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We Left Them Off the List—Now What? Unscheduled Creditors in Chapter 7 Bankruptcies

I. INTRODUCTION

Generally, a discharge under Chapter 7 of the Bankruptcy Code relieves a debtor of personal liability on all debts that either arose or are deemed to have arisen prior to the date of the order for relief.[1] The Bankruptcy Code, however, provides for several situations in which a debtor is not eligible for the protection of the bankruptcy courts.[2] These situations range from the debtor not being an individual to a situation in which the debtor signs a written waiver of discharge. If a debtor qualifies for a discharge, the code provides an additional mechanism in Section 523 whereby individual debts may be excepted from discharge.[3] In particular, Section 523(a)(3) provides for the nondischargeability of certain debts which are not scheduled as mandated by Section 521(1).[4]

The Section 521(1) schedule of creditors is used to provide notice to creditors of the order for relief and of the first meeting of creditors.[5] Presumably, this list would also be used to notify creditors of any additional important events. If a particular creditor is omitted from the list, he may be precluded from, inter alia, filing a claim, filing a request for a determination of dischargeability, or participating in his pro-rata portion of the debtor's estate (the dividend). Additionally, if a creditor does not have knowledge of the bankruptcy, he may continue to expend time, money, and effort attempting to collect from the debtor only to learn later that he was trying to squeeze blood from the proverbial turnip. Bankruptcy Code Section 523(a)(3) attempts to address this situation.

Section 523(a) states, in part:

> [A] discharge under section 727, 1141 . . . or 1328(b) of this title does not discharge an individual debtor from any debt . . . .
> (3) neither listed or scheduled under section 521(1) of this title, 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 of a proof of claim, unless such creditor

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1. 11 U.S.C. § 727(b) (1991).
2. 11 U.S.C. § 727(a) (1991) ("The Court shall grant a discharge, unless—"followed by ten exceptions).
3. 11 U.S.C. § 523(a) (1991).
4. 11 U.S.C. § 521 (1991) states that the debtor shall: "(1) file a list of creditors, and unless the court orders otherwise, a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs . . . ."
5. Fed. R. Bankr. P. 1007.

> 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 of 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 . . . .[6]

Sub-paragraph (A) only excepts unscheduled debts from discharge if the creditor was not able to file a timely proof of claim. Sub-paragraph (B) goes further for certain other debts that are neither listed nor scheduled. Under sub-paragraph (B), not only must a creditor have been denied the opportunity to timely file a proof of claim, but must also have been denied the opportunity to timely request a determination of dischargeability. The "B" debts are specified in Section 523(a), sub-paragraphs (2), (4), and (6). These will be referred to as "tort-type claims." Sub-paragraph (2) is for money, property, or credit obtained under false pretenses; (4) is for fraud while acting as a fiduciary, embezzlement, or larceny; and (6) is for willful or malicious injury by the debtor to the creditor or his property. The distinction is made here because Section 523(a)(1), (3), (5), (7), (8), and (9) claims have no time limit within which a creditor must bring a request for a determination of dischargeability,[7] while Section 523(a)(2), (4), and (6) claims do.[8] The time limits are provided in Section 523(c) and Federal Rule of Bankruptcy Procedure 4007(c).

Section 523(c) separates the tort-type claims from the others. It states that if there is no request for a determination of dischargeability, then the tort-type claims are discharged. Rule 4007(c) additionally sets a time limit of sixty days after the first meeting of creditors for the determination to be requested. The policy behind Section 523(c) and Rule 4007(c) is to prevent debtors from having to defend against charges of fraud, intentional torts, or other malfeasance many years after the event. The other sub-sections of Section 523(a) are much less subjective and, therefore, easier to apply. Section 523(a)(3)(B), then, simply provides a mechanism whereby a creditor who holds a valid tort-type claim, who is not notified of the bankruptcy in time to meet the sixty-day deadline of Rule 4007(c), can circumvent the rule and still assert a claim.

This comment will analyze the various problems that arise under Section 523(a)(3) and propose solutions to those problems. In general, the question is how should debtors who fail to schedule a creditor be treated. Complicating the issue, however, is the fact that the reasons for such failures range from

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6. 11 U.S.C. § 523(a) (1991) (emphasis added).

7. Fed. R. Bankr. P. 4007(b) states, "A complaint other than under § 523(c) [referring to (a) (2), (4) or (6)] may be filed at any time."

8. Fed. R. Bankr. P. 4007(c) states, in part, that any complaint for determination of dischargeability under § 523(c), which refers to § 523(a)(2), (4) or (6), "shall be filed not later than 60 days following the first date set for the meeting of creditors. . . ."

inadvertence or attorney negligence to willful or intentional failure on the part of the debtor. Part II of this comment will outline the historical views of both the majority and the minority positions on this issue. Part III will outline the traditional problems that arise under both views. Finally, Part IV will attempt to rectify the disparities between the majority and minority positions and propose a unified approach to Section 523(a)(3). This solution would allow the minority jurisdictions to reach less harsh and more consistent results and give the majority jurisdictions a firmer statutory footing for the results which they are currently reaching.

