate a limitation or prohibition of application of the FAA, strict enforcement of the arbitration agreement is undone. Where there is no applicable statutory text or legislative history, the court must decide whether there is an inherent conflict between the purposes of the two statutes. Where there is an inherent conflict in purposes, the court has discretion whether to

compel arbitration. But if no inherent conflict in purposes exists, the court lacks discretion and must compel arbitration. *In re Mintze*, 434 F.3d 222, 228 (3d Cir. 2008) (citing *Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1156 (3d Cir. 1989)).

The Bankruptcy Code does not mention arbitration. Nothing in its legislative history indicates any Congressional intent regarding arbitration in the bankruptcy context. Thus, the third factor of the *Shearson* test—whether an inherent conflict exists between arbitration and the underlying purposes of the Bankruptcy Code—is dispositive**.** Indeed, the majority of courts applying the *Shearson* analytical framework have either decided that Congress did not include statutory text or legislative history that limits the FAA's application to Bankruptcy Code matters*, e.g. In re Mintze, supra*; *In the Matter of Eber*, 687 F.3d 1123 (9th Cir. 2012); *In re Electric Machinery Enterprises, Inc.*, 479 F.3d 791 (11th Cir. 2007), or have jumped directly to analysis of the inherent conflict question without even addressing the text and legislative history, *e.g. MBNA America Bank, N.A. v. Hill*, 436 F. 3d 104 (2d Cir. 2006).

The starting point for most courts in addressing the inherent conflict question is generally deciding whether the dispute implicates a core or non-core proceeding under the Bankruptcy Code.

Where the matter before the bankruptcy court is a non-core proceeding, then the bankruptcy court must generally stay the non-core proceeding in favor of arbitration when asked to do so by a party to an arbitration agreement. *In re Crysen/Montenay Energy Co.*, 226 F.3d 160, 166 (2d Cir. 2000) (finding contract dispute to involve a non-core proceeding, which must proceed to arbitration).

Where the bankruptcy court decides that the matter is a core proceeding, "the analysis is more complicated." *Trinity Christian Center of Santa Ana, Inc. v. Koper (In re Koper)*, 516 B.R. 707, 718 (Bankr. E.D.N.Y. 2014). "Certainly not all core bankruptcy proceedings are premised on provisions of the Code that 'inherently conflict' with the Federal Arbitration Act, nor would arbitration of such proceedings necessarily jeopardize the objectives of the Bankruptcy Code." *In re U.S. Lines, Inc*., 197 F.3d at 640 (quoting *Insurance Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Management Corp. (In re Nat'l Gypsum Co.),* 118 F.3d 1056, 1057 (5th Cir. 1997)). This "complication" leads courts to focus on the severity of the policy conflicts between the FAA and the Bankruptcy Code. There appears to be sort of a sliding scale of the impingement by the FAA on the objectives of the core bankruptcy proceeding at issue:

> Where a severe conflict is found, the bankruptcy court has the discretion to determine whether arbitration should be allowed to proceed. However, if the arbitration would not severely jeopardize the objectives of the Bankruptcy Code, then there is no discretion but to stay the bankruptcy proceedings in favor of arbitration.

In re Koper, 516 B.R. at 719(citing *Hill*, 436 F.3d at 109-10)).

Some courts uses the term "substantially core function" to delineate core proceedings that must be arbitrated from core proceedings that the bankruptcy court has the discretion not to order to arbitration. "Accordingly, the inquiry does not end simply because the dispute involves a core proceeding, but rather the conflict must impinge upon a 'substantially core' function of the bankruptcy process." *Koper*, 516 B.R. at 718 (quoting *In re Hostess Brands, Inc*., Case No. 12-22052-rdd, 2013 WL 82914, *3, 2013 Bankr. LEXIS 79, *6-7 (Bankr. S.D.N.Y. Jan. 7, 2013).

2. Application of General Principles to Discharge and Dischargeability Actions

A. Dischargeability Complaints

Section 523(c) of the Bankruptcy Code requires complaints seeking to except debts falling within the exceptions to discharge under § 523(a)(2)[fraud], (4) [fiduciary fraud, embezzlement or larceny] or (6) [willful and malicious injury] to be filed in the bankruptcy court. 11 U.S.C. § 523(a)(2), (4), (6) and (c) These provisions embody the fundamental bankruptcy policy that an honest but unfortunate debtor is entitled to a fresh start, but that certain conduct falls outside those basic norms such that debts arising therefrom should not be discharged. It is clear and undisputed that the dischargeability of a particular debt arises only under a federal statute—the Bankruptcy Code. *See In re Dietz*, 760 F.3d 1038 (9th Cir. 2014)("Simply put, exceptions to discharge and liquidation of related claims are examples of the bankruptcy court doing what they are supposed to do."). Thus, "determinations as to the dischargeability of particular debts" are core proceedings that a bankruptcy judge may hear and determine. 28 U.S.C. § 157(b)(2)(I).

Under the basic principles outlined above, bankruptcy courts have the discretion not to order a § 523(c) dischargeability action to arbitration where there is an agreement to do so and one party—usually, but not always, the creditor plaintiff—moves to compel arbitration. Factors that courts look at in the exercise of their discretion include:

1) Whether the arbitration proceeding was commenced prepetition;
2) Whether the party seeking arbitration has formally appeared in the bankruptcy case;
3) Whether the arbitrator has special knowledge or expertise which would be helpful to the resolution of the disputed issues;
4) Whether there is a strong likelihood that the debtor will confirm a plan;
5) Whether there is an international arbitration provision;
6) The likelihood of piecemeal litigation;
7) Whether the issue to be arbitrated is core or noncore; and
8) What impact resolution of the issue will have on the bankruptcy estate?

Glassman, Edwards, Wyatt, Tuttle & Cox, P.C. v. Wade (In re Wade), 523 B.R. 594, 612 (Bankr. W.D. Tenn. 2014)(citing *In re Nu-Kote Holding, Inc.*, 257 B.R. 855, 863 (Bankr. M.D. Tenn 2001)(gathering factors from six other courts)).

There are three components to a dischargeability action: (1) liability; (2) liquidation of amount of damages, if any; and (3) the dischargeability determination under the statute. Often times the first two components have already been decided in an underlying state or federal action (or even in arbitration) before the bankruptcy case has commenced. Other times all three components remain to be addressed in the bankruptcy court in the dischargeability action.

Parties seeking to compel arbitration of dischargeability complaints sometimes argue that, because liability and damages--collectively, the issue of whether there is a debt to except from discharge--are typically state law questions, that at least those elements should be referred to arbitration. Courts generally reject those arguments on the basis that separating the determination of dischargeability from fixing liability and damages is virtually impossible. *See In re McLaren*, 3 F.3d 958, 966 (6th Cir. 1993)("…it is impossible to separate the determination of dischargeability function from the function of fixing the amount of the nondischargeable debt."). The court's decision in *In re Koper* is representative of court's views of those arguments. *See also, e.g., In re Wade*, 523 B.R. 594 (the debtor-defendant seeks, unsuccessfully, to compel arbitration of dischargeability and other removed claims).

In *In re Koper*, the debtor was a party to employment agreements including arbitration clauses. He was fired for wrongdoing alleged in connection with his employment, leading to state court lawsuits and arbitration proceedings against him involving alleged breach of confidentiality and other agreements with his former employer, as well as alleged embezzlement. After Koper filed a Chapter 7 bankruptcy case, the plaintiffs commenced a dischargeabilty action asserting claims under § 523(a)(2),(4) and (6) and sought to compel arbitration. The bankruptcy court rejected the creditor's attempt to distinguish and divide liability and damages determinations as non-core proceedings from the core dischargeability determination, finding:

> [T] the issues of liability, amount of damages and dischargeability are so intertwined that such a separation of issues may not always be feasible. A finding on liability on the Plaintiff's underlying claims by an arbitrator would necessarily involve a finding of fraud, defalcation, or other wrongdoing which would come within the purview of the bankruptcy court's exclusive jurisdiction over the issue of dischargeability of such claims under section 523(a)(2), (4) and (6) of the Bankruptcy Code...[W]here there is no prepetition arbitration award in place, allowing an arbitrator to decide issues of liability and amount of damages would potentially subsume the dischargeability issue and supplant the bankruptcy court's prerogative to make the determination as to that issue and the issue of the debtor's entitlement to a fresh start. This leaves the bankruptcy court with the role of ratifying a decision made by someone who may or may not have any expertise in bankruptcy and who

> certainly has no authority under the Bankruptcy Code to make a determination as to dischargeability. Therefore, the issues of liability, amount of damages, and dischargeability should essentially be considered as one proceeding that is "substantially core" to the bankruptcy process. Permitting arbitration to proceed on the underlying claims would conflict with a "substantially core" function of the bankruptcy process and override the congressional mandate given to the bankruptcy court.

In re Koper, 516 B.R. at 721. Having determined that the claims were "substantially core," the bankruptcy court exercised its discretion to decline to compel arbitration of the dischargeability claims or any part of them, relying on judicial efficiency and economy and the burden on debtor and witnesses to proceed in multiple fora.

