THE NOT SO FRESH START – OBJECTIONS TO DISCHARGE IN BANKRUPTCY

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Introduction / Overview

Exceptions to discharge are important to consider for both debtor's counsel and creditor's counsel.

For debtors – It is important to anticipate whether any particular debt may be a target for an attempt to have the debt excepted from the debtor's discharge or whether a creditor or creditors may seek the denial of a discharge entirely. Reviewing a debtor's debts and the basis for those debts will allow counsel provide advise to the debtor that such claims may be forthcoming in the case and to avoid being taken off guard. Also, anticipating any objections to discharge can assist determining whether Chapter 7 or 13 would be a more appropriate avenue for a debtor

For creditors – It is important for creditors to be able to determine whether their debt may be excepted from discharge under § 523 or § 1328(a)(1)-(5) and to ensure any action that is required to ensure that any necessary action is taken in a timely manner.

The primary purpose of the bankruptcy discharge is to give the debtor a "fresh start." *In re Chambers,* 348 F.3d 650, 653 (7th Cir.2003); *See also Bukowski v. Patel*, 266 B.R. 838 (E.D.WI 2001). Accordingly, the exceptions to discharge reflect policy decisions that certain debts should not be discharged and that certain types of conduct should prevent a debtor for receiving a "fresh start" in bankruptcy. As the Seventh Circuit has stated, the fresh start provided by the bankruptcy discharge is limited to the "honest but unfortunate debtor." *Peterson v. Scott* (*In re Scott*), 172 F.3d 959, 966-67 (7th Cir.1999), citing *Grogan v. Garner,* 498 U.S. 279, 286-87, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

I. 11 U.S.C. § 523

a. Section 523 excepts certain debts from discharge under the discharge provisions of sections 727, 1141, 1228(a) and (b) and 1328(b). This section does not deal with a denial of a discharge in general, but excepts certain specific types of debt from discharge.

"The various exceptions to discharge in § 523(a) reflect a conclusion on the part of Congress 'that the creditors' interest in recovering full payment of debts in these categories outweigh[s] the debtors' interest in a complete fresh start.'" *Cohen v. de la Cruz*, 523 U.S. 213, 222 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998), *quoting Grogan v. Garner,* 498 U.S. 279, 287, 111 S.Ct. 654, 112 L.Ed.2d 755.

b. The exceptions to discharge are enumerated in the statute -

(i) **§ 523(a)(1)** – Excepts from discharge taxes or customs duties that are -

(A) of the kind and for the periods specified in 507(a)(3) or (a)(8) (of the Bankruptcy Code, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, or equivalent report or notice, if required –

(i) was not filed or given; or

(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.

- § 507(a)(3) deals with “gap" claims, which are claims arising in the ordinary course of business after the commencement of an involuntary case but before the appointment of a trustee and the entry of an order for relief.

- § 507(a)(8) deals with certain unsecured tax claims of governmental units.

(ii) **§ 523(a)(2)** – Excepts from discharge debts due for money, property, services or an extension, renewal, or refinancing of such credit, to the extent obtained, by –

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition;

(B) use of a statement in writing –

(i) that is materially false;

(ii) respecting the debtor’s or an insider’s financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive;

(C)(i) for purposes of subparagraph (A)--

(I) consumer debts owed to a single creditor and aggregating more than $600 for luxury goods or services incurred by an individual debtor on or within 90 days before the order for relief under this title are presumed to be nondischargeable; and

(II) cash advances aggregating more than $875 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the order for relief under this title, are presumed to be nondischargeable; and

(ii) for purposes of this subparagraph--

(I) the terms “consumer”, “credit”, and “open end credit plan” have the same meanings as in section 103 of the Truth in Lending Act; and

(II) the term “luxury goods or services” does not include goods or services reasonably necessary for the support or maintenance of the debtor or a dependent of the debtor.

- *Capital One Bank v. Bungert (In re Bungert)*, 315 B.R. 735 (Bankr. E.D.Wis. 2004) in a nondischargeability action under § 523(a)(2)(A) involving credit card use, the Court found that the creditor must present evidence of the debtor's fraudulent intent not to repay the credit card debt in order for a motion for default judgment to be granted. Citing *Trevisan*, below.

- In the context of NSF checks if the debt is determined to be nondischargeable, the entire amount of the debt, including interest and fees is not discharged. *Mega Marts, Inc. v. Trevisan (In re Trevisan)*, 300 B.R. 708, 713, fn. 4 (Bankr.E.D.Wis.2003). In the same case, the court set forth 3 elements that a claimant must prove to succeed in a claim under § 523(a)(2)(A): "1) The debtor obtained property through representations which the debtor either knew to be false or were made with such reckless disregard for the truth as to constitute willful misrepresentation; 2) The debtor possessed an intent to deceive; and 3) The creditor actually relied upon the false representation and that its reliance was reasonable." *Trevisan*, at 716 (citations omitted).

- The Seventh Circuit Court of Appeals has determined that in order for a claimant to succeed on a claim under § 523(a)(2)(B), the claimant must "prove that the debtor made a materially false written statement about his financial condition with the intent to deceive, and that the creditor reasonably relied on the statement." *In re Cohen*, 507 F.3d 610, 612 (7th Cir. 2007) (citation omitted).