II. HISTORICAL TREATMENT OF UNSCHEDULED CREDITORS

A. *Majority View*

The traditional treatment of unscheduled creditors has been to reopen the case and allow the debtor to amend the schedule of creditors to include the omitted creditor.[9] The result has been to treat the debt as if it had been listed originally and consequently discharged. The seminal case in this line is *Robinson v. Mann.*[10] *Robinson* held that in exceptional circumstances a motion to reopen a case may be allowed in light of the equitable discretion of the bankruptcy court.[11]

Robinson was decided under the Bankruptcy Act Section 57(n),[12] which barred the filing of proofs of claims any later than six months from the date the case was filed. *Robinson*, however, held that Section 57(n) was not an absolute bar to a late filing of a proof of claim or an amendment of schedules. The court stated that an amendment of schedules beyond the statutory six-month bar was allowable under "exceptional circumstances."[13] Factors which the *Robinson* court listed in determining whether a case should or should not be reopened included: a) the reason for the debtor's failure to list the omitted creditors; b) the degree of disruption caused to the court and proceedings by allowing the debtor to amend his schedules; and c) the amount of prejudice or harm to the creditor.[14] *Robinson* asserted that the bar date was a prod to encourage creditors to file their claims in a timely manner, not a stick to be used against debtors.[15]

9. Friendly Fin. Discount Corp. v. Jones (*In re* Jones), 490 F.2d 452 (5th Cir. 1974); Robinson v. Mann, 339 F.2d 547 (5th Cir. 1964), *reh'g denied*, 341 F.2d 297 (5th Cir. 1965).

10. 339 F.2d 547 (5th Cir. 1964), *reh'g denied*, 341 F.2d 297 (5th Cir. 1965).

11. *Id.* at 550.

12. Bankruptcy Act of 1898 § 57(n). Any references to the Act are to the Act of 1898. References to the Code are to the new Bankruptcy Code of 1978.

13. *Robinson*, 339 F.2d at 550.

14. *Id.*

15. *Id.*

The Fifth Circuit bolstered the test of *Robinson*, in *Friendly Finance Discount Corp. v. Jones (In re Jones)*.[16] The court in *Jones* stated that in order to deny a debtor's motion to amend the schedules to add an omitted creditor, "the reasons . . . must be real and substantial, not merely technical or conjectural."[17] The court drew a clear distinction between willful, intentional disobedience or dereliction of duty, and inadvertence and mistake due to excusable neglect of the debtor or his counsel.[18] The clear implication of the court's decision in *Jones* was that inadvertence was not a real and substantial enough reason to deny a discharge to an otherwise honest debtor. *Jones* cited *Spach v. Strauss*[19] as standing for the proposition that "the right to discharge is statutory, and the provisions of Section 14 of the Act relating to discharge should be construed liberally in favor of the bankrupt and strictly against the objecting creditor."[20] *Jones*, citing *Local Loan Co. v. Hunt*,[21] also asserted that the Bankruptcy Act was intended to give a debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."[22] This is commonly referred to as the "fresh start" policy. In the *Jones* opinion, the court implied that equity should prevail over statutory interpretation: "[W]e refuse to make it [the securing of discharge] a treacherous tight-rope on which the slightest misstep spells disaster and over which only the most accomplished acrobat can successfully pass."[23]

Both *Robinson* and *Jones* were decided prior to the enactment of the Bankruptcy Code in 1978. The holdings in these cases, however, serve as the foundation for later cases in the majority of jurisdictions. The basic proposition in the later cases is that the purpose and policy of the bankruptcy statutes are best served by allowing the debtor who failed to list a creditor to reopen the case, schedule the creditor, and thereby obtain a discharge. The only exceptions to this rule have been listed in subsequent cases as willful or intentional omission by the debtor or extreme prejudice or harm to the creditor.[24]

In these cases, the threshold question in determining whether or not to reopen a case to allow amendment of the schedules has generally been whether or not there is any evidence of fraud, intentional design, or scheme on the part of the debtor who omitted the creditor. Once this threshold requirement has been satisfied, the courts then focus on whether or not the creditor will be prejudiced

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16. 490 F.2d 452 (5th Cir. 1974).
17. *Id.* at 456.
18. *Id.* at 456-57.
19. 373 F.2d 641 (5th Cir. 1967).
20. *Jones*, 490 F.2d at 456.
21. 292 U.S. 234, 54 S. Ct. 695 (1934).
22. *Id.* at 244.
23. *Jones*, 490 F.2d at 457.
24. Samuel v. Baitcher (*In re* Baitcher), 781 F.2d 1529 (11th Cir. 1986); Rosinski v. Boyd (*In re* Rosinski), 759 F.2d 539 (6th Cir. 1985); Stark v. St. Mary's Hosp. (*In re* Stark), 717 F.2d 322 (7th Cir. 1983); *In re* Young, 70 B.R. 968 (Bankr. E.D. Pa. 1987); *In re* Gray, 57 B.R. 927 (Bankr. R.I.), *aff'd*, 60 B.R. 428 (D.R.I. 1986).

by allowing the debtor to reopen the case.[25] The focus is on the extent of harm to the creditor, rather than receipt of notice.[26] This author calls this the "no harm/no foul" approach. One line of cases divides the harm test into two steps: 1) whether or not the creditor has lost his opportunity to participate in a dividend; and 2) whether the creditor has lost his opportunity to obtain a determination of dischargeability of the debt.[27] This test stems from the requirements of sub-paragraphs (A) and (B) of Section 523(a)(3).