Other courts, however, have applied these same principles and exercised their discretion to compel arbitration of liability and damages determinations while reserving the ultimate question of dischargeability for the bankruptcy court, even while recognizing the potential for collateral estoppel effects of the arbitrator's decision. *E.g.*, *Holland v. Zimmerman (In re Zimmerman)*, 341 B.R. 77, 80 (Bankr. N.D. Ga. 2006); *In re Hermoyian*, 435 B.R. 456 (Bankr. E.D. Mich. 2010). These cases, however, tend to present unique procedural or substantive issues beyond more routine dischargeability disputes.

In *Zimmerman*, the debtor was a stockbroker. Some customers claimed they lost over $1 million in reliance on his advice. After he filed a Chapter 7 case, the disgruntled former customers filed non-dischargeability claims against him under § 523(a)(2), (4) and (6) and then sought to compel arbitration. Later, they added a securities fraud non-dischargeability claim under § 523(a)(19). Noting the discharge as the critical objective of an individual Chapter 7 debtor, as well as that debtor's interest in having issues relating to the fresh start decided in one forum with particularized expertise, the court stated that "a bankruptcy court ordinarily should decline to relinquish its jurisdiction over dischargeability issues and should deny a request to modify the stay to permit arbitration to proceed." *Id.* at 80. But the § 523(a)(19) claim nevertheless caused the court to exercise its discretion to allow arbitration to proceed because it expressly contemplates postpetition determination by a nonbankruptcy forum of liability for debts resulting from securities law violations. The court allowed liability and damages issues on all of the claims, not just the alleged securities law claims, to proceed to arbitration to avoid the mess of the parties having to proceed in two tribunals at once. However, the court made clear-- to the extent the distinction is clear—that it would not modify the stay to permit the arbitrators to determine that any debt is actually excepted from discharge, an issue over which it retained jurisdiction. *Id*. at 81.

In *Hermoyian,* which also involved a claim objecting to the Chapter 7 debtor's discharge, the claims also arose out of business transactions. The parties had signed a stipulated state court order

submitting their disputes to binding arbitration. The bankruptcy court allowed arbitration to proceed for determination of the fact of liability and the amount of liability of any debt owed. Like the *Zimmerman* court, however, it expressly retained the ultimate determination of "[a]ll issues relating to the determination of whether any such award is nondischargeable under § 523 of the Bankruptcy Code." In doing so, it found no inherent conflict between "arbitration of the limited matters regarding the existence and amount of a debt, and the underlying policy of the Bankruptcy Code to promptly adjudicate the dischargeability of such debt." *Hermoyian*, 435 B.R. at 486. This policy focus is different than the policy focus of other courts deciding these issues, which is more often the fresh start garnered through a specialized uniform and centralized forum. The court also rejected the debtor's arguments that compelling arbitration would impede his fresh start just because of the substantial economic burden of arbitration, including substantial arbitrator's fees, travel costs and attorney's fees. To the court, the fact that Debtor's agreement to arbitrate the parties' disputes was made after those disputes arose played a significant role in the referral to arbitration notwithstanding Debtor's valid concerns about cost and burden.

It is easy to forget that not all dischargeability questions must be litigated in the bankruptcy court; the range of §523(c) is specific and limited. Thus, arbitration versus bankruptcy court conflicts when dischargeability disputes arise outside the realm of § 523(a)(2), (4) and (6) present a different calculus. While still "core" proceedings, they may not be "substantially core." Two cases involving demands to compel arbitration of student loan dischargeability issues under § 523(a)(8) come to different conclusions in the exercise of a bankruptcy judge's discretion.

In *Williams v. Navient Solutions, LLC (In re Williams),* 564 B.R. 770 (Bankr. S.D. Fla. 2017), student loan notes contained arbitration and class action waiver provisions. The debtor-plaintiff filed a class-action complaint in bankruptcy court seeking a determination that loans made for bar examination study purposes are not "qualified education loans" within the meaning of §523(a)(8) and were therefore discharged in her Chapter 7 case.

The bankruptcy court compelled arbitration of the *Williams* action, although it relied heavily on precedent (discussed below) that arguably has just been overruled by the Second Circuit Court of Appeals in the discharge violation context. Debtor first argued that her discharge vitiated not only her personal liability on the debt, but the arbitration and class-action provisions as well. The bankruptcy court rejected that argument: "[t]he discharge entered in the Plaintiff's chapter 7 case has no impact on the viability of the Arbitration and Class Action Waiver Agreement." *Id.* at 775. (Other courts have rejected similar arguments that rejection of an executory contract vitiated the arbitration agreement within it.) *But see In re Jorge*, 568 B.R. 25, 30 (Bankr. N.D. Ohio 2017)(concludes wireless services contract with arbitration provision does

not apply to dispute over alleged post-petition collection of discharged debt). The court decided that there was no inherent conflict between the policies of the Bankruptcy Code and the FAA in this context, relying heavily on the fact that the debtor had already obtained her discharge, such that a decision on this issue will have no effect on distribution of the estate or an existing reorganization. (Query, would this outcome be different in this court's eyes if it were a Chapter 13 case?) Moreover, in the court's view, the dispute really did not entail interpretation of the discharge injunction, but a straightforward interpretation of a federal statute that does not require any particular or unique expertise.

Another bankruptcy court reached the opposite conclusion in *Farmer v. Navient Solutions, LLC (In re Farmer)*, 567 B.R. 895 (Bankr. W.D. Wash. 2017), also a bar examination review course dispute over a loan agreement containing an arbitration clause. The plaintiff in *Farmer* did not, however, make her complaint a class action. The court made the point of characterizing her action as NOT one seeking a hardship discharge under §523(a)(8), although she was seeking a determination under §523(a)(8) that the loan did not qualify as a qualified education loan thereunder and was thus discharged on that basis. Navient first raised, and the court rejected, an argument that the Supreme Court had subsequently impliedly overruled *Shearson's* inherent conflict test. Looking to Ninth Circuit precedent applying the inherent conflict test, the court reached the opposite conclusion from the *Williams* court and declined to compel arbitration: "[P]ermitting an arbitrator to decide whether the Loan constitutes a non-dischargeable educational loan inherently conflicts with the goals of centralized resolution of bankruptcy issues, preventing piecemeal litigation and the power of a bankruptcy court to enforce its own orders." *Id.*, at 900. It expressed concern about having an arbitrator interpret the Bankruptcy Code and gave short shrift to Navient's accurate point that the bankruptcy court did not have exclusive jurisdiction over this dispute. It expressly distinguished *Williams* on three grounds: (1) Farmer's complaint is not a class action; (2) all Ninth Circuit precedents applying *Shearson* in the bankruptcy context have refused to compel arbitration; and (3) it puts little weight on the fact that the bankruptcy court does not have exclusive jurisdiction over the dispute. *Farmer* counsels serious consideration whether to bring any dischargeability issues as a class action. *See also, In re Jorge*, 568 B.R. at 38; *Hill*, 436 F.3d at 109-110. *But cf. Anderson v. Credit One Bank,* 884 F.3d 382, 391 (2d Cir. 2018).

B. Discharge Violation Disputes

Case law is similarly disjointed in the context of motions and complaints seeking sanctions in contempt for violation of the discharge injunction and, sometimes, the automatic stay. These complaints also tend to involve cause of action under other types of state and federal statutes, such as alleged consumer protection act, fair debt collection act and telephone consumer protection act violations. However, the

recent Second Circuit decision in *Anderson v. Credit One Bank* will heavily influence the discussion, particularly since it heavily distinguishes its own precedent in *MBNA Bank America, N.A. v. Hill.*

In *Anderson*, Credit One charged off debtor's credit card debt, sold the account to a debt buyer and reported the default to the credit reporting agencies. After Anderson obtained his discharge, Credit One refused to change its credit reporting to show the discharge. Anderson alleged that the refusal was intended to coerce payment of the debt. Anderson reopened his Chapter 7 case and filed a class action suit complaining about Credit One's inaction with respect to credit reporting of the discharged debt as a violation of the discharge injunction. His credit card agreement, as they virtually all do, contained an arbitration clause. Credit One moved to compel arbitration of the lawsuit.

The Second Circuit Court of Appeals decided that the bankruptcy court did not abuse its discretion in refusing to compel arbitration. The parties agreed that the dispute was a "core proceeding" and that the issue was whether Congress intended to make the question of violation of a bankruptcy discharge injunction non-arbitrable. Credit One tried to argue statutory text and legislative history, but failed to do so in the district court, thus waiving the argument. The Second Circuit thus jumped right to the inherent conflict question. Emphasizing that the discharge is the "foundation upon which all other portions of the Bankruptcy Code are built," the Second Circuit articulated three reasons for its conclusion that arbitration would "seriously jeopardize" a core proceeding: (1) the integral nature of the discharge injunction to an individual debtor's fresh start; (2) the dispute pertains to an ongoing bankruptcy matter that requires continuing supervision; and (3) the equitable power of the bankruptcy court to enforce its own orders was under siege, necessitating continuing bankruptcy court supervision. *Id*. at 390. In so doing, it heavily distinguished *Hill* on the basis (persuasive?) that it involved violations of the automatic stay, which disappears by statute, unlike the discharge injunction, which is essentially forever and thus requires ongoing vigilance in the bankruptcy court to protect. The Second Circuit also specifically noted that the class action nature of the case did not alter its thinking that there was an inherent conflict between arbitration of Anderson's claim and the Bankruptcy Code. *Id.* at 391. And that Professors Ralph Brubaker, Robert Lawless and Bruce A. Markell supported Anderson's position as *amici* certainly did not hurt his cause at the Second Circuit.