(iii) **§ 523(a)(3)** – Excepts from discharge debts that are neither listed or scheduled under § 521(1), with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit –

(A) if such debt is not of a kind specified in paragraph (2), (4) or (6) of this subsection, timely filing a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4) or (6) of this subsection, timely filing a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request.

- In essence, this section excepts from discharge debts not scheduled in such time to permit a creditor to file a claim, object to the dischargeability of a debt or otherwise protect its rights, unless the creditor had actual knowledge or notice of the case.

- § 523(a)(3)(A) requires that there be a distribution to creditors. *See In re Nielsen,* 383 F.3d 922, 927 (9th Cir.2004). In the event the case is a no-asset case, there is no time fixed for filing claims and the failure to notify a creditor of the bankruptcy proceeding does not deprive the creditor of the opportunity for the creditor to file a claim in the case. In the context of a Chapter 13 debtor who failed to list a creditor in the schedules, the court determined that the debtor could not discharge the debt due the omitted creditor in an amended plan after the claims bar date. *In re Schuster*, 425 B.R. 833 (Bankr.E.D.Wis. 2010). The amendment or the filing of a claim

by the debtor on behalf of the creditor would not change the character of the debt from a debt not listed or scheduled under § 523.

(iv) **§ 523(a)(4)** – Excepts from discharge debts arising from fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

- The elements required to establish a nondischargeable debt for defalcation under this section are: (1) the existence of a trust; (2) the debtor is a fiduciary of that trust; and (3) fraud or defalcation by the debtor while acting as a fiduciary of the trust. *In re Ecker*, 400 B.R. 669, 671 (Bankr.E.D.Wis. 2009) (citations omitted).

- The section requires that the debtor have had some sort of a "fiduciary capacity," which has been characterized as some sort of statutory, technical, or express trust relationship between the parties. *See Meyer v. Rigdon,* 36 F.3d 1375 (7th Cir.1994); *Harsch v. Eisenberg (In re Eisenberg),* 189 B.R. 725 (Bankr.E.D.Wis.1995). In a case from the 10th Circuit Bankruptcy Appellate Panel, "defalcation" was defined under the section to include a negligent breach of a fiduciary duty, in contrast to *Meyer v. Rigdon*, which requires the defalcation be intentional, willful or reckless. *In re Storie*, 216 B. R. 283 (10th Cir. B.A.P 1997).

- In a case that has not been overturned, the 7th Circuit took a broad view of what constitutes a fiduciary relationship under §523(a)(4). The section requires either a conventional express trust or a circumstance where a difference in knowledge or power between the fiduciary and principal exists that gives the fiduciary "a position of ascendency" over the principal that occurs when "one party to the relation is incapable of monitoring the other party's performance of his undertaking" a fiduciary relationship may be found to exist. *In re Marchiando*, 13 F.3d 1111, 1116 (7th Cir. 1994) (finding that a store owner's failure to turn over lottery ticket sales to the State of Illinois was a dischargeable debt, as no fiduciary relationship existed).

- When representing parties in the construction industry or any industry that could be involved in making "improvements" to land, as defined under § 779.01(2)(a) Wis. Stats., as the Wisconsin "theft by contractor" statute creates the type of trust required by § 523(a)(4). *Romes Design Inc. v. Dinkins (In re Dinkins)*, 327 B.R. 918 (Bankr.E.D.Wis. 2005); *In re Carlson*, 2011 WL 3805650 (Bankr.E.D.Wis. 2011) (Finding prepetition stipulation resolving theft by contractor claim was to be given preclusive effect in subsequent nondischargeablity action, as the stipulation admitted that damages were "caused by theft by contractor".)

(v) **§ 523(a)(5)** – Excepts from discharge debts for a domestic support obligation.

- In a 2008 case, Judge McGarity determined that W2 overpayments were not dischargeable, as the payments constituted a "domestic support obligation", as defined in 11 U.S.C. § 101(14A). *State of Wisconsin v. Schauer (In re Shauer)*, 391 B.R. 430 (Bankr.E.D. Wis. 2008).

- Likewise, the United States District Court for the Eastern District of Wisconsin determined that food stamp overpayments are domestic support obligations. *Wisconsin Dept. of Workforce Development v. Ratliff*, 390 B.R. 607 (E.D.Wis. 2008).

(vi) **§ 523(a)(6)** – Excepts from discharge debts for willful and malicious injury by the debtor to another entity or to the property of another entity.

- A 2008 case out of the Western District of Wisconsin provides valuable insight for practitioners representing debtors and creditors in connection with secured business loans. In *Farmers Implement Store of Mineral Point, Inc. v. Jorenby (In re Jorenby)*, 393 B.R. 663 (Bankr.W.D. Wis. 2008), two creditors objected to the debtor's discharge of their debts under § 523(a)(6). The debtor sold a tractor that was secured by a loan from Creditor A, without Creditor A's knowledge. The security agreement did not forbid the sale of the collateral or direct that any proceeds from such a sale be turned over to Creditor A. Creditor B lent funds to the debtor that was secured by a lien on, among other things, equipment, inventory and fixtures. The debtor sold some of the collateral pledged to Creditor B without Creditor B's knowledge. As to Creditor A, because the loan documents did not forbid the sale of the collateral there was no conversion under Wisconsin law and the creditor did not allege that it failed to receive anything that it was entitled to under the parties' agreement, the debt could be discharged. *Jorenby* at 664-665. As to Creditor B, the debtor testified that he was injuring the interests of the creditor by selling the collateral, thus the conduct was willful and malicious, under *In re Ries*, 22 B.R. 343 (Bankr.W.D.Wis. 1982) (requiring that a finding of malice requires that the debtor knows his conduct will harm another and proceeding in spite of such knowledge). Thus, Creditor B's debt was nondischargeable. *Jorenby* at 665-666.