Some cases add a third criterion to this two-part test.[28] That is, whether or not the creditor has been harmed by subsequent collection efforts which he made as a result of his lack of knowledge of the debtor's bankruptcy.[29] *In re Mitchell*[30] follows the majority of jurisdictions and states that the unintentional omission of the creditor by the debtor is enough on its own to reopen a case absent any real harm to the creditor.[31] However, *Mitchell* adds subsequent collection efforts as a possible source of harm. Factors this author believes should be considered include: a) how much time has elapsed between the collection efforts of the creditor and notice given by the debtor; and b) the amount of time and money spent in an attempt to collect the debt. The policy in these cases is to place the creditor in no worse a position than if he had been scheduled and notified in the original petition.[32] For example, in *In re David*[33] the court allowed the debtor to reopen the case and schedule the debt. However, the court required the debtor to pay $900 in attorney's fees that the creditor had expended attempting to collect the debt after it had been discharged. This was the amount by which the creditor had been harmed by the lack of notice of the debtor's bankruptcy.

The majority view, with slight permutations, has been followed in the Fifth, Sixth, Seventh, Eighth, Tenth, and Eleventh Circuits.[34] In summary, the goal seems, to this author, to be to allow a debtor who inadvertently fails to list or schedule a creditor to retain the benefit of a "fresh start" as long as there is no prejudice to the unscheduled creditor. This approach, while seemingly fair, does

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25. *Id.*

26. *Rosinski*, 759 F.2d at 541.

27. Powers v. Crum (*In re* Crum), 4 B.R. 486, 491 (Bankr. N.D. Ill. 1985); *In re* Zablocki, 36 B.R. 779, 783 (Bankr. D. Conn. 1984).

28. *In re* Mitchell, 47 B.R. 209, 211 (Bankr. N.D. Tex. 1985); *In re* David, 106 B.R. 126 (Bankr. E.D. Mich. 1989); LaBate & Conti, Inc. v. Davidson (*In re* Davidson), 36 B.R. 538, 545 (Bankr. D.N.J. 1983).

29. *Id.*

30. 47 B.R. 209 (Bankr. N.D. Tex. 1985).

31. *Id.* at 213.

32. *Mitchell*, 47 B.R. at 211.

33. 106 B.R. 126 (Bankr. E.D. Mich. 1989).

34. *In re* Gray, 57 B.R. 927 (Bankr. R.I.), *aff'd*, 60 B.R. 428 (D.R.I. 1986); *In re* Gershenbaum, 598 F.2d 779, 783 (3d Cir. 1979); Robinson v. Mann, 339 F.2d 547 (5th Cir. 1964), *reh'g denied*, 341 F.2d 297 (5th Cir. 1965); Stark v. St. Mary's Hospital (*In re* Stark), 717 F.2d 322 (7th Cir. 1983); *In re* Dodge, 133 B.R. 654, 655 (W.D. Mo. 1991); *In re* Tapley, 66 B.R. 348 (Bankr. S.D. Fl. 1986).

have its problems. These shortcomings will be analyzed in Part III of this comment.

B. Minority View

In contrast, the Second and Ninth Circuits have historically given a much stricter interpretation of the bankruptcy statutes. The seminal decision in this line of cases is *Milando v. Perrone*,[35] which did not allow a debtor to reopen a case to schedule an omitted creditor.[36]

In *Milando*, the debtor had inadvertently omitted a judgement creditor from the original schedules. Some three years later the creditor brought suit in a Connecticut State court to foreclose on later acquired assets. The debtor then petitioned the bankruptcy court to reopen and amend his schedules to include the judgment creditor and thereby preempt the state court action. The court denied the debtor's motion and allowed the state court action to continue.[37]

Judge Clark reasoned, under the Bankruptcy Act, that because more than six months had passed since the first date set for the first meeting of creditors under Section 57, the creditor was barred at that point from filing a proof of claim.[38] As a result, an amendment of the schedule would not allow the creditor to file a proof of claim. Judge Clark also stated that an amendment would only be effective if he had been willing to enjoin the state court action,[39] which he was apparently not willing to do in this case. Since the debtor's purpose, to discharge the debt, could not be effected, "reopening and amendment [were] useless and should not be allowed."[40]

Judge Clark, however, indicated that there were circumstances under which, as a court of equity, the court could extend its rulings beyond the boundary of the statutes.[41] He also cited *Local Loan Co. v. Hunt*[42] which stated that an injunction would be proper "under unusual circumstances."[43] He stated that where it was necessary to prevent fraud or injustice, a case could be reopened.[44] *Pepper* states that the equitable powers of the bankruptcy court have been

35. 157 F.2d 1002 (2d Cir. 1946).

36. The statutes applicable in 1946 were as follows: (a) Bankruptcy Act § 57(n), which gave creditors six months from the first date set for the first meeting of creditors to file a proof of claim; (b) Bankruptcy Act § 2(a)(8) which allowed cases to be reopened for "cause shown"; and (c) Bankruptcy Act § 17(a)(3) which stated that a debt was not discharged when a creditor was not given time for "proof and allowance" unless the creditor had notice or actual knowledge of the proceeding.

37. *Milando*, 157 F.2d at 1004.

38. *Id.* at 1003.

39. *Id.* at 1004.

40. *Id.* at 1003.

41. *Id.* at 1004.

42. 292 U.S. 234, 54 S. Ct. 695 (1934).

43. *Id.* at 241, 54 S. Ct. at 698.

44. *Milando*, 157 F.2d at 1004 (quoting *Pepper v. Litton*, 308 U.S. 295, 304, 305, 60 S. Ct. 238, 244 (1939)).

invoked such that "substance will not give way to form, [and] technical considerations will not prevent substantial justice from being done."[45] Judge Clark's reference to these two cases suggests that had he seen the present situation as unjust, he would have been willing to reopen the case.