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Discharge Objections

I. Introduction

a. 11 U.S.C. § 727 – Discharge: "The court shall grant the debtor a discharge, unless—…"

i. The grounds for a denial of a discharge are contained in § 727(a), including: instances of improper intentional acts or omissions; the making of false oaths or accounts; the existence of fraud in transfer of assets; the failure to provide financial information or explain a loss of assets; the failure to abide by a bankruptcy court order. These claims generally require a showing of intent or objective circumstances evidencing fraud.

ii. § 727 provides that courts "shall" grant the debtor a discharge, unless one of twelve exceptions is met. The mandatory nature of "shall" suggests these are the exclusive grounds for denying a discharge, and discharge cannot be denied on equitable grounds not listed. *See, e.g., Office of Comptroller Gen. of Republic of Bolivia on behalf of Bolivian Air Force v. Tractman*, 107 B.R. 24 (S.D.N.Y. 1989); *In re Bernstein*, 78 B.R. 619, 623 (S.D. Fla. 1987) ("Generally, a Chapter 7 debtor's conduct, no matter how reprehensible, will not forfeit discharge unless covered by one of the grounds listed in § 727."). It is also important to remember that objections to discharge are to be construed liberally in favor of the debtor. *See, e.g., Village of San Jose v. McWilliams,* 284 F.3d 785, 790 (7th Cir. 2002); *First Beverly Bank v. Adeeb (In re Adeeb)*, 787 F.2d 1339, 1342 (9th Cir. 1986).

II. Reasons a Chapter 7 Trustee May Object to a Discharge

a. § 727(a)(2): intentional concealment, transfer or destruction of property.

i. *In practice*: Common actions leading to (a)(2) objections include failing to list transfers of property in the Statement of Financial Affairs and aggressive pre-bankruptcy planning with suspicious transfers to family members.

ii. *Best practice*: Fully disclose all asset transfers within the two-year period before the bankruptcy filing on the Statement of Financial Affairs. Avoid non-arm's length transactions, or sales to insiders—especially family members.

iii. *Case Law*:

1. The discharge can be denied under § 727(a)(2)(A) only if the debtor's conversion of nonexempt property into exempt status is accompanied by actual intent to defraud creditors. *In re Smiley*, 864 F.2d 562 (7th Cir. 1989).

2. Extensive prebankruptcy planning does not establish the requisite intent to hinder, delay or defraud creditors under § 727(a)(2) absent compelling facts to the contrary, because in enacting the Code, Congress recognized: "As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law." H.R. Rep. No. 595, 95th Cong., 1st Sess. 361 (1977); *see also Cirilli v. Bronk (In re Bronk)*, 775 F.3d 871 (7th Cir. 2015); *Neary v. McCarthy (In re McCarthy)*, 418 B.R. 745 (Bankr. E.D. Wis. 2009).

3. The intent to prefer creditors is not equivalent to the intent to hinder, delay or defraud creditors that is required under § 727(a)(2). *Ivory v. Barbe (In re Barbe)*, 466 B.R. 737 (Bankr. W.D. Pa. 2012).

4. A debtor's discharge can be denied under § 727(a)(2)(A) only if his conversion of nonexempt property into exempt status is accompanied by actual intent to defraud creditors. *In re Moreno*, 892 F.2d 417 (5th Cir. 1990).

5. In *Cohen v. Jones (In re Jones)*, 545 B.R. 769 (Bankr. M.D. Fla. 2016), the court found the conversion of exempt property into non-exempt property wasted an asset of the debtor and led to fraudulent activity warranting a denial of discharge. Unrepresented debtors liquidated a $36,500 pension fund and got net proceeds of about $28,000. The husband gave $5,000 in cash to his wife who gave most of the money away as gifts to family. The husband also made a $4,000 cash gift to his church, bought a car for $3,900, paid a $1,000 debt, gave $3,000 to his attorney as a retainer, and testified that he forgot how he spent several thousand dollars. The husband and wife filed a joint chapter 7 petition two months after liquidating the pension fund. The judge said they might have been entitled to exempt the entire $36,500 had it remained in the retirement account, and found the subsequent actions were taken with intent to hinder, delay or defraud creditors warranting a denial of discharge under § 727(a)(2).

b. § 727(a)(3): failure to keep books and records as to finances.

   i. *In practice*: Concealing records, or failing to keep and preserve accurate financial records, can lead to issues. (a)(3) is often invoked when a substantial amount of assets have "dissipated" prior to the filing of the bankruptcy petition—usually related to a business.

   ii. *Best practice*: Forensically recreate what happened during the downfall of the business or the dissipation of assets prior to bankruptcy. Search for all relevant receipts, bills, canceled checks and other loan documents, and consider hiring an accountant or bookkeeper.

   iii. *Case Law*:

      1. Fraudulent intent is not an element of § 727(a)(3). *Peterson v. Scott (In re Scott)*, 172 F.3d 959 (7th Cir. 1999).

      2. Whether a debtor's records are adequate is determined on a case-by-case basis, considering the size and complexity of the debtor's business and the debtor's sophistication, education, business experience, and financial background. This includes the time period for which the debtor is required to account for his pre-petition financial condition, despite (a)(3)'s silence on the issue. Debtors should be made to account for his business and personal transactions for a reasonable period prior to the commencement of a bankruptcy filing. *Structured Asset Servs., LLC v. Self (In re Self)*, 325 B.R. 224 (Bankr. N.D. Ill. 2005).

      3. A delay in producing records does not support a denial of discharge given the Chapter 7 debtor's eventual disclosures to United States Trustee. *United States Tr. v. Riley (In re Riley)*, 2013 Bankr. LEXIS 3941 (Bankr. D. Colo. Sep. 20, 2013).

c. § 727(a)(4): dishonesty in connection with a bankruptcy case.

i. *In practice*: This is a catchall provision that covers any false oath given by the debtor (i.e., perjury, presenting false claims, or incorrect schedules). It must be in connection with a material matter related to the bankruptcy proceedings.

ii. *Best practice*: Stress the importance of providing reliable and honest information. It is better to be open and honest and seek a discharge than to attempt to deceive a creditor and face a denial of that discharge.

iii. *Case Law*:

1. The trustee must prove all these elements by a preponderance of the evidence: (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. *Stamat v. Neary*, 635 F.3d 974 (7th Cir. 2011).

2. A false oath or account, for purposes of § 727(a)(4)(A), applies not only to false statements made under sworn oath, but also to unsworn declarations under penalty of perjury such as those made by debtor on official bankruptcy forms. *Fiala v. Lindemann (In re Lindemann)*, 375 B.R. 450 (Bankr. N.D. Ill. 2007) (statements on petition, schedules, Statement of Financial Affairs and statements at the § 341 meeting all constitute statements under oath).

3. Intent to defraud involves a material representation that you know to be false, or an omission that you know will create an erroneous impression. "Reckless disregard" for the truth, such as not caring whether some representation is true or false, at least for purposes of the provisions of the Bankruptcy Code governing discharge, is the equivalent of knowing that the representation is false and material. *In re Chavin*, 150 F.3d 726 (7th Cir. 1998).

4. Whether a fact is material depends on whether it "bears a relationship to the debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of the debtor's property." *Stamat v. Neary*, 635 F.3d 974, 982 (7th Cir. 2011). Because the bankruptcy system relies on full disclosure, "the issue is not merely the value of the omitted assets or whether the omission was detrimental to creditors." *Id.*

5. Omission of creditors may be material. In *Skavysh v. Katsman (In re Katsman)*, 771 F.3d 1048 (7th Cir. 2014), the debtor intentionally omitted friends and family members who loaned her money. She testified that she intended to repay them, arguing there was no motive to obtain a pecuniary benefit. The 7th Circuit found the debtor had counsel in the bankruptcy case who would have advised listing all creditors and determined the omission could only be immaterial if the amount owed was "utterly trivial." The court also found the debtor's filings had other omissions, like the failure to schedule alimony payments and property owned with her ex-spouse.

6. Lowballing the value of an estate's only significant, non-exempt asset can result in denial of discharge if the debtor is a financial professional. *Van Robinson v. Worley (In re Worley)*, 849 F.3d 577 (4th Cir. 2017). In *Worley*, the debtor had an undergraduate degree in finance and an MBA. When personal investments went sour, he filed under chapter 7. His assets included a $65,000 minority investment in

woodland and farmland that generated minimal income. The debtor filed his petition as a "no asset" case, listing the minority investment as worth $2,500 by using the income capitalization method and multiplying his largest annual distribution, $500, by five. Considering his initial investment, his K-1 showing his capital account at $67,555, and co-investors testifying the value was higher than $2,500, the bankruptcy court found the asset was worth at least $13,200. For making a false oath or account, the bankruptcy court denied the debtor's discharge under § 727(a)(4), which the district court and 4th Circuit affirmed. The 4th Circuit determined the bankruptcy judge "reasonably inferred fraudulent intent from [the debtor's] background, course of conduct, and absence of credibility," and that these conclusions "often boil down to an assessment of a debtor's credibility."

