

Nondischargeability Actions in Bankruptcy

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Exceptions to Discharge

- 11 U.S.C § 523
- Familiar Examples:
 - Fraud
 - Embezzlement
 - Larceny
 - Intentional Torts against another entity or their property
 - Student Loans
 - Support and property settlements
 - Securities Violations
- Objections to Discharge or Revocation of Discharge are Different (See e.g., Sections 727, 1328).

The Bankruptcy Petition

- Bankruptcy Petition filed.
- Beware of the automatic stay
- Some exceptions (some domestic proceedings, criminal actions, some evictions).
- Stay may be lifted in certain instances related to nondischargeability actions.



Timing and Deadlines (Rule 4007)

- 60 days from Meeting of Creditors to file complaints against debtor under Section 523(c):
 - 523(a)(2) – false pretenses, false representation, or actual fraud;
 - 523(a)(4) fraud or defalcation . . .
 - 523(a)(6) willful and malicious injury.
- 30 days to file 523(a)(6) action in chapter 13 if debtor receives hardship discharge.
- Track deadlines in 341 Notice.



Timing/Deadline Continued – Seeking Extension

- May seek an extension “for cause” if filed before time expires.
- If short on time, see if debtor will stipulate to extend.
- If 341 continued, confirm that 341 deadlines are extended.



Cautionary Tales

- *Anwar v. Johnson*, 2013 WL 3306327 (9th Cir. July 2, 2013) (“[A]bsent unique and exceptional circumstances . . . , we do not inquire into the reasons a party failed to file on time in assessing whether she is entitled to an equitable exception from FRBP 4007(c)’s filing deadline”).
- *Willms v. Sanderson*, 723 F.3d 1094 (9th Cir. July 25, 2013) (Rule 4007(c) deadline cannot be retroactively extended).
- *Five Star Laser, Inc. v. Height* (In re Height), 2011 WL 1480265 (E.D. Michigan Apr. 19, 2011) (Stipulation between debtor and trustee to extend deadline to file complaint did not apply to creditors).



Filing an Adversary Proceeding

- Filing a Complaint to Determine Dischargeability of a Debt triggers Part VII of Bankruptcy Rules.
- See Rule 7001(a)(6) – a proceeding to determine the dischargeability of a debt.
- Rule 7004(g) – Service on Debtor’s Attorney
 - Contact Debtor’s Attorney about accepting service on behalf of the Debtor.
 - See Local Rule 5005-2(b)(1) – electronic notice to registered ECF Filer does not waive right to service with regard to service of a summons and complaint under Fed. R. Bankr. P. 7004.



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Pre-Bankruptcy Considerations

Collateral Estoppel (Issue Preclusion)

- “[B]ars a party from relitigating an issue once it has suffered an adverse determination on the issue, even if the issue arises when the party is pursuing or defending against a different claim.” *Park Lake Res., Ltd. Liab. Co. v. U.S. Dep't of Agric.*, 378 F.3d 1132, 1136 (10th Cir. 2004).
- “Collateral estoppel principles do indeed apply in discharge exception proceedings pursuant to §523(a).” *Grogan v. Garner*, 498 U.S. 279 (1991).

Claim Preclusion (Res Judicata)

- “Under res judicata, or claim preclusion, a final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in the prior action.” *Northern Natural Gas v. Grounds*, 931 F.2d 678, 681 (10th Cir.1991).
- *Brown v. Felsen*, 442 U.S. 127 (1979)

Collateral Estoppel

- Which preclusion law applies?
 - “In determining the preclusive effect of a state court judgment, the full faith and credit statute, 28 U.S.C. § 1738, directs a federal court to refer to the preclusion law of the State in which judgment was rendered.” *Nichols v. Bd. of Cnty. Comm'rs*, 506 F.3d 962, 967 (10th Cir. 2007), *abrogated on other grounds as recognized by Onyx Properties LLC v. Bd. of Cnty. Comm'rs*, 838 F.3d 1039, 1043 n.2 (10th Cir. 2016).

Collateral Estoppel

- Elements of Issue Preclusion Under Utah Law:
 - “Issue preclusion applies only when the following four elements are satisfied: (i) the party against whom issue preclusion is asserted was a party to or in privity with a party to the prior adjudication; (ii) the issue decided in the prior adjudication was identical to the one presented in the instant action; (iii) the issue in the first action was completely, fully, and fairly litigated; and (iv) the first suit resulted in a final judgment on the merits.” *Fowler v. Teynor*, 323 P.3d 594, 597 (Utah Ct. App. 2014).

Resolutions Prior to Full Litigation

- Settlements
- Consent Judgment
- Default Judgment
 - *In re Corey*, 583 F.3d 1249 (10th Cir. 2009)
(Issue preclusion applies to a default judgment imposed as a sanction)
- 11 U.S.C. § 523(a)(11) and (a)(19).

Collection Pre-Bankruptcy

- Recording of Judgment
- Expiration/Renewal of State Court Judgment
- Note Expiration/Renewal of State Court Judgments is also a post-bankruptcy collection consideration for non-dischargeable judgments. See, e.g., *Densley v. Dyches (In re Dyches)*, Adv. P. No. 10-2653 (“[T]he original action, within the context of a nondischargeability judgment, is the judicial proceeding in which a party first obtains the judgment liquidating the underlying debt at issue.”).