Judge Clark, however, felt constrained by the precedent of *Birkett v. Columbia Bank*,[46] which held that the "notice or actual knowledge of a proceeding" provision in Bankruptcy Act Section 17 required notice that was sufficient to allow a creditor to share in any dividends of the estate and participate in the administration of the affairs of the estate.[47] Perhaps Judge Clark simply felt that his hands were tied because the estate had already been administered. In any event, *Milando* has since been interpreted as holding that once the bar date for filing a proof of claim has passed, any omitted debts are absolutely precluded from being discharged.[48]

For example, *In re Iannacone* held that since a bar date had been scheduled and had passed at the time of litigation, the motion to reopen would be denied.[49] The court followed the reasoning in *Milando* concluding that reopening the case would not result in relief to the debtor since such an amendment would not relate back in time prior to the bar date for filing claims.[50] A Ninth Circuit Bankruptcy Appellate Panel case, *Laczko v. Gentran, Inc. (In re Laczko)*,[51] also expressly adopted the reasoning of *Milando*. In *Laczko*, the debtors amended their schedules before their case was closed. However, the creditor did not receive notice until approximately two years after the bankruptcy case was filed. The court held that since the creditor did not acquire knowledge until after the bar date for filing a proof of claim, the debt was not discharged.[52] It is important to note that these cases were decided after the promulgation of the new Bankruptcy Code. The *Iannacone* and *Laczko* decisions, however, assumed either that there had been no change in meaning or that there was no need to distinguish the court's interpretation of Section 523(a)(3) of the Bankruptcy Code from its interpretation of old Bankruptcy Act Section 17(a)(3).

While the result in a case where a bar date has passed may be a hardship to the debtor, the minority jurisdictions have been equally harsh to creditors when there is no bar date. In no-asset cases, the fate of unscheduled creditors lies in the hands of the trustee. If it appears to the trustee that there are no assets from which to pay a dividend, then the notice of the meeting of creditors *may* include

45. *Pepper*, 308 U.S. at 305, 60 S. Ct. at 244.
46. 195 U.S. 345, 350, 25 S. Ct. 38, 40 (1904).
47. *Id.*, 25 S. Ct. at 40.
48. *In re* Gray, 57 B.R. 927, 929 (Bankr. D.R.I. 1986); *Crum*, 48 B.R. at 488.
49. 21 B.R. 153, 155 (Bankr. D. Mass. 1982).
50. *Id.*
51. 37 B.R. 676, 679 (Bankr. 9th Cir. 1984), *aff'd*, 772 F.2d 912 (1985).
52. *Id.* at 679.

a notice of no dividend and that there is no need to file a proof of claim.[53] If assets are found thereafter, then creditors will be notified and given ninety days to file proofs of claims,[54] meaning that a debtor does not really *have* to notify any of his or her creditors until assets are found. This can work a very real hardship on creditors who pursue their claims. The courts have avoided the equitable considerations of reopening altogether in these cases, reasoning that since there is no bar date, there can be no violation of Section 523(a)(3)(A).[55] *Laczko* asserted that this is an important distinction and concluded that if there was no bar date, then Section 523(a)(3) was simply "never triggered,"[56] regardless of the expense that the creditor incurred as a result of his lack of knowledge. Because the bar date had not passed in *Laczko*, the creditor was allowed to file a proof of claim and was entitled to notice in the event that assets were found later.[57] These cases should not be interpreted as authorizing the reopening of a case, but rather as being consistent with other decisions that key on whether the bar date has passed.

More recent cases have also concluded that the crucial element in allowing a debtor to reopen a case is whether or not there was a bar date set for the filing of proofs of claims. *Bowen v. Franks (In re Bowen)* held that the only exception to the strict approach is in a case where there are no assets and the trustee has notified creditors that there is no need to file a proof of claim.[58] The court followed *Laczko* in saying that "under these circumstances, Section 523(a)(3) would not have been 'triggered' because no deadline for filing proofs of claims was ever established."[59] In *In re Corgiat*, the court announced the standard for determining whether an unlisted debt is discharged or not: "The crucial circumstance is whether or not a claims bar date has been set by the court."[60]

Under the language of *Birkett* and the strictures of the Bankruptcy Act,[61] these decisions may have been properly decided. However, the new Code is substantively different. In particular, the legislative history of Section 523(a)(3) and the enactment of Section 727(b) have eroded the statutory and jurisprudential bases for the earlier decisions.[62] These issues will be explored in Part III. It should be noted, however, that unlike the majority jurisdictions the minority jurisdictions seem to be focusing properly on the substantive effect of scheduling a creditor. The minority jurisdictions do not see scheduling as talismanic proof of a discharge nor, as will be seen, should they.

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53. Fed. R. Bankr. P. 2002(e).
54. Fed. R. Bankr. P. 3002(c)(5).
55. *Laczko*, 37 B.R. at 679; *Crum*, 48 B.R. at 490.
56. *Laczko*, 37 B.R. at 679.
57. *Id.* at 678.
58. 102 B.R. 752, 754 (Bankr. 9th Cir. 1989).
59. *Id.*
60. 123 B.R. 388, 390 (Bankr. E.D. Cal. 1991).
61. *See supra* note 24.
62. Legislative Statement—"Section 523(a)(3) of the House amendment is derived from the Senate amendment. The provision is intended to overrule *Birkett v. Columbia Bank* . . . ." (1991).