7. Sloppiness in filling out bankruptcy schedules can also lead to a denial of discharge. In *Premier Capital, LLC v. Crawford (In re Crawford)*, 841 F.3d 1 (1st Cir. 2016), the debtor had two retirement accounts with the same bank. One was a 401(k) and the other was a cash balance plan, but each bank statement covered both accounts. Headings on the statements read, "401(k) Plan and Cash Balance Plan." On his schedule of assets, under the line for "Interests in IRA, ERISA, Keogh, or other pension or profit sharing plans," he listed $148,000 as the amount of a "401(k) with Wells Fargo," which was the total amount of the accounts together, but he did not list the name of the cash balance plan. The bankruptcy judge denied discharge under § 727(a)(4) for making a false oath, which the district court and 1st Circuit affirmed. Swearing to the schedules was a false oath because the debtor failed to include the name of the cash balance account, and that failure was material because "we have rejected the notion that valuation determines materiality." The court added that "knowledge of an asset's value alone does little to forewarn creditors and the court of unscrupulous dealings," and creditors "have a right to investigate the history of a debtor's asset." It is unclear whether the omission was intentional on the debtor's part or resulted from a mistake in his lawyer's office. However, the debtor was found to be "less than credible" based on "numerous misrepresentations conflated with evasive answers," and certainly contributed to the denial of discharge.

8. By contrast, misstatements that do not evidence reckless disregard for the truth, but rather "simple negligence or innocent misunderstandings" by a credible debtor should not result in denial of discharge. *See In re Kempff*, 847 F.3d 444(7th Cir. 2017).

d. § 727(a)(5): failure to explain loss or deficiency of assets

i. *In practice*: Trustee will look at the assets owned, lost or dissipated within one year of the bankruptcy filing. Any failure to explain the loss of a substantial amount of property or money prior to filing can lead to an objection.

ii. *Best practice*: Similar to § 727(a)(3), forensically recreating the events leading to bankruptcy can help to explain your client's financial situation. It may also be wise to consider hiring an accountant to forensically recreate.

iii. *Case Law*:

1. A satisfactory explanation of loss of value under (a)(5) is one that induces "a mental attitude of contentment" in the court's evaluation of the debtor's explanation. *In re*

Johnson, 80 B.R. 70 (E.D. La. 1987). Does that clarify the standard for you? Me neither. Alternatively, the 7th Circuit found the explanation must be "good enough to eliminate the need for the Court to speculate as to what happened to all the assets." *In re D'Agnese*, 86 F.3d 732 (7th Cir. 1996) (quoting *In re Martin*, 145 B.R. 933, 950 (Bankr. N.D. Ill. 1992)).

2. Under (a)(5), courts will consider only whether the debtor has satisfactorily explained what actually happened to his assets, regardless of whether the disposition is deemed proper or improper. *In re D'Agnese*, 86 F.3d 732 (7th Cir. 1996). The debtor must provide more than "vague, indefinite, and uncorroborated" assertions.

3. Where the debtor's prior business ceased operations six years before the petition, and where another business ceased operation at least two years before bankruptcy, any losses from those businesses were too remote in time to require explanation by debtor; thus denial of discharge under (a)(5) was not warranted. *Cohen v. Olbur (In re Olbur)*, 314 B.R. 732 (Bankr. N.D. Ill. 2004).

III. Revocation of a Discharge

a. The only grounds for revoking a discharge are those provided in the Bankruptcy Code. A court cannot revoke the discharge on general equitable grounds. It cannot even revoke a discharge at the request of a debtor who has paid all of his or her discharged debts in full and who now wants the discharge revoked to clear his or her credit record.

b. Under § 727(d), there are four statutory grounds to revoke a discharge:

   i. Newly discovered fraud by the debtor in obtaining the discharge;

   ii. Knowing and fraudulent failure by the debtor to report, deliver and surrender property that is, or should become, property of the estate;

   iii. Refusal by the debtor to obey a lawful court order or refusal to answer a material question on grounds other than a properly asserted Fifth Amendment privilege; or

   iv. The debtor failed to satisfactorily explain a material misstatement or failed to make available information necessary for a U.S. Trustee's audit.

c. To satisfy the "newly discovered fraud" ground, the objecting creditor or trustee must show that the discharge was procured by fraud and that the objector neither knew nor could have known of that fraud prior to the discharge. *Mid-Tech Consulting, Inc. v. Swendra*, 938 F.2d 885 (8th Cir. 1991) (burden is on the creditor to investigate diligently any possibly fraudulent conduct before discharge; dismissal of revocation action is proper where creditor knew facts such that he or she is put on notice of fraud); *Hopkins v. Kribs (In re Kribs)*, 523 B.R. 830 (Bankr. D. Idaho 2015) (where trustee knew about problems with debtor's schedules before discharge and failed to object to discharge or seek extension of time, trustee could not prevail on revocation action); *In re Scarpinito*, 196 B.R. 257 (Bankr. E.D.N.Y. 1996) (same; creditor failed to show lack of knowledge).

d. Under § 727(d)(1), "on request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge…if … such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge." In *McDermott v. Larson (In re Larson)*, 553 B.R. 646 (Bankr. W.D. Mich. 2016), the Chapter 7 trustee became aware of the debtor's intention to sell her

home one week before the debtor received a discharge. Learning the details of the sale, the trustee believed it was fraudulent but did not inform the US Trustee's Office (the "UST") until two weeks after the discharge. The day it learned of the fraudulent sale, the UST filed a complaint to revoke the discharge and later filed a motion for partial summary judgment on whether the trustee's knowledge of alleged fraud can be imputed to the UST in relation to § 727(d)(1). The parties agreed the UST did not have actual knowledge of the alleged fraud until after the discharge, but the debtor argued the trustee's knowledge should be imputed to the UST. The court determined the plain language of § 727(d)(1) and the legislative history did not support the debtor's argument, particularly because the statute designates three distinct parties - the trustee, creditors, and the United States trustee - as having the right to request revocation of discharge. The statute then limits each party's right to request revocation to the extent "the requesting party" knew of the alleged fraud prior to discharge. The court also rejected the debtor's argument that common law principles of agency mean the knowledge was imputed, finding the UST and trustee serve different functions, and that the UST's supervisory role over the trustee is not unfettered as often exists in agency relationships. Finally, the court determined the UST was not getting a "second bite at the apple" in a way that "subverts the process and renders the debtor's discharge a 'provisional' order subject to the whim of the UST." The court explained that § 727(d)(1) explicitly allows for revocation of a discharge, meaning the discharge is already somewhat provisional.

e. If the debtor acquires or becomes entitled to acquire the kinds of property listed in § 541(a)(5) and (6), e.g., property inherited within 180 days of the petition, and knowingly and fraudulently fails to report and deliver the property to the trustee, the debtor's discharge can be revoked. *Steege v. Johnsson (In re Johnsson)*, 551 B.R. 384 (Bankr. N.D. Ill. 2016) (discharge revoked for failure to report and surrender inheritance to trustee); *Meabon v. Johnson (In re Meabon)*, 514 B.R. 446 (W.D.N.C. 2014) (discharge revoked for failure to disclose interest in trust); *Yules v. Gillis (In re Gillis)*, 403 B.R. 137 (B.A.P. 1st Cir. 2009).

IV. Resolving to an Objection to Discharge

a. Waiver of discharge

i. Under 11 U.S.C. § 727(a)(10) a waiver of discharge must meet three conditions: (1) must be in writing; (2) must be signed by the debtor after the order for relief; (3) must be approved by the Court. Agreements under which the debtor retains liability for a dischargeable debt are enforceable only if they comply with the Bankruptcy Code's reaffirmation procedures.

ii. Enforcement of "waivers" or other agreements that do not comply with these procedures violates the discharge injunction. *See, e.g., Hebl v. Windeshausen (In re Windeshausen)*, 546 B.R. 798 (Bankr. W.D. Wis. 2016) (pre-petition waiver of discharge in arbitration agreement not binding on debtor).

iii. A pre-bankruptcy waiver of the discharge violates public policy. *See Klingman v. Levinson*, 831 F.2d 1292 (7th Cir. 1987) (waiver violates public policy but stipulation concerning underlying facts is allowed); *Greensward, Inc. v. Cietek (In re Cietek)*, 390 B.R. 773 (Bankr. N.D.N.Y. 2008) (concurring with *Levinson*; noting *Levinson's* dicta that pre-petition waivers of discharge are fundamentally void and offend the public policy of promoting a fresh start for individuals has been widely adopted); *Kohlenberg v. Baumhaft (In re Baumhaft)*, 271 B.R. 517 (Bankr. E.D. Mich. 2001) (a stipulation in a consent decree

that a debt would not be dischargeable did not constitute a waiver of the debtor's right to have a bankruptcy court determine the dischargeability of the debt).