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Post-Bankruptcy Considerations

Collectability



Discovery Tools

- 341 Meeting of Creditors
- 2004 Examination
- Federal Rules of Civil Procedure

Nondischargeability Actions

- Exceptions to discharge are strictly construed against the creditor.
 - Discharge “gives to the honest but unfortunate debtor . . . A new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.” *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).
- Burden of Proof: preponderance of the evidence.
 - *Grogan v. Garner*, 498 U.S. 279 (1991)
- Standing
 - *Corso v. Walker*, 449 B.R. 838, 848 (W.D. Penn. 2011) (“A creditor’s standing to invoke § 523(a)(2)(A) is limited to fraud claims stemming from its own transfers to the debtor and is therefore precluded from seeking exceptions to the discharge of debts based on fraudulent activity allegedly committed by the debtor against third parties.”)

11 U.S.C. § 523(a)

- (a)(2)(a) - for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition
- (a)(4) - for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny
- (a)(6) - for willful and malicious injury by the debtor to another entity or to the property of another entity

727 Actions

- 11 U.S.C. § 727
 - (a)(2) – “the debtor, with intent to hinder, delay, or defraud a creditor . . . has [or has permitted to be] transferred, removed, destroyed, mutilated, or concealed property of the debtor, within one year before the date of the filing of the petition, or property of the estate.
 - (a)(3) – “the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including . . . records . . . from which the debtor’s financial condition or business transactions might be ascertained.
 - (a)(4) – “the debtor knowingly and fraudulently, in or in connection with the case . . . made a false oath . . .

A movie poster for 'Edge of Tomorrow' featuring Tom Cruise and Emily Blunt. They are shown in military armor, with Cruise in the foreground and Blunt behind him. The background is a hazy, orange-tinted sky. The text 'LIVE. DIE. REPEAT.' is overlaid in the center.

LIVE. DIE. REPEAT.

TOM CRUISE EMILY BLUNT

EDGE OF **TOMORROW**

LIVE

- Be on the Front Lines if you can. Be involved in the underlying State or Federal Court cause of action.
- You want that first bite at the apple. You want the opportunity to see what works and what doesn't whether you are prosecuting or defending.
- Not an Ideal World
 - Bankruptcy Attorneys often are left to clean up someone else's mess.
 - Educate your partners - remind them to include you in litigation strategy sessions if bankruptcy may be on the horizon.

DIE

- The point of Tom Cruise dying everyday in Edge of Tomorrow is to gain knowledge.
- If you weren't lucky enough to be involved in the underlying State or Federal Court cause of action
- Pull the Pleadings (Complaint, Answer, Any Amendments)
- Pull any interlocutory rulings (grants or denial of summary judgment)
- Get a copy of the transcripts if possible (trial and depositions)
- Get a copy of the ruling (understand it)
- In order for the Bankruptcy Attorney to gain knowledge, you need to dig into the first case
- Was it simply a default judgment? (important when it comes to res judicata)

RULES

- Adversary Proceedings governed by Part VII of Federal Rules of Bankruptcy Procedures.
- Remember to review local rules. <https://www.utb.uscourts.gov/>
- Requesting a Jury Trial
 - Timing – FRCP Rule 38(b) – “no later than 14 days after the last pleading”
 - Special Designation of Bankruptcy Judge to conduct the jury trial (Local rule 9015-1)
 - Consent of adverse party
 - Withholding consent is deemed an objection (cure by Requesting withdrawal of the reference back to the district court)

ADVICE OF COUNSEL DEFENSE

- At its heart, the advice of counsel defense is not so much an affirmative defense as it is a way for a debtor to negate the element of intent. To meet his burden on the advice of counsel defense, [the debtor] must show (1) that all facts were fully and fairly communicated to counsel; (2) that counsel gave legal advice; (3) that [the debtor relied on the legal advice; and (4) that [the debtor's] reliance was in good faith. *Rupp v. Biorge (In re Biorge)*, 536 B.R. 24, 30 (Bankr. D. Utah 2015).
- In the case of *United Orient Bank v. Green*, that likewise involved a § 523(a)(6) action, the court rejected the debtor's attempt to defend a very aggressive business strategy based on the advice of counsel: "[the debtor] knew that there was, at a minimum, a substantial risk that his actions were improper and elected to run that risk . . . [and the debtor] knew that his actions were 'contrary to commonly accepted duties in the ordinary relationships among people, and injurious to' plaintiffs."

JUSTIFICATION/EXCUSE

- *State Farm Fire & Cas. Co. v. Edie (In re Edie)*, 314 B.R. 6, 15 (Bankr. D. Utah 2004) (citation omitted) (“in order for an act to be willful and malicious it must be a deliberate or intentional injury (willful) that is performed without justification or excuse (malicious).”) (quoting *Am. First Credit Union v. Gagle (In re Gagle)*, 230 B.R. 174, 181 (Bankr. D. Utah 1999)). See also *Tinker v. Colwell*, 193 U.S. 473, 485–86 (1904) (“Malice, in common will against a person, but in its legal sense it means a wrongful act, done intentionally, without just cause or excuse.”) (citation omitted).