III. Problems and Inequities in the Majority and Minority Jurisdictions

A. *Majority View Problems*

The major criticism of the *Stark* and *Rosinski* line of cases is that these cases seem to assume that scheduling a debt is tantamount to its discharge. These cases do not address the underlying question of whether a debt is discharged once it is scheduled. Several recent cases demonstrate this line of reasoning. *In re Hocum* held that

> a creditor holding an otherwise dischargeable claim should not benefit from the debtor's excusable mistake in not listing such creditor; a debtor need not forfeit the benefits of bankruptcy where the creditor has not been harmed . . . . [The *Stark* decision] properly focuses on the substance of the harm that will occur rather than the form of the type notice the creditor received.[63]

In re Miller contains typical language that advances this position: "When a creditor suffers no prejudice and there is no evidence of fraud or intentional design behind the omission, a debtor is permitted to amend his schedules."[64] This language clearly indicates that these courts believe that amending the schedule is what could cause harm to the creditor. The underlying assumption must be that the scheduling in and of itself affects a discharge.

This is in direct contrast, however, to 11 U.S.C. Section 727(b). Section 727(b) provides that unless specifically listed in Section 523 of the code, a discharge under Section 727(a) discharges the debtor from all debts that arose before the date of the order for relief.[65] It seems that the proper inquiry should be whether the debt in question is one that would be excepted from discharge under Section 523, rather than whether or not it was listed. While these courts may have reached desirable results, they do not assert any real statutory authority for their position. They simply rely on "the equitable discretion of the bankruptcy court."[66]

Some of the later cases in the majority jurisdictions have recognized the weakness of the majority position. They have correctly focused not on

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63. 119 B.R. 723, 725 (Bankr. D.S.D. 1990).

64. 125 B.R. 441 (Bankr. W.D. Pa. 1991). *See* Samuel v. Baitcher (*In re* Baitcher), 781 F.2d 1529, 1534 (11th Cir. 1986); Rosinski v. Boyd (*In re* Rosinski), 759 F.2d 539, 542 (6th Cir. 1985); Stark v. St. Mary's Hosp. (*In re* Stark), 717 F.2d 322, 324 (7th Cir. 1983); Soult v. Maddox (*In re* Soult), 894 F.2d 815, 818 (6th Cir. 1980).

65. 11 U.S.C. § 727(b) (1991). In some circumstances, debts that are *deemed* to have arisen pre-petition are also discharged. *See* 11 U.S.C. § 502(f)-(i).

66. Robinson v. Mann, 339 F.2d 547 (5th Cir. 1964).

scheduling but whether or not the debt was dischargeable under Section 523.[67] Chief Judge Kressel, in *In re Anderson*,[68] asserted that while cases decided under *Stark* and *Rosinski*:

> reach the correct result, they are inappropriately applied in the context of the reopening of a case and are for the most part based on false premises regarding the nature and effect of a discharge. . . . [C]areful analysis reveals that the scope of a discharge is final when entered and subsequent events do not change what debts were or were not discharged . . . . The debt in question was either discharged or excepted from discharge based on an analysis of § 523. Subsequent actions by the debtor cannot affect whether or not the debt has already been discharged.[69]

Although these cases seem to be correct, the majority of courts have not adopted this position. Some courts have acknowledged the merits of this position, but continue to focus on reopening rather than dischargeability because they have felt bound by the precedent of *Rosinski*.[70]

Where unnotified creditors have continued to pursue a debtor, some courts simply allow debtors to pay creditors' collection expenses to avoid "prejudice."[71] The problem here is that these decisions are based on the *Stark* and *Rosinski* "prejudice" standard as to whether or not the case should be reopened rather than any provision of the Bankruptcy Code. As discussed above, this reasoning is erroneously based upon the presumption that scheduling the debt is equivalent to that debt's dischargeability. Under a proper analysis, the issue of dischargeability is subject to a judicial determination under Section 523 of the Bankruptcy Code.[72] Often, the majority of jurisdictions do reach equitable and seemingly fair results. It is important, however, that these jurisdictions develop a stronger statutory footing for their results.

B. Minority View Problems

One problem with the minority view is the inconsistency of results in no-asset cases. Similarly situated debtors and creditors are treated differently depending on the decision of the trustee. In a no-asset case with a bar date the inadvertent debtor gets punished and has to pay debts that would normally be

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67. *See In re* Mendiola, 99 B.R. 864, 865-66 (Bankr. N.D. Ill. 1989); *In re* Anderson, 72 B.R. 495, 497 (Bankr. D. Minn. 1987); *see also In re* Karamitsos, 88 B.R. 122, 122-23 (Bankr. S.D. Tex. 1988).

68. 72 B.R. 495.

69. *Id.* at 496, 497.

70. *See, e.g., In re* David, 106 B.R. 126, 130 (Bankr. E.D. Mich. 1989); *In re Davidson*, 36 B.R. at 545.

71. *Id.*

72. *Id.*

dischargeable. The creditor receives a windfall. This result could be a huge price to pay for inadvertently failing to place an otherwise dischargeable debt on the proper list. This result defeats an honest debtor's right to receive a fresh start.

On the other hand, in a no-asset case without a bar date the creditor may be punished. Post-petition collection expenses would not be recoverable. In the extreme, a no-asset debtor could intentionally fail to schedule an aggressive creditor and through non-feasance allow the creditor to expend large sums of money in preparation for litigation, searching for assets, or on other collection activities. The debtor could feign inadvertence, and since there was no bar date, Section 523(a)(3) would not be triggered. In that scenario, the creditor would simply have to eat his losses. It does not seem congruous with the policy behind the Code that a debtor's discharge or a creditor's recovery in a no-asset case should turn on whether or not the trustee elected to set a bar date for the filing of proofs of claims.