iv. The Court does not need to consider the creditors' interest in approving a waiver of discharge. *See In re Akbarian*, 505 B.R. 326 (Bankr. D. Utah 2014). Once the waiver is approved, the debtor will have a difficult time getting out of it. *Walton v. McCutcheon (In re McCutcheon)*, 448 B.R. 863 (Bankr. N.D. Ga. 2011) (debtor not entitled to relief from waiver of discharge validly executed and approved).

b. Settling Discharge Litigation

i. Bankruptcy courts are often asked to approve settlements between debtors and creditors or debtors and the bankruptcy trustee, which call for the dismissal of an objection to discharge. Bankruptcy Rule 7041 provides: "Rule 41 F.R. Civ. P. applies in adversary proceedings, except that a complaint objecting to the debtor's discharge shall not be dismissed at the plaintiff's instance without notice to the trustee, the United States trustee, and such other persons as the court may direct, and only on order of the court containing terms and conditions which the court deems proper."

ii. The Advisory Committee Notes to Rule 7041 states: "Dismissal of a complaint objecting to a discharge raises special concerns because the plaintiff may have been induced to dismiss by an advantage given or promised by the debtor or someone acting in his interest. Some courts by local rule or order have required the debtor and his attorney or the plaintiff to file an affidavit that nothing has been promised to the plaintiff in consideration of the withdrawal of the objection. By specifically authorizing the court to impose conditions in the order of dismissal this rule permits the continuation of this salutary practice."

iii. Settling a discharge complaint involves special procedures, and some courts refuse to approve such compromises due to the statutory right to discharge and public policy considerations. Cases prohibiting the settlement of objections to discharge predate the enactment of the Bankruptcy Code. In *In re Levy*, 127 F.2d 62 (3d Cir. 1942), decided under the Bankruptcy Act of 1898, the debtor sought to settle a turnover action by making a cash payment to the trustee "on condition that there be no opposition to the discharge." The district court approved the compromise and allowed the discharge, but when a creditor appealed, the 3rd Circuit reversed. The court determined that discharge is not personal to the creditors, "it is general to the public and particularly that part of it which constitutes the world of commerce." Not only was the compromise disapproved, the court found grounds to revoke the debtor's discharge.

iv. In *State Bank of India v. Chalasani (In re Chalasani)*, 92 F.3d 1300, 1310, 1311-13 (2d Cir. 1996), the 2nd Circuit noted that granting a discharge "is not the proper subject for negotiation and the exchange of a quid pro quo," and set out these standards for dismissing discharge litigation:

1. There must be no "taint of compromise" involved in the dismissal of a § 727 action;
2. "Because discharge is a statutory right undergirded by public policy considerations, it is not a proper subject for negotiation and the exchange of a quid pro quo;"
3. These public policy concerns may be balanced against "the public interest in encouraging the just, speedy, inexpensive, and final resolution of disputes" by notice of the terms of settlement pursuant to Rule 7041; and

4. Rule 7041 "grants bankruptcy courts sufficient authority and flexibility to place conditions on dismissal adequate to prevent tainted compromise."

v. *In re Moore*, 50 B.R. 661 (Bankr. E.D. Tenn. 1985), the court rejected an attempt to settle separate objections to discharge by the trustee and a creditor with a $1.3 million payment to the bankruptcy estate. Notice of the proposed settlement was given to all creditors and parties in interest, and there were no objections. Despite this, the court refused to approve the settlement, finding the trustee's testimony stating the debtor was "buying his discharge" went against public policy, and that "a discharge in bankruptcy depends on the debtor's conduct; it is not an object of bargain."

vi. *Carbone v. Beltran (In re Beltran)*, Nos. 09 B 17482, 09 A 00778, 2010 Bankr. LEXIS 2548 (Bankr. N.D. Ill. Aug. 25, 2010), the court rejected a settlement because the creditor was attempting to use an objection to the debtor's discharge, which can only be asserted on behalf of all creditors, to obtain a payment solely for the benefit of the one creditor. Because the settlement proceeds were payable only to the creditor, the settlement was not fair, reasonable, or in the best interests of the estate and creditors as a whole.

vii. Ultimately, courts will consider approving the settlement of an objection to discharge on a case-by-case basis, but tend to be more accepting of a settlement by the trustee. In *In re Bates*, 211 B.R. 338 (Bankr. D. Minn. 1997), the debtor filed under Chapter 7 and received a discharge, but when the trustee discovered unscheduled assets and potentially avoidable pre-petition transfers, the trustee filed an action to revoke the discharge. The trustee and debtor reached a settlement where the debtor would pay the estate $250,000 in exchange for dismissing all pending litigation. The court approved the settlement after determining that when an individual creditor files an action objecting to or seeking to revoke a debtor's discharge, that creditor "assumes a duty to act in the best interests of the general creditor body." Due to the existence of this duty, the court concluded it would be "per se inappropriate" to approve any settlement of a § 727 claim where the consideration was paid to a single creditor rather than to the trustee for the benefit of all creditors.

viii. *Cadle Co. v. Reed*, 392 B.R. 675 (N.D. Tex. 2008) - bankruptcy court cannot authorize trustee's settlement of discharge complaint over objection of creditor.

ix. But *see McVay v. Perez (In re Perez)*, 411 B.R. 386 (D. Colo. 2009) - bankruptcy court abused its discretion by denying a debtor's compromise with the trustee on grounds not articulated under § 727, while also failing to address the deficiencies in notice given to creditors. The case was remanded to give creditors notice, and if no objection was made, the proceeding was to be dismissed and discharge entered.

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DISCHARGE AND THE POSTPETITION FINANCIAL MANAGEMENT EDUCATION REQUIREMENT

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") added a postpetition financial management education requirement as a condition of obtaining a discharge. As we approach 13 years after the enactment of BAPCPA, debtors still struggle with timely meeting this no-longer new requirement. When they fail to do so, their cases are eventually closed without discharge. At some point, likely when creditors come calling again, the debtor whose case was closed without discharge will seek to reopen his case to complete the postpetition financial management education requirement and finally obtain a discharge. Not only does a request to reopen require payment of a filing fee (absent *in forma pauperis* status) and likely an additional attorney's fee, bankruptcy judges are explicitly viewing such requests to reopen with skepticism and denying them.

1. The Procedural Framework for Compliance with the Post-Petition Financial Management Education Requirement

A. Code Sections: §§ 111, 727(a)(11), 1141(d)(3) and 1328(g)

One of the exceptions to an individual's right to a Chapter 7 discharge is the failure "to complete an instructional course concerning personal financial management" from an approved agency, as set forth in § 727(a)(11) and § 111. Likewise, under Chapter 13 the "court shall not grant a discharge under this section to a debtor unless after filing a petition the debtor has completed an instructional course concerning personal financial management described in section 111." 11 U.S.C. § 1328(g). *See also* 11 U.S.C. § 1141(d)(3); Fed. R. Bank. P. 1007(b)(7)(B). There is no postpetition course requirement under Chapter 12.

B. Bankruptcy Rules: 1007(b)(7)(A) and (c), 4004(c)(1)(H)

i. Form of Certification: The statutory condition to discharge is implemented by Rule 1007 of the Federal Rules of Bankruptcy Procedure, which requires the filing of evidence to certify completion of the instructional course.

Certification of course completion can occur in two ways under the rule. Fed. R. Bank. P 1007(b)(7)(A).

Since 2013, the approved provider can directly file with the court notification of the debtor's completion of the course.

If the course provider does not directly notify the court of course completion, the debtor must file a statement of completion of the course. Fed. R. Bankr. P. 1007(b)(7)(A). Official Form 423-Certification

About a Financial Management Course is the form on which the debtor's statement of completion of the instructional course must be filed. With the amendment of Rule 9009 effective December 1, 2017, there is no room for departure from the Official Form in the form of the statement of completion.

Official Form 423 requires the debtor to provide the details of completion of the course, including the date and certificate number issued by the course provider, or alternatively certify the limited circumstances, such as disability or active military duty, in which the course requirement may be excused. The Official Form must be signed by the debtor with certification that the information provided is true and correct. The course provider will issue the debtor a certificate upon completion of the course. But unless it is filed directly by the course provider, it is not sufficient for the debtor to file the provider certificate without the formal Official Form 423 certification. The reason the additional certification and the signature of the debtor as included on Official Form 423 is required is to deter the filing of fake certificates.

ii. Timing of Certification: Bankruptcy Rule 1007(c) sets the deadlines for filing certification of completion of the required instructional course.

In a Chapter 7 case, the statement of completion is due within 60 days after the first date set for the meeting of creditors, coinciding with the creditor deadlines for objecting to discharge and filing dischargeability complaints.

In a Chapter 13 (or an individual Chapter 11 case if applicable), the statement of completion is due no later than the date when the last payment was made by the debtor under the plan or the date of filing a motion for hardship discharge under § 1328(b).

If the required certification is not filed by 45 days after the meeting of creditors, the Clerk is now required by Rule 5009 to give notice to the debtor that the case will be closed without discharge unless the statement of completion is filed as required by Rule 1007(c). Fed. R. Bankr. P. 5009. This duty was added in 2010. The Committee Note to the amendment is instructive: "The purpose of the notice is to provide the debtor with the opportunity to complete the course and file the appropriate document prior to the filing deadline. Timely filing of the document avoids the need for a motion to extend the time retroactively. It also avoids the potential for closing the case without discharge, and the possible need to pay an additional fee in connection with reopening. Timely filing also benefits the clerk's office by reducing the number of instances in which cases must be reopened."