- A no contest or guilty plea in a criminal proceeding does not have preclusive effect in later civil proceedings, including nondischargeability proceedings. *Elbing v. Blair (In re Blair)*, 359 B.R. 233, 238 (Bankr.E.D.Wis. 2007). In the same case, the court stated that in the context of a § 523(a)(6) proceeding, "The word 'willful' in (a)(6) modifies the word 'injury,' indicating that nondischargeability takes a deliberate or intentional injury, not just a deliberate or intentional act that leads to injury." *Blair*, at 238, *quoting Kawaauhau v. Geiger,* 523 U.S. 57, 61, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998)

(vii) **§ 523(a)(7)** – Excepts from discharge debts to the extent they are for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty--

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition.

- "governmental unit" is defined in 11 U.S.C. § 101 as "United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States

trustee serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government."

- In a case that has not been overruled, the United States Supreme Court has stated "that § 523(a)(7) preserves from discharge any condition a state criminal court imposes as part of a criminal sentence. " *Kelly v. Robinson*, 479 U.S. 36, 50, 107 S. Ct. 353, 93 L. Ed. 2d 216 (1986).

(viii) **§ 523(a)(8)** – Excepts from discharge debts, unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for-

(A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.

- This exception to discharge is self-executing. Thus, any debtor who wishes to have such a debt discharged must affirmatively act by initiating an adversary proceeding to seek a hardship determination. *See Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 450, 124 S.Ct. 1905, 158 L. Ed. 2d 764 (2004); **HOWEVER,** the United States Supreme Court in *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. ____, 130 S. Ct 1367, 176 L.Ed.2d. 158 (2011), determined that the confirmation order of a Chapter 13 debtor's plan that discharged accrued interest without filing an adversary proceeding and receiving an "undue hardship" finding was not void. The Court determined that the failure to commence an adversary proceeding did not deprive United Student Aid of its right to due process. Due to the fact that the creditor had actual notice of the filing and contents of the proposed plan and did not object, Rule 60(b)(4) did not afford relief from the confirmation order. The Court stated that the risk of existing sanctions were sufficient to deter "bad faith attempts to discharge student loan debt without the undue hardship finding Congress required". *United Student Aid*, 130 S.Ct. at 1382.

- Open account for tuition and fees with educational institution is not an educational loan under § 523(a)(8) and does not require a finding of undue hardship. *In re Chambers*, 348 F.3d 650 (7th Cir. 2003). In *Chambers*, the court stated the following in determining whether a nonpayment of tuition is, in fact, an "educational loan": "nonpayment of tuition qualifies as a loan "in two classes of cases": " 'where funds have changed hands,' or where 'there is an agreement ... whereby the college extends credit.' The agreement to transfer educational services in return for later payment "must be reached prior to or contemporaneous with the transfer" of those educational services. This existence of a separate agreement acknowledging the

transfer and delaying the obligation for repayment distinguishes a loan from a mere unpaid debt." *Chambers*, at 657 (citations omitted).

- In *In re Sokolik*, 635 F.3d 261 (7th Cir. 2011), the Seventh Circuit found that a loan's "educational purpose" rather than the actual use of funds was determinative of whether the loan constitutes an "educational loan". The Court stated: "The "purpose" test avoids this potential problem by refocusing the inquiry on the nature and character of the loan. For example, rather than trying to determine whether a computer purchased with loan money was used for schoolwork, personal use or some combination of both, we need only ask whether the lender's agreement with the borrower was predicated on the borrower being a student who needed financial support to get through school." *Sokolik*, at 266. The Court further upheld an award of attorney fees to the creditor in accordance with the parties' contract.

- What is undue hardship? The Seventh Circuit has utilized a 3 part test to determine whether undue hardship exists: That debtor cannot maintain, based on current income and expenses, minimal standard of living for himself and his dependents if forced to repay loans; additional circumstances exist indicating that state of affairs is likely to persist for significant portion of repayment period of student loan; and that debtor has made good-faith efforts to repay loans. *Matter of Roberson*, 999 F.2d 1132 (7th Cir. 1993). Further, the debtor has the burden of establishing each element of the test by a preponderance of the evidence. *Grogan v. Garner,* 498 U.S. 279, 291, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