In either case, the absence of assets should be a more important factor than the existence of a bar date. The courts should focus on a creditor's ability to get paid instead of the trustee's procedural choice. The language of Section 726(a)(2)(C) supports this idea. This section states that a creditor can file a tardy claim and participate in a dividend if the creditor did not have notice or actual knowledge of the case if he files in time to permit payment of the claim.[73] In no-asset cases it seems that the late filing would be in time to permit payment since there is no payment unless assets are found later. The creditor's rights would have been preserved. Inadvertence on the debtor's part should not entitle a creditor to a windfall, especially in no-asset or small-asset cases because the creditors have not been harmed by the omission.

Another problem with a narrow interpretation of Section 523 is that it can lead to an absurd result when Section 523(a)(3)(B) tort-type claims are involved. Section 523(a)(3)(A) states that any claim, other than a tort-type claim that is not scheduled, is not discharged if the creditor is not able to "timely" file a proof of claim. In the minority jurisdictions, a creditor must only prove that he had a claim and that the bar date for filing a proof of claim has passed. His debt, then, is not discharged.

In contrast, Section 523(a)(3)(B) states that tort-type claims are not discharged if the creditor was not able to "timely" file both a proof of claim and a request to determine the dischargeability of the debt. The court in *In re Corgiat*[74] held that these claims must pass a two-part test. First, the creditor must prove that he had a claim similar to paragraph (A), as to the bar date. Second, he must prove that the tort portion of the claim was valid; i.e., that the creditor had actually been a victim of the type of fraud, intentional tort, or

73. 11 U.S.C. § 726(a)(2)(C) (1991) ("proof of such claim is filed in time to permit payment of such claim").

74. 123 B.R. 388, 391 (Bankr. E.D. Cal. 1991).

malicious injury described in paragraphs (2), (4), and (6) of Section 523(a). The absurd result is that tort-type claims, which for obvious policy reasons were never intended to be dischargeable, are more difficult to except from discharge than are ordinary claims where no intentional wrong has been done to the debtor.

For example, suppose a debtor omitted from the schedule a credit card creditor for an amount of $10,000, and a judgment creditor for $50,000 in damages that the debtor had caused by way of an intentional tort. In the minority jurisdictions, the credit card debt would not be discharged simply because the bar date for filing a proof of claim had passed regardless of whether it was a no-asset case. On the other hand, the victim of the intentional tort would have to prove not only that the bar date for filing proofs of claims and requests for determination of dischargeability had passed, but also that all of the elements of an intentional tort had been satisfied. It is hard to imagine that Congress intended for it to be more difficult to prove, and therefore except from discharge, an intentional tort debt than a credit card debt. It seems that an otherwise dischargeable debt should not be given the same deference as others that are specifically excepted from discharge because of their *nature*. This interpretation effectively writes Section 523(a)(3)(B) out of the Code, because the existence of a passed bar date is all that is required to except the debt from discharge.

A case directly on point is *In re Corgiat*.[75] This was a no-asset case with a claims bar date. The debtor failed to list a default judgment of over $63,400 which he owed to a finance company. The reason for his failure to list the judgment was that he was not personally served with notice of the finance company's suit against him. Apparently, the debtor had personally guaranteed a lease and had been sued in state court as the guarantor. The creditor asserted that its claim was based, at least in part, on alleged fraudulent acts on the part of the debtor.

In his analysis, Judge Russell correctly stated that "[a]ll pre-petition dischargeable debts of a Chapter 7 debtor will be discharged under the provisions of § 727(b)."[76] He failed, however, to reach the issue of whether the debtor had perpetrated fraud upon the creditor. He held instead that "it would clearly be inequitable to require [the creditor] to abandon the more easily established [Section] 523(a)(3)(A) complaint in favor of a § 523(c) complaint."[77] Hence, if there is a bar date for filing proofs of claim, Section 523(a)(3)(B) is meaningless in the Second and Ninth Circuit. The sum of $63,400 is a rather odious penalty for a no-asset debtor to pay where the only proof of the claim is an unanswered state court default judgment combined with a bar date for filing proofs of claims. If all that has to be proven under sub-paragraph (A) is lack of

75. 123 B.R. 388 (Bankr. E.D. Cal. 1991).
76. *Id.* at 390.
77. *Id.* at 392.

knowledge and a passed bar date, why would a creditor ever assert that the debt was owed because of a tort?

Although the minority jurisdictions seem to be uncertain as to what right of the creditor is being protected by Section 523(a)(3)(A), the legislative history indicates that it is the right to participate in a dividend that is being protected. As indicated earlier, the legislative history of Section 523(a)(3) states that Section 523(a)(3) was intended to overrule *Birkett v. Columbia Bank*, especially the portion of *Birkett* that gave a creditor the right to participate in the affairs of the estate, not just the dividend.[78] The underlying rationale for the change was that other creditors would have enough of a similar interest to any omitted creditors that it would be unnecessary for every individual creditor to be allowed to participate in the administration of a particular estate. If this is indeed the right being protected, then in the example above, to except the credit card debt from discharge gives the creditor more rights than Congress intended, because there was no missed dividend.