Rule 9006, titled Computing and Extending Time, addresses extensions to file the statement of completion. Specifically, Rule 9006(b)(3) states in relevant part that "the court may enlarge the time to

file the statement required under Rule 1007(b)(7)…only to the extent and under the conditions stated in Rule 1007(c)." Rule 1007(c) in turn gives the court unusual discretion in terms of timing to enlarge the time for filing Official Form 423. It states that "[t]he court may, at any time and in its discretion, enlarge the time to file the statement required by subdivision (b)(7)." As the Committee Notes on the amendment, which occurred in 2008, state: "The amendment allows the court to enlarge the deadline for the debtor to file the statement of completion. Because no party is harmed by the enlargement, no specific restriction is placed on the court's discretion to enlarge the deadline, even after its expiration." However, Rule 1007(c) still requires the extension to be granted "only on motion *for cause shown* and on notice…." Fed. R. Bank. P. 1007(c)(emphasis added).

iii. Discharge: Rule 4004 gives the court direction on entry of discharge.

In Chapter 7, one of the exceptions to the directive to the court to enter discharge is the absence of a statement of completion of a course concerning personal financial management if required by Rule 1007(b)(7). Fed. R. Bankr. P. 4004(c)(1)(H).

Likewise in a Chapter 11 case in which the debtor is an individual or in a Chapter 13 case, "the court shall not grant a discharge if the debtor has not filed any statement required by Rule 1007(b)(7)." Fed. R. Bankr. P. 4004(c)(4).

If the Chapter 7 case has been fully administered by the trustee or the Chapter 13 plan has been completed, and the required evidence of completion has not been filed, the case will be closed, *see* 11 U.S.C. §350(a), but without entry of discharge. When that occurs, the Clerk is required to notify all parties in interest, including the debtor and debtor's counsel as well as creditors, of case closure without discharge. Fed. R. Bankr. P. 4006. In no asset cases, closure will often occur very shortly after the trustee has filed her notice of no distribution and the deadlines for objecting to discharge and filing the statement of completion have passed. In an asset case, however, the case may remain open for an extended period even though the statement of completion is missing.

2. Bankruptcy Court Approaches to Case Reopening to File Official Form

Reopening a case closed without discharge to file a missing statement of completion of a financial management education course is not a ministerial given. Debtors and counsel should not assume that a bankruptcy court will automatically allow reopening to file the certification and then obtain a discharge, even when the delay is relatively short.

Case reopening is governed by 11 U.S.C. § 350(b), which provides that a case may reopened "to administer assets, to accord relief to the debtor or for other cause." Bankruptcy Rule 5010 specifies that a "case may be reopened on motion of the debtor or other party in interest pursuant to §350(b)of the Code." Fed. R. Bankr. P. 5010. The cause for reopening in such situations will be to move for an order granting the debtor an extension of time to file Official Form 423, which would be to afford relief to the debtor. While the timing is not prohibited under Rule 1007(c), which allows the extension "at any time," the added requirement of "cause" for the extension must still be met. Thus, two requirements of cause must be met: the § 350 "cause" for reopening and the Rule 1007(c) "cause" for the requested extension.

A recent case in the Eastern District of Michigan is emblematic of the manner in which some courts are now approaching motions to reopen to file Official Form 423. *In re Lockhart*, 582 B.R. 1 (Bankr. E.D. Mich. 2018). *See also, e.g., In re Johnson*, 500 B.R.594 (Bankr. D. Minn. 2013)(more than 4 year delay); *In re Chrisman*, Case No. 09-30662, 2016 WL 4447251 (Bankr. N.D. Ohio Aug. 22, 2016)(more than 7 year delay). Whether the delay in seeking reopening is months after closure or years after closure, debtors and their counsel should be prepared to follow the framework outlined by Judge Tucker in *Lockhart* (and several other cases as well) for showing "cause." He applied a four factor inquiry: (1) whether there is a reasonable explanation for the failure to comply; (2) whether the request is timely; (3) whether the fault lies with counsel; and (4) whether creditors are prejudiced.

The Chapter 7 debtor in *Lockhart* waited a year after the case was closed and 16 months after the Rule 1007(c) deadline passed without any prior request for extension. Judge Tucker characterized the delay as "significant." He noted that "[g]enerally speaking, the longer the delay, the greater the prejudice. Here, there was a long delay." In the absence of any reason given for why debtor did not act timely and then waited so long after the case was closed, with no suggestion that the fault for the omission and delay was counsel's, Judge Tucker denied the request to reopen. His order did note that the debtor was not prohibited from refiling another case. Likewise, the dischargeability exception of 11 U.S.C. §523(b)(10) for debts that were or could have been listed in a prior case would not alone prohibit their discharge in a new case because it applies only where discharge was denied or waived in the prior case. The lack of discharge arising from the absence of an Official Form 423 is not a denial or waiver of the right to discharge.

From the creditor perspective, courts are concerned that the longer the delay, the more unfair it is to expose creditors to potential sanctions for violation of the delayed discharge injunction. As the court in *Chrisman* observed, "[t]o spring a discharge on creditors more than seven years later that many of them will now not even receive, at peril of violating the unknown discharge, is simply unfair." *Chrisman*, 2016

WL 4447251, at *3. In another context, a bankruptcy judge in the Northern District of Ohio observed in denying reopening after a 10 month delay, "[c]reditors listed in the case may have sold or transferred the debt, could have moved, or any number of other scenarios may complicate getting notice of the discharge to proper parties." *In re Hicks*, 570 B.R. 291, 292 (Bankr. N.D. Ohio 2017).

So while refusing a request to reopen to clean up an Official Form 423 problem and secure a debtor's discharge might seem like a harsh outcome, the reasoning for such a tough approach has been colorfully expressed as follows, again in a different procedural context (dismissal due to non-payment of the filing fee) but with an equally applicable rationale:

> Discharges are not favors for attending a party. Discharges are the result of a debtor timely and thoroughly fulfilling the duties and responsibilities set forth in the Bankruptcy Code and Rules. Allowing debtors to continually ignore their obligations, only to later seek to avoid the repercussions, creates a culture of only performing obligations if it is convenient. The court cannot condone, and will not foster, this culture.

Id. at 293.

###

Chapter 13 Discharge Requirements and Unintended Consequences

In order to receive a chapter 13 discharge, the debtor must complete "all payments under the plan." 11 U.S.C. §1328(a). But what constitutes a payment "under the plan"?

A. The Issue

1. The requirement to make "all payments under the plan" to receive a discharge pursuant to §1328(a) is not new. This phrase has appeared in §1328(a) of the Bankruptcy Code since it became effective in 1978. *See In re Gibson*, 582 B.R. 15, 18 (Bankr. C.D. Ill. 2018).

2. In a Chapter 13 case, payments may be made directly by the debtor to a creditor or via the Chapter 13 trustee. *See In re Coughlin*, 568 B.R. 461, 468 (Bankr. E.D. N.Y. 2017). This is not a new concept either. A common example of a direct payment is a contractual mortgage payment on the debtor's principal residence.

3. In 2011, Rule 3002.1 was added to the Federal Rules of Bankruptcy Procedure. The intent, in part, was to provide a procedure for resolving disputes at the end of a Chapter 13 case between debtors and holders of claims secured by the debtor's principal residence. Fed. R. Bankr. P. 3002.1 Committee Notes on Rules – 2011, Subdivision (h).

4. Rule 3002.1(f) requires the Chapter 13 trustee to file and serve a notice stating that the debtor has paid all amounts required to cure any default on a claim secured by the debtor's principal residence within 30 days of the debtor completing "all payments under the plan." Fed. R. Bankr. P. 3002.1(f).

5. Within 21 days of the notice, the claim holder is required to file a response indicating (1) whether it agrees or disagrees that the default has been cured and (2) whether the post-petition payments are current. Fed. R. Bankr. P. 3002.1(g).

6. If the secured creditor's claim was paid via the trustee, if there is a disagreement, it should be easy to resolve—but when the creditor is paid directly by the debtor, the debtor may not even dispute that he or she has not made all of the post-petition mortgage payments. For example, the debtor may have misunderstood the requirement to make direct payments, there may be a pending loan modification, the debtor may have had a decrease in income and was unable to make the payments for a period of time, etc.

7. When a creditor files a Rule 3002.1(g) response which disagrees with the trustee's notice, indicating that post-petition payments are not current, and the debtor agrees that the post-petition payments are not current, the question becomes: has the debtor completed "all payments under the plan"?

8. In essence, the dispute resolution procedure has led to the issue: is a payment made directly by the debtor to a creditor is a payment "under the plan." It has also led to unintended consequences.

9. The majority of courts faced with this issue have determined that a payment made directly by the debtor to a creditor is a payment "under the plan." The unintended consequence is that a debtor, despite making every required payment to the trustee, may end up with a case that is dismissed or closed without a discharge based on a non-dischargeable debt!