- Examples: *In re O'Hearn*, 339 F.2d 559 (7th Cir. 2003) – Undue hardship not found, as the debtor was single, with no dependents making $43,000 per year. Debtor resided in his fiancée's home, paying rent of $500 over the going rate for a 2 bedroom apartment in the area. *Goulet v. Educational Credit Management Corp.*, 284 F.3d 773 (7th Cir. 2002) – Undue hardship not found where the Seventh Circuit determined that the debtor's felony convictions and alcoholism do not meet the second prong of the test, as they did not rise to the additional circumstances needed to prove that the inability to pay would be persistent, exceptional circumstances amounting to a certainty that the state of affairs would continue in the future. *In re Richie*, 353 B.R. 569 (Bankr.E.D.Wis. 2006) – Court found the debtor did not lack the ability to get work, simply she could not find a job in her chosen field in her chosen geographic area. Thus, undue hardship did not exist. *Xiong Vang v. UW Stout Business Services and Educational Credit Management (In re Vang)*, 326 B.R. 76 (Bankr.W.D.Wis. 2005) – Court found undue hardship where debtor claimed to have a nominal IQ, the inability to read, write or speak English (and could not read or write in his native language), could not manage daily living skills, was the parent of 2 minor children with developmental disabilities, had not been employed for over a year and had not had an income over $6,729 for any calendar year since 2001; *Hoskins v. Educational Credit Management Corporation (In re Hoskins)*, 292 B.R. 883 (Bankr.C.D.Ill. 2003) - found undue hardship where the debtor had suffered epileptic seizures, had no marketable job skills and a 16 year history of unemployment, along with a good faith attempt to make some payments on a negotiated schedule.

(ix) **§ 523(a)(9)** – Excepts from discharge debts due for death or personal injury caused by the debtor's operation of a motor vehicle, vessel, or aircraft if

such operation was unlawful because the debtor was intoxicated from using alcohol, a drug, or another substance;

- Punitive damages are nondischargeable under § 523(a)(9), as such damages are included the "debts for" language which is broad. *Cohen v. de la Cruz,* 523 U.S. 213, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998)

(x) **§ 523(a)(10)** – Excepts from discharge debts that were or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727(a)(2), (3), (4), (5), (6), or (7) of this title, or under section 14c(1), (2), (3), (4), (6), or (7) of such Act;

(xi) **§ 523(a)(11)** – Excepts from discharged debts which are provided in any final judgment, unreviewable order, or consent order or decree entered in any court of the United States or of any State, issued by a Federal depository institutions regulatory agency, or contained in any settlement agreement entered into by the debtor, arising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to any depository institution or insured credit union;

(xii) **§ 523(a)(12)** – Excepts from discharge debts arising from a malicious or reckless failure to fulfill any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution, except that this paragraph shall not extend any such commitment which would otherwise be terminated due to any act of such agency;

(xiii) **§ 523(a)(13**) – Excepts from discharge debts for any payment of an order of restitution issued under title 18, United States Code;

- Section applies only to restitution orders in connection with a restitution order issued in prosecutions under title 18 U.S.C. (Crimes and Criminal Procedure).

(xiv) **§ 523(a)(14)** – Excepts from discharge debts incurred to pay a tax to the United States that would be nondischargeable pursuant to §523(a)(1);

- When faced with such a possible claim from a creditor's perspective, a Rule 2004 exam to secure information to trace funds would be recommended prior to proceeding with an adversary, if possible. *See In re Mueller*, 2011 WL 2669219 (Bankr.W.D.Wis. 2011), dismissing credit card company's proceeding to have a charge to the U.S. Treasury determined non-dischargeable, as the creditor was required to establish ""(1) the debt was incurred to pay a tax owed to the United States; and (2) the tax owed to the United States would have otherwise been nondischargeable under § 523(a)(1)". *Mueller*, at *1 (citations omitted). The creditor did not establish that the charge was made to pay a tax owed and the claim was dismissed.

(xv) **§ 523(a)(14A)** – Excepts from discharge debts incurred to pay a tax to a governmental unit, other than the United States, that would be nondischargeable pursuant to §523(a)(1);

(xvi) **§ 523(a)(14B)** – Excepts from discharge debts incurred to pay fines or penalties imposed under Federal election law;

(xvii) **§ 523(a)(15)** – Excepts from discharge debts due to a spouse, former spouse, or child of the debtor and not of the kind described in §523(a)(5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit;

- This section supplements § 523(a)(5) to prevent the discharge of debts that arise from a divorce or separation, but do not fit under § 523(a)(5) and should not be discharged.

- This exception can only be asserted by the other party to the divorce or separation, not third parties.

(xviii) **§ 523(a)(16)** – Excepts from discharge debts due for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;

- Excepts from discharge fees and assessments only for the period in which the debtor occupied or received rent from a tenant occupying the dwelling.

- Only applies to fees and assessments accruing after the bankruptcy is commenced.