Finally, the minority jurisdictions seem to be laboring under the belief that a discharge is to be stingily given. Under the Bankruptcy Act of 1898 this may have been true. A debtor under the Act had an affirmative duty to qualify each debt from which he sought relief through a system of proof and allowance.[79] The new Code, however, endeavored to reverse this process and create a presumption of discharge. Section 727(b) has no statutory predecessor. This provision discharges all pre-petition debts whether or not a proof of claim is filed except as provided in Section 523.[80] It would stand to reason that a narrow construction of the *exceptions* to discharge is necessary to avoid frustrating the bankruptcy statute's basic policy of giving the honest debtor a new beginning.[81]

IV. Resolution: A Synthesized Approach

This section will attempt to forge a viable, unified approach which minimizes the shortcomings and accentuates the strengths of both the majority and minority positions. As for the minority jurisdictions, there must be an acceptance of the presumption of discharge under Section 727(b). This is the basis from which a more liberal interpretation of the statutes can be justified. The majority jurisdictions must apply equity to the statutes, not simply make decrees in the interest of policy. The unified approach will deal with three issues: first, the method by which a case should be reopened and its substantive effects; second, the disposition of unscheduled creditors under Section

78. 124 Cong. Rec. H11.864-866 (daily ed. Oct. 6, 1978).

79. Bankruptcy Act of 1898 § 57(n).

80. 11 U.S.C. § 727(b) (1991).

81. Caspers v. Van Horne (*In re* Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987), *abrogated by*, Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654 (1991); Farina v. Balzano (*In re* Balzano), 127 B.R. 524, 529 (Bankr. E.D.N.Y. 1991).

523(a)(3)(A); and third, the disposition of unscheduled creditors under Section 523(a)(3)(B).

As to reopening, the majority jurisdictions should adopt the minority position. Neither reopening in and of itself nor subsequent listing of an omitted creditor should have substantive effects. The proper procedure is for either the creditor or debtor to file a request for a determination of dischargeability of a debt under Rule 4007(a).[82] In cases that deal with unscheduled creditors, the real issue is whether the debt is excepted from discharge under Section 523(a)(3). Listing, vel non, is but one part of a multi-pronged test and is not in itself dispositive of the dischargeability question.

Section 350(b) of the Code states that "[a] case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause."[83] It seems evident that a request for a determination of dischargeability would qualify under the "other cause" provision of Section 350(b). The correctness of this conclusion becomes apparent when one reads Rule 4007(b). It states that "[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."[84] While Rule 4007(b) does use the permissive "may" rather than the imperative "shall," the waiver of fees manifests an intent by Congress that these cases should be reopened and the petitions heard.

The rules applicable to Section 350(b) additionally indicate that the reopening of a case is not to be denied based on the amount of time that has passed since the case was closed. Section 350(b) is implemented through Rule 5010. It allows a case to be reopened on the motion of the debtor or any other party in interest pursuant to Section 350(b) of the code. It is important to note that Bankruptcy Rule 9024 specifically exempts Rule 5010 and Section 350(b) from the one year limit on the reopening of closed cases imposed by the Federal Rules of Civil Procedure 60(b).[85] It is obvious from this rule that Congress intended that debtors, creditors, and other parties in interest have the ability in certain situations to reopen cases beyond the one year period.

Once a complaint has been filed and the case reopened, the remaining issue is how to interpret Section 523(a)(3) in dealing with unscheduled creditors. The challenge here is to interpret the statute in a way that is consistent with the underlying policy of the Bankruptcy Code. Paragraphs (A) and (B) of Section 523(a)(3) have two common elements. These common elements are that the debt "was neither listed or scheduled under Section 521(1) . . ." and the creditor must

82. Fed. R. Bankr. P. 4007(a): "A debtor or any creditor may file a complaint with the court to obtain a determination of the dischargeability of any debt."

83. 11 U.S.C. § 350(b) (1991).

84. Fed. R. Bankr. P. 4007(b) (emphasis added).

85. Fed. R. Bankr. P. 9024 states: "Rule 60 F. R. Civ. P. applies in cases under the Code except that (1) a motion to reopen a case under the Code . . . is not subject to the one year limitation prescribed in Rule 60(b) . . . ."

not have "had notice or actual knowledge of the case. . . ." Determination of these two elements places no great burden on the judicial system. Either a debt was listed or not, and the creditor either had notice or actual knowledge or he did not. The more difficult issues in Section 523(a)(3) cases are whether, under Section 523(a)(3)(A), the creditor was prevented from timely filing a proof of claim and, under Section 523(a)(3)(B), whether the creditor was prevented from timely filing a proof of claim and making a timely request for a determination of dischargeability.

It has been shown above in *Corgiat* that a narrow interpretation of the word "timely," to mean only that a bar date has passed, can lead to results contrary to the policies of the Bankruptcy Code.[86] The word "timely" in Section 523(a)(3)(A) and (B) should be interpreted in light of the right being protected. As stated earlier, the right being protected under Section 523(a)(3)(A) is the right to participate in a dividend. This right deserves protection when a debtor, for any reason, prevents a creditor from exercising that right. Therefore, a creditor should be protected to that extent. The majority jurisdictions have placed much importance on whether an omission was willful, intentional, or inadvertent. In fact, this issue has been crucial in deciding motions to amend the schedule. However, if the purpose of Section 523(a)(3)(A) is to protect the creditor's right to participate in a dividend, the debtor's state of mind should be irrelevant. Courts should look to see if a creditor's rights have been abridged and rule on that basis alone.

Conversely, the minority jurisdictions have paid no attention to equity and have declared debts to be non-dischargeable even when no assets were distributed. Under the approach suggested, equity is achieved through a more liberal interpretation of the statute.

For example, if a $50,000 judgment creditor had not been listed, and the final dividend was ten percent, the debtor would not be discharged to the extent the creditor's rights had been compromised. Those rights would be worth $5,000 plus the amount the creditor expended in pursuing the debtor post-petition. If it were a no-asset case, then the debtor would only be responsible for the creditor's post-petition collection expenses because that would be the extent to which his rights under Section 523(a)(3)(A) had been defeated.