B. Case law

In re Coughlin 568 BR 461 (Bankr. E.D. N.Y. 2017). The *Coughlin* opinion decided 2 separate cases; in both cases, the debtors did not make all of the direct post-petition mortgage payments. In Mr. Coughlin's case, the discharge order had been entered; the Sangamayas were seeking to modify their chapter 13 plan to surrender their residence in the final month of the plan.

Mr. Coughlin's case: The trustee filed the notice required by FRBP 3002.1(f). Within 21 days, the mortgagee filed a response indicating that the pre-petition arrears were cured but that the post-petition direct payments were delinquent. The mortgagee subsequently filed a motion for relief from the automatic stay. The discharge order was entered the day before the hearing on the motion for relief. At the motion for relief hearing, the Court "raised concerns" regarding the entry of the discharge order. A few days later, the Court issued an order to Show Cause why the discharge should not be set aside and why the motion for relief from stay should not be granted. About 6 weeks after the hearing on the motion for relief, the court granted the motion.

The first question Judge Alan S. Trust addressed was whether direct mortgage payments were "payments under the plan". Starting with the U.S. Supreme Court's opinion in *Rake v. Wade*, 508 U.S. 464 (1993) which addressed "provided for by the plan" language in 11 U.S.C. §1325(a)(5), Judge Trust cited the following:

> [T]he most natural reading of the phrase to "provid[e] for by the plan" is to "make a provision for" or "stipulate to" something in a plan….

Coughlin at 469 (internal cites omitted).

Acknowledging that the language considered in *Rake* was similar to, but not the same language as in §1328(a), the *Coughlin* court went on to list a number of cases which have held that "payments under the plan" include direct pay mortgage payments.[1] And Judge Trust agreed that

[1] *Kessler v. Wilson (In re Kessler)*, 655 Fed.Appx. 242, 243-44 (5th Cir. 2016), *Foster v. Heitkamp (In re Foster)*, 670 F.2d 478, 488-89 (5th Cir. 1982); *Evans v. Stackhouse*, 564 B.R. 513, 525-28 (E.D. Va. 2017); *In re Hoyt-Kieckhaben*, 546 B.R. 868, 871 (Bankr. D. Colo. 2016); *In re Gonzales*, 532 B.R. 828, 832 (Bankr. D. Colo. 2015); *In re Heinzle*, 511 B.R. 69, 75-78 (Bankr. W.D. Texas 2014); *In re Hankins*, 62 B.R. 831, 835 (Bankr. W.D. Va. 1986); *In re Perez*, 339 B.R. 385 (Bankr. S.D. Tex. 2006).

"payments under the plan" include direct pay mortgage payments, but made a point of limiting the scope of his holding to claims which the plan treats as "cure and maintain" pursuant to §1322(b)(5).[2]

The *Coughlin* court also made the point that a debtor who did not make direct mortgage loan payments and thus had those amounts available at his or her discretion, should not receive a discharge. *Id*. at 470.

An interesting twist in the *Coughlin* case is that the discharge order had been entered despite the Rule 3002.1(g) response indicating that the post-petition payments were not current. In other words, the discharge was in direct conflict with the Court's holding that direct payments are payments under the plan. At least one court has vacated a discharge under similar circumstances.[3] The *Coughlin* court declined to set aside the discharge because 11 U.S.C. §1328(e) provides for the revocation of discharge only in the event of fraud, and there were no allegations that Mr. Coughlin committed fraud; the court also declined to set aside the discharge pursuant to Fed. R. Civ. P. 60(b)(1).

The Sangamayas' case: The debtors filed a plan modification to surrender their residence in the 60th month of their Chapter 13 Plan (and before their final payment was received by the trustee). The modification was intended to avoid a dismissal or the case being closed without a discharge because of the post-petition mortgage payment delinquency. The Court held that the debtors requested the modification timely, even though it could not be granted prior to the expiration of their Chapter 13 Plan, and the unopposed modification was granted.

In re Gibson, 582 B.R. 15 (Bankr. C.D. Ill. 2018). At the other end of the spectrum, a recent case from the central district of Illinois held that direct payments to a non-modifiable non-dischargeable mortgage loan were not "payments under the plan."

The *Gibson* debtors misunderstood that they were required to make post-petition mortgage payments on their second mortgage. The claim for the second mortgage was treated as a cure and maintain claim in the debtors' Chapter 13 Plan in accordance with §1322(b)(5). The misunderstanding did not come to light until the end of their 60-month plan. The trustee filed the notice required by FRBP 3002.1(f) and the creditor filed a response indicating that the post-petition mortgage loan payments were not current. The trustee then filed a motion to dismiss the case pursuant to 11 U.S.C. §1307(c)(6). Interestingly, the first and second mortgages were held by the same creditor. When the first mortgage became delinquent approximately 18 months after

[2] *Coughlin* at 480. Notably, this leaves open the possibility a court may find that direct payments on a claim secured by the debtor's principal residence which were current when the bankruptcy case was filed are not "payments under the plan."
[3] *In re Gonzales*, 532 B.R. 828 (Bankr. D. Colo. 2015).

the case was filed, a motion for relief from the automatic stay was filed. The motion was resolved with an agreement to cure the delinquency. There was no mention of the second mortgage.

The *Gibson* court starts by expressing its view that it is plausible that "all payments under the plan" excludes or includes direct payments. As such, "all payments under the plan" is ambiguous. *Id*. at 18. The Court continues, "[a] general policy is recognized favoring resolution of ambiguities in the Bankruptcy Code in favor of debtors and even more so where the provision at issue affects a debtor's right to a discharge." *Id*. (internal cites omitted).

A distinction in the language used in §1328(a) was also discussed:

> "all payments under the plan" is used to define when completion of payments occurs (thus triggering entitlement to a full compliance discharge), while the similar but different alternative phrase "provided for by the plan" is used to describe the scope of the discharge. The use of different terminology implies an intended distinction.

Id. at 19 (internal cites omitted).

The Court also found that the "absolutist" view of §1328(a), mandating that a Chapter 13 case be dismissed or closed without a discharge if direct payments are not current at plan expiration, even in the event of an innocent error, was too harsh and incompatible with provisions which provide for revocation of discharge and confirmation orders.

In re Bethe, 2017 WL 3994813, 2017 Bankr. LEXIS 2554 (Bankr. E.D. Wis. Sept. 8, 2017). Following established local procedures, the trustee filed a notice of plan completion and the discharge was granted the same day. Eight days later, the trustee filed the notice required by FRBP 3002.1(f). The mortgage company filed a timely response indicating that the post-petition mortgage payments were not current. Months later, the court discovered the mortgage company's notice and scheduled a hearing, noting that the parties should consider the *Coughlin* opinion.

Bethe adopted the reasoning of *Coughlin* and drew parallels to provisions of Chapter 12. *Bethe* at *2-3. Nevertheless, there was no fraud present to justify setting aside the discharge. *Id*. at *3. Also, because the debtors had modified their mortgage loan, albeit after their Chapter 13 case was complete, the court found no cause to vacate the order pursuant to Fed. R. Civ. P. 60(b). The Court did note that local procedures would have to change going forward.

Additional case cites: *In re Payer*, 2016 WL 5390116 (Bankr. D. Colo. May 5, 2016), *In re Diggins*, 561 B.R. 782 (Bankr. D. Colo. 2016), *In re Chancellor*, 2017 WL 6371364 (Bankr. W.D. Mo. Dec. 12, 2017), *In re Hanley*, 575 B.R. 207 (Bankr. E.D. N.Y. 2017), *In re Thornton*, 572 B.R. 738 (Bankr. W.D. Mo. 2017).

C. Avoiding the Unintended Consequences

1. Become familiar with the Local Bankruptcy Rules. Your district may require the debtor to certify that he or she is current on post-petition direct payments or your district may permit the parties to resolve the response indicating that post-petition payments are not current.

2. Consider having the post-petition mortgage payments paid via the trustee.

3. Review whether the debtor is eligible for conversion or a hardship discharge under 11 U.S.C. §1328(b).

4. If the plan has not expired, modify the plan to surrender the property. *In re Coughlin* 568 BR 461 (Bankr. E.D. N.Y. 2017); *In re Dennett*, 548 B.R. 733 (Bankr. N.D. Tex. 2016), *but see In re Hanley*, 575 B.R. 207 (Bankr. E.D. N.Y. 2017) (for a discussion of surrender at 214-215).

5. The court may permit the debtor to become current within a short period of time. *See In re Payer*, 2016 WL 5390116 (Bankr. D. Colo. May 5, 2016).

6. A loan modification may deem the post-petition payments current. *See In re Diggins*, 561 B.R. 782 (Bankr. E. Colo. 2016).

7. Stipulate with the creditor for relief from the automatic stay; if the automatic stay is vacated, Rule 3002.1 may not apply. *See* Fed. R. Bankr. P. 3002.1(a).

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Husky Int'l Elecs., Inc. v. Ritz, 136 S. Ct. 1581 (2016)

I. Issue

Whether prohibition of a bankruptcy discharge for "actual fraud" under 11 U.S.C. § 523(a)(2)(A) encompasses fraudulent conveyance schemes, even when those schemes do not involve a false representation.