(xix) **§ 523(a)(17)** – Excepts from discharge debts due for a fee imposed on a prisoner by any court for the filing of a case, motion, complaint, or appeal, or for other costs and expenses assessed with respect to such filing, regardless of an assertion of poverty by the debtor under subsection(b) or (f)(2) of section 1915 of title 28 (or a similar non-Federal law), or the debtor's status as a prisoner, as defined in section 1915(h) of title 28 (or a similar non-Federal law);

(xx) **§ 523(a)(18)** – Excepts from discharge debts owed to a pension, profit-sharing, stock bonus, or other plan established under section 401, 403, 408, 408A, 414, 457, or 501(c) of the Internal Revenue Code of 1986, under--

(A**)** a loan permitted under section 408(b)(1) of the Employee Retirement Income Security Act of 1974, or subject to section 72(p) of the Internal Revenue Code of 1986; or

(B) a loan from a thrift savings plan permitted under subchapter III of chapter 84 of title 5, that satisfies the requirements of section 8433(g) of such title;

but nothing in §523(a)(18) may be construed to provide that any loan made under a governmental plan under section 414(d), or a contract or account under section 403(b), of the Internal Revenue Code of 1986 constitutes a claim or a debt under this title;

(xxi) **§ 523(a)(19)** – Excepts from discharge debt that --

(A) is for--

(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, before, on, or after the date on which the petition was filed, from--

(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

c. Additional provisions of § 523.

- **§ 523(c)** – Requires the creditor to file an adversary proceeding to determine the dischargeability of debts that may fall under (a)(2), (4) or (6) or the debt will be discharged.

c. Caution for creditor's counsel - **§ 523(d**) provides that costs and a reasonable attorney fee **shall** be awarded to a debtor if an objection to discharge is filed by a creditor with respect to a consumer debt under § 523(a)(2) and the debt is discharged if the position of the creditor is found by the court not to be "substantially justified". Such costs may not be awarded if the court finds special circumstances that would make such award unjust.

- "Substantially justified" has been interpreted to mean that the plaintiff has a reasonable basis in both law and fact to ask for a determination of dischargeability. *Beneficial of Missouri, Inc. v. Shurbier (In re Shurbier),* 134 B.R. 922, 927 (Bankr.W.D.Mo.1991). If a plaintiff continues to pursue a proceeding after it knew or should have known that it could not prevail, the plaintiff no longer has a reasonable basis for proceeding.. *Shurbier,* at 928.

- The burden of proving substantial justification is on the creditor who is seeking to avoid the imposition of costs. *Chrysler First Financial Services Corporation v. Rhodes (In re Rhodes)*, 93 B.R. 622 (Bankr.S.D.Ill. 1988).

- The language of § 523(d) is mandatory and does not require a defendant to file a counterclaim in order to receive a fee award. *Mercantile Bank of Illinois v. Williamson (In re Williamson*), 181 B.R. 403 (Bankr.W.D.Mo. 1995). There is a split of authority on this issue, however, the Seventh Circuit has not ruled on the issue.

- The Bankruptcy Court for Western District of Wisconsin has found such awards to be mandatory. *Lader's Tiffany Feed & Supply Co., Inc. v. Kohl (In re Kohl),* 18 B.R. 670, 672 (Bkrtcy.W.D.Wis.1982).

- *Desert Palace Inc. v. Baumblit (In re Baumblit)*, 15 Fed. Appx. 30 (2nd Cir. 2001) (costs not awarded where claimants position, although not supported by controlling authority, was not precluded by law); *FIA Card Services, N.A. v. Flowers (In re Flowers)*, 391 B.R.178 (M.D.Ala. 2008) (Court utilized definition of "substantially justified" found in Equal Access to Justice Act, citing case law that states that Congress' intention was that the EAJA standard be utilized in § 523(d) cases. Court did not find substantial justification where plaintiff did not conduct any pre-filing investigation whether there existed evidence to support a fraud claim against the debtor/defendant); *American Express Travel Related Service Company, Inc. v. Christensen (In re Christensen)*, 193 B.R. 863 (N.D.Ill. 1996) (Affirming bankruptcy court's award of fees where plaintiff's argument was "tenuous").

- Under this section, at least one court has refused to award attorney fees to a pro se defendant where the creditor's position was not substantially justified. *Citicorp National Credit & Mortgage Services for Ctibank, N.A. v. Welch (In re Welch)*, 208 B.R. 107 (Bankr.S.D.N.Y. 1997). However, at least one other court has come to the exact opposite result. *Mercantile Bank of Illinois v. Williamson (In re Williamson*), 181 B.R. 403 (Bankr.W.D.Mo. 1995). The Seventh Circuit has not ruled on the issue.

- In order to show substantial justification, the creditor must show: (1) a reasonable basis in law for the theory it propounds; (2) a reasonable basis in truth for the facts alleged; and (3) a reasonable connection between the facts alleged and the legal theory advanced. *Phillips v. Napier (In re Napier)*, 205 B.R. 900, 908 (Bankr.N.D.Ill. 1997)(citations omitted).

III. 11 U.S.C. §727.

a. Provides exceptions to the discharge of the debtor's debts generally. This section does not deal with the dischargeability of individual debts or types of debt, but the overall discharge provided in a Chapter 7 proceeding.

b. Section 727(a) provides that the court shall grant a discharge unless any of the circumstances enumerated are present:

(i) **§ 727(a)(1)** – The debtor is not an individual;

(ii) **§ 727(a)(2)** - The debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

- There are four (4) elements that must be proven to deny a discharge under § 727(a)(2). The elements are: 1) The act complained of must be done within one (1) year before the date of the filing of the petition; 2)The act was done with intent to hinder, delay or defraud a creditor or an officer; 3) The act was carried out by the debtor or his duly authorized agent; and 4) The act consisted of transferring, removing, destroying, mutilating, or concealing any of the debtor's property or permitting the acts to be done. *Village of San Jose v. McWilliams*, 284 F.3d 785 (7th Cir. 2002).