It has been suggested that this type of pro-rata scheme would encourage sloppy or slovenly accounting by debtors; that a draconian result as in *Corgiat* is necessary in order to inspire debtors to be diligent in their listing of debts. The results called for in this approach, however, should be sufficient to inspire debtor diligence. In the example above, the $5,000 and fees would be paid out of post-petition, after acquired assets. The debtor's pre-petition assets would have been liquidated. A debtor should not be punished so much as to vanquish his chance at a fresh start; but, as between two innocents, the debtor is the least innocent and should pay for his mistakes. The proposed method achieves a

86. 123 B.R. 388, 391-92 (Bankr. E.D. Cal. 1991).

balance between creditor protection and debtor relief and makes some sense of a misunderstood provision. While this interpretation may seem somewhat strained, it at least attempts to reach a policy-consistent result under color of statute and not through "the sound discretion" standard of *Robinson, Stark,* and *Rosinski,* which makes no reference to statutory authority.

Another reason for a bifurcated interpretation is that, of all the Section 523(a) exceptions, sub-paragraph (3)(A) claims have the least compelling basis for non-dischargeability. The debts excepted under Section 523(a)(3)(A) are excepted only because they may have missed a dividend. Contrarily, Section 523(a)(1), (2), (3)(B), (4), (5), (6), (7), (8), and (9) are non-dischargeable because of their nature. There are very strong policy reasons behind each of them, which a partial listing illustrates. Section 523(a) relates to (1) taxes; (2) obtaining credit by false pretenses; (4) fraudulent acts; (5) child support and alimony; (6) intentional torts; (8) guaranteed student loans; and (9) death or personal injury caused by a debtor while driving under the influence of drugs or alcohol.[87] Unlike Section 523(a)(3)(A) claims, these claims would not be partially or pro-rata discharged in any event. The only exceptions to this are claims under Section 523(a)(2), (4), or (6), which leads us to Section 523(a)(3)(B).

As stated above, there is a time limit of sixty days, from the first date set, for the meeting of creditors to file requests for a determination of dischargeability of Section 523(a)(2), (4), or (6) claims under Section 523(c) and Rule 4007(c).[88] Again, the reason for the time limit relates to problems of defending a tort or fraud claim after much time has passed. Section 523(a)(3)(B) allows creditors who were unlisted and without notice or actual knowledge of the case to circumvent the time limitations of Section 523(c).

The result is that these creditors are placed on equal ground with the other Section 523(a) claimants who have no time limit as to when a request for determination of dischargeability may be filed. The reason is because the former creditors do not have notice or actual knowledge of the Section 523(c) deadline. The right being protected is the creditor's right to have an entire debt declared non-dischargeable, regardless of the size of the debtor's estate, because of the nature of the claim. This interpretation of the statute allows a creditor to protect that right, and although the burden of proof is greater under sub-paragraph (B) than (A), so too are the benefits, if successful.

In the earlier hypothetical case of two omitted debts, implementation of this approach would give the following results. The $10,000 credit card debt would be analyzed under Section 523(a)(3)(A) and the $50,000 intentional tort would be analyzed under Section 523(a)(3)(B). It will be assumed that there was a twenty percent dividend paid to unsecured creditors.

87. 11 U.S.C. § 523(a) (1991).
88. *See* Fed. R. Bankr. P. 4007(c).

The credit card company's right to participate in a dividend has been compromised to the extent of the dividend paid, plus post-petition collection effort monies spent. Here, the sum is twenty percent of $10,000 ($2,000) assuming that the creditor made no post-petition collection efforts.

The tort victims' right to full compensation has been defeated by his lack of knowledge of the bankruptcy. Therefore, if the victim/creditor can prove the elements of the tort, the tortfeasor/debtor will still be liable to the full extent of the $50,000 in damages that he caused. The total price to be paid by the debtor is $52,000. This represents the $2,000 the credit card company missed in the dividend and the $50,000 the victim would have received if he had been given adequate notice of the proceedings.

The dilemma of what to do with an unscheduled creditor has been much debated and much litigated. Thus, money that could have been distributed to creditors or used to rehabilitate debtors has gone to attorneys' fees and court costs. This is not to mention the time invested by all parties involved. Another result has been that the majority and minority positions have moved slightly in each other's direction. The *Mendiola*[89] line of cases in the majority jurisdictions, which reject the motion that scheduling a debt works a discharge, is one example. The case of *Homestate Insurance Brokers of Alaska, Inc. v. Brasman (In re Brasman)*,[90] in which a minority jurisdiction court rejected *Laczko*[91] as binding precedent, and adopted the majority approach, is another example. It has been suggested that, for policy reasons, the minority circuits should give up and adopt the majority position.[92] This does not seem likely nor is it desirable. Procedurally and statutorily, if not equitably, the minority position is more sound than the majority position. Article I, section 8 of the U.S. Constitution states that Congress shall have the power "[t]o establish . . . uniform laws on the subject of Bankruptcies throughout the United States[.]"[93] But, what is uniformity of statute without uniformity of application? Hopefully this comment will help promote a uniform approach to the problems it addresses.

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89. 99 B.R. 864 (Bankr. N.D. Ill. 1989).

90. 119 B.R. 212 (Bankr. D. Alaska 1990).

91. 37 B.R. 676 (Bankr. 9th Cir. 1984).

92. Sue Ann Slates, *The Unscheduled Creditor In A Chapter 7 No-Asset Case*, 64 Am. Bankr. L.J. 281 (1990).

93. U.S. Const. Art. I, § 8, cl.4.