II. Statutory Context

An individual debtor is not discharged from any debt "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by … false pretenses, a false representation, or actual fraud …" § 523(a)(2)(A). The words "actual fraud" were added by the Bankruptcy Reform Act of 1978. Circuits were split as to whether the added option of "actual fraud" required an affirmative misrepresentation, or whether "actual fraud" encompassed a broader range of behaviors.

III. Facts

Husky International Electronics, Inc. ("Husky") sold its products to Chrysalis Manufacturing Corp. ("Chrysalis"), with Chrysalis incurring a debt of $163,999.38 to Husky. During the business relationship, Chrysalis' director, Daniel Lee Ritz, Jr. ("Ritz"), drained Chrysalis of assets by transferring funds to other entities Ritz controlled. Husky filed a lawsuit against Ritz to hold him personally liable for the debt under a Texas law that allows creditors to hold a shareholder responsible for corporate debt. Ritz filed a Chapter 7 bankruptcy in the Southern District of Texas. Husky initiated an adversary proceeding seeking to hold Ritz personally liable for Chrysalis' debt and for an order that the debt was not dischargeable in bankruptcy because the intercompany-transfer scheme constituted "actual fraud" under § 523(a)(2)(A).

The District Court held that Ritz was personally liable for the debt under Texas law, but the debt could be discharged as it was not "obtained by actual fraud". The Fifth Circuit affirmed, agreeing with the District Court that Ritz did not commit "actual fraud" under § 523(a)(2)(A). The Fifth Circuit held that a necessary element of "actual fraud" is a misrepresentation from the debtor to the creditor. Although Ritz may have hindered Husky's ability to collect its debt, Ritz did not make false representations to Husky, and therefore did not commit "actual fraud." Husky argued that a series of fraudulent conveyances intended to obstruct the collection of debt are "actual fraud". Husky appealed to the Supreme Court.

IV. Holding

In a 7-1 decision reversing the Fifth Circuit, the Supreme Court held that "actual fraud" in § 523(a)(2)(A) includes fraudulent conveyances schemes; "actual fraud" does not require a misrepresentation from a debtor to a creditor. The Court considered the legislative intent of the addition of "actual fraud" to the statute, meant something different than the prior statute, as well as the historical meaning of "actual fraud." "Actual fraud" consists of both "actual" and "fraud".

The common law includes anything that counts as "fraud" to be "actual fraud" if done with wrongful intent. Since the beginning of English bankruptcy, "fraud" has included a debtor's transfer of assets to hide them from creditors. Fraudulent conveyances are a fraud, even without a misrepresentation. Fraudulent conveyances are acts of concealment and hindrance, and thus are "actual fraud", and thus not dischargeable. The Court also discussed that it understood the debtor did not "obtain" debts in a fraudulent transfer, but reasoned that the transferee obtains the transferred assets by fraud if intent exists, and any debt traceable to that transfer would be nondischargeable under § 523(a)(2)(A). Therefore, the Court reasoned that it is "clear that fraudulent conveyances are not wholly incompatible with the 'obtained by' requirement."

The Court disagreed with Justice Thomas' dissenting opinion that the fraud should result from the inception of the credit transaction, reasoning that nothing in § 523(a)(2)(A) requires that. The Court also disagreed with the dissent and found that the addition of "actual fraud" was meant to expand the exception to discharge, not limit it.

V. Significance

Perhaps the most important goal of the Bankruptcy Code is to provide the debtor with a fresh start obtained by the discharge of prepetition debts. By broadening an exception to discharge in *Husky Int'l Elecs., Inc. v. Ritz*, the Supreme Court made it more difficult for debtors to obtain a fresh start. Noting that "there is no need to adopt a definition for all times and all circumstances," the Supreme Court left the door open to further broaden the definition of "actual fraud" and make broader exceptions to a discharge.

Now, the challenge for lower courts is to decide whether there are limits to the *Husky* doctrine, and if so, where. In *Hatfield v. Thompson (In re Thompson)*, 555 B.R. 1 (B.A.P. 10th Cir. 2016), the debtor had applied for an Oklahoma nursing home license and represented that he would be actively involved in operations and physically present at least eight hours a month. When a patient died in the nursing home, allegedly because of substandard care, the surviving spouse sued the nursing home and the debtor. On the eve of trial, the owner filed personal bankruptcy. The trial went ahead only against the nursing home, which defaulted, resulting in a $1 million judgment. In bankruptcy court, the spouse filed a non-dischargeability complaint against the owner, alleging that he was liable for the judgment under Oklahoma law that permits veil piercing "under the legal doctrine of fraud." The spouse alleged that numerous representations made to the state in the license application were false. The owner responded by filing a motion for summary judgment, relying on the fact that the judgment was based on negligence, not fraud. Before the Supreme Court handed down *Husky*, the bankruptcy court granted the summary judgment motion and dismissed the non-dischargeability complaint, because the judgment was for nothing that the owner obtained from the spouse. The surviving spouse appealed and won in a decision that relies heavily on *Husky*. The B.A.P. held that if the debtor obtains money by "actual fraud," "any liability of the debtor arising from the false pretenses, fraud, representations, or actual fraud is excepted from discharge." Non-dischargeable liability is not even limited by the value of the property obtained by fraud. In *Hatfield*, like *Husky*, the alleged fraud was not peculiar to the creditor who that raised the claim, yet that creditor's debt survives, while others who did not file a 523 action do not. The B.A.P.'s decision remanded, but the B.A.P.'s decision highlights the significant impact *Husky* has had on fraudulent transfer case law and dischargeability.

After *Husky,* can anyone who commits any kind of fraud, even without misrepresentation, on behalf of a corporation have non-dischargeable liability for debts owed by the corporation? What has happened to the Debtor's fresh start?

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UPDATE TO DISCHARGE AND DISCHARGEABILITY ISSUES PANEL MATERIALS

The following updates the materials for Arbitration in the Context of Discharge and Dischargeability Actions:

On May 21, 2018, the United States Bankruptcy Court for the Middle District of Florida decided a case involving a class action alleging contempt of court for violation of the discharge injunction by Verizon Wireless. *In re Bateman*, --B.R.--, 2018 WL 2324207 (Bankr. M.D. Fla. May 21, 2018). The *Bateman* case is similar in issues and result to *In re Jorge*, 568 B.R. 25 (Bankr. N.D. Ohio 2017), cited in the materials.

After debtor Bateman's Chapter 7 discharge, Verizon tried to collect an old cellphone debt from him, acting through a third party debt collector. Verizon responded that the arbitration agreement in Bateman's original cell phone contract covers the contempt proceedings and moved to compel arbitration.

Although Eleventh Circuit precedent holds that there is no evidence that Congress intended to create an exception to the FAA in the Bankruptcy Code, the bankruptcy court distinguished that precedent because it arose in a non-core proceeding. Instead, the court was persuaded by and followed the Second Circuit's decision in *Anderson v. Credit One Bank*. While the court decided that the arbitration agreement survived the discharge, it held that there was no agreement to arbitrate contempt proceedings and that arbitration of a contempt proceeding for violation of the discharge injunction inherently conflicts with the Bankruptcy Code because it undermines the Bankruptcy Court's authority to enforce its own orders. The court denied Verizon's motion to compel arbitration.

On the same day that the bankruptcy court decided *Bateman,* the United States Supreme Court decided its most recent arbitration case. In *Epic Systems Corp. v. Lewis*, --U.S.--, Case No. 16-285, 16-300, 16-307, 2018 WL 2292444 (May 21, 2018), the Supreme Court doubled down on its arbitration precedents over the dissent of four justices, this time in the context of the National Labor Relations Act. The Supreme Court decided that the National Labor Relations Act provisions protecting concerted action do not reflect a clearly expressed and manifest Congressional intent to displace the FAA.

The question is what impact *Epiq Systems* has on *Anderson v. Credit One Bank*, *Bateman* and other cases that decline to enforce arbitration clauses in certain

bankruptcy contexts. One commentator has suggested that, while *Epiq Systems* pretty much kills any broader argument that the Bankruptcy Code in general represents Congressional intent at odds with the FAA, cases such as *Anderson v. Credit One Bank* should survive as good law because they decline to compel arbitration of bankruptcy-unique issues. Donald L. Swanson, "U.S. Supreme Court Upholds Arbitration-Again! What Effect on Bankruptcy (Epiq Systems v. Lewis)", mediatbankry.com, May 29, 2018. The Second Circuit's opinion relies on contrary Congressional intent to displace the FAA specifically with respect to the discharge injunction. *Anderson v. Credit One Bank,* 884 F.3d 382, 390 (2d Cir. 2018).

The following updates the materials for Discharge Objections:

On April 23, 2018, the Ninth Circuit decided *In re Taggart*, 888 F.3d 438 (9th Cir. 2018), in which it held that creditors' subjective good faith belief that the discharge injunction did not apply to a state court claim for post-petition attorney's fees, even though that belief was unreasonable, insulated them from a finding of contempt. The bankruptcy court had held that a good faith belief that the discharge injunction was inapplicable to the creditors' claims was irrelevant for determining whether there was a "knowing" violation of the discharge injunction.

6/1/18.