- Intent to defraud under this section may be shown by circumstantial evidence. *McWilliams*, at 791. A finding of intent to defraud may be inferred from the circumstances of the debtor's conduct. *Matter of Smiley*, 864 F.2d 562 (7th Cir. 1989).

- In *McWilliams*, the court set forth six (6) factors, which were originally stated by the United States Court of Appeals for the Fifth Circuit, which indicate that the debtor actually intended to defraud a creditor or officer under § 727(a)(2). The factors are: 1) A lack or inadequacy of consideration; 2) A family, friendship or close associate relationship between the parties; 3) A retention of possession, benefit or use of the property in question; 4) The financial condition of the party sought to be charged both before and after the transaction in question; 5) The existence or cumulative effect of the pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors; and 6) The general chronology of the events and transactions under inquiry. *McWilliams*, at 791, *citing Pacy v. Chastant (In the matter of Chastant)*, 873 F.2d 89, 91 (5th Cir. 1989). If one or more of the above factors is shown, a presumption of intent to defraud is raised, which establishes the creditor's or the Trustee's prima facie case and the burden then shifts to the debtor to prove a lack of fraudulent intent. Ibid.

- If the claimant proves that the debtor did transfer, remove, destroy, mutilate, or conceal, property or has permitted such acts to take place

with actual intent to defraud creditors or an officer, it is not necessary for creditors or an officer to have been harmed. As long as a debtor has the intent to hinder, delay or defraud and takes some action, such as a transfer, that is sufficient to deny the debtor a discharge. *Matter of Smiley*, 864 F.2d 562, 569 (7th Cir. 1989).

(iii) **§ 727(a)(3)** - The debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

- Requires that debtors produce records which provide creditors "with enough information to ascertain the debtor's financial condition and track his financial dealings with substantial completeness and accuracy for a reasonable period past to present." *Matter of Juzwiak*, 89 F.3d 424, 427 (7th Cir. 1996), *quoting In re Martin,* 141 B.R. 986, 995 (Bankr.N.D.Ill.1992).

- Claims under this section have a shifting burden. After an objecting party has established a *prima facie* case that the records are insufficient to ascertain the debtor's financial condition and/or personal transactions, the burden then shifts to the debtor to introduce credible evidence to refute the proof of insufficient records or to justify the absence of such records. *Neary v. Happel (In re Happel)*, 394 B.R. 915 (Bankr.E.D.Wis. 2008).

- Fraudulent intent is not required under this section. *Neary v. Happel (In re Happel)*, 394 B.R. 915 (Bankr.E.D.Wis. 2008).

(iv) **§ 727(a)(4**) - the debtor knowingly and fraudulently, in or in connection with the case--

(A) made a false oath or account;

(B) presented or used a false claim;

(C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or

(D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

- There are 5 elements to a 727(a)(4)(A) claim: (1) the Debtors made a false statement under oath; (2) the statement was false; (3) the Debtors knew the statement was false; (4) the Debtors made the statement with the intent to deceive; and (5) the statement related materially to the bankruptcy case. *Swanson v. Green (In re Green)*, 2007 WL 4570590 (Bkrtcy.E.D.Wis.) (citations omitted). *Neary v. Happel (In re Happel)*, 394 B.R. 915 (Bankr.E.D.Wis. 2008).

- In order for a court to find the degree of intent required to deny the debtor's discharge under §727(a)(4)(A) it must be determined that the debtor "knowingly intended to defraud or engaged in behavior which displayed a reckless disregard for the truth." *Bostrom*, 286 B.R 352, 362-363 (Bankr.N.D.Ill. 2002) (citations omitted). Fraudulent intent may be inferred. *Ibid*. *Neary v. Happel (In re Happel)*, 394 B.R. 915 (Bankr.E.D.Wis. 2008).

- The test of materiality of a false oath or account for purposes of § 727(a)(4)(A) is whether the statement "bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings or the existence or disposition of property" and the false statement need not result in detriment or prejudice to a creditor to be material. *Bostrom*, at 364.

- Omissions from the bankruptcy schedules and Statement of Financial Affairs constitute a false oath for purposes of § 727(a)(4). *Neary v. Happel (In re Happel)*, 394 B.R. 915 (Bankr.E.D.Wis. 2008) (citation omitted).

- A debtor has made a false oath when a knowingly false schedule is sworn to and filed and the making of the false oath cannot be cured by recanting. *United States v. Young,* 339 F.2d 1003, 1004 (7th Cir.1964) (citations omitted). The claimant who is seeking denial of the discharge must still prove that debtor knowingly filed a false schedule.

(v) **§ 727(a)(5)** - The debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

- This section "is broadly drawn and clearly gives a court broad power to decline to grant a discharge in bankruptcy where the debtor does not adequately explain a shortage, loss, or disappearance of assets." *Bostrom*, 286 B.R. at 364, *quoting In re Martin*, 698 F.2d 883, 886 (7th Cir. 1983) (citations omitted). The Court's inquiry is into the truth, detail and completeness of the debtor's explanation of a loss or deficiency of assets. *See Bostrom*, 286 B.R. at 364, *citing Matter of D'Agnese*, 86 F.3d 732, 735 (7th Cir. 1996). In *D'Angnese*, which the 7th Circuit affirmed the bankruptcy court's finding that the debtor failed to satisfactorily explain a loss of $300,000 in assets where she could not provide any evidence of transfers of the property to third parties and claimed that she simply did not know what happened to other items.

- The section requires that the debtor provide "more than vague, indefinite and uncorroborated assertions by a debtor" in order to provide a satisfactory explanation. *Damon v. Chadwick (In re Chadwick)*, 335 B.R. 694, 703 (Bankr.W.D.Wis. 2005) (citation omitted).

(vi) **§ 727(a)(6)** - The debtor has refused, in the case--

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;

(B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or

(C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

- The Western District of Wisconsin (in November, 2008 case) has found that "refused" in connection with a § 727(a)(6)(A) claim means that there must exist a "willful or intentional act" rather than "a mistake or the inability to comply." *C & A Investments v. Kelly (In re Kelly)*, 2008 WL 4889518 W.D. Wis. 2008, *quoting*, *In re Eckert,* 375 B.R. 474, 480 (Bankr.N.D.Ill.2007). In *Kelly*, the Bankruptcy Court further quoted *Eckert* stating that a willful or intentional act requires proof of more than "a failure to obey a court's order that results from inadvertence, mistake, or inability to comply," but that a claimant can prove that a debtor "refused" as the term is used in the section "by showing the debtor received the order in question and failed to comply with its terms." *Eckert,* 375 B.R. at 480.

(vii) **§ 727(a)(7)** - The debtor has committed any act specified in § 727 (2), (3), (4), (5), or (6), on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider;

- "Insider" is defined in 11 U.S.C. § 101(31). If the debtor is an individual, insiders **include** relatives, general partners, partnerships in which the debtor is a partner and corporations in which the debtor is a director or office. The listing in § 101(31) is not exhaustive. 11 U.S.C. § 102(3).

- The Seventh Circuit Court of Appeals has held that a corporation was an insider of the debtor as the debtor had been president, director and day to day manager of the corporation. In the case, the debtor (among other things) concealed corporate assets and absconded with corporate records during the corporation's bankruptcy proceeding. The bankruptcy court denied the debtor's discharge and found that even though certain acts violating § 727 occurred after the debtor resigned from the board of the corporation, the insider status continued, as the debtor was still the corporation's sole stockholder and had the ability to divert corporate receivables and orders to a successor corporation. *Matter of Krehl*, 86 F.3d 737 (7th Cir. 1996).

(viii) **§ 727(a)(8)** – If the debtor has been granted a discharge under 11 U.S.C. §727, under 11 U.S.C. § 1141, or under section 14, 371, or 476 of the Bankruptcy Act, in a case commenced within 8 years before the date of the filing of the petition;

- § 1141 deals with the effect of confirmation of a Chapter 11 plan. Confirmation of such a plan provides the debtor with a discharge. 11 U.S.C § 1141(d).

(ix) **§ 727(a)(9)** – If he debtor has been granted a discharge under 11 U.S.C. § 1228 or 1328 of this title, or under section 660 or 661 of the Bankruptcy Act, in

a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least--

(A) 100 percent of the allowed unsecured claims in such case; or

(B) (i) 70 percent of such claims; and

(ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort;

(x) **§ 727(a)(10)** – If the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter;

(xi) **§ 727(a)(11)** – If, after filing the petition, the debtor failed to complete an instructional course concerning personal financial management described in 11 U.S.C. § 111, except that this paragraph shall not apply with respect to a debtor who is a person described in 11 U.S.C. §109(h)(4) or who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved instructional courses are not adequate to service the additional individuals who would otherwise be required to complete such instructional courses under this section (The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in this paragraph shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter.);

(xii) **§ 727(a)(12)** – If the court after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge finds that there is reasonable cause to believe that--

(A) 11 U.S.C. § 522(q)(1) may be applicable to the debtor; and

(B) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in 11 U.S.C. § 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B).

- Section imposes certain limitations on individual debtors who claim exemptions which, in aggregate, exceed $146,450 that are set forth in § 522(p)(1).

c. Section 727(c)(1) permits either the trustee, a creditor or the U.S. trustee to commence an action objecting to a debtor's discharge under § 727(a).

d. Revocation of a discharge granted to a debtor may occur under limited circumstances set forth in § 727(d).

- The section provides that a discharge may be revoked:

(d) On request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if--

(1) 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;

(2) the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee;

(3) the debtor committed an act specified in subsection (a)(6) of this section; or

(4) the debtor has failed to explain satisfactorily--

(A) a material misstatement in an audit referred to in section 586(f) of title 28 (random audits to be performed of cases filed by individuals under Chapter 7 and 13 which are outside the statistical norms for income and expenses); or

(B) a failure to make available for inspection all necessary accounts, papers, documents, financial records, files, and all other papers, things, or property belonging to the debtor that are requested for an audit referred to in section 586(f) of title 28.

- The time to seek revocation of a debtor's discharge is limited. The time frames are found in § 727(e), which provides:

(e) The trustee, a creditor, or the United States trustee may request a revocation of a discharge--

(1) under subsection (d)(1) of this section within one year after such discharge is granted; or

(2) under subsection (d)(2) or (d)(3) of this section before the later of--

(A) one year after the granting of such discharge; and

(B) the date the case is closed.

- FRBP 9024 does not permit the extension of the time frames for revocation of discharge in a Chapter 7 case.

IV. 11 U.S.C. §1328

a. Provides the parameters of the discharge granted in a Chapter 13 proceeding.

b. **§ 1328(a)** – Discharge is to occur "as soon as practicable after the completion by the debtor of all payments under the plan" and, if applicable, certification that any domestic support obligations required by statute or administrative or judicial order have been paid, unless a written waiver of discharge is approved by the court. The extent of the discharge is limited by 11 U.S.C. 1328(d). The discharge granted under this section extends to all debts provided for by the plan or those that are disallowed under 11 U.S.C. § 502, except -

(1) Debts provided for under 11 U.S.C. § 1322(b)(5) (dealing with secured claims which require payments that continue after the last payment under the plan is due); The debtor's plan must provide for the cure of any such debt in order for the debt to be nondischargeable. *In re Chappell*, 984 F.2d 775 (7th Cir. 1993).

(2) Debts of the kind specified in 11 U.S.C. § 507(a)(8)(C) (taxes that are required to be collected or withheld and for which the debtor is liable in any capacity), or 11 U.S.C. § 523(a)(1)(B), (1)(C), (2), (3), (4), (5), (8) or (9);

(3) Debts which constitute restitution ,or a criminal fine, included in a sentence on the debtor's conviction of a crime; or

(4) Debts for restitution, or damages, awarded in a civil action against the debtor as a result of willful or malicious injury by the debtor that caused personal injury to an individual or the death of an individual.

c. **§ 1328(b)** permits a court to grant a discharge to a debtor after confirmation of the plan and notice and hearing prior to the completion of payments under the plan in limited circumstances (the "Hardship Discharge"). The extent of the discharge is limited by 11 U.S.C. 1328(d). Section 1328(c) limits the discharge granted under § 1328(b) to all unsecured debts provided for by the plan or those that are disallowed under 11 U.S.C. § 502, except -

(1) Debts that are provided for under 11 U.S.C. § 1322(b)(5) (dealing with secured claims which require payments that continue after the last payment under the plan is due); or

(2) Debts of a kind specified in 11 U.S.C. 523(a).

d. **§ 1328(d)** provides that unless the debtor receives prior approval (and such approval was practicable) from the trustee to incur debt under 11 U.S.C. 1305(a)(2) (consumer debt arising after the order for relief that is for property or services not necessary for performance of the plan by the debtor), any allowed claim based on this section will not be discharged.

e. **§ 1328(f)** provides that a discharge will not be granted if the debtor received a discharge -

(1) in a case filed under chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or

(2) in a case filed under chapter 13 of this title during the 2-year period preceding the date of such order.

f. **§ 1328(g)** provides that a discharge shall not be granted unless an instructional course in personal financial management described in 11 U.S.C. § 111 is completed after the filing of the petition, unless the debtor resides in a district in which the United States trustee determines that the approved instructional courses are inadequate or are determined, after notice and hearing, to be unable to complete such a course by reason of incapacity, disability or active duty military service in a combat zone, per 11 U.S.C. § 109(h)(4)

g. **§ 1328(h)** requires the court, before granting discharge, to make a finding (after notice and hearing no more than 10 days before the entry of an order granting discharge) that there is no reasonable cause to believe that -

(1) 11 U.S.C. § 522(q)(1) may be applicable to the debtor; and

(2) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in 11 U.S.C. § 522(q)(1)(A) or liable for a debt of the kind described in 11 U.S.C. § 522(q)(1)(B).

V. Procedural Concerns.

a. Proceedings to determine the dischargeability of a debt or objecting to a debtor's discharge are adversary proceedings and subject to the rules contained in part VII of the Federal Rules of Bankruptcy Procedure. FRBP 7001(6). *See* Local Rules 7004 and 7005 for local rules regarding adversary filing and service procedures.

b. Such proceedings are core proceedings and may be heard and determined by bankruptcy judges. 28 U.S.C § 157(b)(2)(I) and (J).

c. Exceptions to discharge of a debt are construed strictly against a creditor and liberally in the debtor's favor and the party seeking to establish an exception to discharge bears the burden of proof. *Kolodziej v. Reines,* 142 F.3d 970, 972-73 (7th Cir.1998).

d. FRBP 4005 provides that the burden of proving an objection to discharge is on the plaintiff.

e. The time for filing a proceeding objection to discharge under § 727 is set forth in FRBP 4004(a). The Rule provides that the proceeding must be commenced "no later than 60 days after the first date set for the meeting of creditors under § 341(a). This time frame may be extended after notice and hearing by the court, as provided in FRBP 4004(b). Any such motion must be filed prior to the expiration of the time to file.

f. FRBP 4007 relates to actions to determine the dischargeability of a particular debt. The Rule permits the debtor or any creditor to commence such an action. FRBP 4007(a).